



***Indiana Secondary  
Market for Education  
Loans, Inc.***

*Financial Statements and Supplemental Information for the  
Years Ended June 30, 2016 and 2015, and  
Independent Auditors' Report*

# INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

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*Independent Auditors' Report*

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

**Report on the Financial Statements**

We have audited the accompanying financial statements of Indiana Secondary Market for Education Loans, Inc., a component unit of the State of Indiana, which comprise the statements of net position as of June 30, 2016 and 2015, and the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements.

***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

***Auditors' Responsibility***

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, the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States, and the *Uniform Compliance Guidelines for Audit of State and Local Governments by Authorized Independent Public Accountants*, issued by the Indiana State Board of Accounts. Those standards and guidelines require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditors' judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditors consider internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the net position of Indiana Secondary Market for Education Loans, Inc. as of June 30, 2016 and 2015, and the changes in its net position and its cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America.

### **Report on Required Supplementary Information**

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 7 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

### **Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 20, 2016 on our consideration of Indiana Secondary Market for Education Loans, Inc.'s internal control over financial reporting and on 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering Indiana Secondary Market for Education Loans, Inc.'s internal control over financial reporting and compliance.

*Katz, Appen & Miller, LLP*

Indianapolis, Indiana  
October 20, 2016

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

## **INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)**

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The financial discussion, analysis, and overview of Indiana Secondary Market for Education Loans, Inc. (ISM) is required supplementary information. Among other things, it provides an analytical overview of ISM's condensed financial information and should be read in conjunction with the financial statements and related notes that follow.

#### **Overview of Indiana Secondary Market for Education Loans, Inc.**

ISM was established pursuant to Public Law No. 154 of the 1980 Indiana General Assembly and is a public benefit corporation organized exclusively for education purposes. ISM serves as the State of Indiana's designated secondary market for education loans and acts as an eligible lender under the Higher Education Act, as amended. ISM's enabling statute was amended effective April 30, 2013, with the signing of SB 532. SB 532 permits ISM to become a direct lender of non-federal, post-secondary education supplemental loans for the purpose of attending both Indiana and non-Indiana colleges and universities. SB 532 also mandates that ISM engage in financial literacy activities.

ISM is currently governed by a nine member Board of Directors who are appointed by the Governor of the State of Indiana. Taxable floating rate notes and existing cash balances are the primary sources of funding for ISM's programs. The Health Care and Education Reconciliation Act of 2010 (HCEARA) eliminated the origination of new Federal Family Education Loan Program (FFELP) loans after June 30, 2010. This did not impact the terms of existing FFELP loans. ISM continues to administer a program for the servicing of loans guaranteed and reinsured by the United States Department of Education (US DOED). In addition, ISM has a teaming arrangement for servicing loans originated under the Federal Direct Student Loan Program working with the Higher Education Loan Authority of the State of Missouri.

With the change to its enabling statute, ISM created the Hoosier Education Loan Partnership (HELP) and more recently the ISM Student Loan Program (ISLP). These programs are designed to facilitate access for all Indiana residents to educational funding at the lowest possible cost. In addition, ISM continues to expand its support for Indiana residents' pursuit of access to higher education opportunities by providing informational presentations and distributing educational materials related to education funding.

ISM's financial statements consist of the following: the statements of net position, the statements of revenues, expenses and changes in net position, the statements of cash flows and the related notes. These financial statements are prepared in accordance with accounting principles generally accepted in the United States of America as promulgated by the Governmental Accounting Standards Board. The statements of net position present the net position of ISM as of June 30, 2016 and 2015 and include all assets, liabilities and net position of ISM. The statements of revenues, expenses and changes in net position present ISM's changes in net position for the years ended June 30, 2016 and 2015. The statements of cash flows provide information about the sources and uses of ISM's cash resources for the years ended June 30, 2016 and 2015.

During 2015, ISM adopted GASB No. 72, *Fair Value Measurement and Application*. The statement provides guidance for determining fair value for financial reporting purposes, provides guidance for applying fair value to certain investments, and expands disclosure requirements for all fair value measurements. The adoption of the statement resulted in additional disclosure on fair value measurements.

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.****MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED, UNAUDITED)**

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**Condensed Financial Information (in thousands)**

<b>Statement of Net Position as of June 30,</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Cash and investments	\$ 123,805	\$ 131,561	\$ 146,724
Student loans receivable—net	128,295	141,481	157,072
Other assets	<u>4,002</u>	<u>4,456</u>	<u>4,400</u>
Total assets	<u><u>\$ 256,102</u></u>	<u><u>\$ 277,498</u></u>	<u><u>\$ 308,196</u></u>
Notes payable	\$ 119,034	\$ 138,514	
Taxable bonds payable			\$ 168,650
Other liabilities	<u>1,194</u>	<u>1,226</u>	<u>1,204</u>
Total liabilities	120,228	139,740	169,854
Total net position	<u>135,874</u>	<u>137,758</u>	<u>138,342</u>
Total liabilities and net position	<u><u>\$ 256,102</u></u>	<u><u>\$ 277,498</u></u>	<u><u>\$ 308,196</u></u>

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED, UNAUDITED)**

**Condensed Financial Information (in thousands)**

<b>Results Years Ended June 30,</b>	<b>2016</b>	<b>2015</b>	<b>2014</b>
Interest on student loans, including subsidy	\$ 4,952	\$ 5,418	\$ 6,018
Special allowance on student loans	(2,828)	(3,289)	(3,658)
Other income	288	484	506
	<u>2,412</u>	<u>2,613</u>	<u>2,866</u>
Total operating revenues	2,412	2,613	2,866
	<u>44</u>	<u>74</u>	<u>154</u>
Fees	44	74	154
Loan servicing and administration	3,247	3,228	1,371
	<u>3,291</u>	<u>3,302</u>	<u>1,525</u>
Total operating expenses	3,291	3,302	1,525
	<u>(879)</u>	<u>(689)</u>	<u>1,341</u>
Net income (loss) from operations	(879)	(689)	1,341
		89	674
Gain on repurchase of bonds payable		89	674
Net gain on investments	524	2,392	234
Interest expense	(1,529)	(1,381)	(2,070)
Debt issuance costs		(995)	
	<u>(1,005)</u>	<u>105</u>	<u>(1,162)</u>
Total nonoperating revenues (expenses)	(1,005)	105	(1,162)
	<u>(1,884)</u>	<u>(584)</u>	<u>179</u>
Change in net position	(1,884)	(584)	179
	<u>137,758</u>	<u>138,342</u>	<u>138,163</u>
Net Position - Beginning of Year	137,758	138,342	138,163
	<u>\$ 135,874</u>	<u>\$ 137,758</u>	<u>\$ 138,342</u>
Net Position - End of year	\$ 135,874	\$ 137,758	\$ 138,342



