

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

JUNE 30, 2015

Financial Statements

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

June 30, 2015

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INDEPENDENT AUDITOR'S REPORT

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

Report on the Financial Statements

We have audited the accompanying combined financial statements of the governmental activities, the business-type activities, and each major fund of the Kentucky Higher Education Assistance Authority and the Kentucky Higher Education Student Loan Corporation (the Authority/Corporation), component units of the Commonwealth of Kentucky, as of and for the year ended June 30, 2015, and the related notes to the financial statements which collectively comprise the Authority/Corporation's basic combined financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these combined financial statements based on our audit. We did not audit the financial statements of the Kentucky Education Savings Plan Trust, which statements reflect total assets of \$180,392,674 as of June 30, 2015, and an increase to fiduciary net position of \$6,206,635 for the year ended June 30, 2015. Those financial statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Kentucky Education Savings Plan Trust, is based solely on the report of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the combined financial statements are free from material misstatement.

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

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

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Opinions

In our opinion, based on our audit and the report of other auditors, the combined financial statements referred to above present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, and each major fund of the Authority/Corporation as of June 30, 2015, and the respective changes in financial position, and where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note M to the financial statements, the Authority/Corporation adopted Governmental Auditing Standards Board (GASB) Statement No. 68 *Accounting and Financial Reporting for Pensions* - an amendment of GASB Statement No. 27. The implementation resulted in a restatement of the prior year net position. Additionally, as discussed in Notes S to the financial statements, the Authority/Corporation restated prior year net position regarding student aid continuing appropriations recognized as revenue in prior years. Our opinion is not modified with respect to either matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 3 through 15 and the required supplemental information on pages 62 through 64 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated October 1, 2015 on our consideration of the Authority/Corporation's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Authority/Corporation's internal control over financial reporting and compliance.



Louisville, Kentucky
October 1, 2015

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

June 30, 2015

Description of the Business

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

The Authority/Corporation maintains the following operations:

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

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

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

Management's Discussion and Analysis (Unaudited)

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College Savings Programs - The Authority/Corporation administers two savings plans for the Commonwealth of Kentucky; (1) the Trust and (2) the Plan.

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

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

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

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

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

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

The 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.

The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan investment policy goal is to earn rates of return that closely match or exceed anticipated tuition inflation rates and remain sufficiently liquid to meet KAPT benefit payments in a timely manner. The Plan offers certain federal and state tax advantages to purchasers.

Participants purchased annual tuition units at current tuition levels, or current tuition levels at the time of purchase 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 offered 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.

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

Participants were allowed to elect to spread payments to the Plan over three, five or seven years or until the anticipated year of the student's enrollment in a qualified postsecondary education institution. Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States. If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books, and supplies.

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

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

As of June 30, 2015, the Plan maintained a present value fund deficit of \$24.1 million. This represents a \$1.1 million increase over the previous year's deficit. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2023, at which time the liability of the Plan becomes a General Obligation of the Commonwealth of Kentucky. Per KRS 164A.708, once a real liability is expected to accrue, the General Assembly shall appropriate the necessary funds to meet the liability. Over the remaining estimated life of the program, through fiscal year 2028, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$44 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 position 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 position additions and deductions for the Plan are accounted for in the Kentucky Affordable Prepaid Tuition fund, a fiduciary fund of the Authority/Corporation.

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

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

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

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

School Services – School service operations provide services to higher education institutions through a contractual relationship. These areas currently consist of KHEAA Verify and Cohort Default Management Services and new areas of services are continuously analyzed and evaluated based on the needs of school partners across the Commonwealth and beyond.

KHEAA Verify consists of services associated with the required verification of FAFSA information submitted by potential students at an institution. Cohort Default Management Services engages students at an institution to educate them about persistence and completing their education and successfully repaying any educational debt while providing information about the various options available. Personnel, professional and administrative costs associated with school services are accounted for in the Agency Operating Fund ("AOF"), a proprietary fund of the Authority/Corporation and through the collection of revenues generated through service contracts with each institution.

Loan Finance - The Authority/Corporation's loan finance operation is authorized to refinance existing long-term debt and to acquire private supplemental student loans, rehabilitated FFELP loans, FFELP portfolios from other lenders, and certain other FFELP loans required to be repurchased by the Higher Education Act. The Authority/Corporation may issue bonds and notes not to exceed \$5 billion in order to carry out these corporate powers and duties. The FFELP student loans held by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS"), and Federal Consolidation Loans ("Consolidations"). As of June 30, 2015, the loan finance operation owned approximately \$1.17 billion of student loans.

Most FFELP loans held by the Authority/Corporation are insured by the Authority/Corporation's loan guarantee operations. FFELP loans made prior to October 1, 1993, are 100% insured. FFELP

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loans made between October 1, 1993 and June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 98% insured against borrowers' default. FFELP loans made after June 30, 2006, are 100% insured against borrowers' death, disability, or bankruptcy and 97% insured against borrowers' default.

The Authority/Corporation's loan finance operation finances legacy and certain other FFELP loans with revenue bonds, internal warehouse funds, and commercial bank lines of credit. As of June 30, 2015, the Authority/Corporation maintained six separate Indentures of Trust and related Series Resolutions for issues of revenue bonds. The GBRs contain provisions establishing funds and accounts for the segregation of assets and provisions restricting the use of the proceeds of bonds and other funds received. As of June 30, 2015, the loan finance operation maintained \$1.07 billion of revenue bonds outstanding and \$16.4 million of lines of credit payable.

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

Loan Servicing - The loan servicing operation performs servicing and default prevention activities on FFELP and supplemental loans held by the Authority/Corporation's loan finance operation and other lenders. Of the loans serviced, approximately \$1.17 billion in outstanding principal of loans was held by the loan finance operation. Over 90% of these loans were pledged pursuant to the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, and the 2015 Indenture. Approximately \$4 million of FFELP Loans and other education loans were owned by another holder. For those loans, the loan servicing operation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities.

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

Industry Update

The Health Care and Education Reconciliation Act ("HCERA") of 2010 (H.R.4872/Public Law 111-152) was signed into law on March 30, 2010. HCERA eliminated the origination and/or guarantee of FFELP loans, effective July 1, 2010. In accordance with HCERA, the Authority/Corporation continues to provide guarantee services on \$2.27 billion of FFELP loans, continues to own \$1.17 billion of FFELP loans and other education loans, and continues to service an additional \$4 million of FFELP and other education loans. The Authority/Corporation can no longer originate, guarantee or fund any newly originated FFELP loans; however, the Authority/Corporation does continue to look for opportunities to mitigate the impact of the runoff of the FFELP legacy loan portfolio through the acquisition of FFELP rehabilitation loans and other FFELP portfolios and through the origination of KAEL loans.

The Authority/Corporation plans to leverage its experience collecting defaulted FFELP and Direct Loans to become one of the Private Collection Agencies ("PCA") selected by USDE as part of future PCA Request for Proposal processes. In anticipation of future PCA selection processes, the Authority/Corporation sought and received state legislative approval from the Commonwealth of Kentucky to create the Asset Resolution Corporation ("ARC") as the entity that would contract with USDE to become a PCA. ARC was created by the Kentucky General Assembly effective July 12, 2012. ARC is attached to KHESLC for administrative and reporting purposes.

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

Overview of Financial Statements

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

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

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

The Trust publishes separate financial statements and footnotes.

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

The following is a condensed summary of financial information for the years ended June 30, 2015 and 2014, respectively.

Condensed Financial Information - Governmental Fund and Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

	Governmental Fund		Proprietary Funds	
	2015	2014	2015	2014
Net Position Information				
Capital assets	\$ 22,004,402	\$ 18,853,873	\$ 5,315,212	\$ 5,016,462
Other assets (2014 Governmental, as restated)			1,359,175,910	1,443,294,081
Total Assets	<u>22,004,402</u>	<u>18,853,873</u>	<u>1,364,491,122</u>	<u>1,448,310,543</u>
Deferred Outflows of Resources:				
Deferred pension expense			4,624,385	
Total Assets and Deferred Outflows of Resources	<u>22,004,402</u>	<u>18,853,873</u>	<u>1,369,115,507</u>	<u>1,448,310,543</u>
Liabilities				
Long-term liabilities (2014 Proprietary, as restated)			1,148,680,292	1,237,951,746
Other liabilities	17,879	240,690	34,261,358	25,628,069
Deferred pension expense			1,035,000	
Deferred gain on debt retirements, net			20,012,879	21,812,809
Total Liabilities and Deferred Inflows of Resources	<u>17,879</u>	<u>240,690</u>	<u>1,203,989,529</u>	<u>1,285,392,624</u>
Invested in capital assets, net of expended debt proceeds				
Unrestricted			5,315,212	5,016,462
Restricted, other			6,285,287	6,285,287
Restricted for program benefits	21,986,523	18,613,183		
Restricted for student aid and related activities			73,169,113	79,495,392
Total Net Position, 2014 Restated	<u>\$ 21,986,523</u>	<u>\$ 18,613,183</u>	<u>\$ 165,125,978</u>	<u>\$ 162,917,919</u>
Activity Information				
Interest and investment income fund	\$ 619,859	\$ 376,016	\$ 703,223	\$ 769,858
Student aid & advancement fund revenue	203,673,961	200,632,313		
Tobacco settlement revenue	797,714	1,001,536		
Unclaimed lottery revenue	6,500,000	11,000,000		
Contributions from Agency Operating Fund	2,359,798	3,118,697		
Federal funds revenue	5,543	59,795		
Servicing Fees from external sources			923,236	847,298
Servicing Fees from Education Finance Funds			6,882,940	7,530,485
Debt recovery commission			22,377,948	33,858,701
Early retirement of debt			108,828	2,304,111
Federal fees earned			1,536,064	1,721,637
Federal grant revenue				293,245
Default aversion fee income			(501,501)	(390,225)
Interest income on loans			19,372,732	20,929,509
Amortization of deferred gain on debt retirements			1,799,930	10,132,812
Guarantee fee			142,104	175,231
Gain on the sale of loans			2,696,772	364,377
Late payment penalties			1,235,258	1,210,613
School Services			550,429	573,595
Other income	768,482	573,698	151,044	235,601
Total Revenue	<u>214,725,357</u>	<u>216,762,055</u>	<u>57,979,007</u>	<u>80,556,848</u>
Expenditures				
Kentucky Tuition Grants	28,680,413	30,358,991		
College Access Program Grants	61,045,814	62,800,437		
Mary J Young Scholarships	626,859	530,529		
Early Childhood Development Scholarships	995,045	771,883		
National Guard Tuition Awards	5,680,227	4,789,286		
Kentucky Education Excellence Scholarships	107,866,852	105,485,835		
Teacher Scholarships	1,263,932	463,133		
Teacher Loan Forgiveness	1,400,000	1,400,000		
Osteopathic Medicine Scholarships	705,347	435,639		
Work Study Benefits	504,655	444,455		
Go Higher Grant Program	297,812	239,406		
Drive the Dream Scholarship		533,704		
Kentucky Coal County College Completion Scholarship	1,978,674	1,318,796		
John R. Justice Grant	140,429	89,101		
Loan guarantee operations			4,189,182	3,382,216
Default collections			7,292,484	6,470,126
Loan finance and servicing activities			33,506,486	34,216,102
Outreach			3,913,148	2,915,676
Contribution to FSLRF			2,500,000	5,500,000
Student aid administration			1,892,281	2,214,617
Contribution to student aid programs			467,517	904,080
School services			1,890,561	1,917,563
Other activities		40,331	119,289	232,739
Total Expenditures	<u>211,352,017</u>	<u>209,701,526</u>	<u>55,770,948</u>	<u>57,753,119</u>
Net Operating income before Operating Transfers	<u>3,373,340</u>	<u>7,060,529</u>	<u>2,208,059</u>	<u>22,803,729</u>
Transfer to KAPT (the "Plan")				(23,503)
Change in Net Position	<u>\$ 3,373,340</u>	<u>\$ 7,060,529</u>	<u>\$ 2,208,059</u>	<u>\$ 22,780,226</u>

