



The Pennsylvania Higher Education Foundation, Inc.

Annual Financial Report

May 31, 2011 and 2010



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Independent Auditors' Report

The Board of Directors
The Pennsylvania Higher Education Foundation, Inc.:

We have audited the accompanying consolidated statements of financial position of The Pennsylvania Higher Education Foundation, Inc. as of May 31, 2011 and 2010, and the related consolidated statements of activities and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The Pennsylvania Higher Education Foundation, Inc. as of May 31, 2011 and 2010, and the results of its operations and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

As discussed in Note 3 to the financial statements, The Pennsylvania Higher Education Foundation, Inc. anticipates that it will significantly reduce operations during the May 31, 2012 fiscal year.

KPMG LLP

September 21, 2011

The Pennsylvania Higher Education Foundation, Inc.
 Statements of Financial Position
 As of May 31



	2011	2010
Assets:		
Cash	\$ 200,821	69,958
Short-term investments	178,497	177,938
Contributions receivable, net of discount	-	1,000,000
Long-term investments	904,568	7,529,000
Office furnishings and equipment, net of accumulated depreciation	36,046	40,716
Total assets	\$ 1,319,932	8,817,612
Liabilities and net assets:		
Liabilities:		
Accrued expenses	\$ 39,943	329,596
Grants payable	601,035	601,035
Total liabilities	640,978	930,631
Net assets:		
Unrestricted	405,848	400,747
Temporarily restricted	273,106	7,486,234
Total net assets	678,954	7,886,981
Total liabilities and net assets	\$ 1,319,932	8,817,612

See accompanying notes to financial statements.

The Pennsylvania Higher Education Foundation, Inc.
Statements of Activities
For the years ended May 31



	2011	2010
Changes in unrestricted net assets:		
Revenues:		
Donated services	\$ 123,940	179,428
Income on long-term investments	7,496	17,027
Gain on sale of fixed asset	-	11,015
Net unrealized and realized losses on long-term investments	(2,395)	(1,732)
Total revenues	129,041	205,738
Net assets released from restrictions	7,642,915	10,733,612
Increase in unrestricted net assets	7,771,956	10,939,350
Expenses:		
Program services:		
Nursing Education Initiative Grants	7,447,057	10,302,389
Other program services	77,713	112,856
Total program services	7,524,770	10,415,245
Management and general	238,108	484,285
Fundraising	3,977	13,510
Total expenses	7,766,855	10,913,040
Net change in unrestricted net assets	5,101	26,310
Changes in temporarily restricted net assets:		
Contributions	400,000	-
Income on short-term investments	2,062	821
Income on long-term investments	65,503	364,880
Net unrealized and realized losses on long-term investments	(37,778)	(55,230)
Net assets released from restrictions	(7,642,915)	(10,733,612)
Decrease in temporarily restricted net assets	(7,213,128)	(10,423,141)
Decrease in net assets	(7,208,027)	(10,396,831)
Net assets at beginning of year	7,886,981	18,283,812
Net assets at end of year	\$ 678,954	7,886,981

See accompanying notes to financial statements.

The Pennsylvania Higher Education Foundation, Inc.
Statements of Cash Flows
For the years ended May 31



	2011	2010
Cash flows from operating activities:		
Cash received from donors	\$ 1,400,000	1,300,000
Investment income received	114,483	452,907
Grants paid	(7,447,057)	(15,430,152)
Cash paid for other program services, management and general, and fundraising expenses	(480,841)	(404,374)
Net cash used for operating activities	(6,413,415)	(14,081,619)
Cash flows from investing activities:		
Proceeds from sales or maturities of long-term investments	11,663,237	27,844,547
Purchases of long-term investments	(5,118,401)	(14,118,586)
Proceeds from sales or maturities of short-term investments	2	100,007
Purchases of short-term investments	(560)	(821)
Proceeds from sale of fixed assets	-	11,015
Net cash provided by investing activities	6,544,278	13,836,162
Net change in cash	130,863	(245,457)
Cash at beginning of year	69,958	315,415
Cash at end of year	\$ 200,821	69,958

(continued)

The Pennsylvania Higher Education Foundation, Inc.
Statements of Cash Flows
For the years ended May 31



