Missouri Higher Education Loan Authority

Financial Statements for the Years Ended June 30, 2003 and 2002 and Independent Auditors' Report

MISSOURI HIGHER EDUCATIONAL LOAN AUTHORITY

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MISSOURI HIGHER EDUCATION LOAN AUTHORITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2003
(UNAUDITED)

THE AUTHORITY

The Missouri Higher Education Loan Authority (the "Authority") is a body corporate and politic created by the General Assembly of the State of Missouri through passage of HB 326, signed into law on June 15, 1981. The Authority was created in order to insure that all eligible post-secondary education students have access to student loans that are guaranteed or insured. The act was amended, effective August 28, 1994, and again effective August 28, 2003 to provide the Authority with generally expanded powers to finance, acquire, and service student loans. House Bill 221, effective August 28, 2003, allows the Authority to originate Parental Loans for Undergraduate Students (PLUS loans) and extends the date for repayment of bonds issued by the Authority from 30 to 40 years. The Bill also repeals sections of law setting restriction on variable-rate unsecured loans. The repeal of variable rate restrictions allows the Authority to restructure the rates assessed for the Supplemental and Qualified Institution Loan Programs.

The Authority is committed to providing quality service to all participants in the Student Loan Program through the development of all its financial, technical and human resources. By insuring that all eligible citizens within the state of Missouri are provided access to the benefits of higher education, the economic and cultural viability of the State and its citizens will be significantly enhanced.

The Authority owns and services student loans established by the Higher Education Act under the Federal Family Education Loan Program (FFELP). Loans authorized under FFELP include Subsidized and Unsubsidized Stafford, Parental (PLUS) and (SLS), and Consolidation loans. The Authority also owns consolidated Health Education Assistance Loans (HEAL) established by the Public Health Service Act insured through the Department of Health and Human Services (HHS). In addition, the Authority is the lender and guarantor for supplemental loans made available predominantly to students in the Midwestern area who have reached the maximum available under the FFELP. There are several types of loans under the supplemental program providing for eligible borrowers attending eligible medical, law, undergraduate, technical, graduate, and pharmacy schools.

During fiscal year 2003, the Authority purchased/originated $1,156 million of gross principal student loans from a variety of financial institutions. This compares to $878 million gross principal during fiscal year 2002 representing a 32% increase in purchases over the previous fiscal year. The purchase activity less loan pay downs through borrower payment and consolidation payment collections resulted in a 21% growth in the overall portfolio.

The Authority is able to finance the purchase of student loans through the issuance of taxable and tax-exempt student loan revenue bonds and recycled funds. The Authority issued $700 million in taxable bonds during fiscal year 2003 compared to $70.8 million in tax-exempt bonds during fiscal 2002. The Authority did not have to issue taxable bonds during fiscal 2002 because of a $500 million taxable issuance late in fiscal 2001. The Authority is scheduled to issue an additional $500 million in taxable bonds in early fiscal 2004.

The current interest rate environment has not had an adverse effect on the Authority. Interest rate decreases have caused borrower interest revenues to dip 11.4% even with the increase in loans outstanding. However, despite the 27.4% increase in bonds outstanding, debt service has decreased almost 5%. Conversely, should interest rates rise, the immediate effect to the Authority would be higher debt expense. Although borrower interest rates would remain the same through June 2004, the Authority's loan revenues would be leveraged by an increase in government subsidy.

During fiscal 2003 the Authority converted a $50 million tax-exempt variable rate demand note to fixed rate debt. The reoffering enables the Authority to practice long-term debt management without the influence of unpredictable interest rate trends.

This report includes three financial statements: the statements of net assets, the statements of revenues, expenses, and changes in net assets and the statements of cash flows. These financial statements are prepared in accordance with Governmental Accounting Standards Board principles. The statements of net assets present the financial position of the Authority at the end of the fiscal year and includes all assets and liabilities of the Authority. The statements of revenues, expenses and changes in net assets present the Authority's results of operations. The statements of cash flows provide a view of the sources and uses of the Authority's cash resources.

CONDENSED FINANCIAL POSITION
(In thousands)

	2003	2002
Cash, cash equivalents and investments	$ 286,657	$ 193,902
Accrued interest receivable	52,839	53,213
Capital assets	15,453	16,376
Other	9,250	8,482
Student loans receivable	2,980,766	2,458,765
Total assets	$3,344,965	$2,730,738
Current liabilities	$ 59,200	$ 130,105
Long-term liabilities	3,135,016	2,474,061
Total liabilities	$3,194,216	$2,604,166
Invested in capital assets	$ 15,453	$ 16,376
Restricted	87,794	69,064
Unrestricted	47,502	41,132
Total net assets	$ 150,749	$ 126,572

CONDENSED OPERATING RESULTS
(In thousands)

	2003	2002
Interest and interest subsidy on student loans	$ 112,763	$ 127,265
Special allowance	16,272	10,805
Other income	9,953	8,916
Total operating revenue	138,988	146,986
Bond expense	64,221	72,568
Administrative and general expense	39,114	33,584
Provision for arbitrage rebate	11,476	21,118
Total operating expense	114,811	127,270
Operating income	$ 24,177	$ 19,716

FINANCIAL ANALYSIS
2003 AS COMPARED TO 2002

Financial Position

Total assets increased $614 million or 22% compared to an increase in liabilities of $590 million or 23% resulting in an increase to the Authority's net assets of $24 million or 19%.

Cash, cash equivalents, and investments increased by 48% to $286.7 million from $193.9 million in fiscal 2002. The increase in cash, cash equivalents, and investments was due largely to the sale of over $90 million in loans during the last month of the fiscal year. The loans were sold to liquidate a small portion of the Authority's portfolio serviced by a third party. The funds were reinvested the following month in loans that are serviced by the Authority. Student loans receivable increased 21% from $2,459 billion to $2,981 billion reflecting the net purchase activity during fiscal 2003.

