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July 5, 2011

Mr. Joseph Wood, President
Indiana Secondary Market for Education Loans, Inc.
251 N. Illinois St.
Suite 400
Indianapolis, IN 46204

Dear Mr. Wood:

We have received the audit report prepared by Katz, Sapper & Miller, LLP, Certified Public Accountants, for the period of July 1, 2009 to June 30, 2010. Per the auditors' opinion, the audit was conducted in accordance with auditing standards generally accepted in the United States of America and the financial statements included in the report present fairly the financial condition of the Indiana Secondary Market for Education Loans, Inc. as of June 30, 2010, and the results of its operations for the period then ended, on the basis of accounting described in the report.

The Independent Public Accountants' report is filed with this letter in our office as a public record.

STATE BOARD OF ACCOUNTS

Indiana Secondary Market for Education Loans, Inc.

Financial Statements and Supplemental Information for the Years Ended June 30, 2010 and 2009, and Independent Auditors' Report

Katz, Sapper & Miller
Certified Public Accountants

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

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Katz, Sapper & Miller

Katz, Sapper & Miller, LLP
Certified Public Accountants

800 East 96th Street
Suite 500
Indianapolis, IN 46240

Tel 317.580.2000
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Independent Auditors' Report

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

We have audited the accompanying statements of net assets of Indiana Secondary Market for Education Loans, Inc. ("ISM"), a component unit of the State of Indiana, as of June 30, 2010 and 2009, and the related statements of revenues, expenses and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the management of ISM. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes 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 ISM at June 30, 2010 and 2009, and the changes in financial position and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States.

The Management's Discussion and Analysis presented on pages 2-6 is not a required part of the basic financial statements, but is supplemental information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquires of management regarding the methods of measurement and presentation of the supplemental information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 27, 2010, on our consideration of ISM'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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Katz, Sapper & Miller, LLP

Indianapolis, Indiana
October 27, 2010

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (UNAUDITED)

The financial analysis discussion 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.

ISM is currently governed by a nine member Board of Directors who are appointed by the Governor of the State of Indiana. Taxable and tax-exempt bonds, note financings, and line of credit facilities are the primary sources of funding for ISM's programs. ISM administers a program for the purchase and servicing of loans guaranteed and reinsured by the United States Department of Education ("US DOED"). ISM's programs are designed to facilitate access for all Indiana residents to educational funding. In addition, ISM supports Indiana resident's pursuit of access by providing informational presentations and distributing educational materials related to education funding.

ISM's financial statements consist of the following: 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 accounting principles generally accepted in the United States of America as promulgated by the Government Accounting Standards Board. The statements of net assets present the financial position of ISM at the end of the fiscal year and include all assets, liabilities and net assets of ISM. The statements of revenues, expenses and changes in net assets present ISM's results of operations and changes in its net assets for the years ended June 30, 2010 and 2009. The statements of cash flows provide information about the sources and uses of ISM's cash resources for the years ended June 30, 2010 and 2009.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

MANAGEMENT'S DISCUSSION AND ANALYSIS (CONTINUED, UNAUDITED)

Condensed Financial Information (in thousands)

Financial Position	2010	2009	2008
Cash and investments	$ 92,043	$ 71,436	$ 88,313
Student loans receivable—net	1,619,814	1,749,474	1,864,607
Other assets	47,408	47,898	50,506
Total assets	$ 1,759,265	$ 1,868,808	$ 2,003,426
Taxable bonds payable	$ 1,423,275	$ 1,538,700	$ 1,693,200
Tax-exempt bonds payable	225,650	231,650	231,650
Other liabilities	13,520	12,829	9,797
Total liabilities	1,662,445	1,783,179	1,934,647
Total net assets	96,820	85,629	68,779
Total liabilities and net assets	$ 1,759,265	$ 1,868,808	$ 2,003,426
Operating Results			
Interest on student loans	$ 58,912	$ 65,354	$ 72,721
Special allowance on student loans	(31,707)	(14,975)	19,282
Interest income and other	14,193	14,659	3,590
Total operating revenues	41,398	65,038	95,593
Interest expense	21,066	36,452	88,792
Fees and debt issuance costs	1,335	2,670	3,258
Loan servicing and administration	6,699	8,579	15,537
Arbitrage rebate (recovery) provision	1,107	487	(1,030)
Distribution to the State of Indiana			178
Total operating expenses	30,207	48,188	106,735
Change in net assets	$ 11,191	$ 16,850	$ (11,142)

