Strothman & Company P S C

Certified Public Accountants & Advisors

Financial Statements

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

June 30, 2007

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Independent Auditors' Report

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

We have audited the accompanying financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Kentucky Higher Education Assistance Authority and the Kentucky Higher Education Student Loan Corporation (the "Authority/Corporation") as of and for the year ended June 30, 2007, which collectively comprise the Authority/Corporation's basic financial statements as listed in the accompanying table of contents. These financial statements are the responsibility of the Authority/Corporation's management. Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of Kentucky Education Savings Plan Trust, which statements reflect total assets of $100,648,421 as of June 30, 2007, and total additions to fiduciary net assets of $26,459,767 for the year ended June 30, 2007. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Kentucky Education Savings Plan Trust, is solely based on the report of the other auditors.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Authority/Corporation as of June 30, 2007, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 through 16 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 2, 2007 on our consideration of the Authority/Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

STROTHMAN & COMPANY PSC

Louisville, Kentucky
October 2, 2007

Description of the Business

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

The Authority/Corporation maintains the following operations:

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

Personnel, professional and administrative costs associated with loan guarantee operations are accounted for in the Agency Operating Fund (AOF), a proprietary fund of the Authority/Corporation. All federal program activities related to default aversion, claim payment, claim reinsurance from the 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.

<u>Lender assistance</u> - Lender assistance operations are comprised entirely of loan origination and disbursement services provided by the Authority/Corporation for 119 lenders and 91 schools. The lender assistance operation draws money directly from lenders' accounts and disburses those funds directly to schools. This service is provided on a fee basis to lenders and is free for schools. In fiscal year 2007, the lender assistance operation charged lenders an $8 loan origination fee (per loan), a $3 disbursement fee (per loan), and a $3 disbursement scheduling fee (per loan). The disbursement scheduling fee is not charged if the lender assistance operation is also the disbursement agent.

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

Continued

Lending - The Authority/Corporation's lending operation is authorized to finance FFELP loans for students attending eligible post-secondary institutions, service and collect education loans, and issue bonds and notes not to exceed $5 billion in order to carry out its corporate powers and duties. The FFELP student loans held by the Authority/Corporation include Federal Stafford Loans (Stafford), Unsubsidized Stafford Loans (Unsubsidized Stafford), Federal Supplemental Loans for Students (SLS), Federal Parent Loans for Undergraduate Students (PLUS), and Federal Consolidation Loans (Consolidations). As of June 30, 2007, the lending operation owned $1.782 billion of student loans.

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

The Authority/Corporation's lending operation finances all FFELP loans with revenue bonds or a line of credit. The line of credit is used primarily to buy loans held for sale to the Alabama Higher Education Loan Corporation, and to serve as a temporary financing vehicle for FFELP loans. The lending operation maintains General Bond Resolutions (GBRs) and separate Series Resolutions for issue of revenue bonds, which contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received. As of June 30, 2007, the lending operation maintained $2.047 billion of revenue bonds outstanding and an additional $10 million outstanding balance against the line of credit.

Personnel, professional and administrative costs associated with lending operations are accounted for in the operating fund, a proprietary fund of the Authority/Corporation. Loans, revenue bonds, related assets and liabilities and revenues and expenses are accounted for in the Education Finance Fund, a proprietary fund of the Authority/Corporation.

Loan servicing - The loan servicing operation performs servicing and default aversion activities on FFELP and alternative loans held by the Authority/Corporation's lending operation and other lenders. Of the loans serviced, approximately $1.782 billion in outstanding principal of FFELP Loans was held by the lending operation and pledged pursuant to the 1983 GBR, the 1997 GBR, the Line of Credit Trust Agreement or the 2004 GBR and approximately $6.2 billion of FFELP Loans and other education loans were owned by other holders, including holders with national lending operations. For loans owned by other holders, the loan servicing operation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities.

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

Student aid - Student aid operations provide administration of six student aid programs; (1) the Kentucky Tuition Grant program, (2) College Access Program, (3) Kentucky Educational Excellence Scholarship program (4) Teacher Scholarship program, (5) Osteopathic Medicine Scholarship program, and (6) the Work-study program. The student aid operation also provides administrative support and assistance for four student aid program; (1) Robert C. Byrd Scholarship program, (2) Mary Jo Young Scholarship program, (3) Early Childhood Development program, and (4) the

Continued

Kentucky National Guard Tuition Award program. In fiscal year 2007, the student aid program provided direct benefits to students totaling $188.8 million.

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

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

In fiscal year 2007, outreach staff traveled 186,000 miles, provided 586 exhibits, 851 presentations, and made direct contact with 109,000 parents and/or students.

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

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

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

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

Contributions in the Managed Allocation Option are allocated among six age bands, based on the age of the beneficiary. Prior to January 17, 2004, there were eleven age bands. Each age band invests in varying percentages in the Institutional Class of the International Equity, Growth Equity, Growth & Income, Inflation-Linked Bond, Equity Index, Small-Cap Blend Index, Bond, Large-Cap Value Index, Real Estate Securities, and Money Market Funds of the TIAA-CREF Institutional Mutual Funds. The 100% Equity Option invests in varying percentages in the Institutional Class of the International Equity and Growth & Income Funds of the TIAA-CREF Institutional Mutual Funds. These percentages are determined by the Authority/Corporation's Board of Directors and are subject 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

Continued

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

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

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

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

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

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

Continued

Personnel, professional and administrative costs associated with college savings plan operations 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.

Overview of Financial Statements

This discussion and analysis is intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements comprise three components: 1) government-wide financial statements, 2) fund financial statements, and 3) notes to financial statements. This report contains other supplementary information in addition to the basic financial statements.

The government-wide statement of net assets and statement of activities include the Governmental Funds and Proprietary Funds. The government-wide financial statements can be found on pages 17-18 of this report. The fund financial statements can be found on pages 19-24 of this report.

Fiduciary funds are used to account for resources held for the benefit of parties outside the Authority. Fiduciary funds are not reflected in the government-wide financial statements because the resources are not available to support the Authority's programs. The fiduciary fund statement of fiduciary net assets (deficit) and changes in fiduciary net assets (deficit) can be found on pages 25-26 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, 2007 and 2006, respectively.

Condensed Financial Information - Governmental Fund and Proprietary Funds

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

	Governmental Fund		Proprietary Funds	
	2007	2006	2007	2006
Net Asset Information				
Capital assets			$ 13,419,460	$ 14,986,403
Other assets	$ 15,654,343	$ 17,257,192	2,183,307,622	1,838,174,553
Total Assets	**15,654,343**	**17,257,192**	**2,196,727,082**	**1,853,160,956**
Long-term liabilities			2,066,182,349	1,725,995,860
Other liabilities	277,827	185,171	23,970,497	33,832,843
Total Liabilities	**277,827**	**185,171**	**2,090,152,846**	**1,759,828,703**
Net assets invested in capital, net of debt			6,624,884	7,845,152
Restricted net assets	15,376,516	17,072,021	99,949,352	85,487,101
Total Net Assets	**$ 15,376,516**	**$ 17,072,021**	**$ 106,574,236**	**$ 93,332,253**
Activity Information				
Interest and investment income	$ 9,678	$ 205,301	$ 15,655,567	$ 12,640,680
State General Fund revenue	164,481,522	160,557,148		
Student Aid & Advancement Fund revenue				
Unclaimed Lottery Revenue	15,300,000	11,311,000		
Federal funds revenue	1,469,308	1,469,085		
Tobacco settlement revenue	1,005,982	860,503		
Service fees			14,392,322	11,821,926
Debt recovery commission			12,226,438	8,716,891
Federal fees earned			7,721,033	8,666,987
Default aversion fee income			2,246,097	1,659,605
Interest income on loans			137,290,685	108,559,598
Other income	1,088,680	2,449,517	900,423	702,090
Total Revenues	**183,355,170**	**176,852,554**	**190,432,565**	**152,767,777**
Kentucky Tuition Grants	32,168,478	28,225,907		
College Access Program Grants	60,389,711	56,717,885		
Robert C. Byrd Scholarships	571,215	534,530		
Mary Jo Young Scholarships	457,139	495,427		
Early Childhood Development	1,143,543	968,916		
National Guard Tuition Awards	4,027,927	3,042,347		
Kentucky Education Excellence Scholarships	89,295,070	87,577,069		
Teacher Scholarships	2,219,550	2,116,590		
Osteopathic Medicine Scholarships	1,300,407	360,628		
Work-study	895,009	864,008		
Outreach and other activities	1,544,389	1,138,021		
Guarantee operations			4,752,578	5,034,366
Default collection			3,682,205	3,110,830
Lending and related activities			156,705,936	119,191,502
Lender assistance			2,496,441	2,643,711
Other activities			461,783	289,831
Total Expenditures	**194,012,438**	**182,041,328**	**168,098,943**	**130,270,240**
Change in Net Assets Before Operating Transfers	**(10,657,268)**	**(5,188,774)**	**22,333,622**	**22,497,537**
Interfund transfer	8,961,763	10,010,671	(8,961,763)	(10,010,671)
Transfer to state treasury				(59,000,000)
Transfer to KAPT			(129,876)	(241,536)
Change in Net Assets	**$ (1,695,505)**	**$ 4,821,897**	**$ 13,241,983**	**$ (46,754,670)**

Financial Analysis – Governmental and Proprietary Funds

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

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's government-wide performance for the fiscal year ended June 30, 2007. Please read it in conjunction with the Authority's financial statements and notes to the financial statements, which follow this section.

Financial Overview

- The Authority/Corporation's proprietary fund total assets increased approximately $344 million (18.54%), from $1.85 billion to $2.20 billion. This increase was caused primarily by the $313 million increase in loans and related accruals and $31 million increase in cash.

- The Authority/Corporation's proprietary fund liabilities increased $330 million (18.77%), from $1.76 billion to $2.09 billion. The increase in liabilities resulted primarily from $350 million of bonds issued in fiscal year 2007, net of $9.5 million decrease in arbitrage liability and $12.5 million decrease in third-party loan receipts payable to Access Group.

- The Authority/Corporation's proprietary fund revenues increased $37.6 million (26.47%), the majority of which related to loan interest revenue (increased $28.7 million), debt recovery commission (increased $3.5 million) and servicing fees (increased $2.6 million).

- The Authority/Corporation's total proprietary fund expenses increased $37.8 million (29%), comprised almost entirely from the increase in interest expense of $37.5 million (31.5%).

- The Authority/Corporation's governmental fund assets decreased 10% from $17.2 million to $15.6 million, while liabilities remained relatively constant

- The Authority/Corporation's governmental fund revenues increased $6.5 million (3.68%), resulting from additional state funding for student aid programs and use of the unclaimed lottery fund.

- The Authority/Corporation's governmental fund expenditures increased $11.9 million (6.6%), due primarily to increases in the Kentucky Tuition Grant ($3.9 million), College Access program grant ($3.6 million) and Kentucky Educational Excellence Scholarship ($1.7 million) programs.

