EPLUS INC
Form 10-Q
May 05, 2008

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

T QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended December 31, 2007

OR

£ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from____ to ____ .

Commission file number: 0-28926

ePlus inc.

(Exact name of registrant as specified in its charter)

Delaware	54-1817218
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

13595 Dulles Technology Drive, Herndon, VA 20171-3413
(Address, including zip code, of principal executive offices)

Registrant's telephone number, including area code: (703) 984-8400

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.
Yes T No £

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer”, “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer £	Accelerated filer £
Non-accelerated filer £ (Do not check if a smaller reporting company)	Smaller reporting company T

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes £ No T

The number of shares of common stock outstanding as of April 30, 2008 was 8,231,741.

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ePlus inc. AND SUBSIDIARIES

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Cautionary Language About Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain statements that are, or may be deemed to be, "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, and are made in reliance upon the protections provided by such acts for forward-looking statements. Such statements are not based on historical fact, but are based upon numerous assumptions about future conditions that may not occur. Forward-looking statements are generally identifiable by use of forward-looking words such as "may," "will," "should," "intend," "estimate," "believe," "expect," "anticipate," "project" an expressions. Readers are cautioned not to place undue reliance on any forward-looking statements made by us or on our behalf. Any such statement speaks only as of the date the statement was made. We do not undertake any obligation to publicly update or correct any forward-looking statements to reflect events or circumstances that subsequently occur, or of which we hereafter become aware. Actual events, transactions and results may materially differ from the anticipated events, transactions or results described in such statements. Our ability to consummate such transactions and achieve such events or results is subject to certain risks and uncertainties. Such risks and uncertainties include, but are not limited to, the matters set forth below.

Although we have been offering IT financing since 1990 and direct marketing of IT products since 1997, our comprehensive set of solutions—the bundling of our direct IT sales, professional services and financing with our proprietary software—has been available since 2002. Consequently, we may encounter some of the challenges, risks, difficulties and uncertainties frequently faced by companies providing new and/or bundled solutions in an evolving market. Some of these challenges relate to our ability to:

- manage a diverse product set of solutions in highly-competitive markets;
- increase the total number of customers utilizing bundled solutions by up-selling within our customer base and gain new customers;
- adapt to meet changes in markets and competitive developments;
- maintain and increase advanced professional services by retaining highly-skilled personnel and vendor certifications;
- integrate with external IT systems including those of our customers and vendors; and
- continue to update our software and technology to enhance the features and functionality of our products.

We cannot be certain that our business strategy will be successful or that we will successfully address these and other challenges, risks and uncertainties. For a further list and description of various risks, relevant factors and uncertainties that could cause future results or events to differ materially from those expressed or implied in our forward-looking statements, see the "Risk Factors" and "Results of Operations" sections contained elsewhere in this document, as well as our Annual Report on Form 10-K for the fiscal year ended March 31, 2007, any subsequent Reports on Form 10-Q and Form 8-K and other filings with the SEC.

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

	As of December 31, 2007	As of March 31, 2007
ASSETS	(in thousands)	
Cash and cash equivalents	$ 65,590	$ 39,680
Accounts receivable—net	108,457	110,662
Notes receivable	186	237
Inventories	8,717	6,851
Investment in leases and leased equipment—net	161,074	217,170
Property and equipment—net	5,007	5,529
Other assets	15,011	11,876
Goodwill	26,125	26,125
TOTAL ASSETS	$ 390,167	$ 418,130
LIABILITIES AND STOCKHOLDERS' EQUITY		
LIABILITIES		
Accounts payable—equipment	$ 6,482	$ 6,547
Accounts payable—trade	26,980	21,779
Accounts payable—floor plan	51,618	55,470
Salaries and commissions payable	4,491	4,331
Accrued expenses and other liabilities	26,674	25,960
Income taxes payable	3,531	-
Recourse notes payable	-	5,000
Non-recourse notes payable	104,741	148,136
Deferred tax liability	4,457	4,708
Total Liabilities	228,974	271,931
COMMITMENTS AND CONTINGENCIES (Note 6)		
STOCKHOLDERS' EQUITY		
Preferred stock, $.01 par value; 2,000,000 shares authorized; none issued or outstanding	-	-
Common stock, $.01 par value; 25,000,000 shares authorized; 11,210,731 issued and 8,231,741 outstanding at December 31, 2007 and 11,210,731 issued and 8,231,741 outstanding at March 31, 2007	112	112
Additional paid-in capital	77,471	75,909
Treasury stock, at cost, 2,978,990 and 2,978,990 shares, respectively	(32,884)	(32,884)
Retained earnings	115,878	102,754
Accumulated other comprehensive income—foreign currency translation adjustment	616	308
Total Stockholders' Equity	161,193	146,199

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 390,167	$ 418,130

See Notes to Unaudited Condensed Consolidated Financial Statements.

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ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

	Three Months Ended December 31, 2007	Three Months Ended December 31, 2006	Nine Months Ended December 31, 2007	Nine Months Ended December 31, 2006
	(amounts in thousands, except per share data)			
Sales of product and services	$ 168,394	$ 183,277	$ 564,628	$ 538,923
Sales of leased equipment	13,740	2,557	40,544	4,376
	182,134	185,834	605,172	543,299
Lease revenues	12,194	16,000	43,810	40,853
Fee and other income	4,111	3,544	13,124	9,484
Patent settlement income	-	17,500	-	17,500
	16,305	37,044	56,934	67,837
TOTAL REVENUES	198,439	222,878	662,106	611,136
COSTS AND EXPENSES				
Cost of sales, product and services	148,802	161,254	500,202	477,879
Cost of leased equipment	13,308	2,509	38,919	4,284
	162,110	163,763	539,121	482,163
Direct lease costs	4,460	5,574	16,353	16,170
Professional and other fees	2,479	7,245	9,650	13,295
Salaries and benefits	17,069	17,947	53,971	52,912
General and administrative expenses	3,760	4,050	12,135	12,921
Interest and financing costs	1,818	2,839	6,590	7,492
	29,586	37,655	98,699	102,790
TOTAL COSTS AND EXPENSES (1) (2)	191,696	201,418	637,820	584,953
EARNINGS BEFORE PROVISION FOR INCOME TAXES	6,743	21,460	24,286	26,183
PROVISION FOR INCOME TAXES	2,992	9,056	10,671	10,737
NET EARNINGS	$ 3,751	$ 12,404	$ 13,615	$ 15,446
NET EARNINGS PER COMMON SHARE—BASIC	$ 0.45	$ 1.51	$ 1.65	$ 1.88
NET EARNINGS PER COMMON SHARE—DILUTED	$ 0.45	$ 1.47	$ 1.63	$ 1.80
WEIGHTED AVERAGE SHARES OUTSTANDING—BASIC	8,231,741	8,231,741	8,231,741	8,222,700
	8,422,256	8,456,627	8,375,412	8,577,999

WEIGHTED AVERAGE SHARES
OUTSTANDING—DILUTED

(1) Includes amounts to related parties of $274 thousand and $238 thousand for the three months ended December 31, 2007 and December 31, 2006, respectively.
(2) Includes amounts to related parties of $798 thousand and $710 thousand for the nine months ended December 31, 2007 and December 31, 2006, respectively.

See Notes to Unaudited Condensed Consolidated Financial Statements.

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ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

	Nine Months Ended December 31, 2007	Nine Months Ended December 31, 2006
	(in thousands)	
Cash Flows From Operating Activities:		
Net earnings	$ 13,615	$ 15,446
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	17,161	16,153
Reserves for credit losses and sales returns	(246)	788
Provision for inventory losses	65	150
Impact of stock-based compensation	1,562	719
Excess tax benefit from exercise of stock options	-	(95)
Tax benefit of stock options exercised	-	308
Deferred taxes	(251)	-
Payments from lessees directly to lenders—operating leases	(10,754)	(8,244)
Loss on disposal of property and equipment	4	90
Loss (gain) on disposal of operating lease equipment	11,463	(600)
Excess increase in cash value of officers life insurance	(30)	(19)
Changes in:		
Accounts receivable—net	1,071	(48,784)
Notes receivable	51	65
Inventories	(1,090)	(9,219)
Investment in leases and leased equipment—net	(2,926)	(34,335)
Other assets	(2,892)	(279)
Accounts payable—equipment	797	(1,614)
Accounts payable—trade	5,233	3,709
Salaries and commissions payable, accrued expenses and other liabilities	3,912	8,763
Net cash provided by (used in) operating activities	36,745	(56,998)
Cash Flows From Investing Activities:		
Proceeds from sale of operating lease equipment	3,400	1,270
Purchases of operating lease equipment	(7,039)	(19,711)
Proceeds from sale of property and equipment	-	2
Purchases of property and equipment	(1,315)	(2,145)
Premiums paid on officers' life insurance	(238)	(219)
Net cash used in investing activities	(5,192)	(20,803)

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ePlus inc. AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - continued
(UNAUDITED)

	Nine Months Ended December 31, 2007	Nine Months Ended December 31, 2006
	(in thousands)	
Cash Flows From Financing Activities:		
Borrowings:		
Non-recourse	35,792	87,029
Repayments:		
Non-recourse	(32,891)	(19,213)
Purchase of treasury stock	-	(2,900)
Proceeds from issuance of capital stock, net of expenses	-	1,911
Excess tax benefit from exercise of stock options	-	95
Net borrowings (repayment) on floor plan facility	(3,852)	7,126
Net borrowings (repayment) on recourse lines of credit	(5,000)	4,000
Net cash provided by (used in) financing activities	(5,951)	78,048
Effect of Exchange Rate Changes on Cash	308	2
Net Increase in Cash and Cash Equivalents	25,910	249
Cash and Cash Equivalents, Beginning of Period	39,680	20,697
Cash and Cash Equivalents, End of Period	$ 65,590	$ 20,946
Supplemental Disclosures of Cash Flow Information:		
Cash paid for interest	$ 1,020	$ 1,981
Cash paid for income taxes	$ 6,692	$ 457
Schedule of Non-cash Investing and Financing Activities:		
Purchase of property and equipment included in accounts payable	$ 151	$ 67
Principal payments from lessees directly to lenders	$ 46,296	$ 36,589

See Notes To Unaudited Condensed Consolidated Financial Statements.

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ePlus inc. AND SUBSIDIARIES
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
As of and for the three and nine months ended December 31, 2007 and 2006

1. BASIS OF PRESENTATION

The Condensed Consolidated Financial Statements of ePlus inc. and subsidiaries and Notes thereto included herein are unaudited and have been prepared by us, pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") and reflect all adjustments that are, in the opinion of management, necessary for a fair statement of results for the interim periods. All adjustments made were of a normal recurring nature.

Certain information and note disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") have been condensed or omitted pursuant to SEC rules and regulations.

These interim financial statements should be read in conjunction with our Consolidated Financial Statements and Notes thereto contained in our Annual Report on Form 10-K for the year ended March 31, 2007. Operating results for the interim periods are not necessarily indicative of results for an entire year.

PRINCIPLES OF CONSOLIDATION — The Condensed Consolidated Financial Statements include the accounts of ePlus inc. and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated.

REVENUE RECOGNITION — We adhere to guidelines and principles of sales recognition described in Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition," issued by the staff of the SEC. Under SAB No. 104, sales are recognized when the title and risk of loss are passed to the customer, there is persuasive evidence of an arrangement for sale, delivery has occurred and/or services have been rendered, the sales price is fixed or determinable and collectibility is reasonably assured. Using these tests, the vast majority of our sales represent product sales recognized upon delivery.

