

**RHODE ISLAND HIGHER EDUCATION
ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE
OF RHODE ISLAND)**

YEAR ENDED JUNE 30, 2011



RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

YEAR ENDED JUNE 30, 2011

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Lefkowitz, Garfinkel, Champi & DeRienzo P.C.
Certified Public Accountants / Business Consultants

Independent Auditors' Report

Board of Directors
Rhode Island Higher Education
Assistance Authority
Warwick, Rhode Island

We have audited the accompanying financial statements of the business-type activities, each major fund, and the aggregate remaining fund information of the Rhode Island Higher Education Assistance Authority (the Authority), a component unit of the State of Rhode Island, as of and for the year ended June 30, 2011, which collectively comprise the Authority's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Authority's management. Our responsibility is to express opinions on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities, each major fund, and the aggregate remaining fund information of the Rhode Island Higher Education Assistance Authority as of June 30, 2011, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended, in conformity with accounting principles generally accepted in the United States.

As discussed in Note 14, as a result of the Health Care and Education Reconciliation Act of 2010, effective July 1, 2010 all new guaranteed student loans originate under the Federal Direct Loan Program rather than under the FFEL Program. Approximately 60% of the Authority's Operating Fund operating revenues for the year ended June 30, 2011 were generated under activities related to loans originated under the FFEL Program. Also, approximately 75% of the Authority's employees were allocated to guarantee agency functions during the year ended June 30, 2011. The method under which new guaranteed student loans are originated will continue to have a significant effect on the Authority's operations subsequent to June 30, 2011.

Independent Auditors' Report (Continued)

Board of Directors
Rhode Island Higher Education
Assistance Authority

In accordance with Government Auditing Standards, we have also issued our report dated September 29, 2011 on our consideration of the Authority'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis presented on pages 3 through 11 is not a required part of the basic financial statements but consists of supplementary information required by accounting principles generally accepted in the United States. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The supplemental information presented on pages 42 through 46 is presented for purposes of additional analysis as required by the State of Rhode Island, and is not a required part of the basic financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

A handwritten signature in black ink, reading "Jeffrey J. Sunkel, CPA". The signature is written in a cursive style and is positioned to the right of the date.

September 29, 2011

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Rhode Island Higher Education Assistance Authority's (RIHEAA or the "Authority") Management's Discussion and Analysis (MD&A) of the Authority's operations and financial results is intended to provide readers with information which will assist them in understanding and evaluating RIHEAA's financial statements as of and for the year ended June 30, 2011. The MD&A consists of an introduction section, and a financial highlights and comparative analysis section. The introduction section outlines RIHEAA's programs and operations and provides information about the presentation of the financial statements. The financial highlights and comparative analysis section focuses on significant items disclosed within RIHEAA'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

RIHEAA is 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 are organized into three divisions which administer the Scholarship and Grant Program, the Tuition Savings Program, and the Federal Family Education Loan (FFEL) Program, respectively.

The Scholarship and Grant Division administers various student financial assistance programs funded by general revenue appropriations from the State of Rhode Island, as well as by funds received from the U.S. Department of Education (DE) and funds derived from other sources. These programs include the Rhode Island State Scholarship/Grant Program, the Federal LEAP/SLEAP, and the Tuition Savings Scholarship/Grant Programs.

The Tuition Savings Program Division administers the activities of the Rhode Island Higher Education Savings Trust (RIHEST), Rhode Island's IRS Section 529 qualified state tuition savings program, which does business under the name *CollegeBoundfund*®. RIHEST is a separate legal entity created by RIHEAA pursuant to an act of the Rhode Island General Assembly. RIHEST is comprised of two funds: (1) the Tuition Savings Program Fund (the Program Fund), which holds *CollegeBoundfund*® participants' assets as a private purpose trust fund, and (2) an Administrative Fund, the use of which is contractually restricted to RIHEST administrative and marketing expenses and student financial assistance programs authorized by the RIHEAA Board of Directors (Board). The Program Fund is managed by AllianceBernstein, L.P. (AllianceBernstein) under an agreement among RIHEAA, the State Investment Commission (SIC), and AllianceBernstein. Revenues of the Administrative Fund are derived principally from fees paid by non-Rhode Island participants in the Program Fund. This division also accounts for other activities associated with RIHEAA's contract with AllianceBernstein and administration of the Tuition Savings Program.

Effective July 1, 2010, the Authority, the SIC and AllianceBernstein entered into a new contract for the management and promotion of *CollegeBoundfund*®. The contract is for a period of five years with one five-year renewal option. Under the terms of the new agreement, RIHEAA receives \$275,000 annually from AllianceBernstein and also receives a fee equal to 9.5 basis points of the average net asset value of non-Rhode Island resident accounts. In addition, AllianceBernstein is committed to spend \$750,000 annually for the marketing and promotion of *CollegeBoundfund*® in Rhode Island, and established the "CollegeBound Baby" program. Under the CollegeBound Baby program, AllianceBernstein deposits \$100 into the account of every child born to or adopted by a resident who establishes an account for that child within one year.

The Loan Division (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 Loan Division 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. RIHEAA administers the Federal Fund on behalf of the DE. 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 aversion and defaulted loan collections, Guaranty Agencies (GAs) are charged with promoting awareness of and access to post-secondary education opportunities and programs. Towards that purpose, RIHEAA 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.

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 guaranteed student loans are now originated under the Federal Direct Loan Program. RIHEAA’s role as a guaranty agency in the FFEL Program constituted its single largest activity, as approximately 75% of the Authority’s employees were allocated to the guaranty agency functions. The elimination of new loan originations has had a significant impact on the Authority’s ongoing operations. Although the Authority will continue to provide services for loans currently in its portfolio (including claims payments and reinsurance transactions, default prevention and aversion activities, and collection of defaulted student loans), it is difficult to predict the time period over which such services will be required, and to what extent those responsibilities would constitute a substantive activity for the Authority. RIHEAA’s senior management believes that a reasonable estimate of that time period is in the range of three to five years. RIHEAA’s senior management, in conjunction with its Board, have already taken steps necessary to respond to the changes resulting from the Act, and will continue to closely monitor all aspects of the GA operating environment.

On May 31, 2011 the DE published a notice in the Federal Register Vol. 76, No. 104 inviting Guaranty Agencies to submit proposals to participate in a Voluntary Flexible Agreement (VFA). The Higher Education Act (HEA) authorizes the Secretary of Education to enter into agreements with GAs which modify some of the provisions of the traditional GA agreements, including the financing structure. The Secretary has exercised VFA authority in the past, but the last of those agreements expired in 2008. The Secretary’s stated intent of this invitation is “to receive proposals from guaranty agencies or from teams of guaranty agencies, that will lead to VFAs that will enhance the integrity and stability of the FFEL Program, improve services to students, schools and lenders, and use federal resources more cost-effectively and efficiently.” One of the major changes which will be implemented as a result of VFA implementation is that GA functions will be divided into four distinct categories which are to be known as the “GA Responsibility Areas:”

GA Responsibility Area I will include lender claims review, lender claims payment, and collections.

GA Responsibility Area II will include delinquency and default prevention and management.

GA Responsibility Area III will include community outreach, financial literacy and debt management.

GA Responsibility Area IV will include lender and lender servicer oversight.

In addition to defining the GA responsibility areas, the DE has placed restrictions on the combination of services which GAs will be allowed to perform. GAs who are selected to perform Area I services may not also assume either Area II or Area IV responsibilities. GAs may however, perform any combination of services covered by Areas II, III, and IV. The invitation to submit VFAs also stipulates that: proposals may come from individual agencies or from teams of GAs, provided that joint proposals ensure that the agencies comply with the responsibility area restrictions; GAs may submit more than one proposal; proposals are non-binding and ultimately subject to negotiation with the DE prior to implementation; and that GAs who decline to respond to the VFA invitation will be allowed to continue to operate using the current model. The deadline for submissions was August 1, 2011.

RIHEAA has submitted two responses to the Secretary's invitation. One is as part of a consortium of five GAs, all of whom are users of SallieMae's guarantee services system. In this proposal, RIHEAA would perform Area I and Area III responsibilities. RIHEAA's Area II responsibilities would be shifted to one of the other GAs, and RIHEAA would assume responsibility for the lender claims and collection activities for a segment of the Area II GA's portfolios. RIHEAA would also perform community outreach and financial literacy for its current service area. The second proposal submitted by RIHEAA is a "stand-alone" proposal. RIHEAA would again perform Area I and III responsibilities, but in this case RIHEAA would attempt to match up with an as yet unidentified Area II provider (preferably another entity which is a SallieMae system user.) The DE has said that it is amenable to acting as an intermediary to help facilitate arrangements where efficiencies and economies may be realized.

The DE has not yet provided any feedback on VFA proposals, except to publish a list of GAs who did and did not submit proposals, nor has DE issued a timetable for responding to GAs about the proposals. However, given the number of proposals which the DE has received, and the complexities of evaluating both group and stand-alone proposals, it may well be several months before DE moves on to the next step of negotiating and finalizing the agreements.

Overview of Financial Statements

RIHEAA 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, RIHEAA's basic financial statements include the statement of net assets; the statement of revenues, expenses and changes in net assets; the statement of cash flows; the statement of fiduciary net assets; the statement of changes in fiduciary net assets; and notes to the financial statements.

The financial statements (except for the statement of fiduciary net assets and the statement of changes in fiduciary net assets) reflect an "Operating Fund" and a "Scholarship and Grant Fund." The "Operating Fund" includes the administrative expenses associated with the State Scholarship/Grant Program as well as all transactions of the Tuition Savings Program and the Guaranty Agency Operating Fund. The "Scholarship and Grant Fund" includes transactions for scholarship/grant awards to students and the State's membership assessment for the New England Regional Student Program. The statement of fiduciary net assets is provided for the Program Fund and the Federal Fund. The statement of changes in fiduciary net assets is provided for the Program Fund.

