Tennessee Board of Regents
The University of Memphis

For the Year Ended
June 30, 2004

Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Charles K. Bridges, CPA
Assistant Director

Debra D. Bloomingburg, CPA
Audit Manager

Patricia Wakefield, CPA, CFE
Jeff Lafever
In-Charge Auditors

Angela Courtney
LaToya Jones
Harry Lee, CFE
Helen Vose, CFE
Michael Wilbanks
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.
For more information about the Comptroller of the Treasury, please visit our Web site at
www.comptroller.state.tn.us.

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

John G. Morgan
Comptroller

February 15, 2005

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. Shirley Raines, President
The University of Memphis
Memphis, Tennessee 38152

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, The University of Memphis, for the year ended June 30, 2004. 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/th
04/102

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
The University of Memphis
For the Year Ended June 30, 2004

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 grant agreements; 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 Report
Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2004

TABLE OF CONTENTS

TABLE OF CONTENTS (CONT.)

Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2004

INTRODUCTION

POST-AUDIT AUTHORITY

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

In 1909, The General Assembly of Tennessee enacted a general educational law providing for the establishment and maintenance of three normal schools in the state, one of which was to be located in Memphis. On September 15, 1912, West Tennessee State Normal School opened and, in 1925, became a senior college. On July 1, 1957, the institution was designated Memphis State University, and on July 1, 1994, the name was changed to The University of Memphis.

The university is a fully accredited institution of higher education and comprises the Cecil Humphreys School of Law, the graduate school, and six undergraduate colleges: the College of Arts and Sciences, the Fogelman College of Business and Economics, the College of Education, the Herff College of Engineering, the College of Communication and Fine Arts, and University College.

ORGANIZATION

The governance of The University of Memphis 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, 2003, through June 30, 2004, 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, 2004, and for comparative purposes, the year ended June 30, 2003. The University of Memphis 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 opinions on the financial statements;

2. to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements;

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

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99 promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, and not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We also obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

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, 2004, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions 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 Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

November 4, 2004

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 University of Memphis, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit, as of and for the year ended June 30, 2004, and have issued our report thereon dated November 4, 2004. We did not audit the financial statements of The University of Memphis Foundation, a discretely presented component unit of the university. Those financial statements were audited by other auditors whose report thereon has been furnished to us. 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. The financial statements of the University of Memphis Foundation were not audited in compliance with *Government Auditing Standards.* During the year ended June 30, 2004, the university implemented GASB Statement 39, *Determining Whether Certain Organizations Are Component Units.*

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 an opinion 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 reportable 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 caused by error or fraud 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.

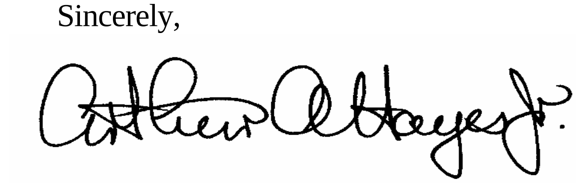
Compliance and Other Matters

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 grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain instances of noncompliance, 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/th

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 4, 2004

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

Dear Mr. Morgan:

We have audited the accompanying basic financial statements of The University of Memphis, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the years ended June 30, 2004, and June 30, 2003, as listed in the table of contents. These financial statements are the responsibility of the university's management. Our responsibility is to express opinions on these financial statements, based on our audits. We did not audit the financial statements of The University of Memphis Foundation, a discretely presented component unit of the university. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for The University of Memphis Foundation, is based on the report of the other auditors.

We conducted our audits 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. The financial statements of The University of Memphis Foundation were not audited in compliance with *Government Auditing Standards.* 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 audits and the report of other auditors provide a reasonable basis for our opinions. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of many agencies, commissions, and component units of the State of Tennessee; managing the state's debt; and making loans to the state's colleges and universities from debt proceeds. Some of the boards of which the Comptroller of the Treasury serves as a member per state statutes include State Building Commission and Tennessee Higher Education Commission.

The Honorable John G. Morgan
November 4, 2004
Page Two

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tennessee Board of Regents, The University of Memphis, and its discretely presented component unit as of June 30, 2004, and June 30, 2003, and the respective changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

During the year ended June 30, 2004, the university implemented GASB Statement 39, *Determining Whether Certain Organizations Are Component Units.*

The management's discussion and analysis on pages 9 through 23 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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.

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying financial information on page 47 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 4, 2004, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* 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/th

Management's Discussion and Analysis

This section of The University of Memphis's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2004, with comparative information presented for the fiscal years ended June 30, 2003, and 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 the financial statements and notes. The financial statements, notes, and this discussion are the responsibility of management.

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 The University of Memphis 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. One notable exception is capital assets, which 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. Unrestricted net assets are available to the institution for any lawful purpose of the institution.

Statement of Net Assets - The University

(in thousands of dollars)

	2004	2003	2002
Assets:			
Current assets	$ 65,151	$ 79,117	$ 81,164
Capital assets, net	218,662	217,053	170,126
Other assets	49,287	42,114	44,619
Total assets	333,100	338,284	295,909

Liabilities:			
Current liabilities	38,409	39,765	40,677
Noncurrent liabilities	56,870	59,953	60,124
Total liabilities	95,279	99,718	100,801
Net assets:			
Invested in capital assets, net of related debt	165,549	161,245	113,104
Restricted - nonexpendable	3,319	4,125	4,159
Restricted - expendable	19,276	26,056	30,008
Unrestricted	49,677	47,140	47,837
Total net assets	$ 237,821	$ 238,566	$ 195,108

- For 2004, total assets experienced no significant change. The decrease in current assets was primarily a result of the change in current cash and cash equivalents from $29.2 million to $17.0 million. The increase in other assets related to a corresponding increase in noncurrent cash and cash equivalents, which was offset by decreases in investments of $2 million and accounts receivable of $1 million.

- Capital assets, net of accumulated depreciation, and invested in capital assets, net of related debt, increased in 2003 due to the following:

  - A federal grant of $29 million that deeded land, buildings, and improvements in Millington, Tennessee, to the University.

  - Increases in construction in progress including the following major projects: FedEx Institute of Technology building - $13.6 million; Athletic Training Center Modifications and Renovations - $3.3 million; and Wilder Tower Renovations - $1.9 million.

- The shift within total net assets from restricted – expendable to invested in capital assets, net of related debt, in 2004 was a result of the completion of the FedEx Institute of Technology.

- In 2004, restricted – nonexpendable net assets had a decrease due to the transfer of the Intercollegiate Athletic Endowment Fund to restricted current funds to be used for athletic scholarship expenditures in accordance with the endowment agreement.

- Restricted – expendable net assets decreased in 2003 due to the following:

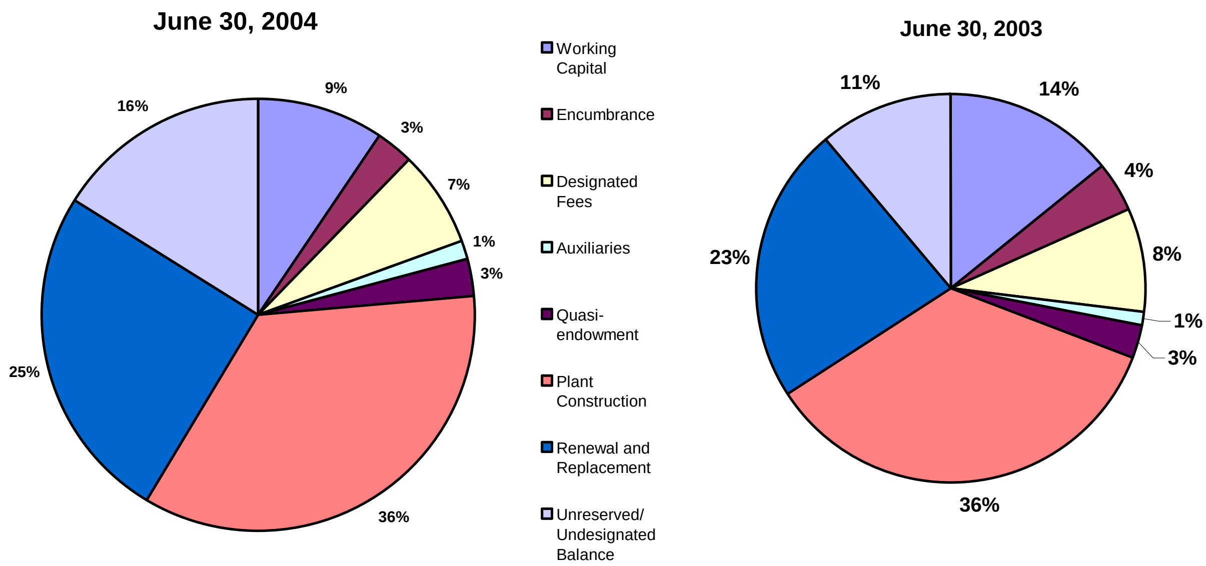
  - Decrease in capital project balances of $3.2 million.

