STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE

Financial and Compliance Audit Report

For the Years Ended June 30, 2015, and June 30, 2014

Justin P. Wilson, Comptroller

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STATE OF TENNESSEE
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August 2, 2016

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable David Gregory, Acting 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, 2015, and June 30, 2014. 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 a deficiency, which is detailed in the Finding and Recommendation section of this report. The Central Office's management 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

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Audit Report
Tennessee Board of Regents
State University and Community College System of Tennessee – Central Office
For the Years Ended June 30, 2015, and June 30, 2014

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For the Years Ended June 30, 2015, and June 30, 2014

Opinions on the Financial Statements

The opinions on the financial statements are unmodified.

Audit Finding

The Tennessee Board of Regents did not provide adequate internal controls in one specific area

The Tennessee Board of Regents did not design and monitor internal controls in one area. We observed conditions in violation of Tennessee Board of Regents policies and/or industry-accepted best practices. The details of this finding are confidential pursuant to Section 10-7-504(i), *Tennessee Code Annotated* (page 42).

STATE OF TENNESSEE
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Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable David Gregory, Acting 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, 2015, and June 30, 2014, 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 opinions 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 Central Office'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 opinions.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the State University and Community College System of Tennessee – Central Office as of June 30, 2015, and June 30, 2014, and the respective 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, 2015, and June 30, 2014, 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 14, the college implemented Governmental Accounting Standards Board Statement 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27,* and Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, during the year ended June 30, 2015. 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 13, the Schedule of the Central Office's Proportionate Share of the Net Pension Liability – Closed State and Higher Education Employee Pension Plan Within TCRS on page 36, the Schedule of the Central Office's Contributions – Closed State and Higher Education Employee Pension Plan Within TCRS on page 37, the Schedule of the Central Office's Contributions – State and Higher Education Employee Retirement Plan Within TCRS on page 38, and the other postemployment benefits schedule of funding progress on page 39 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 13, 2016, 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 13, 2016

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, 2015, and June 30, 2014, with comparative information presented for the fiscal year ended June 30, 2013. 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 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 of resources, 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 of resources, 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 subdivided 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.

The following table summarizes the Central Office's assets, liabilities, deferred outflows/inflows of resources, and net position at June 30, 2015; June 30, 2014; and June 30, 2013.

Summary of Net Position
(in thousands of dollars)

	2015	2014	2013
Assets:			
Current assets	$11,700	$ 8,949	$7,099
Capital assets, net	314	414	436
Other assets	38,604	38,155	28,768
Total Assets	50,618	47,518	36,303
Deferred Outflows of Resources:			
Deferred outflows related to pensions	993	-	-
Total Deferred Outflows of Resources	993	-	-
Liabilities:			
Current liabilities	3,582	3,440	2,650
Noncurrent liabilities	4,344	2,625	2,509
Total Liabilities	7,926	6,065	5,159

Deferred Inflows of Resources:			
Deferred inflows related to pensions	2,312	-	-
Total Deferred Inflows of Resources	2,312	-	-
Net Position:			
Net investment in capital assets	314	414	436
Restricted – expendable	8,523	11,088	7,868
Unrestricted	32,536	29,951	22,840
Total Net Position	$41,373	$41,453	$31,144

Comparison of FY 2015 to FY 2014

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

- Capital assets decreased due to the disposal of equipment and depreciation.

- Other assets increased due to transfers of funds from unrestricted current funds to renewal and replacement funds for Tennessee Colleges of Applied Technology (TCAT) facilities.

- The deferred outflow of resources related to pensions increased to $992,890 at June 30 due to the implementation of GASB Statement 68, *Accounting and Financial Reporting for Pensions*. See Note 8 to the financial statements for more pension information.

- The increase in current liabilities resulted from increased deposits held in custody for others, particularly in the TCAT Foundation funds and the Tennessee Foreign Language Institute (TFLI).

- The decrease in net investment in capital assets is due to the disposal of equipment in the 2015 fiscal year and limited equipment purchases in 2015.

- The increase in unrestricted net position occurred due to unspent TCAT facilities funds.

- The decrease in restricted expendable net position resulted from the nonrecurring equipment funds in the prior year.

- The increase in noncurrent liabilities is the result of recording of the net pension liability not recognized in 2014. The cumulative effect is shown on the statement of revenues, expenses, and changes in net position.

- Deferred inflows of resources increased $2,311,670 due to the implementation of GASB Statement 68, *Accounting and Financial Reporting for Pensions*. See Note 8 to the financial statements for additional information on pensions.

Comparison of FY 2014 to FY 2013

- The increase in current assets was caused by an increase in cash as a result of unspent funds for RODP, data warehousing, and community college transition.

- Capital assets decreased due to the disposal of equipment and depreciation.

- Other assets increased due to transfers of funds from unrestricted current funds to renewal and replacement funds for TCAT facilities and RODP equipment and from an increase in restricted cash from unspent equipment grant funds.

- The increase in current liabilities resulted from increased deposits held in custody for others, particularly in the TCAT maintenance and TFLI funds and an increase in unrestricted accounts payable for some large contract payments for the community college office.

- The decrease in net investment in capital assets is due to the disposal of equipment in the 2014 fiscal year.

- The increase in unrestricted net position resulted from unspent funds for TCAT facilities and RODP equipment.

- The increase in restricted expendable net position resulted from unspent equipment grant funds.

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 received. 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, 2015; June 30, 2014; and June 30, 2013, follows.