## **INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

### **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED, UNAUDITED)**

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#### **Financial Analysis**

##### **Statement of Net Position**

As of June 30, 2016, total assets decreased \$21.4 million compared to a decrease in liabilities of \$19.5 million. This resulted in a decrease to ISM's net position of \$1.9 million or 1.4%. This decrease in net position is due to a decrease in cash and loans receivable and losses from the investment portfolio. This compares to a decrease of 0.4% in the prior fiscal year which was a result of costs associated with debt refinancing, early bond retirement and lease termination expenses.

Cash and investments decreased 5.9% to \$123.8 million compared to a balance of \$131.6 million at June 30, 2015. The decrease in cash and investments is a result of establishing and funding the ISM private loan program, redemption of notes payable, and normal on-going operating expenses. A new investment policy was implemented in the prior fiscal year expanding investment parameters for unencumbered funds.

Student loans receivable decreased 9.3% from \$141.5 million at June 30, 2015 to \$128.3 million at June 30, 2016, compared to a 9.9% decrease in the prior fiscal year. This decrease is primarily due to cash receipts consisting of borrower and claim payments and loan consolidations in excess of loan additions and capitalized interest. As of June 30, 2016, the student loan portfolio held by ISM consists of 99.6% FFELP loans, which is made up of 88% consolidation loans and 12% Stafford and PLUS Loans. The remaining 0.4% is private HELP loans either originated or purchased by ISM. As of June 30, 2016, no private ISLP loans have yet been issued.

Other assets decreased 10.2% from \$4.5 million at June 30, 2015 to \$4.0 million at June 30, 2016. This decrease is due to a decrease in student loan interest receivable as the portfolio size decreases.

Liabilities decreased 14.0% from \$139.7 million at June 30, 2015 to \$120.2 million at June 30, 2016 compared to a decrease of 17.7% in the prior fiscal year. This is due to the decrease in notes payable as monthly principal payments are required based upon available funds.

Total net position at June 30, 2016, decreased 1.4% to \$135.9 million compared to \$137.8 million at June 30, 2015. This compares to a decrease of 0.4% in the prior fiscal year.

##### **Operating Results**

ISM's net loss from operations decreased \$0.2 million on operating revenues of \$2.4 million in the fiscal year ended June 30, 2016, compared to a net loss from operations of \$0.7 million from operating revenues of \$2.6 million in the prior fiscal year. Total operating revenues decreased 7.7% in the fiscal year ended June 30, 2016, compared to a decrease of 8.8% in the prior fiscal year. Interest income on student loans continues to decrease as does special allowance income as the portfolio decreases.

Nonoperating revenues and expenses decreased \$1.1 million during fiscal year ended June 30, 2016, compared to an increase of \$ million in the prior fiscal year. This decrease was due declines in investment earnings of \$1.9 million offset by the fact ISM had no debt issuance costs or gain on sale of bonds in fiscal year 2016 which accounted for expenses of \$0.9 million in the prior fiscal year. The increase in fiscal year 2015 was due to the costs associated with debt refinancing, early bond retirement and lease termination expenses.

## **MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED, UNAUDITED)**

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### **Loan Servicing and ISM's Loan Programs**

ISM utilizes Pennsylvania Higher Education Assistance Agency, Xerox Education Services, LLC, and Great Lakes Education Loan Services, Inc. to service its FFELP portfolio.

ISM has a contract with Aspire Resources, Inc. and First Merchants Bank, an Indiana chartered bank, to originate HELP private student loans. Aspire Resources, Inc. is the service provider for the private HELP loan portfolio. Effective June 1, 2016, ISM contracted with Campus Door and First Merchants Bank, to originate the private ISLP loan portfolio. Pennsylvania Higher Education Assistance Agency is the service provider for this portfolio.

Additional contract compliance, loan servicing support and quality control functions are performed in ISM's Carmel, Indiana location for the student loan portfolios.

### **Requests of Information**

This financial report is designed to provide a general overview of ISM's finances for all those with an interest in ISM's finances. Questions concerning any of the information should be addressed to Indiana Secondary Market for Education Loans, Inc., 11595 North Meridian Street, Suite 200, Carmel, Indiana 40632.

## **FINANCIAL STATEMENTS**

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**STATEMENTS OF NET POSITION  
AS OF JUNE 30, 2016 AND 2015  
(In thousands)**

	<b>2016</b>	<b>2015</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and equivalents:		
Unrestricted	\$ 15,773	\$ 22,399
Restricted	1,640	3,031
Total cash and equivalents	<u>17,413</u>	<u>25,430</u>
Short-term investments:		
Unrestricted	86,451	77,126
Student loans receivable — net	10,814	10,793
Accrued interest receivable — student loans receivable	3,340	3,799
Accrued interest receivable — cash and short-term investments	140	179
Prepays and other assets	<u>330</u>	<u>234</u>
Total current assets	<u>118,488</u>	<u>117,561</u>
<b>NON-CURRENT ASSETS:</b>		
Investments	19,941	29,005
Student loans receivable — net	117,481	130,688
Capital assets — net	<u>192</u>	<u>244</u>
Total non-current assets	<u>137,614</u>	<u>159,937</u>
<b>TOTAL</b>	<u><b>\$ 256,102</b></u>	<u><b>\$ 277,498</b></u>
<b>LIABILITIES AND NET POSITION</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable and accrued expenses	\$ 1,182	\$ 1,207
Accrued interest payable	12	19
Current portion of notes payable — net	<u>16,102</u>	<u>20,216</u>
Total current liabilities	<u>17,296</u>	<u>21,442</u>
<b>NOTES PAYABLE — net</b>	<u>102,932</u>	<u>118,298</u>
Total liabilities	<u>120,228</u>	<u>139,740</u>
<b>NET POSITION:</b>		
Net investment in capital assets	192	244
Unrestricted	134,042	134,483
Restricted	<u>1,640</u>	<u>3,031</u>
Total net position	<u>135,874</u>	<u>137,758</u>
<b>TOTAL</b>	<u><b>\$ 256,102</b></u>	<u><b>\$ 277,498</b></u>

See notes to financial statements.