From time to time, when selling product and services, we may enter into contracts that contain multiple elements. Sales of services currently represent less than 10% of our sales. For services that are performed in conjunction with product sales and are completed in our facilities prior to shipment of the product, sales for both the product and services are recognized upon shipment. Sales of services that are performed at customer locations are recorded as sales of product and services when the services are performed. If the service is performed at a customer location in conjunction with a product sale or other service sale, we recognize the sale in accordance with SAB No. 104 and Emerging Issues Task Force ("EITF") 00-21 "Accounting for Revenue Arrangements with Multiple Deliverables." Accordingly, in an arrangement with multiple deliverables, we recognize sales for delivered items only when all of the following criteria are satisfied:

- the delivered item(s) has value to the client on a stand-alone basis;
- there is objective and reliable evidence of the fair value of the undelivered item(s); and
- if the arrangement includes a general right of return relative to the delivered item, delivery or performance of the undelivered item(s) is considered probable and substantially in our control.

We sell certain third-party service contracts and software assurance or subscription products for which we evaluate whether the subsequent sales of such services should be recorded as gross sales or net sales in accordance with the sales recognition criteria outlined in SAB No. 104, EITF 99-19, "Reporting Revenue Gross as a Principal versus Net as an Agent" and Financial Accounting Standards Board ("FASB") Technical Bulletin 90-1, "Accounting for Separately

Priced Extended Warranty and Product Contracts." We must determine whether we act as a principal in the transaction and assume the risks and rewards of ownership or if we are simply acting as an agent or broker. Under gross sales recognition, the entire selling price is recorded in sales of product and services and our costs to the third-party service provider or vendor is recorded in cost of sales, product and services on the accompanying Condensed Consolidated Statements of Operations. Under net sales recognition, the cost to the third-party service provider or vendor is recorded as a reduction to sales resulting in net sales equal to the gross profit on the transaction and there is no cost of sales.

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In accordance with EITF 00-10, “Accounting for Shipping and Handling Fees and Costs,” we record freight billed to our customers as sales of product and services and the related freight costs as a cost of sales, product and services.

We receive payments and credits from vendors, including consideration pursuant to volume sales incentive programs, volume purchase incentive programs and shared marketing expense programs. Vendor consideration received pursuant to volume sales incentive programs is recognized as a reduction to costs of sales, product and services in accordance with EITF Issue No. 02-16, “Accounting for Consideration Received from a Vendor by a Customer (Including a Reseller of the Vendor’s Products).” Vendor consideration received pursuant to volume purchase incentive programs is allocated to inventories based on the applicable incentives from each vendor and is recorded in cost of sales, product and services, as the inventory is sold. Vendor consideration received pursuant to shared marketing expense programs is recorded as a reduction of the related selling and administrative expenses in the period the program takes place only if the consideration represents a reimbursement of specific, incremental, identifiable costs. Consideration that exceeds the specific, incremental, identifiable costs is classified as a reduction of cost of sales, product and services.

We are the lessor in a number of transactions and these transactions are accounted for in accordance with Statement of Financial Accounting Standards (“SFAS”) No. 13, “Accounting for Leases.” Each lease is classified as either a direct financing lease, sales-type lease, or operating lease, as appropriate. Under the direct financing and sales-type lease methods, we record the net investment in leases, which consists of the sum of the minimum lease payments, initial direct costs (direct financing leases only), and unguaranteed residual value (gross investment) less the unearned income. The difference between the gross investment and the cost of the leased equipment for direct finance leases is recorded as unearned income at the inception of the lease. The unearned income is amortized over the life of the lease using the interest method. Under sales-type leases, the difference between the fair value and cost of the leased property plus initial direct costs (net margins) is recorded as revenue at the inception of the lease. For operating leases, rental amounts are accrued on a straight-line basis over the lease term and are recognized as lease revenue. SFAS No. 140, “Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities,” establishes criteria for determining whether a transfer of financial assets in exchange for cash or other consideration should be accounted for as a sale or as a pledge of collateral in a secured borrowing. Certain assignments of direct finance leases we make on a non-recourse basis meet the criteria for surrender of control set forth by SFAS No. 140 and have therefore been treated as sales for financial statement purposes. We assign all rights, title, and interests in a number of our leases to third-party financial institutions without recourse. These assignments are accounted for as sales since we have completed our obligations as of the assignment date, and we retain no ownership interest in the equipment under lease.

Sales of leased equipment represent revenue from the sales of equipment subject to a lease in which we are the lessor. If the rental stream on such lease has non-recourse debt associated with it, sales revenue is recorded at the amount of consideration received, net of the amount of debt assumed by the purchaser. If there is no non-recourse debt associated with the rental stream, sales revenue is recorded at the amount of gross consideration received, and costs of sales is recorded at the book value of the lease. Sales of leased equipment represents revenue generated through the sale of equipment sold primarily through our financing business unit.

Lease revenues consist of rentals due under operating leases, amortization of unearned income on direct financing and sales-type leases and sales of leased assets to lessees. Equipment under operating leases is recorded at cost and depreciated on a straight-line basis over the lease term to estimated residual value.

Revenue from hosting arrangements is recognized in accordance with EITF 00-3, “Application of AICPA Statement of Position 97-2 to Arrangements That Include the Right to Use Software Stored on Another Entity’s Hardware.” Our hosting arrangements do not contain a contractual right to take possession of the software. Therefore, our hosting arrangements are not in the scope of Statement of Position 97-2 (“SOP 97-2”), “Software Revenue Recognition” and require that the portion of the fee allocated to the hosting elements be recognized as the service is provided. Currently, the majority of our software revenue is generated through hosting agreements and is included in fee and other income on our Condensed Consolidated Statements of Operations.

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Revenue from sales of our software is recognized in accordance with SOP 97-2, as amended by SOP 98-4, "Deferral of the Effective Date of a Provision of SOP 97-2," and SOP 98-9, "Modification of SOP 97-2 With Respect to Certain Transactions." We recognize revenue when all the following criteria exist: (1) there is persuasive evidence that an arrangement exists; (2) delivery has occurred; (3) no significant obligations by us related to services essential to the functionality of the software remain with regard to implementation; (4) the sales price is determinable; and (5) it is probable that collection will occur. Revenue from sales of our software is included in fee and other income on our Condensed Consolidated Statements of Operations.

At the time of each sale transaction, we make an assessment of the collectibility of the amount due from the customer. Revenue is only recognized at that time if management deems that collection is probable. In making this assessment, we consider customer creditworthiness and assess whether fees are fixed or determinable and free of contingencies or significant uncertainties. If the fee is not fixed or determinable, revenue is recognized only as payments become due from the customer, provided that all other revenue recognition criteria are met. In assessing whether the fee is fixed or determinable, we consider the payment terms of the transaction and our collection experience in similar transactions without making concessions, among other factors. Our software license agreements generally do not include customer acceptance provisions. However, if an arrangement includes an acceptance provision, we record revenue only upon the earlier of (1) receipt of written acceptance from the customer or (2) expiration of the acceptance period.

Our software agreements often include implementation and consulting services that are sold separately under consulting engagement contracts or as part of the software license arrangement. When we determine that such services are not essential to the functionality of the licensed software and qualify as "service transactions" under SOP 97-2, we record revenue separately for the license and service elements of these agreements. Generally, we consider that a service is not essential to the functionality of the software based on various factors, including if the services may be provided by independent third parties experienced in providing such consulting and implementation in coordination with dedicated customer personnel. If an arrangement does not qualify for separate accounting of the license and service elements, then license revenue is recognized together with the consulting services using either the percentage-of-completion or completed-contract method of contract accounting. Contract accounting is also applied to any software agreements that include customer-specific acceptance criteria or where the license payment is tied to the performance of consulting services. Under the percentage-of-completion method, we may estimate the stage of completion of contracts with fixed or "not to exceed" fees based on hours or costs incurred to date as compared with estimated total project hours or costs at completion. If we do not have a sufficient basis to measure progress towards completion, revenue is recognized upon completion of the contract. When total cost estimates exceed revenues, we accrue for the estimated losses immediately. The use of the percentage-of-completion method of accounting requires significant judgment relative to estimating total contract costs, including assumptions relative to the length of time to complete the project, the nature and complexity of the work to be performed, and anticipated changes in salaries and other costs. When adjustments in estimated contract costs are determined, such revisions may have the effect of adjusting, in the current period, the earnings applicable to performance in prior periods.

We generally use the residual method to recognize revenues from agreements that include one or more elements to be delivered at a future date when evidence of the fair value of all undelivered elements exists. Under the residual method, the fair value of the undelivered elements (e.g., maintenance, consulting and training services) based on vendor-specific objective evidence ("VSOE") is deferred and the remaining portion of the arrangement fee is allocated to the delivered elements (i.e., software license). If evidence of the fair value of one or more of the undelivered services does not exist, all revenues are deferred and recognized when delivery of all of those services has occurred or when fair values can be established. We determine VSOE of the fair value of services revenue based upon our recent pricing for those services when sold separately. VSOE of the fair value of maintenance services may also be determined based on a substantive maintenance renewal clause, if any, within a customer contract. Our current pricing practices are influenced primarily by product type, purchase volume, maintenance term and customer location. We review services revenue sold separately and maintenance renewal rates on a periodic basis and update our VSOE of fair value for such services to ensure that it reflects our recent pricing experience, when appropriate.

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Maintenance services generally include rights to unspecified upgrades (when and if available), telephone and Internet-based support, updates and bug fixes. Maintenance revenue is recognized ratably over the term of the maintenance contract (usually one year) on a straight-line basis and is included in fee and other income on our Condensed Consolidated Statements of Operations.

When consulting qualifies for separate accounting, consulting revenues under time and materials billing arrangements are recognized as the services are performed. Consulting revenues under fixed-price contracts are generally recognized using the percentage-of-completion method. If there is a significant uncertainty about the project completion or receipt of payment for the consulting services, revenue is deferred until the uncertainty is sufficiently resolved. Consulting revenues are classified as fee and other income on our Condensed Consolidated Statements of Operations.

Training services include on-site training, classroom training and computer-based training and assessment. Training revenue is recognized as the related training services are provided and is included in fee and other income on our Condensed Consolidated Statements of Operations.

Amounts charged for our Procure+ service are recognized as services are rendered. Amounts charged for the Manage+ service are recognized on a straight-line basis over the contractual period for which the services are provided. In addition, other sources of revenue are derived from: (1) income from events that occur after the initial sale of a financial asset; (2) remarketing fees; (3) brokerage fees earned for the placement of financing transactions; (4) agent fees received from various manufacturers in the IT reseller business unit; (5) settlement fees related to disputes or litigation; and (6) interest and other miscellaneous income. These revenues are included in fee and other income on our Condensed Consolidated Statements of Operations.

RESIDUALS — Residual values, representing the estimated value of equipment at the termination of a lease, are recorded in our Condensed Consolidated Financial Statements at the inception of each sales-type or direct financing lease as amounts estimated by management based upon its experience and judgment. Unguaranteed residual values for sales-type and direct financing leases are recorded at their net present value and the unearned income is amortized over the life of the lease using the interest method. The residual values for operating leases are included in the leased equipment's net book value.

We evaluate residual values on an ongoing basis and record any downward adjustment, if required. No upward revision of residual values is made subsequent to lease inception.

RESERVES FOR CREDIT LOSSES — The reserves for credit losses (the "reserve") is maintained at a level believed by management to be adequate to absorb potential losses inherent in our lease and accounts receivable portfolio. Management's determination of the adequacy of the reserve is based on an evaluation of historical credit loss experience, current economic conditions, volume, growth, the composition of the lease portfolio, and other relevant factors. The reserve is increased by provisions for potential credit losses charged against income. Accounts are either written off or written down when the loss is both probable and determinable, after giving consideration to the customer's financial condition, the value of the underlying collateral and funding status (i.e., discounted on a non-recourse or recourse basis).

CASH AND CASH EQUIVALENTS — Cash and cash equivalents include funds in operating accounts as well as money market funds.

