



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

Financial Statements

For the year ended August 31, 2012

(With Independent Auditors' Report Thereon)

TEXAS HIGHER EDUCATION COORDINATING BOARD

Year Ended August 31, 2012

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KPMG LLP
Suite 1900
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, 2012, 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, 2012, 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, 2012, 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 July 8, 2013, 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.



U.S. generally accepted accounting principles require that the management's discussion and analysis and the schedule of budgeted and actual revenues and expenditures on pages 5-16 and 48-49 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

July 8, 2013

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Management's Discussion and Analysis

August 31, 2012

The following is a discussion and analysis of Texas Higher Education Coordinating Board's (hereinafter referred to as THECB) financial performance for the year ended August 31, 2012. Use this section in conjunction with THECB's basic financial statements, which follow this section.

Financial Highlights – 2012

- The assets of THECB exceeded its liabilities at the end of the fiscal year 2012, resulting in \$ 683.9 million of net assets for the governmental activities.
- Unrestricted net assets, which may be used to meet THECB's future obligations, was \$ 0.9 million or 0.1% of total net assets at the end of fiscal year 2012.
- Net assets in the amount of \$ 100.7 million or 14.7% of total net assets was restricted for Debt Service and \$499.9 million, or 73.1% of net assets was restricted for loans and grant programs. Net assets restricted for unappropriated was \$82.3 million, or 12.0% of total net assets.
- THECB's total liabilities of \$890.6 million include \$867.2 million for bonds payable.
- As of August 31, 2012, THECB's governmental funds reported combined fund balances of \$550.2 million, of which less than 1% is designated as nonspendable or committed fund balance.
- THECB's primary revenue source is funding from the State of Texas through legislative appropriations of \$1.4 billion and THECB's primary expenditures are grants to institutions of \$1.5 billion.

Financial Highlights – 2011

- The assets of THECB exceeded its liabilities at the end of the fiscal year 2011, resulting in \$584.9 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 2011.
- Net assets in the amount of \$101.5 million or 17.3% of total net assets was restricted for Debt Service and \$457.8 million, or 78.3% of net assets was restricted for loans and grant programs. Net assets restricted for unappropriated was \$24.8 million, or 4.2% of total net assets.
- THECB's total liabilities of \$863.5 million include \$830.0 million for bonds payable.
- During the fiscal year ending August 31, 2011, House Bill 4 was passed by the 82nd legislature. THECB received mandated budget reductions totaling \$117.2 million for the fiscal year.
- As of August 31, 2011, THECB's governmental funds reported combined fund balances of \$496.4 million, of which less than 1% is designated as nonspendable or committed fund balance.

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August 31, 2012

- THECB's primary revenue source is funding from the State of Texas through legislative appropriations and American Recovery and Reinvestment Act (ARRA) of \$1.6 billion and THECB's primary expenditures are grants to institutions of \$1.7 billion.

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.

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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.

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.

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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, 2012 and 2011:

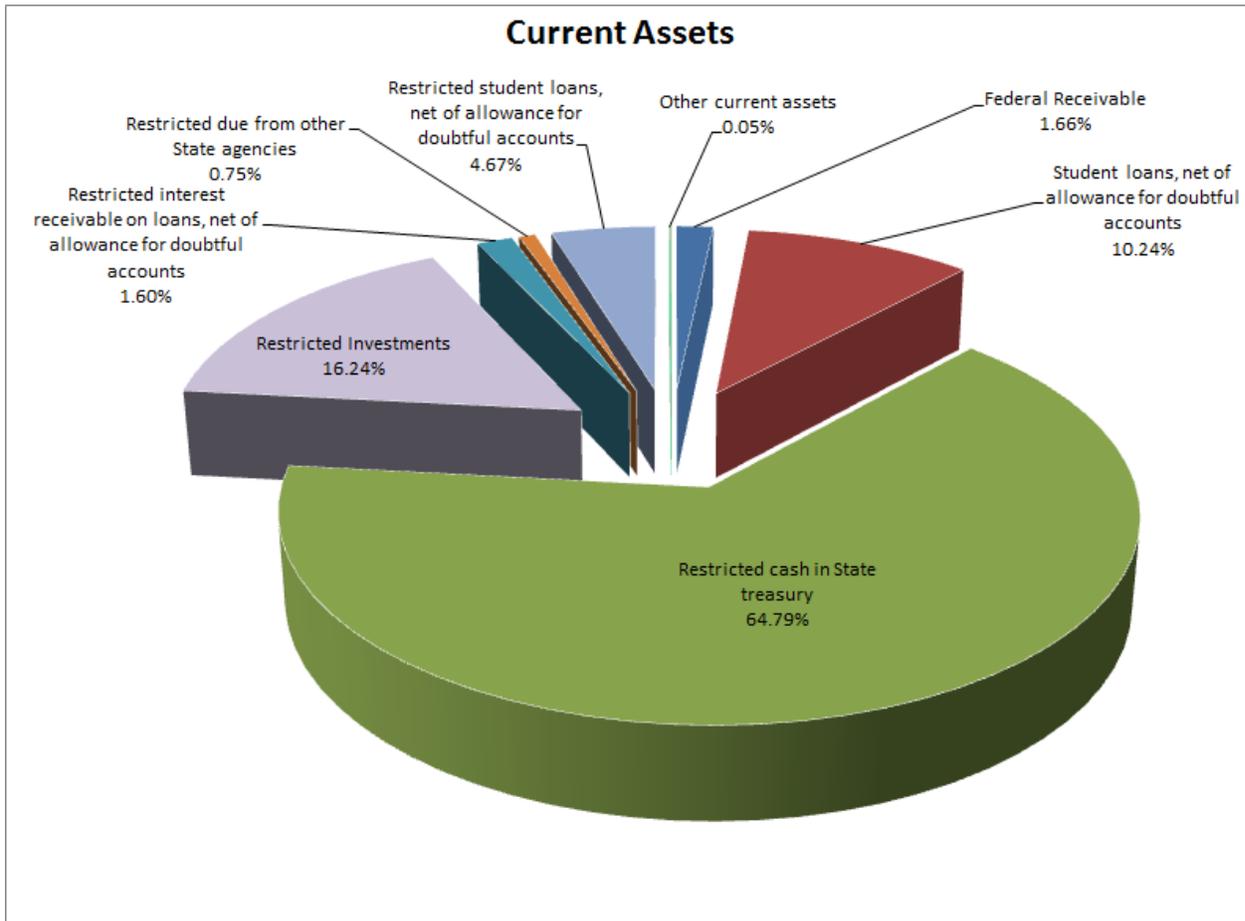
| | Net Assets | |
|----------------------------|---------------------------------|----------------------|
| | August 31, 2012 and 2011 | |
| | <u>2012</u> | <u>2011</u> |
| ASSETS | | |
| Current assets | \$ 572,755,124 | 573,075,973 |
| Capital assets | 77,105 | 134,733 |
| Other non-current assets | 1,001,624,473 | 875,259,587 |
| Total assets | <u>1,574,456,702</u> | <u>1,448,470,293</u> |
| LIABILITIES | | |
| Current liabilities | 85,919,597 | 94,098,540 |
| Noncurrent liabilities | 804,670,797 | 769,444,882 |
| Total liabilities | <u>890,590,394</u> | <u>863,543,422</u> |
| NET ASSETS | | |
| Invested in capital assets | 77,105 | 134,733 |
| Restricted | 682,854,642 | 584,047,110 |
| Unrestricted | 934,561 | 745,028 |
| Total net assets | <u>\$ 683,866,308</u> | <u>584,926,871</u> |

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Net assets may serve as a useful indicator of a government's financial position. For THECB, assets exceeded liabilities by \$683.9 million at the end of the 2012 fiscal year, an increase of \$99 million from prior year or 16.9%. The largest portion of THECB's net assets is restricted for debt service, loans and grants, and unappropriated which represent \$682.9 million.

