

RHODE ISLAND HIGHER EDUCATION SAVINGS TRUST

**(A COMPONENT UNIT OF THE STATE OF
RHODE ISLAND AND PROVIDENCE PLANTATIONS)**

FOR THE YEAR ENDED JUNE 30, 2016

**RHODE ISLAND HIGHER EDUCATION SAVINGS TRUST
(A COMPONENT UNIT OF THE STATE OF RHODE ISLAND AND
PROVIDENCE PLANTATIONS)**

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INDEPENDENT AUDITORS' REPORT

Joint Committee on Legislative Services, General Assembly,
**State of Rhode Island and Providence Plantations and
Rhode Island Office of the Auditor General**

We have audited the accompanying financial statements of the Rhode Island Higher Education Savings Trust (RIHEST), a component unit of the State of Rhode Island and Providence Plantations, as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise RIHEST's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditors' Responsibility

Our responsibility is to express an opinion 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluation of the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of RIHEST as of June 30, 2016, and the changes in its fiduciary net position for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 1, the financial statements presented are only those of RIHEST and are not intended to present the financial position of the State of Rhode Island, and the results of its operations and where applicable, cash flows thereof, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on Pages 4-8 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.

Other Information

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise RIHEST's basic financial statements. The Schedule 1 – Schedule of Costs of Outside Consultants and Independent Contractors is presented for purposes of additional analysis as required by the State of Rhode Island and is not a required part of the basic financial statements.

The Schedule 1 – Schedule of Costs of Outside Consultants and Independent Contractors presented on Page 25 is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the Schedule 1 – Schedule of Costs of Outside Consultants and Independent Contractors is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required By *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 1, 2016 on our consideration of RIHEST's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering RIHEST's internal control over financial reporting and compliance.

Marcum LLP

Providence, RI
December 1, 2016

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL HIGHLIGHTS AND COMPARATIVE ANALYSIS

TUITION SAVINGS PROGRAM FUND (CONTINUED)

The Rhode Island Higher Education Savings Trust's (RIHEST) Management's Discussion and Analysis (MD&A) of RIHEST's operations and financial results is intended to provide readers with information which will assist them in understanding and evaluating the financial statements for the fiscal year which ended on June 30, 2016. The MD&A consists of an introduction, financial highlights with a comparative analysis and discussion of the transition of the trust from Alliance Bernstein to Ascensus College Savings. The introduction section outlines RIHEST's programs and operations. The financial highlights and comparative analysis section focuses on significant items disclosed within RIHEST's financial statements or affecting its financial condition. The transition discussion will include an overview of the RFP process, selection and transition activities accomplished before June 30, 2016. The MD&A should be read in conjunction with the financial statements, notes to financial statements and other information included in the audit document.

Introduction

RIHEST is a legal entity created in 1997 by the Rhode Island Higher Education Assistance Authority (RIHEAA or the "Authority") pursuant to RI GL §16-57-6.1 an act of the Rhode Island General Assembly. As of July 1, 2015, the general assembly transferred the functions and programs handled by the RIHEAA, other than the Tuition Savings Program, to the Rhode Island Division of Higher Education Assistance within the Office of the Postsecondary Commissioner. As of July 1, 2015, the assets, rights, duties, liabilities and obligations related to the Tuition Savings Program (*CollegeBoundfund*) and the *CollegeBoundbaby* Program were transferred to the Office of the General Treasurer (Article 7 of the 2015 Appropriation Act).

RIHEST has a separate and distinct existence from the State of Rhode Island and exists as the Tuition Savings Program Fund, Rhode Island's IRS Section 529 qualified state tuition savings program, which does business under the name *CollegeBoundfund*® (CBf) and holds participant assets as a private purpose trust fund (the Tuition Savings Program).

The Program Fund was managed and promoted by AllianceBernstein L.P. ("AllianceBernstein") under a program management agreement. Effective July 1, 2010, RIHEAA, the Rhode Island State Investment Commission (SIC) and AllianceBernstein entered into a new contract for the management and promotion of *CollegeBoundfund*® (in total, AllianceBernstein served as program manager from 2001-2016). The original term of the contract was five years (July 1, 2010 to June 30, 2015) with one five-year renewal option. In June of 2014, the contract was amended to extend the initial term to June 30, 2016.

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL HIGHLIGHTS AND COMPARATIVE ANALYSIS

TUITION SAVINGS PROGRAM FUND (CONTINUED)

Under the terms of the contract AllianceBernstein paid fees including: \$275,000 annually; a fee equal to 9.5 basis points (0.095%) per annum of the average net asset value of non-Rhode Island resident accounts; 2.0 basis points (0.02%) per annum with respect to non-Rhode Island resident accounts invested in the Age-based Cbf Morningstar Index Portfolio, and revenue from non-Rhode Island participants who make direct investments in CollegeBound*fund*®. Originally, these fees were paid to RIHEAA; for FY 2016 they were paid to Office of the General Treasurer, which subsequently transferred most of them to RIDHEA for a scholarship and grant program.

