Strothman & Company P S C

Certified Public Accountants & Advisors

Financial Statements

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

June 30, 2010

Financial Statements

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

June 30, 2010

Strothman & Company P S C
Certified Public Accountants & Advisors

1600 Waterfront Plaza
325 West Main Street
Louisville, Kentucky 40202-4251

502 585 1600
502 585 1601 Fax
www.strothman.com

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, 2010, 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 $110,205,253 as of June 30, 2010, and total additions to fiduciary net assets of $48,494,870 for the year ended June 30, 2010. 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, 2010, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2010 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 17 be presented to supplement the basic combined financial statements. Such information, although not a part of the basic combined financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic combined financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic combined financial statements, and other knowledge we obtained during our audit of the basic combined financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

STROTHMAN & COMPANY PSC

Louisville, Kentucky
October 25, 2010

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 U.S. Department of Education ("USDE"), defaulted loan recoveries and other federally mandated program sources and uses of funds are accounted for in the Federal Student Loan Reserve Fund ("FSLRF"), a fiduciary fund of the Authority/Corporation.

<u>Lender assistance</u> - Lender assistance operations are comprised entirely of loan origination and disbursement services provided by the Authority/Corporation for up to 68 lenders and 277 schools. The lender assistance operation draws money directly from lenders' accounts and disburses those funds directly to schools. This service is provided on a fee basis to lenders and is free for schools. In fiscal year 2010, the Authority/Corporation charged lenders $3 per loan for origination services and $1 per loan for disbursement services. The disbursement fee is not charged if the lender assistance operation is also the disbursement agent.

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

Continued

Lending - The Authority/Corporation's lending operation is authorized to finance FFELP loans for students attending eligible post-secondary institutions, service and collect education loans, and issue bonds and notes not to exceed $5 billion in order to carry out its corporate powers and duties. The FFELP student loans held by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS"), and Federal Consolidation Loans ("Consolidations"). As of June 30, 2010, the lending operation owned $2.45 billion of student loans.

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

The Authority/Corporation's lending operation finances all FFELP loans with revenue bonds, notes payable, lines of credit, and a FFELP Participation credit facility from USDE. As of June 30, 2010, the lending operation maintained five separate General Bond Resolutions ("GBRs") and related Series Resolutions for issue of revenue bonds, and the Department of Education Conduit Program ("ED Conduit Program"). The GBR's 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, 2010, the lending operation maintained $1.2 billion of revenue bonds outstanding, $703 million for the ED Conduit Program, $536 million Participation Payable to USDE, and $7.4 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, the ED Conduit Program, 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 $2.45 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 Master Indenture, the 2008 Indenture, the 2010 Indenture, the ED Conduit Program, line of credit agreements, and credit facility payable to USDE. Approximately $110 million 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 in the Operating Fund.

Continued

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 attendance rate and decrease the college dropout rate.

In fiscal year 2010, the outreach operation staff traveled 205,000 miles, provided 492 exhibits, 2,848 presentations, and made direct contact with 142,000 parents and/or students.

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

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

The Trust was formed on July 15, 1988, by Kentucky law, to help people save for the costs of education after high school. The Trust is administered by the 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. The Trust offers certain federal and state tax advantages to purchasers.

An individual participating in the Trust establishes an account in the name of a beneficiary. Contributions can be made among six investment options: the managed Allocation Option, the Fixed Income Option, the Balanced Option, two 100% Equity Options 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.

Continued

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

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

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

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

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

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

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

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

Continued

As of June 30, 2010, the Plan maintained a present value fund deficit of $62.2 million. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2018, and the Commonwealth will be required to transfer assets from the unclaimed property fund. Over the remaining estimated life of the program, through fiscal year 2027, actuarial estimates show the Commonwealth will need to transfer approximately $123.9 million from the unclaimed property fund. As of June 30, 2010, the unclaimed property fund has approximately $298.8 million.

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

Student Loan Update

The Health Care and Education Reconciliation Act ("HCERA") of 2010 (H.R.4872/Public Law 111-152) was signed into law on March 30, 2010. HCERA eliminates the origination and/or guarantee of FFELP loans, effective July 1, 2010. HCERA does allow lenders to make subsequent disbursements on loans originated on or before June 30, 2010. In accordance with HCERA, the Authority/Corporation continues to provide guarantee services on $5 billion of FFELP loans, continues to own $2.45 billion of FFELP loans, and continues to service an additional $110 million of loans. The Authority/Corporation cannot originate, guarantee or fund any new FFELP loans after June 30, 2010.

HCERA does provide for servicing opportunities for nonprofit servicers to service 100,000 direct loans. The Authority/Corporation has been pre-approved as an eligible servicer and is preparing operations to accommodate their allotment of direct loans.

HCERA created additional funding for the College Access Challenge Grant program ("CACG"). In CACG year 2010, the Authority/Corporation received $1.019 million of federal funds for CACG. In CACG year 2011, the Authority/Corporation has been awarded $2.51 million of federal funds for CACG.

On September 1, 2010, the Authority/Corporation launched its private loan program, the Kentucky Advantage Education Loan ("KAEL") program. The KAEL program is designed to compete with Direct Plus Loan. The Authority/Corporation began receiving applications for KAEL loans on October 18, 2010.

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.

Continued

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 18 and 19 of this report. The fund financial statements can be found on pages 20 through 26 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 27 and 28 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, 2010 and 2009, respectively.

Condensed Financial Information - Governmental Fund and Proprietary Funds

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

	Governmental Fund		Proprietary Funds	
	2010	2009	2010	2009
Net Asset Information				
Capital assets			$ 4,133,147	$ 4,560,844
Other assets	$ 15,464,299	$ 19,688,834	2,724,493,553	2,834,108,120
Total Assets	**15,464,299**	**19,688,834**	**2,728,626,700**	**2,838,668,964**
Long-term liabilities			2,005,771,154	2,161,509,236
Other liabilities	246,241	689,212	575,079,133	544,602,759
Total Liabilities	**246,241**	**689,212**	**2,580,850,287**	**2,706,111,995**
Invested in capital assets, net of expended debt proceeds			4,133,147	4,575,961
Unrestricted			41,610,407	12,946,259
Restricted, other	15,218,058	18,999,662	53,936,697	69,026,386
Restricted for student aid and related activities			48,096,162	46,008,363
Total Net Assets	**$ 15,218,058**	**$ 18,999,662**	**$ 147,776,413**	**$ 132,556,969**
Activity Information				
Interest and investment income	$ 267,104	$ 153,727	$ 852,478	$ 2,695,505
State General Fund revenue	183,809,001	180,985,962		
Contribution from Agency Operating Fund	4,385,255	5,350,551		
Unclaimed Lottery revenue	9,288,000	8,602,800		
Federal funds revenue	1,406,245	2,403,600		
Tobacco settlement revenue	999,999	1,150,000		
Service fees from external sources			2,491,116	14,635,663
Service fees from Education Finance Funds			11,938,453	11,801,178
Deconversion fees			8,334,322	1,521,920
Debt recovery commission			17,639,072	14,549,502
Early retirement of debt			11,977,102	10,901,634
Federal fees earned			8,162,305	7,474,722
Federal grant revenue			1,019,375	
Default aversion fee income			2,121,448	2,438,716
Interest income on loans			27,993,120	30,102,279
Other income	344,464	368,675	1,823,809	1,358,823
Total Revenues	**200,500,068**	**199,015,315**	**94,352,600**	**97,479,942**
Kentucky Tuition Grants	32,861,850	32,510,491		
College Access Program Grants	63,788,862	61,736,731		
Robert C. Byrd Scholarships	602,493	615,974		
Mary Jo Young Scholarships	431,686	368,236		
Early Childhood Development Scholarships	1,343,791	1,378,787		
National Guard Tuition Awards	4,714,264	4,835,577		
Kentucky Education Excellence Scholarships	94,472,038	91,574,068		
Teacher Scholarships	2,593,363	2,371,073		
Teacher Loan Forgiveness	1,340,500			
Osteopathic Medicine Scholarships	994,099	1,302,628		
Work Study Benefits	715,229	766,261		
Go Higher Grant Program	256,382	266,926		
Outreach and other activities	167,075	1,484,683		
Guarantee operations			4,853,501	4,463,859
Default collection			7,433,539	5,583,869
Lending and related activities			51,321,179	58,252,781
Lender assistance			1,825,592	1,772,621
Borrower assistance			6,915,027	7,125,149
Outreach			2,088,432	1,484,683
Student aid administration			2,809,050	2,945,795
Contribution to student aid programs			1,576,205	920,073
Other activities			162,574	206,342
Total Expenditures	**204,281,632**	**199,211,435**	**78,985,099**	**82,755,172**
Change in Net Assets Before Operating Transfers	**(3,781,564)**	**(196,120)**	**15,367,501**	**14,724,770**
Transfer to General Fund				
Transfer to KAPT			(148,057)	(159,286)
Change in Net Assets	**$ (3,781,564)**	**$ (196,120)**	**$ 15,219,444**	**$ 14,565,484**

Financial Analysis – Governmental and Proprietary Funds

As previously noted, the Authority and the 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, 2010. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- The Authority/Corporation's proprietary fund total assets decreased approximately $100 million (3.93%), from $2.8 billion to $2.7 billion. This decrease was caused primarily by the $69.5 million decrease in loans, and the $38.1 million decrease in restricted cash. Remaining assets increased $7.6 million.

- The Authority/Corporation's proprietary fund liabilities decreased by $125 million (4.59%), from $2.7 billion to $2.5 billion. The decrease in liabilities resulted primarily from decrease in bonds payable and participation facility payable ($209 million), net of the increase in deferred gain on early retirement of debt ($80 million). Remaining liabilities increased $4 million.

