MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION

FINANCIAL REPORT

JUNE 30, 2012

C O N T E N T S

ANDERSON ZURMUEHLEN & CO., P.C. • CERTIFIED PUBLIC ACCOUNTANTS & BUSINESS ADVISORS
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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Montana Higher Education
Student Assistance Corporation
Helena, Montana

We have audited the accompanying balance sheets of the Montana Higher Education Student Assistance Corporation (the Corporation) as of June 30, 2012, and the related statements of revenue, expense and changes in fund net assets, and cash flows for the year then ended. These financial statements are the responsibility of the Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Montana Higher Education Student Assistance Corporation as of June 30, 2012, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Accounting principles generally accepted in the United States of America require that the management's discussion on pages 3 through 9 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.

Anderson ZurMuehlen & Co., P.C.

Helena, Montana
September 13, 2012

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS
Year Ended June 30, 2012 and Comparative Totals for June 30, 2011

This section of the Montana Higher Education Student Assistance Corporation's (MHESAC or the Corporation) annual financial report presents our discussion and analysis of the Corporation's financial performance during the years ended June 30, 2012 and 2011. Please read the following in conjunction with the Corporation's financial statements and accompanying notes.

MHESAC is a Montana not-for-profit corporation that was incorporated in 1980. MHESAC is designated as the sole and exclusive not-for-profit corporation in the State to provide a student loan secondary market to support the Federal Family Education Loan Program (FFELP). MHESAC is supported entirely through earnings on the student loans that it owns. MHESAC's current activities include FFELP student loan servicing and bond management to finance the capital for its FFELP student loan activities and rebates and rate reductions to student loan borrowers as part of its commitment to helping Montana students lower the cost of financing their education. As a not-for-profit entity that has the ability to issue tax-exempt debt, MHESAC is classified as a "governmental nonprofit" entity for financial reporting purposes.

Financial Reporting Methodology Overview

This annual report consists of MHESAC's basic financial statements and Management's Discussion and Analysis. As discussed in Note 1, Summary of Significant Accounting Policies, Statement No. 34 issued by the Governmental Accounting Standards Board (GASB) requires a discussion of results of operations and financial position and a presentation of financial statements in a manner similar to private business. MHESAC follows proprietary fund reporting. Accordingly, the financial statements are presented using the economic resources measurement focus and the accrual basis of accounting.

The basic financial statements include the balance sheet, which reports the assets owned by MHESAC, its liabilities or what it owes to others and total fund net assets as of its fiscal year end; the statement of revenues, expenses and changes in fund net assets, which reports the operating net income plus non-operating revenue and expenses to arrive at a change in fund net assets; and a statement of cash flows, which describes the sources and uses of MHESAC's cash during the year.

It is important to note that MHESAC has both restricted and unrestricted assets and fund net assets. Restricted refers to the assets and net assets whose use is restricted by the bond indentures or escrow agreements. The restricted assets must be used in accordance with stipulations in the governing bond indenture or escrow agreement. They cannot be used for any other purpose. Unrestricted assets and fund net assets are items that are not restricted in their use, located in what we call the general fund.

These unrestricted assets were either acquired outside of the bond indentures or escrow agreements through general fund operations or from previously restricted funds that have now been released to the general fund via indenture satisfaction such as full redemption of outstanding bond issues.

During the fiscal year ending June 30, 2012, MHESAC chose to be an early adopter of GASB 65 for items previously reported as assets. This implementation meant that MHESAC would expense certain items such as the cost of debt issuance and loan acquisition costs. Previously, MHESAC reported these costs as prepaid assets, amortizing them over the life of the bonds and loans. The application of GASB 65 requires a restatement of prior periods to reflect the recognition of those expenses in the year they were incurred, resulting in a restatement of beginning fund balance as more fully explained in the footnotes to the financial statements.

Financial Position Summary

Following is an analysis of MHESAC's financial position at June 30, 2012 with comparative information at June 30, 2011 as restated (000s omitted):

Assets	***6/30/2012***	*6/30/2011*
Cash and cash equivalents	**$ 48,483**	$ 11,615
Investments	**600**	122,237
Educational loans receivable, net	**1,406,163**	1,362,391
Other assets	**21,511**	24,174
Total Assets	**$1,476,757**	$1,520,417
Liabilities and Net Assets		
Current liabilities	**310,890**	74,193
Long term debt and obligations	**1,057,156**	1,428,907
Arbitrage rebate and excess interest liability	**2,020**	4,895
Total liabilities	**1,370,066**	1,507,995
Net assets:		
Restricted net assets	**72,789**	233
Unrestricted net assets	**33,902**	12,189
Total net assets	**106,691**	12,422
Total liabilities and net assets	**$1,476,757**	$1,520,417

At June 30, 2012, MHESAC had cash and cash equivalents of over $48.5 million of which approximately $5.6 million is unrestricted and $42.9 million is restricted under the bond indentures or escrow agreements. The cash equivalents in the restricted fund are made of cash temporarily held by the trustee in short-term investments until the funds are used for debt service. Additionally, cash is held by the trustee for reserve and administration purposes in short-term investments that by definition are cash equivalents.

Following is a breakdown of the different student loan types held by MHESAC at June 30, 2012 (gross loan amounts):

Stafford	$ 343,962,821
PLUS	27,377,002
Consolidation	1,035,434,302
Other	57,149
Total	$1,406,931,274

During the fiscal year MHESAC increased the reserve for bad debts. The reserve, which is netted against the student loans receivable for financial statement presentation, increased slightly from $704,554 to $768,917 to reflect the increased exposure to the risk of default on the loans based on the increase in the portfolio.

Results of Operations Summary

MHESAC is reporting operating income of $91,780,000 for the fiscal year ended June 30, 2012. Note the following analysis of operating revenue and expense sources followed by non-operating revenues (expenses) (000s omitted):

Operating Revenue Sources

	FY Ended 06/30/2012	FY Ended 06/30/2011 (restated)
Interest on investments	**$ 768**	$ 1,009
Interest on student loans	**44,103**	45,181
Gain on bond repurchase	**18,485**	6,514
Revenue from bond restructuring	**56,003**	-
Income from sale of loans	**-**	1,130
Other income	**45**	176
Total operating revenue	**119,404**	54,010

Operating Expense Sources

Bond and note interest	**4,170**	10,681
Bond fees	**839**	1,043
Loan fees	**9,918**	10,222
Management & servicing cost	**12,663**	13,506
Other costs	**34**	19
Total operating expenses	**27,624**	35,471
Operating profit	**91,780**	18,539

Results of Operations Summary (Continued)

	FY Ended 06/3020/12	FY Ended 06/30/2011 (restated)
Non-Operating Revenues (Expenses)		
Arbitrage rebate	**2,209**	1,460
Excess interest rebate (expense)	**280**	(68)
Total non-operating revenues (expenses)	**2,489**	1,392
Increase in net assets	**94,269**	19 931
Fund net assets, beginning of year	**12,422**	(7,509)
Fund net assets, end of year	**$ 106,691**	$ 12,422

Arbitrage and excess interest rebate revenues in the amount of $2,208,769 and $279,856, respectively, for fiscal year 2012 have been classified as non-operating activity. This is consistent with the treatment for the same items in prior years. Management has concluded that this activity is interrelated and directly affected by other activities that are reported as non-operating and should be reported similarly as the fluctuations caused by changes in other non-operating activity may be misleading as a component of operating income.

The following is an overview of changes in financial data from FY 2011 to FY 2012:

- Cash and equivalents increased by $36,868,000
- Net student loan receivables increased by $43,772,000
- Investments decreased by $121,637,000
- Debt consisting of net bonds outstanding decreased by $110,381,000
- MHESAC's net assets increased by $94,269,000
- Total operating revenues increased by $65,394,000
- Total operating expenses decreased by $7,847,000

What the financial statements tell us is that MHESAC's financial health was strengthened to a great degree during fiscal year 2012 in terms of its operating activities. However, of the $119 million of operating revenue, over $56 million of it was one-time revenue generated through a restructuring transaction of MHESAC's debt. Additionally, another $18 million of operating revenue was from gain on discounted bond purchases.

Operating revenues from the student loans are variable in nature and were based on the commercial paper rate during fiscal year 2012. While the commercial paper rate bounced around a little during the fiscal year, it ended the year at close to the same rate as it started the year. As a result, interest earned on student loans was slightly lower in fiscal year 2012 as compared to the previous year due to the portfolio decline that was experienced until May 2012. In May, MHESAC purchased an additional $180 million in student loans which increased student loan revenue for the last two months of the year and explains why the ending student loan balance is higher than the balance at the beginning of the fiscal year.

During the first ten months of the year, MHESAC's auction bonds continued to be illiquid in their periodic auction. What this means is that bondholders wishing to sell their position in MHESAC bonds could not sell because there were no buyers in the market. When this happens, the auction is deemed to have failed.

When the tax-exempt auctions fail, the bond resets at a prescribed rate, called Maximum Bond Rate that during the reporting period was based on 175% of either the SIFMA index or the after-tax equivalent of the AA commercial paper rate. The Maximum Bond Rate on the senior taxable bonds follows a different formula and is 30-day LIBOR plus 1.5% and for the subordinate taxable bonds is 30-day LIBOR plus 3.5%. These are the rates that the bond interest accrued based on the Max Rate formula.

However, there is another rate called the Net Loan Rate that defines how interest on taxable auction bonds will actually be paid out. The difference between the Max Rate and the Net loan Rate is accrued for carry-forward and eventual payout to the bondholder unless the bonds are redeemed prior to any payout. All of the taxable auction bonds were redeemed and retired during May and June of 2012, before any of the terms for payment of the carry-forward interest had been reached. Therefore, this carry-forward interest, totaling $5,726,805, was written off during the fiscal year as it ceased to be a liability of MHESAC when the bonds it was related to were redeemed. This had the effect of reducing operating expenses by a like amount.