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June 30, 2015

Financial Analysis – Governmental and Proprietary Funds

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

This section of the annual financial report presents a discussion and analysis of the Authority/Corporation's government-wide performance for the fiscal year ended June 30, 2015. 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 and deferred outflows decreased approximately \$79 million (5.5%), from \$1.4 billion to \$1.3 billion. The decrease was caused primarily by an \$90.3 million decrease in loans, a \$800,000 decrease in accrued interest income, a \$4.6 million decrease in receivables, and increases in cash and investments of \$12.1 million and deferred outflows related to GASB 68 pension expense of \$4.6 million.
- The Authority/Corporation's proprietary fund liabilities and deferred inflows, as restated, decreased by \$81.4 million (6%), from \$1.3 billion to \$1.2 billion. The decrease in liabilities and deferred inflows resulted primarily from a decrease in bonds payable of \$93.7 million, an increase in other long-term liabilities of \$4.4 million, an increase in the line of credit payable of \$9.1 million, a decrease in deferred gain on early retirement of debt of \$1.8 million, and an increase in deferred inflows related to GASB 68 pension expense of \$1 million.
- The Authority/Corporation's proprietary fund revenues decreased \$22.5 million (28%), from \$80 million to \$58 million. The overall decrease was primarily attributable to the following three variances: an \$11.5 million reduction in debt recovery commission due to the aforementioned Bipartisan Budget Act of 2013, an \$8.3 million reduction in amortization of deferred gain on debt retirements, and a reduction in interest income on loans of \$1.6 million.
- The Authority/Corporation's total proprietary fund expenditures decreased approximately \$2 million (3%), due to various fluctuations with the primary variance resulting from a decrease in the AOF Contribution to FSLRF.
- The Authority/Corporation's governmental fund assets increased \$3.2 million (17%) after taking into consideration the restatement noted in Note S. This resulted primarily from an increase in accounts receivable related to student aid programs of \$2.6 million and an increase in cash and cash equivalents of \$645,000.
- The Authority/Corporation's governmental fund liabilities decreased approximately \$223,000 as compared to prior year.

**Kentucky Higher Education Assistance Authority
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- The Authority/Corporation's governmental fund revenues decreased \$2 million (1%), resulting primarily from additional state General Funds for student aid programs of \$3 million and an increase in investment income of \$244,000 offset by a decrease in unclaimed lottery revenue of \$4.5 million, a decrease in the contribution from the Agency Operating Fund of \$759,000, and a decrease in federal fund revenue of \$54,000.
- The Authority/Corporation's governmental fund expenditures increased \$1.7 million (1%) resulting from decreases in College Access Program and Kentucky Tuition Grants of \$1.8 and 1.7 million, respectively, offset by an increase in the Kentucky Educational Excellence Scholarships of \$2.38 million, an increase in National Guard of \$890,000, an increase in the Kentucky Coal County Completion Scholarship of \$660,000 and a \$1.2 million increase across the remaining programs.

Combined Statement of Net Position – Governmental Fund and Proprietary Funds

Total governmental net position, as restated, increased from \$18.6 million to \$22 million. Total proprietary fund net position increased \$2.2 million comprised of a \$14.8 million increase from default collection operations (compared to \$27.1 million in prior year), \$2.5 million decrease from loan guarantee operations (compared to \$1.4 million decrease in prior year), \$3.9 million contribution for outreach activities (compared to \$2.6 million contribution in prior year), \$2.4 million contribution for student aid and administration (compared to \$3.1 million in prior year), \$25,000 gain in loan finance and servicing activities (compared to \$9.7 million gain in prior year), \$2.5 million contribution to the FSLRF (compared to \$5.5 million in prior year), and \$1.3 million contribution for school services (compared to \$1.3 million in prior year).

Certain highlights related to the combined statement of net position as of June 30, 2015, are as follows:

- The Authority/Corporation purchased \$4 million of its own auction rate securities on the secondary market for a discount, resulting in other income of \$109,000.
- The Authority/Corporation maintained \$2.27 billion of FFELP guarantees outstanding.
- The Authority/Corporation maintained \$1.17 billion of FFELP loans and education loans.
- The Authority/Corporation maintained \$435.5 million of defaulted loans in its collection portfolio.
- Unrestricted net position, as restated, increased from \$0 to \$6.3 million.
- Net position, restricted other, as restated, decreased from \$79.5 million to \$73.2 million.
- Net position restricted for student aid and related activities, as restated, increased from \$78.4 million to \$80.4 million.

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

June 30, 2015

Combined Statement of Revenues, Expenses and Changes in Net Position

The \$2.2 million increase in proprietary fund net position during FY 2015 was \$20.6 million less than the \$22.8 million increase during FY 2014. The change in the overall growth of net position as compared to the previous year's growth was attributable to an approximate \$10.9 million decrease for the Authority and an approximate \$9.7 million decrease for the Corporation. The Authority's \$10.9 million decrease was due primarily to an \$11.5 million reduction in debt recovery commission due to the aforementioned Bipartisan Budget Act of 2013. The reduction in the overall increase for the Corporation resulted primarily from various differences from year to year some of which are offsetting variances. The most significant change over the prior year pertains to an \$8.3 million reduction in amortization of deferred gain on debt retirements.

Certain other highlights related to the combined statement of revenues, expenses and changes in net position for the year ended June 30, 2015, are as follows:

- The Authority/Corporation provided \$11.7 million of FFELP and other program benefits, the majority of which directly benefited the citizens of the Commonwealth of Kentucky.
- The defaulted loan collection operation received \$22.4 million in commissions on the \$140 million collected on behalf of the USDE.

Condensed Financial Information - Fiduciary Funds

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

	Federal Student Loan Reserve Fund		Kentucky's Affordable Prepaid Tuition		Kentucky Education Savings Plan Trust	
	<u>2015</u>	<u>2014</u>	<u>2015</u>	<u>2014</u>	<u>2015</u>	<u>2014</u>
Net Position Information						
Other assets	\$ 17,313,546	\$ 21,180,654	\$ 106,838,962	\$ 120,379,782	\$ 180,392,674	\$ 174,016,252
Total Assets	17,313,546	21,180,654	106,838,962	120,379,782	180,392,674	174,016,252
Total Liabilities	5,768,676	10,119,603	130,893,230	143,379,761	455,471	285,684
Restricted net position (deficit)	11,544,870	11,061,051	(24,054,268)	(22,999,979)	179,937,203	173,730,568
Total Net Position (Deficit)	\$ 11,544,870	\$ 11,061,051	\$ (24,054,268)	\$ (22,999,979)	\$ 179,937,203	\$ 173,730,568
Changes in Fiduciary Net Position Information						
Federal reinsurance	\$ 72,521,422	\$ 85,023,123	\$	\$	\$	\$
Contribution from Agency Operating Fund	2,500,000	5,500,000				
Fee revenue						
Contributions			323,244	152,694		
Subscriptions					56,353,397	47,324,492
Investment revenue	1,287	1,178	3,999,603	17,868,669	3,649,820	19,953,950
Other income	3,598,440	3,631,526				
Total Additions	78,621,149	94,155,827	4,322,847	18,021,363	60,003,217	67,278,442
Administrative expenses			469,904	430,543	720,193	641,205
Refunds			2,553,305	1,666,426		
Trustee expense			320,996	637,866		
Tuition benefits expense, net			2,032,931	796,836		
Loan claims	78,638,831	91,887,117				
Redemptions					53,076,389	45,434,182
Default aversion	(501,501)	(390,225)				
Total Deductions	78,137,330	91,496,892	5,377,136	3,531,671	53,796,582	46,075,387
Change in Net Position before Gain from Legislative Changes and Transfers	483,819	2,658,935	(1,054,289)	14,489,692	6,206,635	21,203,055
Gain from Legislative Changes				15,389,851		
Transfer from Agency Operating Fund				23,503		
Change in Net Position	\$ 483,819	\$ 2,658,935	\$ (1,054,289)	\$ 29,903,046	\$ 6,206,635	\$ 21,203,055

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

June 30, 2015

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, 2015. Please read it in conjunction with the Authority/Corporation's combined financial statements and notes to the combined financial statements, which follow this section.

Financial Overview

- Loan claims paid decreased from \$91.9 million in fiscal year 2014 to \$78.6 million in fiscal year 2015 (14% decrease).
- The Plan noted a decrease in tuition benefits payable of \$12.3 million in fiscal year 2015, due primarily to the net of several different factors including certain losses due to unfavorable investment experience and changes in assumption.

Statement of Fiduciary Net Position (Deficit)

The FSLRF net position increased \$484,000 compared to prior year. Assets decreased approximately 18% (\$3.9 million), while liabilities decreased 43% (\$4.4 million). The increase in net position is primarily comprised of a \$2.5 million contribution from the AOF and \$500,000 for default aversion remittances from the AOF, offset by a \$2.5 million decrease associated with claim related activity.

The Plan recognized an increase in the net deficit of \$1.1 million for fiscal year 2015 compared to a \$29.9 million decrease in net deficit in the prior year. Overall, the current year increase in net deficit from prior year is attributable to the net of various gains and other changes including certain losses due to unfavorable investment experience and changes in assumptions.

The Plan's total assets decreased \$13.5 million, from \$120.4 million as of June 30, 2014 to \$106.8 million as of June 30, 2015. Cash and investments decreased from \$117.4 million to \$104.6 million, a \$12.8 million decrease. The change in tuition and investment return assumptions are as follows:

- 2015-thereafter – investment return decreased from 5.74% to 5.45%.
- 2015-2016 academic year – tuition increase assumption was 6.25%, while actual tuition increases were 2.0% for the Value Plan and 3.0% for the Standard Plan and the Premium Plan
- 2016-thereafter – tuition increase assumption remained at 6.25%

The Trust is an Internal Revenue Code 529 plan managed by the Authority and administered on behalf of the Authority by TFI. Trust assets are entirely comprised of cash and pooled investments. Total net position increased approximately \$6.2 million, due to subscriptions received (\$56.4 million) and investment gain (\$3.6 million), net of expenses and redemptions (\$53.8 million).

Management's Discussion and Analysis (Unaudited)

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

June 30, 2015

Statement of Changes in Fiduciary Net Position (Deficit)

The FSLRF net position increased \$484,000 compared to prior year. Assets decreased approximately 18% (\$3.9 million), while liabilities decreased 43% (\$4.4 million). The increase in net position is primarily comprised of a \$2.5 million contribution from the AOF and \$500,000 for default aversion remittances from the AOF, offset by a \$2.5 million decrease associated with claim related activity.

The Plan recognized an increase in the net deficit of \$1.1 million for fiscal year 2015 compared to a \$29.9 million decrease in net deficit in the prior year. Overall, the current year increase in net deficit from prior year is attributable to the net of various gains and other changes including certain losses due to unfavorable investment experience and changes in assumptions.

