

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

YEAR ENDED JUNE 30, 2004



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

YEAR ENDED JUNE 30, 2004

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Independent Auditors' Report

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

We have audited the accompanying financial statements of the business-type activities and aggregate remaining fund information of the Rhode Island Higher Education Assistance Authority (the Authority), a Component Unit of the State of Rhode Island, as of and for the year ended June 30, 2004, 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.

Except as discussed in the following paragraph, we conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

We were unable to obtain sufficient evidence to support the Authority's inclusion of certain capital assets and loans receivable, and related operating activity and cash flows, in the Operating Fund, as described in Note 5 to the financial statements under "Establishment of Federal Student Loan Reserve Fund."

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the inclusion of certain capital assets and loans receivable, and the related operating activity and cash flows, in the Operating Fund, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and the aggregate remaining fund information of the Rhode Island Higher Education Assistance Authority as of June 30, 2004, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended, in conformity with accounting principles generally accepted in the United States.

Independent Auditors' Report (Continued)

Board of Directors
Rhode Island Higher Education
Assistance Authority

In accordance with Government Auditing Standards, we have also issued our report dated September 24, 2004 on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with Government Auditing Standards and should be considered in assessing the results of our audit.

The Management's Discussion and Analysis on pages 3 through 7 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Leffowitz, Joseph, Charfi & DeGuzo P.C.

September 24, 2004

MANAGEMENT'S DISCUSSION AND ANALYSIS

The following Management's Discussion and Analysis (MD&A) of the Rhode Island Higher Education Assistance Authority's (RIHEAA) operations and financial results is intended to provide readers with information which will assist them in evaluating RIHEAA's financial statements as of and for the year ended June 30, 2004. The MD&A consists of an introduction and a financial highlights and comparative analysis section. The introduction 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 that follow.

Introduction

RIHEAA is a public corporation established July 1, 1977 by an act of the Rhode Island General Assembly and has a distinct legal existence from the State of Rhode Island. 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 respectively, the Scholarship and Grant Program, the Tuition Savings Program, and the Federal Family Education Loan (FFEL) Program.

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

The Tuition Savings Program Division administers the activities of the Rhode Island Higher Education Savings Trust (RIHEST.) 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), Rhode Island's IRS Section 529 qualified state tuition savings program, which holds participant assets as a private purpose trust fund, and (2) an Administrative Fund, the use of which is contractually restricted to RIHEST administrative expenses and student financial assistance programs authorized by the RIHEAA Board of Directors. The Program Fund, which at FY 2004 year-end consisted of two divisions, *CollegeBoundfund* and the JP Morgan Higher Education Plan, is managed by Alliance Capital Management, L.P. under an agreement between RIHEAA, the State Investment Commission, and Alliance Capital. Revenues of the Administrative Fund are derived principally from fees paid by non-Rhode Island participants in the Program Fund.

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 (Federal Fund) and the Guaranty Agency Operating Fund (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 (DE). The AOF principally accounts for the administrative activities related to the operations of the FFEL Program.

RIHEEA 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, RIHEEA'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 RIHEST Administrative Fund 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 Student Loan Reserve Fund. The statement of changes in fiduciary net assets is provided for the Program Fund.

Financial Highlights and Comparative Analysis

Net Assets

RIHEEA's total net assets at June 30, 2004 were just over \$24.8 million, an increase of nearly \$5.5 million from the previous year. The increases in net assets are \$4.4 million in the Operating Fund and \$1.1 million in the Scholarship and Grant Fund. Total assets were \$26.5 million and total liabilities were just under \$1.7 million. Of those total assets, slightly more than \$3.3 million are restricted assets within the Scholarship and Grant Fund for the Academic Promise Scholarship Program and 5 and 10 Matching Grant Program. These funds are invested in the Program Fund on behalf of Academic Promise Scholarship recipients and to provide matching funds for low-income individuals who qualify in the 5 and 10 Matching Grant Program. The net assets of the Operating Fund consist of \$1.5 million invested in capital assets, over \$15.2 million which is restricted by federal statute to the uses of the Guarantee Agency Operating Fund, and over \$4.7 million which is designated for Program Fund administration and student financial assistance purposes. Assets include over \$6.5 million in cash and cash equivalents, and just under \$17.4 million in investments, including the Academic Promise Scholarship and 5 and 10 Matching Grant Program amounts. An allowance for default aversion fee returns of \$573,000 is the largest single component of total liabilities.

Operating Fund Revenues

Total revenues in the Operating Fund were over \$16.7 million in FY 2004 as compared with approximately \$12.7 million in FY 2003, an increase of \$4 million. Over \$2.5 million of that increase was in the Agency's Loan Division and nearly \$1.2 million was in the RIHEST Administrative Fund. Total revenues in the RIHEST Administrative Fund were just over \$5.5 million in FY 2004, up from \$4.3 million in FY 2003. The higher revenues are attributable to the growing number of participants and total amounts invested in the Program Fund (see the section on the Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets below). Although revenues in this fund have grown each year, the rate of growth has slowed, and management believes that the increases that have been realized in recent years are unlikely to be sustained.

Revenues within the Loan Division totaled just over \$10 million in FY 2004, up from \$7.5 million in the prior year. Revenue from collections, consolidations, and rehabilitations of defaulted student loans were over \$7 million, an increase of over \$3 million from the FY 2003 results. Much of the improved performance is the result of an increased emphasis on loan rehabilitations, which provide significant benefits to borrowers that are not available with other defaulted loan recovery methods. RIHEEA's management attributes the increase to a larger portfolio of defaulted loans available for collection and the agreement with the SLM Corporation (Sallie Mae) for the management of outsourced collection activities. In addition to collection based revenues, the other major sources of income in the Loan Division include: account maintenance fees, which were up slightly at \$1.2 million in FY 2004 vs. \$1.1 million in FY 2003; loan processing issuance fees, which were nearly unchanged at just under \$1.1 million (although the volume of loans processed increased, the fee paid to Guarantee Agencies to perform this service was reduced from 0.65% to 0.40% during FY 2004); and default aversion fees, which were down slightly in FY 2004 at \$460,000. Total interest income in the Operating Fund fell from approximately \$415,000 in FY 2003 to just over \$118,000 in the current period, and reflects a reduction of nearly \$165,000 for a decline in the market value of certain U. S. Treasury securities held at year-end. Reduced interest income is also the result of lower rates on the fixed-return securities which RIHEEA purchases.

Scholarship and Grant Division revenue was up from \$853,000 in FY 2003 to just over \$893,000 in FY 2004. These amounts represent the portion of the State appropriation allocated for operating expenses incurred in the administration of the State Scholarship/Grant program.

