Tennessee Board of Regents
Tennessee State University

For the Year Ended
June 30, 2004

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

John G. Morgan
Comptroller

February 3, 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. James A. Hefner, President
Tennessee State University
3500 John A. Merritt Boulevard
Nashville, Tennessee 37209

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, Tennessee State University, 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

John G. Morgan
Comptroller of the Treasury

JGM/cj
04/109

State of Tennessee

Audit Highlights

Comptroller of the Treasury   Division of State Audit

Financial and Compliance Audit
Tennessee State University
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
Tennessee State University
For the Year Ended June 30, 2004

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

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

BACKGROUND

Tennessee State University was first established as the Agricultural and Industrial State Normal School on June 19, 1912, through an act of the Tennessee General Assembly. In 1922, the institution was raised to the status of a four-year teachers' college and was empowered to grant the bachelor's degree. In August 1951, the State Board of Education granted the institution university status. The university was elevated to a land-grant university by the State Board of Education in August 1958. The land-grant university program established a School of Agriculture and Home Economics, School of Engineering, School of Arts and Sciences, School of Education, Graduate School, Division of Business, Division of Extension and Continuing Education, and Department of Aerospace Studies. The university is supported by state and federal funds, the latter in accordance with the Morrill Act and other federal acts that provide for land-grant institutions.

ORGANIZATION

The governance of Tennessee State University is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The chief administrative officer of the university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 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. Tennessee State University is an institution of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the university's internal control over financial reporting to determine auditing procedures for the purpose of expressing 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

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The university filed its report with the Department of Audit on August 16, 2004. A follow-up of all prior audit findings was conducted as part of the current audit.

IMPROPER MANAGEMENT OVERRIDE

Any internal controls, no matter how well designed, are susceptible to being rendered ineffective through actions which override the stated controls. The findings related to the TSU Foundation scholarships noted in the prior audit were largely the result of improper actions by the President. Not only do such actions compromise the integrity of internal controls, but they also serve to undermine the control environment, an essential component of the internal controls in that it sets the bar for all employees to meet in carrying out their duties. The President is retiring in May 2005 but will remain as President Emeritus. It is critical that the President refrain from engaging in additional override of controls or other actions inconsistent with an appropriate control environment. It is also essential that the next President adhere to standards of conduct more consistent with establishing and maintaining the appropriate control environment.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the university has corrected previous audit findings concerning foundation scholarship accounts with negative balances; ineligible foundation honors scholarship recipients; the foundation's lack of adequate procedures for recording revenues and maintaining documentation; the President's exceeding his authority by improperly entering into an agreement with the foundation; the lack of adequate controls over management of computer user accounts; and incorrect data on the FISAP.

<u>Prior Finding 1: Foundation scholarship accounts were permitted to reach significant negative account balances, ultimately resulting in the foundation as a whole not having adequate resources to fund current operations</u>

Pursuant to an understanding between the Tennessee Board of Regents, the university, and the foundation, the university absorbed the costs for the scholarships awarded by the foundation that the foundation was unable to fund, which eliminated the negative account balances. No new scholarships have been issued by the foundation. However, the university awarded scholarships from university funds for spring 2004 and summer 2004 to students who had existing scholarships through the foundation. The foundation has revised its written policies and procedures to require that the Authorization of Credit Award form be routed to the university's Director of Finance and Accounting to certify the availability of funds for all scholarships. If approved, the form will be forwarded to the Financial Aid Office. If not approved, the form will be returned to the foundation.

Since the previous audit, the university's Business Office has established policies and procedures to closely monitor foundation account levels to ensure that should any negative results of foundation operations arise, they will be communicated to the foundation in a timely manner. If a foundation transaction that is sent to the Business Office for processing is from an account that does not have funds available, that transaction would be returned to the foundation without being processed.

Under the requirements of GASB Statement 39, the foundation was determined to be a component unit of the university. As a result, the foundation's financial statements were included in the university's financial statements, except for the statement of cash flows, which was presented separately as supplementary information. The financial statements were audited for the fiscal year ended June 30, 2004, and the opinion on the financial statements was unqualified. The financial statements are included in the Financial Section of this report.

In August 2004, a discussion of the propriety of the transfer for the Endowment for Educational Excellence was held with representatives of the Office of the Attorney General, Tennessee Board of Regents, Tennessee Higher Education Commission, and Division of State Audit. Based on the discussion, the transfer of funds on July 11, 2003, was determined to be consistent with the Geier Consent Decree, as long as funds related to the prior donations are used to carry out the donor's original intent and the terms of the Geier Endowment.

<u>Prior Finding 2: Not all foundation honors scholarship recipients tested were eligible for the aid received, and as a consequence, the foundation incurred scholarship costs that could have been avoided if the eligibility criteria had been properly applied</u>

For the existing scholarships issued, as discussed above, a financial analyst in the foundation office tracks each student and makes sure the student is eligible based on the scholarship criteria. All decisions as to who shall receive new scholarships are to be made in accordance with the intent of the donor(s). If the donor does not establish criteria, decisions will be the responsibility of the foundation's Scholarship Committee. The foundation board reserves the right to inquire about the criteria used for selection of students and reject those that do not meet the donor's restrictions. The selection criteria for a scholarship are to be clearly stated prior to the disbursal of funds. The selection criteria are among the items of information required on the Authorization to Credit Student Account form.

An office of scholarships will be established and is scheduled to go into effect in spring 2005. Management and staff of that office will report to the university's Vice President for Business and Finance, and the office will serve as a clearinghouse for all scholarships issued by the university and the foundation.

Prior Finding 3: The Tennessee State University Foundation does not have adequate procedures for recording and reconciling revenues and maintaining documentation

Based on the receipts testwork performed for the foundation, no significant exceptions were noted.

The foundation has included a new procedure in its Policies and Procedures Manual for solicitation and acceptance of gifts and donations, which addresses the weaknesses noted in the prior audit finding. A procedure for the reconciliation of account activity of the foundation accounts in the university's accounting system has also been included, and a reconciliation report of receipts was started during the 2004-2005 school year.

Prior Finding 4: The university President exceeded his authority by improperly entering into an agreement with the Tennessee State University Foundation

The agreement between the university President and the foundation was an attempt to remedy the problem concerning the negative scholarship account balances, but since the agreement was entered into improperly, it was not considered to be a valid agreement. As noted in the disposition for finding 1, an understanding was reached between the Tennessee Board of Regents, the university, and the foundation to resolve the situation. The university President is scheduled to retire from his position in May 2005. Tennessee Board of Regents' staff advised the university President that board contract policies and guidelines must be followed relative to approval of contracts and agreements. There are to be no special agreements between presidents and their foundations. The TBR staff also stated that similar instructions would be conveyed to all TBR presidents reminding them of the requirements for adherence to policies and guidelines for agreements, including any agreements with foundations.

