

Financial Statements

Federal Fund for American Student Assistance

June 30, 2017 and 2016



FEDERAL FUND FOR AMERICAN STUDENT ASSISTANCE

Financial Statements

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Independent Auditors' Report

Board of Directors
Massachusetts Higher Education Assistance Corporation
d/b/a American Student Assistance

Report on the Financial Statements

We have audited the accompanying financial statements of the Federal Fund for Massachusetts Higher Education Assistance Corporation d/b/a American Student Assistance (the "Federal Fund"), which comprise the statements of financial position as of June 30, 2017 and 2016, and the related statements of activities, and cash flows for the years then ended, and the related notes to the 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 accounting principles generally accepted in the United States of America; 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 an opinion 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 opinion.



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Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Federal Fund as of June 30, 2017 and 2016, and the changes in its net assets and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 14, 2017 on our consideration of the Federal Fund'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 the Federal Fund's internal control over financial reporting and compliance.

Mayer Hoffman McCann P.C.

September 14, 2017
Boston, Massachusetts

FEDERAL FUND FOR AMERICAN STUDENT ASSISTANCE

Statements of Financial Position

(Dollars in Thousands)

June 30,

	<i>2017</i>	<i>2016</i>
Assets		
Cash and cash equivalents	\$ 52,289	\$ 54,658
Receivable from Department of Education - Claims Paid	18,057	11,515
Default aversion fee expected returns	-	3,349
Other receivables	165	274
Default risk sharing projected recoveries	34,119	47,572
	<u>34,119</u>	<u>47,572</u>
Total assets	<u>\$ 104,630</u>	<u>\$ 117,368</u>
Liabilities and Net Assets		
Liabilities:		
Payable to ASA	\$ 1,274	\$ 1,544
Collections due to Department of Education	33,677	41,303
	<u>33,677</u>	<u>41,303</u>
Total liabilities	34,951	42,847
Net assets:		
Net assets owned by the Department of Education	69,679	74,521
	<u>69,679</u>	<u>74,521</u>
Total liabilities and net assets	<u>\$ 104,630</u>	<u>\$ 117,368</u>

FEDERAL FUND FOR AMERICAN STUDENT ASSISTANCE

Statements of Activities

(Dollars in Thousands)

For the Years Ended June 30,

	<i>2017</i>	<i>2016</i>
Operating revenues:		
Interest income	\$ 67	\$ 58
Total operating revenues	67	58
Operating expenses:		
Default risk sharing expense (recovery)	(4,334)	(13,415)
Default aversion fee expense, net of expected returns	9,236	2,740
Bank service charges	7	9
Total operating expenses	4,909	(10,666)
Change in net assets	(4,842)	10,724
Net assets, beginning of year	74,521	63,797
Net assets, end of year	\$ 69,679	\$ 74,521

FEDERAL FUND FOR AMERICAN STUDENT ASSISTANCE

Statements of Cash Flows

(Dollars in Thousands)

For the Years Ended June 30,

	2017	2016
Cash flows from operating activities:		
Change in net assets	\$ (4,842)	\$ 10,724
Adjustments to reconcile change in net assets to cash provided by (used in) operating activities:		
Changes in:		
Receivable from Department of Education - Claims Paid	(6,542)	(1,456)
Default aversion fee expected returns	3,349	(3,349)
Other receivables	109	82
Default risk sharing projected recoveries	13,453	12,342
Payable to ASA	(270)	(49,829)
Collections due to Department of Education	(7,626)	(18,354)
Default risk sharing liability	-	(12,000)
	<u>(2,369)</u>	<u>(61,840)</u>
Net cash used in operating activities	(2,369)	(61,840)
Decrease in cash and cash equivalents	(2,369)	(61,840)
Cash and cash equivalents, beginning of year	<u>54,658</u>	<u>116,498</u>
Cash and cash equivalents, end of year	<u>\$ 52,289</u>	<u>\$ 54,658</u>

FEDERAL FUND FOR AMERICAN STUDENT ASSISTANCE

Notes to Financial Statements

(Dollars in Thousands)

