REPORT OF THE AUDITOR OF PUBLIC ACCOUNTS
AUDIT EXAMINATION OF THE
KENTUCKY EDUCATIONAL DEVELOPMENT CORPORATION
Fiscal Year Ended June 30, 2001

EDWARD B. HATCHETT, JR.
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EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

April 26, 2002

To the People of Kentucky
Honorable Paul E. Patton, Governor
T. Kevin Flanery, Secretary, Finance and Administration Cabinet
Gene Wilhoit, Commissioner, Department of Education
Robert S. Sherman, Director, Legislative Research Commission
Stan Riggs, Executive Director, Kentucky Educational Development Corporation
Board of Directors of the Kentucky Educational Development Corporation

The enclosed report prepared by Michelle, K. Carpenter, CPA, Certified Public Accountant, presents the financial statements of the Kentucky Educational Development Corporation, Ashland, Kentucky, as of June 30, 2001.

We engaged Michelle, K. Carpenter, CPA to perform the financial audit of this educational cooperative. We worked closely with the firm during our report review process; Michelle, K. Carpenter, CPA, evaluated the Kentucky Educational Development Corporation's internal controls and compliance with applicable laws and regulations.

Respectfully submitted,

Edward B. Hatchett, Jr.
Auditor of Public Accounts

Enclosure

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Executive Summary

The audit of the Kentucky Educational Development Corporation for the year ended June 30, 2001 resulted in an unqualified opinion on the cooperative's financial statement. Michelle Carpenter, CPA, performed the audit in conjunction with the Auditor of Public Accounts.

The audit's eight findings, synopsized by the Auditor of Public Accounts, are as follows:

- The taxable value of employees' vehicle usage and meals were included in gross wages for retirement reporting purposes.
- Sam's club memberships for two non-employees were not billed to the non-employees.
- KEDC charged membership fees at inconsistent rates.
- Districts were not consistently informed of their rights to interest earned from the flexible benefit plan.
- One school district submitted payment vouchers for travel without original signatures of approval.
- Not all fixed assets had been tagged.
- One cooperative purchase order was not properly approved.
- Travel expense was coded in error.

These findings, related recommendations and management's responses to the findings are located on pages 17-26. A management letter also accompanied the audit report. Recommendations for strengthening internal controls and operating efficiency are outlined on page 28 of the report.

KENTUCKY EDUCATIONAL DEVELOPMENT CORPORATION

FINANCIAL STATEMENTS AND OTHER SUPPLEMENTAL INFORMATION

FOR THE YEAR ENDED JUNE 30, 2001

TOGETHER WITH INDEPENDENT AUDITOR'S REPORT

TABLE OF CONTENTS
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INDEPENDENT AUDITOR'S REPORT

To the Board of Directors
Kentucky Educational Development Corporation

I have audited the accompanying general purpose financial statements of Kentucky Educational Development Corporation, as of and for the year ended June 30, 2001, as listed in the table of contents. These general purpose financial statements are the responsibility of Kentucky Educational Development Corporation's management. My responsibility is to express an opinion on these general purpose financial statements based on my audit.

I conducted my audit in accordance with the 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 I plan and perform the audit to obtain reasonable assurance about whether the general purpose financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the general purpose financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall general purpose financial statement presentation. I believe that my audit provides a reasonable basis for my opinion.

In my opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of Kentucky Educational Development Corporation, as of June 30, 2001, and the results of its operations for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, I have also issued a report dated February 19, 2002 on my consideration of Kentucky Educational Development Corporation's internal control over financial reporting and my test of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of my audit.

My audit was performed for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The accompanying schedule of expenditures of federal awards is presented for purposes of additional analysis as required by U.S. Office of Management and Budget Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, and is not a required part of the general purpose financial statements of Kentucky Educational Development Corporation. Such information has been subjected to the audit procedures applied in the audit of the general purpose financial statements and, in my opinion, is fairly stated, in all material respects, in relation to the general purpose financial statements taken as a whole.

Michelle K. Carpenter, CPA

February 19, 2002

KENTUCKY EDUCATIONAL DEVELOPMENT CORPORATION
COMBINED BALANCE SHEET – ALL FUND TYPES AND ACCOUNT GROUPS
JUNE 30, 2001

	Governmental Fund Types		
	General Fund	Special Revenue Fund	Debt Service Fund
ASSETS:			
Cash and short-term investments (Note 3)	$ 702,134	$ 155,050	$ 33,005
Receivables-			
Accounts Receivable	526,423	156,098	-
Accrued interest receivable	-	19,518	-
Fixed assets (Note 4)	-	-	-
Amount to be provided for unpaid sick leave	-	-	-
Amount to be provided for debt retirement	-	-	-
Total Assets	$ 1,228,557	$ 330,666	$ 33,005
LIABILITIES:			
Accounts payable	$ 165,468	$ 35,060	$ -
Deferred revenue	389,759	295,606	-
Accrued liabilities	13,924	-	-
Debt Obligations (Note 5 and 7)	-	-	-
Total Liabilities	569,151	330,666	-
COMMITMENTS AND CONTINGENCIES (Note 10)			
FUND EQUITY:			
Investment in General Fixed Assets (Note 4)	-	-	-
Fund Balance-			
Unrestricted fund balance	609,619	-	-
Restricted fund balance (Note 6)	49,787	-	33,005
Total Fund Equity	659,406	-	33,005
Total Liabilities and Fund Equity	$ 1,228,557	$ 330,666	$ 33,005

Fiduciary Fund Type	Account Groups		
Agency Fund	General Fixed Assets	General Long Term Debt	Totals (Memo Only) Reporting Entity
$ 6,920,448	$ -	$ -	$ 7,810,637
-	-	-	682,521
-	-	-	19,518
-	1,360,084	-	1,360,084
-	-	1,522	1,522
-	-	190,000	190,000
$ 6,920,448	$ 1,360,084	$ 191,522	$ 10,064,282
$ 6,920,448	$ -	$ -	$ 7,120,976
-	-	-	685,365
-	-	-	13,924
-	-	191,522	191,522
6,920,448	-	191,522	8,011,787
-	1,360,084	-	1,360,084
-	-	-	609,619
-	-	-	82,792
-	1,360,084	-	2,052,495
$ 6,920,448	$ 1,360,084	$ 191,522	$ 10,064,282

