

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

JUNE 30, 2014

Financial Statements

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

June 30, 2014

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying combined financial statements of the governmental activities, the business-type activities, and each major fund of the Kentucky Higher Education Assistance Authority and the Kentucky Higher Education Student Loan Corporation (the Authority/Corporation), component units of the Commonwealth of Kentucky, as of and for the year ended June 30, 2014, and the related notes to the financial statements which collectively comprise the Authority/Corporation's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Kentucky Education Savings Plan Trust, which statements reflect total assets of \$174,016,252 as of June 30, 2014, and an increase to fiduciary net position of \$21,203,055 for the year ended June 30, 2014. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Kentucky Education Savings Plan Trust, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

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Opinions

In our opinion, based on our audit and the report of other auditors, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, and each major fund of the Authority/Corporation as of June 30, 2014, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 15 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated September 25, 2014, on our consideration of the Authority/Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority/Corporation's internal control over financial reporting and compliance.



Louisville, Kentucky
September 25, 2014

Management's Discussion and Analysis (Unaudited)

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

June 30, 2014

Description of the Business

The Kentucky Higher Education Assistance Authority (the "Authority" or "KHEAA") was established in 1966 as the Commonwealth of Kentucky's agency for improving higher education opportunities. The Authority also guarantees, performs default aversion activities and performs collection activities on eligible student loans. The Kentucky Educational Savings Plan Trust (the "Trust") and the Commonwealth Postsecondary Education Prepaid Trust Fund, Kentucky's Affordable Prepaid Tuition Plan (the "Plan") offer savings and investment opportunities for Kentuckians to save for higher education. The Kentucky Higher Education Student Loan Corporation (the "Corporation" or "KHESLC") makes student loans directly to parents and students as part of the Kentucky Advantage loan programs, purchases and services eligible Federal and Kentucky Advantage student loans and performs collection activities on eligible Federal student loans. 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:

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

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

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

Management's Discussion and Analysis (Unaudited)

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

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

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

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

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

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

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

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

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

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Kentucky Higher Education Assistance Authority
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cost of Kentucky's private colleges and universities and guarantees a return on a participant's investment equal to the tuition inflation rate for the University of Kentucky.

Participants were allowed to elect to spread payments to the Plan over three, five or seven years or until the anticipated year of the student's enrollment in a qualified postsecondary education institution. Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States. If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books, 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 statutorily defined payout value of the contract less benefits received, administrative and cancellation fees. Non-qualified withdrawals are subject to a 10% penalty in accordance with Section 529 of the Internal Revenue Code ("IRC") except in cases where the withdrawal is: (1) made on account of the death or disability of the student; (2) made on account of a scholarship received by a student, or (3) a non-taxable transfer to another account or to another IRC Section 529 program for a different student who is a family member of the original student.

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

As of June 30, 2014, the Plan maintained a present value fund deficit of \$23 million. This represents a \$29.9 million improvement over the previous year's deficit resulting primarily from a \$15.4 million increase related to the aforementioned legislative changes and an \$11.4 million increase related to favorable investment experience. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2023, at which time the liability of the Plan becomes a General Obligation of the Commonwealth of Kentucky. Per KRS 164A.708, once a real liability is expected to accrue, the General Assembly shall appropriate the necessary funds to meet the liability. Over the remaining estimated life of the program, through fiscal year 2028, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$45 million.

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

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

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

Loan Origination and Disbursement – Loan origination and disbursement operations consist of credit underwriting, loan origination, and issuing disbursements directly to schools for the Supplemental Student Loan Program. The Supplemental Student Loan Program is comprised of the Kentucky Advantage Education Loan ("KAEL") and Kentucky Advantage Parent Loan programs ("KAPL") for residents of the Commonwealth of Kentucky and non-residents attending a post-secondary institution or approved program in the Commonwealth of Kentucky, and the Advantage Education Loan and Advantage Parent Loan for non-residents of the Commonwealth of Kentucky.

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

Loan Finance - The Authority/Corporation's loan finance operation is authorized to refinance existing long-term debt and to acquire private supplemental student loans, rehabilitated FFELP loans, and certain other FFELP loans required to be repurchased by the Higher Education Act. The Authority/Corporation may issue bonds and notes not to exceed \$5 billion in order to carry out these corporate powers and duties. The FFELP student loans held by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS"), and Federal Consolidation Loans ("Consolidations"). As of June 30, 2014, the loan finance operation owned approximately \$1.26 billion of student loans.

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

The Authority/Corporation's loan finance operation finances existing FFELP loans with revenue bonds and lines of credit. As of June 30, 2014, the Authority/Corporation maintained six separate General Bond Resolutions ("GBRs") and related Series Resolutions for issues of revenue bonds. The GBRs 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, 2014, the loan finance operation maintained \$1.16 billion of revenue bonds outstanding and \$7.4 million of lines of credit payable.

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

Continued

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Loan Servicing - The loan servicing operation performs servicing and default prevention activities on FFELP and supplemental loans held by the Authority/Corporation's loan finance operation and other lenders. Of the loans serviced, approximately \$1.26 billion in outstanding principal of loans was held by the loan finance operation. Nearly all of these loans were pledged pursuant to the 1997 GBR, the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, and the 2014 Indenture. Approximately \$17 million of FFELP Loans and other education loans were owned by other holders. 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 a proprietary fund of the Authority/Corporation. Student loan remittances and payables to other lenders are also accounted for in a proprietary fund.

Industry Update

The Health Care and Education Reconciliation Act ("HCERA") of 2010 (H.R.4872/Public Law 111-152) was signed into law on March 30, 2010. HCERA eliminated the origination and/or guarantee of FFELP loans, effective July 1, 2010. In accordance with HCERA, the Authority/Corporation continues to provide guarantee services on \$2.6 billion of FFELP loans, continues to own \$1.26 billion of FFELP loans and other education loans, and continues to service an additional \$17 million of FFELP and other education loans. The Authority/Corporation can no longer originate, guarantee or fund any new FFELP loans.

HCERA provides for servicing opportunities for nonprofit organizations to service an initial allocation of 100,000 federal loan borrowers. The Authority/Corporation received their initial allotment of loans in the fall of 2012. The Authority/Corporation is currently partnering with another U.S. Department of Education (USDE) federal loan servicer to service these loans.

USDE currently contracts with Private Collection Agencies ("PCAs") to collect student loans, including defaulted Direct Loans that have been assigned or referred to USDE. In March 2012, the Authority/Corporation contracted with one of the PCAs to collect loans on their behalf. The Authority/Corporation plans to leverage this experience, as well as its experience collecting defaulted FFELP loans, in its pursuit to become one of the PCAs selected by USDE as part of the current PCA Request for Proposal process. In anticipation of this selection process, the Authority/Corporation sought and received state legislative approval from the Commonwealth of Kentucky to create the Asset Resolution Corporation ("ARC") as the entity that would contract with USDE to become a PCA. ARC was created by the Kentucky General Assembly effective July 12, 2012. ARC is attached to KHESLC for administrative and reporting purposes.

A notice was published in the Federal Register on August 14, 2013, inviting guaranty agencies with agreements to participate in FFELP to submit proposals to enter into a Voluntary Flexible Agreement ("VFA") with the Secretary, as authorized by section 428A of the Higher Education Act of 1965, as amended ("HEA"). The invitation requested agencies interested to submit evidence as to their scalability and capacity to assume full responsibility for all or part of the FFELP portfolio of agencies whose agreements with the Secretary have been, or would be, terminated. The Authority/Corporation submitted a letter of interest to the Secretary on September 12, 2013 prior to the September 13, 2013 deadline indicating the Authority/Corporation's willingness to potentially assume responsibility for the FFELP portfolio of other guarantors. The letter of interest does not obligate the Authority/Corporation to assume any such responsibility.

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

Overview of Financial Statements

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

The combined government-wide statement of net position and statement of activities include the Governmental Funds and Proprietary Funds. The combined government-wide financial statements can be found on pages 16 and 17 of this report. The combined fund financial statements can be found on pages 18 through 23 of this report.

Fiduciary funds are used to account for resources held for the benefit of parties outside the Authority/Corporation. Fiduciary funds are not reflected in the combined government-wide financial statements because the resources are not available to support the Authority/Corporation's programs. The fiduciary fund statement of net position (deficit) and changes in fiduciary net position (deficit) can be found on pages 24 and 25 of this report.

The Trust publishes separate financial statements and footnotes.

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

The following is a condensed summary of financial information for the years ended June 30, 2014 and 2013, respectively.

Condensed Financial Information - Governmental Fund and Proprietary Funds

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

	Governmental Fund		Proprietary Funds	
	2014	2013	2014	2013
Net Position Information				
Capital assets	\$	\$	\$ 5,016,462	\$ 4,500,499
Other assets	34,969,975	27,959,655	1,443,294,081	1,544,509,085
Total Assets	<u>34,969,975</u>	<u>27,959,655</u>	<u>1,448,310,543</u>	<u>1,549,009,584</u>
Long-term liabilities			1,162,475,746	1,290,869,840
Other liabilities	240,690	290,899	25,628,069	17,753,430
Deferred gain on debt retirements, net			21,812,809	24,772,621
Total Liabilities and Deferred Inflows of Resources	<u>240,690</u>	<u>290,899</u>	<u>1,209,916,624</u>	<u>1,333,395,891</u>
Invested in capital assets, net of expended debt proceeds			5,016,462	4,500,499
Unrestricted			58,383,649	43,585,902
Restricted, other			88,064,743	93,145,111
Restricted for program benefits	34,729,285	27,668,756		
Restricted for student aid and related activities			86,929,065	74,382,181
Total Net Position	<u>\$ 34,729,285</u>	<u>\$ 27,668,756</u>	<u>\$ 238,393,919</u>	<u>\$ 215,613,693</u>
Activity Information				
Interest and investment income fund	\$ 376,016	\$ 755,271	\$ 769,858	\$ 500,437
Student aid & advancement fund revenue	200,632,313	195,437,075		
Tobacco settlement revenue	1,001,536	1,099,805		
Unclaimed lottery revenue	11,000,000	10,600,000		
Contributions from Agency Operating Fund	3,118,697	2,770,728		
Federal funds revenue	59,795	161,947		
Servicing Fees from external sources			847,298	1,646,074
Servicing Fees from Education Finance Funds			7,530,485	8,600,008
Conversion fees			0	1,000,000
SAFRA revenue			0	203,640
Debt recovery commission			33,858,701	23,916,732
Early retirement of debt			2,304,111	4,718,437
Federal fees earned			1,721,637	1,921,685
Federal grant revenue			293,245	1,802,896
Default aversion fee income			(390,225)	629,785
Interest income on loans			20,929,509	21,760,139
Amortization of deferred gain on debt retirements			10,132,812	18,465,693
Guarantee fee			175,231	195,426
Gain on the sale of loans			364,377	153,234
Late payment penalties			1,210,613	1,546,097
School Services			573,595	137,461
Other income	573,698	1,191,475	235,601	116,533
Total Revenue	<u>216,762,055</u>	<u>212,016,301</u>	<u>80,556,848</u>	<u>87,314,277</u>
Kentucky Tuition Grants	30,358,991	30,074,117		
College Access Program Grants	62,800,437	57,549,144		
Mary J Young Scholarships	530,529	497,020		
Early Childhood Development Scholarships	771,883	906,695		
National Guard Tuition Awards	4,789,286	4,670,292		
Kentucky Education Excellence Scholarships	105,485,835	102,759,512		
Teacher Scholarships	463,133	1,376,372		
Teacher Loan Forgiveness	1,400,000	1,400,000		
Osteopathic Medicine Scholarships	435,639	642,222		
Work Study Benefits	444,455	448,384		
Go Higher Grant Program	239,406	219,042		
Pharmacy Scholarship Program	0	253,800		
Drive the Dream Scholarship	533,704	558,491		
Kentucky Coal County College Completion Scholarship	1,318,796	1,197,828		
John R. Justice Grant	89,101	121,209		
Loan guarantee operations			3,382,216	3,458,272
Default collections			6,470,126	5,275,384
Loan finance and servicing activities			34,216,102	47,120,468
Outreach			2,915,676	3,956,706
Contribution to FSLRF			5,500,000	5,500,000
Student aid administration			2,214,617	1,889,023
Contribution to student aid programs			904,080	881,705
School services			1,917,563	1,921,564
Other activities	40,331	46,498	232,739	(19,850)
Total Expenditures	<u>209,701,526</u>	<u>202,720,626</u>	<u>57,753,119</u>	<u>69,983,272</u>
Net Operating income (loss) before Operating Transfers	<u>7,060,529</u>	<u>9,295,675</u>	<u>22,803,729</u>	<u>17,331,005</u>
Transfer to KAPT (the "Plan")			(23,503)	(24,855)
Change in Net Position	<u>\$ 7,060,529</u>	<u>\$ 9,295,675</u>	<u>\$ 22,780,226</u>	<u>\$ 17,306,150</u>

