

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

2006-07
ANNUAL FINANCIAL REPORT

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

FINANCIAL STATEMENTS

June 30, 2007 and 2006

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Crowe Chizek and Company LLC
Member Horwath International

REPORT OF INDEPENDENT AUDITORS

To the Board of Regents of the
Kentucky Community and Technical College System
and
The Secretary of Finance and Administration Cabinet
of the Commonwealth of Kentucky

We have audited the accompanying financial statements of the business-type activities of Kentucky Community and Technical College System (the "System") as of and for the years ended June 30, 2007 and 2006, which comprise the System's basic financial statements as listed in the table of contents. These financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the business-type activities of Kentucky Community and Technical College System as of June 30, 2007 and 2006, and its changes in net assets and cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

The Management's Discussion and Analysis (MD&A) on pages 2 through 11 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 1, 2007, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

Crowe Chizek and Company LLC

Louisville, Kentucky
October 1, 2007

**KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
June 30, 2007 and 2006**

Management's Discussion and Analysis of the Kentucky Community and Technical College System (KCTCS) financial statements provides an overview of the financial position and activities of KCTCS for the years ended June 30, 2007 and 2006. This discussion has been prepared by management and should be read in conjunction with the financial statements and the related notes thereto, which follow this section. The financial statements and related notes and this discussion and analysis are the responsibility of management.

Financial Highlights

- KCTCS' financial position was strengthened further at June 30, 2007, with assets of \$693.6 million and liabilities of \$72.2 million. Net assets, which represent KCTCS' residual interest in assets after liabilities are deducted, were \$621.4 million or 89.6 percent of total assets. Net assets at June 30, 2006 were 89.5 percent of total assets. Financial operations were in accordance with the revenue expectations and the approved expenditure plan.
- Total assets increased \$75.6 million or 12.2 percent. The increase is primarily in cash and cash equivalents and capital assets.
- Total liabilities increased by \$7.5 million or 11.6 percent. The principal items of increase were capital lease obligations.
- Total net assets increased \$68.0 million or 12.3 percent. This resulted primarily from income before other revenues, expenses, gains and losses of \$34.4 million, capital construction proceeds from the Commonwealth of Kentucky of \$30.0 million and additions to endowments of \$3.3 million, and \$0.5 million from the transfer of the net assets of Kentucky Board of Emergency Medical Services (KBEMS).
- Operating revenues were \$280.0 million and operating expenses were \$483.2 million, resulting in a loss from operations of \$203.2 million. Nonoperating revenues of \$237.6 million (including \$215.3 million in state appropriations) when combined with other revenues of \$33.1 million, and the \$0.5 million transfer of KBEMS net assets, resulted in an increase in net assets of \$68.0 million or a 12.3 percent increase in net assets.

Using the Financial Statements

The Financial Statements consist of a Statement of Net Assets (Balance Sheet), a Statement of Revenues, Expenses and Changes in Net Assets (Income Statement), a Statement of Cash Flows, and 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*. Accordingly, the accrual basis of accounting is used 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.

Reporting Entity

The Kentucky Community and Technical College System is a component unit of the Commonwealth of Kentucky. KCTCS was created in May 1997 by The Higher Education Improvement Act (House Bill 1) of the Kentucky General Assembly. Since its creation, KCTCS has become the largest provider of postsecondary education and workforce training in the Commonwealth. KCTCS colleges provide both credit and noncredit instruction primarily to state residents. In fact, for most Kentuckians the journey to higher education begins at one of KCTCS' 16 colleges located on 65 campuses across the state. KCTCS colleges are committed to making education accessible, relevant, and responsive to the needs of students, employers, and communities. While focusing on quality, KCTCS colleges are the best value in postsecondary education in Kentucky. Year in and year out, tuition and charges are the lowest in the Commonwealth. Students at KCTCS colleges benefit from a single, simple tuition and charge structure.

KCTCS' colleges offer a variety of certificate, diploma, and associate degree programs. In addition, the colleges provide a variety of programs and training opportunities to many of the Commonwealth's employers along with fire and rescue training to fire departments throughout the state. Similarly, the Kentucky Board of Emergency Medical Services is a component of KCTCS and certifies first responders, emergency medical technicians, and licenses paramedics and ambulance services throughout the state. KCTCS offers instructional programs in each of the Commonwealth's correctional institutions as well. All KCTCS colleges have obtained or are in the process of obtaining Southern Association of Colleges and Schools (SACS) accreditation as consolidated comprehensive community and technical colleges.

The KCTCS' campuses are strategically located across the Commonwealth, from Ashland to Paducah, from Covington to Bowling Green. KCTCS is the largest provider of Internet-based courses in the state offering more than 500 on-line courses through the Kentucky Virtual University. KCTCS colleges confer five types of credentials -- certificates, diplomas and three kinds of associate degrees -- upon students who complete credit programs. The single most popular area of study is the baccalaureate transfer program, which allows a student to earn an associate degree at a KCTCS college and transfer those credits to any Kentucky university. While continuing to emphasize its historical mission to provide general education, KCTCS is increasing its focus on occupational/technical education. KCTCS colleges have instituted approximately 2,700 new programs and program options since 1998.

KCTCS also views postsecondary education as a crucial resource for workforce development. KCTCS forges partnerships between colleges and businesses to provide Kentucky workers with the skills required today and to help industries and individuals develop the capabilities they will need tomorrow.

KCTCS also enhances learning opportunities for all Kentuckians through noncredit continuing education. From personal improvement to cultural activities, community development programs at KCTCS institutions are tailored to meet local needs. KCTCS colleges sponsor an array of fine-arts programs that enrich their communities.

Statement of Net Assets

The Statement of Net Assets presents the financial position of KCTCS at the end of the fiscal year and includes all assets and liabilities. Net assets, the difference between total assets and total liabilities, are an important indicator of the current financial condition. Assets and liabilities are generally reported using current values. The major exception is capital assets, which are stated at historical cost, less accumulated depreciation. A summary of the assets, liabilities and net assets of KCTCS at June 30, 2007, 2006 and 2005, is as follows:

Condensed Statements of Net Assets (in thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
ASSETS			
Current assets	\$ 211,799	\$ 171,458	\$ 145,018
Noncurrent assets	<u>481,798</u>	<u>446,583</u>	<u>410,957</u>
Total Assets	<u>693,597</u>	<u>618,041</u>	<u>555,975</u>
LIABILITIES			
Current liabilities	56,989	52,997	47,962
Noncurrent liabilities	<u>15,174</u>	<u>11,649</u>	<u>11,839</u>
Total Liabilities	<u>72,163</u>	<u>64,646</u>	<u>59,801</u>
NET ASSETS			
Invested in capital assets, net of related debt	386,065	362,215	354,642
Restricted			
Nonexpendable	19,504	13,968	12,534
Expendable	83,281	79,609	50,422
Unrestricted	<u>132,584</u>	<u>97,603</u>	<u>78,576</u>
Total Net Assets	<u>\$ 621,434</u>	<u>\$ 553,395</u>	<u>\$ 496,174</u>

Assets: As of June 30, 2007, total assets amounted to \$693.6 million. Of this amount, investment in capital assets (net of depreciation) of \$399.5 million, or 57.6 percent of total assets, represented the largest asset class. Cash and cash equivalents amounted to \$233.0 million or 33.6 percent, and loans and accounts receivable amounted to \$30.7 million or 4.4 percent of total assets. During the year, total assets increased by \$75.6 million, primarily in cash and cash equivalents and capital assets.

Liabilities: As of June 30, 2007, total liabilities amounted to \$72.2 million. Capital leases and other long-term obligations amounted to \$16.3 million, or 22.6 percent of total liabilities. During the year, total liabilities increased by \$7.5 million, primarily in leases payable.

