

**KENTUCKY HIGHER EDUCATION ASSISTANCE AUTHORITY
KENTUCKY HIGHER EDUCATION STUDENT LOAN CORPORATION**

JUNE 30, 2016

Financial Statements

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

June 30, 2016

Independent Auditor’s Report	1
Management’s Discussion and Analysis (Unaudited)	3
Financial Statements	
Combined Government-Wide Statement of Net Position.....	16
Combined Government-Wide Statement of Activities.....	17
Combined Statement of Net Position – Proprietary Funds.....	18
Combined Statement of Revenues, Expenditures and Changes in Net Position – Proprietary Funds.....	19
Combined Statement of Cash Flows – Proprietary Funds.....	20
Balance Sheet – Governmental Fund.....	22
Statement of Revenues, Expenditures and Changes in Fund Balance - Governmental Fund.....	23
Statement of Fiduciary Net Position (Deficit).....	24
Statement of Changes in Fiduciary Net Position (Deficit).....	25
Notes to Financial Statements.....	26
Required Supplementary Information.....	62



INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying combined financial statements of the governmental activities, the business-type activities, and each major fund 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, 2016, and the related notes to the financial statements which collectively comprise the Authority/Corporation's basic combined financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these combined financial statements based on our audit. We did not audit the financial statements of the Kentucky Education Savings Plan Trust, which statements reflect total assets of \$182,438,073 as of June 30, 2016, and an increase to fiduciary net position of \$2,143,796 for the year ended June 30, 2016. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Kentucky Education Savings Plan Trust, is based solely 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 from material misstatement.

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

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

Kentucky
Indiana
Ohio

Mountjoy Chilton Medley LLP

P 502.749.1900 | F 502.749.1930

2600 Meidinger Tower | 462 South Fourth Street | Louisville, KY 40202

www.mcmcpa.com | 888.587.1719

A Member of PrimeGlobal – An Association of Independent Accounting Firms

Opinions

In our opinion, based on our audit and the report of other auditors, 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, and each major fund of the Authority/Corporation as of June 30, 2016, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 15 and the required supplemental information on pages 62 through 64 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic 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 basic combined financial statements, and other knowledge we obtained during our audit of the basic 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2016 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 internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority/Corporation's internal control over financial reporting and compliance.



Louisville, Kentucky
September 29, 2016

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

June 30, 2016

Description of the Business

The Kentucky Higher Education Assistance Authority (the "Authority" or "KHEAA") was established in 1966 as the Commonwealth of Kentucky's agency for improving higher education opportunities. The Authority also guarantees, performs default aversion activities, pays lender default and other claims and performs collection activities on eligible student loans. The Kentucky Educational 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" or "KHESLC") makes student loans directly to parents, students, and borrowers in repayment as part of the Kentucky Advantage loan programs, purchases and services eligible Federal and Kentucky Advantage student loans and performs collection activities on certain eligible Federal student loans. The Authority and the Corporation maintain bundled operations to maximize the efficiency of all Authority and Corporation operational and support activities. 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:

Outreach - Outreach operations provide critical informational 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, Kentucky Educational Excellence Scholarship ("KEES") workshops, Free Application for Federal Student Aid ("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 outreach operations are accounted for as a program benefit in a proprietary fund of the Authority/Corporation.

Student Aid – The Authority/Corporation provides some or all levels of administration of fifteen student aid programs: (1) Kentucky Tuition Grant ("KTG"), (2) College Access Program Grant ("CAP"), (3) Kentucky Educational Excellence Scholarship, (4) Teacher Scholarship, (5) Osteopathic Medicine Scholarship, (6) KHEAA Work-Study Program, (7) Kentucky Coal County College Completion Scholarship, (8) Early Childhood Development Scholarship, (9) Go Higher Grant Program, (10) Coal County Scholarship Program for Pharmacy Students, (11) Mary Jo Young Scholarship, (12) John R. Justice Grant, (13) Kentucky National Guard Tuition Award Program, (14) Early Graduation Scholarship, and (15) Minority Educator Recruitment and Retention Scholarship.

Personnel, professional and administrative costs associated with student aid operations are accounted for as a program benefit in a proprietary fund of the Authority/Corporation. Direct benefits to students are accounted for in the governmental fund.

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2016

College Savings Programs - The Authority/Corporation 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 families save for the costs of higher education. 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 account owners.

An individual or entity 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, Large-Cap Growth, S&P 500 Index, Mid-Cap Growth Fund, Small-Cap Equity, Mid-Cap Value, Short-Term Bond, Bond Index, Inflation-Linked Bond, Equity Index, Bond Fund, Real Estate Securities, Emerging Market Equity, Emerging Market Equity Index, Money Market Funds and Guaranteed Funding Agreement of the TIAA-CREF Institutional Mutual Funds.

All allocation percentages are determined by the Authority/Corporation's Board of Directors and reviewed annually. The assets of the Guaranteed Option and two upper level age bands in Managed Allocation 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 Equity Options invest 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%.

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.

The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan's investment policy goal is to earn rates of return that closely match or exceed anticipated tuition inflation rates and remain sufficiently liquid to meet KAPT benefit payments in a timely manner. The Plan offers certain federal and state tax advantages to purchasers.

Participants purchased annual tuition units at current tuition levels, or current tuition levels at the time of purchase 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 offered three tuition plans – the Value Plan, the Standard Plan, and the Premium Plan. In the Value Plan, participants purchased tuition units and receive benefits indexed to the tuition rate of the Kentucky Community and Technical College System.

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2016

The Standard Plan offers tuition units and benefits indexed to the tuition rate of Kentucky's most expensive public university. The Premium Plan offered 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 were allowed to 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, computers, and required 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 statutorily defined 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.

The Kentucky General Assembly approved certain changes to the Plan during the 2014 Legislative Session that became effective July 2014. These changes included the following: the addition of a utilization period definition; the establishment of June 30, 2028 as the closure date of the Plan; the establishment of certain limitations on the growth of a plan account beyond the utilization period; the prohibition of projected college entrance year extensions; and the clarification of provisions for transferring a plan account to another qualified tuition program.

As of June 30, 2016, the Plan maintained a present value fund deficit of \$35.8 million. This represents an \$11.7 million increase over the previous year's deficit. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2022, at which time the liability of the Plan becomes a General Obligation of the Commonwealth of Kentucky. Per KRS 164A.708, once a real liability is expected to accrue, the General Assembly shall appropriate the necessary funds to meet the liability. Over the remaining estimated life of the program, through fiscal year 2028, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$53 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 position 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 position additions and deductions for the Plan are accounted for in the Kentucky Affordable Prepaid Tuition fund, a fiduciary fund of the Authority/Corporation.

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

June 30, 2016

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 also 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 ("ED"), 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 Supplemental Student Loan Program. The Supplemental Student Loan Program is comprised of the Kentucky Advantage Education Loan ("KAEL") and Kentucky Advantage Parent Loan programs ("KAPL") for residents of the Commonwealth of Kentucky and non-residents attending a post-secondary institution or approved program in the Commonwealth of Kentucky, and the Advantage Education Loan and Advantage Parent Loan for non-residents of the Commonwealth of Kentucky. During fiscal year 2016, the Authority/Corporation introduced the Advantage Refinance Loan to help borrowers manage their education debt.

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

School Services – School service operations provide services to higher education institutions through a contractual relationship. These areas currently consist of KHEAA Verify and Cohort Default Management Services and new areas of services are continuously analyzed and evaluated based on the needs of school partners across the Commonwealth and beyond.

KHEAA Verify consists of services associated with the required verification of FAFSA information submitted by potential students at an institution. Cohort Default Management Services engages current and former students of institutions to educate them about persistence and completing their education and/or successfully repaying any educational debt while providing information about the various options available. Personnel, professional and administrative costs associated with school services are accounted for in the Agency Operating Fund ("AOF"), a proprietary fund of the Authority/Corporation and through the collection of revenues generated through service contracts with each institution.

Loan Finance - The Authority/Corporation's loan finance operation is authorized to refinance existing long-term debt and to acquire private supplemental student loans, rehabilitated FFELP loans, FFELP portfolios from other lenders, and certain other FFELP loans required to be repurchased by the Higher Education Act. The Authority/Corporation may issue bonds and notes not to exceed \$5 billion in order to carry out these 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, 2016, the loan finance operation owned approximately \$1.07 billion of student loans.

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

June 30, 2016

Most FFELP loans held by the Authority/Corporation are insured by the Authority/Corporation's loan guarantee operations. FFELP loans made prior to October 1, 1993, are 100% insured. FFELP 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. FFELP 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 loan finance operation finances legacy and certain other FFELP loans with revenue bonds, internal warehouse funds, and commercial bank lines of credit. As of June 30, 2016, the Authority/Corporation maintained seven separate Indentures of Trust and related Series Resolutions for issues of revenue bonds. The indentures 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, 2016, the loan finance operation maintained \$994.4 million of revenue bonds outstanding and \$7.7 million of lines of credit payable.

Personnel, professional and administrative costs associated with loan finance operations are accounted for in a proprietary fund of the Authority/Corporation.

Loan Servicing - The loan servicing operation performs servicing and default prevention activities on FFELP and supplemental loans held by the Authority/Corporation's loan finance operation and other lenders. Of the loans serviced, approximately \$1.07 billion in outstanding principal of loans was held by the loan finance operation. Over 95% of these loans were pledged pursuant to the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, and the 2016 indenture. Approximately \$3.4 million of FFELP Loans and other education loans were owned by another holder. For those loans, 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 a proprietary fund of the Authority/Corporation. Student loan remittances and payables to other lenders are also accounted for in a proprietary fund.

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. In accordance with HCERA, the Authority/Corporation continues to provide guarantee services on \$1.97 billion of FFELP loans, continues to own \$1.07 billion of FFELP loans and other education loans, and continues to service an additional \$3.4 million of FFELP and other education loans. The Authority/Corporation can no longer originate, guarantee or fund any newly originated FFELP loans; however, the Authority/Corporation does continue to look for opportunities to mitigate the impact of the runoff of the FFELP legacy loan portfolio through the acquisition of FFELP rehabilitation loans and other FFELP portfolios and through the origination of KAEL loans.

The Authority/Corporation plans to leverage its experience collecting defaulted FFELP and Direct Loans to become one of the Private Collection Agencies ("PCA") selected by ED as part of future

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

June 30, 2016

PCA Request for Proposal processes. In anticipation of future PCA selection processes, the Authority/Corporation sought and received state legislative approval from the Commonwealth of Kentucky to create the Asset Resolution Corporation ("ARC") as the entity that would contract with ED to become a PCA. ARC was created by the Kentucky General Assembly effective July 12, 2012. ARC is attached to KHESLC for administrative and reporting purposes.

On December 26, 2013, President Obama signed into law the Bipartisan Budget Act of 2013 (the "2013 Budget"). Section 502 of the 2013 Budget reduces the amount that the Authority/Corporation and other guaranty agencies are permitted to retain on rehabilitated defaulted student loans. Under the old rules, guaranty agencies were permitted to retain 18.5% of the principal balance of the rehabilitated loan and 100% of accrued interest, and could charge the borrower up to another 18.5% of the principal balance and accrued interest at the time of loan sale and retain such amount to defray collection costs. For rehabilitated loan sales on and after July 1, 2014, the 2013 Budget requires that the guaranty agency pay ED 100% of the principal balance of the loan at the time of sale (multiplied by the reinsurance percentage in effect when payment under the guaranty agreement was made). In addition, the guaranty agency can charge to the borrower an amount not to exceed 16% of the outstanding principal and interest at the time of the loan sale in order to defray collection costs.

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 position and statement of activities include the Governmental Funds and Proprietary Funds. The combined government-wide financial statements can be found on pages 16 and 17 of this report. The combined fund financial statements can be found on pages 18 through 23 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 position (deficit) and changes in fiduciary net position (deficit) can be found on pages 24 and 25 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, 2016 and 2015, respectively.

