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

FINANCIAL STATEMENTS

Years Ended June 30, 2004 and 2003

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BAKER NEWMAN & NOYES
LIMITED LIABILITY COMPANY

CERTIFIED PUBLIC ACCOUNTANTS

INDEPENDENT AUDITORS' REPORT

The Board of Directors
Vermont Student Assistance Corporation

We have audited the accompanying basic financial statements of the Vermont Student Assistance Corporation, a component unit of the State of Vermont, as of and for the years ended June 30, 2004 and 2003, as listed in the accompanying table of contents. These financial statements are the responsibility of the Vermont Student Assistance Corporation's management. 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 audits 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 audits provide a reasonable basis for our opinion.

In our opinion, the basic financial statements referred to above present fairly, in all material respects, the financial position of the Vermont Student Assistance Corporation, as of June 30, 2004 and 2003, and the changes in its financial position and its cash flows, for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards,* we have also issued our report dated September 17, 2004, 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.

Management's Discussion and Analysis on pages 2 – 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures to the 2004 and 2003 information, 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.

Baker Newman & Noyes
Limited Liability Company

Portland, Maine
September 17, 2004

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The Vermont Student Assistance Corporation (VSAC or the Corporation) is a public non-profit corporation created by the State of Vermont to provide opportunities for Vermont residents to pursue post-secondary education. VSAC's mission is to ensure that all Vermonters have the necessary financial and informational resources to pursue their educational goals beyond high school. VSAC awards grants and scholarships, and guarantees, makes, finances and services education loans to students and parents. VSAC also administers student employment programs, and outreach services to students and adults seeking post-secondary education opportunities. The Corporation also contracts with several schools and colleges in Vermont to serve as the financial aid office for the institution. Finally, VSAC manages the Vermont Higher Education Investment Plan.

VSAC administers the State grant program, funded by State appropriations, at no cost to the State. VSAC also administers and awards over 100 scholarship funds, including both scholarship funds held and managed by VSAC, and outside scholarships.

The majority of VSAC's education loan programs are financed through 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 Program (FFELP). VSAC also originates certain student loans that are not guaranteed by the federal government. VSAC education loans are available to Vermont students attending both in-state and out-of-state institutions, and to students of Vermont institutions.

VSAC's outreach services are funded through a variety of federal grants, including GEAR UP and Talent Search, as well as through State grants, fund-raising and general corporate support.

Management's Discussion and Analysis follows for Fiscal 2004 and Fiscal 2003.

FISCAL 2004

Fiscal 2004 Highlights and Overall Financial Position

- During the year ended June 30, 2004, VSAC provided over $21.6 million in grants and scholarships to Vermont students.
- VSAC originated $451.7 million in student loans, including new loans to students and parents and consolidation of existing loans. VSAC holds $1.28 billion in education loans receivable at June 30, 2004.
- VSAC returned over $13.3 million in interest and principal rebates to students in its loan programs during fiscal 2004.
- 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 $22.0 million to $101.7 million at June 30, 2004. As a result of a change in interpretation of DE regulations surrounding special allowance, VSAC made a reassignment of student loans that qualify for special allowance categories eligible for the 9.5% floor interest rate. This resulted in approximately $8.3 million of additional special allowance billings in 2004 from the DE. This amount was collected in July of 2004. In September 2004, the DE issued a report indicating the adjustment appeared to be in compliance with current guidance and regulations.
- VSAC's unrestricted net assets increased $22.7 million as a result of available equity from bonds either maturing or refunded. VSAC's net revenue base continued to grow as loan originations, including traditional Stafford and PLUS loans, consolidation loans and alternative loans, increased.

The Financial Statements

VSAC's financial statements are a series of reports that 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. 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 cash payments for the Corporation.

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

CONDENSED FINANCIAL INFORMATION

SUMMARY OF REVENUES AND EXPENSES

	2004	2003
	(In Thousands)	
Revenues:		
Interest earned from student loan financing	$ 84,394	$ 70,530
Other loan and guarantee program revenues	4,948	4,973
Investment interest	2,058	2,568
Vermont state appropriations	16,684	16,582
Federal grants	3,823	2,550
Scholarship revenue	3,710	3,651
Other revenue	697	1,189
Total operating revenues	116,314	102,043
Expenses:		
Student aid	21,609	20,603
Interest rebated to borrowers	13,309	14,664
Interest on debt	17,937	20,043
Other loan financing costs	12,702	12,174
Corporate operating expenses and depreciation	28,776	26,345
Total expenses	94,333	93,829
Excess of revenues over expenses	21,981	8,214
Total net assets, at the beginning of the year	79,689	71,475
Total net assets, at the end of the year	$101,670	$ 79,689

Revenues

VSAC's fiscal 2004 operations resulted in an increase in net assets of $22.0 million. All revenues for 2004 are considered operating revenues. VSAC earned $116.3 million in revenues versus $94.3 million in total expenses in 2004. 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. During 2004, interest revenues and subsidies increased from $70.5 to $84.4 million. Interest for certain student loans is paid by the U.S. Department of Education as a subsidy to qualifying borrowers. This interest subsidy totaled $8.6 million in 2004. VSAC also receives special allowance payments when variable interest rates fall below certain levels. Low interest rates, and the reinterpretation of Department of Education regulations in 2004, accounted for an increase in these special allowance payments from $16.1 to $29.4 million. The reinterpretation accounted for approximately $8.3 million of the increase.

Other revenues associated with the loan and loan guarantee programs include consolidation fees, default aversion fees, collection revenues, and other program fees and revenues. These fees and revenues totaled $5.0 million in 2004 and 2003.

Lower interest rates 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 $2.6 million to $2.1 million in 2004, as interest rates declined. These investments are related to the timing of student loan bond issues.

VSAC's appropriation increased slightly from $16.6 million in 2003 to $16.7 million in 2004. 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 from $2.6 million to $3.8 million in 2004. A one-time award of approximately $1.0 million accounted for the majority of the increase.

Scholarship revenues remained at $3.7 million for 2004.

Expenses

VSAC has four main types of expenses: student aid; interest costs; other loan financing costs; and costs of operations.

Student Aid – VSAC provided Vermont students with $21.6 million in student aid during 2004; $16.7 million was provided from State appropriations. An additional $3.7 million was made available through various scholarship programs managed by VSAC. Direct aid in the form of grants and scholarships represented 22.9% of VSAC's operating expenses. The total aid in 2004 increased 4.9% over 2003.

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 $13.3 million in rebates of interest to borrowers in fiscal 2004, down slightly from 2003, due to the overall decline in interest rates on these loans. These rebates represent 14.1% of VSAC's 2004 operating expenses.

It is also important to note that, while not an expense to the Corporation, the largest portion of aid to students is the $451.7 million of loans VSAC made available to students and parents in 2004.

