

# **MINNESOTA OFFICE OF HIGHER EDUCATION**

(A Component Unit of the State of Minnesota)

Saint Paul, Minnesota

## **FINANCIAL STATEMENTS**

Including Independent Auditors' Report

As of and for the Year Ended June 30, 2012

# MINNESOTA OFFICE OF HIGHER EDUCATION

## TABLE OF CONTENTS As of and for the Year Ended June 30, 2012

---

Independent Auditors' Report	i
Management's Discussion and Analysis	ii – xi
Basic Financial Statements	
Government-Wide Statements	
Statement of Net Assets	1
Statement of Activities	2
Fund Financial Statements	
Balance Sheet – Governmental Funds	3
Reconciliation of the Governmental Funds Balance Sheet to the Statement of Net Assets	4
Statement of Revenues, Expenditures and Changes in Fund Balances – Governmental Funds	5
Reconciliation of the Statement of Revenues, Expenditures and Changes in Fund Balances of Governmental Funds to the Statement of Activities	6
Statement of Revenues, Expenses and Changes in Net Assets – Proprietary (Enterprise) Fund – Loan Capital Fund	7
Statement of Cash Flows – Proprietary (Enterprise) Fund – Loan Capital Fund	8
Index to Notes to the Financial Statements	9
Notes to Financial Statements	10 – 32
Required Supplementary Information	
Budgetary Comparison Schedule – General Fund	33
Notes to Required Supplementary Information	34
Supplementary Information	
Combining Balance Sheet – Nonmajor Governmental Funds	35
Combining Statement of Revenues, Expenditures and Changes in Fund Balances – Nonmajor Governmental Funds	36

Baker Tilly Virchow Krause, LLP  
225 S Sixth St, Ste 2300  
Minneapolis, MN 55402-4661  
tel 612.876.4500  
fax 612.238.8900  
bakertilly.com

## INDEPENDENT AUDITORS' REPORT

Director  
Minnesota Office of Higher Education  
Saint Paul, Minnesota

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Minnesota Office of Higher Education, a component unit of the State of Minnesota, as of and for the year ended June 30, 2012, which collectively comprise the Minnesota Office of Higher Education's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Minnesota Office of Higher Education's management. Our responsibility is to express opinions on these financial statements based on our audit.

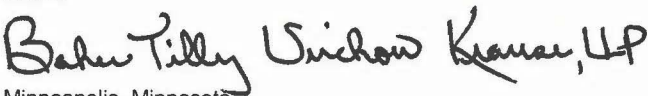
We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and 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 governmental activities, the business-type activities, each major fund, and the aggregate remaining fund information of the Minnesota Office of Higher Education 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 10, 2012 on our consideration of the Minnesota Office of Higher Education's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis and budgetary comparison information as listed in the table of contents be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economical, 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 Minnesota Office of Higher Education's basic financial statements. The combining financial statements as listed in the table of contents are presented for purposes of additional analysis and are 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 basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

  
Minneapolis, Minnesota  
October 10, 2012

## MANAGEMENT'S DISCUSSION AND ANALYSIS

### UNAUDITED

Our discussion and analysis of the financial performance of Minnesota Office of Higher Education (the "Agency") provides an overview of the Agency's financial activities for the fiscal year ended June 30, 2012.

#### Introduction

*Minnesota Statutes, 136A; Minnesota Rules 4800-4880*

THE MINNESOTA OFFICE OF HIGHER EDUCATION works to:

- Help students achieve financial access to postsecondary education;
- Enable students to choose among postsecondary education options;
- Protect and inform educational consumers;
- Produce independent, statewide information on post-secondary education; and
- Facilitate interaction among and collaborate with organizations that share responsibility for education in Minnesota.

The agency employs 65 people of which 25 are state funded.

The Agency is authorized to issue bonds up to a total outstanding of \$850 million. The bonds by law are not a debt of the State of Minnesota or any political subdivision thereof.

The Agency's programs and services are provided through different means including:

The Minnesota State Grant Program (which provides more than \$150 million in need-based aid to Minnesota students annually), and other student financial aid programs such as the Post-Secondary Child Care Grant Program, State Work Study Program, and the Public Safety Officers' Survivors Benefit Program. Other core programs are the Student Educational Loan Fund ("SELF"), the Minnesota College Savings Plan, and the Interstate Tuition Reciprocity Program. These programs enable thousands of Minnesota students to have financial access to, and choice of, postsecondary educational opportunities.

The Agency's publications, web content, interactive media, and direct contact with students and families enable the agency to provide outreach to communities of color, low-income families, and families with no previous higher education experience. The Get Ready! Program, working in tandem with the federally sponsored GEAR UP (Gaining Early Awareness and Readiness for Undergraduate Programs) and Intervention for College Attendance Program Grants, helps to sustain a continuum of contact and service to low-income students from fourth grade through high school as they prepare for college admission and attendance.

The Agency's Web presence includes information for students, parents, educators, and financial aid administrators, enrollment data which can be customized by the user, information concerning private postsecondary institutions licensed or registered by the Agency, online tuition reciprocity applications, and a financial aid estimator.

Through state laws which undergird the registration and licensure of private colleges, universities, and career schools, the Agency provides students with consumer protection by assuring that private post-secondary institutions meet state standards in order to operate legally in Minnesota.

## **Financial Highlights**

- The Agency's net assets increased \$26.8 million or 6.8% from fiscal year 2011 to 2012, mainly as a result of student loan financing activities.
  - The Agency received \$192.2 million for fiscal year 2012 state appropriations. Unexpended funds will be carried forward to fiscal year 2013. The Agency received \$152 million for fiscal year 2011 state appropriations in addition to an \$8.4 million carry forward from the previous year. An additional \$35 million was initially appropriated for fiscal year 2011 but the funds were needed in fiscal year 2010 to fund state grants.
  - The Loan Capital Fund issued 14,124 and 16,323 new loans in fiscal years 2012 and 2011, respectively, with the average student loan amount of \$6,048 and \$5,219, respectively.
  - Loan Receivables in the Loan Capital Fund shrunk by \$19.3 million or 2.7% during fiscal year 2012 and shrunk by \$16.0 million or 2.2% during fiscal year 2011.
  - The Agency received legislative approval to enter into interest rate exchange or swap agreements, or other comparable interest rate protection agreements. This option is limited to agreements related to bonds and notes with an aggregate value of no more than \$20 million. As of June 30, 2012 the Agency has not entered into any interest rate exchange or swap agreements or other comparable interest rate protection agreements.
  - The Agency issued \$85.0 million in fixed rate revenue bonds during fiscal year 2012. Over the course of the fiscal year \$164.4 million of Auction Rate Securities bonds were repurchased from investors and subsequently cancelled.
- 

## **Overview of the Financial Statements**

This discussion and analysis is intended to serve as an introduction to the basic financial statements. The Agency's basic financial statements consist of three components: government-wide financial statements, fund financial statements, and notes to the financial statements. The report also contains other supplementary information.

### **Government-Wide Financial Statements**

The two government-wide financial statements are designed to provide readers with a broad overview of the Agency's finances in a manner similar to private-sector business entities. The *Statement of Net Assets* presents information on all of the Agency's assets and liabilities, with the difference between the two reported as net assets. Over time, increases or decreases in net assets may serve as a useful indicator of whether the financial position of the Agency is improving or deteriorating.

The *Statement of Activities* presents information showing how the Agency's net assets changed during the most recent fiscal year. All changes in net assets are reported as soon as the underlying event giving rise to the change occurs, regardless of the timing of the related cash flows. Thus, revenues and expenses are reported in this statement for some items that will result in cash flows in future fiscal periods (e.g., earned but unused compensated absences). The government-wide financial statements can be found on pages 1 and 2 of this report.

In the Statements of Net Assets and the Statement of Activities, we divide the Agency into two kinds of activities:

- ***Governmental Activities*** — General appropriation funds are received by the Agency for the administration of postsecondary educational grant programs and the Work Study Program, negotiating and administering reciprocity agreements, publishing and distributing financial aid information and materials, collecting and maintaining student enrollment and financial aid data, and administering various federal grant programs that affect students and postsecondary institutions. Licensing and registration fees finance the cost for administering the registration and licensing of private collegiate and career schools.
- ***Business-Type Activities*** — The Agency is designated by statute as the administrative agency for the establishment of one or more loan programs. The purpose of the loan programs is to provide financial assistance for the postsecondary education of students. The two loan programs currently being administered by the Agency are the Student Educational Loan Fund ("SELF") Program and the Graduated Repayment Income Protection ("GRIP") Program.

## **Fund Financial Statements**

The fund financial statements begin on page 3 and provide detailed information about the most significant funds — not the Agency as a whole. Some funds are required to be established by state law, and the Agency established other funds to help it control and manage money for particular purposes or to show that it is meeting legal responsibilities for certain grants. The Agency's two kinds of funds — governmental and proprietary — use different accounting approaches.

- ***Governmental Funds*** — Governmental funds are used for primarily the same functions reported as governmental activities. The governmental fund financial statements are used to analyze resources available in the near-term to manage the Agency's near-term financial obligations. These funds are reported using the modified accrual basis of accounting. Governmental fund information assists the reader in determining whether there are enough financial resources to finance the Agency's programs in the near-term. The differences are illustrated between governmental activities and governmental funds in a statement following each governmental fund financial statement.
- ***Proprietary Funds*** — When the Agency charges customers for the services it provides — whether to outside customers or to other units of the Agency — these services are generally reported in proprietary funds. Proprietary funds are reported in the same way that all activities are reported in the government-wide financial statements. In fact, the Agency's enterprise funds are the same as the business-type activities the Agency reports in the government-wide statements but provides more detail and additional information, such as cash flows, for proprietary funds.

## Notes to the Basic Financial Statements

The notes to the basic financial statements provide additional detail that is essential to a full understanding of the data provided in the government-wide and fund financial statements. The notes to the basic financial statements can be found beginning on page 10 of this report.

## Required Supplemental Information

In addition to the basic financial statements and accompanying notes, this report also presents certain required supplemental information concerning the Agency's budget and actual results of its major governmental fund. This information can be found beginning on page 33 of this report.

## Additional Supplemental Information

Following the required supplemental information are combining statements for the non-major governmental funds.

## The Agency as a Whole

The Agency's combined net assets increased by \$26.8 million or 6.8%. The analysis below focuses on the net assets (Table 1) and changes in net assets (Table 2) of the Agency's governmental and business-type activities.