Condensed Financial Information - Governmental Fund and Proprietary Funds

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

	Governmental Fund		Proprietary Funds	
	2016	2015	2016	2015
Net Position Information				
Capital assets	\$	\$	\$ 5,473,643	\$ 5,315,212
Other assets	16,027,177	22,004,402	1,281,823,021	1,359,175,910
Total Assets	<u>16,027,177</u>	<u>22,004,402</u>	<u>1,287,296,664</u>	<u>1,364,491,122</u>
Deferred Outflows of Resources:				
Deferred pension expense			12,351,990	4,624,385
Total Assets and Deferred Outflows of Resources	<u>16,027,177</u>	<u>22,004,402</u>	<u>1,299,648,654</u>	<u>1,369,115,507</u>
Long-term liabilities			1,090,570,732	1,148,680,292
Other liabilities	75,917	17,879	23,376,921	34,261,358
Deferred pension expense			262,261	1,035,000
Deferred gain on debt retirements, net			18,212,949	20,012,879
Total Liabilities and Deferred Inflows of Resources	<u>75,917</u>	<u>17,879</u>	<u>1,132,422,863</u>	<u>1,203,989,529</u>
Invested in capital assets, net of expended debt proceeds			5,473,643	5,315,212
Unrestricted				6,285,287
Restricted, other			78,413,391	73,169,113
Restricted for program benefits	15,951,260	21,986,523		
Restricted for student aid and related activities			83,338,757	80,356,366
Total Net Position	<u>\$ 15,951,260</u>	<u>\$ 21,986,523</u>	<u>\$ 167,225,791</u>	<u>\$ 165,125,978</u>
Activity Information				
Interest and investment income fund	\$ 744,595	\$ 619,859	\$ 1,456,282	\$ 703,223
Student aid & advancement fund revenue	206,702,000	203,673,961		
Tobacco settlement revenue	1,100,000	797,714		
Unclaimed lottery revenue	6,200,000	6,500,000		
Contributions from Agency Operating Fund	2,370,370	2,359,798		
Federal funds revenue	46,148	5,543		
Servicing Fees from external sources			294,159	923,236
Servicing Fees from Education Finance Funds			6,179,082	6,882,940
Conversion fees			500,000	
Debt recovery commission			18,951,878	22,377,948
Early retirement of debt				108,828
Federal fees earned			1,353,721	1,536,064
Default aversion fee income			(144,580)	(501,501)
Interest income on loans			18,686,985	19,372,732
Amortization of deferred gain on debt retirements			1,799,930	1,799,930
Guarantee fee			131,571	142,104
Gain on the sale of loans			(139,424)	2,696,772
Late payment penalties			1,185,521	1,235,258
School Services			615,824	550,429
Other income	699,118	768,482	127,932	151,044
Total Revenue	<u>217,862,231</u>	<u>214,725,357</u>	<u>50,998,881</u>	<u>57,979,007</u>
Kentucky Tuition Grant	29,093,617	28,680,413		
College Access Program Grant	70,102,359	61,045,814		
Early Graduation Scholarship	212,172			
Mary J Young Scholarship	583,937	626,859		
Early Childhood Development Scholarship	1,104,688	995,045		
Kentucky National Guard Tuition Award Program	6,176,935	5,680,227		
Kentucky Educational Excellence Scholarship	110,850,028	107,866,852		
Teacher Scholarship	820,605	1,263,932		
Teacher Loan Forgiveness	1,300,000	1,400,000		
Osteopathic Medicine Scholarship	624,743	705,347		
KHEAA Work-Study Program	482,692	504,655		
Go Higher Grant Program	324,950	297,812		
Coal County Scholarship Program for Pharmacy Students	249,343	165,958		
Kentucky Coal County College Completion Scholarship	1,776,813	1,978,674		
John R. Justice Grant	194,612	140,429		
Loan guarantee operations			4,521,407	4,189,182
Default collections			5,938,223	7,292,484
Loan finance and servicing activities			29,844,606	33,506,486
Outreach			3,883,857	3,913,148
Contribution to FSLRF				2,500,000
Student aid administration			1,930,370	1,892,281
Contribution to student aid programs			440,000	467,517
School services			2,216,266	1,890,561
Other activities			124,339	119,289
Total Expenditures	<u>223,897,494</u>	<u>211,352,017</u>	<u>48,899,068</u>	<u>55,770,948</u>
Change in Net Position	<u>\$ (6,035,263)</u>	<u>\$ 3,373,340</u>	<u>\$ 2,099,813</u>	<u>\$ 2,208,059</u>

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

June 30, 2016

Financial Analysis – Governmental and Proprietary Funds

As previously noted, the Authority and the Corporation maintain bundled operations to maximize the efficiency of 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, 2016. 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 and deferred outflows decreased approximately \$69 million (5%), from \$1.37 billion to \$1.30 billion. The decrease was caused primarily by a \$112.8 million decrease in loans and a \$422,000 decrease in fixed assets offset by increases in cash and investments of \$35.7 million, accrued interest income of \$380,000 and deferred outflows related to GASB 68 pension expense of \$7.7 million.
- The Authority/Corporation's proprietary fund liabilities and deferred inflows decreased \$71.6 million (6%), from \$1.20 billion to \$1.13 billion. The overall decrease in liabilities and deferred inflows was attributable to the net of various decreases and increases year over year. Bonds payable and line of credit payable decreased \$71.1 million and \$8.7 million, respectively. In addition, there was also a \$2.1 million decrease in the Payable to ED and a \$2.6 million decrease in deferred inflows of resources. The sum of these decreases were offset by a \$13.4 million increase to the Net Pension Liability.
- The Authority/Corporation's proprietary fund revenues decreased \$7 million (12%), from \$58 million to \$51 million. The overall decrease was primarily attributable to a \$3.4 million reduction in debt recovery commission and a change in gain on sales of loans of \$2.8 million.
- The Authority/Corporation's total proprietary fund expenditures decreased approximately \$6.9 million (12.3%), due to the net of various fluctuations including a \$2.5 million decrease in the AOF Contribution to FSLRF, a \$3.7 million decrease in loan finance and servicing activities, and a \$1.35 million decrease in default collections expense offset by slight increases in other costs.
- The Authority/Corporation's governmental fund assets decreased approximately \$6 million (27%) due primarily to a \$6.5 million decrease in accounts receivable offset by a \$380,000 increase in cash.
- The Authority/Corporation's governmental fund liabilities increased by less than \$60,000 over the prior year.

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

June 30, 2016

- The Authority/Corporation's governmental fund revenues increased approximately \$3.1 million (1.5%), resulting primarily from additional state General Funds for student aid programs of \$3 million.
- The Authority/Corporation's governmental fund expenditures increased \$12.5 million (6%) resulting from increases in College Access Program Grants and Kentucky Educational Excellence Scholarships of \$9.1 million and \$3 million, respectively. The remaining difference is attributable to various increases and decreases including slight increases in Kentucky Tuition Grants and National Guard Tuition Awards.

Combined Statement of Net Position – Governmental Fund and Proprietary Funds

Total governmental net position decreased from \$22 million to \$16 million. Total proprietary fund net position increased \$2.1 million comprised of a \$13 million increase from default collection operations (compared to a \$14.8 million increase in prior year), \$2 million decrease from loan guarantee operations (compared to \$2.5 million decrease in prior year), \$3.9 million contribution for outreach activities (compared to \$3.9 million contribution in prior year), \$2.4 million contribution for student aid and administration (compared to \$2.4 million in prior year), \$1,000,000 loss in loan finance and servicing activities (compared to \$25,000 gain in prior year), no contribution to the FSLRF required (compared to \$2.5 million in prior year), and \$1.6 million contribution for school services (compared to \$1.3 million in prior year).

Certain highlights related to the combined statement of net position as of June 30, 2016, are as follows:

- The Authority/Corporation maintained \$1.97 billion of FFELP guarantees outstanding.
- The Authority/Corporation maintained \$1.07 billion of FFELP loans and education loans.
- The Authority/Corporation maintained \$434.2 million of defaulted loans in its collection portfolio.
- Unrestricted net position decreased from \$6.3 million to \$0.
- Net position, restricted other, increased from \$73.2 million to \$78.4 million.
- Net position restricted for student aid and related activities increased from \$80.4 million to \$83.3 million.

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

June 30, 2016

Combined Statement of Revenues, Expenses and Changes in Net Position

The \$2.1 million increase in proprietary fund net position during FY 2016 was \$100,000 less than the \$2.2 million increase during FY 2015. The \$100,000 decrease in the overall growth of net position as compared to the previous year's growth was attributable to the net of a \$900,000 increase for the Authority and a \$1 million decrease for the Corporation. The Authority's increase was aided by an elimination of a contribution to the FSLRF while the Corporation's loss was largely due to increased pension expense.

Certain other highlights related to the combined statement of revenues, expenses and changes in net position for the year ended June 30, 2016, are as follows:

- The Authority/Corporation provided \$8.9 million of program benefits, the majority of which directly benefited the citizens of the Commonwealth of Kentucky.
- The defaulted loan collection operation received approximately \$19 million in commissions on the \$111.8 million collected on behalf of the ED.

Condensed Financial Information - Fiduciary Funds

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

	Federal Student Loan Reserve Fund		Kentucky's Affordable Prepaid Tuition		Kentucky Education Savings Plan Trust	
	2016	2015	2016	2015	2016	2015
Net Position Information						
Other assets	\$ 18,286,941	\$ 17,313,546	\$ 92,489,983	\$ 106,838,962	\$ 182,438,073	\$ 180,392,674
Total Assets	18,286,941	17,313,546	92,489,983	106,838,962	182,438,073	180,392,674
Total Liabilities	1,735,419	5,768,676	128,316,963	130,893,230	357,074	455,471
Restricted net position (deficit)	16,551,522	11,544,870	(35,826,980)	(24,054,268)	182,080,999	179,937,203
Total Net Position	\$ 16,551,522	\$ 11,544,870	\$ (35,826,980)	\$ (24,054,268)	\$ 182,080,999	\$ 179,937,203
Changes in Fiduciary Net Position Information						
Federal reinsurance	\$ 134,880,533	\$ 145,737,342	\$	\$	\$	\$
Contribution from Agency Operating Fund		2,500,000				
Fee revenue						
Contributions			208,770	323,244		
Subscriptions					54,196,665	56,353,397
Investment revenue	1,061	1,287	2,604,321	3,999,603	1,123,568	3,649,820
Other income	7,006,997	3,598,440				
Total Additions	141,888,591	151,837,069	2,813,091	4,322,847	55,320,233	60,003,217
Administrative expenses			383,759	469,904	755,235	720,193
Refunds			2,001,403	2,553,305		
Trustee expense			349,297	320,996		
Tuition benefits expense, net			11,851,344	2,032,931		
Loan claims	137,026,519	151,854,751				
Redemptions					52,421,202	53,076,389
Default aversion	(144,580)	(501,501)				
Total Deductions	136,881,939	151,353,250	14,585,803	5,377,136	53,176,437	53,796,582
Change in Net Position	\$ 5,006,652	\$ 483,819	\$ (11,772,712)	\$ (1,054,289)	\$ 2,143,796	\$ 6,206,635

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

June 30, 2016

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, 2016. 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 \$152 million in fiscal year 2015 to \$137 million in fiscal year 2016 (10% decrease).
- The Plan noted a decrease in tuition benefits payable of \$2.5 million in fiscal year 2016, due primarily to the net of several different factors including less participants, certain losses due to unfavorable investment experience and changes in assumption.

Statement of Fiduciary Net Position (Deficit)

The FSLRF net position increased \$5 million over ending net position in the prior year. Assets increased nearly \$1 million, a 5.6% increase, while liabilities decreased 70% (\$4 million). The increase in net position is primarily comprised of an elimination of the need for a reinsurance reserve. FFELP Guaranty Agencies are now reinsured at 100% of defaulted loan claim amounts (see Note E).