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Statement of Net Assets

Total government fund net assets decreased $1.7 million. In the prior fiscal year, the Authority/Corporation was more conservative with the use of student aid funds to accommodate the use of the newly implemented student aid delivery system, Zip Access. To address new procedures programmed into Zip Access, the Authority/Corporation managed its student aid funds more conservatively, thus resulting in student aid carry forward of $5 million at 2006 fiscal year end. In fiscal year 2007, the student aid staff members and accounting staff members became more familiar with the nuances of the Zip Access system and were able to process student aid awards more efficiently, which resulted in a student aid carry forward of only $3 million at 2007 fiscal year end. The conversion loan (Teacher Scholarship Loans and Osteopathic Medicine Scholarship Loans) balances remained relatively constant from fiscal year 2006 to 2007, increasing only $392,000. Note that the Authority/Corporation implemented a conversion loan amnesty program in fiscal year 2007, where a borrower could pay off his/her loan by paying 106% of the original principal balance. This amnesty program resulted in increased collections on certain portions of the conversion loan portfolio. Unfortunately, some borrowers with older conversion loans did not participate in this program and their loans were forwarded to Department of Revenue (as required by Kentucky House Bill 164 and Kentucky Senate Bill 228).

Total proprietary fund net assets increased $13.2 million (14.2%), of which $1 million is attributable to loan guarantee operations ($6.2 million income), $100,000 attributable to lender assistance operations, $8.5 million attributable to defaulted loan collection operations, and $3.7 million attributable to lending and loan servicing activities, net of student aid administration transfers ($5.3 million).

Certain highlights related to the statement of net assets as of June 30, 2007, are as follows:

- The lending and loan servicing operation maintained cash and investment reserves of $22.5 million, which represents over 6 months operating reserves.
- The loan guarantee, lender assistance and default collection operations maintained cash and investment reserves of $13.5 million, which represents over 9 months operating reserves.
- The lending operation maintained $1.782 billion of student loans.
- The servicing operation serviced $6.8 billion of student loans.
- The guarantee operation insured $3.9 billion of student loans.
- The defaulted loan collection operation serviced a portfolio of defaulted loans totaling $206 million.

Statement of Revenues, Expenditures, and Changes in Net Assets

The Authority/Corporation's Governmental fund received an additional $7.9 million in fiscal year 2007, comprised of General Funds ($3.9 million) and unclaimed lottery proceeds ($4 million). The principle reason for the increase in state funding was an increase in projected lottery net revenues (from $154.5 million in 2006, to $162.5 million in 2007), net of other General Fund receipts.

Continued

In the prior fiscal year (2006) the student aid operation reduced its allowance for uncollectible conversion loans by $1.8 million, which was recorded as other income. The allowance was reduced because of significant improvements made by the Authority's collection area and implementation of Kentucky Senate Bill 228 and Kentucky House Bill 162 (which required the student aid operation to send certain conversion loans to the Department of Revenue for collection, as previously noted). In fiscal year 2007, the student aid operation increased the allowance for loan loss by $900,000, all of which was recorded as expense.

Governmental expenditures increased 6.6% ($11.9 million), which is comprised of a relatively insignificant increase in indirect expenses ($300,000) and an $11.6 million increase in direct benefits. Direct benefits increased primarily due to the increases in the Kentucky Tuition Grant (KTG) awards ($3.9 million), College Access Program (CAP) awards ($3.6 million), and Kentucky Educational Excellence Scholarship (KEES) awards ($1.7 million). The remaining $2.4 million increase was spread relatively evenly among the other student aid programs. The increases in KTG, CAP and KEES resulted from increased lottery funds received. Other increases were funded primarily by carry forward funds from fiscal year 2006.

Total proprietary fund revenues increased $37 million, resulting from additional loans held by the lending operation ($313 million increase in loans and related accruals), increase in interest rates on loans (90 basis point increase in 90-day Commercial Paper rates), increased servicing fees from Access Group (renegotiated service levels resulting in $2.5 million of additional revenue) and increased collection of defaulted loans (from $42 million collected in fiscal year 2006, to $65 million collected in fiscal year 2007).

Total proprietary fund expenditures increased $37.8 million (29%), resulting from additional bonds issued by the lending operation ($350 million), increased interest rates on variable rate bonds (90 basis point increase in 30-day LIBOR, which approximates 90-day Commercial Paper), and increases in servicing costs needed to meet renegotiated service levels for Access Group.

Transfers decreased in fiscal year 2007, primarily resulting from a $59 million transfer to the state's General Fund mandated in prior year. In fiscal year 2007, no such transfer was required.

Certain highlights related to the statement of revenues, expenditures and changes in net assets for the year ended June 30, 2007, are as follows:

- The lending operation provided $44.2 million of borrower benefits to borrowers, including:
    - $20.6 million to all borrowers,
    - $6.2 for Kentucky nurses,
    - $16.4 million for Kentucky teachers,
    - $700,000 for Kentucky public defenders, and
    - $1.2 million for other borrowers
- The loan servicing operation received $11.8 million to service loans held by third-parties.
- The lender assistance operation received $2.6 million to provide loan origination and disbursement services assistance to lenders.
- The defaulted loan collection operation received $12.2 million in commissions on the $65 million collected on behalf of the USDE.
- The lending operation received $45.2 million of interest income, net of interest expense.

Condensed Financial Information - Fiduciary Funds

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

	Federal Student Loan **Reserve Fund**		Agency **Fund**		Kentucky Affordable Prepaid **Tuition**		Kentucky Education Savings **Plan Trust**	
	2007	**2006**	**2007**	**2006**	**2007**	**2006**	**2007**	**2006**
Net Asset Information								
Capital assets								
Other assets	$ 26,379,920	$ 14,475,858	$ 317,442	$ 693,785	$ 157,302,703	$ 143,763,132	$ 100,707,146	$ 78,609,020
Total Assets	**26,379,920**	**14,475,858**	**317,442**	**693,785**	**157,302,703**	**143,763,132**	**100,707,146**	**78,609,020**
Total Liabilities	**19,724,093**	**13,242,816**	**317,442**	**693,785**	**171,317,579**	**164,072,370**	**58,725**	**153,336**
Net assets invested in capital, net of debt					-	-		
Restricted net assets (deficit)	6,655,827	1,233,042			(14,014,876)	(20,309,238)	100,648,421	78,455,684
Total Net Assets	**$ 6,655,827**	**$ 1,233,042**	**$ -**	**$ -**	**$ (14,014,876)**	**$ (20,309,238)**	**$ 100,648,421**	**$ 78,455,684**
Changes in Fiduciary Net Asset Information								
Federal reinsurance	$ 68,527,251	$ 64,027,230						
Fee revenue	7,770,394							
Contributions					$ 1,947,236	$ 5,197,618		
Subscriptions							$ 14,443,308	$ 12,380,079
Investment revenue	554,041	283,129			16,819,098	7,364,072		
Other income	965,373	566,438			3,764		12,016,459	4,971,314
Total Additions	**77,817,059**	**64,876,797**			**18,770,098**	**12,561,690**	**26,459,767**	**17,351,393**
Administrative expenses					747,292	872,900		430,570
Refunds					922,247	1,421,005		
Trustee expense					458,121	313,210		
Tuition benefits					10,477,952	23,907,932		
Loan claims	68,997,032	69,235,562						
Redemptions							4,267,030	3,835,254
Default aversion	2,246,097	1,659,605						
Other expenses	-	3,484,525				2,517		
Total Deductions	**71,243,129**	**74,379,692**			**12,605,612**	**26,517,564**	**4,267,030**	**4,265,824**
Change in Net Assets Before Operating Transfer	**6,573,930**	**(9,502,895)**			**6,164,486**	**(13,955,874)**	**22,192,737**	**13,085,569**
Operating Transfers								
Transfer to USDE for Recall	(1,151,145)							
Transfer from Agency Operating Fund					129,876	241,536		
Transfer from Unclaimed Property Fund								
Change in Net Assets After Operating Transfers	**$ 5,422,785**	**$ (9,502,895)**			**$ 6,294,362**	**$ (13,714,338)**	**$ 22,192,737**	**$ 13,085,569**

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, 2007. Please read it in conjunction with the Authority/Corporation's financial statements and notes to the financial statements, which follow this section.

Financial Overview

- Default claims paid increased from $61 million in fiscal year 2006 to $79 million in fiscal year 2007 (30% increase).

- The Federal Student Loan Reserve Fund (FSLRF) incurred a one-time $3.4 million expense in prior fiscal year (2006) resulting from Account Maintenance Fee shortfall payment from the FSLRF to the Agency Operating Fund (AOF).

- The FSLRF paid the U.S. Treasury $1.15 million in fiscal year 2007, related to guarantee agency mandatory recall included in the 1998 Budget Reduction Act.

- The FSLRF commenced charging the Federal Default Fee on all loans guaranteed and disbursed after June 30, 2006, as required by federal regulations. Default Fee revenue totaled $7.8 million in fiscal year 2007.

- The Plan noted an increase of tuition benefits payable of $13.4 million in fiscal year 2007, largely due to a 9% increase in tuition at the University of Kentucky in academic year 2006-2007.

- Interest and investment income in the Plan increased from $7.3 million to $16.8 million, an increase of 128% compared to prior year.

Statement of Fiduciary Net Assets (Deficit)

The FSLRF net assets increased $5.4 million over prior year. Assets increased approximately 82% ($11.9 million), while liabilities increased only 49% ($6.5 million). The increase in assets is attributed to the increase in cash and cash equivalents of $9.7 million, increase in receivables from the USDE of $3.3 million, net of the reduction of cash restricted for recall of $1.1 million. The increase in cash and cash equivalents was caused by the Authority/Corporation delaying certain payments to the AOF in order to maintain sufficient cash on hand to pay claims in August and September 2007. Proposed Federal legislation, which is expected to pass by September 30, 2007, would eliminate the Exceptional Performer (EP) designation for loan servicers. Currently, lenders who use a loan servicer with the EP designation enjoy a risk share of only 1% on all defaulted loan claims. Lenders who do not use an EP loan servicer have risk exposure up to 3% on defaulted loan claims. With the expectation that the EP designation will be eliminated, the Authority/Corporation's loan guarantee operation expects to be flooded by claims from EP loan servicers in an attempt to minimize the risk share on defaulted loans. The increase in cash also resulted from the newly implemented default fee, which produced $7.8 million in additional revenue.

Continued

The increase in accounts receivable resulted from higher claim volume in June 2007, causing an increased amount due from the USDE for reimbursement of those claims. The increase in liabilities is comprised of the increase in payables to the AOF of approximately $8.3 million and the $1 million increase in rehabilitation loans payable to the USDE, net of a decrease in the reserve for loan loss of $2.8 million. In fiscal year 2007, the USDE provided all guarantee agencies with a standard calculation for reserve for loan loss. As previously noted, the FSLRF has delayed certain payments to the AOF to build cash reserves to pay expected higher claim volume in August and September 2007. The $1 million increase in rehabilitation loans payable to the USDE resulted from a substantial increase in rehabilitation loan collection activity in fiscal year 2007. In fiscal year 2007, the Authority/Corporation's default collection operation collected $21 million via the loan rehabilitation process, compared to $6 million collected via loan rehabilitation in fiscal year 2006. In prior years, each guarantee agency had its own method for calculating the reserve for loan loss, and some (including the Authority/Corporation) were very conservative. The change of estimate by the Authority/Corporation to the standard calculation required by the USDE resulted in the $2.8 million decrease in reserve.