Financial Analysis

Financial Position

As of June 30, 2010, total assets decreased $110 million and combined with a decrease in liabilities of $121 million, this resulted in an increase to ISM's net assets of $11 million or 13%. This compares to an increase from the prior year in net assets of 24% in fiscal 2009. This increase in net assets can be attributed to reduced interest and other operating costs from the previous fiscal year due to restructuring and outsourcing loan servicing as well as gains from bond tenders and purchases.

Cash and investments increased 29% to $92 million as compared to a decrease of 19% in fiscal 2009. The increase in cash is due to existing loan principal payments and the reduced amount of bond tenders from the previous fiscal year and the normal use of cash to pay operating and debt service expenses.

Student loans receivable decreased 7% from $1,749 million in fiscal 2009 to $1,620 million in fiscal 2010, as compared to a 6% decrease from $1,865 million in fiscal 2008 to $1,749 million in fiscal 2009. During fiscal year 2009, ISM discontinued originating Federal Family Education Loan Program ("FFELP") loans due to the College Cost Reduction and Access Act (the "CCRAA") and challenges in the capital markets. This continued through out fiscal year 2010, and effective March 30, 2010 the Health Care and Education Reconciliation Act of 2010 prohibited any new loans after June, 2010 under the FFELP.

The decrease in student loans receivable was also due to existing loan principal decreases through borrower, consolidation, claim and cancellation payment activity. As of June 30, 2010, the student loan portfolio held by ISM was made up of approximately 89% Consolidation Loans and 11% Stafford and PLUS Loans.

Other assets decreased 1% from $48 million in fiscal 2009 to $47 million in fiscal 2010, as compared to a 5% decrease from $51 million in fiscal 2008 to $48 million in fiscal 2009. The majority of these decreases relate to lower special allowance rates and lower return on investments.

Total net assets at June 30, 2010 were $97 million, representing an increase of 13% from $86 million at June 30, 2009. This compared to a 24% increase in fiscal year 2009.

Operating Results

ISM's net assets increased $11.19 million on operating revenues of $41.40 million for the fiscal year ended June 30, 2010, compared to an increase in net assets of $16.85 million from operating revenues of $65.04 million for the prior fiscal year. The current year change in net assets was primarily due to successful bond tenders and bond purchases resulting in a gain of $13.84 million, as well as a drop in interest rate indexes resulting from the deterioration in global credit during the fiscal year. As a result of the decrease in interest rates, interest earned on the student loan portfolio decreased. In addition, interest expense decreased by $15.39 million from the previous year. The market for ISM's student loan auction securities continued to be disrupted for the fiscal year, with auctions initially failing on or around February 14, 2008, and bond interest reverting to the Maximum Auction Rate. This disruption has continued throughout all of 2009 and 2010.

Total operating revenues decreased 36%, from $65.04 million for the fiscal year ended June 30, 2009, to $41.40 million for the fiscal year ended June 30, 2010. Total operating revenues decreased 32%, from $95.59 million for the fiscal year ended June 30, 2008, to $65.04 million for the fiscal year ended June 30, 2009. Interest income on student loans decreased 6.28% during the fiscal year ended June 30, 2010 due to the reduction in the size of the portfolio as well as a drop in interest rate indexes. The special allowance on student loans decreased during fiscal year 2010 from a lower general level of interest rates compared to the fixed rate on loans in ISM's portfolio.

