VERMONT STUDENT ASSISTANCE CORPORATION

(A Component Unit of the State of Vermont)

Basic Financial Statements

June 30, 2002

(With Independent Auditors' Report Thereon)

VERMONT STUDENT ASSISTANCE CORPORATION
(A Component Unit of the State of Vermont)

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Independent Auditors' Report

The Board of Directors
Vermont Student Assistance Corporation:

We have audited the accompanying statement of net assets of Vermont Student Assistance Corporation (a component unit of the State of Vermont) as of June 30, 2002, and the related statements of revenues, expenses, and changes in net assets, and cash flows for the year then ended. These financial statements are the responsibility of Vermont Student Assistance Corporation's management. Our responsibility is to express an opinion on these financial statements based on our audit. The prior year partial comparative information has been derived from the Corporation's 2001 financial statements and, in our report dated September 14, 2001, we expressed an unqualified opinion on those financial statements.

We conducted our audit 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 examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Vermont Student Assistance Corporation as of June 30, 2002, and the respective changes in its financial position and the cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2, the Vermont Student Assistance Corporation implemented the provisions of the Governmental Accounting Standards Board (GASB) Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments*, GASB Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – For State and Local Governments: Omnibus*, and GASB Statement No. 38, *Certain Financial Statement Note Disclosure*, as of July 1, 2001.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 20, 2002 on our consideration of Vermont Student Assistance Corporation's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. This report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be read in conjunction with this report in considering the results of our audit.

The Management's Discussion and Analysis (MD&A) on pages 3 to 8 is not a required part of the financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

September 20, 2002

Vt. Reg. No. 92-0000241

VERMONT STUDENT ASSISTANCE CORPORATION

Management's Discussion and Analysis

For the year ended June 30, 2002

Fiscal 2002 Highlights

- During the year ended June 30, 2002 VSAC provided over $18.6 million in grants and scholarships to Vermont students.

- VSAC originated over $323 million in student loans, including new loans to students and parents and consolidation of existing loans. VSAC holds $987 million in education loans receivable at June 30, 2002.

- VSAC returned over $15.3 million in interest and principal rebates to students in its loan programs during fiscal 2002.

- VSAC expanded its services and offerings to students and families through its Resource Center, outreach counselors, website and through the Vermont Higher Education Investment Plan.

- VSAC's total net assets increased $2.8 million to $71.5 million, primarily strengthening the Corporation's equity position in its student loan bond trust estates. VSAC's net revenue base continued to grow as loan originations, including traditional Stafford and PLUS loans, consolidation loans and alternative loans, increased. While the decrease in interest rates decreased both gross interest revenues and gross interest expenses, the increase in volume and portfolio generated higher net revenues from loans.

The Financial Statements

VSAC's financial statements detail financial information using accounting methods similar to those used by private businesses, especially financial institutions.

The statement of revenues, expenses and changes in net assets presents the results of VSAC's operations. The statement reports all revenues and expenses, and reconciles the beginning and end of year net asset balances.

The statement of net assets includes all the Corporation's assets and liabilities as of June 30, 2002. The statement also presents the balance of assets in excess of liabilities, or net assets.

The statement of cash flows supplements these statements providing relevant information about cash receipts and payments by the corporation.

The notes to the financial statements are an integral part of the financial statements and contain information necessary to obtain a complete view of VSAC's financial position.

Summary of Revenues and Expenses

		2002	2001
		(In Thousands)	
Revenues			
Interest earned from education loan financing	$	71,493	73,915
Other loan and guarantee program revenues		4,164	3,980
Investment interest		5,234	10,490
Vermont state appropriations		15,446	14,912
Federal grants		2,367	2,196
Scholarship revenue		2,503	1,891
Other revenue		1,234	1,180
Total operating revenues		102,441	108,564
Expenses			
Student Aid		18,634	16,634
Interest rebated to borrowers		15,354	12,431
Interest on debt		25,412	41,696
Other loan financing costs		15,577	3,373
Corporate operating expenses and depreciation		24,667	22,397
Total operating expenses		99,644	96,531
Excess of revenue over expenses		2,797	12,033
Total net assets at the beginning of the year		68,678	56,645
Total net assets at the end of the year	$	71,475	68,678

Revenues

VSAC's fiscal 2002 operations resulted in an increase in net assets of $2.8 million. All revenues for 2002 are considered operating revenues in accordance with GASB 34. VSAC generated $102.4 million in revenues versus $99.6 million in total expenses. VSAC's revenues include interest income on student loans, as well as various federal interest subsidies and special allowance payments.

Overall loan revenue to VSAC is closely related to the general interest rate environment. Most student loans held by VSAC have variable interest rates for borrowers. During 2002, interest revenue and subsidies declined from $73.9 to $71.5 million. Interest for certain loans is paid by the U.S. Department of Education as a subsidy to qualifying borrowers. This interest subsidy represented $11.6 million in 2002. VSAC also receives special allowance payments when variable borrower interest rates fall below certain levels. Low interest rates in 2002 accounted for an increase in these special allowance payments from $6.5 to $10.0 million.

Other revenues associated with the loan and loan guarantee programs include consolidation fees, default aversion fees, collections revenues, and other program fees and revenues. These fees and revenues totaled $4.2 million in 2002, compared to $4.0 million in 2001.

Lower interest rates also resulted in declining interest revenue on investments. Investments include student loan funds temporarily invested in cash and short-term investments, and scholarship funds invested for long-term growth and income. Interest on all investments declined from $10.5 million to $5.2 million, as interest rates declined and the amount invested in cash and cash equivalents declined dramatically. These cash investments are related to timing of student loan bond issues.