  - Decrease in loan balances of $2.6 million due to prior year reclassification of federal loan balances from net assets to noncurrent liabilities – due to grantors.

- Undesignated net assets increased approximately $2 million while working capital decreased by the same amount. The decrease in accounts receivable was the result of the university's implementation of new policies to reduce outstanding student accounts.

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, capital projects, and student loans. The following graphic representation shows the allocations.

Allocation of Unrestricted Net Assets
The University of Memphis



Statement of Net Assets - The Foundation

(in thousands of dollars)

	2004	2003	2002
Assets:			
Current assets	$ 7,842	$ 17,493	$ 11,877
Other assets	58,338	40,465	44,252
Total assets	66,180	57,958	56,129
Liabilities:			
Current liabilities	2,500	1,580	1,322

Noncurrent liabilities	385	358	320
Total liabilities	2,885	1,938	1,642
Net assets:			
Restricted - nonexpendable	34,563	32,226	29,868
Restricted - expendable	27,196	22,403	22,744
Unrestricted	1,536	1,391	1,875
Total net assets	$ 63,295	$ 56,020	$ 54,487

Assets

- The change in the distribution of assets between current assets and other assets from 2002 to 2003 was due primarily to the sale of investments before the end of the fiscal year. A large amount of cash and cash equivalents was on hand at year end 2003 which was used to purchase investments in fiscal year 2004. In 2004, more of the cash and cash equivalents were invested in long-term securities resulting in the decrease in current assets and the increase in other assets. The change in total assets from 2003 to 2004 was a combination of additional investments in total and the increase in market value of the investments.

Liabilities

- Current liabilities increased in 2004 because of a $1 million increase in the amount due to the university at fiscal year end.

- Noncurrent liabilities increased both fiscal years due to increases to the revolving loan fund, CIOS.

Net assets

- The overall decrease in restricted expendable net assets from 2002 to 2003 was the result of a net loss on investments. These net assets increased in 2004 due to a $6.2 million increase in restricted revenue.

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, as well as 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 - The University
(in thousands of dollars)

	2004	2003	2002
Operating revenues:			
Net tuition and fees	$ 83,829	$ 77,606	$ 64,194
Grants and contracts	35,514	47,201	46,172
Auxiliary	13,384	12,489	13,103
Other	18,669	14,443	18,312
Total operating revenues	151,396	151,739	141,781
Operating expenses	(290,182)	(280,902)	(253,939)
Operating loss	(138,786)	(129,163)	(112,158)
Nonoperating revenues and expenses:			
State appropriations	104,505	106,141	103,717
Gifts	12,665	15,445	11,924
Grants and contracts	16,492	251	-
Investment income	2,343	3,675	4,623
Other revenues and expenses	(2,004)	(258)	(1,952)
Total nonoperating revenues and expenses	134,001	125,254	118,312
Income (loss) before other revenues, expenses, gains or losses	(4,785)	(3,909)	6,154
Other revenues, expenses, gains, or losses:			
Capital appropriations	4,091	18,675	14,414
Capital grants and gifts	-	29,011	-
Other	(51)	(319)	(8,644)
Total other revenues, expenses, gains, or losses	4,040	47,367	5,770
Increase (decrease) in net assets	(745)	43,458	11,924
Net assets at beginning of year, as originally reported	238,566	195,108	360,676
Cumulative effect of changes in accounting principle	-	-	(177,492)
Net asset at beginning of year, restated	238,566	195,108	183,184
Net assets at end of year	$ 237,821	$ 238,566	$ 195,108

- Total operating revenues
  - The increases in student tuition and fees, net of scholarship allowances, are attributable to a 12% increase in tuition in fiscal year 2004 and a 7.5% tuition increase in 2003. Also, in 2003, a prior period adjustment understated 2002 revenue by $4.6 million (and overstated deferred revenue by the same amount).
  - The decrease in grants and contracts in 2004 was a result of the reclassification of Pell and FSEOG from operating to nonoperating revenue.

- In 2004, other operating revenues increased due to athletics revenue increases.

- For 2003, a decrease in revenues from sales and services of educational activities and a corresponding increase in gifts are attributable to a prior-year reclassification error resulting in an overstatement of fiscal year 2002 sales and services of educational activities of $3.6 million and an understatement of fiscal year 2002 gifts by the same amount.

- State appropriations were relatively unchanged for all three years.

- Total nonoperating revenues and expenses:

  - Nonoperating gifts decreased. There were vacancies in several key fund-raising positions.

  - The reclassification of Pell and FSEOG to nonoperating from operating revenue resulted in the increase in other revenues and expenses.

- Total other revenues, expenses, gains, or losses

  - A reduction of $14.5 million in state capital appropriations occurred during the current year.

  - Capital grants and gifts for 2003 included a one-time $29 million federal grant in land and buildings in Millington, Tennessee.

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

	2004	2003	2002
Operating revenues and expenses			
Gifts and contributions	$ 5,381	$ 4,558	$ 988
Operating expenses	(8,239)	(7,881)	(12,950)
Operating loss	(2,858)	(3,323)	(11,962)
Nonoperating revenues and expenses:			
Investment income (loss)	7,858	97	(5,379)
Income (loss) before other revenues, expenses, gains or losses	5,000	(3,226)	(17,341)
Other revenues, expenses, gains, or losses:	2,275	4,759	4,952
Increase (decrease) in net assets	7,275	1,533	(12,389)
Net assets at beginning of year	56,020	54,487	66,876
Net assets at end of year	$ 63,295	$ 56,020	$ 54,487

Gifts and contributions

- The increase in gifts in 2003 was the result of a $3.0 million grant from Methodist-LeBonheur Healthcare System. In 2004, a $1 million grant from the U.S. Department of Education was received for the Benjamin Hooks Institute.

Operating expenses

- Operating expenses decreased in 2003 by $5 million. There was a $5.5 million decrease in general university support. In 2002, expenditures for the construction of the FedEx Institute of Technology amounted to $5.7 million, a one-time specific contribution. The increase in operating expenses in 2004 was due to an increase in university support and expenditures for furniture and fixtures for the FedEx Institute of Technology.

Investment income

- In fiscal year 2002, there were large losses in investment income as a result of the plunge in stock values. In 2003, stock prices stabilized, and the foundation sold an appreciable amount of stock which was reinvested in 2004.