- The Authority/Corporation's proprietary fund revenues decreased $3.1 million (3.21%), the majority of which related to increase in gain on early retirement of debt (increased $1 million), increase in loan deconversion fees ($6.8 million) and increased debt recovery commissions ($3.1 million), net of decreased interest revenue ($2.1 million) and loan servicing fees from external sources ($12.1 million). The remaining revenues increased $200,000.

- The Authority/Corporation's total proprietary fund expenditures decreased $3.7 million (4.56%), resulting primarily from decreases in lending activities expenses ($6.9 million), net of increases in outreach expenses of $600,000, increase in contributions to student aid programs of $656,000 and increases in default collection operations expenses ($1.8 million). All other expenses increased $744,000.

- The Authority/Corporation's governmental fund assets decreased $4.2 million, resulting primarily from a decrease in accounts receivable ($2 million) and decrease in conversion loans ($2.2 million).

Continued

- The Authority/Corporation's governmental fund liabilities remained relatively consistent with prior year.

- The Authority/Corporation's governmental fund revenues increased $1.5 million (0.75%), resulting from additional state General Funds for student aid programs, net of reductions in federal funds and contributions from the Agency Operating Fund; because the Authority/Corporation move the CACG activities from the governmental fund to the proprietary fund in fiscal year 2010.

- The Authority/Corporation's governmental fund expenditures increased $5 million (2.55%), due primarily to increases in the Kentucky Education Excellence Scholarships ($2.9 million) College Access Program ($2 million), and state-funded teacher forgiveness program ($1.3 million), net of reductions in outreach expenses, moved to proprietary fund ($1.3 million). All other expenses increased a total of $100,000.

Statement of Net Assets

Total government fund net assets decreased from $19 million to $15.2 million. The decreased resulted from a decrease in cash, used to pay for additional Kentucky Education Excellence Scholarships ("KEES") and College Access Program ("CAP") grants.

Total proprietary fund net assets increased $15.2 million (11.48%), of which $6.1 million is from loan guarantee operations (compared to $6.1 million in prior year), $10.2 million from default collection operations (compared to $8.9 in prior year), $770,000 loss from lender assistance activities (compared to $1 million gain in prior year), $6.9 million loss for borrower assistance (compared to a $7.1 million loss in prior year), $1 million loss from outreach activities (which were accounted for in the governmental fund in prior year), $4.3 contributions for student aid and administration (compared to $3.8 million in prior year) and a $12.1 million gain in lending activities (compared to a $11.1 million gain in prior year). Also, the proprietary fund contributed $150,000 to administer the Plan.

Certain highlights related to the statement of net assets as of June 30, 2010, are as follows:

- The Authority/Corporation purchased $1.2 billion of its own auction rate securities on the secondary market for a discount, resulting in gain on early retirement of debt of $11.9 million, and deferred gain on early retirement of debt of $80.1 million.
- The Authority/Corporation lending activities recognized a profit of $216,000 from continuing operations.
- The Authority/Corporation issued a $914 million of new long-term debt in fiscal year 2010.
- The Authority/Corporation sold $478 million of loans in fiscal year 2010, resulting in a gain of $8.3 million.
- The Authority/Corporation placed $536 million into the Ensuring Continued Access to Student Loans Act ("ECASLA") participation trust and related financing, and borrowed $534 million via the Federal participation credit facility.
- The Authority/Corporation maintained $5 billion of FFELP guarantees outstanding.

Continued

- The Authority/Corporation maintained $2.45 billion of FFELP loans.
- The Authority/Corporation maintained $339.7 million of defaulted loans in its collection portfolio.
- Unrestricted net assets increased from $12.9 million to $41.6 million.
- Net assets, restricted other, decreased from $69 million to $53.9 million.
- Net assets restricted for student aid and related activities increased from $46 million to $48 million.

Statement of Revenues, Expenses, and Changes in Net Assets

In fiscal year 2010, the Authority/Corporation continued to see increases in General Fund appropriations for the KEES, CAP, and the Kentucky Tuition Grant ("KTG") program, all resulting from planned increases in Kentucky Lottery net revenues. Despite these increases in General Funds, the Authority/Corporation had to draw down an additional $685,000 of unclaimed lottery funds.

In fiscal year 2009, the USDE awarded a $1.1 million grant; CACG to the Authority/Corporation. The grant period ran from August 14, 2008 through August 13, 2009. The Authority/Corporation is required to provide 1/3rd match for this grant, thus outreach expenses increased $450,000 in the current fiscal year. In fiscal year 2009, the Authority/Corporation accounted for outreach activities (including CACG activities) in the governmental fund.

In fiscal year 2010, the USDE awarded another $1.1 million of CACG funds to the Authority/Corporation, with a grant period from, August 16, 2009 through August 15, 2010. In fiscal year 2010, the Authority accounted for outreach activities (including CACG activities) in the proprietary fund.

Proprietary fund interest income on loans, net, decreased by $2.1 million compared to prior year. Most of the Authority/Corporation's student loan portfolio earns interest based on quarterly resets of 90-day commercial paper rates. The quarterly average 90-day commercial paper rates for fiscal year 2009 were; 2.87%, 2.58%, .74% and .41%. The fiscal year 2010 quarterly averages were; .29%, .21%, .21% and .41%.

Gain on early retirement of debt increased from $10.9 million in fiscal year 2009, to $11.9 million in fiscal year 2010. Note that the economic gain on early retirement of debt in fiscal year 2010 was $92 million; in accordance with GASB Statement No. 23, the Authority/Corporation deferred $80.1 million of the gain to offset interest expense in future periods. In fiscal year 2009, the Authority/Corporation purchased $75.4 million of its own auction rate securities via second market, at a discount, and retired the debt. In fiscal year 2010, the Authority/Corporation purchased $1.2 billion of its own auction rate securities via secondary market, at a discount, and retired the debt. Note that management does not consider retirement of debt as a "line of business". Accordingly, the $92 million economic gain is excluded when evaluating profitability of existing lines of business.

Debt recovery commission revenue increased $3.1 million because of the rehabilitation arrangement with a national bank.

Continued

Deconversion fee revenue increased because the Authority/Corporation sold $478 million of its loans to the USDE.

Lending activity expenses decreased $6.9 million, resulting from an increase in program benefits of $3 million, net of a decrease in operating expenses of $5.6 million, and decrease in financing expense of $4.3 million.

Default collection expenses increased 33% because of additional resources devoted to that line of business. Outreach expenses in the proprietary fund increased to $600,000 because the Authority/Corporation placed a greater emphasis on program benefits activities in fiscal year 2010.

Certain highlights related to the statement of revenues, expenses and changes in net assets for the year ended June 30, 2010, are as follows:

- The Authority/Corporation provided $28.2 million for program benefits for citizens of the Commonwealth of Kentucky.
- The defaulted loan collection operation received $17.6 million in commissions on the $103.5 million collected on behalf of the USDE.
- The lending operation received $28.3 million of net interest revenue (interest income net of interest and finance expense.)

Condensed Financial Information - Fiduciary Funds

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

	Federal Student Loan Reserve Fund		Agency Fund		Kentucky's Affordable Prepaid Tuition		Kentucky Education Savings Plan Trust	
	2010	**2009**	**2010**	**2009**	**2010**	**2009**	**2010**	**2009**
Net Asset Information								
Other assets	$ 38,099,651	$ 33,062,902	$ 1,185,751	$ 1,135,085	$ 117,611,391	$ 115,189,662	$ 110,205,253	$ 94,914,868
Total Assets	**38,099,651**	**33,062,902**	**1,185,751**	**1,135,085**	**117,611,391**	**115,189,662**	**110,205,253**	**94,914,868**
Total Liabilities	**27,292,064**	**23,072,015**	**1,185,751**	**1,135,085**	**179,803,856**	**174,486,403**	**140,337**	**63,765**
Restricted net assets (deficit)	10,807,587	9,990,887			(62,192,465)	(59,296,741)	110,064,916	94,851,103
Total Net Assets	**$ 10,807,587**	**$ 9,990,887**	**$ -**	**$ -**	**$ (62,192,465)**	**$ (59,296,741)**	**$ 110,064,916**	**$ 94,851,103**
Changes in Fiduciary Net Asset Information								
Federal reinsurance	$ 134,094,994	$ 133,808,829						
Fee revenue	10,334,483	11,182,555						
Contributions					$ 782,031	$ 1,112,205		
Subscriptions							$ 38,053,468	$ 34,233,673
Investment revenue (loss)	3,042	80,629			13,065,699	(21,261,961)	10,441,402	(14,229,444)
Other income	1,936,130	1,311,543						
Total Additions	**146,368,649**	**146,383,556**			**13,847,730**	**(20,149,756)**	**48,494,870**	**20,004,229**
Administrative expenses					657,713	658,403	409,699	388,660
Refunds					466,502	938,450		
Trustee expense					236,762	175,527		
Tuition benefits					15,530,534	1,778,452		
Loan claims	143,430,501	142,049,509						
Redemptions							32,871,358	29,086,324
Default aversion	2,121,448	2,438,716						
Other expenses								
Total Deductions	**145,551,949**	**144,488,225**			**16,891,511**	**3,550,832**	**33,281,057**	**29,474,984**
Change in net assets before operating transfer	**816,700**	**1,895,331**			**(3,043,781)**	**(23,700,588)**	**15,213,813**	**(9,470,755)**
Operating Transfers								
Transfer to USDE for Recall								
Transfer from Agency Operating Fund					148,057	159,286		
Transfer from Unclaimed Property Fund								
Change in Net Assets After Operating Transfers	**$ 816,700**	**$ 1,895,331**			**$ (2,895,724)**	**$ (23,541,302)**	**$ 15,213,813**	**$ (9,470,755)**

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, 2010. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- Default claims paid increased from $142 million in fiscal year 2009 to $143 million in fiscal year 2010 (0.97% increase).

