Tennessee Board of Regents
East Tennessee State University

For the Year Ended
June 30, 2002

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Sophia Massey, CFE
Helen Vose, CFE
Staff Auditors

Gerry Boaz, CPA
Technical Analyst

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

Financial/compliance audits of colleges and universities are available on-line at www.comptroller.state.tn.us/sa/reports/index.html.
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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

March 27, 2003

The Honorable Phil Bredesen, 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
and
Dr. Paul E. Stanton, President
East Tennessee State University
Campus Box 70734
Johnson City, Tennessee 37614-0002

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, East Tennessee State University, for the year ended June 30, 2002. 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 resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/sds
02/102

State of Tennessee

Audit Highlights

Comptroller of the Treasury | Division of State Audit

Financial and Compliance Audit
East Tennessee State University
For the Year Ended June 30, 2002

AUDIT OBJECTIVES

The objectives of the audit were to consider the university'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.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, please contact

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Audit Report
Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2002

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Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2002

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Board of Regents, East Tennessee State University. 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

East Tennessee State University was established by an act of the General Assembly in 1909 as East Tennessee State Normal School. In 1924, the name was changed to East Tennessee State Teachers College; in 1930, to State Teachers College, Johnson City; and in 1943, to East Tennessee State College. In 1963, by an act of the General Assembly, East Tennessee College was granted university status, and its name was changed to East Tennessee State University.

The university has nine colleges and schools: the College of Arts and Sciences, College of Business, College of Education, College of Public and Allied Health, School of Graduate Studies, School of Continuing Studies, College of Medicine, College of Applied Science and Technology, and College of Nursing. East Tennessee State University is officially authorized to grant 18 undergraduate and 22 graduate degrees.

ORGANIZATION

The governance of East Tennessee State University 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 university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 2001, through June 30, 2002, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2002. East Tennessee State University is an institution 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 university'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.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The university filed its report with the Department of Audit on May 14, 2002. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the university has corrected previous audit findings concerning the failure to identify unofficial withdrawals on a timely basis and to follow proper acceleration procedures for Perkins Loans.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 2002, 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 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. 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 university's financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

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

November 22, 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 East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the year ended June 30, 2002, and have issued our report thereon dated November 22, 2002. 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. As discussed in Note 12, the university implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The university also implemented GASB Statement 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, and GASB Statement 38, *Certain Financial Statement Note Disclosures*.

Compliance

As part of obtaining reasonable assurance about whether the university's financial statements are free of material misstatement, we performed tests of the university'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*.

We did, however, note certain other less significant instances of noncompliance, which we have reported to the university's management in a separate letter.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university'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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. 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. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted certain matters involving the internal control over financial reporting, which we have reported to the university'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/sds

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

November 22, 2002

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

Dear Mr. Morgan:

We have audited the accompanying statement of net assets of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the year then ended. These financial statements are the responsibility of the university's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit 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 Tennessee Board of Regents, East Tennessee State University, as of June 30, 2002, and the revenues, expenses, and changes in net assets and the cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12, the university implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The university also implemented GASB Statement 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, and GASB Statement 38, *Certain Financial Statement Note Disclosures*.

Management's discussion and analysis on pages 8 through 15 is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 22, 2002, on our consideration of the university'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.

Arthur A. Hayes, Jr., CPA,
Director

AAH/sds

Management's Discussion and Analysis

This section of East Tennessee State University's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2002. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with them. The financial statements, notes, and this discussion are the responsibility of management.

Since this is a transition year for the new financial reporting format required by the Governmental Accounting Standards Board's Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments* and No. 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*, only one year of information is presented in the financial statements and this discussion. Comparative information will be presented in future years.

Using This Annual Report

This report consists of three basic financial statements. The statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows provide information on East Tennessee State University as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

The statement of net assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the university. Assets and liabilities are generally measured using current values. Capital assets, net of related debt, which represent 71.5% of net assets, are stated at historical cost less an allowance for depreciation.

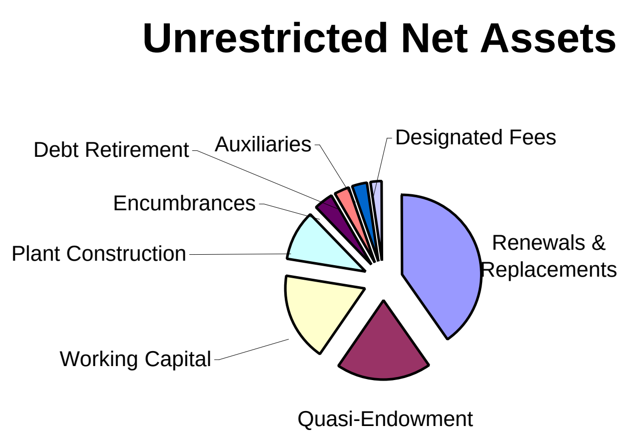
Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the university's equity in property, plant, and equipment owned by the university. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditure by the university 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 assets. The final category is unrestricted net assets. These net assets are available for use by the university for any legal purpose.

