

KENTUCKY STATE UNIVERSITY

Financial Statements

*As of and for the Years Ended June 30, 2012 and 2011
with Independent Auditors' Report Thereon*

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DEAN || DORTON || ALLEN || FORD^{PLLC}

Independent Auditors' Report

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

Secretary of Finance and
 Administration Cabinet of the
 Commonwealth of Kentucky

We have audited the accompanying financial statements of Kentucky State University (the University) as of June 30, 2012 and 2011, and for the years then ended, which collectively comprise the University's basic financial statements as listed on the table of contents. These financial statements are the responsibility of the University's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Kentucky State University Foundation, Inc. (the Foundation), which represents 100% percent, of the assets, net assets, and revenues of the discretely presented component unit as required by Statement No. 39 of the Governmental Accounting Standards Board, as of June 30, 2012 and for the year then ended. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for the Foundation, is based solely on the report of the other auditors.

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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, 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, 2012 and 2011, and the respective changes in its net assets and its cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2012 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, not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of the audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

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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.

Dean Dotson Allen Ford, PLLC

October 25, 2012

Lexington, Kentucky

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis

June 30, 2012

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, 2012, with comparative information for the year ended June 30, 2011 and selected information for the year ended June 30, 2010. 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, 2012, reflected total assets of \$134.7 million and total liabilities of \$17.6 million. Total net assets were \$117.1 million. Financial operations were in accordance with revenue expectations and the approved budget plan.
- Total assets increased \$1.6 million or 1.2%, primarily due to increases in student accounts, grant and loans receivables, capital assets and investments. Total liabilities increased by \$514 thousand or 3.0% primarily due to a decrease in bond and lease obligations, a decrease in compensated absences, and an increase in accounts payable and accrued liability. Total net assets increased \$1.1 million.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Financial Highlights, Continued

- Unrestricted net assets decreased \$2.4 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 \$43.5 million and operating expenditures were \$75.7 million, resulting in a loss from operations of \$32.2 million. Net non-operating revenues were \$33.3 million, including \$24.7 million in state appropriations, which, when combined with the loss from operations and capital appropriations, resulted in an overall increase in net assets of \$1.1 million.

Using the Financial Statements

The University's Financial Statements consist of three financial statements: a Statement of Net Assets (Balance Sheet); a Statement of Revenues, Expenses and Changes in Net Assets (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 Assets

The Statement of Net Assets presents the financial position of the University at the end of the fiscal year and includes all assets and liabilities. Net assets, the difference between total assets and total liabilities, are an important indicator of the current financial condition, while the change in net assets 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, 2012

Condensed Statement of Net Assets

	<u>2012</u>	<u>2011</u>	<u>2010</u>
ASSETS			
Current assets	\$ 38,295,793	\$ 38,395,850	\$ 30,819,820
Noncurrent assets	<u>96,426,815</u>	<u>94,700,547</u>	<u>92,557,670</u>
Total assets	<u>\$ 134,722,608</u>	<u>\$ 133,096,397</u>	<u>\$ 123,377,490</u>
LIABILITIES			
Current liabilities	8,763,719	7,449,319	7,588,173
Non-current liabilities	<u>8,867,398</u>	<u>9,667,863</u>	<u>10,393,089</u>
Total liabilities	<u>17,631,117</u>	<u>17,117,182</u>	<u>17,981,262</u>
NET ASSETS			
Invested in capital assets, net of related debt	75,839,623	73,936,126	71,831,353
Restricted			
Nonexpendable	8,657,506	8,594,513	8,048,379
Expendable	6,668,365	5,119,673	5,063,026
Unrestricted	<u>25,925,997</u>	<u>28,328,903</u>	<u>20,453,470</u>
Total net assets	<u>\$ 117,091,491</u>	<u>\$ 115,979,215</u>	<u>\$ 105,396,228</u>

Assets: As of June 30, 2012, total assets amounted to \$134.7 million. Of this amount, investment in capital assets (net of depreciation) of \$84.5 million, or 62.7% of total assets, represented the largest asset class. Investments amounted to \$11.2 million or 8.3% of total assets. During the year, total assets increased by \$1.6 million, primarily due to increases in cash and cash equivalents, student accounts, grant and loans receivables, capital assets and investments.

Liabilities: As of June 30, 2012, total liabilities amounted to \$17.6 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 increased by \$514 thousand, primarily due to an increase in accounts payable and a decrease in bonds and capital lease obligations.

Net Assets: Net assets of the University were \$117.1 million at June 30, 2012 and were reported in four net asset categories: invested in capital assets, net of related debt \$75.8 million (64.7%), restricted nonexpendable \$8.7 million (7.4%), restricted expendable \$6.7 million (5.7%), and unrestricted \$25.9 million (22.1%).

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

2011 versus 2010. Total assets amounted to \$133.1million and \$123.4million in fiscal year 2011 and 2010 respectively. Total liabilities amount to \$17.1 million in fiscal year 2011 and \$18 million in fiscal year 2010. When compared to fiscal year 2010, the University's total assets for fiscal year 2011increased \$10.6million primarily in the current asset category due to an increase in student accounts, grant and loans receivables, investments, and capital assets.

Statement of Revenues, Expenses and Changes in Net Assets

The Statement of Revenues, Expenses and Changes in Net Assets 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 assets must appear on the Statement of Revenues, Expenses and Changes in Net Assets as revenues, expenses, gains or losses.

Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts, investment income and endowment income to be classified as nonoperating revenues. Accordingly, the University reports an operating loss prior to the addition of nonoperating 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 assets for the years ended June 30, 2012, 2011 and 2010 is as follows.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Condensed Statement of Revenues, Expenses and Changes in Net Assets

