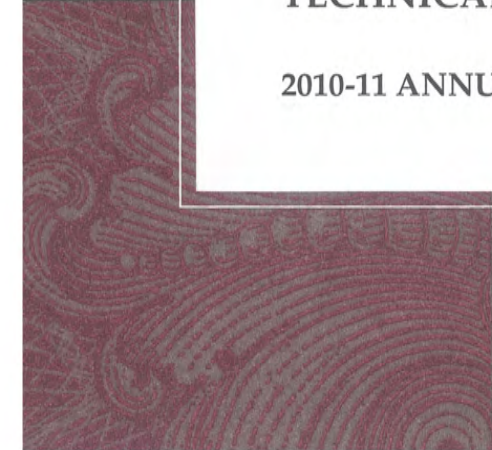


DEAN || DORTON || ALLEN || FORD

**KENTUCKY COMMUNITY AND
TECHNICAL COLLEGE SYSTEM**

2010-11 ANNUAL FINANCIAL REPORT



KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

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DEAN || DORTON || ALLEN || FORD_{PLC}**Independent Auditors' Report**

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

Secretary of Finance and
Administration Cabinet of the
Commonwealth of Kentucky

We have audited the accompanying financial statements of Kentucky Community and Technical College System (the System) as of June 30, 2011, and for the year then ended, which collectively comprise the System's basic financial statements as listed on 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 audit. The financial statements of Kentucky Community and Technical College System as of June 30, 2010, were audited by Dean Dorton Ford, PSC whose report dated October 1, 2010, expressed an unqualified opinion on those statements.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the System as of June 30, 2011, and the respective changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 5 through 17 and the Schedule of Funding Progress for the Retiree Medical Plan on page 44 are not a required part of the basic financial statements but are 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 September 30, 2011 on our consideration of the System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of the audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.

September 30, 2011
Lexington, Kentucky

A handwritten signature in black ink that reads "Deane Don Yore Allen Ford, PLLC". The signature is written in a cursive, flowing style.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

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, 2011 and 2010. 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, 2011, with assets of \$1,071.8 million and liabilities of \$192.5 million. Net assets, which represent KCTCS' residual interest in assets after liabilities are deducted, were \$879.2 million or 82.0 percent of total assets. Net assets at June 30, 2010 were 82.5 percent of total assets. Financial outcomes were in accordance with the revenue expectations and the approved expenditure plan.
- Total assets increased \$72.0 million or 7.2 percent. The increase is primarily in cash, investments, and capital assets.
- Total liabilities increased by \$17.5 million or 10.0 percent. The principal item of increase was other long-term obligations.
- Total net assets increased \$54.6 million, or 6.6 percent. This resulted primarily from income before other revenues, expenses, gains and losses of \$25.1 million, capital construction proceeds from the Commonwealth of Kentucky of \$23.6 million and increases to endowments of \$6.0 million.
- Operating revenues were \$219.2 million and operating expenses were \$674.7 million, resulting in a loss from operations of \$455.4 million. Nonoperating revenues of \$480.5 million (including \$199.2 million in state appropriations) resulted in income before other revenue of \$25.1 million. Other revenues were \$29.5 million in 2011.

Using the Financial Statements

The Financial Statements consist of Statements of Net Assets (Balance Sheets), Statements of Revenues, Expenses and Changes in Net Assets (Income Statements), Statements of Cash Flows, and Notes to the Financial Statements. These financial statements are prepared in accordance with standards issued by the Governmental Accounting Standards Board (GASB). 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 68 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.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

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. All KCTCS colleges have 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 2,100 on-line course sections through KCTCS On-line. 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 offer over 600 programs.

KCTCS also views postsecondary education as a crucial resource for workforce development. To further 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.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

Statements of Net Assets

The Statements of Net Assets present the financial position of KCTCS at the end of the fiscal year and include 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, 2011, 2010 and 2009, is as follows:

Condensed Statements of Net Assets (amounts in thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Assets			
Current assets	\$ 306,175	\$ 285,117	\$ 248,689
Noncurrent assets	<u>765,602</u>	<u>714,633</u>	<u>629,210</u>
 Total assets	 <u>1,071,777</u>	 <u>999,750</u>	 <u>877,899</u>
Liabilities			
Current liabilities	77,733	81,994	60,510
Noncurrent liabilities	<u>114,815</u>	<u>93,086</u>	<u>49,355</u>
 Total liabilities	 <u>192,548</u>	 <u>175,080</u>	 <u>109,865</u>
Net Assets			
Invested in capital assets, net of related debt	558,334	542,756	514,824
Restricted			
Nonexpendable	31,515	26,688	17,258
Expendable	65,308	71,497	99,995
Unrestricted	<u>224,072</u>	<u>183,729</u>	<u>135,957</u>
 Total net assets	 <u>\$ 879,229</u>	 <u>\$ 824,670</u>	 <u>\$ 768,034</u>

Assets: As of June 30, 2011, total assets amounted to \$1,071.8 million. Of this amount, investment in capital assets (net of depreciation) of \$583.2 million, or 54.4 percent of total assets, represented the largest asset class. Cash and cash equivalents amounted to \$304.2 million or 28.4 percent, and loans and accounts receivable amounted to \$42.1 million or 3.9 percent of total assets. During the year, total assets increased by \$72.0 million, primarily in cash, investments, and capital assets.

Liabilities: As of June 30, 2011, total liabilities amounted to \$192.5 million. Capital leases and other long-term obligations amounted to \$118.4 million, or 61.5 percent of total liabilities. During the year, total liabilities increased by \$17.5 million, primarily because of other long-term obligations.

Net Assets: The equity of KCTCS of \$879.2 million as of June 30, 2011 is reported on the Statements of Net Assets in four net asset categories: invested in capital assets, net of related debt, \$558.3 million (63.5 percent); restricted-nonexpendable \$31.5 million (3.6 percent); restricted expendable, \$65.3 million (7.4 percent); and unrestricted, \$224.1 million (25.5 percent).

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

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 \$54.6 million during the year ended June 30, 2011. This increase was comprised primarily of an unrestricted assets increase of \$40.3 million, capital assets, net of debt increase of \$15.6 million, restricted nonexpendable assets increase of \$4.8 million, and expendable capital projects of \$4.4 million.

2010 Versus 2009

- As of June 30, 2010, total assets amounted to \$999.8 million. Of this amount, investment in capital assets (net of depreciation) of \$568.5 million, or 56.9 percent of total assets, represented the largest asset class. Cash and cash equivalents amounted to \$261.0 million or 26.1 percent, and loans and accounts receivable amounted to \$50.8 million or 5.1 percent of total assets. During the year, total assets increased by \$121.9 million. The increase was primarily in cash and cash equivalents, investments, and capital assets.
- As of June 30, 2010, total liabilities amounted to \$175.1 million. Capital leases and other long-term obligations amounted to \$96.2 million, or 54.9 percent of total liabilities. During the year, total liabilities increased by \$65.2 million, primarily because of employee withholdings, leases payable and other long-term obligations.
- Total net assets increased by \$56.6 million during the year ended June 30, 2010. Invested in capital assets, net of related debt, increased by \$27.9 million. Restricted net assets decreased by \$19.1 million as capital project assets decreased. Unrestricted net assets increased \$47.8 million, mainly due to overall revenues in excess of expenditures.

