

Indiana Secondary Market for Education Loans, Inc.

*Financial Statements and Supplemental
Information for the Years Ended June 30,
2005 and 2004 and Independent Auditors'
Report*

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

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INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEARS ENDED JUNE 30, 2005 and 2004 (UNAUDITED)

Indiana Secondary Market for Education Loans, Inc. ("ISM") was established pursuant to Public Law No. 154 of the 1980 Indiana General Assembly. ISM is a not-for-profit corporation established to purchase student loans and provide enhanced access for Indiana residents pursuing education at post-secondary institutions. Taxable and tax-exempt bond and note financings are the primary sources of funding for ISM's programs. The State of Indiana has not appropriated any funds for the administration of ISM's programs. ISM administers programs for the purchase of loans guaranteed and reinsured by the United States Department of Education ("US DOED") under the Federal Family Education Loan Program ("FFELP").

ISM's programs are designed to facilitate access for all students to educational funding, primarily using federal student loans. Under those programs, ISM purchased loans of \$319.28 million and \$113.47 million during the fiscal years June 30, 2005 and 2004, respectively. This represents a 181.38% increase in loans purchased from the previous fiscal year.

ISM's financial statements consist of the following: the balance sheets, the statements of revenues, expenses and changes in net assets and the statements of cash flows. These financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Government Accounting Standards Board. The balance sheets present the financial position of ISM at the end of the fiscal year and include all assets, liabilities and net assets of ISM. The statements of revenues, expenses and changes in net assets present ISM's results of operations and changes in its net assets for the years ended June 30, 2005 and 2004. The statements of cash flows provide information about the sources and uses of ISM's cash resources for the years ended June 30, 2005 and 2004.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED) FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (UNAUDITED)

Condensed Financial Information (in thousands)

Financial Position	2005	2004
Cash and short-term investments	\$ 71,223	\$ 69,081
Student loans receivable, net	506,155	299,845
Other assets	<u>15,846</u>	<u>10,765</u>
Total assets	<u>\$ 593,224</u>	<u>\$ 379,691</u>
Line of credit	\$ 28,350	\$ 48,800
Taxable bonds payable	243,200	93,200
Tax-exempt bonds payable	240,650	167,600
Other liabilities	<u>6,557</u>	<u>2,368</u>
Total liabilities	518,757	311,968
Unrestricted	70,046	66,573
Restricted	<u>4,421</u>	<u>1,150</u>
Total net assets	<u>74,467</u>	<u>67,723</u>
Total liabilities and net assets	<u>\$ 593,224</u>	<u>\$ 379,691</u>
Operating Results		
Interest on student loans	\$ 11,920	\$ 9,221
Special allowance on student loans	14,457	10,265
Interest income and other	<u>2,853</u>	<u>1,157</u>
Total operating revenues	<u>29,230</u>	<u>20,643</u>
Interest expense	11,082	4,063
Fees and debt issuance costs	1,215	1,085
Loan servicing and administration	6,918	5,479
Provision for arbitrage rebate	<u>3,271</u>	<u>775</u>
Total operating expenses	<u>22,486</u>	<u>11,402</u>
Change in net assets	<u>\$ 6,744</u>	<u>\$ 9,241</u>

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED) FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (UNAUDITED)

Financial Position

Total assets increased 56.24% from \$379.69 million at June 30, 2004 to \$593.22 million at June 30, 2005. Total liabilities increased 66.29% from \$311.97 million to \$518.76 million during that same period. The increase in bonds payable and the use of a line of credit have enabled ISM to increase student loans receivable by 68.81% during 2005 to \$506.16 million.

Cash and short-term investments increased by 3.10% from the prior fiscal year to \$71.22 million. Total interest income and other increased 146.59% compared to the prior fiscal year, primarily due to higher cash and short-term investment balances and other income.

Debt arrangements increased from \$309.60 million at June 30, 2004 to \$512.20 million at June 30, 2005. The net increase was the result of net proceeds from the September and December 2004 bond issues.

