

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, 2006 and 2005

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, 2006 and 2005

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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 years ended June 30, 2006 and 2005, 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, 2006 and 2005, 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 15, 2006, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing and not to provide an opinion on the internal control on financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards*, and should be considered in assessing the results of our audit.

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 accounting principles generally accepted in the United States of America. We have applied certain limited procedures to the 2006 and 2005 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.



Limited Liability Company

Portland, Maine
September 15, 2006

VERMONT STUDENT ASSISTANCE CORPORATION

(A Component Unit of the State of Vermont)

MANAGEMENT'S DISCUSSION AND ANALYSIS

Years ended June 30, 2006 and 2005

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, 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 110 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/or reinsured by the U.S. Department of Education through the Federal Family Education Loan Program (FFELP). 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, and general corporate support.

Management's Discussion and Analysis Report includes Fiscal 2006 and Fiscal 2005 information due to the fact that the Financial Statements include Fiscal 2006 and Fiscal 2005 information.

FISCAL 2006

Fiscal 2006 Highlights and Overall Financial Position

During the year ended June 30, 2006, VSAC provided over \$22.8 million in grants and scholarships to Vermont students.

VSAC originated over \$742.5 million in student loans, including new loans to students and parents and consolidation of existing loans. VSAC holds \$1.63 billion in education loans receivable at June 30, 2006.

VSAC returned over \$6.5 million in interest and principal rebates to students in its loan programs during fiscal 2006, and paid over \$600 thousand in fees on behalf of our borrowers.

VSAC's total net assets increased \$15 million to \$122.8 million.

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 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

Statements of Net Assets

	<u>2006</u>	<u>2005</u>
	<i>(in thousands)</i>	
Assets		
Cash and investments	\$ 152,208	\$ 399,072
Education loans receivable (plus interest)	1,670,870	1,473,076
Other assets	<u>35,857</u>	<u>27,873</u>
Total assets	<u>\$1,858,935</u>	<u>\$1,900,021</u>
Liabilities		
Bonds payable (plus interest)	\$1,705,825	\$1,762,638
Arbitrage earnings rebatable	23,525	20,083
Other liabilities	<u>6,737</u>	<u>9,456</u>
Total liabilities	1,736,087	1,792,177
Net Assets		
Restricted	69,951	54,736
Unrestricted	50,786	50,731
Net investment in property and equipment	<u>2,111</u>	<u>2,377</u>
Total net assets	<u>122,848</u>	<u>107,844</u>
Total liabilities and net assets	<u>\$1,858,935</u>	<u>\$1,900,021</u>

Statements of Revenues and Expenses

	<u>2006</u>	<u>2005</u>
	<i>(in thousands)</i>	
Revenues		
Interest earned from education loan financing	\$127,519	\$102,018
Other loan and guarantee program revenues	5,155	4,422
Investment interest	9,414	4,472
Vermont state appropriations	18,746	17,143
Federal grants	3,841	3,425
Scholarship and gift revenue	4,126	3,986
Other revenue	<u>1,087</u>	<u>791</u>
Total operating revenues	169,888	136,257
Expenses		
Student aid	23,429	20,828
Interest rebated to borrowers	6,561	7,567
Interest on debt	56,371	32,317
Other loan financing costs	35,538	39,066
Corporate operating expenses and depreciation	<u>32,985</u>	<u>30,305</u>
Total expenses	<u>154,884</u>	<u>130,083</u>
Excess of revenues over expenses	15,004	6,174
Total net assets at the beginning of the year	<u>107,844</u>	<u>101,670</u>
Total net assets at the end of the year	<u>\$122,848</u>	<u>\$107,844</u>

Net Assets

Cash and investment balances decreased from June 30, 2005 to 2006 from \$399.0 to \$152.2 million. Bonds for fiscal 2007 loan originations were not issued until July 2006. The bonds for fiscal 2006 originations had been issued in June 2005.

Student loans and interest receivable totaled \$1.6 billion at June 30, 2006, up from \$1.4 billion in 2005.

U.S. Treasury arbitrage payable is described in the expense discussion. This liability increased as of June 30, 2006, to \$23.5 million, or approximately 0.3% of total assets.

Unrestricted net assets increased from \$50.7 million in 2005 to \$50.8 million in 2006. The unrestricted funds are used to finance student loans and for corporate working capital. Unrestricted net assets invested in student loans totaled \$42.1 million at June 30, 2006.

Property, plant and equipment increased to \$23.4 million as of June 30, 2006, with the completion of VSAC's new headquarters in Winooski. The net investment in plant, taking into account bonds payable for the construction of the building, was \$2.1 million at June 30, 2006, a reduction of \$266 thousand dollars from June 30, 2005.

Restricted net assets increased from \$54.7 million to \$70.0 million at June 30, 2006. \$66.6 million were restricted by bond resolutions, an increase in equity within the bond estates of \$13.9 million. The remaining \$3.4 million is restricted for scholarships and grants, and for programs to encourage students to pursue higher education.

Revenues

VSAC's fiscal 2006 operations resulted in an increase in net assets of \$15.0 million. All revenues for 2006 are considered operating revenues. VSAC realized \$169.9 million in revenues versus \$154.9 million in total expenses. VSAC's revenues include interest income on student loans, as well as various federal interest subsidies and special allowance payments.

Overall loan revenue to VSAC is closely related to the general interest rate environment. During 2006, interest revenue and subsidies increased from \$102.0 to \$127.5 million. Interest for certain loans is paid by the U.S. Department of Education as a subsidy to qualifying borrowers. This interest subsidy represented \$11.8 million in 2006. VSAC also receives special allowance payments under certain interest rate conditions. Increasing interest rates, and loan portfolio growth during 2006, resulted in an increase in special allowance payments from \$40.9 million in 2005 to \$45.4 million in 2006.

Interest rate risk on student loan assets is managed by closely matching the coupon rate reset frequency of our debt instruments with rates that drive our loan returns. Our outstanding bond rates are reset on 7, 28 and 35 day intervals. Rates on student loans are reset each quarter and are based on short term commercial paper or LIBOR rates. Thus, the net spread on loans carries minimal interest rate risk.