Interest Costs – 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 represent 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 student loans, so revenues and expenses related to the bonds are highly correlated.

With the decrease in interest rates from fiscal 2003 to 2004, VSAC interest costs fell from $20.0 to $17.9 million, even as overall indebtedness increased from $1.33 to $1.55 billion. Interest costs represented 19.0% of VSAC operating expenses in 2004.

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 or recovery of arbitrage earnings liability to the U.S. Treasury, as well as a variety of other costs incurred in issuing and managing over $1.55 billion in outstanding bonds and notes. These costs totaled $12.7 million in 2004, representing approximately 13.5% of total operating expenses. Changes in these financing costs from year to year are principally due to changes in the total outstanding indebtedness, and by 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. In 2004, VSAC actually recovered excess arbitrage.

Costs of Operations – The costs of operating VSAC's programs, as well as facilities and overhead costs totaled $28.8 million in 2004, an increase of approximately 9.2% from 2003. Salaries and benefits were $20.5 million in 2004, approximately 71% of costs of operations. Overall costs of operations represent 30.5% of total operating expenses.

Total expenses for 2004 were $94.3 million. Revenues totaled $116.3 million. The excess of revenues over expenses was $22.0 million. The change in total net assets for 2004 was an increase of $22.0 million. The ending balance of net assets was $101.7 million at June 30, 2004, as compared to $79.7 million at June 30, 2003.

CONDENSED FINANCIAL INFORMATION

SUMMARY OF NET ASSETS

	2004	2003
	(In Thousands)	
Assets:		
Cash and investments	$ 341,371	$ 272,538
Student loans receivable (plus interest)	1,310,175	1,147,143
Other assets	16,843	12,265
Total assets	$1,668,389	$1,431,946
Liabilities:		
Bonds & notes payable (plus interest)	$1,551,701	$1,333,404
U.S. Treasury arbitrage payable	8,604	13,007
Other liabilities	6,414	5,846
Total liabilities	1,566,719	1,352,257
Net assets:		
Restricted	48,405	48,681
Unrestricted	50,816	28,144
Net investment in capital assets, net of related debt	2,449	2,864
Total net assets	101,670	79,689
Total liabilities and net assets	$1,668,389	$1,431,946

Net Assets

Cash balances increased from June 30, 2003 to 2004 from $261.7 to $341.3 million as a result of fiscal 2004 bond proceeds not fully utilized for loan originations at June 30, 2004. Combined cash and investments were $341.3 million at year end. Refer to the Statement of Cash Flows for further details of changes in cash and investments in 2004.

Student loans and interest receivable totaled $1.31 billion at June 30, 2004, up from $1.15 billion in 2003. VSAC used education loan revenue bonds issued in 2004 and 2003 to originate student loans in 2004.

U.S. Treasury arbitrage payable was described in the expense discussion. This liability decreased as of June 30, 2004, to $8.6 million, from $13.0 million at June 30, 2003.

Net assets restricted by bond indenture decreased $0.5 million. These represent VSAC equity positions in trusts established to provide security for bondholders. Upon maturity of the 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 borrowings.

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 capital assets. Unrestricted net assets totaled $50.8 million at June 30, 2004, an increase of $22.7 million from June 30, 2003. Unrestricted net assets invested in student loans totaled $36.3 million at June 30, 2004.

Capital assets increased during fiscal 2004 as new acquisitions of $5.0 million exceeded depreciation expense of $1.5 million. The primary reason for the increase is a result of VSAC purchasing land and beginning construction of a new corporate headquarters in 2004. The purchase of land and construction of the new corporate headquarters is being funded by General Obligation bonds issued in fiscal 2004.

Changes in Long-Term Debt

Bonds, notes and interest payable increased by $218.3 million to $1.55 billion in 2004. The increase resulted from new borrowings exceeding maturities and refundings of existing debt during fiscal year 2004. During the fiscal year, VSAC issued $380.9 million in new bonds and notes. These bonds and notes provided $218 million of new capital, and retired and refunded $160.6 million of existing debt.

See note 8 for additional information on bonds and notes payable.

FISCAL 2003

Fiscal 2003 Highlights and Overall Financial Position

- During the year ended June 30, 2003, VSAC provided over $20.6 million in grants and scholarships to Vermont students.
- VSAC originated over $407.0 million in student loans, including new loans to students and parents and consolidation of existing loans. VSAC held $1.12 billion in education loans receivable at June 30, 2003.
- VSAC returned over $14.7 million in interest and principal rebates to students in its loan programs during fiscal 2003.
- 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 $8.2 million to $79.7 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 interest rates decreased both gross interest revenues and gross interest expenses, the increase in student loan volume generated consistent net revenues from loans.

CONDENSED FINANCIAL INFORMATION

SUMMARY OF REVENUES AND EXPENSES

	2003	2002
	(In Thousands)	
Revenues:		
Interest earned from student loan financing	$ 70,530	$ 71,493
Other loan and guarantee program revenues	4,973	4,254
Investment interest	2,568	5,234
Vermont state appropriations	16,582	15,446
Federal grants	2,550	2,367
Scholarship revenue	3,651	2,503
Other revenue	1,189	1,234
Total operating revenues	102,043	102,531
Expenses:		
Student aid	20,603	18,634
Interest rebated to borrowers	14,664	15,354
Interest on debt	20,043	25,412
Other loan financing costs	12,174	15,576
Corporate operating expenses and depreciation	26,345	24,758
Total operating expenses	93,829	99,734
Excess of revenues over expenses	8,214	2,797
Total net assets, at the beginning of the year	71,475	68,678
Total net assets, at the end of the year	$ 79,689	$ 71,475

Revenues

VSAC's fiscal 2003 operations resulted in an increase in net assets of $8.2 million. All revenues for 2003 are considered operating revenues. VSAC earned $102.0 million in revenues versus incurring $93.8 million in total expenses in 2003. 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. During 2003, interest revenues and subsidies declined from $71.5 to $70.5 million. Interest for certain loans is paid by the U.S. Department of Education as a subsidy to qualifying borrowers. This interest subsidy represented $9.0 million in 2003. VSAC also receives special allowance payments when variable interest rates fall below certain levels. Low interest rates accounted for an increase in these special allowance payments from $10.0 to $16.1 million in 2003.

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 $5.0 million in 2003, compared to $4.2 million in 2002.

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 $5.2 million to $2.6 million in 2003, as interest rates declined and the amount invested in cash and cash equivalents on average declined as well. These investments are related to the 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 $15.4 to $16.6 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 7.7%, to $2.6 million in fiscal 2003.

Scholarship revenues climbed from $2.5 to $3.7 million in fiscal 2003, 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 costs; other loan financing costs; and costs of operations.

