CASTLETON UNIVERSITY
COMMUNITY COLLEGE OF VERMONT
NORTHERN VERMONT UNIVERSITY
VERMONT TECHNICAL COLLEGE

VERMONT STATE COLLEGES SYSTEM

OFFICE OF THE CHANCELLOR
PO BOX 7
MONTPELIER, VT 05601
P (802) 224-3000

MEMORANDUM

TO: VSCS Audit Committee
Lynn Dickinson, Vice Chair
J. Churchill Hindes
Jeffrey Kellar – State Auditor's Office
Karen Luneau
Linda Milne, Chair
Christopher Macfarlane
Michael Pieciak

FROM: Steve Wisloski, Vice Chancellor, Finance and Administration
Sheilah M. Evans, System Controller/Senior Director of Financial Operations
Sophie Zdatny, General Counsel

DATE: October 17, 2018

SUBJECT: Audit Committee Meeting scheduled for October 24, 2018

The Audit Committee of the VSC Board of Trustees will meet at 11:00am in Conference Room 101 at the Office of the Chancellor, Montpelier, VT.

Please note that the draft financial statements included in the board materials includes only the short form, excluding the Single Audit Report. We anticipate receiving the full financial statement report from the auditors early next week and will provide it to you as soon as it becomes available.

If you have any questions, I can be reached at (802) 224-3038.

Thank you.

cc: Other Trustees
Council of Presidents
Business Affairs Council
Sam Winship, Dept. of Finance and Management
Douglas Hoffer, State Auditor

Vermont State College Board of Trustees
Audit Committee Meeting

October 24, 2018
11:00am at the Office of the Chancellor

AGENDA

A. ITEMS FOR DISCUSSION AND ACTION

1. Minutes of the April 30, 2018 Meeting of the Audit Committee

2. Review and Approval of FY2018 Draft Audited Financial Statements and Uniform Guidance Single Audit Report

B. ITEMS FOR INFORMATION AND DISCUSSION

1. Article: *Audit Committees: The Roles and Responsibilities*

2. Article: *Deloitte: Audit Committee Resource Guide*

3. Discussion of the FY19 internal audit process.

A. Items for Discussion and Action

Item 1:

Minutes of the April 30, 2018 Meeting

UNAPPROVED Minutes of the VSC Board of Trustees Audit Committee held Monday, April 30, 2018 at the Office of the Chancellor in Montpelier, VT

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

The Vermont State Colleges Board of Trustees Audit Committee met on April 30, 2018, at the Office of the Chancellor in Montpelier, VT.

Committee members present: Linda Milne (Chair), Lynn Dickinson (Vice Chair) via telecon, Karen Luneau, Chris Macfarlane

Other Trustees: Church Hindes, Michael Pieciak

Presidents: Joyce Judy, Karen Scolforo, Pat Moulton, Elaine Collins

Chancellor's Office Staff: Sheilah Evans, System Controller & Senior Director of Financial Operations
Jeb Spaulding, Chancellor
Sophie Zdatny General Counsel
Steve Wisloski, Chief Financial Officer
Yasmine Ziesler, Chief Academic Advisor
Harriet Johnson, Executive Assistant
Jen Porrier, Administrative Director

From the Colleges: Laura Jakubowski, Chief Budget & Finance Officer, Castleton University
Barbara Martin, Dean of Administration, Community College of Vermont
Sharron Scott, Dean of Administration, Johnson State College
Lit Tyler, Dean of Administration, Vermont Technical College
Maurice Ouimet, Dean of Enrollment, Castleton University
Todd Comen, Grievance Chair VSCFF
Andy Pallito, Dean of Administration, Community College of Vermont
Barb Flathers, VP, VSCUP

Others: David DiIulis, Audit Principal, O'Connor & Drew P.C.
Kieth Goldie, Audit Manager, O'Connor & Drew P.C.
Benjamin DeForest, Audit Supervisor, O'Connor & Drew P.C.

1. Chair Milne called the meeting to order at 1:02p.m.

2. Approval of the Minutes of the February , 2018 Meeting of the Audit Committee

Trustee Luneau moved and Trustee Pieciak seconded the approval of the minutes. The minutes were approved unanimously.

ITEMS FOR INFORMATION AND DISCUSSION

1. Discuss FY18 Audit Plan with O'Connor & Drew

O'Conner and Drew auditors David DiIulis, Kieth Goldie and Benjamin DeForest reiterated that the prior year audit results issued were an unmodified opinion and discussed the current year audit approach, which is in line with last year's plan. The new GASB75 pronouncements were discussed. Chair Milne elected to forgo an executive session at the current meeting, and instead hold it after the conclusion of the audit in October as usual.

2. Review FY18 Internal Audit Summary Report

Sheilah Evans, System Controller & Senior Director of Financial Operations gave a presentation on the Internal Audit Summary Report on cash receipts and travel expenses.

3. Other Business

Chancellor Jeb Spaulding presented a discussion draft of Vermont State Colleges Compliance Acknowledgement for discussion and consideration.

4. Public Comment

There was no public comment.

5. Adjourn

Chair Milne adjourned the meeting at 2:08pm.

A. ITEMS FOR DISCUSSION AND ACTION

2. Review and Approval of FY2018 Draft Audited Financial Statements and Uniform Guidance Single Audit Report

O'Connor & Drew will join us to review the draft FY2018 Audited Financial Statements and Uniform Guidance Single Audit Report.

We submitted the draft FY2018 Financial report to the State of Vermont in draft form on October 15, 2018, thereby meeting our annual deadline for the state.

During FY18, the VSC implemented GASB75 for its accounting and financial reporting of the *Post-Employment Benefits other than Pensions* obligation. This change had a significant impact on the financial statements and required a prior period adjustment. Please note that due to the nature of the accounting change, comparative statements are not available for FY18. The total Net Position as previously reported for FY17 was approximately $41 million. The prior period adjustment required an additional accrual of $100 million. As restated, the FY17 balance is -$59 million. Therefore, the current year change in net position of -$7 million brings the total Net Position of the VSC to -$66 million at June 30, 2018.

Total Operating Revenues decreased by $4.4 million from prior year. This was almost entirely a result of lower net tuition, fee and auxiliary revenues due to lower enrollments. Total Operating Expenses increased slightly, but not significantly in any one category of expense. However, total Non-Operating Revenues increased by $3 million due to the increase to the base state appropriation. The result for FY18 was a deficit of nearly -$7 million compared to -$5 million in FY17.

Total Assets and Deferred Outflows of Resources increased by approximately $17 million; whereas, Total Liabilities increased by just over $124 million. Both were predominantly a result of the GASB75 implementation. Other significant fluctuations in assets year over year include the increase of cash due to the receipt of FY19 state capital monies in June 2018 as well as funds secured from our investments for current endowment spending and in capital assets due to depreciation outpacing investments. Aside from the GASB75 increase, the significant fluctuation in liabilities was in deferred revenue due again to the advance receipt of the state capital monies. Significant changes in the Statement of Net Position include a decrease in long-term investments due to endowment spending net of favorable market conditions, a reduction in Capital Assets of $5.6 million, as depreciation outpaces new investments in our campuses, and an increase in our post retirement liability, bringing that to $188 million. Our unrestricted Net Assets are now at -$145 million, but if adjusted by the post retirement amount, it would be a + $43 million.

A. Items for Discussion and Action

Item 2:

FY2018 Draft Audited Financial Statements and Uniform Guidance Single Audit Report

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

FINANCIAL STATEMENTS AND MANAGEMENT'S DISCUSSION AND ANALYSIS

JUNE 30, 2018

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

Financial Statements and
Management's Discussion and Analysis

June 30, 2018

C O N T E N T S

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 statement of net position as of June 30, 2018, the related statement of revenues and expenses, changes in net position and cash flows for the year 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 audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. 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, 2018 and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Emphasis of Matter
As discussed in Note 2 to the financial statements, GASB Statement 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, is effective for fiscal year 2018 and required the Colleges to restate beginning net position at July 1, 2017 to recognize the actuarial accrued liability as of the actuarial report's valuation date. 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 3-20 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 Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the "Uniform Guidance"), 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

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

Management's Discussion and Analysis (Unaudited)
June 30, 2018

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 is comprised of five public colleges united in the common purpose of providing affordable, high quality, student-centered, and accessible education, fully integrating professional, liberal, and career study, consistent with student aspirations and regional and state needs.

The Vermont State College System includes:

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

Significant Events Affecting These Financial Statements

Events that affect these statements during the past five years include:

- Enrollment trends over the past 5 years are generally down for all VSC institutions, counting by either FTE (full time equivalent) or by headcount. The primary reason for this trend is the declining number of students graduating from high school in the state, as well as increased competition due to aggressive discounting by out-of-state institutions. Vermont is not alone, as nationally, enrollment continues to decline and is down 0.4% since 2015 and 4.7% since 2011.

Vermont State College System - Continued

Significant Events Affecting These Financial Statements - Continued

- The change in accounting for the accrual of the costs of other post-employment benefits (OPEB) implemented in FY2018 had a significant impact - bringing the accrual balance from $65 million at 6/30/17 (before restatement) to a total of $188 million at the end of FY2018. This accrual is not being pre-funded, but paid when incurred during retirement periods. Groups have been closed for all staff hired in the future which will reduce this liability over time.
- In FY2017, the System refinanced its privately-placed, variable rate bank loans issued in FY2006, FY2008 and FY2009, terminated the related interest rate swaps, and amortized a balloon maturity associated with the FY2008 loan. The System structured the repayments to provide debt service relief from FY2018 through FY2021, followed by level debt service from FY2022 through FY2038. The FY2017 debt was issued through the Vermont Municipal Bond Bank, is publicly-traded and fixed rate, and is backed by the System's appropriation from the State of Vermont. The System's debt also includes publicly-traded fixed rate general obligation bonds issued in FY2011 and FY2013.
- In FY2018, Johnson and Lyndon State Colleges unified administration in preparation for the July 1, 2018 origination of Northern Vermont University – one accredited institution with two distinct campuses at Johnson and Lyndon.

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, 2018 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.

<u>Using the Financial Statements - Continued</u>

These financial statements have been prepared in accordance with GASB (Government Accounting Standards Board) 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:

Financial Statements

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

- Statement of Net Position (SNP)
- Statement of Revenues and Expenses (SRE)
- Statement of Changes in Net Position (SCNP)
- 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 7 shows the condensed Statement of Net Position for the past five years.

Assets are items of economic value owed by an institution. They include capital assets like land, buildings and equipment, cash and investments, and amounts owed to us by students or others. Total assets are categorized as either current or noncurrent.

Using the Financial Statements - Continued

Statement of Net Position – Continued

Current assets are available to satisfy current liabilities, which are those amounts expected to be payable within the next year. The major components of current assets are cash and accounts receivable, which are primarily funds due to the VSC by students and granting agencies.

Total assets (including deferred outflows/inflows) of $278 million as of the end of the current fiscal year increased by $11 million or 4% from prior year, the increase was primarily in the OPEB Deferred Outflows and Cash. The increase in cash is due to the receipt of FY19 state capital monies in June 2018, as well as funds secured from our investments for current endowment spending. These increases were offset by a decrease in Capital Assets net of depreciation. Over the 5 years, total assets have decreased by $2 million: an increase of $5 million in current assets plus investments combined with the $17 million increase in deferred outflows, net of the $24 million reduction in capital assets.

Noncurrent assets consist primarily of endowment and other investments, in addition to capital assets. Investments were $46 million at June 30, 2018, which was essentially no change over prior year due to endowment spending net market gains.

Liabilities are obligations owed by the institutions. They include funds owed to others like vendors, employees, taxing agencies, bondholders. Liabilities are also classified as current and long-term. Current liabilities are those that due during the next fiscal year.

Current liabilities of $28 million as of June 30, 2018 include primarily accounts payable, and unearned revenue related to the next fiscal year. Current liabilities have been relatively consistent, with the exception of the $3 million deferred revenue from the FY19 state capital project monies received in June 2018.

Noncurrent liabilities increased by $13 million to $316 million during FY2018. An increase in postemployment benefits (OPEB) liability of $17 million, net of the long-term debt reduction represents the primary changes. The change in accounting standard to GASB 75 had a significant impact on the OPEB liability in FY2018 bringing the total OPEB liability to $188 million at June 30, 2018. Amounts for FY2017 were restated for this purpose.

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

Management's Discussion and Analysis (Unaudited) - Continued
June 30, 2018

<u>Using the Financial Statements - Continued</u>

Statement of Net Position – Continued

TABLE 1: Condensed Statement of Net Position as of June 30

($ in millions)

	2018	% change	Restated 2017	% change	2016	% change	2015	2014
Current Assets	35	21%	29	-3%	30	25%	24	21
Noncurrent Assets								
Investments	46	0%	46	7%	43	-14%	50	55
Capital assets, net	163	-4%	169	-3%	174	-4%	181	187
Other	6	0%	6	0%	6	-19%	6	6
Deferred outflows/inflows	28	65%	17	-27%	15	36%	11	11
Total Assets and Def'd outflows/inflows	278	-3%	267	-3%	268	-1%	272	280
Current liabilities	28	22%	23	-4%	25	4%	24	23
Non current liabilities								
Post employm't benefit oblig	188	9%	172	8%	60	9%	55	49
Bonds and Notes payable	121	-3%	125	7%	117	-5%	123	127
Other	7	17%	6	-71%	21	31%	16	17
Total Liabilities	344	57%	326	-1%	223	2%	218	216
Net investment in cap'l assets	49	-11%	55	0%	54	-5%	57	60
Restricted								
Nonexpendable	18	0%	19	6%	18	6%	17	16
Expendable	12	1%	11	22%	9	0%	9	10
Unrestricted	-145	0%	-144	22%	-36	24%	-29	-22
Total Net Position	-66	-12%	-59	-11%	45	-17%	54	64
Total Liabilities and Net Position	278	4%	267	-3%	268	-1%	272	280

<u>Net Position</u>

Net position is equal to the total assets minus the total liabilities, and represents the value of the institution at a point in time - for VSC, financial statements on June 30.

Net Position - Continued

Net investment in capital assets represents the historic cost of the System's capital assets reduced by total accumulated depreciation, plus the outstanding principal balances on debt used for the acquisition, construction, or improvement of those assets.

Total net position decreased from $64 million to $-66 million over the five years reported here, primarily from the recognition of post retirement costs from FY2013 to FY2016 and compounded by the change to GASB 75 in FY2018 (FY2017 was restated for FY2018 financial statement presentation). Changes in our net position from FY2017 to FY2018 include an increase to cash ($7M), decrease in capital assets (-$6M), the increase in unfunded post-retirement benefit obligations (-$17M), a decrease in amount owed on debt ($4M), as well as the creation of the OPEB Deferred Outflow ($12M).

Net investment in capital assets decreased by $6 million from June 30, 2017 to June 30, 2018 due to depreciation, offset partially by reduction in outstanding debt related to capital assets. Net investment in capital assets have steadily decreased over the five-year period reported here.

The restricted nonexpendable portion of the Net Position represents the permanent endowment funds for the system. These are donations to the colleges that cannot be spent without permission of the donor. These are invested; and the earnings are used based on the instructions of the donor. Most of the earnings on our endowment funds are for scholarships. The increase of $2 million over 5 years is due to gifts received for endowments during this period.

The restricted expendable portion of Net Position includes unexpended restricted gifts and grants, and unexpended endowment appreciation, subject to externally imposed conditions on their use. There was a $1 million increase from June 30, 2017 to June 30, 2018. Over the 5-year period, expendable net assets have increased by $2 million, as earnings have outpaced the 5% spending on endowments permitted by Board policy.

The unrestricted portion of the Net Position is largely affected by general operations, but the most significant impact to date has been the OPEB obligations, which are unfunded. Each year, that liability has increased and has over time eroded the unrestricted net position. Additionally, that liability increased significantly in FY2018 due to implementation of GASB 75 and was restated for FY2017 to be comparative with the new standard. This resulted in the significant change to unrestricted net position in both FY2017 and FY2018 as compared to the previous three years reported herein.

During FY2018, the system's total Net Position declined from $-59 million to $-66 million. This is due primarily to our unrestricted net assets being reduced from the annual booking of the VSC OPEB liability. The details of the change in net position are shown in the Statement of Revenues, Expenses, and Changes in Net Position beginning on page 10.

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 education, research, cultural programs and residential life. Table 2 on page 9 provides detail from the past 5 years related to the Capital Assets held by the System.

Construction in Progress reflects amounts paid for buildings or other assets that were 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.

Construction in Progress has tampered off as the significant construction phase ended in FY14. 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. Table 2 provides detail about Capital Assets, including related information (depreciation expense and outstanding principal on construction loans).

Table 2: Capital Assets as of June 30

($ in millions)

	2018	% Change	2017	% Change	2016	% Change	2015	2014
Land	9	0%	9	0%	10	0%	10	6
Construction in progress	1	0%	1	0%	2	0%	2	3
Infrastructure	40	0%	39	0%	38	0%	38	38
Buildings and improvements	259	0%	257	1%	254	1%	252	250
Leasehold improvements	4	0%	4	0%	4	0%	4	2
Equipment	36	1%	34	0%	33	0%	32	32
Total Capital Assets	349		344		341		338	331
Accumulated Depreciation	-186	1%	-176	1%	-167	1%	-157	-144
Capital Assets, Net	163		168		174		181	187
Related information								
Depreciation Expense	10	0%	10	-29%	10	0%	14	14
Outstanding Principal, Related Loans	125	-3%	129	5%	123	-3%	127	131

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

Management's Discussion and Analysis (Unaudited) - Continued
June 30, 2018

Statement of Revenues and Expenses

The Statement of Revenues and Expenses 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 on page 10 shows the Condensed Statement of Revenues and Expenses for the past five fiscal years.

Operating and Non-operating Revenue

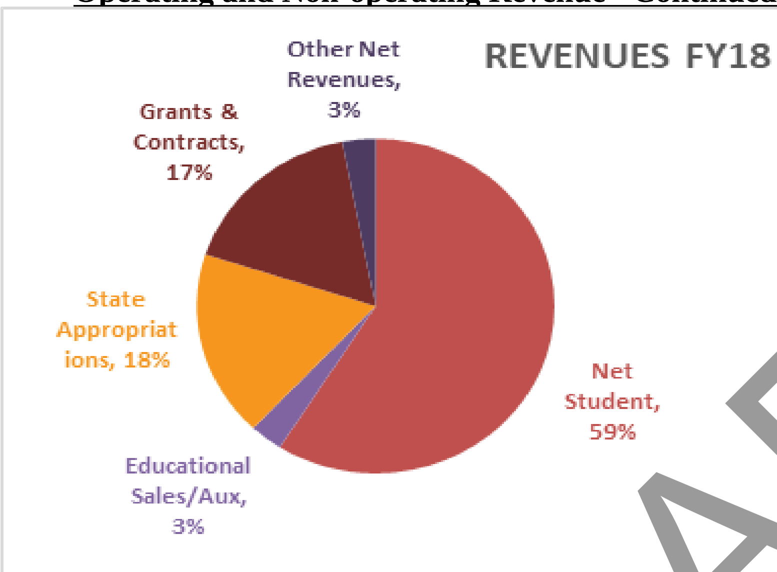
Accounting rules require that our audited financials include operating revenues, operating expenses and non-operating revenues and expenses. The following sections provide an analysis of the total operating and non-operating revenues and expenses. The VSC's primary source of revenue is from student tuition and fees. This accounts for 61% of operating and non-operating income. In addition, the System receives revenue from state appropriations, governmental and privately funded grants and contracts; gifts from individuals, foundations, and corporations; and investment income.

Table 3: Condensed Statement of Revenues and Expenses

($ in millions)

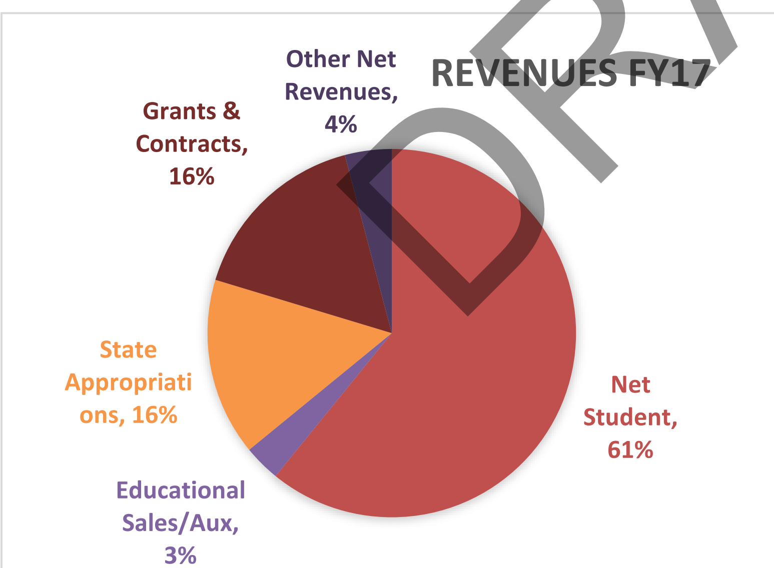
	2018	% Change	2017	% Change	2016	% Change	2015	2014
Net Student Fees	108	0%	112	0%	112	2%	110	112
Grants and contracts	15	0%	14	-1%	15	0%	15	15
Other Operating Revenues	7	0%	7	0%	8	0%	8	8
Operating Revenues	130	0%	133	-1%	135	2%	133	135
Operating Expenses	186	-0%	184	-1%	186	-2%	190	195
Operating Loss	-56	0%	-51	0%	-51	-11%	-57	-60
Nonoperating Revenues (Expenses)								
Non Capital Appropriations	30	1%	27	0%	26	-4%	27	27
Federal Grants & Contracts	16	0%	16	0%	17	-6%	18	20
Gifts currently expendable	3	33%	2	-33%	3	-25%	4	3
Investment Income & Interest	2	-33%	3	200%	1	0%	0	4
Interest Expense	-5	0%	-5	-17%	-6	50%	-4	-6
Other nonoperating revenues	0	0%	0	0%	-1	0%	0	0
Net Nonoperating Revenues	46	7%	43	8%	40	-11%	45	48
Total Change before other Revenues	-10	-25%	-8	-27%	-11	-8%	-12	-12
Other Changes in Net Position								
Capital Appropriation	3	33%	2	-33%	3	50%	2	2
Capital gifts and grants	0	0%	0	0%	0	0%	0	0
Endowment gifts	0	100%	1	0%	0	0%	1	0
Change in Net Position	-7	-40%	-5	-38%	-8	-20%	-10	-9

Operating and Non-operating Revenue - Continued



FY18 Revenues
($ in thousands)

Net Student	$ 108,248	59%
Educational Sales/Aux	5,304	3%
State Appropriations	32,819	18%
Grants & Contracts	30,936	17%
Other Net Revenues	6,436	3%
Total	$ 183,743	100%



FY17 Revenues
($ in thousands)

Net Student	$ 112,533	61%
Educational Sales/Aux	5,969	3%
State Appropriations	28,831	16%
Grants & Contracts	30,006	16%
Other Net Revenues	7,580	4%
Total	$ 184,919	100%

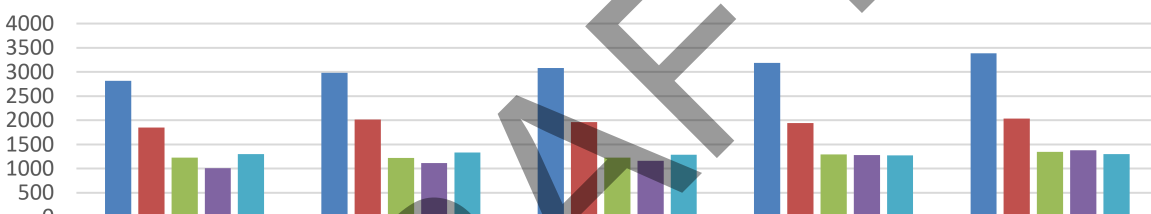
Tuition and Fee Revenue

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 FY2014 through FY2018. For the System, student-based revenue has been relatively flat during the five year period, despite increases in tuition. Enrollments in a time of decreasing high school graduates in the state have created a challenge for the colleges in our system.

Tuition and Fee Revenue - Continued

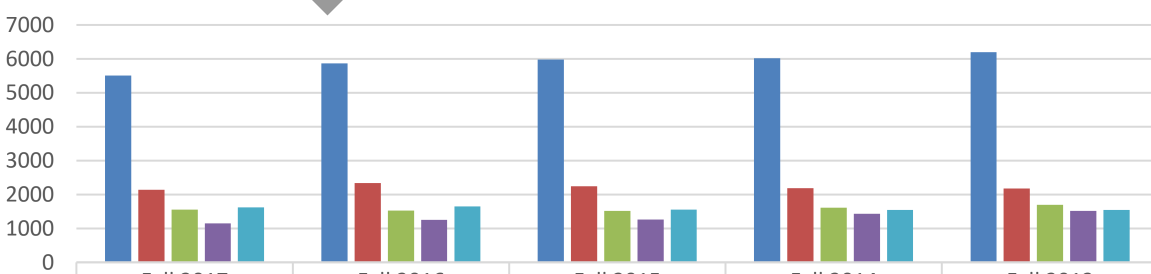
The following Charts show enrollments and student revenues for each college during this 5-year period. Enrollments are displayed by both FTE and by Headcount. FTE (Full Time Equivalent) provides better comparative information, and Headcount shows the total number of individuals who have benefited from VSC education. These charts show a general steady decline in enrollment for CCV, JSC and LSC from Fall 2013 to Fall 2017, with the exception of the Fall 2017 term for JSC. Both Castleton University and Vermont Technical College had increases for two years beginning in Fall 2015, but dipped back in Fall 2017.

Fall Enrollment by FTE by College



	Fall 2017	Fall 2016	Fall 2015	Fall 2014	Fall 2013
CCV	2813	2984	3077	3186	3387
CU	1851	2015	1960	1940	2036
JSC	1229	1222	1225	1296	1343
LSC	1006	1116	1162	1283	1376
VTC	1297	1335	1286	1274	1302

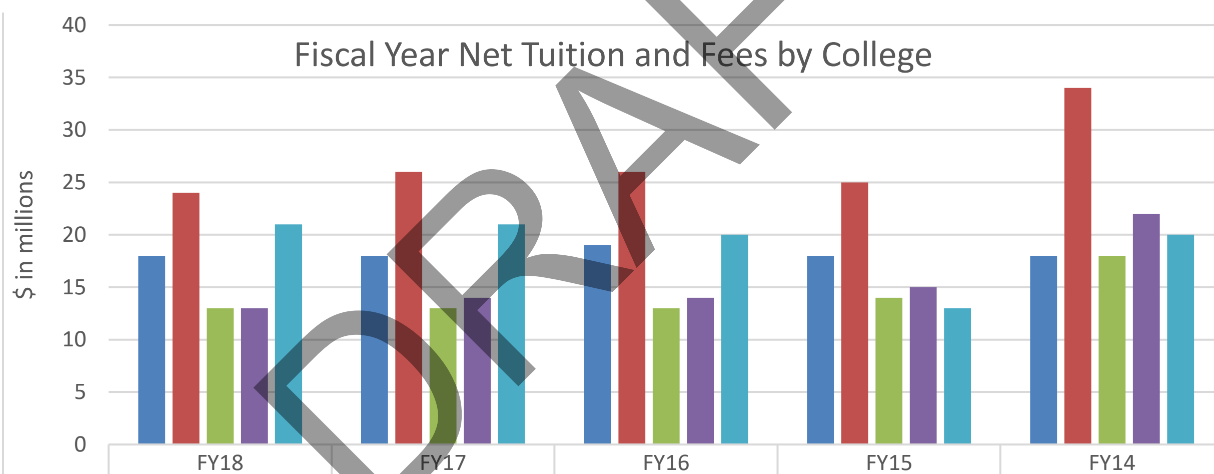
Fall Enrollment by Headcount by College



	Fall 2017	Fall 2016	Fall 2015	Fall 2014	Fall 2013
CCV	5504	5863	5983	6019	6194
CU	2141	2342	2246	2183	2175
JSC	1552	1525	1514	1613	1692
LSC	1147	1256	1266	1430	1519
VTC	1616	1645	1559	1542	1543

<u>Tuition and Fee Revenue – Continued</u>

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 consistently outpaced by Castleton, and generally more on par with Vermont Technical College, who has far fewer students. CCV, as a community college has the lowest tuition cost and charges for courses on a per credit basis, while the residential schools charge a higher tuition rate and on a semester basis. However, CCV's net tuition has remained much more stable during the more recent years than the other colleges which have experienced a sharp decline after FY2014, but have been relatively stable (within $1-2 million) in subsequent years reported herein. The exception being VTC, who rebounded in FY2016 from the significant FY2015 decline, returning to the FY2014 level and maintaining that level to date.