The Agency Fund serves as a conduit for loan proceeds transacted between lenders and schools. The Authority typically maintains Agency funds for lenders and schools for less than three business days. At June 30, 2006, the Authority/Corporation maintained $693,785 on behalf of lenders. At June 30, 2007, the Authority/Corporation maintained $317,442 on behalf of lenders. The amount of agency funds at 2007 fiscal year end is consistent with prior year.

The Plan's total assets increased $13.5 million, which resulted from an increase in investments of $16.8 million, net of the tuition benefits paid to plan participants of $3.3 million. Cash and investments increased approximately $20 million because of contract receipts of $7.8 million (including $2 million of contract income), plus investment income ($16.8 million), less benefits ($3.3 million) and expenses paid ($1.3 million).

The Plan liabilities increased $7.2 million, almost entirely from the increase in tuition benefits payable and related expenses calculated by the actuary. In the prior fiscal year, the actuary projected that the tuition benefit liability would increase approximately $5 million in fiscal year 2007. Accordingly, only $2.2 million of the fiscal year 2007 increase resulted from a change in actuarial assumptions for tuition increases. Note that assumptions related to administrative expenses and investment expense remained consistent with prior year. The change in tuition increases assumptions are as follows:

- 2008-2009 academic year – actual tuition increase was only 9%; compared to the actuarial assumption of 11%.
- 2008-2009 academic year – tuition increase assumption remained at 10%.
- 2009-2010 academic year – tuition increase assumption increased from 7% to 8.5%.
- 2010 – thereafter academic years – tuition increase assumption remained at 7%

Projected investment expense for the life of the program is accrued as a liability and was calculated as 35 basis points on all invested assets. Accrued investment expense ($3.3) million was consistent with prior year. Projected administrative expenses for the life of the program are also accrued as a liability and remained unchanged at $1.7 million.

Continued

The Trust is an Internal Revenue Code 529 plan managed by the Authority and administered on behalf of the Authority by TFI. Trust assets are entirely comprised of cash and pooled investments. Total assets increased approximately $22.1 million, due to new subscriptions received ($14.4 million) and investment income ($12 million), net of expenses and redemptions ($4.3 million). Trust liabilities remained relatively constant during the fiscal year.

Changes in Fiduciary Net Assets (Deficit)

The FSLRF had an increase in fiduciary net assets by approximately $5.4 million for the year ended June 30, 2007, which was $14.9 million better than previous fiscal year. The FSLRF incurred some unusual one-time expenses in fiscal year 2006, which did not occur in 2007; including:

- In fiscal year 2006, the FSLRF increased in reserve for loan loss by $2.6 million, where in fiscal year 2007, the FSLRF actually decreased the loan loss provision by $2.8 million, accounting for $5.4 million of the change from prior year.
- In fiscal year 2006, the FSLRF incurred a one time expense for AMF shortfall of $3.4 million, payable to the AOF. In fiscal year 2007, federal regulations changed FSLRF no longer pay the AMF shortfall amount to the AOF.

Also, in fiscal year 2007, federal regulations required the FSLRF to charge a default fee on all loans guaranteed and disbursed after June 30, 2007, resulting in $7.8 million of additional revenue in fiscal year 2007. In fiscal year 2007, the FSLRF was also required to transfer $1.1 million to the U.S. Treasury as required by the 1998 Budget Reduction Act. The remaining $600,000 change from prior fiscal year resulted from an increase in default aversion fees paid to the AOF. The increase in default aversion fees resulted from an increase in delinquent loans in fiscal year 2007 compared to prior year, mainly attributable to the EP designation program. As lenders enjoyed lower risk share on defaulted loan claims, many of them decreased their investment in "true" default aversion activities; which resulted in additional delinquent accounts.

The Plan recognized a decrease in net deficit of $6.3 million for fiscal year 2007 compared to a $13.7 million increase in net deficit for the prior year. The results from Plan operations improved $20 million compared to prior year.

The $20 million improvement over prior year resulted from the following:

- In fiscal year 2007, the Plan's investment income outperformed prior year's by $9.5 million.
- Tuition benefits and related expenses increased only $10.5 million in fiscal year 2007, compared to $23.9 million in the prior fiscal year; a $13.4 million improvement.
- Contract and other income in fiscal year 2007 was $1.9 million, compared to $5.2 million in the previous fiscal year; a decrease of $3.3 million
- Other administrative expenses, refunds, net of transfers decreased $400,000.

In fiscal year 2007 and fiscal year 2006, the plan did not hold an enrollment period and contract income was comprised entirely of interest income on existing contracts and net reduction in allowance for contract cancellations. As total contracts receivable decrease (from $24.5 million to $18.6 million), the imputed interest income on these contracts will decrease.

Continued

Furthermore contract income is recorded net of change in allowance for uncollectible contracts. In fiscal year 2006, the Plan recorded a substantial decrease in the allowance for uncollectible contracts ($2 million), compared to the current fiscal year where the allowance decreased only $591,000. The increase in investment income resulted from two factors; (1) in fiscal year 2007, the Plan switch investment advisors from Fifth-Third Bank to State Street Global Advisors resulting in better overall performance compared to benchmarks, and (2) better overall market returns in fiscal year 2007. The benchmark market returns for the Plan are as follows;

- The Domestic Equity Index (49.7% of Plan investments) increased 20.8% in fiscal year 2007, and increased only 14.78% over the entire two-year period.
- The International Policy Index (9.7% of Plan investments) increased 27% in fiscal year 2007, and increased only 26.78% over the entire two year period.
- The fixed Income Policy Index (40.6% of the Plan investments) increased 13.49% in fiscal year 2007, and increased only 9.94% over the entire two year period.

Administrative expenses decreased in fiscal year 2007 by approximately $125,000 due to overall efficiencies at the Authority/Corporation. Refunds decreased $500,000 because of the age of accounts in the Plan. Trustee fee expense increase resulted from the change in investment advisors in fiscal year 2007, which caused Fifth-Third Bank to charge the Plan additional fees related to the conversion of securities to the new trustee, JP Morgan.

The Trust noted an increase in subscriptions of $2 million over prior year, due to increased marketing efforts by TFI and the continuing migration of participants from the Plan to the Trust. Investment income in the trust increased approximately $7 million, because the trust had more assets to invest in fiscal year 2007 ($22 million) and, as noted with the Plan, overall market investment performance in fiscal year 2007 was substantially better than prior fiscal year.

Combined Government-Wide Statement of Net Assets

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

June 30, 2007

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	$ 1,822,919	$ 251,931,536	$ 253,754,455
Receivable from Federal Student Loan Reserve Fund		11,388,129	11,388,129
Accounts receivable	1,184,864	5,128,200	6,313,064
Accrued interest income		45,990,557	45,990,557
Special allowance receivable		6,640,845	6,640,845
Default aversion fees receivable		2,586,464	2,586,464
Investments		11,846,563	11,846,563
Teacher and Osteopathic Medicine scholarship loans	450,000		450,000
Loans held for sale		3,922,952	3,922,952
Total Current Assets	3,457,783	339,435,246	342,893,029
Noncurrent:			
Restricted cash and cash equivalents		8,841,900	8,841,900
Investments		8,879,633	8,879,633
Teacher and Osteopathic Medicine scholarship loans, net	2,450,212		2,450,212
Teacher and Osteopathic Medicine scholarship advances	9,746,348		9,746,348
Fixed assets, net		13,419,460	13,419,460
Loans, net		1,782,581,491	1,782,581,491
Deferred loan purchase premiums and originations costs, net		35,432,654	35,432,654
Deferred bond issuance costs, net		8,136,698	8,136,698
Total noncurrent assets	12,196,560	1,857,291,836	1,869,488,396
Total Assets	15,654,343	2,196,727,082	2,212,381,425
LIABILITIES			
Current:			
Accounts payable and accrued expenses	277,827	13,514,317	13,792,144
Accrued interest expense		56,180	56,180
Line of credit payable		10,000,000	10,000,000
Capital lease payable		400,000	400,000
Total Current Liabilities	277,827	23,970,497	24,248,324
Noncurrent:			
Allowance for arbitrage liabilities		12,342,349	12,342,349
Capital lease payable		6,590,000	6,590,000
Bonds payable		2,047,250,000	2,047,250,000
Total Noncurrent Liabilities		2,066,182,349	2,066,182,349
Total Liabilities	277,827	2,090,152,846	2,090,430,673
NET ASSETS			
Invested in capital assets, net of expended debt proceeds		6,624,884	6,624,884
Unrestricted		20,716,146	20,716,146
Restricted, other		48,437,650	48,437,650
Restricted for program benefits	15,376,516		15,376,516
Restricted for student aid and related activities		30,795,556	30,795,556
Total Net Assets	$ 15,376,516	$ 106,574,236	$ 121,950,752

See Notes to Financial Statements

Combined Government-Wide Statement of Activities

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

For the Year Ended June 30, 2007

			Program Revenue		Net (Expenses) Revenues and Changes in Net Assets		
	Direct Expenses	**Indirect Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Governmental Activities**	**Business-Type Activities**	**Total**
Governmental Activities:							
Kentucky Tuition Grants	$ 31,406,027	$ 762,451		$ 30,436,400	$ (1,732,078)		$ (1,732,078)
College Access Program Grants	59,606,764	782,947		59,560,889	(828,822)		(828,822)
Robert C. Byrd Scholarships	483,573	87,642		483,573	(87,642)		(87,642)
Mary Jo Young Scholarships	327,739	129,400			(457,139)		(457,139)
Early Childhood Development	1,075,214	68,329		1,229,982	86,439		86,439
National Guard Tuition Awards	3,867,434	160,493		22,435	(4,005,492)		(4,005,492)
Kentucky Education Excellence Scholarships	88,441,108	853,962		88,461,841	(833,229)		(833,229)
Teacher Scholarships	1,782,098	437,452		2,278,275	58,725		58,725
Osteopathic Medicine Scholarships	1,047,411	252,996		881,511	(418,896)		(418,896)
Work-study	809,449	85,560		264	(894,745)		(894,745)
Outreach and other activities		1,544,389			(1,544,389)		(1,544,389)
Total Governmental Activities	188,846,817	5,165,621		183,355,170	(10,657,268)		(10,657,268)
Business-Type Activities							
Loan guarantee operations	4,752,578		$ 10,967,637			$ 6,215,059	6,215,059
Default collections	3,682,205		12,253,292			8,571,087	8,571,087
Lender assistance	2,496,441		2,589,127			92,686	92,686
Lending activities	156,705,936		164,160,726			7,454,790	7,454,790
Other activities	461,783		461,783				
Total Business-Type Activities	168,098,943		190,432,565			22,333,622	22,333,622
Total Primary Government	$ 356,945,760	$ 5,165,621	$ 190,432,565	$ 183,355,170	(10,657,268)	22,333,622	11,676,354
Transfers:							
Interfund transfer to Government Fund					8,961,763	(8,961,763)	-
Transfer to KAPT						(129,876)	(129,876)
Total Transfers					8,961,763	(9,091,639)	(129,876)
Change in Net Assets					(1,695,505)	13,241,983	11,546,478
Net Assets, Beginning of Year					17,072,021	93,332,253	110,404,274
Net Assets, End of Year					$ 15,376,516	$ 106,574,236	$ 121,950,752

