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, 2014 and 2013

(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, 2014 and 2013

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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, 2014 and 2013 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.

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, 2014 and 2013, 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 29, 2014 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 30, 2014

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, 2014 and 2013. 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 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.

2014 Financial Highlights-Operating Fund

- Current assets increased $6.3 million or 7%.
- Current liabilities increased $2.1 million or 12%.
- Total revenue decreased $7.3 million or 6%.
- Operating expenses decreased $5.1 million or 8%.
- The Operating Fund provided $11.8 million for the cost of administering the New York State grant and scholarship programs.
- The Operating Fund provided $0.3 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.

2013 Financial Highlights-Operating Fund

- Current assets increased $0.8 million or 1%.
- Current liabilities increased $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 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, 2014 and 2013

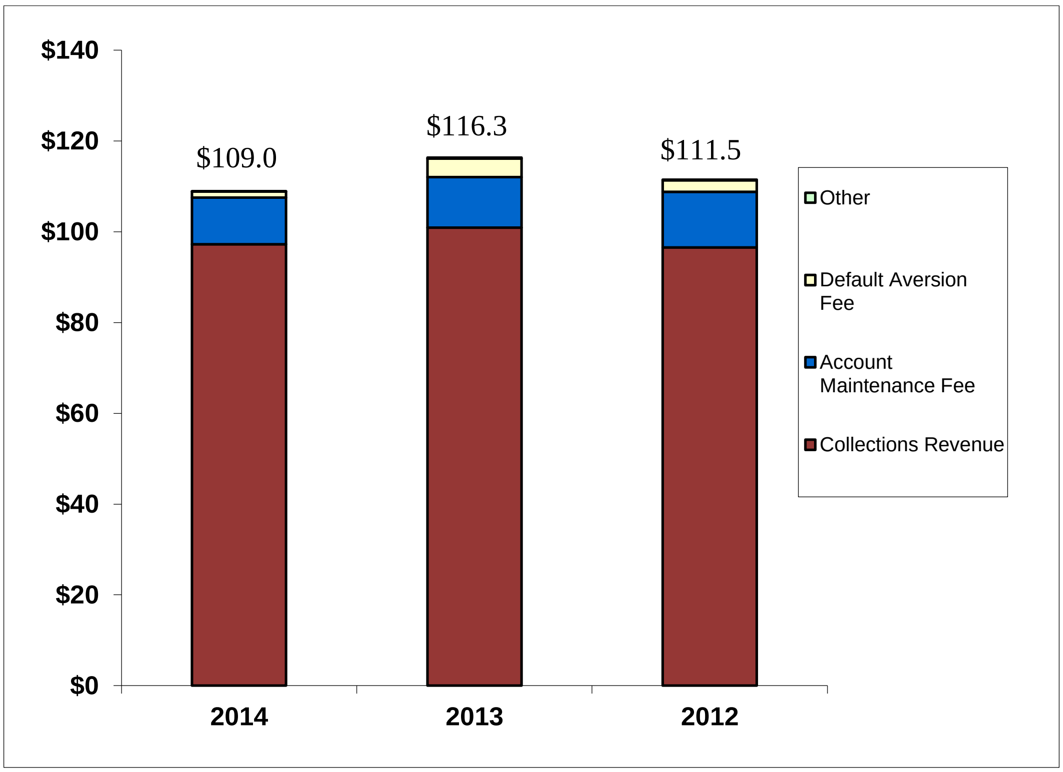
$ in thousands

Condensed Financial Information

		Operating Fund				Federal Fund		
		2014	2013	2012		2014	2013	2012
Current assets	$	93,977	87,666	86,852		49,961	55,354	60,755
Capital assets		153	296	491		-	-	-
Other noncurrent assets		-	-	-		2,905	3,629	5,691
Total assets		94,130	87,962	87,343		52,866	58,983	66,446
Current liabilities		19,575	17,520	17,882		1	-	545
Noncurrent liabilities		2,904	3,629	5,691		-	10,300	10,300
Total liabilities		22,479	21,149	23,573		1	10,300	10,845
Net assets:								
Invested in capital assets		153	296	491		-	-	-
Restricted		71,498	66,517	63,279		52,865	48,683	55,601
Total net position	$	71,651	66,813	63,770		52,865	48,683	55,601

