Vermont Student Assistance Corporation

(A Component Unit of the State of Vermont)

Basic Financial Statements and
Management's Discussion and Analysis

Years Ended June 30, 2003 and 2002

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

FINANCIAL STATEMENTS

Years Ended June 30, 2003 and 2002

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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 year ended June 30, 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 audit. The financial statements of Vermont Student Assistance Corporation for the year ended June 30, 2002, were audited by other auditors whose report, dated September 20, 2002, expressed an unqualified opinion on those 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 *Governmental 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 2003 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, 2003, and the changes in its financial position and its cash flows, for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Governmental Auditing Standards*, we have also issued our report dated September 26, 2003 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 through 6 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 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.

Portland, Maine
September 26, 2003

Limited Liability Company

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 Vermont 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.

VSAC's education loan programs are financed through issuance of limited obligation bonds and are guaranteed by VSAC as a guarantor and reinsured by the U.S. Department of Education through the Federal Family Education Loan Program (FFELP). VSAC also provides certain loan programs 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.

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 holds $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.

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 payments for the Corporation.

The statement of fiduciary net assets displays the funds where VSAC has custodial responsibilities for others.

The notes to the 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

	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 13%, 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.

<u>Expenses</u>

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 $1.1 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 $10.7 million in fiscal 2003, representing approximately 11.4% 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, 2003 and 2002

ASSETS

	2003	2002
	(In Thousands)	
Current assets:		
Cash and cash equivalents (notes 3, 8 and 9)	$ 261,668	$ 143,541
Investments (notes 3, 8 and 9)	10,870	23,987
Receivables:		
Student loans, net (notes 4, 8 and 9)	95,335	81,141
Student loan interest and special allowance (note 10)	23,489	24,895
Investment interest	278	203
Federal administrative and program fees	410	336
Other	800	560
Other assets	1,485	1,226
Total current assets	394,335	275,889
Noncurrent assets:		
Receivables:		
Student loans, net (notes 4, 8 and 9)	1,028,319	905,967
Capital assets (note 7)	2,864	2,790
Deferred bond issuance costs, net	6,428	5,206
Total noncurrent assets	1,037,611	913,963
Total assets	$1,431,946	$1,189,852

LIABILITIES AND NET ASSETS

	2003	2002
	(In Thousands)	
Current liabilities:		
Bonds and notes payable (notes 8 and 9)	$ 40,935	$ 54,300
Accounts payable and other liabilities	3,103	2,750
Deferred revenue	2,743	2,672
Accrued interest on bonds payable	1,211	1,104
Arbitrage earnings rebatable (note 9)	1,260	1,074
Total current liabilities	49,252	61,900
Noncurrent liabilities:		
Bonds and notes payable (notes 8 and 9)	1,291,258	1,043,052
Arbitrage earnings rebatable (note 9)	11,747	13,425
Total noncurrent liabilities	1,303,005	1,056,477
Total liabilities	1,352,257	1,118,377
Commitments and contingencies (notes 12, 13 and 14)		
Net assets:		
Invested in capital assets	2,864	2,790
Restricted:		
Bond resolution	48,288	41,267
Grants and scholarships	393	440
Unrestricted	28,144	26,978
Total net assets	79,689	71,475
Total liabilities and net assets	$1,431,946	$1,189,852

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, 2003 and 2002

	2003	2002
	(In Thousands)	
Operating revenues:		
U.S. Department of Education (note 10):		
Interest benefits	$ 9,019	$ 11,550
Special allowance	16,099	10,011
Interest on student loans	45,412	49,932
State appropriations	16,582	15,446
Interest on investments	2,568	5,234
Guarantee agency administrative revenues	4,973	4,254
Federal grants	2,550	2,367
Scholarship income	3,651	2,503
Other income	1,189	1,234
Total operating revenues	102,043	102,531
Operating expenses:		
Financing expenses – interest	20,043	25,412
Salaries and benefits (note 11)	18,483	17,082
State grants and scholarships	20,603	18,634
Interest rebated to borrowers	14,664	15,354
Other general and administrative	6,095	5,667
Other guarantee agency expenses	435	455
(Reduction in) excess arbitrage (note 9)	(1,181)	5,120
Credit enhancement and remarketing fees	4,385	4,116
Consolidation and lender paid fees	6,861	5,107
Other loan financing expense	151	86
Provision for losses on student loans (note 4)	1,062	685
Depreciation and amortization	1,332	1,554
Amortization of bond issuance costs	896	462
Total operating expenses	93,829	99,734
Excess of operating revenues over operating expenses	8,214	2,797
Net assets, beginning of year	71,475	68,678
Net assets, end of year	$ 79,689	$ 71,475

