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

(A Component Unit of the State of New York)

Financial Statements

March 31, 2013 and 2012

(With Independent Auditors' Report Thereon)

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

Financial Statements

March 31, 2013 and 2012

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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:

Report on the Financial Statements

We have audited the accompanying statements of net position 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 March 31, 2013 and 2012 and the statements of changes in net position and cash flows for the years then ended, and the related disclosures to the financial statements, which collectively comprise the HESC's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditors' Responsibility

Our responsibility is to express 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 from material misstatement.

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

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

KPMG LLP is a Delaware limited liability partnership, the U.S. member firm of KPMG International Cooperative ("KPMG International"), a Swiss entity.

Opinions

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, 2013 and 2012, and the respective changes in net position, and cash flows for the years then ended in accordance with U.S. generally accepted accounting principles.

Other Matters

Required Supplementary Information

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 23, 2013 on our consideration of HESC's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering HESC's internal control over financial reporting and compliance.

KPMG LLP

September 23, 2013

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, 2013 and 2012. 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.

2013 Financial Highlights-Operating Fund

- Current assets increased $0.8 million or 1%.
- Current liabilities decreased $0.4 million or 2%.
- Total revenue increased $4.8 million or 4%.
- Operating expenses increased $0.8 million or 1%.
- The Operating Fund provided $11.9 million for the cost of administering the New York State grant and scholarship programs.
- The Operating Fund provided $0.4 million toward the costs of operations for the New York Higher Education Loan Program (NYHELPs).
- The Operating Fund transferred $32 million to the New York State Tuition Assistance Program (TAP) to subsidize grant expenditures.

(Continued)

2012 Financial Highlights-Operating Fund

- Current assets increased $20.8 million or 31%.
- Current liabilities increased $0.75 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 start up and operating costs for the New York State Higher Education Loan Program (NYHELPs).
- The Operating Fund transferred $16 million to the New York State Tuition Assistance Program (TAP) to subsidize grant expenditures.

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

Management's Discussion and Analysis (Unaudited)

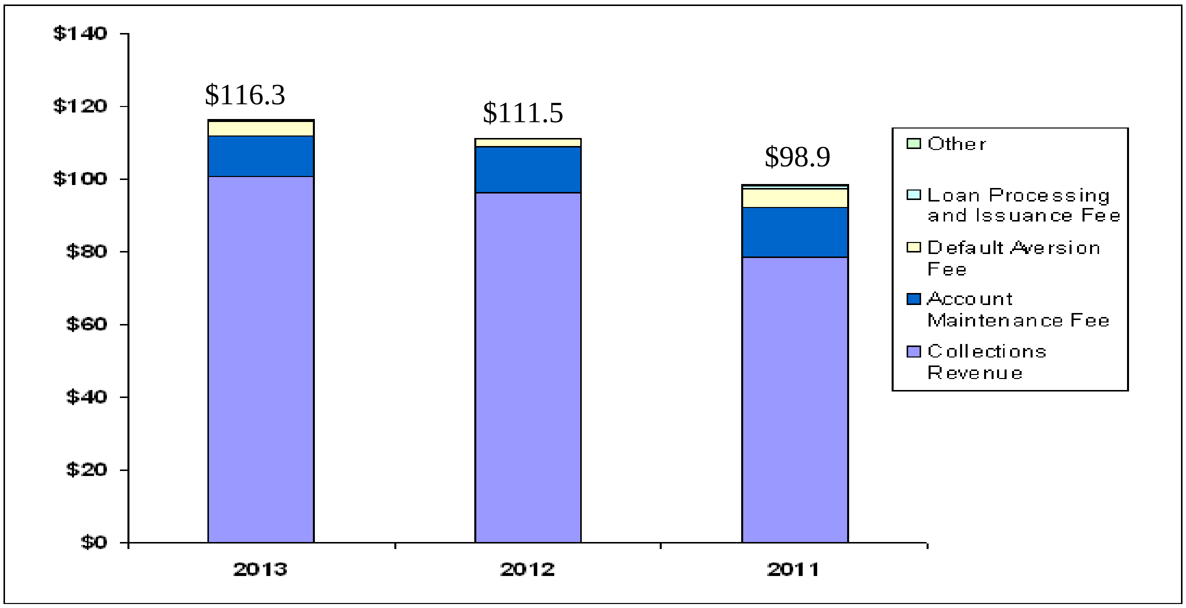
March 31, 2013 and 2012

$ in thousands

		Operating Fund			Federal Fund		
		2013	2012	2011	2013	2012	2011
Current assets	$	87,666	86,852	66,066	55,354	60,755	80,443
Capital assets		296	491	382	-	-	-
Other noncurrent assets		-	-	-	3,629	5,691	4,755
Total assets		87,962	87,343	66,448	58,983	66,446	85,198
Current liabilities		17,520	17,882	17,131	-	545	2,874
Noncurrent liabilities		3,629	5,691	4,755	10,300	10,300	10,300
Total liabilities		21,149	23,573	21,886	10,300	10,845	13,174
Net position:							
Invested in capital assets		296	491	382	-	-	-
Restricted		66,517	63,279	44,180	48,683	55,601	72,024
Total net position	$	66,813	63,770	44,562	48,683	55,601	72,024