Operating Fund Expenses

Total expenses and transfers in the Operating Fund were just above \$12.3 million in FY 2004 as compared with \$9.3 million in FY 2003, an increase of \$3 million. Student financial assistance transfers from the RIHEST Administrative Fund to the Scholarship and Grant Fund increased from \$2.7 million in FY 2003 to almost \$3.3 million in FY 2004, and were allocated as follows: Academic Promise Scholarship Program (\$1,000,000); 5 and 10 Matching Grant Program (\$500,000); and supplemental funding for the State Scholarship/Grant Program (\$1,797,726). Personnel expense totaled just over \$2.6 million in the current year, approximately \$50,000 higher than FY 2003. Personnel expense was allocated as follows: approximately \$1.97 million in the Loan Division; just over \$592,000 in the Scholarship and Grant Division; and slightly more than \$41,000 in the RIHEST Administrative Fund. Commissions paid to collection agencies were just above \$2.3 million in FY 2004, more than double the prior year amount of \$1.1 million. In addition to commissions paid to collection vendors, a portfolio management fee of just over \$1 million was paid to Sallie Mae, up from the FY 2003 amount of \$200,000. The significant increases in these collection related expenses are the direct result of higher collection revenues. Fees paid to Sallie Mae for guarantee processing services were just under \$950,000 in FY 2004 vs. \$840,000 in FY 2003, and resulted from a larger volume of guarantee activity. Fees paid for default aversion and prevention activities were slightly less than \$360,000 in the current year vs. approximately \$395,000 in the previous year. The collection agency commissions, Sallie Mae fees and default aversion fees are all expenses of the Loan Division. Other operating expenses totaled just over \$1.7 million in the current year, an increase of about \$270,000 from FY 2003. Those expenses were approximately \$812,000 in the Loan Division, up from \$648,000 in the prior year, and just over \$298,000 in the Scholarship and Grant Division, vs. \$272,000 in FY 2003. In the RIHEST Administrative Fund, other expenses were just under \$629,000 in the current year as compared to \$550,000 in FY 2003, and include an expenditure of just over \$591,000 to support marketing of CollegeBound*fund* programs in the State of Rhode Island.

Scholarship and Grant Fund Revenues and Expenses

Total revenue and transfers into the Scholarship and Grant Fund totaled nearly \$14 million in FY 2004, vs. approximately \$8.2 million in FY 2003. These totals include the amounts transferred from the RIHEST Administrative Fund described in the previous section. Federal funding for the LEAP/SLEAP programs was over \$376,000, up from \$229,000 in FY 2003. The amount provided for Grant awards from State appropriations was increased to over \$10 million in FY 2004, almost double the amount provided in FY 2003. This significant increase was the result of an initiative taken by the Governor's Office and included in the FY 2004 State Budget. All revenues of the Scholarship and Grant Fund are disbursed to or for the benefit of qualifying, financially needy Rhode Island students.

Statement of Cash Flows

Cash and cash equivalents increased by \$112,000 during FY 2004, and totaled just over \$6.5 million at year-end, with virtually all of that balance in the Operating Fund. 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. RIHEAA's financing activities during FY 2004 included purchases of capital assets totaling nearly \$97,000 and transfers of more than \$605,000 from the Federal government for grants. Also included in financing activities is the State appropriation for the Scholarship and Grant Division of just over \$11 million. Investing activities reflect cash receipts of over \$8.8 million and cash outlays of nearly \$14.5 million. These transactions include maturities and purchases of U.S. Treasury securities, purchases and redemptions of Program Fund investments related to the Academic Promise Scholarship and 5 and 10 Matching Grant Programs, and interest income on investments.

Statements of Fiduciary Net Assets and Changes in Fiduciary Net Assets

The net assets of the Program Fund totaled nearly \$4.73 billion at June 30, 2004, compared with \$3.35 billion at the end of FY 2003, a net increase of over \$1.37 billion. The components of the net increase were: participant investments of nearly \$1.25 billion; investment income of over \$70 million; an increase of over \$490 million in the market value of investments held; expenses of just over \$23 million; and participant redemptions totaling over \$412 million. All of the net assets are held in trust for the participants in the program and the number of accounts grew from approximately 375,000 at the end of FY 2003 to over 429,000 at the end of FY 2004.

Total assets and liabilities of the Federal Student Loan Reserve Fund were just less than \$12.6 million at the end of FY 2004, down from \$13.3 million in the prior year. The decline is attributable to RIHEAA's waiver of guarantee fees on student loans (which resulted in savings of over \$2 million for RIHEAA's borrowers), declining interest income, and unreinsured loan expenses resulting from payments of claims on defaulted student loans. Despite this decline, RIHEAA's Federal Fund is still well above regulatory requirements, and RIHEAA management carefully monitors the status of the Federal Fund. Assets include nearly \$4.4 million in cash and cash equivalents, over \$6 million in U.S. Treasury securities, and a \$1.6 million reinsurance receivable from the Department of Education arising from claims paid to lenders. Among the liabilities of the Federal Fund are a \$2 million allowance for uninsured claims and federal recall of reserves payables of just over \$735,000. In addition, the Federal Fund reflects a liability to the Federal government of just over \$9.5 million. Although recorded as a liability in the audited financial statements, this amount substantively reflects the operating reserves of the Federal Fund, and is available for authorized expenditures.

Requests for Information

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

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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STATEMENT OF NET ASSETS - JUNE 30, 2004

	Operating Fund	Scholarship and Grant Fund	Totals
ASSETS:			
Current assets:			
Cash and cash equivalents	\$ 5,939,761	\$ 18,420	\$ 5,958,181
Investments		1,618,128	1,618,128
Receivables and accruals:			
Account maintenance fees	281,322		281,322
Interest	63,172		63,172
Loan processing issuance fee	29,357		29,357
Loans	40,100		40,100
Other	15,069		15,069
Due from Federal Student Loan Reserve Fund	318,282		318,282
Prepaid expenses	46,821		46,821
Total current assets	6,733,884	1,636,548	8,370,432
Noncurrent assets:			
Restricted cash and cash equivalents	548,051		548,051
Investments	14,019,393	1,721,717	15,741,110
Loans receivable, less current portion	345,867		345,867
Capital assets, less accumulated depreciation of \$1,411,960	1,497,884		1,497,884
Total noncurrent assets	16,411,195	1,721,717	18,132,912
Total assets	23,145,079	3,358,265	26,503,344

(continued)

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

STATEMENT OF NET ASSETS - JUNE 30, 2004 (CONTINUED)

	<u>Operating Fund</u>	<u>Scholarship and Grant Fund</u>	<u>Totals</u>
LIABILITIES:			
Current liabilities:			
Accounts payable	\$ 394,246		\$ 394,246
Payable to federal government		\$ 18,420	18,420
Allowance for default aversion fee returns	260,000		260,000
Compensated absences	94,000		94,000
	<u>748,246</u>	<u>18,420</u>	<u>766,666</u>
Total current liabilities			
Noncurrent liabilities:			
Compensated absences, less current portion	212,532		212,532
Allowance for default aversion fee returns, less current portion	313,000		313,000
Deferred default prevention income	372,199		372,199
	<u>897,731</u>		<u>897,731</u>
Total noncurrent liabilities			
	<u>1,645,977</u>	<u>18,420</u>	<u>1,664,397</u>
Total liabilities			
Contingencies and commitments (Notes 5, 6, 7 and 10)			
NET ASSETS (NOTE 11):			
Invested in capital assets	1,497,884		1,497,884
Restricted	15,244,942	3,339,845	18,584,787
Unrestricted	4,756,276		4,756,276
	<u>21,499,102</u>	<u>3,339,845</u>	<u>24,838,947</u>
Total net assets			

See notes to financial statements.

