Tennessee Board of Regents
State University and Community College
System of Tennessee - Central Office

For the Years Ended
June 30, 2001, and June 30, 2000

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

August 22, 2002

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Charles W. Manning, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, Tennessee 37217

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, 2001, and June 30, 2000. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed one deficiency, which is detailed in the Results of the Audit section of this report. The Central Office's 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,

John G. Morgan
Comptroller of the Treasury

JGM/th
02/040

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit

State University and Community College
System of Tennessee - Central Office

For the Years Ended June 30, 2001, and June 30, 2000

AUDIT OBJECTIVES

The objectives of the audit were to consider the Central Office's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grants; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

SPECIAL INVESTIGATIONS FINDING

Shortages of Moneys Were Not Reported to the Comptroller of the Treasury Immediately as Required by Law

The Central Office did not report shortages of moneys after a collection agency failed to remit funds to numerous Board of Regents schools. Beginning on July 1, 1995, Unger and Associates, Inc., collected bad debts from former students of Tennessee Board of Regents' schools pursuant to a contract with the Central Office. However, the Texas-based agency breached this contract beginning in the fall of 1998 through June 1999, when it failed to remit collections to the respective schools. The agency filed for bankruptcy in June 1999. However, the agency continued to make collections from former Tennessee Board of Regents' students. As of February 28, 2002, the board's net loss from this collection contract was at $68,262. The Central Office did not report these shortages to the Comptroller of the Treasury as required by Section 8-19-501, *Tennessee Code Annotated.*

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, which contains all findings, recommendations, and management comments, please contact

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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, 2001, and June 30, 2000

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Tennessee Board of Regents
State University and Community College
System of Tennessee - Central Office
For the Years Ended June 30, 2001, and June 30, 2000

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the State University and Community College System of Tennessee - Central Office. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The State University and Community College System of Tennessee was created by the General Assembly in 1972. The system now includes 6 universities, 12 community colleges, one technical institute, and 26 technology centers. The Tennessee Board of Regents is vested with the responsibility of governing the system. The Central Office provides essential centralized services and uniform procedures for the institutions in the system. Among the Central Office's major responsibilities are prescribing curricula and requirements for diplomas, approving operating and capital budgets, and establishing policies and procedures regarding campus life.

ORGANIZATION

The governance of the State University and Community College System of Tennessee - Central Office is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The chief administrative officer of the system is the chancellor.

AUDIT SCOPE

The audit was limited to the period July 1, 1999, through June 30, 2001, and was conducted in accordance with government auditing standards generally accepted in the United States of America. Financial statements are presented for the years ended June 30, 2001, and June 30, 2000. The State University and Community College System of Tennessee - Central Office is a part of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the Central Office's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grants;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

The Central Office does not have an internal audit function. Each of the Tennessee Board of Regents system's universities, community colleges, and the technical institute have an internal audit function, but there is not an internal auditor at the Central Office to oversee their activities, coordinate their efforts, and provide assistance when needed. Also, an internal audit function at the Central Office would provide for review of controls and recommendations for changes needed to help safeguard the Central Office's assets and ensure compliance with laws and regulations. The Chancellor should consider establishment of an internal audit function, which should report directly to the Chancellor.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Central Office's financial statements for the years ended June 30, 2001, and June 30, 2000, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by government auditing standards generally accepted in the United States of America. A reportable condition, along with the recommendation and management's response, is detailed in the finding and recommendation. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Central Office's financial statements.

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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

April 5, 2002

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

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, 2001, and June 30, 2000, and have issued our report thereon dated April 5, 2002. We conducted our audit in accordance with government auditing standards generally accepted in the United States of America. As discussed in Note 7, the Central Office changed the threshold for capitalizing equipment. Also, the Central Office implemented GASB 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

Compliance

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Central Office's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. However, we noted one matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Central Office's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The following reportable condition was noted:

- Shortages of moneys were not reported to the Comptroller of the Treasury immediately as required by law

This condition is described in the Finding and Recommendation section of this report.

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we do not believe the reportable condition described above is a material weakness.