Financial Highlights and Comparative Analysis

The tables in each section below reflect three years of financial data; however, the related discussion addresses only the changes from FY 2010 to FY 2011.

	<u>Net Assets</u>		
	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating Fund	\$ 25,701,000	\$ 21,302,000	\$ 18,260,000
Scholarship and Grant Fund	4,529,000	5,469,000	5,468,000
Total RIHEAA	<u>\$ 30,230,000</u>	<u>\$ 26,771,000</u>	<u>\$ 23,728,000</u>

RIHEAA's total net assets at June 30, 2011 were just over \$30.2 million, an increase of approximately \$3.4 million from the previous year. Net assets in the Operating Fund increased by \$4.4 million while the net assets in the Scholarship and Grant Fund decreased \$940,000. All of the net assets within the Scholarship and Grant Fund are restricted for use in the Academic Promise Scholarship Program, the CollegeBoundfund® Matching Grant Program, and the Adult Education Grant Program. These funds are invested in the Program Fund on behalf of Academic Promise Scholarship recipients, to provide funding for low-income individuals who qualify for the Matching Grant Program, and for academic and income-qualifying students in the Adult Education Grant Program. At June 30, 2011, the net assets of the Operating Fund consist of \$19.7 million which is restricted by federal statute to the uses of the AOF, \$5 million which is restricted for use in Tuition Savings Program administration and student financial assistance purposes, and just under \$1 million invested in capital assets. The Authority has total assets of \$33.5 million, which includes \$14.7 million in cash and cash equivalents and \$12.3 million in investments, including the amounts invested in CollegeBoundfund® for the Academic Promise Scholarship, Matching Grant, and Adult Education Grant Programs. Assets also include a receivable from the Rhode Island Student Loan Authority (RISLA) of just over \$1.6 million for rehabilitation loans which were made by RISLA utilizing RIHEAA funds. These loans were made in order to assist some qualifying borrowers who were unable to complete rehabilitation transactions due to a shortage of funding from traditional sources. (See Note 9 to the financial statements). Total liabilities are just over \$3.3 million, with the largest components being accounts payable of just over \$1 million, a liability for the return of default aversion fees of just over \$840,000, and deferred revenues of \$538,000 attributable to the transaction with RISLA referenced above.

RISLA finances a portion of its FFEL portfolio through the DE Asset Backed Commercial Paper Straight A Conduit Program (the Conduit), which was created under the Ensuring Continued Access to Student Loans Act (ECASLA) of 2008. Under this program, eligible FFELP loans are financed by asset backed commercial paper issued by the Conduit and the Conduit holds a security interest on the loans. Under the provisions of the program, FFEL loans that are over 240 days past due (delinquent) must be either repurchased by the lender or "put" to the DE. The "put" process is essentially a sale of those loans to the DE. RISLA's current trust indentures do not allow RISLA to repurchase the delinquent loans from the Conduit, and when the loans are "put" to the DE, the GA which guaranteed the loans loses the guarantee responsibility and the loans are transferred from the GA's portfolio. As a result of these transactions, GAs lose the opportunity to perform collections activities on the loans if the loans should default, and many loans which have reached that stage of delinquency do ultimately default. At the RIHEAA Board meeting on February 18, 2011, the Board authorized the use of up to \$6.5 million of RIHEAA funds to be used by RISLA to repurchase delinquent loans from the Conduit. The first purchase under this arrangement occurred on August 23, 2011 for loans totaling nearly \$3.6 million, and on September 9, 2011 additional loans totaling \$866,000 were acquired (see Note 9 to the financial statements).

Operating Fund Revenues

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Loan Division:			
Collections-Based Revenue	\$ 10,321,000	\$ 10,069,000	\$ 4,860,000
AMF, LPIF, & DAF	1,513,000	3,251,000	3,354,000
Investment and Other	825,000	456,000	549,000
	<u>12,659,000</u>	<u>13,776,000</u>	<u>8,763,000</u>
Tuition Savings Program:			
Program Fund Fees	8,243,000	6,034,000	6,491,000
Investment and Other	296,000	298,000	319,000
	<u>8,539,000</u>	<u>6,332,000</u>	<u>6,810,000</u>
Scholarship and Grant Division	<u>610,000</u>	<u>590,000</u>	<u>654,000</u>
Total Revenues	<u>\$ 21,808,000</u>	<u>\$ 20,698,000</u>	<u>\$ 16,227,000</u>

Revenues in the Loan Division totaled nearly \$12.7 million in FY 2011, a decrease of \$1.1 million from FY 2010. The decline came as a result of the loss of LPIF revenue and declines in AMF and DAF revenue as RIHEAA's outstanding loan portfolio shrank from approximately \$2 billion in FY 2010 to just under \$1.6 billion at the end of FY 2011. Collections-based revenue (from recoveries, consolidations, and rehabilitations of defaulted student loans) was up just over \$250,000 in FY 2011, totaling \$10.3 million. Investment and other income rose from \$456,000 in FY 2010 to \$825,000 in the current year and includes the recognition of deferred revenues associated with the rehabilitation loans made by RISLA using RIHEAA funds.

Revenues in the Tuition Savings Program increased from \$6.3 million in FY 2010 to over \$8.5 million in the current year. The asset-based fee which went into effect on July 1, 2010 (and replaced the account maintenance fees and the penalty administrative fees) generated nearly \$7 million in FY 2011. Direct purchase commissions increased by approximately \$250,000 and totaled nearly \$1.3 million.

Scholarship and Grant Division revenues, which represent the State appropriation used for the personnel and administrative expenses of the Scholarship and Grant Division, increased from \$590,000 in FY 2010 to \$610,000 in FY 2011.

Operating Fund Expenses and Transfers

	2011	2010	2009
Loan Division:			
Collection and Default Aversion	\$ 6,296,000	\$ 6,253,000	\$ 3,641,000
Personnel Expenses	2,048,000	2,084,000	2,264,000
Sallie Mae Guarantee Services	456,000	859,000	1,369,000
Web Portal Expenses	520,000	442,000	707,000
Federal Default Fees		135,000	3,813,000
Other Expenses	870,000	1,080,000	909,000
 Total Loan Division	 10,190,000	 10,853,000	 12,703,000
Tuition Savings Program:			
Personnel Expenses	214,000	213,000	276,000
Marketing and Promotion	42,000	106,000	
Other Expenses	62,000	55,000	65,000
 Total Tuition Savings Program	 318,000	 374,000	 341,000
Scholarship and Grant Division:			
Personnel Expenses	416,000	417,000	430,000
Other Expenses	184,000	178,000	184,000
 Total Scholarship and Grant Division	 600,000	 595,000	 614,000
Transfers to Scholarship and Grant Fund	6,300,000	5,834,000	6,532,000
 Total Expenses and Transfers	 \$ 17,408,000	 \$ 17,656,000	 \$ 20,190,000

Expenses in the Loan Division totaled just under \$10.2 million in FY 2011, a decrease of over \$650,000 from FY 2010. Within the category of collection and default aversion expenses, commissions paid to collection agencies were \$4.3 million in both FY 2011 and FY 2010. In addition to commissions paid to collection vendors, the portfolio management fee paid to Sallie Mae in FY 2011 was just over \$1.4 million, and slightly higher than the amount paid in FY 2010. This fee is directly based upon the amount of net revenue generated from outsourced collection activities. Fees paid for default aversion and prevention activities decreased from \$538,000 in FY 2010 to \$527,000 in the current year. These fees are based on the vendor's ability to bring delinquent loans into a current status. Personnel expenses were \$36,000 less in FY 2011 vs. FY 2010. Total fees paid to Sallie Mae for guarantee processing services decreased from \$859,000 to \$456,000. That amount represents the base rate for system maintenance and data processing in RIHEAA's contract with SallieMae, as new loan originations in the FFEL Program ended July 1, 2010. Expenses associated with the "WaytogoRI" web portal increased from \$442,000 in FY 2010 to \$520,000 in FY 2011. That total includes system service and maintenance of \$485,000 as well as marketing and training expense of \$35,000. Other operating expenses, which include office and administrative expenses, building-related expenses, and depreciation and amortization, totaled \$870,000 in the current year, \$210,000 less than in FY 2010, with reductions occurring in several categories.

Operating Fund Expenses and Transfers (Continued)

In the Tuition Savings Program, personnel expenses were substantively unchanged at \$214,000 in FY 2011 versus \$213,000 in FY 2010, and other administrative expenses increased from \$55,000 in FY 2010 to \$62,000 in the current year. During FY 2011, RIHEAA spent \$42,000 to supplement the marketing efforts of AllianceBernstein in Rhode Island. During FY 2010, the supplemental marketing expenses totaled just over \$106,000.

Expenses in the Scholarship and Grant Division, which are funded with State appropriations, totaled \$600,000 in FY 2011, an increase of \$5,000 from FY 2010. Personnel expenses were virtually unchanged from the FY 2010 amount of \$417,000 and other operating expenses increased by \$6,000 from the prior year.

Student financial assistance transfers from the Operating Fund to the Scholarship and Grant Fund totaled \$6.3 million in FY 2011, an increase of nearly \$500,000 from FY 2010. All of the amount transferred was used to provide supplemental funding for the State Scholarship/Grant Program.