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 \$5.2 million in 2006 and \$4.4 million 2005.

Rising interest rates resulted in increasing 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 increased from \$4.5 million to \$9.4 million, as interest rates increased and our total invested funds increased. The increase in invested funds is related to the timing of student loan bond issues.

VSAC's regular appropriation increased from \$17.1 million to \$17.7 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. In fiscal 2006, VSAC received an additional \$1.0 million supplemental appropriation to invest in programs and other initiatives that encourage Vermont K-12 students to pursue educational opportunities beyond high school. The funds will be expended in future years, and are considered restricted net assets at June 30, 2006.

Federal grants increased from \$3.4 million to \$3.8 million in fiscal 2006.

Scholarship revenues, principally restricted gifts and grants, increased from \$4.0 million in 2005 to \$4.1 million in 2006.

Expenses

VSAC has four main types of expenses: 1. Student aid, 2. Interest and other costs of debt, 3. Non-interest costs of financing loans, and 4. Costs of operations.

Student Aid – VSAC provided Vermont students with \$23.4 million in student aid during fiscal 2006. \$17.7 million in grant aid was provided from State appropriations. An additional \$4.1 million was made available through various scholarship programs managed by VSAC. Direct aid in the form of grants and scholarships represented 14.7% of VSAC’s operating expenses. Beginning in fiscal 2006, VSAC paid origination and guarantee fees on behalf of Stafford loan borrowers to the Department of Education. In 2006, the total fees paid were \$600 thousand.

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 \$6.6 million in rebates of interest to borrowers in fiscal 2006. VSAC has not been able to provide the level of borrower benefits on consolidation loans that it has on other underlying FFELP loans, since VSAC is required to pay a 1.05% annual fee to the Department of Education on consolidated loans. The decrease in interest rebated to borrowers from 2005 to 2006 is primarily the result of the continuing shift from Stafford and PLUS loans to consolidation loans in our portfolio. These rebates represent 4.2% of VSAC’s fiscal 2006 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 \$742.5 million of loans VSAC made available to students and parents in fiscal 2006.

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 all bonds issued to finance loans are variable rate securities, interest costs vary from year to year as the general interest rate environment changes. The variable nature of these securities matches the variable rate structure of most of our loans, so revenues and expenses related to the bonds are highly correlated.

With the increase in interest rates from fiscal 2005 to 2006, VSAC interest costs rose from \$32.3 to \$56.4 million. This represented 36.4% of VSAC operating expenses in fiscal 2006.

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, provisions for changes in arbitrage earnings liability to the U.S. Treasury, and increases in VSAC’s provision for uninsured loan losses, as well as a variety of other costs incurred in issuing and managing over \$1.7 billion in outstanding bonds and notes. These costs totaled \$36.2 million in fiscal 2006, representing approximately 22.9% 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 fiscal 2006, VSAC’s provision for losses on student loans was \$10.7 million compared to \$11.6 million in fiscal 2005. In fiscal 2005, VSAC commissioned a study to gather historical default information from other lenders or servicers of non-guaranteed loans, and utilized both VSAC and industry experience to more accurately estimate expected default performance over the entire economic life of loans in our portfolio.

Costs of Operations – The costs of operating VSAC’s programs, as well as facilities and overhead costs totaled \$33.0 million in fiscal 2006, an increase of approximately 6.7% from fiscal 2005. Salaries and benefits were \$23.6 million in fiscal 2006, approximately 73% of costs of operations. Overall costs of operations represent 20.9% of total operating expenses.

Total expenses for 2006 totaled \$154.9 million. Revenues totaled \$169.9 million. The excess of revenues over expenses was \$15.0 million. The change in total net assets for the year was an increase of \$15.0 million. The ending balance of net assets was \$122.8 million, as compared to \$107.8 million at June 30, 2005.

FISCAL 2005

Fiscal 2005 Highlights and Overall Financial Position

During the year ended June 30, 2005 VSAC provided over \$20.8 million in grants and scholarships to Vermont students.

VSAC originated over \$488.2 million in student loans, including new loans to students and parents and consolidation of existing loans. VSAC holds \$1.4 billion in education loans receivable at June 30, 2005.

VSAC returned over \$7.5 million in interest and principal rebates to students in its loan programs during fiscal 2005.

VSAC's total net assets increased \$6.2 million to \$107.8 million.

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.

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Condensed Financial Information

Statements of Net Assets

	<u>2005</u>	<u>2004</u>
	<i>(in thousands)</i>	
Assets		
Cash and investments	\$ 399,072	\$ 341,371
Education loans receivable (plus interest)	1,473,076	1,310,175
Other assets	<u>27,873</u>	<u>16,843</u>
Total assets	<u>\$1,900,021</u>	<u>\$1,668,389</u>
Liabilities		
Bonds and notes payable (plus interest)	\$1,762,638	\$1,551,701
U.S. Treasury arbitrage payable	20,083	8,604
Other liabilities	<u>9,456</u>	<u>6,414</u>
Total liabilities	1,792,177	1,566,719
Net Assets		
Restricted	54,736	48,829
Unrestricted	50,731	50,392
Net investment in property and equipment	<u>2,377</u>	<u>2,449</u>
Total net assets	<u>107,844</u>	<u>101,670</u>
Total liabilities and net assets	<u>\$1,900,021</u>	<u>\$1,668,389</u>

Statements of Revenues and Expenses

	<u>2005</u>	<u>2004</u>
	<i>(in thousands)</i>	
Revenues		
Interest and fees earned from education loan financing	\$102,018	\$ 84,539
Other loan and guarantee program revenues	4,422	4,948
Investment interest	4,472	2,058
Vermont state appropriations	17,143	16,684
Federal grants	3,425	4,347
Scholarship and gift revenue	3,986	3,186
Other revenue	<u>791</u>	<u>552</u>
Total operating revenues	136,257	116,314
Expenses		
Student aid	20,828	21,609
Interest rebated to borrowers	7,567	13,309
Interest on debt	32,317	17,937
Other loan financing costs	39,066	13,095
Corporate operating expenses and depreciation	<u>30,305</u>	<u>28,383</u>
Total expenses	<u>130,083</u>	<u>94,333</u>
Excess of revenue over expenses	6,174	21,981
Total net assets at the beginning of the year	<u>101,670</u>	<u>79,689</u>
Total net assets at the end of the year	<u>\$107,844</u>	<u>\$101,670</u>

Net Assets

Cash balances increased from June 30, 2004 to 2005 from \$341.4 to \$399.0 million as a result of fiscal 2005 bond proceeds not fully utilized for loan originations at June 30, 2005. Combined cash and investments were \$399.0 million at year end.