Prior Finding 5: The university has not implemented adequate controls over management of computer user accounts

Based on the testwork performed, it appears that management has made progress in establishing more adequate controls over the management of computer user accounts. Some minor problems were noted, which we have reported to the university's management in a separate letter.

Prior Finding 6: The university did not submit correct data on the FISAP

The university submitted a revised 2002-2003 Fiscal Operations Report and Application to Participate (FISAP) in December 2003. Based on review of the revised report, some minor problems were noted, which we have reported to the university's management in a separate letter.

INVESTIGATION REPORT—REVIEW OF ISSUES RELATED TO DR. JAMES SMITH'S TENURE AS ATHLETICS DIRECTOR AT TENNESSEE STATE UNIVERSITY

In April 2004, the Division of State Audit released a special investigation report regarding the Athletic Department at Tennessee State University. This report contained several recommendations for improving controls. The Tennessee Board of Regents appointed a special task force to implement the report's recommendations. The university's internal audit section is conducting a follow-up on these recommendations and will be issuing a report on its findings.

MANAGEMENT OVERRIDE

The same issues noted above with regard to improper override of controls by the university President contributed to problems identified in the Investigation Report. Hence, the President should refrain from override of controls as noted in the Investigation Report as President or President Emeritus. The incoming President should adhere to standards of conduct more consistent with establishing and maintaining the appropriate control environment.

OBSERVATIONS AND COMMENTS

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, 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 also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We 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
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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*

October 29, 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 Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the year ended June 30, 2004, and have issued our report thereon dated October 29, 2004. 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. 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 opinions 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 did, however, note certain less significant 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/cj

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

October 29, 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 Tennessee State University, 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, 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 audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our 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 the State Building Commission and the Tennessee Higher Education Commission.

The Honorable John G. Morgan
October 29, 2004
Page Two

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tennessee Board of Regents, Tennessee State University, and its discretely presented component unit as of June 30, 2004, and the respective changes in financial position and cash flows thereof for the year 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 12 through 22 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 43 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 October 29, 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/cj

Tennessee State University
Management's Discussion and Analysis

This section of Tennessee State University's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2004, with comparative information presented for the fiscal year ended June 30, 2003. 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 Tennessee State University as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

The Statement of Net Assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the university. Assets and liabilities are generally measured using current values. 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 (in thousands of dollars)

	UNIVERSITY		COMPONENT UNIT	
	2004	2003	2004	2003
Assets:				
Current assets	$ 44,088	$ 37,805	$ 2,362	$ 441
Capital assets, net	152,581	153,624	-	-
Other assets	22,356	21,647	11,148	6,698
Total assets	219,025	213,076	13,510	7,139
Liabilities:				
Current liabilities	29,366	21,162	33	3
Noncurrent liabilities	34,317	35,877	-	-
Total liabilities	63,683	57,039	33	3
Net assets:				
Invested in capital assets, net of related debt	122,439	123,734	-	-
Restricted - nonexpendable	62	62	11,163	7,674
Restricted - expendable	7,708	7,721	2,227	64
Unrestricted	25,133	24,520	87	(602)
Total net assets	$ 155,342	$ 156,037	$ 13,477	$ 7,136

- Total net assets for the university decreased as a result of $3.288 million ($2.414 million in prior fiscal years and $874 thousand in fiscal year 2004) in scholarships initially awarded through the TSU Foundation assumed by the university.

- Current assets for the university increased 17% due to the increase in assets held by the university for the foundation as a result of the scholarships assumed by the university noted above and the increase in funds as noted below.

- Current liabilities for the university increased 39% due to the increase in funds held in deposit for the TSU Foundation as a result of fundraising and state matching funds from the state consent decree.

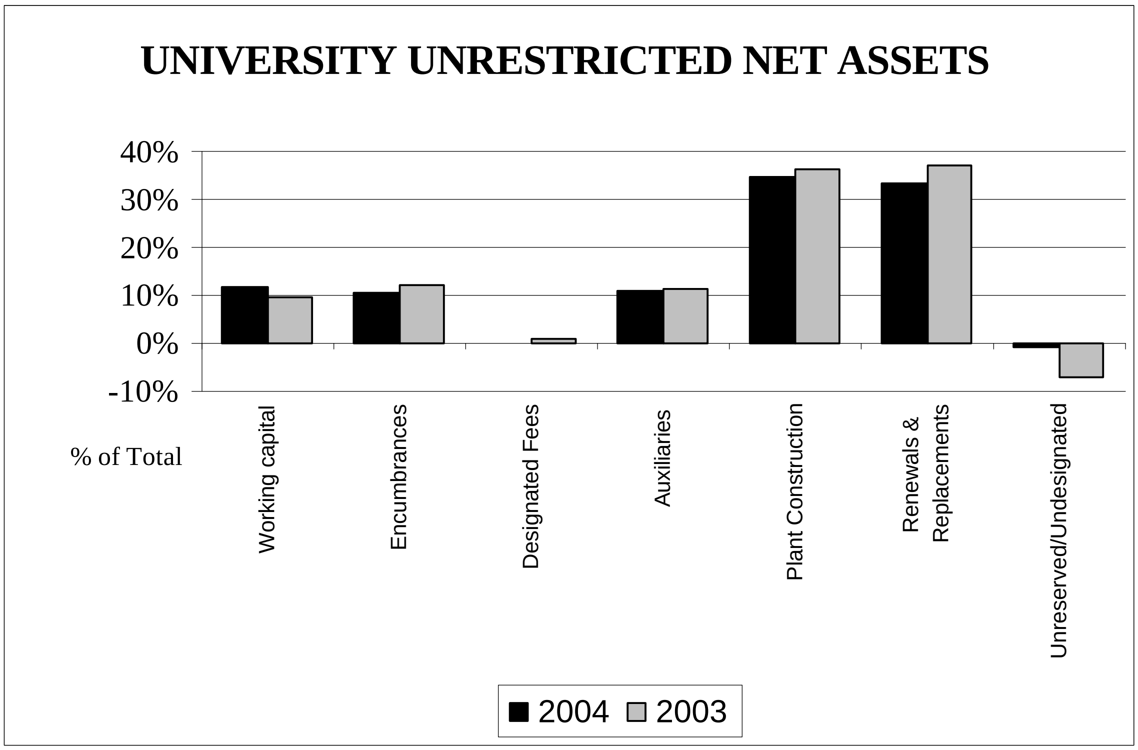
- Current assets for the Tennessee State University Foundation increased over $1.9 million due to the assumption of scholarships by the university as noted above.

- Other assets for the TSU Foundation increased over $4.46 million as a result of fundraising ($1.179 million), state funds ($1.0 million), and federal matching funds ($1.783 million) related to the state consent decree.

- Restricted nonexpendable net assets for the TSU Foundation increased 45% due to the increase in current assets and other assets discussed above.

- Restricted expendable net assets for the TSU Foundation increased over $2.16 million due to a reclassification of funds from unrestricted.

