

KENTUCKY STATE UNIVERSITY
(A Component Unit of the Commonwealth of Kentucky)

FINANCIAL STATEMENTS
June 30, 2017

KENTUCKY STATE UNIVERSITY

FINANCIAL STATEMENTS

June 30, 2017

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INDEPENDENT AUDITOR'S REPORT

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

Secretary of Finance and
Administration Cabinet of the
Commonwealth of Kentucky

Report on the Financial Statements

We have audited the accompanying financial statements of the business-type activities and discretely presented component unit of Kentucky State University (the University) as of and for the year ended June 30, 2017, and the related notes to the financial statements which collectively comprise the University's basic financial statements as listed on the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements based on our audit. We did not audit the financial statements of the Kentucky State University Foundation, Inc. (Foundation) which represent the entire discretely presented component unit of the University. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the Foundation is based solely on the reports of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audit contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement. The financial statements of the Foundation were not audited in accordance with *Government Auditing Standards*.

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

(Continued)

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

Opinions

In our opinion, based on our audit 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, 2017, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the Management's Discussion and Analysis on pages 3 through 14 and required supplementary information on pages 45 through 46 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated June 22, 2018 on our consideration of the University's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the University's internal control over financial reporting and compliance.

Crowe Horwath LLP

Crowe Horwath LLP

Lexington, Kentucky
June 22, 2018

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, 2017, with comparative information for the year ended June 30, 2016. 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, 2017, reflected total assets and deferred outflows of \$136.0 million and total liabilities and deferred inflows of \$127.3 million. Total net position was \$8.7 million.

Total assets and deferred outflows increased by \$9.2 million or 7.3%, primarily due to increases in deferred pension outflows. Total liabilities and deferred inflows increased by \$8.9 million or 7.5% primarily due to increases in deferred pension inflows and net pension liability.

Unrestricted net position, which the University reserves for spending in programs and other capital-related contingencies, decreased \$1.8 million. This decrease was primarily due to a revenue shortfall and changes in the net pension liability.

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 relate to the student loan program.

Operating revenues were \$34.4 million and operating expenditures were \$70.6 million, resulting in a loss from operations of \$36.2 million. Net non-operating revenues were \$31.6 million, including \$26.8 million in state appropriations, which, when combined with the loss from operations and capital appropriations, resulted in an overall increase in net position of \$0.3 million.

KENTUCKY STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017

Using the Financial Statements

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

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

Statement of Net Position

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

Condensed Statement of Net Position

	<u>2017</u>	<u>2016</u>
ASSETS		
Current assets	\$ 22,883,930	\$ 26,157,384
Noncurrent assets	<u>94,780,968</u>	<u>91,594,862</u>
Total assets	<u>\$ 117,664,898</u>	<u>\$ 117,752,246</u>
 DEFERRED OUTFLOWS OF RESOURCES	 \$ 18,349,336	 \$ 9,056,663
LIABILITIES		
Current liabilities	7,470,378	8,610,628
Non-current liabilities	<u>103,064,464</u>	<u>98,952,303</u>
Total liabilities	<u>110,534,842</u>	<u>107,562,931</u>
 DEFERRED INFLOWS OF RESOURCES	 \$ 16,778,028	 \$ 10,883,769
NET POSITION		
Invested in capital assets, net of related debt	72,727,684	69,264,917
Restricted		
Nonexpendable	8,657,506	8,657,506
Expendable	-	1,357,061
Unrestricted	<u>(72,683,826)</u>	<u>(70,917,276)</u>
Total net position	<u>\$ 8,701,364</u>	<u>\$ 8,362,208</u>

Assets and Deferred Outflows: As of June 30, 2017, total assets and deferred outflows amounted to \$136.0 million. Of this amount, investment in capital assets (net of depreciation) of \$77.8 million, or 57.2% of total assets, represented the largest asset class. Investments amounted to \$16.6 million or 12.2% of total assets. During the year, total assets and deferred outflows increased by \$9.2 million, primarily due to increases in deferred outflows of resources related to pension funding.

KENTUCKY STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017

Liabilities and Deferred Inflows: As of June 30, 2017, total liabilities and deferred inflows amounted to \$127.3 million. Net pension liabilities amounted to \$98.1 million. The University's proportion of the net pension liability of the Kentucky Employees Retirement System and the Kentucky Teachers' Retirement System was based on a projection of the University's long-term share of contributions to the pension plans relative to the projected contributions of all participating universities, actuarially determined. 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 and deferred inflows increased by \$8.9 million, primarily due to increases in the net pension liability and deferred inflows of resources related to pension funding.

Net Position: Net position of the University was \$8.7 million at June 30, 2017 and was reported in three net position categories: invested in capital assets, net of related debt \$72.7 million, restricted nonexpendable \$8.7 million, and unrestricted \$(72.7) million.

Statement of Revenues, Expenses and Changes in Net Position

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

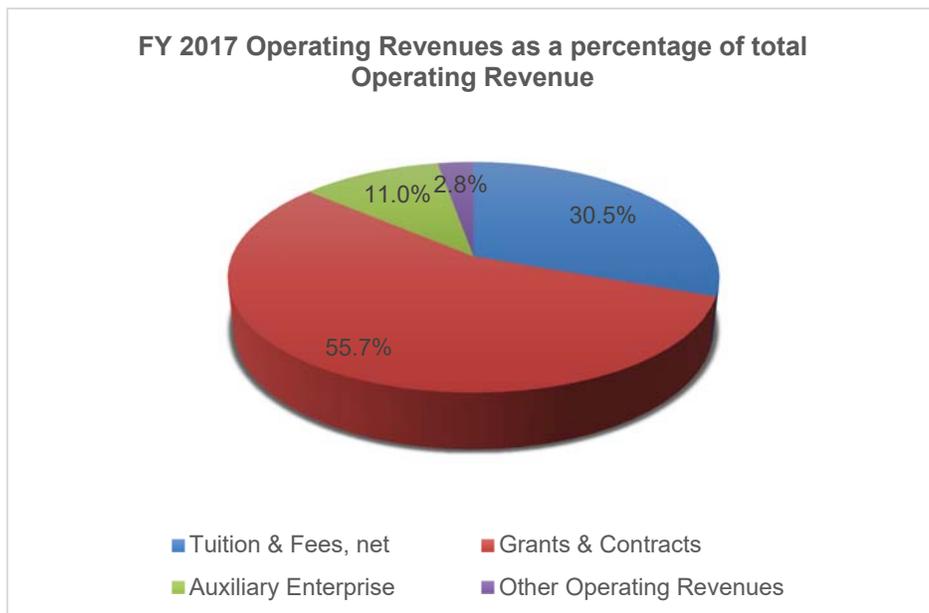
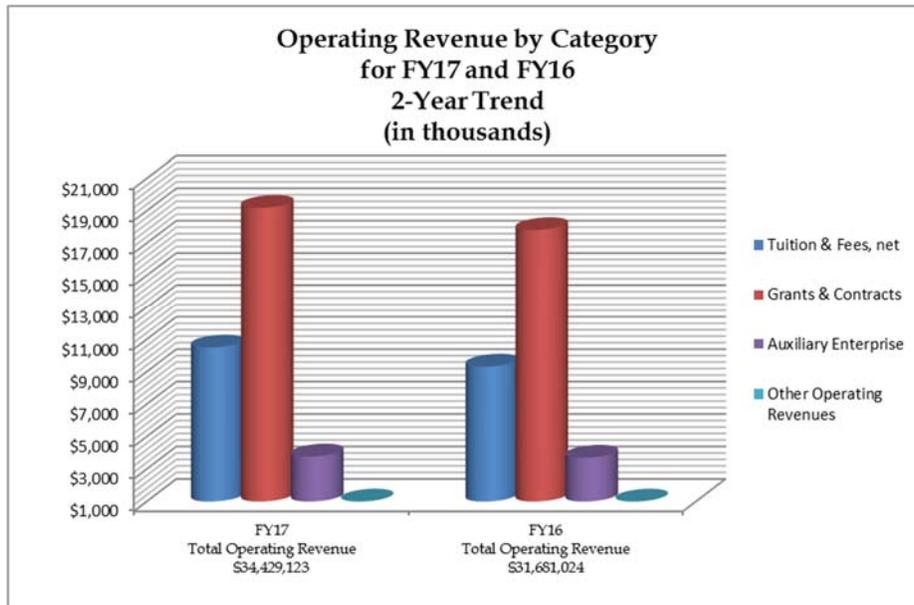
Financial activities are reported as either operating or non-operating. GASB Statement No. 35 requires state appropriations, gifts, investment income and endowment income to be classified as non-operating revenues. Accordingly, the University reports an operating loss prior to the addition of non-operating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. Tuition revenue is reduced by gift scholarships and institutional aid, and is reported net of scholarship allowances in the financial statements. A summarized comparison of the University's revenues, expenses and changes in net position for the years ended June 30, 2017 and June 30, 2016 is as follows.

KENTUCKY STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017

Condensed Statement of Revenues, Expenses and Changes in Net Position

	<u>2017</u>	<u>2016</u>
OPERATING REVENUES		
Student tuition and fees, net	\$ 10,497,944	\$ 9,316,745
Grants and contracts	19,192,283	17,814,452
Auxiliary enterprises	3,774,500	3,702,842
Other operating revenue	<u>964,396</u>	<u>846,985</u>
Total operating revenues	<u>34,429,123</u>	<u>31,681,024</u>
OPERATING EXPENSES		
Educational and general	64,882,362	56,825,667
Auxiliary enterprises	<u>5,712,000</u>	<u>4,499,210</u>
Total operating expenses	<u>70,594,362</u>	<u>61,324,877</u>
OPERATING LOSS	<u>(36,165,239)</u>	<u>(29,643,853)</u>
NON-OPERATING REVENUES (EXPENSES)		
State appropriations	26,729,600	23,429,600
Federal grants and contracts	3,776,772	3,785,004
Investment income (loss)	1,407,599	(209,844)
Interest on capital asset – related debt	(226,835)	(445,054)
Other	<u>(88,964)</u>	<u>187</u>
Total non-operating revenues	<u>31,598,172</u>	<u>26,559,893</u>
Loss before capital appropriations	(4,567,067)	(3,083,960)
Capital appropriations	<u>4,906,223</u>	<u>-</u>
Change in net position	339,156	(3,083,960)
Net position, beginning of year	<u>8,362,208</u>	<u>11,446,168</u>
Net position, end of year	<u>\$ 8,701,364</u>	<u>\$ 8,362,208</u>