Scholarship and Grant Fund Revenues, Transfers, and Expenses

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Revenues:			
State Appropriations	\$ 6,710,000	\$ 6,022,000	\$ 6,630,000
Federal Grants	413,000	635,000	574,000
Investment Income	<u>180,000</u>	<u>137,000</u>	<u>104,000</u>
Total Revenues	7,303,000	6,794,000	7,308,000
Transfers from the Operating Fund	<u>6,300,000</u>	<u>5,834,000</u>	<u>6,532,000</u>
Total Revenues and Transfers	<u>\$ 13,603,000</u>	<u>\$ 12,628,000</u>	<u>\$ 13,840,000</u>
Total Expenses	<u>\$ 14,544,000</u>	<u>\$ 12,627,000</u>	<u>\$ 12,237,000</u>

Total revenue and transfers into the Scholarship and Grant Fund were just over \$13.6 million in FY 2011 vs. approximately \$12.6 million in FY 2010. The State appropriation made to fund the need-based grant program increased by \$688,000 in FY 2011 vs. FY 2010. The increase was made so as to restore funding previously cut which would enable the State of Rhode Island to qualify for federal funds. The total includes the \$6.3 million transfer from the Operating Fund which was provided from Tuition Savings Program revenues. Federal funding for the LEAP/SLEAP programs was \$413,000 in FY 2011, up from \$377,000 in FY 2010. During FY 2010, federal grants also included \$258,000 in funds for the College Access Challenge Grant (CACG). During FY 2011, there were no CACG awards. Investment income increased from \$137,000 to \$180,000. All revenues of the Scholarship and Grant Fund are disbursed to, or for the benefit of, qualifying, financially needy Rhode Island students.

Scholarship and Grant Fund Revenues, Transfers, and Expenses (Continued)

Expenses in the Scholarship and Grant Fund represent the total student financial assistance provided, which was nearly \$2 million more in the current year than in FY 2010. The total includes State Scholarship/Grant Program awards of nearly \$12.9 million, just over \$1.1 million in the Academic Promise Scholarship and CollegeBoundfund® Matching Grant Programs, and approximately \$413,000 in federal LEAP/SLEAP awards.

Statement of Cash Flows

	2011	2010	2009
Cash and Cash Equivalents	\$ 14,700,000	\$ 7,180,000	\$ 4,774,000
Provided by (used in):			
Operating activities	\$ (5,786,000)	\$ (4,967,000)	\$(11,555,000)
Noncapital financing activities	7,733,000	7,246,000	7,858,000
Investing activities	5,619,000	127,000	(8,381,000)
Purchases of capital assets	(46,000)		(482,000)
Net (Decrease) Increase	\$ 7,520,000	\$ 2,406,000	\$(12,560,000)

Cash and cash equivalents totaled over \$14.7 million at the end of FY 2011, an increase of \$7.5 million from FY 2010. The components of the statement of cash flows are principally the revenue and expense items, presented on a cash rather than an accrual basis, that have been described in the previous sections. In addition, the statement of cash flows reflects financing and investing activities. Included in financing activities is the State appropriation for the Scholarship and Grant Division of \$7.3 million and grants from the Federal government totaling \$413,000. Investing activities reflect cash receipts of over \$13.1 million and cash outlays of \$7.5 million. These investing transactions include maturities of U.S. Treasury securities and maturities and purchases of certificates of deposit, purchases and redemptions of Program Fund investments related to the Academic Promise Scholarship and Matching Grant Programs, and interest income on investments. Capital assets purchases totaled only \$46,000 during FY 2011.

Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets

	2011	2010	2009
Net Assets Held in Trust for Participants	\$7,888,394,000	\$6,858,939,000	\$6,280,483,000

The net assets of the Program Fund totaled nearly \$7.9 billion at June 30, 2011, compared with \$6.9 billion at the end of FY 2010, an increase of just over \$1 billion. The value of participant assets held in the plan increased by \$1.1 billion. There were realized losses on investments of \$31 million and unrealized gains of more than \$1.2 billion. The other components of the total change consist of the following: participants invested \$1.4 billion while redeeming approximately \$1.6 billion; investments in the plan provided income of \$192 million; and the plan incurred expenses of just over \$87 million. All of the net assets are held in trust for the participants in the Program Fund. The number of accounts decreased from approximately 505,000 at the end of FY 2010 to just under 500,000 at the end of FY 2011.

Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets (Continued)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Federal Fund Total Assets and Liabilities	<u>\$ 18,923,000</u>	<u>\$ 18,914,000</u>	<u>\$ 15,079,000</u>

Total assets and liabilities of the Federal Student Loan Reserve Fund (the “Federal Fund”) were just under \$19 million at the end of FY 2011, up slightly from FY 2010. Assets include \$14.3 million in cash and cash equivalents, \$1 million in certificates of deposit, and a \$2.8 million reinsurance receivable from the DE arising from claims paid to lenders. The liabilities of the Federal Fund include a \$4.4 million allowance for unreinsured claims and a payable to the AOF of \$1.6 million. In addition, the Federal Fund reflects a liability to the Federal government of \$12.8 million, including \$3.1 million due to the DE for the Secretary’s share of collections and repurchase activity. The remaining \$9.7 million, although recorded as a liability in the audited financial statements, is the reserve balance in the Federal Fund and is restricted by federal statutes to authorized expenditures.

Requests for Information

This financial report is designed to provide a general overview of RIHEAA’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, Rhode Island Higher Education Assistance Authority, 560 Jefferson Blvd, Warwick, RI, 02886.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

STATEMENT OF NET ASSETS – JUNE 30, 2011

	<u>Operating Fund</u>	<u>Scholarship and Grant Fund</u>	<u>Total</u>
ASSETS:			
Current assets:			
Cash and cash equivalents	\$ 13,639,981		\$ 13,639,981
Cash and cash equivalents, restricted	436,750		436,750
Investments	6,702,583	\$ 4,528,773	11,231,356
Receivables and accruals:			
Asset-based fees	1,824,586		1,824,586
Interest	11,656		11,656
Portfolio maintenance fee	237,609		237,609
Due from Federal Student Loan Reserve Fund	1,590,784		1,590,784
Health education assistance loans receivable	24,381		24,381
Due from Rhode Island Student Loan Authority	182,819		182,819
Other	30,108		30,108
Prepaid expenses	191,194		191,194
Total current assets	<u>24,872,451</u>	<u>4,528,773</u>	<u>29,401,224</u>
Noncurrent assets:			
Restricted cash and cash equivalents	623,757		623,757
Investments	1,057,930		1,057,930
Health education assistance loans receivable, less current portion	40,915		40,915
Due from Rhode Island Student Loan Authority, less current portion	1,442,828		1,442,828
Capital assets, less accumulated depreciation	974,394		974,394
Total noncurrent assets	<u>4,139,824</u>		<u>4,139,824</u>
Total assets	<u>29,012,275</u>	<u>4,528,773</u>	<u>33,541,048</u>

(continued)

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

STATEMENT OF NET ASSETS – JUNE 30, 2011 (CONTINUED)

	Operating Fund	Scholarship and Grant Fund	Total
LIABILITIES:			
Current liabilities:			
Accounts payable and accrued expenses	\$ 1,095,795		\$ 1,095,795
Payable to federal government	76,879		76,879
Deferred rehabilitation income	53,837		53,837
Allowance for default aversion fee returns	560,000		560,000
Compensated absences	170,320		170,320
Total current liabilities	1,956,831		1,956,831
Noncurrent liabilities:			
Allowance for default aversion fee returns, less current portion	280,750		280,750
Compensated absences, less current portion	146,052		146,052
Deferred rehabilitation income, less current portion	484,536		484,536
Deferred default prevention income	442,593		442,593
Total noncurrent liabilities	1,353,931		1,353,931
Total liabilities	3,310,762		3,310,762
Commitments and contingencies (Notes 12 and 14)			
NET ASSETS:			
Invested in capital assets	974,394		974,394
Restricted	24,727,119	\$ 4,528,773	29,255,892
Total net assets	\$ 25,701,513	\$ 4,528,773	\$ 30,230,286

See notes to financial statements.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2011

	Operating Fund	Scholarship and Grant Fund	Total
Operating revenues:			
Government fees:			
Default aversion, net	\$ 519,750		\$ 519,750
Account maintenance	993,177		993,177
Recovery, consolidation, and rehabilitation income, net of DE share	10,320,584		10,320,584
Tuition Savings Program Fund:			
Asset-based fees	6,953,357		6,953,357
Direct purchase commissions	1,289,743		1,289,743
AllianceBernstein contract income	275,000		275,000
Other	328,235		328,235
	20,679,846		20,679,846
Total operating revenues			
Operating expenses:			
Student financial assistance		\$ 14,543,982	14,543,982
Salaries, payroll taxes, and employee benefits	2,679,087		2,679,087
Building and maintenance expenses	123,219		123,219
Collection agency commissions	4,344,256		4,344,256
Computer services	178,936		178,936
Web portal maintenance services	484,728		484,728
Web portal marketing and training	34,852		34,852
Default aversion and prevention expenses	526,901		526,901
Depreciation and amortization	241,275		241,275
Marketing and promotion	41,924		41,924
Office expenses and other	246,484		246,484
Printing and postage	49,869		49,869
Professional services	215,698		215,698
Sallie Mae guarantee services fees	456,337		456,337
Sallie Mae portfolio management fees	1,424,533		1,424,533
Travel, conferences, and workshops	59,973		59,973
	11,108,072	14,543,982	25,652,054
Total operating expenses			
Operating income (loss)	9,571,774	(14,543,982)	(4,972,208)

(continued)

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN
NET ASSETS (CONTINUED)

YEAR ENDED JUNE 30, 2011

	Operating Fund	Scholarship and Grant Fund	Total
Nonoperating revenue:			
Investment income	\$ 389,359	\$ 180,388	\$ 569,747
Rental income	128,261		128,261
State appropriations	610,486	6,709,700	7,320,186
Federal grants		413,257	413,257
	1,128,106	7,303,345	8,431,451
Income (loss) before transfers	10,699,880	(7,240,637)	3,459,243
Transfers in (out), State grant program supplement	(6,300,000)	6,300,000	- 0 -
Change in net assets	4,399,880	(940,637)	3,459,243
Net assets:			
Beginning of year	21,301,633	5,469,410	26,771,043
End of year	\$ 25,701,513	\$ 4,528,773	\$ 30,230,286