In addition, AllianceBernstein committed to spending \$750,000 annually for the marketing and promotion of CollegeBound*fund*® in Rhode Island, and established the "CollegeBound*baby*" program. In the event that less than \$750,000 is spent in any given year, the remainder would be carried forward for use in the following year. Under the CollegeBound*baby* program, AllianceBernstein deposited \$100 into the account of every child born to or adopted by a Rhode Island resident whose parent(s) agreed to have the \$100 deposited into a master account held in the RIHEST trust as a separate omnibus account for births during an individual calendar year. The family must permit the release of certain information so that Treasury can document the grant and communicate with the child/family.

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL HIGHLIGHTS AND COMPARATIVE ANALYSIS

TUITION SAVINGS PROGRAM FUND (CONTINUED)

The Transition

The SIC approved the one year extension of the AllianceBernstein contract to conduct a request for proposal (RFP) to insure that our vendor was providing the best possible program. During fiscal year 2016 (FY16) Treasury developed, published and evaluated a comprehensive RFP for a program manager to provide both investment options and full account servicing for Rhode Island's 529 plan. The SIC hired Capital Cities, LLC to review quarterly investment performance for the SIC and to provide analysis of different vendors investment options.

An RFP was issued in July, 2015 with proposals due in August. The evaluation of vendors included site visits, presentations, conference calls and Best and Final Offer. In November 2015, the SIC voted to use Ascensus College Savings to manage the program.

In January, Treasury hired both a Director and Associate Director of College and Retirement Savings. Their responsibilities include oversight of the Defined Contribution Plan (401a) and Deferred Compensation Programs (457s) as well as the CollegeBound funds (529) program. Financing for investment consultants, legal advice and counsel, IT system support and office space, furnishing and equipment was also provided by Treasury.

The conversion included business as usual in the administration of the Cbf, as well as many conversion activities which began in January 2016. Those activities included negotiating a Program Management Agreement with Ascensus, a data transfer agreement with AllianceBernstein and two direction letters from the state.

The actual conversion of assets took place outside of FY2016, occurring from July 8th- July 12th. A separate audit of agreed upon procedures (AUP) is being conducted for the transition period between July 1st and July 12th 2016.

MANAGEMENT'S DISCUSSION AND ANALYSIS
FINANCIAL HIGHLIGHTS AND COMPARATIVE ANALYSIS
TUITION SAVINGS PROGRAM FUND (CONTINUED)

	(in 000's)	
	June 30,	
	2016	2015
Assets		
Cash and investments	\$ 6,693,485	\$ 7,422,817
Receivables	<u>11,439</u>	<u>4,566</u>
Total Assets	<u>6,704,924</u>	<u>7,427,383</u>
Liabilities		
Payables	<u>17,397</u>	<u>10,068</u>
Net Position, Held in Trust for Participants	<u>\$ 6,687,527</u>	<u>\$ 7,437,451</u>
	Year Ended June 30,	
Changes in Net Position		
Investment income	\$ 214,328	\$ 300,681
Net change in fair value of investments	(294,929)	(201,364)
Net expenses (including asset based charges)	<u>(63,857)</u>	<u>(70,363)</u>
	(144,458)	28,954
Net change from unitholder transactions	<u>(585,330)</u>	<u>(474,469)</u>
Change in net position	(729,788)	(445,515)
Net position held in Trust for participants, beginning of year	<u>7,417,315</u>	<u>7,862,830</u>
Net Position Held in Trust for Participants, End of Year	<u>\$ 6,687,527</u>	<u>\$ 7,417,315</u>

The net position of the Tuition Savings Program Fund totaled approximately \$6.7 billion at June 30, 2016, compared with approximately \$7.4 billion at the end of FY 2015, a decrease of approximately \$730 million. The two contributors to the reduction in net position were market performance and withdrawals from the Trust.

Dividend income of \$214 million less expenses of just under \$64 million, resulted in a positive contribution of \$150 million. Offsetting the gain was a net decline of \$295 million in the fair value of investments. The net result from investments was a loss of \$144 million.

MANAGEMENT'S DISCUSSION AND ANALYSIS

FINANCIAL HIGHLIGHTS AND COMPARATIVE ANALYSIS

TUITION SAVINGS PROGRAM FUND (CONTINUED)

The driving factor in the change in net position was significantly greater withdrawals than sales. Participants invested nearly \$766 million and redeemed close to \$1.4 billion, for a net withdrawal of \$585 million. The number of accounts decreased from approximately 399,500 at June 30, 2015 to 364,500 at June 30, 2016.

