VSC
OFFICE OF THE CHANCELLOR
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VERMONT STATE COLLEGES
CASTLETON STATE COLLEGE
COMMUNITY COLLEGE OF VERMONT
JOHNSON STATE COLLEGE
LYNDON STATE COLLEGE
VERMONT TECHNICAL COLLEGE

MEMORANDUM

TO: VSC Audit Committee
Linda Milne, Chair
Michelle Fairbrother
Tim Jerman
Karen Luneau
Martha O'Connor
Gary Moore, *ex officio*

FROM: Tom Robbins, Vice President, Chief Financial Officer Tom
William Reedy, Vice President, General Counsel

DATE: October 16, 2013

SUBJ: Audit Committee Meeting scheduled for October 23, 2013

The Audit Committee of the VSC Board of Trustees will meet from 12:00-2:00 pm in Room 101 at the Chancellor's Office in Montpelier. The VSC Finance & Facilities Committee will follow this meeting.

If you have any questions, I can be reached at (802) 224-3022.

Thank you.

cc: Other Trustees
Council of Presidents
Business Affairs Council
Bradley Kukenberger, State Department of Finance and Management
Douglas Hoffer, State Auditor

Board of Trustees
Audit Committee Meeting

October 23, 2013

AGENDA

A. ITEMS FOR DISCUSSION AND ACTION

1. Minutes of the May 23, 2013 Meeting of the Audit Committee
2. Review and Approval of FY2013 draft Audited Financial Statements and A-133 Report
3. Review O'Connor & Drew Proposal and Discuss Extending Contract through FY2016

B. ITEMS FOR INFORMATION AND DISCUSSION

1. Conduct an Audit Committee Executive Session: Guidelines and Questions
2. Fraud and the Responsibilities of the Government Audit Committee

A. ITEMS FOR DISCUSSION AND ACTION

1. Minutes of the May 23, 2013 Meeting of the Audit Committee

The Audit Committee met on May 23, 2013 in the Stearns Center Performance Space at Johnson State College.

Committee members present: Michelle Fairbrother, Tim Jerman, Karen Luneau, Linda Milne (Chair), Martha O'Connor

Other trustees present: Jerry Diamond, Bill Lippert, Chris Macfarlane

From the Chancellor's Office: Rick Bourassa, Tim Donovan, Annie Howell, Bill Reedy, Tom Robbins, Deb Robinson, Dan Smith, Elaine Sopchak

College Presidents: Joe Bertolino, Phil Conroy, Joyce Judy, Barbara Murphy, Dave Wolk

From the colleges: Scott Dikeman, Wayne Hamilton, Geoff Lindemer, Barbara Martin, Linda Olson, Sharron Scott, Toby Stewart, Julie Theoret

From the Public: Dave Dilulis – O'Connor & Drew, Chris Stenmon – O'Connor & Drew, Steve Vantine – State of Vermont Auditors department.

Chair Milne called the meeting to order at 9:05

A. ITEMS FOR DISCUSSION AND ACTION

1. Minutes of the February 13, 2013Meeting of the Audit Committee
The minutes of the February 13, 2013 meeting were approved.

B. ITEMS FOR INFORMATION AND DISCUSSION

2. Review FY2013 Audit Plan with O'Connor & Drew
Chris Stenmon from O'Connor & Drew (O&D) began with an overview of the audit planning memo. He then reviewed the audit timeline and noted that auditors have already visited the colleges during May for the preliminary FY2013 audit work. He then noted that due to the threshold changing there will be 9 more programs reviewed on the A-133 this year. Chair Milne asked if there were any areas of fraud that the auditors were going to review. Mr. Stenman said that they

review disbursements and the approval process to ensure that VSC policies are being followed consistently. Trustee Lippert asked for a Clery Act update. VSC Counsel Reedy stated that the VSC is working with a law firm to review VSC compliance and modify VSC reporting and compliance as needed.

3. Discuss FY2012 Audit Advisory Comments
CFO Robbins advised the committee that the various finance teams have been working on the FY2012 advisory comments and have put in appropriate procedures. CFO Robbins then reviewed the progress of each comment. Most of the findings and comments were pretty straight forward. He stated that he expected the prior year comments to be resolved for this audit cycle.

4. Discuss FY2013 Internal Audit
CFO Robbins provided an overview of the FY2013 internal audit. The areas of review were; Payroll, Bank Reconciliations, Grant Reporting and ImageNow. Robbins reminded the committee that during FY2012/FY2013 VSC finance staff reviewed where there was exposure to fraud and payroll was at the top of the list. He noted that a lot of work was done during the year with regard to payroll. On a biweekly basis the colleges are sent reports that indicate, by name, any employee whose pay is greater than the prior pay period. This allows the college staff to review and determine if the increases were authorized. Another report lists which employees and/or supervisor did not fill out the electronic timesheet properly. These reports are reviewed with appropriate staff as warranted. Bank reconciliations were reviewed due to audit comments from previous years. The review noted outstanding reconciling items that needed to be reviewed and addressed. Grant Reporting was reviewed and found to be satisfactory with regard to VSC Policy 408. ImageNow is the software deployed across the VSC for scanning and image storage purposes. CFO Robbins said that the ImageNow part of the audit went well, however there were some approval issues that were discovered and subsequently corrected.

Chair Milne adjourned the meeting at 10:12.

2. Review and Approval of FY2013 Draft Audited Financial Statements and A-133 Report

O'Connor & Drew (O&D) will join us to review the draft FY2013 Audited Financial Statements and A-133 Report. Also included in the review will be the Advisory Comments. These documents are enclosed for your review.

The draft FY2013 Financials and A-133 report were submitted to the State of Vermont in draft form on October 13th in order to meet our annual deadline.

The SRECNA shows an increase in Net Assets of $2,731,000. This includes donated software valued at $12M, and related depreciation of that software of -$3M, plus GASB 45 accrual of -$7M. The net of these three items is $2M, mostly accounting for the change in net assets. Operating revenue increased $2M. Operating expenses, adjusted for GASB 45 expense and depreciation of donated software is relatively unchanged from FY2012. Capital appropriations include a one-time appropriation of $2M for the Brattleboro site. Our Unrestricted Net Assets are now negative $15M. This balance includes the cumulative GASB 45 liability of $43M.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

FINANCIAL STATEMENTS

JUNE 30, 2013

DRAFT

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Financial Statements

June 30, 2013 and 2012

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INDEPENDENT AUDITORS' REPORT

To the Board of Trustees of
Vermont State Colleges
Montpelier, Vermont

We have audited the accompanying financial statements of the Vermont State Colleges (a component unit of the State of Vermont) (the "Colleges"), which comprise the statements of net position as of June 30, 2013 and 2012, the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the College's basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

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Auditors' Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards,* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Vermont State Colleges at June 30, 2013 and 2012 and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 3-11 and the schedule of funding progress on page 51 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplemental Information

Our audits were conducted for the purpose of forming an opinion on the financial statements of Vermont State Colleges, taken as a whole. The accompanying schedule of expenditures of Federal awards on page 56 is presented for purposes of additional analysis as required by the U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the basic financial statements. The schedule of expenditures of federal awards have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

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Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated October 23, 2013, on our consideration of Vermont State Colleges' internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. 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 read in conjunction with this report in considering the results of our audits.

Certified Public Accountants
Braintree, Massachusetts

October 23, 2013

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited)

June 30, 2013 and 2012

Introduction

The Management's Discussion and Analysis (MD&A) is required supplemental information due to the Governmental Accounting Standards Board (GASB) reporting model. It is designed to help the reader's understanding of the accompanying financial statements and notes. As this MD&A contains summarized information, tables and graphs, it should be read in conjunction with the accompanying financial statements and notes.

Using the Financial Statements

The following discussion and analysis provides an overview of the financial statements and activities of Vermont State Colleges (VSC) for the year ended June 30, 2013 and selected comparative information for the year ended June 30, 2012. Since this MD&A is designed to focus on current activities, resulting changes and currently known facts, please read in conjunction with the financial statements and notes that follow this section.

VSC's financial reports include three financial statements: the Statements of Net Position, the Statements of Revenues, Expenses and Changes in Net Position and the Statements of Cash Flows. These financial statements have been prepared in accordance with GASB principles. In June 1999, GASB released Statement No. 34, *Basic Financial Statements and Management's Discussion and Analysis*. Changes in Statement No. 34 compared to prior GASB pronouncements require a comprehensive consolidated look at the entity as a whole, as well as capitalization and depreciation of assets. In November 1999, GASB issued Statement No. 35, *Basic Financial Statements and Management's Discussion and Analysis for Public Colleges and Universities*. This essentially applies Statement No. 34 to public colleges and universities. Previously, the financial statements focused on the individual fund groups rather than VSC as a whole.

A brief explanation of each financial statement required by the GASB reporting model follows:

Statement of Net Position (SNP) - this statement accounts for what VSC owns and owes at one point in time. It includes all assets and liabilities of VSC and is therefore the primary statement used to determine financial condition.

Statement of Revenues, Expenses and Changes in Net Position (SRECNP) - this statement aggregates all transactions that have similar characteristics into line items of revenues and expenses. It corresponds to the statement of activities presented by institutions subject to Financial Accounting Standards Board reporting rules.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2013 and 2012

Using the Financial Statements - Continued

Statement of Cash Flows - this statement reports the cash received by and disbursed from VSC during a period of time. The cash flows are segregated into four categories - operating, noncapital financing, capital and related financing, and investing.

Condensed Statement of Net Position

The condensed statement of net position presents the financial position of VSC. This statement shows the assets and liabilities at the end of the fiscal year using the accrual basis of accounting.

Net Position as of June 30:

	2013	2012
Current Assets	**$ 25,134,000**	$ 65,159,000
Non-Current Assets:		
Cash, Long-Term Investments and Deposits with Bond Trustees	**52,058,000**	23,182,000
Capital Assets, Net	**194,505,000**	181,348,000
Other	**16,678,000**	22,986,000
Total Assets	**288,375,000**	292,675,000
Current Liabilities	**22,854,000**	25,549,000
Non-Current Liabilities	**191,360,000**	195,696,000
Total Liabilities	**214,214,000**	221,245,000
Investment in Capital Assets, net	**65,590,000**	51,786,000
Restricted	**23,386,000**	20,639,000
Unrestricted	**(14,813,000)**	(995,000)
Total Net Position	**$ 74,161,000**	$ 71,430,000

Current assets are comprised of cash, accounts receivable, inventories, deposits with bond trustees and prepaid expenses. Cash and equivalents decreased $35,236,000 primarily due to funds being invested in long term investments. Deposits with bond trustees decreased $7,362,000 due to bond funds being disbursed for capital projects. Other assets increased $1,800,000 mostly due to slightly higher software maintenance contracts in prepaid. Changes in accounts receivable and inventories were immaterial.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2013 and 2012

Using the Financial Statements - Continued

Condensed Statement of Net Position - Continued

Non-current assets include cash and equivalents, endowments and other long-term investments, capital assets and notes receivable. Long term investments increased $31,727,000 due to current asset cash being invested during the year. Deposits with bond trustees decreased $2,800,000 due to the 2013 bond refinancing. Fair market values of interest rate swaps decreased $6,206,000 due to the change in the interest rate market. Capital assets, net increased $13,157,000 primarily due to a $12,526,000 software donation to Workforce Development (a subsidiary of Vermont Tech), as well as small capital projects. Changes in notes receivable and other assets were immaterial.

Current liabilities consist of accounts payable and accrued expenses, unearned revenue and deposits, and the current portion of long-term debt. Change in current liabilities was from a decrease of $1,390,000 in accounts payable and accrued expenses and a $1,303,000 decrease in the current term portion of long term debt due to the 2013 bond refinancing. Changes in unearned revenue and deposits were insignificant.

Non-current liabilities consist of accounts payable and accrued expenses, refundable grants, post-employment benefit obligations and the long-term portion of debt. Post-employment benefit obligations increased $7,063,000 due to the annual GASB 45 liability accrual. Fair market value of interest rate swaps decreased $6,206,000 due to a change in short term interest rates. Long term debt decreased $5,323,000 due primarily to annual debt payments.

GASB requires that net position be reported in three net position categories. Investment in capital assets, net represents the historical cost of equipment and property reduced by the corresponding depreciation and related debt outstanding. Restricted net position has two categories: Restricted non-expendable net position are those that are required to be retained in perpetuity. Restricted expendable net position are those funds whose use is subject to externally imposed conditions that can be fulfilled by the actions of VSC or passage of time. Unrestricted net position includes amounts committed or designated to support specific academic programs, capital construction projects and other purposes. Investment in capital assets, net increased $13,804,000 primarily due to a software donation of $12,526,000. Restricted net position increased $2,745,000 primarily due to the increase in the VSC endowment funds. Unrestricted net position decreased $13,834,000 primarily due to recording post-employment benefit obligations of $7,603,000, capital projects of $2,550,000 financed out of unrestricted fund balance, unrealized investments losses of $1,290,000 and loss from operations at a college.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2013 and 2012

Using the Financial Statements - Continued

Condensed Statement of Revenues, Expenses and Changes in Net Position

The condensed statement of revenues, expenses and changes in net position represents the operating results of VSC, as well as the non-operating revenues and expenses. Annual state appropriations are considered non-operating revenues.

	2013	2012
Operating Revenues:		
Tuition and Fees, Net	**$ 91,029,000**	$ 89,751,000
Residence and Dining, Net	**20,652,000**	19,928,000
Grants and Contracts, and Sales and Service Revenue	**20,664,000**	20,638,000
Other	**2,600,000**	1,809,000
Total Operating Revenues	**134,945,000**	132,126,000
Operating Expenses:		
Salaries and Wages	**81,454,000**	79,822,000
Employee Benefits	**35,133,000**	32,960,000
Employee Benefits - GASB 45	**7,063,000**	8,032,000
Scholarships and Fellowships	**8,008,000**	7,909,000
Supplies and Other Services	**42,663,000**	41,899,000
Utilities	**6,926,000**	6,683,000
Depreciation	**13,239,000**	7,624,000
Total Operating Expenses	**194,486,000**	184,929,000
Net Operating Loss	**(59,541,000)**	(52,803,000)
Non-Operating and Other Revenues:		
State Appropriation	**29,991,000**	28,097,000
Non-Operating Federal Grant	**20,797,000**	20,327,000
Gifts	**2,623,000**	2,230,000
Other Non-Operating Revenues and Expenses	**8,861,000**	(3,454,000)
Total Non-Operating and Other Revenues	**62,272,000**	47,200,000
Increase (Decrease) in Net Position	**2,731,000**	(5,603,000)
Net Position, Beginning of Year	**71,430,000**	77,033,000
Net Position, End of Year	**$ 74,161,000**	$ 71,430,000

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2013 and 2012

Using the Financial Statements - Continued

Condensed Statement of Revenues, Expenses and Changes in Net Position - Continued

Tuition and fees, net of regularly provided discounts and scholarship allowances of $22,609,000, increased $1,278,000 or 1% over FY2012 to $91,029,000. This increase was from a combination of increased student enrollment and tuition. Tuition and fees accounts for 67% of total operating revenues. Scholarship allowance increased $1,727,000. Residence and dining, net, which accounts for 15% of total operating revenue increased $723,000. Grants and contracts and other, which account for the remaining 17%, remained relatively unchanged year-on-year.

According to GASB Statement No. 34, State Appropriations are considered non-operating revenue. If they were still considered operating revenue, their contribution thereto would be 16%.

Salaries and employee benefits, excluding GASB 45, increased $3,805,000 or 3% over FY2012 to $116,587,000. This increase was brought about by wage increases and the continued rising cost of health care and other benefits. This expense category clearly represents the largest expense at VSC, comprising 64% of all Operating Expenses. VSC currently employs approximately 2,350 personnel, which includes part-time and full-time faculty, administrative, and professional and technical staff. There are five labor unions representing five units of personnel. Scholarships and fellowships increased slightly. Supplies and other services, which include departmental and operating expenses, increased by $764,000. The increase in utilities reflects increased energy prices compared to the prior year. The significant increase in depreciation reflects the additional depreciation attributable to a software donation.

The increase of $2,000,000 in State Appropriations represents the state funds made available for the VSC to fund the fit up costs of the new academic space in Brattleboro. Non-operating federal grants and gifts had insignificant changes with the prior year. Other non-operating revenues/expenses saw a significant increase of $12,317,000 due primarily to a software donation to VSC.

VERMONT STATE COLLEGES
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Management's Discussion and Analysis (Unaudited) - Continued

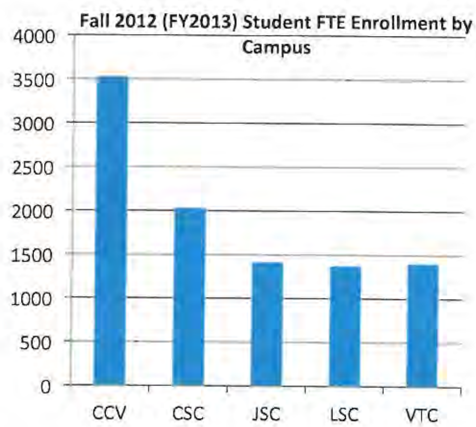
June 30, 2013 and 2012

Student Enrollment

For Fall 2012, the VSC experienced a 2% decline in full time equivalent (FTE) and headcount enrollment. For Fall 2011, the VSC also experienced a 2% decline in FTE and headcount enrollment. On an FTE basis 9,685 were enrolled in Fall 2012 and 9,868 were enrolled in Fall 2011. 12,911 were enrolled on a headcount basis for Fall 2012 while 13,200 were enrolled on a headcount basis for Fall 2011. For Fall 2012, 84% of the student population was full time and 80% were Vermont residents.

