

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

YEAR ENDED JUNE 30, 2012

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

JUNE 30, 2012

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REPORT OF INDEPENDENT AUDITORS

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 and Providence Plantations (State) as of and for the year ended June 30, 2012, 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 of America and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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, 2012, 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 of America.

As discussed in Note 14, as a result of the Health Care and Education Reconciliation Act of 2010, effective July 1, 2010 all new federally 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, 2012 were generated under activities related to loans originated under the FFEL Program. Also, approximately 80% of the Authority's employees were allocated to guarantee agency functions during the year ended June 30, 2012. 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, 2012.

In accordance with Government Auditing Standards, we have also issued our report dated October 1, 2012 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.

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Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on Pages 3-11 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

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 44 through 48 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.

Braver PC

Providence, Rhode Island
October 1, 2012

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 fiscal year (FY) ended June 30, 2012. 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 Grants (which were terminated by DE during FY 2011 and FY 2012), 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 (the "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 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 agreement, RIHEAA receives \$275,000 annually from AllianceBernstein, receives a fee equal to 9.5 basis points (0.095%) of the average net asset value of non-Rhode Island resident accounts, and also receives fee revenue when non-Rhode Island participants make direct investments in *CollegeBoundfund®*. In addition, AllianceBernstein is committed to spend \$750,000 annually for the marketing and promotion of *CollegeBoundfund®* in Rhode Island, and established the "CollegeBoundBaby" program. Under the CollegeBoundBaby 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 of the birth or adoption. Also, if parents do not open accounts on behalf of children during that first year, AllianceBernstein then pays RIHEAA \$50 for each child born or adopted. All of the revenues described above are restricted to the promotion and administration of the Tuition Savings Program or for use in student financial assistance programs authorized by the RIHEAA Board.

Introduction (continued)

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 U. S. Department of Education. The AOF principally accounts for the administrative activities related to the operations of the FFEL Program. In addition to providing the services directly related to guaranteed loan origination, portfolio maintenance, default prevention and aversion, and defaulted loan collections, Guaranty Agencies (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 federally guaranteed student loans are now originated under the Federal Direct Loan Program. RIHEAA's role as a guaranty agency in the FFEL Program constitutes its single largest activity, as approximately 80% of the Authority's employees are 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 will continue to 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, has 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 would occur 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 stipulated 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 nonbinding 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.

Introduction (continued)

RIHEAA submitted two responses to the Secretary's invitation. One was as part of a consortium of five GAs, all of whom are users of SallieMae's guarantee services system. In this proposal, RIHEAA would have performed Area I and Area III responsibilities. RIHEAA's Area II responsibilities would have been shifted to one of the other GAs, and RIHEAA would have assumed responsibility for the lender claims and collection activities for a segment of the Area II GA's portfolios. RIHEAA would also have performed community outreach and financial literacy for its current service area. During January of 2012, and after extensive discussions with the other GAs participating in the consortium, RIHEAA withdrew as a participant in that proposal. The second proposal submitted by RIHEAA was 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 had said that it would be amenable to acting as an intermediary to help facilitate arrangements where efficiencies and economies might be realized. However, RIHEAA was not able to identify an Area II partner, and the DE did not contact RIHEAA to suggest a potential partner. As a result, RIHEAA sent a letter to the VFA Team on January 31, 2012, confirming that RIHEAA had withdrawn from the consortium submittal, and could not pursue its stand-alone proposal without a viable Area II provider. The letter also stated that RIHEAA was willing to continue to work with DE towards a mutually acceptable solution. DE did not respond to the letter, and it does not appear that DE has entered into a VFA agreement with any single GA or group of GAs.

In June 2012, the Rhode Island General Assembly passed and Governor Chafee signed into law the FY 2013 Budget Act. Article 4 (as amended) of the Act, added the following language to section 16-57-10 of RIHEAA's enabling legislation, titled - Reserve Funds: "To assure continued solvency of the authority, the authority's operating fund shall be used solely for the ordinary operating expenses of the authority. Furthermore, it is the intent of the general assembly that these funds eventually be used to increase financial assistance to Rhode Island students in the form of scholarships and grants." The RIHEAA Board has had discussions about the new legislative language and is in the process of developing proposals and programs that are consistent with the legislature's intent.

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 2011 to FY 2012.

	<u>Net Assets</u>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Operating Fund	\$ 27,736,000	\$ 25,701,000	\$ 21,302,000
Scholarship and Grant Fund	4,624,000	4,529,000	5,469,000
Total RIHEAA	<u>\$ 32,360,000</u>	<u>\$ 30,230,000</u>	<u>\$ 26,771,000</u>

RIHEAA's total net assets at June 30, 2012 were just under \$32.4 million, an increase of approximately \$2.1 million from the previous year. Net assets in the Operating Fund increased by \$2 million, while the net assets in the Scholarship and Grant Fund increased by just over \$95,000. 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. The Adult Education Grant Program was planned as a two-year pilot program, however the program did not meet expectations during the pilot phase, and during FY 2012 the program was officially repealed.

The net assets of the Operating Fund consist of \$21.5 million which is restricted by federal and state statute to the uses of the AOF and for student financial assistance purposes, \$5.4 million which is restricted for use in Tuition Savings Program administration and student financial assistance purposes, and just over \$785,000 invested in capital assets. The Authority has total assets of \$36 million, which includes \$12.1 million in cash and cash equivalents and \$12.8 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 under \$1.4 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). In addition, there is also a receivable from RISLA of approximately \$5.8 million, which is a line of credit for a Conduit loan purchase program authorized by the RIHEAA Board (see note 9 to the financial statements).

Total liabilities of the AOF are just under \$3.7 million, with the largest components being a liability for the return of default aversion fees of \$1.75 million (see Default Aversion Fees in note 2 to the financial statements), accounts payable of \$839,000 and deferred revenues of nearly \$459,000 attributable to the rehabilitation loan transaction with RISLA referenced above.

Financial Highlights and Comparative Analysis (continued)

	<u>Operating Fund Revenues</u>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Loan Division:			
Collections-Based Revenue	\$ 11,727,000	\$ 10,321,000	\$ 10,069,000
AMF, LPIF, & DAF	1,708,000	2,032,000	3,875,000
Investment and Other	320,000	825,000	456,000
Total Loan Division	13,755,000	13,178,000	14,400,000
Tuition Savings Program:			
Program Fund Fees	8,004,000	8,243,000	6,034,000
Investment and Other	851,000	296,000	298,000
Total Tuition Savings Program	8,855,000	8,539,000	6,332,000
Scholarship and Grant Division	497,000	610,000	590,000
Total Revenues	\$ 23,107,000	\$ 22,327,000	\$ 21,322,000

Revenues in the Loan Division totaled nearly \$13.8 million in FY 2012, an increase of \$577,000 from FY 2011. The net change resulted from an increase of \$1.4 million in collections-based revenue, which offset declines in account maintenance fees (AMF), default aversion fees (DAF), and interest and other income. The declines in AMF and DAF revenue are attributable to the fact that RIHEAA's outstanding loan portfolio shrank from approximately \$1.6 billion in FY 2011 to \$1.45 billion at the end of FY 2012. However, the defaulted loan portfolio available for collections has not yet begun to decline in a similar fashion as the overall portfolio, and SallieMae has been particularly successful in collections efforts on RIHEAA's behalf.

