



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

Financial Statements

March 31, 2009 and 2008

(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, 2009 and 2008

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**KPMG LLP**  
515 Broadway  
Albany, NY 12207

## **Independent Auditors' Report**

Board of Trustees  
New York State Higher Education  
Services Corporation:

We have audited the accompanying financial statements of the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of the New York State Higher Education Services Corporation (HESC), as of and for the years ended March 31, 2009 and 2008, which collectively comprise HESC's basic financial statements as listed in the table of contents. These financial statements are the responsibility of HESC's management. Our responsibility is to express opinions on these financial statements based on our audits.

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

As discussed in note 1, the financial statements present only the Operating Fund and Federal Fund of the Guaranteed Student Loan Programs of HESC and do not purport to, and do not, present fairly the financial position of the New York State Higher Education Services Corporation as of March 31, 2009 and 2008 and its changes in financial position and its cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial positions of the Guaranteed Student Loan Programs' Operating Fund and Federal Fund of the New York State Higher Education Services Corporation as of March 31, 2009 and 2008, and the respective changes in financial positions, and cash flows thereof for the years then ended in conformity with U.S. generally accepted accounting principles.



In accordance with *Government Auditing Standards*, we have also issued a report dated, August 31, 2009 on our consideration of the Operating Fund's and Federal Fund's internal control over financial reporting and on our tests of their compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The accompanying management's discussion and analysis on pages 3 through 13 is not a required part of the basic financial statements but is supplementary information required by U.S. generally accepted accounting principles. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

KPMG LLP

August 31, 2009



## 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, 2009 and 2008. 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 guaranty agency, HESC makes loans available through lending institutions to students attending colleges, universities, post-secondary educational, and vocational schools. FFELP allows HESC to guarantee repayment of principal and accrued interest to lenders for eligible student loans.

### *HESC'S VALUES*

#### **Our Employees**

We are committed to teamwork, excellence, initiative, personal growth and responsibility.

#### **Our Customers**

We never take our customers for granted. We ask, we listen and we respond.

#### **Our Products and Services**

We are committed to high quality, dependability, and continuous improvements to meet the changing needs of our customers.

HESC has the responsibility of processing loans submitted for guarantee, issuing loan guarantees, 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.

**New York State Higher Education Services Corporation**  
Management's Discussion and Analysis (unaudited)  
March 31, 2009 and 2008

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**2009 Financial Highlights-Operating Fund**

- Current assets increased \$21 million or 41%.
- Current liabilities decreased \$5.7 million or 22%.
- Operating revenue decreased \$33 million or 23%.
- Operating expenses decreased \$11 million or 13%.
- The Operating Fund provided \$ 12.3 million for the cost of administering the New York State grants and scholarship program.
- The Operating Fund provided \$1.1 million for the cost of administering the GEAR UP grant.
- The Operating Fund deposited \$1.3 million into the Federal Fund for the mandatory federal default fee.

**2008 Financial Highlights-Operating Fund**

- Operating revenue increased \$2.8 million or 2%.
- Operating expenses increased \$2.6 million or 3%.
- The Operating Fund transferred \$8 million to the New York State Tuition Assistance Program (TAP) to subsidize grant expenditures.
- The Operating Fund provided \$13 million for the cost of administration of New York State grants and scholarship program.
- The Operating Fund deposited \$27.5 million to the Federal Fund for the mandatory federal default fee.

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**Condensed Financial Information**

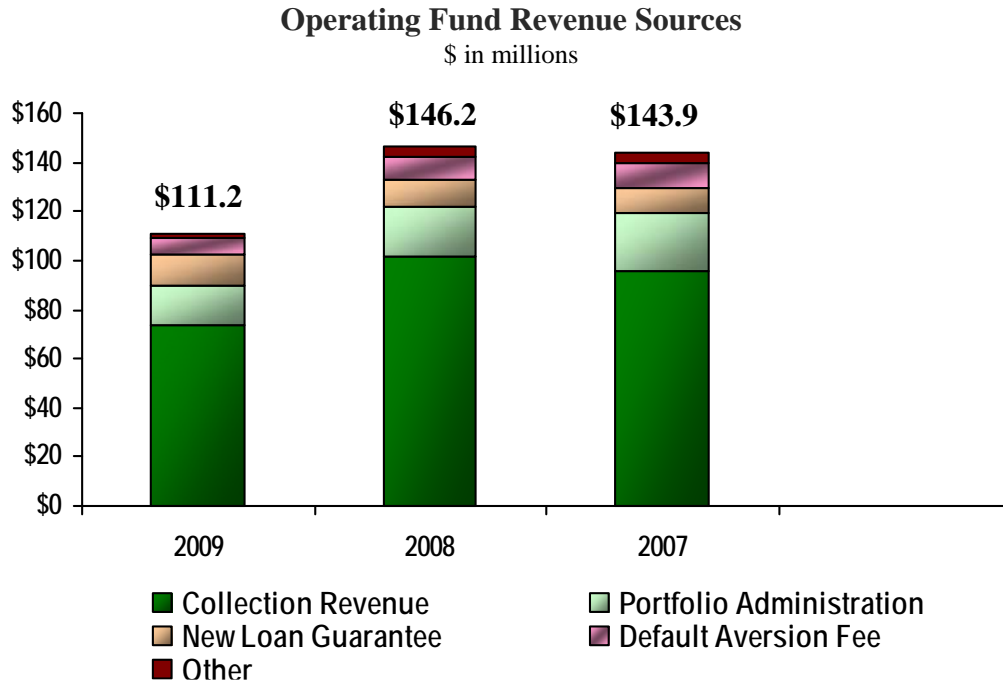
Amounts in thousands

	Operating Fund			Federal Fund		
	2009	2008	2007	2009	2008	2007
Current assets	\$ 72,721	51,698	44,828	90,335	84,373	82,609
Capital assets	38	81	128	—	—	—
Other noncurrent assets	—	—	—	4,183	3,941	6,029
<b>Total assets</b>	<b>72,759</b>	<b>51,779</b>	<b>44,956</b>	<b>94,518</b>	<b>88,314</b>	<b>88,638</b>
Current liabilities	20,380	26,055	29,884	423	—	6,013
Noncurrent liabilities	4,183	3,941	6,029	10,300	10,300	10,300
<b>Total liabilities</b>	<b>24,563</b>	<b>29,996</b>	<b>35,913</b>	<b>10,723</b>	<b>10,300</b>	<b>16,313</b>
Net assets:						
Invested in capital assets	38	81	128	—	—	—
Restricted	48,158	21,702	8,915	83,795	78,014	72,325
<b>Total net assets</b>	<b>\$ 48,196</b>	<b>21,783</b>	<b>9,043</b>	<b>83,795</b>	<b>78,014</b>	<b>72,325</b>