		Operating Fund			Federal Fund		
		2013	2012	2011	2013	2012	2011
Operating Revenue:							
Default loan collections	$	100,900	96,517	78,894	275,146	270,135	236,916
Reimbursement of defaulted loans		-	-	-	526,379	624,206	612,241
Administrative and program fee		15,250	14,795	19,651	6	113	1,580
Other revenues		156	171	315	83	41	94
Total revenues		116,306	111,483	98,860	801,614	894,495	850,831
Operating expenses:							
Administrative		62,419	61,626	59,974	-	-	-
Default loan purchases		-	-	-	547,660	650,561	637,200
Collection payments to ED		-	-	-	262,255	257,876	226,430
Fee subsidies		-	-	-	4,108	2,479	5,208
Other		195	190	89	6	44	20
Non Operating expenses		45,154	30,416	38,983	-	-	-
Total expenses		107,768	92,232	99,046	814,029	910,960	868,858
Transfers		(5,496)	(42)	(105)	5,496	42	105
Change in net position	$	3,042	19,209	(291)	(6,919)	(16,423)	(17,922)

HESC Total Operating Fund Revenue
$ in millions



Operating Fund Revenue Highlights for fiscal year ending March 31,

2013

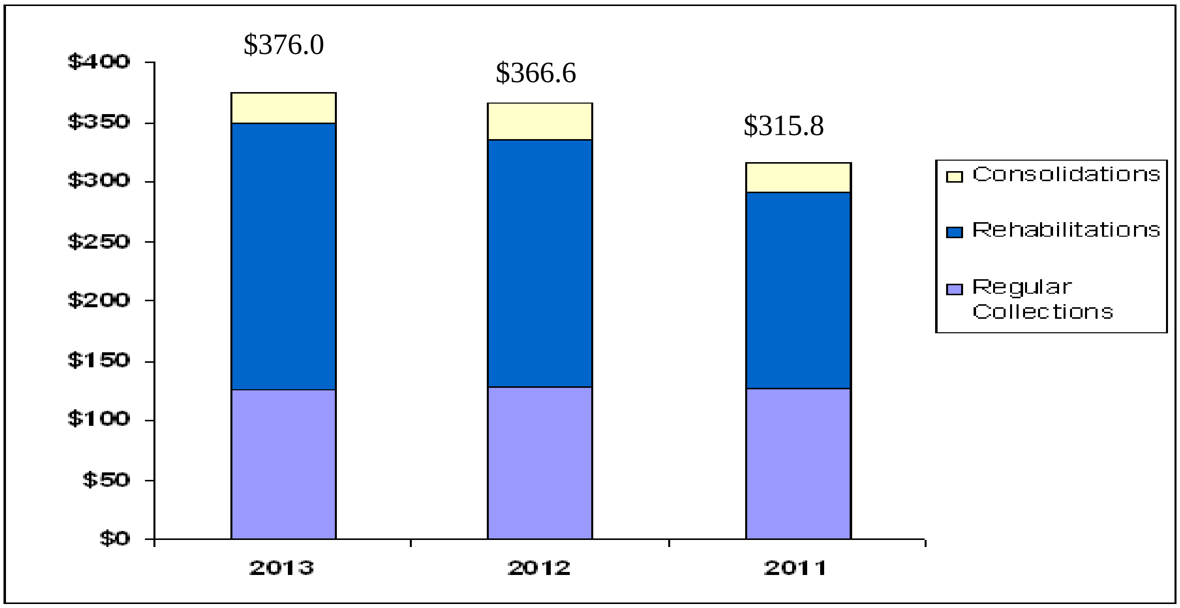
- Collections revenue represents 87% of total revenue, an increase from last year as a result of increased rehabilitation sales.
- Portfolio administration fee revenue decreased by $1.2 million as a result of a decrease in outstanding principal balance of loans outstanding due to the Federal Loan Purchase Commitment (PUT) program and loan balances being paid by borrowers.
- As a result of HCERA, HESC did not guarantee any new loans in SFY 2012-13.
- Default aversion fee (DAF) revenue increased $1.6 million to $4.1 million as a result of a decreased allowance for future aversion fee refunds.