- Default Fee revenue totaled $11.1 million in fiscal year 2009 and $10.3 million in fiscal year 2010. Of the $10.3 million Default Fee revenue, $6.9 million was paid by the Authority/Corporation's loan guarantee operations (related to borrowers attending a Kentucky school).

- The Plan noted an increase in tuition benefits payable of $5.3 million in fiscal year 2010, largely due to increases within prior year liability calculation and changes in assumptions for investment income in future periods.

Statement of Fiduciary Net Assets (Deficit)

The FSLRF net assets increased $816,000 over prior year. Assets increased approximately 15.2% ($5 million), while liabilities increased 18.29% ($4.2 million). The increase in assets is mostly attributed to the increase in cash of $8.3 million, net of the decrease in receivable from the USDE of $3.3 million. The increase in cash resulted from delaying certain payments to the Agency Operating Fund ("AOF") for default aversion fees and the agency share of collections, the reduction in accounts receivable, and results from operations net of increases in loan loss allowance). The decrease in receivable from USDE resulted from a substantial decrease in claim volume in late fiscal year 2010, compared to the same period in fiscal year 2009. The Authority/Corporation spent renewed focus and resources on reducing default claim rates in fiscal year 2010.

The increase in liabilities is comprised of the increase in loan loss allowance, increase in payable to the AOF, net of decreases in payables. The loan loss allowance calculation is a standard calculation (created by the USDE) based on current year default claim volume and original principal outstanding. The original principal outstanding increased from $5.6 billion as of June 30, 2009, to $6.2 billion as of June 30, 2010. Also, the default claim rate increased from 3.86% as of June 30, 2009, to 4.78% as of June 30, 2010. The payable to AOF increased from $16.5 million as of June 30, 2009 to $18.3 million as of June 30, 2010, which resulted from the Authority/Corporation maintaining default collection revenues and default aversion revenues in the FSLRF, net of Default Fees paid by AOF.

Continued

The Agency Fund serves as a conduit for loan proceeds transacted between lenders and schools. The Authority typically maintains Agency funds for lenders and schools for less than three business days. As of June 30, 2009, the Authority/Corporation maintained $1.1 million on behalf of lenders and schools. As of June 30, 2010, the Authority/Corporation maintained $1.1 million on behalf of lenders and schools, which is consistent with prior year.

The Plan's total assets increased $2.5 million, from $115.1 million as of June 30, 2009 to $117.6 million as of June 30, 2010. Cash and investment increased from $104.8 million to $109.6 million, a $4.8 million increase. Accounts receivable decreased from $10.1 million to $7.8 million. The Plan did receive cash from participants of $3.1 million, of which $782,000 represents imputed interest on contracts receivable. The Plan also incurred investment gains of $13 million in fiscal year 2010, and disbursed $13.7 million in program benefits, refunds to participants, and program expenses.

The Plan liabilities increased $5.3 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 and investment return assumptions are as follows:

- 2010-thereafter – investment return decreased from 7.76% to 6.95%
- 2010-2011 academic year – tuition increase assumption was 7%, while actual tuition increases were 4% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan
- 2011-2012 academic year – tuition increase assumption increased from 7.25% to 8%
- 2012-2013 academic year – tuition increase assumption increased remained at 7.25%
- 2013-thereafter – tuition increase assumption lowered to 6.75% from 7.25%

Due to the inherent compounding effect, the Plan deficit was projected to increase by $4.6 million in fiscal year 2010 (without any changes in assumptions). Actual tuition increases in academic year 2010-2011 decreased the deficit by $1.7 million, and favorable investment experience further decreased the deficit by $4.8 million (note however that changes to other assumptions increased the deficit by $5.1 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 (consistent with prior year).

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 $15.2 million, due to new subscriptions received ($38 million) and investment gain ($10.4 million), net of expenses and redemptions ($33.2 million). Trust liabilities remained relatively constant during the fiscal year.

Continued

Changes in Fiduciary Net Assets

The FSLRF had an increase in fiduciary net assets of approximately $816,000 for the year ended June 30, 2010, which was $1.1 million less than the previous fiscal year.

The FSLRF experienced $1.4 million of additional claim volume in fiscal year 2010, compared to fiscal year 2009. The unusually high claim volume in fiscal year 2009, impacted the overall default claim rate as of September 30, 2009, which is used to calculate the loan loss allowance. The loan loss allowance increased $3.3 million in fiscal year 2010 (compared to a $1.7 million increase in 2009), which resulted in the lower than expected change in net fiduciary assets.

The Plan recognized an increase in net deficit of $3 million for fiscal year 2010 compared to a $23.7 million increase in net deficit in the prior year. The results from Plan operations increased $20.7 million over the prior year.

Overall, the primary reasons for the better performance in the current year are as follows.

- Investment income increased from a $21.2 million loss to a $13 million gain.
- Tuition benefits expense increased from $1.8 million to $15.5 million.

The Trust noted an increase in subscriptions of $3.8 million over prior year, due to increased marketing efforts by TFI. Investment income in the trust increased by approximately $24 million (from a loss of $14.2 million fiscal year 2009 to a $10 million gain in fiscal year 2010). Redemptions increased $3.8 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, 2010

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	$ 1,182,385	$ 41,160,765	$ 42,343,150
Investments		1,201,438	1,201,438
Accounts receivable	3,050,923	1,073,918	4,124,841
Accrued interest income		54,300,323	54,300,323
Deferred lender origination cost, net		5,506,680	5,506,680
Teacher and Osteopathic Medicine scholarship loans	450,000		450,000
Loans, net		785,560,529	785,560,529
Total Current Assets	4,683,308	888,803,653	893,486,961
Noncurrent:			
Restricted cash and cash equivalents		102,638,475	102,638,475
Receivable from Federal Student Loan Reserve Fund		18,360,512	18,360,512
Investments		19,083,144	19,083,144
Fixed assets, net		9,760,842	9,760,842
Loans, net		1,661,307,227	1,661,307,227
Teacher and Osteopathic Medicine scholarship loans, net	3,727,989		3,727,989
Teacher and Osteopathic Medicine scholarship advances	7,053,002		7,053,002
Deferred front end borrower benefits, net		16,371,847	16,371,847
Deferred debt issuance costs, net		7,300,078	7,300,078
Deferred lender origination costs, net		5,000,922	5,000,922
Total Noncurrent Assets	10,780,991	1,839,823,047	1,850,604,038
Total Assets	15,464,299	2,728,626,700	2,744,090,999
LIABILITIES			
Current:			
Accounts payable and accrued expenses	246,241	5,946,418	6,192,659
Accrued interest expense		2,791,410	2,791,410
Allowance for arbitrage liabilities		103,737	103,737
Payable to US Department of Education		21,326,083	21,326,083
Participation Facility Payable		536,120,082	536,120,082
Line of credit payable		7,376,403	7,376,403
Bonds payable		950,000	950,000
Capital lease payable		465,000	465,000
Total Current Liabilities	246,241	575,079,133	575,325,374
Noncurrent:			
Capital lease payable		5,265,000	5,265,000
Note payable		703,272,265	703,272,265
Allowance for arbitrage liabilities		604,189	604,189
Deferred gain on early retirement of debt, net		80,169,700	80,169,700
Bonds payable		1,216,460,000	1,216,460,000
Total Noncurrent Liabilities		2,005,771,154	2,005,771,154
Total Liabilities	246,241	2,580,850,287	2,581,096,528
NET ASSETS			
Invested in capital assets, net of expended debt proceeds		4,133,147	4,133,147
Unrestricted		41,610,407	41,610,407
Restricted, other		53,936,697	53,936,697
Restricted for program benefits	15,218,058		15,218,058
Restricted for student aid and related activities		48,096,162	48,096,162
Total Net Assets	$ 15,218,058	$ 147,776,413	$ 162,994,471

See Notes to Financial Statements

Combined Government-Wide Statement of Activities

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For year ended June 30, 2010

			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	$ 32,419,998	$ 441,852		$ 33,023,871	$ 162,021		$ 162,021
College Access Program Grants	63,333,764	455,098		61,703,024	(2,085,838)		(2,085,838)
Robert C. Byrd Scholarships	533,921	68,572		602,493			
Mary Jo Young Scholarships	333,532	98,154		466,455	34,769		34,769
Early Childhood Development	1,261,916	81,875		1,146,454	(197,337)		(197,337)
National Guard Tuition Awards	4,580,621	133,643		4,388,199	(326,065)		(326,065)
Kentucky Education Excellence Scholarships	93,845,459	626,579		94,472,677	639		639
Teacher Scholarships	2,213,908	379,455		953,042	(1,640,321)		(1,640,321)
Teacher Loan Forgiveness	1,340,500			1,340,500			
Osteopathic Medicine Scholarships	761,880	232,219		1,216,736	222,637		222,637
Work Study Benefits	624,129	91,100		810,113	94,884		94,884
Go Higher Grant Program	222,954	33,428		209,429	(46,953)		(46,953)
Other activities		167,075		167,075			
Total Governmental Activities	201,472,582	2,809,050		200,500,068	(3,781,564)		(3,781,564)
Business-Type Activities:							
Loan guarantee operations	4,853,501		$ 10,998,993			$ 6,145,492	6,145,492
Default collections	7,433,539		17,639,072			10,205,533	10,205,533
Lender assistance	1,825,592		1,056,809			(768,783)	(768,783)
Borrower assistance	6,915,027					(6,915,027)	(6,915,027)
Lending activities	51,321,179		63,475,777			12,154,598	12,154,598
Outreach	2,088,432		1,019,375			(1,069,057)	(1,069,057)
Student aid administration	2,809,050					(2,809,050)	(2,809,050)
Contribution to student aid programs	1,576,205					(1,576,205)	(1,576,205)
Other activities	162,574		162,574				
Total Business-Type Activities	78,985,099		94,352,600			15,367,501	15,367,501
Total Primary Government	$ 280,457,681	$ 2,809,050	$ 94,352,600	$ 200,500,068	$ (3,781,564)	$ 15,367,501	$ 11,585,937
Transfers:							
Transfer to Kentucky's Affordable Prepaid Tuition Plan						$ (148,057)	$ (148,057)
Change in Net Assets					$ (3,781,564)	15,219,444	11,437,880
Net assets, July 1, 2009					18,999,622	132,556,969	151,556,591
Net assets, June 30, 2010					$ 15,218,058	$ 147,776,413	$ 162,994,471