We also noted other matters involving the internal control over financial reporting, which we have reported to the Central Office's management in a separate letter.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

FINDING AND RECOMMENDATION - SPECIAL INVESTIGATIONS

<u>Shortages of moneys were not reported to the Comptroller of the Treasury immediately as required by law</u>

Finding

The Central Office did not report shortages of moneys after a collection agency failed to remit funds to numerous Board of Regents schools. Beginning on July 1, 1995, Unger and Associates, Inc., collected bad debts from former students of Tennessee Board of Regents' schools pursuant to a contract with the Central Office. However, the Texas-based agency breached this contract beginning in the fall of 1998 through June 1999, when it failed to remit collections to the respective schools. The agency filed for bankruptcy in June 1999. However, the agency continued to make collections from former Tennessee Board of Regents' students. As of February 28, 2002, the board's net loss from this collection contract was at $68,262.

Although correspondence between the agency and the schools was structured to bypass the Central Office, several of the schools notified the Central Office of the collection problem as soon as March 1999. The Central Office contacted the State Attorney General's Office for assistance in the bankruptcy soon after the declaration in June 1999. The Central Office did not report these shortages to the Comptroller of the Treasury. Section 8-19-501, *Tennessee Code Annotated*, states:

> It shall be the duty of any official of any agency of the state having knowledge of shortages of moneys of the state, or unauthorized removal of state property, occasioned either by malfeasance or misfeasance in office of any state employee, to report the same immediately to the comptroller of the treasury.

The statutory requirement to notify the Comptroller is to ensure a thorough independent investigation and an appropriate solution of the matter.

After being notified of this matter on March 3, 2000, by the Attorney General's Office, the Division of State Audit obtained bank deposits to trace the funds collected on behalf of the Board of Regents by Unger and Associates and obtained collection statements and cancelled checks to determine collections not remitted. An analysis of the agency's trust account established to hold collections exclusively for Tennessee schools showed that the last deposit into this account was in January 1999. Rather than remitting these funds to the respective institutions, Unger and Associates personnel withdrew $15,000 in March 1999 and subsequently $7,000 to close the trust account and moved the funds to the agency's operating account in Texas. The remaining funds approximating $46,000 and collected on behalf of the board's institutions were placed directly in the agency's operating account in a Texas bank. Once the funds reached Texas, they were commingled with other monies held by Unger and Associates. In a 1999 U.S. Bankruptcy Creditors' Meeting, the agency's chief financial officer admitted that trust funds were used to sustain the operations of the agency. According to the agency's accounting records obtained from the U.S. Trustee's Office, those operations included salary payments, housing and car allowances, and other expenses to insiders that appear extravagant.

State Audit coordinated its efforts in this matter with the board, the State Attorney General's Office, the Davidson County District Attorney, and the U.S. Department of Education, Office of the Inspector General in Dallas, Texas. Federal charges were brought against the chief financial officer, the agency's president, and the chief executive officer in Texas, and all three officers pled guilty. The sentencing phase for these three cases is pending. On April 5, 2002, the agency's chief financial officer made full restitution of $70,878 to the Tennessee Board of Regents. This payment included the board's loss of $68,262 in collections and $2,616 for costs the board incurred to resolve the matter.

The Board of Regents does not have a policy that requires schools to report shortages of moneys to its Central Office or to the Comptroller of the Treasury. According to a board official, reporting guidelines for the schools have been drafted and are currently under review.

Recommendation

The Chancellor should establish reporting guidelines that require the schools to report all instances or suspected instances of shortages to the board's Central Office. The Chancellor should ensure that all instances or suspected instances of shortages are immediately reported to the Comptroller of the Treasury.

Management's Comment

We concur with the finding and recommendation. The Central Office and all TBR institutions are aware of the requirement to report shortages immediately to the Comptroller of the Treasury. Since language in the state statute addresses shortages occasioned either by malfeasance or misfeasance in office *of any state employee* (emphasis added), we had not interpreted the Unger situation as meeting the statutory requirement. No state or TBR employee was in any way involved in any malfeasance or misfeasance related to this contract. The board staff had viewed this situation as a legal matter and had involved the Attorney General as soon as it was evident that the company was not remitting payments to the institutions in accordance with the contract. With the clarified interpretation of the statutory requirement, we will immediately report any suspected shortages of this nature to the Comptroller.