**Table 1**  
**Net Assets**

	2012			2011		
	Governmental Activities	Business- Type Activities	Totals	Governmental Activities	Business- Type Activities	Totals
Assets						
Current and other assets	\$ 14,831,408	\$ 973,133,628	\$ 987,965,036	\$ 5,213,662	\$ 1,024,517,852	\$ 1,029,731,514
Capital assets—net	4,461	2,973	7,434	8,848	5,899	14,747
Total assets	14,835,869	973,136,601	987,972,470	5,222,510	1,024,523,751	1,029,746,261
Liabilities						
Current liabilities	13,275,990	1,222,793	14,498,783	4,246,149	912,549	5,158,698
Non-current liabilities	383,474	553,506,103	553,889,577	379,139	631,450,879	631,830,018
Total liabilities	13,659,464	554,728,896	568,388,360	4,625,288	632,363,428	636,988,716
Net assets						
Invested in capital assets	4,461	2,973	7,434	8,848	5,899	14,747
Restricted for grants and licensin	860,912	-	860,912	325,720	-	325,720
Restricted for debt service	-	418,404,732	418,404,732	-	392,154,424	392,154,424
Unrestricted	311,032	-	311,032	262,654	-	262,654
Total net assets	\$ 1,176,405	\$ 418,407,705	\$ 419,584,110	\$ 597,222	\$ 392,160,323	\$ 392,757,545

Net assets of the Agency's governmental activities increased by \$579,183 during the current fiscal year. State appropriations are retained for the portion of severance liability and retired employees insurance benefits liability that the Agency has at fiscal year-end. Unrestricted net assets — the part of net assets that can be used to finance day-to-day operations without constraints established by debt covenants, enabling legislation, or other legal requirements — increased from \$262,654 at June 30, 2011 to \$311,032 at the end of this year.

Net loans receivable have decreased by approximately \$19.3 million, or 2.7%, to \$699 million. This decrease is largely due to changes in federal legislation regarding preferred lender requirements for nonfederal student loans.



U.S. Treasury regulations limit the student loan revenue yield over bond expenses to 2% on tax exempt student loan bond issues (bond expenses are limited to the bond interest paid to bondholders, cost of defaulted loans, and credit liquidity). Excess revenue generated from the student loans must either be paid back to the IRS every ten years or lowered through a decrease in the student loan interest rate charged, loan forgiveness programs, and/or borrower benefits. As of June 30, 2012, the Agency has accrued \$6,091,708 in excess revenue on the 2002B, 2005B, 2006, 2011A, and 2011B tax exempt bond issues based upon internal calculations.

**Table 2**  
**Changes in Net Assets**

	2012			2011		
	Governmental Activities	Business-Type Activities	Totals	Governmental Activities	Business-Type Activities	Totals
<b>REVENUES</b>						
Program revenues						
Charges for services	\$ 1,178,175	\$ 44,191,954	\$ 45,370,129	\$ 795,964	\$ 31,435,520	\$ 32,231,484
State appropriations	181,688,239	-	181,688,239	157,524,487	-	157,524,487
Federal appropriations	4,839,483	-	4,839,483	5,294,121	-	5,294,121
Total revenues	<u>187,705,897</u>	<u>44,191,954</u>	<u>231,897,851</u>	<u>163,614,572</u>	<u>31,435,520</u>	<u>195,050,092</u>
<b>EXPENSES</b>						
Program expenses						
General government	582,595	17,944,572	18,527,167	577,864	17,085,408	17,663,272
State appropriations	182,025,918	-	182,025,918	157,492,664	-	157,492,664
Federal grants	4,518,201	-	4,518,201	5,294,150	-	5,294,150
Total expenses	<u>187,126,714</u>	<u>17,944,572</u>	<u>205,071,286</u>	<u>163,364,678</u>	<u>17,085,408</u>	<u>180,450,086</u>
CHANGE IN NET ASSETS	<u>\$ 579,183</u>	<u>\$ 26,247,382</u>	<u>\$ 26,826,565</u>	<u>\$ 249,894</u>	<u>\$ 14,350,112</u>	<u>\$ 14,600,006</u>

### *Governmental Activities*

Revenues for the Agency's governmental activities (see Table 2) increased by \$24.1 million (or 14.7 %) to \$187.7 million, while total expenses increased by \$23.8 million (or 14.6%). The governmental activities revenue increase was due to higher state appropriations for student grants. The expenditures increase was due to higher state appropriations for individual student state grants. The appropriation for fiscal year 2011 had been lowered by \$35,000,000 because it was needed in fiscal year 2010.

- State appropriation expenditures increased by \$24.5 million to \$182.0 million. \$154.6 million was appropriated by legislature for the state grant program. If the appropriation for either year of the biennium is insufficient for the state grant program, the appropriation for the other year is available for it.

The Agency currently receives federal grant monies from three different programs within the U.S. Department of Education. These federal grants are designed to assist students in meeting their postsecondary education financial obligations for tuition and other related expenses, improve teacher quality and instructional leadership, and increase college attendance and success of low-income students.

### *Business-Type Activities*

The excess of revenues over expenses of the Agency's business-type activities was \$26.2 million in fiscal year 2012, which was 146% of expenses. \$14.9 million of the increase was due to the repurchase of bonds at a discounted price.

## **Financial Analysis of the Agency's Major Funds**

### *Governmental Funds*

The General Fund is the chief governmental fund of the agency, approximately 97% of the agency's governmental spending. At the end of fiscal year 2012, the fund balance was \$0. Since the state operates on a biennial budget, every other year all appropriation resources not expended are returned to the state's General Fund.

For the General Fund, student grant payments were \$172.6 million, a significant increase from \$148 million in fiscal year 2011. Grant aid to post-secondary institutions and organizations decreased \$0.6 million to \$1.2 million. Employee salaries decreased \$0.2 million from fiscal year 2011.

### *Proprietary Fund*

The Agency's proprietary fund statement provides the same type of information found in the government-wide financial statements, but in greater detail. Revenues of the Agency's proprietary fund (see Table 2) increased by 40.6% and expenses increased by .1%. In fiscal year 2012, there was a slightly higher return for interest and investment interest income. The current interest rate charged to SELF II, SELF III, SELF IV and SELF V program student loans is set at a rate of 2.00%, 4.00%, 4.00% and 4.00%, respectively. Rates for the SELF II program have decreased 0.25% over the past fiscal year, and rates for the SELF III and SELF IV programs have varied 0.20% over the past fiscal year. Under the SELF IV and SELF V programs, loans have an optional extended repayment period depending upon the aggregate SELF student loan balance. The SELF IV and SELF V programs calculate the variable interest rate charged to borrowers with the same method as the SELF III program. The interest rate for the SELF V fixed rate program is set at a rate of 7.25%.

### *General Fund Budgetary Highlights*

Over the course of the fiscal year, changes were made to the Agency's budget. \$3.9 million of funds appropriated to the State Grant program were needed to fund the Interstate Reciprocity program. Actual expenditures were \$336,820 below the total budgeted expenditures.

## **Cash Management**

Unexpended general appropriated funds are invested pursuant to Minnesota Statutes 11A under the State Board of Investments. Monies in the Loan Capital Fund are managed by the Agency and invested in instruments allowed by state statute, such as U.S. Treasury bills and notes, general obligation municipals, collateralized certificates of deposit, repurchase agreements, federal agency notes, bankers' acceptances, and commercial paper. The Agency's investment policy prohibits the Agency from investing in instruments with maturities in excess of three years. The total investment income, including change in the fair value of investments, was down from 2011 by \$0.1 million. As of June 30, 2012, the fair value of the Agency's investments was greater than cost by \$8,363. The Agency's policy is to hold all securities until maturity; therefore, it is highly unlikely that any differences between cost and market in investments would be realized. All of the Agency's investment securities are held in trust in the Agency's name.

## DEBT ADMINISTRATION

At year-end, the Agency had \$547,300,000 in bonds outstanding — as shown in Table 3

	Outstanding Debt at Year-End (in millions)					
	2012			2011		
	Governmental Activities	Business- Type Activities	Totals	Governmental Activities	Business- Type Activities	Totals
Revenue bonds	\$ -	\$ 547.3	\$ 547.3	\$ -	\$ 626.8	\$ 626.8

Since 1984, the Agency's revenue bond rating had been AAA, the highest rating possible, in 2008 the 1999, 2002, 2003, 2004, 2005, and 2006 supplemental revenue bonds rating were downgraded to A2 as a result of Municipal Bond Insurance Association, Inc.'s (MBIA) downgrade to A2 in the same year.

The 2008 supplemental revenue bonds have a rating of Aa3 by Moody's rating agency and AA- by Fitch rating agency.

The 2010 supplemental revenue bonds have a rating of A+ by S&P rating agency and AA- by Fitch rating agency.

The 2011 supplemental revenue bonds have a rating of Aa3 by Moody's rating agency.

Other obligations of the Agency include accrued vacation pay and sick leave and the arbitrage liability. More detailed information about the Agency's long-term liabilities is presented in Note III.F. to the financial statements.

### Economic Factors and Next Year's Budgets and Rates

The Agency's officials considered many factors when setting the fiscal year 2012 budget, rates, and fees that will be charged for the business-type activities. Due to federal legislative changes in 2010, school officials are more restricted in directing students to specific student loan programs. This has resulted in a decrease in the issuance of SELF student loans over the last three fiscal years.

The SELF loan program has several phases based on changes in calculating interest and other loan terms. For the SELF II phase, the current margin rate is set at 2.0%, the highest margin allowed under the SELF II phase, to compensate for the additional interest cost and other charges associated with the bonds. In fiscal year 2002, the Agency received approval for the SELF III phase of the loan program which bases the interest rate charged to borrowers on the average of the three-month LIBOR during the calendar quarter immediately preceding the interest rate adjustment date plus a margin. The SELF IV phase of the loan program began in July 2006 with minor changes. The SELF V phase of the loan program began in October 2010 with a fixed and variable interest rate option. On July 1, 2012 the SELF III, SELF IV and SELF V margin was lowered from 3.5% to 3.0%.

For the fixed rate option of the SELF V phase of the loan program, the rate is set at 7.25%.

In 2010 the state legislature approved an increase in the annual loan limit to \$10,000 for students enrolled in a bachelor's degree program, postbaccalaureate, or graduate program. Effective October 25, 2010, the undergraduate student annual loan limits for non-four year degree programs in grade levels 1, 2, and 3 have a limit of \$7,500. The undergraduate student annual loan limits for four year degree programs in grade levels 1, 2, 3, 4 and 5 have a limit of \$10,000.

The increases in college tuitions experienced over the past few years have increased the average amount of loans outstanding for each student. If the national economic volatility continues to negatively impact employment, the Agency could be required to increase its allowance for loan losses.

Careful consideration was given to legislative goals and the agency's mission when adopting the General Fund budget for fiscal year 2013. For the current biennium, the private tuition maximums used in the state grant formula is a maximum of \$10,488 for students enrolled in four-year programs and \$5,808 for students enrolled in two-year programs. The living and miscellaneous expense allowance is set at \$7,000 for fiscal year 2013. Grant awards are based on the lesser of the average tuition and fees charged by the institution for the term, or the maximum established by law. If the appropriation for either year of the biennium is insufficient, the appropriation for the other year is available for it.

The maximum annual award for Post-secondary Child Care Grants is set at \$2,600 for the current biennium.

The Agency intends to issue bonds in fiscal year 2013. Current outstanding bonds rely on the Loan Capital Fund for the payment of various bond fees, student loan servicing costs, reimbursing defaulted loans, and administrative expenses.