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

	2015	2014	2013
Operating revenues	$20,810	$22,720	$20,193
Operating expenses	36,943	49,041	33,377
Operating loss	(16,133)	(26,321)	(13,184)
Total nonoperating revenues and expenses	19,730	36,630	19,650
Increase in net position	3,597	10,309	6,466
Net position at beginning of year as originally reported	41,453	31,144	24,678
Cumulative effect of change in accounting principle	(3,677)	-	-
Net position at beginning of year restated	37,776	34,144	24,678
Net position at end of year	$41,373	$41,453	$31,144

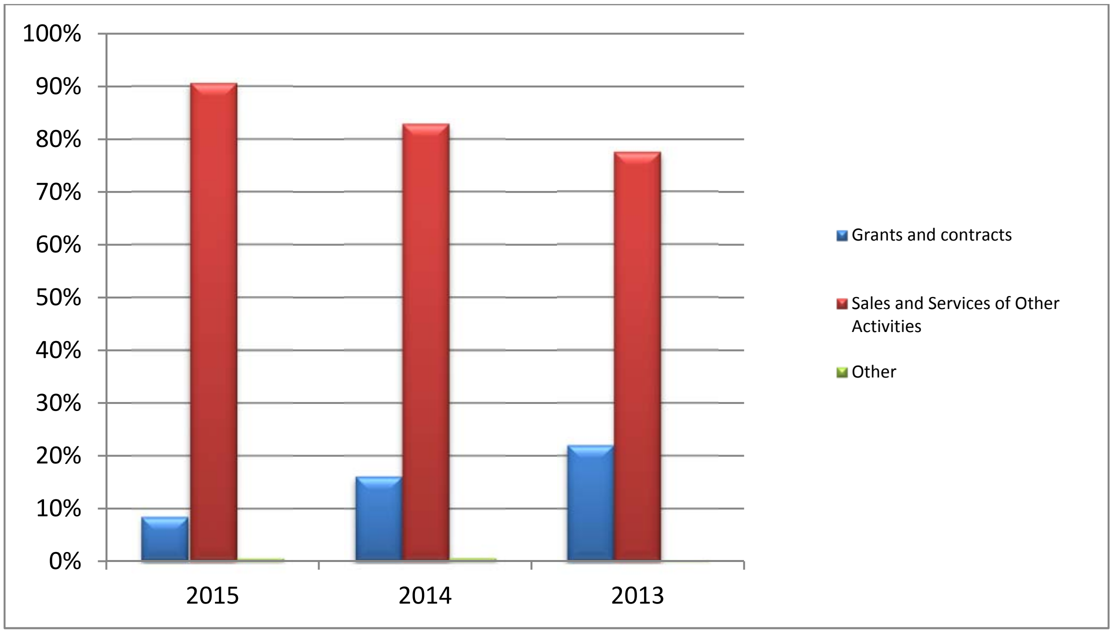
Operating Revenues

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)

	2015	2014	2013
Grants and contracts	$ 1,783	$ 3,688	$ 4,470
Sales and services of other activities	18,887	18,866	15,685
Other	140	166	38
Net position at end of year	$20,810	$22,720	$20,193

Operating Revenues



Comparison of FY 2015 to FY 2014

- Grants and contracts revenue decreased in 2015 because the Tennessee Small Business Development Center funds no longer flow through the Central Office, but are sent directly from the grantor to Middle Tennessee State University.

- Sales and services of other activities increased due to an increase in the system charge.

- Other operating revenues decreased due to reduced participation payments and rebates received from vendors.

Comparison of FY 2014 to FY 2013

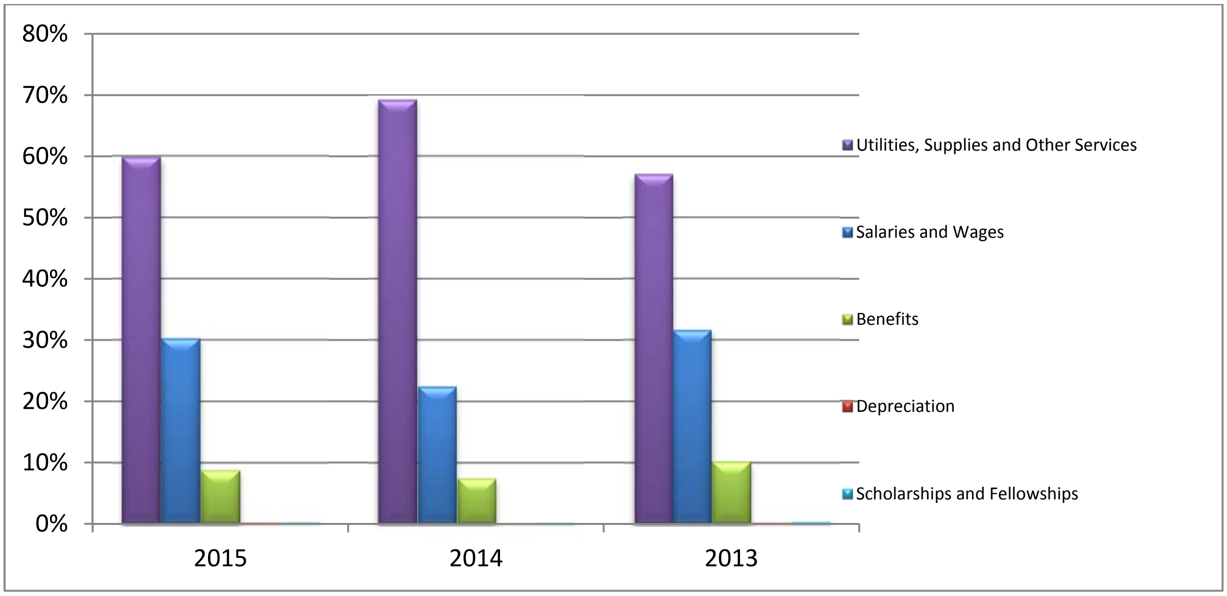
- Grants and contracts revenue decreased due to reduced funds for the Tennessee Small Business Development Center.

- Sales and services of other activities increased due to an increase in the system charge and community college fees.

- Other operating revenues increased due to participation payments and rebates received from vendors.

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:



Comparison of FY 2015 to FY 2014

- Utilities, supplies, and other services costs decreased due to fewer expenses for equipment grants to the community colleges and TCATs. Salaries and benefits increased as a percentage of the total because of the decrease in utilities, supplies, and other services.

Comparison of FY 2014 to FY 2013

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

- Utilities, supplies, and other services costs increased due to expenses for equipment grants to the community colleges and TCATs.