	FY18	FY17	FY16	FY15	FY14
CCV	18	18	19	18	18
CU	24	26	26	25	34
JSC	13	13	13	14	18
LSC	13	14	14	15	22
VTC	21	21	20	13	20

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

Management's Discussion and Analysis (Unaudited) - Continued
June 30, 2018

Operating and Non-operating Expenses

Table 4 on page 14 shows the total Operating and Non-Operating Expenses for the past 5 years, and the charts on page 15 provide a quick view of the percent of expenses by type for FY2018 and FY2017.

The largest percentage of VSC expenses are for salary and benefits (about 64%). Those expenses have generally declined since FY2014 due to staff reductions compounded with a reduction in TIAA employer contribution for all employees except the Full-Time Faculty beginning in FY2018.

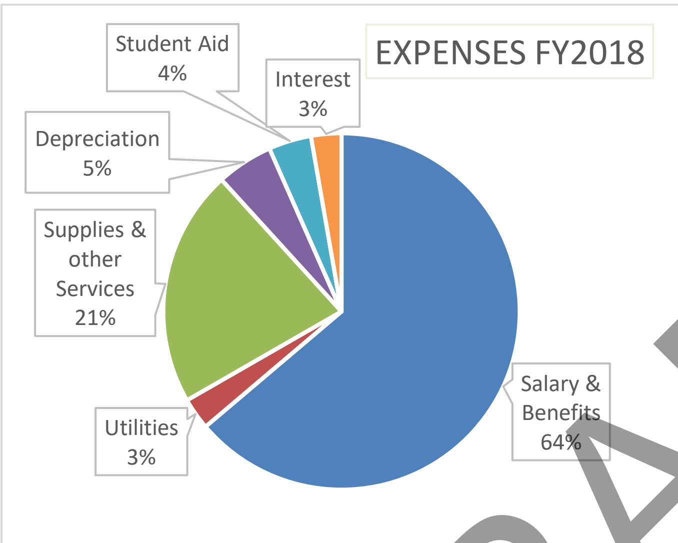
Positive trends in health care over the past couple of years have resulted in far less expense; however, annual accruals related to post-employment benefits are also included in this salary and benefit expense category.

Expenses have generally declined over the five years reported. Changes in utility expenses have been a direct result of solar energy efforts across all the colleges. Supplies and services is the second largest expense (21%). Keeping this expense relatively constant has been the result of the colleges' continued efforts to contain costs in response to the enrollment declines.

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

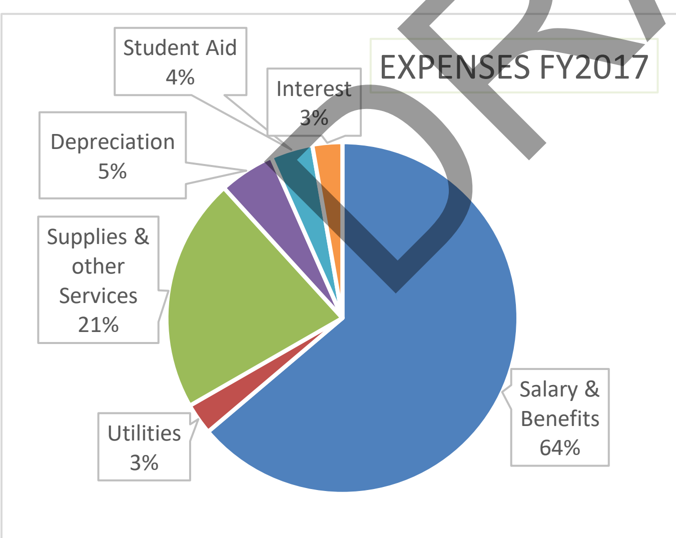
	2018	% change	2017	% change	2016	2015	2014
Operating							
Salaries & Benefits	122	1%	121	0%	121	123	125
Utilities	6	20%	5	-17%	6	7	7
Supplies and Svcs	40	-2%	41	0%	41	39	42
Depreciation	10	0%	10	-9%	11	14	14
Student Aid	7	0%	7	0%	7	7	7
Total Operating	185		184		186	190	195
Nonoperating							
Interest on Debt	6	20%	5	0%	5	6	6
TOTAL Expenses	191	1%	189	-1%	191	196	201

<u>Operating and Non-operating Expenses - Continued</u>



FY18 Expenses
($ in thousands)

Salary/Benefits	$ 121,875	64%
Utilities	5,799	3%
Supplies/Services	40,323	21%
Depreciation	9,843	5%
Student Aid	7,346	4%
Interest on Debt	5,506	3%
Total	$ 190,692	100%



FY17 Expenses
($ in thousands)

Salary/Benefits	$ 121,029	64%
Utilities	5,475	3%
Supplies/Services	40,871	21%
Depreciation	9,722	5%
Student Aid	7,354	4%
Interest on Debt	5,212	3%
Total	$ 189,663	100%

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, and aid funded with endowments is recognized as investment income on the Statement of Revenues and Expenses 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 including both the amounts reported in net tuition revenue and scholarship expenses over the past five years is shown below.

($ in millions)					
	FY18	FY17	FY16	FY15	FY14
Scholarship Allowances (included in revenue)	27	25	25	25	25
Scholarship Expenses (included in expenses)	7	7	7	7	7
Total Student Aid	34	32	32	32	32

Statement of Changes in Net Position

The Statement of Changes in Net Position (SCNP) reports total change in net position for the fiscal year classified by the four net position categories: investment in capital assets, restricted expendable, restricted nonexpendable, and unrestricted. The FY2017 unrestricted net position balance was restated with a prior period adjustment of approximately -$100 million due to the implementation of GASB 75.

Statement of Cash Flows

The Statement of Cash Flows shows inflows and outflows of cash excluding both revenue and expense that is accrued to comply with accounting rules. The Condensed Statement of Cash Flows for VSC is in Table 6 on page 18.

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 and Expenses (SRE) because of the inclusion of noncash items, such as depreciation expenses on the SRE. Also, the SRE is prepared on the accrual basis of accounting, meaning that it shows both revenues earned and expenses incurred though cash has not yet exchanged hands. The primary cash receipts from operating activities consist of tuition and fees, grants and contracts, and auxiliary income from housing and food service operations. Cash outlays include payment of wages and benefits; operating expenses such as utilities, supplies, insurance and repairs; and scholarships awarded 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 depends on them to continue the current level of operations. The increase in FY2018 is largely attributable to the $3 million increase in state operating appropriations.

Cash flows from capital and related financial activities

Cash flows from capital and related financing activities include all capital plant funds and related long term debt activities (excluding depreciation and amortization of bond premiums, since these are non-cash transactions), as well as capital gifts, grants and appropriations. This has remained relatively consistent over the 5-year period presented herein.

Cash flows from investing activities

Purchase or sale of investments and income earned on investments are included in 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 earlier fiscal years reflects the activity surrounding the VSC CD being liquidated in FY12 and reinvested into other instruments, as well as activity related to endowment investments. In FY2018, there was a reduction in the level of investments due to endowment spending.

Cash flows from investing activities - Continued

Table 6: Condensed Statements of Cash Flows
($ in millions)

Cash flows from:	2018	% change	2017	% change	2016	2015	2014
Operating	-34	-3%	-35	-8%	-38	-35	-41
Non capital financing	49	9%	45	0%	45	48	49
Capital and related financing	-10	0%	-10	-17%	-12	-13	-10
Investing	2	0%	0	-100%	7	6	1
Net increase (decrease)	7	0%	0	-100%	2	6	-1
Cash, Beginning of Year	11	0%	11	22%	9	3	4
Cash, End of Year	18	64%	11	0%	11	9	3
Operating cash flows if noncapital appropriations and PELL grants were included							
Operating	-34	-3%	-35	-8%	-38	-35	-41
Non capital appropriations	30	11%	27	4%	26	27	26
Non operating federal grants	16	0%	16	-6%	17	20	21
Operating cash flows including appropriation and fed grants	12	50%	8	60%	5	12	6

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

Consistent with national trends, Vermont continues to experience a demographic decline in the overall number of graduating high school students. This is expected to last for the foreseeable future and likely result in permanently lower enrollments going forward. Additionally, free college initiatives in neighboring states is a newer trend that is increasing the competitive landscape and forcing aggressive discounting strategies to ensure VSC enrollments, especially at Castleton as it borders New York State. 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 receive 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 their overall cost of college, as well as provide some additional revenue for the colleges.

<u>Economic Factors That Will Affect the Future - Continued</u>

In order to respond to these demographic changes, the VSC has also begun some structural changes that are expected to reduce costs, and at the same time enhance our ability to provide high quality services to our students. Beginning in the Fall of 2016 and continuing to date, a series of administrative functions that are non student facing and do not directly impact student experience are being created as shared services at the Office of the Chancellor. Secondly, the system is unifying Lyndon State College and Johnson State College into a single institution, Northern Vermont University, effective at the beginning of the 2018-2019 academic year. Both campuses will be maintained, but administrative functions will be combined to reduce costs, and students from both campuses will be able to attend courses, and participate in student activities at either campus. The goal is to continue to provide high quality educational services to students, to increase both academic and campus life opportunities for students at both the campuses in Johnson and Lyndon, and create a financial model that is sustainable over time for the new unified college and for the system as a whole. The expectation is that both of these initiatives: shared services of administrative functions for all colleges in the system, and the unification of Lyndon and Johnson will reduce administrative costs, enable the colleges to align resources with the academic mission of serving students, and strengthen the Vermont State College system as a whole.

Vermont State Appropriations

For FY2018, State Appropriations for both operating and capital projects were $32,819,000, or 18% 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.

Post-Employment Benefits

A ruling of the Government Accounting Standards Board (GASB) that became effective in FY2008 requires that we recognize the future costs of retirement benefits on our books. Subsequently, GASB 75 replaced the original standard from FY2008 and was adopted by the VSC in FY2018. For VSC, this includes employer costs of medical, prescription, dental and life insurance plans for all current employees who have already become eligible to receive retirement benefits, and those employees who may become eligible before they retire. The cost of these benefits must be recognized during the period of active employment rather than when they are paid during retirement. Because of VSC's unique early retirement wages benefit for the full-time faculty, VSC must also account for this liability under GASB ruling.

The annual cost to VSC includes the actuarially calculated costs for the year, less payments made during the year to our self-insurance plan for current retirees and early retirement benefits paid to retired full-time faculty.

<u>Economic Factors That Will Affect the Future – Continued</u>

Post-Employment Benefits - Continued

For financial reporting purposes, an actuarial valuation is required for OPEB plans with total eligible employees (active, retirees and beneficiaries) of 200 or more.

VSC's current actuarial study estimated that the accumulated value of prior benefits liability for the current list of employees as of July 1, 2017, was approximately $191,297,000 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 $188,498,000. The VSC has come to agreement with all of the bargaining units representing eligible staff, to close the groups of staff eligible for this benefit.

Miscellaneous

As a result of positive market conditions during both FY2018 and FY2017, VSC had net realized and unrealized gains on the endowments, and other investments.

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

Approximately 694 of the 983 full-time employees at VSC are covered by union contracts. VSC employs approximately 2,130 full and part-time employees.

VSC Employees as of November 1, 2017

Bargaining Unit Empoloyees	
Full Time	694
Part Time	319
TOTAL	1,013
Non- Bargaining Unit Empoloyees	
Full Time	289
Part Time & Temp	828
TOTAL	1,117
TOTAL Employees	2,130

VERMONT STATE COLLEGES

(a Component Unit of the State of Vermont)

Statement of Net Position

June 30, 2018

Assets and Deferred Outflows of Resources

Current Assets:	
Cash and equivalents (Note 3)	**$ 17,969,575**
Accounts receivable, net (Note 4)	**11,384,075**
Deposit with bond trustees (Note 3)	**4,942,501**
Other current assets	**1,193,508**
Total Current Assets	**35,489,659**
Non-Current Assets:	
Cash and equivalents (Note 3)	**434,981**
Long-term investments (Note 3)	**46,184,316**
Notes receivable, net (Note 4)	**4,923,967**
Other assets	**169,308**
Capital assets, net (Note 12)	**162,946,720**
Total Non-Current Assets	**214,659,292**
Total Assets	**250,148,951**
Deferred Outflows of Resources:	
Deferred loss on debt refunding (Note 6)	**9,824,025**
OPEB related, net (Note 10)	**17,904,148**
Total Deferred Outflows of Resources	**27,728,173**
Total Assets and Deferred Outflows of Resources	**$ 277,877,124**

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

Liabilities and Net Position

Current Liabilities:	
Accounts payable and accrued liabilities (Note 13)	**$ 14,395,060**
Unearned revenue and deposits	**9,943,657**
Current portion of long-term debt (Note 5)	**3,937,732**
Total Current Liabilities	**28,276,449**
Non-Current Liabilities:	
Other liabilities (Note 13)	**247,529**
Refundable grants	**6,037,232**
Postemployment benefit obligations (Note 10)	**188,498,148**
Long-term debt, excluding current portion (Note 5)	**121,086,246**
Total Non-Current Liabilities	**315,869,155**
Total Liabilities	**344,145,604**
Net Position:	
Investment in capital assets, net	**49,065,357**
Restricted nonexpendable	**18,208,512**
Restricted expendable	**11,517,067**
Unrestricted	**(145,059,416)**
Total Net Position	**(66,268,480)**
Total Liabilities and Net Position	**$ 277,877,124**

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

Statement of Revenues and Expenses

For the Year Ended June 30, 2018

Operating Revenues:	
Tuition and fees	**$ 116,522,454**
Residence and dining	**19,069,865**
Less: scholarship allowances	**(27,344,447)**
Net Tuition, Fees, and Residence and Dining Revenue	**108,247,872**
Federal grants and contracts	**10,951,225**
State and local grants and contracts	**2,778,362**
Non-governmental grants and contracts	**824,657**
Interest income	**86,381**
Sales and services of educational activities	**5,303,557**
Other operating revenues	**1,398,317**
Total Operating Revenues	**129,590,371**
Operating Expenses (Notes 3, 11 and 13):	
Salaries and wages	**79,583,780**
Employee benefits (Notes 9 and 10)	**42,291,707**
Scholarships and fellowships	**7,346,293**
Supplies and other services	**40,322,825**
Utilities	**5,798,694**
Depreciation (Note 12)	**9,842,721**
Total Operating Expenses	**185,186,020**
Net Operating Loss	**(55,595,649)**
Non-Operating Revenues (Expenses):	
State appropriations (Note 8)	**30,319,008**
Federal grants and contracts	**16,382,196**
Gifts	**2,434,193**
Investment income, net of expenses (Note 3)	**2,128,687**
Interest expense on capital debt	**(5,505,852)**
Other non-operating revenues	**41,265**
Net Non-Operating Revenues	**45,799,497**
Decrease in Net Position Before Other Revenues	**(9,796,152)**
Other Revenues:	
State appropriations for capital expenditures (Note 8)	**2,500,000**
Capital grants and gifts	**375**
Additions to non-expendable assets	**347,981**
Decrease in Net Position	**$ (6,947,796)**

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

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

Statement of Changes in Net Position

For the Year Ended June 30, 2018

	Investment in Capital Assets	Restricted Expendable	Restricted Nonexpendable	Unrestricted	Total
Balance June 30, 2017 as previously reported	**$ 54,661,140**	**$ 10,894,871**	**$ 18,924,987**	**$ (43,671,317)**	**$ 40,809,681**
Prior Period Adjustment - Implementation of newly effective accounting standard (Note 2)	**-**	**-**	**-**	**(100,130,365)**	**(100,130,365)**
Balance, June 30, 2017, as restated	**54,661,140**	**10,894,871**	**18,924,987**	**(143,801,682)**	**(59,320,684)**
Changes in net position	**(5,595,783)**	**622,196**	**(716,475)**	**(1,257,734)**	**(6,947,796)**
Balance, June 30, 2018	**$ 49,065,357**	**$ 11,517,067**	**$ 18,208,512**	**$ (145,059,416)**	**$ (66,268,480)**

See accompanying notes to the financial statements

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

Statement of Cash Flows

For the Year Ended June 30, 2018

Cash Flows from Operating Activities:	
Tuition and fees	**$ 100,821,174**
Grants and contracts	**14,144,991**
Sales and services of educational activities	**6,683,153**
Interest received	**86,381**
Payments to suppliers	**(38,708,919)**
Payments to employees	**(121,748,345)**
Loans issued to students	**(837,432)**
Collection of loan payments	**805,831**
Other cash receipts	**4,398,317**
Net Cash Applied to Operating Activities	**(34,354,849)**
Cash Flows from Non-Capital Financing Activities:	
State appropriations	**30,319,008**
Non-operating federal grants	**16,382,196**
Gifts and grants	**2,449,089**
Net Cash Provided by Non-Capital Financing Activities	**49,150,293**
Cash Flows from Capital and Related Financing Activities:	
Capital and non-expendable grants and gifts	**348,356**
Capital appropriations	**2,500,000**
Purchase of capital assets	**(4,139,141)**
Change in deposits with bond trustee	**130,724**
Proceeds from sale of capital assets	**16,445**
Payments on capital debt	**(3,325,000)**
Interest expense on capital debt	**(5,505,852)**
Other receipts	**41,265**
Net Cash Applied to Capital and Related Financing Activities	**(9,933,203)**
Cash Flows from Investing Activities:	
Proceeds from sales and maturities of investments	**$ 11,749,522**
Purchase of investments	**(10,134,299)**
Interest and dividends received on investments	**549,353**
Net Cash Provided by Investing Activities	**2,164,576**
Net Increase in Cash and Equivalents	**7,026,817**
Cash and Equivalents, Beginning of Year	**11,377,739**
Cash and Equivalents, End of Year	**$ 18,404,556**

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

Statement of Cash Flows - Continued

For the Year Ended June 30, 2018

Reconciliation of Operating Loss to Net Cash Applied to Operating Activities:	
Operating loss	**$ (55,595,649)**
Adjustments to reconcile operating loss to net cash applied to operating activities:	
Depreciation	**9,842,721**
Bad debts	**593,909**
Net OPEB activity	**5,427,098**
Changes in assets and liabilities:	
Accounts receivable	**(895,825)**
Other assets	**1,131,316**
Notes receivable	**537,413**
Accounts payable and accrued liabilities	**526,641**
Unearned revenues, deposits and refundable grants	**3,902,045**
Other liabilities	**175,482**
Net Cash Applied to Operating Activities	**$ (34,354,849)**
Non-Cash Transactions:	
Equipment provided by capital grants and gifts	**$ 20,000**
Equipment acquisitions financed through capital leases	**$ 251,086**
Unrealized gains (losses)	**$ 31,248**
Net loss on disposal of capital assets	**$ 2,400**

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

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 University ("CU"), Johnson State College ("JSC"), Lyndon State College ("LSC"), Vermont Technical College ("VTC"), Vermont Manufacturing Extension Center ("VMEC"), Small Business Development Center ("SBDC"), and Vermont Tech Office of Continuing Education and Workforce Development ("TED").

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.

The Colleges have determined that they function as a business-type activity, as defined by GASB. The effect of interfund 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 statement of net position, revenues and expenses, and changes in net position and cash flows on a combined College-wide basis.

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

Basis of Presentation - continued
The Colleges' policy is to define operating activities in the statement of revenues, expenses and changes in net position as those that generally result from exchange transactions such as charges for services provided to students and for the purchase of goods and services. Certain other transactions are reported as non-operating activities. These non-operating activities include the Colleges' operating appropriations from the State of Vermont ("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 (the "Board").

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

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.

Allowance for Doubtful Accounts
Provisions for losses on receivables are determined on the basis of loss experience, known and inherent risks, and current economic conditions.

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

Capital Assets

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

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

Investments

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

Other Significant Accounting Policies

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

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

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

The Federal Perkins Loan Program Extension Act of 2015 (the "Extension Act"), enacted on December 18, 2015, extended the Perkins Loan Program through September 30, 2017. The Extension Act states that new Perkins Loans cannot be disbursed to students after September 30, 2017. Students that received a fall semester Perkins loan disbursement before October 1, 2017 can receive a spring semester Perkins loan disbursement. The College is currently evaluating alternative methods of financial aid for students affected by the Extension Act for the 2018-19 academic year.

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, 2013 and 2017 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. The bond premium for the 2017 bond of $10,557,129 is amortized over 20.5 years. Cumulative amortization of the bond premium totals $1,404,783 as of June 30, 2018. The bond premium is included in bonds and notes payable.

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

Postemployment Benefits Other Than Pensions ("OPEB")
GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other than Pensions* ("GASB 75"), require 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 net OPEB liability is to be measured as the present value of projected benefit payments to be provided to current active and inactive employees that is attributed to those employee's past periods of service. The statement requires that the actuarial present value of projected benefit payments be attributed to the periods of employee services using the entry age actuarial cost method with each period's service cost determined as a level percentage of pay.

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 accounting principles generally accepted in the United States of America requires management to make estimates and assumptions about future events. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Management evaluates the estimates and assumptions on an ongoing basis using historical experience and other factors that management believes to be reasonable under the circumstances. Adjustments to estimates and assumptions are made as facts and circumstances require. As future events and their effects cannot be determined with certainty, actual results may differ from the estimates used in preparing the accompanying financial statements. Significant estimates and assumptions are required as part of estimating an allowance for doubtful accounts, depreciation, net position classification, claims reserves for medical, dental, and workers' compensation, and determining the other post-employment benefits liability.

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

New Governmental Accounting Pronouncements
GASB Statement 83 – *Certain Asset Retirement Obligations* ("ARO's") is effective for periods beginning after June 15, 2018. An ARO is a legally enforceable liability associated with the retirement of a tangible capital asset. This Statement establishes criteria for determining the timing and pattern of recognition of a liability and a corresponding deferred outflow of resources for AROs and requires that recognition occur when the liability is both incurred and reasonably estimable. Management has not completed its review of the requirements of this Statement and its applicability.

GASB Statement 84 – *Fiduciary Activities* is effective for periods beginning after December 15, 2018. The objective of this Statement is to establish criteria for identifying fiduciary activities. Activity meeting the established criteria would then be presented in a statement of net position and a statement of changes in net position. Pension and other employee-benefit trust funds, investment trust funds, private-purpose trust funds and custodial funds would be reported, as applicable, according to this Statement. Information of component units of a primary government would be shown in the aggregate with the fiduciary funds of the primary government. Under this Statement, a liability could be recognized to the beneficiaries in a fiduciary fund if the government has been compelled to disburse fiduciary resources. Management has not completed its review of the requirements of this standard and its applicability.

GASB Statement 87 – *Leases* is effective for periods beginning after December 15, 2019. Implementation of this standard will require lessees to recognize on their statement of net position the rights and obligations resulting from leases categorized as operating leases as assets, liabilities, or deferred inflows / outflows of resources. It provides for an election on leases with terms of less than twelve months to be excluded from this Statement. Management is in the process of evaluating this Statement and has not yet determined its impact on the financial statements.

GASB Statement 88 – *Certain Disclosures Related to Debt, Including Direct Borrowings and Placements* is effective for years beginning after June 15, 2018. Implementation of this standard will require additional disclosures in the notes to financial statements, including unused lines of credit; assets pledged as collateral for the debt; and terms specified in debt agreements related to significant events of default with finance-related consequences, significant termination events with finance-related consequences, and significant subjective acceleration clauses. Management has not completed its review of the requirements of this standard and its applicability.

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

New Governmental Accounting Pronouncements - Continued
GASB Statement 89 – *Accounting for Interest Costs Incurred before the End of a Construction Period* is effective for reporting periods beginning after December 15, 2019. The objectives of this Statement are (1) to enhance the relevance and comparability of information about capital assets and the cost of borrowing for a reporting period and (2) to simplify accounting for interest cost incurred before the end of a construction period. Management has not completed its review of the requirements of this standard and its applicability.

Note 2 - **Implementation of Newly Effective Accounting Standard**

As a result of implementing GASB Statement No. 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, net position was restated to reflect the Net OPEB liability as of June 30, 2017, as displayed below:

As of June 30, 2017		As Previously Reported		As Restated
Statement of Net Position				
Net OPEB Liability	$	64,914,056	$	171,508,646
Deferred outflows related to OPEB	$	-	$	6,464,225
Unrestricted net position	$	(43,671,317)	$	(143,801,682)

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

Cash and Equivalents
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.

Note 3 - Cash and Equivalents, and Investments - Continued

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

At June 30, 2018, the balance of current assets - cash and equivalents consists of approximately $14,000 in petty cash, and the remainder deposited in Federal Deposit Insurance Corporation ("FDIC") insured banking institutions of approximately $17,955,000 per the accounting records of the Colleges, and approximately $18,631,000 per bank records. Of the bank balances, approximately $732,000 was covered by federal depository insurance and approximately $17,900,000 was uninsured and uncollateralized at June 30, 2018.

At June 30, 2018, the balances of non-current assets - cash and equivalents deposited in FDIC insured banking institutions were approximately $435,000 per the accounting records of the Colleges, and approximately $413,000 per bank records. Of the bank balances, approximately $329,000 was covered by federal depository insurance and approximately $84,000 was uninsured and uncollateralized at June 30, 2018.

Investments
Investments of the various funds at June 30, 2018 are as follows:

	Fair Value	Cost
U.S. Government bonds	$ 8,515,105	$ 8,851,742
Corporate bonds	9,761,429	10,175,628
Common stock	6,925,203	6,933,343
Hedge fund shares	1,096,984	1,000,000
Mutual funds	18,378,083	14,428,807
Money market	1,507,512	1,506,665
Held by bond trustee	4,942,501	4,942,501
Total Investments	$ 51,126,817	$ 47,838,685

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

Investments - continued

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. Investment maturities at June 30, 2018 are as follows:

		Investment Maturities (in years)			
Investment Type	**Market Value**	**Less than 1**	**1-5**	**6-10**	**More than 10**
Money Market Investments	$ 1,507,512	$ 1,507,512	$ -	$ -	$ -
Corporate Bonds	9,761,429	1,982,627	5,382,623	2,396,179	-
U.S. Govt. Bonds	8,515,105	2,302,520	3,506,208	2,706,377	-
Total	19,784,046	$ 5,792,659	$ 8,888,831	$ 5,102,556	$ -
Other Investments					
Common Stock and Mutual Funds	26,400,270				
Held by Bond Trustee	4,942,501				
Total	$ 51,126,817				

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.