FALL STUDENT ENROLLMENTS

	Fall 2012		Fall 2011		Fall 2010		Fall 2009		Fall 2008	
Full Time	10,794	84%	11,020	83%	11,381	84%	11,033	84%	10,167	83%
Part Time	2,117	16%	2,180	17%	2,113	16%	2,137	16%	2,143	17%
Headcount	**12,911**	**100%**	**13,200**	**100%**	**13,494**	**100%**	**13,170**	**100%**	**12,310**	**100%**
In State	7,766	80%	7,894	80%	8,188	81%	7,875	80%	7,237	79%
Out of state	1,919	20%	1,974	20%	1,938	19%	1,957	20%	1,975	21%
Full Time Equivalent	**9,685**	**100%**	**9,868**	**100%**	**10,126**	**100%**	**9,832**	**100%**	**9,212**	**100%**



Fall Student Enrollments - FTE

	% Change Fall 2008 - Fall 2012	Fall 2012	% Change	Fall 2011	% Change	Fall 2010	% Change	Fall 2009	% Change	Fall 2008	% Change
CCV	12.2%	3,520	-4.5%	3,685	-3.3%	3,810	8.9%	3,500	11.6%	3,136	2.3%
CSC	5.3%	2,024	0.5%	2,014	-2.1%	2,058	3.2%	1,995	3.7%	1,923	1.1%
JSC	-5.4%	1,415	-5.2%	1,493	-3.2%	1,543	1.0%	1,528	2.1%	1,496	0.9%
LSC	6.3%	1,374	4.1%	1,320	1.3%	1,303	-5.0%	1,371	6.0%	1,293	-1.3%
VTC	-0.4%	1,401	-0.3%	1,405	-3.4%	1,455	1.5%	1,433	1.9%	1,406	6.4%
	5.2%	9,734	-1.8%	9,917	-2.5%	10,169	3.5%	9,827	6.2%	9,254	1.9%

VERMONT STATE COLLEGES
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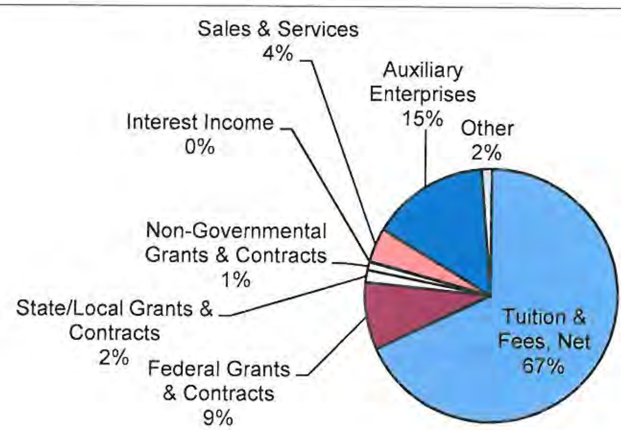
Management's Discussion and Analysis (Unaudited) - Continued

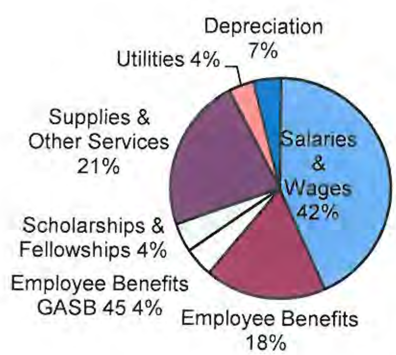
June 30, 2013 and 2012

FY2013 Operating Revenues



VSC receives an annual capital appropriation from the State of Vermont. These appropriations become available for expenditure on July 1 of the fiscal year following the year of appropriation. Capital appropriations for VSC made from the State Bond Funds in fiscal years 2013 and 2012 were $4,099,000 and $2,099,000, respectively.

FY2013 Operating Expenses



VERMONT STATE COLLEGES
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Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2013 and 2012

Capital Assets and Debt Administration

At June 30, 2013, VSC had $194,505,000 invested in Capital Assets, net of Accumulated Depreciation of $129,857,000. Depreciation expense for the current year totaled $13,239,000.

At June 30, 2012, VSC had $181,348,000 invested in Capital Assets, net of Accumulated Depreciation of $116,791,000. Depreciation expense for the 2012 fiscal year totaled $7,625,000.

	2013	2012
Net Capital Assets		
Capital Assets		
Land	**$ 6,428,000**	$ 6,369,000
Infrastructure	**36,441,000**	34,420,000
Buildings and improvements	**240,504,000**	233,344,000
Leasehold improvements	**2,144,000**	350,000
Equipment	**30,854,000**	16,581,000
Construction in Process	**7,991,000**	7,075,000
Total	**324,362,000**	298,139,000
Less: Accumulated Depreciation	**(129,857,000)**	(116,791,000)
Net Capital Assets	**$ 194,505,000**	$ 181,348,000

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VSC has net bonds and notes payable of $134,573,000 that mature from FY2014 through FY2041.

Please see Note 4 for more information.

Economic Factors That Will Affect The Future

Most sources of operating and non-operating revenues increased in FY2013. Vermont continues to experience a demographic decline in the overall number of Vermont high school students. Accordingly, the VSC continues to proactively enhance its recruiting and retention efforts. Because the majority of VSC enrollees are Vermonters, this trend could affect enrollment, although the colleges have adopted programs and strategies to better recruit in a shrinking market. Controlling tuition cost continues to be a top priority for VSC and initiatives are constantly under way to help reduce expenses. Due to the fact that wages and benefits account for a substantial part of expenses, VSC must continually strive to become more efficient in its operations.

VERMONT STATE COLLEGES
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Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2013 and 2012

Economic Factors That Will Affect The Future - Continued

For FY2013, State Operating Appropriations were $25,892,000, or 14%, of total operating and non-operating revenues. VSC continues to rely on this important revenue source from the State of Vermont to help keep tuition as low as possible. For FY2013, in-state tuition increased 4% at Community College of Vermont (CCV), Castleton State College (CSC), Johnson State College (JSC) and Lyndon State College (LSC), and Vermont Technical College (VTC). FY2013 out-of-state tuition increased 4% at CCV, LSC and VTC while increasing 5% at JSC and 7% at CSC. VSC will continue to promote the cause of higher education to the State administration and legislature.

As a result of positive market conditions during FY2013, VSC had net realized and unrealized gains on the endowments.

Approximately 739 of the 1,079 full-time employees at VSC are covered by union contracts. VSC employs approximately 2,350 full and part-time employees.

VSC has contractual commitments for various construction projects currently under way. The funds have been set aside for these projects.

GASB 45, which became effective in FY2008, requires the recognition of the employer costs of medical, prescription, dental and life insurance plans for all eligible employees during the period of their active employment rather than when the benefits are paid during their retirement. Because of VSC's unique early retirement wages benefit for the full-time faculty, VSC must also account for this liability under GASB 45.

The annual cost to VSC is equal to the actuarially calculated costs for the year and a component for the amortization of the unrecognized liability for the plan over a period not to exceed 30 years, less payments made to our self-insurance plan for current retirees.

For financial reporting purposes, an actuarial valuation is required at least biennially for OPEB plans with total eligible employees (active, retirees and beneficiaries) of 200 or more. At each valuation time, the pattern of cost sharing between VSC and the employee as well as certain legal or contractual caps should be considered.

VSC's current actuarial study estimated that the accumulated value of prior benefits liability for the current list of employees, as of July 1, 2011, was approximately $105,578,000 for post-retirement health, dental and life insurance benefits and $12,033,000 for early retirement benefits. The present value of all benefits (past and future obligations) is estimated to be $157,460,000. The VSC has been discussing with its board of trustees and employees about a fair and balanced retirement healthcare package and funding approach that could have the GASB liability fully funded in within ten years.

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VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Statements of Net Position

June 30,

Assets

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	2013	2012
Current Assets:		
Cash and equivalents (Note 2)	**$ 3,446,616**	$ 38,682,802
Accounts receivable, net (Note 3)	**10,804,059**	10,091,212
Inventories	**304,797**	253,839
Deposit with bond trustees (Note 2)	**7,710,558**	15,072,756
Other current assets	**2,868,378**	1,058,338
Total Current Assets	**25,134,408**	65,158,947
Non-current Assets:		
Cash and equivalents (Note 2)	**783,947**	854,558
Long-term investments (Note 2)	**51,274,407**	19,547,377
Deposits with bond trustees (Note 2)	**-**	2,780,101
Notes receivable, net (Note 3)	**5,223,078**	5,207,715
Other assets	**851,136**	969,464
Interest rate swap deferred outflow (Note 4)	**10,603,309**	16,808,535
Capital assets, net (Note 10)	**194,504,801**	181,348,363
Total Non-current Assets	**263,240,678**	227,516,113
Total Assets	**$ 288,375,086**	$ 292,675,060

The accompanying notes are an integral part of these financial statements.

Liabilities and Net Position

	2013	2012
Current Liabilities:		
Accounts payable and accrued liabilities (Note 11)	$ 12,734,330	$ 14,124,206
Unearned revenue and deposits	6,481,816	6,484,210
Current portion of long-term debt (Note 4)	3,637,524	4,940,334
Total Current Liabilities	22,853,670	25,548,750
Non-current Liabilities:		
Accounts payable and accrued liabilities (Note 11)	220,129	92,178
Unearned revenue and deposits	798,016	787,430
Refundable grants	6,049,434	6,058,644
Post-employment benefit obligations (Note 8)	42,753,755	35,690,489
Interest rate swap deferred inflow (Note 4)	10,603,309	16,808,535
Long-term debt, excluding current portion (Note 4)	130,935,970	136,258,923
Total Non-current Liabilities	191,360,613	195,696,199
Total Liabilities	214,214,283	221,244,949
Net Position:		
Investment in capital assets, net	65,590,456	51,786,211
Restricted nonexpendable	15,128,413	14,446,789
Restricted expendable	8,255,108	6,191,758
Unrestricted	(14,813,174)	(994,647)
Total Net Position	74,160,803	71,430,111
Total Liabilities and Net Position	$ 288,375,086	$ 292,675,060

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VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Statements of Revenues, Expenses and Changes in Net Position

For the Years Ended June 30,

	2013	2012
Operating Revenues:		
Tuition and fees	$ 113,637,743	$ 110,632,877
Residence and dining	20,651,576	19,928,368
Less: scholarship allowances	(22,608,571)	(20,881,867)
Net Tuition, Fees, and Residence and Dining Revenue	111,680,748	109,679,378
Federal grants and contracts	12,094,281	11,417,042
State and local grants and contracts	1,696,272	2,034,437
Non-governmental grants and contracts	1,343,831	1,386,443
Interest income	105,440	102,176
Sales and services of educational activities	5,529,267	5,799,595
Other auxiliary enterprises	959,296	661,213
Other operating revenues	1,535,602	1,045,694
Total Operating Revenues	134,944,737	132,125,978
Operating Expenses (Notes 5, 9 and 11):		
Salaries and wages	81,453,823	79,821,981
Employee benefits (Notes 7 and 8)	42,196,246	40,992,260
Scholarships and fellowships	8,007,863	7,908,653
Supplies and other services	42,663,166	41,898,700
Utilities	6,926,313	6,683,132
Depreciation (Note 10)	13,238,072	7,624,758
Total Operating Expenses	194,485,483	184,929,484
Net Operating Loss	(59,540,746)	(52,803,506)
Non-operating Revenues (Expenses):		
State appropriations (Note 6)	25,891,792	25,998,079
Federal grants and contracts	20,797,045	20,327,223
Gifts	2,623,021	2,230,363
Investment income, net of expenses (Note 2)	2,189,117	1,334,768
Interest expense on capital debt (Note 5)	(6,434,642)	(6,397,681)
Other non-operating revenues	853	560,198
Net Non-operating Revenues	45,067,186	44,052,950
Decrease in Net Position Before Other Revenues	(14,473,560)	(8,750,556)
Other Revenues:		
State appropriations for capital expenditures (Note 6)	4,099,241	2,099,484
Capital grants and gifts	12,568,125	58,501
Additions to non-expendable assets	536,886	990,077
Increase (Decrease) in Net Position	2,730,692	(5,602,494)
Net Position, Beginning of Year	71,430,111	77,032,605
Net Position, End of Year	$ 74,160,803	$ 71,430,111

The accompanying notes are an integral part of these financial statements.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Statements of Cash Flows

For the Years Ended June 30,

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	2013	2012
Cash Flows from Operating Activities:		
Tuition and fees	**$ 103,614,930**	$ 102,257,873
Grants and contracts	**14,345,004**	15,471,137
Sales and services of educational activities	**5,529,267**	5,799,595
Auxiliary enterprises	**959,296**	661,213
Interest received	**105,440**	102,176
Payments to suppliers	**(53,004,669)**	(47,473,915)
Payments to employees	**(115,900,598)**	(112,794,155)
Loans issued to students	**(373,109)**	(572,287)
Collection of loan payments	**283,403**	724,929
Other cash receipts	**1,508,967**	1,065,445
Net Cash Applied to Operating Activities	**(42,932,069)**	(34,757,989)
Cash Flows from Non-capital Financing Activities:		
State appropriations	**25,891,792**	25,998,079
Non-operating federal grants	**20,797,045**	20,327,223
Gifts and grants	**2,623,021**	2,230,363
Net Cash Provided by Non-capital Financing Activities	**49,311,858**	48,555,665
Cash Flows from Capital and Related Financing Activities:		
Capital appropriations	**4,099,241**	2,099,484
Capital and non-expendable grants and gifts	**579,281**	1,048,578
Purchase of capital assets	**(13,909,942)**	(28,349,474)
Change in deposits with bond trustee	**10,142,299**	18,815,109
Proceeds from capital debt borrowings	**20,063,889**	-
Payments on capital debt	**(26,689,652)**	(4,341,495)
Interest expense on capital debt	**(6,434,642)**	(6,397,681)
Other receipts	**853**	560,198
Net Cash Applied to Capital and Related Financing Activities	**(12,148,673)**	(16,565,281)

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Statements of Cash Flows - Continued

For the Years Ended June 30,

	2013	2012
Cash Flows from Investing Activities:		
Proceeds from sales and maturities of investments	**$ 41,324,878**	$ 44,490,759
Purchase of investments	**(71,564,092)**	(5,291,666)
Interest and dividends received on investments	**701,301**	1,971,599
Net Cash (Applied to) Provided by Investing Activities	**(29,537,913)**	41,170,692
Net Increase (Decrease) in Cash and Equivalents	**(35,306,797)**	38,403,087
Cash and Equivalents, Beginning of Year	**39,537,360**	1,134,273
Cash and Equivalents, End of Year	**$ 4,230,563**	$ 39,537,360
Reconciliation of Operating Loss to Net Cash Applied to Operating Activities:		
Operating loss	**$ (59,540,746)**	$ (52,803,506)
Adjustments to reconcile operating loss to net cash applied to operating activities:		
Depreciation	**13,238,072**	7,624,758
Bad debts	**126,127**	1,325,564
Net loss on disposal of capital assets	**41,162**	19,751
Changes in assets and liabilities:		
Accounts receivable	**(838,974)**	201,416
Inventories	**(50,958)**	28,659
Other assets	**(1,691,712)**	69,032
Notes receivable	**(15,363)**	152,641
Accounts payable and accrued liabilities	**(1,261,925)**	1,002,212
Unearned revenues, deposits and refundable grants	**(1,018)**	(410,674)
Post-employment benefit obligations	**7,063,266**	8,032,158
Net Cash Applied to Operating Activities	**$ (42,932,069)**	$ (34,757,989)
Non Cash Transactions:		
Equipment provided by capital grants and gifts	**$ 12,525,730**	$ -

The accompanying notes are an integral part of these financial statements.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2013 and 2012

Note 1 - **Summary of Significant Accounting Policies**

Organization

Vermont State Colleges include the following entities: System Office and Services, Community College of Vermont (CCV), Castleton State College (CSC), Johnson State College (JSC), Lyndon State College (LSC), Vermont Technical College (VTC), Vermont Interactive Television (VIT), Allied Health Nursing Program (Allied Health), Vermont Manufacturing Extension Center (VMEC) Small Business Development Center (SBDC), and Vermont Tech Office of Continuing Education and Workforce Development (TED). VIT is an audio-video network bringing instruction and public service events to sites throughout Vermont (currently Bennington, Brattleboro, Johnson, Lyndon, Middlebury, Montpelier, Newport, Randolph Center, Rutland, Springfield, St. Albans, White River and Williston). Budgetary management of VIT is maintained separately.

The accounting policies and procedures used by Vermont State Colleges ("VSC" or the "Colleges") in accounting for and reporting their financial transactions are based on the accrual method of accounting. The significant accounting policies followed by the Colleges are described below.

Basis of Presentation

The accompanying financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America, as prescribed by the Governmental Accounting Standards Board (GASB).

Revenues are recorded when earned and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements have been met. The accompanying statements of activities demonstrate the degree to which the direct expenses of a given function are offset by program revenues. Direct expenses are those that are clearly identifiable within a specific function. Program revenues primarily include charges to students or others who enroll or directly benefit from services that are provided by a particular function. Items not meeting the definition of program revenues are instead reported as general revenues.

The Colleges have determined that they function as a business-type activity, as defined by GASB. The effect of inter-fund activity has been eliminated from these financial statements. The basic financial statements and required supplementary information for general-purpose governments consist of management's discussion and analysis, basic financial statements including the College's discretely presented component units and required supplementary information. The Colleges present the statements of net position, revenues, expenses and changes in net position and cash flows on a combined College-wide basis.