See notes to financial statements.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

STATEMENT OF CASH FLOWS

YEAR ENDED JUNE 30, 2011

	Operating Fund	Scholarship and Grant Fund	Total
Cash flows from operating activities:			
Cash received from:			
Recovery, consolidation, and rehabilitation income	\$ 9,755,649		\$ 9,755,649
Tuition Savings Program Fund fees and commissions	6,418,514		6,418,514
Government fees	1,638,207		1,638,207
AllianceBernstein contract income	275,000		275,000
Rental income	202,060		202,060
Loan repayments:			
Health education assistance loans	32,672		32,672
Loans receivable	669,536		669,536
Cash paid for:			
Employees for services and benefits	(2,678,843)		(2,678,843)
Supplies, materials, and services	(7,552,012)		(7,552,012)
Loans receivable	(2,492)		(2,492)
Student financial assistance		\$ (14,543,982)	(14,543,982)
	8,758,291	(14,543,982)	(5,785,691)
Net cash provided by (used in) operating activities			
Cash flows from noncapital financing activities:			
Operating subsidies and transfers (to) from other funds	(6,300,000)	6,300,000	- 0 -
State appropriations	610,486	6,709,700	7,320,186
Federal grants		413,257	413,257
	(5,689,514)	13,422,957	7,733,443
Net cash provided by (used in) noncapital financing activities			
Cash flows from investing activities:			
Purchases of investments	(7,500,000)		(7,500,000)
Proceeds from sales and maturities of investments	11,600,098	940,637	12,540,735
Interest income	397,787	180,388	578,175
Purchases of capital assets	(46,090)		(46,090)
	4,451,795	1,121,025	5,572,820
Net cash provided by investing activities			

(continued)

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

STATEMENT OF CASH FLOWS (CONTINUED)

YEAR ENDED JUNE 30, 2011

	Operating Fund	Scholarship and Grant Fund	Total
Net increase in cash and cash equivalents	\$ 7,520,572	\$ - 0 -	\$ 7,520,572
Cash and cash equivalents, beginning of year	7,179,916	- 0 -	7,179,916
Cash and cash equivalents, end of year	\$ 14,700,488	\$ - 0 -	\$ 14,700,488
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:			
Operating income (loss)	\$ 9,571,774	\$ (14,543,982)	\$ (4,972,208)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	241,275		241,275
Rental income	128,261		128,261
Provision for default aversion fee refunds	40,250		40,250
Deferred rehabilitation revenue	(210,589)		(210,589)
Changes in assets and liabilities:			
Receivables and accruals:			
Asset-based fees	(1,824,586)		(1,824,586)
Portfolio maintenance fees	60,133		60,133
Loan processing issuance fee	23,941		23,941
Health education assistance loans receivable	32,672		32,672
Loans receivable	667,044		667,044
Other	55,838		55,838
Due from Federal Student Loan Reserve Fund	(662,790)		(662,790)
Prepaid expenses	3,507		3,507
Accounts payable and accrued expenses	632,191		632,191
Payable to federal government	(1,830)		(1,830)
Deferred default prevention income	956		956
Compensated absences	244		244
Net cash provided by (used in) operating activities	\$ 8,758,291	\$ (14,543,982)	\$ (5,785,691)

See notes to financial statements.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

STATEMENT OF FIDUCIARY NET ASSETS

JUNE 30, 2011

	Private Purpose Trust Fund	Agency Fund
	Tuition Savings Program Fund	Federal Student Loan Reserve Fund
ASSETS:		
Cash and cash equivalents	\$ 25	\$ 14,262,226
Investments	7,895,231,942	1,018,945
Receivables and accruals:		
Units sold	34,735,542	
Investments sold	1,206,336	
Interest and dividends	75,176	
Reinsurance claims, federal government		2,800,130
Default aversion fee returns, Operating Fund		841,250
Other	12,391	
	7,931,261,412	\$ 18,922,551
Total assets		
LIABILITIES:		
Accounts payable:		
Investments purchased and units redeemed	35,646,246	
Accrued asset-based charges	7,220,796	
Other		\$ 81,589
Payable to Operating Fund		1,590,784
Allowance for unreinsured claims		4,425,000
Due to the federal government		12,825,178
	42,867,042	\$ 18,922,551
Total liabilities		
NET ASSETS:		
Held in trust for participants	\$ 7,888,394,370	

See notes to financial statements.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS

YEAR ENDED JUNE 30, 2011

	Private Purpose Trust Fund
	Tuition Savings Program Fund
From operations:	
Investment income	\$ 191,742,288
Net increase in fair value of investments	1,123,031,091
Expenses, asset-based charges	(87,160,155)
Net increase in net assets from operations	1,227,613,224
From unitholder transactions:	
Subscriptions	1,396,448,911
Redemptions	(1,594,606,904)
Net decrease in net assets from unitholder transactions	(198,157,993)
Net increase in net assets	1,029,455,231
Net assets held in trust for participants, beginning of year	6,858,939,139
Net assets held in trust for participants, end of year	\$ 7,888,394,370

See notes to financial statements.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2011

1. Organization and reporting entity:

Organization:

Rhode Island Higher Education Assistance Authority:

The Rhode Island Higher Education Assistance Authority (the Authority or RIHEAA) is a public corporation of the State of Rhode Island (the State) established 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 is a component unit of the State for financial reporting purposes and, as such, the financial statements of the Authority will be included in the State's comprehensive annual financial report. The Authority 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 Authority.

The Authority is exempt from federal and state income taxes.

Rhode Island Higher Education Savings Trust:

The Rhode Island Higher Education Savings Trust (RIHEST) is a separate legal entity created by the Authority pursuant to an Act of the Rhode Island General Assembly. RIHEST is comprised of the Tuition Savings Program Fund (the Program Fund) which is reported as a private purpose trust fund in the Authority's fiduciary fund financial statements, and an Administrative Fund which is a component of the Operating Fund in the Authority's proprietary fund financial statements. The Program Fund is Rhode Island's Internal Revenue Service (IRS) Section 529 qualified state tuition savings program, which holds participant assets and is available for families to save and invest for qualified higher education expenses. The investment policies of the Program Fund are established by the Rhode Island State Investment Commission (SIC) and the Authority.

RIHEST is exempt from federal and state income taxes.

Reporting entity:

In evaluating the inclusion of other separate and distinct legal entities as component units within its financial reporting structure, the Authority applies the criteria prescribed by Governmental Accounting Standards Board (GASB) Statement No. 14, "The Financial Reporting Entity," as amended by GASB Statement No. 39, "Determining Whether Certain Organizations are Component Units."

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. Summary of significant accounting policies:

Financial statement presentation, measurement focus and basis of accounting:

The Authority uses the economic resources measurement focus and accrual basis of accounting. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989 generally are followed in the accompanying financial statements to the extent that those standards do not conflict with or contradict guidance of the GASB. The Authority has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to this same limitation; however, the Authority has elected not to follow subsequent private-sector guidance.

Except for the fiduciary funds, the Authority engages only in business-type activities. Business-type activities are those that are financed in whole or in part by fees charged to external users. The proprietary fund and fiduciary fund financial statements are reported using the economic resources measurement focus and accrual basis of accounting. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows.

The Authority distinguishes between operating and nonoperating revenues and expenses. Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations. The principal operating revenues of the Authority are charges to the federal government and other third parties for fees and services provided. Operating expenses include the cost of providing services, administrative expenses, and depreciation and amortization expense on capital assets. All other revenues and expenses not meeting this definition are reported as nonoperating revenues and expenses.

Fund financial statements:

The Authority reports the following major proprietary funds:

Operating Fund:

This fund consists of the following sub-funds which are combined for financial reporting purposes:

Agency Operating Fund – This fund accounts for all transactions relating to the Authority's activities as a State guaranty agency for the Federal Family Education Loan (FFEL) Program.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. Summary of significant accounting policies (continued):

Fund financial statements (continued):

Operating Fund (continued):

Scholarship and Grant Operating Fund – This fund accounts for all transactions relating to the Authority’s administration of the scholarship and grant programs on behalf of the federal government and the State.

RIHEST Administrative Fund – This fund accounts for all transactions relating to the Authority’s administration of RIHEST.

AllianceBernstein L.P. Contract Fund – This fund accounts for fees received by the Authority based on terms of an agreement with AllianceBernstein L.P. (AllianceBernstein) for the management and promotion of the Tuition Savings Program.

The principal sources of revenue for the Operating Fund include a) fees paid principally by the federal government for administering the FFEL Program (such as default aversion fees and account maintenance fees); b) recovery, consolidation, and rehabilitation income earned as a result of collection and consolidation of previously defaulted loans; c) a State appropriation for administering its grant and scholarship programs; and d) fees and commissions earned from administering RIHEST (such as asset-based fees and direct purchase commissions).

Scholarship and Grant Fund:

This fund consists of the following sub-funds which are combined for financial reporting purposes:

Scholarship and Grant Program Fund – This fund accounts for scholarship and grant programs administered on behalf of the State and funded by State appropriations made to the Authority and a supplement provided by the Authority. Scholarship and grant programs administered on behalf of the federal government require the State to match federal amounts in the form of a minimum maintenance of effort level. The programs are Leveraging Educational Assistance Partnership (LEAP) and Special Leveraging Educational Assistance Partnership (SLEAP).