VSAC has worked closely with the University of Vermont and the Vermont State Colleges to enhance the State's financial support of higher education. The result has been significant increases in state appropriations for each party. VSAC's appropriation increased from $14.9 to $15.4 million. As in prior years, the State's appropriation for the grant program is used entirely to provide grant funds directly to students. VSAC receives no administrative allowance for administering the State grant program.

Federal grants also increased by nearly 8%, to $2.37 million in fiscal 2002.

Scholarship revenues climbed from $1.9 to $2.5 million, as more scholarship funds were secured, awarded and invested for the benefit of Vermont students.

Expenses

VSAC has four main types of expenses: Student aid, Interest and other costs of debt, Non-interest costs of financing loans, and Costs of operations.

Student Aid – VSAC provided Vermont students with $18.6 million in student aid during fiscal 2002. $15.4 million was provided from State appropriations. An additional $3.2 million was made available through various scholarship programs managed by VSAC. The total aid represents a 12% increase over grants and scholarships provided by VSAC in fiscal 2001. Direct aid in the form of grants and scholarships represented 18.7% of VSAC's operating expenses.

While not strictly a student aid expense, interest rebated to borrowers is an item that helps current and former students and parents manage their education debt. VSAC provided $15.4 million in rebates of interest to borrowers in fiscal 2002. These rebates represent 15.4% of VSAC's fiscal 2002 operating expenses.

Costs of debt – In order to provide Vermont students and parents with low cost loans, VSAC issues both tax-exempt and taxable bonds in the public markets. The interest costs of these bonds represents a major expense category for VSAC. Since the vast majority of these bonds are variable rate securities, interest costs vary from year to year as the general interest rate environment changes. The variable nature of these securities matches the variable rate structure of most of our loans, so revenues and expenses related to the bonds are highly correlated.

With the decrease in interest rates from fiscal 2001 to 2002, VSAC interest costs fell from $41.7 to $25.4 million, with no reduction in overall debt outstanding. This represented 25.5% of VSAC operating expenses in fiscal 2002.

Other loan financing costs – Other expenses incurred in the loan financing area include credit enhancement and remarketing fees for our bond issues, consolidation and lender fees VSAC pays to the federal government, and provisions for changes in arbitrage earnings liability to the U.S Treasury, as well as a variety of other costs incurred in issuing and managing over $1 billion in outstanding bonds and notes. These costs totaled $15.6 million in fiscal 2002, representing approximately 15.6% of total operating expenses. The increase in this expense is due to changes in arbitrage liability. Arbitrage liability represents earnings on bond-financed loans and investments that would be returned to the U.S. Treasury if the loan portfolios were completely liquidated at June 30, and all bondholders were repaid. It represents earnings to date, and is a function of past and current interest rates on debt and assets held by VSAC. It is fairly volatile and is managed to minimize the probability of a liability balance at the end of a bond life cycle.

Costs of operations – The costs of operating VSAC's programs, as well as facilities and overhead costs totaled $24.7 million in fiscal 2002, an increase of approximately 10% from fiscal 2001. Salaries and benefits were $17.1 million in fiscal 2002, approximately 69% of costs of operations. Overall costs of operations represent 24.8% of total operating expenses.

Total operating expenses for the year totaled $99.6 million. Revenues totaled $102.4. The excess of revenues over expenses was $2.8 million. The change in total net assets for the year was an increase of $2.8 million. The ending balance of net assets was $71.5 million, as compared to $68.7 million at June 30, 2001.

Condensed Net Asset Information

		2002	2001
		(In Thousands)	
Assets			
Cash & Investments	$	167,528	277,298
Education loans receivable (plus interest)		1,012,003	894,391
Other assets		32,987	25,371
Total assets	$	1,212,518	1,197,060
Liabilities			
Bonds & notes payable (plus interest)	$	1,098,456	1,099,458
U.S. Treasury arbitrage payable		14,499	10,677
Other Liabilities		28,088	18,247
Total Liabilities	$	1,141,043	1,128,382
Net Assets			
Restricted	$	41,707	40,091
Unrestricted		26,978	25,370
Invested in Capital Assets		2,790	3,217
Total Net Assets	$	71,475	68,678

Net Assets

Cash balances declined significantly from June 30, 2001 to 2002 from $256.8 to $143.5 million. The decline was due to timing of bond issues. VSAC issued $160 million in new bonds in June 2001. Combined cash and investments were $167.5 million at June 30, 2002.

Student loans and interest receivable totaled $1.0 billion at June 30, 2002, up from $894.4 million in 2001. Deposits in the Vermont Higher Education Investment Plan climbed from $4.9 to $12.0 million, as the program offered a new investment option, and as consumer interest in Section 529 plans increased.

Bonds, notes and interest payable declined by one million dollars to $1.098 billion. There were no new net borrowings or maturities of existing debt during the fiscal year. The decline in bonds and notes payable in due to changes in interest payable at June 30, 2002. In October 2002, VSAC issued an additional $112.5 million in student loan bonds, insured to a AAA rating by three rating agencies.

U.S. Treasury arbitrage payable was described in the expense discussion. This liability increased as of June 30, 2002, to $ $14.5 million, or approximately 1.2% of total assets.

Net assets restricted by bond indenture increased $1.9 million. These represent VSAC equity positions in trusts established to provide security for bondholders. Upon maturity of various bond series, or with permission of bond insurers, these equity positions will be released to VSAC as unrestricted net assets. In the past, these unrestricted net assets have been reinvested in student loans receivable, providing VSAC with continued revenue on these funds, and reducing the need for new borrowing.