The Plan recognized an increase in the net deficit of \$11.8 million for fiscal year 2016 compared to a \$1.1 million decrease in net deficit in the prior year. Overall, the current year increase in net deficit from prior year is attributable to the net of various gains and other changes including certain losses due to unfavorable investment experience and changes in assumptions.

The Plan's total assets decreased \$14.3 million, from \$106.8 million as of June 30, 2015 to \$92.5 million as of June 30, 2016. Cash and investments decreased from \$104.6 million to \$90.8 million, a \$13.8 million decrease. The change in tuition and investment return assumptions are as follows:

- 2016-thereafter – investment return assumption changed from 5.45% in the prior year to a range of future rates by year.
- 2016-2017 academic year – tuition increase assumption was 6.25%, while actual tuition increases were 4.0% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan
- 2017-thereafter – tuition increase assumption remained at 6.25%

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 net position increased approximately \$2.1 million, due to additions related to subscriptions (\$54.2 million) and investment income (\$3.4 million), net of redemptions, fees and loss on investments (\$55.4 million).

Management's Discussion and Analysis (Unaudited)—Continued

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

June 30, 2016

Statement of Changes in Fiduciary Net Position (Deficit)

The FSLRF net position increased \$5 million over ending net position in the prior year. Assets increased nearly \$1 million, a 5.6% increase, while liabilities decreased 70% (\$4 million). The increase in net position is primarily comprised of an elimination of the need for a reinsurance reserve.

The Plan recognized an increase in the net deficit of \$11.8 million for fiscal year 2016 compared to a \$1.1 million increase in net deficit in the prior year. Overall, the current year increase in net deficit from prior year is attributable to the net of various gains and other changes including certain losses due to unfavorable investment experience and changes in assumptions.

Combined Government-Wide Statement of Net Position

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

June 30, 2016

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	\$ 4,051,759	\$ 74,985,274	\$ 79,037,033
Accounts receivable and prepaid expenses	2,144,680	854,481	2,999,161
Accrued interest income		14,448,908	14,448,908
Investments		3,722,517	3,722,517
Teacher and Osteopathic Medicine scholarship loans Loans, net	450,000	162,421,414	450,000 162,421,414
Total Current Assets	6,646,439	256,432,594	263,079,033
Noncurrent:			
Restricted cash and cash equivalents		53,258,187	53,258,187
Receivable from Federal Student Loan Reserve Fund		1,732,174	1,732,174
Investments		77,553,871	77,553,871
Fixed assets, net		8,103,643	8,103,643
Loans, net		883,909,471	883,909,471
Teacher and Osteopathic Medicine scholarship loans, net	4,701,590		4,701,590
Teacher and Osteopathic Medicine scholarship advances	4,679,148		4,679,148
Accrued interest income, net		6,306,724	6,306,724
Total Noncurrent Assets	9,380,738	1,030,864,070	1,040,244,808
Total Assets	16,027,177	1,287,296,664	1,303,323,841
Deferred Outflows of Resources:			
Deferred pension expense		12,351,990	12,351,990
Total Assets and Deferred Outflows of Resources	16,027,177	1,299,648,654	1,315,675,831
LIABILITIES			
Current:			
Accounts payable and accrued expenses	75,917	6,184,933	6,260,850
Accrued interest expense		1,110,100	1,110,100
Payable to US Department of Education		7,746,417	7,746,417
Line of credit payable		7,725,471	7,725,471
Capital lease payable		610,000	610,000
Total Current Liabilities	75,917	23,376,921	23,452,838
Noncurrent:			
Allowance for arbitrage liabilities		200,019	200,019
Net pension liability		93,969,760	93,969,760
Capital lease payable		2,020,000	2,020,000
Bonds payable		994,380,953	994,380,953
Total Noncurrent Liabilities		1,090,570,732	1,090,570,732
Total Liabilities	75,917	1,113,947,653	1,114,023,570
Deferred Inflows of Resources:			
Deferred pension expense		262,261	262,261
Deferred gain on debt retirements, net		18,212,949	18,212,949
Total Liabilities and Deferred Inflows of Resources	75,917	1,132,422,863	1,132,498,780
NET POSITION			
Invested in capital assets, net of expended debt proceeds		5,473,643	5,473,643
Restricted, other		78,413,391	78,413,391
Restricted for program benefits	15,951,260		15,951,260
Restricted for student aid and related activities		83,338,757	83,338,757
Total Net Position	\$ 15,951,260	\$ 167,225,791	\$ 183,177,051

Combined Government-Wide Statement of Activities

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

For the Year Ending June 30, 2016

			Program Revenue		Net (Expenses) Revenues and Changes in Net Position		Total
	Direct Expenses	Indirect Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	
Governmental Activities:							
Kentucky Tuition Grant	\$ 28,942,566	\$ 151,051	\$	\$ 30,360,801	\$ 1,267,184	\$	\$ 1,267,184
College Access Program Grant	69,951,308	151,051		62,458,552	(7,643,807)		(7,643,807)
Early Graduation Scholarship	159,200	52,972		52,972	(159,200)		(159,200)
Mary Jo Young Scholarship	441,040	142,897		582,897	(1,040)		(1,040)
Early Childhood Development Scholarship	956,684	148,004		1,484,528	379,840		379,840
Kentucky National Guard Tuition Award Program	6,031,167	145,768		6,449,708	272,773		272,773
Kentucky Educational Excellence Scholarship	110,698,977	151,051		110,972,274	122,246		122,246
Teacher Scholarship	669,554	151,051		2,327,474	1,506,869		1,506,869
Teacher Loan Forgiveness	1,300,000				(1,300,000)		(1,300,000)
Osteopathic Medicine Scholarship	479,032	145,711		1,020,692	395,949		395,949
KHEAA Work-Study Program	337,037	145,655		546,320	63,628		63,628
Go Higher Grant Program	189,583	135,367		306,867	(18,083)		(18,083)
Coal County Scholarship Program for Pharmacy Students	111,112	138,231		966,175	716,832		716,832
Kentucky Coal County College Completion Scholarship	1,640,619	136,194		151,456	(1,625,357)		(1,625,357)
John R. Justice Grant	59,245	135,367		181,515	(13,097)		(13,097)
Total Governmental Activities	221,967,124	1,930,370		217,862,231	(6,035,263)		(6,035,263)
Business-Type Activities:							
Loan guarantee operations	4,521,407		2,476,829			(2,044,578)	(2,044,578)
Default collections	5,938,223		18,948,553			13,010,330	13,010,330
Loan finance and servicing activities	29,844,606		28,833,336			(1,011,270)	(1,011,270)
Outreach	3,883,857					(3,883,857)	(3,883,857)
Contribution to student aid programs	440,000					(440,000)	(440,000)
Student aid administration	1,930,370					(1,930,370)	(1,930,370)
School services	2,216,266		615,824			(1,600,442)	(1,600,442)
Other activities	124,339		124,339				
Total Business-Type Activities	48,899,068		50,998,881			2,099,813	2,099,813
Total Primary Government	\$ 270,866,192	\$ 1,930,370	\$ 50,998,881	\$ 217,862,231	(6,035,263)	2,099,813	(3,935,450)
Change in Net position					(6,035,263)	2,099,813	(3,935,450)
Net position, July 1, 2015					21,986,523	165,125,978	187,112,501
Net position, June 30, 2016					\$ 15,951,260	\$ 167,225,791	\$ 183,177,051

See accompanying notes

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

June 30, 2016

ASSETS	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Current:							
Cash and cash equivalents	\$ 2,380,283	\$ 18,372,737	\$ 20,753,020	\$	\$ 54,232,254	\$ 54,232,254	\$ 74,985,274
Investments		3,677,290	3,677,290		45,227	45,227	3,722,517
Accounts receivable and prepaid expenses		204,242	204,242		650,239	650,239	854,481
Accrued interest income		265,359	265,359	13,891,445	292,104	14,183,549	14,448,908
Loans, net				160,709,620	1,711,794	162,421,414	162,421,414
Total Current Assets	2,380,283	22,519,628	24,899,911	174,601,065	56,931,618	231,532,683	256,432,594
Noncurrent:							
Restricted cash and cash equivalents				53,258,187		53,258,187	53,258,187
Receivable from Federal Student Loan Reserve Fund		1,732,174	1,732,174				1,732,174
Investments		69,131,941	69,131,941		8,421,930	8,421,930	77,553,871
Fixed assets, net		7,759,606	7,759,606		344,037	344,037	8,103,643
Loans, net				859,626,746	24,282,725	883,909,471	883,909,471
Accrued interest income, net				5,874,050	432,674	6,306,724	6,306,724
Total Noncurrent Assets		78,623,721	78,623,721	918,758,983	33,481,366	952,240,349	1,030,864,070
Total Assets	2,380,283	101,143,349	103,523,632	1,093,360,048	90,412,984	1,183,773,032	1,287,296,664
Deferred Outflows of Resources:							
Deferred pension expense		983,499	983,499		11,368,491	11,368,491	12,351,990
Total Assets and Deferred Outflows of Resources	2,380,283	102,126,848	104,507,131	1,093,360,048	101,781,475	1,195,141,523	1,299,648,654
LIABILITIES							
Current:							
Accounts payable and accrued expenses	1,001,438	727,391	1,728,829	359,868	4,096,236	4,456,104	6,184,933
Interfund payable (receivable)	1,378,845	587,753	1,966,598	(2,442,989)	476,391	(1,966,598)	
Accrued interest expense		22,422	22,422	1,035,355	52,323	1,087,678	1,110,100
Payable (receivable) to U.S. Department of Education		(321,000)	(321,000)	7,523,139	544,278	8,067,417	7,746,417
Line of credit payable					7,725,471	7,725,471	7,725,471
Capital lease payable		610,000	610,000				610,000
Total Current Liabilities	2,380,283	1,626,566	4,006,849	6,475,373	12,894,699	19,370,072	23,376,921
Noncurrent:							
Capital lease payable		2,020,000	2,020,000				2,020,000
Net pension liability		9,749,658	9,749,658		84,220,102	84,220,102	93,969,760
Allowance for arbitrage liabilities				200,019		200,019	200,019
Bonds payable, net				994,380,953		994,380,953	994,380,953
Total Noncurrent Liabilities		11,769,658	11,769,658	994,580,972	84,220,102	1,078,801,074	1,090,570,732
Total Liabilities	2,380,283	13,396,224	15,776,507	1,001,056,345	97,114,801	1,098,171,146	1,113,947,653
Deferred Inflows of Resources:							
Deferred pension expense		262,261	262,261				262,261
Deferred gain on debt retirements, net				18,212,949		18,212,949	18,212,949
Total Liabilities and Deferred Inflows of Resources	2,380,283	13,658,485	16,038,768	1,019,269,294	97,114,801	1,116,384,095	1,132,422,863
NET POSITION							
Invested in capital assets, net		5,129,606	5,129,606		344,037	344,037	5,473,643
Unrestricted				74,090,754	4,322,637	78,413,391	78,413,391
Restricted, other							
Restricted for student aid and related activities		83,338,757	83,338,757				83,338,757
Total Net Position		\$ 88,468,363	\$ 88,468,363	\$ 74,090,754	\$ 4,666,674	\$ 78,757,428	\$ 167,225,791

Combined Statement of Revenues, Expenditures and Changes
in Net Position - Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For the Year Ending June 30, 2016