Statements of Revenues, Expenses and Changes in Net Assets

The Statements of Revenues, Expenses and Changes in Net Assets are 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 Statements of Revenues, Expenses and Changes in Net Assets as revenues, expenses, gains or losses.

Financial activities are reported as either operating or nonoperating. State appropriations, certain grants, gifts and investment and endowment income are required 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 Statements of Revenues, Expenses, and Changes in Net Assets for the years ended June 30, 2011, 2010, and 2009 is presented on the following page.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

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

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Operating revenues			
Student tuition and fees, net	\$ 114,535	\$ 107,009	\$ 96,147
Grants and contracts	89,971	84,647	78,518
Other operating revenue	14,730	10,757	9,583
Total operating revenues	219,236	202,413	184,248
Operating expenses			
Educational and general, excluding depreciation	646,488	627,878	523,648
Depreciation	28,164	25,122	22,859
Total operating expenses	674,652	653,000	546,507
Operating loss	(455,416)	(450,587)	(362,259)
Nonoperating revenues (expenses)			
State appropriations	199,156	200,555	214,931
Federal and state grants and contracts	249,505	211,794	140,387
Other nonoperating revenues	31,854	36,332	18,336
Total nonoperating revenues	480,515	448,681	373,654
Income (loss) before other revenues, expenses, gains or losses	25,099	(1,906)	11,395
Capital construction appropriations	23,646	57,131	70,126
Net realized loss on disposal of capital assets	(154)	(1,214)	(291)
Additions (reductions) to endowments	5,968	2,625	(4,832)
Total other revenues (expenses)	29,460	58,542	65,003
Total increase in net assets	54,559	56,636	76,398
Net assets, beginning of year	824,670	768,034	691,636
Net assets, end of year	\$ 879,229	\$ 824,670	\$ 768,034

Total operating revenues were \$219.2 million for the year ended June 30, 2011. Included in KCTCS' operating revenues are net student tuition and fees of \$114.5 million (52.2 percent), and grants and contracts of \$90.0 million (41.0 percent).

Operating expenses totaled \$674.7 million. Of this amount, \$646.5 million (95.8 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).

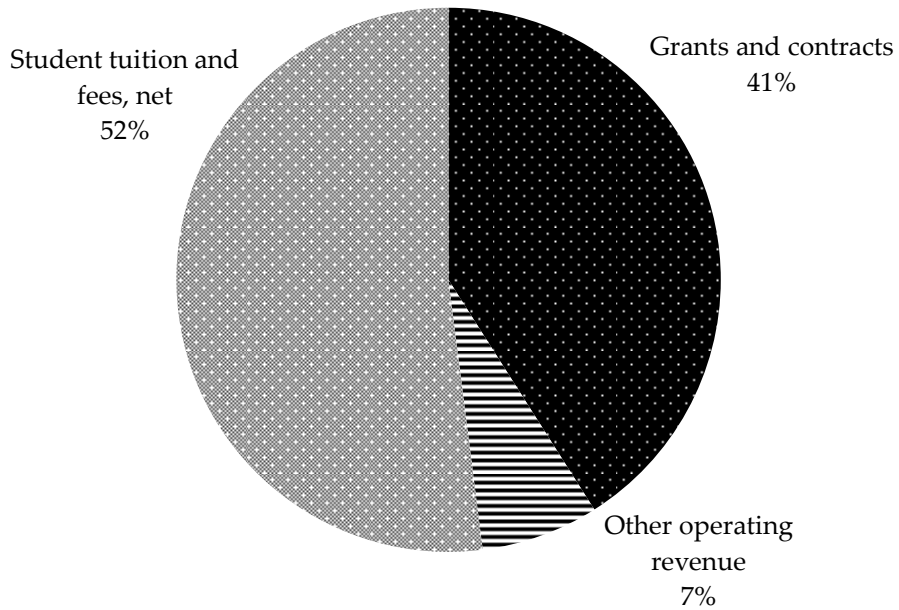
The loss from operations for the year amounted to \$455.4 million. Nonoperating and other revenues, net of related expenses, amounted to \$510.0 million, resulting in an increase in net assets of \$54.6 million for the year. Nonoperating and other revenues reflect a \$2.8 million increase due primarily to decreases in capital construction proceeds of \$33.5 million, federal and state grants and contracts increase of \$37.7 million, decreases in state appropriations of \$1.4 million, other nonoperating revenues decreases of \$4.5 million, and additions to endowments of \$3.3 million.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

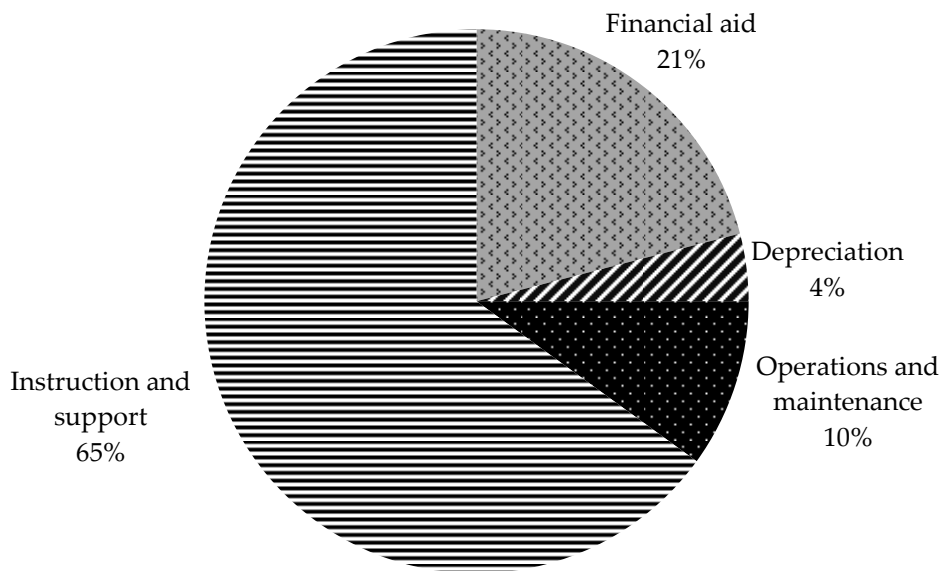
Management's Discussion and Analysis

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

Operating Revenues



Operating Expenses



KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

2010 Versus 2009

Total operating revenues were \$202.4 million for the year ended June 30, 2010, including net student tuition and fees of \$107.0 million (52.9 percent) and grants and contracts of \$84.6 million (41.8 percent).

Operating expenses totaled \$653.0 million. Of this amount, \$627.9 million (96.2 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 \$450.6 million. Nonoperating and other revenues, net of related expenses, amounted to \$507.2 million, resulting in an increase in net assets of \$56.6 million for the year. Nonoperating revenues include state appropriations of \$200.6 million (39.5 percent of total nonoperating and other revenues).

