



TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency of the State of Texas)

Financial Statements

For the year ended August 31, 2010

(With Independent Auditors' Report Thereon)

TEXAS HIGHER EDUCATION COORDINATING BOARD

Year Ended August 31, 2010

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KPMG LLP
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111 Congress Avenue
Austin, TX 78701-4091

Independent Auditors' Report

The Board of Trustees
Texas Higher Education Coordinating Board:

We have audited the accompanying financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of the Texas Higher Education Coordinating Board (THECB), an Agency of the State of Texas, as of and for the year ended August 31, 2010, which collectively comprise the THECB's basic financial statements as listed in the table of contents.. These financial statements are the responsibility of THECB'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 consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of THECB's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, and 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 opinion.

As discussed in note 1, the financial statements of THECB are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Texas that is attributable to the transactions of THECB. They do not purport to, and do not, present fairly the financial position of the State of Texas as of August 31, 2010, the changes in its financial position, or, where applicable, its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, each major fund, and the aggregate remaining fund information of THECB, as of August 31, 2010, and the respective changes in financial position for the year then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated June 30, 2011, on our consideration of THECB's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



The Management's Discussion and Analysis on pages 5 through 15 and the Schedules of Budgeted and Actual Revenues and Expenditures on pages 48 through 49 are not a required part of the basic financial statements of THECB, but are supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

June 30, 2011

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Management's Discussion and Analysis

August 31, 2010

The following is a discussion and analysis of Texas Higher Education Coordinating Board's (hereinafter referred to as THECB) financial performance, providing an overview of THECB's financial position and activities as of and for the year ended August 31, 2010. Please read it in conjunction with THECB's basic financial statements, which follow this section.

Financial Highlights – 2010

- The assets of THECB exceeded its liabilities at the end of the fiscal year 2010, resulting in \$563.0 million of net assets for the governmental activities.
- Unrestricted net assets, which may be used to meet THECB's future obligations, was \$0.7 million or 0.1% of total net assets at the end of fiscal year 2010.
- Net assets in the amount of \$102.9 million or 18.3% of total net assets was restricted for Debt Service and \$459.2 million, or 81.6% of net assets was restricted for loans and grant programs.
- THECB's total liabilities of \$847.2 million include \$770.1 million for bonds payable.
- As of August 31, 2010, THECB's governmental funds reported combined fund balances of \$468.7 million. Approximately \$1.6 million, or 0.3% of fund balance, represents unreserved, undesignated net assets.
- THECB's primary revenue source is funding from the State of Texas through legislative appropriations and American Recovery and Reinvestment Act (ARRA) funding of \$2.1 billion. THECB's primary expenditures are grants to institutions of \$2.0 billion.

Financial Highlights - 2009

- The assets of THECB exceeded its liabilities at the end of the fiscal year 2009, resulting in \$454.7 million of net assets for the governmental activities.
- Unrestricted net assets, which may be used to meet THECB's future obligations, was \$2.8 million or less than 1% of total net assets at the end of fiscal year 2009.
- Net assets in the amount of \$111.0 million or 24.4% of total net assets was restricted for Debt Service and \$340.5 million, or 74.9% of net assets was restricted for loans and grant programs.
- THECB's total liabilities of \$753.2 million include \$717.6 million of bonds payable.
- As of August 31, 2009, THECB's governmental funds reported combined fund balances of \$345.1 million. Approximately \$4.0 million, or 1.1% of fund balance, represents unreserved, undesignated net assets.
- THECB's primary revenue source is funding from the State of Texas through legislative appropriations of \$1.6 billion and THECB's primary expenditures are grants to institutions of \$1.5 billion.

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Management's Discussion and Analysis

August 31, 2010

Overview of the Financial Statements

The reporting focus of this report is on THECB as a whole and on the major individual funds. The report presents a more comprehensive view of THECB's financial activities and makes it easier to compare the performance of THECB to that of other state agencies.

This financial report presents THECB's financial position and activities in the following three components: (1) MD&A, (2) the basic financial statements and the (3) required supplementary information. The basic financial statements include government-wide financial statements, fund financial statements, and notes to financial statements that provide more detailed information to supplement the basic financial statements.

Government-wide financial statements

The government-wide financial statements are designed to present an overall picture of the financial position of THECB. These statements consist of the Statement of Net Assets and the Statement of Activities, which are prepared using the economic resources measurement focus and the accrual basis of accounting. This means that all the current year's revenues and expenses are included, regardless of when cash is received or paid, producing a view of financial position similar to that presented by most private-sector companies.

The Statement of Net Assets combines the government's current financial resources with capital assets and long-term obligations. This statement includes all of the government's assets and liabilities. Net assets, which are the difference between THECB's assets and liabilities, represent one measure of THECB's financial health.

The Statement of Activities presents information showing how THECB'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 related cash flows. Thus, revenues and expenses are reported in this statement for some items that will only result in cash flows in future fiscal periods, such as expenses for future compensable leave balances. This statement also presents a government wide format of expenses, charges for services, operating grants and contributions and net expenses for Governmental activities. The activities are further broken down by function and program. The second section of the Statement of Activities shows general revenues not associated with a particular program but provides resources for THECB's programs and operations.

Fund financial statements

Fund Financial Statements present financial information in a form more familiar to experienced users of governmental financial statements. However, these statements focus on the major funds. A fund is a separate accounting entity with a self-balancing set of accounts. THECB uses funds to keep track of sources of funding and spending related to specific activities. Use these statements to find more detailed information about THECB's most significant activities. All of THECB's funds can be divided into the following two categories: governmental funds and fiduciary funds.

Governmental Funds - A majority of THECB's activities is reported in governmental funds. Reporting of these funds focuses on how money flows in and out of the funds and any amounts remaining at year-end for future spending.

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Governmental funds are accounted for using the modified accrual basis of accounting, which measures cash and other assets that can be readily converted to cash. The governmental fund statements provide a detailed short-term view of THECB's general governmental operations and the basic services it provides. This information should help determine the level of resources available for THECB's programs. The reconciliation following the Fund Financial Statements explains the differences between the governmental activities, reported in the Government-wide Statement of Net Assets and the Government-wide Statement of Activities and the governmental funds.

THECB maintains the following three governmental fund types: General fund, Special Revenue funds and Debt Service fund. Information is presented separately in the governmental fund balance sheet and in the governmental fund statement of revenues, expenditures, and changes in fund balances for the General Fund, Texas Opportunity Plan Fund and the Student Loan Auxiliary Fund, and the Debt Service Fund, all of which are considered to be major funds. Data from other non-major governmental funds are combined into a single aggregated presentation entitled Non-major Governmental Funds.

Fiduciary Funds - Fiduciary Funds are used to account for resources held for the benefit of parties outside THECB. THECB is the trustee for these funds, and is responsible for ensuring that the assets reported in these funds are used for their intended purposes. All THECB fiduciary activities are reported in separate Statements of Fiduciary Net Assets. Since the resources of the fiduciary funds are not available to support THECB's own programs they are not reflected in the government-wide financial statements.

Notes to the financial statements – The notes provide additional information that is essential to a complete understanding of the data provided in the government-wide and fund financial statements.

Other information – In addition to the basic financial statements and accompanying notes, this report also presents certain Required Supplementary Information (RSI) that further explains and supports the information presented in the financial statements. The RSI provides a comparison to budget and demonstrates budgetary compliance.

TEXAS HIGHER EDUCATION COORDINATING BOARD

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August 31, 2010

Financial Analysis of the Government-Wide Financial Statement

Net Assets

The following table reflects a summary of Net Assets for the fiscal year ended August 31, 2010 and 2009:

**Texas Higher Education Coordinating Board
Net Assets
August 31, 2010 and 2009**

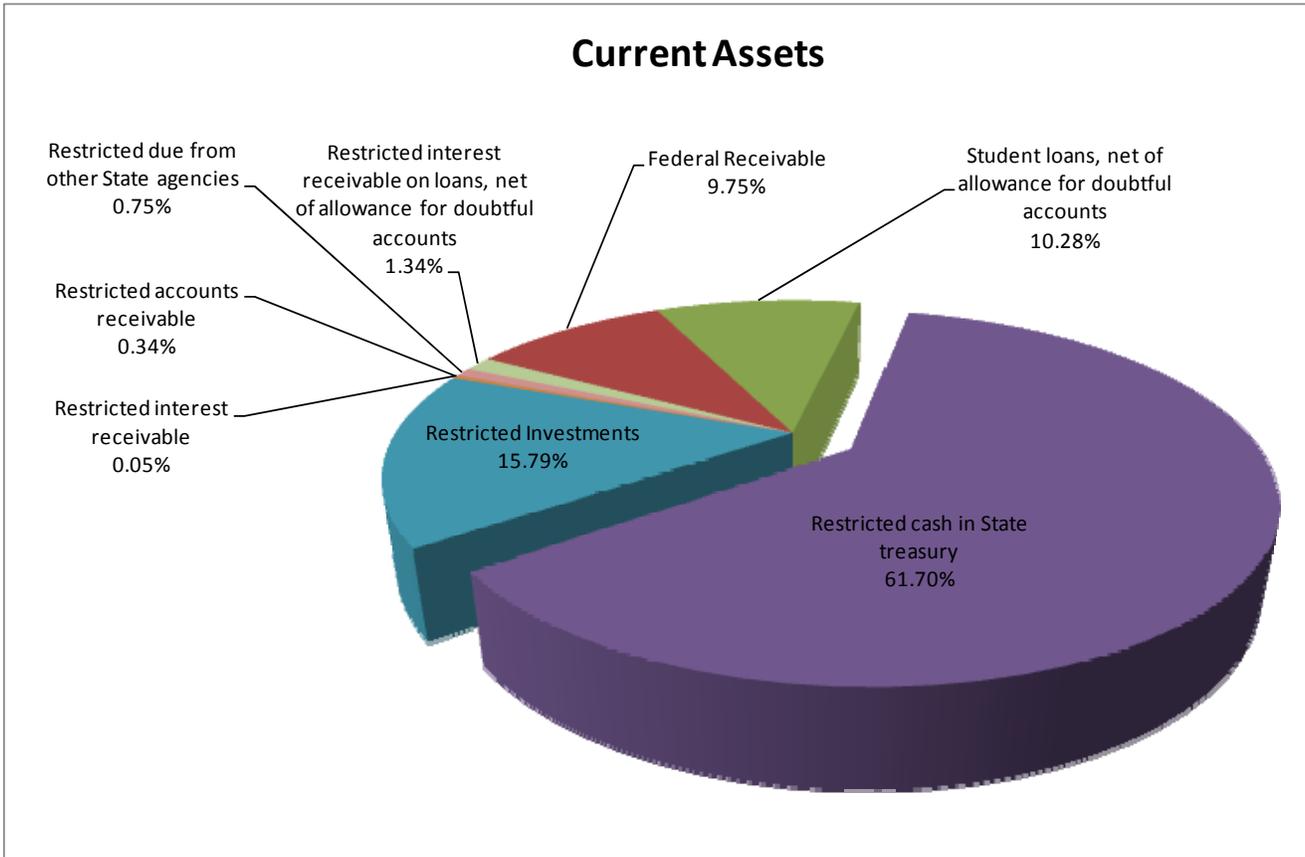
	<u>2010</u>	<u>2009</u>
ASSETS		
Current assets	\$ 611,974,712	443,993,250
Capital assets	213,094	310,984
Other non-current assets	797,994,353	763,525,158
Total assets	<u>1,410,182,159</u>	<u>1,207,829,392</u>
LIABILITIES		
Current liabilities	140,521,487	105,659,030
Noncurrent liabilities	706,704,011	647,498,991
Total liabilities	<u>847,225,498</u>	<u>753,158,021</u>
NET ASSETS		
Invested in capital assets	213,094	310,984
Restricted	562,080,391	451,550,618
Unrestricted	663,176	2,809,769
Total net assets	<u>\$ 562,956,661</u>	<u>454,671,371</u>

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Management's Discussion and Analysis

August 31, 2010



Net assets may serve as a useful indicator of a government's financial position. For THECB, assets exceeded liabilities by \$563.0 million at the end of the 2010 fiscal year, an increase of \$108.3 million from prior year or 23.8%. The largest portion of THECB's net assets is restricted for debt service, loans and grants which represent \$562.1 million, or 99.8% of the total amount of THECB's net assets.