		Operating Fund				Federal Fund		
		2014	2013	2012		2014	2013	2012
Operating Revenue:								
Default loan collections	$	97,260	100,900	96,517		249,347	275,146	270,135
Reimbursement of defaulted loans		-	-	-		450,119	526,379	624,206
Administrative and program fee		11,641	15,250	14,795		-	6	113
Other revenues		62	156	171		10,311	83	41
Total revenues		108,963	116,306	111,483		709,777	801,614	894,495
Operating expenses:								
Administrative		57,327	62,419	61,626		-	-	-
Default loan purchases		-	-	-		468,131	547,660	650,561
Collection payments to U.S. Department of Education		-	-	-		237,593	262,255	257,876
Fee subsidies		-	-	-		1,357	4,108	2,479
Other		143	195	190		13	6	44
Non Operating expenses		45,155	45,154	30,416		-	-	-
Total expenses		102,625	107,768	92,232		707,094	814,029	910,960
Transfers		(1,500)	(5,496)	(42)		1,500	5,496	42
Change in net position	$	4,838	3,042	19,209		4,183	(6,919)	(16,423)

HESC Total Operating Fund Revenue
$ in millions



Operating Fund Revenue Highlights for fiscal year ending March 31,

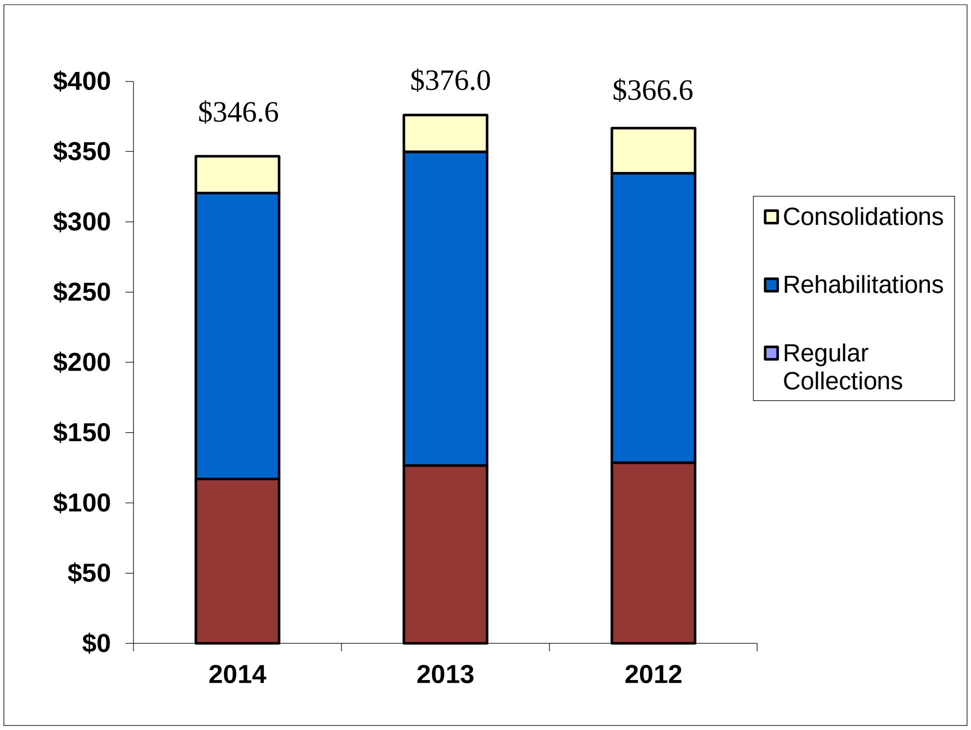
2014

- Collections revenue represents 89% of total revenue, an increase from last year as a result of a decrease in noncollections revenue.
- Account maintenance fee revenue decreased by $0.8 million as a result of a decrease in outstanding principal balance of loans outstanding due to loans being paid by borrowers.
- Default aversion fee (DAF) revenue decreased $2.4 million to $1.4 million as a result of decreased DAF activity, in spite of a decrease in the estimated allowance for future default aversion fee refunds.

2013

- Collections revenue represents 87% of total revenue, an increase from last year as a result of increased rehabilitation sales.
- Portfolio administration fee revenue or account maintenance fee 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.
- 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.