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, 2003 and 2002

	2003	2002
	(In Thousands)	
Cash flows from operating activities:		
Cash received from customers	$ 305,494	$ 236,042
Cash paid to suppliers for goods and services	(55,095)	(49,297)
Student loans originated	(406,839)	(323,864)
Cash paid to employees for services	(18,838)	(17,080)
Interest received on student loans	47,714	51,130
State appropriations received	16,582	15,446
Net cash used in operating activities	(110,982)	(87,623)
Cash flows from noncapital financing activities:		
Proceeds from sale of bonds/notes payable	449,285	25,380
Payments on bonds/notes payable	(214,300)	(25,380)
Interest paid to bond holders	(20,080)	(26,413)
Net cash provided by (used in) noncapital financing activities	214,905	(26,413)
Cash flows from capital and related financing activities:		
Acquisition of capital assets	(1,406)	(1,127)
Net cash used in capital and related financing activities	(1,406)	(1,127)
Cash flows from investing activities:		
Interest received on investments	2,493	5,393
Redemption/(purchase) of investments, net	13,117	(3,529)
Net cash provided by investing activities	15,610	1,864
Net increase (decrease) in cash and cash equivalents	118,127	(113,299)
Cash and cash equivalents, beginning of year	143,541	256,840
Cash and cash equivalents, end of year	$ 261,668	$ 143,541

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

STATEMENTS OF CASH FLOWS
(CONTINUED)

Years Ended June 30, 2003 and 2002

	2003	2002
	(In Thousands)	
Reconciliation of operating income to net cash used in operating activities:		
Excess of operating revenues over operating expenses	$ 8,214	$ 2,797
Adjustments to reconcile the excess of operating revenues over operating expenses to net cash used in operating activities:		
Depreciation and amortization	1,332	1,554
Provision for losses on student loans	1,062	685
Amortization of bond issuance costs	896	462
Amortization of bond premium	(144)	(129)
Investment interest received	(2,493)	(5,393)
Interest paid to bond holders	20,080	26,413
Changes in operating assets and liabilities:		
(Increase) decrease in investment interest receivable	(75)	159
Increase in student loans receivable	(137,608)	(118,742)
Decrease in student loans interest receivable	1,406	445
Increase in federal administrative and program fees receivable	(74)	(12)
Increase in other receivables	(240)	(121)
Increase in other assets	(259)	(58)
Increase in deferred bond issuance costs	(2,118)	(64)
Increase in accounts payable and other liabilities	353	414
Increase in deferred revenue	71	1,018
Increase (decrease) in accrued interest on bonds payable	107	(873)
(Decrease) increase in arbitrage earnings rebatable	(1,492)	3,822
Total adjustments	(119,196)	(90,420)
Net cash used in operating activities	$(110,982)	$ (87,623)

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, 2003 and 2002

	Federal Loan Reserve Fund	VHEIP	2003 Total	2002 Total
	(In Thousands)			
ASSETS HELD FOR OTHERS				
Cash and cash equivalents	$ 7,753	$ 147	$ 7,900	$ 9,015
Investments	–	18,428	18,428	10,729
Student loans receivable and accrued student loan interest	–	2,504	2,504	1,090
Investment interest receivable	6	75	81	40
Other assets	1,076	14	1,090	1,792
Total assets	$ 8,835	$ 21,168	$ 30,003	$ 22,666
LIABILITIES				
Accounts payable and other liabilities	$ 171	$ 37	$ 208	$ 446
Note payable	–	2,563	2,563	1,219
Federal advances	538	–	538	538
Amounts held on behalf of investors	–	18,568	18,568	10,815
Return of reserves due to U.S. Department of Education	552	–	552	2,146
Federal loan reserve funds held for U.S. Department of Education	7,574	–	7,574	7,502
Total liabilities	$ 8,835	$ 21,168	$ 30,003	$ 22,666

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 education loans are financed through the issuance of limited obligation bonds and the loans 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 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. During the in-school and grace periods, the U.S. Department of Education ("DE") pays interest on behalf of the guaranteed student loan borrower. When the repayment period begins, the borrower is responsible for interest payments. Interest on student loans is recognized as revenue in the period earned.

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, 2003 and 2002, 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 these potential losses. 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.

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 primarily consist of guaranteed investment contracts at June 30, 2003. At June 30, 2002, they consisted primarily of guaranteed investment contracts and short-term bonds. 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 approximates their fair values as VSAC can 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 is calculated using the straight-line method over the estimated useful lives of the assets. Capital asset acquisitions that equal or exceed $2,500 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.