Total assets increased to \$1.41 billion from \$1.21 billion, representing a 16.8% change from fiscal year 2009. The change was due to higher cash balances as a result of year-over-year increases in unexpended appropriations of \$46.8 million and bond proceeds of \$50.0 million. Also contributing to the increase in total assets were higher net loan receivables of \$34.4 million and federal receivables related to American Recovery and Reinvestment Act (ARRA) funds of \$58.7 million. Total liabilities increased to \$847.2 million from \$753.2 million, representing a 12.5% change from the prior fiscal year. The change in total liabilities was primarily the result of year-over-year increases in bonds payable as well as larger accruals with other state agencies related to ARRA funds.

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Statement of Activities

The following table reflects a summary of the changes in Net Assets for the fiscal year ended August 31, 2010 and 2009:

**Texas Higher Education Coordinating Board
Changes in Net Assets
For the Years ended August 31, 2010 and 2009**

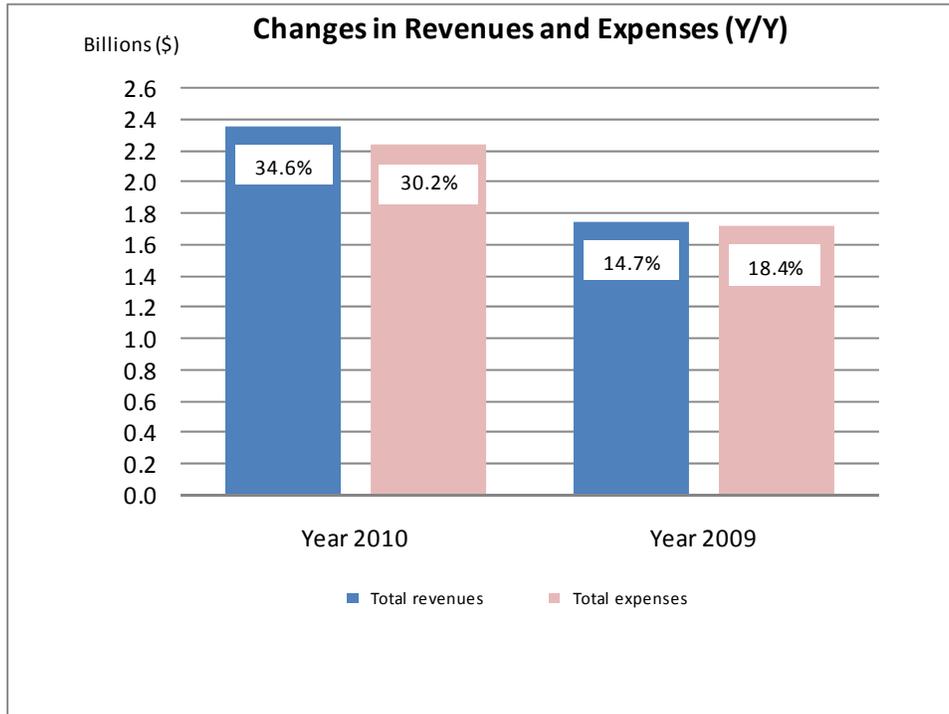
	<u>2010</u>	<u>2009</u>
Program revenues:		
Charges for services	\$ 484,162	232,882
Operating grants and contributions	785,568,770	171,625,361
General revenues	<u>1,563,477,707</u>	<u>1,573,949,936</u>
Total revenues	<u>2,349,530,639</u>	<u>1,745,808,179</u>
Program expenses:		
General administration	33,487,508	29,760,664
Financial assistance – loans	80,335,268	72,394,191
Financial assistance – institutions	1,984,186,308	1,491,942,422
Financial assistance – students	<u>143,236,265</u>	<u>127,606,401</u>
Total expenses	<u>2,241,245,349</u>	<u>1,721,703,678</u>
Change in net assets	108,285,290	24,104,501
Beginning net assets	<u>454,671,371</u>	<u>430,566,870</u>
Ending net assets	\$ <u>562,956,661</u>	<u>454,671,371</u>

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In the current fiscal year, total governmental net assets of THECB increased by \$108.3 million. Revenue increased by \$603.7 million or 34.6% while expenses increased by \$519.5 million or 30.2%. The revenue and expense increases for fiscal year 2010, on a year-over-year basis, were primarily due to federal funding from the American Recovery and Reinvestment Act (ARRA) of 2009.

Approximately \$1.6 billion of revenue was from legislative appropriations from the State of Texas, which decreased from year 2009 by \$10.5 million or less than 1%. For fiscal year 2010, legislative appropriations amounted to approximately 66.5% of total revenues (90.2% in fiscal year 2009). Operating Grants and Contributions, mainly from ARRA, amounted to 33.4% of total revenues. Financial assistance to institutions represented the majority of expenses at \$2.0 billion, or 89.9% of the total financial assistance expenses.

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Financial Analysis of THECB's Funds

As noted earlier, THECB uses fund accounting to ensure and demonstrate compliance with finance-related legal requirements, bond covenants, and segregation for particular purposes.

Governmental Funds

The focus of THECB's governmental funds is to provide information on near-term inflows, outflows, and balances of spendable resources. Such information is useful in assessing THECB's financing requirements. In particular, unreserved, undesignated fund balance may serve as a useful measure of THECB's net resources available for spending at the end of a fiscal year.

The financial performance of THECB as a whole is reflected in its governmental funds. At the end of the current fiscal year, THECB's governmental funds reported combined ending fund balances of \$468.7 million, an increase of \$123.6 million from 2009 or 35.8%. Approximately \$467.2 million or 99.7% of the fund balance constitutes reserved fund balance as compared to \$341.1 million in 2009, which is available for encumbrances, prepaids, debt service and loans and grants. Approximately \$1.6 million or 0.3% of the fund balance constitutes unreserved and undesignated fund balance, which is available for spending at THECB's discretion. Prior year unreserved and undesignated funds were \$4.0 million.

General fund is used to account for all financial resources of THECB except those required to be accounted for in another fund. At the end of the current fiscal year, unreserved, undesignated fund balance was \$1.6 million, while the total general fund balance was \$189.2 million as compared to \$4.0 million and \$90.3 million, respectively, in 2009. The overall increase of \$98.9 million is attributable to:

- Revenues exceeded expenditures by \$91.2 million due to funds received for grants had exceeded the amount of grants issued. This is primarily due to the timing of the receipt of funding in the current fiscal year and the issuance of a portion of these grants that is expected to be expended in the next fiscal year.
- Transfers from loan funds into the General Fund to cover related administrative program costs were \$7.6 million.

The General Fund contains American Recovery and Reinvestment Act (ARRA) funds. In FY 2010, ARRA revenues were \$587.5 million, or 25.7% of total General Fund revenues. Similarly, ARRA expenditures were \$587.5 million, or 26.8% of total General Fund expenditures.

The Texas Opportunity Plan Fund (TOP) and the Student Loan Auxiliary Fund (SLA) special revenue funds are used to account for the proceeds of bond issues and repayment of student loans in excess of what is required to be deposited in the Debt Service Fund to make loans to students attending Texas colleges and universities. The TOP fund reflects bonds issued prior to 1992 and the funds are used to make Hinson-Hazelwood loans. The SLA fund is for bond activity subsequent to 1992 and is used to make Hinson-Hazelwood loans and B-On-Time loans. At the end of the current fiscal year, reserves for loan fund balance for the TOP and the SLA fund was \$167.3 million, an increase of \$31.1 million from \$136.1 million in 2009. The increase was the result of a \$32.2 million increase in Cash in State Treasury, driven primarily by higher year-over-year proceeds from new bond issuances.

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Debt service fund is used to account for the accumulation of resources for, and the payment of, long-term debt principal and interest. At the end of the current fiscal year, reserved fund balance for debt service was \$102.9 million and \$3.4 million for loans and grants as compared to \$111.0 million and \$5.0 million for 2009. The decrease was primarily due to debt service payments exceeding collections from loan repayments in FY 2010.

OTHER INFORMATION

General Fund budgetary highlights

During the current fiscal year, actual revenues were \$112.2 million lower than the final budgeted amount of \$2.4 billion. The difference was primarily due to American Recovery and Reinvestment Act (ARRA) revenues being \$96.0 million lower than budget.

Actual general fund expenditures were \$214.7 million less than final budgeted amount of \$2.4 billion. The primary difference is due to unspent budgeted grants which are expected to be expended in fiscal year 2011.

Capital Assets

THECB's capital assets at year end totaled \$213,094 (net of accumulated depreciation). Capital assets include furniture, equipment, and intangible assets. Net capital assets decreased by \$97,890 primarily due to scheduled depreciation. Additional details on capital assets can be found in Note 4. Capital asset balances are as follows:

**Capital Assets, Net of Accumulated Depreciation
August 31, 2010 and 2009
(in thousands)**

	<u>2010</u>	<u>2009</u>
Furniture and equipment	\$ <u>213</u>	<u>311</u>

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Management's Discussion and Analysis

August 31, 2010

Debt Administration

At the end of the current fiscal year, THECB reported \$770.1 million in outstanding debt. The table below reflects the outstanding debt at August 31, 2010 and 2009. Additional information can be found in Note 8.

