

Strothman & Company P S C

Certified Public Accountants & Advisors



Financial Statements

**Kentucky Higher Education
Assistance Authority/
Kentucky Higher Education
Student Loan Corporation**

June 30, 2011

Financial Statements


**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Independent Auditors' Report	1
Management's Discussion and Analysis (Unaudited)	3
Financial Statements	
Combined Government-Wide Statement of Net Assets	17
Combined Government-Wide Statement of Activities	18
Combined Statement of Net Assets – Proprietary Funds	19
Combined Statement of Revenues, Expenditures and Changes in Net Assets – Proprietary Funds	20
Combined Statement of Cash Flows – Proprietary Funds	21
Balance Sheet – Governmental Fund	24
Statement of Revenues, Expenditures and Changes in Fund Balance – Governmental Fund	25
Statement of Fiduciary Net Assets (Deficit)	26
Statement of Changes in Fiduciary Net Assets (Deficit)	27
Notes to Financial Statements	28

Independent Auditors' Report

Board of Directors
Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Frankfort, Kentucky



We have audited the accompanying combined financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Kentucky Higher Education Assistance Authority and the Kentucky Higher Education Student Loan Corporation (the "Authority/Corporation"), component units of the Commonwealth of Kentucky, as of and for the year ended June 30, 2011, which collectively comprise the Authority/Corporation's combined financial statements as listed in the accompanying table of contents. These combined financial statements are the responsibility of the Authority/Corporation's management. Our responsibility is to express opinions on these combined financial statements based on our audit. We did not audit the financial statements of Kentucky Education Savings Plan Trust, which statements reflect total assets of \$130,753,287 as of June 30, 2011, and total additions to fiduciary net assets of \$57,291,636 for the year ended June 30, 2011. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Kentucky Education Savings Plan Trust, is solely based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the combined financial statements. An audit also includes assessing the accounting principles used and the significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Authority/Corporation as of June 30, 2011, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 14, 2011 on our consideration of the Authority/Corporation'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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis (unaudited) on pages 3 through 16 be presented to supplement the combined financial statements. Such information, although not a part of the combined financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the combined financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the combined financial statements, and other knowledge we obtained during our audit of the combined financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

STROTHMAN & COMPANY PSC

Louisville, Kentucky
October 14, 2011

Management's Discussion and Analysis (Unaudited)

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Description of the Business

The Kentucky Higher Education Assistance Authority (the "Authority") was established in 1966 as the Commonwealth of Kentucky's agency for improving higher education opportunities. The Authority guarantees, performs default aversion activities and performs collection activities on eligible student loans. The Kentucky Education Savings Plan Trust (the "Trust") and the Commonwealth Postsecondary Education Prepaid Trust Fund, Kentucky's Affordable Prepaid Tuition Plan (the "Plan") offer savings and investment opportunities for Kentuckians to save for higher education. The Kentucky Higher Education Student Loan Corporation (the "Corporation") makes student loans directly to parents and students as part of the Kentucky Advantage loan programs, purchases and services eligible Federal and Kentucky Advantage student loans and performs collection activities on eligible, Federal student loans for third-party lenders. The Authority and the Corporation maintain bundled operations to maximize the efficiency of loan guarantee and servicing operations. Accordingly, all senior management positions have responsibilities related to both the Authority and the Corporation. Additionally, the Plan and the Trust are governed by the Authority and Corporation's combined Board of Directors. Throughout the accompanying financial statements, the "Authority/Corporation" refers to the combined group of operations.

The Authority/Corporation maintains the following operations:

Student aid - Student aid operations provide administration of thirteen student aid programs: (1) the Kentucky Tuition Grant ("KTG") program, (2) College Access Program ("CAP") grant, (3) Kentucky Educational Excellence Scholarship ("KEES") program, (4) Teacher Scholarship program, (5) Osteopathic Medicine Scholarship program, (6) the KHEAA Work-Study program, (7) Robert C. Byrd Honors Scholarship program, (8) Early Childhood Development Scholarship program, (9) the Go Higher Grant program, (10) the Coal County Scholarship for Pharmacy Students program, (11) the Mary Jo Young Scholarship program, (12) John R. Justice grant and (13) the Dream the Dream Scholarship program. Student aid operations also provide administrative support and assistance for the Kentucky National Guard Tuition Award program and the Minority Educator Recruitment and Retention Scholarship program.

Personnel, professional and administrative costs associated with student aid operations are accounted for in the Student Aid Fund, a governmental fund of the Authority/Corporation. Direct benefits to students are also accounted for in the Student Aid Fund.

Outreach - Outreach operations provide resources to make higher education accessible to Kentucky's current and future generations. Outreach counselors at the Authority/Corporation are available year-round to provide free college planning and financial aid assistance. They conduct scholarship and other funding searches, help students with the admissions and financial aid application processes and increase motivation for at-risk students. Outreach services are offered through financial aid nights, career fairs, college nights, adult education programs, KEES workshops, FAFSA workshops, PTA and other meetings, financial literacy workshops, professional development/staff training, and other programs and camps. Personnel, professional and administrative costs associated with the outreach operation are accounted for in the Student Aid Fund, a governmental fund of the Authority/Corporation.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Loan guarantee - Loan guarantee operations maintain loan guarantees for qualified students and parents of qualified students made by approved lenders, under the Federal Family Education Loan Program ("FFELP"). The loan guarantee operation is responsible for providing default aversion assistance to lenders for delinquent loans, reporting loan information to the National Student Loan Data System ("NSLDS"), paying lender claims for loans in default, paying lender claims for death, disability or bankruptcy, and collecting loans on which default claims have been paid

Personnel, professional and administrative costs associated with loan guarantee operations are accounted for in the Agency Operating Fund ("AOF"), a proprietary fund of the Authority/Corporation. All federal program activities related to default aversion, claim payment, claim reinsurance from the U.S. Department of Education ("USDE"), defaulted loan recoveries and other federally mandated program sources and uses of funds are accounted for in the Federal Student Loan Reserve Fund ("FSLRF"), a fiduciary fund of the Authority/Corporation.

Loan Origination and Disbursement - Loan origination and disbursement operations consist of credit underwriting, loan origination, and issuing disbursements directly to schools for the Kentucky Advantage Education Loan and Kentucky Advantage Parent Loan programs.

Personnel, professional and administrative costs associated with loan origination and disbursement operations are accounted for in the Operating Fund of the Authority/Corporation.

Lending - The Authority/Corporation's lending operation is authorized to finance private supplemental student loans and rehabilitated FFELP loans for students attending eligible post-secondary institutions, service and collect education loans, and issue bonds and notes not to exceed \$5 billion in order to carry out its corporate powers and duties. The FFELP student loans held by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS"), and Federal Consolidation Loans ("Consolidations"). As of June 30, 2011, the lending operation owned approximately \$1.7 billion of student loans.

Most FFELP loans held by the Authority/Corporation are insured by the Authority/Corporation's loan guarantee operations. Loans made prior to October 1, 1993, are 100% insured. Loans made between October 1, 1993 and June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 98% insured against borrowers' default. Loans made after June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 97% insured against borrowers' default.

The Authority/Corporation's lending operation finances all existing FFELP loans with revenue bonds, notes payable, and lines of credit. As of June 30, 2011, the lending operation maintained four separate General Bond Resolutions ("GBRs") and related Series Resolutions for issue of revenue bonds, and the Department of Education Conduit Program ("ED Conduit Program"). The GBR's contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received. As of June 30, 2011, the lending operation maintained \$1.04 billion of revenue bonds outstanding and \$617 million for the ED Conduit Program.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Personnel, professional and administrative costs associated with lending operations are accounted for in the Operating Fund, a proprietary fund of the Authority/Corporation. A portion of FFELP and private supplemental loans and all related activities are also accounted for in the Operating Fund of the Authority/Corporation. The majority of loans, however, are financed by Revenue bonds and the ED Conduit Note. These loans, bonds and note payable and all other related assets, liabilities, revenues, and expenses are accounted for in the Education Finance Fund, a proprietary fund of the Authority/Corporation.

Loan servicing - The loan servicing operation performs servicing and default prevention activities on FFELP and alternative loans held by the Authority/Corporation's lending operation and other lenders. Of the loans serviced, approximately \$1.7 billion in outstanding principal of loans was held by the lending operation. Nearly all of these loans were pledged pursuant to the 1983 GBR, the 1997 GBR, the 2008 Indenture, the 2010 Indenture and the ED Conduit Program. Approximately \$26 million of FFELP Loans and other education loans were owned by other holders, including holders with national lending operations. For loans owned by other holders, the loan servicing operation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities.

Personnel, professional and administrative costs associated with loan servicing operations are accounted for in the Operating Fund of the Authority/Corporation. Student loan remittances and payables to other lenders are also accounted for in the Operating Fund.

College Savings Plan - The college savings plan operation administers two savings plans for the Commonwealth of Kentucky; (1) the Trust and (2) the Plan.

The Trust was formed on July 15, 1988, by Kentucky law, to help people save for the costs of education after high school. The Trust is administered by the Authority/Corporation's Board of Directors. The Authority/Corporation has contracted with TIAA-CREF Tuition Financing, Inc. ("TFI"), a wholly-owned subsidiary of Teachers Insurance and Annuity Association of America ("TIAA"), for management services for the Trust. The Trust is operated in a manner such that it is exempt from registration as an investment company under the Investment Company Act of 1940. The Trust offers certain federal and state tax advantages to purchasers.

An individual participating in the Trust establishes an account in the name of a beneficiary. Contributions can be made among six investment options: the Managed Allocation Option, the Fixed Income Option, the Balanced Option, the Equity Index Option, the Active Equity Option, and the Guaranteed Option.

Contributions in the Managed Allocation Option are allocated among six age bands, based on the age of the beneficiary. Each age band invests in varying percentages in the Institutional Class of the International Equity, International Equity Index, Large-Cap Value Index, Large-Cap Growth Index, S&P 500 Index, Mid-Cap Growth Fund, Small-Cap Equity, Mid-Cap Value, Short-Term Bond, Bond Index, Large-Cap Growth, Inflation-Linked Bond, Equity Index, Small-Cap Blend Index, Bond, Large-Cap Value Index, Real Estate Securities, Emerging Market Equity, Emerging Market Equity Index and Money Market Funds of the TIAA-CREF Institutional Mutual Funds.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

These percentages are determined by the Authority/Corporation's Board of Directors and are subject to change. The assets of the Guaranteed Option are allocated to a funding agreement issued by TIAA-CREF Life Insurance Company, a subsidiary of TIAA, which offers a guarantee of principal and a minimum rate of return to the Trust.

The college savings plan operation also administers the Plan, which was created by the 2000 Kentucky General Assembly and is governed under Kentucky Revised Statutes ("KRS") 164A.700-709.

The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan investment strategy is to earn rates of return that exceed anticipated tuition inflation rates so that the Plan is able to meet its obligation to pay benefits at future tuition rates. The Plan offers certain federal and state tax advantages to purchasers.

Participants purchased annual tuition units at current tuition levels, or current tuition levels plus a premium, and receive benefits equal to tuition rates in place at the time that the student attends a qualified postsecondary education institution. The Plan offers three tuition plans – the Value Plan, the Standard Plan, and the Premium Plan. In the Value Plan, participants buy tuition units and receive benefits indexed to the tuition rate of the Kentucky Community and Technical College System. The Standard Plan offers tuition units and benefits indexed to the tuition rate of Kentucky's most expensive public university.

The Premium Plan offers tuition units at the current average tuition cost of Kentucky's private colleges and universities and guarantees a return on a participant's investment equal to the tuition inflation rate for the University of Kentucky.

Participants may elect to spread payments to the Plan over three, five or seven years or until the anticipated year of the student's enrollment in a qualified postsecondary education institution. Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States. If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books, and supplies.

Participants may withdraw from the Plan at any time for any reason. Terminating participants are refunded any contract payments made less benefits received, administrative and cancellation fees. Participants who withdraw after July 1 of the beneficiary's college entrance year receive the tuition payout value of the contract less benefits received, administrative and cancellation fees. Non-qualified withdrawals are subject to a 10% penalty in accordance with Section 529 of the Internal Revenue Code ("IRC") except in cases where the withdrawal is: (1) made on account of the death or disability of the student; (2) made on account of a scholarship received by a student, or (3) a non-taxable transfer to another account or to another IRC Section 529 program for a different student who is a family member of the original student.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

As of June 30, 2011, the Plan maintained a present value fund deficit of \$50.96 million. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2019, and the Commonwealth will be required to transfer assets from the unclaimed property fund. Over the remaining estimated life of the program, through fiscal year 2027, actuarial estimates show the Commonwealth will need to transfer approximately \$96 million from the unclaimed property fund. As of June 30, 2011, the unclaimed property fund has approximately \$332.8 million.

Personnel, professional and administrative costs associated with administering the Trust and the Plan are accounted for in the Student Aid Fund, a governmental fund of the Authority/Corporation. All assets, liabilities and net asset additions and deductions for the Trust are accounted for in the Kentucky Educational Savings Plan Trust fund, a fiduciary fund of the Authority/Corporation. All assets, liabilities and net asset additions and deductions for the Plan are accounted for in the Kentucky Affordable Prepaid Tuition fund, a fiduciary fund of the Authority/Corporation.

Industry Update

The Health Care and Education Reconciliation Act ("HCERA") of 2010 (H.R.4872/Public Law 111-152) was signed into law on March 30, 2010. HCERA eliminated the origination and/or guarantee of FFELP loans, effective July 1, 2010. HCERA did allow lenders to make subsequent disbursements on loans originated on or before June 30, 2010. In accordance with HCERA, the Authority/Corporation continues to provide guarantee services on \$3.7 billion of FFELP loans, continues to own \$1.71 billion of FFELP loans, and continues to service an additional \$26 million of FFELP and other education loans. The Authority/Corporation can no longer originate, guarantee or fund any new FFELP loans.

HCERA does provide for servicing opportunities for nonprofit organizations to service an initial allocation of 100,000 Federal loan borrowers. The Authority/Corporation has been pre-approved as an eligible servicer and is preparing operations to accommodate their allotment of Federal loans.

HCERA created additional funding for the College Access Challenge Grant program ("CACG"). In CACG year 2011, the Authority/Corporation received \$1.5 million of federal funds for CACG. In CACG year 2012, the Authority/Corporation has been awarded \$2.06 million of federal funds for CACG.

On September 1, 2010, the Authority/Corporation launched its private loan program, the Kentucky Advantage Education Loan ("KAEL") program. The Kentucky Advantage Parent Loan ("KAPL") was subsequently launched on May 15, 2011 as a companion product to allow parents to borrow for their children's education directly. The KAEL/KAPL programs are designed to compete with Direct PLUS Loans and other supplemental loan products. The Authority/Corporation began receiving applications for KAEL loans on October 18, 2010 and KAPL loans on May 20, 2011.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

A notice was published in the Federal Register on May 23, 2011, inviting guaranty agencies with agreements to participate in FFELP to submit proposals to enter into a Voluntary Flexible Agreement ("VFA") with the Secretary, as authorized by section 428A of the Higher Education Act of 1965, as amended ("HEA"). The invitation requested innovative and sustainable guaranty agency business and funding models and encouraged teams of guaranty agencies to submit proposals that will lead to the development of VFAs that will enhance the integrity and stability of FFELP, improve services to students, schools and lenders, and use Federal resources more cost-effectively and efficiently. The Authority/Corporation joined with several other similar state agencies as a consortium to submit a proposal prior to the August 1, 2011 deadline. The proposal will be the basis for negotiations with the Secretary for a sustainable model for the future.