Unrestricted net assets include those assets released from bond trusts and used to finance student loans, funds used for corporate working capital and investments in property, plant and equipment. Unrestricted net assets designated for and invested in student loans totaled $18.4 million at June 30, 2002.

Capital assets declined during the fiscal year, as depreciation expense of $1.6 million exceeded new acquisitions of $1.1 million. The result was a decline in both the property, plant and equipment asset, and the corresponding net asset figure to $2.8 million at June 30, 2002.

Changes in Long-Term Debt

During the year ending June 30, 2002, VSAC issued the 2001 Series A-XIII note totaling $8,520 and the 2002 Series A-XIV note totaling $16,860 to refund the scheduled principal maturities of the 1985 Series A bonds, the 1992 Series A bonds and the 2001 Series A-XII note of $4,000, $8,620 and $12,760, respectively.

See note 8 for additional information.

VERMONT STUDENT ASSISTANCE CORPORATION
(A Component Unit of the State of Vermont)

Statement of Net Assets

June 30, 2002

(Dollars in Thousands)

Assets		**2002**	**2001**
Current assets:			
Cash and cash equivalents (note 3)	$	143,541	256,840
Investments (note 3)		23,987	20,458
Receivables:			
Investment interest		203	362
Student loans (note 4)		81,141	67,421
Student loan interest and special allowance (note 11)		24,895	25,340
Federal administrative and program fees		336	324
Grants and other receivables		560	439
Other assets		1,226	1,168
Total current assets		275,889	372,352
Noncurrent assets:			
Receivables:			
Student loans (note 4)		905,967	801,630
Assets held for U.S. Department of Education (note 5)		10,582	9,379
Assets held for Vermont Higher Education Investment Plan (note 6)		12,084	4,878
Capital assets (note 7)		2,790	3,217
Deferred bond issuance costs, net of accumulated amortization of $3,796		5,206	5,604
Total noncurrent assets		936,629	824,708
Total assets	$	1,212,518	1,197,060

See accompanying notes to financial statements.

(Dollars in Thousands)

Liabilities and Net Assets		2002	2001
Current liabilities:			
Bonds and notes payable (note 8)	$	54,300	25,381
Accounts payable and other liabilities		2,799	2,441
Grants and scholarships payable		2,295	1,277
Accrued interest on bonds payable		1,104	1,977
U.S. Treasury rebates payable (note 9)		1,074	1,512
Due to U.S. Department of Education		328	272
Total current liabilities		61,900	32,860
Noncurrent liabilities:			
Bonds and notes payable (note 8)		1,043,052	1,072,100
U.S. Treasury rebates payable (note 9)		13,425	9,165
Assets held for U.S. Department of Education (note 5)		10,582	9,379
Assets held for Vermont Education Investment Plan (note 6)		12,084	4,878
Commitments and contingencies (notes 13 and 14)			
Total noncurrent liabilities		1,079,143	1,095,522
Total liabilities		1,141,043	1,128,382
Net assets:			
Invested in capital assets		2,790	3,217
Restricted (note 10):			
Bond resolution		41,267	39,322
Grants and scholarships		440	769
Unrestricted (note 10)		26,978	25,370
Total net assets	$	71,475	68,678

See accompanying notes to financial statements.

VERMONT STUDENT ASSISTANCE CORPORATION
(A Component Unit of the State of Vermont)

Statement of Revenues, Expenses, and Changes in Net Assets

Year ended June 30, 2002

(Dollars in Thousands)

		2002	2001
Operating revenues:			
U.S. Department of Education:			
Interest (note 11)	$	11,550	13,595
Special allowance (note 11)		10,011	6,506
Interest on investments		5,234	10,490
Interest and other charges on student loans, net		49,932	53,814
State appropriations		15,446	14,912
Consolidation fees		691	378
Default aversion fee		419	325
Federal administrative and program fees		2,212	2,173
Collections on defaulted loans		400	549
Loan rehabilitation and repurchase revenue		442	555
Federal grants		2,367	2,196
Scholarship income		2,503	1,891
Other income		1,234	1,180
Total operating revenues		102,441	108,564
Operating expenses:			
Salaries and benefits		17,081	15,249
Other general and administrative		5,667	4,867
State grants and scholarships		18,634	16,634
Reimbursement of collections to U.S.D.E.		—	216
Loan rehabilitation and repurchases to U.S.D.E.		—	43
Other guarantee agency expenses		365	171
Interest rebated to borrowers (note 9)		15,354	12,431
Interest subject to U.S. Treasury rebate (note 9)		5,120	(5,087)
Interest, net of amortization of discount/premium		25,412	41,696
Credit enhancement and remarketing fees		4,116	3,687
Consolidation and lender paid fees		5,107	3,871
Depreciation and amortization		1,554	2,110
Other loan financing expense		772	208
Amortization of bond issuance costs		462	435
Total operating expenses		99,644	96,531
Excess of operating revenues over operating expenses		2,797	12,033
Net assets at beginning of year		68,678	56,645
Net assets at end of year	$	71,475	68,678

See accompanying notes to financial statements.