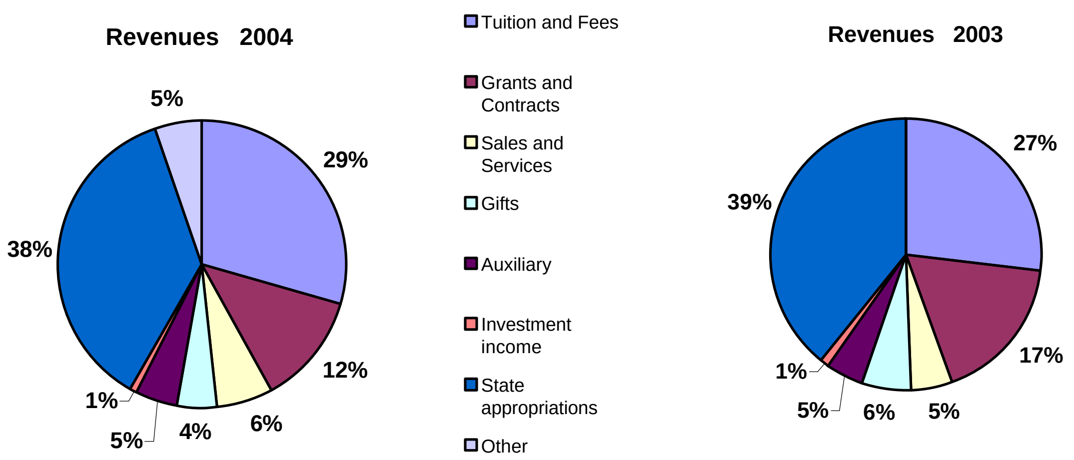
Other revenues, expenses, gains, or losses

- In 2004, contributions to permanently endowed funds decreased.

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which are used to fund the university's operating activities for the years ended June 30, 2004, and June 30, 2003.

The University of Memphis



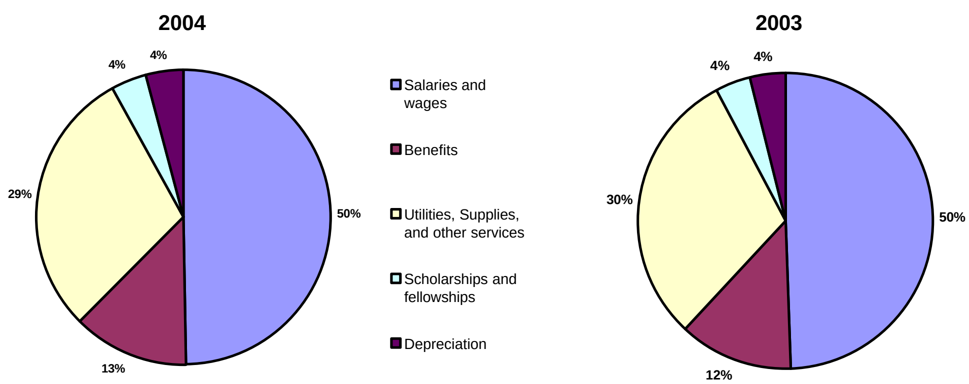
Expenses

Operating expenses can be displayed in two formats, natural classification and program classification. Both formats are displayed below.

Natural Classification - The University
(in thousands of dollars)

	2004	2003	2002
Operating expenses:			
Salaries and wages	$ 144,567	$ 139,019	$ 134,814
Benefits	36,864	34,445	30,383
Utilities, supplies, and other services	85,641	84,998	70,081
Scholarships and fellowships	11,372	11,033	7,836
Depreciation	11,738	11,407	9,825
Total operating expenses	$ 290,182	$ 280,902	$ 253,939

Expenses by Natural Classification
The University of Memphis



There were no significant changes in expenses by natural classification for 2004.

- Salaries and wages increased in 2003 as noted below:
  - A mid-year average faculty salary increase of 5% and staff increase of 2%.
  - Benefits increase of 13%, from increased salaries and health insurance costs.
- Utilities, supplies, and other services increased from the prior year as follows:

- Deferred plant maintenance projects increased from the prior year – Fume Hood Upgrades - $3 million; various plant deferred maintenance - $3 million.
- Utilities and fuel costs increased $.6 million from the prior year.
- $3 million increase in student laboratory computer and noncapital acquisitions.

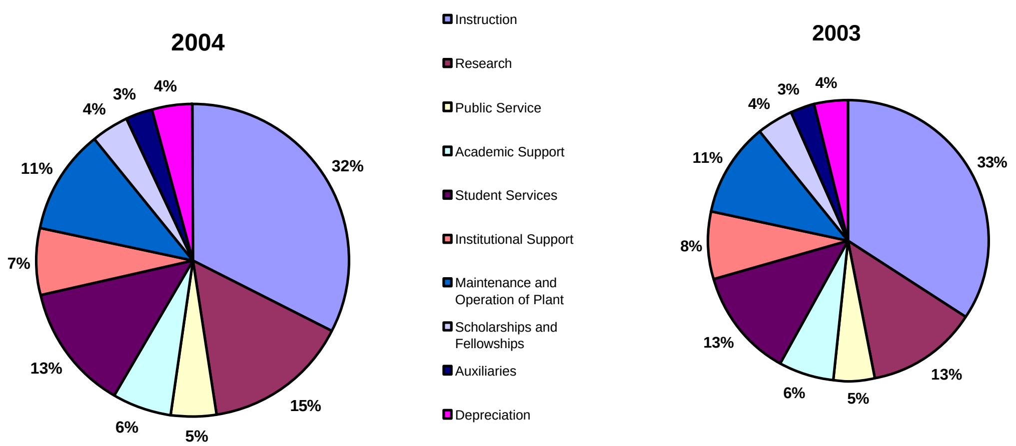
- Scholarships and fellowships increased with the 7.5% increase in fees in addition to a $1.4 million increase in restricted scholarships.

Program Classification - The University
(in thousands of dollars)

	2004	2003	2002
Operating expenses:			
Instruction	$ 91,087	$ 96,144	$ 94,988
Research	42,560	35,162	27,730
Public service	13,475	13,980	11,934
Academic support	23,804	17,397	15,150
Student services	37,343	36,469	38,143
Institutional support	19,747	20,843	17,181
Maintenance and operation of plant	30,922	30,509	22,632
Scholarships and fellowships	11,372	11,033	7,836
Auxiliaries	8,134	7,958	8,520
Depreciation	11,738	11,407	9,825
Total operating expenses	$ 290,182	$ 280,902	$ 253,939

Expenses by Program Classification

The University of Memphis



- The university administration has focused increased attention on research in keeping with its stated mission. The faculty is now expected to spend more time dedicated to research endeavors. Consequently, research expenditures are continuing to increase.

- In 2003, academic support expenditures increased from the prior year primarily due to the new FedEx Institute of Technology Academic Learning Center and a reclassification of nursing dean activities out of instruction.

- Institution support expenditures increased due to the timing of filling vacant positions. Additionally, network services expenditures increased as the university expanded wireless capabilities, and a new student ID system was acquired towards the end of 2003.

- In 2003, increases in deferred maintenance costs and utilities were responsible for the increase in maintenance and operation of plant from the prior year.

Natural Classification - The Foundation
(in thousands of dollars)

	2004	2003	2002
Operating expenses:			
Utilities, supplies, and other services	$ 1,504	$ 2,416	$ 242
Payment to or on behalf of the university	6,735	5,465	12,708
Total operating expenses	$ 8,239	$ 7,881	$ 12,950

- The large part of the change in other services from 2002 to 2003 was a bad debt expense increase of $1.6 million.

- The large expenditures to the university in 2002 were for the construction of the FedEx Institute of Technology. In 2004, payments to the university included expenses relating to furniture and fixtures for the FedEx Institute of Technology.