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.****STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET POSITION  
YEARS ENDED JUNE 30, 2016 AND 2015  
(In thousands)**

	2016	2015
OPERATING REVENUES:		
Interest on student loans	\$ 4,481	\$ 4,919
U.S. Secretary of Education:		
Special allowance	(2,828)	(3,289)
Interest subsidy	471	499
Other income	288	484
	<hr/>	<hr/>
Total operating revenues	2,412	2,613
	<hr/>	<hr/>
OPERATING EXPENSES:		
Fees	44	74
Loan servicing and administration	3,247	3,228
	<hr/>	<hr/>
Total operating expenses	3,291	3,302
	<hr/>	<hr/>
LOSS FROM OPERATIONS	(879)	(689)
	<hr/>	<hr/>
NONOPERATING REVENUES (EXPENSES):		
Gain on repurchase of bonds payable		89
Investment income	524	2,392
Interest expense	(1,529)	(1,381)
Debt issuance costs		(995)
	<hr/>	<hr/>
Total nonoperating revenues (expenses)	(1,005)	105
	<hr/>	<hr/>
CHANGE IN NET POSITION	(1,884)	(584)
	<hr/>	<hr/>
NET POSITION — Beginning of year	137,758	138,342
	<hr/>	<hr/>
NET POSITION — End of year	<u>\$ 135,874</u>	<u>\$ 137,758</u>

See notes to financial statements.

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**STATEMENTS OF CASH FLOWS**  
**YEARS ENDED JUNE 30, 2016 AND 2015**  
(In thousands)

	2016	2015
CASH FLOWS FROM OPERATING ACTIVITIES:		
Student loan interest received, net of special allowance payments	\$ 2,583	\$ 2,459
Purchase of student loans	(6,245)	(8,753)
Principal receipts on student loans	19,431	24,344
Cash received for other operating activities	291	509
Cash payments for employees and vendors	(3,291)	(3,342)
	<u>12,769</u>	<u>15,217</u>
Net cash provided by operating activities		
CASH FLOWS FROM INVESTING ACTIVITIES:		
Maturity of certificates of deposit	5,822	10,611
Proceeds from sale of investments	21,675	23,757
Purchases of investments	(30,008)	(119,721)
Dividends and interest received, net of expenses	2,813	1,790
	<u>302</u>	<u>(83,563)</u>
Net cash provided (used) by investing activities		
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Repayment and redemption of bonds		(168,561)
Payment of debt issue costs		(361)
Repayment of notes	(19,545)	(13,537)
Proceeds from issuance of notes		151,372
Interest paid on bonds	(1,536)	(1,404)
	<u>(21,081)</u>	<u>(32,491)</u>
Net cash used by noncapital financing activities		
CASH FLOWS FROM CAPITAL ACTIVITIES:		
Purchase of capital assets, net	(7)	(126)
	<u>(7)</u>	<u>(126)</u>
Net cash used by capital activities		
CHANGE IN CASH AND EQUIVALENTS	(8,017)	(100,963)
CASH AND EQUIVALENTS — Beginning of year	<u>25,430</u>	<u>126,393</u>
CASH AND EQUIVALENTS — End of year	<u>\$ 17,413</u>	<u>\$ 25,430</u>

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**STATEMENTS OF CASH FLOWS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2016 AND 2015**  
(In thousands)

	2016	2015
RECONCILIATION OF LOSS FROM OPERATIONS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Loss from operations	\$ (879)	\$ (689)
Adjustments to reconcile loss from operations to net cash provided by operating activities:		
Depreciation and amortization expense	772	815
Loss on sales and disposal of capital assets	2	25
Provision for allowance for loan losses, net of write-offs and recoveries	37	10
Interest on student loans recapitalized	(2,873)	(2,690)
Change in assets and liabilities:		
Decrease in student loans receivable	15,372	17,563
Decrease in accrued interest receivable	459	330
Increase in prepaids and other assets	(96)	(95)
Decrease in other liabilities	(25)	(52)
Net cash provided by operating activities	<u>\$ 12,769</u>	<u>\$ 15,217</u>
SUPPLEMENTAL DISCLOSURES:		
Noncash Financing and Capital Activities:		
Proceeds from issuance of notes used for debt issuance costs		\$ 634
Tenant allowance used for purchase of capital assets, included in accrued expenses		97

See notes to financial statements.

## INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

### NOTES TO FINANCIAL STATEMENTS YEARS ENDED JUNE 30, 2016 and 2015

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#### 1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

**Description of Business** - Indiana Secondary Market for Education Loans, Inc. (ISM) is an Indiana public benefit corporation formed to purchase and originate student loans under the Federal Family Education Loan Program (FFELP) provided for by the Higher Education Act (the Act), as well as private student loans. Effective March 30, 2010, the Health Care and Education Reconciliation Act of 2010 prohibited origination of any new loans after June 2010 under FFELP. Outstanding debts payable as specified in the resolutions authorizing the related sale of the debts, 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 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 certain funds are restricted pursuant to bond or note issuances. 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. The Governmental Accounting Standards Board (GASB) is the accepted standard-setting body for establishing governmental and financial reporting principles.

**Student Loans Receivable** - Student loans consist of federally insured FFELP student loans and private student loans. Private student loans consist of the Hoosier Education Loan Partnership (HELP) and more recently the ISM Student Loan Program (ISLP). Student loans receivable are stated at the principal amounts outstanding adjusted for an estimated allowance for loan losses, and unamortized purchase premiums or discounts related to FFELP loans. The related interest income generated from student loans includes premium and discount amortization. ISM amortizes premiums and discounts over the estimated average life of the loan on a straight-line basis over 10 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 for FFELP loans until the student is required, under the provisions of the 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. Depending on the options selected, repayment may begin prior to completing school.



## INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED) YEARS ENDED JUNE 30, 2016 and 2015

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#### 1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The United States Department of Education (US DOED) provides a special allowance to lenders participating in the FFELP program. For FFELP loans first disbursed prior to January 1, 2000, 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 ISM. For FFELP loans first disbursed from January 1, 2000 through June 30, 2006, the special allowance amount is the result of applying a percentage, based upon the average bond equivalent rates of the three-month financial Commercial Paper rate, to the average daily unpaid principal balance and capitalized interest of FFELP loans held by ISM. If a special allowance amount is a negative number on a FFELP loan first disbursed prior to April 1, 2006, special allowance will not be paid for that FFELP loan type for that quarter. If a special allowance amount is a negative number on a FFELP loan first disbursed after April 1, 2006, the lender must remit the excess interest ("negative SAP") to the US DOED. The special allowance amount for a FFELP loan first disbursed on or after October 1, 2007, has additional provisions for lenders qualified as an eligible not-for-profit holder. Those eligible as not-for-profit lenders earn a 15 basis point higher yield. The special allowance is accrued as earned. Effective April 1, 2012, the index used to calculate special allowance for FFELP loans disbursed after January 1, 2000, is based on one-month LIBOR.

**Cash and Equivalents** - Cash and equivalents may consist of money market funds and short-term investments with original maturities of three months or less from the date of acquisition.

**Investments** - Investments consist of certificates of deposit, US Treasury notes, bonds, stocks and mutual funds. Investments are carried at fair value, which is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction, based on available market prices of the investments or similar investments. ISM has an investment policy, approved by the Indiana Finance Authority, for all funds held outside the existing trust. ISM is restricted to investments that meet the rating requirements per the indenture of trust for all funds held within the trust.

Investment income is recorded on the accrual basis, and dividends are recorded on the ex-dividend date. Purchases and sales of investments are recorded on the trade date. Gains and losses on the sale of investments are determined using the specific-identification method. Changes in the fair value of investments are included in the statement of revenues, expenses and changes in net position.

**Allowance for Loan Losses** - Guarantees on federally insured student loans originated after October 1, 1993, but before July 1, 2006, provide for a reduced recovery of 98% of loan principal and accrued interest on FFELP loans which default. Guarantees on FFELP loans originated after July 1, 2006, provide for a reduced recovery of 97% 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.

ISM evaluates the adequacy of the allowance for loan losses on its private loan portfolio separately from federally insured FFELP loans. Several factors are considered including the following: private loans in repayment versus those in a non-paying status, delinquency status, type of credit and any trends from industry data. As the portfolio ages, historical trends and experience will be evaluated as well. ISM considers a private loan to be in default when it reaches 120 days delinquent or greater. A HELP loan is sent to a collection agency when the loan reaches 270 days delinquent without any principal or interest payment activity.

## INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED) YEARS ENDED JUNE 30, 2016 and 2015

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#### 1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

The 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. ISM utilizes two national collection agencies to attempt collection on charged off accounts. The amount attributable to expected recoveries remains in the allowance.

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, document deficiencies, and other factors are considered. Significant changes in these factors could impact the allowance and provision for loan losses. Accordingly, the evaluation of the allowance for loan losses is inherently subjective as it requires material estimates that may be subject to change.

**Capital Assets** - Capital assets consist of office furniture, equipment and leasehold improvements recorded at cost. Depreciation is charged to operations using the straight-line method over the estimated useful lives of the related assets or the term of the lease, which is 3 to 7 years depending on the asset class.

**Discounts on Notes Payable and Debt Issuance Costs** - Discounts on notes payable are amortized using the interest method over the notes issued. Debt issuance costs are recorded as expense when incurred.

**Net Position** - \$134,042,000 and \$134,483,000 of ISM's net position and all related revenues were unrestricted at June 30, 2016 and 2015, respectively. ISM does, however, maintain debt and other arrangements which limit the use of assets. At June 30, 2016 and 2015, ISM's restricted net position of \$1,640,000 and \$3,031,000, respectively, reflect debt reserve requirements (see Note 4) and \$192,000 and \$244,000, respectively, reflect amounts invested in capital assets (see 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 paid for student loans are amortized using a method which approximates the effective interest method over the estimated life of the loans (10 years). At June 30, 2016 and 2015, unamortized premiums totaled \$444,000 and \$1,138,000, respectively.

In addition, loans were purchased at a discount in June 2009, and this discount is being amortized over the estimated life of the loans (10 years). At June 30, 2016 and 2015, the unamortized discount totaled \$150,000 and \$194,000, respectively.

**Servicing Fees** - As of June 30, 2016, Pennsylvania Higher Education Assistance Agency, Xerox Education Services, LLC, and Great Lakes Education Loan Services, Inc. service ISM's FFELP student loan portfolio. Aspire Resources, Inc. services the private HELP loan portfolio for ISM. As of June 1, 2016, ISM has contracted with Pennsylvania Higher Education Assistance Agency to service the private ISLP loan portfolio. Servicing fee expense amounts are included in operating expenses in the statements of revenues, expenses and changes in net position.

## INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED) YEARS ENDED JUNE 30, 2016 and 2015

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#### 1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (CONTINUED)

**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** - Debt and loan issuances are the principal source of the funds. ISM derives revenue from investments, servicing fee income, interest earned on student loans, the U.S. Secretary of Education, and gains (losses) from the sale of student loans. ISM's expenses primarily consist of interest on debt arrangements and loan servicing and administration.

**Income Taxes** - ISM is exempt from federal income taxes under Section 501(c)(3) of the Internal Revenue Code. Therefore, no provision or liability for income taxes has been included in the financial statements. In addition, ISM has been determined by the Internal Revenue Service not to be a private foundation within the meaning of Section 509(a) of the Internal Revenue Code. Additionally, ISM meets the criteria required for classification as an affiliate of a government unit, and therefore, is not required to file federal or state information returns.

**Use of Estimates** - The preparation of financial statements in accordance 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 which are particularly susceptible to change in the near-term relate to the determination of the allowance for loan losses, fair value measurements, and future maturities of notes payable.

**Accounting Pronouncement** - ISM adopted GASB No. 72, *Fair Value Measurement and Application* during 2015. The statement provides guidance for determining fair value for financial reporting purposes, provides guidance for applying fair value to certain investments, and expands disclosure requirements for all fair value measurements. The adoption of the statement resulted in additional disclosure on fair value measurements (see Note 6).

**Subsequent Events** - Management has evaluated the financial statements for subsequent events occurring through October 20, 2016, the date the financial statements were available to be issued.

## INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED) YEARS ENDED JUNE 30, 2016 and 2015

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## 2. DEPOSITS AND INVESTMENTS

### Cash Deposits with Financial Institutions

Deposits are exposed to custodial credit risk if they are not covered by depository insurance and the deposits are uncollateralized or collateralized with securities held by the pledging financial institution. Deposits held in the three demand deposit accounts are carried at cost and are insured up to \$250,000 per financial institution.

The carrying amount of demand deposits was \$11,053,000 and bank balances were \$11,057,000. ISM's maximum risk was \$10,807,000 at June 30, 2016.

### Investments

The investment policy allows for investing in a portfolio balanced between equity and fixed income securities. The permissible investments are detailed in the investment policy. Trust accounts are invested in accordance with trust indentures executed by ISM. Excerpts from the investment policy are as follows:

#### ***(a) Investment Policy:***

- ***Scope of this Investment Policy***

The statement of investment policy reflects the investment policy, objectives, and constraints for ISM assets that are not encumbered by trust or otherwise.

- ***Long Range Goals***

In order to meet its needs, the investment strategy of the invested assets is to emphasize a balanced return of current income and modest growth of principal consistent with the preservation of the purchasing power of the Fund. By investing in a portfolio balanced between equity and fixed income securities the Board is willing to accept fluctuations to the principal value of the portfolio in order to provide an opportunity for higher long-term returns. The Board understands that short to intermediate-term results may be negative.

- ***Investments***

In order to provide the Investment Fund Manager(s) the freedom to invest within the guidelines of this policy statement, the following security classifications are permissible and suitable investment.

1. ***Equity Securities:*** Publicly traded common and preferred stocks, American Depositary Receipts (ADRs), convertible preferred stocks and convertible debentures. Equity securities may be chosen from the NYSE, regional Exchanges and the National Over-the-Counter Market. All assets must have readily ascertainable market values and be fully liquid and marketable. The equity portfolio is limited to a maximum of 5% at cost and 10% at market (of total account value) of the securities of any one issuer with the exception of exchange traded funds or mutual funds. Broad industry diversification must be maintained.

The portfolio may also invest in equity mutual funds or exchange traded funds, without limitation on the percentage weight in the portfolio.

## INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED) YEARS ENDED JUNE 30, 2016 and 2015

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#### 2. DEPOSITS AND INVESTMENTS (CONTINUED)

2. *Fixed Income*: The individually managed portfolio shall be comprised of high quality issues. All individually held Corporate Bonds must be rated no lower than Moody's or Standard & Poor's rating Baa/BBB - to be purchased or retained. The portfolio is restricted to a maximum of 5% at cost and 10% at market (of total account value) of the securities of any one issuer, with the exception of U.S. Government and Agency securities which have no limit.

The portfolio may also invest in fixed income mutual funds or exchange traded funds, without limitation on the percentage weight in the portfolio.

Investment in mutual funds shall be the chosen vehicle for exposure to high yield (below investment grade) fixed income securities should they be included in the portfolio.

The portfolio's average maturity should range from 1-7 years.

3. *Cash and Equivalents*: Cash reserves may consist of individual fixed income securities such as Commercial Paper, U.S. Treasury Bills, and other similar instruments, with less than one year to maturity and/or money market funds. Cash reserves should be free from risk and have instant liquidity. Short-term instruments of maturities less than one year in U.S. Government or U.S. Agencies are not restricted in the size of the position.

4. *Non-Traditional Assets*: Non-Traditional Assets includes SEC registered mutual funds and exchange traded funds that invest in asset classes and/or strategies outside of traditional long only equity and fixed income securities portfolios. These investment classes include, but are not limited to: convertible securities, convertible arbitrage, long/short equity, commodities, precious metals, real estate investment trusts, foreign bonds and senior bank loans. Permitted holdings include open and/or closed-end mutual funds, and exchange traded funds.

The Investment Advisor assists the Investment Committee in balancing the total Fund within the following established strategic allocation parameters:

<u>Investment Class</u>	<u>Target</u>	<u>Allowable Range</u>
Equities	50%	30% - 70%
Fixed income	30%	20% - 70%
Cash and equivalents	0%	0% - 20%
Non-traditional assets	20%	0% - 30%

#### • **Performance Review and Evaluation**

Performance reports generated by the Investment Advisor shall be compiled at least quarterly and communicated to the Investment Committee for review. The purpose of these reports shall be to review and evaluate both the Investment Advisor and the Investment Fund Managers. The investment performance of total portfolios, as well as asset class components, will be measured against commonly accepted performance benchmarks. Consideration shall be given to the extent to which the investment results are consistent with the investment objectives, goals and guidelines as set forth in this policy. The Investment Committee intends to evaluate the portfolio(s) over at least a five to seven year period, but reserve the right to terminate a fund manager for any reason including the following:

# INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

## NOTES TO FINANCIAL STATEMENTS (CONTINUED) YEARS ENDED JUNE 30, 2016 and 2015

### 2. DEPOSITS AND INVESTMENTS (CONTINUED)

1. Investment performance which is significantly less than anticipated given the discipline employed and the risk parameters established, or unacceptable justification of poor results.
2. Failure to adhere to any aspect of this statement of investment policy, including communication and reporting requirements.
3. Significant qualitative changes to the investment fund management organization.

Investment Fund Managers shall be reviewed regularly regarding performance, personnel, strategy, research capabilities, organizational and business matters, and other qualitative factors that may impact their ability to achieve the desired investment results. The Investment Advisor's performance shall also be reviewed regularly. Due diligence reports from the Investment Advisor are expected annually or when deemed appropriate by Investment Advisor, Directors or Investment Committee.

The objective of monitoring is not to set in opposition one Investment Fund Manager or program against another, but rather to ensure prudent management of the Fund and compliance with this policy. It is of primary importance that the guidelines are adhered to and the objectives be met. The Investment Committee shall review the investment management consultant's performance on a full market cycle (five year).

### Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of the investments.