Revenues in the Tuition Savings Program increased from \$8.5 million in FY 2011 to over \$8.8 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 \$ 6.7 million in FY 2012, down \$250,000 from FY 2011. Direct purchase commissions increased slightly and totaled \$1.3 million. Also, FY 2012 was the first year that revenue was recognized from the CollegeBoundBaby program, which totaled nearly \$550,000.

Revenues in the Scholarship and Grant Division, which represent the State appropriation used for the personnel and administrative expenses, decreased from \$610,000 in FY 2011 to \$497,000 in FY 2012, as a result of State budget cuts.

Financial Highlights and Comparative Analysis (continued)

	<u>Operating Fund Expenses and Transfers</u>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Loan Division:			
Collection and Default Aversion	\$ 6,642,000	\$ 6,296,000	\$ 6,253,000
Personnel	2,126,000	2,048,000	2,084,000
Provision for DAF Returns	1,441,000	519,000	624,000
Web Portal	516,000	520,000	442,000
Sallie Mae Guarantee Services	456,000	456,000	859,000
Other	893,000	870,000	1,215,000
	<hr/>	<hr/>	<hr/>
Total Loan Division	12,074,000	10,709,000	11,477,000
	<hr/>	<hr/>	<hr/>
Tuition Savings Program:			
Personnel	136,000	214,000	213,000
Marketing and Promotion	20,000	42,000	106,000
Other	28,000	62,000	55,000
	<hr/>	<hr/>	<hr/>
Total Tuition Savings Program	184,000	318,000	374,000
	<hr/>	<hr/>	<hr/>
Scholarship and Grant Division:			
Personnel	285,000	416,000	417,000
Other	189,000	184,000	178,000
	<hr/>	<hr/>	<hr/>
Total Scholarship and Grant Division	474,000	600,000	595,000
	<hr/>	<hr/>	<hr/>
Transfers to Scholarship and Grant Fund	8,341,000	6,300,000	5,834,000
	<hr/>	<hr/>	<hr/>
Total Expenses and Transfers	\$ 21,073,000	\$ 17,927,000	\$ 18,280,000
	<hr/>	<hr/>	<hr/>

Expenses in the Loan Division totaled \$12.1 million in FY 2012, an increase of nearly \$1.4 million from FY 2011. Over \$900,000 of the increase was a non-cash charge to adjust the liability which RIHEAA records for future returns of default aversion fees (see Default Aversion Fees in note 2 to the financial statements). Within the category of collection and default aversion expenses, commissions paid to collection agencies increased by approximately \$227,000 to just under \$4.6 million in FY 2012. In addition to commissions paid to collection vendors, the portfolio management fee paid to SallieMae in FY 2012 was \$1.7 million, an increase of just under \$300,000 over the FY 2011 amount. 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 \$527,000 in FY 2011 to \$357,000 in the current year. These fees are based on the vendor's ability to bring delinquent loans into a current status. Personnel expenses were \$2.1 million FY 2012, an increase of \$78,000 vs. FY 2011. Total fees paid to SallieMae for guarantee processing services remained level at \$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.

Financial Highlights and Comparative Analysis (continued)

Expenses associated with the WaytogoRI web portal decreased from \$520,000 in FY 2011 to \$516,000 in FY 2012. The FY 2012 total includes system services and maintenance of \$492,000 and marketing and training expense of \$24,000. Other operating expenses, which include office and administrative expenses, building-related expenses, and depreciation and amortization, totaled \$893,000 in the current year, \$23,000 more than in FY 2011.

In the Tuition Savings Program, personnel expenses declined by \$79,000 from FY 2011, the result of a vacant position for part of the year. Other administrative expenses decreased from \$62,000 in FY 2011 to \$28,000 in the current year. During FY 2012, RIHEAA spent \$20,000 to supplement the marketing efforts of AllianceBernstein in Rhode Island. During FY 2011, the supplemental marketing expenses were \$42,000.

Expenses in the Scholarship and Grant Division which are funded with State appropriations totaled \$474,000 in FY 2012 a decrease of \$126,000 from FY 2011. Personnel expenses were \$131,000 lower than FY 2011, as some positions which were previously allocated to Scholarship and Grant functions were shifted to the Loan Division. Other operating expenses increased by \$5,000 from the prior year.

Student financial assistance transfers from the Operating Fund to the Scholarship and Grant Fund totaled over \$8.3 million in FY 2012, an increase of \$1 million from FY 2011. \$7.3 million of the amount transferred was used to provide supplemental funding for the State Scholarship/Grant Program and \$1 million was transferred to the Academic Promise Scholarship Program.

Scholarship and Grant Fund Revenues, Transfers, and Expenses

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Revenues:			
State Appropriations	\$ 5,415,000	\$ 6,710,000	\$ 6,022,000
Investment Income	128,000	180,000	137,000
Federal Grants	-	413,000	635,000
Total Revenues	5,543,000	7,303,000	6,794,000
Transfers from the Operating Fund	8,341,000	6,300,000	5,834,000
Total Revenues and Transfers	\$ 13,884,000	\$ 13,603,000	\$ 12,628,000
Total Expenses	\$ 13,789,000	\$ 14,544,000	\$ 12,627,000

Total revenues and transfers into the Scholarship and Grant Fund were just under \$13.9 million in FY 2012 vs. approximately \$13.6 million in FY 2011. The State appropriation made to fund the need-based grant program decreased by \$1.3 million in FY 2012 vs. FY 2011. The reduction was required in order to comply with budget cuts in general revenue funds. The total includes a \$7.3 million transfer from the Operating Fund which was provided from Tuition Savings Program revenues to supplement the State's need-based grant program, and a \$1 million transfer to support the 2016 cohort of students in the Academic Promise Scholarship Program. Federal funding for the LEAP/SLEAP programs was eliminated in FY 2012. Investment income decreased from \$180,000 to \$129,000. All revenues of the Scholarship and Grant Fund are disbursed to, or for the benefit of qualifying, financially needy Rhode Island students.