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.

(Continued)

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 determine by ED.

Collection Recovery Highlights for the fiscal year ending March 31,

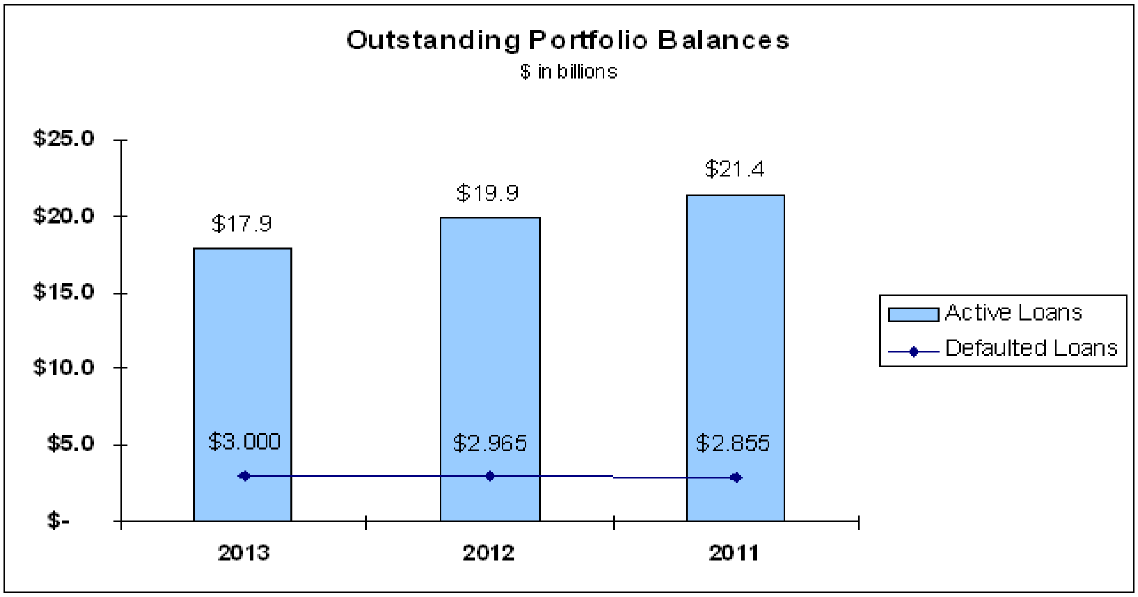
2013

- Collections on rehabilitated loans increased 9% to $223 million as a result of HESC collection efforts to assist borrowers.
- Total regular collections decreased $2 million or 2% from $128.7 million in 2012 to $126.6 million in 2013, as a result of decreased AWG payments and state tax offsets received during the fiscal year.
- Federal direct default consolidation revenue decreased $5.7 million during the fiscal year from $31.9 million in 2012 to $26.2 million in 2013.

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.