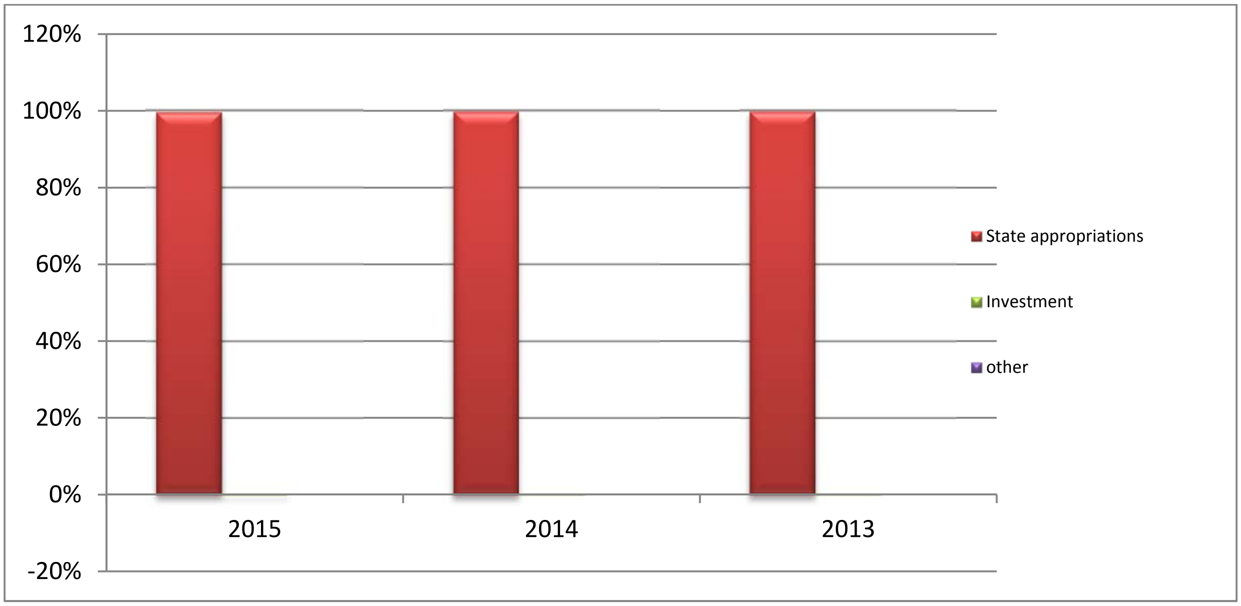
Nonoperating Revenues and Expenses

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)

	2015	2014	2013
State appropriations	$19,675	$36,598	$20,115
Investment income	55	54	63
Other nonoperating revenues (expenses)	-	(22)	(528)
Nonoperating revenues and expenses	$19,730	$36,630	$19,650

Nonoperating Revenues and Expenses



Comparison of FY 2015 to FY 2014

- State appropriations decreased due to nonrecurring legislative appropriations for equipment grants for the community colleges and TCATs in 2014.

- Other nonoperating revenues/(expenses) increased because of changes in gains/losses on disposals of equipment.

Comparison of FY 2014 to FY 2013

- State appropriations increased due to additional nonrecurring legislative appropriations for equipment grants for the community colleges and TCATs in 2014.

- Investment income decreased due to lower interest rates.

- Other nonoperating expenses decreased because of a one-time 2013 transfer of the Jones Endowment funds to the Jackson State Community College Foundation.

Capital Assets

The Central Office had $313,739.07 invested in capital assets, net of accumulated depreciation of $779,655.08 at June 30, 2015; $413,725.52 invested in capital assets, net of accumulated depreciation of $890,663.60 at June 30, 2014; and $436,469.03 invested in capital assets, net of accumulated depreciation of $1,006,191.23 at June 30, 2013. Depreciation charges totaled $115,541.54; $109,750.74; and $102,684.78 for the years ended June 30, 2015; June 30, 2014; and June 30, 2013, respectively.

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

	2015	2014	2013
Equipment	$314	$414	$436

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.

With the passage of the Focus on College and University Success (FOCUS) Act, several changes are being made regarding the relationship of the Tennessee Board of Regents with the universities that are currently governed by the board. While the extent of these changes is not fully known at present, they are likely to have a financial impact on the system office; however, this impact cannot be accurately measured at this time.

Tennessee Board of Regents
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
Statements of Net Position
June 30, 2015, and June 30, 2014

	June 30, 2015	June 30, 2014
ASSETS		
Current assets:		
Cash (Notes 2 and 3)	$ 10,465,802.27	$ 8,240,496.15
Accounts and grants receivable (net) (Note 4)	397,095.32	673,054.95
Due from primary government	361,422.49	31,100.00
Prepaid expenses	475,896.08	4,329.16
Other assets	175.00	175.00
Total current assets	11,700,391.16	8,949,155.26
Noncurrent assets:		
Cash (Notes 2 and 3)	38,603,712.59	38,155,915.87
Capital assets (net) (Note 5)	313,739.07	413,725.52
Total noncurrent assets	38,917,451.66	38,569,641.39
Total assets	50,617,842.82	47,518,796.65
Deferred outflows of resources		
Deferred outflows related to pensions (Note 8)	992,890.00	-
Total deferred outflows of resources	992,890.00	-
LIABILITIES		
Current liabilities:		
Accounts payable	1,035,090.13	1,426,595.64
Accrued liabilities	248,187.25	135,456.44
Compensated absences (Note 6)	433,587.99	442,517.87
Deposits held in custody for others	1,864,597.07	1,435,787.26
Total current liabilities	3,581,462.44	3,440,357.21
Noncurrent liabilities:		
Net OPEB obligation (Note 9)	1,830,366.00	1,725,421.00
Net pension liability (Note 8)	1,604,385.00	-
Compensated absences (Note 6)	909,468.02	899,669.14
Total noncurrent liabilities	4,344,219.02	2,625,090.14
Total liabilities	7,925,681.46	6,065,447.35
Deferred inflows of resources		
Deferred inflows related to pensions (Note 8)	2,311,670.00	-
Total deferred inflows of resources	2,311,670.00	-
NET POSITION		
Net investment in capital assets	313,739.07	413,725.52
Restricted for:		
Expendable:		
Other	8,523,205.42	11,088,690.61
Unrestricted	32,536,436.87	29,950,933.17
Total net position	$ 41,373,381.36	$ 41,453,349.30

