

Strothman & Company P S C

Certified Public Accountants & Advisors



Financial Statements

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

June 30, 2009

Financial Statements

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

June 30, 2009

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Independent Auditors' Report



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

We have audited the accompanying combined financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Kentucky Higher Education Assistance Authority and the Kentucky Higher Education Student Loan Corporation (the "Authority/Corporation"), component units of the Commonwealth of Kentucky, as of and for the year ended June 30, 2009, which collectively comprise the Authority/Corporation's basic combined financial statements as listed in the accompanying table of contents. These combined financial statements are the responsibility of the Authority/Corporation's management. Our responsibility is to express opinions on these combined financial statements based on our audit. We did not audit the financial statements of Kentucky Education Savings Plan Trust, which statements reflect total assets of \$94,914,868 as of June 30, 2009, and total additions to fiduciary net assets of \$37,059,584 for the year ended June 30, 2009. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Kentucky Education Savings Plan Trust, is solely based on the report of the other auditors.

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

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Authority/Corporation as of June 30, 2009, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 through 23 is not a required part of the basic combined financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 30, 2009 on our consideration of the Authority/Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

STROTHMAN & COMPANY PSC

Louisville, Kentucky
September 30, 2009

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

June 30, 2009

Description of the Business

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

The Authority/Corporation maintains the following operations:

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

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

Lender Assistance - Lender assistance operations are comprised entirely of loan origination and disbursement services provided by the Authority/Corporation for up to 68 lenders and 277 schools. The lender assistance operation draws money directly from lenders' accounts and disburses those funds directly to schools. This service is provided on a fee basis to lenders and is free for schools. In fiscal year 2009, the lender assistance operation decreased the (per loan) origination fee from \$8 to \$3, and decreased the (per loan) disbursement fee from \$3 to \$1. The disbursement fee is not charged if the lender assistance operation is also the disbursement agent.

Personnel, professional and administrative costs associated with lender assistance operations are accounted for in the AOF, a proprietary fund of the Authority/Corporation. Program activities related to lender assistance operations are accounted for in the Agency Fund, a fiduciary fund of the Authority/Corporation.

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**Kentucky Higher Education Assistance Authority/
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June 30, 2009

Lending - The Authority/Corporation's lending operation is authorized to finance FFELP loans for students attending eligible post-secondary institutions, service and collect education loans, and issue bonds and notes not to exceed \$5 billion in order to carry out its corporate powers and duties. The FFELP student loans held by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS"), and Federal Consolidation Loans ("Consolidations"). As of June 30, 2009, the lending operation owned \$2.516 billion of student loans.

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

The Authority/Corporation's lending operation finances all FFELP loans with revenue bonds, lines of credit, and a FFELP Participation credit facility from the USDE. As of June 30, 2009, the lending operation maintained four separate General Bond Resolutions ("GBR"s) and related Series Resolutions for issue of revenue bonds, which 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, 2009, the lending operation maintained \$2.205 billion of revenue bonds outstanding, \$10.85 million outstanding balance against the lines of credit, and an additional \$461.20 million outstanding payable to the USDE.

Personnel, professional and administrative costs associated with lending operations are accounted for in the Operating Fund, a proprietary fund of the Authority/Corporation. Lines of credit and related loans, and all activities pertaining to such activities are also accounted for in the Operating Fund of the Authority/Corporation. Revenue bonds, related loans and other assets and liabilities and revenues and expenses are accounted for in the Education Finance Fund, a proprietary fund of the Authority/Corporation.

Loan Servicing - The loan servicing operation performs servicing and default aversion activities on FFELP and alternative loans held by the Authority/Corporation's lending operation and other lenders. Of the loans serviced, approximately \$2.516 billion in outstanding principal of FFELP Loans was held by the lending operation and pledged pursuant to the 1983 GBR, the 1997 GBR, the 2004 GBR, the 2008 GBR, line of credit agreements, and credit facility payable to USDE. Approximately \$1.7 billion of FFELP Loans and other education loans were owned by other holders, including holders with national lending operations. For loans owned by other holders, the loan servicing operation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities.

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

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**Kentucky Higher Education Assistance Authority/
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Student Aid - Student aid operations provide administration of ten student aid programs: (1) the Kentucky Tuition Grant program, (2) College Access Program, (3) Kentucky Educational Excellence Scholarship program, (4) Teacher Scholarship program, (5) Osteopathic Medicine Scholarship program, (6) the Work-Study program, (7) Robert C. Byrd Scholarship program, (8) Early Childhood Development program, (9) the Go Higher Scholarship program and (10) the Pharmacy Scholarship program. The student aid operation also provides administrative support and assistance for two student aid programs, the Mary Jo Young Scholarship program and the Kentucky National Guard Tuition Award program.

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

Outreach - Outreach operations at the Authority/Corporation provide information to current and potential college students of all ages to assist with educational finance and other information to improve the college-going rate and decrease the college dropout rate.

In fiscal year 2009, the outreach operation staff traveled 192,468 miles, provided 632 exhibits, 2,827 presentations, and made direct contact with 155,857 parents and/or students.

Personnel, professional and administrative costs associated with the outreach operation are accounted for in the Student Aid Fund, a Governmental Fund of the Authority/Corporation.

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

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

An individual participating in the Trust establishes an account in the name of a beneficiary. Contributions can be made among three investment options: the managed Allocation Option, the 100% 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. Prior to January 17, 2004, there were eleven age bands. Each age band invests in varying percentages in the Institutional Class of the International Equity, Growth Equity, Growth & Income, Inflation-Linked Bond, Equity Index, Small-Cap Blend Index, Bond, Large-Cap Value Index, Real Estate Securities, and Money Market Funds of the TIAA-CREF Institutional Mutual Funds. The 100% 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. These percentages are determined by the Authority/Corporation's Board of Directors and are subject

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to change. The assets of the Guaranteed Option are allocated to a funding agreement issued by TIAA-CREF Life Insurance Company, a subsidiary of TIAA, which offers a guarantee of principal and a minimum rate of return to the Trust

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

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

The Plan is designed as an investment option for Kentucky families to earn a return that will keep pace with tuition inflation in Kentucky. Participants purchased annual tuition units at current tuition levels, or current tuition levels plus a premium, and receive benefits equal to tuition rates in place at the time that the student attends a qualified postsecondary education institution. The Plan offers three tuition plans – the Value Plan, the Standard Plan, and the Premium Plan. In the Value Plan, participants buy tuition units and receive benefits indexed to the tuition rate of the Kentucky Community and Technical College System. The Standard Plan offers tuition units and benefits indexed to the tuition rate of Kentucky's most expensive public university.

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

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

Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States. If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books, and supplies.

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

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**Kentucky Higher Education Assistance Authority/
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June 30, 2009

As of June 30, 2009, the Plan maintained a present-value fund deficit of \$59.5 million. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2016, and the Commonwealth will be required to transfer assets from the unclaimed property fund. Over the remaining estimated life of the program, through fiscal year 2027, actuarial estimates show total the Commonwealth will need to transfer approximately \$135 million from the unclaimed property fund. As of June 30, 2009, the unclaimed property fund has approximately \$330 million. Based on current assumptions and actuarial calculations, the Plan would need to earn 17.3% on investments, annually to avoid transfers from the unclaimed property fund.

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

Student Loan Update

The College Cost Reduction and Access Act of 2007 ("CCRAA") resulted in, among other things, a reduction in the yield received by the Company on FFELP loans originated on or after October 1, 2007. A description of the CCRAA is included below:

- Reduced special allowance payments to for-profit lenders and not-for-profit lenders for both Stafford and Consolidation Loans disbursed on or after October 1, 2007 by 0.55 percentage points and 0.40 percentage points, respectively;
- Reduced special allowance payments to for-profit lenders and not-for-profit lenders for PLUS loans disbursed on or after October 1, 2007 by 0.85 percentage points and 0.70 percentage points, respectively;
- Reduced fixed interest rates on subsidized Stafford loans to undergraduates from the current 6.8% to 6.0% for loans disbursed beginning July 1, 2008, to 5.6% for loans disbursed beginning July 1, 2009, to 4.5% for loans disbursed beginning July 1, 2010, and to 3.4% for loans disbursed between July 1, 2011 and June 30, 2012. Absent any other legislative changes, the rates would revert to 6.8% for loans disbursed on or after July 1, 2012;
- Increased the lender loan fees on all loan types, from 0.5 percent to 1.0 percent;
- Reduced default insurance to 95 percent of the unpaid principal and accrued interest for loans first disbursed on or after October 1, 2012;
- Eliminated Exceptional Performer designation (and the monetary benefit associated with it) effective October 1, 2007.
- Reduced default collections retention by guaranty agencies from 23 percent to 16 percent.
- Reduced the guaranty agency account maintenance fee from 0.10 percent to 0.06 percent.
- Required ED to develop and implement a pilot auction for participation in the FFELP Parent PLUS loan program, by state, effective July 1, 2009.
- Provided loan forgiveness for all FDLP borrowers, and FFELP borrowers that consolidate in the FDLP, in certain public service jobs who make 120 monthly payments.
- Expanded the deferment authority for borrowers due to an economic hardship and military service.

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**Kentucky Higher Education Assistance Authority/
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June 30, 2009

- Established a new income-based repayment program starting July 1, 2009 for all loans except for parent PLUS loans or Consolidation loans that discharged such loans which includes the potential for loan forgiveness after 25 years.

In the summer of 2007, the global capital markets began to experience a severe dislocation that persists to the present. This dislocation, along with provisions of CCRAA, has resulted in the Authority/Corporation's inability to access traditional financing vehicles.

In the past, the Authority/Corporation relied on the capital markets to finance student loan originations held as long-term assets. During fiscal year 2009, the market for asset-backed debt issued by financial services companies materially deteriorated and became unavailable at profitable terms. The net interest margin earned on a newly-originated FFELP loan came under pressure as the asset yield was cut and funding costs increased, making new lending unprofitable. As a result, over 160 student lenders have exited the FFELP student loan industry since the implementation of CCRAA, and most remaining issuers significantly reduced their lending activities. By January 2008, it became clear that unless the capital markets recovered there would be a sharp contraction in the number of student loans available. The Authority/Corporation, along with other participants in the student loan industry, began to bring this to the attention of legislators, schools and students. As early as February 2008, members of Congress were writing to the USDE and the Federal Reserve alerting them to the imminent crisis and urging them to find a solution. Congress acted quickly and passed legislation that authorized the USDE to take action. The Ensuring Continued Access to Student Loans Act of 2008 ("ECASLA") was passed in both houses of Congress with overwhelming bipartisan support and was signed into law on May 7, 2008. Under ECASLA, the USDE implemented two programs, the Loan Participation Program and Loan Purchase Commitment Program ("Participation Program" and "Purchase Program"). Through the Participation Program, the USDE provides interim short-term liquidity to FFELP lenders by purchasing participation interests in pools of FFELP loans. FFELP lenders are charged at the commercial paper ("CP") rate plus 0.50 percent on the principal amount of participation interests outstanding. Loans funded under the Participation Program must be either refinanced by the lender or sold to the USDE pursuant to the Purchase Program prior to its expiration on September 30, 2010. Under the Purchase Program, the USDE purchases eligible FFELP loans at a price equal to the sum of (i) par value, (ii) accrued interest, (iii) the one-percent origination fee paid to the USDE, and (iv) a fixed amount of \$75 per loan. Generally, loans originated between May 1, 2008 and June 30, 2010 are eligible for these programs.

A description of ECASLA is included below.

- Increased Unsubsidized Stafford loan limits for undergraduate students for loans first disbursed on or after July 1, 2008 —
 - by \$2,000 for the annual limit
 - and to \$31,000 and \$57,500 as the aggregate limits for dependent students and independent students, respectively.

Continued

**Kentucky Higher Education Assistance Authority/
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June 30, 2009

- Required, effective for loans first disbursed on or after July 1, 2008, that repayment of a parent PLUS loan begin no later than 60 days after the final disbursement with interest accrued prior to the beginning of repayment added to the loan principal, or the day after 6 months from the date the dependent student is no longer enrolled at least half time, in which case interest accrued prior to the beginning of repayment may be paid monthly or quarterly, or capitalized no more frequently than quarterly, if agreed by the borrower and lender.
- Removed specification that the repayment period of a PLUS loan begins on the date of the final disbursement and excludes deferment and forbearance periods for loans first disbursed on or after July 1, 2008.
- Allowed extenuating circumstances for credit requirement purposes for a PLUS loan if the applicant is up to 180 days delinquent on mortgage or medical bill payments or not more than 89 days delinquent on any other debt during the period January 1, 2007, through December 31, 2009.
- Broadened lender of last resort ("LLR") provisions so they include subsidized and unsubsidized Stafford loans and PLUS loans, prohibits LLR loans with terms and conditions more favorable than those for non-LLR loans, and subjects lenders and guarantors serving as LLRs to prohibitions on inducements and to prohibitions regarding advertising, marketing or promoting LLR loans.
- Gave the Secretary authority until July 1, 2009 (subsequently extended to July 1, 2010 by Public Law 110-350 enacted October 7, 2008), if there is inadequate loan capital, to purchase or enter into forward purchase commitments for Stafford and PLUS loans first disbursed on or after October 1, 2003 and before July 1, 2009, and makes funds available. Any purchase must be without a net cost to the federal government (including the cost of servicing purchased loans), and funds paid to a lender must be used for the lender's continued FFELP participations and making of FFELP loans.
- Authorized the Secretary to contract for the servicing of purchased FFELP loans, including with selling lenders, as long as the cost is not more than it would be otherwise.

The Participation Program enabled the Authority/Corporation to continue to participate in the FFEL program, and thus ensured student loans were available to Kentucky and Alabama students. In fiscal year 2009, the Corporation/Authority originated \$538.2 million of FFELP loans, a 14.9% increase from the prior year.