Total assets increased to \$1.57 billion from \$1.45 billion, representing an 8.7% change from fiscal year 2011. The changes were primarily driven by an increase in unappropriated cash from tuition set-asides and higher loan receivable balances, as a result of new loans issued during the year exceeding repayments. Total liabilities increased to \$890.6 million from \$863.5 million, representing a 3.1% change from the prior fiscal year. The change in total liabilities was primarily due to year-over-year increases in bonds payable.

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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, 2012 and 2011:

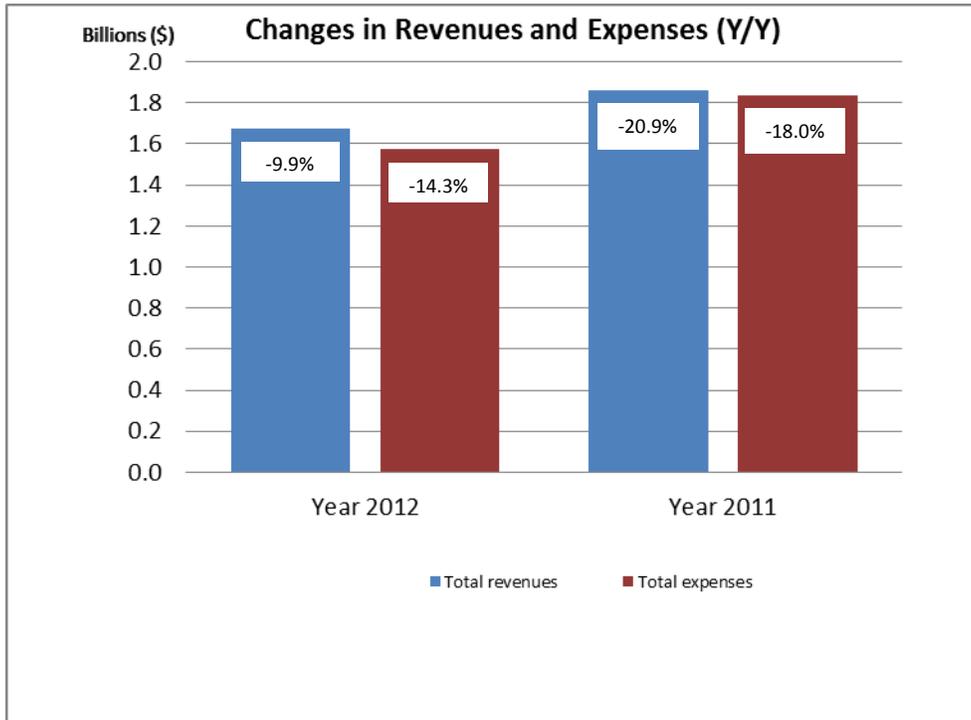
| | <u>2012</u> | <u>2011</u> |
|-------------------------------------|-----------------------|----------------------|
| Program revenues: | | |
| Charges for services | \$ 868,945 | 987,575 |
| Operating grants and contributions | 239,518,161 | 374,400,699 |
| General revenues | <u>1,434,100,797</u> | <u>1,484,056,015</u> |
| Total revenues | <u>1,674,487,903</u> | <u>1,859,444,289</u> |
| Program expenses: | | |
| General administration | 30,840,389 | 35,884,167 |
| Financial assistance – loans | 55,964,018 | 83,803,451 |
| Financial assistance – institutions | 1,460,265,360 | 1,689,695,963 |
| Financial assistance – students | <u>28,478,699</u> | <u>28,090,498</u> |
| Total expenses | <u>1,575,548,466</u> | <u>1,837,474,079</u> |
| Change in net assets | 98,939,437 | 21,970,210 |
| Beginning net assets | <u>584,926,871</u> | <u>562,956,661</u> |
| Ending net assets | <u>\$ 683,866,308</u> | <u>584,926,871</u> |

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In the current fiscal year, total governmental net assets of THECB increased by \$99 million. Revenue decreased by \$185.0 million or 9.9% while expenses decreased by \$261.9 million or 14.3%. Revenues and expenses decreased primarily due to reductions in the ARRA program and legislative appropriations.

Approximately \$1.4 billion of revenue was from legislative appropriations from the State of Texas, which decreased from year 2011 by \$50.0 million or 3.4%. For fiscal year 2012, legislative appropriations amounted to approximately 85.6% of total revenues (79.8% in fiscal year 2011). Operating Grants and Contributions amounted to 14.3% of total revenues. Financial assistance to institutions represented the majority of expenses at \$1.5 billion, or 94.5% 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.

THECB's governmental funds conform to GASB Statement No. 54, *Fund Balance Reporting and Governmental Fund Type Definitions*. It establishes accounting and financial reporting standards for governmental funds by classifying fund balances into specifically defined classifications that comprise a hierarchy based primarily on the extent to which a government is bound to observe constraints imposed upon the use of the resources reported in governmental funds. It also clarifies existing governmental fund type definitions.

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 \$550.2 million, an increase of \$53.8 million from 2011 or 10.8%. Substantially, all of the \$550.2 million of the fund balance constitutes restricted fund balance as compared to \$496.4 million in 2011.

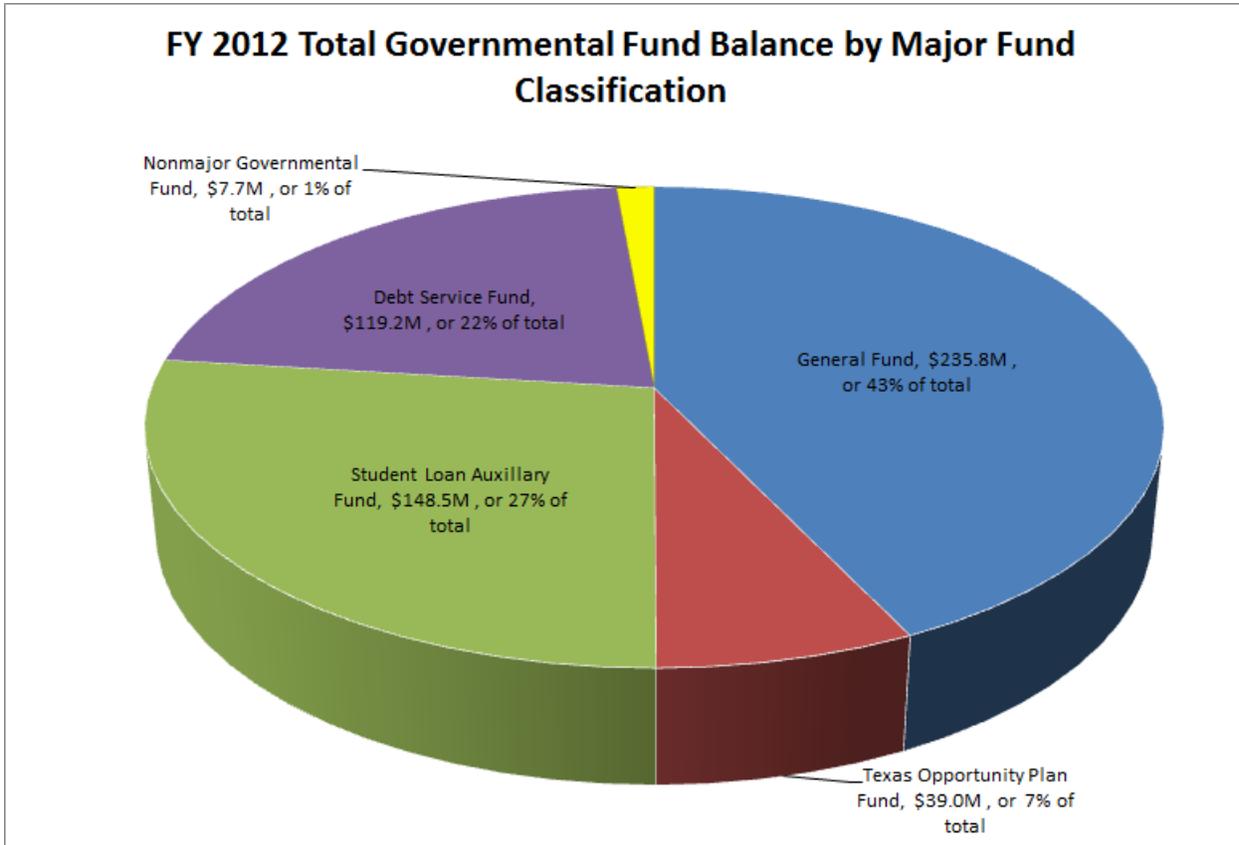
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Management's Discussion and Analysis

