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THE GUARANTEED STUDENT LOAN PROGRAMS' OPERATING FUND AND FEDERAL FUND OF THE NEW YORK STATE HIGHER EDUCATION SERVICES CORPORATION

Financial Statements

March 31, 2012 and 2011

(With Independent Auditors' Report Thereon)

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Financial Statements

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KPMG LLP
515 Broadway
Albany, NY 12207-2974

Independent Auditors' Report

Board of Trustees
New York State Higher Education
Services Corporation:

We have audited the accompanying financial statements of the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of the New York State Higher Education Services Corporation (HESC), as of and for the years ended March 31, 2012 and 2011, which collectively comprise HESC's basic financial statements as listed in the table of contents. These financial statements are the responsibility of HESC's management. Our responsibility is to express opinions on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of HESC's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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 opinions.

As discussed in note 1, the financial statements present only the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of HESC and do not purport to, and do not, present fairly the financial position of the New York State Higher Education Services Corporation as of March 31, 2012 and 2011 and its changes in net assets and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial positions of the Guaranteed Student Loan Programs' Operating Fund and Federal Fund of the New York State Higher Education Services Corporation as of March 31, 2012 and 2011, and the respective changes in net assets, and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued a report dated, September 27, 2012 on our consideration of the Operating Fund's and Federal Fund's internal control over financial reporting and on our tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

U.S. generally accepted accounting principles require that the management's discussion and analysis listed on pages 3 through 12, be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to management's discussion and analysis in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

KPMG LLP

September 27, 2012

Management's Discussion and Analysis

This section of the New York State Higher Education Services Corporation (HESC) Guaranteed Student Loan Programs' financial statements presents management's discussion and analysis of its operations and financial performance during the fiscal years ended March 31, 2012 and 2011. This analysis provides supplementary information on the operations and activities of HESC, and should be read in conjunction with the Operating and Federal Funds' financial statements, which follow this section.

Organization and Operations

HESC is an agency of New York State (NYS) created in 1974 under Chapter 942 of the Laws of 1974 and is responsible for the administration of New York State's student financial aid programs, including the Federal Family Education Loan Program (FFELP) and State loan guarantee program. FFELP was established by Congress and is administered by the U.S. Department of Education (ED) through HESC and other guaranty agencies. As a result of the March 30, 2010 enactment of the Health Care and Education Reconciliation Act (HCERA) (HR4872), new loan guarantees under the FFELP were eliminated effective July 1, 2010.

Under the FFELP, HESC was responsible for processing loans submitted for guarantee and issuing loan guarantees. HESC will continue providing collection assistance to lenders for delinquent loans, paying lender claims for loans in default, and collection activities on loans after purchase by HESC. In addition to FFELP, the Guaranteed Student Loan Programs (GSL) include the residual activity of the State guaranteed loan program in which no new loans have been guaranteed since 1984.

HESC has a Federal Student Loan Reserve Fund (Federal Fund) and an Operating Fund to account for FFELP activity. The Federal Fund assets, and earnings on those assets, are restricted in use and are considered property of ED. The Operating Fund is considered property of HESC, and its assets and earnings may be used generally for guaranty agency and other student financial aid related activities.

2012 Financial Highlights-Operating Fund

- Current assets increased $20.8 million or 31%.
- Current liabilities increased $.75 million or 4%.
- Total revenue increased $12.6 million or 13%.
- Operating expenses increased $1.8 million or 3%.
- The Operating Fund provided $11.2 million for the cost of administering the New York State grant and scholarship programs.
- The Operating Fund provided $2.4 million toward the costs of operations for the New York Higher Education Loan Program (NYHELPs).
- The Operating Fund transferred $16 million to the New York State Tuition Assistance Program (TAP) to subsidize grant expenditures.

2011 Financial Highlights-Operating Fund

- Current assets decreased $2.6 million or 4%.
- Current liabilities decreased $1.6 million or 9%.
- Total revenue increased $3.1 million or 3%.
- Operating expenses decreased $4.7 million or 7%.
- The Operating Fund provided $11.6 million for the cost of administering the New York State grant and scholarship programs.
- The Operating Fund provided $4.3 million toward the start up and operating costs for the New York State Higher Education Loan Program (NYHELPs).
- The Operating Fund transferred $22.2 million to the New York State Tuition Assistance Program (TAP) to subsidize grant expenditures.

Condensed Financial Information

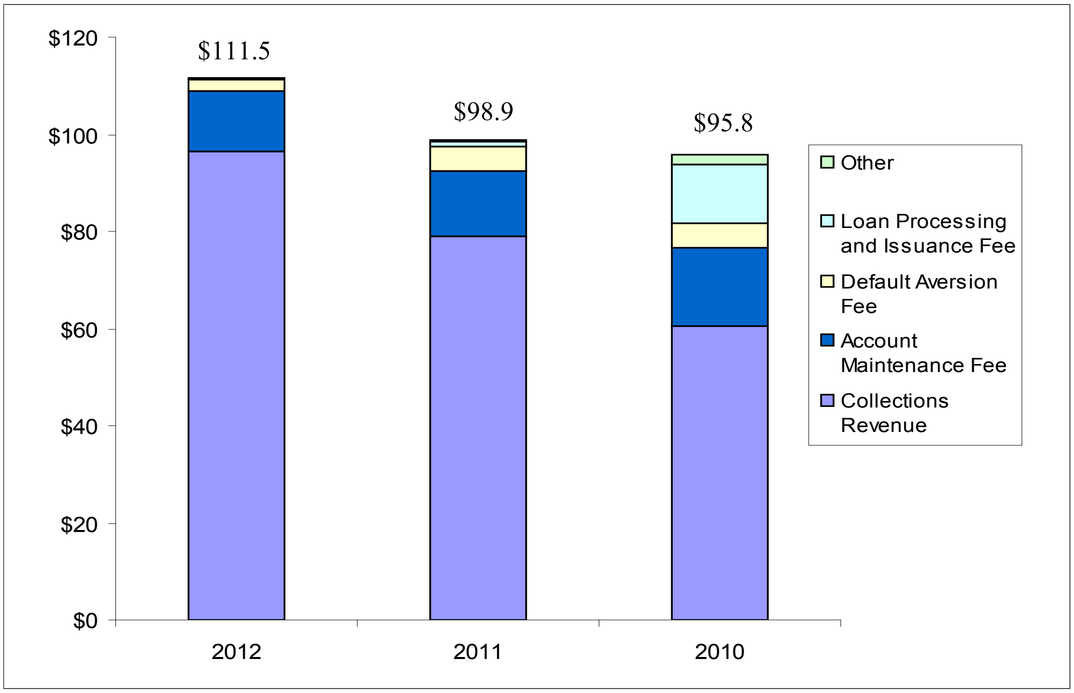
Amounts in thousands

		Operating Fund			Federal Fund		
		2012	**2011**	**2010**	**2012**	**2011**	**2010**
Current assets	$	86,852	66,066	68,683	60,755	80,443	90,335
Capital assets		492	382	203	-	-	-
Other noncurrent assets		-	-	-	5,691	4,755	4,183
Total assets		87,344	66,448	68,886	66,446	85,198	94,518
Current liabilities		17,882	17,131	18,770	545	2,874	423
Noncurrent liabilities		5,691	4,755	5,263	10,300	10,300	10,300
Total liabilities		23,573	21,886	24,033	10,845	13,174	10,723
Net asssets:							
Invested in capital assets		492	382	203	-	-	-
Restricted		63,279	44,180	44,650	55,601	72,024	83,795
Total net assets	$	63,771	44,562	44,853	55,601	72,024	83,795