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 1 - **Summary of Significant Accounting Policies - Continued**

Basis of Presentation - Continued
The Colleges' policy is to define operating activities in the statement of revenues, expenses and changes in net position as those that generally result from exchange transactions such as charges for services provided to students and for the purchase of goods and services. Certain other transactions are reported as non-operating activities. These non-operating activities include the Colleges' operating appropriations from the State of Vermont, net investment income, gifts, certain grants and interest expense.

In accordance with VSC's policy pertaining to the expenditure of restricted dollars, unrestricted dollars are spent first, followed by restricted dollars, if appropriate.

Net Position
GASB Statement No. 34 requires that resources be classified for accounting purposes into the following four net position categories:

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

Restricted - nonexpendable: Net position subject to externally imposed conditions that VSC must maintain in perpetuity.

Restricted - expendable: Net position that is subject to externally-imposed conditions that can be fulfilled by the actions of the Colleges or by the passage of time.

Unrestricted: All other categories of net position. Unrestricted net position may be designated by actions of the Colleges' Board of Trustees.

Cash and Equivalents
The Colleges consider all highly liquid debt instruments purchased with an original maturity date of three months or less to be cash equivalents.

Inventories
Inventories are stated at the lower of cost (first-in, first-out retail inventory method) or market and consist of bookstore items.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 1 - **Summary of Significant Accounting Policies - Continued**

Capital Assets
Real estate assets, including improvements, are generally stated at cost. Furnishings and equipment are stated at cost as of date of acquisition or, in the case of gifts, at fair value as of date of donation. In accordance with the Board's capitalization policy, vehicles, equipment and works of art and historical treasures with a unit cost of at least $5,000 are capitalized. Land, building, leasehold and infrastructure improvements with a unit cost of $50,000 or more are capitalized. Software with a unit cost of $500,000 or more is capitalized. Interest cost on debt related to capital assets is capitalized during the construction period and then depreciated over the life of the project. The Colleges' capital assets, with the exception of land and construction in progress are depreciated on a straight-line basis over their estimated useful lives, which range from 3 to 50 years. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend asset lives are not capitalized.

Restricted expendable net position includes certain capital funds appropriated by the State of Vermont to the Vermont Department of Buildings and General Services for the benefit of VSC and unexpended as of fiscal year-end.

Investments
Investments are stated at fair value. Investment securities are exposed to various risks, such as interest rate, market and credit risks. Due to the level of risk associated with certain investment securities, it is possible that changes in the values of the investment securities will occur and that such changes could materially affect the amounts reported in the statement of net position.

Other Significant Accounting Policies
The Colleges' employees are granted vacation and sick leave in varying amounts. In the event of termination, an employee is paid for those accumulated vacation and sick days allowable in accordance with the applicable union contract in force or in the case of non-union personnel, according to State or Colleges policy.

Amounts of vested and accumulated vacation leave are reported as accrued compensation and benefits. Amounts are determined based upon the personal service rates in effect as of the balance sheet date. No liability is recorded for non-vesting accumulating rights to receive vacation and sick pay benefits.

Refundable Grants
Refundable grants consist primarily of the refundable portion of the Federal Perkins and Nursing Student loans.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 1 - **Summary of Significant Accounting Policies - Continued**

Unearned Revenue and Deposits
Deposits and advance payments received for tuition and fees related to certain summer programs and tuition received for the following academic year are reported as unearned revenues.

Student Fees
Student tuition and fees are presented net of scholarships and fellowships applied to students' accounts. Certain other scholarship amounts are paid directly to, or refunded to the student, and they are reflected as expenses.

Bond and Note Issuance Costs, Discounts, and Premiums
Bonds, note issuance costs and underwriter's discounts are amortized on the straight line basis over the life of the respective bond and consist of costs and issuance discounts incurred at the time of issuance. The 1998 bond issuance costs of $158,544, the 2007 capital construction loan issuance costs of $405,221, and the 2013 bond issuance costs of $193,518 are amortized over 20 years. Bond issuance costs of $334,545 and $393,384 in connection with the 2003 and 2010 bond issues, respectively, are amortized over 30 years. Accumulated amortization as of June 30, 2013 and 2012 aggregated $650,058 and $360,243, respectively. The unamortized portion of the issuance costs are included in other assets. Due to the refinancing of the 2003 bond with the 2013 bond, all costs related to the 2003 bond were written-off in fiscal year 2013.

Underwriter's discounts of $164,124 and $420,597 related to the 1998 and 2003 bond issuances are amortized over 20 and 30 years, respectively, and they are included in bonds and notes payable. Accumulated amortization as of June 30, 2013 and 2012 is $584,721 and $276,283, respectively.

VSC incurred bond premiums related to the 2010 and 2013 bonds at the time of the issuance of the bonds. The bond premium for the 2010 of $377,743 is amortized on a straight-line basis over approximately 8.5 years. The bond premium for the 2013 bond of $1,898,889 is amortized over 20 years. Cumulative amortization of the bond premium totals $136,783 and $68,931 as of June 30, 2013 and 2012, respectively. The bond premium is included in bonds and notes payable.

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 1 - **Summary of Significant Accounting Policies - Continued**

Post-Employment Benefits
GASB Statement No. 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions* (GASBS 45), requires governments to account for other post-employment benefits (OPEB), primarily healthcare, on an accrual basis rather than on a pay-as-you-go basis. The effect is the recognition of an actuarially required contribution as an expense on the statement of revenues and expenses when a future retiree earns their postemployment benefits, rather than when they use their postemployment benefit. To the extent that an entity does not fund their actuarially required contribution, a post-employment benefit liability is recognized on the balance sheet over time.

Income Taxes
The Internal Revenue Service has determined that the Colleges are a wholly-owned instrumentality of the State of Vermont, and as such are generally exempt from Federal income tax. However, the Colleges are subject to Federal income tax on unrelated business income.

Grants
The Colleges receive financial assistance from Federal and state agencies in the form of grants and entitlements. Expenditures of funds under these programs require compliance with the grant agreements and are subject to audit by the granting agency.

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

New Governmental Accounting Pronouncements
GASB 65, *Items Previously Reported as Assets and Liabilities,* effective for periods beginning after December 15, 2012, establishes accounting and financial reporting standards for the reclassification of certain assets and liabilities in accordance with GASB 63. Management believes this Statement will require approximately $835,000 of bond issuance costs to be written-off in the next fiscal year.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 1 - **Summary of Significant Accounting Policies - Continued**

New Governmental Accounting Pronouncements - Continued
GASB 66, *Technical Corrections - 2012 - an amendment of GASB Statements 10 and 62,* effective for periods beginning after December 15, 2012, resolves conflicts between recently issued and earlier GASB statements, as well as modifying guidance related to accounting for certain operating leases. Management believes this Statement will not have a material effect on the financial statements.

GASB 68, *Accounting and Financial Reporting for Pensions - an amendment of GASB Statement No. 27* is required for periods beginning after June 15, 2014. The primary objective of this Statement is to improve accounting and financial reporting by state and local governments for pensions. It also improves information provided by state and local governmental employers about financial support for pensions that is provided by other entities. This statement results from a comprehensive review of the effectiveness of existing standards of accounting and financial reporting for pensions with regard to providing decision-useful information, supporting assessments of accountability and interperiod equity, and creating additional transparency. Management is in the process of reviewing this statement and its potential effect upon their financial reporting, but does not expect any material impact.

GASB 69, *Government Combinations and Disposals of Government Operations* is required for periods ending after December 15, 2013. This Statement establishes accounting and financial reporting standards related to government combinations and disposals of government operations. As used in this Statement, the term government combinations includes a variety of transactions referred to as mergers, acquisitions, and transfers of operations. Management is in the process of reviewing this statement and its potential effect upon their financial reporting. It does not expect any material impact.

GASB 70, *Accounting and Financial Reporting for Nonexchange Financial Guarantees,* is required for periods beginning after June 15, 2013. This Statement requires a state or local government guarantor that offers a nonexchange financial guarantee to another organization or government to recognize a liability on its financial statements when it is *more likely than not* that the guarantor will be required to make a payment to the obligation holders under the agreement. Management does not believe this statement will have a material effect on the financial statements.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 1 - **Summary of Significant Accounting Policies - Continued**

Reclassifications
Certain amounts on the 2012 financial statements have been reclassified to conform to the 2013 presentation.

Note 2 - **Cash, Equivalents and Investments**

Cash and equivalents with maturities of 90 days or less from purchase date are recorded at cost, which approximates market value.

In operating a central treasury and investment pool, individual college cash receipts (except the Federal Loan Funds) are deposited in separate collection deposit accounts in the name of VSC. Disbursements are made from other bank accounts that are funded by transfers from the central treasury.

In accordance with the Uniform Prudent Management of Institutional Funds Act, VSC deems all realized and unrealized gains on permanently restricted investments to be temporarily restricted if the income is restricted by the donor. Absent donor restrictions, the Board of Trustees has adopted a spending policy whereby 5% of the lesser of the current market value of investments or the average portfolio value over the last three years is allowed to be drawn down and allocated to operations.

Cash and Equivalents
Cash and equivalents included with non-current assets are restricted primarily for specific programs or to be used to pay for capital construction projects.

At June 30, 2013, the balance of current assets - cash and equivalents consist of approximately $18,000 in petty cash and the remainder deposited in Federal Deposit Insurance Corporation (FDIC) insured banking institutions of approximately $3,429,000 per the accounting records of the Colleges and approximately $5,318,000 per bank records. Of the bank balances, approximately $1,139,000 was covered by Federal depository insurance and approximately $4,179,000 was uninsured and uncollateralized at June 30, 2013.

At June 30, 2013, the balances of non-current assets - cash and equivalents deposited in FDIC insured banking institutions were approximately $784,000 per the accounting records of the Colleges and approximately $777,000 per bank records. Of the bank balances, approximately $269,000 was covered by Federal depository insurance and approximately $508,000 was uninsured and uncollateralized at June 30, 2013.

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VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 2 - **Cash, Equivalents and Investments - Continued**

Cash and Equivalents - Continued

At June 30, 2012, the balance of current assets - cash and equivalents consist of approximately $18,000 in petty cash and the remainder deposited in Federal Deposit Insurance Corporation (FDIC) insured banking institutions of approximately $38,665,000 per the accounting records of the Colleges and approximately $40,105,000 per bank records. As of June 30, 2012, all bank balances were covered under FDIC banking institution insurance coverage and also by a Federal Home Loan Bank Issuance Letter of Credit.

At June 30, 2012, the balance of non-current assets - cash and equivalents deposited in FDIC insured banking institutions were approximately $855,000 per the accounting records of the Colleges and approximately $734,000 per bank records. Of the bank balances, approximately $614,000 was covered by Federal depository insurance and approximately $120,000 was uninsured and uncollateralized at June 30, 2012.

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Investments

Investments of the various funds at June 30, 2013 are as follows:

	Fair Value	Cost
U.S. government bonds	$ 19,451,817	$ 19,543,271
Corporate bonds	13,397,791	13,436,645
Common stock	5,380,913	6,038,616
Mutual funds	10,980,785	9,210,466
Money market	2,063,101	2,063,101
Held by bond trustee	7,710,558	7,710,558
Total investments	$ 58,984,965	$ 58,002,657

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 2 - **Cash, Equivalents and Investments - Continued**

Investments - Continued

Investments of the various funds at June 30, 2012 are as follows:

	Fair Value	Cost
U.S. government bonds	$ 1,388,565	$ 1,313,836
Corporate bonds	2,653,079	2,464,967
Common stock	10,151,569	13,030,696
Mutual funds	4,817,376	2,527,373
Money market	536,788	528,968
Held by bond trustee	17,852,857	17,852,857
Total investments	$ 37,400,234	$ 37,718,697

Investment maturities include deposits held by bond trustee, which are invested in various government securities, corporate bonds, commercial grade paper, and money market accounts. The majority of these funds are related to the 2013 and 2010 bonds, and are held in the bond fund, the reserve fund and the construction fund. Within the bond fund, there is a principal account, an interest account, and a sinking fund account.

2013
Investment Maturities (in years)

Investment Type	Market Value	Less than 1	1-5	6-10	More than 10
Money Market Investments	**$ 2,063,101**	**$ 2,063,101**	**$ -**	**$ -**	**$ -**
Corporate Bonds	**13,397,791**	**2,522,241**	**7,627,180**	**3,207,942**	**40,428**
U.S. Govt. Bonds	**19,451,817**	**8,403,371**	**8,126,577**	**2,921,869**	**-**
Total	**34,912,709**	**12,988,713**	**15,753,757**	**6,129,811**	**40,428**
Other Investments					
Equity Securities and Mutual Funds	**16,361,698**				
Held by Bond Trustee	**7,710,558**				
Total	**$ 58,984,965**				

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 2 - **Cash, Equivalents and Investments - Continued**

Investments - Continued

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		2012 Investment Maturities (in years)			
Investment Type	Market Value	Less than 1	1-5	6-10	More than 10
Money Market Investments	$ 536,788	$ 536,788	$ -	$ -	$ -
Corporate Bonds	2,653,079	245,580	1,103,452	1,276,821	27,226
U.S. Govt. Bonds	1,388,565	402,190	661,350	325,025	-
Total	$ 4,578,432	$ 1,184,558	$ 1,764,802	$ 1,601,846	$ 27,226
Other Investments					
Equity Securities and Mutual Funds	14,968,945				
Held by Bond Trustee	17,852,857				
Total	$ 37,400,234				

Investment income for the years ended June 30, 2013 and 2012 is as follows:

	2013	2012
Interest and dividend income	$ 962,731	$ 1,897,224
Net realized and unrealized gain (losses)	1,386,936	(443,450)
Total investment income	2,349,667	1,453,774
Less: management fees	(160,550)	(119,006)
Investment income, net	$ 2,189,117	$ 1,334,768

Realized gain (loss) is included as a component of investment income. The calculation of realized gains (losses) is independent of the calculation of the net increase (decrease) in the fair value of investments. Realized gains and losses on investments that had been held in more than one fiscal year and sold in the current year may have been recognized as an increase or decrease in the fair value of investments reported in the prior year.

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 2 - **Cash, Equivalents and Investments - Continued**

Investments - Continued
The risk categories for the bond fund holdings held by VSC at June 30, are as follows:

Investment rating*	2013	2012
AAA	$ 19,046,899	$ 153,563
AA+	1,046,992	1,250,179
AA	1,956,037	97,413
AA-	2,242,423	209,167
A+	2,938,966	684,654
A	1,661,660	410,296
A-	1,338,194	79,970
BBB+	124,264	-
BBB	1,326,981	9,810
BBB-	124,460	117,990
BB+	169,470	154,386
BB	152,612	211,083
BB-	198,318	228,088
B+	227,896	135,449
B	179,528	137,172
B-	62,569	103,663
CCC+	52,339	26,598
CCC	-	32,163
	$ 32,849,608	$ 4,041,644

*These ratings are determined by Standard & Poor's, a division of The McGraw-Hill Companies, Inc. All ratings represent the opinions of the research provider and are disclaimed as not representations or guarantees of performance.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 2 - **Cash, Equivalents and Investments - Continued**

Investments - Continued
The applicable risk ratings as defined by Standard & Poor's are as follows:

AAA - An obligation rated 'AAA' has an extremely strong capacity to meet its financial commitments. It is the highest rating given to an obligor.

AA - An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong.

A - An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong.

BBB - An obligation rated 'BBB' exhibits adequate protection parameters. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitment on the obligation.

BB - An obligation rated 'BB' is less vulnerable to non-payment than other speculative issues. However, it faces major ongoing uncertainties or exposure to adverse business, financial or economic conditions, which could lead to the obligor's inadequate capacity to meet its financial commitment on the obligation.

B - An obligation rated 'B' is more vulnerable to nonpayment than obligations rated 'BB', but the obligor currently has the capacity to meet its financial commitment on the obligation. Adverse business, financial, or economical conditions will likely impair the obligor's capacity or willingness to meet its financial commitment on the obligation.

CCC - An obligation rated 'CCC' is currently vulnerable to non-payment, and is dependent upon favorable business, financial and economic conditions for the obligor to meet its financial commitment on the obligation. In the event of adverse business, financial or economic conditions, the obligor is not likely to have the capacity to meet its financial commitment on the obligation.

Plus (+) or minus (-) - The ratings from 'AAA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories.

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VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 3 - **Accounts Receivable, Notes Receivable and Allowance for Bad Debts**

The composition of the Colleges' accounts receivable at June 30, is summarized as follows:

	2013	2012
Student accounts receivable	**$ 6,814,704**	$ 6,836,661
Grants receivable	**3,962,607**	3,156,976
Other receivable	**2,118,655**	1,820,965
Subtotal	**12,895,966**	11,814,602
Allowance for doubtful accounts	**(2,091,907)**	(1,723,390)
Total accounts receivable, net	**$ 10,804,059**	$ 10,091,212

The notes receivable balance in the statement of net assets represents the Perkins notes receivable. It is shown net of an allowance for bad debts of approximately $515,000 and $537,000 at June 30, 2013 and 2012, respectively. This allowance is the aggregate that was reserved for by each college based upon historical bad loan reserve requirements, the net decrease in the allowance of $22,000 in 2013 and the net increase in the allowance of $126,000 in 2012 has been reflected in operating expenses.