Figure 1



Operating Revenue

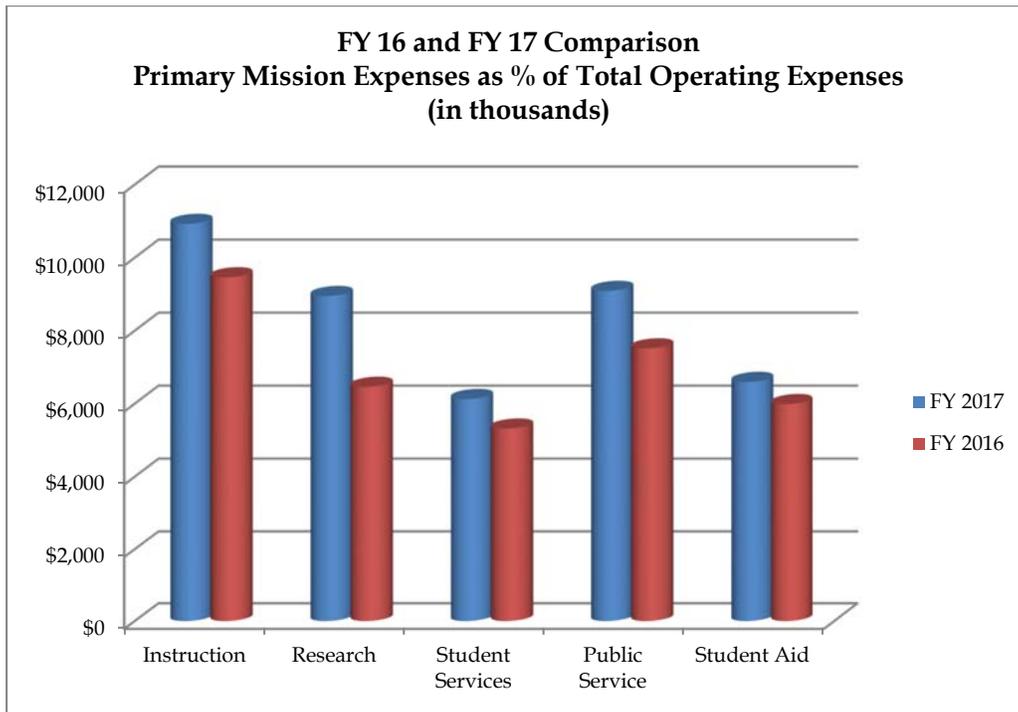
Total operating revenues were \$34.4 million for the year ended June 30, 2017, an increase of \$2.7 million compared to FY16. The primary components of operating revenue were federal, state and local grants and contracts of \$19.2 million (55.7%), student tuition and fees, net, of \$10.5 million (30.5%) and auxiliary services and other revenues of \$4.7 million (13.8%). FY17 net student tuition and fees revenue increased \$1.2 million compared to FY16. FY17 grants and contracts revenue increased \$1.3 million compared to FY16 due to increased awards and spending. FY17 auxiliary services and other revenue increased \$0.2 million compared to FY16. Refer to **Figure 1** for the two-year trend of the operating revenues as a percent to total operating revenues and revenue by category.

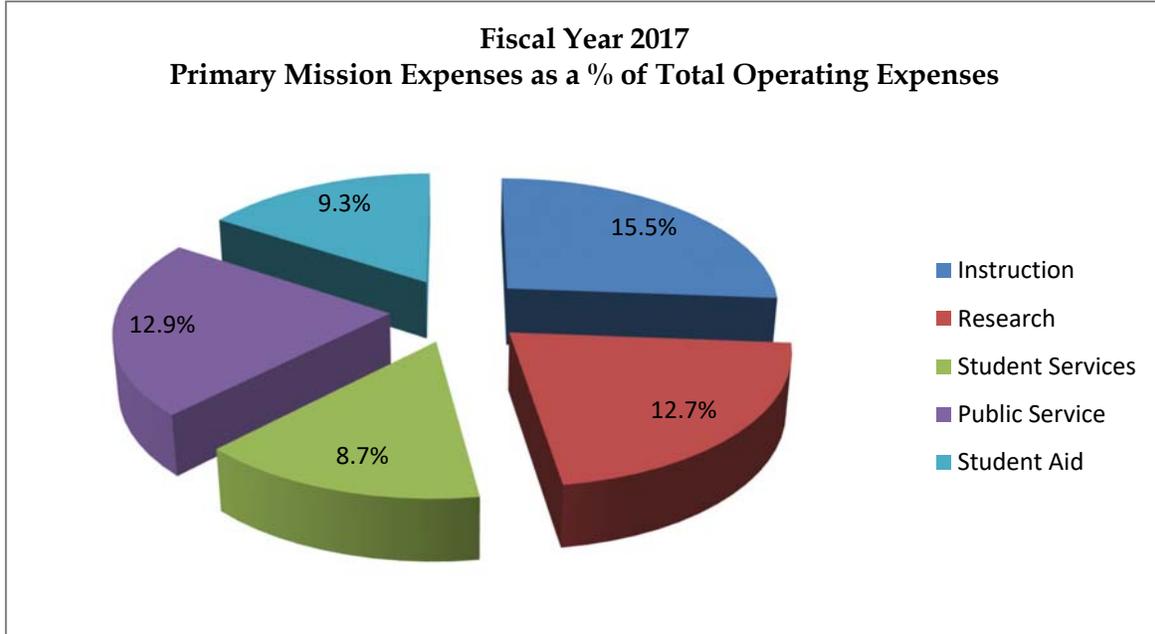
Operating Expenses

Operating expenses totaled \$70.6 million, an increase of \$9.3 million from last year. Of this amount, \$41.7 million (59.1%) was expended directly for the primary mission of the University – instruction (15.5%), research (12.7%), student services (8.7%), student aid (9.3%), and public service (12.9%). Instruction is the main component of Primary Mission expenses amounting to \$10.9 million in fiscal year 2017 or 15.5%. Refer to **Figure 2** for the operating expenses categorized into the Primary Mission of the University.

(Percentages below do not include depreciation or operations/maintenance allocations.)

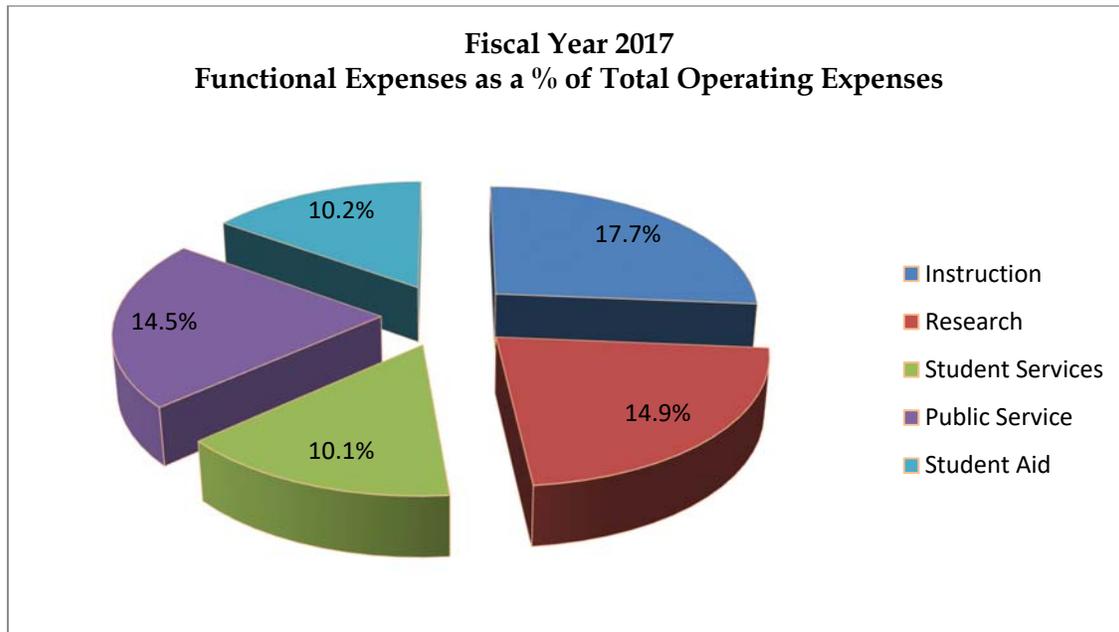
Figure 2





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

(Percentages below include depreciation and operations/maintenance allocations.)



KENTUCKY STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017

The University continued to invest in student aid and support services to provide students with opportunities to be successful in fiscal year 2017. For the year ended June 30, 2017, student aid expenses totaled \$6.6 million and scholarship allowances totaled \$5.0 million.

The University had an overall increase in institutional support of \$1.2 million, which was consistent with the overall expenditure increase University wide. 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 \$36.2 million. Non-operating revenues, net of expenses, amounted to \$31.6 million, resulting in a before capital appropriations of \$4.6 million for the year. With capital appropriations of \$4.9 million, net position increased by \$0.3 million. Non-operating revenues include state appropriations of \$26.7 million and non-operating federal grants and contracts of \$3.8 million.

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.

Condensed Statement of Cash Flows

	<u>2017</u>	<u>2016</u>
Cash (used) provided by:		
Operating activities	\$ (29,095,167)	\$ (26,876,152)
Non-capital financing activities	30,417,408	27,216,483
Capital and related financing activities	(2,831,576)	(3,413,206)
Investing activities	<u>220,901</u>	<u>-</u>
Change in cash	(1,288,434)	(3,072,875)
Cash and cash equivalents, beginning year	<u>19,948,892</u>	<u>23,021,767</u>
Cash and cash equivalents, end of year	<u>\$ 18,660,458</u>	<u>\$ 19,948,892</u>

Cash and Investments

Major sources of cash received from operating activities are student tuition and fees of \$10.3 million and grants and contracts of \$20.5 million. Major uses of cash for operating activities were payments to employees for salaries and benefits of \$35.0 million and to vendors and contractors of \$24.6 million.

Noncapital financing activities included state appropriations from the Commonwealth of Kentucky of \$26.7 million.

Capital and related financing activities include purchases and payments of \$7.7 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.

KENTUCKY STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017

State Appropriations

State appropriations represent approximately 40.5% 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 appropriations are 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, 2017 and 2016.

	<u>2017</u>	<u>2016</u>
Commonwealth appropriations	\$ 26,729,600	\$ 23,429,600

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 2017, the Commonwealth provided capital appropriations of \$4.9 million to the University. State capital appropriations plus federal sources play an important role in the University's efforts to address deferred maintenance projects.

Grant and Contract Revenue

The following table details the University's grant and contract revenue for fiscal years ended June 30, 2017 and 2016.