Overview of Financial Statements

This discussion and analysis is intended to serve as an introduction to the Authority/Corporation's combined financial statements. The Authority/Corporation's combined financial statements are comprised of the following three components: 1) combined government-wide financial statements, 2) combined fund financial statements, and 3) notes to combined financial statements.

The combined government-wide statement of net assets and statement of activities include the Governmental Funds and Proprietary Funds. The combined government-wide financial statements can be found on pages 17 and 18 of this report. The combined fund financial statements can be found on pages 19 through 25 of this report.

Fiduciary funds are used to account for resources held for the benefit of parties outside the Authority/Corporation. Fiduciary funds are not reflected in the combined government-wide financial statements because the resources are not available to support the Authority/Corporation's programs. The fiduciary fund statement of net assets (deficit) and changes in fiduciary net assets (deficit) can be found on pages 26 and 27 of this report.

The Trust publishes separate financial statements and footnotes.

To obtain a copy of the financial statements and footnotes, please contact the Authority at (502) 696-7421.

The following is a condensed summary of financial information for the years ended June 30, 2011 and 2010, respectively.

Continued

Condensed Financial Information - Governmental Fund and Proprietary Funds

Kentucky Higher Education Assistance Authority / Kentucky Higher Education Student Loan Corporation

	Governmental Fund		Proprietary Fund	
	2011	2010	2011	2010
Net Asset Information				
Capital assets			\$ 4,318,950	\$ 9,760,842
Other assets	\$ 15,001,115	\$ 15,464,299	1,921,569,593	2,718,865,858
Total Assets	15,001,115	15,464,299	1,925,888,543	2,728,626,700
Long-term liabilities			1,718,438,951	2,005,771,154
Other liabilities	(153,252)	(246,241)	19,744,120	575,079,133
Total Liabilities	(153,252)	(246,241)	1,738,183,071	2,580,850,287
Invested in capital assets, net of expended debt proceeds			4,334,067	4,133,147
Unrestricted			64,279,737	41,610,407
Restricted, other			62,401,099	53,936,697
Restricted for student aid and related activities	14,847,863	15,218,058	56,690,569	48,096,162
Total Net Assets	\$ 14,847,863	\$ 15,218,058	\$ 187,705,472	\$ 147,776,413
Activity Information				
Interest and investment income fund	\$ 271,582	\$ 267,104	\$ 525,157	\$ 852,478
Student aid and advancement fund revenue	189,937,000	183,809,001		
Tobacco Settlement revenue	999,100	999,999		
Unclaimed Lottery Revenue	5,400,000	9,288,000		
Federal funds revenue	1,628,179	1,406,245		
Contribution from Agency Operating Fund	3,024,842	4,385,255		
Servicing Fees from external sources			694,094	2,491,116
Servicing Fees from Education Finance Funds			10,931,907	11,938,453
Deconversion Fees			11,506,900	8,334,322
Debt recovery commission			20,186,675	17,639,072
Early retirement of debt			4,241,322	11,977,102
Federal fees earned			2,471,570	8,162,305
Federal grant revenue			1,928,450	1,019,375
Default aversion fee income			1,721,666	2,121,448
Interest income on loans			28,995,951	27,993,120
Amortization of deferred gain on early retirement of debt			18,465,693	
Late payment penalties			1,507,824	1,479,397
Other Income	432,972	344,464	320,459	344,412
Total Revenue	201,693,675	200,500,068	103,497,668	94,352,600
Kentucky Tuition Grants	32,682,463	32,861,850		
College Access Program Grants	59,947,679	63,788,862		
Robert C. Byrd Scholarships	631,005	602,493		
Mary Jo Young Scholarships	405,376	431,686		
Early Childhood Development Scholarships	1,243,076	1,343,791		
National Guard Tuition Awards	4,865,270	4,714,264		
Kentucky Education Excellence Scholarships	95,919,021	94,472,038		
Teacher Scholarships	1,598,653	2,593,363		
Teacher Loan Forgiveness	2,032,800	1,340,500		
Osteopathic Medicine Scholarships	869,041	994,099		
Work Study Benefits	611,838	715,229		
Go Higher Grant Program	394,991	256,382		
John R. Justice Grant	119,408			
State General Fund expenditure	535,315			
Loan guarantee operations			4,393,379	6,679,093
Default collections			6,653,593	7,433,539
Lending activities			46,014,337	51,321,179
Outreach			3,027,836	2,088,432
Federal origination fees				2,809,050
Default fee expense			65,832	6,915,027
Contributions to student aid programs			2,704,063	1,576,205
Other activities (MERR & OT/PT)			320,779	162,574
Other activities	207,934	167,075	284,314	
Total Expenditures	202,063,870	204,281,632	63,464,133	78,985,099
Net Operating Income (Loss) Before Operating Transfers	(370,195)	(3,781,564)	40,033,535	15,367,501
Operating Transfers				
Transfer to Kentucky's Affordable Prepaid Tuition Plan			(104,476)	(148,057)
Change in Net Assets	\$ (370,195)	\$ (3,781,564)	\$ 39,929,059	\$ 15,219,444

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Financial Analysis – Governmental and Proprietary Funds

As previously noted, the Authority and the Corporation maintain bundled operations to maximize the efficiency of loan guarantee and servicing operations. Throughout the financial analysis, the "Authority/Corporation" refers to the combined group of operations for both organizations. Financial results for specific operating activities may be discussed as needed to provide appropriate disclosure.

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's government-wide performance for the fiscal year ended June 30, 2011. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- The Authority/Corporation's proprietary fund total assets decreased approximately \$799 million (29.3%), from \$2.7 billion to \$1.9 billion. This total decrease was caused primarily by a \$742 million decrease in loans, a \$20 million decrease in cash and investments, a \$19 million decrease in accrued interest income, and an \$18 million decrease in receivables and deferred assets. \$546 million of the \$742 million decrease in loans related to loans PUT in October 2010 under the ECASLA II Master Loan Sale Agreement.
- The Authority/Corporation's proprietary fund liabilities decreased by \$839 million (32.5%), from \$2.5 billion to \$1.7 billion. The decrease in liabilities resulted primarily from a decrease in bonds payable and participation facility payable of \$812 million and decreases in deferred gain on early retirement of debt and payable to USDE of \$19 million and \$8 million, respectively.
- The Authority/Corporation's proprietary fund revenues increased \$9.2 million (9.7%), the majority of which related to increases in gain on early retirement of debt of \$10.8 million, loan de-conversion fees of \$3.2 million and debt recovery commissions of \$2.5 million net of a decreases in federal fees of \$5.7 million and servicing fees from external sources of \$1.8 million. The remaining revenues increased \$183,000.
- The Authority/Corporation's total proprietary fund expenditures decreased \$15.5 million (19.7%), resulting primarily from decreases in borrower assistance of \$6.8 million, lending activities of \$5.3 million, loan guarantee operations of \$2.3 million, contributions to student aid programs of \$1.3 million and default collection operations of \$800,000 net of an increase in outreach of \$900,000. All other expenses decreased \$100,000.
- The Authority/Corporation's governmental fund assets and liabilities remained relatively consistent with prior year.

Continued

Management's Discussion and Analysis (Unaudited)--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

- The Authority/Corporation's governmental fund revenues increased \$1.2 million (.6%), resulting from additional state General Funds for student aid programs of \$6.1 million, net of reductions in unclaimed lottery revenue of \$3.9 million and contributions from the Agency Operating Fund of \$1.3 million. All other revenues increased \$314,000.
- The Authority/Corporation's governmental fund expenditures decreased \$2.2 million (1.09%), due primarily to reductions in College Access Program of \$3.8 million and teacher scholarships of \$1 million offset by increases in the Kentucky Education Excellence Scholarships of \$1.4 million, state-funded teacher forgiveness program of \$700,000 and State General Fund expenditure of \$535,000. All other expenses decreased a total of \$60,000.

Combined Statement of Net Assets

Total governmental fund net assets decreased from \$15.2 million to \$14.8 million. Despite the FY 2011 decrease in loans, total proprietary fund net assets increased \$39.9 (27%) comprised of a \$13.4 million increase from default collection operations (compared to \$10.2 million in prior year), \$113,000 increase from loan guarantee operations (compared to \$5.4 million in prior year), \$66,000 contribution for borrower assistance (compared to a \$6.9 million contribution in prior year), \$1.5 million contribution for outreach activities (compared to \$1 million loss in prior year), \$3 million contribution for student aid and administration (compared to \$4.4 million in prior year) and a \$31 million gain in lending activities (compared to a \$12.1 million gain in prior year). Also, the proprietary fund contributed \$104,000 to administer the Plan.

Certain highlights related to the combined statement of net assets as of June 30, 2011, are as follows:

- The Authority/Corporation purchased \$102.5 million of its own auction rate securities on the secondary market for a discount, resulting in other income of \$4.2 million.
- The Authority/Corporation sold \$546 million of loans in fiscal year 2011, resulting in a gain of \$11.5 million.
- The Authority/Corporation maintained \$3.7 billion of FFELP guarantees outstanding.
- The Authority/Corporation maintained \$1.71 billion of FFELP loans.
- The Authority/Corporation maintained \$373.5 million of defaulted loans in its collection portfolio.
- Unrestricted net assets increased from \$41.6 million to \$64.3 million.
- Net assets, restricted other increased from \$53.9 million to \$62.4 million.
- Net assets restricted for student aid and related activities increased from \$48 million to \$56.7 million.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Combined Statement of Revenues, Expenses and Changes in Net Assets

In fiscal year 2011, the KEES program was fully funded. However, certain other Student Aid programs, including CAP and KTG, incurred a reduction in General Fund appropriations as a result of the biennial budget process. In fiscal year 2010, USDE awarded \$1,060,923 of CACG funds to the Authority/Corporation, with an award period from August 14, 2009 through August 13, 2010. In fiscal year 2011, USDE awarded another \$2,051,545 CACG grant to the Authority/Corporation with an award period from August 14, 2010 through August 13, 2011. The Authority/Corporation is required to provide 1/3rd match for the fiscal year 2011 grant, thus outreach expenses increased \$450,000 during the fiscal year ended June 30, 2011. Outreach activities (including CACG activities) for both fiscal years were accounted for in the proprietary fund.

Despite the FY 2011 decrease in loans, the \$39.9 million increase in proprietary fund net assets during FY 2011 was \$24.7 million more than the \$15.2 million increase during FY 2010. Approximately \$6.7 million and \$18 million of the \$24.7 million difference from FY 2010 was directly attributable to the Authority and the Corporation, respectively. The Authority incurred \$6.8 million less in default fee expense during FY 2011 as a result of HCERA's elimination of FFELP. Other Authority increases and decreases that nearly offset include a \$2.5 million increase in debt recovery commission, \$6.9 million decrease in other revenues, \$2.9 million decrease in operating expenses, \$421,000 decrease in other program benefits, and a \$964,000 decrease in transfers.

The Corporation's increase in net interest revenues was \$16.9 million. The increase included \$18.5 million of interest revenue from the amortization of the prior year's \$80.2 million deferred gain on debt retirements net of \$1.6 million in other net interest revenue decreases. The remaining \$1 million increase in Corporation net assets included the net of \$7.8 million in reductions in program expenses, other financing expenses and operating expenses offset by decreases in other revenues and transfers of \$6.8 million. During fiscal year 2011, the Authority/Corporation purchased \$102.5 million of its own auction rate securities via secondary market, at a discount, and retired the debt. \$4.2 million was recognized as other income from these bond purchases in the current period. Note that management does not consider retirement of debt as a "line of business". Accordingly, the \$4.2 million economic gain in fiscal year 2011 is excluded when evaluating profitability of existing lines of business.

Certain other highlights related to the combined statement of revenues, expenses and changes in net assets for the year ended June 30, 2011, are as follows:

- The Authority/Corporation provided \$17.1 million for program benefits for citizens of the Commonwealth of Kentucky.
- The defaulted loan collection operation received \$20.2 million in commissions on the \$126.1 million collected on behalf of the USDE.

Continued

Condensed Financial Information - Fiduciary Funds

Kentucky Higher Education Assistance Authority / Kentucky Higher Education Student Loan Corporation

	Federal Student Loan Reserve Fund		Agency Fund		Kentucky Affordable Prepaid Tuition		Kentucky Educational Savings Plan Trust	
	2011	2010	2011	2010	2011	2010	2011	2010
Net Asset Information								
Other assets	\$ 27,486,627	\$ 38,099,651	\$ 4,079	\$ 1,185,751	\$ 127,880,038	\$ 117,611,391	\$ 130,753,287	\$ 110,205,253
Total Assets	27,486,627	38,099,651	4,079	1,185,751	127,880,038	117,611,391	130,753,287	110,205,253
Total Liabilities	18,408,393	27,292,064			178,843,631	179,803,856	157,066	140,337
Restricted net asset (deficit)	9,078,234	10,807,587	4,079	1,185,751	(50,963,593)	(62,192,465)	130,596,221	110,064,916
Total Net Assets	\$ 9,078,234	\$ 10,807,587	\$ 4,079	\$ 1,185,751	(50,963,593)	(62,192,465)	\$ 130,596,221	\$ 110,064,916
Changes in Fiduciary Net Asset Information								
Federal reinsurance	\$ 122,783,419	\$ 134,094,994						
Fee revenue	30,508	10,334,483			\$ 684,285	\$ 782,031	\$ 38,855,124	\$ 38,053,468
Contributions					23,028,151	13,065,699	18,436,512	10,441,402
Investment revenues	3,043	3,042						
Other Income	2,456,002	1,936,130						
Total Additions	125,272,972	146,368,649			23,712,436	13,847,730	57,291,636	48,494,870
Administrative expenses					601,846	657,713	524,487	409,699
Refunds					567,022	466,502		
Trustee expense					255,096	236,762		
Tuition benefit					11,164,076	15,530,534		
Loan claims	125,280,659	143,430,501						
Redemptions	1,721,666	2,121,448						
Default aversion							36,235,844	32,871,358
Total Deductions	127,002,325	145,551,949			12,588,040	16,891,511	36,760,331	33,281,057
Change in Net Assets Before Operating Transfers	(1,729,353)	816,700			11,124,396	(3,043,781)	20,531,305	15,213,813
Operating Transfers								
Transfer from Agency Operating Fund					104,476	148,057		
Change in Net Assets After Operating Transfers	\$ (1,729,353)	\$ 816,700			\$ 11,228,872	\$ (2,895,724)	\$ 20,531,305	\$ 15,213,813

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Financial Analysis – Fiduciary Funds

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's fiduciary fund performance for the fiscal year ended June 30, 2011. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- Loan claims paid decreased from \$143 million in fiscal year 2010 to \$125.3 million in fiscal year 2011 (12.4% decrease).
- Default Fee revenue totaled \$10.3 million in fiscal year 2010, of which \$6.9 million was paid by the Authority/Corporation's loan guarantee operations (related to borrowers attending a Kentucky school). Only a small amount of Default Fee revenue was earned in fiscal year 2011 since the only FFELP disbursements during the year were subsequent disbursements on loans originated prior to July 1, 2010.
- The Plan noted a decrease in tuition benefits payable of \$953,000 million in fiscal year 2011, due primarily to favorable investment experience and due to the actual 2011-2012 academic year tuition percentage increase being below the 2012-2013 tuition inflation assumption utilized in the prior year.