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VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities**

Long-term liabilities consist of the following at June 30:

	2013				
	Beginning balances	**Additions**	**Reductions**	**Ending balances**	**Current portion**
Long-term liabilities					
Bonds and notes payable	$ 141,199,257	$ 20,063,889	$ 26,689,652	$ 134,573,494	$ 3,637,524
Fair market value of interest rate swap	16,808,535		6,205,226	10,603,309	-
Net OPEB obligation	35,690,489	12,047,665	4,984,399	42,753,755	-
Accounts payable and accrued liabilities	14,216,384	12,954,459	14,216,384	12,954,459	12,734,330
Unearned revenue and deposits	7,271,640	6,492,402	6,484,210	7,279,832	6,481,816
Refundable grants	6,058,644	-	9,210	6,049,434	-
Total long-term liabilities	$ 221,244,949	$ 51,558,415	$ 58,589,081	$ 214,214,283	$ 22,853,670

	2012				
	Beginning balances	Additions	Reductions	Ending balances	Current portion
Long-term liabilities					
Bonds and notes payable	$ 145,540,752	$ -	$ 4,341,495	$ 141,199,257	$ 4,940,334
Fair market value of interest rate swap	8,029,595	8,778,940	-	16,808,535	-
Net OPEB obligation	27,658,331	12,394,002	4,361,844	35,690,489	-
Accounts payable and accrued liabilities	13,214,172	14,216,384	13,214,172	14,216,384	14,124,206
Unearned revenue and deposits	7,668,336	6,441,848	6,838,544	7,271,640	6,484,210
Refundable grants	6,072,622	-	13,978	6,058,644	-
Total long-term liabilities	$ 208,183,808	$ 41,831,174	$ 28,770,033	$ 221,244,949	$ 25,548,750

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities - Continued**

Bonds and Notes Payable
Outstanding debt is as follows:

	2013	2012
Student Housing and Dining Hall Bonds: (Collateralized by certain dormitory and dining hall facilities).		
6.25% Series A 1977, called in full on 7/1/12.	$ -	$ 315,000
3% Series B 1977, called in full on 7/1/12.	-	60,000
Revenue Bonds, Series 2003:		
2.0% - 4.125% serial bonds aggregating $16,035,000, maturing 2004 through 2018, and 4.75% term bonds of $3,730,000, $4,695,000 and $5,930,000 due July 2023, July 2028 and July 2033, respectively. Interest on the serial bonds accrues semi-annually and is compounded. Interest on the term bond is payable semi-annually on the unpaid balances. Unamortized original issue discount of $308,438 has been netted against this liability at June 30, 2012. The 2003 bonds were refinanced with proceeds from the 2013 bonds.	-	22,861,562
VSC - Capital Construction Projects		
Variable rate (69% of one-month LIBOR plus 3.12%) term loan of $2,750,000 for 20 years with monthly payments of principal and interest due through January 2029; loan has a negative pledge against assets. [4]	**2,359,365**	2,455,623

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities - Continued**

	2013	2012
Bonds and Notes Payable - Continued		
Revenue Bonds, Series 1998:		
4.9% - 5.45% capital appreciation serial bonds aggregating \$5,205,000, maturing 2006 through 2013, and a 5.125% term bond of \$4,850,000. Interest on the capital appreciation serial bonds accrues semi-annually and is compounded. Interest is payable only at maturity.	**\$ 640,000**	\$ 1,360,000
CSC - New Student Housing		
Variable rate (69% of one-month LIBOR plus 1.31%) term loan of \$5,200,000 for 20 years with monthly payments of principal and interest due through December 2025; collateralized by substantially all unrestricted revenue and assets not previously pledged as collateral on other debt.[1,3]	**3,825,850**	4,040,272
VSC - Capital Construction Projects		
Variable rate (69% of the one-month LIBOR plus 1.21%) term loan of \$72,000,000 for 20 years with monthly payments of principal and interest due through May 2028; collateralized by substantially all unrestricted revenue, accounts receivable, contract rights, inventory and machinery and equipment not previously pledged as collateral on other debt.[2, 3]	**67,838,430**	69,252,988

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities - Continued**

	2013	2012
Bonds and Notes Payable - Continued		
Revenue Bonds, Series 2010A:		
3.0% - 4.0% serial bonds aggregating $5,710,000 maturing 2011 through 2018 and a $5,375,000 4.0% term bond due July 2017. Interest on the serial bonds is paid semi-annually on the unpaid balances. Unamortized bond premium of $264,696 and $308,812 has been added to this liability at June 30, 2013 and 2012, respectively.	**$ 9,604,696**	$ 10,588,812
Revenue Bonds, Series 2010B:		
4.751% - 5.101% serial bonds aggregating $3,800,000 maturing 2018 through 2020, and 6.101%, 6.861%, and 7.211% term bonds of $6,255,000, $5,580,000, and $14,630,000 due July 2025, July 2030, and July 2040, respectively. Interest on the term bond is payable semi-annually on the unpaid balances.	**30,265,000**	30,265,000
Revenue Bonds, Series 2013:		
4.0% - 5.0% serial bonds aggregating $13,715,000 maturing 2015 through 2032 and 3.125% - 5.0% term bonds aggregating $4,450,000 maturing 2027 through 2030. Interest on serial bonds is paid semi-annually on the unpaid balances. Unamortized bond premium of $1,875,153 has been added to the liability at June 30, 2013.	**20,040,153**	-
	$ 134,573,494	$ 141,199,257

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities - Continued**

Bonds and Notes Payable - Continued
In December 2010, VSC issued Revenue Bonds, Series 2010A, in the principal amount of $11,085,000. The 2010A Bonds were issued for the purpose of (1) refinancing a portion of the Series 1998 Bonds; (2) refinancing certain indebtedness of VSC including loans to improve the Blair Park, Williston, Randolph, and Vermont campuses of VSC; and (3) paying the costs of issuance of the 2010A bonds.

In December 2010, VSC issued Federally Taxable Build America Bonds, Series 2010B, in the principal amount of $30,265,000. The 2010B Bonds were issued for the purpose of (1) financing certain upgrades to the Community College of Vermont's Montpelier campus, including a 12,000 square foot building addition; (2) constructing a new residence hall and other related improvements at Castleton State College; (3) renovating an academic building and a visual arts center at Johnson State College; (4) expanding parking facilities at Lyndon State College together with building improvements for Lyndon State College's journalism program; (5) financing library renovations, the installation of certain energy or heating systems, construction of additional on-campus housing at the Randolph campus of Vermont Technical College ("VTC"), and improvements at VTC's Blair Park, Williston, Vermont campus; and (6) paying the costs of issuance of the 2010B bonds. VSC is expected to receive a 35% subsidy of the interest paid on the Series 2010B Build America Bonds from the Federal government, which will be recorded as a reduction of bond interest expense. (Sequester for Federal budget reduced subsidy of interest by 7.6%).

In October 2003, VSC issued Revenue Bonds, Series 2003, in the principal amount of $30,390,000. The 2003 Bonds were issued for the purposes of (1) paying the costs of constructing new dormitories at CSC and LSC and a new teaching facility for CCV in Wilder, Vermont; (2) the current refunding of the Series 1993 Bonds - at a lower interest rate; (3) paying a portion of the interest accruing on the 2003 Bonds through September 2004; (4) funding the Reserve Fund; and (5) paying the costs of issuance of the 2003 bonds.

VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities - Continued**

Bonds and Notes Payable - Continued

[1] To manage its borrowing costs, VSC entered into an interest swap in connection with its $5,200,000 variable-rate loan. The intention of the swap was to effectively change the variable interest rate on the loan to a synthetic fixed rate of 4.97%.

The loan and the related swap agreement mature on December 16, 2025, and the swap's notional amount of $5,200,000 matches the $5,200,000 variable rate loan. The swap was entered into at the same time the loan was issued in December 2005. Under the swap, VSC pays the counterparty a fixed payment of 4.97% and receives a variable payment computed as 69% of the one-month London Interbank Offered Rate (LIBOR) plus 1.31%. Because of interest rate fluctuations since execution of the swap, the swap had a negative fair value of $519,533 as of June 30, 2013 and $742,408 as of June 30, 2012.

[2] To manage its borrowing costs, VSC entered into an interest rate swap in connection with its $72,000,000 variable-rate loan. The intention of the swap was to effectively change VSC's variable interest rate on the loan to a synthetic fixed rate of 4.63%.

The loan and the related swap agreement mature in May 2028, and the swap's notional amount of $72,000,000 matches the $72,000,000 variable rate loan. The swap was entered into at the same time the loan was issued in May 2008. Under the swap, VSC pays the counterparty a fixed payment of 4.63% and receives a variable payment computed as 69% of the one-month USD-LIBOR-BBA (United States Dollar - London Interbank Offered Rate - British Bankers Association) plus 1.21%.

The loan has a thirty year amortization with a twenty year term. The first two years of the loan are interest only payments. This will allow VSC to more closely match the revenue streams produced by the capital projects. Because of interest rate fluctuations since execution of the swap, the swap had a negative fair value of $10,017,328 as of June 30, 2013 and $15,876,742 as of June 30, 2012.

VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities - Continued**

Bonds and Notes Payable - Continued

[3] A former member of senior management also serves on the Board of the lender. Therefore, once the Board approved the capital construction projects, he recused himself completely from all financing proposal reviews, negotiations, financing or banking discussions or decisions relating to these transactions.

[4] To manage its borrowing costs, VSC entered into an interest rate swap in connection with its $2,750,000 variable-rate loan. The intention of the swap was to effectively change the variable interest rate on the loan to a synthetic fixed rate of 5.25%.

The loan and the related swap agreement mature on January 15, 2029, and the swap's notional amount of $2,750,000 matches the $2,750,000 variable rate loan. The swap was entered into at the same time the loan was issued in January 2009. Under the swap, VSC pays the counterparty a fixed payment of 2.25% and receives a variable payment computed as 69% of the one-month LIBOR plus 3.12%. Because of interest rate fluctuations since execution of the swap, the swap had a negative fair value of $66,448 and $189,385 as of June 30, 2013 and 2012, respectively.

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VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities - Continued**

Debt Roll-forward

Long-term debt activity for the years ended June 30, 2013 and 2012 was as follows:

	Balance June 30, 2012	Additions	Repayments	Balance June 30, 2013	Current Portion
Series 1977-A	$ 315,000	$ -	$ (315,000)	$ -	$ -
Series 1977-B	60,000	-	(60,000)	-	-
Series 1998 with accreted interest	1,360,000	-	(720,000)	640,000	640,000
Series 1998 original issue discount	-	-	-	-	-
Series 1998 Bond	1,360,000	-	(720,000)	640,000	640,000
Series 2003	23,170,000	-	(23,170,000)	-	-
Series 2003 original issue discount	(308,438)	-	308,438	-	-
Series 2003 Bond	22,861,562	-	(22,861,562)	-	-
New Housing - CSC	4,040,272	-	(214,422)	3,825,850	225,510
TD Banknorth - FY 2008 Capital Projects	69,252,988	-	(1,414,558)	67,838,430	1,481,613
CCV Montpelier	2,455,623	-	(96,258)	2,359,365	101,341
Series 2010-A	10,280,000	-	(940,000)	9,340,000	1,050,000
Series 2010-B	30,265,000	-	-	30,265,000	-
Series 2010 Bond Premium	308,812	-	(44,116)	264,696	44,116
Series 2010 Bonds	40,853,812	-	(984,116)	39,869,696	1,094,116
Series 2013	-	18,165,000	-	18,165,000	-
Series 2013 Bond Premium	-	1,898,889	(23,736)	1,875,153	94,944
Series 2013 Bonds	-	20,063,889	(23,736)	20,040,153	94,944
Total bonds and notes payable	$ 141,199,257	$ 20,063,889	$ (26,689,652)	$ 134,573,494	$ 3,637,524

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VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities - Continued**

Debt Roll-forward - Continued

	Balance June 30, 2011	Additions	Repayments	Balance June 30, 2012	Current Portion
Series 1977-A	$ 375,000	$ -	$ (60,000)	$ 315,000	$ 315,000
Series 1977-B	79,000	-	(19,000)	60,000	60,000
Aramark Dining Renovation - LSC	32,353	-	(32,353)	-	-
Aramark Dining Renovation - VTC	40,000	-	(40,000)	-	-
Series 1998 with accreted interest	1,977,393	-	(617,393)	1,360,000	720,000
Series 1998 original issue discount	(8,206)	-	8,206	-	-
Series 1998 Bond	1,969,187	-	(609,187)	1,360,000	720,000
Series 2003	24,270,000	-	(1,100,000)	23,170,000	1,150,000
Series 2003 original issue discount	(322,458)	-	14,020	(308,438)	(14,020)
Series 2003 Bond	23,947,542	-	(1,085,980)	22,861,562	1,135,980
New Housing - CSC	4,244,152	-	(203,880)	4,040,272	214,422
TD Banknorth - FY 2008 Capital Projects	70,603,537	-	(1,350,549)	69,252,988	1,414,558
CCV Montpelier	2,547,053	-	(91,430)	2,455,623	96,258
Series 2010-A	11,085,000	-	(805,000)	10,280,000	940,000
Series 2010-B	30,265,000	-	-	30,265,000	-
Series 2010 Bond Premium	352,928	-	(44,116)	308,812	44,116
Series 2010 Bonds	41,702,928	-	(849,116)	40,853,812	984,116
Total bonds and notes payable	$ 145,540,752	$ -	$ (4,341,495)	$ 141,199,257	$ 4,940,334

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VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 4 - **Long-Term Liabilities - Continued**

Debt Roll-forward - Continued

Maturities of long-term debt for the next five fiscal years and thereafter are as follows:

Years Ending June 30,	Principal Amount	Interest Amount
2014	$ 3,637,524	$ 5,744,938
2015	3,759,760	5,790,534
2016	4,661,213	5,621,323
2017	5,422,083	5,400,278
2018	5,647,584	5,167,648
2019-2023	24,387,395	22,620,237
2024-2028	62,786,711	16,723,192
2029-2033	12,036,224	4,432,960
2034-2038	7,095,000	2,164,969
2039-2041	5,140,000	386,159
	$ 134,573,494	$ 74,052,238

The interest amounts above reflect the 4.63%, 4.97% and 5.25% fixed rates on the debt subject to the swap agreements previously described (and interest rebate on 2010 bond).

According to the terms of the agreements under which the revenue bonds were sold, the bonds are general obligations of VSC. The 2013, 2010 and 1998 Revenue Bonds are also collateralized by deposits held by the trustee in the Bond Fund. VSC is required to make payments to the trustee for deposit into the Bond Fund sufficient to pay the principal, interest and sinking fund requirements, when due.

VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 5 - **Functional Expense Classification**

The following table details VSC's operating and interest expenses by functional expense classification:

	2013	2012
Instruction	**$ 58,112,105**	$ 56,469,539
Research	**39,554**	24,171
Public service	**10,538,004**	10,222,554
Academic support	**22,637,181**	21,457,422
Student services	**30,514,111**	27,544,121
Institutional support	**45,798,431**	43,418,623
Physical plant	**5,000,441**	9,178,137
Student financial support	**8,607,584**	8,990,159
Depreciation	**13,238,072**	7,624,758
Total	**$ 194,485,483**	$ 184,929,484

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Note 6 - **Appropriations**

VSC's operating appropriation from the State of Vermont is made directly to the Colleges and is drawn down on the basis of a monthly allotment. Included in the annual state appropriation for operations is funding for Allied Health of approximately $1,117,000 in 2013 and 2012; VMEC of approximately $428,000 in 2013 and 2012; and VIT of approximately $786,000 in 2013 and 2012.

Capital appropriations for VSC made from the State Bond Funds were approximately $4,099,000 and $2,099,000 in fiscal years 2013 and 2012, respectively.

VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 7 - **Retirement Plans**

Eligible faculty and staff participate in a defined contribution retirement plan administered by Teachers Insurance Annuity Association and College Retirement Equities Fund (TIAA-CREF). For the years ended June 30, 2013 and 2012, the Colleges' total payroll expense was approximately $81,454,000 and $79,822,000, respectively, of which approximately $52,914,000 and $51,963,000 represented salaries and wages of employees covered under the defined contribution plan, respectively. The Colleges' requirements to contribute to the retirement plan are specified by four collective bargaining agreements and by personnel policies for nonrepresented employees. Employer contribution rates are established by employee category. There are no required employee contributions to the plan. Depending upon position category, employees may be eligible for the plan from as early as date of hire to as long as two years from date of hire. All eligible employees are vested from the date of eligibility. During the years ended June 30, 2013 and 2012, contributions made by the Colleges under this plan totaled approximately $6,251,000 and $6,133,000, or approximately 11.81% and 11.80% of covered salaries, respectively.

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Additionally, certain employees participate in one of two defined benefit plans (Vermont Employees Retirement System or Vermont State Teachers Retirement System). Employees who were participants in either of these plans prior to their employment by the Colleges are allowed to continue participation. Covered salaries for employees participating in the Vermont Employees Retirement System during the year ended June 30, 2013 and 2012 were approximately $61,500 and $62,500 and employer contributions were approximately $6,000 and $6,100, respectively. There were no contributions to the Vermont State Teachers Retirement System during 2013 and 2012.

In addition, full-time faculty employees who have worked for the Colleges for 15 years may elect early retirement at age 55 and receive 50% of their annual salary as of their retirement date; full-time faculty employees who have worked for VSC for ten years may elect early retirement at age 55 and receive 40% of their annual salary as of their retirement date. In addition, VSC will pay 12% of the retiree's early retirement wages to the individual. This 12% payment represents VSC's contribution, which would have been made to the individual TIAA/CREF pension account. The payments due under this program are funded by VSC as needed. During the years ended June 30, 2013 and 2012, the contributions for these benefits were approximately $1,313,000 and $1,417,000, respectively.

VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 7 - **Retirement Plans - Continued**

The early retirement benefit is no longer being offered to new hires, but those employees who were eligible for early retirement before the benefit was discontinued have the option of electing for early retirement in October of every year. The benefit will be completely phased out when those employees currently eligible for early retirement either elect for early retirement or reach the age of 65.

Note 8 - **Post-Employment Benefits Other Than Pension**

Plan Description: VSC administers a self-insured single-employer defined benefit healthcare plan. The plan provides lifetime healthcare payments for eligible employees, spouses or civil union partners. The self-insured plan, administered by CIGNA, covers both active and retired members. Benefit provisions are established through negotiations between VSC and the unions representing VSC employees and reviewed during the bargaining period prior to the termination date of each union contract. The retiree healthcare plan does not issue a publicly available financial report. During the years ended June 30, 2013 and 2012, 470 and 440 retirees were receiving post-retirement benefits, respectively.

Funding Policy: Contribution requirements are also negotiated between VSC and union representatives. VSC contributes 100% of the current-year utilization costs for eligible employees, spouses or civil union partners. For the fiscal years 2013 and 2012, VSC recognized employer contributions of $4,984,399 and $4,548,286, respectively, for both healthcare and early retirement. The plan is financed on a pay-as-you-go basis. In fiscal years 2013 and 2012, there were no member contributions.

Annual OPEB Cost and Net OPEB Obligation: VSC's OPEB cost (expense) is calculated based on the annual required contribution of the employer (ARC). VSC has elected to calculate the ARC and related information using the unit credit actuarial cost method permitted by GASB Statement No. 45. The ARC represents a level of funding that, if paid on an ongoing basis, is projected to cover estimated utilization of healthcare and the special early retirement payments each year and to amortize any unfunded actuarial liabilities over a period not to exceed thirty years for healthcare and not to exceed ten years for early retirement using a closed period, level dollar amortization method.

VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 8 - **Post-Employment Benefits Other Than Pension - Continued**

The following table shows the components of VSC's annual OPEB costs for the years ended June 30, 2013 and 2012, and the changes in VSC's net OPEB obligation to the Retiree Health and Early Retirement Plans:

	2013	2012
Annual required contribution	**$ 13,262,000**	$ 13,262,000
Interest on net OPEB obligation	**1,338,393**	1,044,179
Adjustment to annual required contribution	**(2,552,728)**	(1,725,735)
Annual OPEB cost	**12,047,665**	12,580,444
Contribution made	**(4,984,399)**	(4,548,286)
Increase in net OPEB obligation	**7,063,266**	8,032,158
Net OPEB obligation - Beginning of year	**35,690,489**	27,658,331
Net OPEB obligation - End of year	**$ 42,753,755**	$ 35,690,489

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VSC's annual OPEB cost, the percentage of annual OPEB cost contributed to the plan, and the net OPEB obligation as of and for the years ended June 30, 2013, 2012 and 2011 are as follows:

Fiscal Year Ended	Annual OPEB Cost	% of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2013	$ 12,047,665	41.4%	$ 42,753,755
June 30, 2012	$ 12,580,444	36.2%	$ 35,690,489
June 30, 2011	$ 10,070,405	41.0%	$ 27,658,331

VERMONT STATE COLLEGES
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Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 8 - **Post-Employment Benefits Other Than Pension - Continued**

Funding Status and Funding Progress: As of the most recent actuarial valuation date, the actuarial accrued liability for benefits was $117,611,000, all of which was unfunded. The annual covered payroll (annual payroll of active employees covered by the plan) was $52,025,735 and the ratio of the unfunded actuarial liability to annual covered payroll was 226.1%. The latest actuarial valuation date was on July 1, 2011.

The projection of future benefit payments for an ongoing plan involves 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, retirement rates, marital status, and the health care cost trend. Amounts determined regarding the funded status of the plan and the annual required contributions of the employer are subject to revision as actual results are compared with past expectations and new estimates are made about the future.

Methods and Assumptions: 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 specified pattern of sharing of benefit costs between employer and plan members to that point. The methods and assumptions used include techniques that are designed to reduce the effects of short-term volatility in actuarial accrued liabilities consistent with the long-term perspective of the calculations.

The following actuarial assumptions were made:

Discount Rate: The discount rate used in the calculation was 3.75%.

Projected Salary Increase Rate: The projected salary increase rate used was 4.5%.

Future Employment: Age related turnover rates were developed based on the experience from the years ended June 30, 2005 through 2009. These rates were used as the basis for assigning active members a probability of remaining employed until the assumed retirement age and for developing an expected future working lifetime assumption for purposes of allocating to periods the present value of total benefits to be paid.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 8 - **Post-Employment Benefits Other Than Pension - Continued**

Mortality: Life expectancies were based on the RP2000 mortality table by gender and status (active versus current retired) published by the Retirement Plans Experience Committee of the Society of Actuaries.

Retirement Rate: Age related retirement rates tables were developed based on input and analysis of the current retiree population overall and the new retirees over the last five years. The age related tables assumed rates of retirement beginning at age 55.

Marital Status: Marital status of member at the calculation date was assumed to be 70% married based on current retiree population. Spousal participation was assumed to be 95% at the calculation date.

Healthcare Cost Trend Rate: The expected rate of increase in healthcare claims was assumed to be 8% for the first year for pre-65 claims and for post-65 claims. This rate was assumed to decrease at 1% per year to an ultimate rate of 5% and remain level at 5% thereafter.

The required schedule of funding progress immediately following the notes to the financial statements presents information related to the actuarial accrued liability for benefits. Pursuant to the requirements of GASB Statement No. 45, this schedule will present multi-year trend information in future years about whether the actuarial accrued liability for benefits is increasing or decreasing over time.

Note 9 - **Leases**

The Colleges have various operating leases for classrooms, office space, equipment and motor vehicles. The majority of these leases have terms equal to or less than ten years and in some cases contain escalation and maintenance clauses, as well as renewal options. Total rental expense for all operating leases was approximately $2,707,000 and $2,494,000 in 2013 and 2012, respectively.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 9 - **Leases - Continued**

Future minimum rental payments required under operating leases with noncancelable terms in excess of one year at June 30, 2013 are as follows:

Years Ending June 30,	Real Estate	Vehicles and Equipment	Total
2014	$ 2,242,565	$ 213,800	$ 2,456,365
2015	1,555,256	192,570	1,747,826
2016	1,300,456	130,740	1,431,196
2017	1,309,744	7,829	1,317,573
2018	1,309,734	1,089	1,310,823
2019 and beyond	13,106,995	-	13,106,995
	$ 20,824,750	$ 546,028	$ 21,370,778

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Note 10 - **Capital Assets**

Property and equipment activity for the years ended June 30, 2013 and 2012 is summarized below:

	Balance June 30, 2012	Additions	Transfers	Retirements	Balance June 30, 2013
Land	$ 6,368,565	$ 59,709	$ -	$ -	$ 6,428,274
Construction-in-process	7,075,650	11,222,383	(10,307,407)	-	7,990,626
Subtotal - Capital assets not depreciated	13,444,215	11,282,092	(10,307,407)	-	14,418,900
Infrastructure	34,420,140	113,824	1,906,604	-	36,440,568
Buildings and improvements	233,344,436	728,707	6,431,069	-	240,504,212
Leasehold improvements	349,821	-	1,913,679	(119,476)	2,144,024
Equipment	16,581,175	14,311,049	56,055	(94,505)	30,853,774
Subtotal - Capital assets depreciated	284,695,572	15,153,580	10,307,407	(213,981)	309,942,578
Less accumulated depreciation	(116,791,424)	(13,238,072)	-	172,819	(129,856,677)
Capital assets, net	$ 181,348,363	$ 13,197,600	$ -	$ (41,162)	$ 194,504,801

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 10 - **Capital Assets - Continued**

	Balance June 30, 2011	Additions	Transfers	Retirements	Balance June 30, 2012
Land	$ 5,712,848	$ -	$ 655,717	$ -	$ 6,368,565
Construction-in-process	7,214,193	23,511,920	(23,650,463)	-	7,075,650
Subtotal - Capital assets not depreciated	12,927,041	23,511,920	(22,994,746)	-	13,444,215
Infrastructure	32,877,703	1,607,060	(64,623)	-	34,420,140
Buildings and improvements	209,933,450	902,042	23,008,389	(499,445)	233,344,436
Leasehold improvements	298,841	-	50,980	-	349,821
Equipment	14,459,891	2,328,452	-	(207,168)	16,581,175
Subtotal - Capital assets depreciated	257,569,885	4,837,554	22,994,746	(706,613)	284,695,572
Less accumulated depreciation	(109,853,528)	(7,624,758)	-	686,862	(116,791,424)
Capital assets, net	$ 160,643,398	$ 20,724,716	$ -	$ (19,751)	$ 181,348,363

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Included in construction-in-process is interest expense of borrowing during the construction period. Totals for the fiscal year 2013 and 2012 are $4,641 and $109,530, respectively.

Note 11 - **Contingencies and Commitments**

Contingencies

VSC participates in various Federally funded programs. These programs are subject to financial and compliance audits and resolution of identified questioned costs. The amount, if any, of expenditures which may be disallowed by the granting agency cannot be determined at this time.

VSC is involved in various claims and legal actions arising in the ordinary course of business. The ultimate disposition of these matters is indeterminable, but in the opinion of management, the amount of ultimate liability would not have a significant impact on VSC's financial condition.

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 11 - **Contingencies and Commitments - Continued**

Contingencies - Continued

VSC is also 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. VSC manages these risks through a combination of commercial insurance packages purchased in the name of VSC, and through self-insurance for medical and dental claims. VSC has entered into contracts with a third-party claims administrator, which essentially caps medical claim costs (stop-loss) at an agreed-upon level. Individual stop-loss is $150,000 of paid claims per covered member per year. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. Reserves for medical and dental claims are included in accrued liabilities in the amount of approximately $1,537,000 at June 30, 2013 and $1,544,000 at June 30, 2012 and are based on historical data. A medical and dental claim roll-forward is presented below:

	2013	2012
Medical and dental claims reserve, Beginning of year	$ **1,544,000**	$ 1,265,000
Incurred claims	**15,162,000**	14,332,000
Payments on claims	**(15,169,000)**	(14,053,000)
Medical and dental claims reserve, End of year	$ **1,537,000**	$ 1,544,000

VSC self-insures its workers' compensation program. Contributions to the plan are based on estimated payroll and rates adjusted by an experience modification factor. VSC has purchased stop-loss insurance, which is effective for aggregate claims in excess of $896,400 per year. VSC has obtained a letter of credit in the amount of $450,000 to be used in the event of failure to pay premiums on the stop-loss policy. This is collateralized by a certificate of deposit. A workers' compensation roll-forward is presented below:

	2013	2012
Workers' compensation reserve, Beginning of year	$ **229,000**	$ 203,000
Workers' compensation accrued during the year	**341,000**	430,000
Claims paid/reserved/claims administration	**(364,000)**	(404,000)
Workers' compensation reserve, End of year	$ **206,000**	$ 229,000

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to the Financial Statements - Continued

June 30, 2013 and 2012

Note 11 - **Contingencies and Commitments - Continued**

Commitments
VSC has entered into various construction contracts. The following commitments are ongoing projects at June 30, 2013.

Project	Expended through June 30, 2013	Committed Future Costs	Total Committed Costs of Project
VSC Brattleboro Facility	$ 15,208	$ 59,792	$ 75,000
CSC Huden Renovation	421,395	1,273,782	1,695,177
CSC Tennis Court Project	507,072	110,803	617,875
JSC Martinette Window Replacement	78,912	47,079	125,991
LSC Masterplan	57,797	53,923	111,720
VTC Bio-digester Project	1,550,756	1,900,994	3,451,750
	$ 2,631,140	$ 3,446,373	$ 6,077,513

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At June 30, 2013, invoices related to construction projects of approximately $1,034,000 were included in accounts payable.

Employment Contracts
The Colleges have employment contracts with certain officers that expire on various dates through fiscal years 2014 and 2015. The agreements provide for aggregate annual base salaries of $1,417,384 in fiscal year 2014 and $1,325,584 in fiscal year 2015 and may be terminated with cause at any time.

REQUIRED SUPPLEMENTARY INFORMATION

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Funding Progress (Unaudited)

June 30, 2013 and 2012

Actuarial Valuation Date	Actuarial Valuation of Assets (a)	Actuarial Accrued Liability (AAL)(b)	Unfunded AAL (UAAL)	Funded Ratio	Covered Payroll	UAAL as a Percentage of Covered Payroll ([b-a]/c)
July 1, 2011	$ -	$ 117,611,000	$ 117,611,000	0%	$ 52,025,735	226.1%
July 1, 2009	$ -	$ 94,168,000	$ 94,168,000	0%	$ 46,127,000	204.1%
July 1, 2007	$ -	$ 119,894,000	$ 119,894,000	0%	$ 41,292,000	290.4%

VSC has to date performed three actuarial valuations, the latest on July 1, 2011, for purposes of satisfying the requirements of GASB Statement No. 45. The actuarial accrued liability for all benefits at this time was $117,611,000, all of which was unfunded. The annual covered payroll (annual payroll of active employees covered by the plan) was $52,025,735, and the ratio of the unfunded actuarial liability to annual covered payroll was 226.1%.

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Independent Auditors' 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*

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Independent Auditors' 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*

To the Board of Trustees of
Vermont State Colleges
Montpelier, Vermont

We have audited, 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, the financial statements of Vermont State Colleges (a component unit of the State of Vermont) (the "Colleges"), which comprise the statements of net position as of June 30, 2013 and 2012, the related statements of revenues, expenses and changes in net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Vermont State College's basic financial statements and have issued our report thereon dated October 23, 2013.

Internal Control Over Financial Reporting

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of this Report

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

DRAFT

Certified Public Accountants
Braintree, Massachusetts

October 23, 2013

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

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INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR PROGRAM AND ON INTERNAL CONTROL OVER COMPLIANCE REQUIRED BY OMB CIRCULAR A-133

To the Board of Trustees of
Vermont State Colleges
Montpelier, Vermont

Report on Compliance for Each Major Federal Program

We have audited Vermont State College's compliance with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Vermont State College's major Federal programs for the year ended June 30, 2013. Vermont State College's major Federal programs are identified in the summary of auditors' results section of the accompanying schedule of findings and questioned costs.

Management's Responsibility

Management is responsible for compliance with the requirements of laws, regulations, contracts, and grants applicable to its Federal programs.

Auditors' Responsibility

Our responsibility is to express an opinion on compliance for each of the Vermont State College's major Federal programs based on our audit of the types of compliance requirements referred to above. We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major Federal program occurred. An audit includes examining, on a test basis, evidence about the Vermont State College's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances.

We believe that our audit provides a reasonable basis for our opinion on compliance for each major Federal program. However, our audit does not provide a legal determination of the Vermont State College's compliance.

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Opinion on Each Major Federal Program

In our opinion, Vermont State College complied, in all material respects, with the types of compliance requirements referred to above that could have a direct and material effect on each of its major federal programs for the year ended June 30, 2013.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as Findings 2013-01 and 2013-02. Our opinion on each major Federal program is not modified with respect to these matters.

Vermont State College's response to the noncompliance findings identified in our audit is described in the accompanying schedule of findings and questioned costs. Vermont State College's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the responses.

Report on Internal Control over Compliance

Management of the Vermont State Colleges is responsible for establishing and maintaining effective internal control over compliance with the types of compliance requirements referred to above. In planning and performing our audit of compliance, we considered Vermont State College's internal control over compliance with the types of requirements that could have a direct and material effect on each major Federal program to determine the auditing procedures that are appropriate in the circumstances for the purpose of expressing an opinion on compliance for each major Federal program and to test and report on internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of Vermont State College's internal control over compliance.

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

Our consideration of internal control over compliance was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over compliance that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses. However, we identified a deficiencies in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as item Findings 2013-01 and 2013-02, that we consider to be significant deficiencies.

Vermont State College's responses to the internal control over compliance findings identified in our audit are described in the accompanying schedule of findings and questioned costs. Vermont State College's responses were not subjected to the auditing procedures applied in the audit of compliance and, accordingly, we express no opinion on the response.

Schedule of Expenditures of Federal Awards

We have audited the financial statements of the Vermont State Colleges as of and for the year ended June 30, 2013, and have issued our report thereon dated October 23, 2013, which contained an unmodified opinion on those financial statements. Our audit was performed for the purpose of forming an opinion on the financial statements taken as a whole. The accompanying schedule of expenditures of Federal awards is presented for the purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organization* and not a required part of the financial statements . Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

The purpose of this report on internal control over compliance is solely to describe the scope of our testing of internal control over compliance and the results of that testing based on the requirements of OMB Circular A-133. Accordingly, this report is not suitable for any other purpose.