Long-term Debt Activity

MHESAC had previously issued both tax-exempt and taxable bonds to raise capital for its student loan origination and acquisition activities as more fully described in the accompanying notes to the financial statements. During fiscal year 2012, MHESAC had the opportunity to restructure its debt with the goal of taking out all auction bonds that had been illiquid since 2008 and all fixed rate bonds that paid a significantly higher than market interest rate and structure MHESAC's debt so that any vulnerability to rising interest rates is mitigated. The 2012 Bonds that were issued in the amount of $1,164,800,000 met those goals. $1,145,300,000 of the bonds that were issued are senior bonds and carry a AA+ rating from Standard & Poor's and a AAA rating by Fitch.

The subordinate bonds issued, in the amount of $19,500,000 are unrated and are held by MHESAC. The floating rate notes in Series 2005B and 2006A remain outstanding and carry a AAA rating by Moody's and Fitch and a AA+ rating from Standard & Poor's. The 2006C subordinate bonds in the amount of $18,000,000 are unrated. Currently, all outstanding bonds are taxable bonds and carry variable interest rates based on either 1-month or 3-month LIBOR rates plus some spread depending on the life of the bond.

In the fiscal year that ended June 30, 2012, MHESAC redeemed some outstanding bonds through both scheduled redemptions and special redemptions. MHESAC also retired some bonds after buying them back on the open market. Scheduled redemptions totaled $34,627,000. Special redemptions of the bank bonds totaled $9,320,000. Bonds totaling $65,600,000 were purchased on the market and retired. In total, bonds redeemed and retired were $109,547,000. An analysis of the change to bonds outstanding follows:

	Current Portion	Long-term Portion
Bonds outstanding at 7/01/11	$ 67,468,000	$ 1,423,876,000
Bonds Issued – Series 2012	230,754,544	934,045,456
Scheduled redemption and targeted payments of 1998, 1999, 2005, 2006 and 2012 Series bonds	(73,072,000)	-
Buyback of 1995, 1999, 2000, 2001, 2002, 2003, 2004 and 2006 Series bonds at discount	-	(234,500,000)
Defeasance or purchase and retirement of all outstanding auction bonds and fixed rate bonds	-	(936,390,000)
Reclassification to current	79,156,399	(79,156,399)
Bonds outstanding at 6/30/12	$ 304,306,943	$ 1,107,875,057
Unamortized bond discount	-	(31,218,532)
Net bonds outstanding	$304,306,943	$1,076,656,525

It should be noted that $19,500,000 of the 2012 bonds issued are subordinate bonds and are owned by the MHESAC general fund. They have therefore been eliminated in the financial statements.

Following is a table showing the face amount of total outstanding by bond type which illustrates the restructuring of all auction and fixed rate bonds during the fiscal year:

	6/30/2012 Par Value	% of Total	6/30/2011 Par Value	% of Total
Auction Rate Bonds:				
Tax-Exempt	$ -	0.0%	$1,052,300,000	70.5%
Taxable	-	0.0%	96,350,000	6.5%
Fixed Rate Bonds:				
Tax-Exempt	-	0.0%	41,205,000	2.8%
Floating Rate Notes:				
Taxable	1,412,182,000	100%	301,489,000	20.2%

Significant Events

The Student Aid and Fiscal Responsibility Act (SAFRA), which was included in the health care reconciliation bill that was signed into law on March 30, 2010, effectively eliminated the Federal Family Education Loan Program (FFELP) in which MHESAC participates. Effective July 1, 2010, all new federal student loans were provided by the Direct Loan program rather than by the private sector participants. Therefore, MHESAC is no longer originating or acquiring new loans. MHESAC will continue to service its existing FFELP student loan portfolio during the remaining life of those loans which can be up to thirty years.

During the year, MHESAC made the election to change the index that was used for the formula for special allowance payments (SAP) to be received from or paid to the federal government. This election was made in April 2012 with an effective date of July 1, 2012. Prior to this election, SAP was calculated based on a formula that involved the 90-day commercial paper rate. MHESAC made the election to switch to a formula based on the 1-month LIBOR rate in order to better match the indices used for calculation of student loan earnings and associated debt.

FINANCIAL STATEMENTS

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
BALANCE SHEET
June 30, 2012 with Comparative Totals for 2011
(expressed in thousands)

ASSETS	2012	(restated) 2011
CURRENT ASSETS		
Cash and cash equivalents	$ 5,636	$ 4,520
Investments	600	971
Accrued interest receivable	100	80
Real estate loan receivable, related party	-	192
Prepaid costs, net of accumulated amortization	8	9
Other assets	1,202	13
Total Current Assets	7,546	5,785
RESTRICTED ASSETS		
Cash and cash equivalents	42,847	7,095
Investments	-	121,266
Educational loans receivable, net	1,399,144	1,357,674
Accrued interest receivable	18,928	20,426
Other assets	1,273	1,762
Total Restricted Assets	1,462,192	1,508,223
OTHER ASSETS		
Educational loans receivable, net	7,019	4,717
Real estate loan receivable, related party	-	1,692
Total Other Assets	7,019	6,409
TOTAL ASSETS	$ 1,476,757	$ 1,520,417

The Notes to Financial Statements are an integral part of this statement.

LIABILITIES AND NET FUND ASSETS	**2012**	(restated) 2011
CURRENT LIABILITIES		
Accounts payable and accrued expenses	**$ 6,119**	$ 6,193
Accrued interest payable	**464**	532
Educational loan revenue bonds payable - current portion	**304,307**	67,468
Total Current Liabilities	**310,890**	74,193
LONG-TERM DEBT		
Accrued interest payable	**-**	5,031
Educational loan revenue bonds payable	**1,057,156**	1,423,876
Total Long-Term Debt	**1,057,156**	1,428,907
OTHER LIABILITIES		
Contingent arbitrage rebate liability	**2,020**	4,318
Contingent excess interest liability	**-**	577
Total Other Liabilities	**2,020**	4,895
TOTAL LIABILITIES	**1,370,066**	1,507,995
FUND NET ASSETS		
Restricted net assets	**72,789**	233
Unrestricted net assets	**33,902**	12,189
Total Fund Net Assets	**106,691**	12,422
TOTAL LIABILITIES AND FUND NET ASSETS	**$ 1,476,757**	$ 1,520,417

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF REVENUE, EXPENSE AND CHANGES IN FUND NET ASSETS
June 30, 2012 with Comparative Totals for 2011
(expressed in thousands)

	2012	(restated) 2011
OPERATING REVENUE		
Interest on investments and cash equivalents	$ 768	$ 1,009
Interest on educational loans (net of expense for uncollectible accounts of $74,300 in 2012 and $(18,808) in 2011)	44,103	45,181
Income from sale of loans	-	1,130
Income from Financing Restructure	56,003	11
Gain on bond repurchase	18,485	6,514
Miscellaneous Income	29	-
Interest on real estate note	16	165
Total Operating Revenue	119,404	54,010
OPERATING EXPENSE		
Financing expenses:		
Bond and note interest	4,170	10,681
Auction agent/broker fees	523	677
Bond fees	316	366
Loan fees	9,918	10,222
Contracted management fees	2,407	2,964
Contracted loan servicing fees	10,256	10,542
Administrative expenses	34	19
Total Operating Expense	27,624	35,471
Operating income	91,780	18,539
NONOPERATING REVENUES (EXPENSES)		
Arbitrage rebate	2,209	1,460
Excess interest rebate	280	(68)
Nonoperating Revenues (Expenses)	2,489	1,392
INCREASE IN NET ASSETS	94,269	19,931
FUND NET ASSETS, BEGINNING OF YEAR (restated)	12,422	(7,509)
FUND NET ASSETS, END OF YEAR	$ 106,691	$ 12,422

The Notes to Financial Statements are an integral part of this statement.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
STATEMENT OF CASH FLOWS
June 30, 2012 with Comparative Totals for 2011
(expressed in thousands)

		2012		(restated) 2011
CASH FLOWS FROM OPERATING ACTIVITIES:				
Interest received on student loans	$	**26,047**	$	28,694
Interest received on investments		**885**		958
Interest received on real estate and operating notes		**16**		165
Income from sale of loans		**-**		1,130
Income from purchase of loans		**-**		11
Bond and note interest paid		**(9,333)**		(10,314)
Auction agent/broker fees paid		**(575)**		(679)
Bond fees paid		**(253)**		(365)
Loan fees paid		**(9,843)**		(10,283)
Contracted management & servicing fees paid		**(12,757)**		(13,371)
Administrative expenses paid		**(33)**		-
Restructure revenue		**1,050**		-
Other operating income		**29**		(17)
Net cash flows from operating activities		**(4,767)**		(4,071)
CASH FLOWS FROM INVESTING ACTIVITIES:				
Purchase of educational loans		**(117,250)**		(33,192)
Sale of educational loans		**-**		54,793
Repayments of educational loans		**126,751**		140,653
Repayments of loans on sale of assets		**1,884**		177
Purchase of investments		**(210,356)**		(320,788)
Proceeds from sale of investments		**331,993**		225,803
Net cash flows from investing activities		**133,022**		67,446
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES:				
Issuance of bonds		**1,133,581**		-
Arbitrage rebate paid		**(90)**		(158)
Repayment of bonds		**(1,225,478)**		(103,033)
Revenue from restructuring		**600**		-
Net cash flows from financing activities		**(91,387)**		(103,191)
Net change in cash and equivalents		**36,868**		(39,816)
Cash and cash equivalents, beginning of year		**11,615**		51,431
Cash and cash equivalents, end of year	$	**48,483**	$	11,615

The Notes to Financial Statements are an integral part of this statement.