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, 2015, and June 30, 2014

	Year Ended June 30, 2015	Year Ended June 30, 2014
REVENUES		
Operating revenues:		
Governmental grants and contracts	$ 1,683,230.99	$ 3,487,599.32
Nongovernmental grants and contracts	100,000.00	200,035.00
Sales and services of other activities	18,886,899.00	18,866,406.00
Other operating revenues	139,931.20	166,398.87
Total operating revenues	20,810,061.19	22,720,439.19
EXPENSES		
Operating expenses (Note 12):		
Salaries and wages	11,235,691.48	11,064,398.59
Benefits	3,290,096.86	3,726,159.83
Utilities, supplies, and other services	22,163,321.91	34,003,051.34
Scholarships and fellowships	138,000.00	137,500.00
Depreciation expense	115,541.54	109,750.74
Total operating expenses	36,942,651.79	49,040,860.50
Operating loss	(16,132,590.60)	(26,320,421.31)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	19,675,000.00	36,597,723.00
Investment income	54,644.66	54,269.28
Other nonoperating revenues (expenses)	-	(22,163.20)
Net nonoperating revenues	19,729,644.66	36,629,829.08
Increase in net position	3,597,054.06	10,309,407.77
NET POSITION		
Net position - beginning of year, as originally reported	41,453,349.30	31,143,941.53
Cumulative effect of change in accounting principle (Note 14)	(3,677,022.00)	-
Net position - beginning of year restated	37,776,327.30	31,143,941.53
Net position - end of year	$ 41,373,381.36	$ 41,453,349.30

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, 2015, and June 30, 2014

	Year Ended June 30, 2015	Year Ended June 30, 2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Grants and contracts	$ 1,812,556.64	$ 3,506,798.96
Sales and services of other activities	18,886,899.00	18,866,406.00
Payments to suppliers and vendors	(23,025,633.49)	(33,295,895.76)
Payments to employees	(11,234,955.04)	(11,007,248.21)
Payments for benefits	(3,817,445.49)	(3,604,925.70)
Payments for scholarships and fellowships	(140,962.60)	(138,219.23)
Other receipts (payments)	139,931.20	166,398.87
Net cash used by operating activities	(17,379,609.78)	(25,506,685.07)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	19,697,400.00	36,560,100.00
Changes in deposits held for others	316,223.05	408,412.50
Net cash provided by noncapital financing activities	20,013,623.05	36,968,512.50
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets and construction	(15,555.09)	(109,170.43)
Net cash used by capital and related financing activities	(15,555.09)	(109,170.43)
CASH FLOWS FROM INVESTING ACTIVITIES		
Income on investments	54,644.66	54,269.28
Net cash provided by investing activities	54,644.66	54,269.28
Net increase in cash	2,673,102.84	11,406,926.28
Cash - beginning of year	46,396,412.02	34,989,485.74
Cash - end of year	$ 49,069,514.86	$ 46,396,412.02
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (16,132,590.60)	$ (26,320,421.31)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	115,541.54	109,750.74
Pension expense	239,033.00	-
Other adjustments (Note 13)	8,700.00	6,523.00
Change in assets, liabilities, and deferrals:		
Receivables, net	22,367.47	(160,042.82)
Prepaid expenses	(471,566.92)	(2,861.26)
Deferred outflows	(992,890.00)	-
Accounts payable	(386,749.08)	688,505.07
Accrued liabilities	112,730.81	4,990.06
Compensated absences	869.00	67,437.45
OPEB liability	104,945.00	99,434.00
Net cash used by operating activities	$ (17,379,609.78)	$ (25,506,685.07)
Noncash investing, capital, and financing activities		
Gain (loss) on disposal of capital assets	$ -	$ (22,163.20)

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 internal activity has 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 (1) tuition and fees, net of scholarship discounts and allowances; (2) certain federal, state, local, and private grants and contracts; (3) sales and services of auxiliary enterprises; and (4) interest on institutional loans. 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 and unrestricted resources are available for use, it is the Central Office's policy to determine which to use 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 property, plant, equipment, library holdings, works of art, historical treasures/collections, and intangible assets, are reported in the statement of net position at historical cost or at fair value at date of donation, less accumulated depreciation/amortization. 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.

Pensions

For purposes of measuring the net pension liability, deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Closed State and Higher Education Employee Pension Plan and the State and Higher Education Employee Retirement Plan in the Tennessee Consolidated Retirement System (TCRS) and additions to/deductions from the plans' fiduciary net positions have been determined on the same basis as they are reported by the TCRS. For this purpose, benefits (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms of the Closed State and Higher Education Employee Pension Plan and the State and Higher Education Employee Retirement Plan. Investments are reported at fair value.

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.

Expendable restricted net position – Expendable restricted net position includes resources that the college 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 state appropriations 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.

Note 2. Cash

This classification includes demand deposits and petty cash on hand. At June 30, 2015, cash consisted of $2,133,005.92 in bank accounts, $100.00 of petty cash on hand, and $46,936,408.94 in the Local Government Investment Pool (LGIP) administered by the State Treasurer. At June 30, 2014, cash consisted of $1,766,696.38 in bank accounts, $100.00 of petty cash on hand, and $44,629,615.64 in the LGIP.

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 college 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; bankers' 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 college and that endowment investments be prudently diversified.

Tennessee Board of Regents policy restricts investments in bankers' acceptances and commercial paper. The policy requires that prime bankers' 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 bankers' 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 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, 2015, and June 30, 2014, the Central Office's investments consisted entirely of investments in the Local Government Investment Pool. The amortized cost of these investments was $46,936,408.94 at June 30, 2015, and $44,629,615.64 at June 30, 2014. LGIP investments are not rated by nationally recognized statistical ratings organizations.