VERMONT STUDENT ASSISTANCE CORPORATION
(A Component Unit of the State of Vermont)

Statement of Cash Flows

Year ended June 30, 2002

(Dollars in Thousands)

Cash flows from operating activities:		
Cash received from customers	$	236,042
Cash paid to suppliers for goods and services		(75,710)
Loans made		(323,864)
Cash paid to employees for services		(17,080)
Interest received		51,130
Vermont State appropriation received		15,446
Net cash used in operating activities		(114,036)
Cash flows from noncapital financing activities:		
Proceeds from sale of notes/bonds payable		25,380
Payments on notes/bonds		(25,380)
Net cash provided by financing activities		—
Cash flows from capital and related financing activities:		
Acquisition and construction of fixed assets		(1,127)
Net cash used in capital and related financing activities		(1,127)
Cash flows from investing activities:		
Interest received on investments		5,393
Redemption of investments, net		(3,529)
Net cash provided by investing activities		1,864
Net decrease in cash and cash equivalents		(113,299)
Cash and cash equivalents at June 30, 2001		256,840
Cash and cash equivalents at June 30, 2002	$	143,541

See accompanying notes to financial statements.

VERMONT STUDENT ASSISTANCE CORPORATION
(A Component Unit of the State of Vermont)

Statement of Cash Flows

Year ended June 30, 2002

(Dollars in Thousands)

Reconciliation of operating income to net cash by operating activities:	
Excess of operating revenues over operating expenses	$ 2,797
Adjustments to reconcile excess of operating revenues over operating expenses to net cash used in operating activities:	
Depreciation	1,554
Amortization of bond issue costs	462
Amortization of bond discount/premium	(129)
Investment interest received	(5,393)
Changes in assets and liabilities:	
Decrease in investment interest receivable	159
Increase in student loans receivable	(118,057)
Decrease in student loan interest and special allowance receivables	445
Increase in federal administrative and program fees	(12)
Increase in grants and other receivables	(121)
Increase in deferred bond issuance costs	(64)
Increase in other assets	(58)
Increase in accounts payable and other liabilities	358
Increase in grants and scholarships payable	1,018
Decrease in accrued interest on bonds payable	(873)
Increase in U.S. Treasury rebates payable	3,822
Increase in due to U.S. Department of Education	56
Total adjustments	(116,833)
Net cash used in operating activities	$ (114,036)

See accompanying notes to financial statements.

(1) Authorizing Legislation

The Vermont Student Assistance Corporation (VSAC) was created as a public nonprofit corporation by an act of the General Assembly of the State of Vermont in accordance with the provisions of the Higher Education Act of 1965, as amended (the Act). The purpose of VSAC is to provide opportunities for Vermont residents to pursue post-secondary education by awarding grants and guaranteeing, making, financing, and servicing loans to students. VSAC also administers scholarships, student employment programs, and outreach services to students seeking post-secondary education. In addition, VSAC manages the Vermont Higher Education Investment Plan.

Pursuant to Vermont statutes, VSAC is responsible for the administration of the Loan Finance Program. Under this program, VSAC originates, purchases, services, and consolidates education loans. The loans are financed through the issuance of limited obligation bonds and are guaranteed by VSAC as a guarantor and/or reinsured by the U.S. Department of Education through the Federal Family Education Loan (FFEL) Program. The bonds outstanding are payable primarily from interest and principal repayments on the financed loans as specified in the underlying resolutions authorizing the sale of the bonds. The bonds are not a general obligation of VSAC or an obligation of the State of Vermont or any of its political subdivisions.

As required by generally accepted accounting principles, VSAC is considered a component unit of the State of Vermont and is included as part of the State's financial reporting entity. VSAC's relationship with the State primarily consists of an annual appropriation designated for grant aid to Vermont students.

The Vermont Student Development Fund, Inc. (the Fund), a nonprofit 501(c)(3) corporation, was established in November of 2000. The primary purpose of the Fund is to receive, hold, and manage securities, cash, or other property whether real, personal, or mixed, acquired by bequest, devise, gift, purchase, or loan. These assets are used primarily for scholarships and other financial assistance to benefit qualified individuals seeking a post secondary education. The Fund provides a financial benefit to VSAC, and its board of directors is the same as the VSAC board of directors, therefore, it is considered a blended component unit of VSAC and is included in the financial statements.

(2) Summary of Significant Accounting Policies

(a) Basis of Accounting

VSAC follows the economic resources measurement focus and the accrual basis of accounting whereby revenues are recorded when earned and expenses are recorded when obligation for payment is incurred.

In accordance with generally accepted accounting principles, VSAC applies all applicable Governmental Accounting Standards Board (GASB) pronouncements as well as all Financial Accounting Standards Board (FASB) pronouncements issued on or before November 30, 1989 to the extent these pronouncements do not conflict with GASB pronouncements.

(Continued)

(b) Changes in Accounting and New Accounting Pronouncements

During 2002, VSAC adopted GASB Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, as amended by GASB Statements No. 37 and No. 38. Statement No. 38, modifies, establishes and rescinds certain financial statement disclosure requirements.

GASB Statement No. 34 establishes standards for external financial reporting for governmental entities and requires that resources be classified for accounting and reporting purposes into the following three net asset categories:

- **Invested in Capital Assets, net of related debt**: Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- **Restricted**:

  Nonexpendable – Net assets subject to externally imposed stipulations that they be maintained in perpetuity.

  Expendable – Net assets whose use by VSAC is subject to externally imposed stipulations that can be fulfilled by actions of VSAC to meet those stipulations or that expire through the passage of time.
- **Unrestricted**: Net assets that are not subject to externally imposed stipulations. Unrestricted net assets may be designated for specific purposes by action of management or the Board of Directors or may otherwise be limited by contractual agreements with outside parties.

