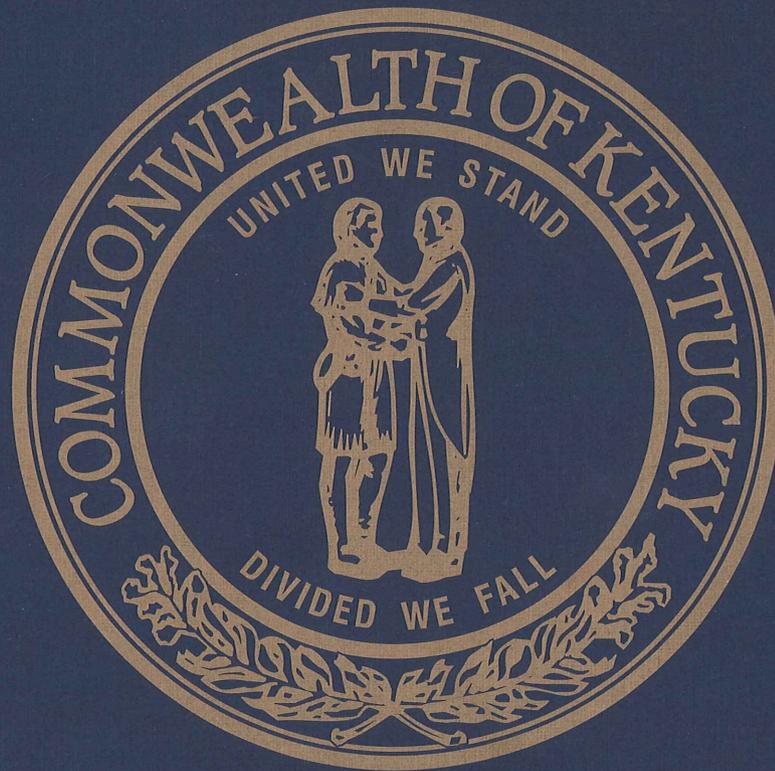


Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2010



Kentucky
UNBRIDLED SPIRIT™

Commonwealth of Kentucky
Comprehensive Annual Financial Report
for the Fiscal Year Ended June 30, 2010

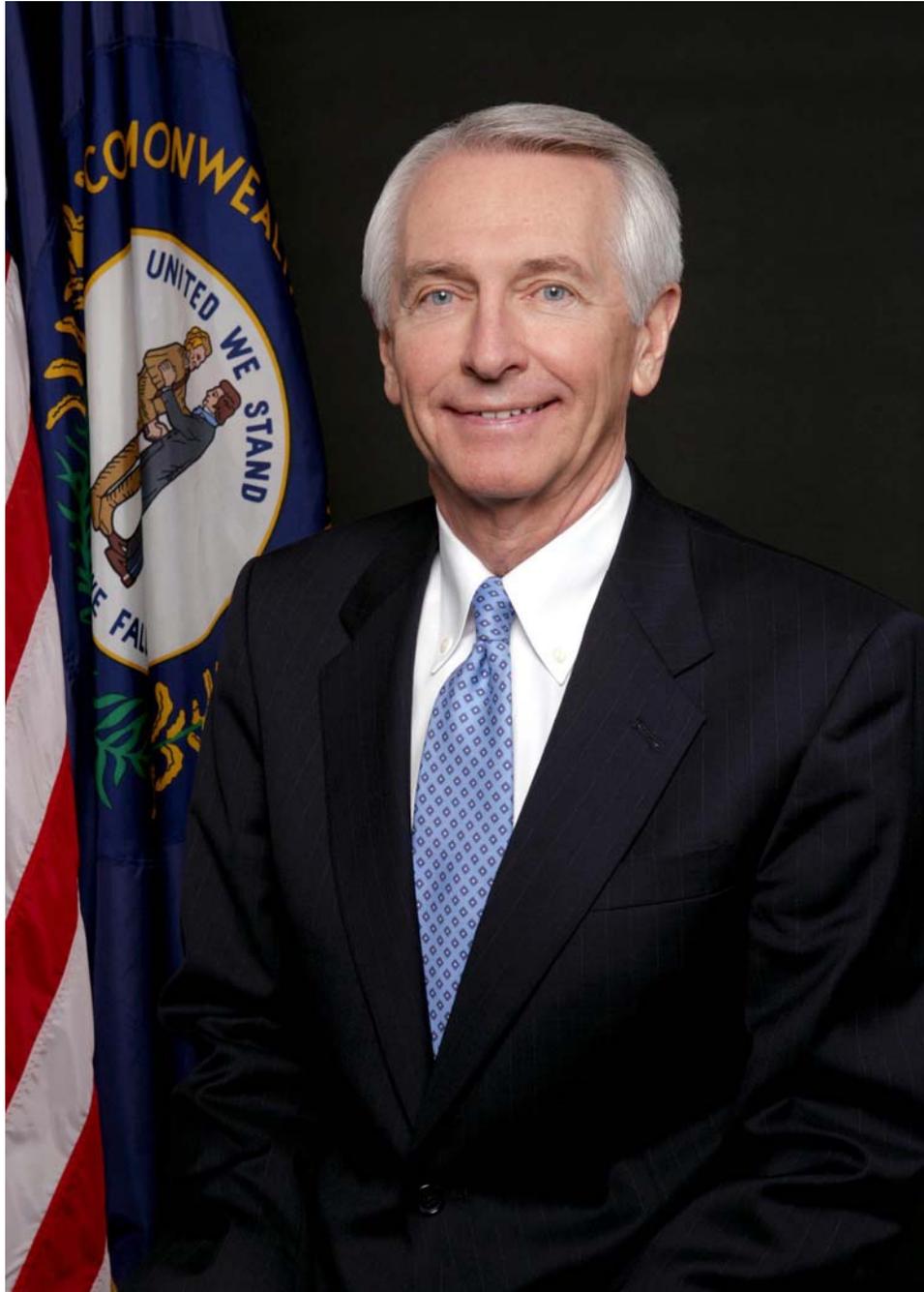
Steven L. Beshear, Governor



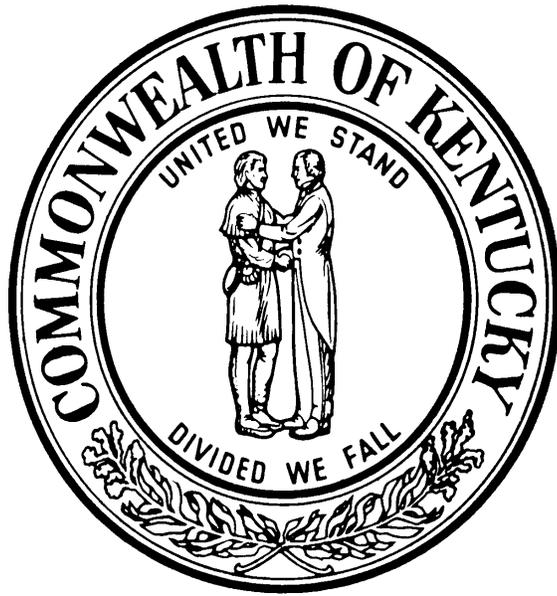
Prepared by:
Finance and Administration Cabinet
Jonathan Miller, Secretary

Office of the Controller
Edgar C. Ross, Controller

Statewide Accounting Services
Donald Sweasy, Assistant Controller



Steven L. Beshear
Governor



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INTRODUCTORY SECTION



STEVEN L. BESHEAR

GOVERNOR

OFFICE OF THE SECRETARY

Finance and Administration Cabinet

383 CAPITOL ANNEX

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JONATHAN MILLER

Secretary

December 17, 2010

The Honorable Steven Beshear, Governor
Members of the Kentucky General Assembly
Citizens of Kentucky

INTRODUCTION

Section 48.800 (3) of the Kentucky Revised Statutes (K.R.S.) requires the Finance and Administration Cabinet to submit a complete report of the financial transactions of the preceding year and of the financial condition of the Commonwealth as of the end of that fiscal year. In accordance with this statute, it is my pleasure to transmit to you the Comprehensive Annual Financial Report of the Commonwealth of Kentucky for the Fiscal Year Ended June 30, 2010. This report is prepared by the Finance and Administration Cabinet, Office of the Controller, Division of Statewide Accounting Services, which assumes responsibility for the accurate, complete, and fair presentation of the data contained herein. The information presented fully describes the Commonwealth's financial condition and results of operations of the primary government and component units for which it is financially accountable. All appropriate disclosures necessary for the reader to gain the maximum understanding of Kentucky's financial affairs are included.

The accompanying financial statements have been audited by the Office of the Auditor of Public Accounts of the Commonwealth of Kentucky. Their examination was conducted 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 independent auditor concluded that the Commonwealth of Kentucky's financial statements for the year ended June 30, 2010, are fairly presented in conformity with GAAP. The report of the independent auditor appears elsewhere in this report.

PROFILE OF THE COMMONWEALTH OF KENTUCKY

The Reporting Entity and Its Services

This report includes all funds and component units for which the Commonwealth is financially accountable, based on criteria established by the Governmental Accounting Standards Board's (GASB) Statement 14 as amended by GASB 39. The component units which are blended into the Commonwealth's primary government and function as actual parts of the Commonwealth are: the State Property and Buildings Commission, Kentucky Asset/Liability Commission, Kentucky Lottery Corporation, Turnpike Authority of Kentucky, Board of Agriculture, Kentucky Savings Bond Authority, Kentucky Retirement System, Judicial Form Retirement, Kentucky Public Employees' Deferred Compensation Authority, Kentucky Tobacco Settlement Trust Corporation, Kentucky Teachers' Retirement System, Kentucky School Facilities Construction Commission, and Kentucky Gas Pipeline Authority.

The Commonwealth's discretely presented component units are: the Bluegrass State Skills Corporation, Kentucky River Authority, Kentucky State Fair Board, Kentucky Center for the Arts Corporation, Kentucky Educational Television Authority, Kentucky Economic Development Finance Authority, Kentucky Higher Education Assistance Authority, Kentucky Higher Education Student Loan Corporation, Kentucky Housing Corporation, Kentucky Infrastructure Authority, Kentucky Artisan Center, Kentucky Agricultural Finance Corporation, Kentucky Grain Insurance Corporation, Kentucky Local Correctional Facilities Construction Authority, Kentucky Access, Kentucky Horse Park Foundation, Kentucky Council on Postsecondary Education, Kentucky Community Technical College System, and the eight state-supported universities.

Additional detailed information pertaining to Commonwealth's component units is located within the Financial Section (particularly Note 1) of this report.

The Commonwealth and Its Services

Located in south central United States along the west side of the Appalachian Mountains, Kentucky was once a part of Virginia. After its split with Virginia, Kentucky retained its “commonwealth” (meaning government based on the consent of the people) status and adopted its Constitution in 1792. The Commonwealth provides the full range of services contemplated by statute, including economic development, educational and human services, energy and natural resources management, law enforcement, correctional and public protection services, transportation, public improvements, and general legislative, administrative, and judicial services. The Commonwealth’s chief executive is the Governor who is popularly elected every four years and may serve for two terms. Policies are directed through the various Cabinets. The General Assembly, or state Legislature, has two components: the Senate and the House of Representatives. The Senate has 38 members who are elected to four-year terms and the House has 100 members who are elected to two-year terms. The Legislature meets annually and has the power to enact all laws, subject to limits imposed by the state constitution. Revenue-raising issues must be initiated in the House. All other bills may be introduced by either the House or the Senate.

Budgetary Controls

The Commonwealth uses a biennial budget to assist with planning and control duties. Budgetary control is maintained at the budget unit level and is described in the notes to the Required Supplementary Information. Encumbrance accounting is utilized to insure the availability of funding before contracts are finalized. Contracts which result in overruns of available balances are not released until budget revisions are approved. Outstanding encumbrances for long-term construction projects in the Transportation Fund and the Capital Projects Fund are reported as reservations of fund balance. Encumbrances in all other funds lapse at the end of the fiscal year.

ECONOMIC CONDITION AND OUTLOOK

National Economy

By late summer, 2010, the outlook for the national economy was beginning to cool somewhat from the pace set earlier in 2010. GDP, personal income, industrial production, exports, and retail sales – the major national economic aggregates that feed into the Kentucky economy – were all moderating from the strong performance in the first calendar quarter of 2010. Corporate profits were the lone bright spot, but it was unclear whether high corporate profits would eventually lead to an increase in productive capacity and higher employment. Employment growth was anemic, wages and salaries dormant, and the unemployment rate persistently high. Talks of a double-dip recession were becoming increasingly mainstream. The national economy was facing a weak and fragile recovery period.

The outlook one quarter later is virtually unchanged. Easy gains, like the inventory correction, federal fiscal policy, and quantitative easing, are in the rear view mirror. A holding pattern has formed pending the resolution of three very critical issues: the path of the consumer; the path of corporations; and foreign demand for US exports.

Consumers have been deleveraging in the aftermath of the housing crash. In the height of the housing market, household wealth from homeowner equity was about \$13.0 trillion. Current estimates place homeowner equity at around \$6.5 to \$7.0 trillion. This represents a deeper loss of household wealth than was experienced in the stock market plunge in 2001. Losses in wealth are noteworthy because they affect consumer sentiment and the ability to purchase goods and services beyond what could be spent from current wages and salaries. While inflation and nominal interest rates are at historic lows, consumers will remain cautious until household wealth and employment gain a more firm foothold.

Domestic corporations are becoming the focal point in the economy. It has been widely reported that corporations are “awash with cash”. This prime cash position is a function of streamlining production, reducing fixed costs, and extreme caution with their workforce levels. Evidence to date indicates that some corporate investment is taking place, but the emphasis is on replacement machinery and updating computers and software. While all investment is stimulative, investments in workforce and productive capacity typically have a higher impact on the overall economy. Through this period of corporate streamlining, domestic companies have positioned themselves well in the area of global competitiveness and profitability. The next step to growing corporate profits must come from growing revenues, which typically requires new productive machinery and additional workers. The path to this stage of the recovery is unclear. It will be required, however, to advance the economy beyond the tepid growth of the current fragile recovery.

Foreign trade is the other critically watched segment of the national economy. This segment of the economy is very important in establishing the expectations of business. If the US consumer is not positioned to be the source of demand for the economy, strong demand for US goods and services must come from another source. Early in the recovery, Federal fiscal spending and tax cuts led to a noticeable bump in the economy. Between tax cuts, aid to state and local governments, Census hiring, and wide-scale infrastructure improvements, federal fiscal policy injected a dose of demand into the economy. Unfortunately, in most cases, fiscal policy can only be a temporary cure as pressures will build as the national debt continues to grow.

Unfortunately, the inherent lagging nature of the employment rebound has several consequences that add considerable uncertainty to the current economic forecast. Employment, at least the wages and salaries from employment, is highly correlated with household consumption, which is in turn a driver for many other elements of the economy. Current consumption helps form the expectations for future consumption demand, which in turn drives business decisions like equipment purchases. Second, uncertainty about employment has a dampening effect on two of the largest consumer super-sectors – housing and vehicles. This uncertainty is compounded by the aftermath of the financial crisis, as consumer lending has tightened especially as it pertains to higher-risk loans.

Finally, it should be noted that recoveries from financial recessions are more pernicious than others, and the period of recovery tends to be flat, or U-shaped. In a more structural recession, the economy can rebound more quickly when the structural problem that created the downturn is reconciled. Financial recession leave deeper scars due to the loss of household wealth and the severe impact on consumer sentiment. The period of recovery is thus extended as consumers must dig out of the hole left behind by the loss of household wealth before becoming a reliable and sustained source of aggregate demand.

Kentucky's Economy

Kentucky personal income increased by \$5.5 billion or 4.0 percent over the first quarter of FY10. Kentucky personal income outperformed US personal income during the first quarter of FY11 and also managed to weather the recession with smaller losses. From peak to trough, the US lost a net 3.0 percent in personal income, while Kentucky lost only 1.5 percent net. Kentucky has experienced six consecutive adjacent-quarter increases in personal income since the recession, while the US has had only four such increases. This is not typical, as Kentucky typically lags the US (for most variables) coming out of recessions.

Kentucky wages and salaries, which make up 50.7 percent of personal income, increased by 2.9 percent in the first quarter of FY11. This is the sixth consecutive quarter of adjacent-quarter growth for wages and salaries. Growth has tamed in the first quarter of FY11 compared to the second half of FY10, where growth was 1.2 and 1.4 percent respectively. The first quarter of FY11 grew by 0.1 percent over the fourth quarter of FY10. The recession really began when Kentucky's personal income plummeted in the third quarter of FY09. Wages and salaries fell by an astounding 3.0 percent in that one quarter. Wages and salaries finally surpassed its previous peak in the fourth quarter of FY10, five quarters after the devastating loss.

Kentucky nonagricultural employment increased by a modest 0.5 percent over the first quarter of FY10. The changes among the supersectors were also small. The biggest winner in both absolute and percentage terms was business services employment which rose 7,800 jobs, or 4.6 percent, since the first quarter of FY10. The biggest loser in both absolute and percentage terms was construction employment which lost 4,700 jobs, or 6.6 percent.

Despite the positive position relative to the US, the recession still had a profound effect on Kentucky nonagricultural employment. From peak to trough, Kentucky lost 113,700 seasonally adjusted jobs during the recession. That is a 6.1 percent net loss in jobs. In the last two quarters, nonagricultural employment has increased by a net 12,400 seasonally adjusted jobs. This is particularly descriptive of the condition of Kentucky employment. Kentucky nonagricultural employment reached 1,831,800 in October 2000; this was the peak preceding the 2001 recession. The most recent peak, preceding the 2007 recession, occurred in January 2008 with 1,871,200 employed. So from peak to peak, Kentucky only gained a net of 39,400 jobs, or 2.2 percent additional jobs above the 2000 peak level. The 2007 recession has been so devastating to Kentucky employment, that even after two quarters of job growth, Kentucky is still 12,600 jobs below the trough from eight years ago.

Manufacturing employment, which makes up 11.9 percent of nonagricultural employment in Kentucky, has grown slightly in the last two quarters. During the 2001 recession, Kentucky manufacturing employment shed 47,500 jobs [May 2000 to April 2003]. Following the 2001 recession, there was no identifiable recovery for manufacturing jobs in Kentucky. Other than a few irregular fluctuations, manufacturing employment was flat or slightly declining from 2003 to 2008. From 2008 until February of 2010, Kentucky shed just over 45,000 additional manufacturing jobs due to the 2007 recession. It is therefore encouraging that first quarter FY11 manufacturing employment is 211,100. That is a net increase of 3,600 jobs since the trough in the third quarter of FY10. This is the first identifiable improvement in manufacturing employment since early 2000.

The various supersectors of employment in Kentucky shared pretty evenly in the losses from the 2007 recession. The largest supersector, trade, transportation and utilities fell by a net 27,300 seasonally adjusted jobs, 7.1 percent, from peak to trough. The second largest loser in absolute terms was the construction sector, which lost 20,600 jobs from peak to trough. Construction was also the largest percentage loser, losing 23.9 percent from peak to trough. Education and health services employment was the least affected sector falling only three times in the last three years. Each time it fell it was only by a small measure. Manufacturing employment was affected the most, in terms of most declines. Manufacturing employment declined for 11 consecutive quarters during the recession. It declined by 15 quarters with only one intervening quarterly improvement.

There are many similarities between the state and national outlooks. Most notably, personal income rebounds before employment. Kentucky employment growth in FY11 is predicted to climb only 1.1 percent while personal income in Kentucky is expected to grow by 3.4 percent. Compared to the national forecast for the same period, the employment outlook is very similar but the rebound in personal income is slightly higher in Kentucky. If the dollar stays low, and global trading powers continue to be able to purchase US exports, then Kentucky should continue to slightly outperform the national averages and continue along the slow path of recovery.

In summary, the forecast calls for growth much in line with the projections used by the Consensus Forecasting Group during the December 2009 official estimates. Although the forecast has slowed in the past few months, the projections for many national economic aggregates have actually increased since the official estimates were rendered. All told, the main revenue drivers (employment, wages, and personal income) are very much congruous with our official estimates. The same risks that apply to the national economy exist for the state economy as well.

Long-Term Financial Planning

Debt financing of the Commonwealth is classified as either appropriation supported debt or non-appropriation supported debt. Appropriation supported debt carries the name of the Commonwealth and is either a general obligation of the state or a lease revenue obligation of an issuing agency created by the Kentucky General Assembly to finance various projects subject to state appropriation for all or a portion of the debt service on the bonds. Non-appropriation or moral obligation debt carries the name of the Commonwealth for the benefit and convenience of other entities within the state. This type of indebtedness is a special obligation of the issuer, secured and payable solely from the sources pledged for the payment thereof and does not constitute a debt, liability, obligation, or pledge of the faith and credit of the Commonwealth.

Debt Administration

The amount of debt service for general bonded debt, the ratio of this amount to total expenditures for general governmental functions, and the amount of debt per capita are useful indicators to citizens, investors, and management regarding the Commonwealth's debt position. The data for 2010 are:

	<u>Debt Service (thousands)</u>	<u>Ratio to Total General Governmental Expenditures</u>	<u>Debt Per Capita</u>
General Bonded Debt	\$719,686	3.47 %	\$1,381

No general obligation bonds were authorized or outstanding at June 30, 2010.

A detailed analysis of the Commonwealth's debt issuance during the fiscal year ended 2010 is presented in Note 15.

Major Initiatives

Fiscal year 2010 was the second fiscal year of the Commonwealth's 2009-2010 biennial period. The Commonwealth of Kentucky is one of the few states that enact a biennial budget in an even-numbered year; meaning that the FY10 budget was enacted in the 2008 Regular Session of the Kentucky General Assembly, prior to the predictions of this significant recession. The first step taken to amend the FY10 General Fund budget was done in the 2009 Regular Session of the General Assembly, that primarily addressed the FY09 revenue shortfall, but enacted several revenue measures that would increase the revenues in FY10. This action was done primarily to replace the Budget Reserve Trust Fund which was nearly depleted in balancing the FY09 budget. The Consensus Revenue Forecasting Group then revised downward the FY10 General Fund revenue estimates by about \$1 billion in the spring of 2009, a 10.7 percent revenue shortfall. The Road Fund revenues were estimated to fall short by \$239 million, a 17 percent shortfall. A Special Session of the General Assembly was called by Governor Beshear to balance the FY10 budget against these revenue shortfalls. General Fund spending was reduced in many areas of the government and supplanted by \$742 million in federal fiscal relief provided by the American Recovery and Reinvestment Act. The federal funding provided the ability to maintain the primary elementary and secondary funding formula, the SEEK program, at its enacted levels, and to enable the Medicaid program to continue to meet its obligations as enrollment swelled due to the recession. An additional \$99 million General Fund revenue shortfall was forecasted mid-year. Governor Beshear took additional spending reduction actions to balance the budget, supplemented by another \$25 million in federal fiscal relief.

Spending in FY10 declined from FY09 by 10.4 percent. This was the first time in over two generations that General Fund spending declined in two consecutive years. In crafting the budget reductions, critical areas were preserved from reductions or incurred only minor reductions. Foremost among them was the Commonwealth's primary education funding program, the SEEK program. Other areas that were not reduced were Corrections, mental health programs, contributions to pension plans, and school and state employee health insurance. Public safety programs were also not reduced as much as the rest of Kentucky state government.

In contrast to the operating budget, the Commonwealth's capital program for the 2008-10 biennial period was budgeted to include a significant level of investment. The majority of it was financed through the issuance of debt. The capital budget included \$2.0 billion in bond financed projects. The largest proportion of new project activity was directed to the Commonwealth's nine postsecondary education institutions, over \$600 million, and for road construction and related transportation investment of \$535 million. Other large areas of commitment of support were for local water and sewer infrastructure projects, over \$280 million. The School Facilities Construction Commission, which aids local school districts in new construction and renovation projects, received \$100 million in new bonds to support offers of assistance to local school districts. The capital budget for the 2008-10 biennial period followed two consecutive biennia with the largest capital spending investments the Commonwealth has ever budgeted. Despite the recessionary period, no capital projects were cancelled.

During FY10, the Commonwealth continued to implement the second year of actions initiated in 2008 to address a significant policy and financial issue, the financing of the large unfunded liabilities of its pension systems, and restructuring future employee benefits to ensure a sustainable pension system. The effort puts in place a phased-in financing plan to achieve the necessary actuarial contributions to the systems. The financing plan includes specific graduated targets over a period of years. Benefits and related eligibility requirements for future employees were significantly changed to modernize the benefits and to reduce the future pension liabilities of the systems. The federal stimulus legislation, which passed in February, 2009, also resulted in an estimated \$3 billion in additional federal funding to Kentucky, spread over three years. Nearly \$1.8 billion of that spending has occurred through the end of FY10.

FINANCIAL INFORMATION

The Accounting System

The Commonwealth's financial statements are prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). Additional discussions of the various funds and how they are reported are located in the Management Discussion and Analysis (MD&A) section of this report.

In developing and operating the Commonwealth's accounting system, management of the Commonwealth placed emphasis on the adequacy of internal accounting controls. The comprehensive internal control framework is designed to provide reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that financial records are reliable for preparing GAAP financial statements that are free from material misstatement and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of internal controls should not exceed the benefits likely to be derived from their use, and that such cost-benefit evaluation requires estimates and judgments by management. All internal control evaluations occur within this framework.

OTHER INFORMATION

Certificate of Achievement for Excellence in Financial Reporting

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Commonwealth of Kentucky for its Comprehensive Annual Financial Report for the year ended June 30, 2009. This is the 23rd consecutive year the Commonwealth has received this prestigious award.

In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report, the contents of which conform to program standards. Such reports must satisfy both accounting principles generally accepted in the United States of America and applicable legal requirements.

The Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement Program requirements, and we are submitting it to GFOA.

Acknowledgments

The preparation of this report could not have been accomplished without the cooperation of all branches and agencies of the Commonwealth. The professionalism demonstrated by the staffs of the Finance and Administration Cabinet's Divisions of Statewide Accounting Services and Printing, as well as the Office of the Auditor of Public Accounts, is especially noteworthy. Their combined dedication made the publication of this report possible.

Respectfully submitted,



Jonathan Miller, Secretary
Finance and Administration Cabinet



STEVEN L. BESHEAR
Governor

Commonwealth of Kentucky
FINANCE AND ADMINISTRATION CABINET
OFFICE OF THE CONTROLLER
Room 484, Capitol Annex
702 Capital Avenue
Frankfort, Kentucky 40601
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JONATHAN MILLER
Secretary

EDGAR C. ROSS
Controller

December 17, 2010

The Honorable Jonathan Miller
Secretary, Finance and Administration Cabinet
383 New Capitol Annex
Frankfort, Kentucky

Dear Secretary Miller:

Pursuant to Section 48.800 (3) of the Kentucky Revised Statutes, the Comprehensive Annual Financial Report (CAFR) of the Commonwealth of Kentucky for the fiscal year ended June 30, 2010, is submitted herewith. It contains all funds of the primary government and component units for which it is financially accountable, based on the criteria developed by the Governmental Accounting Standards Board (GASB).

The basis of accounting upon which the report has been prepared complies with accounting principles generally accepted in the United States of America for state governments as prescribed by both GASB and the American Institute of Certified Public Accountants' (AICPA) publication Audits of State and Local Governments.

The information presents fairly and fully discloses the financial position and results of financial operations of the Commonwealth for the reporting period as measured by the financial activity of the various funds. All appropriate disclosures necessary to assist readers in their understanding and evaluation of Kentucky's financial condition have been included in this report.

Respectfully submitted,

Edgar C. Ross, Controller

Certificate of Achievement for Excellence in Financial Reporting

Presented to

Commonwealth of Kentucky

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2009

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



A stylized handwritten signature in black ink.

President

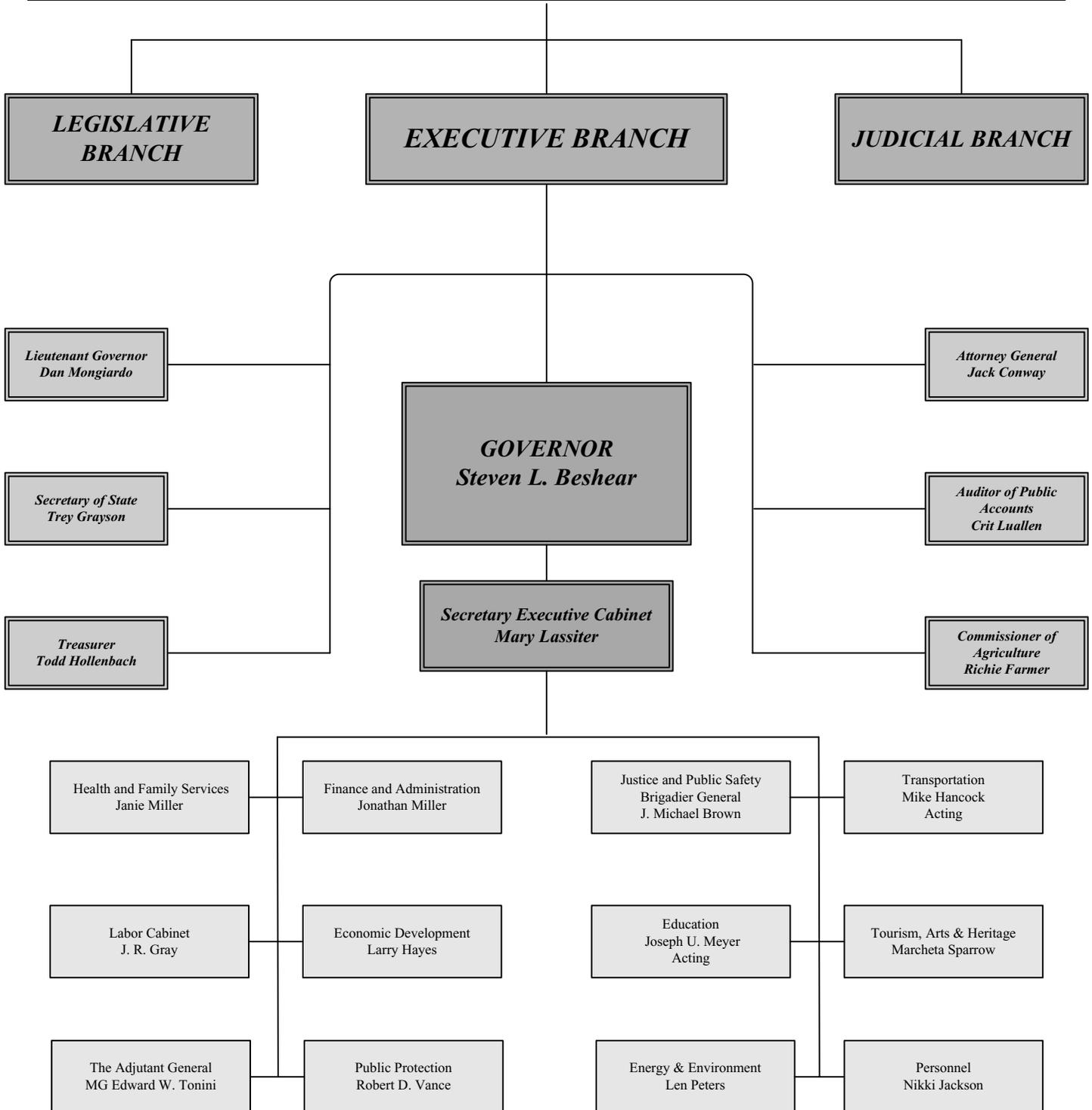
A handwritten signature in black ink, appearing to read "Jeffrey R. Egan".

Executive Director

COMMONWEALTH OF KENTUCKY

ELECTORATE OF KENTUCKY

"UNITED WE STAND, DIVIDED WE FALL"



*Principal Officials at June 30, 2010

FINANCIAL SECTION



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky
The Honorable Steven L. Beshear, Governor
Jonathan Miller, Secretary
Finance and Administration Cabinet

Independent Auditor’s Report

We have audited the accompanying financial statements of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Kentucky, as of and for the year ended June 30, 2010, which collectively comprise the Commonwealth’s basic financial statements as listed in the table of contents. These financial statements are the responsibility of the Commonwealth’s management. Our responsibility is to express opinions on these financial statements based on our audit.

We did not audit the financial statements of some component units and funds that comprise the Commonwealth of Kentucky. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for those component units and funds is based upon the reports of the other auditors. Those component units and funds were:

Certain portions of the Governmental Funds including:

- Debt Service Fund - Turnpike Authority of Kentucky
- Special Revenue Fund - Turnpike Authority of Kentucky

Certain portions of the Proprietary Funds including:

- Within the Insurance Administration Fund:
 - Kentucky Coal Workers’ Pneumoconiosis Fund
 - Kentucky Workers’ Compensation Fund
 - Petroleum Storage Tank Environmental Assurance Fund
- Kentucky Lottery Corporation

Certain portions of the Internal Service Funds within the Risk Management Fund including:

- State Workers’ Compensation Program
- Transportation Cabinet’s Self-Insured Workers’ Compensation Trust Program

Certain Fiduciary Funds including:

- Kentucky Retirement System
- Kentucky Teachers’ Retirement System
- Judicial Form Retirement System
- Kentucky Public Employees’ Deferred Compensation Authority



To the People of Kentucky
 The Honorable Steven L. Beshear, Governor
 Jonathan Miller, Secretary
 Finance and Administration Cabinet
 Page 2

Component Units:

- Bluegrass State Skills Corporation
- Kentucky Center for the Arts Corporation
- Kentucky Economic Development Finance Authority
- Kentucky Educational Television Authority
- Kentucky Higher Education Assistance Authority
- Kentucky Infrastructure Authority
- Kentucky Local Correctional Facilities Construction Authority
- Kentucky State Fair Board
- Kentucky Housing Corporation
- Kentucky Horse Park Foundation, Inc.
- Kentucky Higher Education Student Loan Corporation

Component Units - Colleges and Universities and related entities:

- University of Kentucky
- Eastern Kentucky University
- Morehead State University
- Northern Kentucky University
- Kentucky Community and Technical College System
- University of Louisville
- Kentucky State University
- Murray State University
- Western Kentucky University
- Kentucky Council on Postsecondary Education

Those financial statements reflect total assets and revenues of the government-wide financial statements and total assets and revenues or additions of the fund financial statements as follows:

Government-Wide Financial Statements:	Percent of Assets	Percent of Revenues
Primary Government - Governmental Activities	1.45%	.08%
Primary Government - Business-Type Activities	41.07%	22.03%
Component Units	99.30%	98.42%
Fund Financial Statements:		
Governmental Funds - Non-Major Funds	39.97%	2.08%
Proprietary Funds - Business-Type Activities - Enterprise Funds	41.05%	21.91%
Proprietary Funds - Governmental Activities - Internal Service Funds	5.60%	13.10%
Fiduciary Funds - Pension and Insurance Trust Funds	100.00%	100.00%
Component Units	99.30%	98.42%

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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of other auditors provide a reasonable basis for our opinion.

To the People of Kentucky
The Honorable Steven L. Beshear, Governor
Jonathan Miller, Secretary
Finance and Administration Cabinet
Page 3

In our opinion, based on our audit and the reports of other auditors, the financial statements referred to above, present fairly, in all material respects, the respective financial position of the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Kentucky, as of June 30, 2010, and the respective changes in financial position and cash flows, where applicable, thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

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

The Management's Discussion and Analysis on pages 16 through 22, budgetary comparison schedules and corresponding notes on pages 114 through 129, and information about infrastructure assets reported using the modified approach on pages 130 and 131, and claims development information for entity risk pools on page 132, are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We and the other auditors have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth of Kentucky's basic financial statements. The combining financial statements, presented in this report on pages 136 through 189 are presented for purposes of additional analysis and are not a required part of the basic financial statements of the Commonwealth of Kentucky. This information has been subjected to the auditing procedures applied in our audit of the basic financial statements and in the audits performed by other auditors and, in our opinion, based on our audit and the reports of other auditors, is fairly presented, in all material respects, in relation to the basic financial statements taken as a whole. The Introductory and Statistical sections presented in this report on pages 2 through 10 and 192 through 213 are also presented for purposes of additional analysis and are not a required part of the basic financial statements. This information has not been subjected to the auditing procedures applied by us and the other auditors in the audit of the basic financial statements and, accordingly, we express no opinion on them.

Respectfully submitted,



Cliff Luallen
Auditor of Public Accounts

December 17, 2010

MANAGEMENT'S DISCUSSION AND ANALYSIS

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management's Discussion and Analysis of the Commonwealth of Kentucky's Comprehensive Annual Financial Report (CAFR) presents a discussion and analysis of the State's financial performance during the fiscal year ended June 30, 2010. It is supplementary information required by the Governmental Accounting Standards Board (GASB) and is intended to provide an easily readable explanation of the information in the basic financial statements. It should be read in conjunction with the additional information that is furnished in the letter of transmittal, which can be found preceding this narrative, and with the Commonwealth's financial statements which follow.

FINANCIAL HIGHLIGHTS - PRIMARY GOVERNMENT

Government-Wide Highlights:

The assets of the Commonwealth's governmental activities exceeded its liabilities at fiscal year ending June 30, 2010, by \$12.8 billion, a decrease of \$1.2 billion related to current year activity. Liabilities of the Commonwealth's business-type activities exceeded assets by \$800 million, a decrease in net assets of \$273 million related to current year activity. Total net assets decreased by \$1.46 billion to \$12.02 billion.

The assets of component units exceeded liabilities at fiscal year ending June 30, 2010, by \$8.02 billion, an increase of \$587 million related to current year activity.

Fund Highlights:

As of the close of FY10, the Commonwealth's governmental funds reported combined ending fund balances of \$2.15 billion, an increase of \$139 million in comparison with the prior year. Of this total amount, \$972.8 million was reserved and the balance of approximately \$1.18 billion was unreserved. The unreserved undesignated fund balance of the General Fund was \$2.5 million at June 30, 2010.

Enterprise funds reported net assets of \$(800) million, of which \$350.8 million was restricted or invested in capital assets, and the balance of \$(1.15) billion was unrestricted.

Long-Term Debt:

The Commonwealth's total long-term debt obligations (bonds and notes payable) increased by \$738.1 million to \$7.05 billion during the current fiscal year. The increase is attributable to the issuance of new debt by the Commonwealth's Primary Government to replace short-term notes used to initially fund projects, to advance refund debt outstanding to reduce future interest cost, and to fund new projects authorized and started during FY10. Additional details of these activities can be found in Note 15 beginning on Page 97.

OVERVIEW OF THE FINANCIAL STATEMENTS

The Commonwealth's basic financial statements include: (1) government-wide financial statements, (2) fund financial statements, and (3) notes to the financial statements. This report also includes other required supplementary information (*General and Special Revenue Fund budgetary schedules; condition and maintenance data regarding infrastructure; and claims development information*) and other supplementary information (combining financial statements). Each of these components is described below.

Government-Wide Financial Statements

The *Government-Wide Financial Statements* provide a broad view of the Commonwealth's operations in a manner similar to a private-sector business. These statements report financial information about the entire government except fiduciary activities. The statements provide both short-term and long-term information about the Commonwealth's financial position, which assists in assessing the Commonwealth's economic condition at the end of the fiscal year. These are prepared using the flow of economic resources measurement focus and the accrual basis of accounting. They take into account all revenues and expenses of the fiscal year even if no cash has been received or paid. The government-wide financial statements include two statements: The *Statement of Net Assets* shows the financial position of the Commonwealth at the end of the fiscal year. The *Statement of Activities* presents information showing how the government's financial position has changed since the beginning of the fiscal year.

Both the Statement of Net Assets and the Statement of Activities have separate sections for three different types of state programs or activities.

These three types of activities are:

Governmental Activities – The activities in this section are mostly supported by taxes and intergovernmental revenues (federal grants). Most services normally associated with State government fall into this category. Internal Service Fund balances are reported as a part of governmental activities.

Business-Type Activities – These functions normally are intended to recover all or a significant portion of their costs through user fees and charges to external users of goods and services provided by the State. The business-type activities of the Commonwealth include the operations of various Enterprise Funds as listed later in the text.

Discretely Presented Component Units – These are operations for which the Commonwealth has financial accountability but which possess certain independent qualities as well. More information on the Commonwealth’s discretely presented component units can be found in Note 1, starting on Page 52.

The government-wide financial statements can be found immediately following this discussion and analysis.

Fund Financial Statements

A fund is a grouping of related accounts that is used to maintain control over resources that have been segregated for specific activities or objectives. Some funds are required to be established by state law or bond covenants and additional funds are established for management and fiscal control of resources.

The fund financial statements focus on activities of state government. All of the funds of the Commonwealth can be divided into three categories: Governmental Funds, Proprietary Funds, and Fiduciary Funds. It is important to note that these fund categories use different accounting approaches and should be interpreted differently.

Table 1, below, summarizes the major features of the basic financial statements and how they relate to one another.

	Government-Wide Financial Statements	Fund Financial Statements		
		Governmental	Proprietary	Fiduciary
Scope	Entire government (except fiduciary funds) and the Commonwealth's component units	The activities of the Commonwealth that are not proprietary or fiduciary	Activities of the Commonwealth that are similar to private businesses	Instances where the Commonwealth is the trustee for someone else’s resources
Required Financial Statements	Statement of Net Assets Statement of Activities	Balance Sheet Statement of Revenues, Expenditures and Changes in Fund Balances	Statement of Fund Net Assets Statement of Revenues, Expenses, and Changes in Fund Net Assets Statement of Cash Flows	Statements of Fiduciary Net Assets Statement of Changes in Fiduciary Net Assets
Accounting Basis and Measurement Focus	Accrual accounting and economic resources measurement focus	Modified accrual accounting and current financial resources focus	Accrual accounting and economic resources measurement focus	Accrual accounting and economic resources measurement focus
Type of Asset/Liability Information	All assets and liabilities, both financial and capital, and short-term and long-term	Only assets expected to be used up and liabilities that come due during the year or soon thereafter, no capital assets included	All assets and liabilities, both financial, and capital, and short-term and long-term	All assets and liabilities, both short-term and long-term
Type of Inflow – Outflow Information	All revenues and expenses during the year, regardless of when cash is received or paid	Revenues for which cash is received during or soon after the end of the year and expenditures when goods or services have been received and payment is due during the year or soon thereafter	All revenues and expenses during the year, regardless of when cash is received or paid	All revenues and expenses during the year, regardless of when cash is received or paid

Notes to the Financial Statements - Notes to the financial statements provide information necessary to fully understand the data provided in the government-wide and fund financial statements. They are an integral part of the financial statements and focus on the primary government and its activities.

Required Supplementary Information - In addition to this Management's Discussion and Analysis, which is required supplementary information, the basic financial statements are followed by a section of required supplementary information that further explains and supports the information contained in the financial statements.

Other Supplementary Information - Supplementary information includes the introductory section, combining financial statements for non-major governmental funds, non-major discretely presented component units, the individual internal service funds and fiduciary funds, schedule of fund activities, capital asset information, and the statistical section.

GOVERNMENT-WIDE FINANCIAL ANALYSIS

Net Assets

Net assets may serve as a useful indicator of a government's financial position. The Commonwealth's combined net assets (governmental and business-type activities) totaled \$12 billion at the end of 2010, as compared to \$13.5 billion at the end of the previous year.

The largest portion of the Commonwealth's net assets, \$18.8 billion, is invested in capital assets (e.g. land, infrastructures, buildings and improvements and machinery and equipment), minus any related debt, which is still outstanding and used to acquire those assets. The Commonwealth uses these capital assets to provide services to its citizens; therefore, these assets are not available for future spending.

The second largest portion of the Commonwealth's net assets, totaling \$1.2 billion, is restricted and represents resources that are subject to either external restrictions or legislative restrictions on how they may be used. The remaining balance is unrestricted net assets. The unrestricted net assets, if they have a positive value, could be used at the Commonwealth's discretion. However, the unrestricted balance is a negative \$7.9 billion; therefore funds are not available for discretionary purposes. A contributing factor to the negative balance is that liabilities are recognized on the government-wide statement of net assets when the obligation is incurred. Accordingly, the Commonwealth recognizes long-term liabilities (such as general bonded debt, compensated absences, unfunded employer pension cost, and contingent liabilities-shown in Note 15 to the financial statements) on the statement of net assets.

Table 2 below presents the Commonwealth's condensed statement of net assets as of June 30, 2010 and June 30, 2009, derived from the government-wide Statement of Net Assets.

Table 2: Condensed Statement of Net Assets (Expressed in Thousands)

	Governmental Activities		Business-Type Activities		Total	
	2010	2009	2010	2009	2010	2009
Current Assets	\$ 5,166,369	\$ 5,050,254	\$ 1,037,701	\$ 896,514	\$ 6,204,070	\$ 5,946,768
Capital Assets	21,441,106	20,969,009	341,300	330,289	21,782,406	21,299,298
Other Assets	1,767	3,005	-	-	1,767	3,005
Total Assets	26,609,242	25,996,833	1,379,001	1,226,803	27,988,243	27,249,071
Non Current Liabilities	11,602,000	9,920,632	2,078,069	1,650,335	13,680,069	11,570,967
Other Liabilities	2,186,062	2,096,588	101,205	103,327	2,287,267	2,199,915
Total Liabilities	13,788,062	12,017,220	2,179,274	1,753,662	15,967,336	13,770,882
Invested in Capital Assets						
Net of Related Debt	18,418,874	19,557,082	341,172	330,078	18,760,046	19,887,160
Restricted	1,206,293	1,094,433	9,646	5,615	1,215,939	1,100,048
Unrestricted	(6,803,987)	(6,646,467)	(1,151,091)	(862,552)	(7,955,078)	(7,509,019)
Total Net Assets	\$ 12,821,180	\$ 14,005,048	\$ (800,273)	\$ (526,859)	\$ 12,020,907	\$ 13,478,189

Changes in Net Assets

The revenues and expenses information, as shown in Table 3, was derived from the government-wide Statement of Activities and reflects how the Commonwealth's net assets changed during FY10. The Commonwealth received program revenues of \$13.4 billion and general revenues (including transfers) of \$9.8 billion for total revenues of \$23.2 billion during FY10. Expenses for the Commonwealth during FY10 were \$24.7 billion, which resulted in a total decrease of the Commonwealth's net assets in the amount of \$1.46 billion, net of contributions, transfers and special items.

Table 3: Condensed Statement of Activities (Expressed in Thousands)

	2010 Governmental Activities	2009 Governmental Activities	2010 Business-Type Activities	2009 Business-Type Activities	2010 Total	2009 Total
Revenues:						
Program Revenues:						
Charges for Services	\$ 970,632	\$ 981,463	\$ 4,056,372	\$ 2,765,465	\$ 5,027,004	\$ 3,746,928
Operating Grants and Contributions	7,621,275	6,575,144	3,849	363,028	7,625,124	6,938,172
Capital Grants and Contributions	773,661	550,416	0	4,633	773,661	555,049
General Revenues:						
Income Taxes	3,361,478	3,637,574			3,361,478	3,637,574
Sales Taxes	4,880,831	4,777,321			4,880,831	4,777,321
Property Taxes	504,189	534,441			504,189	534,441
Other Taxes	544,349	590,621			544,349	590,621
Investment Earnings	9,531	(9,977)	47,657	(28,261)	57,188	(38,238)
Other	420,191	358,189	37,636	48,932	457,827	407,121
Total Revenues	<u>19,086,137</u>	<u>17,995,192</u>	<u>4,145,514</u>	<u>3,153,797</u>	<u>23,231,651</u>	<u>21,148,989</u>
Expenses:						
Governmental Activities:						
General Government	4,377,373	4,632,707			4,377,373	4,632,707
Legislative and Judicial	376,743	360,872			376,743	360,872
Commerce	124,263	112,825			124,263	112,825
Education and Humanities	5,148,482	4,885,444			5,148,482	4,885,444
Human Resources	7,725,161	7,611,725			7,725,161	7,611,725
Justice	876,065	822,301			876,065	822,301
Natural Resources and Environmental Protection	192,518	195,366			192,518	195,366
Public Protection and Regulation	113,558	121,952			113,558	121,952
Transportation	1,175,210	1,331,764			1,175,210	1,331,764
Interest Expense	332,639	265,984			332,639	265,984
Business-type Activities:						
State Parks			101,861	98,795	101,861	98,795
Kentucky Lottery Corporation			568,183	619,902	568,183	619,902
Kentucky Horse Park			13,521	11,411	13,521	11,411
Kentucky Public Employees Health Plan			1,497,656	1,434,951	1,497,656	1,434,951
Insurance Administration			107,286	(18,953)	107,286	(18,953)
Unemployment Compensation			1,958,414	1,317,067	1,958,414	1,317,067
Total Expenses	<u>20,442,012</u>	<u>20,340,940</u>	<u>4,246,921</u>	<u>3,463,173</u>	<u>24,688,933</u>	<u>23,804,113</u>
Increase (Decrease) in Net Assets Before Transfers						
Assets Before Transfers	(1,355,875)	(2,345,748)	(101,407)	(309,376)	(1,457,282)	(2,655,124)
Transfers	172,007	264,032	(172,007)	(264,032)		
Change in Net Assets	<u>(1,183,868)</u>	<u>(2,081,716)</u>	<u>(273,414)</u>	<u>(573,408)</u>	<u>(1,457,282)</u>	<u>(2,655,124)</u>
Net Assets, July 1, as restated	14,005,048	16,086,764	(526,859)	46,549	13,478,189	16,133,313
Net Assets, June 30	<u>\$ 12,821,180</u>	<u>\$ 14,005,048</u>	<u>\$ (800,273)</u>	<u>\$ (526,859)</u>	<u>\$ 12,020,907</u>	<u>\$ 13,478,189</u>

Governmental Activities:

The slowing economy, during the fiscal year, caused revenues to decline resulting in the decrease in net assets of governmental activities by \$1.2 billion or 8.46 percent. Approximately 49 percent of the governmental activities' total revenue came from taxes, while 44 percent resulted from grants and contributions (including federal aid). Table 4 below presents program expenses and revenues for governmental activities. Overall, program revenues were insufficient to cover program expenses for governmental activities. Therefore, the net program expenses of these governmental activities were supported by general revenues, mainly taxes.

Table 4 (Expressed in Thousands)

State Programs	Program Expenses	Program Revenues	Net Program Expenses (Revenue)
General Government	\$ 4,377,373	\$ 835,132	\$ 3,542,241
Legislative and Judicial	376,743	22,702	354,041
Commerce	124,263	58,158	66,105
Education and Humanities	5,148,482	1,426,960	3,721,522
Human Resources	7,725,161	5,674,974	2,050,187
Justice	876,065	171,611	704,454
Natural Resources and Environmental Protection	192,518	112,160	80,358
Public Protection and Regulation	113,558	79,030	34,528
Transportation	1,175,210	984,841	190,369
Totals	\$ 20,109,373	\$ 9,365,568	\$ 10,743,805

Business-Type Activities:

Table 5 below presents program expenses and revenues for business-type activities. The business-type activities decreased the Commonwealth's net assets by \$273 million. Program revenues generated by the operations of the State Parks, Kentucky Horse Park, and Unemployment Compensation were not sufficient to cover program expenses. General revenues were needed to support expenses of these programs. Program revenues generated by the operations of the Kentucky Lottery Corporation, Kentucky Public Employees Health Plan and Insurance Administration were sufficient to cover program expenses.

Table 5 (Expressed in Thousands)

State Programs	Program Expenses	Program Revenues	Net Program Expenses (Revenue)
State Parks	\$ 101,861	\$ 51,243	\$ 50,618
Kentucky Lottery Corporation	568,183	772,497	(204,314)
Kentucky Horse Park	13,521	8,325	5,196
Kentucky Public Employees Health Plan	1,497,656	1,548,458	(50,802)
Insurance Administration	107,286	123,408	(16,122)
Unemployment Compensation	1,958,414	1,556,290	402,124
Totals	\$ 4,246,921	\$ 4,060,221	\$ 186,700

Overall Analysis

Financial highlights for the State as a whole during fiscal year ended June 30, 2010 include the following:

- The assets of the State's governmental activities continue to exceed liabilities (net assets) at the close of the fiscal year by \$12.8 billion and the condition of the State's business-type activities worsened to the point that liabilities exceeded assets by \$800 million.
- The State's total net assets decreased during the year by \$1.46 billion. Net assets of governmental activities decreased by \$1.2 billion, while net assets of business-type activities decreased by \$273 million.
- The major reason for the decline in net assets of the governmental activities was an increase in the Employers unfunded pension contribution of \$992 million and an increase in long-term debt in the amount of \$738.1 million. The primary cause of the decrease in business-type activities net assets is the increase in unemployment benefits attributable to the nation's economic downturn.

FINANCIAL ANALYSIS OF THE COMMONWEALTH'S INDIVIDUAL FUNDS

At June 30, 2010, the Commonwealth's governmental funds reported combined ending fund balances of \$2.15 billion, an increase of \$139 million in comparison with the prior year. \$972.8 million of the fund balances are reserved for legal obligations and are not available to fund current operations. The amount available to fund current expenditures is \$1.18 billion.

General Fund

The General Fund is the primary operating fund of the Commonwealth. The fund balance at June 30, 2010, was \$79.6 million. The balance reported reflects an increase of \$50.9 million from the previously reported amount, which represents a increase of 167%. The major factor for the increase is because of an enhanced federal participation for Medicaid; thus, reducing the state's share of these expenditures.

The fund balance is segregated into reserved and unreserved amounts. The reservations of fund balance restrict those amounts for specific purposes such as: encumbrances, inventory, and capital outlay. The General Fund balance at June 30, 2010, has \$77 million as reserved fund balance and \$2.5 million unreserved. The unreserved represents the amount available for current expenditures.

The following governmental funds experienced significant changes during the year:

Major Special Revenue Funds

The major special revenue funds experienced normal cyclical changes in revenues and expenditures, except for the Federal Fund which experienced a significant increase in grant revenue as a result of the American Recovery and Reinvestment Act (ARRA), resulting in a significant increase in federal fund expenditures. The Transportation Fund experienced a slight increase in revenues due to increased tax receipts and a reduction in expenditures, again due to increased federal funds under ARRA, resulting in an increase in fund balance of \$89 million.

Proprietary Funds - The Commonwealth's proprietary funds reported net assets of \$(653.6) million, which included \$(800) million in the enterprise funds and \$146.7 million in the internal service funds. This is a total decrease in net assets of \$283.2 million from the previous year.

The overall decrease in net assets is due to increase in unemployment benefit payments within the Unemployment Compensation Fund. Benefit payments increased by \$668 million for an increase of 51.8%.

GENERAL FUND BUDGETARY HIGHLIGHTS

During the year, as the national and state economy failed to fully recover, the official revenue forecast for the General Fund was decreased. The General Fund revenues, for the year, exceeded the final budgetary estimates by approximately \$18 million. The original budgeted expenditures were decreased to accommodate revenue shortfalls. Actual expenditures for the year were approximately \$412 million less than the final budgeted amount.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets - The Commonwealth's investment in capital assets for its governmental and business-type activities as of June 30, 2010, amounts to \$22.8 billion, with accumulated depreciation of \$1 billion, leaving a net book value of \$21.8 billion. This investment in capital assets includes land, improvements, buildings, equipment, and construction in progress, infrastructure and intangibles. Infrastructure assets are normally immovable and of value only to the Commonwealth, such as roads, bridges, streets and sidewalks, drainage systems, lighting systems, and similar items.

The total increase in the Commonwealth's investment in capital assets for the current fiscal year was about 2.3 percent in terms of net book value. However, actual expenditures to purchase or construct capital assets were \$580 million for the year. Most of this amount was used to construct or reconstruct roads and bridges. Depreciation charges for the year totaled \$87.7 million. Additional information on the Commonwealth's capital assets can be found in Note 6 of the "Notes to the Financial Statements" of this report.

Infrastructure Assets – The Commonwealth has elected to utilize the “Modified Approach” as it relates to guidelines set forth in the GASB (Government Accounting Standards Board) Statement Number 34. Under this alternative method the Commonwealth expenses certain maintenance and preservation costs and does not report depreciation expense. Assets accounted for under the modified approach include nearly 63,000 lane miles of roads and approximately 9,000 bridges that the Commonwealth has responsibility for maintaining.

- There have been no significant changes in the condition level of infrastructure assets
- The asset condition level established by the Commonwealth has approximately been met and exceeded for the past two years.
- Actual expenditures necessary to maintain and preserve infrastructure assets at target condition levels were approximately 1 percent less than the estimate for fiscal year 2010.

A more in-depth discussion of the Commonwealth’s infrastructure assets is located in the “Required Supplemental Information” section of this report.

Debt Administration - The Office of Financial Management as established in KRS 42.4201, is responsible for the oversight of the Commonwealth’s debt. The Office develops a long-term debt plan including criteria for the issuance of debt and an evaluation of the total state debt to be incurred. Debt is issued through the State Property and Buildings Commission and the Kentucky Asset/Liability Commission.

The Commonwealth of Kentucky’s bonded debt increased by \$707.8 million to \$6.0 billion, a 13.5% increase during the current fiscal year. The major factors in this increase were the issuance of bonds to fund new capital projects and to advance refund debt outstanding to reduce future interest cost. No general obligation bonds were authorized or outstanding at June 30, 2010. Additional information on the Commonwealth’s long-term debt obligations can be found in Note 15 of the notes to the financial statements of this report.

ECONOMIC FACTORS AND NEXT YEAR’S BUDGETS AND RATES

The unemployment rate for the Commonwealth of Kentucky is currently 10.0 percent. The October rate is down 0.7 percent compared to the October 2009 level of 10.7 percent. The national unemployment rate has also trimmed falling 0.2 percent from 9.8 percent in October 2009 to 9.6 percent in October 2010. Almost every labor sector is still struggling to rebound following the 2007 recession.

Both the national and Kentucky economies are showing signs of improvement in output and sales, but employment and wages are still stagnant. Federal money to Medicaid has helped curb the impact to the state budget. However, continued high federal budget deficits will make it increasingly unlikely that continued support will occur.

Modest growth in output is expected in FY11 and FY12. An improvement in global demand will continue to improve exports. Suppressed incomes domestically is curbing import demand and improving (albeit slowly) the US’s balance of trade. As production increases, employment and wages will eventually follow. The speed and magnitude of the recovery are dependent upon the willingness of businesses to increase workforces in response to slowly improving product-demand conditions.

Low energy prices and low interest rates will be one impetus for firms to reinvest in capital and labor. Despite historically low interest rates, credit conditions remain tight. Tight credit markets and uncertainty in the financial markets continue to limit the upside in the economy over the next biennium. Consumers are restricted by uncertain job markets and limited credit options.

REQUESTS FOR INFORMATION

This financial report is designed to provide a general overview of the Commonwealth of Kentucky’s finances for all of Kentucky’s citizens, taxpayers, customers, investors, and creditors. This financial report seeks to demonstrate the Commonwealth’s accountability for the money it receives. Questions concerning any of the information provided in this report or requests for additional information should be addressed to: Commonwealth of Kentucky, Finance and Administration Cabinet, Office of the Controller, 702 Capitol Avenue, Frankfort, KY 40601.

BASIC FINANCIAL STATEMENTS

GOVERNMENT-WIDE FINANCIAL STATEMENTS

COMMONWEALTH OF KENTUCKY
STATEMENT OF NET ASSETS
JUNE 30, 2010
(Expressed in Thousands)

	Primary Government		Total	Component Units
	Governmental Activities	Business-Type Activities		
Assets				
Cash and cash equivalents (Note 5)	\$ 528,783	\$ 113,010	\$ 641,793	\$ 1,414,042
Cash with fiscal agents (Note 5)	79,931	97,561	177,492	
Investments, net of amortization (Note 5)	1,560,061	168,841	1,728,902	2,521,809
Invested security collateral	332,091		332,091	
Receivables, net (Note 4)	2,103,521	239,752	2,343,273	4,389,746
Notes receivable	5,312		5,312	
Capital lease receivable (Note 4)	425,990		425,990	
Internal balances (Note 7)	(51,738)	51,738		
Inventories	62,771	2,321	65,092	34,666
Prepaid expenses	12,857	725	13,582	19,627
Deferred charges	74,556		74,556	71,264
Deferred outflow of resource-interest rate swap (Note 15)	32,234		32,234	
Restricted assets:				
Temporarily restricted:				
Cash and cash equivalents (Note 5)				656,258
Investments (Note 5)		363,753	363,753	955,106
Capital assets (Note 6):				
Land	164,125	21,845	185,970	251,193
Improvements other than buildings	15,600	112,686	128,286	263,819
Buildings	1,179,513	240,981	1,420,494	5,333,887
Machinery and equipment	581,845	59,518	641,363	1,733,037
Other capital assets				105,152
Easements and other intangibles	121,604	2,322	123,926	
Less: Accumulated depreciation and amortization	(867,763)	(215,442)	(1,083,205)	(3,344,938)
Construction in progress	2,227,496	119,390	2,346,886	797,838
Infrastructure	18,018,686		18,018,686	
Total Capital Assets	21,441,106	341,300	21,782,406	5,139,988
Other assets	1,767		1,767	919,874
Total Assets	26,609,242	1,379,001	27,988,243	16,122,380
Liabilities				
Accounts payable (Note 4)	1,385,846	80,541	1,466,387	433,299
Tax refunds payable	338,745		338,745	
Unearned revenue	97,146	18,864	116,010	192,708
Other liabilities		1,800	1,800	133,473
Liabilities from restricted assets				
Obligations under securities lending	332,091		332,091	6,438
Derivative instrument-interest rate swap (Note 15)	32,234		32,234	
Noncurrent liabilities:				
Due within one year (Note 15)	606,708	244,762	851,470	820,666
Due in more than one year (Note 15)	10,995,292	1,833,307	12,828,599	6,517,996
Total Liabilities	13,788,062	2,179,274	15,967,336	8,104,580
Net Assets				
Invested in capital assets, net of related debt	18,418,874	341,172	18,760,046	3,438,783
Restricted for:				
Debt service	197,802		197,802	361,730
Capital projects	295,781	2,715	298,496	222,224
Highways	712,710		712,710	
Other purposes (Note 1)		6,931	6,931	2,406,085
Unrestricted	(6,803,987)	(1,151,091)	(7,955,078)	1,588,978
Total Net Assets	\$ 12,821,180	\$ (800,273)	\$ 12,020,907	\$ 8,017,800

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

COMMONWEALTH OF KENTUCKY
STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

Functions/Programs	Expenses	Program Revenues		
		Charges for Services	Operating Grants and Contributions	Capital Grants and Contributions
Primary Government:				
Governmental Activities:				
General government	\$ 4,377,373	\$ 384,050	\$ 436,377	\$ 14,705
Legislative and judicial	376,743	20,226	2,476	
Commerce	124,263	40,657	17,234	267
Education and humanities	5,148,482	55,926	1,371,034	
Human resources	7,725,161	103,025	5,567,178	4,771
Justice	876,065	21,641	144,726	5,244
Natural resources and environmental protection	192,518	41,123	71,037	
Public protection and regulation	113,558	73,066	5,964	
Transportation	1,175,210	230,918	5,249	748,674
Interest expense	332,639			
Total Governmental Activities	<u>20,442,012</u>	<u>970,632</u>	<u>7,621,275</u>	<u>773,661</u>
Business-Type Activities:				
State Parks	101,861	50,802	441	
Kentucky Lottery Corporation	568,183	772,497		
Kentucky Horse Park	13,521	6,880	1,445	
Kentucky Public Employees Health Plan	1,497,656	1,548,458		
Insurance Administration	107,286	121,445	1,963	
Unemployment Compensation	1,958,414	1,556,290		
Total Business-Type Activities	<u>4,246,921</u>	<u>4,056,372</u>	<u>3,849</u>	
Total Primary Government	<u>\$ 24,688,933</u>	<u>\$ 5,027,004</u>	<u>\$ 7,625,124</u>	<u>\$ 773,661</u>
Component Units:				
Authorities:				
Kentucky Housing Corporation	\$ 347,410	\$ 185,237	\$ 204,236	\$
Kentucky Higher Education Student Loan Corporation	51,321	63,476		
Universities, Colleges, & Related Entities:				
University of Kentucky	2,114,979	1,365,667	470,786	44,046
University of Louisville	859,935	433,034	172,813	
Kentucky Community and Technical College System	645,431	107,009	86,621	
Other component units	1,820,283	668,652	426,318	89,944
Total Component Units	<u>\$ 5,839,359</u>	<u>\$ 2,823,075</u>	<u>\$ 1,360,774</u>	<u>\$ 133,990</u>
General Revenues (Note 1):				
Sales and gross receipt tax				
Individual income tax				
Corporate income tax				
Property tax				
License and privilege tax				
Severance tax				
Inheritance and estate tax				
Miscellaneous taxes				
Unrestricted grants and contributions				
Unrestricted investment earnings				
Gain on sale of capital assets				
Miscellaneous general				
Transfers				
Total General Revenues and Transfers				
Change in Net Assets				
Net Assets at July 1, as Restated (Note 2)				
Net Assets at June 30				

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

Net (Expense) Revenue and Changes in Net Assets

Primary Government			
Governmental Activities	Business-Type Activities	Totals	Component Units
\$ (3,542,241)	\$	\$ (3,542,241)	
(354,041)		(354,041)	
(66,105)		(66,105)	
(3,721,522)		(3,721,522)	
(2,050,187)		(2,050,187)	
(704,454)		(704,454)	
(80,358)		(80,358)	
(34,528)		(34,528)	
(190,369)		(190,369)	
(332,639)		(332,639)	
<u>(11,076,444)</u>		<u>(11,076,444)</u>	
	(50,618)	(50,618)	
	204,314	204,314	
	(5,196)	(5,196)	
	50,802	50,802	
	16,122	16,122	
	<u>(402,124)</u>	<u>(402,124)</u>	
	<u>(186,700)</u>	<u>(186,700)</u>	
<u>(11,076,444)</u>	<u>(186,700)</u>	<u>(11,263,144)</u>	
			\$ 42,063
			12,155
			(234,480)
			(254,088)
			(451,801)
			(635,369)
			<u>(1,521,520)</u>
4,880,831		4,880,831	
3,125,824		3,125,824	
235,654		235,654	
504,189		504,189	
29,198		29,198	
325,077		325,077	
38,058		38,058	
152,016		152,016	
9,365		9,365	604,948
9,531	47,657	57,188	121,750
22,682	1,844	24,526	267
388,144	35,792	423,936	1,381,923
172,007	<u>(172,007)</u>		
<u>9,892,576</u>	<u>(86,714)</u>	<u>9,805,862</u>	<u>2,108,888</u>
<u>(1,183,868)</u>	<u>(273,414)</u>	<u>(1,457,282)</u>	<u>587,368</u>
<u>14,005,048</u>	<u>(526,859)</u>	<u>13,478,189</u>	<u>7,430,432</u>
<u>\$ 12,821,180</u>	<u>\$ (800,273)</u>	<u>\$ 12,020,907</u>	<u>\$ 8,017,800</u>

GOVERNMENTAL FUNDS FINANCIAL STATEMENTS

Major Funds

General Fund

The General Fund is the Commonwealth's operating fund and accounts for financial resources appropriated by the General Assembly that are not required to be accounted for in other funds.

Transportation Fund

The Transportation Fund Accounts for activities related to the construction, preservation, and maintenance of roads.

Federal Fund

The Federal Fund accounts for monies received from the federal government to be spent on specific programs and operations.

Agency Revenue Fund

The Agency Revenue Fund accounts for revenues and expenditures of restricted taxes, fees, and charges related to a particular function or activity. The General Assembly usually appropriates this fund.

Capital Projects Fund

The Capital Projects Fund accounts for financial resources appropriated by the General Assembly for the acquisition, construction, or renovation of major capital facilities, and for the acquisition of major equipment other than that financed by proprietary funds, certain trust funds, and university and college funds.

Debt Service Fund

The Debt Service Fund accounts for the payment of principal, interest, and administrative fees due on general long-term issues of the Commonwealth and for the accumulation of financial resources used to make such payments.

Non-Major Funds

Non-Major governmental funds are presented by fund type beginning on page 136

COMMONWEALTH OF KENTUCKY
BALANCE SHEET
GOVERNMENTAL FUNDS
JUNE 30, 2010
(Expressed in Thousands)

	<u>General</u>	<u>Transportation</u>	<u>Federal</u>	<u>Agency Revenue</u>	<u>Capital Projects</u>	<u>Debt Service</u>	<u>Non-Major Governmental Funds</u>	<u>Total Governmental Funds</u>
Assets								
Cash and cash equivalents (Note 5)	\$ 117,255	\$ 46,317	\$ 1	\$ 47,888	\$ 4	\$ 1,128	\$ 276,606	\$ 489,199
Cash with fiscal agents (Note 5)						61,878		61,878
Restricted cash (Note 5)				18,053				18,053
Investments, net of amortization (Note 5)	75,804	321,579		323,571	323,578	2,806	473,794	1,521,132
Invested security collateral	38,529	75,054		66,331	66,588		85,589	332,091
Receivables, net (Note 4)	862,735	132,402	987,888	74,259	7,731	12	37,966	2,102,993
Notes receivable				4,990			322	5,312
Capital lease receivable (Note 4)						425,990		425,990
Interfunds receivable (Note 7)	16,004	575	14,161	72,470	2,703		21,762	127,675
Interfund loans receivable (Note 7)				23,800			68,300	92,100
Inventories	5,079	50,790	645	3,460			40	60,014
Total Assets	\$ 1,115,406	\$ 626,717	\$ 1,002,695	\$ 634,822	\$ 400,604	\$ 491,814	\$ 964,379	\$ 5,236,437
Liabilities and Fund Balances								
Liabilities:								
Accounts payable (Note 4)	\$ 339,002	\$ 72,943	\$ 811,907	\$ 51,932	\$ 11,530	\$	\$ 17,537	\$ 1,304,851
Tax refunds payable	338,745							338,745
Interfunds payable (Note 7)	102,546	1,633	45,022	13,896	104		15,736	178,937
Interfund loans payable (Note 7)			68,300		23,800			92,100
Obligations under securities lending	38,529	75,054		66,331	66,588		85,589	332,091
Deferred revenue	216,997	15,838	141,911	21,014	2,801	425,991	16,646	841,198
Total Liabilities	1,035,819	165,468	1,067,140	153,173	104,823	425,991	135,508	3,087,922
Fund Balances:								
Reserved for:								
Encumbrances		234,092			81,333			315,425
Statutory obligations	71,975	88,454						160,429
Inventories	5,079	50,790	645	3,460			40	60,014
Long-term receivables				4,990			322	5,312
Deposit with fiscal agents				18,053		61,878		79,931
Capital outlay					351,704			351,704
Unreserved, reported in:								
General fund	2,533							2,533
Special revenue funds		87,913	(65,090)	455,146			696,530	1,174,499
Debt service fund						3,945	131,979	135,924
Capital projects fund					(137,256)			(137,256)
Total Fund Balances	79,587	461,249	(64,445)	481,649	295,781	65,823	828,871	2,148,515
Total Liabilities and Fund Balances	\$ 1,115,406	\$ 626,717	\$ 1,002,695	\$ 634,822	\$ 400,604	\$ 491,814	\$ 964,379	\$ 5,236,437

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

**RECONCILIATION OF THE BALANCE SHEET- GOVERNMENTAL FUNDS
TO THE STATEMENT OF NET ASSETS
JUNE 30, 2010**

(Expressed in Thousands)

Total Fund Balances - Governmental Funds		\$ 2,148,515
Amounts reported for governmental activities in the statement of net assets are different because:		
Capital assets used in governmental activities are not financial resources and, therefore, are not reported in the funds.		
Land and other non-depreciable assets	261,275	
Buildings, equipment, and other depreciable assets	1,397,886	
Infrastructure	18,018,686	
Accumulated depreciation	(623,427)	
Construction in progress	<u>2,145,084</u>	21,199,504
Certain revenues are earned but not available, and therefore, are deferred in the funds.		
		744,706
Other long-term assets are not available to pay for current-period expenditures and, therefore, are deferred in the funds.		
		83,673
Internal service funds are used by management to charge the costs of Fleet Management, Computer Services, Central Printing, Prison Industries, Property Management and Risk Management to individual funds. The assets and liabilities of the internal service funds are included in governmental activities in the Statement of Net Assets.		
		146,691
Long-term liabilities are not due and payable in the current period and, therefore, are not reported in the funds.		
Capital lease obligations	(19,633)	
Compensated absences	(215,815)	
Pollution remediation obligations	(29,231)	
Judgements and contingencies	(11,838)	
Net pension obligations	<u>(3,838,092)</u>	(4,114,609)
Long-term bonded debt is not due and payable in the current period and, therefore, is not reported in the funds. Unamortized premiums, loss on refundings, and interest payable are not reported in the funds; however, these amounts are included in the Statement of Net Assets. This is the net effect of these balances on the statement:		
Bonds payable	(5,959,846)	
Notes payable	(1,089,740)	
Unamortized premiums and discounts	(238,521)	
Less deferred amounts on refundings	8,685	
Accrued interest payable	<u>(107,878)</u>	<u>(7,387,300)</u>
Net Assets of Governmental Activities		<u>\$ 12,821,180</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

COMMONWEALTH OF KENTUCKY
STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	General	Transportation	Federal	Agency Revenue	Capital Projects	Debt Service	Non-Major Governmental Funds	Total Governmental Funds
Revenues								
Taxes	\$ 7,862,887	\$ 1,076,592	\$	\$ 306,000	\$	\$	\$ 120,696	\$ 9,366,175
Licenses, fees, and permits	43,360	128,285		157,370			1,372	330,387
Intergovernmental	14,500		8,303,622	38,374	25,026		24	8,381,546
Charges for services	10,082	10,277	930	572,304	11,609	36,484	162,275	803,961
Fines and forfeits	49,367	22	1,154	8,430			28,007	86,980
Interest and other investment income	7,427	187	213	6,654	13,716	5,178	11,839	45,214
Increase (decrease) in fair value of investments	(2,454)	954		555	245	(29)	579	(150)
Securities lending income	198	387		342	343		441	1,711
Other revenues	127,920	3,491	101,234	200,785	3,057		56,021	492,508
Total Revenues	8,113,287	1,220,195	8,407,153	1,290,814	53,996	41,633	381,254	19,508,332
Expenditures								
Current:								
General government	1,775,026		348,802	138,847			329,608	2,592,283
Legislative and judicial	318,064		1,777	58,561			73	378,475
Commerce	30,905		14,642	45,529			1,361	92,437
Education and humanities	3,624,631		1,374,120	34,540			70,757	5,104,048
Human resources	1,549,310		5,675,778	875,346			24,402	8,124,836
Justice	554,593		135,139	90,841			1,870	782,443
Natural resources and environmental protection	68,049		63,881	51,235			9,946	193,111
Public protection and regulation	17,764		5,637	72,788			19,668	115,857
Transportation	4,399	1,081,874	714,132	153,581			60,504	2,014,490
Debt service:								
Principal retirement						56,275	329,937	386,212
Interest and fiscal charges						221,969	84,170	306,139
Other expenditures						26,052	1,283	27,335
Securities lending expense	108	211		187	187		240	933
Capital outlay:								
Buildings					609,309			609,309
Total Expenditures	7,942,849	1,082,085	8,333,908	1,521,455	609,496	304,296	933,819	20,727,908
Excess (Deficiency) of Revenues over (under) Expenditures	170,438	138,110	73,245	(230,641)	(555,500)	(262,663)	(552,565)	(1,219,576)
Other Financing Sources (Uses)								
Transfers in	369,470	9	23	491,658	38,076	216,708	839,330	1,955,274
Transfers out	(499,133)	(48,717)	(58,335)	(387,108)	(73,797)		(709,081)	(1,776,171)
Capitalized leases	10,121	3	6	52				10,182
Insurance proceeds				9,876				9,876
Issuance of bonds:								
New issues					593,875	47,320	232,131	873,326
Refunding issues						166,295	181,540	347,835
Premiums				10,943		10,912	15,587	37,442
Discounts							(2,619)	(2,619)
Issuance of notes								
Payments to refunded bond escrow agent				89,710				89,710
Total Other Financing Sources (Uses)	(119,542)	(48,705)	(58,306)	215,131	558,154	282,075	529,446	1,358,253
Net Change in Fund Balances	50,896	89,405	14,939	(15,510)	2,654	19,412	(23,119)	138,677
Fund Balances at July 1, as restated (Note 2)								
Increase (decrease) in inventories	30,437	364,663	(79,938)	496,806	293,127	46,411	851,959	2,003,465
Fund Balances at June 30	(1,746)	7,181	554	353			31	6,373
Fund Balances at June 30	\$ 79,587	\$ 461,249	\$ (64,445)	\$ 481,649	\$ 295,781	\$ 65,823	\$ 828,871	\$ 2,148,515

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

**RECONCILIATION OF THE STATEMENT OF REVENUES, EXPENDITURES,
AND CHANGES IN FUND BALANCES-GOVERNMENTAL FUNDS
TO THE STATEMENT OF ACTIVITIES
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)**

Net Change in Fund Balances-Total Governmental Funds \$ 138,677

Amounts reported for governmental activities in the statement of activities are different because:

Governmental funds report capital outlays as expenditures. However, in the statement of activities the cost of those assets is allocated over their estimated useful lives and reported as depreciation expense. This is the amount by which capital outlays exceeded depreciation in the current period:

Assets disposed of, net book value	(39,707)	
Donated assets, fair market value	2,224	
Buildings, equipment, and other depreciable assets	45,067	
Infrastructure	524,056	
Accumulated depreciation	<u>(58,295)</u>	473,345

Revenues in the statement of activities that do not provide current financial resources are not reported as revenues in the funds. 59,380

Certain expenditures are reported in the funds; however, they increase assets reported on the Statement of Net Assets and have been eliminated from the Statement of Activities:

Prepaid Expenses	7,350	
Inventories	<u>6,373</u>	13,723

Internal service funds are used by management to charge the costs of Fleet Management, Computer Services, Central Printing, Prison Industries, Property Management and Risk Management to individual funds. The net revenues (expense) of certain activities of the internal service funds are reported with governmental activities. (9,791)

Certain expenditures are reported in the funds; however, they either increase or decrease long-term liabilities reported on the Statement of Net Assets and have been eliminated from the Statement of Activities.

Capital lease payments	5,300	
Compensated absence payments	(6,801)	
Pollution remediation payments	5,293	
Litigation payments	(209)	
Excess contributions to pension funds	<u>(992,004)</u>	(988,421)

The issuance of long-term debt (e.g. bonds, leases) provides current financial resources to governmental funds, while the repayment of the principal of long-term debt consumes the current financial resources of governmental funds. Neither transaction, however, has any effect on net assets. Also, governmental funds report the effect of issuance costs, premiums, discounts and similar items when debt is first issued, whereas these amounts are deferred and amortized in the statement of activities. This amount is the net effect of these differences in the treatment of long-term debt and related items.

Bond proceeds and premiums received	(1,345,694)	
Repayment of bond principal	386,212	
Payment to refunded bond escrow agent	186,602	
Accrued interest	(95,740)	
Loss on refunding	1,649	
Deferred issue costs	<u>(3,810)</u>	<u>(870,781)</u>

Change in Net Assets of Governmental Activities \$ (1,183,868)

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

PROPRIETARY FUNDS FINANCIAL STATEMENTS

Enterprise Funds (All Major)

State Parks Fund

The State Parks Fund accounts for revenues earned and expenses incurred in the commercial operations of the Department of Parks.

Kentucky Lottery Corporation

The Kentucky Lottery Corporation, empowered by KRS 154A, administers the Kentucky State Lottery and is pursuant to amended section 226 of the Constitution of Kentucky as ratified by voters of the Commonwealth.

Kentucky Horse Park Fund

The Kentucky Horse Park Fund accounts for revenues earned and expenses incurred in the commercial operations of the Kentucky Horse Park.

Insurance Administration Fund

The Insurance Administration Fund accounts for insurance risk pools operated by the state. These include:

Workers' Compensation Fund provides benefits for workers with illnesses, which are not attributable to one employer.

Coal Workers' Pneumoconiosis provides benefits for workers with pneumoconiosis resulting from exposure to coal dust created in the severance or processing of coal.

Petroleum Storage Tank Environmental Assurance Program provides for the cleanup of leaking underground storage tanks in amounts that exceed the insurance required of the owners and operators.

Mine Subsidence Insurance Program provides coverage against losses arising out of or due to mine subsidence within the Commonwealth.

Bond Pool Program provides coverage to reclaim surface mined land when the permit holder has forfeited bonds posted for such purpose.

Kentucky Public Employees Health Insurance Fund

The Kentucky Public Employees Health Insurance Fund accounts for the revenues and expenses incurred in the commercial operation of the health insurance program for state employees, teachers and retirees.

Unemployment Compensation Fund

The Unemployment Compensation Fund accounts for assessed employer contributions and related unemployment compensation payments.

Internal Service Funds

Individual fund statements for the Internal Service Funds, whose combined totals are presented on this statement, begin on page146

COMMONWEALTH OF KENTUCKY
STATEMENT OF FUND NET ASSETS
PROPRIETARY FUNDS
JUNE 30, 2010
(Expressed in Thousands)

	Business-Type Activities-		
	State Parks	Kentucky Lottery Corporation	Kentucky Horse Park
Assets			
Current assets:			
Cash and cash equivalents (Note 5)	\$ 3,860	\$ 14,807	\$ 1,242
Cash on deposit with the Federal government (Note 5)			
Investments, net of amortization (Note 5)		28,280	
Receivables, net (Note 4)	626	30,679	746
Interfunds receivable (Note 7)	165		
Inventories	1,579	93	649
Prepaid expenses	55	605	
Total Current Assets	<u>6,285</u>	<u>74,464</u>	<u>2,637</u>
Noncurrent assets:			
Restricted investments (Note 5)			2,373
Investments, net of amortization (Note 5)	7,960	84,431	
Receivables, net		4,594	65
Capital assets (Note 6):			
Land	16,950	442	4,453
Improvements other than buildings	92,380	375	19,931
Buildings	204,882	7,330	28,769
Machinery and equipment	14,335	39,438	4,150
Easements and other intangibles	2,322		
Less: Accumulated depreciation and amortization	(147,839)	(40,655)	(25,908)
Construction in progress	42,671		76,719
Total Capital Assets	<u>225,701</u>	<u>6,930</u>	<u>108,114</u>
Total Noncurrent Assets	<u>233,661</u>	<u>95,955</u>	<u>110,552</u>
Total Assets	<u>239,946</u>	<u>170,419</u>	<u>113,189</u>
Liabilities			
Current liabilities:			
Accounts payable (Note 4)	3,516	10,589	3,096
Judgments payable	6		
Interfunds payable (Note 7)	541		33
Claims liability (Note 15)			
Claims adjustment liability (Note 15)			
Capital lease obligations (Note 10) (Note 15)	45		20
Prize liability		47,062	
Compensated absences (Note 15)	2,680	1,026	301
Deferred revenue	2,248		71
Other liabilities			
Total Current Liabilities	<u>9,036</u>	<u>58,677</u>	<u>3,521</u>
Noncurrent liabilities:			
Claims liability (Note 15)			
Claims adjustment liability (Note 15)			
Capital lease obligations (Note 10) (Note 15)	42		20
Prize liability		75,934	
Compensated absences (Note 15)	2,839		295
Loans payable the Federal Government (Note 15)			
Other liabilities (Note 15)			1,165
Total Noncurrent Liabilities	<u>2,881</u>	<u>75,934</u>	<u>1,480</u>
Total Liabilities	<u>11,917</u>	<u>134,611</u>	<u>5,001</u>
Net Assets			
Invested in capital assets, net of related debt	225,613	6,930	108,074
Restricted for:			
Capital projects			2,715
Other purposes (Note 1)			
Unrestricted	2,416	28,878	(2,601)
Total Net Assets	<u>\$ 228,029</u>	<u>\$ 35,808</u>	<u>\$ 108,188</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

Enterprise Funds				Governmental
Insurance Administration	Kentucky Public Employees Health Plan	Unemployment Compensation	Totals June 30, 2010	Activities-Internal Service Funds
\$ 44,871	\$ 43,139	\$ 5,091	\$ 113,010	\$ 39,586
		97,561	97,561	
17,430	49,075	136,537	28,280	528
27	52,444	1	235,093	1,459
	65		52,637	2,758
			725	5,508
<u>62,328</u>	<u>144,723</u>	<u>239,190</u>	<u>529,627</u>	<u>49,839</u>
358,105		3,275	363,753	
20,958	27,212		140,561	38,927
			4,659	
			21,845	18,285
			112,686	3,133
			240,981	264,898
1,595			59,518	115,535
			2,322	1,675
(1,040)			(215,442)	(244,336)
			119,390	82,412
<u>555</u>			<u>341,300</u>	<u>241,602</u>
<u>379,618</u>	<u>27,212</u>	<u>3,275</u>	<u>850,273</u>	<u>280,529</u>
<u>441,946</u>	<u>171,935</u>	<u>242,465</u>	<u>1,379,900</u>	<u>330,368</u>
888	20,491	41,961	80,541	4,676
120			126	
325			899	1,935
108,571	74,111		182,682	17,334
5,583	3,889		9,472	797
			65	4,751
			47,062	
1,229	119		5,355	3,278
		16,545	18,864	654
	635		635	
<u>116,716</u>	<u>99,245</u>	<u>58,506</u>	<u>345,701</u>	<u>33,425</u>
909,633			909,633	135,245
49,193			49,193	5,143
			62	7,957
			75,934	
187	102		3,423	1,907
		795,062	795,062	
			1,165	
<u>959,013</u>	<u>102</u>	<u>795,062</u>	<u>1,834,472</u>	<u>150,252</u>
<u>1,075,729</u>	<u>99,347</u>	<u>853,568</u>	<u>2,180,173</u>	<u>183,677</u>
555			341,172	218,384
			2,715	
6,931			6,931	
(641,269)	72,588	(611,103)	(1,151,091)	(71,693)
<u>\$ (633,783)</u>	<u>\$ 72,588</u>	<u>\$ (611,103)</u>	<u>\$ (800,273)</u>	<u>\$ 146,691</u>

COMMONWEALTH OF KENTUCKY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Business-Type Activities-		
	<u>State Parks</u>	<u>Kentucky Lottery Corporation</u>	<u>Kentucky Horse Park</u>
Operating Revenues:			
Charges for sales and services:			
State parks sales and services	\$ 52,066	\$	\$
Lottery sales		772,497	
Horse park admissions and sales			6,880
Insurance receipts			
Unemployment insurance receipts			
Internal service fund receipts			
Other services	1,004		1,445
Total Operating Revenues	<u>53,070</u>	<u>772,497</u>	<u>8,325</u>
Operating Expenses:			
Personal services	55,771		5,360
Utilities, rental, and other services	15,449	1,289	2,517
Commodities and supplies	17,599		2,222
Grants and subsidies			
Depreciation and amortization	10,280	1,368	759
Travel	370	94	
Reinsurance expense			
Claims expense			
Claims adjustment expense			
Prize expense		470,993	
Other expenses		84,855	2,639
Total Operating Expenses	<u>99,469</u>	<u>558,599</u>	<u>13,497</u>
Operating Income (Loss)	<u>(46,399)</u>	<u>213,898</u>	<u>(5,172)</u>
Nonoperating Revenues (Expenses):			
Gain (loss) on sale of capital assets	(2,381)	17	(8)
Interest and other investment income		7,259	
Increase (decrease) in fair value of investments	(7)	(612)	70
Interest expense	(11)	(7,113)	(2)
Other revenues (expenses)		(2,471)	(14)
Total Nonoperating Revenues (Expenses)	<u>(2,399)</u>	<u>(2,920)</u>	<u>46</u>
Income (Loss) before Capital Contributions and Transfers	(48,798)	210,978	(5,126)
Capital contributions			16,630
Transfers in	38,766		11,062
Transfers out	(387)	(211,590)	
Change in Net Assets	<u>(10,419)</u>	<u>(612)</u>	<u>22,566</u>
Net Assets at July 1, as restated (Note 2)	238,448	36,420	85,622
Net Assets at June 30	<u>\$ 228,029</u>	<u>\$ 35,808</u>	<u>\$ 108,188</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

Enterprise Funds				Governmental
Insurance Administration	Kentucky Public Employees Health Plan	Unemployment Compensation	Totals June 30, 2010	Activities-Internal Service Funds
\$	\$	\$	\$	\$
			52,066	
			772,497	
			6,880	
121,445	1,548,458		1,669,903	
		1,575,453	1,575,453	
				206,497
1,963			4,412	260
<u>123,408</u>	<u>1,548,458</u>	<u>1,575,453</u>	<u>4,081,211</u>	<u>206,757</u>
19,523	5,033		85,687	61,217
2,149	1,028	8	22,440	34,320
743	24		20,588	36,077
		1,958,406	1,958,406	7
142			12,549	16,794
312	9		785	113
				951
75,474	1,491,786		1,567,260	61,497
(53)	(227)		(280)	(324)
			470,993	
74			87,568	
<u>98,364</u>	<u>1,497,653</u>	<u>1,958,414</u>	<u>4,225,996</u>	<u>210,652</u>
<u>25,044</u>	<u>50,805</u>	<u>(382,961)</u>	<u>(144,785)</u>	<u>(3,895)</u>
(46)			(2,418)	(1,765)
10,831	278	688	19,056	(142)
28,995	183	(28)	28,601	(463)
			(7,126)	(671)
(8,876)	(3)		(11,364)	55
<u>30,904</u>	<u>458</u>	<u>660</u>	<u>26,749</u>	<u>(2,986)</u>
55,948	51,263	(382,301)	(118,036)	(6,881)
			16,630	234
21,962	3	6	71,799	6,747
(31,830)			(243,807)	(9,891)
<u>46,080</u>	<u>51,266</u>	<u>(382,295)</u>	<u>(273,414)</u>	<u>(9,791)</u>
(679,863)	21,322	(228,808)	(526,859)	156,482
<u>\$ (633,783)</u>	<u>\$ 72,588</u>	<u>\$ (611,103)</u>	<u>\$ (800,273)</u>	<u>\$ 146,691</u>

COMMONWEALTH OF KENTUCKY
STATEMENT OF CASH FLOWS
PROPRIETARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Business-Type Activities		
	State Parks	Kentucky Lottery Corporation	Kentucky Horse Park
Cash Flows from Operating Activities			
Cash received from customers - public	\$ 52,879	\$ 722,979	\$ 6,881
Cash received from customers - state	8		
Cash payments to suppliers for goods and services	(33,424)	(530,289)	(5,500)
Cash payments for employee salaries and benefits	(56,100)	(13,012)	(5,323)
Cash payments for claims expense			
Cash payments from other sources	1,004		
Cash payments to other sources			(14)
Net Cash Provided (Used) by Operating Activities	<u>(35,633)</u>	<u>179,678</u>	<u>(3,956)</u>
Cash Flows from Noncapital Financing Activities			
Transfers from other funds	38,766		11,062
Transfers to other funds	(387)	(211,590)	
Net Cash Provided (Used) by Noncapital Financing Activities	<u>38,379</u>	<u>(211,590)</u>	<u>11,062</u>
Cash Flows from Capital and Related Financing Activities			
Acquisition and construction of capital assets	(3,954)	(604)	(4,728)
Principal paid on revenue bond maturities and equipment contracts	(60)		(23)
Interest paid on revenue bonds and equipment contracts	(11)		(2)
Proceeds from the sale of capital assets			
Net Cash Provided (Used) for Capital and Related Financing Activities	<u>(4,025)</u>	<u>(604)</u>	<u>(4,753)</u>
Cash Flows from Investing Activities			
Purchase of investment securities		(890)	(2,247)
Proceeds from the sale of investment securities	666	29,911	496
Interest and dividends on investments	(7)	478	
Net Cash Provided (Used) in Investing Activities	<u>659</u>	<u>29,499</u>	<u>(1,751)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(620)	(3,017)	602
Cash and Cash Equivalents at July 1	4,480	17,824	640
Cash and Cash Equivalents at June 30	<u>\$ 3,860</u>	<u>\$ 14,807</u>	<u>\$ 1,242</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:			
Operating income (loss)	\$ (46,399)	\$ 213,898	\$ (5,172)
Adjustments to reconcile operating income to net cash provided (used) by operating activities:			
Depreciation and amortization	10,280	1,368	759
Miscellaneous nonoperating income (expense)		210	(14)
Change in assets and liabilities:			
(Increase) decrease in assets:			
Receivables, net	(112)	(649)	(175)
Interfund receivables	(141)		
Inventories	196	14	11
Prepaid expenses	(16)		
Other assets		(207)	(9)
Increase (decrease) in liabilities:			
Accounts payable	711	(862)	612
Interfund payables	(1,256)	2,664	33
Claims liability			
Claims adjustment liability			
Compensated absences	40	(22)	
Deferred revenue	1,074		(1)
Other liabilities	(10)	(36,736)	
Net Cash Provided (Used) by Operating Activities	<u>\$ (35,633)</u>	<u>\$ 179,678</u>	<u>\$ (3,956)</u>
Noncash Investing, Capital, and Financing Activities			
Change in fair value of investments	\$ (7)	\$ (612)	\$ 70
Contributions of capital assets		71	16,630
Capital assets acquired through leases			
Accretion of investments held to fund grand prizes, which increased prize liability		7,113	
Total Noncash Investing, Capital, and Financing Activities	<u>\$ (7)</u>	<u>\$ 6,572</u>	<u>\$ 16,700</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

- Enterprise Funds				Governmental Activities - Internal Service Funds
Insurance Administration	Kentucky Public Employees Health Plan	Unemployment Compensation	Totals June 30, 2010	
\$ 123,882	\$ 199,930	\$ 1,547,809	\$ 2,654,360	\$ 63,439
(3,900)	1,328,900		1,328,908	147,624
(19,575)	(80,576)	(8)	(653,697)	(70,453)
(98,785)	(2,603)		(96,613)	(60,775)
1,811	(1,443,217)		(1,542,002)	(58,899)
(10,895)	30,207	(1,468,881)	33,022	316
(7,462)	(3)		(1,479,793)	(1,156)
	32,638	78,920	244,185	20,096
21,962	3	6	71,799	6,747
(31,830)			(243,807)	(9,891)
(9,868)	3	6	(172,008)	(3,144)
(80)			(9,366)	(1,993)
			(83)	(4,427)
			(13)	(673)
				345
(80)			(9,462)	(6,748)
23,108	(4,230)		15,741	(181)
6,228		7,840	45,141	9,758
10,806	278	660	12,215	(387)
40,142	(3,952)	8,500	73,097	9,190
22,732	28,689	87,426	135,812	19,394
22,139	14,450	15,226	74,759	20,192
\$ 44,871	\$ 43,139	\$ 102,652	\$ 210,571	\$ 39,586
\$ 25,044	\$ 50,805	\$ (382,961)	\$ (144,785)	\$ (3,895)
142			12,549	16,794
(8,536)	(3)		(8,343)	57
(892)	(56,402)	(26,681)	(84,911)	2,040
3,175	52,444	(1)	55,477	2,668
	94		221	(118)
			78	335
			(216)	
(710)	10,043	(3,637)	6,157	(1,611)
(2,352)			(911)	1,103
(23,311)	(14,717)		(38,028)	2,676
(53)	(227)		(280)	(324)
(39)	2		(19)	500
		(962)	111	(129)
70	(9,401)	493,162	447,085	
\$ (7,462)	\$ 32,638	\$ 78,920	\$ 244,185	\$ 20,096
\$ 28,995	\$ 183	\$ (28)	\$ 28,601	\$ (463)
			16,701	234
			7,113	5,317
\$ 28,995	\$ 183	\$ (28)	\$ 52,415	\$ 5,088

FIDUCIARY FUNDS FINANCIAL STATEMENTS

Pension (and Other Post Employment Benefit) Trust Funds account for monies received for and expenses incurred by the various public employee retirement systems administered by the Commonwealth. Kentucky uses the following pension (and other post employment benefit) trust funds:

- Kentucky Employees Retirement System**
- County Employees Retirement System**
- Judicial Retirement Plan**
- State Police Retirement System**
- Kentucky Teachers' Retirement System**
- Legislators' Retirement Plan**
- Kentucky Public Employees' Deferred Compensation Authority**

Agency funds account for monies held by the Commonwealth for custodial purposes only. Kentucky uses the following agency funds:

- Commonwealth Choice Program**
- County Fees Trust Fund**
- Special Deposit Trust Fund**

COMMONWEALTH OF KENTUCKY
STATEMENT OF FIDUCIARY NET ASSETS
ALL FIDUCIARY FUNDS
JUNE 30, 2010
(Expressed in Thousands)

	Pension (and Other Post Employment Benefit) Trust Funds	Agency Funds
Assets		
Cash and cash equivalents (Note 5)	\$ 1,517,396	\$ 229,799
Investments, net of amortization (Note 5)		96,492
Pension trust fund investments (Note 5):		
Corporate and government bonds	6,561,948	
Common stocks	15,758,824	
Mortgages	1,247,123	
Mutual funds	1,835,002	
Real estate	434,689	
Invested security collateral	2,980,373	299,764
Receivables, net	278,479	33,357
Prepaid expenses	275	
Capital assets, net	12,837	
Total Assets	<u>30,626,946</u>	<u>659,412</u>
Liabilities		
Investments - accounts payable	900	
Accounts payable	17,372	261,692
Amounts held in custody for others		97,956
Obligations under securities lending	2,980,373	299,764
Total Liabilities	<u>2,998,645</u>	<u>659,412</u>
Net Assets		
Held in trust for:		
Employee pension and post employment benefits	27,628,301	
Total Net Assets	<u>\$ 27,628,301</u>	<u>\$</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

COMMONWEALTH OF KENTUCKY
STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
ALL FIDUCIARY FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Pension (and Other Post Employment Benefit) Trust Funds
Additions	
Contributions:	
Employer	\$ 1,485,889
Member	751,442
Total Contributions	<u>2,237,331</u>
Other Contributions:	
Recovery income	29,943
Medicare D receipts	34,407
Participant fees	6,308
Total Other Contributions	<u>70,658</u>
Investment income:	
Net increase (decrease) in fair value of investments	2,879,301
Interest	534,104
Dividends	136,145
Real estate operating income, net	30,968
Securities lending income, net	12,061
Total Investment Income	<u>3,592,579</u>
Less: Investment expense	70,786
Less: Securities lending expense	4,042
Net Investment Income	<u>3,517,751</u>
Total Additions	<u>5,825,740</u>
Deductions	
Benefit payments	2,944,681
Refunds	37,587
Administrative expenses	50,813
Self funding insurance costs	130,142
Healthcare premiums subsidies	223,352
Other deductions, net	239,923
Total Deductions	<u>3,626,498</u>
Change in Net Assets	2,199,242
Net Assets Held In Trust	
Net Assets at July 1	25,429,059
Net Assets at June 30	<u>\$ 27,628,301</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

COMPONENT UNITS FINANCIAL STATEMENTS

Major Component Units

Kentucky Housing Corporation

The Kentucky Housing Corporation was authorized under KRS Chapter 198A in 1972 to increase the supply of housing for persons of lower income by making and participating in insured construction loans. The Corporation also makes and participates in insured mortgage loans when financing is not available from private lenders under reasonable equivalent terms and conditions.

Kentucky Higher Education Student Loan Corporation

The Kentucky Higher Education Student Loan Corporation was empowered by KRS Chapter 164A to finance state and federally insured loans to students attending eligible post secondary institutions through direct loans to students and the purchase of student loans from lenders.

Universities, Colleges, and Related Entities

The Universities, Colleges, and Related Entities account for all transactions relating to the nine State-supported universities and the community colleges and technical schools. These institutions maintain their own financial records and are not part of the central accounting system operated by the Finance and Administration Cabinet. The major component units-universities, colleges, and related entities are:

University of Kentucky

University of Louisville

Kentucky Community and Technical College System

Non-Major Component Units

The non-major component units are presented beginning on page172

COMMONWEALTH OF KENTUCKY
STATEMENT OF NET ASSETS
COMPONENT UNITS
JUNE 30, 2010
(Expressed in Thousands)

	AUTHORITIES		
	Kentucky Housing Corporation	Kentucky Higher Education Student Loan Corporation	University of Kentucky
Assets			
Current assets:			
Cash and cash equivalents (Note 5)	\$ 69,040	\$ 25,149	\$ 448,967
Restricted cash (Note 5)	341,458		
Investments, net of amortization (Note 5)		564	6,404
Accounts receivable, net	5,945	1,057	221,102
Interest receivable		54,228	3,036
Inventories			25,934
Prepaid expenses		5,507	3,632
Other current assets	42,382	785,560	3,455
Total Current Assets	<u>458,825</u>	<u>872,065</u>	<u>712,530</u>
Noncurrent assets:			
Restricted cash (Note 5)		101,123	44,315
Long-term investments (Note 5)	861,167	7,398	149,858
Restricted long-term investments (Note 5)			793,505
Long-term receivables, net	1,370,543	1,661,307	51,446
Deferred charges	39,857	28,586	
Capital assets (Note 6):			
Land	1,089		63,883
Improvements other than buildings			146,724
Buildings	5,036		1,599,414
Machinery and equipment	4,600	14,081	744,507
Other capital assets			
Less: Accumulated depreciation and amortization	(6,272)	(13,805)	(1,224,235)
Construction in progress			443,562
Total Capital Assets	<u>4,453</u>	<u>276</u>	<u>1,773,855</u>
Other assets	15,457		19,132
Total Noncurrent Assets, Net	<u>2,291,477</u>	<u>1,798,690</u>	<u>2,832,111</u>
Total Assets	<u>2,750,302</u>	<u>2,670,755</u>	<u>3,544,641</u>
Liabilities			
Current liabilities:			
Accounts payable and accruals	49,358	27,858	191,318
Current portion of long-term debt:			
Notes payable (Note 15)	39,940	543,496	4,271
Bonds payable (Note 15)	51,525	950	13,665
Capital lease obligations (Note 10)			28,094
Compensated absences (Note 16)		2,019	507
Claims liability			
Deferred revenues			66,209
Payable from restricted assets			
Other current liabilities	52,366	103	29,554
Total Current Liabilities	<u>193,189</u>	<u>574,426</u>	<u>333,618</u>
Noncurrent liabilities:			
Notes payable (Note 15)		703,272	21,585
Bonds payable (Note 15)	2,188,952	1,216,460	240,445
Capital lease obligations (Note 10)			446,115
Compensated absences (Note 16)			4,822
Other long-term liabilities	33,644	80,774	108,079
Total Noncurrent Liabilities	<u>2,222,596</u>	<u>2,000,506</u>	<u>821,046</u>
Total Liabilities	<u>2,415,785</u>	<u>2,574,932</u>	<u>1,154,664</u>
Net Assets			
Invested in capital assets, net of related debt	4,453	276	1,047,225
Restricted for:			
Debt service	264,076	53,937	6,374
Capital projects			53,149
Other purposes (Note 1)	16,727		668,392
Unrestricted	49,261	41,610	614,837
Total Net Assets	<u>\$ 334,517</u>	<u>\$ 95,823</u>	<u>\$ 2,389,977</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

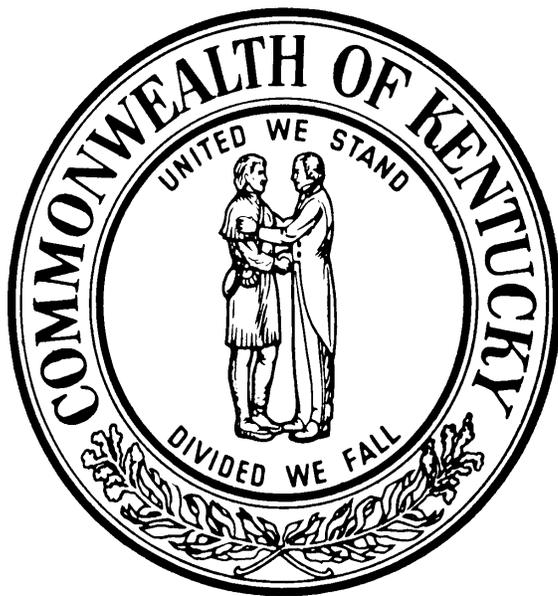
UNIVERSITIES, COLLEGES, AND RELATED ENTITIES			
University of Louisville	Kentucky Community and Technical College System	Non-Major Component Units	All Component Units Totals June 30, 2010
\$ 140,911	\$ 239,152	\$ 490,823	\$ 1,414,042
		30,403	371,861
41,757	38	260,859	309,622
74,110	31,194	205,885	539,293
	2,679	5,091	65,034
1,252		7,480	34,666
351	1,906	8,231	19,627
7,164		22,387	860,948
<u>265,545</u>	<u>274,969</u>	<u>1,031,159</u>	<u>3,615,093</u>
59,716	21,828	57,415	284,397
715,614	117,484	360,666	2,212,187
5,557		156,044	955,106
59,276	6,805	636,042	3,785,419
		2,821	71,264
75,009	24,286	86,926	251,193
8,743	10,155	98,197	263,819
931,594	656,989	2,140,854	5,333,887
408,229	162,377	399,243	1,733,037
		105,152	105,152
(570,775)	(327,275)	(1,202,576)	(3,344,938)
116,539	41,984	195,753	797,838
<u>969,339</u>	<u>568,516</u>	<u>1,823,549</u>	<u>5,139,988</u>
3,984		20,353	58,926
1,813,486	714,633	3,056,890	12,507,287
<u>2,079,031</u>	<u>989,602</u>	<u>4,088,049</u>	<u>16,122,380</u>
81,195	9,052	74,518	433,299
469		5,263	593,439
21,924		50,455	138,519
2,540	3,066	8,410	42,110
	11,095	23,137	36,758
		9,840	9,840
52,292	25,904	48,303	192,708
		6,438	6,438
11,965	22,729	16,756	133,473
<u>170,385</u>	<u>71,846</u>	<u>243,120</u>	<u>1,586,584</u>
31,701		26,271	782,829
288,313		767,494	4,701,664
20,509	22,694	87,204	576,522
		1,146	5,968
84,105	70,392	74,019	451,013
424,628	93,086	956,134	6,517,996
<u>595,013</u>	<u>164,932</u>	<u>1,199,254</u>	<u>8,104,580</u>
633,750	542,756	1,210,323	3,438,783
21,484		15,859	361,730
57,641	35,186	76,248	222,224
437,692	62,999	1,220,275	2,406,085
333,451	183,729	366,090	1,588,978
<u>\$ 1,484,018</u>	<u>\$ 824,670</u>	<u>\$ 2,888,795</u>	<u>\$ 8,017,800</u>

COMMONWEALTH OF KENTUCKY
STATEMENT OF ACTIVITIES
COMPONENT UNITS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	AUTHORITIES		
	Kentucky Housing Corporation	Kentucky Higher Education Student Loan Corporation	University of Kentucky
Expenses:			
Operating and other expenses	\$ 347,410	\$ 51,321	\$ 2,114,979
Depreciation			
Total Expenses	<u>347,410</u>	<u>51,321</u>	<u>2,114,979</u>
Program Revenues:			
Charges for services	185,237	63,476	1,365,667
Operating grants and contributions	204,236		470,786
Capital grants and contributions			44,046
Total Program Revenues	<u>389,473</u>	<u>63,476</u>	<u>1,880,499</u>
Net Program (Expense) Revenue	<u>42,063</u>	<u>12,155</u>	<u>(234,480)</u>
General Revenues:			
Unrestricted grants and contributions			99,357
Unrestricted investment earnings			513
Gain on sale of capital assets			
Miscellaneous general		914	311,506
Total General Revenues		<u>914</u>	<u>411,376</u>
Change in Net Assets	<u>42,063</u>	<u>13,069</u>	<u>176,896</u>
Net Assets at July 1, As Restated (Note 2)	292,454	82,754	2,213,081
Net Assets at June 30	<u>\$ 334,517</u>	<u>\$ 95,823</u>	<u>\$ 2,389,977</u>

THE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS ARE AN INTEGRAL PART OF THIS STATEMENT.

UNIVERSITIES, COLLEGES, AND RELATED ENTITIES			
University of Louisville	Kentucky Community and Technical College System	Non-Major Component Units	All Component Units Totals June 30, 2010
\$ 859,935	\$ 645,431	\$ 1,817,558	\$ 5,836,634
		2,725	2,725
<u>859,935</u>	<u>645,431</u>	<u>1,820,283</u>	<u>5,839,359</u>
433,034	107,009	668,652	2,823,075
172,813	86,621	426,318	1,360,774
		89,944	133,990
<u>605,847</u>	<u>193,630</u>	<u>1,184,914</u>	<u>4,317,839</u>
<u>(254,088)</u>	<u>(451,801)</u>	<u>(635,369)</u>	<u>(1,521,520)</u>
101,440	214,878	189,273	604,948
77,979	8,463	34,795	121,750
		267	267
<u>155,614</u>	<u>285,096</u>	<u>628,793</u>	<u>1,381,923</u>
<u>335,033</u>	<u>508,437</u>	<u>853,128</u>	<u>2,108,888</u>
80,945	56,636	217,759	587,368
1,403,073	768,034	2,671,036	7,430,432
<u>\$ 1,484,018</u>	<u>\$ 824,670</u>	<u>\$ 2,888,795</u>	<u>\$ 8,017,800</u>



NOTES TO FINANCIAL STATEMENTS

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Note 1

SIGNIFICANT ACCOUNTING POLICIES**A. Basis of Presentation**

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America for state governments as prescribed by the Governmental Accounting Standards Board (GASB) and the American Institute of Certified Public Accountants. The financial statements for the Universities, Colleges, and Related Entities Funds have been prepared according to standards established by GASB Statement 35.

B. Financial Reporting Entity

For financial reporting purposes, the Commonwealth of Kentucky includes all fund types, departments, and agencies of the Commonwealth, as well as boards, commissions, authorities, corporations, colleges, and universities. These organizational units comprise the reporting entity of the Commonwealth and are reported in accordance with GASB 14, as amended by GASB 39. Consequently, the reporting entity includes organizations that are not legally separate from the primary government and also those that are legally separate. Organizations not legally separate are reported as part of the primary government. Legally separate organizations are reported as component units if either the Commonwealth is financially accountable for the organization or when exclusion of the organization would cause the Commonwealth's financial statements to be misleading or incomplete.

Component units may be blended or discretely presented. Blended component units are those that either provide services exclusively or almost entirely to the primary government, or their governing bodies are substantively the same as that of the primary government. Amounts related to blended component units are included as if the component units were part of the primary government. All other component units are discretely presented, or shown separately from the primary government.

Audited financial statements are available for the following blended component units: Kentucky Lottery Corporation, Kentucky Retirement System, Kentucky Teachers' Retirement System, Judicial Form Retirement System, Kentucky Public Employees' Deferred Compensation Authority and the Turnpike Authority of Kentucky. Audited financial statements are available for all discretely presented component units except the Kentucky Agricultural Finance Authority, and the Kentucky Grain Insurance Corporation. (See pages 110 and 111 for a complete list of component units' addresses.)

Blended Component Units

The following legally separate organizations provide services entirely or almost entirely to the State or otherwise exclusively, or almost exclusively, that benefit the State, and therefore, these organizations' balances and transactions are reported as though they were part of the State's primary government by using the blending method.

Kentucky Lottery Corporation (KRS 154A.020)

The Kentucky Lottery Corporation is empowered by the Legislature to administer the Kentucky state lottery games. The board of directors is comprised of one ex officio member and seven members appointed by the Governor with the advice and consent of the Senate.

Kentucky Retirement System (KRS 61.645)

The Kentucky Retirement System administers the Kentucky Employees Retirement System, the County Employees Retirement System, and the State Police Retirement System. The board consists of the Commissioner of the Department of Personnel, five members elected by the retirement systems, and three members appointed by the Governor.

Kentucky Teachers' Retirement System (KRS 161.220)

The Kentucky Teachers' Retirement System is an independent agency and instrumentality of the Commonwealth. It provides pension benefit plan coverage to employees of local school districts and educational agencies of the State. The board includes two ex officio members and seven elected members.

Judicial Form Retirement System (KRS 21.530)

The Judicial Form Retirement System accounts for monies and securities, including contributions and earnings, which will be used to pay benefits to the members of the Legislators' Retirement Plan and the Judicial Retirement Plan. The board consists of eight members; three are appointed by the Supreme Court, two by the Governor, one by the President of the Senate, one by the Speaker of the House of Representatives, and one by the President and Speaker jointly.

Turnpike Authority of Kentucky (KRS 175.430)

The Turnpike Authority is a body corporate and politic. It was created solely to perform essential governmental functions and to serve the public purposes of constructing, acquiring, financing, and operating turnpike and other road projects for the use, safety, convenience and general welfare of the traveling public, by leasing such projects to the Transportation Cabinet. The Governor and six other ex officio members comprise the authority.