See Notes to Financial Statements

Combined Statement of Net Assets - Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2010

ASSETS	Authority: Internal Service Fund	Authority: Agency Operating Fund	Authority: Authority Total	Corporation: Education Finance Funds	Corporation: Operating Fund	Corporation: Corporation Total	Combined: Total Proprietary Funds
Current:							
Cash and cash equivalents	$ 3,479,497	$ 12,532,625	$ 16,012,122		$ 25,148,643	$ 25,148,643	$ 41,160,765
Investments		637,690	637,690		563,748	563,748	1,201,438
Accounts receivable	16,972		16,972	$ 651,584	405,362	1,056,946	1,073,918
Accrued interest income		71,760	71,760	43,747,756	10,480,807	54,228,563	54,300,323
Deferred lender origination cost, net				5,506,680		5,506,680	5,506,680
Loans, net				239,207,516	546,353,013	785,560,529	785,560,529
Total Current Assets	3,496,469	13,242,075	16,738,544	289,113,536	582,951,573	872,065,109	888,803,653
Noncurrent:							
Restricted cash and cash equivalents	1,515,117		1,515,117	101,123,358		101,123,358	102,638,475
Internal receivable (payable) for Gear Up Scholarships	(1,500,000)	1,500,000					
Internal receivable (payable) for capital projects	(15,117)	15,117					
Receivable from Federal Student Loan Reserve Fund		18,360,512	18,360,512				18,360,512
Investments		11,685,214	11,685,214		7,397,930	7,397,930	19,083,144
Fixed assets, net		9,484,731	9,484,731		276,111	276,111	9,760,842
Loans, net				1,661,303,932	3,295	1,661,307,227	1,661,307,227
Deferred front end borrower benefits, net				16,371,847		16,371,847	16,371,847
Deferred debt issuance costs, net		87,188	87,188	7,212,890		7,212,890	7,300,078
Deferred lender origination cost, net				5,000,922		5,000,922	5,000,922
Total Noncurrent Assets		41,132,762	41,132,762	1,791,012,949	7,677,336	1,798,690,285	1,839,823,047
Total Assets	$ 3,496,469	$ 54,374,837	$ 57,871,306	$ 2,080,126,485	$ 590,628,909	$ 2,670,755,394	$ 2,728,626,700
LIABILITIES							
Current:							
Accounts payable and accrued expenses	$ 976,763	$ 14,075	$ 990,838	$ 1,291,628	$ 3,663,952	$ 4,955,580	$ 5,946,418
Interfund payable (receivable)	2,519,706	(2,204,354)	315,352	(11,914,937)	11,599,585	(315,352)	
Accrued interest expense		45,619	45,619	2,431,038	314,753	2,745,791	2,791,410
Allowance for arbitrage liabilities				103,737		103,737	103,737
Payable (receivable) to US Department of Education		(1,163,701)	(1,163,701)	13,266,832	9,222,952	22,489,784	21,326,083
Participation Facility Payable					536,120,082	536,120,082	536,120,082
Line of credit payable					7,376,403	7,376,403	7,376,403
Bonds payable				950,000		950,000	950,000
Capital lease payable		465,000	465,000				465,000
Total Current Liabilities	3,496,469	(2,843,361)	653,108	6,128,298	568,297,727	574,426,025	575,079,133
Noncurrent:							
Capital lease payable		5,265,000	5,265,000				5,265,000
Note payable				703,272,265		703,272,265	703,272,265
Allowance for arbitrage liabilities				604,189		604,189	604,189
Deferred gain on early retirement of debt, net				80,169,700		80,169,700	80,169,700
Bonds payable				1,216,460,000		1,216,460,000	1,216,460,000
Total Noncurrent Liabilities		5,265,000	5,265,000	2,000,506,154		2,000,506,154	2,005,771,154
Total Liabilities	3,496,469	2,421,639	5,918,108	2,006,634,452	568,297,727	2,574,932,179	2,580,850,287
NET ASSETS							
Invested in capital assets, net		3,857,036	3,857,036		276,111	276,111	4,133,147
Unrestricted				19,555,336	22,055,071	41,610,407	41,610,407
Restricted, other				53,936,697		53,936,697	53,936,697
Restricted for student aid and related activities		48,096,162	48,096,162				48,096,162
Total Net Assets	$ -	$ 51,953,198	$ 51,953,198	$ 73,492,033	$ 22,331,182	$ 95,823,215	$ 147,776,413

See Notes to Financial Statements

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

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For year ended June 30, 2010

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority' Total	Education Finance Funds	Operating Fund	Corporation Total	Total Proprietary Funds
Operating Revenues:							
Interest Revenues:							
Interest on loans				$ 45,901,270	$ 6,648,364	$ 52,549,634	$ 52,549,634
Interest and investment income		$ 535,054	$ 535,054	225,652	91,772	317,424	852,478
Interest expense on bonds				(21,272,111)	(3,284,403)	(24,556,514)	(24,556,514)
Total Net Interest Revenues		535,054	535,054	24,854,811	3,455,733	28,310,544	28,845,598
Financing Expenses:							
Provision for loan losses				730,605	54,867	785,472	785,472
Provision for arbitrage				91,397		91,397	91,397
Variable bond credit facility and remarketing fees				2,903,007		2,903,007	2,903,007
Debt issuance costs				100,840		100,840	100,840
Amortization of origination costs				2,153,069		2,153,069	2,153,069
Amortization of debt issuance costs				853,402		853,402	853,402
Total Financing Expense		-	-	6,832,320	54,867	6,887,187	6,887,187
Interest Revenues Net of Finance Expense		535,054	535,054	18,022,491	3,400,866	21,423,357	21,958,411
Other Operating Revenues:							
Servicing fees from external sources		1,056,809	1,056,809		1,434,307	1,434,307	2,491,116
Servicing fees from Education Finance Funds					11,938,453	11,938,453	11,938,453
Deconversion fees				19,204	8,315,118	8,334,322	8,334,322
Debt recovery commission		17,639,072	17,639,072				17,639,072
Federal fees earned		8,162,305	8,162,305				8,162,305
Federal Fund revenue		1,019,375	1,019,375				1,019,375
Default aversion fee income		2,121,448	2,121,448				2,121,448
Gain on early retirement of debt				11,977,102		11,977,102	11,977,102
Late payment penalties				1,457,445	21,952	1,479,397	1,479,397
Other Income	$ 162,574	180,186	342,760	169	1,483	1,652	344,412
Total Operating Revenues	162,574	30,714,249	30,876,823	31,476,411	25,112,179	56,588,590	87,465,413
Operating Expenses:							
Administrative expenses	162,574	13,605,670	13,768,244		15,811,299	15,811,299	29,579,543
Servicing fees for Operating Fund				11,938,453		11,938,453	11,938,453
Depreciation and amortization		473,424	473,424		543,690	543,690	1,017,114
Other expenses		33,538	33,538	834,284	527,537	1,361,821	1,395,359
Total Operating Expenses	162,574	14,112,632	14,275,206	12,772,737	16,882,526	29,655,263	43,930,469
Net Operating Income Before Program Benefits	-	16,601,617	16,601,617	18,703,674	8,229,653	26,933,327	43,534,944
Program Benefits:							
Amortization of front end borrower benefits				6,734,200		6,734,200	6,734,200
Principle and interest benefits				726,328	5,311,933	6,038,261	6,038,261
Federal origination fees					2,006,268	2,006,268	2,006,268
Default fee expense		6,915,027	6,915,027				6,915,027
Outreach		2,088,432	2,088,432				2,088,432
Gear-up							
Student aid administration		2,809,050					
Contributions to student aid programs		1,576,205	4,385,255				4,385,255
Total Program Benefits		13,388,714	13,388,714	7,460,528	7,318,201	14,778,729	28,167,443
Operating Income Before Transfers		3,212,903	3,212,903	11,243,146	911,452	12,154,598	15,367,501
Transfers (To) From Other Funds:							
Interfund transfer		(914,710)	(914,710)	1,949,990	(1,035,280)	914,710	
Transfer to Kentucky's Affordable Prepaid Tuition Plan		(148,057)	(148,057)				(148,057)
Total Transfers (To) From Other Funds		(1,062,767)	(1,062,767)	1,949,990	(1,035,280)	914,710	(148,057)
Increase (Decrease) in Net Assets After Transfers		2,150,136	2,150,136	13,193,136	(123,828)	13,069,308	15,219,444
Net Assets, July 1, 2009		49,803,062	49,803,062	60,298,897	22,455,010	82,753,907	132,556,969
Net Assets, June 30, 2010	$ -	$ 51,953,198	$ 51,953,198	$ 73,492,033	$ 22,331,182	$ 95,823,215	$ 147,776,413

See Notes to Financial Statements

Combined Statement of Cash Flows - Proprietary Fund

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For year ended June 30, 2010