	2011	2010
Reconciliation of change in net assets to net cash used for operating activities:		
Change in net assets	\$ (7,208,027)	(10,396,831)
Adjustments to reconcile changes in net assets to net cash used for operating activities:		
Gain on sale of fixed asset	-	(11,015)
Depreciation	4,670	5,333
Net unrealized losses on long-term investments retained	39,175	238,605
Net realized (gains) losses on sales of long-term investments	998	(181,644)
Decrease in investment income receivable	39,422	70,180
Decrease in contributions receivable, net of discount	1,000,000	1,300,000
Decrease in prepaid expenses	-	4,440
Increase (decrease) in accrued expenses	(289,653)	17,076
Decrease in grants payable	-	(5,036,200)
Decrease in amounts payable to specific organizations as designated by donors	-	(91,563)
Net cash used for operating activities	<u>\$ (6,413,415)</u>	<u>(14,081,619)</u>

See accompanying notes to financial statements.

1. Organization and Operation

The Pennsylvania Higher Education Foundation, Inc. ("PHEF" or the "Foundation"), a not-for-profit organization, was formed on June 22, 2001. Its charitable purposes include, but are not limited to, activities intended to improve or enhance postsecondary educational opportunities for students in Pennsylvania and elsewhere. It may fulfill its purposes by assisting students in meeting their expenses of higher education by providing assistance in the form of grants, loans, or scholarships. It may also enable educational institutions that offer postsecondary programs and lenders to make loans or other financial assistance available to students and parents for postsecondary educational purposes and by providing such other assistance to students, parents, and educational institutions as will improve or enhance postsecondary educational opportunities.

Pennsylvania Higher Education Assistance Agency ("PHEAA"), a discretely presented component unit of the Commonwealth of Pennsylvania, supported the formation of the Foundation and paid for the costs of creating the Foundation. The Foundation is tax-exempt under Section 501(c)(3) of the Internal Revenue Code.

2. Related Entity and Related Party Transactions

A majority of the directors of the Foundation are also members of PHEAA's Executive Committee. As such, transactions between PHEAA and the Foundation are related party transactions.

During the years ended May 31, 2011 and 2010, PHEAA provided donated services to the Foundation valued at \$123,940 and \$179,428, respectively. The donated services that PHEAA provided to the Foundation were valued at PHEAA's actual cost and reported as contribution revenue and expenses in the financial statements.

3. Future Plan and Actions

It is the intention of the Foundation to provide grant awards for as long as funds remain available to do so. The Foundation anticipates that there will not be sufficient funds available to award new grants through the May 31, 2012 fiscal year. It is the intention of Foundation management and the board to manage the grant awards so that all approved awards can be fully disbursed and administrative expenses can be paid in full. Since the board has full discretion over the amounts awarded, the Foundation does not anticipate a scenario in which approved awards or incurred administrative expenses would remain unpaid due to a lack of funds.

4. Summary of Significant Accounting Policies

(a) Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. Accordingly, net assets, revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions, as defined in note 5.

(b) Investments

Investments include fixed income and money market securities and are reported at fair value.

(c) Fair Value Measurements

The fair value of a financial instrument is the amount that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date assuming the transaction occurs in the entity's principle (or most advantageous) market.

The fair values of the Foundation's financial instruments represent management's best estimates of the amounts that would be received to sell those assets or that would be paid to transfer those liabilities in an orderly transaction between market participants at that date. Those fair value measurements maximize the use of observable inputs. However, in situations where there is little, if any, market activity for the asset or liability at the measurement date, the fair value measurement reflects the Foundation's own judgments about the assumptions that market participants would use



in pricing the asset or liability. Those judgments are developed by the Foundation based on the best information available in the circumstances.

The following methods and assumptions were used to estimate the fair value of each class of financial instruments:

- Cash, short-term investments, prepaid expenses, accrued expenses, and grants payable: The carrying amounts approximate fair value because of the short maturity of these instruments.
- Contributions receivable: The fair value is determined as the present value of future cash flows discounted at an interest rate that reflects the risks inherent in those cash flows on the date the gift is received.
- Long-term Investments: The fair value of fixed income securities, common stock and equity, mutual, and other funds are determined using quoted market prices at the reporting date multiplied by the quantity on hand. The carrying amount of money market securities approximates the fair value because of the short maturity of these investments.