The board staff has routinely instructed campus business officers to immediately report shortages to the board office of business and finance, which in turn reports those to the Comptroller's office. Standard forms and processes are in place and are used by all institutions for reporting shortages and possible employee misfeasance. A formal guideline will be developed and approved documenting the reporting requirements for inclusion in the business and finance section of the TBR Guidelines.

STATE OF TENNESSEE
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Independent Auditor's Report

April 5, 2002

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying balance sheets 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 June 30, 2001, and June 30, 2000, and the related statements of changes in fund balances and current funds revenues, expenditures, and other changes for the years then ended. These financial statements are the responsibility of the Central Office's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with government auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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, 2001, and June 30, 2000, and the changes in fund balances and the current funds revenues, expenditures, and other changes for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 7, the Central Office changed the threshold for capitalizing equipment. Also, the Central Office implemented GASB 33, *Accounting and Financial Reporting for Nonexchange Transactions*.

In accordance with *Government Auditing Standards*, we have also issued our report dated April 5, 2002, on our consideration of the Central Office's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/th

Exhibit A

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
BALANCE SHEETS
JUNE 30, 2001, AND JUNE 30, 2000

ASSETS	June 30, 2001	June 30, 2000
Current funds:		
Unrestricted:		
General:		
Cash (Notes 2 and 3)	$ 1,089,466.16	$ 970,604.62
Accounts receivable	85,181.09	161.60
Due from restricted current funds	-	263,140.47
Prepaid expenses	439.68	1,561.12
Other assets	175.00	175.00
Total unrestricted	1,175,261.93	1,235,642.81
Restricted:		
Cash (Notes 2 and 3)	155,072.23	-
Accounts and grants receivable	199,688.23	497,137.59
Total restricted	354,760.46	497,137.59
Total current funds	$ 1,530,022.39	$ 1,732,780.40
Endowment and similar funds:		
Cash (Notes 2 and 3)	$ 965,475.08	$ 965,475.08
Total endowment and similar funds	$ 965,475.08	$ 965,475.08
Plant funds:		
Renewals and replacements:		
Cash (Notes 2 and 3)	$ 1,363,012.60	$ 2,106,139.72
Total renewals and replacements	1,363,012.60	2,106,139.72
Investment in plant:		
Equipment	997,818.71	1,070,910.55
Total investment in plant	997,818.71	1,070,910.55
Total plant funds	$ 2,360,831.31	$ 3,177,050.27
Agency funds:		
Cash (Notes 2 and 3)	$ 1,272,454.85	$ 1,189,671.06
Accounts receivable	93,660.76	302,640.74
Total agency funds	$ 1,366,115.61	$ 1,492,311.80

LIABILITIES AND FUND BALANCES	June 30, 2001	June 30, 2000
Current funds:		
Unrestricted:		
General:		
Liabilities:		
Accounts payable	$ 168,296.16	$ 81,527.49
Accrued liabilities	-	241,568.12
Compensated absences	600,516.85	497,296.62
Total liabilities	768,813.01	820,392.23
Fund balances:		
Nondiscretionary allocations:		
Allocation for working capital	85,895.77	1,997.72
Allocation for encumbrances	29,034.24	7,287.84
Allocation for designated appropriations	740,246.87	184,991.00
Discretionary allocations:		
Allocation for subsequent budget	141,100.00	131,000.00
Allocation for Small Business Development Center	-	508,960.69
Allocation for compensated absences	(600,516.85)	(497,296.62)
Unallocated	10,688.89	78,309.95
Total fund balances	406,448.92	415,250.58
Total unrestricted	1,175,261.93	1,235,642.81
Restricted:		
Liabilities:		
Accounts payable	211,729.40	74,555.08
Accrued liabilities	-	20,641.64
Due to unrestricted current funds	-	263,140.47
Total liabilities	211,729.40	358,337.19
Fund balance	143,031.06	138,800.40
Total restricted	354,760.46	497,137.59
Total current funds	$ 1,530,022.39	$ 1,732,780.40
Endowment and similar funds:		
Fund balances:		
Endowment	$ 474,295.88	$ 474,295.88
Quasi-endowment - unrestricted	491,179.20	491,179.20
Total endowment and similar funds	$ 965,475.08	$ 965,475.08
Plant funds:		
Renewals and replacements:		
Fund balance:		
Unrestricted (Note 4)	$ 1,363,012.60	$ 2,106,139.72
Total renewals and replacements	1,363,012.60	2,106,139.72
Investment in plant:		
Fund balance:		
Net investment in plant	997,818.71	1,070,910.55
Total investment in plant	997,818.71	1,070,910.55
Total plant funds	$ 2,360,831.31	$ 3,177,050.27
Agency funds:		
Liabilities:		
Accounts payable	$ 387,306.56	$ 146,577.37
Deposits held in custody for others	978,809.05	1,345,734.43
Total agency funds	$ 1,366,115.61	$ 1,492,311.80