Note 4. Receivables

Receivables included the following:

	June 30, 2015	June 30, 2014
Grants and contracts receivable	$ -	$395,904.70
TFLI receivables	133,762.18	228,582.16
Shared hosting receivables	241,041.57	-
Other receivables	22,291.57	48,568.09
Total receivables	$397,095.32	$673,054.95

Note 5. Capital Assets

Capital asset activity for the year ended June 30, 2015, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Equipment	$1,304,389.12	$ 15,555.09	$226,550.06	$1,093,394.15
Less accumulated depreciation	890,663.60	115,541.54	226,550.06	779,655.08
Capital assets, net	$ 413,725.52	$(99,986.45)	$ -	$ 313,739.07

Capital asset activity for the year ended June 30, 2014, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Equipment	$1,442,660.26	$109,170.43	$247,441.57	$1,304,389.12
Less accumulated depreciation	1,006,191.23	109,750.74	225,278.37	890,663.60
Capital assets, net	$ 436,469.03	$ (580.31)	$ 22,163.20	$ 413,725.52

Note 6. Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2015, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Compensated absences	$1,342,187.01	$883,008.25	$882,139.25	$1,343,056.01	$433,587.99

Long-term liabilities activity for the year ended June 30, 2014, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Compensated absences	$1,274,749.56	$898,562.05	$831,124.60	$1,342,187.01	$442,517.87

Note 7. Endowments

If a donor has not provided specific instructions to the college, state law permits the college to authorize for expenditure the earnings of the investments of endowment funds. When administering its power to spend the earnings, the college is required to consider the Central Office’s 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 revised by the board in March 2015, expenses are limited to one new renewable $500.00 scholarship awarded each year and funding any previously awarded scholarships. The remaining amount, if any, is to be retained for use in future years. At June 30, 2015, net appreciation of $16,435.97 is available to be spent and is included in unrestricted net position.

Under the previous spending plan established by the board, expenses were limited to one new four-year scholarship awarded each year and funding three previously awarded scholarships. The scholarship expenditures were 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, was to be retained for use in future years. Interest earnings had been insufficient to fund new awards for the last several years. At June 30, 2014, net appreciation of $16,496.77 is available to be spent and is included in unrestricted net position.

Note 8. Pension Plans

Defined Benefit Plans

Closed State and Higher Education Employee Pension Plan

General Information About the Pension Plan

Plan description – State employees and higher education employees with membership in the Tennessee Consolidated Retirement System (TCRS) before July 1, 2014, are provided with pensions through the Closed State and Higher Education Employee Pension Plan. This plan is a component of the Public Employee Retirement Plan, an agent, multiple-employer defined benefit pension plan. The Closed State and Higher Education Employee Pension Plan stopped accepting new membership on June 30, 2014, but will continue providing benefits to existing members and retirees. Beginning July 1, 2014, a new agent defined benefit retirement plan, the State and Higher Education Employee Retirement Plan, became effective for state employees and higher education employees hired on or after July 1, 2014.

The TCRS was created by state statute under Title 8, Chapters 34-37, *Tennessee Code Annotated*. The TCRS Board of Trustees is responsible for the proper operation and administration of all employer pension plans in the TCRS. The Tennessee Treasury Department, an agency in the legislative branch of state government, administers the plans of the TCRS. The TCRS issues a publicly available financial report that can be obtained at www.treasury.tn.gov/tcrs.

Benefits provided – Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes the benefit terms and can be amended only by the Tennessee General Assembly. Members of the Closed

State and Higher Education Employee Pension Plan are eligible to retire with an unreduced benefit at age 60 with 5 years of service credit or after 30 years of service credit regardless of age. Benefits are determined using the following formula:

Average of member's highest compensation for 5 consecutive years (up to Social Security integration level)	x	1.50%	x	Years of Service Credit	x	105%
Plus:						
Average of member's highest compensation for 5 consecutive years (over the Social Security integration level)	x	1.75%	x	Years of Service Credit	x	105%

A reduced early retirement benefit is available at age 55 and vested. Members are vested with five years of service credit. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10% and include projected service credits. A variety of death benefits are available under various eligibility criteria. Member and beneficiary annuitants are entitled to automatic cost-of-living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to July 2 of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3%, and applied to the current benefit. No COLA is granted if the change in the CPI is less than 0.5%. A 1% COLA is granted if the CPI change is between 0.5% and 1%. A member who leaves employment may withdraw employee contributions, plus any accumulated interest.

<u>Contributions</u> – Contributions for state employees and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. The Central Office's employees are non-contributory, as are most members in the Closed State and Higher Education Employee Pension Plan. State and higher education agencies make employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. By law, employer contributions for the Closed State and Higher Education Employee Pension Plan are required to be paid. Employer contributions by the Central Office for the year ended June 30, 2015, to the Closed State and Higher Education Employee Pension Plan were $987,942, which is 15.03% of covered payroll. The employer rate is expected to finance the costs of benefits earned by members during the year and the cost of administration, as well as an amortized portion of any unfunded liability.

<u>Annual pension cost</u> – For the years ended June 30, 2014, and June 30, 2013, the Central Office's contributions equaled the annual pension cost of $954,813.70 and $892,513.77, respectively.

Trend Information

Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2014	$954,813.70	100%	$0
June 30, 2013	$892,513.77	100%	$0
June 30, 2012	$805,600.10	100%	$0

Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension liability – At June 30, 2015, the Central Office reported a liability of $1,604,385 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The Central Office's proportion of the net pension liability was based on a projection of the Central Office's contributions during the year ended June 30, 2014, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2014, measurement date, the Central Office's proportion was 0.232537%, representing the first-time presentation of this proportion.

Pension expense – For the year ended June 30, 2015, the Central Office recognized a pension expense of $239,033.