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. Summary of significant accounting policies (continued):

Fund financial statements (continued):

Scholarship and Grant Fund (continued):

CollegeBoundfund® Matching Grant Program Fund – This fund accounts for all transactions relating to the Authority’s operation of the CollegeBoundfund® Matching Grant Program. Under this program, the Authority may make available up to \$500,000 annually to invest in the Program Fund as matching contribution accounts for individuals’ accounts established for the benefit of income-qualifying students and their families. No additional funds were invested during fiscal year 2011.

Academic Promise Scholarship Fund – This fund accounts for all transactions relating to the Authority’s operation of the Academic Promise Scholarship Program. Under this program, the Authority invests in the Program Fund for the benefit of academic and income-qualifying students to provide up to \$10,000 to each student over a four-year scholarship period (\$12,500 for students in qualifying five-year programs). No additional funds were invested during fiscal 2011.

Adult Education Grant Program Fund – This fund accounts for all transactions relating to the Authority’s operation of the Adult Education Grant Program. The Authority invests in the Program Fund for the benefit of academic and income-qualifying students to provide up to \$3,000 to each student enrolled on less than a half-time basis at a Rhode Island college or university over a two-year scholarship period. During fiscal year 2008, the Authority made an initial investment of \$600,000 in the Program Fund to support this program. No additional funds have been invested since that time.

New England Regional Student Program Fund – This fund accounts for all transactions relating to the New England Regional Student Program whereby students from the six New England states pay significantly reduced tuition at out-of-state public colleges and universities within New England when they enroll in certain academic programs that are not offered by their home-state public colleges and universities. The State makes an annual appropriation to the Authority for Rhode Island’s participation in the program. This program is sponsored by the New England Board of Higher Education.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. Summary of significant accounting policies (continued):

Fund financial statements (continued):

The CollegeBoundfund® Matching Grant Program, Academic Promise Scholarship Program, and Adult Education Grant Program are funded with RIHEST revenues through transfers from the RIHEST Administrative Fund. Such programs are subject to certain conditions and limitations including, but not limited to, income eligibility, academic performance, and contribution and withdrawal restrictions.

In addition, the Authority reports the following fund types:

Private Purpose Trust Fund – This fund type is used to account for trust arrangements under which principal and income benefit individuals, private organizations, or other governments. The Authority utilizes this fund type to account for the activities of the RIHEST Tuition Savings Program Fund.

Agency Fund – The Authority administers the Federal Student Loan Reserve Fund (the Federal Fund), an agency fund, on behalf of the federal government. Under the 1998 reauthorization of the Higher Education Act, guaranty agencies were required to establish a Federal Fund, effective October 1, 1998. Additions to the Federal Fund include principally complement fees, reinsurance received for lender claims paid, and income from investments. Deductions from the Federal Fund include only lender claims and default aversion fee payments to the Agency Operating Fund, unless otherwise directed by the U.S. Department of Education (DE). Assets and liabilities of the Federal Fund are those of the DE.

Cash and cash equivalents:

The Authority considers all highly liquid investments (including restricted assets) with a maturity of three months or less when purchased to be cash equivalents.

Investments:

Investments of the Operating Fund may include U.S. Treasury Bills, U.S. Treasury Notes, U.S. Agency collateralized obligations, certificates of deposit, and deposits in AllianceBernstein Funds. Investments of the Scholarship and Grant Fund are solely units in the Program Fund. Investments in U.S. Treasury Bills are reported at their amortized value, which approximates their fair value. All other investments, including mutual funds of the Program Fund, are reported at their estimated fair value established by quoted market prices. Unrealized gains and losses from the changes in fair value are recognized as investment income.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. Summary of significant accounting policies (continued):

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 history and current information regarding the credit worthiness of the debtors. The Authority does not require collateral or other forms of security from its debtors.

Restricted cash and cash equivalents:

Restricted cash and cash 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, 2012. According to an agreement with DCYF, the Authority serves as a fiscal intermediary with respect to the DCYF's scholarship program.

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

Capital assets:

Capital assets are stated at cost. Depreciation and amortization of capital assets is calculated using the straight-line method over the estimated useful lives of the assets.

Compensated absences:

Authority employees receive vacation time under a union contract based upon their years of service. This time may be carried over from one calendar year to another, in an amount not to exceed the vacation time earned in two calendar years. In the event of termination, employees are paid for unused time up to the amount of vacation time earned in one calendar year.

Sick leave is granted to all employees based on total hours worked in a pay period, up to a maximum number of hours as designated under the union contract. In the event of termination, employees are paid for accrued sick time based on a formula in the union contract.

Compensated absences are calculated at the current rate of pay.

Nonunion employees follow the same guidelines for vacation and sick time as union employees.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. Summary of significant accounting policies (continued):

Net assets:

The Authority's net assets have been segregated into the following two components in accordance with GASB Statement No. 34:

Invested in capital assets – This category consists of capital assets, net of accumulated depreciation and amortization.

Restricted – This category consists of net assets whose use is restricted either through external restrictions imposed by creditors, grantors, laws or regulations of governments, or through restrictions imposed by law through constitutional provisions, enabling legislation, or federal regulations.

Under the 1998 reauthorization of the Higher Education Act, the Agency Operating Fund's net assets shall be used for application processing, loan disbursement, enrollment and repayment status management, default aversion activities, default collection activities, school and lender training, financial aid awareness and related outreach activities, compliance monitoring, and other student financial aid related activities. In addition, the net assets of the Scholarship and Grant Operating Fund must be used in the administration of scholarships and grants on behalf of the federal government and the State, the net assets of the RIHEST Administrative Fund must be used in the administration of RIHEST or student financial assistance programs authorized by the Authority's Board of Directors (Board), and the net assets of the AllianceBerstein L.P. Contract Fund must be used for the management and promotion of the Tuition Savings Program or student financial assistance programs authorized by the Authority's Board. Also, the Scholarship and Grant Fund's net assets invested in the Program Fund, in the amount of \$4,528,773, for the Academic Promise Scholarship Program, CollegeBoundfund® Matching Grant Program, and the Adult Education Grant Program are classified as restricted.

Revenue recognition:

Default aversion fees:

The Agency Operating Fund receives a default aversion fee from the Federal Fund. This fee is received for any loan on which a lender request for assistance is received by the Authority after a loan is between 60 and 120 days delinquent. The fee is calculated at 1% of the total unpaid principal and accrued interest at the time the Authority receives the lender request for assistance and is recognized when received. If a default aversion fee is received on a loan and the loan subsequently defaults, fees must be returned to the Federal Fund. The amount that must be returned is determined by the principal amount of the loan on the date of default plus accrued interest, if applicable.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. Summary of significant accounting policies (continued):

Revenue recognition (continued):

Default aversion fees (continued):

The Authority records an allowance for its estimate for default aversion fees to be returned as a result of future loan defaults. For the year ended June 30, 2011, the Authority recorded a provision for fee returns of approximately 50% of fee income. The allowance for default aversion fee returns is management's best estimate of potential fee returns based on the information that is available. Consequently, 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. The 2011 default aversion fees are recorded net of a \$518,750 provision for returns; the allowance for fee returns as of June 30, 2011 is \$840,750.

Account maintenance fees:

The Authority earns an account maintenance fee (AMF) from the DE equal to .06% of the annual average balance of the original principal amount of guaranteed loans outstanding.

Recovery, consolidation, and rehabilitation income:

Recovery, consolidation, and rehabilitation income is recognized as revenue when received, net of the DE's share.

Asset-based fees – Tuition Savings Program Fund:

Tuition Savings Program Fund asset-based fees are recognized as revenue when earned on a quarterly basis.

Direct purchase commissions:

Direct purchase commissions are recognized as revenue when received.

Grants and appropriations:

Revenue from grants and appropriations is recognized to the extent expenditures under such grants or appropriations have been made.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

2. Summary of significant accounting policies (continued):

Retirement and postretirement healthcare benefit plans:

Substantially all Authority employees are covered for retirement and postretirement health benefits by plans administered by the State. Funding, eligibility, participation, and vesting provisions are determined by the State Retirement Board.

Under State law, individuals hired by the Authority who previously participated in certain other retirement plans may elect to remain in those plans rather than participate in the State retirement plan. Currently, certain Authority personnel participate in a defined contribution plan offered by TIAA-CREF, which is substantively identical to the plan offered to employees of the State's colleges and university.

Use of estimates:

The preparation of financial statements in conformity with accounting principles generally accepted in the United States 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.

3. Cash deposits and investments:

Cash deposits:

As of June 30, 2011, the Authority's cash deposits consist of the following:

	Bank balance	Carrying amount
Demand deposits	\$ 26,608,398	\$ 25,998,599
State's general treasury	312,694	312,694
Money market funds	623,757	623,757
Certificate of Deposit Account Registry Service (CDARS)	2,027,689	2,027,689
	\$ 29,572,538	\$ 28,962,739

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

3. Cash deposits and investments (continued):

Cash deposits (continued):

Custodial credit risk is the risk that, in the event of a bank failure, the Authority will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. The Authority does not have a deposit policy for custodial credit risk except for that which is provided by Rhode Island General Laws, Chapter 35-10-1 as described below.

The bank balances of the Authority's cash deposits that were exposed to custodial credit risk as of June 30, 2011 are as follows:

Uninsured, uncollateralized	\$ 312,719
Uninsured, but collateralized with securities held by the pledging bank's trust department or agent not held in the Authority's name	<u>26,550,666</u>
	<u>\$ 26,863,385</u>

The Authority is permitted to invest funds in certificates of deposit, including CDARS, savings accounts, money market accounts and obligations of the United States Government or certain agencies thereof. The Authority may also enter into repurchase agreements with any eligible depository, for a period not exceeding 30 days.