As of June 30, 2016 and 2015, ISM had the following investments and cash equivalents and maturities:

2016 Investment Type	Fair Value (In thousands)	Maturities (In Years)			
		< 1	1-5	6-10	> 10
Money market fund shares	\$ 6,360	\$ 6,360			
Fixed income investments:					
U.S. Treasury notes	3,793		\$ 2,347	\$ 1,446	
Corporate bonds	15,735	1,564	9,929	4,242	
Govt agency bonds	838		150		\$ 688
Municipal bonds	1,396	257	981	158	
Mutual fund bond funds	13,218	13,218			
Certificates of deposit	1,756	1,756			
Common stocks	22,675	22,675			
Equity mutual funds	14,858	14,858			
Exchange traded products	32,123	32,123			
	<u>\$ 112,752</u>	<u>\$ 92,811</u>	<u>\$ 13,407</u>	<u>\$ 5,846</u>	<u>\$ 688</u>

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2016 and 2015**

**2. DEPOSITS AND INVESTMENTS (CONTINUED)**

2015 Investment Type	Fair Value (In thousands)	Maturities (In Years)			
		< 1	1-5	6-10	> 10
Money market fund shares	\$ 14,422	\$ 14,422			
Fixed Income investments:					
U.S. Treasury notes	6,500		\$ 5,803	\$ 697	
Corporate bonds	15,332	261	11,054	4,017	
Govt agency bonds	2,149		1,625		\$ 524
Municipal bonds	1,422		1,150	272	
Mutual fund bond funds	2,099		1,604	495	
Certificates of deposit	7,011	5,247	1,764		
Common stocks	22,661	22,661			
Equity mutual funds	11,161	11,161			
Exchange traded products	37,796	37,796			
	<u>\$ 120,553</u>	<u>\$ 91,548</u>	<u>\$ 23,000</u>	<u>\$ 5,481</u>	<u>\$ 524</u>

**Custodial Credit Risk**

Custodial credit risk is the risk ISM will not be able to recover the value of its deposits, investments or collateral securities that are in the possession of an outside party if the counterparty fails. Investment securities are exposed to risk if the securities are uninsured, are not registered in the name of ISM, and are held by either the counterparty or the counterparty's trust department or agent but not in ISM's name. ISM has no custodial credit risk on investments.

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2016 and 2015**

**2. DEPOSITS AND INVESTMENTS (CONTINUED)**

**Credit Risk**

The following table provides information on the credit ratings associated with ISM's investments and cash equivalents as of June 30, 2016:

<b>Investment Type</b>	<b>Fair Value (In thousands)</b>	<b>S &amp; P</b>	<b>Moody's</b>
Money market fund shares	\$ 3,520	AAAm	Aaa-mf
Money market fund shares	2,840	unrated	unrated
U.S. Treasury notes	3,793	unrated	AAA
Corporate bonds	310	AA+	AAA
Corporate bonds	569	AA+	A1
Corporate bonds	506	AA-	AA2
Corporate bonds	251	AA-	AA3
Corporate bonds	401	AA-	A1
Corporate bonds	251	AA-	A2
Corporate bonds	365	A+	AA3
Corporate bonds	277	A+	A2
Corporate bonds	305	A	AA2
Corporate bonds	269	A	A1
Corporate bonds	1,549	A	A2
Corporate bonds	374	A	A3
Corporate bonds	505	A-	A2
Corporate bonds	2,011	A-	A3
Corporate bonds	473	A-	BAA1
Corporate bonds	621	A-	BAA2
Corporate bonds	1,285	BBB+	A3
Corporate bonds	1,018	BBB+	BAA1
Corporate bonds	417	BBB+	BAA3
Corporate bonds	214	BBB	BAA1
Corporate bonds	1,579	BBB	BAA2
Corporate bonds	605	BBB	BAA3
Corporate bonds	904	BBB-	BAA2
Corporate bonds	536	BBB-	BAA3
Corporate bonds	140	BBB-	BA1
Govt agency bonds	150	AA+	AAA
Govt agency bonds	688	unrated	unrated
Municipal bonds	105	AAA	AA2
Municipal bonds	158	AA	unrated
Municipal bonds	271	AA-	AAA
Municipal bonds	26	A	AA2
Municipal bonds	254	A	A1
Municipal bonds	221	A	unrated
Municipal bonds	361	A-	A3
Certificates of deposit	1,756	unrated	unrated
<b>Grand Total</b>	<b>\$ 29,878</b>		



## INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED) YEARS ENDED JUNE 30, 2016 and 2015

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#### 2. DEPOSITS AND INVESTMENTS (CONTINUED)

##### Concentration of Credit Risk

Concentration of credit risk is the risk of loss that may arise in the event of default by a single issuer.

The following shows investments in issuers that represents 5% or more of the total investments at June 30, 2016:

iShares Russell 1000 Value ETF	7%
Brown Advisory Growth mutual fund	6%

##### Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or a deposit. At June 30, 2016, there was no foreign currency risk exposure.

#### 3. STUDENT LOANS RECEIVABLE - NET

Student loans receivable consist of FFELP loans made under the Act and are carried at their unpaid principal balance net of an allowance for loan losses plus unamortized purchase premiums and discounts. FFELP loans earn interest at various rates ranging from 1.72% to 10.00%, depending upon the type of FFELP loan and the date the FFELP loan was made. Substantially all of the principal and accrued interest on FFELP loans is insured by certain guarantee agencies which are reinsured by the federal government. At June 30, 2016 and 2015, the majority of ISM's FFELP loans were guaranteed by the Pennsylvania Higher Education Assistance Agency (59% as of June 30, 2016), California Student Aid Commission/EDFund (18% as of June 30, 2016), and Educational Credit Management Corporation (10% as of June 30, 2016).

Student loans receivable also consist of private loans either originated or purchased under the HELP loan program. As of June 30, 2016, no ISLP loans have been issued. Private loans are carried at their unpaid principal balance net of an allowance for loan losses. Private loans earn interest at various rates ranging from 3.58% to 10.58%, depending on the type of private loan and date the loan was made. Private loans are not subject to any federal guarantees.

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.****NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2016 and 2015**

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**3. STUDENT LOANS RECEIVABLE - NET (CONTINUED)**

A portfolio of FFELP loans were sold in June 2013 and this sale agreement includes certain recourse provisions where ISM is required to repurchase FFELP loans that have inaccuracies that materially and adversely affect the value of the FFELP loan. The recourse provision is in effect through the life of the FFELP loans. ISM has 60 days to cure any identified issue prior to being required to repurchase the FFELP loan. ISM has recorded an estimated recourse liability which is included as a component of the allowance for loan losses.