Statement of Net Assets
(in thousands of dollars)

		2002
Assets:		
Current assets	$	42,415
Capital assets, net		156,037
Other assets		37,832
Total assets		236,284
Liabilities:		
Current liabilities		18,521
Noncurrent liabilities		40,439
Total liabilities		58,960
Net assets:		
Invested in capital assets, net of related debt		126,804
Restricted – expendable		16,446
Restricted – nonexpendable		39
Unrestricted		34,035
Total net assets	$	177,324

Material assets consist of cash and cash equivalents; accounts, notes, and grants receivable; and capital assets. Material liabilities include long-term bonded debt, compensated absences, and deferred revenue.

Many of the university's unrestricted net assets have been designated or reserved for specific purposes such as repairs and replacement of equipment, future debt service, quasi-endowments, and capital projects. The following graph shows the allocations:



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

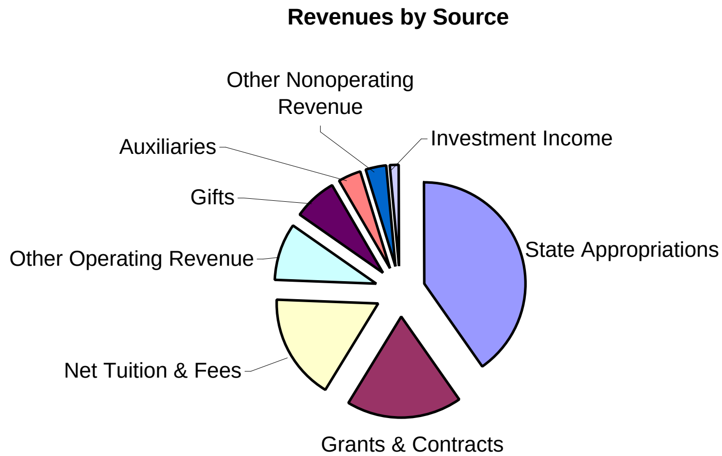
The statement of revenues, expenses, and changes in net assets presents the operating results of the university, and the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to generally accepted accounting principles.

Statement of Revenues, Expenses, and Changes in Net Assets
(in thousands of dollars)

	2002
Operating revenues:	
Net tuition and fees	$ 32,832
Auxiliary enterprises	7,238
Grants and contracts	35,803
Other	17,776
Total operating revenues	93,649
Operating expenses	199,302
Operating loss	(105,653)
Nonoperating revenues and expenses:	
State appropriations	79,011
Gifts	13,659
Investment income	2,515
Other revenues and expenses	6,670
Total nonoperating revenues and expenses	101,855
Income (loss) before other revenues, expenses, gains, or losses	(3,798)
Other revenues, expenses, gains, or losses:	
Capital appropriations	1,905
Capital grants and gifts	35,471
Other	(50)
Total other revenues, expenses, gains, or losses	37,326
Increase (decrease) in net assets	33,528
Net assets at beginning of year, as originally reported	284,250
Cumulative effects of changes in accounting principle	(140,454)
Net assets at beginning of year, restated	143,796
Net assets at end of year	$ 177,324

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the university's operating activities for the year ended June 30, 2002.



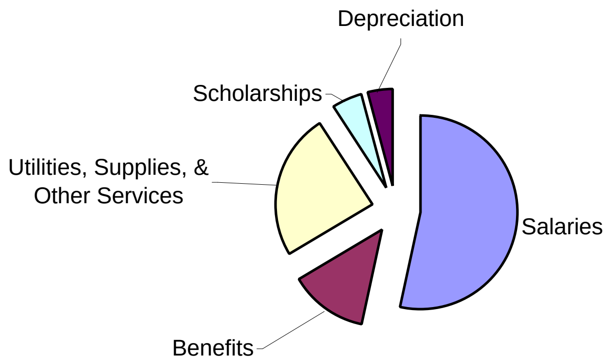
Seventy-six percent of ETSU's revenue is attributed to state appropriations, grants and contracts, and tuition and fees.

Expenses

Operating expenses can be displayed in two formats, natural classification and functional classification. Both formats are displayed below (in thousands of dollars).