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total Proprietary Funds
Cash Flows from Operating Activities:							
Principal received on loans				$ 246,891,314	$ 11,918,334	$ 258,809,648	$ 258,809,648
Interest received on loans				57,918,791	19,847,149	77,765,940	77,765,940
Special allowance benefits received				(34,871,095)	(13,361,846)	(48,232,941)	(48,232,941)
Servicing fees received, internal sources	$ 162,574	$ 1,183,089	$ 1,345,663	(11,938,453)	11,938,453	-	1,345,663
Servicing and deconversion fees received, external sources				19,204	12,084,965	12,104,169	12,104,169
Debt recovery commission received		17,639,072	17,639,072				17,639,072
Federal fees received		8,162,305	8,162,305				8,162,305
Federal revenue received		1,019,375	1,019,375				1,019,375
Default aversion fees received		(4,793,579)	(4,793,579)				(4,793,579)
Outreach activities		(2,088,432)	(2,088,432)				(2,088,432)
Internal activity-payments to other funds	103,307	(103,307)		(10,975,370)	10,975,370		
Loans originated, including costs				(186,377,220)	(363,459,349)	(549,836,569)	(549,836,569)
Administrative expenses paid		(13,925,319)	(13,925,319)	(8,895,743)	(22,325,604)	(31,221,347)	(45,146,666)
Student aid administration		(2,809,050)	(2,809,050)				(2,809,050)
Contribution to student aid program		(1,576,205)	(1,576,205)				(1,576,205)
Credit facility fees paid				(2,905,722)		(2,905,722)	(2,905,722)
Loans purchased, including premiums				(75)	(35,886)	(35,961)	(35,961)
Interfund loan sales and purchases				128,943,684	(128,943,684)		
Client loan receipts					68,438,838	68,438,838	68,438,838
Loan receipts remitted to clients					(69,557,919)	(69,557,919)	(69,557,919)
Net Cash Provided By (Used In) Operating Activities	265,881	2,707,949	2,973,830	177,809,315	(462,481,179)	(284,671,864)	(281,698,034)
Cash Flows from Noncapital Financing Activities:							
Proceeds from debt issued				913,982,265	260,858,333	1,174,840,598	1,174,840,598
Debt principal payments				(1,198,400,000)	(264,332,231)	(1,462,732,231)	(1,462,732,231)
Proceeds from participation facility					565,220,817	565,220,817	565,220,817
Participation facility payments				1,046,004	(84,874,337)	(83,828,333)	(83,828,333)
Interest on debt				(22,784,893)	(3,444,146)	(26,229,039)	(26,229,039)
Debt issuance costs				(2,808,605)		(2,808,605)	(2,808,605)
Gain on early retirement of debt				11,977,102		11,977,102	11,977,102
Deferred gain on early retirement debt				83,569,140		83,569,140	83,569,140
Interfund transfers		(914,710)	(914,710)	(2,816,257)	3,730,967	914,710	-
Transfers to Kentucky's Affordable Prepaid Tuition Plan		(148,057)	(148,057)				(148,057)
Increase in Federal Student Loan Reserve receivable		(1,877,302)	(1,877,302)				(1,877,302)
Net Cash Provided By (Used In) Noncapital Financing Activities		(2,940,069)	(2,940,069)	(216,235,244)	477,159,403	260,924,159	257,984,090

Continued

Combined Statement of Cash Flows - Proprietary Fund

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For year ended June 30, 2010

	Authority			Corporation			Combined
	Internal Service Fund	**Agency Operating Fund**	**Authority Total**	**Education Finance Funds**	**Operating Fund**	**Corporation Total**	**Total Proprietary Funds**
Cash Flows From Capital and Related Financing Activities:							
Capital expenditures		(210,879)	(210,879)		(43,674)	(43,674)	(254,553)
Bond principal payments		(440,000)	(440,000)				(440,000)
Interest paid on capital lease		(3,727)	(3,727)				(3,727)
Net Cash Used In Capital and Related Financing Activities		(654,606)	(654,606)		(43,674)	(43,674)	(698,280)
Cash Flows From Investing Activities:							
Proceeds from sales/maturities of investments		16,185,588	16,185,588		5,973,864	5,973,864	22,159,452
Proceeds from sale of loans held for sale					33,098	33,098	33,098
Purchases of investments		(16,737,544)	(16,737,544)		(13,952,413)	(13,952,413)	(30,689,957)
Acquisition of loans held for sale					(8,183)	(8,183)	(8,183)
Investment income		466,325	466,325	256,019	64,302	320,321	786,646
Gain on sale of loans held for sale					1,483	1,483	1,483
Net Cash Provided By (Used In) Investing Activities		(85,631)	(85,631)	256,019	(7,887,849)	(7,631,830)	(7,717,461)
Net Increase (Decrease) in Cash and Cash Equivalents	265,881	(972,357)	(706,476)	(38,169,910)	6,746,701	(31,423,209)	(32,129,685)
Cash and Cash Equivalents, July 1, 2009	4,728,733	13,504,982	18,233,715	139,293,268	18,401,942	157,695,210	175,928,925
Cash and Cash Equivalents, June 30, 2010	$ 4,994,614	$ 12,532,625	$ 17,527,239	$ 101,123,358	$ 25,148,643	$ 126,272,001	$ 143,799,240

See Notes to Financial Statements

Combined Statement of Cash Flows - Proprietary Fund--Continued

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For year ended June 30, 2010

	Authority			Corporation			Combined
	Internal Service Fund	**Agency Operating Fund**	**Authority Total**	**Education Finance Funds**	**Operating Fund**	**Corporation Total**	**Total Proprietary Funds**
Reconciliation of Operating Income to Net Cash Provided By (Used In) Operating Activities							
Operating income		$ 3,212,903	$ 3,212,903	$ 11,243,146	$ 911,452	$ 12,154,598	$ 15,367,501
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:							
Investment income		(535,054)	(535,054)	(256,019)	(47,431)	(303,450)	(838,504)
Depreciation and amortization		588,542	588,542	9,740,671	543,690	10,284,361	10,872,903
Gain on early retirement of debt				(11,977,102)		(11,977,102)	(11,977,102)
Interest expense		3,727	3,727	21,272,111	3,284,403	24,556,514	24,560,241
Provision for loan losses				730,605	54,867	785,472	785,472
Gain on sale of loans held for sale					(1,483)	(1,483)	(1,483)
Borrower interest converted to principal				(46,537,432)	(1,576,787)	(48,114,219)	(48,114,219)
Loan forgiveness				726,328	2,140	728,468	728,468
Gain or loss on equipment disposal					5,136	5,136	5,136
(Increases) Decreases in Assets:							
Accounts receivables	$ (11,645)	116,178	104,533	(151,075)	2,504,482	2,353,407	2,457,940
Receivable from US Department of Education				7,943,088	6,474,311	14,417,399	14,417,399
Accrued interest receivable		10,102	10,102	7,402,518	(1,420,291)	5,982,227	5,992,329
Principal received on loans				246,891,314	11,918,334	258,809,648	258,809,648
Loans purchased, including premiums				(75)	(35,886)	(35,961)	(35,961)
Loans originated, including costs				(186,377,220)	(363,459,349)	(549,836,569)	(549,836,569)
Interfund loan sales and purchases				128,943,684	(128,943,684)	-	-
Increases (Decreases) in Liabilities:							
Accounts payable and accrued expenses	(202,996)	(288,675)	(491,671)	(838,547)	(3,585,978)	(4,424,525)	(4,916,196)
Interfund receivable/payable	480,522	(396,047)	84,475	(10,975,370)	10,890,895	(84,475)	
Accrued interest payable		(3,727)	(3,727)				(3,727)
Allowance for arbitrage liabilities				28,690		28,690	28,690
Net Cash Provided By (Used In) Operating Activities	$ 265,881	$ 2,707,949	$ 2,973,830	$ 177,809,315	$ (462,481,179)	$ (284,671,864)	$ (281,698,034)

See Notes to Financial Statements

Balance Sheet - Governmental Fund

Kentucky Higher Education Assistance Authority

June 30, 2010

ASSETS		Governmental Fund Student Aid
Current:		
Cash and cash equivalents	$	1,182,385
Accounts receivable		3,050,923
Teacher and Osteopathic Medicine scholarship loans		450,000
Total Current Assets		4,683,308
Teacher and Osteopathic Medicine scholarship loans, net of allowance of $3,800,000		3,727,989
Teacher and Osteopathic Medicine scholarship advances		7,053,002
Total Noncurrent Assets		10,780,991
Total Assets	$	15,464,299
LIABILITIES		
Current - Accounts payable	$	246,241
NET ASSETS		
Fund Balance - Restricted for program benefits		15,218,058
Total Liabilities and Fund Balance	$	15,464,299

See Notes to Financial Statements

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

Kentucky Higher Education Assistance Authority

For year ended June 30, 2010

	Governmental Funds Student Aid
Revenues:	
Interest and investment income fund	$ 264,553
Tobacco Settlement revenue	999,999
Unclaimed Lottery revenue	9,288,000
State General Fund revenue	183,809,001
Federal funds revenue	1,406,245
Contribution from Agency Operating Fund	4,385,255
Other income	347,015
Total Revenues	200,500,068
Expenditures:	
Kentucky Tuition Grants	32,861,850
College Access Program Grants	63,788,862
Robert C Byrd Scholarships	602,493
Mary J Young Scholarships	431,686
Early Childhood Development Scholarships	1,343,791
National Guard Tuition Awards	4,714,264
Kentucky Education Excellence Scholarships	94,472,038
Teacher Scholarships	2,593,363
Teacher Loan Forgiveness	1,340,500
Osteopathic Medicine Scholarships	994,099
Work Study Benefits	715,229
Go Higher Grant Program	256,382
Other activities	167,075
Total Expenditures	204,281,632
Excess of Expenditures over Revenues	(3,781,564)
Fund Balance, July 1, 2009	18,999,622
Fund Balance, June 30, 2010	$ 15,218,058

See Notes to Financial Statements

Statement of Fiduciary Net Assets (Deficit)