August 31, 2012

The following graph illustrates the composition of the \$550.2 million in total governmental fund balance by major fund category for FY 2012.



The 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, substantially all of the \$235.8 million in fund balance constituted restricted fund balance. The total general fund balance for fiscal year 2012 was \$46.6 million higher than fiscal year 2011, an increase of 24.6%. The increase was primarily driven by higher cash balances in unappropriated funding sources.

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. At the end of the current fiscal year, restricted fund balance for the TOP and the SLA fund was \$187.5 million, a decrease of \$1.6 million from \$189.1 million in 2011.

The 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, restricted fund balance for debt service was

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August 31, 2012

\$119.2 million as compared to \$111.1 million for 2011. The increase was primarily due to collections from loan repayments exceeding debt service payments in fiscal year 2012.

Nonmajor Governmental Funds are made up of special revenue funds including the Student Loan Revenue Bond fund (1697) and funds related to the Permanent Health Fund for Higher Education (0810, 0824, and 0825). The Student Loan Revenue Bond funds are used to account for repayments of student loans in excess of what is required to be deposited in the Debt Service Fund. Distribution of a portion of the earnings from the Permanent Health Fund for Higher Education are transferred to THECB into special revenue funds 0810, 0824, 0825 and used for health care related education. In FY 2012, restricted fund balance for nonmajor governmental funds was \$7.8 million as compared to \$7.0 million for FY 2011. The change was primarily due to higher cash balances carried at year-end for grant programs.

OTHER INFORMATION

General Fund budgetary highlights

During the current fiscal year, actual revenues were \$62.3 million higher than the final budgeted amount of \$1.5 billion. The increase from budget was primarily the result of higher unappropriated revenue balances.

Actual general fund expenditures were \$26.5 million lower than the final budgeted amount of \$1.6 billion. The decrease in actual expenditures is mainly a result of Texas Grant funds expenditures being below budget during the reported year.

Capital Assets

THECB's capital assets at year end totaled \$77,105 (net of accumulated depreciation). Capital assets include furniture, equipment, and intangible assets. Net capital assets decreased by \$57,628 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, 2012 and 2011

(in thousands)

| | <u>2012</u> | <u>2011</u> |
|-------------------------|-------------|-------------|
| Furniture and equipment | <u>\$77</u> | <u>135</u> |

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Management's Discussion and Analysis

August 31, 2012

Debt Administration

At the end of the current fiscal year, THECB reported \$867.2 million in outstanding debt. The table below reflects the outstanding debt at August 31, 2012 and 2011. Additional information can be found in Note 8.

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

| | <u>2012</u> | <u>2011</u> |
|-------------------------------------|-------------------|-------------------|
| Bonds outstanding at August 31, net | \$ 829,968 | \$770,122 |
| Bonds issued | 85,615 | 152,240 |
| Bonds retired/refunded | (59,430) | (99,705) |
| Deferred adjustments, net | <u>11,005</u> | <u>7,311</u> |
| Bonds outstanding at August 31, net | <u>\$ 867,158</u> | <u>\$ 829,968</u> |

Ratings at August 31, 2012 of the THECB's obligations for various debt instruments are as follows:

Debt

In 2012, new debt was issued for \$85.6 million. Total bonded indebtedness for the fiscal year 2012 increased by \$37.2 million or 4.5% primarily due to new bond issues exceeding principal payments on outstanding debt.

**Moody's Investors
Service, Inc.**

**Standard
and Poor's**

General Obligation Bonds:

| | | |
|-------------------------------------|------------|----------|
| Col Stud Loan Bds Ser'99 | 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+ |
| Col Stud Loan Bds Ser 2011A | Aaa | AA+ |
| Col Stud Loan Rfd Bds Ser 2011B | Aaa | AA+ |
| Col Stud Loan Rfd Bds Ser 2011C | Aaa | AA+ |
| Col Stud Loan Bds Ser 2012 | Aaa | AA+ |

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Management's Discussion and Analysis

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Economic Factors and Next Year's Budget

Our 2013 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.

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, 2012

| | Governmental Activities |
|---|------------------------------------|
| ASSETS | |
| Current assets: | \$ |
| Prepaid Items | 42,951 |
| Federal Receivable | 9,490,956 |
| Student loans, net of allowance for doubtful accounts | 58,658,112 |
| Restricted cash in State treasury | 371,062,892 |
| Restricted cash in Bank | 8,103 |
| Restricted Investments | 93,008,722 |
| Restricted accounts receivable | 33,688 |
| Restricted interest receivable | 234,768 |
| Restricted due from other State agencies | 4,300,744 |
| Restricted student loans, net of allowance for doubtful accounts | 26,723,252 |
| Restricted interest receivable on loans, net of allowance for doubtful accounts | 9,190,936 |
| Total current assets | 572,755,124 |
| Noncurrent assets: | |
| Student loans, net of allowance for doubtful accounts | 819,589,041 |
| Restricted Investments | 7,788,060 |
| Restricted interest receivable on loans, net of allowance for doubtful accounts | 88,225,233 |
| Restricted cash in State treasury - unappropriated | 82,278,244 |
| Depreciable capital assets: | |
| Furniture and equipment | 801,382 |
| Accumulated depreciation | (724,277) |
| Net depreciable capital assets | 77,105 |
| Deferred issuance costs, net of amortization | 3,743,895 |
| Total noncurrent assets | 1,001,701,578 |
| Total assets | 1,574,456,702 |
| LIABILITIES AND NET ASSETS | |
| Current liabilities: | |
| Accounts payable | 12,945,339 |
| Interest payable | 2,867,766 |
| Due to other State agencies | 5,033,405 |
| Deferred revenues | 24,000 |
| Bonds payable | 63,436,932 |
| Employees' compensable leave | 899,429 |
| Arbitrage rebate liability | 712,726 |
| Total current liabilities | 85,919,597 |
| Noncurrent liabilities: | |
| Bonds payable | 803,721,076 |
| Employees' compensable leave | 747,441 |
| Arbitrage rebate liability | 202,280 |
| Total noncurrent liabilities | 804,670,797 |
| Total liabilities | 890,590,394 |
| NET ASSETS | |
| Invested in capital assets | 77,105 |
| Restricted for: | |
| Debt service | 100,724,460 |
| Loan and grant programs | 499,851,938 |
| Unappropriated | 82,278,244 |
| Unrestricted | 934,561 |
| Total net assets | \$ 683,866,308 |