The Minnesota GI Bill Program provides up to \$1,000 per academic term to veterans, and the dependents of deceased and disabled veterans, who served in active duty after September 11, 2001.

The Agency also administers the Indian Scholarship program. The scholarship is awarded to any Minnesota resident student who is of one-fourth or more Indian ancestry, who has applied for other existing state and federal scholarship and grant programs, and who has the capabilities to benefit from further education.

The Agency's cash and investment balance decreased \$23.6 million, and the loans receivable – net balance decreased \$19.3 million. Over the course of the fiscal year the Agency repurchased and subsequently cancelled \$164.4 million of Auction rate Securities (ARS) bonds. In the upcoming fiscal year, the Agency intends to issue new bonds and refinance a portion or all of the remaining outstanding Auction Rate Securities (ARS) bonds.

In February 2008 the Agency's ARS bonds at auctions began to fail, and continue to fail, as the nation's auction process collapsed. For the outstanding taxable ARS bonds, bond documents limit the interest rate to the lesser of one-month LIBOR plus 1%, 17%, or the 91 day average of the three-month T-Bill plus an applicable spread of 1.25%. For the outstanding tax-exempt ARS bonds, bond documents limit the interest rate to the lesser of the Applicable Percentage of the Kenny index or the After-Tax Equivalent Rate (the current applicable percentage is 175%), 14%, or the three month average of the three-month T-Bill plus an Applicable Spread of 1.25%. MBIA is the insurance provider. When MBIA's rating fell below the Moody's Investors Service rating of A2 in November 2008, Moody's subsequently maintained the A2 rating on the bonds due to the underlying collateral of the SELF loans. On June 30, 2012, the average taxable bond interest rate of the ARS bonds was 1.24% and the average tax-exempt bond interest rate was 0.33%.

### **Contacting the Agency's Financial Management**

This financial report is designed to provide our citizens, customers, and creditors with a general overview of the Agency's finances and to show the Agency's accountability for the money it receives. If you have questions about this report or need additional financial information, contact the Agency at 651 259 3951.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## STATEMENT OF NET ASSETS As of June 30, 2012

	<b>ASSETS</b>	Governmental Activities	Business- type Activities	Totals
<b>CURRENT ASSETS</b>				
Cash and investments		\$ 12,928,000	\$ 172,163,146	\$ 185,091,146
Receivables				
Accounts		1,374,172	1,370,156	2,744,328
Interest		-	2,569,248	2,569,248
Loans receivable - net		-	92,122,171	92,122,171
Due from other governments		529,236	-	529,236
Prepaid expenses		-	189,048	189,048
Total Current Assets		<u>14,831,408</u>	<u>268,413,769</u>	<u>283,245,177</u>
<b>NONCURRENT ASSETS</b>				
Restricted cash and investments		-	94,078,790	94,078,790
Loans receivable - net		-	606,658,102	606,658,102
Debt issuance costs, at cost less accumulated amortization of \$2,325,217		-	3,982,967	3,982,967
Capital assets, net of depreciation		4,461	2,973	7,434
Total Noncurrent Assets		<u>4,461</u>	<u>704,722,832</u>	<u>704,727,293</u>
 Total Assets		 <u>14,835,869</u>	 <u>973,136,601</u>	 <u>987,972,470</u>
	<b>LIABILITIES</b>			
<b>CURRENT LIABILITIES</b>				
Accounts payable		2,492,565	585,676	3,078,241
Accrued liabilities		122,187	35,067	157,254
Accrued interest		-	585,285	585,285
Due to other governments		105,662	-	105,662
Deferred revenue		10,513,760	-	10,513,760
Compensated absences payable		41,816	16,765	58,581
Total Current Liabilities		<u>13,275,990</u>	<u>1,222,793</u>	<u>14,498,783</u>
<b>NONCURRENT LIABILITIES</b>				
Compensated absences payable		383,474	149,349	532,823
Arbitrage liability		-	6,091,708	6,091,708
Revenue bonds payable		-	547,265,046	547,265,046
Total Noncurrent Liabilities		<u>383,474</u>	<u>553,506,103</u>	<u>553,889,577</u>
 Total Liabilities		 <u>13,659,464</u>	 <u>554,728,896</u>	 <u>568,388,360</u>
	<b>NET ASSETS</b>			
Invested in capital assets		4,461	2,973	7,434
Restricted for licensing and grant administration		860,912	-	860,912
Restricted for debt service		-	418,404,732	418,404,732
Unrestricted		311,032	-	311,032
 <b>TOTAL NET ASSETS</b>		 <u>\$ 1,176,405</u>	 <u>\$ 418,407,705</u>	 <u>\$ 419,584,110</u>

See accompanying notes to financial statements.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## STATEMENT OF ACTIVITIES For the Year Ended June 30, 2012

Functions/Programs	Expenses	Program Revenues		Net (Expenses) Revenues and Changes in Net Assets		Totals
		Charges for Services	Operating Grants and Contributions	Governmental Activities	Business- type Activities	
Governmental Activities						
State appropriations	\$ 182,025,918	\$ -	\$ 181,688,239	\$ (337,679)	\$ -	\$ (337,679)
Federal grants	4,518,201	-	4,839,483	321,282	-	321,282
Registration and licensing fees and other	<u>582,595</u>	<u>1,178,175</u>	<u>-</u>	<u>595,580</u>	<u>-</u>	<u>595,580</u>
Total Governmental Activities	<u>187,126,714</u>	<u>1,178,175</u>	<u>186,527,722</u>	<u>579,183</u>	<u>-</u>	<u>579,183</u>
Business-type Activities						
Loan capital fund	<u>17,944,572</u>	<u>44,191,954</u>	<u>-</u>	<u>-</u>	<u>26,247,382</u>	<u>26,247,382</u>
Totals	<u>\$ 205,071,286</u>	<u>\$ 45,370,129</u>	<u>\$ 186,527,722</u>			
<b>Change in Net Assets</b>				579,183	26,247,382	26,826,565
NET ASSETS - Beginning of Year				<u>597,222</u>	<u>392,160,323</u>	<u>392,757,545</u>
<b>NET ASSETS - END OF YEAR</b>				<u>\$ 1,176,405</u>	<u>\$ 418,407,705</u>	<u>\$ 419,584,110</u>

See accompanying notes to financial statements.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## BALANCE SHEET GOVERNMENTAL FUNDS As of June 30, 2012

	General	Other Governmental Funds	Totals
<b>ASSETS</b>			
Cash and investments	\$ 11,317,326	\$ 1,610,674	\$ 12,928,000
Accounts receivable	509,847	864,325	1,374,172
Due from other governments	182,192	347,044	529,236
Due from other funds	242,794	-	242,794
<b>TOTAL ASSETS</b>	<b>\$ 12,252,159</b>	<b>\$ 2,822,043</b>	<b>\$ 15,074,202</b>
<b>LIABILITIES AND FUND BALANCES</b>			
<b>Liabilities</b>			
Accounts payable	\$ 1,674,933	\$ 817,632	\$ 2,492,565
Accrued liabilities	63,466	58,721	122,187
Due to other governments	-	105,662	105,662
Due to other funds	-	242,794	242,794
Deferred revenue	10,513,760	-	10,513,760
Total Liabilities	12,252,159	1,224,809	13,476,968
<b>Fund Balances</b>			
Restricted for licensing and grant administration	-	860,912	860,912
Assigned	-	736,322	736,322
Total Fund Balances	-	1,597,234	1,597,234
<b>TOTAL LIABILITIES AND FUND BALANCES</b>	<b>\$ 12,252,159</b>	<b>\$ 2,822,043</b>	<b>\$ 15,074,202</b>

See accompanying notes to financial statements.



## MINNESOTA OFFICE OF HIGHER EDUCATION

### RECONCILIATION OF THE GOVERNMENTAL FUNDS BALANCE SHEET TO THE STATEMENT OF NET ASSETS As of June 30, 2012

---

Total fund balance - governmental funds	\$	1,597,234
---	----	-----------

Amounts reported for governmental activities in the statement  
of net assets are different because:

Capital assets used in government activities are not financial  
resources and, therefore, are not reported in the fund statements.

Capital assets at year end consist of:

Capital assets	\$	60,847	
Accumulated depreciation		<u>(56,386)</u>	4,461

Certain liabilities are not due in the current period and,  
therefore, are not reported in the fund statements. These  
liabilities at year end consist of compensated absences payable.

	<u>(425,290)</u>
--	------------------

<b>TOTAL NET ASSETS - GOVERNMENTAL ACTIVITIES</b>	<b>\$</b>	<b><u>1,176,405</u></b>
---	-----------	-------------------------

# MINNESOTA OFFICE OF HIGHER EDUCATION

## STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES - GOVERNMENTAL FUNDS For the Year Ended June 30, 2012

	General	Other Governmental Funds	Totals
<b>REVENUES</b>			
State appropriations	\$ 181,688,239	\$ -	\$ 181,688,239
Federal grants	-	4,839,483	4,839,483
Registration and licensing fees	-	635,810	635,810
Other revenue	-	542,365	542,365
Total Revenues	<u>181,688,239</u>	<u>6,017,658</u>	<u>187,705,897</u>
<b>EXPENDITURES</b>			
General government	2,580,141	587,067	3,167,208
State and other grants	179,108,098	-	179,108,098
Federal grants	-	4,839,483	4,839,483
Total Expenditures	<u>181,688,239</u>	<u>5,426,550</u>	<u>187,114,789</u>
<b>Excess of revenues over expenditures</b>	-	591,108	591,108
FUND BALANCE - Beginning of Year	<u>-</u>	<u>1,006,126</u>	<u>1,006,126</u>
<b>FUND BALANCE - END OF YEAR</b>	<u>\$ -</u>	<u>\$ 1,597,234</u>	<u>\$ 1,597,234</u>

See accompanying notes to financial statements.