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

STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

YEAR ENDED JUNE 30, 2004

	Operating Fund	Scholarship and Grant Fund	Totals
Operating revenues:			
Fees:			
Default aversion, net	\$ 461,500		\$ 461,500
Loan processing issuance	1,085,890		1,085,890
Account maintenance	1,189,822		1,189,822
Recovery, consolidation and rehabilitation income, net	7,052,499		7,052,499
Program Fund administrative fees:			
Account maintenance	4,032,856		4,032,856
Direct purchase commissions	616,512		616,512
Other	871,480		871,480
Federal grants		\$ 376,272	376,272
Other	30,073		30,073
	15,340,632	376,272	15,716,904
Total operating revenues			
Operating expenses:			
Student financial assistance		12,885,872	12,885,872
Salaries, payroll taxes and employee benefits	2,603,630		2,603,630
Building and maintenance expenses	149,396		149,396
Collection agency fees	2,333,254		2,333,254
Computer services	87,587		87,587
Default aversion and prevention expenses	358,904		358,904
Depreciation and amortization	229,118		229,118
Marketing and promotion	591,266		591,266
Office expenses and other	242,444		242,444
Printing and postage	126,239		126,239
Professional services	184,893		184,893
Sallie Mae guarantee services fees	945,758		945,758
Sallie Mae portfolio management services	1,042,317		1,042,317
Travel, conferences and workshops	127,982		127,982
	9,022,788	12,885,872	21,908,660
Total operating expenses			
Operating income (loss)	6,317,844	(12,509,600)	(6,191,756)

(continued)

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

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

YEAR ENDED JUNE 30, 2004

	Operating Fund	Scholarship and Grant Fund	Totals
Nonoperating revenue:			
Alliance contract income	\$ 250,000		\$ 250,000
Investment income, interest	118,197	\$ 114,493	232,690
Rental income	124,578		124,578
State appropriations	893,247	10,158,200	11,051,447
Total nonoperating revenue	1,386,022	10,272,693	11,658,715
Income (loss) before transfers	7,703,866	(2,236,907)	5,466,959
Transfers for:			
Academic Promise Scholarship Program	(1,000,000)	1,000,000	- 0 -
5 and 10 Matching Grant Program	(500,000)	500,000	- 0 -
State grant program	(1,797,726)	1,797,726	- 0 -
Total transfers	(3,297,726)	3,297,726	- 0 -
Change in net assets	4,406,140	1,060,819	5,466,959
Net assets:			
Beginning of year	17,092,962	2,279,026	19,371,988
End of year	\$ 21,499,102	\$ 3,339,845	\$ 24,838,947

See notes to financial statements.

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

STATEMENT OF CASH FLOWS

PROPRIETARY FUNDS

YEAR ENDED JUNE 30, 2004

	Operating Fund	Scholarship and Grant Fund	Totals
Cash flows from operating activities:			
Cash received from:			
Alliance contract income	\$ 250,000		\$ 250,000
Program Fund fees	5,520,848		5,520,848
Government fees	2,736,903		2,736,903
Recovery, consolidation and rehabilitation income	6,900,765		6,900,765
Repayments of loans	159,195		159,195
Rental income	124,578		124,578
Cash paid for:			
Employees for services and benefits	(2,603,832)		(2,603,832)
Student financial assistance		\$ (12,870,852)	(12,870,852)
Supplies, materials and services	(6,033,477)		(6,033,477)
Net cash provided by (used in) operating activities	7,054,980	(12,870,852)	(5,815,872)
Cash flows from noncapital financing activities:			
Advance to (from) Scholarship and Grant Fund/Operating Fund	228,948	(228,948)	- 0 -
Operating transfer from Federal Student Loan Reserve Fund	2,902		2,902
Operating subsidies and transfers (to) from other funds	(3,297,726)	3,297,726	- 0 -
State appropriations	893,247	10,158,200	11,051,447
Federal grants		605,220	605,220
Net cash provided by (used in) noncapital financing activities	(2,172,629)	13,832,198	11,659,569
Cash used in capital and related financing activities, purchase of capital assets	(96,935)		(96,935)
Cash flows from investing activities:			
Purchases of investments	(12,957,630)	(1,500,000)	(14,457,630)
Proceeds from sales and maturities of investments	8,000,000	553,674	8,553,674
Interest received on investments	269,153		269,153
Net cash used in investing activities	(4,688,477)	(946,326)	(5,634,803)
Net increase in cash and cash equivalents	96,939	15,020	111,959
Cash and cash equivalents, beginning of year	6,390,873	3,400	6,394,273
Cash and cash equivalents, end of year	\$ 6,487,812	\$ 18,420	\$ 6,506,232

(continued)

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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STATEMENT OF CASH FLOWS (CONTINUED)

PROPRIETARY FUNDS (CONTINUED)

YEAR ENDED JUNE 30, 2004

	Operating Fund	Scholarship and Grant Fund	Totals
Reconciliation of operating income (loss) to net cash provided by (used in) operating activities:			
Operating income (loss)	\$ 6,317,844	\$ (12,509,600)	\$ (6,191,756)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:			
Federal grants		(376,272)	(376,272)
Alliance contract income	250,000		250,000
Rental income	124,578		124,578
Depreciation	229,118		229,118
Provision for default aversion fee refunds	230,500		230,500
Changes in assets and liabilities:			
Receivables and accruals:			
Account maintenance fees	(21,511)		(21,511)
Loan processing issuance fee	49,202		49,202
Loans	159,195		159,195
Other	5,909		5,909
Due from Federal Loan Reserve Fund	(187,716)		(187,716)
Prepaid expenses	(9,314)		(9,314)
Accounts payable	165,877		165,877
Payable to federal government		15,020	15,020
Allowance for default aversion fee returns	(258,500)		(258,500)
Compensated absences	(202)		(202)
	\$ 7,054,980	\$ (12,870,852)	\$ (5,815,872)
Net cash provided by (used in) operating activities	\$ 7,054,980	\$ (12,870,852)	\$ (5,815,872)

See notes to financial statements.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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STATEMENT OF FIDUCIARY NET ASSETS

FIDUCIARY FUNDS

JUNE 30, 2004

	Tuition Savings Program Fund	Federal Student Loan Reserve Fund
ASSETS:		
Cash and cash equivalents	\$ 1,695,173	\$ 4,393,401
Investments	4,726,653,755	6,025,010
Receivables:		
Units sold	3,604,524	
Investments sold	521,063	
Reinsurance claims, federal government		1,581,732
Default aversion fee returns		573,000
Interest and dividends	1,323,368	9,844
Other	65,392	
	4,733,863,275	\$ 12,582,987
Total assets		
LIABILITIES:		
Accounts payable:		
Investments purchased and units redeemed	2,830,205	
Other	3,113,246	\$ 2,019
Payable to Operating Fund		318,282
Allowance for uninsured claims		2,000,000
Federal recall reserve payable		736,637
Due to the federal government		9,526,049
	5,943,451	\$ 12,582,987
Total liabilities		
NET ASSETS:		
Held in trust for participants	\$ 4,727,919,824	

See notes to financial statements.

RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS

TRUST FUND – TUITION SAVINGS PROGRAM FUND

YEAR ENDED JUNE 30, 2004

From operations:	
Investment income	<u>\$ 70,402,973</u>
Net increase in fair value of investments	<u>490,149,102</u>
Expenses:	
Asset based charges	22,640,832
Management fees	<u>372,130</u>
	<u>23,012,962</u>
Net increase in net assets from operations	<u>537,539,113</u>
From unitholder transactions:	
Subscriptions	1,247,225,936
Redemptions	<u>(412,026,755)</u>
Net increase in net assets from unitholder transactions	<u>835,199,181</u>
Net increase in net assets	1,372,738,294
Net assets held in trust for participants, beginning of year	<u>3,355,181,530</u>
Net assets held in trust for participants, end of year	<u><u>\$ 4,727,919,824</u></u>

See notes to financial statements.

