

MEMORANDUM

TO: VSC Audit Committee
Lynn Dickinson
Tim Jerman
Karen Luneau
Christopher Macfarlane
Linda Milne, Chair
Martha O'Connor, *ex officio*

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

DATE: October 15, 2014

SUBJ: Audit Committee Meeting scheduled for October 22, 2014

Tom

The Audit Committee of the VSC Board of Trustees will meet from 1:00-3:00 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, Dept. of Finance and Management
Douglas Hoffer, State Auditor

**Board of Trustees
Audit Committee Meeting**

October 22, 2014

AGENDA

A. ITEMS FOR DISCUSSION AND ACTION

1. Minutes of the May 14, 2014 Meeting of the Audit Committee
2. Review and Approval of FY2014 draft Audited Financial Statements and A-133 Report

B. ITEMS FOR INFORMATION AND DISCUSSION

1. Conduct an Audit Committee Executive Session: Guidelines and Question of the executive session with the external auditors.
2. Fraud and the Responsibilities of the Government Audit Committee

A. ITEMS FOR DISCUSSION AND ACTION

1. Minutes of the May 14, 2014 Meeting of the Audit Committee

The Audit Committee met on May 14, 2014 at the Chancellor's Office in Montpelier.

Note: these are unapproved minutes, subject to amendment and/or approval at the subsequent committee meeting.

Committee members present: Lynn Dickinson, Tim Jerman, Jeff Kellar (state auditor's office), Karen Luneau, Christopher Macfarlane, Linda Milne (Chair)

From the Chancellor's Office: Rick Bourassa, Tim Donovan, Bill Reedy, Tom Robbins, Deb Robinson

College Presidents: Joe Bertolino, Joyce Judy, Barbara Murphy, Dan Smith, Dave Wolk

From the colleges: Tess Conant

Guests: David Dilulis – O'Connor & Drew; Kieth Goldie – O'Connor & Drew; Chris Stenman – O'Connor & Drew

Chair Milne called the meeting to order at 3 p.m.

A. ITEMS FOR DISCUSSION AND ACTION

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

The minutes of the October 23, 2013 meeting were approved.

2. Minutes of the February 12, 2014 Meeting of the Audit Committee

The minutes of the February 12, 2014 meeting were approved.

3. Minutes of the March 12, 2014 Meeting of the Audit Committee

The minutes of the March 12, 2014 meeting were approved.

B. ITEMS FOR INFORMATION AND DISCUSSION

1. Review FY2014 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 some of the colleges during May for the preliminary FY2014 audit work. He then noted that the O&D staff has remained consistent at the VSC engagements. O&D are working on their preliminary schedule for federal expenditures. Mr. Stenman reminded the committee that GASB 65 will require the VSC to write off all bond issuance costs. This will cause a restatement of prior year financials. This had absolutely nothing to do with the VSC but rather a GASB pronouncement.

Chair Milne asked the colleges to address any significant business personnel changes. Noted were: VTC has a new interim president and acting dean of administration; LSC has a new dean of administration and academic dean; and CCV has a new controller.

Chair Milne reviewed a couple of newspaper articles dealing with fraud.

2. Discuss FY2013 Audit Advisory Comments

There was no discussion on this agenda item.

3. Discuss FY2014 Internal Audit

a. Pcard Compliance Review

There was no discussion on this agenda item.

b. Internal Control Questionnaire

There was no discussion on this agenda item.

Trustee Jerman moved that the Audit Committee go into executive session for the purposes of evaluation of a public officer or employee and for consideration of documents excepted from disclosure under the public records act, and to include the auditors from O'Connor & Drew and outside legal counsel Jeff Nolan. The motion was adopted unanimously.

The Committee entered executive session with the auditors at 3:27 p.m. and exited executive session at 3:50 p.m. No action was taken.

Trustee Dickinson moved that the Audit Committee enter executive session for the purposes of evaluation of a public officer or employee and for consideration of documents excepted from disclosure under the public records act, and to include outside legal counsel Jeff Nolan, VSC

General Counsel Bill Reedy and Chancellor Tim Donovan. The motion was seconded by Trustee Jerman and adopted unanimously.

The Committee went into executive session at 4:02 p.m. Bill Reedy and Chancellor Donovan left the executive session at 6:25 p.m. The Committee exited executive session at 6:55 p.m. and no action was taken.

The meeting was adjourned at 6:55 p.m.

2. Review and Approval of FY2014 Draft Audited Financial Statements and A-133 Report

O'Connor & Drew (O&D) will join us to review the draft FY2014 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 FY2014 Financials and A-133 report were submitted to the State of Vermont in draft form on October 15th in order to meet our annual deadline.

The SRECNA shows a decrease in Net Assets of \$9,392,000. Included in this total are these items:

- -\$6M GASB 45 accrual;
- -\$3M of annual depreciation on donated software received in FY13;
- -\$3M use of system cash to fund VTC deficit;
- +\$1.5M increase in state operating appropriations primarily designated for financial aid; Next Gen and Dual Enrollment programs;
- +1.5M improvement in investment returns.

The net of these items is -\$9M. Both operating revenues and operating expenses are relatively flat compared to FY2013. Unrestricted Net Assets are now negative \$23M, with GASB45 liability at \$49M.

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

**FINANCIAL STATEMENTS AND
MANAGEMENT'S DISCUSSION AND ANALYSIS**

JUNE 30, 2014

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

**Financial Statements and
Management's Discussion and Analysis**

June 30, 2014 and 2013

C O N T E N T S

Independent Auditors' Report	1-3
Management's Discussion and Analysis (Unaudited)	4-18
Financial Statements:	
Statements of Net Position	19
Statements of Revenues and Expenses	20
Statements of Changes in Net Position	21
Statements of Cash Flows	22-23
Notes to the Financial Statements	24-55
Required Supplementary Information (Unaudited):	
Schedule of Funding Progress	56
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 <i>Government Auditing Standards</i>	57-58
Independent Auditors' Report on Compliance for Each Major Program and on Internal Control over Compliance Required by OMB Circular A-133	59-61
Supplemental Information:	
Schedule of Expenditures of Federal Awards	62-67
Notes to the Schedule of Expenditures of Federal Awards	68
Schedule of Findings and Questioned Costs	69-71
Summary Schedule of Prior Audit Findings	72-74

INDEPENDENT AUDITORS' REPORT

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

Report on the Financial Statements

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, 2014 and 2013, the related statements of revenues and expenses, changes in net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Colleges' 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.

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, 2014 and 2013 and the results of their operations and their cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Emphasis of a Matter

As discussed in Note 2 to the financial statements, Vermont State Colleges restated prior balances with regards to the adoption of GASB Statement No. 65, *Items Previously Reported as Assets and Liabilities*. Our opinion is not modified with respect to that matter.

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 4-18 and the schedule of funding progress on page 56 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 pages 62 through 67 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated **DATE**, 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**

DATE

DRAFT

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

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.

Vermont State College System

The Vermont State College System unites five distinctive public colleges in the common purposes of providing first-rate higher education at reasonable cost in order to improve the quality of life for the citizens of Vermont.

The colleges are:

Community College of Vermont (CCV)
Castleton State College (CSC)
Johnson State College (JSC)
Lyndon State College (LSC)
Vermont Technical College (VTC)

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, 2014 and selected comparative information for the previous 4 years. 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.

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:

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

Financial Statements

The Vermont State College System's financial statements include three primary components:

- Statement of Net Position (SNP)
- Statement of Revenues and Expenses and Changes in Net Position (SRECNP)
- Statement of Cash Flow (SCF)

Statement of Net Position

The Statement of Net Position presents the financial position of VSC at one point in time - June 30, and includes all assets, liabilities, and the net position of the System. Net position represents the residual interest in the System's assets after liabilities are deducted. The change in net position is an indicator of whether the overall financial condition has improved or deteriorated during the year. Table 1 on page 6 shows the condensed Statement of Net Position for the past five years.

Significant events that affect these statements during the past five years include: accrual of other post-employment benefits (OPEB) totaling over \$40 million through FY2014, which is not being funded at this time; the maturing of a Certificate of Deposit that was considered long term cash, and subsequent new investments in FY2013 are broken up between short term and long term investments; debt financing secured for constructions projects in FY2008 and FY2010, with construction projects placed in service through FY2013; enrollments leveling off and in some instances declining at the end of this period.

Total assets are categorized as either current or noncurrent. Current assets are available to satisfy current liabilities, which are those amounts expected to be payable within the next year. The major component of current assets is accounts receivable, primarily funds due by students and granting agencies. Total assets of \$269 million decreased by \$7 million or 2% from FY2013 to FY2014, primarily in Capital Assets due to depreciation. Over the 5 years, Assets have grown by \$29 million, primarily in Capital Assets constructed using bond financing.

Noncurrent assets consist primarily of endowment and other investments, in addition to capital assets. Investments were \$55 million at June 30, 2014, an increase of \$4 million or 8% since June 30, 2013 – this increase was primarily from investment returns. At the beginning of the 5-year period, current assets included the CD which matured in FY2012. Invested funds from this CD are now reflected in Long Term investments.

Current liabilities of \$22 million and \$23 million as of June 30, 2014 and 2013 respectively include primarily accounts payable, and unearned revenue related to the next fiscal year. Current liabilities have not changed significantly from FY2010.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

Statement of Net Position - Continued

Noncurrent liabilities increased by \$3 million to \$194 million during FY2014. An increase in post-employment benefits liability of \$6 million was partially offset by a decrease in long term debt of \$4 million. During the 5-year period, OPEB liability has increased steadily. Bonds payable increased due to new bonds issued during this time, but have begun to decline as bond holders are being paid.

(\$ in millions)							
	2014	% change	2013	% change	2012	2011	2010
Current Assets	21	-19%	26	-60%	65	84	40
Noncurrent Assets							
Investments	55	8%	51	155%	20	19	28
Capital assets, net	187	-4%	194	7%	181	161	155
Other	6	20%	5	-19%	10	13	18
Deferred outflows	11	0%	11	-35%	17	8	10
Total Assets and Def'd outflows	280	-2%	287	-2%	293	285	251
Current liabilities	22	-4%	23	-12%	26	24	26
Non current liabilities							
Post employ'm't benefit oblig	49	14%	43	19%	36	28	22
Bonds and Notes payable	127	-3%	131	-4%	136	141	115
Other	18	6%	17	-26%	23	15	17
Total Liabilities	216	1%	214	-3%	221	208	180
Net investment in cap'l assets	60	-9%	66	27%	52	52	51
Restricted							
Nonexpendable	16	7%	15	0%	15	13	12
Expendable	10	25%	8	33%	6	6	3
Unrestricted	-22	38%	-16	1500%	-1	6	5
Total Net Position	64	-12%	73	1%	72	77	71
Total Liabilities and Net Position	280		287		293	285	251

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

Statement of Net Position - Continued

Net Position

Net investment in capital assets represents the historical cost of the System's capital assets reduced by total accumulated depreciation and outstanding principal balances on debt attributable to the acquisition, construction, or improvement of those assets.

Total net position decreased from \$73 million to \$64 million or 13% from June 30, 2013 to June 30, 2014. It generally increased from FY2010 to FY2013, with a blip in FY2011 related to the timing of borrowings vs use of debt for capital assets.

Net investment in capital assets decreased by \$6 million from June 30, 2013 to June 30, 2014 due to a net change downward in capital assets of \$8 million less a decrease in principal owed on construction debt of \$2 million. Net investment in capital assets increased during the prior years during a period of capital construction.

The restricted nonexpendable portion of Net Position represents the permanent endowment funds for the system. The increase of \$1 million in FY2014 and \$4 million over 5 years is due to gifts received for endowments during the period.

The restricted expendable portion of Net Position includes unexpended gifts and grants, and unexpended endowment appreciation, above corpus, subject to externally imposed conditions on spending. The increase of \$2 million from June 30, 2013 to June 30, 2014 is due to return on endowment investments. In FY2010, endowment fund earnings were depleted due to the downturn in the market. The earnings have recovered over this 5-year period. The balance of unexpended gifts and grants has remained stable throughout this period.