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,

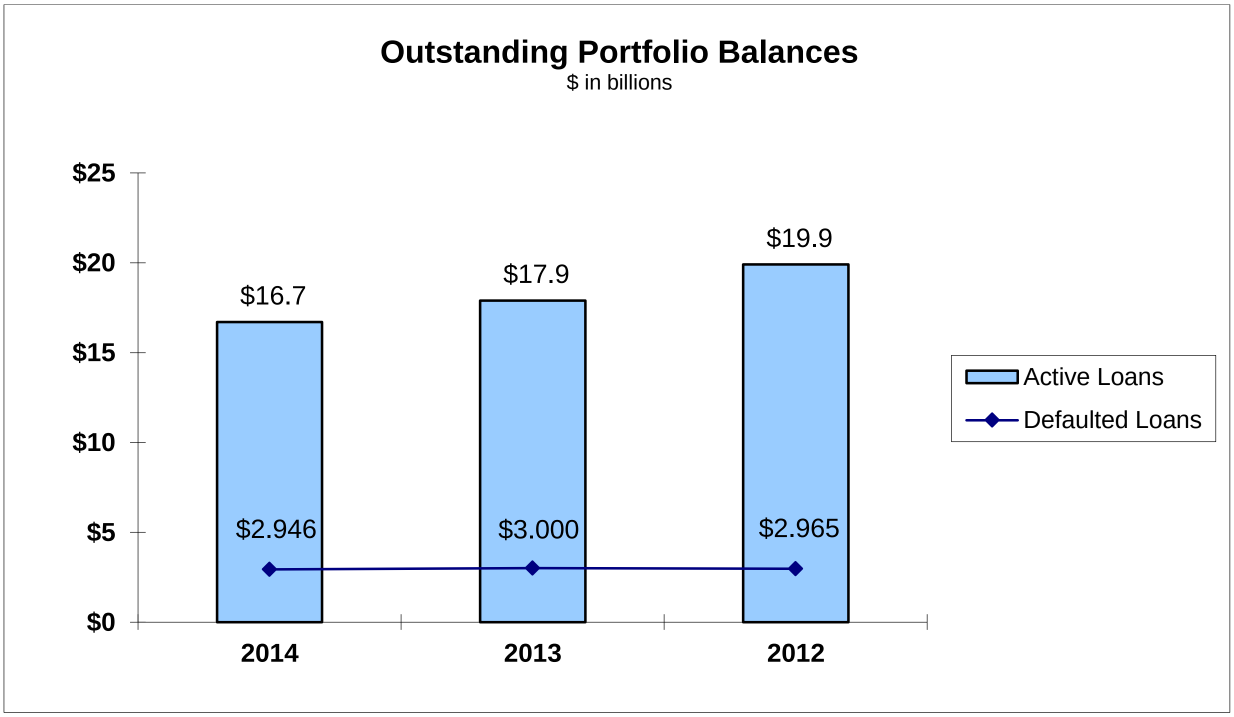
2014

- Collections on rehabilitated loans decreased 9% to $203 from a high collection year in 2012-13 of $223 million.
- Total regular collections decreased $9.6 million or 9% from $126.6 million in 2013 to $117 million in 2014, as a result of decreased vendor collection receipts and state tax offsets received during the fiscal year.
- Federal direct default consolidation revenue remained stable in 2014 at $26.2 million, the same as 2013.

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.

