AUDIT REPORT

Tennessee Board of Regents

State University and Community College System of Tennessee – Central Office

For the Years Ended
June 30, 2013, and June 30, 2012

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

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August 21, 2014

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the State University and Community College System of Tennessee – Central Office, for the years ended June 30, 2013, and June 30, 2012. You will note from the independent auditor's report that unmodified opinions were given on the fairness of the presentation of the financial statements.

Consideration of the internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Finding and Recommendation section of this report. The administration has responded to the audit finding; the response is included following the finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit finding.

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

14/042

Audit Report
Tennessee Board of Regents
State University and Community College System of Tennessee – Central Office
For the Years Ended June 30, 2013, and June 30, 2012

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State University and Community College System of Tennessee – Central Office

For the Years Ended June 30, 2013, and June 30, 2012

Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Finding

The Tennessee Board of Regents - Central Office did not instruct its member institutions to accrue certain capital projects transactions

During the closing procedures for the fiscal year ended June 30, 2013, the Central Office instructed the Tennessee Department of Finance and Administration to accrue over $23 million in liabilities in the state's information system. However, the Central Office did not instruct its member institutions to do so. As a result, accrued liabilities, capital assets, and expenses at the various institutions were understated in total by the same amount (page 31).

STATE OF TENNESSEE
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Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor

Report on the Financial Statements

We have audited the accompanying financial statements of the State University and Community College System of Tennessee – Central Office, a part of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the years ended June 30, 2013, and June 30, 2012, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State University and Community College System of Tennessee – Central Office as of June 30, 2013, and June 30, 2012, and the changes in financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1, the financial statements of the State University and Community College System of Tennessee – Central Office, a part of the Tennessee Board of Regents, are intended to present the financial position, the changes in financial position, and the cash flows of only the Central Office. They do not purport to, and do not, present fairly the financial position of the Tennessee Board of Regents, as of June 30, 2013, and June 30, 2012, and the changes in financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 1, the Central Office implemented GASB Statement 65, *Items Previously Reported as Assets and Liabilities,* during the year ended June 30, 2013. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 12 and the schedule of funding progress on page 28 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated May 9, 2014, on our consideration of the Central Office'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* in considering the Central Office's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
May 9, 2014

Tennessee Board of Regents
STATE UNIVERSITY AND COMMUNITY COLLEGE
SYSTEM OF TENNESSEE – CENTRAL OFFICE
Management's Discussion and Analysis

Introduction

This section of the Central Office's annual financial report presents a discussion and analysis of the financial performance of the Central Office during the fiscal years ended June 30, 2013, and June 30, 2012, with comparative information presented for the fiscal year ended June 30, 2011. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the independent auditor's report, the audited financial statements, and the accompanying notes. The financial statements, notes, and this discussion are the responsibility of management.

Overview of the Financial Statements

The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), which establishes standards for external financial reporting for public colleges and universities. The financial statements are presented on a consolidated basis to focus on the Central Office as a whole. The full scope of the Central Office's activities is considered to be a single business-type activity, and accordingly, is reported within a single column in the basic financial statements.

The Central Office's financial report includes the statement of net position; the statement of revenues, expenses, and changes in net position; and the statement of cash flows. Notes to the financial statements are also presented to provide additional information that is essential to a full understanding of the financial statements.

The Statement of Net Position

The statement of net position is a point-in-time financial statement. The statement of net position presents the financial position of the Central Office at the end of the fiscal year. To aid the reader in determining the Central Office's ability to meet immediate and future obligations, the statement includes all assets, liabilities, deferred outflows/inflows, and net position of the Central Office and segregates the assets and liabilities into current and noncurrent components. Current assets are those that are available to satisfy current liabilities, inclusive of assets that will be converted to cash within one year. Current liabilities are those that will be paid within one year. The statement of net position is prepared under the accrual basis of accounting; assets and liabilities are recognized when goods or services are provided or received, despite when cash is actually exchanged.

From the data presented, readers of the statement are able to determine the assets available to continue the operations of the Central Office. They are also able to determine how much the Central Office owes vendors, lenders, and others. Net position represents the difference between the Central Office's assets and liabilities, along with the difference between deferred outflows and deferred inflows, and is one indicator of the Central Office's current financial condition.

The statement of net position also indicates the availability of net position for expenditure by the Central Office. Net position is divided into three major categories. The first category, net investment in capital assets, represents the Central Office's total investment in property, plant, and equipment, net of outstanding debt obligations related to these capital assets. To the extent debt or deferred inflows of resources have been incurred but not yet expended for capital assets, such amounts are not included. The next category is restricted net position, which is sub-divided into two categories, nonexpendable and expendable. Nonexpendable restricted net position includes endowment and similar resources whose use is limited by donors or other outside sources and as a condition of the gift, the principal is to be maintained in perpetuity. Expendable restricted net position is available for expenditure by the Central Office but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the resources. The final category is unrestricted net position. Unrestricted net position is available to the Central Office for any lawful purpose of the Central Office.

Summary of Net Position
(in thousands of dollars)

	2013	2012	2011
Assets:			
Current assets	$ 7,099	$ 7,034	$ 6,990
Capital assets, net	436	390	426
Other assets	28,768	22,997	17,091
Total Assets	36,303	30,421	24,507
Liabilities:			
Current liabilities	2,650	3,336	3,237
Noncurrent liabilities	2,509	2,407	2,278
Total Liabilities	5,159	5,743	5,515
Net Position:			
Net investment in capital assets	436	390	426
Restricted – nonexpendable	-	534	534
Restricted – expendable	7,868	7,703	7,918
Unrestricted	22,840	16,051	10,114
Total Net Position	$31,144	$24,678	$18,992

Comparison of FY 2013 to FY 2012

- The increase in current assets was caused by an increase in cash as a result of unspent funds for the Regents On-line Degree Program (RODP), data warehousing, and community college transition.