## MINNESOTA OFFICE OF HIGHER EDUCATION

### RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES OF GOVERNMENTAL FUNDS TO THE STATEMENT OF ACTIVITIES For the Year Ended June 30, 2012

---

Net change in fund balances - total governmental funds	\$ 591,108
--	------------

Amounts reported for governmental activities in the statement of activities  
are different because:

Governmental funds report capital outlays as expenditures. However, in the  
statement of activities, the cost of these assets is allocated over their  
estimated useful lives and reported as depreciation expense. The following  
differ in their presentation in the two statements:

Depreciation is reported in the government-wide statements	(4,387)
--	---------

Some expenses in the statement of activities do not require the use of current  
financial resources and, therefore, are not reported as expenditures in the  
governmental funds. The following did not require the use of current  
financial resources:

Compensated absences payable	<u>(7,538)</u>
------------------------------	----------------

<b>CHANGE IN NET ASSETS OF GOVERNMENTAL ACTIVITIES</b>	<b><u>\$ 579,183</u></b>
--	--------------------------

# MINNESOTA OFFICE OF HIGHER EDUCATION

## STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS PROPRIETARY (ENTERPRISE) FUND - LOAN CAPITAL FUND For the Year Ended June 30, 2012

---

### OPERATING REVENUES

Interest on student loans	\$ 28,880,179
---------------------------	---------------

### OPERATING EXPENSES

General and administrative	8,491,574
----------------------------	-----------

Provision for loans losses - net	<u>1,388,425</u>
----------------------------------	------------------

Total Operating Expenses	<u>9,879,999</u>
--------------------------	------------------

Operating Income	<u>19,000,180</u>
------------------	-------------------

### NONOPERATING REVENUES (EXPENSES)

Gain on repurchased bonds	14,895,750
---------------------------	------------

Investment income	416,025
-------------------	---------

Interest expense	(7,345,267)
------------------	-------------

Amortization expense	<u>(719,306)</u>
----------------------	------------------

Total Nonoperating Revenues (Expenses)	<u>7,247,202</u>
--	------------------

CHANGE IN NET ASSETS	26,247,382
----------------------	------------

NET ASSETS - Beginning of Year	<u>392,160,323</u>
--------------------------------	--------------------

NET ASSETS - END OF YEAR	<u>\$ 418,407,705</u>
--------------------------	-----------------------

# MINNESOTA OFFICE OF HIGHER EDUCATION

## STATEMENT OF CASH FLOWS PROPRIETARY (ENTERPRISE) FUND - LOAN CAPITAL FUND For the Year Ended June 30, 2012

---

### CASH FLOWS FROM OPERATING ACTIVITIES

Cash received from loan holders	\$ 132,223,803
Cash paid for loan origination	(85,435,979)
Cash paid to employees and suppliers	(8,818,132)
Net Cash Flows From Operating Activities	<u>37,969,692</u>

### CASH FLOWS FROM INVESTING ACTIVITIES

Purchases of investments	(315,739,751)
Proceeds from maturity of investments	263,572,740
Interest received from investments	413,653
Net Cash Flows From Investing Activities	<u>(51,753,358)</u>

### CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Proceeds from bonds	99,895,750
Bonds purchased and cancelled	(164,375,000)
Capitalized bond issuance costs	(767,928)
Interest paid on bonds	(5,703,772)
Net Cash Flows From Noncapital Financing Activities	<u>(70,950,950)</u>

Net Increase in Cash and Cash Equivalents	(84,734,616)
---	--------------

CASH AND CASH EQUIVALENTS - Beginning of Year	<u>270,943,757</u>
---	--------------------

CASH AND CASH EQUIVALENTS - END OF YEAR	<u>\$ 186,209,141</u>
---	-----------------------

### RECONCILIATION OF CASH AND CASH EQUIVALENTS

Cash and investments per Statement of Net Assets	\$ 172,163,146
Restricted cash and investments per Statement of Net Assets	94,078,790
Less: Non-cash equivalents	<u>(80,032,795)</u>

CASH AND CASH EQUIVALENTS PER STATEMENT OF CASH FLOWS	<u>\$ 186,209,141</u>
---	-----------------------

### RECONCILIATION OF OPERATING INCOME TO NET CASH FLOWS FROM OPERATING ACTIVITIES

Operating income	\$ 19,000,180
Adjustments to Reconcile Operating Income to Net Cash Flows From Operating Activities	
Noncash items included in income	
Depreciation	2,925
Provision for loan loss	8,441,479
Write-off of loans	(8,720,188)
Increase in fair value of investments	19,755
Origination of student loans	(85,435,978)
Principal payments on student loans	105,024,283
Changes in assets and liabilities	
Interest receivable	(130,500)
Other receivable and prepaid expenses	(544,243)
Accounts payable and accruals	<u>311,979</u>

NET CASH FLOWS FROM OPERATING ACTIVITIES	<u>\$ 37,969,692</u>
--	----------------------

### NONCASH CAPITAL, INVESTING AND FINANCING ACTIVITIES

The agency had a \$14,895,750 gain on bonds purchased and cancelled.

See accompanying notes to financial statements.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## INDEX TO NOTES TO THE FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

NOTE	Page
I. Summary of Significant Accounting Policies	10
A. Reporting Entity	10
B. Government-Wide and Fund Financial Statements	10
C. Measurement Focus, Basis of Accounting, and Financial Statement Presentation	12
D. Assets, Liabilities, and Net Assets or Equity	13
1. Deposits and Investments	13
2. Receivables	14
3. Prepaid Expenses	14
4. Restricted Assets	14
5. Capital Assets	14
6. Other Assets – Debt Issuance Costs	14
7. Compensated Absences	15
8. Long-Term Obligations	15
9. Claims and Judgments	16
10. Equity Classifications	16
II. Stewardship, Compliance, and Accountability	18
A. Budgetary Information	18
III. Detailed Notes on All Funds	18
A. Deposits and Investments	18
B. Receivables	20
C. Restricted Assets	22
D. Capital Assets	23
E. Interfund Receivables/Payables	24
F. Long-Term Obligations	25
G. Net Assets	30
IV. Other Information	30
A. Employees' Retirement System	30
B. Risk Management	31
C. Commitments and Contingencies	31
D. Effect of New Accounting Standards on Current Period Financial Statements	32
E. Subsequent Event	32

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

---

The accounting policies of the Minnesota Office of Higher Education conform to generally accepted accounting principles as applicable to governmental units. The accepted standard-setting body for establishing governmental accounting and financial reporting principles is the Governmental Accounting Standards Board (GASB).

#### **A. REPORTING ENTITY**

Effective July 1, 1995, the Minnesota Office of Higher Education (formerly known as Minnesota Higher Education Services Office) (the "Agency") was created in accordance with laws of Minnesota for 1995 as a component unit of the State of Minnesota. The Agency is responsible for the administration of state of Minnesota financial aid programs to students enrolled in eligible postsecondary institutions. In addition, the Agency is also responsible for administering federal financial aid programs that affect eligible students and institutions on a statewide basis. The director, who is appointed by the governor, oversees the performance of the Agency.

The Agency's financial statements are presented discretely in the State of Minnesota's Comprehensive Annual Financial Report as a component unit.

#### **B. GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS**

##### ***Government-Wide Financial Statements***

The statement of net assets and statement of activities display information about the reporting government as a whole. They include all funds of the reporting entity, since the reporting entity has no fiduciary funds. The statements distinguish between governmental and business-type activities. Governmental activities generally are financed through state appropriations and federal grants. Business-type activities are generally financed by fees and charges from student loans.

The statement of activities demonstrates the degree to which the direct expenses of a given function or segment are offset by program revenues. Direct expenses are those that are clearly identifiable with a specific function or segment. The Agency does not allocate indirect expenses to functions in the statement of activities. Program revenues include 1) charges to customers or applicants who purchase, use or directly benefit from goods, services, or privileges provided by a given function or segment, and 2) grants and contributions that are restricted to meeting the operational or capital requirements of a particular function or segment.

##### ***Fund Financial Statements***

Financial statements of the reporting entity are organized into funds, each of which is considered to be a separate accounting entity. Each fund is accounted for by providing a separate set of self-balancing accounts, which constitute its assets, liabilities, net assets/fund equity, revenues, and expenditure/ expenses.

Separate financial statements are provided for governmental funds and proprietary funds. Major individual governmental funds and major individual enterprise funds are reported as separate columns in the fund financial statements.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

---

#### **B. GOVERNMENT-WIDE AND FUND FINANCIAL STATEMENTS (cont.)**

##### ***Fund Financial Statements (cont.)***

Funds are organized as major funds or non-major funds within the governmental and proprietary statements. An emphasis is placed on major funds within the governmental and proprietary categories. A fund is considered major if it is the primary operating fund of the Agency or meets the following criteria:

- a. Total assets, liabilities, revenues, or expenditures/expenses of that individual governmental or enterprise fund are at least 10% of the corresponding total for all funds of that category or type, and
- b. The same element of the individual governmental fund or enterprise fund that met the 10% test is at least 5% of the corresponding total for all governmental and enterprise funds combined.

In addition, any other governmental or enterprise fund that the Agency believes is particularly important to financial statement users may be reported as a major fund.

The Minnesota Office of Higher Education reports the following major governmental funds:

General Fund – accounts for the Agency's primary operating activities. It is used to account for and report all financial resources not accounted for and reported in another fund. The General Fund is used to account and report for the funds received and disbursed for the State of Minnesota's financial aid programs.

The Minnesota Office of Higher Education reports the following major enterprise funds:

Loan Capital Fund (LCF) – accounts for the Agency's student loan activities including the Supplemental Loan programs (SELF II, SELF III, SELF IV, and SELF V), Graduated Repayment Loan programs (GRIP), and payment of expenses of administering such programs. In addition, the Loan Capital Fund is used to account for related long-term debt payable and interest expense.

The Minnesota Office of Higher Education reports the following non-major governmental funds:

Special Revenue Funds – used to account for and report the proceeds of specific revenue sources that are restricted to expenditures for specified purposes.

Miscellaneous Grant Fund (non-Federal Grants and licensing)  
Federal Grant Fund (Federal Grants)



# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

---

#### ***C. MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL STATEMENT PRESENTATION***

##### ***Government-Wide Financial Statements***

The government-wide statement of net assets and statement of activities are reported using the economic resources measurement focus and the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when the liability is incurred or economic asset used. Revenues, expenses, gains, losses, assets, and liabilities resulting from exchange and exchange-like transactions are recognized when the exchange takes place. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider are met. Unbilled receivables are recorded as revenues when services are provided.

The business-type activities follow all pronouncements of the Governmental Accounting Standards Board, and have elected not to follow Financial Accounting Standards Board guidance issued after November 30, 1989.

As a general rule, the effect of interfund activity has been eliminated from the government-wide financial statements. Exceptions to this general rule are charges between the Agency's funds for indirect costs. Elimination of these charges would distort the direct costs and program revenues reported for the various functions concerned.

##### ***Fund Financial Statements***

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when they are both measurable and available. Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period. For this purpose, the Agency considers revenues to be available if they are collected within 60 days of the end of the current fiscal period. Expenditures are recorded when the related fund liability is incurred, except for unmatured interest on long-term debt, claims, judgments, compensated absences, and pension expenditures, which are recorded as a fund liability when expected to be paid with expendable available financial resources.

State appropriations are recognized in the year designated by Minnesota Statutes. Federal grants are recognized in the year during which the eligible expenditures are made. If the amounts of federal grants cannot be reasonably estimated, or realization is not reasonably assured, they are not recognized as revenue in the current year. Amounts owed to the Agency which are not available are recorded as receivables and deferred revenues. Amounts received prior to the entitlement period are also recorded as deferred revenues.