Interest paid on FFELP loans is set by law and is based on the Federal Reserve's Statistical Release 90-day financial CP rate. As of June 30, 2009, the Authority/Corporation had \$2.516 billion of FFELP loans indexed to three-month financial CP, while 15.5% of debt is indexed to 91 day Treasury Bill, 45.2% indexed to the London Interbank Offer Rate ("LIBOR"), and 39.3% indexed to Securities Industry and Financial Markets Association ("SIFMA"). Due to the unintended consequences of government actions in other areas of the capital markets and limited issuances of qualifying financial CP, the relationship between the three-month financial CP and 91 day Treasury Bill, LIBOR and SIFMA became distorted and volatile. Accordingly, interest spread between assets and related debt on related debt has contracted.

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On February 26, 2009, the Administration issued their 2010 budget request to Congress, which included provisions that could eliminate the FFEL program. The President's budget overview states: "FFEL processors would continue to receive federal subsidies for new loans originated in the 2009-2010 academic year and prior academic years under the regular FFEL program and the emergency programs established by the Ensuring Continued Access to Student Loans Act of 2008." The budget proposal must be passed in the Congress, prior to enactment into law. The Authority/Corporation is working with Congress and USDE to assist them in achieving the financial objectives outlined in the Administration's 2010 budget request, without a total elimination of FFELP.

On July 15, 2009, Representative Miller introduced the Student Aid and Fiscal Responsibility Act ("SAFRA"), with the following provisions related to FFELP.

- No new FFEL loans will be made after June 30, 2010.
- Beginning July 1, 2010, a FFEL consolidation borrower who does not have a Direct Consolidation Loan may obtain a subsequent Direct Consolidation Loan.
- A revised special allowance formula becomes effective for special allowance payments for the calendar quarter ending December 31, 2009. Under this change, the special allowance for all loans disbursed after enactment of the bill (and before July 1, 2010) shall be computed using 1-month LIBOR instead of the 3-month commercial paper (financial) rate, beginning with the special allowance payment for calendar quarter ending December 31, 2009. Beginning with the special allowance payment for the calendar quarter ending December 31, 2009, lenders also have the option of being paid using this revised index on all loans disbursed on or after January 1, 2000 and before the date of enactment of the bill if lender waives all rights under the current formula. Such waiver would apply to future payments on all loans disbursed in this time period that are held by any lender identification number associated with the lender and applies to future payments on loans subsequently acquired by the lender.
- Beginning January 1, 2010, the Secretary's participant yield under the ECASLA loan participation program shall be determined by using 1-month LIBOR in substitution for the index in the participation agreement.
- Direct Loans for students and parents attending institutions located outside of the United States will be disbursed by a financial institution designated by the Secretary to serve as an agent of such institutions.
- The Secretary shall, if practicable, award multiple contracts through competitive bidding to entities, including not-for-profit servicers, to service Direct Loans. The bidding process shall take into account price, servicing capacity, and capability, and may also take into account the capacity and capability to provide default aversion services.
- In any contract awarded for servicing of loans, the Secretary shall provide a job incentive payment, in an amount determined by the Secretary, if the servicer agrees to give priority in hiring for positions created by the contract to those geographical locations at which the entity performed loan origination and servicing activities under the FFELP on the date of enactment. Also, in determining allocation of loans to be serviced by entities awarded contracts, the Secretary shall consider the retention of highly qualified employees as a positive factor.

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- Not-for-profit servicers are specifically listed as entities with which the Secretary may contract for services, along with guaranty agencies with which the Secretary has agreements under sections 428(b) and (c) on the date of enactment, provided such servicers and agencies meet qualifications determined by the Secretary. The legislation directs the Secretary, to the extent practicable, to give special consideration to State agencies and not-for-profit servicers with a history of high quality performance and demonstrated integrity. Guaranty agencies and not-for-profit servicers can enter into consortium agreement for such agreements with the Secretary.
- In each State where one or more eligible not-for-profit servicer has its principal place of business, the Secretary shall contract with each such servicer to service loans originated under this part on behalf of borrowers attending institutions located within such State, provided that the servicer demonstrates that it meets the standards for servicing Federal assets and agrees to service the loans at a competitive market rate, as determined by the Secretary. In determining such a competitive market rate, the Secretary may take into account the volume of loans serviced by the servicer. Contracts awarded under this paragraph shall be subject to the same requirements for quality, performance and accountability as contracts awarded to other entities for similar activities.
- In each State, the Secretary shall allocate to such not-for-profit servicers, on an annual basis, a minimum of the lesser of the loans for 100,000 borrowers or the loans of all borrowers who attended institutions located in the State involved. If there is more than one eligible not-for-profit servicer in a State, each gets an equal share of the servicing to the extent there are not enough borrower accounts to give each 100,000 accounts.
- The Secretary may allocate additional servicing rights to not-for-profit servicers based on performance, including performance in customer service and default aversion.
- Notwithstanding these allocation rules, the Secretary may transfer loans among servicers to ensure that the loans of a single borrower remain with a single servicer.
- Not later than three years after enactment, the Secretary shall prepare a report evaluating the performance of not-for-profit servicers.
- In any contract awarded for servicing of loans, the Secretary shall provide a job incentive payment, in an amount determined by the Secretary, if the servicer agrees to give priority in hiring for positions created by the contract to those geographical locations at which the entity performed loan origination and servicing activities under the FFELP on the date of enactment. Also, in determining allocation of loans to be serviced by entities awarded contracts, the Secretary shall consider the retention of highly qualified employees as a positive factor.
- An eligible not-for-profit servicer is a not-for-profit holder defined in section 439(p) of the HEA (this is used for the purpose of determining eligibility for the higher special allowance), or an affiliated not-for-profit entity.
- The interest rate on Stafford loans made on or after July 1, 2012 is a variable annual rate equal to the 91-day Treasury bill rate determined at the last T-Bill auction in May plus 2.5 percent, capped at 6.8 percent.

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SAFRA was adopted by the U.S. House of Representatives on September 17, 2009, and is now under consideration by the Senate. If SAFRA passes the Senate and is signed into law by President Obama, the Authority/Corporation will no longer perform loan guarantee, disbursement services or lending activities on loans originated on or after July 1, 2010. The Authority/Corporation will continue to provide guarantee services and loan servicing on the \$2.516 billion of FFELP loans in its portfolio, and expects to receive an additional 100,000 direct loan borrowers in fiscal year 2011.

Overview of Financial Statements

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

The government-wide statement of net assets and statement of activities include the Governmental Funds and Proprietary Funds. The government-wide financial statements can be found on pages 24-25 of this report. The fund financial statements can be found on pages 26-31 of this report.

Fiduciary funds are used to account for resources held for the benefit of parties outside the Authority. Fiduciary funds are not reflected in the government-wide financial statements because the resources are not available to support the Authority's programs. The fiduciary fund statement of net assets (deficit) and changes in fiduciary net assets (deficit) can be found on pages 32-33 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, 2009 and 2008, respectively.

Condensed Financial Information - Governmental Fund and Proprietary Funds

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

	Governmental Fund		Proprietary Funds	
	2009	2008	2009	2008
Net Asset Information				
Capital assets			\$ 4,560,844	\$ 12,282,525
Other assets	\$ 19,688,834	\$ 19,505,175	2,834,108,120	2,421,473,193
Total Assets	19,688,834	19,505,175	2,838,668,964	2,433,755,718
Long-term liabilities			2,161,509,236	2,237,715,255
Other liabilities	689,212	309,433	544,602,759	78,048,978
Total Liabilities	689,212	309,433	2,706,111,995	2,315,764,233
Non-spendable net assets			59,978,016	69,544,332
Spendable net assets				
Restricted	18,999,662	19,195,742	12,946,259	-
Committed			59,632,694	48,447,153
Total Net Assets	\$ 18,999,662	\$ 19,195,742	\$ 132,556,969	\$ 117,991,485
Activity Information				
Interest and investment income	\$ 153,727	\$ 158,927	\$ 2,695,505	\$ 8,665,255
State General Fund revenue	180,985,962	173,280,600		
Student Aid & Advancement Fund revenue				
Unclaimed Lottery Revenue	8,602,800	11,300,000		
Federal funds revenue	2,403,600	1,342,145		
Tobacco settlement revenue	1,150,000	1,007,678		
Service fees from external sources			14,635,663	15,686,357
Service fees from Education Finance Fund			11,801,178	11,672,966
Deconversion fees			1,521,920	
Debt recovery commission			14,549,502	11,192,020
Early retirement of debt			10,901,634	
Federal fees earned			7,474,722	7,623,775
Default aversion fee income			2,438,716	1,938,795
Interest income on loans			93,136,858	130,631,958
Other income	368,675	2,633,076	1,358,823	1,019,454
Total Revenues	193,664,764	189,722,426	160,514,521	188,430,580
Kentucky Tuition Grants	32,510,491	33,294,343		
College Access Program Grants	61,736,731	60,062,004		
Robert C. Byrd Scholarship	615,974	590,614		
Mary Jo Young	368,236	394,314		
Early Childhood Development	1,378,787	1,173,639		
National Guard Tuition Awards	4,835,577	4,916,400		
Kentucky Education Excellence Scholarships	91,574,068	89,782,202		
Teacher Scholarships	2,371,073	2,855,756		
Osteopathic Medicine Scholarships	1,302,628	866,955		
Work-study	766,261	912,923		
Go Higher Scholarships	266,926	143,415		
Outreach and other activities	1,484,683	1,033,934		
Guarantee operations			4,463,859	4,038,736
Default collection			5,583,869	5,184,650
Lending and related activities			121,287,360	154,732,997
Lender assistance			1,772,621	1,958,410
Borrower assistance			7,125,149	
Other activities			206,342	484,176
Total Expenditures	199,211,435	196,026,499	140,439,200	166,398,969
Change in Net Assets Before Operating Transfers	(5,546,671)	(6,304,073)	20,075,321	22,031,611
Interfund transfer	5,350,551	10,459,799	(5,350,551)	(10,459,799)
Transfer to General Fund		(336,500)		
Transfer to KAPT			(159,286)	(154,552)
Change in Net Assets	\$ (196,120)	\$ 3,819,226	\$ 14,565,484	\$ 11,417,260

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

June 30, 2009

Financial Analysis – Governmental and Proprietary Funds

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

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's government-wide performance for the fiscal year ended June 30, 2009. Please read it in conjunction with the Authority/Corporation's financial statements and notes to the financial statements, which follow this section.

Financial Overview

- The Authority/Corporation's proprietary fund total assets increased approximately \$405 million (14.26%), from \$2.433 billion to \$2.838 billion. This increase was caused primarily by the \$360.4 million increase in loans, plus \$59.7 million of additional cash and investments and a \$3 million increase in long-term receivables, net of \$18.1 decrease in Loans held for sale, fixed assets and deferred expenses.
- The Authority/Corporation's proprietary fund liabilities increased \$390.4 million (14.42%), from \$2.315 billion to \$2.706 billion. The increase in liabilities resulted primarily from \$461.2 increase in the USDE Participation Facility Payable, \$50 million increase in private placement bonds, and \$6.9 million increase in payable to USDE, net of a \$52.8 million decrease in the short-term lines of credit, and a \$74.9 million decrease in long-term debt outstanding.
- The Authority/Corporation's proprietary fund revenues decreased \$27.9 million (16.35%), the majority of which related to loan interest revenue (decreased \$37.5 million) and interest on investments (decreased \$5 million), net of increases of \$10.9 million income from early retirement of debt (which did not exist in prior year), and \$3.4 million from default collections.
- The Authority/Corporation's total proprietary fund expenditures decreased \$25.9 million (18.5%), resulting primarily from a \$40 million decrease in interest expense on bonds, \$3.4 million decrease in borrower benefits, \$3.4 million decrease in administrative expenses, net of \$7.1 million increase in default fee expense, \$11.2 million increase in arbitrage expense, and \$2.6 million increase in loan loss expense.
- The Authority/Corporation's governmental fund assets and liabilities remained relatively consistent with prior year.

Continued

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

June 30, 2009

- The Authority/Corporation's governmental fund revenues increased \$3.9 million (2.08%), resulting from additional state General Funds for student aid programs, net of reductions in receipts from unclaimed lottery fund.
- The Authority/Corporation's governmental fund expenditures increased \$3.2 million (1.62%), due primarily to increases in the Kentucky Education Excellence Scholarships (\$1.8 million) College Access Program (\$1.7 million), and Outreach activities (\$450,000), net of reductions in Kentucky Tuition Grants (\$783,000)

Statement of Net Assets

Total government fund net assets remained relatively unchanged at \$19 million.

Total proprietary fund net assets increased \$14.6 million (11%), of which \$6.1 million is from loan guarantee operations (compared to \$6.7 million in prior year) , \$8.9 million from default collection operations (compared to \$6.05 in prior year), \$1.0 million from lender assistance activities (compared to \$773,000 from prior year) and \$11.1 million from lending activities (compared to \$8.4 million in prior year), net of \$ 7.1 million loss on borrower assistance activities, and \$5.4 million contributed for student aid administration (\$4.4 million), grants and scholarships (\$1.0 million) and contributed administration of the Plan (\$159,000).

Certain highlights related to the statement of net assets as of June 30, 2009, are as follows:

- The Authority/Corporation purchased \$75.4 million of its outstanding auction rate securities on the secondary market for a discount, resulting in gain on early retirement of debt of \$10.9 million.
- The Authority/Corporation issued a \$50 million private placement bond with the Commonwealth of Kentucky to provide initial liquidity for the 2009 academic year loans.
- The Authority/Corporation placed \$478 million into the ECASLA participation trust and related financing, and borrowed \$474 million via the Federal participation credit facility.
- The Authority/Corporation maintained \$5.185 billion of FFELP guarantees outstanding.
- The Authority/Corporation maintained \$2.516 billion of FFELP loans outstanding.
- The Authority/Corporation maintained \$282.2 million of defaulted loans in its collection portfolio.
- Non-Spendable net assets decreased from \$69.5 million to \$59.6 million.
- Spendable restricted net assets increased from \$0 to \$12.9 million.
- Spendable committed net assets increased from \$48.5 million to \$59.6 million.