Student loans and interest receivable totaled \$1.4 billion at June 30, 2005, up from \$1.3 billion in 2004.

U.S. Treasury arbitrage payable is described in the expense discussion. This liability increased as of June 30, 2005, to \$20.1 million, or approximately 1.0% of total assets.

Unrestricted net assets increased from \$50.4 million in 2004 to \$50.7 million in 2005 resulting from available equity from bonds either maturing or refunded. The unrestricted funds are used to finance student loans, funds used for corporate working capital and investments in property, plant and equipment. Unrestricted net assets invested in student loans totaled \$40.0 million at June 30, 2005.

Property, plant and equipment increased during the fiscal year, as new acquisitions of \$11.7 million exceeded depreciation expense of \$1.5 million. Construction costs of VSAC's new building accounted for \$10.3 million of the acquisitions.

Revenues

VSAC's fiscal 2005 operations resulted in an increase in net assets of \$6.2 million. All revenues for 2005 are considered operating revenues. VSAC realized \$136.3 million in revenues versus \$130.1 million in total expenses. VSAC's revenues include interest income on student loans, as well as various federal interest subsidies and special allowance payments.

Overall loan revenue to VSAC is closely related to the general interest rate environment. During 2005, interest revenue and subsidies increased from \$84.5 to \$102.0 million. Interest for certain loans is paid by the U.S. Department of Education as a subsidy to qualifying borrowers. This interest subsidy represented \$8.7 million in 2005. VSAC also receives special allowance payments under certain interest rate conditions. Increasing interest rates, and loan portfolio growth during 2005, resulted in an increase in special allowance payments from \$29.4 million in 2004 to \$40.9 million in 2005.

Other revenues associated with the loan and loan guarantee programs include consolidation fees, default aversion fees, collections revenues, and other program fees and revenues. These fees and revenues totaled \$4.4 million in 2005 and \$4.9 million in 2004.

Rising interest rates resulted in increasing 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 increased from \$2.1 million to \$4.5 million, as interest rates increased. These cash investments are related to timing of student loan bond issues.

VSAC's appropriation increased slightly from \$16.7 million to \$17.1 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 decreased from \$4.3 million to \$3.4 million in fiscal 2005. A one-time award of approximately \$1.0 million was received in fiscal 2004.

Scholarship revenues increased from \$3.2 million in 2004 to \$3.9 million for 2005.

Expenses

VSAC has four main types of expenses: 1. Student aid, 2. Interest and other costs of debt, 3. Non-interest costs of financing loans, and 4. Costs of operations.

Student Aid – VSAC provided Vermont students with \$20.8 million in student aid during fiscal 2005, \$17.1 million was provided from State appropriations. An additional \$4.7 million was made available through various scholarship programs managed by VSAC. Direct aid in the form of grants and scholarships represented 16.0% 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 \$7.6 million in rebates of interest to borrowers in fiscal 2005. VSAC has not been able to provide the level of borrower benefits on consolidation loans that it has on underlying FFELP loans, since VSAC is required to pay a 1.05% annual fee to the Department of Education on consolidated loans. The decrease in interest rebated to borrowers from 2004 to 2005 is primarily the result of the tremendous shift from Stafford and PLUS loans to consolidation loans in our portfolio. These rebates represent 5.8% of VSAC's fiscal 2005 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 \$488.2 million of loans VSAC made available to students and parents in fiscal 2005.

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 loans, so revenues and expenses related to the bonds are highly correlated.

With the increase in interest rates from fiscal 2004 to 2005, VSAC interest costs rose from \$17.9 to \$32.3 million. Overall indebtedness increased from \$1.5 to \$1.8 billion. This represented 24.8% of VSAC operating expenses in fiscal 2005.

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, provisions for changes in arbitrage earnings liability to the U.S. Treasury, and increases in VSAC's provision for uninsured loan losses, as well as a variety of other costs incurred in issuing and managing over \$1.8 billion in outstanding bonds and notes. These costs totaled \$39.0 million in fiscal 2005, representing approximately 30.8% 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 fiscal 2005, VSAC's provision for losses on student loans increased \$10.3 million over the previous year due to a revised methodology to determine its allowance for loan loss. VSAC commissioned a study to gather historical default information from other lenders or servicers of non-guaranteed loans, and utilized both VSAC and industry experience to more accurately estimate expected default performance over the entire economic life of loans in our portfolio.

Costs of Operations – The costs of operating VSAC's programs, as well as facilities and overhead costs totaled \$30.3 million in fiscal 2005, an increase of approximately 6.8% from fiscal 2004. Salaries and benefits were \$21.5 million in fiscal 2005, approximately 71% of costs of operations. Overall costs of operations represent 23.3% of total operating expenses.

Total expenses for 2005 totaled \$130.1 million. Revenues totaled \$136.3. The excess of revenues over expenses was \$6.2 million. The change in total net assets for the year was an increase of \$6.2 million. The ending balance of net assets was \$107.8 million, as compared to \$101.6 million at June 30, 2004.