Total operating expenses decreased 37% from $48.19 million for the fiscal year ended June 30, 2009, to $30.21 million for the fiscal year ended June 30, 2010. Total operating expenses decreased 55% from $106.74 million for the fiscal year ended June 30, 2008, to $48.19 million for the fiscal year ended June 30, 2009. This current year decrease is directly related to the outsourcing of student loan servicing, the continued restructuring of the organization, cost cutting controls and the decrease in interest expense on debt arrangements by $15 million.

Loan Servicing and ISM's Loan Purchase Programs

ISM utilizes Affiliated Computer Services, American Education Services, Great Lakes Education Loan Servicing, Nelnet, Inc. and SLM Corporation to service its student loan portfolio. Additional contract compliance, loan servicing support and quality control functions are performed in ISM's Indianapolis location for the existing Federal Family Education Loan Program portfolio. ISM continues to pursue loan purchase opportunities and will seek to acquire loan portfolios with bond funds until the ability to do so ceases December 2, 2011.

Recent Developments

ISM received a letter dated February 6, 2009, from the U.S. DOED regarding activities performed by Collegiate Risk Management. This was a student loan marketing agent associated with an ISM strategic partner. A preliminary ruling was made and ISM is in the process of appealing this ruling.

On March 30, 2010, the Health Care and Education Reconciliation Act of 2010 (S. 100 and H.R. 3221) was signed into law which amended certain parts of the Higher Education Act of 1965. The Act eliminated new loan originations under the FFELP and moved all new loan originations to the Federal Direct Student Loan Program ("FDSLP"). Loans previously made under the FFELP retained all subsidies, guarantee and reinsurance.

As of June 30, 2010, ISM's portfolio of auction rate securities remain in failed auction mode. ISM continues to seek opportunities to re-finance and tender these securities with excess revenues and recoveries of loan principal. As of June 30, 2010, $275.93 million of securities have been retired as part of ISM's tender and repurchase programs.

As of August 1, 2010, ISM has subleased a majority of the 33,000 square feet of office space under lease contracts through 2016.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF NET ASSETS
AS OF JUNE 30, 2010 AND 2009
(In thousands)

	2010	2009
ASSETS		
CURRENT ASSETS:		
Cash and investments:		
Unrestricted	$ 74,446	$ 56,780
Designated	5,141	4,034
Restricted	9,956	10,622
Total cash and investments	89,543	71,436
Student loans receivable — net	80,603	80,358
Accrued interest receivable — student loans receivable	37,776	36,912
Accrued interest receivable — cash and short-term investments	4	4
Prepaids and other assets	2,410	2,602
Total current assets	210,336	191,312
NON-CURRENT ASSETS:		
Cash and investments:		
Certificates of deposit	2,500	
Student loans receivable — net	1,539,211	1,669,116
Prepaids and other assets	6,693	7,422
Capital assets — net	525	958
Total non-current assets	1,548,929	1,677,496
TOTAL	$ 1,759,265	$ 1,868,808
LIABILITIES AND NET ASSETS		
CURRENT LIABILITIES:		
Accounts payable and accrued expenses	$ 7,985	$ 8,338
Accrued interest payable	394	457
Total current liabilities	8,379	8,795
NON-CURRENT LIABILITIES:		
Bonds payable	1,648,925	1,770,350
Arbitrage rebate payable	5,141	4,034
Total non-current liabilities	1,654,066	1,774,384
Total liabilities	1,662,445	1,783,179
NET ASSETS:		
Invested in capital assets	525	958
Unrestricted	81,198	70,015
Restricted	15,097	14,656
Total net assets	96,820	85,629
TOTAL	$ 1,759,265	$ 1,868,808

See notes to financial statements.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009
(In thousands)

	2010	2009
OPERATING REVENUES:		
Interest on student loans	$ 50,225	$ 53,592
U.S. Secretary of Education:		
Special allowance	(31,707)	(14,975)
Interest subsidy	8,687	11,762
Interest income and other	14,193	14,659
Total operating revenues	41,398	65,038
OPERATING EXPENSES:		
Interest expense	21,066	36,452
Fees and debt issuance costs	1,335	2,670
Loan servicing and administration	6,699	8,579
Arbitrage rebate provision	1,107	487
Total operating expenses	30,207	48,188
CHANGE IN NET ASSETS	11,191	16,850
NET ASSETS — Beginning of year	85,629	68,779
NET ASSETS — End of year	$ 96,820	$ 85,629

See notes to financial statements.