Operating Fund Administration Revenue on Guaranteed FFEL Loans



Administrative Revenue Highlights for the fiscal year ending March 31,

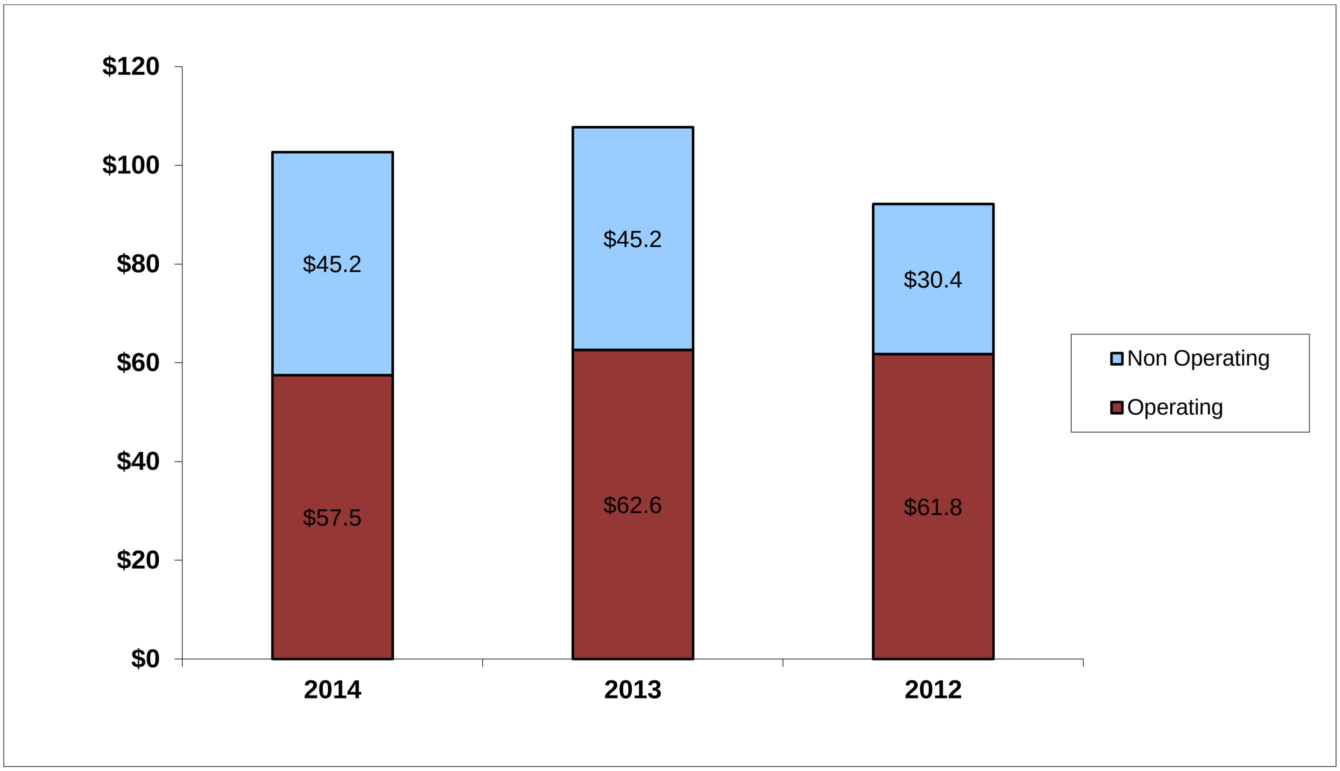
2014

- HESC's outstanding portfolio balance decreased by $1.2 billion or 7% for the fiscal year as a result active loans being paid in full and no new loans being put into the portfolio, causing a decrease in account maintenance fee of $0.8 million.
- Default aversion fee revenue, net of refunds, decreased $2.4 million for the fiscal year as a result of a decrease in the default aversion fee revenue and in spite of a decrease in default aversion fee refunds.

2013

- HESC's outstanding portfolio balance decreased by $2.0 billion or 10% for the fiscal year as a result active loans being paid in full, the elimination of FFELP and new loans being put into 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.

Total HESC Operating Fund Expenses
$ in millions



HESC Operating Expense Highlights for fiscal year ending March 31,

2014

Operating Expenses

- Outsourced vendor collection fees decreased $1.0 million or 4% as a result of decreased collections attributable to outside collection agencies.
- Payroll and fringe benefit expense decreased by $4.7 million or 15% due to a reduction in full time equivalent employees (FTE's) from 422 to 296. The significant reduction in FTE's is a result of staff being transferred to the Office for Information Technology Services as part of the Governor's cost savings initiatives. The transfer occurred in January 2014. In addition, DOB waived approximately $700,000 of HESC's indirect benefits charges for the fiscal year
- Payments to OFT for equipment usage increased $0.4 million from $1.4 million to $1.8 million.

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

Total HESC Operating Fund Expenses (continued)

2014

Non Operating Expenses

- The Operating Fund contributed $32.0 million to subsidize the Tuition Assistance Program.
- Grant and scholarship program expenses resulted in a decrease of $0.2 million, increased personal service costs were offset by reduced non personal service expenses.
- HESC expenses related to NYHELPs decreased $0.1 million, a 29% reduction from the prior year.
- Federal Grant administrative expenses increased $0.3 million or 40% as a result of staff reassignments.