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

STATEMENTS OF NET ASSETS

June 30, 2006 and 2005

ASSETS

	<u>2006</u>	<u>2005</u>
	(In Thousands)	
Current assets:		
Cash and cash equivalents (notes 3, 8 and 9)	\$ 151,041	\$ 398,557
Investments (note 3)	1,167	515
Receivables:		
Student loans, net (notes 4, 5, 8 and 9)	117,298	108,329
Student loan interest and special allowance (note 10)	41,736	32,276
Investment interest	572	577
Federal administrative and program fees	109	253
Other	2,211	727
Other assets	<u>1,572</u>	<u>1,382</u>
Total current assets	315,706	542,616
Noncurrent assets:		
Receivables:		
Student loans, net (notes 4, 5, 8 and 9)	1,511,836	1,332,471
Capital assets, net (note 7)	23,402	16,598
Deferred bond issuance costs, net	<u>7,991</u>	<u>8,336</u>
Total noncurrent assets	1,543,229	1,357,405
Total assets	<u>\$1,858,935</u>	<u>\$1,900,021</u>

LIABILITIES AND NET ASSETS

	<u>2006</u>	<u>2005</u>
	(In Thousands)	
Current liabilities:		
Bonds payable (notes 8 and 9)	\$ 735	\$ 57,675
Accounts payable and other liabilities (note 14)	4,651	6,915
Deferred revenue	2,086	2,541
Accrued interest on bonds payable	3,120	2,459
U.S. Treasury rebates payable (note 9)	<u>233</u>	<u>253</u>
Total current liabilities	10,825	69,843
Noncurrent liabilities:		
Bonds payable (notes 8 and 9)	1,701,970	1,702,504
U.S. Treasury rebates payable (note 9)	<u>23,292</u>	<u>19,830</u>
Total noncurrent liabilities	<u>1,725,262</u>	<u>1,722,334</u>
Total liabilities	1,736,087	1,792,177
Commitments and contingencies (notes 14 and 15)		
Net assets:		
Invested in capital assets, net of related debt	2,111	2,377
Restricted (notes 11 and 12)	69,951	54,736
Unrestricted	<u>50,786</u>	<u>50,731</u>
Total net assets	<u>122,848</u>	<u>107,844</u>
Total liabilities and net assets	<u>\$1,858,935</u>	<u>\$1,900,021</u>

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, 2006 and 2005

	<u>2006</u>	<u>2005</u>
	(In Thousands)	
Operating revenues:		
U.S. Department of Education (note 10):		
Interest benefits	\$ 11,764	\$ 8,667
Special allowance	45,427	40,931
Interest and fees on student loans	70,328	52,420
Vermont state appropriations	18,746	17,143
Interest on cash and investments	9,414	4,472
Guarantee agency administrative revenues	5,155	4,422
Federal grants	3,841	3,425
Scholarship and gift income	4,126	3,986
Other income	<u>1,087</u>	<u>791</u>
Total operating revenues	169,888	136,257
Operating expenses:		
Interest, net of amortization	56,371	32,317
Salaries and benefits (note 13)	23,578	21,516
Grants and scholarships	22,808	20,828
Interest rebated to borrowers	6,561	7,567
Other general and administrative	7,868	7,324
Interest subject to U.S. Treasury rebate (note 9)	4,791	11,529
Credit enhancement and remarketing fees	6,292	5,677
Consolidation and lender paid fees	13,534	9,578
Other loan related expenses	535	284
Provision for losses on student loans (note 4)	10,655	11,640
Depreciation and amortization (note 7)	1,539	1,467
Amortization of bond issuance costs	<u>352</u>	<u>356</u>
Total operating expenses	<u>154,884</u>	<u>130,083</u>
Excess of operating revenues over operating expenses	15,004	6,174
Net assets, beginning of year	<u>107,844</u>	<u>101,670</u>
Net assets, end of year	<u>\$122,848</u>	<u>\$107,844</u>

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, 2006 and 2005

	<u>2006</u>	<u>2005</u>
	(In Thousands)	
Cash flows from operating activities:		
Cash received from customers, donors and governments	\$ 67,606	\$ 66,646
Principal payments received on student loans	551,007	316,109
Cash paid to suppliers for goods and services	(35,985)	(30,580)
Grants and scholarship disbursements	(23,210)	(21,432)
Loans made and purchased	(752,277)	(494,359)
Cash paid to employees for salaries and benefits	(23,567)	(21,504)
Interest and fees received on student loans	65,378	52,191
Vermont state appropriations received	<u>18,746</u>	<u>17,143</u>
Net cash used in operating activities	(132,302)	(115,786)
Cash flows from noncapital financing activities:		
Proceeds from the sale of bonds/notes payable	-	270,385
Payments on bonds/notes payable	(56,950)	(60,800)
Interest paid to bond holders	<u>(54,733)</u>	<u>(30,124)</u>
Net cash (used) provided by noncapital financing activities	(111,683)	179,461
Cash flows from capital and related financing activities:		
Payments on bonds payable	(725)	-
Interest paid to bond holders	(776)	(841)
Acquisition and construction of fixed assets	<u>(10,821)</u>	<u>(9,294)</u>
Net cash used by capital and related financing activities	(12,322)	(10,135)
Cash flows from investing activities:		
Interest received on cash and investments	9,419	4,113
Purchase of investments	<u>(628)</u>	<u>(467)</u>
Net cash provided by investing activities	<u>8,791</u>	<u>3,646</u>
Net (decrease) increase in cash and cash equivalents	(247,516)	57,186
Cash and cash equivalents, beginning of year	<u>398,557</u>	<u>341,371</u>
Cash and cash equivalents, end of year	<u>\$ 151,041</u>	<u>\$ 398,557</u>

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

STATEMENTS OF CASH FLOWS
(CONTINUED)

Years Ended June 30, 2006 and 2005

	<u>2006</u>	<u>2005</u>
	(In Thousands)	
Reconciliation of operating income to net cash used in operating activities:		
Excess of operating revenues over operating expenses	\$ 15,004	\$ 6,174
Adjustments to reconcile the excess of operating revenues over operating expenses to net cash used in operating activities:		
Depreciation and amortization	1,539	1,467
Provision for losses on student loans	10,655	11,640
Amortization of alternative fees received	(889)	(466)
Amortization of bond issuance costs	352	356
Accretion of bond discount	201	200
Unrealized gain on investments	(24)	(48)
Losses on disposal of fixed assets	12	19
Investment interest received	(9,419)	(4,113)
Interest paid to bond holders	55,509	30,964
Changes in operating assets and liabilities:		
Decrease (increase) in investment interest receivable	5	(359)
Increase in student loans receivable	(198,100)	(175,740)
(Increase) decrease in student loans interest receivable	(9,460)	1,665
Decrease in federal administrative and program fees receivable	144	193
(Increase) decrease in other receivables	(1,484)	346
(Increase) decrease in other assets	(190)	7
Increase in deferred bond issuance costs	(7)	(1,298)
Increase in accounts payable and other liabilities	202	1,332
Decrease in deferred revenue	(455)	(756)
Increase in accrued interest on bonds payable	661	1,152
Decrease in U.S. Treasury rebates payable	<u>3,442</u>	<u>11,479</u>
 Total adjustments	 <u>(147,306)</u>	 <u>(121,960)</u>
 Net cash used in operating activities	 <u>\$ (132,302)</u>	 <u>\$ (115,786)</u>

Supplemental disclosure of noncash activity:

At June 30, 2005, approximately \$2,466 of building construction costs were included in accounts payable.