Revenues susceptible to accrual include federal grants and interest on investments. Other general revenues such as registration and licensing fees and miscellaneous revenues are recognized when received in cash or when measurable and available under the criteria described above.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

---

#### ***C. MEASUREMENT FOCUS, BASIS OF ACCOUNTING, AND FINANCIAL STATEMENT PRESENTATION (cont.)***

##### ***Fund Financial Statements (cont.)***

The Agency may report deferred revenues on its governmental funds balance sheet. For governmental fund financial statements, deferred revenues arise when a potential revenue does not meet both the "measurable" and "available" criteria for recognition in the current period. Deferred revenues also arise when resources are received before the Agency has a legal claim to them, as when grant monies are received prior to the incurrence of qualifying expenditures. In subsequent periods, when both revenue recognition criteria are met, or when the Agency has a legal claim to the resources, the liability for deferred revenue is removed from the balance sheet and revenue is recognized.

Proprietary fund financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, as described previously in this note.

##### ***All Financial Statements***

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

#### ***D. ASSETS, LIABILITIES, AND NET ASSETS OR EQUITY***

##### ***1. Deposits and Investments***

For purposes of the statement of cash flows, the Agency considers all highly liquid investments with an initial maturity of three months or less when acquired to be cash equivalents.

Minnesota Statutes 136A.16 Subd. 8 and 11A.24 describe the investments the Agency is authorized to have.

The Agency has adopted an investment policy that addresses investment risks. That policy follows the state statute for allowable investments; except the Agency may only invest in obligations maturing within three years of the date of purchase except those invested in the debt service reserve funds which can be invested to the bond maturity date. In addition, the Agency's investment policy outlines the maximum percentage of any type of deposit or investment it may have at one time and the maximum percentage of investment securities to be held at one bank or bank investment subsidiary.

Investments are stated at fair value, which is the amount at which an investment could be exchanged in a current transaction between willing parties. Fair values are based on quoted market prices. No investments are reported at amortized cost. Adjustments necessary to record investments at fair value are recorded in the operating statement as increases or decreases in investment income. The difference between the bank balance and carrying value is due to outstanding checks and/or deposits in transit.

See Note III.A. for further information.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

---

#### ***D. ASSETS, LIABILITIES, AND NET ASSETS OR EQUITY (cont.)***

##### ***2. Receivables***

Loans receivable have been shown net of an allowance for uncollectible accounts.

During the course of operations, transactions occur between individual funds that may result in amounts owed between funds. Short-term interfund loans are reported as “due to and from other funds.” Interfund receivables and payables between funds within governmental activities are eliminated in the statement of net assets. Any residual balances outstanding between the governmental activities and business-type activities are reported in the government-wide financial statements as “internal balances”.

##### ***3. Prepaid Expenses***

Certain payments to vendors reflect costs applicable to future accounting periods and are recorded as prepaid items in both government-wide and fund financial statements.

##### ***4. Restricted Assets***

Mandatory segregations of assets are presented as restricted assets. Such segregations are required by bond agreements and other external parties. Restricted assets will be used for issuing new student loans and retirement of related long-term debt.

##### ***5. Capital Assets***

###### ***Government-Wide Statements***

Capital assets, which includes equipment, are reported in the government-wide financial statements. Capital assets are defined by the Agency as assets with an initial cost of more than \$30,000 for general capital assets, and an estimated useful life in excess of two years. All capital assets are valued at historical cost or estimated historical cost if actual amounts are unavailable. Donated capital assets are recorded at their estimated fair value at the date of donation.

Depreciation of all exhaustible capital assets is recorded as an allocated expense in the statement of activities, with accumulated depreciation reflected in the statement of net assets. Depreciation is provided over the assets' estimated useful lives using the straight-line method of depreciation. The Agency's only category of capital asset is equipment. The estimated useful life of the equipment is 5 years.

###### ***Fund Financial Statements***

In the fund financial statements, capital assets used in governmental fund operations are accounted for as capital outlay expenditures of the governmental fund upon acquisition. Capital assets used in proprietary fund operations are accounted for the same way as in the government-wide statements.

##### ***6. Other Assets – Debt Issuance Costs***

For the government-wide and the proprietary fund type financial statements, debt issuance costs are deferred and amortized over the term of the debt issue using a method that produces substantially the same results as the effective interest method.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

---

#### ***D. ASSETS, LIABILITIES, AND NET ASSETS OR EQUITY (cont.)***

##### ***7. Compensated Absences***

Under terms of employment, employees are granted sick leave and vacation time in varying amounts. Only benefits considered to be vested are disclosed in these statements.

All vested sick leave and vacation pay is accrued when incurred in the government-wide and proprietary fund financial statements. A liability for these amounts is reported in governmental funds only if they have matured, for example, as a result of employee resignations and retirements, and are payable with expendable available resources.

Employees are not compensated for unused sick leave upon termination; however, unused sick leave enters into the computation of severance pay. All employees who have provided 5 to 20 years or more, depending on employment contract terms, of continuous State of Minnesota service are entitled to receive severance pay upon any separation, except discharge for just cause from service. Severance is calculated based upon a formula using an employee's unused sick leave balance.

All eligible employees accrue vacation at a rate that varies with length of service. Any employee who has been employed more than six months and who has separated from state of Minnesota service is compensated in cash at his or her current rate at the time of separation. However, no payment shall exceed 280 hours, except in the case of death.

Accumulated sick leave and vacation time liabilities at June 30, 2012 are determined on the basis of current salary rates.

##### ***8. Long-Term Obligations***

All long-term obligations to be repaid from governmental and business-type resources are reported as liabilities in the government-wide statements. The long-term obligations consist of bonds payable and accrued compensated absences.

Long-term obligations for governmental funds are not reported as liabilities in the fund financial statements. The face value of debts (plus any premiums) are reported as other financing sources and payments of principal and interest are reported as expenditures. The accounting in proprietary funds is the same as it is in the government-wide statements.

For the government-wide statements and proprietary fund statements, bond premiums and discounts are deferred and amortized over the life of the issue using the straight-line method. Gains or losses on prior refundings are amortized over the remaining life of the old debt, or the life of the new debt, whichever is shorter.

The Agency is restricted on the amount of interest that can be earned on nontaxable loans compared to interest expense. This limit is 2% and in the current year, the yield exceeded this limit and an arbitrage liability was recorded.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

---

#### **D. ASSETS, LIABILITIES, AND NET ASSETS OR EQUITY (cont.)**

##### **9. Claims and Judgments**

Claims and judgments are recorded as liabilities if all the conditions of Governmental Accounting Standards Board pronouncements are met. The liability and expenditure for claims and judgments is only reported in governmental fund types if it has matured. Claims and judgments are recorded in the government-wide statements and enterprise funds as expenses when the related liabilities are incurred. There were no significant claims or judgments at year end.

##### **10. Equity Classifications**

###### **Government-Wide Statements**

Equity is classified as net assets and displayed in three components:

- a. Invested in capital assets, net of related debt – Consists of capital assets including restricted capital assets, net of accumulated depreciation and reduced by the outstanding balances of any bonds, mortgages, notes, or other borrowings that are attributable to the acquisition, construction, or improvement of those assets less any unspent debt proceeds.
- b. Restricted net assets – Consists of net assets with constraints placed on their use either by 1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments or, 2) law through constitutional provisions or enabling legislation.
- c. Unrestricted net assets – All other net assets that do not meet the definition of “restricted” or “invested in capital assets, net of related debt.”

When both restricted and unrestricted resources are available for use, it is the Agency's policy to use restricted resources first, then unrestricted resources as they are needed.

###### **Fund Statements**

Governmental fund equity is classified as fund balance. In accordance with Governmental Accounting Standards Board Statement No. 54 – *Fund Balance Reporting and Governmental Fund Type Definitions*, the Agency classifies governmental fund balance as follows:

- a. Nonspendable – includes fund balance amounts that cannot be spent either because they are not in spendable form or because legal or contractual requirements require them to be maintained intact.
- b. Restricted – Consists of fund balances with constraints placed on their use either by 1) external groups such as creditors, grantors, contributors, or laws or regulations of other governments or, 2) law through constitutional provisions or enabling legislation.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE I – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (cont.)

---

#### **D. ASSETS, LIABILITIES, AND NET ASSETS OR EQUITY (cont.)**

##### **10. Equity Classifications (cont.)**

###### ***Fund Statements (cont.)***

- c. Committed – includes fund balance amounts that are constrained for specific purposes that are internally imposed by the government through formal action of the highest level of decision making authority. Fund balance amounts are committed through a formal action of the Director. This formal action must occur prior to the end of the reporting period, but the amount of the commitment, which will be subject to the constraints, may be determined in the subsequent period. Any changes to the constraints imposed require the same formal action of the Director that originally created the commitment.
- d. Assigned – includes spendable fund balance amounts that are intended to be used for specific purposes that are not considered restricted or committed. Fund balance may be assigned through the following; 1) The Director may take official action to assign amounts. (2) All remaining positive spendable amounts in governmental funds, other than the general fund, are neither restricted nor committed. Assignments may take place after the end of the reporting period.
- e. Unassigned – includes residual positive fund balance within the general fund which has not been classified within the other above mentioned categories. Unassigned fund balance may also include negative balances for any governmental fund if expenditures exceed amounts restricted, committed or assigned for those specific purposes.

The Agency considers restricted amounts to be spent first when both restricted and unrestricted fund balance is available unless there are legal documents / contracts that prohibit doing this, such as in grant agreements requiring dollar for dollar spending. Additionally, the Agency would first use committed, then assigned and lastly unassigned amounts of unrestricted fund balance when expenditures are made.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE II – STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

---

#### A. BUDGETARY INFORMATION

The State of Minnesota operates on a biennial budget. Every other year Agency appropriations must be approved by the Senate and the House of Representatives, and signed by the governor for the upcoming two year period, which begins in July of odd numbered years. Budgets for each appropriation awarded to the Agency are prepared by the Agency and submitted to the Minnesota Management and Budget Agency and set up in the state's accounting system.

Expenditures cannot legally exceed the total initially appropriated unless supplemental appropriations are enacted into law.

The budget is prepared in accordance with generally accepted accounting principles. Budgetary control is at the appropriation level. Unexpended appropriations from the first year (year ended June 30, 2012) of the biennium are carried over and are available for operations in the second year (year ended June 30, 2013) of the biennium.

Unspent appropriations at the end of a biennium shall be returned to the fund from which appropriated. The Agency's expenditures are classified according to the State administrative guidelines. Agency funds are disbursed by the Minnesota Management and Budget Agency.

A budget has been legally adopted for the Agency's general fund. The budgeted amounts presented include any amendments made. The chief financial officer may authorize transfers of budgeted amounts between appropriations as allowable by state statutes.

---

### NOTE III – DETAILED NOTES ON ALL FUNDS

---

#### A. DEPOSITS AND INVESTMENTS

The Agency's cash and investments at year end were comprised of the following:

	Carrying Value	Bank Balance	Associated Risks
Money market mutual fund investments	\$ 99,069,538	\$ 98,867,670	None
Commercial paper	80,032,426	80,032,426	Credit, custodial credit, concentration of credit, and interest rate risks
Pooled Cash held by State Treasury	<u>100,067,972</u>	<u>100,067,972</u>	N/A
Total Cash and Investments	<u>\$ 279,169,936</u>	<u>\$ 278,968,068</u>	
Reconciliation to financial statements			
Per statement of net assets			
Cash and investments	\$ 185,091,146		
Restricted cash and investments	<u>94,078,790</u>		
Total Cash and Investments	<u>\$ 279,169,936</u>		

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

---

#### **A. DEPOSITS AND INVESTMENTS (cont.)**

Deposits in each local and area bank are insured by the FDIC in the amount of \$250,000 for time and savings accounts (including NOW accounts), \$250,000 for interest-bearing demand deposit accounts, and unlimited amounts for noninterest bearing transaction accounts.