Combined Government-Wide Statement of Net Position

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

June 30, 2015

ASSETS	Governmental Activities	Business-Type Activities	Total
Current:			
Cash and cash equivalents	\$ 3,670,700	\$ 30,756,347	\$ 34,427,047
Accounts receivable and prepaid expenses	8,598,775	938,363	9,537,138
Accrued interest income		12,857,744 #	12,857,744 #
Investments		9,673,326	9,673,326
Teacher and Osteopathic Medicine scholarship loans	450,000		450,000
Loans, net		135,303,565	135,303,565
Total Current Assets	12,719,475	189,529,345	202,248,820
Noncurrent:			
Restricted cash and cash equivalents		62,803,830	62,803,830
Restricted from Federal Student Loan Reserve Fund		1,677,485	1,677,485
Investments		70,580,606	70,580,606
Fixed assets, net		8,525,212	8,525,212
Loans, net		1,023,853,277	1,023,853,277
Teacher and Osteopathic Medicine scholarship loans, net	4,387,943		4,387,943
Teacher and Osteopathic Medicine scholarship advances	4,896,984		4,896,984
Accrued interest income, net		7,521,367	7,521,367
Total Noncurrent Assets	9,284,927	1,174,961,777	1,184,246,704
Total Assets	22,004,402	1,364,491,122	1,386,495,524
Deferred Outflows of Resources:			
Deferred pension expense		4,624,385	4,624,385
Total Assets and Deferred Outflows of Resources	22,004,402	1,369,115,507	1,391,119,909
LIABILITIES			
Current:			
Accounts payable and accrued expenses	17,879	6,428,231	6,446,110
Accrued interest expense		922,034	922,034
Payable to US Department of Education		9,885,826	9,885,826
Line of credit payable		16,445,267	16,445,267
Capital lease payable		580,000	580,000
Total Current Liabilities	17,879	34,261,358	34,279,237
Noncurrent:			
Net pension liability		80,527,000	80,527,000
Capital lease payable		2,630,000	2,630,000
Bonds payable		1,065,523,292	1,065,523,292
Total Noncurrent Liabilities		1,148,680,292	1,148,680,292
Total Liabilities	17,879	1,182,941,650	1,182,959,529
Deferred Inflows of Resources:			
Deferred pension expense		1,035,000	1,035,000
Deferred gain on debt retirements, net		20,012,879	20,012,879
Total Liabilities and Deferred Inflows of Resources	17,879	1,203,989,529	1,204,007,408
NET POSITION			
Invested in capital assets, net of expended debt proceeds		5,315,212	5,315,212
Unrestricted		6,285,287	6,285,287
Restricted, other		73,169,113	73,169,113
Restricted for program benefits	21,986,523		21,986,523
Restricted for student aid and related activities		80,356,366	80,356,366
Total Net Position	\$ 21,986,523	\$ 165,125,978	\$ 187,112,501

Combined Government-Wide Statement of Activities

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

For Year Ending June 30, 2015

			Program Revenue		Net (Expenses) Revenues and Changes in Net Position		
	Direct Expenses	Indirect Expenses	Charges for Services	Operating Grants and Contributions	Governmental Activities	Business-Type Activities	Total
Governmental Activities:							
Kentucky Tuition Grant	\$ 28,529,245	\$ 151,168	\$	\$ 32,632,812	\$ 3,952,399	\$	\$ 3,952,399
College Access Program Grant	60,894,646	151,168		59,902,916	(1,142,898)		(1,142,898)
Mary Jo Young Scholarship	482,910	143,949		616,966	(9,893)		(9,893)
Early Childhood Development Scholarship	847,214	147,831		1,157,336	162,291		162,291
Kentucky National Guard Tuition Award Program	5,532,396	147,831		5,074,151	(606,076)		(606,076)
Kentucky Educational Excellence Scholarship	107,715,684	151,168		107,903,492	36,640		36,640
Teacher Scholarship	1,112,294	151,168		2,301,370	1,037,908		1,037,908
Teacher Loan Forgiveness	1,400,000				(1,400,000)		(1,400,000)
Osteopathic Medicine Scholarship	557,625	147,722		1,210,342	504,995		504,995
KHEAA Work Study Program	356,824	147,831		547,994	43,339		43,339
Go Higher Grant Program	161,960	135,852		308,780	10,968		10,968
Pharmacy Scholarship Program	28,670	137,758		950,095	783,667		783,667
Kentucky Coal County College Completion Scholarship	1,834,725	143,949		1,978,674			
John R. Justice Grant	5,543	134,886		140,429			
Total Governmental Activities	209,459,736	1,892,281		214,725,357	3,373,340		3,373,340
Business-Type Activities:							
Loan guarantee operations	4,189,182		1,667,515			(2,521,667)	(2,521,667)
Default collections	7,292,484		22,110,104			14,817,620	14,817,620
Loan finance and servicing activities	33,506,486		33,531,670			25,184	25,184
Outreach	3,913,148					(3,913,148)	(3,913,148)
Contribution to student aid programs	467,517					(467,517)	(467,517)
Student aid administration	1,892,281					(1,892,281)	(1,892,281)
Contribution to FSLRF	2,500,000					(2,500,000)	(2,500,000)
School services	1,890,561		550,429			(1,340,132)	(1,340,132)
Other activities	119,289		119,289				
Total Business-Type Activities	55,770,948		57,979,007			2,208,059	2,208,059
Total Primary Government	\$ 265,230,684	\$ 1,892,281	\$ 57,979,007	\$ 214,725,357	3,373,340	2,208,059	5,581,399
Change in Net position					3,373,340	2,208,059	5,581,399
Net position, July 1, 2014, Restated					18,613,183	162,917,919	181,531,102
Net position, June 30, 2015					\$ 21,986,523	\$ 165,125,978	\$ 187,112,501

See accompanying notes

Combined Statement of Net Position - Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

June 30, 2015

ASSETS	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Current:							
Cash and cash equivalents	\$ 4,123,570	\$ 12,781,675	\$ 16,905,245	\$	\$ 13,851,102	\$ 13,851,102	\$ 30,756,347
Investments		9,673,326	9,673,326				9,673,326
Accounts receivable and prepaid expenses		185,696	185,696	32,780	719,887	752,667	938,363
Accrued interest income		248,054	248,054	11,733,332	876,358	12,609,690	12,857,744
Loans, net				128,941,394	6,362,171	135,303,565	135,303,565
Total Current Assets	4,123,570	22,888,751	27,012,321	140,707,506	21,809,518	162,517,024	189,529,345
Noncurrent:							
Restricted cash and cash equivalents				62,803,830		62,803,830	62,803,830
Internal receivable (payable) for Gear Up Scholarships							
Receivable from Federal Student Loan Reserve Fund		1,677,485	1,677,485				1,677,485
Investments		62,221,101	62,221,101		8,359,505	8,359,505	70,580,606
Fixed assets, net		8,210,914	8,210,914		314,298	314,298	8,525,212
Loans, net				945,157,915	78,695,362	1,023,853,277	1,023,853,277
Accrued interest income, net				7,102,492	418,875	7,521,367	7,521,367
Total Noncurrent Assets		72,109,500	72,109,500	1,015,064,237	87,788,040	1,102,852,277	1,174,961,777
Total Assets	4,123,570	94,998,251	99,121,821	1,155,771,743	109,597,558	1,265,369,301	1,364,491,122
Deferred Outflows of Resources:							
Deferred pension expense		475,279	475,279		4,149,106	4,149,106	4,624,385
Total Assets and Deferred Outflows of Resources	4,123,570	95,473,530	99,597,100	1,155,771,743	113,746,664	1,269,518,407	1,369,115,507
LIABILITIES							
Current:							
Accounts payable and accrued expenses	1,408,838	629,776	2,038,614	417,851	3,971,766	4,389,617	6,428,231
Interfund payable (receivable)	2,714,732	(2,594,309)	120,423	(3,227,437)	3,107,014	(120,423)	
Accrued interest expense		27,283	27,283	892,612	2,139	894,751	922,034
Payable (receivable) to U.S. Department of Education		(366,500)	(366,500)	9,553,977	698,349	10,252,326	9,885,826
Line of credit payable					16,445,267	16,445,267	16,445,267
Capital lease payable		580,000	580,000				580,000
Total Current Liabilities	4,123,570	(1,723,750)	2,399,820	7,637,003	24,224,535	31,861,538	34,261,358
Noncurrent:							
Capital lease payable		2,630,000	2,630,000				2,630,000
Net pension liability		9,093,000	9,093,000		71,434,000	71,434,000	80,527,000
Bonds payable, net				1,065,523,292		1,065,523,292	1,065,523,292
Total Noncurrent Liabilities		11,723,000	11,723,000	1,065,523,292	71,434,000	1,136,957,292	1,148,680,292
Total Liabilities	4,123,570	9,999,250	14,122,820	1,073,160,295	95,658,535	1,168,818,830	1,182,941,650
Deferred Inflows of Resources:							
Deferred pension expense		117,000	117,000		918,000	918,000	1,035,000
Deferred gain on debt retirements, net				20,012,879		20,012,879	20,012,879
Total Liabilities and Deferred Inflows of Resources	4,123,570	10,116,250	14,239,820	1,093,173,174	96,576,535	1,189,749,709	1,203,989,529
NET POSITION							
Invested in capital assets, net		5,000,914	5,000,914		314,298	314,298	5,315,212
Unrestricted					6,285,287	6,285,287	6,285,287
Restricted, other				62,598,569	10,570,544	73,169,113	73,169,113
Restricted for student aid and related activities		80,356,366	80,356,366				80,356,366
Total Net Position	\$	\$ 85,357,280	\$ 85,357,280	\$ 62,598,569	\$ 17,170,129	\$ 79,768,698	\$ 165,125,978

See accompanying notes

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

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For Year Ending June 30, 2015

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Operating revenues:							
Interest Revenues:							
Interest on loans	\$		\$	\$ 26,204,379	\$ 2,246,372	\$ 28,450,751	\$ 28,450,751
Interest and investment income		632,952	632,952	14,110	56,161	70,271	703,223
Amortization of deferred gain on debt retirements				1,799,930		1,799,930	1,799,930
Interest expense on bonds				(8,813,415)	(264,604)	(9,078,019)	(9,078,019)
Total net interest revenues		632,952	632,952	19,205,004	2,037,929	21,242,933	21,875,885
Financing Expenses:							
Provision for loan losses				4,273,400	870,295	5,143,695	5,143,695
Provision for arbitrage				(55,771)		(55,771)	(55,771)
Long-Term debt credit facility and remarketing fees				966,820	19,707	986,527	986,527
Debt issuance costs				961,249		961,249	961,249
Total financing expenses				6,145,698	890,002	7,035,700	7,035,700
Interest revenues net of financing expenses		632,952	632,952	13,059,306	1,147,927	14,207,233	14,840,185
Other Operating Revenues:							
Servicing fees from external sources					923,236	923,236	923,236
Servicing fees from Education Finance Funds					6,882,940	6,882,940	6,882,940
Debt recovery commission		22,110,104	22,110,104		267,844	267,844	22,377,948
Federal fees earned		1,536,064	1,536,064				1,536,064
Default aversion fee income		(501,501)	(501,501)				(501,501)
Guarantee fee				89,812	52,292	142,104	142,104
Gain on early retirement of debt				108,828		108,828	108,828
Gain on sale/purchase of loans				653,493	2,043,279	2,696,772	2,696,772
Late payment penalties				1,179,326	55,932	1,235,258	1,235,258
School services		550,429	550,429				550,429
Other income	119,289		119,289		31,755	31,755	151,044
Total operating revenues	119,289	24,328,048	24,447,337	15,090,765	11,405,205	26,495,970	50,943,307
Operating Expenses:							
Administrative expenses	119,289	10,589,590	10,708,879		17,769,656	17,769,656	28,478,535
Servicing fees for Operating Fund				6,882,940		6,882,940	6,882,940
Depreciation and amortization		534,565	534,565		104,748	104,748	639,313
Other expenses		357,511	357,511	168,283	543,300	711,583	1,069,094
Total operating expenses	119,289	11,481,666	11,600,955	7,051,223	18,417,704	25,468,927	37,069,882
Net operating income (loss) before program benefits		12,846,382	12,846,382	8,039,542	(7,012,499)	1,027,043	13,873,425
Program Benefits:							
Principal and interest benefits				518,421	483,438	1,001,859	1,001,859
School Service		1,890,561	1,890,561				1,890,561
Outreach		3,913,148	3,913,148				3,913,148
Contribution to FSLRF		2,500,000	2,500,000				2,500,000
Contribution to student aid programs		467,517	467,517				467,517
Student aid administration		1,892,281	1,892,281				1,892,281
Total program benefits		10,663,507	10,663,507	518,421	483,438	1,001,859	11,665,366
Operating income (loss) before transfers		2,182,875	2,182,875	7,521,121	(7,495,937)	25,184	2,208,059
Transfers (to) from other funds							
Interfund transfers				(27,269,794)	27,269,794		
Increase (decrease) in Net position after transfers		2,182,875	2,182,875	(19,748,673)	19,773,857	25,184	2,208,059
Net position, July 1, 2014, Restated		83,174,405	83,174,405	82,347,242	(2,603,728)	79,743,514	162,917,919
Net position, June 30, 2015	\$	\$ 85,357,280	\$ 85,357,280	\$ 62,598,569	\$ 17,170,129	\$ 79,768,698	\$ 165,125,978