In accordance with Rhode Island General Laws, Chapter 35-10-1, depository institutions holding deposits of the State, its agencies or governmental subdivisions of the State shall, at a minimum, insure or pledge eligible collateral equal to 100 percent of time deposits with maturities greater than 60 days. Any of these institutions which do not meet minimum capital standards prescribed by federal regulators shall insure or pledge eligible collateral equal to 100 percent of deposits, regardless of maturity. Eligible collateral per the agreement and Rhode Island General Laws, Chapter 35-10-1 includes the following: obligations of the United States; obligations of the State; obligations of any other state with a rating not less than "A" by Standard and Poor's Corporation (S&P) or Moody's Investor Services, Inc. (Moody's); certain one to four-family residential mortgage loans providing they meet certain provisions; and other marketable securities and debt instruments determined to be satisfactory for purposes of providing liquid assets in the event of default or insolvency of a qualified depository institution providing that this type of collateral does not exceed 10% of the total collateral pledged by the financial institution.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

3. Cash deposits and investments (continued):

Cash deposits (continued):

The Authority's cash deposits are presented in the accompanying statements of net assets and fiduciary net assets as of June 30, 2011 as follows:

Statement of net assets:		
Current assets		\$ 14,076,731
Noncurrent assets		623,757
Statement of fiduciary net assets:		
Tuition Savings Program Fund		25
Federal Student Loan Reserve Fund		<u>14,262,226</u>
Cash deposits		<u><u>\$ 28,962,739</u></u>

Investments:

As of June 30, 2011, the Authority's investments consist of the following:

Investment type	Fair value	Investment maturities (in years)	
		Less than 1	1 to 5
Money market funds	\$ 74,117	\$ 74,117	
Mutual funds	7,899,760,716	7,899,760,716	
CDARS	7,647,410	7,647,410	
U.S. Treasury notes	<u>1,057,930</u>		<u>\$ 1,057,930</u>
	<u>\$ 7,908,540,173</u>	<u>\$ 7,907,482,243</u>	<u>\$ 1,057,930</u>

The Authority's investments are presented in the accompanying statements of net assets and fiduciary net assets as follows:

Statement of net assets:		
Current assets		\$ 11,231,356
Noncurrent assets		1,057,930
Statement of fiduciary net assets:		
Tuition Savings Program Fund		7,895,231,942
Federal Student Loan Reserve Fund		<u>1,018,945</u>
		<u><u>\$ 7,908,540,173</u></u>

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

3. Cash deposits and investments (continued):

Investments (continued):

Interest rate risk:

The Authority 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 Authority has no investment policy that would further limit its investment choices beyond those limited by Chapter 10 of Title 35 of the Rhode Island General Laws. Chapter 10 of Title 35 permits the Authority to invest in certificates of deposit (including CDARS), savings accounts, money market accounts, obligations of the United States Government or certain obligations thereof, repurchase agreements with any eligible depository for a period not to exceed 30 days, commercial paper with a rating of P-1, A-I or higher, and investment grade corporate debentures with a rating of AAA, AA by S&P and Aaa, Aa by Moody's. As of June 30, 2011, the Authority's investments in money market and mutual funds were unrated.

Custodial credit risk:

For an investment, custodial credit risk is the risk that, in the event of the failure of a counterparty, the Authority will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The Authority's current approved board investment policy includes only low-risk securities, such as obligations of the United States Government or a state. The Authority's investments in U.S. Treasury Notes were not subject to custodial credit risk as they are held in the Authority's name. The Authority's investments in money market and mutual funds are not exposed to custodial credit risk because they are not evidenced by securities that exist in physical or book entry form.

4. Health education assistance loans receivable:

The Authority operates loan programs directed toward students in graduate studies in health-related professions. As of June 30, 2011, the outstanding loan balances total \$65,296, a portion of which is guaranteed by the federal government.

Certain loans, totaling \$6,371, contain provisions whereby up to 75% of the original loan balance may be forgiven if the borrowers work in or for the State for a specified period of time. These loans do not bear interest until they enter the repayment phase, which begins nine months after graduation or after the students complete the conditions for forgiveness. Students may also get up to a four-year deferment of principal and interest for being enrolled in internship or residency programs. Loan forgiveness is recorded in the period in which the conditions are satisfied by the borrowers. During 2011, no loans were forgiven.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

4. Health education assistance loans receivable (continued):

During 1987, SallieMae purchased from the Authority certain loans that were not guaranteed by the federal government. Under the agreements with SallieMae, the Authority is required to maintain on deposit with a financial institution an escrow account equal to at least 105% of the outstanding principal balance (principal balance of \$26,280 was outstanding at June 30, 2011).

5. Capital assets:

Capital asset activity for the year ended June 30, 2011 is as follows:

	<u>Beginning balance</u>	<u>Increases</u>	<u>Decreases</u>	<u>Transfers</u>	<u>Ending balance</u>
Capital assets not being depreciated:					
Land	\$ 194,096	\$ - 0 -	\$ - 0 -	\$ - 0 -	\$ 194,096
Capital assets being depreciated or amortized:					
Land improvements	135,740		- 0 -	- 0 -	135,740
Building and improvements	2,200,373	22,495			2,222,868
Equipment	676,246	23,595			699,841
Web-based scholarship and grant program system	420,650				420,650
Web portal	453,500				453,500
Total capital assets being depreciated or amortized	<u>3,886,509</u>	<u>46,090</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>3,932,599</u>
Accumulated depreciation and amortization:					
Land improvements	(41,571)	(8,088)	- 0 -	- 0 -	(49,659)
Building and improvements	(1,690,054)	(107,148)			(1,797,202)
Equipment	(622,701)	(35,342)			(658,043)
Web-based scholarship and grant program system	(420,650)				(420,650)
Web portal	(136,050)	(90,697)			(226,747)
Total accumulated depreciation and amortization	<u>(2,911,026)</u>	<u>(241,275)</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>(3,152,301)</u>
Total capital assets being depreciated or amortized, net	<u>975,483</u>	<u>(195,185)</u>	<u>- 0 -</u>	<u>- 0 -</u>	<u>780,298</u>
Total capital assets, net	<u>\$ 1,169,579</u>	<u>\$ (195,185)</u>	<u>\$ - 0 -</u>	<u>\$ - 0 -</u>	<u>\$ 974,394</u>

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

6. Long-term liabilities:

A summary of changes in long-term liabilities for the year ended June 30, 2011 is as follows:

	Beginning balance	Increases	Decreases	Ending balance	Due within one year
Liability for estimated default aversion fee returns	\$ 800,500	\$ 518,750	\$ (478,500)	\$ 840,750	\$ 560,000
Compensated absences	316,128	244		316,372	170,320
Deferred rehabilitation income	748,962	11,747	(222,336)	538,373	53,837
Deferred default prevention Income	441,637	956		442,593	
	<u>\$ 2,307,227</u>	<u>\$ 531,697</u>	<u>\$ (700,836)</u>	<u>\$ 2,138,088</u>	<u>\$ 784,157</u>

7. Allowance for unreinsured claims and reinsurance triggers:

The Authority 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 its 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.

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. 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 Authority 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 Authority will receive 95%, 85% or 75% of the claims paid to lenders based on its “reinsurance trigger”). During the year ended June 30, 2011, the Authority charged the Federal Fund \$2,136,391 pursuant to the above provisions.

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 DE. The allowance for unreinsured claims is based on an evaluation of historical experience and current and anticipated economic conditions. 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.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

8. Net assets:

Restricted net assets consist of the following as of June 30, 2011:

Scholarship and Grant Fund:	
Academic Promise Scholarship Program	\$ 3,622,809
CollegeBound <i>fund</i> ® Matching Grant Program	292,275
Adult Education Grant Program	613,689
Operating Fund	<u>24,727,119</u>
	<u><u>\$ 29,255,892</u></u>

9. Related party transactions:

The Authority is a related party to the Rhode Island Student Loan Authority (RISLA), another component unit of the State. 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, 2011 were as follows:

Guaranteed loans outstanding as of June 30, 2011	\$ 579,819,010
Guarantee claims paid during the year	16,458,459

RISLA, as an eligible FFEL Program lender, acquired rehabilitation loans using funds provided by RIHEAA under an agreement approved by the RIHEAA Board. The loans are serviced by Nelnet Corporation (Nelnet) as part of RISLA's servicing contract with Nelnet. At June 30, 2011, the accompanying statement of net assets includes \$1,625,647 due from RISLA and deferred revenue resulting from the rehabilitation transactions totaling \$538,373. The amount due from RISLA is repayable as RISLA receives payments from borrowers. The Authority recognizes rehabilitation income previously deferred as payments are received from RISLA. During the year ended June 30, 2011, the Authority recognized as income \$222,336 of previously deferred income.

RISLA finances a portion of its FFEL portfolio through the DE Asset Backed Commercial Paper Straight A Conduit Program (the Conduit), which was created under the Ensuring Continued Access to Student Loans Act (ECASLA) of 2008. In February 2011, the RIHEAA Board authorized the use of up to \$6,500,000 of RIHEAA funds to be used by RISLA to purchase delinquent loans from the Conduit. Subsequent to year-end, in an arrangement similar to the rehabilitation loans described above, RISLA purchased approximately \$4,500,000 in delinquent loans from the Conduit using funds provided by RIHEAA.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

9. Related party transactions (continued):

In addition, the Authority leases office space to RISLA. For the year ended June 30, 2011, rental income, including common area maintenance, utilities, and reimbursement for reception services totaled \$128,161.