The unrestricted portion of the Net Position is affected primarily by OPEB obligations, which are unfunded. That liability increased by \$6 million in FY2014 to \$49 million as of June 30, 2014. Since FY2010, the unrestricted net position has declined by \$27 million as post-employment benefit obligations are recorded.

During FY2014 the system's total Net Position declined from \$73 million to \$64 million. This is due primarily to our unrestricted net assets being reduced from the annual booking of the VSC OPEB liability. The details of this change are shown in the Statement of Revenues, Expenses, and Changes in Net Position beginning on page 9.

Capital Assets and Debt Administration

The System's facilities are critical to accomplishing the mission of the System as they provide the physical framework and environment for educational, research, cultural programs and residential life. Table 2 on page 8 provides detail from the past 5 years related to the Capital Assets held by the System.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

Statement of Net Position - Continued

Capital Assets and Debt Administration - Continued

Construction in Progress reflects amounts paid for buildings or other assets that are not completed at year end. When completed and placed in service, the total cost is moved to the appropriate capital asset category. Depreciation of that asset begins the month after it is placed in service.

During the 5-year period, there was significant construction done at all five colleges, funded by debt acquired in FY2008 and FY2010. Construction in Progress increased during the years of construction, representing construction not completed on June 30. During FY2014 as construction projects were completed Construction in Progress returned to an amount similar to FY2010. Building and Improvements increased throughout the period, reflecting the completed projects. Infrastructure includes water & sewer systems, heating & electrical systems, telecommunication systems, and roads. The increase in infrastructure over the five-year period is due to projects on the campuses as well as enhanced communications systems for the entire System. Equipment shows a significant increase in FY2013 due to a donation of software valued at \$12 million. Table 2 provides detail about Capital Assets, including related information (depreciation expense and outstanding principal on construction loans).

	(\$ in millions)						
	2014	%	2013	%	2012	2011	2010
		Change		Change			
Land	6	0%	6	0%	6	6	6
Construction in progress	3	-63%	8	14%	7	7	4
Infrastructure	38	6%	36	3%	35	33	31
Buildings and improvements	250	4%	241	3%	233	210	203
Leasehold improvements	2	0%	2	0%	0	0	
Equipment	32	3%	31	82%	17	15	15
Total Capital Assets	331		324		298	271	259
Accumulated Depreciation	-144	12%	-129	10%	-117	-110	-104
Capital Assets, Net	187		195		181	161	155
Related information							
Depreciation Expense	14	8%	13	63%	8	8	7
Outstanding Principal, Related Loans	131	-3%	135	-4%	141	146	119

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

Statement of Revenues, Expenses, and Changes in Net Position

The Statement of Revenues, Expenses, and Changes in Net Position reports total operating revenues, operating expenses, non-operating revenues and expenses, and other changes in net position, showing the total change in net position for the fiscal year. Table 3 shows the Condensed Statements of Revenues, Expenses, and Changes in Net Position for the past five fiscal years.

Table 3: Condensed Statements of Revenues, Expenses, and Changes in Net Position							
(\$ in millions)							
	2014	% Change	2013	% Change	2012	2011	2010
Net Student Fees	112	0%	112	2%	110	105	103
Grants and contracts	15	0%	15	0%	15	15	15
Other Operating Revenues	8	0%	8	14%	7	8	8
Operating Revenues	135	0%	135	2%	132	128	126
Operating Expenses	195	1%	194	5%	185	179	174
Operating Loss	-60	2%	-59	11%	-53	-51	-48
Nonoperating Revenues (Expenses)							
Non Capital Appropriations	27	4%	26	0%	26	28	29
Federal Grants & Contracts	20	0%	20	0%	20	22	18
Gifts currently expendable	3	0%	3	50%	2	2	3
Investment Income & Interest	4	100%	2	100%	1	6	4
Interest Expense	-6	0%	-6	0%	-6	(6)	-5
Other nonoperating revenues	0	0%	0	-100%	1	1	0
Net Nonoperating Revenues	48	7%	45	2%	44	53	49
Total Change before other Revenues	-12	-14%	-14	56%	-9	2	1
Other Changes in Net Position							
Capital Appropriation	2	-50%	4	100%	2	3	5
Capital gifts and grants	0	-100%	13	-	0	-	0
Endowment gifts	1	0%	0	0%	1	1	1
Change in Net Position	-9	-400%	3	-150%	-6	6	7

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

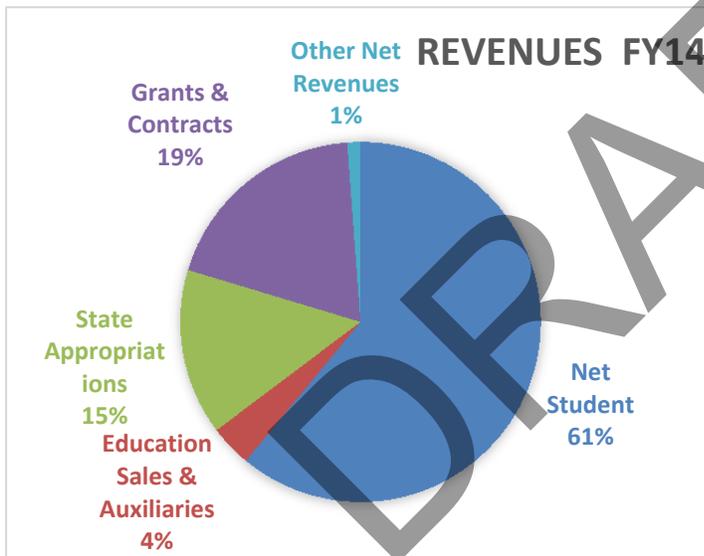
Management’s Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

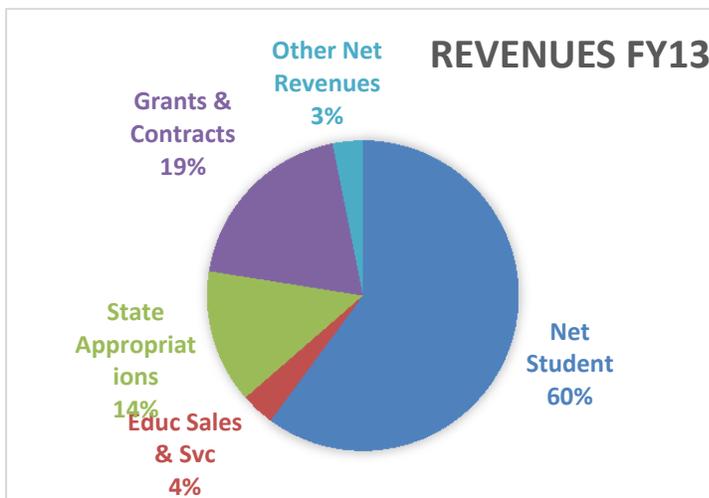
Statement of Revenues, Expenses, and Changes in Net Position - Continued

Operating and Non-operating Revenue

Accounting rules require that our audited financial statements include operating revenues, operating expenses and non-operating revenues and expenses. The following sections provide an analysis of the total operating and non-operating revenues and expenses. The VSC’s primary source of revenue is from student fees. This accounts for 60% of operating and non-operating income. In addition, the System receives revenue from governmental and privately funded grants and contracts; gifts from individuals, foundations, and corporations; and investment income.



Net Student	\$111,611
Educational Sales/Aux	6,766
State Appropriations	27,331
Grants & Contracts	35,053
Other Net Revenues	2,265
<hr/>	
TOTAL	\$183,026



Net Student	\$111,681
Educational Sales/Aux	6,488
State Appropriations	25,892
Grants & Contracts	35,931
Other Net Revenues	5,841
<hr/>	
TOTAL	\$185,883

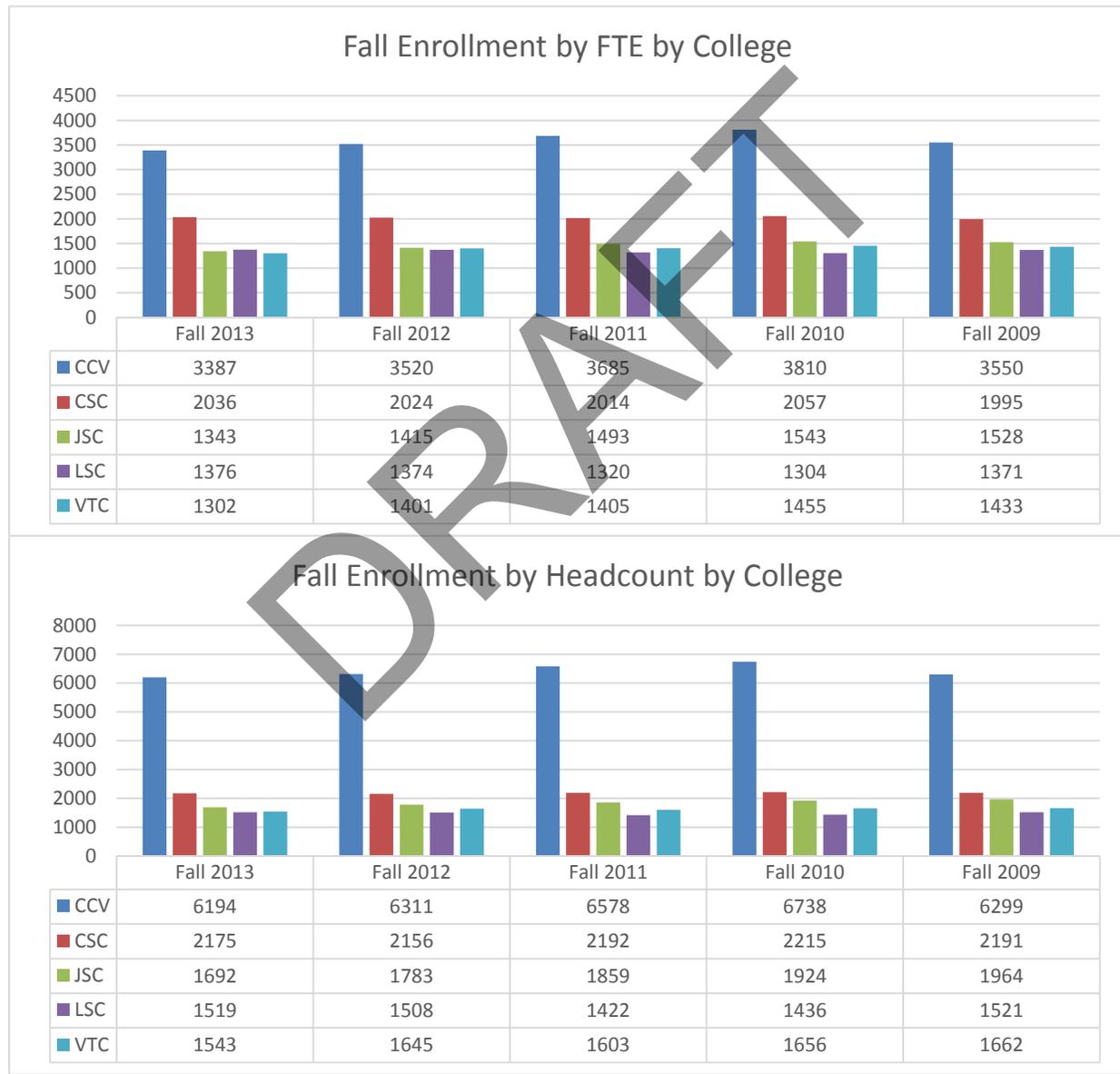
VERMONT STATE COLLEGES (a Component Unit of the State of Vermont)

Management’s Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

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

Tuition and Fee Revenue



Net Tuition and fees includes tuition and fees plus residence and dining fees less scholarship allowances. Table 3 shows the trend for Tuition and Fee Revenue from FY2010 through FY2014. For the System, student-based revenue increased each year from FY2010 through FY2013.