		Operating Fund			Federal Fund		
		2012	**2011**	**2010**	**2012**	**2011**	**2010**
Operating Revenue:							
Default loan collections	$	96,517	78,894	60,662	270,135	236,916	204,007
Reimbursement of defaulted loans		-	-	-	624,206	612,241	561,625
Administrative and program fee		14,795	19,651	33,285	113	1,580	29,952
Other revenues		171	315	1,821	41	94	61
Total revenues		111,483	98,860	95,768	894,495	850,831	795,645
Operating expenses:							
Administrative		61,626	59,974	64,677	-	-	-
Default loan purchases		-	-	-	650,561	637,200	584,411
Collection payments to ED		-	-	-	257,876	226,430	195,313
Fee subsidies		-	-	-	2,479	5,208	4,984
Other		190	89	43	44	20	6
Non Operating expenses		30,416	38,983	39,171	-	-	-
Total expenses		92,232	99,046	103,891	910,960	868,858	784,714
Transfers		(42)	(105)	4,780	42	105	(4,780)
Changes in net assets	$	19,209	(291)	(3,343)	(16,423)	(17,922)	6,151

HESC Total Operating Fund Revenue

$ in millions



Operating Fund Revenue Highlights for fiscal year ending March 31,

2012

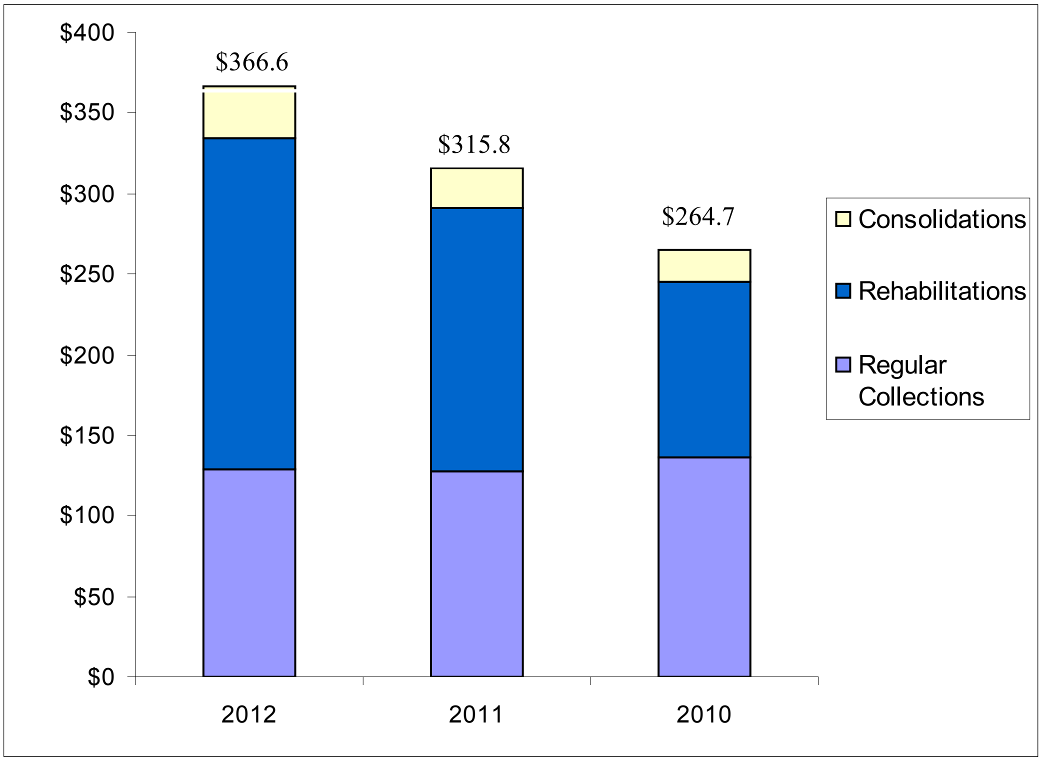
- Collections revenue represents 86% of total revenue, an increase from last year as a result of increased rehabilitation and consolidation sales and decreased administrative revenue.
- Portfolio administration fee revenue decreased by $1.3 million as a result of a decrease in outstanding principal balance of loans outstanding due to the Federal Loan Purchase Commitment (PUT) program.
- As a result of HCERA, HESC did not guarantee any new loans in SFY 2011-12.
- Default aversion fee (DAF) revenue decreased $2.7 million to $2.5 million.

2011

- Collections revenue represents 80% of total revenue, an increase from last year as a result of increased rehabilitation sales and decreased administrative revenue.
- Portfolio administration fee revenue decreased by $2.4 million as a result of a decrease in outstanding principal balance of loans outstanding due to the Federal Loan Purchase Commitment (PUT) program.
- HESC guaranteed $86 million in new loans, a decrease of $3.43 billion in loan volume which resulted in a $11.5 million decrease in loan processing revenue.
- Default aversion fee (DAF) revenue increased $.2 million to $5.2 million.

Total Default Collection Recoveries

$ in millions



HESC's primary source of revenue continues to be from FFELP collection related activity. As a FFELP guarantor, HESC retains a percentage of collection recoveries determined by ED.

Collection Recovery Highlights for the fiscal year ending March 31,

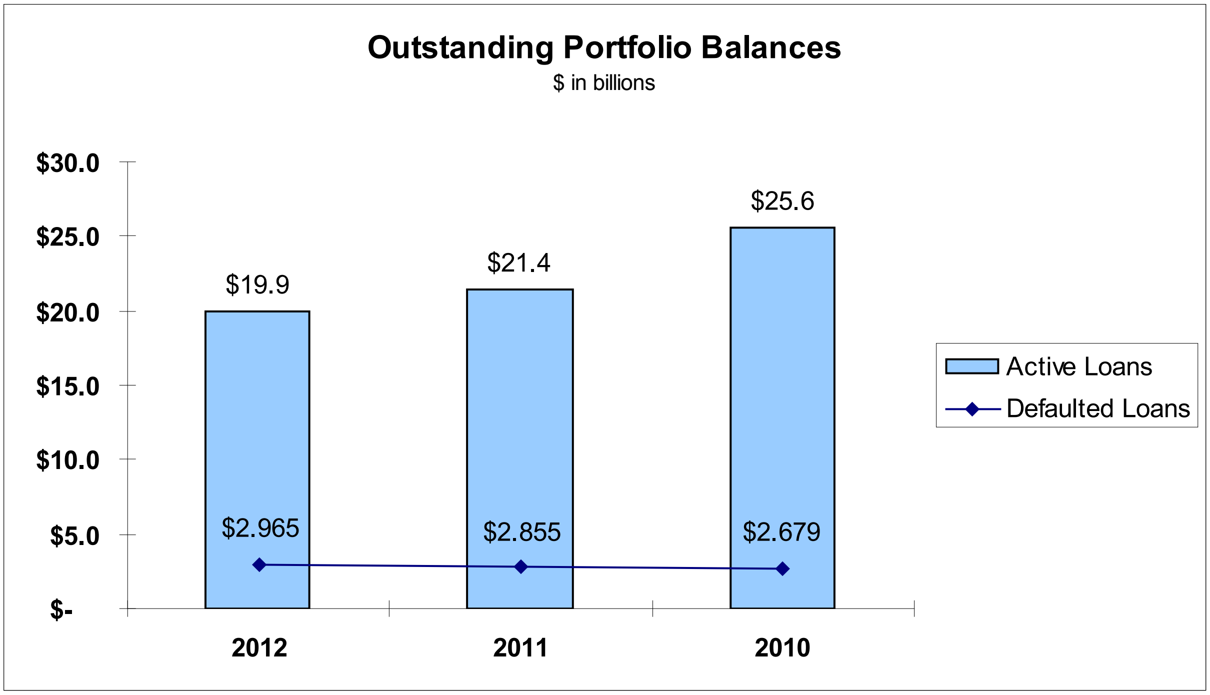
2012

- Collections on rehabilitated loans increased 26% to $206 million as a result of HESC collection efforts.
- Total regular collections increased 1% from $127.6 million in 2011 to $128.7 million in 2012, as a result of HESC's collection efforts.
- Federal direct default consolidation revenue increased $6.7 million during the fiscal year from $25.2 million in 2011 to $31.9 million in 2012, as part of HESC's collection strategy for borrowers with limited repayment options.