The losses from investments (\$144 million) and the net withdrawals (\$585 million), explain the difference in value in the Trust at fiscal year-end.

Requests for Information

This financial report is designed to provide a general overview of RIHEST's finances for any interested parties. Questions concerning any of the information provided in this report or requests for additional information should be addressed to the Chief Operations Officer, Office of the General Treasurer at 50 Service Avenue, Warwick, RI, 02886.

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**PRIVATE PURPOSE TRUST FUND – TUITION SAVINGS PROGRAM FUND
STATEMENT OF FIDUCIARY NET POSITION**

FOR THE YEAR ENDED JUNE 30, 2016

Assets

Investments	\$ 6,693,485,417
Accounts receivable:	
Units sold	9,124,918
Investments sold	1,986,066
Dividends	315,354
Other	<u>12,917</u>

Total Assets

6,704,924,672

Liabilities

Accounts payable:	
Payable for units redeemed	422,355
Advisory fee payable	11,088,713
Accrued asset-based charges	3,724,259
Payable for investments purchased	<u>2,161,770</u>

Total Liabilities

17,397,097

Net Position

Held in Trust for Participants	<u><u>\$ 6,687,527,575</u></u>
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The accompanying notes are an integral part of these financial statements.

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**PRIVATE PURPOSE TRUST FUND – TUITION SAVINGS PROGRAM FUND
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION**

FOR THE YEAR ENDED JUNE 30, 2016

Revenue From Operations	
Dividend and interest income	<u>\$ 214,327,894</u>
Net realized gain on investments	(81,126,171)
Net change in unrealized depreciation on investments	<u>(213,802,837)</u>
Net change in fair value of investments	<u>(294,929,008)</u>
Asset based charges	<u>(63,856,439)</u>
Decrease from operations	<u>(144,457,553)</u>
From Unitholder Transactions	
Subscriptions	765,916,429
Redemptions	<u>(1,351,246,480)</u>
Decrease from Unitholder Transactions	<u>(585,330,051)</u>
Decrease in Net Position	(729,787,604)
Net Position Held in Trust for Participants - Beginning of Year	<u>7,417,315,179</u>
Net Position Held in Trust for Participants - End of Year	<u><u>\$ 6,687,527,575</u></u>

The accompanying notes are an integral part of these financial statements.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 1 – ORGANIZATION AND NATURE OF OPERATIONS

The Rhode Island Higher Education Savings Trust (“RIHEST” or “the Trust”) is a separate legal entity pursuant to Section 16-57-6.1 of the General Laws of Rhode Island. RIHEST is considered a component unit of the State of Rhode Island for financial reporting purposes and the financial statements of the Trust will be included in the State’s Comprehensive Annual Financial Report. The accompanying financial statements present only the activity of RIHEST and are not intended to present the financial position of the State of Rhode Island and the results of its operations in conformity with accounting principles generally accepted in the United States of America.

The CollegeBoundfund® (the “Program Fund”) has been established as part of the Rhode Island Tuition Savings Program (the “Program”) to enable residents of any state (“Participants”) to save money on a tax-advantaged basis to pay qualified higher education expenses of their designated beneficiaries (“Beneficiaries”). As part of the Program, the General Treasurer of Rhode Island serves as trustee, to hold all assets of the Program. Program assets are not the property of the general treasurer of Rhode Island or of the State of Rhode Island (“Rhode Island”). These financial statements reflect the financial position and results of operations of the Program.

RIHEST is comprised of the Program Fund, which holds participant assets as a private purpose trust fund.

When restricted and unrestricted resources are available for use, it is the RIHEST’s practice to use restricted resources first.

The Program Fund is administered as a qualified tuition savings program under Section 529 of the Internal Revenue Code (IRC) to enable residents of any state to save and invest on a tax advantaged basis for qualified higher education expenses of their designated beneficiaries. The Program Fund is managed by an independent contractor under the supervision of the Rhode Island State Investment Commission (SIC) and the general treasurer of Rhode Island. As a private purpose trust, the Program Fund is presented as a fiduciary fund in the accompanying financial statements.

The Program Fund has been designed to permit the Participant and Beneficiary to qualify for federal tax benefits applicable under a program so qualifying. Individuals may participate in the tuition savings program regardless of their income level or age. Accounts may be established by individuals and by most types of legal entities, including trusts, whose purposes and powers so permit. Participants establish accounts representing interests in the Trust and make cash contributions to those accounts, as may other contributors. Each account has a single beneficiary selected by the Participant.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 1 – ORGANIZATION AND NATURE OF OPERATIONS (CONTINUED)

RIHEST is exempt from federal and state income taxes.