Financial Highlights and Comparative Analysis (continued)

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 \$13.8 million in FY 2012. The total includes State Scholarship/Grant Program awards of \$12.6 million just, over \$1 million in the Academic Promise Scholarship and CollegeBoundfund® Matching Grant Programs, and the State's assessment of \$147,000 for participation in the New England Regional Student Program.

	<u>Statement of Cash Flows</u>		
	<u>2012</u>	<u>2011</u>	<u>2010</u>
Cash and Cash Equivalents	<u>\$ 12,136,000</u>	<u>\$14,700,000</u>	<u>\$7,180,000</u>
Provided by (used in):			
Operating activities	(2,443,000)	\$ (5,786,000)	\$ (4,967,000)
Noncapital financing activities	129,000	7,733,000	7,246,000
Investing activities	(214,000)	5,619,000	127,000
Purchase of capital assets	<u>(36,000)</u>	<u>(46,000)</u>	
Net (Decrease) Increase	<u>\$ (2,564,000)</u>	<u>\$ 7,520,000</u>	<u>\$ 2,406,000</u>

Cash and cash equivalents totaled over \$12.1 million at the end of FY 2012, a decrease of \$2.5 million from FY 2011. 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 \$5.9 million, and funds provided to RISLA and repaid by RISLA in conjunction with the Conduit loan purchase program line of credit. Investing activities reflect cash receipts of nearly \$29.9 million and cash outlays of over \$30 million. These investing transactions include maturities of U.S. Treasury securities, 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 \$36,000 during FY 2012.

Statement of Fiduciary Net Assets and Changes in Fiduciary Net Assets

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Net Assets Held in Trust for Participants	<u>\$ 7,262,777,000</u>	<u>\$ 7,888,394,000</u>	<u>\$ 6,858,939,000</u>

The net assets of the Program Fund totaled nearly \$7.3 billion at June 30, 2012 compared with \$7.9 billion at the end of FY 2011, a decrease of approximately \$626 million. The value of participant assets held in the plan declined by \$470 million. There were realized losses on investments of \$211 million and unrealized losses of \$259 million. The other components of the total change consist of the following: participants invested over \$1 billion while redeeming approximately \$1.4 billion; investments in the plan provided income of \$247 million; and the plan incurred expenses of just over \$80 million. All of the net assets are held in trust for the participants in the Program Fund. The number of accounts decreased from 500,000 at the end of FY 2011 to 481,000 at the end of FY 2012.

Financial Highlights and Comparative Analysis (continued)

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

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Federal Fund Total Assets and Liabilities	<u>\$ 16,759,000</u>	<u>\$ 18,923,000</u>	<u>\$ 18,914,000</u>

Total assets and liabilities of the Federal Student Loan Reserve Fund (the "Federal Fund") were just under \$16.8 million at the end of FY 2012, down from \$18.9 million the previous year. Assets include nearly \$7.5 million in cash and cash equivalents, just over \$2 million in certificates of deposit and a \$5.6 million reinsurance receivable from the DE arising from claims paid to lenders. The liabilities of the Federal Fund include a \$7.5 million allowance for unreinsured claims and a payable to the AOF of just over \$805,000. In addition, the Federal Fund reflects a liability to the Federal government of \$8.4 million, including \$2.1 million due to the DE for its share of collections and repurchase activity. The remaining \$6.3 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. Two significant adjustments were made to the Federal Fund during FY 2012. The asset on the Federal Fund which represents expected future payments from RIHEAA's Guaranty Agency Operating Fund for returns of default aversion fees, was increased by over \$900,000. The balance of that asset is now \$1.75 million and matches a corresponding liability on the AOF (see Default Aversion Fees in note 2 to the financial statements). Also, the liability on the Federal Fund for future unreinsured claims expenses was increased from \$4.4 million to \$7.75 million (see note 7 to the financial statements). Management believes that both adjustments represent a more accurate analysis of the underlying characteristics of the remaining FFEL portfolio.

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, and 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, 2012**

	<u>Operating Fund</u>	<u>Scholarship and Grant Fund</u>	<u>Total</u>
ASSETS:			
Current assets:			
Cash and cash equivalents	\$ 11,118,643		\$ 11,118,643
Cash and cash equivalents, restricted (DCYF)	391,740		391,740
Investments	7,181,499	\$ 4,624,072	11,805,571
Receivables and accruals:			
Asset-based fees	1,674,854		1,674,854
Interest	11,514		11,514
Portfolio maintenance fee	216,079		216,079
Rehabilitation loans receivable, RISLA	147,985		147,985
Health education assistance loans receivable	21,968		21,968
Other	18,237		18,237
CollegeBoundBaby receivable	134,600		134,600
Due from federal student loan reserve fund	805,894		805,894
Conduit loans line of credit, RISLA	5,782,532		5,782,532
Prepaid expenses	192,485		192,485
Total current assets	<u>27,698,030</u>	<u>4,624,072</u>	<u>32,322,102</u>
Noncurrent assets:			
Restricted cash and cash equivalents:			
Escrow SLMA principal	181,245		181,245
Recall account - interest	444,202		444,202
Investments	1,035,625		1,035,625
Rehabilitation loans receivable, less current portion, RISLA	1,241,964		1,241,964
Health education assistance loans receivable, less current portion	21,360		21,360
Capital assets, less accumulated depreciation	785,126		785,126
Total noncurrent assets	<u>3,709,522</u>	<u>-</u>	<u>3,709,522</u>
Total assets	<u>31,407,552</u>	<u>4,624,072</u>	<u>36,031,624</u>

(Continued)

The accompanying notes are an integral part of the financial statements

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

**STATEMENT OF NET ASSETS
JUNE 30, 2012**

	Operating Fund	Scholarship and Grant Fund	Total
LIABILITIES:			
Current liabilities:			
Accounts payable and accrued expenses	674,278		674,278
Payable to federal government	164,499		164,499
Deferred rehabilitation loans income	45,864		45,864
Allowance for default aversion fee returns	550,000		550,000
Compensated absences	57,931		57,931
Total current liabilities	<u>1,492,572</u>	-	<u>1,492,572</u>
Noncurrent liabilities:			
Allowance for default aversion fee returns, less current portion	1,200,000		1,200,000
Compensated absences, less current portion	122,140		122,140
Deferred rehabilitation loans income, less current portion	412,778		412,778
Deferred default prevention income	444,202		444,202
Total noncurrent liabilities	<u>2,179,120</u>	-	<u>2,179,120</u>
Total liabilities	<u>3,671,692</u>	-	<u>3,671,692</u>
Commitments and contingencies (Note 12 and 14)			
NET ASSETS:			
Invested in capital assets	785,126		785,126
Restricted	26,950,734	4,624,072	31,574,806
Total net assets	<u>\$ 27,735,860</u>	<u>\$ 4,624,072</u>	<u>\$ 32,359,932</u>