Statement of Fiduciary Net Assets (Deficit)

The FSLRF net assets decreased \$1.7 million compared to prior year. Assets decreased approximately 27.9% (\$10.6 million), while liabilities decreased 32.6% (\$8.9 million). The decrease in assets and liabilities is largely attributable to approximately \$8.9 million of combined reductions in accrued expenses and the Payable to Agency Operating Fund. \$4.4 million of that decrease was directly attributable to a decrease in the loan loss allowance. The loan loss allowance calculation is a standard calculation (created by the USDE) based on current year default claim volume and original principal outstanding. The original principal outstanding decreased from \$6.2 billion as of June 30, 2010, to \$4 billion as of June 30, 2011. Also, the default claim rate decreased from 4.07% as of June 30, 2010, to 3.03% as of June 30, 2011. The increase in receivable from USDE resulted from an increase in claim volume in late fiscal year 2011, compared to the same period in fiscal year 2010.

The Agency Fund serves as a conduit for loan proceeds transacted between lenders and schools. The Authority typically maintains agency funds for lenders and schools for less than three business days. With the elimination of FFELP, the activity in the Agency Fund is limited to FFELP loan cancellations and refunds and loan proceeds related to the Authority/Corporation's Kentucky Advantage Education Loan and Kentucky Advantage Parent Loan programs. As of June 30, 2011, the Authority/Corporation maintained \$4,079 of related funds.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

The Plan's total assets increased \$10.3 million, from \$117.6 million as of June 30, 2010 to \$127.9 million as of June 30, 2011. Cash and investments increased from \$109.6 million to \$121.6 million, a \$12 million increase. Accounts receivable decreased from \$7.8 million to \$6 million. The Plan did receive cash from participants of \$2.3 million, of which \$684,000 represents imputed interest on contracts receivable. The Plan also recognized investment gains of \$23 million in fiscal year 2011, and disbursed \$15.5 million in program benefits, refunds to participants, and program expenses.

The Plan liabilities decreased \$960,000, almost entirely from the decrease in tuition benefits payable and related expenses calculated by the actuary. Assumptions related to administrative expenses and investment expense remained consistent with prior year. The change in tuition increase and investment return assumptions are as follows:

- 2011-thereafter – investment return decreased from 6.95% to 6.56%
- 2011-2012 academic year – tuition increase assumption was 8%, while actual tuition increases were 3.84% for the Value Plan and 6% for the Standard Plan and the Premium Plan
- 2012-2013 academic year – tuition increase assumption decreased from 8% to 7.25%.
- 2013-thereafter – tuition increase assumption lowered to 6.75% from 7.25%

Due to the inherent compounding effect, the Plan deficit was projected to increase by \$4.3 million in fiscal year 2011 (without any changes in assumptions). Actual tuition increases in academic year 2011-2012 decreased the deficit by \$3.3 million, and favorable investment experience further decreased the deficit by \$14.4 million (note however that changes to other assumptions increased the deficit by \$3.1 million). Projected investment expense for the life of the program is accrued as a liability and was calculated as 20 basis points on all invested assets (consistent with prior year).

The Trust is an Internal Revenue Code 529 plan managed by the Authority and administered on behalf of the Authority by TFI. Trust assets are entirely comprised of cash and pooled investments. Total assets increased approximately \$20.5 million, due to new subscriptions received (\$38.9 million) and investment gain (\$18.4 million), net of expenses and redemptions (\$36.8 million).

Statement of Changes in Fiduciary Net Assets (Deficit)

The FSLRF had a decrease in fiduciary net assets of approximately \$1.7 million for the year ended June 30, 2011, which was \$2.5 million less than the previous fiscal year's increase in net assets of \$816,000.

As noted above, the FSLRF did not earn a significant amount of Default Fee revenue as in the prior year. This was the primary contributor to the decrease in net assets despite the overall decrease in loan loss allowance. The \$4.4 million decrease in loan loss allowance in fiscal year 2011 (compared to a \$3.3 million increase in 2010) was due primarily to the aforementioned decrease in original principal outstanding.

Continued

Management's Discussion and Analysis (Unaudited)--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

The Plan recognized a decrease in the net deficit of \$11.23 million for fiscal year 2011 compared to a \$3 million increase in net deficit in the prior year. The results from Plan operations increased \$14.2 million over the prior year.

Overall, the current year increase in net assets is primarily attributable to the following factors:

- Investment income increased from a \$13 million gain to a \$23 million gain.
- Tuition benefits expense decreased from \$15.5 million to \$11.2 million.

The Trust noted an increase in subscriptions of approximately \$801,000 while investment income increased by approximately \$8 million. Redemptions increased \$3.4 million due primarily to the overall age of the program.

Combined Government-Wide Statement of Net Assets

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2011

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	\$ 934,809	\$ 68,434,024	\$ 69,368,833
Investments		1,313,269	1,313,269
Accounts receivable	4,237,197	841,387	5,078,584
Accrued interest income		35,515,427	35,515,427
Teacher and Osteopathic Medicine scholarship loans	450,000		450,000
Loans, net		209,859,749	209,859,749
Total Current Assets	5,622,006	315,963,856	321,585,862
Noncurrent:			
Restricted cash and cash equivalents		55,101,725	55,101,725
Receivable from Federal Student Loan Reserve Fund		13,894,299	13,894,299
Investments		19,228,230	19,228,230
Fixed assets, net		9,506,450	9,506,450
Loans, net		1,494,708,299	1,494,708,299
Teacher and Osteopathic Medicine scholarship loans, net	4,593,029		4,593,029
Teacher and Osteopathic Medicine scholarship advances	4,786,080		4,786,080
Deferred front end borrower benefits, net		10,846,503	10,846,503
Deferred debt issuance costs, net		6,369,422	6,369,422
Deferred lender origination costs, net		3,459,650	3,459,650
Total Noncurrent Assets	9,379,109	1,613,114,578	1,622,493,687
Total Assets	15,001,115	1,929,078,434	1,944,079,549
LIABILITIES			
Current:			
Accounts payable and accrued expenses	153,252	5,687,563	5,840,815
Accrued interest expense		3,189,891	3,189,891
Allowance for arbitrage liabilities		363,188	363,188
Payable to U.S. Department of Education		13,113,369	13,113,369
Bonds payable		100,000	100,000
Capital lease payable		480,000	480,000
Total Current Liabilities	153,252	22,934,011	23,087,263
Noncurrent:			
Capital lease payable		4,785,000	4,785,000
Note payable		616,557,201	616,557,201
Allowance for arbitrage liabilities		282,743	282,743
Deferred gain on early retirement of debt, net		61,704,007	61,704,007
Bonds payable		1,035,110,000	1,035,110,000
Total Noncurrent Liabilities		1,718,438,951	1,718,438,951
Total Liabilities	153,252	1,741,372,962	1,741,526,214
NET ASSETS			
Invested in capital assets, net of expended debt proceeds		4,334,067	4,334,067
Unrestricted		64,279,737	64,279,737
Restricted, other		62,401,099	62,401,099
Restricted for program benefits	14,847,863		14,847,863
Restricted for student aid and related activities		56,690,569	56,690,569
Total Net Assets	\$ 14,847,863	\$ 187,705,472	\$ 202,553,335

See Notes to Financial Statements

Combined Government-Wide Statement of Activities
 Kentucky Higher Education Assistance Authority
 Kentucky Higher Education Student Loan Corporation

Year Ended June 30, 2011

	Program Revenue			Net (Expenses) Revenues and Changes in Net Assets			
	Direct Expenses	Indirect Expenses	Charges for Services	Operating Grants	Governmental Activities	Business-Type Activities	Total
Governmental Activities:							
Kentucky Tuition Grants	\$ 32,313,514	\$ 368,949	\$	\$ 32,452,450	\$ (230,013)	\$	\$ (230,013)
College Access Program Grants	59,567,348	380,331		60,842,480	894,801		894,801
Robert C. Byrd Scholarships	567,168	63,837		631,005			16,647
Mary Jo Young Scholarships	300,235	105,141		422,023	16,647		(101,197)
Early Childhood Development	1,163,232	79,844		1,141,879	(101,197)		271,315
National Guard Tuition Awards	4,715,229	150,041		5,136,585	271,315		76,728
Kentucky Education Excellence Scholarships	95,373,311	545,710		95,995,749	76,728		584,402
Teacher Scholarships	1,275,232	323,421		2,183,055	584,402		(2,032,800)
Teacher Loan Forgiveness	2,032,800			1,202,871	(2,032,800)		333,830
Osteopathic Medicine Scholarships	730,318	138,723		1,202,871	333,830		305,188
Work Study Benefits	532,129	79,709		917,026	305,188		41,719
Go Higher Grant Program	134,068	260,923		436,710	41,719		4,500
John R. Justice Grant	119,408			119,408			(535,315)
Dream the Dream Scholarship	500			5,000	4,500		
State General Fund Expenditure	535,315				(535,315)		
Other activities		207,434		207,434			
Total Governmental Activities	199,359,807	2,704,063		201,693,675	(370,195)		(370,195)
Business-Type Activities:							
Loan guarantee operations	4,393,379		\$ 4,506,721			\$ 113,342	113,342
Default collections	6,653,593		20,186,675			13,533,082	13,533,082
Borrower assistance	65,832					(65,832)	(65,832)
Lending activities	46,014,337		77,006,279			30,991,942	30,991,942
Outreach	3,027,836		1,513,679			(1,514,157)	(1,514,157)
Student aid administration	320,779					(320,779)	(320,779)
Contribution to student aid programs	2,704,063					(2,704,063)	(2,704,063)
Other activities	284,314		284,314				
Total Business-Type Activities	63,464,133		103,497,668			40,033,535	40,033,535
Total Primary Government	\$ 262,823,940	\$ 2,704,063	\$ 103,497,668	\$ 201,693,675	\$ (370,195)	\$ 40,033,535	\$ 39,663,340
Transfers:							
Transfer to Kentucky's Affordable Prepaid Tuition Plan						(104,476)	(104,476)
Change in Net Assets					(370,195)	39,929,059	39,558,864
Net Assets, July 1, 2010					15,218,058	147,776,413	162,994,471
Net Assets, June 30, 2011					\$ 14,847,863	\$ 187,705,472	\$ 202,553,335

See Notes to Financial Statements

Combined Statement of Net Assets - Proprietary Funds
 Kentucky Higher Education Assistance Authority
 Kentucky Higher Education Student Loan Corporation

June 30, 2011

	Internal Service Fund		Authority Agency Operating Fund		Authority Total		Education Finance Funds		Corporation Operating Fund		Corporation Total		Combined Total Proprietary Funds	
ASSETS														
Current:														
Cash and cash equivalents	\$	8,404,728	\$	20,841,679	\$	29,246,407	\$	333,289	\$	38,854,328	\$	39,187,617	\$	68,434,024
Investments				1,313,269		1,313,269								1,313,269
Accounts receivable		11,899		11,899		11,899		510,528		318,960		829,488		841,387
Accrued interest income				72,062		72,062		34,865,019		578,346		35,443,365		35,515,427
Loans, net								201,855,846		8,003,903		209,859,749		209,859,749
Total Current Assets		8,416,627		22,227,010		30,643,637		237,864,682		47,755,537		285,320,219		315,963,856
Noncurrent:														
Restricted cash and cash equivalents		1,510,117		1,495,000		1,510,117		53,591,608				53,591,608		55,101,725
Internal receivable (payable) for Gear Up Scholarships		(1,495,000)		15,117										
Internal receivable (payable) for capital projects														
Receivable from Federal Student Loan Reserve Fund				13,894,299		13,894,299				8,028,384		8,028,384		13,894,289
Investments				11,199,846		11,199,846				129,099		129,099		19,228,230
Fixed assets, net				9,377,351		9,377,351				17,888,481		17,888,481		9,506,450
Loans, net								1,476,819,818				1,494,708,299		1,494,708,299
Deferred front end borrower benefits, net				77,500		77,500		10,846,503				10,846,503		10,846,503
Deferred debt issuance costs, net								6,291,922				6,291,922		6,369,422
Deferred lender origination cost, net								3,459,650				3,459,650		3,459,650
Total Noncurrent Assets				36,059,113		36,059,113		1,551,009,501		26,045,864		1,577,055,465		1,613,114,578
Total Assets		8,416,627		59,286,123		66,702,750		1,788,874,183		73,801,501		1,862,375,684		1,929,078,434
LIABILITIES														
Current:														
Accounts payable and accrued expenses		1,058,734		31,014		1,089,748		757,698		3,840,117		4,597,815		5,687,563
Interfund payable (receivable)		7,357,893		(7,399,206)		(41,313)		(5,889,457)		5,930,770		41,313		3,189,891
Accrued interest expense				43,778		43,778		3,146,113				3,146,113		3,146,113
Allowance for arbitrage liabilities								363,188				363,188		363,188
Payable (receivable) to U.S. Department of Education				(650,000)		(550,000)		13,430,482		232,887		13,663,369		13,113,369
Bonds payable				480,000		480,000		100,000				100,000		100,000
Capital lease payable														480,000
Total Current Liabilities		8,416,627		(7,394,414)		1,022,213		11,908,024		10,003,774		21,911,798		22,934,011
Noncurrent:														
Capital lease payable				4,785,000		4,785,000		616,557,201				616,557,201		4,785,000
Note payable								282,743				282,743		616,557,201
Allowance for arbitrage liabilities								61,704,007				61,704,007		282,743
Deferred gain on early retirement of debt, net								1,035,110,000				1,035,110,000		61,704,007
Bonus payable														1,035,110,000
Total Noncurrent Liabilities				4,785,000		4,785,000		1,713,653,951				1,713,653,951		1,718,438,951
Total Liabilities				(2,609,414)		5,807,213		1,725,561,975		10,003,774		1,735,565,749		1,741,372,962
NET ASSETS														
Invested in capital assets, net				4,204,968		4,204,968				129,099		129,099		4,334,067
Unrestricted								611,109		63,668,628		64,279,737		64,279,737
Restricted, other								62,401,099				62,401,099		62,401,099
Restricted for student aid and related activities				56,690,569		56,690,569								56,690,569
Total Net Assets				\$ 60,895,537		\$ 60,895,537		\$ 63,012,208		\$ 63,797,727		\$ 126,809,935		\$ 187,705,472

See Notes to Financial Statements

Combined Statement of Revenues, Expenditures and Changes
in Net Assets - Proprietary Funds
Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Year Ended June 30, 2011