	Operating Fund			Federal Fund		
	2009	2008	2007	2009	2008	2007
Operating revenue:						
Default loan collections	\$ 73,272	101,876	96,084	207,136	242,674	125,366
Reimbursement on defaulted loans	—	—	—	514,279	472,537	371,442
Other	35,780	40,542	43,552	29,908	4	29
Non Operating revenues	2,185	3,778	4,255	746	2,871	1,681
<b>Total revenues</b>	<b>111,237</b>	<b>146,196</b>	<b>143,891</b>	<b>752,069</b>	<b>718,086</b>	<b>498,518</b>
Operating expenses:						
Administrative	77,116	88,103	85,496	—	—	—
Default loan purchases	—	—	1	534,694	491,519	383,399
Collection payments to ED	—	—	—	199,040	233,822	120,857
Fee subsidies	—	—	—	6,842	9,567	30,611
Other	43	98	101	6	—	8
Non Operating expenses	13,370	22,742	26,990	—	—	—
<b>Total expenses</b>	<b>90,529</b>	<b>110,943</b>	<b>112,588</b>	<b>740,582</b>	<b>734,908</b>	<b>534,875</b>
Transfers	5,705	(22,512)	(52,282)	(5,705)	22,512	3,500
<b>Change in net assets</b>	<b>\$ 26,413</b>	<b>12,741</b>	<b>(20,979)</b>	<b>5,782</b>	<b>5,690</b>	<b>(32,857)</b>

**New York State Higher Education Services Corporation**  
 Management's Discussion and Analysis (unaudited)  
 March 31, 2009 and 2008

**HESC Total Operating Fund Revenue**



**Operating Fund Revenue Highlights for the fiscal year ending March 31,**

**2009**

- Collection revenue represents 66% of total revenue, a decrease from last year as a result of the loss of lenders participating in the rehabilitation program.
- Portfolio administration revenue decreased by \$3.5 million as a result of a decrease in the Account Maintenance Fee (AMF) rate from .10% to .06%, effective 10/1/07. The loss in revenue from the rate change was partially offset by an increase in the loan portfolio balance of 7.8% to \$26.2 billion.
- HESC guaranteed \$3.7 billion in new loans, an increase of \$.5 billion in loan volume.
- Default aversion fee (DAF) revenue decreased \$2.8 million to \$6.8 million in 2008-2009 as a result of an increase in the allowance for DAF refunds, to reflect current trends.

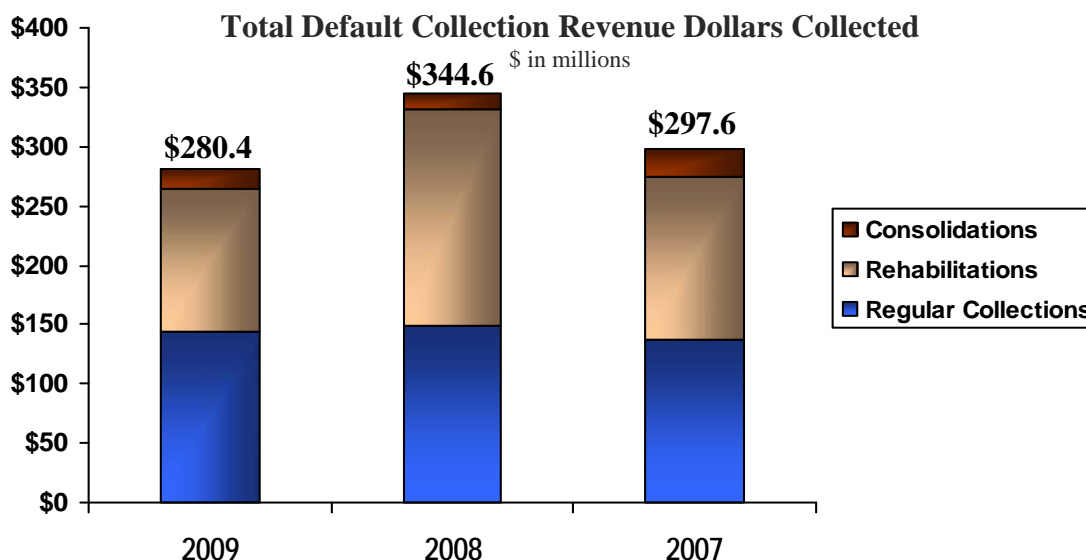
**2008**

- Collection revenue represents 70% of total revenue.
- Portfolio administration revenue decreased by \$3 million as a result of a decrease in the Account Maintenance Fee (AMF) rate from .10% to .06%, effective 10/1/07. The loss in revenue from the rate change was partially offset by an increase in the loan portfolio balance of 3.5% to \$24.48 billion.
- HESC guaranteed \$3.2 billion in new loans, an increase of \$.2 billion in loan volume.
- Default aversion revenue decreased \$.4 million to \$9.6 million as a result of a decrease in the number of default aversion assistance requests processed during 2007-2008 and an increase in refunds required during the same period.

**New York State Higher Education Services Corporation**  
 Management's Discussion and Analysis (unaudited)  
 March 31, 2009 and 2008

## Collection Revenue

*As a FFEL guarantor, HESC retains a percentage determined by ED to collect defaulted student loans. Collection revenue shown below is the gross collection receipts by HESC in the respective years. HESC's primary source of revenue continues to be collection related revenue.*



### Fiscal Year Ending March 31, 2009

- Collections on rehabilitated loans decreased 33.5% to \$120.7 million in 2008. This decrease is a result of the loss of lenders participating in the rehabilitation program.
- Total regular collections decreased 4% from \$149.3 million in 2008 to \$143.3 million in 2009, due to current economic conditions.
- Federal direct default consolidation revenue increased \$3.1 million during the fiscal year from \$13.2 million in 2008 to \$16.3 million in 2009, due to a change in collection strategy as a result of the loss of rehabilitating lenders.