VSAC reports as a Business Type Activity, as defined by GASB Statement No. 34. Business Type Activities are those that are financed in whole or in part by fees charged to external parties for goods or services. GASB Statement No. 34 requires three statements for Business Type Activities: a Statement of Net Assets, a Statement of Revenues, Expenses, and Changes in Net Assets, and a Statement of Cash Flows. The implementation of these GASB statements did not result in a restatement of beginning net assets.

The most significant changes resulting from the implementation of these standards were; consolidating multiple fund columns to show a single column presentation, presenting a classified Statement of Net Assets, and the addition of Management's Discussion and Analysis (MD&A) preceding the required financial statements.

(c) Operating Revenue and Expenses

Operating revenue include interest earned on student loans and investments, fees received from providing services, and grant and scholarship revenue. Operating expenses include interest on bonds, the costs of providing services and operating all programs, and grant and scholarship awards.

(Continued)

(d) Capital Assets

Capital assets are stated at historical cost. Depreciation of property and equipment is calculated using the straight-line method over the estimated useful lives of the assets. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or estimated useful life of the asset.

(e) Cash, Cash Equivalents, and Investments

VSAC considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Investments are comprised of short-term investments other than cash equivalents with original maturities of one year or less, and long-term investments with original maturities in excess of one year. Cash equivalents and investments are carried at fair value which approximates cost.

(f) Costs of Bond Issuances

Costs of bond issuances, which are comprised of underwriters' discount, legal fees, and other related financing costs, are deferred and amortized over the lives of the respective bond issues using the straight-line method.

(g) Amortization of Bond Premiums and Discounts

Bond premiums and discounts are amortized using the interest method over the life of the bonds.

(h) Compensated Absences

Employees may accumulate, subject to certain limitations, unused vacation earned and, upon retirement, termination, or death, may be compensated for certain amounts at their then current rates of pay. The amount of vacation recognized as expense is the amount earned.

(i) Income Tax Status

VSAC is exempt from Federal and state income taxes under Section 115 of the Internal Revenue Code.

(j) Use of Estimates in Financial Statement Preparation

Management has made certain estimates and assumptions relating to the reporting of assets and liabilities and the disclosure of contingent assets and liabilities to prepare these financial statements in conformity with accounting principles generally accepted in the United States of America. Actual results could differ from those estimates.

(Continued)

(Dollars in thousands)

(3) Cash, Cash Equivalents, and Investments

VSAC's deposit and investment policy complies with the underlying bond resolution requirements. In accordance with those bond resolutions, all deposits and investments meet the requirements and approval of the letter of credit and bond insurance providers. Additionally, such requirements mandate specific classes of investment vehicles including: bank time deposits; certificates of deposit; direct obligations of the United States of America, unconditionally guaranteed by the United States of America; indebtedness issued by certain Federal agencies; collateralized repurchase agreements secured by obligations of the United States of America with collateral held by or at the direction of the trustee; guaranteed investment contracts with banks or bank holding companies; commercial paper and open ended investment funds.

Cash and cash equivalents and investments are summarized based on the level of credit risk. Credit risk is classified as follows:

Category 1	Fully insured or collateralized with securities held by VSAC or an agent in VSAC's name.
Category 2	Collateralized with securities held by VSAC's trust corporation or an agent in VSAC's name.
Category 3	Uncollateralized.

		Book balance	Bank balance
Cash and cash equivalents:			
Category 1	$	129	102
Category 2		143,412	143,943
Category 3		—	—
Total cash and cash equivalents	$	143,541	144,045
Investments:			
Category 1	$	—	—
Category 2		23,892	23,892
Category 3		95	95
Total investments	$	23,987	23,987

(4) Student Loans Receivable

Student loans with annual interest rates ranging from 3.2% to 12.0% are insured by the U.S. Department of Education and U.S. Department of Health and Human Services. There is an allowance for loan losses of $604 as of June 30, 2002.

Student loans are classified as being in "interim" status during the period from the date the loan is made until a student is out of school either for six or nine months. Subsequent to this period, student loans are classified as being in "repayment" status. "Deferral" status is a period during the life of the loan when repayment is suspended for authorized purposes.

(Dollars in thousands)

Student loans receivable as of June 30, 2002 are summarized as follows:

Status:		
Interim status	$	224,140
Deferral status		171,958
Repayment status		591,614
Less allowance for loan losses		(604)
Total student loans receivable		987,108
Less: Total non-current student loans receivable		905,967
Total current student loans receivable	$	81,141
Guarantee type:		
Department of Education	$	932,972
Department of Health and Human Services		20,621
Other		34,119
Less allowance for loan losses		(604)
		987,108
Less: Total non-current student loans receivable		905,967
Total student loans receivable	$	81,141

(5) Federal Loan Reserve Fund

Under the Higher Education Amendments of 1998 all liquid and nonliquid assets related to the FFEL program guaranty functions were transferred to the Federal Loan Reserve Fund (Federal Fund) on October 1, 1998. The Federal Reserve Fund is administered by VSAC on behalf of the Department of Education and is the property of the Federal government. VSAC also established the Guarantee Agency Operating Fund on October 1, 1998 in accordance with the Higher Education Amendments of 1998. The Federal reserve funds administered by VSAC on behalf of the Department of Education as of June 30, 2002 and the changes in Federal reserve funds held for the year then ended are presented for information purposes.