	<u>2017</u>	<u>2016</u>
Federal grants and contracts, operating	\$ 16,408,586	\$ 15,260,406
Federal grants and contracts, non-operating	3,776,772	3,785,004
State grants and contracts	<u>2,783,697</u>	<u>2,554,046</u>
Total grants and contracts	\$ <u>22,969,055</u>	\$ <u>21,599,456</u>

Capital Plan

The University continues to face financial challenges to maintain and upgrade its capital assets including its infrastructure, buildings and grounds. A combination of revenue sources fund the University's investment in capital improvements. Those include appropriations provided by the Commonwealth of Kentucky. In fiscal year 2015-16, the Commonwealth funded one capital project, appropriating state bond funds toward Repair Boilers and Aging Distribution Lines. As of June 30, 2017, \$4.7 million has been expended on this project. State capital appropriations for deferred maintenance were not appropriated. Federal funds are the primary source for the University's College of Agriculture and Land Grant departments.

KENTUCKY STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017

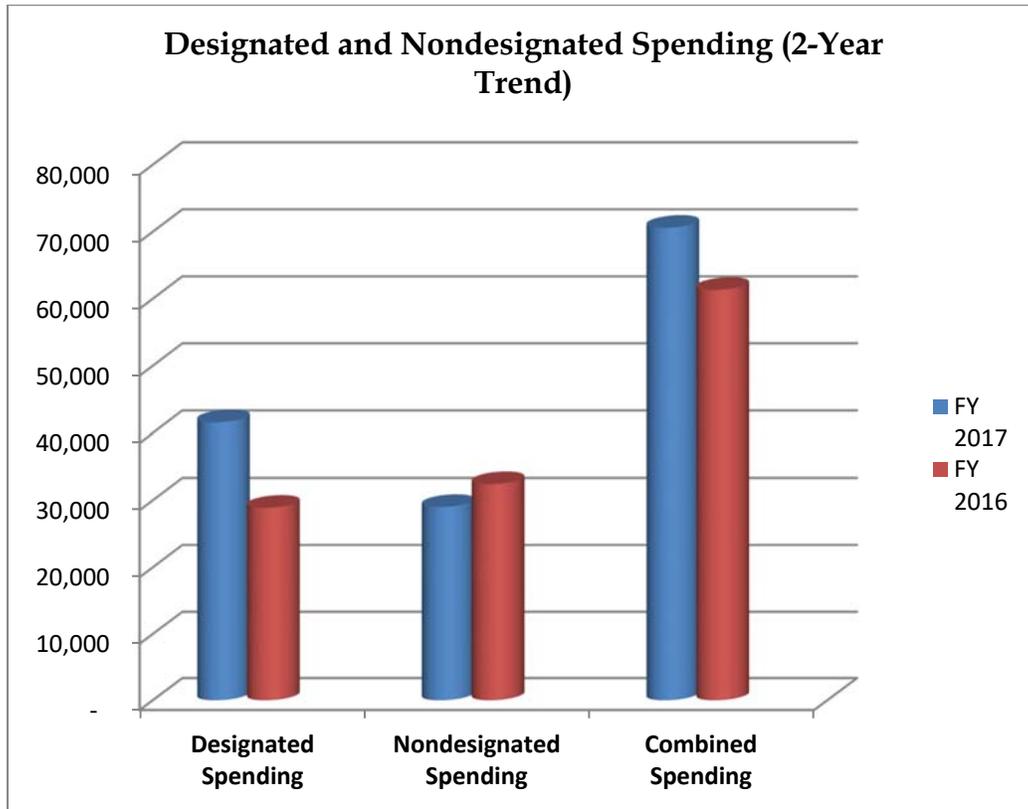
Designated and Non-designated Spending

In the tables below, expenses have been categorized into designated or non-designated spending categories. The designated spending category includes funds expended by function from contracts and grants, land grant, auxiliary and depreciation. These funds must be expended for the purposes for which the funds were received or budgeted. This category also includes funds for student aid. All other spending is categorized as non-designated spending. Total spending for all functions in the non-designated category decreased by approximately \$3.4 million in 2017, primarily due to decreases in available revenue and corresponding budget reductions.

	2017		
	Designated Spending	Non-designated Spending	Combined Spending
Instruction	\$ 1,036,543	\$ 9,886,699	\$ 10,923,242
Research	8,430,813	517,428	8,948,241
Public service	8,782,324	305,979	9,088,303
Academic support	1,593,544	1,265,435	2,858,979
Student services	5,233,363	892,816	6,126,179
Institutional support	1,163,298	10,802,428	11,965,726
Operation and plant maintenance	-	4,632,516	4,632,516
Student aid	5,882,648	713,060	6,595,708
Auxiliary	5,407,271	-	5,407,271
Depreciation	4,048,197	-	4,048,197
	<u>\$ 41,578,001</u>	<u>\$ 29,016,361</u>	<u>\$ 70,594,362</u>
Total			
	2016		
	Designated Spending	Non-designated Spending	Combined Spending
Instruction	\$ 370,589	\$ 9,090,312	\$ 9,460,901
Research	5,300,249	1,160,763	6,461,012
Public service	5,309,416	2,205,324	7,514,740
Academic support	1,689,059	1,170,040	2,859,099
Student services	1,001,060	4,316,586	5,317,646
Institutional support	1,287,531	9,462,217	10,749,748
Operation and plant maintenance	-	4,627,724	4,627,724
Student aid	5,594,355	392,891	5,987,246
Auxiliary	4,196,218	-	4,196,218
Depreciation	4,150,543	-	4,150,543
	<u>\$ 28,899,020</u>	<u>\$ 32,425,857</u>	<u>\$ 61,324,877</u>
Total			

The graph in Figure 3 shows a two-year trend of designated, non-designated, and combined spending. Designated spending increased \$12.7 million in 2017. Non-designated spending decreased \$3.4 million in 2017. Combined spending increased \$9.3 million in 2017.

Figure 3



Capital Asset and Debt Administration

Capital Assets

Capital assets, net of accumulated depreciation, totaled \$77.8 million at June 30, 2017, an increase of \$2.7 million. Capital assets as of June 30, 2017 and significant changes in capital assets during the year are as follows (in millions):

	June 30, 2017	Net Additions (Reductions) FY 16-17	June 30, 2016
Land and land improvements	\$ 6.3	\$ -	\$ 6.3
Buildings, fixed equipment and infrastructure	154.7	-	154.7
Equipment, vehicles and capitalized software	30.3	2.0	28.3
Library materials and art	10.5	-	10.5
Construction in progress	6.6	4.7	1.9
Accumulated depreciation	<u>(130.6)</u>	<u>(4.0)</u>	<u>(126.6)</u>
Total	\$ 77.8	\$ 2.7	\$ 75.1

KENTUCKY STATE UNIVERSITY
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2017

Long Term Debt

At June 30, 2017, bonds and lease payable amounted to \$5.1 million, as summarized below:

	<u>2017</u>	<u>2016</u>
Lease Obligations	\$ 2,245,098	\$ 2,783,028
Note payable to City of Frankfort	150,000	150,000
General Receipts Bonds	2,755,000	2,980,000
Bond discount	<u>(38,307)</u>	<u>(49,798)</u>
Total	<u>\$ 5,111,791</u>	<u>\$ 5,863,230</u>

Economic Factors Impacting Future Periods

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

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

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

The overall financial position of the University was stable during fiscal year 2017. Revenue streams were stressed. As the University adapts to present economic environments, new opportunities for funding will be explored to complement state support. Executive management's goal is to deliver exceptional programs and services to students and constituents while maintaining financial stability. Management believes Kentucky State University is able to sustain its financial position and solidify its being a regional university of excellence.

KENTUCKY STATE UNIVERSITY
STATEMENT OF NET POSITION
June 30, 2017

ASSETS

Current assets

Cash and cash equivalents	\$ 18,660,458
Accounts, grants and loans receivable, net	<u>4,223,472</u>
Total current assets	<u>22,883,930</u>

Noncurrent assets

Accounts, grants and loans receivable, net	381,181
Investments	16,560,312
Capital assets, net	<u>77,839,475</u>
Total noncurrent assets	<u>94,780,968</u>

DEFERRED OUTFLOWS OF RESOURCES

Deferred outflows – KERS	4,201,535
Deferred outflows – KTRS	<u>14,147,801</u>
Total deferred outflows	<u>18,349,336</u>

Total assets and deferred outflows of resources 136,014,234

LIABILITIES

Current liabilities

Accounts payable and accrued liabilities	4,531,347
Accrued compensated absences	1,608,411
Unearned revenue	414,520
Deposits	64,524
Long-term debt, current portion	<u>851,576</u>
Total current liabilities	<u>7,470,378</u>

Noncurrent liabilities

Net pension liability	98,072,554
Long-term debt, noncurrent portion	4,260,215
Federal grants refundable	<u>731,695</u>
Total noncurrent liabilities	<u>103,064,464</u>

DEFERRED INFLOWS OF RESOURCES

Deferred inflows – KERS	3,394,261
Deferred inflows – KTRS	<u>13,383,767</u>
Total deferred inflows	<u>16,778,028</u>

Total liabilities and deferred inflows of resources 127,312,870

NET POSITION

Invested in capital assets, net of related debt	72,727,684
Restricted	
Nonexpendable - endowment	8,657,506
Unrestricted	<u>(72,683,826)</u>
Total net position	<u>\$ 8,701,364</u>

See accompanying notes to financial statements.

KENTUCKY STATE UNIVERSITY FOUNDATION, INC.
STATEMENT OF FINANCIAL POSITION
June 30, 2017

ASSETS

Current assets	
Cash and cash equivalents	\$ 1,610,138
Total current assets	<u>1,610,138</u>
Investments, at fair value	9,082,083
Property and equipment:	
Equipment	140,400
Buildings and improvements	<u>65,526</u>
	205,926
Accumulated depreciation	<u>(181,009)</u>
Property and equipment, net	24,917
Other assets	<u>31,640</u>
Total assets	<u>\$ 10,748,778</u>

LIABILITIES AND NET ASSETS

Current liabilities	
Accounts payable	\$ -
Accrued liabilities	<u>2,081</u>
Total liabilities	2,081
Net assets	
Unrestricted	253,323
Temporarily restricted	6,781,650
Permanently restricted	<u>3,711,724</u>
Total net assets	<u>10,746,697</u>
Total liabilities and net assets	<u>\$ 10,748,778</u>

See accompanying notes to financial statements.