Statements of Cash Flows

The Statements of Cash Flows present information, related to KCTCS' cash inflows and outflows, summarized by operating, capital, financing, and investing activities. The primary purpose of the Statements 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' Statements of Cash Flows for the years ended June 30, 2011, 2010, and 2009 is as follows:

Condensed Statements of Cash Flows (amounts in thousands)

	<u>2011</u>	<u>2010</u>	<u>2009</u>
Cash (used in) provided by:			
Operating activities	\$ (435,164)	\$ (375,108)	\$ (326,006)
State appropriation	199,156	200,555	214,931
Other noncapital financing activities	299,700	273,903	172,007
Capital and related financing activities	(9,835)	(9,119)	(64,413)
Investing activities	<u>(10,644)</u>	<u>(35,210)</u>	<u>(12,004)</u>
Net increase (decrease) in cash and cash equivalents	43,213	55,021	(15,485)
Cash and cash equivalents, beginning of year	<u>260,980</u>	<u>205,959</u>	<u>221,444</u>
Cash and cash equivalents, end of year	<u>\$ 304,193</u>	<u>\$ 260,980</u>	<u>\$ 205,959</u>

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

Major sources of cash received from operating activities are student tuition and fees (\$113.1 million) and grants and contracts (\$91.0 million). Major uses of cash for operating activities were payments to employees for salaries and benefits (\$381.6 million) and student financial aid (\$137.8 million).

Capital and related financing activities include capital appropriations from the Commonwealth of Kentucky of \$35.0 million, proceeds from new capital debt and leases of \$2.7 million, and proceeds from disposal of capital assets of \$0.2 million. Cash of \$43.2 million was expended for construction and acquisition of capital assets and \$4.6 million was expended for principal and interest payments on debt.

Investing activities of \$10.6 million include interest and dividends of \$5.2 million. Cash of \$15.8 million was used to purchase additional investments.

2010 Versus 2009

Major sources of cash received from operating activities for the year ended June 30, 2010 are student tuition and fees (\$147.0 million) and grants and contracts (\$83.3 million). Major uses of cash for operating activities were payments to employees for salaries and benefits (\$364.4 million) and to vendors and contractors (\$137.5 million).

Capital and related financing activities include capital appropriations from the Commonwealth of Kentucky of \$45.8 million. Cash of \$65.8 million was expended for construction and acquisition of capital assets and \$3.3 million was expended for principal and interest payments on debt.

Investing activities include \$40.8 million used to purchase additional investments and interest and dividends on investments of \$5.6 million.

Capital Assets and Debt Administration

Capital assets, net of accumulated depreciation, totaled \$583.2 million at June 30, 2011, an increase of \$14.7 million. Capital assets as of June 30, 2011, 2010, and 2009, and significant changes in capital assets during those years are as follows (in thousands):

Capital Assets (amounts in thousands)

	Balance June 30, <u>2009</u>	Net Additions FY 2010	Balance June 30, <u>2010</u>	Net Additions FY 2011	Balance June 30, <u>2011</u>
Land and land improvements	\$ 33,015	\$ 1,426	\$ 34,441	\$ 3,037	\$ 37,478
Buildings and infrastructures	519,942	137,047	656,989	12,081	669,070
Equipment, autos and campus improvements	88,951	12,692	101,643	6,669	108,312
Library holdings	54,522	1,229	55,751	1,875	57,626
Construction in progress	133,693	(91,709)	41,984	13,615	55,599
Energy saving assets	4,983	-	4,983	-	4,983
Total assets	<u>835,106</u>	<u>60,685</u>	<u>895,791</u>	<u>37,277</u>	<u>933,068</u>
Accumulated depreciation	<u>(305,957)</u>	<u>(21,318)</u>	<u>(327,275)</u>	<u>(22,605)</u>	<u>(349,880)</u>
Capital assets, net	<u>\$ 529,149</u>	<u>\$ 39,367</u>	<u>\$ 568,516</u>	<u>\$ 14,672</u>	<u>\$ 583,188</u>

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

At June 30, 2011, KCTCS had capital construction projects in progress totaling \$55.6 million. These projects are principally financed by appropriations and bond proceeds from the Commonwealth of Kentucky.

Debt

At June 30, 2011, debt consisted of 175 capital leases totaling \$24.9 million.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

Economic Factors Impacting Future Periods

The following are existing conditions and circumstances that will affect future financial results:

- The KCTCS state appropriation (including federal State Fiscal Stabilization Funds for fiscal years 2010 and 2011) has decreased roughly \$21.1 million since fiscal year 2008 – down from \$221.8 million in FY 2008 to \$200.7 million for FY 2012. Federal funds are expected to remain roughly flat for the near future with potential cuts in student aid programs and sponsored project activity possible contingent on the federal budget situation being resolved.
- The KCTCS Board of Regents approved a 2011-12 operating budget totaling \$903.2 million and a 2011-12 capital budget totaling \$150.9 million. The 2011-12 operating budget includes unrestricted budget reserve funds of which \$21.2 million is nonrecurring and \$4.4 million is recurring. Total unrestricted reserve funds for 2011-12 equal \$25.6 million. The reserve funds are for each college and for the systemwide operations and support programs.
- Tuition rates for 2011-12 have been increased from \$130 per credit hour to \$135 per credit hour for resident students. Nonresident students from counties contiguous to Kentucky will pay \$270 per credit hour. Other nonresident students will pay \$465 per credit hour. Online students will pay \$135 per credit hour. Along with these rates for first-time students, the KCTCS Board of Regents approved guaranteed tuition rates for returning students. Students enrolled during the fall 2010 or spring 2011 terms and who return in fall 2011 or spring 2012 are eligible for tuition at 2010-11 rates. Because of KCTCS' low tuition rates for 2011-12, the guaranteed rates for previous term enrolled students, and the growing difference in KCTCS' tuition rates versus Kentucky's other postsecondary education institutions, KCTCS believes its enrollment will maintain current levels or increase.
- The 2010 General Assembly enacted House Bill 160 (HB160), the Transfer Bill. HB160 takes effect in the 2012-13 academic year for first-time students. HB160 will help provide KCTCS students with a clear-cut understanding of which courses will apply toward a four-year degree and create consistency among core courses across Kentucky's public postsecondary education institutions. HB160 also requires advance notice to KCTCS and the Council on Postsecondary Education (CPE) when course changes are proposed that would have an effect on transfer. KCTCS, in anticipation of the implementation of HB160, has created a common course numbering system among its 16 colleges.
- Official fall 2010 enrollment was 106,664 students. This was a 6.3 percent increase over fall 2009 enrollment of 100,348 students. Because of the uncertainty of the economy, students choosing a KCTCS college as their college of first choice and KCTCS' low tuition rates, HB 160's clear-cut path for transfer, student financial aid and enrollment applications are expected to maintain current levels or continue to increase.
- KCTCS has implemented a system-wide multi-year major gifts campaign titled "Fulfilling the Promise." The campaign goal is \$100 million. As of June 30, 2011, total gifts and pledges received stand at \$100,609,152.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