Amortization of Bond Premiums

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

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, 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 2002 financial statements have been reclassified to conform to the current year presentation.

The most significant reclassifications include the Federal Loan Reserve Fund and the Vermont Higher Education Investment Plan Fund being reported as *Fiduciary Funds* in the Statement of Fiduciary Net Assets. At June 30, 2002, the assets and liabilities of these funds were included in VSAC's Statement of Net Assets. The change in 2003 was made to better reflect VSAC's fiduciary role over these Funds as VSAC acts in a custodial capacity for these Funds. The resources in these Funds cannot be used to support VSAC's operations. This reporting change did not result in any change to net assets as previously reported.

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, 2003 and 2002:

	2003		2002	
	Balance	Amount Insured or Collateralized	Balance	Amount Insured or Collateralized
Cash	$ 253	$ 100	$ 156	$ 102
Repurchase agreements	3,194	3,194	2,883	2,883
Money market accounts	258,221	See Below	140,502	See Below
	$261,668		$143,541	

At June 30, 2003 and 2002, 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, 2003, were $4,033 and the bank balances at June 30, 2002, were $3,444. The difference between the net bank balances and the amounts recorded on the financial statements is outstanding checks and deposits in transit. Additionally, $100 and $102 of the bank balances at June 30, 2003 and 2002, respectively, were covered by Federal depository insurance and $3,194 and $2,883, respectively, were collateralized by repurchase agreements for which the securities held are held by the bank's trustee in VSAC's name. The remainder of bank balances of $739 and $459 at June 30, 2003 and 2002, respectively, were uninsured and uncollateralized.

At June 30, 2003 and 2002, 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, 2003 and 2002:

	2003	2002
Guaranteed investment contracts – Category 3	$10,775	$18,892
Certificates of deposit – Category 1	95	95
Short-term bonds – Category 2	–	5,000
	$10,870	$23,987

The bank and book balances of investments at June 30, 2003 and 2002, 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 with annual interest rates ranging from 2.67% to 12.0% are insured by DE and the U.S. Department of Health and Human Services. 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, 2003 and 2002, are summarized as follows:

	2003	2002
Status:		
Interim status	$ 258,982	$224,140
Deferral status	195,002	171,958
Repayment status	670,749	591,614
Less: Allowance for loan losses	(1,079)	(604)
Total student loans receivable	1,123,654	987,108
Less: noncurrent student loans receivable	1,028,319	905,967
Current student loans receivable	$ 95,335	$ 81,141

(Dollars in Thousands)

4. Student Loans Receivable (Continued)

	2003	2002
Guarantee type:		
U.S. Department of Education	$1,058,858	$932,972
U.S. Department of Health and Human Services	20,277	20,621
Other – nonguaranteed	45,598	34,119
Less: Allowance for loan losses	(1,079)	(604)
Total student loans receivable	1,123,654	987,108
Less: noncurrent student loans receivable	1,028,319	905,967
Current student loans receivable	$ 95,335	$ 81,141

The student loans are pledged to the repayment of bonds.

Transactions in the allowance for loan losses for the years ended June 30, 2003 and 2002, were as follows:

	2003	2002
Balance July 1	$ 604	$ 340
Net loans charged off	(587)	(421)
Provision for losses on student loans	1,062	685
Balance June 30	$ 1,079	$ 604

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

Under the Higher Education Act Amendments of 1998, all liquid and nonliquid 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, 2003 and 2002, were as follows:

	2003	2002
Additions:		
Reimbursement from DE on default loan purchases	$11,411	$10,185
Default loan collections	40	22
Loan administrative fees	1,821	1,632
Investment income	88	187
Total additions	13,360	12,026
Deductions:		
Purchases of default loans from lenders	11,655	10,375
Default aversion fee	507	432
Other disbursements	1,126	89
Total deductions	13,288	10,896
Federal loan reserve funds held, at beginning of year	7,502	6,372
Federal loan reserve funds held, at end of year	$ 7,574	$ 7,502

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 Act Amendments of 1998 require VSAC to maintain reserves equal to .25% of student loans guaranteed. During 2003 and 2002, VSAC maintained sufficient reserves to fully comply with these requirements.