KENTUCKY STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES AND CHANGES IN NET POSITION
Year ended June 30, 2017

REVENUES

Operating revenues

Student tuition and fees (net of scholarship allowances of \$4,996,868)	\$ 10,497,944
Federal grants and contracts	16,408,586
State and local grants and contracts	2,783,697
Auxiliary enterprises:	
Residence halls	1,929,890
Dining	1,737,107
Bookstore	76,433
Other auxiliaries	31,070
Other operating revenues	<u>964,396</u>
Total operating revenues	<u>34,429,123</u>

EXPENSES

Operating expenses

Educational and general	
Instruction	10,923,242
Research	8,948,241
Public service	9,088,303
Academic support	2,858,980
Student services	6,126,179
Institutional support	11,965,726
Operation and maintenance of plant	4,632,516
Student aid	6,595,708
Depreciation	3,743,467
Auxiliary enterprises	
Residence halls	1,243,573
Dining	1,933,410
Other auxiliaries	1,238,742
Bookstore	991,545
Depreciation	<u>304,730</u>
Total operating expenses	<u>70,594,362</u>

Operating loss (36,165,239)

NONOPERATING REVENUES (EXPENSES)

State appropriations	26,729,600
Federal grants and contracts	3,776,772
Investment income (net of investment expense)	1,407,599
Interest on capital asset-related debt	(226,835)
Other	<u>(88,964)</u>
Net non-operating revenues	<u>31,598,172</u>

Loss before capital appropriations (4,567,067)

Capital appropriations 4,906,223

Change in net position 339,156

NET POSITION

Net position, beginning of year	<u>8,362,208</u>
Net position, end of year	<u>\$ 8,701,364</u>

See accompanying notes to financial statements.

KENTUCKY STATE UNIVERSITY FOUNDATION, INC.
STATEMENT OF ACTIVITIES
Year ended June 30, 2017

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues, gains and other support				
Contributions	\$ 8,266	\$ 836,808	\$ 105,691	\$ 950,765
Investment income:				
Interest and dividends	2,932	225,154	-	228,086
Realized and unrealized gains	<u>8,764</u>	<u>654,408</u>	<u>-</u>	<u>663,172</u>
Total investment income	11,696	879,562	-	891,258
Releases from restrictions	<u>1,724,050</u>	<u>(1,724,050)</u>	<u>-</u>	<u>-</u>
Total revenues, gains and other support	1,744,012	(7,680)	105,691	1,842,023
Expenses				
Scholarships	346,602	-	-	346,602
Operating expenses	194,744	-	-	194,744
Personal services	110,730	-	-	110,730
University support	955,810	-	-	955,810
Student support	84,476	-	-	84,476
Travel and promotion	<u>59,440</u>	<u>-</u>	<u>-</u>	<u>59,440</u>
Total expenses	<u>1,751,802</u>	<u>-</u>	<u>-</u>	<u>1,751,802</u>
Change in net assets	(7,790)	(7,680)	105,691	90,221
Net assets, beginning of year	261,113	6,786,750	3,608,613	10,656,476
Reclassification	<u>-</u>	<u>2,580</u>	<u>(2,580)</u>	<u>-</u>
Net assets, end of year	<u>\$ 253,323</u>	<u>\$ 6,781,650</u>	<u>\$ 3,711,724</u>	<u>\$ 10,746,697</u>

See accompanying notes to financial statements.

KENTUCKY STATE UNIVERSITY
STATEMENT OF CASH FLOWS
Year ended June 30, 2017

Cash flows from operating activities	
Tuition and fees	\$ 10,328,395
Grants and contracts	20,552,945
Payments to suppliers	(24,566,180)
Payments to employees	(35,003,003)
Payments to students	(5,330,437)
Loans issued to students	(80,475)
Collection of loans issued to students	351,750
Auxiliary enterprises:	
Residence halls and dining	3,562,387
Other auxiliaries	107,503
Other receipts	<u>981,948</u>
Net cash from operating activities	(29,095,167)
Cash flows from non-capital financing activities	
State appropriations	26,729,600
Federal grants and contracts	3,776,772
Other	<u>(88,964)</u>
Net cash from non-capital financing activities	30,417,408
Cash flows from capital financing activities	
Purchases of capital assets	(6,759,524)
Principal paid on capital debt	(751,440)
Interest paid on capital debt	(226,835)
Capital appropriations	<u>4,906,223</u>
Net cash from capital financing activities	(2,831,576)
Cash flows from investing activities	
Investment income	1,407,599
Proceeds from sale of investments	6,985,208
Purchases of investments	<u>(8,171,906)</u>
Net cash from investing activities	<u>220,901</u>
Net change in cash and cash equivalents	(1,288,434)
Cash and cash equivalents at beginning of year	<u>19,948,892</u>
Cash and cash equivalents at end of year	<u>\$ 18,660,458</u>

(Continued)

KENTUCKY STATE UNIVERSITY
STATEMENT OF CASH FLOWS
Year ended June 30, 2017

**Reconciliation of net operating loss to net cash
from operating activities**

Operating loss	\$ (36,165,239)
Adjustments to reconcile operating loss to net cash from operating activities:	
Depreciation expense	4,048,197
Changes in assets and liabilities:	
Receivables, net	1,844,413
Loans to students, net	908,700
Other current assets	140,607
Accounts payable and accrued liabilities	(137,794)
Other current liabilities	(303,807)
Unearned revenue	(635,748)
Deposits	(104,610)
Deferred outflows – KTRS/KERS pension	(9,292,673)
Deferred inflows – KTRS/KERS pension	5,894,259
Net pension liability	<u>4,708,528</u>
Net cash from operating activities	<u>\$ (29,095,167)</u>

See accompanying notes to financial statements.

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

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

- **Invested in capital assets, net of related debt:** Capital assets, net of accumulated depreciation and outstanding principal balances of debt attributable to the acquisition, construction or improvement of those assets.
- **Restricted:**
 - Nonexpendable* – Net position subject to externally imposed stipulations that they be maintained permanently by the University. Such positions include the University's permanent endowment funds.
 - Expendable* – Net position whose use by the University is subject to externally imposed stipulations that can be fulfilled by actions of the University pursuant to those stipulations or that expire by the passage of time.
- **Unrestricted:** Net position whose use by the University is not subject to externally imposed stipulations. Unrestricted net position may be designated for specific purposes by action of management or the Board of Regents or may otherwise be limited by contractual agreements with outside parties.

(Continued)

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

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

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

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.

Investments: Investments are valued at fair value based on quoted market prices.

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.

(Continued)

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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:

Classification	Estimated Life
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 statement of net position and as a component of compensation and benefit expense in the statement of revenues, expenses and changes in net position.

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

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

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.

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

(Continued)

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

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

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

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

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, 2017, the Foundation made distributions of approximately \$956,000 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 Accounting Pronouncements Adopted/Implemented: As of June 30, 2017 the GASB has issued the following statements which were implemented by the University.

- GASB Statement No. 74, *Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans*. The objective of this Statement is to improve the usefulness of information about postemployment benefits other than pensions (other postemployment benefits or OPEB) included in the general purpose external financial reports of state and local governmental OPEB plans for making decisions and assessing accountability. The adoption of this standard had no effect on the University's net position or changes therein.
- GASB Statement No. 77, *Tax Abatement Disclosures*. This Statement establishes financial reporting standards for tax abatement agreements entered into by state and local governments. The adoption of this statement had no effect on the University's net position or change therein.

(Continued)

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

- GASB Statement No. 78, *Pensions Provided through Certain Multiple-Employer Defined Benefit Pension Plans*. The objective of this Statement is to address a practice issue regarding the scope and applicability of GASB Statement No. 68, *Accounting and Financial Reporting for Pensions*. The adoption of this standard had no effect on the University’s net position or changes therein.
- GASB Statement No. 80, *Blending Requirements for Certain Component Units – An Amendment of GASB Statement No. 14*. The objective of this Statement is to improve financial reporting by clarifying the financial statement presentation requirements for certain component units. This Statement amends the blending requirements established in paragraph 53 of Statement No. 14, The Financial Reporting Entity, as amended. The adoption of this standard had no effect on the University’s net position or changes therein.
- GASB Statement No. 82, *Pension Issues—an amendment of GASB Statements No. 67, No. 68, and No. 73*. The objective of this Statement is to address issues regarding (1) the presentation of payroll-related measures in required supplementary information, (2) the selection of assumptions and the treatment of deviations from the guidance in an Actuarial Standard of Practice for financial reporting purposes, and (3) the classification of payments made by employers to satisfy employee (plan member) contribution requirements. The adoption of this standard had no effect on the University’s net position or changes therein.

NOTE 2 - CASH, CASH EQUIVALENTS, AND INVESTMENTS

The statement of net position classification “cash and cash equivalents” includes all readily available sources of cash such as petty cash and demand deposits.

At June 30, 2017, the University had petty cash funds totaling zero, and deposits as reflected by bank balances as follows:

	<u>2017</u>
Insured, commercial banks	\$ 250,000
Uninsured, commercial banks; collateral held by pledging institution’s agent in the University’s name	2,449,820
Maintained by Commonwealth of Kentucky, collateral held by the Commonwealth in the Commonwealth’s name	<u>16,563,843</u>
	<u>\$ 19,263,663</u>

The difference in the cash carrying amount per the statement of net position and the above balances represented items in transit. At June 30, 2017, the University had no cash and cash equivalents that are restricted for capital expenditures.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 2 - CASH, CASH EQUIVALENTS, AND INVESTMENTS (Continued)

As of June 30, 2017, 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>
Money market funds	\$ 615,143	\$ 615,143	\$ -	\$ -	\$ -
Equities and equity funds	8,992,089	8,992,089	-	-	-
Alternative strategies funds	419,128	419,128	-	-	-
Real assets funds	827,067	827,067	-	-	-
Corporate bonds	1,265,941	303,770	471,151	491,020	-
Government bonds	839,231	141,402	388,849	308,980	-
Other bond funds	<u>3,601,713</u>	<u>3,601,713</u>	<u>-</u>	<u>-</u>	<u>-</u>
	<u>\$ 16,560,312</u>	<u>\$14,900,312</u>	<u>\$ 860,000</u>	<u>\$ 800,000</u>	<u>\$ -</u>

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

The University has the following recurring fair value measurements as of June 30, 2017:

	<u>Total</u>	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>
Money market funds	\$ 615,143	\$ 615,143	\$ -	\$ -
Equities and equity funds	8,992,089	8,992,089	-	-
Alternative strategies funds	419,128	419,128	-	-
Real assets funds	827,067	827,067	-	-
Corporate bonds	1,265,941	1,265,941	-	-
Government bonds	839,231	839,231	-	-
Other bond funds	<u>3,601,713</u>	<u>3,601,713</u>	<u>-</u>	<u>-</u>
	<u>\$ 16,560,312</u>	<u>\$ 16,560,312</u>	<u>\$ -</u>	<u>\$ -</u>

All securities classified in level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities.