The Securities Investor Protection Corporation (SIPC), created by the Securities Investor Protection Act of 1970, is an independent government-sponsored corporation (not an agency of the U.S. government). SIPC membership provides account protection up to a maximum of \$500,000 per customer, of which \$100,000 may be in cash.

#### ***Custodial Credit Risk***

Deposits – Custodial credit risk is the risk that in the event of a financial institution failure, the Agency's deposits may not be returned to the Agency.

As of June 30, 2012, the Agency did not have any deposits exposed to custodial credit risk.

Investments – For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the Agency will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party.

As of June 30, 2012, the Agency had \$2,798,144 of investments exposed to custodial credit risk.

#### ***Credit Risk***

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations.

As of June 30, 2012, the Agency's investments in commercial paper were rated as follows:

<u>Commercial Paper</u>	<u>Standard &amp; Poors</u>	<u>Moody's</u>
US Bank N.A. Open IB Monthly	A-1+	P-1
Union BK CP	A-1	P-1
Mitsui and Co. USA Inc.	A-1	P-1



# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

#### A. DEPOSITS AND INVESTMENTS (cont.)

##### **Concentration of Credit Risk**

Concentration of credit risk is the risk of loss attributed to the magnitude of an Agency's investment in a single issuer.

As of June 30, 2012, the Agency's investments in commercial paper were concentrated as follows:

	Percentage of Portfolio
US Bank N.A. Open IB Monthly	82.23%
Union BK CP	13.65%

##### **Interest Rate Risk**

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment.

As of June 30, 2012, the Agency's investment of commercial paper had a fair value of \$80,032,426 and a weighted average maturity of .60 years.

See Note I.D.1. for further information on deposit and investment policies.

#### B. RECEIVABLES

Receivables as of year end for the Agency's individual major funds and nonmajor funds in the aggregate, including the applicable allowances for uncollectible accounts, are as follows:

Fund	Gross Receivables	Allowance For Uncollectibles	Net Receivables	Amounts Not Expected to Be Collected Within One Year
General	\$ 692,039	\$ -	\$ 692,039	\$ -
Loan Capital	712,652,139	9,932,462	702,719,677	606,658,102
Nonmajor Funds	1,211,369	-	1,221,369	-

Loans receivable include amounts due within one year and amounts due in more than one year, based upon loan schedules with each student (loan holder). Approximately 14% of the balance is expected to be collected during fiscal year 2012.

SELF II loans are no longer being issued by the Agency. The interest rate on the loans is equal to the average of the weekly auction average (investment) interest rate on three-month U.S. Treasury bills, plus a current margin of 2.0%. The interest rate cannot change more than two percentage points in any four consecutive calendar quarters. The rate was 2% as of June 30, 2012.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

---

#### **B. RECEIVABLES (cont.)**

SELF III loans, offered for the first time in May of 2002, are made to students who meet the eligibility requirements set forth by the Agency. The interest rate on the loans is equal to the London InterBank Offered Rate (LIBOR) plus a current margin of 3.5%. The interest rate cannot change more than three percentage points in any four consecutive calendar quarters. The rate was 4.0% as of June 30, 2012.

SELF IV loans, offered for the first time in July 2006, are made to students who meet the eligibility requirements set forth by the Agency. The interest rate on the loans is equal to the LIBOR, plus a current margin of 3.5%. The interest rate cannot change more than three percentage points in any four consecutive calendar quarters. The rate was 4.0% as of June 30, 2012.

SELF V variable rate loans, offered for the first time in October 2010, are made to students who meet the eligibility requirements set forth by the Agency. The interest rate on the loans is equal to the LIBOR, plus a current margin of 3.5%. The interest rate cannot change more than three percentage points in any four consecutive calendar quarters. The rate was 4.0% as of June 30, 2012.

SELF V fixed rate loans, offered for the first time in October 2010, are made to students who meet the eligibility requirements set forth by the Agency. The fixed interest rate currently charged to borrowers is set at 7.25%. The interest rate will not change over the life of the loan. The Agency has the option to offer a different fixed rate to future borrowers.

Repayment of interest for SELF loans begins 90 days after disbursement and is due quarterly thereafter. Principal payments begin no later than 36 months after graduation or termination. The balance of SELF II, SELF III, SELF IV, and SELF V loans at June 30, 2012 was \$707,258,249.

GRIP loans were made to borrowers who met certain income and debt standards and had graduated with an eligible medical degree. The LCF makes the required monthly payments on the borrower's student loans, and the borrower makes monthly payments to the Agency based on the average income for their medical profession. The borrower's loan payments increase annually in proportion to the growth of the average income for their profession. The interest rate on GRIP loans is fixed at 8%. The Agency is no longer issuing GRIP loans to new participants. The balance at June 30, 2012 was \$18,437.

SELF and GRIP loans are unsecured. However, the Agency does require a credit worthy cosigner on each loan, and it is able to intercept state tax refunds for both borrower and cosigner in the event of default in addition to other collection methods.

An allowance for uncollectible SELF II, SELF III, SELF IV, and SELF V loans is provided for in the financial statements, and an equal amount of the allowance is maintained as restricted cash in the loan capital fund. The loan capital fund provides for loan losses sufficient to maintain the total balance in the allowance at a level equal to 1.4% of the total outstanding loan balance and also designates restricted cash equal to the balance of the allowance. An allowance for uncollectible GRIP loans equal to 4% of the total outstanding loan balance is maintained as restricted cash in the loan capital fund. The restricted cash has been deposited with the Minnesota Management and Budget Agency. Recoveries on defaulted SELF loans are credited to the loan capital as revenue in the year received.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

---

#### **B. RECEIVABLES (cont.)**

The activity for the allowance for losses on all loan types for the year ended June 30, 2012 is as follows:

Beginning balance	\$ 10,211,172
Provision for loan losses	8,441,398
Write-off of loans	<u>(8,720,108)</u>
Ending Balance	<u>\$ 9,932,462</u>

Recovery on defaulted loans of \$7,052,974 for the year ended June 30, 2012 is recognized as a reduction in the provision for loan losses.

#### **Debt Issuance Costs**

SELF II, SELF III, SELF IV, and SELF V loans are reported at the principal amount outstanding, plus the unamortized amount of costs incurred to originate the loans. The origination costs are amortized over the average life of the loans as a reduction of yield. Interest income is recognized at a constant rate over the life of the loans. The origination costs are being deferred and the net amount amortized using a method that approximates the effective interest method. Amortization of total deferred loan costs for the year ended June 30, 2012 was \$449,671.

#### **C. RESTRICTED ASSETS**

The following represent the balances of the restricted assets:

##### **Long Term Debt Accounts**

Acquisition	–	Funds are originally deposited into this fund at the issuance of the bond and used to finance student loans.
Revenue	–	Used to deposit student loan payments of principal and interest. Payments from this account are made to investors for bond interest and to finance additional student loans.
Surplus	–	Used to deposit excess funds from the revenue account and to finance additional student loans.
Debt Service Reserve	–	Used to reserve funds based on bond indenture requirements for potential deficiencies in the revenue account or the surplus account.
Redemption	–	Used to segregate resources accumulated for payment to investors for the redemption of bond securities.
Student Loan	–	Used to hold only student loans transferred to the trustee from the issuer and all student loans made by the issuer with amounts provided under the indenture.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

#### C. RESTRICTED ASSETS (cont.)

##### **Bad Debt Reserve Account**

The loan capital fund established a bad debt reserve account to purchase uncollectible student loans. This account equals the allowance for uncollectible SELF and GRIP loans. This fund is replenished quarterly.

Following is a list of restricted assets at June 30, 2012:

	Restricted Assets
Acquisition account	\$ 5,505,042
Revenue account	21,565,200
Surplus account	36,546,285
Debt service reserve account	17,632,567
Student loan account	2,897,234
Bad debt reserve account	<u>9,932,462</u>
Total Restricted Assets	<u>\$ 94,078,790</u>

#### D. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2012 was as follows:

	Beginning Balance	Additions	Deletions	Ending Balance
<b>Governmental Activities</b>				
Capital assets being depreciated				
Equipment	\$ 60,847	\$ -	\$ -	\$ 60,847
Less: Accumulated depreciation for				
Equipment	<u>(51,999)</u>	<u>(4,387)</u>	<u>-</u>	<u>(56,386)</u>
Capital Assets, Net of Depreciation	<u>\$ 8,848</u>	<u>\$ (4,387)</u>	<u>\$ -</u>	<u>\$ 4,461</u>

\$4,387 of depreciation expense was charged to the governmental activities function of state appropriations.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

#### D. CAPITAL ASSETS (cont.)

	Beginning Balance	Additions	Deletions	Ending Balance
<b>Business-type Activities</b>				
<u>Loan Capital Fund</u>				
Capital assets being depreciated				
Equipment	\$ 14,586	\$ -	\$ -	\$ 14,586
Less: Accumulated depreciation for Equipment	(8,687)	(2,926)	-	(11,613)
Net Loan Capital Fund	<u>\$ 5,899</u>	<u>\$ (2,926)</u>	<u>\$ -</u>	<u>\$ 2,973</u>

\$2,926 of depreciation expense was charged to the loan capital fund.

#### E. INTERFUND RECEIVABLES/PAYABLES

The following is a schedule of interfund receivables and payables including any overdrafts on pooled cash and investment accounts:

Receivable Fund	Payable Fund	Amount
General Fund	Federal Grant Fund	\$ 242,794
Less: Fund eliminations		(242,794)
Total – Government-Wide Statement of Net Assets		<u>\$ -</u>

The interfund payable is expected to be paid within one year. The purpose of the interfund is to cover an overdraft of pooled cash.

For the statement of net assets, interfund balances which are owed within the governmental activities or business-type activities are netted and eliminated.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

#### F. LONG-TERM OBLIGATIONS

Long-term obligations activity for the year ended June 30, 2012 was as follows:

	Beginning Balance	Increases	Decreases	Ending Balance	Amounts Due Within One Year
<b>GOVERNMENTAL ACTIVITIES</b>					
Other Liabilities					
Vested compensated absences	\$ 417,752	\$ 277,079	\$ 269,541	\$ 425,290	\$ 41,816
<b>BUSINESS-TYPE ACTIVITIES</b>					
Bonds Payable					
Revenue bonds	\$ 625,400,000	\$ 85,000,000	\$ 164,375,000	\$ 546,025,000	\$ -
Add/(Subtract) Deferred Amounts For: (Discounts)/Premiums	1,453,049	-	213,003	1,240,046	-
Subtotal	626,853,049	85,000,000	164,588,003	547,265,046	-
Other Liabilities					
Vested compensated absences	215,561	37,668	87,115	166,114	16,765
Arbitrage liability	4,404,649	1,687,059	-	6,091,708	-
Total Other Liabilities	4,620,210	1,724,727	87,115	6,257,822	16,765
Total Business-type Activities					
Long-Term Liabilities	\$ 631,473,259	\$ 86,724,727	\$ 164,675,118	\$ 553,522,868	\$ 16,765

The issued revenue bonds do not constitute debt of the state of Minnesota.