**Outstanding Debt
General Obligation Bonds
(in thousands)**

	<u>2010</u>	<u>2009</u>
Bonds outstanding at August 31, net	\$717,644	745,897
Bonds issued	165,445	71,730
Bonds retired/refunded	(128,010)	(103,855)
Accretion adjustments	0	1,081
Deferred adjustments, net	<u>15,043</u>	<u>2,791</u>
Bonds outstanding at August 31, net	<u>\$770,122</u>	<u>717,644</u>

In 2010, the Board approved one current bond refunding for \$51.9 million that was issued to refinance all outstanding maturities of the Board's 1997 and 2000 bonds totaling \$56.5 million. Additionally, new debt was issued for \$113.6 million. Total bonded indebtedness for the fiscal year 2010 increased by \$52.5 million or 7.3% primarily due to new bond issues exceeding principal payments on outstanding debt.

The Board's general obligation bond ratings were upgraded to AA+ by Standard and Poor's in August 2009. In April 2010, Moody's Investors Service, Inc. upgraded the Board's general obligation bonds to Aaa. Ratings of the THECB's obligations for various debt instruments as of August 31, 2010 are as follows:

<u>Debt</u>	<u>Moody's Investors Service, Inc.</u>	<u>Standard and Poor's</u>
<u>General Obligation Bonds:</u>		
Col Stud Loan Bds Ser'99	Aaa	AA+
Col Stud Loan Bds Ser'02	Aaa	AA+
Var Rt Col Stud Loan Rfd Bds Ser'03	Aaa1/VMIG1	AA+/A1+
Var Rt Col Stud Loan Rfd Bds Ser'04	Aaa1/VMIG1	AA+/A1+
Var Rt Col Stud Loan Rfd Bds Ser'06	Aaa1/VMIG1	AA+/A-1+
Col Stud Loan Bds Ser'07A&B	Aaa	AA+
Col Stud Loan Bds Ser'08A,B & C	Aaa	AA+
Col Stud Loan Bds Ser'09	Aaa	AA+
Col Stud Loan Bds Ser'10	Aaa	AA+
Col Stud Loan Rfd Bds Ser'10	Aaa	AA+

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Management's Discussion and Analysis

August 31, 2010

Economic Factors and Next Year's Budget

Our 2011 fiscal year budget is guided by our state's higher education plan, *Closing the Gaps by 2015*, which aims to close the educational gaps within Texas and between Texas and other leading states in student participation, student success, and institutional excellence and research.

Considerations during the process of developing the budget for the 2011 fiscal year include:

- One major technology project, the legislatively mandated statewide data center services project, is in process.
- Additional budget reductions as legislatively mandated.
- New programs authorized by the Legislature, such as new student financial aid programs and increased agency responsibilities involving the higher education community.
- THECB received \$40 million in funding for FY11 from the American Recovery and Reinvestment Act (ARRA).

REQUEST FOR INFORMATION

This financial report is designed to provide our citizens, taxpayers, customers, investors, and creditors with a general overview of THECB's finances, as well as demonstrate accountability for funds the agency receives. If you have questions about any information provided by this report or need additional information, please contact THECB Business & Finance Division, 1200 East Anderson Lane, Austin, Texas 78752 or (512) 427-6100 or on the web at <http://www.thecb.state.tx.us/>.

TEXAS HIGHER EDUCATION COORDINATING BOARD
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Statement of Net Assets

For the Year Ended August 31, 2010

	Governmental Activities
ASSETS	
Current assets:	
Prepaid Items	\$ 37,798
Federal Receivable	59,670,955
Student loans, net of allowance for doubtful accounts	62,883,314
Restricted cash in State treasury	377,645,158
Restricted cash in Bank	12,896
Restricted Investments	96,612,372
Restricted accounts receivable	2,070,934
Restricted interest receivable	289,181
Restricted due from other State agencies	4,561,665
Restricted interest receivable on loans, net of allowance for doubtful accounts	8,190,439
Total current assets	611,974,712
Noncurrent assets:	
Student loans, net of allowance for doubtful accounts	703,525,405
Interest receivable on loans, net of allowance for doubtful accounts	18,875,069
Restricted interest receivable on loans, net of allowance for doubtful accounts	72,697,746
Depreciable capital assets:	
Furniture and equipment	1,304,481
Accumulated depreciation	(1,091,387)
Net depreciable capital assets	213,094
Deferred issuance costs, net of amortization	2,896,133
Total noncurrent assets	798,207,447
Total assets	1,410,182,159
 LIABILITIES AND NET ASSETS	
Current liabilities:	
Accounts payable	11,517,947
Interest payable	2,341,249
Due to other State agencies	59,660,177
Deferred revenues	974,187
Bonds payable, net	64,300,664
Employees' compensable leave	982,218
Arbitrage rebate liability	745,045
Total current liabilities	140,521,487
Noncurrent liabilities:	
Bonds payable, net	705,821,828
Employees' compensable leave	831,291
Arbitrage rebate liability	50,892
Total noncurrent liabilities	706,704,011
Total liabilities	847,225,498
 NET ASSETS	
Invested in capital assets	213,094
Restricted for:	
Debt service	102,881,176
Loan and grant programs	459,199,215
Unrestricted	663,176
Total net assets	\$ 562,956,661

TEXAS HIGHER EDUCATION COORDINATING BOARD
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Statement of Activities

For the Year Ended August 31, 2010

		Program Revenues		Net (Expense)
	Expenses	Charges for Services	Operating Grants and Contributions	Revenue and Change in Net Assets - Governmental Activities
Governmental activities:				
General administration	\$ 33,487,508	151,621	1,339,628	(31,996,259)
Financial assistance - loans	80,335,268	—	98,237,936	17,902,668
Financial assistance - institutions	1,984,186,308	240,716	658,760,524	(1,325,185,068)
Financial assistance - students	143,236,265	91,825	27,230,682	(115,913,758)
Total governmental activities	\$ 2,241,245,349	484,162	785,568,770	(1,455,192,417)
General revenues:				
				1,560,627,907
Original legislative appropriations				2,849,800
Additional appropriations				1,563,477,707
Total general revenues				1,563,477,707
		Net change in assets		108,285,290
		Net assets at beginning of year		454,671,371
		Net assets at end of the year	\$	562,956,661

See accompanying notes to the financial statements.

TEXAS HIGHER EDUCATION COORDINATING BOARD
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Balance Sheet – Governmental Funds

August 31, 2010

	General Fund	Texas Opportunity Plan Fund	Student Loan Auxiliary Fund	Debt Service Fund	Nonmajor Governmental Funds	Total Governmental Funds
ASSETS						
Cash in State treasury	\$ 193,319,244	38,100,945	130,357,890	9,343,043	6,524,036	377,645,158
Cash in Bank	—	—	—	12,896	—	12,896
Investments	—	—	—	96,612,372	—	96,612,372
Due from other State agencies	4,506,463	—	—	—	55,202	4,561,665
Prepaid Items	37,798	—	—	—	—	37,798
Accounts receivables	2,066,380	—	—	4,554	—	2,070,934
Federal receivables	59,670,955	—	—	—	—	59,670,955
Interest receivable	14,216	65	—	269,973	4,927	289,181
Student loans, net of allowance for doubtful accounts	52,606,709	165,407,808	545,281,886	—	3,112,316	766,408,719
Interest receivable on loans net of allowance for doubtful accounts	828,806	28,696,798	69,943,361	—	294,289	99,763,254
TOTAL ASSETS	\$ 313,050,571	232,205,616	745,583,137	106,242,838	9,990,770	1,407,072,932
LIABILITIES AND FUND BALANCES						
Liabilities:						
Accounts payable	\$ 9,785,375	991,538	202,406	—	538,628	11,517,947
Due to other State agencies	59,660,177	—	—	—	—	59,660,177
Deferred revenues	54,409,706	194,104,605	615,225,246	—	3,406,603	867,146,160
Total liabilities	123,855,258	195,096,143	615,427,652	—	3,945,231	938,324,284
FUND BALANCES						
Reserved For:						
Encumbrances	41,242,907	—	6,927	—	1,716,356	42,966,190
Imprest accounts	100	—	—	—	—	100
Prepays	37,798	—	—	—	—	37,798
Debt Service	—	—	—	102,881,176	—	102,881,176
Loan and grant programs	146,326,623	37,109,473	130,148,558	3,361,662	4,329,183	321,275,499
Unreserved, undesignated reported in:						
General Fund	1,587,885	—	—	—	—	1,587,885
TOTAL FUND BALANCES	189,195,313	37,109,473	130,155,485	106,242,838	6,045,539	468,748,648
TOTAL LIABILITIES AND FUND BALANCES	\$ 313,050,571	232,205,616	745,583,137	106,242,838	9,990,770	1,407,072,932

See accompanying notes to the financial statements.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency of the State of Texas)

Governmental Funds

Reconciliation of the Governmental funds Balance Sheet to the Statement of Net Assets

For the Year Ended August 31, 2010

Total fund balances - Governmental Funds	\$	468,748,648
Amounts reported for governmental activities in the Statement of Net Assets are different because:		
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds		213,094
Student loan notes receivable and interest receivable are not available and are reported in the funds as deferred revenue		866,171,973
Other long-term assets are not available as current period resources and are not reported in the funds		2,896,133
Long-term liabilities are not due and payable in the current period and are not reported in the funds		<u>(775,073,187)</u>
Total net assets - governmental activities	\$	<u><u>562,956,661</u></u>

See accompanying notes to the financial statements.