Operating Fund Administration Revenue on Guaranteed FFEL Loans



Administrative Revenue Highlights for the fiscal year ending March 31,

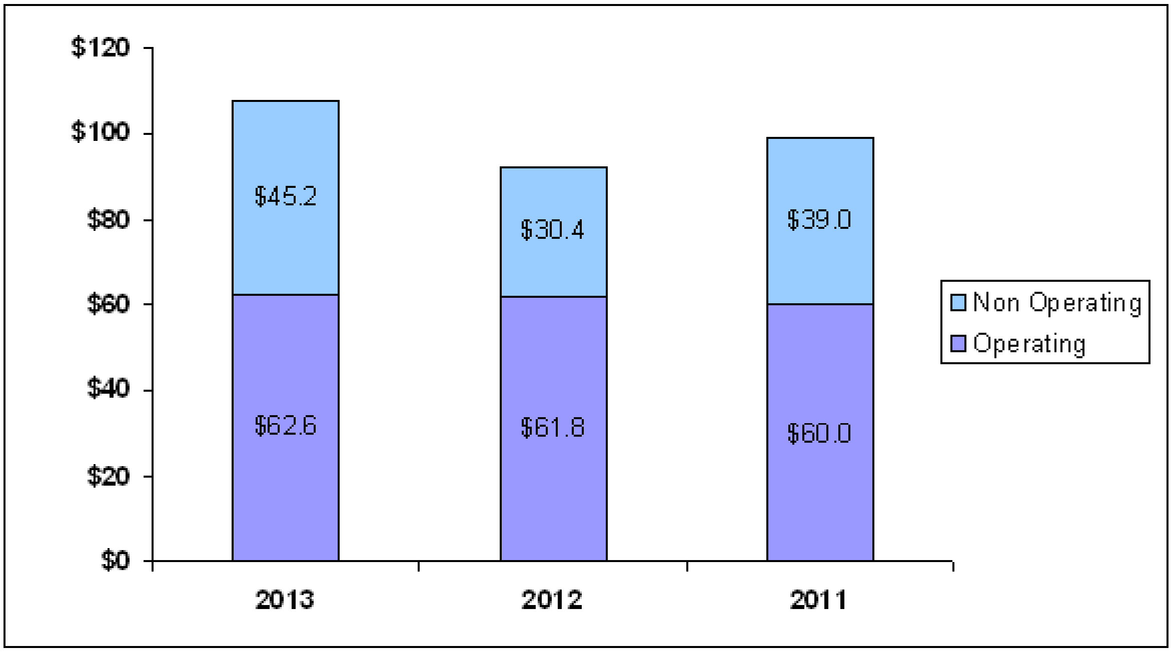
2013

- HESC's outstanding portfolio balance decreased by $2.0 billion or 10% for the fiscal year as a result of active loans being paid in full, the elimination of FFELP and no new loans being added to the portfolio, causing a decrease in account maintenance fee of $1.2 million.
- Default aversion fee revenue, net of refunds, increased $1.6 million for the fiscal year as a result of a decrease in the allowance for future refunds established for the fiscal year.

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 $2.2 million during the fiscal year as a result of a decrease of 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.

Total HESC Operating Fund Expenses
$ in millions



HESC Operating Expense Highlights for fiscal year ending March 31,

2013

Operating Expenses

- Outsourced vendor collection fees increased $2.9 million or 13% as a result of increased collections attributable to outside collection agencies.
- Payroll expense decreased by $1.3 million or 6% due to a reduction in full time equivalent employees from 480 to 422. This reduction was offset by an increase in fringe benefit expense of $1.3 million or 14% due to a rate increase from 48.32% to 54.37%.
- Rent expense decreased from $1.8 million to $1.5 million as a result of HESC's space consolidation efforts.

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 $0.8 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 major unions negotiated a 5 day deficit reduction leave to reduce personal service costs across the state.

Total HESC Operating Fund Expenses continued

- Payments to OFT for equipment usage decreased $0.5 million from $1.9 million to $1.4 million.
- Telephone, postage and supplies expense decreased a total of $.5 in 2012-2013 as a result of cost cutting measures.