DRAFT

Certified Public Accountants
Braintree, Massachusetts

October 23, 2013

SUPPLEMENTAL INFORMATION

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SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2013

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	CFDA Number	State Revenue Code	Total
U.S. Department of Education:			
Student Financial Assistance Cluster:			
Federal Supplemental Educational Opportunity Grant	84.007		$ 1,213,741
Federal Work-Study Program	84.033		1,208,538
Federal Perkins Loan Program	84.038		34,340
Federal Pell Grant Program	84.063		20,792,800
before loans and loan guarantees			23,249,419
Loans and loan guarantees:			
Beginning of year balances under the Federal Perkins Loans			3,623,407
Loans advanced to students under the Federal Perkins	84.038		920,482
Federal Direct Student Loans	84.268		56,754,526
Subtotal - loans and loan guarantees			57,675,008
			-
Total Student Financial Assistance			80,924,427
U.S. Department of Education:			
TRIO Cluster:			
TRIO Student Support Services	84.042A		1,588,820
TRIO_Upward Bound	84.047A		1,065,641
Total			2,654,461
Other Direct from U.S. Department of Education:			-
Center for Rural Students	84.116Z		23,926
Center for Rural Students II	84.116Z		78,288
Total			102,214
Total U.S. Department of Education (Direct)			83,681,102
Direct from Other Federal Sources			
US Dept of Commerce:			
Manufacturing Extension Partnership	11.611		396,483
National Science Foundation			
NSF-Vortex2	47.050		25,945
VORTEX2-Wall Clouds	47.050		28,201
UCAR-Unidata	47.050		4,406
Education and Human Resources (STAR)	47.076		65,052

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2013

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	CFDA Number	State Revenue Code	Total
Small Business Administration			
Small Business Teaming Pilot Program	59.000		$ 32,266
Small Business Development Center	59.037		618,464
Veterans Business Program	59.000		43
Tech Assistance to Small Business/Emerg-Cong Earmark	59.000		65,195
US Small Business Admin-Small Jobs Act Program	59.037		152,033
Portable assistance Program-Irene Disaster Assistance	59.037		64,100
US Dept of Labor			
Green Jobs Initiative	17.261		350,679
TAACCCT	17.282		1,033,299
US Dept of Interior/BLM			
Mammals on the Move	15.236		15,500
Total Other Federal Sources (Direct)			2,851,666
Passed Thru Vermont Department of Education:			
Vocational Education_Basic Grants to States	84.048	4319	167,905
Vocational Education_Basic Grants to States	84.048	4320	(12)
Career & Technical Education	84.048	4306	666,800
CP Basic Grant to the States	84.048		48,000
Subtotal (Perkins)			882,693
Other:			
Summer Food Service Program for Children	10.559	4455	6,883
Improving Teacher Quality State Grants	84.367B	4653	36,946
Sub-total			43,829
			-
Total Passed Through Vermont Dept of Education			926,522
Passed Thru Other Sources:			
Vermont Agency of Human Services:			
Americorps	94.006		166,279
Office of Vermont Health Access (OVHA)			
Global Commitment (Medicaid Regular)	93.778		228,771
Vermont Student Assistance Corp			
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		3,226
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		74,799
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		348,353
Gear UP Guide Program	10.217		8,864

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2013

	CFDA Number	State Revenue Code	Total
Vermont Dept. Children & Families			
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		$ 300,000
Headstart	93.600		32,170
State Administrative Matching Grants for Supplemental Nutritional Assistance	10.561		12,923
University of Vermont:			
EPSCOR	47.076		152,209
EPSCOR - Stem Research	47.081		48,332
Vermont Genetics Network	93.389		281,614
Think College	84.407A		61,445
NASA-CubeSat Lunar Lander	43.000		18,281
NASA National Space Grant	43.000		9,459
Aerospace Educaton Services-NASA Satellite Lab	43.001		10,000
National Science Foundation			
UVM/SWAC	47.050		8,053
National Center for Research Resources			
UVM/VGN	93.389		144,455
VT Agency of Natural Resources			
Pollution Prevention Grants Program	66.078		45,275
USDA			
Rural Business Enterprise Grants	10.769		71,343
Rural Business Enterprise Grants II	10.769		73,001
US Dept of Commerce			
VT Council on Rural Dev-E-Vermont community Broadband (ARRA)	11.557		69,499
VT Council on Rural Dev-E-Commerce for EDA-VCRD	11.307		44,359
Vt Department of Public Service			
Renewable Energy Research & Dev-Pellet Boiler	81.087		128
Red Schoolhouse Pellet Boiler	81.087		12,626
US Dept of Energy-Large Biodigester	81.087		983,480
VT Department of Libraries			
Library Services & Tech Act	45.310		1,000
VT Sustainable Jobs Fund, Inc.			
NE Photovolaic Training Network	81.087		1,253
VT Agency of Commercy & Community Development			
Defense Logistics Agency	12.002		78,388
HUD Community Dev Block Grant-State Prgm-Town of Randolph	14.228		59,512
VT Dept of Energy			
SBDC Environmental Assistance	81.087		20,000

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2013

	CFDA Number	State Revenue Code	Total
Yale University			
Mammals on the Move	15.236		$ 30,000
NCAA			
Strategic Alliance	93.226		20,495
Choicer	93.226		6,338
USGS-Ed Maps	15.810		7,000
VT Council on Rural Development			
Digital Economy	11.307		11,753
Broadband Technology Opportunities Grant (ARRA)	11.557		10,318
Northeast VT Area Health Education Center-HCOP	93.822		6,036
NBRC-National Borders Regional Commission	90.601		78,342
Mathematics and Science Partnerships	84.366A		24,186
Mathematics and Science Partnerships	84.366A		200,000
Total Passed Through Other Sources (Indirect)			3,763,565
Total Federal Funds			$ 91,222,855

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2013

	CFDA Number	State Revenue Code	Community College of Vermont	Castleton State College	Johnson State College	Lyndon State College	Vermont Technical College	Nursing Allied Health	Workforce	System Offices & Services	Total
U.S. Department of Education:											
Student Financial Assistance Cluster:											
Federal Supplemental Educational Opportunity Grant	84.007		$ 136,816	$ 323,990	$ 358,874	$ 164,095	$ 229,966	$ -	$ -	$ -	$ 1,213,741
Federal Work-Study Program	84.033		136,527	321,975	399,255	200,766	150,015	-	-	-	1,208,538
Federal Perkins Loan Program	84.038		-	-	-	10,407	23,933	-	-	-	34,340
Federal Pell Grant Program	84.063		9,580,595	2,877,414	3,180,078	2,574,319	2,580,394	-	-	-	20,792,800
before loans and loan guarantees			9,853,938	3,523,379	3,938,207	2,949,587	2,984,308	-	-	-	23,249,419
Loans and loan guarantees:											
Beginning of year balances under the Federal Perkins Loans			-	2,080,509	885,668	-	628,687	28,543	-	-	3,623,407
Loans advanced to students under the Federal Perkins	84.038			468,910	144,750	208,140	98,682	-	-	-	920,482
Federal Direct Student Loans	84.268		9,696,511	14,669,328	12,493,816	9,940,122	9,954,749	-	-	-	56,754,526
Subtotal - loans and loan guarantees			9,696,511	15,138,238	12,638,566	10,148,262	10,053,431	-	-	-	57,675,008
Total Student Financial Assistance			19,550,449	18,661,617	16,576,773	13,097,849	13,037,739	-	-	-	80,924,427
U.S. Department of Education:											
TRIO Cluster:											
TRIO Student Support Services	84.042A		338,888	295,723	400,551	261,038	292,620	-	-	-	1,588,820
TRIO_Upward Bound	84.047A		-	245,977	462,522	357,142	-	-	-	-	1,065,641
Total			338,888	541,700	863,073	618,180	292,620	-	-	-	2,654,461
Other Direct from U.S. Department of Education:											
Center for Rural Students	84.116Z		-	-	-	23,926	-	-	-	-	23,926
Center for Rural Students II	84.116Z		-	-	-	78,288	-	-	-	-	78,288
Total			-	-	-	102,214	-	-	-	-	102,214
Total U.S. Department of Education (Direct)			19,889,337	19,203,317	17,439,846	13,818,243	13,330,359	-	-	-	83,681,102
Direct from Other Federal Sources											
US Dept of Commerce:											
Manufacturing Extension Partnership	11.611		-	-	-	-	-	-	396,483	-	396,483
National Science Foundation											
NSF-Vortex2	47.050		-	-	-	25,945	-	-	-	-	25,945
VORTEX2-Wall Clouds	47.050		-	-	-	28,201	-	-	-	-	28,201
UCAR-Unidata	47.050		-	-	-	4,406	-	-	-	-	4,406
Education and Human Resources (STAR)	47.076		-	-	65,052	-	-	-	-	-	65,052
Small Business Administration											
Small Business Teaming Pilot Program	59.000		32,266	-	-	-	-	-	-	-	32,266
Small Business Development Center	59.037		-	-	-	-	-	-	618,464	-	618,464
Veterans Business Program	59.000		-	-	-	-	-	-	43	-	43
Tech Assistance to Small Business/Emerg-Cong Earmark	59.000		-	-	-	-	-	-	65,195	-	65,195
US Small Business Admin-Small Jobs Act Program	59.037		-	-	-	-	-	-	152,033	-	152,033
Portable assistance Program-Irene Disaster Assistance	59.037		-	-	-	-	-	-	64,100	-	64,100

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2013

	CFDA Number	State Revenue Code	Community College of Vermont	Castleton State College	Johnson State College	Lyndon State College	Vermont Technical College	Nursing Allied Health	Workforce	System Offices & Services	Total
US Dept of Labor											
Green Jobs Initiative	17.261		$ -	$ -	$ -	$ -	$ -	$ -	$ 350,679	$ -	$ 350,679
TAACCCT	17.282		1,008,465	-	-	-	24,834	-	-	-	1,033,299
US Dept of Interior/BLM											
Mammals on the Move	15.236		-	-	15,500	-	-	-	-	-	15,500
Total Other Federal Sources (Direct)			1,040,731	-	80,552	58,552	24,834	-	1,646,997	-	2,851,666
Passed Thru Vermont Department of Education:											
Vocational Education_Basic Grants to States	84.048	4319	-	-	-	-	167,905	-	-	-	167,905
Vocational Education_Basic Grants to States	84.048	4320	-	-	-	-	-	-	(12)	-	(12)
Career & Technical Education	84.048	4306	666,800	-	-	-	-	-	-	-	666,800
CP Basic Grant to the States	84.048		48,000	-	-	-	-	-	-	-	48,000
Subtotal (Perkins)			714,800	-	-	-	167,905	-	(12)	-	882,693
Other:											
Summer Food Service Program for Children	10.559	4455		-	-	6,883	-	-	-	-	6,883
Improving Teacher Quality State Grants	84.367B	4653	-	-	-	36,946	-	-	-	-	36,946
Sub-total			-	[illegible]	-	43,829	-	-	-	-	43,829
											-
Total Passed Through Vermont Dept of Education			714,800	-	-	43,829	167,905	-	(12)	-	926,522
Passed Thru Other Sources:											
Vermont Agency of Human Services:											
Americorps	94.006		-	-	-	166,279	-	-	-	-	166,279
Office of Vermont Health Access (OVHA)											
Global Commitment (Medicaid Regular)	93.778		-	-	-	-	-	228,771	-	-	228,771
Vermont Student Assistance Corp											
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		3,226	-	-	-	-	-	-	-	3,226
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		-	-	-	-	-	-	-	74,799	74,799
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		-	-	-	-	-	-	-	348,353	348,353
Gear UP Guide Program	10.217		-	-	8,864	-	-	-	-	-	8,864
Vermont Dept. Children & Families											
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		300,000	-	-	-	-	-	-	-	300,000
Headstart	93.600		32,170	-	-	-	-	-	-	-	32,170
State Administrative Matching Grants for Supplemental Nutritional Assistance	10.561		12,923	-	-	-	-	-	-	-	12,923
University of Vermont:											
EPSCOR	47.076		-	-	152,209	-	-	-	-	-	152,209
EPSCOR - Stem Research	47.081		-	-	48,332	-	-	-	-	-	48,332
Vermont Genetics Network	93.389		-	-	281,614	-	-	-	-	-	281,614
Think College	84.407A		-	-	61,445	-	-	-	-	-	61,445
NASA-CubeSat Lunar Lander	43.000		-	-	-	-	18,281	-	-	-	18,281
NASA National Space Grant	43.000		-	-	-	-	9,459	-	-	-	9,459

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2013

	CFDA Number	State Revenue Code	Community College of Vermont	Castleton State College	Johnson State College	Lyndon State College	Vermont Technical College	Nursing Allied Health	Workforce	System Offices & Services	Total
Aerospace Educaton Services-NASA Satellite Lab	43.001		$ -	$ -	$ -	$ -	$ 10,000	$ -	$ -	$ -	$ 10,000
National Science Foundation											
UVM/SWAC	47.050		-	-	-	8,053	-	-	-	-	8,053
National Center for Research Resources											
UVM/VGN	93.389		-	115,219	-	29,236	-	-	-	-	144,455
VT Agency of Natural Resources											
Pollution Prevention Grants Program	66.078		-	-	-	-	-	-	45,275	-	45,275
USDA											
Rural Business Enterprise Grants	10.769		-	-	-	30,533	-	-	40,810	-	71,343
Rural Business Enterprise Grants II	10.769		-	-	-	73,001	-	-	-	-	73,001
US Dept of Commerce											
VT Council on Rural Dev-E-Vermont community Broadband (ARRA)	11.557		-	-	-	-	-	-	69,499	-	69,499
VT Council on Rural Dev-E-Commerce for EDA-VCRD	11.307		-	-	-	-	-	-	44,359	-	44,359
VT Department of Public Service											
Renewable Energy Research & Dev-Pellet Boiler	81.087		-	128	-	-	-	-	-	-	128
Red Schoolhouse Pellet Boiler	81.087		-	-	-	-	12,626	-	-	-	12,626
US Dept of Energy-Large Biodigester	81.087		-	-	-	-	983,480	-	-	-	983,480
VT Department of Libraries											
Library Services & Tech Act	45.310		-	-	-	500	500	-	-	-	1,000
VT Sustainable Jobs Fund, Inc.											
NE Photovolaic Training Network	81.087		-	-	-	-	1,253	-	-	-	1,253
VT Agency of Commercy & Community Development											
Defense Logistics Agency	12.002		-	-	-	-	-	-	78,388	-	78,388
HUD Community Dev Block Grant-State Prgm-Town of Randolph	14.228		-	-	-	-	-	-	59,512	-	59,512
VT Dept of Energy											
SBDC Environmental Assistance	81.087		-	-	-	20,000	-	-	-	-	20,000
Yale University											
Mammals on the Move	15.236		-	-	30,000	-	-	-	-	-	30,000
NCAA											
Strategic Alliance	93.226		-	-	20,495	-	-	-	-	-	20,495
Choicer	93.226		-	-	6,338	-	-	-	-	-	6,338
USGS-Ed Maps	15.810		-	7,000	-	-	-	-	-	-	7,000
VT Council on Rural Development											
Digital Economy	11.307		11,753	-	-	-	-	-	-	-	11,753
Broadband Technology Opportunities Grant (ARRA)	11.557		10,318	-	-	-	-	-	-	-	10,318
Northeast VT Area Health Education Center-HCOP	93.822		6,036	-	-	-	-	-	-	-	6,036
NBRC-National Borders Regional Commission	90.601		-	-	-	78,342	-	-	-	-	78,342
Mathematics and Science Partnerships	84.366A		-	-	-	24,186	-	-	-	-	24,186
Mathematics and Science Partnerships	84.366A		-	-	-	200,000	-	-	-	-	200,000
Total Passed Through Other Sources (Indirect)			376,426	122,347	609,297	630,130	1,035,599	228,771	337,843	423,152	3,763,565
Total Federal Funds			$ 22,021,294	$ 19,325,664	$ 18,129,695	$ 14,550,754	$ 14,558,697	$ 228,771	$ 1,984,828	$ 423,152	$ 91,222,855

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Notes to Schedule of Expenditures of Federal Awards

Year Ended June 30, 2013

Note 1 - **Basis of Presentation**

The accompanying schedule of expenditures of federal awards (the "Schedule") includes the federal grant activity of Vermont State Colleges and is presented on the accrual basis of accounting. The information in the Schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-profit Organizations*. Therefore, some amounts presented in the Schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Findings and Questioned Costs

Year Ended June 30, 2013

I. Summary of Auditor's Results

Financial Statements

Type of audit report issued:	Unqualified
Internal control over financial reporting:	
Material weakness(es) identified?	No
Significant deficiency(ies) identified that are not considered to be material weakness(es)?	No
Noncompliance which is material to financial statements noted?	No

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Federal Awards

Internal control over major programs: Material weakness(es) identified?	No
Significant deficiency(ies) identified that are not considered to be material weakness(es)?	Yes
Type of auditor's report issued:	Unqualified
Any audit findings disclosed that are required to be reported in accordance with section 510(a) of Circular A-133?	Yes

Identification of major programs:

CFDA Numbers	*Name of Federal Program*
84.007, 84.033, 84.038, 84.063, 84.032, 84.268, 84.375, 84.376, 93.364	Student Financial Assistance Cluster
84.042A, 84.047A	TRIO Cluster
11.611	Manufacturing Extension Partnership
59.037	Small Business Development Center
17.261	Green Jobs Initiative

VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Findings and Questioned Costs - Continued

Year Ended June 30, 2013

I. Summary of Auditor's Results - Continued

Identification of major programs - Continued:

CFDA Numbers	*Name of Federal Program*
17.282	Trade Adjustment Assistance Community College and Career Training (TAACCCT) Grants
84.048	Career and Technical Education - Basic Grants to States
84.334	Gaining Early Awareness and Readiness for Undergraduate Programs
93.389	National Center for Research Resources
81.087	Renewable Energy Research and Development

Dollar threshold used to distinguish Between type A and type B programs: $308,953

Auditee qualifies as a low-risk auditee? No

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Findings and Questioned Costs - Continued

Year Ended June 30, 2013

II. Federal Audit Findings and Questioned Costs

Finding number:	2013-01
Federal agency:	U.S. Department of Health and Human Services
Programs:	National Center for Research Resources
CFDA #'s:	93.389
Award year:	2013

CONDITION/CRITERIA
During our testing of grant funds we noted one disbursement selected for testing at Johnson State College that did not have sufficient documentation as to why or how it related to the grant. In accordance with OMB Circular A-133, costs charged to a grant program must be allowable under the grant agreement.