The Trust is proprietary in nature. The Trust is not subject to regulatory oversight and is not registered with the Securities and Exchange Commission as an investment company. The Trust is available for families to save and invest for higher education expenses. An account can be opened for any Rhode Island resident or non-Rhode Island resident meeting specific requirements for the purpose of investing for higher education expenses. A safe harbor in current Internal Revenue Service regulations is satisfied if total contributions do not exceed the amount determined by actuarial estimates that is necessary to pay tuition, required fees, and room and board expenses of the designated beneficiary for five years of undergraduate enrollment at the highest cost institution allowed by the Program. While money is invested in the Trust, there are no taxes (either federal or state) on earnings. Amounts can be withdrawn to pay for tuition, room and board fees, books, supplies, and equipment required by the Beneficiary for enrollment or attendance at any eligible public or private educational institution (“Qualified Higher Education Expenses”). When an amount withdrawn from an account is used to pay Qualified Higher Education Expenses of the Beneficiary (“Qualified Withdrawal”), the earnings portion of the withdrawal is not includable in computing the federal taxable income of the Participant or the Beneficiary.

To satisfy the requirements of Section 529 of the Internal Revenue Code, the earnings portion of a withdrawal that is not a Qualified Withdrawal is subject to a penalty of 10%. For taxable years commencing after 2001, the penalty is in the form of a 10% additional federal tax. For prior taxable years, the penalty was an administrative charge withdrawn from the relevant accounts and retained by the Program.

The Trust is administered under the joint supervision of the SIC and the general treasurer of Rhode Island. RIHEAA, acting with the SIC, entered into an agreement effective August 1, 2000 with AllianceBernstein L.P. (“AllianceBernstein”) for management and promotion of the Trust. That agreement expired as of June 30, 2010, but the parties entered into a new agreement effective July 1, 2010 which is in effect until June 30, 2016. The Program Fund currently includes seven Education Strategies Portfolios, four of which are Age-Based, and twelve Individual Fund Portfolios (collectively, the “Underlying Portfolios”). The Education Strategies Portfolios consist of investments in various mutual funds or other pooled investment vehicles that are managed by AllianceBernstein. The applicable allocation portfolio depends on either (i) the age of the beneficiary, or (ii) owners, at their option, allocating their investments to a Conservative, Appreciation, or Balanced Portfolios, the Principal Protection Income Portfolio, or individual investments available through the Individual Fund Portfolios. The Individual Fund

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 1 – ORGANIZATION AND NATURE OF OPERATIONS (CONTINUED)

Portfolios consist of investments in individual mutual funds or, in the case of the AllianceBernstein International Value Index Portfolio, a separately managed Portfolio held by the Trust, that are managed by AllianceBernstein, except for the Vanguard Total Stock Market Index Portfolio, Vanguard Total Bond Market Index Portfolio and Vanguard Total International Stock Index Portfolio (collectively, the "Vanguard Portfolios") which are managed by the Vanguard Group and are only available to certain participants in Rhode Island accounts.

The Program Fund offers several different structures ("Classes"), including Class A, AX, B, BX, C, CX, R, RA, RI and RZ units. Effective February 8, 2002, the existing Class A, B and C units were renamed Class AX, BX and CX, respectively, and closed to new investors. Class A units are sold with a maximum front-end sales charge of 4.25% and are subject to an asset-based charge at the annual rate of .25 of 1% of the aggregate average daily balance in an account attributable to Class A units. Class AX units are sold with a front-end sales charge of 3.25% and are subject to an asset-based charge at the annual rate of .25 of 1% of the aggregate average daily balance in an account attributable to Class AX units. Class B and BX units are sold at net asset value and are subject to a contingent redemption charge on redemptions made within four years of purchase in the case of Class B and five years of purchase in the case of Class BX. Class B units are subject to an asset-based charge at the annual rate of 1% of the aggregate average daily balance in an account attributable to Class B units. Class BX units are subject to an asset-based charge at the annual rate of .60 of 1% of the aggregate average daily balance in an account attributable to Class BX units. Class B and BX units will automatically convert to Class A and AX units, respectively, eight years after the end of the calendar month of purchase. Class C and CX units are sold at net asset value and are subject to an asset-based charge at the annual rate of 1% of net position attributable to Class C units and .50 of 1% of the aggregate average daily balance in an account attributable to Class CX units. Classes RA, RZ and RI are available to Rhode Island residents, employees of Rhode Island employers, persons whose principal place of business is in Rhode Island, and to accounts whose beneficiary is a Rhode Island resident. Class R units are available to certain clients and employees of selected financial intermediaries. Class RI and R units are sold at net asset value and are not subject to an asset-based charge. Class RA units are sold at net asset value and are subject to an asset-based charge at the annual rate of .25 of 1% of the aggregate average daily balance in an account attributable to Class RA units. Class RZ units are sold with a maximum front-end sales charge of 4.00% and are not subject to an asset-based charge.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

MEASUREMENT FOCUS AND BASIS OF ACCOUNTING

RIHEST uses the economic resources measurement focus and accrual basis of accounting. Under the accrual basis revenues are recorded when earned and expenses recorded at the time liabilities are incurred, regardless of the timing of the related cash flows.