- Changes in governmental accounting standards that took effect in 2007-08 required KCTCS to record on its financial statements an obligation for postemployment benefits for its 403(b) benefit plan employees. In March 2009 the KCTCS Board of Regents revised its employment policies so that for employees hired with an effective date on or after July 1, 2009, that chose to participate in a 403(b) retirement plan, postemployment health benefits will no longer be provided by KCTCS. In early 2011 KCTCS had the actuarial study updated to calculate the projected postemployment obligation. The total estimated present value cost as of July 1, 2011 was \$337.7 million with an unfunded actuarial accrued liability of \$214.5 million. A 4 percent discount rate on a 15-year amortization schedule with 11 years remaining was the basis for the calculation. The 2011-12 expense required to retire this future obligation is \$31.8 million. Of this total, \$29.8 million will be invested with the Commonfund to offset future obligations.
- Despite the current volatility in economic conditions and an uncertain outlook, KCTCS continues to maintain its firm commitment to the vision and goals of the Postsecondary Education Improvement Act of 1997 (House Bill 1). The KCTCS Strategic Plan 2010-16 envisions KCTCS to be the nation's premier community and technical college system. The Plan is designed to place more Kentucky citizens on the path to a postsecondary credential (certificate, diploma and/or associate degree) and a successful career path. The plan includes five goals with specific performance indicators and six-year targets creating an effective way to measure success. The goals are:
 - Advance excellence and innovation in teaching, learning, and service.
 - Cultivate diversity, multiculturalism, and inclusion.
 - Increase student access, transfer, and success.
 - Enhance the economic and workforce development of the Commonwealth.
 - Promote the recognition and value of KCTCS.
- The 2010-11 KCTCS President's Leadership Initiative focused on "TRANSFORMATION". The 2011-2012 President's Leadership Initiative builds on the "TRANSFORMATION" initiative and will focus on "CHANGE". The 2010-11 Transformation Initiative identified "who" and "what" needed to change in order to transform KCTCS, the 2011-12 Change Initiative will focus on "when" and "how" to change. A primary component of the 2011-12 CHANGE initiative is the KCTCS President leading KCTCS in the development and implementation of change management and project management processes and methods to successfully transition KCTCS from its current state to its desired future state as defined by "Transformation" strategies developed by the 2010-11 TRANSFORMATION initiative. For each transformational strategy there will be detailed action steps to provide measurement and accountability. This new KCTCS leadership initiative uses team structures based on change management research and best practices. The timeline for the accomplishment of the strategies ranges from fiscal years 2012 through 2016.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

Among the transformational strategies and areas targeted to be addressed are:

- *Curriculum Review:*
 - Create a technical program development and review process supported by research development and analysis.
 - Create a standardized, rapid-response curriculum and program approval development process.
- *Developmental Education:*
 - Develop and implement an alternative model for the delivery of developmental/transitional education in English, reading, and math, which is modularized, self-paced, competency-driven, and computer-assisted/lab-based.
- *Dual Credit:*
 - Develop a consistent, statewide program of dual credit, using the National Association of Concurrent Enrollment Programs standards as a framework.
- *Financial Aid:*
 - Establish unified financial aid standards at all KCTCS colleges based on industry-wide best practices.
- *Job Placement and Career Development:*
 - Provide comprehensive career development and job placement services to engage students in their educational pursuit from pre-enrollment to post-graduation.
- *Student Services:*
 - Develop a comprehensive outsourced student services delivery model that provides a seamless, scalable, virtual 24/7/365 student services call center help desk for all KCTCS students.
- *Transfer:*
 - Develop a holistic/integrated approach to transfer by developing coherent structures and integrated processes in the design and delivery of instructional and student services utilizing the Foundations of Excellence Transfer Focus.
 - Utilize a comprehensive approach to developing partnerships and agreements with four-year institutions by creating pathways for students completing associate degrees to transfer to baccalaureate degree programs.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Management's Discussion and Analysis

The benefits of successful implementation of the transformational strategies are expected to result in the following:

For Students:

- Increased access to KCTCS programs
- Enhanced awareness and access to financial aid
- Improved convenience and quality of services
- Increased retention and academic success
- Enhanced success in pursuing 4-year degrees
- Increased opportunities for good paying jobs

For KCTCS:

- System-wide standards and benchmarks
- Comprehensive, consistent, and integrated approaches
- Enhanced skills and talents of KCTCS employees
- New and enhanced technological innovations
- Enhanced cost-effectiveness, productivity, and efficiency

For Kentucky:

- Well educated and highly trained workforce
- Employability of Kentucky citizens
- Globally competitive business and industries
- Higher standard of living
- Economic prosperity
- Quality of life

In summary, although many economic challenges have faced KCTCS and will continue to impact the future, KCTCS management believes that our past and current financial management practices have positioned KCTCS to continue to grow during these uncertain times. Further, the KCTCS transformational strategies will enable KCTCS to plan for and embrace change as a path for opportunity to continue its progress to becoming the nation's premier community and technical college system.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Statements of Net Assets

June 30, 2011 and 2010

(amounts in thousands)

	<u>2011</u>	<u>2010</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 268,186	\$ 239,152
Short-term investments	38	38
Loans, accounts and pledges receivable, net of allowances	36,131	44,021
Other current assets	1,820	1,906
Total current assets	306,175	285,117
Noncurrent assets:		
Restricted cash and cash equivalents	36,007	21,828
Loans and other receivables	5,999	6,805
Endowment investments	35,270	29,007
Other long-term investments	105,138	88,477
Capital assets, net	583,188	568,516
Total noncurrent assets	765,602	714,633
Total assets	1,071,777	999,750
Liabilities		
Current liabilities:		
Accounts payable and accrued expenses	8,269	9,052
Employee withholdings and deposits	14,575	22,729
Compensated absences	12,051	11,095
Deferred revenue	39,266	36,052
Leases payable - current	3,572	3,066
Total current liabilities	77,733	81,994
Noncurrent liabilities:		
Leases payable - noncurrent	21,282	22,694
Other long-term obligations	93,533	70,392
Total noncurrent liabilities	114,815	93,086
Total liabilities	192,548	175,080
Net Assets		
Invested in capital assets, net of related debt	558,334	542,756
Restricted for:		
Nonexpendable		
Scholarships, instruction and other	31,515	26,688
Expendable		
Scholarships, instruction and other	8,597	19,520
Loans	17,073	16,791
Capital projects	39,638	35,186
Unrestricted	224,072	183,729
Total net assets	\$ 879,229	\$ 824,670

See accompanying notes.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Statements of Revenues, Expenses and Changes in Net Assets

June 30, 2011 and 2010

(amounts in thousands)

	<u>2011</u>	<u>2010</u>
Operating revenues		
Student tuition and fees	\$ 245,761	\$ 223,576
Less: Scholarship allowances	<u>(131,226)</u>	<u>(116,567)</u>
Net tuition and fees	114,535	107,009
Federal grants and contracts	50,557	44,117
State and local grants and contracts	39,561	40,563
Nongovernmental grants and contracts	(147)	(33)
Indirect cost recoveries	2,424	1,974
Sales and services	5,291	5,478
Other operating revenues	<u>7,015</u>	<u>3,305</u>
Total operating revenues	219,236	202,413
Operating expenses		
Educational and general:		
Instruction	232,593	237,567
Public service	37,835	36,662
Libraries	7,732	6,688
Academic support	28,151	29,509
Student services	54,748	51,738
Institutional support	79,380	74,317
Operation and maintenance of physical plant	66,330	75,108
Depreciation	28,163	25,122
Student financial aid	<u>139,720</u>	<u>116,289</u>
Total operating expenses	674,652	653,000
Operating loss	(455,416)	(450,587)
Nonoperating revenues (expenses)		
State appropriations	199,156	200,555
Federal and local appropriations	14,541	17,682
Federal and state grants and contracts	249,505	211,794
Gifts	3,655	3,084
Investment income	6,631	9,094
Interest expense - capital debt	(936)	(631)
Other nonoperating revenues / (expenses)	<u>7,963</u>	<u>7,103</u>
Net nonoperating revenues	480,515	448,681
Income (loss) before other revenues, expenses, gains or losses	25,099	(1,906)
Capital construction proceeds from state	23,646	57,131
Net realized loss on disposal of capital assets	(154)	(1,214)
Additions to endowments	<u>5,968</u>	<u>2,625</u>
Total other revenues	29,460	58,542
Increase in net assets	54,559	56,636
Net assets - beginning of year	<u>824,670</u>	<u>768,034</u>
Net assets - end of year	<u>\$ 879,229</u>	<u>\$ 824,670</u>