Kentucky Higher Education Assistance Authority

June 30, 2010

ASSETS	Federal Student Loan Reserve Fund	Agency Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Educational Savings Plan Trust
Current:				
Cash and cash equivalents	$ 27,091,905	$ 1,185,751	$ 1,044,267	$ 902
Contributions receivable			2,054,743	
Fees receivable			194,800	
Default fee receivable	11,819			
Receivable from US Department of Education	10,985,743			
Investments				110,102,688
Accrued interest income			4	
Other current assets	10,184			101,663
Total Current Assets	38,099,651	1,185,751	3,293,814	110,205,253
Noncurrent:				
Investments			108,600,848	
Contributions receivable			5,716,729	
Total Noncurrent Assets			114,317,577	
Total Assets	$ 38,099,651	$ 1,185,751	$ 117,611,391	$ 110,205,253
LIABILITIES				
Current:				
Accounts payable	$ 45,284		$ 86,479	$ 101,613
Accrued expenses	8,886,268			38,724
Origination distribution payable		$ 1,185,751		
Total Current Liabilities	8,931,552	1,185,751	86,479	140,337
Noncurrent:				
Payable to Agency Operating Fund	18,360,512			
Tuition benefits payable			179,717,377	
Total Noncurrent Liabilities	18,360,512		179,717,377	
Total Liabilities	27,292,064	1,185,751	179,803,856	140,337
NET ASSETS (DEFICIT)				
Restricted for program benefits			(62,192,465)	110,064,916
Restricted for other purposes	10,807,587			
Total Net Assets (Deficit)	$ 10,807,587	$ -	$ (62,192,465)	$ 110,064,916

See Notes to Financial Statements

Statement of Changes in Fiduciary Net Assets (Deficit)

Kentucky Higher Education Assistance Authority

For year ended June 30, 2010

	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Educational Savings Plan Trust
Additions:			
Federal reinsurance	$ 134,094,994		
Fee revenue	10,334,483	$ (2,345)	
Contract income, net		784,376	
Subscriptions			$ 38,053,468
Investment Revenues:			
Net unrealized gain on investments		10,873,074	8,079,344
Interest and investment Income	3,042	1,999,057	2,362,058
Other Income	1,936,130	193,568	
Total Additions	146,368,649	13,847,730	48,494,870
Deductions:			
Program benefits:			
Loan claims	143,430,501		
Default aversion fee expense	2,121,448		
Redemptions			32,871,358
Administrative expenses		104,593	409,699
Personnel and professional expenses		553,120	
Refunds		466,502	
Trustee fee expense		236,762	
Tuition benefits expense, net		15,530,534	
Total Deductions	145,551,949	16,891,511	33,281,057
Change in Net Assets Before Transfers	816,700	(3,043,781)	15,213,813
Transfer from Agency Operating Fund		148,057	
Change in Net Assets	816,700	(2,895,724)	15,213,813
Net Assets (Deficit), July 1, 2009	9,990,887	(59,296,741)	94,851,103
Net Assets (Deficit), June 30, 2010	$ 10,807,587	$ (62,192,465)	$ 110,064,916

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.

Loan Guarantee Operations

The Authority/Corporation’s loan guarantee operations guarantees loans to qualified students and parents of qualified students made by approved lenders in Kentucky and Alabama. Commencing in 1969, retroactive to 1965, the federal government agreed to insure 80% of such 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”) which were enacted on October 7, 1998, with an effective date of October 1, 1998, changed the manner in which FFELP is administered. Under the 1998 Amendments, the Authority/Corporation established a Federal Student Loan Reserve Fund (“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 (0.06% of original principal balance as of September 30), and loan processing and insurance fees (0.40% 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 and outreach activities. The AOF provides funding to the governmental fund to pay administration costs for twelve student aid programs, administrative costs for the Trust, and direct benefits for the Mary Jo Young Scholarship program and National Guard Tuition Award program. The AOF also transfers funds to the Plan to pay some of the administration costs. Both the FSLRF and AOF are subject to federal oversight.

Lending Operations

The 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").

Continued

Note A--Description of Business--Continued

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

The Authority/Corporation's General Bond Resolutions ("GBR"s) and separate series resolutions for issuance of revenue bonds and notes payable 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, 2010 the Authority/Corporation serviced approximately $2.45 billion outstanding principal amount of FFELP Loans. $1.9 billion loans were pledged pursuant to the 1983 GBR, the 1997 GBR, the 2004 Master Indenture, the 2008 Indenture, the 2010 Indenture and the USDE Conduit Program Note Payable. The remaining $550 million loans were pledged against the Participation Facility Payable to the USDE and the line of credit agreements. Also, the Authority/Corporation services approximately $110 million of FFELP Loans and other education loans on behalf of other holders, including holders with national lending operations. The majority of such education loans are being serviced by the Authority/Corporation pursuant to servicing agreements which do not provide for the acquisition by the Authority/Corporation of the education loans serviced. As a servicer of FFELP loans, the Authority/Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. The Authority/Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Authority/Corporation financings.

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

Tuition Savings Plan

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

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

Continued

Note A--Description of Business--Continued

Contributions in the Managed Allocation Option are allocated among six age bands, based on the age of the beneficiary. Prior to January 17, 2004, there were eleven age bands. Each age band invests in varying percentages in the Institutional Class of the International Equity, International Equity Index, Large-Cap Value Index, Large-Cap Growth Index, S&P 500 Index, Mid-Cap Growth Fund, Small-Cap Equity, Mid-Cap Value, Short-Term Bond, Bond Index, Large-Cap Growth, Inflation-Linked Bond, Equity Index, Small-Cap Blend Index, Bond, Large-Cap Value Index, Real Estate Securities, and Money Market Funds of the TIAA-CREF Institutional Mutual Funds.

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

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

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

Prepaid Tuition Plan

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

On July 1, 2005, governance of the Plan permanently transferred to the Authority/Corporation. The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan investment strategy is to earn rates of return that exceed anticipated tuition inflation rates so that the Plan is able to meet its obligation to pay benefits at future tuition rates. The Plan offered enrollment periods in fiscal years 2002, 2003 and 2005, for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax advantages to purchasers. There have been no enrollment periods since fiscal year 2005 as the plan currently maintains an accumulated net deficit of $62.2 million.

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

Continued

Note A--Description of Business--Continued

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

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

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

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

As of June 30, 2010, the Plan maintained a present value fund deficit of $62.2 million. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2018, and the Commonwealth of Kentucky will be required to transfer assets from the unclaimed property fund. Over the remaining estimated life of the program, through fiscal year 2027, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately $123.9 million from the unclaimed property fund. As of June 30, 2010, the unclaimed property fund has approximately $298.8 million.

Student Aid Programs

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

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

The Authority/Corporation's combined fund financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to state government entities, which 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 USDE.

The Authority/Corporation's loan guarantee, default collection, lender assistance, borrower assistance, lending 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.

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

Continued

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

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

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

In fiscal year 2010, to achieve an actuarially determined target rate of gross return of 7.76%, Plan investments were held in mutual funds with restrictions based on the following composition of indices:

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

Continued

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

In September 2010, the Plan's investment advisor changed the target gross return rate to 6.95% and recommended changing the investments to mutual funds with the following composition of indices:

Large Cap U.S. stocks	37%
Small/Midcap U.S. stocks	13%
Non-U.S. stocks	10%
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.

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

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.

Fixed Assets, Net - Fixed assets are stated at cost, less accumulated depreciation. Fixed assets are depreciated beginning when the assets are placed in service and continuing over the estimated useful lives of the respective asset using the straight-line method. 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 all of the respective guarantee agencies and the USDE will be able to honor all loan claims submitted. However, the Authority/Corporation records a provision for loan losses based upon its expected default claims with respect to 98% and 97% insured loans and for loans with certain loan servicing violations. The allowance for loan loss on FFELP loans funded through normal operations was $5.1 million for loan principal and $347,416 for accrued interest as of June 30, 2010. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2010, the allowance for third party servicing loan losses for loans that have been purchased was $1.9 million for loan principal and $480,851 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 Note H); and (3) the borrowers. All interest is recorded when earned and is shown in the combined financial statements net of the interest related portion of the provision for loan losses.

Servicing Fees - The Authority/Corporation's fees for 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.

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

Deferred Gain on Early Retirement of Debt - In accordance with GASB 23, *Accounting and Financial Reporting of Debt Reported by Proprietary Activities*, the Authority/Corporation defers any gains on the early retirement or refinancing of debt over the shorter of the remaining life of the old debt or the life of the new debt.

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

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

Subsequent Events - In preparing these combined financial statements, the Authority/Corporation has evaluated events and transactions for potential recognition or disclosure through October 25, 2010, the date the financial statements were available to be issued.

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

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

Continued

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

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.

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

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

Restricted Net Assets - Restricted net assets are comprised of net assets with legal or contractual restrictions, thus cannot be used in operations of the Authority/Corporation.

Unrestricted Net Assets - Unrestricted net assets are comprised of net assets available to be used in operations or transfers of the Authority/Corporation.

Note C--Cash and Investments

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

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

Custodial Credit Risk and Interest Rate Risk - Custodial credit risk is the risk that in the event of a bank failure, the Authority/Corporation's deposits may not be returned to it. The Authority/Corporation's investment policy does not contain a requirement for the collateralization of cash and investments nor does it require investments to be maintained in the Authority/Corporation's name. As of June 30, 2010, the Authority/Corporation's Proprietary Funds, Governmental Fund and Fiduciary Funds maintained custodial credit risk for cash on deposit as follows:

	Governmental Fund Bank Balance	Proprietary Fund Bank Balance	Fiduciary Fund Bank Balance
Insured (FDIC)		$ 1,000,000	$ 518,699
Collateralized by securities held by the pledging financial institution		16,879,806	5,945,339
Money market demand deposits		108,102,854	
Money market securities		11,664,079	22,900,327
Cash deposited with Kentucky State Treasurer	$ 1,182,386	4,994,614	64,049
Total	$ 1,182,386	$ 142,641,353	$ 29,428,414

Of the $143.8 million of cash and cash equivalents maintained in the Proprietary Funds, $17.6 million was held for guarantee operations and the remaining $126.2 million was held for lending activities.