- Capital assets increased due to the purchase of equipment and automobiles.

- Other assets increased due to state appropriations being received, but not spent, for renewal and replacement for Tennessee Colleges of Applied Technology (TCAT) facilities and RODP equipment.

- The decrease in current liabilities resulted from reduced deposits held in custody for others, particularly in the TCAT startup, TCAT maintenance, and Tennessee Foreign Language Institute funds.

- The increase in net investment in capital assets is due to the purchase of equipment in the 2013 fiscal year.

- Restricted – nonexpendable decreased because the Jones Endowment and Scholarship funds were transferred to Jackson State Community College Foundation.

- Unrestricted net position increased from 2012 to 2013 because of funds held in renewal and replacement funds for TCAT facilities and RODP.

Comparison of FY 2012 to FY 2011

- The increase in current assets was caused by an increase in RODP and Community College Fee receivable.

- Capital assets decreased due to the disposal of obsolete equipment.

- Other assets increased due to the establishment of renewal and replacement funds for TCAT.

- The decrease in net investment in capital assets is due to the disposal of obsolete equipment during the 2012 fiscal year.

- Unrestricted net position increased from 2011 to 2012 because of funds held in renewal and replacement funds for future computer purchases and TCAT facilities, as well as the transfer of funds to renewal and replacement of equipment.

The Statement of Revenues, Expenses, and Changes in Net Position

The statement of revenues, expenses, and changes in net position presents the results of operations for the fiscal year. Revenues and expenses are recognized when earned or incurred, regardless of when cash is exchanged. The statement indicates whether the Central Office's financial condition has improved or deteriorated during the fiscal year. The statement presents the revenues received by the Central Office, both operating and nonoperating; the expenses paid by the Central Office, operating and nonoperating; and any other revenues, expenses, gains, or losses received or spent by the Central Office.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the Central Office. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the Central Office. Nonoperating revenues are revenues received for which goods and services are not provided directly to the payor. Although the Central Office is dependent upon state appropriations and gifts to fund educational and general operations, under GASB standards these funding sources are reported as nonoperating revenues, as is investment income. As a result, the Central Office has historically reported an excess of operating expenses over operating revenues, resulting in an operating loss. Therefore, the "increase in net position" is more indicative of overall financial results for the year.

A summary of the Central Office's revenues, expenses, and changes in net position for the years ended June 30, 2013; June 30, 2012; and June 30, 2011, follows.

Summary of Revenues, Expenses, and Changes in Net Position
(in thousands of dollars)

	2013	2012	2011
Operating revenues	$20,193	$20,889	$20,995
Operating expenses	33,377	33,797	31,481
Operating loss	(13,184)	(12,908)	(10,486)
Total nonoperating revenues and expenses	19,650	18,594	15,835
Increase in net position	6,466	5,686	5,349
Net position at beginning of year	24,678	18,992	13,643
Net position at end of year	$31,144	$24,678	$18,992

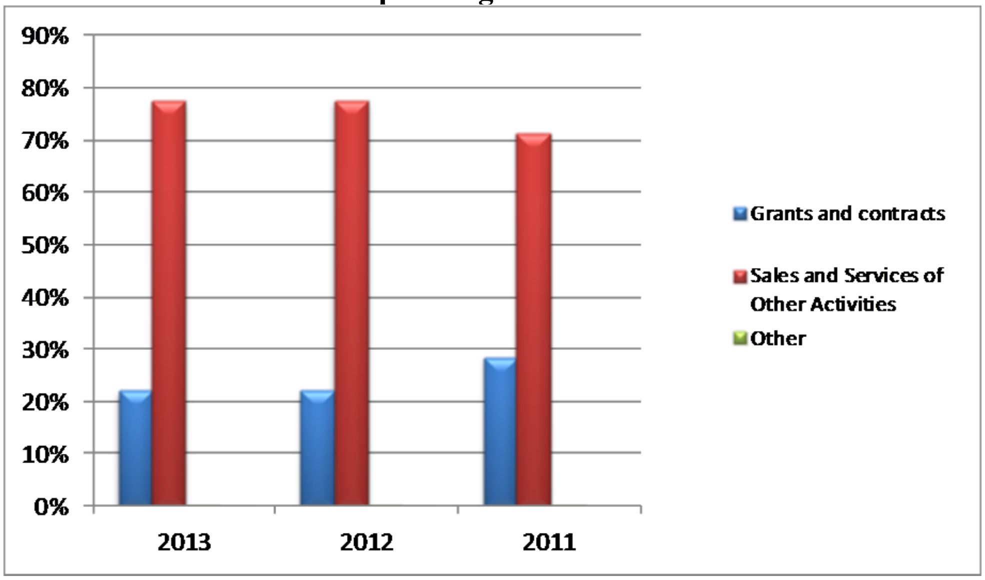
Operating Revenues

The following summarizes the operating revenues by source that were used to fund operating activities for the last three fiscal years:

Operating Revenues
(in thousands of dollars)

	2013	2012	2011
Grants and contracts	$ 4,470	$ 4,632	$ 5,991
Sales and services of other activities	15,685	16,251	14,997
Other	38	6	7
Operating revenues	$20,193	$20,889	$20,995

Operating Revenues



Comparison of FY 2013 to FY 2012

- Grants and contracts revenue decreased due to several grants ending in FY 2012.
- Sales and services of other activities decreased due to a one-year reduction in the system charge to the institutions.
- Other operating revenues increased due to participation payments received from Discover.