(Dollars in thousands)

Federal reserve funds held for the U.S. Department of Education at June 30, 2002 are as follows:

Assets:		
Cash	$	8,834
Receivable from U.S. Department of Education		1,704
Interest income receivable		13
Operational assets		31
Total assets	$	10,582
Liabilities:		
Payable to U.S. Department of Education		346
Federal advances		538
Return of reserves due to U.S. Department of Education		2,146
Operational liabilities		50
Federal reserve funds held for U.S. Department of Education		7,502
Total liabilities	$	10,582

Changes in Federal reserve funds held for U.S. Department of Education as of June 30, 2002 are as follows:

Additions:		
Reimbursement from ED on default loan purchases	$	10,185
Default loan collections		22
Loan administrative fees		1,632
Investment income		187
Total additions		12,026
Deductions:		
Purchases of default loans from lenders		(10,375)
Default aversion fee		(432)
Other expenses		(89)
Total deductions		(10,896)
		1,130
Federal reserve funds held at beginning of period		6,372
Federal reserve funds held at end of period	$	7,502

(Continued)

(Dollars in thousands)

To provide security and liquidity against potential defaults, VSAC is required to maintain reserves as specified by Title 16, Vermont Statutes Annotated §2864, Section 422 of Act 20 United States Code 1072, and under various agreements with the bond liquidity and credit enhancement institutions. The Higher Education Amendments of 1998 require VSAC to maintain reserves equal to 0.25% of loan guaranteed. During 2002, VSAC maintained sufficient reserves to fully comply with these requirements.

(6) Assets held for Vermont Higher Education Investment Plan

The Vermont Higher Education Investment Plan (VHEIP) was established by the Vermont Legislature in April 1998. VHEIP encourages Vermont residents to save for college or other post-secondary education through tax favorable investments. There are two plans available: the Managed Allocation Option, and the Interest Income Option. The Managed Allocation Option is managed by TFI. TFI is part of TIAA-CREF, a New York-based financial services organization. Funds in the Managed Allocation Option are directed into special investment portfolios based on the age of the beneficiary. Investments in this option are not guaranteed. The Interest Income Option is managed by VSAC. Funds in the Interest Income Option are invested in an interest-bearing note to VSAC, which is expected to return at least the 91-day U.S. Treasury Bill rate. VSAC uses the note to make federally guaranteed education loans. The assets administered by VSAC on behalf of others in VHEIP as of June 30, 2002 and the changes in assets held for the year then ended are presented for information purposes.

Assets held for the Vermont Higher Education Investment Plan at June 30, 2002 are as follows:

Assets:		
Cash	$	181
Student loan receivable and accrued student loan interest		1,090
Investment interest receivable		27
Investments		10,729
Operational assets		57
Total assets	$	12,084
Liabilities:		
Operational liabilities		50
Note payable		1,219
Amounts held on behalf of investors		10,815
Total liabilities	$	12,084

Changes in amounts held for the Vermont Higher Education Investment Plan as of June 30, 2002 are as follows:

Additions:		
Investment income	$	223
Student loan interest income		51
Net realized loss on investments		(275)
Net change in unrealized depreciation of investments		(675)
Net participant subscriptions		7,149
Total additions		6,473
Deductions:		
Operational expenses		(7)
Total deductions		(7)
		6,466
Assets held on behalf of others at beginning of period		4,349
Assets held on behalf of other at end of period	$	10,815

(7) Capital Assets

A summary of capital assets at June 30, 2002 is as follows (in thousands):

	Estimated lives		Beginning balance	Additions	Ending balance
Furniture and equipment	3-5 years	$	3,928	716	4,644
Leasehold improvements	5 years		939	276	1,215
Software	3-5 years		4,285	135	4,420
			9,152	1,127	10,279
Less accumulated depreciation			5,935	1,554	7,489
Net property and equipment		$	3,217	(427)	2,790

(Dollars in thousands)

(8) Bonds and Notes Payable – Loan Finance Fund

VSAC has issued the following bonds and notes outstanding at June 30, 2002, which were issued to finance student loans:

		Beginning balance	Additions/ (reductions)	Ending balance
Bonds payable:				
1985 Series A, dated December 27, 1985; comprised of floating rate monthly demand bonds that mature in increments through January 2008; interest is payable monthly at variable rates which ranged from 1.45% to 2.85% in 2002. The current portion of the total outstanding balance is $0.	$	44,900	(4,000	40,900
1992 Series A-2 and A-3, dated June 15, 1992; comprised of serial and auction variable rate bonds maturing in increments between June 15, 1999 and December 15, 2005; interest on Series A-2 is paid every 35 days at rates which ranged from 1.3% to 2.68% during 2002; interest on Series A-3 bonds is paid semi-annually at fixed rates ranging from 5.8% to 6.5%. The face amount of the bonds payable is $48,270 and $20 of unamortized discount has been netted against the liability. The current portion of the total outstanding balance is $8,605.		56,890	(8,620	48,270

(Continued)

(Dollars in thousands)

		Beginning balance	Additions/ (reductions)	Ending balance
1992 Series B and C, dated July 15, 1992; comprised of term, serial, and auction variable rate bonds maturing in increments between June 15, 2003 and December 15, 2012; interest on Series B is paid semi-annually at fixed rates ranging from 6.0% to 6.7%; interest on Series C bonds is paid every 35 days at rates which ranged from 1.34% to 2.59% during 2002. The face amount of the bonds payable is $50,000 and $335 of unamortized premium has been added to the liability. The current portion of the total outstanding balance is $915.	$	50,000	—	50,000
1993 Series D and E, dated June 22, 1993; comprised of term, serial, and auction variable rate bonds maturing in increments between December 15, 2003 and June 15, 2012; interest on Series D is paid semi-annually at fixed rates ranging from 5.3% to 9.5%; interest on Series E bonds is paid every 35 days at rates which ranged from 1.32% to 2.765% during 2002. The face amount of the bonds payable is $80,000 and $337 of unamortized premium has been added to the liability. The current portion of the total outstanding balance is $0.		80,000	—	80,000
1993 Series F, G, H, I, and J, dated September 27, 1993; comprised of auction variable rate bonds maturing in increments between December 21, 2005 and December 15, 2015. Interest is reset every 35 days and payable semi-annually at rates which ranged from 1.299% to 2.7% during 2002. The current portion of the total outstanding balance is $0.		122,500	—	122,500