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

Management’s Discussion and Analysis (Unaudited) - Continued

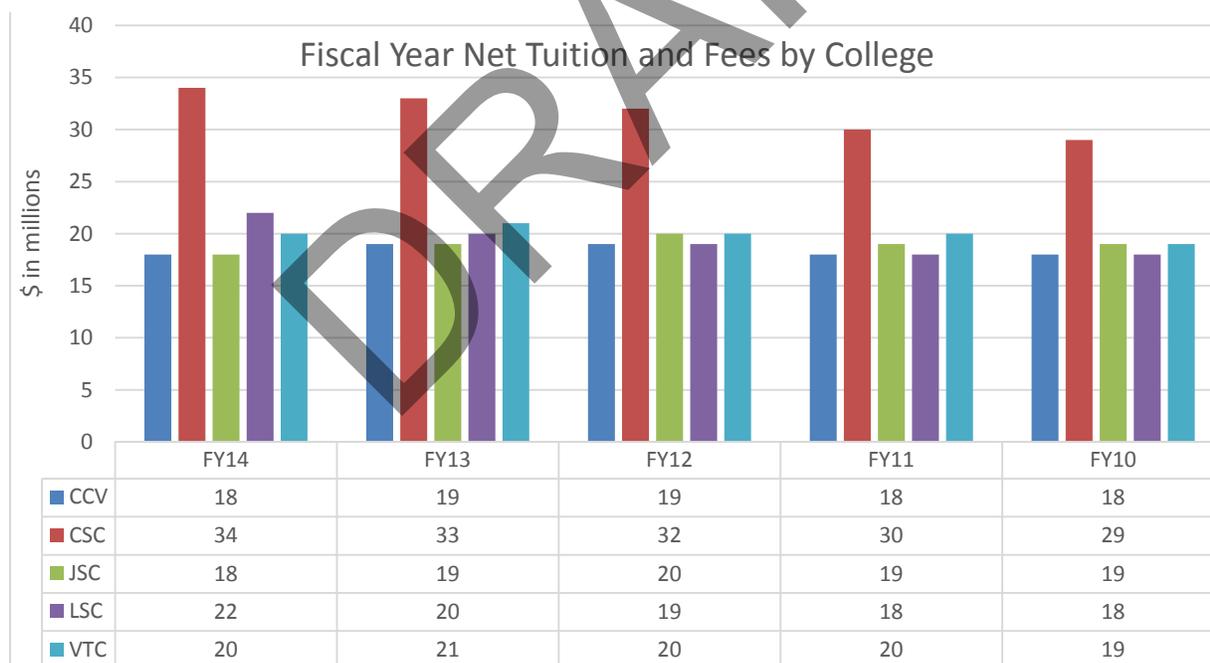
June 30, 2014 and 2013

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

Tuition and Fee Revenue - Continued

The charts on page 11 show student enrollment and revenues for each college during this 5 year period. Enrollments are displayed by both FTE and by Headcount. FTE (Full Time Equivalent) provides better comparative information and Headcount shows the total number of individuals who have benefited from VSC education.

The chart below displays Net Tuition and Fees for each college during the five-year period. It is notable that CCV has by far the largest number of students – both FTE and Headcount, but their net tuition is one of the lowest. CCV, as a Community College has the lowest tuition cost and charges for courses on a per credit basis, while the residential schools charge on a semester basis.



Operating and Non-operating Expenses

Table 4 on page 13 shows the total Operating and Non-operating Expenses for the past 5 years, and the charts on pages 13-14 provide quick view of the percent of expenses by type for FY2014 and FY2013.

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

Management’s Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

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

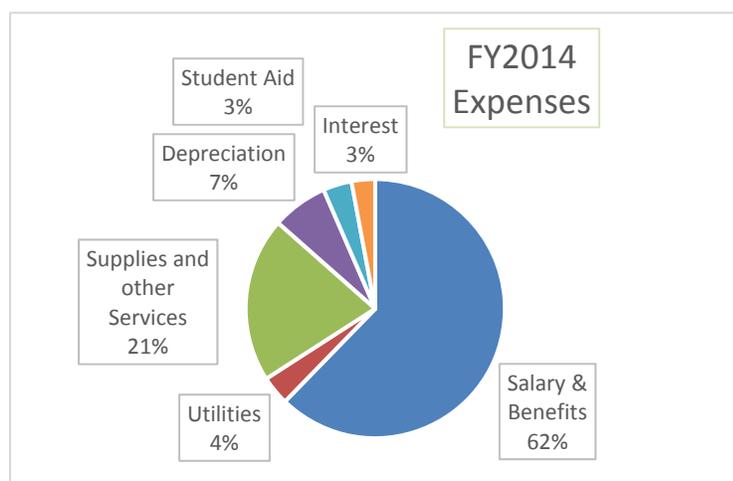
Operating and Non-operating Expenses - Continued

The largest percentage of VSC expenses are for salary and benefits (over 60%). Those expenses have continued to grow through the 5 year period, though there was a slight downturn in the growth last year. The only other expense that has increased significantly during this period is depreciation, related to construction projects in earlier years. Supplies and services is the second largest expense (21%), and there was a slight decrease in monies spent in this area in FY2014.

Included in Salaries and Benefits are annual accruals related to OPEB.

Table 4: Total Operating and Non-operating Expenses for Years Ended June 30
(\$ in millions)

	2014	% chang	2013	% change	2012	2011	2010
Operating							
Salaries & Benefits	125	2%	123	3%	120	116	112
Utilities	7	0%	7	0%	7	6	5
Supplies and Svcs	42	-2%	43	2%	42	40	42
Depreciation	14	8%	13	63%	8	8	8
Student Aid	7	-13%	8	0%	8	9	7
Total Operating	195		194		185	179	174
Nonoperating							
Interest on Debt	6	0%	6	0%	6	6	5
TOTAL Expenses	201	1%	200	5%	191	185	179



**FY2014 Expenses
(\$ in thousands)**

Salary/Benefits	\$125,287
Utilities	7,289
Supplies/Services	41,491
Depreciation	14,030
Student Aid	7,191
Interest on Debt	5,916
TOTAL	\$201,204

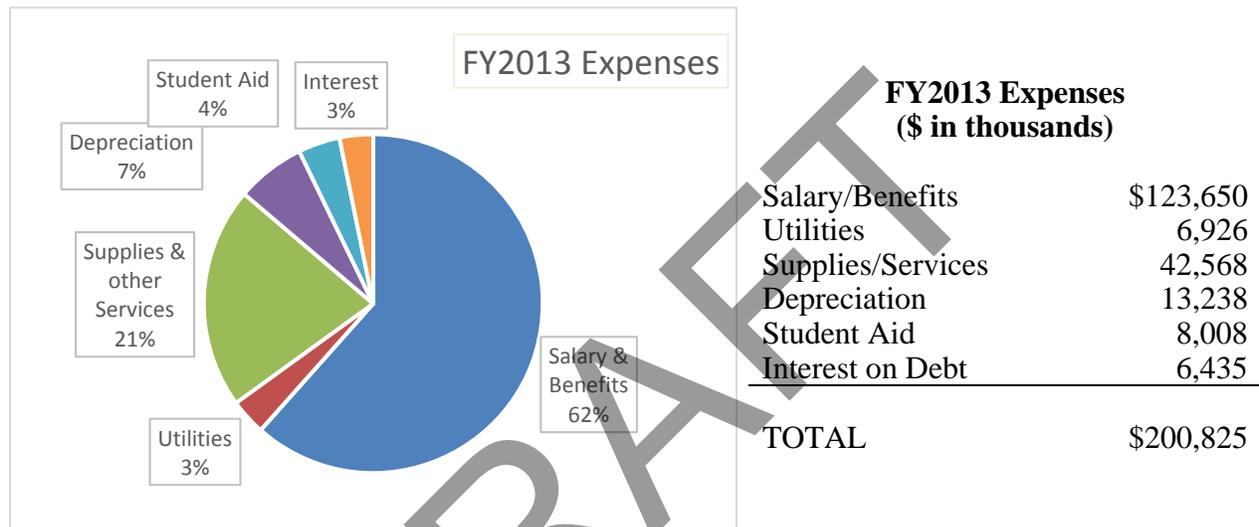
VERMONT STATE COLLEGES (a Component Unit of the State of Vermont)

Management’s Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

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

Operating and Non-operating Expenses - Continued



Student Financial Aid

Student financial aid awards are made from a variety of sources including federal, state, private, and system funds. Aid received from third parties is recognized as grants and contracts revenue on the Statements of Revenues, Expenses, and Changes in Net Position while the distribution of aid from all sources is shown as one of two components:

- Scholarship Allowances – financial aid retained by the System to cover students’ tuition, fees, and on-campus housing and meals. These amounts are reported as a direct offset to operating revenues.
- Scholarships and Fellowships Expense – financial aid refunded to students to cover off-campus living costs, books, and other personal living expenses. These amounts are reported as operating expense.

Total student financial aid over the past five years is show below.

	(\$ in millions)				
	FY14	FY13	FY12	FY11	FY10
Scholarship Allowances (inc in revenue)	25	23	21	21	18
Scholarship Expenses (inc in expenses)	7	8	8	9	7
Total Student Aid	32	31	29	30	25

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

Statement of Cash Flows

The Statement of Cash Flows shows inflows and outflows of cash without regard to accrual items. The Condensed Statement for VSC is in Table 6 on page 16. The temporary blip in cash at the end of FY2012 is related to the maturation of a Certificate of Deposit. In the following fiscal year, these funds were moved into other investments.

Cash flows from operating activities

Cash flows from operating activities on the Statement of Cash Flows will always be different from the operating gain or loss on the Statement of Revenues, Expenses, and Changes in Net Position (SRECNP) because of the inclusion of noncash items, such as depreciation expenses on the SRECNP. Also, the SRECNP is prepared on the accrual basis of accounting, meaning that it shows revenues earned and expenses incurred. The primary cash receipts from operating activities consist of tuition and fees, grants and contracts, and auxiliary income from housing, food service and bookstore operations. Cash outlays include payment of wages and benefits; operating expenses such as utilities, supplies, insurance and repairs; and scholarship to students. During the last five fiscal years operating cash flow has been fairly consistent.

Cash flows from noncapital financing activities

There are two primary sources of noncapital financing: state appropriations and non-operating federal grants that fund PELL student grants. Accounting standards require that we reflect these sources of revenue as non-operating, even though each of the colleges depend on them to continue the current level of operations. Both the state operating appropriations and PELL grant funds from the federal government have been fairly consistent over the last 5 fiscal years.

Cash flows from capital and related financial activities

Cash flows from capital and related financing activities include all plant funds and related long term debt activities (except depreciation and amortization), as well as capital gifts, grants and appropriations. Purchase and sale of investments and income earned on investments are included in cash flows from investing activities.

Cash flows from investing activities

An item on the cash flow statement belongs in the investing activities section if it results from any gains (or losses) from investments in financial markets and operating subsidiaries. The activity from the last three fiscal years reflect the activity surrounding the VSC CD being liquidated and reinvested into other instruments, as well as activity related to endowment investments.

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

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

Statement of Cash Flows - Continued

(\$ in millions)							
Cash flows from:	2014	% change	2013	% change	2012	2011	2010
Operating	-42	-2%	-43	23%	-35	-41	-42
Non capital financing	51	4%	49	0%	49	53	50
Capital and related financing	-10	-17%	-12	-29%	-17	-21	-33
Investing	0	-100%	-29	-171%	41	-2	1
Net increase (decrease)	-1	-97%	-35	-192%	38	-11	-24
Cash, Beginning of Year	4	-90%	39	3800%	1	12	36
Cash, End of Year	3	-25%	4	-90%	39	1	12
Operating cash flows adding noncapital appropriations and PELL grants							
Operating	-42	-2%	-43	23%	-35	-41	-42
Non capital appropriations	27	4%	26	0%	26	28	29
Non operating federal grants	20	-5%	21	5%	20	22	18
Operating cash flows including appropriation and fed grants	5	25%	4	-64%	11	9	5

Consistent with accounting standards, cash flows from state operating appropriations and federal PELL grant revenue are included in noncapital financing activities, even though they provide funding for operating activities. The bottom section of Table 6 shows that with these revenue sources added to the operating cash flows, the result is positive cash flows in all years.