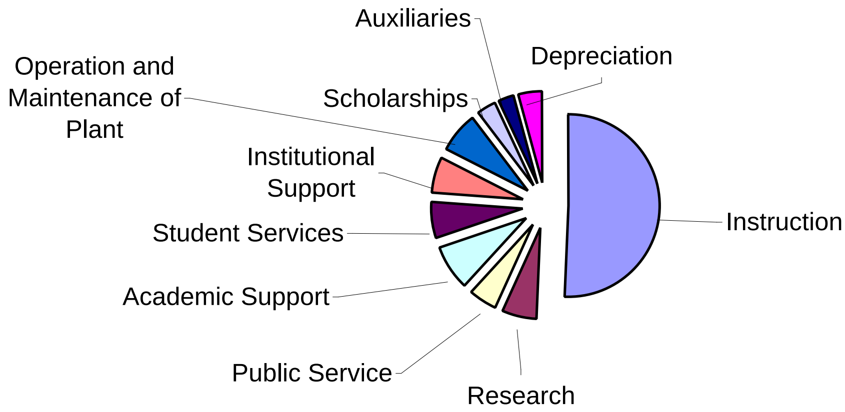
	Natural Classification					
Functional Classification	**Salaries**	**Benefits**	**Utilities, Supplies, and Other Services**	**Scholarships**	**Depreciation**	**Total**
Instruction	$ 63,334	$ 14,005	$ 22,016	$ 1,272	$ -	$ 100,627
Research	6,359	1,682	3,935	62	-	12,038
Public service	5,603	1,348	3,323	72	-	10,346
Academic support	9,602	2,429	3,466	365	-	15,862
Student services	6,286	1,812	3,523	1,406	-	13,027
Institutional support	8,953	2,638	878	183	-	12,652
Operation and Maintenance of plant	4,986	1,754	7,300	2	-	14,042
Scholarships	3	12	327	6,399	-	6,741
Auxiliaries	1,149	261	3,998	165	-	5,573
Depreciation	-	-	-	-	8,394	8,394
Total Expenses	$ 106,275	$ 25,941	$ 48,766	$ 9,926	$ 8,394	$ 199,302

Operating Expenses by Natural Classification



Sixty-seven percent of expenses are attributed to salaries and benefits. Utilities, supplies, and other services represent 24 percent of total expenses. Scholarships and depreciation represent the remaining 9 percent of expenses.

Operating Expenses by Function



Fifty-one percent of operating expenses by function is attributable to instruction. The percentages for the remaining functional areas range from 3 to 8 percent of total operating expenses.

The Statement of Cash Flows

The statement of cash flows provides information about cash receipts and cash payments during the year. This statement also assists users in assessing the university's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Statement of Cash Flows
(in thousands of dollars)

		2002
Cash provided (used) by:		
Operating activities	$	(85,959)
Noncapital financing activities		89,444
Investing activities		2,568
Capital and related financing activities		(6,016)
Net increase (decrease) in cash		37
Cash, beginning of year		54,156
Cash, end of year	$	54,193

Material sources of cash included state appropriations, tuition and fees, and grants and contracts. Material uses of cash were for payments to suppliers and vendors, payments to employees, and payments for scholarships and fellowships.

The cash position of the university increased by $37,000 during the fiscal year ended June 30, 2002.

Capital Asset and Debt Administration

Capital Assets

At June 30, 2002, East Tennessee State University had $156,037,000 invested in capital assets, net of accumulated depreciation. Depreciation charges totaled $8,394,000 for the current fiscal year. Details of these assets are shown below.

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

		2002
Land	$	22,645
Land improvements & infrastructure		10,475
Buildings		105,404
Equipment		8,742
Library holdings		8,327
Projects in progress		444
Total	$	156,037

Major capital additions for ETSU during 2001-2002 include the Center for Physical Activity funded by bonds to be repaid by student fees and the Stanton Gerber Basic Science Building funded by a joint project of the state and federal governments and leased to the university for 35 years under an enhanced use lease agreement (see Note 7 for additional details). Also, additions of land to be used for future campus expansion were recorded as gifts from the federal and state governments.

The state has appropriated funds for the 2002-2003 fiscal year for three capital projects in the amount of $3 million. The projects consist of steamline improvements, electrical upgrades, and a College of Medicine reroofing project. More detailed information about the university's capital assets is presented in Note 6 to the financial statements.

Debt

At June 30, 2002, the university had $29,233,000 in debt outstanding. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt Schedule
(in thousands of dollars)

		2002
Notes	$	500
Loans		2,354
Bonds		26,379
Total Debt	$	29,233

The Tennessee State School Bond Authority (TSSBA) must authorize all capital long-term debt on behalf of the university. TSSBA currently is rated as AA- by Standard & Poor. New debt issuances of $13,397,000 consisted of the Center for Physical Activity and the Chiller Plant Upgrade. Of this amount, $7,935,000 was used to retire commercial paper that had been issued as of June 30, 2001, for financing of the projects. More detailed information about the university's long-term liabilities is presented in Note 8 to the financial statements.

Economic Factors That Will Affect the Future

For fiscal year 2002-2003, the Tennessee Board of Regents has authorized a fee increase of 7.5% that is expected to generate approximately $1.6 million in new funding, net of related scholarships. The university is also expected to receive a modest increase in state funding.

The Tennessee Higher Education Commission (THEC) is currently reviewing recommendations regarding *A Plan of Action for Tennessee Higher Education: A Revision of the 2000-05 Master Plan* that the Commission adopted in principle on April 18, 2002. The original plan contained 11 action items and was distributed widely across the state higher education community. It was presented also to legislative and other bodies. Direct input concerning the 11 policy initiatives was solicited and received.

Six of the original 11 action items received general support and consensus. These included

- revision of institutional admissions standards,
- removal of the moratorium on new academic programs and development of additional program review criteria,
- revision of the funding formula,
- removal of the moratorium on new off-campus instructional activity and adoption of new screening criteria,
- initiation of external peer reviews of Engineering and Agriculture programs, and
- implementation of additional accountability initiatives.