2011

- Collections on rehabilitated loans increased 49% to $163 million as a result of HESC collection efforts.
- Total regular collections decreased 6% from $135.8 million in 2010 to $127.6 million in 2011.
- Federal direct default consolidation revenue increased $5.9 million during the fiscal year from $19.3 million in 2010 to $25.2 million in 2011, as part of HESC's collection strategy for borrowers with limited repayment options.

Operating Fund Administration Revenue on Guaranteed FFEL Loans



Administrative Revenue Highlights for the fiscal year ending March 31,

2012

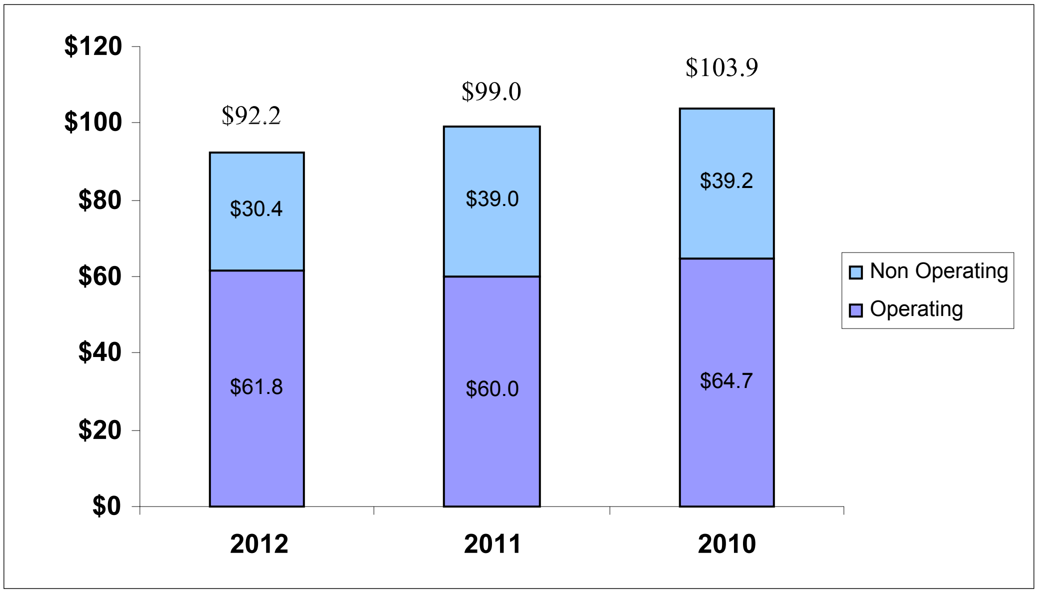
- HESC's outstanding portfolio balance decreased by $1.5 billion or 7% for the fiscal year as a result of the PUT program, causing a decrease in account maintenance fee of $1.3 million.
- Default aversion fee revenue, net of refunds, decreased $2.7 million for the fiscal year as a result of a decrease in DAF revenue and a 35% increase in DAF refunds.
- As a result of the elimination of FFELP effective July 1, 2010, HESC did not guarantee any new loans in state fiscal year 2012. Loan processing and issuance fee is no longer a source of revenue for HESC.

2011

- HESC's outstanding portfolio balance decreased by $4.20 billion or 16% for the fiscal year as a result of the PUT program, causing a decrease in account maintenance fee of $2.5 million.
- Default aversion fee, net of refunds increased $.2 million during the fiscal year because DAF revenue grew at a slightly higher rate than the DAF refunds.
- As a result of the elimination of FFELP effective July 1, 2010, HESC's new loan guarantees in fiscal year 2011 were $85 million, a decrease from 2010 of $3.3 billion resulting in a decrease in loan processing and issuance fee in fiscal year 2011 of $11.5 million.

Total HESC Operating Fund Expenses

$ in millions



HESC Operating Expense Highlights for fiscal year ending March 31,

2012

Operating Expenses

- Outsourced vendor collection fees increased $6.2 million or 40% as a result of increased collections attributable to outside collection agencies.
- Contract programmer expenses decreased approximately $.8 million or 80% from 2011 as a result of cost cutting measures implemented by management.
- Payroll and fringe benefits decreased by $2.9 million or 9% due to a reduction in full time equivalent employees from 500 to 480. In addition, the Governor and labor unions negotiated a 5 day deficit reduction leave to reduce personal service costs across the state.
- Allowance for default aversion fee refunds decreased $1.8 million as a result of reduced projected revenue.

Non Operating Expenses

- The Operating Fund contributed $16.0 million to subsidize the Tuition Assistance Program.
- Grant and scholarship program expenses decreased $.5 million to $11.2 million.
- HESC incurred $2.4 million in expenses related to NYHELPs, a 46% reduction from the prior year.