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Statement of Activities

For the Year Ended August 31, 2012

| | | <u>Program Revenues</u> | | <u>Net (Expense)</u> |
|-------------------------------------|-------------------------|-------------------------------------|---|---|
| | <u>Expenses</u> | <u>Charges for Services</u> | <u>Operating Grants and Contributions</u> | <u>Revenue and Change in Net Assets - Governmental Activities</u> |
| Governmental activities: | | | | |
| General administration | \$ 30,840,389 | 98,965 | 4,411,782 | (26,329,642) |
| Financial assistance - loans | 55,964,018 | — | 119,313,530 | 63,349,512 |
| Financial assistance - institutions | 1,460,265,360 | 653,947 | 95,847,899 | (1,363,763,514) |
| Financial assistance - students | 28,478,699 | 116,033 | 19,944,950 | (8,417,716) |
| Total governmental activities | <u>\$ 1,575,548,466</u> | <u>868,945</u> | <u>239,518,161</u> | <u>(1,335,161,360)</u> |
| | | | | |
| General revenues: | | | | |
| Legislative appropriations | | | | <u>1,434,100,797</u> |
| Total general revenues | | | | 1,434,100,797 |
| | | | Net change in assets | 98,939,437 |
| | | | Net assets at beginning of year | <u>584,926,871</u> |
| | | | Net assets at end of the year | <u><u>\$ 683,866,308</u></u> |

See accompanying notes to the financial statements.

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Balance Sheet – Governmental Funds

August 31, 2012

| | General Fund | Texas Opportunity Plan Fund | Student Loan Auxiliary Fund | Debt Service Fund | Nonmajor Governmental Funds | Total Governmental Funds |
|--|-------------------------|--|--|----------------------------------|--|---|
| ASSETS | | | | | | |
| Cash in State treasury | \$ 156,583,766 | 39,282,777 | 149,032,687 | 18,135,826 | 8,027,836 | 371,062,892 |
| Cash in Bank | — | — | — | 8,103 | — | 8,103 |
| Investments | — | — | — | 100,796,782 | — | 100,796,782 |
| Due from other State agencies | 4,060,393 | — | — | — | 240,351 | 4,300,744 |
| Prepaid Items | 42,951 | — | — | — | — | 42,951 |
| Accounts receivables | 38 | — | — | 3,130 | 30,520 | 33,688 |
| Federal receivables | 9,490,956 | — | — | — | — | 9,490,956 |
| Interest receivable | 19,715 | 23 | — | 212,406 | 2,624 | 234,768 |
| Student loans, net of allowance for doubtful accounts | 115,906,202 | 129,287,232 | 657,613,584 | — | 2,163,387 | 904,970,405 |
| Interest receivable on loans net of allowance for doubtful accounts | 246,248 | 20,273,830 | 76,684,655 | — | 211,436 | 97,416,169 |
| Cash in State treasury - unappropriated | 82,278,244 | — | — | — | — | 82,278,244 |
| TOTAL ASSETS | \$ 368,628,513 | 188,843,862 | 883,330,926 | 119,156,247 | 10,676,154 | 1,570,635,702 |
| LIABILITIES AND FUND BALANCES | | | | | | |
| Liabilities: | | | | | | |
| Accounts payable | \$ 11,606,296 | 270,673 | 527,444 | — | 540,926 | 12,945,339 |
| Due to other State agencies | 5,033,405 | — | — | — | — | 5,033,405 |
| Deferred revenues | 116,176,450 | 149,561,062 | 734,298,239 | — | 2,374,823 | 1,002,410,574 |
| Total liabilities | 132,816,151 | 149,831,735 | 734,825,683 | — | 2,915,749 | 1,020,389,318 |
| FUND BALANCES | | | | | | |
| Nonspendable-Prepaid Items | 42,951 | — | — | — | — | 42,951 |
| Restricted | 235,769,311 | 39,012,127 | 148,505,243 | 119,156,247 | 7,760,405 | 550,203,333 |
| Committed | 100 | — | — | — | — | 100 |
| TOTAL FUND BALANCES | 235,812,362 | 39,012,127 | 148,505,243 | 119,156,247 | 7,760,405 | 550,246,384 |
| TOTAL LIABILITIES AND FUND BALANCES | \$ 368,628,513 | 188,843,862 | 883,330,926 | 119,156,247 | 10,676,154 | 1,570,635,702 |

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, 2012

| | | |
|---|----|----------------------|
| Total fund balances - Governmental Funds | \$ | 550,246,384 |
| 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 | | 77,105 |
| Student loan notes receivable and interest receivable are not available and are reported in the funds as deferred revenue | | 1,002,386,574 |
| Other long-term assets are not available as current period resources and are not reported in the funds | | 3,743,895 |
| Long-term liabilities are not due and payable in the current period and are not reported in the funds | | <u>(872,587,650)</u> |
| Total net assets - Governmental Activities | \$ | <u>683,866,308</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, 2012

| | General Fund | Texas Opportunity Plan Fund | Student Loan Auxiliary Fund | Debt Service Fund | Nonmajor Governmental Funds | Total Governmental Funds |
|---|----------------------|--------------------------------------|--------------------------------------|-------------------------|-----------------------------------|--------------------------------|
| REVENUES | | | | | | |
| Legislative appropriation revenues | \$ 1,434,100,797 | — | — | — | — | 1,434,100,797 |
| Federal revenues | 15,358,630 | 16,736 | 101,604 | 19,967 | 1,504 | 15,498,441 |
| Federal grant pass-through revenues | 31,591,883 | — | — | — | — | 31,591,883 |
| State grant pass-through revenues | 19,924,202 | — | — | — | — | 19,924,202 |
| Intergovernmental revenues | 31,377,569 | — | — | — | 3,423,717 | 34,801,286 |
| Licenses, fees and permits | 2,498,923 | 1,373,686 | 8,243,026 | — | 32,441 | 12,148,076 |
| Interest and investment income | 898,454 | 11,426,043 | 38,102,226 | 1,033,082 | 2,468,050 | 53,927,855 |
| Collections (disbursements) of student loan receivables, net | (44,291,189) | 22,835,323 | (60,780,258) | — | 491,088 | (81,745,036) |
| Other revenues (expenses), net | 14,979,399 | — | — | — | — | 14,979,399 |
| Unappropriated revenues | 57,515,964 | — | — | — | — | 57,515,964 |
| Total revenues, net | 1,563,954,632 | 35,651,788 | (14,333,402) | 1,053,049 | 6,416,800 | 1,592,742,867 |
| EXPENDITURES | | | | | | |
| General administration | 30,430,879 | — | 436,635 | — | 3,250 | 30,870,764 |
| Financial assistance - loans | 12,125,551 | 6,341,230 | 8,384,464 | — | 209,149 | 27,060,394 |
| Financial assistance - institutions | 1,455,439,160 | 2,000 | — | — | 4,824,200 | 1,460,265,360 |
| Financial assistance - students | 28,478,699 | — | — | — | — | 28,478,699 |
| Debt service: | | | | | | |
| Principal | — | — | — | 59,430,000 | — | 59,430,000 |
| Interest | — | — | — | 31,724,559 | — | 31,724,559 |
| Other financing fees | — | — | 1,096,968 | — | — | 1,096,968 |
| Total expenditures | 1,526,474,289 | 6,343,230 | 9,918,067 | 91,154,559 | 5,036,599 | 1,638,926,744 |
| Excess (deficiency) of revenues over expenditures | 37,480,343 | 29,308,558 | (24,251,469) | (90,101,510) | 1,380,201 | (46,183,877) |
| OTHER FINANCING SOURCES (USES) | | | | | | |
| Issuance of Tax Exempt Debt | — | — | 85,615,000 | — | — | 85,615,000 |
| Premium on sale of bonds | — | — | 14,737,131 | — | — | 14,737,131 |
| Discount on sale of bonds | — | — | (356,294) | — | — | (356,294) |
| Transfers in | 9,129,784 | — | — | 98,135,265 | — | 107,265,049 |
| Transfers out | — | (27,195,778) | (79,473,481) | — | (595,790) | (107,265,049) |
| Total other financing sources (uses) | 9,129,784 | (27,195,778) | 20,522,356 | 98,135,265 | (595,790) | 99,995,837 |
| Net change in fund balances | 46,610,127 | 2,112,780 | (3,729,113) | 8,033,755 | 784,411 | 53,811,960 |
| Fund balances at beginning of the year | 189,202,235 | 36,899,347 | 152,234,356 | 111,122,492 | 6,975,994 | 496,434,424 |
| Fund balances at the end of the year | \$ 235,812,362 | 39,012,127 | 148,505,243 | 119,156,247 | 7,760,405 | 550,246,384 |