See Notes to Financial Statements

Combined Statement of Net Assets - Proprietary Funds

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

June 30, 2007

	Authority			Corporation			Combined
ASSETS	**Internal Service Fund**	**Agency Operating Fund**	**Authority Total**	**Education Finance Funds**	**Operating Fund**	**Corporation Total**	**Total Proprietary Funds**
Current:							
Cash and cash equivalents	$ 1,589,053	$ 2,419,423	$ 4,008,476	$ 236,648,992	$ 11,274,068	$ 247,923,060	$ 251,931,536
Receivable from Federal Student Loan Reserve Fund		11,388,129	11,388,129				11,388,129
Accounts receivable	13,806	1,501,841	1,515,647	99,393	3,513,160	3,612,553	5,128,200
Accrued interest income		92,493	92,493	45,818,349	79,715	45,898,064	45,990,557
Special allowance receivable				6,640,845		6,640,845	6,640,845
Default aversion fees receivable		2,586,464	2,586,464				2,586,464
Investments		636,471	636,471		11,210,092	11,210,092	11,846,563
Loans held for sale				3,922,952		3,922,952	3,922,952
Total Current Assets	1,602,859	18,624,821	20,227,680	293,130,531	26,077,035	319,207,566	339,435,246
Noncurrent:							
Restricted cash and cash equivalents	1,531,900	7,310,000	8,841,900				8,841,900
Investments		8,879,633	8,879,633				8,879,633
Internal receivable (payable) for Gear Up Scholarships	(1,500,000)	1,500,000					
Internal receivable (payable) for capital projects	(31,900)	31,900					
Fixed assets, net		10,177,703	10,177,703		3,241,757	3,241,757	13,419,460
Loans, net				1,782,581,491		1,782,581,491	1,782,581,491
Deferred loan purchase premiums and originations costs, net				35,432,654		35,432,654	35,432,654
Deferred debt issuance costs, net		163,524	163,524	7,973,174		7,973,174	8,136,698
Total Noncurrent Assets		28,062,760	28,062,760	1,825,987,319	3,241,757	1,829,229,076	1,857,291,836
Total Assets	1,602,859	46,687,581	48,290,440	2,119,117,850	29,318,792	2,148,436,642	2,196,727,082
LIABILITIES							
Current:							
Accounts payable and accrued expenses	1,008,827	15,843	1,024,670	$8,569,958	$3,869,689	12,439,647	13,464,317
Interfund payable (receivable)	594,032	(1,863,125)	(1,269,093)	(172,107)	1,441,200	1,269,093	
Payable to Governmental Fund					50,000	50,000	50,000
Accrued interest expense		56,180	56,180				56,180
Line of credit payable				10,000,000		10,000,000	10,000,000
Capital lease payable		400,000	400,000				400,000
Total Current Liabilities	1,602,859	(1,391,102)	211,757	18,397,851	5,360,889	23,758,740	23,970,497
Noncurrent:							
Allowance for arbitrage liabilities				12,342,349		12,342,349	12,342,349
Capital lease payable		6,590,000	6,590,000				6,590,000
Bonds payable				2,047,250,000		2,047,250,000	2,047,250,000
Total Noncurrent Liabilities		6,590,000	6,590,000	2,059,592,349		2,059,592,349	2,066,182,349
Total Liabilities	1,602,859	5,198,898	6,801,757	2,077,990,200	5,360,889	2,083,351,089	2,090,152,846
NET ASSETS							
Invested in capital assets, net		3,383,127	3,383,127		3,241,757	3,241,757	6,624,884
Unrestricted					20,716,146	20,716,146	20,716,146
Restricted, other		7,310,000	7,310,000	41,127,650		41,127,650	48,437,650
Restricted for student aid and related activities		30,795,556	30,795,556				30,795,556
Total Net Assets	$ -	$ 41,488,683	$ 41,488,683	$ 41,127,650	$ 23,957,903	$ 65,085,553	$ 106,574,236

See Notes to Financial Statements

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

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

Year Ended June 30, 2007

	Authority			Corporation			Combined
	Internal Service Fund	**Agency Operating Fund**	**Authority Total**	**Education Finance Funds**	**Operating Fund**	**Corporation Total**	**Total Proprietary Funds**
Operating Revenues:							
Servicing fees		$ 2,589,127	$ 2,589,127		$ 11,803,195	$ 11,803,195	$ 14,392,322
Debt recovery commission		12,208,237	12,208,237		18,201	18,201	12,226,438
Federal fees earned		7,721,033	7,721,033				7,721,033
Default aversion fee income		2,246,097	2,246,097				2,246,097
Interest and investment income		1,015,893	1,015,893	$ 12,826,091	1,813,583	14,639,674	15,655,567
Interest on loans				137,252,735	37,950	137,290,685	137,290,685
Loss on sales of loans					(45,335)	(45,335)	(45,335)
Late payment penalties				452,581	1,725	454,306	454,306
Other income	$ 461,783	29,669	491,452				491,452
Total Operating Revenues	461,783	25,810,056	26,271,839	150,531,407	13,629,319	164,160,726	190,432,565
Operating Expenses:							
Personnel and professional services	271,390	8,369,799	8,641,189		22,856,135	22,856,135	31,497,324
Other administrative expenses	183,389	1,890,084	2,073,473		3,896,444	3,896,444	5,969,917
Principal and interest benefits				24,511,457		24,511,457	24,511,457
Depreciation and amortization	3,855	338,620	342,475		2,545,437	2,545,437	2,887,912
Amortization of bond issuance costs		33,325	33,325	319,983		319,983	353,308
Variable bond credit facility and remarketing fees				3,325,792		3,325,792	3,325,792
Change in allowance for arbitrage				(9,396,490)		(9,396,490)	(9,396,490)
Amortization of front end borrower benefits				6,609,536		6,609,536	6,609,536
Amortization of loan purchase premiums and origination costs				1,661,522		1,661,522	1,661,522
Federal consolidation fees				6,437,442		6,437,442	6,437,442
Provision for loan losses				290,341	326,594	616,935	616,935
Interest expense	3,149	276,593	279,742	91,810,838		91,810,838	92,090,580
Other expenses		22,803	22,803	653,265	857,640	1,510,905	1,533,708
Total Operating Expenses	461,783	10,931,224	11,393,007	126,223,686	30,482,250	156,705,936	168,098,943
Operating Income (Loss)		14,878,832	14,878,832	24,307,721	(16,852,931)	7,454,790	22,333,622
Operating Transfers							
Servicing and administration				(21,760,526)	21,760,526		
Interfund transfers				(2,788,028)	2,788,028		
Net Income (Loss) After Operating Transfers		14,878,832	14,878,832	(240,833)	7,695,623	7,454,790	22,333,622
Transfers to/from Other Funds							
Transfer to Government Fund		(5,361,763)	(5,361,763)		(3,600,000)	(3,600,000)	(8,961,763)
Transfer to KAPT		(129,876)	(129,876)				(129,876)
Increase (Decrease) in Net Assets After Transfers		9,387,193	9,387,193	(240,833)	4,095,623	3,854,790	13,241,983
Net Assets, Beginning of Year		32,101,490	32,101,490	41,368,483	19,862,280	61,230,763	93,332,253
Net Assets, End of Year	$ -	$ 41,488,683	$ 41,488,683	$ 41,127,650	$ 23,957,903	$ 65,085,553	$ 106,574,236

See Notes to Financial Statements

Combined Statement of Cash Flows - Proprietary Fund

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

Year Ended June 30, 2007

	Authority			Corporation			Combined
	Internal Service Fund	**Agency Operating Fund**	**Authority Total**	**Education Finance Fund**	**Operating Fund**	**Corporation Total**	**Total Proprietary Funds**
Cash Flows from Operating Activities:							
Service fees received	$ 461,783	$ 2,415,280	$ 2,877,063		$ 10,238,045	$ 10,238,045	$ 13,115,108
Debt recovery commission received		12,208,237	12,208,237		21,060	21,060	12,229,297
Federal fees received		7,721,033	7,721,033				7,721,033
Default aversion fees received		406,028	406,028				406,028
Other, net	(712,077)	(11,315,114)	(12,027,191)	$ (6,571,213)	(34,565,922)	(41,137,135)	(53,164,326)
Principal received on loans				357,842,465	(1,587,376)	356,255,089	356,255,089
Interest received on loans				57,632,350	39,528	57,671,878	57,671,878
Special allowance received				42,483,265		42,483,265	42,483,265
Client loan receipts					1,511,357,557	1,511,357,557	1,511,357,557
Loans purchased, including premiums				(15,051,829)	(276,009)	(15,327,838)	(15,327,838)
Loans originated, including costs				(652,815,925)		(652,815,925)	(652,815,925)
Interfund loan sales and purchases				(1,610,427)	1,610,427		
Credit facility fees paid				(3,370,014)		(3,370,014)	(3,370,014)
Loan receipts remitted to clients					(1,524,240,418)	(1,524,240,418)	(1,524,240,418)
Net Cash Provided By (Used In) Operating Activities	(250,294)	11,435,464	11,185,170	(221,461,328)	(37,403,108)	(258,864,436)	(247,679,266)
Cash Paid from Noncapital Financing Activities:							
Interfund transfers, net		(129,876)	(129,876)				(129,876)
Increase in Federal Student Loan Reserve receivable		(6,391,894)	(6,391,894)				(6,391,894)
Cash requirements		(5,361,763)	(5,361,763)				(5,361,763)
Proceeds from debt issued				361,950,000		361,950,000	361,950,000
Debt issuance costs				(1,384,052)		(1,384,052)	(1,384,052)
Debt principal payments				(1,950,000)		(1,950,000)	(1,950,000)
Interest on debt				(90,491,694)		(90,491,694)	(90,491,694)
Service and Administration Transfer				(21,760,526)	21,760,526		
Interfund Transfers				(2,833,363)	2,833,363		
Transfer to the Government Fund					(3,550,000)	(3,550,000)	(3,550,000)
Net Cash Provided By (Used In) Noncapital Financing Activities		(11,883,533)	(11,883,533)	243,530,365	21,043,889	264,574,254	252,690,721
Cash Flows From Capital and Related Financing Activities							
Interfund transfers, net	1,500,000	(1,500,000)					-
Capital expenditures		(15,750)	(15,750)		(1,414,643)	(1,414,643)	(1,430,393)
Proceeds from sale of equipment		7,236	7,236		150	150	7,386
Bond principle payments		(380,000)	(380,000)				(380,000)
Interest paid on bonds		(279,689)	(279,689)				(279,689)
Net Cash Provided By (Used In) Capital and Related Financing Activities	1,500,000	(2,168,203)	(668,203)		(1,414,493)	(1,414,493)	(2,082,696)
Cash Flows From Investing Activities:							
Purchases of investments		(14,310,607)	(14,310,607)		(17,108,701)	(17,108,701)	(31,419,308)
Proceeds from sales/maturities of investments		14,850,302	14,850,302		16,400,000	16,400,000	31,250,302
Investment income		1,064,714	1,064,714	12,911,446	1,796,829	14,708,275	15,772,989
Proceeds from sale of loans held for sale				4,605,474		4,605,474	4,605,474
Acquisition of loans held for sale				(8,412,913)		(8,412,913)	(8,412,913)
Loss on sale of loans held for sale					(45,335)	(45,335)	(45,335)
Net Cash Provided By Investing Activities		1,604,409	1,604,409	9,104,007	1,042,793	10,146,800	11,751,209