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

NOTES TO FINANCIAL STATEMENTS

YEAR ENDED JUNE 30, 2004

1. Description of organization and summary of significant accounting policies:

Organization:

Rhode Island Higher Education Assistance Authority:

The Rhode Island Higher Education Assistance Authority (the Authority) is a public corporation established July 1, 1977 by an Act of the Rhode Island General Assembly. It is a component unit of the State of Rhode Island (the State) for financial reporting purposes and as such, the financial statements of the Authority will be included in the State's comprehensive annual financial report. The Authority was created for the dual purpose of guaranteeing loans to students in eligible institutions and administering other programs of post secondary student financial assistance assigned by law to the Authority.

The Authority is exempt from federal, state and local income taxes.

External Investment Pool, 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), Rhode Island's IRS Section 529 qualified state tuition savings program, which holds participant assets as a private purpose trust fund, and an Administrative Fund (included in the Operating Fund.) The Program Fund is available for families to save and invest for qualified higher education expenses and the investment policies are established by the Rhode Island State Investment Commission (SIC) and the Authority. The Program Fund is managed by an independent contractor under the supervision of the SIC and the Authority.

RIHEST is exempt from federal and state income taxes. Earnings on investments are tax free for both federal and state tax purposes provided the earnings are withdrawn for qualified higher education expenses.

Reporting entity:

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

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

YEAR ENDED JUNE 30, 2004

1. Description of organization and summary of significant accounting policies (continued):

Reporting entity (continued):

The Authority administers an agency fund on behalf of the federal government, the Federal Student Loan Reserve Fund (Federal Fund). Under the 1998 reauthorization of the Higher Education Act, guaranty agencies were required to establish a Federal Fund, effective October 1, 1998. The sources of revenue for the Federal Fund include principally guarantee fees, reinsurance received for lender claims paid, and income from investments. Effective May 2002, the Authority's Board of Directors voted to allow the Authority to waive guarantee fees on new loans. Assets and liabilities of the Federal Fund are those of the U.S. Department of Education (DOE). This fund can be used only to pay lender claims and to pay the Agency Operating Fund for default prevention activities, unless otherwise directed by the DOE.

Financial statement presentation, measurement focus and basis of accounting:

The Authority engages only in business-type activities. Business-type activities are activities that are financed in whole or in part by fees charged to external users.

The Authority uses the economic resources measurement focus and accrual basis of accounting. The Authority applies all pronouncements of the GASB, as well as Financial Accounting Standards Board (FASB) Statements and Interpretations, Accounting Principles Board Opinions, and Accounting Research Bulletins of the Committee on Accounting Procedure issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. In accordance with GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting," the Authority has elected not to apply any FASB pronouncements and interpretations issued after November 30, 1989.

The Authority distinguishes between operating and nonoperating revenues and expenses. Operating revenues and expenses generally result from providing services in connection with the Authority's principal ongoing operations. Operating expenses include the cost of and losses resulting from services provided, administrative expenses, and depreciation expense. All other revenues and expenses are reported as nonoperating revenues and expenses.

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

YEAR ENDED JUNE 30, 2004

1. Description of organization and summary of significant accounting policies (continued):

Nature of funds:

Operating Fund:

This fund accounts for all transactions relating to a) the Authority's Agency Operating Fund, which principally administers the activities as a State guaranty agency for the Federal Family Education Loan (FFEL) Program, b) the Authority's administration of scholarships and grants on behalf of the federal government and the State (the Scholarship and Grant Operating Fund), and c) the Authority's administration of the RIHEST Program Fund.

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 loan processing issuance fees, default aversion fees, and account maintenance fees); b) recovery, consolidation and rehabilitation income earned as a result of collection and consolidation of previously defaulted loans; c) a state appropriation for administering its grant and scholarship programs; and d) fees and commissions earned from administering the RIHEST Program Fund (such as account maintenance fees and direct purchase commissions).

Scholarship and Grant Fund:

This fund accounts for the activity of several separate grant and scholarship programs administered on behalf of the federal government, the State, the New England Board of Higher Education and the Authority's Academic Promise Scholarship and 5 and 10 Matching Grant Programs.

Scholarship and grant programs administered on behalf of the federal government require the State to match federal amounts in the form of a minimum maintenance of effort level. The programs are Leveraging Educational Assistance Partnership (LEAP) and Special Leveraging Educational Assistance Partnership (SLEAP).

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

YEAR ENDED JUNE 30, 2004

1. Description of organization and summary of significant accounting policies (continued):

Nature of funds (continued):

Scholarship and Grant Fund (continued):

The Authority operates the Academic Promise Scholarship and the 5 and 10 Matching Grant Programs. These programs are funded with RIHEST management fees as transfers from the Operating Fund. Under the Academic Promise Scholarship Program, the Authority invests up to \$1,000,000 annually in the Program Fund for the benefit of 100 academic and income-qualifying students to provide up to \$10,000 to each student over a four-year scholarship period. Under the 5 and 10 Matching Grant Program, the Authority makes 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. The Academic Promise and 5 and 10 Matching Grant Programs are subject to certain conditions and limitations including but not limited to income eligibility, scholastic performance, and contribution and withdrawal restrictions.

Also included in this fund is 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 Authority makes an annual contribution for Rhode Island's participation in the program. This program is sponsored by the New England Board of Higher Education.

Also included in this fund is the employment and student services fund. The employment and student services fund accounts for all transactions regarding work opportunity programs whereby the Authority acts as a liaison between participating students and organizations, placing students in nonprofit or governmental agencies. Funds received from participating organizations are restricted for work-study expenses only.

Significant accounting policies:

Use of estimates:

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

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

YEAR ENDED JUNE 30, 2004

1. Description of organization and summary of significant accounting policies (continued):

Significant accounting policies (continued):

Cash and cash equivalents:

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

Under the "Rhode Island Collateralization of Public Deposits Act," 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 one hundred percent of time deposits with maturities greater than sixty days. Any of these institutions which do not meet minimum capital standards prescribed by federal regulators shall insure or pledge eligible collateral equal to one hundred percent of deposits, regardless of maturity. None of the Authority's deposits were required to be collateralized at June 30, 2004.

Investments:

Investments of the Operating Fund include U.S. Treasury Bills, U.S. Treasury Notes, U.S. Agency collateralized obligations and deposits in Alliance Capital 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 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. The Authority's Operating Fund investments are classified as noncurrent, as it is management's intention to hold the notes and bills until maturity, and reinvest maturities due in one year or less.

Investments in the Program Fund have been classified as current or noncurrent based upon their intended date of withdrawal.

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

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

YEAR ENDED JUNE 30, 2004

1. Description of organization and summary of significant accounting policies (continued):

Significant accounting policies (continued):

Restricted cash and cash equivalents:

Restricted cash and cash equivalents includes escrow deposits with a financial institution under an agreement with the SLM Corporation (Sallie Mae) as collateral for certain loans, and deposits associated with the Department of Education's recall from the Federal Student Loan Reserve Fund, which funds are to be used specifically for default prevention activities.

Capital assets, and depreciation and amortization:

Capital assets are stated at cost. The Authority provides for depreciation and amortization using the straight-line method over the estimated useful lives of the assets.