### Fiscal Year Ending March 31, 2008

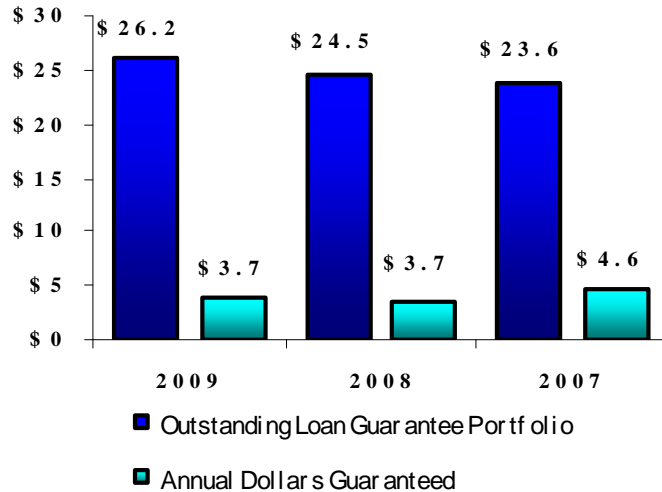
- Collections on rehabilitated loans increased 33% to \$181.5 million in 2008. This increase is a result of the continued shift in collection focus to rehabilitations.
- Total regular collections increased 9% from \$137.3 million in 2007 to \$149.3 million in 2008. Administrative wage garnishment collections increased 39% due to the full implementation of the allowable garnishment percentage increase from 10% to 15% effective July 2006.
- Federal direct default consolidation revenue decreased \$9.8 million during the fiscal year from \$23 million in 2007 to \$13.2 million in 2008, due to the decrease in lenders consolidating loans for borrowers.

**New York State Higher Education Services Corporation**  
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**Operating Fund Administration Revenue on FFEL Guaranteed Loans**

*As a FFELP guarantor, HESC receives fee revenue for issuing new loan guarantees and for administering the outstanding guarantee loan portfolio.*

**Loan Guarantee Volume**  
 Fiscal Year Ending March 31  
 \$'s in billions



**Loan Guarantee Volume**

HESC guaranteed \$3.7 billion in student loans during the fiscal year ending March 31, 2009, an increase of loan guarantees of \$50 million. New loan guarantees increased \$500 million or 15.6% to \$3.7 billion, and consolidation loans decreased \$450 million or 94.9% to \$23.8 million during state fiscal year 2008-2009.

Guarantees for 2008 were \$3.7 billion, a decrease of 20% or \$9 billion from 2007. New loan guarantees were \$3.2 billion, up \$.24 billion from 2007. Consolidation loan guarantees declined 71.2% during state fiscal year 2007-2008.

**Loan Guarantee Revenue**

HESC's outstanding portfolio balance increased by \$1.7 billion or 7% for the current fiscal year ending March 31, 2009. The 10/1/07 AMF rate reduction caused the revenue, based on outstanding portfolio balance, to decrease \$3.5 million. A decrease in AMF revenue of \$3 million was also experienced in 2008 due to the reduction in AMF rate.

New loan guarantee revenue grew \$1.4 million for the fiscal year ending March 31, 2009, due to a slight increase in new guarantees. An increase in new loan guarantee revenue of \$1 million was experienced during fiscal year ending March 31, 2008.

**New York State Higher Education Services Corporation**  
 Management's Discussion and Analysis (unaudited)  
 March 31, 2009 and 2008

**Total HESC Operating Fund Expenses**

*HESC's overall expenses are down 18% for the fiscal year ended March 31, 2009 from \$110.9 million to \$90.5 million.*

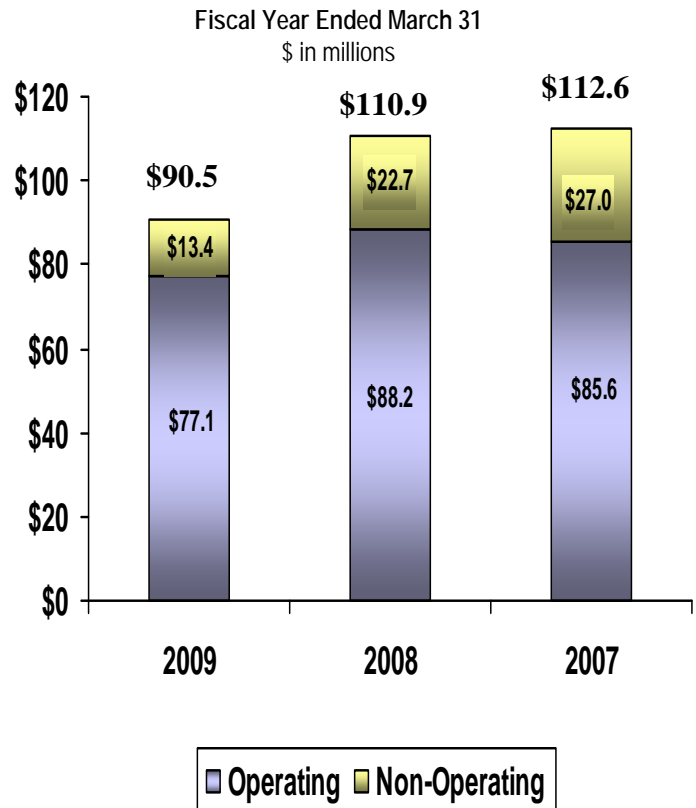
**March 31, 2009**

**Operating Expenses**

- Outsourced vendor collection fees decreased \$5.6 million or 27% as a result of the loss of lenders participating in the rehabilitation program.
- Payments to Office for Technology decreased \$0.9 million or 19.5% from 2008 to 2009 as a result of rate and volume changes from 2008.
- Contract programmer expenses decreased \$1.4 million or 27% from 2008 to 2009 as a result of cost cutting measures.
- Miscellaneous expense decreased from 2008 to 2009 due to the one time expenditure in 2007-2008 for the financial literacy planning aid tool.

**Non-Operating Expenses**

- The Operating Fund was not required to subsidize the Tuition Assistance Program in 2008-2009.
- Grants and scholarship related expenses decreased \$8.8 million in 2008-2009.



**March 31, 2008**

**Operating Expenses**

- Outsourced vendor collection fees decreased \$1.4 million or 7% as a result of decreased vendor collections of 15% as well as negotiated rate reduction resulting from the guaranty agency's retention reduction from 23% to 16%, on regular collections.
- Payroll and fringe benefits increased \$2.8 million due to an increase in full-time equivalent employees.
- Payments to Office for Technology decreased \$1.3 million from 2007 to 2008 as a result of rate and volume changes from 2007.
- HESC spent \$2.5 million on a web based, self service, multi-year debt planning financial aid tool as part of its student financial literacy initiative.