Student Aid – VSAC provided Vermont students with $20.6 million in student aid during fiscal 2003; $16.4 million was provided from State appropriations. An additional $4.2 million was made available through various scholarship programs managed by VSAC. The total aid in 2003 represents an 11% increase over grants and scholarships provided by VSAC in fiscal 2002. Direct aid in the form of grants and scholarships represented 22% 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 $14.6 million in rebates of interest to borrowers in fiscal 2003, down slightly from 2002, due to the overall decline in interest rates on these loans. These rebates represent 15.6% of VSAC's fiscal 2003 operating expenses.

It is also important to note that, while not an expense to the Corporation, the largest portion of aid to students is the $407 million of loans VSAC made available to students and parents in fiscal 2003.

Interest Costs – 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 represent 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 student loans, so revenues and expenses related to the bonds are highly correlated.

With the dramatic decrease in interest rates from fiscal 2002 to 2003, VSAC interest costs fell from $25.4 to $20.0 million, even as overall indebtedness increased from $1.10 to $1.33 billion. Interest costs represented 21.4% of VSAC operating expenses in fiscal 2003.

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 or recovery of the arbitrage earnings liability to the U.S. Treasury, as well as a variety of other costs incurred in issuing and managing over $1.3 billion in outstanding bonds and notes. These costs totaled $12.2 million in fiscal 2003, representing approximately 13.0% of total operating expenses. Changes in these financing costs from year to year are principally due to changes in the total outstanding indebtedness, and by changes in the 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. VSAC actually experienced a recapture of excess arbitrage in fiscal 2003.

Costs of Operations – The costs of operating VSAC's programs, as well as facilities and overhead costs totaled $26.3 million in fiscal 2003, an increase of approximately 6.4% from fiscal 2002. Salaries and benefits were $18.5 million in fiscal 2003, approximately 70% of costs of operations. Overall costs of operations represent 28% of total operating expenses.

Total expenses for 2003 were $93.8 million. Revenues totaled $102.0 million. The excess of revenues over expenses was $8.2 million. The change in total net assets for 2003 was an increase of $8.2 million. The ending balance of net assets was $79.7 million at June 30, 2003, as compared to $71.5 million at June 30, 2002.

Other operating expenses including the provision for loan losses and other general and administrative expenses totaled $1.5 million in 2003.

CONDENSED FINANCIAL INFORMATION

SUMMARY OF NET ASSETS

	2003	2002
	(In Thousands)	
Assets:		
Cash and investments	$ 272,538	$ 167,528
Student loans receivable (plus interest)	1,147,143	1,012,003
Other assets	12,265	10,321
Total assets	$1,431,946	$1,189,852
Liabilities:		
Bonds & notes payable (plus interest)	$1,333,404	$1,098,456
U.S. Treasury arbitrage payable	13,007	14,499
Other liabilities	5,846	5,422
Total liabilities	1,352,257	1,118,377
Net assets:		
Restricted	48,681	41,707
Unrestricted	28,144	26,978
Net investment in capital assets	2,864	2,790
Total net assets	79,689	71,475
Total liabilities and net assets	$1,431,946	$1,189,852

Net Assets

Cash balances increased significantly from June 30, 2002 to 2003, from $143.5 to $261.7 million as a result of fiscal 2003 bond proceeds not fully utilized for loan originations at June 30, 2003. VSAC issued $112.5 million in new bonds in October 2002 and $310.9 million in new bonds in May 2003. Combined cash and investments were $272.5 million at June 30, 2003 an increase of $105 million from June 30, 2002. Refer to the Statement of Cash Flows for further details of changes in cash and investments in 2003.

Student loans and interest receivable totaled $1.15 billion at June 30, 2003, up from $1.01 billion in 2002. The 2003 bond proceeds were used to originate student loans in 2003.

U.S. Treasury arbitrage payable was described in the expense discussion. This liability decreased as of June 30, 2003, to $13.0 million from $14.5 million at June 30, 2002.

Net assets restricted by bond indenture increased $7.0 million. These represent VSAC equity positions in trusts established to provide security for bondholders. Upon maturity of the 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 borrowings.

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 capital assets. Unrestricted net assets invested in student loans totaled $18.6 million at June 30, 2003.

Capital assets increased during the fiscal year, as new acquisitions of $1.4 million exceeded depreciation expense of $1.3 million. The result was an increase in both capital assets, and the corresponding net asset figure to $2.9 million at June 30, 2003.

Changes in Long-Term Debt

Bonds, notes and interest payable increased by $234.9 million to $1.33 billion. The increase resulted from new borrowings exceeding maturities and refundings of existing debt during fiscal year 2003. During the fiscal year, VSAC issued $449.3 million in new bonds and notes. These bonds and notes provided $235 million of new capital, and retired and refunded $214.3 of existing debt.

See note 8 for additional information on bonds and notes payable.

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

STATEMENTS OF NET ASSETS

June 30, 2004 and 2003

ASSETS

	2004	2003
	(In Thousands)	
Current assets:		
Cash and cash equivalents (notes 3, 8 and 9)	$ 341,276	$ 261,668
Investments (notes 3, 8 and 9)	95	10,870
Receivables:		
Student loans, net (notes 4, 8 and 9)	104,380	95,335
Student loan interest and special allowance (note 10)	33,941	23,489
Investment interest	218	278
Federal administrative and program fees	446	410
Other	1,073	800
Other assets	1,389	1,485
Total current assets	482,818	394,335
Noncurrent assets:		
Receivables:		
Student loans, net (notes 4, 8 and 9)	1,171,854	1,028,319
Capital assets, net (note 7)	6,324	2,864
Deferred bond issuance costs, net	7,393	6,428
Total noncurrent assets	1,185,571	1,037,611
Total assets	$1,668,389	$1,431,946

LIABILITIES AND NET ASSETS

	2004	2003
	(In Thousands)	
Current liabilities:		
Bonds and notes payable (notes 8 and 9)	$ 30,400	$ 40,935
Accounts payable and other liabilities	3,117	3,103
Deferred revenue	3,297	2,743
Accrued interest on bonds payable	1,307	1,211
Arbitrage earnings rebatable (note 9)	2,560	1,260
Total current liabilities	40,681	49,252
Noncurrent liabilities:		
Bonds and notes payable (notes 8 and 9)	1,519,994	1,291,258
Arbitrage earnings rebatable (note 9)	6,044	11,747
Total noncurrent liabilities	1,526,038	1,303,005
Total liabilities	1,566,719	1,352,257
Commitments and contingencies (notes 7, 12, 13 and 14)		
Net assets:		
Invested in capital assets, net of related debt	2,449	2,864
Restricted:		
Bond resolution	47,773	48,288
Grants and scholarships	632	393
Unrestricted	50,816	28,144
Total net assets	101,670	79,689
Total liabilities and net assets	$1,668,389	$1,431,946

See accompanying notes to the financial statements.