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Operating revenues:							
Interest Revenues:							
Interest on loans	\$		\$	\$ 25,050,259	\$ 3,611,187	\$ 28,661,446	\$ 28,661,446
Interest and investment income		1,267,688	1,267,688	57,454	131,140	188,594	1,456,282
Amortization of deferred gain on debt retirements				1,799,930		1,799,930	1,799,930
Interest expense on bonds				(9,502,708)	(471,753)	(9,974,461)	(9,974,461)
Total net interest revenues		1,267,688	1,267,688	17,404,935	3,270,574	20,675,509	21,943,197
Financing Expenses:							
Provision for loan losses				1,483,176	(767,140)	716,036	716,036
Provision for arbitrage				200,019		200,019	200,019
Long-Term debt credit facility and remarketing fees				860,021	4,354	864,375	864,375
Debt issuance costs				705,187		705,187	705,187
Total financing expenses				3,248,403	(762,786)	2,485,617	2,485,617
Interest revenues net of financing expenses		1,267,688	1,267,688	14,156,532	4,033,360	18,189,892	19,457,580
Other Operating Revenues:							
Servicing fees from external sources					294,159	294,159	294,159
Servicing fees from Education Finance Funds					6,179,082	6,179,082	6,179,082
Conversion fees					500,000	500,000	500,000
Debt recovery commission		18,948,553	18,948,553		3,325	3,325	18,951,878
Federal fees earned		1,353,721	1,353,721				1,353,721
Default aversion fee income		(144,580)	(144,580)				(144,580)
Guarantee fee					131,571	131,571	131,571
Gain on sale/purchase of loans				368,643	(508,067)	(139,424)	(139,424)
Late payment penalties				1,033,569	151,952	1,185,521	1,185,521
School services		615,824	615,824				615,824
Other income	124,339		124,339		3,593	3,593	127,932
Total operating revenues	124,339	22,041,206	22,165,545	15,558,744	10,788,975	26,347,719	48,513,264
Operating Expenses:							
Administrative expenses	124,339	9,751,050	9,875,389		19,669,824	19,669,824	29,545,213
Servicing fees for Operating Fund				6,179,082		6,179,082	6,179,082
Depreciation and amortization		563,161	563,161		145,939	145,939	709,100
Other expenses		145,419	145,419	127,639	793,180	920,819	1,066,238
Total operating expenses	124,339	10,459,630	10,583,969	6,306,721	20,608,943	26,915,664	37,499,633
Net operating income (loss) before program benefits		11,581,576	11,581,576	9,252,023	(9,819,968)	(567,945)	11,013,631
Program Benefits:							
Principal and interest benefits				432,764	10,561	443,325	443,325
School Service		2,216,266	2,216,266				2,216,266
Outreach		3,883,857	3,883,857				3,883,857
Contribution to student aid programs		440,000	440,000				440,000
Student aid administration		1,930,370	1,930,370				1,930,370
Total program benefits		8,470,493	8,470,493	432,764	10,561	443,325	8,913,818
Operating income (loss) before transfers		3,111,083	3,111,083	8,819,259	(9,830,529)	(1,011,270)	2,099,813
Transfers (to) from other funds							
Interfund transfers				2,672,926	(2,672,926)		
Increase (decrease) in Net position after transfers		3,111,083	3,111,083	11,492,185	(12,503,455)	(1,011,270)	2,099,813
Net position, July 1, 2015		85,357,280	85,357,280	62,598,569	17,170,129	79,768,698	165,125,978
Net position, June 30, 2016	\$	\$ 88,468,363	\$ 88,468,363	\$ 74,090,754	\$ 4,666,674	\$ 78,757,428	\$ 167,225,791

See accompanying notes

Combined Statement of Cash Flows - Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For the Year Ending June 30, 2016

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Cash Flows from Operating Activities:							
Principal received on loans	\$	\$	\$	\$ 183,060,183	\$ 35,195,559	\$ 218,255,742	\$ 218,255,742
Interest received on loans				32,863,570	4,951,440	37,815,010	37,815,010
Special allowance paid				(23,654,405)	(1,717,789)	(25,372,194)	(25,372,194)
Servicing fees received, internal sources	(124,339)	26,954	(97,385)	(6,179,082)	6,179,082		(97,385)
School services fees received		615,824	615,824				615,824
Servicing fees received, external sources					837,509	837,509	837,509
Debt recovery commission received		18,948,553	18,948,553		34,110	34,110	18,982,663
Federal fees received		1,353,721	1,353,721				1,353,721
Default aversion fees received		(144,580)	(144,580)				(144,580)
Outreach		(3,883,857)	(3,883,857)				(3,883,857)
School services		(2,216,266)	(2,216,266)				(2,216,266)
Internal activity-payments to other funds	(1,618,948)	1,618,948		784,448	(784,448)		
Loans originated, including costs				(837,216)	(10,017,668)	(10,854,884)	(10,854,884)
Administrative expenses paid		(7,642,065)	(7,642,065)	(3,698,403)	(18,384,814)	(22,083,217)	(29,725,282)
Credit facility fees paid				(860,021)	(7,900)	(867,921)	(867,921)
Loans purchased, including premiums				(1,211,840)	(75,358,907)	(76,570,747)	(76,570,747)
Contribution to student aid programs		(440,000)	(440,000)				(440,000)
Student aid administration		(1,930,370)	(1,930,370)				(1,930,370)
Interfund loan sales and purchases				(111,330,653)	111,330,653		
Client loan receipts					1,099,769	1,099,769	1,099,769
Loan receipts remitted to clients					(1,010,348)	(1,010,348)	(1,010,348)
Net Cash Provided by (Used in) Operating Activities	(1,743,287)	6,306,862	4,563,575	68,936,581	52,346,248	121,282,829	125,846,404
Cash Paid from Noncapital Financing Activities:							
Proceeds from debt issued				89,500,000	37,293,063	126,793,063	126,793,063
Debt principal payments				(160,685,000)	(46,012,859)	(206,697,859)	(206,697,859)
Interest on debt				(9,317,304)	(421,569)	(9,738,873)	(9,738,873)
Debt issuance costs				(705,187)		(705,187)	(705,187)
Interfund transfers				2,672,926	(2,672,926)		
Increase in Federal Student Loan Reserve receivable		(54,691)	(54,691)				(54,691)
Net Cash Provided by (Used in) Noncapital Financing Activities		(54,691)	(54,691)	(78,534,565)	(11,814,291)	(90,348,856)	(90,403,547)
Cash Flows From Capital and Related Financing Activities:							
Capital expenditures		(411,827)	(411,827)		(175,678)	(175,678)	(587,505)
Interest paid on capital lease		(4,861)	(4,861)				(4,861)
Bond principal payments		(580,000)	(580,000)				(580,000)
Net Cash Used in Capital and Related Financing Activities		(996,688)	(996,688)		(175,678)	(175,678)	(1,172,366)
Cash Flows From Investing Activities:							
Proceeds from sales/maturities of investments		61,773,709	61,773,709		6,404,923	6,404,923	68,178,632
Purchases of investments		(62,842,613)	(62,842,613)		(6,463,908)	(6,463,908)	(69,306,521)
Investment income		1,404,483	1,404,483	52,341	83,858	136,199	1,540,682
Net Cash Provided by Investing Activities		335,579	335,579	52,341	24,873	77,214	412,793
Net Increases (Decrease) in Cash and Cash Equivalents	(1,743,287)	5,591,062	3,847,775	(9,545,643)	40,381,152	30,835,509	34,683,284
Cash and Cash Equivalents, July 1, 2015	4,123,570	12,781,675	16,905,245	62,803,830	13,851,102	76,654,932	93,560,177
Cash and Cash Equivalents, June 30, 2016	\$ 2,380,283	\$ 18,372,737	\$ 20,753,020	\$ 53,258,187	\$ 54,232,254	\$ 107,490,441	\$ 128,243,461

Combined Statement of Cash Flows - Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For the Year Ending June 30, 2016

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities							
Operating income (loss) before transfers	\$	\$ 3,111,083	\$ 3,111,083	\$ 8,819,259	\$ (9,830,529)	\$ (1,011,270)	\$ 2,099,813
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:							
Investment income		(1,267,688)	(1,267,688)	(52,341)	(132,525)	(184,866)	(1,452,554)
Depreciation and amortization		863,137	863,137		145,939	145,939	1,009,076
Amortization of deferred gain on debt retirements				(1,799,930)		(1,799,930)	(1,799,930)
Amortization, expense and write-off of debt issuance costs				705,187		705,187	705,187
Interest expense		4,861	4,861	9,502,708	471,753	9,974,461	9,979,322
Provision for loan losses				1,483,176	(767,140)	716,036	716,036
Borrower interest converted to principal				(17,833,471)	(1,329,650)	(19,163,121)	(19,163,121)
Loan forgiveness				432,764	10,167	442,931	442,931
Pension expense		293,699	293,699		4,648,717	4,648,717	4,942,416
(Increases) decreases in assets:							
Accounts receivables and prepaid expenses		9,649	9,649	32,780	69,648	102,428	112,077
Accrued interest receivable		17,305	17,305	(929,671)	570,455	(359,216)	(341,911)
Principal received on loans				183,060,183	35,195,559	218,255,742	218,255,742
Loans purchased, including premiums				(1,211,840)	(75,358,907)	(76,570,747)	(76,570,747)
Loans originated, including costs				(837,216)	(10,017,668)	(10,854,884)	(10,854,884)
Interfund loan sales and purchases				(111,330,653)	111,330,653		
Increases (decreases) in liabilities:							
Accounts payable and accrued expenses	(407,400)	97,615	(309,785)	(57,983)	124,470	66,487	(243,298)
Payable to U.S. Department of Education				(2,030,838)	(154,071)	(2,184,909)	(2,184,909)
Interfund receivable/payable	(1,335,887)	3,182,062	1,846,175	784,448	(2,630,623)	(1,846,175)	
Accrued interest payable		(4,861)	(4,861)				(4,861)
Allowance for arbitrage liabilities				200,019		200,019	200,019
Net Cash Provided by (Used in) Operating Activities	<u>\$ (1,743,287)</u>	<u>\$ 6,306,862</u>	<u>\$ 4,563,575</u>	<u>\$ 68,936,581</u>	<u>\$ 52,346,248</u>	<u>\$ 121,282,829</u>	<u>\$ 125,846,404</u>

Balance Sheet - Governmental Fund

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

June 30, 2016

ASSETS	Governmental Fund Student Aid
Current:	
Cash and cash equivalents	\$ 4,051,759
Accounts receivable	2,144,680
Teacher and Osteopathic Medicine scholarship loans	<u>450,000</u>
Total Current Assets	<u>6,646,439</u>
Noncurrent:	
Teacher and Osteopathic Medicine scholarship loans, net of allowance of \$3,550,000	4,701,590
Teacher and Osteopathic Medicine scholarship advances	<u>4,679,148</u>
Total Noncurrent Assets	<u>9,380,738</u>
Total Assets	<u>16,027,177</u>
LIABILITIES	
Current:	
Accounts payable	<u>75,917</u>
Total Liabilities	<u>75,917</u>
FUND BALANCE	
Restricted for program benefits	<u>\$ 15,951,260</u>

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

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

For the Year Ending June 30, 2016

	Governmental Fund Student Aid
Revenues:	
Interest and investment income fund	\$ 744,595
Tobacco settlement revenue	1,100,000
Unclaimed lottery revenue	6,200,000
State General Fund revenue	206,702,000
Federal funds revenue	46,148
Other income	699,118
Contribution from Agency Operating Fund	2,370,370
Total Revenues	217,862,231
Expenditures:	
Kentucky Tuition Grant	29,093,617
College Access Program Grant	70,102,359
Early Graduation Scholarship	212,172
Mary Jo Young Scholarship	583,937
Early Childhood Development Scholarship	1,104,688
Kentucky National Guard Tuition Award Program	6,176,935
Kentucky Educational Excellence Scholarship	110,850,028
Teacher Scholarship	820,605
Teacher Loan Forgiveness	1,300,000
Osteopathic Medicine Scholarship	624,743
Coal County Scholarship Program for Pharmacy Students	249,343
KHEAA Work-Study Program	482,692
Go Higher Grant Program	324,950
Kentucky Coal County College Completion Scholarship	1,776,813
John R. Justice Grant	194,612
Total Expenditures	223,897,494
Net Change in Fund Balance	(6,035,263)
Fund Balance, July 1, 2015	21,986,523
Fund Balance, June 30, 2016	\$ 15,951,260