Net Assets: The equity of KCTCS of \$621.4 million as of June 30, 2007 is reported on the Statement of Net Assets in four net asset categories: invested in capital assets, net of related debt, \$386.0 million (62.1 percent); restricted-nonexpendable \$19.5 million (3.1 percent); restricted expendable, \$83.3 million (13.4 percent); and unrestricted, \$132.6 million (21.4 percent).

Restricted net assets are subject to externally imposed restrictions governing their use. Although unrestricted net assets are not subject to externally imposed provisions, substantially all of the unrestricted net assets have been designated for support of instructional programs and initiatives and working capital requirements.

Total net assets increased by \$68.0 million during the year ended June 30, 2007. Invested in capital assets, net of related debt, increased by \$23.9 million as net additions to capital assets of \$28.8 million exceeded the current year increase in debt of \$4.9 million. Restricted net assets increased by \$9.2 million as endowment investments, gift revenue increased. Unrestricted net assets increased \$35.0 million, primarily due to overall revenues in excess of expenditures.

2006 Versus 2005

- As of June 30, 2006, total assets amounted to \$618.0 million. Of this amount, investment in capital assets (net of depreciation) of \$370.7 million, or 60.0 percent of total assets, represented the largest asset class. Cash and cash equivalents amounted to \$196.5 million or 31.8 percent, and loans and accounts receivable amounted to \$30.1 million or 4.9 percent of total assets. During the year, total assets increased by \$62.1 million. The increase was primarily in cash and cash equivalents and capital assets.
- As of June 30, 2006, total liabilities amounted to \$64.6 million. Capital leases and other long-term obligations amounted to \$12.2 million, or 18.8 percent of total liabilities. During the year, total liabilities increased by \$4.8 million primarily in employee withholding and deposits and deferred revenue.
- Total net assets increased by \$57.2 million during the year ended June 30, 2006. Invested in capital assets, net of related debt, increased by \$7.6 million. Restricted net assets increased by \$30.6 million as endowment investments, gift revenue and capital projects increased. Unrestricted net assets increased \$19.0 million, primarily due to overall revenues in excess of expenditures.

Statement of Revenues, Expenses and Changes in Net Assets

The Statement of Revenues, Expenses and Changes in Net Assets is prepared using the accrual basis of accounting. The change in net assets is an indicator of whether the overall financial position has improved or declined during the year. All items that increase or decrease net assets must appear on the Statement of Revenues, Expenses and Changes in Net Assets as revenues, expenses, gains or losses.

Financial activities are reported as either operating or nonoperating. GASB Statement No. 35 requires state appropriations, gifts and investment and endowment income to be classified as nonoperating revenues. Accordingly, KCTCS reports an operating loss for the year prior to the addition of nonoperating revenues. The utilization of long-lived capital assets is reflected in the financial statements as depreciation, which amortizes the cost of an asset over its expected useful life. Tuition is reduced by scholarships. Institutional aid and grants-in-aid funded by federal and state grants are reported net of scholarship allowances. A summary of the Statement of Revenues, Expenses, and Changes in Net Assets for the years ended June 30, 2007, 2006, and 2005 is presented on the following page.

Condensed Statements of Revenues, Expenses and Changes in Net Assets
(in thousands)

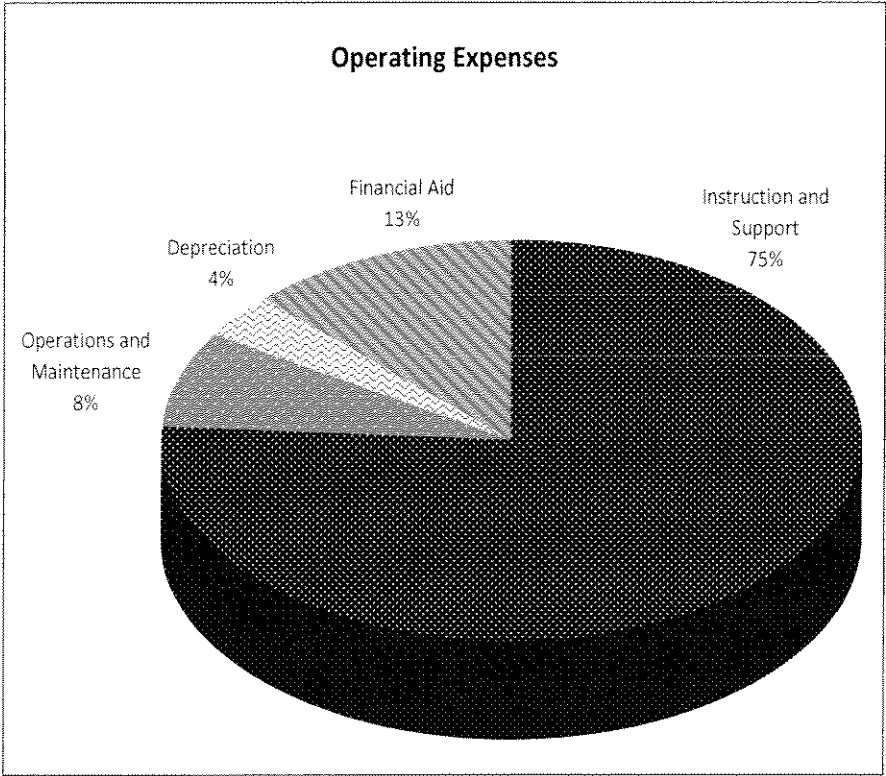
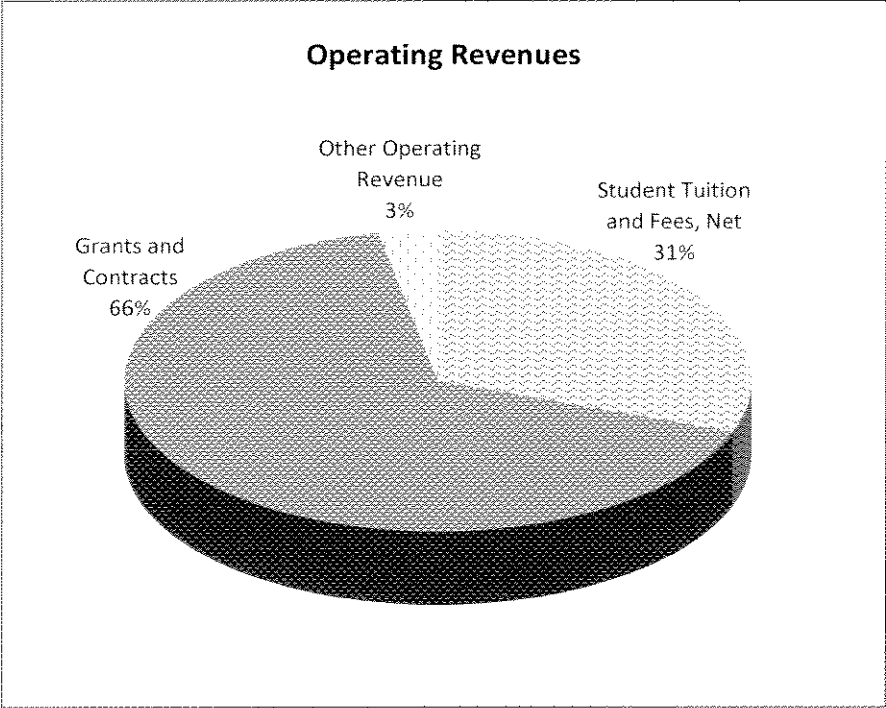
	<u>2007</u>	<u>2006</u>	<u>2005</u>
OPERATING REVENUES			
Student tuition and fees, net	\$ 85,712	\$ 72,360	\$ 71,685
Grants and contracts	185,606	180,417	154,321
Auxiliary enterprises	516	665	894
Other operating revenue	<u>8,161</u>	<u>7,191</u>	<u>7,402</u>
Total operating revenues	<u>279,995</u>	<u>260,633</u>	<u>234,302</u>
OPERATING EXPENSES			
Educational and general, excluding depreciation	465,815	441,781	405,620
Depreciation	<u>17,432</u>	<u>16,440</u>	<u>16,220</u>
Total operating expenses	<u>483,247</u>	<u>458,221</u>	<u>421,840</u>
OPERATING LOSS	<u>(203,252)</u>	<u>(197,588)</u>	<u>(187,538)</u>
NONOPERATING REVENUES (EXPENSES)			
State appropriations	215,321	201,776	181,787
Other nonoperating revenues	<u>22,294</u>	<u>19,760</u>	<u>12,880</u>
Total nonoperating revenues	<u>237,615</u>	<u>221,536</u>	<u>194,667</u>
Income before other revenues, expenses, gains or losses	34,363	23,948	7,129
Capital construction appropriations	29,981	32,521	3,638
Net realized loss on disposal of capital assets	(165)	(676)	(456)
Additions to endowments	<u>3,347</u>	<u>1,428</u>	<u>1,197</u>
Total other revenues (expenses)	<u>33,163</u>	<u>33,273</u>	<u>4,379</u>
Total increase in net assets	67,526	57,221	11,508
Net assets, beginning of year	553,395	496,174	479,698
Net assets from KBEMS transfers on July 1, 2006	513	-	-
Net assets from LCC transfers on July 1, 2004	<u>-</u>	<u>-</u>	<u>4,968</u>
Net assets, end of year	<u>\$ 621,434</u>	<u>\$ 553,395</u>	<u>\$ 496,174</u>