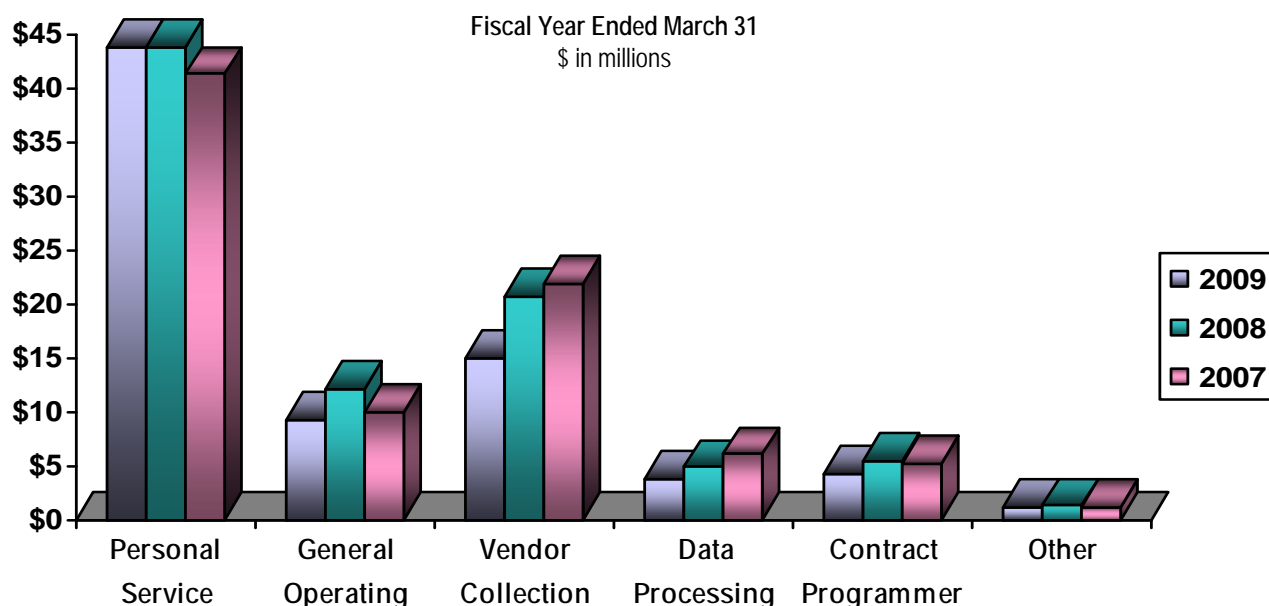
**Non-Operating Expenses**

- The Operating Fund contributed \$8 million to subsidize the TAP program.
- The administrative costs of the grants and scholarship program totaling \$13 million was paid by the Operating Fund in 2008.
- The Operating Fund provided funds for the GEAR UP grant's operational expenses administered by the state in 2008.
- The Operating Fund disbursed \$.6 million in default prevention grants during 2007-2008.

**New York State Higher Education Services Corporation**  
 Management's Discussion and Analysis (unaudited)  
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## Operating Fund Administrative Expenses

*Operating fund administrative expenses decreased from \$88.1 to \$77.1 million for the fiscal year ended March 31, 2009.*



### Personal Service

Personal service costs include salaries and fringe benefits. Fringe benefits for 2009 represent \$13.7 million or 45% of salaries. There is little change between fiscal year 2007-2008 and 2008-2009 due to negotiated raises being offset by a decrease in the fringe benefit rate and the number of full-time equivalent employees (FTEs). FTEs decreased from 584 in 2008 to 549 in 2009. FTEs increased from 579 in 2007 to 584 in 2008.

### General Operating

General operating expenses decreased \$2.8 million during the fiscal year ending March 31, 2009, as a result of cost cutting measures and operational efficiency achieved by HESC. General operating expenses increased \$2.1 million during the fiscal year ended March 31, 2008. Primarily due to the \$2.5 million expenditure for the planning program.

### Vendor Collection

Vendor collection expense decreased \$5.6 million or 27% in fiscal year 2008-2009 as a result of the loss of lenders participating in the rehabilitation program. For the period ended March 31, 2008, vendor collection expense decreased \$1.4 million or 7%.

### Data Processing

Data processing costs decreased approximately \$1 million during fiscal year ended March 31, 2009, as a result of the reduced rate charged by the Office for Technology and transition of programs from mainframe to web based processes. The change in expense from 2007 to 2008 was a decrease of \$1.3 million.

### Contract Programmers

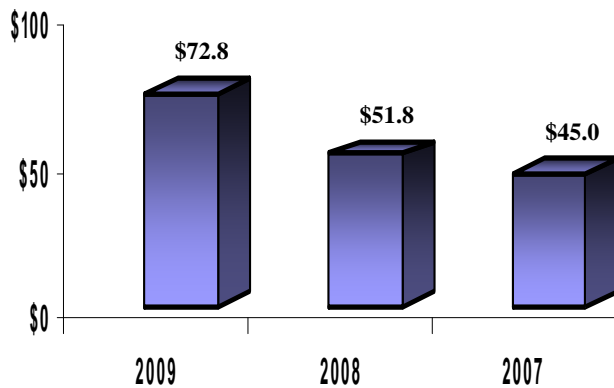
Contract programmer expenses decreased \$1.4 million during 2008-2009 due to cost cutting measures. The cost for 2008 had increased \$ .5 million from 2007.

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**Assets & Liabilities- Operating Fund**

**Assets**

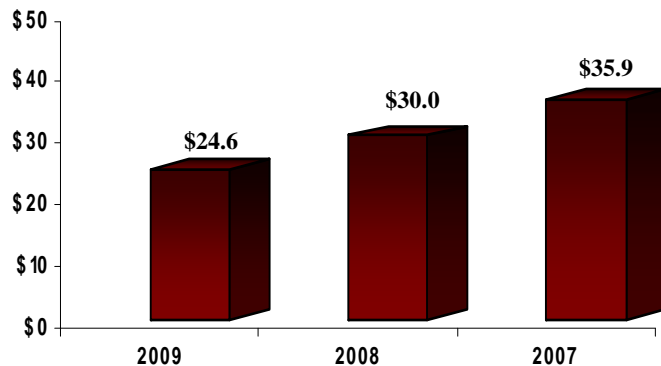
Fiscal Year Ending March 31  
 \$ in millions



- Total operating assets are primarily current assets, consisting of cash and cash equivalents, receivables due from the U.S. Department of Education and the Federal Fund.
- Current assets increased \$21 million or 41% as a result of cash provided from operations of \$28.6 million in fiscal year 2008-2009.
- Administrative fees receivable increased \$0.6 million in 2008 as a result of an increase in loans guaranteed this period.

**Liabilities**

Fiscal Year Ending March 31  
 \$ in millions



- Accrued liabilities represented 66% of total liabilities for the year ended March 31, 2009 and 76% of total liabilities in 2008.
- Accounts payable decreased \$4.8 million in fiscal year 2009 primarily due to reduced spending.
- Non-current liabilities increased \$.2 million, for the year ended March 31, 2009 compared to March 31, 2008, as a result of the increase in the allowance for default aversion fee refund.