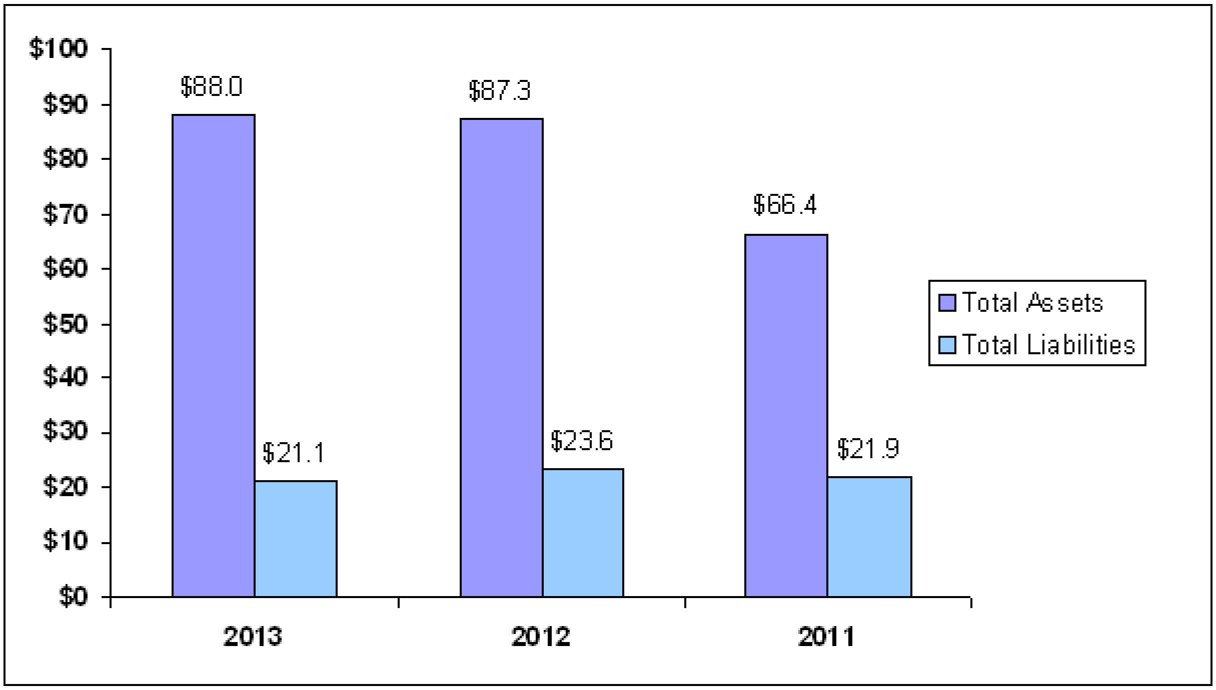
Non Operating Expenses

- The Operating Fund contributed $32.0 million to subsidize the Tuition Assistance Program.
- Grant and scholarship program expenses increased $0.7 million to $11.9 million due to an increase in the fringe benefit rate.
- HESC incurred $0.4 million in expenses related to NYHELPs, a 85% reduction from the prior year.

Non Operating Expenses

- The Operating Fund contributed $16 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 significant portion of which were start up costs.

Operating Fund Assets and Liabilities
$ in millions



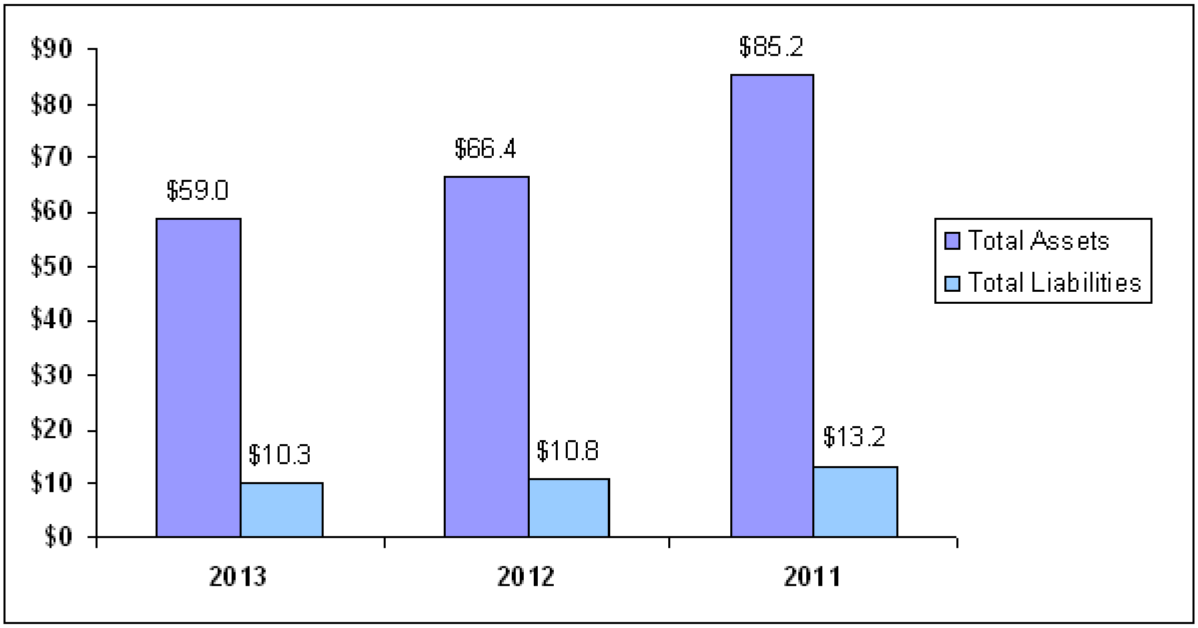
Assets

- Total operating fund 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 $0.6 million or 1% in 2012 – 2013
- Cash and cash equivalents increased $1.5 million as a result of positive cash flow from operations.
- Administrative fee receivable decreased $0.3 million during 2012 – 2013.
- The interfund transfer decreased $0.8 million due to fluctuations in collection transfers between the Federal and Operating Funds.

Liabilities

- Accounts payable and accrued liabilities represented 82% and 75% of total liabilities for the fiscal years ending March 31, 2013 and 2012 respectively.
- Accounts payable decreased $0.5 million during the 2013 state fiscal year due to continued cost cutting efforts.
- Noncurrent liabilities decreased $2.0 million, as a result of the decrease in the allowance for default aversion fee refund in 2012 – 2013.

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 increased $1.4 million or 6% in fiscal year 2012-13 as a result of cash used in operations of $4.1 million offset by interfund transfers received which increased $5.5 million during 2012-13.
- Total assets decreased as a result of the $4.1 million cash used in operations and a decrease in reinsurance receivable and DAF allowance receivable during the year.