(Continued)

(Dollars in thousands)

		Beginning balance	Additions/ (reductions)	Ending balance
1995 Series A, B, C, and D, dated June 27, 1995; comprised of auction variable rate bonds maturing December 2025; interest is reset every 35 days and payable semi-annually at rates which ranged from 1.3% to 2.8% during 2002. The current portion of the total outstanding balance is $0.	$	96,000	—	96,000
1995 Series E, dated October 17, 1995; comprised of auction variable rate bonds maturing December 2002; interest is reset every 35 days and payable semi-annually at rates which ranged from 1.27% to 2.6% during 2002. The current portion of the total outstanding balance is $5,300.		5,300	—	5,300
1996 Series F, G, H, and I, dated May 22, 1996; comprised of auction variable rate bonds maturing February 2036; interest is reset every 35 days and payable semi-annually at rates which ranged from 1.29% to 2.7% during 2002. The current portion of the total outstanding balance is $0.		100,000	—	100,000
1996 Series J, dated October 23, 1996; comprised of auction variable rate bonds maturing December 2002; interest is reset every 35 days and payable semi-annually at rates which ranged from 1.35% to 2.6% during 2002. The current portion of the total outstanding balance is $3,100.		3,100	—	3,100
1998 Series K-O, dated June 16, 1998; comprised of auction variable rate bonds maturing December 2032; interest is reset every 35 days and payable semi-annually; at rates which ranged from 1.32% to 2.8% during 2002. The current portion of the total outstanding balance is $0.		165,000	—	165,000

(Continued)

(Dollars in thousands)

		Beginning balance	Additions/ (reductions)	Ending balance
2000 Series P and Q, dated May 31, 2000; comprised of auction variable rate bonds maturing in increments between December 15, 2002 and December 15, 2005. Interest is reset every 35 days and payable semi-annually; rates ranged from 1.3% to 2.699% during 2002. The current portion of the total outstanding balance is $11,000.	$	22,950	—	22,950
2000 Series R, S, T, and U, dated May 31, 2000; comprised of auction variable rate bonds maturing December 15, 2034. Interest is reset every 35 days and payable semi-annually; interest rates ranged from 1.27% to 2.739% during 2002. The current portion of the total outstanding balance is $0.		172,550	—	172,550
2001 Series V, W, and Z, dated June 27, 2001; comprised of auction variable rate bonds maturing December 15, 2035. Interest is reset every 35 days for Series V and W, and every seven days for Series Z. Interest is payable semi-annually. Interest rates ranged from 0.766% to 2.77% during 2002. The current portion of the total outstanding balance is $0.		84,750	—	84,750
2001 Series X, Y, and AA, dated June 27, 2001; comprised of auction variable rate bonds maturing December 15, 2036. Interest is reset, and payable, every 28 days for Series X and Y, and every seven days for Series AA. Interest rates ranged from 1.8% to 3.88% during 2002. The current portion of the total outstanding balance is $0.		80,000	—	80,000
Notes payable outstanding at June 30, 2002:				
2001 Series A-XII, dated June 15, 2001, principal and interest at 3.25%, due June 15, 2002. This note is fully matured.		12,760	(12,760	—

(Continued)

(Dollars in thousands)

		Beginning balance	Additions/ (reductions)	Ending balance
2001 Series A-XIII, dated December 15, 2001, principal and interest at 2.25%, due December 16, 2002. The current portion of the total outstanding balance is $8,520.	$	—	8,520	8,520
2002 Series A-XIV, dated June 15, 2002, principal and interest at 1.095%, due December 16, 2002. The current portion of the total outstanding balance is $16,860.		—	16,860	16,860
Total bonds and notes payable		1,096,700		1,096,700
Plus: Premium/(discount), net		781		652
Total bonds and notes payable, net of premium/(discount)		1,097,481		1,097,352
Less: Total noncurrent bonds and notes payable		1,072,100		1,043,052
Total current bonds and notes payable	$	25,381		54,300

All bonds are limited obligations of VSAC and are secured, as provided in underlying bond resolutions, by an assignment and pledge to the trustee of all VSAC's rights, title, and interest in student loans and revenues derived therefrom and the guarantee thereof, including the reinsurance of the student loans by the U.S. Department of Education. The 1985 Series A bonds are secured for credit-worthiness and liquidity by an irrevocable letter of credit issued by State Street Bank. The 1995 Series A, B, C, D, and E, 1996 Series F, G, H, I, and J, 1998 Series K-O, 2000 Series P-Q, 2000 Series R-U, 2001 Series V, W, and Z, and 2001 Series X, Y, and Z bonds are secured for credit-worthiness by AMBAC Indemnity Corporation. The 1992 Series A-2, and A-3, 1992 Series B and C, 1993 Series D and E, and 1993 Series F, G, H, I, and J bonds are secured for credit-worthiness by Financial Security Assurance Corporation. All bonds are subject to redemption prior to maturity at the principal amounts outstanding plus accrued interest at date of redemption. At June 30, 2002 all bonds authorized under the underlying bond resolutions have been issued.

