

**RHODE ISLAND DIVISION OF
HIGHER EDUCATION
ASSISTANCE**

**(a Component Unit of the State of Rhode Island and
Providence Plantations)**

FINANCIAL STATEMENTS

JUNE 30, 2016

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Financial Statements

June 30, 2016

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INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Rhode Island Division of Higher Education Assistance
Warwick, Rhode Island

Report on the Financial Statements

We have audited the accompanying financial statements of Rhode Island Division of Higher Education Assistance (a component unit of the State of Rhode Island and Providence Plantations) (the "Division"), which comprise the statement of net position and statement of fiduciary net position for the year ended June 30, 2016, the related statement of revenues and expenses, change in net position and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the Division's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion on the financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in Government Auditing Standards issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Rhode Island Division of Higher Education Assistance as of June 30, 2016, and the respective change in net position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter – Student Loan Originations

As disclosed in Note 1, all new federally guaranteed student loans originate under the Federal Direct Loan program rather than under the Federal Family Education Loans Program (“FFELP”). Substantially, all of the operating revenue of the Operating Fund was generated from activities related to loans originated under the FFELP. The method under which new guaranteed student loans are originated will continue to have a significant effect on the Operating Fund subsequent to June 30, 2016. Our opinions are not modified with respect to this matter.

Emphasis of Matter – Establishment of the Division

As discussed in Notes 1 and 2, the Rhode Island Division of Higher Education Assistance is a division within the Rhode Island Office of the Postsecondary Commissioner established on July 1, 2015 by an Act of the Rhode Island General Assembly. The Division was created for the dual purpose of guaranteeing loans originated under the FFELP and administering other programs of post-secondary student financial assistance assigned by law to the Division. On July 1, 2015, the State of Rhode Island transferred the assets and liabilities of the Operating and Federal Funds from another component unit of the State to the Division. In accordance with GASB Statement No. 69, Government Combinations and Disposals of Government Operations, the Division recognized the June 30, 2015 balances of the Operating and Federal Funds as a transfer of operations on the Statement of Revenues, Expenses and Changes in Net Position.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management’s discussion and analysis on pages 4-8, the schedule of the Division’s proportionate share of the net pension asset on page 41, the schedule of the Division’s contributions on page 42 and the notes to the required supplementary information on page 43 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management’s responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplemental Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Division's basic financial statements. The schedule of travel and entertainment expenses on page 45 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The schedule of travel and entertainment expenses is the responsibility of management and was derived from and relate directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of travel and entertainment expenses is fairly stated in all material respects in relation to the basic financial statements as a whole.

Other Reporting Required by Government Auditing Standards

In accordance with Government Auditing Standards, we have also issued our report dated October 6, 2016 on our consideration of the Rhode Island Division of Higher Education Assistance's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards in considering Rhode Island Division of Higher Education Assistance's internal control over financial reporting and compliance.

O'Connor and Drew, P.C.

**Certified Public Accountants
Braintree, Massachusetts**

October 6, 2016

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Management's Discussion and Analysis (Unaudited)

June 30, 2016

The Rhode Island Division of Higher Education Assistance (the "Division") Management's Discussion and Analysis ("MD&A") of the Division's operations and financial results is intended to provide readers with information which will assist them in understanding and evaluating the division's financial statements as of and for the fiscal year ended June 30, 2016. The MD&A consists of an introduction section and a financial highlight. The introduction section outlines the Division's programs and operations, provides information about the presentation of the financial statements and describes major statutory and regulatory actions which have a material effect on the Division's operations. The financial highlight focuses on significant items disclosed within the Division's financial statements or affecting its financial condition. The MD&A should be read in conjunction with the financial statements, notes to financial statements and other information included in the audit document.

Introduction

The Rhode Island Higher Education Assistance Authority ("RIHEAA") was a public corporation of the State of Rhode Island (the "State") established on July 1, 1977 by an act of the Rhode Island General Assembly, having a distinct legal existence from the State and not constituting a department of State government, which is a governmental agency and public instrumentality of the State. It was created to administer financial assistance programs to expand access to and choice among post-secondary education opportunities for Rhode Islanders. Functionally, and for management financial reporting purposes, RIHEAA's activities were organized into three divisions which administered the Scholarship and Grant Program, the Tuition Savings Program and the Federal Family Education Loan ("FFEL") Program Guaranty Agency, respectively.

On March 30, 2010, the President of the United States signed into law the Health Care and Education Reconciliation Act of 2010 (the "Act"). The Act made sweeping changes in student financial assistance programs, including a provision which eliminated loan originations under the FFEL Program effective July 1, 2010. As a result, all federally guaranteed student loans are now originated under the Federal Direct Loan Program. This Act has effectively ended the growth of the student loan portfolio administered by RIHEAA and placed this division of RIHEAA into a wind-down mode which is anticipated to last from three to five years.

In December 2013, the U.S. Congress passed the Bipartisan Budget Act of 2013 (the "Budget Act"). One of the provisions of the Budget Act was to reduce the Guaranty Agency revenue derived from the rehabilitation of defaulted student loans by approximately 50%, effective July 1, 2014. Revenues from loan rehabilitations constitute a major source of income for most Guaranty Agencies, and this reduction will have major implications on the ability of Guaranty Agencies to operate profitably, especially as portfolio balances decline over time.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2016

Introduction – Continued

RIHEAA implemented GASB 68 regarding the Pension Plan for fiscal year 2015. Certain employees of RIHEAA participate in a cost sharing multiple-employer defined benefits pension plan — the Employees' Retirement System plan — administered by the Employees Retirement System of the State of Rhode Island. Under a cost-sharing plan, pension obligations for employees are pooled and plan assets are available to pay the benefits of the employees of any participating employer providing pension benefits through the plan, regardless of the status of the employers' payment of its pension obligation to the plan. For fiscal 2016 the pension adjustment for the Division was \$30,932.

The Rhode Island fiscal year 2016 budget created the Division of Higher Education Assistance (the “Division”) replacing RIHEAA and merging it into the Office of the Postsecondary Commissioner (“OPC”). This budget went into effect as of July 1, 2015. As the Commissioner of Postsecondary Education for the State of Rhode Island, Dr. James Purcell will now serve as the executive director of the Division, which will assume the rights, assets, powers and obligations of RIHEAA, including our role as a guarantor participating in FFEL and the Rhode Island State Grant Programs.

Additionally, the fiscal year 2016 budget transferred oversight and operations of the CollegeBoundfund to the Rhode Island Office of the General Treasurer.