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



All of the TSU Foundation's unrestricted net assets are considered unreserved/undesignated.

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

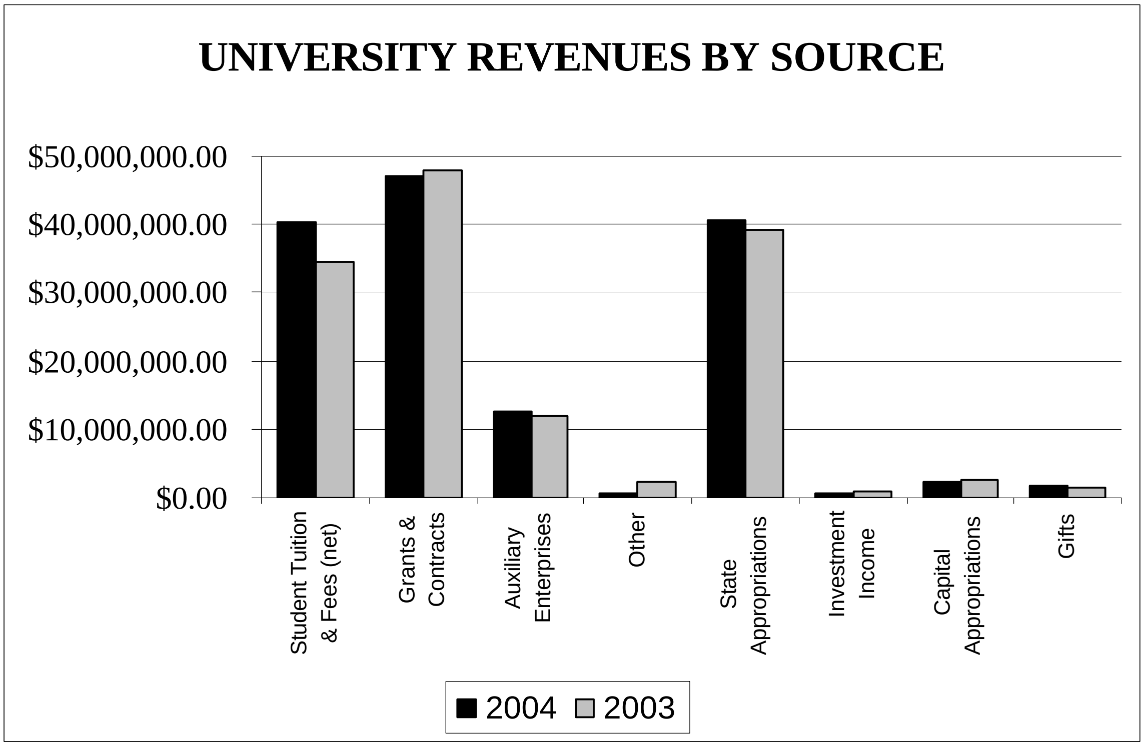
The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the university, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to generally accepted accounting principles.

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

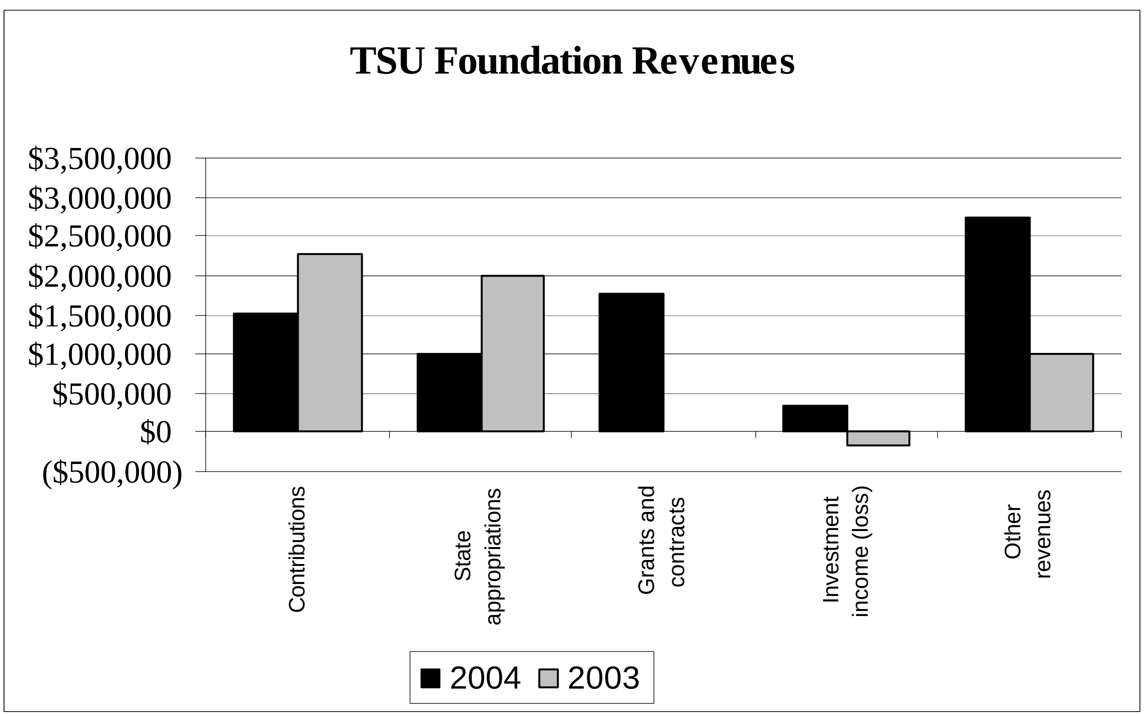
	UNIVERSITY		COMPONENT UNIT	
	2004	2003	2004	2003
Operating revenues:				
Net tuition and fees	$ 40,230	$ 34,591	$ -	$ -
Grants and contracts	34,578	47,997	-	-
Auxiliary	12,444	12,065	-	-
Other	2,649	2,326	1,298	1,588
Total operating revenues	**89,901**	**96,979**	**1,298**	**1,588**
Operating expenses	145,792	138,049	1,135	2,286
Operating income (loss)	**(55,891)**	**(41,070)**	**163**	**(698)**
Nonoperating revenues and expenses:				
State appropriations	40,621	39,040	1,000	2,000
Gifts	943	1,146	-	-
Grants and contracts	12,384	-	1,763	-
Investment income	496	897	352	(172)
Other revenues and expenses	(2,630)	(2,985)	2,738	999
Total nonoperating revenues and expenses	**51,814**	**38,098**	**5,853**	**2,827**
Income (loss) before other revenues, expenses, gains, or losses	**(4,077)**	**(2,972)**	**6,016**	**2,129**
Other revenues, expenses, gains, or losses:				
Capital appropriations	2,431	2,607	-	-
Capital grants and gifts	951	442	-	-
Additions to permanent endowments	-	-	325	775
Total other revenues, expenses, gains, or losses	**3,382**	**3,049**	**325**	**775**
Increase (decrease) in net assets	**(695)**	**77**	**6,341**	**2,904**
Net assets at beginning of year	**156,037**	**155,960**	**7,136**	**4,232**
Net assets at end of year	**$ 155,342**	**$ 156,037**	**$ 13,477**	**$ 7,136**

Revenues

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



- Student tuition and fees (net) increased by $5.639 million due to a 14% increase in student fees in fiscal year 2004.