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

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.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 3 - ACCOUNTS, GRANTS AND LOAN RECEIVABLE

Accounts, grants and loans receivable consist of the following as of June 30, 2017:

Student tuition and fees	\$ 1,701,852
Student loans	1,408,399
Grants and contracts	3,603,156
Other	17,206
	<u>6,730,613</u>
Less: allowance for doubtful accounts	<u>(2,125,960)</u>
	4,604,653
Non-current portion	<u>381,181</u>
Current portion	<u>\$ 4,223,472</u>

NOTE 4 - CAPITAL ASSETS, NET

Capital assets as of June 30, 2017, are summarized as follows:

	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>
<u>Cost</u>				
Land and improvements	\$ 6,275,031	\$ -	\$ -	\$ 6,275,031
Buildings	154,741,818	-	-	154,741,818
Equipment	22,820,873	1,773,925	-	24,594,798
Computer software	1,529,747	81,700	-	1,611,447
Library holdings	10,488,366	-	-	10,488,366
Transportation equipment	3,949,603	210,974	-	4,160,577
Construction in progress	<u>1,961,371</u>	<u>4,690,233</u>	-	<u>6,651,604</u>
	201,766,809	6,756,832	-	208,523,641
Accumulated depreciation				
Buildings	97,037,091	2,484,298	-	99,521,389
Equipment	15,988,875	1,275,767	-	17,264,642
Library holdings	10,189,120	145,051	-	10,334,171
Transportation equipment	<u>3,423,575</u>	<u>140,389</u>	-	<u>3,563,964</u>
	<u>126,638,661</u>	<u>4,045,505</u>	-	<u>130,684,166</u>
Capital assets, net	<u>\$ 75,128,148</u>	<u>\$ 2,711,327</u>	<u>\$ -</u>	<u>\$ 77,839,475</u>

Construction in progress consists primarily of a project to repair and replace boilers and distribution lines. It is estimated that it will cost an additional \$3.5 million to complete and will be completed in fiscal year 2019.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 5 - ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities as of June 30, 2017, are as follows:

Payable to vendors and contractors	\$ 1,618,893
Accrued salaries and other liabilities	<u>2,912,454</u>
	<u>\$ 4,531,347</u>

NOTE 6 - UNEARNED REVENUE

Unearned revenue consists of the following as of June 30, 2017:

Unearned summer school tuition and fees	\$ 257,245
Unearned grants and contracts	<u>157,275</u>
	<u>\$ 414,520</u>

NOTE 7 - LONG-TERM LIABILITIES

Long-term liabilities as of June 30, 2017, 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	\$ 2,980,000	\$ -	\$ 225,000	\$ 2,755,000	\$ 230,000	\$ 2,525,000
Note payable – City of Frankfort	150,000	-	-	150,000	100,000	50,000
Capital lease – police vehicles	33,734	-	33,734	-	-	-
Capital lease obligations - energy savings	2,749,295	-	504,197	2,245,098	526,060	1,719,038
Bond discount	<u>(49,798)</u>	<u>-</u>	<u>(11,491)</u>	<u>(38,307)</u>	<u>(4,484)</u>	<u>(33,823)</u>
Total bonds payable and capital lease obligations	5,863,231	-	751,440	5,111,791	851,576	4,260,215
Federal grants refundable	<u>534,914</u>	<u>196,781</u>	<u>-</u>	<u>731,695</u>	<u>-</u>	<u>731,695</u>
Total long-term liabilities	<u>\$ 6,398,145</u>	<u>\$ 196,781</u>	<u>\$ 751,440</u>	<u>\$ 5,843,486</u>	<u>\$ 851,576</u>	<u>\$ 4,991,910</u>

The outstanding General Receipts Bonds Series A Bonds have interest rates from 3.625% - 3.875%. The bonds mature through 2027. The reserve requirements for these issues have been fully funded as of June 30, 2017.

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 was approximately \$2,967,000 as of June 30, 2017.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 7 - LONG-TERM LIABILITIES (Continued)

In 2009, the University signed a 10-year promissory note with the City of Frankfort, for the purchase of real property. The following is a schedule of future minimum payments required for the note payable at June 30, 2017:

<u>Year ending June 30,</u>	
2018	\$ 100,000
2019	<u>50,000</u>
	<u>\$ 150,000</u>

The principal and interest repayment requirements relating to the outstanding bonds payable at June 30, 2017, are as follows:

<u>Year ending June 30</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2018	\$ 230,000	\$ 105,916	\$ 335,916
2019	240,000	97,291	337,291
2020	250,000	88,291	338,291
2021	260,000	78,791	338,791
2022	270,000	68,781	338,781
2023-2027	<u>1,505,000</u>	<u>179,219</u>	<u>1,684,219</u>
Total	<u>\$ 2,755,000</u>	<u>\$ 618,289</u>	<u>\$ 3,373,289</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 obligations at June 30, 2017:

<u>Year ending June 30,</u>	
2018	\$ 616,792
2019	616,792
2020	616,792
2021	<u>616,791</u>
Total minimum lease payments	2,467,167
Less: amounts representing interest	<u>222,069</u>
Present value of minimum lease payment	<u>\$ 2,245,098</u>

NOTE 8 - OPERATING LEASE

The University leases computer equipment under operating leases, which expire on various dates through 2019. Lease payments to the lessors under these leases totaled \$138,976 for the year ended June 30, 2017. Minimum lease payments for 2018 and 2019 are \$68,135.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS

Kentucky Employees' Retirement System - Defined Benefit Plan

Plan Description – The University contributes to the Kentucky Employees' Retirement System (KERS), a cost sharing - multiple employer public employee retirement system. KERS is a defined benefit plan providing for retirement, disability, death benefits and health insurance. Participants have a fully vested interest after the completion of 60 months of service, 12 of which are current service. KERS issues a publicly available financial report that includes financial statements, required supplementary information, and detailed information about the pension plan's fiduciary net position. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky, 40601-6124 or by calling (502) 696-8800.

Benefits Provided

Non-Hazardous

	Tier 1 Participation Prior to <u>September 1, 2008</u>	Tier 2 Participation September 1, 2008 through <u>December 31, 2013</u>	Tier 3 Participation <u>January 1, 2014</u>
Benefit Formula	Final Compensation x Benefit Factor x Years of Service		Cash Balance Plan
Final Compensation	Average of the highest 5 fiscal years (must contain at least 48 months). Includes lump-sum compensation payments (before and at retirement).	5 complete fiscal years immediately preceding retirement; each year must contain 12 months. Lump-sum compensation payments (before and at retirement) are not to be included in creditable compensation.	No Final Compensation
Benefit Factor	1.97% or 2.0% for those retiring with service for all months between 1/1998 and 1/1999.	10 years or less = 1.10%. Greater than 10 years, but no more than 20 years = 1.30%. Greater than 20 years, but no more than 26 years = 1.50%. Greater than 26 years, but no more than 30 years = 1.75%. Additional years above 30 – 2.00% (2.00% benefit factor only applies to service earned in excess of 30 years).	No benefit factor. A life annuity can be calculated in accordance with actuarial assumptions and methods adopted by the board based on member's accumulated account balance.
Cost of Living Adjustment (COLA)	No COLA unless authorized by the Legislature. If authorized, the COLA is limited to 1.5%. This impacts all retirees regardless of Tier.		
Unreduced Retirement Benefit	Any age with 27 years of service. Age 65 with 48 months of service. Money purchase for age 65 with less than 48 months based on contributions and interest.	Rule of 87: Member must be at least age 57 and age plus earned service must equal 87 years at retirement to retire under this provision. Age 65 with 5 years of earned service. No month purchased calculations.	

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS (Continued)

	Tier 1 Participation Prior to <u>September 1, 2008</u>	Tier 2 Participation September 1, 2008 through <u>December 31, 2013</u>	Tier 3 Participation <u>January 1, 2014</u>
Reduced Retirement Benefit	Any age with 25 years of service. Age 55 with 5 years of service.	Age 60 with 10 years of service. Excludes purchased service (exception: refunds, omitted, free military).	No reduced retirement benefit.

Contributions - Benefit and contribution rates are established by state statute. Per Kentucky Revised Statute 61.565(3) contribution requirements of the active employees and the participating organizations are established and may be amended by the KRS Board. For the fiscal year ended June 30, 2017, University non-hazardous employees were required to contribute 5 percent of their annual covered salary for retirement benefits for the year ended June 30, 2017. Non-hazardous employees with a participation date after 9/1/2008 were required to contribute an additional 1 percent of their covered salary for retiree healthcare benefits. The University was contractually required to contribute 40.24 percent of annual covered payroll for non-hazardous pay to the pension plan for the year ended June 30, 2017. Actuarially determined as an amount that, when combined with employee contributions, is expected to finance the cost of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The University's total contributions to KERS for the year ended June 30, 2017 was \$1,515,810, equal to the required contributions for the year.

Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions - At June 30, 2017, the University reported a liability of \$29,146,180 for its proportionate share of the non-hazardous net pension liability. The net pension liability was measured as of June 30, 2016 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The University's proportion of the net pension liability was based on actual contributions to the pension plan during the measurement period. At June 30, 2017 and 2016, the University's proportion was 0.26 percent and 0.29 percent.

For the year ended June 30, 2017, the University's actuarially calculated pension expense was \$1,733,515. At June 30, 2017, the University reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

<u>2017</u>	Deferred Outflows of <u>Resources</u>	Deferred Inflows of <u>Resources</u>
Non-hazardous:		
Difference between expected and actual experience	\$ 30,443	\$ -
Net difference between projected and actual earnings on investments	447,512	-
Changes of assumptions	2,207,770	-
Changes in proportion and differences between employer contributions and proportionate share of contributions	-	3,394,261
University contributions subsequent to measurement date	<u>1,515,810</u>	<u>-</u>
	<u>\$ 4,201,535</u>	<u>\$ 3,394,261</u>

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS (Continued)

At June 30, 2017, the University reported \$1,515,810 as deferred outflows of resources related to pensions resulting from University contributions subsequent to the measurement date that will be recognized as a reduction of the net pension liability in the following fiscal year. Deferred outflows and deferred inflows of resources at June 30, 2017, related to pensions will be recognized in pension expense as follows:

	<u>Non-hazardous</u>
2018	\$ (396,213)
2019	(243,524)
2020	(44,071)
2021	(24,728)
	<u>\$ (708,536)</u>

Actuarial assumptions - The total pension liability at the measurement date of June 30, 2016 was determined by actuarial valuations as of June 30, 2016, using the following actuarial assumptions, applied to all periods included in the measurement.