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

Exhibit B

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENT OF CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2001

	Current Funds			Plant Funds	
	Unrestricted	Restricted	Endowment and Similar Funds	Renewals and Replacements	Investment In Plant
REVENUES AND OTHER ADDITIONS					
Unrestricted current fund revenues	$ 7,317,183.05	$ -	$ -	$ -	$ -
Federal grants and contracts	-	1,975,542.51	-	-	-
State grants and contracts	-	336,774.44	-	-	-
Endowment income	-	28,835.63	-	-	-
Investment income	-	453.98	-	106,867.33	-
Expended for plant facilities (including $16,249.95 charged to current fund expenditures)	-	-	-	-	103,643.15
Other	-	24,369.71	-	-	39,059.34
Total revenues and other additions	7,317,183.05	2,365,976.27	-	106,867.33	142,702.49
EXPENDITURES AND OTHER DEDUCTIONS					
Educational and general expenditures	7,525,984.71	2,280,806.40	-	-	-
Refunded to grantors	-	57,335.87	-	-	-
Indirect costs recovered	-	23,603.34	-	-	-
Expended for plant facilities	-	-	-	87,393.20	-
Expended for noncapital items	-	-	-	36,101.25	-
Transfer to Austin Peay State University	-	-	-	526,500.00	-
Disposal of plant facilities	-	-	-	-	215,794.33
Total expenditures and other deductions	7,525,984.71	2,361,745.61	-	649,994.45	215,794.33
TRANSFER BETWEEN FUNDS - ADDITION (DEDUCTION)					
Nonmandatory:					
Unrestricted current funds	200,000.00	-	-	(200,000.00)	-
Net increase (decreases) for the year	(8,801.66)	4,230.66	-	(743,127.12)	(73,091.84)
Fund balances at beginning of year	415,250.58	138,800.40	965,475.08	2,106,139.72	1,070,910.55
Fund balances at end of year	$ 406,448.92	$ 143,031.06	$ 965,475.08	$ 1,363,012.60	$ 997,818.71

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

Exhibit C

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENT OF CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2000

	Current Funds			Plant Funds	
	Unrestricted	Restricted	Endowment and Similar Funds	Renewals and Replacements	Investment In Plant
REVENUES AND OTHER ADDITIONS					
Unrestricted current fund revenues	$ 7,095,734.09	$ -	$ -	$ -	$ -
Federal grants and contracts	-	550,858.04	-	-	-
State grants and contracts	-	487,066.78	-	-	-
Endowment income	-	28,500.96	-	-	-
Investment income	-	-	-	111,498.92	-
Expended for plant facilities (including $20,463.26 charged to current fund expenditures)	-	-	-	-	37,730.59
Other	-	10,932.43	-	-	101,436.01
Total revenues and other additions	7,095,734.09	1,077,358.21	-	111,498.92	139,166.60
EXPENDITURES AND OTHER DEDUCTIONS					
Educational and general expenditures	6,842,384.77	945,924.38	-	-	-
Indirect costs recovered	-	15,312.33	-	-	-
Expended for plant facilities	-	-	-	17,267.33	-
Expended for noncapital items	-	-	-	5,890.12	-
Disposal of plant facilities	-	-	-	-	117,338.64
Total expenditures and other deductions	6,842,384.77	961,236.71	-	23,157.45	117,338.64
TRANSFER BETWEEN FUNDS - ADDITION (DEDUCTION)					
Nonmandatory:					
Unrestricted current funds	50,000.00	-	-	(50,000.00)	-
Net increases for the year	303,349.32	116,121.50	-	38,341.47	21,827.96
Fund balances at beginning of year	111,901.26	22,678.90	965,475.08	2,067,798.25	1,736,709.98
Cumulative effect of a change in accounting principle (Note 7)	-	-	-	-	(687,627.39)
Fund balances at beginning of year, as restated	111,901.26	22,678.90	965,475.08	2,067,798.25	1,049,082.59
Fund balances at end of year	$ 415,250.58	$ 138,800.40	$ 965,475.08	$ 2,106,139.72	$ 1,070,910.55