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009
(In thousands)

	2010	2009
CASH FLOWS FROM OPERATING ACTIVITIES:		
Student loan interest and special allowance payments received	$ 27,302	$ 50,427
Purchase of student loans	(2,941)	(20,677)
Principal receipts on student loans	158,313	161,461
Cash payments for origination fees and premiums on student loans, net of refunding		1,716
Cash received for other operating activities	71	891
Cash payments for employees and vendors	(6,285)	(6,517)
Net cash provided by operating activities	176,460	187,301
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of certificates of deposit	(2,500)	
Net cash used by investing activities	(2,500)	
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES:		
Repayment and redemption of bonds	(135,262)	(168,075)
Payment of debt issuance costs, net of refunding	510	576
Interest paid on bonds	(21,128)	(37,418)
Net cash used by noncapital financing activities	(155,880)	(204,917)
CASH FLOWS FROM CAPITAL ACTIVITIES:		
Sale of capital assets	27	739
Net cash provided by capital activities	27	739
CHANGE IN CASH AND INVESTMENTS	18,107	(16,877)
CASH AND INVESTMENTS — Beginning of year	71,436	88,313
CASH AND INVESTMENTS — End of year	$ 89,543	$ 71,436

INDIANA SECONDARY MARKET FOR EDUCATION LOANS, INC.

STATEMENTS OF CASH FLOWS (CONTINUED)
FOR THE YEARS ENDED JUNE 30, 2010 AND 2009
(In thousands)

	2010	2009
RECONCILIATION OF CHANGE IN NET ASSETS TO NET CASH PROVIDED BY OPERATING ACTIVITIES:		
Change in net assets	$ 11,191	$ 16,850
Adjustments to reconcile change in net assets to net cash provided by operating activities:		
Amortization of loan and bond charges	7,437	8,775
Interest expense	21,066	36,452
Provision for allowance for loan losses	(66)	60
Arbitrage rebate provision	1,107	487
Change in assets and liabilities:		
Decrease in student loans receivable	122,477	106,521
Decrease (increase) in accrued interest receivable	(864)	3,618
Decrease in prepaids and other assets	14,465	11,027
Increase (decrease) in other liabilities	(353)	3,511
Net cash provided by operating activities	$ 176,460	$ 187,301

See notes to financial statements.

1. DESCRIPTION OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of Business — Indiana Secondary Market for Education Loans, Inc. ("ISM" or the "Company") is a non-profit 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"). Outstanding bonds are payable as specified in the resolutions authorizing the related sale of the bonds, are not payable by funds received from taxation, and are not debts of the State of Indiana or any of its political subdivisions. ISM is a major, discretely presented, proprietary component unit of the State of Indiana.

ISM's bonds payable mature between 2030 and 2047. ISM's ability to meet its long-term obligations is dependent on borrowing costs, Department of Education subsidies and the ability to control operating expenses. Management has determined that obligations will be paid as due.

Basis of Presentation and Accounting — ISM's financial statements have been prepared on the basis of the governmental enterprise fund concept which pertains to financial activities that operate similarly to a private business enterprise. The assets of each fund are restricted pursuant to the bond resolutions. For financial statement presentation purposes, the funds have been aggregated into one proprietary fund type. ISM's funds are accounted for on the flow of economic resources measurement focus and use the accrual basis of accounting. ISM follows the accounting rules promulgated by the Governmental Accounting Standards Board ("GASB"). Additionally, ISM follows all standards of the Financial Accounting Standards Board ("FASB") Codification issued on or before November 30, 1989, unless pronouncements conflict with or contradict GASB Statements.