Net assets at June 30, 2005 were \$74.47 million representing an increase of 9.97% from \$67.72 million at June 30, 2004. Pursuant to Board resolutions on December 17, 2002 and April 22, 2003, ISM has designated \$7.10 million for use in higher education enhancement related projects as defined by the Indiana Commission for the Higher Education. This amount is included in unrestricted net assets.

Operating Results

ISM's change in net assets was \$6.74 million from operating revenues of \$29.23 million for the fiscal year ended June 30, 2005, compared to \$9.24 and \$20.64 million, respectively for the prior fiscal year ended. The current year change in net assets was primarily due to the \$206.31 million increase in the student loan portfolio and the interest and special allowance income earned related thereto. Additionally, interest expense on debt arrangements increased resulting from increases in related interest rates and added to the current year change in net assets.

Total operating revenues increased 41.62%, from \$20.64 million for the fiscal year ended June 30, 2004, to \$29.23 million for the fiscal year ended June 30, 2005. Interest on student loans increased 23.18% due to increasing general interest rates and the increase in the student loan portfolio. The special allowance on student loans increased because of increasing interest rates and the effect of loans financed with tax-exempt proceeds originally issued prior to October 1, 1993 ("pre-1993 financings"). Loans financed with pre-1993 financings receive a special allowance at ½ the rate on comparably taxable loans, subject to a 9.50% minimum return to the lender.

Total operating expenses increased 97.21% from \$11.40 million for the fiscal year ended June 30, 2004, to \$22.49 million for the fiscal year ended June 30, 2005. This increase is related to loan servicing infrastructure expenses, higher interest expenses on financings, and additional staffing expenses to support higher loan volumes and an increase in the provision for arbitrage rebate.

INDEPENDENT AUDITORS' REPORT

To the Board of Directors of
Indiana Secondary Market for Education Loans, Inc.
Indianapolis, Indiana

We have audited the accompanying balance sheets of Indiana Secondary Market for Education Loans, Inc. ("ISM"), a component unit of the State of Indiana, as of June 30, 2005 and 2004, and the related statements of revenues, expenses, and changes in net assets and of cash flows for the years then ended. These financial statements are the responsibility of the management of ISM. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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, such financial statements present fairly, in all material respects, the financial position of ISM as of June 30, 2005 and 2004, and the results of its operations and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 1 to 3 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. This supplementary information is the responsibility of ISM's management. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit such information and we do not express an opinion on it.

Deloitte & Touche LLP

September 12, 2005

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

BALANCE SHEETS AS OF JUNE 30, 2005 AND 2004 (In thousands)

ASSETS	2005	2004
CURRENT ASSETS:		
Cash and short-term investments:		
Unrestricted	\$ 66,802	\$ 67,931
Designated	4,421	1,150
Total cash and and short-term investments	71,223	69,081
Student loans receivable—net	4,970	2,026
Accrued interest receivable	10,576	7,720
Prepays and other assets	2,128	1,147
Total current assets	88,897	79,974
NON-CURRENT ASSETS:		
Student loans receivable—net	501,185	297,819
Prepays and other assets	3,142	1,898
Total long-term assets	504,327	299,717
TOTAL	\$ 593,224	\$ 379,691
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Line of credit	\$ 28,350	\$ 48,800
Bonds payable	6,000	
Accounts payable and accrued expenses	1,049	879
Accrued interest payable	1,087	339
Total current liabilities	36,486	50,018
NON-CURRENT LIABILITIES:		
Bonds payable	477,850	260,800
Arbitrage rebate payable	4,421	1,150
Total long-term liabilities	482,271	261,950
Total liabilities	518,757	311,968
NET ASSETS:		
Unrestricted	70,046	66,573
Restricted	4,421	1,150
Total net assets	74,467	67,723
TOTAL	\$ 593,224	\$ 379,691

