Strothman & Company P S C

Certified Public Accountants & Advisors

Financial Statements

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

June 30, 2008

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Independent Auditors' Report

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

We have audited the accompanying combined financial statements of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Kentucky Higher Education Assistance Authority and the Kentucky Higher Education Student Loan Corporation (the "Authority/Corporation"), component units of the Commonwealth of Kentucky, as of and for the year ended June 30, 2008, which collectively comprise the Authority/Corporation's basic combined financial statements as listed in the accompanying table of contents. These combined financial statements are the responsibility of the Authority/Corporation's management. Our responsibility is to express opinions on these combined financial statements based on our audit. We did not audit the financial statements of Kentucky Education Savings Plan Trust, which statements reflect total assets of $104,414,637 as of June 30, 2008, and total additions to fiduciary net assets of $20,150,178 for the year ended June 30, 2008. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it relates to the amounts included for Kentucky Education Savings Plan Trust, is solely based on the report of the other auditors.

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

In our opinion, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, each major fund and the aggregate remaining fund information of the Authority/Corporation as of June 30, 2008, 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 19 is not a required part of the basic combined financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 29, 2008 on our consideration of the Authority/Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

STROTHMAN & COMPANY PSC

Louisville, Kentucky
September 29, 2008

Description of the Business

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

The Authority/Corporation maintains the following operations:

<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 up to 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 2008, 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.

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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, 2008, the lending operation owned $2.156 billion of student loans.

Most FFELP loans held by the Authority/Corporation are insured by the Authority/Corporation's loan guarantee operations. Loans made prior to October 1, 1993, are 100% insured. Loans made between October 1, 1993 and June 30, 2007, are 100% insured against borrowers' death, disability, or bankruptcy and 98% insured against borrowers' default. Loans made after June 30, 2007, are 100% insured against borrowers' death, disability, or bankruptcy and 97% insured against borrowers' default.

The Authority/Corporation's lending operation finances all FFELP loans with revenue bonds or lines of credit. A national bank line of credit was used primarily for student loan capital for loans held by the Authority/Corporation's lending operation. A separate national bank line of credit was used primarily to buy loans held for sale to the Alabama Higher Education Loan Corporation. As of June 30, 2008, the lending operation maintained four separate General Bond Resolutions (GBRs) and related Series Resolutions for issue of revenue bonds, which contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received. As of June 30, 2008, the lending operation maintained $2.23 billion of revenue bonds outstanding and an additional $63.6 million outstanding balance against the lines 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. Lines of credit and related loans, and all activities pertaining to such activities are also accounted for in the Operating Fund of the Authority/Corporation. Revenue bonds, related loans and other assets and liabilities and revenues and expenses are accounted for in the Education Finance Fund, a proprietary fund of the Authority/Corporation.

Loan servicing - The loan servicing operation performs servicing and default aversion activities on FFELP and alternative loans held by the Authority/Corporation's lending operation and other lenders. Of the loans serviced, approximately $2.156 billion in outstanding principal of FFELP Loans was held by the lending operation and pledged pursuant to the 1983 GBR, the 1997 GBR, the 2004 GBR, the 2008 GBR and separate line of credit agreements. Approximately $6 billion of FFELP Loans and other education loans were owned by other holders, including holders with national lending operations. For loans owned by other holders, the loan servicing operation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities.

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

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

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

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

In fiscal year 2008, the outreach operation staff traveled 195,628 miles, provided 562 exhibits, 1,031 presentations, and made direct contact with 157,824 parents and/or students.

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

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

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

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

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

Continued

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

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

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

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

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

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

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

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

Overview of Financial Statements

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

The government-wide statement of net assets and statement of activities include the Governmental Funds and Proprietary Funds. The government-wide financial statements can be found on pages 20-21 of this report. The fund financial statements can be found on pages 22-27 of this report.

Fiduciary funds are used to account for resources held for the benefit of parties outside the Authority. Fiduciary funds are not reflected in the government-wide financial statements because the resources are not available to support the Authority's programs. The fiduciary fund statement of net assets (deficit) and changes in fiduciary net assets (deficit) can be found on pages 28-29 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, 2008 and 2007, respectively.

Condensed Financial Information - Governmental Fund and Proprietary Funds

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

	Governmental Fund		Proprietary Funds	
	2008	**2007**	**2008**	**2007**
Net Asset Information				
Capital assets			$ 12,282,525	$ 13,419,460
Other assets	$ 19,505,175	$ 15,654,343	2,421,473,193	2,183,307,622
Total Assets	**19,505,175**	**15,654,343**	**2,433,755,718**	**2,196,727,082**
Long-term liabilities			2,237,715,255	2,066,182,349
Other liabilities	309,433	277,827	78,048,978	23,970,497
Total Liabilities	**309,433**	**277,827**	**2,315,764,233**	**2,090,152,846**
Net assets invested in capital, net of debt			5,869,742	6,624,884
Restricted net assets	19,195,742	15,376,516	112,121,743	99,949,352
Total Net Assets	**$ 19,195,742**	**$ 15,376,516**	**$ 117,991,485**	**$ 106,574,236**
Activity Information				
Interest and investment income	$ 158,927	$ 9,678	$ 8,665,255	$ 15,655,567
State General Fund revenue	173,280,600	164,481,522		
Student Aid & Advancement Fund revenue				
Unclaimed Lottery Revenue	11,300,000	15,300,000		
Federal funds revenue	1,342,145	1,469,308		
Tobacco settlement revenue	1,007,678	1,005,982		
Service fees			15,686,357	14,392,322
Debt recovery commission			11,192,020	12,226,438
Federal fees earned			7,623,775	7,721,033
Default aversion fee income			1,938,795	2,246,097
Interest income on loans			130,631,958	137,290,685
Other income	2,633,076	1,088,680	1,019,454	900,423
Total Revenues	**189,722,426**	**183,355,170**	**176,757,614**	**190,432,565**
Kentucky Tuition Grants	33,294,343	32,168,478		
College Access Program Grants	60,062,004	60,389,711		
Robert C. Byrd Scholarship	590,614	571,215		
Mary Jo Young	394,314	457,139		
Early Childhood Development	1,173,639	1,143,543		
National Guard Tuition Awards	4,916,400	4,027,927		
Kentucky Education Excellence Scholarships	89,782,202	89,295,070		
Teacher Scholarships	2,855,756	2,219,550		
Osteopathic Medicine Scholarships	866,955	1,300,407		
Work-study	912,923	895,009		
Go Higher Scholarships	143,415			
Outreach and other activities	1,033,934	1,544,389		
Guarantee operations			4,038,736	4,752,578
Default collection			5,184,650	3,682,205
Lending and related activities			143,060,042	156,705,936
Lender assistance			1,958,410	2,496,441
Other activities			484,176	461,783
Total Expenditures	**196,026,499**	**194,012,438**	**154,726,014**	**168,098,943**
Change in Net Assets Before Operating Transfers	**(6,304,073)**	**(10,657,268)**	**22,031,600**	**22,333,622**
Interfund transfer	10,459,799	8,961,763	(10,459,799)	(8,961,763)
Transfer to General Fund	(336,500)			
Transfer to KAPT			(154,552)	(129,876)
Change in Net Assets	**$ 3,819,226**	**$ (1,695,505)**	**$ 11,417,249**	**$ 13,241,983**

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, 2008. Please read it in conjunction with the Authority/Corporation's financial statements and notes to the financial statements, which follow this section.

Financial Overview

- The Authority/Corporation's proprietary fund total assets increased approximately $237 million (10.79%), from $2.19 billion to $2.43 billion. This increase was caused primarily by the $390 million increase in loans and related accruals, net of $153 million decrease in cash and investments.

- The Authority/Corporation's proprietary fund liabilities increased $225 million (10.79%), from $2.090 billion to $2.315 billion. The increase in liabilities resulted primarily from $183 million of bonds issued in fiscal year 2008, $53 million of additional debt from the Chase Bank line of credit and net of $11 million decrease in arbitrage liability.

- The Authority/Corporation's proprietary fund revenues decreased $14 million (7.32%), the majority of which related to loan interest revenue (decreased $7 million) and interest on investments (decreased $7 million).

- The Authority/Corporation's total proprietary fund expenditures decreased $13.6 million (8.12%), comprised almost entirely from the decrease in arbitrage and "Best In" benefits of $19 million and decrease in administrative expenses of $2.8 million, net of increases in interest expense of $4.2 million, increase in provision from loan loss of $1.5, and increase in amortization of front-end fees of $2.5 million.

- The Authority/Corporation's governmental fund assets increased 24% from $15.6 million to $19.5 million, while liabilities remained relatively constant

- The Authority/Corporation's governmental fund revenues increased $6.4 million (3.47%), resulting from additional state General Funds for student aid programs, net of reductions in receipts from unclaimed lottery fund.

- The Authority/Corporation's governmental fund expenditures increased $2 million (1%), due primarily to increases in the Kentucky Tuition Grant ($1.1 million) and Kentucky National Guard Tuition Awards ($900,000).

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Statement of Net Assets

Total government fund net assets increased $3.8 million because of additional student aid funds carried forward into the new biennium and reductions in conversion loan allowance for loan loss. To address projected budgetary revenue shortfalls in fiscal years 2009 and 2010, state-government policy makers decreased funding for the need-based College Access Program (CAP) and the Kentucky Tuition Grant (KTG) program to 2008 base-line levels; despite the fact that additional funds are available from the Kentucky Lottery Corporation. In the current fiscal year, the Authority/Corporation decided to be more conservative in disbursing CAP and KTG funds, so they could smooth the effect of the biennial budget funding reductions. Accordingly, the Authority/Corporation carried forward $2.2 million of additional General Fund receivable and restricted fund cash into the new biennium. The Teacher Scholarship (TS) loan and Osteopathic Medicine Scholarship (OMS) loan balances increased substantially ($1.6 million), due to reductions in the allowance for loan loss. Note that the Authority/Corporation utilized a conversion loan amnesty program for TS and OMS loans in calendar 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. Some borrowers with older TS and OMS conversion loans did not participate in this amnesty program and their loans were forwarded to the Department of Revenue, as required by Kentucky House Bill 164 and Kentucky Senate Bill 228. The Department of Revenue did an excellent job collecting on some older accounts that were once considered uncollectible.

Total proprietary fund net assets increased $11.4 million (10.71%), of which $6.7 million is from loan guarantee operations, $6.05 million from default collection operations, $773,000 from lender assistance activities and $8.4 million from lending activities, net of $10.54 million contributed for student aid administration ($4.6 million), grants and scholarships ($5.8 million) and contributed administration of the Plan ($154,000).