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

Investments - continued

Investment income for the year ended June 30, 2018:

Interest and dividend income	$	1,206,026
Net realized and unrealized gain (loss)		1,109,314
Total investment income		2,315,340
Less: management fees		(186,653)
Investment income, net	$	2,128,687

The risk categories for the bond fund holdings held by VSC at June 30, 2018 are as follows:

Investment rating*		
AAA	$	8,554,868
AA+		19,961
AA		2,208,674
AA-		224,407
A+		901,075
A		3,013,271
A-		1,542,103
BBB+		1,028,935
BBB		581,413
BBB-		201,827
BB+		-
BB		-
BB-		-
B+		-
B		-
B-		-
CCC+		-
	$	18,276,534

*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.

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

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

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

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

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

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

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

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

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

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

Investments - continued
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.

Fair Value Hierarchy
The fair value hierarchy categorizes inputs to valuation techniques used to measure fair value into three levels. Level 1 inputs are quoted market prices for identical assets or liabilities in active markets that a government can access at the measurement date. Level 2 inputs are inputs, other than quoted prices included within Level 1, that are observable for an asset or liability, directly or indirectly. Level 3 inputs are unobservable inputs. The highest priority is assigned to Level 1 inputs and the lowest to Level 3 inputs. If the fair value is measured using inputs from more than one level of the hierarchy, the measurement is considered to be based on the lowest priority input level that is significant to the entire measurement. Valuation techniques used should maximize the use of the observable inputs and minimize the use of unobservable inputs.

The asset's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. The following is a description of the valuation methodologies used for assets at fair value on a recurring basis.

U.S. Government Bonds: Valued at the current available closing price reported or based on values obtained on comparable securities of issuers with similar credit ratings.

Corporate Bonds: Valued at the current available closing price reported or based on values obtained on comparable securities of issuers with similar credit ratings.

Common Stock: Value based on quoted prices in active markets of similar instruments.

Hedge Fund Shares: Hedge fund shares held by the Colleges are closed-end hedge funds that are registered with the SEC. The fair values of the investments in this class have been estimated using the net asset value ("NAV") per share of the investments. The hedge fund shares held by the Colleges have redemption periods under 90 days and are considered redeemable in the near term.

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

Notes to the Financial Statements - Continued

June 30, 2018

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

Fair Value Hierarchy - continued

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

Money market: Value based on quoted prices in active markets of similar instruments.

Held by bond trustee: Valued at the current available closing price reported or based on values obtained on comparable securities of issuers with similar credit ratings

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

The following table set forth by level, within the fair value hierarchy, the fair value of the Plan's assets measured on a recurring basis:

Assets at Fair Value as of June 30, 2018

	Level 1	Level 2	Level 3	Total
U.S. Government bonds	$ 8,515,105	$ -	$ -	$ 8,515,105
Corporate bonds	-	9,761,429	-	9,761,429
Common stock	6,925,203	-	-	6,925,203
Hedge fund shares	-	1,096,984	-	1,096,984
Mutual funds	18,378,083	-	-	18,378,083
Money market	1,507,512	-	-	1,507,512
Held by bond trustee	4,942,501	-	-	4,942,501
Total Assets at Fair Value	$ 40,268,404	$ 10,858,413	$ -	$ 51,126,817

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

The composition of the Colleges' accounts receivable at June 30, 2018 is summarized as follows:

Student accounts receivable	**$ 11,713,723**
Grants receivable	**4,686,487**
Other receivable	**1,273,910**
Subtotal	**17,674,120**
Allowance for doubtful accounts	**(6,290,045)**
Total accounts receivable, net	**$ 11,384,075**

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 $1,203,000 at June 30, 2018. 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 $584,000 in 2018 has been reflected in operating expenses.

Note 5 - **Long-Term Liabilities**

Long-term liabilities consist of the following at June 30, 2018:

	Beginning balances	Additions	Reductions	Ending balances	Current portion
Long-term liabilities					
Bonds and notes payable	$ 129,006,709	$ -	$ 3,982,731	$ 125,023,978	$ 3,937,732
Net OPEB obligation	171,508,646	16,989,502	-	188,498,148	-
Other liabilities	66,107	252,677	71,255	247,529	-
Refundable grants	6,037,793	-	561	6,037,232	-
Total long-term liabilities	$ 306,619,255	$ 17,242,179	$ 4,054,547	$ 319,806,887	$ 3,937,732

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

Bonds and Notes Payable
Outstanding debt at June 30, 2018 is as follows:

Revenue Bonds, Series 2010A: 3.0% - 4.0% serial bonds aggregating \$5,710,000 maturing 2011 through 2018. Interest on the serial bonds is paid semi-annually on the unpaid balances. Unamortized bond premium of \$44,116 has been added to this liability at June 30, 2018. [1]	**\$ 1,234,116**
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 serial and term bonds is payable semi-annually on the unpaid balances. [2]	**30,265,000**
Revenue Bonds, Series 2017: 4.0% - 5.0% serial bonds aggregating \$67,660,000 maturing 2021 through 2037 and Interest on serial bonds is paid semi-annually on the unpaid balances. Unamortized bond premium of \$9,984,429 has been added to the liability at June 30, 2018. [3]	**77,644,429**

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

Bonds and Notes Payable - continued

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 the serial and term bonds is paid semi-annually on the unpaid balances. Unamortized bond premium of $1,400,433 has been added to the liability at June 30, 2018.	**15,880,433**
	$ 125,023,978

[1] 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.

[2] 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 University; (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%).

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

Bonds and Notes Payable - continued

[3] On May 24, 2017, VSC issued the Vermont State Colleges System Bonds 2017 Series A, in the principal amount of $67,660,000. The 2017 Bond was issued for the purpose of (1) refinancing certain indebtedness of VSC; (2) paying the costs of issuance of the 2017 Series A Bond; and (3) paying the breakage fee for the interest rate swap agreements. The College entered into the bond refunding with the goal to achieve cost savings primarily through the reduction of interest expense. The refunding increased the College's total debt service by $15,163,384 and resulted in an economic gain (difference between the present value of the old and new debt service payments) of $1,051,774.

Debt Roll-Forward

Long-term debt activity for the year ended June 30, 2018 was as follows:

	Balance June 30, 2017	Additions	Repayments	Balance June 30, 2018	Current Portion
Series 2010-A	$ 3,055,000	-	$ (1,865,000)	$ 1,190,000	$ 1,190,000
Series 2010-B	30,265,000	-	-	30,265,000	1,485,000
Series 2010 Bond Premium	88,232	-	(44,116)	44,116	44,116
Series 2010 Bonds	33,408,232	-	(1,909,116)	31,499,116	2,719,116
Series 2013	15,940,000	-	(1,460,000)	14,480,000	605,000
Series 2013 Bond Premium	1,495,377	-	(94,944)	1,400,433	94,944
Series 2013 Bonds	17,435,377	-	(1,554,944)	15,880,433	699,944
Series 2017	67,660,000	-	-	67,660,000	-
Series 2017 Bond Premium	10,503,100	-	(518,671)	9,984,429	518,672
Series 2017 Bonds	78,163,100	-	(518,671)	77,644,429	518,672
Total Bonds and Notes Payable	$ 129,006,709	$ -	$ (3,982,731)	$ 125,023,978	$ 3,937,732

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:

Years Ending June 30,	Principal Amount	Interest Amount
2019	$ 3,280,000	$ 4,180,716
2020	1,890,000	4,135,674
2021	1,960,000	4,108,972
2022	4,640,000	4,025,732
2023	4,860,000	3,861,557
2024-2028	25,925,000	16,238,100
2029-2033	33,085,000	5,899,078
2034-2038	32,815,000	961,666
2039-2041	5,140,000	370,645
	$ 113,595,000	$ 43,782,140

Amortization of the bond premiums and deferred loss on debt refunding are included in interest expense.

According to the terms of the agreements under which the revenue bonds were sold, the bonds are general obligations of VSC. The 2013 and 2010 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 and interest fund requirements, when due.

Note 6 - **Deferred Outflows of Resources - Debt Refunding**

During 2017, VSC paid a breakage fee of $10,931,885 to discontinue all of its interest rate swap agreements. The breakage fee is recorded on the statement of net position as a "deferred loss on debt refunding" and is amortized of the life of the old debt it was associated with and is included with interest expense. The amortization of the breakage fee that was included in interest expense was $1,003,345 for year ended June 30, 2018.

Note 7 - **Functional Expense Classification**

The following table details VSC's operating expenses by functional expense classification as of June 30, 2018:

Instruction	**$ 56,708,525**
Research	**43,806**
Public service	**10,079,874**
Academic support	**20,464,012**
Student services	**39,368,958**
Institutional support	**36,771,677**
Physical plant	**6,069,746**
Student financial support	**5,836,702**
Depreciation	**9,842,720**
Total	**$ 185,186,020**

Note 8 - **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 for the year ended June 30, 2018, is funding for Allied Health, now part of Vermont Technical College, of approximately $1,158,000 and for VMEC of approximately $428,000.

Capital appropriations for VSC made from the State Bond Funds were $2,500,000 for the year ended June 30, 2018.

Note 9 - **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 year ended June 30, 2018, the Colleges' total payroll expense was approximately $79,584,000 of which approximately $53,887,000 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 year ended June 30, 2018, contributions made by the Colleges under this plan totaled approximately $5,357,000, or approximately 9.94% of covered salaries.

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. During the year ended June 30, 2018, there were no covered salaries for employees participating in the Vermont Employees Retirement System and there were no employer contributions. There were no contributions to the Vermont State Teachers Retirement System during 2018.

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 year ended June 30, 2018, contributions for these benefits were approximately $850,000.

Note 9 - **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 10 - **Postemployment 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. At June 30, 2018, the following employees were covered by the benefits terms:

Retirees and Beneficiaries	**554**
Active plan members	**994**
Total plan members	**1,588**

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 fiscal year 2018, VSC recognized employer contributions of $6,318,175, for both healthcare and early retirement. The plan is financed on a pay-as-you-go basis. In fiscal year 2018, there were no member contributions.

Annual OPEB Cost and Net OPEB Obligation: VSC's OPEB cost (expense) includes most changes in the net OPEB liability. The effect of changes such as service costs and interest on the total OPEB liability must be reported in the current reporting period as an OPEB expense. The effects of changes such as the change in actuarial assumptions and differences between expected and actual experiences are required to be included in OPEB expense over the current and future periods. Such changes must be amortized in a systematic and rational manner over a closed period equal to the average of the expected remaining service lives of all employees that are provided with benefits through the OPEB plan beginning in the current period.

Note 10 - **Postemployment Benefits Other Than Pension - Continued**

The following table shows the components of VSC's annual OPEB costs for the year ended June 30, 2018 and the changes in VSC's net OPEB obligation to the Retiree Health and Early Retirement Plans:

Interest on total OPEB obligation	**$ 6,185,677**
Service cost	**4,359,477**
Amortization of current year for difference between expected and actual experience	**1,254,299**
Amortization of current year for changes in plan actuarial assumptions	**68,301**
Annual OPEB cost	**11,867,754**
Difference between expected and actual experience to be recognized in future years	**10,987,660**
Difference between changes in plan actuarial assumptions to be recognized in future years	**598,313**
Prior year contribution made	**(6,464,225)**
Increase in net OPEB obligation	**16,989,502**
Net OPEB obligation - Beginning of Year (as restated)	**171,508,646**
Net OPEB obligation - End of Year	**$ 188,498,148**

Note 10 - **Postemployment Benefits Other Than Pension - Continued**

Deferred Outflows of Resources related to OPEB:

For the year ended June 30, 2018, VSC reported deferred outflows of resources related to OPEB from the following sources:

Deferred Outflows of Resources	
Differences between projected and actual experience	**$10,987,660**
Changes in plan actual assumptions	**598,313**
Contributions subsequent to the measurement date	**6,318,175**
Total	**$17,904,148**

VSC's contributions of $6,318,175 made during fiscal year ending 2018, subsequent to the measurement date will be recognized as a reduction of the net pension liability in the succeeding year. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized as increases (decreases) in pension expense as follows:

Years Ending June 30,	
2019	$ 1,322,600
2020	1,322,600
2021	1,322,600
2022	1,322,600
2023	1,322,600
2024-2027	4,972,973
	$ 11,585,973

Note 10 - **Postemployment Benefits Other Than Pension - Continued**

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, 2018, 2017, 2016 and 2015 are as follows:

Fiscal Years Ended	Annual OPEB Cost	% of Annual OPEB Cost Contributed	Net OPEB Obligation
June 30, 2018	$ 11,867,754	6.3%	$ 188,498,148
June 30, 2017	$ 11,779,230	54.9%	$ 64,914,057
June 30, 2016	$ 12,029,564	59.6%	$ 59,599,052
June 30, 2015	$ 11,316,963	48.8%	$ 54,733,504

Funding Status and Funding Progress: As of the most recent actuarial valuation date, the actuarial accrued liability for benefits was $188,498,148, all of which was unfunded. The annual covered payroll (annual payroll of active employees covered by the plan) was $51,380,910, and the ratio of the unfunded actuarial liability to annual covered payroll was 366.9%. The latest actuarial valuation date was on July 1, 2017.

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.

Note 10 - **Postemployment Benefits Other Than Pension - Continued**

The following actuarial assumptions were made:

Discount Rate: The discount rate used in the calculation was 3.58%.

Projected Salary Increase Rate: The projected salary increase rate used was 3.5%.

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.

Mortality: Life expectancies were based on the RP-2006 Table (base rates underlying RP-2014) projected to 2017 and thereafter, with MP-2017 projection scale which is 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. 75, 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 - **Postemployment Benefits Other Than Pension - Continued**

Sensitivity of the Colleges' proportionate share of the net OPEB liability to changes in the discount rate: The following presents the Colleges' proportionate share of the net OPEB liability, as well as what the Colleges' proportionate share of the net OPEB liability would be if it were calculated using a discount rate that is 1-percentage-point lower or 1-percentage-point higher than the current discount rate:

1.00% Decrease (2.58%)	Current Discount Rate (3.58%)	1.00% Increase (4.58%)
$ 211,679,150	$ 188,498,148	$ 168,925,037

Sensitivity of the Colleges' proportionate share of the net OPEB liability to changes in the healthcare cost trend rates: The following presents the Colleges' proportionate share of the net OPEB liability, as well as what the Colleges' proportionate share of the net OPEB liability would be if it were calculated using healthcare cost trend rates that are 1-percentage-point lower or 1-percentage-point higher than the current healthcare cost trend rates:

	1.00% Decrease	Current Healthcare Cost trend Rate	1.00% Increase
Net OPEB liability	$ 168,232,241	$ 188,498,148	$ 212,785,134

Note 11 - **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 $3,067,000 in 2018.

Note 11 - **Leases - Continued**

Future minimum rental payments required under operating leases with noncancelable terms in excess of one year at June 30, 2018 are as follows:

Years Ending June 30,	Real Estate	Vehicles and Equipment	Total
2019	$ 2,465,031	$ 334,322	$ 2,799,353
2020	2,266,994	273,630	2,540,624
2021	2,222,156	262,081	2,484,237
2022	1,761,802	232,910	1,994,712
2023	1,427,458	190,446	1,617,904
2024 and thereafter	3,728,417	-	3,728,417
	$ 13,871,858	$ 1,293,389	$ 15,165,248

Note 12 - **Capital Assets**

Property and equipment activity for the year ended June 30, 2018 is summarized below:

	Balance June 30, 2017	Additions	Transfers	Retirements	Balance June 30, 2018
Land	$ 9,004,664	$ -	$ -	$ -	$ 9,004,664
Construction-in-process	591,775	2,931,519	(2,614,801)	-	908,493
Subtotal - Capital assets not depreciated	9,596,439	2,931,519	(2,614,801)	-	9,913,157
Infrastructure	39,314,228	-	550,204	-	39,864,432
Buildings and improvements	257,449,757	85,794	1,811,623	-	259,347,174
Leasehold improvements	4,090,271	-	-	-	4,090,271
Equipment	34,070,153	1,392,914	252,974	(304,104)	35,411,937
Subtotal - Capital assets depreciated	334,924,409	1,478,708	2,614,801	(304,104)	338,713,814
Less accumulated depreciation	(176,106,780)	(9,842,721)	-	269,250	(185,680,251)
Capital assets, net	$ 168,414,068	$ (5,432,494)	$ -	$ (34,854)	$ 162,946,720

Note 13 - **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.

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 $175,000 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 $1,987,000 at June 30, 2018 and are based on historical data. A medical and dental claim roll-forward is presented below:

Medical and dental claims reserve, beginning of year	**$ 1,908,000**
Incurred claims	**18,393,000**
Payments on claims	**(18,314,000)**
Medical and dental claims reserve, end of year	**$ 1,987,000**

Note 13 - **Contingencies and Commitments**

Contingencies - Continued

VSC self-insures its workers' compensation program and is operated by 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 individual claims over $200,000 and for aggregate claims in excess of $1,085,000 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. Reserve for workers' compensation is included in accrued liabilities in the amount of approximately $432,000 at June 30, 2018. A workers' compensation roll-forward is presented below:

Workers' compensation reserve, beginning of year	**$ 265,000**
Workers' compensation accrued during the year	**881,000**
Claims paid/reserved/claims administration	**(714,000)**
Workers' compensation reserve, end of year	**$ 432,000**

Commitments

VSC has entered into various construction contracts. The following commitments are ongoing projects at June 30, 2018:

Project	Expended through June 30, 2018	Committed Future Costs	Total Committed Costs of Project
VTC Keenan Window Replacement	$ 180,000	$ 218,000	$ 398,000
LSC Wheelock Parking Lot	82,000	152,000	234,000
VTC S	67,000	33,000	100,000
LSC Wheelock Bathrooms	98,000	10,000	108,000
JSC Dewey Windows	201,000	49,000	250,000
JSC Senators Sprinkler	66,000	75,000	141,000
	$ 694,000	$ 537,000	$ 1,231,000

At June 30, 2018, invoices related to construction projects of approximately $305,000 were included in accounts payable.

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

Notes to the Financial Statements - Continued

June 30, 2018

Note 13 - **Contingencies and Commitments - Continued**

Employment Contracts
The Colleges have employment contracts with certain officers that expire on various dates through fiscal year 2019. The agreements provide for aggregate annual base salaries of $650,000 and $501,687 in fiscal years 2019 and 2020, respectively, and may be terminated with cause at any time.

Service Concession Agreements
The Colleges have entered into a service concession agreement with Sodexo Operations, LLC ("Sodexo") to manage and operate its food services for VSC's students, faculty, staff, employees and guests through June 2022; the agreement is cancelable by either party at any time. Under the agreement Sodexo shall make annual contributions to VSC to be used at VSC's discretion for food service facility enhancements. The annual contributions shall commence on July 1st of each year and shall be in accordance with the following schedule:

Years Ending June 30,	
2019	$ 225,000
2020	225,000
2021	487,500
2022	487,500
Total	$ 1,425,000

REQUIRED SUPPLEMENTARY INFORMATION

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

Schedule of Funding Progress (Unaudited)

June 30, 2018

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, 2017	$ -	$ 188,498,148	$ 188,498,148	0%	$ 51,380,910	366.9%
July 1, 2015	$ -	$ 157,886,000	$ 157,886,000	0%	$ 51,430,000	307.0%
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%

VSC has to date performed six actuarial valuations, the latest on July 1, 2017, for purposes of satisfying the requirements of GASB Statement No. 75. The actuarial accrued liability for all benefits at this time was $188,498,148, all of which was unfunded. The annual covered payroll (annual payroll of active employees covered by the plan) was $51,380,910, and the ratio of the unfunded actuarial liability to annual covered payroll was 366.9%.

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE *UNIFORM GUIDANCE*

INDEPENDENT AUDITORS' REPORT ON COMPLIANCE FOR EACH MAJOR FEDERAL PROGRAM; REPORT ON INTERNAL CONTROL OVER COMPLIANCE; AND REPORT ON THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS REQUIRED BY THE *UNIFORM GUIDANCE*

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

Report on Compliance for Each Major Federal Program

We have audited Vermont State Colleges' (the Colleges) compliance with the types of compliance requirements described in the *OMB Compliance Supplement* that could have a direct and material effect on each of the Vermont State Colleges' major federal programs for the year ended June 30, 2018. The Colleges' 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 Colleges' 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 the audit requirements of Title 2 U.S. *Code of Federal Regulations* Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (the "Uniform Guidance"). Those standards and the Uniform Guidance 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 Colleges' 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 Colleges' compliance.

Opinion on Each Major Federal Program

In our opinion, the Colleges 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, 2018.

Other Matters

The results of our auditing procedures disclosed instances of noncompliance, which are required to be reported in accordance with the Uniform Guidance and which are described in the accompanying schedule of findings and questioned costs as Finding 2018-001, 2018-002 and 2018-003. Our opinion on each major federal program is not modified with respect to these matters.

The Colleges' response to the noncompliance finding identified in our audit is described in the accompanying schedule of findings and questioned costs. The Colleges' 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 the Vermont State Colleges' 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 the Uniform Guidance, 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 the Vermont State Colleges' 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. We did not identify any deficiencies in internal control over compliance that we consider to be material weaknesses, however, material weaknesses may exist that have not been identified.

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 the Uniform Guidance. Accordingly, this report is not suitable for any other purpose.

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, 2018. We issued our report thereon dated DATE, which contained an unmodified opinion on those financial statements. Our audit was conducted for the purpose of forming an opinion on the financial statements as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by the Uniform Guidance. 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 basic financial statements. The information has been subjected to the auditing procedures applied in the audit of the 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 basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of expenditures of federal awards is fairly stated in all material respects in relation to the basic financial statements as a whole.

Certified Public Accountants
Braintree, Massachusetts

DATE

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*

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 statement of net position as of June 30, 2018, the related statement of revenues and expenses, changes in net position and cash flows for the year 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

SUPPLEMENTAL INFORMATION

SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

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

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2018

	CFDA Number	Pass-Through Entity	Pass-Through Entity Award Number	Total	Total Amounts to Sub-recipients
STUDENT FINANCIAL ASSISTANCE CLUSTER					
U.S. Department of Education:					
Direct Awards:					
Federal Supplemental Educational Opportunity Grant	84.007	N/A	N/A	$ 1,120,904	$ -
Federal Work-Study Program	84.033	N/A	N/A	1,317,496	-
Federal Direct Student Loans	84.268	N/A	N/A	39,319,495	-
Federal Perkins Loan Program (beginning of year)	84.038	N/A	N/A	4,688,176	-
Federal Perkins Loan Program (current year expenditures)	84.038	N/A	N/A	840,800	-
Federal Pell Grant Program	84.063	N/A	N/A	16,382,196	-
Total Student Financial Assistance Cluster				63,669,067	-
TRIO CLUSTER					
U.S. Department of Education:					
Direct Awards:					
TRIO Student Support Services	84.042A	N/A	N/A	1,440,045	-
TRIO Upward Bound	84.047A	N/A	N/A	1,022,583	-
TRIO Upward Bound NY	84.047M	N/A	N/A	134,902	-
TRIO McNair	84.217A	N/A	N/A	152,585	-
Total TRIO Cluster				2,750,115	-
RESEARCH AND DEVELOPMENT CLUSTER					
National Aeronautics and Space Administration:					
Passthrough Awards:					
Science - National Space Grant College & Fellowship Program	43.001	University of Vermont		11,262	-
Education - CubeSat Continued Development	43.008	University of Vermont		22,142	-
Education - National Aeronautics and Space Administration	43.008	University of Vermont		14,953	-
Education - Graduate Fellowship Competition	43.008	University of Vermont		5,015	-
Subtotal - Passthrough Awards				53,372	
National Science Foundation:					
Direct Awards:					
Geosciences	47.050	N/A	N/A	18,778	-
Education and Human Resources	47.076	N/A	N/A	95,232	-
Subtotal - Direct Awards				114,010	-
Passthrough Awards:					
Experimental Program to Stimulate Competitive Research	47.073	University of Vermont		44,837	-
Education and Human Resources	47.076	University of Vermont		13,955	-
Subtotal - Passthrough Awards				58,792	

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

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2018

	CFDA Number	Pass-Through Entity	Pass-Through Entity Award Number	Total	Total Amounts to Sub-recipients
RESEARCH AND DEVELOPMENT CLUSTER - CONTINUED					
U.S. Department of Health and Human Services:					
Passthrough Awards:					
National Center for Research Resources	93.389	University of Vermont		$ 368,793	$ -
Total Research and Development Cluster				594,967	-
CCDF CLUSTER					
U.S. Department of Health and Human Services:					
Passthrough Awards:					
Child Care and Development Block Grant	93.575	Vermont Dept. Children & Families		442,260	-
MEDICAID CLUSTER					
U.S. Department of Health and Human Services:					
Passthrough Awards:					
Medical Assistance Program	93.778	Office of Vermont Health Access (OVHA)		219,962	-
NON-CLUSTER					
U.S. Department of Agriculture:					
Passthrough Awards:					
Higher Education - Institution Challenge Grants Program	10.217	Vermont Student Assistance Corp		7,373	-
Summer Food Service Program for Children	10.559	Vermont Agency of Education		2,166	-
Rural Business Enterprise Giants	10.769	Vermont Department of Agriculture		4,546	-
Subtotal - Passthrough Awards				14,085	
U.S. Department of Commerce:					
Direct Awards:					
Manufacturing Extension Partnership	11.611	N/A	N/A	506,250	-
U.S. Department of Defense:					
Passthrough Awards:					
Procurement Technical Assistance for Business Firms	12.002	Vermont Agency of Commerce & Community Development		20,734	-
U.S. Department of Labor:					
Direct Awards:					
H-1B Job Training Grants	17.268	N/A	N/A	951,069	-
TAACCCT 1 + 4	17.282	N/A	N/A	471,567	-
Subtotal - Direct Awards				1,422,636	-

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

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2018

	CFDA Number	Pass-Through Entity	Pass-Through Entity Award Number	Total	Total Amounts to Sub-recipients
NON-CLUSTER - CONTINUED					
Institute of Museum and Library Services:					
Passthrough Awards:					
Grants to States - Job Hunt Helpers	45.310	VT Department of Libraries		$ 7,602	$ -
Small Business Administration:					
Direct Awards:					
Small Business Development Centers	59.037	N/A	N/A	675,973	-
Passthrough Awards:					
State Trade Expansion	59.061	VT Agency of Commerce & Community Development		21,030	-
U.S. Department of Education:					
Passthrough Awards:					
Career and Technical Education - Basic Grants to States	84.048	Vermont Agency of Education		790,505	-
Career and Technical Education - Basic Grants to States	84.048	Vermont Agency of Education		60,300	-
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334	Vermont Student Assistance Corp		271,304	-
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334S	Vermont Student Assistance Corp		65,484	-
Mathematics and Science Partnerships	84.366	Vermont Agency of Education		300,000	-
Subtotal - Passthrough Awards				1,487,593	-
Northern Border Regional Commission:					
Passthrough Awards:					
Northern Border Regional Development	90.601	Northern Border Regional Commission		28,853	-
U.S. Dept of Veteran Affairs					
Direct Awards:					
U.S. Dept of Veteran Affairs		N/A	N/A	2,198	-
U.S. Department of Transportation					
Direct Awards:					
Highway Research and Development Program	20.200	Federal Highway Administration	N/A	$ 36,899	$ -
Corporation for National and Community Service:					
Passthrough Awards:					
AmeriCorps	94.006	Vermont Agency of Human Services		254,903	-
Total Non-Cluster				4,478,756	-
Total Federal Funds				$ 72,155,127	$ -