Current liabilities decreased by $70.9 million due to the payoff of the $95 million line of credit in early fiscal 2002. The $95 million was partially offset by the current net bonds payable increase of approximately $22.7 million. The line of credit agreement expired during fiscal 2003 and was not renewed. A small decrease in accrued interest payable is the result of continued reduction in market rates throughout the year. Conversely, the low rates are conducive to increases in arbitrage rebate liability which reflects a 25% increase over the prior year.

Long-term liabilities increased $661 million or 27%. The increase is due to the increase in net bonds payable as a result of the issuance of $700 million in bonds in early fiscal 2003. All funds available for loan purchases from this issuance were used to purchase loans during the fiscal year.

Operating Results

Total operating revenue was down approximately $8 million driven by the $14.5 million decrease in interest on loans. For example, subsidized and unsubsidized Stafford loans made between October 1, 1998 and July 1, 2003, which are in status other than in-school, grace and deferment bear interest at a rate equivalent to the 91-day T-Bill rate plus 2.30%, with a maximum rate of 8.25%. Loans made within the same period with in-school, grace and deferment status bear interest at a rate equivalent to the 91-day T-Bill rate plus 1.70%, with a maximum rate of 8.25%. During fiscal 2002 the rate on these loans was set at 5.99% and 5.39% respectively. The rate on the same loans during fiscal 2003 was 4.06% and 3.46% respectively. PLUS loans bear interest at a rate equivalent to the 91-day T-Bill rate with a maximum rate of 9%. The rate is adjusted annually on July 1 based on the 91-day T-Bill rate on the last auction date in May. Consolidation loans for which the application was received by an eligible lender on or after October 1, 1998 and prior to July 1, 2003, bear interest at a rate equal to the weighted average rate of the loans consolidated, rounded to the nearest higher one-eighth of 1%, with a maximum rate of 8.25%. In addition, the Authority offers rate reduction to borrowers who establish payments through automatic deduction and or qualify for relief through the Carnahan Public Service Reward Program. The Carnahan Program provides rate reductions, and in some cases loan principal reduction or forgiveness, for people who have chosen careers in public service in the State of Missouri including peace officers, teachers, social workers, military, nursing, and state government employees. The decrease in loan interest revenues related to the above-mentioned factors was partially offset by loan sale proceeds and the special allowance provided by the U.S. Secretary of Education to lenders participating in the Federal Family Education Loan Program.

Total operating expense realized a 9.8% decrease, or $12.5 million, driven by an $8.4 million decrease in bond expense. Continued reductions in the interest rate market environment reduced the cost of funds despite the additional bonds payable added in July 2002. An additional provision for arbitrage rebate of $11.5 million was added in fiscal 2003. Although the provision was $9.6 million less than the previous fiscal year the continually falling market rates resulted in a need to add to the provision. The Authority has also experienced greater efficiencies as a result of improved technology and staff experience.

INDEPENDENT AUDITORS' REPORT

Board of Directors
Missouri Higher Education Loan Authority

We have audited the accompanying statements of net assets of the Missouri Higher Education Loan Authority (the "Authority") as of June 30, 2003 and 2002, 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 the Authority. 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. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Missouri Higher Education Loan Authority, as of June 30, 2003 and 2002, 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 1-4 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 the Authority'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.

/s/ DELOITTE & TOUCHE LLP

St. Louis, Missouri
August 29, 2003

MISSOURI HIGHER EDUCATION LOAN AUTHORITY

STATEMENTS OF NET ASSETS
JUNE 30, 2003 AND 2002
(In thousands)

ASSETS	2003	2002
CURRENT ASSETS:		
Cash and cash equivalents:		
Restricted	$ 30,743	$ 5,744
Unrestricted	240,955	157,899
Total cash and cash equivalents	271,698	163,643
Investments held by Trustee—unrestricted	503	
Student loans receivable	26,281	21,128
Accrued interest receivable:		
U.S. Secretary of Education:		
Interest subsidy	4,421	5,266
Special allowance	4,022	2,664
Investments held by Trustee	480	440
Student loans receivable	43,916	44,843
Miscellaneous receivables and prepaid expenses	1,610	1,072
Deferred charges	262	249
Total current assets	353,193	239,305
LONG-TERM ASSETS:		
Investments held by Trustee:		
Restricted	5,723	29,739
Unrestricted	8,733	520
Total investments held by Trustee	14,456	30,259
Student loans receivable	2,954,485	2,437,637
Prepaid pension expense	3,936	4,123
Deferred charges—at cost less accumulated amortization of $1,875 in 2003 and $1,672 in 2002	3,442	3,038
Capital assets—at cost less accumulated depreciation of $3,025 in 2003 and $2,071 in 2002	15,453	16,376
Total long-term assets	2,991,772	2,491,433
TOTAL	$3,344,965	$2,730,738

LIABILITIES AND NET ASSETS	2003	2002
CURRENT LIABILITIES:		
Bonds payable—net	$ 45,150	$ 22,378
Line of credit		95,000
Accrued interest payable	7,059	7,997
Other liabilities	6,991	4,730
Total current liabilities	59,200	130,105
LONG-TERM LIABILITIES:		
Bonds payable—net	3,090,044	2,438,127
Arbitrage rebate payable	44,972	35,934
Total long-term liabilities	3,135,016	2,474,061
Total liabilities	3,194,216	2,604,166
NET ASSETS:		
Invested in capital assets	15,453	16,376
Restricted	87,794	68,812
Unrestricted	47,502	41,384
Total net assets	150,749	126,572
TOTAL	$3,344,965	$2,730,738

See notes to financial statements.