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 – The University

(in thousands of dollars)

	2004	2003	2002
Cash provided (used) by:			
Operating activities	$ (127,167)	$ (113,938)	$ (98,890)
Noncapital financing activities	136,082	123,358	116,598
Capital and related financing activities	(15,983)	(15,523)	(12,547)
Investing activities	5,143	3,720	9,850
Net increase (decrease) in cash	(1,925)	(2,383)	15,011
Cash, beginning of year	48,925	51,308	36,297
Cash, end of year	$ 47,000	$ 48,925	$ 51,308

- Cash flows from operating activities – 2004
    - There was a 14% increase in tuition, resulting in an additional $5.8 million to the university.
    - The reclassification of Pell and FSEOG to nonoperating resulted in a decrease in cash for operating activities in the amount of $16 million.
- Cash flows from operating activities – 2003
    - Increases in cash flow from the 7.5% tuition increase for fiscal year 2003 were used to fund increases in payments for employee salaries and benefits.
    - Payments to vendors and suppliers increased $10 million from the prior year, caused by increased deferred maintenance and renewal and replacement projects and increased student laboratory and noncapital acquisitions.
    - Payments for scholarships and fellowships increased from the prior year due to the tuition increase and an increase in restricted federal programs.
- Noncapital financing activities – 2004
    - Pell and FSEOG reclassification accounted for the largest part of the increase - $16 million.
- Noncapital financing activities – 2003

- There were increased gifts ($2.5 million) and increased state appropriations ($2.7 million).

- Capital and related financing activities –2004

  - The decrease is primarily attributable to the decrease in proceeds from capital debt.

- Investing activities – 2004

  - Reductions in the holding periods of investments resulted in increases in the proceeds from sales and maturities of investments net of purchases.

- Investing activities – 2003

  - Cash provided from investing activities decreased from the prior year with decreased earnings on investments and an increased volume in investment purchases due to investment maturities.

- There was a small decrease in liquidity in both 2004 and 2003 from the prior year.

Statement of Cash Flows - The Foundation

(in thousands of dollars)

	2004	2003	2002
Cash provided (used) by:			
Operating activities	$ (2,003)	$ (2,050)	$ (8,407)
Noncapital financing activities	2,275	4,759	4,640
Capital and related financing activities	35	43	-
Investing activities	(9,280)	3,536	6,822
Net increase (decrease) in cash	(8,973)	6,288	3,055
Cash, beginning of year	14,598	8,310	5,255
Cash, end of year	$ 5,625	$ 14,598	$ 8,310

- Cash flows from operating activities

  - Expenditures of $5.7 million in 2002 for the construction of the FedEx Institute of Technology resulted in large uses of cash. In 2004, the foundation paid $740,000 for furniture, fixtures, and equipment for the FedEx Institute of Technology.

- Noncapital financing activities
  - The decrease in cash flow from the prior year was a direct result of the decrease by $2.4 million in private gifts for endowment purposes.
- Investing activities
  - There was a substantial decrease in cash provided by investing activities in fiscal year 2004 due to an increase in purchases of investments.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2004, the university had $218.7 million invested in capital assets, net of accumulated depreciation of $136.7 million. Depreciation charges totaled $11.7 million for the current fiscal year. Details of these assets are shown below.

Schedule of Capital Assets, Net of Depreciation - The University

(in thousands of dollars)

	2004	2003	2002
Land	$ 15,715	$ 15,298	$ 14,286
Land improvements and infrastructure	3,287	3,653	3,805
Buildings	144,346	130,000	100,058
Equipment	11,156	11,773	11,417
Library holdings	14,752	14,126	13,696
Projects in progress	29,406	42,203	26,864
Total	$ 218,662	$ 217,053	$ 170,126

- The increase in buildings in the current year was a result of the completion of the FedEx Institute of Technology at $19.3 million. In 2003, the university received $29 million in land and buildings in Millington, Tennessee, as a federal grant.
- Increases in projects in progress in 2003 include:
  - FedEx Institute of Technology building - $13.6 million. Sources of funds include private and local city and county gifts and state appropriations.
  - Athletic Training Center Modifications - $3.4 million. Private gifts are the primary source of funds.

- Wilder Tower Renovations - $1.9 million. The source of funding is state appropriations.

Capital projects planned for fiscal year 2005 include $3 million for drainage improvements funded from state appropriations, $1 million for parking lot expansion funded from auxiliary renewal and replacement funds, and $3 million for deferred maintenance projects funded from general unrestricted funds. More detailed information about the university's capital assets is presented in Note 6 to the financial statements.

Debt

At June 30, 2004, the university had $53.1 million in debt outstanding. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt - The University

(in thousands of dollars)

		2004		2003		2002
Bonds payable	$	51,668	$	54,445	$	57,023
Commercial paper		1,444		1,363		-
Total	$	53,112	$	55,808	$	57,023

New short-term debt of $1.3 million was issued during 2003 for the Athletic Training Center renovation. This debt is to be paid from future gifts pledged to The University of Memphis Foundation.

Debt repayments of $2.8 million were made during 2004 and 2003. More detailed information about the university's long-term liabilities is presented in Note 7 to the financial statements.

Fitch, Moody's Investors Service, and Standard & Poor's have rated the Tennessee State School Bond Authority bonds AA, Aa3, and AA-, respectively.

Economic Factors That Will Affect the Future

State funding for the university for 2005 was decreased $1 million. The university implemented various cost-saving initiatives along with a 6% increase in student fees for 2005 to offset the loss of state appropriations. Recent increases in student fees have not significantly impacted enrollment, with enrollment steady for the past 10 years. Tennessee implemented the Education Lottery Scholarship program to begin in the fall of 2004. The impact on enrollment is unknown.

Requests for Information

This financial report is designed to provide a general overview of the institution's finances for all those with an interest in the university's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to David Zettergren, Assistant Vice President for Finance; Administration Building, Room 276; Memphis, TN 38152-3370.

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF NET ASSETS
JUNE 30, 2004, AND JUNE 30, 2003

	Institution		Component Unit	
	June 30, 2004	June 30, 2003	June 30, 2004	June 30, 2003
ASSETS				
Current assets:				
Cash and cash equivalents (Notes 2, 3, and 17)	$ 17,036,560.20	$ 29,165,999.86	$ 5,624,885.00	$ 14,597,798.00
Short-term investments (Note 4)	23,941,327.77	24,210,662.92	-	-
Accounts, notes, and grants receivable (net) (Note 5)	22,856,418.86	24,152,368.46	-	-
Pledges receivable (net) (Note 17)	-	-	2,191,490.00	2,852,452.00
Inventories (at lower of cost or market)	422,516.31	451,529.30	-	-
Prepaid expenses and deferred charges	445,403.47	632,275.11	9,878.00	14,569.00
Accrued interest receivable	448,990.79	504,443.11	15,236.00	17,137.00
Other assets	-	-	-	10,566.00
Total current assets	65,151,217.40	79,117,278.76	7,841,489.00	17,492,522.00
Noncurrent assets:				
Cash and cash equivalents (Notes 2 and 3)	29,963,955.53	19,758,884.99	-	-
Investments (Notes 4 and 17)	9,327,772.87	11,354,548.50	54,899,135.00	37,766,519.00
Accounts, notes, and grants receivable (net) (Note 5)	9,995,114.67	11,000,280.62	-	-
Pledges receivable (net) (Note 17)	-	-	3,361,263.00	2,627,216.00
Capital assets (net) (Note 6)	218,661,581.32	217,053,458.74	-	-
Other assets	-	-	77,901.00	71,284.00
Total noncurrent assets	267,948,424.39	259,167,172.85	58,338,299.00	40,465,019.00
Total assets	333,099,641.79	338,284,451.61	66,179,788.00	57,957,541.00
LIABILITIES				
Current liabilities:				
Accounts payable	6,582,555.37	9,966,651.46	2,424,633.00	1,399,212.00
Accrued liabilities	15,265,120.31	14,266,209.06	37,883.00	132,477.00
Student deposits	564,425.99	562,738.14	-	-
Deferred revenue	9,290,136.09	8,906,739.13	37,500.00	37,500.00
Compensated absences (Note 7)	1,657,714.88	1,847,080.21	-	-
Accrued interest payable	488,067.89	516,088.74	-	-
Long-term liabilities, current portion (Note 7)	4,169,793.47	3,216,409.90	-	-
Deposits held in custody for others	391,032.72	423,195.60	-	-
Other liabilities	-	59,910.36	-	10,566.00
Total current liabilities	38,408,846.72	39,765,022.60	2,500,016.00	1,579,755.00
Noncurrent liabilities:				
Note payable (Note 17)	-	-	225,000.00	190,000.00
Compensated absences (Note 7)	5,238,676.64	4,850,362.83	-	-
Long-term liabilities (Note 7)	48,942,295.33	52,591,980.39	-	-
Due to grantors (Note 7)	2,689,000.83	2,511,158.12	-	-
Other liabilities	-	-	160,065.00	167,735.00
Total noncurrent liabilities	56,869,972.80	59,953,501.34	385,065.00	357,735.00
Total liabilities	95,278,819.52	99,718,523.94	2,885,081.00	1,937,490.00
NET ASSETS				
Invested in capital assets, net of related debt	165,549,492.52	161,245,068.45	-	-
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	2,185,417.51	2,927,282.80	-	-
Other	1,133,339.10	1,198,180.81	34,563,328.00	32,225,720.00
Expendable:				
Scholarships and fellowships	1,603,128.54	1,824,986.40	-	-
Research	1,412,782.53	1,658,332.41	-	-
Instructional department uses	2,114,339.70	2,132,208.23	-	-
Loans	2,840,713.37	2,644,154.69	-	-
Capital projects	1,669,266.06	16,482,322.91	-	-
Debt service	8,578,563.36	205,874.11	-	-
Other	1,056,784.69	1,107,695.74	27,196,278.00	22,403,264.00
Unrestricted (Note 8)	49,676,994.89	47,139,821.12	1,535,101.00	1,391,067.00
Total net assets	$ 237,820,822.27	$ 238,565,927.67	$ 63,294,707.00	$ 56,020,051.00