The accompanying notes to financial statements
Are an integral part of this statement

KENTUCKY EDUCATIONAL DEVELOPMENT CORPORATION
COMBINED STATEMENT OF REVENUES, EXPENDITURES, AND
CHANGES IN FUND BALANCE – ALL GOVERNMENTAL FUND TYPES
FOR THE YEAR ENDED JUNE 30, 2001

	General Fund	Special Revenue Fund	Debt Service Fund	Totals (Memo Only)
REVENUES:				
Federal, State and other grants	$ -	$ 1,453,866	$ -	$ 1,453,866
Local and other	3,587,347	784,930	-	4,372,277
Interest income	87,226	-	2,865	90,091
Total Revenues	3,674,573	2,238,796	2,865	5,916,234
EXPENDITURES:				
Personnel and fringe benefits	1,330,952	855,015	-	2,185,967
Professional and technical services	70,157	211,841	-	281,998
Repairs and maintenance	22,490	14,524	-	37,014
Utilities	21,726	3,990	-	25,716
Other purchased services	298,761	251,394	-	550,155
Supplies and materials	1,635,228	222,707	-	1,857,935
Debt service	-	-	26,520	26,520
Fixed assets	560,226	6,000	-	566,226
Miscellaneous	15,807	673,325	111	689,243
Total Expenditures	3,955,347	2,238,796	26,631	6,220,774
EXCESS OF REVENUES OVER EXPENDITURES	(280,774)	-	(23,766)	(304,540)
OTHER FINANCING SOURCES (USES):				
Operating transfers in	-	-	25,145	25,145
Operating transfers out	(25,145)	-	-	(25,145)
EXCESS OF REVENUES AND OTHER SOURCES OVER (UNDER) EXPENDITURES AND OTHER USES	(305,919)	-	1,379	(304,540)
FUND BALANCE - Beginning of year	965,325	-	31,626	996,951
FUND BALANCE - End of year	$ 659,406	$ -	$ 33,005	$ 692,411

The accompanying notes to financial statements
are an integral part of this statement

(1) GENERAL STATEMENT

Kentucky Educational Development Corporation (KEDC), was established in 1969 as a non-profit corporation exempt under Section 501(c)(3) of the Internal Revenue Code of 1954. In July, 1978, the Corporation entered into an interlocal cooperation agreement under KRS 65.160 whereby it was deemed mutually advantageous for KEDC to provide certain services, programs and/or facilities to all member school districts.

Currently, KEDC has a membership of seventy-two school districts and the Board of Directors is comprised of Superintendents of member school districts.

(2) SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The accounting and reporting policies of KEDC relating to the funds and account groups included in the accompanying combined financial statements conform to generally accepted accounting principles (GAAP) applicable to state and local governments.

The following significant accounting policies were applied in the preparation of the accompanying financial statements.

Reporting Entity

The Corporation receives funding from local, state and federal government sources and must comply with the requirements of these funding source entities. However, the Corporation is not included in any other government "reporting entity" as defined by the GASB pronouncement, since Board members have decision making authority, the power to designate management, the ability to significantly influence operation and primary accountability for fiscal matters.

The financial statements of the Corporation do include those of separately administered organizations that are controlled by or dependent on the Corporation. Control or dependence is determined on the basis of budget adoption, funding, and appointment of the respective governing Board. Based on the following criteria, the financial statements of the following organization is included in the accompanying financial statements.

Kentucky Educational Development Finance Corporation

On June 22, 1994 the Kentucky Educational Development Corporation resolved to authorize the establishment of the Kentucky Educational Development Finance Corporation (a non-profit, non-stock, public and charitable corporation organized under KRS 273) as an agency and instrumentality of KEDC in financing the cost of refinancing the acquisition construction of extensions, additions and improvements to the central office headquarters located in Ashland, Kentucky. Board members from KEDC also comprise the Finance Corporation’s Board of Directors.

Basis for Presentation - Fund Accounting

The accounts of the Corporation are organized on the basis of funds or account groups, each of which is considered a separate entity. The operations of each fund are accounted for with a separate set of self-balancing accounts that comprise its assets, liabilities, fund balance, revenues and expenditures or expenses as appropriate. The various funds are summarized by type in the financial statements. The following fund types and account groups are used by the Corporation.

Governmental Fund Types

General Fund - The general operating fund accounts for all financial resources of KEDC that are not required to be accounted for in the special revenue funds.

Special Revenue Funds - Account for the proceeds of specific revenue sources, the expenditures for which are legally restricted for purposes specified in the grant agreements.

Debt Service Fund - Accounts for the accumulation of resources for, and the payment of, general long-term debt principal, interest and related costs.

Fiduciary Fund Type

Agency Fund - Accounts for the assets held by KEDC for other entities. Agency funds are custodial funds whereas assets and liabilities are equivalent, therefore, they do not involve measurement of operations.

Account Groups

Account groups are used to establish accounting control and accountability for KEDC's general fixed assets and general long-term debt. The following are KEDC's account groups:

General Fixed Assets Account Group - Fixed assets purchased by governmental fund types (general fixed assets) are accounted for in the General Fixed Assets Account Group rather than in governmental funds.

General Long-Term Debt Account Group - This account group is established to account for all general long-term debt of KEDC and for those long-term liabilities to be liquidated with resources to be provided in future periods.

Measurement Focus/Basis of Accounting

Measurement focus refers to what is being measured; basis of accounting refers to when revenues and expenditures are recognized in the accounts and reported in the financial statements. Basis of accounting relates to the timing of the measurement made, regardless of the measurement focus applied.