Deferred outflows of resources and deferred inflows of resources – For the year ended June 30, 2015, the Central Office reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ -	$ 346,110
Net difference between projected and actual earnings on pension plan investments		1,965,560
Central Office's contributions subsequent to the measurement date of June 30, 2014	987,942	-
Total	$987,942	$2,311,670

Deferred outflows of resources, resulting from the Central Office's employer contributions of $987,942 subsequent to the measurement date, will be recognized as a decrease in net pension liability in the year ending June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30	
2016	$(577,918)
2017	(577,918)
2018	(577,918)
2019	(577,918)

In the table above, positive amounts will increase pension expense, while negative amounts will decrease pension expense

Actuarial assumptions – The total pension liability as of June 30, 2014, was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0%
Salary increases	Graded salary ranges from 8.97% to 3.71% based on age, including inflation, averaging 4.25%
Investment rate of return	7.5%, net of pension plan investment expenses, including inflation
Cost-of-living adjustment	2.5%

Mortality rates were based on actual experience from the June 30, 2012, actuarial experience study adjusted for some of the expected future improvement in life expectancy.

The actuarial assumptions used in the June 30, 2014, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2008, through June 30, 2012. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees in conjunction with the June 30, 2012, actuarial experience study by considering the following three techniques: (1) the 25-year historical return of the TCRS at June 30, 2012; (2) the historical market returns of asset classes from 1926 to 2012 using the TCRS investment policy asset allocation; and (3) capital market projections that were utilized as a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Four sources of capital market projections were blended and utilized in the third technique. The blended capital market projection established the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding inflation of 3%. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Long-term Expected Real Rate of Return	Target Allocation
U.S. equity	6.46%	33%
Developed market international equity	6.26%	17%
Emerging market international equity	6.40%	5%
Private equity and strategic lending	4.61%	8%
U.S. fixed income	0.98%	29%
Real estate	4.73%	7%
Short-term securities	0.00%	1%
		100%

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees as 7.5% based on a blending of the three factors described above.

Discount rate – The discount rate used to measure the total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current rate and that contributions from all state and higher education agencies will be made at the actuarially determined contribution rate in accordance with the funding policy of the TCRS Board of Trustees and as required to be paid by state statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the net pension liability *(asset)* to changes in the discount rate – The following presents the Central Office's proportionate share of the net pension liability calculated using the discount rate of 7.5%, as well as what the Central Office's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.5%) or 1 percentage point higher (8.5%) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
Central Office's net pension liability	$5,502,856	$1,604,385	$(1,677,110)

Pension plan fiduciary net position – Detailed information about the pension plan's fiduciary net position is available in a separately issued TCRS financial report at www.treasury.tn.gov/tcrs.

Payable to the Pension Plan

At June 30, 2015, the Central Office did not have any outstanding legally required contributions to the pension plan for the year ended June 30, 2015.

State and Higher Education Employee Retirement Plan

General Information About the Pension Plan

Plan description – State employees and higher education employees with membership in the Tennessee Consolidated Retirement System (TCRS) before July 1, 2014, are provided with pensions through the Closed State and Higher Education Employee Pension Plan, an agent plan within the Public Employee Retirement Plan administered by the TCRS. TCRS is a multiple-employer pension plan. The Closed State and Higher Education Pension Plan was closed effective June 30, 2014, and covers employees hired before July 1, 2014. Employees hired after June 30, 2014, are provided with pensions through a legally separate plan referred to as the State and Higher Education Employee Retirement Plan, an agent plan within the Public Employee Retirement Plan administered by the TCRS. The TCRS was created by state statute under Title 8, Chapters 34-37, *Tennessee Code Annotated*.

Benefits provided – Title 8, Chapters 34-37, *Tennessee Code Annotated,* establishes the benefit terms and can be amended only by the Tennessee General Assembly. Members of the State and Higher Education Employee Retirement Plan are eligible to retire at age 65 with 5 years of service credit or pursuant to the rule of 90 in which the member's age and service credit total 90. Members are entitled to receive unreduced service retirement benefits, which are determined by a formula using the member's highest five consecutive year average compensation and the member's years of service credit. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10% and include projected service credits. A variety of death benefits are available under various eligibility criteria. Member and beneficiary annuitants are entitled to automatic cost-of-living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to July 2 of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3%, and applied to the current benefit. No COLA is granted if the change in the CPI is less than 0.5%. A 1% COLA is granted if the CPI change is between 0.5% and 1%. A member who leaves employment may withdraw employee contributions, plus any accumulated interest. Under the State and Higher Education Employee Retirement Plan, benefit terms and conditions, including COLAs, can be adjusted on a prospective basis. Moreover, there are defined cost controls and unfunded liability controls that provide for the adjustment of benefit terms and conditions on an automatic basis.

Contributions – Contributions for state and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. Employees contribute 5% of their salary. The higher education institutions make employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. Per the statutory provisions governing the TCRS, the employer contribution rate cannot be less than 4% for all aggregate employee groups, except in years when the maximum funded level, approved by the TCRS Board of Trustees, is reached. By law, employer contributions for the State and Higher Education Employee Retirement Plan are required to be paid. Employer contributions by the Central Office for the year ended June 30, 2015, to the State and Higher Education Employee Retirement Plan were $4,948, which is 3.87% of covered payroll. The employer rate, when combined with member contributions, is expected to finance the costs of benefits earned by members during the year and the cost of administration, as well as an amortized portion of any unfunded liability.

Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension liabilities – Since the measurement date is June 30, 2014, which is prior to the July 1, 2014, inception of the State and Higher Education Employee Retirement Plan, there is not a net pension liability to report at June 30, 2015.

Pension expense – Since the measurement date is June 30, 2014, the Central Office did not recognize a pension expense at June 30, 2015.

Deferred outflows of resources and deferred inflows of resources – For the year ended June 30, 2015, the Central Office reported deferred outflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
The Central Office's contributions subsequent to the measurement date of June 30, 2014	$4,948	$ -

The Central Office's employer contributions of $4,948 reported as pension-related deferred outflows of resources, subsequent to the measurement date, will be recognized as a reduction in net pension liability in the year ending June 30, 2016.

Payable to the Pension Plan

At June 30, 2015, the Central Office did not have any outstanding legally required contributions to the pension plan for the year ended June 30, 2015.