2011

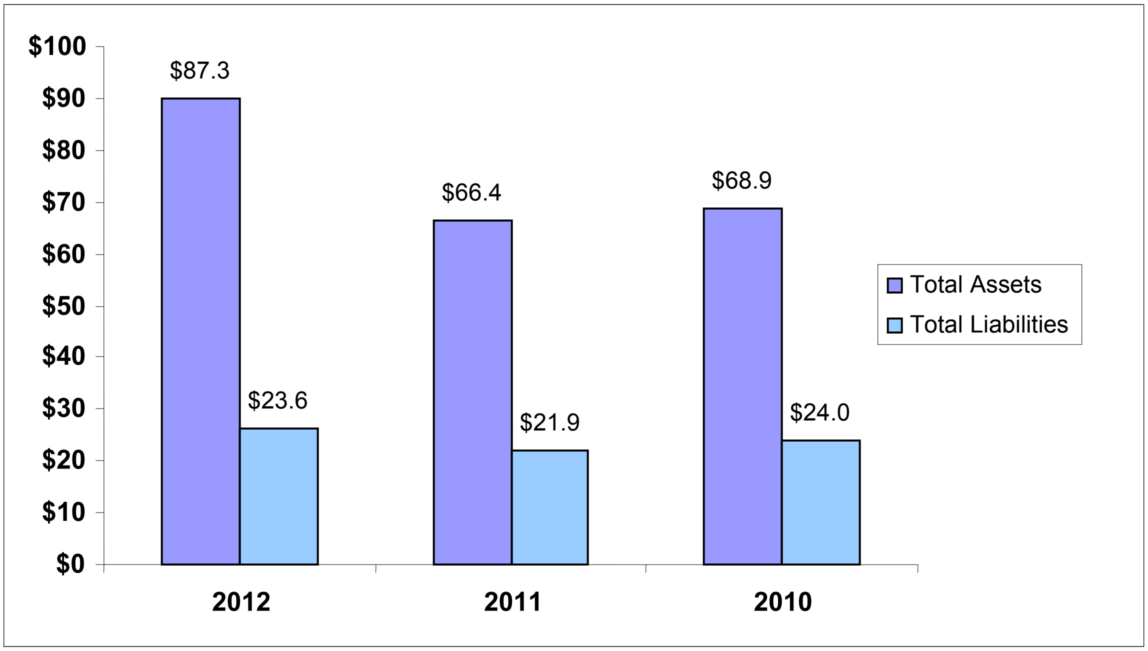
Operating Expenses

- Outsourced vendor collection fees increased $3.3 million or 29% as a result of increased collections attributable to outside collection agencies.
- Contract programmer expenses decreased approximately $1.1 million or 52% as a result of cost cutting measures implemented by management.
- Payroll and fringe benefits decreased $3.9 million or 11% due to a reduction in full time equivalent employees.
- Allowance for default aversion fee refunds decreased $1.2 million as a result of reduced projected revenue.

Non Operating Expenses

- The Operating Fund contributed $22.2 million to subsidize the Tuition Assistance Program.
- Grant and scholarship program expenses decreased $.17 million.
- HESC incurred $4.3 million in expenses related to NYHELPs, a significant portion of which, were start up costs.

Operating Fund Asset and Liabilities
$ in millions



Assets

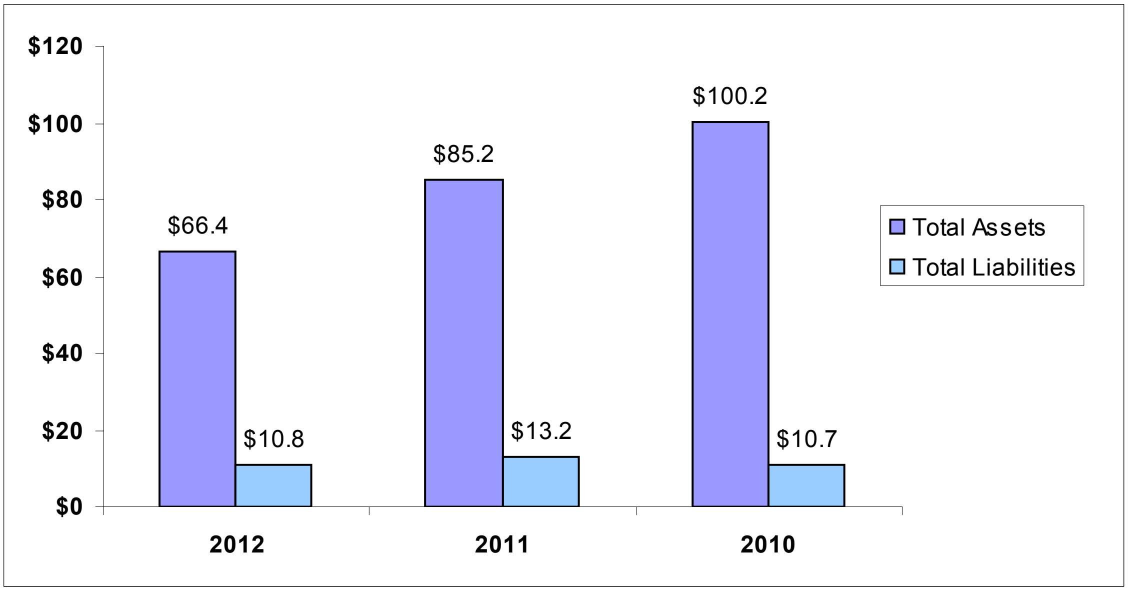
- Total operating assets are primarily current assets, consisting of cash and cash equivalents, receivables due from the U.S. Department of Education and the Federal Fund.
- Total assets increased $20.8 million or 31%, primarily due to a $12.6 million increase in operating revenue and a $8.5 million decline in non-operating expenses. Interfund balances fluctuate due to the timing of transfers between the Federal Fund and Operating Fund. The receivable from the Federal Fund declined during the state fiscal year by $2.3 million.

Liabilities

- Accounts payable and accrued liabilities represented 75% and 77% of total liabilities for the fiscal years ending March 31, 2012 and 2011 respectively.
- Accounts payable increased $.9 million during the 2012 state fiscal year due to the implementation of the new Statewide Financial System which began March 2012.
- Noncurrent liabilities increased approximately $.9 million, as a result of the decrease in the allowance for default aversion fee refund.

The Federal Student Loan Reserve Fund (Federal Fund)

$ in millions



The Federal Fund assets are owned by the U.S. Department of Education (ED) and have restricted use, primarily to reimburse lender claims for defaulted student loans.

Assets

- The Federal Fund cash and cash equivalents decreased $18.5 million or 41% in fiscal year 2011-12 as a result of cash used in operations of $18.6 million.
- The reinsurance receivable decreased $1.2 million.
- The interfund DAF allowance increased $.9 million in fiscal year 2012 based on current refund statistics.

Liabilities

- Current liabilities include $.5 million in interfund payables to the Operating Fund which will settle during the next fiscal year.
- Non current liabilities include $10.3 million for non-interest bearing advances from U.S. Department of Education, for the purpose of helping strengthen the FFELP through the infusion of additional working capital.

Significant Known Facts, Decisions and Conditions

- As part of the Governor's re-stacking cost savings initiative, HESC has consolidated its office space and adjusted its lease accordingly to reflect the decrease in rented square feet.
- The Operating Fund will continue to support the operational expenses of the grant and scholarship programs in the amount of approximately $11.1 million for state fiscal year 2012-2013.
- The 2012-2013 New York State budget appropriated $32 million of the Operating Fund balance for NYS Tuition Assistance Program.
- The fringe benefit rate for state fiscal year 2012-2013 increased 14% from 46.32% to 52.85%.
- HESC is currently participating in several of the Governor's Reimagining Government initiatives to consolidate services that are common among agencies to provide them in the most efficient and effective manner possible, at a reduced cost to taxpayers.
- No new funding has been recommended for the New York Higher Education Loan Program for state fiscal year 2012-2013, due to its continued underutilization. As a result, no new loans will be made for 2012-2013 while the program is evaluated to determine how it can best serve New York State students and families.

Contacting Financial Management

This financial report is designed to provide our customers, business partners and creditors with a general overview of the Guaranteed Student Loan Programs' finances. For detailed information regarding the FFEL Program, you may also review our annual report on the web at **www.hesc.ny.gov.**

Questions about this report can be directed to HESC's Administrative Officer, Warren Wallin at (518) 473-1200 or WWallin@hesc.ny.gov.