In its current form, the Division is responsible for the administration of the following:

Scholarships and Grants

The Scholarship and Grant area administers student financial assistance programs funded by transfers from the State of Rhode Island as well as funds derived from other sources. These programs include the Rhode Island State Scholarship/Grant Program and the Tuition Savings Scholarship/Grant Programs. In addition, the Division provides support services for scholarship and grant programs funded by the Department of Children, Youth and Families (“DCYF”) and the College Crusade of Rhode Island. In fiscal year 2016, the Division worked with the Providence City School District to support the increased completion of the Free Application for Federal Student Aid.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2016

Introduction – Continued

FFEL Program Guaranty Agency (“Guaranty Agency”)

The FFEL Program Guaranty Agency provides services that assist students and their parents in financing higher education expenses with guaranteed student loans. The financial transactions of the Guaranty Agency are segregated into the Federal Student Loan Reserve Fund (the "Federal Fund") and the Guaranty Agency Operating Fund (the "AOF"), pursuant to the provisions and restrictions of the 1998 reauthorization of the Higher Education Act. The Division administers the Federal Fund on behalf of the U. S. Department of Education. The AOF principally accounts for the administrative activities related to the operations of the FFEL Program. In addition to providing the services directly related to guaranteed loan origination, portfolio maintenance, default prevention and aversion, and defaulted loan collections, Guaranty Agencies are charged with promoting awareness of and access to post-secondary education opportunities and programs. Toward that end, the Division has committed AOF resources to develop and maintain the "WaytogoRI" web portal. WaytogoRI is a free, internet-based program that helps students, parents, and educators explore educational options, discover a wide variety of occupations, and make plans to achieve education and career goals. The WaytogoRI web portal is currently in use in all public school systems in Rhode Island and in many private and parochial institutions as well.

Overview of the Financial Statements

The financial statements present the financial picture of the Division from the economic resources measurement focus using the accrual basis of accounting. These statements include all assets of the division as well as all liabilities including long-term debt. The Division engages only in business-type activities, that is, activities that are financed in whole or in part by fees charged to external users, and fiduciary activities. As a result, the Division's basic financial statements include: the statement of net position; the statement of revenues, expenses and changes in net position; the statement of cash flows; the statement of fiduciary net position; and notes to the financial statements. The fiduciary activities are agency funds, which only report a balance sheet and do not have a measurement focus.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2016

Financial Highlights and Comparative Analysis

The tables in each section below reflect first year financial data.

Net Position

	2016
Operating Fund	\$ 35,357,000

The net position of the Operating Fund consists of \$34 million which is restricted by federal and state statute for the uses of the Division's operations and for student financial assistance purposes.

Total liabilities of the AOF are just under \$5.9 million, with the largest components being a liability for the return of default aversion fees of \$1.3 million, net pension liability of \$3 million and accounts payable of \$1 million.

Operating Fund Revenues, Expenses and Transfers

	2016
Operating revenues	\$ 6,112,000
Operating expenses	17,371,000
Operating loss	(11,259,000)
Non-operating revenue	241,000
Change in net position before special item	(11,018,000)
Transfer in from primary government	8,027,000
Special item (Note 2)	38,348,000
Change in Net Position	35,357,000
Net Position, Beginning of Year	\$ -
Net Position, End of Year	\$ 35,357,000

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2016

Statement of Cash Flows

	2016
Restricted Cash and Cash Equivalents	\$ 35,535,000
Provided by (used in):	
Operating activities	\$ (11,169,000)
Noncapital financing activities	4,488,000
Investing activities	2,993,000
Transfer of Restricted Cash and Cash Equivalents (Note 2)	39,223,000
Net Increase	\$ 35,535,000

Requests for Information

This financial report is designed to provide a general overview of DHEA's finances for any interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chief Financial Officer, Office of Postsecondary Commissioner, Division of Higher Education Assistance, 560 Jefferson Blvd, Warwick, RI 02886.

**RHODE ISLAND DIVISION OF HIGHER EDUCATION
ASSISTANCE**

(a Component Unit of the State of Rhode Island and Providence Plantations)

Statement of Net Position

June 30, 2016

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Statement of Net Position

June 30, 2016

Assets

	Operating Fund
Current Assets:	
Restricted cash and equivalents	\$ 34,905,139
Investments	399,722
Portfolio maintenance receivable	143,852
Due From State of Rhode Island	3,539,000
Due from Federal Fund	206,136
Prepaid expenses and other current assets	<u>343,929</u>
Total Current Assets	<u>39,537,778</u>
Noncurrent Assets:	
Restricted cash and equivalents:	
Escrow Sallie Mae principal	181,526
Recall account, interest	449,271
Capital assets, net	<u>1,250,086</u>
Total Noncurrent Assets	<u>1,880,883</u>
Total Assets	<u>41,418,661</u>
Deferred Outflows of Resources:	
Contributions subsequent to the measurement date	<u>147,431</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 41,566,092</u>

The accompanying notes are an integral part of these financial statements.

Liabilities, Deferred Inflows of Resources and Net Position

	Operating Fund
Current Liabilities:	
Accounts payable and accrued expenses	\$ 1,041,030
Compensated absences	<u>48,072</u>
Total Current Liabilities	<u>1,089,102</u>
Noncurrent Liabilities:	
Default aversion fee allowance	1,254,356
Compensated absences, less current portion	112,170
Net pension liability	2,953,800
Unearned default prevention income	<u>449,271</u>
Total Noncurrent Liabilities	<u>4,769,597</u>
Total Liabilities	<u>5,858,699</u>
Deferred Inflows of Resources:	
Difference between projected and actual earnings on pension plan investments	2,431
Difference between expected and actual experience	34,172
Changes of assumptions	22,224
Changes in proportion and differences between employer contributions and proportionate share of contributions	<u>291,484</u>
Total Deferred Inflows of Resources	<u>350,311</u>
Net Position:	
Net investment in capital assets	1,250,086
Restricted - expendable	<u>34,106,996</u>
Total Net Position	<u>\$ 35,357,082</u>

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Statement of Revenues, Expenses and Changes in Net Position

For the Year Ended June 30, 2016

	Operating Fund
Operating Revenues:	
Government fees:	
Default aversion	\$ 374,926
Account maintenance	603,381
Recovery, consolidation, and rehabilitation income, net of U.S. Department of Education share	5,076,656
Other	<u>56,774</u>
Total Operating Revenues	<u>6,111,737</u>
Operating Expenses:	
Student financial assistance	10,171,902
Salaries and employee benefits	1,407,600
Building and maintenance	117,329
Collection agency commissions	2,182,016
Computer services	96,036
Default aversion and prevention	262,033
Depreciation and amortization	432,251
Office and other	356,815
Professional services	138,552
Provision for default aversion fee returns	187,463
Navient guarantee services fee	602,173
Navient portfolio management fees	933,611
Travel, conferences, and workshops	8,893
Web portal maintenance and services	<u>474,253</u>
Total Operating Expenses	<u>17,370,927</u>
Operating Loss	<u>(11,259,190)</u>

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Statement of Revenues, Expenses and Changes in Net Position - Continued

For the Year Ended June 30, 2016

	<u>Operating Fund</u>
Non-Operating Revenue:	
Investment income	\$ 125,167
Rental income	<u>116,263</u>
Total Non-Operating Revenue	<u>241,430</u>
Change in Net Position Before Transfer and Special Item:	<u>(11,017,760)</u>
Transfer:	
Transfer in from primary government	<u>8,027,293</u>
Special Item:	
Transfer of operations (Note 2)	<u>38,347,549</u>
Change in Net Position	<u>35,357,082</u>
Net Position, Beginning of Year	<u>-</u>
Net Position, End of Year	<u>\$ 35,357,082</u>

The accompanying notes are an integral part of these financial statements.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Statement of Cash Flows