Continued

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

Year Ended June 30, 2007

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Fund	Operating Fund	Corporation Total	Total Proprietary Funds
Net Increases (Decrease) in Cash and Cash Equivalents	1,249,706	(1,011,863)	237,843	31,173,044	(16,730,919)	14,442,125	14,679,968
Cash and Cash Equivalents Beginning of Year	1,871,247	10,741,286	12,612,533	205,475,948	28,004,987	233,480,935	246,093,468
Cash and Cash Equivalents, End of Year	$ 3,120,953	$ 9,729,423	$ 12,850,376	$ 236,648,992	$ 11,274,068	$ 247,923,060	$ 260,773,436
Reconciliation of Operating Income (Loss) to							
Net Cash Provided By (Used In) Operating Activities							
Operating income (loss)		$ 14,878,832	$ 14,878,832	$ 24,307,721	$ (16,852,931)	$ 7,454,790	$ 22,333,622
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:							
Investment income		(1,015,893)	(1,015,893)	(12,911,446)	(1,796,829)	(14,708,275)	(15,724,168)
Depreciation and amortization		477,988	477,988		2,545,437	2,545,437	3,023,425
Loss on equipment disposal					(150)	(150)	(150)
Interest expense		279,689	279,689				279,689
Amortization of bond issuance costs				319,983		319,983	319,983
Amortization of loan purchase premiums and origination costs				8,271,058		8,271,058	8,271,058
Interest on debt				91,810,838		91,810,838	91,810,838
Provision for loan losses				290,341	326,594	616,935	616,935
Loss on sale of loans					45,335	45,335	45,335
Borrower interest converted to principal				(25,743,326)	(147)	(25,743,473)	(25,743,473)
Loan forgiveness				24,511,457		24,511,457	24,511,457
Net change in fair value of investments					(1,081)	(1,081)	(1,081)
(Increases) decreases in assets:							
Receivables	$ (9,603)	(173,847)	(183,450)	(98,306)	(1,357,904)	(1,456,210)	(1,639,660)
Default aversion fee receivable		(1,840,069)	(1,840,069)				(1,840,069)
Accrued interest receivable		(8,947)	(8,947)	(18,248,319)	(15,673)	(18,263,992)	(18,272,939)
Special allowance receivable				6,487,300		6,487,300	6,487,300
Interfund receivable/payable	154,477	(1,158,184)	(1,003,707)	1,177,521	(173,814)	1,003,707	
Increases (decreases) in liabilities:							
Accounts payable and accrued expenses	(395,168)	(1,009)	(396,177)	(586,923)	(19,868,987)	(20,455,910)	(20,852,087)
Interest payable		(3,096)	(3,096)				(3,096)
Allowance for arbitrage liabilities				(9,413,511)		(9,413,511)	(9,413,511)
Principal received on loans				357,842,465	(1,587,376)	356,255,089	356,255,089
Loans purchased, including premiums				(15,051,829)	(276,009)	(15,327,838)	(15,327,838)
Loans originated, including costs				(652,815,925)		(652,815,925)	(652,815,925)
Interfund loan sales and purchases				(1,610,427)	1,610,427	-	
Net Cash Provided by (Used In) Operating Activities	$ (250,294)	$ 11,435,464	$ 11,185,170	$ (221,461,328)	$ (37,403,108)	$ (258,864,436)	$ (247,679,266)

See Notes to Financial Statements

Balance Sheet - Governmental Fund

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

Year Ended June 30, 2007

ASSETS	Governmental Fund Student Aid
Current:	
Cash and cash equivalents	$ 1,822,919
Due from Corporation	50,000
Accounts receivable	1,134,864
Teacher and Osteopathic Medicine scholarship loans	450,000
Total Current Assets	3,457,783
Noncurrent:	
Teacher and Osteopathic Medicine scholarship loans, net of allowance of $3,600,000	2,450,212
Teacher and Osteopathic Medicine scholarship advances	9,746,348
Total Noncurrent Assets	12,196,560
Total Assets	15,654,343
LIABILITIES	
Current:	
Accounts payable	277,827
Total Liabilities	277,827
FUND BALANCE	
Fund balance - restricted for program benefits	$ 15,376,516

See Notes to Financial Statements

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

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

Year Ended June 30, 2007

	Governmental Fund Student Aid
Revenues:	
Interest and investment income fund	$ 9,678
Tobacco Settlement revenue	1,005,982
Unclaimed Lottery Revenue	15,300,000
State General Fund revenue	164,481,522
Federal funds revenue	1,469,308
Other income	1,088,680
Total Revenues	183,355,170
Expenditures:	
Kentucky Tuition Grants	32,168,478
College Access Program Grants	60,389,711
Robert C Byrd Scholarships	571,215
Mary J Young Scholarships	457,139
Early Childhood Development Scholarships	1,143,543
National Guard Tuition Awards	4,027,927
Kentucky Education Excellence Scholarships	89,295,070
Teacher Scholarships	2,219,550
Osteopathic Medicine Scholarships	1,300,407
Work Study	895,009
Outreach and other activities	1,544,389
Total Expenditures	194,012,438
Excess of Expenditures Over Revenues	(10,657,268)
Other Financing Sources and Uses, Including Transfers	
Transfer from Authority Agency Operating Fund	5,361,763
Transfer from Corporation Operating Fund	3,600,000
Total Other Financing Sources and Uses, Including Transfers	8,961,763
Net Change in Fund Balance	(1,695,505)
Fund Balance, Beginning of Year	17,072,021
Fund Balance, End of Year	$ 15,376,516

See Notes to Financial Statements

Statement of Fiduciary Net Assets (Deficit)

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

June 30, 2007

ASSETS	Federal Student Loan Reserve Fund	Agency Fund	Kentucky's Affordable Prepaid Tuition	Kentucky's Educational Savings Plan Trust
Current:				
Cash and cash equivalents	$ 15,299,050	$ 317,442	$ 1,565,587	$ 954,178
Contributions receivable			5,296,319	
Fees receivable			202,671	
Investments				99,594,720
Receivables	9,524,313			158,248
Accrued interest income	16		998	
Other current assets	405,396			
Total Current Assets	25,228,775	317,442	7,065,575	100,707,146
Noncurrent:				
Investments			136,897,623	
Contributions receivable			13,339,505	
Restricted investments, cash and cash equivalents	1,151,145			
Total Noncurrent Assets	1,151,145		150,237,128	
Total Assets	26,379,920	317,442	157,302,703	100,707,146
LIABILITIES				
Current:				
Accounts payable	2,242,614		133,280	18,792
Accrued expenses	3,492,137			39,933
Origination distribution payable		317,442		
Payable to Agency Operating Fund	11,402,878			
Default Aversion fees payable	2,586,464			
Total Current Liabilities	19,724,093	317,442	133,280	58,725
Noncurrent:				
Tuition benefits payable			171,184,299	
Total Liabilities	19,724,093	317,442	171,317,579	58,725
NET ASSETS (DEFICIT)				
Restricted for program benefits			(14,014,876)	100,648,421
Restricted for USDE recall	1,151,145			
Restricted for other purposes	5,504,682			
Total Net Assets (Deficit)	$ 6,655,827	$ -	$ (14,014,876)	$ 100,648,421

See Notes to Financial Statements

Statement of Changes in Fiduciary Net Assets (Deficit)

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

Year Ended June 30, 2007

	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky's Educational Savings Plan Trust
Additions:			
Federal reinsurance	$ 68,527,251		
Fee revenue	7,770,394	$ 3,122	
Contract income, net		1,910,898	
Subscriptions			$ 14,443,308
Investment Revenue:			
Net unrealized gain (loss) on investments		(2,341,521)	9,298,506
Interest and investment Income	554,041	19,160,619	3,179,017
Other Income	965,373	3,764	
Total Investment Revenues	1,519,414	16,822,862	12,477,523
Total Additions	77,817,059	18,736,882	26,920,831
Deductions:			
Program benefits:			
Loan claims	68,997,032		
Default aversion fee expense	2,246,097		
Redemptions			4,267,030
Administrative expenses		94,751	
Personnel and professional expenses		554,019	
Other administrative expenses		98,522	461,064
Refunds		922,247	
Trustee fee expense		458,121	
Tuition benefits expense, net		10,444,736	
Total Deductions	71,243,129	12,572,396	4,728,094
Change in Net Assets Before Transfers	6,573,930	6,164,486	22,192,737
Transfers:			
Transfer to USDE for recall	(1,151,145)		
Transfer from Internal Service Fund		129,876	
Change in Net Assets	5,422,785	6,294,362	22,192,737
Net Assets (Deficit), Beginning of Year	1,233,042	(20,309,238)	78,455,684
Net Assets (Deficit), End of Year	$ 6,655,827	$ (14,014,876)	$ 100,648,421

See Notes to Financial Statements

Note A--Description of Business

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

The Authority/Corporation's loan guarantee operations guarantees loans to qualified students and parents of qualified students made by approved lenders in Kentucky and Alabama. Commencing in 1969, retroactive to 1965, the federal government agreed to insure 80% of such guaranteed student loans under the Guaranteed Student Loan Program, now known as the Federal Family Education Loan Program (FFELP). The FFELP, under which the Authority/Corporation operates, was established by Congress and is administered by the U.S. Department of Education (the USDE) as a means of making loans available to students attending colleges, universities, and vocational institutions. The FFELP provides for the Authority/Corporation's loan guarantee operations to guarantee the repayment of principal and accrued interest to lenders for each eligible student loan. The Authority/Corporation's loan guarantee operation is responsible for processing loans submitted for guarantee, issuing loan guarantees, providing collection assistance to lenders for delinquent loans, paying lender claims for loans in default, paying lender claims for death, disability or bankruptcy, and collecting loans on which default claims have been paid. The Authority/Corporation also educates schools and lenders of FFELP requirements and regulatory changes, and encourages lender participation. Effective January 10, 1977, the Authority/Corporation's loan guarantee operation entered into a supplemental guaranty agreement with the federal government, which provided up to 100% reimbursement, depending upon default experience as specified in the agreement. Subsequently, federal reinsurance on guaranteed loans made from October 1, 1992 to September 30, 1998 was reduced to a maximum of 98% and federal reinsurance on guaranteed loans made on or after October 1, 1998, was reduced to a maximum of 95% (see Note E).

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

Continued

Note A--Description of Business--Continued

The guarantee reserves of the Authority/Corporation were required to be deposited in the new Federal Fund no later than 60 days after enactment. The result of this federal legislation was that the Authority/Corporation's guarantee reserve fund equity of approximately $40.6 million was transferred to the newly established FSLRF and the Authority/Corporation's AOF commenced activities with 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 replenished from reimbursements from the federal government.

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

Sources of funds to the AOF include investment income, agency retention on collections of defaulted loans, default aversion fees, account maintenance fees (.10% of original principle balance outstanding as of September 30), and loan processing and insurance fees (.40% of loans guaranteed and disbursed during the federal fiscal year).