In accordance with Minnesota Statutes, the aggregate amount of revenue bonds, issued directly by the Agency, outstanding at any one time, not including refunded bonds or otherwise defeased or discharged bonds, shall not exceed \$850,000,000. Revenue bonds outstanding at year end were \$546,025,000.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

#### F. LONG-TERM OBLIGATIONS (cont.)

Series 1999, 2002, 2003, 2004, 2005, 2006, and 2008 Supplemental Student Loan Program Variable Rate Revenue Bonds were issued to provide SELF II, III, and IV student loans to borrowers. Series 2010 Supplemental Student Loan Program Fixed Rate Revenue Bonds and Series 2011 Supplemental Student Loan Program Variable Rate Revenue Bonds were issued to provide SELF V student loans to borrowers.

	Date of Issue	Final Maturity	6-30-12 Interest Rates	Interest Rates Reset (days)	Original Indebted- ness	Balance 6-30-12
<u>Supplemental Student Loan Program Variable Rate Revenue Bonds</u>						
Series 1999A taxable revenue bonds	Nov 99	Nov 34	1.245%	7	\$ 61,200,000	\$ 42,200,000
Series 2002A taxable revenue bonds	Jan 02	Jan 37	1.245%	7	68,200,000	3,100,000
Series 2002B revenue bonds	Jan 02	Jan 37	.333%	35	27,100,000	27,100,000
Series 2003A taxable revenue bonds	Mar 03	May 38	1.245%	28	64,700,000	45,800,000
Series 2003B revenue bonds	Mar 03	May 38	.333%	35	10,300,000	10,300,000
Series 2004A taxable revenue bonds	July 04	May 39	1.241%	28	67,000,000	8,325,000
Series 2004B revenue bonds	July 04	May 39	.280%	35	88,500,000	46,800,000
Series 2005B revenue bonds	July 05	May 40	.350%	35	70,000,000	56,000,000
Series 2006 revenue bonds	Nov 06	May 41	.333%	35	70,000,000	68,000,000
Series 2008A taxable revenue bonds	Dec 08	Dec 43	.180%	7	66,700,000	66,700,000
Series 2008B revenue bonds	Dec 08	Dec 43	.160%	7	33,300,000	33,300,000
Series 2011A revenue bonds	Oct 11	Oct 46	.160%	7	35,000,000	35,000,000
Series 2011B revenue bonds	Oct 11	Oct 46	.160%	7	50,000,000	50,000,000
<u>Supplemental Student Loan Program Fixed Rate Revenue Bonds</u>						
Series 2010 revenue bonds	Dec 10	Nov 29	2 – 5%	n/a	53,400,000	53,400,000
Total Business-type Activities Revenue Bonds						<u>\$ 546,025,000</u>

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

#### F. LONG-TERM OBLIGATIONS (cont.)

Annual debt service requirements to maturity for revenue bonds, including interest at June 30, 2012 rates for variable rate bonds, are as follows:

Years Ending June 30	Business-type Activities		
	Principal	Interest	Total
2013	\$ -	\$ 4,692,223	\$ 4,692,223
2014	360,000	4,692,223	5,052,223
2015	1,135,000	4,685,019	5,820,019
2016	1,090,000	4,650,972	5,740,972
2017	3,045,000	4,618,272	7,663,272
2018 - 2022	68,370,000	20,275,064	88,645,064
2023 - 2027	18,150,000	14,616,151	32,766,151
2028 - 2032	8,050,000	11,637,151	19,687,151
2033 - 2037	72,400,000	9,418,371	81,818,371
2038 - 2042	188,425,000	3,851,596	192,276,596
2043 - 2047	185,000,000	1,026,680	186,026,680
Totals	<u>\$ 546,025,000</u>	<u>\$ 84,163,722</u>	<u>\$ 630,188,722</u>

The interest rates on all of the Series 1999A, 2002A, 2002B, 2003A, 2003B, 2004A, 2004B, 2005B, and 2006 variable rate bonds are reset periodically as shown in the detailed revenue debt schedule above. The rates on all of these bonds are based on a determination by the auction agent through auction proceedings. The rates on the taxable bonds cannot exceed the lesser of one-month LIBOR plus 1%; 17%; or the 91 day average of the three-month T-Bill plus an applicable spread of 1.25%. The rates on the tax-exempt bonds cannot exceed the lesser of the applicable percentage of the Kenny index or the after-tax equivalent rate; 14%; or the three month average of the three-month T-Bill plus an applicable spread of 1.25%. The interest on the auction rate bonds is payable each time the rates are reset and no principal payments are required until final maturity.

The rates on the taxable Series 2008A bonds and tax-exempt Series 2008B bonds are determined by a remarketing agent. The rates on Series 2008A bonds and Series 2008B bonds cannot exceed 15% and 12%, respectively. The interest on the Series 2008A and Series 2008B bonds is payable monthly and semi-annually, respectively. No principal payments are required until final maturity on the Series 2008A and Series 2008B bonds.

The rates on the tax-exempt Series 2011A and 2011B bonds are determined by a remarketing agent. The rates on the Series 2011A bonds and Series 2011B bonds cannot exceed 12%. The interest on the Series 2011A bonds and Series 2011B bonds is payable monthly. No principal payments are required until final maturity on the Series 2011A bonds and Series 2011B.

The rates on the tax-exempt Series 2010 bonds are fixed and range from 2% to 5%. The interest on the 2010 bonds is paid semi-annually. The annual effective interest rate was 4.62% for the year ended June 30, 2012.



# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

---

#### ***F. LONG-TERM OBLIGATIONS*** (cont.)

All the bond series are secured by the revenues derived by the Agency from student loans financed by the proceeds of the bonds.

The Agency maintains insurance coverage as additional collateral for the auction rate bonds. The fees to maintain this coverage are calculated as 0.12% for Series 1999A, 2002A, 2002B and 2006; 0.14% for Series 2003A and 2003B; and 0.125% for Series 2004A, 2004B, and 2005B of the outstanding principal amount per year. General and administrative expenses include insurance fees of \$595,132 for the year ended June 30, 2012.

The Agency maintains an unsecured irrevocable direct-pay letter of credit as additional collateral for the Series 2008A, 2008B, 2011A, and 2011B bonds. The fee to maintain this letter of credit is 0.9% of the outstanding principal amount per year. In addition there is a remarketing fee of 0.1% of the outstanding principal amount per year. General and administrative expenses include letter of credit and remarketing fees of \$1,549,360 for the year ended June 30, 2012. The letters of credit expire October 1, 2014.

There is no additional collateral maintained for the Series 2010 bonds.

Except for the Series 2010 bond issue, for all bonds the Agency is required to maintain a debt service account equal to 2% of the outstanding revenue bond balance. The amount required to be on deposit at year end is \$9,852,500 and the Agency met this requirement. For the Series 2010 bonds the Agency is required to maintain a debt service account equal to the maximum amount scheduled to be due during the current or any future fiscal year. The amount required to be on deposit at year end is \$7,708,000 and the Agency met this requirement. There are a number of other limitations and restrictions contained in the various bond indentures. The Agency believes it is in compliance with all significant limitations and restrictions.

All bond series are to be repaid solely from the money and investments held by the trustees. For all bonds, an early repayment provision exists. For the Series 2002B, 2003B, 2004B, 2005B, and 2006 tax-exempt bonds, the Agency must give written notice to exercise its option to redeem bonds at least 45 days prior to the desired redemption date. The paying agent would notify the Agency in writing of bonds selected for redemption and the principal amount to be redeemed. The Agency would then be required to make satisfactory provision for deposit in the Redemption Fund for the principal and interest accrued. For the Series 1999A, 2002A, 2003A, and 2004A taxable bond issues, the Agency must give written notice to the bond trustee and credit provider not less than 20 days but no greater than 65 days prior to redemption. For the Series 2008A and 2008B bonds, the Agency must give written notice to exercise its option to redeem bonds not less than 15 days but no greater than 60 days prior to the redemption date. For the Series 2010 tax-exempt bonds, bonds maturing on or after November 1, 2021 are subject to optional redemption on any date after November 1, 2020. The agency must give written notice to exercise its option to redeem bonds not less than 35 days prior to the redemption. For the Series 2011A and 2011B tax-exempt bonds, the Agency must give written notice to exercise its option to redeem bonds not less than 15 days, but no greater than 60 days, prior to the redemption date.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

#### ***F. LONG-TERM OBLIGATIONS*** (cont.)

During the year ended June 30, 2012 the Agency used \$149,479,250 of available cash to purchase \$164,375,000 of outstanding bonds on the secondary market. These bonds were subsequently cancelled by the Agency. Details of these transactions are as follows:

<u>Date Purchased and Cancelled</u>	<u>Bond Issue Series</u>	<u>Amount Purchased and Cancelled</u>
September 2011	1999A	\$ 100,000
September 2011	2002A	500,000
September 2011	2003A	500,000
September 2011	2004A	200,000
November 2011	2005B	1,200,000
November 2011	2006	2,000,000
November 2011	2002A	1,000,000
November 2011	2003A	5,000,000
November 2011	2004B	2,000,000
November 2011	2005B	100,000
December 2011	1999A	500,000
December 2011	2003A	500,000
December 2011	2004B	5,000,000
December 2011	2004B	34,700,000
December 2011	2005B	12,700,000
May 2012	2002A	58,900,000
May 2012	2004A	35,875,000
May 2012	2004A	1,100,000
May 2012	2002A	2,500,000
Total Purchased and Cancelled		<u>\$ 164,375,000</u>

#### ***Arbitrage Regulations***

The \$379,900,000 of tax-exempt bonds issued by the Agency are subject to the 1986 Tax Reform Act regulations relating to arbitrage reporting and rebate. Any earnings in excess of the bond yield must be remitted to the U.S. government not more than five years following the issue date of the bonds. As of June 30, 2012, the Agency accrued a liability of \$6,091,708 resulting from the excess yield on interest rates.

#### ***Other Debt Information***

Estimated payments of compensated absences are not included in the debt service requirement schedules. The compensated absences liability attributable to governmental activities will be liquidated by the general, miscellaneous grant, and federal grant funds.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE III – DETAILED NOTES ON ALL FUNDS (cont.)

---

#### **G. NET ASSETS**

Certain net assets are classified in the statement of net assets as restricted because their use is limited. The business-type activities report restricted net assets for amounts that are not available for operations or are legally restricted by outside parties for use for a specific purpose. As of June 30, 2012, the business-type activities restricted net assets are restricted for debt service.