INVENTORIES — Inventories are stated at the lower of cost (weighted average basis) or market.

PROPERTY AND EQUIPMENT — Property and equipment are stated at cost, net of accumulated depreciation and amortization. Depreciation and amortization are computed using the straight-line method over the estimated useful lives of the related assets, which range from three to ten years.

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CAPITALIZATION OF COSTS OF SOFTWARE FOR INTERNAL USE — We have capitalized certain costs for the development of internal use software under the guidelines of SOP 98-1, “Accounting for the Costs of Computer Software Developed or Obtained for Internal Use.” Software capitalized for internal use was $761 thousand and $178 thousand during the nine months ended December 31, 2007 and December 31, 2006, respectively, which is included in the accompanying Condensed Consolidated Balance Sheets as a component of property and equipment—net. We had capitalized costs, net of amortization, of approximately $1.2 million at December 31, 2007 and $650 thousand at March 31, 2007.

CAPITALIZATION OF COSTS OF SOFTWARE TO BE MADE AVAILABLE TO CUSTOMERS — In accordance with SFAS No. 86, “Accounting for Costs of Computer Software to be Sold, Leased, or Otherwise Marketed,” software development costs are expensed as incurred until technological feasibility has been established. At such time such costs are capitalized until the product is made available for release to customers. For the nine months ended December 31, 2007, there was no such costs capitalized, while for the nine months ended December 31, 2006, $59 thousand were capitalized for software to be made available to customers. We had $619 thousand and $760 thousand of capitalized costs, net of amortization, at December 31, 2007 and March 31, 2007, respectively.

INTANGIBLE ASSETS — In accordance with SFAS No. 142, “Goodwill and Other Intangible Assets,” we perform an impairment test for goodwill at September 30th of each year and follow the two-step process prescribed in SFAS No. 142 to test our goodwill for impairment under the transitional goodwill impairment test. The first step is to screen for potential impairment, while the second step measures the amount of the impairment, if any.

IMPAIRMENT OF LONG-LIVED ASSETS — We review long-lived assets, including property and equipment, for impairment whenever events or changes in circumstances indicate that the carrying amounts of the assets may not be fully recoverable. If the total of the expected undiscounted future cash flows is less than the carrying amount of the asset, a loss is recognized for the difference between the fair value and the carrying value of the asset.

FAIR VALUE OF FINANCIAL INSTRUMENTS — The carrying value of our financial instruments, which include cash and cash equivalents, accounts receivable, accounts payable and accrued expenses and other liabilities, approximates fair value due to their short maturities. The carrying amount of our non-recourse and recourse notes payable approximates its fair value. We determined the fair value of notes payable by applying the average portfolio debt rate and applying such rate to future cash flows of the respective financial instruments. The estimated fair value of our recourse and non-recourse notes payable at December 31, 2007 and March 31, 2007 was $104.2 million and $153.4 million, respectively, compared to a carrying amount of $104.7 million and $153.1 million, respectively.

TREASURY STOCK — We account for treasury stock under the cost method and include treasury stock as a component of stockholders’ equity.

INCOME TAXES — Deferred income taxes are accounted for in accordance with SFAS No. 109, “Accounting for Income Taxes.” Under this method, deferred income tax assets and liabilities are determined based on the temporary differences between the financial statement reporting and tax bases of assets and liabilities, using tax rates currently in effect. Future tax benefits, such as net operating loss carryforwards, are recognized to the extent that realization of these benefits is considered to be more likely than not. In addition, on April 1, 2007, we adopted Financial Accounting Standards Board Interpretation No. 48, “Accounting for Uncertainty in Income Taxes—An Interpretation of FASB Statement No. 109” (“FIN 40.”) Specifically, the pronouncement prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. The interpretation also provides guidance on the related derecognition, classification, interest and penalties, accounting for interim periods, disclosure and transition of uncertain tax positions. In accordance with our accounting policy, we recognize accrued interest and penalties related to unrecognized tax benefits as a component of tax expense. This policy did not change as a result of the adoption of FIN 48. We recorded a cumulative effect adjustment to reduce our fiscal 2008 balance of beginning retained earnings by $491 thousand in our Condensed Consolidated Financial Statements.

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ESTIMATES — The preparation of financial statements in conformity with U.S. 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 reporting period. Actual results could differ from those estimates.

COMPREHENSIVE INCOME — Comprehensive income consists of net income and foreign currency translation adjustments. For the nine months ended December 31, 2007, accumulated other comprehensive income was $308 thousand and net income was $13.6 million. This resulted in total comprehensive income of $13.9 million for the nine months ended December 31, 2007. For the nine months ended December 31, 2006, accumulated other comprehensive income was approximately $2.0 thousand and net income was $15.4 million. This resulted in total comprehensive income of $15.4 million for the nine months ended December 31, 2006.

EARNINGS PER SHARE — Earnings per share ("EPS") have been calculated in accordance with SFAS No. 128, "Earnings per Share." In accordance with SFAS No. 128, basic EPS amounts were calculated based on weighted average shares outstanding of 8,231,741 for the three and nine months ended December 31, 2007 and 8,231,741 and 8,222,700, for the three and nine months ended December 31, 2006, respectively. Diluted EPS amounts were calculated based on weighted average shares outstanding and potentially dilutive common stock equivalents of 8,422,256 and 8,375,412 for the three and nine months ended December 31, 2007, respectively, and 8,456,627 and 8,577,999 for the three and nine months ended December 31, 2006, respectively. Additional shares included in the diluted EPS calculations are attributable to incremental shares issuable upon the assumed exercise of stock options and other common stock equivalents.

STOCK-BASED COMPENSATION — On April 1, 2006, we adopted SFAS No. 123 (revised 2004), "Share-Based Payment," or SFAS No. 123R. SFAS No. 123R replaces SFAS No. 123, "Accounting for Stock-Based Compensation," and supersedes Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and subsequently issued stock option related guidance. We elected the modified-prospective transition method. Under the modified-prospective method, we must recognize compensation expense for all awards subsequent to adopting the standard and for the unvested portion of previously granted awards outstanding upon adoption. We have recognized compensation expense equal to the fair values for the unvested portion of share-based awards at April 1, 2006 over the remaining period of service, as well as compensation expense for those share-based awards granted or modified on or after April 1, 2006 over the vesting period based on the grant-date fair values using the straight-line method. For those awards granted prior to the date of adoption, compensation expense is recognized on an accelerated basis based on the grant-date fair value amount as calculated for pro forma purposes under SFAS No. 123.

RECENT ACCOUNTING PRONOUNCEMENTS — In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurement" ("SFAS No. 157"). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in accordance with U.S. GAAP and expands disclosures about fair value measurements. SFAS No. 157 emphasizes that fair value is a market-based measurement, not an entity-specific measurement. Therefore, a fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability. The provisions of SFAS No. 157 are effective for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB issued Staff Position No. FAS 157-2, "Effective Dates of FASB Statement No. 157," which defers the effective date of SFAS No. 157 for all nonrecurring fair value measurements of nonfinancial assets and liabilities until fiscal years beginning after November 15, 2008. We are in the process of evaluating the impact, if any, SFAS No. 157 will have on our financial condition and results of operations.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities — Including an Amendment of FASB Statement No. 115" ("SFAS No. 159"). SFAS No. 159 permits an entity, at specified election dates, to choose to measure certain financial instruments and other items at fair value. The objective of SFAS No. 159 is to provide entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently, without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for accounting periods beginning after November 15, 2007. We are in the process of evaluating the impact, if any, SFAS No. 159 will have on our financial condition and results of operations.

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2. INVESTMENT IN LEASES AND LEASED EQUIPMENT—NET

Investment in leases and leased equipment—net consists of the following:

	As of December 31, 2007	As of March 31, 2007
	(in thousands)	
Investment in direct financing and sales-type leases—net	$ 125,519	$ 158,471
Investment in operating lease equipment—net	35,555	58,699
	$ 161,074	$ 217,170

INVESTMENT IN DIRECT FINANCING AND SALES-TYPE LEASES—NET

Our investment in direct financing and sales-type leases—net consists of the following:

	As of December 31, 2007	As of March 31, 2007
	(in thousands)	
Minimum lease payments	$ 118,792	$ 154,349
Estimated unguaranteed residual value (1)	18,987	22,375
Initial direct costs, net of amortization (2)	1,231	1,659
Less: Unearned lease income	(12,231)	(18,271)
Reserve for credit losses	(1,260)	(1,641)
Investment in direct financing and sales-type leases—net	$ 125,519	$ 158,471

(1) Includes estimated unguaranteed residual values of $2,010 thousand and $1,191 thousand as of December 31, 2007 and March 31, 2007, respectively, for direct financing SFAS No. 140 leases.

(2) Initial direct costs are shown net of amortization of $1,496 thousand and $1,409 thousand as of December 31, 2007 and March 31, 2007, respectively.

Our net investment in direct financing and sales-type leases is collateral for non-recourse and recourse equipment notes, if any.

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INVESTMENT IN OPERATING LEASE EQUIPMENT—NET

Investment in operating lease equipment—net primarily represents leases that do not qualify as direct financing leases or are leases that are short-term renewals on a month-to-month basis. The components of the net investment in operating lease equipment are as follows:

	As of December 31, 2007	As of March 31, 2007
	(in thousands)	
Cost of equipment under operating leases	$ 67,219	$ 93,804
Less: Accumulated depreciation and amortization	(31,664)	(35,105)
Investment in operating lease equipment—net	$ 35,555	$ 58,699

3. RESERVES FOR CREDIT LOSSES

As of March 31, 2007 and December 31, 2007, our activity in our reserves for credit losses is as follows (in thousands):

	Accounts Receivable	Lease-Related Assets	Total
Balance April 1, 2006	$ 2,060	$ 2,913	$ 4,973
Provision for Bad Debts	460	(1,027)	(567)
Recoveries	23	-	23
Write-offs and other	(483)	(245)	(728)
Balance March 31, 2007	2,060	1,641	3,701
Provision for Bad Debts	(4)	(341)	(345)
Recoveries	40	-	40
Write-offs and other	(320)	(40)	(360)
Balance December 31, 2007	$ 1,776	$ 1,260	$ 3,036

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4. RECOURSE AND NON-RECOURSE NOTES PAYABLE

Recourse and non-recourse obligations consist of the following:

	As of December 31, 2007	As of March 31, 2007
	(in thousands)	
National City Bank – Recourse credit facility of $35,000,000 expiring on July 21, 2009. At our option, the carrying interest rate is either LIBOR rate plus 175–250 basis points, or the Alternate Base Rate of the higher of prime, or federal funds rate plus 50 basis points, plus 0-25 basis points of margin. The interest rate at March 31, 2007 was 6.875%.	$ -	$ 5,000
Total recourse obligations	$ -	$ 5,000
Non-recourse equipment notes secured by related investments in leases with interest rates ranging from 4.90% to 7.75% for the nine months ended December 31, 2007 and 3.05% to 9.25% for year ended March 31, 2007.	$ 104,741	$ 148,136

Principal and interest payments on the recourse and non-recourse notes payable are generally due monthly in amounts that are approximately equal to the total payments due from the lessee under the leases that collateralize the notes payable. Under recourse financing, in the event of a default by a lessee, the lender has recourse against the lessee, the equipment serving as collateral, and us. Under non-recourse financing, in the event of a default by a lessee, the lender generally only has recourse against the lessee, and the equipment serving as collateral, but not against us.