Expenditures from the AOF include personnel, professional and other administrative expenses directly related to the loan program operations. The AOF transfers funds to the Governmental Fund to pay administration costs for the ten student aid programs and outreach activities. The AOF also transfers funds to the Plan to pay some of the administration costs. Both the FSLRF and AOF are subject to federal oversight.

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 Authority/Corporation is authorized to finance loans for students attending eligible post-secondary institutions, service and collect education loans, and issue bonds and notes not to exceed $5 billion in order to carry out its corporate powers and duties. The Authority/Corporation's education finance, servicing and collection activities include: (i) the origination and secondary market acquisition of education loans originated pursuant to the Federal Family Education Loan Program (FFELP); (ii) the financing of FFELP Loans; (iii) the servicing of FFELP Loans and of other education loans, and (iv) the collection of FFELP Loans and other education loans for other holders on a commission or cost reimbursement basis. The FFELP student loans held, serviced and collected by the Authority/Corporation include Federal Stafford Loans (Stafford), Unsubsidized Stafford Loans (Unsubsidized Stafford), Federal Supplemental Loans for Students (SLS), Federal Parent Loans for Undergraduate Students (PLUS), and Federal Consolidation Loans (Consolidations).

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

Continued

Note A--Description of Business--Continued

The Authority/Corporation's General Bond Resolutions (GBRs) and separate Series Resolutions for issues of revenue bonds contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received.

As of June 30, 2007 the Authority/Corporation serviced approximately $1.8 billion outstanding principal amount of FFELP Loans which are pledged pursuant to the 1983 GBR, the 1997 GBR, the Line of Credit Trust Agreement or the 2004 GBR and approximately $6.2 billion of FFELP Loans and other education loans on behalf of other holders, including holders with national lending operations. The majority of such education loans are being serviced by the Authority/Corporation pursuant to servicing agreements which do not provide for the acquisition by the Authority/Corporation of the education loans serviced. As a servicer of FFELP loans, the Authority/Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. The Authority/Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Authority/Corporation financings.

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

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

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

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

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

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.

Continued

Note A--Description of Business--Continued

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.

Effective July 1, 2003, the responsibility for the governance and administration of the Plan was temporarily transferred to the Authority/Corporation. In connection with the transfer of responsibility, the Plan became a fiduciary fund of the Authority/Corporation. On July 1, 2004, governance reverted back to the Plan's board, yet administrative responsibilities remained with the Authority/Corporation. 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 typically offers enrollment periods on at least an annual basis for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax advantages to purchasers.

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

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

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

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

Participants may withdraw from the Plan at any time for any reason. Terminating participants are refunded any contract payments made less benefits received, administrative and cancellation fees. Participants who withdraw after July 1 of the beneficiary's college entrance year receive the tuition payout value of the contract less benefits received, administrative and cancellation fees. Non-qualified withdrawals are subject to a 10% penalty in accordance with Section 529 of the Internal

Continued

Note A--Description of Business--Continued

Revenue Code (IRC) except in cases where the withdrawal is: (i) made on account of the death or disability of the student; (ii) made on account of a scholarship received by a student; or (iii) a non-taxable transfer to another account or to another IRC Section 529 program for a different student who is a family member of the original student.

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

Note B--Summary of Significant Accounting Policies

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

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

The government-wide financial statements do not reflect fiduciary activities whose resources are not available to finance the Authority/Corporation’s programs. Fiduciary activities include private-purpose trust and agency funds administered by the Authority/Corporation pursuant to the FFELP, the Trust and the Plan.

Continued

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

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 government entities, which provides that accounting systems be organized by funds to account for specific activities consistent with legal and operating requirements.

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

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

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

<u>Investments</u> - Investments for all funds consist primarily of securities of the federal government or its agencies, commercial paper and collateralized mortgage obligations and mutual funds, and 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.

Continued

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

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

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

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

i. No more than 5% of the total amount of the equity portion of the investment account in the securities of any one issuer;

ii. No more than 25% of the total amount of the equity portion of the investment account in any one industry, as defined by Standard & Poors;

iii. For portfolios invested in major-market countries, no more than 25% of the total amount of the equity portion of the investment account in any one country with the exception of those countries whose weighting in the Europe, Australia, and Far East (EAFE) index is greater than 25%, where a maximum weight of the current country weight in the EAFE benchmark plus 10% is permitted;

iv. For portfolios invested in emerging markets, no more than 20% of the equity portion of the investment account shall be invested in one country;

v. A minimum of eight countries shall be represented in each investment account; and

vi. No more than 10% of the total amount of the fixed-income portion of the investment account shall be committed to the securities of any one issuer at the time of purchase, with the exception of securities issued or guaranteed by the full faith and credit of the United States of America or AAA-related securities issued by government agencies as to which there is no limit.

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

Continued

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

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

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

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

Allowance for Uncollectible Loans - As discussed in Note A, most of the FFELP loans held by the Authority/Corporation are insured by guarantee agencies and the USDE. Management of the Authority/Corporation believes that the all respective guarantee agencies and the USDE will be able to honor all loan claims submitted. However, the Authority/Corporation records a provision for loan losses based upon its expected default claims with respect to 99% insured loans and for loans with certain loan servicing violations. The allowance for loan losses on FFELP loans was $873,164 for loan principal and $212,848 for accrued interest as of June 30, 2007. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2007, the allowance for third party servicing loan losses was $1,681,285 for loan principal and $309,275 for accrued interest.

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

Commission on Debt Recovery - The fee for collection of defaulted education loans is recorded as commission revenue when earned. As noted above, loans for which the Authority/Corporation performs debt recovery services are not presented on the statement of net assets.

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

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

Continued

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

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

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

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

Income Taxes **-** The Authority is a state government agency established by the Kentucky General Assembly and the Corporation is an independent *de jure* municipal corporation and political subdivision of the Commonwealth of Kentucky; therefore, they are not subject to federal or state income taxes.

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

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

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

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

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

Continued

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

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

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

Indirect Cost **-** 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.

Operating Revenues and Expenses - The Authority/Corporation follows a policy of defining proprietary funds operating and nonoperating revenues and expenses utilizing the guidance set forth in GASB Statement No. 9.

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 and State Sponsored Group Insurance Fund, and policies purchased from outside insurance corporations.

Note C--Cash and Investments

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

The Authority/Corporation's deposit and investment policy complies with the underlying bond resolution requirements. In accordance with those bond resolutions, all deposits and investments meet the requirements and approval of the line of credit and bond insurance providers. Additionally, such requirements mandate specific classes of investment vehicles including bank time deposits, certificates of deposit, direct obligations of the United States of America unconditionally guaranteed by the United States of America, indebtedness issued by certain Federal agencies, collateralized repurchase agreements or investment funds secured by obligations of the United States of America with collateral held by or at the direction of the trustee.

Continued

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, 2007, the Authority/Corporation's proprietary fund, governmental fund and fiduciary funds maintained custodial credit risk for cash on deposit as follows:

	Governmental Fund Bank Balance	Proprietary Fund Bank Balance	Fiduciary Fund Bank Balance
Insured (FDIC)		$ 400,000	$ 200,000
Collateralized by securities held by the pledging financial institution		8,463,966	2,812,831
Uninsured and uncollateralized		271,946	854,178
Cash deposited with Kentucky State Treasurer	$ 1,822,918	3,120,953	174,676
Total	$ 1,822,918	$ 12,256,865	$ 4,041,685

Of the $12.2 million of cash maintained in the Proprietary Fund, $6.5 million was held for loan guarantee operations and the remaining $5.7 million was held for lending operations.

As of June 30, 2007, all Proprietary Fund investments were registered in the Authority/Corporation's name and maintained by an external trustee. The investment balances as of June 30, 2007 are summarized as follows:

	Fair Value	Weighted Average Maturity
Corporate Bonds	$ 4,572,530	6.52
U.S. Treasury and Government Agency Securities	1,426,439	3.95
Collateralized Mortgage Obligations	14,727,227	11.21
Money Market Securities	249,062,581	
	$269,788,777	

Of the $269.5 million of investments maintained in the Proprietary Fund, $16.1 million was held for guarantee operations and the remaining $253.4 million was held for lending activities.

Continued

Note C--Cash and Investments--Continued

As of June 30, 2007, the investment portfolio maintained by the Trust ($99,594,720) was comprised entirely of TIAA mutual funds; the investment portfolio maintained by the FSLRF was comprised of the following:

	Fair Value	Weighted Average Maturity
Collateralized mortgage obligations	$ 2,869	2.88
Money market securities	13,954,362	
	$13,957,231	

Plan investments of $137,121,130, were comprised entirely of money market securities held by State Street Global Advisors.

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

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

Credit Risk - The Authority/Corporation maintains an investment policy that limits the credit risk for securities to investment grade and above by one of the nationally recognized credit rating agencies. As of June 30, 2007, the Authority/Corporation's Proprietary Fund maintained securities issued by U.S. Treasury and governmental agencies with a Standard & Poor rating of AAA. The following table summarizes the Standard & Poor rating for all corporate bonds held by the Authority/Corporation's Proprietary Fund as of June 30, 2007.

Fair Value	Rating
AAA	$3,890,468
AA+	83,802
AA	148,175
AA-	177,535
A+	136,215
BBB+	25,312
BBB	111,023
	$4,572,530

Continued

Note C--Cash and Investments--Continued

All $4.57 million of corporate bonds in the Proprietary Fund were held for loan guarantee operations.

The investment policy for the FSLRF limits the investment type to government back securities. As of June 30, 2007, the U.S. Treasury Notes and U.S. backed collateralized mortgage obligations in the FSLRF contain a Standard and Poors rating of AAA.

The Plan maintains an investment policy that limits the credit risk for fixed income securities and short-term commercial paper. The Plan may only invest in AAA-rated securities issued by governmental agencies and long-term commercial paper with an investment grade rating, as long as the overall fixed income portfolio maintains a minimum rating of A by Moody's or Standard & Poors. The Plan may only invest in short-term commercial paper, maturing within 9 months, with a minimum rating of A-1 by Standard & Poors or Prime 1 by Moody's. As previously noted, at June 30, 2007, the Plan only invested in money market securities.

Note D--Fixed Assets

A summary of fixed assets follows:

	Beginning Balance July 1, 2006	Additions	Disposals	Ending Balance June 30, 2007
Proprietary fund:				
Furniture and equipment	$ 17,936,710	$ 1,287,178	$ (232,612)	$ 18,991,276
Building	11,993,435		(7,235)	11,986,200
System Development	55,955			55,955
Student Loan Servicing System	541,131			541,131
Debt Recovery System	706,644	143,215		849,859
Accumulated depreciation	(16,247,472)	(2,990,100)	232,612	(19,004,960)
	$ 14,986,403	$ (1,559,707)	$ (7,235)	$ 13,419,461
Fiduciary Fund:				
Furniture and equipment	$ 618,175		$ (12,831)	$ 605,344
Accumulated depreciation	(618,175)		12,831	(605,344)
	$ -	$ -	$ -	$ -

Continued

Note D--Fixed Assets--Continued

Depreciation expense totaled $2,990,100 for the year ended June 30, 2007, of which $2,887,912 was allocated to business-type activities and $98,378 was allocated to governmental activities and $3,810 was allocated to the fiduciary activities.