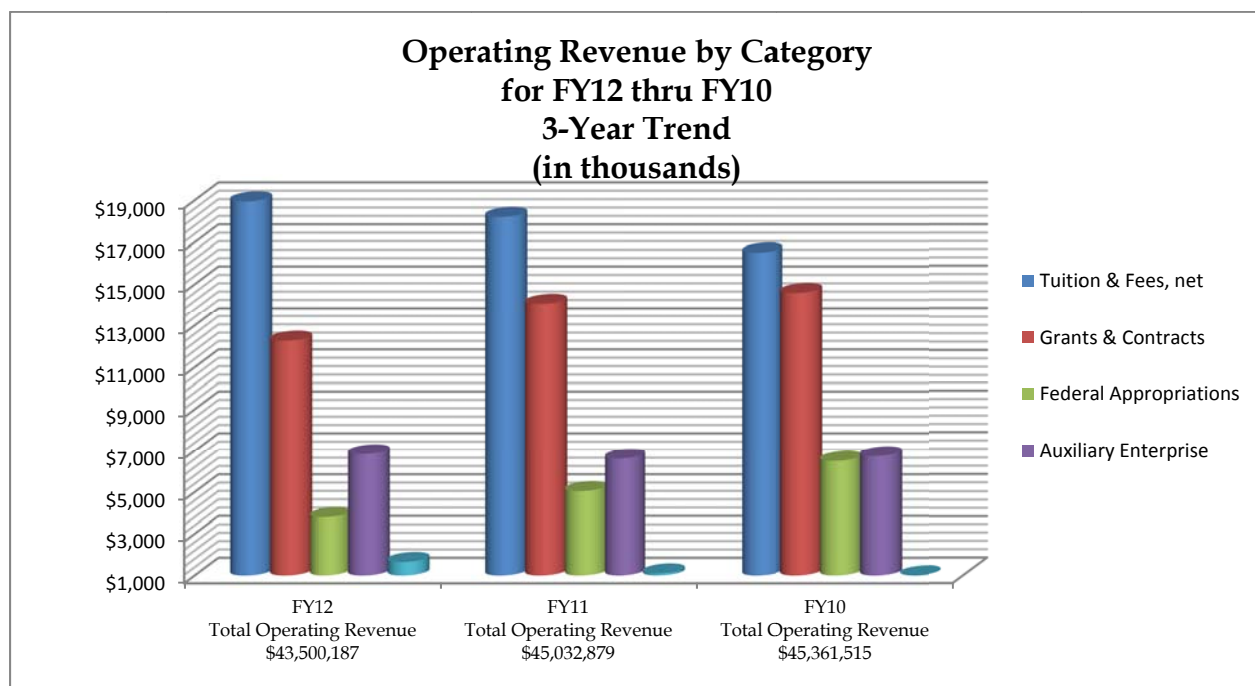
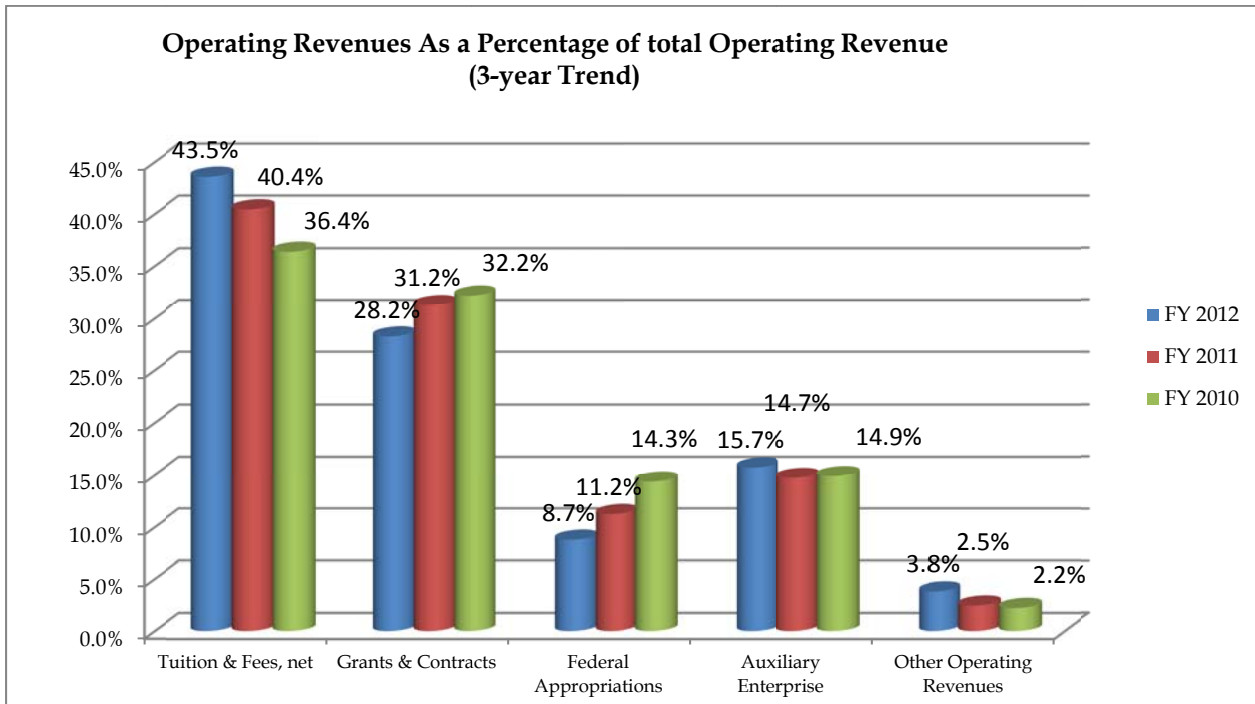
	<u>2012</u>	<u>2011</u>	<u>2010</u>
OPERATING REVENUES			
Student tuition and fees, net	\$ 18,943,062	\$ 18,200,942	\$ 16,512,333
Grants and contracts	12,267,993	14,066,912	14,589,783
Federal appropriations	3,796,394	5,042,652	6,507,463
Auxiliary enterprises	6,838,829	6,618,704	6,745,546
Other operating revenue	<u>1,653,909</u>	<u>1,103,669</u>	<u>1,006,390</u>
Total operating revenues	<u>43,500,187</u>	<u>45,032,879</u>	<u>45,361,515</u>
OPERATING EXPENSES			
Educational and general	69,494,007	63,647,079	61,873,552
Auxiliary enterprises	<u>6,208,366</u>	<u>5,511,984</u>	<u>5,764,044</u>
Total operating expenses	<u>75,702,373</u>	<u>69,159,063</u>	<u>67,637,596</u>
OPERATING LOSS	<u>(32,202,186)</u>	<u>(24,126,184)</u>	<u>(22,276,081)</u>
NONOPERATING REVENUES (EXPENSES)			
State appropriations	24,660,001	25,363,422	24,630,377
Federal grants and contracts	7,373,490	7,062,876	6,556,989
Gifts and grants	251,309	969,703	613,057
Investment income (loss)	849,729	1,789,055	1,158,756
Interest on capital asset – related debt	(373,738)	(429,253)	(483,085)
Other	<u>447,119</u>	<u>(46,632)</u>	<u>(697,500)</u>
Total non-operating revenues	<u>33,207,910</u>	<u>34,709,171</u>	<u>31,778,594</u>
Income before other revenues, expenses, gains (losses)	1,005,724	10,582,987	9,502,513
Endowment Gifts	106,552	-	-
Capital appropriations	<u>-</u>	<u>-</u>	<u>1,760,427</u>
Total net increase in net assets	1,112,276	10,582,987	11,262,940
Net assets, beginning of year	<u>115,979,215</u>	<u>105,396,228</u>	<u>94,133,288</u>
Net assets, end of year	<u>\$ 117,091,491</u>	<u>\$ 115,979,215</u>	<u>\$105,396,228</u>

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Figure 1



KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Total operating revenues were \$43.5 million for the year ended June 30, 2012, a decrease of \$1.5 million compared to FY11. The primary components were federal, state and local grants and contracts of \$12.3 million (28.3%) student tuition and fees, net of \$18.9 million (43.5%), federal appropriations of \$3.8 million (8.8%) and auxiliary services and other revenues of \$8.5 million (19.5%). FY12 Student tuition and fees revenue increased \$742,120 compared to FY11 due to increased tuition fees. FY12 Grants and contracts revenue decreased \$1,798,919 compared to FY11 due to decreased awards and spending. FY12 Federal appropriations decreased \$1,246,258 compared to FY11. FY12 Auxiliary enterprises revenue increased \$220,125 compared to FY11. Refer to *Figure 1* for the three year trend of the operating revenues as a percent to total operating revenues and revenue by category.

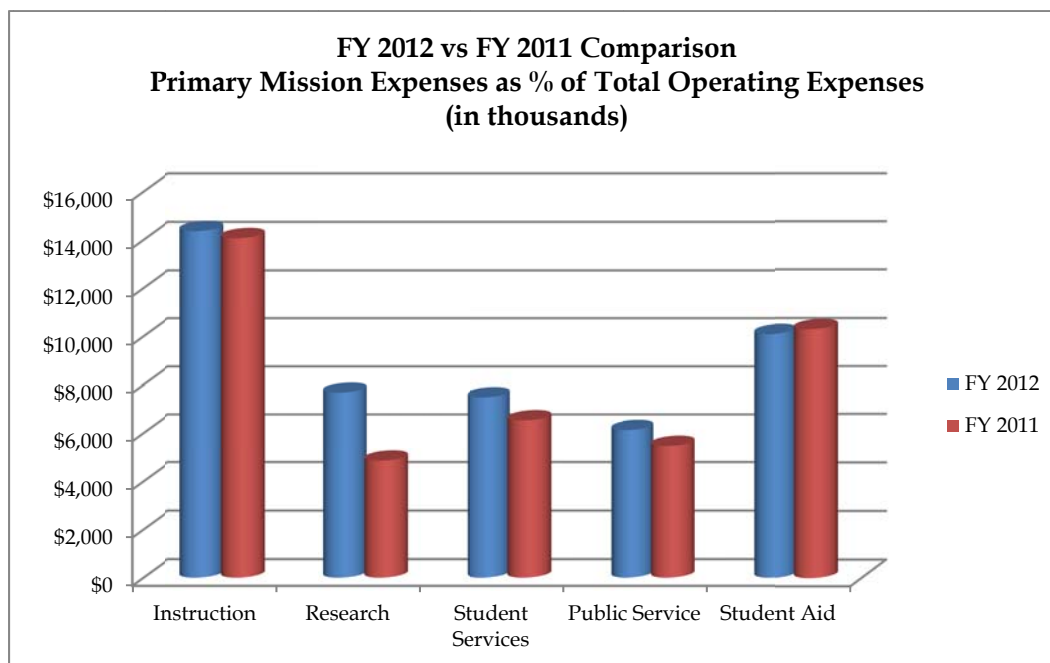
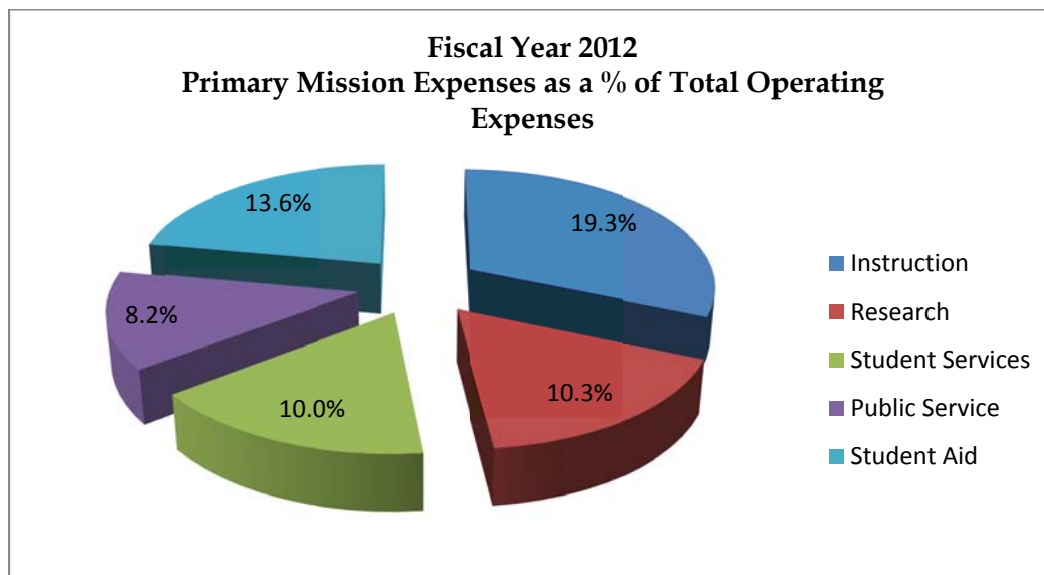
KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Operating expenses totaled \$75.7 million, an increase of \$6,543,310 over last year due to an increase in federal grants pending and bad debt. Of this amount, \$45.7 million (60.4%) was expended directly for the primary mission of the University – instruction (19.0%), research (10.2%), student services (9.9%), student aid (13.3%), and public service (8.0%). Instruction is the main component of Primary Mission expenses amounting to \$14.4 million in fiscal year 2012 or 19%. Refer to *Figure 2* for the operating expenses categorized into the Primary Mission of the University.