There are two components of the GE Commercial Distribution Finance Corporation (“GECDF”) credit facility: (1) a floor plan component and (2) an accounts receivable component. As of December 31, 2007, the facility agreement had an aggregate limit of the two components of $125 million, and the accounts receivable component had a sub-limit of $30 million, which bears interest at prime less 0.5%, or 7.75%. Effective October 29, 2007, the facility with GECDF was amended to increase the aggregate limit to $125 million from $100 million with a sub-limit on the accounts receivable component of $30 million. The temporary overline periods in the previous agreement were eliminated. Availability under the GECDF facility may be limited by the asset value of equipment we purchase and may be further limited by certain covenants and terms and conditions of the facility. These covenants include but are not limited to a minimum total tangible net worth and subordinated debt, and maximum debt to tangible net worth ratio of ePlus Technology, inc. We were in compliance with these covenants as of December 31, 2007. Either party may terminate with 90 days’ advance notice.

The facility provided by GECDF requires a guaranty of up to $10.5 million by ePlus inc. The guaranty requires ePlus inc. to deliver its annual audited financial statements by certain dates. We are currently in compliance with this covenant. The loss of the GECDF credit facility could have a material adverse effect on our future results as we currently rely on this facility and its components for daily working capital and liquidity for our technology sales business and as an operational function of our accounts payable process.

Borrowings under our $35 million line of credit from National City Bank are subject to and in compliance with certain covenants regarding minimum consolidated tangible net worth, maximum recourse debt to net worth ratio, cash flow coverage, and minimum interest expense coverage ratio. We are in compliance with or have received amendments extending these covenants as of December 31, 2007. The borrowings are secured by our assets such as leases, receivables, inventory, and equipment. Borrowings are limited to our collateral base, consisting of equipment, lease receivables, and other current assets, up to a maximum of $35 million. In addition, the credit agreement restricts, and under some circumstances prohibits, the payment of dividends.

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The National City Bank facility requires the delivery of our audited and unaudited financial statements, and pro-forma financial projections, by certain dates. We have not delivered the following documents as required by Section 5.1 of the facility: quarterly Condensed Consolidated Unaudited Financial Statements for the quarter ended December 31, 2007 included herein. We entered into the following amendments which have extended the delivery date requirements for these documents: a First Amendment dated July 11, 2006, a Second Amendment dated July 28, 2006, a third Amendment dated August 30, 2006, a Fourth Amendment dated September 27, 2006, a Fifth Amendment dated November 15, 2006, a Sixth Amendment dated January 11, 2007, a Seventh Amendment dated March 12, 2007, an Eighth Amendment dated June 27, 2007, a Ninth Amendment dated August 22, 2007, a Tenth Amendment dated November 29, 2007 and an Eleventh Amendment dated February 29, 2008. As a result of the amendments, the agents agreed, among other things, to extend the delivery date requirements of the documents above through June 30, 2008.

We believe we will receive additional extensions from our lender, if needed, regarding our requirement to provide financial statements as described above through the date of delivery of the documents. However, we cannot guarantee that we will receive additional extensions.

5. RELATED PARTY TRANSACTIONS

During the three months ended December 31, 2007, we leased approximately 55,880 square feet for use as our principal headquarters from Norton Building 1, LLC. Norton Building 1, LLC is a limited liability company owned in part by Mr. Norton's spouse and in part in trust for his children. As of May 31, 2007, Mr. Norton, our President and CEO, has no managerial or executive role in Norton Building 1, LLC. The lease was approved by the Board of Directors prior to its commencement, and viewed by the Board as being at or below comparable market rents, and ePlus has the right to terminate up to 40% of the leased premises for no penalty, with six months' notice. During the three months ended December 31, 2007 and December 31, 2006, we paid rent in the amount of $274 thousand and $238 thousand, respectively. During the nine months ended December 31, 2007 and December 31, 2006, we paid rent in the amount of $798 thousand and $710 thousand, respectively.

6. COMMITMENTS AND CONTINGENCIES

Litigation

We have been involved in several matters, which are described below, arising from four separate installment sales to a customer named Cyberco Holdings, Inc. ("Cyberco"), which was perpetrating a fraud related to installment sales that were assigned to various lenders and were non-recourse to us.

On November 3, 2006, Banc of America Leasing and Capital, LLC ("BoA") filed a lawsuit against ePlus inc., seeking to enforce a guaranty in which ePlus inc. guaranteed ePlus Group's obligations to BoA relating to the Cyberco transaction. In June 2007 ePlus Group paid to BoA the full amount of a judgment against ePlus Group in favor of BoA. The suit against ePlus inc. seeks attorneys' fees BoA incurred in ePlus Group's appeal of BoA's suit against ePlus Group referenced above, expenses that BoA incurred in a bankruptcy adversary proceeding relating to Cyberco, attorneys' fees incurred by BoA in defending a pending suit by ePlus Group against BoA, and any other costs or fees relating to any of the described matters. The trial has been stayed pending the resolution of litigation in California state court in which ePlus is the plaintiff in a suit against BoA. We are vigorously defending the suit against us by BoA. We cannot predict the outcome of this suit. We do not believe a loss is probable; therefore, we have not accrued for this matter.

In a bankruptcy adversary proceeding, which was filed on December 7, 2006, Cyberco's bankruptcy trustee sought approximately $775 thousand as alleged preferential transfers. In January 2008, we entered into a settlement agreement with the trustee and agreed to pay to the trustee $95 thousand, which we recorded in the year ended March

31, 2007.

On January 18, 2007, a stockholder derivative action related to stock option practices was filed in the United States District Court for the District of Columbia. The amended complaint names ePlus inc. as nominal defendant, and personally names eight individual defendants who are directors and/or executive officers of ePlus. The amended complaint alleges violations of federal securities law, and various state law claims such as breach of fiduciary duty, waste of corporate assets and unjust enrichment. We have filed a Motion to Dismiss the plaintiff's amended complaint. The amended complaint seeks monetary damages from individual defendants and that we take certain corrective actions relating to option grants and corporate governance, and attorneys' fees. We cannot predict the outcome of this suit. We do not believe a loss is probable; therefore, we have not accrued for this matter.

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We are also engaged in other ordinary and routine litigation incidental to our business. While we cannot predict the outcome of these various legal proceedings, management believes that a loss is not probable and no amount has been accrued for these matters.

Regulatory and Other Legal Matters

In June 2006, the Audit Committee commenced an investigation of our stock option grants since our initial public offering in 1996. In August 2006, the Audit Committee voluntarily contacted and advised the staff of SEC of its investigation and the Audit Committee's preliminary conclusion that a restatement would be required. This restatement was included in our Form 10-K for the fiscal year ended March 31, 2006 and was filed with the SEC on August 16, 2007. The SEC opened an informal inquiry and we have and will continue to cooperate with the staff. No amount has been accrued for this matter.

We are currently engaged in a dispute with the government of the District of Columbia ("DC") regarding personal property taxes on property we financed for our customers. DC is seeking approximately $508 thousand plus interest and penalties, relating to property we financed for our customers. We believe the tax is owed by our customers, and are seeking resolution in DC's Office of Administrative Hearings. We cannot predict the outcome of this matter. We do not believe a loss is probable; therefore, we have not accrued for this matter.

7. EARNINGS PER SHARE

Earnings per share ("EPS") have been calculated in accordance with SFAS No. 128, "Earnings per Share" ("SFAS No. 128"). In accordance with SFAS No. 128, basic EPS amounts are calculated based on three and nine months weighted average shares outstanding of 8,231,741 at December 31, 2007 and 8,231,741 and 8,222,700, respectively, at December 31, 2006. Diluted EPS amounts are calculated based on three and nine months weighted average shares outstanding and potentially dilutive common stock equivalents of 8,422,256 and 8,375,412 at December 31, 2007 and 8,456,627 and 8,577,999 at December 31, 2006. Additional shares included in the diluted EPS calculations are attributable to incremental shares issuable upon the assumed exercise of stock options and other common stock equivalents.

The following table provides a reconciliation of the numerators and denominators used to calculate basic and diluted net income per common share as disclosed in our Condensed Consolidated Statements of Operations for the three and nine months ended December 31, 2006 and December 31, 2007 (in thousands, except per share data).

	Three months ended December 31,		Nine months ended December 31,	
	2007	2006	2007	2006
Net income available to common shareholders—basic and diluted	$ 3,751	$ 12,404	$ 13,615	$

* Cost for federal income tax purposes is $911,381,330 and unrealized appreciation (depreciation) consists of:

Gross unrealized appreciation	$ 48,521,745
Gross unrealized depreciation	(19,211,580)

Net unrealized appreciation	$ 29,310,165

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

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Assets	
Investments	
In unaffiliated securities, at value (see cost below)	$ 905,717,073
In affiliated securities, at value (see cost below)	34,974,422
Total investments, at value (see cost below)	940,691,495
Cash	6,673,448
Receivable for interest and dividends	14,283,036
Prepaid expenses and other assets	1,425
Total assets	961,649,404
Liabilities	
Dividends payable	4,826,367
Payable for investments purchased	13,187,515
Secured borrowing payable	230,204,793
Advisory fee payable	315,863
Due to other related parties	38,652
Accrued expenses and other liabilities	295,264
Total liabilities	248,868,454
Total net assets	**$ 712,780,950**
NET ASSETS CONSIST OF	
Paid-in capital	$ 983,331,382
Overdistributed net investment income	(1,534,172)
Accumulated net realized losses on investments	(303,328,948)
Net unrealized gains on investments	34,312,688
Total net assets	**$ 712,780,950**
NET ASSET VALUE PER SHARE	
Based on $712,780,950 divided by 70,983,001 shares issued and outstanding (100,000,000 shares authorized)	$10.04

Investments in unaffiliated securities, at cost	$ 871,404,385
Investments in affiliated securities, at cost	$ 34,974,422
Total investments, at cost	$ 906,378,807

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

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Investment income	
Interest	$ 65,356,498
Dividends	151,507
Income from affiliated securities	14,342
Total investment income	65,522,347
Expenses	
Advisory fee	5,579,727
Administration fee	464,977
Custody and accounting fees	55,981
Professional fees	73,105
Shareholder report expenses	130,402
Trustees fees and expenses	11,698
Transfer agent fees	25,897
Interest expense	474,729
Secured borrowing fees	2,018,429
Other fees and expenses	42,268
Total expenses	8,877,213
Less: Fee waivers and/or expense reimbursements	(1,774,632)
Net expenses	7,102,581
Net investment income	58,419,766
REALIZED AND UNREALIZED GAINS (LOSSES) ON INVESTMENTS	
Net realized gains on investments	8,206,695
Net change in unrealized gains (losses) on investments	(18,641,627)
Net realized and unrealized gains (losses) on investments	(10,434,932)
Net increase in net assets resulting from operations	**$ 47,984,834**

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

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 Statement of changes in net assets

	Year ended April 30, 2014	Year ended April 30, 2013
Operations		
Net investment income	$ 58,419,766	$ 62,380,589
Net realized gains on investments	8,206,695	11,572,543
Net change in unrealized gains (losses) on investments	(18,641,627)	27,158,011
Net increase in net assets resulting from operations	47,984,834	101,111,143
Distributions to shareholders from		
Net investment income	(57,922,129)	(64,767,000)
Capital share transactions		
Net asset value of common shares issued under the Automatic Dividend Reinvestment Plan	162,908	2,403,707
Total increase (decrease) in net assets	(9,774,387)	38,747,850
Net assets		
Beginning of period	**722,555,337**	**683,807,487**
End of period	**$ 712,780,950**	**$ 722,555,337**
Overdistributed net investment income	**$ (1,534,172)**	**$ (4,920,932)**