MISSOURI HIGHER EDUCATION LOAN AUTHORITY

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
YEARS ENDED JUNE 30, 2003 AND 2002
(In thousands)

	2003	2002
OPERATING REVENUES:		
Interest on student loans	$ 96,762	$ 108,255
U.S. Secretary of Education:		
Interest subsidy	16,001	19,010
Special allowance	16,272	10,805
Investment income:		
Interest on cash equivalents and investments	7,898	8,293
Gain (loss) on investments held by Trustee	(181)	499
Gain on sale of loans	1,892	
Servicing fee income	344	124
Total operating revenues	138,988	146,986
OPERATING EXPENSES:		
Interest expense	63,232	71,885
Salaries and employee benefits	13,448	11,117
Program participation fees	12,235	9,628
Provision for arbitrage rebates	11,476	21,118
Computer services	4,355	3,910
Postage	1,560	1,362
Letter of credit fees	997	1,025
Bond maintenance fees	989	683
Depreciation	970	793
Other operating expenses	5,549	5,749
Total operating expenses	114,811	127,270
CHANGE IN NET ASSETS	24,177	19,716
NET ASSETS—Beginning of year	126,572	106,856
NET ASSETS—End of year	$ 150,749	$ 126,572

See notes to financial statements.

MISSOURI HIGHER EDUCATION LOAN AUTHORITY

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2003 AND 2002
(In thousands)

	2003	2002
CASH FLOWS FROM OPERATING ACTIVITIES:		
Student loan and interest purchases	$ (1,195,947)	$ (913,918)
Student loan repayments	605,758	426,427
Cash received for sale of loans and interest	94,854	
Payment to employees and vendors	(35,766)	(31,467)
Cash received for interest	109,244	111,027
Other	(250)	7,619
Net cash from operating activities	(422,107)	(400,312)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Proceeds from issuance of bonds—net	695,975	69,098
Proceeds from line of credit		95,000
Repayment of bonds	(22,627)	(52,879)
Repayment of line of credit	(95,000)	(9,482)
Interest paid on bonds and line of credit	(63,246)	(76,489)
Net cash from noncapital financing activities	515,102	25,248
CASH FLOWS FROM CAPITAL ACTIVITIES— Purchase of capital assets—net	(59)	(9,462)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Proceeds from maturities of investments held by Trustee	273,792	228,930
Purchases of investments held by Trustee	(258,673)	(23,800)
Net cash from investing activities	15,119	205,130
CHANGE IN CASH AND CASH EQUIVALENTS	108,055	(179,396)
CASH AND CASH EQUIVALENTS—Beginning of year	163,643	343,039
CASH AND CASH EQUIVALENTS—End of year	$ 271,698	$ 163,643

(Continued)

MISSOURI HIGHER EDUCATION LOAN AUTHORITY

STATEMENTS OF CASH FLOWS
YEARS ENDED JUNE 30, 2003 AND 2002
(In thousands)

	2003	2002
RECONCILIATION OF OPERATING INCOME TO NET CASH USED IN OPERATING ACTIVITIES:		
Change in net assets	$ 24,177	$ 19,716
Adjustments to reconcile change in net assets to net cash used in operating activities:		
Depreciation and amortization:		
Capital assets	970	793
Loan and bond charges	16,086	12,543
Interest expense	63,232	71,885
Provision for arbitrage rebates expense	11,476	21,118
Gain on sale of loans	1,892	
Loss/(gain) on investments held by Trustee	181	(499)
Loss on disposal of capital assets	12	433
Change in assets and liabilities:		
Increase in student loans receivable	(538,982)	(518,843)
Decrease (increase) in accrued interest receivable	374	(4,557)
Increase in miscellaneous receivables and prepaid expenses	(1,348)	(231)
Decrease in arbitrage rebate payable	(2,438)	(3,184)
Increase in other liabilities	2,261	514
Total adjustments	(446,284)	(420,028)
Net cash used in operating activities	$ (422,107)	$ (400,312)

See notes to financial statements. (Concluded)

1. DESCRIPTION OF THE ORGANIZATION

Legislation, which was signed into law on June 15, 1981 by the Governor of the State of Missouri and became effective on September 28, 1981, created the Missouri Higher Education Loan Authority (the "Authority") for the purpose of providing a secondary market for loans made under the Federal Family Education Loan Program provided for by the Higher Education Act. Student loan revenue bonds outstanding are payable as specified in the resolutions authorizing the sale of bonds. The bonds are not payable from funds received from taxation and are not debts of the State of Missouri or any of its political subdivisions.

The Authority is the lender and guarantor for supplemental loans made available to students in the Midwestern region who have reached the maximum available under the Federal Family Education Loan Program provided under the Higher Education Act. The balance of these loans outstanding is less than 2% of the total loan receivable balance.

Under the bond agreements from the various bond issuances, the Authority purchases loans from a variety of financial institutions with whom they have loan purchase commitments. Of the total remaining commitments at June 30, 2003, 97% are with ten financial institutions and their branches. The most significant financial institutions individually comprise 34%, 18% and 11% of the total remaining commitments. The Authority relies on these sources of loans to increase the loans owned by the Authority. Should any of these ten primary financial institutions cease business operations, the student loans would be originated by another financial institution or directly by the federal government. Management does not believe that the volume of loans purchased would be significantly impacted by lenders ceasing operations.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Accounting—In accordance with Governmental Accounting Standards Board ("GASB") Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, as amended by Statement No. 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and modified by Statement No. 38, *Certain Financial Statement Disclosures*, the Authority'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 Authority's funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. The Authority applies all applicable Financial Accounting Standards Board pronouncements which do not conflict with GASB pronouncements.