Figure 2



KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

The University continued to invest in student aid and support services to provide students with opportunities to be successful in fiscal 2012. For the year ended June 30, 2012, student aid related to tuition and fees totaled \$14.6 million, with student aid expenses of \$10.1million and scholarship allowances of \$4.5 million.

The University had an overall increase in institutional support of \$1.3 million, along with an increase in auxiliary enterprises of \$696,382. 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 \$32.2 million. Nonoperating revenues, net of expenses, amounted to \$33.2 million, resulting in an increase in income before other revenues, expenses, gains or loss of \$1.0 million for the year. After capital appropriations and endowment gifts, the increase in net assets was \$1.1 million. Nonoperating revenues include state appropriations of \$24.7 million, federal grants and contracts of \$7.4 million, gifts of \$358 thousand and investment income of \$850 thousand, and other non-operating income net of revenue of \$447,119.

2011 versus 2010

Operating revenues in fiscal year 2010 were \$45.4 million and operating expenditures were \$67.6 million, resulting in a loss from operations of \$22.3 million. Net nonoperating revenues were \$31.8 million, including \$24.6 million in state appropriations. Compared to fiscal year 2011, revenue decrease has been due to decreases in grant and contracts and federal appropriations.

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, 2012

Condensed Statement of Cash Flows

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Cash (used) provided by:			
Operating activities	\$(32,221,163)	\$(20,655,496)	\$(17,461,609)
Non-capital financing activities	32,923,090	33,349,369	30,885,913
Capital and related financing activities	(6,743,890)	(7,375,948)	(7,777,980)
Investment activities	<u>261,488</u>	<u>1,332,846</u>	<u>261,222</u>
Net increase (decrease) in cash	(5,780,475)	6,650,771	5,907,546
 Cash and cash equivalents, beginning year	<u>29,623,196</u>	<u>22,972,425</u>	<u>17,064,879</u>
Cash and cash equivalents, end of year	<u>\$ 23,842,721</u>	<u>\$ 29,623,196</u>	<u>\$ 22,972,425</u>

Major sources of cash received from operating activities are student tuition and fees of \$18.7 million and grants and contracts of \$11.1 million. Major uses of cash for operating activities were payments to employees for salaries and benefits of \$38.4 million and to vendors and contractors of \$21.8 million.

Noncapital financing activities included state appropriations from the Commonwealth of Kentucky of \$24.7million.

Capital and related financing activities include purchases and payments of \$6.7 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 \$261 thousand was received 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.

2011 versus 2010

Compared to fiscal year 2010, the amount of cash used to fund operations has been reduced primarily due to operational efficiencies that have been implemented. Net cash for noncapital financing activities and investment activities remains constant. Capital and related financing has been reduced due to the completion of capital projects.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

State Appropriations

State appropriations represent approximately 32.1% 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, 2012, 2011 and 2010.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Commonwealth appropriations	\$ 24,660,001	\$ 25,363,422	\$ 24,630,377
Federal appropriations	<u>3,796,394</u>	<u>5,042,652</u>	<u>6,507,463</u>
Total appropriations	<u>\$ 28,456,395</u>	<u>\$ 30,406,074</u>	<u>\$ 31,137,840</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 2012, 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 operating grant and contract revenue for fiscal years ended June 30, 2012, 2011 and 2010.

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Federal grants and contracts	\$ 18,094,479	\$ 18,818,044	\$ 18,890,125
State grants and contracts	1,547,004	2,311,744	2,210,849
Nongovernmental grants and contracts	<u>-</u>	<u>-</u>	<u>45,798</u>
Total grants and contracts	<u>\$ 19,641,483</u>	<u>\$ 21,129,788</u>	<u>\$ 21,146,772</u>

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Capital Plan

During fiscal year 2012, the Kentucky State University completed the work on the Rosenwald Center for Families and Children and the Aquaculture Production Technology Lab.

The Rosenwald Center for Families and Children consists of a new child care facility. The 15,180 square foot, 1-story building consists of six classrooms (an Infant room, two Toddler rooms, one Preschool, one Afterschool and another classroom that can be assigned as enrollment changes), three Observation rooms for KSU student education purposes, three offices, a conference room, Sick Bay, a Multipurpose Room, a demonstration teaching kitchen, serving kitchen, and support spaces. The grounds consist of three separate playground areas with play structures for Toddler, Preschool and Afterschool age children. The entire playground plus lawn space is fenced for child protection.

The Aquaculture Production Technology Lab was constructed for educational instruction and research facility. The building area is 6,953 gross square feet of floor space on one floor. Building height is 19 feet 2 inches. Spaces include 6 offices, one administration/reception, and open office grad student offices, one Lab Classroom, one Seminar Classroom, one video control room, one library, video storage, one Disease Diagnostic Lab, one Certified Processing Room, a Loading Dock, Mechanical Space, and circulation space. The building is located on KSU's main campus in proximity to existing research ponds and hatchery. The building is a one story, wood framed and metal panel exterior wall and roof system.

In April 2011, the University submitted its Six Year Capital Plan to the Kentucky General Assembly to be acted upon during the 2012 regular session of the General Assembly. This plan included projects separated into three biennia beginning in 2012 and ending 2018. The execution of the University's capital plan is contingent upon sufficient funding from the Commonwealth.

The \$487.1 million request for the first biennium (2012-2014) is comprised of new construction projects, maintenance projects and information technology projects. The University primarily funds its projects from four sources: state general fund appropriations, federal USDA funds, agency funds, and private funding. University-issued bond funding is also available.