The governmental fund types use a current financial resources measurement focus and are accounted for using the modified accrual basis of accounting. Even though the Fiduciary

Fund Type (Agency Fund) does not involve the measurement of operations, the modified accrual basis of accounting is followed for recognizing assets and liabilities. Their revenues are recognized when susceptible to accrual (when they become measurable and available). Available means collectible within the current period or soon enough thereafter to be used to pay liabilities of the current period.

Expenditures are generally recognized under the modified accrual basis of accounting when the related fund liability is incurred, if measurable.

The various sources of revenue are grants, member dues, service related, and other revenues are further discussed below:

Federal and State Grant Revenue

Grant revenue is recognized when program expenditures are incurred in accordance with program guidelines. Such revenue is subject to review by the funding agency and may result in retroactive adjustment in subsequent periods.

Member District Dues

All member districts are required to pay dues to KEDC. Dues are determined annually and are recognized as revenues when assessed because they are measurable and collectible within the current period.

Other Revenues

Other revenues are composed primarily of interest, sales, charges for services, and miscellaneous charges. Interest income, sales and charges for services are recorded as earned since it is measurable and available. Miscellaneous charges are recorded as revenues when received because they are generally not measurable until actually received.

Budgets and Budgetary Accounting

KEDC's annual budget is a management tool that assists its users in analyzing financial activity. KEDC's primary funding sources are federal, state, and local grants which have grant periods that may or may not coincide with KEDC's fiscal year. These grants normally are for a twelve-month period; however, they can be awarded for periods shorter or longer than twelve months.

Because of KEDC's dependency on federal, state, and local budgetary decisions, revenue estimates are based upon the best available information as to potential sources of funding. KEDC's annual budget differs from that of a local government in two respects; (1) the uncertain nature of grant awards from other entities and (2) conversion of grant budgets to a fiscal year basis.

The resultant annual budget is subject to constant change within the fiscal year due to:

a. Increases/decreases in actual grant awards from those estimated;
b. Changes in grant periods;

c. Unanticipated grant awards not included in the budget; and
d. Expected grant awards which fail to materialize.

The Board of Directors formally approves the annual budget but greater emphasis is placed on complying with the grant budget terms and conditions on a grant-by-grant basis. These terms and conditions usually specify the period during which costs may be incurred and outline budget restrictions or allowances.

State Administered Grants

State Administered Grants are federal grant funds, appropriated state funds, or a combination of the two, which are allocated to state agencies then reallocated to local units of government.

Operating Transfers

Operating Transfers are the distribution of local cash resources to grant projects requiring local cash match in accordance with the terms and conditions of the grant contract. In addition local funds are used for expenditures in excess of grant proceeds awarded.

General Fixed Assets

Fixed Assets are recorded at historical cost. In accordance with generally accepted accounting principles, no provision is made for depreciation of such assets in the General Fixed Assets Account Group.

Estimates

The preparation of the financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent assets and liabilities at the date of the financial statements and the reported revenues and expenditures during the reporting period. Actual results could differ from those estimates.

Total Columns on Combined Statements

Total columns on the combined statements are captioned “Memorandum Only” to indicate that they are presented only to facilitate financial analysis. No consolidating entries or other eliminations were made in the aggregation of the totals; thus, they do not present consolidated information and do no purport to present financial position, results of operation, or cash flows in conformity with generally accepted accounting principles.

(3) CASH AND INVESTMENTS

The Corporation’s deposits and investments at June 30, 2001 were covered by federal depository insurance or investments of U.S. Treasury Obligations or other Government Agencies. Kentucky Revised Statutes authorize local governmental entities to invest in obligations of the United States and its agencies, obligations of the Commonwealth of Kentucky and it agencies, shares in savings and loan associations insured by federal agencies and deposits in national or state chartered banks insured by federal agencies and larger amounts in such institutions providing such banks pledge as security obligations of the United States government or its agencies.

KEDC invests in the Kentucky Class Portfolio administered by MBIA Municipal Investors Service Corporation. These approved investments are carried at cost, which approximates market and may be liquidated as needed. These investment pools have not been assigned a risk category since KEDC is not issued securities, but rather owns an undivided beneficial interest in the assets of these pools. Due to the short-term nature of the Portfolio's assets and liabilities, the carrying value as recorded in the balance sheet approximates fair value. Listed below are the balances held in the investment pool at June 30, 2001:

	General Fund	Agency Fund	Totals
General Investment	$ 852,706	$ -	$ 852,706
American Fidelity Flex	-	6,922,243	6,922,243
	$ 852,706	$6,922,243	$7,774,949

(4) FIXED ASSETS

A summary of changes in general fixed assets for the year ended June 30, 2001, follows:

	Land and Buildings	Equipment	Vehicles	Totals
Balance, June 30, 2000	$ 243,439	$ 332,729	$ 271,165	$ 847,333
Additions	49,622	433,588	83,016	566,226
Deletions	-	(8,437)	(45,038)	(53,475)
Balance, June 30, 2001	$ 293,061	$ 757,880	$ 309,143	$1,360,084

(5) BONDED DEBT AND LEASE OBLIGATION

In October 1994, Kentucky Educational Development Corporation entered into a lease/option contract with Kentucky Educational Finance Corporation to make semi-annual payments equal to the principal and interest requirements of its 1994 issue of First Mortgage Revenue Bonds totaling $275,000 and bearing interest rates of 5.6% to 6.0%. The purpose of this issue was to provide funds to retire a mortgage note held by KEDC with First and Peoples Bank and Trust Company of Russell, Kentucky, for the purchase of land and building currently occupied by KEDC. Changes in bonds payable for the year ended June 30, 2001 are outlined below:

Balance outstanding at June 30, 2000	$ 205,000
Bonds retired during current year	(15,000)
Balance outstanding at June 30, 2001	$ 190,000