Liabilities

- HESC did not have any current liabilities in 2012-13.
- Noncurrent liabilities include $10.3 million for noninterest 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 continues to consolidate its office space and adjust 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 2013-2014.
- The 2013-2014 New York State budget appropriated $32 million of the Operating Fund balance for NYS Tuition Assistance Program.
- 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.

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 Chief Financial 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 Position

March 31, 2013 and 2012

		2013		2012	
Assets		**Operating Fund**	**Federal Fund**	**Operating Fund**	**Federal Fund**
Current assets:					
Cash and cash equivalents (note 4)	$	84,413,828	28,394,930	82,939,563	26,970,539
Receivables due from U.S. Department of Education:					
Administrative fees (note 5)		2,687,932	—	2,987,094	—
Reinsurance		—	26,672,307	—	33,784,540
EFT fees receivable from lenders		50,614	—	21,577	—
Interfund balances (note 7)		—	254,317	544,105	—
Due from lenders for default fee billing (note 13)		—	31,645	—	—
Prepaid expenses and other assets		513,653	401	359,744	98
Total current assets		87,666,027	55,353,600	86,852,083	60,755,177
Noncurrent assets:					
Interfund default aversion fee allowance (note 5)		—	3,629,448	—	5,690,949
Capital assets, net (note 10)		296,108	—	491,395	—
Total noncurrent assets		296,108	3,629,448	491,395	5,690,949
Total assets		87,962,135	58,983,048	87,343,478	66,446,126
Liabilities and Net Position					
Current liabilities:					
Accounts payable and accrued liabilities		17,255,165	—	17,744,528	442
Interfund balances (note 7)		254,317	—	—	544,105
Amounts payable to lenders through EFT (note 4)		10,435	—	137,440	—
Total current liabilities		17,519,917	—	17,881,968	544,547
Noncurrent liabilities:					
Advance from U.S. Department of Education (note 11)		—	10,300,348	—	10,300,348
Interfund default aversion fee allowance (note 5)		3,629,448	—	5,690,949	—
Total noncurrent liabilities		3,629,448	10,300,348	5,690,949	10,300,348
Total liabilities		21,149,365	10,300,348	23,572,917	10,844,895
Net position:					
Invested in capital assets		296,108	—	491,395	—
Restricted – property of U.S. Department of Education		—	48,682,700	—	55,601,231
Restricted – for student aid related activities		66,516,662	—	63,279,166	—
Total net position	$	66,812,770	48,682,700	63,770,561	55,601,231

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 Position

Years ended March 31, 2013 and 2012

	2013		2012	
	Operating Fund	**Federal Fund**	**Operating Fund**	**Federal Fund**
Operating revenues:				
Defaulted loan collections (note 6)	$ 100,899,995	275,145,901	96,517,379	270,135,266
Administrative and program fee income (notes 5, 13)	15,250,167	6,375	14,795,460	112,892
Reimbursement on purchases of default loans from lenders (note 12)	—	526,379,139	—	624,205,705
Other revenue	45,106	30,094	73,544	3,698
Total operating revenues	116,195,268	801,561,509	111,386,383	894,457,561
Operating expenses:				
Salaries and employee benefits	30,158,721	—	30,255,881	—
General and administrative	6,576,997	—	7,375,155	—
Collections	24,267,567	—	21,405,139	—
NYS Office for Technology equipment usage charges	1,416,008	—	1,878,129	—
D.M.I. program expenses	—	—	711,737	—
Default aversion fee subsidy	—	4,108,203	—	2,479,411
Purchases of default loans from lenders (note 12)	—	547,659,785	—	650,560,910
Defaulted loan collections paid to U.S. Department of Education (note 6)	—	262,255,312	—	257,876,152
Depreciation (note 10)	195,287	—	190,418	—
Other expense	—	5,851	—	43,865
Total operating expenses	62,614,580	814,029,151	61,816,459	910,960,338
Operating income (loss)	53,580,688	(12,467,642)	49,569,924	(16,502,777)
Nonoperating revenues (expenses):				
Interest income	111,125	53,088	96,996	37,691
Gear Up operational expenses	(767,886)	—	(843,394)	—
New York State initiatives (note 8)	(44,385,695)	—	(29,572,149)	—
Total nonoperating (expenses) revenues	(45,042,456)	53,088	(30,318,547)	37,691
Transfer (to) from Federal Fund (note 9)	(5,500,000)	5,500,000	—	—
Transfer of Federal default fee (note 13)	3,977	(3,977)	(42,472)	42,472
Increase (decrease) in net assets	3,042,209	(6,918,531)	19,208,905	(16,422,614)
Net position, beginning	63,770,561	55,601,231	44,561,656	72,023,845
Net position, ending	$ 66,812,770	48,682,700	63,770,561	55,601,231