Combined Statement of Cash Flows - Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For Year Ending June 30, 2015

	Authority			Corporation			Combined
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Cash Flows from Operating Activities:							
Principal received on loans	\$	\$	\$	\$ 204,902,642	\$ 14,712,500	\$ 219,615,142	\$ 219,615,142
Interest received on loans				37,513,688	2,259,087	39,772,775	39,772,775
Special allowance paid				(27,312,708)	(1,091,978)	(28,404,686)	(28,404,686)
Servicing fees received, internal sources	(119,289)	178,307	59,018	(6,882,940)	6,882,940		59,018
School services fees received		550,429	550,429				550,429
Servicing fees received, external sources					931,879	931,879	931,879
Debt recovery commission received		22,110,104	22,110,104		399,684	399,684	22,509,788
Federal fees received		1,536,064	1,536,064				1,536,064
Default aversion fees received		(501,501)	(501,501)				(501,501)
Outreach		(3,913,148)	(3,913,148)				(3,913,148)
School services		(1,890,561)	(1,890,561)				(1,890,561)
Internal activity-payments to other funds	1,308,367	(1,308,367)		4,867,229	(4,867,229)		
Loans originated, including costs				(1,806,260)	(6,231,947)	(8,038,207)	(8,038,207)
Administrative expenses paid		(9,601,163)	(9,601,163)	(3,860,037)	(15,158,678)	(19,018,715)	(28,619,878)
Contribution to FSLRF		(2,500,000)	(2,500,000)				(2,500,000)
Credit facility fees paid				(966,981)	(18,821)	(985,802)	(985,802)
Loans purchased, including premiums				(12,651,374)	(91,481,526)	(104,132,900)	(104,132,900)
Contribution to student aid programs		(467,517)	(467,517)				(467,517)
Student aid administration		(1,892,281)	(1,892,281)				(1,892,281)
Interfund loan sales and purchases				(59,427,074)	59,427,074		
Client loan receipts					3,008,818	3,008,818	3,008,818
Loan receipts remitted to clients					(3,432,935)	(3,432,935)	(3,432,935)
Net Cash Provided by (Used in) Operating Activities	1,189,078	2,300,366	3,489,444	134,376,185	(34,661,132)	99,715,053	103,204,497
Cash Paid from Noncapital Financing Activities:							
Proceeds from debt issued				134,605,000	76,832,623	211,437,623	211,437,623
Debt principal payments				(228,316,000)	(67,757,036)	(296,073,036)	(296,073,036)
Interest on debt				(9,051,744)	(267,204)	(9,318,948)	(9,318,948)
Debt issuance costs				(961,249)	(16,290)	(977,539)	(977,539)
Gain on early retirement of debt				108,828		108,828	108,828
Interfund transfers				(27,269,794)	27,269,794		
Increase in Federal Student Loan Reserve receivable		4,403,172	4,403,172				4,403,172
Net Cash Provided by (Used in) Noncapital Financing Activities		4,403,172	4,403,172	(130,884,959)	36,061,887	(94,823,072)	(90,419,900)
Cash Flows From Capital and Related Financing Activities:							
Capital expenditures		(562,818)	(562,818)		(170,924)	(170,924)	(733,742)
Interest paid on capital lease		(4,600)	(4,600)				(4,600)
Bond principal payments		(550,000)	(550,000)				(550,000)
Net Cash Used in Capital and Related Financing Activities		(1,117,418)	(1,117,418)		(170,924)	(170,924)	(1,288,342)
Cash Flows From Investing Activities:							
Proceeds from sales/maturities of investments		32,407,906	32,407,906		4,579,192	4,579,192	36,987,098
Purchases of investments		(53,411,360)	(53,411,360)		(4,641,820)	(4,641,820)	(58,053,180)
Investment income		902,790	902,790	13,384	54,513	67,897	970,687
Net Cash Provided by (Used in) Investing Activities		(20,100,664)	(20,100,664)	13,384	(8,115)	5,269	(20,095,395)
Net Increases (Decrease) in Cash and Cash Equivalents	1,189,078	(14,514,544)	(13,325,466)	3,504,610	1,221,716	4,726,326	(8,599,140)
Cash and Cash Equivalents, July 1, 2014	2,934,492	27,296,219	30,230,711	59,299,220	12,629,386	71,928,606	102,159,317
Cash and Cash Equivalents, June 30, 2015	\$ 4,123,570	\$ 12,781,675	\$ 16,905,245	\$ 62,803,830	\$ 13,851,102	\$ 76,654,932	\$ 93,560,177

Combined Statement of Cash Flows - Proprietary Funds

Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation

For Year Ending June 30, 2015

	Authority		Corporation			Combined	
	Internal Service Fund	Agency Operating Fund	Authority Total	Education Finance Funds	Operating Fund	Corporation Total	Total
Reconciliation of Operating Income to Net Cash Provided by (Used in) Operating Activities							
Operating income (loss) before transfers	\$	\$ 2,182,875	\$ 2,182,875	\$ 7,521,121	\$ (7,495,937)	\$ 25,184	\$ 2,208,059
Adjustments to reconcile operating income to net cash provided by (used in) operating activities:							
Investment income		(632,952)	(632,952)	(13,384)	(58,902)	(72,286)	(705,238)
Depreciation and amortization		880,246	880,246		104,748	104,748	984,994
Amortization of deferred gain on debt retirements				(1,799,930)		(1,799,930)	(1,799,930)
Amortization, expense and write-off of debt issuance costs				961,249		961,249	961,249
Gain on early retirement of debt				(108,828)		(108,828)	(108,828)
Interest expense		4,600	4,600	8,813,415	264,604	9,078,019	9,082,619
Provision for loan losses				4,273,400	870,295	5,143,695	5,143,695
Borrower interest converted to principal				(21,694,230)	(1,167,526)	(22,861,756)	(22,861,756)
Loan forgiveness				518,421	17,650	536,071	536,071
Pension expense		211,721	211,721		1,249,894	1,249,894	1,461,615
(Increases) decreases in assets:							
Accounts receivables and prepaid expenses		102,909	102,909	4,763	84,155	88,918	191,827
Accrued interest receivable		75,398	75,398	1,440,676	(555,909)	884,767	960,165
Principal received on loans				204,902,642	14,712,500	219,615,142	219,615,142
Loans purchased, including premiums		(47)	(47)	(12,651,374)	(91,481,526)	(104,132,900)	(104,132,947)
Loans originated, including costs				(1,806,260)	(6,231,947)	(8,038,207)	(8,038,207)
Interfund loan sales and purchases				(59,427,074)	59,427,074		
Increases (decreases) in liabilities:							
Accounts payable and accrued expenses	331,970	205,225	537,195	(39,286)	280,660	241,374	778,569
Payable to U.S. Department of Education				(1,316,400)	318,363	(998,037)	(998,037)
Interfund receivable/payable	857,108	(725,009)	132,099	4,867,229	(4,999,328)	(132,099)	
Accrued interest payable		(4,600)	(4,600)				(4,600)
Allowance for arbitrage liabilities				(69,965)		(69,965)	(69,965)
Net Cash Provided by (Used in) Operating Activities	\$ 1,189,078	\$ 2,300,366	\$ 3,489,444	\$ 134,376,185	\$ (34,661,132)	\$ 99,715,053	\$ 103,204,497

Balance Sheet - Governmental Fund

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

June 30, 2015

ASSETS	Governmental Fund Student Aid
Current:	
Cash and cash equivalents	\$ 3,670,700
Accounts receivable	8,598,775
Teacher and Osteopathic Medicine scholarship loans	<u>450,000</u>
Total Current Assets	<u>12,719,475</u>
Noncurrent:	
Teacher and Osteopathic Medicine scholarship loans, net of allowance of \$3,600,000	4,387,943
Teacher and Osteopathic Medicine scholarship advances	<u>4,896,984</u>
Total Noncurrent Assets	<u>9,284,927</u>
Total Assets	<u>22,004,402</u>
LIABILITIES	
Current:	
Accounts payable	<u>17,879</u>
Total Liabilities	<u>17,879</u>
FUND BALANCE	
Restricted for program benefits	<u>\$ 21,986,523</u>

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

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

For Year Ending June 30, 2015

	Governmental Fund Student Aid
Revenues:	
Interest and investment income fund	\$ 619,859
Tobacco settlement revenue	797,714
Unclaimed lottery revenue	6,500,000
State General Fund revenue	203,673,961
Federal funds revenue	5,543
Other income	768,482
Contribution from Agency Operating Fund	<u>2,359,798</u>
Total Revenues	<u>214,725,357</u>
Expenditures:	
Kentucky Tuition Grant	28,680,413
College Access Program Grant	61,045,814
Mary Jo Young Scholarship	626,859
Early Childhood Development Scholarship	995,045
Kentucky National Guard Tuition Award Program	5,680,227
Kentucky Educational Excellence Scholarship	107,866,852
Teacher Scholarship	1,263,932
Teacher Loan Forgiveness	1,400,000
Osteopathic Medicine Scholarship	705,347
Coal County Scholarship Program for Pharmacy Students	165,958
KHEAA Work Study Program	504,655
Go Higher Grant Program	297,812
Kentucky Coal County College Completion Scholarship	1,978,674
John R. Justice Grant	<u>140,429</u>
Total Expenditures	<u>211,352,017</u>
Net Change in Fund Balance	3,373,340
Fund Balance, July 1, 2014, Restated	<u>18,613,183</u>
Fund Balance, June 30, 2015	<u>\$ 21,986,523</u>

Statement of Fiduciary Net Position (Deficit)