For the Year Ended June 30, 2016

	<u>Operating Fund</u>
Cash Flows from Operating Activities:	
Receipts from:	
Recovery, consolidation, and rehabilitation income	\$ 5,094,439
Government fees	948,084
Other	202,074
Payments for:	
Salaries and benefits	(1,280,883)
Supplies, materials, and services	(5,961,119)
Student financial assistance	<u>(10,171,902)</u>
 Net Cash Applied to Operating Activities	 <u>(11,169,307)</u>
 Cash Flows from Noncapital Financing Activities:	
Transfer in from primary government	<u>4,488,293</u>
 Cash Flows from Investing Activities:	
Rental income	116,263
Proceeds from sales and maturities of investments	2,868,768
Investment income	125,167
Purchase of capital assets	<u>(116,685)</u>
 Net Cash Provided by Investing Activities	 <u>2,993,513</u>
 Net decrease in Restricted Cash and Equivalents	 (3,687,501)
 Transfer of Restricted Cash and Equivalents (Note 2)	 <u>39,223,437</u>
 Restricted Cash and Equivalents, End of Year	 <u><u>\$ 35,535,936</u></u>

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Statement of Cash Flows - Continued

For the Year Ended June 30, 2016

Reconciliation of Operating Loss to Net Cash Used in Operating Activities:

Operating loss	\$ (11,259,190)
Adjustments to reconcile operating loss to net cash used in operating activities:	
Depreciation and amortization	432,251
Changes in Assets and Liabilities:	
Receivables	286,175
Prepaid expenses and other current assets	(289,953)
Accounts payable and accrued expenses	(311,992)
Compensated absences	(15,685)
Default aversion fee allowance and unearned default prevention income	(153,315)
Pension	<u>142,402</u>
 Net Cash Applied To Operating Activities	 <u>\$ (11,169,307)</u>

The accompanying notes are an integral part of these financial statements.

**RHODE ISLAND DIVISION OF HIGHER
EDUCATION ASSISTANCE**

(a Component Unit of the State of Rhode Island and Providence Plantations)

Statement of Fiduciary Net Position

June 30, 2016

Assets

	<u>Federal Fund</u>
Assets:	
Restricted cash and equivalents	\$ 9,773,360
Reinsurance claims, Federal Government	2,635,245
Default aversion fee returns, guaranty agency operating fund	<u>1,254,356</u>
Total Assets	<u>\$ 13,662,961</u>

Liabilities

Liabilities:	
Accounts payable	\$ 37,051
Due to Operating Fund	206,136
Due to Federal Government	<u>13,419,774</u>
Total Liabilities	<u>\$ 13,662,961</u>

The accompanying notes are an integral part of these financial statements.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements

June 30, 2016

Note 1 - **Summary of Significant Accounting Policies**

Organization

The Rhode Island Division of Higher Education Assistance (the “Division”) is a division within the Rhode Island Office of the Postsecondary Commissioner (“RIOPC”) established on July 1, 2015 by an Act of the Rhode Island General Assembly having a distinct legal existence from the State of Rhode Island (the “State”) and not constituting a department of State government, which is a governmental agency and public instrumentality of the State. It is a component unit of the State for financial reporting purposes and, as such, the financial statements of the Division will be included in the State’s Comprehensive Annual Financial Report (“CAFR”).

The Division was created for the dual purpose of guaranteeing loans to students in eligible institutions and administering other programs of post-secondary student financial assistance assigned by law to the Division.

On July 1, 2015, the State transferred the assets and liabilities of the Operating and Federal Funds from another component unit of the State to the Division.

The Federal Family Education Loan Program (“FFELP”) was established by Congress and is administered by the U.S. Department of Education (“ED”) through the Division and other guaranty agencies. As a guarantee agency, the Division makes loans available through lending institutions to students attending colleges, universities, vocational and other postsecondary schools. FFELP allows the Division to guarantee payment of principal and accrued interest to lenders for eligible student loans. The Division has the responsibility of providing collection assistance to lenders for delinquent loans, paying lenders claims for loans in default, and performing certain collection activities on loans after purchase by the Division.

On March 30, 2010, the President of the United States signed into law H.R. 4872 – The Health Care and Education Reconciliation Act of 2010, which terminated new loan originations in FFELP on June 30, 2010. Effective July 1, 2010, all new Stafford, PLUS or consolidated loans are originated under the U.S. Department of Education Direct Loan Program. Existing FFELP loans will continue to be eligible for program benefits. The Operating Funds and Federal Fund of Division continue to administer its existing FFELP portfolio of both active and defaulted student loans.

The Division consists of two funds: The Federal Fund and the Operating Fund. The Federal Fund finances FFELP insurance activities. The Operating Fund provides substantially all FFELP operational costs as well as state scholarships, financial aid awareness, and related outreach activities.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 1 - Summary of Significant Accounting Policies - Continued

Organization - Continued

The Federal Fund assets and earnings on those assets are restricted in use and are property of the ED. The Operating Fund is property of the Division and its assets and earnings are restricted in use for student financial aid activities.

Basis of Presentation

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with U.S. generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (“GASB”). Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenues as soon as all eligibility requirements have been met. Operating revenues and expenses result from activities associated with FFELP, including collection on defaulted loans, default prevention, default loan purchase activities. All revenues and expenses not derived from the administration of FFELP are reported as non-operating revenues and expenses.

The Division has determined that the Operating Fund operates as a Business Type Activity and the Federal Fund operates as a Fiduciary Fund, as defined by GASB.

Net Position

Resources are classified for accounting purposes into the following two net position categories:

Net investment in capital assets: Capital assets, net of accumulated depreciation, accounts payable, accrued expenses and of outstanding principal balances of debt attributable to the acquisition, construction, repair or improvement of those assets.

Restricted – expendable: Net position whose use is subject to externally imposed conditions that can be fulfilled by the specific actions of the Division or by the passage of time.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 1 - **Summary of Significant Accounting Policies - Continued**

Net Position - Continued

The Division has adopted a policy of generally utilizing restricted-expendable funds, when available, prior to unrestricted funds.

Restricted Cash and Equivalents

Restricted cash and equivalents consist entirely of highly liquid debt instruments with an original maturity date of three months or less.

Investments

Investments in marketable securities are stated at fair value. Dividends, interest, and net gains or losses on investments of endowments and similar funds are reported in the statements of activities and changes in net position.

Receivables

Receivables are reported at their gross value when earned and are reduced by the estimated portion that is expected to be uncollectible. This estimate is based on historical and current information regarding the credit worthiness of the debtors. The Division does not require collateral or other forms of security from its debtors.

Restricted Cash and Equivalents

Restricted cash and equivalents classified as current assets include amounts held on behalf of the Department of Children Youth and Families (“DCYF”), which will be remitted to various colleges and universities during the fiscal year ending June 30, 2016. According to an agreement with DCYF, the Division serves as a fiscal intermediary with respect to the DCYF’s scholarship program. A corresponding liability of \$771,226 is reflected in accounts payable and accrued expenses.

Restricted cash and equivalents classified as noncurrent assets include escrow deposits with a financial institution under an agreement with Navient Corporation as collateral for certain loans, and deposits associated with the ED’s recall from the Federal Student Loan Reserve Fund, which funds are to be used specifically for default prevention activities.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 1 - **Summary of Significant Accounting Policies - Continued**

Capital Assets

Real estate assets, including improvements, are generally stated at cost. Furnishings and equipment are stated at cost as of date of acquisition or, in the case of gifts, at fair value as of date of donation. In accordance with the Division's capitalization policy, all land is capitalized, regardless of value. The Division's capitalization threshold is a unit cost of at least \$2,500. Interest costs on debt related to capital assets are capitalized during the construction period and then depreciated over the life of the asset. The Division did not capitalize any interest costs during the year ended June 30, 2016. Capital assets, with the exception of land and construction in progress, are depreciated on a straight-line basis over their estimated useful lives, which range from 3 to 30 years. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized.