Proceeds from issuance of the bonds and all revenues related to them are restricted as follows: repurchase bonds; finance student loans; pay interest on the bonds; maintain required reserves; and pay reasonable and necessary program expenses in carrying out the Loan Finance Program.

(Continued)

(Dollars in thousands)

The future maturities of debt are as follows:

Year ending June 30:		
2003	$	54,300
2004		15,050
2005		14,860
2006		70,175
2007		7,920
2008		46,930
2009		2,315
2010		—
2011-2015		136,850
2016-2020		50,000
2021-2025		—
2026-2030		96,000
2031-2035		337,550
2036-2040		264,750
	$	1,096,700

During the year ending June 30, 2002, VSAC issued the 2001 Series A-XIII note totaling $8,520 and the 2002 Series A-XIV note totaling $16,860 to refund the scheduled principal maturities of the 1985 Series A bonds, the 1992 Series A bonds and the 2001 Series A-XII note of $4,000, $8,620 and $12,760, respectively. Based on the terms of the old and new debt, these refundings are estimated to result in additional interest payments in fiscal year 2003 of $371.

(9) U.S. Treasury Rebates Payable

The amount accrued for U.S. Treasury rebates payable at June 30, 2002 represents the estimated amount of arbitrage rebates due to the Federal government for excess earnings on the bond proceeds.

(10) Restricted and Unrestricted Net Assets

As reported on the Statement of Net Assets, there are two classes of restricted net assets, Bond Resolution, and Grants and Scholarships. The net assets restricted by Bond Resolution are available only for Bond related items such as student loans, bond principal and interest, and servicing fees. The net assets restricted by Grants and Scholarships are available only for grants and scholarships.

Unrestricted net assets of $26,978 represents amounts designated to provide funding for student loans, cost of issuance fees and bond issuance.

(Continued)

(11) Student Loan Interest and Special Allowance Revenues

Interest on student loans is accrued when earned. The U.S. Department of Education makes quarterly interest subsidy payments on behalf of certain qualified students until the student is required under the provisions of the Act to begin repayment. Repayment on Stafford Student Loans normally begins within six months after students complete their course of study, leave school, or cease to carry at least one-half the normal full-time academic load as determined by the educational institution. Repayment of PLUS, SLS, and Consolidation loans normally begins within sixty days from the date of loan disbursement unless a deferment of payments has been granted. In these cases, full repayment of principal and interest would resume at the expiration of the deferment. Interest accrues during this deferment period. HEAL loans enter repayment status nine months after the expiration date of an interim period.

The U.S. Department of Education provides a special allowance to lenders participating in the Stafford, PLUS, SLS, and Consolidation student loan programs. Special allowance is paid based on a rate that is established quarterly. For loans first disbursed on or before January 1, 2000, the rate is based on the average rate established in the auction of the thirteen-week U.S. Treasury bill, plus a predetermined factor, less the interest rate on the loan. For loans first disbursed on or after January 1, 2000 financed with obligations issued after October 1, 1993, the rate is based on the average rate established in the auction of the three-month Financial Commercial Paper, plus a predetermined factor, less the interest rate on the loan. Loans made or purchased with funds obtained through the issuance of tax-exempt obligations issued before October 1, 1993 are eligible for one-half of the special allowance rate, subject to a minimum return of 9.5%. Loans originated or purchased with funds obtained through the issuance of tax-exempt obligations originally issued after October 1, 1993 are eligible for full special allowance and are not subject to a minimum return.

(12) Retirement Benefits

Full-time employees of VSAC that meet specific eligibility requirements are participants in a retirement annuity plan. This plan is a multi-employer defined contribution plan sponsored by Teachers Insurance and Annuity Association and College Retirement Equities Fund (TIAA/CREF). The payroll for employees covered under the plan for the fiscal year ended June 30, 2002 amounted to $12,379; VSAC's total payroll was $12,611. Total contributions by VSAC amounted to $1,238 in 2002, which represented 10% of the covered payroll.

(Continued)

(Dollars in thousands)

(13) Commitments Under Operating Lease

VSAC has two noncancelable operating leases for its office facilities that expire in 2004. Both leases provide for renewal options. Rental expense for the year ended June 30, 2002 amounted to $650. Future minimum rental commitments under these noncancelable operating leases as of June 30, 2002 are as follows:

Year ending June 30:		
2003	$	654
2004		663
	$	1,317

(14) Contingencies

VSAC participates in various federally funded programs. These programs are subject to financial and compliance audits and resolution of identified questioned costs. The amount, if any, of expenditures which may be disallowed by the granting agency cannot be determined at this time.

VSAC is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. VSAC manages these risks through a combination of commercial insurance packages purchased in the name of VSAC, and through self-insurance programs for medical and dental claims. With respect to its commercial insurance packages, VSAC has not experienced settled claims resulting from these risks which have exceeded its commercial insurance coverage. VSAC has purchased stop-loss insurance for its self insurance programs and has transferred the risk of loss to the commercial insurance carrier.

A summary of the reserve for self-insured medical and dental liabilities as of June 30, 2002 is as follows:

	Beginning balance	Claims paid	Adjustment to reserve	Ending balance
Reserve for medical and dental claims	$ 14	(2,097	2,089	136

(15) Subsequent Event

In October 2002, VSAC issued the 2002 Series BB, CC, and DD auction variable rate bonds, in the amount of $112,500.