	<u>2016</u>
Inflation	3.25%
Salary increases, average including inflation	4.00
Investment rate of return, net of expense, non-hazardous, including inflation	6.75

For the June 30, 2016 and 2015 actuarial valuation, the rates of mortality for non-hazardous, for the period before retirement are according to the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (multiplied by 50% for males and 30% for females). The rates of mortality for the period after service retirement are according to the RP-2000 Combined Mortality Table projected with Scale BB to 2013 (set back 1 year for females) for all healthy retired members and beneficiaries. The RP-2000 Combined Disabled Mortality Table projected with Scale BB to 2013 (set back 4 years for males) is used for the period after disability retirement.

The actuarial assumptions used in the June 30, 2016 valuation were based on the results of an actuarial experience study for the period July 1, 2008 - June 30, 2013.

The long-term expected return on plan assets is reviewed as part of the regular experience studies prepared every five years for KERS. The most recent analysis is outlined in a report dated December 5, 2015. Several factors are considered in evaluating the long-term rate of return assumption including long-term historical data, estimates inherent in current market data, and a log - normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected return, net of investment expense and inflation) were developed by the investment consultant for each major asset class. These ranges were combined to produce the long- term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and then adding expected Inflation. The assumption is intended to be a long-term assumption and is not expected to change absent a significant change in the asset allocation, a change in the inflation assumption, or a fundamental change in the market that alters expected returns in future years.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS (Continued)

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

<u>Asset Class</u>	<u>Non-hazardous</u>	
	<u>Target Allocation</u>	<u>Long-Term Nominal Rate of Return</u>
<u>2017</u>		
Combined Equity	50%	5.30%
Intermediate Duration Fixed Income	11	1.00
Custom KRS Fixed Income	11	3.33
Core Real Estate	5	4.25
Diversified Hedge Funds	10	4.00
Private Equity	2	8.00
Diversified Inflation Strategies	8	3.15
Cash Equivalents	<u>3</u>	(0.25)
Total	<u>100%</u>	

Changes in Assumptions and Benefit Terms Since Prior Measurement Date - The final TPL as of June 30, 2016 reflects a decrease in the assumed investment rate of return and discount rate from 7.50% to 6.75% for the Non-Hazardous plan.

Changes Since Measurement Date - The following changes in assumptions and benefit terms will be comprehended at the next measurement date of June 30, 2017. The impact on the University's financial statements from this change is not known.

- The assumed investment rate of return was decreased from 6.75% to 5.25%
- The salary increase assumption for both plans was decreased from 4.00% to 0.00%
- The inflation assumption for both plans was decreased from 3.25% to 2.30%

Discount rate - The discount rate used to measure the total pension liability was 6.75% (Non-Hazardous) for the June 30, 2016 actuarial valuation. The projection of cash flows used to determine the discount rate assumed that local employers would contribute the actuarially determined contribution rate of projected compensation over the remaining 27-year amortization period of the unfunded actuarial accrued liability. The actuarial determined contribution rate is adjusted to reflect the phase in of anticipated gains on actuarial value of assets over the first four years of the projection period. Projected inflows from investment earnings were calculated using the long-term assumed investment return of 6.75% for Non-Hazardous for the June 30, 2016 actuarial valuation. The long-term assumed investment rate of return was applied to all periods of projected of benefit payments to determine the total pension liability.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS (Continued)

Sensitivity of the University's proportionate share of the net pension liability to changes in the discount rate - The University's proportionate share of the net pension liability has been calculated using a discount rate of 6.75% (Non-Hazardous) for the June 30, 2016 actuarial valuation. The following presents the University's proportionate share of the net pension liability (in thousands) calculated using a discount rate 1% higher and 1% lower than the current rate as of June 30, 2017:

	1% Decrease <u>(5.75%)</u>	Current Discount Rate (6.75%)	1% Increase <u>(7.75%)</u>
<u>Non-Hazardous</u>			
Proportionate share of the Collective Net Pension Liability	\$ 32,835,265	\$ 29,146,180	\$ 26,045,846

Kentucky Teachers' Retirement System - Defined Benefit Plan

Plan Description –The Kentucky Teachers' Retirement System (KTRS), a cost sharing - multiple employer public employee retirement system. KTRS is a defined benefit plan providing for retirement, disability, death benefits and health insurance. Participants have a fully vested interest after the completion of 60 months of service, 12 of which are current service. KTRS issues a publicly available financial report that includes financial statements, required supplementary information, and detailed information about the pension plan's fiduciary net position. That report may be obtained by writing to Kentucky Teachers' Retirement System, 479 Versailles Road, Frankfort, Kentucky, 40601 or by calling (502) 573-3266.

Benefits Provided

	Tier 1 Participation Prior to <u>July 1, 2008</u>	Tier 2 Participation on or After <u>July 1, 2008</u>
Covered Employees:	University faculty and professional staff that do not choose the Optional Retirement Plan (Deferred Contribution)	University faculty and professional staff that do not choose the Optional Retirement Plan (Deferred Contribution)
Benefit Formula:	Final Compensation X Benefit Factor X Years of Service	
Final Compensation:	Average of the highest 5 annual salaries reduced 5% per year from the earlier of age 60 or the date 27 years of service would have been completed. Average of the highest 3 annual salaries if age 55 with 27 or more years of service. The minimum annual service allowance for all members is \$440 multiplied by credited service.	Average of the highest 5 annual salaries reduced 6% per year from the earlier of age 60 or the date 27 years of service would have been completed. Average of the highest 3 annual salaries if age 55 with 27 or more years of service. The minimum annual service allowance for all members is \$440 multiplied by credited service.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS (Continued)

	Tier 1 Participation Prior to <u>July 1, 2008</u>	Tier 2 Participation on or After <u>July 1, 2008</u>
Benefit Factor:	Non-University members: 2.00% for service prior to 7/1/1983; 2.50% for service after 7/1/1983; 2.00% if participation after 7/1/2002 and less than 10 years; 2.50% if participation after 7/1/2002 and more than 10 years; 3.00% if retire after 7/1/2004 with more than 30 years. University members: 2.0% for each year of service.	Non-University members: 1.70% if less than 10 years; 2.00% if greater than 10 years, but no more than 20 years; 2.30% if greater than 20 years, but no more than 26 years; 2.50% if greater than 26 years, but no more than 30 years; 3.00% for service greater than 30 years. University members: 1.50% if less than 10 years; 1.70% if greater than 10 years, but less than 20 years; 1.85% if greater than 20 years, but less than 27 years; 2.00% if greater than 27 years.
Cost of Living Adjustment (COLA):	1.5% annually additional ad hoc increases must be authorized by the General Assembly.	
Unreduced Retirement Benefit:	Any age with 27 years of Kentucky service. Age 55 with 5 years of Kentucky service.	Any age with 27 years of Kentucky service. Age 60 with 5 years of Kentucky service. Age 55 with 10 years of Kentucky service.
Reduced Retirement Benefit:	Must be retired for service or disability to be eligible. Retired members are given a supplement based upon a contribution supplement table approved by the KTRS Board of Trustees. The retired member pays premiums in excess of the monthly supplement.	

Contributions - Benefit and contribution rates are established by state statute. Per Kentucky Revised Statutes 161.540, 161.550 and 161.565, contribution requirements of the active employees and the participating organizations are established and may be amended by the KTRS Board. For the fiscal year ended June 30, 2017, University employees were required to contribute 7.625 percent of their annual covered salary for retirement benefits. The University was contractually required to contribute 15.87 percent of covered payroll for the year ended June 30, 2017. The actuarially determined amount, when combined with employee contributions, is expected to finance the cost of benefits earned by employees during the year, with an additional amount to finance any unfunded accrued liability. The University's total contributions to KTRS for the year ending June 30, 2017 was \$1,879,131 and were equal to the required contributions for the year. In addition, the Commonwealth of Kentucky contributes ad hoc annual cost of living adjustments provided by the General Assembly for KTRS retirees at a contribution rate of 3.25% for the year ending June 30, 2017.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS (Continued)

Pension liabilities, pension expense, and deferred outflows of resources and deferred inflows of resources related to pensions - At June 30, 2017, the University reported a liability for its proportionate share of the net pension liability that reflected a reduction for pension support provided to the University by the Commonwealth of Kentucky. The amount recognized by the University as its proportionate share of the net pension liability, the related State support, and the total portion of the net pension liability that was associated with the University were as follows:

	<u>2017</u>
University's proportionate share of the net pension liability	\$ 68,926,374
Commonwealth of Kentucky's proportionate share of the net pension liability associated with the University	<u>6,496,181</u>
	<u>\$ 75,422,555</u>

The net pension liability was measured as of June 30, 2016 and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of June 30, 2015 and update procedures were used to roll forward the total pension liability to the measurement date. The University's proportion of the net pension liability was based on actual contributions to the pension plan during the measurement period. At June 30, 2017 and 2016, the University's proportion was 0.22 percent and 0.23 percent, respectively.

For the year ended June 30, 2017, the University's actuarially calculated pension expense was \$2,993,395. The University also recognized revenue of \$510,942 for support provided by the Commonwealth. At June 30, 2017, the University reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
<u>2017</u>		
Net difference between projected and actual earnings on investments	\$ 2,129,668	\$ -
Change in assumptions	10,139,002	398,467
Differences between expected and actual experience	-	1,734,077
Changes in proportion and differences between employer contributions and proportionate share of contributions	-	11,251,223
Contributions subsequent to the measurement date	<u>1,879,131</u>	<u>-</u>
	<u>\$ 14,147,801</u>	<u>\$ 13,383,767</u>

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS (Continued)

At June 30, 2017, the University reported \$1,879,131 as deferred outflows of resources related to pensions resulting from University contributions subsequent to the measurement date that will be recognized as a reduction of the net pension liability in the following fiscal year. Net deferred outflow (inflows) of resources at June 30, 2017, related to pensions will be recognized in pension expense as follows:

2018	\$	(812,472)
2019		(812,472)
2020		(23,121)
2021		548,842
2022		<u>(15,873)</u>
		<u>\$ (1,115,096)</u>

Actuarial assumptions - The total pension liability was determined by actuarial valuations as of June 30, 2015 and update procedures were used to roll forward the total pension liability to the measurement date, using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.50%
Salary Increases	4.00 – 8.20%, including inflation
Investment Rate of Return	7.50%, net pension plan investment expense, including inflation

The rates of mortality for the period after service retirement are according to the RP-2000 Combined Mortality Table for Males and Females, as appropriate with adjustments for mortality improvements based on a projection of Scale AA to 2020 with a setback of 1 year for females.