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, 2006 and 2005

	Federal Loan Reserve <u>Fund</u>	<u>VHEIP</u>	2006 <u>Total</u>	2005 <u>Total</u>
	(In Thousands)			
<u>ASSETS HELD FOR OTHERS</u>				
Cash and cash equivalents	\$ 9,158	\$ 1,160	\$10,318	\$ 9,068
Investments (note 6)	–	52,564	52,564	40,446
Student loans receivable and accrued student loan interest	–	3,814	3,814	3,533
Investment interest receivable	35	14	49	27
Due from U.S. Department of Education	1,878	–	1,878	2,716
Other assets	<u>95</u>	<u>120</u>	<u>215</u>	<u>79</u>
Total assets	<u>\$11,166</u>	<u>\$57,672</u>	<u>\$68,838</u>	<u>\$55,869</u>
<u>LIABILITIES</u>				
Accounts payable and other liabilities	\$ 560	\$ 75	\$ 635	\$ 1,038
Note payable	–	4,338	4,338	3,504
Federal advances	538	–	538	538
Amounts held on behalf of investors (note 6)	–	53,259	53,259	40,858
Return of reserves due to U.S. Department of Education	552	–	552	552
Federal loan reserve funds held for U.S. Department of Education (note 5)	<u>9,516</u>	<u>–</u>	<u>9,516</u>	<u>9,379</u>
Total liabilities	<u>\$11,166</u>	<u>\$57,672</u>	<u>\$68,838</u>	<u>\$55,869</u>

See accompanying notes to the financial statements.

VERMONT STUDENT ASSISTANCE CORPORATION

(A Component Unit of the State of Vermont)

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

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 is 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, the Fund’s financial statements are consolidated and are 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.

VERMONT STUDENT ASSISTANCE CORPORATION

(A Component Unit of the State of Vermont)

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

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, donor restrictions, 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 U.S. Treasury rebates payable.

VERMONT STUDENT ASSISTANCE CORPORATION

(A Component Unit of the State of Vermont)

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

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 refinance existing student loans.

Student loans are stated at their unpaid principal balance net of allowance for loan losses and 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. Loans originated subsequent to October 1, 1993, are only reinsured by DE for 98% of the principal amount. At June 30, 2006 and 2005, most of VSAC's student loans are subject to the 98% guarantee from DE. 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 nonguaranteed 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.

VERMONT STUDENT ASSISTANCE CORPORATION

(A Component Unit of the State of Vermont)

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

2. Summary of Significant Accounting Policies (Continued)

Investments

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*.

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.

Bond Issuance Costs

Costs of bond issuances, which are comprised of underwriters' fees, 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 Discount and Deferred Loss on Refunding

Bond discounts are amortized using a method which approximates the level yield 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, as the services are provided.

VERMONT STUDENT ASSISTANCE CORPORATION

(A Component Unit of the State of Vermont)

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

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 2005 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. Funds not related to the various bond resolutions may also be invested in domestic equities or corporate bonds.

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

3. Cash, Cash Equivalents and Investments (Continued)

Cash and Cash Equivalents

The carrying amounts which represent both cost and fair value of cash and cash equivalents as of June 30, 2006 and 2005 are presented below:

	2006		2005	
	Balance	Amount Insured or Collateralized	Balance	Amount Insured or Collateralized
Cash and repurchase agreements	\$ 14,414	\$ 14,889	\$ 5,871	\$ 6,515
Money market accounts	<u>136,627</u>	<u>See Below</u>	<u>392,686</u>	<u>See Below</u>
	<u>\$151,041</u>		<u>\$398,557</u>	

At June 30, 2006 and 2005, 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, 2006 were \$15,511 and the bank balances at June 30, 2005 were \$6,896. The difference between the net bank balances and the amounts recorded on the financial statements is outstanding checks and deposits in transit. Additionally, \$14,889 and \$6,515 of the bank balances at June 30, 2006 and 2005, 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 \$622 and \$381 at June 30, 2006 and 2005, respectively, were uninsured and uncollateralized.

At June 30, 2006 and 2005, 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 (Standard & Poor's rating AAA) 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 held the following investments at June 30, 2006 and 2005.

	2006		2005	
	<u>Cost</u>	<u>Fair Value</u>	<u>Cost</u>	<u>Fair Value</u>
Domestic equities	\$ 727	\$ 752	\$ 304	\$ 354
Corporate bonds	239	233	123	121
U.S. Government bonds	<u>182</u>	<u>182</u>	<u>40</u>	<u>40</u>
	<u>\$ 1,148</u>	<u>\$ 1,167</u>	<u>\$ 467</u>	<u>\$ 515</u>

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

3. Cash, Cash Equivalents and Investments (Continued)

At June 30, 2006, the ratings for investments in debt securities are summarized as follows:

<u>Investment</u>	<u>Maturities</u>	<u>Fair Value</u>	<u>Standard & Poor's Rating</u>
Corporate bonds:			
Citigroup Commercial Paper (3.5%)	02/01/2008	24	AA+
Target Corporation (5.4%)	10/01/2008	20	A+
Texaco Capital (5.5%)	01/15/2009	20	AA
Washington Mutual (4.0%)	01/15/2009	14	A-
IBM Corporation (5.375%)	02/01/2009	20	A+
Bankamerica Corporation (7.125%)	03/01/2009	21	AA
FPL Group Cap Inc (7.375%)	06/01/2009	21	A
JP Morgan Chase Floating Rate (5.715%)	06/28/2009	19	AA-
Lehman Bros Holdings (7.875%)	11/01/2009	20	A+
Tenn Valley Auth (5.625%)	01/18/2011	10	AAA
Conoco Funding Co (6.35%)	10/15/2011	15	A+
Household Fin Co (6.375%)	10/15/2011	15	AA
Fed Natl Mtg Assn (5.0%)	04/30/2013	5	AAA
Capital One Fin (5.5%)	06/01/2015	<u>9</u>	BBB+
		<u>233</u>	
U.S. Government bonds:			
U.S. Treasury Note (4.375%)	01/31/2008	25	-
U.S. Treasury Note (4.625%)	02/29/2008	25	-
U.S. Treasury Note (4.5%)	02/15/2009	25	-
U.S. Treasury Note (5.5%)	05/15/2009	25	-
U.S. Treasury Note (6.0%)	06/28/2009	26	-
U.S. Treasury Note (5.75%)	08/15/2010	26	-
U.S. Treasury Note (4.5%)	11/15/2010	10	-
iShares Lehman TIPS Bond Fund		<u>20</u>	AAA
		<u>182</u>	

Interest Rate Risk. Through its investment policy, VSAC manages its interest rate risk by establishing a target range of 20% to 70% of its investments in fixed rate securities. VSAC's current investment manager works with a target of 35% of investments in fixed rate securities with a target duration of no greater than three years.

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

3. Cash, Cash Equivalents and Investments (Continued)

Credit Risk. VSAC minimizes its credit risk by requiring marketable bonds, debentures, notes, or instruments to be rated BBB or better by Standard and Poor's and Baa or better by Moody's Investors Service.

Concentration of Credit Risk. VSAC places no limit on the amount of investments in any one issuer. However, VSAC's investment manager is currently instructed to invest approximately 65% of the total portfolio in equity issues, balanced between growth and value styles, biased toward large and mid-cap. As of June 30, 2006, 14% of VSAC's investments were invested in U.S. Treasuries. No other single issuer represented more than 5% of VSAC's investments at either June 30, 2006 or 2005.

Custodial Credit Risk

All of the investments are held by VSAC's agent in VSAC's name.

A significant portion of cash and cash equivalents 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

At June 30, 2006, VSAC held student loans with interest rates ranging from 2.875% to 10.190%; the majority is 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.

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.

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

4. Student Loans Receivable (Continued)

Student loans receivable as of June 30, 2006 and 2005 are summarized as follows:

	<u>2006</u>	<u>2005</u>
Status:		
Interim status	\$ 360,984	\$ 338,598
Deferral status	283,972	254,206
Repayment status	1,011,220	864,105
Less: Allowance for loan losses	(21,265)	(12,611)
Deferred origination fees, net	<u>(5,779)</u>	<u>(3,498)</u>
 Total student loans receivable	 1,629,132	 1,440,800
Less: noncurrent student loans receivable	<u>1,511,836</u>	<u>1,332,471</u>
 Current student loans receivable	 <u>\$ 117,296</u>	 <u>\$ 108,329</u>
 Guarantee type:		
U.S. Department of Education	\$ 1,422,100	\$ 1,298,034
U.S. Department of Health and Human Services	13,928	16,901
Other – nonguaranteed	220,148	141,974
Less: Allowance for loan losses	(21,265)	(12,611)
Deferred origination fees, net	<u>(5,779)</u>	<u>(3,498)</u>
 Total student loans receivable	 1,629,132	 1,440,800
Less: noncurrent student loans receivable	<u>1,511,836</u>	<u>1,332,471</u>
 Current student loans receivable	 <u>\$ 117,296</u>	 <u>\$ 108,329</u>

\$1,614,303 and \$1,406,668 of student loans were pledged to the repayment of bonds as of June 30, 2006 and 2005, respectively.

Transactions in the allowance for loan losses for the years ended June 30, 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
Balance July 1	\$ 12,611	\$ 1,806
Net loans charged off	(2,001)	(835)
Provision for losses on student loans	<u>10,655</u>	<u>11,640</u>
 Balance June 30	 <u>\$ 21,265</u>	 <u>\$ 12,611</u>

VERMONT STUDENT ASSISTANCE CORPORATION

(A Component Unit of the State of Vermont)

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

4. Student Loans Receivable (Continued)

The allowance for loan losses represents management's estimate of probable losses on student loans. Management uses prior default history from its loan portfolios, including wide default trends, and type of loan program to arrive at this estimate. Should any of these factors change significantly from those currently used by management, the estimate will change.

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.

Changes in Federal loan reserve funds held for DE for the years ended June 30, 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
<i>Additions:</i>		
Reimbursement from DE on default loan purchases	\$ 17,780	\$ 14,799
Default loan collections	242	83
Loan administrative fees	2,231	2,128
Investment income	<u>360</u>	<u>157</u>
Total additions	20,613	17,167
<i>Deductions:</i>		
Purchases of defaulted loans from lenders	18,395	15,234
Default aversion fee paid	699	613
Other disbursements	<u>1,382</u>	<u>431</u>
Total deductions	<u>20,476</u>	<u>16,278</u>
Federal loan reserve funds held, at beginning of year	<u>9,379</u>	<u>8,490</u>
Federal loan reserve funds held, at end of year	\$ <u>9,516</u>	\$ <u>9,379</u>

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

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

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 2006 and 2005, VSAC maintained sufficient reserves to fully comply with these requirements.

Total outstanding loans issued under the FFEL Program were \$1,422,100 and \$1,298,034 at June 30, 2006 and 2005, respectively. Defaults on FFEL Program loan guarantees are paid by DE through the Federal Loan Reserve Fund.

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 three plans available: the Managed Allocation Option, the 100% Equity Option, and the Interest Income Option. The Managed Allocation Option and the 100% Equity Option are 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. Funds in the 100% Equity Option are not age based and remain 100% in equity investments. Investments in the Managed Allocation and 100% Equity 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.