Continued

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

June 30, 2009

Statement of Revenues, Expenses, and Changes in Net Assets

In fiscal year 2009, the Authority/Corporation continued to see increases in General Fund appropriations for the Kentucky Education Excellence Scholarship ("KEES") program, College Access Program ("CAP"), and the Kentucky Tuition Grant ("KTG") program, all resulting from planned increases in Kentucky Lottery net revenues. The increases in General Funds supplanted the need for unclaimed lottery funds, resulting in decreased unclaimed lottery funding of \$2.7 million in 2009. As stipulated in the fiscal year 2009-2010 Commonwealth of Kentucky Biennial Budget (Biennial Budget), the Authority/Corporation's lending operation is no longer responsible for funding the Kentucky National Guard Tuition Award ("KNGTA") program, and the Kentucky Work-study ("Work-study") program. In the fiscal year 2009-2010 biennium, the Authority/Corporation's guarantee operation is required to fund a portion of the KNGTA program and the entire Work-study program was funded via state General Funds. Accordingly, transfers to the General fund decreased from \$10.5 million in fiscal year 2008, to \$5.4 million in fiscal year 2009.

In fiscal year 2009, the USDE awarded a \$1.1 million grant; College Access Challenge Grant, to the Authority/Corporation. The grant period runs from August 16, 2008 through August 15, 2009. The Authority/Corporation is required to provide 1/3rd match for this grant, thus outreach expenses increased \$450,000 in the current fiscal year.

Interest income in the propriety fund (on loans and investments) decreased by \$43.5 million compared to prior year. Most of the Authority/Corporation's student loan portfolio earns interest based on quarterly resets of 90-day commercial paper rates. The quarterly average 90-day commercial paper rates for fiscal year 2008 were; 5.39%, 4.92%, 3.24%, 2.75%. The fiscal year 2009 quarterly averages were; 2.87%, 2.58%, .74% and .41%. Also note that while cash and investments at year-end increased from \$126.7 million to \$192.4 million, interest rates on deposits dropped from 70 basis points to zero during the fiscal year.

The decrease in interest income was somewhat offset by a \$10.9 million increase in gain on early retirement of debt. In fiscal year 2009, the Authority/Corporation purchased \$75.4 million of its outstanding auction rate securities in the secondary market, at a discount, and retired the debt.

The decrease in interest revenue was further offset by a \$3.4 million increase in default collection revenue, despite a reduction in direct collection retention rates from 23% to 16%. In fiscal year 2009, the Authority/Corporation collected \$82.4 million, compared to \$68.4 million in fiscal year 2008; a \$14 million increase.

Total proprietary fund expenses decreased \$27.9 million. Interest expense on bonds decreased by \$40 million because of drops in 91-day T-bill rates, LIBOR and SIFMA. As previously noted, of the Authority/Corporation's debt, 15.5% is indexed to 91 day T-bill, 45.2% indexed to LIBOR, and 39.3% is indexed to SIFMA. During the fiscal year 91-day T-bill rates dropped from 1.96% on June 30, 2008, to .198% on June 29, 2009. Three month LIBOR dropped from 2.76% in June 2008, to .51% in June 2009. Note that SIFMA index has strong correlation to 91-day T-bill rates (typically 66% to 70% of the T-bill index).

Continued

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

June 30, 2009

In fiscal year 2008, the Authority/Corporation provided \$6.9 million for "Best In" benefits (loan forgiveness benefits for teachers, nurses and public service attorneys). In fiscal year 2009, the Authority/Corporation processed \$7.6 million of teacher forgiveness benefits (funded by USDE) and the Board of Directors approved an additional \$3.5 million "Best In" benefit loan forgiveness funded by the Authority/Corporation, a \$3.4 million reduction from the prior year.

The Authority/Corporation reduced operating expenses by \$3.4 million in fiscal year 2009 (a 9.53% reduction). The reduction was achieved by maintaining a hiring freeze, renegotiating maintenance contracts, personal service contracts, and insurance contracts, and maintaining closer control over travel, training and supplies expenses.

In fiscal year 2009, the Authority/Corporation's loan guarantee operation started paying the Federal Default Fee (1% of the original loan amount) on behalf of all FFELP borrowers attending a Kentucky school. The Authority/Corporation was concerned that as student loan capital became limited in the summer of 2008, large national FFELP lenders would abandon Kentucky in favor of higher income, states with inherently lower default rates. The default fee payment program proved to be extremely successful, as the Authority/Corporation had to temporarily suspend lending activities in July and August 2008, and lenders such as Sallie Mae and National City Bank picked up that volume; so all Kentucky students could obtain a FFELP loan. This default fee payment program resulted in \$7.1 million of increased costs.

In fiscal year 2008, the Authority/Corporation was able to write-off the remaining balance of arbitrage liability (because of the "Best-In" benefits and "Best Start" provided by the Authority/Corporation). The one-time write down of Arbitrage liability resulted in a one-time contra-expense of \$11.2 million. In fiscal year the Authority/Corporation incurred no additional arbitrage liability or write-off's, because of limited yield on student loan assets and cash and investments, and higher than normal interest rates on debt.

In fiscal year 2009, the Authority/Corporation's cohort default rate increased from 9.2% to 12.7%, resulting in a \$2.6 million increase in loan loss allowance. Loans made prior to October 1, 1993, are 100% insured. Loans made between October 1, 1993 and June 30, 2007, are 100% insured against borrowers' death, disability, or bankruptcy and 98% insured against borrowers' default. Loans made after June 30, 2007, are 100% insured against borrowers' death, disability, or bankruptcy and 97% insured against borrowers' default.

Certain highlights related to the statement of revenues, expenses and changes in net assets for the year ended June 30, 2009, are as follows:

- The lending operation provided \$3.5 million in interest and principal forgiveness benefits (to be written off in fiscal year 2010).
- The loan guarantee operation provided an additional \$7.6 million of Federally-funded interest and principal benefits to teachers.
- The loan servicing operation received \$14.6 million to service loans held by third-parties.
- The loan servicing operation received \$1.5 million of deconversion fees related to a \$4 billion loan deconversion in fiscal year 2009. The remaining \$1.7 billion of loans serviced the Authority/Corporation will be deconverted in September 2009.

Continued

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

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

June 30, 2009

- The lender assistance operation received \$2.8 million to provide loan origination and disbursement services assistance to lenders.
- The defaulted loan collection operation received \$14.5 million in commissions on the \$82.4 million collected on behalf of the USDE
- The lending operation received \$32.1 million of net interest revenue (interest income net of interest and finance expense.)

Condensed Financial Information - Fiduciary Funds

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

	Federal Student Loan Reserve Fund		Agency Fund		Kentucky Affordable Prepaid Tuition		Kentucky Education Savings Plan Trust	
	2009	2008	2009	2008	2009	2008	2009	2008
Net Asset Information								
Capital assets								
Other assets	\$ 33,062,902	\$ 29,070,256	\$ 1,135,085	\$ 1,183,687	\$ 115,189,662	\$ 145,411,786	\$ 94,914,868	\$ 104,414,637
Total Assets	33,062,902	29,070,256	1,135,085	1,183,687	115,189,662	145,411,786	94,914,868	104,414,637
Total Liabilities	23,072,015	20,974,700	1,135,085	1,183,687	174,486,403	181,167,225	63,765	92,799
Net assets invested in capital, net of debt	9,990,887	8,095,556	-	-	(59,296,741)	(35,755,439)	94,851,103	104,321,858
Restricted net assets (deficit)								
Total Net Assets	\$ 9,990,887	\$ 8,095,556	\$ -	\$ -	\$ (59,296,741)	\$ (35,755,439)	\$ 94,851,103	\$ 104,321,858
Changes in Fiduciary Net Asset Information								
Federal reinsurance	\$ 133,808,829	\$ 110,791,847						
Fee revenue	11,182,555	9,829,818						
Contributions					\$ 1,112,205	\$ 1,960,832	\$34,233,673	\$16,734,356
Subscriptions	80,629	492,615			(21,261,961)	(6,401,480)	(14,229,444)	(5,424,332)
Investment revenue (loss)	1,311,543	931,476						
Other income								
Total Additions	146,383,556	122,045,766			(20,149,756)	(4,440,648)	20,004,229	11,310,024
Administrative expenses					658,403	624,659	388,660	
Refunds					938,450	1,169,964		
Trustee expense					175,527	453,777		
Tuition benefits					1,778,452	15,206,067		
Loan claims	142,049,509	117,516,087					29,086,324	7,636,587
Redemptions	2,438,716	1,938,795						
Default aversion								
Other expenses								
Total Deductions	144,488,225	119,454,882			3,550,832	17,454,467	29,474,984	7,636,587
Change in net assets before operating transfer	1,895,331	2,590,874			(23,700,588)	(21,895,115)	(9,470,755)	3,673,437
Operating Transfers								
Transfer to USDE for Recall		(1,151,145)						
Transfer from Agency Operating Fund					159,286			
Transfer from Unclaimed Property Fund								
Change in Net Assets After Operating Transfers	\$ 1,895,331	\$ 1,439,729			\$ (23,541,302)	\$ (21,740,563)	\$ (9,470,755)	\$ 3,673,437

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

June 30, 2009

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, 2009. Please read it in conjunction with the Authority/Corporation's financial statements and notes to the financial statements, which follow this section.

Financial Overview

- Default claims paid increased from \$119 million in fiscal year 2008 to \$144 million in fiscal year 2009 (21% increase).
- The FSLRF paid the U.S. Treasury \$1.15 million in fiscal year 2008, related to guarantee agency mandatory recall included in the 1998 Budget Reduction Act. No such payment was required in fiscal year 2009.
- Default Fee revenue totaled \$9.8 million in fiscal year 2008 and \$11.2 million in fiscal year 2009. Of the \$11.2 million Default Fee Revenue, \$7.1 million was paid by the Authority/Corporation's loan guarantee operations (related to borrowers attending a Kentucky school).
- The Plan's tuition benefits payable decreased \$6.7 million in fiscal year 2009, largely due to payments to Plan participants in fiscal year 2009 and lower than expected tuition increases in fiscal year 2009.
- Interest and investment income in the Plan continued to slide, from a \$6.4 million loss in fiscal year 2008, to a \$21.3 million loss in fiscal year 2009.

Statement of Fiduciary Net Assets (Deficit)

The FSLRF net assets increased \$1.9 million over prior year. Assets increased approximately 13.7% (\$4.0 million), while liabilities increased 23.4% (\$1.9 million). The increase in assets is mostly attributed to the increase in receivables from the USDE of \$2.0 million, and increase in cash of \$2.7 million, net of decreases in other assets (\$700,000). The increase in receivable from the USDE resulted from a substantial increase in claim volume in fiscal year 2009. Overall claims increased from \$138 million in fiscal year 2008 to \$172 million in fiscal year 2009.

Continued

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

June 30, 2009

The increase in liabilities is comprised of the increase in loan loss allowance, increase in payable to the AOF, net of decreases in payables. The loan loss allowance calculation is a standard calculation (created by the USDE) based on current year default claim volume and original principal outstanding. The original principal outstanding increased from \$4.875 billion as of June 30, 2008, to \$5.6 billion as of June 30, 2009. Also, the default claim rate increased from 3.36% as of June 30, 2008, to 3.86% as of June 30, 2009. The payable to AOF increased from \$11.3 million as of June 30, 2008 to \$16.5 million as of June 30, 2009, which resulted from the Authority/Corporation maintaining default collection revenues and default aversion revenues in the FSLRF, net of Default Fees paid by AOF. The remaining change in accounts payable, resulted from reclassification of payables to the USDE to offset receivables from the USDE. In prior fiscal years, these payables and receivables to the USDE were presented "gross".

The Agency Fund serves as a conduit for loan proceeds transacted between lenders and schools. The Authority typically maintains Agency funds for lenders and schools for less than three business days. As of June 30, 2009, the Authority/Corporation maintained \$1.1 million on behalf of lenders and schools, which is a \$100 thousand decrease from the prior year.

The Plan's total assets decreased \$30.2 million. The plan did receive cash from participants of \$4.9 million, of which \$1.1 million represents imputed interest on contracts receivable. The Plan also incurred investment losses of \$21.2 million in fiscal year 2009, and disbursed \$5.2 million in program benefits, refunds to participants, and program expenses.

The Plan liabilities increased \$6.8 million, almost entirely from the increase in tuition benefits payable and related expenses calculated by the actuary. Assumptions related to administrative expenses and investment expense remained consistent with prior year. The change in tuition increase assumptions are as follows:

- 2009-2010 academic year – actual tuition increase was only 3% for the value plan and 5% for the standard plan; compared to the actuarial assumption of 10%.
- 2010-2011 academic year – tuition increase assumption was lowered from 9.0% to 7%.
- 2011 – thereafter academic years – tuition increase assumption increased from 7% to 7.25%

Due to an inherent compounding effect, the Plan deficit was projected to increase by \$2.77 million in fiscal year 2009 (without any changes in assumptions). Assumption changes related to tuition increases in academic year 2009-10 actually decreased the deficit by \$8.2 million. Note however that the unfavorable investment experience in fiscal year 2009 increased the deficit by \$29.2 million and changes to other assumptions decreased the deficit another \$231,000. Projected investment expense for the life of the program is accrued as a liability and was calculated as 20 basis points on all invested assets (consistent with prior year). Accrued investment expense (\$744,000) was \$600,000 less than prior year. Projected administrative expenses for the life of the program increased to 2.4 million (a \$700,000 increase).

Continued

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

June 30, 2009

The Trust is an Internal Revenue Code 529 plan managed by the Authority and administered on behalf of the Authority by TFI. Trust assets are entirely comprised of cash and pooled investments. Total assets decreased approximately \$9.5 million, due to new subscriptions received (\$34.2 million) net of investment loss (\$14.2 million), net of expenses and redemptions (\$29.5 million). Trust liabilities remained relatively constant during the fiscal year.

Changes in Fiduciary Net Assets

The FSLRF had an increase in fiduciary net assets of approximately \$1.9 million for the year ended June 30, 2009, which was \$500,000 better than the previous fiscal year.

The FSLRF experienced \$34 million of additional claim volume in fiscal year 2009, compared to fiscal year 2008. This additional claim volume resulted in \$8.2 million of claim-related expenses in fiscal year 2009 (\$1.6 million from the increase in loan loss allowance and \$6.6 million of actual reinsurance losses on claims paid). Note that per regulation, the FSLRF incurs a loss on reinsurance of up to 5% for default claims paid.