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

Cash flows from operating activities:	
Net increase in net assets resulting from operations	$ 47,984,834
Adjustments to reconcile net increase in net assets resulting from operations to net cash provided by operating activities:	
Purchase of investment securities	(470,611,660)
Proceeds from disposition of investment securities	487,657,226
Amortization	(2,357,481)
Purchase of short-term investment securities, net	(17,776,853)
Decrease in receivable for investments sold	9,083,438
Decrease in receivable for interest and dividends	1,924,087
Decrease in prepaid expenses and other assets	98,456
Decrease in payable for investments purchased	(2,098,092)
Increase in advisory fee payable	12,211
Decrease in due to other related parties	(250)
Increase in accrued expenses and other liabilities	60,305
Litigation payments received	24,940
Net realized gains on investments	(8,206,695)
Net change in unrealized gains (losses) on investments	18,641,627
Net cash provided by operating activities	64,436,093
Cash flows from financing activities:	
Cash distributions paid	(57,758,340)
Decrease in secured borrowing payable	(4,305)
Net cash used in financing activities	(57,762,645)
Net increase in cash	6,673,448
Cash:	
Beginning of period	$ 0
End of period	$ 6,673,448
Supplemental cash disclosure:	
Cash paid for interest	$ 477,803
Supplemental non-cash financing disclosure:	
Reinvestment of dividends	$ 162,908

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

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24 Wells Fargo Advantage Income Opportunities Fund Financial highlights
(For a share outstanding throughout each period)

	Year ended April 30				
	2014	2013	2012	2011	2010
Net asset value, beginning of period	**$ 10.18**	**$ 9.67**	**$ 10.11**	**$ 9.69**	**$ 7.37**
Net investment income	0.82[1]	0.88[1]	0.95[1]	1.02[1]	1.06[1]
Net realized and unrealized gains (losses) on investments	(0.14)	0.54	(0.37)	0.42	2.41
Distributions to preferred shareholders from net investment income	0.00	0.00	0.00	(0.00)[1,2]	(0.01)[1]
Total from investment operations	0.68	1.42	0.58	1.44	3.46
Distributions to common shareholders from					
Net investment income	(0.82)	(0.91)	(1.02)	(1.02)	(1.08)
Tax basis return of capital	0.00	0.00	0.00	0.00	(0.06)[1]
Total distributions to common shareholders	(0.82)	(0.91)	(1.02)	(1.02)	(1.14)
Net asset value, end of period	**$ 10.04**	**$ 10.18**	**$ 9.67**	**$ 10.11**	**$ 9.69**
Market value, end of period	**$ 9.52**	**$ 10.23**	**$ 10.29**	**$ 10.38**	**$ 9.63**
Total return based on market value[3]	**1.60%**	**8.90%**	**10.03%**	**19.68%**	**49.84%**
Ratios to average net assets (annualized)					
Gross expenses[4]	1.27%	1.29%	1.35%	1.44%	1.79%
Net expenses[4]	1.01%	1.05%	1.03%	1.09%	1.13%
Net investment income	8.35%	8.89%	9.89%	10.55%[5]	11.81%[5]
Supplemental data					
Portfolio turnover rate	31%	27%	25%	42%	108%
Net assets of common shareholders, end of period (000s omitted)	$712,781	$722,555	$683,807	$709,850	$676,144
Borrowings outstanding, end of period (000s omitted)	$230,000	$230,000	$230,000	$230,000	N/A
	$4,099	$4,142	$3,973	$4,088	N/A

Asset coverage per $1,000 of borrowing, end of period					
Liquidation value of Preferred Shares, end of period (000s omitted)	N/A	N/A	N/A	N/A	$196,000
Asset coverage ratio for Preferred Shares, end of period	N/A	N/A	N/A	N/A	394%

1. Calculated based upon average common shares outstanding

2. Amount is less than $0.005.

3. Total return is calculated assuming a purchase of common stock on the first day and a sale on the last day of the period reported. Dividends and distributions, if any, are assumed for purposes of these calculations to be reinvested at prices obtained under the Fund s Automatic Dividend Reinvestment Plan. Total return does not reflect brokerage commissions that a shareholder would pay on the purchase and sale of shares.

4. Ratios include interest expense relating to interest associated with borrowings and/or leverage transactions as follows:

Year ended April 30, 2014	0.07%
Year ended April 30, 2013	0.08%
Year ended April 30, 2012	0.08%
Year ended April 30, 2011	0.11%
Year ended April 30, 2010	0.02%

5. The net investment income ratio reflects distributions paid to preferred shareholders.

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

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1. ORGANIZATION

The *Wells Fargo Advantage Income Opportunities Fund* (the Fund) was organized as a statutory trust under the laws of the state of Delaware on December 3, 2002 and is registered as a diversified closed-end management investment company under the Investment Company Act of 1940, as amended.

2. SIGNIFICANT ACCOUNTING POLICIES

The following significant accounting policies, which are consistently followed in the preparation of the financial statements of the Fund, are in conformity with U.S. generally accepted accounting principles which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Securities valuation

All investments are valued each business day as of the close of regular trading on the New York Stock Exchange (generally 4 p.m. Eastern Time).

Fixed income securities acquired with maturities exceeding 60 days are valued based on evaluated bid prices provided by an independent pricing service which may utilize both transaction data and market information such as yield, quality, coupon rate, maturity, type of issue, trading characteristics and other market data. If prices are not available from the independent pricing service or prices received are deemed not representative of market value, prices will be obtained from an independent broker-dealer.

Short-term securities, with maturities of 60 days or less at time of purchase, generally are valued at amortized cost which approximates fair value. The amortized cost method involves valuing a security at its cost, plus accretion of discount or minus amortization of premium over the period until maturity.

Equity securities that are listed on a foreign or domestic exchange or market are valued at the official closing price or, if none, the last sales price. If no sale occurs on the primary exchange or market for the security that day, the prior day s price will be deemed stale and fair values will be determined in accordance with the Fund s Valuation Procedures.

Investments in registered open-end investment companies are valued at net asset value.

Investments which are not valued using any of the methods discussed above are valued at their fair value, as determined in good faith by the Board of Trustees of the Fund. The Board of Trustees has established a Valuation Committee comprised of the Trustees and has delegated to it the authority to take any actions regarding the valuation of portfolio securities that the Valuation Committee deems necessary or appropriate, including determining the fair value of portfolio securities, unless the determination has been delegated to the Management Valuation Team of Wells Fargo Funds Management, LLC (Funds Management). The Board of Trustees retains the authority to make or ratify any valuation decisions or approve any changes to the Valuation Procedures as it deems appropriate. On a quarterly basis, the Board of Trustees receives reports on any valuation actions taken by the Valuation Committee or the Management Valuation Team which may include items for ratification.

Valuations of fair valued securities are compared to the next actual sales price when available, or other appropriate market values, to assess the continued appropriateness of the fair valuation methodologies used. These securities are fair valued on a day-to-day basis, taking into consideration changes to appropriate market information and any significant changes to the inputs considered in the valuation process until there is a readily available price provided on an exchange or by an independent pricing service. Valuations received from an independent pricing service or independent broker-dealer quotes are periodically validated by comparisons to most recent trades and valuations provided by other independent pricing services in addition to the review of prices by the adviser and/or subadviser. Unobservable inputs used in determining fair valuations are identified based on the type of security, taking into consideration factors utilized by market participants in valuing the investment, knowledge about the issuer and the current market environment.

When-issued transactions

The Fund may purchase securities on a forward commitment or when-issued basis. The Fund records a when-issued transaction on the trade date and will segregate assets in an amount at least equal in value to the Fund s commitment to purchase when-issued securities. Securities purchased on a when-issued basis are marked-to-market daily and the Fund begins earning interest on the settlement date. Losses may arise due to changes in the market value of the underlying securities or if the counterparty does not perform under the contract.

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Term loans

The Fund may invest in term loans. The Fund begins earning interest when the loans are funded. The loans pay interest at rates which are periodically reset by reference to a base lending rate plus a spread. The Fund assumes the credit risk of the borrower and there could be potential loss to the Fund in the event of default by the borrower.

Security transactions and income recognition

Securities transactions are recorded on a trade date basis. Realized gains or losses are recorded on the basis of identified cost.

Interest income is accrued daily and bond discounts are accreted and premiums are amortized daily based on the effective interest method. To the extent debt obligations are placed on non-accrual status, any related interest income may be reduced by writing off interest receivables when the collection of all or a portion of interest has become doubtful based on consistently applied procedures. If the issuer subsequently resumes interest payments or when the collectability of interest is reasonably assured, the debt obligation is removed from non-accrual status.

Dividend income is recognized on the ex-dividend date.

Distributions to shareholders

Distributions to shareholders from net investment income and net realized gains, if any, are recorded on the ex-dividend date. Such distributions are determined in conformity with federal income tax regulations, which may differ in amount or character from net investment income and realized gains recognized for purposes of U.S. generally accepted accounting principles.

Federal and other taxes

The Fund intends to continue to qualify as a regulated investment company by distributing substantially all of its investment company taxable income and any net realized capital gains (after reduction for capital loss carryforwards) sufficient to relieve it from all, or substantially all, federal income taxes. Accordingly, no provision for federal income taxes was required.

The Fund s income and federal excise tax returns and all financial records supporting those returns for the prior three fiscal years are subject to examination by the federal and Delaware revenue authorities. Management has analyzed the Fund s tax positions taken on federal, state, and foreign tax returns for all open tax years and does not believe that there are any uncertain tax positions that require recognition of a tax liability.

Reclassifications are made to the Fund s capital accounts for permanent tax differences to reflect income and gains available for distribution (or available capital loss carryforwards) under federal income tax regulations. U.S. generally accepted accounting principles requires that certain components of net assets be adjusted to reflect permanent differences between financial and tax reporting. These reclassifications have no effect on net assets or net asset values per share. The primary permanent difference causing such reclassifications is due to bond premiums. At April 30, 2014, as a result of permanent book-to-tax differences, the following reclassification adjustments were made on the Statement of Assets and Liabilities:

Overdistributed net investment income	Accumulated net realized losses on investments
$ 6,804,353	$(6,804,353)

As of April 30, 2014, capital loss carryforwards available to offset future net realized capital gains were as follows through the indicated expiration dates:

2016	2017	2018
$12,398,698	$130,598,584	$155,329,141

3. FAIR VALUATION MEASUREMENTS

Fair value measurements of investments are determined within a framework that has established a fair value hierarchy based upon the various data inputs utilized in determining the value of the Fund s investments. The three-level hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to significant unobservable inputs (Level 3). The Fund s investments are classified within the fair value hierarchy based on the lowest level of input that is significant to the fair value measurement. The inputs are summarized into three broad levels as follows:

n Level 1 quoted prices in active markets for identical securities

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- Level 2 other significant observable inputs (including quoted prices for similar securities, interest rates, prepayment speeds, credit risk, use of amortized cost, etc.)

- Level 3 significant unobservable inputs (including the Fund s own assumptions in determining the fair value of investments)

The inputs or methodologies used for valuing investments in securities are not necessarily an indication of the risk associated with investing in those securities.

As of April 30, 2014, the inputs used in valuing investments in securities were as follows:

Investments in securities	Quoted prices (Level 1)	Other significant observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
Equity securities				
Common stocks				
Telecommunication Services	$ 1,832,889	$ 0	$ 0	$ 1,832,889
Preferred stocks				
Financials	2,248,242	0	0	2,248,242
Corporate bonds and notes	0	758,668,531	0	758,668,531
Term loans	0	93,942,259	9,669,157	103,611,416
Yankee corporate bonds and notes	0	39,355,995	0	39,355,995
Short-term investments				
Investment companies	34,974,422	0	0	34,974,422
	$ 39,055,553	**$ 891,966,785**	**$ 9,669,157**	**$ 940,691,495**

Transfers in and transfers out are recognized at the end of the reporting period. For the year ended April 30, 2014, the Fund did not have any transfers between Level 1 and Level 2.