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, 2012

| | | |
|---|----|--------------------------|
| Net change in fund balances - Governmental Funds | \$ | 53,811,960 |
| 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. | | (57,628) |
| 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. | | (39,956,883) |
| Disbursements (collections) of student loans receivable, net, in governmental fund are not a revenue source on the statement of activities. | | 81,745,036 |
| 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>3,396,952</u> |
| Change in net assets - Governmental Activities | \$ | <u><u>98,939,437</u></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, 2012

| | <u>Agency Funds</u> |
|-----------------------------------|---------------------|
| Assets | |
| Current assets: | |
| Restricted: | |
| Cash in State Treasury | \$ 358,672 |
| Interest and Dividends Receivable | <u>1</u> |
| Total current assets | <u>358,673</u> |
| Total assets | <u>\$ 358,673</u> |
| Liabilities | |
| Current liabilities: | |
| Funds held for others | \$ <u>358,673</u> |
| Total current liabilities | <u>358,673</u> |
| Total liabilities | <u>\$ 358,673</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, 2012

(1) Summary of Significant Accounting Policies

A. Reporting Entity

The Texas Legislature (Legislature) created the 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, 2012 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.

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

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2012

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 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.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2012

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 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-Hazlewood loans. The SLA fund is for bond activity subsequent to 1992 and is used to make Hinson-Hazlewood loans and B-On-Time loans. 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 2012 consisted of the following: Texas College Student Loan Bonds Interest and Sinking Account, and the Student Loan Revenue Bond Interest and Sinking Account.
- Nonmajor Governmental Funds are made up of special revenue funds including the Student Loan Revenue Bond fund (1697) and funds related to the Permanent Health Fund for Higher Education (0810, 0824, and 0825). The Student Loan Revenue Bond funds are used to account for repayments of student loans in excess of what is required to be deposited in the Debt Service Fund. The Permanent Health Fund for Higher Education is a permanent fund established by the Legislature from a portion of the money received in the settlement of The State of Texas v. The American Tobacco Co., et.al. The corpus of the account is held within

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2012

the state treasury outside of the general fund. Distribution of a portion of the earnings on the account are transferred to THECB into special revenue funds 0810, 0824, 0825 and used for health care related education.

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.

- 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 2012 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 2012 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 nonspendable fund balance which indicates that they are not in a spendable form.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2012

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.

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.

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Notes to Financial Statements

Year Ended August 31, 2012

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 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 Student Loan Auxiliary Fund 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.

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Notes to Financial Statements

Year Ended August 31, 2012

Discounts and Premiums on Debt

Discounts and premiums on debt for bond series 2010 and prior 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 using the straight line method result in the proportionate amortization during the current year of the remaining balance of discounts and premiums on debt. The effective interest method is used for discounts and premiums on debt for bond series 2011 and thereafter in the Statement of Net Assets.

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.

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.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2012

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 into 5 categories: Nonspendable, Restricted, Committed, Assigned, and Unassigned.

- Nonspendable
This represents amounts not available to be spent because they are either (1) not in spendable form or (2) legally or contractually required to be maintained intact.
- Restricted
This represents amounts related to those resources that have constraints placed on their use through external parties or by law through constitutional provisions.
- Committed
This represents amounts that can be used only for specific purposes pursuant to constraints imposed by a formal action of the Board, THECB's highest level of decision making authority.
- Assigned
This represents amounts that are constrained by the THECB's intent to be used for specific purposes, but are neither restricted nor committed. Intent is expressed by (1) the Board or (2) a body (for example, a budget or finance committee) or official to which the governing body has delegated the authority to assign amounts to be used for specific purposes.
- Unassigned
This represents amounts that are the residual classification for the general funds. This classification represents fund balance that was not assigned to other funds and was not restricted, committed or assigned to specific purposes within the general fund.

GASB 54 Note Disclosures

- A. The THECB spending policy is to spend restricted fund balance first, followed by committed, assigned and unassigned fund balances.
- B. See GASB 54 Fund Balance classification by purpose table (see following page).
- C. Significant encumbrances are reported in Note 11 of this financial report.
- D. There are no stabilization arrangements with THECB.
- E. The THECB does not have a minimum fund balance policy.

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. Restrictions are imposed by bond covenants and grant requirements for state and federal programs. Unappropriated net assets consist of legislative appropriation reductions for appropriated funds received through statutory requirement where the cash reductions were retained by the THECB at fiscal year-end. The unappropriated net asset balance will remain on the THECB's books until the legislature can either re-purpose or re-appropriate these funds. 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

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2012

GASB 54 Fund Balance Classification by Purpose (as of August 31st, 2012)

| | General Fund | Texas Opportunity Plan Fund | Student Loan Auxiliary Fund | Debt Service Fund | Nonmajor Governmental Funds | Total Governmental Funds |
|---------------------------------|-----------------------|-----------------------------------|-----------------------------------|----------------------|-----------------------------------|--------------------------------|
| Nonspendable - Prepaids | | | | | | |
| Hinson-Hazlewood Loan Program | \$ 42,951 | | | | | 42,951 |
| Committed: | | | | | | |
| Petty Cash | 100 | | | | | 100 |
| Restricted: | | | | | | |
| ABE Community College Grants | 5,232,863 | | | | | 5,232,863 |
| Advanced Research Program | 613,302 | | | | | 613,302 |
| Armed Services Scholarships | 1,732,674 | | | | | 1,732,674 |
| Baylor College of Medicine GME | 2,050,000 | | | | | 2,050,000 |
| Central Administration | 411,688 | | | | | 411,688 |
| Close The Gaps | 848,475 | | | | | 848,475 |
| College Readiness Initiatives | 6,837,372 | | | | | 6,837,372 |
| Conferences | 119,842 | | | | | 119,842 |
| Debt Service | | | | 119,156,247 | | 119,156,247 |
| Dental Education - LRP | 216,088 | | | | | 216,088 |
| Developmental Ed Program | 2,635,336 | | | | | 2,635,336 |
| Federal Programs | 261,583 | | | | | 261,583 |
| Hinson-Hazlewood Loan Program | (185,136) | | | | | (185,136) |
| Minority Health Research/Ed | | | | | 3,363,958 | 3,363,958 |
| Nursing & Allied Health | | | | | 4,308,536 | 4,308,536 |
| OAG Attorney – LRP | 249,935 | | | | | 249,935 |
| Operating & Support | 289,109 | | | | | 289,109 |
| Other Programs | 419,782 | | | | 2 | 419,784 |
| Physician - LRP | 16,471,186 | | | | | 16,471,186 |
| Prof Nursing Shortage Reduction | 2,504,217 | | | | | 2,504,217 |
| Promote Participation & Success | 565,972 | | | | | 565,972 |
| Student Financial Aid Programs | 97,428,562 | | | | | 97,428,562 |
| Student Loans | | 39,012,127 | 148,505,243 | | | 187,605,279 |
| Top 10% Scholarships | 14,788,217 | | | | 87,909 | 14,788,217 |
| Unappropriated | 82,278,244 | | | | | 82,278,244 |
| Restricted Subtotal | 235,769,311 | 39,012,127 | 148,505,243 | 119,156,247 | 7,760,405 | 550,203,333 |
| Total Governmental Funds | \$ 235,812,362 | 39,012,127 | 148,505,243 | 119,156,247 | 7,760,405 | 550,246,384 |