The Plan recognized an increase in net deficit of \$23.5 million for fiscal year 2009 compared to a \$21.7 million increase in net deficit in the prior year. The results from Plan operations were \$1.8 million less than the prior year.

Overall, the primary reasons for the decrease from prior year performance are as follows.

- Contract income decreased from \$2 million to \$1.1 million.
- Investment loss increased from \$6.4 million to \$21.2 million.
- Tuition benefits expense decreased from \$15.2 million to \$1.8 million.

In fiscal year 2009 and fiscal year 2008, the Plan did not hold an enrollment period and contract income was comprised entirely of interest income on existing contracts and net reduction in allowance for contract cancellations. As total contracts receivable decrease (from \$14.0 million to \$10.2 million), the imputed interest income on these contracts will decrease. Furthermore contract income is recorded net of change in allowance for uncollectible contracts. The increase in investment loss resulted from two factors; (1) the benchmark performed poorly in fiscal year 2009, and (2) the investment advisor underperformed in relation to the benchmark for the Domestic, Equity, and International Policy Securities. The benchmark market returns for the Plan are as follows;

- The Domestic Equity Index (52% of the Plan investments as of June 30, 2008) lost 13.31% in fiscal year 2008, and (55.6% of the Plan investments as of June 30, 2009) lost 26.25%. Related investments for the Plan lost 28.26% in fiscal year 2009, which is worse than the index.
- The International Policy Index (5% of the Plan investments as of June 30, 2008) lost 10.61% in fiscal year 2008, and (4.0% of the Plan investments as of June 30, 2009) lost 31.35% in fiscal year 2009. Related investments for the Plan lost 35.32% in fiscal year 2008, which is worse than the index.

Continued

Management's Discussion and Analysis (Unaudited)—Continued

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

June 30, 2009

- The fixed Income Policy Index (43% of the Plan investments as of June 30, 2008) lost 3.71% in fiscal year 2008, and (40.4% of the Plan investments as of June 30, 2009) gained 1.62% in fiscal year 2009. Related investments for the Plan outperformed the index by gaining 2.13%.

Administrative expenses remained consistent with prior year. Refunds decreased \$200,000 because of the age of accounts in the Plan. Trustee fee expense decreased by \$200,000, due to a renegotiated contract with the investment advisor.

The Trust noted an increase in subscriptions of \$17.5 million over prior year, due to increased marketing efforts by TFI. Investment income in the trust decreased by approximately \$14.9 million (from a loss of \$6.4 million fiscal year 2008 to a \$21.3 million loss in fiscal year 2009), because of poor market conditions in fiscal year 2009. Redemptions increased \$21.4 million due to the overall age of the program.

For additional information, please contact Wendie Beswick at (502) 696-7421.

Combined Government-Wide Statement of Net Assets

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2009

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	\$ 1,118,848	\$ 35,120,540	\$ 36,239,388
Accounts receivable	5,105,669	3,420,621	8,526,290
Deferred front end borrower benefits, net		150,949	150,949
Deferred loan purchase premiums and origination costs, net		4,615,298	4,615,298
Accrued interest income		60,272,449	60,272,449
Investments		133,284	133,284
Teacher and osteopathic medicine scholarship loans	450,000		450,000
Loans, net		685,459,106	685,459,106
Loans held for sale		24,915	24,915
Total Current Assets	6,674,517	789,197,162	795,871,679
Noncurrent:			
Restricted cash and cash equivalents		140,808,385	140,808,385
Restricted from Federal Student Loan Reserve Fund		16,483,210	16,483,210
Investments		11,579,037	11,579,037
Fixed assets, net		10,633,969	10,633,969
Loans, net		1,830,983,381	1,830,983,381
Teacher and osteopathic medicine scholarship loans	4,250,709		4,250,709
Teacher and osteopathic medicine scholarship advances	8,763,608		8,763,608
Deferred front end borrower benefits, net		23,001,399	23,001,399
Deferred bond issuance costs, net		8,754,004	8,754,004
Deferred loan purchase premiums and origination costs, net		7,228,417	7,228,417
Total noncurrent assets	13,014,317	2,049,471,802	2,062,486,119
Total Assets	19,688,834	2,838,668,964	2,858,357,798
LIABILITIES			
Current:			
Accounts payable and accrued expenses	689,212	10,255,084	10,944,296
Accrued interest expense		4,467,662	4,467,662
Deferred deconversion fee income		607,530	607,530
Payable to US Department of Education		6,787,095	6,787,095
Participation facility payable		461,195,087	461,195,087
Line of credit payable		10,850,301	10,850,301
Revenue bonds		50,000,000	50,000,000
Capital lease payable		440,000	440,000
Total Current Liabilities	689,212	544,602,759	545,291,971
Noncurrent:			
Allowance for arbitrage liabilities		679,236	679,236
Capital lease payable		5,730,000	5,730,000
Revenue bonds		2,155,100,000	2,155,100,000
Total Noncurrent Liabilities		2,161,509,236	2,161,509,236
Total Liabilities	689,212	2,706,111,995	2,706,801,207
NET ASSETS			
Non Spendable	18,999,622	59,978,016	78,977,638
Spendable			
Restricted		12,946,259	12,946,259
Committed		59,632,694	59,632,694
Total Net Assets	\$ 18,999,622	\$ 132,556,969	\$ 151,556,591

See Notes to Financial Statements

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

For the Year Ended June 30, 2009

	Program Revenue			Net (Expenses) Revenues and Changes in Net Assets			
	Direct Expenses	Indirect Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Governmental activities:							
Kentucky Tuition Grants	\$ 32,001,827	\$ 508,664		\$ 32,552,111	\$ 41,620		\$ 41,620
College Access Program Grants	61,197,285	538,446		61,145,352	(591,379)		(591,379)
Robert C. Byrd Scholarship	543,356	72,618		545,356	(70,618)		(70,618)
Mary Jo Young Scholarship	259,190	109,046		750	(367,486)		(367,486)
Early Childhood Development Scholarship Program	1,281,665	97,132		1,293,350	(85,437)		(85,437)
National Guard Tuition Awards	4,711,865	123,712		2,453,668	(2,381,909)		(2,381,909)
Kentucky Education Excellence Scholarships	90,789,532	784,536		90,845,784	(728,284)		(728,284)
Teacher Scholarships	1,995,615	375,458		1,871,840	(499,233)		(499,233)
Osteopathic Medicine Scholarships	1,086,391	216,237		909,749	(392,879)		(392,879)
Work-study Benefits	677,659	88,602		850,890	84,629		84,629
Go Higher Grant Program	236,582	30,344		176,489	(90,437)		(90,437)
Outreach and other activities		1,484,683		1,019,425	(465,258)		(465,258)
Total Governmental Activities	194,780,957	4,430,478		193,664,764	(5,546,671)		(5,546,671)
Business-Type Activities							
Loan guarantee operations	4,463,859		\$ 10,589,831			\$ 6,135,972	6,135,972
Default collections	5,583,869		14,555,943			8,972,074	8,972,074
Lender assistance	1,772,621		2,785,858			1,013,237	1,013,237
Borrower assistance	7,125,149					(7,125,149)	(7,125,149)
Lending activities	121,287,360		132,366,547			11,079,187	11,079,187
Other activities	206,342		206,342				
Total Business-Type Activities	140,439,200		160,514,521			20,075,321	20,075,321
Total Primary Government	\$ 335,220,157	\$ 4,430,478	\$ 160,514,521	\$ 193,664,764	(5,546,671)	20,075,321	14,528,650
Transfers:							
Interfund transfer to Government Fund					5,350,551	(5,350,551)	(159,286)
Transfer to KAPT					5,350,551	(5,509,837)	(159,286)
Total Transfers							
Change in Net Assets					(196,120)	14,565,484	14,369,364
Net Assets, July 1, 2008					19,195,742	117,991,485	137,187,227
Net Assets, June 30, 2009					\$ 18,999,622	\$ 132,556,969	\$ 151,556,591

See Notes to Financial Statements

Combined Statement of Net Assets - Proprietary Funds
 Kentucky Higher Education Assistance Authority
 Kentucky Higher Education Student Loan Corporation
 June 30, 2009

ASSETS	Internal Service Fund		Authority Agency Operating Fund		Education Finance Funds		Corporation Operating Fund		Corporation Total		Combined Total Proprietary Funds	
Current:												
Cash and cash equivalents	\$ 3,213,816	\$ 13,504,982	\$ 16,718,598	\$ 18,401,942	\$ 18,401,942	\$ 18,401,942	\$ 18,401,942	\$ 18,401,942	\$ 18,401,942	\$ 18,401,942	\$ 35,120,540	\$ 35,120,540
Investments		133,284	133,284								133,284	133,284
Accounts receivable	5,327	4,941	10,268			\$ 500,509	2,808,844	2,808,844	3,410,353	3,410,353	3,520,621	3,520,621
Accrued interest income		61,658	61,658			51,150,274	9,089,517	9,089,517	60,210,791	60,210,791	60,272,449	60,272,449
Loans, net						215,721,715	489,737,391	150,949	685,459,106	685,459,106	685,459,106	685,459,106
Deferred front end borrower benefits, net									150,949	150,949	150,949	150,949
Deferred loan purchase premiums and origination costs, net								4,615,298	4,615,298	4,615,298	4,615,298	4,615,298
Loans held for sale								24,915	24,915	24,915	24,915	24,915
Total Current Assets	3,218,943	13,704,865	16,923,808	18,401,942	287,372,498	504,900,856	504,900,856	772,273,354	772,273,354	789,197,162	789,197,162	789,197,162
Noncurrent:												
Restricted cash and cash equivalents	1,515,117	1,500,000	1,515,117			139,293,268			139,293,268	139,293,268	140,808,385	140,808,385
Internal receivable (payable) for Gear Up Scholarships	(1,500,000)	15,117										
Internal receivable (payable) for capital projects	(15,117)											
Receivable from Federal Student Loan Reserve Fund		16,483,210	16,483,210								16,483,210	16,483,210
Investments		11,579,037	11,579,037								11,579,037	11,579,037
Fixed assets, net		9,852,707	9,852,707				781,262	781,262	781,262	781,262	10,633,969	10,633,969
Loans, net						1,830,983,381	23,001,399	23,001,399	1,830,983,381	1,830,983,381	1,830,983,381	1,830,983,381
Deferred front end borrower benefits, net						8,657,129			8,657,129	8,657,129	23,001,399	23,001,399
Deferred debt issuances costs, net											8,754,004	8,754,004
Deferred loan purchase premiums and origination costs, net											7,228,417	7,228,417
Total Noncurrent Assets	3,218,943	39,526,946	56,450,754	18,401,942	2,009,163,594	505,692,118	781,262	2,009,944,856	2,009,944,856	2,049,471,802	2,049,471,802	2,049,471,802
Total Assets	3,218,943	17,214,811	73,374,562	36,803,884	2,276,536,092	1,010,592,974	781,262	2,782,218,210	2,782,218,210	2,838,668,964	2,838,668,964	2,838,668,964
LIABILITIES												
Current:												
Accounts payable and accrued expenses	1,179,759	10,572	1,190,331			2,130,175	6,934,578	6,934,578	9,064,753	9,064,753	10,255,084	10,255,084
Interfund payable (receivable)	2,039,184	(2,123,659)	(84,475)			(939,567)	1,024,042	1,024,042	84,475	84,475	607,530	607,530
Deferred revenue		607,530	607,530								4,467,662	4,467,662
Accrued interest expense		49,346	49,346			3,943,820	474,496	474,496	4,418,316	4,418,316	6,787,095	6,787,095
Payable (receivable) to US Department of Education		(1,285,040)	(1,285,040)			5,323,531	2,748,604	2,748,604	8,072,135	8,072,135	10,850,301	10,850,301
Line of credit payable							10,850,301	10,850,301	10,850,301	10,850,301	10,850,301	10,850,301
Participation facility payable							461,195,087	461,195,087	461,195,087	461,195,087	461,195,087	461,195,087
Revenue bonds						50,000,000			50,000,000	50,000,000	50,000,000	50,000,000
Capital lease payable			440,000						440,000,000	440,000,000	440,000,000	440,000,000
Total Current Liabilities	3,218,943	(2,301,251)	917,692	18,401,942	60,457,959	483,227,108	483,227,108	543,685,067	543,685,067	544,602,759	544,602,759	544,602,759
Noncurrent:												
Capital lease payable		5,730,000	5,730,000			679,236			679,236	679,236	5,730,000	5,730,000
Allowance for arbitrage liabilities						2,155,100,000			2,155,100,000	2,155,100,000	2,155,100,000	2,155,100,000
Revenue bonds											2,161,509,236	2,161,509,236
Total Noncurrent Liabilities	3,218,943	5,730,000	5,730,000	18,401,942	2,155,779,236	2,155,779,236	483,227,108	2,639,006,244	2,639,006,244	2,639,006,244	2,639,006,244	2,639,006,244
NET ASSETS	3,218,943	11,483,610	71,923,810	55,205,826	2,215,237,195	527,365,866	302,465,160	2,215,237,195	2,215,237,195	2,277,703,419	2,277,703,419	2,277,703,419
Non Spendable												
Spendable												
Restricted												
Committed												
Total Net Assets	\$ 3,218,943	\$ 11,483,610	\$ 71,923,810	\$ 55,205,826	\$ 2,215,237,195	\$ 527,365,866	\$ 302,465,160	\$ 2,215,237,195	\$ 2,215,237,195	\$ 2,277,703,419	\$ 2,277,703,419	\$ 2,277,703,419

See Notes to Financial Statements

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

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For the Year Ended June 30, 2009