Statement of Fiduciary Net Position (Deficit)

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

June 30, 2016

ASSETS	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Education Savings Plan Trust
Current:			
Cash and cash equivalents	\$ 14,586,550	\$ 1,802,981	\$ 31
Contributions receivable		534,357	
Fees receivable		195,800	
Receivable from U.S. Department of Education	3,677,756		
Investments		89,013,029	182,273,000
Other current assets	<u>22,635</u>		<u>165,042</u>
Total Current Assets	18,286,941	91,546,167	182,438,073
Noncurrent:			
Contributions receivable		<u>943,816</u>	
Total Assets	<u>18,286,941</u>	<u>92,489,983</u>	<u>182,438,073</u>
LIABILITIES			
Current:			
Accounts payable	3,245	76,053	165,042
Accrued expenses			<u>192,032</u>
Total Current Liabilities	3,245	76,053	357,074
Noncurrent:			
Payable to Agency Operating Fund	1,732,174		
Tuition benefits payable		<u>128,240,910</u>	
Total Liabilities	<u>1,735,419</u>	<u>128,316,963</u>	<u>357,074</u>
NET POSITION			
Restricted for program benefits		(35,826,980)	182,080,999
Restricted for other purposes	<u>16,551,522</u>		
Total Net Position (Deficit)	<u>\$ 16,551,522</u>	<u>\$ (35,826,980)</u>	<u>\$ 182,080,999</u>

Statement of Changes in Fiduciary Net Position (Deficit)

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

For the Year Ending June 30, 2016

	<u>Federal Student Loan Reserve Fund</u>	<u>Kentucky's Affordable Prepaid Tuition</u>	<u>Kentucky Education Savings Plan Trust</u>
Additions:			
Federal reinsurance	\$ 134,880,533	\$	\$
Contract income, net		208,770	
Subscriptions			54,196,665
Investment Revenues:			
Net unrealized gain on investments		(2,930,545)	(2,233,299)
Interest and investment income	1,061	5,534,866	3,356,867
Other income	7,006,997		
Total Additions	<u>141,888,591</u>	<u>2,813,091</u>	<u>55,320,233</u>
Deductions:			
Program benefits:			
Loan claims	137,026,519		
Default aversion fee expense	(144,580)		
Redemptions			52,421,202
Administrative expenses		45,951	755,235
Personnel and professional expenses		337,808	
Refunds		2,001,403	
Trustee fee expense		349,297	
Tuition benefits expense, net		11,851,344	
Total Deductions	<u>136,881,939</u>	<u>14,585,803</u>	<u>53,176,437</u>
Change in Net Position	5,006,652	(11,772,712)	2,143,796
Net Position (Deficit), July 1, 2015	<u>11,544,870</u>	<u>(24,054,268)</u>	<u>179,937,203</u>
Net Position (Deficit), June 30, 2016	<u>\$ 16,551,522</u>	<u>\$ (35,826,980)</u>	<u>\$ 182,080,999</u>

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

June 30, 2016

Note A--Description of Business

The Kentucky Higher Education Assistance Authority (the "Authority" or "KHEAA") was established in 1966 as the Commonwealth of Kentucky's agency for improving higher education opportunities. The Authority also guarantees, performs default aversion activities, pays lender default and other claims and performs collection activities on eligible student loans. The Kentucky Educational 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" or "KHESLC") makes student loans directly to parents, students, and borrowers in repayment as part of the Kentucky Advantage loan programs, purchases and services eligible Federal and Kentucky Advantage student loans and performs collection activities on certain eligible Federal student loans. The Authority and the Corporation maintain bundled operations to maximize the efficiency of all Authority and Corporation operational and support activities. 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 newly-originated FFELP loans. However, the Authority/Corporation continues to operate under existing FFELP regulations for loans originated and guaranteed prior to July 1, 2010.

Loan Guarantee Operations

The Authority/Corporation's loan guarantee operations guarantee 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 guaranteed student loans. FFELP was established by Congress and is administered by the ED 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 specialty claims such as 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.

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

June 30, 2016

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%. The maximum reinsurance rate was amended to 100% effective for default claims paid on or after December 1, 2015 (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. FSLRF assets and all earnings on those assets 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 primarily 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 are restricted for financial aid related activities including guaranty agency 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, outreach program activities, school services and other operating activities. The AOF also provides funding to the governmental fund to pay administration costs for fifteen student aid programs, administrative costs for the Trust, and direct benefits for the Mary Jo Young Scholarship program. Both the FSLRF and AOF are subject to federal oversight.

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

June 30, 2016

Note A--Description of Business--Continued

Loan Finance and Servicing 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 or who have attended eligible post-secondary institutions. In addition, the Corporation services and collects education loans and issues bonds and notes not to exceed \$5 billion in order to carry out its corporate powers and duties.

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, KAEL, certain federal and other education loans; and (iv) the collection of FFELP, KAEL, certain federal 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 guaranty 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. KAEL loans are self-insured by the Authority/Corporation.

The Authority/Corporation's indentures and separate series resolutions for issuance of revenue bonds 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. In addition, the Authority/Corporation's lines of credit also provide for certain collateral account and proceeds restrictions.

As of June 30, 2016 the Authority/Corporation held and serviced approximately \$1.08 billion outstanding principal amount of FFELP and other education loans. \$1.03 billion of loans were pledged pursuant to the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, and the 2016 Indenture. The remaining \$45 million of loans were funded by the Corporation's Operating Fund. Also, the Authority/Corporation services approximately \$3.4 million of FFELP and other education loans on behalf of other holders. 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.

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

June 30, 2016

Note A--Description of Business--Continued

In addition to operations related to the FFELP program, the Authority/Corporation administers the Trust, the Plan, student aid programs, and outreach programs.

Kentucky Educational Savings Plan Trust

The Trust was formed on July 15, 1988 by Kentucky law, to help families save for the costs of higher education. 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. The Trust offers certain federal and state tax advantages to account owners.

An individual or entity 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, Large-Cap Growth, S&P 500 Index, Mid-Cap Growth Fund, Small-Cap Equity, Mid-Cap Value, Short-Term Bond, Bond Index, Inflation-Linked Bond, Equity Index, Bond Fund, Real Estate Securities, Emerging Market Equity, Emerging Market Equity Index and Money Market Funds and Guaranteed Funding Agreement of the TIAA-CREF Institutional Mutual Funds.

The Equity Option 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%.

All allocation percentages are determined by the Authority/Corporation's Board of Directors and are subject to change. The assets of the Guaranteed Option and two upper level age bands in Managed Allocation 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.

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

June 30, 2016

Note A--Description of Business--Continued

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 policy goal is to earn rates of return that closely match tuition inflation rates and remain sufficiently liquid to meet KAPT benefit payments in a timely manner. 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 \$35.8 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 offered three tuition plans – the Value Plan, the Standard Plan and the Premium Plan. In the Value Plan, participants bought 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 were allowed to 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, computers, and required 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 statutorily defined 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.

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

June 30, 2016

Note A--Description of Business--Continued

The Kentucky General Assembly approved certain changes to the Plan during the 2014 Legislative Session that became effective July 2014. These changes included the following: the addition of a utilization period definition; the establishment of June 30, 2028 as the closure date of the Plan; the establishment of certain limitations on the growth of a plan account beyond the utilization period; the prohibition of projected college entrance year extensions; and the clarification of provisions for transferring a plan account to another qualified tuition program.

As of June 30, 2016, the Plan maintained a present value fund deficit of \$35.8 million. This represents an \$11.8 million increase over the previous year's deficit. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2022, at which time the liability of the Plan becomes a General Obligation of the Commonwealth of Kentucky. Per KRS 164A.708, once a real liability is expected to accrue, the General Assembly shall appropriate the necessary funds to meet the liability. Over the remaining estimated life of the program, through fiscal year 2028, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$53 million.

Student Aid Programs

Student Aid – The Authority/Corporation provides some or all levels of administration of fifteen student aid programs: (1) Kentucky Tuition Grant (“KTG”), (2) College Access Program Grant (“CAP”), (3) Kentucky Educational Excellence Scholarship, (4) Teacher Scholarship, (5) Osteopathic Medicine Scholarship, (6) KHEAA Work-Study Program, (7) Kentucky Coal County College Completion Scholarship, (8) Early Childhood Development Scholarship, (9) Go Higher Grant Program, (10) Coal County Scholarship Program for Pharmacy Students, (11) Mary Jo Young Scholarship, (12) John R. Justice Grant, (13) Kentucky National Guard Tuition Award Program, (14) Early Graduation Scholarship, and (15) Minority Educator Recruitment and Retention Scholarship.

Outreach Programs

The Authority/Corporation offers college planning and student financial aid guidance to students and families, school counselors, adult education providers and other community contacts. Programs and services include regional field counselors, a mobile college-planning classroom, a one-stop Web portal, near-peer college coaches and targeted publications for students of all ages. Initiatives include Kentucky College Application Campaign, which provides participating seniors with hands-on assistance in applying to college or technical school; Close the Deal, which connects students with community leaders and business representatives to set and meet goals for college and future careers; *Surviving College*, workshops and publications designed to ease the transition to college for traditional students and adult learners, increasing retention; and the Kentucky College Coaches Program, in which recent college graduates serve as coaches to students in schools with predominantly first-generation, low-income students.

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

June 30, 2016

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 position 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, deferred inflows of resources, deferred outflows of resources, 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 the Federal Government.

The Authority/Corporation's business-type activities include administering loan guarantees, default collection, loan finance and servicing, outreach program activities, student aid administration and contributions, school services and other activities.

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 governmental 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 the Federal Government.

The Authority/Corporation's loan guarantee, default collection, loan finance and servicing, outreach program activities, student aid administration and contributions, school services and other business-type activities are presented as proprietary funds. Proprietary 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.

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

June 30, 2016

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 position and a statement of changes of net position. 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 are held in a custodial capacity. FSLRF assets and all earnings on those assets are the property of the Federal government and are used primarily to facilitate FFELP claim payments. 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.

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 with the current following target asset allocation:

Large Cap U.S. stocks	30%
Mid Cap U.S. stocks	5%
Small Cap U.S. stocks	4%
Non-U.S. stocks	9%
	<hr/>
Total Equity	48%
	<hr/> <hr/>
Inflation indexed bonds	7%
Domestic fixed income	44%
Cash	1%
	<hr/>
Total Fixed Income	52%
	<hr/> <hr/>

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

June 30, 2016

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, 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.

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.

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.

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

June 30, 2016

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

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 applicable 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 position.

Allowance for Uncollectible Loans - As discussed in Note A, most FFELP loans held by the Authority/Corporation are insured by guarantee agencies and the ED. Management of the Authority/Corporation believes that all of its respective guaranty agencies and the ED 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 \$6.6 million for loan principal and \$573,000 for accrued interest as of June 30, 2016. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2016, the allowance for third party servicing loan losses for loans that have been purchased was \$1.4 million for loan principal and \$620,000 for accrued interest. In July 2015, the Authority/Corporation purchased an uninsured loan portfolio at a substantial discount. As of June 30, 2016, the allowance for the loans purchased at a discount was \$16.5 million for loan principal and \$3.6 million 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, 2016, the allowance for advances converted to loans was \$3.6 million.

Pensions - For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Kentucky Employees Retirement System (KERS) and additions to/deductions from KERS' fiduciary net position have been determined on the same basis as they are reported by KERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

Interest Income on Loans - The Authority/Corporation earns interest income on loans from the following three sources: (1) subsidized interest from ED earned while certain students are in school, in grace or in deferment status; (2) special allowance from ED (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 and net of any negative special allowance owed to ED (discussed in Note G).

Servicing Fees - The Authority/Corporation's fees for servicing loans held by third parties are recorded as servicing fee revenue when earned.

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

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

June 30, 2016

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

Debt Issuance Costs - Debt issuance costs are expensed when incurred.