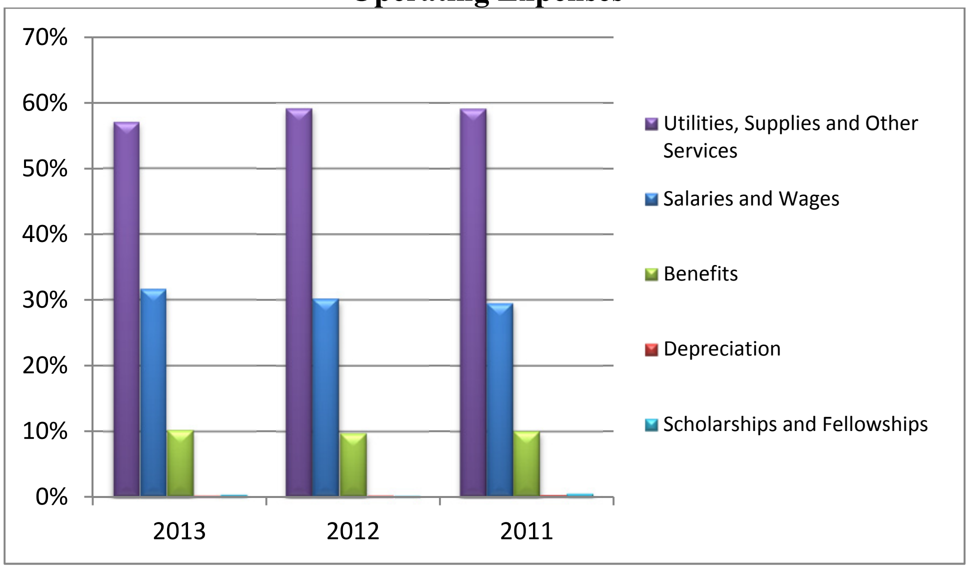
Comparison of FY 2012 to FY 2011

- Grants and contracts revenue decreased due to reduced ARRA stimulus funding and due to several grants ending in FY 2012.
- Sales and services of other activities increased due to an increase in enrollment in RODP.

Operating Expenses

Operating expenses may be reported by nature or function. The Central Office has chosen to report the expenses in their natural classification on the statement of revenues, expenses, and changes in net position and has displayed the functional classification in the notes to the financial statements. The following summarizes the operating expenses by natural classification for the last three fiscal years:

Operating Expenses



Comparison of FY 2013 to FY 2012

- Salaries and benefits increased for additional positions in the RODP and community college offices, as well as general salary increases.

Comparison of FY 2012 to FY 2011

- Salaries and benefits increased due to the additional positions and reclassifications in RODP; additional positions in community colleges and Access Diversity; and employee raises and bonuses.

- Costs for utilities, supplies, and other services increased mostly from RODP and e-Learning programs, as well as continued implementation of the community college office.

- The decrease in scholarships and fellowships resulted from fewer payments for the Washington internship program.

- The decrease in depreciation was caused by the aging of current equipment, the disposal of obsolete equipment, and limited new equipment purchases.

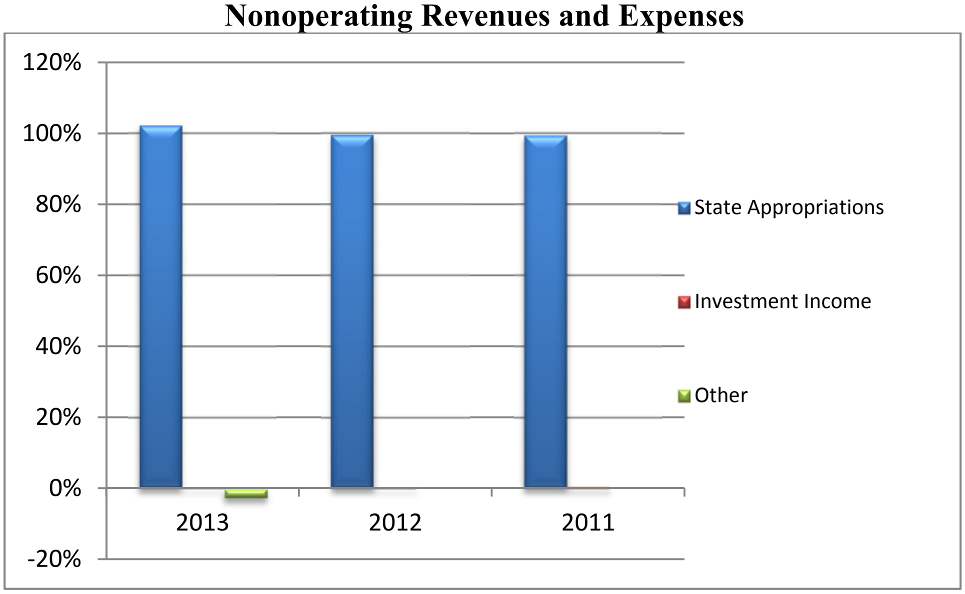
Nonoperating Revenues and Expenses

Certain revenue sources that the Central Office relies on to provide funding for operations, including state noncapital appropriations; certain gifts and grants; and investment income, are defined by the GASB as nonoperating. Nonoperating expenses include capital financing costs and other costs related to capital assets. The following summarizes the Central Office's nonoperating revenues and expenses for the last three fiscal years:

Nonoperating Revenues and Expenses
(in thousands)

	2013	2012	2011
State appropriations	$20,115	$18,535	$15,758
Investment income	63	51	81
Other nonoperating revenues (expenses)	(528)	8	(4)
Nonoperating revenues and expenses	$19,650	$18,594	$15,835

Nonoperating Revenues and Expenses



Comparison of FY 2013 to FY 2012

- State appropriations increased due to additional legislative appropriations, including non-recurring community college transition funds.
- Other nonoperating expenses increased as a result of the transfer of the Jones Endowment funds to JSCC Foundation.