The bonds have been prepared as two fully registered Term Bonds maturing October 1, 2004, and October 1, 2009. The minimum obligations of KEDC at June 30, 2001 for debt service (principal and interest) are as follows:

Year Ended June 30,	Principal	Interest	Total Requirements for Year
2002	$ 15,000	$ 10,680	$ 25,680
2003	20,000	9,700	29,700
2004	20,000	8,580	28,580
2005	20,000	7,460	27,460
2006	20,000	6,300	26,300
2007	20,000	5,100	25,100
2008	25,000	3,750	28,750
2009	25,000	2,250	27,250
2010	25,000	750	25,750
	$ 190,000	$ 54,570	$ 244,570

(6) ACCUMULATED UPAID SICK LEAVE BENEFITS

Upon retirement from KEDC, an employee will receive from the Corporation an amount equal to 10% of the value of accumulated sick leave. At June 30, 2001, five employees were eligible for retirement and thus, a liability of $1,522 was recorded for accumulated sick leave. Also, beginning in 1997, KEDC implemented a policy of funding a percentage of total wages paid for accumulated sick leave benefits as reservation of the General Fund balance. The total reserved at June 30, 2001 was $44,593.

(7) RETIREMENT PLANS

A. Kentucky Teachers Retirement System

Certified employees are covered under the Kentucky Teachers Retirement System (KTRS). KTRS, a cost sharing, multiple-employer, public employee retirement system, provides retirement benefits based on an employee's final average salary and number of years of service. The Kentucky Teachers Retirement System issues a publicly available financial report that includes financial statements and required disclosure information. That report may be obtained by writing to Kentucky Teachers Retirement System, 479 Versailles Road, Frankfort, Kentucky 40601-3868 or by calling (502) 573-5120.

Funding for the plan is provided by contributions from eligible employees and employers (or state) at a rate of 9.855% of salaries. During the year ended June 30, 2001, the Corporation contributed $11,376 and employees contributed $96,107 to the Plan.

B. County Employee's Retirement System

The Corporation contributes to the County Employees' Retirement System (CERS), a cost-sharing, multiple-employer defined benefit pension plan administered by the Kentucky General Assembly. It covers substantially all regular full-time members employed in non-hazardous duty positions of each county and school board, and any additional eligible local agencies electing to participate in the CERS. CERS provides for retirement, disability, and death benefits to plan members. Cost of living adjustments are provided at the discretion of the State legislature.

The CERS issues a publicly available financial report included in the Kentucky Retirement Systems Annual Report that includes financial statements and the required supplementary information for CERS. That report may be obtained by writing to Kentucky Retirement Systems, Perimeter Park West, 1260 Louisville Road, Frankfort, Kentucky, 40601, or by calling (502) 564-4646.

Plan members are required to contribute 5% of their annual creditable compensation, and the Corporation is required to contribute 7.17% of the employee's total compensation. The contribution requirements of CERS members and the Corporation are established and may be amended by the CERS Board of Trustees. The Corporation's contributions to CERS for the year ending June 30, 2001 were $73,333 while employees contributed $53,229.

KEDC is only one of several employers participating in these Plans. Therefore, it is not practicable to determine KEDC’s portion of the unfunded past service cost or the vested benefits of KEDC’s portion of Plan assets.

(8) RISK MANAGEMENT

KEDC is exposed to various risks of loss related to the theft of, damage to and destruction of assets; errors and omissions, fiduciary responsibilities and natural disasters for which it carries commercial insurance. There have been no significant reductions in coverage from the prior year and there have been no significant settlements in the past two years.

(9) INCOME TAX STATUS

The Corporation is exempt from Federal income taxes under Section 501(c)(3) of the Internal Revenue Code of 1954; accordingly the accompanying financial statements include no provision for such taxes.

(10) COMMITMENTS AND CONTINGENCIES

Grant Programs

The Corporation participates in numerous state and federal grant programs, which are governed by various rules and regulations of the grantor agencies. Costs charged to the respective grants programs are subject to audit and adjustment by the grantor agencies; therefore, to the extent that the Corporation has not complied with the rules and regulations governing the grants, refunds of any money received may be required and the collectibility of any related receivable at June 30, 2001 may be impaired. In the opinion of the Corporation, there are no significant contingent liabilities relating to compliance with the rules and regulations governing the respective grants; therefore, no provision has been recorded in the accompanying combined financial statements for such contingencies.

KENTUCKY EDUCAITONAL DEVELOPMENT CORPORATION
SCHEDULE OF FEDERAL AWARDS
FOR THE YEAR ENDED JUNE 30, 2001

FEDERAL GRANTOR/PASS THOUGH GRANT/PROGRAM TITLE	FEDERAL CFDA NUMBER	PASS THROUGH GRANTOR NUMBER	EXPENDITURES
U.S. DEPARTMENT OF EDUCATION			
Passed through Kentucky Department of Adult Education and Literacy			
Adult Education	84.002	DAEL 2001-011	$ 175,127
Project Life	84.002	C-00161496	62,813
Passed through Kentucky Department of Education			
* IDEA, Part B	84.027	0581-00-04	380,313
* IDEA, Part B	84.027	0581-99-04	25,758
* IDEA, Part B	84.027	0581-99-04	2,100
Goals 2000	84.276	0733-99-02	68,030
Passed through Kentucky Cabinet for Workforce Development			
School to Work LMA#21	84.278	9921-08	39,386
Total Department of Education			753,527
TOTAL EXPENDITURES OF FEDERAL AWARDS			$ 753,527

*Denotes Major Programs

NOTE A: BASIS OF PRESENTATION

The accompanying schedule of expenditures of federal awards includes the federal grant activity of the Kentucky Educational Development Corporation and is presented on the accrual basis of accounting. The information in this schedule is presented in accordance with the requirements of OMB Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations.* Therefore, some amounts presented in this schedule may differ from amounts presented in, or used in the preparation of, the basic financial statements.