Compensated absences:

Authority employees receive vacation time under a union contract based upon their years of service. This time may be carried over from one calendar year to another, not to exceed the amount of 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 full-time 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 three components in accordance with GASB Statement No. 34:

Invested in capital assets - represents the net book value of all capital assets less the outstanding balances of bonds and other debt used to acquire, construct or improve these assets.

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

YEAR ENDED JUNE 30, 2004

1. Description of organization and summary of significant accounting policies (continued):

Significant accounting policies (continued):

Net assets (continued):

Restricted - those that have been limited to uses specified either externally by creditors, contributors, laws or regulations of other governments or internally by enabling legislation or law.

Under the 1998 reauthorization of the Higher Education Act, the Agency Operating Fund's net assets shall be used for application processing, loan disbursement, enrollment and repayment status management, default aversion activities, default collection activities, school and lending training, financial aid awareness and related outreach activities, compliance monitoring, and other student financial aid related activities. Therefore, the Operating Fund's net assets relating to the Agency Operating Fund, in the amount of \$15,244,942, are classified as restricted. Also, the Scholarship and Grant Fund's net assets invested in the Program Fund, in the amount of \$3,339,845, for the Academic Promise Scholarship and 5 and 10 Matching Grant Programs are classified as restricted.

Unrestricted - a residual category for the balance of net assets, all of which has been designated for specific purposes by the Authority's Board of Directors (see Note 11).

Revenue from grants and appropriations:

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

Retirement and postretirement healthcare benefit plans:

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

2. Cash, cash equivalents and investments:

Cash and cash equivalents:

The Authority assumes levels of custodial credit risk for its cash and cash equivalents, which are categorized to indicate the level of risk assumed by the Authority. Category 1 includes deposits that are fully insured or collateralized with securities held by the Authority or its agent in the Authority's name. Category 2 includes deposits that are collateralized with securities held by the pledging financial institution's trust department or agent in the Authority's name. Category 3 includes those deposits that are not collateralized.

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

YEAR ENDED JUNE 30, 2004

2. Cash, cash equivalents and investments (continued):

Cash and cash equivalents (continued):

At June 30, 2004, the Authority's cash and cash equivalents consist of and are categorized as follows:

	Category			Not categorized	Total deposit balance	Carrying amount
	1	2	3			
Proprietary funds:						
Demand deposits	\$ 112,448		\$ 75,852		\$ 188,300	\$ 17,828
Repurchase agreements		\$ 876,231			876,231	876,231
Treasury Cash Fund		372,199			372,199	372,199
Deposits with:						
State's general treasury			278,949		278,949	278,949
Alliance Capital				\$ 4,961,025	4,961,025	4,961,025
Total proprietary	<u>112,448</u>	<u>1,248,430</u>	<u>354,801</u>	<u>4,961,025</u>	<u>6,676,704</u>	<u>6,506,232</u>
Fiduciary funds:						
Demand deposits	87,552		50,405		137,957	(475,018)
Repurchase agreements		4,868,419			4,868,419	4,868,419
Deposits with State Street Bank (A)				1,695,173	1,695,173	1,695,173
Total fiduciary	<u>87,552</u>	<u>4,868,419</u>	<u>50,405</u>	<u>1,695,173</u>	<u>6,701,549</u>	<u>6,088,574</u>
Total	<u>\$ 200,000</u>	<u>\$ 6,116,849</u>	<u>\$ 405,206</u>	<u>\$ 6,656,198</u>	<u>\$ 13,378,253</u>	<u>\$ 12,594,806</u>

(A) State Street Bank is Alliance Capital's custodian for the Program Fund daily cash deposits. It is impracticable to determine the amount of deposits that are insured or collateralized.

Restricted cash and cash equivalents includes an escrow deposit of \$175,852 as collateral for loans sold to Sallie Mae (see Note 4), and deposits of \$372,199 restricted for use in default prevention activities (see Note 5).

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

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

2. Cash, cash equivalents and investments (continued):

Investments:

The General Laws of the State of Rhode Island authorize the Authority to invest in low-risk securities, such as obligations issued by the United States or a state. Investments are categorized in accordance with the level of risk assumed. Category 1 includes investments that are insured or registered or for which the securities are held by the Authority or its agent in the Authority's name. Category 2 includes investments that are uninsured and unregistered for which the securities are held by the counterparty's trust department or agent in the Authority's name. Category 3 includes uninsured and unregistered investments for which securities are held by the counterparty or by its trust department or agent but not in the Authority's name.

The Authority's investments consist of the following:

	Category 1	Not categorized	Fair value
<i>Proprietary funds:</i>			
U.S. Treasury Notes	\$ 10,983,190		\$ 11,033,125
U.S. Treasury Bills	2,983,929		2,983,929 (B)
U.S. Agency collateralized mortgage obligations	2,339		2,339
Restricted investments, Alliance Capital Principal Protection Income Fund		\$ 3,339,845	3,339,845
Total proprietary	13,969,458	3,339,845	17,359,238
<i>Fiduciary funds:</i>			
U.S. Treasury Notes	2,995,770		3,033,437
U.S. Treasury Bills	2,991,573		2,991,573 (B)
Alliance Capital Funds		4,280,522,294	4,726,653,755
Total fiduciary funds	5,987,343	4,280,522,294	4,732,678,765
Total	\$ 19,956,801	\$ 4,283,862,139	\$ 4,750,038,003

The Operating Fund's treasury investments mature as follows:

One year or less	\$ 6,000,000
Over one year	8,000,000
	\$ 14,000,000

(B) It is impracticable to determine the fair value of the U.S. Treasury Bills. However, management estimates that the reported amount approximates the fair value.

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

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

3. Capital assets:

	Beginning balance	Increases	Decreases	Ending balance
Capital assets not being depreciated, land	\$ 194,096			\$ 194,096
Capital assets being depreciated or amortized:				
Land improvements	37,030		\$ (8,206)	28,824
Building and improvements	2,138,415	\$ 13,240	(202,233)	1,949,422
Equipment	846,276	20,670	(505,269)	361,677
Web-based program	312,800	63,025	- 0 -	375,825
Total capital assets being depreciated or amortized	3,334,521	96,935	(715,708)	2,715,748
Less accumulated depreciation and amortization for:				
Land improvements	(23,339)	(960)	8,206	(16,093)
Building and improvements	(1,250,395)	(68,548)	202,233	(1,116,710)
Equipment	(624,816)	(84,445)	505,269	(203,992)
Web-based program	-	(75,165)	- 0 -	(75,165)
Total accumulated depreciation and amortization	(1,898,550)	(229,118)	715,708	(1,411,960)
Total capital assets being depreciated or amortized, net	1,435,971	(132,183)	- 0 -	1,303,788
Total capital assets, net	\$ 1,630,067	\$ (132,183)	\$ - 0 -	\$ 1,497,884

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

YEAR ENDED JUNE 30, 2004

4. Loans receivable:

The Authority operates loan programs directed toward students in graduate studies in health-related professions. As of June 30, 2004, the outstanding loan balances total \$385,967, of which \$168,690 is guaranteed by the federal government.

Certain loans, totaling \$112,000, contain provisions whereby up to 75% of the original loan balance may be forgiven if the borrowers work in or for the State for a specified period of time. These loans do not bear interest until they enter the repayment phase, which begins nine months after graduation or after the students complete the conditions for forgiveness. Students may also get up to a four-year deferment of principal and interest for being enrolled in internship or residency programs. Loan forgiveness is recorded in the Scholarship and Grant Operating Fund in the period in which the conditions are satisfied by the borrowers. During 2004, no loans were forgiven.