Total operating revenues were \$280.0 million for the year ended June 30, 2007. Included in KCTCS' operating revenues are net student tuition and fees of \$85.7 million (30.6 percent), and grants and contracts of \$185.6 million (66.3 percent).

Operating expenses totaled \$483.2 million. Of this amount, \$465.8 million (96.4 percent of total operating expenses) was expended for educational and general programs, including instruction, academic support, libraries, public service, student services, institutional support, and operations and maintenance (excluding depreciation).

The loss from operations for the year amounted to \$203.2 million. Nonoperating and other revenues, net of related expenses, amounted to \$270.7 million, resulting in an increase in net assets of \$67.5 million for the year. Nonoperating and other revenues reflect a \$16.0 million increase due primarily to an increase in state appropriation of \$13.5 million.

The following chart depicts operating revenues and operating expenses. According to GASB, state appropriation is not accounted for as operating revenues, and is therefore excluded from the chart below:



2006 Versus 2005

Total operating revenues were \$260.6 million for the year ended June 30, 2006, including net student tuition and fees of \$72.4 million (27.8 percent) and grants and contracts of \$180.4 million (69.2 percent).

Operating expenses totaled \$458.2 million. Of this amount, \$441.8 million (96.4 percent of total operating expenses) was expended for educational and general programs, including instruction, libraries, academic support, public service, student services, institutional support, and operations and maintenance (excluding depreciation).

The loss from operations for the year amounted to \$197.6 million. Nonoperating and other revenues, net of related expenses, amounted to \$254.8 million, resulting in an increase in net assets of \$57.2 million for the year. Nonoperating revenues include state appropriations of \$201.8 million (79.2 percent of total nonoperating and other revenues).

Statement of Cash Flows

The Statement of Cash Flows presents information, related to KCTCS' cash inflows and outflows, summarized by operating, capital, financing, 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 KCTCS during the year that will allow financial statement readers to assess:

- The ability to generate future net cash flows,
- The ability to meet obligations as they become due, and
- The possible need for external financing.

A comparative summary of KCTCS' statement of cash flows for the years ended June 30, 2007, 2006, and 2005 is as follows:

Condensed Statements of Cash Flows (in thousands)

	<u>2007</u>	<u>2006</u>	<u>2005</u>
Cash provided (used by):			
Operating activities	\$ (188,625)	\$ (171,543)	\$ (163,246)
State appropriations	215,321	201,776	181,787
Other noncapital financing activities	20,056	9,644	12,333
Capital and related financing activities	(11,472)	7,462	(20,407)
Investing activities	<u>1,220</u>	<u>3,613</u>	<u>2,531</u>
Net increase in cash and cash equivalents	36,500	50,952	12,998
Cash and cash equivalents, beginning of year	<u>196,524</u>	<u>145,572</u>	<u>132,574</u>
Cash and cash equivalents, end of year	<u>\$ 233,024</u>	<u>\$ 196,524</u>	<u>\$ 145,572</u>

Major sources of cash received from operating activities are student tuition and fees (\$85.2 million) and grants and contracts (\$182.9 million). Major uses of cash for operating activities were payments to employees for salaries and benefits (\$299.3 million) and to vendors and contractors (\$106.5 million).

Capital and related financing activities include capital appropriations from the Commonwealth of Kentucky of \$30.0 million, proceeds from disposal of capital assets of \$0.3 million and proceeds from new capital debt and leases of \$5.8 million. Cash of \$46.6 million was expended for construction and acquisition of capital assets and \$1.3 million was expended for principal and interest payments on debt.

Investing activities of \$1.2 million include interest and dividends of \$7.0 million. Cash of an additional \$5.7 million was used to purchase additional investments.

2006 Versus 2005

Major sources of cash received from operating activities are student tuition and fees (\$72.9 million) and grants and contracts (\$185.8 million). Major uses of cash for operating activities were payments to employees for salaries and benefits (\$284.4 million) and to vendors and contractors (\$96.4 million).

Capital and related financing activities include capital appropriations from the Commonwealth of Kentucky of \$32.5 million. Cash of \$25.2 million was expended for construction and acquisition of capital assets and \$1.0 million was expended for principal and interest payments on debt.

Investing activities include \$0.7 million used to purchase additional investments and interest and dividends on investments of \$4.3 million.

Capital Assets and Debt Administration

Capital assets, net of accumulated depreciation, totaled \$399.5 million at June 30, 2007, a net increase of \$28.8 million. Capital assets as of June 30, 2007, 2006, and 2005, and significant changes in capital assets during those years are as follows (in thousands):

Capital Assets

	Balance June 30, 2005	Net Additions FY 2006	Balance June 30, 2006	Net Additions FY 2007	Balance June 30, 2007
Land and land improvements	\$ 26,558	\$ 657	\$ 27,215	\$ 2,397	\$ 29,612
Buildings and infrastructures	415,315	20,404	435,719	(10)	435,709
Equipment, autos and campus improvements	65,058	3,796	68,854	5,190	74,044
Library holdings	47,853	1,280	49,133	2,912	52,045
Construction in progress	47,689	(4,992)	42,697	33,354	76,051
Assets under capital lease obligations	<u>2,260</u>	<u>-</u>	<u>2,260</u>	<u>-</u>	<u>2,260</u>
Total assets	604,733	21,145	625,878	43,843	669,721
Accumulated depreciation	<u>(241,645)</u>	<u>(13,539)</u>	<u>(255,184)</u>	<u>(15,084)</u>	<u>(270,268)</u>
Capital assets, net	<u>\$ 363,088</u>	<u>\$ 7,606</u>	<u>\$ 370,694</u>	<u>\$ 28,759</u>	<u>\$ 399,453</u>

At June 30, 2007, KCTCS had capital construction projects in progress totaling \$118.8 million. These projects are principally financed by appropriations and bond proceeds from the Commonwealth of Kentucky.

Debt

At June 30, 2007, debts consisted of nine capital leases totaling \$13.4 million.