In accordance with the bond resolutions, the Authority utilizes fund accounting principles, whereby each fund is a separate set of self-balancing accounts. The assets of each bond fund are restricted pursuant to the bond resolutions. To accomplish the various public purpose loan programs empowered by its authorizing legislation and to conform with the bond and note resolutions and indentures, the Authority records financial activities in the various operating and bond related funds. The various bond funds are combined as one segment for financial statement purposes (see Note 14). Administrative transactions and those loan transactions not associated with the Authority's bond issues are recorded in the Operating Fund. For financial statement presentation purposes, the funds have been aggregated into one proprietary fund type.

***Use of Estimates*—**The preparation of the Authority's 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 statement of net assets dates and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the arbitrage rebate payable.

The Authority invests in various securities including U.S. or Missouri government securities, and repurchase agreements. Investment securities, in general, are exposed to various risks, such as interest rate, credit, and overall market volatility. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statements of net assets.

***Cash Equivalents*—**The Authority considers all investment securities with original maturities of less than 90 days at date of purchase to be cash equivalents. All cash equivalents whose proceeds are restricted for debt service reserve or the payment of rebate liabilities are classified as restricted cash equivalents (see Note 7).

***Investments Held by Trustee*—**The Authority considers all investment securities with original maturities of 90 days or greater to be investments held by Trustee. Investments with a remaining maturity of less than one year are considered current; all others are considered long-term. Investments are recorded at fair market value. In accordance with the bond resolutions, such investments consist of cash, securities of the Federal or Missouri governments or their agencies and repurchase agreements. The securities underlying the repurchase agreements are book entry securities. During the years ended June 30, 2003 and 2002, the securities were delivered by appropriate entry into a third-party custodian's account designated by the Authority under a written custodial agreement that explicitly recognizes the Authority's interest in the securities. All investments whose proceeds are restricted for debt service reserve or the payment of rebate liabilities are classified as restricted investments (see Note 7).

***Student Loans Receivable*—**Student loans receivable are stated at the principal amount outstanding adjusted for premiums. The related interest income generated from the loans is offset by premium amortization expense. Premiums on student loans are amortized on a straight-line basis over the estimated life of new loans purchased. The straight-line basis approximates the effective interest method. Because the Authority holds a large number of similar loans, the life of the loans can be estimated while considering expected amounts of prepayments from borrowers and loan consolidations. During the years ended June 30, 2003 and 2002, the Authority amortized loan premiums on a straight-line basis over three years. In addition, for the years ended June 30, 2003 and 2002, the Authority expensed all premiums for pool of loan purchases with less than $40 of initial premiums.

Interest on student loans is accrued based upon the actual principal amount outstanding. The U.S. Secretary of Education makes quarterly interest payments on subsidized loans 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 his or her 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. Secretary of Education provides a special allowance to student loan owners participating in the Federal Family Education Loan Program. 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 Authority. The special allowance is accrued as earned. For loans first disbursed from January 1, 2000, through June 30, 2003, the legislation changed the index to the three-month financial Commercial Paper ("CP") rate from the 91-day Treasury bill rate.

***Miscellaneous Receivables and Prepaid Expenses*—**Miscellaneous receivables and prepaid expenses consist primarily of receivables from service bureaus, prepaid letter of credit fees and prepaid pension costs.

***Deferred Charges*—**Deferred charges consist of bond issuance costs. Deferred charges are amortized over the life of the bonds using a method that produces substantially the same results as the effective interest method.

***Capital Assets*—**Capital assets consist of land, building, office furniture and equipment, and leasehold improvements recorded at cost. The Authority's policy is to capitalize all expenditures in excess of $10. Depreciation is charged to operations on the straight-line method over the estimated useful lives of the related assets, which is 30 years for the building and generally five years for all other asset classes.

***Net Assets*—**The net assets of the Authority are classified into three categories: unrestricted, restricted and invested in capital assets. Unrestricted net assets include net assets available for the operations of the Authority and activities not accounted for in the Bond Fund. Restricted net assets consist of the minimum collateral requirements discussed in Note 7, net of related liabilities, as defined in the bond resolutions. The assets invested in capital assets are discussed in Note 6.

***Operating Revenues and Expenses*—**Bond and note issuance is the principal source of the funds necessary to carry out the purposes of the Authority, which are to originate and acquire student loans. The Authority's revenue is derived primarily from income on student loans, and secondarily, from investment income. The primary cost of the program is interest expense on bonds and notes outstanding. Therefore loan income, net investment income and interest expense are shown as operating revenues and expenses in the statements of revenue, expenses, and changes in net assets.

***Income Taxes*—**The Authority is a body corporate and politic of the State of Missouri and is tax-exempt.

***Interest Expense*—**Interest expense primarily includes scheduled interest payments on bonds as well as accretion of bond discounts, broker commission fees, repricing fees and auction agent fees. Additionally, interest expense includes interest payments on the Authority's line of credit borrowing.

***Bond Maintenance Fees*—**Bond maintenance fees consist primarily of rating agency fees, trustee fees and custodian fees.

***Program Participation Fees*—**The Authority must remit each month to the U.S. Department of Education (the "Department") an interest payment rebate fee for all of its Federal consolidation loans made on or after October 1, 1993. This fee is equal to 1.05% per annum of the unpaid principal balance and accrued interest of the loans. For loans made from applications received during the period beginning October 1, 1998 through January 31, 1999, inclusive, this fee is equal to 0.62% per annum of the principal and accrued interest of the loans. In addition to the monthly payment, a 0.5% origination fee is paid to the Department on each consolidation loan made. Neither fee is charged to the borrower.

Risk Management**—**The Authority 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 coverage in the prior year for all categories of risk. Settlements have not exceeded insurance coverage for the past three fiscal years. Commercial insurance is purchased in an amount that is sufficient to cover the Authority's risk of loss. The Authority will record an estimated loss from a claim as an expense and a liability if it meets the following requirements: (1) information available before the financial statements are issued 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.