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

June 30, 2015

ASSETS	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Education Savings Plan Trust
Current:			
Cash and cash equivalents	\$ 11,009,408	\$ 2,867,739	\$ 30
Contributions receivable		661,925	
Fees receivable		195,798	
Receivable from U.S. Department of Education	6,302,488		
Investments		101,687,668	180,068,341
Other current assets	<u>1,650</u>		<u>324,303</u>
Total Current Assets	17,313,546	105,413,130	180,392,674
Noncurrent:			
Contributions receivable		<u>1,425,832</u>	
Total Assets	<u>17,313,546</u>	<u>106,838,962</u>	<u>180,392,674</u>
LIABILITIES			
Current:			
Accounts payable	6,716	144,534	324,303
Accrued expenses			131,168
Current portion of reinsurance reserve	<u>499,899</u>		
Total Current Liabilities	506,615	144,534	455,471
Noncurrent:			
Reinsurance reserve, less current portion	3,584,574		
Payable to Agency Operating Fund	1,677,487		
Tuition benefits payable		<u>130,748,696</u>	
Total Liabilities	<u>5,768,676</u>	<u>130,893,230</u>	<u>455,471</u>
NET POSITION			
Restricted for program benefits		(24,054,268)	179,937,203
Restricted for other purposes	<u>11,544,870</u>		
Total Net Position (Deficit)	<u>\$ 11,544,870</u>	<u>\$ (24,054,268)</u>	<u>\$ 179,937,203</u>

Statement of Changes in Fiduciary Net Position (Deficit)

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

For Year Ending June 30, 2015

	Federal Student Loan Reserve Fund	Kentucky's Affordable Prepaid Tuition	Kentucky Education Savings Plan Trust
Additions:			
Federal reinsurance	\$ 72,521,422	\$	\$
Contribution from Agency Operating Fund	2,500,000		
Contract income, net		323,244	
Subscriptions			56,353,397
Investment Revenues:			
Net unrealized gain (loss) on investments		(7,351,587)	381,410
Interest and investment income	1,287	11,351,190	3,268,410
Other income	3,598,440		
	<u>78,621,149</u>	<u>4,322,847</u>	<u>60,003,217</u>
Deductions:			
Program benefits:			
Loan claims	78,638,831		
Default aversion fee expense	(501,501)		
Redemptions			53,076,389
Administrative expenses		52,793	720,193
Personnel and professional expenses		417,111	
Refunds		2,553,305	
Trustee fee expense		320,996	
Tuition benefits expense, net		2,032,931	
	<u>78,137,330</u>	<u>5,377,136</u>	<u>53,796,582</u>
Change in Net Position	483,819	(1,054,289)	6,206,635
Net Position (Deficit), July 1, 2014	<u>11,061,051</u>	<u>(22,999,979)</u>	<u>173,730,568</u>
Net Position (Deficit), June 30, 2015	<u>\$ 11,544,870</u>	<u>\$ (24,054,268)</u>	<u>\$ 179,937,203</u>

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

June 30, 2015

Note A--Description of Business

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

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

Loan Guarantee Operations

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

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

June 30, 2015

Note A--Description of Business--Continued

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

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

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

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

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

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

June 30, 2015

Note A--Description of Business--Continued

Loan Finance and Servicing Operations

The Corporation is an independent *de jure* municipal corporation established by the Kentucky General Assembly in 1978 to provide a loan finance program for post-secondary students in the Commonwealth of Kentucky. The Corporation is authorized to finance loans for students attending eligible post-secondary institutions, service and collect education loans, and issue bonds and notes not to exceed \$5 billion in order to carry out its corporate powers and duties.

The Authority/Corporation's finance, servicing and collection activities include: (i) the origination and acquisition of education loans; (ii) the financing of FFELP and KAEL loans; (iii) the servicing of FFELP, KAEL, certain federal and other education loans; and (iv) the collection of FFELP, KAEL, certain federal and other education loans for other holders on a commission or cost reimbursement basis. FFELP student loans held, serviced and collected by the Authority/Corporation include Federal Stafford Loans ("Stafford"), Unsubsidized Stafford Loans ("Unsubsidized Stafford"), Federal Supplemental Loans for Students ("SLS"), Federal Parent Loans for Undergraduate Students ("PLUS") and Federal Consolidation Loans ("Consolidations").

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

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

As of June 30, 2015 the Authority/Corporation held and serviced approximately \$1.17 billion outstanding principal amount of FFELP and other education loans. \$1.08 billion of loans were pledged pursuant to the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, and the 2015 Indenture. The remaining \$89 million of loans were funded by the Corporation's Operating Fund. Also, the Authority/Corporation services approximately \$4 million of FFELP and other education loans on behalf of other holders. The majority of such education loans are serviced by the Authority/Corporation pursuant to servicing agreements which do not provide for the acquisition by the Authority/Corporation of the education loans serviced. As a servicer of FFELP and other education loans, the Authority/Corporation collects student loan remittances and subsequently disburses these remittances to the appropriate lending entities. The Authority/Corporation's obligations pursuant to such servicing and collection agreements are without recourse to assets pledged to collateralize any Authority/Corporation financings.

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

June 30, 2015

Note A--Description of Business—Continued

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

Kentucky Educational Savings Plan Trust

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

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

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

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

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

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

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

June 30, 2015

Note A--Description of Business--Continued

Prepaid Tuition Plan

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

On July 1, 2005, governance of the Plan permanently transferred to the Authority/Corporation. The Plan was established to provide families with an opportunity to save for future postsecondary education expenses. The Plan investment policy goal is to earn rates of return that closely match tuition inflation rates and remain sufficiently liquid to meet KAPT benefit payments in a timely manner. The Plan offered enrollment periods in fiscal years 2002, 2003 and 2005, for purchasers to buy prepaid tuition contracts. The Plan offers certain federal and state tax advantages to purchasers. There have been no enrollment periods since fiscal year 2005 as the Plan currently maintains an accumulated net deficit of approximately \$24.1 million.

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

Participants were allowed to elect to spread payments to the Plan over three, five or seven years or until the anticipated year of the student's enrollment in a qualified postsecondary education institution. Participants may use Plan benefits for eligible educational expenses at any eligible public or private vocational school, college or university in the United States. If a beneficiary attends an eligible educational institution with tuition rates in excess of Plan benefits, the Plan will not be responsible for the difference. If a beneficiary attends an eligible educational institution with tuition rates less than Plan benefits, participants may use the difference for other qualified educational expenses such as room, board, books and supplies.

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

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

June 30, 2015

Note A--Description of Business--Continued

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

As of June 30, 2015, the Plan maintained a present value fund deficit of \$24.1 million. This represents a \$1.1 million increase over the previous year's deficit. Based on actuarial estimates, the Plan's assets will be exhausted in fiscal year 2023, at which time the liability of the Plan becomes a General Obligation of the Commonwealth of Kentucky. Per KRS 164A.708, once a real liability is expected to accrue, the General Assembly shall appropriate the necessary funds to meet the liability. Over the remaining estimated life of the program, through fiscal year 2028, actuarial estimates show the Commonwealth of Kentucky will need to transfer approximately \$44 million.

Student Aid Programs

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

Outreach Programs

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

**Kentucky Higher Education Assistance Authority
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Note B--Summary of Significant Accounting Policies

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

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

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

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

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

**Kentucky Higher Education Assistance Authority
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Note B--Summary of Significant Accounting Policies--Continued

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

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

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

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

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

Large Cap U.S. stocks	30%
Mid Cap U.S. stocks	5%
Small Cap U.S. stocks	4%
Non-U.S. stocks	9%
	<hr/>
Total Equity	48%
	<hr/>
Inflation indexed bonds	7%
Domestic fixed income	44%
Cash	1%
	<hr/>
Total Fixed Income	52%
	<hr/> <hr/>

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

June 30, 2015

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

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

- i. No more than 5% of the total amount of the equity portion of the investment account in the securities of any one issuer;
- ii. No more than 25% of the total amount of the equity portion of the investment account in any one industry, as defined by Standard & 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.

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

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

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

**Kentucky Higher Education Assistance Authority
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June 30, 2015

Note B--Summary of Significant Accounting Policies—Continued

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

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

Allowance for Uncollectible Loans - As discussed in Note A, most FFELP loans held by the Authority/Corporation are insured by guarantee agencies and the USDE. Management of the Authority/Corporation believes that all of the respective guaranty agencies and the USDE will be able to honor all loan claims submitted. However, the Authority/Corporation records a provision for loan losses based upon its expected default claims with respect to 98% and 97% insured loans and for loans with certain loan servicing violations. The allowance for loan loss on all loans funded through normal operations was \$7.3 million for loan principal and \$643,000 for accrued interest as of June 30, 2015. Furthermore, the Authority/Corporation is required to purchase loans owned by third party customers with certain loan servicing violations. As of June 30, 2015, the allowance for third party servicing loan losses for loans that have been purchased was \$1.4 million for loan principal and \$583,000 for accrued interest. In addition, the Authority/Corporation records a provision for loan loss related to Teacher and Osteopathic Medicine advances that have converted to loans. As of June 30, 2015, the allowance for advances converted to loans was \$3.8 million.

Pensions - For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Kentucky Employees Retirement System (KERS) and additions to/deductions from KERS' fiduciary net position have been determined on the same basis as they are reported by KERS. For this purpose, benefit payments (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms. Investments are reported at fair value.

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

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

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

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

Deferred Gain on Early Retirement of Debt - In accordance with GASB No. 23, *Accounting and Financial Reporting of Debt Reported by Proprietary Activities*, the Authority/Corporation defers any

**Kentucky Higher Education Assistance Authority
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June 30, 2015

Note B--Summary of Significant Accounting Policies—Continued

gains related to early retirement associated with a refinancing of debt over the shorter of the remaining life of the old debt or the life of the new debt.

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

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

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

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

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

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

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

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

June 30, 2015

Note B--Summary of Significant Accounting Policies—Continued

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

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

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

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

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

Note C--Cash and Investments

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

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

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

**Kentucky Higher Education Assistance Authority
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June 30, 2015

Note C--Cash and Investments--Continued

Custodial Credit Risk and Interest Rate Risk - Custodial credit risk is the risk that in the event of a bank failure, the Authority/Corporation's deposits may not be returned to it. The Authority/Corporation's investment policy does not contain a requirement for the collateralization of cash and investments nor does it require investments to be maintained in the Authority/Corporation's name. As of June 30, 2015, Authority/Corporation's Proprietary Funds, Governmental Fund and Fiduciary Funds maintained cash on deposit is as follows:

Of the \$92.1 million of cash and cash equivalents maintained in the Proprietary Funds, \$17.1 million was held for guarantee operations and the remaining \$75 million was held for loan finance and servicing activities.

Of the \$13.9 million of cash and cash equivalents maintained in the Fiduciary Funds, \$11 million was related to the FSLRF and the remaining \$2.9 million was associated with the Plan.

	Governmental Fund Bank Balance	Proprietary Fund Bank Balance	Fiduciary Fund Bank Balance
	<u> </u>	<u> </u>	<u> </u>
FDIC Insured	\$	\$ 484,033	\$ 506,124
Uninsured		1,003,136	
Collateralized by securities held by the pledging financial institution		7,457,102	9,039,752
Money market demand deposits			
Money market securities		79,011,773	4,256,092
Cash deposited with Kentucky State Treasurer	3,670,700	4,123,570	80,830
	<u>\$ 3,670,700</u>	<u>\$ 92,079,614</u>	<u>\$ 13,882,798</u>

Notes to Financial Statements--Continued

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

June 30, 2015

Note C--Cash and Investments--Continued

As of June 30, 2015, all Proprietary Funds investments were registered in the Authority/Corporation's name and maintained by an external trustee or investment manager, as applicable. The investment balances as of June 30, 2015 are summarized as follows:

	<u>Fair Value</u>	<u>Weighted Average Maturity (in years)</u>
Corporate bonds	\$ 40,095,247	2.52
U.S. Treasury and government agency securities	33,750,885	1.54
Collateralized mortgage obligations	<u>6,407,800</u>	10.21
	<u>\$ 80,253,932</u>	

As of June 30, 2015, Trust investments of \$180.1 million comprised entirely of TIAA mutual funds.