Comparison of FY 2012 to FY 2011

- State appropriations increased due to additional legislative appropriations.

- Investment income decreased due to market fluctuation on interest rates of investments.

Capital Assets

The Central Office had $436,469.03 invested in capital assets, net of accumulated depreciation of $1,006,191.23, at June 30, 2013; $389,624.16 invested in capital assets, net of accumulated depreciation of $981,279.80, at June 30, 2012; and $425,889.61 invested in capital assets, net of accumulated depreciation of $1,205,653.27, at June 30, 2011. Depreciation charges totaled $102,684.78; $111,722.91; and $130,539.43 for the years ended June 30, 2013; June 30, 2012; and June 30, 2011, respectively.

Schedule of Capital Assets, Net of Depreciation
(in thousands of dollars)

	2013	2012	2011
Equipment	$436	$390	$426

Economic Factors That Will Affect the Future

We are not aware of economic factors that are expected to have a significant impact on the financial position or results of operations in the future. Economic factors will continue to have an effect on investment earnings.

Tennessee Board of Regents
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
Statements of Net Position
June 30, 2013, and June 30, 2012

	June 30, 2013	June 30, 2012
ASSETS		
Current assets:		
Cash (Notes 2 and 3)	$ 6,221,496.03	$ 5,495,818.17
Accounts and grants receivable (net) (Note 4)	875,386.22	1,508,424.45
Due from primary government	-	29,200.00
Prepaid expenses	1,467.90	563.81
Other assets	175.00	175.00
Total current assets	7,098,525.15	7,034,181.43
Noncurrent assets:		
Cash (Notes 2 and 3)	28,767,989.71	22,997,418.61
Capital assets (net) (Note 5)	436,469.03	389,624.16
Total noncurrent assets	29,204,458.74	23,387,042.77
Total assets	36,302,983.89	30,421,224.20
LIABILITIES		
Current liabilities:		
Accounts payable	778,184.53	850,151.20
Accrued liabilities	130,466.38	135,331.30
Compensated absences (Note 6)	391,354.76	339,167.29
Deposits held in custody for others	1,349,654.89	2,011,783.00
Total current liabilities	2,649,660.56	3,336,432.79
Noncurrent liabilities:		
Net OPEB obligation (Note 9)	1,625,987.00	1,542,130.00
Compensated absences (Note 6)	883,394.80	864,852.68
Total noncurrent liabilities	2,509,381.80	2,406,982.68
Total liabilities	5,159,042.36	5,743,415.47
NET POSITION		
Net investment in capital assets	436,469.03	389,624.16
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	-	534,042.85
Expendable:		
Scholarships and fellowships (Note 7)	-	1,562.23
Other	7,868,104.85	7,701,965.37
Unrestricted (Note 7)	22,839,367.65	16,050,614.12
Total net position	$ 31,143,941.53	$ 24,677,808.73

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

Tennessee Board of Regents
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2013, and June 30, 2012

	Year Ended June 30, 2013	Year Ended June 30, 2012
REVENUES		
Operating revenues:		
Governmental grants and contracts	$ 4,369,661.83	$ 4,301,688.88
Nongovernmental grants and contracts	100,000.00	330,000.00
Sales and services of other activities	15,685,417.62	16,251,355.52
Other operating revenues	37,500.00	5,871.02
Total operating revenues	20,192,579.45	20,888,915.42
EXPENSES		
Operating expenses (Note 12):		
Salaries and wages	10,607,450.31	10,244,822.71
Benefits	3,440,611.05	3,315,048.38
Utilities, supplies, and other services	19,078,017.32	20,025,872.47
Scholarships and fellowships	148,651.94	99,583.64
Depreciation expense	102,684.78	111,722.91
Total operating expenses	33,377,415.40	33,797,050.11
Operating loss	(13,184,835.95)	(12,908,134.69)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	20,115,271.50	18,535,306.53
Investment income	63,867.21	50,496.87
Other nonoperating revenues (expenses)	(528,169.96)	8,256.12
Net nonoperating revenues	19,650,968.75	18,594,059.52
Increase in net position	6,466,132.80	5,685,924.83
NET POSITION		
Net position - beginning of year	24,677,808.73	18,991,883.90
Net position - end of year	$ 31,143,941.53	$ 24,677,808.73

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

Tennessee Board of Regents
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
Statements of Cash Flows
For the Years Ended June 30, 2013, and June 30, 2012

	Year Ended June 30, 2013	Year Ended June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Grants and contracts	$ 4,677,776.61	$ 5,098,786.54
Sales and services of other activities	15,685,417.62	16,251,355.52
Payments to suppliers and vendors	(18,923,681.38)	(20,503,139.15)
Payments to employees	(10,547,509.98)	(10,180,403.54)
Payments for benefits	(3,345,458.21)	(3,213,455.09)
Payments for scholarships and fellowships	(148,651.94)	(99,583.64)
Other receipts (payments)	37,500.00	5,871.02
Net cash used by operating activities	(12,564,607.28)	(12,640,568.34)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	20,139,100.00	18,515,750.00
Changes in deposits held for others	(464,411.36)	(361,057.09)
Other non-capital financing receipts (payments)	(535,052.99)	-
Net cash provided by noncapital financing activities	19,139,635.65	18,154,692.91
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets	26,191.38	12,862.84
Purchase of capital assets and construction	(168,838.00)	(80,064.18)
Net cash used by capital and related financing activities	(142,646.62)	(67,201.34)
CASH FLOWS FROM INVESTING ACTIVITIES		
Income on investments	63,867.21	50,496.87
Net cash provided by investing activities	63,867.21	50,496.87
Net increase in cash	6,496,248.96	5,497,420.10
Cash - beginning of year	28,493,236.78	22,995,816.68
Cash - end of year	$ 34,989,485.74	$ 28,493,236.78
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (13,184,835.95)	$ (12,908,134.69)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	102,684.78	111,722.91
Other adjustments (Note 13)	5,371.50	5,556.53
Change in assets, liabilities, and deferrals:		
Receivables, net	410,960.49	251,690.31
Prepaid expenses	(904.09)	2,261.42
Accounts payable	(47,605.68)	(264,120.75)
Accured liabilities	(4,864.92)	12,542.31
Compensated absences	70,729.59	76,014.62
OPEB liability	83,857.00	71,899.00
Net cash used by operating activities	$ (12,564,607.28)	$ (12,640,568.34)
Noncash investing, capital, and financing activities		
Loss on disposal of capital assets	$ (19,308.35)	$ (4,606.72)