Defined Contribution Plans

Optional Retirement Plans

Plan description – The Central Office contributes to the Optional Retirement Plan (ORP). The ORP, administered by the Tennessee Treasury Department, is a defined contribution plan. The ORP was established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated*. This statute also sets out the plan provisions. The plan provisions are amended by the Tennessee General Assembly. The ORP was designed to provide benefits at retirement to faculty and staff who are exempt from the overtime provision of the Fair Labor Standards Act and who waive membership in the TCRS. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings.

Funding policy – For employees employed prior to July 1, 2014, 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. For employees hired after June 30, 2014, plan members will contribute 5% to the ORP and the Central Office will contribute 9% of the employee's base salary. The required contributions made to the ORP were $433,013.30 for the year ended June 30, 2015, and $430,217.09 for the year ended June 30, 2014. Contributions met the requirements for each year.

Members are immediately 100% vested in the employer contributions made pursuant to the ORP. The Treasury Department has selected three investment vendors who offer a variety of investment products in which members are responsible for selecting how the contributions are invested. Each member makes the decision when to reallocate future contributions or when to transfer funds from one investment product to another. Funds are held by the investment vendor in the name of the member, not in the name of the State of Tennessee. The State of Tennessee has no discretion over these funds other than to make the initial contributions. Accordingly, the State of Tennessee is not acting in a trustee capacity, nor does it have a fiduciary responsibility for the funds held by the investment vendors.

Deferred Compensation Plans

Employees are offered three deferred compensation plans. The Central Office, through the State of Tennessee, provides two plans, one established pursuant to the Internal Revenue Code (IRC), Section 457, and the other pursuant to IRC, Section 401(k). The third plan is administered by the Central Office and was established in accordance with IRC, Section 403(b). The plans are outsourced to third-party vendors, and the administrative costs assessed by the vendors of these plans are the responsibility of plan participants. Section 401(k), Section 403(b), and Section 457 plan assets remain the property of the contributing employees; therefore, they are not presented in the accompanying financial statements. IRC Sections 401(k), 403(b), and 457 establish participation, contribution, and withdrawal provisions for the plans. Participation in the 403(b) and the 457 plans are voluntary for employees. The Central Office provides up to a $50 monthly employer match for employees who participate in the state's 401(k) plan. Employees hired before July 1, 2014, voluntarily participate in the state's 401(k) plan. Pursuant to Public Chapter No. 259 of the Public Acts of 2013, employees hired after June 30, 2014, are automatically enrolled in the state's 401(k) plan and contribute 2% of their salary, with the employer contributing an additional non-matching 5%. Employees may opt out of the 2% auto enrollment. Such contribution rates may only be amended by the Tennessee General Assembly. There are certain automatic cost controls and unfunded liability controls in the defined benefit plan where the employees participate that may impact the non-matching 5% employer contribution to the 401(k) plan.

Employees are immediately vested in both the employee and employer contributions in all plans. The IRC establishes maximum limits that an employee can contribute to these plans. The employee may increase, decrease, or stop contributions at any time for all three plans.

During the year ended June 30, 2015, contributions totaling $594,863.75 were made by employees participating in the plan, and the Central Office recognized pension expense of $76,670.57 for employer contributions. During the year ended June 30, 2014, contributions totaling $563,942.67 were made by employees participating in the plan, with contributions of $68,807.76 made by the Central Office.

Note 9. Other Postemployment Benefits

Healthcare is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program that provides postemployment health insurance benefits to eligible college 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 8-27-201, *Tennessee Code Annotated,* for the State Employee Group Plan and Section 8-27-701, *Tennessee Code Annotated,* for the Medicare Supplement Plan. 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 college 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. 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

	2015	2014
Annual required contribution (ARC)	$ 279,000	$ 271,000
Interest on the net OPEB obligation	69,017	65,039
Adjustment to the ARC	(67,239)	(63,364)
Annual OPEB cost	280,778	272,675
Amount of contribution	(175,833)	(173,241)
Increase in net OPEB obligation	104,945	99,434
Net OPEB obligation – beginning of year	1,725,421	1,625,987
Net OPEB obligation – end of year	$1,830,366	$1,725,421

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2015	State Employee Group Plan	$280,778	62.6%	$1,830,366
June 30, 2014	State Employee Group Plan	$272,675	63.5%	$1,725,421
June 30, 2013	State Employee Group Plan	$238,208	64.8%	$1,625,987

Funded Status and Funding Progress

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

State Employee Group Plan

Actuarial valuation date	July 1, 2013
Actuarial accrued liability (AAL)	$3,309,000
Actuarial value of plan assets	0
Unfunded actuarial accrued liability (UAAL)	$3,309,000

Actuarial value of assets as a percentage of the AAL	0.00%
Covered payroll (active plan members)	$10,356,663
UAAL as percentage of covered payroll	31.95%

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, 2013, 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 healthcare cost trend rate of 7.5% initially. The rate decreased to 7.0% in fiscal year 2015 and then reduces by decrements to an ultimate rate of 4.19% in fiscal year 2044. All rates include a 2.5% inflation assumption. 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. Payroll is assumed to grow at a rate of 3.0%.

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 (RMF). 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 RMF. For property coverage, the deductible for an individual state agency is the first $25,000 of losses. The RMF 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 RMF. 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, 2015, 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, Section 9-8-101 et seq., *Tennessee Code Annotated*. 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 Section 50-6-101 et seq., *Tennessee Code Annotated*. Claims are paid through the state's Risk Management Fund. At June 30, 2015, the fund held $127.9 million in cash designated for payment of claims. At June 30, 2014, the fund held $116.3 million in cash designated for payment of claims.

At June 30, 2015, the scheduled coverage for the Central Office was $2,000,000 for contents. At June 30, 2014, the scheduled coverage for the Central Office was $2,000,000 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 $4,726,847.71 at June 30, 2015, and $4,559,235.01 at June 30, 2014.