The actuarial assumptions used in the June 30, 2015 valuation were based on the results of an actuarial experience study for the period July 1, 2005 - June 30, 2010 adopted by the Board on September 19, 2011. The results of the experience study for the period July 1, 2010-June 30, 2015 will be reflected in the June 30, 2016 valuation.

The long-term expected return on plan was determined using a log-normal distribution analysis in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. These ranges are combined to produce the long-term expected rate of return by weighing the expected future real rates of return by the target asset allocation percentage and by adding expected inflation. The June 30, 2017 target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Target Allocation</u>	<u>Long-Term Nominal Rate of Return</u>
U.S. Equity	45.0%	6.4%
Non U.S. Equity	17.0	6.5
Fixed Income	24.0	1.6
High Yield Bonds	4.0	3.1
Real estate	4.0	5.8
Alternatives	4.0	6.8
Cash	<u>2.0</u>	1.5
Total	<u>100%</u>	

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS (Continued)

Changes in Assumptions and Benefit Terms Since Prior Measurement Date - The total pension liability as of June 30, 2016 reflects that the assumed municipal bond index rate decreased from 3.82% to 3.01%, resulting in a change in the Single Equivalent Interest Rate (SEIR) from 4.88% to 4.20%.

Changes Since Measurement Date - There were no changes between the measurement date of the collective net pension liability and the University reporting date that are expected to have a significant effect on the University's proportionate share of the collective net pension liability.

Discount rate - The discount rate used to measure the total pension liability at June 30, 2016 was 4.20%. The projection of cash flows used to determine the discount rate assumed that plan member contributions will be made at the current contribution rates and the Employer contributions will be made at statutorily required rates. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members until the 2040 plan year. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments through 2039 and a municipal bond index rate of 3.01% was applied to all periods of projected benefit payments after 2039. The SEIR that discounts the entire projected benefit stream to the same amount as the sum of the present values of the two separate benefit payments streams was used to determine the total pension liability.

The total pension liability as of June 30, 2016 reflects that the assumed municipal bond index rate decreased from 3.82% to 3.01%, resulting in a change in the SEIR from 4.88% to 4.20%. The impact of this change in the discount rate is a change in assumptions that is added to the expected total pension liability to determine the final total pension liability as of June 30, 2016.

Sensitivity of the University's proportionate share of the net pension liability to changes in the discount rate - The following table presents the net pension liability of the University as of June 30, 2017, calculated using the discount rate of 4.20%, as well as what the University's net pension liability (in thousands) would be if it were calculated using a discount rate that is 1-percentage-point lower (3.20%) or 1-percentage-point higher (5.20%) than the current rate:

	1% Decrease <u>(3.20)</u>	Current Discount Rate <u>(4.20%)</u>	1% Increase <u>(5.20%)</u>
Proportionate share of the Collective Net Pension Liability	\$84,557,944	\$68,926,374	\$56,097,164

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 9 - PENSION PLANS (Continued)

Summary Pension Plan Information:

	<u>KERS</u> <u>Non-hazardous</u>	<u>KTRS</u>	<u>Total</u>
<u>June 30, 2017</u>			
Net pension liability	\$ 29,146,180	\$ 68,926,374	\$ 98,072,554
Deferred outflows of resources	4,201,535	14,147,801	18,349,336
Deferred inflows of resources	(3,394,261)	(13,383,767)	(16,778,028)
Actuarially determined pension expense	1,733,515	2,993,395	4,726,910

NOTE 10 - COMMITMENTS AND CONTINGENCIES

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

The University receives financial assistance from federal and state agencies in the form of grants and awards. The expenditure of funds received from these programs generally requires compliance with terms and conditions specified in the grant agreements and are subject to audit by the grantor agencies. Any disallowed claims resulting from such audit could become a liability of the applicable fund.

The United States Department of Agriculture (USDA) is currently performing a review of the University's administration of NIFA (National Institute of Food and Agriculture)-sponsored programs and associated financial activity. As part of this review, the USDA is questioning if the University has complied with the matching requirements of the grants for the period from 2011 to 2013. If it is determined that the University has not complied with the matching requirements the University could be required to de-obligate an additional amount to meet the matching requirements. As of the date of the audit report, the review was complete with the University agreeing to reduce the available balance by approximately \$952,000 as a result of the review. The agreement was reached in March 2018.

NOTE 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.

(Continued)

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 12 - SCHEDULE OF EXPENSES BY PROGRAM

In the Statement of Revenues, Expenses and Changes in Net Position, operating expenses are presented by functional expense purpose. Depreciation is allocated below based on functional classification as required by IPEDS for Fiscal Year 2017. Functional expense purpose is classified by natural classification as follows:

	Compensation and <u>Benefits</u>	Supplies and <u>Services</u>	Scholarships and <u>Fellowships</u>	<u>Depreciation</u>	Operations and <u>Maintenance</u>	<u>Total</u>
Instruction	\$ 10,138,662	\$ 784,580	\$ -	\$ 633,563	\$ 944,276	\$ 12,501,081
Research	5,389,222	3,559,019	-	777,128	794,657	10,520,026
Public service	5,024,015	4,064,288	-	371,726	772,969	10,232,998
Academic support	2,343,132	515,847	-	215,190	251,179	3,325,348
Student services	4,333,968	1,792,211	-	435,455	536,123	7,097,757
Institutional support	7,359,729	4,564,517	-	611,997	1,023,379	13,559,622
Operation & maintenance of plant	2,071,047	2,602,949	-	657,538	(5,331,534)	-
Auxiliary enterprises	1,017,202	4,390,069	-	304,730	466,706	6,178,707
Student financial aid	<u>410,505</u>	<u>217,341</u>	<u>5,967,862</u>	<u>40,870</u>	<u>542,245</u>	<u>7,178,823</u>
Total operating expense	<u>\$ 38,087,482</u>	<u>\$ 22,490,821</u>	<u>\$ 5,967,862</u>	<u>\$ 4,048,197</u>	<u>\$ -</u>	<u>\$ 70,594,362</u>

NOTE 13 – KENTUCKY STATE UNIVERSITY FOUNDATION, INC.

Description of the Organization

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

Summary of Significant Accounting Policies

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

NOTE 13 – KENTUCKY STATE UNIVERSITY FOUNDATION, INC. (Continued)

Summary of Significant Accounting Policies (Continued)

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

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

Temporarily restricted net assets - Net assets subject to donor-imposed stipulations that will be met by actions of the Foundation, pursuant to those stipulations or that expire by the passage of time. Assets released from restrictions during 2017 primarily relate to scholarships and University and student support.

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

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

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

Property and Equipment: Property and equipment is recorded at cost if purchased or fair market value at date of contribution if contributed. If the donors stipulate how long the assets must be used, the contributions of property and equipment are recorded as restricted support. In the absence of such stipulations, these contributions are recorded as unrestricted support. Depreciation is computed on a straight-line basis over the estimated useful lives of the respective assets. Depreciation expense was \$2,875 for the year ended June 30, 2017.

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

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

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 13 – KENTUCKY STATE UNIVERSITY FOUNDATION, INC. (Continued)

Summary of Significant Accounting Policies (Continued)

Recent Accounting Pronouncements: In August 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-14, Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities, that changes how a not-for-profit organization classifies its net assets, as well as the information it presents in the financial statements and notes about its liquidity, financial performance, and cash flows. The ASU includes a reduction in the number of net asset categories from three to two, conforming requirements on releases of capital restrictions, several new requirements related to expense presentation and disclosure (including investment expenses), and new required disclosures communicating information useful in assessing liquidity. This ASU will be effective for the Foundation for fiscal years beginning after December 15, 2017. Early adoption is permitted. The Foundation is currently evaluating the effects adoption of this guidance will have on the financial statements.

Subsequent Events: The Foundation's management has evaluated subsequent events for accounting and disclosure requirements through February 8, 2018, the date the financial statements were available to be issued. There were no events occurring during the evaluation period that require recognition or disclosure in the financial statements.

Investments

Investments as of June 30, 2017 are summarized as follows:

Equity securities	\$ 6,158,190
Debt securities	2,577,681
Real estate investment trust	8,129
U.S. government securities	<u>338,083</u>
Total investments	<u>\$ 9,082,083</u>

Fair Value Measurements

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

The following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used as of June 30, 2017.

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

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 13 – KENTUCKY STATE UNIVERSITY FOUNDATION, INC. (Continued)

Fair Value Measurements (Continued)

Mutual funds: Valued at the daily closing price as reported by the fund. Mutual funds held by the Foundation are open-end mutual funds that are registered with the Securities and Exchange Commission. These funds are required to publish their daily net asset value (NAV) and to transact at that price. The mutual funds held by the Foundation are deemed to be actively traded.

Real estate investment trust: Valued at the NAV of shares held by the Foundation at year end.

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

Fair value measurements as of June 30, 2017 are as follows:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Common stocks	\$ 3,963,060	\$ -	\$ -	\$ 3,963,060
Mutual funds	1,985,283	-	-	1,985,283
Municipal bonds	-	236,446	-	236,446
Corporate bonds	-	2,341,235	-	2,341,235
U.S government securities	338,083	-	-	338,083
Real estate investment trust	-	8,129	-	8,129
Equity exchange traded funds	<u>209,847</u>	<u>-</u>	<u>-</u>	<u>209,847</u>
Total	<u>\$ 6,496,273</u>	<u>\$ 2,585,810</u>	<u>\$ -</u>	<u>\$ 9,082,083</u>

Temporarily Restricted Net Assets

For the year ended June 30, 2017, net assets were released from donor restrictions by incurring expenses satisfying the purpose of the restrictions specified by donors as follows:

Endowment spending allocation	\$ 772,632
University support	512,984
Scholarships	232,908
Operating and other expenses	91,395
Student support	69,427
Travel and other expenses	<u>44,704</u>
Total release from restrictions	<u>\$ 1,724,050</u>

Retirement Plan

The Foundation has a defined contribution profit sharing plan which covers all employees who meet certain requirements. Foundation contributions are discretionary. No contributions were made for the year ended June 30, 2017.

KENTUCKY STATE UNIVERSITY
NOTES TO FINANCIAL STATEMENTS
June 30, 2017

NOTE 13 – KENTUCKY STATE UNIVERSITY FOUNDATION, INC. (Continued)

Endowment Composition

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

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

Spending Policy: The Foundation spending policy is to distribute an amount at least equal to 3-5% of a moving sixteen quarter average of the fair value of the endowment funds. Accordingly, over the long term, the Foundation expects its spending policy to allow its endowment assets to grow at an average rate of 3% annually. This is consistent with the Foundation's objective to maintain the purchasing power of endowment assets as well as to provide additional real growth through investment return.