- Contributions in 2004 decreased due to special one-time donations received in 2003.

- State appropriations in 2003 included an additional $1.0 million in matching funds for the consent decree.

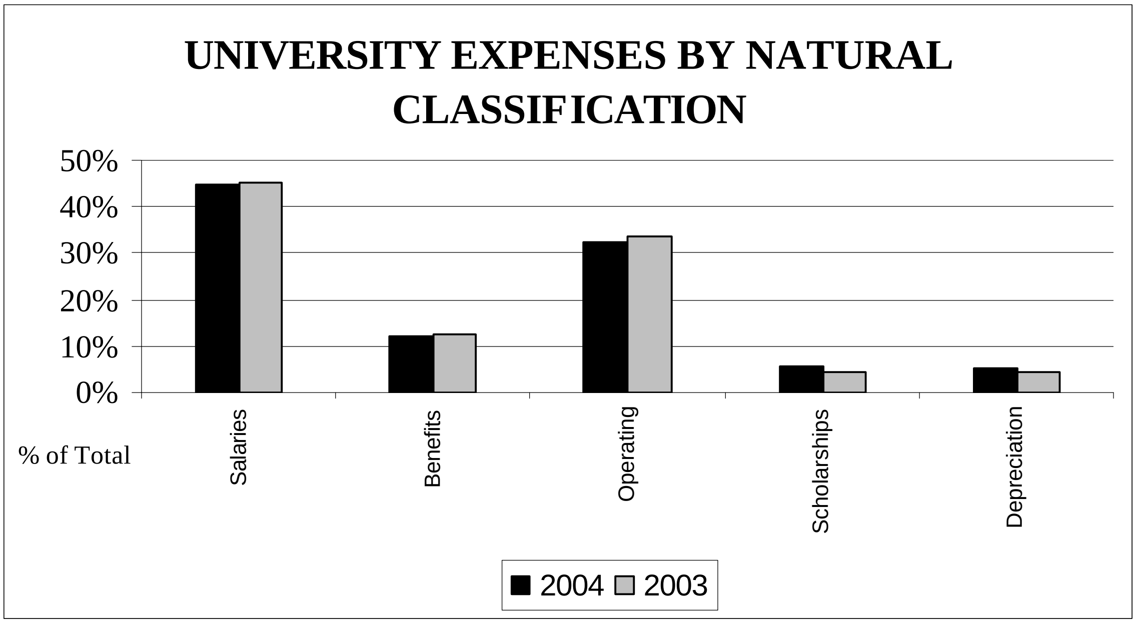
- Grants and contracts increased in 2004 as a result of matching funds received from Title III funds for monies raised during 2003.

- Other operating revenues increased as a result of $2.414 million in scholarships initially awarded through the TSU Foundation in prior fiscal years assumed by the university.

Expenses

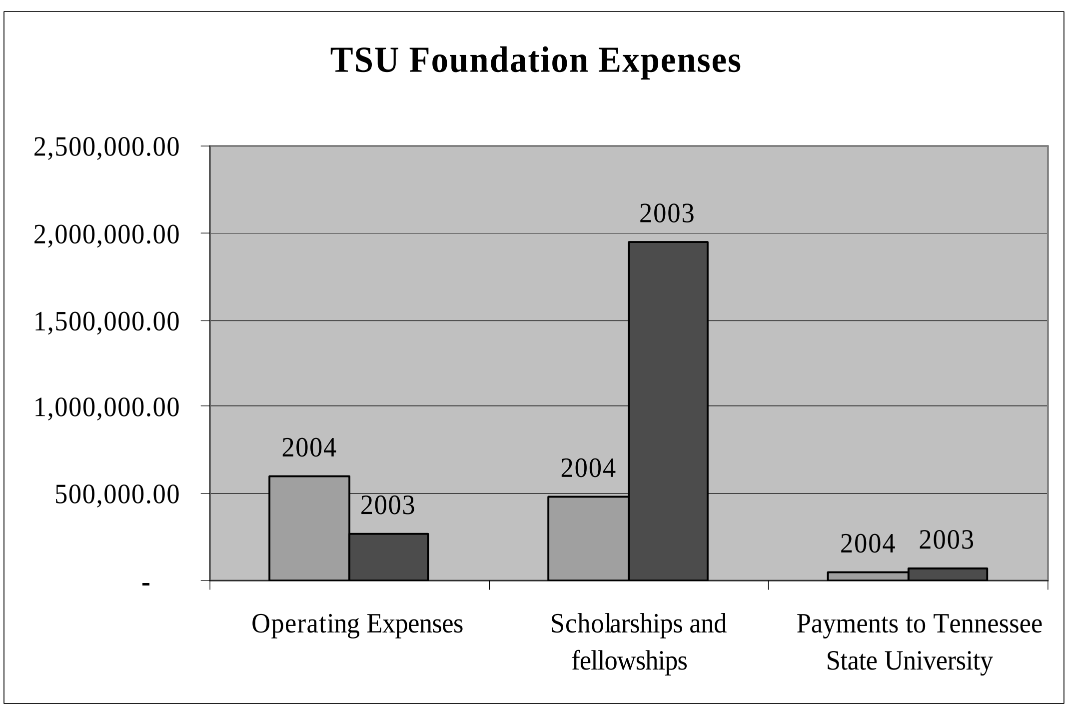
Operating expenses can be displayed in two formats, natural classification and program classification. Both formats are displayed below (in thousands of dollars).

	UNIVERSITY		COMPONENT UNIT	
NATURAL CLASSIFICATION	2004	2003	2004	2003
SALARIES	$ 65,365	$ 62,567	$ -	$ -
BENEFITS	17,461	17,405	-	-
OPERATING	47,190	46,350	601	273
SCHOLARSHIPS	8,160	5,964	487	1,948
PAYMENTS TO TSU	-	-	47	65
DEPRECIATION	7,616	5,763	-	-
TOTAL	$ 145,792	$ 138,049	$ 1,135	$ 2,286



- Scholarship expenses increased as a result of $3.288 million in scholarships initially awarded through the TSU Foundation assumed by the university.