See accompanying notes.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Statements of Cash Flows

June 30, 2011 and 2010

(amounts in thousands)

	<u>2011</u>	<u>2010</u>
Cash flows from operating activities:		
Tuition and fees	\$ 113,084	\$ 146,990
Grants and contracts	91,009	83,250
Indirect cost recoveries	2,424	1,974
Sales and services	5,291	5,478
Payments to vendors and contractors	(134,952)	(137,478)
Student financial aid	(137,817)	(114,847)
Salaries, wages and benefits	(381,615)	(364,372)
Other receipts	7,412	3,897
Net cash from operating activities	<u>(435,164)</u>	<u>(375,108)</u>
Cash flows from noncapital financing activities:		
State appropriations	199,156	200,555
Federal state and local grants, contracts and appropriations	264,046	229,476
Gifts received for non-capital purposes	4,550	4,142
Other liabilities	23,141	33,182
Other nonoperating receipts	7,963	7,103
Net cash from noncapital financing activities	<u>498,856</u>	<u>474,458</u>
Cash flows from capital and related financing activities:		
Capital appropriations	34,996	45,781
Proceeds from disposal of capital assets	170	63
Purchase of capital assets	(43,159)	(65,766)
Principal paid on leases	(3,622)	(2,639)
Proceeds from leases	2,716	14,073
Interest paid on leases	(936)	(631)
Net cash from capital and related financing activities	<u>(9,835)</u>	<u>(9,119)</u>
Cash flows from investing activities:		
Proceeds from sales and maturities of investments	7,221	281
Interest on investments	5,244	5,553
Purchase of investments	(23,109)	(41,044)
Net cash from investing activities	<u>(10,644)</u>	<u>(35,210)</u>
Net change in cash	43,213	55,021
Cash-beginning of year	260,980	205,959
Cash-end of year	<u>\$ 304,193</u>	<u>\$ 260,980</u>
Reconciliation of net operating loss to net cash from operating activities		
Operating loss	\$ (455,416)	\$ (450,587)
Adjustments to reconcile net operating loss to net cash from operating activities:		
Depreciation expense	28,163	25,122
Increase (decrease) in cash due to change in:		
Notes, loans and accounts receivable, net	(3,230)	29,567
Other assets	86	191
Accounts payable and accrued liabilities	(783)	2,020
Employee withholdings and deposits	(8,154)	9,387
Compensated absences	956	(415)
Deferred revenue	3,214	9,607
Net cash from operating activities	<u>\$ (435,164)</u>	<u>\$ (375,108)</u>

See accompanying notes.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

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 considered whether several organizations for which KCTCS is not financially accountable have met the criteria for inclusion as component units based on the nature and significance of their relationship with KCTCS. 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 Financial Accounting Standards Board (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). 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 \$31.5 million, and with the Commonwealth of Kentucky of \$272.7 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.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

1. Organization and Summary of Significant Accounting Policies (continued)

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.

The *Uniform Prudent Management of Institutional Funds Act (UPMIFA)*, as adopted by the Commonwealth of Kentucky, permits KCTCS to allocate 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 and available, a transfer from the endowment of any prior years' accumulated earnings or net realized gain on sales.

If a donor has not provided specific instructions, state law permits the Board of Regents to authorize for expenditure the net appreciation (realized and unrealized) of the investments of endowment funds. When administering its authority to spend net appreciation, the Board of Regents is required to consider KCTCS's "long- and short- term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions." Any net appreciation that is spent is required to be spent for the purposes for which the endowment was established.

The Board of Regents chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the policy established by the Board of Regents, 5 percent of the average market value of endowment investments at the end of the previous three years has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending policy exceeds the investment income. At June 30, 2011, net appreciation of \$2,774,661 is available to be spent, of which \$2,478,882 is restricted to specific purposes.

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 Statements of Revenues, Expenses and Changes in Net Assets.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

1. Organization and Summary of Significant Accounting Policies (continued)

Loans, Accounts and Pledges Receivable

Accounts receivable consist of tuition and fee charges to students. 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. Pledges receivables are commitments from donors to give stated amounts over a specific future period of time. KCTCS records pledges receivable at the present value of the net realizable amount. Loans receivable from fire districts consist of amounts loaned to volunteer fire departments for the purchase of major equipment and construction of facilities. KCTCS records loans from fire districts at the net realizable amount.

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 Statements of Net Assets and as a component of compensation and benefit expense in the Statements of Revenues, Expenses and Changes in Net Assets.

Deferred Revenue

Deferred revenue 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.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

1. Organization and Summary of Significant Accounting Policies (continued)

Net Assets

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 Statements 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.

Federal Grants and Contracts

Pell Grants, Supplemental Educational Opportunity Grants (SEOG), College Access Program (CAP) Grants and Kentucky Educational Excellence Scholarship (KEES) are considered nonexchange transactions and are recorded as nonoperating revenues in the accompanying financial statements.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

1. Organization and Summary of Significant Accounting Policies (continued)

Operating Activities

KCTCS defines operating activities, as reported on the Statements 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, certain grants, gifts and investment income, are recorded as non-operating revenues.

Income Taxes

KCTCS is an agency and instrumentality of the Commonwealth of Kentucky, pursuant to Kentucky Revised Statutes sections 164.580 through 164.600. Accordingly, KCTCS is generally exempt from federal income taxes as an organization described in Section 115 of the Internal Revenue Code of 1986.

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.

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, fair value of investments, useful lives of capital assets, accrued expenses (vacation, sick, long term disability, postemployment benefits, workers compensation and unemployment) and other liability accounts. Actual results could differ from those estimates.

Recent Accounting Pronouncements

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

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

1. Organization and Summary of Significant Accounting Policies (continued)

Recent Accounting Pronouncements (continued)

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

Subsequent Events

Management has evaluated subsequent events for accounting and disclosure requirements through September 30, 2011, the date that 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.

Reclassifications

Certain reclassifications to fiscal 2010 comparative amounts have been made to conform to the 2011 classifications.