Economic Factors Impacting Future Periods

The following are known facts and circumstances that will affect future financial results:

- The General Assembly of the Commonwealth of Kentucky approved in its 2006 regular session an appropriations bill (House Bill [HB] 380) for the 2006-08 biennium. HB 380 provided KCTCS state appropriation increases of \$4.8 and \$12.7 million, respectively, in fiscal years 2007 and 2008. HB 380 also authorized a number of new capital projects (new facility construction and renovation projects). After passage of HB 380 the Governor vetoed several capital projects, including a number of KCTCS capital projects. KCTCS capital projects included in the final enacted appropriations bill totaled \$152.8 million in state funds.
- The KCTCS Board of Regents approved an operating budget for fiscal year 2008 totaling \$665.7 million of which \$471.0 million are unrestricted funds and \$194.7 million are restricted funds. Compared to fiscal year 2007, unrestricted funds increased \$30.2 million, restricted funds increased \$2.0 million, and total funds increased \$32.2 million. Of the total budget, state appropriations comprise 34.4 percent and tuition comprises 24.4 percent.
- Tuition rates for fiscal year 2008 were increased from \$109 per credit hour to \$115 per credit hour for in-state students. Nonresident students from counties contiguous to Kentucky will pay 120 percent of the in-state rate for tuition or \$138 per credit hour. Other nonresident students will pay 300 percent of the in-state rate or \$345 per credit hour. On-line students will pay \$115 tuition per credit hour. The projected revenue increase from these tuition rate increases and enrollment growth is approximately \$6.0 million.
- The 2007-08 operating budget includes an unrestricted budget reserve of \$23.0 million. The reserve includes reserve funds for each college and for system wide operations and support. Several years ago, the KCTCS Board of Regents established the budget reserve as a hedge against a possible shortfall in state general fund revenue. From fiscal year 2001-02 through 2003-04 the Commonwealth of Kentucky experienced severe revenue shortfalls, resulting in substantial budget reductions to KCTCS and other public postsecondary education institutions in Kentucky. For KCTCS the shortfall during this period resulted in state funding cuts amounting to more than \$18.0 million.
- KCTCS is implementing a system wide multi-year major gifts campaign titled "Fulfilling the Promise." Campaign goals have yet to be determined.
- KCTCS has and will continue to use a long-term endowment investment strategy to maximize total returns, at an appropriate level of risk. The investment strategy includes a spending rate policy to insulate programs funded by the endowment from temporary market volatility.
- Current governmental accounting standards do not require KCTCS to record an obligation for post-employment retiree health benefits. Future changes in governmental accounting standards taking effect in fiscal year 2008 will require that this obligation be recognized in the financial statements over an amortization period of not greater than 30 years. This obligation that will need to be amortized is estimated to be approximately \$258 million.
- KCTCS currently is in process of launching its *Students First* Customer Service Initiative. The initiative involves a three-pronged approach that includes mystery shopping, installation of new telephone technology, and customer service training. The initiative was designed to measure and assess the level of service being provided to prospective students at all KCTCS colleges. The initiative has both a short and long-term strategy and will address the issues uncovered via mystery shopping research and a review of KCTCS telephone practices. To improve and promote excellence in customer service, seminars have been developed that target the areas of admissions and registrar, financial aid, and public relations. Attention was also focused to handling of incoming telephone calls and telephone operator training. Additionally, improvements to the KCTCS telephone queuing processes were redesigned enabling the colleges to track and monitor each call with the ability to direct the call to an appropriate operator and/or department.

- KCTCS continues to maintain its firm commitment to the tenets and vision of House Bill 1 (HB1), the Postsecondary Education Improvement Act of 1997. KCTCS management believes that KCTCS is very well positioned to maintain its strong financial position and to continue providing excellent service to the Commonwealth of Kentucky and beyond. The vision of HB1 is embodied in KCTCS' pursuit to be recognized as the nation's best comprehensive community and technical college system. KCTCS' Strategic Plan 2006-2010 is designed to place more Kentuckians on the path to a postsecondary credential (certificate, diploma, or associate's degree) and a successful career. As part of the plan, KCTCS has established an aggressive target of 100,000 students for the fall 2009. The plan is built on four goals with corresponding core indicators of success with one- and five-year targets, creating a yardstick to measure success. The goals are as follows:
 - Promote Excellence in Teaching and Learning
 - Increase Student Access and Success
 - Expand Diversity and Global Awareness
 - Enhance the Economic Development of Communities and the Commonwealth

- For FY 2008 the KCTCS President's Leadership Initiative is entitled "ARISE," an acronym standing for the following themes:
 - Accountability...
 - Reinvent...
 - Implementation...
 - Strategies...
 - Evaluation...

Within the *ARISE* initiative are specific measurable targets to assist KCTCS to gauge its progress with the following: 1) College and Workforce Readiness - development of P-12 partnership plans at each college to implement intervention strategies that improve college and workforce readiness of high school graduates; 2) Virtual Learning Initiative - selection of one or more academic programs for a new model of online implementation; and 3), Workforce Competitiveness Initiative - the creation of a strategic workforce competitiveness program to respond proactively to the identified needs of Kentucky's businesses and industries. The Workforce Competitiveness Initiative was developed from community meetings held by KCTCS President Michael B. McCall with more than 300 business and industry leaders statewide.

- In fiscal year 2008 KCTCS will receive an economic impact study entitled *The Individual, Regional and State Economic Impacts of Kentucky Community and Technical Colleges*. The study will highlight the economic value of KCTCS, both directly to students and indirectly to all residents of Kentucky.

- In fiscal year 2008 KCTCS will develop a business plan that will focus on the specific mission and mandates issued to KCTCS in the enactment of the Kentucky Postsecondary Education Improvement Act of 1997 (HB1) and the goals set forth for the Commonwealth to be achieved by 2020. The business plan will address the proposed outcomes and anticipated funding requirements in the following mission-critical components of KCTCS: workforce education and training, pre-baccalaureate transfer education, and remediation/developmental education.

- KCTCS' colleges provide programs that are relevant to the workplace with programs in every one of the 25 hottest jobs in America (as defined by Money magazine) - exciting careers in such varied fields as computers, health care, and business. KCTCS colleges have and will continue to move rapidly to add or change academic and technical programs to stay relevant to today's economy while positioning Kentucky for a dynamic future. Since KCTCS' inception its Board of Regents has approved approximately 2,700 programs including certificates, diplomas, associate degrees, and program options.

- Since the passage of HB1 in 1997, KCTCS has become the largest provider of postsecondary education and workforce training in the Commonwealth. KCTCS carries a unique strategic advantage in the recruitment of students as its colleges are the most affordable option for pursuing higher education in Kentucky. This is evidenced by its continuing enrollment growth with enrollment increasing in the last 2 years by almost 4,500 students from 81,990 in fall 2004 to 86,475 in fall 2006, or a 5.5 percent increase. To recognize this accomplishment and further strengthen its strategic focus going forward, KCTCS has implemented a new branding campaign: Higher Education Begins Here. The new branding campaign reflects KCTCS' role in making it the number one provider of postsecondary education and workforce training in the Commonwealth and replaces the previous Changing Lives campaign.