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Kentucky Public Employees' Deferred Compensation Authority
(KRS 18A.230 to 18A.275)

The Kentucky Employees' Deferred Compensation Authority administers two deferred compensation plans as authorized by sections 457 and 401(k) of the United States Internal Revenue Code. The plans are defined contribution plans with 762 participating employers. Under provisions of the Plans, employees of the Commonwealth and agencies thereof, including persons in the public school systems, universities, or local governments, are eligible to contribute on a pre-tax basis through payroll deductions. In no event shall the 457, 401(k) or Deemed IRA trust Funds be used for, or diverted to, purposes other than the exclusive benefit of the participants and beneficiaries or in the payment of the expenses of the Plans and Trust.

Kentucky School Facilities Construction Commission (KRS 157.617)

This commission is an independent corporate agency and instrumentality of the Commonwealth. The purpose of the commission is to assist local school districts in meeting the school construction needs of the Commonwealth in a manner that will ensure an equitable distribution of funds based upon unmet needs. One ex officio member and eight members appointed by the Governor comprise the commission.

Administrative Entities

The State Property and Buildings Commission, Kentucky Asset/Liabilities Commission, Kentucky Tobacco Settlement Trust Corporation, Kentucky Savings Bond Authority, Kentucky Gas Pipeline Authority, and the Board of Agriculture are legally separate entities of an administrative nature. They are comprised of elected and appointed officials from various state agencies, and have no cost associated with them. Therefore, there is no separate presentation for these entities.

State Property and Buildings Commission (KRS 56.450)

This commission is a public body corporate that issues all revenue bonds for state agencies, unless those agencies are specifically authorized by other provisions of the Kentucky Revised Statutes to issue bonds. The commission is composed of six ex officio members.

Kentucky Asset/Liability Commission (KRS 56.861)

This commission is a public body corporate that takes a comprehensive view of the Commonwealth's finances and develops policies and strategies to minimize the impact of fluctuating revenue receipts and interest rates on the Commonwealth's interest-sensitive assets and liabilities. The commission consists of five ex officio members.

Kentucky Tobacco Settlement Trust Corporation (KRS 248.480)

The Kentucky Tobacco Settlement Trust Corporation is a public body corporate that performs essential governmental and public functions by assisting in the implementation of the national tobacco grower settlement trust agreement. The board of directors is comprised of five ex officio members and nine members appointed by the Governor with the advice and consent of the Senate and House of Representatives.

Kentucky Savings Bond Authority (KRS 293.030)

This authority is a body corporate and politic that promotes investment by the general public in bonds of the Commonwealth and helps to reduce interest costs to the Commonwealth or its agencies. The authority consists of seven commissioners, three ex officio members and four members appointed by the Governor.

Kentucky Gas Pipeline Authority (KRS 353.752)

This authority is a body corporate and politic to provide a financing mechanism for projects that will increase severance tax revenue for Kentucky, create jobs for Kentuckians, and create a competitive advantage in environmentally responsible development. The authority consists of nine members, the Secretary of the Finance and Administration Cabinet, the Secretary of the Commerce Cabinet, the Secretary of the Environmental and Public Protection Cabinet, a member designated by the Kentucky Oil and Gas Association, a member designated by the Kentucky Society of Professional Engineers, a member designated by the Kentucky Gas Association, a citizen member appointed by the governor, and two legislative members.

Board of Agriculture (KRS 246.120)

This board is a body corporate that acts as an advisory board to the Commissioner of Agriculture, aids in the collection of information concerning crops, promulgates industrial information, and acts as an immigration committee. The board consists of five ex officio members and nine citizens of the Commonwealth appointed by the Governor.

Discretely Presented Component Units

The component units' column in the combined financial statements includes the data of the discretely presented component units described below. The component units are legally separate entities. However, there is a financial interdependence or the primary government controls the selections of the board and operations. They are reported together in a separate column to reflect that they are legally separate, but their interdependence requires that they be included as part of the reporting entity.

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Notes to Financial Statements

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Kentucky River Authority (KRS 151.710)

The Kentucky River Authority possesses the corporate powers that distinguish it as being legally separate from the Commonwealth. The authority is charged with developing comprehensive plans for the management of the Kentucky River Basin. The Governor appoints the twelve members of this authority. A financial benefit/burden exists between the Commonwealth and the Authority.

Kentucky Housing Corporation (KRS 198A.030)

The Housing Corporation is a body corporate and politic that performs essential governmental and public functions in improving and promoting the health and welfare of the citizens of the Commonwealth by the production of residential housing in Kentucky. The board of directors consists of six ex officio members and eight members appointed by the Governor. The Commonwealth has the ability to impose its will since it may appoint, hire, reassign or dismiss management responsible for operations.

Kentucky Higher Education Student Loan Corporation (KHESLC) (KRS 164A.050)

KHESLC is a body corporate and politic created to perform essential governmental and public functions and purposes in improving and promoting the educational opportunities of the citizens of the Commonwealth. The Corporation is governed by board of directors appointed by the Governor, as prescribed in KRS 164A.050. The Commonwealth provides operating support to the Corporation, creating a financial benefit/burden relationship.

Bluegrass State Skills Corporation (KRS 154.12-205)

This corporation attempts to improve and promote employment opportunities of the Commonwealth's citizens by assisting the Kentucky Cabinet for Economic Development in creating and expanding programs offering skills, training and education. The board of directors consists of six ex officio members and twelve members appointed by the Governor. The Commonwealth has the ability to impose its will and there also exists a financial benefit/burden relationship.

Kentucky State Fair Board (KRS 247.090)

This board is a body corporate that accounts for revenues earned and expenses incurred in the commercial operations of the State Fair Board. Three ex officio members and twelve members appointed by the Governor make up the fifteen-member board. The Commonwealth has the ability to impose it will and there also exists a financial benefit/burden relationship.

Kentucky Center for the Arts Corporation (KRS 153.410)

The Center for the Arts is a body corporate created by the General Assembly to promote the growth and development of the arts, convention trade, tourism and hotel industries within Jefferson County and the Commonwealth. The board consists of fifteen members appointed by the Governor. The Commonwealth provides significant operating support to the corporation, creating a financial benefit/burden relationship.

Kentucky Educational Television Authority (KET) (KRS 168.030)

KET is a public body corporate and politic that prescribes and enforces regulations governing the use of educational television and television facilities and related functions. KET also produces and transmits educational television programs. The authority consists of nine members. The Governor appoints five of these members. The board elects a liaison between the authority and the department on matters of curriculum. The Council on Postsecondary Education elects a representative of the University of Kentucky and a representative of the other state universities. The authority's members elect a chairman. A component unit of KET is the Kentucky Educational Television Foundation. The foundation is a non-profit Kentucky corporation that receives, holds and administers gifts and grants in the name of and with the approval of the authority. The Commonwealth provides significant operating support to the Authority, creating a financial benefit/burden relationship.

Kentucky Economic Development Finance Authority (KEDFA) (KRS 154.20-010)

KEDFA possesses the corporate powers necessary to distinguish it as legally separate from the Commonwealth. It was established to assist business enterprises in obtaining financial resources in order to promote the Commonwealth's long-term economic growth. The Kentucky Economic Development Partnership board appoints the five members of this authority. Additionally, other component units of the authority include The Kentucky Industrial Development Authority, the Kentucky Industrial Revitalization Authority, the Kentucky JOBS Development Authority, and the Kentucky Mortgage Insurance and Guarantee Corporation. The financial statements of the component units are combined with those of the authority. Commonwealth funds may be used for operating support to the Authority, creating a financial benefit/burden relationship.

Kentucky Higher Education Assistance Authority (KHEAA) (KRS 164.742)

This authority is a body corporate and politic that operates to improve the higher education opportunities of persons who are attending or planning to attend eligible institutions by insuring eligible student loans. The authority is governed by a board of directors consisting of 15 members appointed by the governor.

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Notes to Financial Statements

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KHEAA also oversees the Kentucky Educational Savings Plan Trust and the Commonwealth Postsecondary Education Prepaid Trust Fund, also known as Kentucky's Affordable Prepaid Tuition (KAPT), both of which are component units of KHEAA. Commonwealth funds are appropriated for program and operating support to the Authority, creating a financial benefit/burden relationship.

Kentucky Council on Postsecondary Education

(KRS 164.011)

This council was established in 1997 under the direction of the Kentucky Postsecondary Education Improvement Act. The board consists of 16 members—13 citizens appointed by the Governor, one faculty member, one student, and the Commissioner of Education. This council coordinates change and improvement in Kentucky's postsecondary education system. This council strives to increase literacy, improve work-related skills, and to raise the number of students attending college and completing college degrees. The Commonwealth provides significant operating support to the Council, creating a financial benefit/burden relationship.

Kentucky Infrastructure Authority (KRS 224A.030)

This authority is a body corporate and politic created to perform essential governmental functions and to serve the local public agencies of the Commonwealth with respect to the construction and acquisition of infrastructure projects. The board consists of five ex officio members and five members appointed by the Governor. The Commonwealth provides significant operating support to the Authority, creating a financial benefit/burden relationship.

Kentucky Agricultural Finance Corporation (KAFC) (KRS 247.944)

KAFC is a corporation that seeks to improve and promote the health and general welfare of the Commonwealth's people through the advancement of agriculture. The board of directors consists of three ex officio members and nine members appointed by the Governor. The Commonwealth provides significant operating support to the Corporation, creating a financial benefit/burden relationship.

Kentucky Grain Insurance Corporation (KGIC) (KRS 251.620)

KGIC is a body politic created to promote the Commonwealth's welfare by improving the economic stability of agriculture and protecting grain producers in the event of a financial failure of a grain dealer or warehouseman. The board of directors consists of four ex officio members and six members appointed by the Commissioner of the Department of Agriculture. The Commonwealth is responsible for any insufficiency of funds to pay claims creating a financial benefit/burden relationship.

Kentucky Health Care Improvement Authority (Kentucky Access) (KRS 304.17B-003)

The Kentucky Health Care Improvement Authority was created as a body corporate and politic and is funded by assessments on insurers, enrollment fees, and Tobacco Trust Funds. Consisting of 15 board members, this authority exists for administrative purposes in the Department of Insurance and administers the Kentucky Access program. Commonwealth funds are appropriated for program and operating support to the Authority, creating a financial benefit/burden relationship.

Kentucky Local Correctional Facilities Construction Authority (KRS 441.615)

This authority is a body corporate and politic created to provide an additional and alternative method of constructing, reconstructing, improving or repairing, and financing jails and appurtenant facilities for any local government in the Commonwealth. The membership consists of six ex officio members and four members appointed by the Governor. The Commonwealth provides funds, staff assistants, facilities and materials required by the Authority in the conduct of its duties and activities, creating a financial benefit/burden relationship.

Appalachian/Kentucky Artisans Gateway Center Authority (The Kentucky Artisan Center) (KRS 148.561)

This authority is an independent, de jure municipal corporation and is a body corporate and politic. It is governed by a board of directors consisting of thirteen members. The authority operates and manages the Kentucky Artisan Center at Berea. The Commonwealth provides significant operating support to the Authority, creating a financial benefit/burden relationship.

Kentucky Horse Park Foundation, Incorporated

This foundation is a legally separate tax-exempt Kentucky corporation that receives, holds, and administers gifts and grants in the name of the Kentucky Horse Park (the Park). Although the Park does not control the timing or amount to receipts from the Foundation, the majority of resources or income thereon that the Foundation holds and invests is restricted by the donors to the activities of the Park. The Foundation's fiscal year ended May 31, 2009 and amounts included are for the year then ended. The Commonwealth provides significant operating support to the Foundation, creating a financial benefit/burden relationship.

Universities, Colleges, and Related Entities (KRS 164.350)

Each board of regents or board of trustees is appointed by the Governor, and constitutes a body corporate with the power to receive and administer revenue and property. Commonwealth funds are appropriated for program and operating support to these entities, creating a financial benefit/burden relationship.

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C. Government-Wide Financial Statements

Government-Wide Financial Statements - The Statement of Net Assets and Statement of Activities report information on all governmental and business-type activities of the primary government and its non-fiduciary component units. Governmental activities are generally characterized by their use of taxes, intergovernmental revenues, and other non-exchange revenues as funding sources. Business-type revenues come mostly from fees charged to external parties for goods or services. Fiduciary funds and fiduciary component units are not included in government-wide financial statements due to the unavailability of fiduciary funds to aid in the support of government programs.

The government-wide statements are reported using the economic resources measurement focus and the accrual basis of accounting, as are the proprietary and pension and other employee benefit trust fund financial statements. Revenues are recognized when earned and expenses are recorded when a liability is incurred, regardless of the timing of cash flows. Therefore, deferred revenues are only reported for receipts of prepayments or revenues collected in advance (unearned revenues). Property taxes are recognized as revenues in the year for which they are levied. Grants and similar items are recognized as revenues once provider-imposed eligibility requirements have been met.

The **Statement of Net Assets** presents the reporting entity's non-fiduciary assets and liabilities with the difference between the two shown as net assets. Net assets are reported in three categories:

- (1) **Invested in capital assets, net of related debt**, consist of capital assets, net of accumulated depreciation and further reduced by debt net of cash balances, for debt related to the acquisition, construction, or improvement of those assets.
- (2) **Restricted net assets** result from constraints placed on net assets by creditors, grantors, contributors, and other external parties, including those constraints imposed by law through constitutional provisions or enabling legislation.
- (3) **Unrestricted net assets** are those net assets that do not meet the definition of restricted net assets or invested in capital assets.

When restricted assets and unrestricted assets are both available for a particular purpose, the Commonwealth's objective is to use any restricted funds first, since unrestricted funds are available for any purpose and provide for greater financial flexibility. If the rules governing restricted assets are met, restricted assets may be the only funds used. However, there may be instances in which restricted funds may only be spent in proportion to unrestricted funds spent. Assets shown as restricted for "other purposes" for the Primary Government and Component Units are as follows:

Restricted Net Assets

(Expressed in Thousands)

Restricted for Other Purposes:	<u>Primary Government Business Type Activities</u>	<u>Major Component Units</u>
Loans	\$	\$ 29,990
Education		112,111
Instruction		103,685
Scholarships and Fellowships		196,296
Research		272,831
Claims	6,931	
Other		470,897
Totals	<u>\$ 6,931</u>	<u>\$ 1,185,810</u>

A significant feature of the government-wide **Statement of Activities** is the presentation of each program's net cost. GAAP require the reporting of a program's net cost to indicate how self-sustaining the program is and to reveal the extent of reliance on other governmental units. Net cost is obtained by subtracting program expenses from program revenues. Program expenses are those costs attributable to a particular function including certain indirect costs. GAAP permit both direct and indirect program expenses to be presented together in an "Expenses" column. Therefore, indirect expenses are not specifically identified with individual functions and activities.

Program revenues are resources that derive directly from the program itself or from parties outside the government that reduce the total expense of the benefiting functional activity to arrive at the net expense of the activity. The Statement of Activities categorizes program revenues into three groups: charges for goods, services, and other benefits; operating grants and contributions; and capital grants and contributions. Revenues not considered program revenues are classified as general revenues. General revenues include all taxes regardless of type. The sales and gross receipts taxes reflected on the statement of activities for the governmental activities include various taxes that are computed using sales price or gross receipts of the reporting entity. For fiscal year 2010, the total amount of sales and gross receipts tax reported in the entity wide statements was \$4,880,831,000 and comprised of:

**Sales and Gross Receipts Tax
(Expressed in Thousands)**

Sales and Use Tax	\$	2,830,061
Motor Fuels Tax		655,245
Motor Vehicles Usage Tax		334,208
Healthcare Provider Tax		292,564
Tobacco Products Tax		303,019
Insurance Premiums Tax		130,199
Limited Liability Entity Tax		150,767
Alcoholic Beverage Tax		111,561
Telecommunications Tax		64,342
Transient Room Tax		8,196
Parimutuel and Race Track Admission Tax		669
Total Sales and Gross Receipts Tax	<u>\$</u>	<u>4,880,831</u>

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D. Fund Financial Statements

Primary Government - The accompanying financial statements are structured into three fund categories including governmental funds, proprietary funds, and fiduciary funds. Funds are characterized as either major or non-major. Major funds are those funds whose assets, liabilities, revenues, or expenditures/expenses are at least ten percent of the corresponding total (assets, liabilities, etc.) for all funds of that category or type (governmental or enterprise funds), and whose total assets, liabilities, revenues, or expenditures/expenses are at least five percent of the corresponding total for all governmental and enterprise funds combined. The Commonwealth's major funds are identified herein.

Governmental Funds

All governmental fund statements are accounted for on the modified accrual basis of accounting and focus on the flow of current financial resources. In accordance with the modified accrual basis of accounting, revenues are recognized when they become both measurable and available to finance expenditures of the fiscal period. Revenues are considered to be available when they are either collected within the current period or their collection is expected shortly after the end of the current period in time to meet current liabilities. The State generally includes those revenues to be received up to 30 days following the end of the accounting period. Revenues expected to be collected after 30 days beyond the end of the accounting period are considered unavailable and are reported as deferred revenues. Deferred revenues also include amounts received but unearned as of June 30.

Principal revenue sources accounted for on the modified accrual basis include federal grants, sales and use tax, coal severance tax, property tax, departmental fees, income taxes, and interest income. Motor vehicle registration fees and fines and forfeitures are accounted for on the cash basis. Generally and except as otherwise provided by law, property taxes are assessed as of January 1, levied (mailed) September 15, due at discount November 1, due at face value December 31, delinquent January 1 following the assessment, and subject to lien and sale February 1 following the delinquency date.

In governmental funds, where the focus is on the flow of current resources, expenditures are usually recorded at the time liabilities are incurred. Exceptions are: inventories, prepayments, and acquisition of capital assets which are recorded at the time of acquisition; and principal and interest on long-term debt, as well as compensated absences which are recorded as expenditures in the period payment is made.

A description of major governmental funds follows:

General Fund - a major fund that accounts for financial resources appropriated by the General Assembly which are not required to be accounted for in another fund.

Special Revenue Funds - a category of governmental funds that accounts for specific revenue sources, other than for major capital projects, dedicated to specific operations.

Included in this category are the transportation fund, federal fund, and agency revenue fund.

Transportation Fund - a major fund that accounts for activities related to the preservation and maintenance of roads.

Federal Fund - a major fund that accounts for monies received from the federal government to be spent on specific programs and operations.

Agency Revenue Fund - a major fund that accounts for revenues and expenditures of restricted taxes, fees, and charges related to a particular function or activity.

Capital Projects Fund - a major fund that accounts for financial resources appropriated by the General Assembly for the acquisition, construction, or renovation of major capital facilities, and for the acquisition of major equipment, other than those financed by proprietary funds and certain trust funds.

Debt Service Fund - a major fund used to account for the accumulation of resources used for the repayment of general long-term obligations principle, interest, and related administrative costs.

Proprietary Funds

Proprietary funds use the full accrual basis of accounting, recognizing revenues and expenses when they occur, regardless of the timing of the cash flows. On the statement of revenues, expenses, and changes in net assets, the term "expenses" (not "expenditures" as in governmental funds on a modified accrual basis) describes decreases in economic benefits and emphasizes the accrual basis of accounting.

Proprietary funds' revenues and expenses are divided into operating and nonoperating revenues and expenses. Although not specifically defined by GAAP, operating revenues and expenses are considered to be those resources gained and consumed to produce and deliver goods and services that are central to that fund's particular purpose. Other revenues and expenses are classified as nonoperating. Operating and nonoperating expenses are further characterized by object (personal services, depreciation expense, travel expense, etc.).

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Furthermore, the Commonwealth has adopted the provisions of GASB Statement No. 20, "Accounting and Financial Reporting for Proprietary Funds and Other Governmental Funds that use Proprietary Fund Accounting." As permitted by GASB Statement No. 20, the primary government's enterprise funds have elected not to adopt FASB Statements or Interpretations issued after November 30, 1989, unless the GASB specifically adopts such FASB Statements or Interpretations. Each proprietary component unit has individually made this election as disclosed in the separate audit reports.

Enterprise Funds - a category of proprietary funds used to account for those public corporations empowered by the Kentucky Revised Statutes (KRS) to provide certain services to the citizens of the Commonwealth and the operations of State agencies that provide goods or services to the general public on a user charge basis. Also included are the operations of the State's risk management pools.

State Parks Fund - a major fund that accounts for revenues earned and expenses incurred in the commercial operations of the Department of Parks.

Kentucky Lottery Corporation - a blended component unit presented as a major fund, empowered by KRS 154A to administer the Kentucky state lottery, created pursuant to amended Section 226 of the Constitution of Kentucky as ratified by the voters of the Commonwealth.

Kentucky Horse Park Fund - a major fund that accounts for revenues earned and expenses incurred in the commercial operations of the Kentucky Horse Park.

Insurance Administration Fund - a major fund that accounts for insurance risk pools operated by the State, including the Workers' Compensation Special Fund, Coal Workers' Pneumoconiosis Fund, Petroleum Storage Tank Environmental Assurance Program, Mine Subsidence Insurance Program, and Bond Pool Program.

Kentucky Public Employees Health Plan - a major fund that accounts for the revenues and expenses incurred in the commercial operation of the health insurance program for state employees, teachers, and retirees.

Unemployment Compensation Fund - a major fund that accounts for assessed employer contributions collected and related unemployment compensation payments to recipients.

Internal Service Funds - a category of proprietary funds that accounts for financing goods and services provided by one agency of the Commonwealth primarily to other agencies or governments on a cost reimbursement basis. All of the proprietary funds (where the measurement focus is on the flow of economic resources) are accounted for on the accrual basis of accounting. Accordingly, revenues are recognized when they are both earned and measurable. Expenses are recognized at the time liabilities are incurred.

Since internal service funds usually exist to support governmental activities, they are normally included as part of the governmental activities reported in the government-wide statements, rather than being presented separately.

Specific activities reported under Internal Service Funds are:

1. Management/maintenance of State motor vehicle fleet
2. Industrial prison operations
3. Rental and maintenance operations for buildings
4. Computer and related data processing services
5. Printing services
6. Fire and tornado insurance programs
7. State workers' compensation program
8. Transportation Cabinet self-insured workers' compensation trust program

Fiduciary Funds

Fiduciary funds are defined as funds used to report assets held in a trustee or agency capacity for others and which, therefore, cannot be used to support the government's own programs. This category of funds includes pension (and other employee benefit) trust funds, investment trust funds, and agency funds. The Commonwealth's fiduciary fund types are described below.

Pension and (Other Post Employment Benefit) Trust Funds - account for monies received for, expenses incurred by, and net assets available for plan benefits of the various public employee retirement systems. This fund type also accounts for monies held in deferred compensation plans. Pension Trust Funds are accounted for on the accrual basis of accounting and reported in the same manner as proprietary fund types.

Agency Funds - account for monies held by the Commonwealth for custodial purposes only. Unlike other funds, the agency fund reports assets and liabilities only; therefore, it has no measurement focus. However, the agency fund uses the accrual basis of accounting when recognizing payables and receivables.

Specific activities listed under the Commonwealth's Agency Funds are:

1. Commonwealth Choice benefit spending accounts
2. Special Deposit Trusts holding monies for specific purposes
3. County Fees Fund holding monies for Kentucky Counties with a population of 70,000 or more

As discussed previously, because the fiduciary fund resources are not available to support government programs, fiduciary funds (and component units that are fiduciary in nature) are excluded from the government-wide financial statements. Inclusion of these funds would create a misleading view of the government's position and results of activities.

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E Presentation of Component Units

Presentation of the underlying fund types of the individual component units (described previously) reported in the discrete column is available from each respective component unit's separately issued financial statements.

The Major Discretely Presented Component Units, including Universities and Colleges are:

- Kentucky Community and Technical College System
- Kentucky Housing Corporation
- Kentucky Higher Education Student Loan Corporation
- University of Kentucky
- University of Louisville

The Non-Major Discretely Presented Component Units, including Universities, Colleges, and Related Entities are:

- Kentucky Agricultural Finance Corporation
- Kentucky Artisan Center at Berea
- Kentucky Center for the Arts Corporation
- Kentucky Economic Development Finance Authority
- Kentucky Educational Television Authority
- Kentucky Grain Insurance Corporation
- Kentucky Horse Park Foundation
- Kentucky Higher Education Assistance Authority
- Kentucky Infrastructure Authority
- Kentucky Local Correctional Facilities Construction Authority
- Kentucky River Authority
- Kentucky State Fair Board
- Bluegrass State Skills Corporation
- Kentucky Council on Postsecondary Education
- Kentucky Access
- Eastern Kentucky University
- Kentucky State University
- Morehead State University
- Murray State University
- Northern Kentucky University
- Western Kentucky University

The Commonwealth has significant transactions with its component units, primarily in providing operating funds to the universities from the State's general fund. During fiscal year 2010, the primary government provided \$293,887,000 to the University of Kentucky, \$200,554,700 to the Kentucky Community and Technical College System, \$169,896,400 to the University of Louisville, and \$185,276,450 to the Kentucky Higher Education Assistance Authority. In addition, the State received \$211,589,563 in proceeds from the Kentucky Lottery Corporation.

F Cash and Cash Equivalents

In addition to amounts held in bank accounts, cash on hand, and imprest cash, this classification includes short-term investments with an original maturity of 90 days or less (from date of purchase). Cash equivalents are generally stated at cost, which approximates market. Deferred Compensation amounts are reported at fair value. Short-term investments classified as cash equivalents at June 30, 2010 are \$1,774,867,344.

G Investments

This classification includes long-term investments that are stated at fair value. Investments of the Deferred Compensation Plan are reported at fair value. See Note 5 for investment details.

H Securities Lending

Cash and securities received as collateral on securities lending transactions are reported as assets in the accompanying financial statements. Liabilities resulting from the securities lending transactions are also reported. Certain component units of the state have deposits in the Commonwealth's Investment Pool, which participates in securities lending activities. The component units' position in the pool and related securities lending assets and liabilities are reported in an agency fund.

I Receivables

Receivables in the Commonwealth's governmental and fiduciary funds primarily consist of Federal revenues, taxes, and interest on investments. Some governmental fund revenues are not susceptible to accrual prior to receipt, including licenses, fees, permits, and similar revenues that are recognized on the cash basis. Receivables in all other funds have arisen in the ordinary course of business. Receivables in the governmental funds are reported net of allowances for uncollectibles. Disaggregation of current accounts receivable and current taxes receivable are shown in Note 4.

J Interfund Transactions

The Commonwealth has the following types of interfund transactions: Interfund services provided and used - Charges for services rendered by one fund to another are treated as revenues of the recipient fund and expenditures or expenses of the disbursing fund.

Reimbursements - Reimbursement of expenditures made by one fund for another are recorded as expenditures in the reimbursing fund and as a reduction of expenditures in the reimbursed fund.

Transfers presented in the fund financial statements represent the flow of assets (such as goods or cash) without equivalent flow of

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assets in return or requirement of repayment. In addition, transfers are recorded when a fund receiving revenue provides it to the fund that expends the resources.

The composition of the interfund transactions is presented in Note 7. Note that at the entity-wide level, the majority of interfund activity has been eliminated. This is to avoid the “doubling up” of such transactions so that revenues and expenses will not be reported more than once.

Transfers and receivables and payables between governmental activities and business-type activities have not been eliminated. Also, remaining are the results of activities between different functional categories. For example, services provided and used are not eliminated because doing so would misstate the expenses of purchasing function and the program revenues of the selling function.

K. Inventories and Prepaid Expenses

Inventories in the governmental funds and similar trust funds consist of expendable supplies held for consumption, the costs of which are recorded as an expenditure at the time of purchase.

Prepaid expenses, including the prepayment of services to vendors (e.g., prepaid insurance), are recorded similarly in the governmental fund statements.

Reserves of fund balance have been established for the inventory balances for governmental funds. Inventories in the proprietary funds and similar trust funds consist of both expendable supplies held for consumption and the cost of goods held for resale, the costs of which are recorded as an expense as they are used.

Inventories are valued at cost (first-in, first-out, or average cost). In the Governmental Activities column of the government-wide Statement of Net Assets, inventory and prepaid expenses are reported as an asset at cost when purchased, then expensed as used.

L. Capital Assets and Depreciation

Included in capital assets are real property, equipment, intangible assets and infrastructure (e.g. roads, bridges, sidewalks and similar items). These are reported in the government-wide statement of net assets, as governmental or business type activities. Capital assets are expensed at the time of acquisition in the fund financial statements for governmental and similar trust funds.

The policy of the primary government is to capitalize assets when the useful life is greater than one year and the acquisition cost meets the capitalization threshold. The primary government capitalizes all land and infrastructure. Buildings, improvements to land, and equipment are capitalized when the acquisition cost is \$5,000 or greater. Intangible capital assets are capitalized when the cost is \$100,000 or more except

software which has a threshold of \$500,000. Component units establish their own capitalization policy and that policy may vary from that of the primary government.

The Kentucky Historical Society, Kentucky Horse Park and Kentucky Department of Parks hold and care for the State’s historical treasures. Among these are historical clothing; china; furniture and other furnishings; a variety of art and decorative art; political memorabilia; pioneer tools and equipment; guns and similar military artifacts; books, manuscripts, and photographs; musical instruments from Kentucky’s musical legends; Native American artifacts; fossilized bones and prehistory artifacts. These assets are not capitalized or depreciated as the assets could not be valued and have inexhaustible useful lives.

The primary government values capital assets at historical cost, estimated historical cost or fair market value at the time of donation. The estimate of historical cost for the primary government was based on appraised value as of June 30, 1986, indexed to the date of acquisition.

Assets are depreciated on the straight-line basis over their estimated useful lives. The table below shows the useful life by asset type for the primary government. Infrastructure assets are not being depreciated, as the Commonwealth has elected to use the modified approach, as defined by GASB statement 34. As a result, certain maintenance and preservation costs are expensed when incurred. Additions and improvements to infrastructure assets are capitalized when capacity and efficiency has increased.

Asset	Useful Life (Expressed in Years)
Land improvements	10-60
Buildings	10-75
Machinery and equipment	3-25
Infrastructure	20-40
Intangibles	2-40

It is the Commonwealth’s policy to capitalize interest expense incurred on significant assets in proprietary funds during their construction in accordance with FASB 62.

The Kentucky Center for the Arts Corporation’s discretely presented component unit financial statements for Fiscal Year 2010 do not contain the Center’s capital assets. The Finance and Administration Cabinet, Office of Statewide Accounting Services, Financial Reporting Branch, adjusted the Commonwealth of Kentucky’s Comprehensive Annual Financial Report to include the capital assets and depreciation of the Center in order to satisfy GAAP requirements.

M. Fund Equity Reserves and Designations

The Commonwealth's fund balance reserves represent those portions of fund balance (1) not appropriate for expenditure, or (2) legally segregated for a specific future use. Designated portions of fund balance represent tentative managerial plans for financial resource utilization in a future period.

N. Deferred Revenue

Deferred revenues are treated as liabilities in the governmental funds until all requirements for revenue recognition are met.

O. Long-Term Obligations

Long-term liabilities that will be financed from governmental funds are presented in the Governmental Activities column of the government-wide Statement of Net Assets. This total reported amount of long-term liabilities includes the following:

1. Payments of principal on revenue bonds which are recorded as expenditures in the Debt Service Fund.
2. Compensated absences includes accumulated unpaid vacation and compensatory time accruals. The amount accruing to proprietary funds and pension trust funds has been included in the respective funds when material. The policy of the Commonwealth is to record the cost of annual and compensatory leave. Annual leave is accumulated at amounts ranging from 7.5 to 15.0 hours per month, determined by length of service, with maximum accumulations ranging from 30 to 60 days. The calendar year is the period used for determining accumulated leave. Compensatory leave is granted to authorized employees on an hour-for-hour basis. June 30 estimated liabilities for both annual leave and compensatory leave are summarized in Note 16.

Sick leave for the Primary Government is earned one day per month with unlimited accumulation. All of the qualifying retiring employees' sick leave balances, expressed in months, shall be added to their service credit for the purpose of determining their annual retirement.

There is no liability in the accompanying financial statements for unpaid accumulated sick leave, since it is the Commonwealth's policy to record the cost of sick leave only when paid. See Note 16 for disclosure of the amount of this contingency. The component units have varying policies for compensated absences. Information regarding these policies is available in the audited financial statement of each component unit.

3. Outstanding capital lease obligations for governmental funds.
4. Judgments and contingent liabilities of governmental funds that will be paid with noncurrent resources.
5. Long-term liabilities of internal service funds.

Long-term obligations generally exclude those amounts reported as expenditures for compensated absences, judgments, contingencies, and employer pension contributions in the governmental funds since these amounts would normally be liquidated with expendable available financial resources.

Long-term liabilities of all proprietary and pension trust funds are reported in their individual fund statements. Long-term liabilities of enterprise and internal service funds are also presented in the government-wide Statement of Net Assets as a single total in the Business-type Activities and Governmental Activities columns respectively. Fiduciary funds' long-term liabilities are not displayed on the government-wide Statement of Activities.

P. Conduit Debt

This debt may take the form of certain types of limited-obligation revenue bonds, certificates of participation, or similar debt instruments issued to benefit a third party that is not a part of the reporting entity. Although conduit debt obligations bear the Commonwealth's name as issuer, the Commonwealth has no obligation for such debt beyond the resources provided by a lease or loan with the third party on whose behalf it is issued. GAAP allow the State to refrain from reporting the conduit debt and the related asset. Since the State is not legally, morally, or in any other way responsible for the repayment of conduit debt, these items are not included in the financial statements. The State has \$2,691,131,905 of conduit debt, the proceeds of which are used to promote the purposes set forth in KRS 103.200 and 103.210.

Note 2

CHANGES IN ACCOUNTING PRINCIPLES, REPORTING PRACTICES, AND PRIOR-PERIOD ADJUSTMENTS

The fund balances/net assets as previously reported have been restated or reclassified to conform to generally accepted accounting principles and to correct balances for erroneously recorded transactions.

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Governmental Activities - Beginning net assets for the Commonwealth's governmental activities have been restated to include amounts which were omitted in the prior year. This includes a decrease in net assets of \$785,618,000 for the inclusion of Kentucky School Facilities Construction Commission as a blended component unit, an increase in net assets of \$9,647,000 for the implementation of GASB 51, "Accounting and Financial Reporting for Intangible Assets", and an increase of \$886,000 for prior period errors. The net effect is a decrease of \$775,085,000

Business Type Activities - Beginning net assets for the Commonwealth's business type activities have been restated for the reason noted below in the section for Enterprise Funds. The net effect is a decrease of \$2,780,000.

Agency Revenue Fund - The Agency Revenue Fund was restated for prior period errors. The effect on fund balance is a net increase of \$886,000.

Enterprise Funds - The Insurance Administration Fund within the Enterprise Funds was restated for prior period errors. The effect on net assets is a decrease of \$2,780,000.

Non-Major Governmental Funds:

Kentucky School Facilities Construction Commission-Special Revenue Fund - The Construction Commission had a fund balance increase of \$14,902,000. The School Facilities Construction Commission was previously reported as a discretely presented component unit. After reevaluation it was determined that the School Facilities Construction Commission meets the requirements to be reported as a blended component unit. The effect on fund balance is an increase of \$14,902,000 on non-major governmental funds.

Component Units - Authorities:

Kentucky Housing Corporation - The Housing Corporation restated net assets with the implementation of a new accounting principle. The net effect on net assets was a decrease of \$3,321,000.

Kentucky School Facilities Construction Commission - The School Facilities Construction Commission was determined to be a blended component unit rather than a discretely presented component unit. The effect on net assets is an increase of \$801,118,000.

Kentucky State Fair Board - The State Fair Board restated net assets with the implementation of a new accounting principle. The net effect on net assets was an increase of \$516,000.

Kentucky Agriculture Finance Corporation - The Agriculture Finance Corporation restated net assets for a prior period error. The effect on net assets is an increase of \$279,000.

Component Units - Universities, Colleges, and Related Entities:

Western Kentucky University - Western Kentucky University restated net assets for a prior period adjustment on a pledge receivable recorded by their Foundation. The effect on net assets is a decrease of \$806,000.

Restatement of all Component Units-Universities, Colleges, and Related Entities results in an overall increase in net assets of \$797,786,000.

Note 3

STEWARDSHIP, COMPLIANCE, AND ACCOUNTABILITY

- A. Federal Funds** - The Federal Fund has a fund balance deficit of \$64,445,000. The deficit is a result of expenditure accruals, which will be funded in future periods.
- B. Enterprise Funds** - The Insurance Administration Fund has a net assets deficit of \$633,783,000. The accumulated claims liability is estimated by actuarial methods for the risk pools, which will be funded in future periods. The Unemployment Compensation Fund has net assets deficit of \$611,103,000, due to an increase in demand for unemployment insurance payments.
- C. Internal Service Funds** - The Risk Management Fund has a net assets deficit of \$131,410,000. The deficit is the result of accumulated claims liabilities of the Commonwealth's self-insured workers' compensation programs, and is to be funded in future periods.
- D. Component Units - Authorities** - The Kentucky Local Correctional Facilities Construction Authority has a net assets deficit of \$4,048,000 resulting from the recognition of loan commitments before financing was arranged. The Authority will issue bonds to satisfy these commitments in the future. Kentucky Access has a net assets deficit of \$1,834,000 resulting from accumulated claims liabilities that are to be funded in future periods. The Bluegrass State Skills Corporation has a net assets deficit of \$23,000 resulting from the recognition of a long-term compensated absence liability.

Note 4

DISAGGREGATION OF ACCOUNTS PAYABLE AND ACCOUNTS RECEIVABLE

Accounts payable for the Commonwealth of Kentucky are amounts owed by the State as of June 30, 2010. Those liabilities that must be paid within one year are considered current. Amounts due after one year are deemed noncurrent accounts payable. Accounts receivable are amounts owed to the State. Similar to accounts payable, any amounts to be received within one year are classified as current. All other receivables are noncurrent. For Governmental Activities and Business-Type Activities, the line indicating "Accounts Payable" and "Net Receivables" are described below.

Amounts reported as "Taxes Receivable" are significant to the State. Taxes receivable report those tax amounts owed to the Commonwealth of Kentucky that remain uncollected as of June 30, 2010. All receivables are reported net of an Allowance for Uncollectibles to reflect the true value of receivables. Fines, forfeitures, and license fees are recognized as revenue when received and, therefore, do not require the recognition of accounts receivable. The "Current Taxes Receivable" for Governmental Activities and Business-Type Activities are described below.

Under the modified accrual basis of accounting, as used in the fund statements, amounts outstanding but owed at the end of the year may be recorded in one of two ways. If the receivable is measurable and expected to be collected within 30 days, revenue is recognized. However, if the receivable is not expected to be collected within 30 days, it is not considered to be available to liquidate the liabilities of the current period and will be reported as deferred revenue. Furthermore, unearned revenue is always reported as deferred revenue. Deferred revenue is reported as a liability until meeting the criteria for revenue recognition.

The State Property and Buildings Commission has issued revenue bonds and the Kentucky Asset Liability Commission has issued notes and entered into lease agreements to finance capital projects for the University of Kentucky, Kentucky State Fair Board, Kentucky Higher Education Assistance Authority and Eastern Kentucky University. The bond issues are shown as liabilities of the State Property and Buildings Commission in the entity wide financial statements. A capital lease liability is reflected in the financial statements of the various discretely presented component units, for which the debt was issued and a corresponding capital lease receivable has been recorded in the financial statements of the Commonwealth to accurately reflect the transaction. Amounts due under these lease agreements are reflected in the following table.

**Disaggregation of Payables and Receivables
(Expressed in Thousands)**

	Governmental Activities			Total Governmental Activities	Business-Type Activities	Total Primary Government
	Major Funds	Non-major Funds	Internal Service Funds		Major Funds	
Current Payables						
Personal services	\$ 137,639	\$ 571	\$ 2,499	\$ 140,709	\$ 32,779	\$ 173,488
Utilities, rental and other services	30,923	1,042	1,107	33,072	1,057	34,129
Commodities and supplies	23,469	183	652	24,304	1,983	26,287
Grants and subsidies	978,408	15,590		993,998	42,033	1,036,031
Capital outlay	82,912	59	392	83,363	89	83,452
Travel	1,570	12	4	1,586	15	1,601
Interest Payable	107,964	12	22	107,998		107,998
Other	748	68		816	2,585	3,401
Total Current Payables	<u>\$ 1,363,633</u>	<u>\$ 17,537</u>	<u>\$ 4,676</u>	<u>\$ 1,385,846</u>	<u>\$ 80,541</u>	<u>\$ 1,466,387</u>
Current Receivables						
Charges for services	\$ 41,346	\$ 18,136	\$ 528	\$ 60,010	\$ 81,164	\$ 141,174
Taxes receivable	1,985,789	24,465		2,010,254		2,010,254
Investment receivable	3,943	1,002		4,945	61	5,006
Intergovernmental revenue	999,700	1		999,701	101,638	1,101,339
Other	103,312	14,835		118,147	61,337	179,484
Allowances for uncollectables	(1,069,063)	(20,473)		(1,089,536)	(9,107)	(1,098,643)
Total Current Receivables	<u>\$ 2,065,027</u>	<u>\$ 37,966</u>	<u>\$ 528</u>	<u>\$ 2,103,521</u>	<u>\$ 235,093</u>	<u>\$ 2,338,614</u>

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Taxes Receivable
(Expressed in Thousands)

Current Taxes Receivable

	Governmental Activities		Total Primary Government
	Major Funds	Non-Major Funds	
Sales and gross receipts	\$ 973,740	\$ 2,806	\$ 976,546
Individual income	726,649		726,649
Corporate	54,947		54,947
Property	136,493		136,493
License and privilege	1,511	4,458	5,969
Coal severance	74,579		74,579
Inheritance and estate	8,449	426	8,875
Miscellaneous	9,421	16,775	26,196
Total Current Taxes Receivable	\$ 1,985,789	\$ 24,465	\$ 2,010,254

The State Property and Buildings Commission has issued revenue bonds and the Kentucky Asset Liability Commission has issued notes and entered into lease agreements to finance capital projects for the University of Kentucky, Kentucky State Fair Board, Kentucky Higher Education Assistance Authority and Eastern Kentucky University. The bond issues are shown as liabilities of the State Property and Buildings Commission in the entity wide financial

statements. A capital lease liability is reflected in the financial statements of the various discretely presented component units, for which the debt was issued and a corresponding capital lease receivable has been recorded in the financial statements of the Commonwealth to accurately reflect the transaction. Amounts due under these lease agreements are reflected in the following table.

Future debt service payments for leases receivable as of June 30, 2010, are as follows (Expressed in Thousands):

	Principal	Interest	Total
2011	\$ 19,821	\$ 19,532	\$ 39,353
2012	20,566	18,764	39,330
2013	21,432	17,901	39,333
2014	22,412	16,916	39,328
2015	23,457	15,867	39,324
2016-2020	130,718	61,651	192,369
2021-2025	122,388	30,614	153,002
2026-2030	65,196	5,251	70,447
Total leases receivable	\$ 425,990	\$ 186,496	\$ 612,486

Note 5

**EQUITY IN POOLED CASH AND INVESTMENTS,
CASH, AND INVESTMENTS**

The Commonwealth maintains an internal cash and investment pool that is available for use by all funds under the auspices of the State Investment Commission as authorized under KRS 42.500 et al. In addition, investments are separately held by several of the State's funds and component units. Legally authorized investments vary by fund but generally include: obligations of or guaranteed by the United States; obligations of any corporation of the United States Government; asset backed securities; U.S. dollar denominated corporate securities; collateralized certificates of deposit; bankers' acceptances; commercial paper; and repurchase agreements. In addition to these, pension plans and certain Component Units are permitted to purchase common stocks, corporate bonds and real property and mineral rights. The Commonwealth is also eligible to invest in reverse repurchase agreements.

PRIMARY GOVERNMENT

Custodial Credit Risk-Deposits – The custodial credit risk for deposits is the risk that in the event of a bank failure, the State's deposits may not be recovered. At year end, the carrying amount of the Commonwealth's deposits for the Primary Government, excluding pension and (OPEB) trust funds, was \$781,467,385 and the bank balance was \$766,231,820. The bank balance of the Primary Government administered by the State Treasurer was covered by Federal depository insurance or by collateral held by the Commonwealth or the Commonwealth's agent in the Commonwealth's name.

Custodial Credit Risk-Investments - Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Commonwealth will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. The Commonwealth holds investments both for its own benefit and as an agent for other related parties. The major investment programs conducted for the direct benefit of the Commonwealth are administered by the Office of Financial Management. The investments held in the Commonwealth's investment pool are insured or registered, or held by the Commonwealth of Kentucky or its agent in the Commonwealth's name.

The credit risk mix of the retirement systems, and other component units, is disclosed in the financial statement footnotes of those individual entities.

Statutes require that securities underlying repurchase agreements must have a fair value of at least 102 percent of the cost of the repurchase agreement. The fair value of securities underlying

repurchase agreements fell below this required level on a few occasions during the year; however, no losses were sustained due to the fall in collateralization levels. The collateralization is monitored on a weekly basis (as specified within 200 KAR 14.081) and at any point where the collateralization falls below 102 percent of the cost of the repurchase agreement, the seller/borrower is contacted and the situation is normally rectified within two business days.

Securities Lending Program – State statutes authorize the Commonwealth to enter into securities lending agreements. The Commonwealth has entered into an agent agreement. The agent lends the Commonwealth's US Treasuries, agencies and corporate bonds in exchange for cash. The cash is invested in short-term securities. After rebate and expenses the Commonwealth receives 80 percent of the profit earned. The securities transferred are a part of the total investments reported above. Cash received as collateral on securities lending transactions and investments made with that cash are reported as assets. The Commonwealth retains the interest income on the securities being transferred. During the year, the Commonwealth earned \$1,477,620 in securities lending income. On June 30, 2010, the fair value of the securities transferred was \$708,336,719 and the fair value of the securities purchased by the Commonwealth was \$631,854,784. The collateralization requirements and monitoring procedures in the securities lending program are the same as those requirements in regard to repurchase agreements. The Commonwealth requires 102% collateralization on all repurchase agreements. The agent also indemnifies the Commonwealth from any losses from borrowers. The Commonwealth lends its securities generally on an overnight basis. Over 20 percent of the reinvested securities mature in less than one month. Thirty percent of the invested securities are in a Credit Suisse security that was received in 2009 in exchange for securities that had become impaired. The remaining purchased securities have laddered maturities covering the next three years. The securities purchased in the securities lending portfolio reset on a monthly or quarterly basis effectively matching the securities lent.

Options - The Commonwealth's investment strategy includes the use of derivatives as a tool in managing market risk and providing an opportunity for enhanced return. The Commonwealth selectively utilizes put and call options on United States Treasury securities. These options are on a covered basis, where the Commonwealth holds either cash or securities sufficient to meet the obligation, should the option be exercised. On June 30, 2010, the portfolio had no obligations under option. The Commonwealth also purchases securities that have built in covered calls (callable agency securities). The risk in holding these securities is the risk that the security can be called (bought back) by the issuing agency at par either on or after a specific date.

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Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The Commonwealth has regulatory limits on investment maturities as a means of managing its exposure to fair value losses arising from rising interest rates. It also has limits on portfolio durations for the same purpose.

The primary government's investments (excluding the pension and (OPEB) trust funds) at June 30, 2010, are presented below. All investments are presented by investment type.

**Cash And Investments By Type
Primary Government**

I. Cash:

	Carrying Amount	Bank Balance
Cash	\$ 459,903,817	\$ 444,924,252
Cash with Fiscal Agents	79,940,885	79,940,885
Cash with Feds	97,561,473	97,561,473
Other	144,061,210	143,805,210
Total Cash	\$ 781,467,385	\$ 766,231,820

II. Investments:

Investments Managed Based On Maturities

Debt Securities

	Fair Value	< 1 year	1-5 Years
Cash Equivalents	\$ 17,390,000	\$ 17,390,000	\$
U.S. Government & Agency Obligations	138,855,535	10,621,496	128,234,039
Total	156,245,535	\$ 28,011,496	\$ 128,234,039

Investments Managed Based Upon Duration

Debt Securities

	Fair Value	Effective
Cash Equivalents	53,739,329	0.265
Fixed Income Mutual Funds	435,623,422	2.308
U.S. Government & Agency Obligations	1,041,523,953	1.154
Mortgage-Backed Securities	176,867,753	0.120
Corporate Obligations	115,965,609	1.054
Asset Backed Securities	171,876,472	0.316
Municipal Obligations	124,430,855	0.478
Other	2,374,828	5.060
Total Debt Securities	2,122,402,221	
Portfolio Effective Weighted Duration		1.174

Other Investments

Cash Equivalents	12,476,152
Fixed Income Mutual Funds	17,121,107
Common Stock	148,519,477
Securities Lending Invest	631,854,784
Total Other Investments	809,971,520

Total Investments **\$ 3,088,619,276**

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Credit Risk of Debt Securities

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Commonwealth is statutorily limited as to credit ratings, at the time of purchase. Commercial paper must be rated in the highest category by a nationally recognized rating agency. United States denominated corporate, Yankee, and Eurodollar securities must be rated in one of the three highest categories by a nationally recognized rating agency. Asset-backed securities must be rated in the highest category by a nationally recognized rating agency. Certificates of Deposit and Bankers acceptances must be rated in one of the three highest categories by a nationally recognized rating agency. By regulation all mortgage pass-through securities and collateralized mortgage obligations must be issued by U.S. government agencies or by government sponsored entities.

The primary government's, excluding the pension and (OPEB) trust funds, rated debt investments as of June 30, 2010, and the ratings are presented in the following table.

Investments and Credit Ratings

Primary Government

	Standard & Poor's/Moody's Credit Ratings				
	AAA/Aaa	AA/Aa	A	BBB/Baa	CCC/Caa
Cash Equivalents	\$ 28,242,907				
Fixed Income Mutual Funds					
U.S. Government &					
Agency Obligations	1,258,588,874	3,803,035			
Mortgage-Backed Securities	143,065,745	5,350,032		2,439,367	6,965,857
Corporate Obligations	115,668,080	33,180,363	20,230,236	26,407,267	9,000
Common Stock					
Asset Backed Securities	128,220,016	7,242,090	16,323,875	1,138,669	10,785,581
Municipal Obligations	52,875,300	33,334,259	17,682,916	25,423,646	
Securities Lending					
Other	149,227,802				
Total Investments	\$ 1,875,888,724	\$ 82,909,779	\$ 54,237,027	\$ 55,408,949	\$ 17,760,438
	CC/Ca	D	Unrated	NA	Total Fair Value of Investments
Cash Equivalents	\$	\$	\$ 42,886,422	\$	\$ 71,129,329
Fixed Income Mutual Funds			238,761,685	9,144,684	247,906,369
U.S. Government &					
Agency Obligations			3,099,094		1,265,491,003
Mortgage-Backed Securities		19,046,752	31,735,274		208,603,027
Corporate Obligations			136,330		195,631,276
Common Stock				15,208,266	15,208,266
Asset Backed Securities	4,926,016	3,240,224			171,876,471
Municipal Obligations					129,316,121
Securities Lending				631,854,784	631,854,784
Other			2,374,828		151,602,630
Total Investments	\$ 4,926,016	\$ 22,286,976	\$ 318,993,633	\$ 656,207,734	\$ 3,088,619,276

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. Regulation limits the amount owned of any given issuer of corporate and commercial paper to \$25,000,000. At June 30, 2010, the primary government had no investments which would constitute a concentration of credit risk.

At June 30, 2010, The Turnpike Authority of Kentucky (TAK) a blended component unit had investments of \$17,390,000 in Ebury Financial LLC which would constitute a concentration of credit risk as it is more than 5% of TAK's total investments.

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Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The Commonwealth's policy historically has been to invest only in securities in U.S. denominations. The Kentucky Workers' Compensation Funding Commission (KWFC), by its policy, now invests in international equities.

The Workers' Compensation Funding Commission's investments in foreign currency as of June 30, 2010, are presented in the following table.

Foreign Currency Risk

Primary Government (KWFC)

<u>Foreign Currency</u>	<u>Cash/Equiv</u>	<u>Equity</u>	<u>Debt</u>	<u>Total</u>
British pound sterling	\$ 17,484	\$ 2,230,567	\$	\$ 2,248,051
Danish krone	275	175,483		175,758
Euro	14,349	2,584,904	115,506	2,714,759
Hong Kong dollar		338,543		338,543
Japanese yen	10,802	2,372,735		2,383,537
Singapore dollar	12	48,994		49,006
Swedish krona		91,249		91,249
Swiss franc		1,145,855		1,145,855
Total Securities Subject To Foreign Currency Risk	<u>42,922</u>	<u>8,988,330</u>	<u>115,506</u>	<u>9,146,758</u>
USD (Securities Held By Int'l Investment Managers)	97,578		1,290,697	1,388,275
Total Int'l Investment Securities	<u>\$ 140,500</u>	<u>\$ 8,988,330</u>	<u>\$ 1,406,203</u>	<u>\$ 10,535,033</u>

PENSION AND (OPEB) TRUST FUNDS

Custodial Credit Risk-Deposits and Investments

The custodial credit risk for deposits is the risk that in the event of a bank failure, the State's deposits may not be recovered. At year end, the carrying amount of the deposits for the Pension and (OPEB) trust funds was \$73,185,190 and the bank balance was \$73,185,190. Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the Commonwealth will not be able to recover the value of the investment or collateral securities that are

in the possession of an outside party. Of the Pension and (OPEB) Trust Funds, only Kentucky Retirement Systems has investments subject to custodial credit risk. The investments are listed as foreign currency in the amount of \$12,545,921 which are uninsured and not registered in the name of the Commonwealth but are held by the counterparty.

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. Kentucky Revised Statutes (KRS 61.650) grants the responsibility for the investment of plan net assets to the Board of Trustees of the Retirement Systems. Each System has very specific policies regarding their investment activity. A detailed discussion of those policies can be found in the notes to the audited financial statements of the various Pension and (OPEB) Trust Funds.

The Pension and (OPEB) Trust Funds investments at June 30, 2010, are presented below. All investments are presented by investment type.

**Cash and Investments by Type
Pension and (OPEB) Trust Funds**

I. Cash

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Cash	\$ 8,812,447	\$ 8,812,447
Money Market	33,883,391	33,883,391
Other	30,489,352	30,489,352
Total Cash	\$ 73,185,190	\$ 73,185,190

II. Investments:

Investments Managed Based On Maturities

Debt Securities	<u>Fair Value</u>	<u>1-5 Years</u>	<u>6-15 Years</u>	<u>15-30 Years</u>
Fixed Income Mutual Funds	\$ 91,446,103	\$ 91,446,103	\$	\$
U.S. Government & Agency Obligations	1,055,845,554	40,578,278	1,015,267,276	
Mortgage-Backed Securities	537,026,774		297,733,549	239,293,225
Corporate Obligations	1,968,030,344	32,474,937	1,935,555,407	
Asset Backed Securities	37,860,172			37,860,172
Municipal Obligations	484,588,328		484,588,328	
Mortgage Loans	116,575,407			116,575,407
Total	\$ 4,291,372,682	\$ 164,499,318	\$ 3,733,144,560	\$ 393,728,804

Investments Managed Based Upon Duration

Debt Securities	<u>Fair Value</u>	<u>Effective</u>	<u>Macaulay</u>
Cash Equivalents	7,174,169	0.380	
U.S. Government & Agency Obligations	2,804,640,377	4.850	
Mortgage-Backed Securities	83,167,785	4.604	
Corporate Obligations	513,442,002	5.530	
Asset Backed Securities	80,459,816	0.930	
Asset Backed Securities	575,280,210		3.290
Municipal Obligations	57,330,669	11.360	
Mortgage Loans	17,369,425	1.450	
Guaranteed Investment Contract/Annuities	45,610,184	2.010	
Total Debt Securities	\$ 4,184,474,637		
Portfolio Weighted Effective Duration		4.896	
Portfolio Weighted Macaulay Duration			3.290

Other Investments

Cash Equivalents	307,378,278
Common Stock	14,013,794,934
Limited Partnerships	1,745,029,107
Real Estate	435,303,926
Securities Lending	2,980,373,837
Other Investments	2,304,450,980
Total Other Investments	\$ 21,786,331,062
Total Investments	\$ 30,262,178,381

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Credit Risk of Debt Securities

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Each Pension and (OPEB) Trust Fund has an investment policy that defines the types of investments and ratings available to them. Specific policies can be found in the notes to the audited financial statements of the individual component unit.

The Pension and (OPEB) Trust Funds, rated debt investments as of June 30, 2010, and the ratings are presented in the following table.

**Investments and Credit Ratings
Pension and (OPEB) Trust Funds**

<u>Quality Rating</u>	<u>Amount</u>
AAA	\$ 2,988,193,913
AA+	267,187,636
AA	482,186,569
AA-	46,648,330
A+	59,293,411
A	1,318,508,188
A-	72,715,716
BBB+	59,200,990
BBB	577,703,721
BBB-	144,675,132
BB+	2,206,904
BB	110,124,086
BB-	2,475,945
B+	4,457,839
B	142,942,043
B-	15,903,098
CCC	2,836,252
CC	1,843,910
Not Rated	70,462,745
Total Credit Risk Debt Securities	<u>6,369,566,428</u>
Cash Equivalents	307,378,278
U.S. Government & Agencies	2,073,805,954
Corporate Obligations	32,474,937
Common Stock	14,013,794,934
Limited Partnerships	1,745,029,107
Real Estate	435,303,926
Securities Lending	2,980,373,837
Other	2,304,450,980
Total Investments	<u>\$ 30,262,178,381</u>

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of a government's investment in a single issuer. With the exception of the Kentucky Public Employees Deferred Compensation Authority's (KPEDCA) there is a policy limiting the amount of investment in a single issuer to 5% or less of the investment portfolios fair value. The following KPEDCA Fund investment contracts represent 5% or more of investments held in trust for Plan benefits at June 30, 2010:

<u>Asset Description</u>	<u>Amount</u>
State Street Bank	\$ 89,994,183
JP Morgan	108,773,404
Pacific Life Insurance	99,509,452
ING Life & Annuity	104,276,721
Monumental Life	88,914,840
Rabobank Nederland	82,911,535

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. With the exception of the KPEDCA fixed contract fund the Pension and (OPEB) Trust Funds do not have a formal policy that addresses investments in foreign currency. Additional disclosures regarding the Pension and (OPEB) Trust Funds exposure to foreign currency risk can be found in the notes to the audited financial statements of the individual pension and (OPEB) trust funds.

The Pension and (OPEB) Trust Funds, investments in foreign currency as of June 30, 2010, are presented in the following table.

**Foreign Currency Risk
Pension and (OPEB) Trust Funds**

Foreign Currency	Equity	None Designated	Total
Australian dollar	\$ 34,626,039	\$	\$ 34,626,039
Brazilian Real	3,698,736		3,698,736
British pound sterling	24,653,829		24,653,829
Canadian dollar	158,378,566		158,378,566
Czech Koruna	224,868		224,868
Danish krone	14,328,588		14,328,588
Euro	(37,682,051)		(37,682,051)
Hong Kong dollar	51,188,572		51,188,572
Hungarian Forint	297,474		297,474
Indonesian Rupiah	408,823		408,823
Japanese yen	382,063,375		382,063,375
Malaysian ringgit	416,103		416,103
Mexican Peso	1,114,264		1,114,264
New Taiwan dollar	9,936,987		9,936,987
Norwegian krone	11,706,274		11,706,274
Polish Zloty	2,445,839		2,445,839
Singapore dollar	30,345,188		30,345,188
South African rand	4,362,175		4,362,175
South Korean won	3,901,638		3,901,638
Swedish krona	3,841,956		3,841,956
Swiss franc	30,641,268		30,641,268
International Equity Mutual Fund (Various Currencies)	897,094,197		897,094,197
American Funds Euro Pacific Growth Fund	56,460,164		56,460,164
Federated Int'l Small Co. Fund	12,869,369		12,869,369
Dodge & Cox International Stock Fund	12,153,436		12,153,436
Baring Asset Management	319,619,142		319,619,142
Baillie Gifford	346,703,154		346,703,154
UBS Global Asset Management	514,470,507		514,470,507
Total Securities Subject To			
Foreign Currency Risk	2,890,268,480		2,890,268,480
USD (Securities Held By Int'l Investment Managers)		1,151,269,621	1,151,269,621
USD in (ADR) American Depository Receipt investments		588,765,127	588,765,127
Total Int'l Investment Securities	\$ 2,890,268,480	\$ 1,740,034,748	\$ 4,630,303,228

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Securities Lending Program

Kentucky Revised Statutes permit the retirement systems to lend their securities to broker-dealers and other entities. The borrowers of the securities agree to transfer to the retirement system's custodial bank(s) either cash collateral or other securities with a fair value of 102 percent of the value of the borrowed securities. The borrowers of the securities simultaneously agree to return the borrowed securities in exchange for the collateral at a later date. At June 30, 2010, the retirement systems have no credit risk exposure to borrowers because the amounts the retirement systems owe the borrowers exceed the amounts the borrowers owe the retirement systems. The retirement systems cannot pledge or sell collateral securities unless the borrower defaults. More detail of individual policies may be found in the audited financial statements of each retirement system.

Derivatives

Derivative instruments are financial contracts whose values depend on the values of one or more underlying assets, reference rates, or financial indices. The Kentucky Retirement Systems was the only Pension and (OPEB) Trust Fund to have investment derivatives at June 30, 2010. More detail on those individual investment derivatives may be found in the audited financial statements of Kentucky Retirement Systems.

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

MAJOR DISCRETELY PRESENTED COMPONENT UNITS

Custodial Credit Risk-Deposits and Investments

The custodial credit risk for deposits is the risk that in the event of a bank failure, the State's deposits may not be recovered. At year end, the carrying amount of the major discretely presented component units' deposits was \$1,150,200,521 and the bank balance was \$1,146,684,689.

Custodial credit risk for investments is the risk that, in the event of a failure of the counterparty, the component unit will not be able to recover the value of the investment or collateral securities that are in the possession of an outside party. Each component unit has informal policies to control custodial credit risk and those policies can be found in the notes to the audited financial statements of the individual component unit.

The following table summarizes the custodial credit risk maintained for investments held by the major discretely presented component units for the fiscal year ended June 30, 2010.

Custodial Risk

Discretely Presented Major Component Units

I. Deposits

Cash And Equivalents (original maturity 90 days or less):

Deposits are uninsured and

a) uncollateralized;	\$ 9,962,000
b) collateralized with securities held by the pledging financial institution; or	26,105,945
c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the Commonwealth's name.	3,814,584

Total Deposits Subject To Custodial Credit Risk \$ 39,882,529

II. Non-Current Cash And Investments:

Non-current cash and investments which are uninsured, are not registered in the name of the Commonwealth, and are held by either

(a) the counterparty or	\$ 782,721,718
(b) the counterparty's trust department or agent but not in the Commonwealth's name.	1,083,543,660

Total Non-Current Cash And Investments Subject To Custodial Credit Risk \$ 1,866,265,378

Investment Types:

	Type A (counterparty)	Type B (trust or agent)
Debt Securities		
Cash Equivalents	\$ 8,445,388	\$ 52,900,664
Fixed Income Mutual Funds		186,833,470
U.S. Government & Agency Obligations	19,862,677	91,244,920
Mortgage Backed Securities		38,000
Corporate Obligations	32,846,000	36,343,838
Municipal Obligations	2,879,293	
Pooled Real Estate Funds		54,465,974
Alternatives		134,718,922
Total Debt Securities	<u>64,033,358</u>	<u>556,545,788</u>
Other Investments		
Cash Equivalents	1,900,029	43,013,590
Fixed Income Mutual Funds	76,407,000	
Common Stock	67,807,796	415,691,178
Alternatives	354,976,000	
Real Estate	3,892,975	
Funds Held In Trust By Others		37,934,000
Other Various	213,704,560	30,359,104
Total Other Investments	<u>718,688,360</u>	<u>526,997,872</u>
Total Type A	<u>782,721,718</u>	Total Type B <u>1,083,543,660</u>
Total Non-Current Cash And Investments Subject To Custodial Credit Risk		<u><u>\$ 1,866,265,378</u></u>

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates of debt investments will adversely affect the fair value of an investment. The component units have numerous policies that limit the amounts and types of investments as a means of managing the exposure to fair value losses arising from increasing interest rates. Specific policies can be found in the notes to the audited financial statements of the individual component unit.

The following table summarizes the investments held by the major discretely presented component units for the fiscal year ended June 30, 2010.

**Cash And Investments By Type
Discretely Presented Major Component Units**

I. Cash

	<u>Carrying Amount</u>	<u>Bank Balance</u>
Cash	\$ 1,030,054,947	\$ 1,026,539,115
Money Market	110,848,874	110,848,874
Other	9,296,700	9,296,700
Total Cash	\$ 1,150,200,521	\$ 1,146,684,689

II. Investments:

Investments Managed Based On Maturities

Debt Securities	<u>Fair Value</u>	<u>< 1 year</u>	<u>1-5 Years</u>	<u>6-10 Years</u>	<u>> 10 Years</u>
Cash Equivalents	\$ 219,306,054	\$ 207,365,054	\$ 7,000,000	\$ 1,008,452	\$ 3,932,548
U.S. Government & Agency Obligations	60,442,278	37,308,101	22,715,418	418,759	
Corporate Obligations	1,893,205	333,015	1,027,247	532,943	
Guaranteed Investment Contract/Annuities	22,204,402	6,659,088	10,897,133	597,556	4,050,625
Total	303,845,939	\$ 251,665,258	\$ 41,639,798	\$ 2,557,710	\$ 7,983,173

Investments Managed Based Upon Duration

Debt Securities	<u>Fair Value</u>	<u>Effective</u>	<u>Modified</u>
Cash Equivalents	203,901,000		
Fixed Income Mutual Funds	89,923,368	3.500	
Fixed Income Mutual Funds	457,702,550		1.223
U.S. Government & Agency Obligations	207,194,430	0.874	
U.S. Government & Agency Obligations	50,857,615		0.759
Mortgage Backed Securities	797,007,118	0.544	
Corporate Debt	2,484,130	5.000	
Corporate Debt	34,450,633		1.490
Other Investments	1,901,671		4.929
Total Debt Securities	1,845,422,515		
Portfolio Effective Weighted Duration		0.724	
Portfolio Modified Weighted Duration			1.210

Other Investments

Fixed Income Mutual Funds	80,310,197
Common Stock	88,157,724
Corporate Bonds	41,291,788
Alternatives	489,185,441
Real Estate	3,892,975
Funds Held In Trust By Others	37,934,000
Other	150,763,177
Total Other Investments	891,535,302
Total Investments	\$ 3,040,803,756

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Credit Risk of Debt Securities

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Each component unit has an investment policy that defines the types of investments and ratings available to them. Specific policies can be found in the notes to the audited financial statements of the individual component unit.

The major discretely presented component units, investments as of June 30, 2010, and the ratings are presented in the following table.

**Investments and Credit Ratings
Discretely Presented Major Component Units**

	Standard & Poor's/Moody's Credit Ratings						Total Fair Value of Investments
	AAA/Aaa	AA/Aa	A	BBB/Baa	Unrated	NA	
Cash Equivalents	\$ 17,690,000	\$	\$	\$	\$ 250,489,575	\$ 161,539,675	\$ 429,719,250
Fixed Income Mutual Funds		89,923,368			534,110,221		624,033,589
U.S. Government & Agency Obligations	250,753,169				24,730,970	45,696,183	321,180,322
Mortgage Backed Securities	797,007,118						797,007,118
Corporate Obligations	11,538,041	894,981	11,126,288	34,921,046	23,540,000		82,020,356
Common Stock					67,807,796	20,349,928	88,157,724
Guaranteed Investment Contracts/Annuities				295,588	23,162,402		23,457,990
Alternatives					489,185,441		489,185,441
Real Estate					3,892,975		3,892,975
Funds Held In Trust By Others					37,934,000		37,934,000
Other					143,478,382	736,609	144,214,991
Total Investments	\$ 1,076,988,328	\$ 90,818,349	\$ 11,126,288	\$ 35,216,634	\$ 1,598,331,762	\$ 228,322,395	\$ 3,040,803,756

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the government's investment in a single issuer. All of the major discretely presented component units except the Kentucky Housing Corporation (KHC) has policies in place that limit the amount that can be invested in a single issuer to 5% of the total portfolio market value. KHC places no limit on the amount they may invest in any one issuer. More than five percent of the KHC's investments are in Fannie Mae, GNMA, U.S. Treasury and Dreyfus. These investments are 40%, 27%, 14% and 17%, respectively, of the KHC's total investments.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. Policies for controlling foreign currency risk will vary with each component unit, individual policies can be found in the notes to the financial statements of the respective component unit.

Of the major discretely presented component units only the University of Kentucky has foreign currency risk as of June 30, 2010. The university has \$3,895,748 in a pooled private equity fund denominated in Euros.

COMMONWEALTH OF KENTUCKY
Notes to Financial Statements
June 30, 2010

Note 6

CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2010
(Expressed in Thousands):

	Primary Government			Ending Balance
	Beginning Balance Restated	Additions	Decreases	
Primary Government:				
Governmental Activities				
<i>Capital assets, not being depreciated:</i>				
Land	\$ 157,335	\$ 10,149	\$ (3,359)	\$ 164,125
Construction in progress	2,436,087	514,587	(723,178)	2,227,496
Infrastructure	17,372,469	672,825	(26,608)	18,018,686
Easements and Other Intangibles	111,504	3,931		115,435
Total capital assets not being depreciated	<u>20,077,395</u>	<u>1,201,492</u>	<u>(753,145)</u>	<u>20,525,742</u>
<i>Capital assets, being depreciated/amortized:</i>				
Improvements other than buildings	15,265	530	(195)	15,600
Buildings	1,132,339	55,911	(8,737)	1,179,513
Machinery and Equipment	570,749	54,113	(43,017)	581,845
Easements and Other Intangibles	6,169			6,169
Total capital assets, being depreciated/amortized	<u>1,724,522</u>	<u>110,554</u>	<u>(51,949)</u>	<u>1,783,127</u>
<i>Less accumulated depreciation/amortization:</i>				
Improvements other than buildings	(6,597)	(558)	40	(7,115)
Buildings	(455,673)	(27,742)	5,156	(478,259)
Machinery and Equipment	(368,146)	(46,585)	34,705	(380,026)
Easements and Other Intangibles	(2,493)	(204)	334	(2,363)
Total accumulated depreciation	<u>(832,909)</u>	<u>(75,089)</u>	<u>40,235</u>	<u>(867,763)</u>
Total capital assets, being depreciated/amortized, net	<u>891,613</u>	<u>35,465</u>	<u>(11,714)</u>	<u>915,364</u>
Governmental activities capital assets, net	<u>\$ 20,969,008</u>	<u>\$ 1,236,957</u>	<u>\$ (764,859)</u>	<u>\$ 21,441,106</u>
Business-type activities				
<i>Capital assets, not being depreciated:</i>				
Land	\$ 22,995	\$ 393	\$ (1,543)	\$ 21,845
Construction in progress	112,844	18,317	(11,771)	119,390
Total capital assets, not being depreciated	<u>135,839</u>	<u>18,710</u>	<u>(13,314)</u>	<u>141,235</u>
<i>Capital assets, being depreciated/amortized:</i>				
Improvements other than buildings	113,695	1,315	(2,324)	112,686
Buildings	225,562	16,079	(660)	240,981
Machinery and Equipment	59,196	1,722	(1,400)	59,518
Easements and Other Intangibles	2,322			2,322
Total capital assets, being depreciated/amortized	<u>400,775</u>	<u>19,116</u>	<u>(4,384)</u>	<u>415,507</u>
<i>Less accumulated depreciation for:</i>				
Improvements other than buildings	(56,881)	(2,930)	1,800	(58,011)
Buildings	(101,477)	(7,232)	417	(108,292)
Machinery and Equipment	(47,092)	(2,300)	1,244	(48,148)
Easements and Other Intangibles	(875)	(116)		(991)
Total accumulated depreciation	<u>(206,325)</u>	<u>(12,578)</u>	<u>3,461</u>	<u>(215,442)</u>
Total capital assets, being depreciated/amortized, net	<u>194,450</u>	<u>6,538</u>	<u>(923)</u>	<u>200,065</u>
Business-type activities capital assets, net	<u>\$ 330,289</u>	<u>\$ 25,248</u>	<u>\$ (14,237)</u>	<u>\$ 341,300</u>

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Depreciation expense, charged to functions/programs of the primary government as follows:

(Expressed in Thousands)

	<u>Governmental Activities</u>	<u>Business-type Activities</u>
General Government	\$ 7,464	\$
Legislative and Judicial	566	
Commerce	3,181	
Education and Humanities	3,977	
Human Resources	3,527	
Justice	17,912	
Natural Resources and Environmental Protection	2,474	
Public Protection and Regulation	277	
Transportation	18,917	
Capital assets held by government's internal service funds are charged to the various functions based on usage of the assets	16,794	
State Parks		10,279
Lottery Corporation		1,368
Horse Park		759
Insurance Administration		172
Total depreciation expense by activities	<u>\$ 75,089</u>	<u>\$ 12,578</u>

Discretely presented major component units

Capital asset activity for the year ended June 30, 2010

(Expressed in Thousands):

	<u>Component Units</u>			
	<u>Beginning Balance</u>	<u>Additions</u>	<u>Retirements</u>	<u>Ending Balance</u>
<i>Capital assets, not being depreciated:</i>				
Land	\$ 159,771	\$ 4,968	\$ (472)	\$ 164,267
Construction in progress	545,820	318,239	(261,974)	602,085
Totals, capital assets not being depreciated	<u>705,591</u>	<u>323,207</u>	<u>(262,446)</u>	<u>766,352</u>
<i>Capital assets, being depreciated/amortized:</i>				
Improvements other than buildings	155,873	9,749		165,622
Buildings	2,856,804	339,196	(2,967)	3,193,033
Machinery and Equipment	1,257,148	115,811	(39,165)	1,333,794
Total capital assets, being depreciated/amortized	<u>4,269,825</u>	<u>464,756</u>	<u>(42,132)</u>	<u>4,692,449</u>
<i>Less accumulated depreciation for:</i>				
Improvements other than buildings	(68,527)	(4,381)	12	(72,896)
Buildings	(1,110,875)	(79,393)	411	(1,189,857)
Machinery and Equipment	(817,865)	(94,575)	32,831	(879,609)
Total accumulated depreciation	<u>(1,997,267)</u>	<u>(178,349)</u>	<u>33,254</u>	<u>(2,142,362)</u>
Total capital assets, being depreciated/amortized, net	<u>2,272,558</u>	<u>286,407</u>	<u>(8,878)</u>	<u>2,550,087</u>
Component units capital assets, net	<u>\$ 2,978,149</u>	<u>\$ 609,614</u>	<u>\$ (271,324)</u>	<u>\$ 3,316,439</u>

Depreciation expense, charged to functions/programs of discretely presented major component units as follows:

(Expressed in Thousands)

Kentucky Housing Corporation	\$ 520
Kentucky Higher Education Student Loan Corporation	3,582
University of Kentucky	101,832
University of Louisville	47,293
Kentucky Community and Technical College System	25,122
Total depreciation expense by functions/programs	<u>\$ 178,349</u>

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Note 7

INTERFUND TRANSACTIONS

Interfund Transfers In and Out

The table below shows the interfund operating transfers for fiscal year 2010
(Expressed in Thousands):

Transfers In	Transfers Out			
	General Fund	Transportation Fund	Federal Fund	Agency Revenue Fund
General Fund	\$	\$	\$ 6,727	\$ 61,751
Transportation Fund				
Federal Fund				
Agency Revenue Fund	33,324			
Capital Projects Fund	800	8,077	1,242	23,836
Debt Service	138,810	9,901	43,901	1,402
Non-Major Governmental Funds	288,540	30,739	5,295	300,014
State Parks Fund	35,085		989	
Kentucky Horse Park Fund	1,378		14	
Kentucky Public Employees Health Plan				3
Insurance Administration Fund			159	4
Unemployment Compensation Fund				
Internal Service Funds	1,196		7	34
Fiduciary Funds			1	64
Total	\$ 499,133	\$ 48,717	\$ 58,335	\$ 387,108

Reasons for transfers:

- 1) to move resources from the General Fund, for budgetary purposes, to the fund that will expend them;
- 2) to move resources from funds recording the revenue to the Debt Service Fund, for debt service payments;
- 3) to move resources from the funds recording the revenue to the Capital Projects Fund to finance acquisition of capital assets; and
- 4) to move resources from the Kentucky Lottery Corporation to the General Fund.

Interfund Receivables and Payables

The table below shows the interfund receivables and payables for fiscal year 2010
(Expressed in Thousands):

Interfund Receivables	Interfund Payables			
	General Fund	Transportation Fund	Federal Fund	Agency Revenue Fund
General Fund	\$	\$ 511	\$ 1,160	\$ 11,544
Transportation Fund	3		98	473
Federal Fund	12,846	44		1,119
Agency Revenue Fund	27,629	323	43,042	
Capital Projects Fund		708	212	44
Non-Major Governmental Funds	17,129		68,734	568
State Parks Fund	83	24	11	47
Kentucky Public Employees Health Plan	43,701			4
Insurance Administration Fund	11			4
Unemployment Compensation Fund	1			
Internal Service Funds	1,143	23	65	93
Total	\$ 102,546	\$ 1,633	\$ 113,322	\$ 13,896

Reasons for interfund payables and receivables:

- 1) to record sales by proprietary funds to other funds; 2) to record reimbursements of expenditures made in one fund for another fund;
- 3) to distribute program cost among funds; and 4) to record short-term loans from one fund to another.

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Transfers Out

Capital Projects Fund	Non-Major Governmental Funds	State Parks Fund	Kentucky Lottery Corporation	Insurance Administration Fund	Internal Service Funds	Fiduciary Funds	Total
\$ 33,283	\$ 28,644	\$	\$ 200,000	\$ 26,500	\$ 8,543	\$ 4,022	\$ 369,470
9							9
23							23
1,114	452,755			3,323	358	784	491,658
	1,910	24		1,217	970		38,076
36	22,598	40			20		216,708
31	202,798	323	11,590				839,330
2,322	370						38,766
9,670							11,062
							3
21,799							21,962
	6						6
5,510							6,747
				790			855
<u>\$ 73,797</u>	<u>\$ 709,081</u>	<u>\$ 387</u>	<u>\$ 211,590</u>	<u>\$ 31,830</u>	<u>\$ 9,891</u>	<u>\$ 4,806</u>	<u>\$ 2,034,675</u>

Interfund Payables

Capital Projects Fund	Non-Major Governmental Funds	State Parks Fund	Kentucky Horse Park Fund	Insurance Administration Fund	Internal Service Funds	Total
\$	\$ 650	\$ 452	\$	\$	\$ 1,687	\$ 16,004
1						575
	152					14,161
23,801	1,191		14	25	245	96,270
	1,439			300		2,703
83	3,548					90,062
						165
	8,739					52,444
	12					27
						1
19	5	89	19		3	1,459
<u>\$ 23,904</u>	<u>\$ 15,736</u>	<u>\$ 541</u>	<u>\$ 33</u>	<u>\$ 325</u>	<u>\$ 1,935</u>	<u>\$ 273,871</u>

Note 8

PENSION PLANS AND OTHER POST EMPLOYMENT BENEFITS

Under the provisions of Kentucky Revised Statutes (KRS) 61.645, the Board of Trustees of the Kentucky Retirement Systems administers the Kentucky Employees Retirement System (KERS), County Employees Retirement System (CERS), and State Police Retirement System (SPRS).

The Commonwealth contributes to the KERS, a multiple-employer cost sharing defined benefit pension plan that covers substantially all regular full-time members employed in non-hazardous and hazardous duty positions of any state department, board, or any agency directed by Executive Order to participate in the System. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of the plan members under certain circumstances. Per KRS 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last proceeding the July 1 of a new biennium. The Board may amend the contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. The System’s administrative budget and employer contribution rates are subject to the approval of the Kentucky General Assembly. Employee contribution rates are set by the statute and may be changed only by the Kentucky General Assembly.

The Commonwealth is the predominant employer for KERS and for note disclosure purposes will be considered as a single employer plan.

CERS, a multiple employer cost sharing defined benefit pension plan, provides for retirement, disability, and death benefits to plan members.

SPRS is a single-employer defined benefit plan that covers all full-time State Troopers employed in a hazardous duty position by the Kentucky State Police. The plan provides for retirement, disability, and death benefits to plan members. Retirement benefits may be extended to beneficiaries of the plan members under certain circumstances. Per KRS 61.565(3), normal contribution and past service contribution rates shall be determined by the Board on the basis of an annual valuation last proceeding the July 1 of a new biennium. The Board may amend the contribution rates as of the first day of July of the second year of a biennium, if it is determined on the basis of a subsequent actuarial valuation that amended contribution rates are necessary to satisfy requirements determined

in accordance with actuarial bases adopted by the Board. However, formal commitment to provide the contributions by the employer is made through the biennial budget. The financial statements are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which contributions are due. Employer contributions to the plan are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with terms of the plan.

Investments are reported at fair value. Short-term investments are reported at cost, which approximates fair value. Securities traded on a national exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate is based on appraisals. Investments that do not have an established market are reported at estimated fair value.

Cost-of-living adjustments (COLA) are provided annually equal to the percentage increase in the annual average of the consumer price index for all urban consumers for the most recent calendar year, not to exceed 1.5% provided the recipient has been receiving a benefit for at least twelve months prior to the effective date of the COLA. If the recipient has been receiving a benefit for less than twelve months prior to the effective date of the COLA, the increase shall be reduced on a pro-rata basis for each month the recipient has not been receiving benefits in the twelve months preceding the effective date of the COLA. The General Assembly reserves the right to suspend or reduce cost-of-living adjustments if in its judgment the welfare of the Commonwealth so demands.

Kentucky Retirement Systems Insurance Fund (Fund) was established to provide hospital and medical insurance for members receiving benefits from the Kentucky Employees Retirement System, the County Employees Retirement System, and the State Police Retirement System. The Fund pays a prescribed contribution for whole or partial payment of required premiums to purchase hospital and medical insurance.

The amount of contribution paid by the Funds is based on years of service. For members participating prior to July 1, 2003, years of service and respective percentages of the maximum contribution are as follows:

<u>Years of Service</u>	<u>Percent Paid by Insurance Fund</u>	<u>Percent Paid by Member Through Payroll Deduction</u>
20 or more	100%	0%
15 - 19	75%	25%
10 - 14	50%	50%
4 - 9	25%	75%
Less than 4	0%	100%

As a result of House Bill 290 (2004 General Assembly), medical insurance benefits are calculated differently for members who began

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participating on or after July 1, 2003. Once members reach a minimum vesting period of ten years, non-hazardous employees whose participation began on or after July 1, 2003 earn ten dollars (\$10) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Hazardous employees whose participation began on or after July 1, 2003 earn fifteen dollars (\$15) per month for insurance benefits at retirement for every year of earned service without regard to a maximum dollar amount. Upon the death of a hazardous employee, such employee's spouse receives ten dollars (\$10) per month for insurance benefits for each year of the deceased employee's hazardous service. This dollar amount is subject to adjustment annually based of the retiree cost of living adjustment (COLA), which is updated annually due to changes in the Consumer Price Index for all urban consumers. This benefit is not protected under the inviolable contract provisions of Kentucky Revised Statute 16.652, 61.692, and 78.852. The General Assembly reserves the right to suspend or reduce this benefit if, in its judgment, the welfare of the Commonwealth so demands.

In prior years, the employers' required medical insurance contribution rate was being increased annually by a percentage that would result in advance-funding the medical liability on an actuarially determined basis using the entry age normal cost method within a 20-year period measured from 1987. In November 1992, the Board of Trustees adopted a fixed percentage contribution rate and suspended future increases under the current medical premium funding policy until the next experience study could be performed. In May 1996, the Board of Trustees adopted a policy to increase the insurance contribution rate by the amount needed to achieve the target rate for full entry age normal funding within twenty years.

Kentucky Retirement Systems commenced self-funding of healthcare benefits for its Medicare eligible retirees on January 1, 2006. A self-funded plan is one in which Kentucky Retirement Systems assumes the financial risk for providing healthcare to its retirees. The self-funded plan pays for claims out-of-pocket as they are presented instead of paying a pre-determined premium to an insurance carrier for a fully-funded plan.

The Kentucky Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the above mentioned retirement systems. That report may be obtained by writing the Kentucky Retirement System, 1260 Louisville Road, Frankfort, Kentucky 40601-6124, or by telephone at 1-800-928-4646.

The Judicial Retirement Plan is a single employer defined benefit plan which provides retirement, disability and death benefits to plan members and their beneficiaries. The annual July 1 cost-of living adjustment (COLA) is 1.50 percent. Additionally, legislation provides that a pension benefit shall be increased, if necessary, so that it equals an amount calculated by using a 1.5125 percent benefit rate and the 60 month average earnings of the position held by the

member at the time of retirement. Contribution rates are established by KRS 21.525.

The percentage of medical insurance premiums paid by the Plan is based on years of service with the Systems, as follows:

<u>Years of Service</u>	<u>Percent Paid by the Fund</u>
4 years - 9 years 11 months	25%
10 years - 14 years 11 months	50%
15 years - 19 years 11 months	75%
20 years or more	100%

The Legislators' Retirement Plan is a single employer defined benefit plan providing retirement, disability, and death benefits to plan members and their beneficiaries. The annual July 1 cost-of living adjustment (COLA) is 1.50 percent. Additionally, legislation provides that a pension benefit shall be increased, if necessary, so that it equals an amount calculated by using a 1.925 percent benefit rate and the 60 month average earnings of the position held by the member at the time of retirement. Contribution rates are established by KRS 21.525.

The percentage of medical insurance premiums paid by the Plan is based on years of service with the Systems, as follows:

<u>Years of Service</u>	<u>Percent Paid by the Fund</u>
4 years - 9 years 11 months	25%
10 years - 10 years 11 months	50%
11 years - 11 years 11 months	55%
12 years - 12 years 11 months	60%
13 years - 13 years 11 months	65%
14 years - 14 years 11 months	70%
15 years - 15 years 11 months	75%
16 years - 16 years 11 months	80%
17 years - 17 years 11 months	85%
18 years - 18 years 11 months	90%
19 years - 19 years 11 months	95%
20 years or more	100%

The financial statements are prepared using the accrual basis of accounting. Plan member contributions to the plan are recognized when due and the employer has made formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with terms of the Plans.

Investments are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair value.

The Judicial Form Retirement System issues a publicly available financial report that includes financial statements and required supplementary information for the above mentioned retirement systems. That report may be obtained by writing to the Judicial Form Retirement System, P.O. Box 791, Frankfort, Kentucky 40601-6124, or by telephone at (502) 564-5310.

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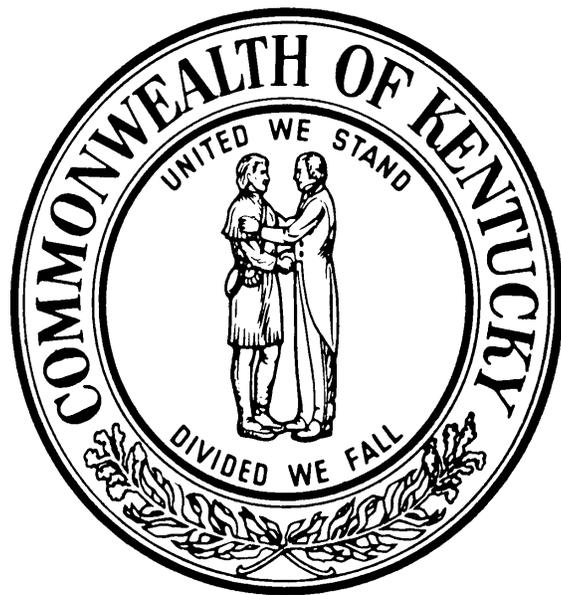
The Kentucky Teachers' Retirement System (KTRS) was established by the 1938 General Assembly and is governed by Chapter 161 Section 220 through Section 990 of the Kentucky Revised Statutes. KTRS is a multiple-employer cost sharing defined benefit plan established to provide pension plan coverage for local school districts and other educational agencies in the state.

The Commonwealth is the predominant contributor to KTRS and for note disclosure purposes it will be considered as a single employer plan.

The financial statements are prepared on the accrual basis of accounting. Member contributions and employer matching are recognized in the fiscal year due. Plan investments are reported at fair value. Short-term securities are carried at cost, which approximates fair value. Fixed income and common and preferred stocks are generally valued based on published market prices and quotations from national security exchanges and security pricing services. Real estate is primarily valued based on appraisals performed by independent appraisers.

COLA are one and one-half percent annually. Additional ad hoc increases and any other benefit amendments must be authorized by the General Assembly.

The Kentucky Teachers' Retirement System issues a publicly available financial report that includes financial statements and required supplementary information. That report may be obtained by writing the Kentucky Teachers' Retirement System, 479 Versailles Road, Frankfort, Kentucky 40601.



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	Kentucky Legislators' Retirement Plan		Kentucky Judicial Retirement Plan		State Police Retirement System	
	Pension	Insurance	Pension	Insurance	Pension	Insurance
Contribution rates:						
State Plan members	7.00%	1.00%	14.30%	2.30%	33.08%	8.0%-9.0%
	5.0%-6.0%		5.0%-6.0%		8.0%-9.0%	
Portion of State Contribution for Health Insurance						
Annual required contribution (ARC) (Thousands)	\$375	\$60	\$4,512	\$838	\$18,765	\$30,302
Contributions made (Thousands)	\$320	\$60	\$4,470	\$830	\$9,489	\$8,917
Actuarial valuation date	June 30, 2009		June 30, 2009		June 30, 2010	
Actuarial cost method	Projected unit credit		Projected unit credit		Entry age normal	
Amortization method	Interest + 1% Unfunded Past Liability		Interest + 1% Unfunded Past Liability		Level percent closed	
Remaining amortization period	25 years		25 years		27 years	
Asset valuation method	Market value		Market value		Five-year smoothed market	
Actuarial assumptions:						
Investment rate of return	7.00%		7.00%		7.75%	4.50%
Inflation Rate					3.50%	
Projected salary increases	1%-4%		1%-4%		5.0%-21.0%	
Increases in Health Insurance Cost	5% - 11%		5% - 11%		5.0%-10.5%	
(Dollar amounts in thousands)						
Actuarial Required Contribution (ARC)	\$ 375	\$ 60	\$ 4,512	\$ 838	\$ 18,765	\$ 30,302
Interest on NPO/NOPEBO	(38)	(22)	(62)	(12)	1,865	6,666
Adjustment to ARC	44	26	75	14	(1,206)	(4,309)
Annual pension cost	381	64	4,525	840	19,424	32,659
Contributions made	320	60	4,470	830	9,489	8,917
Increase (Decrease) in NPO/NOPEBO	61	4	55	10	9,935	23,742
NPO/NOPEBO beginning of year	(526)	(309)	(898)	(169)	24,069	86,015
NPO/NOPEBO as of 6/30/10	\$ (465)	\$ (305)	\$ (843)	\$ (159)	\$ 34,004	\$ 109,757
Percentage APC contributed	83.9%	93.8%	98.8%	98.8%	48.9%	27.3%
6/30/2009						
Annual Pension Cost	\$ 382	\$ 64	\$ 4,526	\$ 840	\$ 16,387	\$ 31,041
Percentage APC Contributed	83.8%	93.8%	98.8%	98.8%	50.0%	24.6%
NPO/NOPEBO as of 6/30/09	\$ (526)	\$ (309)	\$ (898)	\$ (169)	\$ 24,069	\$ 86,015
6/30/2008						
Annual Pension Cost	\$ 433	\$ 288	\$ 2,379	\$ 461	\$ 14,076	\$ 44,181
Percentage APC Contributed	98.8%	99.0%	99.8%	99.8%	52.9%	17.0%
NPO/NOPEBO as of 6/30/08	\$ (588)	\$ (313)	\$ (954)	\$ (179)	\$ 15,868	\$ 62,617

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Kentucky Employees Retirement System				Kentucky Teachers' Retirement System	
Non-Hazardous		Hazardous		Pension	Insurance
Pension	Insurance	Pension	Insurance		
	11.61%		24.69%	12.305%	0.75%
	5.0%-6.0%		8.0%-9.0%	9.105%	0.75%
					28.0%
\$348,495	\$376,556	\$17,815	\$35,045	\$633,938	\$459,047
\$144,051	\$102,528	\$17,658	\$22,241	\$418,558	\$175,347
June 30, 2010			June 30, 2010		
Entry age normal			Projected unit credit		
Level percent closed			Level percent open		
27 years			30 years		
Five-year smoothed market			Five-year smoothed market		Market value of assets
7.75%	4.50%	7.75%		7.50%	7.5%-8.0%
3.50%		3.50%			4.00%
5.0%-17.0%		5.0% - 21.0%		4.00% - 8.20%	
	5.0%-10.5%		5.0%-10.5%		5.0%-10.5%
\$ 348,495	\$ 376,556	\$ 17,815	\$ 35,045	\$ 633,938	\$ 459,047
43,218	72	18	4	30,997	23,097
(27,938)	(47)	(13)	(3)	(83,341)	(18,383)
363,775	376,581	17,820	35,046	581,594	463,761
144,051	102,528	17,658	22,241	418,558	175,347
219,724	274,053	162	12,805	163,036	288,414
557,651	944,621	233,001	69,288	413,293	518,283
\$ 777,375	\$ 1,218,674	\$ 233,163	\$ 82,093	\$ 576,329	\$ 806,697
39.6%	27.2%	99.1%	63.5%	72.0%	37.8%
\$ 304,510	\$ 380,431	\$ 21,925	\$ 36,152	\$ 563,860	\$ 470,911
36.9%	21.7%	72.3%	58.1%	71.1%	39.0%
\$ 557,651	\$ 944,621	\$ 233,001	\$ 69,288	\$ 413,293	\$ 518,283
\$ 270,222	\$ 562,787	\$ 20,228	\$ 51,881	\$ 539,549	\$ 289,294
38.7%	11.3%	75.4%	42.5%	81.3%	57.5%
\$ 365,524	\$ 646,901	\$ 226,919	\$ 54,129	\$ 250,170	\$ 230,919

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Schedule of Funding Progress - Retirement Funds

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
Kentucky Employees Retirement System						
<u>Non-Hazardous</u>						
June 30, 2008	\$ 5,318,792,893	\$ 10,129,689,985	\$ 4,810,897,092	52.5	\$ 1,837,873,488	261.8
June 30, 2009	4,794,611,365	10,658,549,532	5,863,938,167	45.0	1,754,412,912	334.2
June 30, 2010	4,210,215,585	11,004,795,089	6,794,579,504	38.3	1,815,146,388	374.3
<u>Hazardous</u>						
June 30, 2008	\$ 502,132,214	\$ 618,010,827	\$ 115,878,613	81.2	\$ 148,710,060	77.9
June 30, 2009	502,503,287	674,411,781	171,908,494	74.5	146,043,576	117.7
June 30, 2010	502,729,009	688,149,451	185,420,442	73.1	143,557,994	129.2
State Police Retirement System						
June 30, 2008	\$ 350,891,451	\$ 587,129,257	\$ 236,237,806	59.8	\$ 53,269,080	443.5
June 30, 2009	329,966,989	602,328,868	272,361,879	54.8	51,660,396	527.2
June 30, 2010	304,577,292	612,444,806	307,867,514	49.7	51,506,712	597.7
Judicial Retirement Plan						
June 30, 2008	\$ 226,865,320	\$ 255,108,465	\$ 28,243,145	88.9	\$ 31,224,444	90.5
June 30, 2009	211,793,059	290,860,147	79,067,088	72.8	29,886,624	264.6
June 30, 2010	193,940,389	294,521,361	100,580,972	65.8	29,886,624	336.5
Legislators' Retirement Plan						
June 30, 2008	\$ 45,567,209	\$ 43,760,180	\$ (1,807,029)	104.1	\$ 4,755,214	(38.0)
June 30, 2009	42,929,075	60,163,091	17,234,016	71.4	4,916,770	350.5
June 30, 2010	40,231,811	62,774,038	22,542,227	64.1	4,916,770	458.5
Kentucky Teachers' Retirement System						
June 30, 2008	\$ 15,321,325,000	\$ 22,460,304,000	\$ 7,138,979,000	68.2	\$ 3,190,332,000	223.8
June 30, 2009	14,885,981,000	23,400,426,000	8,514,445,000	63.6	3,253,077,000	261.7
June 30, 2010	14,851,330,000	24,344,316,000	9,492,986,000	61.0	3,321,614,000	285.8

Schedule of Funding Progress - Insurance Funds

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded (Overfunded) AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
Kentucky Employees Retirement System						
<u>Non-Hazardous</u>						
June 30, 2008	\$ 603,197,761	\$ 5,431,499,285	\$ 4,828,301,524	11.1	\$ 1,837,873,488	262.7
June 30, 2009	534,172,580	4,507,325,571	3,973,152,991	11.9	1,754,412,912	226.5
June 30, 2010	471,341,628	4,466,136,041	3,994,794,413	10.6	1,815,146,388	220.1
<u>Hazardous</u>						
June 30, 2008	\$ 288,161,759	\$ 541,657,214	\$ 253,495,455	53.2	\$ 148,710,060	170.5
June 30, 2009	301,634,592	491,132,170	189,497,578	61.4	146,043,576	129.8
June 30, 2010	314,427,296	493,297,529	178,870,233	63.7	143,557,944	124.6
State Police Retirement System						
June 30, 2008	\$ 123,961,197	\$ 445,107,468	\$ 321,146,271	27.8	\$ 53,269,080	602.9
June 30, 2009	123,526,647	364,031,141	240,504,494	33.9	51,660,396	465.5
June 30, 2010	121,175,083	434,960,495	313,785,412	27.9	51,506,712	609.2
Judicial Retirement Plan						
June 30, 2008	\$ 44,347,577	\$ 47,851,882	\$ 3,504,305	92.7	\$ 31,224,444	11.2
June 30, 2009	43,816,525	39,816,215	(4,000,310)	110.0	29,886,624	(13.4)
June 30, 2010	43,186,642	41,831,779	(1,354,863)	103.2	29,886,624	(4.5)
Legislators' Retirement Plan						
June 30, 2008	\$ 25,117,103	\$ 23,668,943	\$ (1,448,160)	106.1	\$ 4,755,214	(30.5)
June 30, 2009	24,413,467	18,481,365	(5,932,102)	132.1	4,916,770	(120.7)
June 30, 2010	23,908,481	19,434,535	(4,473,946)	123.0	4,916,770	(91.0)
Kentucky Teachers' Retirement System						
June 30, 2008	\$ 263,541,000	\$ 6,518,787,000	\$ 6,255,246,000	4.0	\$ 3,190,332,000	196.1
June 30, 2009	313,806,000	6,545,067,000	6,231,261,000	4.8	3,253,077,000	191.5
June 30, 2010	329,129,000	3,298,897,000	2,969,768,000	10.0	3,321,614,000	89.4

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Membership of the retirement systems, at June 30, 2010, is shown in the following table:

	Kentucky Employees Retirement System		County Employees Retirement System		State Police Retirement System	Judicial Retirement Plan	Legislators' Retirement Plan	Kentucky Teachers' Retirement System	Total
	Non-Hazardous	Hazardous	Non-Hazardous	Hazardous					
Retirees and beneficiaries receiving benefits	37,945	2,835	41,038	6,068	1,223	306	159	43,134	132,708
Terminated plan members - vested	37,681	3,155	64,004	2,631	345	24	53	5,637	113,530
Active plan members	47,090	4,291	84,681	9,562	961	248	124	76,387	223,344
Total Members	122,716	10,281	189,723	18,261	2,529	578	336	125,158	469,582
Number of participating employers	372		1,396		1	1	1	197	1,968

Three year trend for contributions (Expressed in thousands):

	Pension		Insurance		Total	
	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
<u>Kentucky Employees Retirement System</u>						
<u>Non-Hazardous</u>						
2008	\$ 264,743	39.5%	\$ 558,746	11.3%	\$ 823,489	20.4%
2009	294,495	38.2%	362,707	22.8%	657,202	29.7%
2010	348,495	41.3%	376,556	27.2%	725,051	34.0%
<u>Hazardous</u>						
2008	\$ 14,147	107.8%	\$ 51,215	43.1%	\$ 65,362	57.1%
2009	15,708	100.9%	34,670	60.6%	50,378	73.1%
2010	17,815	99.1%	35,045	63.5%	52,860	75.5%
<u>State Police Retirement System</u>						
2008	\$ 13,823	53.8%	\$ 43,470	17.3%	\$ 57,293	26.0%
2009	15,952	51.3%	29,325	26.1%	45,277	34.9%
2010	18,765	50.6%	30,302	29.4%	49,067	37.5%
<u>Judicial Retirement Plan</u>						
2008	\$ 2,375	100.0%	\$ 460	100.0%	\$ 2,835	100.0%
2009	4,512	99.1%	838	99.1%	5,350	99.1%
2010	4,512	99.1%	838	99.0%	5,350	99.1%
<u>Legislator's Retirement Plan</u>						
2008	\$ 428	100.0%	\$ 285	100.0%	\$ 713	100.0%
2009	375	85.3%	60	100.0%	435	88.0%
2010	375	85.3%	60	100.0%	435	87.4%
<u>Kentucky Teachers' Retirement System</u>						
2008	\$ 563,789	78.0%	\$ 397,196	41.9%	\$ 960,985	76.0%
2009	600,283	66.8%	468,812	39.2%	1,069,095	54.7%
2010	633,938	66.0%	459,047	38.2%	1,092,985	54.3%

Note 9

EMPLOYEE BENEFIT PLAN

Kentucky Public Employees' Deferred Compensation Plan

Employees of the Commonwealth, its cities, counties, and local school districts are eligible to participate in two deferred compensation plans as authorized by the United States Internal Revenue Code. These plans, labeled 457 and 401(k), after sections of the Code, are administered by the Personnel Cabinet and an independent Plan administrator. The Commonwealth, through a board of trustees as defined in KRS 18A.245, selects the administrator to oversee the daily operations and technical compliance of the Plans with applicable sections of the Internal Revenue Code. The Commonwealth's responsibilities consist of withholding payroll deductions for its employees, collecting employee withholdings of the cities, counties, and local school districts, and remitting those withholdings to the plan administrators holding fixed and variable annuity contracts (carriers). Both Plans permit employees to defer collecting a portion of their salary until future years. This deferment is not available to employees until termination, retirement, death, or unforeseeable emergency. Assets of the 457 Plan and the 401(k) Plan are reported in a Pension Trust Fund within the fiduciary fund type, in compliance with Internal Revenue Code and GASB 32 requirements.

Of the \$633,213,708 in the 457 Plan at June 30, 2010, \$318,545,208 was applicable to the Commonwealth, while the remaining \$314,668,500 represents assets of the other jurisdictions participating in the Plan. The 401(k) Plan had total plan assets of \$977,779,558 at June 30, 2010, of which \$379,227,950 was applicable to the state while the remaining \$598,551,608 represents other participating jurisdictions.

Note 10

LEASE OBLIGATIONS

The Commonwealth has entered into various leases for buildings and equipment. Generally, leases contain termination clauses providing for cancellation after a 30-, 60-, or 90-days written notice. In addition, certain leases contain appropriation clauses indicating that continuation of the lease is subject to funding by the General Assembly. It is expected that in the normal course of business most of these leases will be replaced by similar leases.

A portion of the capital lease liability for the University and College Fund is applicable to leases with the Commonwealth.

Changes in leases payable for the year ended June 30, 2010, are summarized in Note 15, Changes in Long-Term Obligations.

COMMONWEALTH OF KENTUCKY

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At June 30, 2010, capitalized leases included Buildings and Equipment as follows (Expressed in Thousands):

Buildings and Equipment acquired through capital leases are recorded at the lesser of fair market value or present value of future minimum lease payments.

	<u>Primary Government</u>		
	<u>Governmental Activities</u>	<u>Business-Type Activities</u>	<u>Component Units-Major</u>
Buildings	\$ 26,519	\$	\$ 475,125
Equipment	27,755	353	56,763
Other			60,336
Total	<u>54,274</u>	<u>353</u>	<u>592,224</u>
Less: Accumulated depreciation	(25,297)	(168)	(119,031)
Total Net of Depreciation	<u>\$ 28,977</u>	<u>\$ 185</u>	<u>\$ 473,193</u>

Future minimum rental commitments for capitalizable leases as of June 30, 2010, are as follows (Expressed in Thousands):

	<u>Primary Government</u>		<u>Component Units-Major Universities, Colleges, and Related Entities</u>	<u>Total</u>
	<u>Governmental Activities</u>	<u>Business-Type Activities</u>		
2011	\$ 10,313	\$ 71	\$ 70,102	\$ 80,486
2012	4,960	48	66,982	71,990
2013	3,409	16	64,023	67,448
2014	2,648		51,674	54,322
2015	5,057		45,604	50,661
2016-2020	10,766		189,578	200,344
2021-2025	3,054		153,230	156,284
2026-2030	206		74,325	74,531
Total minimum lease payments	40,413	135	715,518	756,066
Less: Amount representing interest (1.50-63.60%)	(8,072)	(8)	(192,500)	(200,580)
Present value of future minimum lease payments	<u>\$ 32,341</u>	<u>\$ 127</u>	<u>\$ 523,018</u>	<u>\$ 555,486</u>

Note 11

RISK MANAGEMENT

The Commonwealth is exposed to various risks of loss related to torts: theft, damage, and destruction of assets; errors and omissions; injuries to employees; and natural disasters. The Commonwealth utilizes the Risk Management Fund to account for these activities.

Fire and Tornado Insurance:

The Fire and Tornado Insurance Program is established to account for and finance its uninsured risk of loss arising from damages to State buildings and personal property. Under this program, coverage is provided for up to a maximum of \$500,000 per occurrence of loss for each insured subject of risk. The Fire and Tornado Insurance Program purchases reinsurance for claims in excess of coverage provided by the Program. Settled claims have not exceeded commercial coverage in any of the past three fiscal years.

The claims liability of \$2,702,573 reported in the Program at June 30, 2010, is based on the requirements of GASB 10, which requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that a liability

has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. Changes in the Program's claims liability amount in Fiscal Years 2010 and 2009 were:

	<u>Fiscal Year 2010</u>	<u>Fiscal Year 2009</u>
Beginning of fiscal year liability	\$ 1,326,874	\$ 987,830
Incurred claims	39,955,871	4,702,032
Changes in estimates		
Claims payments	(38,580,172)	(4,362,988)
Balance at Fiscal Year End	<u>\$ 2,702,573</u>	<u>\$ 1,326,874</u>

Self-Insured Workers' Compensation:

The Workers' Compensation Program is self-insurance for the benefit of the Commonwealth's employees, and others as described in KRS 18A.370. Losses payable by the Program include medical claims and loss of wages as a result of an employment related injury. Premiums are established based upon estimated claims and administrative cost for the coming fiscal year. The Program carries reinsurance coverage for large individual or incident claims between \$5,000,000 and \$20,000,000.

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

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The actuarially determined aggregate claims liability of \$133,533,497 reported in the Program at June 30, 2010, includes both reported and unreported insured events, including estimates of future payments of losses and related claims' adjustments. Changes in the Program's claims liability amount in Fiscal Years 2010 and 2009 were:

	<u>Fiscal Year 2010</u>	<u>Fiscal Year 2009</u>
Beginning of fiscal year liability	\$ 130,785,487	\$ 118,833,138
Claims and claims adjustments incurred:		
Current year	19,083,735	21,005,861
Increase (Decrease) in Prior year	<u>1,986,969</u>	<u>10,218,377</u>
Total Claims and Claims Adjustments Incurred:	21,070,704	31,224,238
Claims and claims adjustment payments:		
Current year	(4,613,203)	(4,906,900)
Increase (Decrease) in Prior year	<u>(13,709,491)</u>	<u>(14,364,989)</u>
Total Claims and Claims Adjustment Payments	(18,322,694)	(19,271,889)
Balance at Fiscal Year End	<u>\$ 133,533,497</u>	<u>\$ 130,785,487</u>

Transportation Cabinet Workers' Compensation:

The Transportation Cabinet's Self-Insured Workers' Compensation Trust Program (the "Program") was organized on July 1, 1963, as a self-insurance fund administered by the Transportation Cabinet of the Commonwealth of Kentucky (the "Cabinet"). The purpose of the Program is to provide workers' compensation insurance to the employees of the Cabinet. The losses incurred by the Program are serviced by a designated third-party administrator who processes and reports all claims to the program. Changes in the Program's claims liability amount in Fiscal Years 2010 and 2009 were:

	<u>Fiscal Year 2010</u>	<u>Fiscal Year 2009</u>
Beginning of fiscal year liability	\$ 24,053,754	\$ 24,742,142
Claims and claims adjustments incurred	3,388,000	3,150,000
Changes in estimates	(2,256,000)	(1,297,748)
Claims and claims adjustment payments	<u>(2,903,567)</u>	<u>(2,540,640)</u>
Balance at Fiscal Year End	<u>\$ 22,282,187</u>	<u>\$ 24,053,754</u>

Note 12

RISK POOLS

The Commonwealth's risk pools are the Insurance Administration Fund (enterprise fund) and the Grain Insurance Corporation and Kentucky Access (component units). The Insurance Administration Fund includes the operations of five risk pools as follows: Workers' Compensation Insurance, Coal Workers Pneumoconiosis, Petroleum Storage Tank Assurance, Bond Pool, and Mine Subsidence Insurance. The Insurance Administration Corporation is reported as part of the primary government. Kentucky Access and the Grain Insurance Corporation are risk pools reported as discrete component units.

Risk Pools - Enterprise Funds

Workers' Compensation Insurance:

The Kentucky Workers' Compensation Insurance Program, a risk sharing pool, covers preexisting conditions to protect employers from having to pay for injuries not sustained while under their employment, or more than once for disabilities resulting from the same accident. This Program encourages reemployment of injured workers at adequate wages by relieving the employer of the requirement of paying disability compensation in addition to full wages. The Program also covers claims against uninsured employers.

The Program establishes claims liabilities based on estimates of the ultimate cost of claims (including future claim adjustment expenses) that have been reported but not settled, and of claims that have been incurred but not reported. The claims liability of \$787,872,000, as reported in the financial statements, is the present value of the aggregate actuarially determined claims liability of \$1,446,451,000, discounted at 6.0 percent, and net of the estimated realizable value of reimbursements. The claims adjusted liability of \$12,941,000, as reported in the financial statements is the present value of the aggregate actuarially determined liability of \$20,665,000, discounted at 6.0 percent.

The actuarially determined liabilities described above arise from projections included in a biennial actuarial report that was performed as of June 30, 2010. Changes in the Program's aggregate liabilities for claims and claims adjustment for the past two years were:

	<u>Fiscal Year 2010</u>	<u>Fiscal Year 2009</u>
Beginning of fiscal year liability	\$ 1,533,571,000	\$ 1,815,475,000
Claims and claims adjustments incurred	7,159,000	6,508,500
Changes in estimates	(551,000)	(215,768,500)
Claims and claims adjustment payments	<u>(73,063,000)</u>	<u>(72,644,000)</u>
Balance at Fiscal Year End	<u>\$ 1,467,116,000</u>	<u>\$ 1,533,571,000</u>

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

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Coal Workers' Pneumoconiosis Fund:

The Coal Workers' Pneumoconiosis Fund (CWPF) was created within the Labor Cabinet through the enactment of House Bill No. 1 by the December 1996 Special Session of the General Assembly. The CWPF is liable for one-half of the income benefits and retraining incentive benefits for occupational pneumoconiosis resulting from exposure to coal dust created in the severance or processing of coal. The employer is liable for the remaining half.

In accordance with House Bill No. 1 from the December 1996 Special Session, the Kentucky Workers' Compensation Funding Commission shall impose a pneumoconiosis assessment to pre-fund the liabilities of the CWPF and to finance its administration. The assessment is 3.0 percent of workers' compensation premiums received on or after January 1, 1997, from employers engaged in the severance or processing of coal and an additional assessment of \$0.025 per ton imposed upon coal severed on or after January 1, 1997. All pneumoconiosis assessments collected by the Funding Commission are to be credited to a separate account within the Benefit Reserve Fund and to be transferred as necessary to pay administrative expenses and current claims of the CWPF.