THE GUARANTEED STUDENT LOAN PROGRAMS' OPERATING FUND AND FEDERAL FUND OF THE NEW YORK STATE HIGHER EDUCATION SERVICES CORPORATION

Statements of Net Assets

March 31, 2012 and 2011

	2012		2011	
Assets	**Operating Fund**	**Federal Fund**	**Operating Fund**	**Federal Fund**
Current assets:				
Cash and cash equivalents (note 4)	$ 82,939,563	26,970,539	59,704,478	45,511,488
Receivables due from U.S. Department of Education:				
Administrative fees (note 5)	2,987,094	—	3,208,901	—
Reinsurance	—	33,784,540	—	34,916,482
EFT fees receivable from lenders	21,577	—	20,886	—
Interfund balances (note 7)	544,105	—	2,874,119	—
Due from lenders for default fee billing (note 13)	—	—	—	15,062
Prepaid expenses and other assets	359,744	98	257,279	71
Total current assets	86,852,083	60,755,177	66,065,663	80,443,103
Noncurrent assets:				
Interfund default aversion fee allowance (note 5)	—	5,690,949	—	4,755,209
Capital assets, net (note 10)	491,395	—	381,813	—
Total noncurrent assets	491,395	5,690,949	381,813	4,755,209
Total assets	87,343,478	66,446,126	66,447,476	85,198,312
Liabilities and Net Assets				
Current liabilities:				
Accounts payable and accrued liabilities	17,744,528	442	16,814,673	—
Interfund balances (note 7)	—	544,105	—	2,874,119
Amounts payable to lenders through EFT (note 4)	137,440	—	315,938	—
Total current liabilities	17,881,968	544,547	17,130,611	2,874,119
Noncurrent liabilities:				
Advance from U.S. Department of Education (note 11)	—	10,300,348	—	10,300,348
Interfund default aversion fee allowance (note 5)	5,690,949	—	4,755,209	—
Total noncurrent liabilities	5,690,949	10,300,348	4,755,209	10,300,348
Total liabilities	23,572,917	10,844,895	21,885,820	13,174,467
Net assets:				
Invested in capital assets	491,395	—	381,813	—
Restricted – property of U.S. Department of Education	—	55,601,231	—	72,023,845
Restricted – for student aid related activities	63,279,166	—	44,179,843	—
Total net assets	$ 63,770,561	55,601,231	44,561,656	72,023,845

See accompanying notes to financial statements.

THE GUARANTEED STUDENT LOAN PROGRAMS'
OPERATING FUND AND FEDERAL FUND OF
THE NEW YORK STATE HIGHER EDUCATION
SERVICES CORPORATION

Statements of Revenue, Expenses, and Changes in Net Assets

Years ended March 31, 2012 and 2011

	2012		2011	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
Operating revenues:				
Defaulted loan collections (note 6)	$ 96,517,379	270,135,266	78,893,948	236,916,311
Administrative and program fee income (note 5, 13)	14,795,460	112,892	19,651,171	1,580,295
Reimbursement on purchases of default loans from lenders (note 12)	—	624,205,705	—	612,240,690
Other revenue	73,544	3,698	208,781	12,646
Total operating revenues	111,386,383	894,457,561	98,753,900	850,749,942
Operating expenses:				
Salaries and employee benefits	30,255,881	—	33,499,839	—
General and administrative	7,375,155	—	7,916,132	—
Collections	21,405,139	—	15,248,792	—
NYS Office for Technology equipment usage charges	1,878,129	—	2,225,681	—
D.M.I. program expenses	711,737	—	1,065,432	—
Default aversion fee subsidy	—	2,479,411	—	5,207,517
Purchases of default loans from lenders (note 12)	—	650,560,910	—	637,200,138
Defaulted loan collections paid to U.S. Department of Education (note 6)	—	257,876,152	—	226,430,399
Depreciation (note 10)	190,418	—	89,338	—
Other expense	—	43,865	—	20,415
Purchases of defaulted State loans from lenders	—	—	18,234	—
Total operating expenses	61,816,459	910,960,338	60,063,448	868,858,469
Operating income (loss)	49,569,924	(16,502,777)	38,690,452	(18,108,527)
Nonoperating revenues (expenses):				
Interest income	96,996	37,691	105,969	81,790
Gear Up operational expenses	(843,394)	—	(855,290)	—
New York State initiatives (note 8)	(29,572,149)	—	(38,128,097)	—
Total nonoperating (expenses) revenues	(30,318,547)	37,691	(38,877,418)	81,790
Transfer (to) from Federal Fund (note 9)	—	—	(165,475)	165,475
Transfer of Federal default fee (note 13)	(42,472)	42,472	60,953	(60,953)
Increase (decrease) in net assets	19,208,905	(16,422,614)	(291,488)	(17,922,215)
Net assets, beginning	44,561,656	72,023,845	44,853,144	89,946,060
Net assets, ending	$ 63,770,561	55,601,231	44,561,656	72,023,845

See accompanying notes to financial statements.

THE GUARANTEED STUDENT LOAN PROGRAMS' OPERATING FUND AND FEDERAL FUND OF THE NEW YORK STATE HIGHER EDUCATION SERVICES CORPORATION

Statements of Cash Flows

Years ended March 31, 2012 and 2011

	2012 Operating Fund	2012 Federal Fund	2011 Operating Fund	2011 Federal Fund
Cash flows from operating activities:				
Receipts from:				
Collections	$ 97,695,033	268,074,935	76,690,395	240,674,341
Administrative fees	16,237,384	—	25,253,714	—
Other sources	54,928	3,698	389,888	12,644
Reimbursement on purchases of default loan purchases	—	625,346,421	—	597,474,711
Federal default fee income from lenders	—	128,396	—	3,473,387
Payments for:				
Salaries and employee benefits	(30,134,559)	—	(35,139,276)	—
Administrative fees	—	(3,699,528)	—	(5,076,715)
Purchases of default loans from lenders	—	(650,560,910)	(18,234)	(637,200,138)
Collections paid to U.S. Department of Education (ED)	—	(257,884,926)	—	(226,422,805)
General, administrative and other expenses	(30,287,032)	(43,865)	(28,082,073)	(20,415)
Net cash provided by (used in) operating activities	53,565,754	(18,635,779)	39,094,414	(27,084,990)
Cash flows from noncapital financing activities:				
Payments to NYS – other student aid activities	(30,070,485)	—	(38,375,586)	—
Interfund transfers	(57,166)	57,166	(74,734)	74,734
Net cash (used in) provided by noncapital financing activities	(30,127,651)	57,166	(38,450,320)	74,734
Cash flows from capital and related financing activities:				
Purchases of capital assets	(300,000)	—	(267,601)	—
Net cash used in capital and related financing activities	(300,000)	—	(267,601)	—
Cash flows from investing activities:				
Interest received	96,982	37,664	107,168	81,719
Net cash provided by investing activities	96,982	37,664	107,168	81,719
Increase (decrease) in cash and cash equivalents	23,235,085	(18,540,949)	483,661	(26,928,537)
Cash and cash equivalents, beginning	59,704,478	45,511,488	59,220,817	72,440,025
Cash and cash equivalents, ending	$ 82,939,563	26,970,539	59,704,478	45,511,488
Operating income	$ 49,569,924	(16,502,777)	38,690,452	(18,108,527)
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:				
Depreciation	190,418	—	89,338	—
Change in assets and liabilities:				
Receivables	221,807	1,131,942	5,733,345	(14,758,386)
Other assets	(103,142)	15,504	240,166	1,893,091
Interfund balances	2,344,708	(2,344,708)	(3,381,301)	3,381,301
Accounts payable and accrued liabilities	584,797	—	(474,538)	—
Other liabilities	(178,498)	—	(1,295,517)	—
Allowance for default aversion refunds	935,740	(935,740)	(507,531)	507,531
Total adjustments	3,995,830	(2,133,002)	403,962	(8,976,463)
Net cash provided by (used in) operating activities	$ 53,565,754	(18,635,779)	39,094,414	(27,084,990)

See accompanying notes to financial statements.