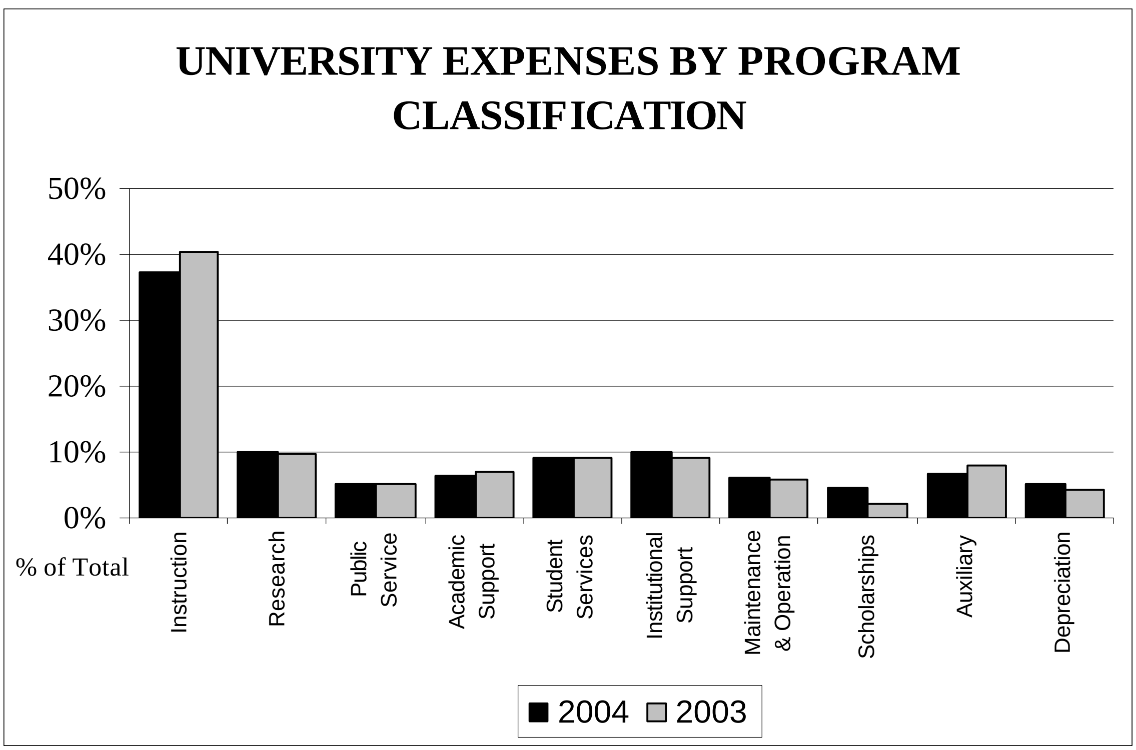
- For the fiscal year 2003, due to a prior period adjustment recorded in error in fiscal year 2002, disposal of plant facilities and revaluation of library holdings were deducted from depreciation expense resulting in depreciation expense being less than usual.



- Operating expenses increased due to an increase in catering services, travel, and professional services for various department-related foundation accounts.

- The university assumed $874 thousand in scholarship expenses for the 2004 fiscal year for scholarships initially awarded through the foundation.

	UNIVERSITY	
PROGRAM CLASSIFICATION	2004	2003
INSTRUCTION	$ 54,244	$ 55,729
RESEARCH	13,489	13,259
PUBLIC SERVICE	7,698	6,940
ACADEMIC SUPPORT	9,120	9,441
STUDENT SERVICES	13,298	12,566
INSTITUTIONAL SUPPORT	14,767	12,650
MAINTENANCE AND OPERATION	9,029	8,110
SCHOLARSHIPS	6,683	2,805
AUXILIARY	9,848	10,786
DEPRECIATION	7,616	5,763
TOTAL	$ 145,792	$ 138,049



- The decrease in instruction is a result of the decrease of instruction-related grants in the Chair of Excellence for Basic Skills.

- Expenses for computer charges, banking fees, and the addition of the Vice President for Research make up the increase in institutional support.

- Scholarship expenses increased for 2004 due to a 14% increase in student fees, an increase in Pell and FWSP funds of approximately $1.0 million, and the assumption by the university of $3.288 million in scholarships initially awarded through the TSU Foundation.

- For the fiscal year 2003, due to a prior period adjustment recorded in error in fiscal year 2002, disposal of plant facilities and revaluation of library holdings were deducted from depreciation expense resulting in depreciation expense being less than usual.

The Statement of Cash Flows

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

Statement of Cash Flows (in thousands of dollars)

	UNIVERSITY		COMPONENT UNIT	
	2004	2003	2004	2003
Cash provided (used) by:				
Operating activities	$ (46,277)	$ (34,469)	$ 1,203	$ (653)
Noncapital financing activities	60,260	43,343	5,826	2,775
Capital and related financing activities	(4,449)	(5,228)	-	-
Investing activities	(62)	(633)	(354)	(2,630)
Net increase (decrease) in cash	9,472	3,013	6,675	(508)
Cash, beginning of year	38,661	35,648	817	1,325
Cash, end of year	$ 48,133	$ 38,661	$ 7,492	$ 817

The university's cash and cash equivalents increased approximately $9.472 million from the prior fiscal year improving the university's liquidity.

- The cash used by operating activities increased and the cash provided by noncapital financing activities increased due to the reclassification of Pell and SEOG receipts from operating grants and contracts to nonoperating grants and contracts.

- The cash used by capital and related financing activities decreased due to the completion of Wilson and Boyd Hall and Phase Two of the Site Utilities program.

- The cash used by investing activities decreased due to the increased investment in items classified as cash equivalents.

The TSU Foundation's cash and cash equivalents increased over $6.675 million from the prior fiscal year improving the foundation's liquidity.

- Cash provided by operating activities increased due to the decrease in scholarship expenses in 2004 due to the assumption of $874 thousand in scholarships by the university.

- Cash provided by noncapital financing activities increased as a result of an increase in federal matching funds ($783 thousand) related to the state consent decree and due to the scholarship expenses initially awarded through the TSU Foundation being assumed by the university in 2004 ($2.414 million).

- Cash used by investing activities decreased $2.276 million as a result of fundraising and state and federal matching funds from the state consent decree.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2004, the university had $152,581,619.90 invested in capital assets, net of accumulated depreciation of $103,269,697.69. At June 30, 2003, the university had $153,624,257.71 invested in capital assets, net of accumulated depreciation of $96,485,257.84. Depreciation charges totaled $7,616,162.97 for the current fiscal year and $5,762,902.60 for the fiscal year ended June 30, 2003. Details of these assets are shown below.

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

	2004	2003
Land	$ 9,525	$ 9,525
Land improvements and infrastructure	15,543	16,618
Buildings	97,134	86,527
Equipment	5,600	5,276
Library holdings	5,586	4,362
Projects in progress	19,193	31,316
Net capital assets	$ 152,581	$ 153,624

- The library is fully automated with the purchase of additional on-line databases. The library purchased over $2.1 million in databases and library books. With depreciation and the write-off of old library books, the net increase in value was over $1.2 million.

- Wilson and Boyd Hall programs were completed in 2004 as well as the new student apartments and Phase Two of the Site Utilities programs. The completion of these projects resulted in a decrease in projects in progress and an increase in the value of buildings.