Although many economic challenges have faced KCTCS in the past year and will continue to impact the future, KCTCS management believes that it will be able to sustain and grow its sound financial position. Further, KCTCS management believes its sound financial position and practices will enable it to continue its progress to becoming recognized as the nation's best comprehensive community and technical college system.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
STATEMENTS OF NET ASSETS
June 30, 2007 and 2006
(In Thousands)

	<u>2007</u>	<u>2006</u>
ASSETS		
Current assets		
Cash and cash equivalents	\$ 186,891	\$ 154,546
Short-term investments	2,759	-
Loans, accounts and gifts receivable, net of bad debt allowances of \$2,689 in 2007 and \$2,671 in 2006	21,122	16,892
Other current assets	<u>1,027</u>	<u>20</u>
Total current assets	<u>211,799</u>	<u>171,458</u>
Noncurrent assets		
Restricted cash and cash equivalents	46,133	41,978
Loans and other receivables	9,608	13,241
Endowment investments	26,604	20,670
Capital assets, net	<u>399,453</u>	<u>370,694</u>
Total noncurrent assets	<u>481,798</u>	<u>446,583</u>
Total Assets	<u>693,597</u>	<u>618,041</u>
LIABILITIES		
Current liabilities		
Accounts payable and accrued expenses	7,348	6,302
Employee withholdings and deposits	12,747	12,323
Compensated absences	10,213	9,689
Deferred revenue	25,580	24,165
Leases payable, current portion	<u>1,101</u>	<u>518</u>
Total current liabilities	<u>56,989</u>	<u>52,997</u>
Noncurrent liabilities		
Leases payable, noncurrent portion	12,287	7,961
Other long-term obligations	<u>2,887</u>	<u>3,688</u>
Total noncurrent liabilities	<u>15,174</u>	<u>11,649</u>
Total Liabilities	<u>72,163</u>	<u>64,646</u>
NET ASSETS		
Invested in capital assets, net of related debt	386,065	362,215
Restricted for:		
Nonexpendable		
Scholarships, instruction and other	19,504	13,968
Expendable		
Scholarships, instruction and other	27,441	24,172
Loans	15,187	14,598
Capital projects	40,653	40,839
Unrestricted	<u>132,584</u>	<u>97,603</u>
Total Net Assets	<u>\$ 621,434</u>	<u>\$ 553,395</u>

See accompanying notes.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN NET ASSETS
Years ended June 30, 2007 and 2006
(In Thousands)

	<u>2007</u>	<u>2006</u>
REVENUES		
Operating revenues		
Student tuition and fees	\$ 151,741	\$ 137,695
Less: scholarships allowance	<u>(66,029)</u>	<u>(65,335)</u>
Net tuition and fees	85,712	72,360
Federal grants and contracts	109,421	107,049
State and local grants and contracts	76,080	73,314
Nongovernmental grants and contracts	105	54
Indirect cost recoveries	1,330	1,411
Sales and services	3,523	3,562
Auxiliary enterprises		
Grills, housing and dining	516	665
Other operating revenues	<u>3,308</u>	<u>2,218</u>
Total operating revenues	<u>279,995</u>	<u>260,633</u>
EXPENSES		
Operating expenses		
Educational and general		
Instruction	190,563	177,564
Public service	35,826	30,278
Libraries	5,789	5,643
Academic support	22,593	21,533
Student services	39,588	37,949
Institutional support	72,216	72,053
Operation and maintenance of physical plant	37,876	36,940
Depreciation	17,432	16,440
Student financial aid	60,764	59,190
Auxiliary enterprises		
Grills, housing and dining	<u>600</u>	<u>631</u>
Total operating expenses	<u>483,247</u>	<u>458,221</u>
Operating loss	(203,252)	(197,588)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	215,321	201,776
Federal and local appropriations	40	37
Gifts	4,920	11,421
Investment income	11,156	5,366
Interest expense, capital debt	(436)	(368)
Other nonoperating revenues	<u>6,614</u>	<u>3,304</u>
Nonoperating revenues	<u>237,615</u>	<u>221,536</u>
Income before other revenues, expenses, gains or losses	34,363	23,948
Capital construction proceeds from state	29,981	32,521
Net realized loss on disposal of capital assets	(165)	(676)
Investment income and gains from endowments	<u>3,347</u>	<u>1,428</u>
Total other revenues	<u>33,163</u>	<u>33,273</u>
Increase in net assets	67,526	57,221
NET ASSETS		
Net assets, beginning of year	553,395	496,174
Net assets from KBEMS transfer on July 1, 2006	<u>513</u>	<u>-</u>
Net assets, end of year	<u>\$ 621,434</u>	<u>\$ 553,395</u>

See accompanying notes.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
 STATEMENTS OF CASH FLOWS
 Years ended June 30, 2007 and 2006
 (In Thousands)

	<u>2007</u>	<u>2006</u>
Cash flows from operating activities		
Tuition and fees	\$ 85,189	\$ 72,912
Grants and contracts	182,944	185,775
Indirect cost recoveries	1,330	1,411
Sales and services	3,523	3,563
Payments to vendors and contractors	(106,490)	(96,413)
Student financial aid	(59,470)	(57,489)
Salaries, wages and benefits	(299,327)	(284,421)
Auxiliary enterprise receipts	516	679
Other receipts	<u>3,160</u>	<u>2,440</u>
Net cash from operating activities	(188,625)	(171,543)
Cash flows from noncapital financing activities		
State appropriations	215,321	201,776
Federal and local appropriations	40	37
Gifts received for non-capital purposes	13,660	6,463
Other liabilities	(341)	(160)
Cash and cash equivalents from KBEMS transfer	200	-
Other nonoperating receipts	<u>6,497</u>	<u>3,304</u>
Net cash from noncapital financing activities	235,377	211,420
Cash flows from capital and related financing activities		
Capital appropriations	29,981	32,521
Proceeds from disposal of capital assets	252	487
Purchase of capital assets	(46,609)	(25,212)
Principal paid on capital debt and leases	(883)	(617)
Proceeds from capital debt and leases	5,792	651
Interest paid on capital debt and leases	(436)	(368)
Other capital receipts related to KBEMS transfer	<u>431</u>	<u>-</u>
Net cash from capital and related financing activities	(11,472)	7,462
Cash flows from investing activities		
Proceeds from sales and maturities of investments	76	13,294
Interest on investments	6,957	4,296
Purchase of investments	<u>(5,813)</u>	<u>(13,977)</u>
Net cash from investing activities	<u>1,220</u>	<u>3,613</u>
Net increase in cash	36,500	50,952
Cash, beginning of year	<u>196,524</u>	<u>145,572</u>
Cash, end of year	<u>\$ 233,024</u>	<u>\$ 196,524</u>
Reconciliation of net operating revenues (expenses) to net cash from operating activities		
Operating loss	\$ (203,252)	\$ (197,588)
Adjustments to reconcile net operating loss to net cash from operating activities		
Depreciation expense	17,432	16,440
Change in assets and liabilities		
Notes, loans and accounts receivable, net	(4,747)	4,338
Other current assets	(1,007)	295
Accounts payable and accrued expenses	586	485
Employee withholdings and deposits	424	2,355
Compensated absences	524	648
Deferred revenue	<u>1,415</u>	<u>1,484</u>
Net cash from operating activities	<u>\$ (188,625)</u>	<u>\$ (171,543)</u>

See accompanying notes.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

NOTE 1 - ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity: The Kentucky Community and Technical College System (KCTCS) is a component unit of the Commonwealth of Kentucky and is included in the basic financial statements of the Commonwealth.

KCTCS has adopted the provisions of GASB Statement No. 39, "Determining Whether Certain Organizations Are Component Units." This statement provided additional guidance to be used in determining whether certain organizations for which KCTCS is not financially accountable should be reported as component units based on the nature and significance of their relationship with KCTCS. KCTCS has considered whether several organizations have met the criteria for inclusion as component units. Currently, KCTCS believes none of these organizations are component units.

Basis of Presentation: KCTCS prepares its financial statements in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). GASB establishes standards for external financial reporting for public colleges and universities.

KCTCS has the option to apply all FASB pronouncements issued after November 30, 1989, unless FASB conflicts with GASB. KCTCS has elected to not apply FASB pronouncements issued after the applicable date.

The financial statement presentation is intended to provide a comprehensive, entity-wide perspective of KCTCS assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows.

Accrual Basis: 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. KCTCS reports as a Business Type Activity (BTA) as defined by GASB No. 35. BTAs are those activities that are financed in whole or in part by fees charged to external parties for goods and services.

Cash and Cash Equivalents: KCTCS considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents. Noncurrent cash and cash equivalents represent cash restricted for capital construction and endowment fund cash pending transfer to the custodian for investment by the endowment fund managers. Cash and cash equivalents held by the KCTCS endowment fund managers are included in noncurrent endowment investments.