As of June 30, 2015, Plan investments of \$101.7 million comprised primarily of mutual funds held by State Street Global Advisors.

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

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

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

June 30, 2015

Note C--Cash and Investments--Continued

Credit Risk - The Authority/Corporation's investment policy limits the credit risk for securities. Securities must have a credit rating of BBB by a nationally recognized credit rating agency. Money Market Securities must be rated A-1 or P-1 or better at the time of purchase. The investment manager is allowed to hold up to 5% in aggregate market value securities that have been downgraded below BBB, but must maintain an average rating of A for the total portfolio. The following table summarizes the Standard & Poors / Moody's rating (as applicable) for all corporate bonds held by the Authority/Corporation's Proprietary Funds as of June 30, 2015:

<u>Rating</u>	<u>Fair Value</u>
AAA / Aaa	\$ 16,026,122
AA / Aa	4,206,850
A / A	9,590,314
BAA / Baa	<u>10,271,961</u>
	<u>\$ 40,095,247</u>

The Plan maintains an investment policy that limits the credit risk for fixed income securities and short-term commercial paper. No more than 10% of the total amount of fixed-income portion of the investment account shall be committed to the securities of any one issuer at the time of purchase, with the exception of securities issued or guaranteed by the full faith and credit of the United States or AAA-rated securities issued by government agencies as to which there is no limit. The Plan may invest in short-term commercial paper of any domestic issuer, maturing within 9 months, with a minimum rating of A-1 by Standard & Poors or Prime 1 by Moody's. As previously noted, at June 30, 2015 the Plan primarily invested in mutual funds.

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Kentucky Higher Education Student Loan Corporation**

June 30, 2015

Note D--Fixed Assets

A summary of fixed assets follows:

	Beginning Balance July 1, 2014	Additions	Disposals	Ending Balance June 30, 2015
Proprietary fund:				
Furniture and equipment	\$ 14,187,991	\$ 731,102	\$ 581,372	\$ 14,337,721
Building	12,072,407	2,642		12,075,049
System development	55,955			55,955
Student loan servicing	541,131			541,131
Debt recovery system	791,556			791,556
Accumulated depreciation and amortization	<u>(18,872,578)</u>	<u>(984,994)</u>	<u>(581,372)</u>	<u>(19,276,200)</u>
	<u>\$ 8,776,462</u>	<u>\$ (251,250)</u>	<u>\$</u>	<u>\$ 8,525,212</u>
Fiduciary Fund:				
Furniture and equipment	\$ 68,217	\$	\$ (529)	\$ 67,688
Accumulated depreciation	<u>(68,217)</u>	<u></u>	<u>529</u>	<u>(67,688)</u>
	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>

Depreciation and amortization expense totaled \$984,994 for the year ended June 30, 2015, of which \$859,763 was allocated to business-type activities, \$116,670 allocated to governmental activities, and \$8,561 allocated to the fiduciary activities.

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

	TOTAL
Loan guarantee operations	\$ 606,342
Default collections	148,673
Loan finance and servicing	<u>104,748</u>
	<u>\$ 859,763</u>

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

June 30, 2015

Note D--Fixed Assets--Continued

The Authority/Corporation has assets under capital lease agreements, as described in Note I, of \$12,075,048 with related accumulated amortization of \$4,889,769. Amortization of assets under capital lease is included in amortization expense in the accompanying combined financial statements. Amortization expense of assets under capital lease agreements was \$402,458 for the year ended June 30, 2015.

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

Pursuant to FFELP, the loan guarantee operating unit of Authority/Corporation insures eligible student loans for losses incurred from the default, death, disability, or bankruptcy and also insures for other losses such as school closures and false certifications. As of June 30, 2015, the outstanding balance of aggregate insured student loans was approximately \$2.27 billion.

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

The Authority/Corporation's annual default claims rate is within the 5%, which allows for reimbursement rates at the highest level. Due to the reduction of the Federal reimbursement rate for loans made subsequent to October 1, 1993, the Authority/Corporation has recorded a reserve of \$4.1 million at June 30, 2015 for losses on federal reinsurance.

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

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

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

June 30, 2015

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

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

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

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

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

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

Default Aversion Fees ("DAF") - Default aversion fees were established under the 1998 Amendments. The Authority/Corporation receives DAF for its aversion activities on delinquent loans at the time lenders request default aversion assistance. DAF 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 are recorded monthly and is recognized as a deduction in the FSLRF and as revenue in the AOF. DAF are remitted back to the FSLRF for loans that default.

Note F--Loans (Finance and Servicing Operations)

The Authority/Corporation originates private supplemental loans, purchases loans and holds various types of student loans as described in Note A. The terms of these loans, which vary on an individual basis depending upon loan type and the date the loan was originated, generally provide for repayment in monthly installments of principal and interest over a period of up to thirty years for consolidation loans and generally up to ten years for other loans. The repayment period begins after a grace period of six months following graduation or loss of qualified student status for the Subsidized and Unsubsidized Stafford loans. The repayment period for Consolidation, SLS and PLUS loans begins within 60 days from the date the loan is fully disbursed. Statutory interest rates on student loans ranged from 1.73% to 12% for the fiscal year ended June 30, 2015 depending upon the type and date of origination of the individual loan. Actual rates may be lower due to interest rate reductions associated with payments via electronic funds transfer or for other reasons such as borrowers making a specified number of consecutive on-time payments.

**Kentucky Higher Education Assistance Authority
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June 30, 2015

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

Loans consist of the following at June 30, 2015:

Stafford - Subsidized	\$ 326,142,684
Stafford - Unsubsidized	368,664,822
PLUS/SLS	26,034,077
Consolidation	422,829,323
Supplemental	25,099,428
Other	<u>1,224,846</u>
Total gross loans	1,169,995,180
Allowance for loan losses	(8,713,750)
Loan rebate due to borrowers	(500,000)
Unamortized discount on purchase of loans	(2,017,359)
Unamortized premium on purchase of loans	<u>392,771</u>
Loans, net	1,159,156,842
Less amount shown as current assets	<u>135,303,565</u>
Noncurrent loans, net	<u><u>\$ 1,023,853,277</u></u>

All principal and accrued interest on FFELP student loans is insured against borrower death, disability, bankruptcy or default, as long as the Authority/Corporation performs all required loan servicing due diligence activities. As of June 30, 2015, \$2,856,682 of student loans were no longer insured due to violations of due diligence requirements. Loan rebate due to borrowers represents the additional loan forgiveness described in Note H.

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

Note G--Special Allowance

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

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

June 30, 2015

Note H--Loan and Other Forgiveness

During fiscal year 2015, the Authority/Corporation forgave approximately \$4 million in loan principal and accrued interest for teachers funded by USDE, and an additional \$1.4 million in loan forgiveness for teachers funded by the Commonwealth of Kentucky. Also, during fiscal year 2015, the Authority/Corporation provided additional loan forgiveness of \$536,252.

The Authority/Corporation's Board of Directors approved \$500,000 of additional loan forgiveness for best in program borrowers who were employed in the Commonwealth, which was accrued as of June 30, 2015 and is scheduled to be provided in the fall of 2015.

The Agency Operating Fund of the Authority/Corporation contributed \$2.5 million to the Federal Student Loan Reserve Fund during fiscal year 2015. The contribution was facilitated through a \$2.5 million reduction in the receivable/payable between the two funds.

Note I--Capital Lease Payable

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

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

In connection with the issuance of the bonds, the Authority/Corporation entered into a financing/lease agreement with the Commission whereby the Authority/Corporation agreed to lease the newly constructed building. The Authority/Corporation renewed the lease for the biennium ending June 30, 2016 and has the right to renew for three additional two-year periods.

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

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

Notes to Financial Statements--Continued

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

June 30, 2015

Note I--Capital Lease Payable--Continued

A summary of the activity for the capital lease for the year ended June 30, 2015 is as follows:

	<u>June 30, 2014</u>	<u>Additions</u>	<u>Payments</u>	<u>June 30, 2015</u>
Capital Lease Payable	<u>\$ 3,760,000</u>	<u>\$</u>	<u>\$ 550,000</u>	<u>\$ 3,210,000</u>

Debt service requirements for the final five fiscal years are as follows:

Year Ending June 30,	<u>Principal</u>	<u>Interest</u>
2016	\$ 580,000	\$ 164,592
2017	610,000	135,268
2018	640,000	103,663
2019	670,000	72,013
2020	710,000	37,275
	<u>\$ 3,210,000</u>	<u>\$ 512,811</u>

Continued

Notes to Financial Statements--Continued

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

June 30, 2015

Note J--Revenue Bonds and Notes Payable

The balance of revenue bonds and notes payable at June 30, 2015 and the related activity for the year ended June 30, 2015 is as follows:

<u>Series</u>	<u>Scheduled Maturity</u>	<u>Interest Rate</u>	<u>Beginning Balance July 1, 2014</u>	<u>Bond Maturities & Refundings</u>	<u>New Issues</u>	<u>Amortization of Premium / (Discount)</u>	<u>Ending Balance June 30, 2015</u>
1997 General Bond Resolution							
1998 A-1	May 1, 2028	28 days	\$ 2,000,000	\$ (2,000,000)	\$	\$	\$
1998 B *	May 1, 2028	35 days	3,000,000	(3,000,000)			
1999 A	May 1, 2029	28 days	3,500,000	(3,500,000)			
1999 B *	May 1, 2029	35 days	750,000	(750,000)			
2000 A-1	May 1, 2030	28 days	4,300,000	(4,300,000)			
2000 A-2	May 1, 2030	28 days	50,000	(50,000)			
2001 A-1	May 1, 2031	35 days	2,900,000	(2,900,000)			
2001 A-2	May 1, 2031	35 days	4,900,000	(4,900,000)			
2002 A-1	May 1, 2032	28 days	1,600,000	(1,600,000)			
2002 A-3 *	May 1, 2032	35 days	24,950,000	(24,950,000)			
			<u>47,950,000</u>				
2008 Indenture							
2008 A-1 *	June 1, 2037	Weekly	73,720,000	(2,300,000)			71,420,000
2008 A-2 *	June 1, 2038	Weekly	58,125,000	(6,800,000)			51,325,000
			<u>131,845,000</u>				<u>122,745,000</u>
2010 Indenture							
2010 A-2 *	May 1, 2034	Quarterl	134,810,000	(14,435,000)			120,375,000
2013-1 Indenture							
2013-1	June 1, 2026	Monthly	463,950,000	(89,525,000)			374,425,000
2013-2 Indenture							
2013-2	June 1, 2028	Monthly	358,356,331	(62,256,000)		174,612	296,274,943
2014 Indenture							
2014 A *	June 1, 2031	Fixed	22,284,450	(1,345,000)		(136,101)	20,803,349
2015-1 Indenture							
2015-1	December 1, 2031	Monthly		(3,705,000)	134,605,000		130,900,000
			<u>\$ 1,159,195,781</u>	<u>\$ (228,316,000)</u>	<u>\$ 134,605,000</u>	<u>\$ 38,511</u>	<u>\$ 1,065,523,292</u>

*This bond series is tax-exempt.

Notes to Financial Statements--Continued

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

June 30, 2015

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

The Authority/Corporation's revenue bonds include fixed and variable rates of interest based on various index rates. Those fixed rates and variable index rates ranged from 0.06% to 5.0% as of June 30, 2015.