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

Schedule of Expenditures of Federal Awards

Year Ended June 30, 2018

	CFDA Number	Pass-Through Entity	Pass-Through Entity Award Number	Community College of Vermont	Castleton University	Johnson State University	Lyndon State College	Vermont Technical College	Workforce	System Offices & Services	Total	Total Amounts to Sub-recipients
STUDENT FINANCIAL ASSISTANCE CLUSTER												
U.S. Department of Education:												
Direct Awards:												
Federal Supplemental Educational Opportunity Grant	84.007	N/A	N/A	$ 164,755	$ 323,990	$ 217,680	$ 180,212	$ 234,267	$ -	$ -	$ 1,120,904	$ -
Federal Work-Study Program	84.033	N/A	N/A	115,367	352,418	515,606	190,345	143,760	-	-	1,317,496	-
Federal Direct Student Loans	84.268	N/A	N/A	4,655,453	11,513,743	8,456,027	6,524,775	8,169,497	-	-	39,319,495	-
Federal Perkins Loan Program (beginning of year)	84.038	N/A	N/A	-	1,883,765	944,187	1,207,531	652,694	-	-	4,688,176	-
Federal Perkins Loan Program (current year expenditures)	84.038	N/A	N/A	-	207,442	194,600	270,071	168,687	-	-	840,800	-
Federal Pell Grant Program	84.063	N/A	N/A	6,119,369	3,047,705	2,939,626	2,095,543	2,179,953	-	-	16,382,196	-
Total Student Financial Assistance Cluster				11,054,944	17,329,063	13,267,725	10,468,477	11,548,858	-	-	63,669,067	-
TRIO CLUSTER												
U.S. Department of Education:												
Direct Awards:												
TRIO Student Support Services	84.042A	N/A	N/A	405,674	294,676	431,183	-	308,512	-	-	1,440,045	-
TRIO Upward Bound	84.047A	N/A	N/A	-	218,595	465,485	338,503	-	-	-	1,022,583	-
TRIO Upward Bound NY	84.047M	N/A	N/A	-	134,902	-	-	-	-	-	134,902	-
TRIO McNair	84.217A	N/A	N/A	-	152,585	-	-	-	-	-	152,585	-
Total TRIO Cluster				405,674	800,758	896,669	338,503	308,512	-	-	2,750,115	-
RESEARCH AND DEVELOPMENT CLUSTER												
National Aeronautics and Space Administration:												
Passthrough Awards:												
Science - National Space Grant College & Fellowship Program	43.001	University of Vermont		-	-	-	-	11,262	-	-	11,262	-
Education - CubeSat Continued Development	43.008	University of Vermont		-	-	-	-	22,142	-	-	22,142	-
Education - National Aeronautics and Space Administration	43.008	University of Vermont		-	-	-	14,953	-	-	-	14,953	-
Education - Graduate Fellowship Competition	43.008	University of Vermont		-	-	-	-	5,015	-	-	5,015	-
Subtotal - Passthrough Awards				-	-	-	14,953	38,420	-	-	53,372	
National Science Foundation:												
Direct Awards:												
Geosciences	47.050	N/A	N/A	-	18,714	-	64	-	-	-	18,778	-
Education and Human Resources	47.076	N/A	N/A	-	-	95,232	-	-	-	-	95,232	-
Subtotal - Direct Awards				-	18,714	95,232	64	-	-	-	114,010	-
Passthrough Awards:												
Experimental Program to Stimulate Competitive Research	47.073	University of Vermont		-	44,837	-	-	-	-	-	44,837	-
Education and Human Resources	47.076	University of Vermont		-	-	13,955	-	-	-	-	13,955	-
Subtotal - Passthrough Awards				-	44,837	13,955	-	-	-	-	58,792	-
U.S. Department of Health and Human Services:												
Passthrough Awards:												
National Center for Research Resources	93.389	University of Vermont		-	224,048	144,745	-	-	-	-	368,793	-
Total Research and Development Cluster				-	287,599	253,932	15,017	38,420	-	-	594,967	-
CCDF CLUSTER												
U.S. Department of Health and Human Services:												
Passthrough Awards:												
Child Care and Development Block Grant	93.575	Vermont Dept. Children & Families		442,260	-	-	-	-	-	-	442,260	-

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

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2018

	CFDA Number	Pass-Through Entity	Pass-Through Entity Award Number								Total	Total Amounts to Sub-recipients
MEDICAID CLUSTER												
U.S. Department of Health and Human Services:												
Passthrough Awards:												
Medical Assistance Program	93.778	Office of Vermont Health Access (OVHA)		$ -	$ -	$ -	$ -	$ 219,962	$ -	$ -	$ 219,962	$ -
NON-CLUSTER												
U.S. Department of Agriculture:												
Passthrough Awards:												
Higher Education - Institution Challenge Grants Program	10.217	Vermont Student Assistance Corp		-	3,139	4,234	-	-	-	-	7,373	-
Summer Food Service Program for Children	10.559	Vermont Agency of Education		-	-	-	2,166	-	-	-	2,166	-
Rural Business Enterprise Giants	10.769	Vermont Department of Agriculture		-	4,546	-	-	-	-	-	4,546	-
Subtotal - Passthrough Awards				-	7,685	4,234	2,166	-	-	-	14,085	-
U.S. Department of Commerce:												
Direct Awards:												
Manufacturing Extension Partnership	11.611	N/A	N/A	-	-	-	-	-	506,250	-	506,250	-
U.S. Department of Defense:												
Passthrough Awards:												
Procurement Technical Assistance for Business Firms	12.002	Vermont Agency of Commerce & Community Development		-	-	-	-	-	20,734	-	20,734	-
U.S. Department of Labor:												
Direct Awards:												
H-1B Job Training Grants	17.268	N/A	N/A	-	-	-	-	-	951,069	-	951,069	-
TAACCCT 1 + 4	17.282	N/A	N/A	471,567	-	-	-	-	-	-	471,567	-
Subtotal - Direct Awards				471,567	-	-	-	-	951,069	-	1,422,636	-
Institute of Museum and Library Services:												
Passthrough Awards:												
Grants to States - Job Hunt Helpers	45.310	VT Department of Libraries		7,602	-	-	-	-	-	-	7,602	-
Small Business Administration:												
Direct Awards:												
Small Business Development Centers	59.037	N/A	N/A	-	-	-	-	-	675,973	-	675,973	-
Passthrough Awards:												
State Trade Expansion	59.061	VT Agency of Commerce & Community Development		-	-	-	-	-	21,030	-	21,030	-
U.S. Department of Education:												
Passthrough Awards:												
Career and Technical Education - Basic Grants to States	84.048	Vermont Agency of Education		623,698	-	-	-	166,807	-	-	790,505	-
Career and Technical Education - Basic Grants to States	84.048	Vermont Agency of Education		60,300	-	-	-	-	-	-	60,300	-
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334	Vermont Student Assistance Corp		1,729	-	-	15,656	-	-	253,920	271,304	-
Gaining Early Awareness and Readiness for Undergraduate Programs	84.334S	Vermont Student Assistance Corp		-	-	-	-	3,074	-	62,410	65,484	-
Mathematics and Science Partnerships	84.366	Vermont Agency of Education		-	-	-	300,000	-	-	-	300,000	-
Subtotal - Passthrough Awards				685,727	-	-	315,656	169,881	-	316,330	1,487,593	-
Northern Border Regional Commission:												
Passthrough Awards:												
Northern Border Regional Development	90.601	Northern Border Regional Commission		21,536	-	-	7,318	-	-	-	28,853	-

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

Schedule of Expenditures of Federal Awards - Continued

Year Ended June 30, 2018

	CFDA Number	Pass-Through Entity	Pass-Through Entity Award Number								Total	Total Amounts to Sub-recipients
NON-CLUSTER - CONTINUED												
U.S. Dept of Veteran Affairs												
Direct Awards:												
U.S. Dept of Veteran Affairs		N/A	N/A	$ 1,680	$ 518	$ -	$ -	$ -	$ -	$ -	$ 2,198	$ -
U.S. Department of Transportation												
Direct Awards:												
Highway Research and Development Program	20.200	Federal Highway Administration	N/A	-	-	-	-	-	36,899	-	36,899	-
Corporation for National and Community Service:												
Passthrough Awards:												
AmeriCorps	94.006	Vermont Agency of Human Services		-	-	-	254,903	-	-	-	254,903	-
Total Non-Cluster				1,186,432	7,685	4,234	580,042	169,881	2,211,955	316,330	4,478,756	-
Total Federal Funds				$ 13,089,309	$ 18,425,104	$ 14,422,559	$ 11,402,039	$ 12,285,633	$ 2,211,955	$ 316,330	$ 72,155,127	$ -

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

Notes to Schedule of Expenditures of Federal Awards

Year Ended June 30, 2018

Note 1 - **Basis of Presentation**

The accompanying Schedule of Expenditures of Federal Awards includes the federal award activity of Vermont State Colleges (the "Colleges") under programs of the Federal Government for the year ended June 30, 2018. The information on this schedule is prepared in accordance with the requirements of Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards* (Uniform Guidance). Because the schedule presents only a selected portion of the operations of the College, it is not intended to and does not present the financial position, changes in net assets or cash flows of the Colleges.

Note 2 - **Summary of Significant Accounting Policies**

Expenditures reported on the schedule are reported on the accrual basis of accounting. Such expenditures are recognized following the cost principles contained in Title 2 U.S. Code of Federal Regulations Part 200, *Uniform Administrative Requirements, Cost Principles, and Audit Requirements for Federal Awards*.

Note 3 - **De Minimis Indirect Cost Rate**

The Colleges have elected not to use the 10-percent de minimis indirect cost rate as allowed under the Uniform Guidance.

Note 4 - **Federal Student Loan Program**

Perkins Loan Program
The Federal Perkins Loan Program ("Perkins") is administered directly by the Colleges and balances and transactions relating to the program are included in the College's basic financial statements. During the year ended June 30, 2018, $778,408 of loans were advanced under the Perkins program and $62,392 of administrative costs were incurred. As of June 30, 2018, loan balances receivable, net under Perkins was $4,923,967.

There was no federal capital contribution or match by the Colleges during the current year.

Note 4 - **Federal Student Loan Program - Continued**

Direct Student Loan Program

The Colleges disbursed $39,319,495 of loans under the Federal Direct Student Loans program, which include Stafford Subsidized and Unsubsidized Loans and Parent Plus Loans. It is not practical to determine the balances of the loans outstanding to students of the Colleges under the program as of June 30, 2018. The Colleges are only responsible for the performance of certain administrative duties and, accordingly, these loans are not included in the Colleges' financial statements.

VERMONT STATE COLLEGES
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Schedule of Current Year Findings and Questioned Costs

Year Ended June 30, 2018

<u>Section I – Summary of Auditors' Results:</u>

Financial Statements

Type of auditors' report issued:	Unmodified	
Internal control over financial reporting:		
• Material weaknesses identified?	_____ yes	__x__ no
• Significant deficiencies identified that are not considered to be material weaknesses?	_____ yes	__x__ no
Noncompliance material to the financial statements noted?	_____ yes	__x__ no

Federal Awards

Type of auditor's report issued:	Unmodified	
Internal control over major programs:		
• Material weaknesses identified?	_____ yes	__x__ no
• Significant deficiencies identified that are not considered to be material weaknesses?	_____ yes	__x__ no
Any audit findings disclosed that are required to be reported in accordance with the Uniform Guidance?	__x__ yes	_____ no

VERMONT STATE COLLEGES
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Schedule of Current Year Findings and Questioned Costs - Continued

Year Ended June 30, 2018

Identification of Major Programs:

Name of Federal Program or Cluster	CFDA Number
Student Financial Assistance Cluster:	
Federal Supplemental Educational Opportunity Grant Program	**84.007**
Federal Work-Study Program	**84.033**
Federal Perkins Loan Program	**84.038**
Federal Pell Grant Program	**84.063**
Federal Direct Student Loans	**84.268**
H-1B Job Training Grant	**17.268**
Small Business Development Centers	**59.037**
Career and Technical Education - Basic Grants to States	**84.048**

Dollar threshold used to distinguish
Between type A and type B programs: $750,000

Auditee qualified as a low-risk auditee? __x__ yes ____ no

VERMONT STATE COLLEGES
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Schedule of Current Year Findings and Questioned Costs - Continued

Year Ended June 30, 2018

<u>Section II – Financial Statement Findings:</u>

None

Section III – Federal Award Findings and Questioned Costs:

Finding number:	2018-001
Federal agency:	U.S. Department of Education Federal Supplemental Educational Opportunity Grant Program, Federal Work-Study Program, Federal Perkins Loan Program, Federal Pell Grant Program, Federal Direct Student Loans Program
CFDA #'s:	84.007, 84.033, 84.038, 84.063, 84.268
Award year:	2018

Criteria

According to 34 CFR Section 685.309(b)(2):

> A school shall, unless it expects to submit its next student status confirmation report to the Secretary within the next sixty days, notify the Secretary within thirty days if it discovers that a Direct Subsidized, Direct Unsubsidized, or Direct PLUS Loan has been made to or on behalf of a student who:
>
> 1. Enrolled at that school but has ceased to be enrolled on at least a half-time basis
> 2. Has been accepted for enrollment at that school but failed to enroll on at least a half-time basis for the period for which the loan was intended
> 3. Has changed his or her permanent address.

Condition

The Federal Government requires the Colleges to report student enrollment changes to the National Student Loan Data System ("NSLDS") within sixty days. During our testing of forty students with enrollment status changes who graduated or withdrew from the institution, we noted the following:

- Two student's status changes (graduated) were never reported to NSLDS.
- One students' status change (withdrawal) was not reported to NSLDS within the 60-day required time frame. Reported 69 days from date of determination, 9 days later than the 60 day limit.

Cause
Our audit disclosed that, although the Colleges uses a third party, the National Student Clearinghouse (the "NSC"), to facilitate the reporting of changes in enrollment data to the NSLDS; there were three instances (two graduates and the withdrawal) in which the Colleges failed to correct enrollment files within an adequate time frame to ensure timely and accurate reporting.

Effect
The College did not properly report student status changes to NSLDS within the required time frame. Improper enrollment reporting results in the students' loan deferment period to be incorrectly calculated.

Questioned Costs
N/A

Perspective
Our sample was not, and was not intended to be statistically valid. Of 40 students selected for testing, three or 7.5% of our sample was determined to have a status change either not reported to NSLDS or not reported timely to the NSLDS within the sixty day requirement.

Identification as a Repeat Finding, if applicable
See Finding 2017-001 included in the summary schedule of prior year findings

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

Views of Responsible Officials
The College concurs with the auditors' finding.

Finding number:	2018-002
Federal agency:	U.S. Department of Education
Programs:	Federal Work-Study Program
CFDA #'s:	84.033
Award year:	2018

Criteria
According to 34 CFR Section 675.18(g):

For the 2000-2001 award year and subsequent award years, an institution must use at least seven percent of the sum of its initial and supplemental FWS allocations for an award year to compensate students employed in community service activities. In meeting this community service requirement, an institution must include at least one:

(1) Reading tutoring project that employs one or more FWS students as reading tutors for children who are preschool age or are in elementary school; or
(2) Family literacy project that employs one or more FWS students in family literacy activities.

According to 34 C.F.R Section 675.2(b):

The Secretary defines other terms used in this part as follows:

Community services: Services which are identified by an institution of higher education, through formal or informal consultation with local nonprofit, governmental, and community-based organizations, as designed to improve the quality of life for community residents, particularly low-income individuals, or to solve particular problems related to their needs.

Condition
The Federal Government requires the Colleges to use at least seven percent of its Federal Work Study (FWS) allocations for an award year to pay for student's employed in community service activities. During our review of Vermont Technical College's Fiscal Operations Report and Application to Participate (FISAP), one of the colleges did not use at least seven percent of its Federal Work Study allocation for compensating students in community service activities.

Cause
The College did not have procedures in place to ensure that they use at least seven percent of its Federal Work Study allocation for compensating students in community service activities.

Effect
A school that fails to meet the FWS community service requirements will be required to return FWS federal funds in an amount that represents the difference between the amount a school should have spent for community service and the amount it actually spent. Furthermore, a school could be denied future participation in the FWS program.

Questioned Costs
$746 ($162,816 Total WorkStudy Funds x 7% = $11,397, $11,397 - $10,651 community service workstudy funds spent = $746).

Identification as a Repeat Finding, if applicable
N/A

Recommendation
We recommend that management implement procedures to ensure compliance with FWS community service requirements.

Views of Responsible Officials
The College concurs with the auditors' finding.

Finding number:	2018-003
Federal agency:	U.S. Department of Education
Programs:	Federal Direct Student Loans Program
CFDA #'s:	84.268
Award year:	2018

Criteria
According to 34 C.F.R. Section 668.22(j)(1):

> An institution must return the amount of Title IV funds from which it is responsible as soon as possible but no later than 45 days after the date of the institution's determination that the student withdrew.

Condition
Federal regulations state that any unearned Title IV grant or loan assistance received by a student must be refunded to the Title IV programs upon a student's withdrawal from the institution. The academic institution is responsible for the calculation of the earned and unearned portion of Title IV assistance using a standard Return of Title IV Funds form ("R2T4"). In our testing sample of 40 students who were determined to have withdrawn from the Colleges, we noted one student for whom funds were not returned within the required 45 days.

Cause
The Colleges has policies and procedures in place to perform this calculation for all students who withdraw. However, in this instance there was oversight when processing the student's withdrawal as the R2T4 form was never completed.

Effect
The Colleges did not complete the R2T4 Form or return the unearned portion of aid within the established time frame.

Questioned Costs
$1,040

Perspective
Our sample was not, and was not intended to be statistically valid. Of forty students selected for testing, one student or 2.5% of our sample was determined to not have the RT24 form completed and the resulting federal aid returned with the established time frame.

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

Schedule of Current Year Findings and Questioned Costs - Continued

Year Ended June 30, 2018

Identification as a Repeat Finding, if applicable
Not applicable

Recommendation
The Colleges should review and update their policies related to student withdrawals to ensure R2T4 forms are completed and the appropriate federal aid is returned within the established time limits.

Views of Responsible Officials
The College concurs with the auditors' finding.

Management's Summary Schedule of Prior Audit Findings

Year Ended June 30, 2018

Finding number:	2017-001
Federal agency:	U.S. Department of Education
Programs:	Federal Supplemental Educational Opportunity Grant Program, Federal Work-Study Program, Federal Perkins Loan Program, Federal Pell Grant Program, Federal Direct Student Loans Program
CFDA #'s:	84.007, 84.033, 84.038, 84.063, 84.268
Award year:	2017

Condition

The Colleges policy is to report student enrollment to a contracted third party, the National Student Clearinghouse ("NSC"). The Colleges utilized the NSC to facilitate its responsibility to notify the National Student Loan Data System ("NSLDS") of changes in the enrollment status of students. However, the Colleges are ultimately responsible to ensure that NSLDS is properly and timely notified of all student enrollment status changes. The Colleges report an initial enrollment status and subsequent changes in enrollment status to the NSC based on a pre-determined schedule throughout each semester.

Award Year 2017:

Out of a sample of forty students with enrollment status changes, two students with a status change were not reported in a timely manner to the NSLDS. One student was never reported to the NSLDS and the other student took ninety-one days to report.

Award Year 2016:

Out of a sample of forty students with enrollment status changes, one student's status change was not reported in a timely manner to the NSLDS and took sixty-two days to report.

Current Year Status:

Out of a sample of 40 students with enrollment status changes, one student was not reported timely and correctly to the NSLDS and five students status changes were never reported to the NSLDS. The College is looking to strengthen its controls in this area. See finding 2018-001 for more information and corrective action plan.

Management's Summary Schedule of Prior Audit Findings

Year Ended June 30, 2018

Finding number:	2017-002
Federal agency:	U.S. Department of Education
Programs:	Federal Perkins Loan Program
CFDA #'s:	84.038
Award year:	2017

Condition
The Federal government requires the Colleges to define exceptional financial need and adhere to that definition when prioritizing which students are awarded a Perkins loan.

The Colleges normally awards Perkins loans to students with exceptional financial need but due to an oversight during the awarding process, one student who did not display exceptional financial need was awarded a Perkins loan.

Current Year Status:
The corrective action plan was fully implemented. The auditors' current year testing revealed no findings in this area.

Management's Summary Schedule of Prior Audit Findings

Year Ended June 30, 2018

Finding number:	2017-003
Federal agency:	U.S. Department of Education
Programs:	Federal Supplemental Educational Opportunity Grant Program, Federal Work-Study Program, Federal Perkins Loan Program, Federal Pell Grant Program, Federal Direct Student Loans Program
CFDA #'s:	84.007, 84.033, 84.038, 84.063, 84.268
Award year:	2017

Condition

The Federal Government requires the Colleges to use an accurate withdrawal date for the Return of Title IV Aid calculation as well as accurately report student enrollment changes to the National Student Loan Data System ("NSLDS").

For students who officially withdraw, the Colleges are inconsistent when applying a withdrawal date to the student for NSLDS reporting and the Return of Title IV Aid calculation. The Colleges use the students' official withdrawal form date as an effective withdrawal date when reporting to NSLDS but uses the last date of attendance as the withdrawal date when performing the students' Return of Title IV Aid calculation.

Out of a sample of forty students with a Return of Title IV Aid calculation, the Colleges had five students whose effective withdrawal dates reported to NSLDS do not match the withdrawal dates per the Return of Title IV Aid calculations.

The withdrawal date per the official withdrawal form and the last date of attendance are both considered valid withdrawal dates for a non-attendance taking school but once one of those dates is determined, the withdrawal dates should be consistently applied to NSLDS reporting and the Return of Title IV Aid calculation.

Current Year Status:

The corrective action plan was fully implemented. The auditors' current year testing revealed no findings in this area.

Management's Corrective Action Plan

Finding number:	2018-001
Federal agency:	U.S. Department of Education
Programs:	Federal Supplemental Educational Opportunity Grant Program, Federal Work-Study Program, Federal Perkins Loan Program, Federal Pell Grant Program, Federal Direct Student Loans Program
CFDA #'s:	84.007, 84.033, 84.038, 84.063, 84.268
Award year:	2018

Corrective Action Plan:

In some cases, it appears the clearinghouse did not submit timely to NSLDS. In the future, the colleges will do a cross check to verify submittals due to the data mishaps and lapses in batch processing by the clearinghouse.

In the case of graduated students, a process will be implemented to identify students with unique circumstances, such as course substitutions, that are required for graduation to better track and report results.

Timeline for Implementation of Corrective Action Plan:

Fall 2018

Contact Person

Sheilah Evans, System Controller

Management's Corrective Action Plan - Continued

Finding number:	2018-002
Federal agency:	U.S. Department of Education
Programs:	Federal Work-Study Program
CFDA #'s:	84.033
Award year:	2018

Corrective Action Plan:

A fraction of money that was awarded to students in community service went unearned. The college has increased its emphasis on community service employment options on campus which is intended to make meeting the 7% obligation more easily attained and allow for closer monitoring.

Timeline for Implementation of Corrective Action Plan:

Fall 2018

Contact Person

Sheilah Evans, System Controller

Management's Corrective Action Plan - Continued

Finding number:	2018-003
Federal agency:	U.S. Department of Education
Programs:	Federal Direct Student Loans Program
CFDA #'s:	84.268
Award year:	2018

Corrective Action Plan:

Financial Aid will work with IT to create a report that identifies student drops/withdraws only, generating a smaller number of students to be reviewed for R2T4 as opposed to working on a larger list from an Informer report that is run regularly.

Timeline for Implementation of Corrective Action Plan:

Fall 2018

Contact Person

Sheilah Evans, System Controller

VERMONT STATE COLLEGES

BOARD OF TRUSTEES

RESOLUTION

Acceptance of the FY2018 Audited Financial Statements and Uniform Guidance Single Audit Report

WHEREAS, The Vermont State Colleges has contracted with O'Connor & Drew to perform its FY2018 financial statements audit, and the auditors have delivered the draft financial statements, Uniform Guidance Single Audit report and Advisory Comments therein; and

WHEREAS, The Board's 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 FY2018 Financial Statement Audit Report by O'Connor & Drew.

B. ITEMS FOR INFORMATION AND DISCUSSION

1. Audit Committees: The Roles and Responsibilities
2. Deloitte: Audit Committee Resource Guide
    a. There is a fair amount of material within this document that relates to NYSE and NASDAQ, which of course does not specifically apply to the VSC; however, this guide is current and nicely comprehensive. It addresses risk assessment, cybersecurity, ethics, as well as the audit oversight and other pertinent general topics for audit committees.

These documents are for Audit Committee members and should be read in advance of the executive session with the external auditors.

3. Discussion of the FY19 Internal Audit Process

At this time each year, we begin to plan for the annual internal audit. The first step in the process is for the VSC Chief Financial Officer to distribute the Internal Controls questionnaire to the colleges and universities in November. Last year, we revised the assessment documents in an effort to make the process more robust. We will use these again as we were pleased with the ease of use and comprehensive nature of these assessment tools. These are included in your materials.

Upon receipt of the completed documents from the colleges and universities, the Internal Audit Committee will begin its analysis of the data and select a topic area for the FY19 internal audit. We will present a proposed Internal Audit Plan to the BOT Audit Committee at its next regularly scheduled meeting in mid-February.

B. Items for Information and Discussion

Item 1:

Article: *Audit Committees: The Roles and Responsibilities*

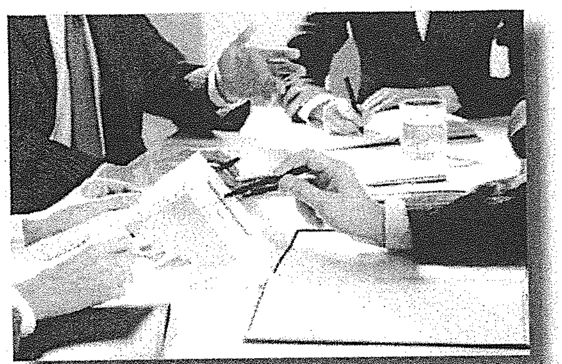
Audit Committees: The Roles and Responsibilities

While audit committees are not required for all organizations, those who use one – or plan to form one – should pay close attention to how audit committees operate.

What is an audit committee?

The primary purpose of an audit committee is to provide oversight of the financial reporting process, the audit process, the system of internal controls and compliance with laws and regulations.

The audit committee can expect to review significant accounting and reporting issues and recent professional and regulatory pronouncements to understand the potential impact on financial statements. An understanding of how management develops internal interim financial information is necessary to assess whether reports are complete and accurate.



The committee reviews the results of the audit with management and external auditors, including matters required to be communicated to the committee under generally accepted auditing standards.

Audit committees will consider internal controls and review their effectiveness. Reports on, and management responses to, observations and significant findings should be obtained and reviewed by the committee. Controls over financial reporting, information technology security and operational matters fall under the purview of the committee.

