

Kentucky State University

Board of Regents Meeting

Audit Committee

October 24, 2014

Regent Mindy Barfield, Chairperson

Regent Karen Bearden

Regent David Guarnieri

Regent Travis Haskins

KENTUCKY STATE UNIVERSITY
Regular Meeting of the
Board of Regents
Audit Committee
October 24, 2014
12:15 – 1:00 p.m.
Board Room – Academic Services Building

AGENDA

- | | | |
|-------|--|------------------------------------|
| I. | Call to Order | Regent Mindy Barfield, Chairperson |
| II. | Roll Call | Sonia Sanders, Staff |
| III. | Opening Remarks | Regent Barfield |
| IV. | <u>Approval of Minutes</u> | Regent Barfield |
| | <ul style="list-style-type: none">• Approval of the July 25, 2014, minutes | |
| V. | Action Item: External Audit Report | Regent Barfield |
| VI. | 2014-15 Risk Assessment Update Report | Tronconi Segarra & Associates |
| VII. | Discussion | |
| VIII. | Adjournment | |

Agenda Item Background

To:	Board of Regents Audit Committee	Date: October 24, 2014
From:	Regent Mindy Barfield, Chairperson Audit Committee	
Subject:	July 25, 2014 Committee Minutes	
Reason for Consideration:	Approval	Enclosures: Yes

Background:

The minutes of the Audit Committee meeting for July 25, 2014, require approval in order to become an official part of the committee records.

Recommendation:

It is recommended that the Audit Committee approve the minutes of the July 25, 2014 meeting.

Approval

Initiator:	Regent Mindy Barfield
Board Action Date:	October 24, 2014
Effective Date:	October 24, 2014

**Regular Meeting of the
Board of Regents
Audit Committee
July 24, 2014
12:00 Noon to 12:30 pm
Board Room – Academic Services Building
Frankfort, Kentucky
MINUTES**

Call to Order

Regent Barfield, called the meeting of the Kentucky State University Board of Regents Audit Committee to order at 12:02 p.m. on July 25, 2014. Meeting was held in the Board Room – Academic Services Building.

Roll Call

Mindy Barfield	Present	Travis Haskins	Present
Karen Bearden	Present	David Guarnieri	Present

A quorum was established

Approval of Minutes

The motion was made for approval of the April 25, 2014 minutes by Regent Haskins and seconded by Regent Bearden. The motion was approved.

Opening Remarks

Regent Barfield noted that a copy of the audit report had not been received by the Audit Committee prior to the meeting. Regent Barfield indicated that the committee would listen to Mr. Ferm's report but asked him to be available for any subsequent questions or comments concerning the report after the committee meeting.

Discussion

Mr. Ferm presented additional focus areas of the 2014 audit plan. Regent Guarnieri and Regent Bearden raised questions regarding Accounts Receivables and Collections which were addressed by Mr. Ferm. Regent Barfield indicated the committee would review in-depth and contact him for items of clarification.

Adjournment

Action: Motion to adjourn by Regent Bearden and seconded by Regent Haskins.
Meeting was adjourned at 12:22 p.m.

Submitted and Approved by:

Regent Mindy Barfield, Chair
Board of Regents

____ Approved with no corrections
____ Approved with corrections

Agenda Item Background

To:	Board of Regents Audit Committee	Date: October 24, 2014
From:	Regent Mindy Barfield, Chair	
Subject:	Audit Update	
Reason for Consideration:	Approval	Enclosures: No

Background:

Final audited financial statements have been completed and issued by Dean Dorton Allen Ford, PLLC.

Recommendation:

Approval

Initiator:	Regent Mindy Barfield, Chair
Board Action Date:	October 24, 2014
Effective Date:	October 24, 2014

Appendices

External Audit Report

2014-15 Risk Assessment Update Report

KENTUCKY STATE UNIVERSITY

Financial Statements

*For the Years Ended June 30, 2014 and 2013
with Report of Independent Auditors*

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Report of Independent Auditors

Members of the Board of Regents
Kentucky State University
Frankfort, Kentucky

Secretary of Finance and
Administration Cabinet of the
Commonwealth of Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities of Kentucky State University (the University) as of and for the years ended June 30, 2014 and 2013, and the related notes to the financial statements which collectively comprise the University's basic financial statements as listed on the table of contents. We have also audited the financial statements of the Kentucky State University Foundation, Inc. (the Foundation), the University's discretely presented component unit, as of and for the years ended June 30, 2014 and 2013.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these 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 financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits 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 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 and the report of other auditors is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, based on our audits the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities and discretely presented component unit of the University as of June 30, 2014 and 2013, and the respective changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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 19 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 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 financial statements, and other knowledge we obtained during our audit of the basic 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 7, 2014 on our consideration of the University'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 University's internal control over financial reporting and compliance.

Dean Dotson Allen Ford, PLLC

October 7, 2014
Lexington, Kentucky

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis

June 30, 2014

Introduction

Management's Discussion and Analysis of Kentucky State University's (the University) financial statements provide an overview of the financial position and activities of the University for the year ended June 30, 2014, with comparative information for the year ended June 30, 2013. This discussion has been prepared by management and should be read in conjunction with the financial statements and the notes thereto, which follow this section. The financial statements and related notes and this discussion and analysis are the responsibility of management.

Kentucky State University is a Commonwealth of Kentucky coeducational institution for higher education. The University's mission is to build on its legacy of achievement as a historically black, liberal arts, and 1890 land-grant university, afford access to and prepare a diverse student population of traditional and non-traditional students to compete in a multifaceted, ever-changing global society by providing student-centered learning while integrating teaching, research, and service through high-quality undergraduate and select graduate programs. Kentucky State University is committed to keeping relevant its legacy of service by proactively engaging the community in partnerships on civic projects driven by the objective of positively impacting the quality of life of the citizens of the Commonwealth.

Basis of Presentation

The annual financial report and statements include the University and Kentucky State University Foundation, a component unit of the University. Kentucky State University Foundation, Inc. (the Foundation) is a not-for-profit Kentucky corporation which was established to receive, invest and expend funds to promote and implement educational and developmental activities at Kentucky State University (the University). The Foundation is managed by a Board of Trustees independent from that of the University. The Foundation is supported primarily through contributions from alumni.

Financial Highlights

- The University's financial position at June 30, 2014, reflected total assets of \$124.5 million and total liabilities of \$14.5 million. Total net position was \$110.0 million.
- Total assets decreased \$5.2 million or 3.0%, primarily due to decreases in student accounts receivable (net of bad debt allowance), grant and loans receivables, capital assets, and cash and cash equivalents. Total liabilities decreased by \$1.1 million or 7.3% primarily due to decreases in bond and lease obligations and in compensated absences. Total net position decreased \$4.0 million, due to bad debt write-off.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Financial Highlights, Continued

- Unrestricted net position decreased \$2.2 million, which the University reserves for spending in programs and other capital-related contingencies.
- The University classifies amounts earned on endowments as spendable or non-spendable in accordance with the endowment's donor stipulations. Nonexpendable restricted net assets represent amounts, which must be maintained in perpetuity. Expendable restricted net assets include endowment earnings that are spendable, consistent with the University's spending policy.
- Operating revenues were \$38.7 million and operating expenditures were \$73.7 million, resulting in a loss from operations of \$35.0 million. Net non-operating revenues were \$30.9 million, including \$23.5 million in state appropriations, which, when combined with the loss from operations and capital appropriations, resulted in an overall decrease in net position of \$4.0 million.

Using the Financial Statements

The University's Financial Statements consist of three financial statements: a Statement of Net Position (Balance Sheet); a Statement of Revenues, Expenses and Changes in Net Position (Income Statement); and a Statement of Cash Flows, along with the accompanying Notes to the Financial Statements. These financial statements are prepared in accordance with Governmental Accounting Standards Board (GASB) Statement No. 35, *Basic Financial Statements – and Management's Discussion and Analysis – for Public Colleges and Universities*.

Kentucky State University is a component unit of the Commonwealth of Kentucky.

Statement of Net Position

The Statement of Net Position presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities. Net position, the difference between total assets and total liabilities, is an important indicator of the current financial condition, while the change in net position is an indicator of whether the overall financial position has improved or worsened during the year.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Condensed Statement of Net Position

	<u>2014</u>	<u>2013</u>
ASSETS		
Current assets	\$ 28,269,249	\$ 32,521,844
Noncurrent assets	<u>96,205,148</u>	<u>97,130,896</u>
Total assets	<u>\$ 124,474,397</u>	<u>\$ 129,652,740</u>
LIABILITIES		
Current liabilities	7,272,906	7,303,864
Non-current liabilities	<u>7,183,955</u>	<u>8,292,611</u>
Total liabilities	<u>14,456,861</u>	<u>15,596,475</u>
NET POSITION		
Invested in capital assets, net of related debt	73,258,914	75,009,634
Restricted		
Nonexpendable	8,657,506	8,657,506
Expendable	5,849,690	5,905,037
Unrestricted	<u>22,251,426</u>	<u>24,484,088</u>
Total net position	<u>\$ 110,017,536</u>	<u>\$ 114,056,265</u>

Assets: As of June 30, 2014, total assets amounted to \$124.5 million. Of this amount, investment in capital assets (net of depreciation) of \$80.7 million, or 64.8% of total assets, represented the largest asset class. Investments amounted to \$15.3 million or 12.3% of total assets. During the year, total assets decreased by \$5.2 million, primarily due to decreases in student accounts receivable (net of bad debt allowance), grant and loans receivables, capital assets, and cash and cash equivalents.

Liabilities: As of June 30, 2014, total liabilities amounted to \$14.5 million. Long-term debt includes bonds payable for housing and dining system and energy-related equipment and technology equipment purchased under a Master Lease Agreement. During the year, total liabilities decreased by \$1.1 million, primarily due to decreases in bond and lease obligations and in compensated absences.

Net Position: Net position of the University was \$110.0 million at June 30, 2014 and was reported in four net position categories: invested in capital assets, net of related debt \$73.3 million (66.6%), restricted nonexpendable \$8.6 million (7.8%), restricted expendable \$5.8 million (5.3%), and unrestricted \$22.3 million (20.3%).

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Statement of Revenues, Expenses and Changes in Net Position

The Statement of Revenues, Expenses and Changes in Net Position is prepared on the accrual basis of accounting, whereby revenues and assets are recognized when the service is provided and expenses and liabilities are recognized when others provide the service, regardless of when cash is exchanged. All items that increase or decrease net position must appear on the Statement of Revenues, Expenses and Changes in Net Position as revenues, expenses, gains or losses.

Financial activities are reported as either operating or non-operating. GASB Statement No. 35 requires state appropriations, gifts, investment income and endowment income to be classified as non-operating revenues. Accordingly, the University reports an operating loss prior to the addition of non-operating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. Tuition revenue is reduced by gift scholarships and institutional aid, and is reported net of scholarship allowances in the financial statements. A summarized comparison of the University's revenues, expenses and changes in net position for the years ended June 30, 2014 and June 30, 2013 is as follows.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Condensed Statement of Revenues, Expenses and Changes in Net Position