Certain highlights related to the statement of net assets as of June 30, 2008, are as follows:

- The lending and loan servicing operation maintained reserves designated for operations of $16.5 million, which represents approximately 6 months operating reserves.
- The loan guarantee, lender assistance and default collection operations maintained $24.1 million of reserves designated for operations, which represents over six months of operating reserves and funds available for lending activities to serve as collateral for future debt.
- The lending operation maintained $2.156 billion of student loans.
- The servicing operation served $6 billion of student loans.
- The guarantee operation insured $4.5 billion of outstanding principal and interest on student loans.
- The defaulted loan collection operation serviced a portfolio of defaulted loans totaling $268 million.

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Statement of Revenues, Expenses, and Changes in Net Assets

The Authority/Corporation's Governmental fund received additional revenue of $6.4 million in fiscal year 2008, comprised of General Funds ($8.8 million), other income ($1.6 million), net of decreased unclaimed lottery funds of $4 million and unclaimed lottery proceeds. The principle reason for the increase in state funding was an increase in projected lottery net revenues (from $162.5 million in 2007 to $170.5 million in 2008). Also, other income increased because the Authority/Corporation reduced the allowance for loan loss on the TS loans and the OMS loans, because of better than expected collection results in fiscal year 2008 (the 2007 amnesty program and Department of Revenue collection results on older accounts).

Governmental expenditures increased only 1% ($2 million), which is comprised of a $1.1 million increase in KTG awards and $900,000 increase in Kentucky National Guard Tuition Scholarship (KNGTS) awards; variances in the Kentucky Education Excellence Scholarship (KEES) program, TS program, OMS program and outreach program essentially offset each other to result in zero impact.

Total proprietary fund revenues decreased by $13.7 million, caused primarily by interest rates dropping during the year and reductions in cash and investments. Most of the Authority/Corporation's student loan portfolio earns interest based on quarterly resets of 90-day commercial paper rates. The average 90-day commercial paper rates were; 5.39% for the quarter ended September 30, 2007, 4.92% for the quarter ended December 31, 2007, 3.24 % for the quarter ended March 31, 2008, and 2.75 % for the quarter ended June 30, 2008. Cash and investments decreased from $281.5 million as of June 30, 2007 to $126.7 million as of June 30, 2008, a $154.8 million decrease.

Total proprietary fund expenses increased $13.4 million, resulting primarily from the decrease in arbitrage expense, net of "Best In" borrower benefits ($19 million). Most of the Authority/Corporation's accrued arbitrage liability resided in the 1983 GBR. When many of the outstanding bonds in the 1983 GBR were refinanced into the 2008 GBR trust, any remaining non-purpose investment arbitrage became due and payable to the Internal Revenue Service. The Authority managed borrower benefits in fiscal year 2008 that, combined with previous borrower benefits, burned all remaining acquired purpose investment arbitrage outstanding. As of June 30, 2008, the Authority/Corporation had only $795,000 of remaining allowance for arbitrage liability (non-purpose excess interest), compared to $12.3 million outstanding allowance for arbitrage liability as of June 30, 2007. Note that the Authority/Corporation did expense $4.2 million more in bond interest expense in fiscal year 2008 (compared to fiscal year 2007), because of additional debt outstanding during the year and the impact of the credit crisis on the Authority/Corporation's ARCs and VRDOs. The Authority/Corporation also expensed an additional $1.5 million in loan loss allowance due to CCRAA elimination of the Exceptional Performer designation (and reducing insurance rate on loans from 99% to as low as 97%) and 2.8 million for amortization of front-end fees and benefits. In response to market conditions, the Authority/Corporation did reduce operating expenses by $2.8 million.

Transfers increased in fiscal year 2008, primarily resulting from additional funding for the National Guard Tuition Scholarship program.

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Certain highlights related to the statement of revenues, expenses and changes in net assets for the year ended June 30, 2008, are as follows:

- The lending operation provided $7.25 million in interest and principal forgiveness benefits ($930 maximum per borrower.)
- The loan servicing operation received $13 million to service loans held by third-parties.
- The lender assistance operation received $2.7 million to provide loan origination and disbursement services assistance to lenders.
- The defaulted loan collection operation received $11.2 million in commissions on the $68 million collected on behalf of the USDE.
- The lending operation received $23.6 million of net interest revenue (interest income net of interest and finance expense.)

Review of Fiscal Year 2008 – A Year of Challenges

On August 30, 2007, the Authority/Corporation issued $250,000,000 of Student Loan Revenue Bonds to continue its student loan finance program. On that date, the Authority/Corporation took delivery of $100 million of bonds related to this transaction. The remaining $150 million of bonds was scheduled as a delayed delivery in January 2008.

On September 27, 2007, the College Cost Reduction and Access Act (CCRAA) was signed into law. CCRAA cut special allowance payments to non-profit lenders (on loans first disbursed after September 30, 2007) by 40 basis points (Stafford in-school, in grace and in deferment loans), 40 basis points (Stafford in-repayment loans and Consolidation loans), and 70 basis points (PLUS loans), doubled the lender origination fee (from 50 basis points to 100 basis points), eliminated the Exceptional Performer Designation for all claims filed after September 30, 2007 which reduced the Authority/Corporation's lender insurance rate from 99% to 97%. CCRAA also impacted non-profit Guaranty Agencies by decreasing the Account Maintenance Fees from 10 basis points on Original Principal Outstanding to 6 basis points on Original Principal Outstanding, and decreasing default collection retention from 23% of the amount collected to 16% of the amount collected. CCRAA did establish a new Federal grant program; The College Challenge Grant to replace some of the funds cut from Guaranty Agencies, and designated those funds or outreach and/or borrower benefit activities.

As previously noted, the Authority/Corporation maintains four separate finance trusts within its Education Finance Fund; (1) the 1983 General Bond Resolution Trust (GBR), (2) the 1997 GBR Trust, (3) the 2004 Master Indenture Trust and (4) the 2008 Master Indenture Trust. As of September 30, 2007, the 1983 GBR Trust, 1997 GBR Trust, and the 2004 GBR Trust had Auction Rate Securities (ARS's) and Variable Rate Demand Obligations (VRDO's) outstanding of $2,147,250,000.

In early fiscal year 2008, financial markets started experiencing a credit crisis, which placed stress on the ARS market. In February 2008, auctions started to fail, which had a domino effect on the overall ARS market. Beginning February 13, 2008, all of the Authority/Corporation's ARS's from that day forward were in failed auction mode, which triggered the maximum interest rate allowed under

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the related bond official statement. In many cases, the maximum interest rate on the Authority/Corporation's taxable ARS's were lower than the interest rates the Authority/Corporation was paying prior to the failed auction. Ironically, the maximum interest rates on tax-exempt ARS's were substantially higher than the rates on taxable ARS's, creating the need to refinance many of the tax-exempt ARS's.

Another result from the credit crisis was tax-exempt VRDO's with credit enhancement supplied by a bond insurer became less attractive to investors. Remarketing of these bonds started to fail resulting in the VRDO's being placed with the underlying liquidity provider (as allowed by the stand-by bond purchase agreements), resulting in further constrictions in the bond market liquidity and skyrocketing interest rates. By May 2008, two-thirds of the Authority/Corporation's VRDO's were placed with the liquidity provider, creating a need to refinance these debt obligations.

As a result from the failed action market, the Authority/Corporation was unable release the second tranche from the August 30, 2007 bond deal. In order to meet current demand for student loan capital, the Authority/Corporation increased its line of credit with a national bank from $40 million to $170 million. In May 2008, that national bank informed the Authority that it was calling the $170 million line of credit, payable in three installments; $83.4 million upon closing of a planned refinancing bond issue, $16.6 million on September 30, 2008, and $47 million on December 31, 2008.

On June 18, 2008, the Authority/Corporation refinanced $300 million of outstanding debt issued, with $262,925,000 million of tax-exempt VRDO's and $37,075,000 of taxable VRDO's, supported by letters of credit from two national banks.

On May 1, 2008, the Authority/Corporation temporarily suspended making FFELP loans to new borrowers due to a lack of funds available. Also as of that date, the Authority/Corporation did announce that the guaranty agency operations would pay the 1% default fee on behalf of all borrowers attending a Kentucky school, to attract other lenders to the Kentucky marketplace and ensure Kentucky students could obtain a FFELP loan.

On May, 7, 2008, the President signed the Ensuring Continued Access to Student Loans Act of 2008 (ECASLA), which provides lenders with access to capital for FFELP loans for the 2008-09 academic year, via a loan participation program. Lenders must fund the first disbursement on a qualified student loan then place that loan in participation trust, held by an approved custodian, and request participation funding from the USDE. Once funds are received from USDE, lenders must use the funds for disbursements on qualifying loans. The participation program is operationally complex and results in negative cashflow for fiscal year 2008; as lenders are required to use operating reserves to pay all costs related to loans held in the participation trust (including the 1% lender fee and negative special allowance benefits raging from 1.91% to 3.81%). The participation program is a profitable line of business, but the profits must remain in the closed trust until the loans are sold to another financing deal or the USDE and the trust is dissolved. The Authority/Corporation expects negative cash flow related to the participation program to be $5.8 million in fiscal year 2008, and expects to realize a $5 million profit from participation program activities.

Continued

On July 1, 2008, the Authority/Corporation started disbursing FFELP loans again with an expectation that ECASLA participation program would be available. Also, all loans disbursed on or after July 1, 2008, were no longer eligible for "Best In" benefits and the Authority/Corporation's lending operation started charging all front-end fees to borrowers.

On August 20, 2008, the Authority/Corporation issued $50 million of variable rate bonds (indexed to 90-day commercial paper rates), privately placed with the Commonwealth of Kentucky. The proceeds from this bond issue were immediately used to fund first disbursements on student loans (all funds were disbursed within 48 hours). On August 22, 2008, the related loans were requested to be placed into the participation program along with $39 million of other qualified loans. The Authority/Corporation received an $89 million wire transfer from USDE on August 27, 2008 for participation interest in these loans.

Early in fiscal year 2008, management began to monitor the impact the credit crisis had on the Authority/Corporation. To prepare for this impact, management started a hiring freeze and executed a budget-reduction plan, which resulted in the elimination of $4.053 million of budgeted expenses in fiscal year 2008 and an additional $3.7 million reduction in the fiscal year 2009 budget (compared to fiscal year 2008 projected actual). As a result of these budget reduction measures, the Authority/Corporation was able to maintain sufficient operating fund cash reserves to pay $10.6 million toward the June 2008 refinanced bond deal, $1.8 million toward the August 2008 private placement bond deal, and still fund the projected $5.8 million negative cash flows related to the participation program.