	Authority		Corporation		Combined		
	Internal Service Fund	Agency Operating Fund	Education Finance Funds	Operating Fund	Corporation Total	Proprietary Funds	Total
Operating Revenues:							
Interest Revenues:							
Interest on loans		\$ 285,751	\$ 41,563,934	\$ 2,751,317	\$ 44,315,251	\$ 44,315,251	
Interest and investment income			104,084	135,312	239,406	525,157	
Amortization of deferred gain on early retirement of debt			18,485,693	18,485,693	18,485,693	18,485,693	
Interest expense on bonds			(13,957,802)	(1,381,489)	(15,319,300)	(15,319,300)	
Total Net Interest Revenues		285,751	46,175,519	1,525,131	47,701,050	47,986,891	
Financing Expenses:							
Provision (recovery) for loan losses			814,693	(591,161)	223,732	223,732	
Reserve for doubtful accounts			35,528		35,528	35,528	
Variable bond credit facility and remarketing fees			5,426,539		5,426,539	5,426,539	
Amortization of origination costs			1,650,417		1,650,417	1,650,417	
Amortization of debt issuance costs			920,868		920,868	920,868	
Total Financing Expense			8,851,342	(591,161)	8,260,181	8,260,181	
Interest Revenues Net of Finance Expense		285,751	37,324,177	2,116,292	39,440,669	39,726,670	
Other Operating Revenues:							
Servicing fees from external sources				684,084	684,084	684,084	
Servicing fees from Education Finance Funds				10,831,907	10,831,907	10,831,907	
Deconvension fees				11,506,900	11,506,900	11,506,900	
Debt recovery commission		20,186,675			20,186,675	20,186,675	
Federal fees earned		2,471,570		414,771	414,771	2,471,570	
Federal grant revenue		1,513,679			1,513,679	1,513,679	
Gain on early retirement of debt		1,721,666	4,241,322		4,241,322	1,721,666	
Late payment penalties			1,454,482	53,342	1,507,824	1,507,824	
Other income		27,734		8,411	8,411	30,459	
Total Other Operating Revenues	284,314	27,734	312,048	8,411	320,493	320,493	
Total Operating Revenues	284,314	285,751	37,324,177	2,116,292	39,440,669	39,726,670	
Operating Expenses:							
Administrative expenses	284,314	10,504,376	10,831,907	14,652,000	14,852,000	25,640,890	
Servicing fees for Operating Fund		532,285		214,270	10,831,907	10,831,907	
Depreciation and amortization		10,311	187,515	572,272	746,565	746,565	
Other expenses		11,046,972	11,118,022	15,639,542	26,757,864	26,757,864	
Total Operating Expenses	284,314	15,189,103	31,900,859	10,887,175	41,988,134	41,988,134	
Net Operating Income Before Program Benefits							
Program Benefits:							
Amortization of front end borrower benefits			5,639,265		5,639,265	5,639,265	
Principle and interest benefits			1,815,165	3,841,762	5,456,927	5,456,927	
Default fee expense		66,832			66,832	66,832	
Outreach		3,027,836			3,027,836	3,027,836	
Student aid administration		2,704,063			2,704,063	2,704,063	
Contributions to student aid programs		320,779			320,779	320,779	
Total Program Benefits		6,118,510	7,154,430	3,841,762	10,898,192	17,114,702	
Operating Income Before Transfers		9,041,593	24,746,529	6,245,413	30,991,942	40,093,535	
Transfers (To) From Other Funds:							
Interfund transfers			(104,476)		(104,476)	(104,476)	
Transfer to Kentucky's Affordable Prepaid Tuition Plan			(89,254)		(89,254)	(89,254)	
Total Transfers (To) From Other Funds		8,942,339	(193,730)	(89,254)	30,902,688	30,902,688	
Increase (Decrease) in Net Assets After Transfers		8,942,339	(10,478,825)	41,486,545	30,996,720	39,628,059	
Net Assets, July 1, 2010		51,953,198	73,492,033	22,331,182	68,823,215	147,778,413	
Net Assets, June 30, 2011	\$ 60,895,537	\$ 60,895,537	\$ 63,013,208	\$ 83,767,777	\$ 128,808,835	\$ 187,705,472	

See Notes to Financial Statements

Combined Statement of Cash Flows - Proprietary Funds
 Kentucky Higher Education Assistance Authority
 Kentucky Higher Education Student Loan Corporation

Year Ended June 30, 2011

	Authority		Education		Corporation		Combined Total	
	Internal Service Fund	Agency Operating Fund	Authority Total	Finance Funds	Operating Fund	Corporation Total	Proprietary Funds	Total
Cash Flows from Operating Activities:								
Principal received on loans				\$ 221,191,852	\$ 29,713,785	\$ 250,905,637	\$ 250,905,637	\$ 250,905,637
Interest received on loans				58,965,752	24,931,290	83,897,042	83,897,042	83,897,042
Special allowance benefits received				(43,357,218)	(18,446,818)	(61,804,036)	(61,804,036)	(61,804,036)
Servicing fees, internal sources	\$ 284,314	\$ 1,163,701	\$ 1,448,015	(10,931,907)	10,931,907			1,448,015
Servicing and deconversion fees received					12,238,986	12,238,986	12,238,986	12,238,986
Debt recovery commission received		20,186,675	20,186,675					20,186,675
Federal fees received		2,471,570	2,471,570					2,471,570
Federal grant revenue received		1,513,679	1,513,679		1,026,111	1,026,111		2,539,790
Default aversion fees received		1,655,834	1,655,834					1,655,834
Outreach		(3,027,836)	(3,027,836)					(3,027,836)
Internal activity-payments to other funds	4,635,917	(4,635,917)		6,025,480	(6,025,480)			(6,619,631)
Loans originated, including costs				5,449,526	(12,089,157)			(41,517,555)
Administrative expenses paid		(11,428,789)	(11,428,789)	(6,818,791)	(23,268,975)	(30,088,766)		(2,704,063)
Student aid administration		(2,704,063)	(2,704,063)					(320,779)
Contribution to student aid program		(320,779)	(320,779)	(5,445,298)		(5,445,298)		(5,445,298)
Credit facility fees paid				40,749,689	2,478	40,749,689	2,478	40,749,689
Loans purchased, including premiums					(14,446,160)	(14,446,160)		(14,446,160)
Interfund loan sales and purchases					(14,589,726)	(14,589,726)		(14,589,726)
Client loan receipts								
Loan receipts remitted to clients								
Net Cash Provided By (Used In) Operating Activities	4,920,231	4,874,075	9,794,306	265,829,085	(21,860,128)	243,968,957	253,763,263	253,763,263
Cash Flows from Noncapital Financing Activities:								
Proceeds from debt issued								
Debt principal payments				(268,915,064)	13,836,482	13,836,482	13,836,482	13,836,482
Proceeds from participation facility					(21,212,885)	(290,127,949)	(290,127,949)	(290,127,949)
Participation facility payments				(210)	16,528,353	16,528,353	16,528,353	16,528,353
Interest on debt				(13,242,727)	(7,137,731)	(20,380,458)	(20,380,458)	(20,380,458)
Gain on early retirement of debt				4,241,322	(1,676,251)	(14,918,978)	(14,918,978)	(14,918,978)
Transfer to Kentucky's Affordable Prepaid Tuition Plan		(104,476)	(104,476)	(35,226,354)	35,226,354			
Interfund transfers		5,222	5,222		(5,222)			
Decrease in Federal Student Loan Reserve receivable		4,466,213	4,466,213					
Net Cash Provided By (Used In) Noncapital Financing Activities	4,366,959	4,366,959	4,366,959	(313,143,033)	35,599,100	(277,583,933)	(273,216,974)	(273,216,974)

Continued

Combined Statement of Cash Flows - Proprietary Funds
 Kentucky Higher Education Assistance Authority
 Kentucky Higher Education Student Loan Corporation

Year Ended June 30, 2011

	Internal Service Fund	Authority Agency Operating Fund	Authority Total	Education Finance Funds	Corporation Operating Fund	Corporation Total	Combined Total Proprietary Funds
Cash Flows From Capital and Related Financing Activities:							
Capital expenditures		(560,377)	(560,377)		(64,247)	(64,247)	(624,624)
Bond principal payments		(465,000)	(465,000)				(465,000)
Interest paid on capital lease		(1,841)	(1,841)				(1,841)
Net Cash Used in Capital and Related Financing Activities		(1,027,218)	(1,027,218)		(64,247)	(64,247)	(1,091,465)
Cash Flows From Investing Activities:							
Proceeds from sales/maturities of investments		7,897,733	7,897,733		6,134,701	6,134,701	14,032,434
Purchases of investments		(8,103,286)	(8,103,286)		(6,220,404)	(6,220,404)	(14,323,690)
Investment income		300,791	300,791	115,487	156,663	272,150	572,941
Net Cash Provided By Investing Activities		95,238	95,238	115,487	70,960	186,447	281,685
Net Increase (Decrease) in Cash and Cash Equivalents	4,920,231	8,309,054	13,229,285	(47,198,461)	13,705,685	(33,492,776)	(20,263,491)
Cash and Cash Equivalents, July 1, 2010	4,994,614	12,532,625	17,527,239	101,123,358	25,148,643	126,272,001	143,799,240
Cash and Cash Equivalents, June 30, 2011	\$ 9,914,845	\$ 20,841,679	\$ 30,756,524	\$ 53,924,897	\$ 38,854,328	\$ 92,779,225	\$ 123,535,749

See Notes to Financial Statements

Combined Statement of Cash Flows - Proprietary Funds--Continued

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

Year Ended June 30, 2011

	Authority		Corporation		Combined Total		
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds		Operating Fund	Corporation Total
Reconciliation of Operating Income to Net Cash Provided By (Used In) Operating Activities							
Operating income							
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:							
Investment income		(285,751)	(285,751)	(115,487)	(137,666)	(253,153)	(538,904)
Depreciation and amortization		677,445	677,445	8,113,650	214,270	8,327,920	9,005,365
Amortization of deferred gain on early retirement of debt				(18,465,693)		(18,465,693)	(18,465,693)
Gain on early retirement of debt				(4,241,322)		(4,241,322)	(4,241,322)
Interest expense		1,841	1,841	13,957,802	1,361,498	15,319,300	15,321,141
Provision (recovery) for loan losses				814,893	(591,161)	223,732	223,732
Borrower interest converted to principal				(42,604,727)	(1,353,369)	(43,958,096)	(43,958,096)
Loan forgiveness				1,615,165	296	1,615,461	1,615,461
Gain on equipment disposal					(3,012)	(3,012)	(3,012)
(Increases) Decreases in Assets:							
Accounts receivables	\$ 5,073	1,163,399	1,168,472	141,056	401,754	542,810	1,711,282
Receivable from U.S. Department of Education				163,860	(8,990,028)	(8,826,168)	(8,826,168)
Accrued interest receivable		302	302	8,882,737	9,902,462	18,785,199	18,785,501
Principal received on loans				221,191,852	29,713,785	250,905,637	250,905,637
Loans purchased, including premiums					2,478	2,478	2,478
Loans originated, including costs				5,449,526	(12,069,157)	(6,619,631)	(6,619,631)
Interfund loan sales and purchases				40,749,689	(40,749,689)		
(Increases) Decreases in Liabilities:							
Accounts payable and accrued expenses	81,971	(848,413)	(766,442)	(533,930)	176,165	(357,765)	(1,124,207)
Interfund receivable/payable	4,833,187	(4,874,500)	(41,313)	6,025,480	(5,984,167)	41,313	(1,841)
Accrued interest payable		(1,841)	(1,841)				
Allowance for arbitrage liabilities				(61,995)		(61,995)	(61,995)
Net Cash Provided By (Used In) Operating Activities	\$ 4,920,231	\$ 4,874,075	\$ 9,794,306	\$ 265,829,085	\$ (21,860,128)	\$ 243,968,957	\$ 253,763,263

See Notes to Financial Statements

Balance Sheet - Governmental Fund

Kentucky Higher Education Assistance Authority

June 30, 2011

	<u>Governmental Fund Student Aid</u>
ASSETS	
Current:	
Cash and cash equivalents	\$ 934,809
Accounts receivable	4,237,197
Teacher and Osteopathic Medicine scholarship loans	<u>450,000</u>
Total Current Assets	<u>5,622,006</u>
Teacher and Osteopathic Medicine scholarship loans, net of allowance of \$3,800,000	4,593,029
Teacher and Osteopathic Medicine scholarship advances	<u>4,786,080</u>
Total Noncurrent Assets	<u>9,379,109</u>
Total Assets	<u>\$ 15,001,115</u>
LIABILITIES	
Current - Accounts payable	\$ 153,252
FUND BALANCE	
Unassigned - for program benefits	<u>14,847,863</u>
Total Liabilities and Fund Balance	<u>\$ 15,001,115</u>

See Notes to Financial Statements

Statement of Revenues, Expenditures and Changes
in Fund Balance - Governmental Funds

Kentucky Higher Education Assistance Authority

For Year Ended June 30, 2011

	Governmental Funds
	Student Aid
Revenues:	
Tobacco Settlement revenue	\$ 999,100
Unclaimed Lottery revenue	5,400,000
State General Fund revenue	189,937,000
Federal funds revenue	1,628,179
Contribution from Agency Operating Fund	3,024,842
Interest and investment income fund	271,582
Other income	432,972
	<hr/>
Total Revenues	201,693,675
	<hr/>
Expenditures:	
Kentucky Tuition Grants	32,682,463
College Access Program Grants	59,947,679
Robert C. Byrd Scholarships	631,005
Mary Jo Young Scholarships	405,376
Early Childhood Development Scholarships	1,243,076
National Guard Tuition Awards	4,865,270
Kentucky Education Excellence Scholarships	95,919,021
Teacher Scholarships	1,598,653
Teacher Loan Forgiveness	2,032,800
Osteopathic Medicine Scholarships	869,041
Work Study Benefits	611,838
Go Higher Grant Program	394,991
John R. Justice Grant	119,408
State General Fund expenditure	535,315
Other activities	207,934
	<hr/>
Total Expenditures	202,063,870
	<hr/>
Excess of Expenditures over Revenues	(370,195)
	<hr/>
Fund Balance, July 1, 2010	15,218,058
	<hr/>
Fund Balance, June 30, 2011	\$ 14,847,863
	<hr/> <hr/>

See Notes to Financial Statements

Statement of Fiduciary Net Assets (Deficit)

Kentucky Higher Education Assistance Authority

June 30, 2011

ASSETS	Federal Student Loan Reserve Fund	Agency Fund	Kentucky's Affordable Prepaid Tuition Plan	Kentucky Education Savings Plan Trust
Current:				
Cash and cash equivalents	\$ 15,066,119	\$ 4,079	\$ 2,240,322	\$ 901
Contributions receivable			1,620,681	
Fees receivable			192,036	
Default fee receivable	2,896			
Receivable from U.S. Department of Education	12,367,428			
Investments			119,402,535	130,637,369
Accrued interest income				80,297
Other current assets	50,184			34,720
Total Current Assets	27,486,627	4,079	123,455,574	130,753,287
Noncurrent:				
Contributions receivable			4,424,464	
Total Assets	27,486,627	4,079	127,880,038	130,753,287
LIABILITIES				
Current:				
Accounts payable	13,241		79,165	111,252
Accrued expenses		4,079		45,814
Payable to Agency Operating Fund	13,894,299			
Current portion of reinsurance reserve	550,859			
Total Current Liabilities	14,458,399	4,079	79,165	157,066
Noncurrent:				
Reinsurance reserve, less current portion	3,949,994			
Tuition benefits payable			178,764,466	
Total Noncurrent Liabilities	3,949,994		178,764,466	
Total Liabilities	18,408,393	4,079	178,843,631	157,066
NET ASSETS (DEFICIT)				
Restricted for program benefits			(50,963,593)	
Restricted for other purposes	9,078,234			130,596,221
Total Net Assets (Deficit)	\$ 9,078,234	\$ -	\$ (50,963,593)	\$ 130,596,221

See Notes to Financial Statements

Statement of Changes in Fiduciary Net Assets (Deficit)

Kentucky Higher Education Assistance Authority

Year Ended June 30, 2011

	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition Plan	Kentucky Education Savings Plan Trust
Additions:			
Federal reinsurance	\$ 122,783,419		
Fee revenue	30,508		
Contract income, net		\$ 684,285	
Subscriptions			\$ 38,855,124
Investment Revenues:			
Net unrealized gain on investments		18,293,203	15,756,768
Interest and investment income	3,043	4,734,948	2,679,744
Other income	2,456,002		
Total Additions	<u>125,272,972</u>	<u>23,712,436</u>	<u>57,291,636</u>
Deductions:			
Program benefits:			
Loan claims	125,280,659		
Default aversion fee expense	1,721,666		
Redemptions			36,235,844
Administrative expenses		94,912	524,487
Personnel and professional expenses		506,934	
Refunds		567,022	
Trustee fee expense		255,096	
Tuition benefits expense, net		11,164,076	
Total Deductions	<u>127,002,325</u>	<u>12,588,040</u>	<u>36,760,331</u>
Change in Net Assets Before Transfers	(1,729,353)	11,124,396	20,531,305
Transfer from Agency Operating Fund		104,476	
Change in Net Assets	(1,729,353)	11,228,872	20,531,305
Net Assets (Deficit), July 1, 2010	<u>10,807,587</u>	<u>(62,192,465)</u>	<u>110,064,916</u>
Net Assets (Deficit), June 30, 2011	<u>\$ 9,078,234</u>	<u>\$ (50,963,593)</u>	<u>\$ 130,596,221</u>

See Notes to Financial Statements

Notes to Financial Statements

Kentucky Higher Education Assistance Authority/ Kentucky Higher Education Student Loan Corporation

June 30, 2011

Note A--Description of Business

The Kentucky Higher Education Assistance Authority (the "Authority") was established in 1966 as the Commonwealth of Kentucky's agency for improving higher education opportunities. The Authority guarantees loans, performs default aversion activities and performs collection activities on eligible student loans. The Kentucky Education Savings Plan Trust (the "Trust"), and the Commonwealth Postsecondary Education Prepaid Trust Fund, Kentucky's Affordable Prepaid Tuition Plan (the "Plan") offer savings and investment opportunities for Kentuckians to save for higher education. The Kentucky Higher Education Student Loan Corporation (the "Corporation") makes student loans directly to parents and students as part of the Kentucky Advantage Education Loan Program ("KAEL"). The Corporation also purchases, services and performs collection activities on eligible education loans. The Authority and the Corporation maintain bundled operations to maximize the efficiency of loan guarantee and servicing operations. Accordingly, all senior management positions have responsibilities related to both the Authority and the Corporation. Additionally, the Plan and the Trust are governed by the Authority and Corporation's combined Board of Directors. Throughout the accompanying financial statements, the "Authority/Corporation" refers to the combined group of operations.