Operating Leases

The Central Office has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for storage/office space were $568,275.00 and expenses for equipment were $3,673.40 for the year ended June 30, 2015. The amounts for the year ended June 30, 2014, were $554,609.04 and $5,300.40. All operating leases are cancelable at the lessee's option.

Litigation

The board is involved in several lawsuits, none of which are expected to have a material effect on the accompanying financial statements.

Note 12. Natural Classification With Functional Classifications

The Central Office's operating expenses for the year ended June 30, 2015, are as follows:

			Natural Classification			
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Institutional support	$11,235,691.48	$3,290,096.86	$21,772,809.87	$ -	$ -	$36,298,598.21
Maintenance & operation	-	-	390,512.04	-	-	390,512.04
Scholarships & fellowships	-	-	-	138,000.00	-	138,000.00
Depreciation	-	-	-	-	115,541.54	115,541.54
Total	$11,235,691.48	$3,290,096.86	$22,163,321.91	$138,000.00	$115,541.54	$36,942,651.79

The Central Office's operating expenses for the year ended June 30, 2014, are as follows:

			Natural Classification			
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Institutional support	$11,064,398.59	$3,726,159.83	$33,612,539.30	$ -	$ -	$48,403,097.72
Maintenance & operation	-	-	390,512.04	-	-	390,512.04
Scholarships & fellowships	-	-	-	137,500.00	-	137,500.00
Depreciation	-	-	-	-	109,750.74	109,750.74
Total	$11,064,398.59	$3,726,159.83	$34,003,051.34	$137,500.00	$109,750.74	$49,040,860.50

Note 13. On-behalf Payments

During the year ended June 30, 2015, the State of Tennessee made payments of $8,700.00 on behalf of the Central Office for retirees participating in the Medicare Supplement Plan. The amount for the year ended June 30, 2014, was $6,523.00. The Medicare Supplement Plan is a postemployment benefit healthcare 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.

Note 14. Cumulative Effect of a Change in Accounting Principle

During fiscal year 2015, the Central Office implemented GASB Statement 68, *Accounting and Financial Reporting for Pensions*, and GASB Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. These statements establish standards for the measurement, recognition, and display of the net pension liability and related expenses, deferred outflows of resources, deferred inflows of resources, note disclosures, and required supplementary information. The implementation of these statements resulted in a cumulative adjustment to beginning net position of $(3,677,022.00). This cumulative adjustment does not include related deferred outflows and deferred inflows of resources.

Tennessee Board of Regents
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE – CENTRAL OFFICE
Required Supplementary Information
Schedule of the Central Office's Proportionate Share of the Net Pension Liability
Closed State and Higher Education Employee Pension Plan Within TCRS

	2014
Central Office's proportion of the net pension liability	0.232537%
Central Office's proportionate share of the net pension liability	$1,604,385
Central Office's covered payroll	$6,352,719
Central Office's proportionate share of the net pension liability as a percentage of its covered payroll	25.26%
Plan fiduciary net position as a percentage of the total pension liability	95.11%

1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.

2) This is a ten-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until ten years of information are available.

Tennessee Board of Regents
STATE UNIVERSITY AND COMMUNITY COLLEGE
SYSTEM OF TENNESSEE – CENTRAL OFFICE
Required Supplementary Information
Schedule of the Central Office's Contributions
Closed State and Higher Education Employee Pension Plan Within TCRS

	2015	2014
Contractually determined contribution	$ 987,942.00	$ 954,814.00
Contributions in relation to the contractually determined contribution	987,942.00	954,814.00
Contribution deficiency (excess)	$ -	$ -
Covered payroll	$6,573,134.00	$ 6,352,719.00
Contributions as a percentage of covered payroll	15.03%	15.03%

This is a ten-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future fiscal years until ten years of information are available.

Tennessee Board of Regents
STATE UNIVERSITY AND COMMUNITY COLLEGE
SYSTEM OF TENNESSEE – CENTRAL OFFICE
Required Supplementary Information
Schedule of the Central Office's Contributions
State and Higher Education Employee Retirement Plan Within TCRS

	2015
Contractually determined contribution	$ 4,948.00
Contributions in relation to the contractually determined contribution	4,948.00
Contribution deficiency (excess)	$ -
Covered payroll	$127,855.00
Contributions as a percentage of covered payroll	3.87%

This is a ten-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future fiscal years until ten years of information are available.

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, 2013	State Employee Group Plan	$ -	$3,309,000	$3,309,000	0%	$10,356,633	31.95%
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%

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 David Gregory, Acting 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, 2015, and June 30, 2014, 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 13, 2016. 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 opinions 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; therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies that we consider to be material weaknesses. We did identify a deficiency in internal control, as described below, that we consider to be a significant deficiency.

- The Tennessee Board of Regents did not provide adequate internal controls in one specific area.

These deficiencies are described in the Finding and Recommendation section of this report.

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*.

Central Office's Response to Finding

The Central Office's response to the finding identified in our audit is included in the Finding and Recommendation section of this report. The Central Office's response was not subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly, we express no opinion on it.

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 13, 2016

Finding and Recommendation

<u>The Tennessee Board of Regents did not provide adequate internal controls in one specific area</u>

<u>Finding</u>

The Tennessee Board of Regents did not design and monitor internal controls in one area. We observed a condition in violation of the Tennessee Board of Regents policies and/or industry-accepted best practices. Inconsistent implementation of internal controls increases the risk of fraud or error.

The details of this finding are confidential pursuant to Section 10-7-504(i), *Tennessee Code Annotated.* We provided the Tennessee Board of Regents with detailed information regarding the specific condition we identified, as well as our recommendations for improvement.

<u>Recommendation</u>

Management should ensure that this condition is remedied by the prompt development and consistent implementation of internal controls. Management should implement effective controls to ensure compliance with applicable requirements; assign staff to be responsible for ongoing monitoring of the risks and mitigating controls; and take action if deficiencies occur.

<u>Management's Comment</u>

We concur with the finding and recommendations. The Tennessee Board of Regents Office of Information Technology Management took corrective action to ensure internal controls are strengthened in the specific area. These controls are presently in place.