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(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 | \$ | 550,246,384 |
| 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 | 801,382 | |
| Less accumulated depreciation | <u>(724,277)</u> | |
| | | 77,105 |
| Student loan notes receivable and interest receivable are not available and are reported in the funds as deferred revenue | | |
| | | 1,002,386,574 |
| Other long-term assets are not available as current period resources and are not reported in the funds | | |
| | | 3,743,895 |
| Long-term liabilities are not due and payable in the current period and are not reported in the funds | | |
| Bonds payable, net | (867,158,008) | |
| Interest payable | (2,867,766) | |
| Employees' compensable leave | (1,646,870) | |
| Arbitrage rebate liability | <u>(915,006)</u> | |
| | | <u>(872,587,650)</u> |
| Total net assets - governmental activities | \$ | <u><u>683,866,308</u></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

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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 | | \$ | 53,811,960 |
| 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 | 5,550 | | |
| Depreciation expense | <u>(63,178)</u> | | (57,628) |
| 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 | 608,954 | | |
| Repayment of bond principal | 59,430,000 | | |
| Bonds issued | (85,615,000) | | |
| Premium on bonds issued | (14,737,131) | | |
| Discount on bonds issued | <u>356,294</u> | | (39,956,883) |
| Disbursements (collections) of student loans receivable, net, in governmental funds are not a revenue source on the Statement of Activities | | | 81,745,036 |
| 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 | 88,003 | | |
| Interest and other | 2,946,534 | | |
| Arbitrage rebate | <u>362,415</u> | | 3,396,952 |
| Change in net assets - Governmental activities | | \$ | <u>98,939,437</u> |

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(3) Deposits and Investments

Deposits of Cash held in the State Treasury:

On August, 31, 2012, THECB's restricted cash balance amounted to \$453.3 million and is comprised as follows:

Restricted

General Fund

Cash in State Treasury \$ 238,862,010

Special Revenue Funds

Texas Opportunity Plan 39,282,777

Student Loan Auxiliary 149,032,687

Debt Service Fund 18,135,826

Nonmajor Governmental Funds 8,027,836

\$ 453,341,136

As of August 31, 2012, the carrying amount of deposits for governmental activities was \$453.3 million. These amounts consist of cash in the State Treasury for which the State makes the related investment decisions. As of August 31, 2012, the total bank balance for governmental activities was \$451.7 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.

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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, 2012, the TTSTC had uninvested cash in bank deposits of \$8,103, 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 | \$ 8,103 |

As of August 31, 2012, the fair value of investments held with TTSTC was \$100,796,782 as presented below:

| <u>Investment Type</u> | <u>Debt Service Fund</u> |
|------------------------|--------------------------|
| U.S. Treasury Notes | \$ 100,796,782 |

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, 2012, is presented below:

| | PRIMARY GOVERNMENT | | | |
|---|---------------------------|-----------|-----------|---------------------|
| | Balance 09/01/11 | Additions | Deletions | Balance 08/31/12 |
| GOVERNMENTAL ACTIVITIES | | | | |
| Depreciable Assets | | | | |
| Furniture and Equipment | \$ 904,756 | 5,550 | (108,924) | 801,382 |
| Total Depreciable Assets | 904,756 | 5,550 | (108,924) | 801,382 |
| Less Accumulated Depreciation for: | | | | |
| Furniture and Equipment | (770,023) | (63,178) | 108,924 | (724,277) |
| Total Accumulated Depreciation | (770,023) | (63,178) | 108,924 | (724,277) |
| Depreciable Assets, Net | 134,733 | (57,628) | 0 | 77,105 |
| Amortizable Assets - Intangible | | | | |
| Computer Software | 43,782 | 0 | (43,782) | 0 |
| Total Amortizable Assets - Intangible | 43,782 | 0 | (43,782) | 0 |
| Less Accumulated Amortization for: | | | | |
| Computer Software | (43,782) | 0 | 43,782 | 0 |
| Total Accumulated Amortization | (43,782) | 0 | 43,782 | 0 |
| Amortizable Assets - Intangible, Net | 0 | 0 | 0 | 0 |
| Governmental Activities Capital Assets, Net | \$ 134,733 | (57,628) | 0 | 77,105 |

Depreciation expense of \$63,178 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 as of August, 31, 2012:

| | <u>General Fund</u> | <u>Texas Opportunity Plan Fund</u> | <u>Student Loan Auxiliary Fund</u> | <u>Nonmajor Governmental Student Loan Fund</u> | <u>Total</u> |
|---|-----------------------|--|--|--|--------------------|
| Student loan notes receivable | \$ 187,506,365 | 169,405,028 | 734,337,536 | 3,963,349 | 1,095,212,278 |
| Less: Allowance for doubtful accounts | (71,600,163) | (40,117,796) | (76,723,952) | (1,799,962) | (190,241,873) |
| Student loan notes receivable, net | <u>\$ 115,906,202</u> | <u>129,287,232</u> | <u>657,613,584</u> | <u>2,163,387</u> | <u>904,970,405</u> |
| Beginning allowance | \$ 70,369,373 | 37,381,783 | 72,769,087 | 1,758,502 | 182,278,745 |
| Write offs - Loan Principal | (88,294) | (230,865) | (667,006) | (22,939) | (1,009,104) |
| Write offs - Loan Forgiveness | (10,458,524) | 0 | (396,527) | 0 | (10,855,051) |
| Provisions for uncollectible loan principal | 4,055,801 | 2,966,878 | 7,221,871 | 64,399 | 14,308,949 |
| Provisions for uncollectible loan forgiveness | 7,721,807 | 0 | (2,203,473) | 0 | 5,518,334 |
| Ending allowance for doubtful accounts | <u>\$ 71,600,163</u> | <u>40,117,796</u> | <u>76,723,952</u> | <u>1,799,962</u> | <u>190,241,873</u> |
| Interest receivable on student loans | \$ 926,086 | 40,458,087 | 94,965,459 | 1,403,382 | 137,753,014 |
| Less: Allowance for doubtful accounts | (679,838) | (20,184,257) | (18,280,804) | (1,191,946) | (40,336,845) |
| Interest receivable on student loans, net | <u>\$ 246,248</u> | <u>20,273,830</u> | <u>76,684,655</u> | <u>211,436</u> | <u>97,416,169</u> |
| Beginning allowance | \$ 341,912 | 18,550,046 | 16,311,129 | 1,088,364 | 36,291,451 |
| Write offs - Loan Interest | (9,475) | (1,700,516) | (365,547) | (38,912) | (2,114,450) |
| Provisions for uncollectible loan interest | 347,401 | 3,334,727 | 2,335,222 | 142,494 | 6,159,844 |
| Ending allowance for doubtful accounts | <u>\$ 679,838</u> | <u>20,184,257</u> | <u>18,280,804</u> | <u>1,191,946</u> | <u>40,336,845</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-Hazlewood 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.

