Strothman & Company PSC

Certified Public Accountants & Advisors

Audited Financial Statements

Commonwealth Postsecondary Education Prepaid Trust Fund aka Kentucky's Affordable Prepaid Tuition

June 30, 2004

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Independent Auditor's Report

Board of Directors
Commonwealth Postsecondary Education Prepaid Trust Fund
aka Kentucky's Affordable Prepaid Tuition
Frankfort, Kentucky

We have audited the accompanying financial statements of Commonwealth Postsecondary Education Prepaid Trust Fund, also known as Kentucky's Affordable Prepaid Tuition (the "Plan"), a fiduciary fund of Kentucky Higher Education Assistance Authority, (a component unit of the Commonwealth of Kentucky), as of and for the year ended June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the Plan's management. Our responsibility is to express opinions on these financial statements based on our audit.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net deficit, as of June 30, 2004, and the respective changes in fiduciary net deficit of the Plan for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated September 17, 2004, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

The management's discussion and analysis on pages 3 through 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Strothman & Company PSC

Louisville, Kentucky
September 17, 2004

I. Description of Business:

The Commonwealth Postsecondary Education Prepaid Trust Fund, also known as Kentucky's Affordable Prepaid Tuition, or KAPT, (the "Plan"), was created by the 2000 Kentucky General Assembly and is governed under Kentucky Revised Statute ("KRS") 164A.700-709.

Effective July 1, 2003, responsibility of the governance and administration of the Plan was transferred to the Kentucky Higher Education Assistance Authority (the "Authority"). In connection with the transfer of responsibility, the Plan became a fiduciary fund of the Authority.

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

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

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

Continued

I. Description of Business--Continued:

Participants may withdraw from the Plan at any time for any reason. Terminating participants are refunded any contract payments made plus applicable investment earnings, less benefits received, administrative and cancellation fees. Non-qualified withdrawals are subject to a 10% penalty in accordance with Section 529 of the Internal Revenue Code ("IRC") except in cases where the withdrawal is: (i) made on account of the death or disability of the student; (ii) made on account of a scholarship received by the student to the extent that that the withdrawal does not exceed the amount of the scholarship; or (iii) a non-taxable transfer to another account or to another IRC Section 529 program for a different student who is a family member of the original student.

II. Overview of Financial Statements:

Management's Discussion and Analysis is intended to serve as an introduction to the Plan's financial statements. The basic financial statements include a statement of fiduciary net deficit and a statement of changes in fiduciary net deficit.

The statement of fiduciary net deficit presents information on Plan assets and liabilities with the difference between the two reported as the net deficit.

The statement of changes in fiduciary net deficit presents information that reflects how the Plan's net deficit changed during the year. All changes in net deficit are reported as soon as the underlying event occurs, regardless of the timing of the related cash flows. Accordingly, additions and deductions are reported in the statement for some items that will result in cash flows in future fiscal periods.

III. Financial Analysis:

The following information presents comparative financial data between the current fiscal year and prior fiscal year. Fiscal year 2004 was only the third year of the Plan, and the first year in the Plan's short history that it did not have an enrollment period to sell new contracts. Accordingly, the Plan experienced little growth in Plan assets and liabilities.

Continued

III. Financial Analysis--Continued:

A condensed summary of Plan net deficit is as follows:

Net Deficit Information	June 30 2004	June 30 2003
Cash, cash equivalents and investments	$63,562,664	$47,651,844
Contributions receivable	24,400,795	35,261,070
Capital assets	4,534	
Other assets	411,757	350,854
Total Assets	88,379,750	83,263,768
Accounts payable, accrued expenses and note payable	945,367	1,007,364
Tuition benefits payable	99,323,706	91,869,771
Total Liabilities	100,269,073	92,877,135
Total Net Deficit	($11,889,323)	($9,613,367)

Statement of Fiduciary Net Deficit

The Plan’s total assets increased $5.1 million, which resulted from an increase in investments of $15.9 million, net of a decrease in contributions receivable of $10.8 million. Investments increased because of cash received from participants, $7 million, investment income of $7.8 million and contract income net of expenses, $1 million. The contributions receivable decreased because of the $7 million received from participants and the $3.8 million of cancelled contracts. Other assets increased marginally due to an increase in accrued investment income. Also, during fiscal year 2004, the plan purchased two computers for Plan employees.