REPORT ON COMPLIANCE AND ON INTERNAL CONTROL OVER FINANCIAL REPORTING BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED IN ACCORDANCE WITH GOVERNMENT AUDITING STANDARDS

To the Board of Directors
Kentucky Educational Development Corporation

I have audited the general purpose financial statements of Kentucky Educational Development Corporation, as of and for the year ended June 30, 2001, and have issued my report thereon dated February 19, 2002. I conducted my 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.

Compliance

As part of obtaining reasonable assurance about whether Kentucky Educational Development Corporation's general purpose financial statements are free of material misstatement, I performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, 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 my audit and, accordingly, I do not express such an opinion. The results of my tests disclosed instances of noncompliance that are required to be reported under *Government Auditing Standards* which are described in Part C of the accompanying schedule of findings and questioned costs.

Internal Control Over Financial Reporting

In planning and performing my audit, I considered Kentucky Educational Development Corporation's internal control over financial reporting in order to determine my auditing procedures for the purpose of expressing my opinion on the general purpose financial statements and not to provide assurance on the internal control over financial reporting. However, I noted certain matters involving the internal control over financial reporting and its operation that I consider to be reportable conditions. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in my judgment, could adversely affect Kentucky Educational Development Corporation's ability to record, process, summarize and report financial data consistent with the assertions of management in the general purpose financial statements. Reportable conditions are described in Part B of the accompanying schedule of findings and questioned costs.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the general purpose financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, I believe none of the reportable conditions described above is a material weakness. I also noted other matters involving internal control over financial reporting that I have reported to the management of KEDC in a separate letter dated February 19, 2002.

This report is intended solely for the information and use of the board of directors, management, 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.

Michelle K. Carpenter, CPA

February 19, 2002

REPORT ON COMPLIANCE WITH REQUIREMENTS
APPLICABLE TO EACH MAJOR PROGRAM AND INTERNAL CONTROL
OVER COMPLIANCE IN ACCORDANCE WITH OMB CIRCULAR A-133

To the Board of Directors
Kentucky Educational Development Corporation

Compliance

I have audited the compliance of Kentucky Educational Development Corporation, with the types of compliance requirements described in the *U.S. Office of Management and Budget (OMB) Circular A-133 Compliance Supplement* that are applicable to each of its major federal programs for the year ended June 30, 2001. Kentucky Educational Development Corporation'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 Kentucky Educational Development Corporation's management. My responsibility is to express an opinion on Kentucky Educational Development Corporation's compliance based on my audit.

I conducted my audit of compliance in accordance with auditing standards generally accepted in the United States of America; the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the *Comptroller General of the United States; and OMB Circular A-133, Audits of States, Local Governments, and Non-Profit Organizations*. Those standards and OMB Circular A-133 require that I 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 Kentucky Educational Development Corporation's compliance with those requirements and performing such other procedures as I considered necessary in the circumstances. I believe that my audit provides a reasonable basis for my opinion. My audit does not provide a legal determination on Kentucky Educational Development Corporation's compliance with those requirements.

In my opinion, Kentucky Educational Development Corporation complied, in all material respects, with the requirements referred to above that are applicable to each of its major federal programs for the year ended June 30, 2001. However, the results of my auditing procedures disclosed instances of noncompliance with those requirements that are required to be reported in accordance with OMB Circular A-133 and which are described in Part C of the accompanying schedule of findings and questioned costs.

Internal Control Over Compliance

The management of Kentucky Educational Development Corporation is responsible for establishing and maintaining effective internal control over compliance with requirements of laws, regulations, contracts and grants applicable to federal programs. In planning and performing my audit, I considered Kentucky Educational Development Corporation's internal control over compliance with requirements that could have a direct and material effect on a major federal program in order to determine my auditing procedures for the purpose of expressing my opinion on compliance and to test and report on internal control over compliance in accordance with OMB Circular A-133.

I noted certain matters involving the internal control over compliance and its operation that I consider to be reportable conditions. Reportable conditions involve matters coming to my attention relating to significant deficiencies in the design or operation of the internal control over compliance that, in my judgment, could adversely affect the Kentucky Educational Development Corporation's ability to administer a major federal program in accordance with the applicable requirements of laws, regulations, contracts and grants. Reportable conditions are described in the accompanying schedule of findings and questioned costs.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that noncompliance with applicable requirements of laws, regulations, contracts and grants that would be material in relation to a major federal program being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. My consideration of the internal control over compliance would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, I believe none of the reportable conditions described above is a material weakness.

This report is intended solely for the information and use of the audit committee, management, 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.

Michelle K. Carpenter, CPA

February 19, 2002

KENTUCKY EDUCATIONAL DEVELOPMENT CORPORATION
SCHEDULE OF FINDINGS AND QUESTIONED COSTS
FOR THE YEAR ENDED JUNE 30, 2001

A. SUMMARY OF AUDIT RESULTS

1. The auditor's report expresses an unqualified opinion on the general purpose financial statements of Kentucky Educational Development Corporation.

2. Reportable conditions were noted during the audit of the general purpose financial statements and are reported in Part B of this schedule. None of the conditions listed below are material weaknesses.

3. No instances of noncompliance material to the general purpose financial statements of Kentucky Educational Development Corporation were disclosed during the audit.

4. Reportable conditions relating to the audit of major federal award programs are reported in Part C of this schedule. The conditions are not reported as material weaknesses.

5. The auditor's report on compliance for the major federal award programs for Kentucky Educational Development Corporation expresses an unqualified opinion.

6. Audit findings relative to the major federal award programs for Kentucky Educational Development Corporation are reported in Part C of this schedule.

7. The programs tested as major programs included:

CFDA No.	Program Title
84.027	IDEA B

8. The threshold for distinguishing Types A and B programs was $300,000.

B. FINDINGS-FINANCIAL STATEMENT AUDIT

REPORTABLE CONDITIONS

01-01 Retirement Calculations

Condition: While testing payroll transactions, it was determined that KEDC included the taxable value of employees' vehicle usage and meals in gross wages for retirement reporting purposes. Inclusion of these amounts resulted in overstating retirement deductions and reported gross wages for state match.