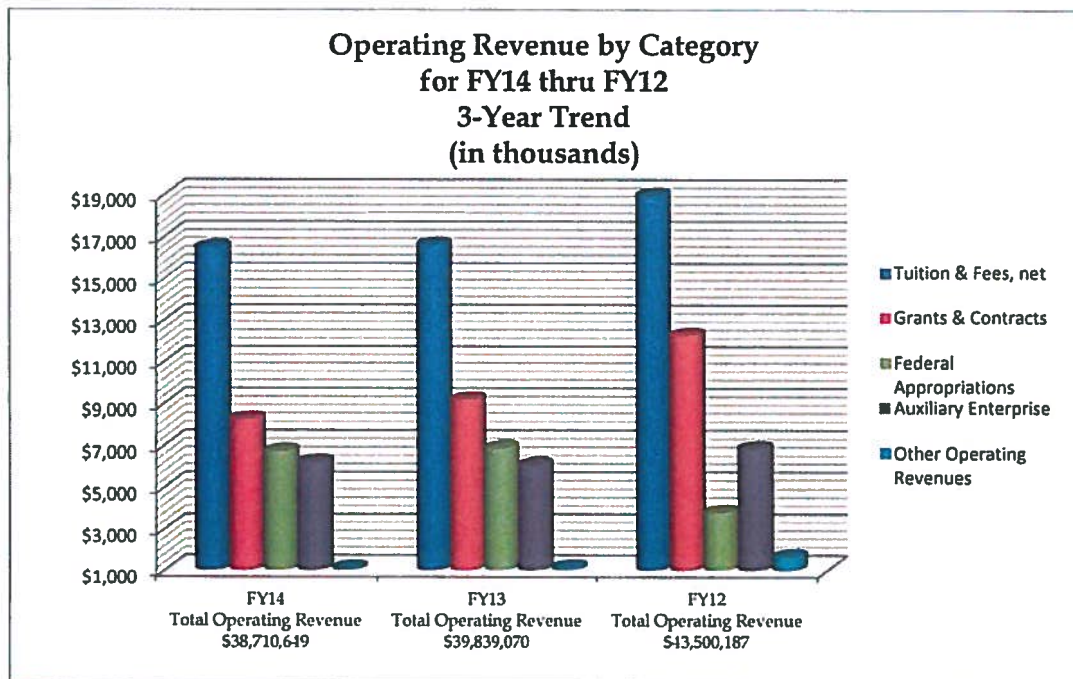
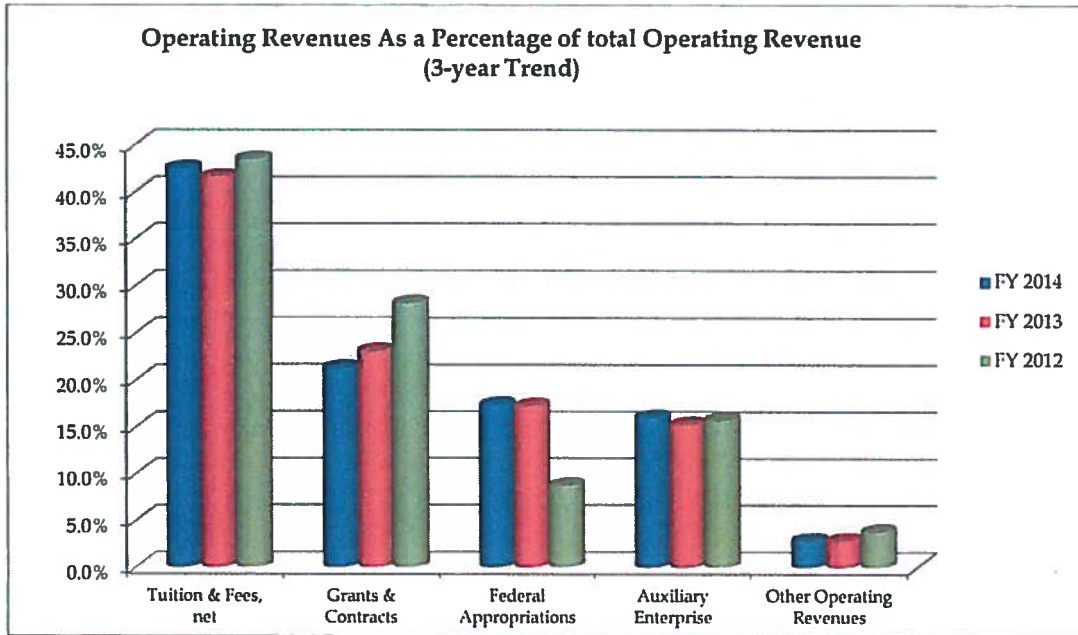
	<u>2014</u>	<u>2013</u>
OPERATING REVENUES		
Student tuition and fees, net	\$ 16,472,026	\$ 16,595,920
Grants and contracts	8,224,822	9,172,968
Federal appropriations	6,722,332	6,873,169
Auxiliary enterprises	6,195,424	6,065,393
Other operating revenue	<u>1,096,045</u>	<u>1,131,620</u>
Total operating revenues	<u>38,710,649</u>	<u>39,839,070</u>
OPERATING EXPENSES		
Educational and general	67,691,056	64,595,994
Auxiliary enterprises	<u>5,990,522</u>	<u>6,610,652</u>
Total operating expenses	<u>73,681,578</u>	<u>71,206,646</u>
OPERATING LOSS	<u>(34,970,929)</u>	<u>(31,367,576)</u>
NONOPERATING REVENUES (EXPENSES)		
State appropriations	23,537,400	23,537,402
Federal grants and contracts	5,928,036	5,922,954
Investment income (loss)	1,700,270	1,150,833
Interest on capital asset – related debt	(317,534)	(276,050)
Other	71,352	583,269
Endowment gifts	<u>12,676</u>	<u>7,276</u>
Total non-operating revenues	<u>30,932,200</u>	<u>30,925,684</u>
Total in net position	(4,038,729)	(441,892)
Net position, beginning of year	<u>114,056,265</u>	<u>114,498,157</u>
Net position, end of year	<u>\$ 110,017,536</u>	<u>\$ 114,056,265</u>

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Figure 1

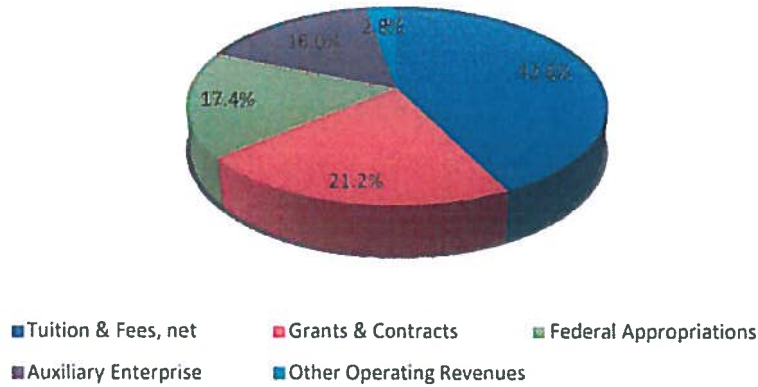


KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

FY 2014 Operating Revenues as a percentage of total Operating Revenue



Operating Revenue

Total operating revenues were \$38.7 million for the year ended June 30, 2014, a decrease of \$1.1 million compared to FY13. The primary components of operating revenue were federal, state and local grants and contracts of \$8.2 million (21.2%) student tuition and fees, net, of \$16.5 million (42.6%), federal appropriations of \$6.7 million (17.4%) and auxiliary services and other revenues of \$7.3 million (18.8%). FY14 Student tuition and fees revenue decreased \$124 thousand compared to FY13. FY14 Grants and contracts revenue decreased \$948 thousand compared to FY13 due to decreased awards and spending. FY14 Federal appropriations decreased \$151 thousand compared to FY13. FY14 Auxiliary services and other revenue decreased \$95 thousand compared to FY13. Refer to *Figure 1* for the three year trend of the operating revenues as a percent to total operating revenues and revenue by category.

KENTUCKY STATE UNIVERSITY

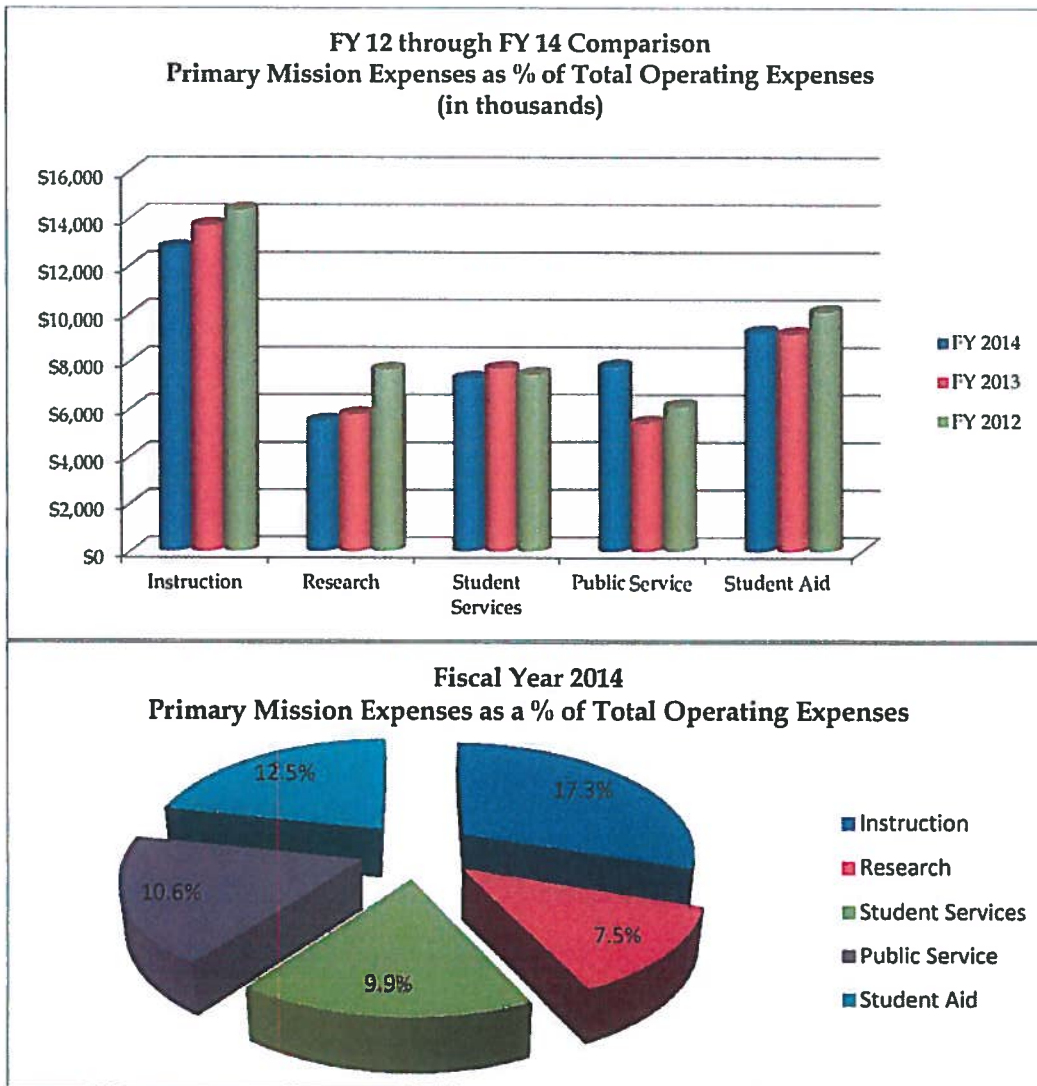
Management's Discussion and Analysis, continued

June 30, 2014

Operating Expenses

Operating expenses totaled \$73.7 million, an increase of \$2.5 million over last year. Of this amount, \$42.6 million (57.8%) was expended directly for the primary mission of the University – instruction (17.3%), research (7.5%), student services (9.9%), student aid (12.5%), and public service (10.6%). Instruction is the main component of Primary Mission expenses amounting to \$12.8 million in fiscal year 2014 or 17.3%. Refer to *Figure 2* for the operating expenses categorized into the Primary Mission of the University. (Percentages below do not include depreciation or operations/maintenance allocations.)

Figure 2

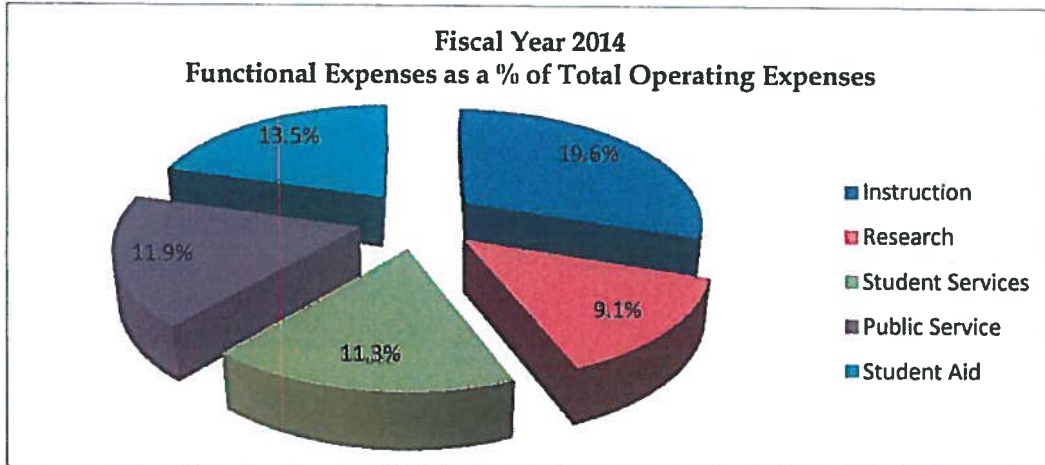


KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

In addition to the Primary Mission expenses of the University, there are expenses from depreciation and operations & maintenance that are allocated to the various functional classifications (See note 12 – Schedule of Expenses by Program). See below for the operating expenses categorized into the Functional Expenses of the University. *(Percentages below include depreciation and operations/maintenance allocations.)*



The University continued to invest in student aid and support services to provide students with opportunities to be successful in fiscal 2014. For the year ended June 30, 2014, student aid related to tuition and fees totaled \$8.3 million, with student aid expenses of \$9.2 million and scholarship allowances of \$4.9 million.

The University had an overall increase in institutional support of \$4.2 million, which was mainly due to the increase in bad debt expensed during the fiscal year. The large expenditures in the primary areas of instruction, research and student services, in conjunction with minimal increases to fixed cost areas, confirms the University resource allocations are clearly aligned with the University's strategic priorities to support academic and student excellence.

The net loss from operations for the year amounted to \$35.0 million. Non-operating revenues, net of expenses, amounted to \$30.9 million, resulting in a decrease in income before other revenues, expenses, gains or loss of \$4.0 million for the year. Non-operating revenues include state appropriations of \$23.5 million, non-operating federal grants and contracts of \$5.9 million, gifts of \$13 thousand and investment income of \$1.7 million, and other non-operating income net of revenue of \$71 thousand.

Statement of Cash Flows

The Statement of Cash Flows presents information related to the University's cash inflows and outflows summarized by operating activities, noncapital financing activities, capital financing activities and investing activities. The primary purpose of the Statement of Cash Flows is to provide information about the cash receipts and cash payments made by the University during the year, to allow financial statement readers to assess the University's ability to generate future net cash flows, its ability to meet obligations as they become due and its possible need for external financing.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Condensed Statement of Cash Flows

	<u>2014</u>	<u>2013</u>
Cash (used) provided by:		
Operating activities	\$(27,961,664)	\$(27,644,376)
Non-capital financing activities	29,557,829	30,090,766
Capital and related financing activities	(3,026,755)	(4,000,212)
Investment activities	<u>(101,431)</u>	<u>(1,180,915)</u>
Net increase (decrease) in cash	(1,532,021)	(2,734,737)
Cash and cash equivalents, beginning year	<u>21,107,984</u>	<u>23,842,721</u>
Cash and cash equivalents, end of year	<u>\$ 19,575,963</u>	<u>\$ 21,107,984</u>

Cash and Investments

Major sources of cash received from operating activities are student tuition and fees of \$18.4 million and grants and contracts of \$15.5 million. Major uses of cash for operating activities were payments to employees for salaries and benefits of \$37.4 million and to vendors and contractors of \$23.5 million.

Noncapital financing activities included state appropriations from the Commonwealth of Kentucky of \$23.5 million.

Capital and related financing activities include purchases and payments of \$3.0 million expended for construction and acquisition of capital assets and for principal and interest payments on the retirement of the University's bonds and other capital related debt.