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	
	2008	**2007**	**2008**	**2007**	**2008**	**2007**	**2008**	**2007**
Net Asset Information								
Other assets	$ 29,070,256	$ 26,379,920	$ 1,183,687	$ 317,442	$ 145,411,786	$ 157,302,703	$ 104,414,637	$ 100,707,146
Total Assets	**29,070,256**	**26,379,920**	**1,183,687**	**317,442**	**145,411,786**	**157,302,703**	**104,414,637**	**100,707,146**
Total Liabilities	**20,974,700**	**19,724,093**	**1,183,687**	**317,442**	**181,167,225**	**171,317,579**	**92,799**	**58,725**
Restricted net assets (deficit)	8,095,556	6,655,827			(35,755,439)	(14,014,876)	104,321,858	100,648,421
Total Net Assets	**8,095,556**	**$ 6,655,827**	**$ -**	**$ -**	**$ (35,755,439)**	**$ (14,014,876)**	**$ 104,321,858**	**$ 100,648,421**
Changes in Fiduciary Net Asset Information								
Federal reinsurance	$ 110,791,847	$ 68,527,251						
Fee revenue	9,829,818	7,770,394						
Contributions					$ 1,960,832	$ 1,947,236		
Subscriptions							$ 15,228,828	$ 14,443,308
Investment revenue (losses)	492,615	554,041			(6,401,480)	16,819,098	(5,426,245)	12,016,459
Other income	931,476	965,373				3,764		
Total Additions	**122,045,756**	**77,817,059**			**(4,440,648)**	**18,770,098**	**9,802,583**	**26,459,767**
Administrative expenses					624,659	747,292		
Refunds					1,169,964	922,247		
Trustee expense					453,777	458,121		
Tuition benefits					15,206,067	10,477,952		
Loan claims	117,516,087	68,997,032						
Redemptions							6,129,146	4,267,030
Default aversion	1,938,795	2,246,097						
Total Deductions	**119,454,882**	**71,243,129**			**17,454,467**	**12,605,612**	**6,129,146**	**4,267,030**
Change in Net Assets Before Operating Transfer	**2,590,874**	**6,573,930**			**(21,895,115)**	**6,164,486**	**3,673,437**	**22,192,737**
Operating Transfers								
Transfer to USDE for Recall	(1,151,145)	(1,151,145)						
Transfer from Agency Operating Fund					154,552	129,876		
Change in Net Assets After Operating Transfers	**$ 1,439,729**	**$ 5,422,785**			**$ (21,740,563)**	**$ 6,294,362**	**$ 3,673,437**	**$ 22,192,737**

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, 2008. 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 $79 million in fiscal year 2007 to $119 million in fiscal year 2008 (50.63% increase).

- The FSLRF paid the U.S. Treasury $1.15 million in fiscal year 2008 and 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 $9.8 million in fiscal year 2008 and $7.8 million in fiscal year 2007.

- The Plan noted an increase of tuition benefits payable of $9.9 million in fiscal year 2008, largely due to a $6.4 million of investment losses in fiscal year 2008.

- Interest and investment income in the Plan decreased from $16.8 million gain to a $6.4 million loss, a decrease of 138% compared to prior year.

Statement of Fiduciary Net Assets (Deficit)

The FSLRF net assets increased $1.4 million over prior year. Assets increased approximately 10.2% ($2.7 million), while liabilities increased 6.341% ($1.2 million). The increase in assets is attributed almost entirely to the increase in receivables from the USDE of $2.7 million. The increase in receivable from USDE resulted from a substantial increase in claim volume in fiscal year 2008. Overall claims increased from $95.2 million in fiscal year 2007 to $138 million in fiscal year 2008. Claims in general have increased because lenders and servicers are experiencing financial difficulties in the wake of CCRAA. Many lenders and servicers have experienced substantial staff reductions and are devoting their existing resources to core servicing activities (they are no longer performing proactive default aversion activities). The increase in liabilities is comprised almost entirely of the increase in loan loss allowance. The loan loss allowance calculation is a standard calculation (created by the USDE) based on current year default claim volume and original principal outstanding. The original principal outstanding increased from $4.295 billion as of June 30, 2007 to $4.875 billion as of June 30, 2008. Also, the default claim rate increased from 2.73% as of June 30, 2007 to 3.36% as of June 30, 2008.

The Agency Fund serves as a conduit for loan proceeds transacted between lenders and schools. The Authority typically maintains Agency funds for lenders and schools for less than three business days. As of June 30, 2007, the Authority/Corporation maintained $317,442 on behalf of lenders and

Continued

schools. As of June 30, 2008, the Authority/Corporation maintained $1.2 million on behalf of lenders and schools. The amount of agency funds at 2008 fiscal year end is relatively consistent with prior year (considering the Authority/Corporation processes over $2 billion of disbursements each year).

The Plan's total assets decreased $11.9 million. The plan did receive cash from participants of $6.5 million, of which $1.6 million represents imputed interest on contracts receivable. The Plan also incurred investment losses of $6.4 million in fiscal year 2008, and disbursed $7.1 million in program benefits, refunds to participants, and program expenses.

The Plan liabilities increased $9.8 million, almost entirely from the increase in tuition benefits payable and related expenses calculated by the actuary. Assumptions related to administrative expenses and investment expense remained consistent with prior year. The change in tuition increase assumptions are as follows:

- 2008-2009 academic year – actual tuition increase was only 9%; compared to the actuarial assumption of 10%.

- 2009-2010 academic year – tuition increase assumption increased from 8.5% to 9.0%.

- 2010 – thereafter academic years – tuition increase assumption remained at 7%

Due to the inherent compounding effect, the Plan deficit was projected to increase by $1.087 million in fiscal year 2008 (without any changes in assumptions). Assumption changes related to tuition increases in academic year 2008-09 actually decreased the deficit by $2.7 million. Note however that the unfavorable investment experience in fiscal year 2008 increased the deficit by $17.5 million and changes to other assumptions increased the deficit another $5.7 million. Projected investment expense for the life of the program is accrued as a liability and was calculated as 20 basis points on all invested assets (compared to 35 basis points in prior year). Accrued investment expense ($1.3) million was $2 million less than prior year. Projected administrative expenses for the life of the program are also accrued as a liability and remained unchanged at $1.7 million.

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 $3.7 million, due to new subscriptions received ($15.2 million) and investment loss ($5.4 million), net of expenses and redemptions ($6.1 million). Trust liabilities remained relatively constant during the fiscal year.

Changes in Fiduciary Net Assets

The FSLRF had an increase in fiduciary net assets of approximately $1.4 million for the year ended June 30, 2008, which was $3.9 million lower than previous fiscal year.

Also, in fiscal year 2007, federal regulations required the FSLRF to charge a default fee on all loans guaranteed and disbursed after June 30, 2006, resulting in $7.8 million of revenue in fiscal year 2007. Since the default fee is applicable to all loan disbursements in fiscal year 2008, the revenue

Continued

increased $2 million to $9.8 million in 2008. The FSLRF experienced $42.8 million of additional claim volume in fiscal year 2008, compared to fiscal year 2007. This additional claim volume resulted in $6.3 million of additional expenses in fiscal year 2008 ($1.5 million from the increase in loan loss allowance and $4.8 million of actual reinsurance losses on claims paid). Note that per regulation, the FSLRF incurs a loss on reinsurance of up to 5% for default claims paid.

The Plan recognized an increase in net deficit of $21.7 million for fiscal year 2008 compared to a $6.3 million reduction in net deficit in the prior year. The results from Plan operations were $28 million worse than prior year.

The reasons for the $28 million decrease from prior year are as follows:

- In fiscal year 2008, the Plan's investment income underperformed prior year by $23.2 million.
- Tuition benefits and related expenses increased $15.2 million in fiscal year 2008, compared to $10.5 million in fiscal year 2007, a $4.7 million difference
- Other administrative expenses actually decreased from prior year (by $100,000), but refunds to participants increased $200,000 over prior year.

In fiscal year 2008 and fiscal year 2007, 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 $18.6 million to $14.0 million), the imputed interest income on these contracts will decrease. Furthermore contract income is recorded net of change in allowance for uncollectible contracts. The decrease in allowance for uncollectible contracts was $289,000 less than the amount recorded in fiscal year 2007. The decrease in investment income resulted from two factors; (1) the benchmark performed poorly in fiscal year 2008, and (2) State Street Global Advisors underperformed in relation to the benchmark. The benchmark market returns for the Plan are as follows;

- The Domestic Equity Index (49.7% of Plan investments as of June 30, 2007) increased 20.8% in fiscal year 2007, and (52% of the Plan investments as of June 30, 2008) decreased 13.31% in fiscal year 2008. Related investments for the Plan decreased 15.54% in fiscal year 2008.
- The International Policy Index (9.7% of Plan investments as of June 30, 2007) increased 27% in fiscal year 2007, and (5% of the Plan investments as of June 30, 2008) decreased 10.61% in fiscal year 2008. Related investments for the Plan decreased 9.35% in fiscal year 2008.
- The fixed Income Policy Index (40.6% of the Plan investments as of June 30, 2007) increased 13.49% in fiscal year 2007, and (43% of the Plan investments as of June 30, 2008) decreased 3.71% in fiscal year 2008. Related investments for the Plan decreased 4.81%.

Administrative expenses decreased in fiscal year 2008 by approximately $100,000 due to overall efficiencies at the Authority/Corporation. Refunds increased $250,000 because of the age of accounts in the Plan and better tracking of cancelled contracts in fiscal year 2008. Trustee fee expense remained consistent with prior year.

Continued

The Trust noted an increase in subscriptions of $2.3 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 decreased by approximately $17.4 million (from a gain of $12.5 million in fiscal year 2007 to a $5.4 million loss in fiscal year 2008), because of poor market conditions in fiscal year 2008. Redemptions increased $3.4 million due to the overall age of the program.