Note 1 - Organization

The Federal Fund for American Student Assistance (the “Federal Fund”) was created as a result of the 1998 Congressional Reauthorization of the Higher Education Act of 1965. Under the terms of the 1998 Reauthorization, the primary purpose of the Federal Fund within the Federal Family Education Loan Program (“FFELP”) was to finance the costs of default aversion activities and lender claims associated with defaulted loans associated with the related guarantee agency. Among other changes to FFELP, Reauthorization requires guaranty agencies to maintain and account for activities within two separate funds; a Federal Fund, which is owned and regulated by the U.S. Department of Education (“ED”), and an Agency Operating Fund (the “Operating Fund”). Under Reauthorization, FFELP guaranty agencies, on behalf of ED, operate the Federal Fund. The financial activities applicable to the Operating Fund are reported under a separate set of financial statements commonly known as American Student Assistance (“ASA”).

The Federal Fund and ASA operate in a complex regulatory environment that evolves as laws, funding and other factors change over time. While reporting is based on current agreements, changes may occur in the future which could have a significant effect on the Federal Fund and ASA.

Financial Statement Presentation

The Federal Fund’s financial statements are prepared on the accrual basis of accounting and in accordance with accounting principles generally accepted in the United States of America.

All dollar amounts, unless otherwise noted, are expressed in thousands.

Note 2 - Summary of Significant Accounting Policies

Cash and Cash Equivalents

All highly liquid debt instruments, including repurchase agreements, with maturities of three months or less from the date of purchase are considered to be cash equivalents. Repurchase agreements are held in the name of ASA for the Federal Fund and are fully collateralized. The Federal Fund monitors its exposure associated with cash and cash equivalents and has not experienced any losses in such accounts.

Receivable from Department of Education - Claims Paid

The Federal Fund pays claims for guaranteed student loans that have defaulted to the associated lender. The Federal Fund is in turn entitled to recover those payments from ED based on default experience. Prior to December 1, 2015, the Federal Fund was reinsured 95% of such claims; effective on that date, all claims are now paid at 100% of such claim value. Reimbursement from ED to the Federal Fund occurs twice a month.

FEDERAL FUND FOR AMERICAN STUDENT ASSISTANCE

Notes to Financial Statements

(Dollars in Thousands)

Note 2 - Summary of Significant Accounting Policies (Continued)

Default Risk Sharing Projected Recoveries

The Federal Fund records as an asset the present value of the expected recoveries from borrowers associated with the default risk sharing costs incurred by the Federal Fund for all claims paid prior to December 1, 2015. In general, this recovery is equal to 5% of the expected future recoveries. In determining the amount of receivable, management constructed a model using historical recovery curves to estimate future collections based on historical performance. While the Federal Fund seeks to use the best available information to make its estimate reasonable, the estimate is established based on these judgments, assumptions and estimates that are difficult, complex and subjective. Use of different judgments, assumptions and estimates could result in material differences in our operating results. Given that there is not default risk sharing on new claims after December 1, 2015, management expects this asset will decline over time. Highlights of numbers used in determining these amounts are as follows at June 30:

	2017	2016
Defaulted loan portfolio under management by ASA	\$2.43 Billion	\$2.91 Billion
Present value factor applied	1.89%	1.01%
Present value of default risk sharing projected recoveries	\$34.12 Million	\$47.57 Million

Advances from U.S. Department of Education for Default and Other Claims

Lender default claims are paid by the Federal Fund on behalf of ED. The liability for the funds is recognized within the Federal Fund. Claim activities consisted of the following for the years ended June 30 (in millions):

	2017	2016
Defaulted loan claim payments	\$ 524.9	\$ 604.2
Rehabilitated loans, repurchased loans and refunds	(426.3)	(476.4)
Net defaulted loan claim payments	98.6	127.8
Death or disability claim payments	136.2	98.8
Bankruptcy claim payments	35.7	39.2
Closed school or false certificate claim payments	0.1	-
Discharges and other claim payments	8.3	8.7
Total net claim payments	\$ 278.9	\$ 274.5

FEDERAL FUND FOR AMERICAN STUDENT ASSISTANCE

Notes to Financial Statements

(Dollars in Thousands)

Note 2 - Summary of Significant Accounting Policies (Continued)

Payable to ASA

Payable to ASA (Agency Operating Fund) results from transactions processed on behalf of the Federal Fund for defaulted loan recoveries due to ASA at year end.