See notes to financial statements.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (In thousands)

	2005	2004
OPERATING REVENUES:		
Interest on student loans	\$ 9,588	\$ 7,784
U.S. Secretary of Education:		
Special allowance	14,457	10,265
Interest subsidy	2,332	1,437
Interest income and other	<u>2,853</u>	<u>1,157</u>
Total operating revenues	<u>29,230</u>	<u>20,643</u>
OPERATING EXPENSES:		
Interest expense	11,082	4,063
Fees and debt issuance costs	1,215	1,085
Loan servicing and administration	6,918	5,479
Provision for arbitrage rebate	<u>3,271</u>	<u>775</u>
Total operating expenses	<u>22,486</u>	<u>11,402</u>
CHANGE IN NET ASSETS	6,744	9,241
NET ASSETS—Beginning of year	<u>67,723</u>	<u>58,482</u>
NET ASSETS—End of year	<u>\$74,467</u>	<u>\$67,723</u>

See notes to financial statements.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (In thousands)

	2005	2004
OPERATING ACTIVITIES:		
Student loan interest received	\$ 7,881	\$ 8,373
Purchase of student loans	(319,277)	(113,468)
Principal receipts on student loans	127,780	58,983
US Department of Education:		
Interest subsidy payments received	2,077	1,509
Special allowance payments received	13,881	9,131
Late fee income	104	94
Cash payments for origination fees and premiums on student loans	(12,175)	(4,354)
Cash received for interest income and other	2,560	839
Cash payments for operating expenses	<u>(11,649)</u>	<u>(6,245)</u>
Net cash used in operating activities	<u>(188,818)</u>	<u>(45,138)</u>
NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from issuance of bonds	223,050	112,800
Proceeds from line of credit		48,800
Repayment of bonds		(101,630)
Repayment of line of credit	(20,450)	
Payment of debt issuance costs	(1,305)	(822)
Interest paid on bonds	<u>(10,335)</u>	<u>(4,088)</u>
Net cash provided by noncapital financing activities	<u>190,960</u>	<u>55,060</u>
INCREASE IN CASH AND SHORT-TERM INVESTMENTS	2,142	9,922
CASH AND SHORT-TERM INVESTMENTS—Beginning of year	<u>69,081</u>	<u>59,159</u>
CASH AND SHORT-TERM INVESTMENTS—End of year	<u>\$ 71,223</u>	<u>\$ 69,081</u>

See notes to financial statements.

(Continued)

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF CASH FLOWS FOR THE YEARS ENDED JUNE 30, 2005 AND 2004 (In thousands)

	2005	2004
RECONCILIATION OF CHANGE IN NET ASSETS TO NET CASH USED IN OPERATING ACTIVITIES:		
Change in net assets	\$ 6,744	\$ 9,241
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Amortization of loan and bond charges	2,956	1,040
Interest expense	11,082	4,063
Provision for allowance for loan losses	60	60
Purchase of student loans	(319,277)	(113,468)
Principal receipts on student loans	127,780	58,983
Change in assets and liabilities:		
Increase in student loans receivable	(17,688)	(3,972)
Increase in accrued interest receivable	(2,856)	(1,613)
Increase in prepaids and other assets	(1,061)	(653)
Increase in other liabilities	171	406
Increase in arbitrage rebate payable	3,271	775
Net cash used in operating activities	<u>\$ (188,818)</u>	<u>\$ (45,138)</u>
NON-CASH OPERATING ACTIVITY—		
Capitalized interest and payment reapplications	<u>\$ 5,513</u>	<u>\$ 3,742</u>

See notes to financial statements.

(Concluded)

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

NOTES TO FINANCIAL STATEMENTS JUNE 30, 2005 AND 2004

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business—Indiana Secondary Market for Education Loans, Inc. (“ISM” or the “Company”) is a not-for-profit corporation formed to purchase and originate student loans in the secondary market under the Federal Family Education Loan Program (“FFELP”) provided for by the Higher Education Act. Outstanding bonds are payable as specified in the resolutions authorizing the related sale of the bonds, are not payable by funds received from taxation, and are not debts of the State of Indiana or any of its political subdivisions. ISM is a major, discretely presented, proprietary component unit of the State of Indiana.