HHCSLP administers several state non-guaranteed loan programs: College Access Loans (CAL), Texas B-On-Time Loan Program (BOT), Health Education Loan Program (HELP) and Texas Armed Services Scholarship Program (TASSP). The College Access Loan Program provides alternative education loans

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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. The TASSP provides loans to eligible students who are attending colleges and universities in Texas and entering the armed services after graduation. The TASSP provides loan forgiveness incentive to those qualifying students. These loan programs are reported in the Student Loan Auxiliary Fund and the General Fund. The state non-guaranteed loans represent 97% of student loans receivable at August 31, 2012.

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 FFELP 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 Unsubsidized Stafford Loan 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 3% of student loans receivable at August 31, 2012. Loan origination through HEAL program ceased in FY1993, and loan origination through the FFELP programs ceased in FY2010. The Board continues to service loans that it made through these programs.

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(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, 2012, were as follows:

| Transfers Out: | Transfers In: | | | |
|------------------------------|----------------------|---------------------|------------------|--------------------|
| | General | Debt Service | Non-Major | Total |
| Texas Opportunity Plan | \$ 547,000 | 26,648,778 | - | 27,195,778 |
| Student loan Auxiliary | 8,582,784 | 70,890,697 | - | 79,473,481 |
| Non-Major Governmental Funds | - | 595,790 | - | 595,790 |
| | <u>\$ 9,129,784</u> | <u>98,135,265</u> | <u>-</u> | <u>107,265,049</u> |

(7) Summary of Long-Term Liabilities

During the year ended August 31, 2012, the following changes occurred in liabilities (in thousands):

| Governmental Activities | Balance 9/01/2011 | Additions | Reductions | Balance 8/31/2012 | Amounts Due Within One Year |
|--------------------------------|------------------------------|------------------|-------------------|------------------------------|--|
| General obligation | | | | | |
| bonds payable | \$ 798,915 | 85,615 | (59,430) | 825,100 | 58,525 |
| Deferred credits | 31,053 | 11,005 | | 42,058 | 4,912 |
| Compensable leave | 1,735 | 1,268 | (1,356) | 1,647 | 899 |
| Arbitrage rebate liability | 1,277 | — | (362) | 915 | 713 |
| Total governmental activities | <u>\$ 832,980</u> | <u>97,888</u> | <u>(61,148)</u> | <u>869,720</u> | <u>65,049</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, 2012 bonds payable consisted of 16 (sixteen) general obligation issues for student loans totaling \$825.1 million. Bond issue dates for all College Student Bonds range from 1999 to 2012. 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. As of August 31, 2012, THECB has approximately \$1.3 billion remaining in authorized but unissued debt. Management believes THECB is in compliance with the various bond covenants as of August 31, 2012.

Throughout its history, THECB has issued refunding bonds from time to time when there has been an operational or economic gain for THECB. These refundings 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, 2012, 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.

(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 \$915 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.

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(c) Deferred Issuance Costs

Deferred Issuance Costs as of August 31, 2012, consist of the following:

| | Amount |
|--------------------------------|---------------|
| Deferred issuance costs | \$ 7,274,839 |
| Less: Accumulated amortization | 3,530,944 |
| Deferred issuance costs, net | \$ 3,743,895 |

(d) Changes in Bonded Indebtedness

A summary of changes in bond indebtedness relating to THECB's governmental activities for the year ended August 31, 2012 is as follows (amounts in thousands):

| Description of Issue | Bonds Outstanding 9/1/11 | Bonds Issued & Accretion | Bonds Matured or Retired | Bonds Refunded or Extinguished | Bonds Outstanding 8/31/12 | Amounts Due Within One Year |
|----------------------------------|---|---|---|---|--|--|
| <u>General Obligation Bonds:</u> | | | | | | |
| COL STUD LOAN BDS SER'99 | 18,755 | - | 7,985 | - | 10,770 | 1,225 |
| VAR RT RFD BDS SER'03 | 75,000 | - | - | - | 75,000 | - |
| VAR RT RFD BDS SER'04 | 17,320 | - | 3,110 | - | 14,210 | 3,670 |
| VAR RT RFD BDS SER'06 | 72,005 | - | 18,430 | - | 53,575 | 35,460 |
| COL STUD LOAN BDS SER'07A | 70,790 | - | 2,115 | - | 68,675 | 2,220 |
| COL STUD LOAN BDS SER'07B | 26,165 | - | - | - | 26,165 | - |
| COL STUD LOAN BDS SER'08A | 74,115 | - | 2,030 | - | 72,085 | 2,140 |
| COL STUD LOAN BDS SER'08B | 27,335 | - | - | - | 27,335 | - |
| COL STUD LOAN BDS SER'08C | 32,580 | - | 4,760 | - | 27,820 | 5,010 |
| COL STUD LOAN BDS SER'09 | 71,730 | - | - | - | 71,730 | 2,115 |
| COL STUD LOAN BDS SER'10 | 113,580 | - | - | - | 113,580 | - |
| COL STUD LOAN RFD BDS SER'10 | 47,300 | - | 13,335 | - | 33,965 | - |
| COL STUD LOAN BDS SER'11A | 118,650 | - | - | - | 118,650 | - |
| COL STUD LOAN RFD BDS SER'11B | 27,020 | - | 7,665 | - | 19,355 | 6,685 |
| COL STUD LOAN RFD BDS SER'11C | 6,570 | - | - | - | 6,570 | - |
| COL STUD LOAN BDS SER'12 | - | 85,615 | - | - | 85,615 | - |
| Total General Obligation Bonds | 798,915 | 85,615 | 59,430 | - | 825,100 | 58,525 |
| <u>Deferred Adjustments:</u> | | | | | | |
| Unamortized Premium | \$ 30,876 | | | | 42,259 | 4,897 |
| Unamortized Discount | (2) | | | | (357) | (14) |
| Unamortized Gain from Refunding | 397 | | | | 332 | 65 |
| Unamortized Loss from Refunding | (218) | | | | (176) | (36) |
| Total Bonded Indebtedness | \$ 829,968 | | | | 867,158 | 63,437 |

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(e) Debt Service Requirements

As of August 31, 2012, the debt service requirements of bonded indebtedness to maturity are as follows (amounts in thousands):

| Year ended August 31: | Principal | Interest | Requirements |
|------------------------------|-------------------|-----------------|---------------------|
| 2013 | \$ 58,525 | 34,145 | 92,670 |
| 2014 | 49,385 | 33,058 | 82,443 |
| 2015 | 51,000 | 31,145 | 82,145 |
| 2016 | 50,925 | 28,743 | 79,668 |
| 2017 | 46,590 | 26,844 | 73,434 |
| 2018-2022 | 164,050 | 104,660 | 268,710 |
| 2023-2027 | 123,680 | 69,616 | 193,296 |
| 2028-2032 | 145,330 | 36,974 | 182,304 |
| 2033-2037 | 60,615 | 6,850 | 67,465 |
| 2038-2042 | 75,000 | 74 | 75,074 |
| Total | \$ <u>825,100</u> | <u>372,109</u> | <u>1,197,209</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, 2012 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'07A | 72,805 | 5.00% 5.25% | N/A | 2011 | 2031 | 8/1/17 | (A,B) |
| COLSTUD LOAN RFD BDS 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 BDS SER'08B | 27,335 | 5.00% 5.50% | N/A | 2014 | 2018 | N/A | (A,B) |
| COLSTUD LOAN RFD BDS SER'08C | 45,265 | 5.25% 5.25% | N/A | 2009 | 2017 | N/A | (A,B) |
| COLSTUD LOAN BDS SER'09 | 71,730 | 4.00% 5.00% | N/A | 2013 | 2033 | 8/1/19 | (A,B) |
| COLSTUD LOAN BDS SER'10 | 113,580 | 3.00% 5.00% | N/A | 2014 | 2034 | 8/1/20 | (A,B) |
| COLSTUD LOAN RFD BDS SER'10 | 51,865 | 3.00% 5.00% | N/A | 2011 | 2017 | N/A | |
| COLSTUD LOAN BDS SER'11A | 118,650 | 5.00% 5.00% | N/A | 2015 | 2036 | 8/1/21 | (A,B) |
| COLSTUD LOAN RFD BDS SER'11B | 27,020 | 2.00% 5.00% | N/A | 2012 | 2018 | N/A | |
| COLSTUD LOAN RFD BDS SER'11C | 6,570 | 5.00% 5.00% | N/A | 2019 | 2022 | N/A | |
| COLSTUD LOAN BDS SER'12 | 85,615 | 3.00% 5.50% | N/A | 2016 | 2035 | 8/1/22 | (A,B) |
| 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>\$ 1,098,675</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'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 |
| COLSTUD LOAN BDS SER'11A | 2031 | 2027 |
| COLSTUD LOAN BDS SER'11A | 2036 | 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.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2012

(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 \$1.4 million were expensed during the year ending August 31, 2012 in the General Fund.