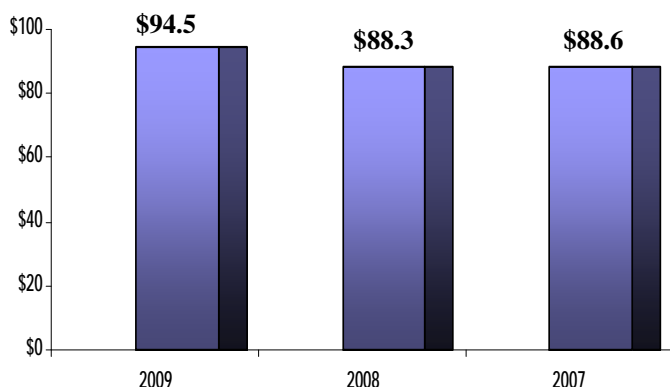
**New York State Higher Education Services Corporation**  
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 March 31, 2009 and 2008

**The Federal Student Loan Reserve Fund (Federal Fund)**

*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.*

**Federal Fund Assets**

Fiscal Year Ending March 31  
 \$ in millions

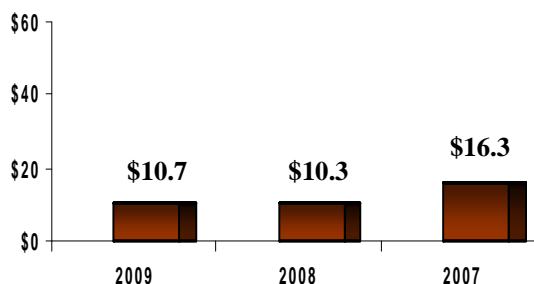


- The Federal Fund's cash and cash equivalents increased \$3.5 million or 6.4% in fiscal year 2008-2009 as a result of cash provided from operations of \$7 million.
- The reinsurance receivable increased \$2.1 million in 2008-2009 as a result of decreased collection payable to ED offset against reinsurance receivable at March 31, 2009.
- The default fee receivable increased \$1.8 million due to an increased amount in loans guaranteed.
- The interfund DAF allowance increased \$0.2 million in 2009 based on historical activities.

- Current liabilities included \$0.4 million in inter-fund payables to the Operating Fund.
- Non-current liabilities in 2009 include \$10.3 million for non-interest bearing advances from the ED, for the purpose of helping to strengthen FFELP through the infusion of additional working capital.

**Federal Fund Liabilities**








Fiscal Year Ending March 31  
 \$ in millions



**New York State Higher Education Services Corporation**  
Management's Discussion and Analysis (unaudited)  
March 31, 2009 and 2008

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## Significant Known Facts, Decisions, or Conditions

-  The "Student Aid and Fiscal Responsibility Act" budget reconciliation legislation introduced by the House on July 15, 2009 calls for a 100 percent transition to the U.S. Direct Lending Program by July 1, 2010 which may have a significant impact on HESC's future revenue streams.
-  HESC has renewed a contract with SunTrust Bank, Inc., to resume the loan rehabilitation program starting July 27, 2009.
-  HESC has been designated by Governor Paterson as the agency to administer the New York Higher Education Loan Program (NYHELPS). NYHELPS will give New York students and families access to low-cost education loans not currently available in the private loan market.
-  On November 10, 2008, the Secretary of Education issued a Dear Colleague Letter extending the Ensuring Continued Access to Student Loans Act (ECASLA) through the 2009-2010 fiscal year.
-  The Operating Fund will continue to support the operational expenses of the Grants and Scholarship program in the amount of approximately \$12.2 million for 2009-2010.
-  HESC reached an agreement with the Federal Department of Education on an outstanding payment regarding HESC's rehabilitation revenue retention from 1996 – 2004. As of March 31, 2009, HESC's Agency Operating Fund has received \$12 million leaving a balance of \$4.9 million, to be transferred in 2009-2010.
-  HESC's fringe benefit rate for 2009-2010 has decreased 1.6% to 44.9%.

## 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 further information regarding the FFEL Program, you may also review our annual report at [www.hesc.org](http://www.hesc.org).

Questions about this report can be directed to HESC's Administrative Officer, Warren E. Wallin at (518) 473-1200 or [wwallin@hesc.com](mailto:wwallin@hesc.com).

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

Statements of Net Assets

March 31, 2009 and 2008

Assets	2009		2008	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
Current assets:				
Cash and cash equivalents (note 4)	\$ 62,077,024	58,091,886	42,169,852	54,591,586
Receivables due from U.S. Department of Education:				
Administrative fees (note 5)	9,386,837	—	8,785,089	—
Reinsurance	—	30,473,096	—	28,367,095
EFT fees receivable from lenders	269,259	—	151,901	—
Interfund balances (note 7)	423,060	—	—	1,412,340
Due from lenders for default fee billing	—	1,770,036	—	—
Prepaid expenses and other assets	564,471	—	589,642	—
Accrued interest	79	159	1,097	2,365
Total current assets	<u>72,720,730</u>	<u>90,335,177</u>	<u>51,697,581</u>	<u>84,373,386</u>
Noncurrent assets:				
Interfund Default Aversion Fee Allowance (note 5)	—	4,183,458	—	3,940,630
Capital assets, net (note 11)	38,559	—	81,229	—
Total noncurrent assets	<u>38,559</u>	<u>4,183,458</u>	<u>81,229</u>	<u>3,940,630</u>
Total assets	<u>72,759,289</u>	<u>94,518,635</u>	<u>51,778,810</u>	<u>88,314,016</u>
<b>Liabilities and Net Assets</b>				
Current liabilities:				
Accounts payable and accrued liabilities (note 17)	16,215,027	—	21,009,317	—
Interfund balances (note 7)	—	423,060	1,412,340	—
Amounts payable to lenders through EFT (note 4)	4,164,666	—	3,633,561	—
Total current liabilities	<u>20,379,693</u>	<u>423,060</u>	<u>26,055,218</u>	<u>—</u>
Noncurrent liabilities:				
Advance from U.S. Department of Education (note 12)	—	10,300,348	—	10,300,348
Interfund Default Aversion Fee Allowance (note 5)	4,183,458	—	3,940,630	—
Total noncurrent liabilities	<u>4,183,458</u>	<u>10,300,348</u>	<u>3,940,630</u>	<u>10,300,348</u>
Total liabilities	<u>24,563,151</u>	<u>10,723,408</u>	<u>29,995,848</u>	<u>10,300,348</u>
Net assets:				
Invested in capital assets	38,559	—	81,229	—
Restricted – property of U.S. Department of Education	—	83,795,227	—	78,013,668
Restricted – for student aid related activities	48,157,579	—	21,701,733	—
Total net assets	<u>\$ 48,196,138</u>	<u>83,795,227</u>	<u>21,782,962</u>	<u>78,013,668</u>

See accompanying notes to financial statements.