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

Exhibit D

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
FOR THE YEAR ENDED JUNE 30, 2001

	Unrestricted	Restricted	Total
REVENUES			
State appropriations	$ 3,672,792.79	$ -	$ 3,672,792.79
Federal grants and contracts	23,603.34	1,975,542.51	1,999,145.85
State grants and contracts	-	310,595.10	310,595.10
Investment income	908,374.18	-	908,374.18
Endowment income	33,635.86	29,289.61	62,925.47
Other sources	2,678,776.88	24,369.71	2,703,146.59
Total current revenues	7,317,183.05	2,339,796.93	9,656,979.98
EXPENDITURES AND TRANSFER			
Educational and general:			
Expenditures:			
Institutional support	7,232,536.55	2,238,294.40	9,470,830.95
Operation and maintenance of plant	273,651.16	-	273,651.16
Scholarships and fellowships	19,797.00	42,512.00	62,309.00
Total educational and general expenditures	7,525,984.71	2,280,806.40	9,806,791.11
Nonmandatory transfer for:			
Renewals and replacements	(200,000.00)	-	(200,000.00)
Total expenditures and transfer	7,325,984.71	2,280,806.40	9,606,791.11
OTHER ADDITION (DEDUCTIONS)			
Excess of restricted receipts over transfers to revenues	-	26,179.34	26,179.34
Refunded to grantors	-	(57,335.87)	(57,335.87)
Indirect costs recovered	-	(23,603.34)	(23,603.34)
Net increase (decrease) in fund balances	$ (8,801.66)	$ 4,230.66	$ (4,571.00)

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

Exhibit E

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
FOR THE YEAR ENDED JUNE 30, 2000

	Unrestricted	Restricted	Total
REVENUES			
State appropriations	$ 3,276,850.00	$ -	$ 3,276,850.00
Federal grants and contracts	15,312.33	707,725.40	723,037.73
State grants and contracts	-	330,199.42	330,199.42
Investment income	841,636.57	-	841,636.57
Endowment income	33,161.79	28,500.96	61,662.75
Other sources	2,928,773.40	10,932.43	2,939,705.83
Total current revenues	7,095,734.09	1,077,358.21	8,173,092.30
EXPENDITURES AND TRANSFER			
Educational and general:			
Expenditures:			
Institutional support	6,539,099.21	923,462.55	7,462,561.76
Operation and maintenance of plant	263,002.56	-	263,002.56
Scholarships and fellowships	40,283.00	22,461.83	62,744.83
Total educational and general expenditures	6,842,384.77	945,924.38	7,788,309.15
Nonmandatory transfer for:			
Renewals and replacements	(50,000.00)	-	(50,000.00)
Total expenditures and transfer	6,792,384.77	945,924.38	7,738,309.15
OTHER DEDUCTION			
Indirect costs recovered	-	(15,312.33)	(15,312.33)
Net increases in fund balances	$ 303,349.32	$ 116,121.50	$ 419,470.82

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
Notes to the Financial Statements
June 30, 2001, and June 30, 2000

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 financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

Basis of Presentation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). The Central Office uses the AICPA College Guide model for accounting and financial reporting.

Basis of Accounting

The financial statements have been prepared on the accrual basis, except that depreciation on plant assets is not recorded. All restricted resources are recorded as additions to the fund balances of the appropriate fund groups. Restricted current resources are then recorded as revenues during the period in which they are expended or all eligibility requirements have been met. The statement of current funds revenues, expenditures, and other changes is a statement of financial activities of current funds related to the current reporting period. It does not purport to present the results of operations or the net income or loss for the period, as would a statement of income or a statement of revenues and expenses.

To the extent that current funds are used to finance plant assets, the funds are accounted for as expenditures, for normal replacement of movable equipment, and nonmandatory transfers, for all other cases.