The Coal Workers' Pneumoconiosis Fund establishes claims liability based on estimates of the ultimate cost of claims (including future claims adjustment expenses) that have been reported but not settled, and of claims that have been incurred but not reported. The claims liability of \$9,160,000, as reported in the financial statements, is the present value of the aggregate actuarially determined liability of \$16,064,000, discounted at 6.0 percent. The claims adjustment liability of \$834,000, as reported in the financial statements, is the present value of the aggregate actuarially determined liability of \$1,462,000, discounted at 6.0 percent. Changes in the aggregate liability for claims and claims adjustments for the past two years were as follows:

	Fiscal Year 2010	Fiscal Year 2009
Beginning of fiscal year liability	\$ 15,550,000	\$ 16,144,000
Claims and claims adjustments incurred	3,241,000	3,039,000
Changes in estimates	60,000	(2,530,000)
Claims and claims adjustment payments	<u>(1,325,000)</u>	<u>(1,103,000)</u>
Balance at Fiscal Year End	<u>\$ 17,526,000</u>	<u>\$ 15,550,000</u>

As stated above, the Coal Workers' Pneumoconiosis Fund was created by the December 1996 Special Session of the General Assembly. Therefore, there are no provisions for claims prior to 1997.

Petroleum Storage Tank Environmental Assurance Program:

The Office of the Petroleum Storage Tank Environmental Assurance Program, a risk sharing pool, was created in the 1990 regular session of the Kentucky General Assembly. The purpose of the Program is to assist petroleum storage tank owners or operators in complying with federal financial responsibility requirements relating to petroleum storage tanks and in cleaning up contamination caused by leaking tanks. A fee paid (at a rate of one and four-tenths cents per gallon) by dealers on each gallon of gasoline funds the Program and special fuels received in the Commonwealth funds the program.

The Program insures petroleum storage tank owners or operators for cost incurred for cleanup and other corrective action required in cleaning up contamination caused by leaking petroleum storage tanks. The Program also provides coverage for third party claims against the owners or operators for damages sustained as a result of leaking storage tanks. Claims paid by the Program are subject to deductibles that are applied separately, by occurrence, for cleanup claims and third party damage claims. The deductible is set at \$1,000 per occurrence for owners or operators of five or fewer tanks, and at \$5,000 for owners or operators of six to ten tanks, and at \$25,000 for owners or operators of more than ten tanks.

The Program establishes claims liabilities based on estimates of the ultimate cost of claims (including future claim adjustment expenses) that have been reported but not settled, and of claims that have been incurred but not reported. The claims liability of \$240,719,503 that was reported in the financial statements is the aggregate actuarially determined claims liability and is not discounted. Changes in the Program's aggregate liabilities for claims and claims adjustment for the past two years were:

	Fiscal Year 2010	Fiscal Year 2009
Beginning of fiscal year liability	\$ 240,382,101	\$ 285,552,792
Claims and claims adjustments incurred	28,542,988	(28,983,624)
Changes in estimates		
Claims and claims adjustment payments	<u>(28,205,586)</u>	<u>(16,187,067)</u>
Balance at Fiscal Year End	<u>\$ 240,719,503</u>	<u>\$ 240,382,101</u>

Bond Pool:

The Bond Pool was established in 1986 to provide an alternative bonding program for small to medium sized coal companies in Kentucky. Membership in the Pool is voluntary and prospective members must apply to become members. Applicants must meet standards set by the Bond Pool Commission to be accepted as members of the Bond Pool. These criteria, used to evaluate potential Bond Pool members, consider factors such as mining experience, reclamation history, and financial condition of the applicant.

COMMONWEALTH OF KENTUCKY

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The Commission, based on the standards considered in the application process, rates accepted members. The members are rated and assessed an initial membership fee based on this rating. This fee ranges from \$1,000 to \$2,500. Additionally members pay tonnage fees of \$.05 per ton of surface mined coal and \$.01 per ton for underground mined coal. Provisions are also in effect where the tonnage fee is suspended for members who have participated in the Program for 36 months, or when the Program balance exceeds \$7 million.

The coal companies participating in the Program are required to post a permit specific bond based on the number of acres permitted and their rating in the Program. The Bond Pool in turn provides coverage for reclamation costs that exceed the permit specific bond but limits claims to the total amount of bond required by the permit. The Bond Pool does not pay claims for costs incurred in excess of the required bond amount.

The Program establishes claims liabilities based on estimates of the ultimate cost of claims (including future claim adjustment expenses) that have been reported but not settled, and of claims that have been incurred but not reported. The claims liability of \$21,452,273, as reported in the financial statements, is the aggregate actuarially determined claims liability. There were no changes in claims adjustment liability during fiscal year 2010. Changes in the Program’s aggregate liabilities for claims and claims adjustments for the past two years were:

	Fiscal Year 2010	Fiscal Year 2009
Beginning of fiscal year liability	\$ 21,452,273	\$ 21,452,273
Claims and claims adjustments incurred		
Changes in estimates		
Claims and claims adjustment payments		
Balance at Fiscal Year End	<u>\$ 21,452,273</u>	<u>\$ 21,452,273</u>

Mine Subsidence Insurance:

The Mine Subsidence Insurance Program is administered by the Department of Insurance. The provisions of the Program require that all insurance policies issued or renewed that insure a structure located in any county in the Commonwealth, except those specifically exempted by KRS 304.44-60, shall include a separately stated premium for mine subsidence damage coverage. This premium is assessed at the amount determined by the Program, and the insurer is required to code this coverage to the Program. The insurer may refuse to provide coverage where preexisting damage is determined to exist. The Program provides coverage subject to a deductible of 2 percent of the policy’s total insured value or not less than \$250 and not more than \$500. The Mine Subsidence Program also limits its coverage to \$50,000 per structure.

GASB 10 requires that a liability for claims be reported if information prior to the issuance of the financial statements indicates that it is probable that liability has been incurred at the date of the financial statements and the amount of the loss can be reasonably estimated. The Mine Subsidence Program had no liabilities reported. Changes in the Program’s claims liability amount in Fiscal Years 2010 and 2009 were:

	Fiscal Year 2010	Fiscal Year 2009
Beginning of fiscal year liability	\$ 0	\$ 0
Claims and claims adjustments incurred		
Changes in estimates		
Claims and claims adjustment payments		
Balance at Fiscal Year End	<u>\$ 0</u>	<u>\$ 0</u>

Kentucky Employees Health Plan:

Kentucky Employees Health Plan was established pursuant to KRS 18A.225, 18A.226, and 18A.227 to administer and facilitate an employee health insurance program as part of a flexible benefits plan. The Department for Employee Insurance (the Department) is responsible for overseeing the Kentucky Employees Health Plan (KEHP).

The health benefits for governmental participants are funded by monthly premiums paid by individuals and state and local governmental units. A participant may extend coverage to dependents for an additional monthly premium based on the coverage requested. Premiums are collected by the Department and held in a trust fund until needed for the payment of benefits.

The Plan develops premium equivalent rates each year by utilizing historical trend information, current claims experience and national trends. An outside actuarial consultant advises the Plan Administrator regarding premium rates. If premium rates are changed, they become effective the beginning of a calendar year.

Plan participants are not subject to supplemental assessment in the event of a premium deficiency. At the time of premium payment, the risk of loss due to incurred benefit costs is transferred from the participant to the Plan. If assets of the Plan were to be exhausted, participants would not be responsible for the Plan’s liabilities.

All state agencies and local boards of education in the Commonwealth are required to offer to their active employees the coverage selections offered by the Plan. Local government entities may elect to participate in the Plan.

COMMONWEALTH OF KENTUCKY
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The Plan establishes liabilities for incurred but unpaid claims based on its estimate of the ultimate cost of settling claims that have been reported but not yet settled, and of claims that have been incurred but not yet reported. The claims liability \$78,000,000 that was reported in the financial statements is the aggregate actuarially determined claims liability. Changes in the aggregate liabilities for claims and claims adjustment expenses for the past two years are as follows:

	<u>Fiscal Year 2010</u>	<u>Fiscal Year 2009</u>
Beginning of fiscal year liability	\$ 92,944,000	\$ 79,838,645
Claims and claims adjustments incurred	1,504,737,813	1,399,015,475
Changes in estimates	(3,777,204)	19,793,826
Claims and claims adjustment payments	<u>(1,515,904,609)</u>	<u>(1,405,703,946)</u>
Balance at Fiscal Year End	<u>\$ 78,000,000</u>	<u>\$ 92,944,000</u>

Risk Pools - Component Units

Kentucky Access:

Kentucky Access was created to ensure that health coverage is made available to each applying and qualifying Kentucky individual. As an implemented state sponsored “high risk” pool, Kentucky Access was established January 2, 2001 by KRS 304.17B-001 to 304.17B-031. Its purpose is that Kentucky may continue flexible regulation of health coverage.

In operating under the Division of Kentucky Access in the Department of Insurance, KRS 12.050 and KRS 304.2-060 guides the appointments of an appropriate division director as appointed by the commissioner of insurance. Also, the Guaranteed Acceptance Program, as established by KRS 304.17A-400 to 304.17A-480, helps participating insurance companies to recover losses from individuals who met the “high risk” pool category by transferring the funds to Kentucky Access.

Under this program, a referral fee is paid to Kentucky Access. A provider network is then established, or a provider network is created by contracting with an insurer for a statewide provider network. Under KRS 304.17B-011 the established provider network is available and limited only to Kentucky Access enrollees.

A third-party administrator chosen through the state bidding process administers Kentucky Access. The administrator develops and establishes policies and procedures for enrolled participants and potential enrollees. However, premium rates charged do not fully cover health care costs; thus, claims exceeding premium rates shall be covered by the Kentucky Access Fund.

Changes in the Program’s claims liability amount in Fiscal Years 2010 and 2009 were:

	<u>Fiscal Year 2010</u>	<u>Fiscal Year 2009</u>
Beginning of fiscal year liability \$	8,890,000	\$ 8,890,000
Claims and claims adjustments incurred	61,504,793	
Changes in estimates		
Claims and claims adjustment payments	<u>(61,504,793)</u>	
Balance at Fiscal Year End	<u>\$ 8,890,000</u>	<u>\$ 8,890,000</u>

Grain Insurance:

The Grain Insurance Program was established to promote economic stability in agriculture by providing coverage to grain producers for losses incurred in the event of a financial failure of a grain dealer or grain warehousemen. The Program is funded by a half-cent per bushel assessment on all marketed grain produced in Kentucky. The Program also has provisions that the assessment can be suspended when the balance of the Program reaches \$3 million and if suspended will be reapplied when the balance of the Program drops to \$2 million.

No claims liability was reported in the Program at June 30, 2010, based on the requirements of GASB 10. This statement prescribes the reporting of a claim liability if information prior to the issuance of the financial statements indicates that a probable liability has been incurred at the date of the financial statements, and the amount of the loss can be reasonably estimated. Claims liability in Fiscal Year 2009 was also zero.

Note 13

DEFEASANCE OF LONG-TERM DEBT

The School Facilities Construction Commission issues revenue bonds on behalf of local school districts to finance construction of new facilities or the major renovation of existing facilities. The Commission participates in the payment of debt service for qualifying districts. By statute, the Commission’s portion of the savings from refunding issues goes to the school district. Therefore, the Commission’s participation remains unchanged and the Commission does not experience an economic gain or loss on these transactions. Proceeds from the issues are placed in escrow accounts to pay the future debt service of the issue(s) being refunded. During the fiscal year ended June 30, 2010 the Commission issued the following refunding revenue bonds:

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Revenue refunding bonds dated June 1, 2009, were issued for the Bellevue Independent School District Finance Corporation to refund a 1998 issue. The Commission's portion of the refunding issue was \$133,958 maturing May 1, 2010 through May 1, 2018 and carrying interest rates from 1.40% to 3.40%.

Revenue refunding bonds dated November 1, 2009, were issued for the Erlanger-Elsmere Independent School District Finance Corporation to refund a 1995 issue and a 1999 issue. The Commission's portion of the refunding issue was \$1,347,880 maturing February 1, 2010 through February 1, 2019 and carrying interest rates from 1.00% to 3.40%.

Revenue refunding bonds dated July 30, 2009, were issued for the Fayette County School District Finance Corporation to refund a 1998 issue. The Commission's portion of the refunding issue was \$533,339 maturing February 1, 2010 through August 1, 2018 and carrying interest rates from 1.00% to 3.25%.

Revenue refunding bonds dated August 4, 2009, were issued for the Jefferson County School District Finance Corporation to refund a 1998 issue. The Commission's portion of the refunding issue was \$9,549,211 maturing February 1, 2010 through February 1, 2019 and carrying interest rates from 2.00% to 4.00%.

Revenue refunding bonds dated July 1, 2009, were issued for the Jessamine County School District Finance Corporation to refund a 1999 issue. The Commission's portion of the refunding issue was \$1,278,097 maturing February 1, 2010 through August 1, 2020 and carrying interest rates of 2.00% to 3.70%.

Revenue refunding bonds dated October 13, 2009, were issued for the Logan County School District Finance Corporation to refund a 2000 issue. The Commission's portion of the refunding issue was \$595,458 maturing June 1, 2010 through December 1, 2020 and carrying interest rates from 2.00% to 3.25%.

Revenue refunding bonds dated April 27, 2010, were issued for the Ohio County School District Finance Corporation to refund a 1999 issue. The Commission's portion of the refunding issue was \$879,086 maturing January 1, 2011 through January 1, 2019 and carrying interest rates from 1.00% to 3.10%.

Revenue refunding bonds dated February 1, 2010, were issued for the Perry County School District Finance Corporation to refund a 1998 issue. The Commission's portion of the refunding issue was \$1,784,162 maturing June 1, 2010 through December 1, 2018 and carrying interest rates from 1.00% to 3.00%.

Revenue refunding bonds dated August 1, 2009, were issued for the Pulaski County School District Finance Corporation to refund a 1998 issue. The Commission's portion of the refunding issue was \$1,137,295 maturing January 1, 2010 through July 1, 2018 and carrying interest rates from 2.00% to 3.00%.

Revenue refunding bonds dated April 1, 2010, were issued for the Scott County School District Finance Corporation to refund a 1999 issue. The Commission's portion of the refunding issue was \$1,272,919 maturing February 1, 2011 through February 1, 2019 and carrying interest rates of 2.00% to 3.375%.

Revenue refunding bonds dated December 1, 2009, were issued for the Spencer County School District Finance Corporation to refund a 1999 issue. The Commission's portion of the refunding issue was \$1,355,713 maturing July 1, 2010 through January 1, 2021 and carrying interest rates from 2.00% to 3.375%.

Revenue refunding bonds dated December 1, 2009, were issued under the Kentucky Interlocal School Transportation Association (KISTA) Small Issued Loan Program on behalf of forty-four (44) school districts. The purpose of these bonds was to refinance certain existing loans issued under the KISTA Small Issuer Loan Program (see accompanying table in this note). The Commission's portion of the refunding issue was \$8,412,381 maturing June 1, 2010 through December 1, 2019 and carrying interest rates from 1.00% to 3.30%.

The State Property and Buildings Commission issued the following Revenue and Revenue Refunding Bonds.

The State Property and Buildings Commission issued Revenue and Revenue Refunding Bonds; Project No. 95 dated July 9, 2009, in the amount of \$392,465,000. The issue consisted of: \$138,310,000 Series A (Revenue Refunding) serial bonds maturing February 1, 2010 through August 1, 2020 and carry interest rates of 2.00% to 5.00%; \$44,925,000 Series B (Federally Taxable – Revenue and Revenue Refunding) serial bonds maturing August 1, 2010 through August 1, 2013 and carry interest rates of 2.00% to 4.004%; and \$209,230,000 Series C (Federally Taxable-Build America Bonds). Term Bonds consisting of \$71,995,000 6.164% Term Bond due August 1, 2023 and \$137,235,000 6.573% Term Bond due August 1, 2029. \$157,882,517.80 (\$153,450,000 principle and \$4,432,517.80 interest) of the bond proceeds were deposited in the Bond Repayment Fund, for partial refunding of a note issued by the Kentucky Asset/Liability Commission, for complete or partial refunding of bonds issued by the Kentucky Infrastructure Authority and as complete or partial refunding of bonds issued by the State Property and Buildings Commission. These funds was used for partially refunding of 2003 Series A notes issued by the Kentucky Asset/Liability Commission maturing on August 15, 2009, for bonds issued by the Kentucky Infrastructure Authority these funds was used to completely refund bond issue 1998E maturing on June 1 of 2010, 2011, 1012, 2013, 2014, 2017 and partially refund bond issues 1995D, 2000F, 2000A, 2001B, 2001G, 2002H, 2004C, 2004I maturing on June 1. The funds deposited in the Note Repayment Fund completely or partially refunded bonds previously issued by the State Property and Building Commission. Completely refunded were project 60 bonds maturing on October 1, 2010 and October 1, 2011 and project 62 bond maturing on September 1, 2009, September 1, 2010, September 1, 2011, September 1, 2012,

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September 1, 2013 and September 1, 2014, partially refunded were project 63 bonds maturing on November 1, 2009, project 65 bonds maturing on February 1, 2010, project 69 bonds maturing on August 1, 2009, project 74 bonds maturing on August 1, 2009 and February 1, 2010, project 76 bonds maturing on August 1, 2009, project 77 bonds maturing on August 1, 2009, project 78 bonds maturing on October 1, 2009, project 82 bonds maturing on October 1, 2009, project 83 bonds maturing on October 1, 2009, project 87 bonds maturing on March 1, 2010, project 88 bonds maturing on November 1, 2009, project 89 bonds maturing on November 1, 2009, project 90 bonds maturing on November 1, 2009. The refunding will result in decrease cash flows in future periods of 26,965,404.80 and a present value loss of 792,380.74 at 3.5540%.

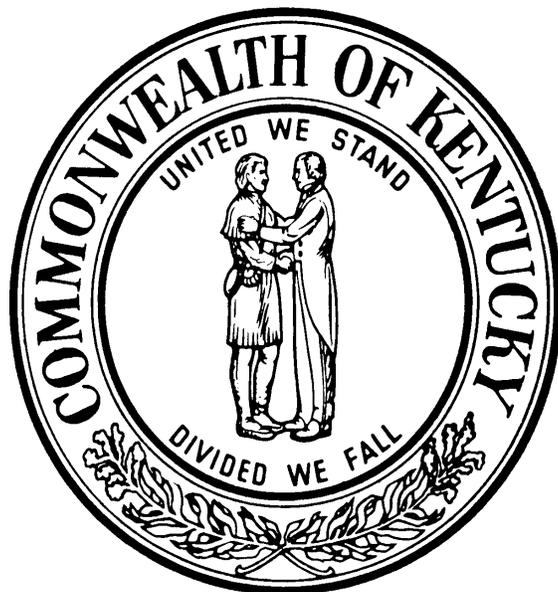
Project 73 (Third Series) Road Fund Revenue Refunding Bonds dated January 6, 2010, in the amount of \$13,680,000. The bonds mature May 1, 2010 through November 1, 2014 and carry interest rates of 1.00% to 2.25%. \$13,680,000 (\$13,505,000 principle and

\$175,000 interest) was deposited in the Bond Repayment Fund, and used for the partial refunding of project 73 (First Series) Road Fund Revenue bonds maturing November 1, 2012, 2013, 2014 and 2015. The net savings (reduction in cash flow) for the Refunding Bonds will be \$499,408.31 and the present value of the savings are \$473,249.78 at a rate of 3.459%.

The Turnpike Authority of Kentucky issued Economic Development Road Revenue and Revenue Refunding Bonds dated June 25, 2010 in the Amount of \$153,260,000. The bonds mature July 1, 2013 through July 1, 2020 and carried interest rates of 2.50% to 5.00%. \$81,434,779.38 was deposited to Bond Fund for Prior Bonds and used for partially refunding of Series 2000 bonds, Series 2001A bonds, Series 2004A bonds, Series 2004B bonds, Series 2005A bonds, Series 2005B bonds and Series 2006A bonds. All the bonds refunded had a maturing date of July 1, 2010.

Kentucky Interlocal School Transportation Association 2009 Issue

<u>School District</u>	<u>SFCC Face Amount</u>	<u>Local District Amount</u>	<u>Issues Refunded</u>
Augusta Independent	\$ 277,782	\$	Refunds KISTA 5/99 Issue
Ballard County	147,545	34,739	Refunds KISTA 5/99 Bonds
Calloway County	872,972	419,988	Refunds KISTA 9/00 Issue
Campbell County	237,430		Refunded KISTA 10/99 Issue
Cloverport Independent	207,774	40,472	Refunds KISTA 4/99 Issue
Dawson Springs Independent	83,563		Refunds KISTA 9/99 Issue
Erlanger Elsmere Independent	72,358	138,126	Refunds KISTA 6/99 Issue
Fleming County	205,442		Refunds KISTA 1/98 Issue
Fulton County	117,676	16,239	Refunded KISTA 8/97 Issue
Fulton County	172,246		Refunded KISTA 7/00 Bonds
Garrard County	194,134		Refunds KISTA 8/98 Issue
Hancock County	208,696	444,763	Refunds KISTA 6/97 & 6/99 Issues
Harlan County	492,220		Refunds KISTA 10/99 Issue
Harlan Independent	35,456		Refunds KISTA Issue 8/98
Hazard Independent	184,909		Refunds KISTA Issue 5/99
Lawrence County	306,631		Refunds KISTA Issue 12/97
Leslie County	244,755		Refunds KISTA Issue 5/00
Lewis County	711,240		Refunds KISTA 12/99 issue
Menifee County	231,660		Refunds KISTA 8/98 issue
Metcalfe County	182,416		Refunds KISTA Issue 7/99 & 9/99 Issue
Muhlenberg County	362,851		Refunds KISTA 11/97 Issue
Nelson County	37,304		Refunds KISTA 9/00 issue
Paris Independent	496,511		Refunds KISTA 7/99 & 9/99 & 2/00 issues
Powell County	75,416		Refunds KISTA 8/00 Issue
Webster County	442,053		Refunds Providence KISTA 5/98,9/98,4/99
Raceland Independent	242,886		Refunds KISTA 10/99 Issue
Robertson County	133,486		Refunds KISTA 4/00 Issue
Russell County	848,067		Refunds KISTA Srs 8/98 & 5/99
Williamsburg Independent	126,696		Refunds KISTA 9/99 Issue
Williamstown Independent	460,206		Refunds KISTA Srs 7/97 & 12/99
Nine Other Districts that were 100% Local Debt		3,308,292	
Totals	<u>\$ 8,412,381</u>	<u>\$ 4,402,619</u>	



Note 14

RELATED ORGANIZATIONS

The Commonwealth has several related organizations. The financial activities of these organizations are not included in the Commonwealth's financial statements. They are the East Kentucky Corporation, Eastern Kentucky Exposition Center Corporation, West Kentucky Corporation, West Kentucky Economic Development Fund, Northern Kentucky Convention Center Corporation, Kentucky Employer's Mutual Insurance Authority, Kentucky Wood Products Competitiveness Corporation, Commonwealth Seed Capital, LLC, World Games 2010 Foundation, Inc. and the Interstate Air Pollution Control Commission. The Commonwealth holds no economic interest in, nor has any financial responsibility for these organizations.

Note 15

LONG-TERM OBLIGATIONS

Long-Term Obligations

General Obligation Bonds are issued through the State Property and Buildings Commission, subject to general referendum approval required by the Kentucky Constitution. General obligation bonds pledge the full faith, credit, and taxing power of the Commonwealth and denote application of specific or general tax revenues to provide payment of principal and interest requirements on the debt. No new issues of this type have been issued since 1965, and none are outstanding or authorized but unissued at June 30, 2010.

Revenue Bonds- General authorization for the use of revenue bonds is contained in Chapter 58 of the Kentucky Revised Statutes. Specific authority is contained in the legislation and related KRS chapters creating and empowering the various debt issuing entities. Reference to such legislation and laws is made throughout the following entity descriptions. Effective July 15, 1980, KRS 56.870 requires prior approval of debt financing projects by the Kentucky General Assembly sitting in regular or special sessions. Succeeding statutes establish the methods for this approval and the exemptions from it. The majority of new debt issues are approved through the appropriation act. Per KRS 56.873, effective July 15, 1980, revenue bonds having passed the above mechanisms, and not requiring Commonwealth appropriations, must receive an "A" rating by Moody's Investors Service or the equivalent rating by another qualified rating agency prior to their sale.

Project revenue debt pledges only the revenues produced by the project so funded as security for repayment and does not directly obligate the Commonwealth. Kentucky's project revenue debt may be further classified by the purpose of the debt. Revenue debt issued by the Kentucky Housing Corporation, Kentucky Infrastructure Authority, Kentucky Higher Education Student Loan Corporation, Kentucky Economic Development Finance Authority, Kentucky Local Correctional Facilities Construction Authority, Kentucky Agricultural Finance Corporation, and Kentucky School Facilities Construction Commission is used as a financing mechanism for activities and facilities not used directly for State purposes. The tax-exempt status of such municipal debt, whether issued by State or local governments, is used to provide financing for entities unable to bear the costs of private financing when the General Assembly deems such entities worthy of public assistance. The other category of revenue debt finances facilities used directly by State Government in activities such as roads, parks, office buildings, and educational facilities. The primary distinction between these categories is that the first type, with the exceptions of the Kentucky School Facilities Construction Commission, which succeeds the Kentucky School

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Building Authority, and the Kentucky Infrastructure Authority, which succeeds the Kentucky Pollution Abatement and Water Resources Finance Authority, requires no State funds of any type to provide debt service, principal and interest payments on the debt. The School Facilities Construction Commission supplements funds provided by local governments and school boards in varying percentages for debt service. The Kentucky Infrastructure Authority may accept appropriations made by the General Assembly, in addition to State and Federal grants, related to the purposes for which it was created. This distinction is important in analyzing the true level of State debt and the burden of that debt on State resources.

During the fiscal year ended June 30, 2010 the debt issuing entities described below sold revenue and revenue refunding bonds as follows:

The Kentucky State Property and Buildings Commission is an independent agency of the Commonwealth created by KRS 56.450 and empowered upon application of any State agency to issue bonds in its own name to pay the costs of acquiring land and equipment, and the construction and equipping of buildings for the occupancy and/or use of said agencies.

The Commission issued \$807,490,000 in revenue and revenue refunding bonds as follows:

\$392,465,000 Project 95 Revenue and Revenue Refunding Bonds, dated July 9, 2009. These bonds consists of: \$138,310,000 Series A (Revenue Refunding) serial bonds maturing February 1, 2010 through August 1, 2020 and carry interest rates of 2.00% to 5.00%; \$44,925,000 Series B (Federal Taxable – Revenue and Revenue Refunding) serial bonds maturing August 1, 2010 through August 1, 2013 and carry interest rates of 2.00% to 4.004%; and \$209,230,000 Series C (Federally Taxable-Build America Bonds) Term Bonds, consisting of: \$71,995,000 6.164% Term Bonds due August 1, 2023, and \$137,235,000 6.573% Term Bonds due August 1, 2029.

\$401,345,000 Project 96, Revenue Bonds, dated November 17, 2009. The issue consists of: \$47,980,000 Series A Serial Bonds maturing November 1, 2012 through November 1, 2014 carrying interest rates of 3.00% to 5.00%; \$4,460,000 4.25% Term Bonds due November 1, 2029; \$11,650,000 5.00% Term Bonds due November 1, 2029; Series B (Federally Taxable) \$7,085,000 .720% Term Bonds due November 1, 2010; and \$7,085,000 1.627% Term Bonds due November 1, 2011; Series C (Federally Taxable-Build America Bonds-Direct Payment to the Commission) \$92,920,000 Serial Bonds maturing November 1, 2015 through November 1, 2019 and carry interest rates of 4.077% to 5.061%; \$63,910,000 5.561% Series C Term Bonds due November 1, 2022; and \$166,255,000 6.155% Series C Term Bonds due November 1, 2029.

\$13,680,000 Project 73 Road Fund Revenue Refunding Bonds (Third Series Bonds), dated January 6, 2010. The bonds mature May 1, 2010 through November 1, 2014, and carry interest rates of 1.00% to 2.25%.

The Turnpike Authority of Kentucky was created in the 1960 regular session of the General Assembly under present KRS sections 175.410 through 175.990 as a body corporate and politic constituting a municipal corporation, political subdivision, and instrumentality of the Commonwealth. The Authority is composed of the Governor, Lieutenant Governor, Attorney General, and Secretary of Transportation, Commissioner of Highways, State Highway Engineer, and Secretary of Economic Development. The Director of the Office of Financial Management currently serves as the Authority's Treasurer.

The Authority issued the following bonds during fiscal year 2010:

\$153,260,000 Economic Development Road Revenue and Revenue Refunding Bonds (Revitalization Projects), 2010 Series A, dated June 25, 2010. The bonds mature July 1, 2013 through July 1, 2020, and carry interest of 2.00% to 5.00%.

\$187,640,000 Economic Development Road Revenue Bonds (Revitalization Projects) (Federally Taxable-Build America Bonds-Direct to the Authority), 2010 Series B, dated June 25, 2010, consisting of: \$91,015,000 5.244% Term Bonds due July 1, 2025 and \$96,625,000 5.722% Term Bonds due July 1, 2030.

Kentucky Gas Pipeline Authority is a body corporate and politic to provide a financing mechanism for projects that will increase severance tax revenue for Kentucky, create jobs for Kentuckians, and create a competitive advantage in environmentally responsible development.

The authority issued no bonds during fiscal year 2010.

State Universities - The Board of Trustees of the University of Kentucky and the Boards of Regents of the University of Louisville, Eastern Kentucky University, Western Kentucky University, Murray State University, Morehead State University, Kentucky State University, and Northern Kentucky University are authorized under KRS 56.495 to issue debt for the purpose of constructing educational buildings and housing and dining facilities. In addition, the University of Louisville is specifically authorized to issue debt for educational buildings under KRS 64.860 but is limited to \$16 million of refunding debt.

State supported universities issued \$142,090,000 in General Receipts Bonds to finance various new construction projects and renovation of existing facilities as follow

University of Kentucky issued \$100,605,000 of University of Kentucky General Receipt Bonds, Taxable Build America Bonds, 2009 Series B,

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dated November 24, 2009. The bonds consist of: \$26,380,000 Serial Bonds maturing November 1, 2017 through November 1, 2024 and carry interest rates of 3.95% to 5.15%; \$20,400,000 5.35% Term Bonds due November 1, 2029 and \$53,825,000 5.70% Term Bonds due November 1, 2039.

Morehead State University issued \$28,930,000 General Receipts Bonds, Taxable Build America Bonds, 2009 Series A, dated July 29, 2009. The bonds consist of: \$21,160,000 Serial Bonds maturing November 1, 2010 through November 1, 2024 and carry interest rates of 2.00% to 5.90%; \$3,735,000 6.00% Term Bonds due November 1, 2026 and \$4,035,000 6.00% Term Bonds due November 1, 2028.

\$5,770,000 General Receipts Bonds, Taxable Build America Bonds, 2010 Series A, dated June 29, 2010. The bonds consist of: \$2,340,000 serial bonds maturing November 1, 2011 through November 1, 2019 and carry interest rates of 1.270% to 4.200%; \$600,000 4.600% Term Bonds due November 1, 2021; \$640,000 4.800% Term Bonds due November 1, 2023; \$680,000 5.200% Term Bonds due November 1, 2025; 725,000 5.600% Term Bonds due November 1, 2027 and \$785,000 5.750% Term Bonds due November 1, 2029.

Northern Kentucky University issued \$6,785,000 Northern Kentucky University General Receipts Bonds 2010 Series A, dated July 29, 2010. The bonds mature September 1, 2010 through September 1, 2020 and carry interest rates of 2.000% to 3.500%.

The Kentucky Housing Corporation was established in 1972 under KRS Chapter 198A, as a municipal corporation. The Corporation is authorized to increase the supply of housing for persons of lower income by making or participating in insured construction loans, and making or participating in insured mortgage loans when financing is not available from private lenders under reasonably equivalent terms and conditions. The Corporation is limited to a \$2.125 billion total maximum principal value of debt outstanding.

The Corporation issued \$160,000,000 in Housing Revenue Bonds which consisted of the following:

\$60,000,000 Housing Revenue Bonds, Series B (NON-AMT) dated October 1, 2009 consisting of: \$12,080,000 Serial Bonds maturing semi annually July 1, 2010 and January 1, 2011 through July 1, 2019 and carry interest rates of 1.050% to 3.875%; \$8,265,000 4.625% Term Bonds due July 1, 2024; \$3,870,000 4.750% Term Bond due July 1, 2026; \$6,545,000 4.850% Term Bond maturing July 1, 2029; \$13,075,000 5.000% Term Bond maturing July 1, 2035 and \$16,165,000 5.150% Term Bond due July 1 2039.

\$100,000,000 Housing Revenue Bonds, dated April 1, 2010. \$40,000,000 2010 Series A (NON-AMT) consisting of: \$29,450,000 Serial Bonds maturing semi annually January 1, 2010 through July 1, 2023 and carry interest rates of .50% to 3.95% and \$10,550,000 5.00% Term Bond due January 1, 2027. \$60,000,000 2009 Series C-1 (NON-AMT) 3.81% Term Bond due July 1, 2041.

The Kentucky Infrastructure Authority was created by House Bill 217, passed into law during the 1988 regular session of the Kentucky General Assembly, to assist governmental agencies of the State with respect to the construction and acquisition of infrastructure projects as defined in the legislation. Pursuant to this Act, which amends KRS Chapter 224A, all powers, duties, and obligations of the Kentucky Pollution Abatement and Water Resources Finance Authority, including administration of debt service on revenue bonds previously issued by the Authority, are transferred to the Kentucky Infrastructure Authority, which is established as a body corporate and politic, constituting a public corporation and a governmental agency and instrumentality of the State.

The Corporation issued \$208,430,000 of Revolving Fund Revenue Bonds during the year ended June 30, 2010 which consisted of the following:

\$208,430,000 Wastewater and Drinking Water Revolving Fund Revenue Bonds, Series 2010A dated April 15, 2010. The bonds mature February 1, 2011 through February 1, 2029 and carry interest rates of 1.500% to 5.000%.

The Kentucky Higher Education Assistance Authority is the Commonwealth of Kentucky's agency for improving higher education opportunities by insuring eligible student loans and providing other financial aid and related services to eligible students. The Authority is an issuer of student loans pursuant to the Federal Higher Education Act of 1965, as amended in Kentucky and Alabama. As such, the Authority is responsible for issuing loan insurance, providing collection assistance to lenders for delinquent loans, paying lender claims for loans, and collecting defaulted loans on which claims have been paid.

The Kentucky Higher Education Student Loan Corporation is empowered by KRS Chapter 164A to make and reinsure student loans with the United States of America, pursuant to the Federal Higher Education Act of 1965, and as a body corporate and politic acts as a financing authority to assure a secondary market for insured student loans. The Corporation is governed by board of directors appointed by the Governor, as prescribed in KRS 164A.050. The Corporation is limited to a maximum principal outstanding of \$5 billion.

The Corporation issued \$210,710,000 in Student Loan Revenue Bonds, Series 2010-1 (Tax-Exempt Non-AMT Libor Floating rate Bonds) dated June 22, 2010 consisting of Class A-1 Bonds and Class A-2 Bonds which carry variable interest rates that change based on specified indices, as follows: \$75,050,000 Class A-1 maturing May 1, 2020. These bonds will bear interest, except for the initial accrual period, at an annual rate equal to 100% of three-month LIBOR as of the second business day prior to the applicable interest accrual period plus .50%: \$135,660,000 Class A-2 maturing May 1, 2034. These bonds will bear interest, except for the initial accrual period,

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at an annual rate equal to 100% of three-month LIBOR as of the second business day prior to the applicable interest accrual period plus 1.20%.

The Kentucky Local Correctional Facilities Construction Authority is a body corporate and politic as well as an agency and instrumentality of the Commonwealth created in 1982 pursuant to KRS 441.605 through 441.695, as amended, to provide additional and alternative methods for acquiring, constructing, improving or repairing, and financing both regional and local jail facilities.

The authority issued no bonds during fiscal year 2010.

The School Facilities Construction Commission was created by act of the 1985 Extraordinary Session of the Kentucky General Assembly as the successor agency to the Kentucky School Building Authority (KSBA) and empowered pursuant to KRS 157.640 with all rights of successorship necessary to assure all legal and contractual functions and liabilities associated with the outstanding bonds issued in the name of the Authority, including refunding of then existing Authority debt. The Commission is an independent corporate agency and instrumentality of the Commonwealth pursuant to KRS 157.611 through 157.640 and empowered therein to: (1) act on behalf of local school districts to issue bonds in the name of the Commission and to enter into lease agreements with local boards of education to finance construction of new facilities or major renovation of existing facilities; (2) enter into agreements which may provide for a percentage discount, on a biennially renewable basis, of annual lease agreements due the Commission for those districts which participate; and (3) enter into lease agreements with the Department of Education to build State-owned facilities operated by the Department of Education.

During the fiscal year ended June 30, 2010, the Commission sold \$72,770,735 school building revenue and revenue refunding bond issues having aggregate state participation of \$72,770,735 maturing through June 1, 2030, at interest rates of 1.400% to 4.000%. Due to the length of the listing, the reader is referred to the detail Schedule of Bonds Outstanding at June 30, 2010, which is contained in the publication titled SUPPLEMENTARY INFORMATION to the Kentucky Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2010. Copies of this report are available from the Division of Statewide Accounting, Financial Reporting Branch, 484 Capitol Annex, Frankfort, Kentucky 40601.

The Kentucky Agricultural Finance Corporation is a public corporation and governmental agency of the Commonwealth established by Act of the 1984 General Assembly for the purpose of “improving and promoting the health, welfare, and prosperity of the people of the Commonwealth through the stimulation of existing agricultural ventures.” The Authority’s bond program is designed to help lender banks and other financial institutions assist eligible farmers in obtaining low interest loans through the issuance of tax-exempt agricultural revenue bonds. The Authority’s debt does not

constitute a legal or moral obligation of the Commonwealth, and this debt is not included in these general-purpose financial statements.

The Corporation issued no bonds during the fiscal year ended June 30, 2010.

The Kentucky Economic Development Finance Authority established in 1958 under KRS Chapter 154, is an independent agency of the Commonwealth that operates in close cooperation with the Secretary of the Economic Development Cabinet to promote the industrial development of Kentucky.

The Authority issued no bonds during the fiscal year ended June 30, 2010.

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The agencies and authorities that issue debt and their respective amounts of principal outstanding, net of discounts and defeased bonds, at June 30, 2010, are as follows (Expressed in Thousands):

Long-Term Obligations	Principal Outstanding	Interest Rate	Annual Maturity To
Agency:			
State Property and Buildings Commission	\$ 3,825,540	1.00%-7.65%	2029
Kentucky School Facilities Construction Commission	798,526	1.00%-6.50%	2031
Turnpike Authority of Kentucky	1,335,780	2.00%-5.75%	2030
Total	\$ 5,959,846		

Future revenue bond debt service requirements, to be paid with State Funds, at June 30, 2010, are as follows (Expressed in Thousands):

Year Ending June 30	Principal	Interest	Totals
2011	\$ 331,879	\$ 256,854	\$ 588,733
2012	309,127	243,781	552,908
2013	319,892	244,574	564,466
2014	339,214	229,037	568,251
2015	358,743	212,911	571,654
2016-2020	1,887,944	805,505	2,693,449
2021-2025	1,448,532	393,765	1,842,297
2026-2030	943,713	99,534	1,043,247
2031-2035	20,802		20,802
Total	\$ 5,959,846	\$ 2,485,961	\$ 8,445,807

Component Unit Revenue Bonds Payable	Principal Outstanding	Interest Rate	Annual Maturity To
Kentucky Housing Corporation *	\$ 2,236,735	0.50-6.06%	2042
Kentucky Infrastructure Authority	317,245	1.50-6.0%	2029
Kentucky Higher Education Student Loan Corporation	1,217,410	0.25-1.848%	2038
Kentucky Local Correctional Facilities Construction Authority *	11,745	5.25-5.25%	2015
University of Kentucky	254,110	2.25-4.66%	2040
University of Louisville	309,905	1.50-6.46%	2035
Eastern Kentucky University	37,020	4.0-4.80%	2024
Western Kentucky University	191,550	1.50-5.00%	2028
Murray State University *	44,080	1.10-5.4%	2029
Morehead State University	53,355	1.27-6.0%	2029
Kentucky State University*	5,810	2.0-3.2%	2027
Northern Kentucky University	86,180	2.00-6.10%	2029
Total Component Unit Revenue Bonds Payable	\$ 4,765,145		

* Amounts reflect original issue

Future revenue bond debt service requirements for bonds issued by the Commonwealth's Component Units at June 30, 2010, are as follows (Expressed in Thousands):

Year Ending June 30	Principal	Interest	Totals
2011	\$ 135,030	\$ 163,576	\$ 298,606
2012	136,360	161,437	297,797
2013	133,445	156,324	289,769
2014	134,626	150,870	285,496
2015	137,820	145,252	283,072
2016-2020	750,230	640,980	1,391,210
2021-2025	689,240	480,800	1,170,040
2026-2030	1,073,094	318,806	1,391,900
2031-2035	908,075	147,837	1,055,912
2036-2040	544,435	25,957	570,392
2041-2045	122,790	82	122,872
Total	\$ 4,765,145	\$ 2,391,921	\$ 7,157,066

NOTES PAYABLE:

At June 30, 2010, the following entities had notes payable as follows:

The Kentucky Asset/Liability Commission, created by House Bill 5 enacted by the 1997 Extraordinary Session of the Kentucky General Assembly, develops policies and strategies to minimize the impact of fluctuating interest rates on the Commonwealth's interest-sensitive assets and liabilities. It is authorized to issue tax and revenue anticipation notes, project notes and funding notes. Tax and revenue notes are to be used for the purpose of providing monies to discharge expenditure demands in anticipation of revenues and taxes to be collected during the fiscal year. Project notes are to be used for authorized projects upon request of the Finance and Administration Cabinet, to be repaid through financing agreements or alternative agreements. Funding notes are to be used for the purpose of funding judgments against the Commonwealth or any state agency.

The commission issued \$89,710,000 in Project Notes 2010 Federal Highway Trust Fund First Series A, matures September 1, 2020 through September 1, 2022, carrying rates of 3.30% to 5.00%. The project to be funded consists of preconstruction development activities related to the Louisville-Southern Indiana Ohio River Bridges Project.

The Component Units of the Commonwealth reported notes payable of \$1,372,487,000 in their individual audited financial statements, details concerning their notes payable are presented in the notes to those financial statements. A copy of their individual financial statements may be obtained from the component unit, at the address shown on pages 110 and 111.

Other Long-term Liabilities - The General Fund, special revenue, and internal service funds in which leases are recorded will liquidate the capital lease obligations. The compensated absences will be liquidated by applicable governmental and internal service funds that account for the salaries and wages of the related employees. The net pension obligations will be liquidated by the State's governmental and internal service funds that contribute toward the pension funds, based on the statutorily required contribution rates. The General Fund and transportation-related Special Revenue fund will generally liquidate other claims and judgments attributable to the governmental activities.

Pollution Remediation Liabilities - GASB Statement 49 establishes the guidance reporting entities are to use in estimating and reporting potential cost which may be incurred for pollution remediation. GASB 49 requires the Commonwealth to reasonably estimate and report a remediation liability when any of the following obligating events has occurred:

Pollution poses an imminent danger to the public and the Commonwealth is compelled to take action;

The Commonwealth is in violation of a pollution related permit or license;

The Commonwealth is named or has evidence that it will be named as a responsible party by a regulator;

The Commonwealth is named or has evidence that it will be named in a lawsuit to enforce a cleanup; or

The Commonwealth commences or legally obligates itself to conduct remediation activities.

The Commonwealth has remediation activities underway and these are in stages from site investigation, planning and design, clean up, and site monitoring. Several agencies, within state government, have as a part of their mission the responsibility to investigate possible pollution sites, and oversee the remediation of those sites. These agencies have the expertise to estimate the remediation obligations presented herein based on prior experience in identifying and funding similar remediation activities. The remediation liabilities reported have been calculated using the expected cash flow technique. Situations posing potential liabilities, for which a reasonable estimate could not be made, have not been included.

The remediation obligation estimates presented in this report are subject to change over time. Cost may vary due to price fluctuations, changes in technology, changes in potential responsible parties, results of environmental studies, changes to statutes or regulations and other factors that could result in revisions to the estimates. Prospective recoveries from responsible parties may reduce the Commonwealth's obligation.

The amounts recorded as obligations are shown in the accompanying chart.

Unemployment Insurance Liability - The downturn in the economy created an increased demand for unemployment insurance payments. The increased demand depleted the funds the Commonwealth had on deposit with Federal government to pay claims. As a result, the Commonwealth has borrowed money from the Federal government to pay unemployment insurance claims. At June 30, 2010 the amount borrowed was \$795.1 million. The loan is interest free, if repaid by January, 2011. The Commonwealth is reviewing ways to repay the loan and replenish the insurance fund.

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Future debt service requirements for aggregated Notes Payable for the Primary Government at June 30, 2010, are as follows (Expressed in Thousands)

Year Ending June 30	Principal	Interest	Totals
2011	\$ 63,920	\$ 48,931	\$ 112,851
2012	58,825	46,338	105,163
2013	58,555	43,680	102,235
2014	61,265	40,943	102,208
2015	59,690	38,181	97,871
2016-2020	371,630	143,031	514,661
2021-2025	325,260	55,788	381,048
2026-2030	90,595	5,841	96,436
Total	<u>\$ 1,089,740</u>	<u>\$ 422,733</u>	<u>\$ 1,512,473</u>

Future debt service requirements for aggregated Notes Payable for the Component Units at June 30, 2010, are as follows (Expressed in Thousands)

Year Ending June 30	Principal	Interest	Totals
2011	\$ 593,289	\$ 8,292	\$ 601,581
2012	13,463	7,235	20,698
2013	3,574	5,787	9,361
2014	746,902	4,120	751,022
2015	2,708	682	3,390
2016-2020	5,714	2,183	7,897
2021-2025	2,177	1,436	3,613
2026-2030	2,705	877	3,582
Thereafter	1,955	163	2,118
Total	<u>\$ 1,372,487</u>	<u>\$ 30,775</u>	<u>\$ 1,403,262</u>

Changes in long-term liabilities for the fiscal year ended June 30, 2010, are summarized as follows (Expressed in Thousands):

	Beginning Balance (Restated)	Additions	Reductions	Ending Balance	Due In One Year	Due Thereafter
Governmental Activities						
Compensated absences	\$ 213,699	\$ 10,010	\$ (2,709)	\$ 221,000	\$ 139,750	\$ 81,250
Capital leases	26,638	15,499	(9,796)	32,341	8,673	23,668
Claims liability	156,166	64,415	(62,062)	158,519	18,131	140,388
Notes payable	1,059,520	89,710	(59,490)	1,089,740	63,920	1,025,820
Bonds payable	5,252,009	1,221,161	(513,324)	5,959,846	331,879	5,627,967
Unamortized premiums	234,300	37,442	(18,233)	253,509	14,117	239,392
Unamortized discounts	(16,685)	(2,619)	4,316	(14,988)	(835)	(14,153)
Deferred amount on refunding	(14,275)	3,810	1,780	(8,685)	(484)	(8,201)
Judgments and contingent liabilities	136,402	5,812	(104,605)	37,609	25,771	11,838
Pollution remediation liabilities	39,379	4,029	(8,391)	35,017	5,786	29,231
Unfunded employer pension contributions	2,846,221	991,871		3,838,092		3,838,092
Total Governmental Activities	<u>9,933,374</u>	<u>2,441,140</u>	<u>(772,514)</u>	<u>11,602,000</u>	<u>606,708</u>	<u>10,995,292</u>
Business-Type Activities						
Compensated absences	8,967	2,523	(2,712)	8,778	5,355	3,423
Capital leases	211		(84)	127	65	62
Claims and claims adjustment liability	1,189,286	1,583,196	(1,621,502)	1,150,980	192,154	958,826
Prize liability	149,955	7,113	(34,072)	122,996	47,062	75,934
Judgments and contingent liabilities	16	141	(31)	126	126	
Loans payable to the Federal government	301,900	493,162		795,062		795,062
Total Business-Type Activities	<u>1,650,335</u>	<u>2,086,135</u>	<u>(1,658,401)</u>	<u>2,078,069</u>	<u>244,762</u>	<u>1,833,307</u>
Total Primary Government	<u>\$ 11,583,709</u>	<u>\$ 4,527,275</u>	<u>\$ (2,430,915)</u>	<u>\$ 13,680,069</u>	<u>\$ 851,470</u>	<u>\$ 12,828,599</u>
Major Component Units						
Compensated absences	\$ 17,778	\$ 13,549	\$ (12,884)	\$ 18,443	\$ 13,621	\$ 4,822
Capital leases	500,731	63,768	(41,481)	523,018	33,700	489,318
Notes payable	543,625	1,574,701	(773,592)	1,344,734	588,176	756,558
Bonds payable	4,875,818	627,158	(1,480,742)	4,022,234	88,064	3,934,170
Total Major Component Units	<u>\$ 5,937,952</u>	<u>\$ 2,279,176</u>	<u>\$ (2,308,699)</u>	<u>\$ 5,908,429</u>	<u>\$ 723,561</u>	<u>\$ 5,184,868</u>

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Interest Rate Swap Agreements - The Commonwealth currently has four outstanding interest rate swaps. Each of these swaps were entered into to synthetically fix the interest rate on floating rate notes. The notes were issued concurrent with the execution of the swap. Each of the interest rate swaps amortizes to match the sinking fund schedule of the hedged notes. Additionally, the maturities exactly match the maturity schedule of the hedged debt. Note: The fair values are model determined values reconciled to indicative pricing from the counter-party.

Credit Risk - There are certain collateral requirements triggered by credit rating thresholds for the Commonwealth State Property and Building Commission and for credit ratings and minimal capital requirements of the counterparty. Those thresholds are not being met as of June 30, 2010. There is no collateral pledged by either party to the interest rate swaps. The Commonwealth's credit risk is limited to the market value of the individual interest rate swaps. The counterparty is rated at A1/A+/A+ by Moody's, S&P, and Fitch respectively.

Interest Rate Risk - The Commonwealth's interest rate swaps were designed to synthetically fix the rate on four floating rate debt issuances. In order to achieve this goal, the amortization schedules,

floating rate formula and index, repricing dates and other variables of both the floating rate side of the swap and the debt are exactly matched. Using the Synthetic Instrument Method for determining hedge effectiveness showed a 100% for each derivative. Because the repricing dates, formulas and indices are identical, there is no basis risk.

Termination Risk - Mandatory termination of each of these swaps would be triggered if the credit ratings of the Commonwealth State Property and Building Commission were to fall below BBB by Standard and Poor's or Baa2 by Moody's or if the credit ratings of the counterparty were to fall below A3 by Moody's or A- by Standard and Poor's or if the credit ratings of the insurer falls below A3 by Moody's and A- by Standard and Poor's. Additional mandatory termination events include default, merger without assumption and failure to perform under the ISDA or indenture by any of the parties. The Commonwealth has the right to exercise optional early termination on each of these swaps with the consent of the insurer. The counterparty does not have the right of optional early termination. Any early termination shall occur at then current market levels.

The following table provides descriptive information for each interest rate swap.

**Terms of each Hedging Derivative
Cashflow Interest Rate Swaps
at June 30, 2010 (Expressed in Thousands)
Governmental Activities**

Project Notes	Effective Date	Notional Amounts		Maturity Date	Pay-Fixed		Fair Value 6/30/2009	Fair Value 6/30/2010	Change in Fair Value
		Original	Outstanding		Rate	Variable Rate			
2007 ALCo	5/31/2007	\$ 25,210	\$ 19,295	11/1/2017	3.839%	67% 3M LIBOR +.4%	\$ (1,329)	\$ (1,582)	\$ (253)
2007 ALCo	5/31/2007	71,310	69,055	11/1/2021	4.042%	67% 3M LIBOR +.52%	(6,365)	(9,249)	(2,884)
2007 ALCo	5/31/2007	70,935	70,935	11/1/2025	4.125%	67% 3M LIBOR +.55%	(8,336)	(12,210)	(3,874)
2007 ALCo	5/31/2007	75,625	68,135	11/1/2027	4.066%	67% 3M LIBOR +.53%	(6,579)	(9,193)	(2,614)
Total		<u>\$ 243,080</u>	<u>\$ 227,420</u> **				<u>\$ (22,609)</u>	<u>\$ (32,234)</u>	<u>\$ (9,625)</u> *

* The Change in Fair Value is classified as Deferred Outflow of Resources on the Statement Of Net Assets

** The Total Outstanding Notional Amount equals the outstanding note liability which is classified as a liability on the Statement of Net Assets

**Governmental Activities
Future debt service requirements for aggregated ALCo Notes Associated with Interest Rate Swaps at
June 30, 2010, are as follows
(Expressed in Thousands)**

Year Ending June 30	Principal	Interest	Net Swap	Totals
			Payments	
2011	\$ 5,365	\$ 2,012	\$ 7,110	\$ 14,487
2012	5,580	2,098	6,806	14,484
2013	5,810	2,072	6,606	14,488
2014	6,045	2,030	6,412	14,487
2015	6,295	1,986	6,211	14,492
2016-2020	63,475	13,891	21,269	98,635
2021-2025	104,690	5,139	12,432	122,261
2026-2030	30,160	(1,024)	2,271	31,407
Total	<u>\$ 227,420</u>	<u>\$ 28,204</u>	<u>\$ 69,117</u>	<u>\$ 324,741</u>

Note 16

COMMITMENTS AND CONTINGENCIES

Litigation - The Commonwealth, its units and employees are parties to numerous legal proceedings, many of which normally occur in governmental operations. The legal proceedings are not, in the opinion of the Attorney General, likely to have a material adverse impact on the Commonwealth's financial position.

The Kentucky Retirement Systems (KRS), a blended component unit of the Commonwealth, is involved in litigation claiming age discrimination. The case challenges Kentucky's civil service retirement laws and seeks restitution on behalf of all public retirees who received a normal pension rather than a disability pension. The KRS has prevailed in the court decisions and legal council is confident they will continue to prevail. Should the previous decisions be reversed, KRS cannot estimate the impact on the liability and future funding requirements.

In addition, the Commonwealth and its units are involved in certain other legal proceedings which, if decided adversely to the Commonwealth, may require the Commonwealth to make material future expenditures for expanded services or capital facilities, may impair future revenue sources, or may require the refund of prior collections. It is neither possible to determine the outcome of these proceedings nor to estimate the possible effects adverse decisions may have on the future expenditures or revenue sources of the Commonwealth.

Judgments and Contingencies – A claim is a suit that has been filed but there has been no decision rendered by the court systems. Amounts reported include claims made against the Commonwealth during the period preceding June 30 of the current fiscal year. Claims are classified according to their chance of occurrence as either remote, possible, or probable. Claims are further classified as payable within one year, within future periods, or a combination of the two periods.

A judgment is any amount that is to be repaid as the result of a court decision or an award for the condemnation of private property. Reasons for such amounts also arise from employment, contracts, and government involvement of personnel or property. The General Fund, the Agency Revenue Fund, the Transportation Fund, and the State Parks Fund generally pay claims and judgments. These amounts are classified as either payable within one year, in future periods, or a combination of the two periods if they remain unpaid after June 30 of the current fiscal year.

Federal Grants - The Commonwealth receives significant financial assistance from the U.S. Government in the form of grants and Federal revenue sharing entitlements. Entitlement to these resources is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable Federal regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits by the grantors. Any disallowance as a result of these audits becomes a liability of the Commonwealth.

Leases - The Commonwealth has entered into various operating leases for land and buildings. All leases contain termination clauses providing for the cancellation after 30, 60, or 90 days written notice to the lessors. In addition, all leases contain appropriation clauses indicating that continuation of the lease is subject to funding by the legislature. It is expected that in the normal course of business, similar leases will replace most of these leases. Primary Government expenditures for rent under leases for the years ended June 30, 2010 and 2009 amounted to \$124.2 million and \$113.8 million, respectively. The operating leases of the Commonwealth do not contain escalation clauses for rental or expense that would require adjustment to be in compliance with GASB Statement 13.

Compensated Absences – Compensated absences include accumulated, unpaid vacation and compensatory time accruals. The amount accruing to proprietary funds has been included in the respective funds when material. The policy of the Commonwealth is to record the cost of annual and compensatory leave. Annual leave is accumulated at amounts ranging from 7.5 to 15.00 hours per month, as determined by the length of service, with the maximum accumulations ranging from 30 to 60 days. The calendar year is the period used for determining accumulated leave. Compensatory leave is granted to authorized employees on an hour-for-hour basis or a time and one half basis. Compensated absences are generally paid from the General Fund, the Transportation Fund, the Federal Fund, the Agency Revenue Fund, and the Other Special Revenue Fund. At June 30, 2010, the estimated liability for annual and compensatory leave was \$221,000,000 for the governmental activities, and \$8,778,000 in the business-type activities.

Compensated absence liabilities for the major component units totaled \$18,443,000 at June 30, 2010.

Sick Leave - The policy of the Commonwealth is to record the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee is absent due to illness, injury, or related family death, there was no liability recorded for sick leave at June 30, 2010. The estimated accumulated amount of unused sick leave at that date for the governmental and business-type activities was \$315,380,318 and \$11,569,796, respectively.

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Construction Projects - The Transportation Cabinet, at June 30, 2010, had contractual commitments of approximately \$994,497,429 for the construction, maintenance and operation of the highway system. It is anticipated that these projects will be funded with approximately 23 percent State funds, 61 percent Federal funds, and the remaining 16 percent with proceeds from the sale of revenue bonds.

Deferred Revenue—Deferred revenue may result from the recognition of assets before the earnings process is complete (unearned revenue), or if using the modified accrual basis of accounting, deferred revenue may represent unavailable revenues. “Unavailable” means that the assets are not available to finance expenditures of the current fiscal period. Regardless of whether the deferred revenue is unearned or unavailable, it is still reported as a contingent liability.

Note 17

SUBSEQUENT EVENTS

The debt-issuing entities of the Commonwealth issued or agreed to administer State participation in debt service payments for revenue bonds sold after June 30, 2010, and prior to December 31, 2010, and reported other subsequent events for the same period, as described below.

The State Property and Buildings Commission issued \$3,430,000 Project No. 97 Taxable Agency Revenue Bonds, dated July 22, 2010. These Series 2010 Serial Bonds mature June 1, 2011 through June 1, 2025 and carry interest rates of 1.25% to 5.45%. The net proceeds will be used for the construction of a hanger at Bluegrass Station in Lexington, Kentucky, for benefit of the State Agency.

\$153,965,000 Project No. 98, Revenue and Revenue Refunding Bonds, dated July 13, 2010, were issued. These Bonds mature August 1, 2011 through August 1, 2021 carrying interest rates of 2.00% to 5.00%. The bonds will be used to refund certain outstanding bonds of the Commission, to refund certain outstanding notes of the Kentucky Asset/Liability Commission and fund various projects for State agencies and component units.

\$323,380,000 Project No. 99, Revenue Bonds, dated November 17, 2010, was issued. These bonds consist of: \$98,065,000 Series A serial bonds maturing November 1, 2012 through November 1, 2021 and carrying interest rates of 2.00% to 5.00%; \$10,325,000 Series B (Federally Taxable) serial bonds maturing November 1, 2012 and carrying an interest rate of 1.65%; \$31,640,000 Series C (Federally Taxable—Build America Bonds—Direct Payment to the Commission) Serial Bonds maturing November 1, 2019 through November 1, 2020 and carrying interest rates of 4.303% to 4.403%; \$73,785,000 5.373% Series C Term Bonds due November 1, 2025 and \$109,565,000 5.921%

Series C Term Bonds due November 1, 2030. The net proceeds will be used to fund various projects for State agencies and component units.

The Kentucky Asset/Liability Commission issued \$467,555,000 Funding Notes, 2010 General Fund First Series (Taxable), dated August 26, 2010, to fund state medical insurance obligations of the Teachers Retirement System of the Commonwealth of Kentucky. These notes consists of \$137,975,000 of notes bearing interest rates of .841% to 4.204% maturing April 1, 2011 through April 1, 2020 and \$329,580,000 3.165% Term Bonds due April 1, 2018.

The Kentucky Housing Corporation issued \$176,000,000 of Housing Revenue Bonds dated August 12, 2010, consisting of: \$26,220,000 Series B (Non-AMT) Serial Bonds maturing semi annually January 1 and July 1, 2011 through July 1, 2022 carrying interest rates of .500% to 3.950%; \$3,505,000 4.05% Series B Term Bonds (Non-AMT) due January 1, 2024; \$10,275,000 5.00% Series B Term Bonds (Non-AMT) due July 1, 2027; \$1,245,000 4.375% 2010 Series C Term Bonds (Non-AMT) due July 1, 2027; \$8,755,000 4.625% 2010 Series C Term Bonds (Non-AMT) due July 1, 2033; \$22,230,000 2010 Series D (AMT) bonds maturing semi annually January 1 and July 1, 2015 through July 1, 2020 and carrying an interest rate of 3.05% to 4.40%; \$19,435,000 5.125% 2010 Series D Term Bonds (AMT) due July 1, 2025; \$4,335,000 5.250% 2010 Series D Term Bonds (AMT) due January 1, 2027; \$1,555,000 2010 Series E (Non-AMT) bonds maturing July 1, 2020 through July 1, 2023 and carrying an interest rate of 3.65% to 4.00%; \$7,370,000 4.50% 2010 Series E Term Bonds (Non-AMT) due July 1, 2030; \$11,075,000 4.75% 2010 Series E Term Bonds (Non-AMT) due July 1, 2035 and \$60,000,000 3.81% 2010 Series C Term Bonds, subseries C-2 (Non-AMT) due July 1, 2041. The proceeds will be used to finance mortgage loans for persons and families of lower and moderate income in the Commonwealth.

University of Kentucky issued \$25,325,000 General Receipts Bonds, dated November 17, 2010. The bonds consist of \$12,370,000 Taxable Build America Bonds, Series A maturing October 1, 2011 through October 1, 2024 and carrying interest rates of .500% to 4.500% and \$12,955,000 Taxable Qualified Energy Conservation Bonds, 2010 Series B maturing October 1, 2024 carrying an interest rate of 4.700%. The proceeds of the bond will be used for a project consisting of multiple energy conservation measures within sixty-one (61) educational and general buildings on the main campus.

Northern Kentucky University issued \$12,265,000 General Receipts Refunding Bonds, 2010 Series B, dated October 21, 2010. These bonds mature March 1, 2011 through September 1, 2027 carrying interest rates of 2.000% to 3.750%. The proceeds of the bond will be used to refund in advance of maturity the principle amount maturing on or after December 1, 2013 of a certain Facilities Lease dated as of July 1, 2002 between Fifth Third Leasing Company and the Commonwealth of Kentucky.

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

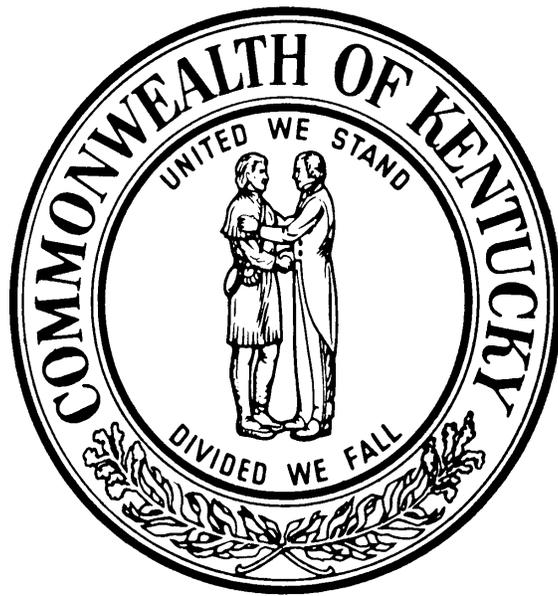
June 30, 2010

School Facilities Construction Commission administers the Commonwealth's participation in the debt service payments of local public school district revenue bonds issued subsequent to June 30, 2010, and maturing as to principal through 2030 as displayed in the table on page 108.

COMMONWEALTH OF KENTUCKY
Notes to Financial Statements
June 30, 2010

KENTUCKY SCHOOL FACILITIES CONSTRUCTION COMMISSION

School District	Delivery Date	Principal at Issue	State Share	Interest Rates (%)
Anderson County	10/28/10	\$ 905,000	\$ 905,000	.500%-2.350%
Bardstown Independent	08/26/10	2,170,000	70,165	3.500%-5.400%
Barren County	12/14/10	1,920,000	894,528	1.000%-4.125%
Bell County	11/10/10	670,000	523,919	2.875%-3.875%
Bourbon County	10/05/10	229,000	163,059	2.250%-2.250%
Bowling Green Independent	07/14/10	510,000	497,271	3.650%-3.650%
Boyle County	09/01/10	5,395,000	1,000,460	1.000%-3.000%
Calloway County	10/14/10	6,265,000	1,151,452	.600%-2.900%
Campbell County	10/28/10	595,000	595,000	.700%-2.700%
Casey County	09/17/10	1,110,000	726,975	.500%-2.550%
Christian County	09/23/10	5,640,000	3,237,976	1.000%-2.375%
Clark County	11/24/10	5,170,000	3,085,275	.800%-5.000%
Clinton County	07/15/10	2,055,000	769,071	2.000%-6.000%
Cloverport Independent	07/08/10	885,000	525,285	1.800%-4.000%
Crittenden County	07/20/10	990,000	990,000	1.000%-4.000%
Crittenden County	09/20/10	3,865,000	900,589	.500%-2.600%
Danville Independent	09/15/10	1,130,000	1,130,000	1.000%-2.000%
Eminence Independent	10/18/10	420,000	420,000	2.250%-4.000%
Estill County	09/30/10	7,350,000	915,465	5.000%-5.000%
Estill County	11/10/10	5,630,000	1,311,555	.700%-5.000%
Floyd County	10/19/10	5,320,000	3,212,115	2.000%-3.000%
Ft. Thomas Independent	09/07/10	2,030,000	2,030,000	1.000%-5.200%
Garrard County	08/10/10	3,830,000	728,261	1.000%-3.000%
Grant County	08/12/10	8,485,000	1,961,710	.800%-5.550%
Grant County	11/03/10	2,215,000	219,258	.600%-3.100%
Green County	08/12/10	4,405,000	905,261	2.000%-3.000%
Greenup County	09/08/10	4,750,000	476,966	1.000%-2.625%
Greenup County	07/07/10	1,630,000	1,040,514	1.000%-4.000%
Harlan County	08/19/10	3,165,000	819,031	2.250%-5.450%
Kenton County	09/08/10	19,855,000	19,632	.500%-2.500%
Laurel County	10/07/10	8,720,000	2,543,286	.750%-5.000%
Larue County	07/29/10	7,395,000	1,678,853	1.500%-3.125%
Lawrence County	10/28/10	1,815,000	154,196	.700%-1.500%
Lee County	08/11/10	1,200,000	547,961	1.500%-4.000%
Letcher County	07/13/10	4,560,000	3,376,411	1.250%-6.000%
Lincoln County	09/16/10	7,415,000	2,632,067	.700%-4.900%
Madison County	09/24/10	10,295,000	915,920	.400%-2.500%
Marshall County	11/30/10	509,000	509,000	3.625%-3.625%
Martin County	11/04/10	3,300,000	3,300,000	.700%-4.850%
McCracken County	09/14/10	12,780,000	869,186	.250%-2.500%
Monroe County	08/25/10	3,155,000	528,005	1.000%-2.750%
Muhlenberg County	12/01/10	12,670,000	2,452,112	.700%-5.550%
Ohio County	09/14/10	890,000	549,476	1.100%-4.800%
Ohio County	09/30/10	1,615,000	517,757	1.000%-1.500%
Owen County	08/18/10	6,460,000	1,618,622	2.000%-2.875%
Owsley County	09/17/10	695,000	165,801	.750%-2.550%
Paris Independent	09/14/10	625,000	625,000	1.200%-3.800%
Powell County	09/13/10	4,050,000	570,121	1.500%-3.000%
Raceland-Worthington Independent	11/10/10	1,575,000	442,068	1.500%-4.000%
Simpson County	07/09/10	4,800,000	927,337	3.250%-6.250%
Todd County	08/04/10	8,435,000	352,027	.700%-5.750%
Trimble County	10/14/10	4,445,000	786,366	1.000%-3.000%
Warren County	07/26/10	4,300,000	277,362	2.000%-3.125%
Warren County	08/10/10	12,415,000	2,098,415	.800%-5.625
Webster County	09/21/10	1,020,000	771,340	1.000%-2.600%
Whitley County	11/18/10	1,850,000	437,703	5.250%-5.250%
Williamsburg Independent	11/30/10	4,985,000	835,051	1.000%-5.375%
		\$ 240,563,000	\$ 61,707,236	



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Notes to Financial Statements

June 30, 2010

Audited financial statements may be requested at the following addresses:

Bluegrass State Skills Corporation
Capital Plaza Tower
500 Mero Street
Frankfort, Kentucky 40601

Kentucky State University
Office of Administrative Affairs
400 East Main Street
Frankfort, Kentucky 40601

Turnpike Authority of Kentucky
Room 78, Capitol Annex Building
Frankfort, Kentucky 40601

Kentucky Lottery Corporation
1011 West Main Street
Louisville, Kentucky 40202-2623

Kentucky Transportation Cabinet
501 High Street
Room 808
Frankfort, Kentucky 40622

Kentucky State Fair Board
Kentucky Fair and Exposition Center
P.O. Box 37130
Louisville, Kentucky 40233-7130

Kentucky Center for the Arts
5 Riverfront Plaza
Louisville, Kentucky 40202-2989

Kentucky Educational Television
600 Cooper Drive
Lexington, Kentucky 40502

Kentucky Economic Development Finance Authority
Capital Plaza Tower
500 Mero Street
Frankfort, Kentucky 40601

Kentucky Higher Education Assistance Authority
1050 U.S. 127 South, Suite 102
Frankfort, Kentucky 40601

Kentucky Housing Corporation
1231 Louisville Road
Frankfort, Kentucky 40601

Kentucky Higher Education Student Loan Corporation
Financial Services Department
10180 Linn Station Road, Suite C200
Louisville, KY 40223

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

Kentucky Infrastructure Authority
1024 Capital Center Dr., Suite 340
Frankfort, Kentucky 40601

Kentucky Teachers' Retirement System
479 Versailles Road
Frankfort, Kentucky 40601

Kentucky Local Correctional Facilities Construction Authority
Suite 261 Capitol Annex
Frankfort, Kentucky 40601

University of Louisville
2301 South 3rd Street
108 Grawemeyer Hall
Louisville, Kentucky 40292

Kentucky Judicial Form Retirement System
P.O. Box 791
Frankfort, Kentucky 40602

Western Kentucky University
Vice President for Finance and Administration
1 Big Red Way
Bowling Green, Kentucky 42101-3576

Kentucky Horse Park
4089 Iron Works Parkway
Lexington, Kentucky 40511

Murray State University
322 Sparks Hall
Murray, Kentucky 42071

University of Kentucky
301 Peterson Service Building
Lexington, Kentucky 40506-0005

Eastern Kentucky University
Vice President for Business Affairs
521 Lancaster Avenue
Richmond, Kentucky 40475-3101

COMMONWEALTH OF KENTUCKY

Notes to Financial Statements

June 30, 2010

Morehead State University
Office of Accounting and Budgetary Control
207 Howell-McDowell Administration Building
Morehead, Kentucky 40351-1689

Kentucky Department of Labor – Special Fund
1047 US Highway 127 S, Suite 4
Frankfort, KY 40601

Northern Kentucky University
Office of Business Affairs
Lucas Administration Center
726 Nunn Drive
Highland Heights, Kentucky 41099-8101

Kentucky Horse Park Foundation
4089 Iron Works Parkway
Lexington, Kentucky 40511

Office of Public Employees Health Insurance
State Office Building, 2nd Floor
501 High Street
Frankfort, KY 40601

Kentucky Community and Technical College System
300 North Main Street
Versailles, KY 40383

Kentucky Access
Department of Insurance
215 West Main Street
Frankfort, Kentucky 40601

Kentucky River Authority
70 Wilkinson Boulevard
Frankfort, Kentucky 40601

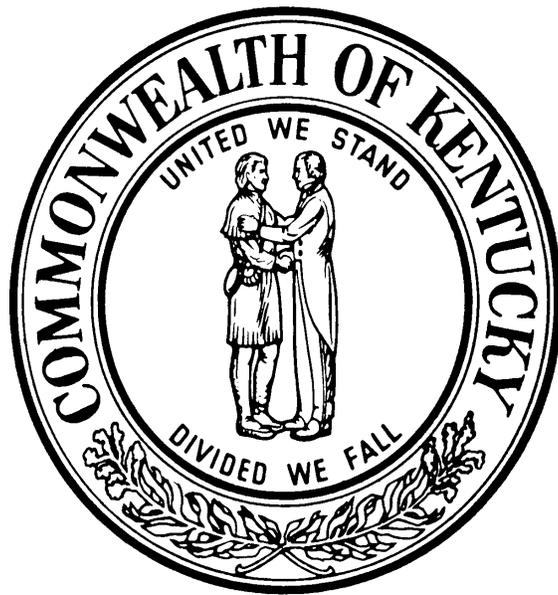
Council on Postsecondary Education
1024 Capital Center Drive, Suite 320
Frankfort, Kentucky 40601

Office of the Petroleum Storage Tank
Environmental Assurance Fund
81 C. Michael Davenport Boulevard
Frankfort, KY 40601

Kentucky Artisan Center at Berea
P.O. Box 280
Berea, KY 40403

Kentucky Public Employees'
Deferred Compensation Authority
101 Sea Hero Road, Suite 110
Frankfort, KY 40601-5404

Workers' Compensation Program
State Office Building, 3rd Floor
501 High Street
Frankfort, KY 40601



**REQUIRED SUPPLEMENTARY INFORMATION OTHER THAN
MANAGEMENT'S DISCUSSION AND ANALYSIS**

COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL (BUDGETARY BASIS) - GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	<u>Original</u>	<u>Final</u>	<u>Actual</u>	<u>Variance</u>
Revenues				
Budgeted:				
Taxes	\$ 8,760,405	\$ 7,841,784	\$ 7,882,542	\$ 40,758
Licenses, fees, and permits	33,036	35,064	34,664	(400)
Intergovernmental	13,800	12,766	14,479	1,713
Charges for services	6,618	6,513	10,153	3,640
Fines and forfeits	54,400	61,654	49,322	(12,332)
Interest and other investment income	23,700		(303)	(303)
Lottery proceeds	195,000	200,000	200,000	
Other revenues	50,250	40,119	32,202	(7,917)
Tobacco Settlement	121,580	112,270	105,494	(6,776)
Subtotal of Budgeted Revenues	<u>9,258,789</u>	<u>8,310,170</u>	<u>8,328,553</u>	<u>18,383</u>
Other Budgeted Financial Resources:				
Transfers in (interfund)	<u>131,425</u>	<u>163,092</u>	<u>169,470</u>	<u>6,378</u>
Total Budgeted Revenues	<u>9,390,214</u>	<u>8,473,262</u>	<u>8,498,023</u>	<u>24,761</u>
Expenditures				
General Government:				
Executive Office of the Governor	8,666	7,841	7,459	382
Office of Homeland Security	290	231	220	11
Kentucky Infrastructure Authority	7,997	7,867	1,585	6,282
Department of Veterans Affairs	18,783	17,617	16,824	793
Office of State Budget Director	3,792	3,670	3,386	284
State Planning Fund	220			
Unified Prosecutorial System:				
Commonwealth Attorneys	33,148	36,164	36,164	
County Attorneys	28,153	31,013	31,013	
Department of Agriculture	21,769	19,165	17,794	1,371
Office of the Attorney General	13,284	11,987	11,408	579
Auditor of Public Accounts	5,660	4,991	4,749	242
Registry of Election Finance	1,382	1,277	1,217	60
Military Affairs	10,834	43,370	34,636	8,734
Governor's Office for Local Development	11,543	9,001	8,683	318
Local Government:				
Economic Assistance Fund	56,989	57,388	57,388	
Economic Development Fund	46,256	61,969	61,969	
Area Development Fund	691	621	590	31
Secretary of State	2,050	1,901	1,809	92
Secretary of Treasury	1,928	1,779	1,693	86
Board of Elections	2,848	2,867	2,837	30
School Facilities Construction Commission	111,003	110,409	102,069	8,340
Executive Branch Ethics Commission	449	456	456	
Commission on Human Rights	2,060	1,845	1,769	76
Commission on Women	238	228	216	12
Council on Postsecondary Education	59,467	53,165	49,868	3,297
Budget Reserve Trust Fund	7,125			
Personnel:				
General Operations				
State Salary Compensation Fund	29,562			
State Group Health Insurance	2,081	1,870	1,776	94

	<u>Original</u>	<u>Final</u>	<u>Actual</u>	<u>Variance</u>
Universities:				
Eastern Kentucky University	\$ 78,000	\$ 70,692	\$ 70,257	\$ 435
Kentucky State University	27,180	24,639	24,639	
Morehead State University	47,002	42,593	42,593	
Murray State University	53,460	48,414	48,414	
Northern Kentucky University	55,442	50,281	50,281	
University of Kentucky	324,367	293,887	293,887	
University of Louisville	186,788	169,896	169,896	
Western Kentucky University	83,372	75,556	74,071	1,485
Kentucky Community and Technical College System	224,430	200,555	200,555	
Finance and Administration:				
General Administration & Support	8,483	7,751	7,377	374
Special Accounts - Capital Construction	800	800	800	
Debt Service	404,968	321,896	146,634	175,262
Office of the Controller	8,078	7,337	6,923	414
Department for Facilities Management	6,295	5,833	5,555	278
Kentucky Higher Education Assistance Authority	188,060	188,060	185,276	2,784
Special Accounts - Tobacco Settlement	121,580	105,494	105,494	
Finance - County Costs	16,582	16,581	15,962	619
Department of Revenue:				
General Operations	72,473	75,587	71,590	3,997
Office of Property Valuation Administrators	35,354	36,230	36,230	
Appropriations Not Otherwise Classified:				
Judgements	3	451	433	18
Board of Claims Awards	1,000	1,200	1,157	43
Guardian Ad Litem	1,600	9,600	9,600	
Prior Year Claims	400	505	434	71
Unredeemed Checks Refunded	1,500	2,365	2,301	64
Involuntary Commitments	60	60	44	16
Blanket Employee Bonds	100	100	69	31
Frankfort In Lieu of Taxes	195	195	195	
Frankfort Cemetery	3	3	3	
Police and Firemen Life Insurance	1,000	334	248	86
Attorney General Expense	225	430	425	5
Medical Malpractice Liability Insurance Reimbursements	185	185	179	6
Total General Government	2,437,253	2,246,202	2,029,100	217,102
Legislative and Judicial:				
General Assembly	24,718	24,718	15,890	8,828
Legislative Research Commission	40,393	40,393	35,861	4,532
Judicial Retirement System	5,779	5,779	5,777	2
Court of Justice - Court Facility Use		248	11	237
Court of Justice - Operation and Administration	185,746	185,746	170,276	15,470
Court of Justice - Local Facility Support	117,712	115,832	90,238	25,594
Total Legislative and Judicial	374,348	372,716	318,053	54,663

COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL (BUDGETARY BASIS) - GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	<u>Original</u>	<u>Final</u>	<u>Actual</u>	<u>Variance</u>
Commerce:				
Economic Development:				
Office of the Secretary	\$ 16,140	\$ 14,841	\$ 12,835	\$ 2,006
Financial Incentives	28,135	28,134	7,104	21,030
Existing Business Development	3,421			
New Business Development	1,330	5,021	4,579	442
Commerce Cabinet: Office of the Secretary				
Kentucky State Fair Board	3,357	3,056	2,869	187
Kentucky Horse Park	181	181		181
Department of Parks	1,448	1,443	1,378	65
Department of Travel	30,242	35,355	35,085	270
Berea Artisans Center	3,982	3,584	3,404	180
	358	328	312	16
Total Commerce	<u>88,594</u>	<u>91,943</u>	<u>67,566</u>	<u>24,377</u>
Education:				
General Administration and Program Support	3,249	3,032	2,886	146
Commission on the Deaf and Hard of Hearing	929	853	811	42
Kentucky Heritage Council	952	833	793	40
Kentucky Arts Council	3,831	3,354	3,186	168
Department of Education:				
Support Education Excellence In KY (SEEK)	2,973,536	2,720,426	2,679,631	40,795
Executive Policy and Management	729	655	642	13
Bureau of Support Services	46,767	44,271	43,455	816
Learning Results Services	894,646	810,602	804,799	5,803
Kentucky Educational Television	13,243	13,010	12,414	596
Kentucky Historical Society	7,154	6,623	6,301	322
Kentucky Center for the Arts	1,510	1,397	950	447
Education Professional Standards Board	9,033	8,348	7,919	429
Libraries and Archives -				
Direct Local Aid	6,175	5,671	5,489	182
General Operations	6,767	6,310	6,004	306
Teachers' Retirement System	201,253	201,253	201,253	
Workforce Investment:				
Office of the Blind	1,328	1,208	1,208	
Technical Education	26,778	26,068	26,068	
Vocational Rehabilitation	12,795	11,842	11,842	
Total Education and Humanities	<u>4,210,675</u>	<u>3,865,756</u>	<u>3,815,651</u>	<u>50,105</u>
Human Resources:				
Health and Family Services:				
Administrative Services	35,410	28,816	28,612	204
Department for Community Based Services	352,193	337,377	325,393	11,984
Governor's Office of Wellness and Physical Activity				
Office of the Inspector General		6,060	6,060	
Office of Health Policy	583	418	393	25
Department for Aging and Independent Living	36,418	43,022	41,579	1,443
Department of Income Support	3,346	1,670	1,397	273
Department for Public Health	71,990	62,778	59,644	3,134
Department for Mental Health and Mental Retardation	199,096	192,174	182,872	9,302
Department for Human Support Services	434	55,866	55,573	293
Department for Medicaid Services	40,885	34,777	34,777	
Medicaid Services Benefits	1,284,706	868,309	843,190	25,119
Commission for Children With Special Health Care Needs	6,038	4,101	4,101	
Total Human Resources	<u>2,031,099</u>	<u>1,635,368</u>	<u>1,583,591</u>	<u>51,777</u>

	Original	Final	Actual	Variance
Justice:				
Office of the Secretary	\$ 11,884	\$ 11,154	\$ 11,126	\$ 28
Department of State Police	73,926	56,236	53,749	2,487
Department of Juvenile Justice	87,469	79,087	77,701	1,386
Department for Public Advocacy	35,679	38,050	38,049	1
Department of Corrections:				
Management	6,889	6,470	6,200	270
Adult Institutions	268,180	191,516	191,516	
Local Jail Allotment	15,964	15,356	14,633	723
Community Services and Local Facilities	149,410	151,539	151,539	
Total Justice	649,401	549,408	544,513	4,895
Natural Resources and Environmental Protection:				
General Administration & Support	4,220	3,986	3,544	442
Energy Development & Independence	1,754	1,644	1,512	132
Kentucky River Authority	1,079	1,055	267	788
Kentucky Nature Preserves Commission	1,181	1,120	1,067	53
Environmental Protection	23,640	23,527	21,757	1,770
Petroleum Storage Tank	1,679			
Department for Natural Resources	14,135	17,681	17,190	491
Mine Safety and Licensing	13,790	11,596	11,596	
Surface Mining Reclamation and Enforcement	9,690	8,901	8,900	1
Total Natural Resources and Environmental Protection	71,168	69,510	65,833	3,677
Public Protection and Regulation:				
General Administration & Support	301	275	275	
Board of Claims and Crime Victims Compensation	740	677	643	34
Board of Tax Appeals	440	418	398	20
Kentucky Racing Commission	444	3,107	3,107	
Public Service Commission	13,831	13,066	9,372	3,694
Mine Safety Review Commission	187	159	159	
Department of: Alcoholic Beverage Control	965	875	832	43
Housing, Buildings, and Construction	2,321	2,211	2,211	
Labor:				
Workplace Standards	2,121	1,974	1,779	195
General Administration & Support	3,628	3,360	3,022	338
Total Public Protection and Regulation	24,978	26,122	21,798	4,324
Transportation:				
Highways	442	442		442
Public Transportation	5,310	4,771	4,416	355
Total Transportation	5,752	5,213	4,416	797
Total Expenditures	9,893,268	8,862,238	8,450,521	411,717
Excess of Revenues Over (Under) Expenditures	(503,054)	(388,976)	47,502	436,478
Fund Balance at July 1		(1,518,695)	105,726	
Non-Budgeted Items			(1,200)	
Fund Balance at June 30	\$ (503,054)	\$ (1,907,671)	\$ 152,028	\$

COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL (BUDGETARY BASIS) - BUDGETED SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Transportation			
	Original	Final	Actual	Variance
Revenues				
Budgeted:				
Taxes	\$ 1,239,126	\$ 1,056,356	\$ 1,061,071	\$ 4,715
Licenses, fees, and permits	148,821	125,771	128,171	2,400
Intergovernmental			1	1
Charges for services	10,245	9,620	9,224	(396)
Fines and forfeits	3	3	22	19
Interest and other investment income	3,700	3,900	3,635	(265)
Other revenues	3,208	3,450	3,409	(41)
Total Budgeted Revenues	1,405,103	1,199,100	1,205,533	6,433
Non-Budgeted:				
Taxes				
Licenses, fees, and permits				
Intergovernmental				
Charges for services				
Fines and forfeits				
Interest and other investment income				
Other revenues				
Transfers in (interfund)			9	9
Transfers in (intrafund)				
Total Non-Budgeted Revenue			9	9
Total Revenues	1,405,103	1,199,100	1,205,542	6,442
Expenditures				
General Government:				
Executive Office of the Governor				
Office of Homeland Security	250	250	250	
Kentucky Infrastructure Authority				
Office of State Budget Director				
Executive Branch Ethics Commission				
Department of Veterans Affairs				
Unified Prosecutorial System:				
Commonwealth Attorneys				
County Attorneys				
Department of Agriculture				
Office of the Attorney General				
Auditor of Public Accounts				
Military Affairs				
Governor's Office of Agricultural Policy:				
Agricultural Development - Statewide Phase				
Governor's Office for Local Development				
Secretary of State				
Secretary of Treasury	250	250	250	
Board of:				
Accountancy				
Alcohol and Drug Counselors				
Auctioneers				
Barbering				
Chiropractic Examiners				
Professional Counselors				
Fee-Based Pastoral Counselors				
Interpreters for Deaf & Hard of Hearing				
Dentistry				
Dietitians and Nutritionists				
Elections				
Embalmers and Funeral Home Directors				
Architects				
Landscape Architects				
Examiners of Psychologists				

Federal				Agency Revenue			
Original	Final	Actual	Variance	Original	Final	Actual	Variance
\$	\$	\$	\$	\$	\$	\$	\$
						308,981	
						156,126	
		8,453,128				46,765	
		930				3,033,440	
		1,153				8,365	
		327				24,637	
		102,283				313,318	
		23				626,783	
		2,023				2,159,885	
		8,559,867				6,678,300	
		8,559,867				6,678,300	
	286	286		284	681	390	291
22,952	22,952	14,586	8,366	1,113	2,171	1,419	752
50,173	51,673	50,614	1,059	1,279	1,279	910	369
				85	84		84
				46	61	34	27
				26,959	28,359	28,179	180
114	410	288	122	1,558	1,558	788	770
585	602	440	162	304	304	142	162
4,707	6,191	6,002	189	5,624	9,288	5,659	3,629
2,607	3,966	2,559	1,407	2,370	3,426	3,066	360
				4,267	5,598	5,524	74
42,183	324,182	226,512	97,670	38,086	42,085	39,697	2,388
	1,054	70		481	606	553	53
55,564	55,564	44,119	11,445	740	740	23	717
				961	961	961	
				801	925	925	
				619	619	514	105
				67	67	63	4
				428	429	315	114
				289	303	295	8
				248	248	221	27
				127	127	94	33
				3	4	2	2
				31	31	26	5
				642	764	764	
				70	70	51	19
12,241	12,241	2,491	9,750	569	569	174	395
				340	371	368	3
				383	398	341	57
				64	70	67	3
				191	191	185	6

COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL (BUDGETARY BASIS) - BUDGETED SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Transportation			
	<u>Original</u>	<u>Final</u>	<u>Actual</u>	<u>Variance</u>
	\$	\$	\$	\$
Board of: (Continued)				
Examiners of Social Workers				
Hairdressers and Cosmetologists				
Hearing Instrument Specialists				
Proprietary Education				
Nursing Home Administrators' Licensing				
Medical Licensure				
Nursing				
Ophthalmic Dispensers				
Optometric Examiners				
Art Therapists				
Occupational Therapy				
Respiratory Care Practitioners				
Marriage and Family Therapists				
Geologists				
Personnel				
Pharmacy				
Physical Therapists				
Podiatry				
Engineers and Land Surveyors				
Speech Pathology and Audiology				
Veterinary Examiners				
Ky. Board of Investigators				
Massage Therapy				
Real Estate Commission				
Real Estate Appraiser Board				
Commission on Human Rights				
Council on Postsecondary Education				
Commission on Women				
Personnel:				
General Operations				
Public Employee Deferred Compensation Authority				
Universities:				
Eastern Kentucky University				
Kentucky State University				
Morehead State University				
Murray State University				
Northern Kentucky University				
University of Kentucky				
University of Louisville				
Western Kentucky University				
Kentucky Community and Technical College System				
Finance and Administration:				
General Administration and Support	400	400	400	
Office of the Controller				
The Commonwealth Office of Technology				
Kentucky Higher Education Assistance Authority				
Finance - County Costs				
Kentucky Retirement Systems				
Department of Revenue:				
General Operations	2,325	1,923	1,917	6
Office of Property Valuation Administrators		402	402	
Department for Facilities Management				
Total General Government	<u>3,225</u>	<u>3,225</u>	<u>3,219</u>	<u>6</u>

Federal				Agency Revenue			
Original	Final	Actual	Variance	Original	Final	Actual	Variance
\$	\$	\$	\$	\$	\$	\$	\$
				145	216	214	2
				1,143	1,183	1,183	
				53	53	50	3
				173	207	201	6
				47	47	46	1
				2,581	2,581	2,530	51
				5,023	5,023	4,664	359
				49	49	33	16
				170	176	176	
				11	11	8	3
				86	86	69	17
				181	184	171	13
				83	83	64	19
				135	135	83	52
				794	794	720	74
				1,088	1,328	1,324	4
				333	333	323	10
				23	23	23	
				1,411	1,411	1,171	240
				112	112	105	7
				238	238	194	44
				80	80	74	6
				91	92	84	8
				2,575	2,575	1,926	649
				623	623	583	40
284	284	208	76	2	2		2
19,100	19,099	12,263	6,836	8,929	8,929	6,570	2,359
				18	18	13	5
				21,005	21,005	19,380	1,625
				7,236	7,236	7,061	175
	5,068	5,068		232,250	232,250	50,273	181,977
	1,766	1,766		35,740	35,740	20,111	15,629
	3,053	3,053		138,683	138,683	85,641	53,042
	3,471	3,471		105,864	105,864	103,933	1,931
	3,604	3,604		175,802	175,802	157,790	18,012
	21,067	21,067		1,896,135	1,896,135	1,382,676	513,459
	12,179	12,179		726,437	726,437	215,464	510,973
	5,416	5,416		259,281	259,281	220,866	38,415
	14,377	14,377		485,472	485,472	212,403	273,069
3,990	31,641	19,728	11,913	2,844	3,894	2,535	1,359
1,000	1,375	1,350	25	7,255	7,254	6,171	1,083
400	1,800	495	1,305	305	306	169	137
1,568	2,587	2,426	161	30,219	31,018	30,162	856
				1,932	1,932	1,617	315
				26,725	26,726	23,914	2,812
				7,202	7,436	7,031	405
				3,500	3,750	3,723	27
	263	76	187	1,043	1,043	846	197
<u>217,468</u>	<u>606,171</u>	<u>454,514</u>	<u>150,673</u>	<u>4,280,156</u>	<u>4,296,243</u>	<u>2,666,118</u>	<u>1,630,125</u>

COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL (BUDGETARY BASIS) - BUDGETED SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Transportation			
	Original	Final	Actual	Variance
Legislative and Judicial:				
General Assembly	\$	\$	\$	\$
Legislative Research Commission				
Judicial Retirement System				
Court of Justice - Operation and Administration				
Total Legislative and Judicial				
Commerce:				
Economic Development:				
Office of the Secretary				
Financial Incentives				
Existing Business Development				
New Business Development				
Commerce: Office of the Secretary				
Department of Travel				
Berea Artisans Center	350	350	350	
Department of Fish and Wildlife Resources				
Total Commerce	350	350	350	
Education:				
Commission on the Deaf and Hard of Hearing				
Environmental Education Council				
Kentucky Heritage Council				
Kentucky Arts Council				
General Administration and Program Support				
Department of Education:				
Support Education Excellence In KY (SEEK)				
Learning Results Services				
Bureau of Support Services				
Kentucky Educational Television				
Kentucky Historical Society				
Education Professional Standards Board				
Libraries and Archives:				
Direct Local Aid				
General Operations				
Kentucky Teachers' Retirement System				
Workforce Investment:				
Office of the Blind				
Employment and Training				
Technical Education				
Vocational Rehabilitation				
Total Education and Humanities				

Federal				Agency Revenue			
Original	Final	Actual	Variance	Original	Final	Actual	Variance
\$	\$	\$	\$	\$	\$	\$	\$
1	1		1	697	698		698
				1,786	1,786		1,786
					250	66	184
2,431	4,896	2,549	2,347	61,186	71,187	58,624	12,563
2,432	4,897	2,549	2,348	63,669	73,921	58,690	15,231
	4,400	11	4,389	1,211	1,425	214	1,211
				1,781	1,781	1,606	175
204	30	1	29				
	174	131	43	300	597	260	337
				10,841	14,341	9,389	4,952
				127	127	71	56
				1,796	1,796	1,704	92
13,563	17,070	14,701	2,369	31,975	32,919	32,669	250
13,767	21,674	14,844	6,830	48,031	52,986	45,913	7,073
				457	807	750	57
	100	28	72	543	543	290	253
752	899	852	47	255	1,031	583	448
705	1,427	1,263	164	216	216	117	99
190	190	145	45	6,156	6,156	4,813	1,343
	223,039	223,039					
718,019	1,046,883	940,152	106,731	2,621	3,521	89	3,432
8,528	16,028	5,178	10,850	2,210	2,210	151	2,059
700	700	288	412	1,554	3,654	1,678	1,976
	477	292	185	908	908	679	229
122	492	341	151	1,397	1,397	434	963
724	724	474	250	1,157	1,157	1,042	115
2,165	2,165	1,658	507	1,434	1,434	1,397	37
				10,851	10,851	8,702	2,149
7,899	9,670	8,219	1,451	1,531	2,637	1,654	983
116,007	195,502	161,470	34,032	2,369	4,369	416	3,953
15,154	15,154	10,947	4,207	20,526	20,526	20,203	323
42,600	51,928	45,272	6,656	2,525	3,000	2,149	851
913,565	1,565,378	1,399,618	165,760	56,710	64,417	45,147	19,270

COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL (BUDGETARY BASIS) - BUDGETED SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Transportation			
	Original	Final	Actual	Variance
Human Resources:				
Health and Family Services:				
Administrative Support	\$	\$	\$	\$
Department for Disability Determination Services				
Department for Community Based Services				
Office of Inspector General				
Office of Health Policy				
Department for Aging and Independent Living				
Department of Income Support				
Department for Public Health				
Department for Mental Health and Mental Retardation				
Department for Medicaid Services				
Medicaid Services Benefits				
Commission for Children with Special Health Care Needs				
Department for Human Support Services				
Total Human Resources				
Justice:				
Office of the Secretary				
Department of State Police	73,882	73,882	73,882	
Department for Public Advocacy				
Department of Juvenile Justice				
Department of Criminal Justice Training				
Department of Corrections:				
Management				
Adult Correctional Institutions				
Community Service and Local Facilities				
Total Justice	73,882	73,882	73,882	
Natural Resources and Environmental Protection:				
General Administration & Support				
Energy Development and Independence				
Kentucky River Authority				
Environmental Quality Commission				
Kentucky Nature Preserves Commission				
Department for Environmental Protection	300	300	300	
Department for Natural Resources				
Mining Safety and Licensing				
Surface Mining Reclamation and Enforcement				
Abandoned Mine Lands Reclamation Projects				
Total Natural Resources and Environmental Protection	300	300	300	
Public Protection and Regulation:				
Office of the Commissioner				
Board of Claims and Crime Victims Compensation				
Kentucky Racing Commission				
Kentucky Athletic Commission				
Public Service Commission				
Occupations and Professions				
Mine Safety Review Commission				
Department - of Alcoholic Beverage Control				
of Charitable Gaming				
of Financial Institutions				
of Housing, Buildings, and Construction				
of Insurance				
Labor: Workplace Standards				
General Administration & Support				
Total Public Protection and Regulation				

Federal				Agency Revenue			
Original	Final	Actual	Variance	Original	Final	Actual	Variance
\$ 25,371	\$ 25,371	\$ 19,809	\$ 5,562	\$ 8,564	\$ 8,564	\$ 7,903	\$ 661
85,170	48,465	44,266	4,199	66	100	82	18
501,480	613,057	561,789	51,268	123,648	134,960	119,658	15,302
12,031	12,031	10,115	1,916	1,764	1,764	1,078	686
				579	821	717	104
20,497	23,981	23,933	48	2,858	3,958	2,402	1,556
	36,705	35,853	852	19,509	20,872	17,039	3,833
185,527	228,327	199,158	29,169	85,101	121,101	110,204	10,897
39,976	41,476	37,350	4,126	229,705	242,820	221,092	21,728
48,954	78,954	69,728	9,226	13,080	20,480	14,111	6,369
3,717,469	4,684,359	4,619,822	64,537	366,616	405,574	382,658	22,916
4,179	4,179	2,809	1,370	6,205	8,372	7,316	1,056
3,256	4,276	4,231	45	626	626	36	590
<u>4,643,910</u>	<u>5,801,181</u>	<u>5,628,863</u>	<u>172,318</u>	<u>858,321</u>	<u>970,012</u>	<u>884,296</u>	<u>85,716</u>
9,009	18,302	12,343	5,959	5,757	6,213	5,421	792
14,746	36,560	30,903	5,657	18,542	18,792	16,137	2,655
1,661	2,661	1,896	765	4,300	4,300	4,127	173
13,698	13,698	12,190	1,508	16,948	17,730	12,088	5,642
1,963	1,963	80	1,883	52,526	52,526	47,469	5,057
	350	346	4	135	135	135	
1,904	80,772	76,955	3,817	4,235	12,744	7,422	5,322
15	663	227	436	2,797	6,308	5,467	841
<u>42,996</u>	<u>154,969</u>	<u>134,940</u>	<u>20,029</u>	<u>105,240</u>	<u>118,748</u>	<u>98,266</u>	<u>20,482</u>
1,288	1,288	1,017	271	313	500	357	143
755	35,755	5,235	30,520	6,533	5,318	3,945	1,373
				4,065	4,065	1,887	2,178
				239	239	191	48
46	1,143	54	1,089	355	355	321	34
20,559	27,379	22,758	4,621	34,974	35,483	33,642	1,841
56,657	7,253	4,708	2,545	15,155	5,703	4,046	1,657
	651	645	6		3,702	2,247	1,455
	11,704	9,226	2,478		1,353	1,126	227
	37,049	22,415	14,634		8,370	5,038	3,332
<u>79,305</u>	<u>122,222</u>	<u>66,058</u>	<u>56,164</u>	<u>61,634</u>	<u>65,088</u>	<u>52,800</u>	<u>12,288</u>
				4,179	3,360	3,122	238
540	540	270	270	1,715	2,315	2,258	57
				27,935	30,935	23,357	7,578
				100	135	121	14
218	410	325	85	841	841	138	703
					1,009	879	130
				6	6	2	4
				4,513	4,513	4,184	329
				3,093	3,093	2,882	211
				9,213	9,913	8,394	1,519
	734	90	644	17,293	17,293	12,854	4,439
	3,878	2,828	1,050	19,519	19,519	16,417	3,102
3,236	3,586	3,565	21				
279	279	165	114	2,127	2,577	2,161	416
<u>4,273</u>	<u>9,427</u>	<u>7,243</u>	<u>2,184</u>	<u>90,534</u>	<u>95,509</u>	<u>76,769</u>	<u>18,740</u>

COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCE
BUDGET AND ACTUAL (BUDGETARY BASIS) - BUDGETED SPECIAL REVENUE FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Transportation			
	Original	Final	Actual	Variance
Transportation:				
Administration & Support	\$ 70,213	\$ 70,468	\$ 64,057	\$ 6,411
Revenue Sharing	390,633	359,661	271,053	88,608
Air Transportation	16,901	14,200	3,989	10,211
Highways	961,746	878,882	660,142	218,740
Public Transportation				
Vehicle Regulation	27,277	22,769	19,880	2,889
Debt Service	136,599	54,278	31,006	23,272
Transfers to Capital Projects	8,215	8,215	5,890	2,325
BRAC Economic Development Road Bonds				
GARVEE Louisville Bridges Project Bonds				
2005 GARVEE Bond Series				
2005 Ed Bond Series				
Total Transportation	<u>1,611,584</u>	<u>1,408,473</u>	<u>1,056,017</u>	<u>352,456</u>
Total Expenditures	<u>1,689,341</u>	<u>1,486,230</u>	<u>1,133,768</u>	<u>352,462</u>
Excess of Revenues over (under)				
Expenditures	<u>(284,238)</u>	<u>(287,130)</u>	<u>71,774</u>	<u>358,904</u>
Other Financing Sources (Uses)				
Proceeds from Trustees			1,052	1,052
Proceeds from Issuance of Notes				
Proceeds from Issuance of Bonds				
Total Other Financing Sources (Uses)			<u>1,052</u>	<u>1,052</u>
Excess of Revenues and Other Financing				
Sources over (under) Expenditures and				
Other Financing Uses	(284,238)	(287,130)	72,826	359,956
Fund Balances at July 1		(1,189,199)	284,764	
Non-Budgeted Items			<u>(1,362)</u>	
Fund Balances at June 30	<u>\$ (284,238)</u>	<u>\$ (1,476,329)</u>	<u>\$ 356,228</u>	<u>\$</u>

Federal				Agency Revenue			
Original	Final	Actual	Variance	Original	Final	Actual	Variance
\$	\$	\$	\$	\$ 20	\$ 20	\$ 6	\$ 14
					9,622	3,182	6,440
111	279	16	263	8,647	13,248	9,960	3,288
1,703,505	1,707,505	711,670	995,835	80,184	108,956	85,339	23,617
30,944	65,825	45,752	20,073	522	523	440	83
641	9,172	1,998	7,174	10,962	10,963	8,835	2,128
					48,866	14,720	34,146
					221,000	4,801	216,199
				117,746	117,746	48,635	69,111
				71,559	481,594	65,542	416,052
<u>1,735,201</u>	<u>1,782,781</u>	<u>759,436</u>	<u>1,023,345</u>	<u>289,640</u>	<u>1,012,538</u>	<u>241,460</u>	<u>771,078</u>
<u>7,652,917</u>	<u>10,068,700</u>	<u>8,468,065</u>	<u>1,599,651</u>	<u>5,853,935</u>	<u>6,749,462</u>	<u>4,169,459</u>	<u>2,580,003</u>
		91,802				2,508,841	
						392	
						100,000	
						250,000	
						350,392	
		91,802				2,859,233	
		117,089				1,239,665	
		(9,268)				(2,551,451)	
<u>\$</u>	<u>\$</u>	<u>\$ 199,623</u>	<u>\$</u>	<u>\$</u>	<u>\$</u>	<u>\$ 1,547,447</u>	<u>\$</u>

Budgetary Reporting

The Commonwealth of Kentucky requires that each branch of government prepare and submit a recommended budget to the General Assembly for each of the two fiscal years to be included in a biennial budget. These budgets are prepared principally on the cash basis. The General Assembly reviews these budget requests, makes any necessary revisions, and legally adopts a biennial budget for each of the three branches of government. The Governor has the power to approve or veto each bill, or to make line-item vetoes, subject to legislative override.

The financial plan for each fiscal year, as presented in a branch budget recommendation, shall be adopted with such modifications as made by the General Assembly (and explained in a budget memorandum) by the passage of the budget bill and such revenue and other acts necessary for the purpose.

Budgetary control is maintained at the budget unit level as designated by the budget bills enacted by the General Assembly (i.e., function, major program area, program, or unit of organization).

Appropriations for the General Fund and Road Fund shall be based upon revenue estimates prepared by the Consensus Forecasting Group and modifications made by the appropriations committee of the General Assembly. Official revenue estimates are not made for the other budgetary funds.

The Major Governmental funds, which have legally adopted annual budgets as part of the primary government, include the following: General, Transportation, Federal, and Agency Revenue Funds.

The funds allotted for each purpose of expenditure shall be used for no other purpose, except when the head of any budget unit, with the approval of the Secretary of the Finance and Administration Cabinet, may transfer allotted funds from one purpose of expenditure to another within the budget unit. No revisions of the allotment schedule may provide for an allotment or allotments in excess of the amount appropriated to that budget unit in a budget bill or for expenditure for any other purpose not contemplated in a budget bill. However, appropriations for budgetary funds other than the General Fund and the Transportation Fund may be amended upon approval by the State Budget Director and the Secretary of the Finance and Administration Cabinet.

Encumbrance accounting is utilized for budgetary control purposes. Encumbrances outstanding at year end for long-term construction contracts other than commitments of a continuing nature are reported as reservations of fund balance for subsequent year expenditures. All other encumbered and unencumbered appropriations lapse at the end of each fiscal year except in the Transportation Fund, which has a project length budget, except where statutory or budget bill authority expressly permits the unexpended appropriation to continue into the subsequent year. Encumbrances are carried forward as revisions to appropriations.

The annual budget is prepared principally on the cash basis, which differs from generally accepted accounting principles (GAAP). A reconciliation between the budgetary basis and the GAAP basis is presented in the notes to the Required Supplemental Information section as follows.

COMMONWEALTH OF KENTUCKY
Notes To Required Supplementary Information
June 30, 2010

Budgetary Basis vs. GAAP

Accounting principles applied for purposes of developing data on budgetary basis differ significantly from those used to present financial statements in conformity with generally accepted accounting principles. A schedule reconciling the fund balance on a cash basis at June 30, 2010, to the fund balance on a modified accrual basis follows :

(Expressed in Thousands)

Financial statement funds (same as budgetary funds)	General Fund	Transportation Fund	Federal Fund	Agency Revenue Fund
Fund balance				
June 30, 2010:				
Budgetary basis	\$ 152,028	\$ 356,228	\$ 199,623	\$ 1,547,447
Adjustments:				
Accrued revenues	270,148	118,993	605,935	79,253
Accrued expenditures	(267,682)	(65,309)	(710,123)	(34,170)
Accrued transfers (net)	(16,599)		(11,158)	11,159
Total Accruals (1)	<u>(14,133)</u>	<u>53,684</u>	<u>(115,346)</u>	<u>56,242</u>
Reclassifications and other adjustments:				
Inventory balances (1)	5,079	50,790	645	3,460
To reclassify financial and other resources into financial statement fund types (2)	(1,387)	547	(149,367)	(1,143,553)
To record financial resources available as non-budgeted funds (3)	<u>(62,000)</u>			<u>18,053</u>
Fund Balance				
Fund balance June 30, 2010:				
GAAP Basis	<u>\$ 79,587</u>	<u>\$ 461,249</u>	<u>\$ (64,445)</u>	<u>\$ 481,649</u>

- (1) Basis differences
- (2) Perspective differences
- (3) Entity differences

COMMONWEALTH OF KENTUCKY
Notes To Required Supplementary Information
June 30, 2010

Infrastructure Assets Reported Using the Modified Approach

As allowed by GASB Statement No. 34, Basic Financial Statements – and Management’s Discussion and Analysis – for State and Local Governments, the Commonwealth has adopted an alternative process for recording depreciation expense on selected infrastructure assets. Under this alternative method, referred to as the modified approach, the Commonwealth expenses certain maintenance and preservation costs and does not report depreciation expense. Assets accounted for, under the modified approach, include approximately 63,000 lane miles of roads and approximately 9,000 bridges that the Commonwealth is responsible to maintain.

In order to utilize the modified approach, the Commonwealth is required to:

- Maintain an asset management system that includes an up-to-date inventory of eligible infrastructure assets.
- Perform condition assessments of eligible assets and summarize the results using a measurement scale.
- Estimate, each year, the annual amount to maintain and preserve the assets at the condition level established and disclosed by the Commonwealth.
- Document that the assets are being preserved approximately at, or above, the established condition level.

Pavements

Measurement Scale

The Kentucky Transportation Cabinet (KYTC) uses numerous methods to determine the condition of roadway pavements; however, the Pavement Condition Index (PCI) serves as KYTC’s primary method to measure and monitor pavement conditions. In use since the mid-1980s, the PCI for any particular pavement section is the mathematical difference between the current pavement smoothness and the acceptable pavement smoothness threshold based on traffic volumes. The corresponding pavement condition is based on the following PCI ranges:

<u>Condition</u>	<u>PCI</u>
Good	Greater than +0.4
Fair	Between 0.0 and 0.4
Poor	Less than 0.0

Established Minimum Condition Level

No more than 30% of the pavements shall be rated as “poor.”

Assessed Conditions

The Commonwealth assesses pavement condition on a calendar year basis. The following table reports the percentage of pavements meeting ratings of “Good”, “Fair”, and “Poor” for the past five years.

<u>Condition</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>	<u>2006</u>	<u>2005</u>
Good	62.8%	60.7%	58.9%	51.9%	50.4%
Fair	19.5%	24.8%	26.1%	32.9%	35.7%
Poor	17.7%	14.5%	15.0%	15.2%	13.9%

Bridges

Measurement Scale

KYTC maintains information on its 8,933 bridges in compliance with the National Bridge Inspection guidelines established by the Federal Highway Administration. KYTC inspects all bridges at least once every two years and the condition assessment results are coded on a 0-9 scale with 9 being the most desirable. The condition ratings are based on the following scale:

<u>Rating</u>	<u>Description</u>
9	Excellent.
8	Very good.
7	Good. Some minor problems.
6	Satisfactory. Structural elements show some minor deterioration.
5	Fair. All primary structural elements are sound but may have minor section loss, cracking, spalling or scour.
4	Poor. Advanced section loss, deterioration, spalling or scour.
3	Serious. Loss of section, deterioration, spalling, or scour have seriously affected primary structural components. Local failures are possible. Fatigue cracks in steel or shear cracks in concrete may be present.
2	Critical. Advanced deterioration of primary structural elements. Fatigue cracks in steel or shear cracks in concrete may be present or scour may have removed substructure support. Unless closely monitored, it may be necessary to close the bridge until corrective action is taken.
1	Imminent failure. Major deterioration or section loss present in critical structural components or obvious vertical or horizontal movement affecting structure stability. Bridge is closed to traffic, but corrective action may put it back in light service.
0	Failure. Out of service; beyond corrective action.

Established Minimum Condition Level

No more than 10% of the bridges shall be rated as “structurally deficient.” In addition, the total deck area of structurally deficient, state maintained bridges will not exceed 12% of the total deck area of all state maintained bridges.