The following is a reconciliation of assets in which significant unobservable inputs (Level 3) were used in determining fair value:

	Common stocks	Term loans	Total
Balance as of April 30, 2013	$ 2,149	$ 20,331,214	$ 20,333,363
Accrued discounts (premiums)	0	5,970	5,970
Realized gains (losses)	0	(2,159)	(2,159)
Change in unrealized gains (losses)	(2,149)	(402,927)	(405,076)

Purchases	0	2,608,184	2,608,184
Sales	0	(4,666,638)	(4,666,638)
Transfers into Level 3	0	0	0
Transfers out of Level 3	0	(8,204,487)	(8,204,487)
Balance as of April 30, 2014	$ 0	$ 9,669,157	$ 9,669,157
Change in unrealized gains (losses) relating to securities still held at April 30, 2014	$ (2,149)	$ (91,602)	$ (93,751)

The investment types categorized above were valued using indicative broker quotes. These indicative broker quotes are considered Level 3 inputs. Quantitative unobservable inputs used by the brokers are often proprietary and not provided to the Fund and therefore the disclosure that would address these inputs is not included above.

4. TRANSACTIONS WITH AFFILIATES AND OTHER EXPENSES

Advisory fee

Funds Management, an indirect wholly owned subsidiary of Wells Fargo & Company (Wells Fargo), is the adviser to the Fund and is entitled to receive a fee at an annual rate of 0.60% of the Fund s average daily total assets. Total assets consist of the net assets of the Fund plus borrowings or other leverage for investment purposes to the extent excluded in calculating net assets. Funds Management has committed through February 23, 2015 to waive fees and/or reimburse expenses to the extent necessary to limit the Fund s borrowing expenses to an amount that is 0.05% lower than what the borrowing expenses would have been if the Fund had not redeemed its Auction Market Preferred Shares (Preferred Shares). Funds Management contractually waived its advisory fee in the amount of $1,774,632 for the year ended April 30, 2014.

Funds Management has retained the services of a subadviser to provide daily portfolio management to the Fund. The fee for subadvisory services is borne by Funds Management. Wells Capital Management Incorporated, an affiliate of Funds Management and an indirect, wholly owned subsidiary of Wells Fargo, is the subadviser to the Fund and is entitled to receive a fee from Funds Management at an annual rate of 0.40% of the Fund s average daily total assets.

Administration fee

Funds Management also serves as the administrator to the Fund, providing the Fund with a wide range of administrative services necessary to the operation of the Fund. Funds Management is entitled to receive an annual administration fee from the Fund equal to 0.05% of the Fund s average daily total assets.

5. CAPITAL SHARE TRANSACTIONS

The Fund has authorized capital of 100,000,000 shares with no par value. For the year ended April 30, 2014 and the year ended April 30, 2013, the Fund issued 15,971 and 241,079 shares, respectively.

The Fund no longer has any Preferred Shares outstanding.

6. BORROWINGS

The Fund has borrowed approximately $230 million through a secured debt financing agreement administered by a major financial institution (the Facility). The Facility has a commitment amount of $230 million which expires on February 25, 2015, at which point it may be renegotiated and potentially renewed for another one-year term. At April 30, 2014, the Fund had secured borrowings outstanding in the amount of $230,204,793 (including accrued interest and usage and commitment fees payable).

The Fund s borrowings under the Facility are generally charged interest at a rate based on the rates of the commercial paper notes issued to fund the Fund s borrowings or at the London Interbank Offered Rate (LIBOR) plus 1.0%. During the year ended April 30, 2014, an effective interest rate of 0.20% was incurred on the borrowings. Interest expense of $474,729, representing 0.07% of the Fund s average daily net assets, was incurred during the year ended April 30, 2014.

The Fund has pledged all of its assets to secure the borrowings and currently pays, on a monthly basis, a usage fee at an annual rate of 0.40% of the daily average outstanding principal amount of borrowings and a commitment fee at an annual rate of 0.40% of the daily average outstanding principal amount of borrowings. Prior to February 25, 2014, the Fund paid a commitment fee at an annual rate of 0.40% of the product of (i) the daily average outstanding principal amount of borrowings and (ii) 1.02. Effective February 25, 2014, the Fund no longer incurs any structuring fees. The secured borrowing fees on the Statement of Operations of $2,018,429 represent the usage fee, commitment fee and structuring fees. For the year ended April 30, 2014, the Fund paid structuring fees in the amount of $134,218.

7. INVESTMENT PORTFOLIO TRANSACTIONS

Purchases and sales of investments, excluding U.S. government obligations (if any) and short-term securities, for the year ended April 30, 2014 were $349,415,046 and $284,867,780, respectively.

As of April 30, 2014, the Fund had unfunded term loan commitments of $8,547,925.

8. DISTRIBUTIONS TO SHAREHOLDERS

The tax character of distributions paid was $57,922,129 and $64,767,000 of ordinary income for the years ended April 30, 2014 and April 30, 2013, respectively.

As of April 30, 2014, the components of distributable earnings on a tax basis were as follows:

Undistributed ordinary income	Unrealized gains	Capital loss carryforward
$3,381,087	$29,310,165	$(298,326,423)

9. INDEMNIFICATION

Under the Fund s organizational documents, the officers and Trustees are indemnified against certain liabilities that may arise out of performance of their duties to the Fund. Additionally, in the normal course of business, the Fund may enter into contracts with service providers that contain a variety of indemnification clauses. The Fund s maximum exposure under these arrangements is dependent on future claims that may be made against the Fund and, therefore, cannot be estimated.

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10. SUBSEQUENT DISTRIBUTIONS

The Fund declared the following distributions to common shareholders:

Declaration date	Record date	Payable date	Per share amount
April 25, 2014	May 14, 2014	June 2, 2014	$0.068
May 16, 2014	June 16, 2014	July 1, 2014	0.068

These distributions are not reflected in the accompanying financial statements. The final determination of the source of all distributions is subject to change and made after the Fund s tax year-end.

BOARD OF TRUSTEES AND SHAREHOLDERS OF WELLS FARGO ADVANTAGE INCOME OPPORTUNITIES FUND:

We have audited the accompanying statement of assets and liabilities, including the portfolio of investments, of the Wells Fargo Advantage Income Opportunities Fund (the Fund), as of April 30, 2014, and the related statement of operations for the year then ended, the statements of changes in net assets for each of the years in the two-year period then ended, the statement of cash flows for the year then ended, and the financial highlights of each of the years in the five-year period then ended. These financial statements and financial highlights are the responsibility of the Fund s management. Our responsibility is to express an opinion on these financial statements and financial highlights based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements and financial highlights are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. Our procedures included confirmation of securities owned as of April 30, 2014, by correspondence with the custodian and brokers, or by other appropriate auditing procedures. 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 audits provide a reasonable basis for our opinion.

In our opinion, the financial statements and financial highlights referred to above present fairly, in all material respects, the financial position of the Wells Fargo Advantage Income Opportunities Fund as of April 30, 2014, the results of its operations, changes in its net assets, its cash flows, and the financial highlights for each of the years noted in the first paragraph above, in conformity with U.S. generally acceptable accounting principles.

Boston, Massachusetts

June 26, 2014

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TAX INFORMATION

Pursuant to Section 854 of the Internal Revenue Code, $143,151 of income dividends paid during the fiscal year ended April 30, 2014 has been designated as qualified dividend income (QDI).

For the fiscal year ended April 30, 2014, $54,938,304 has been designated as interest-related dividends for nonresident alien shareholders pursuant to Section 871 of the Internal Revenue Code.

PROXY VOTING INFORMATION

A description of the policies and procedures that the Fund uses to determine how to vote proxies relating to portfolio securities is available without charge, upon request, by calling **1-800-222-8222**, visiting our website at **wellsfargoadvantagefunds.com**, or visiting the SEC website at sec.gov. Information regarding how the Fund voted proxies relating to portfolio securities during the most recent 12-month period ended June 30 is available without charge on the Fund s website at **wellsfargoadvantagefunds.com** or by visiting the SEC website at sec.gov.

PORTFOLIO HOLDINGS INFORMATION

The complete portfolio holdings for the Fund are publicly available on the Fund s website (**wellsfargoadvantagefunds.com**) on a monthly, 30-day or more delayed basis. The Fund files its complete schedule of portfolio holdings with the SEC for the first and third quarters of each fiscal year on Form N-Q, which is available without charge by visiting the SEC website at sec.gov. In addition, the Fund s Form N-Q may be reviewed and copied at the SEC s Public Reference Room in Washington, DC, and at regional offices in New York City, at 233 Broadway, and in Chicago, at 175 West Jackson Boulevard, Suite 900. Information about the Public Reference Room may be obtained by calling 1-800-SEC-0330.

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BOARD OF TRUSTEES AND OFFICERS

The following table provides basic information about the Board of Trustees (the Trustees) and Officers of the Fund. Each of the Trustees and Officers[1] listed below acts in identical capacities for each fund in the Wells Fargo Advantage family of funds, which consists of 132 mutual funds comprising the Wells Fargo Funds Trust, Wells Fargo Variable Trust, Wells Fargo Master Trust, and four closed-end funds, including the Fund (collectively the Fund Complex). All of the Trustees are also Members of the Audit and Governance Committees of each Trust in the Fund Complex. The mailing address of each Trustee and Officer is 525 Market Street, 12th Floor, San Francisco, CA 94105. The Board of Trustees is classified into three classes of which one is elected annually. Each Trustee serves a three-year term concurrent with the class from which the Trustee is elected. Each Officer serves an indefinite term.

Independent Trustees

Name and year of birth	Position held and length of service	Principal occupations during past five years	Other directorships during past five years
Peter G. Gordon (Born 1942)	Trustee, since 2010; Chairman, since 2010	Co-Founder, Retired Chairman, President and CEO of Crystal Geyser Water Company. Trustee Emeritus, Colby College.	Asset Allocation Trust
Isaiah Harris, Jr. (Born 1952)	Trustee, since 2010	Retired. Prior thereto, President and CEO of BellSouth Advertising and Publishing Corp. from 2005 to 2007, President and CEO of BellSouth Enterprises from 2004 to 2005 and President of BellSouth Consumer Services from 2000 to 2003. Emeritus member of the Iowa State University Foundation Board of Governors. Emeritus Member of the Advisory Board of Iowa State University School of Business. Advisory Board Member, Palm Harbor Academy (charter school). Mr. Harris is a certified public accountant.	CIGNA Corporation; Deluxe Corporation; Asset Allocation Trust
Judith M. Johnson (Born 1949)	Trustee, since 2010; Audit Committee Chairman, since 2010	Retired. Prior thereto, Chief Executive Officer and Chief Investment Officer of Minneapolis Employees Retirement Fund from 1996 to 2008. Ms. Johnson is an attorney, certified public accountant and a certified managerial accountant.	Asset Allocation Trust
Leroy Keith, Jr. (Born 1939)	Trustee, since 2003	Chairman, Bloc Global Services (development and construction). Trustee of the Evergreen Funds from 1983 to 2010. Former Managing Director, Almanac Capital Management (commodities firm), former Partner, Stonington Partners, Inc. (private equity fund), former Director, Obagi Medical Products Co. and former Director, Lincoln Educational Services.	Trustee, Virtus Fund Complex (consisting of 50 portfolios as of 12/16/2013); Asset Allocation Trust
	Trustee, since 2010		

David F. Larcker (Born 1950)		James Irvin Miller Professor of Accounting at the Graduate School of Business, Stanford University, Morgan Stanley Director of the Center for Leadership Development and Research and Senior Faculty of The Rock Center for Corporate Governance since 2006. From 2005 to 2008, Professor of Accounting at the Graduate School of Business, Stanford University. Prior thereto, Ernst & Young Professor of Accounting at The Wharton School, University of Pennsylvania from 1985 to 2005.	Asset Allocation Trust
Olivia S. Mitchell (Born 1953)	Trustee, since 2010	International Foundation of Employee Benefit Plans Professor, Wharton School of the University of Pennsylvania since 1993. Director of Wharton s Pension Research Council and Boettner Center on Pensions & Retirement Research, and Research Associate at the National Bureau of Economic Research. Previously, Cornell University Professor from 1978 to 1993.	Asset Allocation Trust
Timothy J. Penny (Born 1951)	Trustee, since 2010	President and CEO of Southern Minnesota Initiative Foundation, a non-profit organization, since 2007 and Senior Fellow at the Humphrey Institute Policy Forum at the University of Minnesota since 1995. Member of the Board of Trustees of NorthStar Education Finance, Inc., a non-profit organization, since 2007.	Asset Allocation Trust