Combined Government-Wide Statement of Net Assets

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

June 30, 2008

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	$ 1,456,606	$ 36,031,464	$ 37,488,070
Accounts receivable	3,807,771	3,520,622	7,328,393
Accrued interest income		62,183,729	62,183,729
Investments		185,215	185,215
Teacher and Osteopathic Medicine scholarship loans	450,000		450,000
Loans, net		236,238,000	236,238,000
Loans held for sale		11,857,129	11,857,129
Total Current Assets	5,714,377	350,016,159	355,730,536
Noncurrent:			
Restricted cash and cash equivalents		80,798,905	80,798,905
Restricted from Federal Student Loan Reserve Fund		13,753,558	13,753,558
Investments		9,661,966	9,661,966
Property, plant and equipment, net		12,282,525	12,282,525
Loans, net		1,919,839,028	1,919,839,028
Teacher and Osteopathic Medicine scholarship loans	4,634,867		4,634,867
Teacher and Osteopathic Medicine scholarship advances	9,155,931		9,155,931
Deferred front end borrower benefits, net		31,034,083	31,034,083
Deferred bond issuance costs, net		9,691,774	9,691,774
Deferred loan purchase premiums and originations costs, net		9,372,392	9,372,392
Total Noncurrent Assets	13,790,798	2,086,434,231	2,100,225,029
Total Assets	19,505,175	2,436,450,390	2,455,955,565
LIABILITIES			
Current:			
Accounts payable and accrued expenses	309,433	7,628,209	7,937,642
Accrued interest expense		6,400,769	6,400,769
Payable to US Department of Education		2,694,672	2,694,672
Line of credit payable		63,600,000	63,600,000
Bonds payable		250,000	250,000
Capital lease payable		420,000	420,000
Total Current Liabilities	309,433	80,993,650	81,303,083
Noncurrent:			
Capital lease payable		6,170,000	6,170,000
Allowance for arbitrage liabilities		795,255	795,255
Bonds payable		2,230,500,000	2,230,500,000
Total Noncurrent Liabilities		2,237,465,255	2,237,465,255
Total Liabilities	309,433	2,318,458,905	2,318,768,338
NET ASSETS			
Invested in capital assets, net of expended debt proceeds		5,869,742	5,869,742
Restricted for program benefits	19,195,742		19,195,742
Restricted for student aid and related activities		15,070,490	15,070,490
Restricted, other		97,051,253	97,051,253
Total Net Assets	$ 19,195,742	$ 117,991,485	$ 137,187,227

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, 2008

			Program Revenue		Net (Expenses) Revenues and Changes in Net Assets		
	Direct Expenses	**Indirect Expenses**	**Charges for Services**	**Operating Grants and Contributions**	**Governmental Activities**	**Business-Type Activities**	**Total**
Governmental activities:							
Kentucky Tuition Grants	$ 32,683,392	$ 610,951		$ 32,911,295	$ (383,048)		$ (383,048)
College Access Program Grants	59,414,578	647,426		60,892,483	830,479		830,479
Robert C. Byrd Scholarship	485,289	105,325		485,789	(104,825)		(104,825)
Mary Jo Young Scholarship	242,399	151,915		902	(393,412)		(393,412)
Early Childhood Development	1,082,582	91,057		1,122,896	(50,743)		(50,743)
National Guard Tuition Awards	4,670,748	245,652		28,108	(4,888,292)		(4,888,292)
Kentucky Education Excellence Scholarships	88,972,431	809,771		88,938,098	(844,104)		(844,104)
Teacher Scholarships	2,350,254	505,502		2,376,312	(479,444)		(479,444)
Osteopathic Medicine Scholarships	623,273	243,682		1,759,715	892,760		892,760
Work-study Benefits	789,509	123,414		6,828	(906,095)		(906,095)
Go Higher Grant Program	80,345	63,070		200,000	56,585		56,585
Pharmacy School Program				1,000,000	1,000,000		1,000,000
Outreach and other activities		1,033,934			(1,033,934)		(1,033,934)
Total Governmental Activities	191,394,800	4,631,699		189,722,426	(6,304,073)		(6,304,073)
Business-Type Activities							
Loan guarantee operations	4,038,736		$ 10,749,617			$ 6,710,881	6,710,881
Default collections	5,184,650		11,238,336			6,053,686	6,053,686
Lender assistance	1,958,410		2,731,612			773,202	773,202
Lending activities	143,060,042		151,556,589			8,496,547	8,496,547
Other activities	484,176		481,460			(2,716)	(2,716)
Total Business-Type Activities	154,726,014		176,757,614			22,031,600	22,031,600
Total Primary Government	$ 346,120,814	$ 4,631,699	$ 176,757,614	$ 189,722,426	(6,304,073)	22,031,600	15,727,527
Transfers:							
Interfund transfer to Government Fund					10,459,799	(10,459,799)	
Transfer to State General Fund					(336,500)		(336,500)
Transfer to KAPT						(154,552)	(154,552)
Total Transfers					10,123,299	(10,614,351)	(491,052)
Change in Net Assets					3,819,226	11,417,249	15,236,475
Net Assets, July 1, 2007					15,376,516	106,574,236	121,950,752
Net Assets, June 30, 2008					$ 19,195,742	$ 117,991,485	$ 137,187,227

Combined Statement of Net Assets - Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2008

	Authority			Corporation			Combined
ASSETS	**Internal Service Fund**	**Agency Operating Fund**	**Total Proprietary Funds**	**Education Finance Funds**	**Operating Fund**	**Corporation Total**	**Total**
Current:							
Cash and cash equivalents	$ 2,464,367	$ 17,404,550	$ 19,868,917		$ 16,162,547	$ 16,162,547	$ 36,031,464
Investments		185,215	185,215			-	185,215
Accounts receivable	209,886	13,675	223,561	$ 690,073	2,606,988	3,297,061	3,520,622
Accrued interest income		82,855	82,855	59,522,022	2,578,852	62,100,874	62,183,729
Loans, net				236,000,000	238,000	236,238,000	236,238,000
Loans held for sale					11,857,129	11,857,129	11,857,129
Total Current Assets	2,674,253	17,686,295	20,360,548	296,212,095	33,443,516	329,655,611	350,016,159
Noncurrent:							
Restricted cash and cash equivalents	1,831,900		1,831,900	78,967,005		78,967,005	80,798,905
Internal receivable (payable) for Gear Up Scholarships	(1,500,000)	1,500,000					
Internal receivable (payable) for capital projects	(47,017)	47,017					
Receivable from Federal Student Loan Reserve Fund		13,753,558	13,753,558				13,753,558
Investments		9,661,966	9,661,966				9,661,966
Property, plant and equipment, net		10,240,226	10,240,226		2,042,299	2,042,299	12,282,525
Loans, net				1,867,076,727	52,762,301	1,919,839,028	1,919,839,028
Deferred front end borrower benefits, net				31,015,880	18,203	31,034,083	31,034,083
Deferred debt issuance costs, net		130,200	130,200	9,561,574		9,561,574	9,691,774
Deferred loan purchase premiums and originations costs, net				9,362,570	9,822	9,372,392	9,372,392
Total Noncurrent Assets	284,883	35,332,967	35,617,850	1,995,983,756	54,832,625	2,050,816,381	2,086,434,231
Total Assets	2,959,136	53,019,262	55,978,398	2,292,195,851	88,276,141	2,380,471,992	2,436,450,390
LIABILITIES							
Current:							
Accounts payable and accrued expenses	1,497,987	15,847	1,513,834	$2,456,279	$3,658,096	6,114,375	7,628,209
Interfund payable (receivable)	1,461,149	(1,684,321)	(223,172)	(1,350,794)	1,573,966	223,172	
Accrued interest expense		52,868	52,868	6,079,353	268,548	6,347,901	6,400,769
Payable to US Department of Education		(1,105,143)	(1,105,143)	3,613,877	185,938	3,799,815	2,694,672
Line of credit payable					63,600,000	63,600,000	63,600,000
Bonds payable				250,000		250,000	250,000
Capital lease payable		420,000	420,000				420,000
Total Current Liabilities	2,959,136	(2,300,749)	658,387	11,048,715	69,286,548	80,335,263	80,993,650
Noncurrent:							
Capital lease payable		6,170,000	6,170,000				6,170,000
Allowance for arbitrage liabilities				795,255		795,255	795,255
Bonds payable				2,230,500,000		2,230,500,000	2,230,500,000
Total Noncurrent Liabilities		6,170,000	6,170,000	2,231,295,255		2,231,295,255	2,237,465,255
Total Liabilities	2,959,136	3,869,251	6,828,387	2,242,343,970	69,286,548	2,311,630,518	2,318,458,905
NET ASSETS							
Invested in capital assets, net		3,827,443	3,827,443		2,042,299	2,042,299	5,869,742
Restricted for student aid and related activities		15,070,490	15,070,490				15,070,490
Restricted, other		30,252,078	30,252,078	49,851,881	16,947,294	66,799,175	97,051,253
Total Net Assets	$ -	$ 49,150,011	$ 49,150,011	$ 49,851,881	$ 18,989,593	$ 68,841,474	$ 117,991,485

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

For the Year Ended June 30, 2008

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Total	Education Finance Funds	Operating Fund	Corporation Total	Total Funds
Operating Revenues:							
Interest Revenues:							
Interest on loans				$ 127,274,454	$ 3,357,504	$ 130,631,958	$ 130,631,958
Interest and investment income		$ 1,204,011	$ 1,204,011	6,165,870	1,295,374	7,461,244	8,665,255
Total Interest Revenues		1,204,011	1,204,011	133,440,324	4,652,878	138,093,202	139,297,213
Financing Expenses:							
Interest expense on bonds				94,026,479	2,267,817	96,294,296	96,294,296
Amortization of front end borrower benefits				7,491,756		7,491,756	7,491,756
Principle and interest benefits				7,251,309		7,251,309	7,251,309
Change in allowance for arbitrage				(11,153,621)		(11,153,621)	(11,153,621)
Federal consolidation fees				6,527,676	414,281	6,941,957	6,941,957
Provision for loan losses				1,807,651	301,778	2,109,429	2,109,429
Variable bond credit facility and remarketing fees				3,637,746		3,637,746	3,637,746
Amortization of loan purchase premiums and origination costs				2,449,830		2,449,830	2,449,830
Amortization of bond issuance costs				378,684		378,684	378,684
Net Interest Revenues		1,204,011	1,204,011	21,022,814	1,669,002	22,691,816	23,895,827
Other Operating Revenues:							
Servicing fees		2,731,612	2,731,612		12,954,745	12,954,745	15,686,357
Debt recovery commission		11,192,020	11,192,020				11,192,020
Federal fees earned		7,623,775	7,623,775				7,623,775
Default aversion fee income		1,938,795	1,938,795				1,938,795
Gain / Loss on sale of loans					(89,944)	(89,944)	(89,944)
Late payment penalties				594,434	4,152	598,586	598,586
Other Income	$ 481,460	29,352	510,812				510,812
Total Operating Revenues	481,460	24,719,565	25,201,025	21,617,248	14,537,955	36,155,203	61,356,228
Operating Expenses:							
Administrative expenses	479,517	10,954,417	11,433,934		24,808,533	24,808,533	36,242,467
Depreciation and amortization	1,943	190,642	192,585		1,837,526	1,837,526	2,030,111
Other expenses		39,453	39,453	455,519	557,078	1,012,597	1,052,050
Total Operating Expenses	481,460	11,184,512	11,665,972	455,519	27,203,137	27,658,656	39,324,628
Operating Income (Loss) Before Transfers		13,535,053	13,535,053	21,161,729	(12,665,182)	8,496,547	22,031,600
Servicing and Administration Transfer				(24,310,105)	24,310,105		
Net Income (Loss) After Operating Transfers		13,535,053	13,535,053	(3,148,376)	11,644,923	8,496,547	22,031,600
Transfers (To) From Other Funds							
Transfer to Government Fund		(4,831,699)	(4,831,699)		(5,628,100)	(5,628,100)	(10,459,799)
Interfund transfer				11,872,607	(11,872,607)		
Transfer to KHESLC		(887,474)	(887,474)		887,474	887,474	
Transfer to KAPT		(154,552)	(154,552)				(154,552)
Increase in Net Assets After Transfers		7,661,328	7,661,328	8,724,231	(4,968,310)	3,755,921	11,417,249
Net Assets, July 1, 2007		41,488,683	41,488,683	41,127,650	23,957,903	65,085,553	106,574,236
Net Assets, June 30, 2008	$ -	$ 49,150,011	$ 49,150,011	$ 49,851,881	$ 18,989,593	$ 68,841,474	$ 117,991,485

