AUDIT REPORT

Tennessee Board of Regents
The University of Memphis

For the Year Ended
June 30, 2005

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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

Charles K. Bridges, CPA
Assistant Director

Debra D. Bloomingburg, CPA, CFE
Audit Manager

Patricia L. Wakefield, CPA, CFE
In-Charge Auditor

Demaris Anders
Angela Courtney
Wendi Goodwin
Temecha Jones, CFE
Helen Vose, CFE
Michael B. Wilbanks, CFE
Staff Auditors

Gerry Boaz, CPA
Technical Analyst

Amy Brack
Editor

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

Financial/compliance audits of colleges and universities are available on-line at www.comptroller.state.tn.us/sa/reports/index.html.
For more information about the Comptroller of the Treasury, please visit our website 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

May 4, 2006

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, 2005. You will note from the independent auditor's report that unqualified opinions were 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/th
05/106

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, 2005

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.

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

Audit Report
Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2005

TABLE OF CONTENTS

TABLE OF CONTENTS (CONT.)

Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2005

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 schools, 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, 2004, through June 30, 2005, 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, 2005, and for comparative purposes, the year ended June 30, 2004. 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

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the institution. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the institution is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the institution.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the institution. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the controls after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic.

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, 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, 2005, 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 unqualified opinions 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*

December 8, 2005

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, 2005, and have issued our report thereon dated December 8, 2005. 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, 2005, the university implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*.

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.

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

December 8, 2005

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, as of and for the years ended June 30, 2005, and 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 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. 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 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 the State Building Commission and the Tennessee Higher Education Commission.

In our opinion, based on our audits 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, 2005, and June 30, 2004, 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, 2005, the university implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*. During the year ended June 30, 2004, the university implemented GASB Statement 39, *Determining Whether Certain Organizations Are Component Units.*

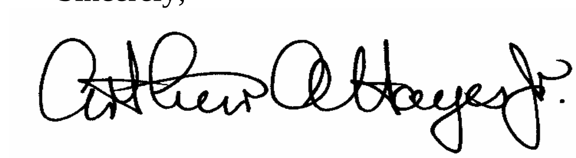
The management's discussion and analysis on pages 10 through 21 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally 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 audits were conducted for the purpose of forming opinions on the basic financial statements. The accompanying financial information on page 46 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 December 8, 2005, 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., CPA
Director

AAH/th

The University of Memphis
Management's Discussion and Analysis
For the Years Ended June 30, 2005, and June 30, 2004

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, 2005, with comparative information presented for the fiscal years ended June 30, 2004, and 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 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)

	2005	2004	2003
Assets:			
Current assets	$ 71,539	$ 65,151	$ 79,117
Capital assets, net	219,082	218,662	217,053
Other assets	47,245	49,287	42,114
Total assets	337,866	333,100	338,284

	2005	2004	2003
Liabilities:			
Current liabilities	41,537	38,409	39,765
Noncurrent liabilities	55,663	56,870	59,953
Total liabilities	97,200	95,279	99,718
Net assets:			
Invested in capital assets, net of related debt	166,474	165,549	161,245
Restricted - nonexpendable	3,398	3,319	4,125
Restricted - expendable	18,150	19,276	26,056
Unrestricted	52,644	49,677	47,140
Total net assets	$ 240,666	$ 237,821	$ 238,566

- For fiscal year 2005 there was no significant change in net assets, either in the asset category or the liability category.
- Likewise, there were no significant changes in total net assets in 2004. 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 which resulted from a charge in how cash and cash equivalents were classified as current or noncurrent. 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.
- 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 fund to be used for athletic scholarship expenditures in accordance with the endowment agreement.