Two of the original items were recommended for partial modification. These were

- consolidation of a freestanding provision to restrict the establishment of new doctoral programs to specific institutions, with the provision for strengthening program review criteria; and
- to allow the continuation of several associate degree programs offered by Austin Peay State University at Fort Campbell as an exception to the recommendation to terminate non-allied health associate degree programs at the university level.

The final three recommendations have not received a unified consensus and are still being reviewed. They include

- a recommendation to establish enrollment ceilings effective with the 2002-03 academic year;
- a recommendation that state appropriations for remedial education be phased out at the university level effective with the appropriations recommendations for the 2003-04 fiscal year (additionally, funding for developmental education at the university level would be funded at the current community college FTE funding rate); and
- a recommendation for a review of intercollegiate athletic programs in an effort to significantly reduce the state subsidy for athletics in the short term and establishing athletics as a self-supporting enterprise by 2007.

It is unknown at this time what effects the final adoption of the above recommendations will have on the university.

Other than the above, the university is not aware of any currently known facts, decisions, or conditions that are expected to have a significant effect on the university’s financial position or results of operations.

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF NET ASSETS
June 30, 2002

ASSETS	
Current assets:	
Cash and cash equivalents (Notes 2 and 3)	$ 25,093,873.36
Short term investments (Notes 3 and 4)	2,010,000.00
Accounts, notes, and grants receivable (net) (Note 5)	14,094,550.98
Inventories	651,344.06
Prepaid expenses and deferred charges	189,279.95
Accrued interest receivable	363,531.37
Other assets	12,746.00
Total current assets	42,415,325.72
Noncurrent assets:	
Cash and cash equivalents (Notes 2 and 3)	28,424,919.67
Accounts, notes, and grants receivable (net) (Note 5)	8,443,237.46
LGIP deposit-capital projects	674,099.68
Deposits with trustees	56,729.84
Capital assets (net) (Note 6)	156,036,851.78
Other assets	232,470.85
Total noncurrent assets	193,868,309.28
Total assets	236,283,635.00
LIABILITIES	
Current liabilities:	
Accounts payable	2,606,136.86
Accrued liabilities	4,809,826.89
Student deposits	380,657.07
Deferred revenue	5,676,183.37
Compensated absences (Note 8)	2,450,131.39
Accrued interest payable	354,164.70
Long term liabilities - current portion (Note 8)	1,426,244.24
Deposits held in custody for others	813,779.09
Other liabilities	3,583.40
Total current liabilities	18,520,707.01
Noncurrent liabilities:	
Compensated absences (Note 8)	5,361,293.04
Long term liabilities (Note 8)	27,806,494.47
Due to grantors	7,271,158.41
Total noncurrent liabilities	40,438,945.92
Total liabilities	58,959,652.93
NET ASSETS	
Invested in capital assets, net of related debt	126,804,113.07
Restricted:	
Nonexpendable:	
Scholarships and fellowships	39,084.76
Expendable:	
Scholarships and fellowships	26,001.41
Research	479,463.69
Instructional departments	10,883,869.12
Loans	1,834,752.76
Debt service	2,146,837.10
Other	1,074,424.69
Unrestricted	34,035,435.47
Total net assets	$ 177,323,982.07

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

Exhibit B

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2002

REVENUES	
Operating revenues	
Student tuition and fees (net of scholarship allowances of $9,956,818.74)	$ 32,831,492.69
Governmental grants and contracts	28,952,481.78
Non-governmental grants and contracts	6,850,647.24
Sales and services of educational departments	15,850,281.67
Auxiliary enterprises:	
Residential life (net of scholarship allowances of $109,839.84; all revenues are used as security for varying revenue bonds; see Note 8)	5,148,192.28
Bookstore	338,953.56
Food service	398,275.35
Center for physical activities (all revenues are used as security for revenue bonds; see Note 8)	778,810.09
Other auxiliaries	573,488.24
Interest earned on loans to students	168,318.83
Other operating revenues	1,757,658.55
Total operating revenue	93,648,600.28
EXPENSES	
Operating expenses	
Salaries and wages	106,275,306.35
Fringe benefits	25,940,555.48
Utilities, supplies, and other services	48,765,991.64
Scholarships and fellowships	9,925,390.25
Depreciation expense	8,394,471.26
Total operating expenses	199,301,714.98
Operating income (loss)	(105,653,114.70)
NONOPERATING REVENUES (EXPENSES)	
State appropriations	79,010,600.00
Gifts	13,659,093.24
Grants and contracts	8,340,854.35
Investment income	2,515,255.48
Interest on capital asset - related debt	(1,126,239.08)
Bond issuance costs	(177,128.35)
Other nonoperating expenses	(366,963.00)
Net nonoperating revenues	101,855,472.64
Income (loss) before other revenues, expenses, gains, or losses	(3,797,642.06)
Capital appropriations	1,904,851.60
Capital grants and gifts	35,471,200.42
Other	(50,390.79)
Total other revenues	37,325,661.23
Increase in net assets	33,528,019.17
NET ASSETS	
Net assets at beginning of year	284,249,754.96
Cumulative effects of changes in accounting principle (Note 12)	(140,453,792.06)
Net assets at beginning of year, restated	143,795,962.90
Net assets at end of year	$ 177,323,982.07