	Internal Service Fund		Authority Agency Operating Fund		Total Proprietary Funds		Education Finance Funds		Corporation Operating Fund		Corporation Total		Combined Total	
Operating Revenues:														
Interest Revenues:														
Interest on loans														
Interest and investment income														
Interest expense on bonds														
Federal consolidation fees														
Total Net Interest Revenues														
Financing Expenses:														
Amortization of front end borrower benefits														
Principal and interest benefits														
Provision for loan losses														
Variable bond credit facility and remarketing fees														
Amortization of origination costs														
Amortization of bond issuance costs														
Interest Revenues Net of Finance Expense														
Other Operating Revenues:														
Servicing fees from external sources														
Servicing Fees from Education Finance Funds														
Deconversion fees														
Debt recovery commission														
Federal fees earned														
Default aversion fee income														
Gain / Loss on sale of loans														
Gain on early retirement of debt														
Late payment penalties														
Other Income														
Total Operating Revenues														
Operating Expenses:														
Administrative expenses														
Default fee expense														
Servicing Fees for Operating Fund														
Depreciation and amortization														
Other expenses														
Total Operating Expenses														
Operating Income (Loss) Before Transfers														
Transfers (To) From Other Funds														
Transfer to Government Fund														
Interfund transfer														
Transfer to / from KHESLC														
Transfer to KAPT														
Increase in Net Assets After Transfers														
Net Assets, July 1, 2008														
Net Assets, June 30, 2009														

See Notes to Financial Statements

Combined Statement of Cash Flows - Proprietary Fund
 Kentucky Higher Education Assistance Authority
 Kentucky Higher Education Student Loan Corporation
 For the Year Ended June 30, 2009

	Authority		Total Proprietary Funds	Corporation		Combined
	Internal Service Fund	Agency Operating Fund		Education Finance Fund	Operating Fund	
Cash Flows from Operating Activities:						
Principal received on loans				\$ 8,320,639	\$ 219,507,585	\$ 219,507,585
Interest received on loans				7,757,371	77,195,669	77,195,669
Special allowance paid	\$ 206,342	\$ 1,509,552	\$ 1,715,894	(6,509,544)	(25,244,714)	(25,244,714)
Servicing fees received, internal sources				11,801,178	1,715,894	1,715,894
Servicing and deconvension fees received, external sources				13,105,363	13,105,363	13,105,363
Debt recovery commission received		14,549,502	14,549,502		14,549,502	14,549,502
Federal fees received		7,474,722	7,474,722		7,474,722	7,474,722
Default aversion fees paid		(3,581,290)	(3,581,290)		(3,581,290)	(3,581,290)
Internal activity-payments to other funds	226,124	(226,124)				
Loans originated, including costs		(10,733,591)	(10,733,591)	(411,227)	(541,316,050)	(541,316,050)
Administrative expenses paid				(247,967,568)	(25,301,406)	(25,301,406)
Credit facility fees paid				(6,112,660)	(3,714,490)	(3,714,490)
Loans purchased				(1,432,183)	(3,714,490)	(3,714,490)
Interfund loan sales and purchases				179,560,828	(1,552,531)	(1,552,531)
Client loan receipts				584,243,227	584,243,227	584,243,227
Loan receipts remitted to clients				(586,766,424)	(586,766,424)	(586,766,424)
Net Cash Provided By (Used In) Operating Activities	432,466	8,982,771	9,425,237	(415,316,907)	(289,843,771)	(280,418,534)
Cash Flows from Noncapital Financing Activities:						
Proceeds from debt issued				113,403,263	163,403,263	163,403,263
Debt principal payments				(166,152,962)	(241,802,962)	(241,802,962)
Proceeds from Participation Facility				474,035,309	474,035,309	474,035,309
Participation Facility payments				(12,840,222)	(12,840,222)	(12,840,222)
Interest on debt				(6,627,368)	(57,941,169)	(57,941,169)
Debt issuance costs				42,856	42,856	42,856
Gain on early retirement of debt		(159,286)	(159,286)		10,901,634	10,901,634
Interfund transfers, net		(5,350,551)	(5,350,551)		(159,286)	(159,286)
Cash requirement		(2,833,246)	(2,833,246)		(5,350,551)	(5,350,551)
Transfers		(2,729,652)	(2,729,652)			
Increase in Federal Student Loan Reserve receivable				3,832,347	2,833,246	2,833,246
Net Cash Provided By (Used In) Noncapital Financing Activities	(11,072,735)	(11,072,735)	(11,072,735)	405,750,367	338,631,955	327,559,220
Cash Flows From Capital and Related Financing Activities						
Interfund transfers, net		139,073	139,073			139,073
Capital expenditures		(127,834)	(127,834)		(195,474)	(323,308)
Bond principal payments		(420,000)	(420,000)			(420,000)
Interest paid on capital lease		(240,130)	(240,130)			(240,130)
Net Cash Used In Capital and Related Financing Activities	(648,891)	(648,891)	(648,891)	(195,474)	(195,474)	(844,365)
Cash Flows From Investing Activities:						
Proceeds from sales/maturities of investments		34,252,668	34,252,668			34,252,668
Proceeds from sale of loans held for sale				48,648,341	48,648,341	48,648,341
Purchases of investments		(36,117,808)	(36,117,808)			(36,117,808)
Acquisition of loans held for sale				(36,816,127)	(36,816,127)	(36,816,127)
Investment income		694,427	694,427	308,654	2,280,193	2,974,620
Gain on sale of loans held for sale				(139,459)	(139,459)	(139,459)
Net Cash Provided By (Used In) Investing Activities	(1,170,713)	(1,170,713)	(1,170,713)	12,001,409	13,972,948	12,802,235
Net increases (Decrease) in Cash and Cash Equivalents	432,466	(3,899,568)	(3,467,102)	2,239,395	62,565,658	59,098,556
Cash and Cash Equivalents, July 1, 2008	4,296,267	17,404,560	21,700,817	16,162,647	95,129,552	116,830,369
Cash and Cash Equivalents, June 30, 2009	\$ 4,728,733	\$ 13,504,992	\$ 18,233,715	\$ 18,401,942	\$ 157,695,210	\$ 175,928,925

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

For the Year Ended June 30, 2009

	Authority		Corporation		Combined	
	Internal Service Fund	Agency Operating Fund	Education Finance Fund	Operating Fund	Corporation Total	Total
Reconciliation of Operating Income to Net Cash Provided By (Used In) Operating Activities						
Operating income (loss)		\$ 8,996,134	\$ 11,546,117	\$ (466,930)	\$ 11,079,187	\$ 20,075,321
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:						
Investment income		(694,427)	(1,971,539)	(308,654)	(2,280,193)	(2,974,620)
Depreciation and amortization		409,605	10,992,227	1,379,960	12,372,187	12,781,782
Gain on early retirement of debt		240,130	(10,901,634)	6,833,316	(10,901,634)	(10,901,634)
Interest expense			49,178,268	(6,245)	56,011,564	56,251,714
Provision for loan losses			4,749,157	139,459	4,742,912	4,742,912
Gain or loss on sale of loans			(45,185,196)	(2,215,496)	139,459	139,459
Borrower interest converted to principal			366,131	3,707	(47,400,692)	(47,400,692)
Loan forgiveness				369,838	369,838	369,838
Gain or loss on equipment disposal				76,870	76,870	76,870
(Increases) decreases in assets:						
Accounts receivables	\$ 204,559	8,734	189,554	(302,856)	(113,292)	100,001
Receivable from the USDE		(179,897)	10,185,824	2,660,469	12,846,293	12,666,396
Accrued interest receivable		21,197	(884,340)	(6,606,307)	(7,480,647)	(7,480,647)
Principal received on loans			211,186,946	8,320,639	219,507,585	219,507,585
Loans purchased, including premiums			(1,432,163)	(120,348)	(1,552,531)	(1,552,531)
Loans originated, including costs			(293,348,482)	(247,967,568)	(541,316,050)	(541,316,050)
Interfund loan sales and purchases			179,580,828	(179,580,828)		
Increases (decreases) in liabilities:						
Accounts payable and accrued expenses	(318,228)	(5,275)	926,240	3,255,132	4,320,069	3,996,566
Deferred deconvension fee income	546,135	607,530	411,227	(411,227)	(138,697)	607,530
Interfund receivable/payable		(407,438)				
Accrued interest payable		(3,522)				(3,522)
Allowance for arbitrage liabilities			(116,019)		(116,019)	(116,019)
Net Cash Provided By (Used In) Operating Activities	\$ 432,466	\$ 8,992,771	\$ 125,473,136	\$ (415,316,907)	\$ (289,843,771)	\$ (280,418,534)

Balance Sheet - Governmental Fund

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2009

ASSETS	<u>Governmental Fund</u> <u>Student Aid</u>
Current:	
Cash and cash equivalents	\$ 1,118,848
Accounts receivable	5,105,669
Teacher and osteopathic medicine scholarship loans	<u>450,000</u>
Total Current Assets	<u>6,674,517</u>
Teacher and osteopathic medicine scholarship loans, net of allowance of \$3,300,000	4,250,709
Teacher and osteopathic medicine scholarship advances	<u>8,763,608</u>
Total Noncurrent Assets	<u>13,014,317</u>
Total Assets	<u>\$ 19,688,834</u>
LIABILITIES	
Current - Accounts payable	\$ 689,212
NET ASSETS	
Fund Balance - Restricted for program benefits	<u>18,999,622</u>
Total Liabilities and Fund Balance	<u>\$ 19,688,834</u>

See Notes to Financial Statements

Statement of Revenues, Expenditures and Changes
in Fund Balance/Net Assets - Government Fund

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

For the Year Ended June 30, 2009

	Governmental Fund Student Aid
Revenues:	
Interest and investment income fund	\$ 153,727
Tobacco Settlement revenue	1,150,000
Unclaimed Lottery Revenue	8,602,800
State General Fund revenue	180,985,962
Federal funds revenue	2,403,600
Other income	368,675
Total Revenues	193,664,764
Expenditures:	
Kentucky Tuition Grants	32,510,491
College Access Program Grants	61,736,731
Byrd Scholarship	615,974
Mary J Young Scholarship	368,236
Early Childhood Development Scholarships	1,378,787
National Guard Tuition Awards	4,835,577
Kentucky Education Excellence Scholarships	91,574,068
Teacher Scholarships	2,371,073
Osteopathic Medicine Scholarships	1,302,628
Work Study Program	766,261
Go Higher	266,926
Outreach and other activities	1,484,683
Total Expenditures	199,211,435
Excess of Expenditures over Revenues	(5,546,671)
Other Financing Sources and Uses, Including Transfers	
Transfers from Authority Agency Operating Fund	5,350,551
Total Other Financing Sources and Uses, Including Transfers	5,350,551
Net Change in Fund Balance	(196,120)
Fund Balance, July 1, 2008	19,195,742
Fund Balance, June 30, 2009	\$ 18,999,622

See Notes to Financial Statements

Statement of Fiduciary Net Assets (Deficit)

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

June 30, 2009

ASSETS	Federal Student Loan Reserve Fund	Agency Fund	Kentucky Affordable Prepaid Tuition	Kentucky's Educational Savings Plan Trust
Current:				
Cash and cash equivalents	\$ 18,711,076	\$ 1,135,085	\$ 1,858,980	\$ 875
Contributions receivable			2,874,743	
Fees receivable			197,145	
Receivable from US Department of Education	14,318,948			
Investments				94,877,255
Accrued interest income			66	
Other current assets	<u>32,878</u>			<u>36,738</u>
Total Current Assets	<u>33,062,902</u>	<u>1,135,085</u>	<u>4,930,934</u>	<u>94,914,868</u>
Noncurrent:				
Investments			102,935,862	
Contributions receivable			<u>7,322,866</u>	
Total Noncurrent Assets			<u>110,258,728</u>	
	<u>33,062,902</u>	<u>1,135,085</u>	<u>115,189,662</u>	<u>94,914,868</u>
LIABILITIES				
Current:				
Accounts payable	60,632		79,415	32,568
Accrued expenses	6,528,171			31,197
Origination distribution payable		<u>1,135,085</u>		
Total Current Liabilities	<u>6,588,803</u>	<u>1,135,085</u>	<u>79,415</u>	<u>63,765</u>
Noncurrent:				
Payable to Agency Operating Fund	16,483,212			
Tuition benefits payable			<u>174,406,988</u>	
Total Noncurrent Liabilities	<u>16,483,212</u>		<u>174,406,988</u>	
Total Liabilities	<u>23,072,015</u>	<u>1,135,085</u>	<u>174,486,403</u>	<u>63,765</u>
NET ASSETS				
Restricted for program benefits			(59,296,741)	94,851,103
Restricted for other purposes	<u>9,990,887</u>			
Total Net Assets (Deficit)	<u>\$ 9,990,887</u>	<u>\$</u>	<u>\$ (59,296,741)</u>	<u>\$ 94,851,103</u>

See Notes to Financial Statements

Statement of Changes in Fiduciary Net Assets (Deficit)

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

For the Year Ended June 30, 2009

	<u>Federal Student Loan Reserve Fund</u>	<u>Kentucky Affordable Prepaid Tuition</u>	<u>Kentucky's Educational Savings Plan Trust</u>
Additions:			
Federal reinsurance	\$ 133,808,829		
Fee revenue	11,182,555		
Contract income, net		\$ 1,112,205	
Subscriptions			\$ 34,233,673
Investment Revenue:			
Net unrealized loss on investments		(16,001,567)	(17,055,355)
Interest and investment Income	80,629	(5,260,394)	2,825,911
Other income	1,311,543		
Total Investment Revenues	<u>1,392,172</u>	<u>(21,261,961)</u>	<u>(14,229,444)</u>
Total Additions (Loss)	<u>146,383,556</u>	<u>(20,149,756)</u>	<u>20,004,229</u>
Deductions:			
Program benefits:			
Loan claims	142,049,509		
Default aversion fee expense	2,438,716		
Redemptions			29,086,324
Administrative expenses		105,249	388,660
Personnel and professional expenses		553,154	
Refunds		938,450	
Trustee fee expense		175,527	
Tuition benefits expense, net		1,778,452	
Total Deductions	<u>144,488,225</u>	<u>3,550,832</u>	<u>29,474,984</u>
Change in Net Assets Before Transfers	1,895,331	(23,700,588)	(9,470,755)
Transfer from Agency Operating Fund		159,286	
Change in Net Assets	1,895,331	(23,541,302)	(9,470,755)
Net Assets (Deficit), July 1, 2008	<u>8,095,556</u>	<u>(35,755,439)</u>	<u>104,321,858</u>
Net Assets (Deficit), June 30, 2009	<u>\$ 9,990,887</u>	<u>\$ (59,296,741)</u>	<u>\$ 94,851,103</u>

See Notes to Financial Statements

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

June 30, 2009

Note A--Description of Business

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

Guarantee Operations

The Authority/Corporation's loan guarantee operations guarantees 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 student loans under the Guaranteed Student Loan Program (now known as the Federal Family Education Loan Program ("FFELP")). The FFELP, under which the Authority/Corporation operates, was established by Congress and is administered by the U.S. Department of Education (the "USDE") as a means of making loans available to students attending colleges, universities, and vocational institutions. The 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 processing loans submitted for guarantee, issuing loan guarantees, providing collection assistance to lenders for delinquent loans, paying lender claims for loans in default, paying lender claims for death, disability or bankruptcy, and collecting loans on which default claims have been paid. The Authority/Corporation also educates schools and lenders of FFELP requirements and regulatory changes, and encourages lender participation. 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, 1992 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 Higher Education Amendments of 1998 (the 1998 Amendments) that 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 ("FSLRF") and an Agency Operating Fund ("AOF") to account for all FFELP guarantee activities. The FSLRF assets and all earnings on those assets (except investment income on the 1998 Balance Budget Act set-aside funds) are the property of the Federal government.