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

Loan guarantee operations	$ 185,946
Default collections	79,114
Lending and related activities	2,545,437
Lender assistance	73,560
Other	3,855
	$ 2,887,912

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

Pursuant to the FFELP, the loan guarantee operating unit of Authority/Corporation insures eligible student loans for losses incurred from the default, death, disability, or bankruptcy and also insures for other losses such as school closures and false certifications. As of June 30, 2007, the outstanding balance of aggregate insured student loans was approximately $4.3 billion.

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

Reimbursement for default claims to loan guarantee operations is determined according to the following schedule:

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

Continued

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

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's loan guarantee operations recorded an allowance of $3.5 million at June 30, 2007 for losses on federal reinsurance.

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

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

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

- Recoveries Payable to Federal Government - The Authority/Corporation is entitled to retain 23% of collections received for defaulted loans for which federal reinsurance has been received. This amount is recorded as an addition when received.

- Account Maintenance Fees (AMF) - The 1998 Amendments established an account maintenance fee based on .12% of the original principal amount of outstanding loans. AMF is paid to the Authority/Corporation on a quarterly bases by the federal government. This fee is recognized as revenue and recorded in the AOF. In fiscal year 2001, the AMF was reduced to .10% of the original principal amount of outstanding loans.

- Loan Processing and Issuance Fees (LPIF) - The 1998 Amendments established a loan processing and issuance fee. The LPIF payments are based on the net guarantee amount, less cancellations, multiplied by .65%. LPIF is paid to the Authority/Corporation on a quarterly basis by the federal government. This fee is recognized as revenue and recorded in the AOF. Effective September 30, 2003, LPIF was reduced to .40% of net guarantees, less cancellations.

- 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--Lease/Bond Payable

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

The original bonds bear interest at a fixed rate, which vary from 5.00% to 5.30% and have a final maturity date of May 1, 2010. The new bonds bear interest at a fixed rate, 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 payment of principal and interest on the bonds is guaranteed under an insurance policy.

In connection with the issuance of the bonds, the Authority/Corporation has a financing/lease agreement with the Commission whereby the Authority/Corporation leases the building for two-year terms. The current term ends June 30, 2008, with the right to renew for six additional two-year renewal periods. The Authority/Corporation can cancel the lease on the last business day in May immediately preceding the beginning of any renewal term.

The lease payments are equal to the debt service required by the bond indenture. In connection with the agreements, the Commonwealth of Kentucky General Assembly appropriates sufficient spending authorization to the Authority/Corporation to pay the lease payments for each two-year period. There can be no assurance that future appropriates will be received to make rent payments past the two-year lease period ending June 30, 2008.

The Authority/Corporation has followed consolidation accounting principles as it related to the issuance of the bonds and entering into the related lease agreement.

As such, the Authority/Corporation has recorded the proceeds of the bonds as restricted cash and cash equivalents and recorded the related debt, debt issuance costs, and construction in progress incurred to date. The total estimated cost of the building is $11.9 million with approximately $3.2 million of the building costs paid from the Authority/Corporation's operating reserves. Net interest costs incurred from the tax exempt debt incurred from the date of the issuance of the bonds to the date that the building was available for use by the Authority/Corporation has been capitalized as part of the building cost.

Continued

Note F--Lease/Bond Payable--Continued

A summary of the activity for the bond issues for the year ended June 30, 2007 is as follows:

	June 30, 2006	Additions	Payments	June 30, 2007
Bond Payable	$ 7,370,000	$ -	$ 380,000	$ 6,990,000

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

Year Ending June 30,	Principal	Interest
2008	$ 400,000	$ 344,569
2009	420,000	324,259
2010	440,000	302,659
2011	465,000	279,799
2012	480,000	264,105
Five Years Ending June 30,		
2013 - 2017	2,765,000	957,012
2018 - 2020	2,020,000	212,950
	$6,990,000	$ 2,685,353

Note G--Loans (Lending and Servicing Operations)

The Authority/Corporation originates, purchases and holds various types of student loans as described in Note A. The terms of these loans, which vary on an individual basis depending upon loan type and the date the loan was originated, generally provide for repayment in monthly installments of principal and interest over a period of up to thirty years for consolidation loans and generally up to ten years for other loans. The repayment period begins after a grace period of six months following graduation or loss of qualified student status for the Subsidized and Unsubsidized Stafford loans. The repayment period for Consolidation, SLS and PLUS loans begins within 60 days from the date the loan is fully disbursed. Statutory interest rates on student loans ranged from 2.875% to 12% for the fiscal year ended June 30, 2007 depending upon the type and date of origination of the individual loan. Actual rates may be lower due to interest rate reductions associated with payments via electronic funds transfer or a specified number of consecutive on-time payments.

Continued

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

Loans consist of the following at June 30, 2007:

Stafford – Subsidized	$ 607,203,693
Stafford – Unsubsidized	503,665,510
PLUS/SLS	50,734,699
Consolidation	622,000,494
Other	1,531,544
Total gross loans	1,785,135,940
Allowance for loan losses	(2,554,449)
Net loans	1,782,581,491
Net deferred premium and loan costs	35,432,654
Net Loans and Deferred Loan Purchase Premiums and Origination Costs	$ 1,818,014,145

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, 2007, $2,553,873 of student loans were no longer insured, due to violations of due diligence requirements.

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

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

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

Note H--Loans Held for Sale (Lending Operation)

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

The Authority/Corporation sells fully disbursed student loans to AHELC annually in May pursuant to the terms of the loan purchase agreement. On May 3, 2007, the Corporation sold loans with a cost value of $4,583,326 for $4,537,991, resulting in a loss of $45,335. As of June 30, 2007, the Authority/Corporation maintained loans held for sale to AHELC with a cost value of $3,923,000.

Note I--Special Allowance (Lending Operation)

The USDE pays a special allowance to the Authority/Corporation after the end of each quarter representing supplemental interest on outstanding, insured loans. Certain FFELP loans disbursed during the period from January 1, 2000 through June 30, 2007 receive special allowance at a rate based upon the average of the bond equivalent rates of the 3-month commercial paper rate as reported by the U.S. Federal Reserve. Other eligible loans receive special allowance based on the 91-day U.S. Treasury bill rates.

Effective October 1, 2006, certain other loans financed through bonds dated prior to October 1, 1993 stopped receiving a 9.5% minimum rate of return and instead began receiving the aforementioned standard SAP rate. USDE's decision not to pay the Authority/Corporation 9.5 percent SAP billings followed a January 23, 2007 "Dear Colleague Letter" (DCL) issued by USDE. The letter restated the requirements of the Higher Education Act of 1965, as amended, and USDE's regulations that control whether FFELP loans made or acquired with funds derived from tax-exempt obligations are eligible for 9.5 percent SAP. The letter's restatement is consistent with claims asserted by the USDE's Office of Inspector General (OIG) in their Final Audit Report on "Special Allowance Payments to Nelnet for Loans Funded by Tax-Exempt Obligations" issued on September 29, 2006. On January 24, 2007, USDE sent a letter to the Authority/Corporation which set forth the same restatement and also imposed management assertion requirements for any 9.5 percent SAP billings after September 30, 2006, as well as guidance regarding the audit and certification requirements for those management assertions. A detailed list of management assertions to retain the 9.5 percent SAP was included in a separate DCL letter published by USDE on April 27, 2007. Due to the nature of the management assertions needed to bill for 9.5 percent SAP, the Authority/Corporation was unable to make such assertions and therefore lost all 9.5 percent SAP payments effective for all quarters ending on or after December 31, 2006.

Note J--Principal and Interest Forgiveness (Lending Operation)

During fiscal year 2007, the Authority/Corporation forgave $15,537,471 in loan principal and $8,973,986 in accrued interest for qualified borrowers including teachers, nurses, and public service attorneys who were employed in the Commonwealth.

Note K--Revenue Bonds (Lending Operation)

The balance of revenue bonds at June 30, 2007 and the related activity for the year ended June 30, 2007 is as follows:

Series		Scheduled Maturity	Interest Rate	Beginning Balance July 1, 2006	Bond Maturities	New Issues	Ending Balance June 30, 2007
1983 General Bond Resolution							
1991 E	*	December 1, 2011	Weekly**	$ 46,000,000			$ 46,000,000
1996 A	*	June 1, 2026	Weekly**	25,000,000			25,000,000
2003 A	*	December 1, 2032	Every 35 days	20,600,000			20,600,000
1997 General Bond							
1997 A-1		May 1, 2027	Every 35 days	45,250,000			45,250,000
1997 A-2		May 1, 2027	Every 35 days	45,200,000			45,200,000
1997 B	*	May 1, 2027	Every 35 days	44,550,000			44,550,000
1998 A-1		May 1, 2028	Every 28 days	36,400,000			36,400,000
1998 A-2		May 1, 2028	Every 28 days	36,400,000			36,400,000
1998 B	*	May 1, 2028	Every 35 days	42,200,000			42,200,000
1999 A		May 1, 2029	Every 28 days	51,350,000			51,350,000
1999 B	*	May 1, 2029	Every 35 days	23,650,000			23,650,000
2000 A-1		May 1, 2030	Every 28 days	42,100,000			42,100,000
2000 A-2		May 1, 2030	Every 28 days	42,100,000			42,100,000
2000 A-3		May 1, 2030	Every 35 days	42,050,000			42,050,000
2000 B	*	May 1, 2030	Every 35 days	23,750,000			23,750,000
2001 A-1		May 1, 2031	Every 35 days	59,850,000			59,850,000
2001 A-2		May 1, 2031	Every 35 days	59,850,000			59,850,000
2001 B	*	May 1, 2031	Every 35 days	30,300,000			30,300,000
2002 A-1		May 1, 2032	Every 28 days	55,450,000			55,450,000
2002 A-2		May 1, 2032	Every 35 days	55,450,000			55,450,000
2002 A-3	*	May 1, 2032	Every 35 days	39,100,000			39,100,000
2003 A-1	*	May 1, 2033	Every 35 days	63,700,000			63,700,000
2003 A-2	*	May 1, 2033	Every 35 days	16,950,000			16,950,000
2004 General Bond Resolution							
2004 A-1	*	June 1, 2034	Every 35 days	18,850,000			18,850,000
2004 A-2	*	June 1, 2034	Every 35 days	57,550,000			57,550,000
2004 A-3	*	June 1, 2034	Every 35 days	57,600,000			57,600,000
2004 A-4	*	June 1, 2034	Every 35 days	57,600,000			57,600,000
2004 A-5		June 1, 2034	Every 28 days	72,400,000			72,400,000
2004 A-6		June 1, 2034	Every 28 days	75,000,000			75,000,000
2004 B-1	*	June 1, 2034	Every 35 days	11,000,000			11,000,000

Continued

Note K--Revenue Bonds (Lending Operation)--Continued

Series		Scheduled Maturity	Interest Rate	Beginning Balance July 1, 2006	Bond Maturities	New Issues	Ending Balance June 30, 2007
2005 A-1	*	June 1, 2035	Every 35 days	80,000,000			80,000,000
2005 A-2		June 1, 2035	Every 28 days	45,000,000			45,000,000
2005 A-3		June 1, 2035	Every 28 days	45,000,000			45,000,000
2005 A-4		June 1, 2035	Every 28 days	70,000,000			70,000,000
2005 A-5		June 1, 2035	Every 28 days	50,000,000			50,000,000
2005 A-6		June 1, 2035	Every 28 days	40,000,000			40,000,000
2005 A-7		June 1, 2035	Every 28 days	50,000,000			50,000,000
2005 B-1	*	June 1, 2035	Every 35 days	20,000,000			20,000,000
2006 A-1	*	June 1, 2036	Every 35 days			$ 28,175,000	28,175,000
2006 A-2		June 1, 2036	Every 28 days			42,825,000	42,825,000
2006 A-3		June 1, 2036	Every 28 days			100,000,000	100,000,000
2006 A-4		June 1, 2036	Every 28 days			60,000,000	60,000,000
2006 A-5		June 1, 2036	Every 28 days			90,000,000	90,000,000
2006 B-1	*	June 1, 2036	Every 35 days			29,000,000	29,000,000
				$1,697,250,000	$ -	$ 350,000,000	$2,047,250,000

* This bond series is tax-exempt.