Net cash of \$101 thousand was spent for conducting investing activities, including purchase and sales of investments, and interest and dividends earned on investments. Investment activity was primarily related to management of the University's endowments.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

State Appropriations

State appropriations represent approximately 33.8% of all operating and non-operating revenues. The level of state support is a key factor influencing the University's overall financial condition. State appropriation is unrestricted revenue and is included as non-operating revenue. State appropriation is used to support payroll and benefits for University employees.

The following details the net Commonwealth appropriations received by the University for fiscal years ending June 30, 2014, 2013 and 2012.

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Commonwealth appropriations	\$ 23,537,400	\$ 23,537,402	\$ 24,660,001
Federal appropriations	<u>6,722,332</u>	<u>6,873,169</u>	<u>3,796,394</u>
Total appropriations	<u>\$ 30,259,732</u>	<u>\$ 30,410,571</u>	<u>\$ 28,456,395</u>

Capital Appropriations for the Commonwealth

The University faces financial challenges to maintain and upgrade its capital assets including its infrastructure, buildings and grounds. A combination of revenue sources funds the University's investment in capital improvements, including appropriations provided by the Commonwealth of Kentucky. In fiscal year 2014, the Commonwealth provided no capital appropriations to the University. State capital appropriations plus federal sources play an important role in the University's efforts to address deferred maintenance projects.

Grant and Contract Revenue

The following table details the University's grant and contract revenue for fiscal years ended June 30, 2014, 2013 and 2012.

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Federal grants and contracts, operating	\$ 5,935,012	\$ 7,588,912	\$ 10,720,989
Federal grants and contracts, non-operating	5,928,036	5,922,954	7,373,490
State grants and contracts	<u>2,289,810</u>	<u>1,584,056</u>	<u>1,547,004</u>
Total grants and contracts	<u>\$ 14,152,858</u>	<u>\$ 15,095,922</u>	<u>\$ 19,641,483</u>

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Capital Plan

During fiscal year 2014, Kentucky State University started construction on the Dr. Cheaney Legacy Plaza. Design of several construction projects started: Old Federal Bldg. Restoration / Renovation Phase II (Aquaculture KY River Interpretive Center); Renovate Atwood Agriculture Research Bldg.; and Privatized Housing. The University completed a roof replacement project for Alumni Stadium Office and Locker Bldg. In addition HVAC improvements were made to the Ceramics Classroom in Shauntee Hall; hallways and stairwells were painted and floor tile replaced in Shauntee Hall.

The execution of the University's capital plan is contingent upon sufficient funding from the Commonwealth. The Kentucky General Assembly during the 2014 regular session approved state bond funding for one project out of the University submitted Six Year Capital Plan. State Bond Funds of \$10,400,000 was approved for "Repair Boilers and Aging Distribution Lines". This project will replace boilers and repair a portion of the existing steam plant system.

New construction projects proposed and only authorized for expenditure of KSU Restricted Funds include: \$9 million to expand or build a new Betty White Nursing Building, which will provide 19,800 square feet of new classroom space to accommodate enrollment into the nursing program; \$46.4 million to construct a centralized boiler plant to replace the existing seventy year old plant; \$31.5 million to construct a Business & Technology Center to house the business school and the computer science program; \$96 million to build a Performing Arts Center to replace antiquated Bradford Hall. Maintenance projects include but are not limited to: Roof Repair & Maintenance Pool; \$3.4 million and a \$1.5 million Capital Renewal & Maintenance Pool. Information Technology projects include but are not limited to: Integrated Digital Campus \$11.4 million; Expand Emergency Notification System \$4.5 million; Upgrade Information Technology Infrastructure \$6.2 million.

Major capital-related needs and issues facing the university with its aging facilities was documented in the 2007 VFA Facility Condition Assessment and Space Study. The process used for determining the 2014-2020 priorities was enhanced by utilization of the 2008 Campus Master Plan Update and the information gathered as part of that effort as well as the VFA findings. These two initiatives are the framework of the 2014-2020 Capital Plan. The Capital Planning and Construction Division, the Facilities Services Division, and the Information Technology Division collaborated to establish initial priorities for the plan. Priorities were further refined when Cabinet-level administrators and the President reviewed the project list linked to specific University initiatives.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Designated and Non-designated Spending

In the tables below, expenses have been categorized into designated or non-designated spending categories. The designated spending category includes funds expended by function from contracts and grants, land grant, auxiliary and depreciation. These funds must be expended for the purposes for which the funds were received or budgeted. This category also includes funds for student aid. All other spending is categorized as non-designated spending. Total spending for all functions in the non-designated category increased by approximately \$3.5 million in 2014, primarily due to the increase in recognizing bad debt expense in the institutional support category.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

	-----2014-----		
	Designated Spending	Non-designated Spending	Combined Spending
Instruction	\$ 303,043	\$ 12,462,869	\$ 12,765,912
Research	4,687,170	821,191	5,508,361
Public service	4,575,910	3,204,924	7,780,834
Academic support	1,378,264	1,060,513	2,438,777
Student services	1,266,023	6,012,994	7,279,017
Institutional support	978,916	12,903,723	13,882,639
Operation and plant maintenance	-	4,680,295	4,680,295
Student aid	9,222,531	-	9,222,531
Auxiliary	5,663,271	-	5,663,271
Depreciation	<u>4,459,941</u>	<u>-</u>	<u>4,459,941</u>
Total	<u>\$ 32,535,069</u>	<u>\$ 41,146,509</u>	<u>\$ 73,681,578</u>
	-----2013-----		
	Designated Spending	Non-designated Spending	Combined Spending
Instruction	\$ 460,694	\$ 13,240,545	\$ 13,701,239
Research	4,931,690	851,901	5,783,591
Public service	4,511,828	907,700	5,419,528
Academic support	1,338,819	2,029,074	3,367,893
Student services	1,404,988	6,307,175	7,712,163
Institutional support	983,132	8,689,664	9,672,796
Operation and plant maintenance	-	5,602,000	5,602,000
Student aid	9,162,677	-	9,162,677
Auxiliary	6,273,691	-	6,273,691
Depreciation	<u>4,511,068</u>	<u>-</u>	<u>4,511,068</u>
Total	<u>\$ 33,578,587</u>	<u>\$ 37,628,059</u>	<u>\$ 71,206,646</u>

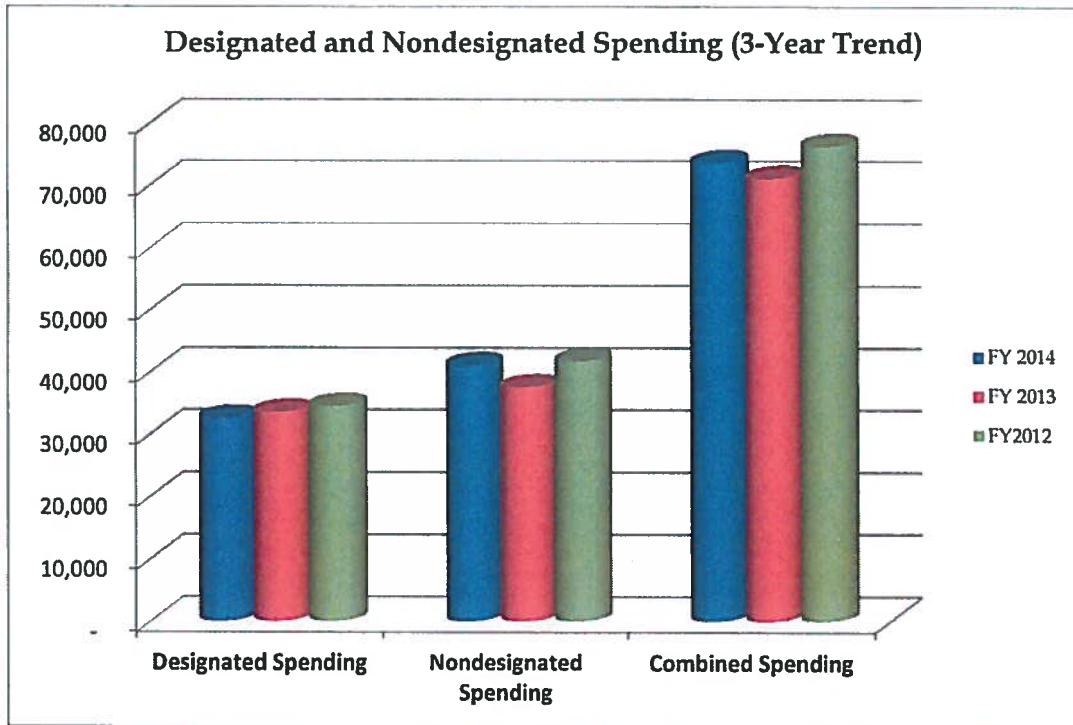
The graph in *Figure 3* shows a three year trend of designated, non-designated, and combined spending. Non-designated spending is higher than designated spending in FY14. However, designated spending decreased \$1.0 million in both 2013 and 2014. Non-designated spending decreased \$4.2 million in 2013 and increased \$3.5 million in 2014. Overall, the combined spending followed the same trend as designated spending with a decrease of \$5.2 million in 2013 and increase of \$2.5 million in 2014.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Figure 3



KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, totaled \$80.7 million at June 30, 2013, a decrease of \$2.5 million. Capital assets as of June 30, 2014 and significant changes in capital assets during the year are as follows (in millions):

	<u>June 30,</u> <u>2014</u>	Net Additions (Reductions) <u>FY 13-14</u>	<u>June 30,</u> <u>2013</u>	Net Additions (Reductions) <u>FY 12-13</u>	<u>June 30,</u> <u>2012</u>
Land and land improvements	\$ 6.3	\$ -	\$ 6.3	\$ 0.6	\$ 5.7
Buildings, fixed equipment and infrastructure	154.7	-	154.7	1.6	153.1
Equipment, vehicles and capitalized software	32.3	0.9	31.4	1.5	29.9
Library materials and art	10.4	-	10.4	0.6	9.8
Construction in progress	1.0	1.0	-	(1.1)	1.1
Accumulated depreciation	<u>(124.0)</u>	<u>(4.4)</u>	<u>(119.6)</u>	<u>(4.5)</u>	<u>(115.1)</u>
Total	<u>\$ 80.7</u>	<u>\$ (2.5)</u>	<u>\$ 83.2</u>	<u>\$ (1.3)</u>	<u>\$ 84.5</u>

At June 30, 2014, the University has capital construction projects in progress totaling \$970,250 in scope.

Long Term Debt

At June 30, 2014, bonds and lease payable amounted to \$7.3 million, as summarized below:

	<u>2014</u>	<u>2013</u>	<u>2012</u>
Lease Obligations	\$ 3,796,904	\$ 4,139,613	\$ 4,565,078
Note payable to City of Frankfort	250,000	300,000	-
General Receipts Bonds	3,405,000	3,790,000	4,165,000
Bond discount and issue costs	<u>(49,798)</u>	<u>(53,629)</u>	<u>(57,460)</u>
Total	<u>\$ 7,402,106</u>	<u>\$ 8,175,984</u>	<u>\$ 8,672,618</u>

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2014

Economic Factors Impacting Future Periods

University management continues its strategic mission to uniquely position Kentucky State University as Kentucky's small public liberal arts institution of excellence for the citizens of the Commonwealth and for advancing higher education in Kentucky by inspiring innovation, growing leaders and advancing Kentucky. Executive management continues to work with the Council on Postsecondary Education to address the needs of the Commonwealth and believes it is positioning the University to become a strong, financially viable and efficient institution of higher learning.

Future economic factors impacting Kentucky State University include the following known facts:

- Tuition and costs of attendance—Kentucky State University continues to weigh its costs of attendance with the funding provided by the General Assembly to successfully deliver its programs and remain one of the most affordable public institutions in the Commonwealth. Funding levels and methodologies used for institutions of higher education in the Commonwealth are developed and approved by the Council on Postsecondary Education.
- Enrollment growth and student retention—Kentucky State University recruits a diverse student body of traditional, nontraditional and transfer students seeking baccalaureate and advanced degrees. Enrollment stabilization is a priority of University management and specifically, an increased strategy for recruiting in-state students.
- Program expansion—the University is well positioned to meet the needs of Kentuckians through its programs and educational activities. The University offers the following programs: Bachelors in Mass Communications and Journalism, a Masters of Arts in Special Education, and a Masters in Business Administration, a Masters in Public Administration, a Masters in Computer Science, a Masters in Environmental Studies, a Masters of Science in Interdisciplinary Behavioral Studies and soon, a Doctorate in Nursing Practice.
- Regional Stewardship—Kentucky State University continues to meet the economic and community needs of its area of geographic responsibility through collaborative initiatives with businesses, community-based organizations, schools and other educational agencies, citizens and local and state officials.
- Land Grant – Kentucky State University continues to fulfill its mission as a land grant institution providing innovative research opportunities on its research vessel, the Kentucky River Thorobred and community based extension through the Rosenwald Center for Families and Children
- State Funding Model – On January 16, 2013, Moody's Investor Service downgraded its outlook for the entire US higher education sector to negative. The state is being forced to innovate and come up with strategies for getting better results with less money. One of the strategies is the idea of tying state education allocations to performance metrics instead of enrollment.

The overall financial position of the University was stable during fiscal year 2014. Revenue streams were stressed. As the University adapts to present economic environments, new opportunities for funding will be explored to compliment state support. Executive management's goal is to deliver exceptional programs and services to students and constituents while maintaining financial stability. Management believes Kentucky State University is able to sustain its financial position and solidify its being a regional university of excellence.