New construction projects proposed include: \$9,028,000 to expand or build a new Betty White Nursing Building, which will provide 24,000 square feet of new classroom space to accommodate enrollment into the nursing program; \$46,382,000 to construct a centralized boiler plant to replace the existing seventy year old plant; \$2,206,000 to construct a pedestrian bridge across U.S. 60 to allow students, faculty and staff safe passage across a heavily traveled highway which bisects campus; \$31,528,000 to construct a Business & Technology Center to house the business school and the computer science program; \$96,034,000 to build a Performing Arts Center to replace antiquated Bradford Hall. Maintenance projects include but are not limited to: Roof Repair & Maintenance Pool \$6.5 million and a \$2.1M 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.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Designated and Nondesignated Spending

In the tables below, expenses have been categorized into designated or nondesignated 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 nondesignated spending. Expenses for nondesignated fund categories in 2012 increased for research, public service, and institutional support over the prior year and decreased for instruction, academic support, student services and plant operations and maintenance. Total spending for all functions in the nondesignated category increased by approximately \$5.5 million in 2012.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

	-----2012-----		
	Designated Spending	Nondesignated Spending	Combined Spending
Instruction	\$ 369,949	\$ 14,011,648	\$ 14,381,597
Research	5,522,265	2,146,725	7,668,990
Public service	4,429,836	1,683,409	6,113,245
Academic support	1,860,720	2,425,369	4,286,089
Student services	1,274,704	6,190,203	7,464,907
Institutional support	652,520	11,407,384	12,059,904
Operation and plant maintenance	-	3,297,562	3,297,562
Student aid	10,098,858	-	10,098,858
Auxiliary	5,864,567	-	5,864,567
Depreciation	<u>4,466,654</u>	<u>-</u>	<u>4,466,654</u>
Total	<u>\$ 34,540,073</u>	<u>\$ 41,162,300</u>	<u>\$ 75,702,373</u>

	-----2011-----		
	Designated Spending	Nondesignated Spending	Combined Spending
Instruction	\$ 1,148,878	\$ 12,941,594	\$ 14,090,472
Research	3,318,645	1,500,901	4,819,546
Public service	4,431,031	1,025,014	5,456,045
Academic support	2,336,289	1,695,298	4,031,587
Student services	768,070	5,749,372	6,517,442
Institutional support	1,850,569	8,914,143	10,764,712
Operation and plant maintenance	-	3,428,856	3,428,856
Student aid	9,899,935	402,826	10,302,761
Auxiliary	4,905,720	-	4,905,720
Depreciation	<u>4,841,922</u>	<u>-</u>	<u>4,841,922</u>
Total	<u>\$ 33,501,059</u>	<u>\$ 35,658,004</u>	<u>\$ 69,159,063</u>

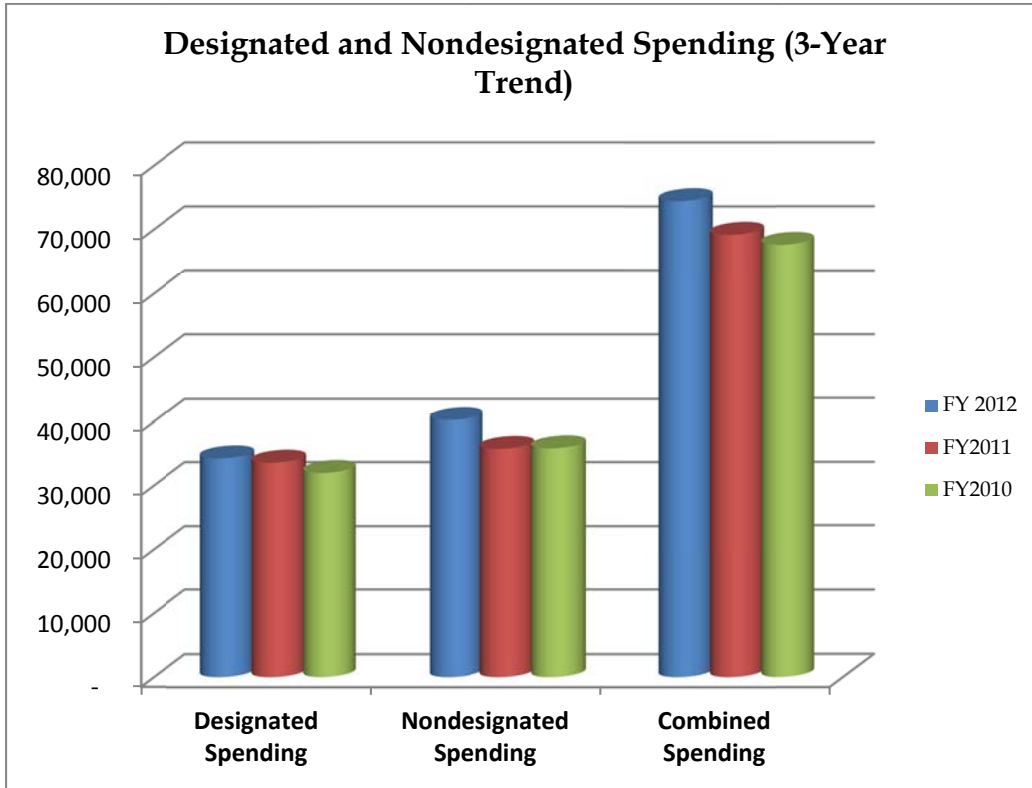
The graph in *Figure 3* shows a three year trend of designated, nondesignated, and combined spending. Nondesignated spending is higher than designated spending in FY12. However, designated spending increased \$1.6 million in 2011 and increased \$1.0 million in 2012. Nondesignated spending decreased \$87 thousand in 2011 and increased \$5.5 million in 2012. Overall, the combined spending followed the same trend as designated spending with an increase of \$1.5 million in 2011 and \$6.5 million in 2012.

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Figure 3



KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, totaled \$84.5million at June 30, 2012, an increase of \$1.1 million. Capital assets as of June 30, 2012 and significant changes in capital assets during the year are as follows (in millions):

	<u>June 30,</u> <u>2010</u>	<u>Net Additions</u> <u>(Reductions)</u> <u>FY 10-11</u>	<u>June 30,</u> <u>2011</u>	<u>Net Additions</u> <u>(Reductions)</u> <u>FY 11-12</u>	<u>June 30,</u> <u>2012</u>
Land and land improvements	\$ 5.6	\$ -	\$ 5.6	\$ -	\$ 5.6
Buildings, fixed equipment and infrastructure	142.0	3.2	145.2	7.4	152.6
Equipment, vehicles and capitalized software	28.1	0.2	28.3	1.6	29.9
Library materials and art	9.7	-	9.7	0.1	9.8
Construction in progress	3.3	1.8	5.1	(3.5)	1.6
Accumulated depreciation	<u>(105.7)</u>	<u>(4.8)</u>	<u>(110.5)</u>	<u>(4.5)</u>	<u>(115.0)</u>
Total	<u>\$ 83.0</u>	<u>\$ 0.4</u>	<u>\$ 83.4</u>	<u>\$ 1.1</u>	<u>\$ 84.5</u>

At June 30, 2012, the University has capital construction projects in progress totaling \$1.6 million in scope.

Long Term Debt

At June 30, 2012, bonds and lease payable amounted to \$8.7 million, as summarized below:

	<u>2012</u>	<u>2011</u>	<u>2010</u>
Lease Obligations	\$ 4,565,078	\$ 4,972,861	\$ 5,402,330
Consolidated Educational Buildings Revenue Bonds		-	935,000
General Receipts Bonds	4,165,000	4,525,000	4,875,000
Bond discount and issue costs	<u>(57,460)</u>	<u>(57,460)</u>	<u>(70,720)</u>
Total	<u>\$ 8,672,618</u>	<u>\$ 9,440,401</u>	<u>\$ 11,141,610</u>

KENTUCKY STATE UNIVERSITY

Management's Discussion and Analysis, continued

June 30, 2012

Economic Factors Impacting Future Periods

University management continues its strategic mission to uniquely position Kentucky State University as an 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 that it has well-positioned the University for becoming a strong, financially viable and efficient institution of higher learning as funding issues continue to be decided.

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.
- Quality Enhancement Plan—*Academics with Attitude*—in 2009, the University developed a plan to address student success. This initiative was part of the University's accreditation reaffirmation process as required by the Southern Association of Colleges and Schools. The plan focuses on student readiness for college level courses. A pilot phase was successfully conducted in summer2009 with full implementation fall2010.
- 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 growth and retention continues to be a priority of University management.
- 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 Art in Special Education, and a Masters in Business Administration, a Masters in Public Administration, a Masters in Computer Science, and a Masters in Environmental Studies
- Regional Stewardship—Kentucky State University began the initiative 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.

The overall financial position of the University strengthened during fiscal year 2012. Revenue streams remain secure and steady. 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 integrity. Management believes Kentucky State University is able to sustain its sound financial position and solidify its progress toward becoming a regional university of excellence.