The Plan liabilities increased $7.4 million, almost entirely from the increase in tuition benefits payable. The increase in tuition benefits payable resulted from current year changes to actuarial assumptions for tuition increases, administrative costs, and investment income expense. Tuition increase assumptions in 2003 were; 7.5% increases annually though June 30, 2008, and 6.5% annually thereafter. In 2004, the tuition increase assumptions were; 7.5% increases annually through June 30, 2011, and 7.0% annually thereafter. In 2003, investment income was projected to be 7.25% (net of .25% investment expense). In 2004, gross investment income was projected as 7.76% and investment expense was projected on a sliding scale of costs related to total assets, .49% of the first $25 million, .28% of the next $25 million, and .21% of assets in excess of $50 million. Projected administrative expenses increased from $1 million in 2003 to $2.5 million in 2004.

Continued

III. Financial Analysis--Continued:

Statement of Fiduciary Net Deficit--Continued:

A condensed summary of Changes in Plan Net Deficit is as follows:

	Year Ended June 30	
Change in Fiduciary Net Deficit Information	**2004**	**2003**
Contract income	$2,256,417	$35,025,146
Fee revenue	102,719	104,768
Investment revenue	7,852,741	3,111,189
Other revenue	17,034	
Total Additions	10,228,911	38,241,103
Administrative expenses, personnel and professional services	729,989	1,399,983
Refunds	354,616	254,316
Trustee expense	139,901	97,402
Tuition benefits	11,399,497	39,669,771
Total Deductions	12,624,003	41,421,472
Change in Net Deficit Before Transfers	(2,395,092)	(3,180,369)
Transfer from KHEAA	119,136	
Change	$ (2,275,956)	$ (3,180,369)

Changes in Fiduciary Net Deficit

The Plan recognized an increase in net deficit of $2.3 million for fiscal year 2004. The Plan had no enrollment period in fiscal year 2004, so no new contracts were sold. The Plan did receive contract income from participants of $2.2 million in fiscal year 2004. The Plan also recognized $7.9 million of investment income in fiscal year 2004, a $4.7 million increase over prior year. Fee revenue was consistent with prior year and the Plan recognized other revenue of $17,000.

Continued

III. Financial Analysis--Continued:

Changes in Fiduciary Net Deficit--Continued

Administrative expenses decreased approximately $670,000, from $1.4 million to $730,000. Administrative expenses decreased because the Plan incurred advertising costs in fiscal year 2003 in connection with the enrollment period, and incurred almost no advertising costs in fiscal year 2004. While the Plan sold no contracts in fiscal year 2004, the tuition benefits expense did increase $11.4 million, due to changes in actuarial assumptions discussed above. Refunds increased approximately $40,000 due to aging of contracts cancelled and trustee expense increased because of the increase in total investments.

The Plan also recorded a transfer from the Authority in fiscal year 2004 of approximately $119,000. The Plan maintains two employees for operational functions. In fiscal year 2004, the Authority provided management, accounting, information technology support, legal services and office space to the Plan at no costs. The Authority allocated certain expenses to the Plan, which were recorded as a permanent transfer.

IV. Conditions Affecting Financial Position

The Commonwealth of Kentucky Constitution and other State laws prohibit the Commonwealth from providing its full faith and credit to obligations of other entities, such as the Plan. As a result, payments from the Plan are not guaranteed in any way by the Commonwealth, and are not considered to have created a debt or obligation of the Commonwealth. Such payments are limited obligations, payable from the Plan assets. The Commonwealth does not offer its pledge of the full faith and credit of the Commonwealth.

However, under Kentucky Revised Statutes 393.015, 75 percent of the balance of the Commonwealth of Kentucky Unclaimed Property Fund administered by the Kentucky State Treasurer is available to meet any unfunded liability of the Plan, as may be determined by the Plan's Board of Directors. As of June 30, 2004, $28.339 million of the Commonwealth of Kentucky Unclaimed Property Fund was specifically reserved to meet the obligations of the Plan (the "Plan Reserve"). It is projected that at least $3.5 million in additional funds will be deposited in the reserve account each year.