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, 2013 and 2012

	2013		2012	
	Operating Fund	**Federal Fund**	**Operating Fund**	**Federal Fund**
Cash flows from operating activities:				
Receipts from:				
Collections	$ 101,061,137	274,614,916	97,695,033	268,074,935
Administrative fees	13,755,653	—	16,237,384	—
Other sources	63,443	30,094	54,928	3,698
Reimbursement on purchases of default loan purchases	—	533,478,330	—	625,346,421
Federal default fee income from lenders	—	(25,712)	—	128,396
Payments for:				
Salaries and employee benefits	(30,757,965)	—	(30,134,559)	—
Administrative fees	—	(2,314,527)	—	(3,699,528)
Purchases of default loans from lenders	—	(547,659,785)	—	(650,560,910)
Collections paid to U.S. Department of Education (ED)	—	(262,242,270)	—	(257,884,926)
General, administrative and other expenses	(32,165,290)	(5,851)	(30,287,032)	(43,865)
Net cash provided by (used in) operating activities	51,956,978	(4,124,805)	53,565,754	(18,635,779)
Cash flows from noncapital financing activities:				
Payments to NYS – other student aid activities	(45,096,991)	—	(30,070,485)	—
Interfund transfers	(5,496,411)	5,496,411	(57,166)	57,166
Net cash (used in) provided by noncapital financing activities	(50,593,402)	5,496,411	(30,127,651)	57,166
Cash flows from capital and related financing activities:				
Purchases of capital assets	—	—	(300,000)	—
Net cash used in capital and related financing activities	—	—	(300,000)	—
Cash flows from investing activities:				
Interest received	110,689	52,785	96,982	37,664
Net cash provided by investing activities	110,689	52,785	96,982	37,664
Increase (decrease) in cash and cash equivalents	1,474,265	1,424,391	23,235,085	(18,540,949)
Cash and cash equivalents, beginning	82,939,563	26,970,539	59,704,478	45,511,488
Cash and cash equivalents, ending	$ 84,413,828	28,394,930	82,939,563	26,970,539
Operating income (loss)	$ 53,580,688	(12,467,642)	49,569,924	(16,502,777)
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:				
Depreciation	195,287	—	190,418	—
Change in assets and liabilities:				
Receivables	299,162	7,112,233	221,807	1,131,942
Other assets	(182,511)	(31,645)	(103,142)	15,062
Interfund balances	798,810	(798,810)	2,344,708	(2,344,708)
Accounts payable and accrued liabilities	(545,952)	(442)	584,797	442
Other liabilities	(127,005)	—	(178,498)	—
Allowance for default aversion refunds	(2,061,501)	2,061,501	935,740	(935,740)
Total adjustments	(1,623,710)	8,342,837	3,995,830	(2,133,002)
Net cash provided by (used in) operating activities	$ 51,956,978	(4,124,805)	53,565,754	(18,635,779)

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. Although the program was suspended in January 2012, HESC's continues to: provide 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.

(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) Net Position

In 2013, HESC adopted GASB Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources and Net Position*. This Statement provides reporting guidance for deferred outflows of resources and deferred inflows of resources to be reported in the statement of financial position in a separate section following assets and liabilities, respectively. This Statement also amends the net asset requirement of GASB Statement No. 34, *Basic Financials Statements and Management's Discussion and Analysis for State and Local Governments*, and other pronouncements by incorporating deferred outflows of resources and deferred inflows of resources into definitions of the required components of the residual measure and by renaming that measure as net position rather than net assets

HESC's net position is classified in the following categories: invested in capital assets, consisting of capital assets, net of accumulated depreciation; restricted – property of U.S. Department of Education, consisting of restricted assets reduced by related liabilities belonging to the U.S. Department of Education; and restricted – for student aid related activities, consisting of assets reduced by related liabilities that are not classified as invested in capital assets or restricted – property of U.S. Department of Education.

(d) 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.

(e) 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, 2013 and 2012, the Federal Fund was the guarantor of loans outstanding with original principal amounts of approximately $17,910,000,000 and $19,877,000,000, 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, 2013 and 2012, the unpaid balances were approximately $14,887,000,000 and $17,009,000,000, respectively.