(d) Fixed Assets

Fixed assets are reported at cost, net of depreciation. Depreciation is calculated on the straight-line method over the estimated useful life of the asset. Estimated useful lives of fixed assets range from 3 to 25 years.

(e) Donor-restricted Contributions

Contributions that are restricted by the donor are reported as increases in temporarily or permanently restricted net assets, depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions. Donor-restricted contributions whose restrictions are met within the same year as received are reported as temporarily restricted net assets and reclassified to unrestricted net assets in the statement of activities as net assets released from restriction.

(f) Grants payable

Grants payable are reported at cost at the time of approval by the Board of Directors for distribution. The grants payable at the end of the current year is the same as the grants payable at the end of the prior year, because all Board approved distributions for 2010-11 have been made, however none of the amounts payable from prior years have been paid out. Grants awards are not distributed until the awardee has completed and returned a signed participation regarding the use of the awarded funds. The grants payable as of yearend will remain outstanding until a signed participation agreement is signed, or Board action is taken to change or cancel the pending award distributions.

(g) Functional Allocation of Expenses

The costs of supporting the programs and other activities have been summarized on a functional basis in the statements of activities. Expenses have been classified based upon the actual direct expenditures and cost allocations based upon estimates of time spent by Foundation personnel.

(h) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(i) Reclassification

Certain prior year amounts have been reclassified to conform to current year presentation.

5. Net Assets

The Foundation classifies its net assets into three categories as follows:

- Permanently Restricted – net assets subject to donor-imposed stipulations that the net assets be maintained permanently by the Foundation.
- Temporarily Restricted – net assets resulting from contributions and other inflows of assets whose use is limited by donor-imposed stipulations that either expire by passage of time or can be fulfilled and removed by actions pursuant to those stipulations.
- Unrestricted – Net assets that are neither permanently restricted nor temporarily restricted by donor-imposed stipulations.

Net assets at May 31, 2011 and 2010 consist of the following:

	2011	2010
Unrestricted	\$ 405,848	400,747
Temporarily restricted:		
Nursing Education Initiative	-	1,914,829
PHEAA's statutory purpose	273,106	5,571,405
Total temporarily restricted	273,106	7,486,234
Total net assets	\$ 678,954	7,886,981

The Foundation created the Nursing Education Initiative to provide a new source of financial support to schools and students. The intent of the program was to encourage additional students to pursue nursing as an academic and professional choice. PHEAA's statutory purpose is to improve higher education opportunities for Pennsylvanians.

6. Tax Status

The Internal Revenue Service ("IRS") has determined and informed the Foundation by a letter dated August 8, 2001 that the Foundation is exempt from federal income tax under Section 501(a) of the Internal Revenue Code as an organization described in Section 501(c)(3). The initial determination of the Foundation's tax status was to expire on May 31, 2006; however, by letter dated September 30, 2005, the IRS issued a final determination confirming the Foundation's status as a publicly supported organization.

During calendar year 2010, the Internal Revenue Services (IRS) conducted an onsite examination of the Form 990 submitted for the May 31, 2008 tax year. Upon completion of the examination, we received a letter dated July 19, 2010 indicating that the organization continued to qualify for exemption from federal income tax, and accordingly our Form 990 return was accepted as filed for the year examined.



7. Investments and Investment Income

Investments at May 31, 2011 and 2010 were as follows:

	2011	2010
Short-term:		
Savings accounts	\$ 178,497	177,938
Long-term:		
Fixed income:		
US treasury bonds	100,814	2,149,728
Government agency bonds	-	1,820,718
Corporate bonds	-	1,509,871
Mutual funds	300,216	902,400
Collateralized mortgage obligations	52,604	696,960
Cash and money market securities	450,934	449,323
	<u>904,568</u>	<u>7,529,000</u>
	<u>\$ 1,083,065</u>	<u>7,706,938</u>

Investment income for the years ended May 31, 2011 and 2010 were as follows:

	2011	2010
Short-term:		
Interest	\$ 2,062	821
Long-term:		
Interest and dividends	72,999	381,907
Net unrealized and realized (losses)	(40,173)	(56,962)
	<u>32,826</u>	<u>324,945</u>
	<u>\$ 34,888</u>	<u>325,766</u>

8. Fair Value Measurements

A fair value hierarchy is used that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quote prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to measurements involving significant unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are as follows:

- Level 1: Quoted prices in active markets for identical assets or liabilities. Level 1 assets and liabilities include debt, equity securities, and funds that are traded in an active exchange market.
- Level 2: Observable inputs other than Level 1 prices such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities. Level 2 assets and liabilities include debt securities with quoted market prices that are traded less frequently than exchange traded instruments.
- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the asset or liabilities. Level 3 assets and liabilities include financial instruments whose value is determined using pricing models, discounted cash flow methodologies or similar techniques, as well as instruments for which the determination of fair value requires significant management judgment or estimation. This category generally includes private equity and limited partnership interests.

The following table presents assets and liabilities that are measured at fair value on a recurring basis as of May 31, 2011:

	Fair Value	Level 1	Level 2	Level 3
Financial Assets:				
Investments:				
Fixed income	\$ 453,634	453,634	-	
Money market securities	450,934	450,934	-	
	<u>\$ 904,568</u>	<u>904,568</u>	<u>-</u>	<u>-</u>

The following table presents assets and liabilities that are measured at fair value on a recurring basis as of May 31, 2010:

	Fair Value	Level 1	Level 2	Level 3
Financial Assets:				
Investments:				
Fixed income	\$ 7,079,677	7,079,677	-	
Money market securities	449,323	449,323	-	
	<u>\$ 7,529,000</u>	<u>7,529,000</u>	<u>-</u>	<u>-</u>

9. Contributions Receivable

Contributions receivable at May 31, 2011 and 2010 consist of the following:

	2011	2010
Due within one year	\$ -	1,000,000
	<u>\$ -</u>	<u>1,000,000</u>

Contributions of unconditional promises to give are recognized as revenue when written agreements are signed or follow-up written confirmations are received. All unconditional promises to give are considered fully collectible; accordingly, no allowance for uncollectible pledges has been recorded. For the year ended May 31, 2011, there are no contributions of unconditional promises to give.

10. Fixed Assets

Fixed assets at May 31, 2011 and 2010 were as follows:

	2011	2010
Office furnishings and equipment	\$ 130,342	130,342
Software	865	865
	<u>131,207</u>	<u>131,207</u>
Less accumulated depreciation	<u>(95,161)</u>	<u>(90,491)</u>
	<u>\$ 36,046</u>	<u>40,716</u>

Depreciation expense for the years ended May 31, 2011 and 2010 were \$4,670 and \$5,333 respectively.



11. Agency Transactions

The Foundation receives donations for which the donor is involved in directing the donation to specified organizations that qualify for Foundation programs. Accordingly, these transactions are considered agency transactions, the donated amount is recorded as a liability in the statement of financial position, and the Foundation does not recognize contribution revenue and will not recognize a program expense when the donations are transferred to the recipients.

Amounts payable to specific organizations as designated by donors at May 31, 2011 and 2010 were as follows:

		2011	2010
Balance at beginning of period	\$	-	91,563
Donations received		-	-
Less donations transferred to specific beneficiaries		-	(91,563)
Balance at end of period	\$	-	-

For the agency transactions, the Foundation has committed to providing matching funds to donations within the Nursing Assistance Program based on a percentage of the amount donated to the Nursing Education Grant Program. These amounts are recognized as expenses within the statements of financial position when the recipients have been identified.

12. Defined Contribution Pension Plan

The Foundation had a defined contribution pension plan. The Foundation's contribution was based on a percentage of salary. On November 17, 2009, the Board of Directors adopted a resolution terminating the pension plan effective immediately. The plan terminated, and all assets were subsequently distributed to the participant by December 31, 2009 in accordance with the resolution.

13. Commitments and Contingencies

For the 2011-12 fiscal year, the Foundation will not be distributing any new grants, and no further commitments or contingencies exist.

14. Subsequent events

The Foundation evaluated subsequent events through the date the financial statements were available to be issued on September 21, 2011. No other subsequent events requiring disclosure were noted.