Economic Factors That Will Affect the Future

Demographic Trend

Vermont continues to experience a demographic decline in the overall number of graduating 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 continue to affect enrollment in future years. All of the colleges have adopted programs and strategies to better recruit in this shrinking market. In addition, the State of Vermont has been initiating programs that permit high school students to attend college, and get both high school and college credits for courses. The VSC has taken a lead in participating in these programs that will benefit the students by reducing the overall cost of college, as well as provide some additional revenue for the colleges. Each of the member colleges is working to develop strategies to deal with controlling tuition costs 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

(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

Economic Factors That Will Affect the Future – Continued

Vermont State Appropriations

For FY2014, State Operating Appropriations were \$27,331,000, or 15%, 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 FY2014, 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). FY2014 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.

Post-Employment Benefits

GASB 45, or OPEB, 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 and early retirement benefits paid to retired full-time faculty.

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, 2013, was approximately \$135,345,000 for post-retirement health, dental and life insurance benefits and for early retirement benefits. The present value of all benefits (past and future obligations) is estimated to be \$140,327,000.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Management's Discussion and Analysis (Unaudited) - Continued

June 30, 2014 and 2013

Economic Factors That Will Affect the Future – Continued

Other Factors

As a result of positive market conditions during FY2014, VSC had net realized and unrealized gains on the endowments, and other investments.

Approximately 761 of the 1,090 full-time employees at VSC are covered by union contracts. VSC employs approximately 2,305 full and part-time employees.

VSC Employees as of November 1, 2013	
Bargaining Unit Employees	
Full Time	761
Part Time	<u>203</u>
TOTAL	964
Non-Bargaining Unit Employees	
Full Time	329
Part Time & Temp	<u>1012</u>
TOTAL	<u>1341</u>
TOTAL Employees	<u><u>2305</u></u>

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

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

Statements of Net Position

June 30,

Assets and Deferred Outflows of Resources

	<u>2014</u>	(Restated) <u>2013</u>
Current Assets:		
Cash and equivalents (Note 3)	\$ 2,451,670	\$ 3,446,616
Accounts receivable, net (Note 4)	11,462,983	11,296,610
Inventories	452,563	304,797
Deposit with bond trustees (Note 3)	4,426,154	7,710,558
Other current assets	<u>2,389,683</u>	<u>2,868,378</u>
Total Current Assets	<u>21,183,053</u>	<u>25,626,959</u>
Non-Current Assets:		
Cash and equivalents (Note 3)	581,822	783,947
Long-term investments (Note 3)	54,972,307	51,274,407
Notes receivable, net (Note 4)	5,419,391	5,223,078
Other assets	52,260	14,982
Capital assets, net (Note 11)	<u>186,999,848</u>	<u>194,012,250</u>
Total Non-Current Assets	<u>248,025,628</u>	<u>251,308,664</u>
Total Assets	<u>269,208,681</u>	<u>276,935,623</u>
Deferred Outflows of Resources:		
Interest rate swap, accumulated decrease in fair value (Note 5)	<u>10,674,356</u>	<u>10,603,309</u>
Total Assets and Deferred Outflows of Resources	<u>\$ 279,883,037</u>	<u>\$ 287,538,932</u>

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

Liabilities and Net Position

	<u>2014</u>	(Restated) <u>2013</u>
Current Liabilities:		
Accounts payable and accrued liabilities (Note 12)	\$ 12,126,093	\$ 12,734,330
Unearned revenue and deposits	6,663,699	6,481,816
Current portion of long-term debt (Note 5)	<u>3,759,760</u>	<u>3,637,524</u>
Total Current Liabilities	<u>22,549,552</u>	<u>22,853,670</u>
Non-Current Liabilities:		
Accounts payable and accrued liabilities (Note 12)	136,055	220,129
Unearned revenue and deposits	427,302	798,016
Refundable grants	6,044,136	6,049,434
Post-employment benefit obligations (Note 9)	48,943,729	42,753,755
Interest rate swap (Note 5)	10,674,356	10,603,309
Long-term debt, excluding current portion (Note 5)	<u>127,176,209</u>	<u>130,935,970</u>
Total Non-Current Liabilities	<u>193,401,787</u>	<u>191,360,613</u>
Total Liabilities	<u>215,951,339</u>	<u>214,214,283</u>
Net Position:		
Investment in capital assets, net	60,152,724	65,590,456
Restricted nonexpendable	16,497,265	15,128,413
Restricted expendable	10,279,496	8,255,108
Unrestricted	<u>(22,997,787)</u>	<u>(15,649,328)</u>
Total Net Position	<u>63,931,698</u>	<u>73,324,649</u>
Total Liabilities and Net Position	<u>\$ 279,883,037</u>	<u>\$ 287,538,932</u>

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

Statements of Revenues and Expenses

For the Years Ended June 30,

	<u>2014</u>	(Restated) <u>2013</u>
Operating Revenues:		
Tuition and fees	\$ 115,690,089	\$ 113,637,743
Residence and dining	20,674,084	20,651,576
Less: scholarship allowances	<u>(24,752,899)</u>	<u>(22,608,571)</u>
Net Tuition, Fees, and Residence and Dining Revenue	111,611,274	111,680,748
Federal grants and contracts	11,917,991	12,094,281
State and local grants and contracts	2,144,216	1,696,272
Non-governmental grants and contracts	1,081,688	1,343,831
Interest income	87,029	105,440
Sales and services of educational activities	5,848,881	5,529,267
Other auxiliary enterprises	916,820	959,296
Other operating revenues	<u>1,001,239</u>	<u>1,535,602</u>
Total Operating Revenues	<u>134,609,138</u>	<u>134,944,737</u>
Operating Expenses (Notes 6, 10 and 12):		
Salaries and wages	82,488,029	81,453,823
Employee benefits (Notes 8 and 9)	42,798,448	42,196,246
Scholarships and fellowships	7,191,107	8,007,863
Supplies and other services	41,490,709	42,567,893
Utilities	7,289,372	6,926,313
Depreciation (Note 11)	<u>14,030,027</u>	<u>13,238,072</u>
Total Operating Expenses	<u>195,287,692</u>	<u>194,390,210</u>
Net Operating Loss	<u>(60,678,554)</u>	<u>(59,445,473)</u>
Non-Operating Revenues (Expenses):		
State appropriations (Note 7)	27,330,899	25,891,792
Federal grants and contracts	19,909,045	20,797,045
Gifts	3,220,107	2,623,021
Investment income, net of expenses (Note 3)	3,861,415	2,189,117
Interest expense on capital debt	(5,916,020)	(6,434,642)
Other non-operating revenues	<u>11,533</u>	<u>853</u>
Net Non-Operating Revenues	<u>48,416,979</u>	<u>45,067,186</u>
Decrease in Net Position Before Other Revenues	(12,261,575)	(14,378,287)
Other Revenues:		
State appropriations for capital expenditures (Note 7)	1,688,000	4,099,241
Capital grants and gifts	110,302	12,568,125
Additions to non-expendable assets	<u>1,070,322</u>	<u>536,886</u>
Increase (Decrease) in Net Position	<u>\$ (9,392,951)</u>	<u>\$ 2,825,965</u>

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

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

Statements of Changes in Net Position

For the Years Ended June 30, 2014 and 2013

	<u>Investment in Capital Assets</u>	<u>Restricted Nonexpendable</u>	<u>Restricted Expendable</u>	<u>Unrestricted</u>	<u>Total</u>
Balance June 30, 2012, as previously reported	\$ 51,786,211	\$ 14,446,789	\$ 6,191,758	\$ (994,647)	\$ 71,430,111
Prior Period Adjustment - Change in Accounting Principle (Note 2)	-	-	-	(931,427)	(931,427)
Balance, June 30, 2012 as restated	<u>51,786,211</u>	<u>14,446,789</u>	<u>6,191,758</u>	<u>(1,926,074)</u>	<u>70,498,684</u>
Changes in net position, as previously reported 2013	13,804,245	681,624	2,063,350	(13,818,527)	2,730,692
Prior period adjustment - change in accounting principle (Note 2)	-	-	-	95,273	95,273
Changes in net position for 2013, as restated	<u>13,804,245</u>	<u>681,624</u>	<u>2,063,350</u>	<u>(13,723,254)</u>	<u>2,825,965</u>
Balance, June 30, 2013 as restated	65,590,456	15,128,413	8,255,108	(15,649,328)	73,324,649
Changes in net position for 2014	<u>(5,437,732)</u>	<u>1,368,852</u>	<u>2,024,388</u>	<u>(7,348,459)</u>	<u>(9,392,951)</u>
Balance, June 30, 2014	\$ 60,152,724	\$ 16,497,265	\$ 10,279,496	\$ (22,997,787)	\$ 63,931,698

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

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

Statements of Cash Flows

For the Years Ended June 30,

	<u>2014</u>	(Restated) <u>2013</u>
Cash Flows from Operating Activities:		
Tuition and fees	\$ 111,179,537	\$ 103,614,930
Grants and contracts	14,763,594	14,345,004
Sales and services of educational activities	5,848,881	5,529,267
Auxiliary enterprises	916,820	959,296
Interest received	87,029	105,440
Payments to suppliers	(57,131,056)	(53,004,669)
Payments to employees	(118,499,313)	(115,900,598)
Loans issued to students	(1,003,012)	(373,109)
Collection of loan payments	838,519	283,403
Other cash receipts	<u>1,584,972</u>	<u>1,016,416</u>
Net Cash Applied to Operating Activities	<u>(41,414,029)</u>	<u>(43,424,620)</u>
Cash Flows from Non-Capital Financing Activities:		
State appropriations	27,330,899	25,891,792
Non-operating federal grants	19,909,045	20,797,045
Gifts and grants	<u>3,220,107</u>	<u>2,623,021</u>
Net Cash Provided by Non-Capital Financing Activities	<u>50,460,051</u>	<u>49,311,858</u>
Cash Flows from Capital and Related Financing Activities:		
Capital appropriations	1,688,000	4,099,241
Capital and non-expendable grants and gifts	1,180,624	579,281
Purchase of capital assets	(7,056,165)	(13,417,391)
Change in deposits with bond trustee	3,284,404	10,142,299
Proceeds from capital debt borrowings	-	20,063,889
Payments on capital debt	(3,637,525)	(26,689,652)
Interest expense on capital debt	(5,916,020)	(6,434,642)
Proceeds from disposal of capital assets	<u>50,073</u>	<u>853</u>
Net Cash Applied to Capital and Related Financing Activities	<u>(10,406,609)</u>	<u>(11,656,122)</u>

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

Statements of Cash Flows - Continued

For the Years Ended June 30,

	<u>2014</u>	(Restated) <u>2013</u>
Cash Flows from Investing Activities:		
Proceeds from sales and maturities of investments	\$ 22,567,016	\$ 41,324,878
Purchase of investments	(23,607,730)	(71,564,092)
Interest and dividends received on investments	<u>1,204,230</u>	<u>701,301</u>
Net Cash (Applied to) Provided by Investing Activities	<u>163,516</u>	<u>(29,537,913)</u>
Net Decrease in Cash and Equivalents	(1,197,071)	(35,306,797)
Cash and Equivalents, Beginning of Year	<u>4,230,563</u>	<u>39,537,360</u>
Cash and Equivalents, End of Year	<u>\$ 3,033,492</u>	<u>\$ 4,230,563</u>
Reconciliation of Operating Loss to Net Cash Applied to Operating Activities:		
Operating loss	\$ (60,678,554)	\$ (59,445,473)
Adjustments to reconcile operating loss to net cash applied to operating activities:		
Depreciation	14,030,027	13,238,072
Bad debts	966,763	126,127
Net (gain) loss on disposal of capital assets	(11,533)	41,162
Changes in assets and liabilities:		
Accounts receivable	(1,121,604)	(1,331,525)
Inventories	(147,766)	(50,958)
Other assets	441,417	(1,786,985)
Notes receivable	(196,313)	(15,363)
Accounts payable and accrued liabilities	(608,237)	(1,261,925)
Unearned revenues, deposits and refundable grants	(278,203)	(1,018)
Post-employment benefit obligations	<u>6,189,974</u>	<u>7,063,266</u>
Net Cash Applied to Operating Activities	<u>\$ (41,414,029)</u>	<u>\$ (43,424,620)</u>
Non-Cash Transactions:		
Equipment provided by capital grants and gifts	<u>\$ -</u>	<u>\$ 12,525,730</u>

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

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

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 the 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 revenues and expenses 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 with 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 reported as general revenues.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

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

Basis of Presentation - Continued

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 and required supplementary information. The Colleges present the statements of net position, revenues and expenses, changes in net position and cash flows on a combined college-wide basis.