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Name and year of birth	Position held and length of service	Principal occupations during past five years	Other directorships during past five years
Michael S. Scofield (Born 1943)	Trustee, since 2003	Served on the Investment Company Institute s Board of Governors and Executive Committee from 2008-2011 as well the Governing Council of the Independent Directors Council from 2006-2011 and the Independent Directors Council Executive Committee from 2008-2011. Chairman of the IDC from 2008-2010. Institutional Investor (Fund Directions) Trustee of Year in 2007. Trustee of the Evergreen Funds (and its predecessors) from 1984 to 2010. Chairman of the Evergreen Funds from 2000-2010. Former Trustee of the Mentor Funds. Retired Attorney, Law Offices of Michael S. Scofield.	Asset Allocation Trust
Donald C. Willeke (Born 1940)	Trustee, since 2010	Principal of the law firm of Willeke & Daniels. General Counsel of the Minneapolis Employees Retirement Fund from 1984 until its consolidation into the Minnesota Public Employees Retirement Association on June 30, 2010. Director and Vice Chair of The Tree Trust (non-profit corporation). Director of the American Chestnut Foundation (non-profit corporation).	Asset Allocation Trust

Officers

Name and year of birth	Position held and length of service	Principal occupations during past five years
Karla M. Rabusch (Born 1959)	President, since 2010	Executive Vice President of Wells Fargo Bank, N.A. and President of Wells Fargo Funds Management, LLC since 2003.
Jeremy DePalma[1] (Born 1974)	Treasurer, since 2012	Senior Vice President of Wells Fargo Funds Management, LLC since 2009. Senior Vice President of Evergreen Investment Management Company, LLC from 2008 to 2010. Vice President, Evergreen Investment Services, Inc. from 2004 to 2007. Head of the Fund Reporting and Control Team within Fund Administration from 2005 to 2010.
C. David Messman (Born 1960)	Secretary, since 2010; Chief Legal Officer, since 2010	Senior Vice President and Secretary of Wells Fargo Funds Management, LLC since 2001. Vice President and Managing Counsel of Wells Fargo Bank, N.A. since 1996.
Debra Ann Early (Born 1964)	Chief Compliance	Chief Compliance Officer of Wells Fargo Funds Management, LLC since 2007. Chief Compliance Officer of

	Officer, since 2010	Parnassus Investments from 2005 to 2007. Chief Financial Officer of Parnassus Investments from 2004 to 2007.
David Berardi (Born 1975)	Assistant Treasurer, since 2009	Vice President of Wells Fargo Funds Management, LLC since 2009. Vice President of Evergreen Investment Management Company, LLC from 2008 to 2010. Assistant Vice President of Evergreen Investment Services, Inc. from 2004 to 2008. Manager of Fund Reporting and Control for Evergreen Investment Management Company, LLC from 2004 to 2010.

1. Jeremy DePalma acts as Treasurer of 59 funds and Assistant Treasurer of 73 funds in the Fund Complex.

BOARD CONSIDERATION OF INVESTMENT ADVISORY AND SUB-ADVISORY AGREEMENTS:

Under Section 15 of the Investment Company Act of 1940 (the 1940 Act), the Board of Trustees (the Board) of *Wells Fargo Advantage Income Opportunities Fund* (the Fund), all the members of which have no direct or indirect interest in the investment advisory and sub-advisory agreements and are not interested persons of the Fund, as defined in the 1940 Act (the Independent Trustees), must determine whether to approve the continuation of the Fund s investment advisory and sub-advisory agreements. In this regard, at an in-person meeting held on March 27-28, 2014 (the Meeting), the Board reviewed: (i) an investment advisory agreement with Wells Fargo Funds Management, LLC (Funds Management) for the Fund, and (ii) an investment sub-advisory agreement with Wells Capital Management Incorporated (the Sub-Adviser), an affiliate of Funds Management, for the Fund. The investment advisory agreement with Funds Management and the investment sub-advisory agreement with the Sub-Adviser are collectively referred to as the Advisory Agreements.

At the Meeting, the Board considered the factors and reached the conclusions described below relating to the selection of Funds Management and the Sub-Adviser and the continuation of the Advisory Agreements. Prior to the Meeting, the Trustees conferred extensively among themselves and with representatives of Funds Management about these matters. Also, the Board has adopted a team-based approach, with each team consisting of a sub-set of Trustees, to assist the full Board in the discharge of its duties in reviewing performance and other matters throughout the year. The Independent Trustees were assisted in their evaluation of the Advisory Agreements by independent legal counsel, from whom they received separate legal advice and with whom they met separately.

In providing information to the Board, Funds Management and the Sub-Adviser were guided by a detailed set of requests for information submitted to them by independent legal counsel on behalf of the Independent Trustees at the start of the Board s annual contract renewal process earlier in 2014. In considering and approving the Advisory Agreements, the Trustees considered the information they believed relevant, including but not limited to the information discussed below. The Board considered not only the specific information presented in connection with the Meeting, but also the knowledge gained over time through interaction with Funds Management and the Sub-Adviser about various topics. In this regard, the Board reviewed reports of Funds Management at each of its quarterly meetings, which included, among other things, portfolio reviews and performance reports. In addition, the Board and the teams mentioned above confer with portfolio managers at various times throughout the year. The Board did not identify any particular information or consideration that was all-important or controlling, and each individual Trustee may have attributed different weights to various factors.

After its deliberations, the Board unanimously approved the continuation of the Advisory Agreements and determined that the compensation payable to Funds Management and the Sub-Adviser is reasonable. The Board considered the continuation of the Advisory Agreements for the Fund as part of its consideration of the continuation of advisory agreements for funds across the complex, but its approvals were made on a fund-by-fund basis. The following summarizes a number of important, but not necessarily all, factors considered by the Board in support of its approvals.

Nature, extent and quality of services

The Board received and considered various information regarding the nature, extent and quality of services provided to the Fund by Funds Management and the Sub-Adviser under the Advisory Agreements. This information included, among other things, a summary of the background and experience of senior management of Funds Management, and the qualifications, background, tenure and responsibilities of each of the portfolio managers primarily responsible for the day-to-day portfolio management of the Fund.

The Board evaluated the ability of Funds Management and the Sub-Adviser to attract and retain qualified investment professionals, including research, advisory and supervisory personnel. The Board further considered the compliance programs and compliance records of Funds Management and the Sub-Adviser. In addition, the Board took into account the full range of services provided to the Fund by Funds Management and its affiliates.

Fund performance and expenses

The Board considered the performance results for the Fund over various time periods ended December 31, 2013. The Board also considered these results in comparison to the performance of funds in a universe that was determined by Lipper Inc. (Lipper) to be similar to the Fund (the Universe), and in comparison to the Fund s benchmark index and to other comparative data. Lipper is an independent provider of investment company data. The Board received a description of the methodology used by Lipper to select the funds in the performance Universe. The Board noted that the performance of the Fund was lower than the average performance of the Universe for all periods under review except for the five-year period. However, the Board noted that the performance of the Fund was higher than its benchmark, the BofA Merrill Lynch High Yield Master II Index, for the three- and five-year periods under review.

The Board also received and considered information regarding the Fund s net operating expense ratio and its various components, including actual management fees (which reflect fee waivers, if any, and include advisory, and administration fees), custodian and other non-management fees, and fee waiver and expense reimbursement arrangements. The Board considered this ratio in comparison to the median ratio of funds in an expense group that was determined by Lipper to be similar to the Fund (the Group). The Board received a description of the methodology used by Lipper to select the funds in the expense Group and an explanation of year-to-year variations in the funds comprising such expense Group and their expense ratios. Based on the Lipper reports, the Board noted that the net operating expense ratio of the Fund was lower than the median net operating expense ratio of the expense Group.

Based on its consideration of the factors and information it deemed relevant, including those described here, the Board concluded that the overall performance and expense structure of the Fund supported the re-approval of the Advisory Agreements.

Investment advisory and sub-advisory fee rates

The Board reviewed and considered the contractual investment advisory fee rate that is payable by the Fund to Funds Management for investment advisory services (the Advisory Agreement Rate), both on a stand-alone basis and on a combined basis with the Fund s contractual administration fee rate (the Management Rate). The Board also reviewed and considered the contractual investment sub-advisory fee rate that is payable by Funds Management to the Sub-Adviser for investment sub-advisory services (the Sub-Advisory Agreement Rate).

Among other information reviewed by the Board was a comparison of the Management Rate of the Fund with those of other funds in the expense Group at a common asset level. The Board noted that the Management Rate of the Fund was lower than the average rate for the Fund s expense Group.

The Board also received and considered information about the portion of the total advisory fee that was retained by Funds Management after payment of the fee to the Sub-Adviser for sub-advisory services. In assessing the reasonableness of this amount, the Board received and evaluated information about the nature and extent of responsibilities retained and risks assumed by Funds Management and not delegated to or assumed by the Sub-Adviser, and about Funds Management s on-going oversight services. However, given the affiliation between Funds Management and the Sub-Adviser, the Board ascribed limited relevance to the allocation of the advisory fee between them.

Based on its consideration of the factors and information it deemed relevant, including those described here, the Board determined that the Advisory Agreement Rate and the Sub-Advisory Agreement Rate were reasonable in light of the services covered by the Advisory Agreements.

Profitability

The Board received and considered information concerning the profitability of Funds Management, as well as the profitability of Wells Fargo as a whole, from providing services to the Fund and the fund family as a whole. The Board did not receive or consider to be necessary separate profitability information with respect to the Sub-Adviser, because its profitability information was subsumed in the collective Wells Fargo profitability analysis.

Funds Management explained the methodologies and estimates that it used in calculating profitability. Among other things, the Board noted that the levels of profitability reported on a fund-by-fund basis varied widely, depending on factors such as the size and type of fund. Based on its review, the Board did not deem the profits reported by Funds Management to be at a level that would prevent it from approving the continuation of the Advisory Agreements.

Economies of scale

The Board considered the extent to which there may be sharing with the Fund of potential economies of scale in the provision of advisory services to the Fund. The Board noted that, as is typical of closed-end funds, there are no breakpoints in the Management Rate. Although the Fund would not share in any potential economies of scale through contractual breakpoints, the Board noted that fee waiver and expense reimbursement arrangements and competitive fee rates at the outset are means of sharing potential economies of scale with shareholders of the Fund and the fund family as a whole. The Board concluded that the Fund s fee waiver and expense arrangements constituted a reasonable approach to sharing potential economies of scale with the Fund and its shareholders. The Board also noted that it would have opportunities to revisit the Management Rate as part of future contract reviews.

Other benefits to Funds Management and the Sub-Adviser

The Board received and considered information regarding potential fall-out or ancillary benefits received by Funds Management and its affiliates, including the Sub-Adviser, as a result of their relationships with the Fund. Ancillary benefits could include, among others, benefits directly attributable to other relationships with the Fund and benefits potentially derived from an increase in Funds Management s and the Sub-Adviser s business as a result of their relationships with the Fund.

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Based on its consideration of the factors and information it deemed relevant, including those described here, the Board did not find that any ancillary benefits received by Funds Management and its affiliates, including the Sub-Adviser, were unreasonable.