KENTUCKY STATE UNIVERSITY

Statements of Net Position

June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$19,575,963	\$ 21,107,984
Accounts, grants and loans receivable, net	8,535,442	10,875,339
Inventory and other current assets	<u>157,844</u>	<u>538,521</u>
Total current assets	<u>28,269,249</u>	<u>32,521,844</u>
Noncurrent assets		
Accounts, grants and loans receivable, net	241,030	443,881
Investments	15,303,098	13,501,397
Capital assets, net	<u>80,661,020</u>	<u>83,185,618</u>
Total noncurrent assets	<u>96,205,148</u>	<u>97,130,896</u>
Total assets	<u>124,474,397</u>	<u>129,652,740</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	3,402,242	3,291,014
Accrued compensated absences	1,557,350	1,633,551
Unearned revenue	1,299,328	1,280,078
Deposits	169,221	160,856
Other current liabilities	91,700	63,283
Long-term debt, current portion	<u>753,065</u>	<u>875,082</u>
Total current liabilities	<u>7,272,906</u>	<u>7,303,864</u>
Noncurrent liabilities		
Long-term debt, noncurrent portion	6,649,041	7,300,902
Federal grants refundable	<u>534,914</u>	<u>991,709</u>
Total noncurrent liabilities	<u>7,183,955</u>	<u>8,292,611</u>
Total liabilities	<u>14,456,861</u>	<u>15,596,475</u>
NET POSITION		
Invested in capital assets, net of related debt	73,258,914	75,009,634
Restricted		
Nonexpendable	8,657,506	8,657,506
Expendable	5,849,690	5,905,037
Unrestricted	<u>22,251,426</u>	<u>24,484,088</u>
Total net position	<u>\$110,017,536</u>	<u>\$ 114,056,265</u>

See accompanying notes.

KENTUCKY STATE UNIVERSITY FOUNDATION, INC.

Statements of Financial Position

June 30, 2014 and 2013

Assets	<u>2014</u>	<u>2013</u>
Current assets:		
Cash and cash equivalents	\$ 1,889,815	\$ 1,966,708
Investments, at fair value	9,175,002	7,924,717
Property and equipment:		
Equipment	140,400	140,400
Buildings and improvements	<u>65,526</u>	<u>65,526</u>
	205,926	205,926
Accumulated depreciation	<u>(158,301)</u>	<u>(142,279)</u>
Property and equipment, net	47,625	63,647
Other assets	<u>35,251</u>	<u>31,203</u>
Total assets	<u>\$ 11,147,693</u>	<u>\$ 9,986,275</u>
Liabilities and Net Assets		
Current liabilities:		
Accounts payable	\$ 15,566	\$ 9,489
Accrued liabilities	<u>3,697</u>	<u>-</u>
Total liabilities	19,263	9,489
Net assets:		
Unrestricted:	377,256	315,740
Temporarily restricted:	7,285,817	6,433,260
Permanently restricted	<u>3,465,357</u>	<u>3,227,786</u>
Total net assets	<u>11,128,430</u>	<u>9,976,786</u>
Total liabilities and net assets	<u>\$ 11,147,693</u>	<u>\$ 9,986,275</u>

See accompanying notes.

KENTUCKY STATE UNIVERSITY

Statements of Revenues, Expenses and Changes in Net Position

Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
REVENUES		
Operating revenues		
Student tuition and fees (net of scholarship allowances of \$4,895,742 and \$4,276,036)	\$ 16,472,026	\$ 16,595,920
Federal grants and contracts	5,935,012	7,588,912
Federal appropriations	6,722,332	6,873,169
State and local grants and contracts	2,289,810	1,584,056
Auxiliary enterprises:		
Residence halls	3,161,664	2,836,181
Dining	2,877,787	2,775,383
Bookstore	75,000	152,500
Other auxiliaries	80,973	301,329
Other operating revenues	<u>1,096,045</u>	<u>1,131,620</u>
Total operating revenues	<u>38,710,649</u>	<u>39,839,070</u>
EXPENSES		
Operating expenses		
Educational and general		
Instruction	12,765,912	13,701,239
Research	5,508,361	5,783,591
Public service	7,780,834	5,419,529
Academic support	2,438,777	3,367,893
Student services	7,279,017	7,712,162
Institutional support	13,882,639	9,672,796
Operation and maintenance of plant	4,680,295	5,602,000
Student aid	9,222,531	9,162,677
Depreciation	4,132,690	4,174,107
Auxiliary enterprises		
Residence halls	2,321,813	2,626,565
Dining	2,655,019	2,608,016
Other auxiliaries	686,439	1,039,110
Depreciation	<u>327,251</u>	<u>336,961</u>
Total operating expenses	<u>73,681,578</u>	<u>71,206,646</u>
Operating loss	(34,970,929)	(31,367,576)

See accompanying notes.

KENTUCKY STATE UNIVERSITY

Statements of Revenues, Expenses and Changes in Net Position, continued

Years ended June 30, 2014 and 2013

	<u>2014</u>	<u>2013</u>
NONOPERATING REVENUES (EXPENSES)		
State appropriations	\$ 23,537,400	\$ 23,537,402
Federal grants and contracts	5,928,036	5,922,954
Investment income (net of investment expense)	1,700,270	1,150,833
Interest on capital asset-related debt	(317,534)	(276,050)
Other non-operating revenues	71,352	583,269
Endowment gifts	<u>12,676</u>	<u>7,276</u>
Net non-operating revenues	<u>30,932,200</u>	<u>30,925,684</u>
 Decrease in net position	 (4,038,729)	 (441,892)
 Net position, beginning of year	 <u>114,056,265</u>	 <u>114,498,157</u>
 Net position, end of year	 <u>\$ 110,017,536</u>	 <u>\$ 114,056,265</u>

See accompanying notes.

KENTUCKY STATE UNIVERSITY FOUNDATION, INC.

Statement of Activities

Year ended June 30, 2014

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues, gains and other support:				
Contributions	\$ 30,000	\$ 877,796	\$ 237,571	\$ 1,145,367
Investment income:				
Interest and dividends	5,328	222,225	-	227,553
Realized and unrealized gains	<u>20,155</u>	<u>849,814</u>	<u>-</u>	<u>869,969</u>
Total investment income	25,483	1,072,039	-	1,097,522
Releases from restrictions	<u>1,097,278</u>	<u>(1,097,278)</u>	<u>-</u>	<u>-</u>
Total revenues, gains and other support	1,152,761	852,557	237,571	2,242,889
Expenses:				
Scholarships	538,908	-	-	538,908
Operating expenses	138,360	-	-	138,360
Personal services	83,895	-	-	83,895
University support	203,637	-	-	203,637
Student support	68,527	-	-	68,527
Travel and promotion	<u>57,918</u>	<u>-</u>	<u>-</u>	<u>57,918</u>
Total expenses	<u>1,091,245</u>	<u>-</u>	<u>-</u>	<u>1,091,245</u>
Change in net assets	61,516	852,557	237,571	1,151,644
Net assets, beginning of year	<u>315,740</u>	<u>6,433,260</u>	<u>3,227,786</u>	<u>9,976,786</u>
Net assets, end of year	<u>\$ 377,256</u>	<u>\$ 7,285,817</u>	<u>\$ 3,465,357</u>	<u>\$ 11,128,430</u>

See accompanying notes.

KENTUCKY STATE UNIVERSITY FOUNDATION, INC.

Statement of Activities

Year ended June 30, 2013

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues, gains and other support:				
Contributions	\$ 20,557	\$ 1,415,205	\$ 82,224	\$ 1,517,986
Investment income:				
Interest and dividends	5,061	222,698	-	227,759
Realized and unrealized gains	<u>17,826</u>	<u>736,259</u>	<u>-</u>	<u>754,085</u>
Total investment income	22,887	958,957	-	981,844
Releases from restrictions	<u>755,245</u>	<u>(755,245)</u>	<u>-</u>	<u>-</u>
Total revenues, gains and other support	798,689	1,618,917	82,224	2,499,830
Expenses				
Scholarships	79,436	-	-	79,436
Operating expenses	156,001	-	-	156,001
Personal services	137,128	-	-	137,128
University support	255,508	-	-	255,508
Student support	86,493	-	-	86,493
Travel and promotion	<u>59,160</u>	<u>-</u>	<u>-</u>	<u>59,160</u>
Total expenses	<u>773,726</u>	<u>-</u>	<u>-</u>	<u>773,726</u>
Change in net assets	24,963	1,618,917	82,224	1,726,104
Net assets, beginning of year	290,777	1,264,132	6,695,773	8,250,682
Reclassification	<u>-</u>	<u>3,550,211</u>	<u>(3,550,211)</u>	<u>-</u>
Net assets, end of year	<u>\$ 315,740</u>	<u>\$ 6,433,260</u>	<u>\$ 3,227,786</u>	<u>\$ 9,976,786</u>

See accompanying notes.

KENTUCKY STATE UNIVERSITY

Statements of Cash Flows

Years ended June 30, 2014 and 2013

Cash flows from operating activities	<u>2014</u>	<u>2013</u>
Tuition and fees	\$18,362,048	\$ 15,559,397
Grants and contracts	15,461,022	17,525,213
Payments to suppliers	(23,480,750)	(20,782,828)
Payments to employees	(37,413,975)	(39,359,104)
Student financial aid	(8,542,435)	(8,254,844)
Collection of loans issued to students	202,850	301,045
Auxiliary enterprises:		
Residence halls and dining	6,039,451	5,611,564
Bookstore	75,000	152,500
Other auxiliaries	80,973	301,329
Other receipts	<u>1,254,152</u>	<u>1,301,352</u>
Net cash from operating activities	(27,961,664)	(27,644,376)
 Cash flows from non-capital financing activities		
State appropriations	23,537,400	23,537,402
Federal grants and contracts	5,928,036	5,922,954
Endowment gifts	12,676	7,276
Student organization agency receipts	78,409	109,910
Student organization agency disbursements	(70,044)	(70,045)
Other receipts	<u>71,352</u>	<u>583,269</u>
Net cash from non-capital financing activities	29,557,829	30,090,766
 Cash flows from capital financing activities		
Purchases of capital assets	(1,834,139)	(3,227,528)
Principal paid on capital debt	(875,082)	(496,634)
Interest paid on capital debt	<u>(317,534)</u>	<u>(276,050)</u>
Net cash from capital financing activities	(3,026,755)	(4,000,212)
 Cash flows from investing activities		
Investment income	1,766,328	1,235,741
Investment expenses	(66,058)	(84,908)
Proceeds from sale of investments	12,830,492	5,932,168
Purchases of investments	<u>(14,632,193)</u>	<u>(8,263,916)</u>
Net cash from investing activities	<u>(101,431)</u>	<u>(1,180,915)</u>
 Net decrease in cash and cash equivalents	(1,532,021)	(2,734,737)
Cash and cash equivalents at beginning of year	<u>21,107,984</u>	<u>23,842,721</u>
Cash and cash equivalents at end of year	<u>\$ 19,575,963</u>	<u>\$ 21,107,984</u>

See accompanying notes.

KENTUCKY STATE UNIVERSITY

Statements of Cash Flows, continued

Years ended June 30, 2014 and 2013

Reconciliation of net operating loss to net cash from operating activities	<u>2014</u>	<u>2013</u>
Operating loss	\$(34,970,929)	\$ (31,367,576)
Adjustments to reconcile operating loss to net cash from operating activities:		
Depreciation expense	4,459,941	4,511,068
Bad debt expense	4,038,728	1,637,173
Changes in assets and liabilities:		
Receivables, net	(1,495,980)	(39,795)
Inventory and other current assets	380,677	(307,373)
Accounts payable and accrued liabilities	111,228	(990,898)
Accrued compensated absences	(76,201)	(96,819)
Other liabilities	(428,378)	(58,900)
Unearned revenue	<u>19,250</u>	<u>(931,256)</u>
Net cash from operating activities	<u>\$ (27,961,664)</u>	<u>\$ (27,644,376)</u>
 Supplemental disclosure of noncash investing and financing activities:		
Purchase of police vehicles with capital lease	\$ 101,204	\$ -

See accompanying notes.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements

1. Organization and Summary of Significant Accounting Policies

Reporting Entity

Kentucky State University (the University) is a component unit of the Commonwealth of Kentucky and is included in the general-purpose financial statements of the Commonwealth. The Kentucky State University Foundation, Inc. (the Foundation) is a legally separate, tax-exempt organization supporting the University. The Foundation acts primarily as a fund-raising organization to supplement the resources that are available to the University in support of its programs. The Foundation's Board of Directors is self-perpetuating and consists of graduates and friends of the University. Although the University does not control the timing or amount of receipts from the Foundation, the majority of resources or income thereon that the Foundation holds and invests is restricted by the donors to the activities of the University. Because these restricted resources held by the Foundation can only be used by, or for the benefit of, the University, the Foundation is considered a component unit of the University and is discretely presented in the University's financial statements.

Basis of Presentation

The accompanying financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB), including Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis for State and Local Governments*, and Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis of Public College and Universities*, issued in June and November, 1999, respectively. The University reports as a Business Type Activity (BTA), as defined by GASB Statement No. 35. BTA's are those activities that are financed in whole or in part by fees charged to external parties for goods and services. The University, as a BTA, has adopted GASB Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. Therefore, the University follows GASB pronouncements and all Financial Accounting Standards Board pronouncements except those that conflict with or contradict GASB pronouncements.

Basis of Accounting

The financial statements have been prepared on the accrual basis of accounting. Under the accrual basis of accounting, revenues are recognized when earned and expenses are recorded when an obligation has been incurred.

GASB Statement No. 35 establishes standards for external financial reporting for public colleges and universities and requires that resources be classified for accounting and reporting purposes into the following net asset categories:

- **Invested in capital assets, net of related debt:** Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Basis of Accounting, continued

- **Restricted:**

Nonexpendable – Net position subject to externally imposed stipulations that they be maintained permanently by the University. Such position include the University's permanent endowment funds.

Expendable– Net position whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.

- **Unrestricted:** Net position whose use by the University is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Trustees or may otherwise be limited by contractual agreements with outside parties.

The financial statement presentation required by GASB Statement No. 35 is intended to provide a comprehensive, entity-wide perspective of the University's assets, liabilities, net position, revenues, expenses, changes in net position and cash flows.