Total outstanding guarantees issued under the FFEL Program were $1,058,858 and $932,972 at June 30, 2003 and 2002, 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 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, 2003 and 2002, were as follows:

	2003	2002
Additions:		
Investment income	$ 327	$ 223
Net realized and unrealized gains (losses)	686	(950)
Student loan interest income	92	51
Net participant subscriptions/redemptions	6,674	7,149
Total additions	7,779	6,473
Deductions:		
Operational expenses	26	7
Total deductions	26	7
Assets held on behalf of investors, at beginning of year	10,815	4,349
Assets held on behalf of investors, at end of year	$18,568	$10,815

(Dollars in Thousands)

7. Capital Assets

A summary of capital assets activity for the years ended June 30, 2003 and 2002, were as follows:

	Estimated Lives	Balance July 1, 2001	Acquisitions	Balance June 30, 2002	Acquisitions	Disposals	Balance June 30, 2003
Furniture and equipment	3 – 5 Years	$ 3,928	$ 716	$ 4,644	$ 998	$ (2,982)	$2,660
Leasehold improvements	5 Years	929	–	929	–	(208)	721
Software	3 – 5 Years	4,285	135	4,420	64	(2,730)	1,754
Construction in process		10	276	286	344	–	630
		9,152	1,127	10,279	1,406	(5,920)	5,765
Less accumulated depreciation		5,935	1,554	7,489	1,332	(5,920)	2,901
Capital assets, net		$ 3,217	$ (427)	$ 2,790	$ 74	$ –	$2,864

Depreciation charged to operations for the years ended June 30, 2003 and 2002, was $1,332 and $1,554, respectively.

8. Bonds and Notes Payable

VSAC has issued the following bonds and notes payable at June 30, 2003 and 2002, which were issued to finance the origination of student loans:

	2003	2002
Bonds Payable:		
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 1.1% to 1.8% during fiscal year 2003 (1.15% at June 30, 2003).	$ 40,900	$ 40,900
1992 Series A-2 and A-3, dated June 15, 1992. Series A-2 bonds were comprised of auction rate bonds that were advance refunded by the 2003 Series EE bonds in 2003; interest was paid every 35 days at rates that ranged from 1.1% to 1.7% during fiscal 2003. 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%.	17,165	48,270

(Dollars in Thousands)

8. Bonds and Notes Payable (Continued)

	2003	2002
1992 Series B and C, 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%. Series C bonds were advance refunded in 2003, by the 2003 Series FF bonds; interest was paid every 35 days at rates which ranged from 1.118% to 1.6% during fiscal year 2003.	$ 24,085	$ 50,000
1993 Series D and E, 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%; interest on Series E bonds is paid every 35 days at rates which ranged from 1.1% to 1.68% during fiscal year 2003. The Series E bonds were advance refunded in 2003.	40,000	80,000
1993 Series F, G, H, I and J dated September 27, 1993. The Series F and G bonds were advance refunded in 2003, by the 2003 Series HH bonds, and the Series J bonds were refunded in 2003, by the 2003 Series EE bonds. Interest was reset every 35 days and payable semi-annually at rates which ranged from 1.1% to 1.75% during fiscal year 2003. 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 0.98% to 1.75% during fiscal year 2003 (0.98% at June 30, 2003).	50,000	122,500
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 1.03% to 1.7% during fiscal year 2003 (1.03% to 1.11% at June 30, 2003).	96,000	96,000
1995 Series E, dated October 17, 1995; comprised of auction rate bonds which matured December 2002; interest was reset every 35 days and payable semi-annually at rates which ranged from 1.25% to 1.7% during fiscal year 2003.	–	5,300
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 0.95% to 1.75% during fiscal year 2003 (0.95% to 1.15% at June 30, 2003).	100,000	100,000

(Dollars in Thousands)

8. Bonds and Notes Payable (Continued)

	2003	2002
1996 Series J, dated October 23, 1996; comprised of auction rate bonds which matured December 2002; interest was reset every 35 days and payable semi-annually at rates which ranged from 1.4% to 1.5% during fiscal year 2003.	$ –	$ 3,100
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 1.0% to 1.7% during fiscal year 2003 (1.0% to 1.10% at June 30, 2003).	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 1.05% to 1.65% during fiscal year 2003 (1.05% at June 30, 2003).	11,950	22,950
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 0.94% to 1.8% during fiscal year 2003 (0.94% to 1.12% at June 30, 2003).	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 0.603% to 1.75% during fiscal year 2003 (1.0% to 1.13% at June 30, 2003).	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 1.02% to 1.96% during fiscal year 2003 (1.02% to 1.34% at June 30, 2003).	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 0.99% to 1.75% during fiscal year 2003 (0.99% to 1.05% at June 30, 2003).	112,500	–