10. Retirement plans:

Substantially all full-time permanent employees of the Authority participate in the Employees' Retirement System of the State of Rhode Island (the System), a cost-sharing, multiple-employer public retirement system. The System was established and benefits can be amended by the General Assembly. The funding policy is determined by the State Retirement Board. Employees who retire at age 60 or older with 10 years of credited service (at any age with 28 years of credited service) are entitled to a retirement benefit. Employees who have not obtained at least 10 years of contributory services as of July 1, 2005 are eligible to retire at or after age 65 with 10 years of credited service, or at age 59 with 29 years of credited service or at age 55 with 20 years of total service, provided that the retirement allowance, as listed below, is reduced actuarially for each month that the age of the member is less than 65 years. The benefit is calculated using the number of years of service and the employee's average salary based on the three highest consecutive years of earned salary. Benefits vest upon reaching 10 years of service.

The System also provides for death and disability benefits. The System issues a publicly available financial report that includes financial statements and required supplementary information for the State. That report may be obtained by writing to Employees' Retirement System of the State of Rhode Island, 40 Fountain Street, Providence, Rhode Island 02903.

Payroll of the Authority's employees covered by the System was approximately \$1,425,000 in 2011. For the fiscal year ended June 30, 2011, the Authority's actuarially computed contribution rate to the System was 20.78% of annual covered payroll. The employees' contribution rate is 8.75% of their annual covered salary; employees contributed approximately \$125,000 in 2011. The Authority's contributions for the years ended June 30, 2011, 2010 and 2009 were approximately \$300,000, \$296,000 and \$315,000, respectively, equal to the required contributions for each year.

Some Authority employees are covered under the TIAA-CREF Plan, a defined contribution plan. The Authority's contributions for the year ended June 30, 2011 were 9.00% of the covered payroll. The Authority's contributions for the years ended June 30, 2011, 2010 and 2009 were approximately \$32,000, \$31,000 and \$40,000, respectively. The Authority's Board of Directors has the authority to establish and/or amend the plan's provisions and the plan's contribution requirements.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

11. Postemployment Health Care Plan:

Plan description:

The Authority 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 (RIGL). 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 Authority.

Pursuant to legislation enacted by the General Assembly, a trust was established in fiscal year 2011 to accumulate assets and pay benefits and other costs associated with the system.

Beginning with the fiscal year ended June 30, 2011, the OPEB system will issue a stand-alone financial report. A copy will be available at the web site of the Office of Accounts & Control-<http://controller.admin.ri.gov/Financial%20Reports/index.php>.

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.

Effective in fiscal year 2011, all participating employers are required by law to fund the actuarially determined annual required contribution (ARC), which for fiscal year 2011 was 6.74% of covered payroll. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal costs each year and amortize any unfunded actuarial liabilities (or funding excess) over a period not to exceed thirty years. The Authority's contribution to the plan for the year ended June 30, 2011 was \$95,000. Prior to the creation of the OPEB trust in fiscal year 2011, the contributions to the plan were made on a pay-as-you-go basis.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

11. Postemployment Health Care Plan (continued):

Funding policy (continued):

In prior years, the Authority contributed to the State Employees' OPEB plan which, consistent with GASB Statement No. 45 provisions, was administered as an agent multiple employer plan because no separate legal trust had been created. The transition by the State of its OPEB plan in fiscal 2011 to an OPEB Trust resulted in the State Employees' OPEB Plan being redefined as a cost-sharing multiple employer plan. In accordance with the requirements of GASB Statement No. 45, the Authority's net OPEB obligation recorded in previous years has been reduced to zero.

12. Commitments and contingencies:

United States Department of Education:

Preservation and recovery of reserves:

The Secretary of the DE 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 has the authority to 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 Authority's share of Reserve Funds to be returned was \$4,310,909. The Authority 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 Authority received interest on the funds, restricted for use in default prevention activities. Upon payment of the \$4,310,909, the Authority was authorized to transfer the accumulated interest to the Agency Operating Fund, subject to its restricted use in default prevention activities. The Authority reports a corresponding liability, deferred default prevention income, for the cash balance restricted for default prevention activities, and recognizes income as allowable expenditures are incurred. The liability totaled \$442,593 as of June 30, 2011.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

12. Commitments and contingencies (continued):

United States Department of Education (continued):

Preservation and recovery of reserves (continued):

In addition, the 1998 reauthorization of the Higher Education Act required the Secretary's recall of \$250 million from guaranty agencies. The Authority's share of this recall amount totaled \$1,116,117 and was based on the ratio of the Authority's share of Reserve Funds to the total amount of all guaranty agencies' Reserve Funds as of September 30, 1996. The Authority's share of the \$250 million recall was payable in three installments. At June 30, 2011, there were no remaining amounts outstanding.

Reserve fund requirements:

The DE 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 .25% of the original principal balance of loans guaranteed (OPO). As of June 30, 2011, the Authority's OPO totaled \$1,593,959,076 and its corresponding minimum reserve balance was \$3,984,898. The actual balance in the reserve fund at year-end was \$9,713,470 and, using the method currently prescribed by the DE, the reserve ratio was 0.89%.

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 (see Note 7).

The Authority has met the required reserve fund level for the federal fiscal year ended September 30, 2011 and the Authority has not exceeded the 5% reinsurance trigger.

Systems Services Agreement:

The Authority has an agreement for computer system services with SallieMae Guarantee Services. In July 2007, RIHEAA and SallieMae agreed to a one-year extension of an existing agreement which provided for services through September 30, 2008. In July 2008, after concluding a competitive bid process, RIHEAA and SallieMae entered into a new agreement which provides for an initial four-year term beginning October 1, 2008 through September 30, 2012 with up to three additional two-year terms at RIHEAA's option.

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

12. Commitments and contingencies (continued):

Systems Services Agreement (Continued):

The agreement provides for fixed fees plus incremental fees for loan guarantee systems services based upon the amount of annual loan applications processed excluding consolidated loans, as well as specified fees for certain administrative services provided to the Authority on an as requested basis. Fees to SallieMae for those services totaled \$456,337 for the year ended June 30, 2011.

Under the same agreement, SallieMae provides portfolio management services to the Authority for defaulted loans outsourced for collection. The Authority compensates SallieMae at the rate of 24% of net revenue generated from collection activities. Net revenue is defined as amounts collected less commissions paid to collection vendors and less amounts remitted to the DE. Fees to SallieMae for portfolio management services totaled \$1,424,533 for the year ended June 30, 2011. In the event the Authority should cancel the portfolio management services, the agreement provides for increases in the fee structure for loan guarantee systems services.

Default Aversion and Prevention Services Agreement:

The Authority has an agreement for default aversion services with NCO Financial Systems, Inc. (NCO) that provides for a .59% fee to be paid to NCO for each loan brought to current status within the specifications of the agreement. The agreement expired in September 2010, and had been extended on a month-to-month basis. On September 23, 2011, RIHEAA entered into an extension of the agreement through September 30, 2012. The extension provides that either party may terminate the agreement without cause upon 60 days written notice to the other party. Fees to NCO totaled \$526,901 for the year ended June 30, 2011.

Tuition Savings Program Management Agreement:

Effective July 1, 2010, the Authority, the SIC, and AllianceBernstein entered in a new contract for the management and promotion of the Tuition Savings Program for a period of five years with one five-year renewal option. The agreement provides for a management fee payable from the Program Fund assets to AllianceBernstein from the assets under management. The RIHEST Administrative Fund records asset-based fees and direct purchase commissions, which are derived from its administration of the Program Fund. The RIHEST administrative income totaled \$8,243,100 for the year ended June 30, 2011 and is recorded in the Operating Fund. Under the terms of the new contract:

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

12. Commitments and contingencies (continued):

Tuition Savings Program Management Agreement (Continued):

- The Authority receives \$275,000 annually to assist it with marketing, promotion, and review of the Tuition Savings Program. These funds are also available for student financial assistance as determined by the RIHEAA Board.
- The Authority receives an asset-based fee of 9.5 basis points (0.095%) of the average net asset value of the assets (as defined by the agreement) held in non-resident accounts; the agreement contains provisions whereby the asset-based fee will not fall below the level under the old agreement.
- AllianceBernstein deposits \$100 into the account of every child born to or adopted by a resident for which an account has been established within one year of birth; the Authority will receive \$50 per child for use in marketing and promotion for every child born who does not establish an account within the program.
- AllianceBernstein is committed to spend \$750,000 annually for the marketing and promotion of the Tuition Savings Program in Rhode Island.

In 2011, the Authority provided additional funds totaling approximately \$42,000 for marketing and promotion expenses.

Web Portal Development and Services Agreement:

The Authority 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, which became operational in the fall of 2008, provides a platform for individualized learning plans, electronic portfolios, and electronic transcripts. The portal is available at no cost to all Rhode Island students, parents, and educators. For the year ended June 30, 2011, maintenance, marketing, and training expenses associated with the web portal totaled approximately \$520,000. During 2010, the Authority extended its systems maintenance agreement with XAP. Under the terms of the agreement; the Authority is committed to expend the following:

<u>Year ending June 30,</u>	<u>Amount</u>
2012	\$ 539,833
2013	499,630
2014	509,622
2015	519,815
2016	351,133

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2011

13. Risk management:

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

14. Legislative development and continuing operations:

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, new guaranteed student loans now originate under the Federal Direct Loan Program. RIHEAA's role as a guaranty agency in the FFEL Program constituted its single largest activity as approximately 75% of the Authority's employees were allocated to the guaranty agency functions. The elimination of new loan originations has had a significant impact on the Authority's ongoing operations.

RIHEAA's management and its Board continue to evaluate the impact of the Act and the options for future operations. The Authority will continue to provide services for loans currently in its portfolio, including claims payments and reinsurance transactions, default prevention and aversion activities, and collections of defaulted student loans. RIHEAA will also continue to promote awareness of and access to post-secondary education opportunities and programs. Although it is difficult to predict the time period over which such services would be required, to what extent they would constitute a substantive activity, and for how long they might be financially viable, RIHEAA currently anticipates the time period to be in the range of three to five years.