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

Statements of Revenue, Expenses, and Changes in Net Assets

Years ended March 31, 2009 and 2008

	2009		2008	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
Operating revenues:				
Defaulted loan collections (note 6)	\$ 73,272,445	207,135,793	101,875,848	242,674,192
Administrative and program fee income (note 5, 14)	35,780,279	29,908,325	40,542,429	—
Reimbursement on purchases of default loans from lenders (note 13)	—	514,279,039	—	472,536,582
Other revenue	1,432,594	1,986	1,224,455	4,467
Total operating revenues	<u>110,485,318</u>	<u>751,325,143</u>	<u>143,642,732</u>	<u>715,215,241</u>
Operating expenses:				
Salaries and employee benefits	44,027,521	—	44,048,457	—
General and administrative (note 19)	13,369,354	—	17,617,672	—
Collections	14,941,352	—	20,567,033	—
NYS Office for Technology equipment usage charges	3,837,644	—	4,765,574	—
D.M.I. program expenses	940,134	—	1,104,125	—
Default aversion fee subsidy	—	6,842,229	—	9,562,760
Purchases of default loans from lenders (note 13)	—	534,694,423	—	491,518,997
Defaulted loan collections paid to U.S. Department of Education	—	199,039,675	—	233,822,374
Depreciation	42,670	—	98,191	—
Other expense	—	5,769	—	4,565
Purchases of defaulted State loans from lenders	383	—	—	—
Total operating expenses	<u>77,159,058</u>	<u>740,582,096</u>	<u>88,201,052</u>	<u>734,908,696</u>
Operating income (loss)	<u>33,326,260</u>	<u>10,743,047</u>	<u>55,441,680</u>	<u>(19,693,455)</u>
Nonoperating revenues (expenses):				
Interest income	752,434	743,364	2,553,125	2,870,922
Default prevention grant (note 9)	—	—	(611,096)	—
Gear Up operational expenses	(1,066,344)	—	(1,005,636)	—
New York State initiatives (note 8)	(12,304,026)	—	(21,126,010)	—
Total nonoperating (expenses) revenues	<u>(12,617,936)</u>	<u>743,364</u>	<u>(20,189,617)</u>	<u>2,870,922</u>
Transfer from/(to) Federal Fund (note 10)	7,000,000	(7,000,000)	5,000,000	(5,000,000)
Transfer of Federal default fee (note 14)	(1,295,148)	1,295,148	(27,511,549)	27,511,549
Increase in net assets	26,413,176	5,781,559	12,740,514	5,689,016
Net assets, beginning	<u>21,782,962</u>	<u>78,013,668</u>	<u>9,042,448</u>	<u>72,324,652</u>
Net assets, ending	<u>\$ 48,196,138</u>	<u>83,795,227</u>	<u>21,782,962</u>	<u>78,013,668</u>

See accompanying notes to financial statements.

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Statements of Cash Flows

Years ended March 31, 2009 and 2008

	2009		2008	
	Operating Fund	Federal Fund	Operating Fund	Federal Fund
Cash flows from operating activities:				
Receipts from:				
Collections	\$ 72,783,491	207,410,113	104,705,220	240,170,515
Administrative fees	35,316,963	—	39,091,130	—
Other sources	1,315,236	1,986	1,412,291	4,467
Reimbursement on purchases of default loan purchases	—	512,274,538	—	467,142,924
Federal default fee income from lenders	—	28,138,289	—	—
Payments for:				
Salaries and employee benefits	(44,032,363)	—	(46,800,788)	—
Administrative fees	—	(6,980,661)	—	(6,176,367)
Purchases of default loans from lenders	(383)	(534,694,423)	—	(491,518,997)
Collections paid to U.S. Department of Education (ED)	—	(199,141,175)	—	(233,810,457)
General, administrative and other expenses	(36,821,589)	(5,769)	(42,315,812)	(4,565)
Net cash provided by (used in) operating activities	<u>28,561,355</u>	<u>7,002,898</u>	<u>56,092,041</u>	<u>(24,192,480)</u>
Cash flows from noncapital financing activities:				
Payments to NYS – other student aid activities	(13,655,802)	—	(22,811,619)	—
Interfund Transfers	(2,751,832)	2,751,832	(31,560,128)	31,560,128
Payment to ED for Federal recall	—	—	—	(6,013,293)
Payment from ED for additional rehabilitated loans	7,000,000	(7,000,000)	5,000,000	(5,000,000)
Payments to schools for financial aid training grant	—	—	(611,096)	—
Net cash (used in) provided by noncapital financing activities	<u>(9,407,634)</u>	<u>(4,248,168)</u>	<u>(49,982,843)</u>	<u>20,546,835</u>
Cash flows from capital and related financing activities:				
Purchases of capital assets	—	—	(51,778)	—
Net cash used in capital and related financing activities	<u>—</u>	<u>—</u>	<u>(51,778)</u>	<u>—</u>
Cash flows from investing activities:				
Interest received	753,451	745,570	2,558,489	2,887,270
Net cash provided by investing activities	<u>753,451</u>	<u>745,570</u>	<u>2,558,489</u>	<u>2,887,270</u>
Increase (decrease) in cash and cash equivalents	19,907,172	3,500,300	8,615,909	(758,375)
Cash and cash equivalents, beginning	42,169,852	54,591,586	33,553,943	55,349,961
Cash and cash equivalents, ending	<u>\$ 62,077,024</u>	<u>58,091,886</u>	<u>42,169,852</u>	<u>54,591,586</u>

See accompanying notes to financial statements.

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	<b>2009</b>		<b>2008</b>	
	<b>Operating Fund</b>	<b>Federal Fund</b>	<b>Operating Fund</b>	<b>Federal Fund</b>
Operating income (loss)	\$ 33,326,260	10,743,047	55,441,680	(19,693,455)
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:				
Depreciation	42,670	—	98,191	—
Change in assets and liabilities:				
Receivables	(601,748)	(3,876,036)	1,935,093	(5,381,741)
Other assets	(92,187)	—	(257,578)	—
Interfund balances	(378,715)	378,715	1,268,924	(1,205,526)
Accounts payable and accrued liabilities	(4,508,858)	—	1,697,356	—
Other liabilities	531,105	—	(2,003,383)	—
Allowance for default aversion refunds	242,828	(242,828)	(2,088,242)	2,088,242
Total adjustments	(4,764,905)	(3,740,149)	650,361	(4,499,025)
Net cash provided by (used in) operating activities	\$ <u>28,561,355</u>	<u>7,002,898</u>	<u>56,092,041</u>	<u>(24,192,480)</u>

See accompanying notes to financial statements.

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**(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 makes 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 processing loans submitted for guarantee, issuing loan guarantees, 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.

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 considered property of the U.S. Department of Education. The Operating Fund is considered 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, State Scholarship Programs, and Robert L. Byrd Federal Scholarship Program under which students apply for payments to attend particular 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 grant 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.