More detailed information about the university's capital assets is presented in Note 7 to the financial statements.

Debt

At June 30, 2004, the university had $30,142,235.20 in debt outstanding. The total debt outstanding as of June 30, 2003, was $29,890,449.09. This debt is in bonds issued through the Tennessee State School Bond Authority (TSSBA). TSSBA currently is rated as AA- by Standard & Poor's. More detailed information about the university's long-term liabilities is presented in Note 8 to the financial statements.

Economic Factors That Will Affect the Future

The Tennessee Board of Regents approved a 7% increase in maintenance and tuition fees for the 2004-05 academic year. The cost for students to attend the university exceeds the amount of financial aid available per student. This requires students to resort to alternative means of financing the cost of attending the university. The impact that will have on enrollment is unknown. The university is not aware of any other factors that will have a significant effect on the financial position or results of operations.

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:

Mrs. Cynthia B. Brooks
Interim Vice President for Business and Finance
3500 John A. Merritt Boulevard
Nashville, Tennessee 37209

Exhibit A

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENTS OF NET ASSETS
JUNE 30, 2004

	University	Component Unit - TSU Foundation
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 3)	$ 28,156,843.31	$ -
Short-term investments (Notes 3 and 4)	6,243,476.51	-
Deposits with the university (Note 17)	-	2,362,295.52
Accounts, notes, and grants receivable (net) (Note 5)	8,280,609.53	-
Pleges receivable (Note 6)	31,000.00	-
Inventories (at lower of cost or market)	38,958.42	-
Accrued interest receivable	1,337,199.08	-
Total current assets	44,088,086.85	2,362,295.52
Noncurrent assets:		
Cash and cash equivalents (Notes 2 and 3)	19,976,498.54	-
Investments (Notes 3 and 4)	591,593.58	-
Deposits with the university (Note 17)	-	11,147,808.43
Accounts, notes, and grants receivable (net) (Note 5)	1,788,020.29	-
Capital assets (net) (Note 7)	152,581,619.90	-
Total noncurrent assets	174,937,732.31	11,147,808.43
Total assets	219,025,819.16	13,510,103.95
LIABILITIES		
Current liabilities:		
Accounts payable	1,793,864.40	32,486.57
Accrued liabilities	7,172,921.50	-
Student deposits	974,402.91	-
Deferred revenue	2,356,070.92	-
Compensated absences (Note 8)	911,347.67	-
Accrued interest payable	250,670.14	-
Long-term liabilities, current portion (Note 8)	1,855,302.87	-
Deposits held in custody for others	13,673,429.31	-
Other liabilities	378,424.55	-
Total current liabilities	29,366,434.27	32,486.57
Noncurrent liabilities:		
Compensated absences (Note 8)	3,391,252.45	-
Long-term liabilities (Note 8)	28,286,932.33	-
Due to grantors (Note 8)	2,639,030.06	-
Total noncurrent liabilities	34,317,214.84	-
Total liabilities	63,683,649.11	32,486.57
NET ASSETS		
Invested in capital assets, net of related debt	122,439,384.70	-
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	61,820.46	11,163,336.83
Expendable:		
Scholarships and fellowships	33,061.91	1,359,076.81
Research	750,655.30	17,746.00
Instructional department uses (Note 9)	3,758,581.82	136,027.11
Loans	838,340.95	-
Other	2,327,356.04	714,503.58
Unrestricted (Note 10)	25,132,968.87	86,927.05
Total net assets	$ 155,342,170.05	$ 13,477,617.38

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

Exhibit B

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

	University	Component Unit - TSU Foundation
REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of $13,092,835.86)	$ 40,229,538.14	$ -
Gifts and contributions	-	1,178,746.57
Governmental grants and contracts	34,577,769.65	-
Sales and services of educational departments	2,034,197.54	-
Auxiliary enterprises:		
Residential life (net of scholarship allowances of $1,052,656.44; all residential life revenues are used as security for revenue bonds; see Note 8)	6,952,892.58	-
Bookstore	344,988.83	-
Food service	4,311,124.38	-
Other auxiliaries	835,606.12	-
Other operating revenues	615,441.31	119,439.75
Total operating revenues	89,901,558.55	1,298,186.32
EXPENSES		
Operating expenses (Note 16):		
Salaries and wages	65,364,769.99	-
Benefits	17,461,182.20	-
Utilities, supplies, and other services	47,190,136.63	601,232.74
Scholarships and fellowships	8,159,952.92	486,926.43
Depreciation expense	7,616,162.97	-
Payments to or on behalf of Tennessee State University	-	46,570.44
Total operating expenses	145,792,204.71	1,134,729.61
Operating income (loss)	(55,890,646.16)	163,456.71
NONOPERATING REVENUES (EXPENSES)		
State appropriations	40,621,306.64	1,000,000.00
Gifts, including $46,570.44 from component unit	943,170.53	-
Grants and contracts	12,383,797.96	1,762,878.00
Investment income	495,789.05	352,005.28
Interest on capital asset-related debt	(1,536,913.17)	-
Bond issuance costs	(1,222.98)	-
Other nonoperating revenues (expenses)	(1,092,429.66)	2,738,251.31
Net nonoperating revenues	51,813,498.37	5,853,134.59
Income (loss) before other revenues, expenses, gains, or losses	(4,077,147.79)	6,016,591.30
Capital appropriations	2,431,246.11	-
Capital grants and gifts	950,802.83	-
Additions to permanent endowments	-	324,806.92
Total other revenues	3,382,048.94	324,806.92
Increase (decrease) in net assets	(695,098.85)	6,341,398.22
NET ASSETS		
Net assets - beginning of year	156,037,268.90	7,136,219.16
Net assets - end of year	$ 155,342,170.05	$ 13,477,617.38

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

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2004

CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$	40,130,066.18
Grants and contracts		36,372,750.30
Sales and services of educational activities		1,941,120.28
Payments to suppliers and vendors		(47,487,592.51)
Payments to employees		(65,185,473.88)
Payments for benefits		(17,427,030.56)
Payments for scholarships and fellowships		(8,159,952.92)
Loans issued to students and employees		(530,136.44)
Collection of loans from students and employees		732,301.46
Interest earned on loans to students		101,592.64
Auxiliary enterprise charges:		
Residence halls		7,001,530.85
Bookstore		344,988.83
Food services		4,311,124.38
Other auxiliaries		867,722.26
Other receipts (payments)		709,821.82
Net cash used by operating activities		(46,277,167.31)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations		40,607,906.64
Gifts and grants received for other than capital purposes, including $46,570.44 from component unit		1,953,023.39
Federal student loan receipts		42,570,952.00
Federal student loan disbursements		(42,517,840.00)
Changes in deposits held for others		6,310,516.13
Other noncapital financing receipts (payments)		11,335,057.86
Net cash provided by noncapital financing activities		60,259,616.02
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt		2,200,659.82
Capital appropriations		2,467,758.54
Capital grants and gifts received		950,802.83
Purchases of capital assets and construction		(6,595,862.47)
Principal paid on capital debt		(1,948,873.71)
Interest paid on capital debt		(1,541,971.84)
Other capital and related financing receipts (payments)		18,982.18
Net cash used by capital and related financing activities		(4,448,504.65)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		5,362,936.67
Income on investments		512,335.71
Purchases of investments		(5,936,980.48)
Net cash used by investing activities		(61,708.10)
Net increase in cash and cash equivalents		9,472,235.96
Cash and cash equivalents - beginning of year		38,661,105.89
Cash and cash equivalents - end of year	$	48,133,341.85