The Health Care and Education Reconciliation Act ("HCERA") of 2010 was signed into law on March 30, 2010. HCERA eliminated the origination and/or guarantee of Federal Family Education Loan Program ("FFELP") loans, effective July 1, 2010. HCERA did allow lenders to make subsequent disbursements on loans originated on or before June 30, 2010. The Authority/Corporation can no longer originate, guarantee or fund any new FFELP loans. However, the Authority/Corporation continues to operate under existing FFELP regulations for loans originated and guaranteed prior to July 1, 2010.

HCERA does provide for servicing opportunities for qualified nonprofit organizations to service an initial allocation of 100,000 federal loan borrowers. The Authority/Corporation has been pre-approved as an eligible servicer and is preparing operations to accommodate their allotment of federal loans.

Loan Guarantee Operations

The Authority/Corporation's loan guarantee operations guarantees existing FFELP loans to qualified students and parents of qualified students made by approved lenders in Kentucky and Alabama. Commencing in 1969, retroactive to 1965, the federal government agreed to insure 80% of such guarantee student loans. FFELP was established by Congress and is administered by the U.S. Department of Education ("USDE") as a means of making loans available to students attending colleges, universities and vocational institutions. FFELP provides for the Authority/Corporation's loan guarantee operations to guarantee the repayment of principal and accrued interest to lenders for each eligible student loan. The Authority/Corporation's loan guarantee operation is responsible for maintaining loan guarantees, providing default aversion assistance to lenders for delinquent loans, paying lender claims for loans in default, paying lender claims for death, disability or bankruptcy and collecting loans on which default claims have been paid. The Authority/Corporation also educates lenders about FFELP requirements and regulatory changes.

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note A--Description of Business--Continued

Effective January 10, 1977, the Authority/Corporation's loan guarantee operation entered into a supplemental guaranty agreement with the federal government, which provided up to 100% reimbursement, depending upon default experience as specified in the agreement. Subsequently, federal reinsurance on guaranteed loans made from October 1, 1993 to September 30, 1998 was reduced to a maximum of 98% and federal reinsurance on guaranteed loans made on or after October 1, 1998, was reduced to a maximum of 95% (see Note E).

The Higher Education Amendments of 1998 (the "1998 Amendments") which were enacted on October 7, 1998, with an effective date of October 1, 1998, changed the manner in which FFELP is administered. Under the 1998 Amendments, the Authority/Corporation established a Federal Student Loan Reserve Fund (the "FSLRF") and an Agency Operating Fund (the "AOF") to account for all FFELP guarantee activities. The FSLRF assets and all earnings on those assets (except investment income on the 1998 Balance Budget Act set-aside funds) are the property of the federal government.

The guarantee reserves of the Authority/Corporation were required to be deposited in the new Federal Fund no later than 60 days after enactment. The result of this federal legislation was that the Authority/Corporation's guarantee reserve fund equity of approximately \$40.6 million was transferred to the newly established FSLRF and the Authority/Corporation's AOF commenced activities with a zero fund equity. The funds in the newly established FSLRF were used to pay for the reimbursements to the lenders for student loan claims and pay the AOF for default aversion fees, Account Maintenance Fee shortfall and any U.S. Treasury recall amounts. Funds used to pay loan claims are mostly replenished from reimbursements from the federal government.

Other sources of revenues to the FSLRF include the federal compliment on collections of defaulted loans and investment income. All of the other sources and uses of funds not related to the FSLRF are recorded in the AOF. The AOF assets and earnings on those assets are the property of the Authority/Corporation and may generally be used for all guaranty agency and other student financial aid related activities.

Sources of funds to the AOF include investment income, agency retention on collections of defaulted loans, default aversion fees and account maintenance fees.

Expenditures from the AOF include personnel, professional and other administrative expenses directly related to the loan program operations and outreach activities. The AOF provides funding to the governmental fund to pay administration costs for thirteen student aid programs, administrative costs for the Trust, and direct benefits for the Mary Jo Young Scholarship program, the Kentucky National Guard Tuition Award program and the Minority Educator Recruitment and Retention Scholarship program. The AOF also transfers funds to the Plan to pay some of the administration costs. Both the FSLRF and AOF are subject to federal oversight.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note A--Description of Business--Continued

Lending Operations

The Corporation is an independent *de jure* municipal corporation established by the Kentucky General Assembly in 1978 to provide a loan finance program for post-secondary students in the Commonwealth of Kentucky. The Corporation is authorized to finance loans for students attending eligible post-secondary institutions, service and collect education loans, and issue bonds and notes not to exceed \$5 billion in order to carry out its corporate powers and duties.

On September 1, 2010, the Authority/Corporation launched its KAEL program. The Kentucky Advantage Parent Loan ("KAPL") was subsequently launched on May 15, 2011 as a companion product to allow parents to borrow for their children's education directly. The KAEL/KAPL programs are designed to compete with Direct PLUS Loans and other supplemental loan products. The Authority/Corporation began receiving applications for KAEL loans on October 18, 2010 and KAPL loans on May 20, 2011.

The Authority/Corporation's finance, servicing and collection activities include: (i) the origination and acquisition of education loans; (ii) the financing of FFELP and KAEL loans; (iii) the servicing of FFELP and other education loans; and (iv) the collection of FFELP and other education loans for other holders on a commission or cost reimbursement basis. FFELP student loans held, serviced and collected by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS") and Federal Consolidation Loans ("Consolidations").

Most FFELP loans held by the Authority/Corporation are insured by a guarantee agency. Loans made prior to October 1, 1993, are 100% insured. Loans made between October 1, 1993 and June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 98% insured against borrowers' default. Loans made after June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 97% insured against borrowers' default.

The Authority/Corporation's General Bond Resolutions ("GBR"s), Indenture, and separate series resolutions for issuance of revenue bonds and notes payable contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note A--Description of Business--Continued

As of June 30, 2011 the Authority/Corporation held and serviced approximately \$1.714 billion outstanding principal amount of FFELP and other education loans. \$1.686 billion of loans were pledged pursuant to the 1983 GBR, the 1997 GBR, the 2008 Indenture, the 2010 Indenture and USDE Conduit Program Note Payable. The remaining \$28 million of loans were funded by the Corporation's Operating Fund. Also, the Authority/Corporation services approximately \$26 million of FFELP and other education loans on behalf of other holders, including a holder with national lending operations. The majority of such education loans are serviced by the Authority/Corporation pursuant to servicing agreements which do not provide for the acquisition by the Authority/Corporation of the education loans serviced. As a servicer of FFELP and other education loans, the Authority/Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. The Authority/Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Authority/Corporation financings.

In addition to operations related to FFELP program, the Authority/Corporation administers the Trust, the Plan and thirteen state grant and scholarship programs.

Kentucky Education Savings Plan Trust

The Trust was formed on July 15, 1988 by Kentucky law, to help people save for the costs of education after high school. The Trust is administered by the Board of Directors. The Authority/Corporation has contracted with TIAA-CREF Tuition Financing, Inc. ("TFI"), a wholly-owned subsidiary of Teachers Insurance and Annuity Association of America ("TIAA"), for management services over the Trust's operations. The Trust is operated in a manner such that it is exempt from registration as an investment company under the Investment Company Act of 1940.

An individual participating in the Trust establishes an account in the name of a Beneficiary. Contributions can be made among six investment options: the Managed Allocation Option, the Fixed Income Option, the Balanced Option, Equity Index Option, Active Equity Option and the Guaranteed Option.

Contributions in the Managed Allocation Option are allocated among six age bands, based on the age of the beneficiary. Each age band invests in varying percentages in the Institutional Class of the International Equity, International Equity Index, Large-Cap Value Index, Large-Cap Growth Index, S&P 500 Index, Mid-Cap Growth, Small-Cap Equity, Mid-Cap Value, Short-Term Bond, Bond Index, Large-Cap Growth, Inflation-Linked Bond, Equity Index, Small-Cap Blend Index, Bond, Large-Cap Value Index, Real Estate Securities, Emerging Market Equity, Emerging Market Equity Index and Money Market Funds of the TIAA-CREF Institutional Mutual Funds.

The Equity Options invests in varying percentages in the Institutional Class of the International Equity and Growth & Income Funds of the TIAA-CREF Institutional Mutual Funds.

The Guaranteed option is contractually obligated to pay a minimum rate of return of 1%.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note A--Description of Business--Continued

All allocation percentages are determined by the Authority/Corporation's Board of Directors and are subject to change. The assets of the Guaranteed Option are allocated to a funding agreement issued by TIAA-CREF Life Insurance Company, a subsidiary of TIAA, which offers a guarantee of principal and a minimum rate of return to the Trust.

Prepaid Tuition Plan

The Authority/Corporation also administers the Plan, which was created by the 2000 Kentucky General Assembly and is governed under Kentucky Revised Statutes ("KRS") 164A.700-709.

On July 1, 2005, governance of the Plan permanently transferred to the Authority/Corporation. The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan investment strategy is to earn rates of return that exceed anticipated tuition inflation rates so that the Plan is able to meet its obligation to pay benefits at future tuition rates. The Plan offered enrollment periods in fiscal years 2002, 2003 and 2005, for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax advantages to purchasers. There have been no enrollment periods since fiscal year 2005 as the Plan currently maintains an accumulated net deficit of approximately \$51 million.

Participants purchased annual tuition units at current tuition levels, or current tuition levels plus a premium, and receive benefits equal to tuition rates in place at the time that the student attends a qualified postsecondary education institution. The Plan offers three tuition plans – the Value Plan, the Standard Plan and the Premium Plan. In the Value Plan, participants buy tuition units and receive benefits indexed to the tuition rate of the Kentucky Community and Technical College System. The Standard Plan offers tuition units and benefits indexed to the tuition rate of Kentucky's most expensive public university. The Premium Plan offers tuition units at the current average tuition cost of Kentucky's private colleges and universities and guarantees a return on a participant's investment equal to the tuition inflation rate for the University of Kentucky.

Participants may elect to spread payments to the Plan over three, five or seven years or until the anticipated year of the student's enrollment in a qualified postsecondary education institution.

Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States.

If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books and supplies.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note A--Description of Business--Continued

Participants may withdraw from the Plan at any time for any reason. Terminating participants are refunded any contract payments made less benefits received, administrative and cancellation fees. Participants who withdraw after July 1 of the beneficiary's college entrance year receive the tuition payout value of the contract less benefits received, administrative and cancellation fees. Non-qualified withdrawals are subject to a 10% penalty in accordance with Section 529 of the Internal Revenue Code ("IRC") except in cases where the withdrawal is: (i) made on account of the death or disability of the student; (ii) made on account of a scholarship received by a student; or (iii) a non-taxable transfer to another account or to another IRC Section 529 program for a different student who is a family member of the original student.

As of June 30, 2011, the Plan maintained a present value fund deficit of approximately \$51 million. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2019, and the Commonwealth of Kentucky will be required to transfer assets from the unclaimed property fund. Over the remaining estimated life of the program, through fiscal year 2027, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$96 million from the unclaimed property fund. As of June 30, 2011, the unclaimed property fund had approximately \$332.8 million.

Student Aid Programs

The Authority/Corporation provides administration of thirteen student aid programs: (1) the Kentucky Tuition Grant program, (2) College Access Program grant, (3) Kentucky Educational Excellence Scholarship program, (4) Teacher Scholarship program, (5) Osteopathic Medicine Scholarship program, (6) the KHEAA Work-Study program, (7) Robert C. Byrd Honors Scholarship program, (8) Early Childhood Development Scholarship program, (9) the Go Higher Grant program, (10) the Coal County Scholarship for Pharmacy Students program, (11) the Mary Jo Young Scholarship program, (12) John R. Justice grant and (13) the Dream the Dream Scholarship program. The Authority/Corporation also provides administrative support and assistance for the Kentucky National Guard Tuition Award program and the Minority Educator Recruitment and Retention Scholarship program. Direct benefits for grant, scholarship, and work-study programs are funded by appropriations from the Kentucky General Assembly, grants from USDE, funding from the Authority/Corporation, allocation of revenues from the Kentucky Lottery Corporation, Coal Severance Tax and Tobacco Settlement funds.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note B--Summary of Significant Accounting Policies

Basis of Presentation - The Authority/Corporation reports its financial information in accordance with the Government Accounting Standard Board ("GASB") Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis – for State and Local Governments* as amended by GASB No. 37 and modified by GASB No. 38, *Certain Financial Statement Disclosures*, (collectively "GASB No. 34"). The Authority/Corporation's basic financial statements are prepared in accordance with GASB No. 34 and are comprised of the following three components: 1) government-wide financial statements; 2) fund financial statements, and 3) notes to financial statements. The government-wide financial statements are comprised of a statement of net assets and a statement of activities. Prepared using the economic resources measurement focus and the accrual basis of accounting, these statements reflect all of the assets, liabilities, revenues, expenses, gains and losses of the combined Authority/Corporation's governmental and business-type activities. The Authority/Corporation's governmental activities reflect the activities of administering the various student grant, scholarship, advance/loan and work-study programs for the Commonwealth of Kentucky and USDE.

The Authority/Corporation's business-type activities include administering loan guarantees, default collection, lender and borrower assistance, lending, and other activities.

Also included in the business-type activities are funds related to the Student Aid and Fiscal Responsibility Act ("SAFRA"). SAFRA provides payments to federal student loan servicers operating in FFELP on January 1, 2010 to retain jobs at locations in the United States. Assets related to SAFRA are held by the Authority/Corporation and transferred to the Operating Fund quarterly to offset permissible job retention related costs.

The combined government-wide financial statements do not reflect fiduciary activities whose resources are not available to finance the Authority/Corporation's programs.

The Authority/Corporation's combined fund financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to state government entities, which provide that accounting systems be organized by funds to account for specific activities consistent with legal and operating requirements. The Authority/Corporation's governmental fund includes the activities of administering grant, scholarship, advance/loan programs and the work-study program for the Commonwealth of Kentucky and USDE.