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

Exhibit C

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2002

CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$	31,679,036.87
Grants and contracts		35,214,217.74
Sales and services of educational activities		15,776,788.49
Payments to suppliers and vendors		(38,075,123.72)
Payments to employees		(104,863,721.69)
Payments for benefits		(25,357,661.52)
Payments for scholarships and fellowships		(9,550,653.77)
Loans issued to students and employees		(2,033,697.54)
Collection of loans to students and employees		2,100,010.84
Interest earned on loans to students		154,344.61
Auxiliary enterprises:		
Residence halls		5,141,353.19
Bookstore		354,799.37
Food service		398,296.23
Center for physical activities		778,810.09
Other auxiliaries		566,146.59
Other receipts (payments)		1,757,658.55
Net cash provided (used) by operating activities		(85,959,395.67)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations		78,182,400.00
Net cash balance implicitly financed (repaid)		(734,365.45)
Gifts and grants for other than capital or endowment purposes		11,608,133.89
Agency transactions		388,121.16
Net cash provided (used) by noncapital financing activities		89,444,289.60
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt		13,396,828.35
Capital appropriations		1,904,851.60
Capital grants and gifts received		123,040.12
Purchase of capital assets and construction		(10,743,413.76)
Principal paid on capital debt and leases		(9,019,038.74)
Interest paid on capital debt and leases		(1,035,392.54)
Bond issuance costs paid on new debt issue		(177,128.35)
Deposit with trustee		(21,341.89)
Other capital and related financing receipts (payments)		(444,049.79)
Net cash provided (used) by capital and related financing activities	$	(6,015,645.00)

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2002

CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	$	2,010,000.00
Interest on investments		2,567,956.26
Purchase of investments		(2,010,000.00)
Net cash provided (used) by investing activities		2,567,956.26
Net increase (decrease) in cash		37,205.19
Cash and cash equivalents at beginning of year		54,155,687.52
Cash and cash equivalents at end of year	$	54,192,892.71
RECONCILIATION OF NET OPERATING LOSS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES:		
Operating loss	$	(105,653,114.70)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:		
Depreciation expense		8,394,471.26
ETSU Foundation expenses on behalf of university		10,391,813.70
Changes in assets and liabilities:		
Receivables, net		(3,028,834.54)
Inventories		35,333.38
Prepaid expenses and deferred charges		475,752.12
Accrued interest receivable		(22,711.13)
Other assets		121,599.61
Accounts payable		56,995.47
Accrued liabilities		1,469,840.88
Deferred revenue		998,111.47
Deposits		61,555.49
Compensated absences		535,148.79
Due to grantors		138,329.23
Loans to students and employees		66,313.30
Net cash provided (used) by operations	$	(85,959,395.67)
Non-Cash Transactions		
Expenditures by ETSU Foundation on behalf of the university	$	10,391,813.70
Gifts of capital assets to the university	$	35,755,143.30

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

Tennessee Board of Regents
East Tennessee State University
Notes to the Financial Statements
June 30, 2002

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The university 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). In June 1999, the GASB issued Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*. This was followed in November 1999 by GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The financial presentation required by those statements provides a comprehensive, entity-wide perspective of the university's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows, and replaces the fund-group perspective previously required.

Significant accounting changes made in order to comply with the new requirements include (1) adoption of depreciation on capital assets and (2) reporting summer school revenues and expenses between fiscal years rather than in one fiscal year.

Basis of Accounting

For financial statement purposes, the university 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 eligibility requirements imposed by the provider have been met. All significant interfund transactions have been eliminated.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The university has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The university has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

Amounts reported as operating revenues include (1) tuition and fees, net of waivers and discounts; (2) sales and services of educational departments; (3) federal, state, local, and private grants and contracts; (4) sales and services of auxiliary enterprises; and (5) other sources of revenue. Operating expenses for the university include (1) salaries and wages; (2) employee benefits; (3) scholarships and fellowships; (4) depreciation; and (5) utilities, supplies, and other services.

All other activity is nonoperating in nature and includes (1) state appropriations for operations; (2) investment income; (3) bond issuance costs; (4) interest on capital asset-related debt; and (5) nonoperating gifts and grants.

When both restricted and unrestricted resources are available for use, generally it is the university's policy to use the restricted resources first.

LGIP Deposit – Capital Projects

Payments related to the university's capital projects are made by the State of Tennessee's Department of Finance and Administration. The university's estimated local share of the cost of each project is held in a separate Local Government Investment Pool (LGIP) account. As expenses are incurred, funds are withdrawn from the LGIP account by the Tennessee Board of Regents and transferred to the Department of Finance and Administration. The funds in the account are not available to the university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

Inventories

Inventories are valued at the lower of cost or market. Items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

The university'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 reported in the statement of net assets.

Capital Assets

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

A capitalization threshold of $100,000 is used for buildings, $50,000 for additions and improvements to land, buildings, or infrastructure, and $5,000 for equipment.