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

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS

Years Ended June 30, 2004 and 2003

	2004	2003
	(In Thousands)	
Operating revenues:		
U.S. Department of Education (note 10):		
Interest benefits	$ 8,590	$ 9,019
Special allowance	29,420	16,099
Interest on student loans	46,384	45,412
State appropriations	16,684	16,582
Interest on investments	2,058	2,568
Guarantee agency administrative revenues	4,948	4,973
Federal grants	3,823	2,550
Scholarship income	3,710	3,651
Other income	697	1,189
Total operating revenues	116,314	102,043
Operating expenses:		
Financing expenses – interest	17,937	20,043
Salaries and benefits (note 11)	20,457	18,483
State grants and scholarships	21,609	20,603
Interest rebated to borrowers	13,309	14,664
Other general and administrative	6,399	6,095
Other guarantee agency expenses	391	435
Reduction in excess arbitrage (note 9)	(3,145)	(1,181)
Credit enhancement and remarketing fees	5,040	4,385
Consolidation and lender paid fees	8,387	6,861
Other loan financing expense	79	151
Provision for losses on student loans (note 4)	1,260	1,062
Depreciation and amortization (note 7)	1,529	1,332
Amortization of bond issuance costs	1,081	896
Total operating expenses	94,333	93,829
Excess of operating revenues over operating expenses	21,981	8,214
Net assets, beginning of year	79,689	71,475
Net assets, end of year	$101,670	$ 79,689

See accompanying notes to the financial statements.

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

STATEMENTS OF CASH FLOWS

Years Ended June 30, 2004 and 2003

	2004	2003
	(In Thousands)	
Cash flows from operating activities:		
Cash received from customers	$ 39,729	$ 35,676
Principal payments received on student loans	297,849	269,818
Cash paid to suppliers for goods and services	(57,949)	(55,095)
Student loans originated	(451,689)	(406,839)
Cash paid to employees for services	(20,329)	(18,838)
Interest received on student loans	47,049	47,714
State appropriations received	16,684	16,582
Net cash used in operating activities	(128,656)	(110,982)
Cash flows from noncapital financing activities:		
Proceeds from the sale of bonds/notes payable	358,850	449,285
Payments on bonds/notes payable	(160,585)	(214,300)
Interest paid to bond holders	(18,123)	(20,080)
Premiums paid at redemption for bond refunding	(1,562)	–
Net cash provided by noncapital financing activities	178,580	214,905
Cash flows from capital and related financing activities:		
Proceeds from the sale of capital debt	22,006	–
Interest paid to bond holders	(226)	–
Acquisition and construction of capital assets	(4,989)	(1,406)
Net cash provided (used) in capital and related financing activities	16,791	(1,406)
Cash flows from investing activities:		
Interest received on investments	2,118	2,493
Redemption of investments, net	10,775	13,117
Net cash provided by investing activities	12,893	15,610
Net increase in cash and cash equivalents	79,608	118,127
Cash and cash equivalents, beginning of year	261,668	143,541
Cash and cash equivalents, end of year	$ 341,276	$ 261,668

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

STATEMENTS OF CASH FLOWS
(CONTINUED)

Years Ended June 30, 2004 and 2003

	2004	2003
	(In Thousands)	
Reconciliation of operating income to net cash used in operating activities:		
Excess of operating revenues over operating expenses	$ 21,981	$ 8,214
Adjustments to reconcile the excess of operating revenues over operating expenses to net cash used in operating activities:		
Depreciation and amortization	1,529	1,332
Provision for losses on student loans	1,260	1,062
Amortization of bond issuance costs	1,081	896
Amortization of bond premium	(508)	(144)
Investment interest received	(2,118)	(2,493)
Interest paid to bond holders	18,349	20,080
Changes in operating assets and liabilities:		
Decrease (increase) in investment interest receivable	60	(75)
Increase in student loans receivable	(153,840)	(137,608)
(Increase) decrease in student loans interest receivable	(10,452)	1,406
Increase in federal administrative and program fees receivable	(36)	(74)
Increase in other receivables	(273)	(240)
Decrease (increase) in other assets	96	(259)
Increase in deferred bond issuance costs	(2,046)	(2,118)
Increase in accounts payable and other liabilities	14	353
Increase in deferred revenue	554	71
Increase in accrued interest on bonds payable	96	107
Decrease in arbitrage earnings rebatable	(4,403)	(1,492)
Total adjustments	(150,637)	(119,196)
Net cash used in operating activities	$(128,656)	$(110,982)

See accompanying notes to the financial statements.

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

STATEMENTS OF FIDUCIARY NET ASSETS

AGENCY FUNDS

June 30, 2004 and 2003

	Federal Loan Reserve Fund	VHEIP	2004 Total	2003 Total
	(In Thousands)			
ASSETS HELD FOR OTHERS				
Cash and cash equivalents	$ 8,869	$ 303	$ 9,172	$ 7,900
Investments	–	29,166	29,166	18,428
Student loans receivable and accrued student loan interest	–	3,028	3,028	2,504
Investment interest receivable	6	13	19	81
Other assets	1,082	7	1,089	1,090
Total assets	$ 9,957	$ 32,517	$ 42,474	$ 30,003
LIABILITIES				
Accounts payable and other liabilities	$ 377	$ 21	$ 398	$ 208
Note payable	–	3,009	3,009	2,563
Federal advances	538	–	538	538
Amounts held on behalf of investors	–	29,487	29,487	18,568
Return of reserves due to U.S. Department of Education	552	–	552	552
Federal loan reserve funds held for U.S. Department of Education	8,490	–	8,490	7,574
Total liabilities	$ 9,957	$ 32,517	$ 42,474	$ 30,003

See accompanying notes to the financial statements.

1. Authorizing Legislation

The Vermont Student Assistance Corporation ("VSAC") was created as a public non-profit 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 (VHEIP).

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 majority of education loans are financed through the issuance of limited obligation bonds and are guaranteed by VSAC as a guarantor and reinsured by the U.S. Department of Education (DE) through the Federal Family Education Loan (FFEL) Program. The bonds and notes 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 and notes. The bonds and notes are not a general obligation of VSAC or an obligation of the State of Vermont or any of its political subdivisions.

For financial reporting purposes, 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 of Vermont primarily consists of an annual appropriation designated for grant aid to Vermont students.

The Vermont Student Development Fund, Inc. (the "Fund"), a separate non-profit 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 component unit of VSAC and is included in the totals on the financial statements. The operations of the Fund are immaterial.

2. Summary of Significant Accounting Policies

Basis of Accounting

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

2. Summary of Significant Accounting Policies (Continued)

As permitted by Governmental Accounting Standards Board (GASB) Statement No. 20, *Accounting and Financial Reporting for Proprietary Funds and Other Governmental Activities that Use Proprietary Fund Accounting*, 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.