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

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The Central Office is a part of the State University and Community College System of Tennessee (Tennessee Board of Regents). This system is a component unit of the State of Tennessee because the state appoints a majority of the system's governing body and provides significant financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*. The financial statements present only that portion of the Tennessee Board of Regents' activities that is attributable to the transactions of the Central Office.

Basis of Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America applicable to governmental colleges and universities engaged in business-type activities as prescribed by the Governmental Accounting Standards Board (GASB).

Basis of Accounting

For financial statement purposes, the Central Office is considered a special-purpose government engaged only in business-type activities. Accordingly, the financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all of the provider's eligibility requirements have been met. All significant interfund transactions have been eliminated.

The Central Office has classified its revenues and expenses as either operating or nonoperating according to the following criteria: Operating revenues and expenses are those that have the characteristics of exchange transactions. Operating revenues include most federal, state, local, and private grants and contracts. Operating expenses include (1) salaries and wages; (2) employee benefits; (3) utilities, supplies, and other services; (4) scholarships and fellowships; and (5) depreciation.

Nonoperating revenues and expenses include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other activities that are defined as nonoperating by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*, and GASB Statement 34, such as state appropriations and investment income.

When both restricted or unrestricted resources are available for use, it is the Central Office's policy to determine whether to use restricted or unrestricted resources first, depending upon existing facts and circumstances.

Compensated Absences

The Central Office's employees accrue annual and sick leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time.

The amount of the liabilities for annual leave and compensatory time and their related benefits are reported in the statement of net position. There is no liability for unpaid accumulated sick leave since the Central Office's policy is to pay this only if the employee dies or is absent because of illness, injury, or related family death.

Capital Assets

Capital assets, which include equipment, are reported in the statement of net position at historical cost or at fair value at date of donation, less accumulated depreciation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's useful life are not capitalized.

Equipment is capitalized when the unit acquisition cost is $5,000 or greater.

These assets are depreciated/amortized using the straight-line method over the estimated useful lives, which range from 5 to 10 years.

Net Position

The Central Office's net position is classified as follows:

<u>Net investment in capital assets</u> – This represents the Central Office's total investment in capital assets, net of accumulated depreciation related to those capital assets.

<u>Nonexpendable restricted net position</u> – Nonexpendable restricted net position consists of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may be expendable or added to principal.

<u>Expendable restricted net position</u> – Expendable restricted net position includes resources that the Central Office is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net position – Unrestricted net position represents resources derived from and system charges to the institutions. These resources are used for transactions relating to the educational and general operations of the Central Office and may be used at the discretion of the Central Office to meet current expenses for any purpose.

Accounting Change

The Central Office implemented GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the Central Office was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets. Amounts on the statement of net position and statement of revenues, expenses, and changes in net position, have been restated for comparative purposes for the period ending June 30, 2012.

Note 2. Cash

This classification includes demand deposits and petty cash on hand. At June 30, 2013, cash consisted of $2,442,624.13 in bank accounts, $100.00 of petty cash on hand, and $32,546,761.61 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer. At June 30, 2012, cash consisted of $2,392,426.93 in bank accounts, $100.00 of petty cash on hand, and $26,100,709.85 in LGIP.

The Central Office has deposits in the LGIP, which is administered by the State Treasurer. The LGIP is part of the State Pooled Investment Fund. The fund's required risk disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at www.treasury.tn.gov.

Note 3. Investments

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Central Office is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies which are backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; banker's acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the Central Office.

Tennessee Board of Regents policy restricts investments in banker's acceptances and commercial paper. The policy requires that prime banker's acceptances must be issued by domestic banks with a minimum AA rating or foreign banks with a AAA long-term debt rating by a majority of the rating services that have rated the issuer. Prime banker's acceptances are required to be eligible for purchase by the Federal Reserve System. To be eligible, the original maturity must not be more than 270 days, and it must 1) arise out of the current shipment of goods between countries or with the United States, or 2) arise out of storage within the United States of goods that are under contract of sale or are expected to move into the channel of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods.

Tennessee Board of Regents policy requires that prime commercial paper shall be limited to that of corporations that meet the following criteria: 1) Senior long-term debt, if any, should have a minimum rating of A1 or equivalent, and short-term debt should have a minimum rating of A1 or equivalent, as provided by a majority of the rating services that rate the issuer. If there is no long-term debt rating, the short-term debt rating must be A1 by all rating services (minimum of two). 2) The rating should be based on the merits of the issuer or guarantee by a nonbank. 3) A financial review should be made to ascertain the issuer's financial strength to cover the debt. 4) Commercial paper of a banking institution should not be purchased. Prime commercial paper shall not have a maturity that exceeds 270 days.