These assets, with the exception of land, are depreciated using the straight-line method over the estimated useful lives, which range from 5 to 40 years.

Net Assets

The university's net assets are classified as follows:

<u>Invested in capital assets, net of related debt</u> – This represents the university's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

<u>Expendable restricted net assets</u> – Expendable restricted net assets include resources which the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

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

Unrestricted net assets – Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university, and may be used at the discretion of the university to meet current expenses for any purpose. The auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

Scholarship Discounts and Allowances

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the university and the amount that is paid by the student and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state, or nongovernmental programs, are recorded as either operating or nonoperating revenues in the university's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the university has recorded a scholarship discount and allowance.

Comparative Data

Comparative financial statements are not presented as the university implemented GASB Statements 34, 35, 37, and 38, and comparative statements are not required. Certain amounts presented in prior years' data have been reclassified to be consistent with the current year's presentation.

NOTE 2. CASH AND CASH EQUIVALENTS

In addition to demand deposits and petty cash on hand, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less. At June 30, 2002, cash and cash equivalents consisted of $394,839.66 in bank accounts, $30,000.00 of petty cash on hand, $47,293,953.37 in the State of Tennessee Local Government Investment Pool, and $5,800,000.00 in overnight repurchase agreements.

NOTE 3. DEPOSITS

The bank balances of certain deposits as of the date of the statement of net assets were entirely insured.

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 university's remaining 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 university 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.* That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 4. INVESTMENTS

The university 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 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 university and that endowment investments be prudently diversified. Investments are valued at fair value.

The university's investments at June 30, 2002, consisted of certificates of deposit with original maturities greater than three months. These have been included with other deposits in Note 3 to determine the adequacy of collateral security pledged.

Excess balances in the university's operating account, a "sweep" account, were automatically invested in overnight repurchase agreements during the year ended June 30, 2002. The college had $5,800,000 invested in overnight repurchase agreements at June 30, 2002. This amount is classified as cash and cash equivalents on the university's statement of net assets. The market value of the securities underlying the repurchase agreements at June 30, 2002, was $5,800,000.

Investments of this type are categorized to indicate the level of risk assumed by the university. Category 1 consists of insured or registered investments or investments for which the securities are held by the university or its agent in the university's name. Category 2 consists of uninsured or unregistered investments for which the securities are held by the counterparty's trust department or agent in the university's name. Category 3 consists of uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the university's name.

The university's investments in overnight repurchase agreements at June 30, 2002, are reported as category 1. These amounts are insured via the bank collateral pool administered by the state treasurer.

NOTE 5. RECEIVABLES

Receivables at June 30, 2002, included the following:

Student accounts receivable	$4,199,777.16
Grants receivable	7,299,128.70
Notes receivable	9,377,809.51
Other receivables	4,782,361.11
Subtotal	25,659,076.48
Less allowance for doubtful accounts	3,121,288.04
Total receivables	$22,537,788.44

Federal Perkins Loan Program funds at June 30, 2002, included the following:

Perkins loans receivable	$8,837,137.76
Less allowance for doubtful accounts	1,098,061.59
Total	$7,739,076.17

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$4,643,209.24	$18,000,000.00	$1,955.00	$ -	$22,645,164.24
Buildings	124,388,365.02	16,978,307.16	33,267,500.59	-	174,634,172.77
Land improvements and infrastructure	10,150,942.79	283,748.80	4,649,839.84	-	15,084,531.43
Equipment	24,748,032.27	1,709,004.77	-	1,867,461.70	24,589,575.34
Library holdings	16,525,605.63	1,377,706.29	-	1,700,967.90	16,202,344.02
Projects in progress	30,186,912.19	8,176,486.04	(37,919,295.43)	-	444,102.80
Total	210,643,067.14	46,525,253.06	-	3,568,429.60	253,599,890.60
Less accumulated depreciation:					
Buildings	64,990,776.81	4,239,420.51	-	-	69,230,197.32
Land improvements and infrastructure	3,879,033.39	730,650.13	-	-	4,609,683.52
Equipment	15,623,801.12	2,041,052.42	-	1,817,070.91	15,847,782.63
Library holdings	7,786,012.05	1,790,331.20	-	1,700,967.90	7,875,375.35
Total accum. depreciation	92,279,623.37	8,801,454.26	-	3,518,038.81	97,563,038.82
Capital assets, net	$118,363,443.77	$37,723,798.80	$ -	$ 50,390.79	$156,036,851.78

NOTE 7. CAPITAL LEASE

The university has entered into an Enhanced Use Lease Agreement with the United States Department of Veteran's Affairs for certain real property and buildings at the Veteran's Affairs Medical Center in Johnson City, Tennessee. The lease is for a period of 35 years. In lieu of lease payments, the university has assumed responsibility for all capital and recurring costs of maintaining the property covered by the agreement.

In conjunction with the lease, the university entered into a memorandum of agreement with the Department of Veteran's Affairs to construct a new building (the Basic Science Building) with joint funding from the State of Tennessee and the federal government. In accordance with the memorandum of agreement, the state provided

$18 million to the federal government for its share of the total construction costs ($34,195,153.41.) The Basic Science Building is included under the provisions of the Enhanced Use Lease Agreement.