(1) Organization and Operations

New York State Higher Education Services Corporation (HESC) is an agency of New York State (the State) created in 1974 under Chapter 942 of the Laws of 1974 and is responsible for the administration of the State's student financial aid programs, including the Federal Family Education Loan Program (FFELP) and State loan guarantee program.

FFELP was established by Congress and is administered by the U.S. Department of Education (ED) through HESC and other guaranty agencies. As a guaranty agency, HESC made loans available through lending institutions to students attending colleges, universities, postsecondary educational, and vocational schools. FFELP allows HESC to guarantee repayment of principal and accrued interest to lenders for eligible student loans. HESC has the responsibility of providing collection assistance to lenders for delinquent loans, paying lender claims for loans in default, and performing certain collection activities on loans after purchase by HESC. In addition to FFELP, the Guaranteed Student Loan Programs include the residual activity of the State guaranteed loan program in which no new loans have been guaranteed since 1984.

On March 30, 2010, the President signed into law H.R. 4872 – The Health Care and Education Reconciliation Act of 2010 (HCERA), which terminated new loan originations in the FFELP on June 30, 2010. Effective July 1, 2010, all new Stafford, PLUS or consolidated loans are originated under the U.S. Department of Education Direct Loan Program. Existing FFELP loans will continue to be eligible for program benefits. The Guaranteed Student Loan Programs' Operating Fund and Federal Fund of HESC continue to administer its existing FFELP portfolio of both active and default student loans.

The accompanying financial statements only reflect the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of HESC. The Federal Fund assets, and earnings on those assets, are restricted in use and are property of the U.S. Department of Education. The Operating Fund is property of HESC and its assets and earnings are restricted in use for student financial aid related activities as required by the Higher Education Amendments of 1998 (1998 Amendments).

HESC also administers the Tuition Assistance Program, and State Scholarship Programs, under which students apply for payments to attend eligible educational institutions based on family income and/or academic achievement. In addition, HESC partners with colleges, universities, school districts and other educational organizations in administering the Federal GEAR UP and College Access and Challenge Grant program which are designed to increase the number of low income students who are prepared to enter and succeed in postsecondary education. These programs are not included in the accompanying financial statements.

In 2009 the State Legislature created the New York Higher Education Loan Program (NYHELPs), a State sponsored student loan program for New York residents attending participating institutions in the State. HESC administers the program in partnership with the State of New York Mortgage Agency (SONYMA) and participating lending institutions. HESC's responsibilities include but are not limited to: monitoring the origination and servicing of loans, marketing the program to various audiences, providing financial literacy education, default aversion services and collection services on defaulted accounts. The financial activities of NYHELPs are not included in the accompanying financial statements.

(2) Significant Accounting Policies

(a) Basis of Accounting

The Guaranteed Student Loan Programs' Operating Fund and Federal Fund follow U.S. generally accepted accounting principles as promulgated by the Governmental Accounting Standards Board (GASB). The Guaranteed Student Loan Programs' Operating Fund and Federal Fund follow fund accounting in which resources are classified for accounting and reporting purposes into funds established according to their purpose.

The Guaranteed Student Loan Programs' funds consist of the Federal Fund and the Operating Fund. The Federal Fund finances FFELP insurance activities, while the Operating Fund accounts for substantially all FFELP operational costs as well as financial aid awareness and related outreach activities. The two funds together constitute the Guaranteed Student Loan Programs and are accounted for as business-type activities using the flow of economic resources measurement focus and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the cost is incurred regardless of the timing of the related cash flow.

In accordance with GASB Statement Number 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Entities that use Proprietary Fund Accounting*, the Operating Fund and Federal Fund apply all applicable Financial Accounting Standards Board (FASB) pronouncements and Accounting Principles Board (APB) opinions issued on or before November 30, 1989, unless those pronouncements conflict with or contradict GASB pronouncements. The Funds have elected not to apply accounting standards issued after November 30, 1989 by FASB and APB.

(b) Cash and Cash Equivalents

Cash and cash equivalents consisting of United States Treasury Bills and collateralized short-term repurchase agreements with original maturities of 90 days or less, are carried at cost plus accrued interest, which approximates fair value. Investment income represents interest on deposits and gains and losses.

(c) Operating Revenues and Expenses

Operating revenues and expenses result generally from activities associated with FFELP, including collection on defaulted loans, default prevention, and default loan purchase activities. All revenues and expenses not derived from the administration of FFELP are reported as nonoperating revenues and expenses.

(d) Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles 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. Management estimates include useful lives in depreciating capital assets, and anticipated future default aversion fee refunds. Actual results could differ from those estimates.

(3) Guaranteed Loans Outstanding and Respective Unpaid Balances

As of March 31, 2012 and 2011, the Federal Fund was the guarantor of loans outstanding with original principal amounts of approximately $19,877,000,000 and $21,399,000,000, respectively, made to students by participating lending institutions. A substantial portion of that amount is guaranteed by the U.S. Department of Education, with an amount representing less than 1% guaranteed by the State. At March 31, 2012 and 2011, the unpaid balances were approximately $17,009,000,000 and $18,734,000,000, respectively.

HESC's management anticipates that a certain portion of the loans outstanding as of March 31, 2012 will go into default status, requiring the Federal Fund to purchase loans from lenders. Because the majority of these loans are federally guaranteed, the Federal Fund will be reimbursed by the U.S. Department of Education.

(4) Cash and Cash Equivalents

In accordance with HESC's investment policy, investments are made in low risk securities that are fully collateralized by the dealer. Cash equivalents are short-term investments with original maturities of three months or less when purchased and generally consist of short-term United States Treasury Bills and collateralized repurchase agreements. Cash equivalents are recorded at cost plus accrued interest, which approximates the fair value at March 31, 2012 and 2011. Federal Fund amounts are restricted in use and are property of the U.S. Department of Education. HESC actively manages the investments of its cash balances to minimize its uninvested funds. Excess cash balances are generally invested in short-term repurchase agreements until such time that HESC anticipates the funds will be required for operational needs. Cash balances in an administrative account in the Operating Fund are invested in the New York State Comptroller's short-term investment pool. These cash balances are available to HESC upon demand.

Custodial credit risk for cash and cash equivalents is the risk that in the event of the failure of the counterparty to a transaction, HESC will not be able to recover the value of cash and cash equivalents that are in the possession of an outside party. In order to manage this risk, HESC requires collateral consisting of Federal government obligations or agency instruments guaranteed by the Federal government pursuant to its investments in repurchase agreements and delivery to its Trustee (agent) of all securities purchased and collateral for repurchase agreements, regardless of the seller institution. To manage custodial credit risk on deposits, HESC requires that its depository banks pledge collateral based on available bank balances. Additionally, HESC's investment policy limits the amount of funds which may be invested at any given dealer to $75 million.

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a cash equivalent. HESC's policy for managing this risk is to hold cash equivalents to maturity, at which time the fair value of the investment is equal to its stated maturity value.

Included in Operating Fund bank balances are $137,440 for 2012 and $315,938 for 2011, which were deposited by lenders, to be forwarded to schools generally within one business day under an electronic funds transfer program (EFT). The offsetting liability is shown as amounts due to lenders, which are held by HESC for future disbursement.