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level the donor requires the Foundation to retain as a fund of perpetual duration. There were no such deficiencies as of June 30, 2017.

Endowment net asset composition by type of fund as of June 30, 2017 is as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Donor-restricted endowment funds	\$ -	\$ 3,981,609	\$ 3,711,724	\$ 7,693,333

Changes in endowment net assets as of June 30, 2017 are as follows:

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total Net Endowment Assets</u>
Endowment net assets, beginning of year	\$ -	\$ 4,030,448	\$ 3,608,613	\$ 7,639,061
Contributions	-	-	105,691	105,691
Interest and dividends	-	189,039	-	189,039
Realized and unrealized losses	-	534,754	-	534,754
Amounts appropriated for expenditure	-	(772,632)	-	(772,632)
Reclassifications	-	-	(2,580)	(2,580)
Endowment net assets, end of year	\$ -	\$ 3,981,609	\$ 3,711,724	\$ 7,693,333

REQUIRED SUPPLEMENTARY INFORMATION

KENTUCKY STATE UNIVERSITY
SCHEDULE OF THE UNIVERSITY'S (KSU)
PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
KENTUCKY EMPLOYEES RETIREMENT SYSTEM
June 30, 2017
(Amounts in thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
KSU's proportion of the net pension liability	\$ 29,146	\$ 29,408	\$ 28,555
KSU's proportionate share of the net pension liability	0.26%	0.29%	0.32%
KSU's covered payroll	\$ 4,321	\$ 5,390	\$ 5,453
KSU's proportionate share of the net pension liability as a share of its covered employee payroll	675.20%	545.60%	523.66%
Plan fiduciary net position as a percentage of total pension liability	14.80%	18.83%	22.32%

Note: This table represents data that is one year in arrears.

SCHEDULE OF THE UNIVERSITY'S CONTRIBUTION
KENTUCKY EMPLOYEES RETIREMENT SYSTEM
June 30, 2017
(Amounts in thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contribution	\$ 1,516	\$ 1,312	\$ 1,515
Contributions in relation to the contractually required contribution	\$ 1,516	\$ 1,312	\$ 1,515
Contribution deficiency (excess)	\$ -	\$ -	\$ -
KSU covered payroll	\$ 3,967	\$ 4,321	\$ 5,390
Contributions as a percentage of covered payroll	38.21%	30.36%	28.11%

Note: These are 10-year schedules. However, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future fiscal years until 10-years of information is available.

KENTUCKY STATE UNIVERSITY
SCHEDULE OF THE UNIVERSITY'S (KSU)
PROPORTIONATE SHARE OF THE NET PENSION LIABILITY
KENTUCKY TEACHERS' RETIREMENT SYSTEM
June 30, 2017
(Amounts in thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
KSU's proportion of the net pension liability	\$ 68,926	\$ 63,956	\$ 64,987
KSU's proportionate share of the net pension liability	0.22%	0.23%	0.30%
State's proportionate share of the collective net pension liability	\$ 6,496	\$ 6,503	\$ 7,374
KSU's covered payroll	\$ 16,961	\$ 19,076	\$ 21,451
KSU's proportionate share of the net pension liability as a share of its covered employee payroll	406.38%	335.27%	302.96%
Plan fiduciary net position as a percentage of total pension liability	35.22%	42.49%	45.59%

Note: This table represents data that is one year in arrears.

Changes in assumptions: For fiscal year 2017, the KTRS plan discount rate decreased from 4.88 percent to 4.20 percent. For fiscal year 2016, there was a decrease in the assumed investment rate of return from 7.75 percent to 7.50 percent; a decrease in the assumed rate of inflation from 3.50 percent to 3.25 percent; a decrease in the assumed rate of wage inflation from 1.00 percent to 0.75 percent and a decrease in the payroll growth assumption from 4.50 percent to 4.00 percent.

SCHEDULE OF THE UNIVERSITY'S CONTRIBUTION
KENTUCKY TEACHERS' RETIREMENT SYSTEM
June 30, 2017
(Amounts in thousands)

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contribution	\$ 1,879	\$ 1,773	\$ 2,059
Contributions in relation to the contractually required contribution	\$ 1,879	\$ 1,773	\$ 2,059
Contribution deficiency (excess)	-	-	-
KSU covered payroll	\$ 17,779	\$ 16,961	\$ 19,076
Contributions as a percentage of covered payroll	10.57%	10.45%	10.79%

Note: These are 10-year schedules. However, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future fiscal years until 10-years of information is available.

INDEPENDENT AUDITOR'S 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, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of the Kentucky State University (the University), a component unit of the Commonwealth of Kentucky, as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the University's basic financial statements and have issued our report thereon dated June 22, 2018. Our report includes a reference to other auditors who audited the financial statements of the Kentucky State University Foundation, Inc. (Foundation) as described in our report on the University's financial statements. The financial statements of the Foundation were not audited in accordance with *Government Auditing Standards*.

Internal Control over Financial Reporting

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

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in the accompanying schedule of findings and questioned costs, we identified certain deficiencies in internal control that we consider to be material weaknesses and a significant deficiency.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies described in the accompanying schedule of findings and questioned costs to be material weaknesses (Finding 2017-001 and 2017-002).

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the deficiency described in the accompanying schedule of findings and questioned costs to be significant deficiency (Finding 2017-003).

(Continued)

Compliance and Other Matters

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

The University's Response to Findings

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

Purpose of this Report

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

Crowe Horwath LLP

Crowe Horwath LLP

Lexington, Kentucky
June 22, 2018

KENTUCKY STATE UNIVERSITY
SCHEDULE OF FINDINGS AND RESPONSES
June 30, 2017

Finding 2017-001 – Controls Over Financial Reporting

Criteria: Applicable standards state that management is responsible for having internal controls in place to provide appropriate and reliable financial reports, and to select and apply appropriate accounting principles. Management is not required to prepare their financial reports, but management needs to demonstrate the level of qualifications and controls to prepare their financial reports without significant deficiencies in these controls.

Condition: During the current year audit, the University did not have adequate controls over financial reporting to allow for timely, accurate financial reporting. Not all general ledger accounts were reconciled to subsidiary ledgers or other supporting detail at least on a quarterly basis.

Context: The University experienced turnover in key accounting positions resulting in a lack of timely reconciliations and production of timely financial reports. Due to the lack of reconciliation controls, there were delays in beginning audit fieldwork and several iterations of the trial balance as management worked to reconcile activity. Management also identified several asset and liability accounts, which had not been reconciled in several years. These account balances primarily related to receivables, accounts payables, and other accrued expenses.

Effect: Not having accurate transactions posted in a timely manner can affect the financial statement information that is available for making informed business decisions and supervision of operations. This weakness in accounting infrastructure increases the risk of errors in the financial records and is less likely to detect irregularities, including fraud on a timely basis. The quarterly reconciliation process allows for the preparation for accurate quarterly financial statements.

Cause: The above condition appears to be the result of the inability to fully implement a timely review and reconciliation process.

Recommendation: We recommend the University implement internal control procedures, which require general ledger accounts to be reconciled at least quarterly.

Views of responsible officials and planned corrective action: Management agrees with the finding. Procedures will be implemented to ensure that account balances are reconciled periodically. Based on the nature and balance of the account, it will be determined whether the account will be reconciled monthly or quarterly.

KENTUCKY STATE UNIVERSITY
SCHEDULE OF FINDINGS AND RESPONSES
June 30, 2017

Finding 2017-002 – Controls Over Payroll Procedures

Criteria: Management is responsible for having adequate internal controls in place surrounding key processes.

Condition: During the current year audit, the University did not have adequate internal controls over payroll procedures.

Context: During the current year audit, the following issues relating to payroll were identified:

- Employees who are required to submit time sheets are not
- Completed time sheets are not properly approved by a supervisor
- Vacation leave is not being properly reported to payroll via time sheets
- Leave time not being taken in accordance with University policy
- Withholdings not tracked and remitted to appropriate agencies in a timely manner resulting in inaccuracies and additional payments for penalties
- Improper classification of employees related to retirement plans
- Former employees being paid benefits after termination
- Current employees not having appropriate withholding from payroll for benefits
- No documentation of required levels of approval of new hires, promotions or pay rate changes
- No payroll change reports processed or reviewed by someone independent of payroll

Effect: Not having reliable controls in place in regards to the payroll process can affect the financial statement information. 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.

Cause: The above condition appears to be the result of a lack of internal controls and segregation of duties within payroll procedures.

Recommendation: We recommend the University review internal controls surrounding payroll procedures to ensure adequate segregation of duties and proper approvals are established and documented. Further, all supporting documentation including pay rate approvals and timesheets should be maintained.

Views of responsible officials and planned corrective action: Management agrees with the finding. Internal controls surrounding payroll procedures will be reviewed and strengthened to ensure adequate segregation of duties, maintenance of supporting documentation, compliance with payroll procedures and accurate and timely reporting.

KENTUCKY STATE UNIVERSITY
SCHEDULE OF FINDINGS AND RESPONSES
June 30, 2017

Finding 2017-003 – Preparation of an Accurate Schedule of Expenditures of Federal Awards

Criteria: Uniform Guidance, Section 200,510(b) requires the auditee prepare a complete and accurate SEFA.

Condition: There is no documented policy or procedure in place to track research grants to ensure proper reporting of the research and development (R&D) cluster on the schedule of expenditures of federal awards (SEFA). There is also no documented policy or procedure in place regarding the reconciliation of the SEFA to underlying activity to ensure the completeness and accuracy of the schedule.

Context: During our testing of the SEFA, we noted management does not internally track R&D grants to ensure proper clustering of R&D activity on the SEFA. We also noted reconciliation variances when comparing federal grant expenditures to federal grant revenues for cost reimbursement grants for the year under.

Effect: Financial reporting of federal expenditures could be inaccurate or incomplete.

Cause: The above condition appears to be the result of a lack of controls surrounding the grants management process.

Recommendation: We recommend management maintain all grant award documents and appropriately flag research grants to proper R&D cluster reporting. We also recommend management implement a documented secondary review of the SEFA to ensure financial and non-financial information is accurate and complete and reconcile federal grant expenditures to federal grant revenues on the general ledger at least annually at June 30 to ensure proper cut-off of grant activity.

Views of responsible officials and planned corrective action: Management agrees with finding. Internal controls surrounding the grants management process and SEFA preparation will be reviewed and strengthened to ensure accurate and timely reporting of grant activity.