How does an audit committee work?

The committee establishes procedures for accepting confidential, anonymous concerns relative to financial reporting and internal control matters. Often referred to as a "whistle-blower policy," the procedures allow individuals to bring questions and issues to light without fear of retribution.

The audit committee is responsible for the appointment, compensation and oversight of the work of the auditor. As such, CPAs report directly to the audit committee, not management.

"Audit committees should re-examine focus, monitor effectiveness and set the course for future activities."

Audit committees should meet separately with external auditors to discuss matters that the committee or auditors believe should be discussed privately. The committee will also review the proposed audit approach and handle coordination of the audit effort with internal audit staff, if applicable.

When an internal audit function exists, the committee will review and approve the audit plan, review staffing and organization of the function and meet with internal auditors and management on a periodic basis to discuss matters of concern that may arise.

What do audit committee members do?

Committee members can expect to participate in an executive session at each meeting. These sessions can be used to meet with auditors, key members of management or financial reporting staff and provide the opportunity to glean candid information on potentially sensitive topics.

A recent survey of audit committee members reveals that a key focus has become enterprise risk management (ERM). Those surveyed ranked the level of challenge related to enterprise risk management significantly above governance, risk management, financial reporting and internal audit.

The reason is simple. ERM embraces every risk perspective of an organization. While the entire board is responsible for enterprise risk management, the ownership may rest with the audit committee. Audit committees should re-examine focus, monitor effectiveness and set the course for future activities. Newly formed committees can benefit from the wealth of experience offered by those who have spent time in the trenches.

Effective internal control emanates from the top and permeates throughout an organization. Senior management must set the tone for internal control and the audit committee can be an important piece in the internal control puzzle.

All too frequently in the past, audit committees were stacked with cronies of the chairman and president. They tended to be rubber stamps of the chief executives that met the letter, but certainly not the spirit, of the rules. In such an environment, they tended to disguise control rather than contribute to it.

However, an audit committee established with the proper attitude and responsibility will accomplish exactly that. If you're a skeptic, you naturally may wonder how more bureaucracy can contribute to profits.

What is an audit committee charter?

An audit committee charter sets forth the general purpose, authority, composition and responsibilities of the committee. The charter should be tailored to the organization.

On an annual basis, the committee should determine that all responsibilities outlined in the charter have been carried out. In addition, the charter should be reviewed and proposed updates presented to the board for approval.

While the charter must remain effective, so must committee members. Best practices include an annual evaluation of members' performance.

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Although audit committees may be reluctant to focus on self-measurement for fear of disclosing weaknesses, evaluation of committee activities is a key tool in achieving and maintaining a high degree of effectiveness.

What are the benefits of an audit committee?

Good management involves matching key tasks with the appropriate people to achieve better results. Your company can derive the most benefit from an audit committee by following these five steps:

1. Leverage your time. Financial reporting is becoming more important and complicated every year. An audit committee should be led by a designated "financial expert" and staffed with a select group of people knowledgeable about financial matters.

2. Improve your internal control. Internal control may not be at the top of your list of important objectives but it should be. Internal control is more than dual signatures on checks and segregation of duties. Properly designed, it will support every aspect of your company.

Proper internal controls will lead to higher efficiencies in all processes, less waste of resources, more objective evaluation methods and more timely and accurate management measurements. Think how valuable such improvements would be for your organization and how much you would be willing to pay a consultant to guide you in the right direction. This is another role an effective audit committee can fill.

Audit Committees: The Roles and Responsibilities

3. Improve your financial management. The audit committee focuses on the financial management and reporting of the company. This group provides a high level of specific expertise in this critical area of your company.

Financial management and reporting determine your credit-worthiness to outsiders and growth targets and successes to insiders. They are the key determinants in establishing the market value of your company – the ultimate scoreboard for management's results.

Does your board actively manage your company's financial and reporting functions – or delegate them to the outside auditor? You and your board have the responsibility and are held accountable for these functions.

4. Clarify the roles and responsibilities of your board of directors. A common myth is that a company can get by without an audit committee. The board of directors may be responsible for doing the work of an audit committee.

But without clear responsibilities assigned, there is the risk that the task may be inefficiently or ineffectively executed or perhaps not executed at all. Having a separate audit committee clarifies key responsibilities for your board.

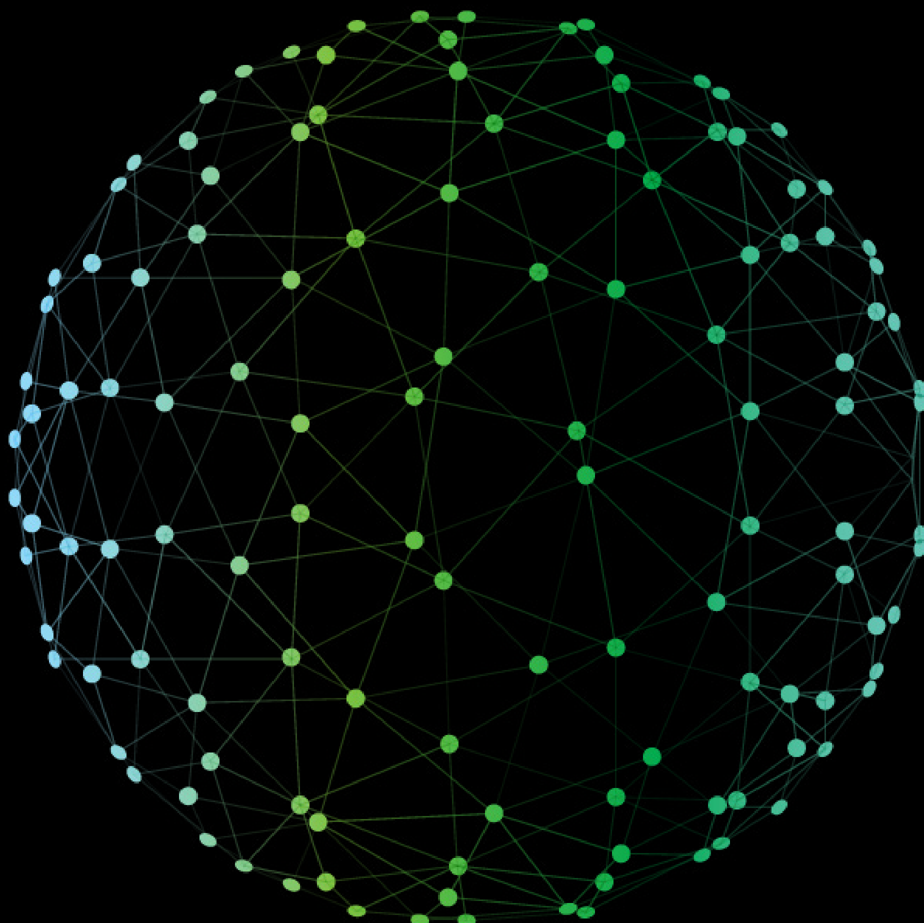
5. Bring value to your audit dollar. An audit is an expensive endeavor that all too many view as a "necessary evil" or another cost of borrowing. An active audit committee stays involved with the auditors throughout the year. The audit committee's relationship with the auditor is similar to a willing and engaged patient who makes the physician better and more effective. Hidden problems can be discovered early and dealt with before they grow into something dangerous.

B. Items for Information and Discussion

Item 2:

Article: *Deloitte: Audit Committee Resource Guide*

Deloitte.



The role of the audit committee

April 2018

Center *for*
Board Effectiveness

The role of the audit committee

Oversight of financial reporting and related internal controls

Review of filings and earnings releases

Risk oversight

Oversight of the independent auditor

Ethics and compliance

Oversight of internal audit

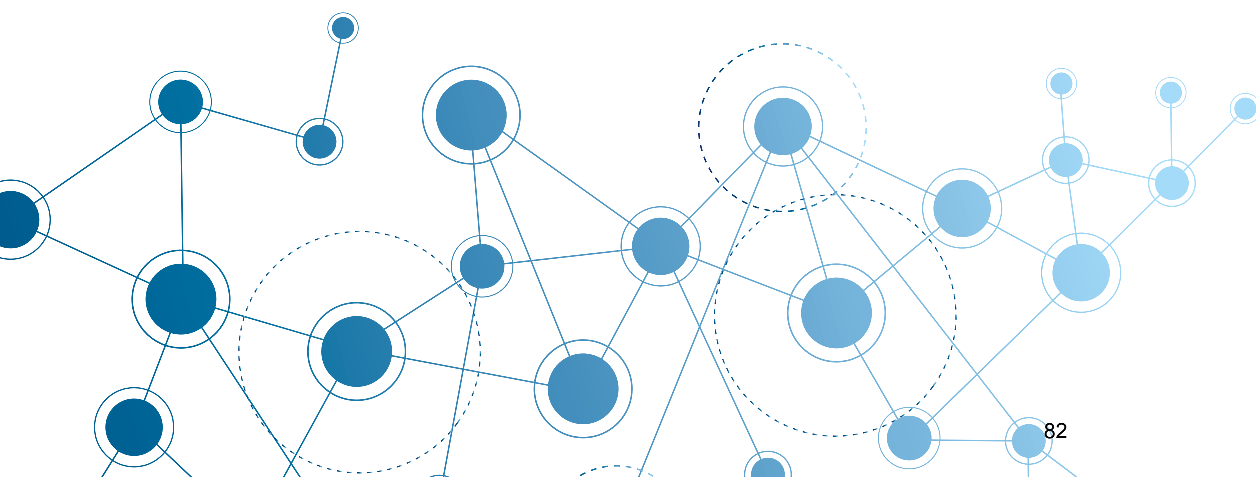
Other interactions with management and the board

Audit committee external communications

The role of the audit committee

As an audit committee member, it is important to understand the rules relevant to your role. This section provides an overview of an audit committee's responsibilities in overseeing financial reporting and related internal controls, risk, and ethics and compliance. It also discusses the committee's role in overseeing the internal and independent auditors, as well as how the committee may interact with other members of management and external stakeholders. Finally, it highlights the committee's responsibilities with respect to disclosures in the proxy statement.

SEC, PCAOB, NYSE, and NASDAQ rules are highlighted where relevant, and we have noted leading practices, tools, and resources to help audit committee members execute their responsibilities.



Oversight of financial reporting and related internal controls

The audit committee, management, and the independent auditor all have distinct roles in financial reporting. Management is responsible for preparing the financial statements, establishing and maintaining adequate internal control over financial reporting (ICFR), and evaluating the effectiveness of ICFR. The independent auditor is responsible for expressing an opinion on the fairness with which the financial statements present, in all material respects, the financial position, the results of operations, and cash flows in conformity with GAAP, and, when applicable, evaluating the effectiveness of ICFR.

To oversee ICFR successfully, the audit committee should be familiar with the processes and controls management has put in place and understand whether those processes and controls are designed and operating effectively. The audit committee should work with management, the internal auditors, and the independent auditor to gain the knowledge needed to provide appropriate oversight of this area.

Likewise, the audit committee is responsible for overseeing the entire financial reporting process. To do so effectively, it should be familiar with the processes and controls that management has established and determine whether they were designed effectively.

The audit committee's role is one of oversight and monitoring, and in carrying out this responsibility, the committee may rely on management, the independent auditor, and any advisers the committee might engage, provided its reliance is reasonable.

The audit committee should consider having management identify and discuss any significant accounting policies, estimates, and judgments made. A quarterly analysis of these areas may be useful to prepare for these discussions, and management should tailor the analysis to highlight changes and include new or unusual items. Because Regulation S-X, Rule 2-07 requires the independent auditor to discuss the effects of alternative GAAP methods on the financial statements, the information presented by management should be corroborated by the independent auditor.

NYSE requirements. NYSE listing standards require the audit committee to review major issues regarding accounting principles and the presentation of the financial statements. These include significant changes in the company's selection or application of accounting principles, the adequacy of internal controls, and any special audit steps adopted in response to what the NYSE terms "material control deficiencies." These discussions can be held, generally with management, during the review of the quarterly financial statements to be filed with the SEC.

The audit committee is also required to review management's analyses of significant issues in financial reporting and judgments made in preparing the financial statements, including the effects of alternative GAAP methods. This discussion may also be held during the review of the quarterly financial statements. The audit committee also should review the effects of regulatory and accounting initiatives, as well as off-balance-sheet transactions, on the financial statements. For example:

- Management and the audit committee should discuss pending technical and regulatory matters that could affect the financial statements, and the audit committee should be updated on management's plans to implement new technical or regulatory guidelines.
- The review of off-balance-sheet structures should also be a recurring agenda item, and may be conducted as part of the committee's review of management's discussion and analysis in the annual and quarterly reports. The exact frequency of these discussions will depend on the company's operations and preferences. Finally, the audit committee should consider reviewing off-balance-sheet transactions, or at least material ones, before they are executed.

NASDAQ requirements. NASDAQ requires disclosure of the audit committee's purpose, as set out in its charter, of overseeing accounting and financial reporting processes of the company and audits of the financial statements. See the **audit committee charter** section of this guide for details.

Fraud risk

In conjunction with risk oversight, the audit committee should be satisfied that the company has programs and policies in place to prevent and identify fraud. It should work with management to oversee the establishment of appropriate antifraud controls and programs and to take the necessary steps when fraud is detected. The audit committee should also be satisfied that the organization has implemented an appropriate ethics and compliance program and established a reporting hotline. See the **ethics and code of conduct** and **reporting hotline procedures** sections later in this guide for more information.

Audit committee members should be aware of three main areas of fraud risk:

- Financial statement fraud, which includes intentional misstatements in or omissions from financial statements
- Asset misappropriation, which may include check forgery, theft of money, inventory theft, payroll fraud, or theft of services
- Corruption, which may include schemes such as kickbacks, shell companies, bribes to influence decision makers, or manipulation of contracts.

One way the audit committee can help oversee the prevention and detection of financial statement fraud is by monitoring management's assessment of ICFR.

The audit committee should also have an awareness of the US Foreign Corrupt Practices Act (FCPA) and other non-US anticorruption laws that may be applicable (e.g., the UK Bribery Act). As the SEC and Department of Justice note in the Resource Guide to the FCPA, anticorruption compliance "begins with the board of directors and senior executives setting the proper tone for the rest of the company." To that end, the audit committee should:

- Understand the company's obligations and responsibilities regarding anticorruption laws to which it is subject
- Determine whether the company has dedicated appropriate oversight, autonomy, and resources to its anticorruption compliance program; depending on the company's size, this could involve assigning an individual who is specifically charged with anticorruption compliance and has a direct reporting line to the committee

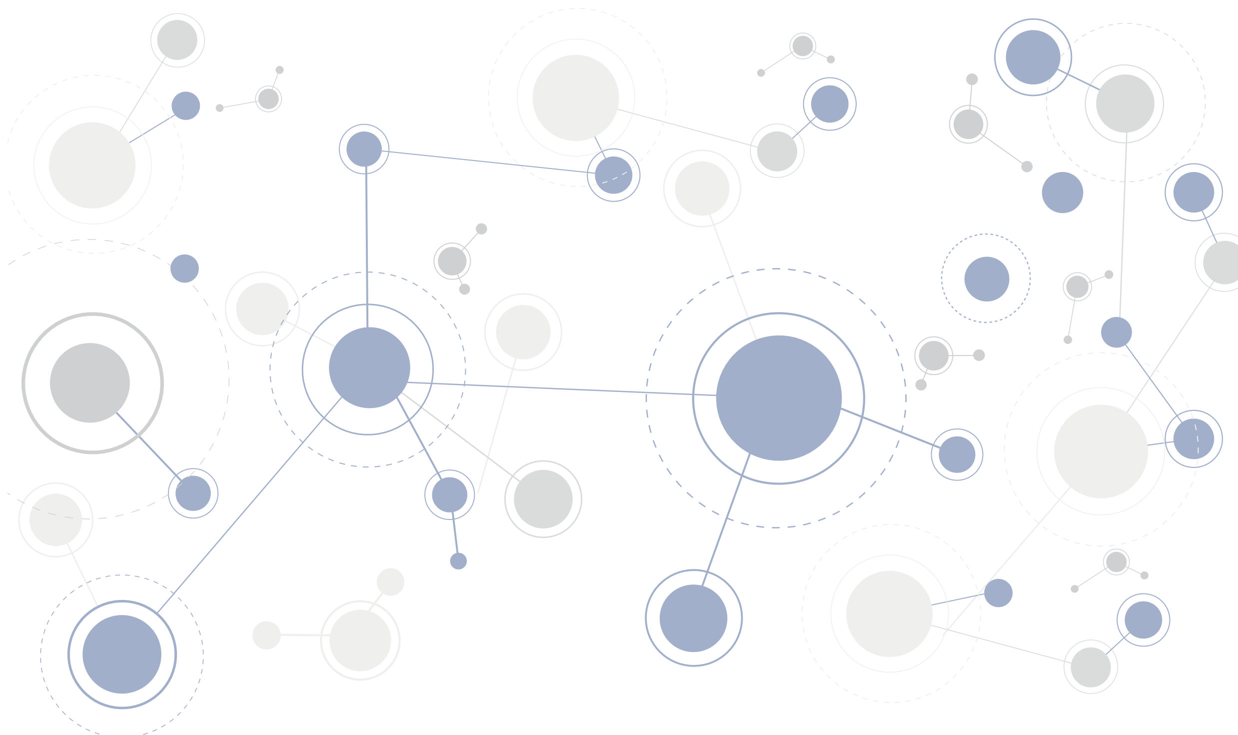
- Understand specific policies and procedures in place to identify and mitigate corruption-related risks
- Discuss with management specific corruption-related risks that have been identified, including allegations of corruption that may have been received through the company's monitoring and reporting mechanisms, as well as management's plans for responding to such risks
- Monitor any actual violations, including management's response.

2013 COSO framework. The 2013 Internal Control—Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) provides a formal structure for designing and evaluating the effectiveness of internal control. It emphasizes the role of the board—and, by delegation or regulation, the role of the audit committee—in overseeing internal control, which remains an essential aspect of effective governance. In particular, the framework highlights:

- The board's role in the control environment, including clarification of expectations for integrity and ethics, conflicts of interest, adherence to codes of conduct, and other matters
- The board's assessment of the risk that management could override internal controls and careful consideration of the possibility that management may override such controls
- The establishment and maintenance of open lines of communication between management and the board and the provision of separate lines of communication, such as whistleblower hotlines.

Tools and resources

The Anti-Fraud Collaboration released a report titled *The Fraud-Resistant Organization* that identifies three central themes critical to fraud deterrence and detection.



Review of filings and earnings releases

The audit committee generally reviews earnings releases, SEC filings containing financial information, and other financial information and earnings guidance provided to analysts, ratings agencies, and others. The committee should consider how it will execute these responsibilities to satisfy itself that all information is presented fairly and in a transparent manner. This should include a focus on consistency of information, tone, and messaging across all financial communications.

The audit committee should confirm that an appropriate legal review has been completed to verify the completeness of disclosures, including any obligation to report on trends. This legal review should also consider compliance with the company's policies on forward-looking statements and the completeness of any related disclaimers.

NYSE requirements. NYSE listing standards require that the audit committee meet to discuss the company's annual audited financial statements and quarterly financial statements with management and the independent auditor. They also require the audit committee charter to address the committee's responsibility to discuss earnings press releases and the financial information and guidance provided to analysts and ratings agencies.

The commentary to the listing standards indicates that this discussion may be in general terms, and the audit committee may discuss the type of information disclosed and the type of presentation made. The commentary also indicates that the discussion should pay particular attention to any pro forma or adjusted non-GAAP financial information.

Note that SEC rules require the audit committee to recommend to the board that the audited financial statements be included in the company's annual report on Form 10-K.

Two-thirds of audit committees meet via conference call to discuss earnings releases, while **22%** review earnings releases at in-person meetings

Source: *Deloitte 2016 Board Practices Report*

Questions for audit committees to consider

Earnings guidance

The audit committee should discuss earnings guidance with management. Questions to consider include:

- When did management last evaluate its approach to providing earnings guidance? Is a change in approach warranted as a result of the current economic environment and other circumstances facing the company?
- How can pressures to meet expectations in the short term influence the quality of the company's reported financial results and management behavior?
- What practices do the company's competitors follow with respect to earnings guidance and other forward-looking information?
- What are management's reasons for providing or not providing earnings-per-share targets and other types of forward-looking information?
- How confident is management in its ability to forecast earnings accurately? Is the disclosure of a range of earnings estimates preferable to a specific target? Should the time frame for which estimates are provided be modified or are more frequent updates necessary?
- What are the company's long-term value drivers? What is the specific quantitative and qualitative information—be it financial or nonfinancial in nature—that best reflects these drivers? Is this information provided to investors and analysts on a forward-looking basis?
- Has management considered seeking input directly from shareholders regarding the types of forward-looking information they would find meaningful?
- Do current circumstances warrant enhanced audit committee review of earnings estimates and other forward-looking information before it is made public?
- If the company changes its approach to the provision of earnings guidance and forward-looking information, should the audit committee modify its practices for reviewing that information?

Questions for audit committees to consider

Non-GAAP measures

The SEC rules regarding the use of non-GAAP financial measures require, among other things, that disclosure of any material information containing non-GAAP financial measures must include the most directly comparable GAAP financial measures, that the GAAP measures must be disclosed with equal or greater prominence, and that the GAAP and non-GAAP measures must be reconciled. The SEC has recently taken a hard look at non-GAAP measures in response to concerns about their increased use and prominence. As a result, companies and audit committees should consider re-examining their use of non-GAAP measures and related controls and the disclosure of those measures. The audit committee should consider asking the following questions:

- Is the measure misleading or prohibited?
- Is the measure presented with the most directly comparable GAAP measure and with no greater prominence than the GAAP measure?
- Is the measure defined and described appropriately and clearly labeled as non-GAAP?
- Does the reconciliation between the GAAP and non-GAAP measure clearly label and describe the nature of each adjustment, and is each adjustment appropriate?
- Is there transparent and company-specific disclosure of the substantive reasons why management believes that the measure is useful for investors and the purpose for which management uses the measure?
- Is the measure prepared consistently from period to period in accordance with a defined policy, and is it comparable to that of the company's peers?
- Is the measure balanced (e.g., does it adjust not only for nonrecurring expenses but also for nonrecurring gains)?
- Does the measure appropriately focus on material adjustments and not include immaterial adjustments that would not seem to be a focus of management?
- Do the disclosure controls and procedures address non-GAAP measures?
- Does the audit committee oversee the preparation and use of non-GAAP measures?
- Does the audit committee have a clear understanding how non-GAAP measures impact compensation? Are the audit and compensation committees aligned on this?

Tools and resources

Deloitte's publications *A Chance to Self-Correct: SEC Urges Companies to Take a Fresh Look at Their Non-GAAP Measures* and *A Roadmap to Non-GAAP Financial Measures* provide additional information, including ways for a company to assess the appropriateness of its non-GAAP measures and control considerations.

Additionally, in March 2018, the Center for Audit Quality issued *Non-GAAP Measures: A Roadmap for Audit Committees*, a guide intended to help audit committees enhance their oversight of these measures used by company management. The roadmap provides key considerations for audit committees, including leading practices to assess whether a company's non-GAAP metrics present a balanced representation of the company's performance.

Questions for audit committees to consider

Related-party transactions

NASDAQ and NYSE listing standards each contemplate that the audit committee of a listed company, or another independent body of the board, will review all related-party transactions. In some instances, this responsibility is assigned to the audit committee. The following questions may help the audit committee assess its process for approving related-party transactions:

- What process will the committee follow in reviewing and approving related-party transactions? Is this process documented?
- Will special meetings be called as potential transactions arise, or is there a process to review transactions between scheduled meetings?
- What information does the committee need to make an informed judgment about the appropriateness of a transaction?
- Who will be responsible for presenting this information?

For each transaction brought for approval, the committee may consider asking:

- What are the business reasons for the transaction? Are these reasons in line with the company's overall strategy and objectives?
- When and how will the transaction have to be disclosed? How will investors view the transaction when it is disclosed?
- Which insiders could benefit from the transaction and in what way?
- What impact will the transaction have on the financial statements?
- Are any outside advisers needed to help understand the implications of the transaction?

Risk oversight

Given the dynamic business environment, which creates an ever-changing risk landscape, boards should make sure the risk oversight function is well defined and effective. The board plays a critical role in understanding and influencing management's processes for identifying, assessing, and continually monitoring risks. The board should clearly define which risks the full board should discuss regularly versus the risks that can appropriately be delegated primarily to a board committee. While many boards have a defined risk governance structure in place, it is important to continually assess the structure as companies face new risks.

A leading practice is for management to maintain a list of all enterprise-wide risks, which are then mapped to specific board committees with the expertise to oversee them. For example, human resource and compensation risks may be delegated to the compensation committee for oversight, and the audit committee should have a key role in overseeing financial risks. In many instances, the full board takes direct responsibility for and regularly discusses the company's most strategic risks, which include risks that could disrupt and materially impact the company's business strategy. Committee charters should be updated to align with the defined risk governance structure.

For companies outside the financial services industry, where many companies have separate board risk committees, any risks not assigned to a specific committee during this process are often delegated to the audit committee. While it may be appropriate for the audit committee to take responsibility for reviewing the guidelines, processes, and policies management has in place to identify, assess, and manage risk, boards should take care not to overburden the audit committee

Questions for audit committees to consider

Risk oversight

When the board or audit committee is considering the effectiveness of the company's enterprise risk management—the process of planning, organizing, leading, and controlling activities to minimize the effect of downside risk on the organization—it may consider the following questions:

- Which board committees are responsible for various aspects of risk governance? Has the risk governance structure been defined?
- How do the various board committees oversee risk? Is there appropriate coordination and communication between all relevant stakeholders?
- Does the board consider the relationship between strategy and risk? What are the potential internal and external risks to the success of the strategy?
- Does management provide the board with the information needed to oversee the risk management process effectively?
- What are the company's policies and processes for identifying, assessing, and continually monitoring the major financial risk exposures on an integrated, enterprise-wide basis?
- Has management assigned owners for each risk that has been identified?
- How might the company's compensation programs encourage inappropriate focus on short-term financial performance? Are the audit committee and compensation committee aligned on such risks?
- What mechanisms does management use to monitor emerging financial risks? What are the early warning mechanisms, and how effective are they? How, and how often, are they calibrated?
- Which framework has management selected for the financial risk management program? What criteria were used to select it?
- What is the role of technology in the risk management program? How was it chosen, and when was it last evaluated?
- Is cyber risk receiving adequate time and focus on the audit committee agenda?

with risk oversight responsibilities. The NYSE listing standards further define the audit committee's role in discussing policies with respect to risk assessment and risk management:

> While it is the job of the CEO and senior management to assess and manage the listed company's exposure to risk, the audit committee must discuss guidelines and policies to govern the process by which this is handled. The audit committee should discuss the listed company's major financial risk exposures and the steps management has taken to monitor and control such exposures. The audit committee is not required to be the sole body responsible for risk assessment and management, but, as stated above, the committee must discuss guidelines and policies to govern the process by which risk assessment and management is undertaken. Many companies, particularly financial companies, manage and assess their risk through mechanisms other than the audit committee. The processes these companies have in place should be reviewed in a general manner by the audit committee, but they need not be replaced by the audit committee.[1]

The SEC considers risk oversight a primary responsibility of the board and requires disclosure of its role in this area. Disclosures include whether the entire board is involved in risk oversight; whether certain aspects are executed by individual board committees; and whether the employees responsible for risk management report directly to the board. Such disclosures informs shareholders' understanding of the board's process for overseeing risk.