HESC's management anticipates that a certain portion of the loans outstanding as of March 31, 2013 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, 2013 and 2012. 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 $100 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 $10,435 for 2013 and $137,440 for 2012, 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:

		2013	2012
Operating Fund:			
Repurchase agreements	$	78,725,105	79,602,703
Cash in State Comptroller's short-term investment pool and cash in bank		5,688,723	3,316,860
Petty cash and travel imprest accounts		—	20,000
Operating Fund cash and cash equivalents	$	84,413,828	82,939,563
Federal Fund:			
Repurchase agreements	$	40,060,742	44,067,424
Cash-net of outstanding bank checks		(11,665,812)	(17,096,885)
Federal Fund cash and cash equivalents	$	28,394,930	26,970,539

(5) Operating Administrative Fees

The 1998 Amendments established two 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 $3,629,448 and $5,690,949 at March 31, 2013 and 2012, 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.

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, 2013 and 2012, the administrative fees receivable from U.S. Department of Education consisted of the following:

		2013	2012
Operating Fund:			
Account maintenance fee receivable	$	2,687,932	2,987,094
	$	2,687,932	2,987,094

For years ended March 31, 2013 and 2012, administrative fee income is as follows:

		2013	2012
Operating Fund:			
Default aversion fee, net of estimated refunds	$	4,108,203	2,479,411
Account maintenance fee		11,141,964	12,316,049
	$	15,250,167	14,795,460

Gross default aversion fee income for the years ended March 31, 2013 and 2012 was $6,979,708 and $9,484,915, respectively. The estimated reserve for default aversion fee refunds is netted against default aversion fee income. In 2013 and 2012, the default aversion fee allowance estimate was 52% and 60% of default aversion fee income, respectively. The estimate of the refunds for 2013 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, 2013, the Operating Fund had a net interfund payable balance of $254,317 and at March 31, 2012 there was an interfund receivable of $544,105. At March 31, 2013, the Operating Fund interfund payable consisted of a payable to the Federal Fund for underpayment of collections for the month of $130,351 and an interfund default aversion fee payable of $123,966. At March 31, 2012, the interfund receivable consisted of an overpayment of collections activity of $400,633, default aversion fee receivable of $143,860 and a default fee payable of $388.

(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 $11.9 million and $11.2 million in 2012-2013 and 2011-2012, respectively.

The 2012-2013 and 2011-2012 New York State budgets appropriated $32 million and $16 million, respectively, of operating funds to subsidize the Tuition Assistance Program (TAP) which is transferred in March each year.

In fiscal years 2012-2013 and 2011-2012, HESC's Operating Fund incurred costs of $.4 million and $2.4 million, respectively. The costs for 2011-12 were part of the implementation and administration of NYHELPs, the costs for 2012-13 were purely administrative costs.

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

(9) Transfer from (to) Federal Fund

In September 2012, HESC transferred from the Operating Fund to the Federal Fund $5.5 million to insure HESC met the Federal Fund minimum reserve balance requirement.

(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.

Intangible assets in excess of $1 million are capitalized and amortized over their useful lives. As of March 31, 2013 and 2012, HESC did not have any projects with costs that exceeded the capitalization threshold.

Capital asset activity in the Operating Fund for the year ended March 31, 2013 is as follows:

		Balance April 1, 2012	Additions	Disposals	Balance March 31, 2013
Office and computer equipment	$	2,145,831	—	—	2,145,831
Less accumulated depreciation		(1,654,436)	(195,287)	—	(1,849,723)
Net capital assets	$	491,395	(195,287)	—	296,108

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

At March 31, 2013 and 2012, 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.

(Continued)

Long-term obligation activity for the year ended March 31, 2013, 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, 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

(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 2013, HESC was processing claims for 12 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, 2013 and 2012, the Federal default fee revenue consisted of the following:

		2013	2012
Federal Fund:			
Default fee revenue from lenders	$	6,375	112,982
Default fee revenue transferred (to) from HESC's Operating Fund		(3,977)	42,472
Total Federal default fee revenue	$	2,398	155,454

(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 $3,534,079 for 2013, $2,933,613 for 2012, and $3,337,823 for 2011, 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 13.14%, 10.19%, and 10.17% 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, 2013, 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, 2013 and 2012, HESC had approximately 460 and 458 retired and/or spouses of retired employees, receiving retiree health care benefits with an annual pay-as-you-go cost of approximately $4.1 million and $4.0 million, respectively.

(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 $1,905,364 and $2,256,131 as of March 31, 2013 and 2012, 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, 2013 and 2012, were $1,616,853 and $1,561,805, respectively. The following is a summary of future minimum rental commitments under noncancelable leases with terms exceeding one year:

Year ending March 31:		
2014	$	2,040,901
2015		2,056,943
2016		2,013,401
2017		2,007,842
2018		683,057
	$	8,802,144

(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, 2013 and 2012, 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.