(Concluded)

The accompanying notes are an integral part of the 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, 2012

	Operating Fund	Scholarship and Grant Fund	Total
Operating revenues:			
Government fees:			
Default aversion	\$ 805,500		\$ 805,500
Account maintenance	902,482		902,482
Recovery, consolidation, and rehabilitation income, net of DE share	11,726,387		11,726,387
Tuition savings program fund administrative fees:			
Asset-based fees	6,700,392		6,700,392
Direct purchase commissions	1,303,987		1,303,987
AllianceBernstein contract income	275,000		275,000
CollegeBoundBaby income	547,100		547,100
Other income	19,257		19,257
Total operating revenues	22,280,105	-	22,280,105
Operating expenses:			
Student financial assistance	-	\$ 13,788,647	13,788,647
Salaries, payroll taxes, and employee benefits	2,546,353		2,546,353
Building and maintenance expenses	104,845		104,845
Collection agency commissions	4,571,712		4,571,712
Computer services	147,301		147,301
Default aversion and prevention expenses	357,383		357,383
Depreciation and amortization	224,949		224,949
Marketing and promotion	20,000		20,000
Office expenses and other	230,403		230,403
Printing and postage	42,642		42,642
Professional services	321,683		321,683
Provision for default aversion fee returns	1,440,750		1,440,750
SallieMae guarantee services fee	456,000		456,000
SallieMae portfolio management fees	1,712,918		1,712,918
Travel, conferences, and workshops	38,898		38,898
Web portal maintenance and services	492,333		492,333
Web portal marketing and training	23,505		23,505
Total operating expenses	12,731,675	13,788,647	26,520,322
Operating income (loss)	9,548,430	(13,788,647)	(4,240,217)

(Continued)

The accompanying notes are an integral part of the 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, 2012**

	Operating Fund	Scholarship and Grant Fund	Total
Nonoperating revenue:			
Investment income	208,594	128,546	337,140
Rental income	121,392		121,392
State appropriations	496,931	5,414,400	5,911,331
Total nonoperating revenue	826,917	5,542,946	6,369,863
Income (loss) before transfers	10,375,347	(8,245,701)	2,129,646
Transfers in (out):			
Academic Promise Scholarship Program	(1,000,000)	1,000,000	-
State grant program	(7,341,000)	7,341,000	-
Total transfers in (out)	(8,341,000)	8,341,000	-
Change in net assets	2,034,347	95,299	2,129,646
Net assets:			
Beginning of the year	25,701,513	4,528,773	30,230,286
End of year	<u>\$ 27,735,860</u>	<u>\$ 4,624,072</u>	<u>\$ 32,359,932</u>

(Concluded)

The accompanying notes are an integral part of the 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, 2012

	Operating Fund	Scholarship and Grant Fund	Total
Cash flows from operating activities:			
Cash received from:			
Recovery, consolidation, and rehabilitation income	\$ 12,519,166		\$ 12,519,166
Tuition Savings Program Fund fees and commissions	8,154,111		8,154,111
Government fees	2,640,371		2,640,371
AllianceBernstein contract income	275,000		275,000
Rental income	121,392		121,392
CollegeBound Baby income	412,500		412,500
Loan repayments:			
Health education assistance loans	21,968		21,968
Loans receivable	266,968		266,968
Cash paid for:			
Employees for services and benefits	(2,682,654)		(2,682,654)
Supplies, materials, and services	(10,383,181)		(10,383,181)
Student financial assistance	-	\$ (13,788,647)	(13,788,647)
Net cash provided by (used in) operating activities	<u>11,345,641</u>	<u>(13,788,647)</u>	<u>(2,443,006)</u>
Cash flows from noncapital financing activities:			
Operating subsidies and transfers (to) from			
Other funds	(8,341,000)	8,341,000	-
Proceeds to RISLA on Conduit Loans	(13,073,878)	-	(13,073,878)
Payments from RISLA on Conduit Loans	7,291,346	-	7,291,346
State appropriations	496,931	5,414,400	5,911,331
Net cash provided by (used in) noncapital financing activities	<u>(13,626,601)</u>	<u>13,755,400</u>	<u>128,799</u>
Cash flows from investing activities:			
Purchases of investments	(29,315,249)	(1,128,546)	(30,443,795)
Proceeds from sales and maturities of investments	28,858,638	1,033,247	29,891,885
Interest income	208,594	128,546	337,140
Purchase of capital assets	(35,681)	-	(35,681)
Net cash provided by (used in) investing activities	<u>(283,698)</u>	<u>33,247</u>	<u>(250,451)</u>
Net increase (decrease) in cash and cash equivalents	\$ (2,564,658)	\$ -	\$ (2,564,658)
Cash and cash equivalents, beginning of year	<u>14,700,488</u>	<u>-</u>	<u>14,700,488</u>
Cash and cash equivalents, end of year	<u>\$ 12,135,830</u>	<u>\$ -</u>	<u>\$ 12,135,830</u>

(Continued)

The accompanying notes are an integral part of the 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, 2012

	Operating Fund	Scholarship and Grant Fund	Total
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:			
Operating income (loss)	\$ 9,548,430	\$ (13,788,647)	\$ (4,240,217)
Adjustments to reconcile operating income (loss) to net cash provided			
By (used in) operating activities:			
Depreciation and amortization	224,949		224,949
Rental income	121,392		121,392
Provision for default aversion fee refunds	909,250		909,250
Deferred rehabilitation revenue	(79,731)		(79,731)
Changes in assets and liabilities:			
Receivables and accruals:			
Decrease in asset-based fees	149,732		149,732
Decrease in interest receivable	142		142
Decrease in portfolio maintenance fees	21,530		21,530
Decrease in health education assistance loans receivable	21,968		21,968
Decrease in loans due from RISLA	235,698		235,698
Decrease in other receivables	11,871		11,871
Increase in CollegeBoundBaby receivable	(134,600)		(134,600)
Decrease in Due from Federal Student Loan Reserve Fund	784,890		784,890
Increase in prepaid expenses	(1,291)		(1,291)
Decrease in accounts payable and accrued expenses	(421,517)		(421,517)
Increase in payable to federal government	87,620		87,620
Deferred to default prevention income	1,609		1,609
Decrease in compensated absences	(136,301)		(136,301)
Net cash provided by (used in) operating activities	<u>\$ 11,345,641</u>	<u>\$ (13,788,647)</u>	<u>\$ (2,443,006)</u>