Concerned with the mounting deficit of the Plan and problems occurring in similar plans sponsored by other states, the Kentucky General Assembly closed the Plan to new applications through June 30, 2004 and commissioned an actuarial study to assess the Plan's financial health in March 2003.

The study concluded that the Plan was financially stable in the short and long term because there were sufficient assets between the Plan's net deficit and the assets available to the Plan through the Plan Reserve to cover the actuarially estimated future tuition obligations. While the Plan has an actuarial deficit of $9.6 million, the Plan Reserve of $12.5 million (as of June 30, 2003) exceeded the deficit by $2.9 million.

Continued

IV. Conditions Affecting Financial Position--Continued

The KAPT Board of Directors commissioned an additional actuarial study in July 2004. That study also concluded that the Plan was actuarially sound because the combination of the plan program fund and the plan reserve fund resulted in an overall surplus of $14.6 million. That study also determined that if the Plan opened enrollment for new applications in fiscal year 2005 and each year thereafter, and charged a 7.5% premium on new contracts, the Plan would actuarially eliminate the net deficit after the fifth enrollment period. Based on the results of the study, the Plan's Board of Directors authorized the Plan to open an enrollment period for new applications beginning August 23 through December 13, 2004 with a 7.5% premium on all new contracts.

The Plan will begin to pay tuition benefits during fiscal year 2005. The Plan expects to pay tuition benefits of $867,000 if fiscal year 2005 and $2.5 million in fiscal year 2006. Projected cash flows, which consider payments received on new and existing tuition contracts, the Plan Reserve Fund, net investment yield, administrative costs and tuition benefit payments are sufficient to meet the obligations of the Plan through 2025, the projected depletion date of all contracts held by the Plan as of June 30, 2004.

The actual value of future tuition benefit obligations of the Plan is dependent on future tuition increases. For the last ten-year period, the annual tuition increase for Kentucky's highest college or university has been 7%. The Plan routinely reviews its actuarial assumptions with regard to tuition increases and makes adjustments whenever considered necessary. The Plan believes that the current assumptions utilized in the determination of its tuition benefits payable adequately estimate future tuition increases.

Statement of Fiduciary Net Deficit

Commonwealth Postsecondary Education Prepaid Trust Fund
aka Kentucky's Affordable Prepaid Tuition

June 30, 2004

ASSETS	
Current:	
Cash and cash equivalents	$ 8,634,271
Contributions receivable, net of allowance for withdrawals of $1,123,018	5,715,443
Fees receivable	175,778
Accrued interest income	235,979
Total Current Assets	14,761,471
Noncurrent:	
Contributions receivable, net of allowance for withdrawals of $3,217,992	18,685,352
Investments	54,928,393
Fixed assets, net	4,534
Total Noncurrent Assets	73,618,279
Total Assets	88,379,750
LIABILITIES	
Current:	
Accounts payable and accrued expenses	45,367
Note payable	900,000
Total Current Liabilities	945,367
Noncurrent:	
Tuition benefits payable	99,323,706
Total Liabilities	100,269,073
NET DEFICIT	
Net Deficit	$ (11,889,323)

See Notes to Financial Statements

Statement of Changes in Fiduciary Net Deficit

Commonwealth Postsecondary Education Prepaid Trust Fund
aka Kentucky's Affordable Prepaid Tuition

June 30, 2004

Additions:	
Contract income, net	$ 2,256,417
Fee revenue	102,719
Investment Revenue:	
Net unrealized gain on investments	4,224,684
Interest and investment income	3,628,057
Other income	17,034
Total Additions	10,228,911
Deductions:	
Administrative expenses	167,051
Personnel and professional expenses	561,844
Refunds	354,616
Trustee fee expense	139,901
Tuition benefits expense	11,399,497
Other expenses	1,094
Total Deductions	12,624,003
Change in Net Deficit Before Transfer	(2,395,092)
Transfer from Internal Service Fund	119,136
Change in Net Deficit After Operating Transfer	(2,275,956)
Net Deficit at Beginning of Year	(9,613,367)
Net Deficit at End of Year	$ (11,889,323)

See Notes to Financial Statements

1. Description of Business:

The Commonwealth Postsecondary Education Prepaid Trust Fund, also known as Kentucky's Affordable Prepaid Tuition, or KAPT, (the "Plan"), was created by the 2000 Kentucky General Assembly and is governed under Kentucky Revised Statutes (KRS) 164A.700-709.