Cash and cash equivalents consist of deposits in local banks of \$21.6 million, and with the Commonwealth of Kentucky of \$211.4 million. Deposits with local banks and investment in repurchase agreements are covered by federal depository insurance or collateralized by securities held in KCTCS' name by its agents. Deposits with the Commonwealth are covered by federal depository insurance or collateralized by securities held by the Commonwealth in the Commonwealth's name.

Pooled Endowment Funds: KCTCS employs the total return concept of investment management for setting investment objectives and determining investment performance. This concept recognizes dividends, interest, and realized and unrealized gains or losses, in determining the total return earned during any particular period. The market value method of accounting for pooled endowment funds is employed to ensure proper distribution of market price changes, realized gain/loss on sales, accrued income earned, and distribution of investment earnings for expenditure by participating funds.

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

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

The Uniform Management of Institutional Funds Act (UMIFA), as adopted by the Commonwealth of Kentucky, permits KCTCS to appropriate an amount of the realized and unrealized endowment appreciation to support current programs. Accordingly, spendable return of the endowment is determined using the total return philosophy. The philosophy recognizes a prudent amount of the increase in the fair value of investments (realized and unrealized gains) as spendable return in addition to interest and dividends earned. Distribution of investment earnings for expenditure by participating funds is supported first by interest and dividends and, if necessary, a transfer from the endowment of any prior years' accumulated earnings or net realized gain on sales. KCTCS' endowment spending rule provides for an annual distribution of 5.5 percent of the three-year moving average market value of fund units. For the years ended June 30, 2007 and 2006, net realized gains of \$1,157,155 and \$1,035,563, respectively, were transferred from endowment to support current expenses.

Investments: Investments in marketable securities are stated at fair value, as determined by the major securities markets. Changes in unrealized gain (loss) on the carrying value of investments are reported as a component of investment income in the Statement of Revenues, Expenses and Changes in Net Assets.

Accounts Receivable: Accounts receivable consist of tuition and fee charges to students and auxiliary enterprise services provided to students, faculty and staff. Accounts receivable also include amounts due from the Federal government, state and local governments or private sources in connection with reimbursement of allowable expenditures made pursuant to KCTCS' grants and contracts. Accounts receivable are recorded net of estimated uncollectible amounts. KCTCS determines its allowance by considering a number of factors, including the length of time accounts receivable are past due, previous loss history and the condition of the general economy as a whole. KCTCS writes off specific accounts receivable when they are assessed as uncollectible.

Capital Assets: Capital assets are stated at cost at date of acquisition or, in the case of gifts, at fair market value at date of gift, except KCTCS has title to certain tracts of land, which were either donated or purchased at a nominal price with no book value assigned to these properties.

Equipment with a unit cost of \$5,000 or more and having an estimated useful life of greater than one year is capitalized. Renovations to buildings, 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 period in which the expense is incurred.

Depreciation of capital assets is computed on a straight-line basis over the estimated useful lives of the respective assets, generally 40 years for buildings and land improvements, 25 years for infrastructure, 10 years for library volumes and 3 to 10 years for equipment. Assets under vendor financing agreements are amortized on the straight-line basis over the estimated useful life of the asset, or the term of the lease, whichever is shorter.

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

Deferred Revenue: Deferred revenue consists primarily of unearned tuition and fees related to the summer session and upcoming fall session, and amounts from grant and contract sponsors that have not yet been earned under the terms of the agreements.

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

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

Net assets: Under GASB standards net assets are required to be classified for accounting and reporting purposes into the following 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 assets subject to externally imposed stipulations that they be maintained permanently by KCTCS. Such assets include permanent endowment funds.
 - Expendable* - Net assets whose use by KCTCS is subject to externally imposed stipulations that can be fulfilled by actions of KCTCS pursuant to those stipulations or that expire by the passage of time.
- **Unrestricted:** Net assets whose use by KCTCS is not subject to externally imposed stipulations. Unrestricted net assets 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.

Student Tuition and Fees: Student tuition and fees are presented net of scholarships and other financial aid applied to student accounts. Payments made directly to students are presented as student financial aid expenses.

Scholarship Allowances: Student tuition and fee revenues, and certain other revenues from students are reported net of scholarship allowances in the statement of revenues, expenses and changes in net assets. Scholarship allowances are the difference between the stated charge for goods and services provided and the amount that is paid by students or third parties making payments on the students' behalf. Certain governmental grants and other Federal, state or nongovernmental programs are recorded as either operating or non-operating revenues in the financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, they are recorded as scholarship allowances.

Operating Activities: KCTCS defines operating activities, as reported on the Statement of Revenues, Expenses, and Changes in Net Assets, as those that generally result from exchange transactions, such as payments received for providing goods and services and payments made for services and goods received. Nearly all of KCTCS' expenses are from exchange transactions. Certain significant revenues relied upon for operations, such as state appropriations, gifts and investment income, are recorded as non-operating revenues, in accordance with GASB Statement No. 35.

Income Taxes: KCTCS is an agency and instrumentality of the Commonwealth of Kentucky, pursuant to Kentucky Revised Statutes sections 164.100 through 164.280. Accordingly, KCTCS is exempt from federal income taxes as an organization described in Section 170 (b)(1)(A)(ii) of the Internal Revenue Code of 1986. The affiliated Foundation has been granted exemption from federal income tax pursuant to the provisions of the Internal Revenue Code section 501(c)(3).

Restricted Asset Spending Policy: KCTCS' 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.

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

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

Use of Estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to use estimates and assumptions. The accompanying financial statements include estimates for items such as bad debt allowances, accrued expenses (vacation, long term disability, workers compensation and unemployment) and other liability accounts. Actual results could differ from those estimates.

Recent Accounting Pronouncements: In June 2004, the GASB issued Statement No. 45, "Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions." This statement establishes standards for the measurement, recognition, and display of other postemployment benefit expenses/expenditures and related liabilities (assets), note disclosures, and, if applicable, required supplementary information in the financial reports of employers subject to governmental accounting standards. The provisions of this statement are effective for financial statements for fiscal periods beginning after December 15, 2006. To assess the impact on its financial statements beginning in fiscal year ended June 30, 2008, KCTCS evaluated the financial implications of adoption of this statement. Based on the results of an actuarial analysis performed by an external third party expert, the estimated obligation for KCTCS is approximately \$258 million, using a 4 percent discount rate. GASB 45 provides for this obligation to be recognized over not more than 30 years.

In September 2006, the GASB issued Statement No. 48, "Sales and Pledges of Receivables and Future Revenues and Intra-Entity Transfers of Assets and Future Revenues." Governmental entities sometimes exchange an interest in their expected future cash flows from collecting specific receivables or specific revenues for immediate cash payments. This statement establishes criteria that the entity will use to ascertain whether the proceeds received should be reported as revenue or as a liability. The statement also includes guidance to be used for recognizing other assets and liabilities arising from the sale of specific receivables or future revenues, including residual interests and recourse provisions. The provisions of this statement are effective for financial statements for fiscal periods beginning after December 15, 2006. KCTCS does not anticipate that this statement will have a material effect on its financial statements.

In November 2006, the GASB issued Statement No. 49, "Accounting and Financial Reporting for Pollution Remediation Obligations." This statement addresses accounting and reporting standards for pollution (including contamination) remediation obligations, which are obligations to address the current or potential detrimental effects of existing pollution by participating in pollution remediation activities such as site assessments and cleanups. The scope of the statement excludes pollution prevention or control obligations with respect to current operations and future remediation activities that are required upon retirement of an asset. The provisions of this statement are effective for financial statements for fiscal periods beginning after December 15, 2007. KCTCS has not yet evaluated the impact that the adoption of this statement will have on its financial statements.