Deferred Gain on Early Retirement of Debt - In accordance with GASB No. 23, *Accounting and Financial Reporting of Debt Reported by Proprietary Activities*, and in accordance with GASB No. 63, *Financial Reporting of Deferred Outflows or Resources, Deferred Inflows of Resources, and Net Position*, the Authority/Corporation defers any gains related to early retirement associated with a 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 are also not subject to federal or state income taxes.

Use of Estimates - Accounting principles generally accepted in the United States of America require 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 position. 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 position. 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, interest income from the corporate loan finance and servicing activities, and other 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.

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 annum of the outstanding balance is charged to participants who enrolled in the Plan during fiscal year 2005.

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

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

June 30, 2016

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

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 Position - Restricted net position is comprised of net position with legal or contractual restrictions and thus cannot be used in operations of the Authority/Corporation.

Unrestricted Net Position - Unrestricted net position is comprised of net position available to be used in operations or transfers of the Authority/Corporation. None of the Authority/Corporation's net position was unrestricted as of June 30, 2016.

Subsequent Events - In preparing these combined financial statements, the Authority/Corporation has evaluated events and transactions for potential recognition or disclosure through the date of the Independent Auditor's Report which represents the date the financial statements were available to be issued.

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, agency mortgage-backed securities, 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. 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

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

June 30, 2016

Note C--Cash and Investments--Continued

agreements or investment funds secured by obligations of the United States of America with collateral held by or at the direction of the trustee.

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, 2016, the Authority/Corporation's Proprietary Funds, Governmental Fund and Fiduciary Funds maintained cash on deposit as follows:

Of the \$128.8 million of cash and cash equivalents maintained in the Proprietary Funds, \$20.9 million was held for guarantee operations and the remaining \$107.9 million was held for loan finance and servicing activities.

Of the \$16.4 million of cash and cash equivalents maintained in the Fiduciary Funds, \$14.6 million was related to the FSLRF and the remaining \$1.8 million was associated with the Plan.

	Governmental Fund Bank Balance	Proprietary Fund Bank Balance	Fiduciary Fund Bank Balance
FDIC Insured	\$	\$ 568,231	\$ 500,504
Uninsured		512,640	
Collateralized by securities held by the pledging financial institution		5,964,088	9,985,437
Money market demand deposits			
Money market securities		119,388,784	5,850,286
Cash deposited with Kentucky State Treasurer	4,051,759	2,380,283	53,337
	<u>\$ 4,051,759</u>	<u>\$ 128,814,026</u>	<u>\$ 16,389,564</u>

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

June 30, 2016

Note C--Cash and Investments--Continued

As of June 30, 2016, all Proprietary Funds investments were registered in the Authority/Corporation's name and maintained by an external trustee or investment manager, as applicable. The investment balances as of June 30, 2016 are summarized as follows:

	<u>Fair Value</u>	<u>Weighted Average Maturity (in years)</u>
Corporate bonds	\$ 42,502,561	2.40
U.S. Treasury and government agency securities	31,899,984	2.35
Collateralized mortgage obligations	<u>6,873,843</u>	10.42
	<u>\$ 81,276,388</u>	

As of June 30, 2016, Trust investments of \$182.3 million comprised entirely of TIAA mutual funds.

As of June 30, 2016, Plan investments of \$89 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.

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

June 30, 2016

Note C--Cash and Investments--Continued

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, 2016:

<u>Rating</u>	<u>Fair Value</u>
AAA / Aaa	\$ 16,767,750
AA / Aa	4,150,455
A / A	10,355,222
BAA / Baa	<u>11,229,134</u>
	<u>\$ 42,502,561</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, 2016 the Plan primarily invested in mutual funds.

Fair Value Measurement

In accordance with GASB 72, *Fair Value Measurement and Application*, the Authority/Corporation categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. The hierarchy is based on the valuation inputs used to measure the fair value of the asset. Level 1 inputs are quoted prices in active markets for identical assets, Level 2 inputs are significant other observable inputs; and Level 3 are significant unobservable inputs.

Level 1: Quoted prices (unadjusted) of identical assets or liabilities in active markets that an entity has the ability to access as of the measurement date, or observable inputs.

Level 2: Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets and liabilities, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3: Significant unobservable inputs that reflect an entity's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

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

June 30, 2016

Note C--Cash and Investments--Continued

Fair Value on a Recurring Basis

The Authority /Corporation has the following recurring fair value measurements as of June 30, 2016:

Money Market Securities of \$119,388,784 are valued using quoted market prices. (Level 1 Inputs)

Corporate bonds, U.S. Treasury and government agency securities, and collateralized mortgage obligations of \$84,276,388 were based on Level 2 inputs.

As of June 30, 2016, 100% of the value of the Trust and Plan investments were based on Level 1 inputs.

Note D--Fixed Assets

A summary of fixed assets follows:

	Beginning Balance July 1, 2015	Additions	Disposals	Ending Balance June 30, 2016
Proprietary fund:				
Furniture and equipment	\$ 14,337,721	\$ 587,507	\$ 99,000	\$ 14,826,228
Building	12,075,049			12,075,049
System development	55,955			55,955
Student loan servicing	541,131			541,131
Debt recovery system	791,556		710,509	81,047
Accumulated depreciation and amortization	<u>(19,276,200)</u>	<u>(1,009,076)</u>	<u>(809,509)</u>	<u>(19,475,767)</u>
	<u>\$ 8,525,212</u>	<u>\$ (421,569)</u>	<u>\$</u>	<u>\$ 8,103,643</u>
Fiduciary Fund:				
Furniture and equipment	\$ 67,688	\$	\$	\$ 67,688
Accumulated depreciation	<u>(67,688)</u>	<u></u>	<u></u>	<u>(67,688)</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>

Depreciation and amortization expense totaled \$1,009,076 for the year ended June 30, 2016, of which \$881,232 was allocated to business-type activities, \$121,455 allocated to governmental activities, and \$6,389 allocated to the fiduciary activities.

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

June 30, 2016

Note D--Fixed Assets--Continued

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

	Total
Loan guarantee operations	\$ 413,311
Outreach	130,057
School Services	42,075
Default collections	149,850
Loan finance & servicing	145,939
	<u>\$ 881,232</u>

The Authority/Corporation has assets under capital lease agreements, as described in Note I, of \$12,075,049 with related accumulated amortization of \$5,292,271. 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 \$402,502 for the year ended June 30, 2016.

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, 2016, the outstanding balance of aggregate insured student loans was approximately \$1.97 billion.

Loans insured by the Authority/Corporation are reinsured under FFELP by the federal government. Death, disability, bankruptcy, lender of last resort, closed school, false certification, and ineligible borrower 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. The following schedule summarizes the reinsurance rates for guarantee agency default claims paid on or after December 1, 2015. On December 18, 2015, the Consolidated Appropriations Act, 2016, was signed into law and amended the maximum reinsurance rate within Section 428(c)(1) of the Higher Education Act by striking 95% and inserting 100%. Therefore, the Authority/Corporation has not recorded a reserve at June 30, 2016 for losses on federal reinsurance.

<u>Annual Default Claims Rate</u>	<u>Reimbursement Rate</u>		
	<u>Through September 30, 1993</u>	<u>October 1, 1993 through September 30, 1998</u>	<u>October 1, 1998 and After</u>
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%

Continued

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

June 30, 2016

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

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 was entitled to retain 18.5% of principal and all accrued interest for rehabilitated loans, plus 18.5% of collection costs through June 30, 2014. Effective July 1, 2014, 100% of principal is paid to ED and the Authority/Corporation is entitled to retain all accrued interest for rehabilitated loans plus 16% of collection costs.

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

Recoveries Payable to Federal Government - The Authority/Corporation is entitled to retain 16% of defaulted loan collections received after October 1, 2007.

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

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 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 are recorded monthly and are recognized as a deduction in the FSLRF and as revenue in the AOF. DAF are remitted back to the FSLRF for loans that default.

Note F--Loans (Finance 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 generally ten years with most FFELP consolidation loans and KAEL refinance loans having longer repayment terms. 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 1.72% to 12% for the fiscal year ended June 30, 2016 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.

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

June 30, 2016

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

Loans consist of the following at June 30, 2016:

Stafford - Subsidized	\$ 288,212,377
Stafford - Unsubsidized	328,309,928
PLUS/SLS	21,916,878
Consolidation	387,700,250
Supplemental	34,563,485
Other	<u>11,924,755</u>
Total gross loans	1,072,627,673
Allowance for loan losses	(24,508,465)
Loan rebate due to borrowers	(24,312)
Unamortized discount on purchase of loans	(1,773,107)
Unamortized premium on purchase of loans	<u>9,096</u>
Loans, net	1,046,330,885
Less amount shown as current assets	<u>162,421,414</u>
Noncurrent loans, net	<u>\$ 883,909,471</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. In July 2015, the Authority/Corporation purchased an uninsured loan portfolio at a substantial discount. As of June 30, 2016, the allowance for the loan principal purchased at a discount was \$16.5 million. In addition, \$2,315,755 of student loan principal was no longer insured due to violations of due diligence requirements.

All student loans in the Education Finance Funds and some student loans of the Corporation Operating Fund are pledged as collateral for certain bonds and lines of credit payable.

Note G--Special Allowance

The Higher Education Act of 1965 provides for quarterly Special Allowance Payments to be made by ED 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 received 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 through March 31, 2012. Pursuant to a December 23, 2011, amendment to the Higher Education Act, the Authority/Corporation elected to change the index for special allowance calculations on its FFELP loans disbursed after January 1, 2000, from the three-month commercial paper (CP) rate to the one-month LIBOR index beginning on April 1, 2012. 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.

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

June 30, 2016

Note H--Loan and Other Forgiveness

During fiscal year 2016, the Authority/Corporation forgave approximately \$2.7 million in loan principal and accrued interest for teachers funded by ED, and an additional \$1.3 million in loan forgiveness for teachers funded by the Commonwealth of Kentucky. Also, during fiscal year 2016, the Authority/Corporation provided additional loan forgiveness of \$443,325.

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.

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, 2018.

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, 2018. There can be no assurance to make rent payments past the two-year lease period.

Notes to Financial Statements--Continued

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

June 30, 2016

Note I--Capital Lease Payable--Continued

A summary of the activity for the capital lease for the year ended June 30, 2016 is as follows:

	<u>June 30, 2015</u>	<u>Additions</u>	<u>Payments</u>	<u>June 30, 2016</u>
Capital Lease Payable	\$ 3,210,000	\$	\$ 580,000	\$ 2,630,000

Debt service requirements for the final four fiscal years are as follows:

Year Ending June 30,	<u>Principal</u>	<u>Interest</u>
2017	\$ 610,000	\$ 135,268
2018	640,000	103,663
2019	670,000	72,013
2020	710,000	37,275
	<u>\$ 2,630,000</u>	<u>\$ 348,219</u>

Continued

Notes to Financial Statements--Continued

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

June 30, 2016

Note J--Revenue Bonds and Notes Payable

The balance of revenue bonds and notes payable at June 30, 2016 and the related activity for the year ended June 30, 2016 is as follows:

<u>Series</u>	<u>Scheduled Maturity</u>	<u>Interest Rate</u>	<u>Beginning Balance July 1, 2015</u>	<u>Bond Reductions</u>	<u>New Issues</u>	<u>Amortization of Premium / (Discount) June 30, 2016</u>	<u>Ending Balance June 30, 2016</u>
<u>2008 Indenture</u>							
2008 A-1	* June 1, 2037	Weekly	\$ 71,420,000	\$	\$	\$	\$ 71,420,000
2008 A-2	* June 1, 2038	Weekly	51,325,000				51,325,000
			<u>122,745,000</u>				<u>122,745,000</u>
<u>2010 Indenture</u>							
2010 A-1	* May 1, 2020	Quarterly					
2010 A-2	* May 1, 2034	Quarterly	120,375,000	(13,835,000)			106,540,000
			<u>120,375,000</u>	<u>(13,835,000)</u>			<u>106,540,000</u>
<u>2013-1 Indenture</u>							
2013-1	June 1, 2026	Monthly	374,425,000	(71,060,000)			303,365,000
<u>2013-2 Indenture</u>							
2013-2	June 1, 2028	Monthly	296,274,943	(51,050,000)		174,612	245,399,555
<u>2014 A Indenture</u>							
2014 A	* June 1, 2031	Fixed	20,803,349	(2,225,000)		(131,951)	18,446,398
<u>2015-1 Indenture</u>							
2015-1	December 1, 2031	Monthly	130,900,000	(22,515,000)			108,385,000
<u>2016-1 Indenture</u>							
2016-1-1-A & B	* June 1, 2026	Monthly			51,250,000		51,250,000
2016-1-2-A & B	June 1, 2026	Monthly			38,250,000		38,250,000
					<u>89,500,000</u>		<u>89,500,000</u>
			<u>\$ 1,065,523,292</u>	<u>\$ (160,685,000)</u>	<u>\$ 89,500,000</u>	<u>\$ 42,661</u>	<u>\$ 994,380,953</u>

* This bond series is tax-exempt.