The Colleges' policy is to define operating activities in the statement of revenues and expenses 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 (the "State"), net investment income, gifts, certain grants and interest expense.

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.

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

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

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

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.

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.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

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

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 the 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.

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 students, and they are reflected as expenses.

Bond and Note Premiums

Bond and note underwriter's premiums are amortized on the straight line basis over the life of the respective bond. 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 bond 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 \$275,843 and \$136,783 as of June 30, 2014 and 2013, 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

June 30, 2014 and 2013

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 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. Management is in the process of reviewing this Statement and its potential effect upon their financial reporting, but does not expect any material impact.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

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

New Governmental Accounting Pronouncements - Continued

GASB 69, *Government Combinations and Disposals of Government Operations* is required for periods beginning 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 combination 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 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date- an amendment of GASB 68* 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 inter-period equity, and creating additional transparency. Management is in the process of reviewing this Statement and its potential effect upon their financial reporting.

Reclassifications

Certain amounts on the 2013 financial statements have been reclassified to conform to the 2014 presentation.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 2 - **Restatement of Prior Year Balances**

Change in Accounting Principles

As a result of implementing GASB No. 65, *Items Previously Reported as Assets and Liabilities*, VSC increased net position by \$95,273 at June 30, 2013 and decreased net position by \$931,427 at June 30, 2012. The changes result from no longer reflecting the unamortized balance of bond issuance costs on the Statement of Net Position.

	<u>As originally reported</u>	<u>As restated</u>
As of June 30, 2013		
Statements of Net Position:		
Other assets	\$ 851,136	\$ 14,982
Unrestricted	(14,813,174)	(15,649,328)
Statements of Revenues and Expenses:		
Supplies and other services	42,663,166	42,567,893

Note 3 - **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.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 3 - **Cash, Equivalents and Investments - Continued**

Cash and Equivalents - Continued

At June 30, 2014, the balance of current assets - cash and equivalents consists of approximately \$18,000 in petty cash, and the remainder deposited in Federal Deposit Insurance Corporation (FDIC) insured banking institutions of approximately \$2,434,000 per the accounting records of the Colleges, and approximately \$3,106,000 per bank records. Of the bank balances, approximately \$786,000 was covered by federal depository insurance and approximately \$2,321,000 was uninsured and uncollateralized at June 30, 2014.

At June 30, 2014, the balances of non-current assets - cash and equivalents deposited in FDIC insured banking institutions were approximately \$582,000 per the accounting records of the Colleges, and approximately \$569,000 per bank records. The bank balances of approximately \$569,000 were covered by federal depository insurance.

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 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.

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

Notes to the Financial Statements

June 30, 2014 and 2013

Note 3 - **Cash, Equivalents and Investments - Continued**

Investments

Investments of the various funds at June 30, 2014 are as follows:

	<u>Fair Value</u>	<u>Cost</u>
U.S. Government bonds	\$ 15,602,328	\$ 15,857,678
Corporate bonds	12,968,607	13,032,119
Common stock	7,161,656	6,693,097
Mutual funds	12,403,889	9,111,365
Money market	6,835,827	6,835,827
Held by bond trustee	<u>4,426,154</u>	<u>4,426,154</u>
Total Investments	\$ <u>59,398,461</u>	\$ <u>55,956,240</u>

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

	<u>Fair Value</u>	<u>Cost</u>
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	<u>7,710,558</u>	<u>7,710,558</u>
Total Investments	\$ <u>58,984,965</u>	\$ <u>58,002,657</u>

Investment maturities include deposits held by the 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 they 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.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 3 - **Cash, Equivalents and Investments - Continued**

Investments - Continued

<u>Investment Type</u>	<u>2014</u>				
	<u>Investment Maturities (in years)</u>				
	<u>Market Value</u>	<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More than 10</u>
Money Market Investments	\$ 6,835,827	\$ 6,835,827	\$ -	\$ -	\$ -
Corporate Bonds	12,968,607	3,013,711	7,655,719	2,284,917	14,260
U.S. Govt. Bonds	<u>15,602,328</u>	<u>7,711,521</u>	<u>6,095,301</u>	<u>1,795,506</u>	<u>-</u>
Total	35,406,762	<u>\$ 17,561,059</u>	<u>\$ 13,751,020</u>	<u>\$ 4,080,423</u>	<u>\$ 14,260</u>

Other Investments

Equity Securities and Mutual Funds	19,565,545
Held by Bond Trustee	<u>4,426,154</u>
Total	<u>\$ 59,398,461</u>

<u>Investment Type</u>	<u>2013</u>				
	<u>Investment Maturities (in years)</u>				
	<u>Market Value</u>	<u>Less than 1</u>	<u>1-5</u>	<u>6-10</u>	<u>More than 10</u>
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	<u>19,451,817</u>	<u>8,403,371</u>	<u>8,126,577</u>	<u>2,921,869</u>	<u>-</u>
Total	34,912,709	<u>\$ 12,988,713</u>	<u>\$ 15,753,757</u>	<u>\$ 6,129,811</u>	<u>\$ 40,428</u>

Other Investments

Equity Securities and Mutual Funds	16,361,698
Held by Bond Trustee	<u>7,710,558</u>
Total	<u>\$ 58,984,965</u>

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

Notes to the Financial Statements

June 30, 2014 and 2013

Note 3 - **Cash, Equivalents and Investments - Continued**

Investments - Continued

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

	<u>2014</u>	<u>2013</u>
Interest and dividend income	\$ 1,367,083	\$ 962,731
Net realized and unrealized gain	<u>2,721,427</u>	<u>1,386,936</u>
Total investment income	4,088,510	2,349,667
Less: management fees	<u>(227,095)</u>	<u>(160,550)</u>
Investment income, net	\$ <u>3,861,415</u>	\$ <u>2,189,117</u>

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

June 30, 2014 and 2013

Note 3 - **Cash, Equivalents and Investments - Continued**

Investments - Continued

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

<u>Investment rating*</u>	<u>2014</u>	<u>2013</u>
AA+	\$ 16,558,229	\$ 20,093,891
AA	2,596,218	1,956,037
AA-	1,285,138	2,242,423
A+	1,962,841	2,938,966
A	2,424,357	1,661,660
A-	1,315,657	1,338,194
BBB+	135,593	124,264
BBB	603,646	1,326,981
BBB-	456,119	124,460
BB+	155,945	169,470
BB	331,670	152,612
BB-	356,173	198,318
B+	148,816	227,896
B	95,812	179,528
B-	131,688	62,569
CCC+	<u>13,033</u>	<u>52,339</u>
	\$ 28,570,935	\$ 32,849,608

*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.

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.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 3 - **Cash, Equivalents and Investments - Continued**

Investments - Continued

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.

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

Notes to the Financial Statements

June 30, 2014 and 2013

Note 4 - **Accounts Receivable, Notes Receivable and Allowance for Bad Debts**

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

	<u>2014</u>	<u>2013</u>
Student accounts receivable	\$ 6,707,508	\$ 6,814,704
Grants receivable	3,528,283	3,962,607
Other receivable	<u>2,822,954</u>	<u>2,611,206</u>
Subtotal	13,058,745	13,388,517
Allowance for doubtful accounts	<u>(1,595,762)</u>	<u>(2,091,907)</u>
Total accounts receivable, net	\$ <u>11,462,983</u>	\$ <u>11,296,610</u>

The notes receivable balance in the statement of net position represents the Perkins notes receivable. It is shown net of an allowance for bad debts of approximately \$580,000 and \$515,000 at June 30, 2014 and 2013, respectively. This allowance is the aggregate that was reserved for by each college based upon historical bad loan reserve requirements, the net increase in the allowance of \$65,000 in 2014 and the net decrease in the allowance of \$22,000 in 2013 has been reflected in operating expenses.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 5 - Long-Term Liabilities

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

	2014				
	Beginning balances	Additions	Reductions	Ending balances	Current portion
Long-term liabilities					
Bonds and notes payable	\$ 134,573,494	\$ -	\$ 3,637,525	\$ 130,935,969	\$ 3,759,760
Fair market value of interest rate swap	10,603,309	71,047	-	10,674,356	-
Net OPEB obligation	42,753,755	11,548,353	5,358,379	48,943,729	-
Accounts payable and accrued liabilities	12,954,459	12,046,640	12,738,951	12,262,148	12,126,093
Unearned revenue and deposits	7,279,832	978,913	1,167,744	7,091,001	6,663,699
Refundable grants	6,049,434	-	5,298	6,044,136	-
Total long-term liabilities	<u>\$ 214,214,283</u>	<u>\$ 24,644,953</u>	<u>\$ 22,907,897</u>	<u>\$ 215,951,339</u>	<u>\$ 22,549,552</u>
	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	<u>\$ 221,244,949</u>	<u>\$ 51,558,415</u>	<u>\$ 58,589,081</u>	<u>\$ 214,214,283</u>	<u>\$ 22,853,670</u>

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 5 - **Long-Term Liabilities - Continued**

Bonds and Notes Payable

Outstanding debt is as follows:

	<u>2014</u>	<u>2013</u>
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	\$ 2,258,024	\$ 2,359,365
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
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}	3,600,340	3,825,850
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}	66,356,816	67,838,430

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 5 - **Long-Term Liabilities - Continued**

	<u>2014</u>	<u>2013</u>
<i><u>Bonds and Notes Payable - Continued</u></i>		
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 \$220,580 and \$264,696 has been added to this liability at June 30, 2014 and 2013, respectively.	\$ 8,510,580	\$ 9,604,696
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 \$1,780,209 and \$1,875,153 has been added to the liability at June 30, 2014 and 2013, respectively.	<u>19,945,209</u>	<u>20,040,153</u>
	<u>\$ 130,935,969</u>	<u>\$ 134,573,494</u>

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 5 - **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%).

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 \$469,030 as of June 30, 2014 and \$519,533 as of June 30, 2013.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 5 - **Long-Term Liabilities - Continued**

Bonds and Notes Payable - Continued

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 \$10,129,047 as of June 30, 2014 and \$10,017,328 as of June 30, 2013.

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 \$76,279 and \$66,448 as of June 30, 2014 and 2013, respectively.