The university's leasing of the Basic Science Building will constitute a capital lease agreement. The lease term is substantially equal to the estimated useful life of the leased property. Accordingly, the university has capitalized the cost of the building at $34,195,153.41.

NOTE 8. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Notes	$ -	$500,000.00	$ -	$500,000.00	$50,000.00
Loans	2,440,505.79	-	86,423.55	2,354,082.24	92,602.88
Bonds	14,479,920.30	12,896,828.35	998,092.18	26,378,656.47	1,283,641.36
Commercial paper	7,934,523.01	-	7,934,523.01	-	-
Subtotal	24,854,949.10	13,396,828.35	9,019,038.74	29,232,738.71	1,426,244.24
Other liabilities:					
Compensated absences	7,276,275.64	4,716,527.94	4,181,379.15	7,811,424.43	2,450,131.39
Total long-term liabilities	$32,131,224.74	$18,113,356.29	$13,200,417.89	$37,044,163.14	$3,876,375.63

Notes Payable

The Tennessee Board of Regents, on behalf of the university, borrowed funds for the renovation of the Memorial Athletic Medical Center. The note bears an annually adjusted interest rate equal to the average Local Government Investment Pool rate for the previous year, a face amount of $500,000, and a minimum annual debt service of $50,000 plus interest, with payments due annually to 2012. The balance owed by the university was $500,000 at June 30, 2002.

Debt service requirements to maturity for the note payable at June 30, 2002, are as follows:

Year Ending June 30	Principal	Interest	Total
2003	$50,000.00	$11,800.00	$61,800.00
2004	50,000.00	10,620.00	60,620.00
2005	50,000.00	9,440.00	59,440.00
2006	50,000.00	8,260.00	58,260.00
2007	50,000.00	7,080.00	57,080.00
2008 – 2012	250,000.00	17,700.00	267,700.00
	$500,000.00	$64,900.00	$564,900.00

Loans Payable

The Tennessee Board of Regents, on behalf of the university, borrowed funds for the construction of the East Tennessee State University Clinical Education Facility. The loan bears a simple interest rate of 7.15%, a face amount of $3,000,000, a minimum annual debt service of $260,919.73, and a due date of January 1, 2017. The balance owed by the university at June 30, 2002, was $2,354,082.24.

Debt service requirements to maturity for the loan payable at June 30, 2002, are as follows:

Year Ending June 30	Principal	Interest	Total
2003	$92,602.88	$168,316.88	$260,919.76
2004	99,223.94	161,695.78	260,919.72
2005	106,318.45	154,601.27	260,919.72
2006	113,920.22	146,999.50	260,919.72
2007	122,065.51	138,854.21	260,919.72
2008 - 2012	754,412.06	550,186.59	1,304,598.65
2013 - 2017	1,065,539.18	239,059.27	1,304,598.45
	$2,354,082.24	$1,559,713.50	$3,913,795.74

Bonds Payable

Bond issues, with interest rates ranging from 3.0% to 5.5% for Tennessee State School Bond Authority bonds, are due serially to 2032 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. The bonded indebtedness with the

Tennessee State School Bond Authority reported on the statement of net assets is shown net of assets held by the authority in the debt service reserve. The reserve amount was $77,148.75 at June 30, 2002.

Debt service requirements to maturity for bonds payable at June 30, 2002, are as follows:

Year Ending June 30	Principal	Interest	Total
2003	$1,283,641.36	$1,324,639.53	$2,608,280.89
2004	1,366,246.73	1,243,083.82	2,609,330.55
2005	1,383,217.12	1,180,144.25	2,563,361.37
2006	910,096.76	1,115,278.04	2,025,374.80
2007	899,261.85	1,073,561.87	1,972,823.72
2008-2012	4,725,255.00	4,718,919.03	9,444,174.03
2013-2017	4,404,957.86	3,571,461.73	7,976,419.59
2018-2022	4,621,544.75	2,472,461.59	7,094,006.34
2023-2027	3,258,375.88	1,384,460.31	4,642,836.19
2028-2032	3,526,059.16	574,977.58	4,101,036.74
	$26,378,656.47	$18,658,987.75	$45,037,644.22

NOTE 9. UNRESTRICTED NET ASSETS

Unrestricted net assets include funds that have been designated or reserved for specific purposes. These purposes include the following:

	Amount
Working capital	$6,174,147.73
Encumbrances	1,394,826.58
Designated fees	780,787.74
Auxiliaries	968,827.02
Quasi-endowment	6,514,492.80
Plant construction	3,477,996.12
Renewal and replacement of equipment	13,676,955.30
Debt retirement	1,054,021.80
Total	$34,042,055.09

NOTE 10. PENSION PLANS

A. Defined Benefit Plan

Tennessee Consolidated Retirement System

Plan Description - The university 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 university is required to contribute an actuarially determined rate. The current rate is 6.19% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2002, 2001, and 2000, were

$1,904,373.30, $1,817,069.99, and $1,552,601.32. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The university 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 university 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 university to the plans was $5,563,890.15 for the year ended June 30, 2002, and $5,291,894.45 for the year ended June 30, 2001. Contributions met the requirements for each year.