Student Loans Receivable — Student loans receivable are stated at the principal amount outstanding adjusted for an estimated allowance for loan losses, unamortized purchase premiums or discounts, and origination fees paid on behalf of banks and borrowers. The related interest income generated from student loans is offset by premium and origination fee amortization expenses. ISM amortizes loan premiums, loan discounts and loan origination fees 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 until the student is required, under the provisions of the Higher Education Act, to begin repayment. Repayment must begin generally within six months after the student completes their course of study, leaves school, or ceases to carry at least one-half the normal full-time academic load as determined by the participating institution.

The U.S. Department of Education ("US DOED") provides a special allowance to lenders participating in the FFELP. For 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 the Company. For 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 ("CP") rate, to the average daily unpaid principal balance and capitalized interest of student loans held by the Company. If a special allowance amount is a negative number on a loan first disbursed prior to April 1, 2006, special allowance will not be paid for that loan type for that quarter. If a special allowance amount is a negative number on a 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 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.

Cash and Investments — Cash and investments are cash equivalents consisting of United States Treasury bills, money market mutual funds, certificates of deposit and guaranteed investment contracts ("GICs"), which are carried at cost and approximate market. ISM is restricted to investments that meet the rating requirements per the bond indenture for all funds held within the trust. At June 30, 2010 and 2009, all investments were money market funds, certificates of deposit and GICs. All cash and investments whose proceeds are designated for the payment of arbitrage rebate liabilities are classified as designated cash and investments (see Note 4).

As of June 30, 2010, ISM had the following investments and maturities:

Investment Type	Fair Value (In thousands)	Investment Maturities (In Years) < 1	1–5	6–10	> 10
Guaranteed investment contracts	$ 9,956	$ 9,956	$	$	$
Money market funds	60,277	60,277			
Certificates of deposit	13,237	10,737	2,500		
	$ 83,470	$ 80,970	$ 2,500	$	$

The following table provides information on the credit ratings associated with ISM's investments as of June 30, 2010:

Investment Type	(In thousands)	S & P	Fitch	Moody's
Guaranteed investment contracts	$ 9,956	AA+	unrated	Aa2
Money market funds	60,277	AAAm	unrated	Aaa
Certificates of deposit	13,237	unrated	unrated	unrated
	$ 83,470			

As of June 30, 2009, ISM had the following investments and maturities:

Investment Type	Fair Value (In thousands)	Investment Maturities (In Years)			
		< 1	1–5	6–10	> 10
Guaranteed investment contracts	$ 10,622	$ 10,622	$	$	$
Money market funds	39,066	39,066			
	$ 49,688	$ 49,688	$	$	$

The following table provides information on the credit ratings associated with ISM's investments as of June 30, 2009.

Investment Type	Fair Value (In thousands)	S & P	Fitch	Moody's
Guaranteed investment contracts	$ 10,622	AA+	unrated	Aa2
Money market funds	39,066	AAAm	unrated	Aaa
	$ 49,688			

Custodial risk is the risk that in the event of bank failure, ISM's deposits may not be returned to it. From time to time, certain investment balances maintained by ISM exceed federally insured limits. As of June 30, 2010, ISM had cash and short-term investment balances of $78,556,000 with custodial risk. There are no limits on the amount that may be invested in any one financial institution or intermediary. The following shows an investment in an issuer that represents 5% or more of the total investments at June 30, 2010:

GE Funding Capital Market Services	12%
Wells Fargo Advantage Money Market	72%

Allowance for Loan Losses — Guarantees on 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 loans which default. Guarantees on student 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. This allowance is increased by a provision charged to operations and reduced for losses actually incurred, and is included in the financial statements as a reduction of student loans receivable. During 2010, ISM has turned over charged off accounts to a national collection agency. The amount attributable to expected recoveries remains in the allowance. At June 30, 2010 and 2009, the allowance for loan losses was $2,959,000 and $3,025,000, respectively.

In completing the analysis of the adequacy of the allowance for loan losses, past collection experience, delinquency trends and size of the portfolio, economic conditions, and other factors are considered. Significant changes in these factors could impact the allowance and provision for loan losses. Accordingly, the evaluation of the allowance for loan losses is inherently subjective as it requires material estimates that may be subject to change.