Minimum Reserve Level

ED established a minimum reserve level requirement for the Federal Fund of at least 25 basis points of the total guaranteed principal outstanding as determined each year as of September 30. ASA accrues such estimated amounts at June 30 for the benefit of the Federal Fund pursuant to a policy adopted by ASA's Board of Directors (the "Board"). While ASA is not legally obligated to fund any shortfalls in the Federal Fund, ASA has provided significant support in the past to enable the Federal Fund to achieve this level of net assets. Management expects that the Federal Fund will not have funding needs in the future relative to projections when looking at a longer term horizon than the measurement date established by ED to measure reserve levels. No support was received or accrued relating to the reserve requirement and the Board's policy to fund such for the years ended June 30, 2017 and 2016.

Revenue Recognition

Default Aversion Fee

The Federal Fund is responsible for payment of a default aversion fee to ASA equal to 1% of the balance of the principal and interest on loans associated with first-time pre-claims assistance requested by lenders. ASA is allowed to withdraw this fee monthly from the Federal Fund. These payments must be returned should the loan associated with the pre-claim assistance ultimately default. As such, when such fees are availed, the Federal Fund records an expense from this payment net of the estimated amount that is expected to be returned using historical data.

In 2017, management determined that default aversion fees would be better accounted for on a portfolio basis considering the entirety of estimated return of funds compared to the amounts advance funded to date. The correct amount of actual and expected future returns amounts to \$26,000 which is less than the prefunded amount of \$31,300 meaning that no obligation exists to the Federal Fund for expected future default aversion fee returns. In 2014, ASA prefunded the expected obligation for the return of default aversion fees that it would expect to need to return over time as loans default. Inherent in the estimation of this amount is the possibility that a greater or lesser portion of loans will go into default. If the number is greater, additional amounts will be payable to the Federal Fund; if amounts are less, ASA does not have a reversionary interest in such an overpayment. Management continues to monitor this estimate. In 2016, default fees availed and the related expected amount that will ultimately be returned have been measured separately from the prior cohort and are reflected as default aversion fee expected returns on the accompanying Consolidating Statements of Financial Position.

In the past, ASA has elected from time to time to not avail itself to such fees given the existing Board Policy seeking to support the Federal Fund in meeting its minimum reserve requirements. Such past undrawn default aversion fees are considered to have been permanently forfeited.

FEDERAL FUND FOR AMERICAN STUDENT ASSISTANCE

Notes to Financial Statements

(Dollars in Thousands)

Note 2 - Summary of Significant Accounting Policies (Continued)

Income Taxes

The activities of the Federal Fund, which is owned and regulated by ED, are not subject to taxation. Accordingly, no provision for income taxes has been made in these financial statements.

Use of Estimates

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates. Significant estimates included in the financial statements relate to the default risk sharing projected recoveries and expected actual default aversion fees refundable to the Federal Fund.

Subsequent Events

The Federal Fund has evaluated events and transactions through September 14, 2017, which is the date the financial statements were issued.

Note 3 - Contingencies

The Federal Fund is 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 loans 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.

Reporting Under Government Auditing Standards



*Independent Auditors' Report on Internal Control Over Financial Reporting and on
Compliance and Other Matters Based on an Audit of Financial Statements
Performed in Accordance with Government Auditing Standards*

Board of Directors
Massachusetts Higher Education Assistance Corporation
d/b/a American Student Assistance

We have audited, in accordance with the 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, the financial statements of the Federal Fund for Massachusetts Higher Education Assistance Corporations d/b/a American Student Assistance (the "Federal Fund"), which comprise the statement of financial position as of June 30, 2017, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated September 14, 2017.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the Federal Fund's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the Federal Fund's internal control. Accordingly, we do not express an opinion on the effectiveness of the Federal Fund's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.



Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Federal Fund's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Maya Heyman McCann P.C.

September 14, 2017
Boston, Massachusetts