Cash Equivalents

For the Statement of Cash Flows, the University considers all highly liquid investments with an original maturity of three months or less to be cash equivalents.

Accounts, Grants, and Loans Receivable, net

Accounts receivables consist of tuition and fee charges, loans to students and amounts due from federal and state governments, non-governmental sources, in connection with reimbursements of allowable expenses made pursuant to grants and contracts. Accounts receivables are recorded net of allowance for doubtful accounts.

Allowance for Doubtful Accounts

The allowance for doubtful accounts is established through a provision for doubtful accounts charged to expense. The allowance represents an amount, which, in management's judgment, will be adequate to absorb probable losses on existing accounts that may become uncollectible.

Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market and consist of physical plant items. Inventories consist of physical plant, postage and printing supplies.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Endowment Funds

Kentucky State University recognizes its fiduciary duty not only to invest the University's endowment holdings in formal compliance with the *Uniform Prudent Management of Institutional Funds Act (UPMIFA)* but also to manage those funds in continued recognition of the basic long-term nature of the University. The University interprets this to mean, in addition to the adopted spending guidelines and restrictions described below, that the assets of the University shall be actively managed, that is, investment decisions regarding the particular securities to be purchased or sold shall be the result of the conscious exercise of discretion. The University recognizes that, commensurate with its overall objective of maximizing long-range return while maintaining a high standard of portfolio quality and consistency of return, it is necessary that proper diversification of assets be maintained both among and within the classes of securities held. Within this context of active management and the necessity of adherence to proper diversification, the University relies upon appropriate professional advice.

The University recognizes that long-term objectives are most important, but it is also necessary that shorter-term benchmarks be used to assess the periodic performance of the investment program. The University anticipates annual spending of five percent (5%) of the average market value for the past three years, the amount of which shall be determined in January of each year.

The University believes that it is prudent to diversify endowment investments so as to minimize the risks of large losses and has established asset allocation ranges based upon the University's participation demographics, anticipated cash flow requirements and the expected returns of the capital markets. The University President will allocate assets within classes of investments which he/she considers to be appropriate.

Investments

Investments are valued at fair value based on quoted market prices. Short-term investments are investments that are not cash equivalents but mature within the next fiscal year and are classified as current assets.

Capital Assets

Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair value at date of gift. Equipment with a unit cost of \$2,000 or more and having an estimated useful life of greater than one year is capitalized. Renovations to buildings and infrastructure and land improvements that significantly increase the value or extend the useful life of the structure are capitalized. Routine repairs and maintenance are charged to operating expense in the year in which the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets. The University capitalizes, but does not depreciate, works of art and historical

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Capital Assets, continued

treasures that are held for exhibition, education, research and public service. Estimated lives used for depreciation purposes are as follows:

<u>Classification</u>	<u>Estimated Life</u>
Improvements	20 years
Buildings	40 years
Transportation equipment	5-15 years
Equipment	5-20 years
Enterprise Resource Software	7 years
Library holdings	10 years

Compensated Absences

The liability and expense incurred for employee vacation and sick pay are recorded as accrued compensated absences in the statements of net position and as a component of compensation and benefit expense in the statements of revenues, expenses and changes in net position.

Unearned Revenue

Unearned revenue includes amounts received for tuition and fees prior to the end of the fiscal year but related to the subsequent reporting period. Unearned revenues also include amounts received from grant and contract sponsors and state deferred maintenance funds that have not yet been earned.

Income Taxes

The University is an agency and instrumentality of the Commonwealth of Kentucky, pursuant to Kentucky Revised Statutes sections 164.290 through 164.475. Accordingly, the University is generally exempt from federal income taxes as an organization described in Section 115 of the Internal Revenue Code of 1986, as amended. The Foundation has received a determination from the Internal Revenue Service granting exemption from federal income taxation pursuant to the provisions of the Internal Revenue Code section 501(c)(3).

Restricted Asset Spending Policy

The University's policy is that restrictions on assets cannot be fulfilled by the expenditure of unrestricted funds for similar purposes. The determination on whether restricted or unrestricted funds are expended for a particular purpose is made on a case-by-case basis. Restricted funds remain restricted until spent for the intended purpose.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Operating Activities

The University defines operating activities, as reported on the statement of revenues, expenses and changes in net position, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for services and goods received. Nearly all of the University's expenses are from exchange transactions. Certain significant revenues relied upon for operations, such as state and certain federal appropriations, gifts and investment income, are recorded as non-operating revenues, in accordance with GASB Statement No. 35.

Scholarship Discounts and Allowances

Financial aid to students is reported in the financial statements under the alternative method as prescribed by the National Association of College and University Business Officers (NACUBO). Certain aid, such as loans and funds provided to students awarded by third parties, is accounted for as third party payments (credited to the student's account as if the student made the payment). All other aid is reflected in the financial statements as operating expenses, or scholarship allowances, which reduce revenues. The amount reported as operating expenses represents the portion of aid that was provided to the student in the form of cash. Scholarship allowances represent the portion of aid provided to the student in the form of reduced tuition. Under the alternative method, these amounts are computed by allocating the cash payments to students, excluding payments for services, on the ratio of total aid to the aid not considered to be third party aid.

Federal Grants and Contracts

Per GASB Statement No. 24, pass-through grants should be reported as revenues and expenses in the financial statements if that entity has any administrative or direct financial involvement in the program. An entity has administrative involvement if it determines eligible secondary recipients or projects, even if using grantor-established criteria. Therefore, Pell Grants are considered non-exchange transactions and are recorded as non-operating revenues in the accompanying financial statements.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Component Unit Disclosure

The accompanying financial statements of the Foundation have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the FASB. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features.

During the year ended June 30, 2014 and 2013, the Foundation made distributions of approximately \$203,600 and \$255,500 respectively, on behalf of the University for both restricted and unrestricted purposes. Complete financial statements for the Foundation can be obtained from the Kentucky State University Foundation, Inc. at P.O. Box 4210, Frankfort, KY 40604.

Recent Pronouncements

In November 2013, the GASB approved Statement No. 71, *Pension transition for contributions made subsequent to the measurement date – an amendment of GASB Statement No. 68*. The objective of this Statement is to address an issue regarding application of the transition provisions of Statement No. 68, *Accounting and Financial Reporting for Pensions*. The issue relates to amounts associated with contributions, if any, made by a state or local government employer or nonemployer contributing entity to a defined benefit pension plan after the measurement date of the government's beginning net pension liability. This Statement amends paragraph 137 of Statement 68 to require that, at transition, a government recognize a beginning deferred outflow of resources for its pension contributions, if any, made subsequent to the measurement date of the beginning net pension liability. Statement 68, as amended, continues to require that beginning balances for other deferred outflows of resources and deferred inflows of resources related to pensions be reported at transition only if it is practical to determine all such amounts. The provisions of this Statement are required to be applied simultaneously with the provisions of Statement 68.

In June 2012, the GASB approved Statement No. 68, *Accounting and Financial Reporting for Pensions*. This Statement replaces the requirements of Statement No. 27, *Accounting for Pensions by State and Local Governmental Employers* and Statement No. 50, *Pension Disclosures*, as they relate to governments that provide pensions through pension plans administrators as trusts or similar arrangements that meet certain criteria. Statement 68 requires governments providing defined benefit pensions to recognize their long-term obligation for pension benefits as a liability for the first time, and to more comprehensively and comparably measure the annual costs of pension benefits.

Cost-sharing governmental employers will also be required to report a net pension liability, pension expense and pension-related assets and liabilities based on their proportionate share of the collective amounts for all governments in the plan. All governments participating in the defined benefit pension plan would also have the following in their note disclosures:

- Descriptions of the plan and benefits provided
- Significant assumptions employed in the measurement of the net pension liability

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Recent Pronouncements, continued

- Descriptions of benefit changes and changes in assumptions
- Assumptions related to the discount rate and impact on the total pension liability of a 1 percentage point increase and decrease in the discount rate
- Net pension assets and liabilities

The provisions of this Statement are effective for fiscal years beginning after June 15, 2014. The University is currently evaluating the effects of this statement on its financial statements.

In March 2012, the GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities and recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. This statement also provides other financial reporting guidance related to the impact of the financial statement elements deferred outflows of resources and deferred inflows of resources, such as changes in the determination of the major fund calculations and limiting the use of the term *deferred* in financial statement presentations. The requirements of this statement were implemented as of June 30, 2014. This statement did not significantly affect the University's financial statements.

2. Cash, Cash Equivalents, and Investments

The statement of net position classification "cash and cash equivalents" includes all readily available sources of cash such as petty cash, demand deposits, certificates of deposit and temporary investments in marketable securities with original maturities less than three months.

At June 30, 2014 and 2013, the University had petty cash funds totaling zero, and deposits as reflected by bank balances as follows:

	<u>2014</u>	<u>2013</u>
Insured, commercial banks	\$ 250,000	\$ 250,000
Uninsured, commercial banks; collateral held by pledging institution's agent in the University's name	-	5,018,080
Maintained by Commonwealth of Kentucky, collateral held by the Commonwealth in the Commonwealth's name	<u>19,298,591</u>	<u>15,926,887</u>
	<u>\$ 19,548,591</u>	<u>\$ 21,194,967</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

2. Cash, Cash Equivalents, and Investments, continued

The difference in the cash carrying amount per the statement of net position and the above bank balances represented items in transit. At June 30, 2014 and 2013, the University had no cash and cash equivalents that are restricted for capital expenditures.

As of June 30, 2014, the University had the following investments and maturities:

Investment Maturities (in years)

<u>Investment Type</u>	<u>Fair Value</u>	<u><1</u>	<u>1-5</u>	<u>6-10</u>	<u>11-20</u>
Bonds	\$ 1,558,440	\$125,000	\$ 722,900	\$ 548,200	\$ 162,340
Bond Mutual Funds	4,696,098	-	4,696,098	-	-
Money Market Funds	833,793	833,793	-	-	-
Real Estate Funds	<u>707,441</u>	<u>-</u>	<u>707,441</u>	<u>-</u>	<u>-</u>
	7,795,772	\$ 958,793	\$ 6,126,439	\$ 548,200	\$ 162,340
Equities and Equity Mutual Funds	<u>7,507,326</u>				
	<u>\$ 15,303,098</u>				

As of June 30, 2013, the University had the following investments and maturities:

Investment Maturities (in years)

<u>Investment Type</u>	<u>Fair Value</u>	<u><1</u>	<u>1-5</u>	<u>6-10</u>	<u>11-20</u>
Bonds	\$ 2,471,417	\$ 160,000	\$1,122,984	\$ 533,278	\$ 655,155
Bond Mutual Funds	2,868,982	-	2,868,982	-	-
Money Market Funds	801,131	801,131	-	-	-
Real Estate Funds	<u>611,011</u>	<u>-</u>	<u>611,011</u>	<u>-</u>	<u>-</u>
	\$ 6,752,541	\$ 961,131	\$4,602,977	\$ 533,278	\$ 655,155
Equities and Equity Mutual Funds	<u>6,748,856</u>				
	<u>\$ 13,501,397</u>				

The University has an investment management agreement with Fifth Third Bank (Fifth Third). Fifth Third serves individual and institutional clients.

Credit Risk

The University's average credit quality rating according to Moody's is Aa3.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

2. Cash, Cash Equivalents, and Investments, continued

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. The University does not have a formal policy to specifically limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. The University does not have a formal policy for concentration of credit risk.

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the University will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The University does not have a formal policy for custodial credit risk.

3. Accounts, Grants and Loan Receivable

Accounts, grants and loans receivable consist of the following as of June 30, 2014 and 2013.

	<u>2014</u>	<u>2013</u>
Student tuition and fees	\$ 11,493,659	\$ 7,760,848
Student loans	1,865,807	2,068,658
Grants and contracts	4,821,116	5,334,984
Other	<u>261,467</u>	<u>419,575</u>
	18,442,049	15,584,065
Less: allowance for doubtful accounts	<u>(9,665,577)</u>	<u>(4,264,845)</u>
	8,776,472	11,319,220
Non-current portion	<u>241,030</u>	<u>443,881</u>
Current portion	<u>\$ 8,535,442</u>	<u>\$ 10,875,339</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

4. Capital Assets, Net

Capital assets as of June 30, 2014, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
<u>Cost</u>				
Land and improvements	\$ 6,275,031	\$ -	\$ -	\$ 6,275,031
Buildings	154,740,029	-	-	154,740,029
Equipment	25,240,976	772,319	-	26,013,295
Computer software	1,458,622	18,371	-	1,476,993
Library holdings	10,366,485	6,501	-	10,372,986
Transportation equipment	4,675,169	172,805	-	4,847,974
Construction in progress	<u>4,903</u>	<u>965,347</u>	-	<u>970,250</u>
	<u>202,761,215</u>	<u>1,935,343</u>	-	<u>204,696,558</u>
<u>Accumulated depreciation</u>				
Buildings	89,551,511	2,496,710	-	92,048,221
Equipment	16,450,103	1,600,844	-	18,050,947
Library holdings	9,490,629	257,631	-	9,748,260
Transportation equipment	<u>4,083,354</u>	<u>104,756</u>	-	<u>4,188,110</u>
	<u>119,575,597</u>	<u>4,459,941</u>	-	<u>124,035,538</u>
Capital assets, net	<u>\$ 83,185,618</u>	<u>\$ (2,524,598)</u>	<u>\$ -</u>	<u>\$ 80,661,020</u>