Criteria: According to KRS 161.220, Section 10, compensation is not to be included in the calculation of retirement benefits unless it is provided to all employees. Furthermore, contributions are not to be withheld on non-allowed compensation. Vehicle usage and meal reimbursements are deemed to be non-allowed compensation.

Effect: Inclusion of vehicle usage and meal reimbursements overstated retirement deductions from employees and ultimately overstated amounts to be matched by KTRS or CERS.

Recommendation: Management should review computer master payroll files to ensure the system only calculates retirement on allowable forms of compensation for all future payrolls. Additionally, management should amend wage and contribution reports supplied to KTRS and CERS that erroneously included calculations based on non-allowed compensation.

Response: We concur with the recommendation and will correct all payroll reports to reflect only allowable wages and their related contributions.

01-02 Sam's Club Memberships

Condition: During 2001 KEDC offered Sam's Club memberships to employees as a fringe benefit. However, an invoice for the renewal of memberships was found to include the memberships of two non-employees. Due to client oversight, these non-employees were not billed for the cost of their memberships which resulted in the entire invoice being charged to general supplies expense.

Criteria: Procedures should be in place to ensure that the general ledger only reflects those expenditures incurred on behalf of KEDC and its employees in the course of doing business.

Effect: Payment was rendered and expenditures recorded in excess of the amount incurred on behalf of KEDC employees.

Recommendation: Management should only code those memberships relating to current employees as expenditures in the general ledger. All other amounts should be posted to accounts receivable to ensure that all such items are properly billed and collected by the accounting department.

Response: Effective February 2001, KEDC changed its policy to discontinue providing memberships for employees. Therefore, all future invoices will be coded in their entirety to accounts receivable to ensure KEDC incurs no cost associated with membership renewals.

01-03 Membership Fees

Condition: KEDC assesses membership fees to its districts based upon fixed rates per district size. However, while testing membership fees, it was noted that KEDC accepted the memberships of other educational cooperative's members at rates different than those offered to KEDC member districts.

Criteria: Memberships fees should be assessed using identical criteria for all applying districts.

Effect: Inconsistency in billing practices fosters discriminatory actions as well as affects the amount of membership revenues earned by the Cooperative.

Recommendation: KEDC should charge membership fees consistently to all applying district based upon a standardized fee schedule.

Response: We agree with the recommendation and have billed accordingly for 2001-2002 memberships.

01-04 Membership Sales

Condition: While testing membership revenues, an invoice for the renewal of a school district's collective bidding membership was examined along with an email correspondence initiated by a KEDC sales staff member. The email, which was used to document the district's agreement to the renewal, explained that only those districts with at least a collective bidding membership with KEDC would be eligible to receive the interest earnings on contributions made to the American Fidelity Flexible Benefits plan held in the custody of KEDC. This correspondence resulted in misinformation considering KEDC is contractually obligated to refund all interest earnings of school districts regardless of membership status. The sales staff member that initiated this correspondence receives incentive bonuses based upon membership sales.

Criteria: All potential members should be provided complete and accurate information regarding the benefits provided by their memberships. Furthermore, procedures should be in place to offer proper monitoring of revenues subject to employee incentive bonuses.

Effect: The district may have been influenced in its decision to renew its membership based upon inaccurate information. Additionally, KEDC staff members receive incentive bonuses based upon membership sold which may encourage aggressive sales methods.

Recommendation: Management should consider developing standardized sales materials to be utilized by sales staff outlining the benefits offered with the various types of KEDC memberships. This process along with periodic monitoring by management, should ensure that not only potential members are properly informed of KEDC's services, but should also limit the potential for staff to become overly aggressive in their selling methods.

Response: We will provide our staff with materials outlining benefits offered with each type of membership. Furthermore, we will instruct staff to limit themselves to these materials when making sales calls.

01-05 School District Professional Development Accounts

Condition: Several school districts deposit retainers with KEDC to cover their anticipated professional development expenses for the year. Each district's professional development director submits signed payment vouchers along with supporting invoices or travel reports to KEDC for payment processing. However, one school district submitted payment vouchers without original signatures of approval. It appears a signed blank voucher was copied for easy assembly of invoice packets.

Criteria: Ideally, only invoices containing proper, original approvals should be processed for payment to ensure payments are only made for valid professional development expenses.

Effect: Payment was rendered without obtaining proper approvals.

Recommendation: Management should require professional development expense payments to meet the same invoice payment requirements of KEDC invoices. Therefore, payment should only be rendered after obtaining original signatures of professional development directors.

Response: We concur with the recommendation and will request original signatures from all professional development directors of school districts.

01-06 Fixed Asset Records

Condition: Upon physical observation and inquiry, it was determined that bar coding tags had been prepared for all fixed assets maintained in the general fixed assets group of accounts. The bar code numbers were also included on the detail inventory listing of assets. However, several tags remained in the possession of the accounting department and were not affixed to the applicable assets.

Criteria: All assets should be affixed with tags to appropriately identify them as the property of KEDC.

Effect: The potential exists for the fixed assets of KEDC to be lost or stolen without proper identification.

Recommendation: Identification tags should be affixed to all capital assets immediately upon receipt.

Response: We agree with the recommendation and will immediately affix prepared tags to all remaining fixed assets.

01-07 Purchase Orders

Condition: During the test of disbursements, an instance was noted where an unsigned purchase order was the only documentation for amounts paid from a school district's retainer account for technology services.

Criteria: All purchase orders must be completely and accurately prepared to provide necessary controls over disbursements.

Effect:	Issuing a check without obtaining proper approvals compromised controls over disbursements.
Recommendation:	All purchase orders should be carefully reviewed for completeness and contain proper approvals before remitting payment.
Response:	We agree with the recommendation and will review purchase orders more carefully in the future.