During 1987, Sallie Mae purchased from the Authority certain loans that were not guaranteed by the federal government. Under the agreements with Sallie Mae, 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 (approximately \$141,000 principal balance was outstanding at June 30, 2004).

5. Contingencies and commitments:

Federal audits:

Under the reinsurance agreement with the federal government, the Authority's accounting records are subject to review and audit by the federal government. Such audits could lead to requests for reimbursement if terms of the various programs and agreements are not met. During 1997, the DOE completed a review of the Agency Operating Fund's activities and reports submitted to it. The DOE's report of findings and observations required the Authority to respond to three findings related to the FFEL Program and related FFEL reserves. During 1998, the Authority responded to one of the findings, which required the return of certain consolidation recoveries. The DOE has not commented on the Authority's response or the amount calculated and returned. The Authority has incorporated its response to the other two findings within its proposal submitted to the DOE, as discussed in the following section; "Establishment of Federal Student Loan Reserve Fund."

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NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

5. Contingencies and commitments (continued):

Establishment of Federal Student Loan Reserve Fund:

Under the 1998 reauthorization of the Higher Education Act, guaranty agencies were required to establish the Federal Fund, effective October 1, 1998. Therefore, the Authority was required to determine and separate Federal Fund assets and liabilities from assets and liabilities from other sources, principally the State. The Authority has calculated the cash and investments attributable to State contributions plus an allocation of investment activity through October 1, 1998. In addition, the Authority's management believes its building and loans receivable (see Note 4) should also be property of the Authority because of the timing of their acquisition and the provisions of certain enacted laws of the Higher Education Act.

Accordingly, effective October 1, 1998, the Authority included within the Agency Operating Fund the calculated amount of cash and investments attributable to State contributions, the building and loans receivable. All other assets and liabilities were transferred to the Federal Fund. The Authority has provided the DOE with a proposal which includes this separation of the funds, and incorporated the resolution of the pending findings discussed in the previous section, "Federal audits." The Authority's proposal provided for, among other provisions, the transfer of approximately \$2,314,000 to the Federal Fund for the building and loans receivable. Discussions with the DOE are ongoing and management believes a settlement of outstanding issues is reasonably possible. Management believes that a settlement would result in a transfer of assets from the Agency Operating Fund to the Federal Fund. However, management is unable to estimate with certainty whether the DOE will accept the Authority's settlement proposal, or the amount of any potential changes to the proposal. It is at least reasonably possible that the separation of assets and liabilities between the Federal Fund and Agency Operating Fund could change within the near term, and the change could be material to the financial statements.

United States Department of Education:

Preservation and recovery of reserves:

The Secretary of the DOE 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.

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

YEAR ENDED JUNE 30, 2004

5. Contingencies and commitments (continued):

United States Department of Education (continued):

Preservation and recovery of reserves (continued):

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.

In addition, the 1998 reauthorization of the Higher Education Act requires the Secretary's recall of \$250 million from guaranty agencies. The Authority's share of this recall amount, totaling \$1,116,117, is 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 is payable in three installments. At June 30, 2004, the remaining amount outstanding and recorded in the Federal Fund, totaling \$736,637, is payable in two installments of \$368,319 and \$368,318 on September 1, 2006 and 2007, respectively.

Reserve Fund requirements:

The DOE has established guidelines for guaranty agency Federal Student Loan Reserve Funds to assist in determining an agency's ability to meet its guarantor obligations. Under these guidelines, the minimum reserve fund requirement is .25% of outstanding loans guaranteed. As of June 30, 2004, the Authority has guaranteed outstanding loans totaling \$1,165,493,509.

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 year ended June 30, 2004 and the Authority has not exceeded the 5% reinsurance trigger.

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

YEAR ENDED JUNE 30, 2004

5. Contingencies and commitments (continued):

Rental revenue:

The Authority rents a portion of the first floor and the entire second floor of its building to various tenants under leases which expired in 2004. The lease arrangements are continuing on a month-to-month basis and the Authority expects to extend the lease arrangements under similar terms.

Systems services agreement:

The Authority has an agreement for computer system services with Sallie Mae Guarantee Services. The agreement expires September 30, 2005 and has a two-year automatic renewal expiring through September 30, 2007. The Authority may cancel the Agreement with 180 days notice. The agreement provides for base fees plus .30% of the amount of annual loan applications processed in excess of \$100 million excluding consolidated loans, and specified fees for certain administrative services provided to the Authority on an as requested basis. For 2004, the fees to Sallie Mae Guarantee Services amounted to \$945,758.

Under the same agreement, Sallie Mae Guarantee Services provides portfolio management service to the Authority for defaulted loans outsourced for collection. For 2004, the fees to Sallie Mae Guarantee Services for management of defaulted loans amounted to \$1,042,317. Also, the Authority receives a portion of the collections managed by Sallie Mae Guarantee Services. The Authority receives guaranteed annual net revenue from collections managed by Sallie Mae Guarantee Services of 2.25% of the dollar amount of the defaulted portfolio placed with Sallie Mae Guarantee Services, plus a percentage of collections above certain minimum levels. Collections received by the Authority through Sallie Mae Guarantee Services are included in recovery income.

In the event the Authority should cancel the portfolio management services, the agreement provides for increases in the base fees, a .35% fee on all consolidated loans, and a .40% fee on all other loans in excess of \$100 million processed thereafter.

Default aversion and prevention services agreements:

The Authority has an agreement, which expires in March 2005, for default aversion services with OSI Education Services, Inc. (OSI) which provides for a .59% fee to be paid to OSI for each loan brought to current status within the specifications of the agreement. For 2004, the fees to OSI amounted to \$358,904.

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

YEAR ENDED JUNE 30, 2004

5. Contingencies and commitments (continued):

Tuition Savings Program Management Agreement:

The Authority has an agreement with Alliance Capital Management, L.P. (Alliance) for the management and promotion of the Tuition Savings Program. The agreement has an initial term expiring June 30, 2005, and provides for an additional five year term through June 30, 2010. The agreement provides for a management fee payable from the Program Fund assets to Alliance from the assets under management. The RIHEST Administrative Fund receives account maintenance, direct commission and other fees from the Program Fund. The RIHEST administrative income, totaling \$5,520,848, is recorded in the Operating Fund. In addition, the Authority receives \$250,000 annually (in quarterly installments) from Alliance which is recorded as nonoperating income in the Operating Fund.

Under the agreement with Alliance, Alliance has committed to spend \$600,000 annually through the initial term ending June 2005 for the marketing and promotion of the Tuition Savings Program in the State of Rhode Island and the Authority provides additional funds to supplement the marketing and promotion. During 2004, the Authority paid to Alliance additional funds of \$559,158 under the agreement for the marketing and promotion expenses. For 2005, the Authority has authorized additional funds up to \$600,000 for marketing and promotion expenses.

6. Operating Fund revenues:

Default aversion fees:

The 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 lender request for assistance is received. If a default aversion fee is received on a loan and the loan subsequently defaults, the default aversion fee must be returned to the Federal Fund.