Capital assets as of June 30, 2013, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
<u>Cost</u>				
Land and improvements	\$ 5,648,990	\$ 626,041	\$ -	\$ 6,275,031
Buildings	153,206,036	1,533,993	-	154,740,029
Equipment	24,267,330	973,646	-	25,240,976
Computer software	1,433,622	25,000	-	1,458,622
Library holdings	9,780,929	585,556	-	10,366,485
Transportation equipment	4,153,384	521,785	-	4,675,169
Construction in progress	<u>1,043,396</u>	<u>724,880</u>	<u>1,763,373</u>	<u>4,903</u>
	<u>199,533,687</u>	<u>4,990,901</u>	<u>1,763,373</u>	<u>202,761,215</u>
<u>Accumulated depreciation</u>				
Buildings	87,131,071	2,420,440	-	89,551,511
Equipment	14,796,247	1,653,856	-	16,450,103
Library holdings	9,217,036	273,593	-	9,490,629
Transportation equipment	<u>3,920,175</u>	<u>163,179</u>	-	<u>4,083,354</u>
	<u>115,064,529</u>	<u>4,511,068</u>	-	<u>119,575,597</u>
Capital assets, net	<u>\$ 84,469,158</u>	<u>\$ 479,833</u>	<u>\$ 1,763,373</u>	<u>\$ 83,185,618</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

5. Accounts Payable and Accrued Liabilities

Accounts payable and accrued liabilities as of June 30, 2014 and 2013, are as follows:

	<u>2014</u>	<u>2013</u>
Payable to vendors and contractors	\$ 563,431	\$ 63,548
Accrued sick leave liability	346,431	500,000
Accrued salaries and other liabilities	<u>2,492,380</u>	<u>2,727,466</u>
	<u>\$ 3,402,242</u>	<u>\$ 3,291,014</u>

6. Unearned Revenue

Unearned revenue consists of the following as of June 30, 2014 and 2013:

	<u>2014</u>	<u>2013</u>
Unearned summer school tuition and fees	\$ 261,467	\$ 390,665
Unearned grants and contracts	<u>1,037,861</u>	<u>889,413</u>
	<u>\$ 1,299,328</u>	<u>\$ 1,280,078</u>

7. Long-Term Liabilities

Long-term liabilities as of June 30, 2014, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent portion</u>
General receipts bonds	\$ 3,790,000	\$ -	\$ 385,000	\$ 3,405,000	\$ 210,000	\$ 3,195,000
Note payable – City of Frankfort	300,000	-	50,000	250,000	50,000	200,000
Capital lease – police vehicles	-	101,204	-	101,204	33,735	67,469
Capital lease obligations- energy savings	4,139,613	-	443,913	3,695,700	463,161	3,232,539
Bond discount	<u>(53,629)</u>	<u>-</u>	<u>(3,831)</u>	<u>(49,798)</u>	<u>(3,831)</u>	<u>(45,967)</u>
Total bonds payable and capital lease obligations	8,175,984	101,204	875,082	7,402,106	753,065	6,649,041
Federal grants refundable	<u>991,709</u>	<u>-</u>	<u>456,795</u>	<u>534,914</u>	<u>-</u>	<u>534,914</u>
Total long-term liabilities	<u>\$ 9,167,693</u>	<u>\$ 101,204</u>	<u>\$ 1,331,877</u>	<u>\$ 7,937,020</u>	<u>\$ 753,065</u>	<u>\$ 7,183,955</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

7. Long-Term Liabilities, continued

Long-term liabilities as of June 30, 2013, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Noncurrent portion</u>
General receipts bonds	\$ 4,165,000	-	\$ 375,000	\$ 3,790,000	\$ 385,000	\$ 3,405,000
Note payable – City of Frankfort	-	500,000	200,000	300,000	50,000	250,000
Capital lease obligations- energy savings	4,565,078	-	425,465	4,139,613	443,913	3,695,700
Bond discount	<u>(57,460)</u>	<u>-</u>	<u>(3,831)</u>	<u>(53,629)</u>	<u>(3,831)</u>	<u>(49,798)</u>
Total bonds payable and capital lease obligations	8,672,618	500,000	996,634	8,175,984	875,082	7,300,902
Federal grants refundable	<u>991,709</u>	<u>-</u>	<u>-</u>	<u>991,709</u>	<u>-</u>	<u>991,709</u>
Total long-term liabilities	<u>\$ 9,664,327</u>	<u>\$ 500,000</u>	<u>\$ 996,634</u>	<u>\$ 9,167,693</u>	<u>\$ 875,082</u>	<u>\$ 8,292,611</u>

The outstanding General Receipts Bonds Series A Bonds have interest rates from 3.625% - 3.875%. The bonds mature through 2027. The reserve requirements for these issues have been fully funded as of June 30, 2014.

All bonds are collateralized by University property and the pledge of certain revenues, tuition and fees.

The net book value of assets acquired through the capital leases included in the above schedule totaled \$4,013,670 and \$4,362,446 as of June 30, 2014 and 2013, respectively.

In August 2009, the University signed a 10 year promissory note with the City of Frankfort, for the purchase of real property. The note and all current and prior payments were recognized and recorded as of June 30, 2013.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

7. Long-Term Liabilities, continued

The following is a schedule of future minimum payments required for the promissory note at June 30, 2014:

Year ending June 30,		
2015	\$	50,000
2016		50,000
2017		50,000
2018		50,000
2019		<u>50,000</u>
Total	\$	<u>250,000</u>

The principal and interest repayment requirements relating to the outstanding bonds payable at June 30, 2014, are as follows:

Year ending June 30,	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2015	\$ 210,000	\$ 129,701	\$ 339,701
2016	215,000	122,089	337,089
2017	225,000	114,241	339,241
2018	230,000	105,916	335,916
2019	240,000	97,291	337,291
2020 – 2024	1,350,000	341,651	1,691,651
2025 – 2027	<u>935,000</u>	<u>73,431</u>	<u>1,008,431</u>
Total	<u>\$ 3,405,000</u>	<u>\$ 984,320</u>	<u>\$ 4,389,320</u>

During 2005, the University entered into a capital lease for an energy management project. The lease obligation has an interest rate of 4.29% and requires annual payments of principal and interest through 2021. The lease obligation will be paid with guaranteed energy savings.

During 2014, the University entered into a capital lease for the purchase of four police vehicles. The lease is payable in 4 annual installments, of which the first was paid in 2014.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

7. Long-Term Liabilities, continued

The following is a schedule of future minimum payments required for the capital lease obligations at June 30, 2014:

Year ending June 30,	
2015	\$ 650,527
2016	650,527
2017	650,526
2018	616,792
2019	616,792
Thereafter	<u>1,233,585</u>
Total minimum lease payments	4,418,749
Less: amounts representing interest	<u>621,845</u>
Present value of minimum lease payment	<u>\$ 3,796,904</u>

8. Operating Lease

The University leases computer equipment under operating leases, which expired and was renewed on August 1, 2014. Lease payments to the lessors under these leases totaled \$122,016 and \$125,232 for the years ended June 30, 2014 and 2013, respectively.

Minimum future lease payments are as follows:

2015	\$ 106,104
2016	<u>69,794</u>
	<u>\$ 175,898</u>

9. Employee Benefits

Kentucky Teachers Retirement System

All faculty and exempt employees required to hold a degree and occupying full-time positions, defined as seven-tenths (7/10) of normal full-time service on a daily or weekly basis, are required by state law to participate either in the Kentucky Teachers Retirement System (KTRS) or the Optional Retirement Plan (ORP). KTRS, a cost sharing, multiple-employer, public employee retirement system, provides retirement

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

9. Employee Benefits, continued

Kentucky Teachers Retirement System, continued

benefits based on an employee's final average salary and number of years of service. Benefits are subject to certain reductions if the employee retires before reaching age sixty, unless the employee has twenty-seven or more years of participation in the plan. The plan also provides for disability retirement, death and survivor benefits and medical insurance.

The Kentucky Teachers Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Teachers Retirement System, 479 Versailles Road, Frankfort, Kentucky 40601-3868 or by calling (502) 848-8500.

Funding for the plan is provided from eligible employees who contribute 7.16% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 14.84% of current eligible employees' salaries to the KTRS through appropriations to the University. Contribution requirements of the plan members and the University are established by Kentucky Revised Statute and the KTRS Board of Trustees. The University's contributions to KTRS for the years ended June 30, 2014, 2013 and 2012 were \$2,483,138, \$2,037,331, and \$2,155,711, respectively, and equaled the required contribution for that year.

Kentucky Employees Retirement System

Substantially all other full-time University employees are required by law to participate in the Kentucky Employees Retirement System (KERS), a cost sharing multiple-employer, public employee retirement system. KERS provides retirement benefits based on an employee's final average salary and number of years of service. Benefits are subject to certain reductions if the employee retires before reaching age sixty-five, or less than twenty-seven years of service. The plan also provides for disability retirement, death and survivor benefits and medical insurance.

The Kentucky Employees Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing to Kentucky Employees Retirement System, 1260 Louisville Road, Perimeter Park West, Frankfort, Kentucky 40601 or by calling (502) 564-4646.

Funding for the plan is provided from eligible employees who contribute 5.00% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 26.79% of current eligible employees' salaries to the KERS through appropriations to the University. Employees hired on or after July 1, 2008 contribute 6.00% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 26.79% to the KERS through appropriations to the University. The University contribution rates are determined by the Kentucky Revised Statute and the Board of Trustees of the Kentucky Retirement System each biennium. The University's contributions to KERS for the years ended June 30, 2014, 2013 and 2012 were \$1,432,369, \$1,218,234, and \$1,041,753, respectively, and equaled the required contribution for that year.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

9. Employee Benefits, continued

Health care and life insurance benefits are provided for eligible retired employees through the above pension plans. Expenditures for all employee benefits are included as expenditures within the appropriate functional areas.

Optional Retirement Plan

All faculty and exempt employees who are eligible to participate in the KTRS retirement plan may elect to participate in the Optional Retirement Plan (ORP) instead of KTRS. In doing so, the employee may choose both Teachers Insurance and Annuity Association of America, (TIAA-CREF) or The Variable Annuity Life Insurance Company (VALIC). Both offer a defined contribution, 403b plan.

TIAA-CREF is one of the largest and most respected financial service providers in the world (unaudited). TIAA-CREF Individual & Institutional Services, Inc. distributes CREF and TIAA Real Estate Account variable annuities. Teachers Personal Investors Services, Inc. distributes Personal Annuity variable annuities, TIAA-CREF Mutual Funds, TIAA-CREF Institutional Mutual Funds, and TIAA-CREF Tuition Financing, Inc. products. TIAA-CREF Trust Company, FSB, provides trust services. Located in New York, NY, Teachers Insurance and Annuity Association of America (TIAA) and TIAA-CREF Life Insurance Company issue insurance and annuities. Financial statements are available on the website, www.tiaa-cref.com.

VALIC is the marketing name for the family of companies comprising VALIC Financial Advisors, Inc.; VALIC Retirement Services Company; VALIC Trust Company; and The Variable Annuity Life Insurance Company (VALIC); which are all members of American International Group, Inc. (AIG).

Complete information about VALIC's variable annuities, including financial statements, fees, charges, expenses and contract limitations, can be obtained by visiting the website www.aigvalic.com or by calling 1-800-428-2542.

Funding for the ORP is provided from eligible employees who contribute 6.16% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 8.74% of current eligible employees' salaries to the ORP through appropriations to the University. The University's contributions to ORP for the years ended June 30, 2014, 2013 and 2012 were \$554,207, \$485,224, and \$434,586, respectively, and equaled the required contribution for the year.

Effective July 1, 2010, KRS 61.546 states that the value of any accumulated sick leave that is added to the member's service credit in the KERS and KTRS on or after July 1, 2010 shall be paid to the retirement system by the last participating employer, based upon a formula adopted by the KERS and KTRS Boards. The KERS/KTRS sick leave liability as of June 30, 2014 and 2013 was \$346,431 and \$500,000.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

10. Commitments and Contingencies

The University is a party to various law suits and other claims in the ordinary course of business. University officials are of the opinion, based upon the advice of legal counsel, that the ultimate resolution of these matters will not have a material effect on the financial statements of the University.

The University receives financial assistance from federal and state agencies in the form of grants and awards. The expenditure of funds received from these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audit could become a liability of the applicable fund. In the opinion of management, such potential disallowed claims, if any, would not have a material adverse effect on the overall financial position of the University at June 30, 2014.

11. Risk Management

The University is exposed to various risks of loss from torts; theft of, damage to, destruction of assets; business interruption; employee injuries and illnesses; natural disasters; and employee health and accident benefits. Commercial insurance coverage is purchased for claims arising from these risks. Settled claims have not exceeded this commercial coverage in any of the three preceding years. As a sovereign entity of the Commonwealth of Kentucky, the Kentucky Board of Claims handles tort claims on behalf of the University.