Compensated Absences

Certain employees are granted vacation and sick leave in varying amounts. In the event of termination, an employee is paid for accumulated vacation and sick days allowable in accordance with the applicable union contract or in the case of non-union personnel, according to State or Division policy. Amounts of vested and accumulated vacation and sick leave are reported as accrued compensation and benefits. Amounts are determined based upon the compensation rates in effect as of the balance sheet date.

Post-Employment Benefits

GASB 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other than Pensions*, requires governments to account for other postemployment benefits ("OPEB") on the accrual basis, rather than pay-as-you go (cash basis). Furthermore, the determination of the OPEB liability is dependent upon the type of plan in which the employer participates. Effective July 1, 2011, the State of Rhode Island established an independent entity titled the OPEB Board, to manage OPEB benefits for all state government employers including the Division. A separate legal OPEB entity classified as a cost sharing multiple employer plan, as established by the State, assesses the annual required contribution ("ARC") of each participating entity based on the plan's parameters to each participating employer. To the extent the employer does not pay the entire ARC or contractual obligation, they will have an OPEB related liability.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 1 - Summary of Significant Accounting Policies - Continued

Health Insurance

The State offers one state paid health plan to each of its participating agencies. The premiums for these plans are divided among the agencies based upon their number of eligible employees. All employees share in healthcare costs. Employee co-pays range from 10% to 15% of healthcare premiums for non-classified staff, and from 15% to 25% for classified employees. The employee contributions are automatically deducted through the payroll system on a bi-weekly basis. Amounts paid by the Division for the 2016 health premiums amounted to approximately \$203,000. Employee contributions for 2016 were approximately \$160,000.

Assessed Fringe Benefit Administrative Fund

In July 2000, the State established the Assessed Fringe Benefit Administrative Fund. This fund is used to make all payments relating to workers' compensation charges, unemployment payments and payments to employees for unused vacation and sick leave at the time of retirement or termination from State service. The State funds this account by assessing a charge based on bi-weekly payrolls of all State agencies. The fringe benefit assessment rate was 4.30%. The assessed fringe benefit cost for the year ended June 30, 2016 was approximately \$36,000.

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Employees' Retirement System plan ("ERS") and the additions to/deductions from ERS' fiduciary net position have been determined on the same basis as they are reported by ERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 1 - **Summary of Significant Accounting Policies - Continued**

Tax Status

The Division is a component unit of the State of Rhode Island and Providence Plantations and is therefore generally exempt from income taxes under Section 115 of the Internal Revenue Code.

Revenue Recognition

The 1998 reauthorization of the Higher Education Act established two fees recorded in the Operating Fund for administering the loan program on behalf of the Federal Government based on performance of a guarantee agency.

A default aversion fee is recognized in the Operating Fund on delinquent loans at the time the lenders request aversion assistance between the 60th and 120th day of a borrower's delinquency. A fee of 1% of principal and interest on the loan may be charged to the Federal Fund at the time the guaranty agency receives a request from a lender for assistance. However, the fee must be refunded by the Operating Fund to the Federal Fund in the event the loan is later paid as a default claim. Accordingly, an estimate of default aversion fee refunds of \$1,254,356 at June 30, 2016 is reported as a liability in the Operating Fund and a receivable in the Federal Fund. The net default aversion fee is transferred from the Federal Fund to the Operating Fund on a monthly basis. For the year ended June 30, 2016, the Operating Fund recognized default aversion fee revenue, net of estimated refunds of \$187,463. The estimate for refunds is based upon historical loan collections of the portfolio.

An account maintenance fee is calculated on the original principal amount of loans outstanding at a rate of .06%. This fee is paid to the Federal Fund by the ED and transferred to the Operating Fund on a quarterly basis.

Recovery, consolidation and rehabilitation income is the result of the Division's collections of defaulted student loans on behalf of the ED and recognized as revenue when received, net of the ED's share, which approximates recording this revenue on the accrual basis.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 1 - **Summary of Significant Accounting Policies - Continued**

Guaranteed Loans Outstanding

As of June 30, 2016, the Federal Fund was the guarantor of loans outstanding with original principal amounts of approximately \$944,910,763 made to students by participating lending institutions. The Division guarantees approximately 1% of these loans, with the balance guaranteed by the ED. At June 30, 2016, the unpaid balances were approximately \$944,034,270 including student loans as described in Note 7.

Based on historical data, certain of these loans will go into default status requiring the Federal Fund to purchase the loan from the respective lender. The Federal Fund will be reimbursed for these actions by the ED in accordance with the ED's guarantee.

New Governmental Accounting Pronouncements

GASB Statement 75 - Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions is effective for periods beginning after June 15, 2017. This Statement replaces Statement 45, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pension Plans and Statement 57, OPEB Measurements by Agent Employers and Agent Multiple-Employer Plans. The objective of Statement 75 is to improve accounting and financial reporting by state and local governments for postemployment benefits other than pensions ("OPEB"). It also requires additional information by state and local governmental employers about financial support for OPEB that is provided by other entities. The Statement establishes standards for recognizing and measuring liabilities, deferred outflows and inflows of resources, and expense/expenditures. GASB 75 also identifies the assumptions and methods that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value and attribute that present value to periods of employee service for defined benefit OPEB. Management has not yet evaluated the effects of the implementation of this Statement.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 2 - **Transfer of Operations**

As described in Note 1 and in accordance with GASB Statement No. 69, *Government Combinations and Disposals of Government Operations*, the State of Rhode Island transferred the assets and liabilities of the Operating and Federal Funds to the Division on July 1, 2016. As a result of the transfer, the Division recognized the following items:

	Operating <u>Fund</u>	Federal <u>Fund</u>
Current assets	\$ 42,552,278	\$ 9,620,947
Capital assets, net	1,565,652	-
Other assets	<u>629,788</u>	<u>4,804,870</u>
 Total assets	 44,747,718	 14,425,817
 Deferred outflows of resources	 231,825	 -
 Current liabilities	 1,828,371	 355,720
Noncurrent liabilities	<u>4,542,252</u>	<u>14,070,097</u>
 Total liabilities	 6,370,623	 14,425,817
 Deferred inflows of resources	 261,371	 -
 Net investment in capital assets	 1,565,652	 -
Restricted net position	<u>36,781,897</u>	<u>-</u>
 Total net position	 <u>\$ 38,347,549</u>	 <u>\$ -</u>

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 3 - **Restricted Cash and Equivalents and Investments**

The Division does not have a policy for custodial credit risk associated with deposits except for which is provided by Chapter 35-10.1 of the Rhode Island General Laws dealing with the Public Finance, which states that any depository institutions holding public deposits shall insure or pledge eligible collateral equal to one hundred percent (100%) of any time deposit with maturities greater than sixty days. If any depository institution does not meet its minimum capital standards as prescribed by its federal regulator, it shall insure or pledge eligible collateral equal to one hundred percent (100%) of all public deposits.