The financial statements are prepared in accordance with Governmental Accounting Standards Board Statements No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus – an amendment of GASB Statements No. 21 and 34*, and No. 38, *Certain Financial Statement Note Disclosures*. VSAC reports as a business-type activity, as defined, in GASB No. 34.

Restriction on Net Assets

The restricted net assets of VSAC are restricted by the bond resolutions, state statutes, or various Federal regulations and program agreements and are restricted for the origination of student loans, payment of debt service on bonds and notes payable and grant and scholarship activities. Financial activities and resulting account balances which are not so restricted are presented in the Statements of Net Assets as unrestricted net assets. VSAC's unrestricted net assets are generally reserved for educational assistance purposes.

Management Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management of VSAC 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. Actual results could differ from those estimates. The most significant estimates utilized in the preparation of the financial statements of VSAC relate to the allowance for losses on student loans and the arbitrage earnings rebatable liability.

2. Summary of Significant Accounting Policies (Continued)

Student Loans

Student loans consist primarily of guaranteed student loans which are made to post-secondary students attending eligible educational institutions and guaranteed parental loans made to parents of dependent undergraduate students, graduate and professional students, and independent undergraduate students attending eligible educational institutions. Student loans also include consolidation loans which are loans to eligible students that combine two or more existing student loans and extend the repayment period.

Student loans are stated at their unpaid principal balance less net deferred loan origination fees. Loan origination fees received are deferred and amortized over the estimated life of the loan using a method that approximates the level yield method.

Allowance for Loan Losses

A substantial portion of student loans are guaranteed by VSAC, as guarantor under the FFEL Program, and substantially all such loans are reinsured by DE. However, there is still the risk that loans may lose their guarantee and become uncollectible under certain circumstances and certain student loans are not guaranteed. Also, loans originated subsequent to October 1, 1993, are only reinsured by DE for 98% of the principal amount. Student loans issued under the FFEL program originated prior to October 1, 1993, are 100% reinsured by DE. At June 30, 2004 and 2003, most of VSAC's student loans are subject to the 98% guarantee from DE. Therefore, management of VSAC has established an allowance for loan losses to provide for probable losses on the 98% guaranteed loans and for loans that have no guarantee. The amount of the allowance, which is established through a provision for losses on student loans charged to expense, is based on management's estimation of the probable losses within the portfolio. Primary considerations in establishing the allowance are the amounts of unguaranteed loans in the portfolio, delinquencies, current economic conditions and historical loss experience.

Operating Revenue and Expenses

Operating revenues include interest earned on student loans and investments, fees received from providing services, state appropriations, 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.

Cash Equivalents

VSAC considers all highly liquid investments with original maturities of three months or less to be cash equivalents. Cash equivalents include funds held in an institutional money market fund account.

2. Summary of Significant Accounting Policies (Continued)

Investments

Investment securities consist of a certificate of deposit at June 30, 2004. At June 30, 2003, they consisted primarily of guaranteed investment contracts. Investments are carried at fair value in accordance with GASB Statement No. 31, *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The cost of the guaranteed investment contracts approximated their fair values as VSAC could withdraw funds at par during the contract period according to the related bond indentures.

Capital Assets

Capital assets are stated at historical cost. Depreciation of capital assets that are placed in service is calculated using the straight-line method over the estimated useful lives of the assets. Capital asset acquisitions that equal or exceed $2.5 are capitalized. Leasehold improvements are amortized using the straight-line method over the shorter of the lease term or estimated useful life of the asset.

Bond Issuance Costs

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.

Bond Premium, Discount and Deferred Loss on Refunding

Bond premiums and discounts are amortized using the interest method over the life of the bonds. Any unamortized deferred loss related to refunded bonds is deferred and amortized over the life of the original or refunded bonds, whichever is shorter.

Grants

Unrestricted grants are recorded as revenue when received. Restricted grants are recorded as revenue upon compliance with the restrictions. Amounts received for grant programs that are restricted are recorded in deferred revenue until they become unrestricted.

FFEL Program Support

VSAC receives a percentage of the amounts collected on defaulted loans, an origination fee, a portfolio maintenance fee and a default aversion fee from DE as its primary support for the administration of the FFEL Program. These fees are recorded as guarantee agency administrative revenues when earned.

2. Summary of Significant Accounting Policies (Continued)

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 and this obligation is accrued.

Income Tax Status

VSAC is exempt from Federal and state income taxes under Section 115 of the Internal Revenue Code and, accordingly, no provision for income taxes has been made in the accompanying financial statements.

Reclassification

Certain items in the 2003 financial statements have been reclassified to conform to the current year presentation.

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.

(Dollars in Thousands)

3. Cash, Cash Equivalents and Investments (Continued)

Cash and Cash Equivalents

Cash and cash equivalents consist of the following as of June 30, 2004 and 2003:

	2004		2003	
	Balance	Amount Insured or Collateralized	Balance	Amount Insured or Collateralized
Cash and repurchase agreements	$ 4,212	$ 4,614	$ 3,447	$ 3,294
Money market accounts	337,064	See Below	258,221	See Below
	$341,276		$261,668	

At June 30, 2004 and 2003, cash and repurchase agreements are comprised of various bank accounts and principal cash held by a bank trust department. The bank balances at June 30, 2004, were $5,066 and the bank balances at June 30, 2003, were $4,033. The difference between the net bank balances and the amounts recorded on the financial statements is outstanding checks and deposits in transit. Additionally, $4,614 and $3,294 of the bank balances at June 30, 2004 and 2003, respectively, were covered by Federal depository insurance or collateralized by repurchase agreements for which the securities are held by the bank's trustee in VSAC's name. The remainder of bank balances of $452 and $739 at June 30, 2004 and 2003, respectively, were uninsured and uncollateralized.

At June 30, 2004 and 2003, the money market accounts are primarily invested in the Federated Prime Cash Obligations Fund. The Fund objective is to provide current income consistent with stability of principal and liquidity. The Prime Cash Obligations Fund invests primarily in a portfolio of short-term, high quality fixed income securities insured by banks, corporations and the U.S. Government. The underlying assets are not held in the name of VSAC.

Investments

VSAC categorizes its investments to give an indication of the level of credit risk assumed by VSAC at year end. The categories are as follows:

(1) Insured or collateralized with securities held by VSAC or by its agent in VSAC's name.
(2) Collateralized with securities held by the pledging financial institution's trust department or agent in VSAC's name.
(3) Uncollateralized.

(Dollars in Thousands)

3. Cash, Cash Equivalents and Investments (Continued)

Investment securities and the level of credit risk assumed by VSAC were as follows at June 30, 2004 and 2003:

	2004	2003
Guaranteed investment contracts (not subject to categorization)	$ –	$ 10,775
Certificates of deposit – Category 1	95	95
	$ 95	$ 10,870

The bank and book balances of investments at June 30, 2004 and 2003, were the same.