Conclusion

After considering the above-described factors and based on its deliberations and its evaluation of the information described above, the Board unanimously approved the continuation of the Advisory Agreements for an additional one-year period and determined that the compensation payable to Funds Management and the Sub-Adviser is reasonable.

AUTOMATIC DIVIDEND REINVESTMENT PLAN

All common shareholders are eligible to participate in the Automatic Dividend Reinvestment Plan (the Plan). Pursuant

to the Plan, unless a common shareholder is ineligible or elects otherwise, all cash dividends and capital gains distributions are automatically reinvested by Computershare Trust Company, N.A., as agent for shareholders in administering the Plan (Plan Agent), in additional common shares of the Fund. Whenever the Fund declares an ordinary income dividend or a capital gain dividend (collectively referred to as dividends) payable either in shares or in cash, nonparticipants in the Plan will receive cash, and participants in the Plan will receive the equivalent in common shares. The shares are acquired by the Plan Agent for the participant s account, depending upon the circumstances described below, either (i) through receipt of additional unissued but authorized common shares from the Fund (newly issued common shares) or (ii) by purchase of outstanding common shares on the open-market (open-market purchases) on the NYSE Amex or elsewhere. If, on the payment date for any dividend or distribution, the net asset value per share of the common shares is equal to or less than the market price per common share plus estimated brokerage commissions (market premium), the Plan Agent will invest the amount of such dividend or distribution in newly issued shares on behalf of the participant. The number of newly issued common shares to be credited to the participant s account will be determined by dividing the dollar amount of the dividend by the net asset value per share on the date the shares are issued, provided that the maximum discount from the then current market price per share on the date of issuance may not exceed 5%. If on the dividend payment date the net asset value per share is greater than the market value (market discount), the Plan Agent will invest the dividend amount in shares acquired on behalf of the participant in open-market purchases. There will be no brokerage charges with respect to shares issued directly by the Fund as a result of dividends or capital gains distributions payable either in shares or in cash. However, each participant will pay a pro rata share of brokerage commissions incurred with respect to the Plan Agent s open-market purchases in connection with the reinvestment of dividends. The automatic reinvestment of dividends and distributions will not relieve participants of any federal, state or local income tax that may be payable (or required to be withheld) on such dividends. All correspondence concerning the Plan should be directed to the Plan Agent at P.O. Box 30170, College Station, Texas 77842-3170 or by calling 1-800-730-6001.

The following is a list of common abbreviations for terms and entities that may have appeared in this report.

ACA	ACA Financial Guaranty Corporation
ADR	American depositary receipt
ADS	American depositary shares
AGC	Assured Guaranty Corporation
AGM	Assured Guaranty Municipal
Ambac	Ambac Financial Group Incorporated
AMT	Alternative minimum tax
AUD	Australian dollar
BAN	Bond anticipation notes
BHAC	Berkshire Hathaway Assurance Corporation
BRL	Brazilian real
CAB	Capital appreciation bond
CAD	Canadian dollar
CCAB	Convertible capital appreciation bond
CDA	Community Development Authority
CDO	Collateralized debt obligation
CHF	Swiss franc
COP	Columbian Peso
CLP	Chilean peso
DKK	Danish krone
DRIVER	Derivative inverse tax-exempt receipts
DW&P	Department of Water & Power
DWR	Department of Water Resources
ECFA	Educational & Cultural Facilities Authority
EDA	Economic Development Authority
EDFA	Economic Development Finance Authority
ETF	Exchange-traded fund
EUR	Euro
FDIC	Federal Deposit Insurance Corporation
FFCB	Federal Farm Credit Banks
FGIC	Financial Guaranty Insurance Corporation
FHA	Federal Housing Administration
FHLB	Federal Home Loan Bank
FHLMC	Federal Home Loan Mortgage Corporation
FICO	The Financing Corporation
FNMA	Federal National Mortgage Association
FSA	Farm Service Agency
GBP	Great British pound
GDR	Global depositary receipt
GNMA	Government National Mortgage Association
GO	General obligation

HCFR	Healthcare facilities revenue
HEFA	Health & Educational Facilities Authority
HEFAR	Higher education facilities authority revenue
HFA	Housing Finance Authority
HFFA	Health Facilities Financing Authority
HKD	Hong Kong dollar
HUD	Department of Housing and Urban Development
HUF	Hungarian forint
IDA	Industrial Development Authority
IDAG	Industrial Development Agency
IDR	Indonesian rupiah
IEP	Irish pound
JPY	Japanese yen
KRW	Republic of Korea won
LIBOR	London Interbank Offered Rate
LIQ	Liquidity agreement
LLC	Limited liability company
LLLP	Limited liability limited partnership
LLP	Limited liability partnership
LOC	Letter of credit
LP	Limited partnership
MBIA	Municipal Bond Insurance Association
MFHR	Multifamily housing revenue
MSTR	Municipal securities trust receipts
MTN	Medium-term note
MUD	Municipal Utility District
MXN	Mexican peso
MYR	Malaysian ringgit
National	National Public Finance Guarantee Corporation
NGN	Nigerian naira
NOK	Norwegian krone
NZD	New Zealand dollar
PCFA	Pollution Control Financing Authority
PCL	Public Company Limited
PCR	Pollution control revenue
PFA	Public Finance Authority
PFFA	Public Facilities Financing Authority
PFOTER	Puttable floating option tax-exempt receipts
plc	Public limited company
PLN	Polish zloty
PUTTER	Puttable tax-exempt receipts
R&D	Research & development
Radian	Radian Asset Assurance
RAN	Revenue anticipation notes
RDA	Redevelopment Authority
RDFA	Redevelopment Finance Authority
REIT	Real estate investment trust
ROC	Reset option certificates
RON	Romanian lei
RUB	Russian ruble
SAVRS	Select auction variable rate securities

SBA	Small Business Authority
SEK	Swedish krona
SFHR	Single-family housing revenue
SFMR	Single-family mortgage revenue
SGD	Singapore dollar
SKK	Slovakian koruna
SPA	Standby purchase agreement
SPDR	Standard & Poor s Depositary Receipts
STRIPS	Separate trading of registered interest and principal securities
TAN	Tax anticipation notes
TBA	To be announced
THB	Thai baht
TIPS	Treasury inflation-protected securities
TRAN	Tax revenue anticipation notes
TRY	Turkish lira
TTFA	Transportation Trust Fund Authority
TVA	Tennessee Valley Authority
ZAR	South African rand

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Transfer Agent, Registrar, Shareholder Servicing

Agent & Dividend Disbursing Agent

Computershare Trust Company, N.A.

P.O. Box 30170

College Station, TX 77842-3170

1-800-730-6001

Website: wellsfargoadvantagefunds.com

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NOT FDIC INSURED ¡ NO BANK GUARANTEE ¡ MAY LOSE VALUE

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ITEM 2. CODE OF ETHICS

(a) As of the end of the period, covered by the report, Wells Fargo Advantage Income Opportunities Fund has adopted a code of ethics that applies to its President and Treasurer. A copy of the code of ethics is filed as an exhibit to this Form N-CSR.

(c) During the period covered by this report, there were no amendments to the provisions of the code of ethics adopted in Item 2(a) above.

(d) During the period covered by this report, there were no implicit or explicit waivers to the provisions of the code of ethics adopted in Item 2(a) above.

ITEM 3. AUDIT COMMITTEE FINANCIAL EXPERT

The Board of Trustees of Wells Fargo Advantage Income Opportunities Fund has determined that Judith Johnson is an audit committee financial expert, as defined in Item 3 of Form N-CSR. Mrs. Johnson is independent for purposes of Item 3 of Form N-CSR.

ITEM 4. PRINCIPAL ACCOUNTANT FEES AND SERVICES

(a), (b), (c), (d) The following table presents aggregate fees billed in each of the last two fiscal years for services rendered to the Registrant by the Registrant s principal accountant. These fees were billed to the registrant and were approved by the Registrant s audit committee.

	Fiscal year ended April 30, 2014	**Fiscal year ended April 30, 2013**
Audit fees	$ 49,110	$ 47,910
Audit-related fees (1)	16,585	16,180
Tax fees (2)	2,090	3,780
All other fees		
	$ 67,785	$ 67,870

(1) Audit-related fees consist of agreed-upon procedures performed that are not reported under audit fees.

(2) Tax fees consist of fees for tax compliance, tax advice and tax planning. Excise tax fees for fiscal year ended April 30, 2013 in the amount of $1,740 was billed on December 2013 and is included in the fiscal year ended April 30, 2013 value. Excise tax fees for fiscal year ended April 30, 2014 have not yet been billed.

(e) The Chairman of the Audit Committees is authorized to pre-approve: (1) audit services for the Wells Fargo Advantage Income Opportunities Fund; (2) non-audit tax or compliance consulting or training services provided to the Wells Fargo Advantage Income Opportunities Fund by the independent auditors (Auditors) if the fees for any particular engagement are not anticipated to exceed $50,000; and (3) non-audit tax or compliance consulting or training services provided by the Auditors to Wells Fargo Advantage Income Opportunities Fund s investment adviser and its controlling entities (where pre-approval is required because the engagement relates directly to the operations and financial reporting of Wells Fargo Advantage Income Opportunities Fund) if the fee to the Auditors for any particular engagement is not anticipated to exceed $50,000. For any such pre-approval sought from the Chairman, Management shall prepare a brief description of the proposed services. If the Chairman approves of such service, he or she shall sign the statement prepared by Management. Such written statement shall be presented to the full Committees at their next regularly scheduled meetings.

(f) Not applicable

(g) Not applicable

(h) Not applicable

ITEM 5. AUDIT COMMITTEE OF LISTED REGISTRANTS

Not applicable.

ITEM 6. INVESTMENTS

The Portfolio of investments is included as part of the report to shareholders filed under Item 1 of this Form.

ITEM 7. DISCLOSURE OF PROXY VOTING POLICIES AND PROCEDURES FOR CLOSED-END MANAGEMENT INVESTMENT COMPANIES

PROXY VOTING POLICIES AND PROCEDURES

REVISED AS OF FEBRUARY 8, 2012

1. Scope of Policies and Procedures. These Policies and Procedures (Procedures) are used to determine how to vote proxies relating to portfolio securities held by the series of Wells Fargo Funds Trust, Wells Fargo Master Trust, Wells Fargo Variable Trust, Asset Allocation Trust, Wells Fargo Advantage Global Dividend Opportunity Fund, Wells Fargo Advantage Income Opportunities Fund, Wells Fargo Advantage Multi-Sector Income Fund, and Wells Fargo Advantage Utilities and High Income Fund (the Trusts) except for those series that exclusively hold non-voting securities (hereafter, all such series, and all such Trusts not having separate series, holding voting securities are referred to as the Funds).

2. Voting Philosophy. The Funds and Wells Fargo Funds Management, LLC (Funds Management) have adopted these Procedures to ensure that proxies are voted in the best interests of Fund shareholders, without regard to any relationship that any affiliated person of the Fund (or an affiliated person of such affiliated person) may have with the issuer. Funds Management exercises its voting responsibility, as a fiduciary, with the goal of maximizing value to shareholders consistent with governing laws and the investment policies of each Fund. While securities are not purchased to exercise control or to seek to effect corporate change through share ownership, the Funds support sound corporate governance practices within companies in which they invest.

3. Responsibilities

(a) Board of Trustees. The Board of Trustees of each Trust (the Board) has delegated the responsibility for voting proxies relating to the Funds portfolio securities to Funds Management. The Board retains the authority to make or ratify any voting decisions or approve any changes to these Procedures as the Board deems appropriate. Funds

Management will provide reports to the Board regarding voting matters when and as reasonably requested by the Board. The Board shall review these Procedures as often as it deems appropriate to consider whether any revisions are warranted. On an annual basis, the Board shall receive and review a report from Funds Management on the proxy voting process.

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(b) Funds Management Proxy Committee