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2004

Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(55,890,646.16)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense		7,616,162.97
Other		94,380.51
Change in assets and liabilities:		
Receivables, net		1,940,939.98
Inventories		616.51
Accounts payable		(393,938.37)
Accrued liabilities		722,504.52
Deferred revenue		141,212.64
Deposits		107,395.00
Compensated absences		(615,794.91)
Net cash used by operating activities	$	(46,277,167.31)
Noncash transactions		
Unrealized loss on investments	$	(403,572.94)

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

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 restricted resources first.

Inventories

Inventories are valued at the lower of cost or market 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 $12,492,856.32 in bank accounts, $4,525.00 of petty cash on hand, $27,939,700.43 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, $2,750,129.21 in LGIP deposits for capital projects, and $4,946,130.89 in capital management account money funds.

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 $17,500,303.73, and the bank balance including accrued interest was $19,481,668.70. 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.

At June 30, 2004, the carrying amount of the university's deposits was $17,772,035.80, and the bank balance including accrued interest was $19,754,368.58. Of the bank balance, $19,582,636.51 was category 1, and $171,732.07 was category 2.

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. The Tennessee State University Foundation is authorized to invest funds in accordance with its board of directors' policies.

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/foundation's investments are categorized below to indicate the level of risk assumed by the university/foundation at year-end. Category 1 consists of insured or registered investments or investments for which the securities are held by the university/foundation or its agent in the university's/foundation's name. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparties' trust department or agent in the university's/foundation's name.

Category 2:	
University:	
U.S. government securities	$ 530,277.06
Foundation:	
U.S. government securities	840,999.00
Corporate bonds	1,321,148.25
Corporate stocks	2,604,628.30
Mortgage backed securities	167,329.15
Investments not susceptible to credit risk categorization:	
Foundation mutual funds	1,037,639.74
University certificates of deposit classified as investments	333,048.59
Total	$ 6,835,070.09

NOTE 5. RECEIVABLES

Receivables included the following:

Student accounts receivable	$ 3,808,381.76
Grants receivable	4,518,977.36
Notes receivable	468,645.46
State appropriation receivable	174,600.00
Other receivables	857,286.29
Subtotal	9,827,890.87
Less allowance for doubtful accounts	1,512,091.46
Total receivables	$ 8,315,799.41

Federal Perkins Loan Program funds included the following:

Perkins loans receivable	$ 15,332,428.34
Less allowance for doubtful accounts	13,579,597.93
Total	$ 1,752,830.41

NOTE 6. PLEDGES RECEIVABLE

Pledges receivable are promises of private donations that are reported as a receivable and revenue. At June 30, 2004, all were considered to be collectible.

NOTE 7. CAPITAL ASSETS

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$9,525,009.24	$ -	$ -	$ -	$ 9,525,009.24
Land improvements and infrastructure	39,385,193.92	394,337.82	-	-	39,779,531.74

Buildings	142,621,218.55	1,293,321.11	13,052,044.31	-	156,966,583.97
Equipment	20,355,945.62	1,923,648.38	-	541,444.57	21,738,149.43
Library holdings	6,905,758.17	2,128,127.37	-	384,659.06	8,649,226.48
Projects in progress	31,316,390.05	928,470.99	(13,052,044.31)	-	19,192,816.73
Total	250,109,515.55	6,667,905.67	-	926,103.63	255,851,317.59
Less accum. depreciation:					
Land improvements and infrastructure	22,766,947.96	1,469,799.97	-	-	24,236,747.93
Buildings	56,094,135.18	3,737,924.24	-	-	59,832,059.42
Equipment	15,080,236.84	1,505,050.23	-	447,064.06	16,138,223.01
Library holdings	2,543,937.86	903,388.53	-	384,659.06	3,062,667.33
Total accum. depreciation	96,485,257.84	7,616,162.97	-	831,723.12	103,269,697.69
Capital assets, net	$153,624,257.71	$ (948,257.30)	$ -	$ 94,380.51	$152,581,619.90

NOTE 8. 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	$29,890,449.09	$ 1.345,684.16	$ 1,473,873.71	$29,762,259.54	$ 1,475,327.21
Commercial paper	-	854,975.66	475,000.00	379,975.66	379,975.66
Subtotal	29,890,449.09	2,200,659.82	1,948,873.71	30,142,235.20	1,855,302.87
Other liabilities:					
Compensated absences	4,918,395.03	319,377.83	935,172.74	4,302,600.12	911,347.67
Due to grantors	2,620,613.00	126,152.48	107,735.42	2,639,030.06	-
Subtotal	7,539,008.03	445,530.31	1,042,908.16	6,941,630.18	911,347.67
Total long-term liabilities	$37,429,457.12	$ 2,646,190.13	$ 2,991,781.87	$37,083,865.38	$ 2,766,650.54

Bonds Payable

Bond issues, with interest rates ranging from 4.00% to 6.90% 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 $996,680.00 at June 30, 2004.

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

Year Ending June 30	Principal	Interest	Total
2005	$ 1,475,327.21	$ 1,525,479.58	$ 3,000,806.79
2006	1,029,416.86	1,478,968.03	2,508,384.89
2007	1,084,166.32	1,430,722.56	2,514,888.88
2008	1,096,136.79	1,407,053.40	2,503,190.19
2009	1,127,442.45	1,378,262.70	2,505,705.15
2010-2014	7,065,249.08	5,692,141.53	12,757,390.61
2015-2019	6,786,433.94	3,698,211.52	10,484,645.46
2020-2024	4,148,994.14	2,187,646.81	6,336,640.95
2025-2029	4,517,553.29	1,019,238.77	5,536,792.06
2030-2032	1,431,539.46	152,969.26	1,584,508.72
	$ 29,762,259.54	$ 19,970,694.16	$ 49,732,953.70

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 $379,975.66 at June 30, 2004.

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 9. ENDOWMENTS

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

The university chooses to spend only a portion of the investment income each year. Under the spending plan established by the university, a scholarship is awarded to a student whose residence is in the county specified by the donor, if it has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income. At June 30, 2004, investment income of $702.67 is available to be spent, which is included in restricted net assets expendable for instructional department uses.