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

Exhibit B

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2004, AND JUNE 30, 2003

	Institution		Component Unit	
	Year Ended June 30, 2004	Year Ended June 30, 2003	Year Ended June 30, 2004	Year Ended June 30, 2003
REVENUES				
Operating revenues:				
Student tuition and fees (net of scholarship allowances of $11,988,831.00 for the year ended June 30, 2004, and $10,432,780.00 for the year ended June 30, 2003)	$ 83,828,648.78	$ 77,606,295.17	$ -	$ -
Gifts and contributions	-	-	5,381,075.00	4,558,035.00
Governmental grants and contracts	30,859,976.63	36,083,614.89	-	-
Nongovernmental grants and contracts	4,654,987.48	11,117,112.63	-	-
Sales and services of educational departments	18,354,317.29	14,103,245.53	-	-
Auxiliary enterprises:				
Residential life (net of scholarship allowances of $88,616.00 for the year ended June 30, 2004, and $76,697.00 for the year ended June 30, 2003)	7,972,053.37	7,407,532.12	-	-
Bookstore	1,279,357.23	570,832.97	-	-
Food service	288,784.76	275,000.00	-	-
Other auxiliaries	3,843,403.78	4,235,503.53	-	-
Interest earned on loans to students	315,077.19	339,574.85	-	-
Total operating revenues	151,396,606.51	151,738,711.69	5,381,075.00	4,558,035.00
EXPENSES				
Operating expenses:				
Salaries and wages	144,566,864.96	139,019,548.73	-	-
Benefits	36,864,312.87	34,444,837.47	-	-
Utilities, supplies, and other services	85,640,829.08	84,998,624.44	1,504,162.00	2,415,808.00
Scholarships and fellowships	11,371,897.55	11,032,400.54	-	-
Depreciation expense	11,738,268.57	11,406,685.86	-	-
Payments to or on behalf of the university	-	-	6,734,897.00	5,465,055.00
Total operating expenses	290,182,173.03	280,902,097.04	8,239,059.00	7,880,863.00
Operating loss	(138,785,566.52)	(129,163,385.35)	(2,857,984.00)	(3,322,828.00)
NONOPERATING REVENUES (EXPENSES)				
State appropriations	104,505,200.00	106,141,400.00	-	-
Gifts	12,664,829.42	15,445,235.80	-	-
Grants and contracts	16,491,902.75	251,224.37	-	-
Investment income (net of investment expense for the institution of $25,543.07 ended June 30, 2004, and $35,788.64 for the year ended June 30, 2003; and for the component unit of $188,284 for the year ended June 30, 2004, and $147,752.09 for the year ended June 30, 2003)	2,342,864.34	3,674,864.65	7,857,442.00	96,467.00
Interest on capital asset-related debt	(3,019,868.78)	(3,285,105.27)	-	-
Other nonoperating revenues (expenses)	1,015,827.81	3,026,391.60	-	-
Net nonoperating revenues	134,000,755.54	125,254,011.15	7,857,442.00	96,467.00
Gain (loss) before other revenues, expenses, gains, or losses	(4,784,810.98)	(3,909,374.20)	4,999,458.00	(3,226,361.00)
Capital appropriations	4,091,362.95	18,675,168.09	-	-
Capital grants and gifts	-	29,011,572.00	-	-
Additions to permanent endowments	-	-	2,275,198.00	4,759,441.00
Other	(51,657.37)	(319,411.83)	-	-
Total other revenues	4,039,705.58	47,367,328.26	2,275,198.00	4,759,441.00
Increase (decrease) in net assets	(745,105.40)	43,457,954.06	7,274,656.00	1,533,080.00
NET ASSETS				
Net assets - beginning of year	238,565,927.67	195,107,973.61	56,020,051.00	54,486,971.00
Net assets - end of year	$ 237,820,822.27	$ 238,565,927.67	$ 63,294,707.00	$ 56,020,051.00

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

Exhibit C

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2004, AND JUNE 30, 2003

	FY 2004	FY 2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 82,452,162.92	$ 77,194,424.48
Grants and contracts	35,569,474.45	47,466,840.27
Sales and services of educational activities	18,382,283.84	13,478,803.96
Payments to suppliers and vendors	(85,828,178.47)	(83,726,607.73)
Payments to employees	(143,639,283.50)	(138,694,666.11)
Payment for benefits	(36,300,498.73)	(34,032,092.31)
Payments for scholarships and fellowships	(11,371,897.55)	(11,032,400.54)
Loans issued to students and employees	(1,412,380.23)	(2,344,271.97)
Collection of loans from students and employees	1,731,336.98	3,798,377.28
Residence halls	7,856,977.44	7,484,012.86
Bookstore	1,279,357.23	570,832.97
Food services	273,940.15	272,253.25
Other auxiliaries	3,840,136.55	4,280,393.20
Other receipts (payments)	-	1,345,836.06
Net cash flows provided (used) by operating activities	(127,166,568.92)	(113,938,264.33)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
State appropriations	104,459,300.00	106,906,100.00
Gifts and grants received for other than capital or endowment purposes (including $5,709,476.00 from The University of Memphis Foundation for the year ended June 30, 2004, and $5,349,430.00 for the year ended June 30, 2003)	30,548,729.53	13,434,758.46
Private gifts for endowment purposes	7,525.00	-
Federal student loan receipts	69,098,687.00	57,131,166.32
Federal student loan disbursements	(69,098,687.00)	(57,131,166.32)
Changes in deposits held for others	(32,162.88)	(5,803.66)
Other non-capital financing receipts (payments)	1,098,433.95	3,023,249.24
Net cash flows provided (used) by non-capital financing activities	136,081,825.60	123,358,304.04
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	126,908.42	1,645,699.79
Capital - state appropriations	4,091,362.95	18,675,168.09
Capital grants and gifts received	-	29,011,572.00
Proceeds from sale of capital assets	38,000.00	2,660.00
Purchase of capital assets and construction	(14,368,246.75)	(58,655,868.59)
Principal paid on capital debt and lease	(2,823,209.91)	(2,859,879.76)
Interest paid on capital debt and lease	(3,047,889.63)	(3,342,033.04)
Net cash flows provided (used) by capital and related financing activities	(15,983,074.92)	(15,522,681.51)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	39,336,377.13	3,533,796.84
Income on investments	2,847,338.34	3,461,636.04
Purchase of investments	(37,040,266.35)	(3,275,698.50)
Net cash provided (used) by investing activities	5,143,449.12	3,719,734.38
Net increase (decrease) in cash and cash equivalents	(1,924,369.12)	(2,382,907.42)
Cash and cash equivalents - beginning of year	48,924,884.85	51,307,792.27
Cash and cash equivalents - end of year (Note 2)	$ 47,000,515.73	$ 48,924,884.85

Exhibit C (Cont.)