As of June 30, 2013, and June 30, 2012, the Central Office's investments consisted entirely of investments in the Local Government Investment Pool. The fair value of these investments was $32,546,761.61 at June 30, 2013, and $26,100,709.85 at June 30, 2012. LGIP investments are not rated by nationally recognized statistical ratings organizations. The LGIP is part of the State Pooled Investment Fund. The fund's required risk disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at www.treasury.tn.gov.

Note 4. Receivables

Receivables included the following:

	June 30, 2013	June 30, 2012
Grants and contracts receivable	$233,819.34	$ 483,634.52
Receivables from institutions	486,849.16	939,976.97
Other receivables	154,717.72	84,812.96
Total receivables	$875,386.22	$1,508,424.45

Note 5. Capital Assets

Capital asset activity for the year ended June 30, 2013, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Equipment	$1,370,903.96	$168,838.00	$ -	$97,081.70	$1,442,660.26
Less accumulated depreciation	981,279.80	102,684.78	-	77,773.35	1,006,191.23
Capital assets, net	$ 389,624.16	$ 66,153.22	$ -	$19,308.35	$ 436,469.03

Capital asset activity for the year ended June 30, 2012, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Equipment	$1,631,542.88	$ 80,064.18	$ -	$340,703.10	$1,370,903.96
Less accumulated depreciation	1,205,653.27	111,722.91	-	336,096.38	981,279.80
Capital assets, net	$ 425,889.61	$(31,658.73)	$ -	$ 4,606.72	$ 389,624.16

Note 6. Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2013, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Compensated absences	$1,204,019.97	$818,727.32	$747,997.73	$1,274,749.56	$391,354.76

Long-term liabilities activity for the year ended June 30, 2012, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Compensated absences	$1,128,005.35	$733,544.83	$657,530.21	$1,204,019.97	$339,167.29

Note 7. Endowments

If a donor has not provided specific instructions to the Central Office, state law permits the Central Office to authorize for expenditure the earnings of the investments of endowment funds. When administering its power to spend the earnings, the Central Office is required to consider the long-term and short-term needs; present and anticipated financial requirements; expected return on its investments; price-level trends; and general economic conditions. Any earnings spent are required to be spent for the purposes for which the endowment was established.

For the Floyd Endowment, the Central Office chooses to spend only a portion of the investment income each year. Under the spending plan established by the Board, expenses are limited to one new four-year scholarship awarded each year, and funding three previously awarded scholarships. The scholarship expenses are limited to the following: 1) the cost of in-state tuition and fees, 2) room and board (or a commuting allowance), 3) a stipend of $500.00 per year, and 4) a $500.00 annual book allowance. The remaining amount, if any, is retained to be used in future years. At June 30, 2013, investment income of $16,040.21 is available to be spent and is included in unrestricted net position. At June 30, 2012, investment income of $15,364.36 is available to be spent and is included in unrestricted net position.

Scholarship expenses for the Jones Endowment are at the direction of the Jones Companies. The Jones Endowment and scholarship accounts were transferred to the Jackson State Community College Foundation on May 6, 2013. At June 30, 2012, investment income of $1,562.23 is available to be spent and is included in restricted net position expendable for scholarships and fellowships.

Note 8. Pension Plans

Defined Benefit Plans

Tennessee Consolidated Retirement System

Plan Description – The Central Office contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing, multiple-employer, defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits, as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly.

TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report is available on the state's website at www.treasury.tn.gov/tcrs.

Funding Policy – Plan members are noncontributory. The Central Office is required to contribute an actuarially determined rate. The current rate is 15.03% of annual covered payroll. Contribution requirements for the Central Office are established and may be amended by the TCRS Board of Trustees. The Central Office's contributions to TCRS for the years ended June 30, 2013; June 30, 2012; and June 30, 2011, were $892,513.77, $805,600.10 and $739,318.12 respectively. Contributions met the requirements for each year.

Defined Contribution Plans

Optional Retirement Plans

Plan Description – The Central Office contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund, ING Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company. These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly.

Funding Policy – Plan members are noncontributory. The Central Office contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contributions made by the Central Office to the plans were $402,475.73 for the year ended June 30, 2013, and $414,943.65 for the year ended June 30, 2012. Contributions met the requirements for each year.

Note 9. Other Postemployment Benefits

Health care is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program which provides postemployment health insurance benefits to eligible Central Office retirees. This program includes two plans available to higher education employees—the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Section 8-27-101, *Tennessee Code Annotated*. Prior to reaching age 65, all members have the option of choosing between the standard or partnership preferred provider organization plan for health care benefits. Subsequent to age 65, members who are also in the state's retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. The state makes on-behalf payments to the Medicare Supplement Plan for the Central Office's eligible retirees; see Note 13. The plans are reported in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Special Funding Situation

The State of Tennessee is legally responsible for contributions to the Medicare Supplement Plan, which covers the retirees of other governmental entities, including the Central Office. The state is the sole contributor for the Central Office retirees who participate in the Medicare Supplement Plan and, therefore, is acting as the employer.

Funding Policy

The premium requirements of members of the State Employee Group Plan are established and may be amended by the insurance committee. The plan is self-insured and financed on a pay-as-you-go basis with the risk shared equally among the participants. The plan's claims liabilities are periodically computed using actuarial and statistical techniques to establish premium rates. The plan's administrative costs are allocated to plan participants. In accordance with Section 8-27-205(b), *Tennessee Code Annotated*, retirees in the State Employee Group Plan pay the same base premium, adjusted for years of service, as active employees. Retirees with 30 years of service are subsidized 80%; retirees with 20 years of service but less than 30 years of service, 70%; and retirees with less than 20 years of service, 60%. Retirees in the Medicare Supplement Plan have flat-rate premium subsidies based on years of service. Retirees with 30 years of service receive $50 per month; retirees with 20 years of service but less than 30 years of service, $37.50; and retirees with 15 years of service but less than 20 years of service, $25.