Student loans receivable - net as of June 30, 2016 and 2015, consisted of the following:

	<b>2016</b>	<b>2015</b>
	<b>(In thousands)</b>	
Federal family education loan program	\$ 127,808	\$ 140,833
Private loan programs	1,146	694
Purchase premiums and discounts - net	294	944
Less - allowance for loan losses	<u>(953)</u>	<u>(990)</u>
End of year	<u><u>\$ 128,295</u></u>	<u><u>\$ 141,481</u></u>
Current portion	<u><u>\$ 10,814</u></u>	<u><u>\$ 10,793</u></u>
Long-term portion	<u><u>\$ 117,481</u></u>	<u><u>\$ 130,688</u></u>

The activity for the allowance for loan losses for the years ended June 30, 2016 and 2015 is as follows:

	<b>2016</b>	<b>2015</b>
	<b>(In thousands)</b>	
Beginning of year	\$ 990	\$ 1,000
Provision for loan losses	110	81
Recoveries	1	
Write-offs of loans	<u>(148)</u>	<u>(91)</u>
End of year	<u><u>\$ 953</u></u>	<u><u>\$ 990</u></u>

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2016 and 2015**

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**4. NOTES PAYABLE**

Notes payable as of June 30, 2016 and 2015, consisted of Floating Rate Notes (FRNs). The following table displays the aggregate changes in and notes payable for the years ended June 30, 2016 and 2015:

	<b>2015</b>	<b>Additions</b>	<b>Reductions</b>	<b>2016</b>
Notes payable, net	<u>\$ 138,514</u>	<u>\$</u>	<u>\$ (19,480)</u>	<u>\$ 119,034</u>

  

	<b>2014</b>	<b>Additions</b>	<b>Reductions</b>	<b>2015</b>
Bonds payable	\$ 168,650	\$	\$ (168,650)	\$
Notes payable, net	<u>152,006</u>	<u>152,006</u>	<u>(13,492)</u>	<u>138,514</u>
	<u>\$ 168,650</u>	<u>\$ 152,006</u>	<u>\$ (182,142)</u>	<u>\$ 138,514</u>

Notes payable at June 30, 2016, includes \$119,423 million of taxable LIBOR FRNs less an unamortized bond discount of \$389 thousand. The FRNs mature on February 25, 2044. Interest on the FRNs ranged from 0.987% to 1.246% and 0.968% to 1.005% during the years ended June 30, 2016 and 2015, respectively. The interest rate is based on one-month LIBOR on a set determination date which is the second business day immediately preceding each Distribution Date plus a spread of .80% per annum. Interest is paid on the Distribution Date which is the 25<sup>th</sup> of each calendar month or the next succeeding business day. These notes payable are limited obligations of ISM and are payable from the student loans, revenues, and recoveries of principal and all amounts held in any account established under the note documents. Principal payments are required to be made monthly based on available funds less required fees and transfers as stipulated in the note documents.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

NOTES TO FINANCIAL STATEMENTS (CONTINUED)  
YEARS ENDED JUNE 30, 2016 and 2015

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4. NOTES PAYABLE (CONTINUED)

The following table displays estimated future debt maturities and interest payments for notes payable at June 30, 2016 (in thousands), based on ISM's best estimate of expected available future cash flows as stipulated in the note documents:

Year Ending, June 30,	Principal	Interest	Total
2017	\$ 16,102	\$ 1,646	\$ 17,748
2018	14,714	1,779	16,493
2019	13,756	1,809	15,565
2020	13,625	1,596	15,221
2021	12,712	1,286	13,998
2022-2026	<u>48,125</u>	<u>2,486</u>	<u>50,611</u>
	<u>\$ 119,034</u>	<u>\$ 10,602</u>	<u>\$ 129,636</u>

Significant changes in the estimated available future cash flows could impact the reported future debt maturities and interest payments. Accordingly, the estimated future debt maturities and interest payments are inherently subjective as it requires material estimates that may be subject to change.

Notes payable are secured by (a) the proceeds derived from the sale of the notes, (b) eligible loans, and (c) certain accounts established by the respective note resolutions, including monies and securities therein.

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

**Collection Fund** - This fund is used to account for all revenues received by ISM with respect to the FFELP Loans. The funds are used for the following distributions: (a) department reserve funds for payments to the US DEOD, (b) estimated program expenses, (c) principal and interest payments, and (d) transfers to reinstate balance of Debt Service Reserve Fund.

**Reserve Funds** - These funds may either be used to maintain a minimum reserve requirement or to be paid to the US DOED for required funds due based on the FFELP Loans.

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2016 and 2015**

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**5. CAPITAL ASSETS**

Capital assets activity for the years ended June 30, 2016 and 2015, (in thousands) were as follows:

	<b>2015</b>	<b>Additions</b>	<b>Retirements</b>	<b>2016</b>
Depreciable capital assets:				
Furniture and equipment	\$ 593	\$ 8	\$ 26	\$ 575
Leasehold improvements	111	1		112
Total depreciable capital assets	704	9	26	687
Less accumulated depreciation	460	58	23	495
Net depreciable capital assets	<u>\$ 244</u>	<u>\$ (49)</u>	<u>\$ 3</u>	<u>\$ 192</u>

  

	<b>2014</b>	<b>Additions</b>	<b>Retirements</b>	<b>2015</b>
Depreciable capital assets:				
Furniture and equipment	\$ 587	\$ 107	\$ 101	\$ 593
Leasehold improvements	865	120	874	111
Total depreciable capital assets	1,452	227	975	704
Less accumulated depreciation	1,344	62	946	460
Net depreciable capital assets	<u>\$ 108</u>	<u>\$ 165</u>	<u>\$ 29</u>	<u>\$ 244</u>

## INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

### NOTES TO FINANCIAL STATEMENTS (CONTINUED) YEARS ENDED JUNE 30, 2016 and 2015

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#### 6. FAIR VALUE MEASUREMENTS

ISM has categorized its assets and liabilities that are measured at fair value into a three-level fair value hierarchy. The hierarchy prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). The asset or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The three levels of the fair value hierarchy are described as follows:

**Level 1** - Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that ISM has the ability to access.

**Level 2** - Inputs to the valuation methodology may include: quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in inactive markets; inputs other than quoted prices that are observable for the asset or liability; and/or inputs that are derived principally from or corroborated by observable market data by correlation or other means. If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.

**Level 3** - Inputs to the valuation methodology are unobservable and significant to the fair value measurement. In situations where there is little or no market activity for the asset or liability, ISM makes estimates and assumptions related to the pricing of the asset or liability including assumptions regarding risk.