In May 2007, the GASB issued Statement No. 50, "Pension Disclosures - an amendment of GASB Statements No. 25 and No. 27. This statement more closely aligns the financial reporting requirements for pensions with those for other postemployment benefits and, in doing so, enhances information disclosed in notes to financial statements or presented as required supplementary information by pension plans and by employers that provide pension benefits. The provisions of this statement are effective for financial statements for fiscal periods beginning after June 15, 2007. KCTCS does not anticipate that this statement will have a material effect on its financial statements.

In June 2007, the GASB issued Statement No. 51, "Accounting and Financial Reporting for Intangible Assets." This statement requires that all intangible assets not specifically excluded by its scope provisions be classified as capital assets. Accordingly, existing authoritative guidance related to the accounting and financial reporting for capital assets should be applied to these intangible assets, as applicable. The statement also provides authoritative guidance that specifically addresses the nature of these intangible assets. The provisions of this statement are effective for financial statements for fiscal periods beginning after June 15, 2009. KCTCS has not yet evaluated the impact that the adoption of this statement will have on its financial statements.

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2007 and 2006

NOTE 2 - LOANS, ACCOUNTS AND GIFTS RECEIVABLE

Loans, accounts and gifts receivable (net of allowances) as of June 30, 2007 and 2006, are as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Student (net of allowances of \$2,689 and \$2,671)	\$ 7,514	\$ 6,655
Reimbursement receivable - grants and contracts	8,058	4,318
Pledges receivable, net	6,001	11,393
Accrued interest receivable	1,420	178
Loans receivable from fire districts	<u>7,737</u>	<u>7,589</u>
Total	30,730	30,133
Current portion	<u>21,122</u>	<u>16,892</u>
Noncurrent portion	<u>\$ 9,608</u>	<u>\$ 13,241</u>

Pledges receivable totaling \$6,325,237 is expected to be collected primarily over the next ten years, as follows (in thousands):

2008	\$ 3,122
2009	1,187
2010	863
2011	416
2012	271
2013-2017	<u>466</u>
	6,325
Present value discount	<u>324</u>
Pledges receivable, net	<u>\$ 6,001</u>

In accordance with GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*, as amended by GASB Statement No. 36, *Recipient Reporting for Certain Shared Nonexchange Revenues*, an amendment of GASB Statement No. 33, KCTCS is required to record operating and capital pledges as revenue when all eligibility requirements have been met. Endowment pledges are not recognized as revenue until the gifts are actually received.

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
 NOTES TO FINANCIAL STATEMENTS
 June 30, 2007 and 2006

NOTE 3 - INVESTMENTS

All investments are stated at fair value. Investments acquired by gift are stated at fair value at the date of the gift if a fair value is available, and otherwise at an appraised or nominal value.

As of June 30, 2007 and 2006, KCTCS had the following investments (in thousands). The investments consist of mutual funds, and property.

<u>Investment Type</u>	<u>Fair Value</u>	
	<u>2007</u>	<u>2006</u>
Bond Mutual Funds	\$ 6,605	\$ 4,971
Money Market Funds	3,627	806
Other	<u>1,182</u>	<u>892</u>
	11,414	6,669
Equities and Equity Funds	<u>17,949</u>	<u>14,001</u>
	<u>\$ 29,363</u>	<u>\$ 20,670</u>

Securities within the bond mutual funds have a weighted average life of 6.6 years.

Money market funds are available within 90 days.

KCTCS has an investment management agreement with the Common Fund (Fund). The Fund managed \$26,520,354 of the investments at June 30, 2007. The Common Fund was founded in 1971 to serve higher education and not for profit organizations. It currently serves 1,700 organizations and has \$37 billion in assets under management. The Common Fund is unrated.

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. As noted, KCTCS has the majority of its assets invested with the Common Fund which has its assets invested in a highly diversified asset base.

Custodial Credit Risk: For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, KCTCS will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. KCTCS does not have a formal policy for custodial credit risk. As of June 30, 2007, all of KCTCS' U.S. Treasuries, U.S. Agencies, and Corporate Notes were held by the investment's counterparty.

Interest Rate Risk: Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of an investment. KCTCS' Investment Policy does not specifically limit investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

NOTE 5 - DEFERRED REVENUE

Deferred revenue as of June 30, 2007 and 2006 is as follows (in thousands):

	<u>2007</u>	<u>2006</u>
Unearned summer and fall tuition revenues	\$ 4,717	\$ 4,381
Grants and contracts	<u>20,863</u>	<u>19,784</u>
	<u>\$ 25,580</u>	<u>\$ 24,165</u>

NOTE 6 - NONCURRENT LIABILITIES

Noncurrent liabilities as of June 30, 2007 and 2006 are summarized as follows (in thousands):

2007						
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Non Current Portion</u>
Lease and bonds obligations						
Capital lease obligations	\$ 8,479	\$ 5,792	\$ 883	\$ 13,388	\$ 1,101	\$ 12,287
Total lease and bond obligations	<u>8,479</u>	<u>5,792</u>	<u>883</u>	<u>13,388</u>	<u>1,101</u>	<u>12,287</u>
Other liabilities						
Compensated absences	9,689	11,914	11,390	10,213	10,213	-
Other noncurrent liabilities	460	-	-	460	460	-
Long-term supplemental disability	<u>3,367</u>	<u>-</u>	<u>336</u>	<u>3,031</u>	<u>144</u>	<u>2,887</u>
Total other liabilities	<u>13,516</u>	<u>11,914</u>	<u>11,726</u>	<u>13,704</u>	<u>10,817</u>	<u>2,887</u>
Total noncurrent obligations	<u>\$ 21,995</u>	<u>\$ 17,706</u>	<u>\$ 12,609</u>	<u>\$ 27,092</u>	<u>\$ 11,918</u>	<u>\$ 15,174</u>
2006						
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Non Current Portion</u>
Lease and bonds obligations						
Capital lease obligations	\$ 8,445	\$ 651	\$ 617	\$ 8,479	\$ 518	\$ 7,961
Total lease and bond obligations	<u>8,445</u>	<u>651</u>	<u>617</u>	<u>8,479</u>	<u>518</u>	<u>7,961</u>
Other liabilities						
Compensated absences	9,041	10,732	10,084	9,689	9,689	-
Other noncurrent liabilities	460	-	-	460	-	460
Long-term supplemental disability	<u>3,522</u>	<u>(101)</u>	<u>54</u>	<u>3,367</u>	<u>139</u>	<u>3,228</u>
Total other liabilities	<u>13,023</u>	<u>10,631</u>	<u>10,138</u>	<u>13,516</u>	<u>9,828</u>	<u>3,688</u>
Total noncurrent obligations	<u>\$ 21,468</u>	<u>\$ 11,282</u>	<u>\$ 10,755</u>	<u>\$ 21,995</u>	<u>\$ 10,346</u>	<u>\$ 11,649</u>

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

NOTE 6 - NONCURRENT LIABILITIES (Continued)

Capital lease obligations as of June 30, 2007 and 2006 consist of the following (in thousands):

	<u>2007</u>	<u>2006</u>
Computer equipment leases, all with three to five year terms with annual payments ranging from \$66,870 to \$178,611 and interest rates from .8% to 8.14%.	\$ 1,038	\$ 412
Energy savings equipment leases with 1 to 12 year remaining terms. Two with annual payments of \$21,975 and \$284,377, and interest rates of 4.3% and 3.66%, and one lease with semi-annual payments of \$112,316, and a rate of 4.3% and a ten year remaining term.	4,622	2,017
A building lease with monthly payments of \$53,085, interest rate of 4.04% and 16 years remaining.	<u>7,728</u>	<u>6,050</u>
	<u>\$ 13,388</u>	<u>\$ 8,479</u>

Principal maturities and interest on capital leases payable for the next five years and in subsequent five-year periods as of June 30, 2007 are as follows (in thousands):

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2008	\$ 1,101	\$ 529	\$ 1,630
2009	1,118	490	1,608
2010	1,012	439	1,451
2011	815	398	1,213
2012	781	365	1,146
2013-2017	4,407	1,323	5,730
2018-2022	3,379	481	3,860
2023-2027	<u>775</u>	<u>22</u>	<u>797</u>
	<u>\$ 13,388</u>	<u>\$ 4,047</u>	<u>\$ 17,435</u>

NOTE 7 - RISK MANAGEMENT

KCTCS is exposed to various risks of loss related to torts; theft of, damage to, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. These risks are covered by (1) the State Fire and Tornado Insurance Fund (the Fund), (2) Sovereign Immunity and the State Board of Claims, or (3) in the case of risks not covered by the Fund and Sovereign Immunity, commercial insurance.