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

YEAR ENDED JUNE 30, 2004

6. Operating Fund revenues (continued):

Default aversion fees (continued):

There is limited historical and projected information available for the evaluation of the provision for fee returns. Management has been working with the Authority's service provider to calculate a provision for fee returns and develop a means to track and evaluate future activity. The Authority records a provision for fee returns at approximately 33% of fee income, which is management's best estimate of potential fee returns based on the information that is available. Consequently, it is at least reasonably possible that this estimate could change in the near term and the change could be material to the financial statements. The 2004 default aversion fees are recorded net of a \$230,500 provision for returns, and the allowance for fee returns as of June 30, 2004 is \$573,000.

Loan processing issuance fees:

The Authority receives a loan processing and issuance fee (LPIF) from the DOE equal to .65% of the total loans disbursed (excluding consolidations) through September 30, 2003 and .40% of the total loans disbursed thereafter.

Account maintenance fee:

The Authority receives an account maintenance fee (AMF) from the DOE equal to .10% of the original principal balance of guaranteed loans outstanding.

7. Reinsurance triggers and reserve for uninsured claims:

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 agreement with the federal government, the federal government reimburses guaranty agencies for a percentage of amounts expended in the discharge of its guarantor obligations. The agreement contains certain annual limitations, commonly referred to as the "reinsurance trigger," which could reduce the reinsurance amount during the remainder of any federal fiscal year.

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

NOTES TO FINANCIAL STATEMENTS (CONTINUED)

YEAR ENDED JUNE 30, 2004

7. Reinsurance triggers and reserve for uninsured claims (continued):

The "reinsurance trigger" clause provides that whenever default claims in any federal fiscal year exceed 5% and 9% of the insured loans that were in repayment at the end of the previous federal fiscal year, the amount of reinsurance for loans disbursed prior to October 1, 1993 will drop from 100% to 90% and 80%, respectively, of the default claims for the balance of the federal fiscal year. 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, 2004, the Authority charged operations of the Federal Fund with \$1,750,674 pursuant to the above provisions and as of June 30, 2004, the allowance for uninsured claims totals \$2,000,000. During the year ended June 30, 2004, claims totaling \$950,674 were paid and charged against the allowance.

Based upon the Authority's past experience, management does not expect to reach the "reinsurance triggers" that would reduce its reimbursement below 100%, 98% and 95%. Accordingly, the provision for uninsured claims is based on estimated defaults in excess of the 100%, 98% and 95% reinsurance provisions.

8. 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, 2004 were as follows:

Guaranteed loans outstanding at June 30, 2004	\$ 576,245,000
Loans guaranteed during the year	260,851,000
Guarantee claims paid during the year	21,390,000
Rental income received during the year	92,000

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

YEAR ENDED JUNE 30, 2004

9. Retirement plan:

Substantially all full-time permanent employees of the Authority participate in the Employees' Retirement System of the State of Rhode Island (the System), a cost-sharing, multiple-employer public retirement system. Employees who retire at age 60 or older with 10 years of credited service (at any age with 28 years of credited service) are entitled to a retirement benefit. The benefit is calculated using the number of years of service and the employee's average salary based on the three highest consecutive years of earned salary. Benefits fully vest upon reaching 10 years of service and equal 1.7% of average salary for the first 10 years of service accruing to a maximum rate of 80% of average salary after 35 years of service. The System also provides for death and disability benefits. The System issues a publicly available financial report that includes financial statements and required supplementary information for the State. That report may be obtained by writing to Employees' Retirement System of the State of Rhode Island, 40 Fountain Street, Providence, Rhode Island 02903.

Payroll of the Authority's employees covered by the System was \$1,803,233 in 2004. For the fiscal year ended June 30, 2004, the Authority's actuarially computed contribution rate to the System was 9.6% of annual covered payroll. The employees' contribution rate is 8.75% of their annual covered salary. Employees contributed approximately \$145,000 in 2004. The Authority's contributions for the years ended June 30, 2004, 2003 and 2002 were approximately \$160,000, \$135,000 and \$100,000, respectively, equal to the required contributions for each year.

10. Postretirement healthcare benefits plan:

In accordance with the General Laws of the State of Rhode Island, postretirement healthcare benefits are provided to all state employees who retire on or after July 1, 1989. The benefits, in general, cover medical and hospitalization costs for pre-Medicare retirees and a Medicare supplement for Medicare-eligible retirees. The State is required to pay a portion of the monthly premium. This payment varies with years of service and ranges from 50% for retirees with 10-15 years of service to 100% for retirees with 35 years or more of service. During fiscal year 1999, the period covered by the most recent financial report on the System, the State was required to fund the program at a rate of approximately .98% of active member state employees' payroll (exclusive of overtime). A required actuarial valuation of the plan has been performed; however, significant assumptions and funding options have not been adopted.

The cumulative cost of the postretirement healthcare benefits is not available to the Authority. The State Controller is currently analyzing all related transactions occurring since inception of the plan to determine the financial status of the postretirement healthcare benefits plan.

The Authority contributed approximately \$22,000 to the plan during 2004.

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

YEAR ENDED JUNE 30, 2004

11. Net assets:

At June 30, 2004, restricted net assets consist of the following:

Academic Promise Scholarship Program	\$ 2,471,717
5 and 10 Matching Grant Program	868,128
Agency Operating Fund FFEL Program	<u>15,244,942</u>
Total restricted	<u>\$ 18,584,787</u>

At June 30, 2004, unrestricted net assets consist of the following:

Designation of unrestricted net assets for Program Fund Administration and Student Financial Assistance Programs	<u>\$ 4,756,276</u>
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Lefkowitz, Garfinkel, Champi & DeRienzo P.C.
Certified Public Accountants / Business Consultants

Principals
Jerome L. Lefkowitz, CPA
Stephen M. Garfinkel, CPA
Frank J. Champi, CPA
Richard J. DeRienzo, CPA
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Peter Mezei, CPA
Stephen W. Geremia, CPA
Susan R. Johnson, CPA
Michael E. Criscione, CPA
John E. Finnerty, Jr., CPA

Independent Auditors' Report on Accompanying Information

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

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Authority's basic financial statements. The supplementary schedules contained on pages 36 through 41 are presented for additional analysis as required by the State of Rhode Island, and are not a required part of the basic financial statements. These schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the inclusion of certain capital assets and loans receivable in the Operating Fund, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

September 24, 2004

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

SCHEDULE OF AGENCY OPERATING FUND TRAVEL EXPENSES

YEAR ENDED JUNE 30, 2004

Payee	Purpose of travel	Airfare	Lodging	Meals	Automobile and other	
American Express	W. Hurry – MYF/Meteor Project Meeting		\$ 618			
	W. Hurry – NCHELP CEOs		305			
	T. Tedeschi – NCHELP Debt Meeting		496			
	T. Tedeschi – OSI Meeting	\$ 255				
	N. Dooley – OSI Meeting	255				
	C. Miller – MYF/Meteor Project Meeting		618		\$ 207	
	C. Miller – Meteor Project Meeting	1,100	722		313	
	N. Dooley – SLMA Training		289			
Diane Carlin	D. Carlin – NCHELP Training	414				
American Express	W. Hurry – NCHELP Meeting	274				
	W. Hurry – NCHELP CEOs		262			
American Express	C. Miller – NCHELP Meeting	279				
	W. Hurry – NCHELP Meeting		498		278	
	W. Hurry – SLMA Meeting	388				
	T. Tedeschi – NCHELP Debt Meeting	578				
	T. Tedeschi – NCHELP Training	723				
	C. Miller – PESC Meeting	528				
	C. Miller – Meteor Project/NCHELP Meeting		830			
	N. Dooley – NCHELP Meeting		332			
	N. Dooley – NCHELP Training	433				
	M. Lacroix – NCHELP Meeting		504			
	G. Mance-Rios – NASSGAP Conference	268				
	American Express	W. Hurry – NCHELP CEOs	373	319		
		C. Miller – PESC Meeting		431		
C. Miller – DE Meeting		574	751			
C. Miller – DE Meeting		496				
C. Miller – NCHELP Training		875				
	N. Dooley – NCHELP Training	384				