At June 30, 2016, the carrying amounts of the Division's cash deposits were \$45,309,296 and the bank balances were \$45,790,753. Deposits are exposed to custodial credit risk if they are not covered by depository insurance, and the deposits are:

- a) Uncollateralized,
- b) Collateralized with securities held by the pledging financial institution, or
- c) Collateralized with securities held by the pledging financial institution's trust department or agent but not in the depositor-government's name.

Of the bank balances, \$9,473,559 was covered by federal depository insurance as of June 30, 2016. The remaining amount of \$36,317,194 was uninsured but collateralized with securities held by the pledging bank's trust department or an agent not held in the Division's name as of June 30, 2016.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 3 - Restricted Cash and Equivalents and Investments - Continued

Investments

As of June 30, 2016, the Division's investments are contained in a mutual fund. The Division does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk

The Division has no investment policy that would further restrict its investment choices beyond the limitations in Chapter 10 of Title 35 of the Rhode Island General Laws. As of June 30, 2016, the Division's investments were unrated.

Custodial Credit Risk

Custodial credit risk is the risk that, in the event of the failure of the counterparty, the Division will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Division's current approved board investment policy includes only low-risk securities, such as obligations of the United States Government or a state.

Fair Value Hierarchy

The fair value hierarchy categorizes inputs to valuation techniques used to measure fair value into three levels. Level 1 inputs are quoted market prices for identical assets or liabilities in active markets that a government can access at the measurement date. Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for an asset or liability, directly or indirectly. Level 3 inputs are unobservable inputs. The highest priority is assigned to Level 1 inputs and the lowest to Level 3 inputs. If the fair value is measured using inputs from more than one level of the hierarchy, the measurement is considered to be based on the lowest priority input level that is significant to the entire measurement. Valuation techniques used should maximize the use of the observable inputs and minimize the use of unobservable inputs.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 3 - **Restricted Cash and Equivalents and Investments - Continued**

Fair Value Hierarchy – Continued

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at June 30, 2016.

Registered investment companies: Valued at the daily closing price as reported by the fund. Mutual funds held by the Division are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value (NAV) and to transact at that price. The mutual funds held by the Division are deemed to be actively traded.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Division believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine if the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

**RHODE ISLAND DIVISION OF HIGHER
EDUCATION ASSISTANCE**
(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 4 - **Capital Assets, Net**

Capital assets consist of the following at June 30, 2016

	<u>Beginning Balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>(Note 2) Transfers</u>	<u>Ending Balance</u>
Capital assets not depreciated:					
Land	\$ -	\$ -	\$ -	\$ 194,096	\$ 194,096
Capital assets depreciated:					
Land improvements	-	-	-	135,740	135,740
Building and improvements	-	-	-	2,291,087	2,291,087
Equipment	-	116,685	-	797,614	914,299
Software and web portal	-	-	-	<u>2,232,791</u>	<u>2,232,791</u>
Total capital assets depreciated depreciated or amortized	<u>-</u>	<u>116,685</u>	<u>-</u>	<u>5,457,232</u>	<u>5,573,917</u>
Less accumulated depreciation:					
Land improvements	-	4,525	-	82,012	86,537
Building and improvements	-	77,990	-	2,111,589	2,189,579
Equipment	-	47,927	-	762,484	810,411
Software and web portal	-	<u>301,809</u>	-	<u>1,129,591</u>	<u>1,431,400</u>
Total accumulated depreciation	<u>-</u>	<u>432,251</u>	<u>-</u>	<u>4,085,676</u>	<u>4,517,927</u>
Total capital assets depreciated, net	<u>-</u>	<u>(315,566)</u>	<u>-</u>	<u>1,371,556</u>	<u>1,055,990</u>
Total capital assets, net	<u>\$ -</u>	<u>\$ (315,566)</u>	<u>\$ -</u>	<u>\$ 1,565,652</u>	<u>\$ 1,250,086</u>

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 5 - **Long-Term Liabilities**

A summary of changes in long-term liabilities for the year ended June 30, 2016 is as follows:

	Beginning <u>Balance</u>	<u>Increases</u>	<u>Decreases</u>	(Note 2) <u>Transfers</u>	Ending <u>Balance</u>	Due within <u>One Year</u>
Default aversion fee allowance	\$ -	\$ -	\$ (154,214)	\$ 1,408,570	\$ 1,254,356	\$ -
Compensated absences	-	-	(15,685)	175,927	160,242	48,072
Net pension liability	-	-	(30,932)	2,984,732	2,953,800	-
Unearned default prevention income	<u>-</u>	<u>899</u>	<u>-</u>	<u>448,372</u>	<u>449,271</u>	<u>-</u>
	<u>\$ -</u>	<u>\$ 899</u>	<u>\$ (200,831)</u>	<u>\$ 5,017,601</u>	<u>\$ 4,817,669</u>	<u>\$ 48,072</u>

Note 6 - **Allowance for Unreinsured Claims and Reinsurance Triggers**

The Division primarily acts as a guaranty agency for educational loans made to students by lending institutions which have agreed to participate in the FFEL Program. Under the terms of the reinsurance agreements with the Federal Government, the Federal Government reimburses guaranty agencies for a percentage of amounts expended in the discharge of their guarantor obligations. The agreements contain certain annual limitations, commonly referred to as the “reinsurance trigger”, which could reduce the reinsurance amount during the remainder of any federal fiscal year.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 6 - Allowance for Unreinsured Claims and Reinsurance Triggers - Continued

The “reinsurance trigger” clause provides that whenever default claims in any federal fiscal year exceed 5% and 9% of the insured loans that were in repayment at the end of the previous federal fiscal year, the amount of reinsurance for loans disbursed prior to October 1, 1993 will drop from 100% to 90% and 80%, respectively, of the default claims for the balance of the federal fiscal year which ends on September 30. For loans disbursed between October 1, 1993 and September 30, 1998, the maximum amount of reinsurance that guaranty agencies may receive from the Federal Government was reduced by 2% (the Division will receive 98%, 88% or 78% of the claims paid to lenders based upon its “reinsurance trigger”). For loans disbursed on or after October 1, 1998, the maximum amount of reinsurance was reduced by 5% (the Division will receive 95%, 85% or 75% of the claims paid to lenders based on its “reinsurance trigger”). During the year ended June 30, 2016, default claims did not exceed the applicable reinsurance trigger, and accordingly, the Federal Government’s reinsurance payments to the Division never fell below the maximum amount allowed by law. During the year ended June 30, 2016, the reduction in the Federal Fund for unreinsured claims payments totaled \$609,285.

The Federal Fund records an allowance for unreinsured claims based on management’s best estimate of amounts payable to lending institutions as a result of a borrower’s default that is not insured by the ED. Management believes that the allowance is reasonable given that the balance of loans guaranteed is declining at an annual rate of approximately 10% (see “reserve fund requirements” within Note 12). It is at least reasonably possible that this estimate could change in the near term and the change could be material to the financial statements.