Reclassifications**—**Where appropriate, prior year's financial information has been reclassified to conform to current year presentation.

3. CASH AND CASH EQUIVALENTS

At June 30, 2003 and 2002, the Authority's carrying amount of deposits was $13,143 and $8,961. These deposits are classified in the type (1) credit risk category; type (1) deposits are insured or collateralized with securities held by the Authority or by its agent in the Authority's name.

Cash equivalents are categorized into three categories of credit risk: (1) insured or registered, or securities held by the Authority or its agent in the Authority's name, (2) uninsured and unregistered, with securities held by the counterparty's trust department or agent in the Authority's name or (3) uninsured and unregistered with securities held by the counterparty, or trust department or agent, but not in the Authority's name. At June 30, 2003 and 2002 the Authority held $-0- and $5,744, respectively, of cash equivalents in "Flexicash" repurchase transactions. These cash equivalents are category 2 investments. Money market funds are not categorized because they are not evidenced by securities that exist in physical or book entry form. At June 30, 2003 and 2002, the Authority's investment in money market funds totaled $258,555 and $148,938, respectively.

4. INVESTMENTS HELD BY TRUSTEE

Investments held by Trustee at June 30, 2003 and 2002 are summarized as follows:

	2003	2002
U.S. Treasury securities	$ 5,867	$ -
Repurchase agreements	5,723	5,723
Treasury zero coupon investments	1,932	
FNMA discount note	934	24,016
Mortgage-backed securities	503	520
Total	$ 14,959	$ 30,259

At June 30, 2003 and 2002, all investments are insured or registered, or securities held by the Authority or its agent in the Authority's name. All investments held as of June 30, 2003 and 2002 are category 1 investments, as defined in Note 3.

5. STUDENT LOANS RECEIVABLE

Student loans receivable are either insured by the Secretary of the United States Department of Health & Human Services (the Secretary of HHS), or by state organizations, namely the Missouri Department of

Higher Education on behalf of the Coordinating Board for Higher Education (CBHE), the Student Loan Guarantee Foundation of Arkansas (SLGFA), United Student Aid Funds, Inc. (USA Funds), Pennsylvania Higher Education Assistance Agency (PHEAA), the Tennessee Student Assistance Corporation (TSAC), the California Student Aid Commission (CSAC), the Kentucky Higher Education Assistance Authority (KHEAA), the Illinois Student Assistance Commission (ISAC), the Nebraska Student Loan Program (NSLP), the New York State Higher Education Services Corporation (HESC), the American Student Assist (ASA), the Texas Guaranteed Student Loan Corporation (TGSLC), the Northwest Education Loan Association (NELA), the Rhode Island Higher Education Assistance Authority (RIHEAA) or the Educational Credit Management Corporation (ECMC), as to principal and accrued interest to the fullest extent allowed under current law. The supplemental loans are not federally insured.

Student loans receivable at June 30, 2003 and 2002 are as follows:

	2003	**2002**
CBHE	$1,103,311	$ 895,999
SLGFA	474,542	344,397
USA Funds	461,032	423,092
PHEAA	325,274	289,548
Secretary of HHS	206,672	219,697
TSAC	121,258	96,863
CSAC	58,290	46,775
KHEAA	42,874	24,018
ISAC	41,762	37,603
NSLP	22,541	8,010
HESC	12,241	159
ASA	7,394	12
TGSLC	6,903	8
NELA	2,290	897
RIHEAA	1,310	749
ECMC	1,028	8,219
Other	4,996	1,475
Total federal loans	2,893,718	2,397,521
Supplemental loans:		
Third party insured	44,237	43,333
Self-insured	42,811	17,911
Total supplemental loans	87,048	61,244
Total student loans receivable	$2,980,766	$2,458,765
Weighted average yield at end of period	5.12 %	6.45 %

6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003:

	Beginning Balance	Additions/ Transfers	Retirements/ Transfers	Ending Balance
Land	$ 3,304	$ -	$ -	$ 3,304
Depreciable capital assets:				
Building	11,499			11,499
Furniture and equipment	3,449	60	(29)	3,480
Leasehold improvements	195			195
Total depreciable capital assets	15,143	60	(29)	15,174
Less accumulated depreciation	2,071	970	(16)	3,025
Net depreciable capital assets	13,072	(910)	(13)	12,149
Total	$ 16,376	$ (910)	$ (13)	$ 15,453

Capital asset activity for the year ended June 30, 2002:

	Beginning Balance	Additions/ Transfers	Retirements/ Transfers	Ending Balance
Land	$ 3,304	$ -	$ -	$ 3,304
Construction in process	3,002	8,000	(11,002)	
Depreciable capital assets:				
Building		11,499		11,499
Furniture and equipment	5,448	974	(2,973)	3,449
Leasehold improvements	320		(125)	195
Total depreciable capital assets	5,768	12,473	(3,098)	15,143
Less accumulated depreciation	3,934	793	(2,656)	2,071
Net depreciable capital assets	1,834	11,680	(442)	13,072
Total	$ 8,140	$ 19,680	$ (11,444)	$ 16,376

The Authority purchased 14.3 acres of land in the Chesterfield Valley on July 25, 2000. The land was used to build the headquarters for the Authority. The building was completed and the Authority moved its operations in April 2002. As of June 30, 2002, the Authority has satisfied all contractual commitments related to the construction of the building.