Basis of Presentation and Accounting—ISM’s financial statements have been prepared on the basis of the governmental enterprise fund concept which pertains to financial activities that operate similarly to a private business enterprise. The assets of each fund are restricted pursuant to the bond resolutions. For financial statement presentation purposes, the funds have been aggregated into one proprietary fund type. ISM’s funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. ISM applies all applicable Financial Accounting Standards Board pronouncements which do not conflict with Governmental Accounting Standards Board (“GASB”) pronouncements.

Student Loans Receivable—Student loans receivable are stated at the principal amount outstanding adjusted for an estimated allowance for loan losses, unamortized purchase premiums, and origination fees paid on behalf of banks and borrowers. The related interest income generated from student loans is offset by premium and origination fee amortization expenses. ISM amortizes loan premiums and loan origination fees on a straight-line basis over four years which approximates the effective interest method.

Interest on student loans is accrued based upon the actual principal amount outstanding. The U.S. Secretary of Education makes quarterly interest subsidy payments until the student is required, under the provisions of the Higher Education Act, to begin repayment. Repayment must begin generally within six months after the student completes their course of study, leaves school, or ceases to carry at least one-half the normal full-time academic load as determined by the participating institution.

The U.S. Department of Education (“US DOED”) provides a special allowance to lenders participating in the FFELP. The special allowance amount is the result of applying a percentage, based upon the average bond equivalent rates of 91-day United States Treasury bills, to the average daily unpaid principal balance and capitalized interest of student loans held by the Company. The special allowance is accrued as earned. For loans first disbursed from January 1, 2000, through June 30, 2006, the legislation changed the lender index to the three-month financial Commercial Paper (“CP”) rate from the 91-day Treasury bill rate.

Cash and Short-Term Investments—Cash and short-term investments are cash equivalents consisting of United States Treasury bills, commercial paper, and money market mutual funds, which are carried at cost and approximate market, with an original maturity of less than 90 days. At June 30, 2005 and 2004,

all short-term investments are money-market funds, commercial paper, and Guaranteed Insurance Contracts (“GICs”). All cash and short-term investments whose proceeds are designated for the payment of arbitrage rebate liabilities are classified as designated cash and short-term investments (see Note 3).

Deposit and investment policies – ISM has few short term investments and has not adopted a formal investment policy.

As of June 30, 2005, ISM had the following short-term investments and maturities:

Investment Type	Fair Value (In Thousands)	Investment Maturities (In Years)			
		< 1	1 - 5	6 - 10	> 10
Commercial paper	\$ 2,830	\$ 2,830			
Guaranteed investment contracts	15,109	15,109			
	<u>\$ 17,939</u>	<u>\$ 17,939</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>

The following table provides information on the credit ratings associated with ISM’s short-term investments as of June 30, 2005:

Investment Type	Fair Value (In Thousands)	S & P	Fitch	Moody's
Commercial paper	\$ 2,830	P -1	unrated	A - 1
Guaranteed investment contracts	15,109	unrated	unrated	unrated
	<u>\$ 17,939</u>			

From time to time, certain short-term investment balances maintained by ISM exceed federally insured limits.

Allowance for Loan Losses—Guarantees on student loans originated after October 1, 1993 provide for a reduced recovery of 98 percent of loan principal and accrued interest on loans which default. Accordingly, ISM provides for an allowance for the estimated loss associated with the portion not recoverable. This allowance is increased by a provision charged to operations and reduced for losses actually incurred, and is included in the financial statements as a reduction of student loans receivable. At June 30, 2005 and 2004, the allowance for loan losses was \$579,000 and \$519,000, respectively. In completing the analysis of the adequacy of the allowance for loan losses, past collection experience, delinquency trends and size of the portfolio, economic conditions, and other factors are considered. Significant changes in these factors could impact the allowance and provision for loan losses. A large percentage of the ISM’s loans have not matured to a point at which predictable loss patterns have developed. Accordingly, the evaluation of the allowance for loan losses is inherently subjective as it requires material estimates that may be subject to change.