COMMONWEALTH OF KENTUCKY
Notes To Required Supplementary Information
June 30, 2010

Assessed Conditions

A bridge coded 4 or less for its deck, superstructure, or substructure, or coded 2 or less for its structural evaluation or waterway adequacy is classified as “structurally deficient.” A structurally deficient bridge is inadequate to carry legal loads, whether caused by structural deterioration, obsolete design standards, or an insufficient waterway opening. A bridge coded 3 or less for its structural evaluation, deck geometry, vertical or horizontal underclearance, water adequacy, or approach roadway alignment is classified as “functionally obsolete.” A functionally obsolete bridge cannot properly accommodate the current traffic. The following table reports the percentage of bridges whose condition was assessed as “structurally deficient” in the corresponding year:

Fiscal Year 2006:

Estimated	\$690.0	\$110.0	\$800.0
Actual	\$734.5	\$64.5	\$799.0

Fiscal Year 2005:

Estimated	\$665.0	\$100.0	\$765.0
Actual	\$542.2	\$89.9	\$632.1

<u>Calendar Year</u>	<u>Deck Area</u>	
	<u>Structurally Deficient</u>	<u>Structurally Deficient</u>
2009	7.4%	7.3%
2008	7.6%	8.7%
2007	6.1%	7.6%
2006	6.1%	8.2%
2005	6.2%	8.0%

Estimated and Actual Costs to Maintain

The following table presents the Commonwealth’s estimate of spending necessary to preserve and maintain the pavements, bridges, and maintenance condition at, or above, the “Established Condition Levels” cited above and the actual amount spent during the past six fiscal years (in millions):

	Roadways	Bridges	Total
<u>Fiscal Year 2011:</u>			
Estimated	\$1,016.8	\$126.9	\$1,143.7
<u>Fiscal Year 2010:</u>			
Estimated	\$809.4	\$103.1	\$912.5
Actual	\$806.6	\$97.6	\$904.2
<u>Fiscal Year 2009:</u>			
Estimated	\$929.0	\$150.0	\$1,079.0
Actual	\$846.4	\$64.1	\$910.5
<u>Fiscal Year 2008:</u>			
Estimated	\$707.8	\$181.5	\$889.3
Actual	\$840.1	\$155.0	\$995.1
<u>Fiscal Year 2007:</u>			
Estimated	\$700.0	\$120.0	\$820.0
Actual	\$817.4	\$114.1	\$931.5

**COMMONWEALTH OF KENTUCKY
REQUIRED SUPPLEMENTARY INFORMATION
ENTITY RISK POOLS
CLAIMS DEVELOPMENT INFORMATION
FOR THE LAST TEN YEARS
(Expressed in Thousands)**

State Workers' Compensation Program

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Earned Premiums	\$ 13,543	\$ 13,628	\$ 17,058	\$ 18,146	\$ 22,950	\$ 24,812	\$ 23,395	\$ 24,293	\$ 21,764	\$ 23,666
Administrative Expense	533	545	777	480	385	1,149	1,127	1,070	1,094	936
Incurred Claims as Originally Estimated	19,097	19,501	21,342	20,320	20,899	19,493	18,161	16,765	21,006	19,084
Claims Paid (Cumulative) as of:										
End of Fiscal Year	3,790	3,846	3,733	3,656	4,520	4,131	4,898	4,078	4,907	4,613
One Year Later	7,216	7,320	7,449	7,225	7,233	7,862	8,716	7,585	8,252	
Two Years Later	8,987	9,260	9,330	8,596	9,347	9,632	10,947	9,316		
Three Years Later	10,252	10,414	10,627	10,008	10,424	10,873	12,259			
Four Years Later	11,254	11,236	11,432	10,921	11,209	11,609				
Five Years Later	11,945	11,990	12,182	11,842	11,798					
Six Years Later	12,886	12,717	12,883	12,644						
Seven Years Later	13,711	13,247	13,401							
Eight Years Later	14,525	13,757								
Nine Years Later	15,253									
Re-estimation of Incurred Claims:										
End of Fiscal Year	19,097	19,501	21,342	20,320	20,899	19,493	18,161	16,765	21,006	19,084
One Year Later	19,315	20,172	20,514	19,209	18,824	17,769	19,152	17,770	19,270	
Two Years Later	19,186	18,805	19,888	18,694	17,659	17,758	20,192	17,851		
Three Years Later	19,067	19,198	19,894	18,682	17,753	18,338	20,618			
Four Years Later	19,382	19,546	19,442	18,446	18,502	18,755				
Five Years Later	19,532	19,233	19,685	18,946	18,717					
Six Years Later	20,002	19,450	20,487	19,282						
Seven Years Later	20,315	20,004	20,350							
Eight Years Later	21,166	20,129								
Nine Years Later	21,502									
Increase (Decrease) in Estimated Incurred Claims From the Original Estimate Using Re-estimation at the End of the Most Recent Fiscal Year	2,405	628	(992)	(1,038)	(2,183)	(738)	2,458	1,086	(1,736)	

SOURCE: Compilation Report

Kentucky Public Employees Health Plan

	2006	2007	2008	2009	2010
Earned Premiums	\$ 578,263	\$ 1,091,702	\$ 1,191,248	\$ 1,310,553	\$ 1,466,303
Administrative Expense	28,998	57,782	68,883	72,836	77,104
Incurred Claims as Originally Estimated	467,315	1,042,931	1,164,712	1,292,059	1,391,340
Claims Paid (Cumulative) as of:					
End of Fiscal Year	398,456	970,764	1,089,989	1,264,866	1,318,824
One Year Later	473,766	1,035,700	1,173,449	1,290,727	
Two Years Later	473,046	1,043,837	1,173,366		
Three Years Later	475,709	1,043,442			
Four Years Later	475,656				
Re-estimation of Incurred Claims:					
End of Fiscal Year	467,315	1,042,931	1,164,712	1,292,059	1,391,340
One Year Later	473,872	1,035,976	1,173,890	1,289,389	
Two Years Later	473,046	1,043,923	1,173,323		
Three Years Later	475,715	1,043,442			
Four Years Later	475,656				
Increase (Decrease) in Estimated Incurred Claims From the Original Estimate Using Re-estimation at the End of the Most Recent Fiscal Year	8,341	511	8,610	(2,670)	

SOURCE: Audited Financial Statements

OTHER SUPPLEMENTARY INFORMATION

**COMBINING AND INDIVIDUAL FUND STATEMENTS AND
SCHEDULES - NON-MAJOR FUNDS**

NON-MAJOR GOVERNMENTAL FUNDS

Debt Service Fund

Turnpike Authority of Kentucky - accounts for the payment of principal, interest, and administrative fees due on debt issued to acquire infrastructure, which is then leased to the Transportation Cabinet of the Commonwealth.

The Kentucky School Facilities Construction Commission - accounts for the payment of the Commonwealth's portion of principal, interest, and administrative fees due on debt issued by local school districts for school construction.

Special Revenue Funds

The **Other Special Revenue Fund** - accounts for revenues and expenditures of restricted taxes, fees, and charges related to a particular function or activity, but not usually appropriated by the General Assembly.

The **Turnpike Authority of Kentucky** - was created to issue debt, which is used to acquire infrastructure, which is then leased to the Transportation Cabinet of the Commonwealth.

The Kentucky School Facilities Construction Commission - was established to assist local school districts in meeting the school construction needs of the Commonwealth in a manner that ensures an equitable distribution of funds based upon unmet needs.

The **Special Benefits Fund** - accounts for other fiduciary monies that will be expended for designated operations.

COMMONWEALTH OF KENTUCKY
COMBINING BALANCE SHEET
NON-MAJOR GOVERNMENTAL FUNDS
JUNE 30, 2010
(Expressed in Thousands)

	Debt Service Funds		
	Turnpike Authority of Kentucky	Kentucky School Facilities Construction Commission	Other Special Revenue
Assets			
Cash and cash equivalents	\$ 87,253	\$	\$ 46,170
Investments, net of amortization	43,535		143,016
Invested security collateral			52,648
Receivables, net	1,191		30,357
Notes receivable			322
Interfund receivables	917		726
Interfund loan receivable			68,300
Inventories			40
Total Assets	\$ 132,896	\$	\$ 341,579
Liabilities and Fund Balances			
Liabilities:			
Accounts payable	\$	\$	\$ 9,582
Interfund payables	917		9,721
Obligations under securities lending			52,648
Deferred revenue			16,350
Total Liabilities	917	\$	88,301
Fund Balances:			
Reserved for:			
Inventories			40
Long-term receivables			322
Unreserved, reported in:			
Special revenue funds			252,916
Debt service fund	131,979		
Total Fund Balances	131,979	\$	253,278
Total Liabilities and Fund Balances	\$ 132,896	\$	\$ 341,579

Special Revenue Funds			
Turnpike Authority of Kentucky	Kentucky School Facilities Construction Commission	Special Benefits	Total Non-Major Governmental Funds
\$ 42,158	\$ 10,379	\$ 90,646	\$ 276,606
208,667	6,780	71,796	473,794
838		32,941	85,589
917		5,580	37,966
		19,202	322
			21,762
			68,300
			40
<u>\$ 252,580</u>	<u>\$ 17,159</u>	<u>\$ 220,165</u>	<u>\$ 964,379</u>
\$ 77	\$ 10	\$ 7,868	\$ 17,537
917	1,459	2,722	15,736
125		32,941	85,589
1,119	1,469	171	16,646
		43,702	135,508
251,461	15,690	176,463	696,530
<u>251,461</u>	<u>15,690</u>	<u>176,463</u>	<u>131,979</u>
<u>\$ 252,580</u>	<u>\$ 17,159</u>	<u>\$ 220,165</u>	<u>\$ 964,379</u>

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
NON-MAJOR GOVERNMENTAL FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Debt Service Funds		
	Turnpike Authority of Kentucky	Kentucky School Facilities Construction Commission	Other Special Revenue
Revenues			
Taxes	\$	\$	\$ 120,637
Licenses, fees, and permits			727
Intergovernmental			
Charges for services			61,323
Fines and forfeits			24,110
Interest and other investment income	1,227		3,630
Increase (decrease) in fair value of investments			69
Securities lending income			271
Other revenues	2,299		34,303
Total Revenues	3,526		245,070
Expenditures			
Current:			
General government		44,491	126,598
Legislative and judicial			73
Commerce			243
Education and humanities			53,975
Human resources			2,140
Justice			
Natural resources and environmental protection			373
Public protection and regulation			
Transportation			1
Debt service:			
Principal retirement	260,645	69,292	
Interest and fiscal charges	51,888	32,282	
Other expenditures	902	381	
Securities lending expense			148
Total Expenditures	313,435	146,446	183,551
Excess (Deficiency) of Revenues over (under) Expenditures	(309,909)	(146,446)	61,519
Other Financing Sources (Uses)			
Transfers in	134,908	101,768	365,949
Transfers out			(417,096)
Issuance of bonds:			
New issues		44,491	
Refunding issues		28,280	
Premiums			
Discounts		(651)	
Payments to refunded bond escrow agent		(27,442)	
Total Other Financing Sources (Uses)	134,908	146,446	(51,147)
Net Change in Fund Balances	(175,001)		10,372
Fund Balances at July 1	306,980		242,875
Increase (Decrease) in Inventory			31
Fund Balances at June 30	\$ 131,979	\$	\$ 253,278

Special Revenue Funds			
Turnpike Authority of Kentucky	Kentucky School Facilities Construction Commission	Special Benefits	Total Non-Major Governmental Funds
\$	\$	\$	\$
		59	120,696
		645	1,372
		24	24
		100,952	162,275
		3,897	28,007
4,117	62	2,803	11,839
	(1)	511	579
		170	441
284	9,238	9,897	56,021
4,401	9,299	118,958	381,254
86,542	12,902	59,075	329,608
			73
		1,118	1,361
		16,782	70,757
		22,262	24,402
		1,870	1,870
		9,573	9,946
		19,668	19,668
		60,503	60,504
			329,937
			84,170
			1,283
		92	240
86,542	12,902	190,943	933,819
(82,141)	(3,603)	(71,985)	(552,565)
30,739	18,825	187,141	839,330
(134,908)	(14,434)	(142,643)	(709,081)
187,640			232,131
153,260			181,540
15,587			15,587
(1,968)			(2,619)
250,350	4,391	44,498	(27,442)
250,350	4,391	44,498	529,446
168,209	788	(27,487)	(23,119)
83,252	14,902	203,950	851,959
\$ 251,461	\$ 15,690	\$ 176,463	\$ 828,871

SCHEDULE OF FUND ACTIVITIES

COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES BY SOURCE
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed In Thousands)

Revenues by Source	June 30, 2010
Taxes:	
Sales and gross receipts	\$ 3,566,359
Income:	
Individual	3,114,270
Corporations	235,493
Property	584,354
Coal severance	318,330
Licenses and privileges	5,455
Inheritance and estate	36,211
Miscellaneous	2,415
Total Taxes	<u>7,862,887</u>
Licenses, fees, and permits	43,360
Intergovernmental	14,500
Charges for services	10,082
Fines and forfeits	49,367
Interest and other investment income	7,427
Increase (decrease) in fair value of investments	(2,454)
Securities lending income	198
Other revenues	127,920
Total Revenues by Source	<u>\$ 8,113,287</u>

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES BY FUNCTION, CABINET, AND OBJECT
GENERAL FUND
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed In Thousands)

	June 30, 2010
General Government:	
Personal services	\$ 240,122
Utilities, rentals, and other services	40,002
Commodities and supplies	23,359
Grants and subsidies	1,466,564
Capital outlay	32
Travel	1,857
Judgments and contingent liabilities	477
Other	2,613
Total General Government	<u>1,775,026</u>
Legislative and Judicial:	
Personal services	185,775
Utilities, rentals, and other services	99,819
Commodities and supplies	21,962
Grants and subsidies	6,328
Capital outlay	412
Travel	3,648
Judgments and contingent liabilities	120
Total Legislative and Judicial	<u>318,064</u>
Commerce:	
Personal services	12,555
Utilities, rentals, and other services	1,409
Commodities and supplies	687
Grants and subsidies	16,073
Travel	181
Total Commerce	<u>30,905</u>
Education and Humanities:	
Personal services	93,447
Utilities, rentals, and other services	25,168
Commodities and supplies	6,074
Grants and subsidies	3,497,868
Capital outlay	346
Travel	1,728
Total Education and Humanities	<u>3,624,631</u>
Human Resources:	
Personal services	194,229
Utilities, rentals, and other services	37,444
Commodities and supplies	7,891
Grants and subsidies	1,297,923
Capital Outlay	6,376
Travel	5,447
Total Human Resources	<u>1,549,310</u>
Justice:	
Personal services	275,445
Utilities, rentals, and other services	40,205
Commodities and supplies	24,824
Grants and subsidies	207,351
Capital outlay	3,637
Claims	7
Travel	2,456
Judgments and contingent liabilities	668
Total Justice	<u>554,593</u>

	June 30, 2010
Natural Resources and Environmental Protection:	
Personal services	\$ 57,442
Utilities, rentals, and other services	5,639
Commodities and supplies	2,685
Grants and subsidies	1,979
Capital outlay	51
Travel	253
Total Natural Resources and Environmental Protection	<u>68,049</u>
Public Protection and Regulation:	
Personal services	15,484
Utilities, rentals, and other services	1,507
Commodities and supplies	249
Grants and subsidies	200
Capital outlay	15
Travel	309
Total Public Protection and Regulation	<u>17,764</u>
Transportation:	
Personal services	387
Grants and subsidies	4,010
Capital outlay	2
Total Transportation	<u>4,399</u>
Securities Lending Expense	<u>108</u>
Total Expenditures	<u><u>\$ 7,942,849</u></u>

COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES AND EXPENDITURES BY TYPE
TRANSPORTATION FUND
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed In Thousands)

	June 30, 2010
Revenues:	
Taxes	\$ 1,076,592
Licenses, fees and permits	128,285
Charges for services	10,277
Fines and forfeits	22
Interest and other investment income	187
Increase (decrease) in fair value of investments	954
Securities lending income	387
Other revenues	3,491
Total Revenues	<u>1,220,195</u>
Expenditures:	
Transportation:	
General administration and support	59,012
Motor vehicle regulation	18,155
Justice - state police	73,909
Highways	927,137
Aviation	3,311
Securities lending expense	211
Other	350
Total Expenditures	<u>\$ 1,082,085</u>

INTERNAL SERVICE FUNDS

Internal Service Funds account for the financing of goods and services provided on a cost reimbursement basis by one agency of the Commonwealth to other state agencies. Kentucky uses the following Internal Service Funds:

Fleet Management Fund - accounts for expenses incurred and reimbursements received for the management and maintenance of the Commonwealth's motor vehicle fleet.

Computer Services Fund - accounts for expenses incurred and reimbursements received for computer and related data processing services.

Prison Industries Fund - accounts for expenses incurred and reimbursements received for industrial operations within the correctional system.

Central Printing Fund - accounts for expenses incurred and reimbursements received by the Division of Printing.

Property Management Fund - accounts for expenses incurred and reimbursements received for space rental and maintenance operations.

Risk Management Fund accounts for the self-insurance operations administered by the State which include the following programs:

Fire and Tornado Insurance Program - accounts for monies received by the Department of Insurance from State agencies and expended for insuring State property against loss from fires, tornadoes, etc.

State Workers' Compensation Program - accounts for monies received by the Personnel Cabinet from State agencies and expended for claims of job related injuries to State employees.

Transportation Cabinet's Self-Insured Workers' Compensation Trust Program - provides workers' compensation insurance for the employees of the Transportation Cabinet.

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF FUND NET ASSETS
INTERNAL SERVICE FUNDS
JUNE 30, 2010
(Expressed in Thousands)

	<u>Fleet Management</u>	<u>Computer Services</u>	<u>Prison Industries</u>
Assets			
Current assets:			
Cash and cash equivalents	\$ 10,260	\$ 8,613	\$ 655
Receivables, net	17	96	408
Interfunds receivable	93	879	278
Inventories	15	310	2,355
Prepaid expenses	12	523	
Total Current Assets	<u>10,397</u>	<u>10,421</u>	<u>3,696</u>
Noncurrent assets:			
Investments, net	6,980	12,397	425
Land			723
Improvements other than buildings			
Buildings		9,253	6,470
Machinery and equipment	71,449	37,592	4,135
Easements and other intangibles		1,675	
Less: Accumulated depreciation	(57,108)	(35,498)	(5,021)
Construction in progress			
Total Capital Assets	<u>14,341</u>	<u>13,022</u>	<u>6,307</u>
Total Noncurrent Assets, Net	<u>21,321</u>	<u>25,419</u>	<u>6,732</u>
Total Assets	<u>31,718</u>	<u>35,840</u>	<u>10,428</u>
Liabilities			
Current liabilities:			
Accounts payable	255	1,969	449
Interfund payables		1,933	
Claims liability			
Claims adjustment liability			
Capital lease obligations	3,191	995	15
Compensated absences	130	1,826	277
Deferred revenue		513	
Total Current Liabilities	<u>3,576</u>	<u>7,236</u>	<u>741</u>
Noncurrent liabilities:			
Claims liability			
Claims adjustment liability			
Capital lease obligations	272	1,518	7
Compensated absences	38	1,265	272
Total Noncurrent Liabilities	<u>310</u>	<u>2,783</u>	<u>279</u>
Total Liabilities	<u>3,886</u>	<u>10,019</u>	<u>1,020</u>
Net Assets			
Invested in capital assets, net of related debt	10,878		6,285
Unrestricted	16,954	25,821	3,123
Total Net Assets	<u>\$ 27,832</u>	<u>\$ 25,821</u>	<u>\$ 9,408</u>

Central Printing	Property Management	Risk Management	Totals June 30, 2010
\$ 106	\$ 6,315	\$ 13,637	\$ 39,586
18	149	7	528
78		42	1,459
		4,973	2,758
<u>202</u>	<u>6,464</u>	<u>18,659</u>	<u>49,839</u>
72	10,051	9,002	38,927
	17,562		18,285
	3,133		3,133
	249,175		264,898
744	1,615		115,535
(509)	(146,200)		1,675
	82,412		(244,336)
<u>235</u>	<u>207,697</u>		<u>82,412</u>
<u>307</u>	<u>217,748</u>	<u>9,002</u>	<u>241,602</u>
<u>509</u>	<u>224,212</u>	<u>27,661</u>	<u>280,529</u>
			<u>330,368</u>
35	1,564	404	4,676
	1	1	1,935
		17,334	17,334
		797	797
165	385		4,751
70	858	117	3,278
	141		654
<u>270</u>	<u>2,949</u>	<u>18,653</u>	<u>33,425</u>
		135,245	135,245
		5,143	5,143
142	6,018		7,957
16	286	30	1,907
<u>158</u>	<u>6,304</u>	<u>140,418</u>	<u>150,252</u>
<u>428</u>	<u>9,253</u>	<u>159,071</u>	<u>183,677</u>
(72)	201,293		218,384
153	13,666	(131,410)	(71,693)
<u>\$ 81</u>	<u>\$ 214,959</u>	<u>\$ (131,410)</u>	<u>\$ 146,691</u>

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
INTERNAL SERVICE FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Fleet Management	Computer Services	Prison Industries
Operating Revenues:			
Charges for services	\$ 29,523	\$ 58,822	\$ 10,911
Other revenues	194	58	7
Total Operating Revenues	<u>29,717</u>	<u>58,880</u>	<u>10,918</u>
Operating Expenses:			
Personal services	1,588	35,766	4,076
Utilities, rentals, and other services	2,814	11,977	737
Commodities and supplies	12,430	15,512	4,511
Grants and subsidies			7
Depreciation and amortization	6,431	3,927	381
Travel		66	27
Reinsurance expense			
Claims expense			
Claims adjustment expense			
Total Operating Expenses	<u>23,263</u>	<u>67,248</u>	<u>9,739</u>
Operating Income (Loss)	<u>6,454</u>	<u>(8,368)</u>	<u>1,179</u>
Nonoperating Revenues (Expenses):			
Gain (loss) on sale of fixed assets	345	(742)	(445)
Interest and other investment income			
Increase (decrease) in fair value of investments	(191)	(144)	(14)
Interest expense	(225)	(104)	(2)
Other revenues (expenses)			
Total Nonoperating Revenues and Expenses	<u>(71)</u>	<u>(990)</u>	<u>(461)</u>
Income (Loss) before Transfers	6,383	(9,358)	718
Capital contributions	234		
Transfers in	75	5,584	
Transfers out	(6,293)	(1,800)	
Change in Net Assets	399	(5,574)	718
Net Assets at July 1	27,433	31,395	8,690
Net Assets at June 30	<u>\$ 27,832</u>	<u>\$ 25,821</u>	<u>\$ 9,408</u>

Central Printing	Property Management	Risk Management	Totals June 30, 2010
\$ 1,822	\$ 34,394	\$ 71,025	\$ 206,497
1,822	1 34,395	71,025	260 206,757
956	16,162	2,669	61,217
446	13,999	4,347	34,320
234	3,362	28	36,077
260	5,795	11	7 16,794
	9	951	113
	1	61,496	951
		(324)	61,497
1,896	39,328	69,178	(324) 210,652
(74)	(4,933)	1,847	(3,895)
(14)	(909)		(1,765)
	2	(144)	(142)
(2)	(112)		(463)
(26)	(314)		(671)
(42)	(1,333)	55	55 (2,986)
(116)	(6,266)	1,758	(6,881)
	1,085		234
	(1,132)	3	6,747
		(666)	(9,891)
(116)	(6,313)	1,095	(9,791)
197	221,272	(132,505)	156,482
\$ 81	\$ 214,959	\$ (131,410)	\$ 146,691

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF CASH FLOWS
INTERNAL SERVICE FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Fleet Management	Computer Services	Prison Industries
Cash Flows from Operating Activities			
Cash received from customers - public	\$ 29,363	\$ 59,608	\$ 3,831
Cash received from customers - state		1,491	7,270
Cash payments to suppliers for goods and services	(15,326)	(25,815)	(5,965)
Cash payments for employee salaries and benefits	(1,577)	(35,515)	(4,095)
Cash payments for claims expense			7
Cash payments from other sources	194	58	(7)
Cash payments to other sources			(7)
Net Cash Provided (Used) by Operating Activities	<u>12,654</u>	<u>(173)</u>	<u>1,041</u>
Cash Flows from Noncapital Financing Activities			
Transfers from other funds	75	5,584	
Transfers to other funds	(6,293)	(1,800)	
Net Cash Provided (Used) by Noncapital Financing Activities	<u>(6,218)</u>	<u>3,784</u>	
Cash Flows from Capital and Related Financing Activities			
Acquisition and construction of capital assets	(127)	(783)	(400)
Principal paid on revenue bond maturities and equipment contracts	(3,054)	(764)	(14)
Interest paid on revenue bonds and equipment contracts	(225)	(104)	(2)
Proceeds from the sale of capital assets	345		
Net Cash Provided (Used) for Capital and Related Financing Activities	<u>(3,061)</u>	<u>(1,651)</u>	<u>(416)</u>
Cash Flows from Investing Activities			
Purchase of investment securities		1	(173)
Proceeds from the sale of investment securities	1,552	3,229	
Interest and dividends on investments	(191)	(144)	
Net Cash Provided (Used) in Investing Activities	<u>1,361</u>	<u>3,086</u>	<u>(173)</u>
Net Increase (Decrease) in Cash and Cash Equivalents	4,736	5,046	452
Cash and Cash Equivalents at July 1	5,524	3,567	203
Cash and Cash Equivalents at June 30	<u>\$ 10,260</u>	<u>\$ 8,613</u>	<u>\$ 655</u>
Reconciliation of Operating Income to Net Cash Provided by Operating Activities:			
Operating income (loss)	\$ 6,454	\$ (8,368)	\$ 1,179
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and amortization	6,431	3,927	381
Miscellaneous nonoperating income (expense)			
Change in assets and liabilities:			
(Increase) Decrease in assets:			
Receivables, net	119	176	33
Interfund receivables	(80)	2,023	157
Inventories	1	81	(190)
Prepaid expenses	(11)	1,159	
Increase (decrease) in liabilities:			
Accounts payable	(69)	(1,148)	(527)
Interfund payables	(3)	1,583	
Claims liability			
Claims adjustment liability			
Compensated absences	11	318	8
Deferred revenue	(199)	76	
Net Cash Provided by Operating Activities	<u>\$ 12,654</u>	<u>\$ (173)</u>	<u>\$ 1,041</u>
Noncash Investing, Capital, and Financing Activities			
Change in fair value of investments	\$ (191)	\$ (144)	\$ (14)
Contributions of capital assets	234		
Capital assets acquired through leases		2,657	
Total Noncash Investing, Capital, and Financing Activities	<u>\$ 43</u>	<u>\$ 2,513</u>	<u>\$ (14)</u>

Central Printing	Property Management	Risk Management	Totals June 30, 2010
\$	\$	\$	\$
1,896	34,967	72,637	63,439
(750)	(17,445)	(5,152)	147,624
(950)	(16,016)	(2,622)	(70,453)
	(1)	(58,898)	(60,775)
	1	56	(58,899)
		(1,149)	316
		4,872	(1,156)
196	1,506		20,096
	1,085	3	6,747
	(1,132)	(666)	(9,891)
	(47)	(663)	(3,144)
	(683)		(1,993)
(94)	(501)		(4,427)
(26)	(316)		(673)
			345
(120)	(1,500)		(6,748)
(9)			(181)
	3,051	1,926	9,758
(2)	(110)	60	(387)
(11)	2,941	1,986	9,190
65	2,900	6,195	19,394
41	3,415	7,442	20,192
\$ 106	\$ 6,315	\$ 13,637	\$ 39,586
\$	\$	\$	\$
(74)	(4,933)	1,847	(3,895)
260	5,795	57	16,794
			57
28	20	1,664	2,040
47	560	(39)	2,668
(10)		(813)	(118)
			335
(60)	348	(155)	(1,611)
	(433)	(44)	1,103
		2,676	2,676
		(324)	(324)
	155	3	500
5	(6)		(129)
196	1,506	4,872	20,096
\$	\$	\$	\$
(2)	(112)		(463)
			234
68	2,592		5,317
\$ 66	\$ 2,480	\$	\$ 5,088

CAPITAL ASSETS

COMMONWEALTH OF KENTUCKY
CAPITAL ASSETS USED IN THE OPERATION OF GOVERNMENTAL FUNDS BY SOURCE
JUNE 30, 2010
(Expressed In Thousands)

	June 30, 2010
Governmental Funds Capital Assets	
Land	\$ 145,840
Improvements other than buildings	12,467
Buildings	914,615
Machinery and equipment	466,310
Other intangibles	3,775
Easements	116,154
Construction in progress	2,145,084
Infrastructure	18,018,686
Total Governmental Funds Capital Assets	\$ 21,822,931
Investments in Governmental Funds Capital Assets by Source	
General Fund	\$ 104,019
Special Revenue Funds	2,568,531
Donations	130,843
Other	65,461
Capital Projects Fund:	
State appropriations	54,409
Revenue bonds	444,739
Federal grants	159,766
Other	47,439
Infrastructure (A)	18,018,686
Capital assets acquired prior to July 1, 1984 (A)	152,682
Capital assets acquired after July 1, 1984 (A)	76,356
Total Governmental Funds Capital Assets	\$ 21,822,931

(1) Internal Service Funds are not included in this schedule. Internal Service Fund assets are included as governmental activities in the Statement of Net Assets.

(A) Capital assets with an undetermined funding source.

COMMONWEALTH OF KENTUCKY
CAPITAL ASSETS USED IN THE OPERATION OF GOVERNMENTAL FUNDS
SCHEDULE BY FUNCTION
JUNE 30, 2010
(Expressed in Thousands)

FUNCTION	<u>Land</u>	<u>Improvements Other Than Buildings</u>	<u>Buildings</u>
General Government	\$ 28,737	\$ 3,721	\$ 185,268
Legislative & Judicial	42		
Commerce	64,589	2,653	24,680
Education & Humanities	1,317	664	41,408
Human Resources	1,766	696	79,013
Justice	4,602	4,733	400,064
Natural Resources and Environmental Protection	28,030		1,128
Public Protection and Regulation			
Transportation	16,757		183,054
Total Governmental Funds Capital Assets	<u><u>\$ 145,840</u></u>	<u><u>\$ 12,467</u></u>	<u><u>\$ 914,615</u></u>

(1) Internal Service Funds are not included in this schedule. Internal Service Fund assets are included as governmental activities in the Statement of Net Assets.

<u>Machinery and Equipment</u>	<u>Software / Other Intangibles</u>	<u>Easements</u>	<u>Construction in Progress</u>	<u>Infrastructure</u>	<u>Totals June 30, 2010</u>
\$ 37,550	\$ 3,775	\$ 52,615	\$ 72,918	\$	\$ 384,584
10,940					10,982
25,709			827		118,458
41,749		11,824	1,547		98,509
19,931			7,266		108,672
85,526			95,146		590,071
34,754		10,483	307		74,702
4,115					4,115
206,036		41,232	1,967,073	18,018,686	20,432,838
<u>\$ 466,310</u>	<u>\$ 3,775</u>	<u>\$ 116,154</u>	<u>\$ 2,145,084</u>	<u>\$ 18,018,686</u>	<u>\$ 21,822,931</u>

COMMONWEALTH OF KENTUCKY
CAPITAL ASSETS USED IN THE OPERATION OF GOVERNMENTAL FUNDS
SCHEDULE OF CHANGES BY FUNCTION
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	<u>Balance</u> <u>June 30, 2009</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balance</u> <u>June 30, 2010</u>
General Government	\$ 369,866	\$ 32,124	\$ 17,406	\$ 384,584
Legislative & Judicial	10,618	426	62	10,982
Commerce	114,524	9,343	5,409	118,458
Education & Humanities	96,265	4,441	2,197	98,509
Human Resources	102,085	11,640	5,053	108,672
Justice	588,540	45,032	43,501	590,071
Natural Resources and Environmental Protection	72,734	3,713	1,745	74,702
Public Protection and Regulation	3,678	727	290	4,115
Transportation	19,950,706	3,630,057	3,147,925	20,432,838
Total Governmental Funds Capital Assets	<u>\$ 21,309,016</u>	<u>\$ 3,737,503</u>	<u>\$ 3,223,588</u>	<u>\$ 21,822,931</u>

(1) Internal Service Funds are not included in this schedule. Internal Service Fund assets are included as governmental activities in the Statement of Net Assets.

PENSION AND OTHER POST EMPLOYMENT BENEFIT TRUST FUNDS

Pension and other post employment benefit trust funds account for monies received for and expenses incurred by the various public employee retirement systems administered by the Commonwealth. Kentucky uses the following Pension Trust Funds:

Kentucky Employees Retirement System (KERS) accounts for pension and other post employment benefits administered by the System, which covers substantially all regular full-time employees of any State department, board or agency directed by Executive Order to participate in the System.

County Employees Retirement System (CERS) accounts for pension and other post employment benefits administered by the System, which covers substantially all regular full-time employees of each county, local school board, and additional local agencies electing to participate in the System.

State Police Retirement System (SPRS) accounts for pension and other post employment benefits administered by the System, which covers substantially all regular full-time officers of the Kentucky State Police.

Kentucky Teachers' Retirement System (KTRS) accounts for pension and other post employment benefits administered by the System, which covers substantially all persons occupying positions in the public elementary and secondary schools for which a certificate is required, faculty members of five regional universities, the Commissioner of Education and the professional staff members of the Department of Education.

Judicial Retirement Plan accounts for pension and other post employment benefits administered by the Plan, which covers all District Judges, Judges of the Court of Appeals, and Judges of the Supreme Court.

Legislators' Retirement Plan accounts for pension and other post employment benefits administered by the Plan, which that covers all members of the General Assembly.

Kentucky Public Employees Deferred Compensation Authority accounts for the monies withheld from participating employees payroll to be placed in an Internal Revenue Code Section 401 or 457 deferred compensation plan. The amounts are deposited with third party administrators which oversee the investment activities of such monies.

COMMONWEALTH OF KENTUCKY
COMBINED STATEMENT OF FIDUCIARY NET ASSETS
PENSION AND OTHER POST EMPLOYMENT BENEFIT TRUST FUNDS
JUNE 30, 2010
(Expressed in Thousands)

	<u>Pension Funds</u>	<u>Insurance Funds</u>	<u>Totals June 30, 2010</u>
Assets			
Cash and Short-Term Investments:			
Cash	\$ 7,087	\$ 1,722	\$ 8,809
Medicare drug deposit		100	100
Short-term investments	726,143	782,344	1,508,487
Total Cash and Short-Term Investments	<u>733,230</u>	<u>784,166</u>	<u>1,517,396</u>
Receivables:			
Investments - accounts receivable	99,244	8,877	108,121
Interest receivable	907	253	1,160
Accounts receivable	135,616	33,582	169,198
Total Receivables	<u>235,767</u>	<u>42,712</u>	<u>278,479</u>
Investments at Fair Value:			
Corporate and government bonds	6,188,016	373,932	6,561,948
Common stocks	14,138,513	1,620,311	15,758,824
Mortgages	1,247,123		1,247,123
Mutual funds	1,834,388	614	1,835,002
Real estate	434,689		434,689
Total Investments at Fair Value	<u>23,842,729</u>	<u>1,994,857</u>	<u>25,837,586</u>
Invested security collateral	2,415,366	565,007	2,980,373
Capital assets, net	12,837		12,837
Prepaid expenses	128	147	275
Total Assets	<u>27,240,057</u>	<u>3,386,889</u>	<u>30,626,946</u>
Liabilities			
Investments - accounts payable	900		900
Accounts payable	9,571	7,801	17,372
Obligations under securities lending	2,415,366	565,007	2,980,373
Total Liabilities	<u>2,425,837</u>	<u>572,808</u>	<u>2,998,645</u>
Net assets held in trust for pension and other post employment benefits	<u>\$ 24,814,220</u>	<u>\$ 2,814,081</u>	<u>\$ 27,628,301</u>

**COMMONWEALTH OF KENTUCKY
 COMBINED STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
 PENSION AND OTHER POST EMPLOYMENT BENEFIT TRUST FUNDS
 FOR THE YEAR ENDED JUNE 30, 2010
 (Expressed in Thousands)**

	<u>Pension Funds</u>	<u>Insurance Funds</u>	<u>Totals June 30, 2010</u>
Additions			
Contributions:			
Employer	\$ 950,163	\$ 535,726	\$ 1,485,889
Member	687,129	64,313	751,442
Total Contributions	<u>1,637,292</u>	<u>600,039</u>	<u>2,237,331</u>
Other Contributions:			
Recovery Income	623	29,320	29,943
Medicare D Receipts		34,407	34,407
Participant fees	6,308		6,308
Total Other Contributions	<u>6,931</u>	<u>63,727</u>	<u>70,658</u>
Investment Income:			
Net increase (decrease) in fair value of investments	2,597,298	282,003	2,879,301
Interest	476,356	57,748	534,104
Dividends	135,532	613	136,145
Real estate operating income, net	30,968		30,968
Securities lending income, net	10,439	1,622	12,061
Total Investment Income	<u>3,250,593</u>	<u>341,986</u>	<u>3,592,579</u>
Less: Investment expense	64,182	6,604	70,786
Less: Securities lending expense	3,665	377	4,042
Net Investment Income	<u>3,182,746</u>	<u>335,005</u>	<u>3,517,751</u>
Total Additions	<u>4,826,969</u>	<u>998,771</u>	<u>5,825,740</u>
Deductions			
Benefit payments	2,940,532	4,149	2,944,681
Refunds	37,586	1	37,587
Administrative expenses	41,038	9,775	50,813
Self funding insurance cost		130,142	130,142
Healthcare premium subsidies		223,352	223,352
Other deductions, net		239,923	239,923
Total Deductions	<u>3,019,156</u>	<u>607,342</u>	<u>3,626,498</u>
Change in Net Assets	1,807,813	391,429	2,199,242
Net Assets Held in Trust			
Net Assets at July 1	23,006,407	2,422,652	25,429,059
Net Assets at June 30	<u>\$ 24,814,220</u>	<u>\$ 2,814,081</u>	<u>\$ 27,628,301</u>

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF FIDUCIARY NET ASSETS
PENSION AND OTHER POST EMPLOYMENT BENEFIT TRUST FUNDS - PENSION FUNDS
JUNE 30, 2010
(Expressed in Thousands)

	Kentucky Employees Retirement System		County Employees Retirement System	
	Non-Hazardous	Hazardous	Non-Hazardous	Hazardous
Assets				
Cash and Short-Term Investments:				
Cash	\$ 797	\$ 104	\$ 749	\$ 235
Short-term investments	114,677	78,396	246,699	141,692
Total Cash and Short-Term Investments	<u>115,474</u>	<u>78,500</u>	<u>247,448</u>	<u>141,927</u>
Receivables:				
Investments - accounts receivable	14,565	1,446	19,150	5,429
Interest receivable				
Accounts receivable	19,657	1,378	35,247	9,743
Total Receivables	<u>34,222</u>	<u>2,824</u>	<u>54,397</u>	<u>15,172</u>
Investments at Fair Value:				
Corporate and government bonds	942,106	93,631	1,274,561	355,572
Common stocks	2,223,543	244,184	2,948,021	908,766
Mortgages	184,890	22,010	290,020	81,924
Mutual funds				
Real estate	3,708	2,407	4,947	3,438
Total Investments at Fair Value	<u>3,354,247</u>	<u>362,232</u>	<u>4,517,549</u>	<u>1,349,700</u>
Invested security collateral	751,948	95,378	1,032,658	323,200
Capital assets, net	3,159	271	5,400	469
Prepaid expenses				
Total Assets	<u>4,259,050</u>	<u>539,205</u>	<u>5,857,452</u>	<u>1,830,468</u>
Liabilities				
Investments - accounts payable				
Accounts payable	2,602	221	4,304	374
Obligations under securities lending	751,948	95,378	1,032,658	323,200
Total Liabilities	<u>754,550</u>	<u>95,599</u>	<u>1,036,962</u>	<u>323,574</u>
Net assets held in trust for employee retirement benefits	<u>\$ 3,504,500</u>	<u>\$ 443,606</u>	<u>\$ 4,820,490</u>	<u>\$ 1,506,894</u>

State Police Retirement System	Kentucky Teachers' Retirement System	Judicial Retirement Plan	Legislators' Retirement Plan	Kentucky Public Employees' Deferred Compensation Authority	Totals June 30, 2010
\$ 150	\$ 2,545	\$ 77	\$ 144	\$ 2,286	\$ 7,087
19,635	64,964	13,721	2,084	44,275	726,143
<u>19,785</u>	<u>67,509</u>	<u>13,798</u>	<u>2,228</u>	<u>46,561</u>	<u>733,230</u>
1,045	57,550	57	2		99,244
	8	758	141		907
964	38,946			29,681	135,616
<u>2,009</u>	<u>96,504</u>	<u>815</u>	<u>143</u>	<u>29,681</u>	<u>235,767</u>
73,126	3,392,215	47,120	9,685		6,188,016
154,762	7,526,938	109,161	23,138		14,138,513
14,677	653,602				1,247,123
	299,636			1,534,752	1,834,388
575	419,614				434,689
<u>243,140</u>	<u>12,292,005</u>	<u>156,281</u>	<u>32,823</u>	<u>1,534,752</u>	<u>23,842,729</u>
56,955	155,227				2,415,366
55	3,483				12,837
	128				128
<u>321,944</u>	<u>12,614,856</u>	<u>170,894</u>	<u>35,194</u>	<u>1,610,994</u>	<u>27,240,057</u>
	900				900
40	1,124		5	901	9,571
56,955	155,227				2,415,366
<u>56,995</u>	<u>157,251</u>		<u>5</u>	<u>901</u>	<u>2,425,837</u>
<u>\$ 264,949</u>	<u>\$ 12,457,605</u>	<u>\$ 170,894</u>	<u>\$ 35,189</u>	<u>\$ 1,610,093</u>	<u>\$ 24,814,220</u>

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
PENSION AND OTHER POST EMPLOYMENT BENEFIT TRUST FUNDS - PENSION FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Kentucky Employees Retirement System		County Employees Retirement System	
	Non-Hazardous	Hazardous	Non-Hazardous	Hazardous
Additions				
Contributions:				
Employer	\$ 144,050	\$ 17,659	\$ 207,075	\$ 82,887
Member	92,579	11,228	107,903	37,374
Total Contributions	<u>236,629</u>	<u>28,887</u>	<u>314,978</u>	<u>120,261</u>
Other Contributions:				
Recovery Income				
Participant fees				
Total Other Contributions				
Investment Income:				
Net increase (decrease) in fair value of investments	449,279	57,391	567,121	175,317
Interest	90,808	9,718	118,486	35,056
Dividends				
Real estate operating income, net				
Securities lending income, net	2,931	378	4,079	1,279
Total Investment Income	<u>543,018</u>	<u>67,487</u>	<u>689,686</u>	<u>211,652</u>
Less: Investment expense	15,745	1,765	19,151	5,121
Less: Securities lending expense	1,065	134	1,462	458
Net Investment Income	<u>526,208</u>	<u>65,588</u>	<u>669,073</u>	<u>206,073</u>
Total Additions	<u>762,837</u>	<u>94,475</u>	<u>984,051</u>	<u>326,334</u>
Deductions				
Benefit payments	825,627	37,797	470,247	136,810
Refunds	8,887	1,286	10,001	1,956
Administrative expenses	8,424	737	14,323	1,234
Total Deductions	<u>842,938</u>	<u>39,820</u>	<u>494,571</u>	<u>140,000</u>
Change in Net Assets	(80,101)	54,655	489,480	186,334
Net Assets Held in Trust				
Net Assets at July 1	3,584,601	388,951	4,331,010	1,320,560
Net Assets at June 30	<u>\$ 3,504,500</u>	<u>\$ 443,606</u>	<u>\$ 4,820,490</u>	<u>\$ 1,506,894</u>

State Police Retirement System	Kentucky Teachers' Retirement System	Judicial Retirement Plan	Legislators' Retirement Plan	Kentucky Public Employees' Deferred Compensation Authority	Totals June 30, 2010
\$ 9,489	\$ 479,865	\$ 4,697	\$ 245	\$ 4,196	\$ 950,163
4,138	297,614	1,776	220	134,297	687,129
<u>13,627</u>	<u>777,479</u>	<u>6,473</u>	<u>465</u>	<u>138,493</u>	<u>1,637,292</u>
		476	147		623
		<u>476</u>	<u>147</u>	<u>6,308</u>	<u>6,308</u>
				<u>6,308</u>	<u>6,931</u>
34,874	1,168,485	17,382	3,581	123,868	2,597,298
6,602	194,116	2,933	513	18,124	476,356
	133,352	1,759	421		135,532
	30,968				30,968
223	1,549				10,439
<u>41,699</u>	<u>1,528,470</u>	<u>22,074</u>	<u>4,515</u>	<u>141,992</u>	<u>3,250,593</u>
1,016	18,206	180		2,998	64,182
80	466				3,665
<u>40,603</u>	<u>1,509,798</u>	<u>21,894</u>	<u>4,515</u>	<u>138,994</u>	<u>3,182,746</u>
<u>54,230</u>	<u>2,287,277</u>	<u>28,843</u>	<u>5,127</u>	<u>283,795</u>	<u>4,826,969</u>
45,582	1,321,890	21,440	2,782	78,357	2,940,532
144	15,310		2		37,586
130	8,830	213	47	7,100	41,038
<u>45,856</u>	<u>1,346,030</u>	<u>21,653</u>	<u>2,831</u>	<u>85,457</u>	<u>3,019,156</u>
8,374	941,247	7,190	2,296	198,338	1,807,813
256,575	11,516,358	163,704	32,893	1,411,755	23,006,407
<u>\$ 264,949</u>	<u>\$ 12,457,605</u>	<u>\$ 170,894</u>	<u>\$ 35,189</u>	<u>\$ 1,610,093</u>	<u>\$ 24,814,220</u>

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF FIDUCIARY NET ASSETS
PENSION AND OTHER POST EMPLOYMENT BENEFIT TRUST FUNDS - INSURANCE FUNDS
JUNE 30, 2010
(Expressed in Thousands)

	Kentucky Employees Retirement System		County Employees Retirement System	
	<u>Non-Hazardous</u>	<u>Hazardous</u>	<u>Non-Hazardous</u>	<u>Hazardous</u>
Assets				
Cash and Short-Term Investments:				
Cash	\$ 378	\$ 58	\$ 509	\$ 31
Medicare drug deposit	20	10	42	23
Short-term investments	39,019	61,539	268,927	153,167
Total Cash and Short-Term Investments	<u>39,417</u>	<u>61,607</u>	<u>269,478</u>	<u>153,221</u>
Receivables:				
Investments - accounts receivable	1,497	879	3,370	1,835
Interest receivable				
Accounts receivable	4,411	918	14,743	5,213
Total Receivables	<u>5,908</u>	<u>1,797</u>	<u>18,113</u>	<u>7,048</u>
Investments at Fair Value:				
Corporate and government bonds	43,244	28,288	121,051	71,248
Common stocks	281,825	179,556	687,797	355,144
Mutual funds	102	67	272	146
Total Investments at Fair Value	<u>325,171</u>	<u>207,911</u>	<u>809,120</u>	<u>426,538</u>
Invested security collateral	85,994	63,563	254,253	136,732
Prepaid expenses				
Total Assets	<u>456,490</u>	<u>334,878</u>	<u>1,350,964</u>	<u>723,539</u>
Liabilities				
Accounts payable	1,698	75	1,891	189
Obligations under securities lending	85,994	63,563	254,253	136,732
Total Liabilities	<u>87,692</u>	<u>63,638</u>	<u>256,144</u>	<u>136,921</u>
Net assets held in trust for other post employment benefits	<u>\$ 368,798</u>	<u>\$ 271,240</u>	<u>\$ 1,094,820</u>	<u>\$ 586,618</u>

State Police Retirement System	Kentucky Teachers' Retirement System	Judicial Retirement Plan	Legislators' Retirement Plan	Totals June 30, 2010
\$ 52	\$ 592	\$ 17	\$ 85	\$ 1,722
5				100
12,985	242,414	3,055	1,238	782,344
<u>13,042</u>	<u>243,006</u>	<u>3,072</u>	<u>1,323</u>	<u>784,166</u>
386	896	13	1	8,877
371	7,926	169	84	253
<u>757</u>	<u>8,822</u>	<u>182</u>	<u>85</u>	<u>33,582</u>
12,796	81,056	10,493	5,756	373,932
77,931		24,308	13,750	1,620,311
27				614
<u>90,754</u>	<u>81,056</u>	<u>34,801</u>	<u>19,506</u>	<u>1,994,857</u>
24,465				565,007
	147			147
<u>129,018</u>	<u>333,031</u>	<u>38,055</u>	<u>20,914</u>	<u>3,386,889</u>
43	3,903		2	7,801
24,465				565,007
<u>24,508</u>	<u>3,903</u>		<u>2</u>	<u>572,808</u>
<u>\$ 104,510</u>	<u>\$ 329,128</u>	<u>\$ 38,055</u>	<u>\$ 20,912</u>	<u>\$ 2,814,081</u>

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF CHANGES IN FIDUCIARY NET ASSETS
PENSION AND OTHER POST EMPLOYMENT BENEFIT TRUST FUNDS - INSURANCE FUNDS
FOR THE YEAR ENDED JUNE 30, 2010

(Expressed in Thousands)

	Kentucky Employees Retirement System		County Employees Retirement System	
	Non-Hazardous	Hazardous	Non-Hazardous	Hazardous
Additions				
Contributions:				
Employer	\$ 93,976	\$ 21,921	\$ 166,607	\$ 83,043
Member				
Total Contributions	<u>93,976</u>	<u>21,921</u>	<u>166,607</u>	<u>83,043</u>
Other Contributions:				
Recovery Income	12,290	749	15,641	435
Medicare D Receipts	8,550	319	9,157	1,493
Total Other Contributions	<u>20,840</u>	<u>1,068</u>	<u>24,798</u>	<u>1,928</u>
Investment Income:				
Net increase (decrease) in fair value of investments	44,706	38,367	121,100	58,828
Interest	7,290	4,583	17,726	9,507
Dividends				
Securities lending income, net	242	183	733	394
Total Investment Income	<u>52,238</u>	<u>43,133</u>	<u>139,559</u>	<u>68,729</u>
Less: Investment expense	1,415	685	2,862	1,350
Less: Securities lending expense	58	42	170	91
Net Investment Income	<u>50,765</u>	<u>42,406</u>	<u>136,527</u>	<u>67,288</u>
Total Additions	<u>165,581</u>	<u>65,395</u>	<u>327,932</u>	<u>152,259</u>
Deductions				
Benefit payments				
Refunds				
Administrative expenses	4,333	200	4,469	554
Self funding insurance cost	60,876	2,236	60,044	5,288
Healthcare Premiums Subsidies	96,941	11,219	63,089	43,032
Other deductions, net				
Total Deductions	<u>162,150</u>	<u>13,655</u>	<u>127,602</u>	<u>48,874</u>
Change in Net Assets	3,431	51,740	200,330	103,385
Net Assets Held in Trust				
Net Assets at July 1	365,367	219,500	894,490	483,233
Net Assets at June 30	<u>\$ 368,798</u>	<u>\$ 271,240</u>	<u>\$ 1,094,820</u>	<u>\$ 586,618</u>

<u>State Police Retirement System</u>	<u>Kentucky Teachers' Retirement System</u>	<u>Judicial Retirement Plan</u>	<u>Legislators' Retirement Plan</u>	<u>Totals June 30, 2010</u>
\$ 8,369	\$ 160,728	\$ 948	\$ 134	\$ 535,726
	63,806	387	120	64,313
<u>8,369</u>	<u>224,534</u>	<u>1,335</u>	<u>254</u>	<u>600,039</u>
16	4	104	81	29,320
274	14,614			34,407
<u>290</u>	<u>14,618</u>	<u>104</u>	<u>81</u>	<u>63,727</u>
11,314	1,944	3,784	1,960	282,003
1,970	15,753	639	280	57,748
		383	230	613
70				1,622
<u>13,354</u>	<u>17,697</u>	<u>4,806</u>	<u>2,470</u>	<u>341,986</u>
253		39		6,604
16				377
<u>13,085</u>	<u>17,697</u>	<u>4,767</u>	<u>2,470</u>	<u>335,005</u>
<u>21,744</u>	<u>256,849</u>	<u>6,206</u>	<u>2,805</u>	<u>998,771</u>
	4,149			4,149
147		46	1	1
1,698			26	9,775
9,071				130,142
	237,377	1,973	573	223,352
<u>10,916</u>	<u>241,526</u>	<u>2,019</u>	<u>600</u>	<u>239,923</u>
10,828	15,323	4,187	2,205	391,429
93,682	313,805	33,868	18,707	2,422,652
<u>\$ 104,510</u>	<u>\$ 329,128</u>	<u>\$ 38,055</u>	<u>\$ 20,912</u>	<u>\$ 2,814,081</u>

AGENCY FUNDS

Agency Funds account for monies held by the Commonwealth for custodial purposes only. Kentucky uses the following Agency Funds:

Commonwealth Choice Program - accounts for flexible benefits spending accounts.

County Fees Trust Fund - accounts for monies held by the Commonwealth for those counties with a population greater than 70,000.

Special Deposit Trust Fund - accounts for monies held by the Commonwealth and are marked for specific purposes such as employee withholdings.

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF FIDUCIARY NET ASSETS
AGENCY FUNDS
JUNE 30, 2010
(Expressed in Thousands)

	<u>Commonwealth Choice Program</u>	<u>County Fees Trust Fund</u>	<u>Special Deposit Trust Fund</u>	<u>Totals June 30, 2010</u>
Assets				
Cash and cash equivalents	\$ 2,179	\$ 201	\$ 227,419	\$ 229,799
Investments, net of amortization			96,492	96,492
Invested security collateral			299,764	299,764
Receivables, net		11,094	22,263	33,357
Total Assets	<u>\$ 2,179</u>	<u>\$ 11,295</u>	<u>\$ 645,938</u>	<u>\$ 659,412</u>
Liabilities				
Accounts payable	\$ 2,179	\$ 11,295	\$ 261,692	\$ 261,692
Amounts held in custody for others			84,482	97,956
Obligations under securities lending			299,764	299,764
Total Liabilities	<u>\$ 2,179</u>	<u>\$ 11,295</u>	<u>\$ 645,938</u>	<u>\$ 659,412</u>

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
AGENCY FUNDS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	<u>Balances</u> <u>June 30, 2009</u>	<u>Additions</u>	<u>Deductions</u>	<u>Balances</u> <u>June 30, 2010</u>
<u>COMMONWEALTH CHOICE PROGRAM</u>				
<u>Assets</u>				
Cash & cash equivalents	\$ 1,993	\$ 6,757	\$ 6,571	\$ 2,179
Total assets	<u>\$ 1,993</u>	<u>\$ 6,757</u>	<u>\$ 6,571</u>	<u>\$ 2,179</u>
<u>Liabilities</u>				
Amounts held in custody for others	\$ 1,993	\$ 6,757	\$ 6,571	\$ 2,179
Total liabilities	<u>\$ 1,993</u>	<u>\$ 6,757</u>	<u>\$ 6,571</u>	<u>\$ 2,179</u>
<u>COUNTY FEES TRUST FUND</u>				
<u>Assets</u>				
Cash & cash equivalents	\$ 201	\$	\$	\$ 201
Accounts Receivable	9,694	120,878	119,478	11,094
Total assets	<u>\$ 9,895</u>	<u>\$ 120,878</u>	<u>\$ 119,478</u>	<u>\$ 11,295</u>
<u>Liabilities</u>				
Amounts held in custody for others	\$ 9,895	\$ 120,878	\$ 119,478	\$ 11,295
Total liabilities	<u>\$ 9,895</u>	<u>\$ 120,878</u>	<u>\$ 119,478</u>	<u>\$ 11,295</u>
<u>SPECIAL DEPOSIT TRUST FUND</u>				
<u>Assets</u>				
Cash & cash equivalents	\$ 38,597	\$ 679,602	\$ 490,780	\$ 227,419
Investments	136,664	297	40,469	96,492
Invested security collateral	289,381	10,383		299,764
Interfund loans receivable	154,395		154,395	
Accounts receivable	9,537	12,726		22,263
Total assets	<u>\$ 628,574</u>	<u>\$ 703,008</u>	<u>\$ 685,644</u>	<u>\$ 645,938</u>
<u>Liabilities</u>				
Accounts payable	\$ 256,733	\$ 9,921	\$ 4,962	\$ 261,692
Amounts held in custody for others	82,460	5,960	3,938	84,482
Obligations under securities lending	289,381	10,383		299,764
Total liabilities	<u>\$ 628,574</u>	<u>\$ 26,264</u>	<u>\$ 8,900</u>	<u>\$ 645,938</u>
<u>ALL AGENCY FUNDS</u>				
<u>Assets</u>				
Cash & cash equivalents	\$ 40,791	\$ 686,359	\$ 497,351	\$ 229,799
Investments	136,664	297	40,469	96,492
Invested security collateral	289,381	10,383		299,764
Interfund loan receivable	154,395		154,395	
Accounts receivable	19,231	133,604	119,478	33,357
Total assets	<u>\$ 640,462</u>	<u>\$ 830,643</u>	<u>\$ 811,693</u>	<u>\$ 659,412</u>
<u>Liabilities</u>				
Accounts payable	\$ 256,733	\$ 9,921	\$ 4,962	\$ 261,692
Amounts held in custody for others	94,348	133,595	129,987	97,956
Obligations under securities lending	289,381	10,383		299,764
Total liabilities	<u>\$ 640,462</u>	<u>\$ 153,899</u>	<u>\$ 134,949</u>	<u>\$ 659,412</u>

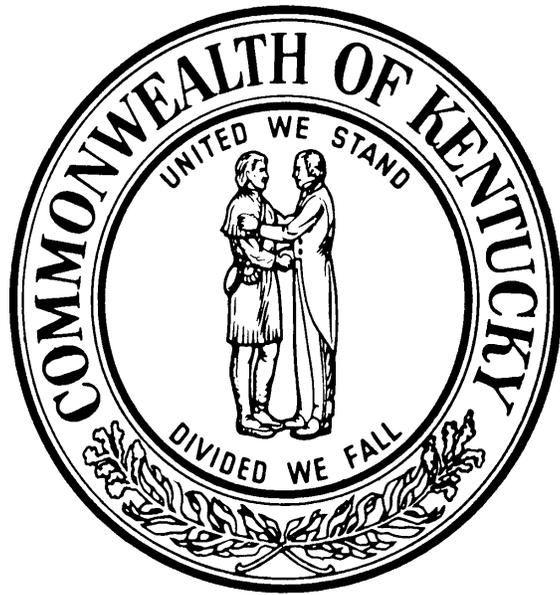
NON-MAJOR COMPONENT UNITS - COMBINING

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF NET ASSETS
NON-MAJOR COMPONENT UNITS
JUNE 30, 2010
(Expressed in Thousands)

	Non-Major Component Units - Authorities	Non-Major Component Units - Universities	Totals June 30, 2010
Assets			
Current assets:			
Cash and cash equivalents	\$ 190,779	\$ 300,044	\$ 490,823
Restricted cash	4,200	26,203	30,403
Investments, net of amortization	247,957	12,902	260,859
Accounts receivable, net	102,742	103,143	205,885
Interest receivable	2,368	2,723	5,091
Inventories	866	6,614	7,480
Prepaid expenses	893	7,338	8,231
Other current assets	13,722	8,665	22,387
Total Current Assets	563,527	467,632	1,031,159
Noncurrent assets:			
Restricted cash	5,929	51,486	57,415
Long-term investments	191,013	169,653	360,666
Restricted long-term investments	14,684	141,360	156,044
Long-term receivables, net	601,134	34,908	636,042
Deferred charges	2,821		2,821
Land	26,924	60,002	86,926
Improvements other than buildings	1,592	96,605	98,197
Buildings	431,833	1,709,021	2,140,854
Machinery and equipment	74,261	324,982	399,243
Other capital assets	21,707	83,445	105,152
Less: Accumulated depreciation and amortization	(242,553)	(960,023)	(1,202,576)
Construction in progress	28,455	167,298	195,753
Total Capital Assets	342,219	1,481,330	1,823,549
Other assets	11,528	8,825	20,353
Total Noncurrent Assets	1,169,328	1,887,562	3,056,890
Total Assets	1,732,855	2,355,194	4,088,049
Liabilities			
Current liabilities:			
Accounts payable and accruals	27,578	46,940	74,518
Current portion of long-term debt:			
Notes payable	150	5,113	5,263
Bonds payable	24,596	25,859	50,455
Capital lease obligations	1,576	6,834	8,410
Compensated absences	1,717	21,420	23,137
Claims liability	8,890	950	9,840
Deferred revenues	8,972	39,331	48,303
Payable from restricted assets		6,438	6,438
Other current liabilities	97	16,659	16,756
Total Current Liabilities	73,576	169,544	243,120
Noncurrent liabilities:			
Notes payable	3,631	22,640	26,271
Bonds payable	377,024	390,470	767,494
Capital lease obligations	23,175	64,029	87,204
Compensated absences	915	231	1,146
Other long-term liabilities	3,467	70,552	74,019
Total Noncurrent Liabilities	408,212	547,922	956,134
Total Liabilities	481,788	717,466	1,199,254
Net Assets			
Invested in capital assets, net of related debt	265,329	944,994	1,210,323
Restricted for:			
Debt service		15,859	15,859
Capital projects	16,376	59,872	76,248
Other purposes	861,027	359,248	1,220,275
Unrestricted	108,335	257,755	366,090
Total Net Assets	\$ 1,251,067	\$ 1,637,728	\$ 2,888,795

**COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF ACTIVITIES
NON-MAJOR COMPONENT UNITS
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)**

	Non-Major Component Units - Authorities	Non-Major Component Units - Universities	Totals June 30, 2010
Expenses:			
Operating and other expenses	\$ 569,846	\$ 1,247,712	\$ 1,817,558
Depreciation	2,725		2,725
Total expenses	<u>572,571</u>	<u>1,247,712</u>	<u>1,820,283</u>
Program Revenues:			
Charges for services	136,834	531,818	668,652
Operating grants and contributions	244,460	181,858	426,318
Capital grants and contributions	53,734	36,210	89,944
Total Program Revenues	<u>435,028</u>	<u>749,886</u>	<u>1,184,914</u>
Net Program (Expense) Revenue	<u>(137,543)</u>	<u>(497,826)</u>	<u>(635,369)</u>
General Revenues:			
Unrestricted grants and contributions	401	188,872	189,273
Unrestricted investment earnings	3,214	31,581	34,795
Gain on sale of capital assets	267		267
Miscellaneous general	191,954	436,839	628,793
Total General Revenues	<u>195,836</u>	<u>657,292</u>	<u>853,128</u>
Change in Net Assets	<u>58,293</u>	<u>159,466</u>	<u>217,759</u>
Net Assets at July 1, as Restated	1,192,774	1,478,262	2,671,036
Net Assets at June 30	<u>\$ 1,251,067</u>	<u>\$ 1,637,728</u>	<u>\$ 2,888,795</u>



NON-MAJOR COMPONENT UNITS - AUTHORITIES

Kentucky River Authority – is responsible for the maintenance of the Commonwealth’s locks and dams on the Kentucky River.

Kentucky Higher Education Assistance Authority - was established by KRS 164.742 to improve higher education opportunities by insuring eligible student loans and providing grants and scholarship awards to eligible students.

Bluegrass State Skills Corporation - established to improve and promote the employment opportunities of the citizens of the Commonwealth by assisting the Economic Development Cabinet in creating and expanding programs of skill, training and education.

Kentucky State Fair Board - accounts for the revenues earned and expenses incurred in the commercial operations of the State Fair Board.

Kentucky Center for the Arts Corporation - established by the General Assembly to promote the growth and development of the arts, convention trade, tourism and hotel industries within Jefferson County and the Commonwealth. The Center has the responsibility of maintaining, operating and insuring the Kentucky Center for the Arts building.

Kentucky Educational Television Authority - established by KRS 168.030 to produce and transmit educational television programming to the citizens of the Commonwealth.

Kentucky Economic Development Finance Authority - established in 1958 under KRS Chapter 154 to promote industrial development, and authorized to issue industrial revenue bonds that do not constitute a legal or moral obligation of the Commonwealth.

Kentucky Artisan Center - established to celebrate Kentucky’s artisan heritage and encourage Kentuckians and those traveling in Kentucky to enjoy artisan products and activities.

Kentucky Infrastructure Authority - established in 1988 by KRS 224A.030, and amended, to assume all powers, duties and obligations of the Kentucky Pollution Abatement and Water Resources Finance Authority in assisting governmental agencies within the Commonwealth in constructing and acquiring infrastructure projects.

Kentucky Agricultural Finance Corporation - created by the 1984 General Assembly to “improve and promote the health, welfare and prosperity of the people of the Commonwealth through stimulation of existing agricultural ventures.” This corporation helps banks and other financial institutions assist eligible farmers in receiving low interest loans through the issuance of tax-exempt agricultural revenue bonds.

Kentucky Grain Insurance Corporation - provides protection to grain producers in the event of the failure of a grain dealer or grain warehouseman.

Kentucky Local Correctional Facilities Construction Authority - created in 1982 pursuant to Sections 441.605 through 441.695 of the KRS to provide an additional and alternative method for constructing, improving, repairing, and financing regional and local jail facilities.

Kentucky Access - provides healthcare to Kentucky’s qualifying applicants who are at high risk.

Kentucky Horse Park Foundation, Inc. – is a legally separate tax-exempt Kentucky corporation that receives, holds, and administers gifts and grants in the name of the Kentucky Horse Park.

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF NET ASSETS
NON-MAJOR COMPONENT UNITS - AUTHORITIES
JUNE 30, 2010
(Expressed in Thousands)

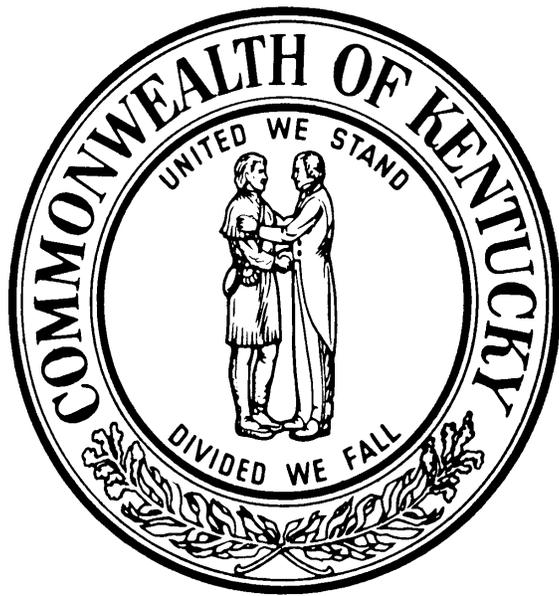
	<u>Kentucky River Authority</u>	<u>Kentucky Higher Education Assistance Authority</u>	<u>Bluegrass State Skills Corporation</u>	<u>Kentucky State Fair Board</u>	<u>Kentucky Center for the Arts Corporation</u>
Assets					
Current assets:					
Cash and cash equivalents	\$ 1,608	\$ 17,194	\$	\$ 7,362	\$ 3,118
Restricted cash	3,300				
Investments, net of amortization		637			5,498
Accounts receivable, net	13,643	3,068	9	2,623	241
Interest receivable	298	72			15
Inventories					24
Prepaid expenses				661	190
Other current assets		450	1,662		
Total Current Assets	<u>18,849</u>	<u>21,421</u>	<u>1,671</u>	<u>10,646</u>	<u>9,086</u>
Noncurrent assets:					
Restricted cash		1,515		3,608	
Long-term investments		11,685			13,761
Restricted long-term investments				931	
Long-term receivables, net		18,361			
Deferred charges		87			
Land	532			25,020	129
Improvements other than buildings				1,170	
Buildings	408	11,986		366,010	31,571
Machinery and equipment	440	5,687		5,678	22,271
Other capital assets	15,000				4,334
Less: Accumulated depreciation and amortization	(4,476)	(8,188)		(147,665)	(43,679)
Construction in progress	22,892			625	
Total Capital Assets	<u>34,796</u>	<u>9,485</u>		<u>250,838</u>	<u>14,626</u>
Other assets		10,781		747	
Total Noncurrent Assets	<u>34,796</u>	<u>51,914</u>		<u>256,124</u>	<u>28,387</u>
Total Assets	<u>53,645</u>	<u>73,335</u>	<u>1,671</u>	<u>266,770</u>	<u>37,473</u>
Liabilities					
Current liabilities:					
Accounts payable and accruals	821	594	1,638	2,797	1,871
Current portion of long-term debt:					
Notes payable					
Bonds payable				2,490	
Capital lease obligations	494	465		617	
Compensated absences	33	643	24		146
Claims liability					
Deferred revenues				4,623	338
Other current liabilities		(803)			
Total Current Liabilities	<u>1,348</u>	<u>899</u>	<u>1,662</u>	<u>10,527</u>	<u>2,355</u>
Noncurrent liabilities:					
Notes payable					
Bonds payable				46,352	
Capital lease obligations	12,933	5,265		4,977	
Compensated absences	57		32		
Other long-term liabilities					
Total Noncurrent Liabilities	<u>12,990</u>	<u>5,265</u>	<u>32</u>	<u>51,329</u>	
Total Liabilities	<u>14,338</u>	<u>6,164</u>	<u>1,694</u>	<u>61,856</u>	<u>2,355</u>
Net Assets					
Invested in capital assets, net of related debt	21,452	3,857		201,821	11,272
Restricted for:					
Capital projects	16,247				
Other purposes		63,314			2,296
Unrestricted	1,608		(23)	3,093	21,550
Total Net Assets	<u>\$ 39,307</u>	<u>\$ 67,171</u>	<u>\$ (23)</u>	<u>\$ 204,914</u>	<u>\$ 35,118</u>

Kentucky Educational Television Authority	Kentucky Economic Development Finance Authority	Kentucky Artisan Center	Kentucky Infrastructure Authority	Kentucky Agricultural Finance Corporation	Kentucky Grain Insurance Corporation
\$ 3,394	\$ 17,668 900	\$ 42	\$ 122,800	\$ 4,004	\$ 2,929
7,135			229,686		
1,408	19	3	49,840	28,469	
45	37		1,850		4
480		362			
		12			
273	11,052				
<u>12,735</u>	<u>29,676</u>	<u>419</u>	<u>404,176</u>	<u>32,473</u>	<u>2,933</u>
806					
	149	145	160,906	2,522	1,845
4,322			6,096		
81	26,792		552,782		
21			2,573		
76		1,167			
14,001		6,706			
39,036		1,001	79		
2,373					
(36,409)		(1,029)	(73)		
<u>19,077</u>		<u>7,845</u>	<u>6</u>		
<u>24,307</u>	<u>26,941</u>	<u>7,990</u>	<u>722,363</u>	<u>2,522</u>	<u>1,845</u>
<u>37,042</u>	<u>56,617</u>	<u>8,409</u>	<u>1,126,539</u>	<u>34,995</u>	<u>4,778</u>
881	45	60	17,059	5	
			19,936		
744	70	57			
1,410					
	900				
<u>3,035</u>	<u>1,015</u>	<u>117</u>	<u>36,995</u>	<u>5</u>	
			320,870		
655	86	71		14	
3,467					
<u>4,122</u>	<u>86</u>	<u>71</u>	<u>320,870</u>	<u>14</u>	
<u>7,157</u>	<u>1,101</u>	<u>188</u>	<u>357,865</u>	<u>19</u>	
19,077		7,844	6		
129					
5,749	14,196		768,668		
4,930	41,320	377		34,976	4,778
<u>\$ 29,885</u>	<u>\$ 55,516</u>	<u>\$ 8,221</u>	<u>\$ 768,674</u>	<u>\$ 34,976</u>	<u>\$ 4,778</u>

Continued

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF NET ASSETS
NON-MAJOR COMPONENT UNITS - AUTHORITIES
JUNE 30, 2010
(Expressed in Thousands)

	Kentucky Local Correctional Facilities Construction Authority	Kentucky Access	The Kentucky Horse Park Foundation, Inc.	Totals June 30, 2010
Assets				
Current assets:				
Cash and cash equivalents	\$ 3,798	\$ 5,323	\$ 1,539	\$ 190,779
Restricted cash				4,200
Investments, net of amortization		3,229	1,772	247,957
Accounts receivable, net	315	2,180	924	102,742
Interest receivable	39	8		2,368
Inventories				866
Prepaid expenses			30	893
Other current assets	285			13,722
Total Current Assets	<u>4,437</u>	<u>10,740</u>	<u>4,265</u>	<u>563,527</u>
Noncurrent assets:				
Restricted cash				5,929
Long-term investments				191,013
Restricted long-term investments	2,335		1,000	14,684
Long-term receivables, net	1,115		2,003	601,134
Deferred charges	140			2,821
Land				26,924
Improvements other than buildings			422	1,592
Buildings			1,151	431,833
Machinery and equipment			69	74,261
Other capital assets				21,707
Less: Accumulated depreciation and amortization			(1,034)	(242,553)
Construction in progress			4,938	28,455
Total Capital Assets			<u>5,546</u>	<u>342,219</u>
Other assets				11,528
Total Noncurrent Assets	<u>3,590</u>		<u>8,549</u>	<u>1,169,328</u>
Total Assets	<u>8,027</u>	<u>10,740</u>	<u>12,814</u>	<u>1,732,855</u>
Liabilities				
Current liabilities:				
Accounts payable and accruals	103	1,083	621	27,578
Current portion of long-term debt:				
Notes payable			150	150
Bonds payable	2,170			24,596
Capital lease obligations				1,576
Compensated absences				1,717
Claims liability		8,890		8,890
Deferred revenues		2,601		8,972
Other current liabilities				97
Total Current Liabilities	<u>2,273</u>	<u>12,574</u>	<u>771</u>	<u>73,576</u>
Noncurrent liabilities:				
Notes payable			3,631	3,631
Bonds payable	9,802			377,024
Capital lease obligations				23,175
Compensated absences				915
Other long-term liabilities				3,467
Total Noncurrent Liabilities	<u>9,802</u>		<u>3,631</u>	<u>408,212</u>
Total Liabilities	<u>12,075</u>	<u>12,574</u>	<u>4,402</u>	<u>481,788</u>
Net Assets				
Invested in capital assets, net of related debt				265,329
Restricted for:				
Capital projects				16,376
Other purposes			6,804	861,027
Unrestricted	(4,048)	(1,834)	1,608	108,335
Total Net Assets	<u>\$ (4,048)</u>	<u>\$ (1,834)</u>	<u>\$ 8,412</u>	<u>\$ 1,251,067</u>



COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF ACTIVITIES
NON-MAJOR COMPONENT UNITS - AUTHORITIES
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Kentucky River Authority	Kentucky Higher Education Assistance Authority	Bluegrass State Skills Corporation	Kentucky State Fair Board	Kentucky Center for the Arts Corporation
Expenses:					
Operating and other expenses	\$ 2,506	\$ 233,009	\$ 5,305	\$ 49,670	\$ 9,856
Depreciation					2,718
Total expenses	<u>2,506</u>	<u>233,009</u>	<u>5,305</u>	<u>49,670</u>	<u>12,574</u>
Program Revenues:					
Charges for services	2,447	30,877		43,160	4,757
Operating grants and contributions		200,500			1,471
Capital grants and contributions					
Total Program Revenues	<u>2,447</u>	<u>231,377</u>		<u>43,160</u>	<u>6,228</u>
Net Program (Expense) Revenue	<u>(59)</u>	<u>(1,632)</u>	<u>(5,305)</u>	<u>(6,510)</u>	<u>(6,346)</u>
General Revenues:					
Unrestricted grants and contributions					401
Unrestricted investment earnings	107			(1,690)	1,507
Gain on sale of capital assets	267				
Miscellaneous general			5,257	943	7,571
Total General Revenues	<u>374</u>		<u>5,257</u>	<u>(747)</u>	<u>9,479</u>
Change in Net Assets	<u>315</u>	<u>(1,632)</u>	<u>(48)</u>	<u>(7,257)</u>	<u>3,133</u>
Net Assets at July 1, as Restated	38,992	68,803	25	212,171	31,985
Net Assets at June 30	<u>\$ 39,307</u>	<u>\$ 67,171</u>	<u>\$ (23)</u>	<u>\$ 204,914</u>	<u>\$ 35,118</u>

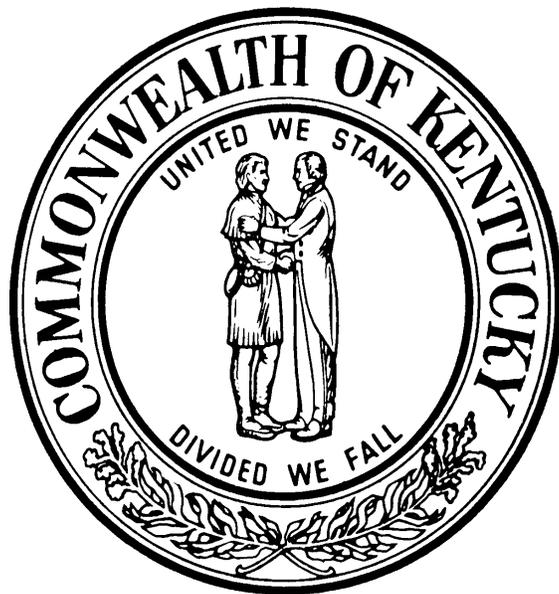
Kentucky Educational Television Authority	Kentucky Economic Development Finance Authority	Kentucky Artisan Center	Kentucky Infrastructure Authority	Kentucky Agricultural Finance Corporation	Kentucky Grain Insurance Corporation
\$ 29,699	\$ 4,763	\$ 2,501	\$ 161,321	\$ 495	\$ 171
29,699	4,763	2,501	161,321	502	171
2,056	1,049	1,641	13,081		
9,125		662			
11,181	1,049	2,303	53,734		
(18,518)	(3,714)	(198)	66,815		
			(94,506)	(502)	(171)
992	(1)		1,841		50
14,590	8,510		153,502	1,581	
15,582	8,509		155,343	1,581	50
(2,936)	4,795	(198)	60,837	1,079	(121)
32,821	50,721	8,419	707,837	33,897	4,899
\$ 29,885	\$ 55,516	\$ 8,221	\$ 768,674	\$ 34,976	\$ 4,778

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF ACTIVITIES
NON-MAJOR COMPONENT UNITS - AUTHORITIES
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Kentucky Local Correctional Facilities Construction Authority	Kentucky Access	The Kentucky Horse Park Foundation, Inc.	Totals June 30, 2010
Expenses:				
Operating and other expenses	\$ 3,083	\$ 65,502	\$ 1,965	\$ 569,846
Depreciation				2,725
Total expenses	<u>3,083</u>	<u>65,502</u>	<u>1,965</u>	<u>572,571</u>
Program Revenues:				
Charges for services	4,029	31,153	2,584	136,834
Operating grants and contributions	76	32,184	442	244,460
Capital grants and contributions				53,734
Total Program Revenues	<u>4,105</u>	<u>63,337</u>	<u>3,026</u>	<u>435,028</u>
Net Program (Expense) Revenue	<u>1,022</u>	<u>(2,165)</u>	<u>1,061</u>	<u>(137,543)</u>
General Revenues:				
Unrestricted grants and contributions				401
Unrestricted investment earnings		69	339	3,214
Gain on sale of capital assets				267
Miscellaneous general				191,954
Total General Revenues		<u>69</u>	<u>339</u>	<u>195,836</u>
Change in Net Assets	<u>1,022</u>	<u>(2,096)</u>	<u>1,400</u>	<u>58,293</u>
Net Assets at July 1, as Restated	(5,070)	262	7,012	1,192,774
Net Assets at June 30	<u>\$ (4,048)</u>	<u>\$ (1,834)</u>	<u>\$ 8,412</u>	<u>\$ 1,251,067</u>

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF CASH FLOWS
NON-MAJOR COMPONENT UNITS-AUTHORITIES
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Kentucky Agricultural Finance Corporation	Kentucky Grain Insurance Corporation	Totals June 30, 2010
Cash Flows from Operating Activities			
Cash payments to suppliers for goods and services	\$ (18)	\$ (3)	\$ (21)
Cash payments for employee salaries and benefits	(126)	(12)	(138)
Cash payments from other sources	(3,901)		(3,901)
Cash payments to other sources	(10)	(157)	(167)
Net Cash Provided (Used) by Operating Activities	<u>(4,055)</u>	<u>(172)</u>	<u>(4,227)</u>
Cash Flows from Capital and Related Financing Activities			
Acquisition and construction of capital assets	45		45
Net Cash Provided (Used) for Capital and Related Financing Activities	<u>45</u>		<u>45</u>
Cash Flows from Investing Activities			
Proceeds from the sale of investment securities	3,924	1,129	5,053
Interest and dividends on investments		47	47
Net Cash Provided (Used) in Investing Activities	<u>3,924</u>	<u>1,176</u>	<u>5,100</u>
Net Increase (Decrease) in Cash and Cash Equivalents	(86)	1,004	918
Cash and Cash Equivalents at July 1	4,090	1,925	6,015
Cash and Cash Equivalents at June 30	<u>\$ 4,004</u>	<u>\$ 2,929</u>	<u>\$ 6,933</u>
Reconciliation of Operating Income to Net Cash			
Provided (Used) by Operating Activities:			
Operating income (loss)	\$ 1,433	\$ (172)	\$ 1,261
Adjustments to reconcile operating income to net cash provided by operating activities:			
Depreciation and Amortization	7		7
Change in assets and liabilities:			
(Increase) Decrease in assets:			
Receivables, net	(5,483)		(5,483)
Increase (decrease) in liabilities:			
Accounts payable	(11)		(11)
Compensated absences	(1)		(1)
Net Cash Provided (Used) by Operating Activities	<u>\$ (4,055)</u>	<u>\$ (172)</u>	<u>\$ (4,227)</u>



NON-MAJOR COMPONENT UNITS - UNIVERSITIES, COLLEGES, AND RELATED ENTITIES

Universities, Colleges, and Related Entities

The Universities, Colleges, and Related Entities Funds account for all transactions relating to the State supported universities and the community colleges and technical schools. These institutions maintain their own financial records and are not part of the central accounting system operated by the Finance and Administration Cabinet. The non-major component units-universities are:

Eastern Kentucky University
Western Kentucky University
Morehead State University
Murray State University
Northern Kentucky University
Kentucky State University

Kentucky Council on Postsecondary Education—established in 1997 by the Postsecondary Education Improvement Act to coordinate changes and improvements within Kentucky’s postsecondary education system.

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF NET ASSETS
NON-MAJOR COMPONENT UNITS - UNIVERSITIES, COLLEGES, AND RELATED ENTITIES
JUNE 30, 2010
(Expressed in Thousands)

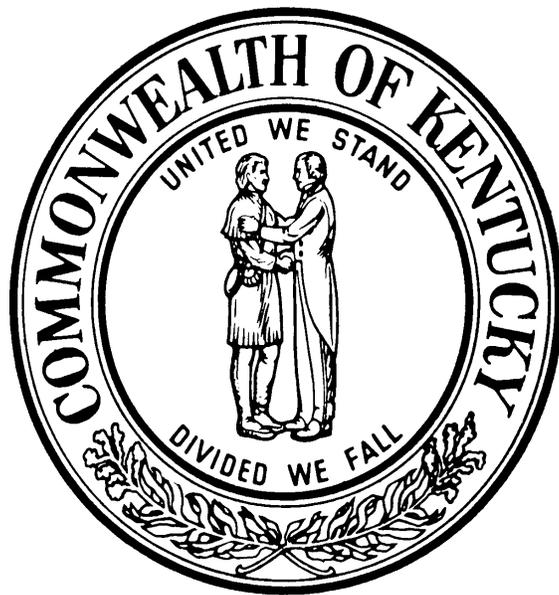
	Eastern Kentucky University	Western Kentucky University	Morehead State University
Assets			
Current assets:			
Cash and cash equivalents	\$ 40,859	\$ 97,470	\$ 32,480
Restricted cash			5,742
Investments, net of amortization	4,375	1,813	
Accounts receivable, net	22,360	13,177	14,782
Interest receivable	430	923	12
Inventories	241	2,374	1,405
Prepaid expenses	1,334	2,387	
Other current assets		5,479	422
Total Current Assets	<u>69,599</u>	<u>123,623</u>	<u>54,843</u>
Noncurrent assets:			
Restricted cash	1,957	16,227	
Long-term investments	39,022	99,742	29,089
Restricted long-term investments			
Long-term receivables, net	5,813	19,285	3,809
Land	7,906	11,239	18,682
Improvements other than buildings	22,052	37,278	
Buildings	263,522	492,017	219,063
Machinery and equipment	29,349	98,977	20,079
Other capital assets	40,136		29,684
Less: Accumulated depreciation and amortization	(181,899)	(214,754)	(126,027)
Construction in progress	93,807	40,212	10,702
Total Capital Assets	<u>274,873</u>	<u>464,969</u>	<u>172,183</u>
Other assets		6,218	817
Total Noncurrent Assets, Net	<u>321,665</u>	<u>606,441</u>	<u>205,898</u>
Total Assets	<u>391,264</u>	<u>730,064</u>	<u>260,741</u>
Liabilities			
Current liabilities:			
Accounts payable and accruals	11,265	9,348	5,472
Current portion of long-term debt:			
Notes payable		3,491	
Bonds payable	4,525	7,398	3,555
Capital lease obligations	4,346	17	505
Compensated absences	5,241	2,746	2,184
Claims liability			
Deferred revenues	8,158	15,722	4,178
Payable from restricted assets	343	553	409
Other current liabilities	582	5,883	1,090
Total Current Liabilities	<u>34,460</u>	<u>45,158</u>	<u>17,393</u>
Noncurrent liabilities:			
Notes payable		2,750	
Bonds payable	32,495	183,216	49,800
Capital lease obligations	40,324	3	2,886
Compensated absences			
Other long-term liabilities	427	49,062	4,611
Total Noncurrent Liabilities	<u>73,246</u>	<u>235,031</u>	<u>57,297</u>
Total Liabilities	<u>107,706</u>	<u>280,189</u>	<u>74,690</u>
Net Assets			
Invested in capital assets, net of related debt	189,676	239,627	114,660
Restricted for:			
Debt service	3,462	3,807	
Capital projects	1,581	31,744	
Other purposes	44,531	98,541	53,900
Unrestricted	44,308	76,156	17,491
Total Net Assets	<u>\$ 283,558</u>	<u>\$ 449,875</u>	<u>\$ 186,051</u>

Murray State University	Northern Kentucky University	Kentucky State University	Kentucky Council on Postsecondary Education	Totals June 30, 2010
\$ 45,976	\$ 59,153	\$ 24,064	\$ 42	\$ 300,044
	17,661		2,800	26,203
		6,714		12,902
7,674	29,870	6,201	9,079	103,143
1,122	231		5	2,723
2,279	253	62		6,614
1,297	1,659	287	374	7,338
2,639	91	34		8,665
<u>60,987</u>	<u>108,918</u>	<u>37,362</u>	<u>12,300</u>	<u>467,632</u>
28,161	5,141			51,486
	1,538		262	169,653
71,724	57,642	8,828	3,166	141,360
3,255	1,989	757		34,908
11,025	9,399	1,751		60,002
11,413	21,964	3,898		96,605
248,758	343,669	141,992		1,709,021
57,305	91,802	26,781	689	324,982
2,500		11,125		83,445
(163,830)	(167,312)	(105,802)	(399)	(960,023)
4,963	14,270	3,344		167,298
<u>172,134</u>	<u>313,792</u>	<u>83,089</u>	<u>290</u>	<u>1,481,330</u>
<u>631</u>	<u>1,159</u>			<u>8,825</u>
<u>275,905</u>	<u>381,261</u>	<u>92,674</u>	<u>3,718</u>	<u>1,887,562</u>
<u>336,892</u>	<u>490,179</u>	<u>130,036</u>	<u>16,018</u>	<u>2,355,194</u>
7,013	8,966	1,680	3,196	46,940
911	711			5,113
2,236	6,860	1,285		25,859
168	1,369	429		6,834
5,941	2,913	1,770	625	21,420
914		36		950
2,680	6,457	2,136		39,331
	5,133			6,438
2,713	45	296	6,050	16,659
<u>22,576</u>	<u>32,454</u>	<u>7,632</u>	<u>9,871</u>	<u>169,544</u>
14,558	5,332			22,640
41,185	79,320	4,454		390,470
982	14,861	4,973		64,029
			231	231
3,513	11,973	966		70,552
<u>60,238</u>	<u>111,486</u>	<u>10,393</u>	<u>231</u>	<u>547,922</u>
<u>82,814</u>	<u>143,940</u>	<u>18,025</u>	<u>10,102</u>	<u>717,466</u>
117,422	211,488	71,831	290	944,994
6,136	2,454			15,859
15,002	11,545			59,872
64,924	71,835	19,727	5,790	359,248
50,594	48,917	20,453	(164)	257,755
<u>\$ 254,078</u>	<u>\$ 346,239</u>	<u>\$ 112,011</u>	<u>\$ 5,916</u>	<u>\$ 1,637,728</u>

COMMONWEALTH OF KENTUCKY
COMBINING STATEMENT OF ACTIVITIES
NON-MAJOR COMPONENT UNITS - UNIVERSITIES, COLLEGES, AND RELATED ENTITIES
FOR THE YEAR ENDED JUNE 30, 2010
(Expressed in Thousands)

	Eastern Kentucky University	Western Kentucky University	Morehead State University
Expenses:			
Operating and other expenses	\$ 265,017	\$ 309,282	\$ 143,740
Total Expenses	<u>265,017</u>	<u>309,282</u>	<u>143,740</u>
Program Revenues:			
Charges for services	92,715	159,630	53,041
Operating grants and contributions	62,135	10,540	23,241
Capital grants and contributions	26,992		
Total Program Revenues	<u>181,842</u>	<u>170,170</u>	<u>76,282</u>
Net Program (Expense) Revenue	<u>(83,175)</u>	<u>(139,112)</u>	<u>(67,458)</u>
General Revenues:			
Unrestricted grants and contributions	39,826	68,543	20,954
Unrestricted investment earnings	6,708	14,247	299
Miscellaneous general	75,250	104,828	63,308
Total General Revenues	<u>121,784</u>	<u>187,618</u>	<u>84,561</u>
Change in Net Assets	<u>38,609</u>	<u>48,506</u>	<u>17,103</u>
Net Assets at July 1, as Restated	244,949	401,369	168,948
Net Assets at June 30	<u>\$ 283,558</u>	<u>\$ 449,875</u>	<u>\$ 186,051</u>

Murray State University	Northern Kentucky University	Kentucky State University	Kentucky Council on Postsecondary Education	Totals June 30, 2010
\$ 165,616	\$ 198,423	\$ 68,121	\$ 97,513	\$ 1,247,712
165,616	198,423	68,121	97,513	1,247,712
85,712	114,846	24,741	1,133	531,818
8,623	12,553	20,620	44,146	181,858
	8,894		324	36,210
94,335	136,293	45,361	45,603	749,886
(71,281)	(62,130)	(22,760)	(51,910)	(497,826)
27,664	24,715	7,170		188,872
8,179	982	1,159	7	31,581
48,820	68,026	26,237	50,370	436,839
84,663	93,723	34,566	50,377	657,292
13,382	31,593	11,806	(1,533)	159,466
240,696	314,646	100,205	7,449	1,478,262
\$ 254,078	\$ 346,239	\$ 112,011	\$ 5,916	\$ 1,637,728



STATISTICAL SECTION

This part of the Commonwealth of Kentucky's comprehensive annual financial report presents detailed information as a context for understanding what the information in the financial statements, note disclosures, and required supplementary information says about the Commonwealth's overall financial health.

Financial Trends

The schedules presented, in this section, contain trend information to help the reader understand how the Commonwealth's financial performance and fiscal health has changed over time. The schedules presented from an entity wide perspective included only data from FY02 and forward, coinciding with the implementation of GASB 34. Fund perspective statements are presented for the last ten fiscal years, except where noted.

Revenue Capacity

The schedules presented, in this section, contain information to help the reader assess the Commonwealth's most significant revenue source, which is personal income tax.

Debt Capacity

The schedules presented, in this section, contain information to help the reader assess the affordability of the Commonwealth's current levels of outstanding debt, and the Commonwealth's ability to issue additional debt in the future.

Demographic Information

The schedules presented, in this section, offer demographic and economic indicators to help the reader understand the environment within the Commonwealth, and the financial impact of those activities.

Operating Information

The schedules presented, in this section, offer operating data to help the reader understand how the information in the Commonwealth's financial report relates to the services it provided and the activities performed, by the governmental agencies.

**COMMONWEALTH OF KENTUCKY
FUND BALANCES - GOVERNMENTAL FUNDS
FOR THE LAST TEN FISCAL YEARS
(Expressed in Thousands)**

	2010	2009	2008	2007
General Fund:				
Reserved	\$ 77,054	\$ 80,135	\$ 290,108	\$ 295,917
Unreserved	2,533	(49,698)	(1,937)	517,277
Total General Fund	<u>\$ 79,587</u>	<u>\$ 30,437</u>	<u>\$ 288,171</u>	<u>\$ 813,194</u>
All Other Governmental Funds:				
Reserved	\$ 892,159	\$ 882,654	\$ 919,085	\$ 704,496
Unreserved, reported in:				
Debt Service Fund	135,924	309,234	369,603	381,313
Special Revenue Funds	1,178,101	719,767	786,125	1,031,387
Capital Projects Funds	(137,256)	45,585	72,094	(66,785)
Total All Other Governmental Funds	<u>\$ 2,068,928</u>	<u>\$ 1,957,240</u>	<u>\$ 2,146,907</u>	<u>\$ 2,050,411</u>

Note: Information is presented on the modified accrual basis of accounting.
In FY 2002 funds were reclassified in conjunction with the implementation of GASB 34.

2006	2005	2004	2003	2002	2001
\$ 183,555	\$ 76,505	\$ 85,834	\$ 114,415	\$ 123,502	\$ 404,057
713,339	593,472	303,623	183,922	(36,033)	(8,870)
<u>\$ 896,894</u>	<u>\$ 669,977</u>	<u>\$ 389,457</u>	<u>\$ 298,337</u>	<u>\$ 87,469</u>	<u>\$ 395,187</u>
\$ 597,827	\$ 664,265	\$ 941,891	\$ 575,983	\$ 1,064,829	\$ 947,481
377,202	292,406	293,654	354,836	316,560	282,653
1,394,633	1,112,499	603,323	969,767	1,219,937	1,111,739
(129,103)	(120,098)	(201,248)	(36,012)	(265,510)	(300,205)
<u>\$ 2,240,559</u>	<u>\$ 1,949,072</u>	<u>\$ 1,637,620</u>	<u>\$ 1,864,574</u>	<u>\$ 2,335,816</u>	<u>\$ 2,041,668</u>

COMMONWEALTH OF KENTUCKY
CHANGES IN FUND BALANCE, GOVERNMENTAL FUNDS
FOR THE LAST TEN FISCAL YEARS
(Expressed in Thousands)

	2010	2009	2008	2007
Revenues				
Taxes	\$ 9,366,175	\$ 9,560,283	\$ 9,871,590	\$ 9,668,573
Licenses, fees, and permits	330,387	323,012	309,413	303,849
Intergovernmental	8,381,546	7,055,624	6,169,116	5,810,270
Charges for services	803,961	774,553	758,805	752,532
Fines and forfeits	86,980	90,812	97,898	80,741
Interest and other investment income	45,214	67,076	149,833	163,833
Increase (decrease) in fair value of investments	(150)	(4)	6,529	11,241
Securities lending income	1,711	11,060	31,576	36,673
Other revenues	492,508	461,824	474,555	517,266
Total Revenues	19,508,332	18,344,240	17,869,315	17,344,978
Expenditures				
Current:				
General government	2,592,283	2,472,452	2,702,730	2,591,176
Legislative and judicial	378,475	359,666	338,839	303,799
Commerce	92,437	94,989	100,535	96,572
Education and humanities	5,104,048	4,860,442	4,800,460	4,554,565
Human resources	8,124,836	7,919,632	7,301,114	6,764,174
Justice	782,443	737,997	767,270	727,178
Natural resources and environmental protection	193,111	188,039	192,957	195,980
Public protection and regulation	115,857	120,406	97,482	98,517
Transportation	2,014,490	1,977,924	2,090,584	1,825,318
Debt Service:				
Principal retirement	386,212	299,940	341,733	285,809
Interest and fiscal charges	306,139	252,466	210,331	200,297
Other expenditures	27,335	25,036	21,025	15,960
Securities lending expense	933	6,080	26,774	35,318
Capital outlay:				
Buildings	609,309	442,315	582,550	583,302
Total Expenditures	20,727,908	19,757,384	19,574,384	18,277,965
Excess (Deficiency) of Revenues over (under) Expenditures	(1,219,576)	(1,413,144)	(1,705,069)	(932,987)
Other Financing Sources (Uses)				
Transfers in	1,955,274	2,157,662	2,357,766	2,216,889
Transfers from component units				
Transfers out	(1,776,171)	(1,880,360)	(2,258,283)	(2,041,824)
Transfers to component units				
Capitalized leases	10,182	4,456	3,280	7,364
Insurance proceeds	9,876			
Issuance of bonds:				
New issues	873,326	655,350	372,135	159,140
Refunding issues	347,835	508,520	100,000	105,085
Premiums	37,442	35,905	46,322	16,610
Discounts	(2,619)	(4,193)		
Proceeds from notes	89,710		750,085	520,354
Other financing sources				
Payments to refunded bond escrow agent	(186,602)	(508,320)	(100,000)	(330,193)
Total Other Financing Sources (Uses)	1,358,253	969,020	1,271,305	653,425
Net Change in Fund Balances	\$ 138,677	\$ (444,124)	\$ (433,764)	\$ (279,562)
Debt service as a percentage of noncapital expenditures	3.57%	3.02%	3.05%	2.66%

Note: Information is presented on the modified accrual basis of accounting.
In FY 2002 funds were reclassified in conjunction with the implementation of GASB 34.

	2006	2005	2004	2003	2002	2001
\$	9,465,785	\$ 8,745,358	\$ 7,933,198	\$ 7,777,612	\$ 7,474,709	\$ 7,534,101
	294,575	287,045	265,699	252,123	308,209	200,239
	5,662,112	5,351,830	5,150,705	5,093,078	4,821,756	4,208,631
	781,105	728,998	616,638	548,226	506,924	426,173
	90,118	86,771	95,745	73,691	54,169	54,297
	111,894	84,006	75,980	133,532	188,385	213,523
	(5,799)	9,408	(40,558)	15,614	13,548	18,577
	39,918	16,831	15,549			
	597,088	611,966	625,008	506,272	406,869	616,361
	<u>17,036,796</u>	<u>15,922,213</u>	<u>14,737,964</u>	<u>14,400,148</u>	<u>13,774,569</u>	<u>13,271,902</u>
	2,444,023	2,131,008	1,933,909	1,889,243	2,036,798	672,605
	302,303	277,792	265,847	246,838	239,515	216,608
	81,037	66,609	65,518	62,486	58,741	51,283
	4,395,948	4,091,135	3,823,798	3,752,918	3,584,412	3,442,741
	6,602,797	6,188,350	5,984,514	5,650,039	5,563,087	5,110,365
	710,142	633,662	563,890	575,237	564,427	553,499
	171,407	161,899	149,401	135,349	143,924	127,048
	67,329	73,868	112,587	139,299	120,764	124,725
	1,661,585	1,520,371	1,724,342	1,695,652	1,724,061	1,588,052
	246,404	247,290	286,166	260,977	227,648	265,689
	174,972	190,225	181,424	195,126	124,625	181,006
	26,649	26,574	78,052	4,153	(14,727)	(36,637)
	38,144	15,619	13,123			
	446,855	279,953	293,761	244,419	483,145	309,011
	<u>17,369,595</u>	<u>15,904,355</u>	<u>15,476,332</u>	<u>14,851,736</u>	<u>14,856,420</u>	<u>12,605,995</u>
	(332,799)	17,858	(738,368)	(451,588)	(1,081,851)	665,907
	2,124,893	1,791,143	1,781,871	1,926,260	1,698,673	1,268,907
	(1,969,206)	(1,645,143)	(1,563,679)	(1,676,970)	(1,523,710)	(1,552,020)
	6,079	18,905	5,359	7,592	6,414	(1,428,957)
						941
	445,350	213,750	508,991		653,696	516,697
		257,685	601,879		322,659	410,706
	21,416	53,484	103,316		44,824	
					(4,798)	
	(58)	232,760	171,260		19,135	100,400
		(258,550)	(944,495)	(1,567)	(321,565)	(463,429)
	<u>628,474</u>	<u>664,034</u>	<u>664,502</u>	<u>255,315</u>	<u>895,328</u>	<u>(1,145,813)</u>
\$	<u>295,675</u>	<u>\$ 681,892</u>	<u>\$ (73,866)</u>	<u>\$ (196,273)</u>	<u>\$ (186,523)</u>	<u>\$ (479,906)</u>
	<u>2.65%</u>	<u>2.99%</u>	<u>3.71%</u>	<u>3.27%</u>	<u>2.38%</u>	<u>3.33%</u>

COMMONWEALTH OF KENTUCKY
NET ASSETS BY COMPONENT
FOR THE LAST NINE FISCAL YEARS
(Expressed in Thousands)

	2010	2009	2008	2007
Governmental Activities:				
Invested in capital assets, net of related debt	\$ 18,418,874	\$ 19,547,435	\$ 19,911,942	\$ 17,947,656
Restricted	1,206,293	1,094,433	1,139,727	1,237,151
Unrestricted	(6,803,987)	(5,861,735)	(4,816,142)	(1,807,615)
Total Governmental Activities Net Assets	<u>12,821,180</u>	<u>14,780,133</u>	<u>16,235,527</u>	<u>17,377,192</u>
Business-type Activities:				
Invested in Capital Assets, net of related debt	341,172	330,078	290,365	267,144
Restricted	9,646	5,615	310,216	359,605
Unrestricted	(1,151,091)	(859,772)	(553,995)	(634,297)
Total Business-Type Activities Net Assets	<u>(800,273)</u>	<u>(524,079)</u>	<u>46,586</u>	<u>(7,548)</u>
Primary Government:				
Invested in capital assets, net of related debt	18,760,046	19,877,513	20,202,307	18,214,800
Restricted	1,215,939	1,100,048	1,449,943	1,596,756
Unrestricted	(7,955,078)	(6,721,507)	(5,370,137)	(2,441,912)
Total Primary Government Net Assets	<u>\$ 12,020,907</u>	<u>\$ 14,256,054</u>	<u>\$ 16,282,113</u>	<u>\$ 17,369,644</u>

NOTE: This schedule is presented on the accrual basis of accounting.

2006	2005	2004	2003	2002
\$ 17,633,886	\$ 17,188,142	\$ 17,156,329	\$ 16,368,574	\$ 15,678,028
1,376,301	1,081,388	994,827	1,189,894	1,524,926
(1,191,204)	(819,692)	(1,480,592)	(1,288,090)	(1,576,870)
17,818,983	17,449,838	16,670,564	16,270,378	15,626,084
254,623	249,728	257,794	249,023	220,996
392,318	375,488	382,173	464,354	451,761
(612,782)	(633,046)	(721,878)	(774,119)	(915,565)
34,159	(7,830)	(81,911)	(60,742)	(242,808)
17,888,509	17,437,870	17,414,123	16,617,597	15,899,024
1,768,619	1,456,876	1,377,000	1,654,248	1,976,687
(1,803,986)	(1,452,738)	(2,202,470)	(2,062,209)	(2,492,435)
\$ 17,853,142	\$ 17,442,008	\$ 16,588,653	\$ 16,209,636	\$ 15,383,276

COMMONWEALTH OF KENTUCKY
GOVERNMENT-WIDE EXPENSES, PROGRAM REVENUES, AND NET (EXPENSE)/REVENUE
FOR THE LAST NINE FISCAL YEARS
(Expressed in Thousands)

	2010	2009	2008	2007
Function/Program Revenues				
Primary Government:				
Governmental Activities:				
Charges for Services:				
General government	\$ 384,050	\$ 366,634	\$ 494,587	\$ 375,662
Legislative and judicial	20,226	28,561	15,225	14,558
Commerce	40,657	47,770	41,821	42,267
Education and humanities	55,926	50,988	68,609	85,538
Human Resources	103,025	121,752	200,913	197,556
Justice	21,641	20,611	24,096	22,189
Natural resources and environmental protection	41,123	35,959	42,511	39,412
Public protection and regulation	73,066	71,078	66,495	64,260
Transportation	230,918	238,110	16,849	215,869
Operating Grants and Contributions	7,621,275	6,575,144	5,554,089	5,261,989
Capital Grants and Contributions	773,661	550,416	750,184	658,132
Total Governmental Activities	<u>9,365,568</u>	<u>8,107,023</u>	<u>7,275,379</u>	<u>6,977,432</u>
Business-Type Activities:				
Charges for Services:				
State Parks	50,802	52,439	57,605	56,208
Kentucky Lottery Corporation	772,497	810,544	778,211	744,222
Kentucky Horse Park	6,880	6,423	6,763	6,632
Insurance Administration	121,445	93,438	129,870	130,994
Kentucky Public Employees' Health Plan	1,548,458	1,392,971	1,270,899	1,158,078
Unemployment Compensation	1,556,290	412,430	381,410	357,396
Operating Grants and Contributions	3,849	363,028	53,838	46,798
Capital Grants and Contributions		4,633	1,735	476
Total Business-Type Activities	<u>4,060,221</u>	<u>3,135,906</u>	<u>2,680,331</u>	<u>2,500,804</u>
Total Primary Government	<u>\$ 13,425,789</u>	<u>\$ 11,242,929</u>	<u>\$ 9,955,710</u>	<u>\$ 9,478,236</u>
Expenses				
Primary Government:				
Governmental Activities:				
General government	\$ 4,377,373	\$ 3,837,639	\$ 4,370,883	\$ 3,708,700
Legislative and judicial	376,743	360,872	335,635	313,010
Commerce	124,263	112,825	107,774	96,486
Education and humanities	5,148,482	4,887,919	4,852,742	4,608,914
Human Resources	7,725,161	7,611,725	6,904,568	6,468,225
Justice	876,065	822,301	845,153	803,120
Natural resources and environmental protection	192,518	197,086	197,265	191,052
Public protection and regulation	113,558	121,952	97,360	116,770
Transportation	1,175,210	1,331,764	1,170,102	1,123,493
Interest expense	332,639	265,984	254,488	266,388
Total Governmental Activities	<u>20,442,012</u>	<u>19,550,067</u>	<u>19,135,970</u>	<u>17,696,158</u>
Business-Type Activities:				
State Parks	101,861	98,795	104,672	111,973
Kentucky Lottery Corporation	568,183	619,902	599,490	563,549
Kentucky Horse Park	13,521	11,411	12,799	10,624
Insurance Administration	107,286	(18,953)	117,817	176,338
Kentucky Public Employees' Health Plan	1,497,656	1,434,951	1,288,981	1,152,794
Unemployment Compensation	1,958,414	1,317,067	493,397	450,629
Total Business-Type Activities	<u>4,246,921</u>	<u>3,463,173</u>	<u>2,617,156</u>	<u>2,465,907</u>
Total Primary Government	<u>\$ 24,688,933</u>	<u>\$ 23,013,240</u>	<u>\$ 21,753,126</u>	<u>\$ 20,162,065</u>
Net (Expense)/Revenue				
Governmental Activities	\$ (11,076,444)	\$ (11,443,044)	\$ (11,860,591)	\$ (10,718,726)
Business-Type Activities	(186,700)	(327,267)	63,175	34,897
Total Primary Government Net Expense	<u>\$ (11,263,144)</u>	<u>\$ (11,770,311)</u>	<u>\$ (11,797,416)</u>	<u>\$ (10,683,829)</u>

	2006	2005	2004	2003	2002
\$	374,655	\$ 355,890	\$ 312,007	\$ 276,792	\$ 249,343
	13,667	11,314	11,111	9,755	8,752
	34,390	35,002	34,689	32,247	27,918
	102,783	106,059	14,185	8,789	9,298
	106,238	181,921	138,487	418,444	419,916
	33,185	22,790	23,011	18,631	32,730
	33,205	31,094	39,311	19,961	21,547
	63,341	53,629	69,194	71,829	55,609
	202,569	227,700	207,151	235,700	247,265
	5,139,428	4,915,115	4,528,038	4,583,434	4,366,372
	597,282	520,194	524,936	547,363	646,847
	<u>6,700,743</u>	<u>6,460,708</u>	<u>5,902,120</u>	<u>6,222,945</u>	<u>6,085,597</u>
	52,751	50,655	50,925	49,368	47,640
	742,312	707,260	725,252	673,485	638,728
	6,010	5,791	5,896	5,840	5,379
	178,305	133,380	129,084	157,109	133,749
	595,435				
	377,265	371,099	332,047	354,432	226,762
	45,573	49,509	130,212	210,488	220,812
	112	33	586	1,046	
	<u>1,997,763</u>	<u>1,317,727</u>	<u>1,374,002</u>	<u>1,451,768</u>	<u>1,273,070</u>
\$	<u>8,698,506</u>	<u>7,778,435</u>	<u>7,276,122</u>	<u>7,674,713</u>	<u>7,358,667</u>
\$	2,714,165	\$ 2,234,111	\$ 2,322,043	\$ 1,949,067	\$ 1,917,289
	305,466	282,389	268,001	247,503	243,571
	103,996	81,639	128,548	80,459	88,229
	4,421,812	4,092,896	3,824,742	3,752,426	3,639,130
	6,259,383	5,897,619	5,630,683	5,646,075	5,576,596
	794,698	702,796	564,202	616,236	611,350
	207,369	164,498	150,380	136,057	114,496
	68,108	68,956	111,928	139,518	50,798
	1,263,891	1,191,512	1,020,786	1,062,576	1,093,070
	250,622	201,564	200,315	227,926	335,499
	<u>16,389,510</u>	<u>14,917,980</u>	<u>14,221,628</u>	<u>13,857,843</u>	<u>13,670,028</u>
	90,283	92,193	92,287	88,423	97,706
	558,435	552,410	554,880	515,629	475,944
	9,690	9,387	11,732	8,562	6,715
	70,683	101,312	77,241	83,536	156,851
	507,282				
	396,052	429,007	556,870	490,348	612,112
	<u>1,632,425</u>	<u>1,184,309</u>	<u>1,293,010</u>	<u>1,186,498</u>	<u>1,349,328</u>
\$	<u>18,021,935</u>	<u>16,102,289</u>	<u>15,514,638</u>	<u>15,044,341</u>	<u>15,019,356</u>
\$	(9,688,767)	\$ (8,457,272)	\$ (8,319,508)	\$ (7,634,898)	\$ (7,584,431)
	365,338	133,418	80,992	265,270	(76,258)
\$	<u>(9,323,429)</u>	<u>(8,323,854)</u>	<u>(8,238,516)</u>	<u>(7,369,628)</u>	<u>(7,660,689)</u>

Continued

COMMONWEALTH OF KENTUCKY
GOVERNMENT-WIDE EXPENSES, PROGRAM REVENUES, AND NET (EXPENSE)/REVENUE
FOR THE LAST NINE FISCAL YEARS
(Expressed in Thousands)

	2010	2009	2008	2007
General Revenues and Other Changes in Net Assets				
Governmental Activities:				
Taxes:				
Sales and gross receipt	\$ 4,880,831	\$ 4,777,321	\$ 4,828,223	\$ 4,623,126
Individual income	3,125,824	3,359,471	3,512,908	2,975,875
Corporate income	235,654	278,103	397,842	961,204
Property	504,189	534,441	497,326	503,853
License and privilege	29,198	37,442	33,049	42,738
Severance	325,077	362,965	310,294	279,924
Inheritance and estate	38,058	43,237	51,423	49,574
Miscellaneous taxes	152,016	146,977	163,842	164,715
Unrestricted grants and contributions	9,365	10,263	11,923	731
Unrestricted investment earnings	9,531	(9,977)	31,335	57,070
Gain on sale of capital assets	22,682	12,730	10,123	3,288
Miscellaneous general	388,144	319,408	596,079	421,772
Transfers	172,007	264,032	126,716	169,150
Total General Revenues and Transfers	<u>9,892,576</u>	<u>10,136,413</u>	<u>10,571,083</u>	<u>10,253,020</u>
Change in Net Assets	(1,183,868)	(1,306,631)	(1,289,508)	(465,706)
Net Assets at July 1, as Restated	14,005,048	16,086,764	17,525,035	17,842,898
Net Assets at June 30	<u>\$ 12,821,180</u>	<u>\$ 14,780,133</u>	<u>\$ 16,235,527</u>	<u>\$ 17,377,192</u>
Business-Type Activities:				
Unrestricted grants and contributions	\$	\$	\$	\$
Unrestricted investment earnings	47,657	(28,261)	16,531	83,846
Gain on sale of capital assets	1,844	38	59	72
Miscellaneous general	35,792	48,894	18,746	8,628
Transfers	(172,007)	(264,032)	(126,716)	(169,150)
Total General Revenues and Transfers	<u>(86,714)</u>	<u>(243,361)</u>	<u>(91,380)</u>	<u>(76,604)</u>
Change in Net Assets	(273,414)	(570,628)	(28,205)	(41,707)
Net Assets at July 1, as Restated	(526,859)	46,549	74,791	34,159
Net Assets at June 30	<u>\$ (800,273)</u>	<u>\$ (524,079)</u>	<u>\$ 46,586</u>	<u>\$ (7,548)</u>
Change in Net Assets				
Governmental Activities	\$ (1,183,868)	\$ (1,306,631)	\$ (1,289,508)	\$ (465,706)
Business-Type Activities	<u>(273,414)</u>	<u>(570,628)</u>	<u>(28,205)</u>	<u>(41,707)</u>
Total Primary Government Changes in Net Assets	<u>\$ (1,457,282)</u>	<u>\$ (1,877,259)</u>	<u>\$ (1,317,713)</u>	<u>\$ (507,413)</u>

NOTE: This schedule is presented on the accrual basis of accounting.