Fund Accounting

To ensure observance of limitations and restrictions placed on the use of the resources available, the Central Office maintains accounts in accordance with the principles of fund accounting. With this procedure, resources for various purposes are classified for accounting and reporting purposes into funds for specified activities or objectives.

Separate accounts are maintained for each fund; however, in the accompanying financial statements, funds with similar characteristics have been combined into fund groups. Accordingly, all financial transactions have been recorded and reported by fund group.

Within each fund group, fund balances restricted by outside sources are so indicated and are distinguished from unrestricted funds which are allocated to specific purposes by the governing board. Externally restricted funds may be used only in accordance with the purposes established by the source of such funds and contrast with unrestricted funds over which the governing board retains full control to use in achieving any of its institutional purposes.

All gains and losses arising from the sale, collection, or other disposition of investments and other noncash assets are accounted for in the fund that owned such assets. Ordinary income derived from investments, receivables, and the like is accounted for in the fund owning such assets, except for income derived from investments of endowment and similar funds. This income is accounted for in the fund to which it is restricted or, if unrestricted, as revenues in unrestricted current funds. All other unrestricted revenue is accounted for in the unrestricted current funds. Restricted gifts, grants, appropriations, endowment income, and other restricted resources are accounted for in the appropriate restricted funds. Restricted current funds are reported as revenues when expended or all eligibility requirements have been met and expenditures when expended for current operating purposes.

Current Funds

Unrestricted current funds consist of those funds over which the Central Office retains full control for use in achieving its authorized institutional purposes. Restricted current funds are externally restricted and may be used only in accordance with the purposes established by their source.

Endowment and Similar Funds

Endowment funds are subject to the restrictions of gift instruments requiring in perpetuity that the principal be invested and only the income be used. Although quasi-endowment funds have been established by the governing board for the same purposes as endowment funds, any portion of quasi-endowment funds may be expended.

Plant Funds

The plant funds group consists of (1) funds set aside for the renewal and replacement of Central Office properties and (2) funds expended for, and thus invested in, Central Office properties.

Agency Funds

In handling these funds, the Central Office acts solely as an agent; consequently, transactions of these funds do not affect the Central Office's operating statements.

Compensated Absences

The Central Office's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. The amount of these liabilities and their related benefits are recorded in the current funds. Since the liability is expected to be funded primarily from future unrestricted revenue sources, a related allocation has been made to the current fund balances so that these fund balances reflect current available funds.

Allocation for Working Capital

The unrestricted fund balance is allocated for the amount of working capital. "Working capital" is defined as the total of all petty cash, accounts receivable, and prepaid expenses in the unrestricted fund at the balance sheet date.

Plant Assets

The equipment is stated at cost at date of purchase or at fair value at date of donation. Depreciation on the equipment is not recorded.

NOTE 2. CASH

This classification includes demand deposits and petty cash on hand. At June 30, 2001, cash consisted of $35,184.43 in bank accounts, $100.00 of petty cash on hand, and $4,810,196.49 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer. At June 30, 2000, cash consisted of $954,788.52 in bank accounts, $100.00 of petty cash on hand, and $4,277,001.96 in the State of Tennessee Local Government Investment Pool.

NOTE 3. DEPOSITS

The Central Office's deposits are in financial institutions which participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

The laws of the State of Tennessee require that collateral be pledged to secure all uninsured deposits. Tennessee Board of Regents policies require that the market value of collateral pledged equal 115%, 100%, or 90% of the uninsured deposits at financial institutions participating in the collateral pool and 105% of the uninsured deposits at all other financial institutions. The pledge level for financial institutions participating in the collateral pool is based on financial criteria set by the Collateral Pool Board with the financially strongest institutions being eligible for the lowest pledge level.

The Central Office also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report.*

NOTE 4. PLANT FUND ENCUMBRANCES

Plant fund encumbrances outstanding at June 30, 2000, amounted to $47,993.30 for renewals and replacements.

NOTE 5. PENSION PLANS

A. Defined Benefit Plan

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.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee 37243-0230, or by calling (615) 741-8202.