Continued

Note C--Cash and Investments--Continued

As of June 30, 2010, 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, 2010 are summarized as follows:

	Fair Value	Weighted Average Maturity
Corporate bonds	$ 8,341,498	3.34
U.S. Treasury and government agency securities	6,364,589	1.77
Collateralized mortgage obligations	5,578,495	9.3
	$ 20,284,582	

Of the $140 million of investments maintained in the Proprietary Funds, $20.9 million was held for guarantee operations and the remaining $119.1 million was held for lending activities.

As of June 30, 2010, the investment portfolio maintained by the Trust ($110,102,688) was comprised entirely of TIAA mutual funds.

As of June 30, 2010, the investment portfolio maintained by the FSLRF ($22,409,915) was entirely comprised of money market securities held in a trust by Bank of New York Mellon.

As of June 30, 2010, Plan investments of $108,600,848, 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.

<u>Concentration of Credit Risk</u> **-** 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 limits the credit risk for securities. Securities must have a credit rating of BBB by a nationally recognized credit rating agency. Money Market Securities must be rated A-1 or P-1 or better at the time of purchase. The investment manager is allowed to hold up to 5% in aggregate market value securities that have been downgraded below BBB, but must maintain an average rating of A for the total portfolio. The following table summarizes the Standard & Poor rating for all corporate bonds held by the Authority/Corporation's Proprietary Funds as of June 30, 2010.

Rating	Fair Value
AAA	$ 4,308,081
AA	1,309,384
A	1,899,588
BAA	824,445
	$ 8,341,498

All $8.3 million of bonds in the Proprietary Funds were held for guarantee operations.

The Plan maintains an investment policy that limits the credit risk for fixed income securities and short-term commercial paper. The Plan may only invest in AAA-rated securities issued by governmental agencies and long-term commercial paper with an investment grade rating, as long as the overall fixed income portfolio maintains a minimum rating of A by Moody's or Standard & Poors. The Plan may invest in short-term commercial paper, maturing within 9 months, with a minimum rating of A-1 or P-1 Moody's. As previously noted, at June 30, 2010, the Plan only invested in money market securities.

Note D--Fixed Assets

A summary of fixed assets follows:

	Beginning Balance July 1, 2009	Additions	Disposals	Ending Balance June 30, 2010
Proprietary fund:				
Furniture and equipment	$ 18,652,233	$ 265,554	$ (457,274)	$ 18,460,513
Building	11,986,200			11,986,200
System development	55,955			55,955
Student loan servicing system	541,131			541,131
Debt recovery system	710,509			710,509
Accumulated depreciation	(21,312,059)	(1,122,545)	441,138	(21,993,466)
	$ 10,633,969	$ (856,991)	$ (16,136)	$ 9,760,842
Fiduciary Fund:				
Furniture and equipment	$ 593,568		$ (96,967)	$ 496,601
Accumulated depreciation	(593,568)		96,967	(496,601)
	$ -	$ -	$ -	$ -

Depreciation expense totaled $1,122,545 for the year ended June 30, 2010, of which $1,017,114 was allocated to business-type activities, $97,887 was allocated to governmental activities, and $7,544 was allocated to the fiduciary activities.

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

Loan guarantee operations	$ 252,213
Default collections	134,889
Lending and related activities	543,690
Lender assistance	86,322
	$ 1,017,114

Note E--Federal Family Education Loan Programs (Loan 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, 2010, the outstanding balance of aggregate insured student loans was approximately $5 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 $8.9 million at June 30, 2010 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%

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

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

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

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

Continued

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

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

Loan Processing and Issuance Fees ("LPIF") - The 1998 Amendments established a loan processing and issuance fee. The LPIF payments are based on the net guarantee amount, less cancellations, multiplied by 0.40%.

Default Aversion Fees ("DAF") - Default aversion fees were established under the 1998 Amendments. The Authority/Corporation receives DAF for its aversion activities on delinquent loans at the time lenders request default aversion assistance. DAF'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--Capital Lease Payable

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

The original bonds bear interest at a fixed rate, which vary from 5.00% to 5.30% and have a final maturity date of May 2020. 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.

Continued

Note F--Capital Lease Payable--Continued

The lease payments are equal to the debt service required by the bond indenture. In connection with the agreements, the 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, 2012.

A summary of the activity for the capital lease for the year ended June 30, 2010 is as follows:

	June 30, 2009	Additions	Payments	June 30, 2010
Capital Lease Payable	$ 6,170,000	$ -	$ 440,000	$ 5,730,000

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

Year Ending June 30,	Principal	Interest
2011	$ 465,000	$ 279,799
2012	480,000	264,105
2013	500,000	244,905
2014	525,000	219,905
2015	550,000	192,342
Five Years Ending June 30,		
2016 - 2020	3,210,000	512,810
	$ 5,730,000	$ 1,713,866

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 10% for the fiscal year ended June 30, 2010 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, 2010:

Stafford - Subsidized	$ 892,169,587
Stafford - Unsubsidized	888,908,781
PLUS/SLS	82,602,493
Consolidation	593,679,862
Other	1,443,744
Total gross loans	2,458,804,467
Allowance for loan losses	(6,936,711)
Loan rebate due to borrowers	(5,000,000)
Loans, net	2,446,867,756
Deferred front end borrower benefits, net of accumulated amortization of $40,991,010	16,371,847
Deferred lender origination costs, net of accumulated amortization of $17,387,575	10,507,602
Net loans and deferred origination costs	$ 2,473,747,205

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, 2010, $2,761,414 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--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, 2010 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 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 special allowance rate.

Note I--Principal and Interest Forgiveness

During fiscal year 2010, the Authority/Corporation forgave $7 million in loan principal and accrued interest for teachers, funded by the USDE, and an additional $1.3 million in loan forgiveness for teachers funded by the Commonwealth of Kentucky. Also, during fiscal year 2010, the Authority/Corporation provided additional loan forgiveness of $1,038,261.

The Authority/Corporation's Board of Directors approved $5 million of additional loan forgiveness for teachers, nurses, and public service attorneys who were employed in the Commonwealth, which was accrued as of June 30, 2010, and will be provided to borrowers in October 2010.

Note J--Revenue Bonds and Notes Payable

The balance of revenue bonds and notes payable at June 30, 2010 and the related activity for the year ended June 30, 2010 is as follows:

Series		Scheduled Maturity	Interest Rate	Beginning Balance July 1, 2009	Bond Maturities & Refundings	New Issues	Ending Balance June 30, 2010
1983 General Bond Resolution							
2008A		November 15, 2011	Quarterly	$ 50,000,000	$ (49,900,000)		$ 100,000
1997 General Bond Resolution							
1997 A-1		May 1, 2027	Every 35 days	45,250,000	(9,500,000)		35,750,000
1997 A-2		May 1, 2027	Every 35 days	44,900,000	(8,350,000)		36,550,000
1997 B	*	May 1, 2027	Every 35 days	44,550,000	(7,400,000)		37,150,000
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	42,150,000			42,150,000
1999 A		May 1, 2029	Every 28 days	51,350,000	(7,800,000)		43,550,000
1999 B	*	May 1, 2029	Every 35 days	23,650,000			23,650,000
2000 A-1		May 1, 2030	Every 28 days	42,000,000	(1,600,000)		40,400,000
2000 A-2		May 1, 2030	Every 28 days	42,100,000	(4,300,000)		37,800,000
2000 A-3		May 1, 2030	Every 35 days	40,950,000	(2,000,000)		38,950,000
2000 B	*	May 1, 2030	Every 35 days	23,750,000			23,750,000
2001 A-1		May 1, 2031	Every 35 days	53,100,000	(2,000,000)		51,100,000
2001 A-2		May 1, 2031	Every 35 days	47,350,000			47,350,000
2001 B	*	May 1, 2031	Every 35 days	30,300,000	(1,700,000)		28,600,000
2002 A-1		May 1, 2032	Every 28 days	46,900,000	(15,250,000)		31,650,000
2002 A-2		May 1, 2032	Every 35 days	40,450,000	(3,500,000)		36,950,000
2002 A-3	*	May 1, 2032	Every 35 days	39,100,000	(2,500,000)		36,600,000
2003 A-1	*	May 1, 2033	Every 35 days	63,700,000	(22,800,000)		40,900,000
2003 A-2	*	May 1, 2033	Every 35 days	16,950,000	(16,950,000)		

Continued

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

Series		Scheduled Maturity	Interest Rate	Beginning Balance July 1, 2009	Bond Maturities & Refundings	New Issues	Ending Balance June 30, 2010
2004 Master Indenture							
2004 A-2	*	June 1, 2034	Every 35 days	51,250,000	(51,250,000)		
2004 A-3	*	June 1, 2034	Every 35 days	57,600,000	(57,600,000)		
2004 A-4	*	June 1, 2034	Every 35 days	50,600,000	(50,600,000)		
2004 A-5		June 1, 2034	Every 28 days	70,550,000	(70,550,000)		
2004 A-6		June 1, 2034	Every 28 days	75,000,000	(75,000,000)		
2004 B-1	*	June 1, 2034	Every 35 days	11,000,000	(11,000,000)		
2005 A-1	*	June 1, 2035	Every 35 days	72,250,000	(71,450,000)		800,000
2005 A-2		June 1, 2035	Every 28 days	45,000,000	(45,000,000)		
2005 A-3		June 1, 2035	Every 28 days	45,000,000	(45,000,000)		
2005 A-4		June 1, 2035	Every 28 days	68,900,000	(68,900,000)		
2005 A-5		June 1, 2035	Every 28 days	50,000,000	(50,000,000)		
2005 A-6		June 1, 2035	Every 28 days	40,000,000	(40,000,000)		
2005 A-7		June 1, 2035	Every 28 days	49,900,000	(49,900,000)		
2005 B-1	*	June 1, 2035	Every 35 days	20,000,000	(20,000,000)		
2006 A-1	*	June 1, 2036	Every 35 days	28,175,000	(28,025,000)		150,000
2006 A-2		June 1, 2036	Every 28 days	39,025,000	(39,025,000)		
2006 A-3		June 1, 2036	Every 28 days	99,950,000	(99,950,000)		
2006 A-4		June 1, 2036	Every 28 days	60,000,000	(60,000,000)		
2006 A-5		June 1, 2036	Every 28 days	80,600,000	(80,600,000)		
2006 B-1	*	June 1, 2036	Every 35 days	29,000,000	(29,000,000)		
2008 Indenture							
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
2010 Indenture							
2010 A-1	*	May 1,2020	Quarterly			$ 75,050,000	75,050,000
2010 A-2	*	May 1,2034	Quarterly			135,660,000	135,660,000
ED Conduit Program							
		January 19, 2014	Weekly			703,272,265	703,272,265
				$2,205,100,000	$ (1,198,400,000)	$ 913,982,265	$1,920,682,265

*This bond series is tax-exempt.