KENTUCKY STATE UNIVERSITY

Statements of Net Assets

June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 23,842,721	\$ 29,623,196
Accounts, grants and loans receivable, net	13,941,173	8,408,728
Inventory and other current assets	<u>511,899</u>	<u>363,926</u>
Total current assets	<u>38,295,793</u>	<u>38,395,850</u>
Noncurrent assets		
Accounts, grants and loans receivable, net	744,925	742,612
Investments	11,169,649	10,581,408
Capital assets, net	<u>84,512,241</u>	<u>83,376,527</u>
Total noncurrent assets	<u>96,426,815</u>	<u>94,700,547</u>
Total assets	<u>134,722,608</u>	<u>133,096,397</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued liabilities	3,781,912	2,210,577
Accrued compensated absences	1,730,370	2,131,019
Deferred revenue	2,211,334	2,146,007
Deposits	120,991	36,372
Other current liabilities	122,183	161,097
Bonds and capital lease obligations, current portion	<u>796,929</u>	<u>764,247</u>
Total current liabilities	<u>8,763,719</u>	<u>7,449,319</u>
Noncurrent liabilities		
Bonds and capital lease obligations, noncurrent portion	7,875,689	8,676,154
Federal grants refundable	<u>991,709</u>	<u>991,709</u>
Total noncurrent liabilities	<u>8,867,398</u>	<u>9,667,863</u>
Total liabilities	<u>17,631,117</u>	<u>17,117,182</u>
NET ASSETS		
Invested in capital assets, net of related debt	75,839,623	73,936,126
Restricted		
Nonexpendable	8,657,506	8,594,513
Expendable	6,668,365	5,119,673
Unrestricted	<u>25,925,997</u>	<u>28,328,903</u>
Total net assets	<u>\$117,091,491</u>	<u>\$ 115,979,215</u>

See accompanying notes.

KENTUCKY STATE UNIVERSITY FOUNDATION, INC.

Statements of Financial Position

June 30, 2012

(With comparative totals for June 30, 2011)

	2012				2011
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
ASSETS					
Cash and cash equivalents	\$ 41,100	\$ 230,102	\$ 760,184	\$ 1,031,386	\$ 1,128,337
Marketable securities	169,585	1,034,857	5,907,007	7,111,449	6,585,258
Property and equipment, net of accumulated depreciation	81,365	-	-	81,365	99,083
Other assets	848	5,176	28,582	34,606	35,125
Total assets	\$ 292,898	\$ 1,270,135	\$ 6,695,773	\$ 8,258,806	\$ 7,847,803
LIABILITIES AND NET ASSETS					
Accounts payable	\$ 2,121	\$ 6,003	-	\$ 8,124	\$ 22,523
Total liabilities	2,121	6,003	-	8,124	22,523
Net assets	290,777	1,264,132	\$ 6,695,773	8,250,682	7,825,280
Total liabilities and net assets	\$ 292,898	\$ 1,270,135	\$ 6,695,773	\$ 8,258,806	\$ 7,847,803

See accompanying notes.

KENTUCKY STATE UNIVERSITY

Statements of Revenues, Expenses and Changes in Net Assets

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
REVENUES		
Operating revenues		
Student tuition and fees (net of scholarship allowances of \$4,533,476 and \$4,902,590)	\$ 18,943,062	\$ 18,200,942
Federal grants and contracts	10,720,989	11,755,168
Federal appropriations	3,796,394	5,042,652
State and local grants and contracts	1,547,004	2,311,744
Auxiliary enterprises		
Residence halls	3,278,362	3,327,151
Dining	3,261,069	3,016,738
Bookstore	152,500	164,725
Other auxiliaries	146,898	110,090
Other operating revenues	<u>1,653,909</u>	<u>1,103,669</u>
Total operating revenues	<u>43,500,187</u>	<u>45,032,879</u>
EXPENSES		
Operating expenses		
Educational and general		
Instruction	14,381,597	14,090,472
Research	7,668,990	4,819,546
Public service	6,113,245	5,456,045
Academic support	4,286,089	4,031,587
Student services	7,464,907	6,517,442
Institutional support	12,059,904	10,764,712
Operation and maintenance of plant	3,297,562	3,428,856
Student aid	10,098,858	10,302,761
Depreciation	4,122,855	4,235,658
Auxiliary enterprises		
Residence halls	2,426,878	1,668,880
Dining	2,896,641	2,809,722
Other auxiliaries	541,047	427,119
Depreciation	<u>343,800</u>	<u>606,263</u>
Total operating expenses	<u>75,702,373</u>	<u>69,159,063</u>
Operating loss	(32,202,186)	(24,126,184)

KENTUCKY STATE UNIVERSITY

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

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
NONOPERATING REVENUES (EXPENSES)		
State appropriations	\$ 24,660,001	\$ 25,363,422
Federal grants and contracts	7,373,490	7,062,876
Gifts	251,309	969,703
Investment income (net of investment expense)	849,729	1,789,055
Interest on capital asset-related debt	(373,738)	(429,253)
Other non-operating revenues (expenses)	447,119	(46,632)
Endowment gifts	<u>106,552</u>	<u>-</u>
Net nonoperating revenues	<u>33,314,462</u>	<u>34,709,171</u>
 Increase in net assets	 1,112,276	 10,582,987
 Net assets, beginning of year	 <u>115,979,215</u>	 <u>105,396,228</u>
 Net assets, end of year	 <u>\$ 117,091,491</u>	 <u>\$ 115,979,215</u>

See accompanying notes.

KENTUCKY STATE UNIVERSITY FOUNDATION, INC

Statements of Activities

June 30, 2012

(With comparative totals for June 30, 2011)

	2012				2011
	Unrestricted	Temporarily Restricted	Permanently Restricted	Total	Total
Revenue and support:					
Contributions	\$ 19,000	\$ 495,980	\$ 145,448	\$ 660,428	\$ 799,105
Interest and dividends	5,922	25,006	180,566	211,494	191,372
Net realized and unrealized gains (losses) on marketable securities	5,451	19,761	145,223	170,435	769,335
Interfund management fees and other income	148,055	-	-	148,055	128,098
Net assets released from restrictions	546,976	(357,962)	(189,014)	-	-
Total revenue and support	725,404	182,785	282,223	1,190,412	1,887,910
Expenses:					
Scholarships	75,285	-	-	75,285	48,589
Operating expenses	122,873	-	-	122,873	98,419
Personal services	61,084	-	-	61,084	48,783
Interfund management fees	147,749	-	-	147,749	126,491
University support	261,016	-	-	261,016	193,179
Student support	36,725	-	-	36,725	89,181
Travel and promotion	60,278	-	-	60,278	73,080
Total expenses	765,010	-	-	765,010	677,722
Increase (decrease) in net assets	(39,606)	182,785	282,223	425,402	1,210,188
Transfers	-	(41,359)	41,359	-	-
Net assets, beginning of year	330,383	1,122,706	6,372,191	7,825,280	6,615,092
Net assets, end of year	\$ 290,777	\$ 1,264,132	\$ 6,695,773	\$ 8,250,682	\$ 7,825,280

See accompanying notes.

KENTUCKY STATE UNIVERSITY

Statements of Cash Flows

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities		
Tuition and fees	\$ 18,669,508	\$ 17,013,052
Grants and contracts	11,096,565	18,371,985
Payments to suppliers	(21,787,788)	(17,398,053)
Payments to employees	(38,395,403)	(36,041,598)
Student financial aid	(10,068,725)	(10,090,455)
Loans issued to students	(241,777)	(127,276)
Collection of loans issued to students	239,465	141,366
Auxiliary enterprises:		
Residence halls and dining	6,539,431	6,343,889
Bookstore	152,500	164,725
Other auxiliaries	146,898	110,090
Other receipts	<u>1,428,163</u>	<u>856,779</u>
Net cash from operating activities	(32,221,163)	(20,655,496)
Cash flows from non-capital financing activities		
State appropriations	24,660,001	25,363,422
Federal grants and contracts	7,373,490	7,062,876
Gifts for other than capital purposes	251,309	969,703
Endowment gifts	106,552	-
Student organization agency receipts	158,164	23,225
Student organization agency disbursements	(73,545)	(39,096)
Other receipts (payments)	<u>447,119</u>	<u>(30,761)</u>
Net cash from non-capital financing activities	32,923,090	33,349,369
Cash flows from capital financing activities		
Purchases of capital assets	(5,602,369)	(5,245,486)
Principal paid on capital debt	(767,783)	(1,701,209)
Interest paid on capital debt	<u>(373,738)</u>	<u>(429,253)</u>
Net cash from capital financing activities	(6,743,890)	(7,375,948)
Cash flows from investing activities		
Investment income	901,436	1,835,922
Investment expenses	(51,707)	(46,867)
Proceeds from sale of investments	3,977,271	1,988,570
Purchases of investments	<u>(4,565,512)</u>	<u>(2,444,779)</u>
Net cash from investing activities	261,488	1,332,846
Net (decrease) increase in cash and cash equivalents	(5,780,475)	6,650,771
Cash and cash equivalents at beginning of year	<u>29,623,196</u>	<u>22,972,425</u>
Cash and cash equivalents at end of year	<u>\$ 23,842,721</u>	<u>\$ 29,623,196</u>