Continued

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

June 30, 2009

Note A--Description of Business--Continued

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 reimbursements to the lenders for student loan claims and pay the AOF for default aversion fees, Account Maintenance Fee shortfall and any U.S. Treasury recall amounts. Funds used to pay loan claims are mostly replenished from reimbursements from the federal government.

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

Sources of funds to the AOF includes investment income, agency retention on collections of defaulted loans, default aversion fees, account maintenance fee (.06% of original principal balance as September 30), and loan processing and insurance fees (.40% of loans guaranteed and disbursed during the federal fiscal year).

Expenditures from the AOF include personnel, professional and other administrative expenses directly related to the loan program operations. The AOF transfers funds to the Governmental Fund to pay administration costs for twelve student aid programs and outreach activities, and direct benefits for the Mary Jo Young Scholarship program, and National Guard Tuition Award program. The AOF also transfers funds to the Plan to pay some of the administration costs. Both the FSLRF and AOF are subject to federal oversight.

Lending Operations

The Authority/Corporation's lending organization 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 Authority/Corporation is authorized to finance loans for students attending eligible post-secondary institutions, service and collect education loans, and issue bonds and notes not to exceed \$5 billion in order to carry out its corporate powers and duties. The Authority/Corporation's education finance, servicing and collection activities include: (i) the origination and secondary market acquisition of education loans originated pursuant to the FFELP; (ii) the financing of FFELP Loans; (iii) the servicing of FFELP Loans and of other education loans; and (iv) the collection of FFELP Loans and other education loans for other holders on a commission or cost reimbursement basis. The 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").

Continued

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

June 30, 2009

Note A--Description of Business--Continued

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

The Authority/Corporation's General Bond Resolutions ("GBR"s) 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.

As of June 30, 2009 the Authority/Corporation serviced approximately \$2.516 billion outstanding principal amount of FFELP Loans. \$2.046 billion loans were pledged pursuant to the 1983 GBR, the 1997 GBR, the 2004 GBR and the 2008 GBR. The remaining \$470 million loans were pledged against the Participation Facility Payable to the USDE and the line of credit agreements. Also, the Authority/Corporation services approximately \$1.7 billion of FFELP Loans and other education loans on behalf of other holders, including holders with national lending operations. The majority of such education loans are being 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 loans, the Authority/Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. The Authority/Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Authority/Corporation financings.

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

Tuition Savings Plan

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

An individual participating in the Trust establishes an Account in the name of a beneficiary. Contributions can be made among four investment options: the managed Allocation Option, two 100% Equity Options, and the Guaranteed Option.

Continued

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

June 30, 2009

Note A--Description of Business--Continued

Contributions in the Managed Allocation Option are allocated among six age bands, based on the age of the beneficiary. Prior to January 17, 2004, there were eleven age bands. Each age band invests in varying percentages in the Institutional Class of the International Equity, Growth Equity, Growth & Income, Inflation-Linked Bond, Equity Index, Small-Cap Blend Index, Bond, Large-Cap Value Index, Real Estate Securities, and Money Market Funds of the TIAA-CREF Institutional Mutual Funds.

The 100% Equity Options invests in varying percentages in the Institutional Class of the International Equity and Growth & Income Funds of the TIAA-CREF Institutional Mutual Funds.

The Guaranteed option is contractually obligated to pay a minimum rate of return of 3%.

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

Prepaid Tuition Plan

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

On July 1, 2005, governance of the Plan permanently transferred to the Authority/Corporation. The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan investment strategy is to earn rates of return that exceed anticipated tuition inflation rates so that the Plan is able to meet its obligation to pay benefits at future tuition rates. The Plan offered enrollment periods in fiscal years 2002, 2003 and 2005, for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax advantages to purchasers. There have been no enrollment periods since fiscal year 2005 as the plan currently maintains an accumulated net deficit of \$59.3 million.

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

Continued

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

June 30, 2009

Note A--Description of Business--Continued

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

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

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

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

As of June 30, 2009, the Plan maintained a present-value fund deficit of \$59.5 million. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2016, and the Commonwealth will be required to transfer assets from the unclaimed property fund. Over the remaining estimated life of the program, through fiscal year 2027, actuarial estimates show total the Commonwealth will need to transfer approximately \$135 million from the unclaimed property fund. As of June 30, 2009, the Commonwealth's unclaimed property fund has approximately \$330 million.

Student Aid Programs

The Authority/Corporation has administrative responsibilities related to twelve student aid programs in the Commonwealth of Kentucky. The Authority/Corporation administers the Kentucky Educational Excellence Scholarship program, College Access program, Kentucky Tuition Grants program, Teacher Scholarship program, Osteopathic Medicine Scholarship program, Work Study program, Go Higher Scholarship program and the Pharmacy School Scholarship program. The Authority/Corporation has financial responsibilities over the Robert C. Byrd Scholarship program, the Mary Jo Young Scholarship program, the Early Childhood Development Scholarship program and the Kentucky National Guard Tuition program. Direct benefits for grant, scholarship and work-study programs are funded by appropriations from the Kentucky General Assembly, grants from the USDE, transfers from the Authority/Corporation, allocation of revenues from the Kentucky Lottery Corporation, Coal Severance Tax and Tobacco Settlement funds.

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

June 30, 2009

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 Analysis - for State and Local Governments* as amended by GASB No. 37 and modified by GASB No. 38, *Certain Financial Statement Disclosures*, (collectively GASB 34). The Authority/Corporation's basic financial statements are prepared in accordance with GASB 34 and are comprised of three components: 1) government-wide financial statements; 2) fund financial statements, and 3) notes to the financial statements. The government-wide financial statements are comprised of a statement of net assets and a statement of activities. Prepared using the economic resources measurement focus and the accrual basis of accounting, these statements reflect all of the assets, liabilities, revenues, expenses, gains and losses of the combined Authority/Corporation's governmental and business-type activities.

The Authority/Corporation's governmental activities reflect the activities of administering the various student grant, scholarship, advance/loan programs and work-study programs for the Commonwealth of Kentucky and the U.S. Department of Education.

The Authority/Corporation's business-type activities include the activities of administering loan guarantee, default collection, lender assistance, lending and related activities, 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.

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

The Authority/Corporation's combined fund financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to state government entities, which provides 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 work-study program for the Commonwealth of Kentucky and U.S. Department of Education.

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

Continued

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

June 30, 2009

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

The Authority/Corporation's fiduciary funds include the FSLRF, which is used to account for assets, liabilities, revenues, and expenses administered on behalf of the federal government as noted above.

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

Investments - Investments for all funds consist primarily of securities of the federal government or its agencies, commercial paper and 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.

To achieve an actuarially determined target rate of gross return of 7.76%, Plan investments shall be held in approximately the following composition:

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

Continued

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

June 30, 2009

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

- 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.

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.

Fixed Assets, Net--Fixed assets are stated at cost, less accumulated depreciation. Fixed assets are depreciated beginning when the assets is placed in service and continues over the estimated useful lives of the respective asset using the straight-line method. Net interest cost incurred during the construction period of significant proprietary fund assets is capitalized as part of the respective asset cost.

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

Continued

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

June 30, 2009

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

Allowance for Uncollectible Loans - As discussed in Note A, most of the FFELP loans held by the Authority/Corporation are insured by guarantee agencies and the USDE. Management of the Authority/Corporation believes that the all respective guarantee agencies and the USDE will be able to honor all loan claims submitted. However, the Authority/Corporation records a provision for loan losses based upon its expected default claims with respect to 98% and 97% insured loans and for loans with certain loan servicing violations. The allowance for loan losses on FFELP loans funded through normal operations was \$5,241,732 for loan principal and \$368,060 for accrued interest as of June 30, 2009. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2009, the allowance for third party servicing loan losses for loans that have been purchased was \$1,870,210 for loan principal and \$461,463 for accrued interest.

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

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

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

Loans Held for Sale - The Authority/Corporation capitalizes all costs associated with the acquisition of loans held for sale, net of interest income.

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

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

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 Internal Revenue Code Section 529 education savings plans. As such, they are not subject to federal or state income taxes.

Continued

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

June 30, 2009

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

Statement of Cash Flows - In the statements of cash flows, the Authority/Corporation considers cash and cash equivalents to include highly liquid investments, which mature within one month of purchase.

Subsequent Events - In preparing these combined financial statements, the Authority/Corporation has evaluated events and transactions for potential recognition or disclosure through September 30, 2009, the date the financial statements were available to be issued.

Use of Estimates - The preparation of combined financial statements in conformity with Generally Accepted Accounting Principles ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

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

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

Program-specific operating grant and contributions include revenues from mandatory and voluntary nonexchange transactions with other governments and organizations that are restricted for use in a particular program. Program-specific operating grants and contributions 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 year is charged to participants based on outstanding balance.

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

Continued

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

June 30, 2009

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

Indirect Cost - Indirect costs are allocated amount 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.

Non-Spendable Net Assets - Non-spendable net-assets are comprised on non-liquid net assets that are not available for use in operations. Non-spendable net assets include deferred expenses and certain long-term receivables.

Restricted Spendable Net Assets - Restricted spendable net assets are comprised of highly liquid and short-term assets with legal or contractual restrictions, thus cannot be used in operations of the Authority/Corporation.

Committed Spendable Net Assets - Committed spendable net assets are comprised of highly liquid and short-term assets that are available for specific board-restricted purposes.

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 deposit and investment policy complies with the underlying bond resolution requirements. In accordance with those bond resolutions, all deposits and investments meet the requirements and approval of bond underwriters and rating agencies. Additionally, such requirements mandate specific classes of investment vehicles including bank time deposits, certificates of deposit, direct obligations of the United States of America (which are unconditionally guaranteed by the United States of America), indebtedness issued by certain federal agencies, collateralized repurchase agreements or investment funds secured by obligations of the United States of America with collateral held by or at the direction of the trustee.

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, 2009, the Authority/Corporation's Proprietary Funds, Governmental Fund and Fiduciary Funds maintained custodial credit risk for cash on deposit as follows:

Continued

Notes to Financial Statements--Continued

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

June 30, 2009

Note C--Cash and Investments--Continued

Of the \$177.4 million of cash maintained in the Proprietary Funds, \$7.7 million was held for guarantee operations and the remaining \$169.7 million was held for lending activities.

	Governmental Fund Bank Balance	Proprietary Fund Bank Balance	Fiduciary Fund Bank Balance
Insured - FDIC		\$ 22,976,622	\$ 6,542,660
Cash deposited with Kentucky State Treasurer	\$ 1,118,848	4,728,733	136,834
Money market securities		<u>149,692,947</u>	
Total	<u>\$ 1,118,848</u>	<u>\$ 177,398,302</u>	<u>\$ 6,679,494</u>

As of June 30, 2009, all Proprietary Funds investments were registered in the Authority/Corporation's name and maintained by an external trustee. The investment balances as of June 30, 2009 are summarized as follows:

	Fair Value	Weighted Average Maturity
Corporate Bonds	\$ 5,572,525	7.43
U.S. Treasury and government agency securities	3,904,645	2.16
Collateralized Mortgage Obligations	<u>2,235,151</u>	11.06
	<u>\$ 11,712,321</u>	

All of the \$11.7 million of investments maintained in the Proprietary Funds was held for guarantee operations.

As of June 30, 2009, the investment portfolio maintained by the Trust (\$94,877,255) was comprised entirely of TIAA mutual funds.

The investment portfolio maintained by the FSLRF was entirely comprised of money market securities (\$15,262,367) held in a trust by Bank of New York.

Plan investments of \$102,935,862 were comprised entirely of money market securities held by State Street Global Advisors.

Continued

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

June 30, 2009

Note C--Cash and Investments--Continued

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

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

Credit Risk - The Authority/Corporation's investment policy limits the credit risk for securities. Securities must have a credit rating of BBB by a nationally recognized credit rating agency. Money Market Securities must be rated A-1 or P-1 or better at the time of purchase. The investment manager is allowed to hold up to 5% in aggregate market value securities that have been downgraded below BBB, but must maintain an average rating of A for the total portfolio. The following table summarizes the Standard & Poor rating for all corporate bonds held by the Authority/Corporation's Proprietary Funds as of June 30, 2009.

<u>Rating</u>	<u>Fair Value</u>
AAA	\$ 2,542,345
AA	998,350
A	831,900
BAA	497,933
B	93,505
NR	608,492
	<u>\$ 5,572,525</u>

All \$5.6 million of bonds in the Proprietary Funds were held for guarantee operations.

The Plan maintains an investment policy that limits the credit risk for fixed income securities and short-term commercial paper. The Plan may only invest in AAA-rated securities issued by governmental agencies and long-term commercial paper with an investment grade rating, as long as the overall fixed income portfolio maintains a minimum rating of A by Moody's or Standard & Poors. The Plan may only invest in short-term commercial paper, maturing within 9 months, with a minimum rating of A-1 or P-1 Moody's. As previously noted, at June 30, 2009, the Plan only invested in money market securities.