2. Loans, Accounts and Pledges Receivable

Loans, accounts and pledges receivable (net of allowances) as of June 30, 2011 and 2010, are as follows (amounts in thousands):

	<u>2011</u>	<u>2010</u>
Student (net of allowances of \$6,142 and \$5,980)	\$ 10,486	\$ 8,874
Other receivables	710	348
Capital appropriations receivable	-	11,350
Reimbursement receivable – grants and contracts	20,446	18,793
Pledges receivable	1,648	2,543
Accrued interest receivable	2,998	2,679
Bridge loans	503	583
Loans receivable from fire districts	<u>5,339</u>	<u>5,656</u>
Total	42,130	50,826
Current portion	<u>36,131</u>	<u>44,021</u>
Non-current portion	<u>\$ 5,999</u>	<u>\$ 6,805</u>

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

2. Loans, Accounts and Pledges Receivable (continued)

Pledges receivable and loans from fire districts totaling \$1,915,000 and \$5,339,000, respectively, are expected to be collected primarily over the next ten years, as follows (amounts in thousands):

	<u>Pledges Receivable</u>	<u>Loans from Fire Districts</u>
2012	\$ 558	\$ 933
2013	197	846
2014	68	668
2015	40	540
2016	26	500
2017-2021	<u>1,026</u>	<u>1,852</u>
	1,915	5,339
Present value discount	<u>267</u>	<u>-</u>
	<u>\$ 1,648</u>	<u>\$ 5,339</u>

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.

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.

KCTCS had the following investments as of June 30:

<u>Investment Type</u>	<u>Fair Value</u>	
	<u>2011</u>	<u>2010</u>
Bond funds	\$ 112,699	\$ 89,923
Money market funds	364	6,512
Equities and equity funds	26,451	20,350
Other	932	737
	<u>\$ 140,446</u>	<u>\$ 117,522</u>

KCTCS has an investment management agreement with the Commonfund (Fund). The Fund managed \$140.1 million of the investments at June 30, 2011; which consist of funds of funds. The Commonfund was founded in 1971 to serve higher education and not for profit organizations. It currently serves 1,500 organizations and has \$26 billion in assets under management. The Commonfund is unrated.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

3. Investments (continued)

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. KCTCS 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, 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, 2011, 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.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

4. Capital Assets, Net

Capital assets as of June 30, 2011 and 2010 and the changes therein for the years then ended are summarized as follows (in thousands):

Cost	-----2011-----			
	Beginning Balance	Additions	Reductions	Ending Balance
Land	\$ 24,286	\$ 2,841	\$ 22	\$ 27,105
Land improvements	10,155	218	-	10,373
Infrastructure	44,955	-	-	44,955
Buildings and structures	612,034	12,329	248	624,115
Construction in progress	41,984	13,615	-	55,599
Vehicles	7,625	1,121	477	8,269
Equipment, furniture, etc.	85,687	10,713	4,857	91,543
Leasehold improvements	7,080	-	-	7,080
Library materials	55,751	1,883	8	57,626
Energy saving assets	4,983	-	-	4,983
Equine	30	5	25	10
Computer software	1,221	434	245	1,410
Total	<u>895,791</u>	<u>43,159</u>	<u>5,882</u>	<u>933,068</u>
Less accumulated depreciation				
Land improvements	5,097	188	-	5,285
Infrastructure	8,080	1,780	-	9,860
Buildings and structures	203,270	14,546	224	217,592
Vehicles	5,190	975	487	5,678
Equipment, furniture, etc.	47,261	8,156	4,597	50,820
Leasehold improvements	6,238	65	-	6,303
Energy saving assets	1,900	498	-	2,398
Library materials	49,604	1,724	5	51,323
Computer software	635	231	245	621
Total accumulated depreciation	<u>327,275</u>	<u>28,163</u>	<u>5,558</u>	<u>349,880</u>
Capital assets, net	<u>\$ 568,516</u>	<u>\$ 14,996</u>	<u>\$ 324</u>	<u>\$ 583,188</u>
	-----2010-----			
Cost	Beginning Balance	Additions	Reductions	Ending Balance
Land	\$ 23,814	\$ 472	\$ -	\$ 24,286
Land improvements	9,201	954	-	10,155
Infrastructure	41,530	3,425	-	44,955
Buildings and structures	478,412	134,776	1,154	612,034
Construction in progress	133,693	(91,709)	-	41,984
Vehicles	6,806	1,080	261	7,625
Equipment, furniture, etc.	73,809	15,539	3,661	85,687
Leasehold improvements	7,080	-	-	7,080
Library materials	54,522	1,229	-	55,751
Energy saving assets	4,983	-	-	4,983
Equine	35	-	5	30
Computer software	1,221	-	-	1,221
Total	<u>835,106</u>	<u>65,766</u>	<u>5,081</u>	<u>895,791</u>
Less accumulated depreciation				
Land improvements	4,602	495	-	5,097
Infrastructure	8,508	1,807	2,235	8,080
Buildings and structures	188,209	12,992	(2,069)	203,270
Vehicles	4,633	789	232	5,190
Equipment, furniture, etc.	43,740	6,927	3,406	47,261
Leasehold improvements	6,168	70	-	6,238
Energy saving assets	1,402	498	-	1,900
Library materials	48,262	1,342	-	49,604
Computer software	433	202	-	635
Total accumulated depreciation	<u>305,957</u>	<u>25,122</u>	<u>3,804</u>	<u>327,275</u>
Capital assets, net	<u>\$ 529,149</u>	<u>\$ 40,644</u>	<u>\$ 1,277</u>	<u>\$ 568,516</u>

Of the total capital construction projects at June 30, 2011 of \$96,008,000, there is \$40,409,000 remaining to complete the projects.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

5. Deferred Revenue

Deferred revenue as of June 30, 2011 and 2010 is as follows (amounts in thousands):

	<u>2011</u>	<u>2010</u>
Unearned summer and fall tuition revenues	\$ 9,091	\$ 8,568
Grants and contracts	<u>30,175</u>	<u>27,484</u>
	<u>\$ 39,266</u>	<u>\$ 36,052</u>

Included in grants and contracts are monies deferred for the Kentucky Workforce Investment Network System (KY WINS) program.

6. Noncurrent Liabilities

Noncurrent liabilities as of June 30, 2011 and 2010 are summarized as follows (amounts in thousands):

-----2011-----						
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Non Current Portion</u>
Lease obligations						
Capital lease obligations	\$ 25,760	\$ 2,716	\$ 3,622	\$ 24,854	\$ 3,572	\$ 21,282
Total lease obligations	<u>25,760</u>	<u>2,716</u>	<u>3,622</u>	<u>24,854</u>	<u>3,572</u>	<u>21,282</u>
Other liabilities						
Compensated absences	11,095	14,885	13,929	12,051	12,051	-
Long-term disability and post retirement benefits	<u>70,505</u>	<u>23,729</u>	<u>556</u>	<u>93,678</u>	<u>145</u>	<u>93,533</u>
Total other liabilities	<u>81,600</u>	<u>38,614</u>	<u>14,485</u>	<u>105,729</u>	<u>12,196</u>	<u>93,533</u>
Total noncurrent obligations	<u>\$ 107,360</u>	<u>\$ 41,330</u>	<u>\$ 18,107</u>	<u>\$ 130,583</u>	<u>\$ 15,768</u>	<u>\$ 114,815</u>
-----2010-----						
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Reductions</u>	<u>Ending Balance</u>	<u>Current Portion</u>	<u>Non Current Portion</u>
Lease obligations						
Capital lease obligations	\$ 14,326	\$ 14,073	\$ 2,639	\$ 25,760	\$ 3,066	\$ 22,694
Total lease obligations	<u>14,326</u>	<u>14,073</u>	<u>2,639</u>	<u>25,760</u>	<u>3,066</u>	<u>22,694</u>
Other liabilities						
Compensated absences	11,510	12,469	12,884	11,095	11,095	-
Other noncurrent liabilities	460	-	460	-	-	-
Long-term disability and post retirement benefits	<u>37,323</u>	<u>33,182</u>	<u>-</u>	<u>70,505</u>	<u>113</u>	<u>70,392</u>
Total other liabilities	<u>49,293</u>	<u>45,651</u>	<u>13,344</u>	<u>81,600</u>	<u>11,208</u>	<u>70,392</u>
Total noncurrent obligations	<u>\$ 63,619</u>	<u>\$ 59,724</u>	<u>\$ 15,983</u>	<u>\$ 107,360</u>	<u>\$ 14,274</u>	<u>\$ 93,086</u>