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2004, AND JUNE 30, 2003

	Institution	
	FY 2004	FY 2003
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income (loss)	$ (138,785,566.52)	$ (129,163,385.35)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:		
Depreciation expense	11,738,268.57	11,406,685.86
Gifts in-kind	-	1,674,506.32
Change in assets and liabilities		
Receivables, net	497,567.05	1,172,589.38
Inventories	29,012.99	22,137.34
Prepaid/deferred items	186,871.64	(444,539.10)
Other assets	17,939.32	1,137,030.77
Accounts payable	(2,433,606.51)	2,840,573.25
Accrued liabilities	998,911.25	(286,263.18)
Deferred revenues	383,396.96	1,830,890.15
Deposits	1,687.85	28,314.71
Compensated absences	198,948.48	412,745.16
Due to grantor	-	85,470.04
Loans to students and employees	-	(689,672.77)
Prior audit adjustment	-	(4,033,871.27)
Other liabilities	-	68,524.36
Net cash provided (used) by operating activities	$ (127,166,568.92)	$ (113,938,264.33)

Non-cash transactions		
Gifts in-kind	$ 258,795.15	$ 1,674,506.32
Unrealized gain/losses on investments	$ 105,699.83	$ 148,964.12
Loss on disposal of capital assets	$ 51,657.37	$ -

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

Tennessee Board of Regents
The University of Memphis
Notes to the Financial Statements
June 30, 2004, and June 30, 2003

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* and in May 2002 by GASB Statement 39, *Determining Whether Certain Organizations Are Component Units.* The financial statement presentation required by those statements provides a comprehensive, entity-wide perspective of the university's, including component units, assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows.

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) federal, state, local, and private grants and contracts; (3) sales and services of auxiliary enterprises; and (4) 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) gifts.

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

Inventories

Inventories are valued at the lower of cost or market. All other 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, and $50,000 is used for infrastructure. Equipment is capitalized when the unit acquisition cost is $5,000 or greater. The capitalization threshold for additions and improvements to buildings and land is set at $50,000.

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:

Invested in capital assets, net of related debt – 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.

Nonexpendable restricted net assets – 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.

Expendable restricted net assets – 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.

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.

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, 2004, cash and cash equivalents consisted of $7,737,597.60 in bank accounts, $75,065.00 of petty cash on hand, $33,548,708.85 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, $3,640,433.17 in LGIP deposits for capital projects, and $1,998,711.11 in commercial paper. At June 30, 2003, cash and cash equivalents consisted of $6,680,139.26 in bank accounts, $74,010.00 of petty cash on hand, $35,296,059.01 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $6,874,676.58 in LGIP deposits for capital projects.

LGIP deposits for 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.

NOTE 3. DEPOSITS

Some of the university's deposits are in financial institutions that 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.

At June 30, 2004, the carrying amount of the university's deposits in financial institutions participating in the collateral pool was $7,737,597.60, and the bank balance including accrued interest was $12,031,541.36. The bank balance was insured. At June 30, 2003, the carrying amount of the university's deposits in financial institutions participating in the collateral pool was $6,680,139.26, and the bank balance including accrued interest was $9,220,126.38. The bank balance was 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.

Deposits with financial institutions are required to be categorized to indicate the level of risk assumed by the university. Category 1 consists of deposits that are insured or collateralized with securities held by the university or by its agent in the university's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the university's name. Category 3 deposits are uncollateralized. This category includes any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the university's name.

At June 30, 2004, the carrying amount of the university's deposits was $7,937,597.60, and the bank balance including accrued interest was $12,238,129.16. The entire bank balance of $12,238,129.16 was category 1.

At June 30, 2003, the carrying amount of the university's deposits was $6,880,139.26, and the bank balance including accrued interest was $9,422,240.83. The entire bank balance of $9,422,240.83 was category 1.

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.

All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase. Certificates of deposit have been included with other deposits in Note 3 to determine the adequacy of collateral security pledged.

The university's investments are categorized below to indicate the level of risk assumed by the university at year-end. 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 and unregistered investments for which the securities are held by the counterparty's/counterparties' 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.

	June 30, 2004	June 30, 2003
Category 1:		
U.S. government securities	$ 31,071,399.25	$ 28,374,609.75
Commercial paper	3,996,412.50	6,990,601.67
Investments not susceptible to credit risk categorization:		
Certificates of deposit classified as investments	200,000.00	200,000.00
Amount classified as cash equivalents	(1,998,711.11)	-
Total	$ 33,269,100.64	$ 35,565,211.42

NOTE 5. RECEIVABLES

Receivables included the following:

	June 30, 2004	June 30, 2003
Student accounts receivable	$ 7,830,521.16	$ 8,028,646.80
Grants receivable	10,144,155.94	12,570,964.88
Notes receivable	1,938,025.90	1,681,156.19
State appropriation receivable	282,600.00	236,700.00
Other receivables	16,108,532.52	15,387,387.41
Subtotal	36,303,835.52	37,904,855.28
Less allowance for doubtful accounts	(6,070,181.34)	(5,329,164.39)
Total receivables	$ 30,233,654.18	$ 32,575,690.89

Federal Perkins Loan Program funds included the following:

	June 30, 2004	June 30, 2003
Perkins loans receivable	$ 3,236,465.21	$ 3,607,060.22
Less allowance for doubtful accounts	(618,585.86)	(1,030,102.03)
Total	$ 2,617,879.35	$ 2,576,958.19

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 15,298,523.50	$ 436,150.00	$ -	$ 19,341.00	$ 15,715,332.50
Land improvements and infrastructure	14,693,216.80	-	-	-	14,693,216.80
Buildings	206,950,314.82	518,403.50	19,396,464.67	-	226,865,182.99
Equipment	37,171,212.81	2,166,787.57	-	1,357,294.27	37,980,706.11
Library holdings	29,346,122.04	3,696,767.07	-	2,336,884.00	30,706,005.11
Projects in progress	42,202,693.22	6,599,281.38	(19,396,464.67)	-	29,405,509.93
Total	345,662,083.19	13,417,389.52	-	3,713,519.27	355,365,953.44
Less accum. depreciation:					
Land improvements and infrastructure	11,040,469.01	366,029.73	-	-	11,406,498.74
Buildings	76,949,828.69	5,569,085.99	-	-	82,518,914.68
Equipment	25,398,122.22	2,732,552.34	-	1,305,636.90	26,825,037.66
Library holdings	15,220,204.53	3,070,600.51	-	2,336,884.00	15,953,921.04
Total accum. depreciation	128,608,624.45	11,738,268.57	-	3,642,520.90	136,704,372.12
Capital assets, net	$217,053,458.74	$ 1,679,120.95	$ -	$ 70,998.37	$218,661,581.32

Capital asset activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 14,286,239.50	$ 1,012,284.00	$ -	$ -	$ 15,298,523.50
Land improvements and infrastructure	14,465,804.80	227,412.00	-	-	14,693,216.80
Buildings	171,922,220.61	29,872,304.13	5,155,790.08	-	206,950,314.82
Equipment	36,072,971.63	3,665,635.41	-	2,567,394.23	37,171,212.81
Library holdings	28,261,542.95	365,212.94	-	2,280,633.85	29,346,122.04
Projects in progress	26,864,395.34	20,510,360.11	(5,155,790.08)	16,272.15	42,202,693.22
Total	291,873,174.83	58,653,208.59	-	4,864,300.23	345,662,083.19
Less accum. depreciation:					
Land improvements and infrastructure	10,660,561.27	379,907.74	-	-	11,040,469.01
Buildings	71,864,273.12	5,085,555.57	-	-	76,949,828.69
Equipment	24,655,766.42	3,006,610.35	-	2,264,254.55	25,398,122.22
Library holdings	14,566,226.18	2,934,612.20	-	2,280,633.85	15,220,204.53