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

June 30, 2009

Note D--Fixed Assets

A summary of fixed assets follows:

	Beginning Balance July 1, 2008	Additions	Disposals	Ending Balance June 30, 2009
Proprietary fund:				
Furniture and equipment	\$ 19,549,573	\$ 323,308	\$ (1,220,647)	\$ 18,652,234
Building	11,986,200			11,986,200
System Development	55,955			55,955
Student Loan				
Servicing System	541,131			541,131
Debt Recovery System	710,509			710,509
Accumulated Depreciation	<u>(20,560,843)</u>	<u>(1,894,994)</u>	<u>1,143,778</u>	<u>(21,312,059)</u>
	<u>\$ 12,282,525</u>	<u>\$ (1,571,687)</u>	<u>\$ (76,869)</u>	<u>\$ 10,633,969</u>
Fiduciary Fund:				
Furniture and Equipment	\$ 593,568			\$ 593,568
Accumulated Depreciation	<u>(593,568)</u>			<u>(593,568)</u>
	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>

Depreciation expense totaled \$1,894,994 for the year ended June 30, 2009, of which \$1,760,587 was allocated to business-type activities, \$127,812 was allocated to governmental activities, and \$6,595 was allocated to the fiduciary activities.

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

Loan guarantee operations	\$ 199,894
Default collections	107,276
Lending and related activities	1,379,641
Lender assistance	69,110
Other	<u>4,666</u>
	<u>\$ 1,760,587</u>

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

June 30, 2009

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

Pursuant to the 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, 2009, the outstanding balance of aggregate insured student loans was approximately \$5.185 billion.

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

The Authority/Corporation's annual default claims rate is within the 5%, which allows for reimbursement rates at the highest level. Due to the reduction of the federal reimbursement rate for loans made subsequent to October 1, 1993, the Authority/Corporation has recorded an allowance of \$6.5 million at June 30, 2009 for losses on federal reinsurance.

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

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

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

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

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

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

Continued

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

June 30, 2009

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

Account Maintenance Fees ("AMF") - The 1998 Amendments established an account maintenance fee based on .06% of the original principal amount of outstanding loans as of September 30. AMF is paid to the Authority/Corporation on a quarterly basis by the federal government.

Loan Processing and Issuance Fees ("LPIF") - The 1998 Amendments established a loan processing and issuance fee. The LPIF payments are based on the net guarantee amount, less cancellations, multiplied by .40%.

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 is recorded monthly and is recognized as a deduction in the FSLRF and as revenue in the AOF.

Note F--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 bear interest at fixed rates, which vary from 5.00% to 5.30% and have a final maturity date of May 1, 2020. The refunding 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 lease is for an initial two-year term ending June 30, 2002, with the right to renew for nine additional two-year renewal periods.

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

Continued

Notes to Financial Statements--Continued

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

June 30, 2009

Note F--Capital Lease Payable--Continued

The lease payments are equal to the debt service required by the bond indenture. In connection with the agreements, the Commonwealth of Kentucky General Assembly appropriated sufficient spending authorization to the Authority/Corporation to pay the lease payments required for the initial two-year term. The Authority/Corporation renewed the lease for the biennium ending June 30, 2010.

A summary of the activity for the bond issues for the year ended June 30, 2009 is as follows:

	<u>June 30, 2008</u>	<u>Additions</u>	<u>Payments</u>	<u>June 30, 2009</u>
Bond Payable	\$ 6,590,000	\$ -	\$ 420,000	\$ 6,170,000

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

Year Ending June 30,	<u>Principal</u>	<u>Interest</u>
2010	\$ 440,000	\$ 302,659
2011	465,000	279,799
2012	480,000	264,105
2013	500,000	244,905
2014	525,000	219,905
 Five Years Ending June 30,		
2015 - 2019	\$ 3,050,000	\$ 667,877
2020	710,000	37,275
	<u>\$ 6,170,000</u>	<u>\$ 2,016,525</u>

Note G--Loans (Lending and Servicing Operations)

The Authority/Corporation originates, purchases and holds various types of student loans as described in Note A. The terms of these loans, which vary on an individual basis depending upon loan type and the date the loan was originated, generally provide for repayment in monthly installments of principal and interest over a period of up to thirty years for consolidation loans and generally up to ten years for other loans. The repayment period begins after a grace period of six months following graduation or loss of qualified student status for the Subsidized and Unsubsidized Stafford loans. The repayment period for Consolidation, SLS and PLUS loans begins within 60 days

Continued

Notes to Financial Statements--Continued

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

June 30, 2009

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

from the date the loan is fully disbursed. Statutory interest rates on student loans ranged from 2.875% to 10% for the fiscal year ended June 30, 2009 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 a specified number of consecutive on-time payments.

Loans consist of the following at June 30, 2009:

Stafford - Subsidized	\$ 912,943,244
Stafford - Unsubsidized	878,125,034
PLUS/SLS	88,504,074
Consolidation	642,407,302
Other	<u>1,574,775</u>
 Total gross loans	 2,523,554,429
Allowance for loan losses	<u>(7,111,942)</u>
 Net loans	 2,516,442,487
 Deferred front end borrower benefits, net of accumulated amortization of \$34,197,796	 23,152,348
Deferred lender origination costs, net of accumulated amortization of \$15,293,520	 <u>11,843,715</u>
 Net loans and deferred origination costs	 <u>\$ 2,551,438,550</u>

All principal and accrued interest on FFELP student loans is insured against borrower death, disability, bankruptcy or default, as long as the Authority/Corporation performs all required loan servicing due diligence activities. As of June 30, 2009, \$2,911,101 of student loans were no longer insured due to violations of due diligence requirements.

Borrowers are required to pay certain origination fees to the USDE, based on a percentage of the gross loan amount. These origination fees are typically withheld from the loan proceeds provided to the borrower and remitted to the USDE on a quarterly basis. Lenders may choose to pay a portion or all of the origination fees on behalf of the borrower, and therefore would send the borrower an increased amount of loan proceeds, but would still be required to remit the full amount of origination fees to the USDE. All origination fees paid on behalf of the borrower are capitalized as deferred origination costs and amortized over the life of the loan.

Continued

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

June 30, 2009

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

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

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

Note H--Loans Held for Sale

The Authority/Corporation entered into loan purchase and management agreements with the Alabama Higher Education Loan Corporation ("AHELC") on February 28, 2006. These agreements detail the long-term arrangement for the Authority/Corporation to originate, market, administer and sell to AHELC, loans made to Alabama students.

The Authority/Corporation sells student loans to AHELC any date mutually agreed on by both parties pursuant to the terms of the loan purchase agreement. During the year, the Corporation sold loans with a cost of \$48,508,881 for \$48,648,340, resulting in a loss of \$139,459. As of June 30, 2009, the Authority/Corporation maintained loans held for sale to AHELC with a cost of \$24,915. Note however that the Authority/Corporation originated 14,371 loans totaling \$50,341,685, on behalf of AHELC in fiscal year 2009, which were placed in the ECASLA Trust and funded by the Participation credit facility payable to the USDE.

The Authority/Corporation anticipates Putting all of these loans in October 2009, which will result in deconversion fee income of \$1,077,825. Accordingly, the Authority/Corporation anticipates a profit on fiscal year 2009 AHELC activities of \$938,366.

Note I--Special Allowance

The USDE makes a Special Allowance Payment ("SAP") to the Authority/Corporation after the end of each quarter representing supplemental interest on outstanding insured loans. Certain FFELP loans disbursed during the period from January 1, 2000 through June 30, 2009 receive SAP at a rate based upon the average of the bond equivalent rates of the 3-month commercial paper rate as reported by the U.S. Federal Reserve. Other eligible loans receive SAP based on the 91-day Treasury bill rates. Effective October 1, 2006, certain other loans financed through bonds dated prior to October 1, 1993 stopped receiving a 9.5% minimum rate of return and instead began receiving the aforementioned standard SAP.

Notes to Financial Statements--Continued

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

June 30, 2009

Note J--Principal and Interest Forgiveness

During fiscal year 2009, the Authority/Corporation forgave \$7,623,467 in loan principal and accrued interest for teachers, funded by the USDE. The Authority/Corporation's Board of Directors approved \$3.5 million of additional loan forgiveness for teachers, nurses and public service attorneys who were employed in the Commonwealth. The Commonwealth of Kentucky also provided General Funds of \$1,340,500 for additional write-offs of loans for teachers. The Authority/Corporation will record the loan forgiveness transactions in September 2009.

Note K--Revenue Bonds

The balance of revenue bonds at June 30, 2009 and the related activity for the year ended June 30, 2009 is as follows:

<u>Series</u>	<u>Scheduled Maturity</u>	<u>Interest Rate</u>	<u>Beginning Balance July 1, 2008</u>	<u>Bond Maturities & Refundings</u>	<u>New Issues</u>	<u>Ending Balance June 30, 2009</u>
<u>1983 General Bond Resolution</u>						
1991 E	* December 1, 2011	Weekly	\$ 100,000	\$ (100,000)		
1996 A	* June 1, 2026	Weekly	150,000	(150,000)		
2008A	November 15, 2009	Quarterly			\$ 50,000,000	\$ 50,000,000
<u>1997 General Bond</u>						
1997 A-1	May 1, 2027	Every 35 days	45,250,000			45,250,000
1997 A-2	May 1, 2027	Every 35 days	45,200,000	(300,000)		44,900,000
1997 B	* May 1, 2027	Every 35 days	44,550,000			44,550,000
1998 A-1	May 1, 2028	Every 28 days	36,400,000			36,400,000
1998 A-2	May 1, 2028	Every 28 days	36,400,000			36,400,000
1998 B	* May 1, 2028	Every 35 days	42,200,000	(50,000)		42,150,000
1999 A	May 1, 2029	Every 28 days	51,350,000			51,350,000
1999 B	* May 1, 2029	Every 35 days	23,650,000			23,650,000
2000 A-1	May 1, 2030	Every 28 days	42,100,000	(100,000)		42,000,000
2000 A-2	May 1, 2030	Every 28 days	42,100,000			42,100,000
2000 A-3	May 1, 2030	Every 35 days	42,050,000	(1,100,000)		40,950,000
2000 B	* May 1, 2030	Every 35 days	23,750,000			23,750,000
2001 A-1	May 1, 2031	Every 35 days	59,850,000	(6,750,000)		53,100,000
2001 A-2	May 1, 2031	Every 35 days	59,850,000	(12,500,000)		47,350,000
2001 B	* May 1, 2031	Every 35 days	30,300,000			30,300,000
2002 A-1	May 1, 2032	Every 28 days	55,450,000	(8,550,000)		46,900,000
2002 A-2	May 1, 2032	Every 35 days	55,450,000	(15,000,000)		40,450,000
2002 A-3	* May 1, 2032	Every 35 days	39,100,000			39,100,000
2003 A-1	* May 1, 2033	Every 35 days	63,700,000			63,700,000
2003 A-2	* May 1, 2033	Every 35 days	16,950,000			16,950,000

Continued

Notes to Financial Statements--Continued

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

June 30, 2009

Note K--Revenue Bonds--Continued

<u>Series</u>	<u>Scheduled Maturity</u>	<u>Interest Rate</u>	<u>Beginning Balance July 1, 2008</u>	<u>Bond Maturities & Refundings</u>	<u>New Issues</u>	<u>Ending Balance June 30, 2009</u>
2004 General Bond Resolution						
2004 A-2 *	June 1, 2034	Every 35 days	51,250,000			51,250,000
2004 A-3 *	June 1, 2034	Every 35 days	57,600,000			57,600,000
2004 A-4 *	June 1, 2034	Every 35 days	57,600,000	(7,000,000)		50,600,000
2004 A-5	June 1, 2034	Every 28 days	72,400,000	(1,850,000)		70,550,000
2004 A-6	June 1, 2034	Every 28 days	75,000,000			75,000,000
2004 B-1 *	June 1, 2034	Every 35 days	11,000,000			11,000,000
2005 A-1 *	June 1, 2035	Every 35 days	80,000,000	(7,750,000)		72,250,000
2005 A-2	June 1, 2035	Every 28 days	45,000,000			45,000,000
2005 A-3	June 1, 2035	Every 28 days	45,000,000			45,000,000
2005 A-4	June 1, 2035	Every 28 days	70,000,000	(1,100,000)		68,900,000
2005 A-5	June 1, 2035	Every 28 days	50,000,000			50,000,000
2005 A-6	June 1, 2035	Every 28 days	40,000,000			40,000,000
2005 A-7	June 1, 2035	Every 28 days	50,000,000	(100,000)		49,900,000
2005 B-1 *	June 1, 2035	Every 35 days	20,000,000			20,000,000
2006 A-1 *	June 1, 2036	Every 35 days	28,175,000			28,175,000
2006 A-2	June 1, 2036	Every 28 days	42,825,000	(3,800,000)		39,025,000
2006 A-3	June 1, 2036	Every 28 days	100,000,000	(50,000)		99,950,000
2006 A-4	June 1, 2036	Every 28 days	60,000,000			60,000,000
2006 A-5	June 1, 2036	Every 28 days	90,000,000	(9,400,000)		80,600,000
2006 B-1 *	June 1, 2036	Every 35 days	29,000,000			29,000,000
2008 General Bond Resolution						
2008 A-1 *	June 1, 2037	Weekly**	179,525,000			179,525,000
2008 A-2 *	June 1, 2038	Weekly**	83,400,000			83,400,000
2008 A-3	June 1, 2038	Weekly**	37,075,000			37,075,000
			<u>\$2,230,750,000</u>	<u>\$ (75,650,000)</u>	<u>\$ 50,000,000</u>	<u>\$2,205,100,000</u>

*This bond series is tax-exempt.