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

June 30, 2014

Financial Analysis – Governmental and Proprietary Funds

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

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's government-wide performance for the fiscal year ended June 30, 2014. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- The Authority/Corporation's proprietary fund total assets decreased approximately \$101 million (6.5%), from \$1.5 billion to \$1.4 billion. The decrease was caused primarily by an \$82.3 million decrease in loans, a \$2 million decrease in accrued interest income, a \$2.7 million decrease in receivables, and a decrease in cash and investments of \$14 million.
- The Authority/Corporation's proprietary fund liabilities and deferred inflows decreased by \$123.5 million (9%), from \$1.3 billion to \$1.2 billion. The decrease in liabilities resulted primarily from a decrease in bonds payable of \$127.8 million, an increase in line of credit payable of \$7.4 million, a decrease in deferred gain on early retirement of debt of \$2.9 million, and decrease in various payables of \$70,000.
- The Authority/Corporation's proprietary fund revenues decreased \$7 million (8%), from \$87 million to \$80 million. The overall decrease was caused by the net of the following changes: \$9.9 million increase in debt recovery commissions, \$8.3 million decrease in the amortization of deferred gain on debt retirement, \$2.8 million decrease in servicing and conversion fees, \$2.4 million decrease related to early retirement of debt, \$1.5 million decrease in federal grant revenue, \$1.2 million decrease in other guarantor related revenue, and various other decreases of approximately \$623,000.
- The Authority/Corporation's total proprietary fund expenditures decreased \$12 million (17%), due primarily to loan finance and servicing expenses.
- The Authority/Corporation's governmental fund assets increased by \$7 million (25%) resulting primarily from increase in accounts receivable related to student aid programs of \$5.6 million, an increase in scholarship and advances of \$990,000, and an increase in cash and cash equivalents \$400,000.
- The Authority/Corporation's governmental fund liabilities remained relatively consistent with the prior year.

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Kentucky Higher Education Student Loan Corporation**

June 30, 2014

- The Authority/Corporation's governmental fund revenues increased \$4.7 million (2.2%), resulting from additional state General Funds for student aid programs of \$5.2 million, increases in unclaimed lottery revenue of \$400,000, an increase in the contribution from the Agency Operating Fund of \$348,000 offset by a decrease in investment income of \$379,000, a decrease in federal fund revenue of \$102,000 and a decrease in other income related to prior year student aid refunds of \$618,000.
- The Authority/Corporation's governmental fund expenditures increased \$6.98 million (3.4%) resulting from increases in the Kentucky Educational Excellence Scholarships of \$2.73 million and increases in College Access Program Grants of \$5.25 million offset by a \$1.0 decrease across the remaining programs.

Combined Statement of Net Position – Governmental Fund and Proprietary Funds

Total governmental fund balance increased from \$27.6 million to \$34.7 million. Total proprietary fund net position increased \$22.8 million (10.6%) comprised of a \$27.1 million increase from default collection operations (compared to \$18.5 million in prior year), \$1.4 million decrease from loan guarantee operations (compared to \$530,000 contribution in prior year), \$2.9 million contribution for outreach activities (compared to \$2.2 million contribution in prior year), \$3.1 million contribution for student aid and administration (compared to \$2.8 million in prior year), \$9.7 million gain in loan finance and servicing activities (compared to \$11.6 million gain in prior year), \$5.5 million contribution to the FSLRF (compared to \$5.5 million in prior year), and \$1.3 million contribution for school services (compared to \$1.8 million in prior year). Also, the proprietary fund contributed \$23,503 to administer the Plan.

Certain highlights related to the combined statement of net position as of June 30, 2014, are as follows:

- The Authority/Corporation purchased \$52.95 million of its own auction rate securities on the secondary market for a discount, resulting in other income of \$2.3 million.
- The Authority/Corporation maintained \$2.6 billion of FFELP guarantees outstanding.
- The Authority/Corporation maintained \$1.26 billion of FFELP loans and education loans.
- The Authority/Corporation maintained \$448.9 million of defaulted loans in its collection portfolio.
- Unrestricted net position increased from \$43.6 million to \$58.4 million.
- Net position, restricted other decreased from \$93.1 million to \$88.1 million.
- Net position restricted for student aid and related activities increased from \$74.3 million to \$86.9 million.

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

June 30, 2014

Combined Statement of Revenues, Expenses and Changes in Net Position

In fiscal year 2014, the KEES program was fully funded. In fiscal year 2014, the Authority/Corporation recognized \$293,000 of Federal grant revenue related to the conclusion of the College Access Challenge Grant program "CACG" for the award period ending August 13, 2013. Outreach activities (including CACG activities) are accounted for in a proprietary fund of the Authority/Corporation.

The \$22.8 million increase in proprietary fund net position during FY 2014 was \$5.5 million more than the \$17.3 million increase during FY 2013. The change in the overall growth of net position as compared to the previous year's growth was attributable to an approximate \$7.4 million increase for the Authority and an approximate \$1.9 million decrease for the Corporation. The Authority's \$7.4 million increase was due primarily to increases in revenue of \$8.1 million combined with increases in expenses \$900,000. The reduction in the overall increase for the Corporation resulted primarily from the net of the following changes: a decrease in interest revenues net of financing expenses of \$7.2 million resulting primarily from less amortization of deferred gain on debt retirements, a decrease in other operating revenues of \$5.6 million, and a decrease in total operating expenses and program benefits of \$10.9 million.

Certain other highlights related to the combined statement of revenues, expenses and changes in net position for the year ended June 30, 2014, are as follows:

- The Authority/Corporation provided \$17.2 million for program benefits for citizens of the Commonwealth of Kentucky.
- The defaulted loan collection operation received \$33.6 million in commissions on the \$140 million collected on behalf of the USDE.

Condensed Financial Information - Fiduciary Funds

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

	Federal Student Loan Reserve Fund		Kentucky's Affordable Prepaid Tuition		Kentucky Education Savings Plan Trust	
	<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>2013</u>
Net Position Information						
Other assets	\$ 21,180,654	\$ 20,541,989	\$ 120,379,782	\$ 119,082,448	\$ 174,016,252	\$ 152,762,614
Total Assets	21,180,654	20,541,989	120,379,782	119,082,448	174,016,252	152,762,614
Total Liabilities	<u>10,119,603</u>	<u>12,139,873</u>	<u>143,379,761</u>	<u>171,985,473</u>	<u>285,684</u>	<u>173,569</u>
Restricted net position (deficit)	<u>11,061,051</u>	<u>8,402,116</u>	<u>(22,999,979)</u>	<u>(52,903,025)</u>	<u>173,730,568</u>	<u>152,589,045</u>
Total Net Position	<u>\$ 11,061,051</u>	<u>\$ 8,402,116</u>	<u>(22,999,979)</u>	<u>(52,903,025)</u>	<u>\$ 173,730,568</u>	<u>\$ 152,589,045</u>
Changes in Fiduciary Net Position Information						
Federal reinsurance	\$ 85,023,123	\$ 95,392,394	\$	\$	\$	\$
Contribution from Agency Operating Fund	5,500,000	5,500,000				
Contributions			152,694	310,439		
Subscriptions					47,324,492	47,998,799
Investment revenue	1,178	1,080	17,868,669	12,858,989	19,953,950	11,502,563
Other income	<u>3,631,526</u>	<u>2,747,959</u>				
Total Additions	<u>94,155,827</u>	<u>103,641,433</u>	<u>18,021,363</u>	<u>13,169,428</u>	<u>67,278,442</u>	<u>59,501,362</u>
Administrative expenses			430,543	425,447	641,205	611,036
Refunds			1,666,426	948,279		
Trustee expense			637,866	319,566		
Tuition benefits expense, net			796,836	9,898,664		
Loan claims	91,887,117	100,976,457				
Redemptions					45,434,182	42,872,623
Default aversion	<u>(390,225)</u>	<u>629,785</u>				
Total Deductions	<u>91,496,892</u>	<u>101,606,242</u>	<u>3,531,671</u>	<u>11,591,956</u>	<u>46,075,387</u>	<u>43,483,659</u>
Change in Net Position before Gain from Legislative Changes and Transfers	<u>2,658,935</u>	<u>2,035,191</u>	<u>14,489,692</u>	<u>1,577,472</u>	<u>21,203,055</u>	<u>16,017,703</u>
Gain from Legislative Changes			15,389,851			
Transfer from Agency Operating Fund			<u>23,503</u>	<u>24,855</u>		
Change in Net Position	<u>\$ 2,658,935</u>	<u>\$ 2,035,191</u>	<u>\$ 29,903,046</u>	<u>\$ 1,602,327</u>	<u>\$ 21,203,055</u>	<u>\$ 16,017,703</u>

Continued

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

June 30, 2014

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, 2014. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- Loan claims paid decreased from \$101 million in fiscal year 2013 to \$91.9 million in fiscal year 2014 (9% decrease).
- The Plan noted a decrease in tuition benefits payable of \$28.9 million in fiscal year 2014, due primarily to legislative program changes, lower than expected tuition rates, higher than expected investment experience, and the continued maturity of a program that has not been open for new enrollments since fiscal year 2005.