Effective July 1, 2003, responsibility for the governance and administration of the Plan was transferred to the Kentucky Higher Education Assistance Authority (the "Authority"). In connection with the transfer of responsibility, the Plan became a fiduciary fund of the Authority.

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

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

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

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

2. Summary of Significant Accounting Policies:

a. **Basis of Presentation:** The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and the Standards of the Governmental Accounting Standards Board ("GASB"). The Plan is a private-purpose trust fund, reporting assets held in a trustee capacity for others which are unavailable to finance government functions that does not meet the definition of a pension trust or investment trust as defined by Government Accounting Standards Board Statement No. 34, "Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments." As a fiduciary fund of the Authority, the Plan's financial statements are presented using the economic resources management focus and the accrual basis of accounting in conformity with accounting principles generally accepted in the United States of America. The Commonwealth of Kentucky Constitution and other State laws prohibit the Commonwealth from providing its full faith and credit to obligations of other entities, such as the Plan. As a result, payments from the Plan are not guaranteed in any way by the Commonwealth, and are not considered to have created a debt or obligation of the Commonwealth. Such payments are limited obligations, payable from the Plan assets. The Commonwealth does not offer its pledge of the full faith and credit of the Commonwealth. However, under KRS 393.015, 75 percent of the balance of the Commonwealth of Kentucky Unclaimed Property Fund administered by the Kentucky State Treasurer is available to meet any unfunded liability of the Plan, as may be determined by the Plan's Board of Directors. As of June 30, 2004, $28.339 million of the Commonwealth of Kentucky's Unclaimed Property Fund was specifically reserved to meet the obligations of the Plan.

b. **Administration:** Administrative costs are paid from application and administrative fees, plus earnings on Plan investments.

c. **Cash and Equivalents:** Cash and cash equivalents include all cash, demand deposit accounts, money market accounts, and all investments with a purchased maturity of 90 days or less.

d. **Investments:** The Plan invests in certain debt and equity instruments, which are reported at fair value. Fair values are determined using quoted market values as of the last day of the reporting period where available. Securities for which quoted market prices are not available are valued using estimates based on similar securities.

Continued

2. Summary of Significant Accounting Policies--Continued:

To achieve an actuarially determined target rate of gross return of 7.76% before fees and expenses, investments are to be held in approximately the following composition:

Large cap U.S. stocks		45%
Small/Miscap U.S. stocks		10%
Non-U.S. stocks		3%
Private equity	(not to exceed)	2%
Total Equity		60%
Inflation indexed bonds		25%
Corporate bonds		15%
Total Fixed Income		40%

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

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

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

iii. For portfolios invested in major-market countries, no more than 25% of the total amount of the equity portion of the investment account in any one country with the exception of those countries whose weighting in the Europe, Australia, and Far East index 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.

Continued

2. Summary of Significant Accounting Policies--Continued:

e. Contribution Receivable: As discussed in Note 1, participants may elect to make payments on executed tuition contracts over a specific period. Contributions receivable are recorded at their net realizable value in the period in which a tuition contract is purchased. A finance charge of 7.25% per year is charged to participants based on outstanding balance.

f. Note Payable: The Plan's start-up costs were funded by a $1 million note from the Commonwealth of Kentucky Unclaimed Property Fund.