TEXAS HIGHER EDUCATION COORDINATING BOARD
(An Agency of the State of Texas)

Statement of Revenues, Expenditures and Changes
in Fund Balances – Governmental Funds

For the Year Ended August 31, 2010

	General Fund	Texas Opportunity Plan Fund	Student Loan Auxiliary Fund	Debt Service Fund	Nonmajor Governmental Funds	Total Governmental Funds
REVENUES						
Legislative appropriations:						
Original legislative appropriation revenue	\$ 1,560,627,907	—	—	—	—	1,560,627,907
Additional legislative appropriation revenue	2,849,800	—	—	—	—	2,849,800
Federal revenues	605,168,235	(6,403)	104,936	70,435	1,293	605,338,496
Federal grant pass-through revenues	41,435,463	—	—	—	—	41,435,463
State grant pass-through revenues	28,933,664	—	—	—	—	28,933,664
Intergovernmental revenues	41,066,588	—	—	—	3,506,195	44,572,783
Licenses, fees and permits	7,425,478	—	—	—	—	7,425,478
Interest and investment income	604,821	13,041,738	30,872,886	2,318,313	2,522,953	49,360,711
Collections (disbursements) of student loan receivables, net	(4,074,079)	19,237,447	(52,650,898)	—	495,108	(36,992,422)
Other revenues (expenses), net	2,491,944	785,847	5,681,140	—	27,406	8,986,337
Total revenues, net	2,286,529,821	33,058,629	(15,991,936)	2,388,748	6,552,955	2,312,538,217
EXPENDITURES						
General administration	33,095,282	—	303,330	—	—	33,398,613
Financial assistance - loans	37,081,024	4,174,564	11,055,633	—	139,317	52,450,538
Financial assistance - institutions	1,981,881,649	—	—	—	2,304,659	1,984,186,308
Financial assistance - students	143,236,265	—	—	—	—	143,236,265
Debt service:						
Principal	—	—	—	71,470,000	—	71,470,000
Interest	—	—	—	26,055,501	—	26,055,501
Other financing fees	—	—	1,579,103	—	—	1,579,103
Total expenditures	2,195,294,221	4,174,564	12,938,066	97,525,501	2,443,976	2,312,376,328
Excess (deficiency) of revenues over expenditures	91,235,600	28,884,065	(28,930,002)	(95,136,753)	4,108,979	161,889
OTHER FINANCING SOURCES (USES)						
Issuance of Tax Exempt Debt	—	—	113,580,000	—	—	113,580,000
Bond proceeds for refunding debt	—	—	—	51,865,000	—	51,865,000
Premium on sale of bonds	—	—	11,417,798	4,673,925	—	16,091,723
Payment to escrow for refunding debt	—	—	—	(58,057,206)	—	(58,057,206)
Transfers in	7,635,975	—	—	86,905,065	—	94,541,040
Transfers out	—	(33,509,196)	(60,321,176)	—	(710,668)	(94,541,040)
Total other financing sources (uses)	7,635,975	(33,509,196)	64,676,622	85,386,784	(710,668)	123,479,517
Net change in fund balances	98,871,575	(4,625,131)	35,746,620	(9,749,969)	3,398,311	123,641,406
Fund balances at beginning of the year	90,323,738	41,734,604	94,408,865	115,992,807	2,647,228	345,107,242
Fund balances at the end of the year	\$ 189,195,313	37,109,473	130,155,485	106,242,838	6,045,539	468,748,648

See accompanying notes to the financial statements.

TEXAS HIGHER EDUCATION COORDINATING BOARD
(An Agency of the State of Texas)

Reconciliation of the Governmental Funds Statement of Revenue, Expenditures and
Changes in Fund Balances to the Statement of Activities

For the Year Ended August 31, 2010

Net change in fund balances - Governmental Funds	\$ 123,641,406
Governmental funds report capital outlay as expenditures. In the statement of activities, the cost of assets is allocated over the estimated useful life of the asset and reported as depreciation expense.	(97,890)
Costs associated with the issuance of long term debt are reported as expenditures in the governmental funds, but are deferred and amortized throughout the period during which the related debt is outstanding in the statement of activities. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.	(51,044,387)
Disbursements (collections) of student loans receivable, net, in governmental fund are not a revenue source on the statement of activities.	36,992,422
Some expenses reported in the statement of activities do not require the use of current financial resources and therefore are not reported as expenditures in governmental funds.	<u>(1,206,261)</u>
Change in net assets - Governmental activities	<u>\$ 108,285,290</u>

See accompanying notes to the financial statements.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency of the State of Texas)

Statement of Fiduciary Net Assets

For the Year Ended August 31, 2010

	<u>Agency Funds</u>
Assets	
Current assets:	
Restricted:	
Cash in State Treasury	\$ 360,100
Interest and Dividends Receivable	<u>19</u>
Total current assets	<u>360,119</u>
Total assets	<u>\$ 360,119</u>
Liabilities	
Current liabilities:	
Funds held for others	\$ <u>360,119</u>
Total current liabilities	<u>360,119</u>
Total liabilities	<u>\$ 360,119</u>

See accompanying notes to the financial statements.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2010

(1) Summary of Significant Accounting Policies

A. Reporting Entity

The Texas Legislature (Legislature) created Texas Higher Education Coordinating Board (THECB) in 1965. THECB is presently governed by a board composed of 9 members. The board members serve a six-year term and are appointed by the Governor with the advice and consent of the Texas Senate. The Governor also appoints the chairman and vice-chairman and the Board appoints the Commissioner.

THECB is an agency of the State of Texas (State) and is included in the State comprehensive annual financial report. The financial statements of THECB are intended to present the financial position and the changes in financial position of only that portion of the governmental activities, each major fund, and the aggregate remaining fund information of the State of Texas that is attributable to the transactions of THECB. THECB's financials do not present fairly the financial position of the State of Texas as of August 31, 2010 nor the changes in its financial position. THECB's general fund is included within the State of Texas General Fund, the Texas Opportunity Plan and Student Loan Auxiliary major funds are included within the State of Texas nonmajor special revenue funds, and the Debt Service Fund is included within the State of Texas nonmajor debt service funds.

B. Organizational Purpose

THECB's mission is to work with a wide array of constituencies to provide the people of Texas the widest access to higher education of the highest quality, and in the most efficient manner, guided by the state's higher education plan, *Closing the GAPS by 2015*. In order to carry out its mission, THECB performs three major functions:

- Establishing state higher education policy; planning for the future of Texas higher education; and gathering, analyzing, and interpreting information and data on higher education,
- Coordinating degree programs at higher education institutions and the construction of major facilities at public higher education institutions, except community colleges, and
- Administering state and federal programs to expand access, raise quality, improve efficiency, and increase research in higher education.

In order to achieve these functions, THECB engages in a variety of activities that include:

- Advising the Legislature on higher education.
- Coordinating higher education services statewide.
- Classifying and prescribing the institutional role and mission for each public institution of higher education in Texas.
- Establishing enrollment limits at all institutions of higher education.
- Reporting to the Legislature annually on the "state of higher education."

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Notes to Financial Statements

Year Ended August 31, 2010

- Presenting to the Legislature a comprehensive summary and analysis of institutional appropriations requests and formula development in order to provide a statewide view of funding requirements.
- Maintaining a management information system including uniform statistics which are appropriate to planning, financing and decision-making rather than regulation.
- Administering designated programs such as financial assistance to students and universities, trustee funds, incentive/discretionary grants, federal funds programs, research competition awards, and other programs assigned by the Legislature.
- Issuing tax-exempt bonds for the purpose of originating state educational loans for students attending Texas colleges and universities.
- Developing funding formulas through an ongoing process of committee review and expert input.
- Offering technical assistance to the Legislature, systems offices, and institutions.
- Approving degree programs and certain construction projects.
- Publishing materials on admission policies, transferable courses among universities and community/junior colleges, financial assistance programs and other information to assist in making decisions about higher education.
- Developing and implementing policies on the transferability of lower division courses among institutions of higher education.
- Developing guidelines for institutional reporting of student performance.
- Encouraging cooperative programs and agreements among institutions of higher education including, among others, degree offerings, research activities, library and computer sharing.
- Improving access to higher education institutions by providing loans to students. The majority of these loans are funded by selling General Obligation bonds. Income from repayments on these loans is used to pay back the bonds.

C. Government-Wide and Fund Financial Statements

The accompanying financial statements of THECB have been prepared to conform with Generally Accepted Accounting Principles (GAAP) as prescribed by the Governmental Accounting Standards Board (GASB).

The government-wide financial statements (i.e., the statement of net assets and the statement of activities) report information on all of the nonfiduciary activities of THECB. The effect of interfund activity has been removed from these statements.

The statement of activities demonstrates the degree to which the direct expenses of a given function are offset by program revenues. Governmental activities are supported by state appropriations, state and federal grants, interest earnings, and other user service charges. Direct expenses are those that are clearly identifiable with a specific function. All capital asset depreciation is reported as a direct

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2010

expense of the functional program that benefits from the use of the capital assets. Program revenues include 1) grants and state contributions that are restricted to meeting the operational or capital requirements of a particular function, and 2) charges to customers or applicants for services provided by a given function. Appropriations are not properly included among program revenues and are reported instead as general revenues. Interest earnings are included in operating grants and contributions on the Statement of Activities as interest relates to student loans.

Separate financial statements are presented for governmental funds and fiduciary funds. In accordance with Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements – And Management’s Discussion And Analysis – for State And Local Governments* (GASB Statement No. 34), the fiduciary funds are excluded from the government-wide financial statements. Major individual governmental funds are reported as separate columns in the fund financial statements.

D. Measurement Focus, Basis of Accounting, and Financial Statement Presentation

Government-wide financial statements

The government-wide financial statements are reported using the economic resources measurement focus and the accrual basis of accounting, in accordance with U.S. generally accepted accounting principles, as are the private purpose trust funds. Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements by the provider have been met.

As a general rule the effect of interfund activity has been eliminated from the government-wide financial statements. Amounts reported as program revenues include charges for services and operating grants and contributions.

Fund Financial Statements

Governmental fund financial statements are reported using the current financial resources measurement focus and the modified accrual basis of accounting in accordance with U.S. generally accepted accounting principles. Operating statements of these funds present resources (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in fund balances. Under the modified accrual basis, revenues are recognized in the period in which they become both measurable and available.

THECB includes student loan notes receivable and related interest receivable in the governmental fund financial statements even though they are noncurrent as these assets represent a significant operational purpose of THECB. Deferred revenue is reported in the governmental funds in an amount equal to the student loan notes receivable and related interest receivable. Collections (disbursements) of student loans receivable are reported as revenue, net.

All revenue associated with the current fiscal period and collected within one-year is considered to be susceptible to accrual and has been recognized as revenue in the current fiscal period. Grant funds

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Notes to Financial Statements

Year Ended August 31, 2010

are considered to be earned when all eligibility requirements have been met and to the extent of expenditures made under the provisions of the grant, and, accordingly, when such funds are received in advance, they are recorded as deferred revenue. Expenditures and other uses of financial resources are recognized when the related liability is incurred. However, debt service expenditures, as well as expenditures related to compensated absences and arbitrage are recorded only when payment has matured.

The accounts of THECB are organized on the basis of funds, each of which is considered a separate accounting entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund equity, revenues and expenditures, or expenses, as appropriate. Government resources are allocated to and accounted for the purpose of carrying on specific activities in accordance with laws, regulations, bond indentures, or other appropriate requirements.

Governmental Funds

Governmental Funds are those through which most governmental functions of THECB are financed. The acquisition, use and balances of THECB's expendable financial resources, and the related liabilities are accounted for through the Governmental Fund Types. The following are THECB major governmental funds:

- The General Fund is THECB's primary operating fund. It is used to account for all financial resources of THECB except those required to be accounted for in another fund.
- The Texas Opportunity Plan Fund (TOP) and the Student Loan Auxiliary Fund (SLA) special revenue funds are used to account for the proceeds of bond issues and repayment of student loans in excess of what is required to be deposited in the Debt Service Fund to make loans to students attending Texas colleges and universities. The TOP fund reflects bonds issued prior to 1992 and the funds are used to make Hinson-Hazelwood loans. The SLA fund is for bond activity subsequent to 1992 and is used to make Hinson-Hazelwood loans and B-On-Time loans. At the end of the current fiscal year, the reserved for loan fund balance for TOP and the Student Loan Auxiliary Fund was \$167.3 million. The primary revenue source is interest on student loans and the expenditures include items related to the student loans such as change in allowance for doubtful accounts.
- The Debt Service fund is used to account for the accumulation of resources for, and the payment of, long-term debt principal and interest. The accounts used by THECB during fiscal year 2010 consisted of the following: Texas College Student Loan Bonds Interest and Sinking Account, and the Student Loan Revenue Bond Interest and Sinking Account.