KENTUCKY STATE UNIVERSITY

Statements of Cash Flows, continued

Years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Reconciliation of net operating loss to net cash from operating activities		
Operating loss	\$ (32,202,186)	\$ (24,126,184)
Adjustments to reconcile operating loss to net cash from operating activities:		
Depreciation expense	4,466,655	4,841,921
Bad debt expense:	2,746,807	400,000
Changes in assets and liabilities:		
Receivables, net	(8,281,565)	(2,593,974)
Inventory and prepaid expenses	(147,973)	(14,388)
Accounts payable and accrued liabilities	1,571,335	574,790
Accrued compensated absences	(400,649)	360,623
Other Liabilities	(38,914)	(108,227)
Deferred revenue	<u>65,327</u>	<u>9,943</u>
Net cash from operating activities	<u>\$ (32,221,163)</u>	<u>\$ (20,655,496)</u>

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. BTAs 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, applies (a) all applicable Financial Accounting Standards Board (FASB) pronouncements issued before December 1, 1989, and (b) those GASB pronouncements issued after that date.

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

Expendable– Net assets 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 assets whose use by the University is not subject to externally imposed stipulations. Unrestricted net assets 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 assets, revenues, expenses, changes in net assets 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 treasures that are held for exhibition, education, research and public service. Estimated lives used for depreciation purposes are as follows:

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Capital Assets, continued

<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 assets and as a component of compensation and benefit expense in the statements of revenues, expenses and changes in net assets.

Deferred Revenue

Deferred revenue includes amounts received for tuition and fees prior to the end of the fiscal year but related to the subsequent reporting period. Deferred 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 assets, 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 nonexchange transactions and are recorded as nonoperating 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, 2012 and 2011, the Foundation made distributions of approximately \$261,016 and \$193,179 respectively, or 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 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 administered 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.

Governmental employers participating in a cost-sharing plan 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
- 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.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Recent Pronouncements, continued

In March 2012, the GASB issued Statement No. 66, *Technical Corrections-2012-an amendment of GASB Statements No. 10 and No. 62*. This Statement amends Statement No. 10, *Accounting and Financial Reporting for Risk Financing and Related Insurance Issues*, by removing the provision that limits fund-based reporting of an entity's risk financing activities to the general fund and the internal service fund type. This Statement also amends Statement 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*, by modifying the specific guidance on accounting for (1) operating lease payments that vary from a straight-line basis, (2) the difference between the initial investment (purchase price) and the principal amount of a purchased loan or group of loans, and (3) servicing fees related to mortgage loans that are sold when the stated service fee rate differs significantly from a current (normal) servicing fee rate. The provisions of this Statement are effective for financial statements for periods beginning after December 15, 2012. The University does not expect this statement to have a significant impact 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 provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. The University is currently evaluating the effects of this statement on its financial statements.

In June 2011, the GASB issued Statement No. 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*. The objective of this statement is to improve financial reporting by standardizing the presentation of deferred outflows of resources and deferred inflows of resources and their effects on net position. It alleviates uncertainty about reporting those financial statement elements by providing guidance where none previously existed. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2011. The University is currently evaluating the effects of this statement on its financial statements.

In December 2010, the GASB issued Statement No. 62, *Codification of Accounting and Financial Reporting Guidance Contained in Pre-November 30, 1989 FASB and AICPA Pronouncements*. The objective of this statement is to improve financial reporting by contributing to the GASB's efforts to codify all sources of generally accepted accounting principles for state and local governments so that they derive from a single source. It eliminates the need for financial statement preparers to determine which accounting principles apply to state and local governments. The requirements of this statement are effective for financial statements for periods beginning after December 15, 2011. The University does not expect this statement to have a significant impact on its financial statements.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

1. Organization and Summary of Significant Accounting Policies, continued

Reclassifications

Certain reclassifications have been made to 2011 amounts in order to make them comparable with the 2012 presentation.

2. Cash, Cash Equivalents, and Investments

The statement of net assets 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, 2012 and 2011 the University had petty cash funds totaling zero, and deposits as reflected by bank balances as follows:

	<u>2012</u>	<u>2011</u>
Insured, commercial banks	\$ 250,000	\$ 250,000
Uninsured, commercial banks; collateral held by pledging institution's agent in the University's name	7,864,956	4,207,544
Maintained by Commonwealth of Kentucky, collateral held by the Commonwealth in the Commonwealth's name	<u>17,325,437</u>	<u>25,954,476</u>
	<u>\$ 25,440,393</u>	<u>\$ 30,412,020</u>

The difference in the cash carrying amount per the statement of net assets and the above bank balances represented items in transit.

At June 30, 2012 and 2011, the University had no cash and cash equivalents that are restricted for capital expenditures.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

2. Cash, Cash Equivalents, and Investments, continued

As of June 30, 2012, 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	\$ 1,982,885	\$ 405,000	\$ 770,000	\$ 387,885	\$ 420,000
Bond Mutual Funds	1,397,341	-	1,397,341	-	-
Money Market Funds	736,937	736,937	-	-	-
Real Estate Funds	<u>391,442</u>	<u>-</u>	<u>391,442</u>	<u>-</u>	<u>-</u>
	\$ 4,508,605	\$ 1,141,937	\$ 2,558,783	\$ 387,885	\$ 420,000
Equities and Equity Mutual Funds	<u>6,661,044</u>				
	<u>\$11,169,649</u>				

As of June 30, 2011, 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	\$ 1,954,384	\$ 204,384	\$ 1,075,000	\$ 400,000	\$ 275,000
Bond Mutual Funds	1,261,347	-	1,261,347	-	-
Money Market Funds	694,000	694,000	-	-	-
Real Estate Funds	<u>51,595</u>	<u>-</u>	<u>51,595</u>	<u>-</u>	<u>-</u>
	\$ 3,961,326	\$ 898,384	\$ 2,387,942	\$ 400,000	\$ 275,000
Equities and Equity Mutual Funds	<u>6,620,082</u>				
	<u>\$ 10,581,408</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, 2012 and 2011. Approximately \$5.6 million (unaudited) related to grants and contracts was collected in the first quarter of fiscal year ending June 30, 2013.

	<u>2012</u>	<u>2011</u>
Student tuition and fees	\$ 6,883,207	\$ 4,835,906
Student loans	2,369,702	2,367,390
Grants and contracts	8,980,080	3,944,606
Other	<u>589,309</u>	<u>588,286</u>
	18,822,298	11,736,188
Less: allowance for doubtful accounts	<u>(4,136,200)</u>	<u>(2,584,848)</u>
	14,686,098	9,151,340
Non-current portion	<u>744,925</u>	<u>742,612</u>
Current portion	<u>\$ 13,941,173</u>	<u>\$ 8,408,728</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

4. Capital Assets, Net

Capital assets as of June 30, 2012, 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	\$ -	\$ -	\$ 5,648,990
Buildings	145,243,348	7,352,059	-	152,595,407
Equipment	22,785,173	1,482,157	-	24,267,330
Computer software	1,428,493	5,129	-	1,433,622
Library holdings	9,695,371	85,558	-	9,780,929
Transportation equipment	4,042,874	110,510	-	4,153,384
Construction in progress	<u>5,087,069</u>	<u>3,919,015</u>	<u>7,352,059</u>	<u>1,654,025</u>
	<u>193,931,318</u>	<u>12,954,428</u>	<u>7,352,059</u>	<u>199,533,687</u>
<u>Accumulated depreciation</u>				
Buildings	84,830,610	2,257,378	-	87,087,988
Equipment	13,357,648	1,438,599	-	14,796,247
Library holdings	8,721,684	495,352	-	9,217,036
Transportation equipment	<u>3,644,849</u>	<u>275,326</u>	<u>-</u>	<u>3,920,175</u>
	<u>110,554,791</u>	<u>4,466,655</u>	<u>-</u>	<u>115,021,446</u>
Capital assets, net	<u>\$ 83,376,527</u>	<u>\$ 8,487,773</u>	<u>\$ 7,352,059</u>	<u>\$ 84,512,241</u>