(Concluded)

The accompanying notes are an integral part of the financial statements

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

**STATEMENT OF FIDUCIARY NET ASSETS
JUNE 30, 2012**

	Private Purpose	Agency Fund
	Tuition Savings Program Fund	Federal Student Loan Reserve Fund
<u>ASSETS:</u>		
Cash and cash equivalents		\$ 7,451,182
Investments	\$ 7,268,943,353	2,037,029
Accounts receivable:		
Units sold	18,496,789	
Investments sold	2,280,318	
Interest and dividends	99,838	
Reinsurance claims, federal government		5,520,907
Default aversion fee returns, Guaranty agency operating fund		1,750,000
Other	13,415	
Total Assets	7,289,833,713	\$ 16,759,118
<u>LIABILITIES:</u>		
Accounts payable:		
Investments purchased and units redeemed	20,598,012	
Accrued asset-based charges	2,636,351	
Other	3,922	\$ 92,071
Advisory fee payable	3,818,705	
Payable to guaranty agency operating fund		805,894
Allowance for unreinsured claims		7,500,000
Due to federal government		8,361,153
Total liabilities	27,056,990	\$ 16,759,118
<u>NET ASSETS:</u>		
Held in trust for participants	\$ 7,262,776,723	

The accompanying notes are an integral part of the 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, 2012**

	Private Purpose
	Tuition Savings Program Fund
From operation:	
Investment income	\$ 246,595,554
Net decrease in fair value of investments	(470,283,406)
Contributions from program manager	768
Expenses, asset-based charges	(80,028,624)
Net decrease in net assets from operations	(303,715,708)
From unitholder transactions:	
Subscriptions	1,083,156,151
Redemptions	(1,405,058,090)
Net decrease in net assets from unitholder transactions	(321,901,939)
Net decrease in net assets	(625,617,647)
Net assets held in trust for participants, beginning of year	7,888,394,370
Net assets held in trust for participants, end of year	\$ 7,262,776,723

The accompanying notes are an integral part of the financial statements

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

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 or developed by the Authority and approved by the RIHEAA Board of Directors (the Board).

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."

(CONTINUED)

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

1. Organization and reporting entity (continued):

Recently Issued Accounting Standards:

The Authority has implemented GASB No. 64, Derivative Instruments: Application of Hedge Accounting Termination Provisions – an amendment of GASB Statement No. 53, for the year ended June 30, 2012. The adoption of this Statement did not have an impact on the Authority’s financial position or results of operations.

The Authority will adopt the following new accounting pronouncements in future years:

- ✓ GASB Statement No. 60 – Accounting and Financial Reporting for Service Concession Arrangements, effective for the Authority’s fiscal year ending June 30, 2013.
- ✓ GASB Statement No. 61 – The Financial Reporting Entity: Omnibus, an amendment of GASB Statements No. 14 and No. 34, effective for the Authority’s fiscal year ending June 30, 2013.
- ✓ GASB Statement No. 62 – Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements, effective for the Authority’s fiscal year ending June 30, 2013.
- ✓ GASB Statement No. 63 – Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position, effective for the Authority’s fiscal year ending June 30, 2013.
- ✓ GASB Statement No. 65 – Items Previously Reported as Assets and Liabilities, effective for the Authority’s fiscal year ending June 30, 2014.
- ✓ GASB Statement No. 66 – Technical Corrections – 2012 – an amendment of GASB Statement No. 10 and No. 62, effective for the Authority’s fiscal year ending June 30, 2014.
- ✓ GASB Statement No. 67 – Financial Reporting for Pension Plans – an amendment of GASB Statement No. 25, effective for the Authority’s fiscal year ending June 30, 2014.
- ✓ GASB Statement No. 68 – Financial Reporting for Pensions – an amendment of GASB Statement No. 27, effective for the Authority’s fiscal year ending June 30, 2015.

The impact of these pronouncements on the Authority’s financial statements has not been determined.

(CONTINUED)

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

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 non-operating 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 non-operating 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.

(CONTINUED)

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

2. Summary of significant accounting policies (continued):

Fund financial statements (continued):

Operating Fund (continued):

Scholarship and Grant Operating Administrative Fund - This fund accounts for all transactions relating to the Authority's administration of 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 scholarship and grant 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 required the State to match federal amounts in the form of a minimum maintenance of effort level. The programs were Leveraging Educational Assistance Partnership (LEAP) and Special Leveraging Educational Assistance Partnership (SLEAP). Both programs have been discontinued and no funding was provided during fiscal year 2012.

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

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 2012.

Academic Promise Scholarship Program 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). During fiscal year 2012, \$1,000,000 was invested to provide awards to students entering college starting in September 2012.

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 invested \$600,000 during fiscal year 2008 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. The program was planned as a two year pilot program, however the program did not meet expectations during the pilot phase and during fiscal year 2012 the program was officially repealed. At June 30, 2012, there was approximately \$634,000 of the unused funds in the Program. At the July 2012 board meeting, the Board authorized the transfer of \$200,000 of those funds to the CollegeBoundfund® Matching Grant Program. The disposition of the remainder of the funds will be determined by the Board at a later date.

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.

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

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. These 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) 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, default aversion fee returns, 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.

(CONTINUED)

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

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 historical 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, 2013. 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. Useful lives of the assets are as follows:

Land improvements	15 - 30 years
Buildings	30 years
Building improvements	5 years
Office equipment	5 years
Computers and software	3-5 years

Capital assets are defined by the Authority as assets with an initial individual cost of \$2,500 or more and an estimated useful life in excess of one year.

(CONTINUED)

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

2. Summary of significant accounting policies (continued):

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.

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 must 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 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 Board. Also, the Scholarship and Grant Fund's net assets invested in the Program Fund, in the amount of \$4,624,072, for the Academic Promise Scholarship Program, CollegeBoundfund® Matching Grant Program, and the Adult Education Grant Program are classified as restricted.

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

2. Summary of significant accounting policies (continued):

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.

The Authority records an allowance for its estimate of default aversion fees to be returned as a result of future loan defaults. During fiscal year 2012 however, and as a result of the changes which arose from the HERA Act of 2010, RIHEAA management adjusted the estimate of the allowance. This resulted in a net increase to the allowance of \$909,250. Also, the fee income is now reflected on the financial statements as the total amount transferred from the Federal Fund. In prior years the income was shown net of the provision for losses. 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. During fiscal year 2012, the fee income was \$805,500, the amount added to the allowance was \$1,440,750 and charges against the allowance for actual fee returns were \$531,500.