Fiduciary Funds

Fiduciary funds account for assets held by THECB as an agent for individuals, private organizations, other governmental units, and/or other funds. It contains agency fund and private-purpose trust funds.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2010

- Agency funds have no equity, assets equal liabilities, and do not include revenues or expenditures for general operations of THECB. The agency fund used by THECB during fiscal year 2010 was the Child Support Deductions Suspense Account.
- Private-purpose trust funds are used to account for all other trust arrangements whose principal and interest benefit individuals, private organizations, or other governments. The trust fund used by the THECB during FY 2010 consisted of the Baylor College of Medicine Permanent Endowment Fund.

E. Financial Statement Elements

Cash

All cash is held by the State Treasury and an agent of the State Treasury.

Investments

Investments held in Texas Treasury Safekeeping Trust Company at fair value.

Interest Receivable

Interest receivable consists of interest earned or accrued that is not due to be received until after the balance sheet date. Interest receivable is derived from interest due from the State Treasury for the interest bearing cash, investments and loans issued from the student loan program and is reported net of allowance for doubtful accounts.

Prepaid Items

Prepaid items consist of postage paid in advance of the related services being received using the consumption method of accounting. Prepaid items reported in the general fund are offset by a fund balance reserve which indicates that they do not request "available spendable resources".

Student Loan Notes Receivable

Federal and state student loans are reported at their outstanding principal balances net of the allowance for doubtful accounts. Student loans are recorded at cost when disbursed and are serviced by THECB throughout the life of the loan – school, grace, and repayment.

Allowance for Doubtful Accounts

The allowance for doubtful accounts includes the estimated amount of student loans that will be forgiven or will not be collected due to default. The allowance is calculated based on loan status and loan type and current collection trends. Guarantees of certain loans are provided by U.S. Department of Education and U.S. Department of Health and Human Services.

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Notes to Financial Statements

Year Ended August 31, 2010

Capital Assets

Capital assets, which include furniture, equipment, and intangibles, are reported in the governmental activities column in the government-wide financial statements. THECB generally defines capital assets as assets with an initial, individual cost of more than \$5,000 and an estimated life greater than one year. Such assets are recorded at historical cost. Donated capital assets are recorded at estimated fair value at the date of the donation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend assets lives are not capitalized. Capital assets of THECB are depreciated using the straight-line method over the following estimated useful lives:

<u>Classification</u>	<u>Useful Life</u>
Furniture and Equipment	1 to 15

The term depreciation (and related forms of the term) includes amortization of intangible assets.

Transfers and Interfund Receivables and Payables

Transfers occur when resources of one fund are transferred to another. Legally required transfers are reported when incurred as “Transfers In” by the recipient fund and as “Transfers Out” by the disbursing fund.

Transactions occur between funds for goods provided and services rendered. These receivables and payables are classified as “due from/to other funds” on the fund-level statements when they are expected to be liquidated within one year.

Restricted Assets

Restricted assets are assets whose use is subject to constraints that are either (a) externally imposed by creditors (such as through debt covenants), grantors, contributors, or laws or regulations of other governments or (b) imposed by law through constitutional provisions or enabling legislation.

Accounts Payable

Accounts payable represents the liability for the value of assets or services received at year-end for which payment is pending.

Deferred Revenue and Collections (Disbursements) on Student Loan Receivables

Deferred revenues in the government-wide and fund financial statements consist of revenues that have been received but have not met the criteria for recognition. Also included in deferred revenue in the fund financial statements is an amount to offset student loan notes receivables and related interest receivable reported in the funds as they are a significant operational asset. Changes in the student loan notes receivable and related interest receivable balances are reflected in the governmental fund

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2010

statement of revenues, expenditures and changes in fund balances as revenue – collections (disbursements) on student loans receivable.

Employees' Compensable Leave Balances

A state employee is entitled to be paid for all unused vacation time accrued, in the event of the employee's resignation, dismissal, or separation from State employment, provided the employee has had continuous employment with the State for six months. Expenditures for accumulated annual leave balances are recognized in the period paid or taken in governmental fund types. For these fund types, the liability for unpaid benefits is recorded in the Statement of Net Assets.

Bonds Payable

General obligation bonds payable are reported separately as either current or non-current in the statement of net assets. Serial interest bonds payable are recorded net of discounts and premiums in the statement of net assets.

In the fund financial statements, governmental funds recognize bond premiums, discounts, and issuance costs during the current period. The face amount of debt issued is reported as other financing sources in the fund received and expenditures for payment of principal and interest are recorded in Debt Service Funds when paid. Premiums received on debt issued are reported as other financing sources while discounts on debt issued are reported as other financing uses. Issuance costs, whether or not withheld from the debt proceeds received, are reported as debt service expenditures.

Deferred Issuance Costs

Deferred issuance costs on bonds are amortized using the straight-line interest method over the contractual life of the bonds in the Statements of Net Assets and Activities. Payments on the bonds result in the proportionate amortization during the current year of the remaining balance of discounts and premiums on debt.

Discounts and Premiums on Debt

Discounts and premiums on debt are recognized using the straight-line method which is not substantially different than the effective interest method over the life of the bonds in the Statements of Net Assets and Activities. Prepayments on the bonds result in the proportionate amortization during the current year of the remaining balance of discounts and premiums on debt.

Arbitrage Rebate Liability

Arbitrage rebate liability is earned interest revenue on unspent bond proceeds in excess amounts allowed by Federal regulations. The amount represents the estimated payable at year end in the Statements of Net Assets and Activities.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2010

Appropriations

Appropriations are revenues approved by the Legislature for designated programs. Appropriations are recognized as revenue when they become available from the State to fund current expenditures.

State and Intergovernmental Revenues and Receivables

State and intergovernmental revenues and related receivables arise primarily through funding received from State grants. Revenues and receivables are earned through expenditures of money for grant purpose.

Interest Subsidy and Special Allowance (Federal Revenue)

During the in-school, grace, and deferment periods, the U.S. Government pays THECB interest on subsidized Stafford student loans on behalf of the borrower. When the repayment period begins, the borrower is responsible for interest payments. The interest subsidy and special allowance are accrued as earned.

Use of Estimates

Management of THECB has made some estimates and assumptions relating to the reporting of the useful life of assets and for the allowance of doubtful accounts to prepare these financial statements in conformity with the U.S. generally accepted accounting principles. Actual results could differ from those estimates.

Taxes

As a state government, THECB is exempt from federal income taxes and state sales tax.

Fund Balance

The Fund Balance is the difference between funds assets and liabilities on the governmental fund statements. Fund balances for governmental funds are classified as either reserved or unreserved in the fund financial statements. Reservations are legally restricted to a specific future use or not available for expenditure.

- Reserved for Encumbrances

This represents commitments of the value of contracts awarded or assets ordered prior to year-end but not received as of that date. Encumbrances are not included within expenditures or liabilities. They represent current resources designated for specific expenditures in subsequent operating periods.

- Reserved for Prepaids

This represents the amount of postage to be used in the next fiscal year.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2010

- Reserve for Imprest Accounts

This represents reserves for travel and imprest cash in amounts equal to the assets.

- Reserve for Debt Service

This represents reserves for principal and interest payment.

- Reserve for Loans and Grant Programs

This represents reserves for student loans and grant programs.

- Unreserved/Undesignated

Unreserved represents the unappropriated balance at year-end.

Net Assets

Invested in Capital Assets consists of capital assets, net of accumulated depreciation. No capital assets were financed with long term debt. THECB reports net assets as restricted when constraints placed on net assets are externally imposed by bond covenants and federal grants. Unrestricted Net Assets consist of net assets that do not meet the definition of Invested in Capital Assets or Restricted Net Assets.

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Notes to Financial Statements

Year Ended August 31, 2010

(2) Reconciliation of Government-Wide and Fund Financial Statements

(a) Explanation of Certain Differences Between the Governmental Fund Balance Sheet and Government-wide Statement of Net Assets.

Total fund balance reported in THECB's fund-level governmental funds balance sheet differs from the net assets reported in governmental activities within the government-wide financial statements. The differences result from the long-term economic resources measurement focus in the government-wide financial statement of net assets versus the current financial resources measurement focus of the governmental fund balance sheets. The differences are shown below:

Total fund balances - Governmental funds		\$	468,748,648
Amounts reported for governmental activities in the Statement of Net Assets are different because:			
Capital assets used in governmental activities are not financial resources and therefore are not reported in the funds			
Capital assets, depreciable	1,304,481		
Less accumulated depreciation	<u>(1,091,387)</u>		
			213,094
Student loan notes receivable and interest receivable are not available and are reported in the funds as deferred revenue			866,171,973
Other long-term assets are not available as current period resources and are not reported in the funds			2,896,133
Long-term liabilities are not due and payable in the current period and are not reported in the funds			
Bonds payable, net	(770,122,492)		
Interest payable	(2,341,249)		
Employees' compensable leave	(1,813,509)		
Arbitrage rebate liability	<u>(795,937)</u>		
			<u>(775,073,187)</u>
Total net assets - governmental activities		\$	<u>562,956,661</u>

(b) Explanation of Certain Differences between the Governmental Fund Statement of Revenues, Expenditures, and Changes in Fund Balances, and the Government-wide Statement of Activities.

The net change in fund balances of governmental funds differs from the change in net assets for governmental activities as reported in the statement of activities. The differences result from the long-term economic resources measurement focus in the government-wide statement of net assets

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2010

versus the current financial resources measurement focus of the governmental fund balance sheets. The differences are shown below:

Net change in fund balances - Governmental funds	\$	123,641,406
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Governmental funds report capital outlay as expenditures.

In the statement of activities, the cost of assets is allocated over the estimated useful life of the asset and reported as depreciation expense.

Capital outlay	62,535	
Capital adjustment for Warranty	(4,352)	
Depreciation expense	<u>(156,073)</u>	
		(97,890)

Costs associated with the issuance of long-term debt are reported as expenditures in the governmental funds, but are deferred and amortized throughout the period during which the related debt is outstanding in the statement of activities. Repayment of debt principal is an expenditure in the governmental funds, but the repayment reduces long-term liabilities in the statement of net assets.

Bond Issuance Costs	965,130	
Repayment of Bond Principal	71,470,000	
Bonds Issued	(165,445,000)	
Premium on Bonds Issued	(16,091,723)	
Payment to Escrow for Refunding Debt	<u>58,057,206</u>	
		(51,044,387)

Disbursements (collections) of student loans receivable, net, in governmental funds are not a revenue source on the statement of activities

36,992,422

Some expenses reported 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.