Statement of Fiduciary Net Position (Deficit)

The FSLRF net position increased \$2.6 million compared to prior year. Assets increased approximately 3% (\$639,000), while liabilities decreased 16.6% (\$2 million). The increase in net position is primarily comprised of a \$5.5 million contribution from the Agency Operating Fund offset by a \$2.9 million decrease associated with claim payments.

The Plan recognized a decrease in the net deficit of \$29.9 million for fiscal year 2014 compared to a \$1.6 million decrease in net deficit in the prior year. Overall, the current year decrease in net deficit from prior year is primarily related to legislative program changes, gains associated with favorable tuition inflation and favorable investment experience.

The Plan's total assets increased \$1.3 million, from \$119.1 million as of June 30, 2013 to \$120.4 million as of June 30, 2014. Cash and investments increased from \$115.2 million to \$117.4 million, a \$2.2 million increase. The change in tuition and investment return assumptions are as follows:

- 2014-thereafter – investment return decreased from 5.94% to 5.74%
- 2014-2015 academic year – tuition increase assumption was 6.75%, while actual tuition increases were 2.9% for the Value Plan and 3% for the Standard Plan and the Premium Plan
- 2015-thereafter – tuition increase assumption remained at 6.75%

The Trust is an Internal Revenue Code 529 plan managed by the Authority and administered on behalf of the Authority by TFI. Trust assets are entirely comprised of cash and pooled investments. Total net position increased approximately \$21.2 million, due to subscriptions received (\$47.3 million) and investment gain (\$20 million), net of expenses and redemptions (\$46.1 million).

Management's Discussion and Analysis (Unaudited)

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

June 30, 2014

Statement of Changes in Fiduciary Net Position (Deficit)

The FSLRF net position increased \$2.6 million compared to prior year. Assets increased approximately 3% (\$639,000), while liabilities decreased 16.6% (\$2 million). The increase in net position is primarily comprised of a \$5.5 million contribution from the Agency Operating Fund offset by a \$2.9 million decrease associated with claim payments.

The Plan recognized a decrease in the net deficit of \$29.9 million for fiscal year 2014 compared to a \$1.6 million decrease in net deficit in the prior year. Overall, the current year decrease in net deficit from prior year is primarily related to legislative program changes, gains associated with favorable tuition inflation and favorable investment experience.

Combined Government-Wide Statement of Net Position

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

June 30, 2014

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	\$ 3,025,284	\$ 42,859,382	\$ 45,884,666
Accounts receivable and prepaid expenses	22,127,848	1,158,088	23,285,936
Accrued interest income		11,502,631	11,502,631
Investments		7,309,664	7,309,664
Teacher and Osteopathic Medicine scholarship loans	450,000		450,000
Loans, net		<u>204,397,604</u>	<u>204,397,604</u>
Total Current Assets	<u>25,603,132</u>	<u>267,227,369</u>	<u>292,830,501</u>
Noncurrent:			
Restricted cash and cash equivalents		59,299,935	59,299,935
Restricted from Federal Student Loan Reserve Fund		6,080,659	6,080,659
Investments		52,219,033	52,219,033
Fixed assets, net		8,776,462	8,776,462
Loans, net		1,045,021,236	1,045,021,236
Teacher and Osteopathic Medicine scholarship loans, net	4,485,322		4,485,322
Teacher and Osteopathic Medicine scholarship advances	4,881,521		4,881,521
Accrued interest income, net		<u>9,685,849</u>	<u>9,685,849</u>
Total Noncurrent Assets	<u>9,366,843</u>	<u>1,181,083,174</u>	<u>1,190,450,017</u>
Total Assets	<u>34,969,975</u>	<u>1,448,310,543</u>	<u>1,483,280,518</u>
LIABILITIES			
Current:			
Accounts payable and accrued expenses	240,690	5,665,952	5,906,642
Accrued interest expense		1,206,074	1,206,074
Payable to US Department of Education		10,836,363	10,836,363
Line of credit payable		7,369,680	7,369,680
Capital lease payable		<u>550,000</u>	<u>550,000</u>
Total Current Liabilities	<u>240,690</u>	<u>25,628,069</u>	<u>25,868,759</u>
Noncurrent:			
Allowance for arbitrage liabilities		69,965	69,965
Capital lease payable		3,210,000	3,210,000
Bonds payable		<u>1,159,195,781</u>	<u>1,159,195,781</u>
Total Noncurrent Liabilities		<u>1,162,475,746</u>	<u>1,162,475,746</u>
Total Liabilities	240,690	1,188,103,815	1,188,344,505
Deferred Inflows of Resources:			
Deferred gain on debt retirements, net		<u>21,812,809</u>	<u>21,812,809</u>
Total Liabilities and Deferred Inflows of Resources	<u>240,690</u>	<u>1,209,916,624</u>	<u>1,210,157,314</u>
NET POSITION			
Invested in capital assets, net of expended debt proceeds		5,016,462	5,016,462
Unrestricted		58,383,649	58,383,649
Restricted, other		88,064,743	88,064,743
Restricted for program benefits	34,729,285		34,729,285
Restricted for student aid and related activities		<u>86,929,065</u>	<u>86,929,065</u>
Total Net Position	<u>\$ 34,729,285</u>	<u>\$ 238,393,919</u>	<u>\$ 273,123,204</u>

Combined Government-Wide Statement of Activities

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

For Year Ending June 30, 2014

	Program Revenue			Net (Expenses) Revenues and Changes in Net Position			
	Direct Expenses	Indirect Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Governmental Activities:							
Kentucky Tuition Grant	\$ 30,032,465	\$ 326,526	\$	\$ 33,011,329	\$ 2,652,338	\$	\$ 2,652,338
College Access Program Grant	62,343,527	456,910		65,342,501	2,542,064		2,542,064
Mary Jo Young Scholarship	430,171	100,358		506,948	(23,581)		(23,581)
Early Childhood Development Scholarship	716,832	55,051		1,179,407	407,524		407,524
Kentucky National Guard Tuition Award Program	4,733,992	55,294		5,008,752	219,466		219,466
Kentucky Educational Excellence Scholarship	104,897,439	588,396		105,052,834	(433,001)		(433,001)
Teacher Scholarship	149,176	313,957		2,172,345	1,709,212		1,709,212
Teacher Loan Forgiveness	1,400,000				(1,400,000)		(1,400,000)
Osteopathic Medicine Scholarship	391,607	44,032		1,166,459	730,820		730,820
KHEAA Work Study Program	394,211	50,244		650,307	205,852		205,852
Go Higher Grant Program	203,238	36,168		325,889	86,483		86,483
Pharmacy Scholarship Program				602,301	602,301		602,301
Kentucky Coal County College Completion Scholarship	1,229,956	88,840		1,084,267	(234,529)		(234,529)
Drive the Dream Scholarship	504,500	29,204		529,284	(4,420)		(4,420)
John R. Justice Grant	59,795	29,306		89,101			
Kentucky Education Savings Plan Trust		40,331		40,331			
Total Governmental Activities	207,486,909	2,214,617		216,762,055	7,060,529		7,060,529
Business-Type Activities:							
Loan guarantee operations	3,382,216		2,003,616			(1,378,600)	(1,378,600)
Default collections	6,470,126		33,557,575			27,087,449	27,087,449
Loan finance and servicing activities	34,216,102		43,896,078			9,679,976	9,679,976
Outreach	2,915,676		293,245			(2,622,431)	(2,622,431)
Contribution to student aid programs	904,080					(904,080)	(904,080)
Student aid administration	2,214,617					(2,214,617)	(2,214,617)
Contribution to FSLRF	5,500,000					(5,500,000)	(5,500,000)
School services	1,917,563		573,595			(1,343,968)	(1,343,968)
Other activities	232,739		232,739				
Total Business-Type Activities	57,753,119		80,556,848			22,803,729	22,803,729
Total Primary Government	\$ 265,240,028	\$ 2,214,617	\$ 80,556,848	\$ 216,762,055	7,060,529	22,803,729	29,864,258
Transfers:							
Transfer to KAPT (the "Plan")						(23,503)	(23,503)
Total Transfers						(23,503)	(23,503)
Change in Net position					7,060,529	22,780,226	29,840,755
Net position, July 1, 2013, as restated (Note S)					27,668,756	215,613,693	243,282,449
Net position, June 30, 2014					\$ 34,729,285	\$ 238,393,919	\$ 273,123,204

See accompanying notes

Combined Statement of Net Position - Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2014

ASSETS	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Current:							
Cash and cash equivalents	\$ 2,933,777	\$ 27,296,219	\$ 30,229,996	\$	\$ 12,629,386	\$ 12,629,386	\$ 42,859,382
Investments		7,284,280	7,284,280		25,384	25,384	7,309,664
Accounts receivable and prepaid expenses		316,503	316,503	37,543	804,042	841,585	1,158,088
Accrued interest income		172,656	172,656	10,867,713	462,262	11,329,975	11,502,631
Loans, net				195,217,555	9,180,049	204,397,604	204,397,604
Total Current Assets	2,933,777	35,069,658	38,003,435	206,122,811	23,101,123	229,223,934	267,227,369
Noncurrent:							
Restricted cash and cash equivalents	715		715	59,299,220		59,299,220	59,299,935
Internal receivable (payable) for Gear Up Scholarships	(715)	715					
Receivable from Federal Student Loan Reserve Fund		6,080,659	6,080,659				6,080,659
Investments		43,951,929	43,951,929		8,267,104	8,267,104	52,219,033
Fixed assets, net		8,528,340	8,528,340		248,122	248,122	8,776,462
Loans, net		(47)	(47)	992,997,279	52,024,004	1,045,021,283	1,045,021,236
Accrued interest income, net				9,408,787	277,062	9,685,849	9,685,849
Total Noncurrent Assets		58,561,596	58,561,596	1,061,705,286	60,816,292	1,122,521,578	1,181,083,174
Total Assets	2,933,777	93,631,254	96,565,031	1,267,828,097	83,917,415	1,351,745,512	1,448,310,543
LIABILITIES							
Current:							
Accounts payable and accrued expenses	1,076,868	424,551	1,501,419	457,137	3,707,396	4,164,533	5,665,952
Interfund payable (receivable)	1,856,909	(1,868,585)	(11,676)	(8,094,666)	8,106,342	11,676	
Accrued interest expense		31,883	31,883	1,169,452	4,739	1,174,191	1,206,074
Payable (receivable) to U.S. Department of Education		(414,000)	(414,000)	10,870,377	379,986	11,250,363	10,836,363
Line of credit payable					7,369,680	7,369,680	7,369,680
Capital lease payable		550,000	550,000				550,000
Total Current Liabilities	2,933,777	(1,276,151)	1,657,626	4,402,300	19,568,143	23,970,443	25,628,069
Noncurrent:							
Capital lease payable		3,210,000	3,210,000				3,210,000
Allowance for arbitrage liabilities				69,965		69,965	69,965
Bonds payable, net				1,159,195,781		1,159,195,781	1,159,195,781
Total Noncurrent Liabilities		3,210,000	3,210,000	1,159,265,746		1,159,265,746	1,162,475,746
Total Liabilities	2,933,777	1,933,849	4,867,626	1,163,668,046	19,568,143	1,183,236,189	1,188,103,815
Deferred Inflows of Resources:							
Deferred gain on debt retirements, net				21,812,809		21,812,809	21,812,809
Total Liabilities and Deferred Inflows of Resources	2,933,777	1,933,849	4,867,626	1,185,480,855	19,568,143	1,205,048,998	1,209,916,624
NET POSITION							
Invested in capital assets, net		4,768,340	4,768,340		248,122	248,122	5,016,462
Unrestricted					58,383,649	58,383,649	58,383,649
Restricted, other				82,347,242	5,717,501	88,064,743	88,064,743
Restricted for student aid and related activities		86,929,065	86,929,065				86,929,065
Total Net Position	\$	\$ 91,697,405	\$ 91,697,405	\$ 82,347,242	\$ 64,349,272	\$ 146,696,514	\$ 238,393,919