Debt Issuance Costs—Debt issue costs are amortized using a method that approximates the effective interest method over the terms of their respective agreements, ranging from 18 months to 40 years. Unamortized debt issue costs are included in prepaids and other assets and totaled \$2,956,000 and \$1,790,000 at June 30, 2005 and 2004, respectively.

Net Assets—\$70,046,000 and \$66,573,000 of ISM's net assets and all related revenues are unrestricted at June 30, 2005 and 2004, respectively. ISM does, however, maintain debt and other arrangements which limit the use of assets as described in Note 3. In addition, pursuant to Board resolutions on December 17, 2002 and April 22, 2003, ISM has designated \$7,100,000 for use in higher education enhancement related projects as defined by the Indiana Commission for the Higher Education. This amount is included in unrestricted net assets. At June 30, 2005 and 2004, ISM's restricted net assets of \$4,421,000 and \$1,150,000, respectively, reflect amounts restricted to fund the arbitrage rebate payable (Note 5).

Loan Income and Related Expenses—Interest and special allowance on loans are recognized as income in the period earned and servicing costs are charged to expense as incurred. Premiums and transfer fees paid for student loans are amortized using a method which approximates the effective interest method over the estimated life of the loans. Unamortized premiums at June 30, 2005 and 2004 totaled \$9,113,000 and \$1,606,000, respectively, and are included in the financial statements as a component of student loans receivable.

Servicing Fee—American Education Services, Nelnet Corporation, Sallie Mae Servicing, Affiliated Computer Services, and Great Lakes Education Loan Services service the majority of ISM's student loan portfolio. Servicing fee expense amounts are included in operating expenses in the statement of revenues and expenses and changes in net assets. In addition, ISM services a portion of the student loan portfolio that is not in repayment status.

Risk Management—ISM is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries. Coverage for these various risks of loss is obtained through commercial insurance. There has been no significant reduction in insurance coverage from the prior year for all categories of risk. Commercial insurance is purchased in an amount that is sufficient to cover ISM's risk of loss. ISM will record an estimated loss from a claim as an expense and a liability if it meets the following requirements: (1) information available indicates that it is probable that an asset has been impaired or a liability has been incurred at the date of the financial statements and (2) the amount of the loss can be reasonably estimated.

Operating Revenues and Expenses—Bond and loan issuances are the principal source of the funds. ISM derives revenue from short-term investments, interest on student loans and the U.S. Secretary of Education. ISM's expenses primarily consist of interest on debt arrangements and loan servicing and administration.

Income Taxes—The Company is a tax-exempt organization under the provisions of the Internal Revenue Code, Section 501(c)(3) and, accordingly, no provision for income taxes has been made in the accompanying financial statements.

Use of Estimates—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities 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. Significant estimates that are particularly susceptible to change in the near-term relate to the determination of the arbitrage rebate payable and the allowance for loan losses.

Reclassifications—Certain amounts in the 2004 financial statements have been reclassified to conform to the 2005 presentation.

2. STUDENT LOANS RECEIVABLE—NET

Student loans receivable consist of loans made under the Higher Education Act and are carried at their unpaid principal balance net of an allowance for loan losses plus unamortized purchase premiums, origination fees, and transfer fees. Student loans earn interest at various rates ranging from 3.19% to 10.00% depending upon the type of student loan and the date the student loan was made. The principal and accrued interest on student loans are substantially insured by certain guarantee agencies which are reinsured by the federal government. At June 30, 2005, the majority of the Company's student loans are guaranteed by United Student Aid Funds, Inc. or the Pennsylvania Higher Education Assistance Authority.