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

6. Noncurrent Liabilities (continued)

Capital leases consist of the following leases at June 30, 2011 and 2010 (amounts in thousands):

	<u>2011</u>	<u>2010</u>
Computer equipment capitalized leases, all with 1 to 4 year remaining terms with total annual payments ranging from \$6,368 to \$574,800 and interest rates from 1.24% to 5.31%.	\$ 2,003	\$ 2,682
Four energy savings capitalized leases with 8 to 14 year remaining terms with total annual payments from \$224,633 to \$664,402, and interest rates from 3.66% to 4.65%.	13,760	14,598
One building capitalized lease with monthly payments of \$53,085, interest rate of 4.04% and 13 years remaining.	6,148	6,529
Copier leases, with 1 to 5 year remaining terms with total annual payments ranging from \$738 to \$249,709 and interest rates from 3.33% to 6.88%.	2,801	1,887
Other equipment leases, with 1 to 4 year remaining terms with total annual payments ranging from \$756 to \$34,833 and interest rates from 0% to 5.27%.	<u>142</u>	<u>64</u>
	<u>\$ 24,854</u>	<u>\$ 25,760</u>

Principal maturities and interest on capital leases payable for the next five years and in subsequent five-year periods as of June 30, 2011 are as follows (amounts in thousands):

<u>Fiscal Year</u>	<u>Principal</u>	<u>Interest</u>	<u>Total</u>
2012	\$ 3,572	\$ 1,105	\$ 4,677
2013	2,903	951	3,854
2014	2,293	808	3,101
2015	1,973	685	2,658
2016	1,831	586	2,417
2017-2021	7,698	1,757	9,455
2022-2026	<u>4,584</u>	<u>361</u>	<u>4,945</u>
	<u>\$ 24,854</u>	<u>\$ 6,253</u>	<u>\$ 31,107</u>

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

6. Noncurrent Liabilities (continued)

Operating Leases

KCTCS is obligated under several operating leases for office equipment, classroom space, and office space with expirations through October 2020. Rent expense was \$3,850,000 and \$3,994,000 for 2011 and 2010, respectively. Future minimum lease payments as of June 30, 2011 are as follows (amounts in thousands):

Years ending June 30	
2012	\$1,300
2013	735
2014	417
2015	388
2016	249
Thereafter	196
	<u>\$3,285</u>

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 under contract with the State Fire and Tornado Insurance Fund up to a maximum of \$700,000,000 per occurrence.

The Commonwealth of Kentucky is covered by sovereign immunity. Per KRS 44.073, state institutions of higher education, including KCTCS, under KRS Chapter 164 are considered agencies of the state. As such, KCTCS is covered by the Board of Claims for acts of negligence up to \$200,000 for a single claim and an aggregate of \$350,000 per negligent act. The Board has primary and exclusive jurisdiction over all acts of negligence for state institutions of higher education.

For risks not covered by sovereign immunity, 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 accidents. KCTCS has general liability insurance with an aggregate total limit of \$2,000,000 and a per occurrence limit of \$1,000,000 without a deductible. An umbrella policy extends the liability aggregate total limit to \$10,000,000 with a per occurrence limit of \$10,000,000 without a deductible.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

7. Risk Management (continued)

Educator’s Legal Liability coverage has been secured through commercial insurance to insure KCTCS faculty and staff against claims arising from actions undertaken within the scope of their job responsibilities. This coverage also extends to the KCTCS Board of Regents. The limit is \$2,000,000 without a deductible. There have been no significant reductions in insurance coverage from 2010 to 2011. Settlements have not exceeded insurance coverage during the past three years.

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), are covered under a self-insured long-term disability income program. This program is funded through a trust established by the University of Kentucky and now funded by KCTCS for the purpose of paying claims and establishing necessary reserves. KCTCS reimburses the fund for long-term disability payments made to its employees. The estimated liability for long-term disability claims at June 30, 2011 totals \$2,076,000 of which \$1,931,000 is included in “Other long-term obligations” and \$145,000 is included in “Employee withholdings and deposits”.

8. Natural Classification

The operating expenses for KCTCS by natural classification were as follows for the years ended June 30, 2011 and 2010 (amounts in thousands):

	<u>2011</u>	<u>2010</u>
Salaries and wages	\$ 266,212	\$ 260,400
Student scholarships and financial aid	137,817	114,847
Employee benefits	108,205	112,943
Depreciation	28,163	25,122
Equipment not capitalized	20,436	29,267
Supplies	17,202	16,203
Utilities	15,107	13,156
Professional services	13,808	13,452
Fire commission incentive	11,600	11,589
Repairs and maintenance	10,158	10,644
Fire commission state aid	5,639	5,757
Travel	5,452	5,420
Bad debts	4,330	3,991
Communications	4,255	3,706
Fire commission workers compensation	3,985	3,457
Rental/lease	3,850	3,994
Fire commission pension	3,404	3,369
Advertising	2,167	1,839
Participant support costs	1,917	2,768
Other, various	10,945	11,076
	<u>\$ 674,652</u>	<u>\$ 653,000</u>

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

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 defined contribution 403(b) plan. Employees that choose a defined benefit plan can participate in either *Kentucky Teachers' Retirement System (KTRS)* or *Kentucky Employees' Retirement System (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. Employees hired with an effective date of July 1, 2009 or after who choose the 403(b) plan option of retirement have a five year vesting period (60 months) of continuous service to be eligible to receive the employee's accrued benefits derived from employer contributions. These employees are immediately vested for employee accrued contributions. Other employees already enrolled in the 403(b) plan option prior to July 1, 2009 do not have the vesting period requirement and are vested with employee and employer contributions from the date of initial employment. Employees that have a break in service and are rehired with an effective date of July 1, 2009 or after default to having the five year vesting period (60 months) of continuous service to be eligible to receive the employee's accrued benefits derived from employer contributions from the date of rehire. These employees are immediately vested for employee accrued contributions.

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

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

Regular full-time employees that were employed by antecedent organizations 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. The defined benefit plans, KTRS or KERS, have a 5-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 for 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 of the University of Kentucky Retirement Plan. 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 two retirement plan carriers, as follows:

- Fidelity Institutional Services Company
- Teachers Insurance and Annuity Association/College Retirement Equities Fund (TIAA/CREF)

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

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

9. Pension Plans (continued)

KERS participants hired with an effective date prior to September 1, 2008 contribute 5 percent of their covered compensation; KCTCS contributes 16.98 percent. KERS participants hired with an effective date on or after September 1, 2008 contribute 6 percent of their covered compensation; KCTCS contributes 16.98 percent. KTRS participants hired with an effective date prior to July 1, 2008 contribute 6.33 percent; KCTCS contributes 14.01 percent. KTRS participants hired with an effective date on or after July 1, 2008 contribute 7.16 percent or 10.11 percent, depending on the participant's personnel classification; KCTCS contributes 14.84 percent or 13.36 percent.