See Notes to Financial Statements

Combined Statement of Cash Flows - Proprietary Funds

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

For the Year Ended June 30, 2008

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Total Authority Funds	Education Finance Fund	Operating Fund	Total Corporation Funds	Total Funds
Cash Flows From Operating Activities:							
Principal received on loans				$ 231,097,484	$ 4,122,736	$ 235,220,220	$ 235,220,220
Interest received on loans				70,638,368	(162,521)	70,475,847	70,475,847
Special allowance received				15,700,732	160,387	15,861,119	15,861,119
Service fees received	$ 481,460	$ 4,219,778	$ 4,701,238		14,110,921	14,110,921	18,812,159
Debt recovery commission received		11,192,020	11,192,020				11,192,020
Federal fees received		7,623,775	7,623,775				7,623,775
Default Aversion Fees received		3,420,116	3,420,116				3,420,116
Internal activity-payments to other funds	678,737	(678,737)	-	(279,486)	279,486		
Loans originated, including costs				(588,661,062)	(806,243)	(589,467,305)	(589,467,305)
Administrative expenses paid		(10,317,176)	(10,317,176)	(8,769,418)	(23,860,418)	(32,629,836)	(42,947,012)
Credit facility fees paid				(3,609,928)		(3,609,928)	(3,609,928)
Loans purchased, including premiums				(4,871,670)	(131,277)	(5,002,947)	(5,002,947)
Interfund loan sales and purchases				55,423,489	(55,423,489)		
Client loan receipts					913,026,324	913,026,324	913,026,324
Loan receipts remitted to clients					(916,549,817)	(916,549,817)	(916,549,817)
Net Cash Provided By (Used In) Operating Activities	1,160,197	15,459,776	16,619,973	(233,331,491)	(65,233,911)	(298,565,402)	(281,945,429)
Cash Paid From Noncapital Financing Activities:							
Proceeds from debt issued				400,000,000	152,500,000	552,500,000	552,500,000
Debt principal payments				(216,500,000)	(98,900,000)	(315,400,000)	(315,400,000)
Interest on debt				(93,743,079)	(1,999,269)	(95,742,348)	(95,742,348)
Debt issuance costs				(1,510,609)		(1,510,609)	(1,510,609)
Interfund transfers, net		(154,552)	(154,552)	(13,324,972)	7,646,872	(5,678,100)	(5,832,652)
Increase in Federal Student Loan Reserve receivable		(2,365,429)	(2,365,429)				(2,365,429)
Cash requirements		(4,831,699)	(4,831,699)				(4,831,699)
Transfer (to) from KHESLC		(887,474)	(887,474)	887,474		887,474	
Net Cash Provided By (Used In) Noncapital Financing Activities		(8,239,154)	(8,239,154)	75,808,814	59,247,603	135,056,417	126,817,263
Cash Flows From Capital and Related Financing Activities							
Interfund transfers, net	15,117	(15,117)					
Capital expenditures		(400,000)	(400,000)		(668,123)	(668,123)	(1,068,123)
Interest paid on capital lease		(3,312)	(3,312)				(3,312)
Net Cash Provided By (Used In) Capital and Related Financing Activities	15,117	(418,429)	(403,312)		(668,123)	(668,123)	(1,071,435)
Cash Flows From Investing Activities:							
Proceeds from sales/maturities of investments		27,950,893	27,950,893		21,183,349	21,183,349	49,134,242
Proceeds from sale of loans held for sale					31,492,796	31,492,796	31,492,796
Purchases of investments		(28,013,946)	(28,013,946)		(9,969,227)	(9,969,227)	(37,983,173)
Acquisition of loans held for sale					(39,396,917)	(39,396,917)	(39,396,917)
Investment income		935,987	935,987	6,816,890	1,346,653	8,163,543	9,099,530
Loss on sale of loans held for sale					(89,944)	(89,944)	(89,944)
Net Cash Provided By Investing Activities		872,934	872,934	6,816,890	4,566,710	11,383,600	12,256,534
Net Increase (Decrease) in Cash and Cash Equivalents	1,175,314	7,675,127	8,850,441	(150,705,787)	(2,087,721)	(152,793,508)	(143,943,067)
Cash and Cash Equivalents, July 1, 2007	3,120,953	9,729,423	12,850,376	229,672,792	18,250,268	247,923,060	260,773,436
Cash and Cash Equivalents, June 30, 2008	$ 4,296,267	$ 17,404,550	$ 21,700,817	$ 78,967,005	$ 16,162,547	$ 95,129,552	$ 116,830,369

Continued

Combined Statement of Cash Flows - Proprietary Fund--Continued

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

For the Year Ended June 30, 2008

	Authority			Corporation			Combined
	Internal Service Fund	**Agency Operating Fund**	**Total Authority Funds**	**Education Finance Fund**	**Operating Fund**	**Total Corporation Funds**	**Total Funds**
Reconciliation of Operating Income (Loss) to Net Cash Provided By (Used In) Operating Activities							
Operating income (loss)		$ 13,535,053	$ 13,535,053	$ 21,161,729	$ (12,665,182)	$ 8,496,547	$ 22,031,600
Adjustments to reconcile operating income (loss) to net cash provided by (used in) operating activities:							
Investment income		(1,204,011)	(1,204,011)	(6,816,890)	(1,350,683)	(8,167,573)	(9,371,584)
Depreciation and amortization		(29,199)	(29,199)	10,320,270	1,837,526	12,157,796	12,128,597
Interest expense		3,312		94,026,479	2,267,817	96,294,296	96,294,296
Provision for loan losses				1,807,651	301,778	2,109,429	2,109,429
Gain or loss on sale of loans					89,944	89,944	89,944
Borrower interest converted to principal				(37,429,817)	(995,282)	(38,425,099)	(38,425,099)
Loan forgiveness				7,251,309		7,251,309	7,251,309
Interest forgiveness							
(Increases) decreases in assets:							
Accounts receivables	$ (196,080)	1,488,166	1,292,086	(590,680)	906,172	315,492	1,607,578
Receivable from US Department of Education		1,481,321	1,481,321	10,254,722	185,938	10,440,660	11,921,981
Accrued interest receivable		9,638	9,638	(13,703,673)	(2,499,137)	(16,202,810)	(16,193,172)
Principal received on loans				231,097,484	4,122,736	235,220,220	235,220,220
Loans purchased, including premiums				(4,871,670)	(131,277)	(5,002,947)	(5,002,947)
Loans originated, including costs				(588,661,062)	(806,243)	(589,467,305)	(589,467,305)
Interfund loan sales and purchases				55,423,489	(55,423,489)		
Increases (decreases) in assets:							
Accounts payable and accrued expenses	489,160	4	489,164	(774,203)	(1,570,855)	(2,345,058)	(1,855,894)
Interfund receivable/payable	867,117	178,804	1,045,921	(279,535)	496,326	216,791	1,262,712
Accrued interest payable		(3,312)					
Allowance for arbitrage liabilities				(11,547,094)		(11,547,094)	(11,547,094)
Net Cash Provided By (Used In) Operating Activities	$ 1,160,197	$ 15,459,776	$ 16,619,973	$ (233,331,491)	$ (65,233,911)	$ (298,565,402)	$ (281,945,429)

See Notes to Financial Statements

Balance Sheet - Governmental Fund

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

For the Year Ended June 30, 2008

	Governmental Fund Student Aid
ASSETS	
Current:	
Cash and cash equivalents	$ 1,456,606
Accounts receivable	3,807,771
Teacher and Osteopathic Medicine scholarship loans	450,000
Total Current Assets	5,714,377
Teacher and Osteopathic Medicine scholarship loans, net of allowance of $2,300,000	4,634,867
Teacher and Osteopathic Medicine scholarship advances	9,155,931
Total Noncurrent Assets	13,790,798
Total Assets	19,505,175
LIABILITIES	
Current:	
Accounts payable	309,433
Total Liabilities	309,433
Fund Balance	
Fund Balance - Restricted for program benefits	19,195,742
Total Liabilities and Fund Balance	19,505,175

See Notes to Financial Statements

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

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

For the Year Ended, June 30, 2008

	Governmental Fund Student Aid
Revenues:	
Interest and investment income fund	$ 158,927
Tobacco Settlement revenue	1,007,678
Unclaimed Lottery Revenue	11,300,000
State General Fund revenue	173,280,600
Federal funds revenue	1,342,145
Other income	2,633,076
Total Revenues	189,722,426
Expenditures:	
Kentucky Tuition Grants	33,294,343
College Access Program Grants	60,062,004
Robert C. Byrd Scholarships	590,614
Mary J Young Scholarships	394,314
Early Childhood Development Scholarships	1,173,639
National Guard Tuition Awards	4,916,400
Kentucky Education Excellence Scholarships	89,782,202
Teacher Scholarships	2,855,756
Osteopathic Medicine Scholarships	866,955
Work Study Benefits	912,923
Go Higher Grant Program	143,415
Outreach and other activities	1,033,934
Total Expenditures	196,026,499
Excess of Expenditures Over Revenues	(6,304,073)
Other Financing Sources and Uses, Including Transfers	
Transfer to State General Fund	(336,500)
Transfer from Authority Agency Operating Fund	4,831,699
Transfer from Corporation Operating Fund	5,628,100
Total Other Financing Sources and Uses, Including Transfers	10,123,299
Net Change in Fund Balance	3,819,226
Fund Balance, July 1, 2007	15,376,516
Fund Balance, June 30, 2008	$ 19,195,742