Student loans receivable, net consist of the following at June 30:

	2005 (In Thousands)	2004 (In Thousands)
Student loans	\$ 493,163	\$ 296,153
Purchase premiums, origination fees and other, net	13,571	4,211
Less: allowance for loan losses	<u>(579)</u>	<u>(519)</u>
	<u>\$ 506,155</u>	<u>\$ 299,845</u>

3. BONDS PAYABLE

The following displays the aggregate changes in bonds payable for the fiscal years ended June 30:

	2005 (In Thousands)	2004 (In Thousands)
Bonds payable—beginning of year	\$ 260,800	\$ 249,630
Proceeds	223,050	112,800
Repayments	<u> </u>	<u>(101,630)</u>
	<u>\$ 483,850</u>	<u>\$ 260,800</u>

Bonds payable consist of the following at June 30:

	2005 (In Thousands)	2004 (In Thousands)
Education Loan Revenue Bonds - Series 1993	\$ 9,000	\$ 9,000
Auction Rate Certificates	<u>474,850</u>	<u>251,800</u>
	<u>\$ 483,850</u>	<u>\$ 260,800</u>

The Education Loan Revenue Bonds issued in Series 1993 are due in annual installments through fiscal 2007. Interest is payable semi-annually at rates ranging from 5.90% to 6.00%.

Bonds payable at June 30, 2005 include \$243.20 million and \$231.65 million of taxable and tax-exempt Auction Rate Certificates (“ARCs”), respectively. Bonds payable at June 30, 2004 include \$93.20 million and \$158.60 million of taxable and tax-exempt ARC’s, respectively. The ARCs mature on various dates between December 1, 2030 and 2044, respectively. Interest on the ARCs ranged from 1.28% to 3.40% during the year ended June 30, 2005, and is payable either at each auction, which occurs every 28 or 35 days as stipulated in the related ARC agreement, or semiannually.

The following table displays scheduled debt maturities and contractual interest payments at June 30, 2005:

Years Ending, June 30:	Principal	Interest	Total
2006	\$ 6,000,000	\$ 19,623,075	\$ 25,623,075
2007	3,000,000	19,356,075	22,356,075
2008		19,266,075	19,266,075
2009		19,266,075	19,266,075
2010		19,266,075	19,266,075
2011–2015		96,330,375	96,330,375
2016–2020		96,330,375	96,330,375
2021–2025		96,330,375	96,330,375
2026–2030		96,330,375	96,330,375
2031–2035	59,000,000	84,573,696	143,573,696
2036–2040	265,850,000	66,028,059	331,878,059
2041–2045	150,000,000	27,208,356	177,208,356
Total	<u>\$483,850,000</u>	<u>\$659,908,986</u>	<u>\$1,143,758,986</u>

Bonds of each series are secured by (a) the proceeds derived from the sale of the bonds, (b) eligible loans, and (c) certain accounts established by the respective bond resolutions, including monies and securities therein. ISM maintains a minimum amount of pledged assets as defined by each respective bond indenture. The total of all minimum requirements for all bond issuances at June 30, 2005, was \$528,278,055 (\$317,941,855 at June 30, 2004.)

The respective bond resolutions establish the following special trust accounts for each bond series, unless otherwise indicated:

Loan Accounts—The loan accounts are used to account for the proceeds of bond issues not required to be deposited in the debt service reserve accounts. Generally, amounts in the loan accounts may be expended (a) to finance eligible student loans, (b) to pay bond issue costs, and (c) to make deposits to the revenue accounts for the purpose of paying principal and/or interest on the bonds.

Revenue Accounts—The revenue accounts are used to account for all revenues received by ISM. Generally, amounts in the revenue accounts are used (a) to make principal and/or interest payments on the bonds, (b) to fund debt service reserve accounts, (c) to pay estimated program expenses to the operating account, and (d) to reimburse the issuers of insurance guaranteeing the bonds for amounts borrowed under the terms of the policies. Excess amounts in the revenue account may be transferred to the loan accounts or to optional redemption accounts.