7. BONDS PAYABLE

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

	2003	2002
Beginning bonds payable	$2,472,546	$2,454,845
Additional proceeds	700,000	70,580
Repayments	(22,627)	(52,879)
Ending bonds payable	$3,149,919	$2,472,546

Bonds payable at June 30 consist of:

	2003	2002
Student loan revenue bonds, variable interest rates ranging from 0.92% to 1.45% at June 30, 2003 and from 1.25% to 2.33% at June 30, 2002 maturing from 2005 to 2033	$2,930,119	$2,288,711
Student loan revenue bonds, fixed interest rates ranging from 2.25% to 6.75% at June 30, 2003 and 2002, maturing through 2022	219,800	183,835
Gross student loan revenue bonds	3,149,919	2,472,546
Less unaccreted discount	14,725	12,041
Bonds payable—net	$3,135,194	$2,460,505
Weighted average rate	1.94 %	1.54 %

The following is a summary of debt service requirements at June 30:

Fiscal Year	Principal	Interest	Total
2004	$ 45,911	$ 42,521	$ 88,432
2005	12,591	42,033	54,624
2006	53,532	41,836	95,368
2007	3,555	41,466	45,021
2008	4,400	41,466	45,866
Total fiscal years 2004-2008	119,989	209,322	329,311
2009-2013	106,730	189,343	296,073
2014-2018	50,000	181,861	231,861
2019-2023	103,300	169,343	272,643
2024-2028	721,500	150,803	872,303
2029-2033	2,048,400	71,937	2,120,337
	$3,149,919	$972,609	$4,122,528

Variable student loan revenue bonds consist of variable rate bonds and auction rate certificates. Variable rate bonds bear interest at a rate determined by the remarketing agent. Such rate is determined on a weekly basis. The remarketing agent is authorized to use its best efforts to sell the repurchased bonds at a price equal to 100% of the principal amount by adjusting the interest rate. The repricing fee is expensed as incurred and included within interest expense on the statements of revenues, expenses and changes in net assets. Auction rate certificates bear interest at the applicable auction rate as determined by a bidding process every 28 or 35 days as stipulated in the related Bond Agreement. The debt service requirements in the table above were prepared using the applicable variable rates on June 30, 2003 and may significantly differ from the rates paid in future periods. Fixed rate bonds pay interest at a rate specified in the related Bond Agreement.

Certain bonds are subject to redemption or rate period adjustment at the discretion of the Authority under certain conditions as set forth in the Bond Agreement. In addition, at June 30, 2003, $259,705 of the bonds are subordinate to the remainder of the outstanding bonds.

In connection with the 1988A student loan revenue bonds, the Authority executed an agreement in which the interest rate was converted from a variable interest rate to a fixed interest rate.

Bonds of each series are secured by (a) a pledge of 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. For certain bonds, the Authority has entered into agreements with the Municipal Bond Investors Assurance Corporation, Bank of America N.A., State Street Bank and Trust and AMBAC Indemnity, whereby the parties have issued letters of credit or insurance policies to the Trustees as beneficiaries for the respective bondholders. The purpose of the letters of credit or insurance policies is to guarantee payment of the bonds upon maturity or earlier redemption. The agreements contain certain covenants which, among other requirements, include minimum collateral requirements. The Authority maintains a minimum amount of assets pledged under required bond resolutions. The total of all minimum requirements for all bond issuances at June 30, 2003 and 2002 is $3,235,002 and $2,535,929, respectively.

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, (c) to make deposits to the revenue accounts for the purpose of paying principal and/or interest on the bonds, and (d) to pay letter of credit fees.

Revenue Accounts—The revenue accounts are used to account for all revenues received by the Authority. 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 letters of credit guaranteeing the bonds for amounts borrowed under the letters of credit. 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.

Debt Service Reserve Accounts—Under the terms of certain bond provisions, minimum amounts are required to be maintained in the debt service reserve accounts for related bond series. The total of these minimum requirements at June 30, 2003 and 2002 were $37,367 and $38,093, respectively. These funds are only to be used to make principal and/or interest payments on the bonds and any interest due on the borrowed funds. In accordance with the bond provisions, the Authority has purchased a non-cancelable Surety Bond in lieu of cash deposits in the debt service reserve accounts for certain of the bond obligations in the amount of $7,038 at June 30, 2003 and 2002. Such Surety Bonds expire on the earlier of the bond maturity date or the date in which the Authority satisfies all required payments related to such bond obligations.

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.

As of June 30, 2003 and 2002, cash, cash equivalents and investments were segregated as follows:

	June 30,	
	2003	**2002**
Special trust accounts:		
Unrestricted:		
Loan accounts	$ 194,638	$ 103,705
Revenue accounts	28,839	32,057
Restricted:		
Debt service reserve accounts	35,996	35,018
Rebate accounts	470	465
Total special trust accounts	259,943	171,245
Operating Fund:		
Unrestricted	17,737	14,230
Due to special trust accounts	8,977	8,427
Total operating fund	26,714	22,657
Total cash, cash equivalents and investments	$ 286,657	$ 193,902

8. LINE OF CREDIT

The Authority had available a $100,000 revolving line of credit at June 30, 2002. This credit agreement charged an interest rate of LIBOR plus .45% payable monthly (2.29% at June 30, 2002) and was collateralized by the loans purchased with the line of credit. At June 30, 2002, the Authority had $95,000 outstanding. The line of credit matured on January 27, 2003 and was not extended.

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

	2003	**2002**
Beginning balance	$ 95,000	$ 9,482
Additional borrowings		95,000
Repayments	(95,000)	(9,482)
Ending balance	$ -	$ 95,000

9. CONTRACTS AND COMMITMENTS

The Authority leases certain equipment and premises under non-cancelable operating leases which expire at various dates through fiscal year 2005. Minimum rental commitments remaining under all leases are as follows:

Year	Minimum Premise Rental Commitment	Minimum Equipment Rental Commitment
2004	$ 93	$ 209
2005		11
Total	$ 93	$ 220

Total rent and leased equipment expense charged to operations amounted to $975 and $1,035 in 2003 and 2002, respectively.