See Notes to Financial Statements

Statement of Fiduciary Net Assets (Deficit)

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

June 30, 2008

ASSETS	Federal Student Loan Reserve Fund	Agency Fund	Kentucky's Affordable Prepaid Tuition	Kentucky's Educational Savings Plan Trust
Current:				
Cash and cash equivalents	$ 15,977,296	$ 1,183,687	$ 1,020,892	$ 998,591
Contributions receivable			3,960,881	
Fees receivable			200,332	
Receivable from US Department of Education	12,260,562			38,021
Investments				103,378,025
Accrued interest income			967	
Other current assets	832,398			
Total Current Assets	29,070,256	1,183,687	5,183,072	104,414,637
Noncurrent:				
Investments			130,176,073	
Contributions receivable			10,052,641	
Total Noncurrent Assets			140,228,714	
Total Assets	29,070,256	1,183,687	145,411,786	104,414,637
LIABILITIES				
Current:				
Accounts payable	2,354,150		123,508	51,210
Accrued expenses	4,866,992			41,569
Origination distribution payable		1,183,687		
Payable to Agency Operating Fund	11,285,308			
Default Aversion fees payable	2,468,250			
Total Current Liabilities	20,974,700	1,183,687	123,508	92,779
Noncurrent:				
Tuition benefits payable			181,043,717	
Total Liabilities	20,974,700	1,183,687	181,167,225	92,779
NET ASSETS				
Restricted for program benefits			(35,755,439)	104,321,858
Restricted for other purposes	8,095,556			
Total Net Assets (Deficit)	$ 8,095,556	$ -	$ (35,755,439)	$ 104,321,858

See Notes to Financial Statements

Statement of Changes in Fiduciary Net Assets

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

For the Year Ended, June 30, 2008

	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky's Educational Savings Plan Trust
Additions:			
Federal reinsurance	$ 110,791,847		
Fee revenue	9,829,818		
Contract income, net		$ 1,960,832	
Subscriptions			$ 16,734,356
Investment Revenue:			
Net unrealized loss on investments		(11,765,149)	(8,321,286)
Interest and investment Income	492,615	5,363,669	3,415,822
Other Income	931,476		
Total Investment Revenue (Losses)	1,424,091	(6,401,480)	(4,905,464)
Total Additions (Losses)	122,045,756	(4,440,648)	11,828,892
Deductions:			
Program benefits:			
Loan claims	117,516,087		
Default aversion fee expense	1,938,795		
Redemptions			7,636,587
Administrative expenses		624,659	518,868
Refunds		1,169,964	
Trustee fee expense		453,777	
Tuition benefits expense, net		15,206,067	
Total Deductions	119,454,882	17,454,467	8,155,455
Change in Net Assets Before Transfers	2,590,874	(21,895,115)	3,673,437
Transfers			
Transfer to USDE for recall	(1,151,145)		
Transfer from Internal Service Fund		154,552	
Change in Net Assets	1,439,729	(21,740,563)	3,673,437
Net Assets (Deficit), July 1, 2007	6,655,827	(14,014,876)	100,648,421
Net Assets (Deficit), June 30, 2008	$ 8,095,556	$ (35,755,439)	$ 104,321,858

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

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 guarantee 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 a zero fund equity. The funds in the newly established FSLRF were used to pay for the reimbursements to the lenders for student loan claims and pay the AOF for default aversion fees, Account Maintenance Fee shortfall and any U.S. Treasury recall amounts. Funds used to pay loan claims are mostly replenished from reimbursements from the federal government.

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

Sources of funds to the AOF includes investment income, agency retention on collections of defaulted loans, default aversion fees, account maintenance fee (.10% of original principle balance outstanding prior to October 1, 2007, and .06% thereafter) , 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 twelve 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 between October 1, 1993 and June 30, 2007, are 100% insured against borrowers' death, disability, or bankruptcy and 98% insured against borrowers' default. Loans made after June 30, 2007, are 100% insured against borrowers' death, disability, or bankruptcy and 97% insured against borrowers' default.

Continued

Note A--Description of Business--Continued

The Authority/Corporation's General Bond Resolutions (GBRs) and separate Series Resolutions for issue 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, 2008 the Authority/Corporation serviced approximately $2.156 billion outstanding principal amount of FFELP Loans which are pledged pursuant to the 1983 GBR, the 1997 GBR, the Line of Credit Trust Agreement, the 2004 GBR and the 2008 GBR and approximately $6.0 billion of FFELP Loans and other education loans on behalf of other holders, including holders with national lending operations. The majority of such education loans are being serviced by the Authority/Corporation pursuant to servicing agreements which do not provide for the acquisition by the Authority/Corporation of the education loans serviced. As a servicer of FFELP loans, the Authority/Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. The Authority/Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Authority/Corporation financings.

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

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 offered enrollment periods in fiscal years 2002, 2003 and 2005, for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax advantages to purchasers. There have been no enrollment periods since fiscal year 2005 as the plan currently maintains an accumulated net deficit of $35.7 million.

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

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-

Continued

Note A--Description of Business--Continued

qualified withdrawals are subject to a 10% penalty in accordance with Section 529 of the Internal Revenue Code (IRC) except in cases where the withdrawal is: (i) made on account of the death or disability of the student; (ii) made on account of a scholarship received by a student; or (iii) a non-taxable transfer to another account or to another IRC Section 529 program for a different student who is a family member of the original student.

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

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

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

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

Continued

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

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

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

The Authority/Corporation's loan guarantee, default collection, lender assistance, lending and related activities and other business-type activities are presented as proprietary funds. Propriety funds also include internal service funds, which are used to report activity that provides goods or services on a cost reimbursement basis predominantly to the Authority/Corporation's other business-type activities. The Authority/Corporation follows all applicable 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 also include Agency Funds, which are held in purely a custodial capacity. Agency Funds include proceeds received from other student loan lenders and later remitted to a college or university to pay for tuition assistance for a respective student. The fiduciary fund also includes assets, liabilities, additions and deductions to net assets related to the Trust and the Plan. Assets of the Trust are held by the Authority/Corporation on behalf of program participants. Assets of the Plan are held by the Authority/Corporation to offset future tuition obligations of participants. The Authority/Corporation uses the accrual basis of accounting.

<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, which are stated at fair market value. Fair market value is determined by using quoted market prices as of the last day of the fiscal year.

Continued

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

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/Miscap 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, Plant and Equipment – Property, plant 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 a contra-revenue. Federal defaulted loans outstanding are accounted for by the Authority/Corporation but are not presented on the accompanying combined statement of net assets.

Allowance for Uncollectible Loans - As discussed in Note A, most 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 97% insured loans and for loans with certain loan servicing violations. The allowance for loan losses on FFELP loans funded through normal operations was $2,015,326 for loan principal and $262,743 for accrued interest as of June 30, 2008. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2008, the allowance for third party servicing loan losses for loans that have been purchased was $1,771,551 for loan principal and $395,881 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 I); and (3) the borrowers. All interest is recorded when earned and is shown in the financial statements net of the interest related portion of the provision for loan losses.

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

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

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

Continued

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

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

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

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

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

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 dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

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

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

Program-specific operating grant and contributions include revenues from mandatory and voluntary nonexchange transactions with other governments and organizations that are restricted for use in a particular program. Program-specific operating 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 balance.

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

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

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

Designated Net Assets – The Authority/Corporation has adopted GASB No. 46 *Net Assets Restricted by Enabling Legislation*—an amendment of GASB Statement No. 34 to designate certain classifications of net assets to better inform the readers of the financial statements. The designated net asset classifications are as follows:

Designated for Operations – Net assets comprised of current assets available for use in operations, less current obligations outstanding.

Designated for Bond Holders – Net assets comprised of all tangible financial assets in bond trusts, less related debt outstanding.

Designated for Deferred Assets – Net assets comprised of all intangible assets.

Designated for Default Fee – Net assets needed to pay budgeted default fees on behalf of Kentucky students in fiscal year 2009.

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 (which are unconditionally guaranteed by the United States of America), indebtedness issued by certain Federal agencies, collateralized repurchase agreements or investment funds secured by obligations of the United States of America with collateral held by or at the direction of the trustee.

Custodial Credit Risk and Interest Rate Risk - Custodial credit risk is the risk that in the event of a bank failure, the Authority/Corporation's deposits may not be returned to it. The Authority/Corporation's investment policy does not contain a requirement for the collateralization of cash and investments nor does it require investments to be maintained in the Authority/Corporation's name. As of June 30, 2008, the Authority/Corporation's Proprietary Funds, Governmental Fund and Fiduciary Funds maintained custodial credit risk for cash on deposit as follows:

Of the $23.1 million of cash maintained in the Proprietary Funds, $7.5 million was held for guarantee operations and the remaining $15.6 million was held for lending activities.

	Governmental Fund Bank Balance	Proprietary Funds Bank Balance	Fiduciary Funds Bank Balance
Insured (FDIC)		$ 300,000	$ 200,000
Uninsured		410,218	
Collateralized by securities held by the pledging financial institution		18,072,951	3,835,699
Cash deposited with Kentucky State Treasurer	$ 1,456,606	4,296,267	83,236
Total	$ 1,456,606	$ 23,079,436	$ 4,118,935

Continued

Note C--Cash and Investments--Continued

As of June 30, 2008, all Proprietary Funds investments were registered in the Authority/Corporation's name and maintained by an external trustee. The investment balances as of June 30, 2008 are summarized as follows:

	Fair Value	Weighted Average Maturity
Corporate Bonds	$ 5,076,164	9.57
U.S. Treasury and government agency securities	1,552,969	2.79
Collateralized Mortgage Obligations	3,218,048	22.93
Money market securities	98,090,906	
	$ 107,938,087	

Of the $107.9 million of investments maintained in the Proprietary Funds, $24.1 million was held for guarantee operations and the remaining $83.8 million was held for lending activities.

As of June 30, 2008, the investment portfolio maintained by the Trust ($103,378,025) was comprised entirely of TIAA mutual funds and cash equivalents maintained by the Trust ($998,591) were comprised of highly liquid money market securities.