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

NOTES TO FINANCIAL STATEMENTS

June 30, 2006 and 2005

(Dollars in Thousands)

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

The changes in assets held on behalf of investors for the years ended June 30, 2006 and 2005 were as follows:

	<u>2006</u>	<u>2005</u>
<i>Additions:</i>		
Investment income	\$ 2,686	\$ 1,279
Net realized and unrealized gains	251	1,224
Student loan interest income	231	152
Net participant subscriptions/redemptions	<u>9,272</u>	<u>8,761</u>
Total additions	12,440	11,416
<i>Deductions:</i>		
Operational expenses	<u>39</u>	<u>45</u>
Total deductions	<u>39</u>	<u>45</u>
Assets held on behalf of investors, at beginning of year	<u>40,858</u>	<u>29,487</u>
Assets held on behalf of investors, at end of year	<u>\$53,259</u>	<u>\$40,858</u>

7. Capital Assets

A summary of capital assets activity for the years ended June 30, 2006 and 2005, were as follows:

	<u>Estimated Lives</u>	Balance July 1, 2004	Acqui- sitions	Balance June 30, 2005	Acqui- sitions	Dispo- sitions	Balance June 30, 2006
Land	-	\$ 3,150	\$ -	\$ 3,150	\$ -	\$ -	\$ 3,150
Furniture and equipment	3 - 5 Years	4,361	705	5,066	2,496	189	7,373
Leasehold improvements	5 Years	721	-	721	-	721	-
Software	3 - 5 Years	1,797	680	2,477	278	1,508	1,247
Building		<u>725</u>	<u>10,347</u>	<u>11,072</u>	<u>5,581</u>	<u>-</u>	<u>16,653</u>
		10,754	11,732	22,486	8,355	2,418	28,423
Less accumulated depreciation		<u>4,430</u>	<u>1,458</u>	<u>5,888</u>	<u>1,539</u>	<u>2,406</u>	<u>5,021</u>
Capital assets, net		<u>\$ 6,324</u>	<u>\$ 10,274</u>	<u>\$ 16,598</u>	<u>\$ 6,816</u>	<u>\$ 12</u>	23,402
Less bonds payable, net							<u>21,291</u>
Net investment in property and equipment							<u>\$ 2,111</u>

VERMONT STUDENT ASSISTANCE CORPORATION
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(Dollars in Thousands)

7. Capital Assets (Continued)

Depreciation charged to operations for the years ended June 30, 2006 and 2005 was \$1,539 and \$1,467, respectively.

8. Bonds Payable

VSAC has issued the following bonds payable at June 30, 2006 and 2005, which were issued to finance the origination of student loans:

<i><u>Bonds Payable:</u></i>	<u>2006</u>	<u>2005</u>
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 2.60% to 3.75% during fiscal year 2006 (3.40% at June 30, 2006).	\$ 40,900	\$ 40,900
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 2.48% to 4.00% during fiscal year 2006 (3.60% to 4.00% at June 30, 2006).	96,000	96,000
1996 Series F, G, H and I, dated May 29, 1996; comprised of auction rate bonds maturing December 2036; interest is reset every 35 days and payable semi-annually at rates which ranged from 2.47% to 4.00% during fiscal year 2006 (3.65% to 4.00% at June 30, 2006).	100,000	100,000
1998 Series K-O, dated June 24, 1998; comprised of auction rate bonds maturing December 2032; interest is reset every 35 days and payable semi-annually at rates which ranged from 2.45% to 4.00% during fiscal year 2006 (3.60% to 4.00% at June 30, 2006).	165,000	165,000
2000 Series P and Q, dated May 31, 2000; comprised of auction rate bonds matured in December 2005. Interest was reset every 35 days and paid semi-annually; at rates which ranged from 2.56% to 3.25% during fiscal year 2006.	-	11,950
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 2.50% to 3.95% during fiscal year 2006 (3.53% to 3.95% at June 30, 2006).	172,550	172,550

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(Dollars in Thousands)

8. Bonds Payable (Continued)

	<u>2006</u>	<u>2005</u>
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 2.01% to 3.95% during fiscal year 2006 (3.68% to 3.95% at June 30, 2006).	\$ 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 3.00% to 5.35% during fiscal year 2006 (5.00% to 5.35% at June 30, 2006).	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 2.55% to 3.75% during fiscal year 2006 (3.62% to 3.70% at June 30, 2006).	112,500	112,500
2003 Series EE dated May 30, 2003; comprised of auction rate bonds matured December 2005; interest was reset every 35 days and paid semi-annually at rates which ranged from 2.55% to 3.12% during fiscal year 2006.	–	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 at rates which ranged from 2.40% to 4.10% during fiscal year 2006 (3.58% to 4.10% at June 30, 2006).	165,900	165,900
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 at rates which ranged from 2.55% to 3.95% during fiscal year 2006 (3.73% to 3.95% at June 30, 2006).	150,000	150,000
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 at rates which ranged from 2.6% to 3.75% during fiscal year 2006 (3.75% at June 30, 2006).	74,700	74,700

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8. Bonds Payable (Continued)

	<u>2006</u>	<u>2005</u>
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 at rates which ranged from 2.57% to 3.85% during fiscal year 2006 (3.72% to 3.85% at June 30, 2006).	\$ 134,500	\$ 134,500
2004 Series OO dated June 3, 2004; comprised of auction rate bonds maturing December 2038; interest is reset and payable every 28 days, interest rates ranged from 3.35% to 5.08% during fiscal year 2006 (5.08% at June 30, 2006).	65,800	65,800
2005 Series QQ dated June 21, 2005; comprised of floating rate weekly demand bonds maturing December 2039; interest is reset every 7 days and payable semi-annually at rates which ranged from 2.00% to 4.05% during fiscal year 2006 (4.05% at June 20, 2006).	120,385	120,385
2005 Series RR/SS dated June 21, 2005; comprised of auction rate bonds maturing December 2039; interest is reset and payable every 28 days at rates which ranged from 3.44% to 5.30% during fiscal year 2006 (5.15% and 5.30% at June 20, 2006).	119,600	119,600
2003 General Obligation bond dated December 9, 2003, with a final maturity date of March 1, 2034, interest rates fixed ranging from 2.00% to 5.00% payable semi-annually (5.00% at June 30, 2006).	<u>21,430</u>	<u>22,155</u>
Total bonds payable	1,704,015	1,761,690
Bond discount, net	(138)	(144)
Deferred loss on refunding, net	<u>(1,172)</u>	<u>(1,367)</u>
Total bonds payable	1,702,705	1,760,179
Less current portion of bonds payable	<u>735</u>	<u>57,675</u>
Noncurrent portion bonds payable	<u>\$1,701,970</u>	<u>\$1,702,504</u>