Employees Compensable Leave	8,995	
Interest and Other	(939,837)	
Arbitrage Rebate	<u>(275,419)</u>	
		<u>(1,206,261)</u>

Change in net assets - Governmental activities	\$	<u><u>108,285,290</u></u>
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TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2010

(3) Deposits and Investments

Deposits of Cash held in the State Treasury:

On August, 31, 2010, THECB's restricted cash balance amounted to \$377.6 million and is comprised as follows:

Restricted

General Fund

Cash in State Treasury	\$	193,319,144
Cash on Hand		100

Special Revenue Funds

Texas Opportunity Plan		38,100,945
Student Loan Auxiliary		130,357,890
Debt Service Fund		9,343,043
Nonmajor Governmental Funds		6,524,036

\$ 377,645,158

As of August 31, 2010, the carrying amount of deposits for governmental activities was \$377.6 million. These amounts consist of cash in the State Treasury for which the State makes the related investment decisions. As of August 31, 2010, the total bank balance for governmental activities was \$375.7 million.

Custodial Credit Risk – Custodial credit risk for deposits is the risk that, in the event of the failure of a depository financial institution, THECB will not be able to recover deposits or will not be able to recover collateral securities that are in the possession of an outside party. THECB nor the state have a deposit policy for custodial credit risk however, the state's security lending program is subject to custodial credit risk.

On August 31, 2010, THECB's deposits in the State Treasury amount to \$375.7 million. Of that amount, \$375.7 million was fully collateralized by securities held with a trustee in the state's name, as reported to THECB by the Comptroller of Public Accounts of the State of Texas.

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Investments – Governmental Activities

THECB is authorized to invest in direct obligations of or unconditionally guaranteed by the United States which are scheduled to mature prior to the date money must be available for use for its intended purpose under Article III, Section 50b et seq. of the State Constitution, as amended (the "Constitutional Provision") and Chapter 52, Texas Education Code, as amended ("Chapter 52").

The investment agreement between THECB, the Comptroller of Public Accounts and Texas Safekeeping Trust Company (TTSTC) requires debt service funds to be invested with TTSTC. The Comptroller is the sole officer, director, and shareholder of the trust company (Section 404.104 of the Texas Government Code).

As of August 31, 2010, the TTSTC had uninvested cash in bank deposits of \$12,896, representing the carrying amount of deposits. The following schedule reflects the bank balance and carrying amount of deposits held by TTSTC.

<u>Cash Type</u>	<u>Debt Service Fund</u>
Cash in Bank	\$ 12,896

As of August 31, 2010, the fair value of investments held with TTSTC was \$96,612,372 as presented below:

<u>Investment Type</u>	<u>Debt Service Fund</u>
U.S. Treasury Bills	\$ 46,734,342
U.S. Treasury Notes	49,878,030
Total Investments	<u>\$ 96,612,372</u>

Interest Rate Risk– Interest rate risk is the risk that changes in market interest rates will adversely affect the fair value of an investment. To minimize the risk of interest rate fluctuations, the THECB holds U.S. government obligations. Interest rate risk is further mitigated by holding investments to maturity.

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(4) Capital Assets

A summary of changes in Capital Assets for the year ended August 31, 2010, is presented below:

	PRIMARY GOVERNMENT			Balance 08/31/10
	Balance 09/01/09	Additions	Deletions	
GOVERNMENTAL ACTIVITIES				
Depreciable Assets				
Furniture and Equipment	\$ 1,960,741	62,535	(762,577)	1,260,699
Total Depreciable Assets	1,960,741	62,535	(762,577)	1,260,699
Less Accumulated Depreciation for:				
Furniture and Equipment	(1,649,757)	(156,073)	758,225	(1,047,605)
Total Accumulated Depreciation	(1,649,757)	(156,073)	758,225	(1,047,605)
Depreciable Assets, Net	310,984	(93,538)	(4,352)	213,094
Amortizable Assets - Intangible				
Computer Software	43,782	-	-	43,782
Total Amortizable Assets - Intangible	43,782	-	-	43,782
Less Accumulated Amortization for:				
Computer Software	(43,782)	-	-	(43,782)
Total Accumulated Amortization	(43,782)	-	-	(43,782)
Amortizable Assets - Intangible, Net	-	-	-	-
Governmental Activities Capital Assets, Net \$	310,984	(93,538)	(4,352)	213,094

Depreciation expense of \$156,073 was allocated to General Administration in the Statement of Activities for the Governmental Activities.

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(5) Student Loan Notes Receivable and Guarantee Agencies

Student loan notes receivable consist of the following at August, 31, 2010:

	General Fund	Texas Opportunity Plan Fund	Student Loan Auxiliary Fund	Nonmajor Governmental Student Loan Fund	Total
Student loan notes receivable	\$ 106,664,930	208,282,247	612,171,579	4,844,841	931,963,597
Less: Allowance for doubtful accounts	(54,058,221)	(42,874,439)	(66,889,693)	(1,732,525)	(165,554,878)
Student loan notes receivable, net	\$ <u>52,606,709</u>	<u>165,407,808</u>	<u>545,281,886</u>	<u>3,112,316</u>	<u>766,408,719</u>
Beginning allowance	\$ 38,817,354	41,990,658	63,933,340	1,738,119	146,479,471
Write offs - Loan Principal	(51,629)	(125,208)	(413,067)	(18,069)	(607,973)
Write offs - Loan Forgiveness	(21,739,718)	-	(4,051,873)	-	(25,791,591)
Provisions for uncollectible loan principal	1,236,649	1,008,989	5,769,420	12,475	8,027,533
Provisions for uncollectible loan forgiveness	35,795,565	-	1,651,873	-	37,447,438
Ending allowance for doubtful accounts	\$ <u>54,058,221</u>	<u>42,874,439</u>	<u>66,889,693</u>	<u>1,732,525</u>	<u>165,554,878</u>
Interest receivable on student loans	\$ 965,076	59,083,109	84,489,017	1,297,437	145,834,639
Less: Allowance for doubtful accounts	(136,270)	(30,386,311)	(14,545,656)	(1,003,148)	(46,071,385)
Interest receivable on student loans, net	\$ <u>828,806</u>	<u>28,696,798</u>	<u>69,943,361</u>	<u>294,289</u>	<u>99,763,254</u>
Beginning allowance	\$ 77,121	28,540,603	12,532,828	892,715	42,043,267
Write offs - Loan Interest	(12,515)	(1,126,586)	(274,999)	(17,860)	(1,431,960)
Provisions for uncollectible loan interest	71,664	2,972,294	2,287,827	128,293	5,460,078
Ending allowance for doubtful accounts	\$ <u>136,270</u>	<u>30,386,311</u>	<u>14,545,656</u>	<u>1,003,148</u>	<u>46,071,385</u>

The student loan notes receivable represents loans to students who, when the loans were originated, were enrolled in post-secondary institutions. In general, the notes bear interest and are payable by the student following a specified grace period after graduation or termination from the institution.

THECB administers the Hinson-Hazelwood College Student Loan Program (HHCSLP), created subsequent to the 1965 federal Higher Education Act, which established the federally guaranteed student loan program. HHCSLP provides low-interest loans to undergraduate, graduate and professional resident students attending post-secondary schools in Texas. Provisions of the Texas Education Code stipulate that HHCSLP is intended for students with insufficient resources to finance their college education.

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HHCSLP administers several state non-guaranteed loan programs: College Access Loans (CAL), Texas B-On-Time Loan Program (BOT) and Health Education Loan Program (HELP). The College Access Loan Program provides alternative education loans to Texas students who are unable to meet the cost of attendance. The CAL may be used to cover part or all of the student's Expected Family Contribution (EFC); students do not have to demonstrate financial need. However, the amount of federal aid for which you are eligible must be deducted from the cost of attendance in determining the CAL loan amount. The Texas B-On-Time Loan Program provides non-interest bearing loans to eligible students to enable them to attend colleges and universities in Texas. Additionally, the Texas B-On-Time Loan Program provides loan forgiveness incentive to those qualifying students. The Health Education Loan Program provided educational loans to Texas students enrolled in the following programs of study: medicine, osteopathy, dentistry, podiatry, veterinary medicine, pharmacy, public health, nursing, and allied health. Loan origination through this program ceased in FY2010, but the Board continues to service loans that it made through this program. These loan programs are reported in the Student Loan Auxiliary Fund and the General Fund. The state non-guaranteed loans represent 95% of student loans receivable at August 31, 2010.

HHCSLP also provided federally guaranteed loans: Federal Family Education Loan Program (FFELP) Subsidized Stafford, Federal Family Education Loan Program (FFELP) Unsubsidized Stafford Loan, and the Federal Health Education Assistance Loan (HEAL) Program. (Effective June 30, 2010, the Board is no longer permitted to originate loans under these federally guaranteed loan programs due to the implementation of the Health Care and Education Reconciliation Act of 2010). The purpose of the Federal Family Education Loan Program (FFELP) Subsidized Stafford Loan was to provide low interest educational loans that enabled a student to pay the cost of attendance at a public or private, non-profit college or university. The federal government continues to pay the interest on these loans while a student is in school, during a grace period, and during authorized periods of deferment. The purpose of the Federal Family Education Loan Program (FFELP) Unsubsidized Stafford Loan was to provide low interest educational loans that enabled a student to pay the cost of attendance at a public or private, non-profit college or university. The borrower is responsible for interest that accrues while in school, during a grace period, or during authorized periods of deferment or forbearance. The purpose of the Federal Health Education Assistance (HEAL) Loan was to provide low interest educational loans to eligible graduate students in schools of medicine, osteopathy, dentistry, veterinary medicine, optometry, podiatry, public health, pharmacy, chiropractic, or in programs in health administration, and clinical psychology. Federally guaranteed loans are protected by federal reinsurance from the U.S. Department of Education for all FFELP loans and by the U.S. Department of Health and Human Services for all HEAL loans. The loans are guaranteed provided applicable program requirements have been met. Management of THECB believes that the student loan notes have met these requirements and are valid obligations of the student borrowers. Federal loans are reported in the Texas Opportunity Plan Fund, and the Student Loan Auxiliary Fund. The federally guaranteed loans represent 5% of student loans receivable at August 31, 2010. Loan origination through these programs ceased in FY2010, but the Board continues to service loans that it made through these programs.

The Teach for Texas (TFT) and Be On Time (BOT) conditional grant programs are included in the General Fund. The TFT program provides repayment assistance for eligible classroom teachers and

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the BOT program provides repayments assistance for eligible students. If the recipient fails to satisfy any or all of the conditions or requirements prescribed in the promissory note and in the agreement, the “grant” automatically converts to a loan and the loan is repaid in installments over a period of 10 years.