The Authority has four contracts to utilize electronic data processing systems. One of those contracts matures on September 30, 2003, two mature on December 31, 2005, and the other contract remains intact until the serviced loans are paid in full. The contracts provide for monthly charges based on the number of student loan accounts serviced and the amount of computer equipment supplied.

Charges incurred under the contracts for the years ended June 30, 2003 and 2002 are as follows:

	2003	2002
Charges based on loan accounts	$ 4,334	$ 3,871
Hardware rentals	21	39
Total	$ 4,355	$ 3,910

10. EMPLOYEE BENEFITS

The Authority maintains a single employer defined contribution plan, the Missouri Higher Education Loan Authority 401(k) Plan (the “401(k) Plan”), with investment management performed by Goldman Sachs and recordkeeping provided by ADP Inc., a wholly owned subsidiary of Automatic Data Processing, Inc., for all employees who are at least 21 years of age, and who work in excess of 1,000 hours per plan year, and who have been employed at least one year by the Authority. Employees may elect to defer 1% to 50% of their total compensation into the 401(k) Plan, not to exceed the limits defined in the 401(k) Plan. Sixteen investment fund options are available for choice by the employee. The Authority contributes an amount equal to 100% of the first 8% contributed by the employee. Employer matching funds are invested in the same fund choices made by the employee and are subject to a five-year vesting schedule. Some employer matching funds are offset by accumulated forfeiture credits. The Authority may make a non-matching contribution to the 401(k) Plan. The amount of this contribution, if any, will be determined by the Authority when granted. To be eligible for the contribution, an employee must be credited with at least 1,000 hours of service and be employed on the last day of the 401(k) Plan year. During 2003 and 2002, the Authority contributed $543 and $418 and employees contributed $394 and $290 to the 401(k) Plan.

The Authority offers a noncontributory defined benefit pension plan, the Missouri Higher Education Loan Authority Pension Plan (the "Pension Plan"), to supplement the benefits provided under the defined contribution plan. The Pension Plan is administered by A.G. Edwards Trust Company. Employees vest in this Pension Plan after five years of service. A report of the Pension Plan may be obtained by writing to the Authority's Pension Plan Administrator, 633 Spirit Drive, Chesterfield, Missouri 63005-1243 or by calling (636) 532-0600 with your request for a copy of the report of the Pension Plan. The Authority has elected to recognize prior service costs over a 25-year period which represents the estimated remaining service lives of the employees at the Pension Plan origination date.

Substantially all employees of the Authority are covered by the Pension Plan. Pension benefits are based upon the employee's length of service and average compensation.

Pension Plan assets are invested primarily in growth and income stocks at the discretion of the trustee. During the current year the Authority contributed the actuarially determined minimum required funding. The annual required contribution for the years ended June 30, 2003, 2002 and 2001, was determined as part of the July 1, 2002, 2001 and 2000, respectively, actuarial valuations. The Authority's policy is to contribute annually not less than the actuarially determined minimum required contribution determined by using the Aggregate Actuarial Cost Method. Because this method is used, the amortization is a level percentage of payroll over the average remaining service life of active members. Separate determination and amortization of the unfunded actuarial liability are not part of such method and are not required when that method is used.

The following tables detail the components of net periodic pension cost. The funded status of the Pension Plan as of June 30, 2003, 2002 and 2001, the amounts recognized in the Authority's financial statements, and major assumptions used to determine these amounts are as follows:

	2003	2002	2001
Change in plan assets:			
Fair value of plan assets at beginning of year	$ 7,222	$ 5,941	$ -
Actual return on plan assets	681	(317)	41
Employer contributions	2,463	1,660	5,937
Benefits disbursed from plan assets (including expense charges)	(92)	(62)	(37)
Fair value of plan assets at the end of the year	10,274	7,222	5,941
Net pension obligation (NPO):			
NPO at beginning of year	(4,321)	(4,509)	
Annual required contribution (ARC)	2,650	1,848	1,428
Contributions for year	(2,463)	(1,660)	(5,937)
NPO at end of year	(4,134)	(4,321)	(4,509)
Funding excess	$ 6,140	$ 2,901	$ 1,432
Percentage of ARC contributed	92.9 %	89.8 %	415.7 %
Major assumptions:			
Investment return	7 %	7 %	7 %
Inflation rate	4 %	4 %	4 %
Discount rate used for amortization of NPO	3 %	3 %	3 %
Salary scale	5 %	5 %	5 %
Amortization period (open) (years)	10.4	10	11
Cost method	Aggregate	Aggregate	Aggregate
Components of the ARC:			
Annual normal cost	$ 2,463	$ 1,660	$ 1,335
Interest	(303)	(315)	93
Adjustment	490	503	
	$ 2,650	$ 1,848	$ 1,428
Annual covered payroll	$ 7,727	$ 5,742	$ 5,980
Annual pension cost	$ 2,650	$ 1,848	$ 1,428
ARC as a % of payroll	34.3 %	32.1 %	23.9 %
Funding excess to annual covered payroll	65.7 %	67.9 %	75.4 %
Funded ratio	248.5 %	167.1 %	131.8 %

11. STUDENT LOAN PURCHASE COMMITMENTS

In addition to the student loans already purchased, the Authority was contractually committed to primary lending institutions to purchase student loans under purchase agreements. These agreements require the lending institution to offer all student loans generated to the Authority; however, the Authority has the right to refuse the purchase. The average length of the purchase commitments is three years. Management intends to fulfill the commitments using funds held by the Trustee and funds generated through the normal financing operations of the Authority. At June 30, 2003 and 2002, the Authority was servicing $631,597 and $562,719, respectively, in student loans for these and other lending institutions.