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

h. Asset Restrictions: Assets of the Plan are restricted for payment of participant benefits and plan administration.

i. Contributions: Contributions are recorded in the period in which a contract is entered into by a participant. Lump sum amounts received as payment in full are recorded at the amount received. Tuition contracts to be paid over time are recorded net of an allowance for withdrawals and terminations.

j. Use of Estimates: The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America and include amounts based on estimates and assumptions that affect the reported values of assets, liabilities, contributions, and deductions. Actual results and amounts may vary significantly from these estimates.

k. Risks and Uncertainties: Investment securities are exposed to various risks, such as interest rate, market and credit. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect the amounts reported in the amounts reported in the statement of fiduciary net deficit and the statement of changes in fiduciary net deficit.

3. Cash and Cash Equivalents and Investments:

Cash and cash equivalents and investments as of June 30, 2004 are summarized as follows:

	Investments	Equivalents	Cash	Total
Corporate bonds	$18,794,208			$18,794,208
Corporate stock	36,134,185			36,134,185
Money market securities		$ 8,132,340		8,132,340
	54,928,393	8,132,340		63,060,733
Cash on deposit with Kentucky State Treasurer			$ 90,463	90,463
Cash in bank			411,468	411,468
Totals	$54,928,393	$ 8,132,340	$ 501,931	$63,562,664

Deposits identified as cash in the above summary as of June 30, 2004 are as follows:

	Financial Statement Amount	Bank Balance
Insured (FDIC)	$ 100,000	$ 100,000
Uninsured:		
Covered by trustee agreement	311,468	311,468
On deposit with Kentucky State Treasurer	90,463	90,463
Total	$ 501,931	$ 501,931

Continued

3. Cash and Cash Equivalents and Investments--Continued:

Investments including cash and equivalents categorized as of June 30, 2004 are summarized as follows:

	Category 1	Uncategorized	Total
Corporate bonds	$ 18,794,208		$18,794,208
Corporate stock	36,134,185		36,134,185
Money market securities		$ 8,132,340	8,132,340
Total	$ 54,928,393	$ 8,132,340	$63,060,733

The Plan's investments are categorized to give an indication of the level of credit risk assumed by the Plan. Category 1 investments include investments that are issued, registered or held by the Plan or its agents in the Plan's name.

4. Note Payable:

The Plan has an interest-free note payable to the Commonwealth of Kentucky Unclaimed Property Fund in the amount of $1 million. The Plan paid $100,000 of principal on the note during the fiscal year ended June 30, 2004. The remaining $900,000 of principal is due in fiscal year 2005.

5. Tuition Benefit Payable:

The following assumptions developed by management were used in the actuarial valuation as of June 30, 2004. These assumptions are based on historical data for both state and national trends.

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

Investment Expenses: The investment expense assumption is based on a sliding scale of costs related to total assets. The investment expense is projected as .49% of the first $25 million, .28% of the next $25 million and .21 % of assets in excess of $50 million.

Continued

5. Tuition Benefit Payable--Continued:

Tuition Increases: Tuition increases are based on the current best estimate of future tuition increases for Kentucky's public vocational schools, colleges, and universities. For the period from inception to June 30, 2003, the assumption for tuition increases had been 6.5%. On July 1, 2003, the tuition increase assumption was adjusted to 7.5% annually. The tuition increase assumption remains at 7.5% annually through year ending June 30, 2011, and 7.00% annually thereafter. For the period from inception to June 30, 2004, the annualized tuition increase for the highest-priced Kentucky public university, relative to the KAPT Standard Plan, which represents 92% of KAPT enrollments, has been 9.1%. For the Kentucky Community and Technical College System, relative to the KAPT Value Plan, the average annualized tuition increase from inception to June 30, 2004 has been 15.7%. For the University of Kentucky, relative to the KAPT Premium Plan, the average annualized tuition increase from inception to June 30, 2004 has been 9.73%.

Payment of Tuition and Mandatory Fees: Payments of tuition and mandatory fees are assumed to be 32 credit hours per year of utilization and payments occur twice annually.

6. Subsequent Events:

The 2004 Kentucky General Assembly did not pass a biennial budget for the executive branch of government, which resulted in governing control of the KAPT program being transferred from the Authority's Board of Directors to a KAPT Board of Directors, effective July 1, 2004.