The Authority/Corporation's loan guarantee, default collection, lender and borrower assistance, lending and other business-type activities are presented as proprietary funds. Propriety funds also include internal service funds, which are used to report activity that provides goods or services on a cost reimbursement basis predominantly to the Authority/Corporation's other business-type activities. The Authority/Corporation follows all applicable GASB pronouncements as well as Financial Accounting Standards Board pronouncements and Accounting Principles Board Opinions, issued on or before November 30, 1989 for its proprietary funds, unless those pronouncements conflict with or contradict GASB pronouncements.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note B--Summary of Significant Accounting Policies--Continued

Fiduciary activities include private-purpose trust and agency funds administered by the Authority/Corporation pursuant to FFELP, the Trust and the Plan. The fiduciary fund financial statements are comprised of a statement of net assets and a statement of changes of net assets. Prepared using the economic resources measurement focus and the accrual basis of accounting, these statements reflect all of the assets, liabilities, revenues, expenses, gains and losses of the FSLRF, the Trust and the Plan.

The Authority/Corporation's Fiduciary Funds also include Agency Funds, which are held in a custodial capacity. Agency Funds include proceeds received from other student loan lenders and later remitted to a college or university to pay for tuition assistance for a respective student. Assets of the Trust are held by the Authority/Corporation on behalf of program participants. Assets of the Plan are held by the Authority/Corporation to offset future tuition obligations of participants.

Cash and Cash Equivalents - The Authority/Corporation considers cash and cash equivalents to include highly liquid investments, which mature within one month or less of purchase.

Investments - Investments for all funds consist primarily of securities of the federal government or its agencies, corporate bonds, commercial paper collateralized mortgage obligations and mutual funds, which are stated at fair market value. Fair market value is determined by using quoted market prices as of the last day of the fiscal year.

The Plan maintains a separate investment policy, which includes targeted rate of return of 6.56% as of June 30, 2011. The target asset allocation for the Plan is as follows:

Large Cap U.S. stocks	45%
Small/Midcap U.S. stocks	10%
Non-U.S. stocks	5%
	<hr/>
Total Equity	60%
	<hr/> <hr/>
Inflation indexed bonds	25%
Corporate bonds	15%
	<hr/>
Total Fixed Income	40%
	<hr/> <hr/>

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note B--Summary of Significant Accounting Policies--Continued

To decrease overall investment risk, the following restrictions apply to the Plan's investments:

- i. No more than 5% of the total amount of the equity portion of the investment account in the securities of any one issuer;
- ii. No more than 25% of the total amount of the equity portion of the investment account in any one industry, as defined by Standard & Poors;
- iii. For portfolios invested in major-market countries, no more than 25% of the total amount of the equity portion of the investment account in any one country with the exception of those countries whose weighting in the Europe, Australia, and Far East ("EAFE") index is greater than 25%, where a maximum weight of the current country weight in the EAFE benchmark plus 10% is permitted;
- iv. For portfolios invested in emerging markets, no more than 20% of the equity portion of the investment account shall be invested in one country;
- v. A minimum of eight countries shall be represented in each investment account; and
- vi. No more than 10% of the total amount of the fixed-income portion of the investment account shall be committed to the securities of any one issuer at the time of purchase, with the exception of securities issued or guaranteed by the full faith and credit of the United States of America or AAA-related securities issued by government agencies as to which there is no limit.

Under the Kentucky Revised Statutes ("KRS"), the Authority/Corporation's Board of Directors is charged with selecting the various options in which the participants of the Trust can invest their funds. An individual participating in the Trust establishes an account in the name of a Beneficiary. Contributions can be made among six investment options: the Managed Allocation Option, the Fixed Income Option, the Balanced Option, Equity Index Option, Active Equity Option and the Guaranteed Option.

Contributions in the Managed Allocation Option are allocated among six age bands, based on the age of the beneficiary. Each age band invests in varying percentages in the Institutional Class of the International Equity, International Equity Index, Large-Cap Value Index, Large-Cap Growth Index, S&P 500 Index, Mid-Cap Growth, Small-Cap Equity, Mid-Cap Value, Short-Term Bond, Bond Index, Large-Cap Growth, Inflation-Linked Bond, Equity Index, Small-Cap Blend Index, Bond, Large-Cap Value Index, Real Estate Securities, Emerging Market Equity, Emerging Market Equity Index and Money Market Funds of the TIAA-CREF Institutional Mutual Funds.

Teacher and Osteopathic Medicine Scholarship Loan and Advances - Teacher Scholarship advances to students may be repaid via eligible service credits granted for specified teaching in primary or secondary schools. The disbursements are recorded as advances and charged to program benefits over the period that the teaching service is performed. If the teaching requirements are not satisfied, the advances are converted to loans, which are repayable with interest.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note B--Summary of Significant Accounting Policies--Continued

Osteopathic medicine scholarship advances to students may be repaid via eligible service credits granted for working as a doctor in Kentucky. The expenditures are recorded as advances and charged to program benefits over the period that the medical services are provided. If the medical requirements are not satisfied, the advances are converted to loans, which are repayable with interest.

Fixed Assets, Net - Fixed assets are stated at cost, less accumulated depreciation. Fixed assets are depreciated beginning when the assets are placed in service and continuing over the estimated useful lives of the respective asset using the straight-line method.

Defaulted Student Loans - All collections on defaulted loans are recorded as income when received. The portion of collections due to the federal government is treated as a contra-revenue. Federal defaulted loans outstanding are accounted for by the Authority/Corporation but are not presented on the accompanying combined statement of net assets.

Allowance for Uncollectible Loans - As discussed in Note A, most FFELP loans held by the Authority/Corporation are insured by guarantee agencies and the USDE. Management of the Authority/Corporation believes that all of the respective guarantee agencies and the USDE will be able to honor all loan claims submitted. However, the Authority/Corporation records a provision for loan losses based upon its expected default claims with respect to 98% and 97% insured loans and for loans with certain loan servicing violations. The allowance for loan loss on all loans funded through normal operations was \$4.2 million for loan principal and \$396,000 for accrued interest as of June 30, 2011. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2011, the allowance for third party servicing loan losses for loans that have been purchased was \$1.55 million for loan principal and \$480,000 for accrued interest. In addition, the Authority/Corporation records a provision for loan loss related to Teacher and Osteopathic Medicine advances that have converted to loans. As of June 30, 2011, the allowance for advances converted to loans was \$3.8 million.

Interest Income on Loans - The Authority/Corporation earns interest income on loans from the following three sources: (1) subsidized interest from USDE earned while certain students are in school, in grace or in deferment status; (2) special allowance from USDE (discussed in Note G); and (3) borrower interest. All interest is recorded when earned and is shown in the combined financial statements net of the interest related portion of the provision for loan losses.

Servicing Fees - The Authority/Corporation's fees for originating loans on behalf of other lenders and servicing loans held by third parties are recorded as servicing fee revenue when earned. Loan proceeds held by the Authority/Corporation are accounted for in the Agency Fund.

Third party loans serviced by the Authority/Corporation are not presented on the combined statement of net assets, as they are not owned by the Authority/Corporation.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note B--Summary of Significant Accounting Policies--Continued

Deferred Loan Purchase Premium and Deferred Loan Origination Costs - Loan purchase premiums and certain origination costs are deferred and amortized over the estimated life of the loans acquired or originated, based on projected balances outstanding, which approximates the effective interest method.

Deferred Debt Issuance Costs - Debt issuance costs are deferred and amortized over the life of the bonds, utilizing the bonds outstanding method, which approximates the effective interest method.

Deferred Gain on Early Retirement of Debt - In accordance with GASB No. 23, *Accounting and Financial Reporting of Debt Reported by Proprietary Activities*, the Authority/Corporation defers any gains on the early retirement or refinancing of debt over the shorter of the remaining life of the old debt or the life of the new debt.

Income Taxes - The Authority is a state government agency established by the Kentucky General Assembly and the Corporation is an independent *de jure* municipal corporation and political subdivision of the Commonwealth of Kentucky, therefore they are not subject to federal or state income taxes. The Trust and the Plan are state sponsored IRC Section 529 education savings plans and therefore, are also not subject to federal or state income taxes.

Use of Estimates - Generally Accepted Accounting Principles ("GAAP") 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 combined financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Interfund Eliminations - Interfund receivables and payables are eliminated in the governmental and business-type activities column of the combined government-wide statement of net assets. Net residual amounts due between governmental and business-type activities are reflected as receivable (payable) for internal balances. Amounts reported in funds as receivable from or payables to fiduciary funds are reflected in the combined government-wide statement of net assets. Eliminations are made in the combined government-wide statement of activities to remove the doubling-up effect of internal service fund activity.

Program Revenues - Program revenues are reported in two categories including (1) charges for services and (2) program-specific operating grants and contributions. Charges for services include revenues received in the form of fees and charges for the Authority/Corporation loan guarantee, default collection, lender services, other activities and interest income from the corporate lending activities.

Program-specific operating grants and contributions include revenues from mandatory and voluntary non-exchange transactions with other governments and organizations that are restricted for use in a particular program. Program-specific operating grant and contribution services include the interest earned on scholarship loans.

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note B--Summary of Significant Accounting Policies--Continued

Contribution Receivable - As discussed in Note A, participants in the Plan may elect to make payments on executed tuition contracts over a specific period. Contributions receivable are recorded at their net realizable value in the period in which a tuition contract is purchased. A finance charge of 7.25% per year is charged to participants based on outstanding balance.

Tuition Benefits and Other Payable - Tuition benefits payable are reported at the actuarial net present value of estimated future benefits to be paid on behalf of participants of the Plan. The reported amount reflects actuarial assumptions, including anticipated tuition and fee increases, expected investment earnings, and refunds and other terminations.

Indirect Costs - Indirect costs are allocated among functions/programs utilizing a full cost allocation approach with the objective of allocating all expenses to the Authority/Corporation's various functions and programs.

Risk Management - The Authority/Corporation is exposed to various risks of loss related to property loss, torts, errors and omissions, and employee injuries. Coverage against various risks of loss is obtained through participation in the State of Kentucky's Risk Management Fund, State Sponsored Group Insurance Fund, and policies purchased from outside insurance corporations.

Restricted Net Assets - Restricted net assets are comprised of net assets with legal or contractual restrictions and thus cannot be used in operations of the Authority/Corporation.

Unrestricted Net Assets - Unrestricted net assets are comprised of net assets available to be used in operations or transfers of the Authority/Corporation.

Subsequent Events - In preparing these combined financial statements, the Authority/Corporation has evaluated events and transactions for potential recognition or disclosure through October 14, 2011, the date the financial statements were available to be issued.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note C--Cash and Investments

The Authority/Corporation has adopted provisions of GASB Statement No. 40, *Deposits and Investment Risk Disclosures*. This statement adds certain additional disclosures about cash and investments, including common areas of investment risk.

The Authority/Corporation's operating funds and investments comply with the Operating Funds Investment Policy. The policy permits investments in bank time deposits, certificates of deposit, commercial paper, asset-backed commercial paper, bankers acceptance and floating-rate notes with a coupon reset of 30 days or less, direct obligations of the United States of America (which are unconditionally guaranteed by the United States of America), indebtedness issued by certain Federal agencies, U.S. dollar denomination corporate bonds and obligations of foreign governments, asset-backed securities, and taxable and tax-exempt municipal bonds. All securities must have a minimum rating of investment grade BBB or better by a nationally recognized credit rating agency at the time of purchase. Money market instruments must be rated A-1 or P-1 or better at the time of purchase. An average rating of A must be maintained by the total portfolio.

The investments in the Authority/Corporation's Education Finance Funds comply with the underlying bond resolution and indenture requirements, as applicable. In accordance with those requirements, all deposits and investments meet the requirements and approval of bond underwriters and rating agencies. Additionally, such requirements mandate specific classes of investment vehicles including bank time deposits, certificates of deposit, direct obligations of the United States of America (which are unconditionally guaranteed by the United States of America), indebtedness issued by certain Federal agencies, collateralized repurchase agreements or investment funds secured by obligations of the United States of America with collateral held by or at the direction of the trustee.

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note C--Cash and Investments--Continued

Custodial Credit Risk and Interest Rate Risk - Custodial credit risk is the risk that in the event of a bank failure, the Authority/Corporation's deposits may not be returned to it. The Authority/Corporation's investment policy does not contain a requirement for the collateralization of cash and investments nor does it require investments to be maintained in the Authority/Corporation's name. As of June 30, 2011, no custodial credit risk exists for any of the Authority/Corporation's Proprietary Funds, Governmental Fund and Fiduciary Funds. Bank balance cash on deposit is as follows:

	Governmental Fund Bank Balance	Proprietary Fund Bank Balance	Fiduciary Fund Bank Balance
FDIC Insured		\$ 391,652	\$ 504,552
Collateralized by securities held by the pledging financial institution		3,261,210	7,752,391
Money market demand deposits		790,519	
Money market securities		110,353,770	9,022,881
Cash deposited with Kentucky State Treasurer	\$ 934,809	9,914,872	38,564
	<u>\$ 934,809</u>	<u>\$ 124,712,023</u>	<u>\$ 17,318,388</u>

Of the \$123.9 million of cash and cash equivalents maintained in the Proprietary Funds, \$30.9 million was held for guarantee operations and the remaining \$93 million was held for lending activities.

As of June 30, 2011, the FSLRF maintained money market securities of \$8.9 million held in a trust by Bank of New York Mellon.

As of June 30, 2011, all Proprietary Funds investments were registered in the Authority/Corporation's name and maintained by an external trustee. The investment balances as of June 30, 2011 are summarized as follows:

	Fair Value	Weighted Average Maturity (in years)
Corporate bonds	\$ 9,030,100	2.70
U.S. Treasury and government agency securities	7,102,603	1.54
Collateralized mortgage obligations	4,408,796	9.53
	<u>\$ 20,541,499</u>	

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note C--Cash and Investments--Continued

As of June 30, 2011, Trust investments of \$130.6 million comprised entirely of TIAA mutual funds.

As of June 30, 2011, Plan investments of \$119.4 million comprised primarily of mutual funds held by State Street Global Advisors.

Investments are made based upon prevailing market conditions at the time of the transaction with the intent to hold the instrument until maturity. If the yield of the portfolio can be improved upon sale of an investment, prior to its maturity, with the reinvestment of proceeds, then this provision is also allowed.

Concentration of Credit Risk - The Authority/Corporation does not maintain investments in any one issuer that represents 5% or more of the total investment base, excluding investments issued or explicitly guaranteed by the U.S government and investments in mutual funds.

Credit Risk - The Authority/Corporation's investment policy limits the credit risk for securities. Securities must have a credit rating of BBB by a nationally recognized credit rating agency. Money Market Securities must be rated A-1 or P-1 or better at the time of purchase. The investment manager is allowed to hold up to 5% in aggregate market value securities that have been downgraded below BBB, but must maintain an average rating of A for the total portfolio. The following table summarizes the Standard & Poors / Moody's rating (as applicable) for all corporate bonds held by the Authority/Corporation's Proprietary Funds as of June 30, 2011:

<u>Rating</u>	<u>Fair Value</u>
AAA / Aaa	\$ 4,330,177
AA / Aa	1,472,236
A / A	2,334,198
BAA / Baa	893,489
	<u>\$ 9,030,100</u>

The Plan maintains an investment policy that limits the credit risk for fixed income securities and short-term commercial paper. No more than 10% of the total amount of fixed-income portion of the investment account shall be committed to the securities of any one issuer at the time of purchase, with the exception of securities issued or guaranteed by the full faith and credit of the United States or AAA-rated securities issued by government agencies as to which there is no limit. The Plan may invest in short-term commercial paper of any domestic issuer, maturing within 9 months, with a minimum rating of A-1 by Standard & Poors or Prime 1 by Moody's. As previously noted, at June 30, 2011 the Plan primarily invested in mutual funds.