Debt Issuance Costs — Debt issue costs are amortized using a method that approximates the effective interest method over the terms of their respective agreements, ranging from 18 months to 40 years. Unamortized debt issue costs are included in prepaids and other assets and totaled $6,503,000 and $7,201,000 at June 30, 2010 and 2009, respectively.

Capital Assets — Capital assets consist of office furniture, equipment and leasehold improvements recorded at cost. Depreciation is charged to operations on 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.

Net Assets — $81,198,000 and $70,015,000 of ISM's net assets and all related revenues were unrestricted at June 30, 2010 and 2009, respectively. ISM does, however, maintain debt and other arrangements which limit the use of assets. At June 30, 2010 and 2009, ISM's restricted net assets of $9,956,000 and $10,622,000, respectively, per bond reserve requirements (see Note 3) and $5,141,000 and $4,034,000, respectively, reflect amounts restricted to fund the arbitrage rebate payable (see Note 6) and $525,000 and $958,000, 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 and origination fees paid on behalf of banks and borrowers are amortized using a method which approximates the effective interest method over the estimated life of the loans (10 years). At June 30, 2010 and 2009, unamortized premiums totaled $34,377,000 and $40,099,000, respectively, and unamortized origination and default fees totaled $10,547,000 and $12,265,000, respectively, and are included in the financial statements as a component of student loans receivable. 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, 2010 and 2009, the unamortized discount totaled $1,709,000 and $1,898,000, respectively.

Servicing Fee — As of June 30, 2010, Affiliated Computer Services, American Education Services, Great Lakes Education Loan Servicing, Nelnet, Inc. and SLM Corporation service ISM's student loan portfolio. Servicing fee expense amounts are included in operating expenses in the statement of revenues and expenses and changes in net assets.

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

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

Income Taxes — 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. There was no unrelated business income for the years ended June 30, 2010 and 2009.

Use of Estimates — The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates that are particularly susceptible to change in the near-term relate to the determination of the arbitrage rebate payable and the allowance for loan losses.

2. STUDENT LOANS RECEIVABLE — NET

Student loans receivable consist of loans made under the Higher Education Act and are carried at their unpaid principal balance net of an allowance for loan losses plus unamortized purchase premiums, discounts, origination fees, and default fees. Student loans earn interest at various rates ranging from 1.88% to 10.00% depending upon the type of student loan and the date the student loan was made. Substantially all of the principal and accrued interest on student loans is insured by certain guarantee agencies which are reinsured by the federal government. At June 30, 2010 and 2009, the majority of ISM's student loans were guaranteed by the Pennsylvania Higher Education Assistance Agency (73% and 72% as of June 30, 2010 and 2009, respectively), California Student Aid Commission/EDFUND (15% and 15% as of June 30, 2010 and 2009, respectively), or United Student Aid Funds, Inc. (7% and 8% as of June 30, 2010 and 2009, respectively). Effective in October 2010, California Student Aid Commission/EDFUND will be taken over by Educational Credit Management Corp.

Student loans receivable, net as of June 30, 2010 and 2009, consisted of the following:

	2010 (In thousands)	2009
Student loans	$ 1,579,557	$ 1,702,034
Purchase premiums, discounts origination fees and other — net	43,216	50,465
Less — allowance for loan losses	(2,959)	(3,025)
	$ 1,619,814	$ 1,749,474

3. BONDS PAYABLE

The following displays the aggregate changes in bonds payable for the fiscal years ended June 30, 2010 and 2009:

	2010 (In thousands)	2009
Bonds payable — beginning of year	$ 1,770,350	$ 1,924,850
Repayments	(121,425)	(154,500)
Bonds payable — end of year	$ 1,648,925	$ 1,770,350

Bonds payable as of June 30, 2010 and 2009 consisted of the following:

	2010 (In thousands)	2009
Auction Rate Certificates	$ 1,648,925	$ 1,770,350

Bonds payable at June 30, 2010 include $1,423.28 million and $225.65 million of taxable and tax-exempt Auction Rate Certificates ("ARCs"), respectively. The ARCs mature on various dates between December 1, 2030 and May 1, 2047. Interest on the ARCs ranged from .00% to 2.8510% and 0.00% to 14.0% during the years ended June 30, 2010 and 2009, respectively, and was payable either at each auction, which generally occurs every 28 or 35 days as stipulated in the related ARC agreement, or semiannually. The interest rates are reset via a "dutch auction." Since February 2008, the auction process to establish these rates has failed; thus the ARCs will generally pay interest to the holder at a maximum rate as defined by the indenture. This failure also resulted in auctions occurring every 7 days.