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

Notes to the Financial Statements

June 30, 2014 and 2013

Note 5 - **Long-Term Liabilities - Continued**

Debt Roll-Forward

Long-term debt activity for the years ended June 30, 2014 and 2013 was as follows:

	<u>Balance</u> <u>June 30, 2013</u>	<u>Additions</u>	<u>Repayments</u>	<u>Balance</u> <u>June 30, 2014</u>	<u>Current</u> <u>Portion</u>
Series 1998 with accreted interest	\$ <u>640,000</u>	\$ <u>-</u>	\$ <u>(640,000)</u>	\$ <u>-</u>	\$ <u>-</u>
New Housing - CSC	<u>3,825,850</u>	<u>-</u>	<u>(225,510)</u>	<u>3,600,340</u>	<u>237,162</u>
TD Banknorth - FY 2008 Capital Projects	<u>67,838,430</u>	<u>-</u>	<u>(1,481,614)</u>	<u>66,356,816</u>	<u>1,551,838</u>
CCV Montpelier	<u>2,359,365</u>	<u>-</u>	<u>(101,341)</u>	<u>2,258,024</u>	<u>106,700</u>
Series 2010-A	<u>9,340,000</u>	<u>-</u>	<u>(1,050,000)</u>	<u>8,290,000</u>	<u>1,725,000</u>
Series 2010-B	<u>30,265,000</u>	<u>-</u>	<u>-</u>	<u>30,265,000</u>	<u>-</u>
Series 2010 Bond Premium	<u>264,696</u>	<u>-</u>	<u>(44,116)</u>	<u>220,580</u>	<u>44,116</u>
Series 2010 Bonds	<u>39,869,696</u>	<u>-</u>	<u>(1,094,116)</u>	<u>38,775,580</u>	<u>1,769,116</u>
Series 2013	<u>18,165,000</u>	<u>-</u>	<u>-</u>	<u>18,165,000</u>	<u>-</u>
Series 2013 Bond Premium	<u>1,875,153</u>	<u>-</u>	<u>(94,944)</u>	<u>1,780,209</u>	<u>94,944</u>
Series 2013 Bonds	<u>20,040,153</u>	<u>-</u>	<u>(94,944)</u>	<u>19,945,209</u>	<u>94,944</u>
Total Bonds and Notes Payable	\$ <u>134,573,494</u>	\$ <u>-</u>	\$ <u>(3,637,525)</u>	\$ <u>130,935,969</u>	\$ <u>3,759,760</u>

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

Notes to the Financial Statements

June 30, 2014 and 2013

Note 5 - **Long-Term Liabilities - Continued**

Debt Roll-Forward - Continued

	Balance <u>June 30, 2012</u>	<u>Additions</u>	<u>Repayments</u>	Balance <u>June 30, 2013</u>	Current <u>Portion</u>
Series 1977-A	\$ 315,000	\$ -	\$ (315,000)	\$ -	\$ -
Series 1977-B	60,000	-	(60,000)	-	-
Series 1998	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

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

Notes to the Financial Statements

June 30, 2014 and 2013

Note 5 - **Long-Term Liabilities - Continued**

Debt Roll-Forward - Continued

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

<u>Years Ending June 30,</u>	<u>Principal Amount</u>	<u>Interest Amount</u>
2015	\$ 3,759,760	\$ 5,745,501
2016	4,661,213	5,560,090
2017	5,422,083	5,325,744
2018	5,647,584	5,078,704
2019	5,707,937	4,854,637
2020-2024	23,876,537	21,337,839
2025-2029	59,924,806	13,604,977
2030-2034	10,986,049	3,608,018
2035-2039	7,445,000	1,608,673
2040-2041	<u>3,505,000</u>	<u>108,211</u>
	<u>\$ 130,935,969</u>	<u>\$ 66,832,394</u>

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
(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 6 - **Functional Expense Classification**

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

	<u>2014</u>	<u>2013</u>
Instruction	\$ 58,399,475	\$ 58,112,105
Research	30,947	39,554
Public service	10,825,104	10,538,004
Academic support	22,566,674	22,637,181
Student services	29,400,400	30,514,111
Institutional support	44,830,185	45,703,158
Physical plant	7,931,182	5,000,441
Student financial support	7,273,698	8,607,584
Depreciation	<u>14,030,027</u>	<u>13,238,072</u>
Total	\$ <u>195,287,692</u>	\$ <u>194,390,210</u>

Note 7 - **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 \$1,150,000 in 2014 and \$1,117,000 in 2013; VMEC of approximately \$428,000 in 2014 and 2013; and VIT of approximately \$809,000 in 2014 and \$786,000 in 2013.

Capital appropriations for VSC made from the State Bond Funds were approximately \$1,688,000 and \$4,099,000 in fiscal years 2014 and 2013, respectively.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 8 - **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, 2014 and 2013, the Colleges' total payroll expense was approximately \$82,488,000 and \$81,454,000, respectively, of which approximately \$54,018,000 and \$52,914,000 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 non-represented employees. Employer contribution rates are established by employee category. There are no required employee contributions to the plan. Depending upon the 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, 2014 and 2013, contributions made by the Colleges under this plan totaled approximately \$6,432,000 and \$6,251,000, or approximately 11.91% and 11.81% of covered salaries, respectively.

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 years ended June 30, 2014 and 2013 were approximately \$61,800 and \$61,500, respectively, and employer contributions were approximately \$6,300 and \$6,000, respectively. There were no contributions to the Vermont State Teachers Retirement System during 2014 and 2013.

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, 2014 and 2013, contributions for these benefits were approximately \$1,083,000 and \$1,313,000, respectively.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 8 - **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 9 - **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 they are 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, 2014 and 2013, 465 and 470 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 2014 and 2013, VSC recognized employer contributions of \$5,358,379 and \$4,984,399, respectively, for both healthcare and early retirement. The plan is financed on a pay-as-you-go basis. In fiscal years 2014 and 2013, 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
(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 9 - **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, 2014 and 2013, and the changes in VSC's net OPEB obligation to the Retiree Health and Early Retirement Plans:

	<u>2014</u>	<u>2013</u>
Annual required contribution	\$ 12,610,000	\$ 13,262,000
Interest on net OPEB obligation	1,603,266	1,338,393
Adjustment to annual required contribution	<u>(2,664,913)</u>	<u>(2,552,728)</u>
Annual OPEB cost	11,548,353	12,047,665
Contribution made	<u>(5,358,379)</u>	<u>(4,984,399)</u>
Increase in net OPEB obligation	6,189,974	7,063,266
Net OPEB Obligation - Beginning of Year	<u>42,753,755</u>	<u>35,690,489</u>
Net OPEB Obligation - End of Year	<u>\$ 48,943,729</u>	<u>\$ 42,753,755</u>

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, 2014, 2013 and 2012 are as follows:

<u>Fiscal Years Ended</u>	<u>Annual OPEB Cost</u>	<u>% of Annual OPEB Cost Contributed</u>	<u>Net OPEB Obligation</u>
June 30, 2014	\$ 11,548,353	46.4%	\$ 48,943,729
June 30, 2013	\$ 12,047,665	41.4%	\$ 42,753,755
June 30, 2012	\$ 12,580,444	36.2%	\$ 35,690,489

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 9 - **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 \$135,344,000, all of which was unfunded. The annual covered payroll (annual payroll of active employees covered by the plan) was \$54,018,000, and the ratio of the unfunded actuarial liability to annual covered payroll was 250.6%. The latest actuarial valuation date was on July 1, 2013.

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.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 9 - **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 90% at the calculation date.

Healthcare Cost Trend Rate: Dental claims are expected to increase at 2.0 per annum. Medical trend rates are based on the Society of Actuaries (SOA) Long-Run Medical Cost Trend Model.

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 10 - **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 \$2,801,000 and \$2,707,000 in 2014 and 2013, respectively.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Notes to the Financial Statements

June 30, 2014 and 2013

Note 10 - Leases - Continued

Future minimum rental payments required under operating leases with noncancelable terms in excess of one year at June 30, 2014 are as follows:

<u>Years Ending June 30,</u>	<u>Real Estate</u>	<u>Vehicles and Equipment</u>	<u>Total</u>
2015	\$ 2,521,389	\$ 254,542	\$ 2,775,930
2016	1,831,486	235,557	2,067,043
2017	1,846,311	59,018	1,905,329
2018	1,822,321	38,446	1,860,768
2019	1,757,192	-	1,757,192
2020 and beyond	<u>13,166,165</u>	<u>-</u>	<u>13,166,165</u>
	<u>\$ 22,944,864</u>	<u>\$ 587,563</u>	<u>\$ 23,532,427</u>

Note 11 - Capital Assets

Property and equipment activity for the years ended June 30, 2014 and 2013 is summarized below:

	<u>Balance June 30, 2013</u>	<u>Additions</u>	<u>Transfers</u>	<u>Retirements</u>	<u>Balance June 30, 2014</u>
Land	\$ 6,428,274	\$ -	\$ -	-	\$ 6,428,274
Construction-in-process	<u>7,498,075</u>	<u>6,044,799</u>	<u>(10,345,739)</u>	<u>-</u>	<u>3,197,135</u>
Subtotal - Capital assets not depreciated	<u>13,926,349</u>	<u>6,044,799</u>	<u>(10,345,739)</u>	<u>-</u>	<u>9,625,409</u>
Infrastructure	36,440,568	160,630	1,354,078	-	37,955,276
Buildings and improvements	240,504,212	-	8,963,061	-	249,467,273
Leasehold improvements	2,144,024	-	-	-	2,144,024
Equipment	<u>30,853,774</u>	<u>850,736</u>	<u>28,600</u>	<u>(254,828)</u>	<u>31,478,282</u>
Subtotal - Capital assets depreciated	<u>309,942,578</u>	<u>1,011,366</u>	<u>10,345,739</u>	<u>(254,828)</u>	<u>321,044,855</u>
Less accumulated depreciation	<u>(129,856,677)</u>	<u>(14,030,027)</u>	<u>-</u>	<u>216,288</u>	<u>(143,670,416)</u>
Capital assets, net	<u>\$ 194,012,250</u>	<u>\$ (6,973,862)</u>	<u>\$ -</u>	<u>\$ (38,540)</u>	<u>\$ 186,999,848</u>

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

Notes to the Financial Statements

June 30, 2014 and 2013

Note 11 - Capital Assets - Continued

	Balance <u>June 30, 2012</u>	Additions	Transfers	Retirements	Balance <u>June 30, 2013</u>
Land	\$ 6,368,565	\$ 59,709	\$ -	\$ -	\$ 6,428,274
Construction-in-process	<u>7,075,650</u>	<u>10,729,832</u>	<u>(10,307,407)</u>	-	<u>7,498,075</u>
Subtotal - Capital assets not depreciated	<u>13,444,215</u>	<u>10,789,541</u>	<u>(10,307,407)</u>	-	<u>13,926,349</u>
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	<u>16,581,175</u>	<u>14,311,049</u>	<u>56,055</u>	<u>(94,505)</u>	<u>30,853,774</u>
Subtotal - Capital assets depreciated	<u>284,695,572</u>	<u>15,153,580</u>	<u>10,307,407</u>	<u>(213,981)</u>	<u>309,942,578</u>
Less accumulated depreciation	<u>(116,791,424)</u>	<u>(13,238,072)</u>	-	<u>172,819</u>	<u>(129,856,677)</u>
Capital assets, net	\$ <u>181,348,363</u>	\$ <u>12,705,049</u>	\$ -	\$ <u>(41,162)</u>	\$ <u>194,012,250</u>

Included in construction-in-process is interest expense on borrowing during the construction period. Total interest expense for fiscal year 2013 was \$4,641. There was no such interest expense for fiscal year 2014.

Note 12 - 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 that 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

June 30, 2014 and 2013

Note 12 - **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 \$1,592,000 at June 30, 2014 and \$1,537,000 at June 30, 2013 and are based on historical data. A medical and dental claim roll-forward is presented below:

	<u>2014</u>	<u>2013</u>
Medical and dental claims reserve, beginning of year	\$ 1,537,000	\$ 1,544,000
Incurred claims	21,335,000	15,162,000
Payments on claims	(21,280,000)	(15,169,000)
Medical and dental claims reserve, end of year	\$ <u>1,592,000</u>	\$ <u>1,537,000</u>

VSC self-insures its workers' compensation program and uses a third-party claims administrator. 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:

	<u>2014</u>	<u>2013</u>
Workers' compensation reserve, beginning of year	\$ 206,000	\$ 229,000
Workers' compensation accrued during the year	355,000	341,000
Claims paid/reserved/claims administration	(386,000)	(364,000)
Workers' compensation reserve, end of year	\$ <u>175,000</u>	\$ <u>206,000</u>

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

Notes to the Financial Statements

June 30, 2014 and 2013

Note 12 - **Contingencies and Commitments - Continued**

Commitments

VSC has entered into various construction contracts. The following commitments are ongoing projects at June 30, 2014.

<u>Project</u>	<u>Expended through June 30, 2014</u>	<u>Committed Future Costs</u>	<u>Total Committed Costs of Project</u>
VSC Brattleboro Facility	\$ 82,162	\$ 4,263	\$ 86,425
CSC Leavenworth Window Replacement	-	400,123	400,123
VTC Bio-digester Project	<u>3,379,064</u>	<u>78,785</u>	<u>3,457,849</u>
	<u>\$ 3,461,226</u>	<u>\$ 483,171</u>	<u>\$ 3,944,397</u>

At June 30, 2014, invoices related to construction projects of approximately \$130,000 were included in accounts payable.

Employment Contracts

The Colleges have employment contracts with certain officers that expire on various dates through fiscal years 2015 and 2016. The agreements provide for aggregate annual base salaries of \$1,117,593 in fiscal year 2015 and \$723,948 in fiscal year 2016 and may be terminated with cause at any time.