NOTE 10. 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:

Working capital	$ 2,913,083.32
Encumbrances	2,617,227.22
Designated fees	12,640.00
Auxiliaries	2,766,203.68
Plant construction	8,687,338.88
Renewal and replacement of equipment	8,370,229.31
Unreserved/undesignated	(233,753.54)
Total	$ 25,132,968.87

NOTE 11. 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 $1,908,272.45, $1,875,558.81, and $1,543,054.62. Contributions met the requirements for each year.

2. Federal Retirement Program

Plan Description - The university contributes to the Federal Retirement Program, a cost-sharing, multiple-employer, defined benefit pension plan administered by the Civil Service Retirement System (CSRS) for participants employed prior to January 1, 1984, and the Federal Employees Retirement System (FERS) for participants employed after December 31, 1983. Both systems provide retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. All regular full-time employees of the Tennessee State University Agricultural Extension Service who hold federal appointments for 51% or more of their time are required to participate in either one of the two Federal Retirement Programs. For both systems, benefit provisions are established in federal statutes. Federal statutes are amended by the U.S. Congress. All the university's extension employees currently participate in CSRS.

The CSRS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the Office of Personnel Management, Retirement Information Office, P. O. Box 45, Boyers, Pennsylvania 16017-0045, or by calling (202) 606-0500.

Funding Policy - Participating employees and the university are required to contribute to the CSRS plan. Contribution requirements are established and may be amended by federal statutes. The university is currently required to contribute 7% of covered payroll to the CSRS plan, and employees are required to contribute 7% of covered payroll. Contributions to CSRS for the year ended June 30, 2004, were $71,197.35, which consisted of $36,415.63 from the university and $34,781.72 from the employees. Contributions for the year ended June 30, 2003, were $70,842.67, which consisted of $37,126.04 from the university and $33,716.63 from the employees. Contributions for the year ended June 30, 2002, were $74,028.73, which consisted of $40,626.62 from the university and $33,402.11 from the employees. 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 $3,407,176.38 for the year ended June 30, 2004, and $3,088,789.29 for the year ended June 30, 2003. Contributions met the requirements for each year.

NOTE 12. 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 13. INSURANCE-RELATED ACTIVITIES

It is the policy of the state not to purchase commercial insurance for the risks of losses for general liability, automobile liability, professional malpractice, and workers'compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund. The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The Risk Management Fund is also responsible for claims for damages to state owned property up to the amount of the property insurance aggregate deductible amount. The insurance policy deductibles vary from $25,000 per occurrence, depending on the type of coverage, to an aggregate of $7.5 million.

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. At June 30, 2004, the Risk Management Fund held $101.1 million in cash designated for payment of claims.

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 $250,371,800 for buildings and $50,685,200 for contents.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The 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 14. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The dollar amount of unused sick leave was $28,522,866.28 at June 30, 2004.

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 $181,503.11 and for personal property were $245,383.68 for the year ended June 30, 2004. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2004, outstanding commitments under construction contracts totaled $3,904,415.43 for the following projects: new Performing Arts Building, north campus improvements, ADA improvements, utility systems and tunnel renovation, Agriculture Extension I.T., Avon Williams campus improvements, Power Plant Bag House replacement, McCord Hall mechanical, Elliot Hall preservation, and roof repair of several buildings, which will be funded by future state capital outlay appropriations.

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

NOTE 15. CHAIRS OF EXCELLENCE

The university had $3,271,808.31 on deposit at June 30, 2004, 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 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	$31,774,370.51	$ 8,075,375.63	$12,532,346.15	$1,861,421.99	$ -	$ 54,243,514.28
Research	5,318,006.33	1,132,822.36	6,235,431.85	802,518.75	-	13,488,779.29
Public service	4,329,709.99	1,394,162.54	1,923,864.24	50,715.11	-	7,698,451.88
Academic support	4,737,646.41	1,274,006.14	3,087,420.78	20,751.00	-	9,119,824.33
Student services	6,141,555.57	1,589,033.25	3,841,560.53	1,725,687.74	-	13,297,837.09

Institutional support	8,580,910.59	2,640,254.43	3,538,021.07	7,801.00	-	14,766,987.09
Operation & maint.	2,691,475.68	885,214.23	5,452,476.18	-	-	9,029,166.09
Scholar. & fellow.	4,007.00	(25,816.15)	3,210,501.74	3,495,042.87	-	6,683,735.46
Auxiliary	1,787,087.91	496,129.77	7,368,514.09	196,014.46	-	9,847,746.23
Depreciation	-	-	-	-	7,616,162.97	7,616,162.97
Total	$65,364,769.99	$17,461,182.20	$47,190,136.63	$8,159,952.92	$7,616,162.97	$145,792,204.71

NOTE 17. COMPONENT UNIT

The Tennessee State University Foundation is a legally separate, tax-exempt organization supporting Tennessee State University. 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 currently has 16 members. The size of the board shall be determined by the majority vote of its members, and any vacancy in its membership shall be filled in the same way. The entire membership of the Board of Trustees shall not exceed 25 in number with a minimum of 8. All trustees shall serve until the expiration of these respective terms and until their respective successors are selected and qualified. 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 are 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.

During the year ended June 30, 2004, the foundation made distributions of $46,570.44 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Mr. Homer Wheaton, Interim Vice President for University Relations and Development, 3500 John A. Merritt Boulevard, Nashville, Tennessee 37209.

Deposits with university - Deposits with university consists of certain assets of the foundation that are held and managed by the university for the foundation. At June 30, 2004, these assets include $7,491,831.11 in cash and cash equivalents, $5,971,744.44 in investments, and $46,528.40 in receivables. These assets have been reported by the university and included in the university's applicable note disclosures above.

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
SUPPLEMENTARY INFORMATION
STATEMENT OF CASH FLOWS - COMPONENT UNIT
FOR THE YEAR ENDED JUNE 30, 2004

CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$	2,187,475.80
Payments to suppliers and vendors		(571,392.12)
Payments for scholarships and fellowships		(486,926.43)
Payments to Tennessee State University		(46,570.44)
Other receipts (payments)		119,439.75
Net cash provided by operating activities		1,202,026.56
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations		1,000,000.00
Private gifts for endowment purposes		324,806.92
Other noncapital financing receipts (payments)		4,501,129.31
Net cash provided by noncapital financing activities		5,825,936.23
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		1,875,376.30
Income on investments		352,005.28
Purchases of investments		(2,581,001.46)
Net cash used by investing activities		(353,619.88)
Net increase in cash and cash equivalents		6,674,342.91
Cash and cash equivalents - beginning of year		817,488.20
Cash and cash equivalents - end of year	$	7,491,831.11
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	163,456.71
Adjustments to reconcile operating income to net cash provided by operating activities:		
Change in assets and liabilities:		
Receivables, net		1,008,729.23
Accounts payable		29,840.62
Net cash provided by operating activities	$	1,202,026.56