12. ARBITRAGE REBATE PAYABLE

In accordance with Section 148 and the regulations thereunder of the Internal Revenue Code of 1986, as amended, the Authority is required to pay to the United States Treasury certain amounts related to the Authority's 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. 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. Management estimates at June 30, 2003 and 2002, the liability to be $44,972 and $35,934, respectively, which has been provided for in the current financial statements, however, the ultimate liability, if any, is dependent on investment yields and bond rates in the future.

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

	2003	2002
Beginning balance	$ 35,934	$ 18,000
Additional liability	11,476	21,118
Student loan forgiveness	(2,139)	(2,671)
Payments	(299)	(513)
Ending balance	$ 44,972	$ 35,934

13. FAIR VALUE OF FINANCIAL INSTRUMENTS

The following disclosure of the estimated fair value of financial instruments is made in accordance with the requirements of SFAS No. 107, *Disclosures About Fair Value of Financial Instruments*. The estimated fair value amounts have been determined by the Authority 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 the Authority 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 the Authority’s financial instruments are as follows:

	June 30, 2003		June 30, 2002	
	Carrying Amount	Estimated Fair Value	Carrying Amount	Estimated Fair Value
ASSETS:				
Cash and cash equivalents	$ 271,698	$ 271,698	$ 163,643	$ 163,643
Investments held by Trustee	14,959	14,959	30,259	30,259
Student loans receivable	2,980,766	3,020,157	2,458,765	2,497,170
LIABILITIES:				
Bonds payable—net	3,135,194	3,146,354	2,460,505	2,084,301
Line of credit			95,000	95,000
OFF-BALANCE SHEET INSTRUMENTS:				
Standby letters of credit		3,738		3,238

Cash and Cash Equivalents**—**For cash and cash equivalents, the carrying amount is a reasonable estimate of fair value.

Investments Held by Trustee**—**Investment securities are recorded at fair value.

Student Loans Receivable**—**Loans are categorized by repayment type (in-school, grace, repayment, and delinquent). The fair value is estimated using the Authority’s current pricing policies; this estimated fair value approximates the amount for which similar loans could currently be purchased on the open market.

Bonds Payable**—**For fixed bonds, fair value was calculated from quoted market prices of the bonds. For variable rate bonds, the carrying amount is a reasonable estimate of fair value.

Standby Letters of Credit**—**The fair value is based on fees currently charged for similar agreements at the reporting date.

14. SEGMENT INFORMATION

A segment is an identifiable activity reported as a stand-alone entity for which one or more revenue bonds are outstanding. A segment has a specific identifiable revenue stream pledged in support of revenue bonds and has related expenses, gains and losses, assets, and liabilities that are required by an external party to be accounted for separately. The Authority has one segment that meets the reporting requirements of GASB Statement No. 34.

The outstanding bonds payable of the Authority consists of Student Loan Revenue Bonds. The Student Loan Revenue Bonds are issued in accordance with six separate General Student Loan Program Bond Resolutions adopted by the Board of Directors in various years from 1988 through 2003. The Resolutions provide that the bonds are payable from the eligible loans pledged under the Resolutions, amounts deposited in the accounts pledged under the Resolutions and all other revenues and recoveries of principal from the loans purchased with the bond proceeds.

Administrative transactions and those loan transactions not associated with the Authority’s bond issues are recorded in the Operating Fund.

Summary financial information for the Student Loan Revenue Bonds as of June 30, 2003 and 2002, are as follows (in thousands of dollars):

	2003		2002	
Condensed Statements of Net Assets	**Operating Fund**	**Bond Fund**	**Operating Fund**	**Bond Fund**
Assets:				
Current assets	$18,735	$ 334,458	$ 24,185	$ 215,120
Noncurrent assets	28,200	2,963,572	113,838	2,377,595
Total assets	$46,935	$3,298,030	$138,023	$2,592,715
Liabilities:				
Current liabilities	$26,522	$ 32,678	$117,134	$ 12,971
Noncurrent liabilities		3,135,016		2,474,061
Total liabilities	26,522	3,167,694	117,134	2,487,032
Net assets:				
Invested in capital assets	15,453		16,376	
Restricted		87,794		68,812
Unrestricted	4,960	42,542	4,513	36,871
Total net assets	20,413	130,336	20,889	105,683
Total liabilities and net assets	$46,935	$3,298,030	$138,023	$2,592,715
Condensed Statements of Revenues, Expenses and Changes in Net Assets				
Operating revenues	$ 983	$ 138,005	$ 2,591	$ 144,395
Operating expenses	2,942	111,869	2,767	124,503
Operating (loss) income	(1,959)	26,136	(176)	19,892
Interfund transfers	1,483	(1,483)	9,500	(9,500)
Increase in net assets	(476)	24,653	9,324	10,392
Net assets, beginning of year	20,889	105,683	11,565	95,291
Net assets, end of year	$20,413	$ 130,336	$ 20,889	$ 105,683

Condensed Statements of Cash Flow	2003 Operating Fund	2003 Bond Fund	2002 Operating Fund	2002 Bond Fund
Net cash flows from operating activities	$ 99,260	$ (521,367)	$ (81,442)	$ (318,870)
Net cash flows from non-capital financing activities	(95,180)	610,282	85,012	(59,764)
Net cash flows from capital activities	(59)		38	(9,500)
Net cash flows from investing activities	(8,681)	23,800	4,000	201,130
Net (decrease) increase in cash and cash equivalents	(4,660)	112,715	7,608	(187,004)
Cash and cash equivalents, beginning of year	22,137	141,506	14,529	328,510
Cash and cash equivalents, end of year	$ 17,477	$ 254,221	$ 22,137	$ 141,506

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