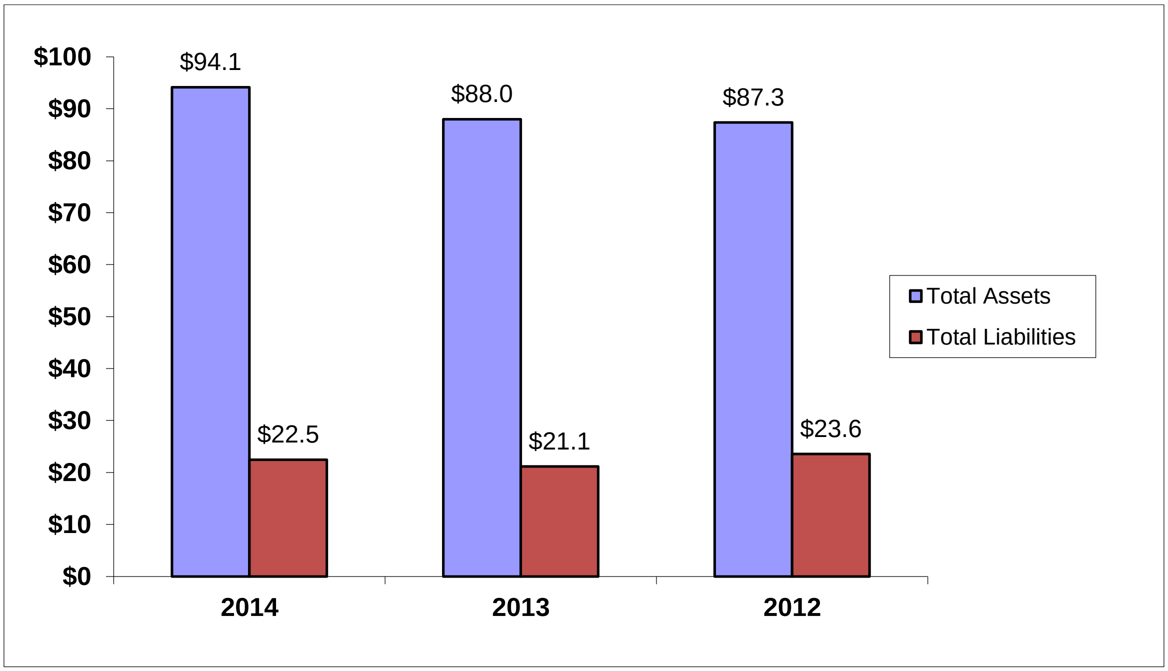
2013

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 increased fringe benefit rate.
- HESC incurred $0.4 million in expenses related to NYHELPs, a 85% reduction from the prior year.

(Continued)

Operating Fund Assets and Liabilities
$ in millions



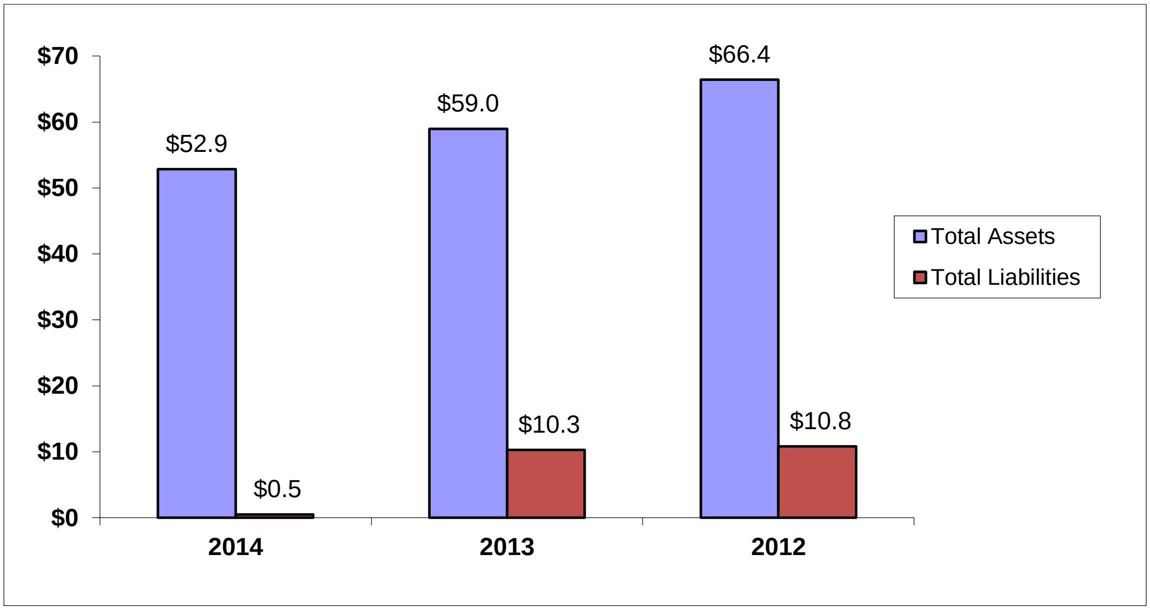
Assets

- 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 $6.2 million or 7%, primarily due to an increase in cash from operational activities of $6.5 million. The receivable from the U.S. Department of Education decreased $0.2 million during the year reducing the cash from operation activities for the year.

Liabilities

- Accounts payable and accrued liabilities represented 83% and 82% of total liabilities for the fiscal years ending March 31, 2014 and 2013 respectively.
- Accounts payable increased $0.6 million during the 2014 state fiscal year due to outstanding fringe benefit bills.
- Accrued expenses increased $0.9 million as a result of payments received at the end of the 2013-14 fiscal year and processed in the subsequent year.
- Noncurrent liabilities decreased $0.7 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 and have restricted use, primarily to reimburse lender claims for defaulted student loans.