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note D--Fixed Assets

A summary of fixed assets follows:

	Beginning Balance July 1, 2010	Additions	Disposals	Ending Balance June 30, 2011
Proprietary fund:				
Furniture and equipment	\$ 18,460,513	\$ 627,635	\$ (166,006)	\$ 18,922,142
Building	11,986,200			11,986,200
System development	55,955			55,955
Student loan servicing system	541,131			541,131
Debt recovery system	710,509			710,509
Accumulated depreciation and amortization	<u>(21,993,466)</u>	<u>(882,027)</u>	<u>166,006</u>	<u>(22,709,487)</u>
	<u>\$ 9,760,842</u>	<u>\$ (254,392)</u>	<u>\$ -</u>	<u>\$ 9,506,450</u>
Fiduciary Fund:				
Furniture and equipment	\$ 496,601		\$ (4,679)	\$ 491,922
Accumulated depreciation	<u>(496,601)</u>		<u>4,679</u>	<u>(491,922)</u>
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Depreciation and amortization expense totaled \$882,027 for the year ended June 30, 2011, of which \$746,555 was allocated to business-type activities, \$126,046 was allocated to governmental activities, and \$9,426 was allocated to the fiduciary activities.

Depreciation and amortization expense was allocated to the business-type activities functions as follows:

Loan guarantee operations	\$ 273,489
Default collections	167,968
Lending and related activities	214,270
Lender assistance	<u>90,828</u>
	<u>\$ 746,555</u>

The Authority/Corporation has assets under capital lease agreements, as described in Note I, of \$11,986,200 with related accumulated amortization of \$3,284,381. Amortization of assets under capital lease is included in amortization expense in the accompanying combined financial statements. Amortization expense of assets under capital lease agreements was \$399,501 for the year ended June 30, 2011.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note E--Federal Family Education Loan Programs (Loan Guarantee Operations)

Pursuant to FFELP, the loan guarantee operating unit of Authority/Corporation insures eligible student loans for losses incurred from the default, death, disability, or bankruptcy and also insures for other losses such as school closures and false certifications. As of June 30, 2011, the outstanding balance of aggregate insured student loans was approximately \$3.7 billion.

Loans insured by the Authority/Corporation are reinsured under FFELP by the federal government. Death, disability, bankruptcy, lender of last resort, and closed school claims are reinsured at 100%. Default claims are subject to the Authority/Corporation's default claims rate (reimbursed default claims for the federal fiscal year divided by the original principal amount of loans in repayment at the beginning of the fiscal year).

The Authority/Corporation's annual default claims rate is within the 5%, which allows for reimbursement rates at the highest level. Due to the reduction of the Federal reimbursement rate for loans made subsequent to October 1, 1993, the Authority/Corporation has recorded a reserve of \$4.5 million at June 30, 2011 for losses on federal reinsurance.

The following schedule summarizes the reinsurance rates for guarantee agency paid default claims.

Annual Default Claims Rate	Reimbursement Rate		
	Through September 30, 1993	October 1, 1993 through September 30, 1998	October 1, 1998 and After
0% to 5%	100%	98%	95%
More than 5% up to 9%	90% of claims over 5% up to 9%	88% of claims over 5% up to 9%	85% of claims over 5% up to 9%
Over 9%	80% of claims over 9%	78% of claims over 9%	75% of claims over 9%

The Authority/Corporation is entitled to charge certain fees associated with its reinsurance activities. A summary of those fees are as follows:

Rehabilitated Loans - The Authority/Corporation is entitled to retain 18.5% of principal and interest for rehabilitated loans, plus 18.5% of collection costs.

Consolidated Loans - For FFELP Consolidations, the Authority/Corporation is entitled to the 18.5% collection costs. For William D. Ford Consolidation, the Authority/Corporation is entitled to 10% collection costs (18.5% collected, less 8.5% rebate to USDE).

Recoveries Payable to Federal Government - The Authority/Corporation is entitled to retain 16% of defaulted loan collections received after October 1, 2007. This amount is recorded as an addition when received.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note E--Federal Family Education Loan Programs (Loan Guarantee Operations)--Continued

Account Maintenance Fees ("AMF") - The 1998 Amendments established an account maintenance fee based on 0.06% of the original principal amount of outstanding loans as of September 30. AMF is paid to the Authority/Corporation on a quarterly basis by the Federal government.

Loan Processing and Issuance Fees ("LPIF") - The 1998 Amendments established a loan processing and issuance fee. The LPIF payments are based on the net guarantee amount, less cancellations, multiplied by 0.40%. This fee ended with the elimination of FFELP. No residual activity occurred beyond the quarter ended March 31, 2011.

Default Aversion Fees ("DAF") - Default aversion fees were established under the 1998 Amendments. The Authority/Corporation receives DAF for its aversion activities on delinquent loans at the time lenders request default aversion assistance. DAF's are equal to 1% of principal and interest on the loan at the time the Authority/Corporation receives a request from a lender for preclaim assistance. DAF is recorded monthly and is recognized as a deduction in the FSLRF and as revenue in the AOF.

Note F--Loans (Lending and Servicing Operations)

The Authority/Corporation originates private supplemental loans, purchases loans and holds various types of student loans as described in Note A. The terms of these loans, which vary on an individual basis depending upon loan type and the date the loan was originated, generally provide for repayment in monthly installments of principal and interest over a period of up to thirty years for consolidation loans and generally up to ten years for other loans. The repayment period begins after a grace period of six months following graduation or loss of qualified student status for the Subsidized and Unsubsidized Stafford loans. The repayment period for Consolidation, SLS and PLUS loans begins within 60 days from the date the loan is fully disbursed. Statutory interest rates on student loans ranged from 1.87% to 10% for the fiscal year ended June 30, 2011 depending upon the type and date of origination of the individual loan. Actual rates may be lower due to interest rate reductions associated with payments via electronic funds transfer or for other reasons such as borrowers making a specified number of consecutive on-time payments.

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note F--Loans (Lending and Servicing Operations)--Continued

Loans consist of the following at June 30, 2011:

Stafford - Subsidized	\$ 555,445,853
Stafford - Unsubsidized	560,674,655
PLUS/SLS	48,709,745
Consolidation	547,810,947
Other	<u>1,723,039</u>
Total gross loans	1,714,364,239
Allowance for loan losses	(5,796,191)
Loan rebate due to borrowers	<u>(4,000,000)</u>
Loans, net	1,704,568,048
Deferred front end borrower benefits, net of accumulated amortization of \$46,530,275	10,846,503
Deferred lender origination costs, net of accumulated amortization of \$19,040,992	<u>3,459,650</u>
Net loans and deferred origination costs	<u>\$ 1,718,874,201</u>

All principal and accrued interest on FFELP student loans is insured against borrower death, disability, bankruptcy or default, as long as the Authority/Corporation performs all required loan servicing due diligence activities. As of June 30, 2011, \$2,493,437 of student loans were no longer insured due to violations of due diligence requirements. Loan rebate due to borrowers represents the additional loan forgiveness described in Note H.

Prior to the elimination of FFELP, borrowers were required to pay certain origination fees to USDE, based on a percentage of the gross loan amount. These origination fees were typically withheld from the loan proceeds provided to the borrower and remitted to USDE on a quarterly basis. The Authority/Corporation sometimes elected to pay a portion or all of the origination fees on behalf of the borrower and therefore, would send the borrower an increased amount of loan proceeds, but was still required to remit the full amount of origination fees to USDE. All origination fees paid on behalf of the borrower were capitalized as deferred origination costs and are amortized over the estimated life of the loan.

The Authority/Corporation was also required to pay to USDE certain lender fees. The amount of the lender fees was based on a certain percentage of the gross loan amount on all FFELP loans originated after October 1, 1993. Lender fees were capitalized as deferred origination costs and are amortized over the estimated life of the loan.

Generally, all student loans in the Education Finance Fund of the Authority/Corporation are pledged as collateral for the various obligations of the Authority/Corporation.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note G--Special Allowance

The Higher Education Act of 1965 provides for quarterly Special Allowance Payments to be made by USDE to holders of student loans to the extent necessary to ensure that they receive at least specified market interest rates of return. Certain FFELP loans disbursed during the period from January 1, 2000 through June 30, 2010 receive special allowance at a rate based upon the average of the bond equivalent rates of the three-month commercial paper rate as reported by the U.S. Federal Reserve. Other eligible loans receive special allowance based on the 91-day Treasury bill rates. The special allowance is accrued as either earned or payable, as applicable. Effective October 1, 2006, certain other loans financed through bonds dated prior to October 1, 1993 stopped receiving a 9.5% minimum rate of return and instead began receiving the aforementioned standard special allowance rate.

Note H--Principal and Interest Forgiveness

During fiscal year 2011, the Authority/Corporation forgave \$7.3 million in loan principal and accrued interest for teachers funded by USDE, and an additional \$2 million in loan forgiveness for teachers funded by the Commonwealth of Kentucky. Also, during fiscal year 2011, the Authority/Corporation provided additional loan forgiveness of \$1,615,461.

The Authority/Corporation's Board of Directors approved \$4 million of additional loan forgiveness for teachers, nurses and public service attorneys who were employed in the Commonwealth, which was accrued as of June 30, 2011 and was provided to borrowers in October 2011.

Note I--Capital Lease Payable

On June 22, 2000, the Commonwealth of Kentucky, State Property and Building Commission (the "Commission") issued \$8,825,000 in bonds payable on behalf of the Authority/Corporation. The proceeds of the bonds are used to house the Authority/Corporation's operations located in Frankfort, Kentucky. On October 8, 2003, the Commission issued additional bonds payable on behalf of the Authority/Corporation as a partial refunding of original bonds payable.

The original bonds had a final principal payment in May 2010. The new bonds bear interest at fixed rates which vary from 2.0% to 5.25% and have a maturity date of May 2020. The bonds are special and limited obligations of the Commission. The bonds do not constitute a debt, liability or obligation of the Commonwealth of Kentucky or a pledge of the full faith and credit or taxing power of the Commonwealth of Kentucky, but are payable solely from amounts derived from the biennially renewable lease agreement with the Authority/Corporation as described below. The bondholders have no security interest in any properties constituting the project or any amounts derived there from. The scheduled payments of principal and interest on the bonds are guaranteed under an insurance policy.

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note I--Capital Lease Payable--Continued

In connection with the issuance of the bonds, the Authority/Corporation entered into a financing/lease agreement with the Commission whereby the Authority/Corporation agreed to lease the newly constructed building. The Authority/Corporation renewed the lease for the biennium ending June 30, 2012 and has the right to renew for four additional two-year periods.

The Authority/Corporation can cancel the lease on the last business day in May immediately preceding the beginning of any renewal term.

The lease payments are equal to the debt service required by the bond indenture. In connection with the agreements, the Kentucky General Assembly appropriated sufficient spending authorization to the Authority/Corporation to pay the lease payments required through June 30, 2012. There can be no assurance to make rent payments past the two-year lease period.

A summary of the activity for the capital lease for the year ended June 30, 2011 is as follows:

	<u>June 30, 2010</u>	<u>Additions</u>	<u>Payments</u>	<u>June 30, 2011</u>
Capital Lease Payable	\$ 5,730,000	\$ -	\$ 465,000	\$ 5,265,000

Debt service requirements for the next five fiscal years and thereafter are as follows:

Year Ending June 30,	<u>Principal</u>	<u>Interest</u>
2012	\$ 480,000	\$ 264,105
2013	500,000	244,905
2014	525,000	219,905
2015	550,000	192,342
2016	580,000	164,592
Five Years Ending June 30,		
2017 - 2020	<u>2,630,000</u>	<u>348,218</u>
	<u>\$ 5,265,000</u>	<u>\$ 1,434,067</u>

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note J--Revenue Bonds and Notes Payable

The balance of revenue bonds and notes payable at June 30, 2011 and the related activity for the year ended June 30, 2011 is as follows:

<u>Series</u>	<u>Scheduled Maturity</u>	<u>Auction Rate Period</u>	<u>Beginning Balance July 1, 2010</u>	<u>Bond Maturities and Refundings</u>	<u>New Issues</u>	<u>Ending Balance June 30, 2011</u>
2008A	November 15, 2011	Quarterly	\$ 100,000			\$ 100,000
<u>1997 General Bond Resolution</u>						
1997 A-1	May 1, 2027	Every 35 days	35,750,000	\$ (23,800,000)		11,950,000
1997 A-2	May 1, 2027	Every 35 days	36,550,000			36,550,000
1997 B	* May 1, 2027	Every 35 days	37,150,000	(13,250,000)		23,900,000
1998 A-1	May 1, 2028	Every 28 days	36,400,000			36,400,000
1998 A-2	May 1, 2028	Every 28 days	36,400,000			36,400,000
1998 B	* May 1, 2028	Every 35 days	42,150,000			42,150,000
1999 A	May 1, 2029	Every 28 days	43,550,000	(3,650,000)		39,900,000
1999 B	* May 1, 2029	Every 35 days	23,650,000	(100,000)		23,550,000
2000 A-1	May 1, 2030	Every 28 days	40,400,000	(16,900,000)		23,500,000
2000 A-2	May 1, 2030	Every 28 days	37,800,000	(1,700,000)		36,100,000
2000 A-3	May 1, 2030	Every 35 days	38,950,000			38,950,000
2000 B	* May 1, 2030	Every 35 days	23,750,000	(20,000,000)		3,750,000
2001 A-1	May 1, 2031	Every 35 days	51,100,000	(2,000,000)		49,100,000
2001 A-2	May 1, 2031	Every 35 days	47,350,000			47,350,000
2001 B	* May 1, 2031	Every 35 days	28,600,000			28,600,000
2002 A-1	May 1, 2032	Every 28 days	31,650,000	(50,000)		31,600,000
2002 A-2	May 1, 2032	Every 35 days	36,950,000	(800,000)		36,150,000
2002 A-3	* May 1, 2032	Every 35 days	36,600,000			36,600,000
2003 A-1	* May 1, 2033	Every 35 days	40,900,000	(20,250,000)		20,650,000
<u>2004 Master Indenture</u>						
2005 A-1	* June 1, 2035	Every 35 days	800,000	(800,000)		
2006 A-1	* June 1, 2036	Every 35 days	150,000	(150,000)		
<u>2008 Indenture</u>						
2008 A-1	* June 1, 2037	Weekly	179,525,000	(42,655,000)		136,870,000
2008 A-2	* June 1, 2038	Weekly	83,400,000	(13,645,000)		69,755,000
2008 A-3	June 1, 2038	Weekly	37,075,000			37,075,000
<u>2010 Indenture</u>						
2010 A-1	* May 1, 2020	Quarterly	75,050,000	(22,450,000)		52,600,000
2010 A-2	* May 1, 2034	Quarterly	135,660,000			135,660,000
<u>ED Conduit Program</u>						
	January 19, 2014	Weekly	703,272,265	(86,715,064)		616,557,201
			<u>\$ 1,920,682,265</u>	<u>\$ (268,915,064)</u>	<u>\$ -</u>	<u>\$ 1,651,767,201</u>

*This bond series is tax-exempt.

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note J--Revenue Bonds and Notes Payable--Continued

The Authority/Corporation's revenue bonds include a variable rates of interest based on various index rates. Those variable rates ranged from .21% to 1.69% as of June 30, 2011.