Continued

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

Debt service requirements to maturity or redemption date, assuming interest rates on variable rate debt based index rates at June 30, 2010.

	Principal Repayment Amount (Thousands)						
	83 GBR	97 GBR	04 GBR	08 GBR	10 GBR	ED Conduit	Total
Year Ending June 30, 2011			$ 950				$ 950
4 Years Ending June 30, 2015	$ 100					$ 703,272	703,372
5 Years Ending June 30, 2020					$ 75,050		75,050
5 Years Ending June 30, 2025							
5 Years Ending June 30, 2030		$ 432,500					432,500
5 Years Ending June 30, 2035		273,150			135,660		408,810
3 Years Ending June 30, 2038				$ 300,000			300,000
	$ 100	$ 705,650	$ 950	$ 300,000	$ 210,710	$ 703,272	$1,920,682

	Interest Payments Amount (Thousands)						
	83 GBR	97 GBR	04 GBR	08 GBR	10 GBR	ED Conduit	Total
Year Ending June 30, 2011	$ 1	$ 8,924		$ 877	$ 3,295	$ 2,883	$ 15,980
Year Ending June 30, 2012		8,924		877	3,295	2,883	15,979
Year Ending June 30, 2013		8,924		877	3,295	2,883	15,979
Year Ending June 30, 2014		8,924		877	3,295	1,442	14,538
Year Ending June 30, 2015		8,924		877	3,295		13,096
5 Years Ending June 30, 2020		44,620		4,385	16,336		65,341
5 Years Ending June 30, 2025		44,620		4,385	12,300		61,305
5 Years Ending June 30, 2030		37,513		4,385	12,300		54,198
5 Years Ending June 30, 2035		5,967		4,385	9,430		19,782
3 Years Ending June 30, 2038				2,092			2,092
	$ 1	$ 177,340		$ 24,017	$ 66,841	$ 10,091	$ 278,290

All assets of the 1983 General Bond Resolution Fund, the 2004 General Bond Resolution Fund, the 2008 General Bond Resolution Fund, the 2010 General Bond Resolution Fund, and the Department of Education ("ED") Conduit Program are pledged for repayment of the specific bond or note issues under each resolution or program. Assets of the 1997 General Bond Resolution are also pledged for repayment of the bonds issued in the 1997 GBR but only up to the minimum excess coverage amounts required by the Resolution.

Note K--Lines of Credit and Other Financing

On June 19, 2008, the Authority/Corporation entered into a line of credit agreement with a commercial bank. The agreement provided for a commitment amount not to exceed the lesser of $45 million or the combined cash and investments maintained at that bank, adjusted for asset class factors. On January 8, 2009, the line of credit agreement was amended to reduce the principal amount ceiling from $45 million to $30 million. On that same date, the Authority/Corporation entered into a second line of credit agreement with that bank. That agreement provides for a commitment amount not to exceed $25 million. Advances under this second agreement are only allowable to fund the origination or purchase of loans eligible for ECASLA participation or put. Effective July 1, 2010, the second line of credit agreement was amended to reduce the principal amount thereof from $25 million to $10 million, since new FFELP originations ceased on that date. As of June 30, 2010, the Authority/Corporation had $7.4 million outstanding debt related to these lines of credit.

Under the ECASLA I Participation Program for 2008-2009 academic year loans, the Authority/Corporation maintained a participation facility payable to USDE of $461 million, as of July 1, 2009. In fiscal year 2010, the Authority/Corporation drew down an additional $7.8 million from the USDE. The Authority/Corporation repaid the entire $468.8 million by October 8, 2009.

On August 12, 2009 the Authority/Corporation received its initial advance from the USDE under the ECASLA II Participation Program for 2009-2010 academic year loans. During the fiscal year, the Authority/Corporation received a total of $557 million from the USDE and repaid $21 million back to the USDE. Accordingly as of June 30, 2010, the Authority/Corporation maintained $536 million outstanding on the credit facility payable to the USDE under the ECASLA II Participation Program, which was collateralized by $534 million of loans and $2 million of cash equivalents.

Note L--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, 2010, the Authority/Corporation is reporting a liability for arbitrage rebate of $103,737.

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.

Continued

Note L--Allowance for Arbitrage Liabilities--Continued

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.

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

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

Note M--Deferred Gain on Retirement of Debt

In fiscal year 2010, the Authority/Corporation purchased $1.198 billion of its own auction rate securities, and retired the debt. The Authority/Corporation purchased this debt using $284 million of cash and $914 million of proceeds from newly issued debt. The portion of gain related to debt purchased by cash ($11.9 million) was recognized as income in the current period. The portion of gain related to debt purchased using proceeds from newly issued debt ($83.5 million) was offset by the related unamortized deferred debt issuance costs on that debt ($3.4 million), and the resulting $80.2 million of gain was deferred and will be amortized over the life of the new debt.

Note N--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 11.61% of gross wages for the year ended June 30, 2010. The employees contributed 5% of their gross wages to the plan for the year ended June 30, 2010. 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 $16,034,935 for the year ended June 30, 2010. Total payroll for the year ended June 30, 2010 was $16,065,295. 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, 2010 was $2,663,402 which consisted of employer contributions of $1,861,656 and $801,746 from employees. Employer contributions for the years ended June 30, 2009 and 2008 were $1,898,813 and $1,778,731, respectively.

Continued

Note N--Retirement Plans--Continued

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 the Kentucky Employers Retirement System ("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 four employees covered. Plan assets and the accrued liability for the postretirement healthcare plan totaled $200,000 at June 30, 2010.

Note O--Tuition Benefit Payable

The following assumptions developed by management were used in the actuarial valuation of tuition benefits payable as of June 30, 2010. These assumptions are based on historical data for both state and national trends.

Investment Rates - The investment yield assumption is based on estimates of the yields that will be available on the investment portfolio and cash and cash equivalents. From inception to June 30, 2010, the gross investment yield assumption was 7.76% per annum. For periods after June 30, 2010, the gross investment yield assumption is 6.95% per annum.

Investment Expenses - The investment expense is assumed to be 20 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 tuition increases for the 2003-2004 academic year were 23.4% for the Value Plan and 14.4% for the Standard Plan and the Premium Plan.

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

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

Continued

Note O--Tuition Benefit Payable--Continued

- The tuition increases for the 2006-2007 academic year were 11.2% for the Value Plan and 12% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2007-2008 academic year were 5.5% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2008-2009 academic year were 5.2% for the Value Plan and 9.0% for the Standard Plan and the Premium Plan.
- The tuition increases for the 2009-2010 academic year were 3.3% for the Value Plan and 5.0% for the Standard Plan and the Premium Plan.
- As of June 30, 2010, the tuition increases for the 2010-2011 academic year were 4% for the Value Plan and 6.0% for the Standard Plan and the Premium Plan. The tuition increase assumption was adjusted to 8% for the 2011-2012 academic year, 7.25% for the 2012-2013 academic year, and 6.75% for each year thereafter.

For the period from inception to June 30, 2010, 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 92% of KAPT enrollments, has been 9.9%. For the Kentucky Community and Technical College System ("KCTCS"), as applicable to the tuition benefits payout rate of the Value Plan, the average annualized tuition increase from inception to June 30, 2009, has been 14.2%. 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, 2009 has been 10.65%.

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 P--Restricted Net Assets

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

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

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

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

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

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

Note Q--Operating Leases

The Authority/Corporation leases office space and equipment under agreements expiring in 2012. Rental expense was $1,322,797 for the year ended June 30, 2010. The following are the approximate minimum lease commitments under operating leases:

Year Ending June 30	
2011	$ 1,340,908
2012	727,826

Note R--Commitments and Contingencies

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

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

Amount of guaranteed student loans outstanding at lenders	$	5,039,365,115
Less minimum federal government share - 75%		3,779,523,836
	$	1,259,841,279

Note S--Subsequent Events

The Health Care and Education Reconciliation Act ("HCERA") of 2010 (H.R.4872/Public Law 111-152) was signed into law on March 30, 2010. HCERA eliminates the origination and/or guarantee of FFELP loans, effective July 1, 2010. HCERA does allow lenders to make subsequent disbursements on loans originated on or before June 30, 2010. In accordance with HCERA, the Authority/Corporation continues to provide guarantee services on $5 billion of FFELP loans, continues to own $2.45 billion of FFELP loans, and continues to service an additional $110 million of loans. The Authority/Corporation cannot originate, guarantee or fund any new FFELP loans after June 30, 2010.

Continued

Note S--Subsequent Events--Continued

HCERA does provide for servicing opportunities for nonprofit servicers to service 100,000 direct loans. The Authority/Corporation has been pre-approved as an eligible servicer and is preparing operations to accommodate their allotment of direct loans.

On September 1, 2010, the Authority/Corporation launched its private loan program, the Kentucky Advantage Education Loan ("KAEL") program. The KAEL program is designed to compete with Direct Plus Loan. The Authority/Corporation began receiving applications for KAEL loans on October 18, 2010.