Assets

- The Federal Fund cash and cash equivalents increased $3.4 million or 12% in fiscal year 2013-2014 as a result of cash provided by operations.
- Interfund transfers receivable increased $0.6 million during 2013-2014.
- Total assets decreased as a result of decreased receivables from U.S. Department of Education in the amount of $9.3 million.
- Noncurrent assets decreased $0.7 million as a result of decreased default aversion fee revenue and estimated future returns.

Liabilities

- HESC current liabilities at March 31, 2014 consisted of accrued investment income.
- Noncurrent liabilities consisting of $10.3 million for noninterest bearing advances from U.S. Department of Education in prior years, was removed as a liability as instructed by a representative from U.S. Department of Education during 2013-2014.

Significant Known Facts, Decisions and Conditions

- The Operating Fund will continue to support the operational expenses of the grant and scholarship programs in the amount of approximately $10.2 million for state fiscal year 2014-2015.
- The 2014-2015 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.
- As a result of the Bipartisan Budget Act (BBA) of 2013, the revenue from default rehabilitation collections will be reduced significantly. As of July 1, 2014, guaranty agencies will retain the maximum of 16% collection costs charged to the borrower and will no longer retain 18.5% of the principle balance of the loan.

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) 486-7443 or Warren.Wallin@hesc.ny.gov.

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)

Statements of Net Position

March 31, 2014 and 2013

		2014		2013	
Assets		**Operating Fund**	**Federal Fund**	**Operating Fund**	**Federal Fund**
Current assets:					
Cash and cash equivalents (note 4)	$	90,912,474	31,771,128	84,413,828	28,394,930
Receivables due from U.S. Department of Education:					
Administrative fees (note 5)		2,499,898	—	2,687,932	—
Reinsurance		—	17,386,559	—	26,672,307
Interfund balances (note 7)		—	803,526	—	254,317
Due from lenders for default fee billing (note 13)		—	—	—	31,645
Prepaid expenses and other assets		565,041	—	564,267	401
Total current assets		93,977,413	49,961,213	87,666,027	55,353,600
Noncurrent assets:					
Interfund default aversion fee allowance (note 5)		—	2,904,516	—	3,629,448
Capital assets, net (note 10)		152,828	—	296,108	—
Total noncurrent assets		152,828	2,904,516	296,108	3,629,448
Total assets		94,130,241	52,865,729	87,962,135	58,983,048
Liabilities and Net Position					
Current liabilities:					
Accounts payable and accrued liabilities		18,746,817	458	17,255,165	—
Interfund balances (note 7)		803,526	—	254,317	—
Amounts payable to lenders through EFT (note 4)		24,448	—	10,435	—
Total current liabilities		19,574,791	458	17,519,917	—
Noncurrent liabilities:					
Advance from U.S. Department of Education (note 11)		—	—	—	10,300,348
Interfund default aversion fee allowance (note 5)		2,904,516	—	3,629,448	—
Total noncurrent liabilities		2,904,516	—	3,629,448	10,300,348
Total liabilities		22,479,307	458	21,149,365	10,300,348
Net position:					
Invested in capital assets		152,828	—	296,108	—
Restricted – property of U.S. Department of Education		—	52,865,271	—	48,682,700
Restricted – for student aid related activities		71,498,106	—	66,516,662	—
Total net position	$	71,650,934	52,865,271	66,812,770	48,682,700

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

(A Component Unit of the State of New York)

Statements of Revenue, Expenses, and Changes in Net Position

Years ended March 31, 2014 and 2013

	2014		2013	
	Operating Fund	**Federal Fund**	**Operating Fund**	**Federal Fund**
Operating revenues:				
Defaulted loan collections (note 6)	$ 97,260,314	249,347,136	100,899,995	275,145,901
Administrative and program fee income (notes 5, 13)	11,640,921	—	15,250,167	6,375
Reimbursement on purchases of default loans from lenders (note 12)	—	450,118,727	—	526,379,139
Other revenue	34,352	—	45,106	30,094
Total operating revenues	108,935,587	699,465,863	116,195,268	801,561,509
Operating expenses:				
Salaries and employee benefits	25,501,519	—	30,158,721	—
General and administrative	6,735,960	—	6,576,997	—
Collection vendors	23,300,585	—	24,267,567	—
NYS Office for Technology equipment usage charges	1,788,586	—	1,416,008	—
Default aversion fee subsidy	—	1,356,769	—	4,108,203
Purchases of default loans from lenders (note 12)	—	468,131,362	—	547,659,785
Defaulted loan collections paid to U.S. Department of Education (note 6)	—	237,593,150	—	262,255,312
Depreciation (note 10)	143,280	—	195,287	—
Other expense	—	13,247	—	5,851
Total operating expenses	57,469,930	707,094,528	62,614,580	814,029,151
Operating income (loss)	51,465,657	(7,628,665)	53,580,688	(12,467,642)
Nonoperating revenues (expenses):				
Interest income	27,756	10,888	111,125	53,088
Reclassification of federal advance	—	10,300,348	—	—
Federal grant administrative expenses	(1,073,197)	—	(767,886)	—
New York State initiatives (note 8)	(44,082,052)	—	(44,385,695)	—
Total nonoperating (expenses) revenues	(45,127,493)	10,311,236	(45,042,456)	53,088
Transfer (to) from Federal Fund (note 9)	(1,500,000)	1,500,000	(5,500,000)	5,500,000
Transfer of Federal default fee (note 13)	—	—	3,977	(3,977)
Increase (decrease) in net assets	4,838,164	4,182,571	3,042,209	(6,918,531)
Net position, beginning	66,812,770	48,682,700	63,770,561	55,601,231
Net position, ending	$ 71,650,934	52,865,271	66,812,770	48,682,700