01-08 General Ledger Account Coding

Condition:	While testing IDEA B invoices an instance was noted where travel related expenses were coded in error to professional fees expense accounts.
Criteria:	Invoices should be coded to general ledger accounts to reflect the nature of the expenditure to ensure reports provide complete and accurate financial information.
Effect:	Control over disbursements and effectiveness of coding to general ledger accounts was compromised. Also, this practice limits the usefulness of reports for management and budgetary purposes.
Recommendation:	All invoices should be coded to appropriate general ledger accounts based upon items purchased or services received. This process will provide better reports for management and budgeting tools.
Response:	We agree with the recommendation and have instructed grant coordinators to code invoices based upon items purchased.

C. FINDINGS AND QUESTIONED COSTS-MAJOR FEDERAL AWARD PROGRAMS

	Questioned Costs
U.S. DEPARTMENT OF EDUCATION	
IDEA B, CFDA NO. 84.027	
1. Reportable Conditions: As fully discussed in Part B, the following reportable conditions related to the IDEA B program as well:	
01-01	
01-08	
Total Department of Education	$ -

KENTUCKY EDUCATIONAL DEVELOPMENT CORPORATION
SCHEDULE OF PRIOR AUDIT FINDINGS
FOR THE YEAR ENDED JUNE 30, 2001

00-01 Fixed Asset Activity

Condition:	Adequate documentation was not on file to determine the amount of consideration received for two fleet vehicles removed from service.
Current Status:	All supporting documentation for fixed asset additions and disposals was obtained in 2001.

00-02 Accounts Receivable

Condition:	Invoices for incomplete wiring jobs were generated at June 30, 2000 to ensure inclusion in year-end revenues, accounts receivable, and departmental incentive bonuses. Such invoices were voided and reissued for different amounts subsequent to year-end. Payments were received approximately five months after year-end.
Current Status:	Wiring jobs were billed based upon work completed and were therefore, more timely collected than the past year.

00-03 Membership Fees

Condition:	KEDC accepted the memberships of other educational cooperative's members at different rates than the pre-established rates charged to KEDC member districts based upon district size.
Current Status:	This condition existed in 2001. However, KEDC management asserted fees charged for the 2001-2002 fiscal year were based on standardized rates.

00-04 Sales Invoice Pricing

Condition:	Different methodologies were used in determining the prices charged for resale items. Markups on resale items ranged from 12% to 130% for invoices tested. Additionally, handling fees of three, five, or ten dollars were arbitrarily charged per item.
Current Status:	The above condition was prevalent through February 2001. However, the Board of Directors approved a new billing procedure at its February 2001 meeting. The new procedure requires for all merchandise to be stated at cost with a separate line item charged for administration. Such administration costs appear to be consistently charged based upon type of items ordered by the districts.

00-05 Personal Credit Card Purchases

Condition: The audit revealed that personal expenses of employees, superintendents, and spouses were frequently charged to company credit cards. These expenses were then subsequently reimbursed to KEDC.

Current Status: Procedures were implemented in February 2001 to curtail such purchasing arrangements.

00-06 Documentation of Credit Card Purchases

Condition: Several instances were noted where documentation to support credit card purchases was not attached to month-end credit card statements. This appeared to be particularly predominant for online (internet) and gasoline purchases.

Current Status: Emphasis was placed on obtaining complete documentation for credit card purchases. Accordingly, such attachments were more complete than in prior years.

00-07 Employee Travel Expenses

Condition: An instance was noted where employees duplicated meal expenses. Specifically, an employee was reimbursed for two meals purchased on one receipt while the other employee received a meal per diem. Furthermore, in an unrelated incident, another employee was reimbursed without providing adequate documentation of travel expenses incurred.

Current Status: Management issued revised travel guidelines prohibiting employees from submitting receipts for other employees' meals. Additionally these revised guidelines required for expense reports to be properly documented with receipts and submitted on a timely basis for reimbursement.

00-08 Employment Contract

Condition: During the test of payroll transactions, an employment contract for an instructor could not be located to verify the terms of employment.

Current Status: A written statement was obtained from the employee to verify the terms of the fiscal year 2000 contract. All contracts chosen for testing in 2001 were properly located in employee personnel files.

00-09 Sam's Club Credit Purchases

Condition: KEDC allows school districts to purchase supplies from Sam's Club on its account, which is subsequently billed back to the district. This process is initiated by KEDC faxing a partially completed purchase order along with a copy of a KEDC Sam's club membership card to the requesting school district personnel.

Current Status: KEDC continues to provide this service to districts. However, KEDC now completes the purchase orders with quantities and dollar amounts. As an added measure of control, KEDC directly contacts Sam's Club to inform them of the purchase orders issued.

00-10 Fixed Asset Records

Condition: Upon physical examination, it was determined that fixed assets were not tagged.

Current Status: KEDC tagged numerous fixed assets with bar code identifications in 2001. However, several assigned bar coding tags were not affixed to the designated assets during our physical observation.

00-11 Superintendent Travel

Condition: While reviewing a sample of invoices for superintendent travel expenses, an instance was noted where a school district employee was reimbursed for tours taken while attending a conference. No documentation was attached to the receipt to support its educational purpose.

Current Status: KEDC discontinued reimbursing superintendent travel near the end of the fiscal year 2000. Any remaining funds on hand were returned to the applicable school districts.

00-12 Purchase Orders

Condition: During the testing of disbursements, two instances were noted where purchase orders attached to cancelled invoices were incomplete. One purchase order lacked a signature of approval while the other purchase order omitted general ledger account codes.

Current Status: A similar instance was noted in 2001. See schedule of findings.

00-13 General Ledger Account Coding

Condition: While testing Adult Education invoices it was noted that some invoices paid in June 2000 were coded to inappropriate expense accounts. According to program coordinators, this was done to "use up" unexpended dollars for needed items whose budget line item was exhausted for the year.