Following is a description of the valuation methodologies used by ISM for assets that are measured at fair value on a recurring basis. There have been no changes in the methodologies used at June 30, 2016 and 2015.

**Mutual Fund Shares and Money Market Fund Shares:** Valued at the daily closing price, as reported by each fund. These funds are required to publish net asset value (NAV) and the transaction price. These funds are deemed to be actively traded.

**Common Stocks, Exchange Traded Funds, and Government Obligations:** Valued at the closing price reported on the active market on which the individual securities are traded.

**Corporate Bonds:** Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issues with similar credit ratings.

**Certificates of Deposit:** Determined by discounting the related cash flows on current yields of similar investments with comparable durations considering the credit-worthiness of the issuer.

For those assets measured at fair value, management determines the fair value measurement policies and procedures in consultation with ISM's Finance Committee. Those policies and procedures are reassessed at least annually to determine if the current valuation techniques are still appropriate. At that time, the unobservable inputs used in the fair value measurements are evaluated and adjusted, as necessary, based on current market conditions and other third-party information.

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2016 and 2015**

**6. FAIR VALUE MEASUREMENTS (CONTINUED)**

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although ISM's management believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain assets could result in a different fair value measurement at the reporting date.

Following is a summary, within each level of the fair value hierarchy, of ISM's assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2016 and 2015:

<b>2016</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<b>Assets:</b>				
Cash equivalents:				
Money market fund shares	\$ 6,360			\$ 6,360
Investments:				
Exchange-traded funds	32,123			32,123
Equity mutual fund shares:				
International	6,268			6,268
Other	8,590			8,590
Fixed income mutual fund shares	13,218			13,218
Other fixed income investments:				
Corporate bonds		\$ 15,735		15,735
Government agency	838			838
Municipal bonds	1,396			1,396
U.S. Treasury notes	3,793			3,793
Certificates of deposit		1,756		1,756
Common stocks:				
Consumer discretionary	3,566			3,566
Consumer staples	2,313			2,313
Energy	1,436			1,436
Financials	3,357			3,357
Healthcare	3,702			3,702
Industrials	2,850			2,850
Information technology	4,916			4,916
Telecommunications	535			535
Total Assets at Fair Value	<u>\$ 95,261</u>	<u>\$ 17,491</u>	<u>\$ -</u>	<u>\$ 112,752</u>

**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2016 and 2015**

**6. FAIR VALUE MEASUREMENTS (CONTINUED)**

	2015	Level 1	Level 2	Level 3	Total
<b>Assets:</b>					
Cash equivalents:					
Money market fund shares		\$ 14,422			\$ 14,422
Investments:					
Exchange-traded funds		37,796			37,796
Equity mutual fund shares:					0
International		4,769			4,769
Other		6,392			6,392
Fixed income mutual fund shares		2,099			2,099
Other fixed income investments:					
Corporate bonds			\$ 15,332		15,332
Government agency		2,149			2,149
Municipal bonds		1,422			1,422
U.S. Treasury notes		6,500			6,500
Certificates of deposit			7,011		7,011
Common stocks:					
Consumer discretionary		3,521			3,521
Consumer staples		2,149			2,149
Energy		1,346			1,346
Financials		3,376			3,376
Healthcare		3,751			3,751
Industrials		3,000			3,000
Information technology		5,074			5,074
Telecommunications		444			444
Total Assets at Fair Value		<u>\$ 98,210</u>	<u>\$ 22,343</u>	<u>\$ -</u>	<u>\$ 120,553</u>

**7. RETIREMENT PLANS**

ISM established the Indiana Secondary Market 401(k) Retirement Plan (Plan) in July 2002. Effective March 16, 2012, this Plan was merged into the EmPower Retirement Savings Plan as part of the contract with Human Capital Concepts, LLC. The Plan is a "Safe Harbor 401(k) Plan" as described in the Code. All employees 18 or older are eligible to participate on the first day of the month following their hire date. ISM makes a safe-harbor matching contribution equal to 100% of the first 4% that each participant contributes to the Plan. ISM also may make a discretionary profit-sharing contribution to the Plan for participants who are employed at the end of the Plan year. Participants are 100% vested in ISM's contributions after one year of service. ISM's contributions to the Plan during fiscal years 2016 and 2015 were approximately \$35,000 and \$32,000, respectively.



**INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.**

**NOTES TO FINANCIAL STATEMENTS (CONTINUED)**  
**YEARS ENDED JUNE 30, 2016 and 2015**

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**8. COMMITMENT**

ISM moved offices during 2015 and leases office space under the terms of a long-term non-cancellable operating lease. Future minimum required payments under this operating lease at June 30, 2016, were as follows:

<b>Years Ending June 30,</b>	<b>Rental Payments (in Thousands)</b>
2017	\$ 104
2018	107
2019	109
2020	112
2021	105
	<hr/>
	\$ 537
	<hr/>

Rent expense under operating leases were approximately \$71,000 and \$708,000 for the years ended June 30, 2016 and 2015, respectively.

ISM entered into sublease agreements for a portion of its previous office space. The amount of rental income received for the year ended June 30, 2015, was approximately \$200,000.

**9. CONTINGENCIES**

ISM is subject to various legal proceedings and claims which arise primarily in the ordinary course of conducting its business. In management's opinion, the ultimate resolution of such matters will not have a material adverse effect on ISM's net position or its changes in net position.

## **OTHER REPORT**

*Independent Auditors' Report on Internal Control over  
Financial Reporting and on Compliance and Other Matters  
Based on an Audit of Financial Statements Performed  
in Accordance with Government Auditing Standards*

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

We have audited, in accordance with the 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, the financial statements of Indiana Secondary Market for Education Loans, Inc. (ISM), a component unit of the State of Indiana, which comprise the statement of net position as of June 30, 2016, and the related statements of revenues, expenses, and changes in net position and cash flows for the year then ended, and the related notes to the financial statements and have issued our report thereon dated October 20, 2016.

### **Internal Control over Financial Reporting**

In planning and performing our audit of the financial statements, we considered ISM's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of ISM's internal control. Accordingly, we do not express an opinion on the effectiveness of ISM's internal control.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether ISM's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## **Purpose of this Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Katz, Sapper & Miller, LLP*

Indianapolis, Indiana  
October 20, 2016