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
479 Versailles Road
Frankfort, Kentucky 40601

KCTCS contributions and costs for all of its retirement plans for 2011 and 2010 were \$24,648,000 and \$22,577,000, respectively; the employees contributed \$16,541,000 and \$16,190,000 for 2011 and 2010, respectively. KCTCS' total payroll costs were \$266,212,000 and \$260,400,000 for 2011 and 2010, respectively.

10. Postemployment Benefits

As discussed in Note 9, KCTCS offers a defined contribution 403(b) retirement plan (the Plan). This Plan provides postemployment medical benefits to eligible retirees that were hired with an effective date prior to July 1, 2009. Employees hired or rehired with an effective date of July 1, 2009 or after who choose the defined benefit 403(b) plan option of retirement are not eligible for the postemployment health benefit. The required contribution for eligible employees is based on projected pay-as-you-go financing requirements. KCTCS funds on a cash basis as benefits are paid. No assets have been segregated and restricted to provide postemployment benefits. For fiscal year 2011, KCTCS contributed approximately \$2,261,000 to the Plan.

KCTCS' annual other postemployment benefit (OPEB) cost (expense) is calculated based on the annual required contribution of the employer (ARC), an amount actuarially determined in accordance with the parameters of GASB Statement 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover normal cost each year and amortize any unfunded actuarial liabilities (or funding excess) over a period of thirty years. In June 2010 in order to reduce the term from 30 to 15 years (using July 1, 2007 as the initial effective date for KCTCS when GASB Statement 45 was first applicable) KCTCS recorded a onetime catch-up accrued expense in the amount of approximately \$14.7 million.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

10. Postemployment Benefits (continued)

The following table shows the components of KCTCS's annual OPEB cost for the year, the amount actually contributed to the Plan and the changes in KCTCS's net OPEB obligation for the years ended June 30, 2011 and 2010 (amounts in thousands):

	<u>2011</u>	<u>2010</u>
Annual required contribution	\$ 11,302	\$ 10,644
Interest	1,173	811
Amortization	<u>13,515</u>	<u>8,973</u>
Annual OPEB cost (expense)	25,990	20,428
Contributions made	<u>(2,261)</u>	<u>(1,960)</u>
Increase in net OPEB obligation	23,729	18,468
One time adjustment	-	14,713
Net OPEB obligation, beginning of year	<u>67,872</u>	<u>34,691</u>
Net OPEB obligation, end of year	<u>\$ 91,601</u>	<u>\$ 67,872</u>

The net OPEB obligation is included in other long-term liabilities on the accompanying Statements of Net Assets.

KCTCS' annual OPEB cost, the percentage of annual OPEB cost contributed to the plan and the net OPEB obligation for 2011 and 2010 are as follows (amounts in thousands):

Fiscal Year <u>Ended</u>	Annual <u>OPEB Cost</u>	Percentage of Annual OPEB <u>Cost Contributed</u>	Net OPEB <u>Obligation</u>
June 30, 2011	\$ 25,990	8.7%	\$ 91,601
June 30, 2010	\$ 20,428	9.6%	\$ 67,872

As of June 30, 2011, the plan was not funded. The actuarial accrued liability for benefits for the July 1, 2011 date was \$214,445,748 and the actuarial value of assets was \$0, resulting in an unfunded actuarial accrued liability ("UAAL") of \$214,445,748. The covered payroll (annual payroll of active employees covered by the plan) was \$150,469,663, and the ratio of the UAAL to the covered payroll was 142.5 percent.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Notes to Financial Statements

10. Postemployment Benefits (continued)

Actuarial valuations of an ongoing plan involve estimates of the value of reported amounts and assumptions about the probability of occurrence of events far into the future. Examples include assumptions about future employment, mortality, and the healthcare cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to continual revision as actual results are compared with past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liabilities for benefits.

Projections of benefits for financial reporting purposes are based on the substantive plan (the plan as understood by the employer and the plan members) and include the types of benefits provided at the time of each valuation and the historical pattern of sharing of benefit costs between the employer and plan members to that point. The actuarial methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities and the actuarial value of assets, consistent with the long-term perspective of the calculations.

In the July 1, 2011 actuarial valuation, the projected unit credit method was used. The actuarial assumptions included a 4 percent investment rate of return (net of administrative expenses), which is a blended rate of the expected long-term investment returns on plan assets and on the employer’s own investments calculated based on the funded level of the plan at the valuation date, and an annual healthcare cost trend rate of 8 percent initially, reduced by decrements to an ultimate rate of 4.5 percent after eighteen years. Salaries were assumed to increase at a rate of 3 percent. The UAAL is being amortized as a level percentage of projected payrolls on an open basis. The remaining amortization period at June 30, 2011, was 11 years.

Actuarial Valuation Date	Actuarial Value of Assets	Actuarial Accrued Liability (AAL)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll
July 1, 2011	\$ 0	\$ 214,446	\$ 214,446	0.0%	\$ 150,470	142.5%

11. 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, 2011.

**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 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, 2011, and have issued our report thereon dated September 30, 2011. 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 effectiveness over 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 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 significant deficiency is a deficiency, or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention to those charged with governance.

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

Our consideration of the 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 the internal control that might be significant deficiencies or material weakness. We did not identify any deficiencies in internal control over financial reporting that we consider to be a material weakness, as defined above.

Compliance and Other Matters

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

We noted certain other matters that we have reported to management.

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

September 30, 2011
Lexington, Kentucky

A handwritten signature in black ink that reads "Dean Robert Allen Ford, PLLC". The signature is written in a cursive, flowing style.

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Officers of the KCTCS Board of Regents, KCTCS Board of Regents and KCTCS President's Cabinet

Officers of the KCTCS Board of Regents

Thomas O. Zawacki, Chair
Porter G. Peeples, Sr. Vice Chair
Jackie B. Cecil, Secretary

KCTCS Board of Regents

Richard A. Bean
Elijah Buell, Jr.
Tonya J. Davidson
Danita F. Fisher
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Gail R. Henson, Ph.D.
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C. Ronald James
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Marcia L. Roth
Doris C. Thomas

KCTCS President's Cabinet

Michael B. McCall, Ed.D., President
Jay K. Box, Ed.D.
Timothy R. Burcham, CFRE
Beth R. Hilliard
Gwendolyn G. Joseph, Ph.D.
J. Kenneth Walker

KENTUCKY COMMUNITY AND TECHNICAL COLLEGE SYSTEM

Schedule of Funding Progress for the Retiree Medical Plan

Year ended June 30, 2011

(amounts in thousands)

Actuarial Valuation Date	Actuarial Value of <u>Assets</u>	Actuarial Accrued Liability <u>(AAL)</u>	Unfunded AAL <u>(UAAL)</u>	Funded <u>Ratio</u>	Covered <u>Payroll</u>	UAAL as a Percentage of Covered <u>Payroll</u>
July 1, 2011	\$ 0	\$ 214,446	\$ 214,446	0.0%	\$ 150,470	142.5%

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