The following table displays scheduled debt maturities and contractual interest payments for bonds payable at June 30, 2010 (in thousands):

Years Ending June 30	Principal	Interest	Total
2011		$ 107,987	$ 107,987
2012		107,987	107,987
2013		107,987	107,987
2014		107,987	107,987
2015		107,987	107,987
2016–2020		539,937	539,937
2021–2025		539,937	539,937
2026–2030	$ 58,950	537,814	596,764
2031–2035		521,663	521,663
2036–2040	254,800	463,333	718,133
2041–2045	520,100	383,955	904,055
2046–2050	815,075	57,328	872,403
Total	$1,648,925	$3,583,902	$5,232,827

Bonds of each series are secured by (a) the proceeds derived from the sale of the bonds, (b) eligible loans, and (c) certain accounts established by the respective bond resolutions, including monies and securities therein.

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

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

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

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

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

4. CASH AND INVESTMENTS

Cash and investments as of June 30, 2010 and 2009, consisted of the following:

	2010	2009
	(In thousands)	
Special trust accounts:		
Unrestricted:		
Loan accounts	$ 54,596	$ 32,686
Revenue accounts	540	2,346
Designated — rebate accounts	5,141	4,034
	60,277	39,066
Restricted:		
Reserve accounts	9,956	10,622
Operating account	21,810	21,748
	$ 92,043	$ 71,436

5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2010 (in thousands) was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Depreciable capital assets:				
Furniture and equipment	$ 1,553	$ 21	$ 106	$ 1,468
Leasehold improvements	741	3		744
Total depreciable capital assets	2,294	24	106	2,212
Less accumulated depreciation	1,336	424	73	1,687
Net depreciable capital assets	$ 958	$ (400)	$ 33	$ 525

Capital asset activity for the year ended June 30, 2009 (in thousands) was as follows:

	Beginning Balance	Additions	Retirements	Ending Balance
Depreciable capital assets:				
Furniture and equipment	$ 2,304	$ 24	$ 775	$ 1,553
Leasehold improvements	729	12		741
Total depreciable capital assets	3,033	36	775	2,294
Less accumulated depreciation	1,302	518	484	1,336
Net depreciable capital assets	$ 1,731	$ (482)	$ 291	$ 958

6. ARBITRAGE REBATE PAYABLE

In accordance with Section 148 of the Internal Revenue Code of 1986 (the “Code”), as amended, and the regulations promulgated thereunder, ISM is required to pay to the United States Treasury certain amounts related to the ISM tax-exempt bond issues. The amount required to be paid represents the excess of amounts earned over the interest cost of the tax-exempt borrowings as defined in the Code. Non-purpose rebate payments are due every fifth year and when the bonds are retired. Purpose rebate payments are due every tenth year and every fifth year thereafter during the life of each bond issue and when the bonds are retired. The rebate calculation utilizes various assumptions and allows for the selection of alternative calculation options under the Code. At June 30, 2010 and 2009, the estimated arbitrage rebate liability was $5,141,000 and $4,034,000, respectively, which has been provided for in the financial statements. The factors used in determining this estimate are sensitive to change in the future and the change in estimate may be material to the financial statements. However, the ultimate amount payable, if any, is dependent on the investment yields and bond rates in the future.