RIHEST distinguishes between operating and non-operating revenues and expenses. Operating revenues and expenses generally result from investment transactions in connection with RIHEST's principal ongoing operations. The operating revenues of RIHEST consist of investment income, realized / unrealized gains (losses) and expenses include asset based charges and redemptions of plan assets. The non-operating revenues and expenses would include all other transactions within the fiduciary fund not described in the operating revenue and expense area.

USE OF ESTIMATES

The preparation of financial statements may require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, income, expenses and related disclosures. Actual results may differ from those estimates.

INVESTMENT VALUATION

Governmental Accounting Standards Board (“GASB”) issued Statement No. 72 - *Fair Value Measurement and Application*, effective for the RIHEST’s fiscal year ending June 30, 2016. This Statement addresses accounting and financial reporting issues related to fair value measurements. The definition of fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. This Statement provides guidance for determining a fair value measurement for financial reporting purposes. This Statement also provides guidance for applying fair value to certain investments and disclosures related to all fair value measurements. The adoption of this standard no effect on the Net Position as of June 30, 2016 but required additional disclosures in the financial statements of the RIHEST.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

FAIR VALUE OF FINANCIAL INSTRUMENTS

GASB 72 establishes a fair value hierarchy for inputs used in measuring fair value that maximizes the use of observable inputs and minimizes the use of unobservable inputs by requiring that the most observable inputs be used when available, of how the market would price the asset or liability. The fair value hierarchy is categorized into three levels based on the inputs as follows:

Level 1 – Unadjusted quoted priced in active markets that are accessible at the measurement date for identical assets or liabilities.

Level 2 – Inputs other than quoted prices in active markets for identical assets and liabilities that are observable either directly or indirectly for substantially the full term of the asset or liability.

Level 3 – Unobservable inputs for the asset or liability (supported by little or no market activity). Level 3 inputs include management's own assumption about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk).

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques maximize the use of relevant observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There has been no change in valuation methodology used at 2016.

Investment Companies And Other Investment Vehicles: Valued at the fair value based on the net asset value of the mutual funds or other pooled investment vehicles as of the close of business on each valuation date which are traded on an active market.

There were no transfers between any levels during the year ended June 30, 2016.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

INVESTMENT TRANSACTIONS AND RELATED INCOME

Purchases and sales of securities are recorded for on a trade-date basis. Dividend income is recognized as earned on the ex-dividend date.

The calculation of realized gains and losses on investments is independent of the calculation of unrealized appreciation and depreciation on investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year were included in the unrealized appreciation or depreciation of investments reported in prior years and the current year.

UNIT TRANSACTIONS AND PRICING

All unit prices are determined daily based on the net asset value of each class of units divided by the number of units outstanding. Purchases and redemptions of units are based on the net asset value of each class of units on the day an order to purchase and/or redeem is received.

DISTRIBUTIONS

There are no distributions of net investment income or realized gains on investments to unitholders.

FEDERAL INCOME TAXES

The Trust, a Qualified Tuition Program under Section 529 of the Internal Revenue Code, is fully exempt from federal taxation on all income earned on Trust assets.

NET POSITION

RIHEST's net position is restricted due to external restrictions imposed by the contractual agreements of the investors that hold accounts within the trust fund.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 2 – SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

CHANGES IN PRESENTATION

As of July 1, 2015, the assets, rights and obligations related to the Tuition Savings Program (*CollegeBoundfund*) and the *CollegeBoundbaby* Program were transferred to the Office of the General Treasurer – State of Rhode Island. Accordingly, certain activities (e.g. receipt and disbursement of the asset based fees) previously accounted for in the Program’s “Administrative Fund” are now included in the State’s General Fund. For fiscal 2016, this activity is not included within the RIHEST financial statements.

The reorganization and transfer of oversight of the RIHEST also resulted in RIHEST being considered a component unit of the State of Rhode Island for financial reporting purposes. Accordingly the financial statements of the RIHEST will be included within the fiduciary activities of the State within its Comprehensive Annual Financial Report.

NOTE 3 – CASH DEPOSITS AND INVESTMENTS

CASH DEPOSITS

Custodial credit risk is the risk where, in the event of a bank failure, RIHEST will not be able to recover its deposits or will not be able to recover collateral securities that are in the possession of an outside party. RIHEST does not have a policy for custodial credit risk except for that which is provided by Rhode Island General Laws, Chapter 35-10-1 as described below.