CAUSE/EFFECT
The expense transactions did not have a complete package of supporting documentation. Unallowable costs could potentially be charged to a grant program.

RECOMMENDATION
We recommend that proper documentation be provided for disbursements for the usage of grant monies. In addition, we recommend that a "self audit" be performed on a periodic basis.

QUESTIONED COSTS
$5,000

AUDITEE RESPONSE
The college worked with the grant administrator to review and document the value of the payments made to research participants of the grant and has confirmed that payments were made as expected according to the terms of the grant. In addition, new procedures have been established to maintain the confidentiality of research participants while simultaneously allowing the college to follow its internal control procedures.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Findings and Questioned Costs - Continued

Year Ended June 30, 2013

II. Federal Audit Findings and Questioned Costs

Finding number:	2013-02
Federal agency:	U.S. Department of Education
Programs:	Federal Supplemental Educational Opportunity Grants Federal Direct Student Loans Federal Pell Grants Federal Work-Study Program
CFDA #'s:	84.007, 84.033, 84.063, 84.268
Award year:	2013

CONDITION/CRITERIA
The United States Department of Education (ED) 34 CFR sections 668.51 through 668.61 states the following with the regards to institutions participating in Student Financial Assistance Programs:

> Such an institution shall require each applicant whose application is selected by the central processor, based on edits specified by ED, to verify the information specified in 34 CFR section 668.56. However, certain applicants are excluded from the verification process as listed in 34 CFR section 668.54(b). The institution is not required to verify the applications of more than 30 percent of its total number of applicants selected by ED (34 CFR section 668.54(a)(2)). The institution shall also require applicants to verify any information used to calculate an applicant's EFC that the institution has reason to believe is inaccurate. Generally, the information that must be updated is the number of family members, number of family members attending postsecondary educational institutions, and the applicant's dependency status (34 CFR section 668.55). Information that must be verified or updated is adjusted gross income, U.S. income tax paid, aggregate number of family members in the household, number of family members in the household who are enrolled as at least half-time students in postsecondary educational institutions if that number is greater than one, and untaxed income and benefits including:
>
> - Social security benefits if the institution has reason to believe that those benefits were received and were not reported or were not correctly reported;
> - Child support if the institution has reason to believe child support was received;
> - U.S. income tax deductions for a payment made to an individual retirement account or Keogh account;
> - Interest on tax-free bonds;

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Findings and Questioned Costs - Continued

Year Ended June 30, 2013

II. Federal Audit Findings and Questioned Costs - Continued

- Foreign income excluded from U.S. income taxation if the institution has reason to believe that foreign income was received; and
- All other untaxed income subject to U.S. income tax reporting requirements in the base year included on the tax return form, excluding information contained on schedules appended to such forms (34 CFR section 668.56).

Our audit disclosed that out of a sample of 40 students selected for testing, Johnson State College did not perform adequate verification procedures for one student who was flagged for verification.

CAUSE/EFFECT
Vermont State College's policy is to perform verification procedures for all students specified by ED. Management has noted that those verification procedures were only partially performed for this student because the College did not verify the financial information for the spouse of the student which was included in the AGI on the student's ISIR. As such, the College failed to fully complete the verification procedures. .

RECOMMENDATION
We recommend that when verifying the household's AGI listed on a student's ISIR, the College should trace to support for both the student and their spouse.

QUESTIONED COSTS
None

AUDITEE RESPONSE
Upon notification of this issue, Johnson State College recalculated the student's ISIR to include the additional partial support in the household's AGI and recalculated the student's financial aid package. This resulted in a zero dollar change to the student's financial aid package.

At the time of this error the college was training a new employee in financial aid who was unfamiliar with the requirements for verification of partial support. Training of this resource has been addressed and is not expected to recur.

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VERMONT STATE COLLEGES
(a Component Unit of the State of Vermont)

Schedule of Prior Audit Findings and Questioned Costs

Year Ended June 30, 2013

II. Federal Audit Findings and Questioned Costs - Continued

Finding number:	2012-01
Federal agency:	U.S. Department of Education
Programs:	Federal Direct Student Loans (Direct Loans)
CFDA #'s:	84.268
Award year:	2012

CONDITION/CRITERIA
Colleges must report student financial aid payment data to COD (Common Origination and Disbursement system) within 30 calendar days after the school credits a student's account for a Pell or a Direct Loan disbursement. Out of a sample of forty students, we noted one student who did not have their payment information reported to COD within 30 days.

CAUSE/EFFECT
This condition occurred due to management at CCV not reporting disbursements of student aid to COD in a timely manner.

RECOMMENDATION
We recommend that management strengthen their oversight of COD reporting to ensure for timely reporting of aid disbursement information.

QUESTIONED COSTS
None

AUDITEE RESPONSE
The Community College of Vermont is now sending Pell disbursement information to COD on a weekly basis to reduce timely reporting errors.

AUDITOR COMMENT
The recommendation was adopted by management during the fiscal year ended June 30, 2013. No similar findings were noted during the audit.

DRAFT

VERMONT STATE COLLEGES

MANAGEMENT LETTER

JUNE 30, 2013

DRAFT

VERMONT STATE COLLEGES

Management Letter

June 30, 2013

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To the Board of Trustees
Vermont State Colleges
Montpelier, Vermont

Management of the Vermont State Colleges is responsible for establishing and maintaining effective internal controls over financial reporting. In planning and performing our audit of the financial statements of Vermont State Colleges (the "Colleges") as of and for the year ended June 30, 2013, in accordance with auditing standards generally accepted in the United States of America, we considered the Colleges' internal control over financial reporting (internal control) 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 Colleges' internal control. Accordingly, we do not express an opinion on the effectiveness of the Colleges' internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the Colleges' financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph 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 that we consider to be material weaknesses or significant deficiencies, as defined above. However, we noted certain matters relating to the internal control environment of the Colleges and have included those comments and recommendations within this report.

This communication is intended solely for the information and use of management, the Board of Trustees and others within the Colleges and is not intended to be, and should not be, used by anyone other than these specified parties.

Certified Public Accountants
Braintree, Massachusetts

DATE

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CURRENT YEAR COMMENTS

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Vermont State Colleges
Page 2

Bank Account Control and Disbursement Support

Current situation:
During our A-133 compliance audit procedures of the "Vermont Genetics Network" grant at Johnson State College (JSC), we noted a bank account listed under the name and social security number of a JSC faculty member, which contained federal grant funds issued to the College. Per our inquiry of management at the College, it was determined that this account was established separately from the College by the grant administrator in order to protect the sensitive and personal nature of the information of those who participated in the grant study. Individuals who participated in the study were paid in cash with funds from the federal grant which were held in the bank account that was established and controlled by the grant administrator.

In addition, we noted that support for disbursements related to this grant could not be provided. Therefore, disbursements were not in compliance with both the established College internal control procedures and A-133 compliance requirements.

Auditor's recommendation:
We recommend that the College close this account and process all disbursements through the internal control system of the College so as to maintain accurate records and support for all grant disbursements. Going forward, all unexpended money should be maintained in bank accounts controlled by the Vermont State Colleges and the Colleges should ensure that no additional private bank accounts exist that contain College funds.

Management's response:
The bank account opened by the grant administrator was closed immediately after this issue was identified. The college worked with the grant administrator to review and document the value of the payments made to research participants and has confirmed that payments were made as expected according to the terms of the grant. In addition, new procedures have been established to maintain the confidentiality of research participants while simultaneously allowing the college to follow its internal control procedures.

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Institutional Student Information Record (ISIR) Verification

Current situation:
While performing testing at Johnson State College (JSC) for the A-133 compliance audit, we noted one student whose ISIR was selected for verification by the Department of Education (DOE). The College was required by the DOE to verify the Adjusted Gross Income (AGI) balances indicated on the student's ISIR. While performing the verification procedures, the College only traced to partial support, as they did not verify the financial information for the spouse of the student which was included in the AGI on the ISIR. As such, the College failed to fully complete the verification procedures.

Institutional Student Information Record (ISIR) Verification - Continued

Auditor's recommendation:
We recommend that when verifying the household's AGI listed on a student's ISIR, the College should trace to support for both the student and their spouse.

Management's response:
Upon notification of this issue, Johnson State College recalculated the student's ISIR to include the additional partial support in the household's AGI and recalculated the student's financial aid package. This resulted in a zero dollar change to the student's financial aid package.

At the time of this error the college was training a new employee in financial aid who was unfamiliar with the requirements for verification of partial support. Training of this resource has been addressed and is not expected to recur

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PRIOR YEAR COMMENTS THAT REMAIN OUTSTANDING

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"Best Practices"

Current situation:
During our year-end audit procedures, we noted the following instances where procedures were not being performed consistently between all of the Colleges.

- During year-end audit procedures of accrued payroll, we noted that the faculty payroll accrual was not being calculated on a consistent basis between all of the Colleges. We noted that as of June 30, 2013 all schools except Lyndon State accrued 2 pay periods for the faculty accrual, but that Lyndon State accrued 2.5 pay periods. We noted that Lyndon State double accrued .5 of the faculty payroll because they included those faculty employees in the regular year-end accrued payroll balance as well as in the faculty accrued payroll balance.

Auditor's recommendation:
We recommend that management institute controls to ensure that all schools are performing the same procedures for all accounts between all of the Colleges.

Management's response:
The Colleges' financial staff will review procedures for calculating the payroll accrual prior to closing to ensure consistency across the system.

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STATUS OF PRIOR YEAR COMMENTS

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Prior Year Comments:

Recommendation	*Status*
Construction Costs	Issue Resolved
Capital Asset Software	Issue Resolved
Whistleblower Policy	Issue Resolved
Authorized Checks Signers	Issue Resolved
Clery Act Compliance	Issue Resolved

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CONCLUSION

We would like to thank all of the management and staff who assisted during the course of our fieldwork. The staff was very helpful and exhibited a genuine effort and pride in their work. If we can be of any assistance in the implementation of any of the above-mentioned recommendations, please do not hesitate to call our office.

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VERMONT STATE COLLEGES

BOARD OF TRUSTEES

RESOLUTION

Acceptance of the FY2013 Audited Financial Statements and A-133 Report

WHEREAS, The Vermont State Colleges has contracted with O'Connor & Drew to perform its FY2013 financial statements audit, and the auditors have delivered the draft financial statements, A-133 report and Advisory Comments thereon; and

WHEREAS, The Trustees' Audit Committee has reviewed these materials and recommended that the Board accept them; therefore, be it

RESOLVED, That the Board of Trustees of the Vermont State Colleges hereby accepts the FY2013 Financial Statement Audit Report by O'Connor & Drew.

October 31, 2013

3. Review O'Connor & Drew Proposal and Discuss Extending Contract through FY2016

VSC Policy 429 – Contracting Goods and Services states that contracts may be renewed beyond the original term, including any renewals contained therein, once without resorting to a new solicitation or Request for Proposals process, provided however the renewed term does not exceed the original term and in no event may the renewal period exceed three years.

The VSC and the colleges have previously discussed with the Audit Committee that they are satisfied with the work that O&D is performing and would be in favor of extending the contract. O&D is independent, professional, communicative, and available when needed for advice.

O& D has submitted their proposal for audit services of the VSC financials statements and A-133. The FY2013 audit fee from O&D was $180,000. O&D has proposed keeping the annual audit fee flat at $180,000 for FY2014, FY2015 and FY2016. Any new GASB changes which result in unforeseen expenses for O&D will be negotiated and mutually agreed upon.

Please read and contemplate the attached document "Evaluating the Independent Auditor: Questions to Consider" prior to the meeting.

Evaluating the Independent Auditor: Questions to Consider

Purpose of This Tool. The audit committee (or its equivalent) may have the responsibility to hire, fire, and evaluate the independent auditor. If the audit committee (or its equivalent) has this responsibility, the audit committee should answer a series of questions about its relationship with the independent auditor and should ask key executives in the government organization for their comments as well.

In considering information gathered through the process of evaluating the independent auditors, it is important that the audit committee give consideration to the source of the information. For example, if the chief financial officer (CFO) or controller comments that he or she believes the auditor went too far in certain areas, that would probably carry less weight in your deliberations than if the CFO or controller comments that certain areas were not tested adequately or that auditor independence had been breached. As with all deliberative processes, the different perspectives and motivations of those having input into the deliberations should be considered.

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Instructions for Using This Tool. The sample questions included in this tool are only a starting point in evaluating the performance and effectiveness of the independent auditors. Audit committee members should ask follow-up questions as appropriate and required.

Evaluation of the Independent Auditors	**Yes**	**No**	**Not Sure**	**Comments**
Questions for Audit Committee Members 1. Did the auditor meet with the audit committee when requested?	☐	☐	☐	
2. Did the auditor address issues of “tone at the top,” and antifraud programs and controls in place in the government organization?	☐	☐	☐	
3. Did the auditor inform the audit committee of any risks of which the committee was not previously aware?	☐	☐	☐	
4. Did the auditor adequately discuss issues of the quality of financial reporting, including the applicability of new and significant accounting principles? Did the auditor adequately discuss issues relating to the government’s conformance with local laws, regulations, and oversight requirements?	☐	☐	☐	
5. Did the auditor communicate issues freely with the audit committee, or did they seem protective of management?	☐	☐	☐	
6. Does it appear that management exercises undue influence on the independent auditors?	☐	☐	☐	
7. Does it appear that the independent auditors are reluctant or hesitant to raise issues that would reflect negatively on management?	☐	☐	☐	

Evaluation of the Independent Auditor	**Yes**	**No**	**Not Sure**	**Comments**
Questions for Audit Committee Members (cont.) 8. Is the audit committee satisfied with the planning and conduct of the audit, including the financial statements and internal control over financial reporting (as applicable)?	☐	☐	☐	
9. Review all audit-related and nonaudit services conducted by the independent auditor in the prior year. Are you satisfied that the independent auditor remains independent and objective both in fact and appearance?	☐	☐	☐	
10. Understand the size of the firm and its total revenues firm-wide, for the office(s) providing a substantial amount of services to the government, and the book-of-business of the partner-in-charge of the audit. Is the firm, the office, or the partner dependent on the government engagement for a material percentage of its fee income? If so, the audit committee should consider whether this impairs the appearance of independence with respect to the government.	☐	☐	☐	

Evaluation of the Independent Auditor	**Yes**	**No**	**Not Sure**	**Comments**
Questions for Audit Committee Members (cont.) 11. Is the audit committee satisfied with its relationship with the auditor? In making this determination, the audit committee should consider (*a*) whether the partner-in-charge of the audit participated in audit committee meetings, (*b*) whether the auditor was frank and complete in the required discussions with the audit committee, (*c*) whether the auditor was frank and complete during executive sessions with the audit committee, (*d*) whether the auditor was on time in the delivery of services to the government.	☐	☐	☐	
12. Was the audit fee fair and reasonable in relation to what the audit committee knows about fees charged to other government organizations, and in line with fee benchmarking data the audit committee might have available?	☐	☐	☐	
13. Did the independent auditor provide constructive observations, implications, and recommendations in areas needing improvement, particularly with respect to the organization's internal control system over financial reporting? How constructive are the key issues communicated in the management letter and other disclosures on audit findings and recommendations?	☐	☐	☐	

Evaluation of the Independent Auditors	Yes	No	Not Sure	Comments
Following are some questions the audit committee (or its equivalent) should ask different individuals in the government organization to assist in evaluating the performance of the independent auditors.				
Chief Audit Executive				
1. From your perspective in working with the independent auditors, are you satisfied with the scope, nature, extent, and timing of the testing performed by the independent auditor?	☐	☐	☐	
2. Did the independent auditor work with you to ensure the coordination of audit efforts to assure the completeness of coverage, reduction of redundant efforts, and the effective use of audit resources?	☐	☐	☐	
3. *a*. Are you satisfied with the knowledge, skills, and abilities of the staff assigned to do the audit work?	☐	☐	☐	
b. Are you satisfied with the engagement leadership assigned, including the partner(s), manager(s), and fieldwork leaders?	☐	☐	☐	
4. *a*. Did the independent auditors work with the internal auditors according to the plan?	☐	☐	☐	
b. Was the cooperative work conducted in the spirit of professionalism and mutual respect?	☐	☐	☐	
5. Are you satisfied that the independent auditors remain independent of the government in spite of any audit-related or nonaudit services the auditor provides to the government?	☐	☐	☐	

Evaluation of the Independent Auditors	Yes	No	Not sure	Comments
Chief Audit Executive (cont.)				
6. *a*. Are you aware of any other information that might impair the independence of the independent audit firm?	☐	☐	☐	
b. Are you aware of any individuals on the audit team that might not be independent with respect to the government for whatever reason?	☐	☐	☐	
7. *a*. If the choice were yours, would you hire the firm to conduct next year's audit?	☐	☐	☐	
b. What changes would you make?	☐	☐	☐	
CFO and Controller				
1. From your perspective in working with the independent auditor, are you satisfied with the scope, nature, extent, and timing of the testing performed by the independent auditors?	☐	☐	☐	
2. Are you satisfied with the knowledge, skills, and abilities of the staff assigned to the audit work? Did the auditor appear to have sufficient knowledge of the most recent generally accepted government auditing standards (GAGAS) as set forth by the Government Accountability Office (GAO), as well as AICPA auditing standards?	☐	☐	☐	
3. Are you satisfied with the engagement leadership assigned, including the partner(s), manager(s), and fieldwork leaders?	☐	☐	☐	

Evaluation of the Independent Auditors	**Yes**	**No**	**Not Sure**	**Comments**
CFO and Controller (cont.)				
4. *a*. If the choice were yours, would you hire the firm to conduct next year's audit?	☐	☐	☐	
b. What changes would you make?	☐	☐	☐	
5. Did the auditor comply with the requirements as set forth in the request for proposal and/or subsequent contract for auditor services?	☐	☐	☐	
Independent Auditor				
1. What were the results of the firm's peer review?	☐	☐	☐	
2. Does the audit organization have a quality control system for monitoring compliance with independence requirements?	☐	☐	☐	
3. Does the audit organization have a quality control system for monitoring compliance with continuing professional education requirements?	☐	☐	☐	
Other Comments and Further Questions				

VERMONT STATE COLLEGES

BOARD OF TRUSTEES

RESOLUTION

Audit Contract Extension for FY2014 through FY2016

WHEREAS, The VSC has ended a four year audit contract cycle with O'Connor & Drew (O&D); and

WHEREAS, The VSC and the VSC Audit Committee have been satisfied with the work of O&D; and

WHEREAS, VSC Policy 429 – Contracting Goods and Services states that an existing contract may be extended one time but no longer than the original term or a maximum of three years; and

WHEREAS, O&D has submitted a proposal for their auditing services for FY2014 through FY2016 that the VSC Audit Committee has found to be acceptable; therefore be it

RESOLVED, That the Vermont State Colleges Board of Trustees hereby authorizes retaining O'Connor and Drew as the VSC financial statement and A-133 auditors for the fiscal years 2014 through 2016.