Debt service requirements to maturity or redemption date, assuming interest rates based on fixed rates and variable index rates at June 30, 2015, are as follows:

	Principal Repayment Amount (Thousands)						Total
	2008 Indenture	2010 Indenture	2013-1 Indenture	2013-2 Indenture	2014 Indenture	2015-1 Indenture	
Year Ending June 30, 2016	\$	\$	\$	\$	\$ 850	\$	\$ 850
4 Years Ending June 30, 2020					4,500		4,500
5 Years Ending June 30, 2025					4,500		4,500
5 Years Ending June 30, 2030			374,425	298,574	8,455		681,454
5 Years Ending June 30, 2035		120,375			2,000	130,900	253,275
3 Years Ending June 30, 2038	122,745						122,745
	<u>\$ 122,745</u>	<u>\$ 120,375</u>	<u>\$ 374,425</u>	<u>\$ 298,574</u>	<u>\$ 20,305</u>	<u>\$ 130,900</u>	<u>\$1,067,324</u>

	Interest Payments Amount (Thousands)						Total
	2008 Indenture	2010 Indenture	2013-1 Indenture	2013-2 Indenture	2014 Indenture	2015-1 Indenture	
Year Ending June 30, 2016	\$ 72	\$ 1,785	\$ 2,572	\$ 2,350	\$ 854	\$ 1,227	\$ 8,860
Year Ending June 30, 2017	72	1,785	2,572	2,350	828	1,227	8,834
Year Ending June 30, 2018	72	1,785	2,572	2,350	792	1,227	8,798
Year Ending June 30, 2019	72	1,785	2,572	2,350	732	1,227	8,738
Year Ending June 30, 2020	72	1,785	2,572	2,350	696	1,227	8,702
5 Years Ending June 30, 2025	363	8,926	12,863	11,748	2,695	6,132	42,727
5 Years Ending June 30, 2030	363	8,926	2,572	7,049	1,019	6,132	26,061
5 Years Ending June 30, 2035	363	7,141			90	1,226	8,820
3 Years Ending June 30, 2038	175						175
	<u>\$ 1,624</u>	<u>\$ 33,918</u>	<u>\$ 28,295</u>	<u>\$ 30,547</u>	<u>\$ 7,706</u>	<u>\$ 19,625</u>	<u>\$ 121,715</u>

Continued

Notes to Financial Statements--Continued

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

June 30, 2015

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

The Authority/Corporation entered into an irrevocable direct pay Letter of Credit and Reimbursement Agreement ("LOC") with two banks relating to the Series 2008 Bonds in the amount of \$300,000,000 issued on June 18, 2008. The LOC was issued in an amount (the "Original Stated Amount") equal to the sum of (i) the aggregate principal amount of the outstanding Series 2008A-1 Bonds and the Series 2008A-2 Bonds, plus an amount equal to 202 days of interest thereon at a rate of 14% per annum plus (ii) the aggregate principal amount of the outstanding Series 2008A-3 Bonds, plus an amount equal to 51 days of interest thereon at a rate of 18% per annum. The LOC had an original maturity date of June 17, 2011. The Authority/Corporation and the banks extended the Stated Expiration Date as defined in the LOC to October 14, 2011. On September 8, 2011, the Stated Expiration Date as defined in the LOC was extended to September 13, 2013. On February 19, 2013 a portion of the outstanding Series 2008 Bonds were redeemed pursuant to a Mandatory Tender. On February 20, 2013 an amended LOC was entered into with one of the two banks in an amount of \$142,060,278 representing outstanding principal (\$131,845,000) and accrued interest (\$10,215,278) calculated as described above. At June 30, 2015, there was no balance nor has there been activity on the LOC.

All assets of the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, and the 2015 Indenture are pledged for repayment of the specific bond or note issues under each resolution or program.

Note K--Allowance for Arbitrage Liabilities

Certain of the Authority/Corporation's tax-exempt bond issues are subject to potential arbitrage liabilities under U.S. tax law. Arbitrage liabilities, under current federal income tax law regarding tax-exempt bond issues, consist of three types; (1) yield adjustment payments, (2) forgiveness and (3) arbitrage rebate. At June 30, 2015, the Authority/Corporation is reporting a liability for arbitrage rebate of zero.

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.

Notes to Financial Statements--Continued

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

June 30, 2015

Note K--Allowance for Arbitrage Liabilities--Continued

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

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

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

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

Note L--Deferred Gain on Retirement of Debt

In fiscal year 2010, the Authority/Corporation purchased \$1.198 billion of its own auction rate securities and retired the debt. The resulting \$80.2 million of gain was deferred and is being amortized over the life of the new debt. In addition in fiscal year 2014, the Authority/Corporation purchased \$358.65 million of its own auction rate securities and retired the debt. This resulted in an additional \$7.2 million of gain which was deferred and is being amortized over the remaining life of the old debt. The Authority/Corporation recognized a gain of \$1.8 million for the year ended June 30, 2015. The Authority/Corporation retired additional debt during fiscal year 2015 with cash and recognized approximately \$109,000 as income in the current period.

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

June 30, 2015

Note M--Retirement Plans

Plan Description. Employees of the Authority/Corporation participate in Kentucky Employees Retirement systems (KERS), a cost-sharing multiple-employer defined benefit pension plan administered by Kentucky Retirement Systems (KRS). KRS is governed by Kentucky Revised Statutes 61.510 through 61.705 and can only be modified by the state legislature.

Benefits Provided. KERS provides retirement, disability, and death benefits. Benefit provisions are established by state statute and can only be modified by the state legislature.

All regular full-time employees of the Authority/Corporation are covered by KERS. A regular full-time employee is an employee that averages one hundred or more hours per month over a calendar or fiscal year. KERS consist of three tiers:

- Tier 1: Participation prior to September 1, 2008
- Tier 2: Participation on or after September 1, 2008 to December 31, 2013
- Tier 3: Participation on or after January 1, 2014

For Tiers 1 and 2, the benefit paid is based on the following formula: Final Compensation X Benefit Factor X Years of Service = Annual Benefit. For Tier 3, the benefit paid is based on the member's accumulated account balance at the time of retirement.

In 2013, all Cost of Living Adjustments (COLA's) were eliminated unless the State Legislature so authorizes on a biennial basis and either (1) the system is over 100% funded or (2) the Legislature appropriates sufficient funds to prepay the increased liability for the COLA.

Contributions. Kentucky statutes set the rates for employer and employee contributions. Contributions rates can only be modified by the state legislature.

The employer and each employee contribute a percentage of the employee's creditable compensation. Creditable compensation consists of all wages includable on the employee's Federal Form W-2, Wage and Tax statement, under the heading "Wages, Tips, and Other Compensation". There are two exceptions of payment of wages not included in creditable compensation: (1) the lump-sum compensatory leave payments to employees in Tier 2 and 3 and (2) vacation payout at termination. The employer total contribution rate for FY15 was 38.77% comprised of 30.84% for pension contributions and 7.93% for insurance contributions. The employer total contribution rate for FY14 was 26.79% comprised of 17.29% for pension contributions and 9.5% for insurance contributions. The employee's contribution rates are as follows: Tier 1 - 5%, Tier 2 and 3 - 6%.

Notes to Financial Statements--Continued

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

June 30, 2015

The contributions for the employer and employee are as follows:

	<u>FY15</u>
Authority: Employer	\$ 475,279
Authority: Employee	78,959
	<u>554,238</u>
Corporation: Employer	4,149,106
Corporation: Employee	717,270
	<u>4,866,376</u>
Total: Employer	4,624,385
Total: Employee	796,229
	<u>\$ 5,420,614</u>

The employer is responsible for additional contributions if pension spiking occurs. Pension spiking may be deemed to have occurred for certain large compensation increases in the five years immediately preceding retirement. Kentucky Revised Statute 61.598 requires the last participating employer, for employees retiring on or after January 1, 2014, to pay for any additional actuarial costs resulting from annual increases in an employee's creditable compensation greater than ten percent over the employee's last five fiscal years of employment that are not a direct result of a bona fide promotion or career advancement.

Pension Costs. At June 30, 2015, the Authority/Corporation reported a net pension liability of \$80,527,000 for its proportionate share of the KERS's net pension liability. The Authority's portion is \$9,093,000 and the Corporation's is \$71,434,000. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by the actuarial valuation as of that date. The Authority/Corporation's estimated proportionate share of the collective net pension liability was based on a projection of the Authority/Corporation's long-term share of contributions to the pension plan relative to the projected contributions of all employer participants, as actuarially determined. The Authority's contributions during the measurement period were \$449,460 with a proportionate share percentage of .101355%. The Corporation's contributions during the measurement were \$3,530,779 with a proportionate share percentage of .796208%.

Notes to Financial Statements--Continued

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

June 30, 2015

For the year ended June 30, 2015, the Authority/Corporation recognized pension expense of \$6,086,000 for its proportionate share of KERS's pension expense. The Authority's portion was \$687,000 and the Corporation's was \$5,399,000.

At June 30, 2015, the Authority reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

<u>Authority</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between projected and actual investment earnings	\$	\$ 117,000
Authority's contributions to KERS subsequent to the measurement date	475,279	
	<u>\$ 475,279</u>	<u>\$ 117,000</u>

\$475,279 reported as deferred outflows of resources related to pensions resulting from the Authority's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2016. Other amounts reported as deferred outflows and inflows of resources related to KERS pensions will be recognized in pension expense as follows:

Year ended June 30	<u>Authority</u>
2016	\$ (29,250)
2017	(29,250)
2018	(29,250)
2019	(29,250)
	<u>\$ (117,000)</u>

Notes to Financial Statements--Continued

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

June 30, 2015

At June 30, 2015, the Corporation reported its proportionate share of KERS's deferred outflows of resources and deferred inflows of resources, and its contributions subsequent to the measurement date, from the following sources:

<u>Corporation</u>	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Difference between projected and actual investment earnings	\$	\$ 918,000
Corporation's contributions to KERS subsequent to the measurement date	4,149,106	
	<u>\$ 4,149,106</u>	<u>\$ 918,000</u>

\$4,149,106 reported as deferred outflows of resources related to pensions resulting from the Corporation's contributions to KERS subsequent to the measurement date will be recognized as a reduction of the net pension liability in the year ended June 30, 2016. Other amounts reported as deferred outflows and inflows of resources related to KERS pensions will be recognized in pension expense as follows:

Year ended June 30	Corporation
2016	\$ (229,500)
2017	(229,500)
2018	(229,500)
2019	(229,500)
	<u>\$ (918,000)</u>

Actuarial Assumptions. The total pension liability in the June 30, 2014, actuarial valuation was determined using the entry age normal actuarial cost method and the following actuarial assumptions:

<u>Assumptions</u>	<u>Percentage</u>
Inflation	3.50% per year
Active Member Payroll Growth	4.50% per year
Investment Rate of Return	7.75% per year

Salary increases were based on a service-related table.

Notes to Financial Statements--Continued

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

June 30, 2015

The rates of mortality for the period after service retirement are according to the 1983 Group Annuity Mortality Table for all retired members and beneficiaries as of June 30, 2006 and the 1994 Group Annuity Mortality Table for all other members.

The actuarial assumptions used in the June 30, 2014, valuation were based on the results of an actuarial experience study for the period July 1, 2005 - June 30, 2008.

The long-term expected rate of return on pension plan investments is reviewed as part of the regular experience studies prepared every five years. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data, and a log-normal distribution analysis in which best estimate ranges of expected future real rates of return were developed by the investment consultant for each major asset class. These ranges were combined to produce the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected inflation.