	2012	2011
A reconciliation of cash and cash equivalents as shown on the balance sheet for MHESAC follows:		
Cash	**$ 5,636**	$ 4,520
Restricted assets	**42,847**	7,095
Cash and cash equivalents	**$ 48,483**	$ 11,615

A reconciliation of operating income to net cash flows from operating activities follows:

	2012	2011
Cash Flows From Operating Activities:		
Operating income	**$ 91,780**	$ 18,539
Adjustments to reconcile operating income to net cash flows from operations:		
Restructure revenue	**(54,353)**	-
Uncollectible accounts	**(74)**	19
Gain on reacquisition of bonds	**(18,485)**	(6,514)
Discounted bond accretion	**(407)**	-
Change in assets and liabilities:	**-**	
Interest receivable	**(16,344)**	(15,105)
Other assets	**(1,722)**	25
Accounts payable and accrued expenses	**(71)**	(1,405)
Accrued interest payable	**(5,091)**	370
Net cash flows from operating activities	**$ (4,767)**	$ (4,071)

	2012	2011
Supplemental Information:		
Non-cash Investing and Financing Activity:		
Accrued interest capitalized	**$ 17,817**	$ 17,624
Student loan borrower rebates granted	**297**	279
	$ 18,114	$ 17,903

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization:
Montana Higher Education Student Assistance Corporation (herein referred to as MHESAC or the Corporation) is a Montana not-for-profit corporation incorporated in 1980. The governor of the State of Montana has designated MHESAC as the sole and exclusive not-for-profit corporation in the State to provide a statewide student loan acquisition program in connection with the guaranteed student loan program provided by the Higher Education Act and Section 103(e) of the Internal Revenue Code. The Corporation was organized exclusively for the purposes of lending and providing funds for the acquisition of student loans and performing procedures for servicing loans. Effective July 1, 2010, the Federal Family Education Loan program (FFELP) was eliminated and replaced by the Federal Direct Loan program. MHESAC will no longer acquire or provide capital for new FFELP student loans. On February 1, 2000, the Corporation sold all its operating assets and transferred its employees to Student Assistance Foundation of Montana (SAF), a Montana not-for-profit corporation. The Corporation and SAF entered into management and servicing agreements, pursuant to which SAF agrees (1) to provide the Corporation with all necessary management and administrative services, including those required to operate the Corporation's student loan program and to perform the Corporation's responsibilities under the Indenture, and (2) to service all student loans owned by MHESAC.

Income Tax Status:
MHESAC is a not-for-profit corporation exempt from taxation under Internal Revenue Code Section 501(c)(3). Accordingly, no provision for income taxes is necessary in the accompanying financial statements.

Generally, the Corporation's returns are no longer subject to review by federal taxing authorities for years prior to the tax year ended June 30, 2009.

Measurement Focus, Basis of Accounting and Basis of Presentation:
As a non-profit entity that has the ability to issue tax-exempt debt, MHESAC is classified as a "governmental nonprofit" entity in accordance with generally accepted accounting principles (GAAP) as promulgated by the Governmental Accounting Standards Board (GASB). The Corporation implemented GASB Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments" for financial reporting effective for fiscal years beginning July 1, 2002. As provided by this standard, MHESAC follows proprietary fund reporting and has elected to apply pronouncements issued by the Financial Accounting Standards Board (FASB) after November 30, 1989, provided they do not conflict with or contradict guidance of the GASB.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Measurement Focus, Basis of Accounting and Basis of Presentation (Continued):
In accordance with GAAP, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The Balance Sheet is presented in a classified format and separates unrestricted and restricted assets. The Statement of Revenues, Expenses and Changes in Fund Net Assets is formatted to report operating and non-operating revenues and expenses. The Statement of Cash Flows is presented using the direct method. MHESAC considers the following revenue components to be operating income: interest income derived from investments, cash equivalents and educational loans, gains on bond repurchases, gains on loan sales, interest on real estate notes and operating notes as well as other miscellaneous income.

Management's Discussion and Analysis ("MD&A") is considered to be required supplemental information and precedes the financial statements.

Accounting Estimates:
The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reported period. Significant estimates include contingent liabilities for excess interest on student loans and arbitrage rebate, both more fully described below. Both may vary depending on adopted methodology and are subject to regulatory change. During the year-ended June 30, 2012, the Corporation refinanced its tax-exempt debt with a taxable issue and will no longer be subject to excess interest or arbitrage rebate regulations going forward.

Cash and Cash Equivalents:
Cash and cash equivalents includes all checking accounts, money market accounts and highly liquid securities with a maturity of three months or less at the date of purchase. MHESAC maintains deposits at one financial institution. Accounts at this financial institution are insured by the Federal Deposit Insurance Corporation (FDIC) up to $250,000 for interest-bearing accounts and unlimited deposit insurance coverage on non-interest bearing accounts. At June 30, 2012, the book balance amount of MHESAC deposits was $5,945,580 with a bank balance of $5,945,580. The majority of those deposits are in a non-interest bearing account with unlimited federal depository insurance, however MHESAC interest bearing accounts exceeded FDIC insured limits by $105,385.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Cash and Cash Equivalents (Continued):
The cash and cash equivalents in the restricted fund are comprised of cash and liquid investments held by the trustee for the bond financings and cash held in escrow for the General Fund that is being held in short-term or liquid investments pursuant to the Escrow Agreement among MHESAC, Student Assistance Foundation and the Escrow Agent, dated May 4, 2012.

Investments:
Investment instruments held in the restricted funds for the year ended June 30, 2011 were restricted by the bond indenture. The Corporation invests in highly liquid investments such as U.S. government obligations. Credit risk on investment agreements were based on the agreement providers' ability to repay funds loaned by MHESAC for investment under the agreements. These agreements contained collateral provisions to mitigate such risk. Investment instruments are reported at fair value when they are classified as trading investments and at amortized cost when classified as held-to-maturity investments. Cost of investments exceeded fair value by $7,975 at June 30, 2011. The resulting unrealized gain or loss on investments is reported in the Statement of Revenue, Expense and Changes in Fund Balance as a component of investment income. At June 30, 2012, there were no investments in the restricted funds and unrestricted investment cost approximated fair value.

Interest on Educational Loans:
The United States Department of Education makes quarterly interest payments on subsidized Stafford and subsidized Consolidation loans until the borrower is required to begin repayment under the provisions of the Higher Education Act. For Stafford loans, repayment generally begins 6 to 9 months after the student completes his/her course of study, leaves school or fails to carry a minimum academic load. Repayment begins immediately upon full disbursement for Consolidation, PLUS and SLS loans disbursed prior to July 1, 2008. PLUS loan borrowers with loans disbursed on or after July 1, 2008 may choose to begin repayment 6 months after the student, for whom the parent borrowed the funds, ceases to be enrolled at least half-time. In addition, the United States Department of Education pays the interest for subsidized Stafford and subsidized Consolidation loans during the time a borrower is in an authorized deferment period. Authorized deferment periods are specific situations and statuses determined by the United States Department of Education.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Special Allowance Payments:
The United States Department of Education provides a special allowance or subsidy to lenders participating in the FFELP if the interest rate is below the guaranteed interest rate. Conversely, if the interest rate is above the guaranteed interest rate, the excess portion of the borrower payment is remitted to the Federal government. This allowance is paid on the average quarterly unpaid principal balance of student loans, based on an annual rate equal to the average rate of 91-day U.S. Treasury Bills or 3-month Commercial Paper Rates for that quarter increased by various rates, depending on loan origination date. If the average yield rate is lower than the interest rate paid by the borrower, then the excess portion of the borrower payment is rebated to the federal government. A minimum yield of 9.5% exists on certain loans purchased with tax-exempt funds. As of June 30, 2012 and 2011, rebates of $19,801,477 and $21,343,600 were netted in Special Allowance revenue on the financial statements.

During the year ended June 30, 2010, the Income Based Repayment (IBR) Plan was enacted as part of the College Cost Reduction and Access Act of 2007. IBR is a repayment plan option for borrowers with loans in the Direct Loan Program or the Federal Family Education Loan Program (FFELP). The IBR plan may result in additional subsidy payments by the federal government on behalf of borrowers and a potential discharge of remaining debt balances at the end of 25 years.

Effective July 1, 2012, MHESAC has elected to have the special allowance payment on student loans (SAP) calculated based on the one-month LIBOR index rather than 90-day commercial paper index. This was done to provide better matching of interest rate mechanisms on the student loans and the bonds.

Loan Measurement & Allowance for Uncollectible Loans:
Loans held by the Corporation are measured at the outstanding principal amount net of any allowance for credit losses or uncollectible amounts. Estimates for uncollectible amounts are based on outstanding principal amounts and portfolio default rates. (See Note 3 for details on Education Loans Receivable and Uncollectible Loans).

Restricted Fund Net Assets:
In connection with the issuance of the Series 2012 Bonds, assets were placed in escrow in order to assure that the Corporation will have sufficient funds to pay servicing and management fees over the life of the indenture. Specified cash and student loans (including, without limitation, all principal, interest, special allowance payments and guarantee or insurance payments with respect thereto) received by MHESAC have been deposited in an escrow account. Loans restricted in the escrow total $32,784,920 net of an allowance for uncollectible accounts of $2,754. Accrued interest receivable of $31,603, repayment interest receivable of $322,426 and other assets of $59,702 were restricted in the escrow fund as of June 30, 2012.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

Restricted Fund Net Assets (Continued):
Other restricted fund net assets represent revenue bond funds that are required to be expended only as prescribed by the bond indenture. Due to the limited obligation nature of this debt, the funds and accounts established by the indenture are pledged as collateral for the bonds under the indenture.