Current Status: No such instances came to our attention during the 2001 audit.

KENTUCKY EDUCATIONAL DEVELOPMENT CORPORATION
JUNE 30, 2001 AUDIT FINDINGS
CORRECTIVE ACTION PLAN

February 19, 2002

Kentucky Educational Development Corporation respectfully submits the following corrective action plan for the year ended June 30, 2001. The findings from the schedule of findings and questioned costs presented by our independent auditor, Michelle K. Carpenter, CPA are discussed below. The findings are numbered consistently with the numbers assigned in the schedule.

B. FINDINGS-FINANCIAL STATEMENT REPORTABLE CONDITIONS

01-01 Recommendation: Management should review computer master payroll files to ensure the system only calculates retirement on allowable forms of compensation for all future payrolls. Additionally, management should amend wage and contribution reports supplied to KTRS and CERS that erroneously included calculations based on non-allowed compensation.

Action Taken: We are currently working with KTRS and CERS to amend retirement reports. Additionally the payroll system has been updated to exclude vehicle usage and meals from gross wages for retirement purposes.

01-02 Recommendation: Management should only code those memberships relating to current employees as expenditures in the general ledger. All other amounts should be posted to accounts receivable to ensure that all such items are properly billed and collected by the accounting department.

Action Taken: Effective February 2001, KEDC changed its policy to discontinue providing memberships for employees. Therefore, invoices are now coded in their entirety to accounts receivable to ensure KEDC incurs no cost associated with membership renewals.

01-03 Recommendation: KEDC should charge membership fees consistently to all applying district based upon a standardized fee schedule.

Action Taken: Effective with the 2001-2002 fiscal year, all districts were billed on the same fee scale.

01-04 Recommendation: Management should consider developing standardized sales materials to be utilized by sales staff outlining the benefits offered with the various types of KEDC memberships. This process along with periodic monitoring by management, should ensure that not only potential members are properly informed of KEDC's services, but should also limit the potential for staff to become overly aggressive in their selling methods.

Action Taken: We will be providing our staff with materials outlining the specific benefits offered with each type of membership. Furthermore, we will instruct staff to limit themselves to these materials when making sales calls.

01-05 Recommendation: Management should require professional development expense payments to meet the same invoice payment requirements of KEDC invoices. Therefore, payment should only be rendered after obtaining original signatures of professional development directors approving invoices for payment.

Action Taken: We will require original signatures from all professional development directors of school districts before payment is rendered.

01-06 Recommendation: Identification tags should be affixed to all capital assets immediately upon receipt.

Action Taken: We will immediately affix prepared tags to all remaining fixed assets.

01-07 Recommendation: All purchase orders should be carefully reviewed for completeness and contain proper approvals before remitting payment.

Action Taken: We will review purchase orders more carefully in the future to ensure that proper approvals are received before payment is rendered.

01-08 Recommendation: All invoices should be coded to appropriate general ledger accounts based upon items purchased or services received. This process will provide better reports for management and budgeting tools.

Action Taken: We have instructed grant coordinators to code invoices based upon items purchased.

C. FINDINGS - MAJOR FEDERAL AWARDS

All such findings were related to financial statements reportable conditions and have been adequately addressed in Part B of this corrective action plan.

If the Commonwealth of Kentucky has questions regarding this plan, please contact the undersigned at (606)928-0205.

Sincerely,

Stan Riggs
Executive Director

To the Board of Directors
Kentucky Educational Development Corporation

In planning and performing the audit of the general purpose financial statements of Kentucky Educational Development Corporation (the Corporation) for the year ended June 30, 2001, I considered the Corporation's internal control to determine my auditing procedures for the purpose of expressing an opinion on the general purpose financial statements and not to provide assurance on the internal control.

However, during the audit, I became aware of several matters that are opportunities for strengthening internal control and operating efficiency. The memorandum that accompanies this letter summarizes my comments and suggestions regarding those matters. A separate report dated February 19, 2002, contains my report of internal control over financial reporting which disclosed no internal control related matters which were considered to be material weaknesses. This letter does not affect my report dated February 19, 2002, on the general purpose financial statements of Kentucky Educational Development Corporation.

I will review the status of these comments during my next audit engagement. I have already discussed these comments and suggestions with various personnel of KEDC, and I will be pleased to discuss them in further detail at your convenience, to perform any additional study of these matters, or to assist you in implementing the recommendations.

Michelle K. Carpenter, CPA

February 19, 2002

DEPOSITS IN TRANSIT

KEDC charges all funds for the amount of indirect costs (vehicles, postage, etc) incurred by the funds on a monthly basis. Checks are written to "pay" these costs back to KEDC's general fund. However, at year end a corresponding deposit in transit was not recorded for two checks, which resulted in an understated cash balance. Special consideration should be given to month-end transactions to ensure that cash balances are properly stated.

GROSSED UP ACCOUNT ACTIVITY

Currently, KEDC records local transfers from the General Fund to grant programs as expenditures of the General Fund, as well as expenditures of the grant program in the Special Revenue Fund. Therefore, on an entity-wide basis, both revenues and expenditures are overstated by the amount of operating transfers. Additionally, reimbursements to grantors for unexpended grant funds are coded to all accounts with remaining budgets rather than reducing revenues to match actual expenditures. Therefore, project budget reports for grants erroneously appear to be fully expended.

PAID INVOICE DATES

While tracing accounts receivable billings to subsequent receipts, it was noted that many invoices were stamped "paid" but lacked the date payment was made. Efforts should be made to stamp all invoice copies with date paid to provide a better audit trail to trace to subsequent deposits.

RETAINER ACCOUNTS

Numerous invoices to school districts were outstanding for several months. These amounts were then applied to the districts' retainer accounts in October 2001. Management should apply invoices to district retainer accounts on a monthly basis not only to facilitate the timely clearance of accounts receivable, but to also to reflect accurate balances available for use by the school districts.

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