Notes to Financial Statements--Continued

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

June 30, 2016

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

The Authority/Corporation's revenue bonds include fixed and variable rates of interest based on various index rates. Those fixed rates and variable index rates ranged from 0.44% to 5.0% as of June 30, 2016.

Debt service requirements to maturity or redemption date, assuming interest rates based on fixed rates and variable index rates at June 30, 2016, are as follows:

	Principal Repayment Amount (Thousands)							Total
	2008	2010	2013-1	2013-2	2014	2015-1	2016-1	
Year Ending June 30, 2017					\$ 900			\$ 900
3 Years Ending June 30, 2020					3,600			3,600
5 Years Ending June 30, 2025					4,500			4,500
5 Years Ending June 30, 2030			\$ 303,365	\$ 247,524	7,080		\$ 89,500	647,469
5 Years Ending June 30, 2035		\$ 106,540			2,000	\$ 108,385		216,925
3 Years Ending June 30, 2038	\$ 122,745							122,745
	<u>\$ 122,745</u>	<u>\$ 106,540</u>	<u>\$ 303,365</u>	<u>\$ 247,524</u>	<u>\$ 18,080</u>	<u>\$ 108,385</u>	<u>\$ 89,500</u>	<u>\$ 996,139</u>
	Interest Repayment Amount (Thousands)							
	2008	2010	2013-1	2013-2	2014	2015-1	2016-1	Total
Year Ending June 30, 2017	\$ 540	\$ 1,957	\$ 2,902	\$ 2,616	\$ 776	\$ 1,308	\$ 1,357	\$ 11,456
Year Ending June 30, 2018	540	1,957	2,902	2,616	740	1,308	1,357	11,420
Year Ending June 30, 2019	540	1,957	2,902	2,616	681	1,308	1,357	11,361
Year Ending June 30, 2020	540	1,957	2,902	2,616	644	1,308	1,357	11,324
5 Years Ending June 30, 2025	2,700	9,783	14,511	13,076	2,438	6,539	6,785	55,832
5 Years Ending June 30, 2030	2,700	9,783	2,902	7,846	968	6,539	1,356	32,094
5 Years Ending June 30, 2035	2,700	7,827			90	1,307		11,924
3 Years Ending June 30, 2038	1,308							1,308
	<u>\$ 11,568</u>	<u>\$ 35,221</u>	<u>\$ 29,021</u>	<u>\$ 31,386</u>	<u>\$ 6,337</u>	<u>\$ 19,617</u>	<u>\$ 13,569</u>	<u>\$ 146,719</u>

Notes to Financial Statements--Continued

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

June 30, 2016

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

The Authority/Corporation entered into an irrevocable direct pay Letter of Credit and Reimbursement Agreement ("LOC") with two banks relating to the Series 2008 Bonds in the amount of \$300,000,000 issued on June 18, 2008. The LOC 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. The LOC had an original maturity date of June 17, 2011. The Authority/Corporation and the banks extended the Stated Expiration Date as defined in the LOC to October 14, 2011. On September 8, 2011, the Stated Expiration Date as defined in the LOC was extended to September 13, 2013. On February 19, 2013 a portion of the outstanding Series 2008 Bonds were redeemed pursuant to a Mandatory Tender. On February 20, 2013 an amended LOC was entered into with one of the two banks in an amount of \$142,060,278 representing outstanding principal (\$131,845,000) and accrued interest (\$10,215,278) calculated as described above. At June 30, 2016, there was no balance nor has there been activity on the LOC.

All assets of the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, and the 2016 Indenture are pledged for repayment of the specific bond or note issues under each resolution or program.

Note K--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, may be satisfied in three ways (1) yield adjustment payments (with respect to non-purpose obligations to purpose obligations that were acquired after July 18, 2016 or that were acquired prior to such date if allocated to tax exempt bonds bearing interest on a variable rate basis or to tax exempt bonds issued primarily to finance Federal Family Education Loan Program loans, (2) forgiveness and (3) arbitrage rebate. At June 30, 2016, the Authority/Corporation is reporting a liability for excess yield on acquired purpose investments of \$200,019.

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.

Notes to Financial Statements--Continued

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

June 30, 2016

Note K--Allowance for Arbitrage Liabilities--Continued

Yield adjustment payments, which also relate to yield restriction on acquired purpose investments, are applicable to all tax exempt bonds with respect to such investments that were acquired after July 18, 2016 and also apply to such investments that were acquired prior to such date if allocated to tax exempt bonds bearing interest on variable rate basis or to tax exempt bonds issued primarily to finance Federal Family Education Loan Program loans. 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 75% of the excess yield to the US treasury at least once every five years subsequent to the 10th anniversary date of the issuance and the full amount 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.

On May 6, 2013, the Corporation entered into a voluntary closing agreement (the "VCA") with the Internal Revenue Service (the "IRS") relating to certain of its tax-exempt bonds (collectively, the "Subject Bond Issues"). The VCA resulted from a request that was submitted by KHESLC on July 31, 2012 pursuant to IRS Announcement 2012-14, 2012-14 I.R.B. 721, titled TEB Voluntary Closing Agreement Program: Relief from Allocation and Accounting Errors for Certain Issuers of Tax-Exempt Student Loan Bonds (the "Announcement"). The VCA modified the application of the foregoing excess yield discussion with respect to the Subject Bond Issues. The determination of excess yield on acquired purpose investments is no longer applicable for the Subject Bond Issues.

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.

Note L--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. In addition in fiscal year 2014, the Authority/Corporation purchased \$358.65 million of its own auction rate securities and retired the debt. This resulted in an additional \$7.2 million of gain which was deferred and is being amortized over the remaining life of the old debt. The Authority/Corporation recognized a gain of \$1.8 million for the year ended June 30, 2016.

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

June 30, 2016

Note M--Retirement Plans

Plan Description. Employees of the Authority/Corporation participate in Kentucky Employees Retirement systems (KERS), a cost-sharing multiple-employer defined benefit pension plan administered by Kentucky Retirement Systems (KRS). KRS is governed by Kentucky Revised Statutes 61.510 through 61.705 and can only be modified by the state legislature.

Benefits Provided. KERS provides retirement, disability, and death benefits. Benefit provisions are established by state statute and can only be modified by the state legislature.

All regular full-time employees of the Authority/Corporation are covered by KERS. A regular full-time employee is an employee that averages one hundred or more hours per month over a calendar or fiscal year. KERS consist of three tiers:

- Tier 1: Participation prior to September 1, 2008
- Tier 2: Participation on or after September 1, 2008 to December 31, 2013
- Tier 3: Participation on or after January 1, 2014

For Tiers 1 and 2, the benefit paid is based on the following formula: Final Compensation X Benefit Factor X Years of Service = Annual Benefit. For Tier 3, the benefit paid is based on the member's accumulated account balance at the time of retirement.

In 2013, all Cost of Living Adjustments (COLA's) were eliminated unless the State Legislature so authorizes on a biennial basis and either (1) the system is over 100% funded or (2) the Legislature appropriates sufficient funds to prepay the increased liability for the COLA.

Contributions. Kentucky statutes set the rates for employer and employee contributions. Contributions rates can only be modified by the state legislature.

The employer and each employee contribute a percentage of the employee's creditable compensation. Creditable compensation consists of all wages includable on the employee's Federal Form W-2, Wage and Tax statement, under the heading "Wages, Tips, and Other Compensation". There are two exceptions of payment of wages not included in creditable compensation: (1) the lump-sum compensatory leave payments to employees in Tier 2 and 3 and (2) vacation payout at termination. The employer total contribution rate for FY16 and FY15 were 38.77% comprised of 30.84% for pension contributions and 7.93% for insurance contributions. The employee's contribution rates are as follows: Tier 1 - 5%, Tier 2 and 3 - 6%.

Notes to Financial Statements--Continued

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

June 30, 2016

Note M--Retirement Plans--Continued

The contributions for the employer and employee are as follows:

	<u>FY16</u>	<u>FY15</u>
Authority: Employer	\$ 467,558	\$ 475,279
Authority: Employee	75,449	78,959
	<u>\$ 543,007</u>	<u>\$ 554,238</u>
Corporation: Employer	\$ 4,186,642	\$ 4,149,106
Corporation: Employee	698,419	717,270
	<u>\$ 4,885,061</u>	<u>\$ 4,866,376</u>
Total: Employer	\$ 4,654,200	\$ 4,624,385
Total: Employee	773,868	796,229
	<u>\$ 5,428,068</u>	<u>\$ 5,420,614</u>

The employer is responsible for additional contributions if pension spiking occurs. Pension spiking may be deemed to have occurred for certain large compensation increases in the five years immediately preceding retirement. Kentucky Revised Statute 61.598 requires the last participating employer, for employees retiring on or after January 1, 2014, to pay for any additional actuarial costs resulting from annual increases in an employee's creditable compensation greater than ten percent over the employee's last five fiscal years of employment that are not a direct result of a bona fide promotion or career advancement.

Pension Costs. At June 30, 2016, the Authority/Corporation reported a net pension liability of \$93,969,760 for its proportionate share of the KERS's net pension liability. The Authority's portion is \$9,749,658 and the Corporation's is \$84,220,102. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by the actuarial valuation as of that date. The Authority/Corporation's estimated proportionate share of the collective net pension liability was based on a projection of the Authority/Corporation's long-term share of contributions to the pension plan relative to the projected contributions of all employer participants, as actuarially determined. The Authority's contributions during the measurement period as provided by KRS were \$502,383 with a proportionate share percentage of .097187%. The Corporation's contributions during the measurement period as provided by KRS were \$4,339,713 with a proportionate share percentage of .839524%.

Notes to Financial Statements--Continued

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

June 30, 2016

Note M--Retirement Plans--Continued

For the year ended June 30, 2016, the Authority/Corporation recognized pension expense of \$9,596,616 for its proportionate share of KERS's pension expense. The Authority's portion was \$761,257 and the Corporation's was \$8,835,359.