Contingent Excess Interest Liability:
MHESAC is bound by IRS regulations that require tax exempt bond issuers to rebate educational loan earnings that exceed specified limits. Such excess earnings may be rebated to the U.S. Treasury or to educational loan borrowers. The liability for June 30, 2011 was booked at current value. The 2012 bond refinancing and payment in full of all tax exempt bonds eliminated all Excess Interest Liability of the corporation as of June 30, 2012.

Contingent Arbitrage Rebate Liability:
Internal Revenue Service regulations require that tax-exempt bond issuers rebate investment earnings that exceed specified limits to the U.S. Treasury. Limits vary depending on the bond issue date. Such excess earnings are determined annually and the cumulative excess is payable on every fifth anniversary date of the bonds' issuance and on final maturity of the bonds. At June 30, 2012 and June 30, 2011, the Corporation's arbitrage rebate liability was $ 2,020,093 and $4,318,442, respectively. The final payment of this liability was remitted to the Internal Revenue Service on July 25, 2012. All tax exempt bonds were retired in the 2012 bond refinancing eliminating the applicability of arbitrage rebate regulations going forward.

New GAAP Implementation:
GASB adopted Statement No. 65, “Items Previously Reported as Assets and Liabilities” in March 2012. The guidance specifically changes the reporting and recognition for debt issuance, loan acquisition and loan purchase costs. Previously, these items were reported as deferred assets and amortized over the life of the related asset or liability. Under the new requirements, debt issuance and loan acquisition costs should be recognized as an expense in the period they are incurred. MHESAC previously reported both debt issuance and loan acquisition costs as deferred assets, amortizing them over the life of the underlying activity.

MHESAC has elected early implementation of GASB Statement No. 65, which is required to be effective for financial statement periods beginning after December 15, 2012, but earlier implementation is encouraged. The effect of this early implementation is reported as a restatement of beginning fund net assets for the fiscal year June 30, 2011. Comparative financial statements for that year have been adjusted to apply the new requirements retrospectively.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

New GAAP Implementation (Continued):
The financial statements for fiscal year ended June 30, 2011 have been restated to adjust the activity related to deferred bond issuance and loan acquisition costs. Beginning fund net assets have been reduced by $33,472,257 for net balances of $23,638,202 in bond issuance costs and $9,834,055 in loan acquisition costs carried forward as deferred assets from June 30, 2010. In addition, the net deferred asset balances and amortized expenses previously reported for June 30, 2011 have been adjusted to reflect this change. The following financial statement line items for fiscal year 2011 were affected by the change in accounting principle (in thousands):

Balance Sheet June 30, 2011:

	As Originally Reported	As Adjusted	Effect of Change
Unrestricted prepaid costs, net	$ 131	$ 9	$ (122)
Restricted prepaid costs, net	19,117	-	(19,117)
Deferred bond issuance costs, net	9,194	-	(9,194)
Total	$28,442	$ 9	$(28,433)
Restricted net assets	$19,350	$ 233	(19,117)
Unrestricted net assets	21,505	12,189	(9,316)
Total	$40,855	$12,422	$(28,433)

Statement of Revenue, Expense and Change in Fund Net Assets June 30, 2011:

	As Originally Reported	As Adjusted	Effect of Change
Amortization of bond issuance costs	$ 639	$ -	$ (639)
Loan fees	14,622	10,222	(4,400)
Operating income impact of items	$ 15,261	$ 10,222	$ (5,039)
Fund net assets, beginning of year	$25,963	$(7,509)	$(33,472)

Reclassifications:
Other reclassifications unrelated to the restatement described above were made to the 2011 financial statements in order to conform to the 2012 presentation. These reclassifications had no effect on net assets, total assets or increase in net assets previously reported.

NOTE 2. INVESTMENTS

Since the restricted funds are governed by bond indentures, the Corporation adheres to the requirements specified within the bond indenture for investment activity of those funds. The Corporation has adopted a formal internal policy related to the investment of the General Fund activity that is in accordance with the Internal Revenue Code and the prudent expert principle. General Fund moneys are invested in securities similar in nature to those in the indenture.

For the year ended June 30, 2011 pledged revenues and other amounts in the pledged funds and accounts that were not invested in financed student loans were used to acquire investment agreements with one or more investment agreement providers. The quality rating of the obligations of the provider of the investment contracts must be maintained at a level defined by each agreement using standard ratings by Standard and Poor's, Moody's or Fitch. The bond trustee monitors compliance with the established quality ratings and the provider is required to provide prompt notice if any credit event occurs that adversely affects the minimum quality rating. All investment agreements were terminated during the fiscal year ended June 30, 2012.

The General Fund owns $19,500,000 of the 2012 bonds issued under the MHESAC indenture. This activity is eliminated in the consolidated financial statements.

Investment securities are exposed to custodial credit risk if the securities are uninsured, are not registered in the name of the Corporation or bond trustee, and are held by either the counterparty or the counterparty's trust department or agent but not in the Corporation's or bond trustee's name.

The Corporation does not have any custodial credit risk as all securities are held in its name. Obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government are not considered to have credit risk and do not require disclosure of credit risk. In addition, investment contracts are not considered securities for purposes of credit risk classification.

Investments issued or guaranteed by the U.S. government and investments in mutual funds, external investment pools, and other pooled investments are excluded from concentration of credit risk disclosure requirements.

Interest rate risk is the risk that interest rate changes will adversely affect the fair value of an investment. The Corporation utilizes the specific identification method in regard to interest rate risk as evidenced by the listing of each specific investment and the related interest rates in the chart below. Investment maturities are structured to meet cash requirements for bond redemption schedules as outlined in the indenture.

NOTE 2. INVESTMENTS (CONTINUED)

The Corporation's investments are reported at fair value when they are classified as trading investments and are reported at amortized cost when they are classified as held-to-maturity investments.

The following summarizes investments held at June 30, 2012:

INVESTMENTS – CURRENT	AMOUNT	RATE	MATURITY
Federal Home Loan Bank Note	$ 599,843	.230%	05/17/2013
Wells Fargo MT Higher Ed 2012–B Security	19,500,000	1.44%	12/20/2044
	20,099,843		
Less intercompany holding:			
Wells Fargo MT Higher Ed 2012–B Security	(19,500,000)		
TOTAL INVESTMENTS	$ 599,843		

NOTE 3. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES

The educational loans receivable are loan portfolios purchased from various banks and other financial institutions as well as loans originated by MHESAC. Purchased and originated portfolios are accounted for in the same manner. Servicing of all student loans is governed by regulations issued by the Department of Education under FFELP.

The educational loans receivable are classified as student/interim or repayment status. Student/interim status represents the period from the date the educational loan is made until a student is out of school, including the grace period and any authorized deferment periods, at which time repayment status commences. The educational loans receivable are disclosed in the financial statements net of allowances for uncollectible loans.

Educational loans are summarized as follows:

	June 30, 2012	June 30, 2011
Student/interim status	$ 458,774,858	$ 488,349,492
Repayment status	948,156,416	874,745,273
Educational loans receivable	1,406,931,274	1,363,094,765
Allowance for uncollectible loans	(768,917)	(704,554)
Educational loans receivable, net	$ 1,406,162,357	$ 1,362,390,211

NOTE 3. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES (CONTINUED)

In addition to the special allowance paid by the federal government on certain loans, payments of principal and interest are made by the borrower using the various rates and terms for loans outstanding. Interest on performing loans is accrued on the outstanding principal balance.

Depending on factors specified in the Higher Education Act, educational loans have either fixed or variable interest rates and various maximum repayment terms.

Fixed interest rates to the borrower on Consolidation loans are based upon the weighted average interest rates of the loans consolidated rounded up to the nearest one-eighth or whole percentage depending on the disbursement date. Consolidation loans disbursed on or after November 13, 1997 have a maximum interest rate of 8.25%.

Variable interest rates to the borrower are based upon either the 91 day or one year constant maturity Treasury bill, subject to maximum interest rates ranging from 7.00% to 12.00%. All Stafford and PLUS loans disbursed on or after July 1, 1994 and before July 1, 2006 are variable rate and have maximum interest rates of 8.25% and 9.00%, respectively. Unsubsidized Stafford loans disbursed after July 1, 2006 have a fixed rate to the borrower of 6.80%. Subsidized Stafford loans disbursed after July 1, 2006 and before July 1, 2008 have a fixed rate to the borrower of 6.80%. Subsidized Stafford loans disbursed after June 30, 2008 and before July 1, 2012 have a decreasing rate each year between 6.00% and 3.40%, depending on the actual year disbursed. PLUS loans disbursed after July 1, 2006, have a fixed rate to the borrower of 8.50%. SLS, PLUS, and FISL loans have a maximum repayment term of 10 years. Stafford loans have maximum repayment terms of 10 or 25 years depending on the borrower's original disbursement date and cumulative balance. Consolidation loans have maximum repayment terms of 10 to 30 years depending on the original balance.

Allowance for Uncollectible Loans:
Under contracts with the Montana Guaranteed Student Loan Program (MGSLP), other non-Montana guarantors and the United States Department of Education, MHESAC is guaranteed reimbursement of principal and accrued interest on defaulted educational loans for which the applicable due diligence procedures have been performed. The Corporation receives 100% reimbursement on loans disbursed prior to October 1, 1993. Loans disbursed on or after October 1, 1993 until June 30, 2006 are reimbursed at 98% and loans disbursed on or after June 30, 2006 are reimbursed at 97%. The Corporation recognizes an allowance for loan losses in an amount believed to be sufficient to absorb losses inherent in our loan portfolio. This provision is based on the current default rates of each segment of the portfolio funding source that is applied to the nonguaranteed portion of the loan portfolio balance. A provision for uncollectible educational loans has been made for the years ended June 30, 2012 and 2011.