Cash and cash equivalents at March 31 were as follows:

		2012	2011
Operating Fund:			
Repurchase agreements	$	79,602,703	58,261,299
Cash in State Comptroller's short-term investment pool and cash in bank		3,316,860	1,423,179
Petty cash and travel imprest accounts		20,000	20,000
Operating Fund cash and cash equivalents	$	82,939,563	59,704,478
Federal Fund:			
Repurchase agreements	$	44,067,424	46,231,407
Cash-net of outstanding bank checks		(17,096,885)	(719,919)
Federal Fund cash and cash equivalents	$	26,970,539	45,511,488

(5) Operating Administrative Fees

The 1998 Amendments established three fees recorded in the Operating Fund for administering the loan program on behalf of the Federal Government based on performance as a guaranty agency.

A Default Aversion Fee is recognized for default aversion activities on delinquent loans at the time the lenders request aversion assistance between the 60th and 120th days of a borrower's delinquency. A fee of 1% of principal and interest on the loan may be charged to the Federal Fund at the time the guaranty agency receives a request from a lender for preclaim assistance. However, the fee must be refunded by the Operating Fund to the Federal Fund in the event the loan is later paid as a default claim. Accordingly, an estimate of default aversion fee refunds of $5,690,949 and $4,755,209 at March 31, 2012 and 2011, respectively, are reported as a liability in the Operating Fund and a receivable in the Federal Fund. The net default aversion fee is transferred from the Federal Fund to the Operating Fund on a monthly basis.

(Continued)

As a result of HCERA, the last payment of Loan Processing and Issuance Fee was paid for the quarter ended December 31, 2010. The Loan Processing and Issuance Fee was paid based on the original principal amount of new loans guaranteed and disbursed during the period at a rate of 0.40%.

An Account Maintenance Fee is calculated on the original principal amount of loans outstanding at a rate of 0.06%. This fee is paid to the Operating Fund either directly by the U.S. Department of Education or as an authorized transfer from the Federal Fund on a quarterly basis.

For the years ended March 31, 2012 and 2011, the administrative fees receivable from U.S. Department of Education consisted of the following:

		2012	2011
Operating Fund:			
Account maintenance fee receivable	$	2,987,094	3,208,901
	$	2,987,094	3,208,901

For years ended March 31, 2012 and 2011, administrative fee income is as follows:

		2012	2011
Operating Fund:			
Default aversion fee, net of estimated refunds	$	2,479,411	5,207,517
Loan processing and issuance fee		—	792,521
Account maintenance fee		12,316,049	13,651,133
	$	14,795,460	19,651,171

Gross default aversion fee income for the years ended March 31, 2012 and 2011 was $9,484,915 and $10,417,118, respectively. The estimated reserve for default aversion fee refunds is netted against default aversion fee income. In 2012 and 2011, the default aversion fee allowance estimate was 60% and 50% of default aversion fee income, respectively. The estimate of the refunds for 2012 is based on the current year's refunds to revenue, which reflects actual experience.

(6) Collections on Defaulted Loans

HESC management is required by Federal statutes to pursue collections on loans upon default claim payment. Collections on defaulted loans and related complements are recorded at the time such collections are received. All collection receipts are initially deposited in the Operating Fund and daily estimated collection transfers are made to the Federal Fund. The Operating Fund retained 16% of borrower payments, approximately 37% of rehabilitation collection payments and 10% of principal and interest at the time of consolidation.

(7) Interfund Balances

Interfund balances are monies due to and/or due from the Federal Fund to the Operating Fund and includes collection transfer balances, default aversion fees and federal default fees pending transfer. A daily transfer between funds is made based on an estimate of ED's equitable share of daily collections. A final settlement for the actual amount of collections due to the Federal Fund is made at month end.

At March 31, 2012 and 2011, the Operating Fund had a net interfund receivable balance of $544,105 and $2,874,119 which included a receivable from the Federal Fund for overpayment of collections activity of $400,633 and $2,460,964 respectively. In addition, there were interfund default aversion fee receivable balances in the Operating Fund of $143,860 and $428,237 at March 31, 2012 and 2011, respectively. In 2012 and 2011, loan cancellations resulted in a federal default fee payable of $388 and $15,082 in the Operating Fund.

(8) New York State Initiatives

The New York State budget required the Operating Fund to pay the operational expenses related to the administration of the State's grant and scholarship programs, which amounted to approximately $11.2 million and $11.6 million in 2011-2012 and 2010-2011, respectively.

The 2011-2012 and 2010-2011 New York State budgets appropriated $16 million and $22.2 million, respectively, of operating funds to subsidize the Tuition Assistance Plan (TAP) which was transferred in March each year.

In fiscal years 2011-2012 and 2010-2011, HESC's Operating Fund incurred costs of $2.4 million and $4.3 million, respectively, as part of the implementation and administration of NYHELPs.

The activities of these programs are excluded from the accompanying financial statements.

(9) Transfer from (to) Federal Fund

In February 2011, HESC was notified by ED that loan processing and issuance fees for the quarters ended June 30, 2010 and September 30, 2010 were overpaid to guaranty agencies. HESC was instructed to transfer the overpayment of $165,475 to the federal fund. The transfer was made in June 2011.

(10) Capital and Intangible Assets

Capital assets are recorded at cost. Capital assets are defined as assets with initial, individual costs exceeding a capitalization threshold of $40,000. Depreciation for Operating Fund assets is based on an estimated five year useful life, using an accelerated depreciation method. The majority of the Federal and Operating Funds' capital assets consists of computer equipment, while a small part of these assets are office equipment.

HESC implemented GASB Statement No. 51, *Accounting and Financial Reporting for Intangible Assets*, effective April 1, 2010. Based on the New York State Office of the Comptroller Accounting Bulletin A-614, HESC established a $1 million threshold for capitalization and amortization of intangible assets. As of March 31, 2012, HESC did not have any projects with costs exceeding or expected to exceed the capitalization threshold.

Capital asset activity in the Operating Fund for the year ended March 31, 2012 is as follows:

		Balance April 1, 2011	Additions	Disposals	Balance March 31, 2012
Office and computer equipment	$	1,845,831	300,000	—	2,145,831
Less accumulated depreciation		(1,464,018)	(190,418)	—	(1,654,436)
Net capital assets	$	381,813	109,582	—	491,395

Capital asset activity in the Operating Fund for the year ended March 31, 2011 is as follows:

		Balance April 1, 2010	Additions	Disposals	Balance March 31, 2011
Office and computer equipment	$	1,578,230	267,601	—	1,845,831
Less accumulated depreciation		(1,374,680)	(89,338)	—	(1,464,018)
Net capital assets	$	203,550	178,263	—	381,813

At March 31, 2012 and 2011, the Federal Fund had capitalized equipment with a book value of $294,255 which was fully depreciated.

(11) Federal Reserve Recall and Federal Advances

HESC has received, in prior years, noninterest-bearing advances from the U.S. Department of Education totaling $10,300,348, for the purpose of helping to strengthen FFELP through the infusion of additional working capital. Under the terms of the agreement, HESC will be required to repay these advances at such time as the amount of federally guaranteed loans outstanding (note 3) is reduced to less than $54,950,000 HESC has recorded these advances as noncurrent liabilities.

Long-term obligation activity for the year ended March 31, 2012, is as follows:

Federal Fund		Beginning balance	Additions	Reductions	Ending balance
Federal advances	$	10,300,348	—	—	10,300,348
Total Federal Fund	$	10,300,348	—	—	10,300,348

Long-term obligation activity for the year ended March 31, 2011, is as follows:

Federal Fund		Beginning balance	Additions	Reductions	Ending balance
Federal advances	$	10,300,348	—	—	10,300,348
Total Federal Fund	$	10,300,348	—	—	10,300,348

(12) Purchase of Defaulted Federal Loans

Purchases of defaulted loans and amounts repurchased by lenders are recorded as Federal Fund activity. The reinsurance reimbursement results in a net reduction to the Federal Fund, due to reduced reinsurance rates of 98% and 95% as a result of various amendments to the Higher Education Act.