See accompanying notes

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

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For Year Ending June 30, 2014

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Operating revenues:							
Interest Revenues:							
Interest on loans	\$	\$ 610	\$ 610	\$ 27,854,610	\$ 1,929,955	\$ 29,784,565	\$ 29,785,175
Interest and investment income		671,594	671,594	13,007	85,257	98,264	769,858
Amortization of deferred gain on debt retirements				10,132,812		10,132,812	10,132,812
Interest expense on bonds				(8,765,541)	(90,125)	(8,855,666)	(8,855,666)
Total net interest revenues		672,204	672,204	29,234,888	1,925,087	31,159,975	31,832,179
Financing Expenses:							
Provision for loan losses				1,762,818	348,573	2,111,391	2,111,391
Long-Term debt credit facility and remarketing fees				1,130,584	19,422	1,150,006	1,150,006
Debt issuance costs				2,688,340		2,688,340	2,688,340
Total financing expenses				5,581,742	367,995	5,949,737	5,949,737
Interest revenues net of financing expenses		672,204	672,204	23,653,146	1,557,092	25,210,238	25,882,442
Other Operating Revenues:							
Servicing fees from external sources					847,298	847,298	847,298
Servicing fees from Education Finance Funds					7,530,485	7,530,485	7,530,485
Conversion fees							
SAFRA revenue							
Debt recovery commission		33,557,575	33,557,575	301,126	301,126	33,858,701	33,858,701
Federal fees earned		1,721,637	1,721,637			1,721,637	1,721,637
Federal grant revenue		293,245	293,245			293,245	293,245
Default aversion fee income		(390,225)	(390,225)			(390,225)	(390,225)
Guarantee fee				1,700	173,531	175,231	175,231
Gain on early retirement of debt				2,304,111		2,304,111	2,304,111
Gain on sale/purchase of loans				(158,225)	522,602	364,377	364,377
Late payment penalties				1,170,902	39,711	1,210,613	1,210,613
School services		573,595	573,595			573,595	573,595
Other income	232,739		232,739		2,862	2,862	235,601
Total operating revenues	232,739	36,428,031	36,660,770	26,971,634	10,974,707	37,946,341	74,607,111
Operating Expenses:							
Administrative expenses	101,942	9,293,482	9,395,424		16,086,451	16,086,451	25,481,875
Servicing fees for Operating Fund				7,530,485		7,530,485	7,530,485
Depreciation and amortization		546,849	546,849		92,702	92,702	639,551
Other expenses	130,797	12,011	142,808	246,515	580,259	826,774	969,582
Total operating expenses	232,739	9,852,342	10,085,081	7,777,000	16,759,412	24,536,412	34,621,493
Net operating income (loss) before program benefits		26,575,689	26,575,689	19,194,634	(5,784,705)	13,409,929	39,985,618
Program Benefits:							
Principal and interest benefits				773,528	2,956,425	3,729,953	3,729,953
School Service		1,917,563	1,917,563			1,917,563	1,917,563
Outreach		2,915,676	2,915,676			2,915,676	2,915,676
Contribution to FSLRF		5,500,000	5,500,000			5,500,000	5,500,000
Contribution to student aid programs		904,080	904,080			904,080	904,080
Student aid administration		2,214,617	2,214,617			2,214,617	2,214,617
Total program benefits		13,451,936	13,451,936	773,528	2,956,425	3,729,953	17,181,889
Operating income (loss) before transfers		13,123,753	13,123,753	18,421,106	(8,741,130)	9,679,976	22,803,729
Transfers (to) from other funds							
Interfund transfers				(23,218,975)	23,218,975		
Transfer to KAPT (the "Plan")		(23,503)	(23,503)				(23,503)
Increase (decrease) in Net position after transfers		13,100,250	13,100,250	(4,797,869)	14,477,845	9,679,976	22,780,226
Net position, July 1, 2013, as restated (Note S)		78,597,155	78,597,155	87,145,111	49,871,427	137,016,538	215,613,693
Net position, June 30, 2014	\$	\$ 91,697,405	\$ 91,697,405	\$ 82,347,242	\$ 64,349,272	\$ 146,696,514	\$ 238,393,919

See accompanying notes

Combined Statement of Cash Flows - Proprietary Fund

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

For Year Ending June 30, 2014

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Cash Flows from Operating Activities:							
Principal received on loans	\$	\$	\$	\$ 195,949,695	\$ 5,321,414	\$ 201,271,109	\$ 201,271,109
Interest received on loans				40,462,436	2,161,543	42,623,979	42,623,979
Special allowance paid				(28,208,003)	(412,943)	(28,620,946)	(28,620,946)
Servicing fees received, internal sources	(232,739)	(196,033)	(428,772)	(7,530,485)	7,530,485		(428,772)
School services fees received		573,595	573,595				573,595
Servicing fees received, external sources					1,019,951	1,019,951	1,019,951
Debt recovery commission received		33,557,575	33,557,575		272,501	272,501	33,830,076
Federal fees received		1,721,637	1,721,637				1,721,637
Federal grant revenue received		293,245	293,245				293,245
Default aversion fees received		(390,225)	(390,225)				(390,225)
Outreach		(2,915,676)	(2,915,676)				(2,915,676)
School services		(1,917,563)	(1,917,563)				(1,917,563)
Internal activity-payments to other funds	136,465	(136,465)		(1,395,739)	1,395,739		
Loans originated, including costs				(2,944)	(6,953,215)	(6,956,159)	(6,956,159)
Administrative expenses paid		(8,286,274)	(8,286,274)	(5,189,958)	(18,793,886)	(23,983,844)	(32,270,118)
Contribution to FSLRF		(5,500,000)	(5,500,000)				(5,500,000)
Credit facility fees paid				(1,131,983)	(16,558)	(1,148,541)	(1,148,541)
Loans purchased, including premiums				(8,380,348)	(81,335,915)	(89,716,263)	(89,716,263)
Contribution to student aid programs		(904,080)	(904,080)				(904,080)
Student aid administration		(2,214,617)	(2,214,617)				(2,214,617)
Interfund loan sales and purchases				(47,827,755)	47,827,755		
Client loan receipts					4,149,580	4,149,580	4,149,580
Loan receipts remitted to clients					(3,796,813)	(3,796,813)	(3,796,813)
Net Cash Provided by (Used in) Operating Activities	<u>(96,274)</u>	<u>13,685,119</u>	<u>13,588,845</u>	<u>136,744,916</u>	<u>(41,630,362)</u>	<u>95,114,554</u>	<u>108,703,399</u>
Cash Paid from Noncapital Financing Activities:							
Proceeds from debt issued				403,708,924	19,314,146	423,023,070	423,023,070
Debt principal payments				(531,630,000)	(11,944,466)	(543,574,466)	(543,574,466)
Interest on debt				(9,722,530)	(85,386)	(9,807,916)	(9,807,916)
Debt issuance costs				(2,688,340)	16,290	(2,672,050)	(2,672,050)
Gain on early retirement of debt				2,304,111		2,304,111	2,304,111
Deferred gain on early retirement debt				7,173,000		7,173,000	7,173,000
Interfund transfers				(23,218,975)	23,218,975		
Transfer to KAPT (the "Plan")		(23,503)	(23,503)				(23,503)
Increase in Federal Student Loan Reserve receivable		1,954,367	1,954,367				1,954,367
Net Cash Provided by (Used in) Noncapital Financing Activities		<u>1,930,864</u>	<u>1,930,864</u>	<u>(154,073,810)</u>	<u>30,519,559</u>	<u>(123,554,251)</u>	<u>(121,623,387)</u>
Cash Flows From Capital and Related Financing Activities:							
Capital expenditures		(842,069)	(842,069)		(116,171)	(116,171)	(958,240)
Interest paid on capital lease		(4,569)	(4,569)				(4,569)
Bond principal payments		(525,000)	(525,000)				(525,000)
Net Cash Used in Capital and Related Financing Activities		<u>(1,371,638)</u>	<u>(1,371,638)</u>		<u>(116,171)</u>	<u>(116,171)</u>	<u>(1,487,809)</u>
Cash Flows From Investing Activities:							
Proceeds from sales/maturities of investments		32,442,479	32,442,479		5,276,307	5,276,307	37,718,786
Purchases of investments		(33,800,284)	(33,800,284)		(5,418,540)	(5,418,540)	(39,218,824)
Investment income		1,011,467	1,011,467	14,542	45,805	60,347	1,071,814
Net Cash Provided by (Used in) Investing Activities		<u>(346,338)</u>	<u>(346,338)</u>	<u>14,542</u>	<u>(96,428)</u>	<u>(81,886)</u>	<u>(428,224)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	<u>(96,274)</u>	<u>13,898,007</u>	<u>13,801,733</u>	<u>(17,314,352)</u>	<u>(11,323,402)</u>	<u>(28,637,754)</u>	<u>(14,836,021)</u>
Cash and Cash Equivalents, July 1, 2013, as restated (Note S)	<u>3,030,766</u>	<u>13,398,212</u>	<u>16,428,978</u>	<u>76,613,572</u>	<u>23,952,788</u>	<u>100,566,360</u>	<u>116,995,338</u>
Cash and Cash Equivalents, June 30, 2014	<u>\$ 2,934,492</u>	<u>\$ 27,296,219</u>	<u>\$ 30,230,711</u>	<u>\$ 59,299,220</u>	<u>\$ 12,629,386</u>	<u>\$ 71,928,606</u>	<u>\$ 102,159,317</u>