NOTE 3. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES (CONTINUED)

Allowance for Uncollectible Loans (Continued):
Defaulted loans are eligible for claims reimbursement after 270 days of delinquency. At this time, default prevention due diligence is conducted in an attempt to prevent the need for claim submission. The corporation files claim prior to the 360th day of delinquency, the deadline required by the guarantor. Interest is accrued on delinquent loans up to the date of claim payment by the guarantor, if applicable. At June 30, 2012, loans in the amount of $15,384,731 were classified as delinquent more than 270 days, the stage at which a default claim can be filed.

As of the year ended June 30, 2012, MHESAC held a loan portfolio of $1,406,931,274. The average default rate of 1.96% results in a provision for uncollectible educational loans of $768,917 at year ended June 30, 2012. Following is a reconciliation of the change in the allowance for uncollectible loans for the year ended June 30, 2012:

Balance, July 1, 2011	$ 704,554
Nonguaranteed writeoffs	(9,937)
Adjustments per allowance policy	74,300
Balance, June 30, 2012	$ 768,917

Loan guarantor rates are considered segments for purposes of GAAP disclosure. Following is a breakdown by loan guarantor rates of the current loan portfolios held at June 30, 2012:

100% Guarantee	$ 1,741,491
98% Guarantee	792,934,262
97% Guarantee	612,255,521
TOTAL PORTFOLIO	$ 1,406,931,274

No changes were implemented in the accounting policies or methodologies during the year ended June 30, 2012 regarding calculation of the allowance for uncollectible loans.

Sale of Student Loans:
MHESAC participated in the PUT (Loan Purchase Commitment Program) program on August 10, 2010. The Department of Education was authorized to purchase federal student loans from lenders to ensure on-going availability of funds for student loans. MHESAC sold $54,792,925 in loans from the 2007 bond series that were originated in fiscal year 2010. The sale of loans resulted in a gain of $1,129,992 from the reimbursement by the Department of Education of $75 per loan for previously incurred loan origination costs. The Department of Education also reimbursed 1% of lender loan fees originally paid by MHESAC.

NOTE 3. EDUCATIONAL LOANS RECEIVABLE & ALLOWANCE FOR LOSSES (CONTINUED)

Special Servicer Consolidation Loan Program:
The Department of Education offered a special servicer consolidation loan program to eligible borrowers from January 1, 2012 through June 30, 2012. Eligible borrowers with both FFELP loans and eligible commercially-held Federal Direct Student Loan Program loans were permitted to have their existing FFELP loans reissued into the Federal Direct Student Loan Program during the period from January 1, 2012 through June 30, 2012. Borrowers received up to a 0.5% interest rate reduction on the reissued FFELP loan with the terms and conditions of the borrowers' existing FFELP student loans continuing. Holders of such FFELP loans are paid 100% of the outstanding principal and interest balance on any loans reissued.

As a result of this special servicer consolidation loan program, MHESAC had transferred approximately $28 million in student loans to designated servicing companies for the six month period ending June 30, 2012. Approximately $18 million of additional loans met the June 30th application deadline and will continue to be processed and sold to the Federal Direct Loan Program subsequent to June 30, 2012.

NOTE 4. RELATED PARTY TRANSACTIONS

MHESAC has entered into agreements with Student Assistance Foundation of Montana (SAF) to provide management and loan servicing to MHESAC. SAF has one of its nine Board members in common with the Corporation's seven Board members. Effective February 1, 2000, the Corporation transferred, for fair value, all of its operations and non-financial assets including personnel, all furniture and equipment, as well as its interest in the office building, to SAF. The note for the sale of land and building bore interest at a fixed rate of 8.22% and was an 18 year note. On August 3, 2011 the note for the sale of land and building between MHESAC and SAF was paid in full in the amount of $1,868,513.

Following are details of the financial transactions between MHESAC and SAF:

Sale of real estate and building for which note was received	$ 2,900,000
Principal payments received through June 30, 2012	(2,900,000)
Long-term receivable balance at June 30, 2012	$ -

NOTE 4. RELATED PARTY TRANSACTIONS (CONTINUED)

On June 28, 2003, MSLF was created as a limited liability corporation with SAF as the sole member. The corporation is a bankruptcy remote company that was formed to acquire and originate student loans. Bankruptcy remote status provides that all debts, obligations and liabilities are solely that of the established company and neither the members, special members nor any managers are obligated for those activities including insolvency of the bankruptcy remote vehicle. Previously, the loan activity conducted by MSLF was for the specific purpose of an eventual sale to MHESAC with no obligation by MHESAC to acquire the loans until it was able to obtain financing for that specific purpose. During the year ended June 30, 2012, MSLF transferred the loan portfolio to Citicorp in a consensual relinquishment to satisfy its obligations. MHESAC subsequently acquired this portfolio.

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE

Educational Loan Revenue Bonds Payable:
The bonds outstanding are summarized in the table below.

Bonds outstanding at June 30, 2011	$ 1,491,344,000
Bonds issued during the year	1,164,800,000
Bond discount, 2012 A-2 & A-3	(31,625,846)
Bond discount accreted during the year	407,314
Bonds redeemed during the year	(73,072,000)
Bonds acquired & retired during the year	(234,500,000)
Bonds extinguished by special redemption	(936,390,000)
Bonds outstanding	1,380,963,468
Less: General Fund 2012 bond holding	(19,500,000)
Bonds outstanding at June 30, 2012	$ 1,361,463,468

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

A description of significant terms and conditions of each Student Loan Revenue Bond issue outstanding at June 30, 2012 follows:

Issue	Year End Interest Rate	Original Issue Amount	June 30, 2012
Taxable Floating Rate Bonds:			
2005 Series B Bonds	0.588%	$ 114,880,000	$ 98,578,000
2006 Series A Bonds	0.568%	226,775,000	136,408,000
2006 Series C Bonds **	1.444%	30,000,000	18,000,000
2012 Series A-1 Bonds	.844%	191,000,000	185,396,000
2012 Series A-2 Bonds	1.244%	640,298,435	640,484,199
2012 Series A-3 Bonds	1.294%	282,375,719	282,597,269
2012 Series B-1 **	1.444%	19,500,000	19,500,000
TOTAL BONDS		$ 1,504,829,154	$ 1,380,963,468

The Bonds are limited obligations of the Corporation payable solely from and secured by specific revenues and funds as described in the indenture. All of the outstanding bonds are taxable.

** These bonds are classified as subordinate bonds and all other bonds reported have payment and certain other priorities over these bonds.

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Issue	Original Issue Date	Average Interest Rate from Issuance Date to Current	Maturity Date	Interest Due Status	Variable Rate Basis	June 30, 2011
2005 Senior Series B	5/26/2005	2.65%	6/20/2030	Quarterly	3 month LIBOR + 12 basis points	$ 98,578,000
2006 Senior Series A	5/3/2006	2.52%	3/20/2024	Quarterly	3 month LIBOR + 10 basis points	136,408,000
2006 Subordinate Series C	5/3/2006	2.09%	12/20/2044	monthly	1 month LIBOR + 120 basis points	18,000,000
2012 Senior Series A1	5/4/2012	0.89%	9/20/2022	monthly	1 month LIBOR + 60 basis points	185,396,000
2012 Senior Series A-2	5/4/2012	1.29%	5/20/2030	monthly	1 month LIBOR + 100 basis points	649,000,000
2012 Senior Series A-3	5/4/2012	1.34%	7/20/2043	monthly	1 month LIBOR + 105 basis points	305,300,000
2012 Subordinate Series B-1	5/4/2012	1.49%	12/20/2044	monthly	1 month LIBOR + 120 basis points	19,500,000
						$ 1,412,182,000

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Additional Information on Series 2005 – 2006 Bonds:

2005 Series B Student Loan Revenue Bonds

The 2005 Series B Bonds have targeted principal balance reduction schedules as follows:

2005 B Senior Bonds

Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount	Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount
September 20, 2012	$3,906,000	December 20, 2016	$2,850,000
December 20, 2012	3,849,000	March 20, 2017	2,818,000
March 20, 2013	3,788,000	June 20, 2017	2,776,000
June 20, 2013	3,715,000	September 20, 2017	2,731,000
September 20, 2013	3,666,000	December 20, 2017	2,699,000
December 20, 2013	3,623,000	March 20, 2018	2,670,000
March 20, 2014	3,577,000	June 20, 2018	2,640,000
June 20, 2014	3,503,000	September 20, 2018	2,610,000
September 20, 2014	3,416,000	December 20, 2018	2,580,000
December 20, 2014	3,374,000	March 20, 2019	2,551,000
March 20, 2015	3,335,000	June 20, 2019	2,523,000
June 20, 2015	3,089,000	September 20, 2019	2,494,000
September 20, 2015	3,029,000	December 20, 2019	2,465,000
December 20, 2015	2,989,000	March 20, 2020	2,437,000
March 20, 2016	2,954,000	June 20, 2020	2,345,000
June 20, 2016	2,919,000	September 20, 2020	1,773,000
September 20, 2016	2,884,000		

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Additional Information on Series 2005 – 2006 Bonds (Continued):

2006 Series A Student Loan Revenue Bonds

The 2006 Series A Bonds have a targeted principal balance reduction schedule as follows:

2006 A Senior Bonds

Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount	Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount
September 20, 2012	$6,682,000	June 20, 2015	$7,043,000
December 20, 2012	6,839,000	September 20, 2015	6,910,000
March 20, 2013	6,893,000	December 20, 2015	6,934,000
June 20, 2013	6,890,000	March 20, 2016	6,809,000
September 20, 2013	6,846,000	June 20, 2016	6,639,000
December 20, 2013	6,969,000	September 20, 2016	6,228,000
March 20, 2014	6,967,000	December 20, 2016	6,166,000
June 20, 2014	6,966,000	March 20, 2017	6,005,000
September 20, 2014	6,923,000	June 20, 2017	5,672,000
December 20, 2014	6,990,000	September 20, 2017	2,109,000
March 20, 2015	6,928,000		

Additional Information on Series 2012 Bonds:

The 2012 Series A1, A2, A3 and B1 Student Loan Revenue Bonds, issued May 4, 2012, were taxable issues with the proceeds used to purchase loans from the other financings to provide funds to retire all outstanding bond issues of the indenture except the 2005 Series B,the 2006 Series A bonds, and a portion of the 2006 Series C bonds as well as to purchase an external loan portfolio. See Redemptions section below for details. The Series 2012-A2 and Series 2012-A3 were issued at a discount of $8,701,565 and $22,924,281, respectively.