**(2) Significant Accounting Policies**

**(a) Basis of Accounting**

The Guaranteed Student Loan Programs' Operating Fund and Federal Fund follow fund accounting under U.S. generally accepted accounting principles 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

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and the accrual basis of accounting. Revenues are recognized when earned and expenses are recognized when the liability is incurred regardless of the timing of the related cash flow.

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

**(b) *Cash and Cash Equivalents***

Cash and cash equivalents consisting of United States Treasury Bills and collateralized short-term repurchase agreements are carried at fair value. Investment income represents interest on deposits and gains and losses.

**(c) *Operating Revenues and Expenses***

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

**(d) *Use of Estimates***

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Management estimates include useful lives in depreciating capital assets, and anticipated future default aversion fee refunds. Actual results could differ from those estimates.

**(3) *Guaranteed Loans Outstanding and Respective Unpaid Balances***

As of March 31, 2009 and 2008, the Federal Fund was the guarantor of loans outstanding with original principal amounts of approximately \$26,249,000,000 and \$24,484,000,000, respectively, made to students by participating lending institutions. Substantially all 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, 2009 and 2008, the unpaid balances were approximately \$23,772,000,000 and \$22,306,000,000, respectively.

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HESC's management anticipates that a certain portion of the loans outstanding as of March 31, 2009 and 2008 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 remaining maturities of three months or less when purchased and are generally 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, 2009 and 2008. Federal Fund amounts are restricted in use and are property of the U.S. Department of Education. HESC actively manages the investments of its cash balances to minimize its uninvested funds. Excess cash balances are generally invested in short-term repurchase agreements until such time that HESC anticipates the funds will be required for operational needs. Cash balances in an administrative account in the Operating Fund are invested in the New York State Comptroller's short-term investment pool. These cash balances are available to HESC upon demand.

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

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

Included in Operating Fund bank balances are \$4,164,666 for 2009 and \$3,633,561 for 2008, which were deposited by lenders, to be forwarded to schools generally within three business days 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.

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Cash and cash equivalents at March 31 were as follows:

	<b>2009</b>	<b>2008</b>
Operating Fund:		
Repurchase agreements	\$ 28,617,923	31,587,250
Cash in State Comptroller's short-term investment pool and Cash in Bank	33,428,101	10,551,602
Petty cash and travel imprest accounts	31,000	31,000
Operating Fund cash and cash equivalents	\$ 62,077,024	42,169,852
Federal Fund:		
Repurchase agreements	\$ 73,705,509	65,501,594
Cash-net of outstanding bank checks	(15,613,623)	(10,910,008)
Federal Fund cash and cash equivalents	\$ 58,091,886	54,591,586

As of March 31, the cost and fair value of cash equivalents are as follows:

<b>Operating Fund</b>	<b>2009</b>		<b>2008</b>	
	<b>Cost</b>	<b>Fair value</b>	<b>Cost</b>	<b>Fair value</b>
Held by HESC's agent in HESC's name	\$ 28,617,923	28,617,923	31,587,250	31,587,250

<b>Federal Fund</b>	<b>2009</b>		<b>2008</b>	
	<b>Cost</b>	<b>Fair value</b>	<b>Cost</b>	<b>Fair value</b>
Held by HESC's agent in HESC's name	\$ 73,705,509	73,705,509	65,501,594	65,501,594

**(5) Operating Administrative Fees**

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

A Default Aversion Fee is recognized for default aversion activities on delinquent loans at the time the lenders request aversion assistance between the 60th and 120th days of a borrower's delinquency. A fee of 1% of principal and interest on the loan may be charged to the Federal Fund at the time the guaranty agency receives a request from a lender for preclaim assistance. However, the fee must be refunded by the Operating Fund to the Federal Fund in the event the loan is later paid as a default claim. Accordingly, an estimate of default aversion fee refunds of \$4,183,458 and \$3,940,630 at March 31, 2009 and 2008,

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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.

A Loan Processing and Issuance Fee is paid based on the original principal amount of new loans guaranteed and disbursed during the period at a rate of 0.40%. This fee is paid to the Operating Fund on a quarterly basis.

An Account Maintenance Fee is calculated on the original principal amount of loans outstanding at a rate of 0.10% effective through September 30, 2007. The College Cost Reduction and Access Act reduced the rate from 0.10% to 0.06% beginning October 1, 2007. This fee is paid 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, 2009 and 2008, the administrative fees receivable from U.S. Department of Education consisted of the following:

	<b>2009</b>	<b>2008</b>
Operating Fund:		
Loan processing and issuance fee receivable	\$ 5,409,741	5,065,205
Account maintenance fee receivable	3,977,096	3,719,884
	\$ 9,386,837	8,785,089

For years ended March 31, 2009 and 2008, administrative fee income is as follows:

	<b>2009</b>	<b>2008</b>
Operating Fund:		
Default aversion fee, net of estimated refunds	\$ 6,842,229	9,562,760
Loan processing and issuance fee	12,515,243	11,086,731
Account maintenance fee	16,422,807	19,892,938
	\$ 35,780,279	40,542,429

Gross default aversion fee income for the years ended March 31, 2009 and 2008 was \$11,952,738 and \$12,853,735, respectively. The estimated reserve for default aversion fee refunds is netted against default aversion fee income. In 2009 and 2008, the default aversion fee allowance estimate was 35% and 25.6% of default aversion fee income, respectively. The estimate of the refunds for 2009 is based on the five year average of current year's refunds to revenue, which reflects actual experience.

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**(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 23% of borrower payments through September 30, 2007, the rate of HESC retention decreased to 16% for regular payments effective October 1, 2007. HESC's Operating Fund retains approximately 37% of rehabilitation collection payments. The Operating Fund's retention on consolidated loans is 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.

In fiscal year 2009, the Operating Fund had a net interfund receivable balance of \$423,060 which included a payable to the Federal Fund for underpayment of collections activity of \$218,659. In fiscal year 2008, the Operating Fund had a net interfund payable balance of \$1,412,340 which included a payable to the Federal Fund for underpayment of collections activity of \$492,979. In both years, the appropriate interest earnings were transferred with the funds' settlement at the end of the month. In addition, there were interfund default aversion fee receivable balances in the Operating Fund of \$684,781 and \$580,386 at March 31, 2009 and 2008, respectively. The default prevention fee payable from the Operating Fund to the Federal Fund totaled \$43,062 and \$1,499,747 at March 31, 2009 and 2008, respectively.

**(8) New York State Initiatives**

The 2008-2009 New York State budget required the Operating Fund to pay the operational expenses related to the administration of the State's grants and scholarship programs, which amounted to approximately \$12.3 million and \$13 million in 2008-2009 and 2007-2008, respectively.

The 2007-2008 New York State budget appropriated \$8 million of Operating Funds to subsidize the Tuition Assistance Plan (TAP) transferred in March 2008. The New York State budget did not require an appropriation in March 2009.