Operating Accounts—Amounts deposited in operating accounts are used to pay reasonable and necessary program expenses for the bond issues.

Rebate Accounts—Amounts deposited in the rebate accounts are used to pay the United States Treasury amounts required by Section 148 of the Internal Revenue Code.

Cash and short-term investments consist of the following at June 30:

	2005 (In Thousands)	2004 (In Thousands)
Special trust accounts:		
Unrestricted:		
Loan accounts	\$ 50,600	\$ 26,686
Revenue accounts	5,015	8,807
Designated:		
Rebate accounts	<u>4,421</u>	<u>1,150</u>
Total special trust accounts	60,036	36,643
Operating account (includes \$7,100 to the State of Indiana)	<u>11,187</u>	<u>32,438</u>
Total cash and short-term investments	<u>\$ 71,223</u>	<u>\$ 69,081</u>

4. LINE OF CREDIT

ISM maintains a Line of Credit Agreement (“Agreement”) with KeyBank, N.A. which provides for maximum borrowings of \$50,000,000. The Agreement is collateralized by loans pledged under the Agreement and certain cash balances on deposit with KeyBank and contains certain financial and restrictive covenants. The Agreement matured on June 30, 2005. However, on August 8, 2005, the Corporation renewed the Agreement until June 30, 2007 and increased the aggregate amount available to \$75,000,000. At June 30, 2005, the line of credit balance was \$28,350,000. Interest is charged based on LIBOR plus the applicable margin.

The following table displays the aggregate changes in line of credit borrowing for fiscal years ended June 30:

	2005 (In Thousands)	2004 (In Thousands)
Line of credit—beginning of year	\$ 48,800	\$
Proceeds		48,800
Repayments	<u>(20,450)</u>	
Line of credit—end of year	<u>\$ 28,350</u>	<u>\$ 48,800</u>

5. ARBITRAGE REBATE PAYABLE

In accordance with Section 148 of the Internal Revenue Code of 1986 (the “Code”), as amended, and the regulations promulgated thereunder, ISM is required to pay to the United States Treasury certain amounts related to the ISM tax-exempt bond issues. The amount required to be paid represents the excess of amounts earned over the interest cost of the tax-exempt borrowings as defined in the Code.

Non-purpose rebate payments are due every fifth year and when the bonds are retired. Purpose rebate payments are due every tenth year and every fifth year thereafter during the life of each bond issue and when the bonds are retired. The rebate calculation utilizes various assumptions and allows for the selection of alternative calculation options under the Code. At June 30, 2005 and 2004, the estimated arbitrage rebate liability is \$4,421,000 and \$1,150,000, respectively, which has been provided for in the financial statements. The factors used in determining this estimate are sensitive to change in the future and the change in estimate may be material to the financial statements. However, the ultimate amount payable, if any, is dependent on the investment yields and bond rates in the future.

The following table displays the aggregate changes in the arbitrage rebate payable during the fiscal years ending June 30:

	2005 (In Thousands)	2004 (In Thousands)
Beginning balance	\$ 1,150	\$ 375
Additional liability	3,271	1,071
Payments	<u> </u>	<u>(296)</u>
Ending balance	<u>\$ 4,421</u>	<u>\$ 1,150</u>

6. FAIR VALUE OF FINANCIAL INSTRUMENTS

The estimated fair value amounts have been determined by ISM using available market information and appropriate valuation methodologies. However, considerable judgment is necessarily required to interpret market data to develop the estimates of fair value. Accordingly, the estimates presented herein are not necessarily indicative of the amounts ISM could realize in a current market exchange. The use of different market assumptions and/or estimation methodologies may have a material effect on the estimated fair value amounts.