Debt service requirements to maturity or redemption date, assuming interest rates based on variable index rates at June 30, 2011, are as follows:

	Principal Repayment Amount (Thousands)						Total
	83 GBR	97 GBR	04 GBR	08 GBR	10 GBR	ED Conduit	
Year Ending June 30,	\$ 100						\$ 100
4 Years Ending June 30,						\$ 616,557	616,557
5 Years Ending June 30,					\$ 52,600		52,600
5 Years Ending June 30,		\$ 478,150					478,150
5 Years Ending June 30,		125,000			135,660		260,660
2 Years Ending June 30,				\$ 243,700			243,700
	<u>\$ 100</u>	<u>\$ 603,150</u>	<u>\$ -</u>	<u>\$ 243,700</u>	<u>\$ 188,260</u>	<u>\$ 616,557</u>	<u>\$1,651,767</u>
	Interest Payments Amount (Thousands)						
	83 GBR	97 GBR	04 GBR	08 GBR	10 GBR	ED Conduit	Total
Year Ending June 30,		\$ 6,920		\$ 587	\$ 2,354	\$ 1,622	\$ 11,483
Year Ending June 30,		6,920		587	2,354	1,622	11,483
Year Ending June 30,		6,920		587	2,354	1,622	11,483
Year Ending June 30,		6,920		587	2,354		9,861
Year Ending June 30,		6,920		587	2,354		9,861
5 Years Ending June 30,		34,600		2,935	11,378		48,913
5 Years Ending June 30,		34,600		2,935	9,810		47,345
5 Years Ending June 30,		25,886		2,935	9,810		38,631
5 Years Ending June 30,		1,557		2,935	5,886		10,378
2 Years Ending June 30, 2038				892			892
	<u>\$ -</u>	<u>\$ 131,243</u>	<u>\$ -</u>	<u>\$ 15,567</u>	<u>\$ 48,654</u>	<u>\$ 4,866</u>	<u>\$ 200,330</u>

The Authority/Corporation entered into an irrevocable direct pay Letter of Credit and Reimbursement Agreement with two banks relating to the Series 2008 Bonds in the amount of \$300,000,000 issued on June 18, 2008. The Letter of Credit was issued in an amount (the "Original Stated Amount") equal to the sum of (i) the aggregate principal amount of the outstanding Series 2008A-1 Bonds and the Series 2008A-2 Bonds, plus an amount equal to 202 days of interest thereon at a rate of 14% per annum plus (ii) the aggregate principal amount of the outstanding Series 2008A-3 Bonds, plus an amount equal to 51 days of interest thereon at a rate of 18% per annum. At June 30, 2011, there was no balance nor has there been activity on the letter of credit. The letter of credit had an original maturity date of June 17, 2011. The Authority/Corporation and the banks extended the Stated Expiration Date as defined in the letter of credit to October 14, 2011. On September 8, 2011, the Stated Expiration Date as defined in the letter of credit was extended to September 13, 2013.

All assets of the 1983 General Bond Resolution Fund, the 1997 General Bond Resolution Fund, the 2008 Indenture, the 2010 Indenture, and the Department of Education ("ED") Conduit Program are pledged for repayment of the specific bond or note issues under each resolution or program.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note K--Lines of Credit and Other Financing

The Authority/Corporation maintains a line of credit agreement with a commercial bank (the "Bank"). The agreement provides for a commitment amount not to exceed the lesser of \$30 million or the combined cash and investments maintained at the Bank, adjusted for asset class factors. The operating cash and investments are pledged as collateral against outstanding balances. The outstanding balance bears interest at the Authority/Corporation's choice of the Bank's prime rate or the London Interbank Offering Rate ("LIBOR") plus .50%. The agreement expires on June 18, 2012. As of June 30, 2011, there was no outstanding balance on the agreement.

Under the ECASLA II Participation Program for 2009-2010 academic year loans, the Authority/Corporation maintained a participation facility payable to USDE of \$536.1 million as of July 1, 2010. In fiscal year 2011, the Authority/Corporation drew down an additional \$16.5 million from USDE. The Authority/Corporation repaid the entire \$552.6 million on October 8, 2010.

Note L--Allowance for Arbitrage Liabilities

Certain of the Authority/Corporation's tax-exempt bond issues are subject to potential arbitrage liabilities under U.S. tax law. Arbitrage liabilities, under current federal income tax law regarding tax-exempt bond issues, consist of three types; (1) yield adjustment payments, (2) forgiveness and (3) arbitrage rebate. At June 30, 2011, the Authority/Corporation is reporting a liability for arbitrage rebate of \$645,931.

The determination of excess yield on acquired purpose investments is cumulative over the life of the applicable bond series, as is the determination of arbitrage rebate on non-purpose investments, except for variable rate bonds for which arbitrage rebate is generally determined for each five-year period without retroactivity.

Yield adjustment payments, which also relate to yield restriction on acquired purpose investments, are applicable to all tax exempt bonds. The allowable yield is 2% above the bond yield (arbitrage yield), with the federal special allowance included in income. The loss of tax-exempt status may be avoided by rebating the excess yield to the U.S. Treasury every 10 years, and upon final maturity of the bonds.

Forgiveness is applicable to all tax exempt bonds. In general, a yield restriction is imposed on acquired purpose investments, designating the allowable yield as 2% above the bond yield (arbitrage yield). The loss of tax-exempt status may be avoided by partial forgiveness of the applicable student loans. Forgiveness can be applied upon maturity of the bonds or as otherwise prescribed by the bond resolutions.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note L--Allowance for Arbitrage Liabilities--Continued

Arbitrage rebate is applicable to all of the Authority/Corporation's tax-exempt bonds. With certain limited exceptions, income earned on non-purpose investments (investments other than student loans) which exceeds the bond yield (arbitrage yield), must be rebated to the U.S. Treasury. Payments of at least 90% are due every five years after the year of issuance, and upon final maturity of bonds.

The estimate of the Authority/Corporation's arbitrage liability is computed by an outside company who specializes in this area.

Note M--Deferred Gain on Retirement of Debt

In fiscal year 2010, the Authority/Corporation purchased \$1.198 billion of its own auction rate securities, and retired the debt. The resulting \$80.2 million of gain was deferred and is being amortized over the life of the new debt, beginning with fiscal year 2011. The Authority/Corporation recognized a gain of \$18.5 million for the year ended June 30, 2011. The Authority/Corporation retired additional debt during fiscal year 2011 with cash and recognized \$4.2 million as income in the current period.

Note N--Retirement Plans

The Authority/Corporation provides retirement benefits to all full-time employees through the KRS. KRS is a multiple-employer, defined benefit plan sponsored by the Commonwealth of Kentucky, which provides retirement, disability and death benefits. The Authority/Corporation contributed 16.98% of gross wages for the year ended June 30, 2011. The employees contributed up to 6% of their gross wages to the plan for the year ended June 30, 2011. Such rates are intended to provide for normal costs on a current basis, plus an amount equal to the amortization of unfunded past service costs over thirty years, using the level percentage of payroll method. These contribution rates are determined by the Board of Trustees of KRS each biennium. The payroll of employees covered by the retirement plan was \$14,765,528 for the year ended June 30, 2011. Total payroll for the year ended June 30, 2011 was \$15,052,313. KRS participants have fully vested interests after the completion of sixty months of service, twelve months of which are current service. The KRS contribution requirement for the year ended June 30, 2011 was \$3,197,548 which consisted of employer contributions of \$2,455,542 and \$742,006 from employees. Employer contributions for the years ended June 30, 2010 and 2009 were \$1,861,656 and \$1,898,813, respectively.

Although separate measurements of assets and pension benefit obligation are not available for individual employers, KRS's annual financial report (which is a matter of public record) contains this information for KRS as a whole. It may be obtained from the KRS by writing to them at 1260 Louisville Road, Perimeter Park West, Frankfort, Kentucky 40601.

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note O--Tuition Benefit Payable

The following assumptions developed by management were used in the actuarial valuation of tuition benefits payable as of June 30, 2011. These assumptions are based on historical data for both state and national trends.

Investment Rates - The investment yield assumption is based on estimates of the yields that will be available on the investment portfolio and cash and cash equivalents. The gross investment yield assumption utilized in the calculation of the tuition benefit payable as of June 30, 2011 and June 30, 2010 was 6.56% and 6.95%, respectively.

Investment Expenses - The investment expense is assumed to be 20 basis points on all invested assets.

Tuition Increases - Tuition increases are based on the known increases for the next academic year and best estimates of future tuition increases for Kentucky's public colleges and universities. The historical tuition increases are as follows:

- The tuition increases for the 2003-2004 academic year were 23.4% for the Value Plan and 14.4% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2004-2005 academic year were 24.2% for the Value Plan and 16.9% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2005-2006 academic year were 6.5% for the Value Plan and 12.5% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2006-2007 academic year were 11.2% for the Value Plan and 12% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2007-2008 academic year were 5.5% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2008-2009 academic year were 5.2% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2009-2010 academic year were 3.3% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2010-2011 academic year were 4.0% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- As of June 30, 2011, the tuition increases for the 2011-2012 academic year were 3.8% for the Value Plan and 6% for the Standard Plan and the Premium Plan. The tuition increase assumption was 7.25% for the 2012-2013 academic year and 6.75% for each year thereafter.

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note O--Tuition Benefit Payable--Continued

For the period from inception to June 30, 2011, the annualized tuition increase for the highest-priced Kentucky public university, as applicable to the tuition benefits payout rate of the KAPT Standard Plan, which represents 90% of KAPT enrollments, has been 9.4%. For the Kentucky Community and Technical College System ("KCTCS"), as applicable to the tuition benefits payout rate of the Value Plan, the average annualized tuition increase from inception to June 30, 2011, has been 12.9%. For the University of Kentucky, as applicable to the tuition benefits payout rate of the KAPT Premium Plan, the average annualized tuition increase from inception to June 30, 2011 has been 11.69%.

Payment of Tuition and Mandatory Fees - Payments of tuition and mandatory fees are assumed to be 128 credit hours of utilization and payments occur twice annually.

Note P--Restricted Net Assets

The following categories of restricted net assets are included in the combined statement of net assets for the following purposes:

- a. **Federal Student Loan Reserve Fund:** Net assets are restricted for certain FFELP activities, primarily the payments of claims.
- b. **Agency Operating Fund:** Net assets are restricted for certain FFELP activities and other student aid activities.
- c. **Education Finance Funds:** Net assets are restricted as required by the 1983 General Bond Resolution Fund, the 1997 General Bond Resolution Fund, the 2008 Indenture, the 2010 Indenture and the Department of Education ("ED") Conduit Program.
- d. **Student Aid Funds:** The Student Aid net assets are restricted for the Student Aid Programs.
- e. **The Trust:** Net assets are restricted for use by trust participants.

Note Q--Operating Leases

The Authority/Corporation leases office space and equipment under agreements expiring through 2013. Rental expense was \$1,844,830 for the year ended June 30, 2011. The following are the approximate minimum lease commitments under operating leases:

<u>Year Ending June 30</u>	
2012	\$ 1,861,534
2013	621,196

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note R--Commitments and Contingencies

The FSLRF is contingently liable for loans made by financial institutions that qualify for guarantee. The default ratio for loans guaranteed by the Authority/Corporation's loan guarantee operations is below 5% for the fiscal year ended June 30, 2011. As a result, the federal government's reinsurance rate for defaults for the fiscal year ended September 30, 2010, is 100% for loans made prior to October 1, 1993, 98% for loans made on or after October 1993 to September 30, 1998, and 95% for loans made after September 30, 1998. In the event of future adverse default experience, the FSLRF could be liable for up to 25% of defaulted loans. At the beginning of each fiscal year, the reinsurance rate returns to baseline (100%, 98% or 95%); management does not expect that all guaranteed loans could default in one year.

While management believes the FSLRF's expected maximum contingent liability is less than 25% of outstanding guaranteed loans, the maximum contingent liability at June 30, 2011 is calculated as follows:

Amount of guaranteed student loans outstanding at lenders	\$ 3,748,429,535
Less minimum federal government share - 75%	<u>2,811,322,151</u>
	<u>\$ 937,107,384</u>

In July 2011, Federal Student Aid ("FSA") contacted the Authority/Corporation to provide advance notice of official FSA correspondence the Authority/Corporation would soon be receiving. FSA noted that the correspondence would state that the Authority/Corporation would not be allowed to settle liabilities owed to the AOF by the FSLRF. The Authority/Corporation has managed the cash flow of the FSLRF in a manner to assure its customers that sufficient funds are available to continue to pay default claims by not immediately transferring certain fees such as default aversion fees. As of October 14, 2011 the Authority/Corporation had not received the aforementioned correspondence from FSA. If the FSLRF was not allowed to pay its liability of \$13.9 million to the AOF, the net assets of the AOF would decrease, and the net assets of the FSLRF would increase, by this amount. Management believes that all receivable amounts from the FSLRF are fully collectible and intends to vigorously contest any assertions to the contrary.

In August of 2009, KHESLC was served with a copy of a First Amended Complaint in the matter of *Jon H. Oberg v. Nelnet, Inc., et al.*, Civil No. 1:07-cv-960, pending in the United States District Court for the Eastern District of Virginia. This is a Federal False Claims Act case filed by a former employee of USDE. The matter was originally filed under seal in 2007, and the plaintiff was not permitted to serve the defendants until August 2009. USDE elected not to intervene in the prosecution of the action. In short, the plaintiff alleged that KHESLC and the other named defendants illegally submitted claims for the 9.5% floor loan special allowance payments in violation of applicable law and regulatory guidance.

Continued

**Kentucky Higher Education Assistance Authority/
Kentucky Higher Education Student Loan Corporation**

June 30, 2011

Note R--Commitments and Contingencies--Continued

Separately, on May 28, 2009, the Authority/Corporation received a final audit report from the Office of Inspector General ("OIG") titled "*Special Allowance Payments to the Kentucky Higher Education Student Loan Corporation for Loans Made or Acquired with Proceeds of Tax-Exempt Obligations.*" The Authority/Corporation submitted its comments to Federal Student Aid ("FSA") within 30 days as requested. Subsequently, FSA has requested additional information related to the audit on three separate occasions as recent as August 2011. Regarding the audit, one of the three findings has been resolved. The primary outstanding finding is entitled, "KHESLC Used Ineligible Refunding Obligations to Support Loans Billed Under the 9.5 Percent Floor". The amount that the OIG recommended that KHESLC repay under this finding was approximately \$9 million. While the Authority/Corporation is unable to predict the ultimate outcome of this audit, the Authority/Corporation believes its practices complied with applicable law, including the provisions of the Higher Education Act, the rules and regulations adopted by USDE thereunder, and USDE's guidance regarding those rules and regulations. These practices were reviewed by FSA in October 2005. On May 11, 2006, FSA issued its final "Tax-Exempt Review Report" related to the October 2005 review. That review included an assessment of the Authority/Corporation's 9.5 percent floor billings associated with tax-exempt obligations originally issued before October 1, 1993. The final "Tax-Exempt Review Report" contained no findings related to that specific issue.

As for the lawsuit, on December 1, 2009, the trial court granted to KHESLC as well as to the three other state-related defendants their motion to dismiss the lawsuit as to all of the state-related defendants. Subsequently, the other, non-state related defendants settled and on November 18, 2010, a Final Order was entered in this matter. Thereafter, the plaintiff filed a Notice of Appeal on November 22, 2010. The previously dismissed state-related defendants filed their briefs with the United States Court of Appeals for the Fourth Circuit on April 12, 2011. Management vigorously contests this matter and, as of June 30, 2011, do not believe a loss contingency exists.