Account maintenance fees:

The Authority earns an account maintenance fee (AMF) from the DE equal to 6 basis points (0.06%) 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, which approximates recording this revenue on the accrual basis.

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, which approximates recording this revenue on the accrual basis.

Grants and appropriations:

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

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

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 of America 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, 2012, the Authority's cash deposits consist of the following:

	Bank Balance	Carrying Amount
Demand deposits	\$ 20,778,657	\$ 19,334,280
State's general treasury	71,487	71,487
Money market funds	181,245	181,245
	\$ 21,031,389	\$ 19,587,012

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

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, 2012 are as follows:

Uninsured, collateralized	\$	71,787
Uninsured, but collateralized with securities held by the pledging bank's trust department or agent not held in the Authority's name		<u>11,780,180</u>
	\$	<u><u>11,851,967</u></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.

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

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, 2012 as follows:

Statement of net assets:	
Current assets	\$ 11,510,383
Noncurrent assets	625,447
Statement of fiduciary net assets:	
Federal Student Loan Reserve Fund	7,451,182
Cash deposits	\$ 19,587,012

Investments:

As of June 30, 2012 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	\$ 517,941	\$ 517,941	
Mutual funds	7,273,567,422	7,273,567,422	
CDARS	8,700,590	8,700,590	
U.S Treasury Notes	1,035,625	1,035,625	
	\$ 7,283,821,578	\$ 7,283,821,578	\$ -

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

3. Cash deposits and investments (continued):

Investments (continued):

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	\$	11,805,571
Noncurrent assets		1,035,625
Statement of fiduciary net assets		
Tuition Savings Program Fund		7,268,943,353
Federal Student Loan Reserve Fund		<u>2,037,029</u>
	\$	<u>7,283,821,578</u>

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-1 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, 2012, 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.

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

4. Health education assistance loans receivable:

The Authority administers loan programs which were made to students in graduate studies in health-related professions. As of June 30, 2012, the outstanding loan balances total \$43,328, a portion of which is guaranteed by the federal government.

Certain loans, totaling \$3,218, 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 did not bear interest until they entered the repayment phase, which began nine months after graduation or after the students complete the conditions for forgiveness. Students may also have been able to have received up to a four-year deferment of principal and interest during their enrollment in internship or residency programs. Loan forgiveness is recorded in the period in which the conditions are satisfied by the borrowers. During fiscal year 2012, no loans were forgiven.

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 \$21,535 was outstanding at June 30, 2012).

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

5. Capital assets:

Capital asset activity for the year ended June 30, 2012 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	\$ -	\$ -	\$ -	\$ 194,096
Capital assets being depreciated or amortized:					
Land improvements	135,740				135,740
Building and improvements	2,222,868				2,222,868
Equipment	699,841	35,681			735,522
Web-based scholarship and grant program system	420,650				-
Web portal	453,500				453,500
Total capital assets being depreciated or amortized	<u>3,932,599</u>	<u>35,681</u>	<u>-</u>	<u>-</u>	<u>3,968,280</u>
Accumulated depreciation and amortization:					
Land improvements	(49,659)	(8,088)			(57,747)
Building and improvements	(1,797,202)	(88,607)			(1,885,809)
Equipment	(658,043)	(37,557)			(695,600)
Web-based scholarship and grant program system	(420,650)				-
Web portal	(226,747)	(90,697)			(317,444)
Total Accumulated depreciation and amortization	<u>(3,152,301)</u>	<u>(224,949)</u>	<u>-</u>	<u>-</u>	<u>(3,377,250)</u>
Total capital assets being depreciated or amortized, net	<u>780,298</u>	<u>(189,268)</u>	<u>-</u>	<u>-</u>	<u>591,030</u>
Total capital assets, net	<u>\$ 974,394</u>	<u>\$ (189,268)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ 785,126</u>

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

6. Long-term liabilities:

A summary of changes in long-term liabilities for the year ended June 30, 2012 is as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Due within one year
Liability for estimated default aversion fee returns	\$ 840,750	\$ 1,440,750	\$ (531,500)	\$ 1,750,000	\$ 550,000
Compensated absences	316,372		(136,301)	180,071	57,931
Deferred rehabilitation income	538,373		(79,731)	458,642	45,864
Deferred default prevention income	442,593	1,609		444,202	-
	<u>\$ 2,138,088</u>	<u>\$ 1,442,359</u>	<u>\$ (747,532)</u>	<u>\$ 2,832,915</u>	<u>\$ 653,795</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 their guarantor obligations. The agreements contain certain annual limitations, commonly referred to as the "reinsurance trigger," which could reduce the reinsurance amount during the remainder of any federal fiscal year.

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, 2012, the Authority charged the Federal Fund \$2,424,833 pursuant to the above provisions.

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

7. Allowance for unreinsured claims and reinsurance triggers (continued):

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. During fiscal year 2012, RIHEEA management adjusted the estimate of the allowance, and as a result, increased the liability from \$4.4 million at June 30, 2011 to \$7.75 million at the end of the current year. Management believes that the analysis accurately reflects the underlying characteristics of the remaining portfolio and represents a more conservative approach in the calculation of this liability. 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. Also, it should be noted that this change in the amount of the allowance does not adversely affect RIHEEA's Federal Fund reserve ratio (see "reserve fund requirements" within Note 12).

8. Net assets:

Restricted net assets consist of the following as of June 30, 2012:

Scholarship and Grant Fund:	
Academic Promise Scholarship Program	\$ 3,903,599
CollegeBoundfund® Matching Grant Program	86,345
Adult Education Grant Program	634,128
Operating Fund	<u>26,950,734</u>
	<u>\$ 31,574,806</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, 2012 were as follows:

Guaranteed loans outstanding as of June 30, 2012	\$502,286,268
Guarantee claims paid during the year	\$ 18,010,783

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

9. Related party transactions (continued):

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, 2012, the accompanying statement of net assets includes \$1,389,949 due from RISLA and deferred revenue resulting from the rehabilitation transactions totaling \$458,642. The amount due from RISLA is payable as RISLA receives payments from borrowers or when claims payments are received if loans default. The Authority recognizes rehabilitation income previously deferred when principal payments are received from RISLA. During the year ended June 30, 2012 the Authority recognized as income \$79,731 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. Under the terms of the Conduit, loans that become 240 days delinquent must be purchased out of the conduit or "put" to the DE. In February 2011, the RIHEAA Board authorized the use of up to \$6,500,000 of RIHEAA funds in the form of a line of credit to be used by RISLA to purchase delinquent loans from the Conduit. This program allows RIHEAA to derive collections revenue on loans which would otherwise have been put to DE. The line of credit gets repaid when RISLA receives claims payments on loans which default. In addition, RISLA is repaying the line of credit by purchasing loans which become current. These purchases are funded from RISLA's sources. At June 30, 2012, the receivable from RISLA for this program was \$5,782,532. Subsequent to year-end, RISLA paid RIHEAA nearly \$2.7 million to reduce the line and RIHEAA provided an additional \$2 million for new loan purchases.