(Dollars in Thousands)

8. Bonds and Notes Payable (Continued)

	2003	2002
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; initial rate was 1.15%.	$ 45,000	$ –
2003 Series FF, GG and HH 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; initial rates were 1.15%.	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; initial rates were 1.15%.	150,000	–
Notes Payable:		
2001 Series A-XIII, dated December 15, 2001, matured December 2002. Interest at 2.25%, was paid June 15, 2002 and at maturity.	–	8,520
2002 Series A-XIV, dated June 15, 2002, matured December 2002. Interest at 1.95% was paid at maturity.	–	16,860
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	–
Total bonds and notes payable	1,331,685	1,096,700
Plus: premium	508	652
Total bonds and notes payable	1,332,193	1,097,352
Less current portion of bonds and notes payable	40,935	54,300
Noncurrent portion bonds and notes payable	$1,291,258	$1,043,052

(Dollars in Thousands)

8. Bonds and Notes Payable (Continued)

All 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.

The 1985 Series A bonds are secured for credit-worthiness and liquidity by an irrevocable letter of credit issued by State Street Bank. The 1992 Series A-3, 1992 Series B, 1993 Series D and E, and 1993 Series H and I bonds are secured for credit-worthiness by Financial Security Assurance Corporation. The 1995 Series A-D and E, 1996 Series F-I and J, 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-HH and 2003 Series II-KK bonds are secured for credit-worthiness by AMBAC Assurance Corporation. The 2003 and 2002 Series notes payable and the 1998 Series O bonds payable have no credit support.

All bonds are subject to redemption prior to maturity at the principal amounts outstanding plus accrued interest at date of redemption. At June 30, 2003, all bonds authorized under the underlying bond resolutions have been issued, except the $50,000 2003 Series LL, which was issued in September 2003.

Proceeds from issuance of the bonds payable 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 debt service requirements, which are based on the interest rates at June 30, 2003, through 2010 and in five-year increments thereafter to maturity for VSAC, are as follows:

Year ending June 30,	Principal	Interest	Total
2004	$ 40,935	$ 18,075	$ 59,010
2005	14,860	16,978	31,838
2006	70,175	15,714	85,889
2007	7,920	14,798	22,718
2008	48,200	14,119	62,319
2009	7,575	13,458	21,033
2010	5,890	13,046	18,936
2011 – 2015	125,330	59,074	184,404
2016 – 2020	50,000	51,747	101,747
2021 – 2025	–	51,523	51,523
2026 – 2030	96,000	46,835	142,835
2031 – 2035	337,550	40,949	378,499
2036 – 2040	527,250	9,187	536,437
Total	$ 1,331,685	$ 365,503	$ 1,697,188

(Dollars in Thousands)

8. Bonds and Notes Payable (Continued)

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, 2003 and 2002:

	2003	2002
Balance at beginning of year	$1,097,352	$1,097,481
Issuance	449,285	25,380
Redemptions and refundings	(214,300)	(25,380)
Amortization of premiums	(144)	(129)
Balance at end of year	$1,332,193	$1,097,352

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 advance refund certain 1993 and 1992 Series bonds, totaling $160,900. $120,900 of the 2003 Series EE-KK proceeds were use to advance 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. The deferred loss on refunding was immaterial to VSAC, as well as any economic gain. VSAC completed the advance 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, 2003 and 2002, of $13,007 and $14,499, respectively. VSAC has estimated the current portion to be $1,260 and $1,074 at June 30, 2003 and 2002, 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.

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, 2003 and 2002, amounted to $12,666 and $12,379, respectively; VSAC's total payroll was $13,191 and $12,611, respectively. Total contributions by VSAC amounted to $1,267 and $1,238 in 2003 and 2002, 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 that expire in 2005. Both leases provide for renewal options. Rental expense for the years ended June 30, 2003 and 2002, amounted to $676 and $650, respectively. Future minimum rental commitments under these noncancelable operating leases as of June 30, 2003, are as follows:

Year ending June 30,	
2004	$ 654
2005	299
	$ 953

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, 2003 and 2002, is as follows:

	2003	2002
Balance, beginning of year	$ 136	$ 144
Claims paid	(2,637)	(2,097)
Adjustment to reserve	2,759	2,089
Balance, end of year	$ 258	$ 136

14. Loan Commitments

At June 30, 2003, VSAC had commitments to extend credit for student loans of approximately $31,000. 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.

15. Subsequent Event

In September of 2003, VSAC issued 2003 Series LL auction rate bonds, in the amount of $50,000.