A significant portion of cash, cash equivalents and investments are limited to their use for the repayment of bond and note obligations, and to satisfy certain reserve requirements specified by the bond and note indentures.

4. Student Loans Receivable

Student loans have annual interest rates ranging from 2.43% to 12.0%; the majority are insured by DE and the U.S. Department of Health and Human Services. There are certain student loans that are not guaranteed. Most of VSAC's borrowers are located in the New England states, primarily in the State of Vermont.

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.

Student loans receivable as of June 30, 2004 and 2003, are summarized as follows:

	2004	2003
Status:		
Interim status	$ 306,215	$ 258,982
Deferral status	214,247	195,002
Repayment status	759,031	670,749
Less: Allowance for loan losses	(1,806)	(1,079)
Deferred origination fees, net	(1,453)	–
Total student loans receivable	1,276,234	1,123,654
Less: noncurrent student loans receivable	1,171,854	1,028,319
Current student loans receivable	$ 104,380	$ 95,335

(Dollars in Thousands)

4. Student Loans Receivable (Continued)

	2004	2003
Guarantee type:		
U.S. Department of Education	$1,179,464	$1,058,858
U.S. Department of Health and Human Services	18,713	20,277
Other – nonguaranteed	81,316	45,598
Less: Allowance for loan losses	(1,806)	(1,079)
Deferred origination fees, net	(1,453)	–
Total student loans receivable	1,276,234	1,123,654
Less: noncurrent student loans receivable	1,171,854	1,028,319
Current student loans receivable	$ 104,380	$ 95,335

The student loans are pledged to the repayment of bonds.

Transactions in the allowance for loan losses for the years ended June 30, 2004 and 2003, were as follows:

	2004	2003
Balance July 1	$ 1,079	$ 604
Net loans charged off	(533)	(587)
Provision for losses on student loans	1,260	1,062
Balance June 30	$ 1,806	$ 1,079

5. Net Assets Held for the U.S. Department of Education

Under the Higher Education Act Amendments of 1998, all assets related to the FFEL Program guaranty functions were transferred to the Federal Loan Reserve Fund on October 1, 1998. The Federal Loan Reserve Fund is administered by VSAC on behalf of DE 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 Act Amendments of 1998. The Guarantee Agency Operating Fund, which is included within the Statements of Net Assets, is the property of VSAC and is used to account for the activities under the FFEL Program that fall outside of the Federal Loan Reserve Fund.

(Dollars in Thousands)

5. Net Assets Held for the U.S. Department of Education (Continued)

Changes in Federal loan reserve funds held for DE for the years ended June 30, 2004 and 2003, were as follows:

	2004	2003
Additions:		
Reimbursement from DE on default loan purchases	$13,444	$11,411
Default loan collections	72	40
Loan administrative fees	1,982	1,821
Investment income	54	88
Total additions	15,552	13,360
Deductions:		
Purchases of defaulted loans from lenders	13,794	11,655
Default aversion fee paid	585	507
Other disbursements	257	1,126
Total deductions	14,636	13,288
Federal loan reserve funds held, at beginning of year	7,574	7,502
Federal loan reserve funds held, at end of year	$ 8,490	$ 7,574

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 providers. The Higher Education Act Amendments of 1998 require VSAC to maintain reserves equal to .25% of student loans guaranteed. During 2004 and 2003, VSAC maintained sufficient reserves to fully comply with these requirements.

Total outstanding loans issued under the FFEL Program were $1,179,464 and $1,058,858 at June 30, 2004 and 2003, respectively. Defaults on FFEL Program loan guarantees are paid by DE through the Federal Loan Reserve Fund.

(Dollars in Thousands)

6. Net Assets Held for the Vermont Higher Education Investment Plan (VHEIP)

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. The program has been designed to comply with the requirements for treatment as a "Qualified Tuition Program" under Section 529 of the Internal Revenue Code. 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 proceeds from the note to make federally guaranteed education loans.

The changes in assets held on behalf of investors for the years ended June 30, 2004 and 2003, were as follows:

	2004	2003
Additions:		
Investment income	$ 860	$ 327
Net realized and unrealized gains	1,845	686
Student loan interest income	101	92
Net participant subscriptions/redemptions	8,144	6,674
Total additions	10,950	7,779
Deductions:		
Operational expenses	31	26
Total deductions	31	26
Assets held on behalf of investors, at beginning of year	18,568	10,815
Assets held on behalf of investors, at end of year	$29,487	$18,568

(Dollars in Thousands)

7. Capital Assets

A summary of capital assets activity for the years ended June 30, 2004 and 2003, were as follows:

	Estimated Lives	Balance July 1, 2002	Acquisitions	Disposals	Balance June 30, 2003	Acquisitions	Balance June 30, 2004
Land	–	$ –	$ –	$ –	$ –	$ 3,150	$ 3,150
Furniture and equipment	3 – 5 Years	4,644	998	(2,982)	2,660	1,701	4,361
Leasehold improvements	5 Years	929	–	(208)	721	–	721
Software	3 – 5 Years	4,420	64	(2,730)	1,754	43	1,797
Construction in progress		286	344	–	630	95	725
		10,279	1,406	(5,920)	5,765	4,989	10,754
Less accumulated depreciation		7,489	1,332	(5,920)	2,901	1,529	4,430
Capital assets, net		$ 2,790	$ 74	$ –	$ 2,864	$ 3,460	$ 6,324

Depreciation charged to operations for the years ended June 30, 2004 and 2003, was $1,529 and $1,332, respectively.

VSAC has a commitment to construct new corporate headquarters. At June 30, 2004, VSAC had incurred $617 in construction costs under this contract which leaves an outstanding commitment of $14,044.

8. Bonds and Notes Payable

VSAC has issued the following bonds and notes payable at June 30, 2004 and 2003, which were issued to finance the origination of student loans:

Bonds Payable:	2004	2003
1985 Series A, dated December 27, 1985; comprised of floating rate monthly demand bonds with the balance maturing in January 2008; interest is payable monthly at variable rates which ranged from 1.0% to 1.2% during fiscal year 2004 (1.2% at June 30, 2004).	$ 40,900	$ 40,900
1992 Series A-3, dated June 15, 1992. Series A-3 bonds are comprised of serial rate bonds maturing in increments through December 2005; interest is paid semi-annually at fixed rates ranging from 5.8% to 6.5%. The Series A-3 bonds were refunded in advance of their maturity in 2004 by the 2004 Series MM bonds.	–	17,165

(Dollars in Thousands)