See accompanying notes

Combined Statement of Cash Flows - Proprietary Fund

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

For Year Ending June 30, 2014

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Reconciliation of Operating Income to Net Cash							
Provided by (Used in) Operating Activities							
Operating income (loss) before transfers	\$	\$ 13,123,753	\$ 13,123,753	\$ 18,421,106	\$ (8,741,130)	\$ 9,679,976	\$ 22,803,729
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:							
Investment income		(672,204)	(672,204)	(14,542)	(88,550)	(103,092)	(775,296)
Depreciation and amortization		813,703	813,703		92,702	92,702	906,405
Amortization of deferred gain on debt retirements				(10,132,812)		(10,132,812)	(10,132,812)
Amortization, Expense and Write-off of Debt Issuance Costs				2,688,340		2,688,340	2,688,340
Gain on early retirement of debt				(2,304,111)		(2,304,111)	(2,304,111)
Interest expense		4,569	4,569	8,765,541	90,125	8,855,666	8,860,235
Provision for loan losses				1,762,818	348,573	2,111,391	2,111,391
Borrower interest converted to principal				(24,865,347)	(389,401)	(25,254,748)	(25,254,748)
Loan forgiveness				773,528	26,000	799,528	799,528
Loss on equipment disposal					60,872	60,872	60,872
(Increases) decreases in assets:							
Accounts receivables and prepaid expenses	1,005,962	(183,159)	822,803	(14,508)	513,583	499,075	1,321,878
Accrued interest receivable		(12,874)	(12,874)	2,389,490	(372,339)	2,017,151	2,004,277
Principal received on loans				195,949,695	5,321,414	201,271,109	201,271,109
Loans purchased, including premiums		47	47	(8,380,348)	(81,335,915)	(89,716,263)	(89,716,216)
Loans originated, including costs				(2,944)	(6,953,215)	(6,956,159)	(6,956,159)
Interfund loan sales and purchases				(47,827,755)	47,827,755		
Increases (decreases) in liabilities:							
Accounts payable and accrued expenses	(40,499)	1,716	(38,783)	(73,976)	301,643	227,667	188,884
Payable to U.S. Department of Education				1,031,355	271,782	1,303,137	1,303,137
Interfund receivable/payable	(1,061,737)	614,137	(447,600)	(1,395,739)	1,395,739		(447,600)
Accrued interest payable		(4,569)	(4,569)				(4,569)
Allowance for arbitrage liabilities				(24,875)		(24,875)	(24,875)
Net Cash Provided by (Used in) Operating Activities	\$ (96,274)	\$ 13,685,119	\$ 13,588,845	\$ 136,744,916	\$ (41,630,362)	\$ 95,114,554	\$ 108,703,399

Balance Sheet - Governmental Fund

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

June 30, 2014

	Governmental Fund Student Aid
ASSETS	
Current:	
Cash and cash equivalents	\$ 3,025,284
Accounts receivable	22,127,848
Teacher and Osteopathic Medicine scholarship loans	<u>450,000</u>
Total Current Assets	<u>25,603,132</u>
Noncurrent:	
Teacher and Osteopathic Medicine scholarship loans, net of allowance of \$3,600,000	4,485,322
Teacher and Osteopathic Medicine scholarship advances	<u>4,881,521</u>
Total Noncurrent Assets	<u>9,366,843</u>
Total Assets	<u>34,969,975</u>
LIABILITIES	
Current:	
Accounts payable	<u>240,690</u>
Total Liabilities	<u>240,690</u>
FUND BALANCE	
Restricted for program benefits	<u>\$ 34,729,285</u>

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

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

For Year Ending June 30, 2014

	Governmental Fund Student Aid
Revenues:	
Interest and investment income fund	\$ 376,016
Tobacco settlement revenue	1,001,536
Unclaimed lottery revenue	11,000,000
State General Fund revenue	200,632,313
Federal funds revenue	59,795
Other income	573,698
Contribution from Agency Operating Fund	3,118,697
	<hr/>
Total Revenues	216,762,055
Expenditures:	
Kentucky Tuition Grant	30,358,991
College Access Program Grant	62,800,437
Mary Jo Young Scholarship	530,529
Early Childhood Development Scholarship	771,883
Kentucky National Guard Tuition Award Program	4,789,286
Kentucky Educational Excellence Scholarship	105,485,835
Teacher Scholarship	463,133
Teacher Loan Forgiveness	1,400,000
Osteopathic Medicine Scholarship	435,639
Pharmacy Scholarship Program	
KHEAA Work Study Program	444,455
Go Higher Grant Program	239,406
Drive the Dream Scholarship	533,704
Kentucky Coal County College Completion Scholarship	1,318,796
John R. Justice Grant	89,101
Kentucky Education Savings Plan Trust	40,331
	<hr/>
Total Expenditures	209,701,526
	<hr/>
Net Change in Fund Balance	7,060,529
	<hr/>
Fund Balance, July 1, 2013	27,668,756
	<hr/>
Fund Balance, June 30, 2014	\$ 34,729,285
	<hr/> <hr/>

Statement of Fiduciary Net Position (Deficit)

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

June 30, 2014

ASSETS	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Education Savings Plan Trust
Current:			
Cash and cash equivalents	\$ 13,355,049	\$ 3,310,378	\$ 60
Contributions receivable		800,759	
Fees receivable		192,488	
Receivable from U.S. Department of Education	7,824,490		
Investments		114,099,448	173,843,959
Other current assets	1,115		172,233
Total Current Assets	21,180,654	118,403,073	174,016,252
Noncurrent:			
Contributions receivable		1,976,709	
Total Assets	21,180,654	120,379,782	174,016,252
LIABILITIES			
Current:			
Accounts payable	92,059	321,554	171,737
Accrued expenses			113,947
Current portion of reinsurance reserve	483,059		
Total Current Liabilities	575,118	321,554	285,684
Noncurrent:			
Reinsurance reserve, less current portion	3,463,826		
Payable to Agency Operating Fund	6,080,659		
Tuition benefits payable		143,058,207	
Total Liabilities	10,119,603	143,379,761	285,684
NET POSITION			
Restricted for program benefits		(22,999,979)	173,730,568
Restricted for other purposes	11,061,051		
Total Net Position (Deficit)	\$ 11,061,051	\$ (22,999,979)	\$ 173,730,568

Statement of Changes in Fiduciary Net Position (Deficit)

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

For Year Ending June 30, 2014

	<u>Federal Student Loan Reserve Fund</u>	<u>Kentucky's Affordable Prepaid Tuition</u>	<u>Kentucky Education Savings Plan Trust</u>
Additions:			
Federal reinsurance	\$ 85,023,123	\$	\$
Contribution from Agency Operating Fund	5,500,000		
Contract income, net		152,694	
Subscriptions			47,324,492
Investment Revenues:			
Net unrealized gain on investments		10,577,255	17,052,458
Interest and investment income	1,178	7,291,414	2,901,492
Other income	3,631,526		
Total Additions	<u>94,155,827</u>	<u>18,021,363</u>	<u>67,278,442</u>
Deductions:			
Program benefits:			
Loan claims	91,887,117		
Default aversion fee expense	(390,225)		
Redemptions			45,434,182
Administrative expenses		67,196	641,205
Personnel and professional expenses		363,347	
Refunds		1,666,426	
Trustee fee expense		637,866	
Tuition benefits expense, net		796,836	
Total Deductions	<u>91,496,892</u>	<u>3,531,671</u>	<u>46,075,387</u>
Change in Net Position before Gain from Legislative Changes and Transfers	<u>2,658,935</u>	<u>14,489,692</u>	<u>21,203,055</u>
Gain from Legislative Changes		15,389,851	
Transfer from Agency Operating Fund		23,503	
Change in Net Position	<u>2,658,935</u>	<u>29,903,046</u>	<u>21,203,055</u>
Net Position (Deficit), July 1, 2013, as restated (Note S)	<u>8,402,116</u>	<u>(52,903,025)</u>	<u>152,527,513</u>
Net Position (Deficit), June 30, 2014	<u>\$ 11,061,051</u>	<u>\$ (22,999,979)</u>	<u>\$ 173,730,568</u>

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

June 30, 2014

Note A--Description of Business

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

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

HCERA does provide for servicing opportunities for qualified nonprofit organizations to service an initial allocation of 100,000 federal loan borrowers. The Authority/Corporation received their initial allotment of loans in the fall of 2012. The Authority/Corporation is currently partnering with another U.S. Department of Education ("USDE") federal loan servicer to service these loans.

Loan Guarantee Operations

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

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

June 30, 2014

Note A--Description of Business--Continued

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

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

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

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

Sources of funds to the AOF include investment income, agency retention on collections of defaulted loans, default aversion fees and account maintenance fees. Expenditures from the AOF include personnel, professional and other administrative expenses directly related to the loan program operations, outreach program activities, and other operating activities. The AOF provides funding to the governmental fund to pay administration costs for fifteen student aid programs, administrative costs for the Trust, and direct benefits for the Mary Jo Young Scholarship program. The AOF also transfers funds to the Plan to pay some of the Plan's administration costs. Both the FSLRF and AOF are subject to federal oversight.

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

June 30, 2014

Note A--Description of Business--Continued

Loan Finance and Servicing Operations

The Corporation is an independent *de jure* municipal corporation established by the Kentucky General Assembly in 1978 to provide a loan finance program for post-secondary students in the Commonwealth of Kentucky. The Corporation is authorized to finance loans for students attending 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 finance, servicing and collection activities include: (i) the origination and acquisition of education loans; (ii) the financing of FFELP and KAEL loans; (iii) the servicing of FFELP, KAEL, certain federal and other education loans; and (iv) the collection of FFELP, KAEL, certain federal and other education loans for other holders on a commission or cost reimbursement basis. FFELP student loans held, serviced and collected by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS") and Federal Consolidation Loans ("Consolidations").

Most FFELP loans held by the Authority/Corporation are insured by a guaranty agency. Loans made prior to October 1, 1993, are 100% insured. Loans made between October 1, 1993 and June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 98% insured against borrowers' default. Loans made after June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 97% insured against borrowers' default. KAEL loans are self-insured by the Authority/Corporation. KAEL borrowers are charged a guarantee fee at the time their loan is originated to fund any future losses on defaulted KAEL loans. Effective July 1, 2014, the guarantee fee is waived for KAEL loans to residents of the Commonwealth of Kentucky and to non-residents attending a post-secondary institution or approved program in the Commonwealth of Kentucky.

The Authority/Corporation's General Bond Resolution ("GBR"), Indentures, and separate series resolutions for issuance of revenue bonds contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received. In addition, the Authority/Corporation's lines of credit also provide for certain collateral account and proceeds restrictions.

As of June 30, 2014 the Authority/Corporation held and serviced approximately \$1.26 billion outstanding principal amount of FFELP and other education loans. \$1.19 billion of loans were pledged pursuant to the 1997 GBR, the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture the 2013-2 Indenture, and the 2014 Indenture. The remaining \$61 million of loans were funded by the Corporation's Operating Fund. Also, the Authority/Corporation services approximately \$17 million of FFELP and other education loans on behalf of other holders. The majority of such education loans are serviced by the Authority/Corporation pursuant to servicing agreements which do not provide for the acquisition by the Authority/Corporation of the education loans serviced. As a servicer of FFELP and other education loans, the Authority/Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. The Authority/Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Authority/Corporation financings.

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

June 30, 2014

Note A--Description of Business—Continued

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

Kentucky Educational Savings Plan Trust

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

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

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

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

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

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.

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

June 30, 2014

Note A--Description of Business--Continued

Prepaid Tuition Plan

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

On July 1, 2005, governance of the Plan permanently transferred to the Authority/Corporation. The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan investment strategy is to earn rates of return that exceed anticipated tuition inflation rates so that the Plan is able to meet its obligation to pay benefits at future tuition rates. The Plan offered enrollment periods in fiscal years 2002, 2003 and 2005, for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax advantages to purchasers. There have been no enrollment periods since fiscal year 2005 as the Plan currently maintains an accumulated net deficit of approximately \$23 million.