RIHEST is permitted to invest funds in certificates of deposit, savings accounts, money market accounts, and obligations of the United States Government or certain agencies thereof. RIHEST may also enter into repurchase agreements with any eligible depository for a period not exceeding 30 days.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 3 – CASH DEPOSITS AND INVESTMENTS (CONTINUED)

CASH DEPOSITS (CONTINUED)

In accordance with Rhode Island General Laws, Chapter 35-10-1, depository institutions holding deposits of the State, its agencies or governmental subdivisions of the State shall, at a minimum, insure or pledge eligible collateral equal to 100 percent of time deposits with maturities greater than 60 days. Any of these institutions which do not meet minimum capital standards prescribed by federal regulators shall insure or pledge eligible collateral equal to 100 percent of deposits, regardless of maturity. Eligible collateral per the agreement and Rhode Island General Laws, Chapter 35-10-1 includes the following: obligations of the United States; obligations of the State of Rhode Island; obligations of any other State with a rating not less than "A" by Standard and Poor's Corporation or Moody's Investor Services, Inc.; certain one to four-family residential mortgage loans providing they meet certain provisions; and other marketable securities and debt instruments determined to be satisfactory for purposes of providing liquid assets in the event of default or insolvency of a qualified depository institution providing that this type of collateral does not exceed 10% of the total collateral pledged by the financial institution.

**RHODE ISLAND HIGHER EDUCATION SAVINGS TRUST
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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 3 – CASH DEPOSITS AND INVESTMENTS (CONTINUED)

INVESTMENTS

As of June 30, 2016, RIHEST's investments, at fair value, consists of the following:

	Private Purpose Trust Fund
AB CBF Transition Accounts:	
AB CBF Small-Mid Cap Growth Transition Account (a)	\$ 129,425,177
AB CBF Global Core Bond Transition Account (c)	536,546,141
AB CBF Small-Mid Cap Value Transition Account (a)	128,938,984
AB CBF Bond Inflation Protection Transition Account (c)	535,741,369
AB CBF Growth & Income Transition Account (a)	1,087,853,866
AB CBF Short Duration Bond Transition Account (c)	761,892,836
AB CBF High Yield Transition Account (b)	184,573,548
AB Pooling Portfolios:	
AB Multi-Asset Real Return Portfolio	188,701,707
AB Volatility Management Portfolio	589,744,507
AB Trust:	
AB Discovery Value Fund - Class Z	46,929,355
AB Bond Inflation Strategy Portfolio - Class Z	1,808,258
AB Cap Fund:	
AB Discovery Growth Fund - Class Z	70,167,032
AllianceBernstein Principal-Protection Income Fund	619,017,969
AB Large Cap Growth Fund-Class I	102,623,183
AB Government Exchange Reserves-Class I	768,188,942
AllianceBernstein Index Series Trust :	
AllianceBernstein US Equity Index Portfolio	9,794,701
AllianceBernstein International Equity Index Portfolio	2,887,152
AllianceBernstein REIT Index Portfolio	1,259,752
AllianceBernstein US Treasury Inflation Protected Securities Index Portfolio	4,565,792
AllianceBernstein US Bond Index Portfolio	11,009,992
AllianceBernstein International Government Bond Index Portfolio	1,521,997
AB International Value Index Portfolio	30,300,155
AB International Factor Portfolio	802,125,168
AB Global Bond Portfolio - Class Z	48,180,177
Vanguard Total Stock Market Index Fund - Institutional Class	25,168,234
Vanguard Total Bond Market Index Fund - Admiral Class	1,253,956
Vanguard Total International Stock Index Fund - Admiral Class	3,265,467
Total Investments (Cost of \$6,573,444,397)	\$ 6,693,485,417

(a) Assets transition occurred at the close of business day on May 6, 2016.

(b) Assets transition occurred at the close of business day on May 13, 2016.

(c) Assets transition occurred at the close of business day on May 25, 2016.

Transition accounts were established in anticipation of the liquidation of assets.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 3 – CASH DEPOSITS AND INVESTMENTS (CONTINUED)

INVESTMENTS (CONTINUED)

Description	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Investment Companies and Other Investment Vehicles	\$ 6,693,485,417	\$ --	\$ --
Total	<u>\$ 6,693,485,417</u>	<u>\$ --</u>	<u>\$ --</u>

INTEREST RATE RISK

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment in a debt instrument. AllianceBernstein manages the Underlying Portfolios which are valued daily and have no definitive maturity dates.

CREDIT RISK

Under the agreements governing the Program Fund, all of the trust's investments are in the Underlying Portfolios, substantially all of which are managed by AllianceBernstein and are not rated.

CUSTODIAL CREDIT RISK

For an investment, custodial credit risk is the risk that in the event of the failure of a counterparty, RIHEST will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. RIHEST's investments in mutual funds are not exposed to custodial credit risk because they are not evidenced by securities that exist in physical or book entry form.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 3 – CASH DEPOSITS AND INVESTMENTS (CONTINUED)

DERIVATIVES

Derivatives are generally defined as a contract whose value depends on or derives from the value of an underlying asset, reference rate, or index. RIHEST reports derivative instruments at fair value.