The Fund covers losses to property from fire, wind, earthquake, flood, and other named perils between \$500 and \$500,000. Losses in excess of \$500,000 are insured by commercial carriers. The general liability aggregate total limit is \$2,000,000 with each occurrence limit of \$1,000,000 without a deductible. The excess umbrella liability aggregate total limit is \$5,000,000 with each occurrence limit of \$5,000,000 without a deductible. Claims against educators' legal and employment practices are insured through commercial insurance. The limit is \$2,000,000 without a deductible. There have been no significant reductions in insurance coverage from 2006 to 2007. Settlements have not exceeded insurance coverage during the past three years.

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

NOTE 7 - RISK MANAGEMENT (Continued)

Employees hired at the community colleges prior to January 14, 1998 (the date the KCTCS Board of Regents accepted management of the community colleges from the University of Kentucky), that have not opted to the KCTCS benefits plan, are covered under the University of Kentucky's self-insured long-term disability income program. This program is funded through a trust established by the University of Kentucky for the purpose of paying claims and establishing necessary reserves. KCTCS reimburses the University of Kentucky for long-term disability payments made to its employees. The estimated liability for long-term disability claims **Error! Not a valid link.** at June 30, 2007 totals \$3,031,258 of which \$2,887,258 is included in "Other long-term obligations" and \$144,000 is included in "Employee withholdings and deposits".

KCTCS has purchased commercial insurance policies covering risks of loss due to damage to property and automobiles, general and automobile liability claims, employee dishonesty, and student accident.

NOTE 8 - NATURAL CLASSIFICATION

The operating expenses for KCTCS by natural classification were as follows for the years ended June 30, 2007 and 2006 (in thousands):

	<u>2007</u>	<u>2006</u>
Salaries and wages	\$ 230,406	\$ 217,598
Employee benefits	69,871	69,793
Supplies	15,595	15,273
Depreciation	17,432	16,440
Student scholarships and financial aid	59,470	57,489
Utilities	12,027	11,529
Communications	3,584	3,615
Advertising	2,156	2,183
Professional services	10,174	7,269
Fire commission state aid	5,896	5,862
Fire commission incentive	11,500	11,143
Fire commission pension	3,030	2,630
Travel	4,483	4,355
Repairs and maintenance	6,919	6,204
Bad debts	3,620	3,466
Rental/lease	3,775	3,306
Equipment not capitalized	12,376	10,176
Other, various	<u>10,933</u>	<u>9,890</u>
	<u>\$ 483,247</u>	<u>\$ 458,221</u>

NOTE 9 - PENSION PLANS

Regular full-time employees of KCTCS, faculty and staff, are required to participate in a retirement plan.

Regular full-time employees subject to KCTCS personnel policies have the opportunity to choose between a defined benefit plan and a 403(b) plan. Employees that choose a defined benefit plan can participate in either KTRS or KERS depending on the requirements of the position. The decision to participate in a defined benefit plan or a 403(b) plan is made in the first 30 days of regular full-time employment.

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

NOTE 9 - PENSION PLANS (Continued)

KCTCS has authorized four 403(b) retirement plan carriers as follows:

American Century Investors, Inc.
Fidelity Investments
ING
Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF)

Regular full-time employees that were employed prior to the creation of KCTCS' personnel policies and benefits, either from a community or technical college, that voluntarily elect to join the KCTCS personnel system may choose a retirement option based on each employee's eligibility criteria. Defined benefit plans have a five-year vesting period. Employer contributions that are forfeited by employees prior to vesting are used to reduce future employer contributions.

Regular full-time employees who have not opted to follow KCTCS personnel policies and benefits and who were employed before January 14, 1998 at a community college are subject to the personnel policies of the University of Kentucky personnel system and are participants in the University of Kentucky Retirement Plan.

Participation in the University of Kentucky Retirement Plan is mandatory for regular full-time employees who are age 30 and older. Participation is voluntary for regular full-time employees under the age of 30. Participants contribute 5 percent and KCTCS contributes 10 percent of the participant's eligible compensation to the retirement plan. The University of Kentucky has authorized three retirement plan carriers, as follows:

American Century Investors, Inc.
Fidelity Institutional Services Company
Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF)

Regular full-time employees who have not opted to KCTCS personnel policies and benefits who were employed at a technical college before June 30, 1998 are participants in either Kentucky Teachers' Retirement System (KTRS) or Kentucky Employees' Retirement System (KERS) depending on the requirements of the position. Both KTRS and KERS are cost-sharing multiple employer plans.

KERS participants contribute 5 percent of their covered compensation; KCTCS contributes 7.75 percent. KTRS participants contribute 6.16 percent or 9.855 percent; KCTCS contributes 13.105 percent or 13.84 percent, depending upon the participant's personnel classification.

KERS and KTRS issue stand-alone financial reports. Copies of these reports may be obtained by requesting them in writing at the following addresses:

Kentucky Retirement System
1260 Louisville Road
Perimeter Park West
Frankfort, Kentucky 40601

Kentucky Teachers Retirement System
477 Versailles Road
Frankfort, Kentucky 40601

KCTCS contributions and costs for all of its retirement plans for 2007 and 2006 were \$20,663,835 and \$19,366,330, respectively; the employees contributed \$16,608,095 and \$15,711,277 for 2007 and 2006, respectively. KCTCS total payroll costs were \$230,406,261 and \$217,597,872 for 2007 and 2006, respectively.

(Continued)

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM
NOTES TO FINANCIAL STATEMENTS
June 30, 2007 and 2006

NOTE 10 - CONTINGENCIES

KCTCS is a defendant in various lawsuits. However, management is of the opinion, based on advice of in-house legal counsel, that the ultimate outcome of all litigation will not have a material effect on the future operations or financial position of KCTCS.

KCTCS receives financial assistance from federal and state agencies in the form of grants and awards. The expenditure of funds received under 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 audits could become a liability of the applicable fund. KCTCS has had no disallowed claims in the past. In the opinion of management, such potential disallowed claims, if any, would not have a material adverse effect on the overall financial position of KCTCS at June 30, 2007.

NOTE 11 - RECLASSIFICATIONS

Certain reclassifications to fiscal 2006 comparative amounts have been made to conform to the 2007 classifications.



Crowe Chizek and Company LLC
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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

Board of Regents
Kentucky Community and Technical College System
Versailles, Kentucky

We have audited the financial statements of Kentucky Community and Technical College System (the "System") as of and for the year ended June 30, 2007, and have issued our report thereon dated October 1, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the System's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the System's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the System's internal control over financial reporting.

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the System's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the System's financial statements that is more than inconsequential will not be prevented or detected by the System's internal control.

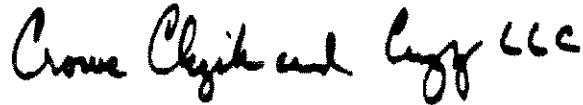
A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the System's internal control.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we noted certain other matters that we have reported to management in a separate letter dated October 1, 2007.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the System'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*.

This report is intended solely for the information and use of the Board of Regents, management, federal awarding agencies and pass-through entities and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Crowe Chizek and Company LLC". The signature is written in a cursive, flowing style.

Crowe Chizek and Company LLC

Louisville, Kentucky
October 1, 2007

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