Continued

Notes to Financial Statements--Continued

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

June 30, 2009

Note K--Revenue Bonds--Continued

Debt service requirements to maturity or redemption date, assuming interest rates on variable rate debt remains at June 30, 2009 levels, are as follows:

	Principal Repayment Amount (Thousands)				
	83 GBR	97 GBR	04 GBR	08 GBR	Total
Year Ending June 30, 2010	\$ 50,000				\$ 50,000
4 Years Ending June 30, 2014					
5 Years Ending June 30, 2019					
5 Years Ending June 30, 2024					
5 Years Ending June 30, 2029		\$ 324,650			324,650
5 Years Ending June 30, 2034		486,650	\$ 316,000		802,650
4 Years Ending June 30, 2038			727,800	\$ 300,000	1,027,800
	<u>\$ 50,000</u>	<u>\$ 811,300</u>	<u>\$ 1,043,800</u>	<u>\$ 300,000</u>	<u>\$ 2,205,100</u>
	Interest Payments Amount (Thousands)				
	83 GBR	97 GBR	04 GBR	08 GBR	Total
Year Ending June 30, 2010	\$ 170	\$ 12,361	\$ 13,834	\$ 1,958	\$ 28,323
Year Ending June 30, 2011		12,361	13,834	1,958	28,153
Year Ending June 30, 2012		12,361	13,834	1,958	28,153
Year Ending June 30, 2013		12,361	13,834	1,958	28,153
Year Ending June 30, 2014		12,361	13,834	1,958	28,153
5 Years Ending June 30, 2019		61,805	69,170	9,790	140,765
5 Years Ending June 30, 2024		61,805	69,170	9,790	140,765
5 Years Ending June 30, 2029		55,925	69,170	9,790	134,885
5 Years Ending June 30, 2034		16,864	68,843	9,790	95,497
4 Years Ending June 30, 2038			13,543	6,582	20,125
	<u>\$ 170</u>	<u>\$ 258,204</u>	<u>\$ 359,066</u>	<u>\$ 55,532</u>	<u>\$ 672,972</u>

All assets of the 1983 General Bond Resolution Fund, the 1997 General Bond Resolution Fund, the 2004 General Bond Resolution Fund and the 2008 General Bond Resolution Fund are pledged for repayment of the specific bond issues under each resolution.

During fiscal year 2009, the Authority/Corporation purchased \$75.4 million of its own auction rate securities at a discount resulting in a \$10.9 million gain on the retirement of debt, which is included on the Statement of Revenues, Expenditures and Changes in Net Assets – Proprietary Funds.

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

June 30, 2009

Note L--Lines of Credit and Other Financing

On December 22, 2006, the Authority/Corporation entered into a line of credit agreement with a commercial bank. The agreement provided for an initial commitment amount to the Authority/Corporation not to exceed an aggregate outstanding principal balance of \$40 million, with a provision where the Authority/Corporation may request an increase in the commitment amount not to exceed \$120 million. On December 18, 2007, the Authority/Corporation increased the commitment on the line of credit to \$120 million, and then by mutual agreement between the Authority/Corporation and the bank on January 2, 2008, the line of credit increased an additional \$50 million to \$170 million. The Authority/Corporation drew down as much as \$162.5 million to originate FFELP loans. On June 26, 2008, the Authority/Corporation used proceeds from the 2008 bond issue to pay \$83.4 million against the line of credit. The outstanding balance of this line of credit was \$63.6 million as of June 30, 2008. On September 30, 2008, the Authority/Corporation made a \$16.6 million principal payment. The Authority/Corporation made final principal payments at the end of January (\$15.7 million), February (\$15.7 million) and March 2009 (\$15.6 million). Therefore, as of June 30, 2009, the Authority/Corporation had no outstanding debt related to this line of credit.

On June 19, 2008, the Authority/Corporation entered into a line of credit agreement with another commercial bank. The agreement provides for a commitment amount not to exceed the lesser of \$45 million or the combined cash and investments maintained by the Authority/Corporation with that the investment management arm of that bank, adjusted for asset class factor. On January 8, 2009, the line of credit agreement was amended to reduce the principal amount thereof from \$45 million to \$30 million. On that same date, the Authority/Corporation entered into a second line of credit agreement with that bank. That agreement provides for a commitment amount not to exceed \$25 million. Advances under this agreement are only allowable to fund the origination or purchase of loans eligible for ECASLA participation or put. As of June 30, 2009, the Authority/Corporation had \$10.9 million outstanding debt related to this line of credit.

On August 27, 2008 the Authority/Corporation received its initial advance from the USDE under the ECASLA participation program. During the fiscal year, the Authority/Corporation received a total of \$474 million from the USDE and repaid \$13 million back to the USDE. Accordingly as of June 30, 2009, the Authority/Corporation maintained \$461 million outstanding on the credit facility payable to the USDE under the ECASLA participation program, which was collateralized by \$460 million of loans and \$1 million of cash equivalents.

Note M--Allowance for Arbitrage Liabilities

Certain of the Authority/Corporation's tax-exempt bond issues are subject to potential arbitrage liabilities under U.S. tax law. Arbitrage liabilities, under current federal income tax law regarding tax-exempt bond issues, consist of three types; (1) yield adjustment payments, (2) forgiveness and (3) arbitrage rebate. At June 30, 2009, the Authority/Corporation is reporting a liability for arbitrage rebate of \$679,236.

Continued

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

June 30, 2009

Note M--Allowance for Arbitrage Liabilities--Continued

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

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

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

In previous fiscal years, the Authority/Corporation included amortization of purchased loan premium as a yield adjustment to student loans in the calculation of arbitrage liability. To more effectively manage potential arbitrage liability in fiscal year 2008, the Authority/Corporation included lender-paid origination fees as a yield adjustment to student loans (similar to the treatment of loan purchase premium).

Arbitrage rebate is applicable to all of the Authority/Corporation's tax-exempt bonds.

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

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

Note N--Credit and Liquidity Facilities and Bond Remarketing

As of July 1, 2008, the 1991 Series E and 1996 Series A Bonds were collateralized with Standby Bond Purchase Agreements.

On July 3, 2008, the Authority/Corporation retired the remaining the \$100,000 of 1991 Series E bonds and on August 20, 2008, the Authority/Corporation defeased the remaining \$150,000 of 1996 Series A bonds. The \$150,000 was paid in full on December 1, 2008.

Continued

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

June 30, 2009

Note N--Credit and Liquidity Facilities and Bond Remarketing--Continued

As of June 30, 2009, the Authority/Corporation has no Standby Bond Purchase Agreements outstanding.

The \$262.9 million of tax-exempt and \$37.1 million of taxable variable rate demand obligation bonds in the 2008 GBR are supported letters of credit from two commercial banks.

The Authority/Corporation pays certain fees with respect to its variable rate bonds to auction agents, broker dealers, market agents, remarketing agents and tender agents for remarketing bonds or conducting auctions of bonds. These arrangements are generally cancelable with prior notice by either party.

Note O--Retirement Plans

The Authority/Corporation provides retirement benefits to all full-time employees through the Kentucky Employees Retirement System ("KERS"). KERS is a multiple-employer, defined benefit plan sponsored by the Commonwealth of Kentucky, which provides retirement, disability and death benefits. The Authority/Corporation contributed 10.01% of gross wages for the year ended June 30, 2009. The employees contributed 5% of their gross wages to the plan for the year ended June 30, 2009. Such rates are intended to provide for normal costs on a current basis, plus an amount equal to the amortization of unfunded past service costs over thirty years, using the level percentage of payroll method. These contribution rates are determined by the Board of Trustees of KERS each biennium. The payroll of employees covered by the retirement plan was \$18,969,160 for the year ended June 30, 2009. Total payroll for the year ended June 30, 2009 was \$19,093,919. KERS participants have fully vested interests after the completion of sixty months of service, twelve months of which are current service. The KERS contribution requirement for the year ended June 30, 2009 was \$2,847,271 which consisted of employer contributions of \$1,898,813 and \$948,458 from employees in 2008. Employer contributions for the years ended June 30, 2008 and 2007 were \$1,778,731 and \$1,623,915, respectively.

Due to a change in the KERS policies, effective July 1, 2010 the Authority/Corporation will be responsible to make payments to KERS for a portion of the unpaid sick leave accumulated by retiring employees. Management is currently reviewing its sick leave policies in order to minimize the Authority/Corporation's obligations to KERS for this unpaid sick leave. As of June 30, 2009, this potential liability cannot be reasonably estimated and therefore it has not been recorded in the accompanying combined financial statements.

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

Continued

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

June 30, 2009

Note O--Retirement Plans--Continued

Until June 30, 1994, TIAA was offered to eligible employees. TIAA was terminated as of June 30, 1994, and all TIAA participants became covered by KERS effective July 1, 1994. In order to provide coverage equivalent with KERS participants to the Authority/Corporation's employees who were former TIAA participants regarding retirees' health insurance premiums, the Authority/Corporation established an allowance for retirees' insurance based on management's projected estimate of future requirements. The portion of retirees' premiums paid by KERS is based on years of service under KERS; the allowance provides for the Authority/Corporation to fund a portion of premiums, which will result in the same coverage for the 4 employees covered. Plan assets and the accrued liability for the postretirement healthcare plan totaled \$105,000 at June 30, 2009.

Note P--Tuition Benefit Payable

The following assumptions developed by management were used in the actuarial valuation of tuition benefits payable as of June 30, 2009. These assumptions are based on historical data for both state and national trends.

Investment Rates--The investment yield assumption is based on estimates of the yields that will be available on the investment portfolio and cash and cash equivalents. Since inception, the gross investment yield assumption has been 7.76% per annum.

Investment Expenses--The investment expense is assumed to be 35 basis points on all invested assets.

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

- The known 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 known 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 known 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 known 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.
- As of June 30, 2007, the known 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.

Continued

Notes to Financial Statements--Continued

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

June 30, 2009

Note P--Tuition Benefit Payable--Continued

- As of June 30, 2008, the known 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.
- As of June 30, 2009, the known 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 increase assumption was adjusted to 7% for the 2010-2011 academic year and 7.25% for each year thereafter

For the period from inception to June 30, 2009, the annualized tuition increase for the highest-priced Kentucky public university, as applicable to the tuition benefits payout rate of the KAPT Standard Plan, which represents 90% of KAPT enrollments, has been 10.6%. 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, 2009, has been 15.5%. For the University of Kentucky, as applicable to the tuition benefits payout rate of the KAPT Premium Plan, the average annualized tuition increase from inception to June 30, 2009 has been 11.5%.

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 Q--Restricted Net Assets

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

- a. **Federal Student Loan Reserve Fund:** Net assets are restricted for certain FFELP activities, primarily the payments of claims.
- b. **Agency Operating Fund:** Net assets are restricted for certain FFELP activities and other student aid activities.
- c. **Education Finance Funds:** Net assets are restricted as required by the 1983, 1997, 2004 and 2008 General Bond Resolutions.
- d. **Student Aid Funds:** The Student Aid net assets are restricted for the Student Aid Programs.
- e. **The Trust:** Net assets are restricted for use by trust participants

Note R--Committed Net Assets

The Authority/Corporation's Board of Directors has committed spendable net assets for specific purposes.

Notes to Financial Statements--Continued

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

June 30, 2009

Note S--Operating Leases

The Authority/Corporation leases office space and equipment under agreements expiring through 2014. The following are the approximate minimum lease commitments under operating leases:

<u>Year Ending June 30</u>	
2010	\$ 1,337,000
2011	773,000
2012	703,000
2013	2,500
2014	2,500

Note T--Commitments and Contingencies

The FSLRF, a fiduciary fund maintained on behalf of the USDE, is contingently liable for loans made by financial institutions that qualify for guaranty. The default ratio for loans guaranteed by the Authority/Corporation's loan guarantee operations is below 5% for the federal fiscal year ending June 30, 2009. As a result, the federal government's reinsurance rate for defaults for the federal fiscal year ending September 30, 2008 is 100% for loans made prior to October 1, 1993, 98% for loans made on or after October 1993 to September 30, 1998, and 95% for loans made after September 30, 1998. In the event of future adverse default experience, the FSLRF could be liable for up to 25% of defaulted loans. At the beginning of each fiscal year, the reinsurance rate returns to baseline (100%, 98% or 95%); management does not expect that all guaranteed loans could default in one year.

While management believes the FSLRF's expected maximum contingent liability is less than 25% of outstanding guaranteed loans, the maximum contingent liability at June 30, 2009 is calculated as follows:

Amount of guaranteed student loans outstanding at lenders	\$ 5,185,607,061
Less minimum federal government share - 75%	<u>3,889,205,296</u>
	<u>\$ 1,296,401,765</u>

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

June 30, 2009

Note U--Office of Inspector General Audit

On May 28, 2009, the Authority/Corporation received the final audit report, which presented the results of the Office of Inspector General's ("OIG") audit titled *Special Allowance Payments to the Kentucky Higher Education Student Loan Corporation for Loans Made or Acquired with Proceeds of Tax-Exempt Obligations*. The audit report lists three findings. The first finding, entitled "*KHESLC Used Ineligible Refunding Obligations to Support Loans Billed Under the 9.5 Percent Floor*", contains a recommendation that the Chief Operating Officer of Federal Student Aid ("FSA") calculate the "improper special allowance", which is estimated to be \$9 million. The Authority/Corporation believes the finding is without merit, and has assessed an extremely low probability of any liability resulting from this finding. The second finding, entitled "*KHESLC Made Billing Errors That Resulted in Improper Payments of Special Allowance*", contains a recommendation for the Authority/Corporation to reimburse the USDE \$18,400. The Authority/Corporation concurs with the second finding and is working with the USDE to return the \$18,400. The third finding, entitled "*KHESLC Billed Under the 9.5 Percent Floor for Loans That Were Not First-Generation or Second-Generation Loans*", contain a recommendation that the Authority/Corporation cease billing 9.5 percent floor on or after the quarter ended December 31, 2006, which the Authority/Corporation did (two years ago). The final report has been sent from OIG to FSA for final determination.

Note V--Subsequent Events

The *Student Aid and Fiscal Responsibility Act of 2009* ("SAFRA") was adopted by the U.S. House of Representatives on September 17, 2009, and is now under consideration by the Senate. SAFRA eliminates all new FFELP loan guarantees and disbursements, effective July 1, 2010, but does provide that designated state not-for-profit loan servicing organizations will service 100,000 direct loan borrowers. Accordingly, if SAFRA passes the Senate and is signed into law by President Obama, the Authority/Corporation will no longer perform loan guarantee, disbursement services or lending activities on loans originated on or after July 1, 2010. The Authority/Corporation will continue to provide guarantee services and loan servicing on the \$2.516 billion of FFELP loans in its portfolio, and expects to receive an additional 100,000 direct loan borrowers in fiscal year 2011.