[1] NYSE listing standards, 303A.07 *Audit Committee Additional Requirements*.

Tools and resources

Deloitte's publications, *Risk Committee Resource Guide for Boards*; *Risk Intelligent Governance: Lessons from State of the Art Board Practices*; and *Bank Board Risk Governance: Driving Performance through Enhanced Risk Oversight*, provide additional information for boards and audit committee members on risk oversight.

The audit committee's potential role in overseeing cyber risk

It is often challenging for even the most tech-savvy business leaders to keep up with the scope and pace of developments related to big data, social media, cloud computing, IT implementations, cyber risk, and other technology matters. These developments carry a complex set of risks, the most serious of which can compromise sensitive information and significantly disrupt business processes. Cyber risk is often at the top of the agenda for management and boards at companies of all sizes and industries. The pervasiveness of cyber risk significantly increases concerns about financial information; internal controls; and a wide variety of risks, including the reputational risks that can result from a cyber incident. Oversight of a successful cyber risk management program requires proactive engagement and is most frequently the responsibility of the full board. In some organizations, a level of oversight may be delegated to a risk committee or the audit committee.

In companies where the audit committee holds some responsibility for cyber risk management, the committee should first obtain a clear understanding of the specific areas it is expected to oversee. In those organizations, the audit committee, in its capacity of overseeing financial risks and monitoring management's policies and procedures, may have expertise and be asked to play a significant strategic role in monitoring management's preparation for and response to cyber threats, coordinating cyber risk management initiatives and policies, and confirming their efficacy. Those audit committees may take the lead in monitoring cyber threat trends, regulatory developments, and major threats to the company. Other responsibilities may include setting expectations and accountability for management, as well as assessing the adequacy of resources, funding, and focus on cyber risk management activities.

For those audit committees charged with this oversight, engaging in regular dialogue with the chief information officer, chief information security officer, and other technology-focused leaders can help the committee determine where attention should be focused. Although cyber risk is frequently on the full board's agenda, audit committees are increasingly receiving regular updates from relevant technology leaders, with some technology risk-related topic on almost every meeting agenda. The audit committee chairman can be a particularly effective liaison with other groups in enforcing and communicating expectations regarding cyber and financial risk mitigation.

We need to arm corporate boards with a mechanism to thoughtfully assess management's assertions about the design and effectiveness of their organizations' cyber defenses.

Sarah Bloom Raskin, Former Deputy Secretary of the US Department of Treasury, at the PCAOB's 10th annual International Institute on Audit Regulation event in Washington, DC

To which groups has the board allocated the majority of tasks connected to the following areas of risk oversight? (Respondents could select multiple groups for each risk.)

	The "big" picture	Reputational risks	Financial stability risk	Cyber risks	Compliance risks	Talent risks	Incentive risks
The full board	96%	86%	47%	41%	22%	46%	21%
Audit committee	5%	9%	51%	51%	69%	2%	5%

Source: *2016–2017 NACD Public Company Governance Survey*, National Association of Corporate Directors

Cybersecurity risk management

In April 2017, the AICPA released its cybersecurity risk management attestation reporting framework, which is intended to expand cyber risk reporting to address the marketplace need for greater stakeholder transparency. This reporting framework establishes a standardized reporting mechanism to provide a broad range of users with useful information about an entity's cybersecurity risk management program to support informed and strategic decision making. It consists of the following components:

- Management's description of the entity's cybersecurity risk management program
- Management's assertion on the presentation of the description and the operating effectiveness of the controls to achieve the cybersecurity objectives
- Practitioner's report on the presentation of the description and the operating effectiveness of the controls to achieve the cybersecurity objectives.

Leveraging a unified approach for performing and reporting on an entity's cyber risk management program and related controls could help boards and audit committees effectively execute their oversight responsibilities with respect to cyber risk.

See Deloitte's Cybersecurity risk management assessment page.

Enhanced cybersecurity disclosure guidance

The SEC issued interpretive guidance on February 21, 2018, that largely refreshes the SEC's 2011 staff guidance related to cybersecurity disclosure obligations. The latest guidance does not establish any new disclosure obligations but rather presents the SEC's views on how its existing rules should be interpreted in connection with cybersecurity threats and incidents. It also expands on the initial concepts discussed, concentrating more heavily on cybersecurity policies and controls, most notably those related to cybersecurity escalation procedures and the application of insider trading prohibitions. The guidance also addresses the importance of avoiding selective disclosure, as well as considering the role of the board of directors in risk oversight. The release applies to public operating companies, including foreign private issuers, but does not address the specific implications of cybersecurity for other regulated entities under the federal securities laws, such as registered investment companies, investment advisers, brokers, dealers, exchanges, and self-regulatory organizations.

The new guidance clarifies the SEC's view on the role of the board of directors in overseeing cybersecurity risk. If the risk is material to a company's business, the discussion of the board of directors' role in the risk oversight function should include the nature of its responsibilities for overseeing the management of this risk. The SEC believes that "disclosures regarding a company's cybersecurity risk management program and how the board of directors engages with management on cybersecurity issues allow investors to assess how a board of directors is discharging its risk oversight responsibility in this increasingly important area."

For more information about the latest guidance, refer to Deloitte's *Heads Up: In the Spirit of Full Cybersecurity Disclosure.*

The audit committee's role in M&A

The audit committee has an important role in M&A, both before and after a transaction.

Before the deal is done: Due diligence

Although due diligence is largely management's responsibility, the audit committee can provide critical oversight in areas such as risk analysis, internal controls, and even the basic financial information on which the terms are based. Weakness in a target's internal control systems can create unpleasant surprises that, in the absence of due diligence, may not be discovered until it is too late. This could be a critical factor when management is required to evaluate the post-integration controls in accordance with the Sarbanes-Oxley Act. While target financial information may be prepared with the best of intentions, and may even be audited, audit committee oversight can provide greater comfort that the financial information is accurate and complete. Other areas of due diligence oversight include tax, insurance, and Foreign Corrupt Practices Act compliance.

Audit committees can and should satisfy themselves that the due diligence process is thorough and that the board is fully informed of related risks before the transaction is approved. They can do this in much the same way they address day-to-day matters: ask questions, identify areas of risk to consider, and provide guidance on how to solve problems.

Post-merger integration oversight

While post-merger integration is sometimes overlooked in the excitement of closing a deal, it can be critical to the success or failure of the transaction. The audit committee has a vital role to play here, too.

One area of audit committee focus is the melding of internal control systems and processes so they are stable on Day 1 or as soon as possible thereafter. SEC rules adopted under the Sarbanes-Oxley Act require public companies to integrate disclosure controls as well as controls over financial reporting. Failure to do so can have significant consequences. Even when both parties have high-quality systems, processes that do not work well together may create control problems, leading to reportable deficiencies or even material weaknesses.

Other areas of audit committee responsibility include oversight of talent integration in the financial and accounting areas and monitoring that computer systems and technology platforms can communicate with each other from the outset.

For additional information, read Deloitte's *On the Board's Agenda: Post-Merger Integration*.

Special requirements for financial institutions

Following the enactment of the Dodd-Frank Act in July 2010, the Federal Reserve Board issued a new regulation setting forth enhanced prudential standards for large banking organizations, including risk committee requirements. Specifically, all bank holding companies (BHCs) with total consolidated assets of $10 billion or more are required to maintain a risk committee that approves and periodically reviews the risk management policies of the BHC's global operations and oversees the operation of the BHC's global risk management framework. More stringent requirements apply to BHCs with total consolidated assets of $50 billion or more. The corporate governance requirements state that the risk committee must:

- Have a formal, written charter that is approved by the BHC's board of directors
- Meet at least quarterly, or more frequently if needed, and fully document and maintain records of its proceedings, including risk management decisions.

Moreover, the risk committee at each BHC with total consolidated assets of $50 billion or more is required to:

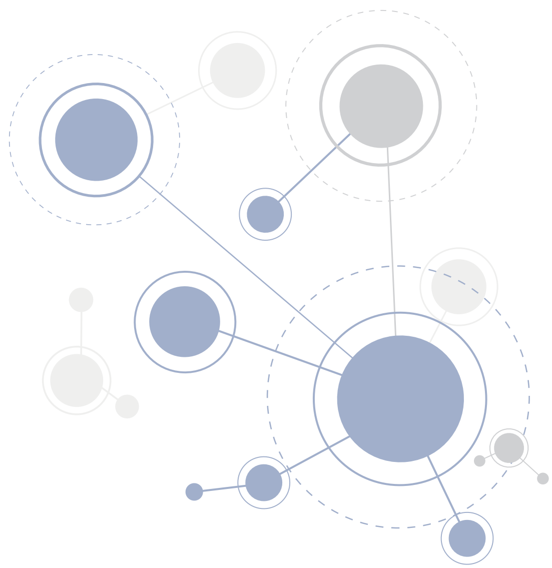
- Be an independent committee of the board of directors that has, as its sole and exclusive function, responsibility for the risk management policies of the BHC's global operations and oversight of the operation of the BHC's global risk management framework
- Report directly to the BHC's board of directors
- Receive and review regular reports not less than quarterly from the BHC's chief risk officer.

See the Federal Reserve's final rule and Deloitte's practical guide to the rule for additional requirements and guidance.

Soon after the Federal Reserve Board finalized its EPS framework, the Office of the Comptroller of the Currency (OCC) issued heightened standards applicable to national banks, insured federal savings associations, insured federal branches of foreign banks with total consolidated assets of $50 billion or more, and OCC-regulated institutions with total consolidated assets of less than $50 billion if that institution's parent company controls at least one other covered institution.

Among other things, each covered institution is required to establish and adhere to a formal, written risk governance framework that is designed by independent risk management and approved by the board of directors or the board's risk committee.

See the OCC's heightened standards for additional requirements and guidance.



Oversight of the independent auditor

Audit committees of listed companies are directly responsible for the appointment, compensation, and oversight of the independent auditor, including the resolution of any disagreements with management. It is optimal for the audit committee, management, the internal auditors, and the independent auditor to work together in a spirit of mutual respect and cooperation.

The audit committee and the independent auditor typically meet at least quarterly to thoroughly discuss a wide variety of matters, including the company's financial reporting, internal controls, and the audit, from planning to conclusion of the audit. These discussions should also include educational and evaluative topics. Executive sessions with the independent auditor are a way to maintain open communication and identify concerns, and they are required for NYSE-listed companies.

Auditor communications

The NYSE, NASDAQ, and PCAOB outline communications that are required between the audit committee and the independent auditor. Many of these communications are focused on the responsibility of the audit committee to oversee the independent auditor.

NYSE requirements. NYSE listing standards require the audit committee to communicate with the independent auditor in the following ways:

- Meet with the independent auditor to review and discuss the company's annual audited financial statements and quarterly financial statements, including disclosures in management's discussion and analysis
- Periodically, meet separately with the independent auditor, management, and the internal auditors
- Obtain a formal written communication from the independent auditor regarding independence and other matters annually
- Review with the independent auditor any audit problems or difficulties and management's response
- Set clear hiring policies for employees or former employees of the company's independent auditor.

NASDAQ requirements. NASDAQ listing standards require the audit committees of listed companies to obtain a formal written statement from the independent auditor consistent with PCAOB Ethics and Independence Rule 3526, *Communication with Audit Committees Concerning Independence*.

PCAOB requirements.[1] Some communications between the auditor and the audit committee are driven by standards the auditor must follow in conducting the audit. There are a number of PCAOB standards that require communications with the audit committee. The primary one is Auditing Standard No. 1301 (AS 1301), *Communications with Audit Committees*, The communications under this standard can be oral or written, but must be made in a timely manner and prior to issuance of the auditor's report. The standard addresses communications relevant to different phases of the audit, from the auditor's engagement through the issuance of the auditor's report. It also requires communications relevant to various aspects of the company's accounting and reporting, as well any disagreements between the auditor and management.

[1] The PCAOB requirements encompass the items the independent auditor is required to communicate to the audit committee by SEC's Regulation S-X, Rule 2-07, *Communication with Audit Committees*. The SEC stated in its release adopting this rule that it expects these discussions to occur prior to filing Form 10-Q or Form 10-K.

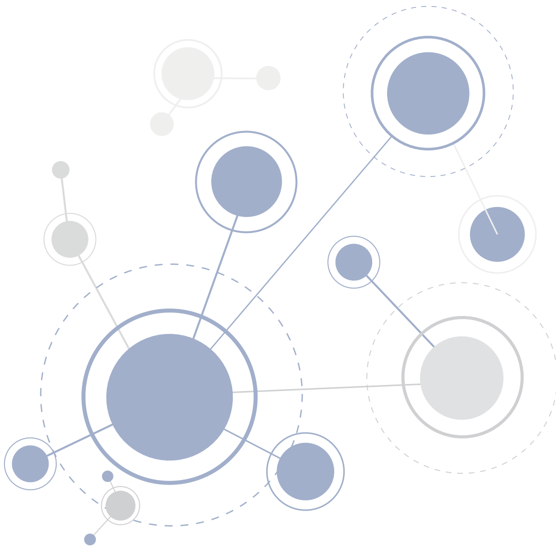
Summary of PCAOB required communications

Communications required by AS 1301

- Significant issues discussed with management before the auditor's appointment or retention
- An understanding of the terms of the audit
- Information relevant to the audit
- Overview of the audit strategy, timing of the audit, and significant risks
- Results of the audit, including:
  - Significant accounting policies and practices
  - Critical accounting policies and practices
  - Critical accounting estimates
  - Significant unusual transactions
- Auditor's evaluation of the quality of the company's financial reporting
- Other information in documents containing audited financial statements
- Difficult or contentious matters about which the auditor consulted
- Management consultations with other accountants
- Going-concern matters
- Uncorrected and corrected misstatements
- Material written communications
- Departure from the auditor's standard report
- Disagreements with management
- Difficulties encountered in performing the audit
- Other matters

Communications required by other PCAOB standards or rules

- Material weaknesses and significant deficiencies in internal control (AS 2201)
- Representations of management (AS 2201)
- Fraud and illegal acts (AS 2401 and 2405)
- Communications in connection with interim reviews (AS 4105)
- Preapproval of services (Rules 3524 and 3525)
- Independence matters (Rule 3526)
- Related parties (AS 2410)
- Auditing fair-value measurements and disclosures (AS 2502)



PCAOB adopts changes to the auditor's report

The SEC approved the standard requiring changes to the auditor's report on October 23, 2017. In a statement announcing its approval of this standard that significantly modifies the auditor's reporting model, Chairman Jay Clayton stated his strong support for the objective of the rule, namely for the auditors to provide investors with meaningful insights into the audit. Chairman Clayton highlighted the important role of the audit committee and noted that the SEC and PCAOB will monitor the results of the new standard's implementation, including consideration of any unintended consequences.

The new auditor reporting standard will significantly modify the auditor's reporting model while retaining the current "pass/fail" opinion of the existing auditor's report. The primary changes include:

- Standardized ordering and inclusion of section headers, with the opinion section appearing first
- Enhanced descriptions of the auditor's role and responsibilities, including a statement regarding independence requirements
- Communication of critical audit matters (CAMs)
- Disclosure of auditor tenure—the year in which the auditor began serving consecutively as the company's auditor.

A CAM is defined as a matter communicated, or required to be communicated, to the audit committee that:

- Relates to accounts or disclosures that are material to the financial statements
- Involves especially challenging, subjective, or complex auditor judgment.

The new requirements will be phased in, with CAM disclosure effective for large accelerated filers for audits of fiscal years ending on or after June 30, 2019, and for all other audits to which the requirement applies for fiscal years ending on or after December 15, 2020. The remaining changes apply to auditor reports issued for fiscal years ending on or after December 15, 2017.

Although the standard will be implemented in accordance with phased-in effective dates, management and audit committees will most likely want to start to consider the implications of the new requirements and discuss them with their auditors. Potential questions regarding CAMs may include:

- What matters could be CAMs?
- How will management and the audit committee engage with the auditor as CAMs are identified and the auditor's descriptions of the CAMs are developed and finalized?
- How will the timing of auditor communications with management and the audit committee accommodate the discussion of CAMs?
- How do the auditor's statements regarding CAMs compare to management's disclosures regarding the same matters?

Deloitte's *Heads Up* provides additional information on the new rule.

I strongly support the objective of the rule to provide investors with meaningful insights into the audit from the auditor. CAMs are designed to provide investors and other financial statement users with the auditor's perspective on matters discussed with the audit committee that relate to material accounts or disclosures and involve especially challenging, subjective, or complex auditor judgment. Investors will benefit from understanding more about how auditors view these matters.

Jay Clayton, SEC Chairman

Auditor independence

The SEC and PCAOB rules govern the independence of accountants who audit or review financial statements and prepare attestation reports filed with the SEC. The rules recognize the critical role of audit committees in financial reporting, their unique position in monitoring auditor independence, and their direct responsibility for the oversight of the independent auditor. Although most audit firms are rigorous in monitoring and enforcing these independence requirements, it is important that audit committee members be aware of them as well.

The SEC independence rules address the following issues related to registrants.

Financial interests. The rule states that independence is impaired if the audit firm or certain of its people have a direct or material indirect financial interest in an audit client. Examples of prohibited financial interests include an investment in the audit client's debt or equity securities, certain loans, deposits not fully insured by the Federal Deposit Insurance Corporation, broker-dealer account balances not fully insured by the Securities Investor Protection Corporation, and certain individual insurance products.

Employment relationships. The rule states that independence is impaired if a current partner, principal, shareholder, or professional employee of the independent auditor has an employment relationship with, or serves as a member of the board or similar management or governing body of, the audit client. Former partners, principals, shareholders, or professional employees of the independent auditor cannot be employed in an accounting role or financial reporting oversight role—one who exercises more than minimal influence over the contents of accounting records or prepares them—at an audit client unless they are fully separated from the independent auditor, financially and otherwise. Even if this separation is achieved, former members of the audit engagement team for an issuer cannot take a financial reporting oversight role for the issuer before completion of one annual audit subsequent to the engagement period when the individual was a part of the engagement team. Employment restrictions also apply to certain close family members of the independent auditor's personnel.

Business relationships. The rule prohibits an independent auditor from having a direct or material indirect business relationship with an audit client, or with persons associated with the audit client in a decision-making capacity, such as an audit client's officers, directors, or substantial stockholders. This prohibition does not preclude the independent auditor from providing permissible services to the audit client or purchasing goods or services from the audit client as a consumer in the ordinary course of business, commonly known as a vendor business relationship.

Nonaudit services provided by auditors. The rule sets forth 10 categories of services that impair the auditor's independence if provided to an audit client. The rule permits an auditor to provide other nonaudit services to an issuer if the services are preapproved by the audit committee. Permissible nonaudit services include due diligence for mergers and acquisitions, internal control reviews, and tax services that are not prohibited by the PCAOB.

In certain limited circumstances, the independent auditor may provide bookkeeping, design, and implementation of financial information systems; appraisal or valuation services; actuarial services; and internal audit outsourcing to a nonclient affiliate of an audit client if "it is reasonable to conclude that the results of these services will not be subject to auditing procedures during an audit of the audit client's financial statements." This is referred to as the "not-subject-to-audit" exception.

The following nonaudit services are prohibited to the independent auditor:

- Bookkeeping or other services related to the accounting records or financial statements of the audit client
- Design and implementation of financial information systems
- Appraisal or valuation services, fairness opinions, or contribution-in-kind reports
- Actuarial services
- Internal audit outsourcing
- Management functions
- Human resources
- Broker-dealer, investment advisory, or investment banking services
- Legal services
- Expert services.

The audit committee's administration of the audit engagement (preapproval). The audit committee must preapprove permissible audit and nonaudit services to be provided to the issuer and its subsidiaries. Preapproval can be obtained directly or based on policies and procedures established by the audit committee that are detailed as to the type of service. These policies and procedures do not circumvent the need to inform the audit committee of the service, and the committee cannot delegate its preapproval responsibilities to management. It can, however, delegate preapprovals to one or more members of the committee if the preapprovals are reported at the next scheduled meeting of the full committee.

Further, the PCAOB rules provide that an audit firm seeking preapproval of tax services or nonaudit services related to internal control over financial reporting must:

- Describe, in writing, the scope of the service. For tax services, the audit firm must describe, in writing, (i) the fee structure for the engagement, any side letter or other amendment to the engagement letter, or any other agreement between the firm and the audit client relating to the service; and (ii) any compensation arrangement or other agreement between the registered public accounting firm or an affiliate and any person other than the audit client with respect to promoting, marketing, or recommending a transaction covered by the service.
- Discuss with the audit committee of the issuer the potential effects of the services on the independence of the firm.

Contingent fees and commissions. The rule states that independence is impaired if the independent auditor provides any service or product to an audit client for a contingent fee or a commission, or receives a contingent fee or commission from an audit client. The PCAOB also has discretion to prohibit any other service that it determines, by regulation, to be impermissible. In addition to prohibiting the independent auditor from providing a service or product to an audit client for a contingent fee or commission, the PCAOB has issued rules prohibiting the independent auditor from:

- Marketing, planning, or opining in favor of the tax treatment of a confidential or aggressive tax transaction
- Providing tax services to persons in a financial reporting oversight role for an audit client.

Partner rotation. The rule requires the lead audit and engagement quality review partners to rotate after five years, at which time they are subject to a five-year "time-out" period. Audit partners who are significantly involved with senior management or the audit committee or who are responsible for decisions on accounting matters that affect the financial statements must rotate after seven years and are subject to a two-year time-out period. This includes audit partners who serve as the lead partner for significant subsidiaries. Significant subsidiaries are defined as those accounting for greater than 20 percent of an issuer's revenues or assets. Other specialty partners, such as tax partners, are not required to rotate.

Compensation of audit partners. Under the SEC's rule, an auditor is not independent if, at any point during the audit and professional engagement period, any audit partner receives compensation from selling engagements to provide the audit client with any services other than audit, review, or attest services.

For the purpose of this restriction, the SEC defines the term "audit partner" as the lead and concurring partners and other partners on the engagement team who have responsibility for making decisions on significant auditing, accounting, and reporting matters that affect the financial statements or who maintain regular contact with management or the audit committee. This includes all audit partners serving the client at the issuer or parent, with the exception of specialty partners, as well as the lead partner at subsidiaries whose assets or revenues constitute at least 20 percent of the consolidated assets or revenues.

Evaluation of the independent auditor

Inherent in the audit committee's duty to appoint, compensate, and oversee the independent auditor is the idea that the audit committee will do some form of evaluation of the auditor.

The NYSE listing standards require the audit committee to review a report by the independent auditor describing its quality controls, results of investigations, and independence. The commentary accompanying this listing standard states that after reviewing the report and the independent auditor's work throughout the year, the audit committee will be in a position to evaluate the auditor's qualifications, performance, and independence. The commentary to this standard specifies that the "evaluation should include the review and evaluation of the lead partner of the independent auditor," and "should take into account the opinions of management and the company's internal auditors (or other personnel responsible for the internal audit function)."

Practices for evaluating the independent auditor range from highly formalized processes with extensive documentation to more informal assessments. Factors the audit committee may consider in developing an evaluation process include:

- **Frequency and timing of the evaluation.** Many audit committees perform the evaluation annually, immediately following the issuance of the Form 10-K and in conjunction with their decision to reappoint the independent auditor.
- **Parties involved in the assessment.** Although the SEC does not explicitly require the audit committee to formally evaluate the independent auditor, many committees conduct some form of evaluation to make decisions on the auditor's initial appointment or annual reappointment. While the audit committee is responsible for the appointment, compensation, and oversight of the independent auditor, it may not be practical for the audit committee to oversee and coordinate the entire evaluation. In many instances, the audit committee delegates the coordination responsibility to internal

audit, the legal department, or another group in the company. The party responsible for coordinating the evaluation should obtain information not only from the audit committee, but also from senior financial management and the internal auditors. Depending on the size and structure of the company, it may be appropriate to obtain input from the management of significant operating locations or business units.

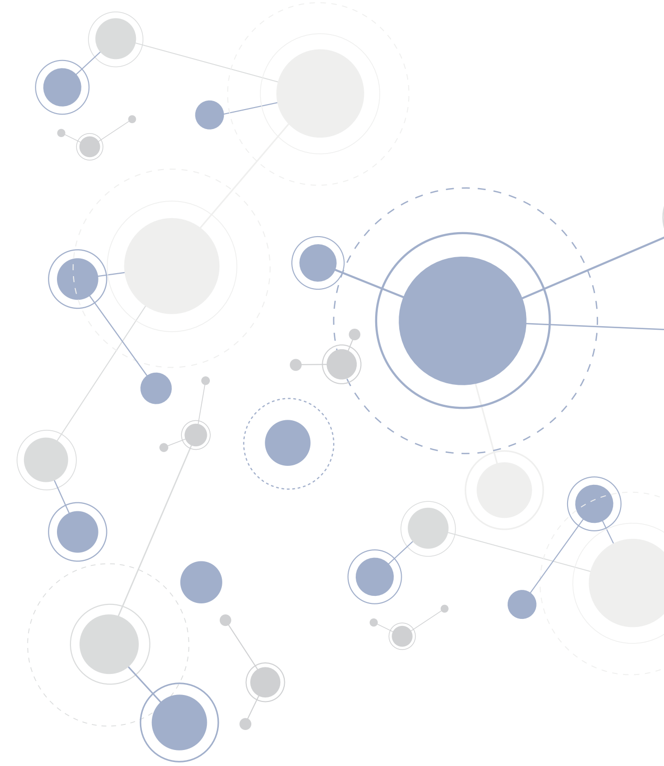
- **Form and nature of the assessment.** Some independent auditors have assessment questionnaires for evaluating client service. Audit committees can use these questionnaires, tailor them to fit their needs, or create their own. The assessment can be done by having the relevant parties complete the questionnaire in writing or by holding interviews. They may also have a discussion about the experience the audit committee and others at the company have had in working with the independent auditor.
- **Assessment criteria.** The criteria for evaluating the independent auditor vary. Common criteria specific to the engagement team include technical competence; industry knowledge; frequency and quality of communication; cohesiveness as a team; demonstrated independence, objectivity, and professional skepticism; and the level of support provided to the audit committee in fulfilling its responsibilities. Audit committees may consider information about the characteristics of the audit firm itself, such as size, financial strength and stability, presence in key markets, approach to professional development, technological capabilities, nature of the audit approach, quality of thought leadership, and eminence in the marketplace. The results of the PCAOB inspection process and peer reviews may also be considered in the evaluation.

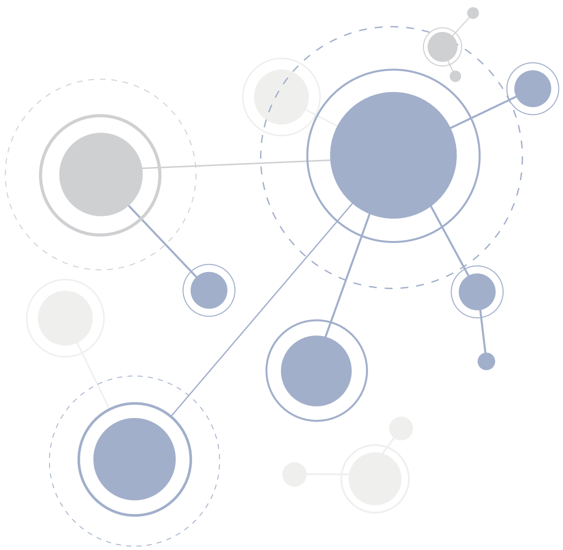
Tools and resources

For additional information, read Deloitte's *Appointing, Assessing, and Compensating the Independent Auditor: The Role of the Audit Committee*.