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
(A Component Unit of the State of New York)

Statements of Cash Flows

Years ended March 31, 2014 and 2013

	2014		2013	
	Operating Fund	**Federal Fund**	**Operating Fund**	**Federal Fund**
Cash flows from operating activities:				
Receipts from:				
Collections	$ 98,824,828	248,658,706	101,061,137	274,614,916
Administrative fees	10,964,802	—	13,755,653	—
Other sources	84,966	—	63,443	30,094
Reimbursement on purchases of default loan purchases	—	459,454,842	—	533,478,330
Federal default fee income from lenders	—	31,645	—	(25,712)
Payments for:				
Salaries and employee benefits	(26,494,038)	—	(30,757,965)	—
Administrative fees	—	(492,616)	—	(2,314,527)
Purchases of default loans from lenders	—	(468,131,362)	—	(547,659,785)
Collections paid to U.S. Department of Education	—	(237,643,059)	—	(262,242,270)
General, administrative and other expenses	(30,539,836)	(13,247)	(32,165,290)	(5,851)
Net cash provided by (used in) operating activities	52,840,722	1,864,909	51,956,978	(4,124,805)
Cash flows from noncapital financing activities:				
Payments to NYS – other student aid activities	(44,870,257)	—	(45,096,991)	—
Interfund transfers	(1,500,000)	1,500,000	(5,496,411)	5,496,411
Net cash (used in) provided by noncapital financing activities	(46,370,257)	1,500,000	(50,593,402)	5,496,411
Cash flows from investing activities:				
Interest received	28,181	11,289	110,689	52,785
Net cash provided by investing activities	28,181	11,289	110,689	52,785
Increase in cash and cash equivalents	6,498,646	3,376,198	1,474,265	1,424,391
Cash and cash equivalents, beginning	84,413,828	28,394,930	82,939,563	26,970,539
Cash and cash equivalents, ending	$ 90,912,474	31,771,128	84,413,828	28,394,930
Operating income (loss)	$ 51,465,657	(7,628,665)	53,580,688	(12,467,642)
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:				
Depreciation	143,280	—	195,287	—
Change in assets and liabilities:				
Receivables	188,034	9,285,748	299,162	7,112,233
Other assets	(1,199)	31,645	(182,511)	(31,645)
Interfund balances	549,209	(549,209)	798,810	(798,810)
Accounts payable and accrued liabilities	1,206,660	458	(545,952)	(442)
Other liabilities	14,013	—	(127,005)	—
Allowance for default aversion refunds	(724,932)	724,932	(2,061,501)	2,061,501
Total adjustments	1,375,065	9,493,574	(1,623,710)	8,342,837
Net cash provided by (used in) operating activities	$ 52,840,722	1,864,909	51,956,978	(4,124,805)

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 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 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 College Access and Challenge Grant program which is 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 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

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, 2014 and 2013, the Federal Fund was the guarantor of loans outstanding with original principal amounts of approximately $16,681,000,000 and $17,910,000,000, 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, 2014 and 2013, the unpaid balances were approximately $13,543,000,000 and $14,887,000,000, respectively.