NOTE 4 – PRINCIPAL PROTECTION INCOME PORTFOLIO

The AllianceBernstein Principal Protection Income Portfolio, the Age-Based CBf Morningstar Index Pre-1999, and Age-Based CBf Morningstar Index 1999-2001 Portfolios invest in the AllianceBernstein Principal Protection Income Fund (“APPIF”), a separately managed portfolio of assets held directly by the Trust. The net assets and results of operations of APPIF are not consolidated into the Trust financial statements but are reflected in the financial information for the AllianceBernstein Principal Protection Income Portfolio, the Age-Based CBf Morningstar Index Pre-1999 and Age-Based CBf Morningstar Index 1999-2001 Portfolios.

APPIF combines a diversified fixed-income portfolio with Wrapper Agreements, each with a financial institution (the “Wrapper Provider”). The Wrapper Agreements are designed to eliminate the daily fluctuation in value of the assets covered by the Wrapper Agreement (“Covered Assets”). The Wrapper Agreements permit the APPIF to effect participant subscriptions and redemption of units supported by the Covered Assets at their book value. Book value essentially means all contributions allocated to APPIF to the extent invested in Covered Assets, plus all income accrued at the crediting rate as in effect from time to time, less the sum of withdrawals from the Covered Assets.

At June 30, 2016, the net position of APPIF amounted to approximately \$618,021,568 consisting of Covered Assets (measured at book value) of \$593,080,281, short-term investments of \$24,782,145 and other assets of \$159,142.

The Trust is a governmental entity and thus subject to the financial reporting requirements of the Governmental Accounting Standards Board (“GASB”). The Wrapper Agreements are structured to be considered fully-benefit responsive Synthetic Guaranteed Investment Contracts (SGICs) as defined by GASB Statement No. 53, *Accounting for Financial Reporting for Derivative Instruments* (“GASB 53”). Pursuant to the requirements of GASB 53, the fair market value of the Covered Assets amounted to \$622,374,527 on June 30, 2016, and since the fair market value of the Covered Assets was substantially greater than the book value, the fair market value of the Wrapper Agreements was estimated to be \$0. At June 30, 2016, the Covered Assets were comprised primarily of United States government and agency bonds, foreign government bonds, corporate bonds, asset-backed securities, mortgage related securities, cash and cash related items.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 4 – PRINCIPAL PROTECTION INCOME PORTFOLIO (CONTINUED)

As a result of the Wrapper Agreements, an APPIF shareholder may realize more or less than the actual investment return on the Covered Assets depending upon the timing of the shareholder's purchases and redemption of shares, as well as those of other shareholders. A default by a Wrapper Provider on its obligation may result in a decrease in value of the APPIF assets. Also, the Wrapper Agreements do not protect the APPIF from loss if an issuer of the portfolio securities defaults on payments of interest or principal. Generally, such losses will reduce the future crediting rates. Under certain circumstances, such an asset would no longer benefit from the book value protection under the Wrapper Agreements.

NOTE 5 – MANAGEMENT AGREEMENTS

The Authority and the SIC have selected AllianceBernstein (referred to herein as “Program Manager”) to serve as manager of the CollegeBoundfund® program and initially entered into a Management Agreement dated as of August 1, 2000 which provided for AllianceBernstein's services and related matters. As Program Manager, AllianceBernstein provides comprehensive investment, operational, and other services for the Program Fund. The Management Agreement had an initial term that expired on June 30, 2005 and was automatically renewed for an additional five-year term through June 30, 2010. The parties entered into a new Management Agreement effective July 1, 2010 which was amended as of June 5, 2014 to provide that the initial term will end on June 30, 2016, with a provision for automatic renewal for an additional five year term provided certain conditions are satisfied. On June 26, 2015, RIHEAA and the SIC notified AllianceBernstein of their desire not to have the Management Agreement automatically renew. On March 28, 2016, the State of Rhode Island and AllianceBernstein agreed to extend the term through July 8, 2016.