Note 7 - Related Party Transactions

The Division is a related party to the Rhode Island Student Loan Division (“RISLA”). RISLA is a public instrumentality created to provide a statewide student loan program through the acquisition and origination of student loans. Transactions with RISLA as of and during the year ended June 30, 2016 were as follows:

Guaranteed loans outstanding with RISLA as of June 30, 2016	\$ 280,354,509
Guarantee claims paid to RISLA during the year	\$ 13,075,653

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 8 - **Pension**

Plan Description

Certain employees of the Division participate in a cost-sharing multiple-employer defined benefit pension plan - the Employees' Retirement System plan - administered by the Employees' Retirement System of the State of Rhode Island (the "System"). Under a cost-sharing plan, pension obligations for employees of all employers are pooled and plan assets are available to pay the benefits of the employees of any participating employer providing pension benefits through the plan, regardless of the status of the employers' payment of its pension obligation to the plan. The plan provides retirement and disability benefits and death benefits to plan members and beneficiaries.

The System issues a publicly available financial report that includes financial statements and required supplementary information for the plans. The report may be obtained at <http://www.ersri.org>.

Benefit Provisions

The level of benefits provided to participants is established by Chapter 36-10 of the General Laws, which is subject to amendment by the General Assembly. Member benefit provisions vary based on service credits accumulated at dates specified in various amendments to the General Laws outlining minimum retirement age, benefit accrual rates and maximum benefit provisions. In general, members accumulate service credits for each year of service subject to maximum benefit accruals of 80% or 75%. For those hired after June 30, 2012, the benefit accrual rate is 1% per year with a maximum benefit accrual of 40%. Members eligible to retire at September 30, 2009 may retire with 10 years of service at age 60 or after 28 years of service at any age. The retirement eligibility age increases proportionately for other members reflecting years of service and other factors until it aligns with the Social Security Normal Retirement Age, which applies to any member with less than 5 years of service as of July 1, 2012. Members are vested after 5 years of service.

The plan provides for survivor's benefits for service-connected death and certain lump sum benefits. Joint and survivor benefit provision options are available to members.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 8 - **Pension - Continued**

Benefit Provisions - Continued

Cost of living adjustments are provided but are currently suspended until the collective plans covering state employees and teachers reach a funded status of 80%. Until the plans reach an 80% funded status, interim cost of living adjustments are provided at five-year intervals.

The plan also provides nonservice-connected disability benefits after 5 years of service, and service-connected disability benefits with no minimum service requirement.

Contributions

The funding policy, as set forth in the General Laws, Section 36-10-2, provides for actuarially determined periodic contributions to the plan. For fiscal 2016, the Division's employees were required to contribute 3.75% of their annual covered salary. The Division is required to contribute at an actuarially determined rate; the rate was 23.64% of annual covered payroll for the fiscal year ended June 30, 2016. The Division contributed \$147,431 for the fiscal year ended June 30, 2016 equal to 100% of the required contributions for each year.

Pension Liabilities, Pension Expense and Deferred Outflows of Resources and Deferred Inflows of Resources

At June 30, 2016 the Division reported a liability of \$2,953,800 for its proportionate share of the net pension liability related to its participation in ERS. The net pension liability was measured as of June 30, 2015, the measurement date, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2014 rolled forward to June 30, 2015. The Division's proportion of the net pension liability was based on its share of contributions to the ERS for fiscal year 2015 relative to the total contributions of all participating employers for that fiscal year. At June 30, 2015 the Division's proportion was 0.15%.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 8 - **Pension - Continued**

*Pension Liabilities, Pension Expense and Deferred Outflows of Resources and
Deferred Inflows of Resources - Continued*

For the year ended June 30, 2016, the Division recognized pension expense of \$142,402. At June 30, 2016, the Division reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

Deferred Outflows of Resources

Contributions made subsequent to measurement date	\$ <u>147,431</u>
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Deferred Inflows of Resources

Difference between expected and actual experience	\$ 34,172
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Changes of assumptions	22,224
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Changes in proportion and differences between employer contributions and proportionate share of contributions	291,484
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Net difference between projected and actual earnings on pension plan investment earnings	<u>2,431</u>
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	<u>\$ 350,311</u>
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RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 8 - **Pension - Continued**

*Pension Liabilities, Pension Expense and Deferred Outflows of Resources and
Deferred Inflows of Resources - Continued*

Contributions of \$147,431 are reported as deferred outflows of resources related to pensions resulting from the Division's contributions in fiscal year 2016 subsequent to the measurement date will be recognized as a reduction of the net pension liability for the year ended June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended <u>June 30,</u>	
2017	\$ (101,327)
2018	(101,327)
2019	(101,327)
2020	<u>(46,330)</u>
	<u>\$ (350,311)</u>

Actuarial Assumptions

The total pension liability was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.75%
Salary increases	3.50% to 6.50%
Investment rate of return	7.50%

Mortality rates were based on 115% (males) and 95% (females) of the RP-2000 combined healthy mortality tables with white collar adjustments projected with scale AA from 2000.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 8 - **Pension - Continued**

Actuarial Assumptions - Continued

The actuarial assumptions used in the June 30, 2014 valuations rolled forward to June 30, 2015 and the calculation of the total pension liability at June 30, 2015 were consistent with the results of an actuarial experience study performed as of June 30, 2013.

The long-term expected rate of return best-estimate on pension plan investments was determined by the actuary using a building-block method. The actuary started by calculating best-estimate future expected real rates of return (expected returns net of pension plan investment expense and inflation) for each major asset class, based on a collective summary of capital market expectations from 23 sources.

The June 30, 2015 expected arithmetic returns over the long-term (20 years) by asset class are summarized in the following table:

Asset Class	Target allocation	Medium-Term Expected Real Rate of Return
Global Equity:	38.00%	
U.S. Equity		6.93%
International Developed		7.32%
International Emerging Markets		9.52%
Equity Hedge Funds	8.00%	3.98%
Private Equity	7.00%	9.99%
Core Fixed Income	15.00%	2.18%
Absolute Return Hedge Funds	7.00%	3.98%
Infrastructure	3.00%	5.70%
Real Estate	8.00%	4.85%
Other Real Return Assets:	11.00%	
Master Limited Partnerships		4.51%
Credit		4.51%
Inflation Linked Bonds		1.24%
Cash, Overlay and Money Market	3.00%	0.78%
	100.00%	

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 8 - **Pension - Continued**

Actuarial Assumptions - Continued

These return assumptions are then weighted by the target asset allocation percentage, factoring in correlation effects, to develop the overall long-term expected rate of return best-estimate on an arithmetic basis.

Discount Rate

The discount rate used to measure the total pension liability was 7.5 percent. The projection of cash flows used to determine the discount rate assumed that contributions from plan members will be made at the current contribution rate and that contributions from the employers will be made at statutorily required rates, actuarially determined. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Net Pension Liability (Asset) to Changes in the Discount Rate

The following presents the net pension liability (asset) calculated using the discount rate of 7.5 percent as well as what the net pension liability (asset) would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current rate.

1.00% Decrease	Current Discount Rate	1.00% Increase
6.50%	7.50%	8.50%
\$ 3,662,068	\$ 2,953,800	\$ 2,373,982

Pension Plan Fiduciary Net Position

As noted earlier, ERS issues a publicly available financial report that includes financial statements and required supplementary information for the plans. The report may be obtained at <http://www.ersri.org>. The report contains detailed information about the pension plan's fiduciary net position.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 9 - **Retirement Plan**

Defined Contribution Plan

Description

Employees participating in the defined benefit plan (those with less than 20 year of service as of 7/1/2015), as described above, also participate in a defined contribution plan of the Employees' Retirement System as authorized by General Law Chapter 36-10.3. The defined contribution plan is established under IRS section 401(a) and is administered by TIAA-CREF. The Retirement Board is the plan administrator and plan trustee. Employees may choose among various investment options available to plan participants. The State Investment Commission is responsible for implementing the investment policy of the plan and selecting the investment options available to members.