(6) Interfund Transfers

THECB experienced transfers between different funds within the agency, which are consistent with the activities of the fund making the transfer. The Texas Opportunity Plan (TOP), the Student Loan Auxiliary (SLA), and the nonmajor governmental funds transfer funds to the debt service fund to cover debt service payments and/or reserve amounts required by bond indentures. Any excess funds in the debt service fund are transferred to the general fund to cover loan related expenses and/or the TOP, SLA, and nonmajor governmental funds for additional loans and grants.

Individual balances at August 31, 2010, were as follows:

		<u>Transfers In:</u>			
<u>Transfers Out:</u>		<u>General</u>	<u>Debt Service</u>	<u>Non-Major</u>	<u>Total</u>
Texas Opportunity Plan	\$	—	33,509,196	—	33,509,196
Student Loan Auxiliary		7,635,975	52,685,201	—	60,321,176
Non Major Governmental Funds		—	710,668	—	710,668
Total	\$	<u>7,635,975</u>	<u>86,905,065</u>	<u>—</u>	<u>94,541,040</u>

(7) Summary of Long-Term Liabilities

During the year ended August 31, 2010, the following changes occurred in liabilities (in thousands):

<u>Governmental Activities</u>	<u>Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Balance</u>	<u>Amounts Due Within</u>
	<u>9/01/2009</u>			<u>8/31/2010</u>	<u>One Year</u>
General obligation					
bonds payable	\$ 708,945	165,445	(128,010)	746,380	64,300
Deferred credits	8,699	15,043	0	23,742	—
Compensable leave	1,823	1,356	(1,365)	1,814	982
Arbitrage rebate liability	521	275	0	796	745
Total governmental activities	\$ <u>719,988</u>	<u>182,119</u>	<u>(129,375)</u>	<u>772,732</u>	<u>66,027</u>

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(8) Long-Term Debt and Arbitrage Rebate

(a) Bonds Payable

THECB issues bonds for educational loans to eligible Texas college students. Payments received on the student loans are applied to the debt service on the bonds. As of August 31, 2010 bonds payable consisted of 13 (thirteen) general obligation issues for student loans totaling \$746.4 million. Bond issue dates for all College Student Bonds range from August 4, 1999 to June 23, 2010. Interest on bonds is payable periodically.

Proceeds from the issuance of bonds will be used to fund an ongoing student loan program which provides low interest loans to eligible students at institutions of higher education in the State and to pay for costs of issuance related to the Bonds.

The State Constitution limits the amount of bonds that can be issued by THECB. At August 31, 2010, THECB has approximately \$400.4 million remaining in authorized but unissued debt. Management believes THECB is in compliance with the various bond covenants at August 31, 2010.

Throughout its history, THECB has issued refunding bonds from time to time when there has been an operational or economic gain for THECB. These refunding have been structured as legal defeasances of the old debt as ruled by the Texas Attorney General, and such debt has been removed from THECB's general ledger. As of August 31, 2010, there is no defeased debt in escrow.

General Obligation Bonds

All bonds are on a parity basis and are secured by the following pledged collateral:

1. All monies received from loan and interest payments and the interest thereon.
2. Bond proceeds, if required, and to the extent permitted by the Act.
3. First monies coming into the Treasury of the State not otherwise appropriated by the State Constitution, if necessary.

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(b) Arbitrage Rebate

Bonds issued after 1986 are subject to arbitrage rebate requirements imposed by section 148 (f) of the Internal Revenue Code of 1986. That provision of the Code requires that any excess earnings from the investment of proceeds of a tax-exempt bond, be rebated to the federal government no later than every five years after the date of issue. In effect, any excess amounts, i.e., earnings that represent a yield higher than the yield on the bonds, will be required to be repaid to the United States government. It is estimated that \$795.9 thousand in excess earnings may become due to the federal government at some point in the future. This estimate, however, does not take into account predictions of the next year's activity. Therefore, at the time payment is due to the United States government, it is probable that this figure will have changed and cannot be reasonably determined at this time what amount, if any, may be due.

(c) Deferred Issuance Costs

Deferred Issuance Costs at August 31, 2010, consist of the following:

	<u>Amount</u>
Deferred issuance costs	\$ 5,898,815
Less: Accumulated amortization	<u>3,002,682</u>
Deferred issuance costs, net	<u>\$ 2,896,133</u>

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(d) Changes in Bonded Indebtedness

A summary of changes in bond indebtedness relating to THECB's governmental activities for the year ended August 31, 2010 is as follows (amounts in thousands):

<u>Description of Issue</u>	<u>Bonds Outstanding 9/1/09</u>	<u>Bonds Issued</u>	<u>Bonds Matured or Retired</u>	<u>Bonds Refunded or Extinguished</u>	<u>Bonds Outstanding 8/31/10</u>	<u>Amounts Due Within One Year</u>
<u>General Obligation Bonds:</u>						
COL STUD LOAN BDS SER'97	\$ 25,800	—	8,105	17,695	—	—
COL STUD LOAN BDS SER'99	35,440	—	8,130	—	27,310	8,555
COL STUD LOAN BDS SER'00	46,105	—	7,260	38,845	—	—
COL STUD LOAN BDS SER'02	52,650	—	8,050	—	44,600	8,080
VAR RT RFD BDS SER'03	110,630	—	35,630	—	75,000	—
VAR RT RFD BDS SER'04	52,765	—	—	—	52,765	35,445
VAR RT RFD BDS SER'06	72,005	—	—	—	72,005	—
COL STUD LOAN BDS SER'07A	72,805	—	—	—	72,805	2,015
COL STUD LOAN BDS SER'07B	26,165	—	—	—	26,165	—
COL STUD LOAN BDS SER'08A	74,115	—	—	—	74,115	—
COL STUD LOAN BDS SER'08B	27,335	—	—	—	27,335	—
COL STUD LOAN BDS SER'08C	41,400	—	4,295	—	37,105	4,525
COL STUD LOAN BDS SER'09	71,730	—	—	—	71,730	—
COL STUD LOAN BDS SER'10	—	113,580	—	—	113,580	465
COL STUD LOAN RFD BDS SER'10	—	51,865	—	—	51,865	5,215
Total General Obligation Bonds	708,945	165,445	71,470	56,540	746,380	64,300
<u>Deferred Adjustments:</u>						
Unamortized Premium	\$ 9,042				24,160	
Unamortized Discount	(406)				(361)	
Unamortized Gain from Refunding	243				207	
Unamortized Loss from Refunding	(180)				(264)	
Total Bonded Indebtedness	\$ 717,644				770,122	

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(e) Debt Service Requirements

As of August 31, 2010, the debt service requirements of bonded indebtedness to maturity are as follows (amounts in thousands):

Year ended August 31:	Principal	Interest	Requirements
2011	\$ 63,185	27,857	91,042
2012	59,515	26,187	85,702
2013	58,810	24,260	83,070
2014	49,685	23,206	72,891
2015	48,235	21,268	69,503
2016-2020	144,555	79,359	223,914
2021-2025	85,110	55,034	140,144
2026-2030	99,590	32,365	131,955
2031-2035	62,695	7,873	70,568
2036-2040	75,000	600	75,600
Total	\$ <u>746,380</u>	<u>298,009</u>	<u>1,044,389</u>

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(f) Miscellaneous Bond Information

A summary of miscellaneous bond information relating to THECB's governmental activities for the year ended August 31, 2010 is as follows (amounts in thousands):

Description of Issue	Bonds Issued To Date	Range of Interest Rates	Terms of Variable Interest Rates	Scheduled Maturities		First Call Date	Note
				First Year	Last Year		
<u>General Obligation Bonds:</u>							
COLSTUD LOAN BDS SER '99	75,000	4.50% - 5.25%	N/A	2004	2023	8/1/13	(A,B)
COLSTUD LOAN BDS SER '02	75,000	4.75% - 5.00%	N/A	2007	2026	8/1/12	(A,B)
COLSTUD LOAN BDS SER '07A	72,805	5.00% - 5.25%	N/A	2011	2031	8/1/17	(A,B)
COLSTUD LOAN RFD BDC SER '07B	26,165	4.50% - 5.00%	N/A	2014	2018	N/A	(A,B)
COLSTUD LOAN BDS SER '08A	74,115	5.00% - 5.50%	N/A	2012	2032	8/1/18	(A,B)
COLSTUD LOAN RFD BDC SER '08B	27,335	5.00% - 5.50%	N/A	2014	2018	N/A	(A,B)
COLSTUD LOAN RFD BDC SER '08C	45,265	5.25% - 5.25%	N/A	2009	2017	N/A	(A,B)
COLSTUD LOAN BDC SER '09	71,730	4.00% - 5.00%	N/A	2013	2033	N/A	(A,B)
COLSTUD LOAN BDC SER '10	113,580	3.00% - 5.00%	N/A	2014	2034	8/1/20	(A,B)
COLSTUD LOAN RFD BDC SER '10	51,865	3.00% - 5.00%	N/A	2011	2017	N/A	
VAR RT RFD BDS SER '03	178,190	Variable	Annually	2006	2038	7/1/04	(C,D)
VAR RT RFD BDS SER '04	52,765	Variable	Monthly	2011	2016	8/1/04	(C,D)
VAR RT RFD BDS SER '06	<u>72,005</u>	Variable	Annually	2012	2017	8/1/06	(C,D)
TOTAL	<u>\$ 935,820</u>						

NOTE A: Bonds having stated maturities after this date are subject to optional redemption on this date, or on any payment date thereafter.

NOTE B: Additionally, the term bonds maturing on the following dates, are subject to mandatory redemption prior to maturity beginning on August 1 of each of the years listed below and continuing each subsequent year until scheduled maturity:

General Obligation Bonds : Description of Issue	Scheduled Maturity Date	First Redemption Date
COLSTUD LOAN BDS SER '99	2018	2016
COLSTUD LOAN BDS SER '99	2023	2019
COLSTUD LOAN BDS SER '02	2021	2016
COLSTUD LOAN BDS SER '02	2026	2022
COLSTUD LOAN BDS SER '07A	2023	2022
COLSTUD LOAN BDS SER '07A	2025	2024
COLSTUD LOAN BDS SER '07A	2028	2026
COLSTUD LOAN BDS SER '07A	2031	2029
COLSTUD LOAN BDS SER '08A	2026	2025
COLSTUD LOAN BDS SER '08A	2028	2027
COLSTUD LOAN BDS SER '08A	2032	2029
COLSTUD LOAN BDS SER '09	2033	2031
COLSTUD LOAN BDS SER '10	2034	2032

NOTE C: Bonds are subject to optional redemption following the end of any Variable Rate Period beginning with this date.

NOTE D: Additionally, all bonds (other than Purchased Bonds) are subject to special mandatory redemption upon the occurrence of an "Event of Termination" as defined in the Bond Resolution. Purchased Bonds are subject to special mandatory redemption (1) provided that all Purchased Bonds then outstanding shall be redeemed in full on the Amortization End Date, or (2) upon the occurrence of an "Event of Default" under the Liquidity Agreement unless such redemption is waived by the Liquidity Provider.