8. Bonds and Notes Payable (Continued)

	2004	2003
1992 Series B, dated July 15, 1992. Series B bonds are comprised of term and serial variable rate bonds maturing in increments through December 2012; interest on Series B bonds is paid semi-annually at fixed rates ranging from 6.0% to 6.7%. The Series B bonds were refunded in advance of their maturity in 2004 by the 2004 Series MM bonds.	$ –	$ 24,085
1993 Series D, dated June 22, 1993; comprised of term, serial and auction rate bonds maturing in increments between December 2003 and June 2012; interest on Series D is paid semi-annually at fixed rates ranging from 5.3% to 9.5%. The Series D bonds were refunded in advance of their maturity in 2004 by the 2004 Series MM bonds.	–	40,000
1993 Series H and I dated September 27, 1993. Series H and I bonds are comprised of auction rate bonds maturing December 2015; interest is reset every 35 days and payable semi-annually at rates which ranged from 0.88% to 0.90% during fiscal year 2004. The Series H and I bonds were refunded in advance of their maturity in 2004 by the 2003 Series LL bonds.	–	50,000
1995 Series A, B, C and D, dated June 27, 1995; comprised of auction rate bonds maturing December 2025; interest is reset every 35 days and payable semi-annually at rates which ranged from 0.84% to 1.4% during fiscal year 2004 (1.3% to 1.4% at June 30, 2004).	96,000	96,000
1996 Series F, G, H and I, dated May 22, 1996; comprised of auction rate bonds maturing December 2036; interest is reset every 35 days and payable semi-annually at rates which ranged from 0.86% to 1.35% during fiscal year 2004 (1.3% to 1.35% at June 30, 2004).	100,000	100,000
1998 Series K-O, dated June 16, 1998; comprised of auction rate bonds maturing December 2032; interest is reset every 35 days and payable semi-annually at rates which ranged from 0.85% to 1.38% during fiscal year 2004 (1.3% to 1.38% at June 30, 2004).	165,000	165,000
2000 Series P and Q, dated May 31, 2000; comprised of auction rate bonds maturing in December 2005. Interest is reset every 35 days and payable semi-annually; rates ranged from 0.81% to 1.4% during fiscal year 2004 (1.4% at June 30, 2004).	11,950	11,950

(Dollars in Thousands)

8. Bonds and Notes Payable (Continued)

	2004	2003
2000 Series R, S, T and U, dated May 31, 2000; comprised of auction rate bonds maturing December 2034. Interest is reset every 35 days and payable semi-annually at rates which ranged from 0.82% to 1.35% during fiscal year 2004 (1.28% to 1.35% at June 30, 2004).	$ 172,550	$ 172,550
2001 Series V, W and Z dated June 27, 2001; comprised of auction rate bonds maturing December 2035. Interest is reset every 35 days for Series V and W, and every 7 days for Series Z. Interest is payable semi-annually at rates which ranged from 0.53% to 1.4% during fiscal year 2004 (1.25% to 1.4% at June 30, 2004).	84,750	84,750
2001 Series X, Y and AA dated June 27, 2001; comprised of auction rate bonds maturing December 2036; interest is reset, and payable, every 28 days for Series X and Y, and every 7 days for Series AA. Interest rates ranged from 0.97% to 1.5% during fiscal year 2004 (1.4% to 1.5% at June 30, 2004).	80,000	80,000
2002 Series BB, CC and DD dated October 8, 2002; comprised of auction rate bonds maturing December 2036. Interest is reset every 35 days and payable semi-annually at rates which ranged from 0.82% to 1.33% during fiscal year 2004 (1.15% to 1.33% at June 30, 2004).	112,500	112,500
2003 Series EE dated May 30, 2003; comprised of auction rate bonds maturing December 2005; interest is reset every 35 days and payable semi-annually which ranged from 0.88% to 1.37% during fiscal year 2004 (1.37% at June 30, 2004).	45,000	45,000
2003 Series FF, GG, HH and LL dated May 30, 2003; comprised of auction rate bonds with maturity dates ranging from June 2009 through December 2014; interest is reset every 35 days and payable semi-annually which ranged from 0.8% to 1.41% during fiscal year 2004 (1.32% to 1.41% at June 30, 2004).	165,900	115,900
2003 Series II, JJ and KK dated May 30, 2003; comprised of auction rate bonds maturing December 2037; interest is reset every 35 days and payable semi-annually which ranged from 0.88% to 1.35% during fiscal year 2004 (1.27% to 1.35% at June 30, 2004).	150,000	150,000

(Dollars in Thousands)

8. Bonds and Notes Payable (Continued)

	2004	2003
2004 Series MM dated June 3, 2004; comprised of auction rate bonds maturing December 2038; interest is reset every 35 days and payable semi-annually; initial rates were 1.32%.	$ 74,700	$ –
2004 Series NN and PP dated June 3, 2004; comprised of auction rate bonds maturing December 2038; interest is reset every 35 days and payable semi-annually; initial rates were 1.32%.	134,500	–
2004 Series OO dated June 3, 2004; comprised of auction rate bonds maturing December 2038; interest is reset every 35 days and payable semi-annually; initial rates were 1.38%.	65,800	–
2003 General Obligation bond dated December 9, 2003, with a final maturity date of March 1, 2034, interest rates fixed ranging from 2.0% to 5.0% payable semi-annually.	22,155	–
Notes Payable:		
2002 Series A-XV, dated December 16, 2002, is due December 2003, and interest at 1.8% is paid semi-annually.	–	21,515
2003 Series A-XVI, dated June 16, 2003, is due December 2003, and interest at 1.35% is due at maturity.	–	4,370
2003 Series A-XVII, dated December 15, 2003, is due December 2004, and interest at 1.5% is due at maturity.	30,400	–
Total bonds and notes payable	1,552,105	1,331,685
Bond premium, net	–	508
Bond discount, net	(149)	–
Deferred loss on refunding, net	(1,562)	–
Total bonds and notes payable	1,550,394	1,332,193
Less current portion of bonds and notes payable	30,400	40,935
Noncurrent portion bonds and notes payable	$1,519,994	$1,291,258

8. Bonds and Notes Payable (Continued)

All bonds, except the 2003 General Obligation bonds, are limited obligations of VSAC and are secured, as provided in the 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 thereon and the guarantee thereof, including the insurance of certain student loans by DE. In addition, a significant portion of cash, cash equivalents and investments (including debt service reserve accounts which may be used to replenish any deficiency in funds required to pay principal and interest due on the bonds) are held in trust to secure the bonds, except the 2003 General Obligation bonds.

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-D, 1996 Series F-I, 1998 Series K-N, 2000 Series P-Q, 2000 Series R-U, 2001 Series V, W and Z, 2001 Series X, Y and AA, 2002 Series BB-DD, 2003 Series EE, 2003 Series FF-LL, 2003 Series II-KK, 2004 Series MM, 2004 Series NN-PP and 2004 Series OO bonds are secured for credit-worthiness by AMBAC Assurance Corporation. The 2003 and 2003 Series notes payable and the 1998 Series O bonds payable have no credit support.