Contributions

Certain employees (those with less than 20 year of service as of 7/1/2015) contribute 5% of their annual covered salary and employers contribute at the following percentages of annual covered salary for these employees based on their years of service as of July 1, 2015:

<u>Years of Service</u> <u>As of 7/1/2015</u>	<u>Employer Contribution</u> <u>Rate</u>
15 - 20 years	1.50%
10 - 15 years	1.25%
0 - 10 years	1.00%

The Division contributed \$6,210 for the fiscal year ended June 30, 2016, equal to 100% of the required contributions for that year.

The ERS issues a publicly available financial report that includes financial statements and required supplementary information for plans administered by the system. The report may be obtained by writing to the Employees' Retirement System of Rhode Island, 50 Service Avenue, Warwick, RI 02886.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 10 - **Postemployment Health Care Plan**

Plan Description

The Division contributes (for certain employees) to the State Employees' defined benefit post-employment health care plan, a cost sharing multiple employer plan administered through the Rhode Island State Employees' and Electing Teachers OPEB System ("OPEB System"). The State of Rhode Island OPEB Board ("Board") was authorized, created and established under Chapter 36-12.1 of the RI General Laws. The Board was established to independently hold and administer, in trust, the funds of the OPEB System. The plan provides medical benefits to certain retired employees of participating employers including the Division.

Pursuant to legislation enacted by the General Assembly, a trust has been established to accumulate assets and pay benefits and other costs associated with the OPEB System.

The OPEB System issues a stand-alone financial report. A copy can be obtained from the State Controller's Office, 1 Capitol Hill, Providence, RI 02908.

Funding Policy

RIGL Sections 36-12.1, 36-12-2.2, and 36-12-4 govern the provisions of the OPEB System. The contribution requirements of plan members, the State, and other participating employers are established and may be amended by the General Assembly. Active employees make no contribution to the OPEB plan. Employees who retired after October 1, 2008 must contribute 20% of the annual estimated benefit cost (working rate) or annual premium for Medicare supplemental coverage. Employees retiring before October 1, 2008 have varying co-pay percentages ranging from 0% to 50% based on age and years of service at retirement. Further information about the contributions of plan members can be found in the financial report of the OPEB System.

For fiscal 2016, employers were required to contribute 5.97% of covered payroll. The employer required contribution rate is determined on an actuarially determined basis consistent with a funding approach outlined in the General Laws and as adopted by the OPEB System Board. The Division fully funded its required contribution to the plan for the year ended June 30, 2016 which was \$43,204.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

(a Component Unit of the State of Rhode Island and Providence Plantations)

Notes to the Financial Statements - Continued

June 30, 2016

Note 11 - **Preservation and Recovery of Reserves**

The Secretary of the ED is authorized to require the return of all of a guaranty agency's Federal Fund if the Secretary determines that such return is in the best interests of the Federal Family Education Loan or Federal Direct Student Loan Programs. Alternatively, the Secretary can require a guaranty agency to return to the Secretary any portion of the Reserve Funds from the Federal Fund that the Secretary determines is unnecessary for paying the program expenses and contingent liabilities of the programs.

Pursuant to the Omnibus Budget Reconciliation Act of 1993, the Secretary required the return of \$1 billion in guaranty agency Reserve Funds nationwide. The Division's share of Reserve Funds to be returned was \$4,310,909. The Division was required to account separately for 20% of the \$4,310,909 in each of the fiscal years 1998 through 2002, and the entire amount was returned to the Secretary on August 30, 2002. Until the funds were returned to the Secretary, the Division received interest on the funds, restricted for use in default prevention activities. Upon payment of the \$4,310,909, the Division was authorized to transfer the accumulated interest to the Operating Fund, subject to its restricted use in default prevention activities. The Division reports a corresponding liability, unearned default prevention income, for the cash balance restricted to default prevention activities, and recognizes income as allowable expenditures are incurred. The liability totaled \$449,271 as of June 30, 2016.

Note 12 - **Commitments and Contingencies**

Reserve Fund Requirements

The ED has established guidelines for guaranty agency Federal Student Loan Reserve Funds to assist in determining an agency's ability to meet its guarantor obligations. Under these guidelines, the minimum reserve fund requirement is 0.25% of the original principal balance of loans guaranteed ("OPO"). As of June 30, 2016, the Division's OPO totaled \$944,910,763 and its corresponding minimum reserve balance was \$2,362,277. The actual balance in the reserve fund at year-end was \$12,063,446, and using the method currently prescribed by the ED (which provides that the liability for unreinsured losses be added back to the fund balance), the reserve ratio was 2.02%, substantially in excess of the minimum required.

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Notes to the Financial Statements - Continued

June 30, 2016

Note 12 - **Commitments and Contingencies - Continued**

Reserve Fund Requirements - Continued

In the event an agency does not meet the minimum reserve fund level, the Secretary will require a management plan. The Secretary also may request a management plan if the agency exceeds the 5% reinsurance trigger as defined in the reinsurance agreement.

The Division met the required reserve fund level for the federal fiscal year ended September 30, 2015 and the Division has not exceeded the 5% reinsurance trigger.

Systems Services Agreement

The Division has an agreement for computer system services with Navient Corporation (“Navient”) that expires in September 2016 and is automatically renewed, subject to prior mutual agreement of any adjustment of fees, for up to two (2) additional one (1) year periods, unless Navient or the Division, not less than 180 days prior to the expiration date of the current term or any renewal term, if applicable, notifies the other party in writing of its intent to allow this Agreement to expire. The Division will renew the agreement at the end of the term.

In addition, Navient provides portfolio management services to the Division for defaulted loans collections. The agreement provides for fixed fees plus incremental fees for loan guarantee systems services based upon the amount of annual loan applications processed excluding consolidation loans, as well as specified fees for certain administrative services provided to the Division when requested.

The agreement provides that fees for system services are calculated at the rate of 0.04% annually on the balance of the Division’s guaranteed loan portfolio and paid monthly. Fees to Navient for those services totaled \$602,173 for the year ended June 30, 2016. The agreement also provides that the fees for portfolio management services would be calculated at 27.5% of net revenue. Net revenue is defined as amounts collected less commissions paid to collection vendors and less amounts remitted to the ED. Fees to Navient for portfolio management services totaled \$933,611 for the year ended June 30, 2016. In the event that the Division should cancel the portfolio management services, the agreement provides for increases in the fee structure for administrative services.

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Notes to the Financial Statements - Continued

June 30, 2016

Note 12 - Commitments and Contingencies - Continued

Default Aversion and Prevention Services Agreement

The Division has an agreement for default aversion services with NCO Financial Systems, Inc. (“NCO”) that expires in September 2016 and is automatically renewed, subject to prior mutual agreement of any adjustment of fees, for up to two (2) additional one (1) year periods, unless NCO or the Division, not less than 180 days prior to the expiration date of the current term or any renewal term, if applicable, notifies the other party in writing of its intent to allow this Agreement to expire. The Division will renew the agreement at the end of the term. NCO is a paid service fee equal to 0.59% of the delinquent loan balance for each loan brought to current status within the specifications of the agreement. Fees to NCO totaled \$262,033 for the year ended June 30, 2016.