All FFELP claims are paid at 97% of the claim value. As of March 2012, HESC was processing claims for 13 servicers.

(13) Federal Default Fee

As a result of the Deficit Reduction Act of 2005, signed into law by the President in February 2006, a 1% default fee must be deposited into the Federal Fund on all Stafford and PLUS loans guaranteed after July 1, 2006. The fees are Federal Fund revenue subject to the Federal Fund's restricted use. This fee replaces the guarantee fee (insurance premium) which was not a mandatory fee. HESC elected to pay the 1% default fee from the Operating Fund for loans guaranteed prior to May 1, 2008. HESC collects from lenders the 1% fee for loans guaranteed after May 1, 2008 and deposits the fee into the Federal Fund. The enactment of the HCERA on March 30, 2010 eliminated the FFEL program. As of July 1, 2010 no new Stafford, PLUS or consolidated loans were disbursed through the FFELP and therefore the federal default fee deposit requirement was substantially eliminated.

For the years ended March 31, 2012 and 2011, the Federal default fee revenue consisted of the following:

		2012	2011
Federal Fund:			
Default fee revenue from lenders	$	112,982	1,580,295
Default fee revenue transferred (to) from HESC's Operating Fund		42,472	(60,953)
Total Federal default fee revenue	$	155,454	1,519,342

(14) Pension Benefits

Substantially all employees working for the Guaranteed Student Loan Programs are members of the New York State and Local Employees' Retirement System (System), a cost-sharing, multiple employer public employee retirement system. The State Comptroller is sole trustee and administrative head of the System. The System issues a publicly available financial report that includes financial statements and required supplementary information which may be obtained by writing to the New York State and Local Employees' Retirement System, 110 State Street, Albany, New York 12236.

The System provides retirement benefits as well as death and disability benefits. All benefits vest after five years of accredited service. Retirement benefits are established by the New York State Retirement and Social Security Law. Retirement benefits and contributory requirements depend upon the point in time at which an employee last joined the system. Most members of the System who joined before July 27, 1976 are enrolled in a noncontributory plan. The Operating Fund contributes the entire amount determined to be payable to the system for these employees. Personnel who joined the System after July 27, 1976 are required by law to contribute 3% of their gross salary for the first ten years of employment. The Operating Fund contributes the balance payable to the System for these employees.

The Operating Fund paid to the System $2,933,613 for 2012, $3,337,823.25 for 2011 and $3,292,422 for 2010, to cover 100% of the required employer contributions for retirement benefits. These payments, made through application of the New York State Fringe Benefit rate calculated by the State's Division of the Budget, represent 10.19%, 10.17% and 9.08% of covered payroll for each of the years, respectively.

(15) Postretirement Benefits

As a State agency, HESC participates in the New York State Health Insurance Program (NYSHIP), which is administered by the State as an agent multiple employer defined benefit plan. The plan under the State provides certain healthcare benefits for eligible retired employees and their dependents under a single employer noncontributory healthcare plan. The State's plan states that employees and/or their dependents become eligible for these benefits at 55 years of age when the employee has 10 years of State service. In calculating the 10 year service requirement, all of the employee's service need not be with the State, but may be a composite of State service elsewhere, with a minimum of three years with the State. Employees with no prior State service must work a minimum of 10 years before they and their dependents are eligible for the retirement medical benefits. Eligible retirees hired on or after November 1, 2001, contribute 10% of the cost of single coverage and 25% of the cost of dependent coverage for health insurance benefits. The State covers 100% of the cost of single and dependent coverage for employees hired before November 1, 2001. NYSHIP does not issue a stand-alone financial report and NYSHIP's agent activities are included within the financial statements of the State.

During the fiscal year ended March 31, 2011, NYSHIP provided health insurance coverage through the Empire Plan, an indemnity health insurance plan with managed care components; 12 Health Maintenance Organizations (HMOs); and through the Student Employee Health Plan (SEHP). Generally, these include hospital, medical, mental health and substance abuse benefits, and prescription drug benefits.

HESC's policy regarding retiree healthcare benefits is to pay the amounts billed through the State's fringe benefit rate on a pay-as-you-go basis. HESC has no obligation beyond the payment of the State's fringe benefit rate for retiree healthcare benefits. The State's policy is that the State is responsible for recording the annual required contribution and the actuarial accrued liability under GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* for HESC's retiree health care benefits in the State's governmental-wide financial statements.

As of March 31, 2012 and 2011, HESC had approximately 458 and 417 retired and/or spouses of retired employees, receiving retiree health care benefits with an annual pay-as-you-go cost of approximately $4.0 million and $3.5 million.

(16) Employees' Vacation Pay Benefits

Under the terms of HESC management's personnel policies and its union agreements, vacation pay benefits may be paid upon termination up to a combined maximum of 30 days. The Operating Fund recognizes employees' vacation pay benefits when earned. The liability for employees' vacation pay benefits is $2,256,131 and $2,153,739 as of March 31, 2012 and 2011, respectively, and is recorded in accounts payable and accrued expenses in the Operating Fund.

(17) Deferred Compensation

The State offers its employees, including HESC employees, a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All amounts of compensation deferred under the plan are placed in trust for participants and their beneficiaries.

(18) Leases

HESC leases office and storage space under noncancelable operating leases effective through 2017. Total rental expense recorded in the Operating Fund, which includes utilities for one of two major leases, for the years ended March 31, 2012 and 2011, were $1,561,805 and $1,564,183, respectively. The following is a summary of future minimum rental commitments under noncancelable leases with terms exceeding one year:

Year ending March 31:		
2013	$	2,092,587
2014		2,040,901
2015		2,056,943
2016		2,013,401
2017		2,007,842
2018		683,057
	$	10,894,731

(19) Contingencies

The Operating Fund and the Federal Fund are subject to ED oversight and audit that at times may result in program issues and potential liabilities payable to ED. The issues relate to possible violations of rules and regulations established by ED to administer the federal loan program. Management diligently attempts to interpret ED's rules and regulations, and believes that its implementation of policies and procedures properly adheres to those rules and regulations, and that any resulting liabilities would not be material.

During the normal course of business the Guaranteed Student Loan Programs are involved in various legal proceedings and investigations, pertaining to matters relating to the Programs' operations and activities. While these proceedings and investigations may lead to a possible liability, in the opinion of HESC management, after considering all relevant facts, these possible liabilities will not in the aggregate have a material adverse effect on the financial position of the Operating Fund or Federal Fund as of March 31, 2012 and 2011, respectively.

As of the financial issuance date, HESC was working to verify the collections process performed in relation to certain classes of student loans purchased by the agency. There is the potential for a liability resultant from the activities being performed that cannot reasonably be determined at this time. Management believes, however, that the resolution of the verification and any resultant liability will not likely materially affect the financial position or operations of HESC.

HESC is exposed to various risks of loss related to damage and destruction of assets, injuries to employees, or noncompliance with Federal requirements and other natural and other unforeseen disasters. HESC in general does not insure its buildings, contents or related risks and does not insure its assets for claims and assessments arising from bodily injury, property damages, and other perils. Unfavorable judgments, claims, or losses incurred by HESC are covered by the State on a self-insured basis. The State does have fidelity insurance on State employees.