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

Participants were allowed to elect to spread payments to the Plan over three, five or seven years or until the anticipated year of the student's enrollment in a qualified postsecondary education institution. Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States. If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books 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 statutorily defined payout value of the contract less benefits received, administrative and cancellation fees. Non-qualified withdrawals are subject to a 10% penalty in accordance with Section 529 of the Internal Revenue Code ("IRC") except in cases where the withdrawal is: (1) made on account of the death or disability of the student; (2) made on account of a scholarship received by a student, or (3) a non-taxable transfer to another account or to another IRC Section 529 program for a different student who is a family member of the original student.

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

June 30, 2014

Note A--Description of Business--Continued

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

As of June 30, 2014, the Plan maintained a present value fund deficit of \$23 million. This represents a \$29.9 million improvement over the previous year's deficit resulting primarily from a \$15.4 million increase related to the aforementioned legislative changes and an \$11.4 million increase related to favorable investment experience. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2023, at which time the liability of the Plan becomes a General Obligation of the Commonwealth of Kentucky. Per KRS 164A.708, once a real liability is expected to accrue, the General Assembly shall appropriate the necessary funds to meet the liability. Over the remaining estimated life of the program, through fiscal year 2028, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$45 million.

Student Aid Programs

The Authority/Corporation provides administration of fifteen student aid programs: (1) the Kentucky Tuition Grant program, (2) College Access Program grant, (3) Kentucky Educational Excellence Scholarship program, (4) Teacher Scholarship program, (5) Osteopathic Medicine Scholarship program, (6) the KHEAA Work-Study program, (7) Kentucky Coal County College Completion Scholarship, (8) Early Childhood Development Scholarship program, (9) the Go Higher Grant program, (10) the Coal County Scholarship for Pharmacy Students program, (11) the Mary Jo Young Scholarship program, (12) John R. Justice grant, (13) the Drive the Dream Scholarship program, (14) the Kentucky National Guard Tuition Award program, and (15) the Minority Educator Recruitment and Retention Scholarship program. Direct benefits for grant, scholarship, and work-study programs are funded by appropriations from the Kentucky General Assembly, federal grants, funding from the Authority/Corporation, allocation of revenues from the Kentucky Lottery Corporation, Coal Severance Tax and Tobacco Settlement funds.

Outreach Programs

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

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

June 30, 2014

Note B--Summary of Significant Accounting Policies

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

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

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

The Authority/Corporation's loan guarantee, default collection, borrower assistance, loan finance and servicing, student aid administration and contributions, outreach program activities and other business-type activities are presented as proprietary funds. Proprietary funds also include internal service funds, which are used to report activity that provides goods or services on a cost reimbursement basis predominantly to the Authority/Corporation's other business-type activities. The Authority/Corporation follows all applicable GASB pronouncements.

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

June 30, 2014

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

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

The Authority/Corporation's Fiduciary Funds are held in a custodial capacity. FSLRF assets and all earnings on those assets are the property of the Federal government and are used primarily to facilitate FFELP claim payments. Assets of the Trust are held by the Authority/Corporation on behalf of program participants. Assets of the Plan are held by the Authority/Corporation to offset future tuition obligations of participants.

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

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

The Plan maintains a separate investment policy with the current following target asset allocation:

Large Cap U.S. stocks	37%
Mid Cap U.S. stocks	6%
Small Cap U.S. stocks	5%
Non-U.S. stocks	9%
	<hr/>
Total Equity	57%
	<hr/> <hr/>
Inflation indexed bonds	7%
Corporate bonds	
Domestic fixed income	36%
	<hr/>
Total Fixed Income	43%
	<hr/> <hr/>

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

June 30, 2014

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

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

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

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

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

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

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

June 30, 2014

Note B--Summary of Significant Accounting Policies—Continued

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

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

Allowance for Uncollectible Loans - As discussed in Note A, most FFELP loans held by the Authority/Corporation are insured by guarantee agencies and the USDE. Management of the Authority/Corporation believes that all of the respective guaranty agencies and the USDE will be able to honor all loan claims submitted. However, the Authority/Corporation records a provision for loan losses based upon its expected default claims with respect to 98% and 97% insured loans and for loans with certain loan servicing violations. The allowance for loan loss on all loans funded through normal operations was \$3.8 million for loan principal and \$490,000 for accrued interest as of June 30, 2014. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2014, the allowance for third party servicing loan losses for loans that have been purchased was \$1.4 million for loan principal and \$547,000 for accrued interest. In addition, the Authority/Corporation records a provision for loan loss related to Teacher and Osteopathic Medicine advances that have converted to loans. As of June 30, 2014, the allowance for advances converted to loans was \$3.7 million.

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

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

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

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

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

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

June 30, 2014

Note B--Summary of Significant Accounting Policies—Continued

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

Use of Estimates - Accounting principles generally accepted in the United States of America require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the combined financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

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

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

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

Contribution Receivable - As discussed in Note A, participants in the Plan may elect to make payments on executed tuition contracts over a specific period. Contributions receivable are recorded at their net realizable value in the period in which a tuition contract is purchased. A finance charge of 7.25% per annum of the outstanding balance is charged to participants who enrolled in the Plan during fiscal year 2005.

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

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

June 30, 2014

Note B--Summary of Significant Accounting Policies—Continued

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

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

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

Unrestricted Net Position - Unrestricted net position is comprised of net position available to be used in operations or transfers of the Authority/Corporation.

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

Note C--Cash and Investments

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

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

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

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

June 30, 2014

Note C--Cash and Investments--Continued

Custodial Credit Risk and Interest Rate Risk - Custodial credit risk is the risk that in the event of a bank failure, the Authority/Corporation's deposits may not be returned to it. The Authority/Corporation's investment policy does not contain a requirement for the collateralization of cash and investments nor does it require investments to be maintained in the Authority/Corporation's name. As of June 30, 2014, Authority/Corporation's Proprietary Funds, Governmental Fund and Fiduciary Funds maintained cash on deposit is as follows:

Of the \$103.2 million of cash and cash equivalents maintained in the Proprietary Funds, \$30.2 million was held for guarantee operations and the remaining \$73 million was held for loan finance and servicing activities.

Of the \$16.7 million of cash and cash equivalents maintained in the Fiduciary Funds, \$13.4 million was related to the FSLRF and the remaining \$3.3 million was associated with the Plan.

	Governmental Fund Bank Balance	Proprietary Fund Bank Balance	Fiduciary Fund Bank Balance
FDIC Insured	\$	\$ 500,437	\$ 539,406
Uninsured		398,279	
Collateralized by securities held by the pledging financial institution		9,287,810	12,304,419
Money market demand deposits			
Money market securities		90,284,940	3,829,617
Cash deposited with Kentucky State Treasurer	3,025,284	2,934,489	30,919
	<u>\$ 3,025,284</u>	<u>\$103,405,955</u>	<u>\$ 16,704,361</u>

Notes to Financial Statements--Continued

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

June 30, 2014

Note C--Cash and Investments--Continued

As of June 30, 2014, all Proprietary Funds investments were registered in the Authority/Corporation's name and maintained by an external trustee or investment manager, as applicable. The investment balances as of June 30, 2014 are summarized as follows:

	<u>Fair Value</u>	<u>Weighted Average Maturity (in years)</u>
Corporate bonds	\$ 25,980,703	2.52
U.S. Treasury and government agency securities	27,394,854	1.56
Collateralized mortgage obligations	<u>6,153,140</u>	9.28
	<u>\$ 59,528,697</u>	

As of June 30, 2014, Trust investments of \$173.9 million comprised entirely of TIAA mutual funds.

As of June 30, 2014, Plan investments of \$114 million comprised primarily of mutual funds held by State Street Global Advisors.

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

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

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

June 30, 2014

Note C--Cash and Investments--Continued

Credit Risk - The Authority/Corporation's investment policy limits the credit risk for securities. Securities must have a credit rating of BBB by a nationally recognized credit rating agency. Money Market Securities must be rated A-1 or P-1 or better at the time of purchase. The investment manager is allowed to hold up to 5% in aggregate market value securities that have been downgraded below BBB, but must maintain an average rating of A for the total portfolio. The following table summarizes the Standard & Poors / Moody's rating (as applicable) for all corporate bonds held by the Authority/Corporation's Proprietary Funds as of June 30, 2014:

<u>Rating</u>	<u>Fair Value</u>
AAA / Aaa	\$ 9,892,561
AA / Aa	3,091,630
A / A	5,282,816
BAA / Baa	<u>7,713,696</u>
	<u>\$ 25,980,703</u>

The Plan maintains an investment policy that limits the credit risk for fixed income securities and short-term commercial paper. No more than 10% of the total amount of fixed-income portion of the investment account shall be committed to the securities of any one issuer at the time of purchase, with the exception of securities issued or guaranteed by the full faith and credit of the United States or AAA-rated securities issued by government agencies as to which there is no limit. The Plan may invest in short-term commercial paper of any domestic issuer, maturing within 9 months, with a minimum rating of A-1 by Standard & Poors or Prime 1 by Moody's. As previously noted, at June 30, 2014 the Plan primarily invested in mutual funds.

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2014

Note D--Fixed Assets

A summary of fixed assets follows:

	Beginning Balance July 1, 2013	Additions	Disposals	Ending Balance June 30, 2014
Proprietary fund:				
Furniture and equipment	\$ 13,527,503	\$ 904,371	\$ 243,883	\$ 14,187,991
Building	12,072,407			12,072,407
System development	55,955			55,955
Student loan servicing	541,131			541,131
Debt recovery system	735,509	56,047		791,556
Accumulated depreciation and amortization	<u>(18,147,006)</u>	<u>(906,406)</u>	<u>(180,834)</u>	<u>(18,872,578)</u>
	<u>\$ 8,785,499</u>	<u>\$ 54,012</u>	<u>\$ 63,049</u>	<u>\$ 8,776,462</u>
Fiduciary Fund:				
Furniture and equipment	\$ 69,557	\$	\$ (1,340)	\$ 68,217
Accumulated depreciation	<u>(69,557)</u>	<u></u>	<u>1,340</u>	<u>(68,217)</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>

Depreciation and amortization expense totaled \$906,406 for the year ended June 30, 2014, of which \$782,805 was allocated to business-type activities, \$119,861 allocated to governmental activities, and \$3,740 allocated to the fiduciary activities.

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

	TOTAL
Loan guarantee operations	\$ 592,697
Default collections	97,406
Loan finance and servicing	<u>92,702</u>
	<u>\$ 782,805</u>

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

June 30, 2014

Note D--Fixed Assets--Continued

The Authority/Corporation has assets under capital lease agreements, as described in Note I, of \$12,072,407 with related accumulated amortization of \$4,487,312. Amortization of assets under capital lease is included in amortization expense in the accompanying combined financial statements. Amortization expense of assets under capital lease agreements was \$402,414 for the year ended June 30, 2014.