The Audit Committee Collaboration, a partnership of the Center for Audit Quality and US corporate governance and policy organizations, has issued an *External Auditor Assessment Tool* for audit committees. The tool assists audit committees in carrying out their responsibility of appointing, overseeing, and determining compensation for the independent auditor.

The PCAOB issued *Information for Audit Committees about the PCAOB Inspection Process* to help audit committees better understand the PCOAB's inspection process and how to gather information from their audit firms about inspections.





Questions for audit committees to consider

Audit innovation

With advances in technology, auditors are turning to innovation to enhance quality and drive value into the audit. In understanding how the independent auditor is using innovation, the audit committee may consider the following questions:

- How is the independent auditor leveraging innovation to enhance audit execution?
- What investments is the independent auditor making in audit innovation, and how do those investments translate to enhanced audit quality and value for the company?
- What insights is the independent auditor able to provide about the company and its financial and internal controls processes through the audit and with the use of new technologies, including audit analytics?
- What are some of the emerging technologies that the independent auditor is exploring for use in the audit? How may the company benefit from the independent auditor's use of these emerging technologies?
- With respect to innovation, how is the independent auditor differentiating itself from competitors to add value to the audit?

Ethics and compliance

As highlighted by several court rulings and the US Federal Sentencing Guidelines for organizations, executives and boards of directors have special responsibilities for the oversight and management of ethics and compliance programs, an important component of which is a robust code of ethics or conduct.

The board should consider the audit committee's role in overseeing the company's ethics and compliance programs, noting that NYSE-listed companies are required to have the audit committee oversee legal and regulatory compliance.

Ethics and code of conduct

A culture that embraces the importance of ethics and compliance can be established only if employees, officers, and directors understand the requirements of the code of ethics.

The SEC, the NYSE, and NASDAQ all require a code of ethics or a code of conduct. There are similarities among the requirements, but there are also differences.

SEC requirements. The SEC requires registrants to disclose whether they have written codes of ethics that apply to their principal executive officers, principal financial officers, principal accounting officers or controllers, or individuals performing similar functions. If they do not, they must explain why not. A company registered in the United States must disclose any changes to, or waivers from, the code of ethics that apply to the CEO or senior financial officers, generally within four business days after it amends its code of ethics or grants a waiver. The NYSE and NASDAQ listing standards have the same four-day rule.

The SEC rule defines a code of ethics as a written standard that is reasonably designed to deter wrongdoing and to promote:

- Honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest in personal and professional relationships
- Full, fair, accurate, timely, and understandable disclosure in the company's SEC filings and other public communications
- Compliance with applicable laws, rules, and regulations
- The prompt internal reporting of violations to parties identified in the code
- Accountability for adherence to the code.

Companies must include these disclosures in their annual reports and must make the code of ethics available to the public through one of the methods listed in Item 406 of Regulation S-K.

NYSE requirements. NYSE listing standards require a code of conduct that covers not only senior financial officers, but all employees. Specifically, the websites of NYSE-listed companies must disclose the code of conduct applicable to employees, directors, and officers. Companies can determine their own policies, but the code must contain the items listed in NYSE 303A.10, only some of which are required by the SEC.

NASDAQ requirements. NASDAQ listing standards require public disclosure of a code of conduct applicable to all employees, officers, and directors. NASDAQ's criteria for the code of conduct are consistent with the SEC's requirements.

86%
of audit committees receive a report on internal tips from a hotline or other reporting mechanism at least once a year

26%
of audit committees receive these reports at every committee meeting

Source: *Deloitte 2016 Board Practices Report*

In addition, each code of conduct must provide for prompt and consistent enforcement, protection for individuals who report questionable behavior, clear and objective standards for compliance, and a fair process for addressing violations.

Both the NYSE and NASDAQ listing standards permit companies to have more than one code of conduct as long as all directors, officers, and employees are covered by a code. For example, some companies have developed a separate code for directors, whose roles and responsibilities differ from those of officers and other employees.

Common practices and considerations. Those responsible for overseeing ethics and compliance should work with management to determine that the company's code of ethics or conduct complies with the applicable requirements. Companies may update the code in response to new issues or situations. Legal counsel should be consulted on modifications to the code.

Communication and training are critical to fostering an ethical culture. The code should be available to everyone in the organization, perhaps through inclusion on the company's intranet site and in the employee orientation program and manual. Some companies require individuals, including directors, to sign an annual certification noting that they have read, understood, and complied with the code. If an employee refuses to sign the certification, committees should encourage companies to take prompt and appropriate disciplinary action, up to and including termination. Communication of disciplinary actions taken in response to code violations is a common way of communicating to employees that violations are taken seriously.

Questions for audit committees to consider

Ethics and compliance

To the extent the audit committee is charged with the responsibility to oversee ethics and compliance:

- Does the committee hear directly from the person who has day-to-day responsibility for ethics and compliance matters? Does this person have the ability to hold these discussions in an executive session?
- Do the ethics and compliance governance framework, organizational structure, and reporting lines provide sufficient independence for the audit committee to execute its responsibilities (e.g., does the chief ethics and compliance officer report directly or indirectly to the audit committee)?
- Does the ethics and compliance officer have adequate staff, technology, and other resources to do an effective job?
- Does the company regularly and systematically scrutinize the sources of ethics and compliance failures and react appropriately?
- How does management take action on reports? Is there evidence of employees being disciplined promptly, appropriately, and consistently?
- Does the reporting process keep the audit committee informed of ethics and compliance issues, as well as the actions taken to address them? Is ethics and compliance a regular item on the committee's agenda?
- What type of ongoing monitoring and auditing processes are in place to assess the effectiveness of the ethics and compliance program?
- Is the company's risk culture encouraging the right type of behaviors?

Tools and resources

Deloitte's ethics and compliance resources offer additional information on establishing codes of ethics and robust ethics and compliance programs, including *Building World-Class Ethics and Compliance Programs: Making a Good Program Great*, and *In Focus: Compliance Trends Survey*, a collaboration between Deloitte and *Compliance Week*.

Reporting hotline procedures

Companies often use hotlines as a mechanism to report a range of ethics and compliance issues, including potential violations of the code of ethics. A thorough, independent, and objective process should be established by management and the audit committee for investigating complaints. Companies use various procedures, but the most common method of receiving tips from inside and outside the organization is through a telephone and Web-based hotline administered by an internal department or a third party.

SEC regulations and the NYSE and NASDAQ listing standards require the audit committees of listed companies to establish procedures for:

- Receiving, retaining, and addressing complaints regarding accounting, internal controls, or auditing matters, whether from internal or external sources who wish to remain anonymous, as well as reporting a range of compliance matters, including violations of the code of conduct and allegations of fraud or corruption
- The confidential, anonymous submission of employee concerns regarding questionable accounting or auditing matters.

The audit committee should work with management to confirm that the appropriate members of management are aware of questions or complaints received from internal sources and third parties, including vendors, through the various reporting methods available. Responsibility for investigating questions or concerns and reporting back to the audit committee often falls on individuals in the ethics and compliance, internal audit, legal, or risk management departments.

The audit committee should also establish expectations with respect to the type of complaints that will be reported to them and how they will be communicated. Some complaints may warrant immediate communication, such as those involving senior management and significant dollar amounts. In addition to these immediate reporting situations, the audit committee should receive a regular analysis of the complaints received, including a root-cause analysis; their resolution; and the steps taken to avoid similar violations in the future. The audit committee should also determine which complaints warrant a discussion with the board.

A telephone and Web-based hotline monitored by an independent third party is common. If the hotline is administered internally, operators should have specific training on where to direct questions or complaints, including those related to human resources, as well as the ability to provide coverage 24 hours a day, 365 days a year and include an anonymous reporting option. Employees can be informed of reporting channels in the code of ethics, the employee handbook, human resources orientation, ethics training, and periodic communications. Instructions for submitting questions or complaints can be posted in company facilities and on intranet sites.

The company's public website is a natural vehicle for communicating the procedures to individuals outside the organization. As discussed in the code of ethics section, NYSE listing standards require companies to adopt codes of ethics and disclose them on their websites. NASDAQ-listed companies also must adopt and disclose codes of ethics, and many have chosen to post their codes on their websites. Telephone operators working in customer service and investor relations should be prepared to answer questions on how to submit concerns and complaints regarding financial reporting.

Under the SEC's whistleblower programs, employees with knowledge of potential securities fraud who report original information to the government or a self-regulatory organization can receive a minimum of 10 percent and as much as 30 percent of monetary sanctions if the enforcement action results in fines of at least $1 million.

Whistleblowers are not required to report issues first through internal company channels; however, those who do so are still eligible for the reward if the company reports the problem to the government or if the whistleblower does so within 120 days of notifying the company.

It is important for the audit committee to work with management and internal audit to understand:

- How hotlines are evaluated, tested, and audited to ensure calls are received, recorded, and managed in a consistent, confidential, accurate, and timely manner
- Opportunities to enhance internal whistleblowing systems and promote reporting mechanisms to all personnel
- The potential value of transaction monitoring tools to help promptly identify potential securities fraud issues such as bribery or financial statement fraud.

Companies with operations in different countries should be careful to comply with those countries' laws, as they may impose requirements, restrictions, and prohibitions different from those applicable in the United States.

Internal auditing is an independent, objective assurance and consulting activity designed to add value and improve an organization's operations. It can help an organization accomplish its objectives by bringing a systematic, disciplined approach to evaluating and improving the effectiveness of risk management, control, and governance processes.

Institute of Internal Auditors

Oversight of internal audit

An effective relationship between the audit committee and the internal auditors is fundamental to the success of the internal audit function. It is important for audit committees to assess whether internal audit's priorities, such as monitoring critical controls and developing an audit plan focused on risks identified in the enterprise risk management program, are aligned with those of the audit committee. At some companies, internal audit evaluates and considers suggestions to improve operations and processes.

When the internal audit function reports to the audit committee directly, it allows the internal auditors to remain structurally separate from management and enhances objectivity. This also encourages the free flow of communication on issues and promotes direct feedback from the audit committee on the performance of the chief audit executive.

NYSE requirements. The NYSE listing standards require companies to have an internal audit function. Audit committees are required to oversee the internal audit function and to note this responsibility in their charters. Specific requirements include:

- The audit committee charter must include oversight of the internal audit function as one of its purposes.
- The audit committee's regular report to the board should include issues involving the performance of the internal audit function.
- The audit committee must meet separately with the internal auditors.

NASDAQ requirements. The audit committee oversees the accounting and financial reporting processes of the company. Although NASDAQ companies are not required to have an internal audit function, for those that do, oversight of internal audit is often one component of overseeing accounting and financial reporting.

Common practices and considerations. The specific expectations for internal audit functions vary by organization, but may include:

- Objectively monitor and report on the health of financial, operational, and compliance controls
- Provide insight into the effectiveness of risk management
- Offer guidance regarding internal/compliance controls
- Act as a catalyst for positive change in processes and controls
- Deliver value to the audit committee, other directors, and management in the areas of controls and risk management to assist in the audit committee's assessment of the efficacy of programs and procedures
- Coordinate activities and share perspectives with the independent auditor.

In support of these expectations, the audit committee and the chief audit executive (CAE) should have a strong relationship characterized by open communication. The audit committee should challenge the CAE and the internal audit department by setting high expectations, communicating those expectations clearly, and holding the department accountable for meeting them. The CAE should be candid in raising concerns with the audit committee when they arise.

It is important for the audit committee to see that the internal auditors have appropriate independence and stature and are visibly supported by senior management throughout the organization. They should support the CAE, providing guidance and assistance when he or she reports potential management lapses.

In addition to making themselves available when contacted by the CAE, members of the audit committee should engage with the CAE regularly to maintain a reporting relationship that is both substantive and communicative. Holding regular executive sessions with the CAE is common and is required for NYSE-listed companies. The audit committee should actively participate in discussing goals and evaluating the performance of the CAE; these responsibilities should not be delegated solely to the CFO or CEO.

The audit committee should understand and approve the annual internal audit plan and determine if the CAE has a sufficient budget and related resources to execute against it. In determining that resources are adequate, audit committees often consider whether the CAE and his or her staff are adequately compensated. As part of this review, they should review and evaluate the status of the enterprise-wide risk management program and the alignment of risks to the internal audit plan. The audit committee should also evaluate the progress and results of the internal audit plan against the original plans and any significant changes made subsequently.

The International Standards for Professional Practice of Internal Auditing established by the Institute of Internal Auditors (IIA) require internal auditors to maintain a certain level of independence from the work they audit. This means that an internal auditor should have no personal or professional involvement with the area being audited and should maintain an impartial perspective on all engagements. Internal auditors should have access to records and personnel when necessary, and they should be allowed to employ appropriate investigative techniques without impediment.

Internal audit departments should also employ quality processes with a focus on continuous improvement. These processes should be periodically reviewed through self-assessment and/or external reviews. The IIA's standards require external assessments to be conducted by a qualified, independent party at least once every five years. The CAE should discuss the form and frequency of the external assessment, as well as the qualifications and independence of the external assessor, with the audit committee.

Oversight of internal audit

There are several ways the audit committee can oversee the internal audit function. The IIA provides the following checklist of considerations for audit committees in overseeing the internal auditors:

- The audit committee engages in an open, transparent relationship with the CAE.
- The audit committee reviews and approves the internal audit charter and internal audit plan annually.
- As a result of discussions with the CAE, the audit committee has a clear understanding of the strengths and weaknesses of the organization's internal control and risk management systems.
- Internal audit is sufficiently resourced with competent, objective professionals to carry out the internal audit plan, which has been reviewed and approved by the audit committee.
- Internal audit is empowered to be independent by its appropriate reporting relationships to executive management and the audit committee.
- The audit committee addresses with the CAE all issues related to internal audit independence, objectivity, and resources.
- Internal audit is quality-oriented and has a quality assurance and improvement program in place.
- The audit committee regularly communicates with the CAE about the performance and improvement of the CAE and internal audit.
- Internal audit reports are actionable, and audit recommendations and other improvements are implemented by management satisfactorily.
- The audit committee meets periodically with the CAE without the presence of management.

Questions for audit committees to consider

Interactions with internal audit

- Does internal audit have a clearly articulated strategy that is reviewed and approved by the audit committee periodically?
- Does internal audit have a clear set of performance expectations that are aligned with the success measures of the audit committee and measured and reported to the audit committee?
- Does internal audit have a charter that is reviewed and approved by the audit committee periodically? Does internal audit operate in accordance with its charter?
- Is the internal audit plan aligned to the primary risks of the organization and other assurance activities? Is internal audit's risk assessment process linked to the company's enterprise risk management activities appropriately?
- Is internal audit flexible and dynamic in addressing new risks promptly and meeting the needs of the audit committee?
- Is internal audit effective in using advanced technologies, such as data analytics, to improve audit quality?
- Does internal audit organize or perform peer reviews or self-assessments of its performance and report the results to the audit committee?
- Does the CAE have the right mix of experience and capabilities, including industry knowledge and business acumen, to understand the company's risks?
- Does the CAE have a professional certification, such as certified internal auditor, and participate in relevant continuing education programs?
- Is internal audit funded and adequately and staffed with the appropriate mix of professionals needed to achieve its objectives?
- Does internal audit's reporting structure within the organization ensure sufficient independence and respect from management and other employees?
- Is the level of assurance provided by internal audit and its interaction with other assurance sources clear and appropriate for the audit committee?
- Does the internal audit function have and demonstrate the level of independence needed to execute its responsibilities properly?
- Does internal audit meet with the independent auditor regularly to discuss risk assessments, the scope of procedures, or opportunities to achieve greater efficiencies and effectiveness in the company's audit services?
- Does internal audit report issues in a timely manner and address them with management?
- Are issues identified and reported by internal audit highlighted to the audit committee appropriately, and is the progress of remediation tracked and reported?
- Are reports and other communications from internal audit to the audit committee of an appropriate standard and do they provide value?

Other interactions with management and the board

In executing their governance responsibilities, audit committees frequently interact with other stakeholders, in addition to the internal and independent auditors.

Interactions with the finance organization

The finance function's leaders and professionals can have a direct impact on a company's risk profile, value creation, and return on investment for investors and other stakeholders. The audit committee relies significantly on the finance function and needs to maintain an open and effective relationship with them. Their oversight can contribute to the finance organization's interest in having the right resources available to support the quality and reliability of financial accounting, reporting, and related controls. Audit committees may also provide input on the assessment and compensation of finance professionals who they interact with regularly.

The audit committee can help monitor and strengthen finance talent initiatives, in particular the succession plans for leaders and finance professionals in roles of critical importance, through regular discussions with the CEO, CFO, and other finance executives, as well as regular oversight of issues related to finance talent.

Common practices and considerations. Interactions with the finance organization vary, but may include the following practices:

- To foster open communication, meet periodically with management, the director of the internal audit function, and the independent auditor in separate executive sessions (NYSE Corporate Governance Rule 303A.07(b)(iii)(E)).
- Provide input on the performance of key finance executives, including the CFO and CAO.
- Provide input into management's goal-setting process.
- Hold annual discussions of succession planning for the finance organization with the CEO and CFO and regular discussions of the finance organization's bench strength.
- Invite succession candidates to present during audit committee meetings to develop a firsthand view of their potential.
- Understand management's process for early identification and resolution of accounting and other issues.
- Understand plans to address new accounting and reporting requirements and related risks.
- Visit company locations and meet with members of management periodically.

Questions for audit committees to consider

Finance organization talent

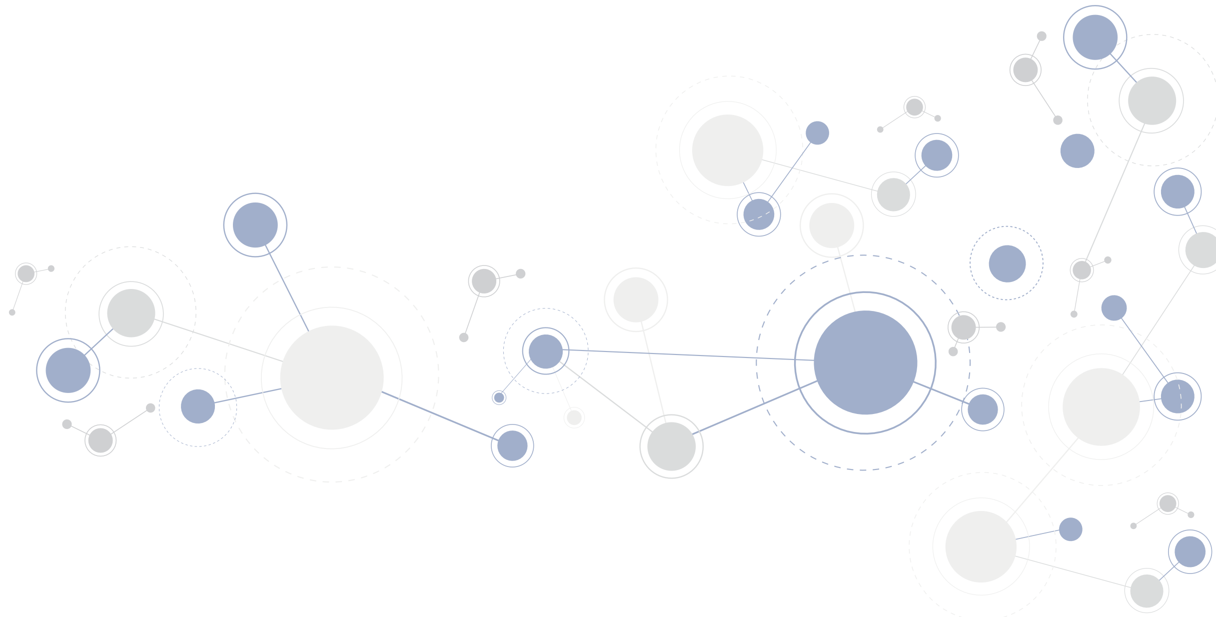
- Do you have adequate personnel, both in numbers and quality, to fulfill your responsibilities with respect to the financial statements and internal control over financial reporting?
- What is the succession plan for key finance positions?
- Are there finance professionals in the pipeline of potential leaders that the audit committee should meet? Are succession candidates given an opportunity to meet with the audit committee?
- What plans are in place to respond to unexpected turnover in finance roles? Is someone ready to begin immediately, and if not, what are the backup plans to hire temporary resources?
- What formal training and development programs are in place to keep finance professionals up to date with the latest developments and requirements? Do professionals receive training on advanced technologies that could enhance the effectiveness of the finance organization?
- How does the audit committee participate in the evaluation of the CFO? What kind of evaluation criteria are important to the audit committee?

Interactions with the board and other committees

As the audit committee seeks to align its structure with the company's strategic priorities, it should consider the coordination required among other board committees and the full board to facilitate the optimal allocation and coverage of topics that affect more than one group and to reduce the likelihood of something falling through the cracks. The audit committee should understand the roles and responsibilities of other board committees and consider whether they could benefit from periodic joint meetings to discuss areas of common interest and significant matters.

It is particularly important for the audit committee to coordinate with the compensation committee as it considers the risk that compensation policies have on the financial statements and internal controls. The audit committee should understand management and general employee compensation plans and how related metrics may affect fraud risks. Additionally, as companies increasingly use non-GAAP metrics to determine compensation, the audit committee should understand how those metrics may impact risk and may need to be addressed in the reconciliation between non-GAAP and GAAP information.

The audit committee chairman should also coordinate with the nominating and governance committee as it considers board candidates. The chairman should communicate the skills and experiences needed from members to effectively carry out the audit committee's responsibilities.



Audit committee external communications

Investors, policymakers, and regulators are continuing to show interest in more detailed disclosure about audit committees, their activities, and their oversight of the relationship with independent auditors. As these external parties request additional clarification about the roles and responsibilities, audit committees should consider whether they should enhance disclosures in the proxy statement.

Various SEC rules and exchange listing requirements address audit- and audit committee-related information that must be disclosed in the proxy statement, including the audit committee report, and on company websites.

SEC rules require companies to disclose the name of each audit committee member and include an audit committee report in their proxy statements. In the report, the audit committee must state whether it has:

- Reviewed and discussed the audited financial statements with management
- Discussed with the independent auditor all matters required under applicable auditing standards
- Received required independence disclosures from the independent auditor.

Based on this review and discussion, the report must also include a statement of whether the audit committee recommended to the board that the audited financial statements be included in the annual report to be filed with the SEC.

Proxy statements must disclose whether the board has adopted a written charter for the audit committee, and if so, include a copy of the charter as an appendix to the proxy statements at least once every three years.

Audit committee reporting

Over the past several years, investors and other governance groups and investors have sought expanded disclosures on how audit committees execute their duties. As recently as November 2016, the United Brotherhood of Carpenters' Pension Fund announced that it would send letters to 75 companies encouraging their audit committees to enhance auditor independence disclosures in 2017 proxy statements—a request they have been making since 2013. The SEC weighed in on the discussion when it issued a request for public comment in a July 2015 concept release titled *Possible Revisions to Audit Committee Disclosures*.

Deloitte's latest proxy statement analysis, *Audit Committee Disclosure in Proxy Statements – 2017 Trends*, indicates that companies have generally increased voluntary disclosures about the role and activities of audit committees over the past several years. While it is not necessary, or possible, to disclose everything an audit committee does each year in fulfilling its duties, additional insight into the structure and activities of the audit committee can help increase investor confidence in both the committee and the company as a whole.

The Center for Audit Quality (CAQ) and Audit Analytics published the *Audit Committee Transparency Barometer* in November 2016, which presents findings from an analysis of audit committee disclosures in proxy statements and measures the robustness of these disclosures among S&P Composite 1500 companies. The report measures the content of proxy statement disclosures in areas that include auditor oversight and scope of duties. The CAQ joined with several governance organizations in 2013 to form the Audit Committee Collaboration,[1] which released a report titled Enhancing the Audit Committee Report: A Call to Action in November 2013 to encourage enhanced audit committee disclosures.

The calls for increased transparency into audit committee duties, including the oversight of the independent auditor, are expected to continue to grow. Audit committees can respond by providing more meaningful disclosures that increase awareness of their responsibilities and how individual committees carry them out. For more information, read the *July 2015 Audit Committee Brief: SEC Issues Concept Release Concerning Audit Committee Reporting Requirements*.

[1] The following groups are members of the Audit Committee Collaboration: Association of Audit Committee Members, Inc.; Center for Audit Quality; Corporate Board Member/NYSE Euronext; The Directors' Council; Independent Directors Council; Mutual Fund Directors Forum; National Association of Corporate Directors; and Tapestry Networks.

41%

of audit committees go beyond what is required with regard to audit committee disclosures in the proxy statement

44%

disclose only what is required

Source: *Deloitte 2016 Board Practices Report*

Companies whose securities are quoted on NASDAQ or listed on the NYSE must disclose whether the audit committee members are independent as defined in the applicable listing standards, as well as certain information regarding any director on the audit committee who is not independent.

Regulators continue to solicit views of audit committees with respect to industry- and company-specific knowledge and experience. Taking the time to engage in formal or informal communication with regulators, industry groups, or the independent auditor on these topics can have a substantive impact on the development of standards and rules.

Fee disclosure

The SEC rule requires disclosure of fees paid to the independent auditor for the current and prior years, as well as a description of the services included in all categories, other than for audit fees, for both years. The audit committee's preapproval policies and procedures must be disclosed in a detailed description or by including the policy itself, along with disclosure of any services that were initially missed and later approved under a de minimis exception in the SEC's rule. Disclosures are required in the issuer's annual report as well as the proxy statement, but companies are allowed to incorporate the information into their Form 10-K from their proxy statement.

The SEC's rule that implemented the Sarbanes-Oxley Act expanded the requirements to disclose fees paid to the auditor, and many companies have opted to provide even more information. For instance, many companies subtotal the audit and audit-related fees so shareholders can easily quantify the portion of services that are audit and audit-related in nature.

Because certain institutional investors and proxy advisers, such as Institutional Shareholder Services, have guidelines for proxy-vote recommendations related to audit fees, many companies disclose not only the nature of services in the fee categories but also the amounts associated with specific services. Issuers should consult with legal counsel to determine the content of the fee disclosure. The SEC's four fee categories are:

- **Audit fees** are fees for services that normally would be provided in connection with statutory and regulatory filings or engagements, including the audit of internal control over financial reporting. This category also may include services that only the independent auditor reasonably can provide, such as comfort letters, statutory audits, attest services, consents, and assistance with documents filed with the SEC. Audit fees may include certain services provided by specialists who assist in the audit, such as tax specialists needed to audit the tax provision or valuation specialists needed to audit a fair-value assertion; certain accounting consultations in connection with the audit; and similar items that are not billed as audit services and that only the independent auditor reasonably can provide.
- **Audit-related fees** are for assurance and related services that are performed by the independent auditor, such as audits of employee benefit plans; due diligence related to mergers and acquisitions; accounting consultations and audits in connection with acquisitions; internal control reviews, although not the audit of internal control over financial reporting, which is part of audit fees; attest services that are not required by statute or regulation; and consultation concerning financial accounting and reporting standards to the extent that such consultation is not necessary to complete the GAAS audit.
- **Tax fees** include all tax services except those related to the audit, such as review of the tax provision, which would be included in audit fees. Typically, tax fees cover tax compliance, planning, and advice. Tax compliance generally involves preparation of original and amended tax returns, refund claims, and planning services related to tax payments. Tax planning and tax advice encompass a diverse range of services, including assistance with tax audits and appeals, tax advice related to mergers and acquisitions, employee benefit plans, and requests for rulings or technical advice from tax authorities. The provision of tax services is subject to certain restrictions, among which are that company personnel must make all management decisions and perform all management functions, and that services cannot be provided for an employee with a financial oversight role.
- **All other fees** include all fees paid to the independent auditor for services other than audit, audit-related, or tax services.