Total accum. depreciation	121,746,826.99	11,406,685.86	-	4,544,888.40	128,608,624.45
Capital assets, net	$ 170,126,347.84	$ 47,246,522.73	$ -	$ 319,411.83	$217,053,458.74

NOTE 7. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2004, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Bonds	$ 54,445,263.22	$ 45,994.49	$ 2,823,209.91	$ 51,668,047.80	$2,725,752.47
Commercial paper	1,363,127.07	80,913.93	-	1,444,041.00	1,444,041.00
Subtotal	55,808,390.29	126,908.42	2,823,209.91	53,112,088.80	4,169,793.47
Other liabilities:					
Compensated absences	6,697,443.04	5,212,625.12	5,013,676.64	6,896,391.52	1,657,714.88
Due to grantors	2,511,158.12	194,167.65	16,324.94	2,689,000.83	-
Subtotal	9,208,601.16	5,406,792.77	5,030,001.58	9,585,392.35	1,657,714.88
Total long-term liabilities	$ 65,016,991.45	$ 5,533,701.19	$ 7,853,211.49	$ 62,697,481.15	$5,827,508.35

Long-term liabilities activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Bonds	$ 57,022,570.26	$ 282,572.72	$ 2,859,879.76	$ 54,445,263.22	$3,216,409.90
Commercial paper	-	1,363,127.07	-	1,363,127.07	-
Subtotal	57,022,570.26	1,645,699.79	2,859,879.76	55,808,390.29	3,216,409.90
Other liabilities:					
Compensated absences	6,284,697.88	5,368,852.99	4,956,107.83	6,697,443.04	1,847,080.21
Due to grantors	2,425,688.08	123,071.50	37,601.46	2,511,158.12	-
Subtotal	8,710,385.96	5,491,924.49	4,993,709.29	9,208,601.16	1,847,080.21
Total long-term liabilities	$ 65,732,956.22	$ 7,137,624.28	$ 7,853,589.05	$ 65,016,991.45	$5,063,490.11

Bonds Payable

Bond issues, with interest rates ranging from 2% to 7.15% 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 and unexpended debt proceeds. The reserve amount was $270,768.89 at June 30, 2004, and $663,968.89 at June 30, 2003.

Debt service requirements to maturity for bonds payable at June 30, 2004, are as follows:

Year Ending June 30	Principal	Interest	Total
2005	$ 2,725,752.47	$ 2,882,762.23	$ 5,608,514.70
2006	2,550,436.53	2,725,189.84	5,275,626.37
2007	2,714,288.16	2,572,529.96	5,286,818.12
2008	2,871,177.50	2,416,360.56	5,287,538.06
2009	3,047,284.61	2,249,713.96	5,296,998.57
2010-2014	9,355,376.25	9,107,515.89	18,462,892.14
2015-2019	7,758,963.09	7,088,132.48	14,847,095.57
2020-2024	8,552,005.80	4,860,834.75	13,412,840.55
2025-2029	9,887,328.53	2,403,167.45	12,290,495.98
2030-2032	2,205,434.86	161,824.10	2,367,258.96
	$ 51,668,047.80	$ 36,468,031.22	$ 88,136,079.02

Commercial paper

The Tennessee State School Bond Authority also authorized the issuance of commercial paper to finance the costs of various capital projects. The amount issued for projects at the university was $1,444,041.00 at June 30, 2004, and $1,363,127.07 at June 30, 2003.

For the commercial paper program, the Tennessee State School Bond Authority maintains an interest rate reserve fund. The university contributes amounts to the reserve fund based on the amounts drawn. The principal of the reserve will be contributed to pay off notes or credited back to the university when the notes are converted to bonds. The interest earned on the reserve is used to pay interest due during the month.

NOTE 8. UNRESTRICTED NET ASSETS

Unrestricted net assets include funds that have been designated or reserved for specific purposes. The unrestricted net assets are composed of the following:

	June 30, 2004	June 30, 2003
Working capital	$ 4,643,645.50	$ 6,720,040.22
Encumbrances	1,378,163.42	1,929,433.87
Designated fees	3,630,348.77	3,995,943.67
Auxiliaries	673,610.76	628,308.29
Quasi-endowment	1,447,639.51	1,247,639.51
Plant construction	17,407,718.92	16,452,508.78
Renewal and replacement of equipment	12,500,780.92	10,876,938.24
Unreserved/undesignated	7,995,087.09	5,289,008.54
Total	$ 49,676,994.89	$ 47,139,821.12

NOTE 9. ENDOWMENTS

If a donor has not provided specific instructions to the university, state law permits the university to authorize for expenditure the net appreciation (realized and unrealized) of the investments of endowment funds. When administering its power to spend net appreciation, the university is required to consider the university's long-term and short-term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions. Any net appreciation spent is required to be spent for the purposes for which the endowment was established.

The university chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the university, 4.75% of a three-year moving average of the fair value of endowment investments has been authorized for expenditure. The remaining amount, if any, is retained for use in future years when the spending plan exceeds current year investment income or is returned to corpus in accordance with the terms of the endowment agreement. At June 30, 2004, investment income of $5,645,290.32 is available to be spent, all of which is included in restricted net assets expendable for specific purposes as determined by the terms of the endowment. At June 30, 2003, investment income of $5,559,780.57 is available to be spent, all of which is included in restricted net assets expendable for specific purposes as determined by the terms of the endowment.

NOTE 10. PENSION PLANS

A. Defined Benefit Plans

1. 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 7.3% 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, 2004, 2003, and 2002 were $3,503,862.94, $3,398,360.32, and $2,927,856.69. 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 $7,480,968.15 for the year ended June 30, 2004, and $7,048,162.33 for the year ended June 30, 2003. 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. INSURANCE-RELATED ACTIVITIES

The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The insurance policy deductibles vary from $1 million to $7.5 million by type of risk coverage. A designation of $5 million for incurred losses at June 30, 2004, was established in the state's Risk Management Fund.

During the year ended June 30, 2003, the state incurred 13 property claims which exceeded the per occurrence deductible. The gross amount of claims for the period was approximately $7.2 million, of which the state's property insurance carrier will ultimately assume approximately $2.2 million.

At June 30, 2004, the scheduled coverage for the university was $480,013,400.00 for buildings and $293,254,100.00 for contents. At June 30, 2003, the scheduled coverage for the university was $452,832,500.00 for buildings and $288,220,900.00 for contents.

The state has set aside assets for claim settlement in an internal service fund, the Risk Management 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 Risk Management 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 Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the 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 Risk Management 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.

NOTE 13. 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 $59,428,498.93 at June 30, 2004, and $58,246,071.92 at June 30, 2003.

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 $1,441,762.36 and for personal property were $633,206.73 for the year ended June 30, 2004. Comparative amounts for the year ended June 30, 2003, were $1,823,695.24 and $382,123.82. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2004, outstanding commitments under construction contracts totaled $4,058,291.26 for FedEx Technology Institute, Millington Center Facility, and North Center Parking Lot Expansion, of which $857,688.04 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 14. CHAIRS OF EXCELLENCE

The university had $57,102,602.46 on deposit at June 30, 2004, and $54,584,937.18 on deposit at June 30, 2003, 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 15. FUNDS HELD IN TRUST BY OTHERS

The university is a beneficiary under the Van Vleet, the Mike Driver, the Pope M. Farrington, the C. M. Gooch, and the Herbert Herff trusts. The underlying assets are not considered assets of the university and are not included in the university's financial statements. The university received $956,539.74 from these funds during the year ended June 30, 2004, and $896,674.83 during the year ended June 30, 2003.