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

Pursuant to FFELP, the loan guarantee operating unit of Authority/Corporation insures eligible student loans for losses incurred from the default, death, disability, or bankruptcy and also insures for other losses such as school closures and false certifications. As of June 30, 2014, the outstanding balance of aggregate insured student loans was approximately \$2.6 billion.

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

The Authority/Corporation's annual default claims rate is within the 5%, which allows for reimbursement rates at the highest level. Due to the reduction of the Federal reimbursement rate for loans made subsequent to October 1, 1993, the Authority/Corporation has recorded a reserve of \$3.95 million at June 30, 2014 for losses on federal reinsurance.

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

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

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

June 30, 2014

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

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

Rehabilitated Loans - The Authority/Corporation is entitled to retain 18.5% of principal and all accrued interest for rehabilitated loans, plus 18.5% of collection costs through June 30, 2014. Effective July 1, 2014, 100% of principal would be paid to USDE and the Authority/Corporation would be entitled to retain all accrued interest for rehabilitated loans plus 16% of collection costs.

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

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

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

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

Note F--Loans (Finance and Servicing Operations)

The Authority/Corporation originates private supplemental loans, purchases loans and holds various types of student loans as described in Note A. The terms of these loans, which vary on an individual basis depending upon loan type and the date the loan was originated, generally provide for repayment in monthly installments of principal and interest over a period of up to thirty years for consolidation loans and generally up to ten years for other loans. The repayment period begins after a grace period of six months following graduation or loss of qualified student status for the Subsidized and Unsubsidized Stafford loans. The repayment period for Consolidation, SLS and PLUS loans begins within 60 days from the date the loan is fully disbursed. Statutory interest rates on student loans ranged from 1.75% to 9% for the fiscal year ended June 30, 2014 depending upon the type and date of origination of the individual loan. Actual rates may be lower due to interest rate reductions associated with payments via electronic funds transfer or for other reasons such as borrowers making a specified number of consecutive on-time payments.

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

June 30, 2014

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

Loans consist of the following at June 30, 2014:

Stafford - Subsidized	\$ 366,699,912
Stafford - Unsubsidized	403,557,795
PLUS/SLS	29,557,966
Consolidation	442,223,615
Supplemental	18,083,044
Other	<u>1,238,889</u>
Total gross loans	1,261,361,221
Allowance for loan losses	(5,232,906)
Loan rebate due to borrowers	(3,000,000)
Unamortized discount on purchase of loans	<u>(3,709,428)</u>
Loans, net	1,249,418,887
Less amount shown as current assets	<u>204,397,604</u>
Noncurrent loans, net	<u><u>\$ 1,045,021,283</u></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, 2014, \$2,348,784 of student loans were no longer insured due to violations of due diligence requirements. Loan rebate due to borrowers represents the additional loan forgiveness described in Note H.

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

Note G--Special Allowance

The Higher Education Act of 1965 provides for quarterly Special Allowance Payments to be made by USDE to holders of student loans to the extent necessary to ensure that they receive at least specified market interest rates of return. Certain FFELP loans disbursed during the period from January 1, 2000 through June 30, 2010 received special allowance at a rate based upon the average of the bond equivalent rates of the three-month commercial paper rate as reported by the U.S. Federal Reserve through March 31, 2012. Pursuant to a December 23, 2011, amendment to the Higher Education Act, the Authority/Corporation elected to change the index for special allowance calculations on its FFELP loans disbursed after January 1, 2000, from the three-month commercial paper (CP) rate to the one-month LIBOR index beginning on April 1, 2012. Other eligible loans receive special allowance based on the 91-day Treasury bill rates. The special allowance is accrued as either earned or payable, as applicable.

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

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Note H--Loan and Other Forgiveness

During fiscal year 2014, the Authority/Corporation forgave \$4.5 million in loan principal and accrued interest for teachers funded by USDE, and an additional \$1.4 million in loan forgiveness for teachers funded by the Commonwealth of Kentucky. Also, during fiscal year 2014, the Authority/Corporation provided additional loan forgiveness of \$799,632.

The Authority/Corporation's Board of Directors approved \$3 million of additional loan forgiveness for teachers, nurses and public service attorneys who were employed in the Commonwealth, which was accrued as of June 30, 2014 and is scheduled to be provided in the fall of 2014.

The Agency Operating Fund of the Authority/Corporation contributed \$5.5 million to the Federal Student Loan Reserve Fund during fiscal year 2014. The contribution was facilitated through a \$2.5 million reduction in the receivable/payable between the two funds with the remaining \$3 million as a cash contribution.

Note I--Capital Lease Payable

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

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

In connection with the issuance of the bonds, the Authority/Corporation entered into a financing/lease agreement with the Commission whereby the Authority/Corporation agreed to lease the newly constructed building. The Authority/Corporation renewed the lease for the biennium ending June 30, 2014 and has the right to renew for three additional two-year periods.

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

The lease payments are equal to the debt service required by the bond indenture. In connection with the agreements, the Kentucky General Assembly appropriated sufficient spending authorization to the Authority/Corporation to pay the lease payments required through June 30, 2016. There can be no assurance to make rent payments past the two-year lease period.

Notes to Financial Statements--Continued

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

June 30, 2014

Note I--Capital Lease Payable--Continued

A summary of the activity for the capital lease for the year ended June 30, 2014 is as follows:

	<u>June 30, 2013</u>	<u>Additions</u>	<u>Payments</u>	<u>June 30, 2014</u>
Capital Lease Payable	<u>\$ 4,285,000</u>	<u>\$</u>	<u>\$ 525,000</u>	<u>\$ 3,760,000</u>

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

Year Ending June 30,	<u>Principal</u>	<u>Interest</u>
2015	\$ 550,000	\$ 192,342
2016	580,000	164,592
2017	610,000	135,268
2018	640,000	103,663
2019	670,000	72,013
One Year Ending June 30, 2020	<u>710,000</u>	<u>37,275</u>
	<u>\$ 3,760,000</u>	<u>\$ 705,153</u>

Continued

Notes to Financial Statements--Continued

**Kentucky Higher Education Assistance Authority
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June 30, 2014

Note J--Revenue Bonds and Notes Payable

The balance of revenue bonds and notes payable at June 30, 2014 and the related activity for the year ended June 30, 2014 is as follows:

Series	Scheduled Maturity	Intere Rate	Beginning Balance July 1, 2013	Bond Maturities & Refundings	New Issues	Premium / (Discount) June 30, 2014	Ending Balance June 30, 2014
1997 General Bond Resolution							
1997 A-1	May 1, 2027	35 days	\$ 11,950,000	\$ (11,950,000)	\$	\$	\$
1997 A-2	May 1, 2027	35 days	36,550,000	(36,550,000)			
1997 B *	May 1, 2027	35 days	23,900,000	(23,900,000)			
1998 A-1	May 1, 2028	28 days	36,400,000	(34,400,000)			2,000,000
1998 A-2	May 1, 2028	28 days	36,400,000	(36,400,000)			
1998 B *	May 1, 2028	35 days	42,150,000	(39,150,000)			3,000,000
1999 A	May 1, 2029	28 days	39,900,000	(36,400,000)			3,500,000
1999 B *	May 1, 2029	35 days	23,050,000	(22,300,000)			750,000
2000 A-1	May 1, 2030	28 days	23,500,000	(19,200,000)			4,300,000
2000 A-2	May 1, 2030	28 days	36,100,000	(36,050,000)			50,000
2000 A-3	May 1, 2030	35 days	38,950,000	(38,950,000)			
2000 B *	May 1, 2030	35 days	3,750,000	(3,750,000)			
2001 A-1	May 1, 2031	35 days	14,950,000	(12,050,000)			2,900,000
2001 A-2	May 1, 2031	35 days	19,900,000	(15,000,000)			4,900,000
2002 A-1	May 1, 2032	28 days	12,700,000	(11,100,000)			1,600,000
2002 A-2	May 1, 2032	35 days	9,900,000	(9,900,000)			
2002 A-3 *	May 1, 2032	35 days	29,600,000	(4,650,000)			24,950,000
2003 A-1 *	May 1, 2033	35 days	19,900,000	(19,900,000)			
			<u>459,550,000</u>				<u>47,950,000</u>
2008 Indenture							
2008 A-1 *	June 1, 2037	Weekly	73,720,000				73,720,000
2008 A-2 *	June 1, 2038	Weekly	58,125,000				58,125,000
			<u>131,845,000</u>				<u>131,845,000</u>
2010 Indenture							
2010 A-1 *	May 1, 2020	Quarterl	13,255,000	(13,255,000)			
2010 A-2 *	May 1, 2034	Quarterl	135,660,000	(850,000)			134,810,000
			<u>148,915,000</u>				<u>134,810,000</u>
2013-1 Indenture							
2013-1	June 1, 2026	Monthly	546,705,000	(82,755,000)			463,950,000
2013-2 Indenture							
2013-2	June 1, 2028	Monthly		(23,170,000)	384,000,000	(2,473,669)	358,356,331
2014 Indenture							
2014 A *	June 1, 2031	Fixed			21,650,000	634,450	22,284,450
			<u>\$ 1,287,015,000</u>	<u>\$ (531,630,000)</u>	<u>\$ 405,650,000</u>	<u>\$ (1,839,219)</u>	<u>\$ 1,159,195,781</u>

*This bond series is tax-exempt.

Notes to Financial Statements--Continued

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

June 30, 2014

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

The Authority/Corporation's revenue bonds include fixed and variable rates of interest based on various index rates. Those fixed rates and variable index rates ranged from 0.14% to 5.0% as of June 30, 2014.