The target allocation and arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Long Term Expected Real Rate of Return</u>	<u>Target Allocation</u>
Domestic Equity	8.45%	30.00%
International Equity	8.85%	22.00%
Emerging Market Equity	10.50%	5.00%
Private Equity	11.25%	7.00%
Real Estate	7.00%	5.00%
Core US Fixed Income	5.25%	10.00%
High Yield US Fixed Income	7.25%	5.00%
Non US Fixed Income	5.50%	5.00%
Commodities	7.75%	5.00%
TIPS	5.00%	5.00%
Cash	3.25%	1.00%
Total		100.00%

The long-term expected rate of return on plan assets is 7.75%, which was established by the Board of Trustees of the Kentucky Retirement Systems based on a blending of the factors described above.

Discount Rate. The discount rate used to measure the total pension liability was 7.75%. The projection of cash flows used to determine the discount rate assumed employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 29 year amortization period

Continued

Notes to Financial Statements--Continued

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

June 30, 2015

of the unfunded actuarial accrued liability. The actuarial determined contribution rate is adjusted to reflect the phase in of anticipated gains on actuarial value of assets over the first four years of projection period.

Pension Liability Sensitivity. The following table presents the Authority/Corporation's proportionate share of the net pension liability in KRS, calculated using the discount rate disclosed in the preceding paragraph, as well as what the Authority/Corporation's proportionate share of the net pension liability would be if it were calculated using a discount rate 1 percentage point lower or 1 percentage point higher than the current discount rate:

	<u>1% Decrease in Discount Rate</u>	<u>Discount Rate</u>	<u>1% Increase in Discount Rate</u>
KRS Discount Rate	6.75%	7.75%	8.75%
Authority's proportionate share of net pension liability	\$ 10,229,000	\$ 9,093,000	\$ 8,068,000
Corporation's proportionate share of net pension liability	\$ 80,361,000	\$ 71,434,000	\$ 63,385,000

Pension Plan Fiduciary Net Position. Detailed information about KERS's fiduciary net position is available in a KRS financial report. That report may be obtained on the Internet at www.kyret.ky.gov; by writing to Kentucky Retirement Systems at Perimeter Park West, 1260 Louisville Road, Frankfort, KY 40601; or by calling 1-800-928-4646.

Note N--Tuition Benefit Payable

The following assumptions provided by management were used in the actuarial valuation of tuition benefits payable as of June 30, 2015. These assumptions are based on national and state specific economic data, previous program actuarial valuation reports, historical state general fund appropriations to the University of Kentucky and KCTCS, actual tuition increases from previous years (2002-2014) and other state prepaid tuition programs' annual tuition inflation assumptions.

Investment Rates - The investment yield assumption is based on estimates of the yields that will be available on the investment portfolio and cash and cash equivalents. The gross investment yield assumption utilized in the calculation of the tuition benefit payable was 5.45% and 5.74% as of June 30, 2015 and June 30, 2014, respectively.

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

Notes to Financial Statements--Continued

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

June 30, 2015

Note N--Tuition Benefit Payable--Continued

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

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

Continued

Notes to Financial Statements--Continued

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

June 30, 2015

Note N--Tuition Benefit Payable--Continued

- As of June 30, 2015, the tuition increases for the 2015-2016 academic year were 2.0% for the Value Plan and 3.0% for the Standard Plan and the Premium Plan. The tuition increase assumption was 6.25% for the 2015-2016 academic year and 6.25% for each year thereafter.

For the period from inception to June 30, 2015, the annualized tuition increase for the highest-priced Kentucky public university, as applicable to the tuition benefits payout rate of Kentucky's Affordable Prepaid Tuition Standard and Premium Plans, which represents 94.8% of the Plan's enrollments, has been 8.2%. For the Kentucky Community and Technical College System ("KCTCS"), as applicable to the tuition benefits payout rate of the Value Plan, the average annualized tuition increase from inception to June 30, 2015, has been 9.3%.

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

Note O--Restricted Net Position

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

- Federal Student Loan Reserve Fund:** Net position is restricted for certain FFELP activities, primarily the payments of claims.
- Agency Operating Fund:** Net position is restricted for certain FFELP activities and other student aid activities.
- Education Finance Funds:** Net position is restricted as required by the 2008 Indenture, the 2010 Indenture, the 2013-1 Indenture, the 2013-2 Indenture, the 2014 Indenture, and the 2015 Indenture.
- Corporation Operating Fund:** Net position is primarily restricted for an estimated amount of mandatory repurchases of loans subject to bankruptcy claims.
- Student Aid Funds:** The Student Aid fund balance is restricted for the Student Aid Programs.
- The Trust:** Net position is restricted for use by trust participants.

Notes to Financial Statements--Continued

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

June 30, 2015

Note P--Operating Leases

The Authority/Corporation leases office space and equipment under agreements through 2022. Rental and space utilization expense was \$2,570,560 for the year ended June 30, 2015. Minimum future rental payments for real estate and equipment, including common area maintenance commitments, at June 30, 2015 are as follows:

Year Ending June 30,	
2016	\$ 1,456,760
2017	603,303
2018	648,085
2019	648,085
2020	648,085
Two Years Ending June 30,	
2021 - 2022	<u>1,243,273</u>
	<u>\$ 5,247,591</u>

Note Q--Commitments and Contingencies

The FSLRF is contingently liable for loans made by financial institutions that qualify for guarantee. The default ratio for loans guaranteed by the Authority/Corporation's loan guarantee operations is below 5% for the fiscal year ended June 30, 2015. The federal government's reinsurance rate for defaults 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, 2015 is calculated as follows:

Amount of guaranteed student loans outstanding at lenders	\$ 2,273,256,993
Less minimum federal government share - 75%	<u>1,704,942,745</u>
	<u>\$ 568,314,248</u>

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

June 30, 2015

Note R--Subsequent Events

On September 18, 2015, the Authority/Corporation executed a Warehouse Loan and Security Agreement with a commercial bank (the "Bank") to provide up to \$60,000,000 through a multi-draw term loan ("Credit Facility"). The Credit Facility is restricted to the acquisition of loans made through the Federal Family Education Loan Program and is collateralized by the loans financed with funds advanced by the Bank. In addition, this \$60,000,000 Credit Facility and an existing \$30,000,000 Line of Credit with the same Bank are cross-collateralized. Cash and marketable securities of the Operating Funds of the Authority/Corporation are pledged as collateral against any outstanding balance on the \$30,000,000 Line of Credit. The final date for advances on the Credit Facility is the earlier of the date the full \$60,000,000 is advanced or September 17, 2016. The maturity dates on the Credit Facility and the Line of Credit are September 17, 2017.

The Authority/Corporation entered into two separate agreements in June 2015 related to the federal loan servicing operations it is doing business as "KSA Servicing." The first agreement terminates KSA Servicing's relationship with its existing USDE federal loan servicer contingent upon the effective date of the second agreement, a new teaming arrangement with a different federal loan servicer that was approved by USDE. The teaming arrangement agreement shall constitute a transfer by KSA Servicing to the new federal loan servicer upon receipt of approval from USDE. On August 4, 2015, the first of five scheduled transfers of these loans occurred with the last of the five occurring on September 4, 2015. In addition, no telephone calls transferred to the KSA Servicing call center after August 31, 2015.

On June 23, 2015, the Authority/Corporation entered into a Loan Purchase Agreement with another student loan entity to acquire three portfolios of loans. The first of the three portfolios of loans was acquired for approximately \$16.44 million and converted to the Authority/Corporation's loan servicing system on June 26, 2015. The remaining two portfolios of loans were acquired and converted on July 10, 2015 for a total of approximately \$1.05 million.

Note S—Restatement

The Fund Balance of the Governmental Fund at June 30, 2014 was restated from \$34,729,285 to \$18,613,183. The \$16,116,102 decrease represents adjustments made to reduce accounts receivable by the sum of related student aid continuing appropriations recognized as revenue during the three previous fiscal years.

Note T - Recent Pronouncements

In February 2015, the GASB issued Statement No. 72, *Fair Value and Measurement and Application*. The requirements of this Statement are effective for financial statements for reporting periods beginning after June 15, 2015.

This statement establishes standards for valuation techniques to measure fair value. This statement establishes a hierarchy of inputs to valuation techniques used to measure fair value. This statement requires disclosures to be made about fair value measurements, the level of fair value hierarchy, and valuation techniques.

Notes to Financial Statements--Continued

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

June 30, 2015

In June 2015, the GASB issued Statement No. 75, *Accounting and Reporting for Postemployment Other Than Pensions*. The provisions of this statement are effective for fiscal years beginning after June 15, 2017.

This statement establishes new accounting and financial reporting requirements for OPEB plans. The scope of this Statement addresses accounting and financial reporting for OPEB that is provided to the employees of state and local governmental employers. This Statement establishes standards for recognizing and measuring liabilities, deferred outflows of resources, deferred inflows of resources, and expense/expenditures. For defined benefit OPEB, this Statement identifies the methods and assumptions that are required to be used to project benefit payments, discount projected benefit payments to their actuarial present value, and attribute that present value to periods of employee service. Note disclosure and required supplementary information requirements about defined benefit OPEB also are addressed.

The Authority/Corporation is currently evaluating the impact that will result from adopting GASB No. 72 and GASB No. 75 and is therefore unable to disclose the impact that adopting these Standards will have on the Authority/Corporation's financial position and the results of its operations when the Statement is adopted.

**Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Schedule of Proportionate Share of the Net Pension Liability and Related Ratios
June 30, 2014**

	<u>FY 2014</u>
Authority's proportion of the net pension liability	0.101355%
Authority's proportionate share of the net pension liability	\$ 9,093,000
Authority's covered-employee payroll	\$ 1,740,891
Authority's proportionate share of the net pension liability as a percentage of its covered-employee payroll	522.32%
Plan fiduciary net position as a percentage of the total pension liability	22.32%

	<u>FY 2014</u>
Corporation's proportion of the net pension liability	0.796208%
Corporation's proportionate share of the net pension liability	\$ 71,434,000
Corporation's covered-employee payroll	\$ 13,672,643
Corporation's proportionate share of the net pension liability as a percentage of its covered-employee payroll	522.46%
Plan fiduciary net position as a percentage of the total pension liability	22.32%

Total collective net pension liability for the Kentucky Employees Retirement System (KERS) non-hazardous employees	\$ 8,971,820,000
KERS' non-hazardous employees total fiduciary net position	\$ 2,578,290,000
KERS' non-hazardous employees total pension liability	\$ 11,550,110,000

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

**Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Required Supplementary Information
Schedule of Required Contributions**

	<u>FY 2014</u>
Authority's contractually required contribution	\$ 567,008
Authority's contributions in relation to the contractually required contribution	301,000
Authority's contribution deficiency	<u>\$ (266,008)</u>
Authority's covered-employee payroll	1,740,891
Authority's contributions as a percentage of covered-employee payroll	17.29%

	<u>FY 2014</u>
Corporation's contractually required contribution	\$ 4,453,180
Corporation's contributions in relation to the contractually required contribution	2,364,000
Corporation's contribution deficiency	<u>\$ (2,089,180)</u>
Corporation's covered-employee payroll	13,672,643
Corporation's contributions as a percentage of covered-employee payroll	17.29%

Note: Schedule is intended to show information for 10 years. Additional years will be displayed as they become available.

**Kentucky Higher Education Assistance Authority
Kentucky Higher Education Student Loan Corporation
Note to the Required Supplemental Information
June 30, 2014**

Actuarial valuation date	June 30, 2014
Actuarial cost method	Entry age
Amortization method	Level of percentage of payroll, closed
Remaining amortization period	29 years
Asset valuation method	5-year smoothed market
Inflation	3.50%
Projected salary increases	4.50%, average, including inflation
Investment rate of return	7.75%, net of investment expense, including inflation

See accompanying independent auditor's report.