HESC's management anticipates that a certain portion of the loans outstanding as of March 31, 2014 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, 2014 and 2013. 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 $125 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 $24,448 and $10,435 at March 31, 2014 and 2013, respectively, 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:

		2014	2013
Operating Fund:			
Repurchase agreements	$	85,693,730	78,725,105
Cash in State Comptroller's short-term investment pool and cash in bank		5,218,744	5,688,723
Operating Fund cash and cash equivalents	$	90,912,474	84,413,828
Federal Fund:			
Repurchase agreements	$	42,759,880	40,060,742
Cash-net of outstanding bank checks		(10,988,752)	(11,665,812)
Federal Fund cash and cash equivalents	$	31,771,128	28,394,930

(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 $2,904,516 and $3,629,448 at March 31, 2014 and 2013, 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, 2014 and 2013, the administrative fees receivable from U.S. Department of Education consisted of the following:

		2014	2013
Operating Fund:			
Account maintenance fee receivable	$	2,499,898	2,687,932
	$	2,499,898	2,687,932

For years ended March 31, 2014 and 2013, administrative fee income is as follows:

		2014	2013
Operating Fund:			
Default aversion fee, net of estimated refunds	$	1,356,769	4,108,203
Account maintenance fee		10,284,152	11,141,964
	$	11,640,921	15,250,167

Gross default aversion fee income for the years ended March 31, 2014 and 2013 was $4,840,860 and $6,979,708, respectively. The estimated reserve for default aversion fee refunds is netted against default aversion fee income. In 2014 and 2013, the default aversion fee allowance estimate was 60% and 52% of default aversion fee income, respectively. The estimate of the refunds for 2014 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 U.S. Department of Education'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, 2014, the Operating Fund had a net interfund payable balance of $803,526. The Operating Fund interfund payable consisted of a payable to the Federal Fund for underpayment of collections for the month of $818,782 and an interfund default aversion receivable of $15,256. At March 31, 2013, the interfund payable consisted of an underpayment of collections activity of $130,351 and a default aversion fee payable of $123,966.

(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 $11,753,226 and $11,925,992 in 2013-2014 and 2012-2013, respectively.

The 2013-2014 and 2012-2013 New York State budgets appropriated $32,000,000 of operating funds to subsidize the Tuition Assistance Program (TAP) which was transferred in March each year.

In fiscal years 2013-2014 and 2012-2013, HESC's Operating Fund incurred costs of $251,817 and $358,417, respectively, for costs associated with administering the program. The activities of these programs are excluded from the accompanying financial statements.

(9) Transfer from (to) Federal Fund

In September 2013 and 2012 HESC transferred from the Operating Fund to the Federal Fund approximately $1,500,000 and $5,500,000, respectively, to ensure 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 $1,000,000 are capitalized and amortized over their useful lives. As of March 31, 2014 and 2013, 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, 2014 is as follows:

		Balance April 1, 2013	Additions	Disposals	Balance March 31, 2014
Office and computer equipment	$	2,145,831	—	—	2,145,831
Less accumulated depreciation		(1,849,723)	(143,280)	—	(1,993,003)
Net capital assets	$	296,108	(143,280)	—	152,828

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

At March 31, 2014 and 2013, 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. In January 2014, HESC was notified by the U.S. Department of Education that this liability was absolved as part of the 1997 reserve recall requirement. HESC removed this liability during 2013-2014.

Long-term obligation activity for the year ended March 31, 2014, 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, 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

(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 2014, HESC was processing claims for 10 servicers and 5 lenders.

(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. 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, 2014 and 2013, the Federal default fee revenue consisted of the following:

		2014	2013
Federal Fund:			
Default fee revenue from lenders	$	—	6,375
Default fee revenue transferred (to) from HESC's Operating Fund		—	(3,977)
Total Federal default fee revenue	$	—	2,398

(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 $3,879,924 for 2014, $3,534,079 for 2013, and $2,933,613 for 2012, to cover 100% of the required employer contributions for retirement benefits. These payments, made through application of the pension benefit rate within the New York State Fringe Benefit rate calculated by the State's Division of the Budget, represent 15.59%, 13.14%, and 10.19% 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, 2014, 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, 2014 and 2013, HESC had approximately 480 and 460 retired and/or spouses of retired employees, receiving retiree health care benefits with an annual pay-as-you-go cost of approximately $4.4 million and $4.1 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 $1,063,324 and $1,905,364 as of March 31, 2014 and 2013, 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 2018. Total rental expense recorded in the Operating Fund, which includes utilities for one of two major leases, for the years ended March 31, 2014 and 2013, were $1,680,622 and $1,616,853, respectively. The following is a summary of future minimum rental commitments under noncancelable leases with terms exceeding one year:

Year ending March 31:		
2015	$	1,694,781
2016		1,674,156
2017		1,668,597
2018		555,272
	$	5,592,806

(19) Contingencies

The Operating Fund and the Federal Fund are subject to U.S. Department of Education oversight and audit that at times may result in program issues and potential liabilities. The issues relate to possible violations of the rules and regulations established by the U.S. Department of Education to administer the federal loan programs. Management diligently attempts to interpret the FFELP 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, 2014 and 2013, 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 resulting from the activities being performed that cannot reasonably be determined at this time. Management believes, however, that the resolution of the verification and any resulting 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.