The investment portfolio maintained by the FSLRF was entirely comprised of money market securities ($13,758,216) held in a trust by Bank of New York.

Plan investments of $130,696,660, 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.

Continued

Note C--Cash and Investments--Continued

Credit Risk - The Authority/Corporation's investment policy does not limit the credit risk for securities. The following table summarizes the Standard & Poor rating for all corporate bonds held by the Authority/Corporation's Proprietary Funds as of June 30, 2008.

Fair Value	Rating
AAA	$ 4,365,540
AA	251,240
A	255,268
BBB+	80,817
BBB	35,042
NR	88,257
	$ 5,076,164

All $5.1 million of bonds in the Proprietary Funds were held for guarantee operations.

The investment policy for the FSLRF limits the investment type to government back securities. As of June 30, 2008, 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, 2008, the Plan only invested in money market securities.

Note D--Property, Plant and Equipment

A summary of Property, Plant and Equipment follows:

	Beginning Balance July 1, 2007	Additions	Disposals	Ending Balance June 30, 2008
Proprietary fund:				
Furniture and equipment	$ 18,991,276	$ 976,626	$ (418,329)	$ 19,549,573
Building	11,986,200			11,986,200
System development	55,955			55,955
Student loan servicing system	541,131			541,131
Debt recovery system	849,859		(139,350)	710,509
Accumulated depreciation	(19,004,960)	(2,113,562)	557,679	(20,560,843)
	$ 13,419,461	$ (1,136,936)	$ -	$ 12,282,525
Fiduciary Fund:				
Furniture and equipment	$ 605,344		$ (11,776)	$ 605,344
Accumulated depreciation	(605,344)		11,776	(605,344)
	$ -	$ -	$ -	$ -

Depreciation expense totaled $2,113,562 for the year ended June 30, 2008, of which $2,030,111 was allocated to business-type activities, $50,846 was allocated to governmental activities, $30,056 was allocated to loans for held for sale and $2,549 was allocated to the fiduciary activities.

Continued

Note D--Property, Plant and Equipment--Continued

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

Loan guarantee operations	$ 112,268
Default collections	43,212
Lending and related activities	1,837,526
Lender assistance	35,162
Other	1,943
	$ 2,030,111

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

Pursuant to the FFELP, the loan guarantee operating unit of Authority/Corporation insures eligible student loans for losses incurred from the default, death, disability, or bankruptcy and also insures for other losses such as school closures and false certifications. As of June 30, 2008, the outstanding balance of aggregate insured student loans was approximately $4.9 billion.

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

The Authority/Corporation's annual default claims rate is within the 5%, which allows for reimbursement rates at the highest level. Due to the reduction of the Federal reimbursement rate for loans made subsequent to October 1, 1993, the Authority/Corporation has recorded an allowance of $4.9 million at June 30, 2008 for losses on federal reinsurance.

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

	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 (Guarantee Operations)--Continued

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

Rehabilitated Loans - The Authority/Corporation is entitled to retain 18.5% of principal and 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 defaulted loan collections received prior to October 1, 2007. The Authority/Corporation is entitled to retain 16% of defaulted loan collections received after October 1, 2007. This amount is recorded as an addition when received.

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 basis by the federal government.

This fee is recognized as revenue and recorded in the AOF. In federal fiscal year 2001, the AMF was reduced to .10% of the original principal amount of outstanding loans. Effective October 1, 2007, the AMF was further reduced to .06% of original principal outstanding.

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 in 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.

Continued

Note F--Lease/Bond Payable--Continued

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

In connection with the issuance of the bonds, the Authority/Corporation entered into a financing/lease agreement with the Commission whereby the Authority/Corporation agreed to lease the newly constructed building. The lease is for an initial two-year term ending June 30, 2002, with the right to renew for nine additional two-year renewal periods.

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

The lease payments are equal to the debt service required by the bond indenture. In connection with the agreements, the Commonwealth of Kentucky General Assembly appropriated sufficient spending authorization to the Authority/Corporation to pay the lease payments required for the initial two-year term. There can be no assurance to make rent payments past the initial two-year lease period. The Authority/Corporation did renew the lease for the biennium ending June 30, 2010.

A summary of the activity for the bond issues for the year ended June 30, 2008 is as follows:

	July 1, 2007	Additions	Payments	June 30, 2008
Bond Payable	$ 6,990,000	$ -	$ 400,000	$ 6,590,000

Continued

Note F--Lease/Bond Payable--Continued

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

	Principal	Interest
Year Ending June 30,		
2009	$ 420,000	$ 324,259
2010	440,000	302,659
2011	465,000	279,799
2012	480,000	264,105
2013	500,000	244,905
Five Years Ending June 30,		
2014 - 2018	2,905,000	815,770
2019 - 2020	1,380,000	109,288
	$ 6,590,000	$ 2,340,784

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, 2008 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, 2008:

Stafford – Subsidized	$	751,702,102
Stafford – Unsubsidized		657,217,620
PLUS/SLS		70,501,590
Consolidation		678,850,410
Other		1,592,183
Total gross loans		2,159,863,905
Allowance for loan loss		(3,786,877)
Loans, net		2,156,077,028
Deferred front end borrower benefits, net of accumulated amortization of $25,849,982		31,034,083
Deferred loan purchase premium and loan originations costs, net of accumulated amortization of $13,037,954		9,372,392
Net Loans and Deferred Loan Purchase Premiums and Origination Costs	$	2,196,483,503

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, 2008, $2,616,424 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

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 or any date mutually agreed on by both parties pursuant to the terms of the loan purchase agreement. During the year, the Corporation sold loans with a cost value of $31,582,740 for $31,492,796, resulting in a loss of $89,944. As of June 30, 2008, the Authority/Corporation maintained loans held for sale to AHELC with a cost of $11,857,129.

Note I--Special Allowance

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, 2008 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% 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% 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% 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 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% SAP, the Authority/Corporation was unable to make such assertions and therefore lost all 9.5% SAP payments effective for all quarters ending on or after December 31, 2006.

Note J--Principal and Interest Forgiveness

During fiscal year 2008, the Authority/Corporation forgave $7,190,447 in loan principal and $60,862 in accrued interest for qualified borrowers including teachers, nurses, and public service attorneys who were employed in the Commonwealth.

Note K--Revenue Bonds

The balance of revenue bonds at June 30, 2008 and the related activity for the year ended June 30, 2008 is as follows:

Series		Scheduled Maturity	Interest Rate	Beginning Balance July 1, 2007	Bond Maturities & Refundings	New Issues	Ending Balance June 30, 2008
1983 General Bond Resolution							
1991 E	*	December 1, 2011	Weekly**	$ 46,000,000	$ (45,900,000)		$ 100,000
1996 A	*	June 1, 2026	Weekly**	25,000,000	(24,850,000)		150,000
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	(6,300,000)		51,250,000
2004 A-3	*	June 1, 2034	Every 35 days	57,600,000			57,600,000
2004 A-4	*	June 1, 2034	Every 35 days	57,600,000			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
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

Continued

Note K--Revenue Bonds--Continued

Series		Scheduled Maturity	Interest Rate	Beginning Balance July 1, 2007	Bond Maturities & Refundings	New Issues	Ending Balance June 30, 2008
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
2007 A-1	*	June 1, 2037	Every 35 or 7 days		(42,925,000)	$ 42,925,000	
2007 A-2		June 1, 2037	Every 7 days		(37,075,000)	37,075,000	
2007 B-1	*	June 1, 2037	Every 35 or 7 days		(20,000,000)	20,000,000	
2008 General Bond Resolution							
2008 A-1	*	June 1,2037	Weekly**			179,525,000	179,525,000
2008 A-2	*	June 1,2038	Weekly**			83,400,000	83,400,000
2008 A-3		June 1,2038	Weekly**			37,075,000	37,075,000
				$ 2,047,250,000	$ (216,500,000)	$ 400,000,000	$ 2,230,750,000

*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, 2008 levels, are as follows:

	Principal Repayment Amount (Thousands)				
	83 GBR	97 GBR	04 GBR	08 GBR	Total
Year Ending June 30, 2009	$ 250				$ 250
4 Years Ending June 30, 2013					
5 Years Ending June 30, 2018					
5 Years Ending June 30, 2023					
5 Years Ending June 30, 2028		250,000			250,000
5 Years Ending June 30, 2033		605,650			605,650
5 Years Ending June 30, 2038		-	1,074,850	300,000	1,374,850
	$ 250	$ 855,650	$ 1,074,850	$ 300,000	$ 2,230,750

Continued

Note K--Revenue Bonds--Continued

	Interest Payments Amount (Thousands)				
	83 GBR	97 GBR	04 GBR	08 GBR	Total
Year Ending June 30, 2009	$ 2	$ 22,759	$ 28,216	$ 5,178	$ 56,155
Year Ending June 30, 2010		22,759	28,216	5,178	56,153
Year Ending June 30, 2011		22,759	28,216	5,178	56,153
Year Ending June 30, 2012		22,759	28,216	5,178	56,153
Year Ending June 30, 2013		22,759	28,216	5,178	56,153
5 Years Ending June 30, 2018		113,795	141,080	25,890	280,765
5 Years Ending June 30, 2023		113,795	141,080	25,890	280,765
5 Years Ending June 30, 2028		109,094	141,080	25,890	276,064
5 Years Ending June 30, 2033		46,446	141,080	25,890	213,416
5 Years Ending June 30, 2038			54,090	22,521	76,611
	$ 2	$ 496,925	$ 759,490	$ 151,971	$ 1,408,388

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

On June 18, 2008, the Authority/Corporation issued $300 million variable rate demand obligation bonds, supported by letters of credit from commercial banks and issued under the 2008 GBR. The proceeds from the bond issue were used to refund certain outstanding bonds ($216.5 million in fiscal year 2008 and $.1 million subsequent to year-end) (see Note N) and reduce the outstanding balance on a commercial bank line of credit (see Note L below) ($83.4 million). As a result of the financing, the Corporation is expected to realize debt service savings over the remaining life of the refunding bonds.