The Agency's business-type activities net assets (up to a certain level) are restricted for debt service according to their bond financial covenants. The amount subject to the restriction increases each year and is as follows:

<u>Years Ending June 30,</u>	
2012	\$ 450,000,000
2013	475,000,000
2014	500,000,000
2015	525,000,000
2016	550,000,000
2017	575,000,000
2018	600,000,000
2019	625,000,000
2020	650,000,000
2021	675,000,000
2022	700,000,000
2023	725,000,000
2024 and thereafter	750,000,000

As the Agency's net assets are less than the required minimum per the bond covenants, the net assets are shown first as invested in capital assets and then as restricted for loan capital fund use, as required in the bond financial covenants.

---

### NOTE IV – OTHER INFORMATION

---

#### **A. EMPLOYEES' RETIREMENT SYSTEM**

Employees of the Agency meeting certain age and length of service requirements participate in the State Employees' Retirement Fund ("SERF") of the Minnesota State Retirement System ("MSRS"). The SERF requires contributions by both employers and employees. The Agency's contribution to the SERF for the years ended June 30, 2012, 2011, and 2010 was \$179,391, \$186,936, and \$183,448, respectively. The total covered payroll of the Agency for the years ended June 30, 2012 and 2011 was \$3,505,045 and \$3,705,104, respectively.

The SERF is a statewide plan that covers employees of the state of Minnesota, school districts, counties, cities, and other political subdivisions. The SERF is a multiple-employer, cost-sharing defined benefit plan administered by MSRS. Benefits are based on average salary and are fully vested after three years of credited service. Participants are required to contribute 5% of their total compensation with a matching the Agency contribution of 5%. The contribution rates for the SERF are not actuarially determined, but rather are determined by the state statute.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE IV – OTHER INFORMATION (cont.)

---

#### **A. EMPLOYEES' RETIREMENT SYSTEM (cont.)**

The pension benefit obligation is a standardized measure of the actuarial present value of credited projected benefits. The measure is intended to help users assess the SERF's funding status on a going-concern basis, assess progress made in accumulating sufficient assets to pay benefits when due, and make comparisons among public employee retirement systems.

The unfunded vested benefit liabilities of the SERF are not actuarially segregated by employer unit. As of June 30, 2010 (the most recent information available), the Agency's contributions and employees represented less than 1% of all participating entity contributions and active plan participants in SERF.

The SERF issues a publicly available financial report that includes financial statements and required supplementary information for the plan. The report may be obtained by writing or calling the plan at:

Minnesota State Retirement System  
Affinity Plus Building, Suite 300  
175 West Lafayette Frontage Road  
Saint Paul, Minnesota 55107-1425  
651 296 2761

As of June 30, 2011, the SERF had a projected benefit obligation of \$9,130,011,000, unfunded liabilities of \$1,446,470,000, and net assets available for benefits, at fair value, of \$10,576,481,000. As of June 30, 2010, the SERF had a projected benefit obligation of \$8,960,391,000, unfunded liabilities of \$1,303,680,000, and net assets available for benefits, at fair value, of \$10,264,071,000. Ten-year historical trend information showing the SERF's progress in accumulating sufficient assets to pay benefits when due is presented in the SERF's June 30, 2011, Comprehensive Annual Financial Report.

#### **B. RISK MANAGEMENT**

The Agency is exposed to various risks of loss related to torts; theft of, damage to, or destruction of assets; errors and omissions; workers compensation; and health care of its employees. The Agency is self insured through the State of Minnesota for all types of losses. A fee is paid annually for property insurance and an administrative fee is paid annually for workers' compensation, but no other premiums are paid.

#### **C. COMMITMENTS AND CONTINGENCIES**

From time to time, the Agency is party to various pending claims and legal proceedings. Although the outcome of such matters cannot be forecasted with certainty, it is the opinion of management and the Agency's attorney that the likelihood is remote that any such claims or proceedings will have a material adverse effect on the Agency's financial position or results of operations.

The Agency has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to requests for reimbursements to the grantor agency for expenditures disallowed under terms of the grants. Management believes such disallowances, if any, would be immaterial.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO FINANCIAL STATEMENTS As of and for the Year Ended June 30, 2012

---

### NOTE IV – OTHER INFORMATION (cont.)

---

#### **C. COMMITMENTS AND CONTINGENCIES (cont.)**

Funding for the operating budget of the Agency's general fund comes from the State of Minnesota. The Agency's general fund is dependent on continued approval and funding by the Minnesota governor and legislature, through their budget processes. The State of Minnesota is currently experiencing budget problems. Any changes made by the State to appropriations for the Agency's general fund could have a significant impact on the future operating results of the Agency.

#### **D. EFFECT OF NEW ACCOUNTING STANDARDS ON CURRENT PERIOD FINANCIAL STATEMENTS**

The Governmental Accounting Standards Board (GASB) has approved GASB Statement No. 61, *The Financial Reporting Entity: Omnibus*; Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*; Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*; Statement No. 64, *Derivative Instruments: Application of Hedge Accounting Termination Provisions - an amendment of GASB Statement No. 53*; Statement No. 65, *Items Previously Reported as Assets and Liabilities*; Statement No. 66, *Technical Corrections – 2012 – an Amendment of GASB Statements No. 10 and No. 62*; Statement No. 67, *Financial Reporting for Pension Plans – and Amendment of GASB Statement No. 25*; and Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*. Application of these standards may restate portions of these financial statements.

#### **E. SUBSEQUENT EVENT**

The agency issued \$375 million of revenue bonds in September 2012 to refinance certain existing debt and provide additional new funding.

## **REQUIRED SUPPLEMENTARY INFORMATION**

# MINNESOTA OFFICE OF HIGHER EDUCATION

## BUDGETARY COMPARISON SCHEDULE GENERAL FUND For the Year Ended June 30, 2012

	Budgeted Amounts		Actual	Variance With Final Budget
	Original	Final		
<b>REVENUES</b>				
General Administration	\$ 2,494,000	\$ 1,796,820	\$ 1,796,820	\$ -
Safety Office Survivors	100,000	87,871	87,871	-
MN College Savings Program	350,000	339,075	339,075	-
Child Care Grant Program	6,684,000	6,328,331	6,328,331	-
MN Link Gateway and Minitex Library	5,605,000	5,602,948	5,602,948	-
State Grant Program	154,624,000	143,544,204	143,544,204	-
State Work Study	14,502,000	14,408,891	14,408,891	-
Interstate Reciprocity	3,150,000	5,640,460	5,640,460	-
Midwest Compact	95,000	95,000	95,000	-
Other Small Programs	347,000	197,804	197,804	-
United Family Practice	351,000	351,000	351,000	-
MN GI Bill Program	1,394,000	958,460	958,460	-
Intervention College Attendance	671,000	537,626	537,626	-
American Indian Scholarship	1,850,000	1,799,749	1,799,749	-
Total Revenues	192,217,000	181,688,239	181,688,239	-
<b>EXPENDITURES</b>				
General Administration	2,494,000	1,954,171	1,796,820	157,351
Safety Office Survivors	100,000	87,871	87,871	-
MN College Savings Program	350,000	339,075	339,075	-
Child Care Grant Program	6,684,000	6,328,331	6,328,331	-
MN Link Gateway and Minitex Library	5,605,000	5,602,948	5,602,948	-
State Grant Program	154,624,000	143,544,204	143,544,204	-
State Work Study	14,502,000	14,408,891	14,408,891	-
Interstate Reciprocity	3,150,000	5,640,460	5,640,460	-
Midwest Compact	95,000	95,000	95,000	-
Other Small Programs	347,000	248,304	197,804	50,500
United Family Practice	351,000	351,000	351,000	-
MN GI Bill Program	1,394,000	965,706	958,460	7,246
Intervention College Attendance	671,000	659,349	537,626	121,723
American Indian Scholarship	1,850,000	1,799,749	1,799,749	-
Total Expenditures	192,217,000	182,025,059	181,688,239	336,820
<b>NET CHANGE IN FUND BALANCE</b>	<b>\$ -</b>	<b>\$ (336,820)</b>	<b>\$ -</b>	<b>\$ 336,820</b>

See independent auditors' report and accompanying notes to required supplementary information.

# MINNESOTA OFFICE OF HIGHER EDUCATION

## NOTES TO REQUIRED SUPPLEMENTARY INFORMATION For the Year Ended June 30, 2012

---

### ***Budgetary Information***

Budgetary information is derived from the annual operating budget and is presented using generally accepted accounting principles and the modified accrual basis of accounting.



## **SUPPLEMENTARY INFORMATION**

# MINNESOTA OFFICE OF HIGHER EDUCATION

## COMBINING BALANCE SHEET NONMAJOR GOVERNMENTAL FUNDS As of June 30, 2012

	Miscellaneous Grant Fund	Federal Grant Fund	Totals
<b>ASSETS</b>			
Cash and investments	\$ 1,610,674	\$ -	\$ 1,610,674
Accounts receivable	22,944	841,381	864,325
Due from other governments	-	347,044	347,044
<b>TOTAL ASSETS</b>	<b>\$ 1,633,618</b>	<b>\$ 1,188,425</b>	<b>\$ 2,822,043</b>
<b>LIABILITIES AND FUND BALANCES</b>			
Liabilities			
Accounts payable	\$ 24,830	\$ 792,802	\$ 817,632
Accrued liabilities	11,554	47,167	58,721
Due to other governments	-	105,662	105,662
Due to other funds	-	242,794	242,794
Total Liabilities	36,384	1,188,425	1,224,809
Fund Balances			
Restricted for licensing and grant administration	860,912	-	860,912
Assigned	736,322	-	736,322
Total Fund Balances	1,597,234	-	1,597,234
<b>TOTAL LIABILITIES AND FUND BALANCES</b>	<b>\$ 1,633,618</b>	<b>\$ 1,188,425</b>	<b>\$ 2,822,043</b>

# MINNESOTA OFFICE OF HIGHER EDUCATION

## COMBINING STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES NONMAJOR GOVERNMENTAL FUNDS For the Year Ended June 30, 2012

	Miscellaneous Grant Fund	Federal Grant Fund	Totals
<b>REVENUES</b>			
Federal grants	\$ -	\$ 4,839,483	\$ 4,839,483
Registration and licensing fees	635,810	-	635,810
Other revenue	542,365	-	542,365
Total Revenues	<u>1,178,175</u>	<u>4,839,483</u>	<u>6,017,658</u>
<b>EXPENDITURES</b>			
General government	587,067	-	587,067
Federal grants	-	4,839,483	4,839,483
Total Expenditures	<u>587,067</u>	<u>4,839,483</u>	<u>5,426,550</u>
<b>Excess (deficiency) of revenues over expenditures</b>	591,108	-	591,108
FUND BALANCE - Beginning of Year	<u>1,006,126</u>	-	<u>1,006,126</u>
<b>FUND BALANCE - END OF YEAR</b>	<u>\$ 1,597,234</u>	<u>\$ -</u>	<u>\$ 1,597,234</u>