The estimated fair values of ISM's financial instruments at June 30 are as follows:

	2005	
	Carrying Amount	Estimated Fair Value
	(In Thousands)	
ASSETS:		
Cash and short-term investments	\$ 71,223	\$ 71,223
Student loans receivable—net	506,155	517,970
Accrued interest receivable	10,576	10,576
LIABILITIES:		
Bonds payable	483,850	473,951
Line of credit	28,350	28,350
Accrued interest payable	1,087	1,087

	2004	
	Carrying Amount	Estimated Fair Value
	(In Thousands)	
ASSETS:		
Cash and short-term investments	\$ 69,081	\$ 69,081
Student loans receivable—net	299,845	302,676
Accrued interest receivable	7,720	7,720
LIABILITIES:		
Bonds payable	260,800	267,284
Line of credit	48,800	48,800
Accrued interest payable	339	339

Cash and Short-Term Investments—Cash and short-term investments are carried at cost, which approximates fair value.

Student Loans Receivable, Net—Loans are categorized by status (in-school, grace, repayment, and delinquent). The fair value is estimated by discounting the future cash flows using current rates of return required by investors in similar assets, less an estimated allowance for credit losses.

Accrued Interest Receivable—Accrued interest receivable is carried at cost, which approximates fair value.

Bonds Payable—For fixed-rate bonds, fair value was calculated based on quoted current market prices of the bonds. For variable rate bonds, the carrying amount is a reasonable estimate of its fair value.

Line of Credit—For line of credit borrowings, the carrying amount is a reasonable estimate of its fair value.

Accrued Interest Payable—Accrued interest payable is carried at cost, which approximates fair value.

7. 401(K) RETIREMENT PLAN

ISM established the Indiana Secondary Market 401(k) Retirement Plan (“Plan”) in July 2002. The Plan is a “Safe Harbor 401(k) Plan” as described in the Internal Revenue Code. All employees 18 or older are eligible to participate on the first day of the month following their hire date. Under the Plan, ISM may elect to make a special safe harbor contribution of at least 3% of the participants’ salary. ISM also may contribute a discretionary profit sharing benefit if the participants are employed at the end of the Plan year. ISM also matches participant contributions for an amount equal to 100% of participant contributions to a maximum of 4% of the participant’s annual earnings. Participants vest in ISM contributions 100% after one year of service. ISM’s contributions to the Plan during fiscal years 2005 and 2004 were approximately \$109,000 and \$91,000, respectively. The employees of ISM contributed approximately \$112,000 and \$109,000 to the Plan during fiscal years 2005 and 2004, respectively.

8. COMMITMENT

ISM leases office space and office equipment under the terms of a noncancellable operating lease. Future minimum lease payments under this operating lease at June 30, 2005 are as follows:

Years Ending, June 30

2006	\$ 98,000
2007	105,000
2008	112,000
2009	123,000
2010	132,000
Thereafter	<u>261,000</u>
	<u>\$ 831,000</u>

Lease expense under this operating lease was approximately \$108,000 for both fiscal years ended June 30, 2005 and 2004, respectively.

9. SUBSEQUENT EVENTS

On April 19, 2005, ISM's Board of Directors authorized a revolving line of credit agreement (the "FIB LOC Agreement") with First Indiana Bank in the amount of \$25,000,000. The FIB LOC Agreement was executed on July 18, 2005, matures on June 30, 2006 and can be extended at the request of ISM and with the consent of First Indiana Bank.

On July 19, 2005, ISM's Board of Directors authorized a revolving line of credit agreement (the "BOA LOC Agreement") with Bank of America in an amount up to \$300,000,000. The BOA LOC Agreement was executed in August, 2005 in the amount of \$100,000,000 and expires in August, 2006. In October, 2005 the BOA LOC agreement was amended to increase ISM's available borrowings to \$200,000,000.

On September 2, 2005, ISM executed a lease termination agreement whereby ISM has the option to terminate its office space lease by delivering written notice at any time prior to January 31, 2006.

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