Note L--Lines of Credit

On December 22, 2006, the Authority/Corporation entered into a Line of Credit Agreement with JP Morgan Chase Bank, N.A (Chase Bank). The agreement provides for an initial commitment amount to the Authority/Corporation not to exceed an aggregate outstanding principal balance of $40 million, with a provision where the Authority/Corporation may request an increase in the commitment amount not to exceed $120 million. On December 18, 2007, the Authority/Corporation increased the commitment on the line of credit to $120 million, and then by mutual agreement between the Authority/Corporation and Chase Bank on January 2, 2008, the line of credit increased an additional $50 million to $170 million. The Authority/Corporation drew down as much as $162.5 million to originate FFELP loans. On June 26, 2008, the Authority/Corporation used proceeds from the 2008 bond issue to pay $83.4 million against the line of credit. As of June 30, 2008, the Authority/Corporation maintained $63.6 million outstanding debt related to the Chase Bank Line of

Continued

Note L--Lines of Credit--Continued

Credit, which is payable in two installments, $16.6 million on September 30, 2008 and $47 million on December 31, 2008. The borrowing period ends December 31, 2008, and can be extended at the discretion of both parties through December 31, 2009.

On June 19, 2008, the Authority/Corporation entered into a line of credit agreement with PNC Bank, N.A. The agreement provides for a commitment amount not to exceed the lesser of $45 million or the combined cash and investments maintained by the Authority/Corporation with PNC Bank, adjusted for asset class factor. The PNC Bank Line of Credit may only be used to originate loans held for sale to AHELC, and expires on June 18, 2009. The Authority/Corporation did not make any draws against this line of credit in fiscal year 2008.

Note M--Allowance for Arbitrage Liabilities

Certain of the Authority/Corporation's tax-exempt bond issues are subject to potential arbitrage liabilities under U.S. tax law. Arbitrage liabilities, under current federal income tax law regarding tax-exempt bond issues, consist of three types; (1) yield adjustment payments, (2) forgiveness and (3) arbitrage rebate. At June 30, 2008, the Authority/Corporation is reporting a liability for arbitrage rebate of $795,255.

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

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

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

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

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

Continued

Note M--Allowance for Arbitrage Liabilities--Continued

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

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

Note N--Credit and Liquidity Facilities and Bond Remarketing

As of July 1, 2007, the 1991 Series E and 1996 Series A Bonds were collateralized with Standby Bond Purchase Agreements, pursuant to which Landesbank Hessen-Thuringen Girozentrale will purchase any bonds not remarketed. Also, as of June 30, 2007, the 1991 Series E Bonds and the 1996 Series A Bonds had 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 were scheduled to expire on December 1, 2011 for the 1991 Series E Bonds and December 31, 2015 for the 1996 Series A Bonds. The AMBAC Municipal Bond Insurance Policy did extend through the term of the 1991 Series E Bonds, December 1, 2011, and the MBIA Municipal Bond Insurance Policy did extend through the term of the 1996 Series A Bonds, June 1, 2026.

During fiscal year 2008, $45.9 million of 1991 Series E Bonds and $24.85 million 1996 Series A Bonds were purchased by Landesbank Hessen-Thuringen Girozentrale pursuant to the Standby Bond Purchase Agreement. On June 24, 2008, the Authority/Corporation refinanced the $45.9 million of 1991 Series E Bonds and $24.85 million of Series A bonds, leaving $250,000 of bonds outstanding. On July 3, 2008, the Authority/Corporation retired the remaining the $100,000 of 1991 Series E bonds and on August 20, 2008, the Authority/Corporation defeased the remaining $150,000 of 1996 Series A bonds.

The 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 8.50% of gross wages for the year ended June 30, 2008. The employees contributed 5% of their gross wages to the plan for the year ended June 30, 2008. 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 $20,926,247 for the year ended June 30, 2008. Total payroll for the year ended June 30, 2008 was $21,196,271. 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, 2008 was $2,825,044 which consisted of employer contributions of $1,778,731 and $1,046,313 from employees in 2008. Employer contributions for the years ended June 30, 2007 and 2006 were $1,623,915 and $917,975, 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 4 employees covered. Plan assets and the accrued liability for the postretirement healthcare plan totaled $102,000 at June 30, 2008.

Note P--Tuition Benefit Payable

The following assumptions developed by management were used in the actuarial valuation of tuition benefits payable as of June 30, 2008. These assumptions are based on historical data for both state and national trends.

<u>Investment Rates</u>--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--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:

- The known tuition increases for the 2003-2004 academic year were 23.4% for the Value Plan and 14.4% for the Standard Plan and the Premium Plan.

- The known tuition increases for the 2004-2005 academic year were 24.2% for the Value Plan and 16.9% for the Standard Plan and the Premium Plan.

- The known tuition increases for the 2005-2006 academic year were 6.5% for the Value Plan and 12.5% for the Standard Plan and the Premium Plan.

- The known tuition increases for the 2006-2007 academic year were 11.2% for the Value Plan and 12% for the Standard Plan and the Premium Plan.

- As of June 30, 2007, the known tuition increases for the 2007-2008 academic year were 5.5% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan. 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.

- As of June 30, 2008, the known tuition increases for the 2008-2009 academic year were 5.2% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan. The tuition increase assumption was adjusted to 10% for the 2009-2010 academic year, 9% for 2010-2011 academic year, and 7% for each year thereafter.

For the period from inception to June 30, 2008, the annualized tuition increase for the highest-priced Kentucky public university, as applicable to the tuition benefits payout rate of the KAPT Standard Plan, which represents 90% of KAPT enrollments, has been 10.8%. For the Kentucky Community and Technical College System (KCTCS), as applicable to the tuition benefits payout rate of the Value Plan, the average annualized tuition increase from inception to June 30, 2008, has been 17.2%. 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, 2008 has been 11.9%.

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

Note Q--Restricted Net Assets

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

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

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

c. **Education Finance Funds:** Net assets are restricted as required by the 1983, 1997, 2004 and 2008 General Bond Resolutions, the separate Series Resolutions, and Line of Credit Agreements.

d. **Student Aid Funds:** The Student Aid net assets are restricted for the Student Aid Programs.

e. **The Trust:** Net assets are restricted for use by trust participants

Note R--Designated Net Assets

The Authority/Corporation's Board of Directors has designated net assets for specific purposes. Descriptions of these designations, by fund, as of June 30, 2008, are as follows:

<u>Agency Operating Fund:</u>

In fiscal year 2009, the AOF will pay the default fee to the FSLRF on behalf of all borrowers attending a Kentucky School. The Authority/Corporation has designated $6 million for this purpose.

The Authority/Corporation has designated $130,200 of AOF net assets to pay for intangible assets (unamortized deferred costs).

Cash, investments and highly liquid receivables, less current liabilities ($24,121,878) are designated as net assets available for loan guarantee, lender assistance, student aid, outreach and college savings plan activities.

Remaining net assets of $15,070,490 are federally restricted and relatively illiquid, thus cannot be counted upon for use in operations.

<u>Education Finance Fund:</u>

The Authority/Corporation has designated $49,940,024 of Education Finance Fund net assets to pay for intangible assets (unamortized deferred costs).

Remaining net deficit of $88,143 represents a shortfall of securities collateralizing debt outstanding.

Continued

Note R--Designated Net Assets--Continued

Operating Fund:

The Authority/Corporation has designated $28,025 of operating fund net assets to pay for intangible assets (unamortized deferred costs).

Cash, investments and highly liquid receivables, less current liabilities ($16,527,578) are designated as net assets available for lending and loan servicing activities.

Remaining net assets of $391,691 are relatively illiquid, thus cannot be counted upon for use in operations.

Note S--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	
2009	$ 1,483,400
2010	785,000
2011	710,000
2012	578,000
2013	69,000

Note T--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 September 30, 2008, had plans to purchase a minimum of $282,000 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, 2008. As a result, the federal government's reinsurance rate for defaults for the federal fiscal year ending September 30, 2008, is 100% for loans made prior to October 1, 1993, 98% for loans made on or after October 1993 to September 30, 1998, and 95% for loans made after September 30, 1998. In the event of future adverse default experience, the FSLRF could be liable for up to 25% of defaulted loans. At the beginning of each fiscal year, the reinsurance rate returns to baseline (100%, 98% or 95%); management does not expect that all guaranteed loans could default in one year.

Continued

Note T--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, 2008 is calculated as follows:

Amount of guaranteed student loans outstanding at lenders	$ 4,875,636,858
Less minimum federal government share - 75%	3,656,727,644
	$ 1,218,909,215

Note U--Subsequent Events

On August 20, 2008, the Corporation issued $50 million of variable rate bonds under the 1983 General Bond Resolution. The bonds bear interest at a spread to the average of 90-day commercial paper rates and mature on November 15, 2009. The proceeds of the bond issue will be applied to the origination of student loans whereby, participations thereof will be sold to the USDE under the terms of a Master Participation Agreement (Participation Agreement), discussed below. Proceeds from the sale of participations will then be applied to the origination of additional student loans

On August 20, 2008, the Authority/Corporation (lending activities) received notification that the USDE had approved the Participation Agreement submitted to the USDE for the Authority/Corporation to begin participating in the USDEs Loan Participation Program (the Participation Program) and loan Purchase Program (Purchase Program). The Authority/Corporation has engaged Bank of New York (BONY) as Custodian, in accordance with the Participation Agreement.

Under the terms of the Participation Agreement, the USDE will provide interim short-term liquidity to the Authority/Corporation by purchasing participation interests in pools of FFELP loans. The Authority/Corporation will be charged a rate of 90-day commercial paper plus 50 basis points on the principal amount of participation interests outstanding. Loans funded under the Participation Program must be either refinanced by the lender or sold to the USDE pursuant to the Purchase Program prior to its expiration on September 30, 2009. All payments and other proceeds received on or with respect to the participation interests will be applied in the following order of priority: (i) to the USDE to pay accrued interest; (ii) to the USDE to reduce the outstanding principal balance of participation interests held by the USDE; and (iii) to the Authority/Corporation any remaining amounts. In addition, the Authority/Corporation must fund the USDE lender fees (1% of originated principal) and any negative special allowance payments and servicing costs on the participated loans.

Continued

Note U--Subsequent Events--Continued

The Authority/Corporation has designated $5.8 million to pay lender fees and negative special allowance in fiscal year 2009. The Authority/Corporation expects to utilize the Participation Program to fund a significant portion of its loan originations for the 2008-2009 academic year. The Authority/Corporation may elect to sell to the USDE, through a put option, loans which are subject to participation interests. Any such sale must occur by September 30, 2009. In the event the participation interests are not redeemed and the loans are not sold to the USDE by September 30, 2009, USDE will take title to the loans without any further compensation to the Authority/Corporation; however, in such event the Custodian shall remit to the Authority/Corporation the excess (if any) of the aggregate amount of any redemption payments made under the Participation Agreement over the obligations due and owing to the USDE by the Authority/Corporation. All loans in the Participation Program are also subject to the terms of the Purchase Agreement.