In addition to the proceeds from the issuance of bonds, the debt restructure resulted in the recognition of $56,002,973 of revenue related to assets placed in escrow and investments in order to assure that the Corporation will have sufficient funds to pay servicing and management fees over the life of the indenture as well as consideration for completion of the restructuring.

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Additional Information on Series 2012 Bonds (Continued):
The General Fund owns $19,500,000 of the 2012 series subordinate bonds as an investment and this amount is eliminated from the consolidated financial statements.

Series 2012 -A1 Student Loan Revenue Bonds
The Series 2012-A1 Bonds have a targeted principal balance reduction schedule as follows:

Series 2012-A1 Senior Bonds

Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount	Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount
July 20, 2012	$25,915,555	December 20, 2012	$16,031,969
August 20, 2012	25,815,006	January 20, 2013	26,063,060
September 20, 2012	17,839,721	February 20, 2013	21,870,224
October 20, 2012	27,603,898	March 20, 2013	1,418,028
November 20, 2012	22,838,539		

The targeted principal reduction amount for the Series 2012 A-1 Bonds was not fully met for June 20, 2012. The anticipated principal reduction amount for July 20, 2012 includes $10,155,777 in carry over principal reduction.

Series 2012 –A2 Student Loan Revenue Bonds
The Series 2012-A2 Bonds have a targeted principal balance reduction schedule as follows:

Series 2012-A2 Senior Bonds

Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount	Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount
March 20, 2013	$13,894,382	March 20, 2015	$ 7,264,774
April 20, 2013	25,860,162	April 20, 2015	17,047,574
May 20, 2013	21,705,459	May 20, 2015	13,853,049
June 20, 2013	14,888,938	June 20, 2015	6,401,435
July 20, 2013	24,690,935	July 20, 2015	15,928,181
August 20, 2013	20,241,019	August 20, 2015	12,977,371

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Series 2012 –A2 Student Loan Revenue Bonds (Continued)

Series 2012-A2 Senior Bonds (Continued)

Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount	Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount
September 20, 2013	$ 13,384,513	September 20, 2015	$ 5,385,060
October 20, 2013	23,347,332	October 20, 2015	14,970,456
November 20, 2013	19,201,629	November 20, 2015	12,239,865
December 20, 2013	12,107,042	December 20, 2015	4,603,386
January 20, 2014	22,031,852	January 20, 2016	14,067,230
February 20, 2014	19,008,051	February 20, 2016	11,544,513
March 20, 2014	11,791,352	March 20, 2016	3,942,792
April 20, 2014	21,838,284	April 20, 2016	13,233,845
May 20, 2014	17,943,750	May 20, 2016	10,840,479
June 20, 2014	10,850,583	June 20, 2016	3,587,267
July 20, 2014	20,535,721	July 20, 2016	12,411,469
August 20, 2014	16,773,531	August 20, 2016	10,202,210
September 20, 2014	9,587,644	September 20, 2016	2,899,013
October 20, 2014	19,353,450	October 20, 2016	11,648,115
November 20, 2014	15,842,406	November 20, 2014	9,609,716
December 20, 2014	8,497,837	December 20, 2016	2,349,795
January 20, 2015	18,208,800	January 20, 2017	10,933,296
February 20, 2015	14,827,625	February 20, 2017	4,646,812

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Series 2012 –A3 Student Loan Revenue Bonds

The Series 2012-A3 Bonds have a targeted principal balance reduction schedule as follows:

Series 2012-A3 Senior Bonds

Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount	Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount
February 20, 2017	$ 4,420,655	March 20, 2019	$ 3,638,337
March 20, 2017	2,031,967	April 20, 2019	6,030,601
April 20, 2017	10,260,336	May 20, 2019	5,083,170
May 20, 2017	8,467,935	June 20, 2019	3,247,277
June 20, 2017	4,960,051	July 20, 2019	5,501,777
July 20, 2017	9,574,988	August 20, 2019	4,656,822
August 20, 2017	7,903,171	September 20, 2019	2,787,011
September 20, 2017	6,447,112	October 20, 2019	5,090,526
October 20, 2017	8,926,668	November 20, 2019	4,332,478
November 20, 2017	7,431,253	December 20, 2019	2,405,662
December 20, 2017	5,880,390	January 20, 2020	4,732,617
January 20, 2018	8,370,507	February 20, 2020	4,050,268
February 20, 2018	6,999,771	March 20, 2020	2,182,795
March 20, 2018	5,369,596	April 20, 2020	4,430,949
April 20, 2018	7,847,358	May 20, 2020	3,793,029
May 20, 2018	6,558,695	June 20, 2020	2,464,205
June 20, 2018	4,907,581	July 20, 2020	4,137,556
July 20, 2018	7,347,293	August 20, 2020	3,561,109
August 20, 2018	6,169,118	September 20, 2020	3,959,934
September 20, 2018	4,466,081	October 20, 2020	3,867,935
October 20, 2018	6,884,938	November 20, 2020	3,345,148
November 20, 2018	5,807,462	December 20, 2020	3,694,038
December 20, 2018	4,041,085	January 20, 2021	3,605,591
January 20, 2019	6,447,586	February 20, 2021	3,134,857
February 20, 2019	5,463,939		

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Additional Information on Series 2012 Bonds (Continued):

Series 2012-A3 Senior Bonds (Continued)

Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount	Anticipated Principal Reduction Date	Anticipated Principal Reduction Amount
March 20, 2021	$3,401,402	January 20, 2022	$2,468,867
April 20, 2021	3,320,162	February 20, 2022	2,162,661
May 20, 2021	2,768,533	March 20, 2022	2,356,852
June 20, 2021	3,047,140	April 20, 2022	2,302,981
July 20, 2021	2,965,778	May 20, 2022	2,018,126
August 20, 2021	2,517,167	June 20, 2022	2,182,983
September 20, 2021	2,770,358	July 20, 2022	2,131,166
October 20, 2021	2,677,134	August 20, 2022	1,869,680
November 20, 2021	2,331,823	September 20, 2022	2,011,468
December 20, 2021	2,545,363	October 20, 2022	731,128

Acquisition and Retirements:

During the year ended June 30, 2012, the Corporation had targeted payments, scheduled redemptions and extinguishment of student loan revenue bonds. These redemptions are summarized in the tables below:

Scheduled Redemptions:

Bond Series	*Redemption Date*	*Redemption Amount*
2005 Series B	09/20/2011	$ 4,180,000
2006 Series A	09/20/2011	3,700,000
2005 Series B	12/20/2011	4,114,000
2006 Series A	12/20/2011	3,611,000
1998 Series A	12/20/2011	670,000
1999 Series B	12/20/2011	295,000
2005 Series B	03/20/2012	4,038,000
2006 Series A	03/20/2011	3,425,000
2005 Series B	06/20/2012	3,970,000
2006 Series A	06/20/2012	39,465,000
2012 Series A1	06/20/2012	5,604,000

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Other Redemptions:
On May 4, 2012, the Corporation refunded or purchased and retired the 1995, 1998, 1999, 2000, 2001, 2002, 2003, and 2004 Tax Exempt Bonds in their entirety; the 2006 Series D, E and F Tax Exempt Bonds; 2000, 2001, 2002, and 2003 Taxable Bonds in their entirety; and 2006 Series B and a portion of the 2006 Series C Taxable Bonds. The funds used for the redemption were obtained from proceeds of the issuance of the Series 2012 refunding bonds. The Corporation refunded or retired bonds with an aggregate principal balance of $936,390,000.