Note 13 - **Management's Acceptance of Financial Statements**

Management has evaluated subsequent events through **XXXXXX**, the date for which the financial statements were available for issuance.

REQUIRED SUPPLEMENTARY INFORMATION

DRAFT

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

Schedule of Funding Progress (Unaudited)

June 30, 2014 and 2013

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, 2013	\$ -	\$ 135,344,800	\$ 135,344,800	0%	\$ 54,018,000	250.6%
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%

VSC has to date performed four actuarial valuations, the latest on July 1, 2013, for purposes of satisfying the requirements of GASB Statement No. 45. The actuarial accrued liability for all benefits at this time was \$135,344,800, all of which was unfunded. The annual covered payroll (annual payroll of active employees covered by the plan) was \$54,018,000, and the ratio of the unfunded actuarial liability to annual covered payroll was 250.6%.

SUPPLEMENTAL INFORMATION

DRAFT

**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***

DRAFT

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, 2014 and 2013, the related statements of revenues and expenses, 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 Colleges' basic financial statements and have issued our report thereon dated **DATE**.

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 Colleges' 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.

**Certified Public Accountants
Braintree, Massachusetts**

DATE

DRAFT

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

DRAFT

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, 2014. 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.

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, 2014.

Other Matters

The results of our auditing procedures disclosed an instance of noncompliance, which is required to be reported in accordance with OMB Circular A-133 and which is described in the accompanying schedule of findings and questioned costs as Finding 2014-01. Our opinion on each major Federal program is not modified with respect to these matters.

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

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.

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 deficiency in internal control over compliance, as described in the accompanying schedule of findings and questioned costs as item Finding 2014-01, that we consider being a significant deficiency.

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, 2014, and have issued our report thereon dated **DATE**, 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.

**Certified Public Accountants
Braintree, Massachusetts**

DATE

**SCHEDULE OF EXPENDITURES
OF FEDERAL AWARDS**

DRAFT

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

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2014

	CFDA Number	State Revenue Code	Total
U.S. Department of Education:			
Student Financial Assistance Cluster:			
Federal Supplemental Educational Opportunity Grant	84.007		\$ 1,242,549
Federal Work-Study Program	84.033		1,244,344
Federal Perkins Loan Program	84.038		15,004
Federal Pell Grant Program	84.063		19,906,605
before loans and loan guarantees			22,408,502
Loans and loan guarantees:			
Beginning of year balances under the Federal Perkins Loans			4,489,236
Loans advanced to students under the Federal Perkins	84.038		1,078,072
Federal Family Education Loans	84.032		629,308
Federal Direct Student Loans	84.268		37,317,583
			39,024,963
Subtotal - loans and loan guarantees			-
Total Student Financial Assistance			61,433,465
U.S. Department of Education:			
TRIO Cluster:			
TRIO Student Support Services	84.042A		1,509,754
TRIO Upward Bound	84.047A		1,018,454
Total			2,528,208
Other Direct from U.S. Department of Education:			
Center for Rural Students	84.116Z		363
Center for Rural Students II	84.116Z		85,137
Total			85,500
Total U.S. Department of Education (Direct)			64,047,173
Direct from Other Federal Sources			
US Dept of Commerce:			
Manufacturing Extension Partnership	11.611		396,483
EDA Disaster Assistance	11.307		33,396
National Science Foundation			
NSF-Rapid/Moore OK, Tornado	47.050		9,299
VORTEX2-Wall Clouds	47.050		84,503

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

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2014

	CFDA Number	State Revenue Code	Total
Small Business Administration			
Small Business Development Center	59.037		\$ 542,718
Tech Assistance to Small Business/Emerg-Cong Earmark	59.000		53,548
US Small Business Admin-Small Jobs Act Program	59.037		81,084
Portable assistance Program-Irene Disaster Assistance	59.037		(15)
SBDC FAST Grant	59.058		19,542
US Dept of Health and Human Services (STAR)	47.076		123,380
US Dept of Labor			
Green Jobs Initiative	17.261		219,518
TAACCCT	17.282		1,777,840
Total Other Federal Sources (Direct)			<u>3,341,296</u>
Passed Thru Vermont Department of Education:			
Vocational Education_Basic Grants to States	84.048	4319	156,618
Career & Technical Education	84.048	4306	673,818
CP Basic Grant to the States	84.048		50,000
Subtotal (Perkins)			<u>880,436</u>
Other:			
Summer Food Service Program for Children	10.559	4455	4,842
Sub-total			<u>4,842</u>
Total Passed Through Vermont Dept of Education			<u>885,278</u>
Passed Thru Other Sources:			
Vermont Agency of Human Services:			
Americorps	94.006		327,628
Office of Vermont Health Access (OVHA)			
Global Commitment (Medicaid Regular)	93.778		228,812
Vermont Student Assistance Corp			
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		15,829
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		285,093
Gear UP Guide Program	10.217		20,408
Vermont Dept. Children & Families			
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		301,231
CCDF-Discretionary Funds	93.575		37,906
National Science Foundation			
UVM/SWAC	47.050		9,333
National Center for Research Resources			
Aerospace Edu Services Prog-NASA Satellite	93.389		185,936

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

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2014

	CFDA Number	State Revenue Code	Total
University of Vermont:			
EPSCOR	47.790		\$ 4,935
EPSCOR	47.076		162,349
EPSCOR - Stem Research	47.081		120,752
Vermont Genetics Network	93.389		183,104
Think College	84.407A		64,557
NASA-CubeSat Lunar Lander	43.000		1,572
Aerospace Education Services-NASA Satellite Lab	43.001		6,316
VT Agency of Natural Resources			
Pollution Prevention Grants Program	66.708		48,807
USDA			
Rural Business Enterprise Grants	10.769		57,228
VT Department of Libraries			
Library Services & Tech Act	45.310		502
VT Agency of Commerce & Community Development			
Defense Logistics Agency	12.002		42,777
HUD Community Dev Block Grant-State Prgm-Town of Randolph	14.228		47,894
VT Dept of Energy			
Large Biodigester-US Dept of Energy	81.087		438,020
NCAA			
Strategic Alliance	93.226		30,115
Choices	93.226		6,504
USGS-Ed Maps	15.810		19,740
VT Council on Rural Development			
Digital Economy	11.307		84,050
E-Commerce for EDA/VCRD	11.307		206,191
Broadband Technology Opportunities Grant (ARRA)	11.557		8,297
Northeast VT Area Health Education Center-HCOP	93.822		13,009
NBRC-National Borders Regional Commission	90.601		47,344
Mathematics and Science Partnerships	84.366A		269,441
Total Passed Through Other Sources (Indirect)			<u>3,275,680</u>
Total Federal Funds			<u><u>\$ 71,549,427</u></u>

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

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2014

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	\$ 155,751	\$ 323,990	\$ 358,874	\$ 173,644	\$ 230,290	\$ -	\$ -	\$ -	\$ 1,242,549
Federal Work-Study Program	84.033	127,681	332,543	429,515	196,094	158,511	-	-	-	1,244,344
Federal Perkins Loan Program	84.038	-	-	-	15,004	-	-	-	-	15,004
Federal Pell Grant Program	84.063	8,682,470	3,086,421	3,072,794	2,730,038	2,334,882	-	-	-	19,906,605
before loans and loan guarantees		8,965,902	3,742,954	3,861,183	3,114,780	2,723,683	-	-	-	22,408,502
Loans and loan guarantees:										
Beginning of year balances under the Federal Perkins Loans		-	1,795,764	876,425	1,205,223	583,582	28,242	-	-	4,489,236
Loans advanced to students under the Federal Perkins	84.038	-	403,860	238,452	299,292	136,468	-	-	-	1,078,072
Federal Family Education Loans	84.032	-	-	629,308	-	-	-	-	-	629,308
Federal Direct Student Loans	84.268	8,028,611	-	10,957,393	9,761,084	8,570,495	-	-	-	37,317,583
Subtotal - loans and loan guarantees		8,028,611	403,860	11,825,153	10,060,376	8,706,963	-	-	-	39,024,963
Total Student Financial Assistance		16,994,513	4,146,814	15,686,336	13,175,156	11,430,646	-	-	-	61,433,465
U.S. Department of Education:										
TRIO Cluster:										
TRIO Student Support Services	84.042A	340,025	259,666	379,345	260,947	269,771	-	-	-	1,509,754
TRIO Upward Bound	84.047A	-	242,040	445,615	330,799	-	-	-	-	1,018,454
Total		340,025	501,706	824,961	591,745	269,771	-	-	-	2,528,208
Other Direct from U.S. Department of Education:										
Center for Rural Students	84.116Z	-	-	-	363	-	-	-	-	363
Center for Rural Students II	84.116Z	-	-	-	85,137	-	-	-	-	85,137
Total		-	-	-	85,500	-	-	-	-	85,500
Total U.S. Department of Education (Direct)		17,334,538	4,648,520	16,511,297	13,852,401	11,700,417	-	-	-	64,047,173
Direct from Other Federal Sources										
US Dept of Commerce:										
Manufacturing Extension Partnership	11.611	-	-	-	-	-	-	396,483	-	396,483
EDA Disaster Assistance	11.307	-	-	-	-	-	-	33,396	-	33,396
National Science Foundation										
NSF-Rapid/Moore OK, Tornado	47.050	-	-	-	9,299	-	-	-	-	9,299
VORTEX2-Wall Clouds	47.050	-	-	-	84,503	-	-	-	-	84,503
Small Business Administration										
Small Business Development Center	59.037	-	-	-	-	-	-	542,718	-	542,718
Tech Assistance to Small Business/Emerg-Cong Earmark	59.000	43,011	-	-	-	-	-	10,537	-	53,548
US Small Business Admin-Small Jobs Act Program	59.037	-	-	-	-	-	-	81,084	-	81,084
Portable assistance Program-Irene Disaster Assistance	59.037	-	-	-	-	-	-	(15)	-	(15)
SBDC FAST Grant	59.058	-	-	-	-	-	-	19,542	-	19,542

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

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2014

	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 Health and Human Services (STAR)	47.076	\$	-	\$	-	\$	123,380	\$	-	\$	-	\$	123,380
US Dept of Labor													
Green Jobs Initiative	17.261		-	-	-	-	-	-	219,518	-	-	-	219,518
TAACCCT	17.282		1,064,112	-	-	-	713,728	-	-	-	-	-	1,777,840
Total Other Federal Sources (Direct)			1,107,123	-	123,380	93,802	713,728	-	1,303,263	-	-	-	3,341,296
Passed Thru Vermont Department of Education:													
Vocational Education_Basic Grants to States	84.048	4319	-	-	-	-	156,618	-	-	-	-	-	156,618
Career & Technical Education	84.048	4306	673,818	-	-	-	-	-	-	-	-	-	673,818
CP Basic Grant to the States	84.048		50,000	-	-	-	-	-	-	-	-	-	50,000
Subtotal (Perkins)			723,818	-	-	-	156,618	-	-	-	-	-	880,436
Other:													
Summer Food Service Program for Children	10.559	4455	-	-	-	4,842	-	-	-	-	-	-	4,842
Sub-total			-	-	-	4,842	-	-	-	-	-	-	4,842
Total Passed Through Vermont Dept of Education			723,818	-	-	4,842	156,618	-	-	-	-	-	885,278
Passed Thru Other Sources:													
Vermont Agency of Human Services:													
Americorps	94.006		-	-	-	327,628	-	-	-	-	-	-	327,628
Office of Vermont Health Access (OVHA)													
Global Commitment (Medicaid Regular)	93.778		-	-	-	-	-	228,812	-	-	-	-	228,812
Vermont Student Assistance Corp													
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		14,182	-	-	-	-	-	-	1,647	-	-	15,829
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334		-	-	-	-	-	-	-	285,093	-	-	285,093
Gear UP Guide Program	10.217		-	-	20,408	-	-	-	-	-	-	-	20,408
Vermont Dept. Children & Families													
Child Care Mandatory and Matching Funds of the Child Care and Development Fund	93.596		301,231	-	-	-	-	-	-	-	-	-	301,231
CCDF-Discretionary Funds	93.575		37,906	-	-	-	-	-	-	-	-	-	37,906
University of Vermont:													
EPSCOR	47.790		-	4,935	-	-	-	-	-	-	-	-	4,935
EPSCOR	47.076		-	-	162,349	-	-	-	-	-	-	-	162,349
EPSCOR - Stem Research	47.081		-	-	120,752	-	-	-	-	-	-	-	120,752
Vermont Genetics Network	93.389		-	-	183,104	-	-	-	-	-	-	-	183,104
Think College	84.407A		-	-	64,557	-	-	-	-	-	-	-	64,557
NASA-CubeSat Lunar Lander	43.000		-	-	-	-	1,572	-	-	-	-	-	1,572
Aerospace Education Services-NASA Satellite Lab	43.001		-	-	-	-	6,316	-	-	-	-	-	6,316