Capital assets as of June 30, 2011, 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	\$ -	\$ -	\$ 5,648,990
Buildings	141,992,351	3,250,997	-	145,243,348
Equipment	22,544,322	370,176	129,325	22,785,173
Computer software	1,428,493	-	-	1,428,493
Library holdings	9,696,930	56,249	57,808	9,695,371
Transportation equipment	4,030,858	12,016	-	4,042,874
Construction in progress	<u>3,343,888</u>	<u>5,107,391</u>	<u>3,364,210</u>	<u>5,087,069</u>
	<u>188,685,832</u>	<u>8,796,829</u>	<u>3,551,343</u>	<u>193,931,318</u>
<u>Accumulated depreciation</u>				
Buildings	82,165,784	2,664,826	-	84,830,610
Equipment	12,087,481	1,270,167	-	13,357,648
Library holdings	8,129,165	592,519	-	8,721,684
Transportation equipment	<u>3,330,440</u>	<u>314,409</u>	<u>-</u>	<u>3,644,849</u>
	<u>105,712,870</u>	<u>4,841,921</u>	<u>-</u>	<u>110,554,791</u>
Capital assets, net	<u>\$ 82,972,962</u>	<u>\$ 3,954,908</u>	<u>\$ 3,551,343</u>	<u>\$ 83,376,527</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, 2012 and 2011, are as follows:

	<u>2012</u>	<u>2011</u>
Payable to vendors and contractors	\$ 1,745,138	\$ 82,500
Accrued salaries and other liabilities	<u>2,036,774</u>	<u>2,128,077</u>
	<u>\$ 3,781,912</u>	<u>\$ 2,210,577</u>

6. Deferred Revenue

Deferred revenue consists of the following as of June 30, 2012 and 2011:

	<u>2012</u>	<u>2011</u>
Unearned summer school tuition and fees	\$ 605,875	\$ 661,763
Unearned grants and contracts	<u>1,605,459</u>	<u>1,484,244</u>
	<u>\$ 2,211,334</u>	<u>\$ 2,146,007</u>

7. Long-Term Liabilities

Long-term liabilities as of June 30, 2012, 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	\$ 4,525,000	\$ -	\$ 360,000	\$ 4,165,000	\$ 375,000	\$ 3,790,000
Capital lease Obligations						
Master leases	-	-	-	-	-	-
Energy savings	4,972,861	-	407,783	4,565,078	425,465	4,139,613
Bond discount and issuance costs	<u>(57,460)</u>	<u>-</u>	<u>-</u>	<u>(57,460)</u>	<u>(3,536)</u>	<u>(53,924)</u>
Total bonds payable and capital lease obligations	9,440,401	-	767,783	8,672,618	796,929	7,875,689
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>\$10,432,110</u>	<u>\$ -</u>	<u>\$ 767,783</u>	<u>\$ 9,664,327</u>	<u>\$ 796,929</u>	<u>\$ 8,867,398</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

7. Long-Term Liabilities, continued

Long-term liabilities as of June 30, 2011, 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>
Consolidated Educational Building Revenue Bonds	\$ 935,000	\$ -	\$ 935,000	\$ -	\$ -	\$ -
General Receipts Bonds	4,875,000	-	350,000	4,525,000	360,000	4,165,000
Capital Lease Obligations						
Master Leases	38,631	-	38,631	-	-	-
Energy Savings	5,363,698	-	390,837	4,972,861	407,783	4,565,078
Bond discount and issuance costs	<u>(70,720)</u>	<u>-</u>	<u>(13,260)</u>	<u>(57,460)</u>	<u>(3,536)</u>	<u>(53,924)</u>
Total bonds payable and capital lease obligations	11,141,609	-	1,701,208	9,440,401	764,247	8,676,154
Federal Grants Refundable	<u>965,947</u>	<u>43,973</u>	<u>18,211</u>	<u>991,709</u>	<u>-</u>	<u>991,709</u>
Total long-term liabilities	<u>\$ 12,107,556</u>	<u>\$ 43,973</u>	<u>\$ 1,719,419</u>	<u>\$10,432,110</u>	<u>\$ 764,247</u>	<u>\$ 9,667,863</u>

The outstanding General Receipts Bonds Series A Bonds have an interest rate of 3.625%. The bonds mature in 2027. The reserve requirements for these issues have been fully funded as of June 30, 2012.

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 \$4,711,222 and \$5,059,998 as of June 30, 2012 and 2011 respectively.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

7. Long-Term Liabilities, continued

The principal and interest repayment requirements relating to the outstanding bonds payable at June 30, 2012, are as follows:

	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
Year ending June 30,			
2013	\$ 375,000	\$ 157,251	\$ 532,251
2014	385,000	143,658	528,658
2015	210,000	129,701	339,701
2016	215,000	122,089	337,089
2017	225,000	114,241	339,241
2018 – 2023	1,250,000	439,071	1,689,071
2023 – 2028	<u>1,505,000</u>	<u>179,219</u>	<u>1,684,219</u>
Total	<u>\$ 4,165,000</u>	<u>\$ 1,285,230</u>	<u>\$ 5,450,230</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.

The following is a schedule of future minimum payments required for the capital lease obligation at June 30, 2012:

Year ending June 30,	
2013	\$ 616,792
2014	616,792
2015	616,792
2016	616,792
2017	616,792
Thereafter	<u>2,467,168</u>
Total minimum lease payments	5,551,128
Less: amounts representing interest	<u>986,050</u>
Present value of minimum lease payment	<u>\$ 4,565,078</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

8. Operating Lease

The University leased apartment units for students which expired on May 31, 2012. The University leases computer equipment under operating leases expiring on August 1, 2014. Lease payments to the lessors under these leases totaled \$196,807 and \$87,000 for the years ended June 30, 2012 and 2011, respectively.

Minimum future lease payments under all leases are as follows:

2013	\$ 125,232
2014	125,232
2015	<u>20,872</u>
	<u>\$ 271,336</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 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 6.16% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 13.84% of current eligible employees' salaries to the KTRS through appropriations to the University. Employees hired on or after July 1, 2008 contribute 7.16% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 14.84% 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, 2012, 2011 and 2010 were \$2,155,711, \$2,128,980, and \$2,009,627, respectively, and equaled the required contribution for that year.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

9. Employee Benefits, continued

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 16.98% of current eligible employees' salaries to the KERS through appropriations to the University. Employees hired on or after July 1, 2008 contribute 6.0% of their salary through payroll deductions and the Commonwealth of Kentucky, which also indirectly contributes 16.98% 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 year ending June 30, 2012, 2011 and 2010 were \$1,041,753, \$929,940, and \$647,378, respectively, and equaled the required contribution for that year.

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.

Teachers Insurance and Annuity Association College Retirement Equities Fund (TIAA-CREF), is one of the largest and most respected financial service providers in the world. 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.

AIG 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); all members of American International Group, Inc. complete information.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

9. Employee Benefits, continued

Optional Retirement Plan, continued

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 plan 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, 2012, 2011 and 2010 were \$434,586, \$412,711, and \$393,650, respectively, and equaled the required contribution for the year.

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.

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 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, 2012.

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.

The Commonwealth of Kentucky operates a public entity risk pool operating as a common risk management and insurance program for its members. The University pays an annual premium to the pool for its workers' compensation insurance coverage. The pool's governing agreement specifies that the pool will be self-sustaining through member premiums and will reinsure through commercial carriers for claims in excess of specified stop loss amounts.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

12. Schedule of Expenses by Program

In the Statement of Revenues, Expenses and Changes in Net Assets, operating expenses are presented by functional expense purpose. Functional expense purpose is classified below by natural classification, such as salaries, benefits, and goods and services.