12. Schedule of Expenses by Program

In the Statement of Revenues, Expenses and Changes in Net Position, operating expenses are presented by functional expense purpose. Depreciation is allocated below based on functional classification as required by IPEDS for Fiscal Year 2014. Functional expense purpose is classified by natural classification:

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

12. Schedule of Expenses by Program, continued

2014

	<u>Compensation & Benefits</u>	<u>Supplies & Services</u>	<u>Scholarships & Fellowships</u>	<u>Depreciation</u>	<u>Operations & Maintenance</u>	<u>Total</u>
Instruction	\$ 11,762,119	\$ 1,003,793	\$ -	\$ 648,258	\$ 1,022,374	\$14,436,544
Research	3,557,471	1,940,452	10,438	754,727	477,347	6,740,435
Public service	4,516,253	3,020,059	244,522	350,219	619,716	8,750,769
Academic support	1,616,845	822,031	(98)	311,103	209,585	2,959,466
Student services	5,159,056	2,111,594	8,367	452,728	589,282	8,321,027
Institutional support	6,952,041	6,930,598	-	932,053	1,262,892	16,077,584
Operation & maintenance of plant	1,908,262	2,772,033	-	662,023	(5,342,318)	-
Auxiliary enterprises	1,203,789	4,459,481	-	327,251	456,573	6,447,094
Student financial aid	<u>661,939</u>	<u>278,484</u>	<u>8,282,108</u>	<u>21,579</u>	<u>704,549</u>	<u>9,948,659</u>
Total operating expense	<u>\$ 37,337,775</u>	<u>\$23,338,525</u>	<u>\$ 8,545,337</u>	<u>\$ 4,459,941</u>	<u>\$ -</u>	<u>\$73,681,578</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

12. Schedule of Expenses by Program, continued

2013

	Compensation & <u>Benefits</u>	Supplies & <u>Services</u>	Scholarships & <u>Fellowships</u>	<u>Depreciation</u>	Operations & <u>Maintenance</u>	<u>Total</u>
Instruction	\$ 12,400,132	\$ 1,261,665	\$ 39,442	\$ 648,012	\$ 1,345,441	\$ 15,694,692
Research	3,698,586	2,085,005	-	797,270	617,047	7,197,908
Public service	4,002,827	1,416,702	-	287,160	535,081	6,241,770
Academic support	2,001,154	1,366,739	-	279,201	341,966	3,989,060
Student services	5,368,188	2,314,885	29,089	477,347	767,880	8,957,389
Institutional support	6,832,234	2,915,953	(75,391)	984,830	1,197,048	11,854,674
Operation & maintenance of plant	2,029,743	3,572,257	-	683,049	(6,285,049)	-
Auxiliary enterprises	1,192,313	5,081,378	-	336,961	619,841	7,230,493
Student financial aid	<u>556,159</u>	<u>344,814</u>	<u>8,261,704</u>	<u>17,238</u>	<u>860,745</u>	<u>10,040,660</u>
Total operating expense	<u>\$ 38,081,336</u>	<u>\$ 20,359,398</u>	<u>\$ 8,254,844</u>	<u>\$ 4,511,068</u>	<u>\$ -</u>	<u>\$ 71,206,646</u>

13. Kentucky State University Foundation, Inc.

a. Organization:

Kentucky State University Foundation, Inc. (the Foundation) is a Kentucky not-for-profit corporation formed to receive, invest and expend funds to promote and implement educational and developmental activities at Kentucky State University (the University). The Foundation is managed by a Board of Trustees independent from that of the University. The Foundation is supported primarily through contributions from alumni.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc. continued

b. Summary of Significant Accounting Policies:

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) which require management to make estimates and assumptions that affect the reported amounts and disclosures in the financial statements. Actual results could differ from those estimates. The following is a summary of the significant accounting policies consistently followed by the Foundation in the preparation of its financial statements.

Basis of Presentation

Net assets and revenues, expenses, gains, and losses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, net assets of the Foundation are classified and reported as follows:

Unrestricted net assets - Net assets that are not subject to donor-imposed stipulations.

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that will be met by actions of the Foundation, pursuant to those stipulations or that expire by the passage of time. Assets released from restrictions during 2014 and 2013 primarily relate to scholarships and University and student support.

Permanently restricted net assets - Net assets subject to donor-imposed stipulations that neither expire by passage of time nor can be fulfilled or removed by actions of the Foundation pursuant to those stipulations. Permanently restricted net assets consist of assets from which the income can be used toward University scholarships and Foundation operations.

Cash and Cash Equivalents

The Foundation considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents. The Foundation has a concentration of credit risk in that it periodically maintains bank accounts which, at times, may exceed the coverage provided by the Federal Deposit Insurance Corporation (FDIC). The Foundation has not experienced any losses on such amounts. The Foundation believes it is not exposed to any significant credit risk on cash.

Investments

Investments are stated at fair value based on closing market quotations for such securities or similar securities.

Property and Equipment

Property and equipment is recorded at cost if purchased or fair market value at date of contribution if contributed. If the donors stipulate how long the assets must be used, the contributions of property and equipment are recorded as restricted support. In the absence of such stipulations, these contributions are recorded as unrestricted support. Depreciation is computed on a straight-line basis over the estimated

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc. continued

b. Summary of Significant Accounting Policies, continued:

Property and Equipment, continued

useful lives of the respective assets. Depreciation expense was \$16,022 and 17,718 for the years ended June 30, 2014 and 2013, respectively.

Revenue Recognition

Contributions are generally recognized when received. However, pledges are recognized when the donor makes a promise to give to the Foundation that is, in substance, unconditional. Contributions that are restricted by the donor are reported as increases in unrestricted net assets if the restrictions expire in the fiscal year in which the contributions are recognized. All other donor-restricted contributions are reported as increases in temporarily or permanently restricted net assets depending on the nature of the restrictions. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets.

Income Taxes

Kentucky State University Foundation, Inc., a not-for-profit organization operating under Section 501(c)(3) of the Internal Revenue Code, is generally exempt from federal, state and local income taxes. The Foundation's management does not believe the Foundation has any unrelated business income. Accordingly, no provision for income taxes is recorded in the financial statements.

Management has evaluated the Foundation's tax positions and concluded that the Foundation had taken no material uncertain tax positions that require recognition or disclosure in the financial statements. With few exceptions, the Foundation is no longer subject to income tax examinations by the U.S. federal, state or local tax authorities for years before 2010.

Subsequent Events

The Foundation's management has evaluated subsequent events for accounting and disclosure requirements through October 2, 2014, the date the financial statements were available to be issued. There were no events occurring during the evaluation period that require recognition or disclosure in the financial statements.

Reclassification

The presentation of certain items in 2013 were reclassified to conform with the 2014 presentation, this reclassification had no impact on net assets or change in net assets.

During 2013, the Foundation determined that certain amounts were improperly classified between the net asset categories. Certain amounts have been reclassified to more accurately reflect the net asset balances of the Foundation based on donor intent. This reclassification had no effect on total change in net assets or total net assets.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc. continued

c. Investments

Investments as of June 30, 2014 and 2013 are summarized as follows:

	<u>2014</u>	<u>2013</u>
Equity securities	\$ 6,534,855	\$ 5,720,145
Debt securities	1,820,065	1,202,729
Real estate investment trust	140,400	140,400
U.S government securities	<u>679,682</u>	<u>861,443</u>
 Total investments	 <u>\$ 9,175,002</u>	 <u>\$ 7,924,717</u>

d. Fair Value Measurements

The Foundation classifies its investments based on a hierarchy consisting of: Level 1 (valued using quoted prices from active markets for identical assets), Level 2 (not traded on an active market but for which observable market inputs are readily available), and Level 3 (valued based on significant unobservable inputs). The investment's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as of June 30, 2014 and 2013.

Common stocks, debt securities, U.S. government securities, equity exchange traded funds, and marketable limited partnerships: Valued at the closing price reported on the active market on which the individual securities are traded. Some level 2 inputs are used for pricing of municipal and corporate bonds; therefore, they are all classified as level 2.

Mutual funds and real estate investment trust: Valued at the net asset value (NAV) of shares held by the Foundation at year end.

The methods described above may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, while the Foundation believes its valuation methods are appropriate and consistent with those of other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc. continued

d. Fair Value Measurements, continued

Fair value measurements as of June 30, 2014 are as follows:

	Level 1	Level 2	Level 3	Total
Common stocks	\$ 3,984,702	\$ -	\$ -	\$ 3,984,702
Mutual funds:				
Bond funds	344,807	-	-	344,807
Daily accrual funds	271,160	-	-	271,160
Small cap equity funds	135,624	-	-	135,624
Mid cap equity funds	6,331	-	-	6,331
Large cap equity funds	14,568	-	-	14,568
International equity funds	1,246,540	-	-	1,246,540
Balanced equity funds	180,105	-	-	180,105
Debt securities:				
Municipal bonds	-	264,543	-	264,543
Corporate bonds	-	1,555,522	-	1,555,522
U.S government securities	679,682	-	-	679,682
Real estate investment trust	-	140,400	-	140,400
Equity exchange traded funds	213,334	-	-	213,334
Marketable limited partnerships	137,684	-	-	137,684
Total	<u>\$ 7,214,537</u>	<u>\$ 1,960,465</u>	<u>\$ -</u>	<u>\$ 9,175,002</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc. continued

d. Fair Value Measurements, continued

Fair value measurements as of June 30, 2013 are as follows:

	Level 1	Level 2	Level 3	Total
Common stocks	\$ 3,720,273	\$ -	\$ -	\$ 3,720,273
Mutual funds:				
Bond funds	279,862	-	-	279,862
Daily accrual funds	259,993	-	-	259,993
Small cap equity funds	117,643	-	-	117,643
Mid cap equity funds	126,293	-	-	126,293
International equity funds	803,320	-	-	803,320
Balanced equity funds	144,846	-	-	144,846
Debt securities:				
Municipal bonds	-	232,207	-	232,207
Corporate bonds	-	970,522	-	970,522
U.S government securities	861,443	-	-	861,443
Real estate investment trust	-	140,400	-	140,400
Equity exchange traded funds	137,742	-	-	137,742
Marketable limited partnerships	130,173	-	-	130,173
Total	\$ 6,581,588	\$ 1,343,129	\$ -	\$ 7,924,717

e. Temporarily Restricted Net Assets

For the years ended June 30, 2014 and 2013, net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restrictions specified by donors as follows:

	2014	2013
Scholarships	\$ 521,629	\$ 45,378
Endowment spending allocation	191,899	215,070
University support	188,717	224,330
Student support	66,027	86,493
Operating and other expenses	61,899	55,465
Travel and other expenses	55,820	57,788
Personal services	11,287	70,721
Total release from restrictions	\$ 1,097,278	\$ 755,245

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc. continued

f. Retirement Plan

The Foundation has a defined contribution profit sharing plan which covers all employees who meet certain requirements. Foundation contributions are discretionary. No contributions were made for the years ended June 30, 2014 and 2013.

g. Endowment Composition

On July 15, 2010, The Commonwealth of Kentucky adopted the Uniform Prudent Management of Institutional Funds Act (UPMIFA). The Foundation follows UPMIFA and its own governing documents. The Foundation has interpreted UPMIFA as requiring the preservation of the corpus of the donor-restricted endowment funds absent explicit donor stipulations to the contrary, and other amounts as deemed necessary by the board. As a result of this interpretation, the Foundation classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment, (2) the original value of subsequent gifts to the permanent endowment, and (3) accumulations to permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The Foundation has determined that the balance of its endowments includes funds that require that the income and net appreciation be restricted to certain uses for the benefit of participants.

Upon review, the Foundation has determined that appropriate expenditures have been made to meet all donor restrictions regarding balances recorded in the endowment fund.

Spending Policy: The Foundation employs a conservative endowment spending policy which is evaluated annually. The amount of earnings distributed annually is based on an analysis of many factors including, the amount of earnings available to be distributed, as well as, the long and short term financial needs of the Foundation. The Foundation manages its long-term investments in accordance with the total return concept and the goal of maximizing long-term return within acceptable levels of risk. The Foundation's spending policy is designed to provide a stable level of financial support and to preserve the real value of its endowment.

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level the donor requires the Foundation to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2014 and 2013.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc. continued

g. Endowment Composition, continued

Endowment net asset composition by type of fund as of June 30, 2014 is as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Donor-restricted endowment funds	\$ -	\$ 4,891,754	\$ 3,465,357	\$ 8,357,111

Endowment net asset composition by type of fund as of June 30, 2013 was as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Donor-restricted endowment funds	\$ -	\$ 4,164,902	\$ 3,227,786	\$ 7,392,688

Changes in endowment net assets as of June 30, 2014 are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Endowment net assets, beginning of year	\$ -	\$ 4,164,902	\$ 3,227,786	\$ 7,392,688
Contributions	-	-	237,571	237,571
Interest and dividends	-	190,208	-	190,208
Realized and unrealized gains	-	728,543	-	728,543
Amounts appropriated for expenditure	-	(191,899)	-	(191,899)
Endowment net assets, end of year	\$ -	\$ 4,891,754	\$ 3,465,357	\$ 8,357,111

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc. continued

g. Endowment Composition, continued

Changes in endowment net assets as of June 30, 2013 were as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total Net Endowment Assets
Endowment net assets, beginning of year	\$ -	\$ -	\$ 6,695,773	\$ 6,695,773
Contributions	-	-	82,224	82,224
Interest and dividends	-	192,093	-	192,093
Realized and unrealized gains	-	637,668	-	637,668
Amounts appropriated for expenditure	-	(215,070)	-	(215,070)
Reclassifications	-	3,550,211	(3,550,211)	-
Endowment net assets, end of year	<u>\$ -</u>	<u>\$ 4,164,902</u>	<u>\$ 3,227,786</u>	<u>\$ 7,392,688</u>



**Report on Internal Control Over Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements Performed in Accordance with
*Government Auditing Standards***

Report of Independent Auditors

Members of the Board of Regents
Kentucky State University
Frankfort, Kentucky

We have audited, in accordance with the 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, the financial statements of Kentucky State University (the University) as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise Kentucky State University's basic financial statement as listed on the table of contents, and have issued our report thereon dated October 7, 2014.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the University's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the University's internal control. Accordingly, we do not express an opinion on the effectiveness of the University's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified. We did identify certain deficiencies in internal control, described in the accompanying Schedule of Findings and Responses that we consider to be significant deficiencies, findings 2014-001 and 2014-002.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

The University's Response to Findings

The University's responses to the findings identified in our audit are described in the accompanying Schedule of Findings and Responses. The University's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them.

Purpose of this Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Dean Dotson Allen Ford, PLLC

October 7, 2014
Lexington, Kentucky

KENTUCKY STATE UNIVERSITY

Schedule of Findings and Responses, continued

Year ended June 30, 2014

Section I – Summary of Auditors’ Results:

Financial Statements:

a. The type of report issued on the financial statements: **Unmodified Opinion**

b. Internal control over financial reporting:

Material weaknesses: **No**

Significant deficiencies identified that are not considered to be material weaknesses: **Yes**

c. Non-compliance which is material to the financial statements: **No**

Section II – Financial Statement Findings:

Finding 2014-001:

Condition:

The student accounts receivable subsidiary ledger and the allowance for uncollectible student accounts receivable are not reconciled and adjusted periodically throughout the year. The student accounts receivable aging should be analyzed and reconciled to the general ledger at least quarterly. The aging should be analyzed in accordance with University policy to ensure that the allowance for uncollectible student accounts receivable is accurately reflected in accordance with University policy. This reconciliation and associated allowance calculation should be submitted to University management for review and approval.