2006	2005	2004	2003	2002
\$ 4,433,893	\$ 4,031,452	\$ 3,780,204	\$ 3,653,535	\$ 3,343,082
2,863,269	3,060,274	2,790,732	2,764,133	2,564,182
1,013,768	476,524	311,284	290,403	607,213
492,532	479,815	462,062	439,129	450,134
73,679	142,962	142,048	162,929	92,953
290,203	237,512	194,369	176,300	158,354
40,498	66,766	66,287	93,553	94,609
161,663	180,045	152,921	149,089	147,126
723	1,836	69,037	68,721	2
58,428	31,858	24,368	10,184	49,259
4,637			(73,096)	(3,768)
499,657	456,736	468,056	392,330	344,484
187,101	141,338	201,712	231,828	184,084
<u>10,120,051</u>	<u>9,307,118</u>	<u>8,663,080</u>	<u>8,359,038</u>	<u>8,031,714</u>
431,284	849,846	343,572	724,140	447,283
17,387,699	16,599,992	16,326,992	15,546,140	15,178,801
<u>\$ 17,818,983</u>	<u>\$ 17,449,838</u>	<u>\$ 16,670,564</u>	<u>\$ 16,270,280</u>	<u>\$ 15,626,084</u>
\$ 26,793	\$ 36,782	\$ 20	\$ (5,015)	\$ (370)
30	61	21,259	19,251	7,178
25,900	47,820	75	437	
<u>(187,101)</u>	<u>(141,338)</u>	<u>(201,712)</u>	<u>(231,828)</u>	<u>(184,084)</u>
<u>(134,378)</u>	<u>(56,675)</u>	<u>(113,669)</u>	<u>(219,142)</u>	<u>(177,276)</u>
230,960	76,743	(32,677)	46,128	(253,534)
(196,801)	(84,573)	(49,234)	(106,870)	10,726
<u>\$ 34,159</u>	<u>\$ (7,830)</u>	<u>\$ (81,911)</u>	<u>\$ (60,742)</u>	<u>\$ (242,808)</u>
\$ 431,284	\$ 849,846	\$ 343,572	\$ 724,140	\$ 447,283
<u>230,960</u>	<u>76,743</u>	<u>(32,677)</u>	<u>46,128</u>	<u>(253,534)</u>
<u>\$ 662,244</u>	<u>\$ 926,589</u>	<u>\$ 310,895</u>	<u>\$ 770,268</u>	<u>\$ 193,749</u>

**COMMONWEALTH OF KENTUCKY
PERSONAL INCOME TAX INFORMATION
CALENDAR YEARS 2000 and 2008**

Personal Income Tax Filers and Liability by Income Level (C)

KY Federal AGI (from KY form 740) Income Level	Calendar Year 2008			
	Number of Filers	Percentage of Total	Personal Income Tax Liability	Percentage of Total
Resident Taxpayer				
less than \$25,001	761,355	43.92%	\$ 232,408,458	7.35%
\$25,001-\$50,000	424,732	24.50%	540,503,162	17.10%
\$50,001-\$100,000	387,313	22.34%	1,004,755,017	31.79%
\$100,001-\$200,000	128,450	7.41%	678,208,736	21.46%
\$200,001-\$500,000	25,578	1.48%	349,569,002	11.06%
Greater than \$500,000	5,934	0.34%	355,036,647	11.23%
Total Resident	1,733,362	100.00%	3,160,481,022	100.00%
Non-Resident Taxpayer				
less than \$25,001	47,981	36.07%	12,042,116	7.09%
\$25,001-\$50,000	23,333	17.54%	12,151,840	7.16%
\$50,001-\$100,000	25,424	19.11%	22,361,246	13.17%
\$100,001-\$200,000	16,045	12.06%	23,895,478	14.07%
\$200,001-\$500,000	9,737	7.32%	21,738,606	12.80%
Greater than \$500,000	10,501	7.89%	77,647,244	45.72%
Total Non-Resident	133,021	100.00%	169,836,530	100.00%
Totals	1,866,383		\$ 3,330,317,552	

Personal Income Tax Rates

Tax Years 2000 - 2008	2%	3%	4%	5%	6.0%
Tax Rate					\$8,001 and UP
Income Bracket	\$0-3,000	\$3,001-4,000	\$4,001-5,000	\$5,001-8,000	
	2008		2000		
Personal Income Tax Revenue	\$ 3,330,317,552	(A)	\$ 2,618,135,253		
Personal Income	101,288,250	(B)	68,851,883		
Average Effective Rate	3.0%		2.6%		

Source of Tax Information:

(A) Kentucky Department of Revenue

NOTE: Calendar year 2008 is the most current year for which data is available and calendar year 2000 was the first year for which comparable data was available.

(B) See Schedule of Personal Income

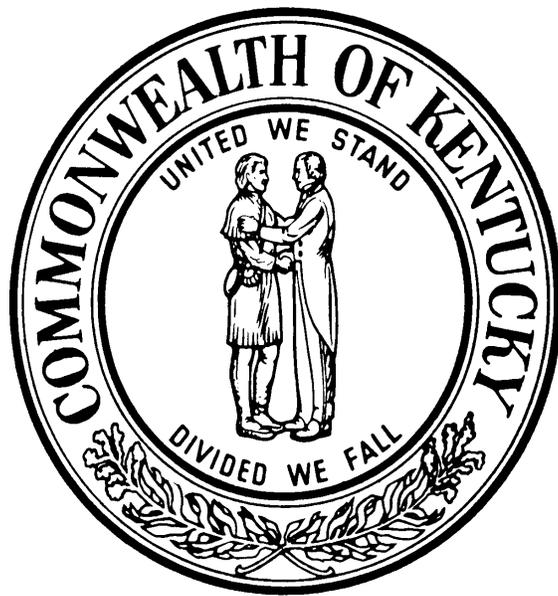
(C) This information is presented on a cash basis.

Calendar Year 2000

<u>Number of Filers</u>	<u>Percentage of Total</u>	<u>Personal Income Tax Liability</u>	<u>Percentage of Total</u>
805,957	50.05%	\$ 218,426,319	8.68%
408,903	25.39%	551,103,310	21.91%
306,597	19.04%	843,345,292	33.53%
68,021	4.22%	394,353,831	15.68%
16,749	1.04%	243,645,359	9.69%
4,228	0.26%	264,123,850	10.50%
1,610,455	100.00%	2,514,997,961	100.00%

<u>Number of Filers</u>	<u>Percentage of Total</u>	<u>Personal Income Tax Liability</u>	<u>Percentage of Total</u>
49,232	43.32%	5,390,760	5.23%
23,750	20.90%	12,641,801	12.26%
19,663	17.30%	20,389,476	19.77%
9,465	8.33%	17,063,873	16.54%
5,583	4.91%	12,843,514	12.45%
5,953	5.24%	34,807,868	33.75%
113,646	100.00%	103,137,292	100.00%

1,724,101.00		\$ 2,618,135,253	
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COMMONWEALTH OF KENTUCKY
ASSESSED AND ESTIMATED ACTUAL VALUE OF TAXABLE PROPERTY
FOR CALENDAR YEARS 2000-2009
(Expressed in Thousands, Except Ratio Data)

For the Year Ended December 31	Real Property		Personal Property		Totals		Ratio of Total Assessed to Total Estimated Actual Value
	Assessed Value	Estimated Actual Value	Assessed Value	Estimated Actual Value	Assessed Value	Estimated Actual Value	
	2000	\$ 134,604,823	\$ 143,196,620	\$ 141,579,703	\$ 141,579,703	\$ 276,184,525	
2001	144,947,137	154,199,082	148,966,508	148,966,508	293,913,645	303,165,590	96.9%
2002	153,558,852	163,360,481	178,290,246	178,290,246	331,849,099	341,650,727	97.1%
2003	162,167,033	172,518,120	188,846,577	188,846,577	351,013,610	361,364,697	97.1%
2004	171,533,143	182,482,067	190,803,292	190,803,292	362,336,435	373,285,359	97.1%
2005	183,052,164	194,736,345	198,811,311	198,811,311	381,863,476	393,547,656	97.0%
2006	195,349,504	207,818,621	146,437,150	146,437,150	341,786,654	354,255,771	96.5%
2007	209,408,191	222,774,671	155,998,799	155,998,799	365,406,990	378,773,470	96.5%
2008	219,881,174	233,916,143	160,465,814	160,465,814	380,346,988	394,681,957	96.4%
2009	226,213,765	240,652,941	160,898,648	160,898,648	387,112,413	401,551,589	96.4%

SOURCE: Kentucky Department of Revenue

NOTE: Assessed values are established through the utilization of an annual ad valorem tax based on the fair value of property.

COMMONWEALTH OF KENTUCKY
PROPERTY TAX LEVIES AND COLLECTIONS
FOR CALENDAR YEARS 2000-2009
(Expressed in Thousands, Except Percentages)

For the Year Ended June 30	Total Levied	Current Tax Collections	Percent of Levy Collected	Delinquent Tax Collections	Total Tax Collections	Percent of Total Tax Collections to Tax Levy	Weighted Average State Rate **
2000	\$ 402,428	\$ 371,715	92.4%	\$ 17,346	\$ 389,061	96.7%	67.58
2001	416,490	386,890	92.9%	22,408	409,298	98.3%	67.14
2002	429,425	407,380	94.9%	22,045 *	429,425	100.0%	66.98
2003	450,348	414,399	92.0%	23,353	437,752	97.2%	68.35
2004	478,017	432,937	90.6%	18,813	451,750	94.5%	70.03
2005	505,847	451,949	89.3%	23,632	475,581	94.0%	71.12
2006	483,608	467,209	96.6%	16,299 *	483,508	100.0%	65.05
2007	513,301	483,127	94.1%	17,520	500,647	97.5%	66.45
2008	527,149	490,176	93.0%	22,946	513,122	97.3%	65.26
2009	530,822	491,218	92.5%	24,952	516,170	97.2%	64.26

SOURCE: Kentucky Department of Revenue

NOTE: Property taxes are assessed as of January 1 of each year in one of two ways: 1) by the 120 Property Valuation Administrators within the State, or 2) by the Revenue Cabinet. The tax rates are set by the various taxing jurisdictions and applied to the particular assessment. Tax bills are delivered by September 15 of each year. Also, the "Total Tax Levy" in this table has been re-specified for the years shown to adjust for the fact that the receipts for motor vehicles involve two different assessment years.

* Delinquent tax collections in excess of the current year levy have been allocated to prior years.

** The weighted average state rate includes state and local rates and are expressed in cents per \$100 of assessed value.

COMMONWEALTH OF KENTUCKY
RATIOS OF OUTSTANDING DEBT BY TYPE
FOR THE LAST TEN FISCAL YEARS
(Expressed in Thousands, Except Ratio Data)

	<u>2010</u>	<u>2009</u>	<u>2008</u>	<u>2007</u>
Governmental Activities Debt				
Revenue Bonds (2)	\$ 5,959,845	\$ 4,429,520	\$ 3,617,080	\$ 3,442,634
Notes (2)	1,089,740	1,059,520	1,516,350	910,310
Capital Leases (2)	<u>32,341</u>	<u>26,638</u>	<u>30,968</u>	<u>39,079</u>
Total Government Activities Debt	<u>7,081,926</u>	<u>5,515,678</u>	<u>5,164,398</u>	<u>4,392,023</u>
Business-Type Activities Debt				
Notes (2)				
Capital Leases (2)	<u>127</u>	<u>211</u>	<u>212</u>	<u>197</u>
Total Business-Type Activities Debt	<u>127</u>	<u>211</u>	<u>212</u>	<u>197</u>
Total Primary Government Debt	<u>\$ 7,082,053</u>	<u>\$ 5,515,889</u>	<u>\$ 5,164,610</u>	<u>\$ 4,392,220</u>
Total Debt Ratios				
Ratio of Total Debt to Personal Income	<u>7.09%</u>	<u>5.45%</u>	<u>5.21%</u>	<u>4.64%</u>
Total Debt Per Capita (1)	<u>\$ 1,641.60</u>	<u>\$ 1,292.01</u>	<u>\$ 1,217.65</u>	<u>\$ 1,044.26</u>
Net Bonded Debt				
Gross Bonded Debt	\$ 5,959,845	\$ 4,429,520	\$ 3,617,080	\$ 3,442,634
Less: Debt Service Funds	<u>197,802</u>	<u>353,391</u>	<u>405,028</u>	<u>415,386</u>
Net Bonded Debt	<u>\$ 5,762,043</u>	<u>\$ 4,076,129</u>	<u>\$ 3,212,052</u>	<u>\$ 3,027,248</u>
Net Bonded Debt Ratios				
Ratio of Net Bonded Debt to Governmental Funds Revenues	<u>29.54%</u>	<u>22.22%</u>	<u>17.97%</u>	<u>17.77%</u>
Net Bonded Debt Per Capita (1)	<u>\$ 1,335.63</u>	<u>\$ 954.77</u>	<u>\$ 757.30</u>	<u>\$ 719.73</u>

(1) Per Capita calculations are based on the population figures for the prior year. (See Demographics Schedule on page 208)

(2) See Note 15 for Debt Amounts

2006	2005	2004	2003	2002	2001
\$ 3,546,468	\$ 3,236,766	\$ 3,225,431	\$ 3,165,223	\$ 3,405,046	\$ 2,944,839
554,790	373,990	186,970	31,475	81,535	73,875
28,450	32,518	17,252	8,565	24,712	2,153
<u>4,129,708</u>	<u>3,643,274</u>	<u>3,429,653</u>	<u>3,205,263</u>	<u>3,511,293</u>	<u>3,020,867</u>
		451		339	1,697
307	275	245	77	183	4,630
<u>307</u>	<u>275</u>	<u>696</u>	<u>77</u>	<u>522</u>	<u>6,327</u>
<u>\$ 4,130,015</u>	<u>\$ 3,643,549</u>	<u>\$ 3,430,349</u>	<u>\$ 3,205,340</u>	<u>\$ 3,511,815</u>	<u>\$ 3,027,194</u>
<u>4.54%</u>	<u>4.26%</u>	<u>4.28%</u>	<u>4.42%</u>	<u>4.98%</u>	<u>4.40%</u>
<u>\$ 989.60</u>	<u>\$ 878.83</u>	<u>\$ 833.05</u>	<u>\$ 783.15</u>	<u>\$ 863.10</u>	<u>\$ 747.67</u>
\$ 3,546,468	\$ 3,236,766	\$ 3,225,431	\$ 3,165,223	\$ 3,405,046	\$ 2,944,839
403,002	314,554	317,665	354,836	329,267	529,164
<u>\$ 3,143,466</u>	<u>\$ 2,922,212</u>	<u>\$ 2,907,766</u>	<u>\$ 2,810,387</u>	<u>\$ 3,075,779</u>	<u>\$ 2,415,675</u>
<u>18.45%</u>	<u>18.35%</u>	<u>18.26%</u>	<u>17.65%</u>	<u>19.32%</u>	<u>15.17%</u>
<u>\$ 753.21</u>	<u>\$ 704.84</u>	<u>\$ 706.14</u>	<u>\$ 686.65</u>	<u>\$ 755.94</u>	<u>\$ 596.64</u>

**COMMONWEALTH OF KENTUCKY
UNIVERSITY AND COLLEGE REVENUE BOND COVERAGE
FOR THE LAST TEN FISCAL YEARS**
(Expressed in Thousands, Except Ratio Data)

Fiscal Year Ending June 30	Net Revenue Available For Debt Service	Debt Service Requirement	Coverage Ratio
2001	\$ 301,649	\$ 83,069	3.63
2002	269,609	66,828	4.03
2003	112,670	53,825	2.09
2004	337,945	54,034	6.25
2005	326,099	57,375	5.68
2006	499,346	57,141	8.74
2007	613,592	43,071	14.25
2008	235,398	47,782	4.93
2009	231,058	55,549	4.16
2010	308,774	61,448	5.02

SOURCE: Commonwealth of Kentucky Comprehensive Annual
Financial Reports; State universities' audited financial statements

**TOP 10 MANUFACTURERS
(Ranked by Number of Employees)
CURRENT YEAR AND NINE YEARS AGO**

Company	2010			2001		
	Number of Employees	Rank	Percentage of Total Employment	Number of Employees	Rank	Percentage of Total Employment
United Parcel Service, Inc.	13,307	1	0.71%			
Toyota Motor Corp.	9,611	2	0.51%	7,800	3	0.42%
Humana Inc.	9,123	3	0.48%			
Ford Motor Co.	5,391	4	0.29%	9,580	1	0.51%
General Electric Co.	5,067	5	0.27%	9,410	2	0.51%
Citigroup	4,097	6	0.22%			
FMR LLC	3,900	7	0.21%			
Affiliated Computer Services Inc.	3,360	8	0.18%			
Lexmark International Inc.	3,130	9	0.17%	5,500	5	0.30%
Delta Air Lines, Inc.	2,700	10	0.14%			
Johnson Controls, Inc.				5,972	4	0.32%
Dana Corp.				4,746	6	0.25%
Emerson Electric Company				3,510	7	0.19%
Publishers Printing				2,650	8	0.14%
R.R. Donnelly and Sons Company				2,400	9	0.13%
Toyota Tsusho				2,293	10	0.12%
	<u>59,686</u>		<u>3.17%</u>	<u>53,861</u>		<u>2.89%</u>

SOURCE:
Website Address: <http://www.thinkkentucky.com>
<http://www.workforcekentucky.ky.gov>

**DEMOGRAPHIC STATISTICS
FOR CALENDAR YEARS 2000-2009**

For the Year Ended December 31	Estimated Population	Per Capita Income	Unemployment Rate
2000	4,048,832	\$ 24,258	4.1%
2001	4,068,816	24,878	5.4%
2002	4,092,891	25,579	5.6%
2003	4,117,827	26,252	6.2%
2004	4,145,922	27,709	5.3%
2005	4,173,405	28,513	6.1%
2006	4,206,074	29,352	5.7%
2007	4,241,474	31,111	5.5%
2008	4,269,245	31,826	6.4%
2009	4,314,113	32,306	10.5%

SOURCE: Website Addresses: <http://www.bea.gov>
<http://www.bls.gov>

COMMONWEALTH OF KENTUCKY
SOURCES OF PERSONAL INCOME
FOR CALENDAR YEARS 2000-2009
(Expressed in Thousands, Except Percent Data)

Source	2000		2001		2002*		2003**		2004**	
	Amount	Percent								
Farm	\$ 1,361,530	2.0%	\$ 973,207	1.4%	\$ 883,000	1.2%	\$ 854,000	1.1%	\$ 580,000	0.7%
Agriculture services, forestry, fisheries and others	502,305	0.7%	521,571	0.7%	521,000	0.7%	383,250	0.5%	359,250	0.4%
Mining	1,197,845	1.7%	1,332,006	1.9%	1,382,000	1.9%	1,310,500	1.6%	1,495,250	1.7%
Manufacturing	13,945,732	20.3%	13,636,163	19.3%	13,611,000	18.8%	14,816,000	18.5%	16,142,000	18.9%
Construction	4,196,268	6.1%	4,330,236	6.1%	4,276,000	5.9%	4,821,250	6.0%	4,819,750	5.6%
Wholesale and retail trade	10,537,792	15.3%	10,699,135	15.2%	11,088,000	15.3%	9,940,250	12.4%	10,475,250	12.3%
Finance, insurance and real estate	3,690,749	5.4%	3,776,761	5.4%	4,034,000	5.6%	4,962,750	6.2%	5,274,250	6.2%
Transportation and public utilities	5,337,433	7.8%	5,495,944	7.8%	5,478,000	7.6%	5,023,250	6.3%	5,386,750	6.3%
Services	15,629,585	22.6%	16,507,154	23.4%	17,285,000	23.8%	23,330,250	29.1%	24,756,000	29.0%
Government and government enterprises	12,452,644	18.1%	13,218,964	18.8%	13,940,000	19.2%	14,686,250	18.3%	16,196,000	18.9%
Earnings by Place of Work	<u>\$ 68,851,883</u>	<u>100.0%</u>	<u>\$ 70,491,141</u>	<u>100.0%</u>	<u>\$ 72,498,000</u>	<u>100.0%</u>	<u>\$ 80,127,750</u>	<u>100.0%</u>	<u>\$ 85,484,500</u>	<u>100.0%</u>

Source	2005**		2006**		2007**		2008**		2009**	
	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent	Amount	Percent
Farm	\$ 1,520,500	1.7%	\$ 532,750	0.6%	\$ 1,040,750	1.0%	\$ 932,500	0.9%	\$ 1,364,000	1.4%
Agriculture services, forestry, fisheries and others	369,750	0.4%	422,500	0.4%	407,250	0.4%	421,500	0.4%	319,250	0.3%
Mining	1,879,750	2.1%	2,128,750	2.3%	2,227,000	2.2%	2,475,000	2.4%	2,121,000	2.1%
Manufacturing	16,364,000	18.0%	17,033,000	18.0%	17,069,000	17.2%	16,305,750	16.1%	13,446,500	13.5%
Construction	5,133,750	5.6%	5,225,750	5.5%	5,292,750	5.3%	5,356,750	5.3%	5,045,000	5.1%
Wholesale and retail trade	10,857,250	11.9%	11,430,750	12.1%	11,726,500	11.8%	11,870,500	11.7%	11,548,500	11.6%
Finance, insurance and real estate	5,487,250	6.0%	5,922,750	6.3%	6,345,250	6.4%	6,390,750	6.3%	5,979,500	6.0%
Transportation and public utilities	5,452,500	6.0%	5,653,750	6.0%	6,237,000	6.3%	6,008,000	5.9%	6,062,250	6.1%
Services	26,222,250	28.9%	27,810,500	29.3%	29,033,250	29.4%	30,718,250	30.5%	31,714,500	31.6%
Government and government enterprises	17,594,750	19.4%	18,420,500	19.5%	19,826,000	20.0%	20,809,250	20.5%	22,249,500	22.3%
Earnings by Place of Work	<u>\$ 90,881,750</u>	<u>100.0%</u>	<u>\$ 94,581,000</u>	<u>100.0%</u>	<u>\$ 99,204,750</u>	<u>100.0%</u>	<u>\$ 101,288,250</u>	<u>100.0%</u>	<u>\$ 99,850,000</u>	<u>100.0%</u>

SOURCE: U.S. Department of Commerce, Bureau of Economic Analysis (<http://www.bea.gov>)

NOTE: Percentages may not add to 100% due to rounding.

* 2002 annual estimates computed with BEA table SQ5 by adding 4 quarters of 2002 and dividing by 4.

** Annual estimates computed with BEA table SQ5N by adding 4 quarters of each year and dividing by 4.

Quarterly charts show each quarter as an annualized amount based on amounts to date.

Amounts are based on the North American Industry Classification System (NAICS) instead of the Standard Industrial Classification (SIC) system used in previous years. This affects comparability of amounts. NAICS will be used in the future fiscal years.

**COMMONWEALTH OF KENTUCKY
OPERATING INDICATORS BY FUNCTION
FOR THE LAST FIVE FISCAL YEARS**

	2010	2009	2008	2007	2006
Personnel					
Number of Full Time Employees- Executive Branch	33,225	32,747	33,608	33,204	34,947
Health Insurance Expenditures - Percentage Increase/(decrease)	18.7%	(1.3%)	6.1%	(1.8%)	29%
Education					
K-12 Enrollment	636,188	671,147	671,542	668,337	664,606
K-12 Attendance Rate	94.18%	94.17%	94.18%	94.60%	94.31%
K-12 Graduation Rate	83.91%	84.52%	83.72%	83.26%	82.84%
Statewide Academic Index	*	*	82.20%	81.80%	78.30%
Average ACT Score	19.4	19.4**	20.9	20.7	20.6
GED Graduates	3,357	9,382	10,307	9,757	9,054
College Going Rate for 9th Graders	42%	44%	38%	38%	37%
Postsecondary Education Enrollment	223,893	211,179	212,994	206,419	202,197
Bachelor's and Higher Degrees Awarded	28,798	27,983	27,246	27,042	26,544
Justice and Public Safety					
Incarcerated Population-Daily Average	20,798	21,470	22,219	20,772	19,943
Probation and Parole Population - Daily Average	39,364	38,933	39,206	33,642	33,643
Health and Family Services					
Medicaid Enrollment-Average	788,236	748,296	722,559	710,000	699,595
Food Stamp Recipients-Monthly Average	761,654	680,087	623,997	595,366	598,486
Temporary Assistance for Needy Families (TANF)-Monthly Average	58,049	48,368	48,743	68,260	69,696
Children with substantiated incidences	15,092	14,475	15,196	15,500	15,526
Environmental and Public Protection					
Air Pollution Source Inspections	5,910	3,085	4,310	4,000	4,600
Waste Management Inspections	7,060	5,910	6,443	7,500	7,200
Acres of Land Reforested	4,520	5,580	5,105	2,000	1,600
Mine Permits Issued	608	688	848	954	1,025
Mine Reclamation and Enforcement Inspections	25,686	24,890	26,062	22,898	22,001
Mine Safety-Completed Inspections	4,611	2,888	2,718	2,364	2,500
Transportation					
Percentage of Total Road System Needing Improvement	17.70%	14%	15%	15%	14%
Statewide Road Maintainance Rating (Top Score = 80)	79.7	80.9	81.7	80.1	79.1
Daily Miles Traveled-Percentage Changed (as compared to 2005 Data)	(0.1%)	0.0%	(0.5%)	0.1%	(0.3%)
State-Maintained Lane Miles- Annual Percent Change	0.10%	1.6%	0.6%	0.2%	0.2%
Kentucky Road Construction Cost Index-Percent Increase (1987 Base Year)	13.85%	22.69%	27.95%	32.0%	19.5%

* The Statewide Academic Index is no longer generated.

** First graduating class in which all students were required to take the ACT. A reduction was expected.

**COMMONWEALTH OF KENTUCKY
CAPITAL ASSET STATISTICS BY FUNCTION
FOR THE LAST FIVE FISCAL YEARS**

	2010	2009	2008	2007	2006
<u>General Government</u>					
Number of Buildings	326	309	558	566	297
Number of Vehicles	365	356	411	487	258
Land (Acres)	14,614	14,293	13,352	14,108	13,294
<u>Commerce</u>					
Number of Resort Parks	17	17	17	17	17
Number of Recreation Parks	23	24	24	24	24
Number of Historic Sites	10	11	11	11	10
Area of State Parks (Acres)	42,035	42,597	42,428	42,428	45,137
<u>Education and Humanities</u>					
Number of Buildings	73	72	70	69	70
Number of Vehicles	101	113	123	134	209
Land (Acres)	388	388.4	372	388.4	388
<u>Human Resources</u>					
Number of Buildings	200	196	196	193	190
Number of Vehicles	46	40	150	165	215
Land (Acres)	1,206	1,206	1,007	1,206	1,206
<u>Justice</u>					
Number of Buildings	508	479	482	449	440
Number of Vehicles	1,863	1,861	1,696	1,668	3,911
Land (Acres)	8,867	8,903	6,166	5,314	9,044
<u>Natural Resources and Environmental Protection</u>					
Number of Buildings	26	26	26	27	25
Number of Vehicles	916	815	847	1,319	2,622
Land (Acres)	59,149	58,325	51,175	50,983	64,134
<u>Public Protection and Regulation</u>					
Number of Vehicles	121	90	76	86	44
<u>Transportation</u>					
Number of Lane Miles -State Maintained Highways	62,913	62,823	62,419	62,071	62,193
Number of State maintained Bridges	8,933	8,870	8,842	8,974	8,974
Land (Acres)	1,981	1,981	1,977	1,977	1,961

**COMMONWEALTH OF KENTUCKY
OPERATING INFORMATION
STATE GOVERNMENT EMPLOYEES BY FUNCTION
FOR THE LAST TEN FISCAL YEARS**

	2010	2009	2008	2007
<u>FULL-TIME EMPLOYEES</u>				
FUNCTION				
General government	4,841	4,706	4,855	4,984
Legislative and judicial	3,597	3,759	3,730	3,626
Commerce	2,023	2,038	2,141	2,155
Education and humanities	2,712	2,760	2,967	2,984
Human resources	7,482	7,182	7,387	7,751
Justice	7,938	7,955	8,090	7,967
Natural resources and environmental protection	1,675	1,649	1,601	1,673
Public protection and regulation	1,127	1,102	1,208	1,194
Transportation	4,713	4,467	4,549	4,711
Total full-time employees	36,108	35,618	36,528	37,045
<u>PART-TIME and TEMPORARY EMPLOYEES</u>				
FUNCTION				
General government	662	659	649	757
Legislative and judicial	483	539	574	554
Commerce	1,376	1,496	1,506	1,548
Education and humanities	306	219	228	281
Human resources	124	91	71	165
Justice	39	27	58	33
Natural resources and environmental protection	56	31	27	67
Public protection and regulation	31	14	15	54
Transportation	133	129	156	202
Total part-time and temporary employees	3,210	3,205	3,284	3,661
Total Employees	39,318	38,823	39,812	40,706

2006	2005	2004	2003	2002	2001
5,004	5,150	5,062	5,317	5,514	5,160
3,445	3,332	3,138	3,177	2,861	3,047
2,212	2,206	2,188	2,348	2,357	2,412
2,906	2,923	3,158	2,026	3,184	3,218
8,411	8,861	9,015	9,395	9,607	9,489
7,932	7,693	7,488	7,139	7,121	7,002
1,659	1,681	1,692	1,575	1,564	1,580
1,199	1,164	1,112	1,819	1,815	1,821
4,715	5,082	5,251	5,860	6,057	6,123
<u>37,483</u>	<u>38,092</u>	<u>38,104</u>	<u>38,656</u>	<u>40,080</u>	<u>39,852</u>
781	787	665	684	707	746
583	751	747	720	516	696
1,516	1,522	1,525	1,587	1,468	1,431
306	265	347	408	468	507
114	97	69	112	289	215
50	49	27	33	66	93
54	51	38	26	31	35
34	35	23	33	33	48
165	126	80	88	117	257
<u>3,603</u>	<u>3,683</u>	<u>3,521</u>	<u>3,691</u>	<u>3,695</u>	<u>4,028</u>
<u>41,086</u>	<u>41,775</u>	<u>41,625</u>	<u>42,347</u>	<u>43,775</u>	<u>43,880</u>

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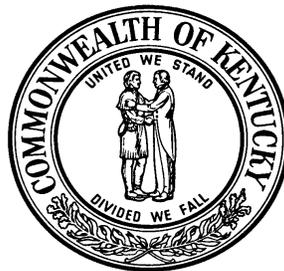
All fiscal and accounting personnel throughout Kentucky State Government, along with the Auditor of Public Accounts' staff, whose dedicated efforts and cooperation contributed to the compilation of financial information that appears in the report.

The Finance and Administration Cabinet, Commonwealth Office of Technology, Division of Printing staff who provided printing services.

**REPORT OF THE STATEWIDE SINGLE AUDIT OF THE
COMMONWEALTH OF KENTUCKY**

VOLUME I

**For the Year Ended
June 30, 2010**



**CRIT LUALLEN
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The Statewide Single Audit of the Commonwealth of Kentucky
Volume I
For the Year Ended June 30, 2010

Background

The Single Audit Act of 1984, subsequent amendments, and corresponding regulations, requires an annual audit of the financial statements and compliance with requirements applicable to major federal programs. The Auditor of Public Accounts (APA) meets these requirements and submits audit findings required to be reported by auditing standards generally accepted in the United States of America, *Government Auditing Standards* and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, through our opinion on the Commonwealth's Comprehensive Annual Financial Report (CAFR) and through the Statewide Single Audit of Kentucky (SSWAK). Our SSWAK report is contained in two volumes as noted below.

SSWAK - Volume I contains financial reporting information based on our audit of the CAFR. It includes the APA's opinion on the Schedule of Expenditures of Federal Awards (SEFA) in relation to the financial statements, the *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*, and financial statement findings related to internal control and compliance.

SSWAK - Volume II will present elements required under OMB Circular A-133, including the *Report on Compliance with Requirements Applicable to Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133*, and the Schedule of Findings and Questioned Costs.

Comprehensive Annual Financial Report

The CAFR, including our report thereon based on our audit and the reports of other auditors, has been issued under separate cover. We identified in our Independent Auditor's Report on the CAFR the percentages of various funds and component units audited by other auditors. The agencies and funds audited by other auditors, as well as contact information, are presented in the Appendix of this report.

The scope of the CAFR audit included:

- An audit of the basic financial statements and combining financial statements;
- Limited procedures applied to required supplementary information;
- An audit of the SEFA sufficient to give an opinion in relation to the basic financial statements; and,
- Tests of compliance with certain provisions of laws, regulations, contracts, and grants, and tests of internal controls, where applicable.

The Statewide Single Audit of the Commonwealth of Kentucky
Volume I
For the Year Ended June 30, 2010

Background (Continued)

Schedule of Expenditures of Federal Awards

The SEFA presented within this report is organized by federal grantor. The Catalog of Federal Domestic Assistance (CFDA) numbers and program names are listed under the federal grantor administering the program. The state agencies expending the federal funds are listed beside each CFDA number. The notes to the SEFA provide more detailed information on certain aspects of the expenditures. Clusters of programs are indicated in the schedule by light gray shading. The identification of major federal programs and our report thereon will be presented in our report *SSWAK - Volume II*.

For fiscal year ended June 30, 2010, the total federal dollars expended by the Commonwealth of Kentucky was \$ 10,401,012,066 in cash awards and \$ 1,245,313,065 in noncash awards. For fiscal year 2010, the total federal cash expenditures as reported on the SEFA increased in comparison with the total for June 30, 2009.

Component Units

The reporting entity of the Commonwealth of Kentucky for the purposes of the CAFR includes various discretely presented component units, including state universities, identified in accordance with GASBS No. 14 and 39. However, except for CAFR reporting, the Commonwealth has elected to exclude discretely presented component units from the statewide single audit. Thus, these discretely presented component units, including state universities, are not included in the accompanying SEFA and reports on internal control and compliance over financial reporting. These entities are still required to have audits performed in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, if applicable, based on their total federal expenditures.



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

February 11, 2011

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

As Auditor of Public Accounts, I am pleased to transmit herewith our report of the Statewide Single Audit of Kentucky - Volume I for the year ended June 30, 2010. Volume I contains financial statement findings identified during our audit of the Comprehensive Annual Financial Report (CAFR), the Schedule of Expenditures of Federal Awards (SEFA), related notes, and our opinion thereon, as well as the 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*.

We will subsequently report to you the required elements of the Federal government's Office of Management and Budget (OMB) Circular A-133 in Volume II of this report upon completion of our audit of the Commonwealth's major federal programs.

On behalf of the Office of Financial Audits of the Auditor of Public Accounts, I wish to thank the employees of the Commonwealth for their cooperation during the course of our audit. Should you have any questions concerning this report, please contact Sally Hamilton, Executive Director, Office of Financial Audits, or me.

Respectfully submitted

A handwritten signature in black ink that reads "Crit Luallen".

Crit Luallen
Auditor of Public Accounts



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LIST OF ABBREVIATIONS/ACRONYMS

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2010**

ACH	Automated Clearing House
ADB	Agriculture Development Board
AFR	Annual Financial Report
AGR	Department of Agriculture
AOC	Administrative Office of the Courts
APA	Auditor of Public Accounts
ARRA	American Recovery and Reinvestment Act
BCP	Business Contingency Plan
BDC	Backup Domain Controller
BHDID	Behavioral Health, Developmental and Intellectual Disabilities
CAFR	Comprehensive Annual Financial Report
CAMRA	Complete Asset Management Reporting and Accounting
CDC	Centers for Disease Control
CED	Cabinet for Economic Development
CFDA	Catalog of Federal Domestic Assistance
CHFS	Cabinet for Health and Family Services
CICS	Customer Information Control System
CIO	Chief Information Officer
CMA	Commission on Military Affairs
Commonwealth	Commonwealth of Kentucky
CORR	Department of Corrections
COT	Commonwealth Office of Technology
CPA	Certified Public Accountant
CW	Checkwriter
CWC	Checkwriter Cancellation
DC	Domain Controller
DCJT	Department of Criminal Justice Training
DCTRL	Document Control
DLA	Department of Libraries and Archives
DLG	Department for Local Government
DMS	Department for Medicaid Services
DNHS	Division of Nutrition and Health Services
DOC	Department of Corrections
DOR	Department of Revenue
DoS	Denial of Service
DPM	Data Protection Manager
DRP	Disaster Recovery Plan
DSC	Designated Security Contacts
DTS	Division of Technology Services
DWI	Department for Workforce Investment
EDU	Department of Education
EEC	Energy and Environment Cabinet
eMARS	enhanced Management Administrative Reporting System
ePAY	ePayment Gateway
EPPC	Environmental and Public Protection Cabinet

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2010
(Continued)**

EPSB	Education Professional Standards Board
ERQ	Event Requirements
F&W	Department of Fish and Wildlife Resources
FAC	Finance and Administration Cabinet
FAP	Finance and Administration Cabinet Policy
FICA	Federal Insurance Contributions Act
Finance	Finance and Administration Cabinet
FSC	Forward Schedule of Changes
FTP	File Transfer Protocol
FY	Fiscal Year
GASB	Governmental Accounting Standards Board
GAX	General Accounting Expense/Expenditure
GSA	Government Services Administration
HR	Human Resource
HRC	Kentucky Commission on Human Rights
HTTP	Hyper Text Transfer Protocol
ID	Identification
IRS	Internal Revenue Service
IT	Information Technology
ITSM	Information Technology Service Management
JUST	Justice and Public Safety Cabinet
JUV	Department of Juvenile Justice
KAC	Kentucky Arts Council
KASBO	Kentucky Association of School Business Officials
KBE	Kentucky Board of Elections
KDE	Kentucky Department of Education
KETS	Kentucky Education Technology System
KHC	Kentucky Heritage Council
KHEAA	Kentucky Higher Education Assistance Authority
KHP	Kentucky Horse Park
KHRIS	Kentucky Human Resource Information System
KHS	Kentucky Historical Society
KIP	Kentucky Immunization Program
KOEP	Kentucky Office of Energy Policy
KOHS	Kentucky Office of Homeland Security
KOMS	Kentucky Offender Management System
KRS	Kentucky Revised Statute
KSP	Kentucky State Police
KST	Kentucky State Treasury
KVE	Kentucky Vehicle Enforcement
KVP	Kentucky Vaccine Program
KY	Kentucky
KY OSCAR	Kentucky On-line System for Collection of Accounts Receivable
KYSTE	Kentucky Society for Technology in Education

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2010
(Continued)**

KYTC	Kentucky Transportation Cabinet
LABOR	Labor Cabinet
LWIA	Local Workforce Investment Area
MARS	Management Administrative Reporting System
MHMR	Department for Mental Health and Mental Retardation Services
MIL	Military Affairs
MSF	Microsoft Solutions Framework
MUNIS	Municipal Information System
NA	Not Applicable
NHSP	Nutrition and Health Services Payment
NSF	Non Sufficient Funds
OAG	Office of Attorney General
OB1	Management Budget
OC	Office of the Controller
ODSS	Office of District Support Services
OET	Office of Education Technology
OET	Office of Employment Training
OFM	Office of Financial Management
OMB	Office of Management and Budget
OMS	Operations Management System
PARKS	Department of Parks
PC	Personnel Cabinet
PDC	Primary Domain Controller
Personnel	Personnel Cabinet
PHA	Public Health Advisor
PPC	Public Protection Cabinet
PRC	Commodity Based Purchase Request
PRCI	Commodity Based Internal Payment Requisition
PUBAD	Department of Public Advocacy
R&D	Research and Development
REV	Department of Revenue
RFC	Request for Change
SAS	Statewide Accounting Services
SDLC	System Development Life Cycle
SEEK	Support Education Excellence in Kentucky
SEFA	Schedule of Expenditures of Federal Awards
SME	Subject Matter Expert
SNAP	Supplemental Nutritional Assistance Program
SOS	Secretary of State
SP	State Park
SR	Solicitation Response
SRP	State Resort Park
SRW	Solicitation Response Wizard
SSWAK	Statewide Single Audit of Kentucky

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2010
(Continued)**

T&A	Time and Attendance
TAH	Tourism, Arts, and Heritage Cabinet
TC	Transportation Cabinet
Treasury	Kentucky State Treasury
UI	Unemployment Insurance
UIA	Unemployment Insurance Accounts
UIB	Unemployment Insurance Benefits
UNIX	Uniplexed Information and Computing System
UPPS	Uniform Personnel and Payroll System
UPS	Unified Prosecutorial System
US	United States
USDA	United States Department Of Agriculture
VA	Department of Veterans' Affairs
VFC	Vaccines for Children
WIA	Workforce Investment Act
WORK	Online Reporting of Kentucky
WRX	Wage Records Systems
XSS	Cross Site Scripting
Y2K	Year 2000



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

Independent Auditor's Report

We have audited the financial statements of the governmental activities, business-type activities, the aggregate discretely presented component units, each major fund, and the aggregate remaining fund information of the Commonwealth of Kentucky as of and for the year ended June 30, 2010, and have issued our report thereon dated December 17, 2010. Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the Commonwealth's basic financial statements. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by OMB Circular A-133 and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements taken as a whole.

The schedule of expenditures of federal awards is prepared on the basis of cash disbursements as modified by the application of KRS 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed and not when incurred.

In our opinion, except for the effects of the application of a different basis of accounting, as explained above, the schedule of expenditures of federal awards is fairly stated, in all material respects, in relation to the Commonwealth's basic financial statements taken as a whole.

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

Respectfully submitted,

A handwritten signature in black ink that reads "Crit Luallen".

Crit Luallen
Auditor of Public Accounts

December 17, 2010



SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Agriculture					
Direct Programs:					
10.025	Plant and Animal Disease, Pest Control, and Animal Care (Note 7)	AGR	\$ 552,381	\$	\$
		F&W	40,539		
10.028	Wildlife Services (Note 7)	F&W	15,086		
10.066	Livestock Assistance Program (Note 15)	AGR			
10.069	Conservation Reserve Program	EEC	16,234		
10.086	ARRA-Aquaculture Grants Program (AGP) (Note 14)	ADB	53,261		
10.153	Market News	AGR	9,387		
10.156	Federal-State Marketing Improvement Program	AGR	135		
10.163	Market Protection and Promotion	AGR	74,002		
10.169	Specialty Crop Block Grant Program	AGR	84,883		
10.170	Specialty Crop Block Grant Program-Farm Bill	AGR	97,610		
Supplemental Nutrition Assistance Program Cluster:					
10.551	Supplemental Nutrition Assistance Program (Note 2) (Note 11) (Note 16)	CHFS		1,164,591,491	
10.561	State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (Note 2)	CHFS	43,123,864		7,813,168
10.561	ARRA-State Administrative Matching Grants for the Supplemental Nutrition Assistance Program (Note 2) (Note 14)	CHFS	5,313,750		187,352
Child Nutrition Cluster:					
10.553	School Breakfast Program (Note 2)	EDU	59,206,813		59,121,200
		JUV	474,072		
10.555	National School Lunch Program (Note 2) (Note 11)	EDU	165,822,650		165,657,063
		AGR		20,296,803	
		JUV	848,782		
10.556	Special Milk Program for Children (Note 2)	EDU	82,376		82,376
10.559	Summer Food Service Program for Children (Note 2)	EDU	7,269,789		7,214,968
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children (Note 2)	CHFS	125,228,544		22,748,532
10.558	Child and Adult Care Food Program (Note 2)	EDU	31,125,962		30,788,439
10.560	State Administrative Expenses for Child Nutrition	EDU	2,071,378		20,770
		AGR	298,714		
10.565	Commodity Supplemental Food Program (Note 11) (Note 12)	AGR	982,211	3,254,679	
Emergency Food Assistance Cluster:					
10.568	Emergency Food Assistance Program (Administrative Costs)	AGR	1,340,386		
10.568	ARRA-Emergency Food Assistance Program (Administrative Costs) (Note 14)	AGR	826,903		
10.569	Emergency Food Assistance Program (Food Commodities) (Note 11)	AGR		8,983,247	
10.572	WIC Farmers' Market Nutrition Program (FMNP)	CHFS	120,055		
		AGR	147		
10.574	Team Nutrition Grants (Note 15)	EDU			
10.576	Senior Farmers Market Nutrition Program	AGR	306,454		
10.579	ARRA-Child Nutrition Discretionary Grants Limited Availability (Note 14)	EDU	1,769,340		
10.582	Fresh Fruit and Vegetable Program	EDU	1,002,480		994,834
10.652	Forestry Research	EEC	454,204		
10.664	Cooperative Forestry Assistance (Note 11)	EEC	3,125,541	47,799	828,336
10.676	Forest Legacy Program	EEC	32,722		
10.678	Forest Stewardship Program	EEC	118,924		
10.680	Forest Health Protection	EEC	66,342		58,258
10.769	Rural Business Enterprise Grants (Note 15)	AGR			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U.S. Department of Agriculture (Continued)</u>					
Direct Programs (Continued):					
10.771	Rural Cooperative Development Grants (Note 15)	AGR			
10.902	Soil and Water Conservation	EEC	612,071		3,601
		F&W	429,308		
10.913	Farm and Ranch Lands Protection Program	AGR	830,939		
10.914	Wildlife Habitat Incentive Program (Note 15)	EEC			
		F&W			
10.NA(1)	Rural Rehabilitation Student Loan Program (Note 3)	AGR	145,426		
Total U.S. Department of Agriculture			\$ 453,973,665	\$ 1,197,174,019	\$ 295,518,896
<u>U.S. Department of Commerce</u>					
Direct Programs:					
Public Works and Economic Development Cluster:					
11.307	Economic Adjustment Assistance (Note 15)	DLG	\$	\$	\$
11.469	Congressionally Identified Awards and Projects (Note 15)	PARKS			
11.555	Public Safety Interoperable Communications Grant Program	KSP	5,263,575		
		KOHS	1,843,719		1,821,523
11.558	State Broadband Data and Development Grant Program	COT	490,538		
Total U.S. Department of Commerce			\$ 7,597,832	\$ 0	\$ 1,821,523
<u>U.S. Department of Defense</u>					
Direct Programs:					
12.002	Procurement Technical Assistance For Business Firms	CED	\$ 131,020	\$	\$
12.113	State Memorandum of Agreement Program for the Reimbursement of Technical Services	EEC	125,615		
12.400	Military Construction, National Guard	MIL	3,098,869		
12.401	National Guard Military Operations and Maintenance (O & M) Projects	MIL	19,594,387		
12.401	ARRA-National Guard Military Operations and Maintenance (O & M) Projects (Note 14)	MIL	3,258,736		
12.404	National Guard Challenge Program	MIL	1,968,617		
12.607	Community Economic Adjustment for Establishment, Expansion, Realignment, or Closure of a Military Installation	CMA	285,700		
12.700	Donations/Loans of Obsolete DOD Property (Note 11)	KSP		267,437	
12.NA(1)	Chemical Demilitarization and Remediation Activity for Hazardous Waste Activities at Chemical Demilitarization Facilities	EEC	390,160		14,769
12.NA(2)	Monitoring of Wildlife	F&W	693,887		
12.NA(3)	Teacher and Teacher's Aide Placement Assistance Program	EPSB	81,176		
Total U.S. Department of Defense			\$ 29,628,167	\$ 267,437	\$ 14,769
<u>U.S. Department of Housing and Urban Development</u>					
Direct Programs:					
Community Development Block Grants-State-Administered Small Cities Program					
14.228	Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii (Note 2) (Note 8)	DLG	\$ 40,116,857	\$	\$ 38,556,573
14.255	ARRA-Community Development Block Grants/State's program and Non-Entitlement Grants in Hawaii (Note 14)	DLG	1,567,844		1,561,107
14.401	Fair Housing Assistance Program-State and Local	HRC	128,021		
14.408	Fair Housing Initiatives Program	HRC	12,746		
14.251	Economic Development Initiative-Special Project, Neighborhood Initiative and Miscellaneous Grants	PARKS	21,774		
Total U.S. Department of Housing and Urban Development			\$ 41,847,242	\$ 0	\$ 40,117,680
<u>U.S. Department of the Interior</u>					
Direct Programs:					
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining (Note 11)	EEC	\$ 11,041,810	\$ 26,193	\$ 49,859

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of the Interior (Continued)					
Direct Programs (Continued):					
15.252	Abandoned Mine Land Reclamation (AMLR) Program	EEC	26,466,848		10,723,985
15.255	Applied Science Program Cooperative Agreements Related to Coal Mining and Reclamation	EEC	28,682		
Fish and Wildlife Cluster:					
15.605	Sport Fish Restoration Program (Note 7)	F&W	5,068,221		
15.611	Wildlife Restoration (Note 9)	F&W	6,683,505		
15.614	Coastal Wetlands Planning, Protection and Restoration Act	F&W	16,684		
15.615	Cooperative Endangered Species Conservation Fund (Note 7)	F&W	308,410		
		EEC	55,637		
15.616	Clean Vessel Act	F&W	85,320		
15.622	Sportfishing and Boating Safety Act	F&W	124,975		
15.623	North American Wetlands Conservation Fund	EEC	9,000		
15.632	Conservation Grants Private Stewardship for Imperiled Species (Note 15)	F&W	62,064		
		EEC			
15.633	Landowner Incentive Program	F&W	229,117		
15.634	State Wildlife Grants (Note 7)	F&W	1,173,994		
15.657	Endangered Species Conservation-Recovery Implementation Funds (Note 11)	EEC		3,276	
15.656	ARRA-Recovery Act-Habitat Enhancement, Restoration and Improvement (Note 14)	F&W	1,904		
15.808	U.S. Geological Survey-Research and Data Collection (Note 15)	EEC	1,088		
		COT			
15.809	National Spatial Data Infrastructure Cooperative Agreements Program	COT	4,152		
15.904	Historic Preservation Fund Grants-In-Aid	KHC	851,850		81,596
15.916	Outdoor Recreation-Acquisition, Development and Planning (Note 10) (Note 6)	DLG	544,951		543,081
		PARKS	964		
Total U.S. Department of the Interior			<u>\$ 52,759,176</u>	<u>\$ 29,469</u>	<u>\$ 11,398,521</u>
U.S. Department of Justice					
Direct Programs:					
16.003	Law Enforcement Assistance-Narcotics and Dangerous Drugs Technical Laboratory Publications (Note 15)	COT	\$	\$	\$
16.202	Prisoner Reentry Initiative Demonstration	CORR	97,239		
16.203	Comprehensive Approaches to Sex Offender Management Discretionary Grant (Note 15)	JUV	85,552		
		CORR			
		JUST			
16.523	Juvenile Accountability Block Grants (Note 15)	JUV	499,397		42,097
		AOC	54,862		
		UPS	33,798		
		PUBAD			
16.540	Juvenile Justice and Delinquency Prevention-Allocation to States	JUV	909,046		629,972
16.543	Missing Children's Assistance	KSP	389,838		
16.548	Title V-Delinquency-Prevention Program	JUV	155,506		155,337
16.549	Part E-State Challenge Activities (Note 15)	JUV			
16.550	State Justice Statistics Program for Statistical Analysis Centers	JUST	65,117		
16.554	National Criminal History Improvement Program (NCHIP) (Note 15)	KSP	274,778		
		KOHS			
		JUST			
16.560	National Institute of Justice Research, Evaluation, and Development Project Grants	KSP	380,848		
		JUST	81,085		
16.575	Crime Victim Assistance	JUST	5,030,906		4,806,189
		UPS	331,406		
16.576	Crime Victim Compensation	PPC	180,335		
16.579	Edward Byrne Memorial Formula Grant Program (Note 15)	JUST	427,883		349,638
		CORR	15,219		
		KSP			
		JUV			
		PUBAD			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Justice (Continued)					
Direct Programs (Continued):					
16.580	Edward Byrne Memorial State and Local Law Enforcement Assistance Discretionary Grants Program (Note 15)	CHFS KSP JUST PUBAD	330,609		
16.585	Drug Court Discretionary Grant Program (Note 15)	AOC CHFS	193,884		
16.586	Violent Offender Incarceration and Truth in Sentencing Incentive Grants (Note 15)	JUST			
16.588	Violence Against Women Formula Grants	JUST UPS OAG CHFS	1,585,169 139,508 11,681 5,023		1,345,196
16.588	ARRA-Violence Against Women Formula Grants (Note 14)	JUST	180,152		180,152
16.589	Rural Domestic Violence, Dating Violence, Sexual Assault, and Stalking Assistance Program (Note 15)	JUST			
16.592	Local Law Enforcement Block Grants Program (Note 15)	KSP JUST			
16.593	Residential Substance Abuse Treatment for State Prisoners (Note 15)	CORR JUST	155,232		
16.606	State Criminal Alien Assistance Program	CORR	58,995		
16.607	Bulletproof Vest Partnership Program (Note 15)	KSP CORR JUST	23,447 12,736		
16.609	Community Prosecution and Project Safe Neighborhoods (Note 15)	UPS			
16.610	Regional Information Sharing Systems (Note 15)	COT			
16.710	Public Safety Partnership and Community Policing Grants	JUST KSP	165,402 134,740		
16.727	Enforcing Underage Drinking Laws Program	KSP	377,443		203,505
16.728	Drug Prevention Program (Note 15)	TC			
16.735	Protecting Inmates and Safeguarding Communities Discretionary Grant Program	CORR	4,257		
16.738	Edward Byrne Memorial Justice Assistance Grant Program	JUST KSP CORR AOC JUV UPS	2,458,033 465,721 200,988 78,367 27,815 23,541		2,120,060
16.738	ARRA-Edward Byrne Memorial Justice Assistance Grant Program (Note 14)	CORR DCJT	918,946 30,007		13,568
16.740	Statewide Automated Victim Information Notification (SAVIN) Program	CORR	288,627		
16.741	Forensic DNA Backlog Reduction Program	KSP	431,555		
16.748	Convicted Offended and/or Arrestee DNA Backlog Reduction Program (In-House Analysis and Data Review) (Note 15)	JUST			
16.743	Forensic Casework DNA Backlog Reduction Program	PUBAD JUST	475,248 89,245		
16.744	Anti-Gang Initiative	KSP	49,762		
16.745	Criminal and Juvenile Justice and Mental Health Collaboration Program (Note 7)	AOC	19,568		
16.746	Capital Case Litigation	JUST OAG PUBAD	49,950 10,197 5,883		
16.750	Support for Adam Walsh Act Implementation Grant Program	KSP	69,817		
16.800	ARRA-Recovery Act-Internet Crimes Against Children Task Force Program (ICAC) (Note 14)	KSP	19,908		
16.801	ARRA-Recovery Act-State Victim Assistance Formula Grant Program (Note 14)	JUST	93,489		93,489
16.802	ARRA-Recovery Act-State Victim Compensation Formula Grant Program (Note 14)	PPC	89,537		

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Justice (Continued)					
Direct Programs (Continued)					
16.803	ARRA-Recovery Act-Edward Byrne Memorial Justice Assistance Grant (JAG) Program/Grants to States and Territories (Note 14)	KSP	3,294,266		
		JUST	1,555,218		1,085,711
		UPS	137,315		
		F&W	136,492		
		AOC	34,088		
		PUBAD	9,305		
		JUV	122		
16.804	ARRA-Recovery Act-Edward Byrne Memorial Justice Assistance Grant(JAG) Program/Grants to Units of Local Government (Note 14)	OAG	12,493		
16.808	ARRA-Recovery Act-Edward Byrne Memorial Competitive Grant Program (Note 14)	KSP	161,904		
16.810	ARRA-Recovery Act-Assistance to Rural Law Enforcement to Combat Crime and Drugs Competitive Grant Program (Note 14)	OAG	214,961		
		UPS	62,408		
16.NA(1)	Drug Enforcement Administration	KSP	1,101,565		
16.NA(2)	Federal Bureau of Investigation	KSP	154,648		
16.NA(3)	Federal Methamphetamine Initiative (Note 15)	KSP			
16.NA(4)	Bureau of Alcohol, Tobacco, Firearms & Explosives (ATF) Program	KSP	20,178		
16.NA(5)	Prescription Drug Monitoring Program (Note15)	CHFS			
16.NA(6)	District Fugitive Task Force	KSP	12,501		
Total U.S. Department of Justice			\$ 25,194,761	\$ 0	\$ 11,024,914
U.S. Department of Labor					
Direct Programs:					
17.002	Labor Force Statistics	DWI	\$ 1,034,065	\$	\$
17.005	Compensation and Working Conditions	LABOR	165,054		
Employment Services Cluster:					
17.207	Employment Service/Wagner-Peyser Funded Activities	DWI	6,079,231		
17.207	ARRA-Employment Service/Wagner-Peyser Funded Activities (Note 14)	DWI	2,802,147		
17.801	Disabled Veterans' Outreach Program (DVOP)	DWI	698,182		
17.804	Local Veterans' Employment Representative Program	DWI	1,811,005		
17.225	Unemployment Insurance (Note 2)(Note 4)	DWI	921,020,873		40,017
17.225	ARRA-Unemployment Insurance (Note 2) (Note 4) (Note 14)	DWI	1,075,269,000		
17.235	Senior Community Service Employment Program	CHFS	2,145,651		2,102,125
17.235	ARRA-Senior Community Service Employment Program (Note 14)	CHFS	435,387		421,989
17.245	Trade Adjustment Assistance	DWI	12,793,338		12,310,416
Workforce Investment Act Cluster:					
17.258	WIA Adult Program (Note 2)	DWI	14,008,723		12,950,156
17.258	ARRA-WIA Adult Program (Note 2) (Note 14)	DWI	5,882,719		5,867,354
17.259	WIA Youth Activities (Note 2)	DWI	16,038,744		14,731,707
		EDU	62		
17.259	ARRA-WIA Youth Activities (Note 2) (Note 14)	DWI	12,001,715		11,666,028
17.260	WIA Dislocated Workers (Note 2)	DWI	28,089,476		26,472,392
		EDU	787,358		722,421
		LABOR	2,012		
17.260	ARRA-WIA Dislocated Workers (Note 2) (Note 14)	DWI	10,168,716		10,168,716
17.261	WIA Pilots, Demonstrations, and Research Projects (Note 15)	DWI			
17.267	Incentive Grants-WIA Section 503 (Note 15)	DWI			
17.268	H-1B Job Training Grants	DWI	2,958,658		2,922,732
17.271	Worker Opportunity Tax Credit Program (WOTC)	DWI	387,451		
17.272	Permanent Labor Certification for Foreign Workers (Note 15)	DWI			
17.273	Temporary Labor Certification For Foreign Workers	DWI	298,335		
17.275	ARRA-Program of Competitive Grants for Worker Training and Placement in High Growth and Emerging Industry Sectors	DWI	26,230		
17.276	ARRA-Health Coverage Tax Credit (HCTC) (Note 14)	DWI	1,536,653		
17.503	Occupational Safety and Health-State Program (Note 4)	LABOR	3,743,207		113,400
17.504	Consultation Agreements (Note 4) (Note 15)	LABOR			
17.505	OSHA Data Initiative (Note 15)	LABOR			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Labor (Continued)					
Direct Programs (Continued)					
17.600	Mine Health and Safety Grants	EEC	649,127		
17.603	Brookwood-Sago Grant (Note 15)	EEC			
Total U.S. Department of Labor			<u>\$ 2,120,833,119</u>	<u>\$ 0</u>	<u>\$ 100,489,454</u>
U.S. Department of Transportation					
Direct Programs:					
20.106	Airport Improvement Program	TC PARKS	\$ 1,261 6,340	\$	\$
Highway Planning and Construction Cluster:					
20.205	Highway Planning and Construction (Note 2) (Note 5) (Note 15)	TC PARKS	522,339,327		59,878,739
20.205	ARRA-Highway Planning and Construction (Note 2) (Note 14) (Note 15)	KSP TC	185,458,469		
20.219	Recreational Trails Program (Note 2) (Note 6) (Note 15)	KHP DLG PARKS	743,311		640,736
20.218	National Motor Carrier Safety	KSP	4,589,852		245,257
20.232	Commercial Driver License Programs Improvement Grant (Note 15)	TC	675,041		
20.238	Commercial Drivers License Information System (CDLIS) Modernization Grant	TC	178,636		
20.505	Metropolitan Transportation Planning	TC	660,829		660,829
Federal Transit Cluster:					
20.500	Federal Transit-Capital Investment Grants	TC	4,286,579		4,286,579
20.507	Federal Transit-Formula Grants	TC	2,082,662		2,082,662
20.507	ARRA-Federal Transit-Formula Grants (Note 14)	TC	2,106,849		2,106,849
20.509	Formula Grants for Other Than Urbanized Areas	TC	12,341,098		11,831,187
20.509	ARRA-Formula Grants for Other Than Urbanized Areas (Note 14)	TC	18,574,062		18,574,062
Transit Services Programs Cluster:					
20.513	Capital Assistance Program for Elderly Persons and Persons with Disabilities	TC	2,064,550		2,014,550
20.516	Job Access-Reverse Commute	TC	1,493,367		1,493,367
20.521	New Freedom Program	TC	987,143		987,143
20.514	Public Transportation Research	TC	1,154,509		1,154,509
Highway Safety Cluster:					
20.600	State and Community Highway Safety (Note 15)	TC KSP OAG AOC DCJT	2,580,609 634,212 164,771 57,340		2,076,870
20.601	Alcohol Impaired Driving Countermeasures Incentive Grants I	KSP TC	252,996 63,774		
20.602	Occupant Protection Incentive Grants	TC KSP	710,081 144,615		136,987
20.604	Safety Incentive Grants for Use of Seatbelts (Note 15)	KSP			
20.605	Safety Incentives to Prevent Operation of Motor Vehicles by Intoxicated Persons (Note 15)	TC			
20.609	Safety Belt Performance Grants	TC	271,922		47,780
20.610	State Traffic Safety Information System Improvement Grants	KSP TC	273,500 193,505		
20.612	Incentive Grant Program to Increase Motorcyclist Safety	TC	119,774		
20.700	Pipeline Safety Program Base Grants	EEC	255,276		
20.703	Interagency Hazardous Materials Public Sector Training and Planning Grants	MIL	284,818		
Total U.S. Department of Transportation			<u>\$ 765,751,078</u>	<u>\$ 0</u>	<u>\$ 108,218,106</u>

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U.S. Department of Treasury</u>					
Direct Programs:					
21.NA(1)	Internal Revenue Service	KSP	\$ 6,443	\$	\$
Total U.S. Department of Treasury			\$ 6,443	\$ 0	\$ 0
<u>U.S. Appalachian Regional Commission</u>					
Direct Programs:					
23.002	Appalachian Area Development (Note 15)	DLG TAH	\$	\$	\$
23.011	Appalachian Research, Technical Assistance, and Demonstration Projects	DLG AOC	1,109,052 13,281		984,646
Total U.S. Appalachian Regional Commission			\$ 1,122,333	\$ 0	\$ 984,646
<u>U.S. Equal Employment Opportunity Commission</u>					
Direct Programs:					
30.002	Employment Discrimination-State and Local Fair Employment Practices Agency Contracts	HRC	\$ 156,520	\$	\$
Total U.S. Equal Employment Opportunity Commission			\$ 156,520	\$ 0	\$ 0
<u>U.S. General Services Administration</u>					
Direct Programs:					
39.003	Donation of Federal Surplus Personal Property (Note 11)	FAC	\$	\$ 478,254	\$
39.011	Election Reform Payments (Note 13)	KBE	454,560		
Total U.S. General Services Administration			\$ 454,560	\$ 478,254	\$ 0
<u>National Aeronautics and Space Administration</u>					
Direct Programs:					
43.002	Aeronautics (Note 15)	COT	\$	\$	\$
Total National Aeronautics and Space Administration			\$ 0	\$ 0	\$ 0
<u>U.S. National Foundation on the Arts and the Humanities</u>					
Direct Programs:					
45.024	Promotion of the Arts-Grants to Organizations and Individuals	KHS	\$ 35,000	\$	\$
45.025	Promotion of the Arts-Partnership Agreements	KAC	930,689		832,562
		KHS	25,000		
45.025	ARRA-Promotion of the Arts-Partnership Agreements (Note 14)	KAC	306,933		306,776
45.161	Promotion of the Humanities-Research (Note 15)	HRC			
45.310	Grants to States	DLA	1,870,192		458,858
Total U.S. National Foundation on the Arts and Humanities			\$ 3,167,814	\$ 0	\$ 1,598,196
<u>U.S. Department of Veterans Affairs</u>					
Direct Programs:					
64.005	Grants to States for Construction of State Home Facilities (Note 15)	VA	\$	\$	\$
64.203	State Cemetery Grants (Note 15)	VA			
Total U.S. Department of Veterans Affairs			\$ 0	\$ 0	\$ 0
<u>U.S. Environmental Protection Agency</u>					
Direct Programs:					
66.001	Air Pollution Control Program Support (Note 4)	EEC	\$ 1,116,443	\$	\$
66.032	State Indoor Radon Grants	CHFS	363,551		313,665
66.034	Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act (Note 4) (Note 11)	EEC	653,736	142,053	

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Environmental Protection Agency (Continued)					
Direct Programs (Continued):					
66.040	State Clean Diesel Grant Program (Note 4) (Note 19)	EEC	155,505		155,505
66.040	ARRA-State Clean Diesel Grant Program (Note 14)	EEC	850,484		760,952
66.418	Construction Grants for Wastewater Treatment Works	EEC	43,208		
66.419	Water Pollution Control State, Interstate, and Tribal Program Support	EEC	2,469,457		89,689
66.432	State Public Water System Supervision	EEC	254,379		
66.436	Surveys, Studies, Investigations, Demonstrations, and Training Grants and Cooperative Agreements-Section 104(B)(3) of the Clean Water Act (Note 4) (Note 15)	EEC			
66.454	Water Quality Management Planning	EEC	74,744		67,687
66.454	ARRA-Water Quality Management Planning (Note 14)	EEC	330,952		28,804
66.458	Capitalization Grants for Clean Water State Revolving Funds	EEC	207,387		
		PARKS	550,391		
66.458	ARRA-Capitalization Grants for Clean Water State Revolving Funds (Note 14) (Note 15)	EEC	231,416		
		KHP			
66.460	Nonpoint Source Implementation Grants	EEC	4,116,510		3,059,000
66.461	Regional Wetland Program Development Grants	EEC	223,341		
66.463	Water Quality Cooperative Agreements (Note 15)	EEC			
66.467	Wastewater Operator Training Grant Program (Technical Assistance) (Note 15)	EEC			
66.468	Capitalization Grants for Drinking Water State Revolving Funds	EEC	2,361,877		
66.468	ARRA-Capitalization Grants for Drinking Water State Revolving Funds (Note 14)	EEC	318,550		
66.471	State Grants to Reimburse Operators of Small Water Systems for Training and Certification Costs	EEC	70,582		
66.474	Water Protection Grants to the States	EEC	45,376		23,402
66.608	Environmental Information Exchange Network Grant Program and Related Assistance (Note 15)	EEC	31,194		
		COT			
66.605	Performance Partnership Grants	AGR	598,759		
66.701	Toxic Substances Compliance Monitoring Cooperative Agreements	EEC	99,533		
66.707	TSCA Title IV State Lead Grants Certification of Lead-Based Paint Professionals	CHFS	216,677		29,308
66.708	Pollution Prevention Grants Program	EEC	80,890		37,750
66.709	Multi-Media Capacity Building Grants for States and Tribes	EEC	18,171		
66.717	Source Reduction Assistance (Note 15)	EEC			
66.801	Hazardous Waste Management State Program Support	EEC	1,720,075		
66.802	Superfund State, Political Subdivision, and Indian Tribe Site-Specific Cooperative Agreements	EEC	188,503		
66.804	Underground Storage Tank Prevention, Detection and Compliance Program	EEC	279,039		
66.805	Leaking Underground Storage Tank Trust Fund Corrective Action Program	EEC	1,644,183		
66.805	ARRA-Leaking Underground Storage Tank Trust Fund Corrective Action Program (Note 14)	EEC	307,468		
66.809	Superfund State and Indian Tribe Core Program-Cooperative Agreements	EEC	77,130		
66.817	State and Tribal Response Program Grants	EEC	440,704		
66.940	Environmental Policy and State Sustainability Grants	EEC	43,058		
66.951	Environmental Educational Grants	EEC	4,891		
Total U.S. Environmental Protection Agency			\$ 20,188,164	\$ 142,053	\$ 4,565,762
U.S. Department of Energy					
Direct Programs:					
81.039	National Energy Information Center	EEC	\$ 6,937	\$	\$
81.041	State Energy Program	EEC	626,750		193,178
81.041	ARRA-State Energy Program (Note 14)	EEC	3,033,274		962,449
		FAC	75,564		
		EDU	27,800		
		ADB	16,856		
		CED	11,297		
81.042	Weatherization Assistance for Low-Income Persons (Note 15)	FAC	5,935,356		5,935,356
		CHFS			
81.042	ARRA-Weatherization Assistance for Low-Income Persons (Note 14)	FAC	13,792,599		13,792,599
81.086	ARRA-Conservation Research and Development (Note 14)	EDU	34,942		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
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FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Energy (Continued)					
Direct Programs (Continued):					
81.104	Office of Environmental Waste Processing (Note 4)	EEC	1,125,382		288,830
		CHFS	851,927		380,535
81.119	ARRA-State Energy Program Special Projects (Note 14)	EEC	44,835		44,330
81.122	ARRA-Electricity Delivery and Energy Reliability, Research, Development and Analysis (Note 14)	EEC	164,273		
81.127	ARRA-Energy Efficient Appliance Rebate Program (EEARP) (Note 14)	EEC	1,780,778		1,749,121
81.128	ARRA-Energy Efficiency and Conservation Block Grant Program (EECBG) (Note 14)	DLG	38,070		
		EEC	85,201		
		PPC	89,967		
81.502	Paducah Gaseous Diffusion Plant Environmental Monitoring and Oversight (Note 15)	CHFS			
81.NA(1)	Department of Energy (Note 15)	F&W			
Total U.S. Department of Energy			<u>\$ 27,741,808</u>	<u>\$ 0</u>	<u>\$ 23,346,398</u>
U.S. Department of Education					
Direct Programs:					
Title I, Part A Cluster:					
84.010	Title I Grants to Local Educational Agencies (Note 2)	EDU	\$ 226,055,723	\$	\$ 225,133,857
84.389	ARRA-Title I Grants to Local Educational Agencies, Recovery Act (Note 14) (Note 2)	EDU	82,194,502		
84.011	Migrant Education-State Grant Program	EDU	8,197,113		8,073,145
84.013	Title I Program for Neglected and Delinquent Children	JUV	918,693		787,101
		CORR	22,775		
		EDU	6,495		
Special Education Cluster:					
84.027	Special Education - Grants to States (Note 2)	EDU	151,805,010		149,690,535
84.173	Special Education - Preschool Grants (Note 2)	EDU	9,752,321		9,520,769
84.391	ARRA-Special Education Grants to States, Recovery Act (Note 2) (Note 14)	EDU	81,325,320		
84.392	ARRA-Special Education-Preschool Grants, Recovery Act (Note 2) (Note 14)	EDU	4,370,843		
84.048	Career and Technical Education-Basic Grants to States	DWI	9,371,175		7,041,497
		EDU	7,063,390		6,813,992
		EPSB	172,802		
Vocational Rehabilitation Services Cluster:					
84.126	Rehabilitation Services-Vocational Rehabilitation Grants to States (Note 2)	DWI	48,441,534		2,021,195
84.390	ARRA-Rehabilitation Services-Vocational Rehabilitation Grants to States, Recovery Act (Note 2) (Note 14)	DWI	2,738,478		
84.128	Rehabilitation Services-Service Projects	DWI	225,112		221,625
84.144	Migrant Education-Coordination Program	EDU	8,882		
84.161	Rehabilitation Services-Client Assistance Program	DWI	144,680		
84.169	Independent Living-State Grants	DWI	277,097		208,021
84.177	Rehabilitation Services-Independent Living Services for Older Individuals Who are Blind	DWI	522,980		
84.181	Special Education-Grants for Infants and Families	CHFS	4,729,448		
84.181	ARRA-Special Education-Grants for Infants and Families (Note 14)	CHFS			
84.393	ARRA-Special Education-Grants for Infants and Families, Recovery Act (Note 14)	CHFS	1,267,330		484,401
84.186	Safe and Drug-Free Schools and Communities-State Grants	EDU	3,171,599		2,960,440
		JUST	561,095		
		CHFS	40,895		40,895
84.187	Supported Employment Services for Individuals with the Most Significant Disabilities	DWI	337,107		
Education of Homeless Children and Youth Cluster:					
84.196	Education for Homeless Children and Youth	EDU	1,029,489		586,289
84.387	ARRA-Education for Homeless Children and Youth, Recovery Act (Note 14)	EDU	519,922		
84.213	Even Start-State Educational Agencies	EDU	1,010,363		937,096
84.215	Fund for the Improvement of Education (Note 10) (Note 15)	KHS	191,305		
		EDU			
84.224	Assistive Technology	DWI	464,920		224,051
84.240	Program of Protection and Advocacy of Individual Rights	PUBAD	312,680		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Education (Continued)					
Direct Programs (Continued):					
84.243	Tech-Prep Education	DWI	1,576,425		762,699
		EDU	209,661		134,743
84.265	Rehabilitation Training-State Vocational Rehabilitation Unit In-Service Training	DWI	296,345		
84.287	Twenty-First Century Community Learning Centers	EDU	11,561,331		11,452,485
84.298	State Grants for Innovative Programs	EDU	106,647		106,643
Educational Technology State Grants Cluster:					
84.318	Education Technology State Grants	EDU	3,954,737		3,703,034
84.386	ARRA-Education Technology State Grants, Recovery Act	EDU	1,222,939		
84.323	Special Education-State Personnel Development	EDU	1,198,272		1,194,220
84.326	Special Education-Technical Assistance and Dissemination to Improve Services and Results for Children with Disabilities	EDU	197,990		197,990
84.330	Advanced Placement Program (Advanced Placement Test Fee; Advanced Placement Incentive Program Grants)	EDU	741,123		547,946
84.331	Grants to States for Workplace and Community Transition Training for Incarcerated Individuals	CORR	293,235		
84.336	Teacher Quality Partnership Grants (Note 15)	EPSB			
84.343	Assistive Technology - State Grants for Protection and Advocacy	PUBAD	56,517		
84.350	Transition to Teaching	EDU	202,517		155,456
84.357	Reading First State Grants	EDU	10,033,462		9,397,491
84.358	Rural Education	EDU	5,587,520		5,587,520
84.365	English Language Acquisition Grants	EDU	3,116,519		3,008,459
84.366	Mathematics and Science Partnerships	EDU	3,670,582		3,608,361
84.367	Improving Teacher Quality State Grants (Note 2)	EDU	45,465,656		44,699,023
84.369	Grants for State Assessments and Related Activities	EDU	4,620,651		25,555
84.371	Striving Readers	EDU	124,251		75,515
84.372	Statewide Data Systems	EDU	416,274		
		EPSB	87,205		
School Improvements Grants Cluster:					
84.377	School Improvement Grants	EDU	5,630,040		5,414,888
84.388	ARRA-School Improvement Grants, Recovery Act (Note 14) (Note 15)	EDU			
State Fiscal Stabilization Fund Cluster:					
84.394	ARRA-State Fiscal Stabilization Fund (SFSF)-Education State Grants, Recovery Act (Note 14) (Note 2)	FAC	70,000,000		70,000,000
		EDU	223,038,700		
84.397	ARRA-State Fiscal Stabilization Fund (SFSF)-Government Services, Recovery Act (Note 14) (Note 15) (Note 2)	CORR	75,367,600		
		KSP	14,831,700		
		FAC			
84.398	ARRA-Independent Living State Grants, Recovery Act (Note 14)	DWI	36,895		
84.399	ARRA-Independent Living Services for Older Individuals Who Are Blind, Recovery Act (Note 14)	DWI	59,384		
Passed Through From the Powell County Board of Education:					
84.215	Fund for the Improvement of Education Pass Through Grantor-Variou (Note 15)	KHS			
Passed Through From the Letcher County Board of Education:					
84.215	Fund for the Improvement of Education Pass Through Grantor-Variou (Note 15)	KHS			
Passed Through From the Civic Education Center:					
84.304	Civic Education- We the People and the Cooperative Education Exchange Program Pass Through Grantor-Variou (Note 10)	AOC	108,516		
Passed Through From the Center for Civic Education:					
84.929	We the People Pass Through Grantor-Variou (Note 10)	AOC			
Total U.S. Department of Education			\$ 1,131,063,771	\$ 0	\$ 574,816,936

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. National Archives and Records Administration					
Direct Programs:					
89.003	National Historical Publications and Records Grants	DLA	\$ 21,288	\$	\$
Total U.S. National Archives and Records Administration			\$ 21,288	\$ 0	\$ 0
U.S. Election Assistance Commission					
Direct Programs:					
90.401	Help America Vote Act Requirements Payments	KBE	\$ 1,871,414	\$	\$ 1,871,414
90.402	Help America Vote Mock Election Program (Note 15)	SOS			
Total U.S. Election Assistance Commission			\$ 1,871,414	\$ 0	\$ 1,871,414
U.S. Department of Health and Human Services					
Direct Programs:					
93.003	Public Health and Social Services Emergency Fund (Note 15)	CHFS	\$	\$	\$
93.041	Special Programs for the Aging-Title VII, Chapter 3-Programs for Prevention of Elder Abuse, Neglect, and Exploitation	CHFS	69,154		69,154
93.042	Special Programs for the Aging-Title VII, Chapter 2-Long Term Care Ombudsman Services for Older Individuals	CHFS	160,910		148,064
93.043	Special Programs for the Aging-Title III, Part D-Disease Prevention and Health Promotion Services	CHFS	283,550		283,550
Aging Cluster:					
93.044	Special Programs for the Aging-Title III, Part B-Grants for Supportive Services and Senior Centers	CHFS	5,740,255		5,058,859
93.045	Special Programs for the Aging-Title III, Part C-Nutrition Services	CHFS	8,241,707		7,721,787
93.053	Nutrition Services Incentive Program	CHFS	1,816,133		1,816,133
93.705	ARRA-Aging Home-Delivered Nutrition Services for States (Note 14)	CHFS	416,888		381,798
93.707	ARRA-Aging Congregate Nutrition Services for States (Note 14)	CHFS	831,775		772,725
93.048	Special Programs for the Aging-Title IV-and Title II-Discretionary Projects	CHFS	245,934		228,368
93.051	Alzheimer's Disease Demonstration Grants to States	CHFS	111,881		72,954
93.052	National Family Caregiver Support, Title III,Part E	CHFS	2,102,255		2,079,049
93.069	Public Health Emergency Preparedness (Note 2) (Note 11)	CHFS	24,357,870	10,444,736	18,034,289
93.070	Environmental Public Health and Emergency Response	CHFS	132,215		60,058
93.071	Medicare Enrollment Assistance Program	CHFS	152,682		152,682
93.087	Enhance the Safety of Children Affected by Parental Methamphetamine or Other Substance Abuse	CHFS	610,340		274,255
93.089	Emergency System for Advance Registration of Volunteer Health Professionals	CHFS	15,854		
93.103	Food and Drug Administration-Research	CHFS	8,484		
93.104	Comprehensive Community Mental Health Services for Children with Serious Emotional Disturbances (SED)	CHFS	2,688,536		2,397,485
93.110	Maternal and Child Health Federal Consolidated Programs	CHFS	275,631		69,687
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs (Note 11)	CHFS	826,666	79,796	529,982
93.130	Cooperative Agreements to States/Territories for the Coordination and Development of Primary Care Offices	CHFS	101,216		32,246
93.134	Grants to Increase Organ Donations (Note 15)	CHFS			
93.136	Injury Prevention and Control Research and State and Community Based Programs	CHFS	651,216		651,216
93.138	Protection and Advocacy for Individuals with Mental Illness	PUBAD	418,453		
93.150	Projects for Assistance In Transition from Homelessness (PATH)	CHFS	432,001		432,001
93.197	Childhood Lead Poisoning Prevention Projects - State and Local Childhood Lead Poisoning Prevention and Surveillance of Blood Lead Levels in Children	CHFS	482,429		323,040
93.217	Family Planning - Services	CHFS	5,729,621		5,097,676
93.230	Consolidated Knowledge Development and Application (KD&A) Program (Note 15)	CHFS			
93.234	Traumatic Brain Injury State Demonstration Grant Program	CHFS	43,102		
93.235	Abstinence Education Program	CHFS	395,755		382,046
93.236	Grants for Dental Health Residency Training	CHFS	1,041		
93.242	Mental Health Research Grants (Note 15)	CHFS			

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Health and Human Services (Continued)					
Direct Programs (Continued):					
93.243	Substance Abuse and Mental Health Services-Projects of Regional and National Significance (Note 15) (Note 7)	CHFS AOC JUV JUST	2,868,170 1,257,721		2,608,643
93.251	Universal Newborn Hearing Screening	CHFS	451,421		
93.262	Occupational Safety and Health Program (Note 15)	CHFS			
93.267	State Grants for Protection and Advocacy Services	PUBAD	45,102		
Immunization Cluster:					
93.268	Immunization Grants (Note 11) (Note 2)	CHFS	3,064,297	34,912,487	1,482,412
93.712	ARRA-Immunization (Note 14) (Note 2)	CHFS	99,254	1,550,567	
93.276	Drug-Free Communities Support Program Grants (Note 15)	KVE			
93.414	ARRA-State Primary Care Offices (Note 14)	CHFS	30,121		30,121
93.283	Centers for Disease Control and Prevention-Investigations and Technical Assistance	CHFS	5,005,001		4,126,422
93.556	Promoting Safe and Stable Families	CHFS	6,734,795		6,493,077
Temporary Assistance for Needy Families Cluster:					
93.558	Temporary Assistance for Needy Families (Note 2)	CHFS	147,928,175		23,764,491
93.714	ARRA-Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program (Note 14) (Note 15)	DWI CHFS	3,825,203		3,825,203
93.563	Child Support Enforcement (Note 15) (Note 2)	CHFS OAG	14,245,360		147,824
93.563	ARRA-Child Support Enforcement (Note 2) (Note 14)	CHFS	30,290,029		25,202,702
93.568	Low-Income Home Energy Assistance (Note 2)	CHFS	66,792,655		66,660,766
Community Services Block Grant Cluster:					
93.569	Community Services Block Grant	CHFS	10,922,004		10,682,066
93.710	ARRA-Community Services Block Grant (Note 14)	CHFS	10,501,439		10,501,439
93.571	Community Services Block Grant Formula and Discretionary Awards Community Food and Nutrition Programs (Note 15)	CHFS			
93.585	Empowerment Zones Program	OC	1,350,000		1,350,000
Child Care and Development Block Grant Cluster:					
93.575	Child Care and Development Block Grant (Note 2)	CHFS	85,131,885		3,425,606
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund (Note 2)	CHFS	24,564,662		9,142,104
93.713	ARRA-Child Care and Development Block Grant (Note 2) (Note 14)	CHFS	32,260,858		1,805,281
93.586	State Court Improvement Program (Note 7)	AOC	427,586		
93.590	Community-Based Child Abuse Prevention Grants	CHFS	2,851,166		2,739,596
93.597	Grants to States for Access and Visitation Programs	CHFS	122,440		122,440
93.599	Chafee Education and Training Vouchers Program (ETV)	CHFS	571,388		
Head Start Cluster:					
93.600	Head Start	EDU	133,637		
93.603	Adoption Incentive Payments	CHFS	764,000		764,000
93.617	Voting Access for Individuals with Disabilities-Grants To States	KBE	164,702		88,912
93.618	Voting Access for Individuals with Disabilities-Grants for Protection and Advocacy Systems	PUBAD	41,403		
93.630	Developmental Disabilities Basic Support and Advocacy Grants	CHFS PUBAD	2,060,800 547,055		791,912
93.643	Children's Justice Grants to States	CHFS AOC OAG	150,179 82,175 55,000		
93.645	Child Welfare Services-State Grants	CHFS	4,212,770		
93.647	Social Services Research and Demonstration (Note 15)	CHFS			
93.652	Adoption Opportunities	CHFS	418,441		415,965
93.658	Foster Care-Title IV-E (Note 2)	CHFS JUV AOC	41,896,044 2,796,202 293,616		2,698,355
93.658	ARRA-Foster Care-Title IV-E (Note 2) (Note 14)	CHFS	2,432,663		
93.659	Adoption Assistance (Note 2)	CHFS	38,532,212		
93.659	ARRA-Adoption Assistance (Note 2) (Note 14)	CHFS	3,320,988		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
U.S. Department of Health and Human Services (Continued)					
Direct Programs (Continued):					
93.667	Social Services Block Grant (Note 15)	CHFS	23,534,845		56,388
		JUV	5,624,386		
		FAC			
93.667	ARRA-Social Services Block Grant (Note 14)	CHFS	20,092		
93.669	Child Abuse and Neglect State Grants	CHFS	342,869		267,433
93.671	Family Violence Prevention and Services/Grants for Battered Women's Shelters-Grants to State and Indian Tribes	CHFS	1,137,773		1,129,375
93.674	Chafee Foster Care Independence Program	CHFS	1,930,830		1,172,458
93.717	ARRA-Preventing Healthcare-Associated Infections (Note 14)	CHFS	43,897		40,626
93.719	ARRA- State Grants to Promote Health Information Technology (Note 14)	CHFS	35,356		
93.720	ARRA-Survey and Certification Ambulatory Surgical Center Healthcare-Associated Infection (ASC-HAI) Prevention Initiative (Note 14)	CHFS	14,495		
93.725	ARRA-Communities Putting Prevention to Work: Chronic Disease Self-Management Program (Note 14)	CHFS	2,019		
93.723	ARRA-Prevention and Wellness-State, Territories and Pacific Islands (Note 14)	CHFS	5,062		
93.767	Children's Health Insurance Program (Note 2)	CHFS	123,192,943		158,684
Medicaid Cluster:					
93.775	State Medicaid Fraud Control Units (Note 2)	OAG	2,090,299		
93.777	State Survey and Certification of Health Care Providers and Suppliers (Note 2)	CHFS	5,784,172		
93.778	Medical Assistance Program (Note 2)	CHFS	4,087,341,324		2,659,913
93.778	ARRA-Medical Assistance Program (Note 2)(Note 14)	CHFS	505,415,419		
93.779	Centers for Medicare and Medicaid Services (CMS) Research, Demonstrations and Evaluations	CHFS	1,987,592		1,032,135
93.780	Grants to States for Qualified High-Risk Pools (Note 15)	PPC			
93.793	Medicaid Transformation Grants	CHFS	329,458		
93.889	National Bioterrorism Hospital Preparedness Program	CHFS	6,518,012		5,720,213
		MIL	137,777		
93.917	HIV Care Formula Grants	CHFS	7,357,481		3,180,193
93.938	Cooperative Agreements to Support Comprehensive School Health Programs to Prevent the Spread of HIV and Other Important Health Problems	EDU	636,840		176,653
		CHFS	129,295		29,358
93.940	HIV Prevention Activities - Health Department Based	CHFS	1,825,271		1,367,123
93.941	HIV Demonstration, Research, Public and Professional Education Projects	CHFS	221,211		68,221
93.944	Human Immunodeficiency Virus (HIV)/Acquired Immunodeficiency Virus Syndrome (AIDS) Surveillance (Note 15)	CHFS			
93.945	Assistance Programs for Chronic Disease Prevention and Control	CHFS	415,712		331,431
93.958	Block Grants for Community Mental Health Services	CHFS	5,359,628		4,951,716
		DWI	75,000		
		CORR	45,500		
93.959	Block Grants for Prevention and Treatment of Substance Abuse (Note 15)	CHFS	20,027,580		19,631,262
		KSP	43,786		
		JUST			
93.977	Preventive Health Services - Sexually Transmitted Diseases Control Grants (Note 11)	CHFS	649,035	234,247	43,384
93.988	Cooperative Agreements for State-Based Diabetes Control Programs and Evaluation of Surveillance Systems	CHFS	83		
93.991	Preventive Health and Health Services Block Grant	CHFS	1,122,889		849,976
93.994	Maternal and Child Health Services Block Grant to the States	CHFS	9,814,383		7,309,777
93.NA(1)	Other Federal Assistance	CHFS	244,284		
Total U.S. Department of Health and Human Services			\$ 5,420,042,771	\$ 47,221,833	\$ 276,114,761
U.S. Corporation for National and Community Service					
Direct Programs:					
94.003	State Commissions	CHFS	\$ 195,259	\$	\$
94.004	Learn and Serve America-School and Community Based Programs	EDU	245,103		230,020

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U.S. Corporation for National and Community Service (Continued)</u>					
Direct Programs (Continued):					
94.006	AmeriCorps	CHFS	3,184,001		2,991,293
		CORR	47,019		
94.006	ARRA-AmeriCorps (Note 14)	CHFS	622,810		609,414
94.007	Program Development and Innovation Grants	CHFS	67,505		
94.009	Training and Technical Assistance	CHFS	90,870		
Foster Grandparents/Senior Companion Cluster:					
94.011	Foster Grandparent Program	CHFS	557,077		9,000
94.NA(1)	Clinical Laboratory Improvement Act (Note 15)	CHFS			
Total U.S. Corporation for National and Community Service			\$ 5,009,644	\$ 0	\$ 3,839,727
<u>U.S. Office of National Drug Control Policy</u>					
Direct Program:					
95.001	High Intensity Drug Trafficking Areas Program	KSP	\$ 997,033	\$	\$
Total U.S. Office of National Drug Control Policy			\$ 997,033	\$ 0	\$ 0
<u>U.S. Social Security Administration</u>					
Direct Programs:					
Disability Insurance/Supplemental Security Income Cluster:					
96.001	Social Security-Disability Insurance (Note 2)	CHFS	\$ 45,931,639	\$	\$
96.009	Social Security State Grants for Work Incentives Assistance to Disabled Beneficiaries	PUBAD	34,044		
Total U.S. Social Security Administration			\$ 45,965,683	\$ 0	\$ 0
<u>U. S. Department of Homeland Security</u>					
Direct Programs:					
Homeland Security Cluster:					
97.004	Homeland Security Grant Program (Note 15)	KOHS	\$	\$	\$
		DCJT			
		MIL			
		KSP			
		EPPC			
97.067	Homeland Security Grant Program (Note 15)	KOHS	12,269,603		11,068,374
		DCJT			
		TC	14,577		
		F&W	8,663		
		KSP	6,668		
		MIL			
		KVE			
		COT			
		AGR			
		JUST			
		EPPC			
97.001	Pilot Demonstration or Earmarked Projects	KOHS	204,072		202,462
97.012	Boating Safety Financial Assistance	F&W	1,334,018		
97.017	Pre-Disaster Mitigation (PDM) Competitive Grants	MIL	750,288		750,288
97.023	Community Assistance Program State Support Services Element (CAP-SSSE) (Note 4)	EEC	133,777		
97.029	Flood Mitigation Assistance (Note 15)	MIL	946,860		946,860
		TC			
97.032	Crisis Counseling	MIL	36,630		
97.036	Disaster Grants-Public Assistance (Presidentially Declared Disasters) (Note 2)	MIL	186,532,761		178,409,197
		TC	15,881,929		
		PARKS	265,662		
		KSP	234,924		

See accompanying Notes to the Schedule of Expenditures of Federal Awards

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

CFDA	Program Title	State Agency	Expenditures		Provided to Subrecipient
			Cash	Noncash	
<u>U. S. Department of Homeland Security (Continued)</u>					
Direct Programs (Continued):					
97.039	Hazardous Mitigation Grant	MIL	681,925		461,440
97.040	Chemical Stockpile Emergency Preparedness Program (Note 15)	MIL	14,480,920		12,956,528
		CHFS			
97.041	National Dam Safety Program	EEC	46,100		
97.042	Emergency Management Performance Grants (Note 15)	MIL	4,611,537		2,990,573
		KOHS			
97.045	Cooperating Technical Partners	EEC	3,734,265		
97.047	Pre Disaster Mitigation	MIL	1,056,120		893,374
97.056	Port Security Grant Program	F&W	1,223		
97.070	Map Modernization Management Support	EEC	113,816		
97.076	National Center for Missing and Exploited Children (NCMEC) (Note 19)	KSP			
97.077	Homeland Security Research Testing, Evaluation, and Demonstration of Technologies Related to Nuclear Detection	TC	79,587		
97.078	Buffer Zone Protection Program (BZPP)	KOHS	269,804		240,692
		F&W	312,661		
		KSP	91,825		
97.082	Earthquake Consortium	MIL	24,324		
97.089	Driver's License Security Grant Program	TC	1,493,242		
97.116	ARRA-Port Security Grant Program (ARRA) (Note 14) (Note15)	KSP			
Total U.S. Department of Homeland Security			\$ 245,617,781	\$ 0	\$ 208,919,788
<u>Other Federal Assistance</u>					
Direct Programs:					
NA(1)	Tennessee Vally Authority (Note 15)	F&W	\$	\$	\$
Total Other Federal Assistance			\$ 0	\$ 0	\$ 0
Total All State Agencies			\$ 10,401,012,066	\$ 1,245,313,065	\$ 1,664,661,491

See accompanying Notes to the Schedule of Expenditures of Federal Awards

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010

Note 1 - Purpose of the Schedule and Significant Accounting Policies

Basis of Presentation - OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, requires a Schedule of Expenditures of Federal Awards showing each federal financial assistance program as identified in the *Catalog of Federal Domestic Assistance*. The accompanying schedule includes all federal grant activity for the Commonwealth, except those programs administered by state universities and other discretely presented component units, and is presented primarily on the basis of cash disbursements as modified by the application of Kentucky Revised Statute (KRS) 45.229. Consequently, certain expenditures are recorded in the accounts only when cash is disbursed. The Commonwealth elected to exclude state universities and other discretely presented component units from the statewide single audit, except as part of the audit of the basic financial statements.

KRS 45.229 provides that the Finance and Administration Cabinet may, “for a period of thirty (30) days after the close of any fiscal year, draw warrants against the available balances of appropriations made for that fiscal year, for the payment of expenditures incurred during that year or in fulfillment of contracts properly made during the year, but for no other purpose.” However, there is an exception to the application of KRS 45.229 in that regular payroll expenses incurred during the last pay period of the fiscal year are charged to the next year.

The basic financial statements of the Commonwealth are presented on the modified accrual basis of accounting for the governmental fund financial statements and the accrual basis of accounting for the government-wide, proprietary fund, and fiduciary fund financial statements. Therefore, the schedule may not be directly traceable to the basic financial statements in all cases.

Noncash assistance programs are not reported in the basic financial statements of the Commonwealth for FY 2010. The noncash expenditures presented on this schedule represent the noncash assistance expended using the method or basis of valuation described in Note 11.

Clusters of programs are indicated in the schedule by light gray shading.

Programs that do not have CFDA numbers are identified using the two-digit federal identifier prefix, and the letters “NA” to denote that no specific number is applicable. Each program is numbered in parentheses, following the NA for each federal grantor.

The state agencies’ schedule is presented on the cash, modified cash, or accrual basis of accounting.

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Note 1 - Purpose of the Schedule and Significant Accounting Policies (Continued)

Inter-Agency Activity - Certain transactions relating to federal financial assistance may appear in the records of more than one (1) state agency. To avoid the overstatement of federal expenditures, the following policies were adopted for the presentation of the schedule:

- (a) Federal funds may be received by a state agency and passed through to another state agency where the moneys are expended. Except for pass-throughs to state universities and discretely presented component units as discussed below, this inter-agency transfer activity is reported by the agency expending the moneys.

State agencies that pass federal funds to state universities and discretely presented component units report those amounts as expenditures.

- (b) Federal funds received by a state agency and used to purchase goods or services from another state agency are reported in the schedule as an expenditure by the purchasing agency only.

Note 2 - Type A Programs

Type A programs for the Commonwealth mean any program for which total expenditures of federal awards exceeded \$34.9 million for FY 2010. The Commonwealth had the following programs (cash and noncash) that met the Type A program definition for FY 10, some of which were administered by more than one (1) state agency. Certain component units and agencies audited by certified public accounting firms had lower dollar thresholds. The Commonwealth identified clusters among the Type A programs by gray shading. Programs with both ARRA and non-ARRA funding sharing the same CFDA number and not included as part of a cluster are presented as a combined amount, in this note and denoted with an asterisk (*). These Type A programs and clusters were:

CFDA	Program Title	Expenditures
Supplemental Nutrition Assistance Program Cluster:		
10.551	Supplemental Nutrition Assistance Program	\$ 1,164,591,491
10.561	State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	43,123,864
10.561	ARRA-State Administrative Matching Grants for the Supplemental Nutrition Assistance Program	5,313,750
Child Nutrition Cluster:		
10.553	School Breakfast Program	59,680,885
10.555	National School Lunch Program	186,968,235
10.556	Special Milk Program for Children	82,376
10.559	Summer Food Service Program for Children	7,269,789
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children	125,228,544

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Note 2 - Type A Programs (Continued)

CFDA	Program Title	Expenditures
Community Development Block Grant-State-Administered Small Cities Program		
Cluster:		
14.228	Community Development Block Grants/States Programs and Non-Entitlement Grants in Hawaii	40,116,857
14.255	ARRA-Community Development Block Grants/States Programs and Non-Entitlement Grants in Hawaii	1,567,844
17.225	Unemployment Insurance	921,020,873
17.225	ARRA-Unemployment Insurance	1,075,269,000
Workforce Investment Act Cluster:		
17.258	WIA Adult Program	14,008,723
17.258	ARRA-WIA Adult Program	5,882,719
17.259	WIA Youth Activities	16,038,806
17.259	ARRA-WIA Youth Activities	12,001,715
17.260	WIA Dislocated Workers	28,878,846
17.260	ARRA-WIA Dislocated Workers	10,168,716
Highway Planning and Construction Cluster:		
20.205	Highway Planning and Construction	522,339,327
20.205	ARRA-Highway Planning and Construction	185,458,469
20.219	Recreational Trails Program	743,311
Title I, Part A Cluster:		
84.010	Title I Grants to Local Educational Agencies	226,055,723
84.389	ARRA-Title I ARRA Grants to Local Education Agencies, Recovery Act	82,194,502
Special Education Cluster:		
84.027	Special Education - Grants to States	151,805,010
84.173	Special Education - Preschool Grants	9,752,321
84.391	ARRA-Special Education - Grants to States	81,325,320
84.392	ARRA-Special Education - Preschool Grants	4,370,843
Vocational Rehabilitation Services Cluster:		
84.126	Rehabilitation Services - Vocational Rehabilitation Grants to States	48,441,534
84.390	ARRA-Rehabilitation Services - Vocational Rehabilitation Grants to States, Recovery Act	2,738,478

COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)

Note 2 - Type A Programs (Continued)

CFDA	Program Title	Expenditures
84.367	Improving Teacher Quality State Grants	45,465,656
State Fiscal Stabilization Fund Cluster:		
84.394	ARRA-State Fiscal Stabilization Fund (SFSF)- Education State Grants, Recovery Act	293,038,700
84.397	ARRA-State Fiscal Stabilization Fund (SFSF)- Government Services, Recovery Act	90,199,300
Immunization Cluster:		
93.268	Immunization Grants	37,976,784
93.712	ARRA-Immunization	1,649,821
Temporary Assistance for Needy Families Cluster:		
93.558	Temporary Assistance for Needy Families	147,928,175
93.714	ARRA-Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program	3,825,203
93.563*	Child Support Enforcement	44,535,389
93.568	Low-Income Home Energy Assistance	66,792,655
Child Care Cluster:		
93.575	Child Care and Development Block Grant	85,131,885
93.596	Child Care Mandatory and Matching Funds of the Child Care and Development Fund	24,564,662
93.713	ARRA- Child Care and Development Block Grant	32,260,858
93.658*	Foster Care-Title IV-E	47,418,525
93.659*	Adoption Assistance	41,853,200
93.767	Children's Health Insurance Program	123,192,943

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Note 2 - Type A Programs (Continued)

CFDA	Program Title	Expenditures
Medicaid Cluster:		
93.775	State Medicaid Fraud Control Units	2,090,299
93.777	State Survey and Certification of Health Care Providers and Suppliers	5,784,172
93.778	Medical Assistance Program	4,087,341,324
93.778	ARRA-Medical Assistance Program	505,415,419
Disability Insurance/Supplemental Security Income Cluster:		
96.001	Social Security - Disability Insurance	45,931,639
97.036	Disaster Grants-Public Assistance (Presidentially Declared Disasters)	202,915,276
	Total Type A Programs	\$ 10,967,749,756

Note 3 - Rural Rehabilitation Student Loan Program (CFDA 10.NA (1))

The Kentucky Rural Rehabilitation Student Loan Program was initially awarded \$672,629 in 1970 by the U. S. Farmers Home Administration. Since 1970, the program has operated on interest from student loans outstanding and on income from investments administered by the Office of Financial Management. The Department of Agriculture is no longer in the business of making student loans and reassigned all loans in payment compliance to the Kentucky Higher Education Assistance Authority (KHEAA). The Department of Agriculture retained only those loans that had a delinquent payment history. This program is currently in phase-out status, with authorization from the U. S. Department of Agriculture (USDA) to eliminate the principal through issuance of specific grants and scholarships. Most outstanding loans have been classified as contingent uncollectible liabilities; however, if loan payments are received, they are directly deposited into the principal account. The total amount of money in the investment account as of June 30, 2010 was \$92,251. Student loans and investment earned interest of \$6,072. Outstanding student loans totaled \$64,466. The total grants and scholarships authorized by the USDA in FY 10 totaled \$145,426.

Note 4 - Unemployment Insurance (CFDA 17.225)

The Commonwealth paid out \$1,955,285,075 in benefits in FY 2010. The amounts shown on the accompanying schedule reflect both the amount expended for benefits from the Trust Fund and an additional \$41,004,798 of federal funds expended for administration of the program, resulting in a combined total of \$1,996,289,873 in federal expenditures. Included in this amount is \$1,075,269,000 in benefit payments funded by the American Recovery and Reinvestment Act (ARRA).

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Note 5 - Highway Planning and Construction (CFDA 20.205)

The information reported for CFDA 20.205 Highway Planning and Construction program represents the activity of all open projects during FY 2010. These projects were funded from several apportionments. Apportionments refer to a federal, statutorily prescribed division or assignment of funds. The expenditures reflected on the schedule include expenditures for advance construction projects, which are not yet under agreements with the Federal Highway Administration.

Program Income - The Highway Planning and Construction Program earned program income of \$17,551,409 in FY 2010. This income is comprised of program income (interest) attributable to the Garvee Bonds.

Refunds - Expenditures for the Highway Planning and Construction Program were shown net of any refunds, resulting from a reimbursement of prior or current year expenditures. Refunds totaled \$2,386,468 for FY 2010.

Note 6 - Outdoor Recreation - Acquisition, Development and Planning (CFDA 15.916) and Recreational Trails Program (CFDA 20.219)

Administrative costs are shown as expended when received from the federal government. These costs are recovered through a negotiated, fixed indirect cost rate. Any over or under recovery will be recouped in the future.

Note 7 - Research and Development Expenditures

OMB Circular A-133 Section 105 states, "Research and development (R&D) means all research activities, both basic and applied, and all development activities that are performed by a non-federal entity."

The expenditures presented in the SEFA include R&D expenditures. The R&D portion of the expenditures for each program is listed below.

CFDA	Program Title	State Agency	Expenditures
10.025	Plant and Animal Disease, Pest Control, and Animal Care	F&W	\$ 40,539
10.028	Wildlife Services	F&W	15,806
15.605	Sport Fish Restoration	F&W	389,670
15.615	Cooperative Endangered Species Conservation Fund	F&W	109,667
15.634	State Wildlife Grants	F&W	1,019,270
16.745	Criminal and Juvenile Justice and Mental Health Collaboration Program	AOC	16,874
93.243	Substance Abuse and Mental Health Services-Projects of Regional and National Significance	AOC	221,826
93.586	State Court Improvement Program	AOC	29,516
Total Research and Development Expenditures			\$ 1,843,168

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Note 8 - Community Development Block Grants/State's Program and Non-Entitlement Grants in Hawaii (CFDA 14.228)

The Commonwealth matches the federal portion of administration dollar for dollar. Cash expenditures include the federal portion of administration.

Note 9 - Wildlife Restoration (CFDA 15.611)

The Department of Fish and Wildlife Resources leases properties from the U.S. Army Corp of Engineers for Condition Three and Condition Five Projects. These projects stipulate that the properties leased be managed for wildlife purposes and may produce income. The leases for wildlife management rights on these properties are non-monetary. The Department of Fish and Wildlife Resources currently leases the following properties:

- Barren River
- Green River
- Dewey Lake
- Fishtrap Lake
- Barlow Bottoms-Olmstead
- Birdsville Island
- Lake Cumberland
- Paintsville Lake
- Sloughs-Grassy Pond

Any expenditure in excess of revenue from each property listed above will be eligible for reimbursement under the Wildlife Restoration (CFDA 15.611) grant from the U.S. Department of the Interior. The properties listed above are not reimbursed with federal funds if the grant has already been expended to manage other wildlife properties.

Note 10 - Pass Through Programs

OMB Circular A-133 Section 105 defines a recipient as "a non-Federal entity that expends Federal awards received directly from a Federal awarding agency to carry out a Federal program" and a pass-through entity as "a non-Federal entity that provides a Federal award to a subrecipient to carry out a Federal program."

Federal program funds can be received directly from the federal government or passed through from another entity. Below is a list of all federal programs that are either (1) passed through, or (2) both direct and passed through.

Received From	Direct/Pass Through (Grantor)	State Agency	Amount
<u>Fund for the Improvement of Education (CFDA 84.215)</u>			
Powell County Board of Education	Pass Through (Various)	KHS	\$ 213,855
Total Fund for the Improvement of Education			\$ 213,855

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Note 11 - Noncash Expenditure Programs

The Commonwealth's noncash programs and a description of the method/basis of valuation follows:

CFDA	Program Title	Amount	Method/Basis of Valuation
10.551	Supplemental Nutrition Assistance Program	\$ 1,164,591,491	EBT Issuance.
10.555	National School Lunch Program	20,296,803	Commodities issued for FY 2010 per ECOS report.
10.565	Commodity Supplemental Food Program	3,254,679	Quantity issued to recipients valued using May 2010 Commodity File.
10.569	Emergency Food Assistance Program (Food Commodities)	8,983,247	Quantity issued to recipients valued using FY2010 ECOS Report.
10.664	Cooperative Forestry Assistance	47,799	Acquisition Cost as indicated by Government Services Administration (GSA).
12.700	Donations/Loans of Obsolete DOD Property	267,437	Depreciated value.
15.250	Regulation of Surface Coal Mining and Surface Effects of Underground Coal Mining	26,193	Inventory of Controlled Property.
15.657	Endangered Species Recovery Program	3,276	Invoice Copy.
39.003	Donation of Federal Surplus Personal Property	478,254	23.3% of federal acquisition cost (\$2,052,593).
66.034	Surveys, Studies, Investigations, Demonstrations and Special Purpose Activities Relating to the Clean Air Act	142,053	EPA contracts with Research Triangle Institute for sample analysis.
93.069	Public Health Emergency Preparedness	10,444,736	Grant Award Document.

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Note 11 - Noncash Expenditure Programs (Continued)

CFDA	Program Title	Amount	Method/Basis of Valuation
93.116	Project Grants and Cooperative Agreements for Tuberculosis Control Programs	79,796	Grant Award Document.
93.268	Immunization Grants	34,912,487	Grant Award Document.
93.712	ARRA-Immunization Grants	1,550,567	
93.977	Preventive Health Services-Sexually Transmitted Diseases Control Grants	234,247	Grant Award Document.
	Total Noncash Expenditures	\$ 1,245,313,065	

Note 12 - Activity Occurring in Programs with Inventoriable Items

The Department of Agriculture operates a statewide Commodity Supplemental Food Program (CFDA 10.565). The dollar value of the inventory, based on the 2010 USDA Commodity File is as follows:

Commodity Supplemental Food Program CFDA 10.565

Beginning Inventory, July 1, 2009	\$ 861,864
Price Adjustments	114,742
Adjusted Inventory, July 1, 2009	976,606
Received Commodities	3,748,769
Issued to Recipients	(3,254,679)
Net Value of Inventory Adjustments, June 30, 2010	3,064
Ending Inventory, June 30, 2010	\$ 1,473,760

Note 13 - Election Reform Payments (CFDA 39.011)

Interest earned must be used for additional program expenditures.

Note 14 - Pertaining to ARRA Designation

In order to identify ARRA funds on the Schedule of Expenditures of Federal Awards, the ARRA- prefix will precede the Program Title on the Grantor Schedule.

**COMMONWEALTH OF KENTUCKY
NOTES TO THE SCHEDULE OF EXPENDITURES OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Note 15 - Zero Expenditure Programs

These programs had no expenditures related to the respective state agency during FY 10. The zero expenditure programs included programs with no activity during the year, such as old programs not officially closed out or new programs issued late in the fiscal year. They also included programs with activity other than expenditures. For CFDA numbers with multiple state agencies listed, the schedule is presented in descending expenditure amount order.

Note 16 - Supplemental Nutrition Assistance Program and ARRA (CFDA 10.551)

The reported expenditures for benefits under the Supplemental Nutrition Assistance Program (SNAP) (CFDA 10.551) are supported by both regularly appropriated funds and incremental funding made available under section 101 of the American Recovery and Reinvestment Act of 2009. The portion of total expenditures for SNAP benefits that is supported by Recovery Act funds varies according to fluctuations in the cost of the Thrifty Food Plan, and to changes in participating households' income, deductions, and assets. This condition prevents USDA from obtaining the regular and Recovery Act components of SNAP benefits expenditures through normal program reporting processes. As an alternative, USDA has computed a weighted average percentage to be applied to the national aggregate SNAP benefits provided to households in order to allocate an appropriate portion thereof to Recovery Act funds. This methodology generates valid results at the national aggregate level but not at the individual State level. Therefore, we cannot validly disaggregate the regular and Recovery Act components of our reported expenditures for SNAP benefits. At the national aggregate level, however, Recovery Act funds account for approximately 15 percent of USDA's total expenditures for SNAP benefits in the Federal fiscal year ended September 30, 2009.

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**REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING
AND ON COMPLIANCE AND OTHER MATTERS BASED ON
AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH
*GOVERNMENT AUDITING STANDARDS***



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

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

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

We have audited the governmental activities, the business-type activities, the aggregate discretely presented component units, each major fund and the aggregate remaining fund information of the Commonwealth of Kentucky as of and for the year ended June 30, 2010, and have issued our report thereon dated December 17, 2010. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

Our consideration of internal control over financial reporting was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as described in the accompanying schedule of financial statement findings we identified certain deficiencies in internal control over financial reporting that we consider to be material weakness and other deficiencies that we consider to be significant deficiencies.

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. We consider the deficiency described in the accompanying schedule of financial statement findings to be a material weakness, which is identified as finding 10-KST-1.

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.



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
(Continued)

We consider the deficiencies described in the accompanying schedule of financial statement findings to be significant deficiencies, which are identified as findings; 10-KST-1, 10-CHFS-2, 10-CHFS-3, 10-CHFS-4, 10-CHFS-5, 10-CHFS-6, 10-CHFS-7, 10-DOC-8, 10-DOC-9, 10-DOC-10, 10-DOC-11, 10-DOC-12, 10-DOC-13, 10-DOC-14, 10-DWI-15, 10-DWI-16, 10-DWI-17, 10-DWI-18, 10-DWI-19, 10-FAC-20, 10-FAC-21, 10-FAC-22, 10-FAC-23, 10-FAC-24, 10-FAC-25, 10-KDE-26, 10-KDE-27, 10-KDE-28, 10-KDE-29, 10-KDE-30, 10-KDE-31, 10-KDE-32, 10-KDE-33, 10-KDE-34, 10-KHP-35, 10-KHP-36, 10-KSP-37, 10-KST-38, 10-KST-39, 10-KST-40, 10-KST-41, 10-KST-42, 10-KST-43, 10-KST-44, 10-KST-45, 10-PARKS-46, 10-PARKS-47, 10-PC-48, 10-PC-49, 10-REV-50, 10-TC-51, 10-TC-52, and 10-TC-53.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Commonwealth's financial statement for the year ended June 30, 2010, is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Management's response to the findings identified in our audit is described in the accompanying comments and recommendations. We did not audit management's response and, accordingly, we express no opinion on it.

We noted certain matters that we reported to management in separate letters.