**(9) Default Prevention Grant**

In fiscal year 2007-2008, HESC awarded up to \$50,000 to colleges and universities, based on a competitive bid process. The grant was to be used by schools to identify risks that contribute to student loan default and to develop and implement new programs which have the best potential to significantly reduce the dollar amount of defaults. A total of \$661,096 was distributed to 29 schools throughout the State. There were no awards granted in fiscal year 2008-2009.

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**(10) Transfer from/(to) Federal Fund**

On October 7, 2005, HESC submitted a letter for approximately \$16.9 million to the U.S. Department of Education (ED) seeking reimbursement for additional rehabilitated loan retention not previously requested, for the periods April 1996 through September 2004. The amount of reimbursement requested represents agency retention on rehabilitated loans. From April 1996 through September 2004, HESC retained only the collection costs charged borrowers on rehabilitated loans. The remaining funds, including agency retention, were transferred to ED. Subsequent to clarification by ED, HESC changed its procedures prospectively to report rehabilitated loans and calculated agency retention as instructed. On April 19, 2007, HESC received a letter from the Chief Business Operations Officer, Financial Student Aid at ED resolving the outstanding rehabilitation issue. ED authorized HESC to transfer amounts in the Federal Fund which exceed the minimum required reserve level until the full \$16.9 million is recuperated in the Operating Fund. This agreement is valid from September 30, 2007 to September 30, 2010. HESC transferred \$5 million from the Federal Fund to the Operating Fund as part of the rehabilitation recuperation in 2007-2008, and \$7 million in 2008-2009. The remaining balance of \$4.9 million will be transferred as excess funds are available.

**(11) Capital Assets**

Capital assets are recorded at cost. Capital assets are defined as assets with initial, individual costs exceeding a capitalization threshold of \$25,000. 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.

Capital asset activity in the Operating Fund for the year ended March 31, 2009 is as follows:

	<b>Balance April 1, 2008</b>	<b>Additions</b>	<b>Disposals</b>	<b>Balance March 31, 2009</b>
Office and computer equipment	\$ 1,370,630	—	—	1,370,630
Less accumulated depreciation	(1,289,401)	(42,670)	—	(1,332,071)
Net capital assets	<u>\$ 81,229</u>	<u>(42,670)</u>	<u>—</u>	<u>38,559</u>

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Capital asset activity in the Operating Fund for the year ended March 31, 2008 is as follows:

	<b>Balance April 1, 2007</b>	<b>Additions</b>	<b>Disposals</b>	<b>Balance March 31, 2008</b>
Office and computer equipment	\$ 1,318,852	51,778	—	1,370,630
Less accumulated depreciation	(1,191,210)	(98,191)	—	(1,289,401)
Net capital assets	<u>\$ 127,642</u>	<u>(46,413)</u>	<u>—</u>	<u>81,229</u>

At March 31, 2009 and 2008, the Federal Fund had capitalized equipment with a book value of \$294,255, which was fully depreciated.

**(12) Federal Reserve Recall and Federal Advances**

The 1998 Amendments to the Higher Education Act contain a provision for a recall of federal reserve funds held by guaranty agencies totaling \$250 million nationwide. HESC's share of this recall is \$18,222,100. HESC transferred \$6,195,514 to the U.S. Treasury on September 3, 2002. The second payment of \$6,013,293 was paid to U.S. Treasury on September 6, 2006. The remaining payment of \$6,013,293 was paid on August 31, 2007.

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

Long-term obligation activity for the year ended March 31, 2009, is as follows:

<b>Federal Fund</b>	<b>Beginning balance</b>	<b>Additions</b>	<b>Reductions</b>	<b>Ending balance</b>
Federal advances	\$ 10,300,348	—	—	10,300,348
Total Federal Fund	<u>\$ 10,300,348</u>	<u>—</u>	<u>—</u>	<u>10,300,348</u>

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Long-term obligation activity for the year ended March 31, 2008, is as follows:

<u>Federal Fund</u>	<u>Beginning balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending balance</u>
Federal reserve recall	\$ 6,013,293	—	(6,013,293)	—
Federal advances	10,300,348	—	—	10,300,348
Total Federal Fund	\$ 16,313,641	—	(6,013,293)	10,300,348

**(13) 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.

The College Cost Reduction and Access Act repealed the Secretary's authority to recognize qualified lenders, guaranty agencies and servicers as exceptional performer effective October 1, 2007. Prior to October 2007, the Higher Education Act allowed the Secretary to designate qualified lenders, guaranty agencies and servicers as exceptional performer in servicing FFELP loans making them eligible for 99% reimbursement on all claims submitted for insurance. As of October 1, 2007, all FFELP claims are paid at 97% of the claim value. As of March 2009, HESC was processing claims for 15 servicers.

**(14) 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.

For the years ended March 31, 2009 and 2008, the Federal default fee revenue consisted of the following:

	<u>2009</u>	<u>2008</u>
Federal Fund:		
Default fee revenue from lenders	\$ 29,908,325	—
Default fee revenue transferred from HESC's Operating Fund	1,295,148	27,511,549
Total Federal default fee revenue	\$ 31,203,473	27,511,549

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HESC's Operating Fund transferred to the Federal Fund approximately \$1.3 million and \$27.5 million in Federal default fees on behalf of the borrowers during the state fiscal years ended March 31, 2009 and 2008, respectively.

**(15) 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 \$3,203,568 for 2009, \$3,488,604 for 2008 and \$3,392,998 for 2007, 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 8.58%, 9.61% and 9.81% of covered payroll for each of the years, respectively.

**(16) 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. Under the plan 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.

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During the fiscal year ended March 31, 2009, 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, 2009 and 2008, HESC had approximately 353 and 430 retired and/or spouses of retired employees, receiving retiree health care benefits with an annual pay-as-you-go cost of approximately \$2.9 million and \$2.5 million.

**(17) Employees' Vacation Pay Benefits**

Under the terms of HESC management's personnel policies and its union agreements, vacation pay benefits may be paid upon termination up to a combined maximum of 30 days. The Operating Fund recognizes employees' vacation pay benefits when earned. The liability for employees' vacation pay benefits is \$2,760,994 and \$2,733,626 as of March 31, 2009 and 2008, respectively, and is recorded in accounts payable and accrued expenses in the Operating Fund.

**(18) 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.

**(19) Leases**

HESC leases office space and storage space under noncancelable operating leases effective through 2017 and month-to-month agreements. Total rental expense recorded in the Operating Fund, which includes utilities for one of two major leases, for the years ended March 31, 2009 and 2008, were \$1,710,715 and \$1,358,008, respectively.

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**(20) 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, 2009 and 2008, respectively.

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.