Funding Policy - Plan members are noncontributory. The Central Office is required to contribute an actuarially determined rate. The current rate is 6.19% 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, 2001, 2000, and 1999, were $188,313.27, $158,870.93, and $180,231.33. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The Central Office contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund (TIAA-CREF), Aetna Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). 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 the 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 contribution made by the Central Office to the plans was $172,414.79 for the year ended June 30, 2001, and $121,292.56 for the year ended June 30, 2000. Contributions met the requirements for each year.

NOTE 6. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible Central Office retirees. This benefit is provided and administered by the State of Tennessee. The Central Office assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*.

NOTE 7. CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE

During the year ended June 30, 2000, the threshold for capitalizing equipment increased from $1,000 to $5,000. As a result of the change, equipment decreased by $687,627.39.

NOTE 8. INSURANCE-RELATED ACTIVITIES

The state purchases commercial insurance for real property losses above $5 million per year and surety bond coverage on the state's officials and employees. During the year ended June 30, 1999, the state incurred losses in Clarksville and Jackson due to damage from tornadoes. The final settlement of $8.96 million for the tornado damage in Clarksville was made during the year ended June 30, 2001. In the years ended June 30, 2000, and June 30, 1998, the state did not have any claims filed with the commercial insurer. A designation for casualty losses in the amount of $8.731 million at June 30, 2001, and $7.256 million at June 30, 2000, was established in the state's general fund to provide for any property losses not covered by the commercial insurance.

At June 30, 2001, the scheduled coverage for the Central Office was $1,600,000 for contents. At June 30, 2000, the scheduled coverage was $1,700,000 for contents.

The state has set aside assets for claim settlement in an internal service fund, the Claims Award Fund. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The Central Office participates in the Claims Award 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. Since the Central Office participates in the Claims Award 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 Claims Award Fund.

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 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 9. COMMITMENTS AND CONTINGENCIES

Sick Leave - The Central Office records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The dollar amount of unused sick leave was $2,156,535.49 at June 30, 2001, and $1,864,240.24 at June 30, 2000.

Operating Leases - The Central Office has entered into various operating leases for office and storage space. Such leases will probably continue to be required. Expenditures under operating leases were $378,608.08 for the year ended June 30, 2001, and $384,469.35 for the year ended June 30, 2000. All operating leases are cancelable at the lessee's option.

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

NOTE 10. TENNESSEE FOREIGN LANGUAGE INSTITUTE

Section 49-50-1306(b), *Tennessee Code Annotated*, states that the Tennessee Foreign Language Institute shall be attached to the Tennessee Board of Regents for administrative purposes. The institute's financial records, investments, and other financial transactions are handled by the Central Office, and the assets and liabilities of the institute are included in the agency funds on the Central Office's balance sheet.

NOTE 11. NEW ACCOUNTING PRONOUNCEMENTS

In November 1999, the Governmental Accounting Standards Board (GASB) issued Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities, an amendment of GASB Statement No. 34.* As originally issued, Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for States and Local Governments* was not applicable to public institutions. Rather than issuing separate standards, GASB decided to provide financial reporting guidance for public institutions by amending Statement 34 to extend its applicability to them. Statement 35 supersedes GASB

Statement 15, which currently allows public institutions to choose one of two models when preparing their financial statements—the AICPA College Guide model or the governmental model. As component units of a state government, most public institutions will implement GASB Statement 35 at the same time as the state government implements GASB Statement 34.

Under the provisions of the GASB standards, the Central Office is permitted to report as a special purpose government engaged only in business-type activities (BTA). BTA reporting will require the Central Office to present only the basic financial statements and required supplementary information (RSI) for an enterprise fund that includes management's discussion and analysis; a statement of net assets or a balance sheet; a statement of revenues, expenses, and changes in net assets; a statement of cash flows; notes to the financial statements; and other applicable RSI. The required basic financial statements described above are prepared using the economic resources measurement focus and the accrual basis of accounting. Fund financial statements are not required for BTA reporting.

Statement 34 will also require the Central Office to retroactively and prospectively report all capital assets, net of accumulated depreciation, including infrastructure assets (long-lived capital assets such as roads and bridges) in the statement of net assets and report depreciation expense in the statement of revenues, expenses, and changes in net assets. Retroactive reporting of capital assets will require a prior-period adjustment to net assets. Management has not yet determined the effect of the implementation of this statement on the Central Office's financial statements.