This report is intended solely for the information and use of management, of the Commonwealth of Kentucky, others within the entity, and the General Assembly and is not intended to be and should not be used by anyone other than these specified parties.

Respectfully submitted,



Crit Luallen

Auditor of Public Accounts

December 17, 2010

FINANCIAL STATEMENT FINDINGS

FINANCIAL STATEMENT FINDINGS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-1: The Kentucky State Treasury Should Reconcile The Commonwealth's Bank Accounts To eMARS In A Timely Manner

Historically, the Kentucky State Treasury has performed a reconciliation of the Commonwealth's bank accounts to the accounting system on a daily and monthly basis. Largely due to the implementation of a new financial accounting system, eMARS, Treasury had been unable to reconcile bank accounts to the accounting system in a timely manner for FY 07, FY 08 and FY 09. Treasury has worked with the Finance and Administration Cabinet to develop new reconciliation procedures and to create a more efficient and effective process. However, these problems persisted into FY 10 and as of June 30, 2010, the most recent reconciliation completed was for May 2009.

Although Treasury has made progress in FY 10 the reconciliation process is still behind. The reconciliation process had to be modified due to the implementation of the eMARS accounting system, and new, customized reports had to be developed, which are time-consuming processes and contributed to the delay in reconciliations.

Bank accounts that are not reconciled could result in oversights, errors, and miscalculations that misstate account balances for financial reporting purposes. Given the volume and the size of receipts and disbursements processed by Treasury, these reconciling items could potentially materially misstate the cash and other account balances reported in the CAFR.

Good internal controls dictate that bank accounts be reconciled in a timely manner. Daily reconciliations should be performed within a few days of the actual occurrence and monthly account reconciliations should be performed within a few weeks after the necessary system reports are run at the end of the month.

Recommendation

Treasury should continue to take appropriate steps to ensure monthly bank reconciliations are performed timely. We understand the Commonwealth's change in financial accounting systems was beyond Treasury's control and that this has made the reconciliation process more difficult. However, every effort should be made between Treasury and the Finance and Administration Cabinet (FAC) to complete the FY 10 reconciliations as soon as possible. Going forward, as future accounting system changes occur, we recommend FAC and Treasury address the impact of those changes on Treasury processes as early in the implementation as possible to avoid significant and prolonged gaps in internal controls.

Management's Response and Corrective Action Plan

The Treasury Department is very pleased that the Auditor acknowledges that the reconciliation backlog was beyond the Treasury's Control. The eMARS accounting system, when implemented by the Finance Cabinet, did not have a workable bank reconciliation system. In recent months the Treasury Department has created a reconciliation system, worked to identify and correct data weaknesses in eMARS, and cut the reconciliation backlog by two-thirds. Because of the diligence and determination of current Treasury Department staff, the accounts should be totally balanced within this fiscal year.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-2: The Cabinet For Health And Family Services Should Develop Procedures To Ensure Accuracy And Completeness Of Non-Cash Expenditures Reported In The SEFA

The Cabinet for Health and Family Services (CHFS) does not have a reliable system in place for ensuring that accurate and complete financial information is reported for the Immunizations Grants and ARRA-Immunization programs (CFDA 93.268 and 93.712) on the Schedule of Expenditures of Federal Awards - Non-Cash Programs. During our audit of the SEFA, we identified the following problems with the SEFA 3 report:

- The initial non-cash expenditures of \$40,552,567 reported to the Finance and Administration Cabinet (FAC) on the SEFA 3 for the Immunization Grants program (CFDA 93.268) was an estimate and not based on the actual Immunizations supplied to Kentucky, during state fiscal year 2010. OMB Circular A-133 requires states to report the actual value of the immunizations used by the state during the period under audit. CHFS provided the auditor with a “replenishment report” from the Centers for Disease Control that showed actual non-cash expenditures of \$34,912,487 after a verbal audit finding was issued. Had the original estimate been used, the program’s non-cash expenditures would have been misstated by \$5,640,080. CHFS should not be using an estimate when the actual expenditures are available.
- CHFS did not report non-cash ARRA expenditures of \$1,550,567 for the ARRA-Immunizations program (CFDA 93.712) on the initial SEFA 3 schedule that was submitted to the Finance and Administration Cabinet (FAC). And, the initial documentation that was provided to the Auditor as support for the non-cash expenditures reported on the SEFA 3 schedule did not include the non-cash ARRA expenditures for the ARRA-Immunization program. Federal guidelines specify that all ARRA expenditures should be separately accounted for and disclosed on the SEFA.

CHFS lacks adequate controls to ensure the accuracy and completeness of the information that is reported in the SEFA 3 for the Immunizations programs. The likely cause is a lack of written procedures for requesting information from the various departments overseeing the Immunizations programs.

CHFS is not complying with Federal requirements in using an estimate when the actual expenditures are available and by not separately reporting the ARRA non-cash expenditures in the SEFA 3.

OMB Circular A-133 Audits states:

7.22 - The Special Tests and Provisions section of the 2010 *OMB Circular A-133, Compliance Supplement (Compliance Supplement)*‡ (Part 3, Section N) and appendix 7, “Other Circular A-133 Advisories,” describe the compliance requirements for separate accountability of Recovery Act funding Recipients of Recovery Act awards agree (as a condition of accepting the award) to maintain records that identify adequately the source and application of Recovery Act awards. In addition, recipients agree to identify the expenditure of Recovery Act awards separately on the SEFA and the data collection form....

§____.205 - Basis for determining Federal awards expended.

(a) Determining Federal awards expended. The determination of when an award is expended should be based on when the activity related to the award occurs.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-2: The Cabinet For Health And Family Services Should Develop Procedures To Ensure Accuracy And Completeness Of Non-Cash Expenditures Reported In The SEFA (Continued)

Additionally, page 3 of the SEFA instructions from FAC states:

On all schedules indicate on the schedule if the information on that schedule is from an ARRA award (i.e. on schedule 6 if there is ARRA funds going to a sub-recipient note on the schedule that this pertains to ARRA funds). Also when there is a CFDA that has both regular and ARRA funds you must identify the regular and ARRA funds separately.

Recommendation

We recommend CHFS develop procedures to ensure accurate accounting and reporting of Immunizations Grants and ARRA-Immunizations program non-cash expenditures in the SEFA. For the non-cash expenditures, the Division of General Accounting personnel who prepare the agency's SEFA should ask for supporting documentation to confirm the non-cash expenditures that are reported in the SEFA.

Management's Response and Corrective Action Plan

In response to the findings during the audit of the SEFA 3 Schedule, the Kentucky Immunization Program (KIP) as a part of the Infectious Disease Branch of the Division of Epidemiology and Health Planning, Department for Public Health, has developed the following written procedures for ensuring the accuracy and completeness of non-cash expenditures reported in the SEFA 3.

An estimate of non-cash expenditures for CFDA 93.268 will not continue to be part of the process of calculating these totals in the future. KIP receives quarterly notices of award for the vaccine budget, which is the main source of non-cash expenditures. The Vaccines for Children (VFC) Coordinator manages this budget in conjunction with Centers for Disease Control (CDC) and the Immunization Program Manager. However, as additional funds become available on a federal level, the actual non-cash expenditure of these funds may increase for Kentucky Vaccine Program (KVP) for vaccine purchase. In this case, CDC does not issue an additional notice of award and often times the notice that the program will receive additional non-cash funds for vaccine purchase is done by e-mail. In the future, the report of SEFA 3 non-cash expenditures will include copies of the quarterly notice of awards for the vaccine budget as well as CDC produced monitoring reports of vaccine non-cash expenditure. This will provide a more accurate account of the funds awarded by formal notice of award as well as additional non-cash funds provided.

As an additional note, CDC has plans to place a Public Health Advisor (PHA) in KIP. When this person is placed, the program will have an increase in non-cash expenditures as PHA's are documented in the federal immunization grant as non-cash expenditures.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-3: The Cabinet For Health And Family Services Should Have Controls In Place To Ensure Financial Reports Are Complete And Accurate

During testing of accounts payable, a review of the 2009 Medicaid Benefit Payments was conducted. Upon review of the 2009 Medicaid Benefits Payment, it was determined that the American Recovery and Reinvestment Act (ARRA) funds were not included in the final SFY 09 Medicaid Benefit amount utilized in calculating the accounts payable estimate for FY 10. The Medicaid Benefit amount was understated, causing the percentage of accounts payable for Medicaid to be incorrect.

Reports maintained by agency personnel failed to include ARRA funds for FY 10. This omission of funds caused the accounts payable for FY 10 to be understated. Controls were not in place to ensure that all funds were reported in the closing package, which reports accounts payable to the Finance and Administration Cabinet for reporting in the Commonwealth's Comprehensive Annual Financial Report. The miscalculation of the percentage caused the Medicaid portion of accounts payable estimate to be understated by \$54,652,088, for FY 10.

Good internal controls dictate procedures be in place to ensure that all reports used for financial reporting are complete and accurate. It also requires that personnel be up to date on reporting regulations and requirements, to ensure that all funds are being recorded correctly to limit misstatements.

Recommendation

We recommend CHFS incorporate the following procedures to ensure accurate and complete reporting.

- Require all reporting personnel to be up to date on reporting requirements for all funds.
- Implement procedures to verify that the information is complete and accurate, including agency reports.

Management's Response and Corrective Action Plan

We agree. The accounts payable estimate for FY 2010 has been corrected. DMS staff in the Division of Administration and Financial Management no longer rely solely on the accuracy of the CHFS agency reports in eMARS. Staff now run custom reports and compare the results in order to determine variances and improve accuracy.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-4: The Cabinet For Health And Family Services Hazelwood Facility Should Ensure Invoices Are Paid In A Timely Manner

During our FY 10 audit of the Cabinet for Health and Family Services (CHFS) expenditures, we tested forty invoices at Hazelwood Intermediate Care Facility for timeliness of payment. We noted the following exceptions:

- Two invoices totaling \$870 with two different invoice dates for July 2009 and November 2009 were paid seven and eleven months late.
- One invoice totaling \$395 was paid three days late.
- One invoice totaling \$242 was paid two weeks late.

This continues to be a problem. This is a repeat finding from the FY 09 audit noted in Finding 09-CHFS-2.

Payments are not being processed and paid within the specified thirty (30) working days in accordance with KRS 45.453.

Vendors were not paid in a timely manner. Payments may be assessed a 1% late penalty.

KRS 45.453 states, "All bills shall be paid within thirty (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agent has transmitted a rejection notice to the vendor."

Recommendation

We recommend Hazelwood review and improve the invoice payment process to ensure payments on invoices are made within the prescribed timeframes as set forth in KRS 45.453 and not incur a 1% late penalty as set forth in KRS 45.454.

Management's Response and Corrective Action Plan

The Business Office Staff developed and is implementing new written Accounts Payable processes in order to avoid similar issues in the future. All invoices are date stamped and matched with the correct purchase order. Invoices will be processed immediately if there are no issues with the goods or services procured. Weekly audits of pending invoices by the Business Office Manager are now done to ensure that all invoices are paid within a timely manner or that appropriate follow up actions are taken to resolve any outstanding issues. Executive Staff from each department have been instructed by written memo that no orders shall be placed without prior approval from the Business Office. When orders are placed, vendor information will be secured and verified in the eMARS system to ensure payments are made timely and that multiple vendor names for the same vendor are not being utilized that would create confusion.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-CHFS-4: The Cabinet For Health And Family Services Hazelwood Facility Should Ensure Invoices Are Paid In A Timely Manner (Continued)**

Management's Response and Corrective Action Plan (Continued)

This will help eliminate issues of having to add a vendor to the system after the purchase has already been made. It will also enable the business office to be aware of all purchases that are made within the facility. A new Business Office manager with an accounting degree and a background in health care is being recruited to begin work at the facility January 2011. In the interim, a central office employee from the Division of Administration and Financial Management has been detailed to oversee daily operations of the business office. This individual reports daily to the Department's Director of Administration and Financial Management.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-5: The Cabinet For Health And Family Services Should Provide Additional Guidance And Oversight At The Hazelwood Facility

Testing of expenditure procedures at Hazelwood Intermediate Care Facility identified that the business office lacked proper segregation of duties for expenditures in FY 2010. Auditors tested the Imprest Cash Fund for the facility and determined there were many instances of purchases being made without purchase order requests, supporting documentation for the purchase (receipts), or purchases were made lacking approval from appropriate facility personnel. The auditors also noted the facility lacks segregation of duties over purchases. The business office manager was documented requesting and approving the purchase order documents that were available, as well as one instance of a program director requesting and approving the purchase of tickets to a wrestling event, as referred to in finding 10-CHFS-7. The business manager is also responsible for writing checks and requesting reimbursements for those checks, without anyone else in the office verifying who the check was written to, or that it was processed through the bank.

There is a lack of effective oversight by the Cabinet for Health and Family Services, specifically Behavioral Health, Developmental and Intellectual Disabilities (BHDID). Internal controls at the facility are weak; employees of Hazelwood are able to request checks for events or programs without any type of tracking document for the purchase. When those employees return from the event or program, they are not required to provide any type of supporting documentation, such as travel logs, receipts or employee and patient lists for attendees.

The lack of internal controls allowed \$11,574 in purchases to be made by the Hazelwood Intermediate Care Facility with little to no supporting documentation for purchases from the Imprest Cash Fund Account.

Good internal controls dictate that controls be in place to monitor expenditures being made by the facility and personnel. These controls include monitoring of purchases to ensure they are allowable, reasonable, and follow standard purchasing procedures as outlined by Finance in FAP 111-55-00.

- An agency shall maintain a small purchase order file containing the price quotations requested, quotations received, a tabulation of prices offered, and comments by the agency handling the small purchase concerning the basis for placing the order. The agency shall retain these records for audit and review purposes.

Recommendation

We recommend CHFS implement more stringent internal controls:

- Require purchase orders be signed and approved by appropriate business office personnel for any purchase.
- Require all personnel return receipts, travel logs, personnel and patient logs, as supporting documentation for purchases made.
- Purchase orders with invoices should be maintained in accordance with Finance policy.
- Purchasing personnel should be trained and up to date on Finance requirements for purchases made.
- Provide guidance and oversight at the Hazelwood Intermediate Care Facility.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-CHFS-5: The Cabinet For Health And Family Services Should Provide Additional Guidance And Oversight At The Hazelwood Facility (Continued)**

Management's Response and Corrective Action Plan

The auditors noted that the Business Office did not have proper segregation of duties for expenditures during the FY 2010 year. This was due to short staffing resulting from several extended medical leaves. Accordingly, the Business Office has now put policies in place that will assure proper separation of duties, notwithstanding any employee absences or turnover. The list of duties is in writing and in the process of being incorporated into formal facility policy (after review by governing board).

It was also noted that there were imprest cash purchases made without proper purchase requests and signatures. In order to minimize the opportunity for similar occurrences, the Department is revoking Hazelwood's imprest cash authority and closing the account. While imprest cash will no longer be used, the Hazelwood Business Office is updating purchasing processes and will make written policies available to staff. Purchase requests exceeding \$500 will require sign off by both the Fiscal/Business Office manager and the facility director; with purchases less than \$500 requiring approval of the Fiscal/Business Office manager. A new Business Office manager with an accounting degree and a background in health care is being recruited to begin work January 2011. In the interim, a central office employee from the Division of Administration and Financial Management has been detailed to oversee daily operations of the business office. This individual reports daily to the Department's Director of Administration and Financial Management.

All recommendations by the auditor's office are being incorporated into current practice including requiring receipts, travel logs, personnel and patient logs as supporting documentation. Practices will be in writing and will be consistent with the Finance and Administration Cabinet's FAP's and any other requirements. Updates to procedures will be presented to the Facility Director by December 15, 2010. The Facility Director will review and forward them to the Commissioner for the Department's review with an anticipated effective date of January 1, 2011. This will ensure future transactions have necessary documentation and approvals.

Additionally, the Cabinet's Division of Procurement Services is scheduling on-site Procurement training for staff. Anticipated completion of the on-site training is not later than January 31, 2011.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-6: The Cabinet For Health And Family Services Should Improve Policies And Procedures Over Its Imprest Cash Accounts

In testing expenditures of the Hazelwood Intermediate Care Facility, we reviewed the Imprest Cash Account utilized by the facility. Review of this account revealed that bank reconciliations were not being performed by the business office in a timely manner. During the audit the following problems were noted:

- Eleven months (July, August, September, October, November, December, January, February, March, April, and May) had reconciliations that were not performed until September 2010. June's reconciliation was not available to auditors for review.
- One instance of conflicting dates noted on reconciliation supplied to the auditors. The date on the first page of the reconciliation was dated eleven (11) months prior to the actual month end of the account.
- Reconciliations were being signed off as complete, but were missing supporting documentation marked as reviewed per the Imprest Cash Internal Audit checklist (such as purchase orders, receipts, manager approvals)
- One instances of missing reconciliations, and associated account information.
- Two instances in which the Imprest Cash Fund Account was overdrawn. Auditors noted that NSF fees were being paid from the account in the amount of \$60.
- Reimbursements to the facility for expenses paid from the Imprest Cash Account ceased in December 2009. Claims are not being submitted to CHFS.
- Based upon review of available reconciliations, there were twenty eight (28) instances of checks being voided after reimbursement, reimbursed twice, or requesting reimbursement for wrong amount.

There is a lack of effective oversight by the Cabinet for Health and Family Services, specifically Behavioral Health, Developmental and Intellectual Disabilities (BHDID). Business office personnel of Hazelwood Intermediate Care Facility were not performing reconciliations or monthly reimbursements as required. Personnel at the facility informed audit staff that there was a high turnover in staff at the beginning of the fiscal year, causing required business office functions to not be performed in a timely manner.

Monthly bank reconciliations must be performed to ensure that accounts are up to date and that all amounts withdrawn have been accounted for and to verify the accuracy of bank statements and ledger balances. This will ensure that all recorded expenditures are accounted for. Proper reconciliation procedures should also help ensure that the facility is performing requests for reimbursement in a timely manner and not overdrawing the account, thereby avoiding unnecessary NSF charges.

Per the Finance and Administration Cabinet, the following recommendations are made concerning reconciliations of cash accounts:

- Someone independent of the cash receipt process should summarize cash receipts. This summary should be compared to the State Treasury deposits to ensure that all collections are deposited intact. Reconciliation of cash receipts into eMARS against an agency's internal accounting system should also be performed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-6: The Cabinet For Health And Family Services Should Improve Policies And Procedures Over Its Imprest Cash Accounts (Continued)

- Someone independent of the cash receipt function should reconcile the mail log where cash and receipts are initially received, to the daily cash and receipts activity. Subsequently, a comparison of actual currency and coins deposited with actual currency and coins received should be conducted.
- Monies received on prepaid accounts should be reconciled with deposits and posting to the accounting records.

Per FAP 111-56-00 IMPREST CASH FUNDS:

- **PROPER USE OF IMPREST CASH FUNDS:** The preferred methods of payment for all expenses are the state's procurement and accounting systems and the state procurement card. An agency shall use imprest cash funds only if it is impractical or impossible to make payments through one of the preferred methods.
- **HOW TO ESTABLISH IMPREST CASH FUNDS:** (d) The agency custodian shall establish a bank account for the Imprest Cash Fund at the Commonwealth's depository bank and order checks. The custodian shall write checks to make payments authorized by the authority and prepare an agency imprest cash voucher. The custodian shall also prepare a summary of disbursements and requests for reimbursement per instructions of the Division of Statewide Accounting Services.

Recommendation

The following are recommendations for bank reconciliations of the Hazelwood Imprest Cash Account:

- Accounts should be reconciled within 30 days of the month end for cash accounts.
- Reconciliations should agree the bank balance and the ledger balance, and those balances should be readily traceable to the bank statement and ledger.
- Reconciliations should be performed by someone not directly involved with recording transactions in the Imprest Cash Account.
- The preparer and reviewer (preferably the finance director) sign and date the reconciliations indicating they are complete and have been reviewed.
- Reconciliations, supporting bank statements and ledger balances should be maintained on file in accordance with the facilities' and CHFS' record retention policy.

Management's Response and Corrective Action Plan

The Department is revoking Hazelwood's imprest cash authority and closing the account.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-7: The Cabinet For Health And Family Services Should Strengthen Policies And Procedures To Ensure That Appropriate Documentation And Authorization For Expenditures Are Maintained At The Hazelwood Facility

During our review of the Hazelwood Intermediate Care Facility imprest cash account, we found a lack of appropriate documentation and proper authorization for expenditures from the account, including:

- One expense in the amount of \$469 for the replacement of a patient's chair that disappeared. No documentation of complaint filed by parent or police report was on file to justify the purchase.
- One expense for lodging in the amount of \$150 had no supporting documentation.
- Expenses for program entertainment trips totaling \$3,939 with no documentation logging the patients and staff attending events. These trips were to movie theaters, wrestling events and other activities that could easily be used by non-authorized individuals.
- Several expenses totaling \$470 for local wrestling events with circumstances suggesting the purchase of these tickets benefited a staff member, who wrestled in the wrestling association. Auditors learned that the association selects the main event based on tickets sold, giving the employee a possible incentive to inflate sales. This is a conflict of interest.
- Ten checks totaling \$1,121 were reimbursed twice.
- Seventeen checks totaling \$724 were voided after being reimbursed.
- Imprest Cash Account documentation at the Finance and Administration Cabinet does not list the correct bank account information and appears to not be updated.

The facility is using Imprest Cash Account rather than eMARS to process many programmatic and operating expenditures which obscures the details of the expenses and keeps all controls and monitoring at a local level. Also, the agency lacks proper controls over maintaining appropriate supporting documentation to justify expenditures and authorizations for purchases.

Failure to maintain appropriate supporting documentation and evidence of authorizations increases risk that expenditures could be made that are not necessary or reasonable for the program's operations, and also increases the risk of fraud.

Good internal controls dictate maintenance of adequate supporting documentation of expenditures and proper authorization documentation.

Per the Finance and Administration Cabinet Policy FAP 111-56-00:

Proper Use of Imprest Cash Funds: The preferred methods of payment for all expenses are the state's procurement and accounting systems and the state procurement cards. An agency shall use imprest cash funds only if it is impractical or impossible to make payments through one of the preferred methods.

Per KRS 11A.020, Public servant prohibited from certain conduct - Exception - Disclosure of personal or private interest.

- (2) If a public servant appears before a state agency, he shall avoid all conduct which might in any way lead members of the general public to conclude that he is using his official position to further his professional or private interest.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-7: The Cabinet For Health And Family Services Should Strengthen Policies And Procedures To Ensure That Appropriate Documentation And Authorization For Expenditures Are Maintained At The Hazelwood Facility (Continued)

Recommendation

We recommend the CHFS Behavioral Health, Developmental and Intellectual Disabilities (BHDID) implement policies to:

- Document the types of expenditures permissible to run through Imprest Cash Account, and file this with CHFS and FAC for Imprest Cash Account documentation. This policy should be in line with FAP 111-56-00.
- Update imprest cash bank account documentation with Finance and Administration Cabinet.
- Maintain all documentation supporting expenditures, their authorization and justification.
- Educate employees about the Executive Branch Code of Ethics Conflict of Interest policy and have employees sign a statement of awareness and understanding of the policy and implications of violating the policy. Refrain from expenditures that present conflicts of interest for staff. When unavoidable, ensure the appropriate justification and authorization is documented and require employee to recuse him/herself from decisions regarding the matter and from initiating, processing, or authorizing transactions related to it.

Management's Response and Corrective Action Plan

Effective immediately any client-owned items found missing will be investigated by Hazelwood's facility security before the item is replaced. A report from Security and/or the Police will be included with the request for replacement.

The facility's imprest cash account is being closed. The individual involved in this purchase of tickets for resident activities is no longer employed by this facility.

All Executive Staff, Business Office staff, and Human Resources staff will attend mandatory in-service training on the Executive Branch Code of Ethics Conflict of Interest within the next six months with the first training session being conducted December 17, 2010. Training will be conducted annually thereafter.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-8: The Department Of Corrections Should Expand, Finalize, And Implement A System Development Life Cycle Policy To Govern System Development, Testing, Modifications And Implementation

As noted during three previous audits, the Department of Corrections (DOC) has not finalized or implemented formal System Development Life Cycle (SDLC) procedures governing controls for system development, testing, modifications, and implementation in relation to the Kentucky Offender Management System (KOMS). DOC drafted an SDLC policy based upon the Microsoft Solutions Framework (MSF); however, completion and distribution of the policy was not anticipated until the end of June 2010.

DOC chose to use the Governance Model to direct their SDLC process. This model utilizes the following five stages: envisioning, planning, developing, stabilizing, and deploying. DOC has also adopted a modified version of the Royce Waterfall Model as their preferred method for developing software solutions. This model follows a sequential software development process and includes the following seven phases: requirements gathering, design/develop, implementation, integration, testing, installation, and maintenance.

KOMS has been divided into three phases for complete statewide implementation. DOC is in the process of completing the third phase to implement KOMS statewide. For KOMS, the vendor is only responsible for performing the initial system qualification testing using test scripts developed by the vendor. Following successful completion of this test, the scripts are turned over to DOC who is responsible for functional testing and for making any modifications to the system.

The vendor has provided DOC with a Software Test Plan, which guides the testing before implementation. According to this process, appointed individuals, called Subject Matter Experts (SMEs), review the software and system to ensure that the proper functionalities are included, according to the External Design Functions. This process is performed each time a system is replaced by a function of KOMS. Documentation of the testing is retained by DOC through HelpBox tickets and release notes. Any changes or enhancements that are made to the system require Executive Staff approval. After each KOMS module is tested, the Commonwealth Office of Technology (COT) is responsible for moving the modules into the production environment. It appears this process will be adequate, once formally implemented and if properly followed.

Without formalized SDLC procedures, management increases the risk of implementing ineffective and inefficient systems and the risk of entering inaccurate or incomplete data within the production environment, thereby adversely affecting system processing results.

SDLC procedures should be developed and distributed to all key personnel to ensure consistent implementation of new systems. The SDLC procedures should address all key steps comprising the software development process. SDLC procedures require that formal test plans be adequately developed and documented, that testing be performed within a test environment separate from production environments, and that test results and resolutions be documented. All testing documentation should be reasonably retained for future reference. Further, SDLC procedures must be consistently applied.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-DOC-8: The Department Of Corrections Should Expand, Finalize, And Implement A System Development Life Cycle Policy To Govern System Development, Testing, Modifications And Implementation (Continued)**

Recommendation

We recommend DOC expand, finalize, and implement adequate formal SDLC control policies and procedures to govern all DOC systems currently under development and to be used for all future software development projects. These policies and procedures should outline all stages of the SDLC process and should include testing strategies and methodologies, control and maintenance of test and production environments, testing documentation and retention requirements, and procedures for migration of system changes to the production environment. Further, these formal procedures should be developed centrally and distributed to all divisions within DOC for compliance.

Management's Response and Corrective Action Plan

DOC has finalized the Software Development Life Cycle documents and has posted them to our intranet. The document templates can be found on the intranet site.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-9: The Department Of Corrections Should Strengthen And More Closely Adhere To The Kentucky Offender Management System (KOMS) Defect Management Process

As noted in the prior two audits, review of program modification controls for the Department of Corrections (DOC) Kentucky Offender Management System (KOMS) identified multiple instances where the existing program change control procedures were not being consistently followed.

The KOMS Defect Management Process describes the procedures for requesting and completing modifications to KOMS. DOC Information Technology (IT) staff and KOMS trainers may request changes to KOMS using tickets within the in-house HelpBox application. Issues are prioritized, and either DOC or the vendors develop a solution. The vendors view the KOMS requests and address any software defects; defects are resolved by the creation of new KOMS releases or patches. All defects are logged and tracked in the vendor-maintained KOMS Defect Tracking Tool. If the issue does not require a programming solution, it is deemed to be a technical assistance request and is assigned to DOC IT staff for completion.

Releases or patches developed by the vendors are sent to DOC for approval and testing, and then the testing documentation is sent back to the vendors to review. The KOMS Defect Management Process developed by DOC states DOC Executive Staff is to provide written approval to the vendors for releases or patches; however, DOC management indicated they do not adhere to this approval procedure. Once the release, patch, or DOC-developed change is tested and approved by the appropriate parties, DOC IT staff makes an email request to the Commonwealth Office of Technology (COT) Service Desk for movement of the change into production. Once the change has been implemented and the associated ticket has been closed by COT, a notification email is sent to DOC IT staff.

Our review of 126 unique logged KOMS software issues and associated release notes since the prior year fieldwork revealed:

- Forty-four issues (approximately 34.9 percent) had a priority level of '0'. This is not a valid priority level based on the KOMS Defect Management Process and discussions with agency staff.
- Nineteen issues (approximately 15.1 percent) lacked a priority level.
- Twenty issues (approximately 15.9 percent) did not have the tester, testing date or results recorded.
- One issue (approximately 0.80 percent) omitted the Issue Identification (ID).

To further test the controls surrounding KOMS program modifications, a sample of eleven completed KOMS issues was reviewed to ensure all supporting documentation for testing and approvals were appropriately developed and maintained. This examination revealed the following exceptions:

- Three issues (approximately 27.3 percent) did not have an associated HelpBox ticket on file to justify the initial defect notification.
- Seven issues (approximately 63.6 percent) for which the release notes and HelpBox ticket reflected differing priority levels.
- Four issues (approximately 36.4 percent) for which documentation could not be provided to show the approval was sent to COT prior to being placed into production.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-9: The Department Of Corrections Should Strengthen And More Closely Adhere To The Kentucky Offender Management System (KOMS) Defect Management Process (Continued)

DOC is currently in the process of implementing a new tracking system, Trac. The first phase of converting HelpBox tickets to Trac has been completed. Trac will allow KOMS software errors and fixes to be connected to the various milestones within the change process. Trac will also work in conjunction with the current HelpBox application to enhance the ability to determine the type and status of changes to KOMS. The migration to Trac means that tickets will still go to HelpBox initially and will be classified as either functional, defect, or enhancement. Functional issues will remain within HelpBox until closure. Defects and enhancements, however, will be migrated from HelpBox to Trac for further tracking.

Failure to properly apply and monitor change control procedures increases the risk that incorrect or unauthorized changes could be made to critical applications and, potentially, be moved into the live production environment. Further, this failure in process increases the risk that changes will not be prioritized appropriately, which could untimely affect the progress of changes to implementation.

Program modification control procedures should be consistently applied in order to ensure that only appropriately authorized changes to critical applications are made and implemented within the production environment in a timely fashion. Consistent monitoring of the change control process helps ensure adequate documentation exists for all changes and that the changes made are acceptable to the user business areas prior to implementation.

Recommendation

We recommend DOC take the following actions to strengthen the controls of the KOMS program modification process:

- Review the current KOMS Defect Management Process document to ensure the established procedures are appropriate and acceptable to all parties. Revisions should be made where necessary.
- Ensure all KOMS software issues are logged within the HelpBox tracking system and assigned an accurate priority level and issue ID.
- Proceed with the implementation of Trac system. Within the new system, all defect and enhancement details should be retained, as well as the associated authorization, testing, and promotion documentation.
- Once the Trac system is formally implemented, procedures in the KOMS Defect Management Process document should be updated to reflect appropriate changes in the program change tracking process.
- Ensure the KOMS release notes are thoroughly completed to reflect all issue details and testing documentation.
- Consistently apply all established procedures within the KOMS Defect Management Process document.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

FINDING 10-DOC-9: The Department Of Corrections Should Strengthen And More Closely Adhere To The Kentucky Offender Management System (KOMS) Defect Management Process (Continued)

Management's Response and Corrective Action Plan

DOC has been working actively to migrate from the HelpBox system into the new defect tracking system. DOC will migrate to the new tracking system by August 15, 2010. All KOMS software defects that are identified will be assigned a ticket number for tracking. All changes to the KOMS workflow will be documented and posted to the project website by the end of September 2010.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-10: The Department Of Corrections Should Formalize And Consistently Apply Logical Security Controls Over KRONOS

As noted in the two previous audits, the Department of Corrections (DOC) did not have formal written security policies and procedures related to the KRONOS payroll system. Therefore, DOC did not have a KRONOS security manual to address management, user, and administrator responsibilities concerning the system. An informal procedure was used for requesting, approving, and granting access to KRONOS for applicable users. However, discussions with DOC management indicated they anticipate formal procedures will be drafted by the end of June 2010.

The current informal procedures dictate elevated permissions provided through the Project View and Super access levels is only granted to managers with a direct supervisory relationship to the employees whose payroll records they have the ability to update. Managers requiring access to view payroll records corresponding to employees not under their direct supervision must complete the KRONOS Access Request form to justify the reason for the additional access. After completion, the request form must be emailed to the manager's immediate supervisor. The request form instructions require the supervisor to sign off and submit the request form to the payroll staff. Once received by the Payroll Branch Manager, the form will be marked approved, denied, or will be returned for additional information. No supervisor or Payroll Branch Manager approval sign off fields were available on the request form.

Of 14 users currently requiring access to view the payroll data of employees outside their direct supervision, we noted the following:

- Six users, or approximately 42.9 percent, had the KRONOS Access Request form on file; however, it lacked a supervisor sign off.
- Four users, or approximately 28.6 percent, had the KRONOS Access Request form on file; however, it was completed and submitted by the user requesting access and not their immediate supervisors as required by the form instructions.
- One user, or approximately 7.1 percent, had no KRONOS Access Request form on file. According to agency management, this user no longer performs timekeeping responsibilities for the group to which she was originally assigned. Her access was removed during our audit fieldwork.

Allowing users the ability to access information without proper authorization may subject the processing of data to errors and/or omissions and may compromise the integrity of data processed through the KRONOS system.

The foundation of logical security is access control, which refers to how system access is determined and granted to users. Formal policies provide a security framework to educate management and users of their security responsibilities. Consistent application of formalized security policies and procedures provides continuity for implementation and sets the tone of management concern for strong system controls. Further, the level of system access granted to users should be restricted to only areas necessary for an employee to perform assigned job duties.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-10: The Department Of Corrections Should Formalize And Consistently Apply Logical Security Controls Over KRONOS (Continued)

Recommendation

We recommend DOC proceed with drafting, formalizing, and implementing a KRONOS security manual. Included in this manual should be descriptions of the processes and procedures for requesting, approving, and granting appropriate system access to all users requiring KRONOS access. The procedures should, at a minimum, achieve the following:

- Provide guidance for the authorization and establishment of general user accounts and manager accounts granted Read access.
- Detail the use of organizational structure in the authorization and setup of manager accounts granted elevated permissions through Super and Project View access.
- Stipulate a requirement for the submission of a KRONOS Access Request form where a manager is required to read the payroll data for employees not falling under the direct chain of command.
- Specify steps to be taken in the event an account requires an amendment to the granted access level or revocation.

Further, we recommend the KRONOS Access Request form be revised to include an authorization sign off field for the supervisor and Payroll Branch Manager. Due to there being a relatively small number of users with access to view other employee's data not under their direct supervision, we suggest the revised request form be completed for all of these users and the form be consistently used in the future.

Management's Response and Corrective Action Plan

KRONOS Security Manual will be drafted, revised and finalized by the end of October 2010. KRONOS Access Request form will be revised to incorporate changes recommended by the audit team. A new access form was created by Payroll Manager on July 14, 2010. This form will be sent out to all payroll liaisons with specific instructions to detail who needs to request the access, with manager approval as well as Payroll Manager approval prior to access being granted. The form is to be disseminated by close of business on July 31, 2010.

All manager access/super access authorities will be audited in house monthly to ensure proper procedures are being followed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-11: The Department Of Corrections Should Complete Implementation Of Information Technology Security Policies

As noted since our Fiscal Year (FY) 2006 audit, the Department of Corrections (DOC) has not implemented formalized security policies. Though the DOC Information Technology Branch drafted a security policy entitled Individual User Access to Computer Information and Resources as early as December 2005 and updated the draft policy as recently as December 2006, it was not formally adopted and implemented. Since that time, additional draft policies were created, but were not formalized and implemented.

Specifically, the following DOC policies have been developed, but not finalized:

- Individual User Access to Computer Information and Resources;
- DOCIT-010 User ID and Password Protocol;
- DOCIT-011 Anti-Virus Protocol;
- DOCIT-012 Internet and Acceptable Use Code of Conduct;
- DOCIT-013 Password Auditing and Protocol Enforcement for Network Domains;
- DOCIT-014 Securing Unattended Workstations Protocol;
- DOC Standard Application User Profiles; and
- Information Technology Appropriate Use Protocol.

In discussions with agency personnel during the FY 2010 audit, it was noted the completion and distribution of the DOC security policy was scheduled for the end of June 2010. Once completed and distributed, these policies are to include policies relating to security passwords, userids, user access, regular review of unauthorized login attempts and disaster recovery procedures. All applications and systems are to be covered by the policy.

Failure to implement formal information system security policies increases the risk of unauthorized access or modification to computer programs and data, destruction of assets, and interruption of services.

Development and consistent application of information system security policies and procedures provides continuity for policy implementation and sets the tone of management concern for securing information system assets and resources. To strengthen security over the DOC computing resources, a formal security policy that addresses all applications must be centrally and formally developed, implemented, distributed and enforced.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-11: The Department Of Corrections Should Complete Implementation Of Information Technology Security Policies (Continued)

Recommendation

We recommend DOC ensure currently developed information security policies are updated to reflect management's decisions related to the security procedures, officially adopted, implemented and distributed to all DOC personnel. Further, DOC should ensure compliance with all security policies is enforced on a consistent basis.

Management's Response and Corrective Action Plan

DOC has updated the protocols and formalized them and posted them to the DOC intranet.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-12: The Department Of Corrections Should Ensure All Agency Machines Are Properly Configured To Include Only Necessary Services

As noted in the prior year, our FY 2010 security vulnerability assessment on machines owned by the Kentucky Department of Corrections (DOC) revealed 29 of 115 scanned machines, or approximately 25.2 percent, could potentially be mis-configured. A mis-configured machine could waste resources, entice an attack using ports that are unnecessarily open, or allow excessive hypertext transfer protocol (HTTP) methods. The ports open on each of these machines should be reviewed to ensure they have a specific business purpose and that the services are properly authorized. Fifteen of these machines contained open ports reported during the prior year audit. Of the 29 potentially mis-configured machines, two machines reported the potential use of a remote shell suite of programs.

For security purposes, detailed information that would identify the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

System misconfigurations that allow unnecessary services can negate other security configurations established on the machine, increase potential security vulnerabilities, and provide enticements for intruders to enter the system. Further, improperly secured services could allow unauthorized access to sensitive or critical system resources. Specific to web servers, excessive HTTP methods provide additional avenues for system intrusion. The use of unsecured transmission programs also increases the risk of compromised data transmissions.

To assist in securing a network adequately, it is necessary to ensure all machines and web services are configured to only allow necessary services to operate. Only necessary business-related ports should be open and anonymous or default profiles should be avoided. Only the necessary HTTP methods (such as POST, HEAD, and GET) should be supported on agency web servers.

Recommendation

We recommend DOC take the necessary actions to ensure the noted services on each machine have a specific business purpose and are properly authorized. If the service is necessary, it should be reviewed to ensure it is properly authorized, licensed, and configured as well as adequately secured. Any unnecessary services should be disabled or the associated ports should be closed. HTTP methods not required for the operation and maintenance of a web server should be disabled. If the remote shell suite of programs is being utilized, it should be replaced by a more secured shell suite.

Management's Response and Corrective Action Plan

DOC will investigate all listed devices and reported vulnerabilities within the report. DOC will compile all actions taken for each IP address that was provided and will complete this task by the end of September 2010. The DOC would like to note that access to the devices that were provided is only accessible from within the DOC network because of the firewall that we have in place.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-13: The Department Of Corrections Should Ensure Sufficient Authentication Is Required To Access Potentially Sensitive Information

As noted in the prior year, during the FY 2010 audit of the Kentucky Department of Corrections (DOC), instances were discovered where no authentication was required to allow an outside user to gain access either to information about the machine or to the service running on a designated port. We determined 12 out of the 115 machines scanned, or approximately 10.4 percent of the population, did not have sufficient authentication. Ten of these machines were reported to the agency during the prior year audit.

For security purposes, detailed information that would identify the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

If a machine is allowed to provide excessive information associated with the machine to an anonymous user, then an intruder could potentially use this information to attempt to gain access to the machine or network.

Only necessary and required users should have access to services, particularly those services containing potentially sensitive information.

Recommendation

We recommend DOC restrict the level of information provided by their network machines to public or anonymous users. If a service is not necessary, required, and properly configured, it should be disabled. For appropriate services, authentication should be configured, and only users who have a need for services should be given user IDs and passwords for access.

Management's Response and Corrective Action Plan

DOC will investigate all devices listed and disable anonymous/public access where permissible. The DOC would like to note that access to the devices that were provided is only accessible from within the DOC network because of the firewall that we have in place. Documentation and configuration of this will be completed by the end of August 2010.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DOC-14: The Department Of Corrections Should Ensure Necessary Steps Are Taken To Mitigate Identified Vulnerabilities On Agency Machines

While performing the FY 2010 security vulnerability assessment for the Kentucky Department of Corrections (DOC) machines, we determined 1 out of 115 scanned machines, or approximately 0.9 percent, contained a user login webpage that was susceptible to authentication parameter manipulation. Specifically, the user ID and password length restrictions could be manipulated at the client side before being exchanged with the server.

For security purposes, detailed information that would identify the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

The ability to circumvent established input restrictions at the client could allow the submission of malicious code or superfluous information. These could then result in potential buffer overflows, Denial of Service (DoS) attacks, or Cross Site Scripting (XSS).

Client communication should be appropriately sanitized at the server to ensure that only appropriate responses are submitted to the server.

Recommendation

We recommend DOC ensure all client communication with the noted machine is appropriately sanitized to comply with all input restrictions. All client communication in non-compliance should be rejected.

Management's Response and Corrective Action Plan

DOC will investigate the device that was detected and document any configuration changes made to the device to comply with the recommendation. This will be completed by August 15, 2010. The DOC would like to note that access to the devices that were provided is only accessible from within the DOC network because of the firewall that we have in place.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DWI-15: Unemployment Insurance Should Implement Procedures To Ensure Its Accounts Payable Estimate Is Accurate And Complete

During the Department for Workforce Investment (DWI) Accounts Payable audit, the auditor was unable to verify some of the check registers provided as support for the estimated accounts payable to claimants and to the IRS. Based on our review, two errors were discovered that would amount to \$14,435,835 if not corrected.

The first error was a check register being omitted from their closing package preparation process. The amount omitted that should have been included in the accounts payable was \$2,734,702.

The second error was more complex and amounted to \$11,701,133. Each of DWI's check registers is generated for a two week pay period without consideration of the different fiscal years. The UI check registers show totals for each week of the two week period. Their process only picked up the full weeks which ended on or before June 30. When the fiscal year end falls on Friday or Saturday, their process gives the correct results. When the fiscal year falls on Sunday through Thursday, their process did not give the correct results.

After the auditors explained the errors, DWI took pro-active steps to correct the errors. The AFR-70 accounts payable was updated by DWI. A revised closing package was re-issued and submitted to FAC to reflect the adjusted amount for inclusion in the CAFR.

One check register was omitted from the closing package preparation process causing an understatement in accounts payable. The other check registers were included, but the days were not properly prorated among fiscal years. Such mistakes lead to misstating the UI accounts payable and subsequently misstating the closing package AFR-70 amounts.

Good internal controls over the accounts payable function require that all check register transactions be captured and allocated where appropriate. Proper internal controls are needed in order to ensure the appropriate AFR-70 closing package amount is reported. These measures are necessary to ensure the completeness of UI accounts payables, facilitate the reconciliation to accounting records, and ensure accurate financial reporting.

Recommendation

We recommend DWI-UI take steps each year to review the fiscal year end check registers and the accounts payable allocation process to ensure accuracy and completeness

Management's Response and Corrective Action Plan

We agree with the auditor's finding and have taken corrective action to prevent this issue in the future.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DWI-16: The Department For Workforce Investment Should Strengthen The Disaster Recovery Plan

As noted during the last six audits, our assessment of the Department For Workforce Investment (DWI) business continuity planning revealed that, although planning documents have been created, some information was either not sufficiently detailed or required clarification.

The DWI has created and formalized the following documents regarding disaster recovery:

- The Kentucky Unemployment Insurance (UI) Disaster Recovery Plan (DRP);
- EDU-06 Backup Procedures Policy;
- Division of Technology Services (DTS) Business Contingency Plan (BCP); and,
- DWI DTS DRP.

Review of the UI DRP revealed a lack of information for the back-up schedule and off-site storage location, details about the pyramid notification system used by supervisors in case of an emergency, details surrounding cooperative efforts with the Department of Revenue to back up quarterly reports and payments, information regarding employee awareness and training related to the DRP, and documentation concerning how alternate work sites would be determined in the case of an emergency.

The EDU-06 Backup Procedures Policy provides details concerning back up strategies, schedules and requirements for the entire Education Cabinet. Discussions with agency personnel revealed DTS is responsible for back-ups at the central level; however, the policy does not specifically state this responsibility.

A review of the DTS DRP revealed there was no specific information presented for recovery procedures related to the Unemployment Insurance Accounts (UIA) and the Unemployment Insurance Benefits (UIB) system. Further, there is no documentation within the DTS DRP related to employee awareness and training or disaster recovery testing procedures, results, or future testing plans.

The Commonwealth Office of Technology (COT) performs annual Disaster Recovery tests for select systems. Discussions with DWI personnel revealed that UIA, UIB, and Wage Records Systems (WRX) were last tested successfully in 2004. The UIA and UIB systems were included in a 2009 test; however, due to problems with two critical databases, system recovery was unable to be completed. According to agency management, budgetary constraints were the reason for the length of time between tests.

We are aware additional funding has been requested from the Federal government to assist in the updating of DWI disaster recovery plans.

Failure to maintain a complete and current disaster recovery plan increases the possibility of loss due to excessive recovery time, costs, and disruption of processing capabilities in the case of a disaster or extended system outage.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DWI-16: The Department For Workforce Investment Should Strengthen The Disaster Recovery Plan (Continued)

Good management practices minimize risks through planning. The goal of a DRP or BCP is to improve preparedness at minimal cost using available resources. Accordingly, proper documentation, knowledge, and periodic training for the DRP assures that DWI's IT systems can be recovered in cases of emergency, and that critical processes are not hindered by lengthy system down time. An effective DRP should document the most current critical personnel and contact information, critical systems and related data files with specific backup and recovery procedures, training and testing requirements, and update procedures intended for the DRP. In addition, assurance of adequate asset management and insurance coverage should be considered as part of the DRP.

Recommendation

We recommend DWI update current documentation related to the agency overall DRP. Specifically, we recommend the UI DRP be updated to include details regarding:

- the back-up schedule and where the off-site storage is located,
- the pyramid notification system,
- the back-up of quarterly reports and payments at the Department of Revenue,
- how employees are educated or trained concerning the procedures in case of an emergency,
- documentation of how alternate work sites are determined in case of an emergency, and
- an incorporation, by reference, of the EDU-06 Backup Procedures Policy.

We recommend DWI update the EDU-06 Backup Procedures Policy to reflect agency staff responsible for performing back-up procedures at the central and field level.

Updated copies of these documents should be distributed to key personnel and a copy be maintained centrally and within an appropriate off-site storage area.

In addition, we encourage DWI to continue working with the Department of Revenue on creating electronic images of hard copy forms to allow all critical data to be backed-up electronically.

Finally, DWI should continue discussions with COT to allow for scheduling of Disaster Recovery testing for the UIA/UIB and WRX systems as soon as funding is available.

Management's Response and Corrective Action Plan

The Division of Technology Services agrees with this finding. An independent vendor is currently doing an evaluation of the Business Continuity Policy including the Disaster Recovery Plan, upon completion recommendations will be evaluated and implemented. We have and will continue to evaluate and update the current policies in place making them more comprehensive in their scope, to include but not limited to back-up schedules, off-site storage location, and notification system.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-DWI-17: The Office Of Employment And Training Should Develop Formal System Documentation To Support Processing Performed By The Workforce Investment Act Online Reporting Of Kentucky System**

Our FY 2010 audit of the Office of Employment and Training's (OET) Workforce Investment Act (WIA) Online Reporting of Kentucky (WORK) system revealed OET did not maintain basic documentation of the overall functionality or specific processing of the WORK system.

The WORK system was based on a vendor-developed application customized for the Commonwealth of Kentucky. It was designed to manage the process of initiating, reviewing, and awarding grant monies offered by the State Pass-Through Entity for WIA, the Department for Workforce Investment (DWI), to the Local Workforce Investment Area (LWIA) offices. WORK also manages the processes of reimbursement, financial reporting, and progress reporting. The original contract with the application vendor required a user manual be created for use at the LWIAs and training be provided for the central level staff. The vendor did not provide specific user or technical manuals to OET for use by the central level staff. Further, no user or technical documentation has been developed and finalized internally at OET for central level staff. OET recently drafted a manual for central level staff; however, the draft manual is limited in scope and does not cover administrative or other grant or reporting functions for central level staff.

We are aware the contract with the application vendor for the WORK system expires on May 31, 2010, and OET is looking at potential options for either replacing or upgrading the current system.

Lack of documentation increases the likelihood of erroneous or incomplete processing. It further increases the likelihood of unauthorized data modification, destruction of assets, and interruption of services.

Proper documentation should be maintained for each critical system in production to, at a minimum, identify the purpose of the system, what procedures can be performed within the system, how the system will interact with other systems, and what output of data or reports are anticipated.

Recommendation

We recommend OET work with the application vendor to develop an overview of the specific procedures currently available within the WORK system. Due to the fact the WORK system may be replaced or upgraded within the next year, we further recommend OET include a requirement within the next contract to provide a technical manual for the new system. This manual should specifically cover the overall functionality of the system, the administration of the system, and the processing of transactions at the central and LWIA levels. Finally, going forward, OET should specifically monitor the adherence of the vendor to all contractual obligations.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-DWI-17: The Office Of Employment And Training Should Develop Formal System Documentation To Support Processing Performed By The Workforce Investment Act Online Reporting Of Kentucky System (Continued)**

Management's Response and Corrective Action Plan

DTS Security will be working with OET to implement the policies and procedures manual for the WORK system. We will work with the vendor to obtain the scope of this application and will create procedures for granting access, creating and assigning passwords, resetting passwords, the different levels of access and develop the guidelines for who gets the different levels of access.

We will develop a policy manual with following information:

- *The scope of the project.*
- *Procedures for granting access*
- *Documentation of how the program works.*
- *Training of staff - how to use the program.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DWI-18: The Office Of Employment And Training Should Strengthen And Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System

Our FY 2010 audit of the Office of Employment and Training's (OET) Workforce Investment Act (WIA) Online Reporting of Kentucky (WORK) system revealed the informal administrative logical security controls over the WORK system were lax. This lack of formal documentation of controls for the system has allowed a situation where staff were provided excessive rights based on current job duties and a lack of understanding on the requirements for administering the system.

Six levels of access were allowed to the WORK system. Three of these levels were explicitly defined within the Grantee Help Manual and are being used by staff at the Local Workforce Investment Area (LWIA) offices. The remaining three levels of access are being used by central level Department of Workforce Investment (DWI) staff; however, there is no documentation of the exact functionality established for each of these central access levels. The auditor was able to glean from discussion with staff and inference of functional characteristics within the Grantee Help Manual, that these three central access levels allow administration of user accounts, development of allocation for grants, and approval of applications from LWIAs for grant funding. The only specific difference identified by OET management between these access levels is one access level has the ability to create a new grant within WORK. Therefore, all central level staff, no matter individual job duties within the system, have been provided both administrative and operational functionality, which creates a segregation of duties situation.

During discussions with OET staff related to the WORK system, it was determined there is currently no access level established within the system that would allow "read" only access to data and reports. If someone needs information from WORK and does not have access, an authorized WORK user will publish reports for the individual. However, our review identified an instance where this process was not followed. Specifically, as part of the review process for the Financial portion of the DWI audit, an auditor requested access to the WORK system. OET provided this auditor with the same access level as a central level employee; thereby, providing the user with both administrative and operational functionality, which is excessive based on the auditor's needs and request.

Our review of the Grantee Help Manual, which is provided to LWIA staff for processing at the LWIA level within the WORK system, identified the process to be followed by LWIA staff to request, delete, or change access for users, was no longer accurate. According to Section 1.1.6 of the Grantee Help Manual, DWI requires that the Chief Executive Officer of a LWIA write a letter to the DWI Budget and Support Branch Manager requesting access for each member of the LWIA that will be accessing WORK. This process was followed when WORK was first implemented; however, has since been changed. Currently, requests for new access, deletion, or changes in status require a written request from either the LWIA Fiscal Officer or Authorized Signatory. A written request is the only requirement for Level 2 (LWIA Staff Member) or Level 4 (Fiscal Officer) access. A Level 5 (Authorized Signature) access request requires both a written request and a signed OET Authorized Signature Form.

We examined supporting documentation for 12 new user accounts to determine compliance with the established informal procedures currently in use for granting access.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-DWI-18: The Office Of Employment And Training Should Strengthen And Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System (Continued)**

Our examination revealed that only 2 users had sufficient documentation on file to support all access levels granted. The remaining 10 users, or 83.3 percent of new user accounts, did not have documentation on file supporting all or part of their granted access levels to the WORK system.

As was noted in the prior year, the OET Authorized Signature Form only authorizes a user to apply for signatory authority access within WORK. There is currently no way to designate on this form any other type of access level for the WORK system, nor has there been a separate request form developed and used for the other access levels. The auditor is aware of a new access form being developed for use at the central level to request access to the WORK system. However, at this point, no specific access form has been developed for use with LWIA staff.

During the FY 2009 audit of the WORK system, we identified several accounts that appeared no longer to be needed. For FY 2010, we found that all but two of the unnecessary accounts were made inactive as had been indicated by OET at the end of the prior audit. These two accounts are associated with the same user. It was explained that this individual left the agency in December 2008, but had returned to the agency in May 2009. One of the accounts was currently being used by the individual and was required for his job; the other account was no longer needed, but had been inadvertently allowed to remain active after the prior year.

Additionally, within the FY 2009 audit, we questioned the need for individual users to be established with both Fiscal Officer and Authorized Signatory rights at the LWIAs. Due to staffing resources at some LWIAs, OET management decided to allow this dual function for users if the LWIA Director provided approval through a formal request for the access. During the FY 2010 review of users, there were nine users identified with both Fiscal Officer and Authorized Signatory rights. We examined supporting documentation for all nine user accounts to determine compliance with the established informal procedure. Our examination revealed that only one user had sufficient documentation on file. The remaining 8 users, or 88.9 percent of users, did not have documentation on file supporting all or part of their granted access levels to the WORK system. In one case where there was insufficient support, the individual provided the Fiscal Officer and Authorized Signatory rights is the LWIA Director.

We are aware the contract with the application vendor for the WORK system expires on May 31, 2010, and OET is looking at potential options for either replacing or upgrading the current system.

Failure to develop and implement administrative logical security controls could lead to a lack of understanding by management and users of specific roles and responsibilities, which could result in a failure to comply with security policies, a failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. If the developed controls are not sufficiently strong, this situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, and inappropriate or illegal use of system resources.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DWI-18: The Office Of Employment And Training Should Strengthen And Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System (Continued)

The foundation of logical security is access control, which refers to how system access is determined and granted to users. Formal policies provide a security framework to educate management and users of their security responsibilities. Consistent application of formalized security policies and procedures provides continuity for implementation and sets the tone of management concern for strong system controls. Further, the level of system access granted to users should be restricted to only areas necessary for an employee to perform assigned job duties.

Recommendation

We recommend OET create, formalize, and implement a WORK security manual. This manual should include the procedures for requesting, approving, and granting system access to all users requiring WORK access. The Grantee Help Manual should be updated to reflect the current access request process. Additionally, a new WORK access request form should be developed for central level and LWIA staff. This form should include a listing of the available access levels, a description of the access levels, and space for all appropriate management approvals. Access request forms should be completed and maintained for all users.

We recommend OET work with the application vendor to determine whether a security access level is currently available which would allow only read access to the system. If this is currently available, then OET should alter the auditor's access to this access level.

For those LWIA staff provided both Level 4 (Fiscal Officer) and Level 5 (Authorized Signatory) access, OET should require authorization from the current LWIA Director confirming the necessity of both levels of access. OET should define an alternative procedure for approval for those instances where the staff requiring the Fiscal Officer and Authorized Signatory access is the LWIA Director. This authorization should be maintained for audit purposes.

Due to the fact the WORK system may be replaced or upgraded within the next year, we are recommending OET include the following items within the next contract:

- The next vendor should provide a security manual for the new system. This manual should, at a minimum, specifically cover all access levels available in the system; the process for requesting access to the system; the process for establishing, altering, revoking, and deleting access to the system for users; and appropriate use guidelines for all users.
- All available access levels should be identified and associated access rights for each level should be explicitly described.
- A read-only access level should be available for use.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-DWI-18: The Office Of Employment And Training Should Strengthen And Consistently Apply Administrative Logical Security Procedures Over The Workforce Investment Act Online Reporting Of Kentucky System (Continued)**

Recommendation (Continued)

In anticipated of the new or upgraded system,

- OET should provide a listing of all currently active users to the individual LWIAs to be reviewed and validated for appropriateness.
- OET should review the currently active central level staff to ensure access is still necessary.
- Any user accounts identified as no longer necessary should be changed to inactive status.
- OET should specifically identify the functionality needed within the system for each central level staff. Using this information, functional groups should be identified, such as administration, grant review, and allocation. These functional groups should be provided as defined access levels to the vendor for inclusion in the new system.

Management's Response and Corrective Action Plan

DTS will work with OET and the vendor on the different levels of access and develop the guidelines for who gets what level. We will also have the levels of access on the request form and have a designator requestor from OET send us requests after their approval.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DWI-19: The Office Of Employment And Training Should Ensure Programmatic Logical Security Controls Are Properly Designed And Configured

Our FY 2010 audit of the Office of Employment and Training's (OET) Workforce Investment Act (WIA) Online Reporting of Kentucky (WORK) system revealed programmatic logical security controls were not designed or properly configured to ensure only authorized users interact with the system.

User accounts can be established by users granted one of three central access levels. When a new user account is created, the user will be provided a user name and initial password. The password must be changed by the user on first login. The criteria established for the syntax of a valid password are very minimal:

- Password must be at 7-12 characters in length.
- Password must not be "password."
- The same password may not be used twice in a row.

However, there is not a password lockout threshold and passwords do not expire.

Additionally, OET staff is unaware of a function within the WORK system that would allow a password for a current user account to be reset. According to OET, if a user is unable to remember his or her password, then an authorized member of OET may either create a new account for the user or look up the current account's password. It was determined the password is shown in clear text within the source code of the user information screen in the WORK system.

Finally, it was noted that user accounts within the WORK system are numeric and issued sequentially. There were three user accounts identified during review of user accounts within the system that did not follow this anticipated syntax. OET management was unaware of why these accounts were established differently from the other accounts, nor how the account names were established with a different syntax.

We are aware the contract with the application vendor for the WORK system expires on May 31, 2010, and OET is looking at potential options for either replacing or upgrading the current system.

The existence of non-expiring passwords, the lack of a lockout threshold, and the sequentially numbered user names increase the risk that an unauthorized user could attempt to access the system and would not be identified. A password cracking tool could be run against a known user account without causing a disruption in service to the user, since the account would never be locked out, even if a large number of incorrect passwords were attempted. Since the tendency of most users with non-expiring passwords is to keep the same password indefinitely, a potential intruder has the advantage of an unlimited amount of time to work with an account to determine the correct password.

Further, the fact passwords are viewable in clear text increases the risk a current user of the system with access to this information might impersonate another valid user. Because a legitimate user account name and password would be used, there would be no direct indication of inappropriate use.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DWI-19: The Office Of Employment And Training Should Ensure Programmatic Logical Security Controls Are Properly Designed And Configured (Continued)

The Commonwealth Office of Technology (COT) has issued an Enterprise Policy related to logical security controls over user accounts and passwords, CIO-072, UserID and Password Policy. This policy was originally established in 2002 and most recently updated in May 2007. Within this policy, COT establishes specific expectations for user IDs and password controls.

Passwords must be:

- Kept confidential;
- Changed at least every 31 days unless otherwise approved (non-expiring passwords must be approved on an exception basis);
- Changed whenever there is a chance that the password or the system could be compromised;
- Encrypted when held in storage or when transmitted across the network when the path is connected to an external network.

Passwords must:

- Be eight (8) or more characters;
- Contain uppercase letter(s);
- Contain lowercase letter(s);
- Contain a number;
- Contain a special character.

Password History

Individuals must not reuse previously used passwords. To prevent this, a password history of 12 or more previous passwords must be kept.

Password Change

Passwords must be changed by the user at least every 31 days. If inadvertent disclosure is known or suspected, the passwords must be changed immediately. NOTE: In the event misuse is suspected, do NOT change the password; IMMEDIATELY notify the System/Network Administrator and/or the agency's security office. A security incident must be documented. Subsequent password change shall be made by the System/Network Administrator's and/or agency's security office direction only.

Minimum Password Age

Where supported, the minimum password age must be set to one day. This will help prevent users from "cycling" through passwords, thus bypassing the password history list. However, if inadvertent disclosure is known or suspected, the password must be changed immediately. In such instances, notify the systems administrator immediately.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-DWI-19: The Office Of Employment And Training Should Ensure Programmatic Logical Security Controls Are Properly Designed And Configured (Continued)**

Password and UserID Lockout

To prevent individuals from attempting to log-in with UserIDs by guessing passwords, accounts will be locked after three (3) consecutive invalid log-in attempts. Password resets must follow the policy stated herein for password length/composition.

Further, it is good business practice to develop a system that would allow a password to be reset, if there is an occasion where a user has forgotten his or her password. This control should be maintained at an appropriately high level of management and requests for password resets should be documented and maintained for review.

Recommendation

We recommend OET work with the application vendor to alter the password control configurations within the system to comply with the CIO-072, UserID and Password Policy. These control configurations should include, at a minimum,

- Passwords should be at least 8 characters.
- Passwords should contain at least one upper case letter, lower case letter, number, and special character.
- Passwords should be changed every 31 days.
- Passwords should have a minimum age value of 1 day.
- A password history of the last 12 passwords should be maintained.
- Accounts should be locked out of the application after three consecutive invalid log-in attempts.

OET should request the application vendor to restrict access to the underlying source code of the user information page, if possible. If that is not possible, the password information should be removed from the source code and stored only in an encrypted format to be used within the password validation process.

Further, OET should work with the application vendor to determine if a password reset function is available within the current system. If so, this process should be formally documented, distributed to all appropriate staff, and immediately implemented.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-DWI-19: The Office Of Employment And Training Should Ensure Programmatic Logical Security Controls Are Properly Designed And Configured (Continued)**

Recommendation (Continued)

Due to the fact the WORK system may be replaced or upgraded within the next year, we are recommending OET include the following items within the next contract:

- The password control configurations must adhere to the CIO-072, UserID and Password Policy settings.
- Any instance of the password being stored within or transmitted from the application should be appropriately encrypted.
- A password reset function should be available within the system.

Management's Response and Corrective Action Plan

DTS will work with the vendor to determine if a password reset function is available and a password lockout threshold. DTS will also work with the vendor to remove the password information from the source code.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-20: The Finance And Administration Cabinet Should Ensure Formalized Policies Are Developed And Implemented Governing Security Over Microsoft Outlook Public Folders

During the fiscal year (FY) 2010 audit of the Finance and Administration Cabinet (Finance), we discovered the Commonwealth Office of Technology (COT) had not developed formalized policies or consistently provided other guidance to agency staff related to the Microsoft Outlook Public Folders.

A concern was brought to our attention from another audit conducted by this office where agency staff responsible for Public Folders was not provided guidance on how to properly administer the folders leading several folders to be open for viewing and modification by anonymous users. Discussions with COT staff in charge of the Public Folders revealed that once the top level folder was established, the administration of this top level folder and any sub-folders will be the responsibility of agency staff. The COT staff confirmed no policies, procedures, or guidance were provided to agency staff explicitly defining their responsibilities related to the security of these Public Folders.

While researching this issue, on March 9, 2010, we found a video on the COT website discussing how to establish and secure Public Folders. According to this video, COT establishes top level Public Folders at the request of the agency's COT Technical Contact. The top level folder will be established with security role for the Default and Anonymous Permissions set to "None," thereby restricting access to the folder to all users. The security of the folder and any sub-folders are then turned over to the agency to administer. Further, examples were provided on how to secure the folders.

On March 22, 2010, we found the COT website had been updated and redesigned. During the website change, the Public Folders video had been removed from the COT website. At this time, there is no plan for COT to return this video to the website.

As noted during the prior year audit, we discovered the Finance Cabinet and the Information Systems Public Folders were not secured adequately. Our review of the Finance Cabinet Public Folder identified two calendars viewable by an anonymous user. Appointments were viewable for agency-use vehicles containing information related to the vehicle use such as requesting employee, reasons for use, and destinations. Further, our review of the Information Systems Public Folder identified one calendar and one email folder viewable by an anonymous user. The calendar appears to be used for scheduling of program changes and outages for State systems. The Role was set to "Author" for the email folder, which allows access to not only view contents, but also add and modify the contents. The issues associated with the calendars in each folder were identified during the prior year audit.

Failure to document in writing formalized policies and procedures that affect all state agencies increases the risk that users will be unaware of critical business processes and allow sensitive information to be viewable to all state employees. The permissions granted to the 'Finance Cabinet' and 'Information Systems' Public Folders could allow an individual to potentially gain or change useful information concerning staff movements and schedules.

Development and consistent application of formalized policies and procedures provides continuity for policy implementation and sets the tone of management concern for ensuring the appropriate usage of information system assets and resources.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-20: The Finance And Administration Cabinet Should Ensure Formalized Policies Are Developed And Implemented Governing Security Over Microsoft Outlook Public Folders (Continued)

Upon agency request, COT creates the top level Public Folder in Outlook for use by the agency. Agency representatives control permission rights to files and folders as determined by each agency's business requirements.

According to the Office of the Chief Information Officer (CIO), Enterprise Policy CIO-060, Internet and Electronic Mail Acceptable Use Policy, "Agencies that permit the use of E-mail to transmit sensitive or confidential information should be aware of the potential risks of sending unsecured transmissions. E-mail of this nature should, at a minimum, contain a confidentiality statement. E-mail content and file attachments considered highly sensitive or confidential must be encrypted using the Enterprise Standards (X.509 certificates) and approved product for secure electronic messaging services. To protect confidential data, some federal laws require the use of encrypted transmission to ensure regulatory compliance."

Recommendation

We recommend the following actions be implemented by Finance to ensure confidential information is properly secured:

- Formalized policies and procedures should be developed and communicated to agency personnel to ensure all appropriate staff is aware of how to use, setup, and maintain Microsoft Outlook Public Folders.
- COT should return the instructional video related to Public Folders to the website and reference the video to all new agency staff working with Public Folders.
- The user permissions established for the calendars and email folder discussed within this comment should be changed to "None," thereby eliminating the ability of unauthorized users to view entries within the calendars or email folders.
- Specified Finance staff should periodically review the security control permissions applied to all agency Public Folders and subfolders to ensure secure roles restrict anonymous access.

Management's Response and Corrective Action Plan

Permissions assigned to Outlook Public Folders are highly dependent on agency business needs. Individual agencies are responsible for assigning the permissions to their Outlook Public Folders and assessing the appropriateness of this access. To offer guidance in this area, COT is working to place the instructional video in an appropriate location on the COT website to be referenced by all agencies that utilize Outlook Public Folders.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-21: The Finance And Administration Cabinet Should Ensure Anonymous Access Is Limited Through Network Neighborhood

Based on an issue originally identified during the fiscal year (FY) 2009 audit of the Office of Financial Management (OFM) related to the ability to access a machine housing the Complete Asset Management, Reporting, and Accounting (CAMRA) application, it was determined the Finance and Administration Cabinet (Finance) did not properly restrict access to machines on one of its domains. As noted during the prior year audit, review of this Finance domain through Network Neighborhood revealed 206 out of 253 machines within the oversight responsibility of the Commonwealth Office of Kentucky (COT) allowed access without authentication of the requesting user. Of the 206 machines, 143 machines had files or folders that were accessible. Also, the auditor was able to access into sub-folders within 71 machines. Of the machines holding sub-folders, 38 machines contained files or documents in which the auditor could view. The information found on the accessible machines included databases, reports, resource drivers, messaging logs, image files, and various executable files.

Additionally, further review of the machine housing the CAMRA application identified an anonymous user had the ability to access files within a production data directory and download them to an external location.

For security purposes, detailed information concerning the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Sensitive or inappropriate material that is placed in a shared file can be obtained by unauthorized users if not properly secured. Further, if a machine is not configured to prohibit anonymous access, then an intruder could potentially use this available resource to attempt to gain access to the network.

Security measures should be in place to adequately secure files on local workstations. Access to an agency's domain machines should be restricted to only users requiring access related to a valid business purpose. All anonymous access should be prohibited.

Recommendation

We recommend Finance work with COT to review all machines within the domain discussed above to ensure resources are adequately secured. Security on all network machines should be configured to prohibit anonymous access, unless a valid business purpose is determined and specifically documented. Periodic reviews of domain machines should be performed to ensure anonymous access is not allowed.

Management's Response and Corrective Action Plan

COT is in the process of reviewing the detail findings provided by the auditors. All network machines included in the detail findings will be reviewed to ensure that they are adequately secured. Access that does not have a specific business need will be removed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-22: The Finance And Administration Cabinet Should Expand Logical Security Over The UNIX Servers

As noted during the prior three audits of the Finance and Administration Cabinet (Finance), logical security controls should be strengthened over enhanced Management Administrative and Reporting System (eMARS) UNIX servers. We tested the security controls established for three UNIX servers determined to be critical to eMARS processing. Various security related control weaknesses were noted during the audit as detailed below.

Security Policy and Procedures Documentation

For fiscal year (FY) 2010, the Commonwealth Office of Technology (COT) stated UNIX servers are managed in accordance with COT-067, Security Standard Procedure Manual, and CIO-072, User ID and Password Policy. These two documents adequately address logical security. However, they do not discuss on-going monitoring of access to ensure users continue to have a valid business purpose for retaining access to the servers.

It was documented during the FY 2007 review that user audits were being performed periodically to ensure only authorized users have access to the three UNIX servers. Discussion with COT personnel revealed user audits have not been performed since FY 2007. Current plans are in place for COT to develop a procedure for the auditing and monitoring of UNIX accounts; however, this was not completed during FY 2010.

User Access Accountability and Authorization

An examination of new UNIX server accounts revealed user access authorization was inadequate for one user on all three servers under review. An authorization form was provided for this user; however, it did not specify the machines for which the user was shown as having access. This user was also a member of a group on all three servers, but the group profile was not identified on the access authorization form.

Additionally, five users continue to have access to one of the servers reviewed despite COT stating the access was unnecessary in the prior year's review.

Default Security Options

The last password change date was reviewed for all user and system accounts with access to the three UNIX servers to determine if the password had been changed according to policy. A comparison between the last password change date and the last time a user logged in resulted in the following issues:

- One account with access to one or more of the servers had changed its password according to policy, however, the account had not been used to login to the server recently. Due to inactivity, this account should be reviewed to ensure access is necessary.
- Two accounts with access to one or more of the servers had not changed their password recently, but the last login attempt was made prior to the date in which the password was changed. Due to inactivity, these accounts should be reviewed to ensure access is necessary.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-22: The Finance And Administration Cabinet Should Expand Logical Security Over The UNIX Servers (Continued)

- Thirteen accounts with access to one or more of the servers were found to have been last changed prior to the date expected for our testing and the last login attempt was within 35 days of the last changed date. Due to password age, these accounts should be reviewed to ensure access is necessary.
- One account with access to one or more of the servers was found to have been last changed prior to the date expected for our testing; however, the last login time stamp was over 35 days past the last changed date. This account appears to violate the password policy of requiring a password reset after 35 days.

COT had established default security options for their UNIX servers, as well as user account password restriction defaults. We tested the actual settings of the three critical eMARS UNIX servers and the active users to ensure the settings agreed with the established defaults. Our testing revealed the following:

- One account on one server where the password setting was weaker than both the COT policy and industry recommended setting.

For security purposes, detailed information that would identify the specific servers or user accounts that contributed to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Failure to implement and consistently apply logical security controls could lead to a lack of understanding by management and users that could result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources. The existence of unnecessary accounts is inviting to intruders and can lead to those accounts being utilized by unauthorized users.

Adequate security policies and procedures should be implemented, properly maintained, and consistently applied to provide continuity for policy implementation and set the tone of management concern for a strong system to secure assets and resources.

Recommendation

We recommend Finance management work with COT to expand UNIX logical security policies and procedures to include a procedure for the auditing and monitoring of UNIX accounts. Further, UNIX server settings should be reviewed to ensure the established user security options conform to COT policy.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-FAC-22: The Finance And Administration Cabinet Should Expand Logical Security Over The UNIX Servers (Continued)**

Management's Response and Corrective Action Plan

COT has developed a process to conduct annual reviews of user access on the UNIX servers. This process is scheduled to be implemented by the end of the current calendar year. Once in place, this process will be evaluated to determine if all requirements within the findings have been met. COT will continue to work with the Finance Cabinet to address any concerns that are not resolved by this process.

COT has reviewed the detail findings provided by the auditors. Through this review, it has been determined that a significant number of the accounts identified in the findings as having active access to systems were in a state that prevented this access. Each finding has been reviewed and appropriate actions have been taken, or put in motion, to resolve items identified that do not have a documented valid business need. Some review and actions will require participation by the agency. COT will work with the Finance Cabinet to address these concerns.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-23: The Finance And Administration Cabinet Should Formalize And Consistently Apply A Policy To Govern The Security Of The eMARS Production Databases

During the fiscal year (FY) 2010 audit of the Finance and Administration Cabinet (Finance), it was determined informal logical security procedures existed for granting access to the Enhanced Management Administrative and Reporting System (eMARS) production databases and establishing non-expiring passwords for specific types of accounts; however, these procedures were neither formally documented nor consistently applied. This situation was also noted during the previous two audits.

In order to request access to the eMARS production databases, a COT-F181 form must be completed, authorized electronically, and emailed to the Commonwealth Service Desk for processing within the FrontRange Information Technology Service Management (ITSM) application. Of 2 new individual users with access to the eMARS production databases, 1 user, or 50 percent, did not have a COT-F181 form on file.

Additionally, nine instances were identified where database user accounts were active for employees who were either no longer employed by the state or associated agencies, or who transferred to positions that no longer required access to the production databases. Specifically noted:

- Two users with access to the infoAdvantage production database transferred to another agency and no longer required access to the database. One of these users was noted during the prior year's audit.
- Four users' eMARS access had been revoked, yet all four still retained access to the infoAdvantage production database. Two of these users were noted during the prior year's audit.
- Two former CGI employees retained access to the financial production database, one of which also had access to the Vendor Self Service database. Both of these users were noted during the prior year's audit.
- One user with access to the Advantage Financial production database, infoAdvantage production database, and ePayment Gateway (ePAY) production database transferred to another agency and no longer requires access to the ePAY or Advantage Financial production databases.

As a result of the inquiry into these accounts, Finance indicated all of the unnecessary database accounts would be removed.

There are three user profiles utilized for the eMARS production databases. Two of these profiles are for system accounts or by outside agency automated jobs to extract information from the data warehouse. The accounts within these profiles require non-expiring passwords. The final user profile is used for the remaining individual users who are required to change passwords. The current process related to establishing accounts with non-expiring passwords requires the submission of the COT-F085 Security Exemption Request Form to the COT Security Administration Branch. The agency director and executive director must sign the request, and COT must indicate approval.

There were a total of six accounts established since the previous audit granted one of the profiles allowing non-expiring passwords. A COT-F085 form was not on file for two of the six accounts.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-23: The Finance And Administration Cabinet Should Formalize And Consistently Apply A Policy To Govern The Security Of The eMARS Production Databases (Continued)

Failure to consistently apply logical security controls could lead to a lack of understanding by management and users that could result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources. In addition, whenever electronic signatures are accepted forms of authorization, there should be another form of documentation on file, such as emails, to substantiate those signatures. The existence of unnecessary accounts is inviting to intruders and can lead to those accounts being utilized by unauthorized users.

Established security policies and procedures should be formally documented and consistently applied to provide continuity for policy implementation and set the tone of management concern for a strong system to secure assets and resources. Access should only be granted to approved users, and access should be removed promptly upon termination of employment or when said access is no longer required.

Recommendation

We recommend Finance formally document and consistently apply logical security procedures to ensure only authorized access is granted to the ePayment Gateway, Finance and Administration, Vendor Self Service, and infoAdvantage production databases. These procedures should require the COT-F181 form for establishing or changing access for accounts and the COT-F085 forms for authorizing a non-expiring password. Furthermore, emails authorizing these forms should be retained for audit purposes. All user setup documentation should be retained in a central repository for audit purposes.

In addition, Finance should develop procedures related to state employees, CGI employees, and agency contractors to ensure Finance Controller's Office is informed of terminations. Upon notification, Finance should ensure access to the eMARS application and underlying databases is promptly removed or revoked, depending upon whether historical account maintenance is required. Further, all production database accounts should be monitored at least bi-annually to ensure inactive or unnecessary accounts are removed or revoked.

Management's Response and Corrective Action Plan

COT has logical security procedures in place for the addition, modification, or removal of access to production databases. These procedures require that access be appropriately documented and authorized with a completed COT-F181 form. In addition, any account that requires a non-expiring password must be documented with an authorized and approved COT-F085 Security Exemption Request form. This documentation is to be retained within the COT service ticket system. The COT Security Administration Branch will work with the COT Data Management Branch to ensure that they are fully aware of the existing procedures.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

FINDING 10-FAC-23: The Finance And Administration Cabinet Should Formalize And Consistently Apply A Policy To Govern The Security Of The eMARS Production Databases (Continued)

Management's Response and Corrective Action Plan (Continued)

The Finance Cabinet has obtained a listing of existing accounts for the eMARS production databases from the COT Data Management Branch and is in the process of reviewing this information to remove unneeded or unnecessary accounts. The Finance Cabinet will establish a procedure to request a listing of production database accounts on a semi-annual basis to review this access. In addition, the Finance Cabinet will work to include language in the security documentation for eMARS that will require that they are notified of terminated employees to facilitate removal of unneeded or unnecessary accounts.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-24: The Finance And Administration Cabinet Should Develop And Implement A Formal Policy To Govern Security Of The eMARS Checkwriter Interface Process

As noted during the previous three audits, the Finance and Administration Cabinet (Finance) has yet to develop or implement a formal policy identifying responsibilities of those individuals involved with the Enhanced Management Administrative and Reporting System (eMARS) Checkwriter (CW) interface process. The Finance Statewide Accounting Services (SAS) is ultimately responsible for the processing of CW files. Further, SAS is responsible for ensuring access to CW files is reasonable. SAS should ensure a proper segregation of duties exists between the creator of the CW file and the person certifying the file for processing and check generation through eMARS. These duties are established through the use of eMARS security roles and a manual review process performed by SAS during the central level certification.

Our examination of the CW certification process revealed one CW file where the individual who loaded and certified at the department level was the same user.

Allowing users the ability to both create CW files and certify those files for processing and check generation increases the likelihood of unauthorized payments and may compromise the integrity of data processed through the system. A lack of formalized policy and procedures concerning the CW file access and processes can lead to inconsistent understandings between the agency, management, and users.

Formally implemented policy and procedures concerning CW access and established processes is necessary to allow both management and users to have a clear understanding of respective responsibilities. These controls are imperative to ensure the reasonableness of individual access as it relates to CW files and proper segregation of duties when processing CW files.

Recommendation

We recommend Finance establish formal policy and procedures to govern the security surrounding CW interface access and the submission and certification processes. This effort should include standardized procedures to ensure proper segregation of duties at the agency and central levels between the individuals creating and uploading the CW file and those individuals placing the certification on the CW file. This policy should explain the responsibilities associated with each of the CW interface security roles and discuss the need to assign these roles to different individuals, where possible, to ensure proper segregation of duties.

In the event that the same user is required to load and department certify a checkwriter file, the formalized CW interface security policy should require the department head or designee to request prior approval from SAS. Further, if the central level certifier determines that a checkwriter file has already been loaded and certified by the same user, SAS should elicit justification for these actions from the department. SAS should document the request and associated approval or refusal.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-FAC-24: The Finance And Administration Cabinet Should Develop And Implement A Formal Policy To Govern Security Of The eMARS Checkwriter Interface Process (Continued)****Management's Response and Corrective Action Plan**

Finance agrees that formal procedures should be established to govern the security surrounding the checkwriter submission/load and agency certification process. These procedures should explain the necessity to have a proper segregation of duties in regards to the checkwriter load and checkwriter certification process.

Finance also agrees that there should be procedures in place to sufficiently document those times when the segregation of duties cannot be met and the same person performs both functions. We are preparing for an upgrade to eMARS (implementation tentatively scheduled for March 2012). One of the goals of the upgrade is to focus on documentation of key business areas/processes. We want to provide sufficient documentation in areas where we feel documentation may not be where we would like it to be. Formalizing the security surrounding the eMARS checkwriter interface process would be a good example of the type of documentation we would like to develop as part of the upgrade.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-25: The Finance and Administration Cabinet Should Ensure All Reporting From infoAdvantage Is Accurate and Complete

As noted in the prior three audits, our fiscal year (FY) 2010 audit of the Finance and Administration Cabinet (Finance) revealed that infoAdvantage, the reporting solution used in conjunction with the Enhanced Management Administrative and Reporting System (eMARS) Advantage Financial application, could not be fully relied upon to provide the user with complete and accurate data. During the audit we found instances where reporting was not functioning as expected.

We identified instances where a data field related to a document was not available within the associated universe, but was required by the Document Control (DCTRL) table and available for use on the online version of the document.

- We noted that an active “Vendor” is required for the Solicitation Response (SR) and Solicitation Response Wizard (SRW) documents, and the “Commodity Line Description” field is required for the SR document, based on the DCTRL table; however there is not a “Vendor” code or “Commodity Line Description” field within the Solicitation Response class or linked to the document codes within the Procurement Awards Universe. These fields are available to be populated when the document is developed. When a user develops a report of SR and SRW documents from the infoAdvantage Procurement Awards universe including these fields, the values for the “Vendor” code and “Commodity Line Description” fields are coming from the Award Accounting Line. However, there is not a direct relationship between the Solicitation Response and the Award Accounting Line tables in the Procurement Awards universe. Therefore, the data values returned cannot be relied upon.
- We found that the “Cited Authority” field is required for the General Accounting Expense/Expenditure (GAX), Commodity Based Payment Requisition (PRC), and Commodity Based Internal Payment Requisition (PRCI) documents based on the DCTRL table; however the “Cited Authority” field is not available in the Accounting Journal class or linked to the document codes within the General Accounting Universe. The field, however, is available for use when the GAX, PRC, and PRCI documents are developed.

Additionally, we identified two instances where a data field related to a document is available within the anticipated universe, but the linking is not established to allow for reporting that will include the data field.

- We identified instances where the “Event Type” field is available, but not linked, to the Document Header within the Accounts Payable and Accounts Payable-Kentucky Universes. Without this linking to the “Event Type,” it is not possible for reporting to be developed to determine the appropriateness of coding for required and prohibited fields from the Event Requirements (ERQ) table on the Management Budget (OB1) or Check Writer Cancellation (CWC) documents.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-25: The Finance and Administration Cabinet Should Ensure All Reporting From infoAdvantage Is Accurate and Complete (Continued)

- We determined that it was not possible to create a report within infoAdvantage from the Procurement Awards Universe that would show all procurement awards associated with a specific federal program. Currently, a link does not exist between the Award Line information and Cost Accounting Chart of Accounts fields, which would allow this type of reporting.

The lack of a data dictionary in conjunction with the inability of a normal end-user to see the underlying database joins related to data elements increases the risk that a user will develop reports based on incorrect data elements, or inadvertently exclude data due to joins that the user is unaware of when developing the report.

For reports to be useful and valid for management decision-making purposes, the reporting solution used should be appropriately designed to allow users to view data and develop reports that are complete and accurate. A reporting solution must, therefore, be understandable by the end user in structure, content, and context. Further, the underlying structure of the data must be appropriate for the overall accounting regulations of the organization; otherwise, the solution may provide information that is not expected by the end user.

Recommendation

We recommend Finance continue work on the infoAdvantage reporting solution, in conjunction with the vendor, to ensure that all known reporting problems are corrected or properly addressed. Further, a review of the established joins within the universes should be performed to ensure they are functioning as intended for the Commonwealth of Kentucky.

To further assist end user reporting capabilities, Finance should develop a data dictionary that is available to all users. This data dictionary should include information concerning:

- The originating table location of the data element;
- A description of the data element;
- A description of all pertinent joins involving the data element; and,
- A listing of other data elements that the data element is dependent upon for reporting purposes.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-FAC-25: The Finance and Administration Cabinet Should Ensure All Reporting From infoAdvantage Is Accurate and Complete (Continued)**

Management's Response and Corrective Action Plan

It is not feasible to create a "data dictionary" at this time. The eMARS team is currently reviewing the newest version of the Advantage software (Version 3.9) with the anticipation of going live March 2012. This version contains many Universe changes particularly within the Fixed Asset and Procurement areas. The team anticipates these updates will provide additional data elements that are not readily available today.

In addition, a new Kentucky specific universe is available. The KY-Contract Expenditure Summary Universe was made available in September 2010 to provide a summary of cash expenditures against all awards. This universe will provide expenditures against grants.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-26: The Kentucky Department Of Education Should Develop A Formal Disaster Recovery Plan And Formalize Backup Procedures

As noted within the past four audits of system controls for the Kentucky Department of Education (KDE), our FY 2010 audit found KDE had not developed or implemented a formalized Disaster Recovery Plan to address the backup and recovery of critical business servers, applications, and data in the case of a prolonged interruption. We are aware that a disaster recovery lead has been designated and a draft policy document related to the backup of information and data resources noted as critical has been developed. In addition, KDE is working to develop an Information Technology (IT) Disaster Recovery Plan; however, it is not expected to be completed until late December 2010.

An outside vendor has developed a Disaster Recovery Service for the MUNIS application. This service is available through the MUNIS contract and has currently been contracted by 28 districts, or 16.1 percent, of the 174 school districts. Because KDE does not have the authority over school district MUNIS servers to require participation, KDE encourages school district personnel to use this feature during training at the annual MUNIS User Conference, the Kentucky Association of School Business Officials (KASBO) conference, and the Kentucky Society for Technology in Education (KySTE) conference. Further, the Office of Education Technology (OET) has provided the Kentucky school districts with guidelines to assist with the backup of critical programs and data files.

To assist with the development of the IT Disaster Recovery Plan, KDE has purchased a planning system from a separate outside vendor. KDE began working with this vendor to start this project in March 2010. The anticipated completion date of this project is December 2010.

Further, KDE's Security Program Manager has drafted a data backup policy for critical systems and servers. All but one system requiring backup has been migrated to the Microsoft Data Protection Manager (DPM) backup system. An alternate backup solution is in place for the remaining system. KDE servers are reviewed regularly to determine whether it is necessary to backup the servers and new servers are added to the backup process as necessary. However, the KDE backup policy was not finalized during FY 2010.

Failure to develop and implement a formalized disaster recovery plan increases the possibility of loss due to excessive recovery time, costs, and disruption of processing capabilities in the case of a disaster or extended system outage.

Good management practices minimize risks through planning. The goal of a disaster recovery plan is to improve preparedness for extended system outages at minimal cost using available resources. Disaster Recovery Plans should be documented, approved, properly distributed, tested on a consistent basis, and updated as needed.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-26: The Kentucky Department Of Education Should Develop A Formal Disaster Recovery Plan And Formalize Backup Procedures (Continued)

Recommendation

We recommend KDE continue to work toward the development of a comprehensive Disaster Recovery Plan. This comprehensive plan should include an overall Disaster Recovery Plan for the cabinet, but also a specific plan for each of the KDE offices and departments. These individual plans should be reviewed and updated annually as necessary to reflect accurate information related to:

- emergency personnel contacts;
- potential alternative processing sites;
- system descriptions and process requirements;
- backup procedures;
- designation of on-site and off-site storage facilities;
- backup and retention schedules for electronic media;
- procedures to recover applications and data from backup media; and,
- planned testing procedures.

Once completed, the comprehensive plan should be distributed to key personnel. Training on the disaster recovery procedures should be provided to these key personnel. Further, annual testing should be performed to ensure that all necessary personnel are aware of their respective roles in the implementation of the plan.

We also recommend OET continue to encourage all Kentucky school districts to develop a Disaster Recovery Plan that, at a minimum, addresses the backup and recovery of their MUNIS server. A central level oversight authority or third party should review and approve all school district's contingency plans. OET should also continue to inform all school districts not currently using this service of the benefits of the Disaster Recovery Service for MUNIS.

Management's Response and Corrective Action Plan

As reported in past audit responses, KDE has various decentralized Disaster Recovery procedures for critical systems and services in place. With the hiring of a full-time Security Program Manager in 2008, KDE has focused on collecting this information in a centralized plan. KDE has a project underway to develop a documented plan that will ensure the continuity of operations and availability of critical resources and services in the event of a disaster. Initially, the KDE Enterprise Disaster Recovery Plan will include Crisis Management functions for business recovery. And, the bulk of the plan will address Recovery Functions for the enterprise IT services provided to the KDE Agency and K-12 School Districts. Before the project is completed, all necessary personnel will be notified of the location of the plan and the update process going forward. Once the project is completed, an on-going Disaster Recovery Program will include annual testing and other awareness activities.

School districts will continue to be informed of the Disaster Recovery services provided by the outside vendor for MUNIS (KDE's Financial Management system).

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-27: The Kentucky Department Of Education's Office Of Education Technology Should Expand And Consistently Apply Logical Security Policies For The KETS Network And MUNIS

As noted in our prior three audits of the Kentucky Department of Education (KDE) system controls, the Office of Education Technology (OET) has not formalized and implemented a security policy that identifies management and user responsibilities concerning security surrounding the Kentucky Education Technology System (KETS) network and MUNIS. Although KDE has developed an Acceptable Use Policy and Access Control Policy to address appropriate use of resources within KDE, these policies do not specifically address IT responsibilities associated with the KETS network and MUNIS.

OET management is responsible for central workstations and servers, as well as OET-related employee and contractor network access. Our audit revealed OET had not implemented a formalized security policy to control system access by these employees and contractors or access to OET-maintained servers by system users within other business units. Further, audit logging was enabled by OET for all UNIX and Windows-based servers; but, no security policy was formalized at the central level concerning procedures to periodically review the audit logs for users with high-level privileges.

All KDE users were granted Local Administrator rights on their workstations. This is considered unnecessary access for most KDE employees. Technical and support staff should be the only personnel with this level of access to prevent the accidental or intentional introduction of viruses or the loss of programs or data and to ensure workstations utilize only approved software.

In addition, an access request form was not developed for requesting and granting access to agency resources and applications. Currently, the OET Data Center Services team grants server access. The level of access is determined by the Division of Financial Data Management. Employees are required to sign Confidentiality Agreements upon hire. However, this form did not specifically identify the agency resources or applications to which the user requires access, did not list the level of access to be granted to the user, and was not required to be updated for changes in access. KDE intends to require access requests be processed through the KETS Service Desk in the future, although this is not currently a formalized procedure.

The school districts primarily use the MUNIS financial system to manage their finances. In addition, certain financial and staffing reports exist that KDE uses from the districts for state and federal purposes. When districts are ready to forward files to KDE, a transfer utility program transfers the file to a Gateway server maintained by OET, and then the files are transported daily to a File Transfer Protocol (FTP) server and temporarily stored for pickup by the Office of District Support Services (ODSS) staff. As MUNIS is a purchased system, specialized for Kentucky, select vendor staff also have access to the districts' MUNIS servers in the event that support is needed. Review of supporting documentation on file for a sample of five vendor staff with update access to district servers revealed none of the five users had a Confidentiality Agreement on file with KDE.

During FY 2010, five new user accounts were established on the Gateway server and three new user accounts were established on the FTP server.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-27: The Kentucky Department Of Education's Office Of Education Technology Should Expand And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)

Based on our review, two of the new users on the Gateway server and one new user on the FTP server were considered testing exceptions due to the Confidentiality Agreement being signed at least seven months after access was granted. Further, one new user on the Gateway server for which we had requested supporting documentation, was determined by the agency to have left the employment of KDE; therefore, the access was deemed unnecessary and was revoked at that time. Information provided by the agency indicated this access was available for approximately 11 months after the employee's transfer.

Further, one new security group was established on the FTP server during FY 2010, but no supporting documentation for its creation was on file. Eight new users were added to groups on the Gateway server and five new users were added to groups on the FTP server; again there was no documentation supporting the access granted to these users. Additionally, we identified 11 disabled accounts on the Gateway server and 8 disabled accounts on the FTP server that remained members of one or more security groups on the respective servers.

Although no new Jefferson County school district employees had access to the servers reviewed for FY 2010, we determined KDE still does not request Confidentiality Agreements or other supporting documentation for Jefferson County employees. However, it was determined OET plans to establish an agreement with Jefferson County in the future to ensure all Jefferson County employees with MUNIS access agree to an appropriate level of confidentiality.

Although neither KDE nor OET had implemented a formal security policy related to specifically accessing MUNIS servers or software in the districts, an informal process was in place for KDE or OET staff to first obtain authorization from the school district before accessing the district's MUNIS server or software. A log was maintained at OET to track access to district servers by the root account. However, review of this log revealed that the activity being captured does not include the district server being accessed.

We are aware an overarching KDE Security Program exists including a Program Charter and Framework, governing technology policies, procedures, and initiatives. However, this group of documents was not finalized.

Without strong, formalized, logical security controls, the opportunity increases for unauthorized modification to financial and staffing reports as well as the likelihood of errors or losses occurring from incorrect use of data and other resources. Granting users local administrator rights to their workstations allows those users the ability to download and install unauthorized software as well as possibly pirated data.

Formalized security policies set the tone of management concern for strong system security and provide a security framework used to educate management and users of their responsibilities. System security should be administered in such a way as to ensure proper segregation of duties.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-27: The Kentucky Department Of Education's Office Of Education Technology Should Expand And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)

System access should be limited to the level necessary for performing assigned duties, and system accounts should not be shared to ensure individual user activity could be tracked. Granting users system administration access to their computers increases the likelihood that unauthorized and unlicensed software could be installed and increases the chance of system attacks by viruses or other malware.

Further, access to servers that house critical financial and staffing data should be restricted to only necessary employees. Intruders often use inactive accounts to break into a network. If an account is not used within a reasonable period of time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will access the account. Accounts that are not anticipated as being used in the future should be periodically purged. Finally, system user accounts and audit trails should be reviewed periodically in order to ensure identification and tracking of user activity.

Recommendation

We recommend OET standardize security responsibilities for all OET employees and ensure critical programs and data related to the KETS network and MUNIS, as well as the servers housing such data, are properly secured. The agency should, at a minimum:

- Formalize procedures related to the management of locked and disabled accounts on agency servers. These procedures should address the process of disabling or removing terminated employee accounts, as well as unnecessary generic accounts. Accordingly, a methodology should be developed so that a distinction can be made between accounts that can be safely removed versus accounts that must be retained on the server for performance reasons or audit trail history. These procedures should include the requirement for a periodic review of disabled and locked accounts to determine their necessity. If an account is deemed unnecessary, it should be permanently removed from the OET servers unless there is a pragmatic reason for maintaining the account, in which case it should be, at a minimum, disabled. All disabled accounts should be removed from current group membership on the OET servers.
- Evaluate all security group assignments on the OET servers to ensure that all assigned users require membership in the assigned groups. Implement procedures to periodically review security audit logs with special attention being given to users with high-level privileges so that inappropriate use of resources can be further investigated, if the need arises.
- Restrict Local Administrator rights to technical and support staff.
- Ensure all Confidentiality Agreements for sensitive information are completed, signed no later than the time access is granted, and retained by appropriate personnel.
- Finalize and implement plans to establish an agreement with Jefferson County to require a confidentiality agreement for all Jefferson County employees with access to OET servers.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-27: The Kentucky Department Of Education's Office Of Education Technology Should Expand And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)

Recommendation (Continued)

- Develop and implement a user access request form. Users requesting access to KDE resources or applications should be required to complete this form. The completed forms should be approved by appropriate management and should be maintained in the user's file as supporting documentation for their access. Until an access request form is established, OET should continue to use KETS Service Desk tickets to establish or alter access. These tickets should be maintained for audit purposes.
- Ensure sufficient information is captured with the log used to track access to the district servers to allow the reviewer to determine the server on which the activity took place.

This comment is a result of our IT Audit fieldwork, which focused specifically on logical security policies governing MUNIS and the KETS Network. The same type of review was performed on specific critical applications for which the ODSS is responsible, which also resulted in a comment governing ODSS logical security policies, see 10-KDE-30. KDE should determine whether similar weaknesses exist in relation to other agency-identified critical applications. If so, then we recommend KDE ensure either a centralized or an individual security policy be developed and implemented to cover all critical applications owned by KDE.

Management's Response and Corrective Action Plan

- *KDE disagrees with the assessment that the Office of Knowledge, Information and Data Services (formerly OET) has not formalized and implemented a security policy that identifies management and user responsibilities surrounding the KETS and MUNIS and that the Acceptable Use Policy and Access Control Policies do not specifically address IT responsibilities. KDE has established an IT Security Program to introduce security control policies and processes and has a Security Program Manager. IT Security policies are being put forth and adopted for all of KDE. The existing policies broadly address management and user responsibilities and more work will come to further define the processes and procedures to support these policies as well as others.*
- *Due to the large number of services authenticated through Active Directory, KDE has started a formal process to review and remove accounts that have not been recently accessed. KDE plans to formalize additional processes to review enterprise accounts and sensitive servers administrated by KDE business owners thereby increasing current security controls.*
- *KDE plans to develop a process to review the security group assignments of sensitive servers. Currently KDE has limited resources, staff, and tools to regularly review security logs in an effective and efficient manner. Logs are retained short-term for review once an incident/issue is identified.*
- *KDE continues to investigate current methods available to reduce the number of KDE workstations with Local Administrator rights.*

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances***

FINDING 10-KDE-27: The Kentucky Department Of Education's Office Of Education Technology Should Expand And Consistently Apply Logical Security Policies For The KETS Network And MUNIS (Continued)

Management's Response and Corrective Action Plan (Continued)

- *KDE will improve the management of Confidentiality Agreements for sensitive information including Jefferson County agreements.*
- *KDE will introduce a common User Access Request process that will be used by all offices to administrate and track access to KDE Enterprise applications and other critical systems.*
- *KDE will investigate new methods to capture the district MUNIS server identification within the District server access log.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-28: The Kentucky Department Of Education's Office Of Education Technology Should Consistently Apply Program Modification Procedures

As noted during the prior four audits of the Kentucky Department of Education (KDE) system controls, the program modification process developed by the Office of Education Technology (OET) is not sufficient to ensure only authorized changes to the IT environment, which includes the Municipal Information System (MUNIS), are made.

OET developed and implemented a formalized Change Management Policy and Procedures Manual. This manual stipulates changes made to the IT environment must be documented on a properly completed and approved Request for Change (RFC) form. However, the manual does not specify the individuals responsible for performing testing of a proposed change or migration of a change to production. The current informal process has members of the MUNIS Support Team and one Tyler Corporation employee responsible for testing MUNIS-related changes. On the approval of the Project Manager, MUNIS-related changes are moved into production by a member of the MUNIS Support Team. This informal process could lead to a segregation of duties issue between the request for change, development of the change, testing of the change, and promotion to production. It could also lead to a failure to complete any one of these tasks.

Over the past four years, we have recommended the implementation of digital signatures on the RFC forms. However, due to budgetary constraints, OET does not anticipate moving to this technology. Since the RFC forms are submitted and approved electronically through a simple process of typing an individual's name in the approver's field, there is not sufficient information maintained within the documentation to determine who provided an approval for a change. Furthermore, OET had not developed a listing of authorized Requesters/Owners who can request a change to the IT environment. These two features should be developed and used in conjunction to ensure only authorized requests are processed.

Further, changes to the KDE utilities are not consistently tracked through the OET change management process. Our review of five KDE utilities revealed there were 284 lines of code changed that affect processing within the source codes of two of these utility programs; however, these changes were not individually logged within the tracking spreadsheet. Therefore, we could not determine, based on the documentation provided, that approval was granted for each line changed within the code.

Also, testing of the Forward Schedule of Change (FSC) worksheet revealed four of the completed changes did not have actual start times and completion times properly documented. Finally, an examination of nine Request For Change (RFC) forms related to changes to the MUNIS system since our prior year review revealed one RFC form was not properly filled out to reflect the completion date. Another RFC form tested was not properly filled out to reflect personnel performing the testing, date of testing, and results of testing.

Failure to properly apply and monitor change control procedures increases the risk that incorrect or unauthorized changes could be made to critical applications and, potentially, be moved into the live production environment.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-28: The Kentucky Department Of Education's Office Of Education Technology Should Consistently Apply Program Modification Procedures (Continued)

Program modification control procedures should be consistently applied in order to ensure that only appropriately authorized changes to critical applications are made and implemented within the production environment. All program modifications are to be requested on a Request for Change form. They should be monitored and thoroughly documented, with procedures established to log all program change requests, review and approval processes to be followed, and supporting documentation to be maintained for the process. Changes to OET utilities should also be included in the change management process.

Recommendation

We recommend an expansion of the OET Change Management Policy and Procedure manual to identify specific individuals or groups responsible for performing changes, testing changes, authorizing promotion of changes, and moving changes into production. All change management controls should be consistently applied to critical system software and utility programs. This process should be attributed to changes for both the IT environment and the OET utilities.

All changes should be requested and approved using the RFC form. Individuals responsible for approving the RFC form either should be required to print, sign, and date the RFC form or provide email correspondence indicating approval which can be linked to the RFC form in order to validate approvals and avoid segregation of duties issues. Further, in the event a major change is made to utility codes, OET should perform a comparison of the old and new versions of the utility code to determine which lines specifically were changed. RFC forms as well as other supporting documentation should be maintained for audit purposes. Also, each time a change is made to the utility source code; it should be documented in the 'Revision' section of the coding.

Management's Response and Corrective Action Plan

KDE will review the KDE/KIDS Change Management documentation and add the following improvements:

- *Identify groups responsible for performing, testing, and approving changes for critical system software and utility programs.*
- *Identify major changes to utility code for critical systems in the Revision section of the code.*
- *Review and improve the monitoring and approval procedure for the Request for Change form and Forward Schedule of Changes documents.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-29: The Kentucky Department Of Education Should Ensure All Agency Machines Are Properly Configured To Include Only Necessary Services

As noted in the previous audit, our FY 2010 security vulnerability assessment on machines owned by the Kentucky Department of Education (KDE) revealed 56 of 70 scanned central level machines, or approximately 80.0 percent, could potentially be mis-configured. A mis-configured machine could waste resource, entice an attack using ports that are unnecessarily open, have default services running, or allow excessive hypertext transfer protocol (HTTP) methods. The ports open on each of these machines should be reviewed to ensure they have a specific business purpose and that the services are properly authorized. Nine of the machines contained open ports addressed with the agency during the previous audit. Of the 50 potentially mis-configured machines, four machines reported the potential use of a remote shell suite of programs.

For security purposes, detailed information that would identify the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

System misconfigurations that allow unnecessary services can negate other security configurations established on the machine, increase potential security vulnerabilities, and provide enticements for intruders to enter the system. Specific to web servers, excessive HTTP methods provide additional avenues for system intrusion. The use of unsecured transmission programs also increases the risk of compromised data transmissions.

To assist in securing a network adequately, it is necessary to ensure all machines and web services are configured to only allow necessary services to operate. Only necessary business-related ports should be open. Default services should be disabled. Only the necessary HTTP methods (such as POST, HEAD, and GET) should be supported on agency web servers.

Recommendation

We recommend KDE take the necessary actions to ensure the noted services on each machine have a specific business purpose and are properly authorized. If the service is necessary, it should be reviewed to ensure it is properly authorized, licensed, and configured as well as adequately secured. Default services should be disabled or removed from all servers. Any unnecessary services should be disabled or the associated ports should be closed. HTTP methods not required for the operation and maintenance of a web server should be disabled. If the remote shell suite of programs is being utilized, it should be replaced by a more secured shell suite.

Management's Response and Corrective Action Plan

KDE will review all KDE managed servers noted and take action to address. We will remove unnecessary and default services where possible. Rtools are used on the UNIX environment supporting the MUNIS application. The UNIX hardware is dated and limits the ability to upgrade support tools. KDE is currently evaluating options to migrate the MUNIS application to another platform where Rtools would no longer be used. KDE will continue to revise the Security Best Practice documentation for districts and encourage them to resolve configuration and vulnerability problems identified in these or other scanning processes.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-30: The Kentucky Department Of Education's Office Of District Support Services Should Expand And Consistently Apply Its Logical Security Policies

As noted during the prior four audits, we determined through the review of the Kentucky Department of Education (KDE) controls the Office of District Support Services (ODSS) did not properly secure the critical financial data associated with the Support Education Excellence in Kentucky (SEEK) II program. This is the fifth consecutive year we have commented on similar weaknesses, although we did note some improvement since FY 2009. The logical security issues identified during our audit are presented below.

ODSS implemented the new SEEK II application on July 1, 2008. SEEK II allows for better control of user access through the assignment of individual user accounts and associated security roles. In addition, the SEEK II production and development servers were segregated with assigned server administrators having oversight responsibilities on each server. ODSS had also created a SEEK II User Manual, which documents vague logical security procedures surrounding SEEK II. Discussions with KDE staff revealed the manual has been finalized; however, the word 'DRAFT' is still noted on the front of the document. Also, the procedures still lack management and user responsibilities concerning Information Technology (IT) security surrounding the SEEK II program. Further, SEEK II password policies were not documented in the SEEK II User Manual to ensure user understanding and compliance.

Also, an ODSS Systems Access Request Form was developed on January 31, 2010 to assist in documenting user requests to ODSS-maintained systems, including SEEK II. However, no instructions were developed on how to complete the form or explanations of the levels of access available for the individual systems. Formal procedures were not developed related to the ODSS-maintained systems nor were application specific procedures incorporated into the SEEK II User Manual. A review of the SEEK II User Manual identified some information related to logical security; however, this information was scattered within the Manual and specific details related to user access levels available within the application were not discussed.

During FY 2010, we identified eleven new users with access to the SEEK II application. Seven of these users, or approximately 63.6 percent, had no documentation supporting their request for access. These requests were made verbally and were created prior to the implementation of the ODSS Systems Access Request Form.

We also identified one operating system group on the development server with an enticing name and unknown function. This group had Full Control rights on the development server. ODSS staff indicated the group was created by default at installation and was not actively used. During the prior year audit, this group was also noted on the production server, but was removed.

While auditing the logical security controls surrounding SEEK II, we discovered segregation of duties issues where two SEEK server administrators and a developer had excessive access to both production and development.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KDE-30: The Kentucky Department Of Education's Office Of District Support Services Should Expand And Consistently Apply Its Logical Security Policies (Continued)**

Without strong and formalized logical security controls, the opportunity increases for unauthorized modification of production files as well as the likelihood of errors or losses occurring from incorrect use of data and other resources. Without sufficiently strong password criteria and allowing excessive access rights to groups increases the risk of system exploration by unauthorized users.

Formalized and consistently applied security policies set the tone of management concern for strong system security and provide a security framework used to educate management and users on their responsibilities. System security should be administered in such a way as to ensure proper segregation of duties. System access should be limited to the level necessary to perform assigned duties, and unnecessary accounts and groups should be removed. Unless a formal agency policy is in place that is more restrictive stating otherwise, agency passwords should conform to the Commonwealth Office of Technology (COT) standards as stipulated in the CIO-072 UserID/Password Policy. Of particular note, passwords should be a minimum of eight characters in length, should contain at least one special character, and should be changed at least every 31 days.

Recommendation

We recommend ODSS formalize the SEEK II User's Manual by removing the word 'DRAFT' on the front page. ODSS should incorporate a 'Revision History' section within the manual to capture future changes made. This history should show a brief description of what change was made, by whom, and when. ODSS should document the password policies for the SEEK II application and peripherals within the SEEK II User Manual. Specifically, password policies should be documented for the SEEK II application, the production database, the production web server, and the development server. The SEEK II User's Manual should also be expanded to include management and user responsibilities concerning IT security surrounding the SEEK II program.

We recommend ODSS develop general user request procedures requiring the use of the ODSS Systems Access Request Form. ODSS should expand the ODSS Systems Access Request form to include instructions on how to complete the form and explanations of the levels of access available for the individual ODSS-maintained systems.

Finally, the group on the development server identified with an enticing name should be disabled if there is no business purpose for its operation. If this is not feasible, ODSS should reduce the group's rights on the development server to Read Only.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-30: The Kentucky Department Of Education's Office Of District Support Services Should Expand And Consistently Apply Its Logical Security Policies (Continued)

Management's Response and Corrective Action Plan

Management has reviewed the recommendations and has identified the necessary correction plans for each identified issue. Here are the individual responses:

- *As indicated in the May 12th response, the word 'DRAFT' was an oversight when originally sent for review and was removed at that time.*
- *A revision history block was added to the manual as follows:*

<i>Date of Issue</i>	<i>Author(s)</i>	<i>Brief Description of Revision</i>
<i>8/16/2010</i>	<i>Tim Cooper</i>	<i>In response to Auditor comments added the following: additional security language, list of available roles, user request form step for new users, password requirements, and revision history block for the document.</i>

- *The following verbiage has been added to the manual to specifically document the password polices for the application, the databases and the servers. The password requirements for the application are as follows: minimum 5 characters in length, at least one numeric character, at least one upper-case character and does not expire. The same password requirements exist for the databases. The password requirements for the servers themselves follow AD requirements as defined by KDE OET, but a user of the SEEK II system does not need a login to either the servers or databases.*
- *The SEEK manual already indicated the basic user responsibilities concerning IT security and their individual responsibilities. For example the manual includes the following:*

Your password is confidential and should be known only by you. If someone else knows your password, they can make changes to very sensitive data and those changes, no matter how big or small will be attributed to you. Again, your password is confidential and should be known only by you.

Once each new user has been created and assigned rights, the system will handle the enforcement of user rights via the user ID used to log in to the system. For this reason, it is very important for SEEK users to never trade login IDs and/or passwords. It is also important that users refrain from leaving unattended, a workstation upon which they are logged in to the SEEK II system.

FINANCIAL STATEMENT FINDINGS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-KDE-30: The Kentucky Department Of Education's Office Of District Support Services Should Expand And Consistently Apply Its Logical Security Policies (Continued)**

Management's Response and Corrective Action Plan (Continued)

To reinforce the responsibilities associated with utilizing the system, the following text was added to the manual to identify the user's security responsibilities that are applicable to the use of all KDE systems including SEEK II:

Users and management must understand that use of the system falls under KDE policies such as Acceptable Use Policy and Access Control Policy.

- *The ODSS Access Request form now has instructions for completing the form.*
- *The identified group on the development server that was thought to have an 'enticing name' has been removed.*

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-31: The Division Of Nutrition And Health Services Should Develop, Implement, And Consistently Apply A Formal Logical Security Policy

As noted during our previous audit, our FY 2010 audit of system controls determined the Kentucky Department of Education's (KDE) Division of Nutrition and Health Services (DNHS) had not developed or implemented formal logical security control policies and procedures concerning the Nutrition and Health Services Payment (NHSP) Application. Further, review of user accounts within the application revealed multiple accounts for active users and accounts associated with users no longer employed by DNHS.

In order to grant access to the NHSP Application, a completed Network/Server Access Request Form (COT-F-181) is sent to the Commonwealth Office of Technology (COT) requesting a user be established with access to the State's mainframe. Once mainframe access is granted by COT, security personnel at DNHS establish user access within the NHSP application. Currently, no formal procedure exists to regulate the request for user access, approval of the access requested, and the access level assigned to a user within the NHSP application, or removal of access when job duties change or an employee leaves DNHS. Discussions with DNHS staff revealed that the process of documenting system access processes was begun during FY 2010; however, a formal policy was not completed by the end of audit fieldwork.

Our review of the security table related to sponsorship access revealed the existence of six user Ids being explicitly associated with the previous Program Coordinator, who retired in July 2008. Additionally, four previous DNHS users continued to have access to the NHSP application during FY 2010. After identifying these 10 Ids, DNHS security staff deleted them from the system.