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(g) Early Extinguishment

During fiscal year 2010, THECB sold general obligation refunding bonds totaling \$51.9 million. They were issued as College Student Loan Refunding Bonds Series 2010. The bonds closed on June 23, 2010. The proceeds from the 2010 Refunding Bonds were used to refund all outstanding maturities of the State of Texas College Student Loan Bonds, Series 1997 and 2000 in the aggregate principal amount of \$56.5 million. Net proceeds for the issue were \$56.5 million. A payment of \$310,949 was made for issuance costs.

The debt service requirements on the Series 2010 refunding bonds are \$61.6 million. THECB realized an economic gain of \$7.4 million on this transaction.

The change in net cash flows that resulted was an increase of approximately \$1.5 million. An accounting loss of \$117,937 which will be deferred and amortized in accordance with GASB Statement No. 7, was recognized on this refunding.

(9) Operating Lease Obligations

Included in expenditures are assets leased on a long-term basis that have been classified as operating leases. Amounts of rent paid or due under operating leases of \$1.2 million were expensed during the year ending August 31, 2010 in the General Fund.

The facility lease was renewed as of April 2010 wherein the terms of the contract allow for the total monthly rent to be adjusted for changes in the Consumer Price Index (CPI) beginning on July 1, 2011 and every year thereafter. The future minimum lease rental payments presented below follow the straight line method in accordance with GASB.

Estimated future minimum lease rental payments under non-cancelable operating leases having an initial term in excess of one year are as follows:

Year Ended August 31:	Amount
2011	\$ 1,418,672
2012	1,418,672
2013	1,418,672
2014	1,418,672
2015	1,418,672
2016-2020	7,093,359
Total minimum future lease rental payments	\$ <u>14,186,719</u>

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(10) Employee Health and Retirement Benefits

THECB contributes to the Employees Retirement System of Texas (ERS) and the Optional THECB contributes to the Employees Retirement System of Texas (ERS) and the Optional Retirement Plan (ORP), which are defined benefit pension plans, which provides service retirement, disability retirement benefits, and death benefits to plan members and beneficiaries. Under provisions in State law, plan members are required to contribute 6.5% of their salary to ERS and THECB contributes an amount equal to 6.95% of THECB's covered payroll. The ORP plan members contribute 6.65% of their salary to ORP, and THECB contributes 6.4% for non-grandfathered members and 8.50% to grandfathered (participants whose 1st date of participation in ORP is prior to September 1, 1995 are grandfathered). The total employee ERS contribution for the year ending August 31, 2010 was \$951,700 and THECB's matching contribution was \$998,353. The total employee ORP contribution for year ending August 31, 2010 was \$105,796 and THECB's matching contribution was \$115,628.

Employees of THECB are offered health insurance paid by the State. Employees have options to add spouse or children to the plan and pay a portion of the expense. Based on an allocation from the State, total health benefits for the year ending August 31, 2010 was \$1.6 million as determined by the State, and is primarily included in general administration expense.

(11) Contingent Liabilities

(a) Litigation

A number of claims against THECB are pending with respect to various matters arising in the normal course of THECB's operations. Legal counsel and THECB's management are of the opinion that settlement of these claims and pending litigation will not have a material effect on THECB's financial statements.

(b) Federal and State Financial Assistance Programs

THECB has received several financial assistance grants for specific purposes that are subject to review and audit by the grantor agencies. Such audits could lead to request for reimbursements to grantor agencies for expenditures disallowed under the terms of the grant. Based on prior experience, management believes such disallowances, if any, will be immaterial.

(c) Arbitrage

THECB's financial advisor has determined that THECB has earned interest revenue on unused bond proceeds in excess of amounts allowed by applicable federal regulations. THECB may be required to rebate funds to the federal government.

(d) Continuance Subject to Review

Under the Texas Sunset Act, THECB will be abolished effective September 1, 2015, unless continued in existence by the 84th Legislature as provided by the Act. If abolished, THECB may continue until September 1, 2016, to close out its operations.

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Year Ended August 31, 2010

(12) Risk Financing and Related Insurance

THECB is exposed to a variety of potential civil claims and assumes certain risks associated with tort and liability claims resulting from the performance of its duties. It is agency policy to periodically assess the proper combination of commercial insurance and assumption of risk to address potential liability claims. Currently there is no purchase of commercial insurance.

Workers' compensation claims are paid in accordance with the provisions of the State Office of Risk Management, through an assessment payment in a closed and non-voluntary pool of risks with other agencies. THECB's assessment for fiscal year 2010 was \$25,549. For unemployment compensation claims, the State, and THECB by extension, is generally self-insured, and funds such liabilities on a pay-as-you-go basis. THECB's unemployment compensation total payments for fiscal year 2010 were \$40,670.

THECB's liabilities are reported when it is both probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities will be reevaluated periodically taking into account current settlements, frequency of claims, past experience, and economic factors.

(13) Subsequent Events

At its January 27, 2011 Board meeting, the THECB passed a resolution authorizing the issuance of up to \$190 million of new and refunding bonds. Of this amount, \$118.7 million will be new bonds that will provide funds for the Hinson-Hazelwood loan program and \$34.2 million will be refunding bonds for the THECB's outstanding Series 2002 bonds. The bonds are expected to close in July 2011.

TEXAS HIGHER EDUCATION COORDINATING BOARD
(An Agency for the State of Texas)

General Fund
Schedule of Budgeted and Actual Revenues and Expenditures
Year Ended August 31, 2010
(Unaudited)

	Budgetary Amounts		Actual Amount	Final to Actual Variance Positive (Negative)
	Original	Final		
Revenues				
Legislative appropriations	\$ 1,666,300,500	1,566,541,025	1,563,477,707	(3,063,318)
Federal revenues	14,371,114	697,404,198	605,168,235	(92,235,963)
Federal pass-through revenues	39,901,366	39,901,366	41,435,463	1,534,097
State pass-through revenues	26,894,271	26,894,271	28,933,664	2,039,393
Intergovernmental revenues	62,813,500	62,780,702	41,066,588	(21,714,114)
Licenses, fees and permits	10,443,000	9,243,000	7,425,478	(1,817,522)
Interest and investment income	—	—	604,821	604,821
Other revenues	60,000	60,000	2,491,944	2,431,944
Total revenues	<u>1,820,783,751</u>	<u>2,402,824,562</u>	<u>2,290,603,900</u>	<u>(112,220,662)</u>
Expenditures				
General administration	27,600,765	27,361,206	33,095,282	(5,734,076)
Financial assistance - loans	17,487,328	16,066,153	37,081,024	(21,014,871)
Financial assistance - institutions	1,756,211,633	2,337,095,879	1,981,881,649	355,214,230
Financial assistance - students	27,735,663	27,703,163	143,236,265	(115,533,102)
Capital outlay	1,771,485	1,771,485	—	1,771,485
Total expenditures	<u>1,830,806,874</u>	<u>2,409,997,886</u>	<u>2,195,294,221</u>	<u>214,703,665</u>
Excess (deficit) of revenues over Expenditures	<u>(10,023,123)</u>	<u>(7,173,324)</u>	<u>95,309,679</u>	<u>102,483,003</u>
Other financing sources (uses)				
Transfer in	10,023,123	10,023,123	7,635,975	(2,387,148)
Total other financing sources (uses)	<u>10,023,123</u>	<u>10,023,123</u>	<u>7,635,975</u>	<u>(2,387,148)</u>
Net change in fund balance	<u>—</u>	<u>2,849,799</u>	<u>102,945,654</u>	<u>100,095,855</u>
Fund balance at the beginning of the year	90,323,738	90,323,738	90,323,738	—
Fund balance at the end of the year	<u>\$ 90,323,738</u>	<u>93,173,537</u>	<u>193,269,392</u>	<u>100,095,855</u>

Note - collections (disbursements) of student loans receivable, net, is not included above
since it is not a budgetary item.

	(4,074,079)
Fund Balance for General Fund (Governmental Funds):	\$ 189,195,313

See accompanying independent auditor's report

TEXAS HIGHER EDUCATION COORDINATING BOARD

Notes to Schedule of Budgeted and Actual Revenues and Expenditures – General Fund

For the Year Ended August 31, 2008

1. General Budget Policies

The budget is prepared biennially following generally accepted accounting principles (GAAP) and represents appropriations authorized by the Legislature and approved by the Governor. The budget authority to spend state funds, as detailed in the General Appropriations Act, is then used as a basis for THECB's annual operating budget. The proposed annual operating budget is submitted to the Commissioner of Higher Education who recommends an annual operating budget to the nine (9) member Board at its regular quarterly meeting held in July of each year. The nine (9) member Board approves the annual operating budget, including sources of funds and detailed expenditures of all funds administered by the agency. Obligations may be incurred and disbursements made only as authorized by the approved budget. Subsequent changes in the budget must have the approval of the Commissioner of Higher Education if no new funds are involved and THECB if new funds are involved.

The State monitors its statewide budget by establishing the legal level of control at the agency to ensure that expenditures are not made in excess of budgetary authority. Within THECB, procedures are used to ensure that expenditures do not exceed their total budget at the division level, but the State Comptroller ultimately ensures that each total authorized agency budget is not exceeded. Unencumbered appropriations are generally subject to lapse sixty days after the end of the fiscal year for which they were appropriated.

THECB prepares its annual operating budget based on the modified accrual basis. The accompanying schedules of Budgeted and Actual Revenues and Expenditures compare the agency's legally adopted budget with actual data in accordance with THECB's basis of budgeting.

2. Budget Amendments

The original budget for the General Fund was amended during fiscal year 2010 for additional appropriations. The original and final budget is presented in the accompanying financial statements.

3. Legally Adopted Budgets

Certain revenues and expenditures, including Debt Service, the Texas Opportunity Plan Fund, and the Student Loan Auxiliary Fund, are not budgeted by the Legislature. The activity for these programs has been excluded from the Schedule of Budgeted to Actual Revenues and Expenditures.

All funds that have excess of expenditures over appropriations variance is a result of direct funding from either appropriated transfers-in and/or beginning cash balances. Other variances due to presenting data on a budgetary basis of accounting can be attributed to a net increase in accruals which include prior year amounts.



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

The Board of Trustees
Texas Higher Education Coordinating Board:

We have audited the financial statements of the governmental activities, each major fund, and the aggregate remaining fund information of Texas Higher Education Coordinating Board (THECB) as of and for the year ended August 31, 2010, and have issued our report thereon dated June 30, 2011. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

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

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

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



Compliance and Other Matters

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

This report is intended solely for the information and use of THECB management, the Board of Trustees, others within the entity, and the State of Texas Auditor's Office and is not intended to be and should not be used by anyone other than these specified parties.

KPMG LLP

June 30, 2011