Under the terms of the contract:

- The General Treasurer of Rhode Island receives from Alliance Bernstein an asset-based fee of 9.5 basis points (0.095%) of the average net position value of the assets (as defined by the agreement) held in non-Rhode Island resident accounts (2.0 basis points (0.02%) with respect to non-Rhode Island resident accounts invested in the Age-Based CBf Morningstar Index Portfolio) and the agreement contains provisions whereby the asset-based fee will not fall below the level of the account maintenance fee in place under the previous contract. The total of asset-based fees have been recorded in the State of Rhode Island’s general fund for the year ended June 30, 2016.
- The General Treasurer of Rhode Island receives direct purchase commissions, derived from the direct purchases by certain non-Rhode Island residents. The total of direct purchase commissions have been recorded in the State of Rhode Island’s general fund for the year ended June 30, 2016.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 5 – MANAGERIAL AGREEMENTS (CONTINUED)

- AllianceBernstein deposits \$100 into the account of every child born to or adopted by a Rhode Island resident for which an account has been established within one year of birth; also the General Treasurer of Rhode Island will receive \$50 per child for every child born to a Rhode Island resident who does not establish an account within the program. The total of CollegeBound*baby* income has been recorded in the State of Rhode Island's general fund for the year ended June 30, 2016.
- The Rhode Island Division of Higher Education Assistance ("RIDHEA") received \$275,000 annually to assist it with marketing, promotion, and review of the Tuition Savings Program. These funds are also available for programs of student financial assistance as determined by the RIDHEA Board.
- AllianceBernstein provided \$750,000 annually for the marketing and promotion of the Tuition Savings Program in Rhode Island.

With respect to each Individual Fund Portfolio, other than the Vanguard Portfolios, AllianceBernstein's compensation for serving as Program Manager is its compensation from the underlying mutual funds or other pooled investment vehicles in which the Portfolio is invested. AllianceBernstein does not receive compensation with respect to the Vanguard Portfolios. With respect to each Education Strategy Portfolio, AllianceBernstein receives a program management fee from the Trust at an annual rate equal to the expense ratio of each Portfolio as stated in the CollegeBoundfund® Program Description minus the weighted average of the expenses of the underlying Pooling Portfolios in which the Education Strategy Portfolio is invested. For the year ended June 30, 2016, the Program Manager waived fees in the amounts of \$159,142 for the AllianceBernstein Principal Protection Income Portfolio.

AllianceBernstein has retained State Street Bank and Trust Co. ("State Street") to provide custodial and accounting services for the Trust. AllianceBernstein Investor Services, Inc. (ABIS), a wholly-owned subsidiary of AllianceBernstein, provides personnel and facilities to perform transfer agency services for the Trust. No fees are paid by the Trust for custodial, accounting, or transfer agency services.

The Trust incurs management fees through its investment in the AllianceBernstein mutual funds or other pooled investment vehicles by each Underlying Portfolio of the Program Fund as well as its pro-rata share of other expenses. Total expenses paid indirectly to AllianceBernstein through investment in the AllianceBernstein mutual funds as well as direct expenses paid by the Trust are aggregated in calculating minimum expenses.

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NOTES TO THE FINANCIAL STATEMENTS

FOR THE YEAR ENDED JUNE 30, 2016

NOTE 6 – RELATED PARTY TRANSACTIONS

Under the agreement with AllianceBernstein, the State of Rhode Island received asset-based fees from AllianceBernstein and direct purchase commissions from direct purchases by certain non-Rhode Island residents. As for the amounts paid to the State of Rhode Island in 2016, the total cash paid during 2016 equals \$8,446,261.

In addition, Treasury accrued a receivable of \$1,738,270 from Alliance Bernstein at 6/30/2016 for amounts earned in 2016, and a corresponding payable to RIDHEA. That amount was also accrued by DHEA as receivable from the State.

NOTE 7 – SUBSEQUENT EVENTS

RIHEST has evaluated subsequent events through December 1, 2016, the date the financial statements were available to be issued. Events that required disclosure have been identified below.

In November 2015, the SIC voted to use Ascensus College Savings to manage the program. The conversion included business as usual in the administration of the CBf. The actual conversion of assetFinas took place outside of FY2016, occurring from July 8th - July 12th, 2016.

SUPPLEMENTARY INFORMATION

**RHODE ISLAND HIGHER EDUCATION SAVINGS TRUST
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SCHEDULE OF OUTSIDE CONSULTANTS AND INDEPENDENT CONTRACTORS

FOR THE YEAR ENDED JUNE 30, 2016

Program Fund Expenses

Asset-based charges, AllianceBernstein L.P.

\$ 63,856,439

**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**

Joint Committee on Legislative Services, General Assembly,
**State of Rhode Island and Providence Plantations and
Rhode Island Office of the Auditor General**

We have audited, in accordance with the 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, the financial statements of the Rhode Island Higher Education Savings Trust (RIHEST), (a component unit of the State of Rhode Island), as of and for the year ended June 30, 2016, and the related notes to the financial statements, which collectively comprise the Rhode Island Higher Education Savings Trust's basic financial statements and have issued our report thereon dated December 1, 2016.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered RIHEST's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of RIHEST's internal control. Accordingly, we do not express an opinion on the effectiveness of the RIHEST's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. *A material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Internal Control Over Financial Reporting (Continued)

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or, significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the RIHEST'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*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Marcum LLP

Providence, RI
December 1, 2016