Bond Redemptions by Acquisition and Retirement:

Bond Series	Acquisition Date	Par Value	Purchase Price	Gain
2004 Series B	08/02/2011	$ 6,000,000	$ 5,520,000	$ 480,000
2000 Series A	08/02/2011	12,500,000	11,500,000	1,000,000
1995 Series B	11/16/2011	10,000,000	9,400,000	600,000
1999 Series A	11/16/2011	17,000,000	15,980,000	1,020,000
2000 Series B	11/16/2011	25,500,000	23,970,000	1,530,000
2003 Series A	11/18/2011	1,100,000	1,023,000	77,000
2000 Series A	11/29/2011	3,000,000	2,797,500	202,500
2004 Series A	11/30/2011	10,000,000	9,300,000	700,000
2006 Series F	12/7/2011	10,000,000	9,250,000	750,000
2002 Series A	12/9/2011	1,100,000	1,012,000	88,000
2003 Series B	12/9/2011	9,900,000	9,108,000	792,000
1995 Series A	12/9/2011	8,600,000	7,933,500	666,500
2001 Series A	12/9/2011	15,000,000	13,837,500	1,162,500
2003 Series B	12/9/2011	4,200,000	3,874,500	325,500
2004 Series A	12/9/2011	16,800,000	15,498,000	1,302,000
2004 Series B	3/23/2012	4,200,000	3,822,000	378,000
2003 Series A	3/23/2012	2,400,000	2,184,000	216,000
1999 Series A	3/23/2012	3,000,000	2,730,000	270,000
2006 Series E	3/23/2012	3,700,000	3,367,000	333,000
2003 Series A	3/28/2012	1,500,000	1,380,000	120,000
2002 Series E	5/4/2012	15,000,000	13,593,317	1,406,683
2006 Series C	5/4/2012	12,000,000	10,874,653	1,125,347
2006 Series G	5/4/2012	20,000,000	18,124,422	1,875,578
2004 Series C	5/4/2012	12,000,000	10,874,653	1,125,347
2003 Series D	5/4/2012	10,000,000	9,062,211	937,789

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Summary of Maturities:
The following is a summary of stated maturities on long-term debt. Interest is calculated using the average bond interest rate since bond issuance dates:

Year Ending June 30	Revenue Bonds Payable	Interest	Total
2013	$ 304,306,943	$ 20,713,715	$ 325,020,658
2014	258,553,349	20,713,715	279,267,064
2015	209,291,846	20,713,715	230,005,561
2016	162,503,440	20,713,715	183,217,155
2017	130,240,366	20,713,715	150,954,081
2018-2022	303,042,610	103,568,576	406,611,186
2023-2027	6,743,446	90,079,453	96,822,899
2028-2032	-	67,148,729	67,148,729
2033-2037	-	23,248,850	23,248,850
2038-2044	37,500,000	31,708,403	69,208,403
Total	$1,412,182,000	$419,322,586	$ 1,831,504,586

Compliance:
The bond indenture contains several covenants. These covenants include minimum reserve requirements, restrictions and limitations related to administrative expenses and requirements for the purchase of educational loans. The Corporation is substantially in compliance with the covenants of the bond indenture outstanding at June 30, 2012.

Bond Ratings:
On September 28, 2010, MHESAC was notified that Fitch Ratings, one of the three rating agencies that issue ratings on MHESAC bonds, lowered its rating of all subordinate bonds from A/LS3 to B/LS3, with a stable outlook. At that time, Fitch again affirmed the AAA rating of all senior bonds. The impact of the ratings action was a change in the mechanism for calculating the periodic interest rate on the subordinate bonds resulting in higher interest. As of June 30, 2012 all outstanding MHESAC Senior bonds are rated AAA by Fitch Ratings and are rated AA+ by Standard & Poor’s Ratings Services. The 2005B and 2006A bonds are also rated Aaa by Moody’s. The outstanding subordinate bonds are unrated.

NOTE 5. EDUCATIONAL LOAN REVENUE BONDS PAYABLE (CONTINUED)

Auction Rate Bond Provisions for Illiquid Auctions:
In the event of a bond auction being illiquid, there is a provision in the Indenture that states the interest rate for tax-exempt auction bonds shall be equal to the Maximum Auction Rate and the interest rate for taxable auction bonds will be the lesser of the Net Loan Rate or the Maximum Auction Rate. During the fiscal year ending June 30, 2008 this provision went into effect due to Auction liquidity issues. Since June 30, 2008, all auction bonds have continued to be illiquid on each auction date except the 2006C bond series. During the fiscal year ended June 30, 2012 there were no successful auctions before all auction rate bonds were fully redeemed. As of May 4, 2012, all auction bonds had been refunded or retired.

The Maximum Auction Rate for the tax-exempt auction bond series is determined by terms specified in the Indenture that consider Bond ratings, the Composite Commercial Paper rate, the SIFMA Index and the Statutory Corporate Tax Rate. The indenture provides specific calculation methodologies that use combinations of the above mentioned criteria to determine the interest rate for the 35 day auction period.

Per Indenture terms, the taxable auction bond series are subject to an interest rate limitation of the lesser of the Net Loan Rate or the Maximum Auction Rate. Net Loan Rate is determined by specific indenture calculation methodologies that use a combination of average 91-day T-bills and Auction rates to determine the interest rate for the 7 or 28 day auction period. Maximum Auction Rate, for the taxable bond series, is calculated based on One-Month LIBOR plus a percentage based on the bond rating.

When the interest rate limitation is the Net Loan Rate, a Carry-Over Amount is calculated accruing the difference between the amount of interest paid using the Net Loan Rate and the amount of interest due if the taxable Maximum Auction Rate was used. The Carry-Over Amount is payable subject to terms in the Indenture and will bear interest calculated using One-Month LIBOR. Per Indenture terms, when the net loan rate exceeds the auction rate the issuer is required to pay down the prior accrued Carry-Over subject to Surplus fund availability. Surplus funds were not available during the year ended June 30, 2011. At June 30, 2011 the Corporation’s Carry-Over liability was $5,031,057 and was included in the financial statements as a long term liability. Due to the financing restructure during fiscal year 2012, the Corporation’s Carry-Over liability was eliminated when the bonds were refunded or retired.

NOTE 6. CONTINGENT EXCESS INTEREST LIABILITIES

Excess Interest:
Internal Revenue Service regulations require that tax exempt bond issuers rebate educational loan earnings that exceed specified limits. Such excess earnings may be rebated to the U.S. Treasury or to educational loan borrowers. Limits vary depending on the bond issue date. For bonds issued prior to July 1, 1993, such excess earnings are determined annually with 50% of the cumulative excess payable within sixty (60) days of the tenth anniversary date of the bond issuance. Within sixty (60) days after every subsequent fifth anniversary of the issuance date, 75% of the cumulative excess is payable and within sixty (60) days after final retirement of the bond issue, 100% of the cumulative excess is payable.

For all other bonds, such excess earnings are determined annually and 75% of the cumulative excess is payable within sixty (60) days of the tenth anniversary date of bond issuance and every subsequent fifth anniversary date with 100% payable within sixty (60) days after final retirement of the bond issue. At June 30, 2011, the Corporation's excess interest liability was $577,247. At June 30, 2012 the Corporation's excess interest liability was eliminated when all tax exempt debt was retired.

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS

The Corporation follows the guidance established for measuring fair value under GAAP and related disclosure requirements. As such fair value is considered the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants on the measurement date in the principal or most advantageous market for the specific asset or liability.

Fair value measurement assumes the highest and best use of the asset by market participants and requires valuation techniques that maximize use of observable inputs and minimize the use of unobservable inputs. The fair value hierarchy prioritizes valuation inputs into three broad levels:

Level 1 – Quoted prices in active markets for identical assets or liabilities;

Level 2 – Significant observable inputs other than Level 1 such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active, or inputs other than quoted prices that are observable or can be corroborated by observable market data. This level input must be observable for substantially the full term of the assets or liabilities;

Level 3 – Significant unobservable inputs for situations in which there is little, if any, market activity.

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

The following are the assets and liabilities measured on a recurring basis as of and for the year ended June 30, 2012 and 2011. There were no transfers between Levels 1, 2 or 3 in 2012 or 2011.

Financial Instrument	Carrying Value	Fair Value	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2012:				
Assets:				
Investment Securities				
Federal Home Loan Bank Notes	$ 599,843	$ 599,843	$ 599,843	$ -

Financial Instrument	Carrying Value	Fair Value	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
2011:				
Assets:				
Investment Securities				
Federal Home Loan Bank Notes	$ 630,399	$ 630,399	$ 630,399	$ -
Freddie Mac	340,833	340,833	340,833	-
Federal Home Loan Mortgage Corp	2,130,348	2,130,348	2,130,348	-
Guaranteed Investment Contracts	119,135,900	119,135,900	-	119,135,900
	$ 122,237,480	$ 122,237,480	$ 3,101,580	$ 119,135,900

The following valuation methods are used to determine the fair value of the above items on a recurring basis, which did not change in 2012.

Investment Securities and Contracts:
Fair value for securities and balances of investment contracts are based on market prices provided by the Bond Trustee managing the investments or the contract provider (market approach).

Following is a reconciliation of beginning and ending values for Level 3 items, consisting of guaranteed investment contracts:

	2012	2011
Fair Value at July 1	**$ 119,135,900**	$ 26,378,449
Receipts/Inflows	**136,479,521**	209,148,549
Payments/Outflows	**(255,615,421)**	(116,391,098)
Fair Value at June 30	**$ -**	$ 119,135,900

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

GAAP also requires disclosure of estimated fair values for other financial instruments recognized at amounts other than fair value and the methods used to determine those values:

	2012		2011	
Financial assets:	**Carrying Amount**	**Fair Value**	Carrying Amount	Fair Value
Cash and cash equivalents	**$ 48,483,138**	**$ 48,483,138**	$ 11,614,614	$ 11,614,614
Interest receivable	**19,042,518**	**19,042,518**	20,506,303	20,506,303
Real estate loan receivable	**-**	**-**	1,883,706	1,883,706
Educational loans receivable, net	**1,406,162,357**	**1,354,874,817**	1,362,390,211	1,299,100,874
Total financial assets	**$ 1,473,688,013**	**$ 1,422,400,473**	$ 1,396,394,834	$ 1,333,105,497
Financial liabilities:				
Interest payable	**$ 472,325**	**$ 472,325**	$ 5,563,797	$ 5,563,797
Educational bonds payable	**1,380,963,468**	**1,354,530,226**	1,491,344,000	1,361,299,408
	$ 1,381,435,793	**$ 1,355,002,551**	$ 1,496,907,797	$ 1,366,863,205

The following is a description of the methods used to estimate the above fair values:

Cash and Cash Equivalents:
The carrying amount for cash and cash equivalents is considered to approximate fair value at June 30, 2012.

Interest Receivable and Payable:
The carrying amounts of interest receivable and payable are considered to approximate fair value at June 30, 2012 and 2011, given their short-term nature.