Testing of those accounts with transactional access within the NHSP application revealed 85 out of 1,405 unique users, or 6.0 percent, had one or more user Ids with specific access to the system, which were determined to be inappropriate. There were 121 unique user Ids associated with these 85 users. Issues noted with these accounts include:

- 19 user ids where a data entry error was made when establishing the user Id. These type errors were corrected by deleting the invalid user IDs from the system.
- 66 user Ids were no longer needed. These were due to a sponsor leaving the program. The associated user Id is deactivated (as opposed to being deleted) in the event that they return.
- 34 user Ids were identified as having more than one valid user Id, but there was no additional explanation provided to validate the necessity of multiple accounts.
- 2 user Ids are related to one user in order to complete testing associated with the system.

As previously noted, there were six user Ids associated with the previous Program Coordinator. These accounts continued to have level '7' access, or full access to sponsor claims. As recently as March 2010, all six user Ids associated with the previous Program Coordinator had access to sponsor data. Documentation was provided during the previous audit indicating the removal of these accounts was completed on November 5, 2009. However, review of the original security table for FY 2010 indicated that these user Ids either were not deleted or were subsequently reinstated. DNHS staff subsequently provided an updated Security table to document that the user Ids in question were deleted.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-31: The Division Of Nutrition And Health Services Should Develop, Implement, And Consistently Apply A Formal Logical Security Policy (Continued)

Furthermore, three DNHS staff members that have access to the NHSP application were not listed on the current NHS staff listing to show what security level was granted to them within the system.

Finally, review of the security table revealed one individual whose access level to the NHSP application was inappropriate based on current job duties. When brought to the attention of DNHS, this account was removed.

Failure to adequately document, implement, and communicate acceptable computer security policies and procedures could lead to a lack of understanding by management and users, thereby heightening the risk of noncompliance with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This increases the likelihood of unauthorized or inaccurate data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources.

Formal security policies set the tone of management commitment for strong system security and provide a security framework used to educate management and users of their responsibilities. Specific policies should be established related to system access controls to help ensure only authorized users are granted access to the application. These policies should include procedures for requesting new system access, changes to existing system access, and termination of system access. Management authorization of access requests should be documented. All supporting documentation should be maintained for management and audit review. Additionally, system users should be made aware of their responsibilities concerning data confidentiality, as well as appropriate and efficient usage of system resources. Consistent application of formalized security policy and procedures provides continuity for implementation and sets the tone of management concern for strong system controls.

Recommendation

We recommend DNHS develop and implement formal policies and procedures to administer the logical security over the NHSP application and ensure those procedures are consistently applied. Security access requests and applicable authorizations should be properly documented and maintained for all system users. DNHS should ensure all access requests contain adequate information necessary to grant approval to system resources and that appropriate approvals are applied. This policy should also address procedures to follow when employees are terminated or leave employment to ensure access is disabled appropriately and in a timely fashion. These policies and procedures, once developed, should be properly distributed and all system users made aware of their responsibilities concerning system access.

Further, we recommend DNHS perform a periodic review of all user accounts with access to the NHSP application to ensure users are current employees and associated access levels are appropriate based on job duties.

FINANCIAL STATEMENT FINDINGS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-KDE-31: The Division Of Nutrition And Health Services Should Develop, Implement, And Consistently Apply A Formal Logical Security Policy (Continued)**

Management's Response and Corrective Action Plan

NHS concurs with these findings and will implement a more rigorous set of procedures to monitor and control system access. A new NHS assistant director will act as the security officer for NHS. All requests for access to the NHSP system will be routed through the assistant director, who will then review and approve access. Formal procedures regarding security policies will be developed and disseminated with NHS/COT personnel. The procedures will contain steps to ensure only valid users are given access, the appropriate security level will be assigned and steps will be formulated for monitoring. A separation checklist has been enacted that contains a section on terminating user accounts for departing staff. To verify system integrity, a periodic audit will be completed on user accounts. The list of active user accounts will be compared to all active sponsors and NHS staff to confirm the list of active user accounts is correct.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KDE-32: The Division Of Nutrition And Health Services Should Ensure Proper Segregation Of Duties**

As noted during our prior year audit, our FY 2010 audit of the Kentucky Department of Education's (KDE) Division of Nutrition and Health Services' (DNHS) Nutrition and Health Services Payment (NHSP) Application revealed DNHS did not employ proper segregation of duties between the system administration and processing functions.

Currently, it appears that security levels available within the application will not allow sufficient segregation of duties. DNHS made the necessary changes to staff roles and responsibilities to promote greater segregation of duties within the NHSP application. However, the Commonwealth Office of Technology (COT), which developed and currently maintains the application, has not made the necessary configuration changes to update the security levels in order to implement the newly designed roles.

Testing revealed there are differences between the available security access levels, the documented access rights for central level staff, and the actual rights provided to users. Specifically, two DNHS IT staff members, although identified for other access levels, were provided with full administrative control over the security as well as the ability to process data through the system. Also, two DNHS administrative staff members had access levels to the application which do not correlated to the documented levels to be provided to these users. Given the fact that the system does not retain historical data and no formal review process is in place, elevated or inappropriate levels of access could potentially allow controls to be circumvented.

Employing strong segregation of duty controls decreases the opportunity for unauthorized modification to files and programs, and decreases the likelihood of errors or losses occurring because of incorrect or unauthorized use of data, programs, and other resources.

Employees that process payments should not be allowed to input or approve a claim on the system. Smaller organizations that cannot easily segregate duties should implement compensatory controls to supervise and monitor system activities to ensure erroneous claims are not processed.

Recommendation

We recommend DNHS continue to work with COT to ensure the newly developed security levels and associated roles promote adequate separation of duties within the NHSP application and are appropriately implemented within the current NHSP application. Once implemented, DNHS should perform a review of access rights granted to all central level staff to ensure access rights are appropriate and reasonable given their individual job functions. These new security levels and roles should also be taken into consideration when designing the security of the new NHSP application currently under development.

Further, we recommend DNHS develop a formal review process to ensure all claims submitted and approved within the current application are appropriate.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KDE-32: The Division Of Nutrition And Health Services Should Ensure Proper Segregation Of Duties (Continued)**

Management's Response and Corrective Action Plan

The security levels are in the development phase by COT. Rigorous testing will be performed by NHS in the test environment before these are released into production. NHS will reassign the appropriate security level to all staff members based on their current job duties. Security level assignment will be restricted to key management staff: NHS director, assistant director and the project manager. Security levels will be reviewed and potentially revised with the new system to meet the current security needs of NHS. This will be included within the RFP as a system requirement for the new system.

Regarding the quality control on claims payment, NHS will review this with COT to develop the best possible approach. Once a process has been developed a monthly review of claims will be conducted and documented to ensure the system is functioning properly.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-33: The Division Of Nutrition And Health Services Should Develop Formal System Documentation To Support Processing Performed By The Nutrition And Health Services Payment Application

As noted during our prior year audit, the Kentucky Department of Education's (KDE) Division of Nutrition and Health Services (DNHS) did not maintain current, basic documentation describing the processing performed by the Nutrition and Health Services Payment (NHSP) Application.

The NHSP application, which was developed by and is currently maintained by the Commonwealth Office of Technology (COT), went into production in 1982. Updates and expansions of services were made to the application over the last 28 years, most recently in February 2010. Discussion with COT personnel during the FY 2009 audit revealed no technical manuals existed documenting the design or functionality of the system. They did indicate a series of binders had been maintained containing notes documenting how to perform different tasks within the application; however, many of the notes were identified as being outdated or obsolete.

During FY 2010, DNHS staff produced a Nutrition and Health Services (NHS) Technology Manual. Although the manual was not dated with the most recent revision date, review of this manual determined the manual was several years out of date. Specifically,

- several key personnel referenced within the manual no longer work for DNHS;
- COT policies included in the manual are outdated; and,
- references are made to the Management Administrative Reporting System (MARS), the Commonwealth's statewide accounting system which was superseded in July 2006.

Further, during the planning phase of the FY 2010 audit, DNHS staff produced a copy of the CESN User Setup document, which provides a security administrator with the steps necessary to grant Customer Information Control System (CICS) access to a user. A review of additional documentation obtained during fieldwork related to the security levels available within the application do not consistently match the levels identified within this User Setup document.

We are aware DNHS had plans to hire a business analyst to formulate clear, comprehensive, and well-organized business rules of the existing system. This documentation will be used as part of the development process for a new NHSP application.

Lack of documentation increases the likelihood of erroneous or incomplete processing. It further increases the likelihood of unauthorized data modification, destruction of assets, and interruption of services.

Proper documentation should be maintained for each critical program in production in order to, at a minimum, identify the purpose of the programs, the origin of data, the specific calculations or other procedures performed, and the output of data or reports.

FINANCIAL STATEMENT FINDINGS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-KDE-33: The Division Of Nutrition And Health Services Should Develop Formal System Documentation To Support Processing Performed By The Nutrition And Health Services Payment Application (Continued)**

Recommendation

We recommend DNHS work with COT to develop documentation that provides an understanding of critical programs or jobs currently running in production. All available guides or user documentation should be updated to reflect current policies or formally superseded with more up to date documentation. The documentation could include a network diagram; user and operational manuals; and flowcharts, diagrams, or descriptive narratives of functional areas. Information normally collected in design documents includes a technical description of the program, sources and location of files used by the program, and the processing steps for main functions. This documentation should be used during the planning of the new NHSP application for cross-walking procedures from the old to the new system.

Management's Response and Corrective Action Plan

NHS concurs with the findings regarding inadequate, incomplete and outdated documentation in regards to the current NHSP application. NHS documentation will be either developed or revised to reflect the current NHSP application status. COT will be enlisted to assist in this project. The new business analyst will assist in this effort to update the current system documentation. For the new system, procurement efforts are focused on a commercial off the shelf (COTS) application. As such, it is expected to be USDA compliant in all program areas with customization for Kentucky's own specific needs. The historical claims and application/agreement data is expected to be migrated over from the current system. Documenting the current system will assist us with developing the business requirements as well as with the migration effort.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDE-34: The Division Of Nutrition And Health Services Should Enable System Auditing On Its Nutrition And Health Services Payment System

As noted during our prior year audit concerning application security over the Kentucky Department of Education's (KDE) Division of Nutrition and Health Services' (DNHS) Nutrition and Health Services Payment (NHSP) Application, our FY 2010 audit revealed historical transactions, including those related to security, are not logged or tracked within the system. The United States Department of Agriculture (USDA) Southeast Regional Office (SERO) of Food and Nutrition Service (FNS) had a finding related to this issue since FY 2007.

The NHSP application, which was developed and currently maintained by the Commonwealth Office of Technology (COT), retained the date of the last update to claims and approvals, as well as the user Id of the person that made the update. However, it did not identify what information was changed. Further, the system did not retain a historic version of transactions.

Additionally, users with an access level of '1' are given full control over claims, sponsor and organization screens, applications, agreements, approvals, system access, and bank balances within the application. Since the system did not maintain a history of changes to security levels, it was not possible for the system administrator or management to review changes to a user's security level within the system. DNHS had worked during FY 2010 to alter the staff's security roles and job tasks associated with each security level to improve segregation of duties; however, COT had not made the necessary system changes to accommodate these improvements.

DNHS did not believe it is feasible to enable security auditing on the current NHSP application since a new system is currently being developed.

Failure to adequately monitor security events and transaction logs could result in failure to identify suspicious activities that may be occurring on the system.

Without effective monitoring of event and security logs, the risk of inappropriate transactions being processed by the system increases. A logging and monitoring function within an application and consistent review of the results enables early detection of unusual or abnormal activities.

Recommendation

We recommend DNHS work in conjunction with COT to ensure the proposed security level changes within the NHSP application are incorporated to improve segregation of duties and, thereby, system security. DNHS should implement compensating controls to ensure only appropriate transactions are processed within the NHSP application. An appropriate level of management should perform regular reviews of the data maintained by the NHSP application. This review should be documented for audit purposes.

Further, we recommend DNHS ensure audit logging is a requirement for the new system. Once the new system is implemented, DNHS management should review the event and history logs on a regular basis. Identified security violations should be thoroughly documented to ensure they are resolved in a timely manner. This review should be documented for audit purposes.

FINANCIAL STATEMENT FINDINGS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-KDE-34: The Division Of Nutrition And Health Services Should Enable System Auditing On Its Nutrition And Health Services Payment System (Continued)**

Management's Response and Corrective Action Plan

NHS is collaborating with COT to implement security levels that will ensure a greater segregation of job duties and allow for more defined control on system access. These new security levels have been assigned to COT and are in the development phase. NHS will request assistance from COT in developing mechanisms to review transactions for aberrant activity. Once this is implemented, a regular review will be initiated and the results documented.

The future system will have role based security and is expected to have higher granularity in allowing access to the system than what is currently available. Event and history logs maintained by the system will allow NHS to closely monitor transactions. Periodic reviews will be undertaken for compliance with the security procedures.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KHP-35: The Kentucky Horse Park Should Enforce Controls Regarding Payroll Records And Segregate Duties For Payroll And Personnel Activities

The Kentucky Horse Park (KHP) employs full time and interim employees throughout the year. Approximately 200 employees worked at the KHP in FY 10. The employees complete a Time and Attendance (T&A) Report and the supervisor transfers the time from the T&A report onto a timesheet. The employee is required to sign the T&A report and the supervisor should sign both the T&A report and the timesheet; however, according to the Human Resource (HR) Manager, the time keeping is acceptable as long as one document is signed by the employee and supervisor. The HR Manager acts as the timekeeper and inputs the time into the state's payroll system, Unified Personnel and Payroll System (UPPS). UPPS generates a 1017 Report and the HR Manager compares the report to the timesheet and checks for errors.

During the FY 10 payroll audit, we requested 40 employees T&A Report and timesheets for various pay periods. Out of the 40 employees tested, we noted the following exceptions related to 11 employees:

- Ten instances in which the supervisor did not sign either the Time and Attendance (T&A) Report or the timesheet;
- One instance in which the employee did not sign either the T&A Report or the timesheet;
- One error in which the employee was not paid correctly according to the T&A Report, the timesheet, and the 1017 UPPS Report; and
- Forty instances in which the timekeeper did not sign the timesheets.

The internal controls over the payroll process were also reviewed. The prior year audit identified a significant deficiency in that the entire payroll process was completed by one person, the HR Manager. This deficiency continued to exist in FY 10. Specifically, the HR Manager is responsible for:

- Hiring new employees
- Sending employee information to the Personnel Cabinet
- Entering employee information in the UPPS
- Collecting timesheets from KHP employees
- Entering timesheet information in UPPS
- Reconciling timesheet information to the 1017 UPPS Report
- Receiving, sorting, and delivering payroll checks and check stubs to KHP employees
- Terminating employees
- Processing supplemental payrolls

This combination of these duties is incompatible, and, as a result, the errors identified above have gone undetected.

The KHP personnel are required to complete both a T&A report and timesheet. This is a duplication of effort since the supervisor re-enters the information on the T&A report (completed by employees) on timesheets (sent to KHP Personnel for entry into UPPS). Maintaining two separate timekeeping documents increases a risk of errors, especially if the personnel are not required to review and sign both documents.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KHP-35: The Kentucky Horse Park Should Enforce Controls Regarding Payroll Records And Segregate Duties For Payroll And Personnel Activities (Continued)

When an employee does not sign a T&A Report and/or timesheet they are not certifying that the reported time is accurate and complete. When the supervisor does not sign the T&A Report and/or timesheet they are not verifying that the time documented is accurate. If the regular timekeeper was absent and someone else entered time into UPPS, there is no way to determine who entered the time for each pay period without the timekeeper signing the timesheet.

As stated in the prior year, given the responsibilities of the HR Manager, the lack of segregated duties related to hiring, entering personnel information in UPPS, entering timesheet data in UPPS, reconciling timesheet data, processing supplemental payrolls, and receiving and distributing payroll checks increases the risk of intentional or unintentional errors. Under these circumstances, errors or fraud cannot be detected in the ordinary course of business. Subsequently, errors did occur in FY 10.

KHP did implement a few controls during FY 10, including assigning another individual to receive and deliver the payroll checks and check stubs to the KHP employees with management oversight for one pay period. Also, another employee did receive a UPPS report for a time period and validated the employees hired. No discrepancies were noted in either effort. Unfortunately, these efforts did not prevent the errors that did take place.

Proper internal controls dictate that one individual should not have authority to hire, enter the new employee information in UPPS, enter timesheet data, reconcile the same timesheet data, process supplemental payrolls, and receive and distribute checks.

Employing strong segregation of duty controls over payroll functions decreases the opportunity for unauthorized modification to transactions and files and decreases the likelihood of errors or losses occurring because of incorrect use of data.

Proper internal controls dictate the payroll records are accurate, properly authorized, and completed. Also, proper reconciliation of the time inputted into the UPPS system should be in place. This should be performed by a separate individual that inputs the employees time.

Recommendation

We recommend the KHP:

- Consider updating the payroll time and attendance procedures to reduce or eliminate the duplication of effort as a way to reduce potential errors caused by the re-entry of the same data.
- Develop and implement a consistent policy regarding who is to sign time and attendance forms, including timesheets. Extra signature lines should be removed from documents the employee/supervisor is not required to sign to avoid confusion and inconsistencies.
- Require the timekeeper initial or sign the timesheet form when time is entered into UPPS.
- Consider hiring additional personnel or reorganizing the job functions of existing employees to assist with the proper segregation of duties.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KHP-35: The Kentucky Horse Park Should Enforce Controls Regarding Payroll Records And Segregate Duties For Payroll And Personnel Activities (Continued)**

Management's Response and Corrective Action Plan

Auditor's recommendation: Consider updating the payroll time and attendance procedures to reduce or eliminate the duplication of effort as a way to reduce potential errors caused by the re-entry of the same data.

Management's response: The Time and Attendance (T&A) report is an essential managerial tool that records an employee's beginning and ending work day as well as records reasons an employee worked over or short their allotted time. There is not a place to record this information on the time sheet which is required to input data into the UPPS system. Although it might seem that there is a duplication of effort, the purpose of the two documents is different. An automated time keeping system would help eliminate potential errors that may occur when the summary data is taken from the T&A report and input into the time sheet. This purchase request has been discussed and may become part of a future budget. The new time system would have to be compatible with KHRIS.

Auditor's recommendation: Develop and implement a consistent policy regarding who is to sign time and attendance forms, including timesheets. Extra signature lines should be removed from documents the employee/supervisor is not required to sign to avoid confusion and inconsistencies.

Management's response: It is management's intent to implement a policy that requires the signature of the employee on the T&A report and supervisors are to sign both the T&A forms and timesheets.

Auditor's recommendation: Require the timekeeper initial or sign the timesheet form when time is entered into UPPS.

Management's response: It is management's intent to implement a policy that the person who enters the time will be required to initial as the timekeeper.

Auditor's recommendation: Consider hiring additional personnel or reorganizing the job functions of existing employees to assist with the proper segregation of duties.

Management's response: The KHP management has considered hiring an employee to help alleviate the substantial workload in both the personnel office and business office. At this time the budget is not available for this position. When possible, an interim employee will be instructed to provide assistance in the personnel office to help provide a segregation of duties as well as a check on proper procedure management. In addition, the business office will continue to test the controls in the personnel office. This, along with the regular assistance provided by the Executive Administrator, will improve the oversight within the personnel office.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KHP-36: The Kentucky Horse Park Should Ensure Invoices Are Paid Timely**

During testing of the Kentucky Horse Park's (KHP) FY 10 expenditure payment process, we requested a sample of 37 invoices to verify the propriety of the expenditures and accuracy of amounts posted to the eMARS accounting system. The results indicated 16 instances in which invoices were not paid in a timely manner. In addition, five test sample items related to object code E370, *Late Payment Interest-1099 Report*. Pursuant to Kentucky statutes, a 1% late fee may be applied when invoices are not paid by a state agency within thirty (30) working days. The 1% late fee was appropriately included in the total payment to the vendor for these five items. According to eMARS, the total paid in late fees during FY 10 was \$2,595.

Late payments have been a repeat issue with the Kentucky Horse Park since FY 07.

We noted several variables that possibly contributed to the late payment of invoices. The KHP business office personnel do not always receive invoices from the various departments within the park upon receipt, which impairs the timely payment of invoices.

Failure to make payments in a timely manner causes an unnecessary loss in KHP resources, primarily through the payment of late fees. This also could negatively impact the established vendor customer relationship, which in turn could affect future business transactions. Furthermore, the failure to input expenditures into the eMARS accounting system in a timely manner could result in inaccurate financial reporting of expenditures, particularly transactions at the end of the fiscal year.

Good internal controls necessitate that invoices are accounted for and paid timely to ensure accurate financial reporting. Failure to make timely payments constitutes a non compliance with KRS 45.453 which states, "All bills shall be paid within thirty (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agency has transmitted a rejection notice to the vendor."

Further, KRS 45.454 states that "An interest penalty of one percent (1%) of any amount approved and unpaid shall be added to the amount approved for each month or fraction thereof after the thirty (30) working days which followed receipt of the goods or services or vendor's invoice by a purchasing agency."

Recommendation

We recommend KHP develop and implement controls to ensure all invoices are paid timely as required by KRS 45.453. This includes working with all park departments to ensure all invoices are submitted to the business office as soon as possible.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KHP-36: The Kentucky Horse Park Should Ensure Invoices Are Paid Timely (Continued)**

Management's Response and Corrective Action Plan

The Kentucky Horse Park management agrees with the auditor's recommendation. One reason some invoices are not paid timely is that the volume of transactions are difficult on the Business Office staff to keep pace with. In addition, some invoices were not properly expedited by receiving staff which adds to the process time. Another reason why certain invoices were paid late is a continuing restricted cash flow situation that began in the last quarter of fiscal year 2008. Due to this, at fiscal year-end some invoices had to be held longer than appropriate. Together, these reasons have contributed to the late payment of a number of invoices. The Kentucky Horse Park understands the urgency of paying invoice in a timely manner and is constantly striving to improve this matter.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KSP-37: The Kentucky State Police Clothing Allowance Payments Should Be Reported As Taxable Fringe Benefits

The FY 2009 audit of the Kentucky State Police's payroll identified that Kentucky State Police provides a clothing allowance to eligible employees for non-uniformed assignments. Furthermore, the clothing allowances were not included on the employee's Federal Form W-2, Wage and Tax Statement.

Our FY 2010 follow-up of the clothing allowance finding, identified that Kentucky State Police did not implement procedures requiring employee clothing allowances be included as "Wages, Tips, Other Compensation" reported on Federal Form W-2, Wage and Tax Statement for taxable year 2010.

Failure to implement policies and procedures which incorporate tax legislation set forth in the Internal Revenue Code constitutes a noncompliance with Federal law.

The present practice of excluding the clothing allowance from the employees' taxable income is in error. Since the clothing allowance does not qualify as a deductible expense (e.g., uniforms), the payments should be treated as taxable fringe benefits and subject to income, social security, and Medicare taxes.

The Internal Revenue Code requires that all wages, tips, and/or compensation be reported on Federal Form W-2, including those benefits associated with clothing allowances. Good internal controls dictate that policies and procedures be implemented to ensure amounts are properly reported for income tax purposes.

Recommendation

As recommended in FY 09, policies and procedures should be implemented requiring employee clothing allowances be included as "Wages, Tips, Other Compensation" reported on Federal Form W-2, Wage and Tax Statement. As such, the allowances should be subject to federal income tax withholding and FICA withholding, as well as reported and remitted timely with the agency's regular payroll filings.

Management's Response and Corrective Action Plan

The Financial/Grants Management Branch of the Kentucky State Police in the past has processed the Clothing Allowance checks for the Department of State Police. Because their process is not W-2 reportable, the Clothing Allowance checks will now be processed through a dataset within the payroll system of the Human Resources Branch. We have discussed procedures with the Personnel Cabinet as to how we can process the Clothing Allowance and have it appear on the W-2.

During the 1st supplemental payroll of 2011 (January 1 - 15 supplemental), a spreadsheet will be generated by the Financial/Grants Management Branch of the Kentucky State Police including names, social security number, location and amount of money. The spreadsheet will be sent to the Human Resources Branch. The Personnel Cabinet will produce a dataset for the Clothing Allowance.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KSP-37: The Kentucky State Police Clothing Allowance Payments Should Be Reported As Taxable Fringe Benefits (Continued)**

Management's Response and Corrective Action Plan (Continued)

After the dataset is entered, there will be an audit conducted prior to payroll running. In addition, after supplemental payroll runs, the Human Resources Branch will conduct another audit to ensure that all individuals listed on the spreadsheet are paid the correct amounts.

At the conclusion of the audit, the Human Resources Branch will examine the efficiency of the process. If there are changes to be made, the changes will be set forth prior to the next Clothing Allowance cycle- July 1, 2011.

The corrective action will be taken beginning January 1, 2011 and will be included as "Wages, Tips, Other Compensation" reported on Federal Form W-2, Wage and Tax Statement.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-38: The Kentucky State Treasury Should Strengthen System Security Settings And Values

As noted during the prior two audits, review of application security over the Kentucky State Treasury (Treasury) data processing system revealed Treasury did not establish sufficiently strong system values to properly secure the data processing system. Further, critical system values on the Treasury data processing system did not adhere to industry best practice recommendations. System values are flags that configure and control various aspects of the data processing system.

During fiscal year (FY) 2010, Treasury developed a System Value Change Requests policy; however, this policy is a very high level discussion of the request process. According to the System Value Change Requests policy, requests for system value changes should be submitted to the Division Director for justification, and the approved request should be submitted through email to the Information Technology (IT) Division Manager. Subsequent to review, IT staff perform changes and maintain the request email for documentation. Although a policy was developed, it did not include appropriate benchmark settings for system values as determined by Treasury, it omitted the retention location for request emails, and it did not reference the overarching Treasury program modifications policy.

Further, we reviewed industry best practice recommendations from the data processing system's vendor and another vendor partner for 42 system settings or values to ensure security was adequate to protect the system from known vulnerabilities. Of the 42 system values examined, we discovered 15 system values, or 35.7 percent, were more lax than the recommended industry best practices.

For security purposes, detailed information concerning the specific system values that contributed to these findings was intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Failure to adequately document and communicate application-based security policies, including system settings or values, could lead to a lack of understanding by management and users. Without adequate security settings, the system may be subject to vulnerabilities that otherwise could have been prevented. By allowing excessive system value settings, Treasury exposes their processing system to a more heightened risk of unauthorized access and manipulation.

System settings and values are an integral part of the security environment within a system. It is important to note that the default values, which are set when the system is shipped and installed, do not represent industry best practices or the most secure values.

Recommendation

We recommend Treasury expand the System Values Change Requests policy to identify all security-related system settings deemed as being critical, a description of the function of the system setting, the suggested value established for the setting, and the justification for the selected value. Reputable resources should be used to ensure settings comply with industry best practices, and any required deviations should be explained and documented. In addition, the System Values Change Requests policy should be updated to stipulate the location where request emails will be retained and should reference the overarching Treasury program modifications policy for additional guidance on the process for requesting and completing changes.

FINANCIAL STATEMENT FINDINGS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-KST-38: The Kentucky State Treasury Should Strengthen System Security Settings And Values (Continued)**

Recommendation (Continued)

Once the policy has been expanded, management should review the current settings on the data processing system to ensure compliance and make changes where necessary. The revised System Values Change Requests policy should be made available to staff that require this information to perform their job duties. Management should ensure strict adherence to the policy, and the policy should be updated as needed.

Management's Response and Corrective Action Plan

Treasury has addressed some of the system value recommendations, and has made the suggested changes to the Treasury systems. The others will be evaluated to determine the impact that the changes would have on system performance and production jobs. In addition, the Treasury will begin to keep a hard copy of all system change requests. A Data Processing Services Request Form will be developed for the office. This will allow the consolidation of all requests for changes, with complete documentation of the history of the change. The forms will be kept in a binder in the Data Processing Division.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-39: The Kentucky State Treasury Should Improve Segregation Of Duty Controls

As noted during the prior two audits, our fiscal year (FY) 2010 review of the Kentucky State Treasury (Treasury) system controls revealed Treasury did not employ sufficient segregation of duties between the system security administration, operation, programming, and librarian functions in relation to their data processing system. Our testing revealed all these functions had been granted to a single individual. This individual has unlimited access to every aspect of Treasury's data processing system including management of the use, configuration, functionality, and security of the system. Because of the lack of management oversight related to these functions, there are numerous security controls that could potentially be circumvented without detection.

Of major concern is the fact that this individual had unlimited access to the following production libraries through either a system profile or individual user profile:

- The vendor-supplied library housing all production and test libraries used to perform daily and monthly processing;
- The library housing 'new' objects used to pull enhanced Management Administrative and Reporting System (eMARS) data to assist with the monthly reconciliation; and,
- The library housing all source code objects used to process the reconciliation programs and generate the monthly reconciliation reports.

This individual had the ability to make any change deemed necessary, without management approval, to system values, user profiles, and critical objects and resource authorities. Along with vendor staff, this individual was granted the use of the vendor-supplied profiles to access the system.

During the course of fieldwork, it was noted this individual was functioning as the operator of the main monthly reconciliation program. In addition, this individual acted as the librarian for the library containing the reconciliation programs. Therefore, this individual was responsible for running the programs in production which generate the monthly reconciliation reports, but could also make changes to the programs producing the reconciliation reports. Further, this individual was responsible for monitoring a history log for suspicious activity on the data processing system, yet he had the ability to alter the data within this log.

Also, this individual, along with two computer operators, had read and write access to a directory on the processing system housing the Automated Clearing House (ACH) file provided by the Finance and Administration Cabinet (FAC), which contains several eMARS electronic fund documents. This file is generated from eMARS production tables, downloaded by the Treasury computer operators from a file transfer protocol (FTP) server and stored on the data processing system, and then submitted to the bank using software provided by the bank. The two computer operators are both responsible for the retrieval of the ACH file from FAC and submission of the file to the bank; the individual noted above with multiple incompatible duties serves as the backup for the computer operators. Although this is not considered direct access to eMARS production data, it still represents a segregation of duties issue since unauthorized changes could be made to this file prior to submission to the bank.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-39: The Kentucky State Treasury Should Improve Segregation Of Duty Controls (Continued)

It is possible that these segregations of duties issues have existed since the implementation of the data processing system, which dates back to FY 2000.

For security purposes, detailed information concerning the specific account profiles and libraries contributing to this finding are being intentionally omitted from this comment. However, these issues are thoroughly documented and will be sent hardcopy to the appropriate agency personnel.

Employing strong segregation of duty controls decreases the opportunity for unauthorized modification to files and programs, and decreases the likelihood of errors or losses occurring because of incorrect use of data, programs, and other resources.

Computer programmers should not have direct access to the production version of program source code or be able to directly affect the production environment. The reason for this control is to ensure that the programmer does not intentionally or unintentionally introduce unauthorized or malicious source code into the production environment. Smaller organizations that cannot easily segregate programmer duties from librarian duties should implement compensatory controls to supervise programmer activities to ensure only properly tested and authorized programs are migrated into production.

Programmer duties should not include the migration of programs into production libraries or performing operator procedures such as executing production programs. Programmers should be restricted from the production environment and their activities should be conducted solely on “test” data. This control is designed to ensure an independent and objective testing environment without jeopardizing the integrity of production data.

The same individual should not retrieve the text file with eMARS funding data and also submit that same file to the bank, unless there are compensating controls in place to ensure no changes have been made to the data from the time it was received from FAC to the time it was submitted to the bank.

Recommendation

We recommend Treasury review the current job duties of the individual performing the security administrator, programmer, librarian, and operator function within the data processing system, and determine how these job functions can be redistributed among staff to ensure a proper segregation of duties. Specifically, Treasury should ensure:

- Someone other than the system administrator, who has unlimited access to the system, be the primary programmer who creates changes within the production programs.
- Someone other than the system administrator or the accounting staff be the operator that processes the reconciliation programs.
- Someone other than the programmer or operator be required to move changes into the production environment as the librarian.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-39: The Kentucky State Treasury Should Improve Segregation Of Duty Controls (Continued)

Recommendation (Continued)

In addition, Treasury should ensure the individual performing the programming function is restricted to a "Read Only" level of access within the production environment (including libraries, files, programs, etc.). Treasury should closely monitor the use of the vendor-supplied profiles for accessing the system. The individual responsible for monitoring the history log of suspicious activity should have "Read Only" access to that file.

Further, we recommend one computer operator be primarily responsible for the retrieval of the ACH file from FAC and the other be primarily responsible for the submission of the ACH file to the bank. In addition, we recommend the operator sending the file to the bank review it against the original file downloaded from FAC to identify any changes prior to submission. A log with the date, time, and name of the reviewer should be maintained to document this review. In the event one of the computer operators cannot fulfill his duties, a backup should be appointed to perform his part of the above process.

Management's Response and Corrective Action Plan

In a perfect world, and particularly in a much larger computer operation, the type of segregation of duties envisioned by the Auditor would be both useful and desirable. We certainly cannot disagree with their point of view from a theoretical standpoint. However, the reality is that the Treasury Data Processing Division is a very small operation, with only 5 total members. There is only one data processing system expert. By default, that person must perform the duties of system security administrator, programmer, librarian, operator, and every other function associated with the data processing system. He is the only one with the knowledge to write, test, and put into operation any new programs. There is no one else with whom he can share those duties. The Treasury Department has requested funding in the last two budget cycles to add an additional programmer, citing the Auditor's concern as justification. It is estimated that an additional programmer to allow this segregation would cost \$85,000 - \$90,000 per year. That funding has been denied. Until there are funds to have the necessary staff to do so, the type of segregation of duties called for by the Auditor cannot happen.

Similarly, it is not possible to segregate duties between the two computer operators. There are only two people. If one is absent, the other must perform all of the duties. These daily responsibilities include drawing down payment data from eMARS, printing all checks, and transmitting ACH files to the depository bank. The process for sending the ACH files to the bank is simply a conduit for that file. The operators do not have the knowledge of the file layout or ACH file requirements to make any changes in the file content. To segregate the duties as desired by the Auditor would require an additional operator, at an approximate cost of \$65,000 per year.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KST-39: The Kentucky State Treasury Should Improve Segregation Of Duty Controls (Continued)**

Management's Response and Corrective Action Plan (Continued)

The type of segregation of duties envisioned in this comment is not feasible at the present time, and will not be in the foreseeable future. The additional personnel cost to the Treasury of \$150,000 - \$155,000 that would be required to make this level of segregation possible is not available.

Auditor's Reply

We acknowledge the efforts Treasury made to add an additional staff member to properly segregate job duties on the data processing system, yet we will continue to make this recommendation to ensure, when funding is available, a proper segregation of duties is achieved through additional personnel.

With regard to the ACH retrieval and submission process, the opportunity remains for the computer operators to alter the file prior to submission to the bank. The issue is not that they necessarily have the expertise to do so; however, it is that the opportunity is present. Further, we recommend a backup be formally appointed in the event that a computer operator is absent.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-40: The Kentucky State Treasury Should Strengthen Logical Security Controls To Ensure Only Authorized Users Can Access The Data Processing System

As noted during the prior two audits, during our fiscal year (FY) 2010 audit of the application security of the Kentucky State Treasury (Treasury) data processing system, we determined Treasury did not implement adequate logical security controls governing user access to the data processing system. During our review, 72 user profiles were shown as having access to the data processing system. Based on a review of the profile naming conventions, there appear to be three types of profiles - individual user, vendor-supplied, and group.

Fifty-one profiles with access to the data processing system were vendor-supplied. Forty-four of these profiles did not require a password in order to access the data processing system. The remaining seven profiles required a password to access the system; however, two of the profiles, or approximately 28.6 percent, were enabled and had not changed their password since 1988. Additionally, one profile complied with the password age requirement; however, it was noted the profile functioned as a group account. The group account was shared by two system operators. Treasury established an individual profile for one of the two operators; however, the user still accessed the group profile. An individual profile was not created for the remaining operator.

Detailed profile setting documentation was obtained for one of the individual user profiles and one of the vendor-supplied profiles to determine if adequate security settings were established for the profile. All settings appeared appropriate, with the exception of one. The 'Limit Device Sessions' setting on each profile was set according to the system value setting, which allowed users to have more than one active device session at a time.

Treasury has implemented the Information Technology (IT) Security Access Request Policy governing access requests to the data processing system. According to the policy, requests are to be discussed with the Division Director and, when determined appropriate, submitted to the Information Technology Division Manager through email. The policy does not include the requirement to maintain supporting email documentation, the location where the emails are to be stored, specific information that should be included in the request email, guidelines for determining appropriate access for users, or approval and completion notifications. An examination of profiles within the system identified three user profiles that were granted access to the data processing system during FY 2010. Testing revealed an email request was not on file for one of the three, or approximately 33.3 percent, new user profiles. This user profile was created for testing of individual profiles for operators recommended in the prior year audit. Although reasonable, the creation of this profile did not follow the new IT Security Access Request Policy in place.

During testing related to the security surrounding critical utilities and commands, we found out of a sample of five key commands, a vendor-supplied group account had access to one of the five key commands sampled, or 20 percent. In addition, the public user authority was granted excessive access to one of these resources, or 20 percent. While the public user authority is not an individual, vendor-supplied, or group account, when active it does allow anyone with access to the data processing system the ability to access an object. In follow-up performed regarding three commands reported during the prior year to which the public user authority was granted excess access, we noted this access was still granted access to two commands, or approximately 66.7 percent.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KST-40: The Kentucky State Treasury Should Strengthen Logical Security Controls To Ensure Only Authorized Users Can Access The Data Processing System (Continued)**

Testing related to the security surrounding critical files and programs revealed the public user authority was granted access to the reconciliation program and resulting report file. The employee responsible for generating the reconciliation reports did not have direct access to the reconciliation report file; however, the public user authority granted access to read the file. Although her job duties necessitated this access, all users of the data processing system would also have these rights as they were granted through the public user authority and not through the individual user profile. In addition, the vendor-supplied group account had access to the reconciliation report file.

The public user authority also had elevated access to the directory on the processing system housing the Automated Clearing House (ACH) file. The ACH file contains electronic payment information that is to be submitted to the bank. This elevated access would grant all users the ability to make changes to the directory and underlying ACH files prior to their submission to the bank.

Finally, testing of the audit history log file permissions determined the vendor-supplied group account was provided access.

For security purposes, detailed information concerning the specific profiles that contributed to these findings was intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Incomplete logical security procedures increase the risk that users are provided inappropriate or unauthorized access to the system. Allowing users the ability to access information without proper authorization may subject the processing of data to errors and/or omissions and may compromise the integrity of data processed through the system. Granting access to the public user authority could provide users the ability to access resources beyond the scope of their required job duties. The use of group profiles increases the risk that account passwords could be compromised and limits the ability to maintain an accurate audit trail. Permitting concurrent device sessions increases the risk that an account could be exploited through another machine. The existence of unused accounts also increases the risk of unauthorized use.

Management should ensure that the agency's logical security procedures are sufficiently thorough to reflect the entire logical security process. The user profile is one of the most powerful and versatile objects on the system. It contains things such as the user's password, special authorities and what menu the user sees after signing on. The user profile defines what a person can and cannot do on the system. Adequate security should be applied to user profiles to limit unauthorized access to the data processing system. Management should review all access requests to the network and data processing system and approve the requests only where appropriate based on job duties. Unnecessary accounts should be disabled, as well as concurrent device sessions. Security surrounding system objects and commands should be controlled at the individual profile level and the public user authority should be removed or set to EXCLUDE. Group profiles should be avoided in favor of individual user profiles.

FINANCIAL STATEMENT FINDINGS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-KST-40: The Kentucky State Treasury Should Strengthen Logical Security Controls To Ensure Only Authorized Users Can Access The Data Processing System (Continued)**

Recommendation

We recommend Treasury strengthen its IT Security Access Request Policy related to data processing system access. Specifically, the policy should be expanded to include:

- A requirement to maintain all supporting documentation regarding additions, changes, or deletions to access, as well as the location of retained files;
- A listing of required information to be included in a request email, (at a minimum, this should include the user name, date access should become effective, reason requested, type of access/change requested, and a statement of division director approval);
- Guidelines for determining appropriate access for users based on necessary job functions;
- A requirement for an approval or denial email from the IT Division Manager to the requesting division director, as well as retention of this email in the designated repository; and,
- A requirement for a completion email from the IT Division Manager to the requesting division director indicating the requested action has been taken. This email should be retained in the designated repository.

All new user profiles developed and provided access to the data processing system should have a formal email request on file showing justification for the access granted and authorization from management. We recommend Treasury perform a periodic review of all user and vendor-supplied user profiles to ensure access is appropriate. All unnecessary accounts should be disabled. All vendor-supplied user profiles should be required to provide a password to access system resources and should be forced to comply with the password age requirement. The number of concurrent device sessions should be set to one in accordance with industry best practices. In addition, the vendor-supplied group profile should be disabled, and an individual user profile should be created for each computer operator. Treasury should either remove the public user authority from all command, utility, file, and program resources or change its Object Authority to *EXCLUDE, which would restrict access to the object to only the owner, security officer, and users with specific authority. If individuals who previously used the public user authority to gain access to libraries or object and still require this access, their individual profiles should be granted access to only those resources required for the completion of their job duties.

Additional recommendations regarding segregation of duties were also addressed in comment 10-KST-39.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KST-40: The Kentucky State Treasury Should Strengthen Logical Security Controls To Ensure Only Authorized Users Can Access The Data Processing System (Continued)**

Management's Response and Corrective Action Plan

The Treasury Department will develop a Data Processing Services Request Form to document all change requests. This form will be stored in hard copy in a binder, ready for easy review by the Auditor. The form will show the history of the request, with approvals or denials, testing and implementation dates, and similar information.

Most of the user profiles have been evaluated for need, and the ones not needed have been disabled or removed. This includes vendor profiles. The vendor profiles that we do not use have been disabled. The remaining vendor profiles are needed to run system processes. Those that do not require passwords are disabled. Some vendor profiles are sent without passwords.

We are in the process of going through the system to eliminate the public authority. It is a very time consuming task.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-41: The Kentucky State Treasury Should Ensure Critical Libraries Are Adequately Secured To Protect System Resources

As noted during the prior two audits, during our FY 2010 audit concerning application-level security over the Kentucky State Treasury (Treasury) data processing system, we determined that Treasury did not have adequate procedures in place governing the security over critical libraries housed on the data processing system. Our examination of the directory for the main system library supplied by the vendor revealed there were 138 libraries maintained on the data processing system. Of these libraries, 135 had a library type of 'production' and the other three had a library type of 'test.' However, testing revealed the library type attribute was not consistently used to accurately label production and test libraries. Specifically, 93 of the 138 libraries, or approximately 67.4 percent, did not have a description. Of the remaining 45 libraries, 2 had library type attributes indicating they were used in production; however, the descriptions indicated they may not be used in production. Specifically, one description contained the word 'test,' and the other indicated an older date. Therefore, it was not possible to conclusively separate those libraries used in production from those used for test purposes, which limited the ability to ensure the libraries were properly segregated and restricted based on function.

In addition to the vendor supplied system library, we identified three additional critical libraries. These libraries contained critical objects, such as bank master files and individual bank files that provide bank activity, bank reconciliation programs, check information, check writer programs, payroll files, bank deposit files, and program development files. Review of these libraries revealed the Treasury employee responsible for multiple duties related to the data processing system, including programming, librarian, operator, and administration functions had elevated access rights through both personal and assigned system accounts.

For security purposes, detailed information concerning the specific account profiles and libraries that contributed to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Without an adequate object authority scheme, unauthorized excessive access could be granted to production libraries as well as critical objects and data. Granting a user unlimited concurrent access to critical production, test, and development libraries increases the risk of unauthorized or inaccurate changes being implemented and executed in production.

System resources should be specifically identifiable as to whether they are part of the production, development, or test environment. Further, access to production, development, and test libraries should be restricted to only those individuals requiring access based on their job duties in order to protect critical resources on the data processing system. Default security settings should be altered as needed to properly restrict user access to confidential or otherwise critical programs and data. Programmers and program operators should not have direct access to make changes to critical production libraries.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KST-41: The Kentucky State Treasury Should Ensure Critical Libraries Are Adequately Secured To Protect System Resources (Continued)**

Recommendation

We recommend Treasury review all users with access to the critical production, development, and test libraries to ensure the access is required and properly segregated. We also recommended Treasury review all libraries and ensure the library type field appropriately reflects the function of those objects held within the library.

A separate comment, 10-KST-39, has been issued related to the segregation of duties issue.

Management's Response and Corrective Action Plan

The Treasury Department has addressed many of these concerns. All libraries are now designated as "production", and descriptions have been added. Relative to the vendor libraries, if a description was not given when the library was installed, none will be given. That would fall to the vendor.

The Treasury Department has addressed the issue of segregation of duties in 10-KST-39. The Data Processing Supervisor must have access to all levels of security. He is the only data processing system expert in the office. The very nature of his position requires this access. Until such time as the Treasury Department's budget provides funding for an additional programmer, this situation will not change.

Auditor's Reply

As noted in 10-KST-39, we acknowledge the efforts Treasury made to add an additional staff member to properly segregate job duties on the data processing system, yet we will continue to make this recommendation to ensure that, when funding is available, a proper segregation of duties is achieved through additional personnel.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-42: The Kentucky State Treasury Should Update Formal System Documentation To Reflect Processing Performed

As noted during the prior two audits, our fiscal year (FY) 2010 audit of the Kentucky State Treasury (Treasury) system controls related to their main data processing system revealed Treasury did not maintain clear and accurate descriptions of critical system programs and associated files utilized in the bank reconciliation process. Based on testing and discussions held with agency personnel, it appears this lack of documentation has existed since the implementation of the data processing system in 2000.

The Treasury Bank Reconciliation Manual provides a high-level general overview of the reconciliation process, the reconciliation data extract process, each of the critical programs that are run to generate the monthly reconciliation reports, and timing difference and analysis reports. Treasury has also implemented an Operators Guide for performing critical tasks on the data processing system.

During the examination of the contents of three critical computer libraries used by Treasury, it was determined that documentation was insufficient to allow a user to determine if the individual objects (files, programs, etc.) maintained within the libraries were used in production. The following specific issues were identified during testing:

- Of the 257 objects residing within the library housing the 'new' check processing/accounting objects, 186 objects, or approximately 72.4 percent, did not have a description. Of the remaining 71 objects containing descriptions, 5 objects, or approximately 1.9 percent, contained the word 'test' within the description, indicating the object may not be used in production.
- Of the 2,002 objects residing within Treasury's main production library used to run the reconciliation programs, 1,280 objects, or approximately 63.9 percent, did not have a description. Of the remaining 722 objects containing descriptions, 98 objects, or approximately 4.9 percent, did not appear to be run in production based on the description. Words found within the descriptions included 'onetime,' 'under development,' 'Y2K,' 'test,' 'MARS,' 'temporary,' 'temp,' and 'special run.' Additionally, 41 objects, or approximately 2.0 percent, had descriptions only reflecting the name of the object.
- Of the 14 objects residing within the library used by the Treasury employee responsible for making program changes, 12 objects, or approximately 85.7 percent, did not have a description.

During the FY 2008 audit, Treasury indicated the intention to re-name the library objects to provide a better understanding of the individual program functionality. However, this project has not yet been started and is not anticipated to occur until the reconciliation process is current.

For security purposes, detailed information concerning the specific objects that contributed to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-42: The Kentucky State Treasury Should Update Formal System Documentation To Reflect Processing Performed (Continued)

Lack of documentation increases the likelihood of erroneous or incomplete processing. This increases the likelihood of unauthorized data modification, destruction of assets, and interruption of services. Failure to appropriately update system documentation increases the risk that users will be unaware of changes that could potentially alter their business processes. The inability to determine the function of library objects could lead to agency staff being unable to differentiate between production, development, and test objects.

Proper descriptive documentation should be maintained for each critical library object in order to, at a minimum, identify the purpose of the objects, the origin of data, the specific calculations or other procedures performed, and the output of data or reports. Object descriptions should provide a clear distinction between active production and test objects.

Recommendation

We recommend Treasury thoroughly review the objects within each library and ensure all objects are needed. All unnecessary objects should be removed. If any objects are housed in an incorrect library, such as testing objects in a production library, the objects should be moved to the appropriate library. For all necessary objects, adequate descriptions should be provided identifying the intended function of each object. This information is critical given the complexity of the programs currently used by Treasury to perform monthly processing.

We further recommend Treasury follow through with the renaming of library objects to better reflect their functionality.

Management's Response and Corrective Action Plan

The Auditor's recommendation represents a monumental task which cannot be accomplished with present personnel and resources. To accomplish this in a timely manner would require an additional programmer devoted solely to this task until completed. The cost of an additional programmer, including all benefits, would be approximately \$85,000 per year.

There are currently over 35,000 objects on the Treasury system. Since the Auditor's comments last year, the Treasury Department has been in the process of removing unneeded objects. It is an extremely slow process, however. With so many objects on the system, it takes time to research and verify the object's use. This will be an on-going process which will span many years' audit periods. As the Auditor has indicated, some of these programs were developed before 2000. Some are actually much older than that, and represent the work of many different programmers and data processing managers. To go back and analyze decades of work done by numerous people is daunting. It takes time to evaluate the impact to the functions of the system and applications. If the name on an object is changed, that name must be changed in every single program that utilizes that object.

FINANCIAL STATEMENT FINDINGS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-KST-42: The Kentucky State Treasury Should Update Formal System Documentation To Reflect Processing Performed (Continued)**

Management's Response and Corrective Action Plan (Continued)

With the ongoing Treasury reconciliation project, the new payroll and personnel system (KHRIS) which will go live in March, the new Revenue Department collection system, and other immediate projects demanding programming time, it will not be possible to give this priority treatment.

Auditor's Reply

We acknowledge the intentions of Treasury to perform a review of all database objects for necessity. We also understand the demands of daily operations, as well as the new initiatives scheduled for implementation in the near future. However, due to the potential risk to processing, we will continue to recommend that unneeded objects on the data processing system be eliminated as time is available for this task.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-43: The Kentucky State Treasury Should Develop And Implement An Application Security Policy Related To The Data Processing System

As noted during our two prior year audits, our FY 2010 audit of application-level security over the Kentucky State Treasury (Treasury) data processing system revealed Treasury did not have formal security control policies or procedures in place concerning critical functionality on the data processing system. Of greatest concern is the lack of management-defined security controls related to critical utilities, commands, libraries, and objects such as programs and files residing on the data processing system.

Treasury has created an Information Technology (IT) Security Access Request Policy; however, this policy only discusses the process to request access to the network and data processing system. It does not discuss any security controls specific to the critical aspects of the data processing system.

Failure to adequately document, implement, and communicate acceptable application security policies and procedures could lead to a lack of understanding by management and users. This lack of understanding could potentially result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system functionality or resources. Additionally, it increases the likelihood of unauthorized or inaccurate data modification, destruction of assets, interruption of services, or inappropriate or illegal use of system resources.

Formal policies should be established specifically addressing security controls over critical utilities, commands, libraries, and objects to help ensure only authorized access is granted to these resources and appropriate actions can be taken against Treasury's data processing system. Consistent application of formal security policies and procedures provides continuity for implementation and sets the tone of management concern for strong system controls.

Recommendation

We recommend Treasury develop formal policies and procedures to administer the security of their data processing system. The system security policy should include:

- functional and technical requirements;
- management's objectives and expectations for information security in clear, unambiguous terms, along with the implications of noncompliance;
- key risks and mechanisms for dealing with those risks;
- roles and responsibilities of management and users;
- a process for regular monitoring and feedback to ensure the policies are enacted and enforced;
- flow charts of the system and interfaces;
- procedures for performing major functions;
- sample reports, screens, and forms;
- recovery procedures;
- physical security procedures;

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-43: The Kentucky State Treasury Should Develop And Implement An Application Security Policy Related To The Data Processing System (Continued)

Recommendation (Continued)

- virus prevention and protection procedures;
- end user accountability and acceptable use;
- policy for enabling auditing and frequency of review; and,
- listing of critical libraries, commands, utilities, and objects and authority that should be established over them.

These policies and procedures, once developed, should be properly distributed and all necessary system users made aware of their responsibilities. Further, management should ensure the consistent application of these procedures.

Management's Response and Corrective Action Plan

While Treasury does not dismiss the importance of the security of the network or applications, the suggestions would seem to be somewhat excessive for an agency this size. It is important not to lose sight of the fact that the entire Treasury Data Processing Division consists of five people: a data processing system manager/programmer; 2 operators who run the check print program, an agency network administrator, and a data coordinator. The entire office staff is approximately 30 people. The elements recommended to be included in the system security policy, though certainly desirable, may be difficult to put together quickly with current staff levels and workloads. Many of the major recommendations are already in place, however. We have procedures for major functions (i.e. Operator's Manual), recovery procedures included in the Business Recovery Plan, and physical security procedures. A virus prevention and protection package is already in place and is updated regularly per COT recommendations. COT Alerts are disseminated throughout the office each time one is issued. End user accountability standards and acceptable policies are in place and are distributed to all employees upon employment.

The Treasury Department will continue to upgrade and enhance its formal security policy and procedure elements as conditions and time allow. It will be an on-going process, with the end goal of having a completely documented and accountable system.

Auditor's Reply

Our recommendation addresses the need for a comprehensive security policy to include key security elements. We acknowledge that Treasury does have certain procedures currently in place; however, procedures have not been created for the critical elements of the data processing system, including utilities, commands, libraries, and objects. Since the data processing system is an integral component of Treasury operations, it is necessary that adequate policies and procedures be developed. We also recognize that the creation of policies will not occur immediately and will, therefore, continue to recommend policy development until a comprehensive policy governing the data processing system is complete.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-44: The Kentucky State Treasury Should Enable System Auditing On Its Data Processing System

As noted within our prior two audits, during our FY 2010 audit concerning application security over the Kentucky State Treasury (Treasury) data processing system, we determined that, according to the system value settings at the time of our review, security auditing of the system was not being performed.

Although these system settings did not require security auditing to be performed, a history log is produced by the system. This log contains past system operator messages, device status, job status changes, and program temporary fix activities that are stored as system messages. While the information reported on this log appears to be useful, we were not able to confirm that Treasury is actively monitoring this log sufficiently to ensure security of the system. The program administrator stated that he performs a review of the history log three to four times a year in order to identify suspicious activity. However, no documentation is maintained to support these reviews nor is anyone outside of the program administrator performing this review.

As was noted in the previous year, it appears that the system audit feature was not made operational since the implementation of the data processing system, which dates as far back as year 2000.

Failure to adequately monitor security events and logs could result in failure to identify suspicious activities that may be occurring on the system.

With effective monitoring of event and security logs, a decreased risk of fraud exists due to unauthorized access and system changes. A logging and monitoring function enables the early detection of unusual or abnormal activities that may need to be addressed.

Recommendation

We recommend Treasury enable security auditing for critical objects on the data processing system and ensure management reviews the event and history logs on a regular basis. The reviews of event and history logs should be documented and retained for audit purposes.

Management's Response and Corrective Action Plan

Treasury will evaluate the audit log process to determine the best option, and will request additional funds in the budget for an outside service to perform audit log reviews. The Commonwealth Office of Technology does not have any professionals for the Treasury data processing system. This will be a new budget item for the Treasury to fund this regular review.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KST-45: The Kentucky State Treasury Should Expand And Strengthen Formal Program Change Control Procedures

As noted during the prior two audits, our FY 2010 audit of system controls revealed weaknesses with regard to the program change control procedures of the Kentucky State Treasury (Treasury). In response to the prior year recommendations, Treasury developed and implemented a formal Programming Requests Policy governing controls for program development and modifications of critical data processing systems. However, the policy did not adequately address all phases of the program change control process.

The Programming Requests Policy dictates that all programming requests for new development or modification to existing systems are to be discussed with the appropriate Division Director. Once there is justification for the change request, the Division Director makes a formal request by email to the Information Technology (IT) Division Manager. The requests are then reviewed for feasibility by the IT Division Manager and either approved, returned for more information, or rejected with explanation. Although not specified in the policy, the IT Division Manager stores all requests in a Microsoft Outlook folder.

The Programming Requests Policy is stated at a very high level and does not contain specific requirements related to the following areas:

- Supporting content of the initial request email;
- Testing of program changes prior to submitting to production;
- Approval to move to production;
- Final acceptance notification;
- Retention of all documentation supporting change, including request emails, testing documentation, and approval documentation; and,
- For new program development, the creation and retention of program specifications and other related technical documentation.

Further, testing of supporting documentation for two secondary program changes made since the prior year review revealed adequate documentation was not on file for the implementation of these changes. Both changes had an email on file requesting the change, but no emails were maintained to show approval of the change, approval to move the change from testing to production, and final approval of the change. Further, there was no documentation on file showing the changes were tested prior to being moved to production.

Also, the operating system running the main reconciliation program was updated since the prior year review. However, no documentation was on file to substantiate who made the update, when the update was made, or who approved the update to be installed.

Without specific and detailed program change control procedures, management increases the risk of developing and implementing ineffective or inaccurate systems and the risk of unauthorized changes being placed into the production environment that have an adverse affect on system processing results.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KST-45: The Kentucky State Treasury Should Expand And Strengthen Formal Program Change Control Procedures (Continued)**

Policies and procedures ensure that an organization's program change control methodology applies to the development of new systems and programs, major changes to existing systems and programs, and user participation. Program change control procedures require adequate program specifications be provided to a programmer prior to program development to mitigate processing errors and the need for numerous program modifications. Sufficient procedures dictate that complete and accurate system documentation be developed and maintained for all critical systems, as this information is vital to ensuring longevity of the system. Program change control procedures must be consistently applied and include adequate procedures to segregate the live production environment from development and testing environments. They should also be distributed to all key personnel to ensure consistent implementation of new systems.

Recommendation

We recommend Treasury expand their current Programming Requests Policy to ensure all steps of a complete program change control process are adequately defined. With regards to the formal request by email, the policy should state the requirements of the emails. The initial request emails should include (at a minimum) the following:

- a necessity for the change;
- programmatic specifications related to the proposed change;
- the affected system(s); and,
- the program and/or report the change will affect.

We also recommend the following expansion of the procedures in order to strengthen the Programming Requests Policy:

- add requirement to retain all documentation supporting the change, including request emails, testing documentation, and approval documentation within the specific retention location;
- add requirement to test program changes prior to submitting to production;
- add requirement for approving changes to be implemented in production;
- add requirement for a final acceptance notification from requestor accepting changes after moved to production; and,
- add requirement for new program development related to the main accounting/reconciliation system to create and retain detailed program specifications and technical documentation.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-KST-45: The Kentucky State Treasury Should Expand And Strengthen Formal Program Change Control Procedures (Continued)**

Recommendation (Continued)

Once these changes have been made to the Programming Requests Policy, Treasury should provide this information to all appropriate staff and ensure strict adherence to the policy going forward.

Further, documentation should be maintained regarding any updates or fixes concerning system maintenance and changes. This documentation should include who made the update, when the update occurred and who approved the update.

Management's Response And Corrective Action Plan

The Treasury Department will design and implement a "Data Processing Services Request Form" for use within the office. This will be an on-line Word document that will establish justification for any data processing change request. The document will also provide a history of that request. It will be printed and kept in hard copy in a binder in our Data Processing Division, ready for inspection by the Auditor. On this form the Data Processing Staff will be able to document all approvals, testing and implementation. It should provide a concise but thorough record of the change. This will primarily be used for internal requests.

In actuality, most of the Treasury Department's change requests come from other agencies. These requests are usually made verbally and by email. When made verbally, they are followed by a written request, usually by email. The email chain is kept as documentation for that request. We would envision that these, too, could be printed, coupled with a "Data Processing Services Request Form" completed by our staff, and retained in the binder for future review by the Auditor.

We will also maintain documentation regarding any updates or fixes concerning system maintenance and changes. This documentation will include who made the update, when the update occurred and who approved the update.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-PARKS-46: The Department Of Parks Should Ensure That Vendors Are Paid Timely In Compliance With Statute

During the FY 2010 audit of the Department of Parks (Parks), the auditor discovered 10 instances in which invoices were not paid within 30 working days as required by statute. One of these instances involved a payment exceeding 60 working days from the date of the invoice.

Agencies are responsible for a 1% penalty on each payment not made within 30 working days. Failure to pay vendors in a timely manner also erodes relationships with those vendors who may decide to stop doing business with Parks. Thus, failure to pay invoices on time costs the agency money, can affect the running of the state parks, and can negatively impact the services provided to guests.

KRS 45.453 states, "All bills shall be paid within thirty (30) working days of receipt of goods and services or a vendor's invoice except when the purchasing agency has transmitted a rejection notice to the vendor."

In addition, the purchasing agency is responsible for a 1% penalty when payment is not made within 30 working days.

Recommendation

While there were a significant number of late invoices noted during testing, there was a significant decrease in the number of late payments noted during the previous year's audit.

We continue to recommend that payments be made in a timely manner. Controls should be developed and implemented to ensure payments are made in a reasonable time frame in compliance with legal statutes. The agency should review the statutes and policy noted above to ensure full compliance. The agency should take steps to ensure that the people involved in processing and approving payments read and understand the relevant laws and policies.

Management's Response and Corrective Action Plan

The Department of Parks is in agreement with the findings and has addressed the issue with the parks involved directly. We will continue to monitor timeframe of payments made and address those falling outside the guidelines. In most instances, with the specific documents listed, it is difficult to tell if the invoice was truly paid late or if the items in question arrived after the date of the invoice thus delaying the payment. With the recent addition of new staff, we are in the process of realigning job duties and responsibilities. This realignment includes specific staff being assigned to specific parks for auditing of all payment documents.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-PARKS-47: The Department Of Parks Should Ensure That Timesheets And Leave Forms Are Completed And Approved To Support Payroll Expenditures

During testing of payroll expenditures for the FY 2010, the auditor noted the following exceptions:

- Five timecards or timesheets that were not signed by either the employee, their supervisor or both.
- Four timecards with changes made to the electronically stamped time that was not initialed.
- Five timecards were not mathematically accurate or not totaled on the card. In two of these instances overtime or compensatory time earned does not agree to the approved overtime form.
- Five instances where there was no documented approval of overtime worked or leave time taken for the time period.
- Four instances where approved overtime or leave time forms did not agree to the timecard.

Expenditures including payroll should be supported by documentation that agrees to the amount paid for that expenditure. Due to the errors and omission described above these payroll expenditures were not adequately substantiated by the documentation including timesheets, properly approved leave requests, and overtime forms.

Good internal control over payroll dictates that payroll charges should be supported by adequate documentation including signed timesheets or timecards, leave and overtime forms that detail and substantiate hours and times worked by each employee.

Recommendation

We recommend Parks review established standards for recordkeeping including requirements for the use of leave and overtime approvals and ensure that procedures are uniform across all Parks facilities. In addition, Parks should consider establishing a periodic review of payroll at each park that includes agreeing timecards and other supporting documents to ensure that they support payroll and are completed per the established guidelines.

Management's Response and Corrective Action Plan

The Human Resources Director and a Human Resources Specialist have reviewed the exceptions and agree with the findings. We are in the process of contacting each park manager that had exceptions. The Human Resources Director will be reviewing the errors and have the park manager and payroll officer make corrections as required. The parks with exceptions were Barren River SRP, Dale Hollow SRP, EP Tom Sawyer SP, Cumberland Falls SRP, and Parks - Cafeteria.

Department of Parks currently has a park policy that requires employees and supervisors to sign all timecards as well as initial any times written in or any changes made to the time card. Park Policy also requires employees to utilize the leave slip for all leave time and compensatory time earned and used.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-PARKS-47: The Department Of Parks Should Ensure That Timesheets And Leave Forms Are Completed And Approved To Support Payroll Expenditures (Continued)**

Management's Response and Corrective Action Plan (Continued)

On December 15, 2010 the Human Resources Director sent a memo, via email, to all park managers, business managers, and payroll officers reiterating established standards for recordkeeping including requirements for the use of leave and overtime approvals and ensure that procedures are uniform across all Parks facilities. The Human Resources Director reiterated Park Policy 01-01, instructing managers/payroll officers to review with supervisors and employees the payroll policies as well as the types of errors that were found to ensure that all employees are fully aware of the payroll policies and to ensure that payroll officers are reviewing employee payroll more carefully. The Human Resources Director believes that our payroll officers and managers have a good understanding of the payroll process. However they do need to review the payroll more closely and catch these type errors.

In a memo to park managers and payroll officers the Human Resources Director did inform them that all employees are required to use the leave/compensatory earned slip to record all hours worked on holidays. Even though the holiday may be the employee's scheduled work day, the hours should be coded as compensatory time earned on the slip. The Human Resources Director did discover that our parks were not consistent with this process.

The Human Resources Director also discussed the exceptions with our internal auditor. She will be scheduling an internal payroll audit in a few months as a follow up. This review will agreeing timecards and other supporting documents to ensure that they support payroll and are completed per the established guidelines.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-PC-48: The Personnel Cabinet Should Ensure Sufficient Authentication Is Required To Access Potentially Sensitive Information

As noted during the prior year audit, while performing the FY 2010 audit of the Personnel Cabinet, we discovered instances where no authentication was required to allow an outside user to gain access either to information about the machine or to the service running on a designated port. We determined 4 out of the 16 machines scanned, or 25 percent of the population, were running the File Transfer Protocol (FTP) service allowing unauthorized access through the anonymous default accounts on the machines. One of these machines was commented on during the prior year audit.

For security purposes, detailed information that would identify the specific machines contributing to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

If a machine properly configured to allow only authorized users access to the service, the risk of intentional or unintentional modifications to system data and resources is increased.

Services running on agency machines should be properly configured and default accounts should be disabled to ensure unauthorized access is prohibited.

Recommendation

We recommend the Personnel Cabinet review the services noted within this comment to ensure that they are properly configured to ensure only authorized users gain access. If a service is determined not to have a specific business purpose, it should be disabled. For those services that do have a business purpose, authentication features should be reviewed to ensure that they are configured to restrict access to only users who have a need for the service.

Management's Response and Corrective Action Plan

The Personnel Cabinet Network Support Branch staff has reviewed the machines identified from the previous scan. The indicated VoIP device is maintained by an outside vendor; to our knowledge this service is properly authorized, configured, and up-to-date. Further, this proprietary device has no domain rights to the Personnel Cabinet network. The indicated printers will be moved to a private IP address upon implementation of the Deferred Compensation Authority's new third-party administrator. Thank you for your continued efforts in scanning mission critical systems to secure the information resources of the Commonwealth.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-PC-49: The Personnel Cabinet Should Strengthen Logical Security Procedures Over The Uniform Personnel And Payroll System

As noted within our previous audit, during the FY 2010 audit of the logical security controls over the Personnel Cabinet's Uniform Personnel and Payroll System (UPPS), we noted that while a formal policy was developed for establishing access to the UPPS, it was not consistently adhered to for granting user access to the application.

In order to request access to UPPS, an electronic copy of the Customer Information Control System (CICS) Access Request form must be completed by the security officer of the applicable agency. On this form, the user's supervisor or manager must indicate what type of access should be granted to each of the applications that make up the UPPS. The form is then forwarded to Personnel Cabinet security staff where verification of approval by the appropriate supervisor/management is performed prior to establishing requested access. To ensure compliance with this process, we examined the CICS Access Request forms for 15 users that had been granted access to UPPS during FY 2010. Our testing revealed insufficient documentation was maintained to support the access granted to four users, or 26.7 percent.

In addition, we identified two users that had more than one user Id with access to the UPPS. Subsequent to bringing this situation to management's attention during our field work, the Personnel Cabinet removed the unnecessary access associated with these users. Also, we identified eleven accounts that appeared to be used by more than one individual, none of which had supporting documentation available to support this access. Additionally, four apparent group accounts were found to be active, only one for which the Personnel Cabinet could identify the underlying users.

We are aware informal procedures were implemented by Personnel Cabinet security staff in August 2009 to attempt to mitigate issues identified during the prior year audit. Also, the formal security policies were under review by management during audit field work. However, they were not completed during FY 2010.

Failure to consistently apply logical security controls could lead to a lack of understanding by management and users that could result in a failure to comply with security policies, failure to perform assigned security responsibilities, or inappropriate and inefficient use of system resources. This situation increases the risk of unauthorized data modification, destruction of assets, interruption of services, and inappropriate or illegal use of system resources.

The foundation of logical security is access control, which refers to how system access is determined and granted to users. Formal policies provide a security framework to educate management and users of their security responsibilities. These controls must be comprehensive in nature and consistently applied to ensure the security of agency resources and data. Consistent application of formal security policies and procedures provides continuity for implementation and sets the tone of management concern for strong system controls.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-PC-49: The Personnel Cabinet Should Strengthen Logical Security Procedures Over The Uniform Personnel And Payroll System (Continued)**

Recommendation

We recommend the Personnel Cabinet ensure all procedures related to the establishment of access for the UPPS system and associated datasets, are consistently and completely performed. The Personnel Cabinet should ensure the CICS Request Form is completed properly and authorization is obtained prior to granting access to the application. Any group accounts in use should be disabled and individual accounts for related users should be established with similar rights. The Personnel Cabinet should also review all accounts and ensure users only have one active account on file. Unnecessary accounts should be removed. All documentation should be maintained for audit purposes.

Management's Response and Corrective Action Plan

The Personnel Cabinet (Personnel) agrees with this finding and continues to strengthen security measures with improved policies and procedures related to system security. Effective July 2010, Personnel revised and updated procedures for providing access to mission critical systems. These policies and procedures will be followed to ensure authorization is granted appropriately for all users. Personnel security is currently reviewing the four user group accounts and detail of multiple userids to determine the status of these accounts.

The security staff will work with all necessary parties to ensure correct access and/or reassignment from group accounts. All related parties will be kept informed and involved as we resolve these issues. Further, Personnel security will utilize the PERPOPA2 report to produce a list of all users by agency. This report will be used to locate multiple users assigned to one account and correct these account assignments.

The updated policy and procedures require agency designated security contacts (DSC) to analyze this system report on a monthly basis and correct inconsistencies and discrepancies in user access. Documentation related to user access is now being stored using the Front Range "helpdesk" application. Use of this application provides electronic storage of security request documentation. Thank you for your continued assistance in protecting the information resources of the Commonwealth.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-REV-50: The Department Of Revenue Should Strengthen Logical Security Controls Over The On-Line System For The Collection Of Accounts Receivable

As noted during the previous three audits, our FY 2010 audit of the Department of Revenue (DOR) logical security controls revealed that the Systems Administration Branch within the Division of Collections did not consistently follow the existing procedures for granting access to Kentucky's On-Line System for the Collection of Accounts Receivable (KY OSCAR).

According to Finance and Administration Cabinet (FAC) standard procedure 6.5.2, the DOR requires supervisors or managers to complete the Authorization to Access Department of Revenue Confidential Computer Information and the KY OSCAR User ID Request forms to request system access. Both forms are then submitted to the DOR Security Office. The DOR Security Office reviews the Authorization to Access Department of Revenue Confidential Computer Information form to ensure it is approved and properly indicates access to KY OSCAR and ensures the user has also submitted a KY OSCAR User ID Request form. The DOR Security Office then grants access to the KY OSCAR group and initials both forms. Once completed by the DOR Security Office, the Authorization to Access Department of Revenue Confidential Computer Information form is filed for audit purposes, and the KY OSCAR User ID Request form is forwarded to the Systems Administration Branch within the Division of Collections for processing. The Systems Administration Branch next establishes the KY OSCAR User ID, and they sign and retain the KY OSCAR User ID Request form.

Review of the Authorization to Access Department of Revenue Confidential Computer Information and KY OSCAR User ID Request forms specific to a sample of 20 KY OSCAR new users revealed DOR did not adhere to the established procedures as follows:

- Three Authorization to Access Department of Revenue Confidential Computer Information forms, or 15 percent of the tested user population, were not on file.
- Two KY OSCAR User Id Request Forms, or 10 percent of the tested user population, did not specify a user capability level.
- One KY OSCAR User Id Request Form, or 5 percent of the tested user population, lacked supervisor approval.

Allowing users the ability to access information without proper authorization may subject the processing of data to errors, omissions, or unauthorized transactions and may compromise the integrity of data processed through the KY OSCAR.

The foundation of logical security is access control, which refers to control of how the system is being accessed and by whom. Guidelines provide a framework to educate users of their security responsibilities. The Authorization to Access Department of Revenue Confidential Computer Information and KY OSCAR User Id Request forms should be completed and authorized for each new user in order to substantiate access to KY OSCAR.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-REV-50: The Department Of Revenue Should Strengthen Logical Security Controls Over The On-Line System For The Collection Of Accounts Receivable (Continued)**

Recommendation

We recommend the DOR consistently adhere to the established procedures for requesting and granting access to KY OSCAR. Specifically, the DOR should ensure all forms are completed and properly authorized and the Security Office and Systems Administration Branch signs off on the applicable forms identifying approval for processing the access request.

Management's Response and Corrective Action Plan

DOR will continue to ensure consistent adherence to established procedures for requesting and granting access to KY OSCAR. In addition, the DOR Security Office will continue to work with the Division of Collections, Systems Administration Branch to ensure that all KY OSCAR forms are properly authorized.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-TC-51: The Transportation Cabinet Should Ensure Inventory Values Entered By Personnel Are Reasonable**

During the FY 2010 audit of inventory, an OMS (Operations Management System) operator entered the linear feet of backer rod instead of the number of 200 foot sections (or rolls) received. The operator was charging out the linear foot for each project. An adjustment to the closing package in the amount of \$318,798 was required as a result of the error.

In the preliminary planning of the inventory audit, the auditor requested a report of inventory for each area (Materials, Traffic, and Equipment). After receiving the report, the Office of Internal Audit informed the auditor a data entry error occurred. For signs, personnel had entered a unit cost of \$209,171 for each sign when the actual unit cost was about \$8. This overstated the inventory in District 2 by approximately \$11,713,130 prior to the end of the fiscal year.

The cause of both issues noted above is data entry error, one error related to quantity and the other cost. The backer rod data entry resulted in the year-end inventory showing a quantity of 8900 instead of 44.5. The cost was \$36 per roll so the inventory on hand at year end was actually \$1,602 instead of \$320,400, a decrease of \$318,798.

If the Office of Audits had not noticed the \$11,713,130 error, a material misstatement of traffic inventories could have occurred in the financial statements. Good internal controls should ensure the quantity and cost of materials entered is reasonable.

Recommendation

We recommend KYTC:

- Establish maximum values in OMS.
- Consider reviewing inventory amounts at various times throughout the year to determine if the amount of each item appears reasonable.

Management's Response and Corrective Action Plan

OMS was recently updated to include maximum and minimum unit costs for all materials. Routine spot inspections for all material unit costs will be conducted until we are comfortable that this has resolved the issue.

District 2 Response on the Backer Rod inventory

We will set maximum allowable amounts in OMS in order to control this type of error in the future and management will review inventory periodically to determine if the amount indicated is within reason.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-TC-52: The Transportation Cabinet Should Implement Procedures To Ensure Compliance With Kentucky Laws For Transferring Property

The Auditor of Public Accounts (APA) received concerns indicating that unauthorized right of way transfers may have occurred between the Kentucky Transportation Cabinet (KYTC) and a coal company in eastern Kentucky. Four filed Quitclaim deeds were reviewed to determine whether the right of way conveyances were performed in accordance with state statutes. The detail of these records, in which KYTC is the grantor in two of the conveyances and the grantee in the other two, are listed below:

- Deed 1 (recorded June 29, 2007): The grantor (KYTC) conveyed to the grantee all of the grantor's interest in a parcel of land in Perry County, with certain agreements. These agreements included the grantee's agreement to convey a section of property to KYTC to be used as a temporary roadway during construction of a new section of road, as well as the conveyance to KYTC the surface rights for right of way associated with the newly constructed section of highway once it is complete.
- Deed 2 (recorded June 29, 2007): Per the agreement in Deed 1, the grantor conveyed to the grantee (KYTC) the surface rights of certain property noted in Deed 1 that is to be used for a temporary roadway during construction of a new section of highway. The deed contained an agreement that KYTC would convey this parcel back to the grantor upon the completion of the construction of the new section of highway.
- Deed 3 (recorded December 8, 2008): Per the agreement in Deed 1, the grantor conveyed to the grantee (KYTC) surface rights to right of way associated with the newly constructed section of highway.
- Deed 4 (recorded December 8, 2008): Per the agreement in Deed 2, the grantor (KYTC) conveyed to the grantee its interest in the parcel of land transferred to it in Deed 2 and used for a temporary road.

Upon review of these deeds, it appears the only person authorizing these conveyances on behalf of KYTC and the Commonwealth of Kentucky was the KYTC district Right of Way Supervisor. The conveyance of property from another party in this manner is inconsistent with KYTC's written policies and procedures on the acquisition of right of way. KYTC does not have the authority to dispose of property or transfer property, and therefore the conveyance of property to another party in this manner is not compliant with KRS 45A.045, which requires all instruments required by law to convey property be executed and signed by the secretary of the Finance and Administration Cabinet (FAC) and approved by the Governor.

It appears internal controls within the agency were circumvented in order to complete these property conveyances. When district personnel implement procedures outside the agency's standard processes, then central office personnel do not have the appropriate knowledge of the activity to provide proper monitoring and oversight, and to assess whether procedures are being performed in accordance with state and federal requirements.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-TC-52: The Transportation Cabinet Should Implement Procedures To Ensure Compliance With Kentucky Laws For Transferring Property (Continued)**

The APA recognizes it is difficult to implement sufficient procedures to prevent the circumvention of controls by an employee or employee(s), however, appropriate disciplinary actions taken against employees involved in such actions should be clearly communicated. The effect of unauthorized property conveyances could expose KYTC and the Commonwealth to significant loss of assets. In this situation, the conveyances of property from the Commonwealth to the grantee may be considered void due to the KYTC employee not having appropriate authority to convey property to other parties.

KRS 45A.045 (4) states, "...All instruments required by law to be recorded which convey any interest in any real property so disposed of shall be executed and signed by the secretary of the Finance and Administration Cabinet and approved by the Governor. Unless the secretary of the Finance and Administration Cabinet deems it in the best interest of the state to proceed otherwise, all interests in real property shall be sold either by invitation of sealed bids or by public auction. The selling price of any interest in real property shall not be less than the appraised value thereof as determined by the cabinet, or the Transportation Cabinet for the requirements of that cabinet."

Recommendation

We recommend:

- KYTC should work with FAC legal counsel to determine what, if any, remedies are appropriate to rectify the unauthorized property conveyances. The opinion of the FAC legal counsel should be documented in writing and maintained by KYTC.
- KYTC should consider the circumstances that created or permitted the circumvention of controls, and determine the additional procedures that can be put in place to further protect assets from such risk.

Management's Response and Corrective Action Plan

We agree with your recommendations. We will work with FAC General Counsel on an appropriate resolution to rectify the unauthorized property conveyances. We will obtain an FAC legal counsel opinion in writing and maintain that on file at KYTC.

We have documented policies and procedures in the Right of Way Manual (ROW 1502 and 1503) regarding property transfer and have had those for many years. The Secretary of State Highway Engineer will send a reminder to all Chief District Engineers, Right of Way Supervisors and other appropriate personnel and require a signed acknowledgement form from all pertinent personnel. We will do this within the next 2 months.

FINANCIAL STATEMENT FINDINGS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-TC-53: The Transportation Cabinet In Coordination With The Commonwealth Office Of Technology Should Strengthen The Security Of System Accounts

While performing the FY 2010 security vulnerability assessments for Kentucky Transportation Cabinet (KYTC) machines, which are partially managed by the Commonwealth Office of Technology (COT), we identified various system user accounts with password ages that exceeded the established password policy or that had never been used.

We obtained NetBIOS account information from two Domain Controllers (DC). To determine if user accounts on these machines were in compliance with established KYTC policies, the auditor used the criterion that account passwords with ages over 31 days were non-compliant, which is the established agency policy. On both the Primary Domain Controller (PDC) and Backup Domain Controller (BDC), there were 196 accounts out of a total of 867, or approximately 22.6 percent, that met this criterion. In relation to the PDC, 21 of these accounts appear to have never been used. There were 85 accounts on the BDC that appeared to have never been used. These accounts had password ages between 33 and 2520 days.

For security purposes, detailed information concerning the specific machines or user accounts that contributed to these findings is being intentionally omitted from this comment. However, these issues were thoroughly documented and communicated to the appropriate agency personnel.

Lax enforcement of the agency's established password policy or the existence of unused accounts increases the likelihood that accounts could be compromised, as well as the underlying data accessible by those accounts.

Intruders often use inactive accounts to break into a network. If an account was not used for a reasonable period of time, the account should be disabled until it is needed. This minimizes the possibility that an unauthorized user will access the account. Established password policies should be consistently applied and enforced.

Recommendation

We recommend KYTC work with COT to review all user accounts on the identified machines to ensure compliance with the established security and password policies. These accounts should be evaluated to determine if they are still valid accounts and are required for a business related purpose. If they are needed, then they should be forced to comply with agency password policies. Otherwise, the accounts should be disabled or deleted depending on the necessity of reinstatement of the account.

FINANCIAL STATEMENT FINDINGS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-TC-53: The Transportation Cabinet In Coordination With The Commonwealth Office Of Technology Should Strengthen The Security Of System Accounts (Continued)**

Management's Response and Corrective Action Plan

KYTC Response: KYTC ISO contacted KYTC Drivers License Agency Contact requesting review and validation of the user accounts reported. KYTC IT Request Log # 201002016 has been created for tracking purposes. KYTC will work to validate and take action on inactive/stale accounts.

COT Response: COT assumed the management of accounts in the domain in question in September of 2006. The detail findings from the auditors have been provided to the Commonwealth Service Desk for review. Some of these accounts may have been in existence prior to COT taking ownership of the account management responsibilities for this domain. The Commonwealth Service Desk is aware of the enterprise policy and accounts should not be created with password expiration exceeding 31 days without the appropriate approvals. All actions taken on accounts in this domain are taken at the specific request of KYTC. KYTC should work with COT to remediate the issues identified by the auditors in the detail findings.

COT currently employs a process to review stale accounts located in the enterprise Active Directory Forest. The domain in question resides outside of the enterprise Active Directory Forest and therefore is not included in this process. KYTC is currently working with COT to make considerable changes to this domain but these efforts are in the early planning phase and no completion date has been defined at this time. These changes may allow the ability to include all or some of these accounts in the COT review processes in the future. All actions taken on accounts in this domain are taken at the specific request of KYTC. KYTC should work with COT to address the potentially stale accounts identified by the auditors in the detail findings.

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APPENDIX

COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2010

This report is available on our website, www.auditor.ky.gov in PDF format. For other requests, please contact Gregory Giesler, APA's Open Records Administrator, at (502) 564-5841 or gregory.giesler@auditor.ky.gov. If copies of the CAFR for FY 10 are required, please contact Jonathan Miller, Finance and Administration Cabinet Secretary, at (502) 564-4240 or jonathan.miller@ky.gov.

The list includes agencies receiving financial statement audits by Certified Public Accounting firms (CPA) used for preparing the Commonwealth's CAFR. CPA reports are available upon request to the respective agency.

Bluegrass State Skills Corporation
Capital Plaza Tower
500 Mero Street
Frankfort, Kentucky 40601

Turnpike Authority of Kentucky
Room 78, Capitol Annex Building
Frankfort, Kentucky 40601

Kentucky Transportation Cabinet
Kentucky Transportation Cabinet Worker's Compensation
200 Mero Street
Frankfort, Kentucky 40622

Kentucky Center for the Arts
5 Riverfront Plaza
Louisville, Kentucky 40202-2989

Kentucky Economic Development Finance Authority
Capital Plaza Tower
500 Mero Street
Frankfort, Kentucky 40601

Kentucky Housing Corporation
1231 Louisville Road
Frankfort, Kentucky 40601

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

Kentucky Teachers' Retirement System
479 Versailles Road
Frankfort, Kentucky 40601

**COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2010
(Continued)**

University of Louisville
2301 South 3rd Street
108 Grawemeyer Hall
Louisville, Kentucky 40292

Western Kentucky University
Vice President for Finance and Administration
1 Big Red Way
Bowling Green, Kentucky 42101-3576

Murray State University
322 Sparks Hall
Murray, Kentucky 42071

Kentucky State University
Office of Administrative Affairs
400 East Main Street
Frankfort, Kentucky 40601

Kentucky Lottery Corporation
1011 West Main Street
Louisville, Kentucky 40202-2623

Kentucky State Fair Board
Kentucky Fair and Exposition Center
P.O. Box 37130
Louisville, Kentucky 40233-7130

Kentucky Educational Television Authority
600 Cooper Drive
Lexington, Kentucky 40502

Kentucky Higher Education Assistance Authority
1050 U.S. 127 South, Suite 102
Frankfort, Kentucky 40601

Kentucky Higher Education Student Loan Corporation
Financial Services Department
10180 Linn Station Road, Suite C200
Louisville, KY 40223

Kentucky Infrastructure Authority
1024 Capital Center Dr., Suite 340
Frankfort, Kentucky 40601

**COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2010
(Continued)**

Kentucky Local Correctional Facilities Construction Authority
Suite 261 Capitol Annex
Frankfort, Kentucky 40601

Kentucky Judicial Form Retirement System
P.O. Box 791
Frankfort, Kentucky 40602

University of Kentucky
301 Peterson Service Building
Lexington, Kentucky 40506-0005

Eastern Kentucky University
Vice President for Business Affairs
521 Lancaster Avenue
Richmond, Kentucky 40475-3101

Morehead State University
Office of Accounting and Budgetary Control
207 Howell-McDowell Administration Building
Morehead, Kentucky 40351-1689

Northern Kentucky University
Office of Business Affairs
Lucas Administration Center
726 Nunn Drive
Highland Heights, Kentucky 41099-8101

Kentucky Community and Technical College System
300 North Main Street
Versailles, KY 40383

Kentucky Council on Postsecondary Education
1024 Capital Center Drive, Suite 320
Frankfort, Kentucky 40601

Office of the Petroleum Storage Tank
Environmental Assurance Fund
81 C. Michael Davenport Boulevard
Frankfort, KY 40601

Kentucky Public Employees' Deferred Compensation Authority
101 Sea Hero Road, Suite 110
Frankfort, KY 40601-5404

**COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2010
(Continued)**

Workers' Compensation Program
State Office Building, 3rd Floor
501 High Street
Frankfort, KY 40601

Kentucky Department of Labor - Special Fund
1047 US Highway 127 S, Suite 4
Frankfort, KY 40601

Kentucky Horse Park Foundation
4089 Iron Works Parkway
Lexington, Kentucky 40511

**REPORT OF THE STATEWIDE SINGLE AUDIT OF THE
COMMONWEALTH OF KENTUCKY**

VOLUME II

**For the Year Ended
June 30, 2010**



**CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS
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CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

March 31, 2011

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

As Auditor of Public Accounts, I am pleased to transmit herewith our report of the Statewide Single Audit of the Commonwealth of Kentucky-Volume II for the year ended June 30, 2010. Our Statewide Single Audit of the Commonwealth of Kentucky report will be transmitted in two volumes in order to meet reporting guidelines established by the American Institute of Certified Public Accountants. Volume I contains financial statement findings identified during our audit of the Comprehensive Annual Financial Report (CAFR), the Schedule of Expenditures of Federal Awards (SEFA), related notes, and our opinion thereon, as well as the 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*. Volume I was issued under a separate cover. Volume II contains the Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133, federal award findings and questioned costs identified during our audit, and the summary schedule of prior audit findings.

The Auditor of Public Accounts also calculates a dollar threshold, based on OMB Circular A-133 guidance, to determine the federal programs to be audited for internal controls and compliance. For FY 10, the threshold for auditing federal programs was \$34.9 million.

On behalf of the Office of Financial Audits of the Auditor of Public Accounts' Office, I wish to thank the employees of the Commonwealth for their cooperation during the course of our audit. Should you have any questions concerning this report, please contact Sally Hamilton, Executive Director, Office of Financial Audits, or me.

Respectfully submitted,

A handwritten signature in black ink, appearing to read "Crit Luallen".

Crit Luallen
Auditor of Public Accounts



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INTRODUCTION

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2010**

Single Audit

The Single Audit Act of 1984, subsequent amendments, and corresponding regulations, requires an annual audit of the financial statements and compliance with requirements applicable to major federal programs. The Auditor of Public Accounts (APA) meets these requirements and submits audit findings required to be reported by auditing standards generally accepted in the United States of America, *Government Auditing Standards* and OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, through our opinion on the Commonwealth's Comprehensive Annual Financial Report (CAFR) and through the Statewide Single Audit of Kentucky (SSWAK). Our SSWAK report is contained in two volumes as noted below.

SSWAK - Volume I contains financial reporting information based on our audit of the CAFR. It includes the APA's opinion on the Schedule of Expenditures of Federal Awards (SEFA) in relation to the financial statements, the *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*, and financial statement findings related to internal control and compliance.

SSWAK - Volume II contains elements required under OMB Circular A-133, including the *Report on Compliance with Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control over Compliance in Accordance with OMB Circular A-133*, and the Schedule of Findings and Questioned Costs.

Schedule of Findings and Questioned Costs

The Schedule of Findings and Questioned Costs consists of three sections: Summary of Auditor's Results, Financial Statement Findings, and Federal Award Findings and Questioned Costs. The Summary of Auditor's Results summarizes the type of audit reports issued and lists major programs audited. The Financial Statement Findings section is reported in SSWAK Volume I. The Federal Award Findings and Questioned Costs, presented within this report, lists findings related to federal awards. For the Federal Award Findings, material weaknesses and material instances of noncompliance are presented first, then significant deficiencies and reportable instances of noncompliance.

Summary Schedule of Prior Audit Findings

Audit findings related to federal awards reported in the Schedule of Findings and Questioned Costs for FY 09, as well as any previous federal awards findings that have not been resolved in the past three fiscal years, are reported in the Summary Schedule of Prior Audit Findings for FY 10.

The Summary Schedule of Prior Audit Findings is organized based on whether the prior audit finding was a significant deficiency or a material weakness or noncompliance. The findings of each classification are categorized as (1) fully corrected, (2) not corrected or partially corrected, (3) corrective action taken differs significantly from corrective action previously reported, or (4) finding no longer valid or does not warrant further action.

**COMMONWEALTH OF KENTUCKY
INTRODUCTION
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Audit Approach

The scope of the statewide single audit for FY 10 included:

Financial

- An audit of the basic financial statements and combining financial statements;
- Limited procedures applied to required supplementary information;
- An audit of the SEFA sufficient to give an opinion in relation to the basic financial statements;
- Tests of compliance with certain provisions of laws, regulations, contracts, and grants, and tests of internal controls, where applicable;
- Findings related to internal control and compliance over financial reporting, when noted during the audit of the CAFR.

Federal Awards

- An audit of compliance with the compliance requirements described in the U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement that could have a direct and material effect on each major federal program; and
- Test of internal control over compliance in accordance with OMB Circular A-133.

Component Units

The Single Audit Act Amendments permit the single audit to cover the entire operations of the entity or include a series of audits covering departments, agencies, or other organizational units expending federal awards. The Commonwealth has elected to exclude discretely presented component units from the statewide single audit, except as part of the audit of the basic financial statements. Thus, discretely presented component units are not included in the report on compliance and internal control and corresponding Schedule of Findings and Questioned Costs. It should be noted, however, that these entities are still required to have audits performed in accordance with the provisions of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, if applicable.

LIST OF ABBREVIATIONS/ACRONYMS

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2010**

ADO	Annual Disclosures of Ownership
AF	Air Force
AOA	American Osteopathic Association
APA	Auditor of Public Accounts
ARRA	American Recovery and Reinvestment Act
CA	Cooperative Agreement
CAFR	Comprehensive Annual Financial Report
CAQH	Counsel for Affordable Quality Healthcare
CCDF	Childcare and Development Fund
CFDA	Catalog of Federal Domestic Assistance
CFR	Code of Federal Regulations
CHFS	Cabinet for Health and Family Services
CSBG	Community Service Block Grant
CSE	Child Support Enforcement
CSEPP	Chemical Stockpile Emergency Preparedness Program
DCBS	Department of Child Benefits Services
DCP	Division of Construction Procurement
DFO	Disaster Field Office
DFS	Division of Family Support
DGA	Division of General Accounting
DHS	US Department of Homeland Security
DMA	Department for Military Affairs
DMS	Department of Medicaid Services
DoD	US Department of Defense
DSR	Division of Service Regions
DWI	Department for Workforce Development
EBT	Electronic Benefits Transfer
EFO	Emergency Feeding Organization
eMARS	enhanced Management Administrative Reporting System
EOC	Emergency Operations Center
ERA	Eligible Recipient Agencies
FAC	Finance and Administration Cabinet
FAD	Family Alternatives Diversion
FEMA	Federal Emergency Management Agency
FMAP	Federal Medical Assistance Percentage
FSS	Field Services Supervisor
FY	Fiscal Year
ID	Identification
JCAHO	Joint Commission on Accreditation Healthcare Organization
K-TAP	Kentucky Transitional Assistance Program
KAMES	Kentucky Automated Management Eligibility System
KAR	Kentucky Administrative Regulations
KASES	Kentucky Automated Support and Enforcement System
KC	Kinship Care Program
KDA	Kentucky Department of Agriculture

**COMMONWEALTH OF KENTUCKY
LIST OF ABBREVIATIONS/ACRONYMS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

KRS	Kentucky Revised Statutes
KY	Kentucky
KyDEM	Kentucky Department of Emergency Management
KyDMA	Kentucky Department of Military Affairs
KYTC	Kentucky Transportation Cabinet
LPA	Local Public Agency
MAP	Medical Assistance Program
MMIS	Medicaid Management Information Service
MOU	Memorandum of Understanding
MPAS	Medicaid Program Assistance Section
NG	National Guard
NPDB	National Practitioner Data Bank
OAS	Office of Administrative Services
OCSE	Office of Child Support Enforcement
OIG	Office of Inspector General
OLP	Office of Local Programs
OMB	Office of Management and Budget
ONA	Other Needs Assistance
OPA	Office of Policy and Audit
PA	Public Assistance
PAPS	Public Assistance Program Specialists
SAS	Statement on Auditing Standards
SEFA	Schedule of Expenditures of Federal Awards
SFSF	State Fiscal Stabilization Fund
SFY	State Fiscal Year
SNAP	Supplemental Nutrition Assistance Program
SRAA	Service Region Administrative Assistants
SSWAK	Statewide Single Audit of Kentucky
TANF	Temporary Assistance for Needy Families
TC	Transportation Cabinet
TEFAP	The Emergency Food Assistance Program
US	United States
USC	United States Code
Vol	Volume
WIA	Workforce Investment Act
WIC	Women, Infants, and Children

**REPORT ON COMPLIANCE WITH REQUIREMENTS THAT COULD HAVE A DIRECT
AND MATERIAL EFFECT ON EACH MAJOR PROGRAM AND ON INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133**



CRIT LUALLEN
AUDITOR OF PUBLIC ACCOUNTS

Honorable Steven L. Beshear, Governor
Cabinet Secretaries and Agency Heads
Members of the Commonwealth of Kentucky Legislature

Report on Compliance With Requirements That Could Have a Direct and
Material Effect on Each Major Program and on Internal Control
Over Compliance in Accordance With OMB Circular A-133

Independent Auditor's Report

Compliance

We have audited the compliance of the Commonwealth of Kentucky (Commonwealth) with the types of compliance requirements described in the *OMB Circular A-133 Compliance Supplement* that could have a direct and material effect on each of the Commonwealth's major federal programs for the year ended June 30, 2010. The Commonwealth's major federal programs are identified in the summary of auditor's results section of the accompanying schedule of findings and questioned costs. Compliance with the requirements of laws, regulations, contracts, and grants applicable to each of its major federal programs is the responsibility of the Commonwealth's management. Our responsibility is to express an opinion on the Commonwealth's compliance based on our audit.

We conducted our audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States; and OMB Circular A-133, *Audits of States, Local Governments, and Not-Profit Organizations*. Those standards and OMB Circular A-133 require that we plan and perform the audit to obtain reasonable assurance about whether noncompliance with the types of compliance requirements referred to above that could have a direct and material effect on a major federal program occurred. An audit includes examining, on a test basis, evidence about the Commonwealth's compliance with those requirements and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion. Our audit does not provide a legal determination of the Commonwealth's compliance with those requirements.

As described in item(s) 10-DMA-54, 10-DMA-55, and 10-KDA-56 in the accompanying schedule of findings and questioned costs, the Commonwealth did not comply with requirements regarding subrecipient monitoring that are applicable to its DMA Chemical Stockpile and Emergency Preparedness Program and KDA Emergency Food Assistance Program. Compliance with such requirements is necessary, in our opinion, for the Commonwealth to comply with the requirements applicable to those programs.



Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (Continued)

In our opinion, except for the noncompliances described in the preceding paragraph, the Commonwealth complied, in all material respects, with the compliance requirements referred to above that could have a direct and material effect on each of the Commonwealth's major federal programs for the year ended June 30, 2010. The results of our auditing procedures also disclosed other instances of noncompliance with those requirements, which are required to be reported in accordance with OMB Circular A-133 and which are described in the accompanying schedule of findings and questioned costs as items 10-CHFS-58, 10-CHFS-59, 10-CHFS-61, 10-DMA-63, 10-DMA-64, 10-DMA-65, 10-DMA-66, 10-DMA-67, 10-DMA-68, 10-FAC-69, 10-KDA-70, 10-KDA-71, 10-TC-72, 10-TC-73 and 10-TC-74.

Internal Control Over Compliance

The management of the Commonwealth is responsible for establishing and maintaining effective internal control over compliance with the requirements of laws, regulations, contracts, and grants applicable to federal programs. In planning and performing our audit, we considered the Commonwealth's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine our auditing procedures for the purpose of expressing our opinion on compliance and to test and report on the internal control over compliance in accordance with OMB Circular A-133, but not for the purpose of expressing an opinion on the effectiveness of internal control over compliance. Accordingly, we do not express an opinion on the effectiveness of the Commonwealth's internal control over compliance.

Our consideration of internal control over compliance was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control over compliance that might be significant deficiencies or material weaknesses and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control over compliance that we consider to be material weaknesses and other deficiencies that we consider to be significant deficiencies.

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. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 10-DMA-54, 10-DMA-55, and 10-KDA-56 to be material weaknesses.

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. We consider the deficiencies in internal control over compliance described in the accompanying schedule of findings and questioned costs as items 10-CHFS-57, 10-CHFS-58, 10-CHFS-59, 10-CHFS-60, 10-CHFS-61, 10-CHFA-62,

Report on Compliance With Requirements That Could Have a Direct and Material Effect on Each Major Program and on Internal Control Over Compliance in Accordance With OMB Circular A-133 (Continued)

10-CHFS-63, 10-CHFS-64 10-DMA-65, 10-DMA-66 10-DMA-67, 10-DMA-68, 10-FAC-69, 10-KDA-70, 10-KDA-71, 10-TC-72, 10-TC-73, and 10-TC-74 to be significant deficiencies.

We also noted certain immaterial instances of noncompliance and other matters involving internal control over compliance, which we have communicated to management in separate letters.

Management's responses to the findings identified in our audit are included in the accompanying schedule of findings and questioned costs. We did not audit their responses and, accordingly, we express no opinion on them.

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

Sincerely,

A handwritten signature in black ink, appearing to read "Crit Luallen", written in a cursive style.

Crit Luallen

Auditor of Public Accounts

March 17, 2011

SCHEDULE OF FINDINGS AND QUESTIONED COSTS

**COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2010**

SECTION 1 - SUMMARY OF AUDITOR'S RESULTS

Financial Statements

Financial Statements: We issued unqualified opinions on the governmental activities, business-type activities, aggregate discretely presented component units, each major fund, and aggregate remaining fund information of the Commonwealth as of and for the year ended June 30, 2010.

Compliance: In relation to the audit of the basic financial statements of the Commonwealth, the results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Internal Control Over Financial Reporting: Our consideration of the Commonwealth's internal control over financial reporting disclosed 52 significant deficiencies and one material weakness.

Federal Awards

Compliance: We issued a qualified opinion on the Commonwealth's compliance with the subrecipient monitoring requirements applicable to two of its major federal programs. The results of our auditing procedures disclosed 18 instances of noncompliance, which are required to be reported in accordance with OMB Circular A-133. We believe three of these instances of noncompliance are material.

Internal Control Over Compliance: Our consideration of the Commonwealth's internal control over compliance disclosed 18 significant deficiencies and three material weaknesses.

Identification of Major Programs

The Commonwealth identified clusters by gray shading.

Major Type A programs:

CFDA Program Title

Supplemental Nutrition Assistance Program Cluster:

10.551	Supplemental Nutrition Assistance Program
10.561	State Administrative Matching Grants for Special Nutrition Assistance Program
10.561	ARRA-State Administrative Matching Grants for Special Nutrition Assistance Program

Child Nutrition Cluster:

10.553	School Breakfast Program
10.555	National School Lunch Program
10.556	Special Milk Program for Children
10.559	Summer Food Service Program for Children

SECTION 1 - SUMMARY OF AUDITOR'S RESULTS (CONTINUED)**Identification of Major Programs (Continued)**

Major Type A programs (Continued):

CFDA	Program Title
10.557	Special Supplemental Nutrition Program for Women, Infants, and Children
Community Development Block Grant-State-Administered Small Cities Program Cluster:	
14.228	Community Development Block Grants/States Programs and Non-Entitlement Grants in Hawaii
14.255	ARRA-Community Development Block Grants/States Programs and Non-Entitlement Grants in Hawaii
17.225	Unemployment Insurance
17.225	ARRA- Unemployment Insurance
Workforce Investment Act Cluster:	
17.258	WIA Adult Program
17.258	ARRA-WIA Adult Program
17.259	WIA Youth Activities
17.259	ARRA-WIA Youth Activities
17.260	WIA Dislocated Workers
17.260	ARRA-WIA Dislocated Workers
Highway Planning and Construction Cluster:	
20.205	Highway Planning and Construction
20.205	ARRA-Highway Planning and Construction
20.219	Recreational Trails Program
Title I, Part A Cluster:	
84.010	Title I Grants to Local Educational Agencies
84.389	ARRA-Title I Grants to Local Educational Agencies, Recovery Act
Special Education Cluster:	
84.027	Special Education-Grants to States
84.173	Special Education-Preschool Grants
84.391	ARRA-Special Education-Grants to States
84.392	ARRA-Special Education-Preschool Grants
Vocational Rehabilitation Services Cluster:	
84.126	Rehabilitation Services-Vocational Rehabilitation Grants to States
84.390	Rehabilitation Services-Vocational Rehabilitation Grants to States, Recovery Act
State Fiscal Stabilization Fund Cluster:	
84.394	ARRA-State Fiscal Stabilization Fund (SFSF)-Education State Grants, Recovery Act
84.397	ARRA-State Fiscal Stabilization Fund (SFSF)-Government Services, Recovery Act

SECTION 1 - SUMMARY OF AUDITOR'S RESULTS (CONTINUED)**Identification of Major Programs (Continued)**Major Type A programs (Continued):**CFDA Program Title**

Immunization Cluster:

93.268 Immunization Grants

93.712 ARRA-Immunization

Temporary Assistance for Needy Families Cluster:

93.558 Temporary Assistance for Needy Families

93.714 ARRA-Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program

Child Care Cluster:

93.575 Child Care and Development Block Grant

93.596 Child Care Mandatory and Matching Funds of the Child Care and Development Fund

93.713 ARRA-Child Care and Development Block Grant

93.658 Foster Care-Title IV-E

93.659 Adoption Assistance

Medicaid Cluster:

93.775 State Medicaid Fraud Control Units

93.777 State Survey and Certification of Health Care Providers and Suppliers

93.778 Medical Assistance Program

93.778 ARRA-Medical Assistance Program

Major Type B programs:**CFDA Program Title**

10.558 Child and Adult Care Food Program

Emergency Food Assistance Cluster:

10.568 Emergency Food Assistance Program (Administrative Costs)

10.568 ARRA-Emergency Food Assistance Program (Administrative Costs)

10.569 Emergency Food Assistance Program (Food Commodities)

12.401 National Guard Military Operations and Maintenance (O&M) Projects

Fish and Wildlife Cluster:

15.605 Sport Fish Restoration Program

15.611 Wildlife Restoration

SECTION 1 - SUMMARY OF AUDITOR'S RESULTS (CONTINUED)**Identification of Major Programs (Continued)**

Major Type B programs (Continued):

CFDA	Program Title
20.509	Formula Grants for Other Than Urbanized Areas
20.509	ARRA-Formula Grants for Other Than Urbanized Areas
84.013	Title I Program for Neglected and Delinquent Children
93.563	Child Support Enforcement
93.563	ARRA-Child Support Enforcement
Community Services Block Grant Cluster:	
93.569	Community Services Block Grant
93.710	ARRA-Community Services Block Grant
93.667	Social Services Block Grant
97.040	Chemical Stockpile Emergency Preparedness Program

Dollar Threshold Used To Distinguish Between Type A and Type B Programs

The maximum dollar threshold used to distinguish between Type A and Type B programs was \$34.9 million.

Auditee Risk

The Commonwealth did not qualify as a low-risk auditee.

SECTION 2 - FINANCIAL STATEMENT FINDINGS

See SSWAK Volume I for the FY 10 Financial Statement Findings 1 through 53.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Material Weaknesses Relating to Internal Controls and/or Noncompliances***FINDING 10-DMA-54: The Department Of Military Affairs Should Strengthen Internal Controls To Ensure Compliance With CSEPP Subrecipient Monitoring Requirements**

State Agency: Department of Military Affairs

Federal Program: CFDA 97.040-Chemical Stockpile Emergency Preparedness Program

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: \$0

During FY 10 we audited the Kentucky Department of Military Affairs (KYDMA) Emergency Management's (KyEM) Chemical Stockpile Emergency Preparedness Program (CSEPP). As part of our work, we discovered multiple instances of poor internal controls and noncompliance with regulations over subrecipient monitoring. CSEPP subrecipients consist of ten counties surrounding the Bluegrass Army Depot in Richmond, Kentucky.

KyEM is required to conduct onsite visits as part of its subrecipient monitoring. KyEM's CSEPP branch calls these visits Trip Reports and conducts them twice a year for each subrecipient. During these Trip Reports, KyEM reviews a sample of equipment purchased by or assigned to the subrecipient with CSEPP funds. This sample is selected from a list maintained by KyEM staff that is updated through the 1801 reimbursement process. Subrecipients are not aware of the equipment selected before the Trip Report. KyEM examines the equipment to determine it exists, matches specifications from the 1801, and is ready for deployment. KyEM documents this with photographs of the equipment and a written summary of the visit. When we reviewed KyEM's Trip Reports we found the following items of concern:

Laurel County 6/15/09 Trip Report:

- The CSEPP Property Officer's (PO) report stated he noticed one trailer, purchased as a mass purchase of trailers by the Laurel County CSEPP director, was different from the others purchased. The PO ran a title check on the trailer and discovered the trailer was titled to another person. The report states that the CSEPP Property Officer tried to contact the owner listed with no success. There is no documented reason to justify Laurel County presenting a trailer for reimbursement as new that is actually titled to a private citizen. The auditor could not determine why KyEM did not continue this investigation and require resolution of these findings. This property purchase was identified as questionable in previous audits, and therefore is a high fraud risk.
- This report also contains information regarding a separate visit to Laurel County during which KyEM was provided a list of missing equipment. The trip report does not document further inspection if the equipment was later found or if replacement equipment was purchased. This equipment was also related to the mass trailer/equipment purchase mentioned above.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-54: The Department Of Military Affairs Should Strengthen Internal Controls To Ensure Compliance With CSEPP Subrecipient Monitoring Requirements (Continued)

Laurel County 6/2/10 Trip Report:

- Included with this report is the photograph of the side of a trailer that was identified as the property of Laurel County, which had been purchased with CSEPP funds. The photograph shows “Bull of the Woods” faded into the side of the trailer, which is the name of a construction company owned by the former Laurel County CSEPP director. The trip report does not mention this photograph. Upon inquiry, the Branch Manager stated he informed the FBI about the photographs, but did not indicate when that notification took place or who he contacted, nor was this information included in the report.
- Also, the CSEPP Property Officer sent a memo to the CSEPP Branch Manager with the results of the title search after the trip report. This memo states the trailer was white. All the trailers documented during the 6/2/10 trip report are black. None of the trip reports indicate KyEM staff noticed this or followed up on how the trailer color changed.

Laurel County 9/13/10 Trip Report:

- Included with this report is a photograph of a light tower with what appears to be a flat tire. The trip report states “Inspected all above items and found that all equipment issued to or purchased by Laurel County was in good condition, well maintained, clean and was ready for deployment.” The Branch Manager indicated that the FBI was visiting to inspect the equipment on the next day, and therefore the Laurel County staff did not want to alter the equipment until after their visit. However, the trip report did not mention this, or any follow up regarding the equipment’s readiness.

In FY 10 we continue to see the deficiencies related to CSEPP compliance and internal controls at KyEM. The findings released in the FY 08 and FY 09 audits identified deficiencies of KyEM to thoroughly monitor subrecipients, and to act on indications of fraud/misuse.

KyEM’s Trip Reports appear to document potential fraud and misuse of CSEPP funds. However, due to the lack of effective monitoring, KyEM cannot provide evidence of the steps it took to follow up and bring the situations to a resolution. These deficiencies result in continued ineffective administration of the CSEPP program, and increase the risk of fraud, waste and abuse by subrecipients. Due to the problems identified in this finding, as well as deficiencies reported in a separate finding related to CSEPP’s subrecipient monitoring, KyEM is not compliant with applicable requirements related to subrecipient monitoring for CSEPP.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-54: The Department Of Military Affairs Should Strengthen Internal Controls To Ensure Compliance With CSEPP Subrecipient Monitoring Requirements (Continued)

44 CFR Part 13 §13.40 Monitoring and reporting program performance states in part:

- (a) Monitoring by grantees. Grantees are responsible for managing the day to day operations of grant and subgrant supported activities. Grantees must monitor grant and subgrant supported activities to assure compliance with applicable Federal requirements and that performance goals are being achieved. Grantee monitoring must cover each program, function or activity.

Recommendation

We make the following recommendations to the Department of Military Affairs Division of Emergency Management:

- KyEM should implement procedures to improve its subrecipient monitoring process. KyEM should create controls to ensure the proper documentation of issues when found and documentation of the communication of that information throughout the chain of commands. KyEM should be able to provide specific documentation of communications of specific concerns to law enforcement officials, the federal grantor, and/or the APA.
- KyEM should encourage staff to approach their job with professional skepticism with the goal of efficient and effective administration of CSEPP funds. KyEM should convey to staff the importance of not just detecting fraud/misuse, but the importance of discouraging fraud/misuse by enforcing strong control.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for subrecipient monitoring is to provide reasonable assurance that Federal grant award information and compliance requirements are identified to subrecipients, subrecipient activities are monitored, subrecipient audit findings are resolved, the impact of any subrecipient noncompliance on the pass-through entity is evaluated, and subrecipients obtain required audits and take appropriate corrective action on audit findings. The department's current internal control environment, effected by executive management, establishes executive management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-54: The Department Of Military Affairs Should Strengthen Internal Controls To Ensure Compliance With CSEPP Subrecipient Monitoring Requirements (Continued)

Management's Response and Corrective Action Plan (Continued)

Based on the auditor's findings, DMA management has conducted an analysis of the overall risk environment currently facing the department and concurs with the auditor's finding.

KyDEM-CSEPP program manager will continue to improve established policies and procedures to conduct bi-annual on-site visits to verify equipment specifications, conditions and serviceability on open CSEPP grants and programs for required essential equipment. During on-site visits, any report of or suspected fraud, waste and/or abuse will be forwarded to State and FEMA officials as well as law enforcement when warranted.

KyDEM-CSEPP program manager will work with the KyEM Subrecepting monitoring team to review procedures and processes to insure proper verification of equipment specifications, conditions and serviceability

KyDEM will follow up on site visits that require additional information or documentation.

KyDEM subrecipient section has established guidance for all site visits.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-55: The Department Of Military Affairs Should Ensure CSEPP Subrecipient Reimbursement Requests Are Properly Reviewed And Include Valid Supporting Documentation

State Agency: Department of Military Affairs

Federal Program: CFDA 97.040-Chemical Stockpile Emergency Preparedness Program

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: \$7,691

During the FY 10 audit of Kentucky Emergency Management's (KyEM) Chemical Stockpile Emergency Preparedness Program (CSEPP), we discovered multiple instances of poor internal controls and noncompliance with regulations. These deficiencies centered around the reimbursements and monitoring of subrecipients for CSEPP. CSEPP subrecipients consist of ten counties surrounding the Bluegrass Army Depot in Richmond, Kentucky.