VERMONT STUDENT ASSISTANCE CORPORATION

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8. Bonds 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 and cash equivalents (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, 2004 Series OO, 2005 Series QQ and 2005 Series RR/SS bonds are secured for credit-worthiness by AMBAC Assurance Corporation. The 2003 General Obligation bonds and the 1998 Series O bonds payable have no credit support. The 2005 Series QQ bonds have liquidity support by a Standby Bond Purchase Agreement issued by the Bank of New York.

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, 2006, all bonds authorized under the underlying 1985 – 2005 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 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.

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8. Bonds Payable (Continued)

The debt service requirements, which are based on the interest rates at June 30, 2006 through 2011 and in five-year increments thereafter to maturity for VSAC, are as follows:

<u>Year ending June 30,</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2007	\$ 735	\$ 67,683	\$ 68,418
2008	41,655	66,918	108,573
2009	1,670	66,149	67,819
2010	795	66,094	66,889
2011	820	66,069	66,889
2012 – 2016	167,355	316,723	484,078
2017 – 2021	2,980	298,597	301,577
2022 – 2026	99,815	295,822	395,637
2027 – 2031	4,865	278,801	283,666
2032 – 2036	425,840	244,020	669,860
2037 – 2039	<u>957,485</u>	<u>78,174</u>	<u>1,035,659</u>
Total	<u>\$1,704,015</u>	<u>\$1,845,050</u>	<u>\$3,549,065</u>

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, 2006 and 2005:

	<u>2006</u>	<u>2005</u>
Balance at beginning of year	\$ 1,760,179	\$ 1,550,394
Issuance	–	270,385
Redemptions and refundings	(57,675)	(60,800)
Deferred loss on refunding	–	–
Amortization of premiums	–	–
Accretion of discount	<u>201</u>	<u>200</u>
Balance at end of year	<u>\$1,702,705</u>	<u>\$1,760,179</u>

9. U.S. Treasury Rebates Payable

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 U.S. Treasury. VSAC has estimated that there is an arbitrage liability at June 30, 2006 and 2005 of \$23,525 and \$20,083, respectively. VSAC has estimated the current portion to be \$233 and \$253 at June 30, 2006 and 2005, respectively. VSAC has refunded the U.S. Treasury \$1,112 in excess earnings in 2006.

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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 prior to February 8, 2006 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 made 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. Endowment funds

Donors have established a number of endowment funds through the Vermont Student Development Fund, Inc. All endowment funds are restricted to provide scholarship funds to Vermont students. All endowment funds are guided by specific agreements and instructions from donors regarding the uses of earnings and appreciation on invested funds.

In 1998, the Vermont General Assembly enacted a version of the Uniform Prudent Investor Act. The Act does not address in any explicit or clear manner a trustee's ability to spend net appreciation of donor-restricted endowments. The VSAC Board of Directors has established a policy, and most endowment agreements specify gains and appreciation on these funds be treated with a total return approach. In this approach, the amount of funds that may be expended from an endowment is based on a percentage of the fund's total value, and may come from the total return on the fund, including interest and dividend earnings, appreciation or original gift value. Total investment return in excess of the established spending rate is considered to be nonexpendable in future periods. The spending rate may be adjusted by the Board of Directors at their discretion.

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11. Endowment funds (Continued)

At June 30, 2006 the total net assets related to endowment funds was \$1,564. Expendable restricted net assets totaled \$66. The remaining \$1,498 of net assets related to endowment funds were nonexpendable.

12. Restricted Net Assets

Restrictions on net assets are the result of bond resolutions, state statutes, various federal regulations and program agreements, and donor restrictions. Bond resolutions restrict net assets to the origination of student loans and payment of debt service on bonds and notes payable. State statutes and federal regulations and program agreements restrict various net assets to use for specific grant, scholarship and educational activities. Donors have restricted a number of endowment funds for scholarship awards. Restricted net assets as of June 30, 2006 and 2005 are as follows:

	<u>2006</u>	<u>2005</u>
Restricted by bond resolutions	\$66,576	\$52,696
Restricted for grants and scholarships	811	1,169
Donor restricted for scholarships	1,564	871
Restricted appropriation for educational programs	<u>1,000</u>	<u>—</u>
Total restricted net assets	<u>\$69,951</u>	<u>\$54,736</u>

13. 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, 2006 and 2005 amounted to \$16,753 and \$14,408, respectively; VSAC's total payroll was \$16,464 and \$15,215, respectively. Total contributions by VSAC amounted to \$1,675 and \$1,441 in 2006 and 2005, respectively, which represented 10% of the covered payroll.

14. Contingencies

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

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14. Contingencies (Continued)

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 liability for self-insured medical and dental liabilities included in accounts payable and other liabilities on the statement of net assets for the years ended June 30, 2006 and 2005 is as follows:

	<u>2006</u>	<u>2005</u>
Balance, beginning of year	\$ 253	\$ 237
Claims paid	(3,576)	(3,177)
Accrual for estimated claims	<u>3,742</u>	<u>3,193</u>
Balance, end of year	<u>\$ 419</u>	<u>\$ 253</u>

15. Loan Commitments

At June 30, 2006 and 2005, VSAC had commitments to extend credit for student loans of approximately \$56,557 and \$59,278, 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.

16. Subsequent Event

In July 2006, VSAC issued tax-exempt 2006 Series TT, UU and VV auction rate bonds totaling \$172,250 maturing December 2040.