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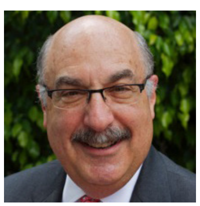

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B. Items for Information and Discussion

Item 3:

Discussion of the FY19 internal audit process: supporting documents

Overall Risk Assessment Questionnaire

GENERAL RISK ASSESSMENT
Risk Assessment Questionnaire - Summary

COLLEGE			
FISCAL YEAR		SYSTEM	VERMONT STATE COLLEGES
PREPARED BY			**DATE:**

Given the results of the risk assessment guideline and other factors I have considered, in my opinion, the college being assessed has the following risk to the system:

	HIGH RISK	Internal control evaluation required
	MEDIUM RISK	Internal control evaluation recommended on a cyclical basis.
	LOW RISK	Internal control evaluation not required.

Please read the explanation of each risk category and evaluation factor on the following pages. Then **assign a rating value in the box provided below**. The rating should be from 0 to 5, with 0 being the lowest or no risk and 5 being the highest or maximum risk.

ASSIGNED RISK CATEGORY	EVALUATION FACTOR	NO.	RATING
General	Outside Interest	1	
	Regulatory/Contractual	2	
	Employee Turnover	3	
Other Reviews and Audits	Audit Coverage	4	
	Results of Prior Reviews	5	
Specific Financial Risk Areas	Account Balance Size	6	
	General Fund State	7	
	Federal Assistance Programs	8	
	Cash	9	
	Merchandise	10	
	Fixed Assets	11	
System	Automation	12	
	Decentralization	13	
	Sensitive Data	14	

Risk Assessment Questionnaire - DETAIL

This document is prepared as a guideline for identifying areas where a college should ensure the adequate controls are in place and operating properly. The absence of sound internal controls increases the system's risk of noncompliance with laws or regulations, of producing unreliable accounting data, loss from fraud or misstatement, and can result in negative publicity.

RISK CATEGORY—GENERAL

EVALUATION FACTOR—Outside Interest.

Interest shown by outside parties such as legislators, news media, citizen groups, the general public or others (including agency personnel) increases the system risk related to a college.

RATING SCALE—(Circle Choice)	DEFINITION
1	Outside parties have shown no or very little interest in the area.
3	Outside parties have shown a moderate amount of interest in the area.
5	Outside parties have shown a lot of interest in the area.

EVALUATION FACTOR—Regulatory/Contractual

The existence and applicability of external laws, regulations, contractual or reporting requirements increases the diversity and complexity of system requirements and hence, the opportunity for noncompliance.

RATING SCALE—(Circle Choice)	DEFINITION
0	Subject to no apparent external laws, regulations, contractual, or reporting requirements of outside entities.
1	Subject to one outside entities.
3	Subject to two to four outside entities.
5	Subject to five or more outside entities.

EVALUATION FACTOR—Employee Turnover

Employee turnover increases the risk associated with a particular college.

RATING SCALE—(Circle Choice)	DEFINITION
0	No turnover in key management or staff.
1	Limited turnover in key management or staff.
3	Major turnover in key management or staff.
5	Major turnover in key management and staff.

RISK CATEGORY—OTHER REVIEW OR AUDITS

EVALUATION FACTOR—Extent of Audit Coverage.

External and internal auditing of a college's internal controls may decrease the system's risk.

RATING SCALE—(Circle Choice)	DEFINITION
0	Reviewed by both external and internal auditors within the last year.
1	Reviewed by either external or internal auditors within the last year.
3	Not reviewed within the last year.
4	Not reviewed within the last two years.
5	Not reviewed within the last three years.

EVALUATION FACTOR—Results of Prior Reviews

Colleges with a history of audit findings and/or informal internal control comments (external or internal audit) normally have a higher level of risk for the system.

RATING SCALE—(Circle Choice)	DEFINITION
0	No internal control audit findings in the last 4 years.
1	Last internal control audit finding four years ago.
2	Last internal control audit finding less than three years ago.
3	Informal internal control comment less than two years ago.
5	Internal control audit finding less than two years ago that resulted in either a compliance failure or a significant adjustment to an account balance.

RISK CATEGORY—SPECIFIC FINANCIAL RISK AREAS

EVALUATION FACTOR—Account Balance Size

Account or activity balance size has an effect on an agency's risk due to materiality considerations. The majority of expense account balances are:

RATING SCALE—(Circle Choice)	DEFINITION
1	Under $1 million.
2	Between $1 and $3 million.
3	Between $3 and $7 million.
5	More than $15 million.

EVALUATION FACTOR—General Fund Expenditures

Processing general fund expenditures increases college risk due to the budgetary constraints and oversight.

RATING SCALE—(Circle Choice)	DEFINITION
0	Processes no general fund expenditures.
1	Processes under $100,000 in general fund expenditures.
2	Processes between $100,000 and $1 million in general fund expenditures.
3	Processes between $1 and $3 million in general fund expenditures.
4	Processes between $3 and $10 million in general fund expenditures.
5	Processes more than $10 million in general fund expenditures.

EVALUATION FACTOR—Federal Assistance Programs

Processing federal assistance transactions causes an increase in college risk due to the stringent administrative and cost principle guidelines that must be met.

RATING SCALE—(Circle Choice)	DEFINITION
0	Processes no federal assistance transactions.
2	Processes between $100,000 and $500,000 in federal assistance.
3	Processes between $500,000 and $1 million in federal assistance.
5	Processes more than $4 million in federal assistance.

EVALUATION FACTOR—Cash and Checks

Cash and checks are more susceptible to fraud/theft than other assets. They increase a college's risk with their presence, especially if a major function of the system.

RATING SCALE—(Circle Choice)	DEFINITION
0	Includes no cash or other highly liquid instruments.
1	Limited opportunity for access to cash and checks or other attractive negotiable items.
3	Some actual handling of cash and checks or other attractive negotiable items, or affords good potential for access to them.
5	The handling of cash and checks or other attractive negotiable instruments is the major part of system/organization.

EVALUATION FACTOR—Access to Inventories

A college's risk increases with the presence of large inventory balances or specialized inventories such as controlled substances, hazardous wastes, or precious metals.

RATING SCALE—(Circle Choice)	DEFINITION
0	No access to inventories.
1	Inventories under $50,000 that does not include specialized inventories.
3	Inventories between $50,000 and $500,000 that do not include specialized inventories.
5	Inventories more than $500,000 or that includes specialized inventories.

EVALUATION FACTOR—Fixed Assets

A college's risk increases with the presence of large fixed asset balances or highly desirable small and attractive assets such as technology equipment.

RATING SCALE—(Circle Choice)	DEFINITION
0	No fixed asset balance or inventoriable highly desirable assets.
2	Fixed asset balances between $200,000 and $2 million and no inventoriable highly desirable assets.
3	Fixed asset balance between $2 million and $15 million or limited inventoriable highly desirable assets.
5	Fixed asset balance over $15 million or extensive inventoriable highly desirable assets.

RISK CATEGORY—SYSTEM ENVIRONMENT

EVALUATION FACTOR—Automation/System Changes

Generally, a college's risk will increase with low levels of automation within systems. Risk will tend to increase with major system changes.

RATING SCALE—(Circle Choice)	DEFINITION
1	Manual with no changes since last evaluation.
2	Manual with minor changes since last evaluation.
3	Automated with minor changes since last evaluation.
5	Automated with major changes since the last evaluation or a new system.

EVALUATION FACTOR—Decentralization

The extent of decentralization has an effect on a college's internal accounting controls. Generally, decentralized operations are more difficult to control than centralized.

RATING SCALE—(Circle Choice)	DEFINITION
1	One location.
2	Two locations.
3	Three or four locations.
4	Five to ten locations.
5	More than ten locations.

EVALUATION FACTOR—Sensitive Data

A college's risk increases by the degree that it is involved in the creation, handling, storage, or affords potential access to sensitive data. (E.g. personnel files, medical records, client files, research records, student records or other activities deemed confidential by law or policy.)

RATING SCALE—(Circle Choice)	DEFINITION
0	Does not include the creation or handling of sensitive data.
1	Does not include the creation or handling of sensitive data; however, information is used by outside parties.
3	Includes the handling or creation of sensitive data that is not an integral part of the system's internal controls.
5	Includes the creation or handling of sensitive data that is an integral part of the system's internal controls.

Internal Control Self-Assessment Questionnaire

PURPOSE:

As a Vermont State Colleges director, manager or administrator it is important to periodically determine if good business practices are being observed within your department. You have been asked to complete this questionnaire as part of a scheduled internal audit.

Specifically, completing the questionnaire will help to:

- Identify operating areas within your department where required business policies, administrative processes and regulatory compliance are important;
- Assess the adequacy of existing policies and procedures and other internal controls that are designed to ensure compliance in each of the identified areas;
- Raise awareness concerning certain efficiencies and cost saving opportunities that result from complying with Vermont State College policies and procedures.

We encourage you to engage your co-workers in brainstorming ways to address areas where you believe certain internal controls need to be improved.

HOW TO COMPLETE THE ASSESSMENT QUESTIONNAIRE:

- Please complete the questionnaire below by checking the appropriate box beside each question and adding additional information into the comment box as necessary.
- If certain sections of the questionnaire do not apply to your organizational activities, please write "N/A" in the comment box.
- If you have any questions related to the items covered in the self-assessment questionnaire, please contact Sheilah M. Evans, System Controller/Senior Director of Financial Operations at Sheilah.evans@vsc.edu.
- Please email the completed questionnaire to Stephen.Wisloski@vsc.edu.

SELF-ASSESSMENT QUESTIONNAIRE

Internal Control Assessment Questionnaire Provider Information	
College:	
Department:	
Date:	
Name:	
Phone:	
Email:	

		YES	NO	Do Not Know	COMMENT
A	**ORGANIZATIONAL GOVERNANCE**				
1	Does your department/organization have a written mission statement?				
2	Does management clearly communicate and demonstrate integrity and other ethical values consistent with the College's/University's business conduct policy?				
3	Does your department have an organizational chart that defines lines of authority and responsibility?				
4	Is the organizational chart up to date?				
5	Has your department documented all internal policies and procedures that are related to performing all significant administrative processes specific to your department or division's operations?				
6	Are these policies and procedures reviewed and up to date?				
7	Do you believe that responsible persons in your department are sufficiently familiar with Vermont State College policies related to personnel management, financial matters, use of information and related technology, and regulatory compliance?				
8	Are administrators within your department aware of how to access on-line policies and procedures from Human Resources, Finance, Procurement, the Public Safety Office, Research Administration and other key areas of the College/University?				
B	**FINANCIAL PLANNING AND MONITORING**				
1	Are funding sources evaluated annually to assess the sustainability of current funding levels?				
2	Does the budget process include key members of management?				

VERMONT
STATE COLLEGES SYSTEM

		YES	NO	Do Not Know	COMMENT
3	Are one or more individuals in your department responsible for reviewing the department's monthly Synoptix financial reports?				
4	Are these reports reviewed: ☐ Monthly ☐ Every few months ☐ Infrequently				
5	Are budget managers held accountable for financial performance?				
6	Are responsibilities divided among staff members (so that no single employee controls all steps of a financial transaction) thereby maintaining appropriate segregation of duties? (If inadequate segregation of duties does exist, please indicate the process or transaction affected in the *Comments* section.)				
7	If segregation of duties is not practical, does supervisory oversight exist at any level over these financial transactions?				
8	Are there any important financial reconciliations that are not being routinely performed that you think should be?				
C	**PERSONNEL**				
1	Are up-to-date position descriptions available for each employee in the organization?				
2	Are sufficient training opportunities provided to improve employee work related competencies in accordance with their job responsibilities?				
5	Has the department established cross-training or contingency plans for significant changes in personnel?				
6	Are Time Entry records pertaining vacation and sick leave up to date?				
7	Are overtime hours, and other special work requirements (on-call, shift premium) reviewed and approved in advance by the employee's supervisor?				
8	Are annual performance evaluations given to departmental employees in accordance with the bargaining contracts or personnel handbook?				

		YES	NO	Do Not Know	COMMENT
9	Have procedures been established to ensure that terminating employees return all College/University ID cards, keys, laptops, purchasing/travel related credit cards, equipment, etc., and that appropriate systems administrators are notified to remove all logon privileges to departmental and College/University systems?				
10	Are forms completed promptly and submitted to the Payroll/HR for new hires and changes in employment status?				
12	Are employees sufficiently trained to perform assigned roles and responsibilities to support payroll processing (time reported, on-line time entry, etc.)?				
13	Are payroll reports monitored to identify unapproved time, miscodings, etc.?				
D	**BUSINESS CONDUCT POLICY**				
1	Are all department personnel aware of the Whistleblower Policy #211?				
2	Are all faculty and staff members in your department aware of the Vermont State College's Employee Conflict of Interest Policy that requires employees to avoid conflicts (or any appearance of conflicts) between their personal interests and those of the College/University?				
3	Do you know of any individual(s) in your department who, because of the nature of his or her position should be asked to complete an annual Conflict of Interest Disclosure Statement?				
4	Are all department personnel familiar with the Hospitality Policy #425?				
E	**REPORTING OF FRAUD/ FRAUD INDICATORS**				
1	Until completing this questionnaire are you aware of any instances of suspected fraud that should be reported to the College/University President, Chancellor or reported using the VSC's reporting hotline (see below)?				
2	Have any unusual trends or discrepancies in department accounts been recently detected?				
4	Are there any department assets (property, equipment, supplies, etc.) that you believe are not adequately protected against theft or misuse?				

		YES	NO	Do Not Know	COMMENT
5	Have any missing numbers in sequences of numerically controlled documents been recently identified?				
6	Until completing this questionnaire were you aware that a website exists to report suspected instances of employee misconduct and that it can be done anonymously? http://www.vsc.edu/faculty-and-staff/Pages/Employee-Benefits.aspx. Access is also toll-free: (866)-215-4016				
F1	**INFORMATION TECHNOLOGY**				
1	Are all department personnel familiar with the VSC Computing and Telecommunications Technology Conditions of Use Policy #502?				
2	Are all department workstations upgraded with the latest security patches and virus protection?				
3	Is critical information backed-up and stored off-site?				
4	Is sensitive information protected by operator ID/password?				
5	Are all passwords adequately controlled and protected from unauthorized use?				
6	Are passwords kept confidential (i.e., not shared or posted at work sites)?				
7	Are you aware of any “default” passwords that are still being used for any IT applications rather than having been changed to more secure, personal passwords?				
8	Are computer applications logged-off when the user is going to be away from the terminal or PC for an hour or more?				
9	Are computers and servers maintained in a secure area?				
10	Are laptop computers secured when not in use?				
11	Are electrical surge suppressers used on all computer equipment?				
12	Is each departmental server equipped with an Uninterrupted Power Supply (UPS)?				
13	If a department has a critical information system that is connected to an outside network, is it protected by a firewall?				
14	Is all software properly licensed using either a site or individual licensing arrangement?				
15	Has a disaster recovery/business resumption plan been developed should one of your critical information business systems fail or be destroyed?				
16	Has the disaster recovery/business resumption plan been tested/simulated and if so, when (indicate in *Comments* section)?				

		YES	NO	Do Not Know	COMMENT
F2	**INFORMATION CONFIDENTIALITY AND DATA PRIVACY**				
1	Are all department personnel familiar with the requirements concerning the handling of private and confidential College/University information?				
2	Do your computers/applications contain any of the following combinations of confidential data elements that are considered to be “*individually-identifiable*” information that could be used to assist with identify theft? 1) Name & Social Security # 2) Name & Date of Birth 3) Name & Bank Account # 4) Name & Credit Card # 5) Name and Mother’s Maiden-name 6) User ID & Passwords for University Systems? (NOTE: List those combinations in use by number in the Comment section)				
3	Do your computers/applications contain private or confidential information about students?				
4	Do your computers/applications contain private or confidential information about faculty/employees?				
5	Do your computers/applications contain private or confidential information about donors?				
6	Does your area collect any (as defined above) individually-identifiable private or confidential University information on paper forms or records?				
7	Do these paper forms/records contain private or confidential information about students?				
8	Do these paper forms/records contain private or confidential information about faculty/employees?				
9	Do these paper forms/records contain private or confidential information about donors?				

		YES	NO	Do Not Know	COMMENT
10	Do these paper forms/records contain any of the following combinations of confidential data elements that are considered to be *"individually-identifiable"* information that could be used to assist with identify theft? 1) Name & Social Security # 2) Name & Date of Birth 3) Name & Bank Account # 4) Name & Credit Card # 5)Name and Mother's Maiden-name 6) User ID & Passwords for VSC systems? (NOTE: List those combinations in use by number in the Comment section)				
11	Are these paper forms/records stored in secure cabinets that prevent unauthorized personnel from gaining access to this data?				
12	If you maintain information related to students, have you received FERPA training?				
13	If you maintain information related to patients, have you received HIPAA training?				
14	Does your department accept payment via credit card?				
15	If you answered yes to question 14, are you utilizing Touchnet?				
G	**BANK ACCOUNTS/PETTY CASH**				
1	Does your College/University have a checking account with an outside banking institution?				
2	If yes, what it is used for? (use comments section)				
4	Does your department maintain a petty cash fund? If yes, what is the amount of this fund? (use comments section)				
5	Was this petty cash fund established with the approval of the Dean of Administration?				
6	Do more than two individuals have physical access to the petty cash fund cash box or safe? (If so, how many?) (use comments section)				
7	Is the petty cash fund maintained in a safe or lockable cash box and stored in a secured place?				
8	Is supporting documentation provided for all petty cash disbursements?				
9	Is the petty cash fund reconciled and replenished at least monthly? (If not, please indicate how often)				

VERMONT
STATE COLLEGES SYSTEM

		YES	NO	Do Not Know	COMMENT
10	Does a person other than the fund custodian reconcile the fund or perform an independent review of the reconciliation?				
H	**CASH RECEIPTS/REVENUE**				
1	Does adequate segregation of duties exist within your department between staff members responsible for receiving, depositing and reconciling cash and checks?				
2	Are all checks made payable to the College/University?				
3	Are all checks restrictively endorsed immediately upon receipt with a stamp, "**For Deposit Only – College/University ?**"				
4	Is a cash receipt log maintained to create supporting documentation to which you can reconcile deposits?				
5	If cash is accepted, are pre-numbered receipts used to track payment?				
6	Are all unused pre-numbered receipts/tickets accounted for?				
7	Are deposits of funds made on the next business day?				
8	When funds cannot be deposited daily, are they transported or stored in a secure location at the end of the workday?				
9	Are cash and checks adequately protected when transferred to the Business Office or bank?				
10	Is there adequate physical security where cash handling activities occur?				
11	Is all information on cash or checks gifted to the College/University forwarded to the Advancement Office for gift processing?				
12	If you have any revenue generating activities, have you consulted with the System Controller at the Chancellor's Office to determine if any of the revenue is subject to unrelated business income tax (UBIT)?				
13	Has your Department consulted with the Chancellor's Office concerning whether sales tax should be charged to customers and how it should be deposited?				
I	**TRAVEL AND BUSINESS EXPENSES**				
1	Are members of your department aware of the VSC online Travel Policies and Procedures?				

		YES	NO	Do Not Know	COMMENT
2	Are travel plans made sufficiently in advance to obtain the most favorable transportation rates?				
3	Is all overnight travel authorized in advance by the traveler's Department Head, Supervisor or Director?				
4	Do you know of any instances of non-compliance with policies for reimbursing travel and entertainment expenses in accordance with the VSC's Travel policy or Federal regulations?				
5	Do reimbursement requests include exchange rates for receipts submitted for international travel?				
6	When traveling internationally on federally funded grants, are any international carriers being used when departing from/to the United States?				
7	Does someone in your department review travel and meeting expense reports to ensure alcohol expenses are not charged?				
8	Are travelers required to provide original receipts for all travel expenses over $25 per day?				
9	Are copies in lieu of original receipts ever submitted by travelers in your department?				
10	Are all requests for business and entertainment expenses documented in terms of how the activity was College/University or business related, including a listing of attendees (with titles)?				
J	**PROCUREMENT CARDS (Pcard)**				
1	Have P-cards been issued to all department personnel who are responsible for procurement?				
2	Has everyone that has a p-card read the p-card policy and procedures manual?				
3	Has a formal reconciliation protocol been established for each cardholder to reconcile his or her monthly P-card statements with packing slips, invoices or register receipts? (Note: Certain charges may be automatic such as water or cell phone services.)				
4	Is documentation of P-card activity, including supporting documents, sorted and stored by Month and/or Cardholder and by P-card Transaction report?				
K	**PROCUREMENT OF GOODS AND SERVICES**				
1	Does your department rely on someone outside of your department to coordinate bids for goods and services?				

		YES	NO	Do Not Know	COMMENT
2	Does the department solicit at least 3 competitive bids for any purchase that exceeds $25,000 and perform a competitive RFP process for purchases exceeding $100,000?				
3	Does the department maintain written documentation for justifying any purchasing of sole source or preferred vendor for purchases that are not bid?				
4	Does the department reconcile purchases/goods received to their monthly budget statements?				
5	Do you ever pay a state sales tax on your purchases?				
6	Does your department split orders to avoid higher approval levels or to bypass limits, (i.e. Pcard limits or bidding levels)?				
L	**RECORDS RETENTION**				
1	Does your department have a copy of the appropriate records retention policy for your area?				
3	Are important documents, including electronic media, stored in a secure area with adequate protection from fire and/or water damage?				
M	**INVENTORY CONTROL**				
1	Are inventory items maintained in a secure location?				
2	Is there adequate protection from fire and water?				
3	Is inventory well organized?				
4	Is flammable material stored according to code in a special fireproof cabinet and kept in an isolated location?				
5	Are any controlled substances stored and dispensed according to Drug Enforcement Agency (DEA) regulations?				
6	Are receiving documents matched to purchase orders and invoices?				
7	Are all materials received counted and inspected prior to entry on storeroom/inventory records?				
8	Are back-ordered items properly followed up on to ensure timely receipt of items ordered?				
10	Are inventory records maintained based on periodic physical counts or a perpetual system?				

		YES	NO	Do Not Know	COMMENT
12	Have formal procedures been established for reviewing and disposing obsolete and slow-moving inventory items?				
13	Are there currently any items in stock that are obsolete or slow-moving?				
14	Is a physical inventory conducted at least annually?				
15	Are items physically counted matched against inventory records?				
16	Has a cycle counting program been considered?				
17	Are inventory records adjusted immediately based on the results of a physical inventory or cycle counting program?				
18	Do individuals independent of inventory custody investigate unusually large discrepancies, between inventory records and physical counts?				
19	Is any inventory stored or consigned at an outside location?				
N	**BUILDING SAFETY & SECURITY**				
1	Have all concerns about the safety of the building(s) been brought to the attention of the individual or group responsible for building safety (e.g. lack of building exit routes, trained safety monitors, regular evacuation drills)?				
O	**COMPLIANCE WITH FEDERAL AND STATE GOVERNMENTAL REGULATIONS**				
1	Do you believe that department personnel are sufficiently informed about important federal and state laws and regulations that govern activities performed within your department?				
2	Please answer for each of the following that applies: Does your department participate in activities that are governed by:				
	• Occupational Safety and Health (OSHA)				
	• Environmental Protection Agency (EPA)				
	• UG Federally Funded Research				
	• IRS				
	• HIPAA				
	If you answered 'YES' for OSHA				
1	Have employees been trained for workplace safety by the Environmental Health & Safety Office (EH&S) to comply with the appropriate regulatory requirements for their job responsibilities?				

		YES	NO	Do Not Know	COMMENT
2	Does your department have a policy of conducting (or requesting) periodic walk-through inspections of workspaces to identify and correct any unsafe or potentially hazardous conditions and work practices that could result in OSHA violations in consultation with the Office of Risk Management?				
	If you answered 'YES' for EPA				
1	Has the EH&S notified your department about how to avoid hazards in the handling of hazardous materials and emergency response procedures?				
2	Does your department, research or teaching labs perform any activities using bio-hazardous agents, hazardous chemicals or radioactive material?				
3	If so, are they properly labeled and stored?				
	Are records maintained concerning inventories of these materials?				
4	Do you believe that adequate security exists over access to any bio-hazardous, radioactive or other hazardous materials?				
5	Has all hazardous waste been stored and disposed of in accordance with federal regulations and College/University policy as managed by EH&S?				
6	Do all individuals working with radioactive materials wear monitoring badges?				
7	Do you know of any teaching or research labs within your college that might represent a health or safety risk due to poor housekeeping practices?				
8	Do individuals in your teaching and research labs know how to correctly respond to a hazardous spill or chemical release?				
9	Are you aware of any violations of any existing hazardous materials storage laws or documentation requirements for using such materials?				
	If you answered 'YES' for Uniform Guidance Federally Funded Programs				
1	Are all grant proposals reviewed and approved by the appropriate programmatic Dean, Dean of Administration and President's Office before they are submitted to granting agencies?				
2	Are the Forms A, B & C completed in a timely manner for each grant and submitted to the Office of the Chancellor as per Policy 408?				

		YES	NO	Do Not Know	COMMENT
3	Do you believe that your department's principal investigators (PIs) and project directors are sufficiently familiar with Uniform Guidance cost principles governing allowable costs and activities?				
4	Do you believe that your department's principal investigators and project directors are sufficiently familiar with VSC guidelines for charging administrative or clerical salaries and other administrative costs to federal grants and contracts?				
5	Do you believe that principal investigators require additional training concerning effort reporting requirements to ensure that salaries charged to federal grants and contracts properly reflect the time and effort directed to the grant or contract activities?				
6	Do you know of instances where principal investigators are not signing off on Quarterly Time & Effort Reports for those individuals who work on their grants and contracts?				
7	Do you believe that principal investigators and project directors require additional training concerning VSC' policies and procedures regarding purchasing, procurement card usage, capital equipment requests, and travel and business expense reimbursement as they relate to charging federal grants and contracts?				

	If you answered 'YES' to IRS				
1	Is your head department administrator sufficiently familiar with federal and state tax regulations that pertain to department operations (e.g., HR - federal employment taxes, social security, COBRA, foreign students, pension requirements; check writing/AP functions - independent contractors, abandoned property and sales tax)?				
2	Has department management contacted the System Controller at the Office of the Chancellor with any questions regarding potential tax liabilities?				
	If you answered 'YES' to HIPAA				
1	Does your department retain medical records for faculty, staff or students?				
2	Does your department maintain any confidential employee/student records that require special treatment for privacy protection?				
3	Do you believe that refresher HIPAA training would benefit individuals responsible for providing treatment or maintaining confidential medical records?				

Comments