The following table displays the aggregate changes in the arbitrage rebate payable during the fiscal years ended June 30, 2010 and 2009:

	2010	2009
	(In thousands)	
Arbitrage rebate payable — beginning of year	$ 4,034	$ 3,547
Provision	1,107	487
Ending balance	$ 5,141	$ 4,034

7. FAIR VALUE OF FINANCIAL INSTRUMENTS

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

The estimated fair values of ISM’s financial instruments as of June 30, 2010 and 2009, were as follows:

	2010	
	Carrying Amount	Estimated Fair Value
	(In thousands)	
ASSETS:		
Cash and short-term investments	$ 92,043	$ 92,043
Student loans receivable — net	1,619,814	1,595,353
Accrued interest receivable	37,780	37,780
LIABILITIES:		
Bonds payable	1,648,925	1,476,830
Accrued interest payable	394	394

	2009	
	Carrying Amount	Estimated Fair Value
	(In thousands)	
ASSETS:		
Cash and short-term investments	$ 71,436	$ 71,436
Student loans receivable — net	1,749,474	1,719,082
Accrued interest receivable	36,916	36,916
LIABILITIES:		
Bonds payable	1,770,350	1,635,360
Accrued interest payable	457	457

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

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

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

Bonds Payable — The estimated fair value is a reasonable estimate based on quoted current market prices.

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

8. RETIREMENT PLANS

ISM established the Indiana Secondary Market 401(k) Retirement Plan ("Plan") in July 2002. The Plan is a "Safe Harbor 401(k) Plan" as described in the Internal Revenue Code. All employees 18 or older are eligible to participate on the first day of the month following their hire date. ISM also may contribute a discretionary profit sharing benefit if the participants are employed at the end of the Plan year. ISM also matches participant contributions for an amount equal to 100% of participant contributions to a maximum of 4% of the participant's annual earnings as the Safe Harbor contribution. Participants vest in ISM's contributions 100% after one year of service. ISM's contributions to the Plan during fiscal years 2010 and 2009 were approximately $26,000 and $42,000, respectively. Participants of the Plan contributed approximately $55,000 and $70,000 to the Plan during fiscal years 2010 and 2009, respectively.

ISM established a Top Hat 457 Plan for certain officers of ISM in December 2006. Pursuant to the plan document, benefits are paid upon separation of service from ISM. ISM's contributions to the Plan during fiscal years 2010 and 2009 were $0 and $14,000, respectively. This plan will be terminated in fiscal year 2011.

9. COMMITMENT

ISM 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, 2010, were as follows:

Years Ending June 30	Rental Payments
2011	$ 573,000
2012	582,000
2013	590,000
2014	599,000
2015	607,000
Thereafter	306,000
	$ 3,257,000

Rent expense under this operating lease was approximately $467,000 and $472,000 for the fiscal years ended June 30, 2010 and 2009, respectively.

ISM has entered into sublease agreements for a portion of the existing office space. The amount of rental income received for the fiscal year ended June 30, 2010 was $76,000. The sublease agreements expire in January 2011 and January 2016. At June 30, 2010, the future sublease rental income to be received through January 2016 is as follows:

Years Ending June 30	Rental Income
2011	$ 139,691
2012	211,852
2013	174,795
2014	177,687
2015	180,579
Thereafter	106,619
	$ 991,223

10. CONTINGENCIES

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

11. SUBSEQUENT EVENTS

As of the date of this report, bonds in the amount of $58,300,000 were defeased at a discount using available funds on hand.

* * * * * *

KATZ, SAPPER & MILLER

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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

Year Ended June 30, 2010

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

We have audited the financial statements of Indiana Secondary Market for Education Loans, Inc. (ISM), a component unit of the State of Indiana, as of and for the year ended June 30, 2010, and have issued our report thereon, dated October 27, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

In planning and performing our audit, we considered ISM's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of ISM's internal control over financial reporting.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether ISM's financial statements are free of 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*.

We noted certain other matters that we reported to management of ISM in a separate letter dated October 27, 2010.

This report is intended solely for the information and use of the Board of Directors, management, the specified lender clients, and the U.S. Department of Education and is not intended to be and should not be used by anyone other than these specified parties.

Katz, Sapper & Miller, LLP

Indianapolis, Indiana
October 27, 2010