At June 30, 2016, the Authority reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

<u>Authority</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between expected and actual experience	\$ 20,829	\$
Net difference between projected and actual investment earnings on pension plan investments	27,769	
Changes in assumptions	467,343	
Changes in proportion and differences between employer contributions and proportionate share of contributions		262,261
Authority's contributions to KERS subsequent to the measurement date	467,558	
	<u>\$ 983,499</u>	<u>\$ 262,261</u>

\$467,558 reported as deferred outflows of resources related to pensions resulting from the Authority's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows and inflows of resources related to KERS pensions will be recognized in pension expense as follows:

Authority Deferred Outflows of Resources

<u>Original Deferral Year</u>	<u>Original Deferral Amount</u>	<u>2017</u>	<u>2018</u>	<u>2019</u>	<u>2020</u>
2015	<u>\$ 515,941</u>	<u>\$ (128,985)</u>	<u>\$ (128,985)</u>	<u>\$ (128,985)</u>	<u>\$ (128,986)</u>

Notes to Financial Statements--Continued

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

June 30, 2016

Note M--Retirement Plans--Continued

Authority Deferred Inflows of Resources

Original Deferral Year	Original Deferral Amount	2016	2017	2018	2019	2020
2014	\$ 117,000	\$ (29,250)	\$ (29,250)	\$ (29,250)	\$ (29,250)	\$
2015	174,511		(43,628)	(43,628)	(43,628)	(43,627)
	<u>\$ 291,511</u>	<u>\$ (29,250)</u>	<u>\$ (72,878)</u>	<u>\$ (72,878)</u>	<u>\$ (72,878)</u>	<u>\$ (43,627)</u>
Amortization 2016						<u>\$ (29,250)</u>
Unamortized Amount 2016						<u>\$ 262,261</u>

At June 30, 2016, the Corporation reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

Corporation	Deferred Outflows of Resources	Deferred Inflows of Resources
Difference between expected and actual experience	\$ 179,929	\$
Net difference between projected and actual investment earnings on pension plan investments	239,876	
Changes in assumptions	4,037,028	
Changes in proportion and differences between employer contributions and proportionate share of contributions	2,725,016	
Authority's contributions to KERS subsequent to the measurement date	4,186,642	
	<u>\$ 11,368,491</u>	<u>\$</u>

Continued

Notes to Financial Statements--Continued

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

June 30, 2016

Note M--Retirement Plans--Continued

\$4,186,642 reported as deferred outflows of resources related to pensions resulting from the Corporation's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2017. Other amounts reported as deferred outflows and inflows of resources related to KERS pensions will be recognized in pension expense as follows:

Corporation Deferred Outflows of Resources

Original Deferral Year	Original Deferral Amount	2017	2018	2019	2020
2015	\$ 7,181,849	\$(1,795,462)	\$(1,795,462)	\$(1,795,462)	\$(1,795,463)

Corporation Deferred Inflows of Resources

Original Deferral Year	Original Deferral Amount	2016	2017	2018	2019	2020
2014	\$ 918,000	\$ (229,500)	\$ (229,500)	\$ (229,500)	\$ (229,500)	\$
2015	(688,500)		172,125	172,125	172,125	172,125
	<u>\$ 229,500</u>	<u>\$ (229,500)</u>	<u>\$ (57,375)</u>	<u>\$ (57,375)</u>	<u>\$ (57,375)</u>	<u>\$ 172,125</u>
Amortization 2016						<u>\$ (229,500)</u>
Unamortized Amount 2016						<u>\$</u>

Actuarial Assumptions. The total pension liability was determined by an actuarial valuation as of June 30, 2015, using the entry age normal actuarial cost method and the following actuarial assumptions:

Assumptions	Percentage
Inflation	3.25% per year
Active Member Payroll Growth	4.00% per year
Investment Rate of Return	7.50% per year

Salary increases were based on a service-related table.

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

June 30, 2016

Note M--Retirement Plans--Continued

The mortality table used for active members is RP-200 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). For healthy retired members and beneficiaries, the mortality table used is the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (setback one year for females). For disabled members, the RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (setback four years for males) is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2015, valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

The long-term expected rate of return on pension plan investments is reviewed as part of the regular experience studies prepared every five years. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best estimate ranges of expected future real rates of return were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation.

The target asset allocation and arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Long Term Expected Real Rate of Return	Target Allocation
Combined Equity	5.40%	42.00%
Combined Fixed Income	1.50%	20.00%
Real Return (Diversified Inflation Strategies)	3.50%	10.00%
Real Estate	4.50%	3.00%
Absolute Return (Diversified Hedge Funds)	4.25%	10.00%
Private Equity	8.50%	10.00%
Cash Equivalent	-0.25%	5.00%
		100.00%
Total		

The long-term expected rate of return on plan assets is 7.50%, which was established by the Board of Trustees of the Kentucky Retirement Systems based on a blending of the factors described above.

Notes to Financial Statements--Continued

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

June 30, 2016

Note M--Retirement Plans--Continued

Discount Rate. The discount rate used to measure the total pension liability was 7.50%. The projection of cash flows used to determine the discount rate assumed employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 28 year amortization period of the unfunded actuarial accrued liability.

Pension Liability Sensitivity. The following table presents the Authority/Corporation's proportionate share of the net pension liability in KRS, calculated using the discount rate disclosed in the preceding paragraph, as well as what the Authority/Corporation's proportionate share of the net pension liability would be if it were calculated using a discount rate 1 percentage point lower or 1 percentage point higher than the current discount rate:

	<u>1% Decrease in Discount Rate</u>	<u>Discount Rate</u>	<u>1% Increase in Discount Rate</u>
KRS Discount Rate	6.50%	7.50%	8.50%
Authority's proportionate share of net pension liability	\$ 10,982,658	\$ 9,749,658	\$ 8,706,658
Corporation's proportionate share of net pension liability	\$ 94,867,102	\$ 84,220,102	\$ 75,213,102

Pension Plan Fiduciary Net Position. Detailed information about KERS's fiduciary net position is available in a KRS financial report. That report may be obtained on the Internet at www.kyret.ky.gov; by writing to Kentucky Retirement Systems at Perimeter Park West, 1260 Louisville Road, Frankfort, KY 40601; or by calling 1-800-928-4646.

Note N--Tuition Benefit Payable

The following assumptions provided by management were used in the actuarial valuation of tuition benefits payable as of June 30, 2016. These assumptions are based on national and state specific economic data, previous program actuarial valuation reports, historical state general fund appropriations to the University of Kentucky and KCTCS, actual tuition increases from previous years (2002-2014) and other state prepaid tuition programs' annual tuition inflation assumptions.

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 changed from 5.45% in the prior year to a range of future rates by year.

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

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

June 30, 2016

Note N--Tuition Benefit Payable--Continued

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 2002-2003 academic year were 32.4% for the Value Plan and 6.4% for the Standard Plan and the Premium Plan.
- 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.
- The tuition increases for the 2011-2012 academic year were 3.8% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2012-2013 academic year were 3.8% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2013-2014 academic year were 2.9% for the Value Plan and 3.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2014-2015 academic year were 2.1% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.

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

June 30, 2016

Note N--Tuition Benefit Payable--Continued

- The tuition increases for the 2015-2016 academic year 3.0% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.
- As of June 30, 2016, the tuition increases for the 2016-2017 academic year were 4.0% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan. The tuition increase assumption was 6.25% for the 2016-2017 academic year and 6.25% for each year thereafter.

For the period from inception to 2016-2017 academic year, the annualized tuition increase for the highest-priced Kentucky public university, as applicable to the tuition benefits payout rate of Kentucky's Affordable Prepaid Tuition Standard and Premium Plans, which represents 94.8% of the Plan's enrollments, has been 8%. 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, 2016, has been 9%.

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 O--Restricted Net Position

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

- Federal Student Loan Reserve Fund:** Net position is restricted for certain FFELP activities, primarily the payments of claims.
- Agency Operating Fund:** Net position is restricted for certain FFELP activities and other student aid activities.
- Education Finance Funds:** Net position is restricted as required by the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, the 2015 Indenture, and the 2016 Indenture.
- Corporation Operating Fund:** Net position is primarily restricted for an estimated amount of mandatory repurchases of loans subject to bankruptcy claims.
- Student Aid Funds:** The Student Aid fund balance is restricted for the Student Aid Programs.
- The Trust:** Net position is restricted for use by trust participants.

Notes to Financial Statements--Continued

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

June 30, 2016

Note P--Operating Leases

The Authority/Corporation leases office space and equipment under agreements through 2022. Rental and space utilization expense was \$1,401,134 for the year ended June 30, 2016. Minimum future rental payments for real estate and equipment, including common area maintenance commitments, at June 30, 2016 are as follows:

Year Ending June 30,	
2017	\$ 1,266,060
2018	1,300,445
2019	788,244
2020	655,369
2021	655,369
One Year Ending June 30,	
2022	<u>602,472</u>
	<u>\$ 5,267,959</u>

Note Q--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, 2016. Prior to December 1, 2015, the federal government's reinsurance rate for defaults was 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. Effective December 1, 2015, the maximum reinsurance rate was amended from 95% to 100%. 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 applicable baseline; 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, 2016 is calculated as follows:

Amount of guaranteed student loans outstanding at lenders	\$ 1,971,863,633
Less minimum federal government share - 75%	<u>1,478,897,725</u>
	<u>\$ 492,965,908</u>

Notes to Financial Statements--Continued

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

June 30, 2016

Note R - Recent Pronouncements

In June 2015, the GASB issued Statement No. 75, *Accounting and Reporting for Postemployment Other Than Pensions*. The provisions of this statement are effective for fiscal years beginning after June 15, 2017.

This statement establishes new accounting and financial reporting requirements for OPEB plans. The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed.

The Authority/Corporation is currently evaluating the impact that will result from adopting GASB No. 75 and is therefore unable to disclose the impact that adopting these Standards will have on the Authority/Corporation's financial position and the results of its operations when the Statement is adopted.

REQUIRED SUPPLEMENTARY INFORMATION

**Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Schedule of Proportionate Share of the Net Pension Liability and Related Ratios
June 30, 2015**

	<u>FY 2015</u>	<u>FY 2014</u>
Authority's proportion of the net pension liability	0.971870%	0.101355%
Authority's proportionate share of the net pension liability	\$ 9,749,658	\$ 9,093,000
Authority's covered-employee payroll	\$ 1,628,998	\$ 1,740,891
Authority's proportionate share of the net pension liability as a percentage of its covered-employee payroll	598.51%	522.32%
Plan fiduciary net position as a percentage of the total pension liability	18.83%	22.32%
	<u>FY 2015</u>	<u>FY 2014</u>
Corporation's proportion of the net pension liability	0.839524%	0.796208%
Corporation's proportionate share of the net pension liability	\$ 84,220,102	\$ 71,434,000
Corporation's covered-employee payroll	\$ 14,071,702	\$ 13,672,643
Corporation's proportionate share of the net pension liability as a percentage of its covered-employee payroll	598.51%	522.46%
Plan fiduciary net position as a percentage of the total pension liability	18.83%	22.32%
Total collective net pension liability for the Kentucky Employees Retirement System (KERS) non-hazardous employees	\$ 10,031,891,000	\$ 8,971,820,000
KERS' non-hazardous employees total fiduciary net position	\$ 2,327,782,000	\$ 2,578,290,000
KERS' non-hazardous employees total pension liability	\$ 12,359,673,000	\$ 11,550,110,000

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

**Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Schedule of Required Contributions
June 30, 2015**

	<u>FY 2015</u>	<u>FY 2014</u>
Authority's contractually required contribution	\$ 502,383	\$ 567,008
Authority's contributions in relation to the contractually required contribution	(502,383)	(301,000)
Authority's contribution deficiency	<u>\$ -</u>	<u>\$ 266,008</u>
Authority's covered-employee payroll	1,628,998	1,740,891
Authority's contributions as a percentage of covered-employee payroll	30.84%	17.29%

	<u>FY 2015</u>	<u>FY 2014</u>
Corporation's contractually required contribution	\$ 4,339,713	\$ 4,453,180
Corporation's contributions in relation to the contractually required contribution	(4,339,713)	(2,364,000)
Corporation's contribution deficiency	<u>\$ -</u>	<u>\$ 2,089,180</u>
Corporation's covered-employee payroll	14,071,702	13,672,643
Corporation's contributions as a percentage of covered-employee payroll	30.84%	17.29%

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

**Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Notes to the Required Supplemental Information
June 30, 2015**

Actuarial valuation date	June 30, 2015
Actuarial cost method	Entry age
Amortization method	Level of percentage of payroll, closed
Remaining amortization period	28 years
Asset valuation method	5-year smoothed market
Inflation	3.25%
Projected salary increases	4.00%, average, including inflation
Investment rate of return	7.50%, net of investment expense, including inflation

See accompanying independent auditor's report.