In addition, the Authority leases office space to RISLA. For the year ended June 30, 2012, rental income totaled \$121,392.

10. Retirement plans:

Plan Description:

Substantially all full-time permanent employees of the Authority participate in a cost-sharing multiple-employer defined benefit pension plan administered by the State of Rhode Island Employees' Retirement System (ERS). The plan provides retirement and disability benefits, annual cost-of-living adjustments (COLAs), and death benefits to plan members and beneficiaries. The level of benefits provided to state employees is established by Chapter 36-10 of the General Laws, which is subject to amendment by the General Assembly. The ERS issues a publicly available financial report that includes financial statements and required supplementary information for plans administered by the system. The report may be obtained by writing to the Employees' Retirement System of Rhode Island, 50 Service Avenue, Warwick, RI 02886.

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

10. Retirement plans (continued):

Funding Policy:

The funding policy, as set forth in the General Laws, Section 36-10-2, provides for actuarially determined periodic contributions to the plan. Authority employees are required to contribute 8.75% of their annual covered salary. The Authority is required to contribute at an actuarially determined rate; the rate was 22.98% of annual covered payroll for the fiscal year ended June 30, 2012. The Authority contributed \$336,000, \$300,000, and \$296,000 for the fiscal years ended June 30, 2012, 2011 and 2010, respectively, equal to 100% of 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, 2012 were 9.00% of the covered payroll. The Authority's contributions for the years ended June 30, 2012, 2011 and 2010 were approximately \$20,000, \$32,000 and \$31,000, 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.

Pension Reform Impacting Future Periods:

In November 2011, the Rhode Island General Assembly enacted comprehensive pension reform legislation which included implementing a supplemental defined contribution plan and other benefit and eligibility changes including suspending COLAs. The above changes and other provisions of the reform enacted are effective July 1, 2012.

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. 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 has been established to accumulate assets and pay benefits and other costs associated with the system.

The OPEB system issues a stand-alone, publically available financial report that includes the financial statements and required supplementary information. A copy of the report can be obtained from the State Controller's Office, 1 Capitol Hill, Providence, RI 02903.

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

11. Postemployment Health Care Plan (continued):

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.

All participating employers are required by law to fund the actuarially determined annual required contribution (ARC), which for fiscal year 2012 was 6.86% 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, 2012 and 2011 was \$100,000 and \$95,000, respectively which represents 100% of the ARC.

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 \$444,202 as of June 30, 2012.

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, 2012, there were no remaining amounts outstanding.

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**RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

12. Commitments and contingencies (continued):

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 0.25% of the original principal balance of loans guaranteed (OPO). As of June 30, 2012, the Authority's OPO totaled \$1,450,033,186 and its corresponding minimum reserve balance was \$3,625,083. The actual balance in the reserve fund at year-end was \$6,299,710, and using the method currently prescribed by the DE, the reserve ratio was 0.95%.

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, provided that the parties reach mutually agreed upon financial terms.

The current 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 \$456,000 for the year ended June 30, 2012. In addition, SallieMae provides portfolio management services to the Authority for defaulted loans collections. 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 \$1,712,918 for the year ended June 30, 2012. In the event that the Authority should cancel the portfolio management services, the agreement provides for increases in the fee structure for loan guarantee systems services.

Recently, RIHEAA management has had substantive discussions with SallieMae concerning the terms of the first two-year renewal option referenced above. SallieMae has presented RIHEAA with a proposal, and at the RIHEAA Board meeting of September 28, 2012, the Board authorized RIHEAA senior management to execute the extension agreement, subject to final review by the Authority's legal counsel.

(CONTINUED)

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

12. Commitments and contingencies (continued):

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 0.59% 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 \$357,383 for the year ended June 30, 2012. RIHEAA management is currently evaluating options concerning default aversion activities, however another extension with NCO is currently being discussed.

Tuition Savings Program Management Agreement:

Effective July 1, 2010, the Authority, the SIC, and AllianceBernstein entered into a 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 \$8,004,379 for the year ended June 30, 2012 and is recorded in the Operating Fund. Under the terms of the contract:

- 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-Rhode Island resident account and the agreement contains provisions whereby the asset-based fee will not fall below the level of the account maintenance fee in place under the previous contract.
- 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; also the Authority will receive \$50 per child for use in marketing and promotion for every child born or adopted 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 2012, the Authority provided additional funds totaling approximately \$20,000 for marketing and promotion expenses.

(CONTINUED)

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

12. Commitments and contingencies (continued):

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, 2012, maintenance, marketing, and training expenses associated with the web portal totaled approximately \$516,000. Under the terms of the agreement; the Authority is committed to expend the following:

<u>Year Ending</u>	<u>Amount</u>
2013	\$ 499,630
2014	509,622
2015	519,815
2016	351,133

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 developments 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 80% 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.

(CONTINUED)

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

**NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2012**

14. Legislative developments and continuing operations (continued):

In June of 2012, the Rhode Island General Assembly passed and Governor Chafee signed into law House Bill 2012 – H 7323 substitute A as amended, also referred to as the FY 2013 Budget Act. Article 4 of the Act, added the following language to section 16-57-10 of RIHEAA’s enabling legislation, titled - Reserve Funds: “To assure continued solvency of the authority, the authority’s operating fund shall be used solely for the ordinary operating expenses of the authority. Furthermore, it is the intent of the general assembly that these funds eventually be used to increase financial assistance to Rhode Island students in the form of scholarships and grants.” The RIHEAA Board has had discussions about the new legislative language and is in the process of developing proposals and programs that are consistent with the legislature’s intent.