Web Portal Development and Services Agreement

The Division has an agreement with a software developer, XAP Corporation (“XAP”), to develop and maintain an internet-based program (WaytogoRI.org) that helps students explore career options and prepare and apply for a college education. The web portal provides a platform for individualized learning plans, electronic portfolios and additional services. The portal is available at no cost to all Rhode Island students, parents and educators. For the year ended June 30, 2016, maintenance, marketing and training expenses associated with the web portal totaled approximately \$474,253. Under the terms of its agreement with XAP, and including the expenses associated with the additions and enhancements, the Division is committed to expend the following:

<u>Year Ending</u>	<u>Amount</u>
2017	\$ 475,000
2018	475,000
2019	<u>79,166</u>
	\$ <u>1,029,166</u>

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Financial Statements - Continued

June 30, 2016

Note 13 - **Risk Management**

The Division is exposed to various risks of loss related to torts, errors and omissions, property casualty and liability, and workers' compensation claims for which the Division carries commercial insurance or participates in State programs and coverage. Management believes the Division has sufficient net position for potential claims, if any, that are subject to deductibles or are in excess of stated coverage maximums. The Division is not aware of any potential claims. Claims settled in the past three years have not exceeded the Division's coverage, and there have been no significant reductions in insurance coverage.

Note 14 - **Continuing Operations**

Due to changes in the FFELP, the guaranteed loan portfolio will decrease and as a result, revenues from collections, account maintenance fees and default aversion fees will decline, affecting the ability of the guaranty agency's operation to be self-sustaining.

The Division's management continues to evaluate the impact of the changes to FFELP and the options for future operations. The Division intends to continue in its role as the State's designated Guaranty Agency. Over a number of years, the Division has moved away from performing some functions with in-house personnel, and its number of employees has declined.

The successful operating model for small state-based guaranty agencies could be one where virtually all activities are outsourced to large servicers and only a small number of in-house employees perform financial, regulatory reporting and contract oversight services. Nevertheless, a time will come when the volume of defaulted and outstanding loans will not be sufficient to produce enough revenue to support a guaranty agency infrastructure. The Division's management cannot accurately predict the time period over which even a pared-down guaranty agency would be financially viable. Management anticipates the time period to be in the range of three to five years. However, weakness in the economic environment and federal regulatory changes could have a negative effect on that outlook.

**REQUIRED SUPPLEMENTARY
INFORMATION**

**RHODE ISLAND DIVISION OF HIGHER
EDUCATION ASSISTANCE**

(a Component Unit of the State of Rhode Island and Providence Plantations)

Schedule of the Division's Proportionate Share of the Net Pension Liability

Employees Retirement System

Year ended	June 30, 2016
Valuation date	6/30/2014
Measurement date	6/30/2015
Division's proportionate share of the net pension liability	0.15%
Division's proportion of the net pension liability	\$ 2,953,800
Division's covered employee payroll	\$ 1,323,817
Division's proportionate share of the net pension liability as a percentage of its covered employee payroll	223.13%
Plan fiduciary net position as a percentage of the total pension liability	55.03%

Notes:

The GASB pronouncement requiring the presentation of the information on this schedule became effective for years beginning after June 15, 2014 and is intended to provide data for the most recent ten years.

See accompanying notes to the required supplementary information.

**RHODE ISLAND DIVISION OF HIGHER
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Schedule of Division's Contribution

For the Year Ended June 30, 2016

Contractually required contribution	\$ 147,431
Contributions in relation to the contractually required contribution	<u>(147,431)</u>
Contribution excess	<u>-</u>
Division's covered-employee payroll	<u>\$ 623,651</u>
Contribution as a percentage of covered-employee payroll	23.64%

Notes:

- 1) Employers participating in the State Employees' Retirement System are required by RI General Laws, Section 36-10-2, to contribute an actuarially determined contribution rate each year.
- 2) The GASB pronouncement requiring the presentation of the information on this schedule became effective for years beginning after June 15, 2014 and is intended to provide data for the most recent ten years.

RHODE ISLAND DIVISION OF HIGHER EDUCATION ASSISTANCE

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Notes to the Required Supplementary Information

June 30, 2016

Note 1 - **Change in Assumptions**

The change in assumptions which is primarily related to reductions in wage inflation, salary increases for individual members, and the overall payroll growth assumptions resulted from an experience study performed for the six-year period ended June 30, 2013 and is amortized over the average of the expected remaining service life of all employees, which is 4.9977 years. The Division's proportionate share of the collective amounts below is equal to the collective amount multiplied by the employer proportionate share percentage as shown in the schedule of the employer proportionate share of the net pension liability.

	<u>2016</u>	<u>2015</u>
Change in assumptions	\$ 23,762,000	\$ 23,762,000
Accumulated amortization	<u>(8,817,000)</u>	<u>(4,408,000)</u>
Change in assumptions, net	\$ 14,945,000	\$ 19,354,000

SUPPLEMENTAL INFORMATION

**RHODE ISLAND DIVISION OF HIGHER
EDUCATION ASSISTANCE**

(a Component Unit of the State of Rhode Island and Providence Plantations)

Schedule of Travel and Entertainment Expenses

For the Year Ended June 30, 2016

<u>Payee</u>	<u>Purpose</u>	<u>Airfare</u>	<u>Lodging</u>	<u>Meals/Auto Other</u>
Joyce, Michael	NASSGAP Conference	\$ 866	\$ 59	\$ 168
Mance-Rios, Gail	NCAN Conference	298	403	201
Mance-Rios, Gail	NCHER Conference	1,201	954	195
Mance-Rios, Gail	NCHER Legislative Conference	532	992	305
Mance-Rios, Gail	NCHER Spring Resources Conference	765	685	159
Miller, Charlie	NCHER Conference	510	856	308
Amounts less than \$200		<u>-</u>	<u>-</u>	<u>1,212</u>
Total Guaranty Agency		<u>4,172</u>	<u>3,949</u>	<u>2,548</u>
Grand Total				<u>\$ 10,669</u>

**Independent Auditors' Report on Internal Control Over
Financial Reporting and on Compliance and Other Matters
Based on an Audit of Financial Statements Performed in
Accordance with *Government Auditing Standards***



INDEPENDENT AUDITORS' REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING AND ON COMPLIANCE AND OTHER MATTERS BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors of
Rhode Island Division of Higher Education Assistance
Warwick, Rhode Island

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of Rhode Island Division of Higher Education Assistance (the "Division"), which comprise the statement of net position and statement of fiduciary net position for the year ended June 30, 2016, the related statement of revenues and expenses, change in net position and cash flows for the year then ended, and the related notes to the financial statements, which collectively comprise the Division's basic financial statements, and we have issued our report thereon dated October 6, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Division's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Division's internal control. Accordingly, we do not express an opinion on the effectiveness of the Division's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Division's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Division's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

O'Connell and Duen, P.C.

**Certified Public Accountants
Braintree, Massachusetts**

October 6, 2016