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RHODE ISLAND HIGHER EDUCATION ASSISTANCE AUTHORITY
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SCHEDULE OF AGENCY OPERATING FUND TRAVEL EXPENSES (CONTINUED)

YEAR ENDED JUNE 30, 2004

Payee	Purpose of travel	Airfare	Lodging	Meals	Automobile and other
Gail Mance-Rios	G. Mance-Rios – NASSGAP Conference		\$ 376		
Diane Carlin	D. Carlin – NCHELP Training		841		
American Express	W. Hurry – NCHELP Training	\$ 1,058			
	W. Hurry – College Ready		264		
	W. Hurry – SLMA Meeting	448			
	W. Hurry – NCHELP CEOs	773			
	W. Hurry – NCHELP Meeting	235			
	T. Tedeschi – NCHELP Training		336		
	T. Tedeschi – SLMA Meeting	468			
	C. Miller – Meteor Project Meeting		452		
	C. Miller – NCHELP Training		504		\$ 287
	C. Miller – DE Meeting		449		
	N. Dooley – NCHELP Training		504		
	N. Dooley – DE Meeting	426			
	N. Dooley – SLMA Meeting	567			
	M. Lacroix – NCHELP Meeting	362			
	G. Silva – NCHELP Training		208		
American Express	W. Hurry – SLMA Meeting		553		
	T. Tedeschi – SLMA Meeting		347		
	C. Miller – NCHELP Meeting	442			
	N. Dooley – SLMA Meeting		520		
	G. Silva – MYF Meeting	303			
Gail Mance-Rios	G. Mance-Rios – SLMA Meeting		520		
Greg Silva	G. Silva – MYF Meeting		265		
Marguerite Cote	M. Cote – Network Training		278		
American Express	W. Hurry – NCHELP Meeting	580	718		265
	W. Hurry – NCHELP Meeting		899		269
	W. Hurry – NCHELP CEOs		319		
	W. Hurry – SLMA Meeting	265			

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

SCHEDULE OF AGENCY OPERATING FUND TRAVEL EXPENSES (CONTINUED)

YEAR ENDED JUNE 30, 2004

Payee	Purpose of travel	Airfare	Lodging	Meals	Automobile and other
American Express	W. Hurry – Meteor Project Meeting	\$ 265			
	T. Tedeschi – NCHELP Debt Meeting	429			
	C. Miller – NCHELP Meeting		\$ 675		
	C. Miller – Meteor Project Meeting		398		
	C. Miller – Meteor Project Meeting	305			
	G. Silva – ELM Conference	352			
American Express	W. Hurry – NCHELP Meeting	347			
	W. Hurry – SLMA Meeting		884		
	W. Hurry – Meteor Project Meeting		521		
	C. Miller – Meteor Project Meeting		695		
	C. Miller – Meteor Project Meeting	299			
	C. Miller – Meteor Project Meeting	365			
	C. Miller – NCHELP Meeting	267			
	N. Dooley – NCHELP Meeting	851			
	N. Dooley – SLMA Meeting	1,342	217		
	D. Carlin – NCHELP Meeting	851			
Greg Silva	G. Silva – ELM Conference		356		
William Hurry	W. Hurry – SLMA Meeting		295		
Kim Cournoyer	K. Cournoyer – TechMentor Conference	342	776		\$ 247
American Express	W. Hurry – NCHELP Legal Meeting	710	906		293
	W. Hurry – NCHELP Meeting		634		349
	W. Hurry – NCHELP CEOs		319		
	T. Tedeschi – NCHELP Debt Meeting		475		
	N. Dooley – NCHELP Meeting		634		
	D. Carlin – NCHELP Meeting		634		
Diane Carlin	D. Carlin – ELM Meeting	353	356		
American Express	W. Hurry – PESC Meeting		589	\$ 333	
	C. Miller – PESC Meeting		927		
	C. Miller – Meteor Project Meeting		522		

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

SCHEDULE OF AGENCY OPERATING FUND TRAVEL EXPENSES (CONTINUED)

YEAR ENDED JUNE 30, 2004

Payee	Purpose of travel	Airfare	Lodging	Meals	Automobile and other
American Express	C. Miller – DE Meeting		\$ 344		
	M. Lacroix – Accounting Seminar		258		
American Express	W. Hurry – NCHELP Meeting		337		
	W. Hurry – NCHELP Meeting		659		\$ 309
	T. Tedeschi – NCHELP Debt Meeting	\$ 239			
	C. Miller – NCHELP Meeting		1,318		
	M. Lacroix – NCHELP Meeting		659	\$ 310	
	G. Mance-Rios – NCHELP Meeting		659		
Gail Mance-Rios	G. Mance-Rios – NCHELP Meeting	288			
	W. Hurry – NCHELP Meeting	301			
	C. Miller – Meteor Project Meeting	467	428		
Amounts less than \$200		<u>4,276</u>	<u>4,619</u>	<u>10,024</u>	<u>10,030</u>
	Total \$85,709	<u>\$ 26,773</u>	<u>\$ 35,422</u>	<u>\$ 10,667</u>	<u>\$ 12,847</u>

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

SCHEDULE OF SCHOLARSHIP AND GRANT OPERATING FUND TRAVEL EXPENSES

YEAR ENDED JUNE 30, 2004

<u>Payee</u>	<u>Purpose of travel</u>	<u>Airfare</u>	<u>Lodging</u>	<u>Meals</u>	<u>Automobile and other</u>
American Express	M. Welch – NASSGAP Conference	\$ 300			
American Express	M. Welch – NASSGAP Conference		\$ 377		
American Express	M. Joyce – MSRB 529 Plan Conference		285		
American Express	M. Welch – NASSGAP Conference	277			
American Express	M. Welch – NASSGAP Conference		642		
Amounts less than \$200			145	\$ 101	\$ 580
Total	\$2,707	<u>\$ 577</u>	<u>\$ 1,449</u>	<u>\$ 101</u>	<u>\$ 580</u>

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

SCHEDULE OF RIHEST ADMINISTRATIVE FUND TRAVEL EXPENSES

YEAR ENDED JUNE 30, 2004

<u>Payee</u>	<u>Purpose of travel</u>	<u>Airfare</u>	<u>Lodging</u>	<u>Meals</u>	<u>Automobile and other</u>
American Express	W. Hurry – Alliance Capital Meeting		\$ 277		
	C. Totoro – Alliance Capital Meeting		277		
Michael Joyce	M. Joyce – NAST Conference		684		
American Express	M. Joyce – Alliance Capital Meeting	\$ 513			
American Express	M. Joyce – Alliance Capital Meeting		324		
	M. Joyce – NAST Conference				\$ 213
American Express	M. Joyce – NAST Conference		639		
Amounts less than \$200				\$ 185	394
	Total \$3,506	\$ 513	\$ 2,201	\$ 185	\$ 607