The terms of the facility lease contract allow for the total monthly rent to be annually adjusted for changes in the Consumer Price Index (CPI). 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 |
|--|----------------------|
| 2013 | \$ 1,446,966 |
| 2014 | 1,446,966 |
| 2015 | 1,446,966 |
| 2016 | 1,446,966 |
| 2017 | 1,446,966 |
| 2018-2020 | 4,340,897 |
| Total minimum future lease rental payments | <u>\$ 11,575,727</u> |

(10) Employee Health and Retirement Benefits

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 6.0% of THECB's covered payroll. The ORP plan members contribute 6.65% of their salary to ORP, and THECB contributes 6.0% 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, 2012 was \$854,588 and THECB's matching contribution was \$794,966. The total employee ORP contribution for year ending August 31, 2012 was \$94,910 and THECB's matching contribution was \$99,745.

Employees of THECB are offered health insurance paid primarily by the State, with a portion paid by the agency. 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, 2012 was \$1.5 million as determined by the State, and is primarily included in general administration expense. Beginning in fiscal year 2012, state agencies were required by the legislature to contribute an amount equal to 1.0 percent of total base wages and salaries for each benefits-eligible employee as an agency-paid health insurance benefit. The portion of benefits paid by THECB for the year-ending August 31, 2012 was \$142,807, and is included in general administration expense.

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to Financial Statements

Year Ended August 31, 2012

(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

Texas Education Code, Sec. 61.0211. SUNSET PROVISION. The Texas Higher Education Coordinating Board is subject to Chapter 325, Government Code (Texas Sunset Act). Unless continued in existence as provided by that chapter, the board is abolished and this chapter expires September 1, 2025.

(e) Significant Encumbrances

As of August 31st, 2012, THECB had significant encumbered expenditures in governmental funds for signed contracts and purchase orders as presented in the table below*:

| | General Revenue Fund | Student Loan Auxiliary Fund | Nonmajor Governmental Funds |
|--------------|----------------------|-----------------------------|-----------------------------|
| Encumbrances | \$34,650,073 | \$1,126,836 | \$537,674 |

*Significant encumbrances are individual contracts greater than \$100K.

TEXAS HIGHER EDUCATION COORDINATING BOARD

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Notes to Financial Statements

Year Ended August 31, 2012

(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 2012 was \$22,636. 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 2012 were \$62,543.

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

- (a) After fiscal year end 2012, the unappropriated cash balance increased from \$82M to \$164M as of May, 2013. It is not known at this time as to the timing of a decision nor the future disposition of these funds.
- (b) On June 5th, 2013, THECB sold general obligation refunding bonds totaling \$98.6 million. The funds were used to refund all of the remaining 1999, 2003, 2004 and 2006 series bonds.

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, 2012
(Unaudited)

| | <u>Budgetary Amounts</u> | | <u>Actual Amount</u> | <u>Final to Actual Variance Positive (Negative)</u> |
|--|--------------------------|----------------------|--------------------------|---|
| | <u>Original</u> | <u>Final</u> | | |
| Revenues | | | | |
| Legislative appropriations | \$ 1,435,313,949 | 1,437,096,041 | 1,434,100,797 | (2,995,244) |
| Tax revenues | 5,600,000 | 5,600,000 | — | (5,600,000) |
| Federal revenues | 24,690,297 | 24,690,297 | 15,358,630 | (9,331,667) |
| Federal pass-through revenues | 37,120,366 | 37,120,366 | 31,591,883 | (5,528,483) |
| State pass-through revenues | 95,000 | 95,000 | 19,924,202 | 19,829,202 |
| Intergovernmental revenues | 41,018,859 | 41,018,859 | 31,377,569 | (9,641,290) |
| Licenses, fees and permits | 274,000 | 274,000 | 2,498,923 | 2,224,923 |
| Interest and investment income | — | — | 898,454 | 898,454 |
| Other revenues | 2,000 | 2,000 | 14,979,399 | 14,977,399 |
| Unappropriated revenues | — | — | 57,515,964 | 57,515,964 |
| Total revenues | <u>1,544,114,471</u> | <u>1,545,896,563</u> | <u>1,608,245,821</u> | <u>62,349,258</u> |
| Expenditures | | | | |
| General administration | 28,798,604 | 28,726,537 | 30,430,879 | (1,704,342) |
| Financial assistance - loans | — | — | 12,125,551 | (12,125,551) |
| Financial assistance - institutions | 1,433,668,183 | 1,433,668,183 | 1,455,439,160 | (21,770,977) |
| Financial assistance - students | 90,570,185 | 90,570,185 | 28,478,699 | 62,091,486 |
| Total expenditures | <u>1,553,036,973</u> | <u>1,552,964,906</u> | <u>1,526,474,289</u> | <u>26,490,617</u> |
| Excess (deficit) of revenues over Expenditures | <u>(8,922,502)</u> | <u>(7,068,343)</u> | <u>81,771,532</u> | <u>88,839,875</u> |
| Other financing sources (uses) | | | | |
| Transfer in | 8,922,502 | 8,922,502 | 9,129,784 | 207,282 |
| Total other financing sources (uses) | <u>8,922,502</u> | <u>8,922,502</u> | <u>9,129,784</u> | <u>207,282</u> |
| Net change in fund balance | <u>—</u> | <u>1,854,159</u> | <u>90,901,316</u> | <u>89,047,157</u> |
| Fund balance at the beginning of the year | <u>189,202,235</u> | <u>189,202,235</u> | <u>189,202,235</u> | <u>—</u> |
| Fund balance at the end of the year | <u>\$ 189,202,235</u> | <u>191,056,394</u> | <u>280,103,551</u> | <u>89,047,157</u> |

Note - collections (disbursements) of student loans receivable, net, is not included above

since it is not a budgetary item.

(44,291,189)

Fund Balance for General Fund (Governmental Funds):

\$ 235,812,362

See accompanying independent auditor's report

TEXAS HIGHER EDUCATION COORDINATING BOARD

(An Agency for the State of Texas)

Notes to the Schedule of Budgeted and Actual Revenues and Expenditures

Year Ended August 31, 2012

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 or designee.

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 and final budget is presented in the accompanying financial statements. The original budget for the General Fund was amended during Fiscal Year 2012 for required changes that were received for the appropriation year 2012.

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.



KPMG LLP
Suite 1900
111 Congress Avenue
Austin, TX 78701-4091

**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, 2012, which collectively comprise THECB's basic financial statements and have issued our report thereon dated July 8, 2013. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of THECB is responsible for establishing and maintaining effective 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 deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

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



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

July 8, 2013