Effect:

The University posted an adjusting journal entry to reconcile student accounts receivable subsidiary to the general ledger and to increase the allowance for doubtful accounts subsequent to year end. Increased management effort in this area could result in a reduction in the number and amount of delinquent and potentially worthless receivables. The positive results from this process may include significantly improved cash flow and profitability and should minimize the need for a year-end adjustment of this account.

Recommendation:

We recommend the University reconcile the student accounts receivable subsidiary ledger to the general ledger at least quarterly and assess the collectability of all student accounts receivable on a quarterly basis.

KENTUCKY STATE UNIVERSITY

Schedule of Findings and Responses, continued

Year ended June 30, 2014

Finding 2014-001, continued:

The following formal collection procedures should be established:

- The continuous review of accounts receivable for old and slow-paying accounts.
- A formal periodic review of the account receivable aged trial balance.
- The implementation of formalized procedures for contacting delinquent accounts for payment, such as sending letters to slow-paying students.
- The increased use of collection agencies and the department of revenue to aid in collecting delinquent accounts.

Management's Response:

Management concurs. Accounts receivable will be reviewed for old and slow-paying accounts at least quarterly. The aged trial balance will also be reviewed at least quarterly. Management is developing new processes for contacting slow-paying or delinquent registered students. Beginning Fall 2014, the University has implemented more stringent policies for new and returning students, with regard to their responsibility to pay their outstanding bill. Students that fail to pay their outstanding balances will be sent to collection agencies at minimum, the end of each term, to assist with the collection of outstanding balances.

Finding 2014-002:

Condition:

During the audit it was noted that the University has not performed a physical count of capital assets in several years.

Effect:

The University cannot substantiate that the capital assets ledger is accurate.

Recommendation:

We recommend that the University implement a process such that a physical count of capital assets is performed at least every two years and reconciled to the general ledger.

KENTUCKY STATE UNIVERSITY

Schedule of Findings and Responses, continued

Year ended June 30, 2014

Finding 2014-002, continued:

Management Response:

Management concurs. A plan to conduct a physical count of inventory will be established and then performed by the end of fiscal year 2015.

KENTUCKY STATE UNIVERSITY

Schedule of Prior Year Audit Findings

Year ended June 30, 2014

Finding 2013-001:

Condition:

During the year ended June 30, 2013 the University did not have adequate controls over financial reporting to allow for timely, accurate financial reporting. All general ledger accounts were not reconciled to subsidiary ledgers or other supporting detail at least on a quarterly basis.

Effect:

During the audit several adjusting journal entries which impacted the years ended June 30, 2013, 2012, and prior years, were recorded to accurately reflect the financial position of the University as of June 30, 2013. These journal entries primarily related to the reconciliation of student accounts receivable, grants receivable and the accrual of the sick leave liability. The sick leave liability was required by KRS 61.456 beginning with the year ended June 30, 2011. Net Position for years prior to the year ended June 30, 2012 was decreased by \$2,368,336 as a result of these entries and Change in Net Position for the year ended June 30, 2012 was decreased by \$809,127 as a result of these entries.

Recommendation:

We recommend the University implement internal control procedures which require general ledger accounts to be reconciled at least quarterly. Not having accurate transactions posted in a timely manner can affect the financial statement information that is available for making informed business decisions and supervision of operations. This weakness in accounting infrastructure increases the risk of errors in the financial records and is less likely to detect irregularities, including fraud, on a timely basis. The quarterly reconciliation process allows for the preparation of accurate quarterly financial statements. The reconciliations of significant accounts should be reviewed as part of the quarterly financial statement package in preparation for presentation of the financial statements to the Board of Regents. Management should then satisfy itself as to the nature of any unusual reconciling items before authorizing adjustments to correct the balances. These adjustments should be thoroughly documented and promptly made so that it will not be necessary to carry them forward to the next reconciliation.

Current Status:

Except as noted in 2014-001, this finding has been resolved in the current year.

KENTUCKY STATE UNIVERSITY

Schedule of Prior Year Audit Findings, continued

Year ended June 30, 2014

Finding 2013-002:

Condition:

Prompt, accurate reconciliations of the student, grant, and other accounts receivable subsidiary ledgers to the general ledger account balances should be prepared at least on a quarterly basis. Included in this reconciliation should be a review of the aging of the receivables and a calculation of the allowance that is based on University policy. This reconciliation and associated allowance calculation should be submitted for management's review and approval.

Effect:

The University posted an adjusting journal entry to reconcile student and grant accounts receivable to the general ledger account balances and to increase the allowance for doubtful accounts subsequent to year end. Increased management effort in this area can result in a reduction in the number and amount of delinquent and potentially worthless receivables. The positive results from this process may include significantly improved cash flow and profitability and should minimize the need for a year-end adjustment of this account.

Recommendation:

We recommend the University complete reconciliation's of the student, grant, and other accounts receivable subsidiary ledgers to the general ledger account balances at least on a quarterly basis and assess the collectability of all receivables, especially student receivables on a quarterly basis.

The following formal collection procedures should be established:

- The continuous review of accounts receivable for old and slow-paying accounts.
- A formal periodic review of the account receivable aged trial balance.
- The implementation of formalized procedures for contacting delinquent accounts for payment, such as sending letters to slow-paying customers.
- The increased use of collection agencies and the department of revenue to aid in collecting delinquent accounts.

Current Status:

See finding 2014-001.

Kentucky State University



2014-2015 Risk Assessment Update October 2014

Presented by:

**TRONCONI SEGARRA
& ASSOCIATES, LLP**

Certified Public Accountants
Business Consultants

SOLUTIONS BEYOND THE OBVIOUS

Kentucky State University
Risk Assessment Update
October 2014

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To the Audit Committee of
Kentucky State University

We are pleased to present an update of our risk assessment of the internal controls of Kentucky State University (the "University"). The purpose of our engagement is to assist you in the development of a risk assessment of University operations, to perform various internal audit services, and provide recommendations to strengthen controls and reduce the identified risks. This report was developed from inquiry of University faculty and staff, observations, inspection of various policies and procedures, and testing of the operating effectiveness of some controls. We plan to issue additional periodic reports throughout the course of the engagement, which will follow the proposed rotation plan for significant cycles as documented in the internal audit plan.

The importance of an adequate system of internal control is to promote effective and efficient operations so as to help the University carry out its mission; to provide reasonable, but not absolute, assurance that assets are safeguarded against inappropriate or unauthorized use; to promote the accuracy and reliability of accounting data and financial reporting to ensure transactions are executed in accordance with management's authorization and recorded properly in accounting records; to encourage adherence to management's policies and procedures for conducting programs and operations; and to ensure compliance with applicable laws and regulations. Furthermore, a successful system of internal control includes performing an annual assessment to identify potential weaknesses in policies and procedures and to implement corrective actions.

This report contains a summary of the status of our audit plan. Detail recommendations will be included in future updates as we complete our work.

Internal control testing was performed through tailored procedures designed based on our understanding of the University's relevant policies and procedures in effect.

The University's risks are the risks that an action or event will adversely affect the University's ability to successfully achieve its objectives. The Risk Assessment section of the report analyzes the significant risk findings that were identified during our assessment.

The accompanying comments are intended solely for the information and use of the Audit Committee, Board of Regents, department heads, and others within the University and should not be used for any other purpose.

We appreciate the opportunity to serve you and thank the employees of the University for their cooperation. We have already discussed many of these comments and suggestions with various University personnel, and we will be pleased to discuss them in further detail at your convenience. Through our ongoing involvement with you as a client and our knowledge of your processes, we would be pleased to perform any additional studies of these matters, or to assist you in implementing the recommendations.

Tronconi Segarra & Associates LLP

October 24, 2014

Risk Assessment

Kentucky State University

Risk Assessment

Overview

The University's risks are the risks that an action or event will adversely affect its ability to successfully achieve its objectives. During our engagement we became aware of various sources of risk that impact the University. We evaluated these risks by using two distinct assessments of impact and likelihood. A simple rating scale has been developed for this purpose. The rating scale ranges from minor to significant impact, and low to high likelihood, using a 3-point scale.

Impact refers to the extent of the consequences or implications if the risk does occur. To assess impact, we have determined how much of an impact the risk has if it does occur:

- A minor impact suggests that the risk would not have important implications on the University.
- A moderate impact suggests that the risk could have implications for the University's ability to succeed.
- A significant impact suggests that the risk would have important implications on the University.

Likelihood refers to the probability that the risk may occur given the current context of the University. To assess likelihood, we have determined how likely it is that the risk will occur in the future, given what is currently done to manage said risk:

- A low likelihood suggests that the risk is unlikely to occur, given its nature and current risk management practices in place.
- A medium likelihood of occurrence suggests that the risk has a moderate probability of occurrence.
- A high likelihood of occurrence suggests that the risk is likely to occur, despite the current risk management practices in place.

The Risk Management Tolerance Model and the Risk Assessment Matrix that follows summarizes these risks and assesses their impact and likelihood.

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Risk Assessment (continued)

Cycles plotted in the red sections of the model are considered to be high risk and, as such, the related deficiencies should be given urgent attention in terms of priority. Cycles plotted in the yellow sections are considered to have moderate risk, are considered to be important, and should be given second priority after the high risk cycles. Cycles plotted in the green section of the model are considered least risky and remediation efforts to address deficiencies in these cycles would be expected to be addressed during routine operations of the University.

We have developed the risk assessment around significant transaction cycles as a means by which the associated risks can be easily understood and managed. The cycles or areas that are being evaluated for the 2014-2015 fiscal period are:

- Student Financial Aid - Reporting (SFA – RP)
- Student Financial Aid – GAP’s and Cash Management (SFA – CM)
- Student Financial Aid - Administrative Capability (SFA – AC)
- Land and Other Grants (G)
- Payroll and Personnel (PP)
- Travel and Entertainment (T&E)
- Debt (D)
- Accounts Receivable and Collections (AR)
- Auxiliary Enterprises –Xerox (AE)
- Information Technology (IT)

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Risk Assessment (continued)

Timeline

We anticipate the following activities and timeline to accomplish our internal audit plan for the 2014 – 2015 year, which may be amended from time to time (if need be) to address any emerging high-risk issues identified:

Transaction Cycle/Area	Interviews and Walkthroughs	Control Testing Performed	Recommendations Proposed
Student Financial Aid (SFA) ▪ Reporting (SFA –RP)	X	October	January
Student Financial Aid (SFA) ▪ GAP's and Cash Management (SFA – CM)	X	October	January
Student Financial Aid (SFA) ▪ Administrative Capability (SFA – AC)	January	April	June
Land and Other Grants (G)	October	January	April
Payroll and Personnel (PP)	October	January	April
Travel & Entertainment (T&E)	January	April	June
Debt (D)	X	October	January
Accounts Receivable and Collections (AR)	January	April	June
Auxiliary Enterprises - Xerox (AE)	X	October	January
Information Technology (IT)*	October	October	January

*In the area of Information Technology, our focus will be to analyze the status of management's progress in implementing our recommendations resulting from our Final Risk Assessment Report for fiscal 2012-2013.

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Risk Assessment (continued)

Risk Management Tolerance Model

Impact	Significant		IT	
	Moderate	PP, SFA –RP & CM, D	G	
	Minor	T&E, AE		
		Low	Medium	High
		Likelihood		

We have not yet rated the areas surrounding Accounts Receivable and Collections, and the Student Financial Aid area of Administrative Capability. We will provide an initial risk assessment on these areas in a future report. The next page provides further detail of observations and reasoning for assessed impact and likelihood for those cycles that have been reviewed thus far in fiscal 2014 – 2015.

Kentucky State University
Risk Assessment (continued)

Risk Assessment Matrix

<u>Cycle</u>	<u>Risk Assessment Based on Procedures Performed for the 2014 - 2015 Fiscal Year</u>	<u>Impact</u>	<u>Likelihood</u>
SFA –RP & CM	We noted a low overall risk in the Student Financial Aid cycle related to the areas of Reporting and Cash Management. The procedures implemented appear to be designed appropriately and are supported by written policies and procedures. Additionally, the personnel interviewed appear to be knowledgeable of the federal financial aid guidelines. Testing is to be performed in October which may affect the initial risk rating.	Moderate	Low
D	Due to turnover in the Finance and Business Department, there is a lack of knowledge regarding outstanding debt. Further, written policies and procedures do not exist to aid personnel. We noted a low overall risk in the debt cycle as outside parties manage outstanding debt resulting in the likelihood assessed as low; impact is considered moderate due to the large dollar amounts related to debt.	Moderate	Low
AE	Currently there are few controls related to invoice review prior to the monthly payment. However, as there are few benefits or motivating factors for Xerox to inappropriately invoice the University and other controls exist such as individual copy codes, the likelihood is assessed as low. Further, the impact on the University is considered minor as the payment to Xerox is not considered material to the operations of the University.	Minor	Low

The area of Information Technology, Payroll and Personnel, Grants, and Travel & Entertainment were rated based on prior audits; the risk rating on such areas may change based on the results of our 2014 – 2015 audit plan.

Kentucky State University
Risk Assessment (continued)

**Status of 2012 – 2013
 Recommendation Remediation**

We will review prior findings with personnel that were reported throughout the 2012 – 2013 fiscal year to ensure procedures have been implemented to mitigate or resolve the associated risk. Upon meeting with personnel we will perform inquiry, observation, and if determined necessary, testing of the newly implemented procedures. The University will be made aware of unresolved or outstanding findings at future scheduled board meetings. Timing of the review is based upon the following estimated schedule:

2012 - 2013 Process Cycles	Original Recommendations	Timing for Review of Remediation of Findings
Capital Assets	3	January
Information Technology	16	October
Travel & Entertainment	-	Not Applicable
Land and Other Grants	3	October
Payroll & Personnel	5	October