**All interest rates are variable interest rates that change based on specified indices.

Debt service requirements to maturity or redemption date, assuming interest rates on variable rate debt remains at June 30, 2007 levels, are as follows:

	Principal Repayment Amount (Thousands)			
	83 GBR	97 GBR	04 GBR	Total
Year Ending June 30, 2012	$ 46,000			$ 46,000
5 Years Ending June 30, 2017				0
5 Years Ending June 30, 2022				0
5 Years Ending June 30, 2027	25,000	$ 135,000		160,000
5 Years Ending June 30, 2032	20,600	640,000		660,600
4 Years Ending June 30, 2036		80,650	$ 1,100,000	1,180,650
	$ 91,600	$ 855,650	$ 1,100,000	$ 2,047,250

Continued

Note K--Revenue Bonds (Lending Operation)--Continued

	Interest Payments Amount (Thousands)			
	83 GBR	**97 GBR**	**04 GBR**	**Total**
Year Ending June 30, 2008	$ 3,413	$ 40,826	$ 52,527	$ 96,766
Year Ending June 30, 2009	3,413	40,826	52,527	96,766
Year Ending June 30, 2010	3,413	40,826	52,527	96,766
Year Ending June 30, 2011	3,413	40,826	52,527	96,766
Year Ending June 30, 2012	2,417	40,826	52,527	95,770
5 Years Ending June 30, 2017	8,530	204,130	262,635	475,295
5 Years Ending June 30, 2022	8,530	204,130	262,635	475,295
5 Years Ending June 30, 2027	7,526	203,050	262,635	473,211
5 Years Ending June 30, 2032	3,895	111,556	262,635	378,086
4 Years Ending June 30, 2036	325	2,541	155,361	158,227
	$ 44,875	$ 929,537	$ 1,468,536	$ 2,442,948

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

Note L--Line of Credit (Lending Operation)

On December 27, 2006, the Authority/Corporation terminated its Line of Credit Agreement with Bank of America, N.A. During the year ended June 30, 2007, the Authority/Corporation drew down $1,950,000 and made principal payments of $1,950,000 on this line of credit. Effective December 22, 2006, the Authority/Corporation entered into a new Line of Credit Agreement with JP Morgan Chase Bank, N.A. The new agreement provides for an initial commitment amount to the Authority/Corporation not to exceed an aggregate outstanding principal balance of $40,000,000. In addition, the Authority/Corporation may request an increase in the commitment amount not to exceed $120,000,000. The borrowing period ends December 31, 2008, and can be extended at the discretion of both parties through December 31, 2009. At June 30, 2007, total advances outstanding were $10,000,000.

Note M--Allowance for Arbitrage Liabilities (Lending Operation)

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, 2007, the liability for yield adjustment payments and forgiveness is $11,163,929 and the liability for arbitrage rebate is $1,178,420.

Continued

Note M--Allowance for Arbitrage Liabilities (Lending Operation)--Continued

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

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

Forgiveness is applicable to all tax exempt bonds. In general, a yield restriction is imposed on acquired purpose investments, designating the allowable yield as 2.0% 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.

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

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

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

Note N--Credit and Liquidity Facilities and Bond Remarketing (Lending Operation)

The 1991 Series E and 1996 Series A Bonds are collateralized with Standby Bond Purchase Agreements, pursuant to which Landesbank Hessen-Thuringen Girozentrale will purchase any bonds not remarketed. The 1991 Series E Bonds and the 1996 Series A Bonds also have a Municipal Bond Insurance Policy issued by AMBAC Indemnity Corporation and MBIA Insurance Corporation, respectively, which collateralizes payment of principal and interest on the bonds. The Standby Bond Purchase Agreements expires December 1, 2011 for the 1991 Series E Bonds and December 31, 2015 for the 1996 A Bonds. The AMBAC Municipal Bond Insurance Policy extends through the term of the 1991 Series E Bonds, December 1, 2011 and the MBIA Municipal Bond Insurance Policy extends through the term of the 1996 Series A Bonds, June 1, 2026.

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

Note O--Retirement Plans

The Authority/Corporation provides retirement benefits to all full-time employees through the Kentucky Retirement System (KRS). KRS is a multiple-employer, defined benefit plan sponsored by the Commonwealth of Kentucky, which provides retirement, disability, and death benefits. The Authority/Corporation contributed 7.75% of gross wages for the year ended June 30, 2007. The employees contributed 5% of their gross wages to the plan for the year ended June 30, 2007. Such rates are intended to provide for normal costs on a current basis, plus an amount equal to the amortization of unfunded past service costs over thirty years, using the level percentage of payroll method. These contribution rates are determined by the Board of Trustees of KRS each biennium. The payroll of employees covered by the retirement plan was $20,955,000 for the year ended June 30, 2007. Total payroll for the year ended June 30, 2007 was $21,290,000. KRS participants have fully vested interests after the completion of sixty months of service, twelve months of which are current service. The KRS contribution requirement for the year ended June 30, 2007 was $2,671,614 which consisted of employer contributions of $1,623,915 and $1,047,699 from employees in 2007. Employer contributions for the years ended June 30, 2006 and 2005 were $917,975 and $729,919, respectively.

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

Until June 30, 1994, Teachers Insurance and Annuity Association (TIAA) was offered to eligible employees. TIAA was terminated as of June 30, 1994, and all TIAA participants became covered by KERS effective July 1, 1994. In order to provide coverage equivalent with KERS participants to the Authority/Corporation's employees who were former TIAA participants regarding retirees' health insurance premiums, the Authority/Corporation established an allowance for retirees' insurance based on management's projected estimate of future requirements. The portion of retirees' premiums paid by KERS is based on years of service under KERS; the allowance provides for the Authority/Corporation to fund a portion of premiums, which will result in the same coverage for the 3 employees covered. Plan assets and the accrued liability for the postretirement healthcare plan totaled $164,000 at June 30, 2007.

Note P--Tuition Benefit Payable (College Saving Plan Operations)

The following assumptions developed by management were used in the actuarial valuation as of June 30, 2007. These assumptions are based on historical data for both state and national trends.

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

Continued

Note P--Tuition Benefit Payable (College Saving Plan Operations)--Continued

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

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

- Upon inception of the Plan, in fiscal year 2002, the assumption for tuition increase was 6.5% for all future academic years.

- As of June 30, 2003, known tuition increases for the 2003-2004 academic year were 23.4% for the Value Plan and 14.4% for the Standard Plan and the Premium Plan. The assumption for tuition increases was adjusted to 7.5% for the next five academic years and 6.5% for all academic years thereafter.

- As of June 30, 2004, known tuition increases for the 2004-2005 academic year were 24.2% for the Value Plan and 16.9% for the Standard Plan and the Premium Plan. The tuition increase assumption was adjusted to 7.5% annually through the academic year ending June 30, 2011, and increased from 6.5% to 7.00% for each academic year thereafter.

- As of June 30, 2005, known tuition increases for the 2005-2006 academic year were 6.5% for the Value Plan and 12.5% for the Standard Plan and the Premium Plan. The tuition increase assumption was adjusted to 7.5% through year ending June 30, 2012, 7.25% annually through year ending June 30, 2014, and 7.0% annually thereafter.

- As of June 30, 2006, the known tuition increases for the 2006-2007 academic year were 11.2% for the Value Plan and 12% for the Standard Plan and the Premium Plan. The tuition increase assumption was adjusted to 11% for the 2007-2008 academic year, 10% for 2008-2009 academic year, and 7% for each year thereafter.

- As of June 30, 2007, the known tuition increases for the 2007-2008 academic year were 5.5% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan. The tuition increase assumption was adjusted to 10% for the 2008-2009 academic year, 8.5% for 2009-2010 academic year, and 7% for each year thereafter.

For the period from inception to June 30, 2007, the annualized tuition increase for the highest-priced Kentucky public university, as applicable to the tuition benefits payout rate of the KAPT Standard Plan, which represents 90% of KAPT enrollments, has been 11.2%. 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, 2007, has been 19.5%. For the University of Kentucky, as applicable to the tuition benefits payout rate of the KAPT Premium Plan, the average annualized tuition increase from inception to June 30, 2007 has been 12.4%.

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

Note Q--Restricted Net Assets

- Federal Student Loan Reserve Fund **-** Net assets are restricted for certain FFELP activities, primarily the payments of claims.

- Agency Operating Fund - Net assets are restricted for certain FFELP activities and other student aid activities.

- Education Finance Funds - Net assets are restricted as required by the 1983, 1997 and 2004 General Bond Resolutions, the separate Series Resolutions, and Line of Credit Agreements.

- Student Aid Funds - The Student Aid net assets are restricted for the Student Aid Programs.

Note R--Operating Leases

The Authority/Corporation leases office space and equipment under agreements expiring through 2012. The following are the approximate minimum lease commitments under operating leases:

Year Ending June 30	
2008	$ 1,485,000
2009	943,000
2010	785,000
2011	708,000
2012	578,000

Note S--Commitments and Contingencies

The Authority/Corporation has entered into loan purchase contracts with various eligible lenders. Subject to the terms and conditions of these agreements, the Authority/Corporation on June 30, 2007, had plans to purchase a minimum of $1.3 million of loans.

The FSLRF, a fiduciary fund maintained on behalf of the USDE, is contingently liable for loans made by financial institutions that qualify for guaranty. The default ratio for loans guaranteed by the Authority/Corporation's loan guarantee operations is below 5% for the federal fiscal year ending June 30, 2007. As a result, the federal government's reinsurance rate for defaults for the fiscal year ending September 30, 2007, 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.

Continued

Note S--Commitments and Contingencies--Continued

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, 2007 is calculated as follows:

Amount of guaranteed student loans outstanding at lenders	$ 3,931,562,000
Less minimum federal government share - 75%	2,948,671,500
	$ 982,890,500

Note T--Subsequent Events

On August 30, 2007, the Authority/Corporation issued $250,000,000 of Student Loan Revenue Bonds to continue its student loan finance program. The Bonds are scheduled to mature on June 1, 2037, and bear interest rates that change on a frequency determined upon issuance.