October 31, 2013

B. ITEMS FOR INFORMATION AND DISCUSSION

1. Conduct an Audit Committee Executive Session: Guidelines and Questions

This document is for the Audit Committee members and should be read in advance of the executive session with the external auditors.

2. Fraud and the Responsibilities of the Government Audit Committee

This document is for the Audit Committee members and should be read in advance of the executive session with the external auditors.

Conducting an Audit Committee Executive Session: Guidelines and Questions

Purpose of This Tool. Although it is generally accepted that audit committees should hold executive sessions with various members of the executive management, leaders of the financial management team, the leader of the internal audit team, and the independent auditor, the audit committee member may not understand the type of questions and the extent of the questions they should ask. This tool is intended to help the audit committee ask the right *first* questions, bearing in mind that the audit committee should have the necessary expertise to evaluate the answers and the insight to identify the appropriate follow-up question. See the "Other Questions for Management" section of this tool for possible follow-up questions audit committee members can ask key members of the financial management team in order to improve their understanding of the day-to-day operating environment and management teams' decision-making processes and interactions.

What is an Executive Session?

An executive session is a best practice that could be employed by audit committees for any reason, but here we are advocating that the executive session be used to meet with key members of the financial management team on a one-on-one basis. Executive sessions should occur at every meeting of the audit committee, though not every individual need be in an executive session at every meeting. For example, it is appropriate for the chief audit executive (CAE) and the independent auditor to have an executive session at every meeting, but the director of financial reporting might be in executive session with the audit committee only at the meeting before year-end results are released.

During an executive session meeting, minutes are (usually) not recorded, and when meeting with members of the financial management team, anyone who is not a member of the audit committee is excluded from the meeting. The purpose is to ask questions of various members of the financial management staff in a safe environment. It is important that, when meeting with the controller for example, the chief financial officer (CFO) not be in the room. Executive sessions should be a matter of routine at every audit committee meeting, and not on an exception basis.

The audit committee should avoid asking in an open session whether an individual has anything to discuss in an executive session. Such a question could put the individual in an awkward position with others in the government.

Asking open-ended questions in this kind of environment could be a major source of information for the audit committee. This tool includes examples of the kinds of questions the audit committee should ask. These are meant to be sample questions to help start a conversation and create dialogue between the individual and the audit committee. *These sample questions are not intended to be a checklist.* Audit committee members need to be financially sophisticated enough to understand the answers to the questions and to use these answers to develop

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appropriate follow-up questions. Since it will not be unusual to ask similar questions of key government officials or employees the independent auditor and/or the internal auditor, a comparison of their respective responses could be a good source of insight. Depending on the answers, follow-up action may also be necessary, and the audit committee must be prepared to take that action. The most important thing to do when conducting an executive session is to *listen to the answers that are given and follow up on anything that is not understood!*

Note an executive session provides "safety" and comfort that allows discussants to give honest answers to questions that they might not feel free to answer in an open environment.

Nevertheless, the audit committee may want additional information. "Other Questions for Management" is an associated section of questions that follow the suggested executive session questions. The formality of an executive session may not be required for these questions, which nevertheless may elicit information the audit committee wants.

Audit committee members should also consider the history of the governmental entity, the current economic climate, the political environment, etc., when asking questions in executive session. Finally, each executive session should be concluded with a reminder to the member of management that audit committee members are accessible outside the meeting, and that they should feel free to reach out to the audit committee member at other times if the need arises.

It is important to note that not every government will have different individuals in each position, as assumed in the following questions. Nevertheless, the audit committee should be aware of the functions that are part of dual roles, and adjust the questions accordingly. For example, in a small government, the CFO and controller might share the duties of the director of financial reporting. The audit committee should explore how a function or role is accomplished, and compose questions accordingly. Also, the audit committee should consider and take into account other roles in the government. It may be that other people within a government should also be asked to meet with the audit committee in executive session.

Instructions for Using This Tool. This tool is intended to help audit committee ask the right *first* questions, bearing in mind that the audit committee should have the necessary expertise to evaluate the answers and the insight to identify the appropriate follow-up question. Audit committee members may want to use the questions in the "Other Questions for Management" section in conjunction with this one in order to formulate and ask the appropriate follow-up question.

Conducting an Executive Session—Sample Questions
Independent Auditor
Note that certain communications are required between the independent auditor and the audit committee. A separate tool, "Discussions to Expect from the Independent Auditors," has been prepared for the audit committee to ensure the completeness of the independent auditor's required communication with the audit committee. These suggested questions are meant to be in addition to the required communications.
1. Explain the process your firm goes through to assure that all of your engagement personnel are independent and objective with respect to our audit. Particularly, with respect to nonaudit services, how do those services affect the work that you do or the manner in which the engagement team or others are compensated? Are you aware of any anticipated event that could possibly impair the independence, in fact or in appearance, of the firm and any member of the engagement team?
Comments:
2. Has management, legal counsel, or others made you aware of anything that could remotely be considered a significant violation of laws, regulations, contracts or grants, or significant departures from GAAP? Are you aware of any abuse within the government that you would consider to be material?
Comments:
3. Are there any areas of the financial statements, including, and most important, the notes, in which you believe we could be more explicit or transparent, or provide more clarity to help a user better understand our financial statements?
Comments:

Conducting an Executive Session—Sample Questions
Independent Auditor (cont.)
4. Have you expressed any concerns or comments to management with respect to how our presentation, including the notes or Management's Discussion & Analysis could be improved?
Comments:
5. Which accounting policies or significant accounting transactions do you think a user would have trouble understanding based on our disclosure? What additional information could (should) we provide?
Comments:
6. Based on your auditing procedures, do you have any concerns as to whether management may be attempting to commit management override? Have you noticed any biases as a result of your audit tests with respect to accounting estimates made by management?
Comments:
7. In which areas have you and management disagreed?
Comments:
8. Discuss your impressions of the performance of the CAE in terms of the completeness, accuracy, and faithfulness of the financial reporting process.
Comments:
9. Has the firm been engaged to provide any services besides the independent audit of which the audit committee is not already aware?
Comments:
10. How can management improve in terms of setting an appropriate "tone at the top"?
Comments:

Conducting an Executive Session—Sample Questions
Independent Auditor (cont.)
11. Describe the ideas you have discussed with management for improving the internal control system over financial reporting.
Comments:
12. Describe for us any situation in which you believe management has attempted to circumvent the spirit of GAAP, but has yet complied with GAAP.
Comments:
13. Is there anything going on within the government that you are uncomfortable with or consider unusual that would warrant further investigation?
Comments:
14. Are there any questions we have *not* asked that you wish to share with the audit committee?
Comments:

Fraud and the Responsibilities of the Government Audit Committee

Purpose of This Tool. A government audit committee should take an active role in the prevention, deterrence, and detection of fraud and encourage the government organization to establish an effective ethics and compliance program. The government audit committee should constantly challenge management and the auditors to ensure that the organization has appropriate antifraud programs and controls in place to identify potential fraud, and, that investigations are undertaken if fraud is detected. Also, the committee should take an interest in ensuring that appropriate action is taken against known perpetrators of fraud.

This tool is intended to make government audit committee members aware of their responsibilities as they undertake this important role. It highlights areas of activity that may require additional scrutiny by the audit committee.

Introduction

Historically, the audit committee has been associated with the private sector and, in particular, publicly traded companies. With the recent occurrence of a number of high profile corporate fraud scandals and resulting passage of the Sarbanes-Oxley Act of 2002, audit committees' roles and responsibilities have been greatly elevated, discussed, and scrutinized. The Act's audit committee requirements were intended for publicly traded companies. A halo effect has occurred, however, transferring to the public sector much of the same corporate concern over fraud and ethics. This, in turn, has spawned a renewed interest in *government* audit committees.

The June 2003 revision of the *Government Auditing Standards* (GAS) issued by the Comptroller General of the United States through the Government Accountability Office (GAO — formerly General Accounting Office) and known as the Yellow Book, recognizes the melding of AICPA standards and GAS concerning fraud in paragraph 5.17 stating, "AICPA standards and GAGAS[1] require auditors to address the effect fraud or illegal acts may have on the audit report and to determine that the **audit committee or others with equivalent** [emphasis added] authority and responsibility are adequately informed about the fraud or illegal acts." This section also links the government audit committee or its equivalent to fraud responsibility.

Also, AICPA issued Statement on Auditing Standards (SAS) No. 99, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Publications,* vol. 1, AU sec. 316), which details the responsibilities and functions of the auditor as they relate to fraud in an audit of financial statements. The Statement gives new and expanded guidance for identifying and assessing the risks of material misstatement due to fraud; evaluating and documenting evidence; and communicating to management, the audit committee, and others.

[1] The terms GAS, for Government Auditing Standards, and GAGAS, for Generally Accepted Government Auditing Standards are used interchangeably here. Further, both are synonymous with the term Yellow Book, as noted.

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Definition and Categories of Fraud

An understanding of fraud is essential for the audit committee to carry out its responsibilities. The term *fraud* is defined in *Black's Law Dictionary* (Sixth Edition, 1990) as:

> An intentional perversion of truth for the purpose of inducing another in reliance upon it to part with some valuable thing belonging to him or to surrender a legal right. A false representation of a matter of fact, whether by words or by conduct, by false or misleading allegations, or by concealment of that which should have been disclosed, which deceives and is intended to deceive another so that he shall act upon it to his legal injury... A generic term, embracing all multifarious means which human ingenuity can devise, and which are resorted to by one individual to get advantage over another by false suggestions or by suppression of truth, and includes all surprise, trick, cunning, dissembling, and any unfair way by which another is cheated.

Categories of Fraud

The audit committee needs to be aware that fraud affecting the organization often falls into one of two categories:

- *Internal fraud* involves activities perpetrated within the organization such as intentional misrepresentation of financial statements or financial statement transactions, theft, embezzlement, or improper use of the organization's resources.

- *External fraud* involves theft or improper use of the organization's resources perpetrated by individuals outside the organization. Some examples of external fraud prevalent in the government arena include false claims and statements, beneficiary fraud, and contract and procurement fraud.

This categorization of fraud is useful but not absolute. For example, an organization's employees may collude with outside individuals to procure contracts or provide goods and services (that is, kickbacks).

Fraud and the Responsibilities of the Government Audit Committee or Its Equivalent

The members of the government audit committee should understand their role of ensuring that the organization has antifraud programs and controls in place to help prevent fraud and to properly fulfill their fiduciary duties of:

- Monitoring the financial reporting process.

- Overseeing the internal control system.

- Overseeing government auditors and public accounting firms engaged to perform government audits.

- Reporting findings to the legislative body or other independent governing body.

Fraud can be a catastrophic risk to a government organization. If the organization does not identify and monitor fraud, the results can be devastating to the organization's financial position, reputation, citizens' confidence level, and success in achieving its goals and objectives.

Setting the tone to reduce the risks of fraud begins with the governing body. Depending on the type of government organization that will be applying these concepts, the governing body can consist of a legislative body, council, supervisory board, or any designee approved by that government as the responsible party for ensuring the accountability of public resources.

Create an Environment to Reduce Risk of Fraud

Often, a government organization's elected officials and management must adhere to a code of ethics, or choose to establish one in the absence of a legal requirement to do so. An audit committee can help the governing body provide the guidance necessary to create a culture of honesty and integrity in preventing, deterring, and detecting fraud. It is important to clearly communicate to each employee acceptable behavior and expectations that foster an environment where the risks of fraud are reduced. Such a culture is rooted in a strong set of core values that provides the foundation for employees as to how the organization conducts business. It also allows an organization to develop an ethical framework that discourages (1) fraudulent financial reporting, (2) misappropriation of assets, (3) circumventing internal controls, and (4) other forms of corruption.

An ethical framework should include:

- A code of ethics that is based on the organization's core values and that clearly states acceptable and unacceptable behaviors.

- A training program for its code of ethics that includes sessions for new hires, management, and newly elected officials, and continuing education for all employees and officials.

- An adequate channel of communication for employees and others to obtain advice when facing difficult ethical decisions and the reporting of known or potential unlawful activities against the government organization.

- A system to monitor compliance with the code of ethics.

Establish Antifraud Programs and Internal Controls

The audit committee should ensure that the government organization establishes antifraud programs and internal controls to help prevent and detect fraud. To meet its responsibilities, the audit committee should ensure that the government organization has:

- Designated a senior level member of the government organization to manage fraud risk.
- Established policies and procedures that identify, evaluate, and mitigate the organization's fraud risk exposure.
- Maintained an effective internal control structure designed to prevent, deter, and detect fraud.
- Created a system to monitor compliance with policies and procedures and controls.
- Established and communicated the process for reporting potential fraudulent activities, for example, fraud hotline, Web site address, suggestion box, or tracking report.
- Developed a process for investigating potential unlawful activities against the organization.

When Fraud Is Discovered

Many large government organizations have a structure for reporting potential fraud and resources available such as an audit or investigative function that gathers the evidence and coordinates with appropriate law enforcement agencies. With this structure, the government audit committee should ensure that a process is in place to receive periodic reports describing the nature, status, and eventual disposition of any fraud investigations.

With smaller government organizations, the audit committee may be directly responsible for overseeing the investigation of a potential fraud. In this circumstance, if fraud is discovered, or there is a reasonable basis to believe that fraud may have occurred, the audit committee is responsible for ensuring that an investigation is undertaken. The committee should retain professionals with experience and training in fraud investigations. Professionals such as internal or external auditors, forensic accountants, legal counsel, and law enforcement officials can provide the expertise to assist with the investigation. The audit committee should stay informed on the progress of the investigation to its conclusion.

Accounting and auditing professionals may also provide audit committees with other related services, for example, (1) evaluation of controls and operating effectiveness through compliance verification, (2) creation of special investigation units (SIUs), (3) incident management committees, (4) assessment of risks, (5) ethics hotlines, (6) and code of conduct.

Government Auditors

Government auditors can serve a vital role in aiding the audit committee in determining whether the government organization is achieving its goals and objectives. Auditors that are experienced and trained in fraud prevention, deterrence, and detection can help provide assurance that the government organization's risks are effectively identified and monitored; processes are effectively controlled and tested periodically; and appropriate follow-up action is taken to address control weaknesses. If the government organization does not have an audit or oversight function trained in fraud prevention, deterrence, and detection, the organization may consider contracting with an audit firm for specialized accounting/auditing services.

The audit committee needs to ensure that the auditors are fulfilling their responsibilities in deterring potential fraud by following applicable professional standards. *Government Auditing Standards* and AICPA Statements on Auditing Standards require auditors to assess the risk of material misstatements of financial statement amounts or other financial data significant to the audit objectives due to fraud and to consider that assessment in designing the audit procedures to be performed. Specifically, SAS No. 99 addresses auditor responsibilities in planning and performing financial statement audits, including the requirement that fraud involving senior management, and any fraud (whether caused by senior management or other employees) that causes material misstatement of the financial statements, should be reported directly to the audit committee.

Whistleblowers

Many federal, state, and local government organizations have whistleblower laws and regulations. These regulations may require the organization to establish procedures for the confidential receipt, retention, and treatment of complaints received regarding suspected fraudulent activities. The audit committee should ensure that the organization has established a process to address applicable whistleblower laws and regulations.

Conclusion

The demands of the public, U.S. corporations, and the regulatory environment have focused attention on the increased need to fight fraud. The public is demanding greater vigilance from all parties involved in organizational governance. Audit committees are required to play a pivotal role in the prevention of fraud and to take appropriate action in the discovery of fraud. Government auditors can provide additional assistance to audit committees so they may better carry out their fiduciary responsibilities in fighting fraud and protecting the public interest.

Other Information

To obtain more information on fraud and implementing antifraud programs and controls, please visit the following Web sites where additional materials, guidance, and tools can be found:

American Institute of Certified Public Accountants	www.aicpa.org
AICPA Antifraud & Corporate Responsibility Resource Center (including SAS No. 99)	www.aicpa.org/antifraud/homepage.htm
Association of Certified Fraud Examiners	www.cfenet.com