Depreciation is allocated below based on functional classification as required by IPEDS for Fiscal Year 2012. The tables below summarize operating expenses by functional purpose for the years ended June 30, 2012 and 2011:

2012

	Compensation & <u>Benefits</u>	Supplies & <u>Services</u>	Scholarships & <u>Fellowships</u>	<u>Depreciation</u>	Operations & <u>Maintenance</u>	<u>Total</u>
Instruction	\$ 13,054,252	\$ 1,322,344	\$ 5,001	\$ 644,000	\$ 804,395	\$15,829,992
Research	3,480,460	4,188,530	-	681,001	447,016	8,797,007
Public service	3,552,916	2,547,744	12,585	81,150	331,617	6,526,012
Academic support	2,450,151	1,835,938	-	403,533	251,059	4,940,681
Student services	4,423,096	3,012,705	29,106	489,589	425,844	8,380,340
Institutional support	7,214,811	4,769,702	75,391	1,168,663	805,456	14,034,023
Operation & maintenance of plant	2,061,642	1,235,920	-	641,547	(3,939,109)	-
Auxiliary enterprises	1,183,966	4,663,407	17,193	343,800	332,364	6,540,730
Student financial aid	<u>573,460</u>	<u>(404,051)</u>	<u>9,929,449</u>	<u>13,372</u>	<u>541,358</u>	<u>10,653,588</u>
Total operating expense	<u>\$ 37,994,754</u>	<u>\$23,172,239</u>	<u>\$ 10,068,725</u>	<u>\$ 4,466,655</u>	<u>\$ -</u>	<u>\$75,702,373</u>

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

12. Schedule of Expenses by Program, continued

2011

	Compensation & <u>Benefits</u>	Supplies & <u>Services</u>	Scholarships & <u>Fellowships</u>	<u>Depreciation</u>	Operations & <u>Maintenance</u>	<u>Total</u>
Instruction	\$ 12,380,019	\$ 1,574,896	\$ 135,557	\$ 664,461	\$ 838,218	\$ 15,593,151
Research	3,100,235	1,719,311	-	511,307	525,057	5,855,910
Public service	3,094,408	1,915,254	446,383	54,253	371,741	5,882,039
Academic support	2,673,141	1,358,446	-	404,745	276,381	4,712,713
Student services	4,527,107	1,723,410	266,925	537,122	456,827	7,511,391
Institutional support	7,219,969	3,161,499	383,244	1,246,296	874,231	12,885,239
Operation & maintenance of plant	2,024,003	1,404,853	-	817,474	(4,246,330)	-
Auxiliary enterprises	926,533	3,979,188	-	606,263	317,851	5,829,835
Student financial aid	<u>456,806</u>	<u>987,609</u>	<u>8,858,346</u>	<u>-</u>	<u>586,024</u>	<u>10,888,785</u>
Total operating expense	<u>\$ 36,402,221</u>	<u>\$ 17,824,466</u>	<u>\$ 10,090,455</u>	<u>\$ 4,841,921</u>	<u>\$ -</u>	<u>\$ 69,159,063</u>

13. Kentucky State University Foundation, Inc.

a. Organization:

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.

b. Summary of Significant Accounting Policies:

The financial statements of the Foundation have been prepared on the accrual basis of accounting and include the assets, liabilities and results of operations of the Foundation.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc., continued

(a) Cash and Cash Equivalents:

For purposes of the statement of cash flows, the Foundation considers all highly liquid investments purchased with a maturity of three months or less to be cash equivalents.

(b) Depreciation:

Depreciation is computed by the straight-line method over the estimated useful life of the respective asset. Accumulated depreciation at June 30, 2012 and 2011 was \$124,561 and \$106,843, respectively.

(c) 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.

(d) Estimates:

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

(e) Marketable Securities:

Marketable securities are composed primarily of publicly-traded U.S. Government obligations, corporate bonds and notes, and equity securities and are carried at fair value.

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc., continued

c. Marketable Securities:

Marketable securities as of June 30, 2012 and 2011 are as follows:

	2012		2011	
	Cost	Market Value	Cost	Market Value
U.S. Government obligations	\$1,012,468	\$1,083,521	\$1,302,887	\$1,396,810
Equity securities	3,476,051	4,447,689	3,000,264	4,153,689
Bonds and notes	1,517,016	1,580,239	990,833	1,034,759
	\$6,005,535	\$7,111,449	\$5,293,984	\$6,585,258

d. Federal Income Taxes:

The Foundation is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code.

e. Summarized Financial Statements for the Year Ended June 30, 2011:

The financial statements include certain prior year summarized comparative information in total but not by net asset class. Such information does not include sufficient detail to constitute a presentation in conformity with generally accepted accounting principles. Accordingly, such information should be read in conjunction with the Foundation's financial statements for the year ended June 30, 2011 from which the summarized information was derived.

f. Temporarily Restricted Net Assets:

Temporarily restricted net assets are available primarily for scholarships and University and student support.

For the year ended June 30, 2012, net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restrictions specified by donors as follows:

Scholarships	\$ 36,655
University support	175,507
Operating and other expenses	31,134
Interfund management fees	20,289
Student support	35,991
Travel and other expenses	58,386
Total restrictions released	\$ 357,962

KENTUCKY STATE UNIVERSITY

Notes to the Financial Statements, continued

13. Kentucky State University Foundation, Inc., continued

g. Permanently Restricted Net Assets:

Net assets are permanently restricted primarily for scholarships and University support. For the year ended June 30, 2012 net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restrictions by donors as follows:

Scholarships	\$ 38,630
Operating and other expenses	22,924
Interfund management fees	127,460
Total restrictions released	\$189,014

h. Retirement Plan:

The Foundation has a defined contribution profit sharing plan which covers all employees who meet certain requirements. Foundation contributions are discretionary. No contribution was made for the year ended June 30, 2012.

i. Fair Value Measurement:

The fair value of the Foundation's marketable securities are based on quoted market prices for those specific or identical instruments. On a recurring basis, all assets were classified as Level 1 in the fair value hierarchy for financial assets measured at fair value.

j. Subsequent Events:

The Foundation has evaluated subsequent events through October 5, 2012, the date management's review of the financial statements was completed. There were no events that would impact the results of operations or financial position as of that date.

DEAN || DORTON || ALLEN || FORD^{PLLC}

**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***

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

We have audited the financial statements of Kentucky State University (the University) as of and for the year ended June 30, 2012, and have issued our report thereon dated October 25, 2012. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control over Financial Reporting

Management of the University is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the University's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the University's internal control over financial reporting.

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 combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the University's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying Schedule of Findings and Responses, we identified a deficiency in internal control over financial reporting that we considered to be a significant deficiency. We consider the deficiency described in the accompanying Schedule of Findings and Questioned Costs to be a significant deficiency, Finding 12-01. 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 the attention by those charged with governance.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the University's financial statements are free of material misstatements, 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*.

We noted certain other matters that we have reported to management in a letter dated October 25, 2012.

The University's response to the finding identified in our audit is described in the accompanying Schedule of Findings and Responses. We did not audit the University's response and, accordingly, we express no opinion on it.

This report is intended solely for the information and use of the management and Board of Regents of the University and is not intended to be and should not be used by anyone other than these specified parties.

Dean Dotson Allen Ford, PLLC

October 25, 2012
Lexington, Kentucky

KENTUCKY STATE UNIVERSITY

Schedule of Findings and Responses

Year ended June 30, 2012

Section I – Summary of Auditors’ Results:

Financial Statements:

- a. The type of report issued on the financial statements: **Unqualified 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 12-01:

Condition:

The year-end accounts receivable aged trial balance that was presented to us for audit purposes indicated that a large percentage of receivables were over 365 days old, and several accounts were as much as two years old. We believe that some of these accounts are not collectable at this point in time and the University should review the adequacy of the allowance during the year and appropriately adjust the allowance.

Effect:

The University posted an adjusting journal entry to increase the allowance for doubtful accounts after year end. 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. 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:

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.

KENTUCKY STATE UNIVERSITY

Schedule of Findings and Responses, continued

Year ended June 30, 2012

Finding 12-01, continued:

Recommendation, continued:

- 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.

We recommend the University conduct an overall evaluation of the allowance for doubtful accounts at year end and base the allowance on the aging of the balance, instead of the last semester the student attended to ensure a more accurate balance in the allowance for doubtful accounts.

Management's Response:

We concur. The University has increased its collection efforts and has added three collection agencies to assist in collection efforts. We will increase our efforts to manage these agencies and rotate accounts with no collections activity. The student allowance account was increased substantially this fiscal year. We have also increased communication with the students to include monthly reminders of outstanding balances. Additionally, we have drafted a revision to the student accounts write-off method to expedite submission of delinquent accounts to collection agencies and decrease the timing of writing off student accounts.