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

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2014

	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		
National Science Foundation													
US Dept Of Energy-Northeast Photovoltaic Training Network	47.050	\$	-	\$	-	\$	9,333	\$	-	\$	-	\$	9,333
National Center for Research Resources													
Aerospace Edu Services Prog-NASA Satellite	93.389		-	134,787	-	51,149	-	-	-	-	-	-	185,936
VT Agency of Natural Resources													
Pollution Prevention Grants Program	66.708		-	-	-	-	-	-	48,807	-	-	-	48,807
USDA													
Rural Business Enterprise Grants	10.769		-	-	-	57,228	-	-	-	-	-	-	57,228
VT Department of Libraries													
Library Services & Tech Act	45.310		-	-	-	-	502	-	-	-	-	-	502
VT Agency of Commercy & Community Development													
Defense Logistics Agency	12.002		-	-	-	-	-	-	42,777	-	-	-	42,777
HUD Community Dev Block Grant-State Prgm-Town of Randolph	14.228		-	-	-	-	-	-	47,894	-	-	-	47,894
VT Sustainable Jobs Fund, Inc.													
Large Biodigester-US Dept of Energy	81.087		-	-	-	-	438,020	-	-	-	-	-	438,020
NCAA													
Strategic Alliance	93.226		-	-	30,115	-	-	-	-	-	-	-	30,115
Choices	93.226		-	-	6,504	-	-	-	-	-	-	-	6,504
USGS-Ed Maps	15.810		-	19,740	-	-	-	-	-	-	-	-	19,740
VT Council on Rural Development													
Digital Economy	11.307		84,050	-	-	-	-	-	-	-	-	-	84,050
E-Commerce for EDA/VCRD	11.307		-	-	-	-	-	-	206,191	-	-	-	206,191
Broadband Technology Opportunities Grant (ARRA)	11.557		8,297	-	-	-	-	-	-	-	-	-	8,297
Northeast VT Area Health Education Center-HCOP	93.822		13,009	-	-	-	-	-	-	-	-	-	13,009
NBRC-National Borders Regional Commission	90.601		-	-	-	47,344	-	-	-	-	-	-	47,344
Mathematics and Science Partnerships	84.366A		-	-	-	269,441	-	-	-	-	-	-	269,441
Total Passed Through Other Sources (Indirect)			458,675	159,462	587,789	762,123	446,410	228,812	345,669	286,740	-	-	3,275,680
Total Federal Funds			\$ 19,624,154	\$ 4,807,982	\$ 17,222,466	\$ 14,713,168	\$ 13,017,173	\$ 228,812	\$ 1,648,932	\$ 286,740	\$	\$	71,549,427

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

Notes to Schedule of Expenditures of Federal Awards

Year Ended June 30, 2014

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.

DRAFT

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

Schedule of Findings and Questioned Costs

Year Ended June 30, 2014

I. Summary of Auditor's Results

Financial Statements

Type of audit report issued: Unmodified

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

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: Unmodified

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

84.007, 84.033, 84.038, 84.063, 84.032, 84.268.

84.042A, 84.047A

11.611

59.037

94.006

Name of Federal Program

Student Financial Assistance Cluster

TRIO Cluster

Manufacturing Extension Partnership

Small Business Development Center

Americorps

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

Schedule of Findings and Questioned Costs - Continued

Year Ended June 30, 2014

I. Summary of Auditor's Results - Continued

Identification of major programs - Continued:

<u>CFDA Numbers</u>	<u>Name of Federal Program</u>
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
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund
81.087	Renewable Energy Research and Development
Dollar threshold used to distinguish Between type A and type B programs:	\$300,000
Auditee qualifies as a low-risk auditee?	No

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Schedule of Findings and Questioned Costs - Continued

Year Ended June 30, 2014

II. Federal Audit Findings and Questioned Costs

Finding number: 2014-01
Federal agency: U.S. Department of Education
Programs: Federal Pell Grant Program
CFDA #'s: 84.063
Award year: 2014

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

CCV acknowledged these errors when discovered during interim audit testing. The errors highlighted a weakness in the College's Colleague electronic reporting process to the COD system, whereby it was difficult to discern after the data was transmitted, which individual Pell records were accepted by the COD system. This type of error was not noticed until reconciliation between the two systems was performed at a later date. The College has redesigned and implemented in its electronic reporting process, a new system report edit function which helps to quickly identify data reporting errors with the COD system and will allow CCV to provide the correct Pell student data within the required 30 day reporting window.

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Schedule of Prior Audit Findings and Questioned Costs

Year Ended June 30, 2014

II. Federal Audit Findings and Questioned Costs - Continued

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.

AUDITOR COMMENT

The recommendation was adopted by management during the fiscal year ended June 30, 2014. No similar findings were noted during the audit.

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

Schedule of Prior Audit Findings and Questioned Costs - Continued

Year Ended June 30, 2014

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;

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Schedule of Prior Audit Findings and Questioned Costs - Continued

Year Ended June 30, 2014

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.

AUDITOR COMMENT

The recommendation was adopted by management during the fiscal year ended June 30, 2014. No similar findings were noted during the audit.

VERMONT STATE COLLEGES

MANAGEMENT LETTER

JUNE 30, 2014

VERMONT STATE COLLEGES

Management Letter

June 30, 2014

CONTENTS

Management Report	1
Current Year Findings:	
Reporting Student Financial Aid Payment Data to COD (Common Origination and Disbursement System)	2
Current Year Comments:	
Capital Asset Software	3
Procurement Cards	3-4
Status of Prior Year Comments	5
Conclusion	6

DRAFT

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, 2014, 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

October 23, 2014

CURRENT YEAR FINDINGS

DRAFT

Vermont State Colleges
Page 2

Reporting Student Financial Aid Payment Data to COD (Common Origination and Disbursement System)

Current situation:

Colleges must report student financial aid payment data to the COD (Common Origination and Disbursement System) within 30 calendar days after the school credits the student account. During our financial aid testing, we noted a number of errors with regard to this timing. The Community College of Vermont failed to report PELL grant disbursements within the required timeframe for three out of eight students tested. Our financial aid testing results are as follows:

Student Name	Date Credited to Students Account	Date Reported to COD	# Days
Melody Maher	8/5/2013	11/11/2013	97
Melody Maher	9/25/2013	2/5/2014	132
Mark Porter	9/25/2013	11/13/2014	48
Cole Stevens	9/25/2013	1/29/2014	125

Auditor's recommendation:

We recommend that management review its control procedures for reporting student financial aid data to the COD to insure proper controls are in place to insure that all information is reported in a timely manner.

Management's response:

CCV acknowledged these errors when discovered during interim audit testing. The errors highlighted a weakness in the College's Colleague electronic reporting process to the COD system, whereby it was difficult to discern after the data was transmitted, which individual Pell records were accepted by the COD system. This type of error was not noticed until reconciliation between the two systems was performed at a later date. The College has redesigned and implemented in its electronic reporting process, a new system report edit function which helps to quickly identify data reporting errors with the COD system and will allow CCV to provide the correct Pell student data within the required 30 day reporting window.

CURRENT YEAR COMMENTS

DRAFT

Vermont State Colleges
Page 3

Capital Asset Software

Current situation:

The Colleges have implemented a new fixed asset software. This helped to improve the efficiency and effectiveness of auditing the capital assets. We did note that there are specific reports that the Colleges, with the exception of Vermont Technical College and the Chancellors Office, were not able to run which included a roll forward of the accumulated depreciation, current year depreciation expense, and ending accumulated depreciation.

Auditor's recommendation:

We recommend the Colleges work with their IT departments to prepare specific reports that would include the roll forward of accumulated depreciation in total as well as on an asset by asset basis.

Management's response:

The report showing the roll forward of accumulated depreciation is available within the database used for capital assets. Training will be provided to ensure that all Colleges know how to access and run the Capital Asset reports for their school.

Procurement Cards

Current situation:

The Colleges have approximately 485 procurement cards issued to employees of the VSC's colleges and offices. Cardholders are required to adhere to the College's P-card and general purchasing policies. During our year-end audit testing of P-card transactions, we noted a number of exceptions to these policies. We noted a number of instances where the approval date of the expense log by the cardholder's supervisor was after month-end and the purchase had already been paid for. We noted a number of instances where the employee's signature or the supervisor's signature approving the expense log was missing from the documentation. We noted a number of instances where the back-up documentation for the expenditure was missing; the employee did complete a "Missing Receipt Form" in its absence. We also noted a number of transactions that included sales tax on the expenditure and the Colleges were never reimbursed. All our findings are consistent with the FY2014 Internal Audit Report prepared by the Chancellors Office.

Vermont State Colleges
Page 4

Procurement Cards - Continued

Auditor's recommendation:

We recommend the Colleges continue to monitor their P-card transactions for errors or abuse and also remind employees on an annual basis of the College's various P-card and purchasing policies. If employees continuously violate these policies, then we recommend temporary revocation of the individual Cardholder's privileges or if necessary permanent revocation of the procurement card.

Management's response:

The issues related to P-Cards were raised during our own internal audit process. VSC concurs that the issues raised need to be addressed, and will initiate discussions with all colleges on processes to improve compliance with procedures and controls. Possible responses to the issue may include regular refresher training for P-Card users, more specific actions and timelines for P-Card users and supervisors who do not comply with policies on reporting and approving P-Card purchases including suspension of P-Card privileges for staff who consistently miss deadlines or fail to comply with policies and procedures related to the use of P-Cards.

Possible responses to the issue of paying VT state sales tax may include having Tax ID for the college imprinted on cards to make it easier for staff to get sales tax waived at time of purchase, or change in policy to permit payment of sales tax for de minimus amounts.

STATUS OF PRIOR YEAR COMMENTS

DRAFT

Vermont State Colleges
Page 5

Prior Year Comments:

Recommendation

Status

Bank Account Control and Disbursement Support

Issue Resolved

Institutional Student Information Record (ISIR) Verification

Issue Resolved

“Best Practices” – Accrued Payroll

Issue Resolved

DRAFT

Vermont State Colleges
Page 6

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.

DRAFT

VERMONT STATE COLLEGES

BOARD OF TRUSTEES

RESOLUTION

Acceptance of the FY2014 Audited Financial Statements and A-133 Report

- WHEREAS, The Vermont State Colleges has contracted with O'Connor & Drew to perform its FY2014 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 FY2014 Financial Statement Audit Report by O'Connor & Drew.

B. ITEMS FOR INFORMATION AND DISCUSSION

1. Conducting 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

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	
<i>Independent Auditor</i>	
<p>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.</p>	
<p>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?</p>	
<i>Comments:</i>	
<p>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?</p>	
<i>Comments:</i>	
<p>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?</p>	
<i>Comments:</i>	

Conducting an Executive Session—Sample Questions
<i>Independent Auditor (cont.)</i>
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?
<i>Comments:</i>
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?
<i>Comments:</i>
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?
<i>Comments:</i>
7. In which areas have you and management disagreed?
<i>Comments:</i>
8. Discuss your impressions of the performance of the CAE in terms of the completeness, accuracy, and faithfulness of the financial reporting process.
<i>Comments:</i>
9. Has the firm been engaged to provide any services besides the independent audit of which the audit committee is not already aware?
<i>Comments:</i>
10. How can management improve in terms of setting an appropriate “tone at the top”?
<i>Comments:</i>

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 GAGAS¹ 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.

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