(CONCLUDED)

**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, 2012**

Statement of Net Assets	Attachment B
Assets	
Current assets:	
Cash and cash equivalents	\$ 11,118,643
Investments	11,805,571
Receivables (net)	2,077,252
Restricted assets:	
Cash and cash equivalents	391,740
Investments	
Receivables (net)	
Due from other component units	5,930,517
Due from other governments	805,894
Other assets	192,485
	32,322,102
Total current assets	32,322,102
Noncurrent assets:	
Investments	1,035,625
Receivables (net)	21,360
Restricted assets:	
Cash and cash equivalents	625,447
Investments	
Receivables (net)	
Other assets	
Due from other component units	1,241,964
Capital assets - nondepreciable	194,096
Capital assets - depreciable (net)	591,030
	3,709,522
Total noncurrent assets	3,709,522
Total assets	36,031,624

**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, 2012**

Statement of Net Assets (continued)	Attachment B
Liabilities	
Current liabilities:	
Accounts payable	674,278
Due to other governments	164,499
Deferred revenue	45,864
Other liabilities	57,931
Current portion of long-term debt	550,000
Total current liabilities	1,492,572
Noncurrent liabilities:	
Deferred revenue	856,980
Other liabilities	1,200,000
Compensated absences	122,140
Total noncurrent liabilities	2,179,120
Total liabilities	3,671,692
Net assets	
Invested in capital assets, net of related debt	785,126
Restricted for:	
Debt	
Other	31,574,806
Other nonexpendable	
Unrestricted	
Total net assets	\$ 32,359,932

**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, 2012**

<u>Statement of Changes in Net Assets</u>	<u>Attachment C</u>
Operating revenues:	
Charges for services	\$ 22,260,848
Interest income on loans	
Investment income (net)	
Other operating income	<u>19,257</u>
Total operating revenues	<u>22,280,105</u>
Operating expenses:	
Personnel services	2,546,353
Supplies, materials, and services	9,960,373
Interest expense	
Grants, scholarships and contract programs	13,788,647
Depreciation, depletion and amortization	224,949
Other operating expenses	
Total operating expenses	<u>26,520,322</u>
Operating income (loss)	<u>(4,240,217)</u>
Nonoperating revenues (expenses):	
Interest revenue	337,140
Grants	
Payments from primary government	5,911,331
Gain (loss) on sale of property	
Interest expense	
Investment income (net)	
Other nonoperating revenue (expenses)	<u>121,392</u>
Total nonoperating revenue (expenses)	<u>6,369,863</u>
Income (loss) before contributions	2,129,646
Capital contributions	
Special items	
Extraordinary items	
Change in net assets	<u>2,129,646</u>
Total net assets - beginning	<u>30,230,286</u>
Total net assets - ending	<u>\$ 32,359,932</u>

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

**SCHEDULE OF TRAVEL EXPENSES
YEAR ENDED JUNE 30, 2012**

Payee	Purpose of Travel	Airfare	Lodging	Meals	Auto/Other
Loan Division					
American Express	G. Mance-Rios - XAP Meeting	\$	544		
"	K. Sisson - XAP Meeting		544		
Joseph Palumbo	J. Palumbo - EFC Conference		555		
American Express	K. Sisson - NCAN Conference	\$ 465			
"	S. Rodrigues - NCAN Conference	465			
"	C. Miller - NCHELP Conference	219			
"	C. Cox - NCHELP Conference	290			
"	T. Pearce - NCHELP Conference	290			
"	C. Miller - NCHELP Conference		456		
"	K. Sisson - NCAN Conference		327		
"	S. Rodrigues - NCAN Conference		374		
Christina Faulkner	C. Faulkner - CRI Training	410	366		
Gary LeFrancois	G. LeFrancois - Meteor Meeting		368		
Gary LeFrancois	G. LeFrancois - Meteor Meeting	553	368		
American Express	C. Miller - Meteor Meeting	385	432		
"	C. Miller - NCHELP Conference		808		
"	M. Joyce - College Board Forum		432		
"	C. Cox - NCHELP Conference		432		
"	T. Pearce - NCHELP Conference				
"	G. Mance-Rios - DE Conference	494			
"	C. Cox - DE Conference	494			
"	K. Courtoyer - Software Conference		388		280
"	G. Mance-Rios - DE Conference		488		
"	C. Cox - DE Conference		488		
"	C. Miller - Clearinghouse Meeting	214			
"	C. Miller - Clearinghouse Meeting		284		
"	G. Mance-Rios - CACG Meeting	653			
"	M. Lacroix - NCHELP CFO Caucus		239		
"	K. Sisson - XAP Meeting	544			
"	S. Rodrigues - XAP Meeting	649			
"	G. Mance-Rios - XAP Meeting	649			
Accrual	K. Sisson - XAP Meeting		431		
"	S. Rodrigues - XAP Meeting		431		
"	G. Mance-Rios - XAP Meeting		431		
Amounts less than \$200		1,219	200	2,248	3,014
Total Loan Division		\$ 7,993	\$ 9,386	\$ 2,248	\$ 3,294

(CONTINUED)

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

**SCHEDULE OF TRAVEL EXPENSES
YEAR ENDED JUNE 30, 2012**

Payee	Purpose of Travel	Airfare	Lodging	Meals	Auto/Other
Scholarship and Grant Division					
American Express	M. Joyce - NASGAAP	\$	966	220	184
Amounts less than \$200		\$	-	220	184
Total S & G		\$1,370	966	220	184
RIHEST					
American Express	P. Kerwin - AllianceBermstein Meeting			\$	256
"	P. Kerwin - AllianceBermstein Meeting		255		251
"	P. Kerwin - CSPN Meeting	\$	448	368	
"	P. Kerwin - CSPN Meeting		283		
"	P. Kerwin - CSPN Meeting	468			
"	P. Kerwin - CSPN Meeting		644		
Amounts less than \$200			\$	334	388
Total RIHEST		\$3,695	1,550	334	895
Grand Total		8,909	11,902	2,802	4,373

(CONCLUDED)

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

To the Board Members
Rhode Island Higher Education Assistance Authority

We have audited the financial statements of the Rhode Island Higher Education Assistance Authority (a component unit of the State of Rhode Island and Providence Plantations), as of and for the year ended June 30, 2012, and have issued our report thereon dated October 1, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Needham
Boston
Concord
Taunton

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 be material weaknesses, as defined above. However, we identified deficiencies in internal control, which are 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, 2012, we tested a sample of 40 cash disbursements to determine if the Authority's internal controls were being implemented. The results of our testing identified 9 invoices that didn't have the proper approval according to the internal controls documented by management. Due to the significant amount of exceptions noted during this test, we recommend that the Authority evaluate the current internal controls over this function and modify them to match the controls that are in place or implement a review process that ensures that the controls have been implemented and documented appropriately.

During the fiscal year ended June 30, 2012, there were times where the Chief Financial Officer (CFO) prepared, reviewed and approved certain transactions; 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.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Rhode Island Higher Education Assistance 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*.

The report is intended solely for the information of the Board of Directors and management of the Rhode Island Higher Education Assistance Authority, the Rhode Island Department of Administration, the Rhode Island Auditor General, federal awarding agencies, and others within the Authority and is not intended to be and should not be used by anyone other than these specified parties.



Providence, Rhode Island
October 1, 2012