Educational Loans Receivable:
The fair value was estimated by reference to sale information from the limited marketplace and by discounting the future cash flows using current rates of return on similar assets (market approach). A number of significant inputs into the models are internally derived and not observable to market participants. External verification of cash flow values for a recent loan portfolio acquisition supports the inputs and methodology of this valuation.

NOTE 7. FAIR VALUE OF FINANCIAL INSTRUMENTS (CONTINUED)

Educational Bonds Payable:
The Corporation's subordinate bonds consist of floating rate debt at June 30, 2012. The estimated fair value of bonds was determined by discounting the cash flows using current market rates (income approach). The fair value of floating rate senior educational loan revenue bonds is based on the brokered market for those bonds at June 30, 2012 (market approach).

NOTE 8. COMMITMENTS AND CONTINGENCIES

Management and Servicing Agreements:
MHESAC has entered into management and servicing agreements with Student Assistance Foundation of Montana (SAF). SAF will provide portfolio servicing for a term equal to the life of each of MHESAC's related financings. Management services will be provided to MHESAC for an 18-year term beginning February 1, 2000. The cost of these services will be an amount equal to the allocable cost incurred by SAF in performing its duties and obligations under the agreements plus, for the period prior to February 1, 2003, fifteen percent of those costs.

For each successive three-year period the mark-up percentage of such costs will be mutually agreed upon by MHESAC and SAF, but in no event will it be less than five percent. For the three year period beginning July 1, 2009, MHESAC and SAF agreed to continue the mark-up percentage at fifteen percent along with an efficiency incentive to provide a cost savings sharing opportunity.

By contract, the fees are payable in advance for each month. Therefore, an estimate is made of anticipated cost levels and SAF bills MHESAC on that basis with a final adjustment to the advance billing based on actual expenses incurred. During the years ended June 30, 2012 and 2011, SAF billed MHESAC $12,756,583 and $13,370,225, respectively. At June 30, 2012 and 2011 the reconciliation for billed and actual costs resulted in a balance payable to SAF of $21,103 and $115,483, respectively. These balances are included in 2012 and 2011 accounts payable balances.

Supplemental Indenture:
As part of the Nineteenth Supplemental Indenture of Trust executed on July 15, 2011, the indenture trustee was appointed as back-up administrator of MHESAC in the event Student Assistance Foundation of Montana (SAF) is unable to perform its administrative duties. As back-up administrator the trustee will be entitled to a back-up administrator fee. SAF remains the trust administrator and servicer.

NOTE 9. SUBSEQUENT EVENTS

Contingent Arbitrage Rebate Liability

On July 25, 2012 MHESAC paid $2,020,093 to the Internal Revenue Service as payment in total of the corporation's contingent arbitrage rebate liability. See Note 1 Contingent Arbitrage Rebate Liability for additional details on this payment.

Management has evaluated subsequent events through September 13, 2012, the date which the financial statements were available for issue and did not identify any further events to disclose.

A C C O M P A N Y I N G   I N F O R M A T I O N

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INDEPENDENT AUDITOR'S REPORT ON SUPPLEMENTARY INFORMATION

To the Board of Directors
of Montana Higher Education
Student Assistance Corporation
Helena, Montana

We have audited the financial statements of Montana Higher Education Student Assistance Corporation as of and for the year ended June 30, 2012, and have issued our report thereon dated September 13, 2012, which contained an unqualified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The combining schedule of assets, liabilities, and fund net assets under restricted bond indentures and the combining schedule of revenue, expense, and changes in fund net assets under restricted bond indentures are presented for purposes of additional analysis and are not a required part of the financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Anderson ZurMuehlen & Co., P.C.

Helena, Montana
September 13, 2012

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
COMBINING SCHEDULE OF ASSETS, LIABILITIES AND FUND NET ASSETS
UNDER RESTRICTED BOND INDENTURES
June 30, 2012
(expressed in thousands)

	1995 REVENUE BONDS	1998 REVENUE BONDS	1999 REVENUE BONDS	2000 REVENUE BONDS	2001 REVENUE BONDS	2002 REVENUE BONDS	2003 REVENUE BONDS	2004 REVENUE BONDS	2005 REVENUE BONDS	2006-1 REVENUE BONDS	2006-2 REVENUE BONDS	2007 REVENUE BONDS	2012 REVENUE BONDS	GRAND TOTAL
ASSETS														
Cash and cash equivalents	$ -	$ -	$ -	$ 2,016	$ -	$ -	$ -	$ -	$ 4,392	$ 7,226	$ -	$ -	$ 27,908	$ 41,542
Educational loans receivable, net	-	-	-	-	-	-	-	-	150,228	184,890	-	-	1,031,241	1,366,359
Accrued interest receivable	-	-	-	-	-	-	-	-	882	1,107	-	-	16,584	18,573
Inter-fund Activity	-	-	-	-	-	-	-	-	(29,983)	(12,101)	-	-	42,084	-
Due From Other Funds	-	-	-	4	-	-	-	-	-	-	-	-	-	4
Other assets	-	-	-	-	-	-	-	-	30	29	-	-	1,154	1,213
Total assets	$ -	$ -	$ -	$ 2,020	$ -	$ -	$ -	$ -	$ 125,549	$ 181,151	$ -	$ -	$ 1,118,971	$ 1,427,691
LIABILITIES AND FUND NET ASSETS														
LIABILITIES														
Accounts payable and accrued expenses	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 135	$ 186	$ -	$ -	5,629	$ 5,950
Accrued interest payable	-	-	-	-	-	-	-	-	18	31	-	-	424	473
Contingent arbitrage rebate liability	-	-	-	2,020	-	-	-	-	-	-	-	-	-	2,020
Educational loan revenue bonds payable	-	-	-	-	-	-	-	-	98,578	154,408	-	-	1,127,977	1,380,963
Total liabilities	-	-	-	2,020	-	-	-	-	98,731	154,625	-	-	1,134,030	1,389,406
FUND NET ASSETS														
Restricted net assets (deficit)	-	-	-	-	-	-	-	-	26,818	26,526	-	-	(15,059)	38,285
Total liabilities and net assets	$ -	$ -	$ -	$ 2,020	$ -	$ -	$ -	$ -	$ 125,549	$ 181,151	$ -	$ -	$ 1,118,971	$ 1,427,691

See Independent Auditor's Report on Accompanying Information.

MONTANA HIGHER EDUCATION STUDENT ASSISTANCE CORPORATION
COMBINING SCHEDULE OF REVENUE, EXPENSE AND CHANGE IN FUND NET ASSETS UNDER RESTRICTED BOND INDENTURES
June 30, 2012
(expressed in thousands)

	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	REVENUE BONDS	GRAND TOTAL
REVENUE														
Interest income on investments and cash equivalents	$ 9	$ 197	$ 190	$ 140	$ 55	$ 15	$ 82	$ 19	$ 6	$ 3	$ 11	$ -	$ 1	$ 728
Interest on educational loans	1,725	2,524	2,996	2,806	3,537	2,333	3,627	3,353	5,243	6,403	3,836	571	4,648	43,602
Gain on bond repurchase	1,267	-	1,290	2,733	1,163	1,495	2,468	3,985	-	1,125	2,959	-	-	18,485
	3,001	2,721	4,476	5,679	4,755	3,843	6,177	7,357	5,249	7,531	6,806	571	4,649	62,815
EXPENSE														
Bond and note interest	157	1,305	1,161	(92)	(373)	3	(15)	260	584	(2,039)	460	-	2,768	4,179
Auction agent/broker fees	37	33	31	41	53	53	79	60	-	36	100	-	-	523
Bond fees	19	16	15	20	27	25	33	24	20	42	39	-	36	316
Loan fees	410	451	499	620	707	419	702	601	1,647	2,160	458	-	1,226	9,900
Contracted management fees	102	163	155	163	179	158	255	267	147	198	362	64	18	2,231
Contracted loan servicing fees	417	666	635	672	740	652	1,047	1,092	827	1,103	1,479	263	515	10,108
	1,142	2,634	2,496	1,424	1,333	1,310	2,101	2,304	3,225	1,500	2,898	327	4,563	27,257
Excess (deficiency) of revenue over expense before other changes and bond issuance costs	1,859	87	1,980	4,255	3,422	2,533	4,076	5,053	2,024	6,031	3,908	244	86	35,558
Other Revenue (Expense)														
Arbitrage rebate	2,522	(79)	(78)	(140)	(27)	-	-	-	-	-	11	-	-	2,209
Excess interest rebate	(8)	(17)	(19)	(5)	437	110	(57)	(50)	-	-	(94)	(17)	-	280
Excess of revenue over expense before transfers	4,373	(9)	1,883	4,110	3,832	2,643	4,019	5,003	2,024	6,031	3,825	227	86	38,047
Transfers from other funds	(12,219)	(3,466)	(4,459)	(6,064)	(6,848)	(2,932)	4,693	3,482	16,985	18,805	2,738	4,434	(15,145)	4
Excess (deficiency) of revenue over expense	(7,846)	(3,475)	(2,576)	(1,954)	(3,016)	(289)	8,712	8,485	19,009	24,836	6,563	4,661	(15,059)	38,051
FUND NET ASSETS (DEFICIT) BEGINNING OF YEAR	$ 7,846	$ 3,475	$ 2,576	$ 1,954	$ 3,016	$ 289	$ (8,712)	$ (8,485)	$ 7,809	$ 1,690	$ (6,563)	$ (4,661)	$ -	$ 234
FUND NET ASSETS (DEFICIT), END OF YEAR	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ -	$ 26,818	$ 26,526	$ -	$ -	$ (15,059)	$ 38,285

See Independent Auditor’s Report on Accompanying Information.