RIHEAA's management and Board also await the DE response to the proposals submitted by RIHEAA in July 2011 as a result of the Secretary of Education's invitation to guaranty agencies to participate in a Voluntary Flexible Agreement (VFA). RIHEAA submitted a stand-alone proposal and also joined with five other guaranty agencies in a consortium proposal. The VFA proposals feature different sharing of responsibilities including, but not limited to: i) lender claims review, payment, and collections, ii) delinquency and default prevention and management, and iii) community outreach, financial literacy, and debt management.

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STATE OF RHODE ISLAND REQUIRED FORMAT

JUNE 30, 2011

<u>Statement of Net Assets</u>	<u>Attachment B</u>
Assets	
Current assets:	
Cash and cash equivalents	\$ 13,639,981
Investments	11,231,356
Receivables	2,128,340
(Receivables allowance)	
Restricted assets:	
Cash and cash equivalents	436,750
Investments	
Other assets	
Due from primary government	
Due from other component units	182,819
Due from other governments	1,590,784
Inventories	
Other assets	<u>191,194</u>
Total current assets	<u>29,401,224</u>
Noncurrent assets:	
Investments	1,057,930
Receivables	40,915
(Receivables allowance)	
Restricted assets:	
Cash and cash equivalents	623,757
Investments	
Other assets	
Due from other component units	1,442,828
Capital assets - nondepreciable	194,096
Capital assets - depreciable (net)	780,298
Other assets, net of amortization	<u></u>
Total noncurrent assets	<u>4,139,824</u>
Total assets	<u>33,541,048</u>

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STATE OF RHODE ISLAND REQUIRED FORMAT

JUNE 30, 2011

<u>Statement of Net Assets (continued)</u>	<u>Attachment B</u>
Liabilities	
Current liabilities:	
Cash overdraft	
Accounts payable	\$ 1,095,795
Due to primary government	
Due to other component units	
Due to other governments	76,879
Deferred revenue	53,837
Other liabilities	730,320
Current portion of long-term debt	
	<hr/>
Total current liabilities	1,956,831
	<hr/>
Noncurrent liabilities:	
Due to primary government	
Due to other governments	
Deferred revenue	927,129
Notes payable	
Loans payable	
Obligations under capital leases	
Other liabilities	280,750
Compensated absences	146,052
Bonds payable	
	<hr/>
Total noncurrent liabilities	1,353,931
	<hr/>
Total liabilities	3,310,762
	<hr/>
Net assets	
Invested in capital assets, net of related debt	974,394
Restricted for:	
Debt	
Other	29,255,892
Other nonexpendable	
Unrestricted	
	<hr/>
Total net assets	<u><u>\$ 30,230,286</u></u>

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)

STATE OF RHODE ISLAND REQUIRED FORMAT

YEAR ENDED JUNE 30, 2011

<u>Statement of Changes in Net Assets</u>	<u>Attachment C</u>
Operating revenues:	
Charges for services	\$ 20,351,611
Interest income on loans	
Interest on investments	
Net increase (decrease) in fair value of investments	
Other operating income	<u>328,235</u>
Total operating revenues	<u>20,679,846</u>
Operating expenses:	
Personnel services	2,679,087
Supplies, materials, and services	8,187,710
Interest expense	
Grants, scholarships and contract programs	14,543,982
Depreciation, depletion and amortization	241,275
Other operating expenses	
Total operating expenses	<u>25,652,054</u>
Operating income (loss)	<u>(4,972,208)</u>
Nonoperating revenues (expenses):	
Interest revenue	569,747
Grants	413,257
Payments from primary government	7,320,186
Gain (loss) on sale of property	
Interest expense	
Payments (to) from other component units	128,261
Net increase (decrease) in fair value of investments	
Other nonoperating revenue (expenses)	
Total nonoperating revenue (expenses)	<u>8,431,451</u>
Income (loss) before contributions	3,459,243
Capital contributions	
Special items	
Extraordinary items	
Change in net assets	<u>3,459,243</u>
Total net assets - beginning	<u>26,771,043</u>
Total net assets - ending	<u><u>\$ 30,230,286</u></u>

**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)**

SCHEDULE OF TRAVEL EXPENSES

YEAR ENDED JUNE 30, 2011

<u>Payee</u>	<u>Purpose of travel</u>	<u>Airfare</u>	<u>Lodging</u>	<u>Meals</u>	<u>Automobile and other</u>
Loan Division					
American Express	C. Miller - ADA Mtg	\$ 293			
"	K. Cournoyer - Software Conf	457			
"	J. Knight - Linux Conf		\$ 580		
G. Silva	G. Silva - NCHELP Symposium	313			
American Express	W. Hurry - NCHELP Mtg		804		
"	W. Hurry - XAP Mtg	379	319		
"	C. Cox - NCHELP Symposium	295			
American Express	W. Hurry - USAF Mtg	299			
"	K. Cournoyer - Software Conf		336		\$ 335
G. Silva	G. Silva - NCHELP Symposium		600		
American Express	W. Hurry - NCHELP Symposium		800		243
"	C. Cox - NCHELP Symposium		800		300
"	C. Cox - Dept of Ed Conf	499	783		301
Mapping Your Future	MYF Speaker at RIHEAA Conf	308			
American Express	W. Hurry - Meteor Mtg	236			
"	C. Miller - Meteor Mtg	236			
"	G. Mance-Rios - CACG Mtg	207			
J. Palumbo	J. Palumbo - NCHELP Legal		324		
G. Silva	G. Silva - MYF Mtg	466			
American Express	W. Hurry - Meteor Mtg		368		210
"	C. Miller - Meteor Mtg		553		
"	G. Mance-Rios - CACG Mtg		465		
"	C. Cox - NCHELP Debt Mgt				216
C. Faulkner	C. Faulkner - SallieMae Training	355			
American Express	C. Cox - NCHELP Debt Mgt		481		
G. Silva	G. Silva - MYF Mtg		563		
M. Lacroix	M. Lacroix - NCHELP CFO Mtg	651			
American Express	M. Lacroix - NCHELP CFO Mtg		229		
"	G. Mance-Rios - XAP Mtg	515			
"	K. Sisson - XAP Mtg	515			
Amounts less than \$200		<u>2,314</u>	<u>1,819</u>	<u>\$ 1,630</u>	<u>4,676</u>
Total Loan Division	\$26,073	<u>8,338</u>	<u>9,824</u>	<u>1,630</u>	<u>6,281</u>

(continued)

**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND)**

SCHEDULE OF TRAVEL EXPENSES (CONTINUED)

YEAR ENDED JUNE 30, 2011

<u>Payee</u>	<u>Purpose of travel</u>	<u>Airfare</u>	<u>Lodging</u>	<u>Meals</u>	<u>Automobile and other</u>
Scholarship and Grant Division					
American Express	M. Joyce - College Board Conf		\$ 203		
Amounts less than \$200		\$ -	361	\$ 128	\$ 792
Total S & G	\$1,484	<u>-</u>	<u>564</u>	<u>128</u>	<u>792</u>
RIHEST					
American Express	P. Kerwin - CSPN Mtg				327
American Express	P. Kerwin - CSF Mtg	271	357		
American Express	P. Kerwin - CSF Mtg	359			
American Express	P. Kerwin - CSF Mtg		638		
American Express	P. Kerwin - Alliance Mtg				278
"	W. Hurry - NAST Conf	318	653		320
Amounts less than \$200		<u>376</u>	<u>1,007</u>	<u>463</u>	<u>712</u>
Total RIHEST	\$6,079	<u>1,324</u>	<u>2,655</u>	<u>463</u>	<u>1,637</u>
Grand Total	\$33,636	<u>\$ 9,662</u>	<u>\$ 13,043</u>	<u>\$ 2,221</u>	<u>\$ 8,710</u>



Lefkowitz, Garfinkel, Champi & DeRienzo P.C.
Certified Public Accountants / Business Consultants

**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**

Board of Directors
Rhode Island Higher Education
Assistance Authority
Warwick, Rhode Island

We have audited the financial statements of the Rhode Island Higher Education Assistance Authority (the Authority), a Component Unit of the State of Rhode Island, as of and for the year ended June 30, 2011 and have issued our report thereon dated September 29, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the Authority is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the Authority's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Authority's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Authority's internal control over financial reporting.

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 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.

**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 (Continued)**

Board of Directors
Rhode Island Higher Education Assistance Authority

Internal Control over Financial Reporting (Continued)

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to material weaknesses, as defined above. However, we identified the deficiency in internal control described below that we consider to be a significant deficiency. 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.

Observation and Recommendation:

During the fiscal year ended June 30, 2011, the Authority experienced turnover in its finance department. Thus, certain duties that were previously segregated are performed by the chief financial officer (CFO). As a result, the CFO prepares, reviews, and approves bank and investment account reconciliations; has access to blank check stock; and can transfer cash between financial institutions. Properly segregated duties minimize the risk of potential material financial statement misstatement, whether due to error or fraud. We recommend that the Authority evaluate its current human resources and segregate the above functions such that the CFO can independently exercise his review responsibilities.

Management's Response:

On August 15, 2011, RIHEAA hired a person in the role of Senior Accountant. This individual will be taking responsibility for bank statement reconciliations in the near future. In addition, RIHEAA's management has been reviewing the roles of all members of the finance department so as to determine how best to accomplish appropriate segregation of duties.

The Authority's response to the significant deficiency identified in our audit is described above. We did not audit the Authority's response and, accordingly, we express no opinion on it.

**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 (Continued)**

Board of Directors
Rhode Island Higher Education Assistance Authority

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Authority's financial statements are free of 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.

This report is intended solely for the information and use of the Board of Directors, management, others within the entity, and the State of Rhode Island Auditor General, and is not intended to be and should not be used by anyone other than these specified parties.

DeFlauro, Inc. & Company, P.C.

September 29, 2011