NOTE 11. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible university retirees. This benefit is provided and administered by the State of Tennessee. The university 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*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 12. CUMULATIVE EFFECTS OF CHANGES IN ACCOUNTING PRINCIPLE

During the year ended June 30, 2002, the university implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. As a result of this implementation, the university was required to make changes in certain accounting principles, specifically the (1) adoption of capitalization criteria of $100,000 and $50,000 for buildings and additions, respectively; (2) change in method of capitalizing library holdings; (3) adoption of depreciation on capital assets; (4) recording of certain summer semester revenues between fiscal years rather than in the fiscal year in which the semester was predominantly conducted; and (5) reclassification of the U.S. government grants refundable amount as a liability. The cumulative effects of these changes on net assets are shown below:

Adoption of capitalization criteria for buildings and additions	($4,571,227.64)
Change in method of capitalizing library holdings	($37,490,305.35)
Adoption of depreciation on capital assets	($92,279,623.37)
Deferred revenue recognition	$1,020,193.48
Reclassification of U.S. government grants refundable	($7,132,829.18)

NOTE 13. 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. In the past three fiscal years, the state has not had any claims filed with the commercial insurer. A designation for casualty losses in the amount of $6.356 million at June 30, 2002, was established in the state's general fund to provide for any property losses not covered by the commercial insurance.

At June 30, 2002, the scheduled coverage for the university was $430,010,700 for buildings and $104,047,100 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 university participates in the Claims Award Fund.

The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university'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 university 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 university 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 university 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 university 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.

The university also provides health insurance coverage for residents associated with the James H. Quillen College of Medicine with the risk retained by the university. At June 30, 2002, there were 245 participants.

The plan establishes claims liabilities 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. Participants have 90 days to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made.

As discussed above, the university establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years:

	2002	2001
Unpaid claims at beginning of year	$831,763.51	$988,474.92
Incurred claims, provision for insured events of the current year	1,029,444.76	833,097.10
Total incurred claims expenses	1,861,208.27	1,821,572.02
Payments	1,221,361.69	989,808.51
Total unpaid claims at end of year	$639,846.58	$831,763.51

NOTE 14. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university 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 $36,886,162.69 at June 30, 2002.

Operating Leases - The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $368,053.00 and for personal property were $125,317.06 for the year ended June 30, 2002. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2002, outstanding commitments under construction contracts totaled $485,510.72 for the Physical Activity Center and ADA Improvements project, of which $67,911.37 will be funded by future state capital outlay appropriations.

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

NOTE 15. AFFILIATED ENTITIES NOT INCLUDED

The university is the sole beneficiary of the Medical Education Assistance Corporation (MEAC) and the East Tennessee State University Foundation. These private, nonprofit corporations are controlled by boards independent of the university. The financial records, investments, and other financial transactions are not handled by the university, and these amounts are not included in the university's financial statements. As reported in MEAC's most recently audited financial report, at June 30, 2002, the corporation's assets totaled $13,487,842, liabilities were $3,642,920, and the fund balance amounted to $9,844,922. As reported in the foundation's most recently audited financial report, at June 30, 2002, the foundation's assets totaled $22,095,878, liabilities were $82,285, and the fund balance amounted to $22,013,593.

NOTE 16. CHAIRS OF EXCELLENCE

The university had $18,165,659.31 on deposit at June 30, 2002, with the State Treasurer for the university's Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

NOTE 17. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2002, are as follows:

Tennessee Board of Regents
East Tennessee State University
Notes to the Financial Statements (Cont.)
June 30, 2002

Functional Classification	Natural Classification Salaries	Benefits	Utilities, Supplies, and Other Services	Scholarships	Depreciation	Total
Instruction	$63,333,968.53	$14,005,395.94	$22,016,234.77	$1,272,067.16	$ -	$100,627,666.40
Research	6,358,735.60	1,682,395.94	3,934,616.19	61,746.45	-	12,037,494.18
Public service	5,603,335.00	1,348,286.98	3,323,368.20	71,453.05	-	10,346,443.23
Academic support	9,602,215.55	2,428,656.23	3,466,405.05	364,855.69	-	15,862,132.52
Student services	6,286,484.01	1,811,678.72	3,522,972.95	1,406,102.61	-	13,027,238.29
Institutional support	8,952,953.85	2,638,053.53	877,533.72	183,187.60	-	12,651,728.70
Operation & maint.	4,985,561.75	1,753,924.00	7,299,598.65	1,564.13	-	14,040,648.53
Scholar. & fellow.	2,667.00	12,081.04	327,181.70	6,399,030.49	-	6,740,960.23
Auxiliary	1,149,385.06	260,083.10	3,998,080.41	165,383.07	-	5,572,931.64
Depreciation	-	-	-	-	8,394,471.26	8,394,471.26
Total	$106,275,306.35	$25,940,555.48	$48,765,991.64	$9,925,390.25	$8,394,471.26	$199,301,714.98