All bonds, except the 2003 General Obligation bonds, are subject to redemption prior to maturity at the principal amounts outstanding plus accrued interest at date of redemption. At June 30, 2004, all bonds authorized under the underlying bond resolutions have been issued.

Proceeds from issuance of the bonds payable, except the 2003 General Obligation bonds, and all revenues thereon are held in trust and are restricted as follows: to repurchase bonds; finance student loans; pay interest on the bonds; maintain required reserves; and pay reasonable and necessary program expenses.

The 2003 General Obligation bonds are general obligation bonds payable from available revenues of VSAC. The bonds were issued for the purpose of financing the acquisition of land, construction, renovation, and equipment outfitting of a new corporate headquarters for VSAC.

(Dollars in Thousands)

8. Bonds and Notes Payable (Continued)

The debt service requirements, which are based on the interest rates at June 30, 2004, through 2010 and in five-year increments thereafter to maturity for VSAC, are as follows:

Year ending June 30,	Principal	Interest	Total
2005	$ 30,400	$ 23,548	$ 53,948
2006	57,675	22,830	80,505
2007	735	22,430	23,165
2008	41,655	22,178	63,833
2009	1,670	21,924	23,594
2010	795	21,888	22,683
2011 – 2015	117,660	105,923	223,583
2016 – 2020	52,840	96,595	149,435
2021 – 2025	3,630	95,484	99,114
2026 – 2030	100,635	88,143	188,778
2031 – 2035	342,160	78,580	420,740
2036 – 2040	802,250	27,097	829,347
Total	$1,552,105	$626,620	$2,178,725

The actual maturities and interest may differ due to changes in interest rates or other factors.

The following summarizes the debt activity for VSAC for the years ended June 30, 2004 and 2003:

	2004	2003
Balance at beginning of year	$1,332,193	$1,097,352
Issuance	380,856	449,285
Redemptions and refundings	(160,585)	(214,300)
Deferred loss on refunding	(1,562)	–
Amortization of premiums	(508)	(144)
Balance at end of year	$1,550,394	$1,332,193

8. Bonds and Notes Payable (Continued)

In June 2004, VSAC issued $275,000 in education loan revenue bonds, 2004 Series MM-PP. The primary purpose was to finance the origination of qualifying student loans. The bonds were also issued to refund certain 1993 and 1992 Series bonds, totaling $74,700 prior to June 30, 2004. The loss of $1,562 on the refunding, resulting from the difference between the reacquisition price and the net carrying amount of the old debt, was deferred. The deferred loss on refunding, reported in the Statements of Net Assets as a reduction from bonds payable, is being amortized over the life of the original bonds. The refunding reduced VSAC's debt service payments over the next 8.5 years by $23,889 which results in an economic gain of $17,536. The economic gain is calculated using the interest rates outstanding as of June 30, 2004. The interest rates on the refunding debt are variable and subject to change in the future. As interest rates rise, the amount of the economic gain will be reduced. VSAC completed the refunding to reduce its total debt service payments and to consolidate its credit enhancement providers.

Included in the above refunding was a $2,000 advance refunding. $2,000 of the proceeds from the 2004 Series bonds issuance was deposited into an irrevocable trust with the trustee to provide for all future debt service payments on certain bonds outstanding. As a result, $2,000 of bonds were considered to be defeased and the bonds payable and the amounts held in the trust have been removed from VSAC's Statement of Net Assets at June 30, 2004.

In May 2003, VSAC issued $310,900 in education loan revenue bonds, 2003 Series EE-KK. The primary purpose was to finance the origination of qualifying student loans. The bonds were also issued to refund certain 1993 and 1992 Series bonds, totaling $160,900. $120,900 of the 2003 Series EE-KK proceeds were used to refund certain 1993 and 1992 Series bonds prior to June 30, 2003. $40,000 of the proceeds of the 2003 Series EE-KK bonds were deposited into an irrevocable trust with the trustee to provide for all future debt service payments for the 1993 E Series bonds. As a result, the 1993 E Series of bonds are considered to be defeased and the bonds payable and the amounts held in trust have been removed from VSAC's Statement of Net Assets at June 30, 2003.

There was no early call premium paid on any of the refunded bonds in 2003. The deferred loss on refunding was immaterial to VSAC, as well as any economic gain. VSAC completed the refunding to further consolidate its credit enhancement providers.

9. Arbitrage Earnings Rebatable

The bonds issued by VSAC are subject to Internal Revenue Service regulations which limit the amount of income which may be earned on certain cash equivalents, investments and student loans acquired with bond proceeds. Any excess earnings are to be refunded to the Federal government. VSAC has estimated that there is an arbitrage liability at June 30, 2004 and 2003, of $8,604 and $13,007, respectively. VSAC has estimated the current portion to be $2,560 and $1,260 at June 30, 2004 and 2003, respectively.

10. Student Loan Interest and Special Allowance Revenues

DE 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.

DE 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 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 pre-determined 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 three-month Financial Commercial Paper, plus a pre-determined 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.

In 2004, as a result of a change in interpretation of DE regulations surrounding special allowance, VSAC made a reassignment of student loans that qualify for special allowance categories eligible for the 9.5% floor interest rate. This resulted in approximately $8,300 of additional special allowance billings in 2004 from the DE. This amount was collected in July of 2004. In September 2004, the DE issued a report indicating the adjustment appeared to be in compliance with current guidance and regulations.

11. 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, 2004 and 2003, amounted to $14,224 and $12,666, respectively; VSAC's total payroll was $14,652 and $13,191, respectively. Total contributions by VSAC amounted to $1,422 and $1,267 in 2004 and 2003, respectively, which represented 10% of the covered payroll.

(Dollars in Thousands)

12. Commitments Under Operating Lease

VSAC has two noncancelable operating leases for its office facilities, one that expires in fiscal year 2005 and the other in fiscal year 2006. Both leases provide for renewal options. Rental expense for the years ended June 30, 2004 and 2003, amounted to $686 and $676, respectively. Future minimum rental commitments under these noncancelable operating leases as of June 30, 2004, are as follows:

Year ending June 30,	
2005	$ 629
2006	181
	$ 810

13. 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 or settled claims resulting from these risks which have exceeded its commercial insurance coverage. In addition, 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 for the years ended June 30, 2004 and 2003, is as follows:

	2004	2003
Balance, beginning of year	$ 258	$ 136
Claims paid	(2,815)	(2,637)
Adjustment to reserve	2,794	2,759
Balance, end of year	$ 237	$ 258

14. Loan Commitments

At June 30, 2004 and 2003, VSAC had commitments to extend credit for student loans of approximately $15,932 and $31,000, respectively. Commitments to extend credit are agreements to lend to a borrower as long as there is no violation of any condition established in the commitment agreement. Commitments generally have fixed expiration dates or other termination clauses. VSAC uses the same credit policies in making commitments as it does for student loans receivable.