Debt service requirements to maturity or redemption date, assuming interest rates based on fixed rates and variable index rates at June 30, 2014, are as follows:

	Principal Repayment Amount (Thousands)						Total
	97 GBR	2008 Indenture	2010 Indenture	2013-1 Indenture	2013-2 Indenture	2014 Indenture	
Year Ending June 30, 2015	\$	\$	\$	\$	\$	\$	\$
4 Years Ending June 30, 2019						4,150	4,150
5 Years Ending June 30, 2024						5,700	5,700
5 Years Ending June 30, 2029	9,250			463,950	360,830	9,800	843,830
5 Years Ending June 30, 2034	38,700		134,810			2,000	175,510
4 Years Ending June 30, 2038		131,845					131,845
	<u>\$ 47,950</u>	<u>\$ 131,845</u>	<u>\$ 134,810</u>	<u>\$ 463,950</u>	<u>\$ 360,830</u>	<u>\$ 21,650</u>	<u>\$1,161,035</u>
	Interest Payments Amount (Thousands)						
	97 GBR	2008 Indenture	2010 Indenture	2013-1 Indenture	2013-2 Indenture	2014 Indenture	Total
Year Ending June 30, 2015	\$ 400	\$ 189	\$ 1,929	\$ 3,040	\$ 2,725	\$ 904	\$ 9,187
Year Ending June 30, 2016	400	189	1,929	3,040	2,725	904	9,187
Year Ending June 30, 2017	400	189	1,929	3,040	2,725	879	9,162
Year Ending June 30, 2018	400	189	1,929	3,040	2,725	843	9,126
Year Ending June 30, 2019	400	189	1,929	3,040	2,725	783	9,066
5 Years Ending June 30, 2024	1,995	945	9,645	15,200	13,625	3,223	44,633
5 Years Ending June 30, 2029	1,957	945	9,645	6,080	10,900	1,451	30,978
5 Years Ending June 30, 2034	708	945	9,645			180	11,478
4 Years Ending June 30, 2038		650					650
	<u>\$ 6,660</u>	<u>\$ 4,430</u>	<u>\$ 38,580</u>	<u>\$ 36,480</u>	<u>\$ 38,150</u>	<u>\$ 9,167</u>	<u>\$ 133,467</u>

Continued

Notes to Financial Statements--Continued

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

June 30, 2014

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

The Authority/Corporation entered into an irrevocable direct pay Letter of Credit and Reimbursement Agreement ("LOC") with two banks relating to the Series 2008 Bonds in the amount of \$300,000,000 issued on June 18, 2008. The LOC was issued in an amount (the "Original Stated Amount") equal to the sum of (i) the aggregate principal amount of the outstanding Series 2008A-1 Bonds and the Series 2008A-2 Bonds, plus an amount equal to 202 days of interest thereon at a rate of 14% per annum plus (ii) the aggregate principal amount of the outstanding Series 2008A-3 Bonds, plus an amount equal to 51 days of interest thereon at a rate of 18% per annum. The LOC had an original maturity date of June 17, 2011. The Authority/Corporation and the banks extended the Stated Expiration Date as defined in the LOC to October 14, 2011. On September 8, 2011, the Stated Expiration Date as defined in the LOC was extended to September 13, 2013. On February 19, 2013 a portion of the outstanding Series 2008 Bonds were redeemed pursuant to a Mandatory Tender. On February 20, 2013 an amended LOC was entered into with one of the two banks in an amount of \$142,060,278 representing outstanding principal (\$131,845,000) and accrued interest (\$10,215,278) calculated as described above. At June 30, 2014, there was no balance nor has there been activity on the LOC.

All assets of the 1997 General Bond Resolution Fund, the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, and the 2014 Indenture are pledged for repayment of the specific bond or note issues under each resolution or program.

Note K--Allowance for Arbitrage Liabilities

Certain of the Authority/Corporation's tax-exempt bond issues are subject to potential arbitrage liabilities under U.S. tax law. Arbitrage liabilities, under current federal income tax law regarding tax-exempt bond issues, consist of three types; (1) yield adjustment payments, (2) forgiveness and (3) arbitrage rebate. At June 30, 2014, the Authority/Corporation is reporting a liability for arbitrage rebate of \$69,965.

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.

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

June 30, 2014

Note K--Allowance for Arbitrage Liabilities--Continued

Yield adjustment payments, which also relate to yield restriction on acquired purpose investments, are applicable to all tax exempt bonds. The allowable yield is 2% above the bond yield (arbitrage yield), with the federal special allowance included in income. The loss of tax exempt status may be avoided by rebating 75% of the excess yield to the US treasury at least once every five years subsequent to the 10th anniversary date of the issuance and the full amount upon final maturity of the bonds.

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

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

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

Note L--Deferred Gain on Retirement of Debt

In fiscal year 2010, the Authority/Corporation purchased \$1.198 billion of its own auction rate securities and retired the debt. The resulting \$80.2 million of gain was deferred and is being amortized over the life of the new debt. In addition in fiscal year 2014, the Authority/Corporation purchased \$358.65 million of its own auction rate securities and retired the debt. This resulted in an additional \$7.2 million of gain which was deferred and is being amortized over the life of the remaining life of the old debt. The Authority/Corporation recognized a gain of \$10.1 million for the year ended June 30, 2014. The Authority/Corporation retired additional debt during fiscal year 2014 with cash and recognized approximately \$2.3 million as income in the current period.

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

June 30, 2014

Note M--Retirement Plans

The Authority/Corporation provides retirement benefits to all full-time employees through the Kentucky Employee Retirement System ("KERS"). KERS is a multiple-employer, defined benefit plan sponsored by the Commonwealth of Kentucky, which provides retirement, disability and death benefits. KERS was revised by the Kentucky legislature in March 2013. Employees who begin participation on or after January 1, 2014 contribute to the Cash Balance plan. KERS participants are considered fully vested after the completion of sixty months of service. The Authority/Corporation contributed 26.79% of gross wages for the year ended June 30, 2014. The employees contributed up to 6% of their gross wages to the plan for the year ended June 30, 2014. The KERS contribution requirement for the year ended June 30, 2014 was \$4,720,532 which consisted of employer contributions of \$3,952,533 and employee contributions of \$767,999. Employer contributions for the years ended June 30, 2013 and 2012 were \$3,467,460 and \$2,674,236, respectively. In addition, the March 2013 KERS changes increased participating employers' annual contribution rate by approximately 12% effective July 1, 2014, to reach the full actuarially required contribution rate. These contribution rates are determined by the Board of Trustees of KERS each biennium.

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

Note N--Tuition Benefit Payable

The following assumptions developed by management were used in the actuarial valuation of tuition benefits payable as of June 30, 2014. These assumptions are based on historical data for both state and national trends.

Investment Rates - The investment yield assumption is based on estimates of the yields that will be available on the investment portfolio and cash and cash equivalents. The gross investment yield assumption utilized in the calculation of the tuition benefit payable was 5.74% and 5.94% as of June 30, 2014 and June 30, 2013, respectively.

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

Notes to Financial Statements--Continued

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

June 30, 2014

Note N--Tuition Benefit Payable--Continued

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

- The tuition increases for the 2002-2003 academic year were 32.4% for the Value Plan and 6.4% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2003-2004 academic year were 23.4% for the Value Plan and 14.4% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2004-2005 academic year were 24.2% for the Value Plan and 16.9% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2005-2006 academic year were 6.5% for the Value Plan and 12.5% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2006-2007 academic year were 11.2% for the Value Plan and 12% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2007-2008 academic year were 5.5% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2008-2009 academic year were 5.2% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2009-2010 academic year were 3.3% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2010-2011 academic year were 4.0% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2011-2012 academic year were 3.8% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2012-2013 academic year were 3.8% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2013-2014 academic year were 2.9% for the Value Plan and 3.0% for the Standard Plan and the Premium Plan.
- As of June 30, 2014, the tuition increases for the 2014-2015 academic year were 2.1% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan. The tuition increase assumption was 6.75% for the 2014-2015 academic year and 6.75% for each year thereafter.

Continued

Notes to Financial Statements--Continued

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

June 30, 2014

Note N--Tuition Benefit Payable--Continued

For the period from inception to June 30, 2014, the annualized tuition increase for the highest-priced Kentucky public university, as applicable to the tuition benefits payout rate of Kentucky's Affordable Prepaid Tuition Standard Plan, which represents 92.3% of the Plan's enrollments, has been 8.3%. 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, 2014, has been 10.50%. For the University of Kentucky, as applicable to the tuition benefits payout rate of the Premium Plan, the average annualized tuition increase from inception to June 30, 2014 has been 8.90%.

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

Note O--Restricted Net Position

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

- a. **Federal Student Loan Reserve Fund:** Net position is restricted for certain FFELP activities, primarily the payments of claims.
- b. **Agency Operating Fund:** Net position is restricted for certain FFELP activities and other student aid activities.
- c. **Education Finance Funds:** Net position is restricted as required by the 1997 General Bond Resolution Fund, the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, and the 2014 Indenture.
- d. **Corporation Operating Fund:** Net position is primarily restricted for an estimated amount of mandatory repurchases of loans subject to bankruptcy claims.
- e. **Student Aid Funds:** The Student Aid net position is restricted for the Student Aid Programs.
- f. **The Trust:** Net position is restricted for use by trust participants.

Notes to Financial Statements--Continued

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

June 30, 2014

Note P--Operating Leases

The Authority/Corporation leases office space and equipment under agreements expiring through 2022. Rental expense was \$1,919,767 for the year ended June 30, 2014. Minimum future rental payments for real estate and equipment, including common area maintenance commitments, at June 30, 2014 are as follows:

Year Ending June 30,	
2015	\$ 1,810,610
2016	659,686
2017	593,990
2018	638,772
2019	638,772
Five Years Ending June 30,	
2020 - 2024	<u>1,863,419</u>
	<u>\$ 6,205,249</u>

Note Q--Commitments and Contingencies

The FSLRF is contingently liable for loans made by financial institutions that qualify for guarantee. The default ratio for loans guaranteed by the Authority/Corporation's loan guarantee operations is below 5% for the fiscal year ended June 30, 2014. The federal government's reinsurance rate for defaults for the fiscal year ending September 30, 2012, 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, 2014 is calculated as follows:

Amount of guaranteed student loans outstanding at lenders	\$ 2,584,192,690
Less minimum federal government share - 75%	<u>1,938,144,518</u>
	<u>\$ 646,048,172</u>

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

June 30, 2014

Note R--Subsequent Events

On August 20, 2014, the Authority/Corporation executed a Warehouse Loan and Security Agreement with a commercial bank (the "Bank") to provide up to \$25,000,000 through a multi-draw term loan ("Credit Facility"). The Credit Facility is restricted to the acquisition of loans made through the Federal Family Education Loan Program and is collateralized by the loans financed with funds advanced by the Bank. In addition, this \$25,000,000 Credit Facility and an existing \$30,000,000 Line of Credit with the same Bank are cross-collateralized. Cash and marketable securities of the Operating Funds of the Authority/Corporation are pledged as collateral against any outstanding balance on the \$30,000,000 Line of Credit. The final date for advances on the Credit Facility is the earlier of the date the full \$25,000,000 is advanced or August 19, 2015. The maturity dates on the Credit Facility and the Line of Credit are August 19, 2016 and September 30, 2016, respectively.

Note S—Restatement

The Net Position of the Trust at July 1, 2013 was restated from \$152,589,045 to \$152,527,513. The \$61,532 decrease represents TIAA-managed funds belonging to the Authority/Corporation but previously accounted for in the financial statements of the Trust. The July 1, 2013 Net Position of the Authority/Corporation's Agency Operating Fund was restated by the same amount from \$78,535,623 to \$78,597,155 as was the July 1, 2013 Net Position of the Business-Type Activities on the Combined Government-Wide Statement of Activities from \$215,552,161 to \$215,613,693.

Note T—Recent Pronouncements

In June 2012, the GASB issued Statement No. 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27*. GASB Statement No. 68 addresses accounting and financial reporting for pensions that are provided to the employees of state and local governmental employers through trusts that have defined characteristics. This statement establishes standards for measuring and recognizing liabilities, deferred outflows/inflows of resources and expenses/expenditures. For defined benefit pensions this Statement identifies the methods and assumptions that should be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. In addition, this Statement details the recognition and disclosure requirements for employers with liabilities to a defined pension plan. The Authority/Corporation are currently evaluating this guidance and, while a negative impact on financial position is expected, has not yet determined the dollar amount of the effect of implementation.