Central Office's Annual OPEB Cost and Net OPEB Obligation
State Employee Group Plan

	2013	2012
Annual required contribution (ARC)	$ 242,000	$ 239,000
Interest on the net OPEB obligation	61,685	58,809
Adjustment to the ARC	(65,477)	(62,425)
Annual OPEB cost	238,208	235,384
Amount of contribution	(154,351)	(163,485)
Increase in net OPEB obligation	83,857	71,899
Net OPEB obligation – beginning of year	1,542,130	1,470,231
Net OPEB obligation – end of year	$1,625,987	$1,542,130

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2013	State Employee Group Plan	$238,208	64.8%	$1,625,987
June 30, 2012	State Employee Group Plan	$235,384	69.5%	$1,542,130
June 30, 2011	State Employee Group Plan	$362,944	36.3%	$1,470,231

Funded Status and Funding Progress

The funded status of the Central Office's portion of the State Employee Group Plan was as follows:

Actuarial valuation date	July 1, 2011
Actuarial accrued liability (AAL)	$2,797,000
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$2,797,000
Actuarial value of assets as a percentage of the AAL	0.0%
Covered payroll (active plan members)	$9,098,824
UAAL as percentage of covered payroll	30.7%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress, presented as Required Supplementary Information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions

Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. Actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

In the July 1, 2011, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4% investment rate of return (net of administrative expenses) and an annual health care cost trend rate of 9.25% initially. The rate decreased to 8.75% in fiscal year 2013 and then reduces by decrements to an ultimate rate of 5% in fiscal year 2021. All rates include a 2.5% inflation assumption, which also represents the projected salary increase. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007.

Note 10. Insurance-related Activities

It is the policy of the state not to purchase commercial insurance for the risks associated with casualty losses for general liability, automobile liability, professional medical malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund. The state purchases commercial insurance for real property; builder's risk (for construction projects starting prior to July 1, 2012); and crime and fidelity coverage on the state's officials and employees. The contractor is responsible for acquiring builder's risk insurance for all construction projects after June 30, 2012; thus, builder's risk is no longer covered by the Risk Management Fund. For property coverage, the deductible for an individual state agency is the first $25,000 of losses. The Risk Management Fund is responsible for property losses for the annual aggregate deductible of $10 million for perils other than earthquakes and flood. Purchased insurance coverage is responsible for losses exceeding the $10 million annual aggregate deductible. For earthquake and flood, there is a deductible of $10 million per occurrence. The maximum insurance coverage is $750 million per year for perils other than earthquake and flood. The maximum flood insurance coverage is $50 million per occurrence, except there is only $25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is $50 million per occurrence. The amounts of settlements have not exceeded insurance coverage for each of the three past fiscal years.

The Central Office participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the Central Office based on a percentage of the Central Office's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the year ended June 30, 2013, is presented in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml. Since the Central Office participates in the Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the Central Office for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated,* Section 50-6-101 et seq. Claims are paid through the state's Risk Management Fund. At June 30, 2013, the Risk Management Fund held $108.5 million in cash designated for payment of claims. At June 30, 2012, the Risk Management Fund held $97.2 million in cash and cash equivalents designated for payment of claims.

At June 30, 2013, the scheduled coverage for the Central Office was $2,000,000.00 for contents. At June 30, 2012, the scheduled coverage for the Central Office was $2,000,000.00 for contents.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state, with the risk retained by the state. The Central Office participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the Central Office based on estimates of the ultimate cost of claims, including the cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

Note 11. Commitments and Contingencies

Sick Leave

The Central Office records the cost of sick leave when paid. The dollar amount of unused sick leave was $4,426,334.69 at June 30, 2013, and $4,043,370.32 at June 30, 2012.

Operating Leases

The Central Office has entered into various operating leases for storage, office space, and equipment. Such leases will probably continue to be required. Expenses under operating leases for storage/office space were $554,609.04 and expenses for equipment were $5,300.40 for the year ended June 30, 2013. The amounts for the year ended June 30, 2012, were $554,522.04 and $4,922.25. All operating leases are cancelable at the lessee's option.

Note 12. Natural Classification with Functional Classifications

The Central Office's operating expenses for the year ended June 30, 2013, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Institutional support	$10,607,450.31	$3,440,611.05	$18,687,505.28	$ -	$ -	$32,735,566.64
Maintenance & operation	-	-	390,512.04	-	-	390,512.04
Scholarships & fellowships	-	-	-	148,651.94	-	148,651.94
Depreciation	-	-	-	-	102,684.78	102,684.78
Total	$10,607,450.31	$3,440,611.05	$19,078,017.32	$148,651.94	$102,684.78	$ 33,377,415.40

The Central Office's operating expenses for the year ended June 30, 2012, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Institutional support	$10,244,822.71	$3,315,048.38	$19,635,360.43	$ -	$ -	$33,195,231.52
Maintenance & operation	-	-	390,512.04	-	-	390,512.04
Scholarships & fellowships	-	-	-	99,583.64	-	99,583.64
Depreciation	-	-	-	-	111,722.91	111,722.91
Total	$10,244,822.71	$3,315,048.38	$20,025,872.47	$99,583.64	$111,722.91	$33,797,050.11

Note 13. On-behalf Payments

During the year ended June 30, 2013, the State of Tennessee made payments of $5,371.50 on behalf of the Central Office for retirees participating in the Medicare Supplement Plan. The amount for the year ended June 30, 2012, was $5,556.53. The Medicare Supplement Plan is a postemployment benefit health care plan and is discussed further in Note 9. The plan is reported in the *Tennessee Comprehensive Annual Financial Report*. That report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Tennessee Board of Regents
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE – CENTRAL OFFICE
Required Supplementary Information
OPEB Schedule of Funding Progress

Actuarial Valuation Date	Plan	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c)]
July 1, 2011	State Employee Group Plan	$ -	$2,797,000	$2,797,000	0%	$9,098,824	30.74%
July 1, 2010	State Employee Group Plan	$ -	$4,713,000	$4,713,000	0%	$8,513,566	55.36%
July 1, 2009	State Employee Group Plan	$ -	$5,695,000	$5,695,000	0%	$8,197,659	69.47%

The amount reported here for covered payroll relates to the fiscal year in which the valuations were performed.