NOTE 16. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2004, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 59,930,386.62	$13,898,493.40	$ 17,258,329.45	$ -	$ -	$91,087,209.47
Research	28,597,944.73	6,266,860.49	7,694,841.07	-	-	42,559,646.29
Public service	6,100,408.02	1,551,907.16	5,822,408.58	-	-	13,474,723.76
Academic support	14,556,039.93	4,253,856.81	4,994,511.86	-	-	23,804,408.60
Student services	13,146,849.41	3,909,191.34	20,287,177.19	-	-	37,343,217.94
Institutional support	12,044,544.46	3,421,467.86	4,280,707.44	-	-	19,746,719.76
Operation & maint.	8,405,679.48	3,131,260.73	19,384,869.92	-	-	30,921,810.13
Scholar. & fellow.	-	-	-	11,371,897.55	-	11,371,897.55
Auxiliary	1,785,012.31	431,275.08	5,917,983.57	-	-	8,134,270.96
Depreciation	-	-	-	-	11,738,268.57	11,738,268.57
Total	$ 144,566,864.96	$36,864,312.87	$ 85,640,829.08	$ 11,371,897.55	$ 11,738,268.57	$290,182,173.03

The university's operating expenses by functional classification for the year ended June 30, 2003, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 62,019,123.22	$13,530,671.43	$20,594,337.97	$ -	$ -	$96,144,132.62
Research	22,474,118.23	5,253,344.12	7,434,436.30	-	-	35,161,898.65
Public service	5,916,997.39	1,439,194.29	6,623,888.85	-	-	13,980,080.53
Academic support	14,273,296.61	4,073,555.62	(949,202.96)	-	-	17,397,649.27
Student services	12,790,652.78	3,530,362.72	20,148,038.16	-	-	36,469,053.66
Institutional support	11,589,624.95	3,336,192.63	5,917,187.62	-	-	20,843,005.20
Operation & maint.	8,143,522.56	2,867,054.78	19,499,074.06	-	-	30,509,651.40
Scholar. & fellow.	-	-	-	11,032,400.54	-	11,032,400.54

Auxiliary	1,812,212.99	414,461.88	5,730,864.44	-	-	7,957,539.31
Depreciation	-	-	-	-	11,406,685.86	11,406,685.86
Total	$ 139,019,548.73	$34,444,837.47	$84,998,624.44	$11,032,400.54	$11,406,685.86	$280,902,097.04

NOTE 17. COMPONENT UNIT

The University of Memphis Foundation is a legally separate, tax-exempt organization supporting The University of Memphis. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources or income thereon that the foundation holds and invests is restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

The foundation is a nonprofit organization that reports under Financial Accounting Standards Board (FASB) standards, including FASB Statement 117, *Financial Statements of Not-for-Profit Organizations*. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. With the exception of necessary presentation adjustments, no modifications have been made to the foundation's financial information in the university's financial statements for these differences.

During the year ended June 30, 2004, the foundation made distributions of $5,847,378.00 to or on behalf of the university for both restricted and unrestricted purposes. During the year ended June 30, 2003, the foundation made distributions of $4,773,508.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Larry Bunch, Executive Director; 108 Billy Mac Jones Building; Memphis, Tennessee 38152-3750.

Cash and cash equivalents - Cash and cash equivalents consist of demand deposit accounts and money market funds. Of the bank balances of deposits at June 30, 2004, $100,000.00 was insured by FDIC and $5,524,885.00 was not insured. Of the bank balances of deposits at June 30, 2003, $100,000.00 was FDIC insured and $14,497,798.00 was not insured.

Investments - Investments are recorded on the date of contribution and are stated at market value. Unrealized gains and losses are determined by the difference between market values at the beginning and end of the year.

Investments held in marketable securities at June 30, 2004, were as follows:

	Cost	Market Value
Common stock and mutual funds	$ 42,873,351.00	$ 46,503,483.00
U.S. government, foreign, and other bonds	384,704.00	389,917.00
Total	$ 43,258,055.00	$ 46,893,400.00

Investments held in marketable securities at June 30, 2003, were as follows:

	Cost	Market Value
Common stock and mutual funds	$ 38,469,673.00	$ 36,816,549.00
U.S. government, foreign, and other bonds	610,356.00	635,590.00
Total	$ 39,080,029.00	$ 37,452,139.00

Investments in donated real and personal property consist principally of land, works of art, and books and periodicals.

The interest in limited partnerships, with a fair value of $7,681,855 and a net capital investment (capital invested less capital distributions) of $6,955,347 at June 30, 2004, consists of investments in Barlow Partners Offshore Limited, CSFB Strategic Partners II RE, L.P., and CSFB Strategic Partners II, L.P.

Pledges Receivable - Pledges receivable are summarized below, net of the allowance for doubtful accounts.

	June 30, 2004	June 30, 2003
Current pledges	$ 2,191,490.00	$ 2,852,452.00
Pledges due in one to five years	3,334,954.00	3,191,653.00
Pledges due after five years	286,600.00	412,600.00
Subtotal	5,813,044.00	6,456,705.00
Less allowance for uncollectible contributions	(28,060.00)	(806,206.00)
Less discounts to net present value	(232,231.00)	(170,831.00)
Total pledges receivable, net	$ 5,552,753.00	$ 5,479,668.00

Long-term liabilities - Long-term liabilities at June 30, 2003, consisted of the following:

	Ending Balance	Current Portion
Notes payable	$ 190,000.00	$ -
Total long-term liabilities	$ 190,000.00	$ -

Note payable - The note payable to C.I.O.S. is non-interest bearing. During the year ended June 30, 2004, C.I.O.S. demanded repayment of the note according to the terms of the agreement. According to the agreement, the foundation is not obligated to repay the note at a rate greater than the rate at which the foundation receives repayments from The University of Memphis on loans made to students that were funded with C.I.O.S. loan proceeds.

SUPPLEMENTARY INFORMATION
TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
COMPONENT UNIT STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2004, AND JUNE 30, 2003

	FY 2004	FY 2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$ 5,307,990.00	$ 5,610,496.00
Payments to suppliers and vendors	(1,601,735.00)	(2,310,935.00)
Payments to The University of Memphis	(5,709,476.00)	(5,349,430.00)
Net cash flows provided (used) by operating activities	(2,003,221.00)	(2,049,869.00)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes	2,275,198.00	4,759,441.00
Net cash flows provided (used) by non-capital financing activities	2,275,198.00	4,759,441.00
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Other capital and related financing receipts (payments)	35,000.00	42,500.00
Net cash flows provided (used) by capital and related financing activities	35,000.00	42,500.00
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	-	3,443,380.00
Income on investments	7,852,726.00	91,886.00
Purchase of investments	(17,132,616.00)	-
Net cash provided (used) by investing activities	(9,279,890.00)	3,535,266.00
Net increase (decrease) in cash and cash equivalents	(8,972,913.00)	6,287,338.00
Cash and cash equivalents - beginning of year	14,597,798.00	8,310,460.00
Cash and cash equivalents - end of year	$ 5,624,885.00	$ 14,597,798.00
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income (loss)	$ (2,857,984.00)	$ (3,322,828.00)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:		
Change in assets and liabilities		
Receivables, net	(73,085.00)	1,014,961.00
Prepaid/deferred items	4,691.00	(5,925.00)
Accounts payable	1,025,421.00	115,625.00
Accrued liabilities	(94,594.00)	115,146.00
Deferred revenues	-	37,500.00
Other liabilities	(7,670.00)	(4,348.00)
Net cash provided (used) by operating activities	$ (2,003,221.00)	$ (2,049,869.00)
Non-cash transactions		
Unrealized gain/losses on investments	$ 61,793.00	$ 192,605.00