Subrecipients can request reimbursement for CSEPP related expenditures using an 1801 reimbursement form. These forms must be signed by the subrecipient's CSEPP director and must have supporting documentation. We reviewed the documentation supporting the reimbursement requests, and noted the following questionable costs associated with these reimbursements:

- Powell County: We questioned a total of \$626 of expenditures submitted for reimbursement due to a lack of appropriate or legible documentation and questions as to whether the expenditure is necessary for the administration of the grant. Also, it appears several of the invoices had been tampered with. Examples of these items include:
 - Account statements provided as support, rather than evidence indicating the amount was paid;
 - Invoices totaling \$233 for the purchase of groceries, one having a receipt that had the merchant name cut off;
 - An invoice for decals totaling \$136 with the name of the business and date cut off;
 - An invoice for \$170 related to a \$202 reimbursement request.
- Jackson County: We questioned a total of \$3,600 of expenditures submitted on two separate reimbursement requests for Jackson County. The county submitted check stubs, not check copies or invoices, as supporting documentation for rental payments. Also, the check stubs indicated the two checks were written for \$1,500 each, for a total of \$3,000. Since the amounts did not agree to the requests for reimbursement, the auditor followed up with the KyEM CSEPP Branch Manager. The CSEPP Branch Manager provided a copy of a letter dated February 3, 2010 between the landlord and the county treasury for a \$300 retroactive rent increase applied from October 2009 through January 2010 totaling \$1,200, and a grand total due of \$3,000. The CSEPP Branch Manager provided additional information obtained from Jackson County, but the information could not be reconciled back to the reimbursement request, nor could the \$600 difference between the supporting documentation and the reimbursement be sufficiently

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-55: The Department Of Military Affairs Should Ensure CSEPP Subrecipient Reimbursement Requests Are Properly Reviewed And Include Valid Supporting Documentation (Continued)

explained by the CSEPP Branch Manager. Furthermore, the auditor did not receive an explanation regarding the allowability of a retroactive rental increase, or an explanation as to why the county continued to pay \$1,500 in rental payments after it became aware of a rent increase.

- Clark County: We initially questioned a total of \$227 related to a reimbursement request submitted by Clark County due to insufficient supporting documentation for two items. KyEM was able to subsequently provide the documentation to support these amounts, but it could not explain why the reimbursement was paid prior to receipt of adequate supporting documentation. Since these invoices were provided to the auditor, this amount is not included as questioned costs.
- Rockcastle County: We questioned costs totaling \$87 for Rockcastle County due to insufficient documentation and unclear justification as to the allowability of the expenses. Examples of the problems noted with the supporting documentation included:
 - Four receipts were related to food charges, such as pizza, sandwiches, and donuts with no explanation of the necessity of the purchases. These receipts also indicated sales tax was paid.
 - Two of the four receipts above were for purchases of meals on separate days. The receipts were labeled “Fire Chief’s Meeting”. Although meals are allowable under the EX benchmark of the Cooperative Agreement, meals are restricted to volunteers for training exercises. KyEM could not provide the additional supporting documentation to prove these costs were allowable.
 - One of the four receipts noted contained a printed notation that the receipt was preliminary, and that the transaction was not complete. A final receipt was not included.
- Estill County: We questioned a total of \$3,148 related to expenditures for payments to individuals who performed night watchman duties at a radio tower construction site and payments for equipment rental. The supporting documentation related to the watchman duties was a list of names, dates, and rates, but did not contain signatures from either the employees or the Estill County official approving the payment. The county also provided a copy of checks, but did not copy the back of the checks to verify endorsements. Also, the equipment rental receipt provided as supporting documentation contained information that was not legible, preventing the auditor from determining the allowability of the cost for CSEPP. Although these activities may have been allowable, the supporting documentation was not sufficient to permit proper monitoring or to protect the program from the potential for fraud or abuse.

As noted in previous audits, deficiencies continue to exist related to CSEPP compliance and internal controls over federal program requirements. The findings released in the FY 08 and FY 09 audits outlined KyEM’s deficiencies in thoroughly scrutinizing reimbursement requests and acting on

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-55: The Department Of Military Affairs Should Ensure CSEPP Subrecipient Reimbursement Requests Are Properly Reviewed And Include Valid Supporting Documentation (Continued)

indications of fraud/misuse. Previous audit findings suggested recommendations to improve monitoring of subrecipients, which do not appear to have been properly implemented.

The lack of effective internal controls to adequately review subrecipient reimbursement requests leads to the program paying for questionable expenditures. KyEM's CSEPP branch has weak controls that failed to identify inadequate supporting documentation and unallowable costs. Furthermore, auditors believe that problems noted in this finding are pervasive, and therefore actual questioned costs could be higher than detected in our sample. Due to these weaknesses, as well as additional subrecipient monitoring deficiencies reported in a separate finding, DMA is not compliant with subrecipient monitoring requirements applicable to CSEPP.

2 CFR Part 225, Cost Principles for State, Local, and Indian tribal Governments (formerly OMB Circular A-87), C. Post Award Administration, 3. Monitoring states in part:

The recipient is responsible for monitoring award activities, to include sub-awards, to provide reasonable assurance that the Federal award is administered in compliance with requirements. Responsibilities include the accounting of receipts and expenditures, cash management, maintaining of adequate financial records, and refunding expenditures disallowed by audits.

44 CFR Part 13; Subpart C-Post-Award Requirements; Financial Administration states in part:

§13.20 Standards for financial management systems.

A State must expand and account for grant funds in accordance with State laws and procedures for expending and accounting for its own funds. Fiscal control and accounting procedures of the State, as well as its subgrantees and cost-type contracts, must be sufficient to-Permit preparation of reports required by this part and the statutes authorizing the grant, and Permit the tracing of funds to a level of expenditures adequate to establish that such funds have not been used in violation of the restrictions and prohibitions of applicable statutes.

Allowable cost. Applicable OMB cost principles, agency program regulations, and the terms of grant and subgrant agreements will be followed in determining the reasonableness, allowability, and allocability of costs.

Source documentation. Accounting records must be supported by such source documentation as cancelled checks, paid bills, payrolls, time and attendance records, contract and subgrant award documents, etc.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-55: The Department Of Military Affairs Should Ensure CSEPP Subrecipient Reimbursement Requests Are Properly Reviewed And Include Valid Supporting Documentation (Continued)

Recommendation

We make the following recommendations to the Department of Military Affairs Division of Emergency Management:

- KyEM should take review it process for monitoring subrecipients and take steps to implement strong internal controls to ensure efficient and effective subrecipient monitoring procedures.
- KyEM should continue to evaluate the 1801 reimbursement process. KyEM should ensure employees have appropriate knowledge of allowable and unallowable costs stated in the Cooperative Agreement and federal guidelines. KyEM should also ensure employees are aware of adequate supporting documentation requirements.
- KyEM management should establish a tone that encourages compliance and good stewardship of state and federal funds, and remind employees to approach their job with professional skepticism with the goal of efficient and effective administration of CSEPP funds. KyEM should convey to staff the importance of not just detecting fraud/misuse but the importance of discouraging fraud/misuse by enforcing strong internal controls.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for subrecipient monitoring is to provide reasonable assurance that Federal grant award information and compliance requirements are identified to subrecipients, subrecipient activities are monitored, subrecipient audit findings are resolved, the impact of any subrecipient noncompliance on the pass-through entity is evaluated, and subrecipients obtain required audits and take appropriate corrective action on audit findings. The department's current internal control environment, effected by executive management, establishes executive management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

Based on the auditor's findings, DMA management has conducted an analysis of the overall risk environment currently facing the department and concurs, completely, with the auditor's finding.

By 1 June 2011, KyDEM-CSEPP program manager will conduct an internal review of expenditures and require the repayment of ineligible expenses. Also, will establish strong procedures to ensure staff has appropriate knowledge of allowable and unallowable costs stated in the Cooperative Agreement and the guidelines in 2 CFR Part 225 by working with the KyDEM

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Material Weaknesses Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-55: The Department Of Military Affairs Should Ensure CSEPP Subrecipient Reimbursement Requests Are Properly Reviewed And Include Valid Supporting Documentation (Continued)

Management's Response and Corrective Action Plan (Continued)

subrecipients team to insure proper training and understanding of procedures with proper verification of receipts.

By 1 June 2011, KyDEM-CSEPP program will provide updated training to the CSEPP counties by communicating these expectations to subrecipients on allowable and unallowable costs stated in the Cooperative Agreement and the guidelines in 2 CFR Part 225.

KyDEM-CSEPP program manager will continue to improve established policies and procedures to include conduct bi-annual on-site visits to verify equipment specifications, conditions and serviceability on open CSEPP grants and programs for required essential equipment. During on-site visits, any report of or suspected fraud, waste and/or abuse will be forwarded to State and FEMA officials as well as law enforcement when warranted.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Material Weaknesses Relating to Internal Controls and/or Noncompliances*****FINDING 10-KDA-56: Kentucky Department Of Agriculture Should Implement And Follow Formal Policies And Procedures For Subrecipient Monitoring**

State Agency: Department of Agriculture

Federal Program: CFDA 10.568-Emergency Food Assistance Program (Administrative Costs)
CFDA 10.569-Emergency Food Assistance Program (Food Commodities)

Federal Agency: U.S. Department of Agriculture

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: \$0

During our FY 10 audit testing of controls over compliance of The Emergency Food Assistance Program (TEFAP) administered by Kentucky's Department of Agriculture (KDA), we requested the list of Eligible Recipient Agencies (ERAs-food banks) and Emergency Feeding Organization (EFOs-food pantries) monitored on-site during the fiscal year. The monitoring process was not completed by KDA as noted by the following problems:

- The monitoring tracking log demonstrated only eight of the required 20 pantries were reviewed during the fiscal year.
- Of those eight EFOs (food pantries) reviewed per the tracking log, only four reports were documented in file. These copies had no signatures indicating who performed the review, no dates indicating when the report was conducted or dates reports were submitted to EFOs to determine whether it was final.
- We were able to review four EFOs (food pantries) reports in word or excel format. One of these reports contained a discrepancy which required a follow-up action. There was no evidence of follow-up action by either KDA or the food pantry.
- There was only documentation that one of two required food banks received an on-site review.
- There was no documentation of management review of the monitoring reports issued.

KDA's internal controls over subrecipient monitoring were not sufficient to ensure that all required reviews were completed, deficiencies were followed up on, supporting documentation was maintained, and monitoring reports were reviewed and approved by management at KDA. As a result KDA did not comply with Federal Compliance requirements over subrecipient monitoring for the TEFAP program.

Per OMB Circular -A-133 Compliance Supplement for TEFAP for Subrecipient Monitoring:

A State agency must make on-site reviews of ERAs under its oversight and of distribution sites operated by such ERAs, in accordance with its distribution plan. At a minimum, the State agency's annual review coverage must include 25 percent of the ERAs that operate TEFAP as a subrecipient of the State agency and one-tenth or 20

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Material Weaknesses Relating to Internal Controls and/or Noncompliances***FINDING 10-KDA-56: Kentucky Department Of Agriculture Should Implement And Follow Formal Policies And Procedures For Subrecipient Monitoring (Continued)**

(whichever is less) of the ERAs that operate TEFAP as subrecipients of other ERAs in the State. To the maximum extent practicable, review scheduling should enable State agency staff to observe TEFAP commodity issuance and prepared meal service operations (7 CFR section 251.10(e) (2)).

Good internal control dictates that supporting documentation should be maintained to support the on-site reviews conducted, the conclusions reached, approval of those reports by management, the communication of those reports to the monitored entity, and follow-up of any problems noted during the reviews.

Recommendation

We recommend KDA create written procedures related to the required on-site monitoring of food banks and food pantries. These procedures should ensure that KDA staff plans and tracks the monitoring of the required number of subrecipients and required follow-up of any findings that result from on-site monitoring. These procedures should also include management review of on-site monitoring reports. Further KDA should ensure that documentation of the on-site monitoring visits are maintained in a format that prevents any changes being made and supports the timely completion of the monitoring procedures.

Management's Response and Corrective Action Plan

We concur that we were deficient on the monitoring of the subrecipient agencies and will make sure that all required reviews of sub recipient agencies are done in a timely manner going forward. Management has developed a tracking tool to monitor the review procedure. This tracking device will follow a review from the time it is due, all the way through to scheduling follow up reviews and any findings together with the correction of those findings. The responsibility of posting reviews has been moved from the Branch Manager to the Training Development Specialist II who will convert them in to pdf format. Due to some vacancies in the Division, we have initiated a more in depth check and balance system that will have more than one person access to reviews both pending and complete.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-57: The Cabinet For Health And Family Services Should Ensure Annual On-Site Inspections Are Performed For All Non-Deemed Hospitals

State Agency: Cabinet for Health and Family Services

Federal Program: CFDA 93.777-State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare

CFDA 93.778-Medical Assistance Program

CFDA 93.778-ARRA-Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Special Tests and Provisions

Amount of Questioned Costs: \$0

During the FY 2010 Medicaid audit, we tested 18 Non-Deemed Hospitals for compliance with Provider Health and Safety Standards. Non-Deemed Hospitals are not accredited by an approved accrediting organization, such as the Joint Commission on Accreditation of Healthcare Organizations (JCAHO) or the American Osteopathic Association (AOA). The purpose of JCAHO is to promote specific improvements in patient safety. The AOA promotes public health, encourages scientific research, and has federal authority to accredit hospitals and other health care facilities. Of the 18 Non-Deemed Hospitals tested, we noted the following exceptions:

- Two Non-Deemed Hospitals have not had their annual licensing inspection since September 2007.
- One Non-Deemed Hospital has not had an annual licensing inspection since October 2007.
- One Non-Deemed Hospital has not had an annual licensing inspection since August 2008.

A licensing inspection must be performed annually for hospitals that are not accredited to ensure adequate patient care. Since the annual on-site licensing inspections have not been conducted for these Non-Deemed Hospitals, CHFS is not in compliance with the Provider Health and Safety Standards and cannot be assured that providers are providing acceptable care for patients.

The annual on-site licensing inspections are not being conducted due to cuts in staffing.

When Provider Health and Safety Standards are not adhered to, CHFS is not in compliance with Federal Regulations. In addition, if CHFS Office of Inspector General does not perform the annual inspections, CHFS cannot be assured that non-deemed hospitals are in compliance with the Provider Health and Safety Standards.

The U.S. Department of Health and Human Services, Centers for Medicare and Medicaid Services defines accredited hospitals as, "A hospital accredited by the Joint Commission or AOA."

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-57: The Cabinet For Health And Family Services Should Ensure Annual On-Site Inspections Are Performed For All Non-Deemed Hospitals (Continued)

Kentucky Revised Statute 216B.185 (1) states,

- (1) The Office of the Inspector General shall accept accreditation by the Joint Commission on Accreditation of Healthcare Organizations or another nationally recognized accrediting organization with comparable standards and survey processes that has been approved by the United States Centers on Medicare and Medicaid Services, as evidence that a hospital demonstrates compliance with all licensure requirements under this chapter. An annual on-site licensing inspection of a hospital shall not be conducted if the Office of the Inspector General receives from the hospital:
 - (a) A copy of the accreditation report within 30 days of the initial accreditation and all subsequent reports; or
 - (b) Documentation from a hospital that holds full accreditation from an approved accrediting organization on or before July 15, 2002.

Recommendation

We recommend CHFS ensure annual on-site inspections are performed on all non-deemed hospitals.

Management's Response and Corrective Action Plan

Surveys have been scheduled for the facilities in question.

The audit findings indicated that the annual on-site licensing inspections were not conducted due to "cuts in staffing". This statement is incorrect. The Office of Inspector has experienced significant staff turnover and retirements, which have led to increased vacancies, but staffing has not been "cut". OIG has also experienced difficulty in recruiting new nurses due to the high demand for nurses generally, the significant overnight travel that the surveys require, and the fact that state government is at a disadvantage when competing with the private sector for nurses since state government cannot offer the same salary, bonus and recruitment packages as private health care providers. To address these issues, the OIG has recently implemented a staffing plan focusing on recruitment, training, and retention of nurse consultant inspectors as well as other survey staff. Early indications are that these changes are resulting in more candidates appearing on state employment registers for nurse consultant inspectors. Other recent actions to increase retention include providing electronic reference and data input devices to surveyors in the field, restructuring business processes in the field and use of temporary staff to assist in survey of less complex facilities in order to keep surveys up-to-date.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-58: The Cabinet For Health And Family Services Should Maintain Supporting Documentation In Accordance With The State Plan

State Agency: Cabinet for Health and Family Services

Federal Program: CFDA 93.777-State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare

CFDA 93.778-Medical Assistance Program

CFDA 93.778-ARRA-Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Eligibility

Amount of Questioned Costs: \$0

During the FY 2010 Medicaid audit, we tested a sample of 90 Medical Assistance Program cases for compliance with the approved State Plan. We tested member eligibility requirements at the Department for Community Based Services (DCBS) offices located in seventeen counties: Bell, Bullitt, Carlisle, Clinton, Elliott, Floyd, Gallatin, Garrard, Henderson, Jefferson, Kenton, Madison, Mason, McCracken, Simpson, Spencer and Wolfe. Of the 90 cases selected for testing, twenty case files did not contain the required documentation to support member eligibility. The exceptions are as follows:

Twenty cases were missing the MA-2 Medicaid Penalty Warning, which is signed by members to acknowledge the potential for prosecution for committing fraud:

- One case from Bell, Floyd, Henderson, Kenton, McCracken, and Simpson
- Two cases from Bullitt and Clinton
- Three cases from Gallatin and Spencer
- Four cases from Jefferson

Ten cases were missing the PAFS-203 Checklist of Factual Information Provided, which is signed by members to acknowledge that pertinent information was received for participating in the Medicaid program:

- One case from Floyd, Henderson, Kenton, McCracken and Simpson
- Two cases from Gallatin
- Three cases from Spencer

Since documentation was missing from 20 of the 90 cases reviewed, CHFS is not in compliance with the State Plan.

The required documentation was not obtained or pulled forward in the current year certification packet with the case folder by the local DCBS office.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-58: The Cabinet For Health And Family Services Should Maintain Supporting Documentation In Accordance With The State Plan (Continued)

When member eligibility procedures in the State Plan are not adhered to, CHFS is not in compliance with Federal Regulations. In addition, if DCBS offices do not maintain adequate case records, CHFS cannot be assured that benefits are being issued to eligible recipients.

Per CHFS, DCBS Operation Manual Volume IV under Application Interview:

- A. Inform all individuals of their rights and responsibilities at the time of application and recertification.
 - 1. Provide the individual with informational pamphlets such as; Hearings, Civil Rights, Medicaid, EPSDT, WIC, child and spousal support, etc. and complete form PAFS-203, Checklist of Factual Information Provided.
 - 8. Explain MA IPV policy and penalties according to MS 1750 through 1795.

A local office memo dated May 16, 2008 regarding Medicaid Program Violations with instruction in paragraph three as follows: “Ensure that form MA-2, Medicaid Penalty Warning, is signed by and explained to all Medicaid applicants, recipients or interested parties at every application and member add. File the original in the case record, and pull forward and review the form with the recipient at each recertification.

Good internal controls dictate that adequate supporting documentation is maintained to support member eligibility for program benefits.

Recommendation

We recommend CHFS DCBS offices maintain appropriate documentation to support member eligibility in accordance with the State Plan.

Management’s Response and Corrective Action Plan

A listing of the cases found in non-compliance has been sent to the Program Specialist in the respected regions for correction. The Program Specialist in each of the regions affected reviewed current policy with each staff person involved.

Additionally, the Medicaid Program Assistance Section (MPAS) is currently traveling to each region and reading cases in the two counties within each region having the highest error rate. Subsequent to the case readings, an exit interview with management in the region is conducted 30 days after conclusion of the case readings. MPAS is already addressing this issue while completing the case review process. At the time MPAS addresses its noncompliance findings with each region, MPAS will also address the noncompliance noted by the APA in this audit, emphasizing the importance of staff following policy and maintaining compliance with the Federal Regulations.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-59: The Cabinet For Health And Family Services Should Maintain Documentation To Support Provider Eligibility In Accordance With The State Plan

State Agency: Cabinet for Health and Family Services

Federal Program: CFDA 93.777-State Survey and Certification of Health Care Providers and Suppliers (Title XVIII) Medicare

CFDA 93.778-Medical Assistance Program

CFDA 93.778-ARRA-Medical Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Eligibility

Amount of Questioned Costs: \$0

The Department for Medicaid Services is required to maintain case files on each eligible Medicaid provider in accordance with state and federal regulations. The provider eligibility case files are scanned into the On-Base system. We tested a sample of 60 provider case files in the On-Base system for compliance with Medicaid Provider Eligibility requirements set forth in the State Plan and noted the following exceptions:

- Fifty-four disclosures of ownership were not updated annually; and, CHFS did not terminate the provider's participation in the Medicaid Program, in accordance with 907 KAR 1:672, Section 3.
- One application or provider agreement could not be located in the On-Base system.
- Twenty-one providers with old provider agreements or applications that were over the three-year re-credentialing requirement.

The required documentation was not obtained from the providers and scanned into the On-Base system to update the provider case files.

We cannot determine if these providers were eligible to participate in the Medicaid program. When the procedures in the State Plan are not adhered to, CHFS is not in compliance with state regulations at 907 KAR. In addition, if current provider case files are not maintained, CHFS cannot be assured that providers receiving payments are eligible to participate in the Medicaid program.

907 KAR 1:671 Section 1, Definitions, Paragraph 7 states,

"Application" means the completion and submission of a Medicaid provider agreement and all required addendum and documentation specific to a provider type, which is the contract between the provider and the department for the provision of Medicaid services.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-59: The Cabinet For Health And Family Services Should Maintain Documentation To Support Provider Eligibility In Accordance With The State Plan (Continued)

907 KAR 1:672, Sections 2 and 3 state:

Section 2. Enrollment Process for Provider Participation in Medicaid.

- (2) To apply for enrollment in the Medicaid Program as a non-credentialed provider, an individual or entity shall:
- (a) Complete, and submit to the department, the non-credentialed provider section of a MAP-811, Provider Application; and,
 - (b) Submit of a valid professional license, registration, or certificate that allows the:
 1. Individual to provide services within the individual's scope of practice; or
 2. Entity to operate or provide services within the entity's scope of practice.

Section 3. Required Provider Disclosure:

- (1) A provider shall comply with the disclosure of information requirements contained in 42 C.F.R. 455.100 through 455.106 and KRS 205.8477.
- (2) Time and manner of disclosure. Information disclosed in accordance with 42 C.F.R. 455.100 through 455.106 shall be provided:
 - (a) Upon application for enrollment;
 - (b) Annually thereafter; and
 - (c) Within 35 days of a written request by the department or the United States Department of Health and Human Services.
- (3) If a provider fails to disclose information required by 42 C.F.R. 455.100 through 455.106 within 35 days of the department's written request, the department shall terminate the provider's participation in the Medicaid Program in accordance with 907 KAR 1:671, Section 6, on the day following the last day for submittal of the required information.

Recommendation

We recommend CHFS:

- Ensure all documentation required to support provider eligibility is updated and scanned into the On-Base system.
- Comply with the provisions of 907 KAR 1:672 Section 3, which requires termination of the provider's participation in the Medicaid program on "the last day for submittal of the required information," if all applicable information is not disclosed.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-CHFS-59: The Cabinet For Health And Family Services Should Maintain Documentation To Support Provider Eligibility In Accordance With The State Plan (Continued)****Management's Response and Corrective Action Plan**

- *The first area of concern is that Annual Disclosures of Ownership (ADO) have not been updated and providers have not been terminated. In 2005, under a different administration, the decision was made to outsource provider enrollment and the Department ceased the processing of ADO's as this was a duty of the vendor. When provider enrollment was brought back in-house in January 2009, the processing of ADO's was re-implemented. There are 53 provider types that require ADO's and to date the Department for Medicaid Services has begun the process for 16 of those provider types. Each month additional provider types are rolled out, with the intent of having all provider types addressed by the end of 2011. When provider enrollment was brought back in-house to DMS, many system changes had to be undertaken; some of which are still being implemented. For the first 6 months, the sole focus was basic enrollment functions. After establishing a branch and functional MMIS, duties could be extended beyond the bare minimum enrollment requirements. Moreover, due to the fact that the Commonwealth has limited staff to complete all enrollment functions, it was an administrative necessity to spread the implementation of all provider types out over a period of several months. Because each provider type requires annual update, the burden of immediate re-implementation of all provider types at once would have been an administrative burden. Further, because DMS made the decision in 2005 to outsource the provider enrollment function, it would be inappropriate to penalize the providers.*

The Plan of Correction has been underway since mid-2009, whereby a different provider type is released each month and again annually for subsequent years. At a rate of 1.76 provider types per month the re-implementation will be completed by the end of 2011. As we roll out provider types we hold the provider accountable per 907 KAR 1:671.

- *The second area of concern was that the APA could not locate a provider agreement in OnBase. We are attempting to locate the provider agreement through a search of hard copy files. If the provider is recently enrolled the file may not have been imaged in OnBase yet, as it takes several days. It should also be noted that if the provider was enrolled many years ago, they would not have been imaged in OnBase because OnBase did not exist. As we do re-credentialing we add the newest application to OnBase.*

The Plan of Correction will include locating a hard copy of the file and having it imaged in OnBase. That application will be furnished to the APA auditor as soon as possible.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-59: The Cabinet For Health And Family Services Should Maintain Documentation To Support Provider Eligibility In Accordance With The State Plan (Continued)

Management's Response and Corrective Action Plan (Continued)

- *The third area of concern was that 21 providers had old provider agreements or applications that were over the three year re-credentialing requirement. The APA indicated that because the applications could not be located in OnBase there was no way to ensure that the providers are eligible to participate in Medicaid and to receive payments.*

907 KAR 1:672 Section 2, No. 9 states,

“Recredentialing. A credentialed provider currently enrolled in the Medicaid Program shall submit to the department's recredentialing process three (3) years from the date of the provider's initial evaluation or last reevaluation”.

DMS contends that it is in compliance with this regulation based on internal policies and procedures. The recredentialing process is not outlined in regulation, therefore we request that the APA delineate what is specifically lacking. DMS ensures that all licensure and certification is updated per the standards of the governing licensure boards for each provider type and in accordance with the Office of the Inspector General's licensure and survey standards. In many cases licensure and survey certifications are updated yearly, thereby exceeding the three year recredentialing standards. On an ongoing basis, the MMIS monitors sanctions through an interface with the CMS Medicare Exclusion Database. Each time a Change of Ownership occurs, an Annual Disclosure of Ownership is required prior to enrollment. And, by year end the ADO process will be fully implemented so that each provider type required to submit an ADO will be reviewed annually. Additional verifications are undertaken, such as utilization of the National Practitioner Data Bank (NPDB) and the Counsel for Affordable Quality Healthcare (CAQH). State licensure boards address malpractice incidents and further information can be obtained through the NPDB if required. Any questionable issues are reviewed by in-house medical staff.

While it is true that the applications should be imaged in OnBase, the lack of that image does not mean that the provider is not eligible to participate in Medicaid and to receive payments. Each provider type must undergo licensure and certification review at a specified time, depending on the type of provider involved. For instance, physicians are required to update their licensure yearly. If DMS does not obtain a license from the provider or through the KY Board of Medical Licensure license file, the provider number will be terminated. Entities such as hospitals undergo various surveys and certifications by the Office of the Inspector General (OIG). If the OIG finds that the hospital is out of compliance or that their licensure will not be renewed, DMS is immediately notified and

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-CHFS-59: The Cabinet For Health And Family Services Should Maintain Documentation To Support Provider Eligibility In Accordance With The State Plan (Continued)****Management's Response and Corrective Action Plan (Continued)**

DMS will act accordingly to terminate the provider agreement. Additional interrogation of provider files is done on an ongoing basis for such things as sanctions and date of death, thus ensuring that providers and owners are reviewed.

DMS does not feel that a Plan of Correction is needed for this area other than to complete the full implementation of the ADO process for all provider types.

DMS would point out that older applications were not imaged in the late 70s – 90s and that credentialing was not required until the late 2000s. (This was explained to the APA when the APA review of Medicaid provider enrollment began in SFY 2007). If an application is chosen for review which falls into one of these categories, there is a greater likelihood that imaging will not be found.

Auditor's Reply

In its response, CHFS asks the auditors to delineate what specifically was noted as lacking in our finding. In order to be eligible to receive Medicaid payments, certain providers currently enrolled in the Medicaid Program are required to be credentialed, and then must adhere to the department's recredentialing process three years from the date of the provider's initial evaluation or last reevaluation. The initial credentialing process requires the completion of a MAP-811 Provider Application, as well as attachments to this application such as a completed evaluation/reevaluation form (KAPER-1). The recredentialing process should adhere to these same requirements since its intent is to identify changes that have occurred since the last evaluation. Specifically, we were unable to locate the MAP-811 Provider Applications or the KAPER-1, in the recredentialed provider files noted in our finding.

The auditor understands that some providers are not required to be recredentialed every three years, and all 21 exceptions noted related to providers that are required to be recredentialed. Also, although CHFS's response indicates it believes it currently adheres to the recredentialing regulations, the auditor's testing noted that all other tested provider files that were required to be recredentialed contained the appropriate documentation. Therefore, the procedures are not consistent for the 21 files identified in our finding.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-CHFS-60: The Cabinet For Health And Family Services Should Update The KASES System**

State Agency: Cabinet for Health and Family Services

Federal Program: CFDA 93.563-Child Support Enforcement

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: \$0

The Cabinet for Health and Family Services' Office of Child Support Enforcement (CSE) is required to submit the OCSE - 34A - Collections Report to the Federal government annually. We tested the OCSE - 34A report reconciliation and noted the report information that is provided by the Kentucky Automated Support and Enforcement System (KASES) is manually corrected after it's submitted to CSE because of programming errors. The OCSE - 34A report requires the monies received or distributed internationally (Line 2) be reported, as well as the \$25 fee removed from Line 7d column E and 7d column F, Distributed and Undistributed. The fee is already accounted for and, if not removed from these lines, it will be included twice on the report. The agency risks overstating the amounts collected. Due to delays in programming updates, the employees have to manually change these amounts. CSE personnel are also still utilizing percentages to determine line 7 amounts.

This is an ongoing problem that was reported in the FY 08 and FY 09 audits.

Due to the employees having to manually input the amounts posted, the risk for errors and omissions increases. The OCSE-34A Report that is submitted to the Federal Government may be inaccurate.

Good internal controls dictate the underlying accounting records are the basis for collections reported to the Federal government.

Recommendation

We recommend CHFS take the appropriate steps to update the KASES system to ensure that information reported to the Federal government is accurate and complete.

Management's Response and Corrective Action Plan

The Child Support Enforcement (CSE) program welcomes the opportunity to address concerns raised in this record of control weakness referencing federal reporting on the OCSE 34A. The program recognizes the concerns and continues working with CHFS partners towards a successful resolution.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-CHFS-60: The Cabinet For Health And Family Services Should Update The KASES System (Continued)**

Management's Response and Corrective Action Plan (Continued)

As noted in prior year responses, CSE staff initially identified system concerns during preparation of the FFY 2007 fourth Quarterly Report of Collections (OCSE 34A) and began working with KASES staff to address the issues. In SFY 2010, these efforts culminated in the parallel release of a rewritten automated OCSE 34A report that addressed many, but not all, of the identified concerns.

During this same period, CSE began planning towards the implementation of a group of system enhancements, including a data warehouse/business intelligence solution with reporting capabilities that will provide for automated production of the OCSE 34A and 157 reports. Development on those enhancements began in August 2010 and is currently ongoing, with a planned completion date of fall 2011.

Until implementation of the business intelligence solution is complete, the data generated for the quarterly filing continues to be adjusted manually to account for identifiable variances that are not recognized by the existing report generation program.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-CHFS-61: The Cabinet For Health And Family Services Should Ensure All Federal Financial Reports Are Adequately Reviewed Prior To Submission**

State Agency: Cabinet for Health and Family Services

Federal Program: CFDA 93.575-Child Support Enforcement

CFDA 93.596-Child Care Mandatory and Matching Funds of the Child Care and Development Fund

CFDA 93.713-ARRA-Child Care and Development Block Grant

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Reporting and Matching, Level of Effort, Earmarking

Amount of Questioned Costs: \$0

The Cabinet for Health and Family Services (CHFS) is required to submit the ACF-696, Child Care and Development Fund (CCDF) Financial Report quarterly for the CCDF program. The report preparation process involves accounting for and reporting on different grant years and sub-function codes, gathering and analyzing data from the statewide accounting system, and making adjustments and corrections as needed.

We performed testing procedures over the ACF-696 reports from each of the open grant periods and noted the following errors:

- The 2009 grant for quarter ending 6/30/2010, reveals a reporting oversight on Lines 1(c) Earmark to Infant & Toddler and 1(d) Earmark to Quality Expansion on the ACF-696. The internal spreadsheet Year-To-Date Report used to develop the ACF-696 information includes the correct amount of ARRA funds. This amount was incorrectly transferred to the ACF-696 report, resulting in reporting the 2009 Grant ARRA funds (Line 1 - Total) incorrectly.
- The 2010 grant for quarter ending 6/30/2010, reveals a matching oversight in Column B on the ACF-696. State expenditures were matched at an incorrect Federal Medical Assistance Percentage (FMAP) rate for the applicable fiscal year.

Due to the discrepancies noted, the ACF-696 reports that were submitted do not agree to supporting documentation. We could not verify the accuracy and completeness of the information that was reported to the Federal government.

Failure to maintain effective internal controls over the report preparation process and inadequate management review of Federal reporting could lead to significant accounting errors. These errors, when undetected, could lead to erroneous assumptions, reimbursements, noncompliance with Federal reporting requirements, and inaccurate financial data being reported to the Federal government.

Good internal control dictates the underlying accounting records are the basis for financial reports and that reports are adequately reviewed before they are submitted to the Federal government.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-61: The Cabinet For Health And Family Services Should Ensure All Federal Financial Reports Are Adequately Reviewed Prior To Submission (Continued)

The foundation for a good internal control system begins with a minimum of reconciling the amounts reported in financial reports to the accounting system. Reconciling ensures that Federal monies are being reported accurately and in accordance with program regulations.

Good internal controls dictate that rate information being reported is applicable for each fiscal year. Thus, ensuring Federal requirements are met and data needed to verify the states eligibility for Federal Matching funds is correctly stated.

OMB Circular A-133, Compliance Supplement, Part 3, "Reporting" indicates auditors should be able to review CHFS records and "...trace reported data elements to supporting worksheets or other documentation that link reports to the data."

OMB Compliance supplement, Part 3, "Matching" indicates a state is eligible for Federal matching funds for expenditures that exceed the State's MOE requirement. State expenditures will be matched at the Federal Medical Assistance Percentage (FMAP) rate for the applicable fiscal year.

Recommendation

We recommend CHFS:

- Decrease probability of error by creating one supporting worksheet (taking the place of worksheets: Expenditures by Sub-Function report and the Year-To-Date report), which will decrease movement/transferring of data from worksheet to worksheet during the development of the ACF-696 report.
- Reconcile the ACF-696 report to the eMARS report during the review process to ensure the accuracy of the data reported to the Federal government.
- Confirm the applicable fiscal year Federal Medical Assistance Percentage (FMAP) rate is the rate stated on the applicable ACF-696 report prior to submission to the Federal Government.

Management's Response and Corrective Action Plan

The Division of General Accounting (DGA) agrees with the issue of ARRA funds not being reported correctly and the inaccurate match rate on the 6/30/2010 ACF 696 Child Care Report. These errors were caught and reported correctly on the 12/30/2010 ACF 696 Child Care Report.

The Division of General Accounting does not agree with the recommendation to use only one supporting worksheet in order to decrease movement/transferring of data from worksheet to worksheet during the development of the ACF-696 Report. Child Care has several targeted earmarks to hit within the lifetime of the grant. Different spreadsheets help DGA track these targets and identify the appropriate columns to use on the ACF-696 report.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-61: The Cabinet For Health And Family Services Should Ensure All Federal Financial Reports Are Adequately Reviewed Prior To Submission (Continued)

Management's Response and Corrective Action Plan (Continued)

The Division of General Accounting does agree to reconcile the ACF-696 report to eMARS. In addition, DGA will confirm the correct match rates are being used by going to the Child Care Bureau and confirming the match rate for the particular grant and year.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-62: The Cabinet For Health And Family Services Should Implement Review Procedures To Ensure CSBG ARRA-Related Expenditures Are Coded Correctly In EMARS

State Agency: Cabinet for Health and Family Services

Federal Program: CFDA 93.569-Community Services Block Grant

CFDA 93.710-ARRA-Community Services Block Grant

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Costs/Cost Principles and Activities Allowed or Unallowed

Amount of Questioned Costs: \$0

During the FY 2010 audit of the Community Service Block Grant program (CSBG), we tested seventy expenditures for internal controls over compliance related to the allowable activities and allowable costs requirements. Of the items tested, we noted an expenditure transaction of American Reinvestment and Recovery Act (ARRA) CSBG funds that was coded to the regular CSBG grant in eMARS. It should be noted the subrecipient had separate contracts for CSBG funds and ARRA CSBG funds. This error was undetected by the agency's internal controls, but was investigated and corrected by CHFS staff after auditor inquiry. A journal voucher was done to correct the error during the audit.

There is no supervisory review of the expenditures before they are submitted to general accounting for payment in eMARS.

When there is no supervisory review to ensure that expenditures are coded correctly it increases the risk for errors and fraud and could result in incorrect information being reported to the Federal Government.

OMB Circular A-133, Compliance Supplement Part 3, requires that accounting records provide for the separate identification and accounting of ARRA fund expenditures from non-ARRA funds.

Good internal controls dictate the need for a review of expenditures to ensure they are recorded in the accounting system correctly.

Recommendation

We recommend CHFS develop and implement review procedures to ensure expenditures are coded to the correct account codes in eMARS. We recommend an independent review by someone other than the staff member who posts to the system.

Management's Response and Corrective Action Plan

DCBS agrees with the finding of one (1) invoice being paid with incorrect funds. This particular subrecipient has two like contracts; one using CSBG Regular funds and the other funded with CSBG ARRA. The invoice as submitted by the subrecipient incorrectly identified the wrong contract number, thereby allowing expenditures to be posted to the wrong contract. To ensure future compliance, DCBS Contract Specialists will include the step of verification of the contract number when reviewing invoices.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-63: The Cabinet For Health And Family Services Should Improve The Security Over EBT Cards Received At Local Offices

State Agency: Cabinet for Health and Family Services

Federal Program: CFDA 10.551-Supplemental Nutrition Assistance Program

CFDA 10.561-State Administrative Matching Grants for the Supplemental Nutrition Assistance Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Special Tests and Provisions

Amount of Questioned Costs: \$0

During the audit of the Supplemental Nutrition Assistance Program (SNAP), we tested the security of Electronic Benefit Transfer (EBT) cards received directly by local offices to determine if security procedures were in place and operating in accordance with the Department of Community Based Services (DCBS) Policy Manual. We noted problems with card issuance and security in 13 counties, as follows:

Barren County:

- In three cases, the employee receiving the supply of EBT cards also issued the EBT cards.
- In one case, two forms of ID were not obtained and the recipient did not sign the card log.
- In four cases, EBT cards were not destroyed after 30 days as stated in the CHFS manual.
- Employee A and Employee B along with the supervisor failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Bath County:

- In one case, only one form of ID was documented.

Boyle County:

- In six cases, the employee receiving the supply of EBT cards also issued the EBT cards.
- In two cases, the date the card was issued was not stated.
- Employee A and Employee B along with the supervisor failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Floyd County:

- In nine cases, the employee receiving the supply of EBT cards also issued the EBT cards.
- Employee A and Employee B along with the supervisor failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Gallatin County:

- In 18 cases, the employee receiving the supply of EBT cards also issued the EBT cards.
- In one case, two forms of ID were not obtained and the recipient did not sign the card log.
- In one case, the EBT card was not destroyed after 30 days as stated in the CHFS manual.
- Employee A and Employee B along with the supervisor failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-CHFS-63: The Cabinet For Health And Family Services Should Improve The Security Over EBT Cards Received At Local Offices (Continued)**

Jefferson County:

- In six cases, the employee receiving the supply of EBT cards also issued the EBT cards.
- In 54 cases, two forms of ID were not documented.
- In seven cases, the EBT cards were not destroyed after 30 days as stated in the CHFS manual.
- In two cases, the signature of the worker issuing the card was blank.
- In four cases, the date the card was issued was blank.
- Employee A and Employee B along with the supervisor failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Kenton County:

- The key to the locked file cabinet is kept on top of the desk for use by anyone.
- The EBT logs for September 2009 were missing.
- In 105 cases, the employee receiving the supply of EBT cards also issued the EBT cards.
- In 124 cases, only one form of ID was documented.
- In four cases, the recipient did not produce any form of ID and the recipient did not sign the card log.
- In 73 cases, the EBT cards were not destroyed after 30 days as stated in the CHFS manual.
- Employee A and Employee B along with the supervisor failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Mercer County:

- In three cases, the employee receiving the supply of EBT cards also issued the EBT cards.
- In one case, two forms of ID were not obtained and the recipient did not sign the card log.
- In four cases, the EBT card was not destroyed after 30 days as stated in the CHFS manual.
- Employee A and Employee B along with the supervisor failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Montgomery County:

- In two cases, the employee receiving the supply of EBT cards also issued the EBT cards.
- In two cases, the EBT card was not destroyed after 30 days as stated in the CHFS manual.
- Employee A and Employee B failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Pulaski County:

- In 14 cases, the employee receiving the supply of EBT cards also issued the EBT cards.
- Employee A and Employee B failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-63: The Cabinet For Health And Family Services Should Improve The Security Over EBT Cards Received At Local Offices (Continued)

Taylor County:

- Employee A and Employee B failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Warren County:

- In one case, the employee receiving the supply of EBT cards also issued the EBT cards.
- In 11 cases, only one form of ID was documented.
- In two cases, two forms of ID were not obtained and the recipient did not sign the card log.
- In two cases, the signature of the worker issuing and/or receiving the card was blank.
- In one case, the date the card was issued was blank.
- In seven cases, the EBT card was not destroyed after 30 days as stated in the CHFS manual.
- Employee A and Employee B along with the supervisor failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Wolfe County:

- In two cases, only one form of ID was documented.
- Employee A and Employee B along with the supervisor failed to review and sign the EBT-2 and EBT-5 at the end of the month to confirm the EBT cards remaining in the local office.

Personnel responsible for the EBT cards were not familiar with the EBT Security policies in the manual or chose not to follow the policies. The failure to follow the policies related to EBT card security created a lack of proper segregation of duties caused by the same employee receiving the supply of EBT cards and also issuing those cards to beneficiaries.

When EBT cards are not secured in the local offices, the cards could be misplaced or stolen and the office personnel may not notice for a period of time.

The DCBS Policy Manual at MS 0290 states, “The recipient has 30 days to pick up their EBT card in the local office. If they fail to pick up their EBT card within 30 days, the card must be destroyed.”

The DCBS Policy Manual at MS 0290 further states: “When EBT cards are received in the local office and the envelope has been opened, or is returned by the general public for any reason; the EBT card is logged onto form EBT-5, Affidavit of Destruction, and immediately destroyed.”

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-CHFS-63: The Cabinet For Health And Family Services Should Improve The Security Over EBT Cards Received At Local Offices (Continued)**

To maintain the security of EBT cards in the local office:

A. The Field Services Supervisor (FSS):

1. Maintains overall responsibility for secure storage of EBT cards and logs;
2. Designates two individuals (Employee A and Employee B mentioned below) to handle, secure, issue, destroy and complete logs for EBT cards;
3. Ensures EBT cards are NEVER left unsecured;
4. Routinely inspects the secure storage area;
5. Destroys or witnesses the destruction of EBT cards as they are returned to the local office, received damages, or not picked up within 30 days;
6. Signs form EBT-5 at the time of destruction; and
7. Reviews and signs forms EBT-2, County EBT Card Log, and EBT-5 monthly to confirm the EBT cards remaining in the local office at the end of each month.

B. Employee A:

1. Has responsibility for receiving and securing EBT cards;
2. Ensures that the EBT cards are logged on form EBT-2 as received;
3. Obtains a card from the secure location and releases the card to Employee B at the time a recipient comes in to pick up the EBT card;
4. Records the release of each EBT card to Employee B on form EBT-2 daily; and
5. Attests to a daily reconciliation of EBT cards through comparison of EBT-2 and EBT-5 logs to cards remaining in the secure location.

C. Employee B:

1. Has responsibility for releasing EBT cards to recipients;
2. Obtains the appropriate EBT card from Employee A as recipients come in to the local office to pick up their cards;
3. Views two forms of identification from the recipient picking up the card and documents the verification on form EBT-2;
4. Requires the recipient to sign, not initial, form EBT-2 to confirm receipt of the EBT card in a manner which preserves the confidentiality of others listed on form EBT-2.
5. Signs form EBT-2 to indicate that the recipient's EBT card was released; and
6. Attests to a daily reconciliation of EBT cards through comparison of EBT-2 and EBT-5 logs to cards remaining in the secure location.

D. Either Employee A or B and the FSS destroys or witnesses the destruction of EBT cards as they are returned to the local office, received damaged or not picked up within 30 days, and signs form EBT-5 at the time of destruction.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-63: The Cabinet For Health And Family Services Should Improve The Security Over EBT Cards Received At Local Offices (Continued)

E. Ensure that the following action is taken at the end of each month:

1. Both Employee A and B sign forms EBT-2 and EBT-5;
2. The FSS reviews and signs form EBT-2, comparing the list of outstanding cards to the cards remaining in the secure location; and
3. Retain forms EBT-2 and EBT-5 in a county file.

Recommendation

We recommend DCBS:

- Provide training to the staff responsible for EBT cards on proper receipt, maintenance, and destruction of the EBT cards.
- Evaluate current policies for appropriateness, update policies if necessary, and enforce the application of the policies.
- Ensure Kenton County properly secures the key to the file cabinet containing the EBT cards.

Management's Response and Corrective Action Plan

After the last APA review two years ago, the Division of Family Support (DFS) revised EBT maintenance policy to eliminate one EBT tracking log in order to simplify procedures and clarify the separate responsibilities for the person receiving the EBT cards from the person issuing the EBT cards to participants. As a result of this review, DFS plans to revise issuance procedures to only require one form of identification from participants, instead of two. These findings have also been reviewed and discussed with each Region. Field Service Supervisors (FSS) will review policy in Vol. I, MS 0280 and 0290, related to the receipt, maintenance and destruction of EBT cards, with all staff responsible for handling EBT cards during upcoming staff meetings to ensure they understand correct procedures. Some counties will address with all staff, as some may be designated as backups for handling EBT cards. Specific corrective actions will be implemented in each county with deficiencies as specified below:

- *In Kenton County, the key to the filing cabinet will be secured in the Supervisor's office, no longer available to staff who aren't responsible for EBT card security;*
- *Service Region Administrative Associates (SRAA) and/or Public Assistant Program Specialists (PAPS) will complete random reviews of EBT logs in Boyle, Mercer, Gallatin, Kenton, Warren, Barren and Jefferson;*
- *The staff meetings to discuss EBT security will be conducted by the SRAA in Boyd and Mercer counties;*
- *EBT logs will be reviewed by PAPS in Floyd and Wolfe Counties when they complete monthly visits for case reviews;*

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-63: The Cabinet For Health And Family Services Should Improve The Security Over EBT Cards Received At Local Offices (Continued)

Management's Response and Corrective Action Plan (Continued)

- *The FSS responsible for EBT 2 & EBT 5 in Barren, Warren, Gallatin and Kenton counties will e-mail these forms to the SRAA and SNAP PAPS by the 10th calendar day each month beginning March 2011. Discrepancies will be immediately addressed with the appropriate Supervisor;*
- *Jefferson County will ensure appropriate staff are assigned to all roles associated with EBT logs and each FSS will provide a list of assigned EBT staff to SRAA by 2/18/11. EBT logs will be reviewed at peer review meetings each month, beginning March 2011;and,*
- *Wolfe County will re-emphasize and monitor the policy to require 2 forms of identification from clients when picking up an EBT card and the requirement to destroy EBT cards issued to the local office if not picked up within 30 days.*

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-64: The Cabinet For Health And Family Services Should Ensure The Jefferson County DCBS Office Maintains Case Files In Accordance With Federal Requirements

State Agency: Cabinet for Health and Family Services

Federal Program: CFDA 93.558-Temporary Assistance for Needy Families

CFDA 93.714-ARRA-Emergency Contingency Fund for Temporary Assistance for Needy Families (TANF) State Program

Federal Agency: U.S. Department of Health and Human Services

Pass-Through Agency: Not Applicable

Compliance Area: Eligibility

Amount of Questioned Costs: \$0

The Temporary Assistance for Needy Families' (TANF) program is administered by the Cabinet for Health and Family Services (CHFS). The TANF program includes the following Federal assistance programs: Kentucky Transitional Assistance Program (K-TAP), Kentucky Works Program, Kinship Care Program (KC), Family Alternatives Diversion (FAD), Work Incentive Program, and Safety Net.

We requested a sample of 33 case files from the Jefferson County Department for Community Based Services (DCBS) office for Federal eligibility requirements for KC, K-TAP and FAD programs and noted six case files that were missing as follows, four case files from FAD and two from KC.

The Jefferson County DCBS office did not comply with the agency's policies regarding storage and record retention.

When case files are missing, CHFS is not in compliance with Federal requirements concerning record retention.

When case files are missing we cannot determine if the recipients were eligible to receive benefit payments, in accordance with Federal regulations and 921 KAR 2. When case files are missing there is an increased risk that errors or fraud may have occurred and would not be promptly detected or corrected by the agency's control system. The risk for fraud within these programs is significant because eligible recipients can receive cash assistance. For example, families who are eligible to participate in the FAD program could receive up to a maximum of \$1300 during a 3-month eligibility period that may be used for transportation, child care, housing or employment-related expenses, in accordance with 921 KAR 2:500.

In addition to the increased risk of fraud within the program, there is also the concern that recipients could get additional benefits that they are no longer eligible to receive. When case files are missing there is a risk that individuals could reapply for benefits either before the required 24 month waiting period expires or apply for benefits more than twice in the beneficiary's lifetime.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-64: The Cabinet For Health And Family Services Should Ensure The Jefferson County DCBS Office Maintains Case Files In Accordance With Federal Requirements (Continued)

OMB Circular A-133 Part 6 states, “The A-102 Common Rule and OMB Circular A-110 require that non-Federal entities receiving Federal awards (i.e., agency management) establish and maintain internal control designed to reasonably ensure compliance with Federal laws, regulations, and program compliance requirements.”

According to the CHFS, DCBS Operations Manual - Volume I:

The case record is the official document of the Department that establishes accountability for the expenditure of state and federal funds. Local management staff is responsible for insuring case records are properly maintained, purged of obsolete material, and accessible to staff. (MS 0030)

Case records are required to be retained for a length of time specified by each program. Material not directly related to eligibility or benefit authorization is not retained. To assure records contain only relevant material, case records are purged of all outdated material during the recertification process. Purged material is shredded or burned prior to disposal. (MS 0040)

TANF has a required record retention of five years.

Do not purge a case record if the case is involved in an audit until the audit is completed and a response to the audit has been filed. (MS 0040)

Recommendation

We recommend CHFS comply with Federal requirements, as follows:

- Locate the missing case files or discontinue program benefits.
- Ensure the Jefferson County DCBS office maintains case files in accordance with Federal requirements and the agency’s policy.

Management’s Response and Corrective Action Plan

Since the completion of the audit, the Jefferson County DCBS office has located four of the six missing case files. Three of the cases found were FAD cases and one case was Kinship Care. Attached are copies of the applications for the four cases that were found. Jefferson County will continue to make efforts to locate the other two missing files.

CHFS agrees that the Jefferson County DCBS office did not comply with the agency’s policies regarding storage and record retention. The Division of Service Regions (DSR) and Division of

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-CHFS-64: The Cabinet For Health And Family Services Should Ensure The Jefferson County DCBS Office Maintains Case Files In Accordance With Federal Requirements (Continued)**

Management's Response and Corrective Action Plan (Continued)

Family Support (DFS) will work with Jefferson County to assist them in developing and maintaining an adequate filing system to ensure the location and tracking of case files. DSR and DFS are reviewing Jefferson County's current policies and make recommendations to ensure any inadequacies are identified and resolved. In addition, follow-up will be conducted to ensure the recommendations are fully implemented.

Additionally, Jefferson County DCBS office supervisors reviewed current policy regarding the maintenance of case records and office protocol for maintaining discontinued case records, including FAD cases at its scheduled Peer Review meeting on March 10, 2011. The Jefferson County DCBS office will also ensure that case managers review policy and protocol for maintaining case records at a meeting scheduled on March 24, 2011. A Regional Program Specialist will attend the monthly meeting of the Kinship team in March of 2011 to discuss and review correct procedures and protocol for maintaining case records. Once policy and procedures are revised, Jefferson County DCBS management will review policy with staff immediately.

If a case record is requested for review and cannot be located, Regional Program Specialists in Jefferson County will notify the Service Region Administrator Associate (SRAA) immediately. The Program Specialists will develop protocol for follow-up, request corrective action plans and monitor local corrective action plans to ensure case records are filed appropriately and can always be located. All FAD cases will be provided to the SRAA for storage upon discontinuance of the case.

DFS issues instructional material to local field staff on a regular, on-going basis. Tips are posted weekly on the Kentucky Automated Management Eligibility System (KAMES) on various topics related to the proper application of policy and procedures. DFS has developed and will issue tips on a quarterly basis to remind staff of procedures outlined in Volume I, MS 0030 and MS 0040 to ensure information is available on proper maintenance of case files. Additionally, a Family Support Memorandum (FSM) is issued annually which provides information for properly maintaining case records.

The Cabinet has many edits and procedures in place to prevent workers from creating fictitious cases. These edits and procedures are built into the application, approval and payment processes. For example, before an application can be entered on KAMES, an agency contact must be entered by support staff (not a caseworker). An application cannot be processed and benefits cannot be issued without completion of the agency contact or the supervisor signing off on the case. Additionally, if the worker is on probation, the supervisor must sign off on the case prior to the case being approved.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-CHFS-64: The Cabinet For Health And Family Services Should Ensure The Jefferson County DCBS Office Maintains Case Files In Accordance With Federal Requirements (Continued)

Management's Response and Corrective Action Plan (Continued)

Four of the cases in question were from the state's TANF diversion program known as Family Alternatives Diversion (FAD). Edits and procedures have been created for this program as FAD is processed on a separate system. These include:

- *Limiting the number of times a client may receive FAD assistance to once every 24 months and only twice in a lifetime;*
- *Creating an interface/link on KAMES to access the FAD system that prevents the receipt of FAD and K-TAP benefits simultaneously;*
- *Creating specific need categories on FAD to identify the exact type of payment issued;*
- *Restricting payments from being issued directly to the client; and,*
- *Requiring supervisory approval for all payments.*

In addition to the above edits and procedures, several reports are generated that are monitored by designated staff within the region. Those reports include payments made by county and approval code, payments created and issued by the same person, payments pending more than 10 days, daily FAD payments and FAD monthly payment report.

Quality control reviews performed by the Quality Control Branch in the Division of Program Performance will begin another level of case review by expanding to encompass compliance for Kinship Care cases. DFS staff is working with the Quality Control Branch to develop this process with a target date for implementation of September 2011.

Additionally, the Cabinet is in the process of developing an electronic case file system that will take the place of all hard copy case records. By converting to a paperless system, the Cabinet will further reduce the risk of loss of case records and the possibility of issuing duplicate benefits. The Cabinet anticipates commencing a phased rollout in August 2011 with statewide rollout to be completed in 2012.

Although any missing hard copy case record is of significant concern, the risk of an individual's ability to obtain duplicate benefits, or to receive benefits before a mandatory waiting period expires is low due to the electronic tracking of time limits and issuance of benefits within the Kentucky Automated Management Eligibility System.

Auditor's Reply

In its response, CHFS indicated it provided the auditors four of the six missing case files noted in our finding. This information was not obtained early enough for audit consideration, but the information will be considered in our follow-up of this finding during the FY 11 audit.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-65: The Kentucky Department Of Military Affairs Should Ensure Improve Processing Of Payments To Ensure State Sales Tax And Late Fees Are Not Paid On Utility Bills

State Agency: Department of Military Affairs

Federal Program: CFDA 12.401-National Guard Military Operations and Maintenance Projects

CFDA 12.401-ARRA-National Guard Military Operations and Maintenance Projects

Federal Agency: U.S. Department of Defense

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Cost/Activities Allowed

Amount of Questioned Costs: \$127

During our testing of the Kentucky Department of Military Affairs (KYDMA) National Guard Operations & Maintenance (CFDA 12.401) program we selected a sample of 60 telephone and utility charges for testing. Our testing of these items identified the following two deficiencies:

- In August 2009, the National Guard program paid sales tax on a gas bill. The billing of sales tax continued until December 2010, when the bill was corrected and the vendor refunded the sales tax owed to the National Guard.
- On a May 2010 electricity bill, the National Guard program paid a late fee associated with a prior month's bill for the amount of \$59.

In following up on these deficiencies, the auditor became aware that National Guard invoices were not being received timely in the business office. The auditor also noted during follow-up inquiries that although only two instances of late telephone and utility payments were identified in the testing sample, these are not isolated incidents. The inability of personnel to receive invoices timely from the field hampers the National Guard's ability to process and pay bills in a timely manner.

Also, a breakdown in internal control, for reviewing invoices being processed and paid by the National Guard, led to sales tax being paid on its gas bills.

The failure of the KYDMA to implement strong internal controls led to a breakdown in their control structure. The breakdown results in invoices being paid late, which cause penalties or late fees to be incurred. Having bills/invoices lag in the field or on someone's desk for months is not an acceptable practice. Additionally, lack of review over utility bills led to the Commonwealth's tax exempt status not being utilized on gas bills for over a year.

KRS 139.470 (7) states,

Kentucky sales and use tax shall not apply to purchases of tangible personal property or services made by any cabinet, department, bureau, commission, board, or other statutory or constitutional agency of the Commonwealth. This exemption applies only to purchases of property or services for use solely in the government function. A purchaser not qualifying as a governmental agency or unit is not entitled to the exemption even though such purchaser may be the recipient of public funds or grants.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-65: The Kentucky Department Of Military Affairs Should Ensure Improve Processing Of Payments To Ensure State Sales Tax And Late Fees Are Not Paid On Utility Bills (Continued)

NGR 5-1 National Guard Grants and Cooperative Agreements Chapter 5-3 states,

Allocable Costs: Costs must actually have been incurred by the grantee and be allocable to the CA supported program, project or facility. This means the CA received a direct benefit from the activity causing the charge; there is a causal relationship between the activity causing the charge and the Federal program (i.e., the cost effect of the additional burden caused by the CA is measurable); and the cost would disappear without the existence of the CA.

Recommendation

We recommend the Department of Military Affairs:

- Develop and implement controls to ensure invoice payments are made timely and accurately.
- Ensure sufficient supervisory review by competent individuals over invoiced documents.
- Centralize accounting/business services by having all bills come to one central location to ensure payments are made timely and reviewed correctly.
- Utilize the pre-audit function, along with three distinct levels of approval.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for allowable costs and cost principles is to provide reasonable assurance that funds are expended only for allowable activities and that the costs of goods and services charged are allowable and in accordance with the applicable cost principles. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of the identified deficiency.

Based on the auditor's finding, DMA management has conducted an analysis of the overall risk environment currently facing the department and concurs with the auditor's finding.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-DMA-65: The Kentucky Department Of Military Affairs Should Ensure Improve Processing Of Payments To Ensure State Sales Tax And Late Fees Are Not Paid On Utility Bills (Continued)**

Management's Response and Corrective Action Plan (Continued)

Sales tax was inadvertently paid on an August 2009 Louisville Gas & Electric Company (LG&E) billing by a former Facilities Division employee. Payment of the sales tax continued until December 2010 when the present employee responsible for creating the payment noticed the incorrect charge and contacted LG&E for a full refund and supplied the appropriate sales tax exemption certificate to LG&E. This error has now been remedied.

The payment of a late fee to Kentucky Utilities (KU) on the May 2010 bill was the result of the prior month's bill not being paid in a timely manner because final approval at the Department Level 3 was delayed nine days from the date the invoice was submitted for approval by the Division of Facilities due to insufficient funds in the grant agreement which was caused by the federal CRA activity or, more specifically, lack thereof.

All staff in the Division of Facilities responsible for the payment of invoices or the approval of invoices have been counseled on the necessity of performing a thorough review of all invoices and supporting documentation before processing vendor payments.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-66: The Department Of Military Affairs Should Strengthen Internal Controls Over Expenditures To Avoid Penalty And Interest Charges And Comply With Policies Requiring Proper Segregation Of Duties Between Pre-Audit And Approval Processes

State Agency: Department of Military Affairs

Federal Program: CFDA 12.401-National Guard Military Operations and Maintenance Projects

CFDA 12.401-ARRA-National Guard Military Operations and Maintenance Projects

Federal Agency: U.S. Department of Defense

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Cost/Activities Allowed

Amount of Questioned Costs: \$38,987

During our audit of the Kentucky Department of Military Affairs (KYDMA), we tested payments for utilities, capital construction, payroll, rental, and maintenance of buildings and grounds. While examining these transactions we noted that KYDMA bills were paid late resulting in the assessment of penalties and interest for non-payment and/or late payment. Because payments were not made timely, KYDMA incurred charges for penalty and interest related to two separate disasters in the amounts of \$17,384 and \$21,603, for a total questioned cost of \$38,987.

In addition to this, during inquiry of these weaknesses, auditors were made aware of control deficiencies that extended beyond the year under audit. The auditors obtained information indicating past due bills for garbage collection that occurred in November 2010 and December 2010. Furthermore, the auditor noted instances in which transactions were being processed without following the prescribed approval process. The auditor obtained 31 transactions indicating the same person performed both the pre-audit function and applied the level I approval. This approval method is not consistent with KYDMA's policies, and therefore appears to be a circumvention of the agency's internal controls.

KYDMA personnel failed to adhere to its policies and procedures, which led to the control weaknesses identified above. It appears that KYDMA does not have strong centralized processing or monitoring of its payment functions. When KYDMA fails to practice good internal controls, it subjects the Commonwealth to pay late fees, as well as additional risks associated with not having a properly segregated approval process. Furthermore, late fees or penalty and interest charges are not allowable federal grant charges. FEMA also indicates it can withhold reimbursements or advancement of payments due to the Commonwealth if invoices are not being paid timely.

The application of pre-audit and approval controls by the same person circumvents the agency's procedures, which requires one individual to perform the pre-audit function and the branch manager to perform the level I approval. By circumventing these requirements, there is an increased risk for the bill to be processed incorrectly or for funds to be misappropriated.

FEMA criteria contained in 31 U.S.C. 3717 and Title 6 CFR 11.10 states,

If this bill is not paid within 30 days of the bill date, interest at 3% per annum and an administrative charge for any costs incurred in collection will be assessed according to provisions of 31 U.S.C. 3717 and Title 6 CFR 11.10. Also, a penalty of 6% will be assessed on the unpaid balance, including any interest and administrative charges, if the bill is not paid within 90 days of the bill date.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-66: The Department Of Military Affairs Should Strengthen Internal Controls Over Expenditures To Avoid Penalty And Interest Charges And Comply With Policies Requiring Proper Segregation Of Duties Between Pre-Audit And Approval Processes (Continued)

NGR 5-1 National Guard Grants and Cooperative Agreements Chapter 5-3 states,

Allocable Costs: Costs must actually have been incurred by the grantee and be allocable to the CA supported program, project or facility. This means the CA received a direct benefit from the activity causing the charge; there is a causal relationship between the activity causing the charge and the Federal program (i.e., the cost effect of the additional burden caused by the CA is measurable); and the cost would disappear without the existence of the CA.

(2) Allowable Costs: Costs must conform to Federal, DoD, Army, AF and NG policies concerning the use and management of Federal funds and may not be contrary to any restriction, limitation, or instruction contained in any approved budget.

As set forth in KYDMA's manual *eMARS Security - Approval Roles in Internal Control*, "the division-level pre-audit approval is to ensure the document submitted to e-Mars for payment is correct in all aspects. The branch approval or level I is to be performed by a branch manager and the approval is to indicate the charge is a allowable cost against the program and budget funds are available."

Recommendation

We recommend the KYDMA consider the following:

- Implement policies and procedures to improve the timeliness of payments. KYDMA should consider whether centralized accounting/business services are more efficient and effective than its current decentralized structure, or otherwise improve controls over the monitoring of accounting functions at decentralized locations. Also, KYDMA's procedures should ensure the accounting and monitoring functions are staffed and supervised by individuals possessing the appropriate knowledge and skills in accounting.
- Reinforce the policies and procedures identified in the agency's manual, *eMARS Security - KYDMA Approval Roles in Internal Control*, to ensure proper segregation of duties related to pre-audit and approval processes, and also implement procedures to reduce the potential for internal controls over pre-audit and approvals to be circumvented.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-DMA-66: The Department Of Military Affairs Should Strengthen Internal Controls Over Expenditures To Avoid Penalty And Interest Charges And Comply With Policies Requiring Proper Segregation Of Duties Between Pre-Audit And Approval Processes (Continued)**

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for allowable costs and cost principles is to provide reasonable assurance that funds are expended only for allowable activities and that the costs of goods and services charged are allowable and in accordance with the applicable cost principles. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of the identified deficiency.

Based on the auditor's finding, DMA management has conducted an analysis of the overall risk environment currently facing the department and concurs with the auditor's finding.

In the Facilities Division, the invoices from ID/Republic Service were being sent by the vendor to the service address and not to the billing address at the Division of Facilities. Facilities Division discovered this on January 24, 2011 and the Division has remedied the situation by contacting the vendor to change the billing address as appropriate and made immediate payment on the outstanding balance. In addition, the Division has communicated with personnel at the supported service location and informed them of the proper billing address for all invoices.

In the Emergency Management Division (KyDEM), the Other Needs Assistance (ONA) payments identified in the audit finding were mailed by FEMA to the KyDEM ONA Program Coordinator who, at that time, was working away from the office at another location for the Disaster Field Office (DFO) to help process claims. Therefore, the bills accumulated on his desk at his regular office without anyone's knowledge. KyDEM has contacted FEMA to change the procedure to where FEMA will email the bills directly to the KyDEM fiscal management office thereby eliminating any further potential delay.

KyDEM has also revised their divisional fiscal payment processing procedures to restore the pre-audit function as a stand-alone approval in the overall processing and approval of automated accounting documents.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-67: The Department Of Military Affairs Should Avoid Charging Non-CSEPP Related Activities To The CSEPP Grant

State Agency: Department of Military Affairs

Federal Program: CFDA 97.040-Chemical Stockpile Emergency Preparedness Program

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Allowable Cost/Activities Allowed

Amount of Questioned Costs: \$41,031

In the FY 10 audit of Kentucky Emergency Management (KyEM) Chemical Stockpile Emergency Preparedness Program (CSEPP), we tested employee timesheets and work plans to ensure payroll charges for the CSEPP grant are allowable and accurately reported. We identified the following deficiencies:

- We identified that KyEM 100% CSEPP employees performs work on non-CSEPP activities. KyEM CSEPP staff does not separately account for time spent on various activities in their timesheets or other documentation. Timesheets only reflected notes about the employees' daily activity when they worked overtime. KyEM's Finance and Grants Administrative Branch Manager stated that all salary and benefits for these employees are charged to CSEPP each pay period, and that KyEM does not adjust the payroll charges for any time spent by these employees on non-CSEPP activity. We identified 1,771 hours spent on non-CSEPP activities that were billed to the CSEPP grant, resulting in an estimated \$39,118 in questioned costs.
- All the work plans reviewed required individuals to work at least 30 hours per week on CSEPP. Because KyEM does not require CSEPP employees to account for the exact number of hours per activity on timesheets, we cannot determine if KyEM is in compliance with these work plans. The auditor does agree with KyEM that these work plans do allow KyEM CSEPP staff to work on non-CSEPP activities. However, it does not permit KyEM to charge CSEPP for non-CSEPP activities.
- We found evidence indicating one 100% funded CSEPP employee had time submitted for reimbursement as forced labor charges for the Public Assistance grant (PA), even though his salary and benefits were charged to CSEPP. The Administrative Branch Manager indicated this employee was not assigned as 100% CSEPP funded until January 1, 2010 and that the May 2010 billing to PA was an oversight. KyEM was not able to provide written documentation to support this. This error resulted in a double billing for the hours worked by the employee to the CSEPP grant and the PA grant, resulting in \$1,913 in questioned costs.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-67: The Department Of Military Affairs Should Avoid Charging Non-CSEPP Related Activities To The CSEPP Grant (Continued)

Because KyEM does not make CSEPP staff allocate the amount of time spent on various activities we are questioning the hours worked during the entire day when non-CSEPP activities were identified in the overtime notes. Requests for employee pay were made, but supporting documentation was never supplied from Kentucky Department of Military Affairs. Therefore, the auditor estimated the questioned cost amount by averaging the hourly rate for the CSEPP employees. Based on this methodology, we question \$39,118 in unallowable charges.

Auditors noted the most common non-CSEPP tasks were disasters, such as winter storms, flooding, and wind storms. Another common task was Manager on Call (MOC). The employee assigned to the MOC function took general emergency calls coming into KyEM and responded as needed. The Administrative Branch Manager noted that this is routine and staff can complete their normal daily tasks while being available to answer the phone. The Administrative Branch Manager stated that KyEM does not assign this task anymore. We also noted instances in which CSEPP employees were sent to non-CSEPP counties to perform damage assessments, and one instance in which the CSEPP Branch Manager charged 21 hours in two days for "Painting RM Room".

The Administrative Branch Manager stated that responding to these disaster situations was practice for CSEPP staff. The auditor agrees that it would be reasonable to utilize CSEPP staff in non-CSEPP situations, and it is particularly understandable that CSEPP employees are utilized when a state of emergency is declared. However, the time the employees spend on those activities should be charged to the program they are assisting, rather than CSEPP. KyEM has been unable to supply any supporting documentation that costs for non-CSEPP activity is allowable for the CSEPP grant.

By double billing the CSEPP grant and the PA grant, KyEM has received reimbursement for costs that are not unallowable for the CSEPP grant. Furthermore, since CSEPP is paying the cost for work of other programs, those programs are being under charged and therefore the actual cost of those programs is understated.

The U.S. Department of Homeland Security's Chemical Stockpile Emergency Preparedness Program (CSEPP) provides a Cooperative Agreement Guide which offers guidance for administering the CSEPP program. Included, by reference, in this guide is OMB Circular A-87, 2 CFR Part 225 and 44 CFR Part 13, which provide cost principles for determining allowable costs, including allowable personnel costs. These principles require that federal awards are used efficiently and effectively to achieve the objectives of the federal program. DMA assumes responsibility for administering the funds in a manner consistent with all underlying agreements, program objectives, and all terms and conditions of the federal grant award.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS***Significant Deficiencies Relating to Internal Controls and/or Noncompliances*****FINDING 10-DMA-67: The Department Of Military Affairs Should Avoid Charging Non-CSEPP Related Activities To The CSEPP Grant (Continued)**

2 CFR Part 225 Appendix B states in part:

8. Compensation for personal services.
 - a. General. Compensation for personnel services includes all remuneration, paid currently or accrued, for services rendered during the period of performance under Federal awards, including but not necessarily limited to wages, salaries, and fringe benefits. The costs of such compensation are allowable to the extent that they satisfy the specific requirements of this and other appendices under 2 CFR Part 225, and that the total compensation for individual employees:
 - (1) Is reasonable for the services rendered and conforms to the established policy of the governmental unit consistently applied to both Federal and non-Federal activities;
 - (2) Follows an appointment made in accordance with a governmental unit's laws and rules and meets merit system or other requirements required by Federal law, where applicable; and
 - (3) Is determined and supported as provided in subsection h.
 - h. Support of salaries and wages. These standards regarding time distribution are in addition to the standards for payroll documentation.
 - (4) Where employees work on multiple activities or cost objectives, a distribution of their salaries or wages will be supported by personnel activity reports or equivalent documentation which meets the standards in subsection 8.h.(5) of this appendix unless a statistical sampling system (see subsection 8.h.(6) of this appendix) or other substitute system has been approved by the cognizant Federal agency. Such documentary support will be required where employees work on:
 - (a) More than one Federal award,
 - (b) A Federal award and a non-Federal award,
 - (c) An indirect cost activity and a direct cost activity,
 - (d) Two or more indirect activities which are allocated using different allocation bases, or
 - (e) An unallowable activity and a direct or indirect cost activity.
 - (5) Personnel activity reports or equivalent documentation must meet the following standards:
 - (a) They must reflect an after-the-fact distribution of the actual activity of each employee,
 - (b) They must account for the total activity for which each employee is compensated,
 - (c) They must be prepared at least monthly and must coincide with one or more pay periods, and
 - (d) They must be signed by the employee.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-67: The Department Of Military Affairs Should Avoid Charging Non-CSEPP Related Activities To The CSEPP Grant (Continued)

Cooperative Agreement Guide Part IV, Subsection 3 – Program Specific Narrative and Work Plan, requires each CSEPP employee must submit an annual work plan using CSEPPWebCA. In developing Work Plans, the following must be considered:

- CSEPP funded positions are restricted in their availability to perform non-CSEPP activities and must work full-time on CSEPP.
- CSEPP funded employees can respond and support emergencies or disasters within their jurisdictions for a period of up to two weeks.
- For Federally-declared disasters, employees' time should be charged directly to the disaster code.
- If a position is partially funded by CSEPP, the Grantee/Subgrantee must ensure that the individual's time performing CSEPP-related work is proportional to the percentage paid by CSEPP.

Recommendation

We make the following recommendations to the Department of Military Affairs Division of Emergency Management:

- KyEM's should implement policies and procedures that comply with the CSEPP Cooperative Agreement, ensuring that the CSEPP grant is only charged for the time employees spend on CSEPP-related work. These internal controls should require a timesheet system with a clear distinction of employees hours charged to various federal and non-federal activities.
- KyEM should alter its procedures to allocate salary and benefits for all KyEM staff to the appropriate grant based on these timesheets.
- KyEM should review prior year records for unallowable costs. Those costs deemed to be unrelated to the grant should be disallowed and repaid.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for allowable costs and cost principles is to provide reasonable assurance that funds are expended only for allowable activities and that the costs of goods and services charged are allowable and in accordance with the applicable cost principles. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of the identified deficiency.

Based on the auditor's finding, DMA management has conducted an analysis of the overall risk environment currently facing the department and concurs with the auditor's finding.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-DMA-67: The Department Of Military Affairs Should Avoid Charging Non-CSEPP Related Activities To The CSEPP Grant (Continued)**

Management's Response and Corrective Action Plan (Continued)

KyDEM will modify its internal controls to annotate any EOC activation for non-CSEPP emergency response (such as EOC activations for floods, forest fires, tornados, etc.) on CSEPP employee timesheets and then JV2E those costs to an appropriate state emergency account. Also, KyDEM will contact the federal grantor to clarify the federal grantor's regulation regarding their allowance of 105 hours per person per year for non-CSEPP related activities to see if this federal stipulation was intended for other, non-CSEPP specific training (such as eMARS training of programmatic personnel, sexual harassment training, personnel benefit seminars, etc.) or whether they allow non-CSEPP emergency EOC response personnel costs to be an allowable cost against their grant. A written response will be requested.

To alleviate any perception of impropriety, KyDEM will JV2E out the personnel cost previously posted to the CSEPP grant of a CSEPP employee painting a room and charge that cost against an appropriate agency account.

KyDEM will audit prior year CSEPP grant costs to determine applicability, and credit the grant for any questionable charges.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-68: The Department Of Military Affairs Should Implement Procedures To Improve CSEPP Cash Management

State Agency: Department of Military Affairs

Federal Program: CFDA 97.040-Chemical Stockpile Emergency Preparedness Program

Federal Agency: U.S. Department of Homeland Security

Pass-Through Agency: Not Applicable

Compliance Area: Cash Management

Amount of Questioned Costs: \$0

During the FY 10 audit of Kentucky Emergency Management's (KyEM) Chemical Stockpile Emergency Preparedness Program (CSEPP), we discovered instances of poor internal controls and noncompliance with regulations relating to cash management. During the cash management test we selected 40 transactions and evaluated KyEM's ability to process reimbursement requests to ensure subrecipients are reimbursed timely. When we reviewed the number of days between the subrecipient signature on the 1801 reimbursement form and the date Treasury issued payment we found 12 transactions that did not appear to be paid in a reasonable period of time. We noted reimbursements totaling \$547,415 paid between 31 and 131 days after the 1801 reimbursement form was signed.

The failure of the KyEM branch to institute a set of strong internal controls over cash management led to timeliness issues with the reimbursement process. We inquired with KyEM CSEPP Branch Manager about these items and the reasons why such delays may exist. The Branch Manager cited several items as possible contributing factors, including Emergency Operations Center activations during States of Emergency, staff vacations at Christmas/New Year's holidays, delays in contract negotiations with subrecipients, and delays in the expenditure process in other areas of Department of Military Affairs (DMA). However, it appears that the exceptions are dispersed evenly throughout the year. KyEM did not provide support as to why specific reimbursements were delayed.

The failure to reimburse or process reimbursement requests timely and efficiently, leads to slow reimbursement of funds to the counties in the ten county CSEPP Region. Delayed reimbursements by KyEM place an undue hardship on smaller local governments.

2 CFR Part 225; Appendix A; A. Purpose and Scope; 2. Policy guides states in part:

The application of these principles is based on the fundamental premises that:

Governmental units are responsible for the efficient and effective administration of Federal awards through the application of sound management practices. Governmental units assume responsibility for administering Federal funds in a manner consistent with underlying agreements, program objectives, and the terms and conditions of the Federal award. Each governmental unit, in recognition of its own unique combination of staff, facilities, and experience, will have the primary responsibility for employing whatever form of organization and management techniques may be necessary to assure proper and efficient administration of Federal awards.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-DMA-68: The Department Of Military Affairs Should Implement Procedures To Improve CSEPP Cash Management (Continued)

44 CFR Part 13; Subpart C-Post-Award Requirements; Financial Administration §13.21 Payment states in part:

(f) Withholding payments.

Unless otherwise required by Federal statute, awarding agencies shall not withhold payments for proper charges incurred by grantees or subgrantees unless-
The grantee or subgrantee has failed to comply with grant award conditions; or the grantee or subgrantee is indebted to the United States.

Recommendation

We recommend the Department of Military Affairs Division of Emergency Management evaluate the 1801 reimbursement process to ensure procedures are in place to permit timely reimbursements to CSEPP subrecipients.

Management's Response and Corrective Action Plan

Management's goal for the internal control process, within the Dept. of Military Affairs (DMA), is to obtain reasonable assurance that material misstatements will not occur or will be detected in a timely manner. The department's internal control objective for cash management is to provide reasonable assurance that the drawdown of Federal grant cash is only for immediate needs, States comply with applicable Treasury agreement, and recipients limit payment to subrecipients to immediate cash needs. The department's current internal control environment, effected by executive management, establishes management's full support of ethical, efficient, and effective internal control activities and sets a positive tone for correction of identified deficiencies.

Based on the auditor's findings, DMA management has conducted an analysis of the overall risk environment currently facing the department from this finding and concurs with the auditor's finding.

KyDEM will modify its internal controls to require that any automated eMARS document that doesn't pass the pre-audit test for further approval, be rejected all the way back to the submitter instead of allowing it to sit on the document catalog in a submitted, Branch approved status until the correct source documentation or clarification is received. An internal log of these rejections will also be maintained in the KyDEM Fiscal Mgt Branch. Also, KyDEM will insure that all invoices are date stamped by the programmatic initiator of the payment document and again at the pre-audit level to help identify any back-dated original invoice documents that are being processed as current payments which would have the appearance of tardy reimbursements.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-DMA-68: The Department Of Military Affairs Should Implement Procedures To Improve CSEPP Cash Management (Continued)**

Management's Response and Corrective Action Plan (Continued)

Also, KyDEM will modify its internal controls to require that the internal CSEPP 1801 form will no longer be used as a source document for CSEPP grant payments in eMARS. A copy of the original, date stamped invoice must accompany the eMARS payment document either physically or via attached pdf file. The 1801 may also be attached to the payment but will only serve an internal CSEPP federal grant budget tracking purpose and will not be a source document for payment.

Furthermore, programmatic individuals will be designated as having primary responsibility for processing payments in eMARS and a back-up individual will also be designated in the absence of the primary. These individuals will also annotate any EOC activations and dates (or other emergency factor) on the original invoice that occurred after the receipt of the invoice which affected it's timely processing. This annotated, date stamped original invoice will then become part of the accounting record.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-FAC-69: The Finance And Administration Cabinet Should Ensure The Accuracy Of ARRA Expenditures For The State Fiscal Stabilization Fund

State Agency: Finance and Administration Cabinet

Federal Program: CFDA 84.394-State Fiscal Stabilization Fund (SFSF) – Education State Grants, Recovery Act
CFDA 84.397-State Fiscal Stabilization Fund (SFSF) - Government Services, Recovery Act

Federal Agency: U.S. Department of Education

Pass-Through Agency: Not Applicable

Compliance Area: Reporting

Amount of Questioned Costs: \$0

Among the transparency-related requirements in the American Recovery and Reinvestment Act (ARRA) is a quarterly report (1512 report) to disclose federal dollars received and spent and jobs created for every program. The Commonwealth of Kentucky's 1512 report on the State Fiscal Stabilization Fund (SFSF) - Government Services, Recovery Act program (referred to as SFSF Government Services) for the quarter ending December 31, 2009 stated in error that no program funds had been expended. In fact, \$25,357,271 had been expended by the Department of Corrections by the end of that quarter.

The Office of Administrative Services (OAS) within the Finance and Administration Cabinet (FAC) is responsible for preparing and filing SFSF Government Services 1512 reports. The reporting error occurred because OAS' source for expenditure data was requests for federal reimbursement from the agencies that actually spent and received the SFSF Government Services grant, the Department of Corrections and Kentucky State Police.

Department of Corrections charges to the SFSF Government Services grant were \$21,207,463 in November 2009, \$4,149,808 in December 2009, \$19,207,193 in January 2010, \$6,323,840 in February 2010, \$6,295,214 in March 2010, and \$6,366,082 in April 2010; however, the Department of Corrections waited until May to submit its first request for federal reimbursement. OAS was not aware that the Department of Corrections had begun to spend this grant, although that information was available in the Enhanced Management and Reporting System (eMARS), the state's accounting system.

The effect was an inaccurate second quarter 1512 report that understated SFSF Government Services funds expenditures by \$25,357,271.

FAC's Office of Policy and Audit (OPA) monitors the 1512 reports and noted a similar understatement in the third quarter report. OAS corrected the third quarter report, but the second quarter report could not be corrected after the third quarter report had been filed.

Section 2.1 of OMB Memorandum M-09-21, *Implementing Guidance for the Reports on Use of Funds Pursuant to the American Recovery and Reinvestment Act of 2009*, states that recipient reports "are required to include the following detailed information: Total amount of funds received; and of that, the amount spent on projects and activities...." Good internal controls dictate preparing reports by using the most reliable source of data readily available.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-FAC-69: The Finance And Administration Cabinet Should Ensure The Accuracy Of ARRA Expenditures For The State Fiscal Stabilization Fund (Continued)**

Recommendation

We recommend FAC use an eMARS expenditure report as its source of 1512 report expenditure data, while continuing to use federal reimbursement request data to determine funds received.

We further recommend that all agencies endeavor to request federal reimbursements promptly, particularly when reimbursements are performed manually (as is the case for fiscal stabilization grants) instead of automatically through eMARS.

Management's Response and Corrective Action Plan

The Finance and Administration Cabinet Office of Policy and Audit (OPA) reviews all state ARRA 1512 Reports to help ensure accuracy and compliance with the reporting requirements. As a part of their review, OPA detected that the SFSF ARRA 1512 Report expenditures for the Quarter Ending December 31, 2009 did not agree with the expenditures reported in eMARS. OPA notified the Office of Administrative Services (OAS) that a discrepancy existed. Therefore, FAC implemented using an eMARS report to check/report the expenditures data, starting with the FY 2010 third quarter report. FAC continues to use federal reimbursement request data to determine funds received.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDA-70: The Kentucky Department Of Agriculture Should Ensure Subrecipients Are Compliant With Federal Audit Requirements

State Agency: Department of Agriculture

Federal Program: CFDA 10.568-Emergency Food Assistance Program (Administrative Costs)
CFDA 10.569-Emergency Food Assistance Program (Food Commodities)

Federal Agency: U.S. Department of Agriculture

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: \$0

During the course of the 2010 audit of the Emergency Food Assistance Program (TEFAP), we found that the Kentucky Department of Agriculture (KDA) had not complied with requirements to inform subrecipients of A-133 audit requirements, or determine which subrecipients required an A-133 audit, or ensure that subrecipients had an A-133 audit when required.

At the time of testing, KDA had audit reports from four of the five food banks on file for the 2009 fiscal year. KDA could not provide any documentation that any of these audits had been reviewed by the agency. It did not obtain the report for the fifth food bank until after auditors asked about the report.

KDA included outdated audit requirements in its contracts with food banks and did not make any determination of which subrecipients were required to submit an audit. Further they did not have internal controls in place to ensure that audits were received timely and reviewed by the agency. Although we noted that documented controls were insufficient to ensure required subrecipient audits were received and reviewed, our review of those audits did not identify any findings related to the program that may have been missed by the agency.

Per the OMB Circular No. A-133 Subpart D--Federal Agencies and Pass-Through Entities§____.400 Responsibilities:

- (d) Pass-through entity responsibilities. A pass-through entity shall perform the following for the Federal awards it makes:
- (1) Identify Federal awards made by informing each subrecipient of CFDA title and number, award name and number, award year, if the award is R&D, and name of Federal agency. When some of this information is not available, the pass-through entity shall provide the best information available to describe the Federal award.
 - (2) Advise subrecipients of requirements imposed on them by Federal laws, regulations, and the provisions of contracts or grant agreements as well as any supplemental requirements imposed by the pass-through entity.
 - (3) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-KDA-70: The Kentucky Department Of Agriculture Should Ensure Subrecipients Are Compliant With Federal Audit Requirements (Continued)**

- (4) Ensure that subrecipients expending \$500,000 or more in Federal awards during the subrecipient's fiscal year have met the audit requirements of this part for that fiscal year.
- (5) Issue a management decision on audit findings within six months after receipt of the subrecipient's audit report and ensure that the subrecipient takes appropriate and timely corrective action.
- (6) Consider whether subrecipient audits necessitate adjustment of the pass-through entity's own records.

Recommendation

We recommend KDA update and amend its contracts with the food banks to include the correct A-133 audit requirements. KDA should also strengthen internal controls over subrecipient monitoring by creating written procedures to ensure that A-133 audit requirements are met. These procedures should include communication of the audit requirements in addition to the contracts, making a determination about which food banks require an A-133 audit, tracking of audit reports, ensuring that the reports are received and reviewed timely, issuing management decisions timely, and that all procedures are documented.

Management's Response and Corrective Action Plan

We concur that the contracts with the Food Banks were deficient. We are in the process of amending contracts to meet the OMB A-133 requirements. Management will review all contracts for required standards and notify Food Banks of such requirements. Additionally, we are developing written procedures to aid in the full range of compliance with OMB A-133.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-KDA-71: Kentucky Department Of Agriculture Should Not Charge Expenditures To Grants After The Period Of Availability Has Expired**

State Agency: Department of Agriculture

Federal Program: CFDA 10.568-Emergency Food Assistance Program (Administrative Costs)
CFDA 10.569-Emergency Food Assistance Program (Food Commodities)

Federal Agency: U.S. Department of Agriculture

Pass-Through Agency: Not Applicable

Compliance Area: Period of Availability

Amount of Questioned Costs: \$26,822

The funding period for the 2009 TEFAP grant was October 1, 2009 through September 30, 2010. Therefore all expenditures should have been paid before December 31, 2010, which would be 90 days after the end of the funding period. Expenditures paid after the 90 day period are disallowed. Our testing of the period of availability compliance requirement indicated the Kentucky Department of Agriculture (KDA) paid expenditures totaling \$26,822 from the 2009 the Emergency Food Assistance Program (TEFAP) more than 90 days after the end of the funding period.

While KDA's subrecipients had incurred these expenditures prior to the end of the grant on September 30, 2009, the reimbursements were not made until February and April of 2010. Because these expenditures were paid after the funding period and the closeout period expired they are not allowable expenditures of the 2009 TEFAP grant and we question these costs.

Per the A-133 Compliance Supplement:

H. Period Of Availability Of Federal Funds

Federal awards may specify a time period during which the non-Federal entity may use the Federal funds. Where a funding period is specified, a non-Federal entity may charge to the award only costs resulting from obligations incurred during the funding period and any pre-award costs authorized by the Federal awarding agency. Also, if authorized by the Federal program, unobligated balances may be carried over and charged for obligations of a subsequent funding period. Obligations means the amounts of orders placed, contracts and subgrants awarded, goods and services received, and similar transactions during a given period that will require payment by the non-Federal entity during the same or a future period (A-102 Common Rule, §____.23; OMB Circular A-110 (2 CFR section 215.28)).

Non-Federal entities shall liquidate all obligations incurred under the award not later than 90 days after the end of the funding period (or as specified in a program regulation).

Recommendation

We recommend KDA work with the U.S. Department of Agriculture to resolve the \$26,822 of questioned costs. We also recommend that KDA improve internal controls over the expenditure process to ensure that payments are not made outside of the period of availability.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-KDA-71: Kentucky Department Of Agriculture Should Not Charge Expenditures To Grants After The Period Of Availability Has Expired (Continued)

Management's Response and Corrective Action Plan

We concur that the payments were paid subsequent to the ninety (90) days and should have been paid more timely and or classified as "unliquidated obligations" on the FNS-667 "Final" report until such time as payment could be made. We have communicated the findings to our Federal Contact at the South East Regional Office and will increase oversight of the expenditure process to ensure payments are made in a timely manner.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-TC-72: KYTC Should Ensure Compliance With Davis Bacon Act Requirements

State Agency: Transportation Cabinet

Federal Program: CFDA 20.205-Highway Planning and Construction

Federal Agency: U.S. Department of Transportation

Pass-Through Agency: Not Applicable

Compliance Area: Davis Bacon Act

Amount of Questioned Costs: \$0

The Kentucky Transportation Cabinet (KYTC) is required to follow the provisions of the Davis Bacon Act and other related acts on construction contracts greater than \$2,000. Contractors and subcontractors submit payrolls for each week or pay period, along with a statement of compliance (certifying the payroll). During the KYTC FY 10 audit, we selected ten contracts for amounts exceeding \$2,000 (four American Reinvestment and Recovery (ARRA) and six Highway Construction and Planning (CFDA 20.205) projects). Each contract had a prime contractor along with varying numbers of subcontractors. We reviewed contracts and payroll for ten prime contractors and eight subcontractors and noted:

For ARRA funded projects:

1. For two contractors, payrolls for one or more pay periods and the statements of compliance were missing.
2. For one subcontractor, the payroll record was not received timely.
3. For one contractor and one subcontractor, the payrolls were submitted, but not date stamped by KYTC.

For Highway Planning and Construction projects:

1. For two contractor and two subcontractors, payrolls for one or more pay periods and the statements of compliance were missing.
2. For two contractors and one subcontractor, the payroll records were not received timely.
3. For two contractors, one or more statements of compliance submitted to KYTC were not signed.

In addition, a state subcontractor agreement was used for nine subcontractors of one prime contractor when a federal subcontractor agreement should have been used. The federal subcontractor agreement clearly communicates Davis Bacon requirements to the subcontractors by including the following clause:

Further, the prime contractor is to submit or require the above subcontractor to submit for all federal projects the following forms:

Certified Transcript of Weekly Payroll, Form TC 14-308 and Form WH 348 must accompany each weekly payroll.

The state subcontractor agreement does not contain this clause.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-TC-72: KYTC Should Ensure Compliance With Davis Bacon Act Requirements (Continued)

KYTC is not ensuring all contractors and subcontractors required to submit payroll records are submitting the payrolls timely. Missing and late payrolls were issues in FY 09 also and some corrective actions were taken by KYTC at the end of FY 10 to correct the issues; however, we still noted similar problems during FY 10. Without proper oversight, there is a risk the certified payrolls are not being filed by the contractors and/or subcontractors; thus, there is a risk that contractors are not complying with the Davis-Bacon Act.

By not including the specific Davis-Bacon Act language in the subcontracts, the subcontractors may not be aware of the need to submit weekly payrolls. In addition, the state may not be in compliance with Davis-Bacon Act requirements by not including the specific clause in the subcontracts.

29 CFR 3.3 (b) Weekly Statement With Respect To Payment Of Wages in pertinent part states:

Each contractor or subcontractor engaged in the construction, prosecution, completion, or repair of any public building or public work, or building or work financed in whole or in part by loans or grants from the United States, shall furnish each week a statement with respect to wages paid each of its employees engaged on work covered by this part 3 or part 5 of this chapter during the preceding weekly payroll period.

The OMB Circular A-133 Compliance Supplement Part 3 Davis Bacon Act states:

Non-federal entities shall include in their construction contracts subject to the Davis-Bacon Act a requirement that the contractor or subcontractor comply with the requirements of the Davis-Bacon Act and the DOL regulations.... This includes a requirement for the contractor or subcontractor to submit to the non-Federal entity weekly, for each week in which any contract work is performed, a copy of the payroll and a statement of compliance (certified payrolls) (29 CFR sections 5.5 and 5.6).

Recommendation

We recommend KYTC evaluate the effectiveness of the additional procedures implemented in April 2010 and determine if additional procedures are required to ensure compliance with Davis-Bacon Act requirements. Additional procedures could include:

- Randomly selecting a sample of contractor files and verifying all payrolls and statements of compliance were received. This review should be documented.
- Consider generating a report every so often and verifying the contractors and subcontractor performing work during that week have submitted payrolls and statements of compliance. The report and results (or a scanned version) should be maintained as documentation of the procedure.
- Developing methods to ensure contractor and subcontractor compliance.

In addition, KYTC should consider reviewing the project funding information before signing subcontractor agreements to ensure the correct agreement is signed.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-TC-72: KYTC Should Ensure Compliance With Davis Bacon Act Requirements (Continued)**

Management's Response and Corrective Action Plan

The majority of the findings occurred prior to the changes the Division of Construction Procurement (DCP) implemented to manage the large number of payrolls that have to be monitored. However, there were a few issues found that occurred after that change. DCP will continue to randomly audit their files to verify the completeness of the payrolls submitted. To assist in doing this, DCP will generate a report from the construction records of active contractors and subcontractors. Then, DCP will check that all payrolls have been received on all active contractors and subcontractors. DCP will document this process.

Regarding the recommendation to “consider reviewing the project funding information before signing subcontractor agreements to ensure the correct agreement is signed” our processes have changed. The document is actually an approval letter issued by the Director of Construction for subcontracts. There was an oversight by the KYTC personnel sending the letter in this finding. If the project number is not a known federal or state project number, KYTC personnel look the project code up to verify if it is a state or federal project before the letter goes out.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-TC-73: KYTC Should Ensure Subrecipient Site Visits Are Properly Performed And Documented

State Agency: Transportation Cabinet

Federal Program: CFDA 20.205-Highway Planning and Construction

Federal Agency: U.S. Department of Transportation

Pass-Through Agency: Not Applicable

Compliance Area: Subrecipient Monitoring

Amount of Questioned Costs: \$0

The Kentucky Transportation Cabinet (KYTC) is responsible for monitoring all subrecipients for the Highway Planning and Construction Program (CFDA 20.205). Per OMB A-133 Compliance Supplement Section 3:

Monitoring activities normally occur throughout the year and may take various forms, such as:

- Reporting-Reviewing financial and performance reports submitted by the subrecipient.
- Site Visits-Performing site visits at the subrecipient to review financial and programmatic records and observe operations.
- Regular Contact-Regular contacts with subrecipients and appropriate inquiries concerning program activities.

We tested a sample of ten subrecipients listed on the subrecipient list submitted with the FY 10 Schedule of Expenditures of Federal Awards (SEFA) to verify the subrecipients were monitored by KYTC. We noted the following:

- KYTC had not documented site visits or regular contact with three subrecipients. Also, no performance reports were on file for 2010.
- KYTC conducted a site visit on another subrecipient but the documentation was not sufficient for ensuring the subrecipient administered the Federal award in compliance with laws, regulations, and the provisions of the contract while achieving performance goals.

KYTC does not have cabinet wide policies for subrecipient monitoring. Some subrecipients are monitored by the district with limited central office oversight. This can lead to subrecipients not being consistently and properly monitored and the documentation of the monitoring being inadequate or non-existent.

Sufficient procedures related to monitoring the subrecipient project progress were not performed. Without proper monitoring, KYTC does not know if the subrecipient is in compliance with federal requirements.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-TC-73: KYTC Should Ensure Subrecipient Site Visits Are Properly Performed And Documented (Continued)

OMB Circular A-133, Subpart D, §____.400 (d) states:

A pass-through entity shall perform the following for the Federal awards it makes:

- (2) Monitor the activities of subrecipients as necessary to ensure that Federal awards are used for authorized purposes in compliance with laws, regulations, and the provisions of contracts or grant agreements and that performance goals are achieved.

Recommendation

We recommend KYTC:

- Implement a cabinet wide policy for subrecipient monitoring including site visits and/or periodic performance (or progress) reports.
- Standardize the documentation required of site visits and other subrecipient monitoring activities.
- Identify specific sanctions for subrecipients that show an unwillingness to facilitate site visits or submit progress reports relating to their projects.

Management's Response and Corrective Action Plan

Office of Local Programs (OLP) Response

The OLP requires subrecipients to submit semi-annual progress reports. The progress report indicates what phase of the project is underway, any delays in the project, and whether the subrecipient has followed appropriate federal and/or state procedures where applicable. This requirement began in 2010; therefore some project files for older projects will not have two progress reports for each year. The Department of Rural and Municipal Aid employs field representatives who have been assisting with site visits along with the OLP staff. OLP projects are monitored by these field representatives, as well as OLP and district office staff. The OLP is working on providing a more comprehensive system for handling site visits for the project files.

The OLP maintains a tracking system for all the OMB A-133 audits related to our project audits and follow up with subrecipients who have failed to respond to initial correspondence. Our office strives to have all subrecipients respond to documentation requests in a timely fashion; however, some subrecipients do not follow up as requested. The OLP will strengthen the monitoring system in the areas suggested in the audit.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-TC-73: KYTC Should Ensure Subrecipient Site Visits Are Properly Performed And Documented (Continued)

Management's Response and Corrective Action Plan (Continued)

Office of Audits Response

KYTC conducted three training courses for applicable KYTC staff, including LPA Coordinators, Office of Local Programs, and the Division of Planning in July 2010. This training provided specific instructions regarding subrecipient monitoring, including what should be included in project files. We will continue to work on our subrecipient monitoring processes and strive for continuous improvement. We will work with the Cabinet's LPA coordinator on having a centralized policy for subrecipient monitoring including site visits and periodic progress reports.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-TC-74: KYTC Should Ensure Subrecipient Desk Reviews Are Completed Timely

State Agency: Transportation Cabinet
 Federal Program: CFDA 20.205-Highway Planning and Construction
 Federal Agency: U.S. Department of Transportation
 Pass-Through Agency: Not Applicable
 Compliance Area: Subrecipient Monitoring
 Amount of Questioned Costs: \$0

The Kentucky Transportation Cabinet (KYTC) is responsible for monitoring all subrecipients for the Highway Planning and Construction Program (CFDA 20.205). KYTC does this by completing a desk review checklist documenting the review of the subrecipients' audit reports. We tested a sample of ten subrecipients from the 2009 Schedule of Expenditures of Federal Awards to verify the subrecipients FY 09 OMB Circular A-133 audit reports were properly reviewed by KYTC during FY 10. We noted the following:

- Two subrecipient OMB Circular A-133 audit reports were not in the Office of Local Programs even though the audit reports were completed November 18, 2009 and July 15, 2010, respectively. Therefore, no desk review was performed on these audits.
- One subrecipient's OMB Circular A-133 desk review was dated March 11, 2010, but not received by the Division of Planning until January 4, 2011. Although the desk review was completed, the delay in receiving the results did not allow the Division of Planning time to provide the subrecipient with management's decision within six months.

Procedures should be in place to ensure all audit reports are reviewed and management decisions provided to the subrecipient within six months.

While the Office of Local Programs and Division of Planning have both implemented an OMB Circular A-133 Audit Tracking Log, improvements can be made in using that log to ensure compliance with OMB Circular A-133. In all three instances above, the tracking log reflected the exceptions we noted. If audits are either not received or the results of desk reviews are not communicated to the appropriate KYTC division or office, KYTC is unable to follow up with subrecipient on action plans regarding audit findings.

OMB Circular A-133, Subpart D, §____.400 (d) states:

A pass-through entity shall perform the following for the Federal awards it makes:

- (4) Ensure that subrecipients expending \$500,000 or more in Federal awards during the subrecipients fiscal year have met the audit requirements of this part for that fiscal year.

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS

Significant Deficiencies Relating to Internal Controls and/or Noncompliances

FINDING 10-TC-74: KYTC Should Ensure Subrecipient Desk Reviews Are Completed Timely (Continued)

- (5) Issue a management decision on audit findings within six months after receipt of the subrecipients audit report and ensure that the subrecipient takes appropriate and timely corrective action.

OMB Circular A-133, Subpart D, §__.405 states:

- (c) Pass-through entity. As provided in §__. 400(d) (5), the pass through entity shall be responsible for making the management decision for audit findings that relate to Federal awards it makes to subrecipients.
- (d) Time requirements. The entity responsible for making the management decision shall do so within six months of receipt of the audit report. Corrective action should be initiated within six months after receipt of the audit report and proceed as rapidly as possible.

Recommendation

We recommend KYTC:

- Follow up if the OMB Circular A-133 tracking log indicates a subrecipient requiring an A-133 audit has not sent in a copy of the audit report.
- Submit a management letter to the subrecipient with the results of the desk review or management decision within six months of the receipt of the audit. If corrective action is needed, then KYTC should follow-up “as rapidly as possible.”
- Evaluate the potential benefits or efficiencies gained by creating a central location for receiving and reviewing OMB Circular A-133 audit reports.

Management’s Response and Corrective Action Plan

Division of Planning Response

The Division of Planning concurs with all three recommendations of the APA.

- *We will follow up if the OMB Circular A-133 tracking log indicates a subrecipient requiring an A-133 audit has not sent in a copy of the audit report. The APA noted “One subrecipient’s OMB Circular A-133 desk review was dated March 11, 2010, but not received by the Division of Planning until January 4, 2011....” It has been brought to our attention that two KYTC program managers outside of this division received the same report shortly after issuance. Regardless of when we receive a desk review report, we would have noticed if we monitored the OMB Circular A-133 tracking log. We will follow up using the OMB Circular A-133 tracking log.*

SECTION 3 - FEDERAL AWARD FINDINGS AND QUESTIONED COSTS*Significant Deficiencies Relating to Internal Controls and/or Noncompliances***FINDING 10-TC-74: KYTC Should Ensure Subrecipient Desk Reviews Are Completed Timely (Continued)**

Management's Response and Corrective Action Plan (Continued)

- *We will submit a management letter to the subrecipient with the results of the desk review or management decision within 6 months of the receipt of the audit. We will monitor the OMB Circular A-133 tracking log to help ensure that we send management letters timely. If corrective action is needed, then we will follow-up timely.*
- *We are evaluating the potential benefits or efficiencies gained by creating a central location for receiving and reviewing OMB Circular A-133 audit reports with other KYTC stakeholders. The Division of Planning suggests the Cabinet designate a single office/individual to be in charge of tracking OMB Circular A-133 audits, which would include requesting, receiving, and delivering to the Office of Audits for a desk review.*

The Office of Audits will then provide a memo back to that office/individual summarizing the audit report and providing information the project manager can use when following up with the subrecipient for any deficiencies noted, when necessary.

Office of Local Programs (OLP) Response

The OLP maintains a tracking system for all the OMB A-133 audits related to our project audits and follow up with subrecipients who have failed to respond to initial correspondence. Our office strives to have all subrecipients respond to documentation requests in a timely fashion; however, some subrecipients do not follow up as requested. The OLP will strengthen the monitoring system in the areas suggested in the audit.

SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Material Weaknesses/Noncompliances</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 09	09-TC-72	The Kentucky Transportation Cabinet Should Ensure Vendors Are Not Reported As A Subrecipient On The SEFA Subrecipient List	20.205	0	Resolved during FY 10.
FY 07	07-TC-92	The Kentucky Transportation Cabinet Should Implement Formal Policies And Procedures For Subrecipient Monitoring, And Implement Controls To Ensure Proper Reporting Of Subrecipients On The Schedule Of Expenditures Of Federal Awards	20.205	0	Resolved during FY 10.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 09	09-DMA-71	The Department Of Military Affairs Failed To Apply Appropriate Controls Over And Require Proper Supporting Documentation From Subrecipients	97.040	\$29,241	See 10-DMA-54 and 10-DMA-55.
FY 08	08-DMA-86	The Department Of Military Affairs Should Take Immediate Action To Address Potential CSEPP Subrecipient Misappropriation And Should Implement Appropriate Subrecipient Monitoring Procedures To Detect Future Noncompliances	97.040	\$1,874,615	See 10-DMA-54 and 10-DMA-55.

(3) Corrective action taken is significantly different from corrective action previously reported:

There were no findings to report in this category.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Material Weaknesses/Noncompliances (Continued)</u>					
<i>(4) Audit finding no longer valid or does not warrant further action:</i>					
FY 09	09-TC-73	The Kentucky Transportation Cabinet Should Implement And Follow Formal Policies And Procedures For Subrecipient Monitoring	20.205	0	Finding is not material in FY 10. See 10-TC-73 and 10-TC-74.
FY 08	08-TC-88	The Kentucky Transportation Cabinet Should Implement Formal Policies And Procedures For Subrecipient Monitoring	20.205	0	Finding is not material in FY 10. See 10-TC-73 and 10-TC-74.
<u>Significant Deficiencies/Noncompliances</u>					
<i>(1) Audit findings that have been fully corrected:</i>					
FY 09	09-CHFS-76	The Cabinet For Health And Family Services Should Develop Formal Policies And Procedures Over Preparation And Review Of Federal Financial Reports	93.575 93.596	0	Resolved during FY 10.
FY 09	09-CHFS-77	The Cabinet For Health And Family Services Should Ensure Regulations Regarding Foster Parent Eligibility Requirements Are Followed	93.658	0	Resolved during FY 10.
FY 09	09-CHFS-78	The Cabinet For Health And Family Services Should Review Subrecipient Audit Reports And Issue A Management Decision Within Six Months	93.596 93.778 93.959	0	Resolved during FY 10.
FY 09	09-CHFS-80	The Cabinet For Health And Family Services Should Ensure Interstate Case Files Are Reviewed For Completeness And Appropriate Follow-up Action Is Taken	93.563	0	Resolved during FY 10.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Significant Deficiencies/Noncompliances (Continued)</u>					
<i>(1) Audit findings that have been fully corrected(Continued):</i>					
FY 09	09-CHFS-81	The Cabinet For Health And Family Services Should Ensure Staff Who Perform Federal Self Assessment Reviews Are Sufficiently Trained And Update The Computer System	93.563	0	Resolved during FY 10.
FY 09	09-CHFS-82	The Cabinet For Health And Family Services Should Require CDP To Submit A SAS 70 Audit	10.557	0	Resolved during FY 10.
FY 09	09-CHFS-83	The Cabinet For Health And Family Services Should Cross Train Other Employees In Preparing The Foster Care Title IV-E Report	93.658 93.659	0	Resolved during FY 10.
FY 09	09-CHFS-84	The Cabinet For Health And Family Services Should Evaluate The Benefits Of Implementing A Fully Functional Internal Audit Department	10.551 93.558 93.778	0	Resolved during FY 10.
FY 09	09-DWI-86	The Department For Workforce Investment Should Improve Oversight Of Subrecipient Monitoring	17.258 17.259 17.260	0	Resolved during FY 10.
FY 09	09-EDU-87	The Kentucky Department Of Education Is Not Able To Reconcile Nutrition Program Meal Counts To Reported Expenditures	10.553 10.555 10.556 10.558 10.559	0	Resolved during FY 10.
FY 08	08-CHFS-76	The Cabinet For Health And Family Services Should Ensure That All Subrecipients Are Monitored	93.283 93.563 93.959	0	Resolved during FY 10.
<i>(2) Audit findings not corrected or partially corrected:</i>					
FY 09	09-CHFS-74	The Cabinet For Health And Family Services Should Maintain Recertification Documentation In Accordance With The State Plan	93.778	0	See 10-CHFS-59.
FY 09	09-CHFS-75	The Cabinet For Health And Family Services Should Maintain Documentation To Support Provider Eligibility In Accordance With The State Plan	93.778	0	See 10-CHFS-59.

**COMMONWEALTH OF KENTUCKY
SUMMARY SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2010
(CONTINUED)**

Fiscal Year	Finding Number	Finding	CFDA Number	Questioned Costs	Comments
<u>Significant Deficiencies/Noncompliances (Continued)</u>					
<i>(2) Audit findings not corrected or partially corrected(Continued):</i>					
FY 09	09-CHFS-79	The Cabinet For Health And Family Services Should Update The KASES System	93.563	0	See 10-CHFS-60.
FY 09	09-CHFS-85	The Cabinet For Health And Family Services Should Improve The Security Over EBT Cards Received At Local Offices	10.551 10.561	0	See 10-CHFS-63.
FY 09	09-TC-89	The Kentucky Transportation Cabinet Should Adhere To Established Procedures To Ensure Compliance With The Davis Bacon Act	20.205	0	See 10-TC-72.
FY 08	08-CHFS-75	The Cabinet For Health And Family Services Should Ensure The Supporting Documentation From KASES Is Accurate And Reliable	93.563	0	See 10-CHFS-60.
FY 08	08-CHFS-79	The Cabinet For Health And Family Services Should Improve The Security Over EBT Cards At Local Offices	10.551 10.561	0	See 10-CHFS-63.
FY 08	08-TC-84	The Kentucky Transportation Cabinet Should Adhere To Established Procedures To Ensure Compliance With The Davis-Bacon Act	20.205	0	See 10-TC-72.
<i>(3) Corrective action taken is significantly different from corrective action previously reported:</i>					
There were no findings to report in this category.					
<i>(4) Audit finding no longer valid or does not warrant further action:</i>					
FY 09	09-TC-88	The Kentucky Transportation Cabinet Should Implement Formal Policy And Procedures On Suspension And Debarment When Awarding Federal Contracts	20.205	0	Due to improvements, this finding is downgraded to an informal finding for FY 10. This finding is no longer required to be reported under Government Auditing Standards.

APPENDIX

**COMMONWEALTH OF KENTUCKY
APPENDIX
FOR THE YEAR ENDED JUNE 30, 2010**

This report is available on the APA website, www.auditor.ky.gov in pdf format. For other requests, please contact Greg Giesler, Open Records Administrator, with the APA's office at (502) 564-5841 or Gregory.Giesler@auditor.ky.gov. If copies of the FY 10 CAFR are required, please contact Lori Flanery, Finance and Administration Cabinet Secretary, at (502) 564-4240.

The following is a list of individuals by state agency to contact regarding federal award findings listed in the Schedule of Findings and Questioned Costs or the Summary Schedule of Prior Audit Findings.

State Agency	Contact
Cabinet for Health and Family Services	Kelli Hill, Assistant Director Division of General Accounting Cabinet for Families and Health Services 275 East Main Street 4E-A Frankfort, KY 40601 Phone (502) 564-8890
Department of Military Affairs	Charles R. Flynn, Chief Administrative Officer Division of Administrative Services Department of Military Affairs Boone National Guard Center 100 Minuteman Parkway, EOC Building Frankfort, KY 40601 Phone (502) 607-1545
Finance and Administration Cabinet	Robin Kinney, Executive Director Office of Administrative Services Finance and Administration Cabinet 702 Capitol Ave, Rm 183 Frankfort, KY 40601 Phone (502)-564-5781
Kentucky Department of Agriculture	Ann Smith, Director Division of Food Distribution Department of Agriculture 107 Corporate Drive Frankfort, KY 40601 (502)-573-0282
Transportation Cabinet	Alice Wilson, Executive Director Office of Audits Transportation Cabinet 200 Mero Street 4E Frankfort, KY 40622 Phone (502) 564-676