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Independent Auditor's 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*

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor

We have audited the financial statements of the State University and Community College System of Tennessee – Central Office, a part of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the years ended June 30, 2013, and June 30, 2012, and the related notes to the financial statements, which collectively comprise the Central Office's basic financial statements, and have issued our report thereon dated May 9, 2014. We conducted our 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.

Internal Control Over Financial Reporting

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

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

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

Compliance and Other Matters

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

Purpose of This Report

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

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
May 9, 2014

Finding and Recommendation

The Tennessee Board of Regents - Central Office did not instruct its member institutions to accrue certain capital projects transactions

Finding

During the closing procedures for the fiscal year ended June 30, 2013, the Central Office instructed the Tennessee Department of Finance and Administration to accrue over $23 million in liabilities in the state's information system. However, the Central Office did not instruct its member institutions to do so. As a result, accrued liabilities, capital assets, and expenses at the various institutions were understated in total by the same amount.

The Central Office coordinates certain capital projects for the institutions within its system. These projects may be funded by either capital appropriations received from the State of Tennessee or by debt issued by the Tennessee State School Bond Authority. While there are several entities involved in the approval and payment process, including the State Building Commission and the Department of Finance and Administration, the Central Office acts as the liaison between the member institutions and these entities.

After the various disbursements are made, the member institutions will record the transactions within their individual information systems according to the TBR policies and procedures. Depending on the type of transaction and its funding source, several types of accounts could be affected. These accounts include capital assets; long-term liabilities; capital appropriations revenue; and utilities, supplies, and other services expenses.

As stated in Note 1 to the Financial Statements, the Tennessee Board of Regents Central Office and its member institutions prepare their financial statements using the economic resources measurement focus and the accrual basis of accounting. Revenues and expenses are recorded when earned and incurred, respectively, regardless of cash receipt or disbursement.

For the first time, during the closing of the fiscal year ended June 30, 2013, the state's Department of Finance and Administration asked the Central Office's capital outlay coordinator to identify those payments made in July 2013 that should have been accrued at June 30, 2013. The coordinator identified $23 million in these accruals across the Tennessee Board of Regents System. By identifying these transactions as items that should be accrued at June 30, 2013, the Central Office recognized that the institutions had incurred these expenses at June 30, 2013. However, the Central Office did not instruct the institutions to record these transactions at June 30, 2013. As a result, the institutions recorded them during the fiscal year ending June 30, 2014. For some institutions, the amounts that should have been recorded were insignificant (less than $100); however, for other institutions, the amounts were material (up to $8 million at one institution).

According to Central Office staff, in previous years, no liabilities were accrued at all by the Central Office or by the institutions. Consequently, reporting errors of varying sizes also existed in previous years.

Recommendation

The capital outlay coordinator should analyze invoices and progress billings at and after fiscal year-end to determine amounts susceptible to accrual. When the capital outlay coordinator determines which transactions should be accrued at the end of each fiscal year, she should also instruct the institutions to record those transactions accordingly. The Assistant Vice Chancellor for Business and Finance should ensure that these transactions are recorded correctly at the Central Office and the institutions.

Management's Comment

We concur. Procedures have been implemented to ensure capital projects transactions processed at the System Office are properly communicated to the institutions for accrual at fiscal year-end.

Observations and Comments

The Tennessee Board of Regents State University and Community College System of Tennessee – Central Office (Central Office) was not compensated for services provided to the Tennessee Foreign Language Institute (TFLI) during fiscal year 2013.

Section 49-50-1306(b), *Tennessee Code Annotated*, states that the Tennessee Foreign Language Institute (TFLI) "shall be attached to the board of regents for administrative purposes." As a result of this legislation, the Central Office provides an administrative structure and support services to TFLI. According to the Agreement between Tennessee Foreign Language Institute Board and Tennessee Board of Regents dated August 23, 1990, these support services include

- accepting into account the state appropriation designated for TFLI, any grant monies received for projects, and other payments for TFLI services;
- processing payroll at the accounting level with records provided by TFLI staff;
- disbursing monies for payments and charges as incurred by the TFLI; and
- providing copies of financial transactions and monthly (or quarterly) reports to TFLI.

Beginning June 1, 2012, the Central Office also provided TFLI with the services of a full-time marketing and communications director. The marketing and communications director is responsible for providing media relations, public information, marketing, and external communications services for TFLI. TFLI does not provide any compensation for the use of this director.

In the past, although not included in the written agreement, TFLI agreed to compensate the Central Office for the administrative services provided. According to Central Office personnel, this practice started in the mid-1990s and continued through 2012. The amount originally paid was $10,000 per year but grew to $50,000 in 2010. However, when TFLI began having financial difficulties during fiscal year 2013, the Central Office agreed to waive the fee.

As a result, the financial statements for TFLI do not reflect the true costs of the Tennessee Foreign Language Institute. Total costs of operations are understated by a minimum of $100,000 and an amount that could exceed $140,000. Because TFLI is not reimbursing the Central Office for the cost of services provided, it appears that the appropriations process is being circumvented.