Statement of Net Assets - The Foundation

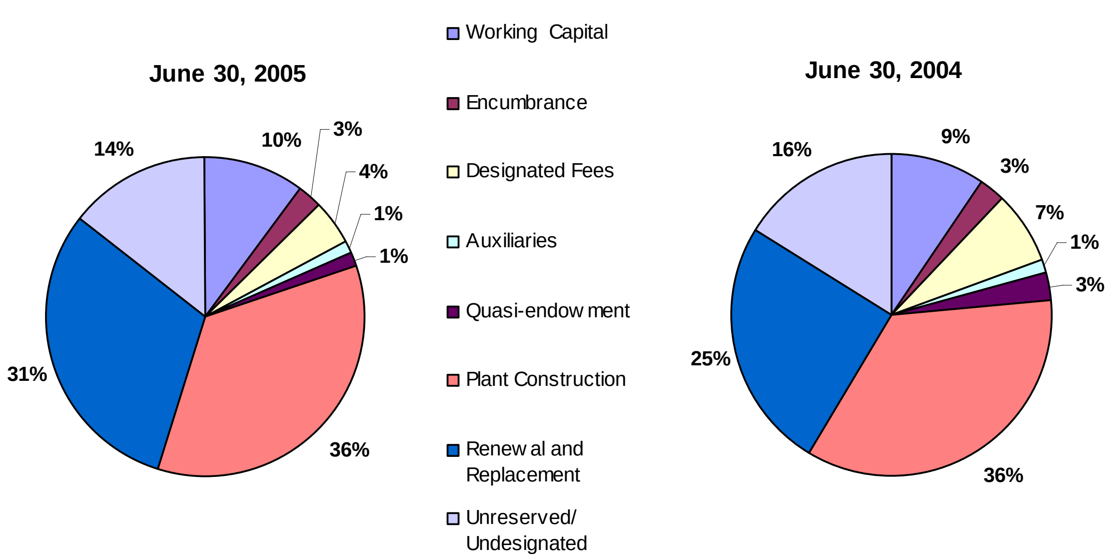
(in thousands of dollars)

	2005	2004	2003
Assets:			
Current assets	$ 9,253	$ 7,842	$ 17,493
Noncurrent assets	69,830	58,338	40,465
Total assets	79,083	66,180	57,958
Liabilities:			
Current liabilities	1,583	2,500	1,580
Noncurrent liabilities	165	385	358
Total liabilities	1,748	2,885	1,938
Net assets:			
Restricted - nonexpendable	36,219	34,563	32,226
Restricted - expendable	39,445	27,196	22,403
Unrestricted	1,671	1,536	1,391
Total net assets	$ 77,335	$ 63,295	$ 56,020

- Noncurrent assets increased in the current year due to the increase of $9 million in investments. Funds were available as a result of an increase in gifts of $4.3 million and a decrease in expenses of $2.4 million.
- 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.
- In fiscal year 2005, current liabilities decreased significantly. This was primarily the result of a decrease in payables to the university at the end of the fiscal year.
- In fiscal year 2004, current liabilities increased because of a $1 million increase in the amount due to the university at fiscal year end.
- There was an increase in restricted – expendable in the current year. Of the increase, $5.5 million was due to investment income and an additional $5 million increase in restricted revenue that had not yet met the requirements to be transferred to unrestricted.
- For fiscal year 2004, the restricted – expendable increased due to a $6.2 million increase in restricted revenue that had not yet met the requirements to be transferred to unrestricted.

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 graph shows the allocations:

Allocation of Unrestricted Net Assets – The University



- The allocation for renewals and replacements increased from 25% to 31%. This was due to an increase of $l.5 million for the Information Systems Enterprise Resource Plan. This was a major project of the university to upgrade the software for a system-wide computing system. Student housing, an auxiliary, increased its contribution to renewals and replacements by $500,000 and the total for parking services increased by $750,000.

- Quasi-endowment funds decreased from 3% of the total to 1%. This was a result of the transfer of $675,000 to the unexpended plant fund for the construction of a women's softball field from the Intercollegiate Athletics Quasi-Endowment Fund.
- Designated fees decreased from 7% to 4% in fiscal year 2005. An amount of $350,000 was transferred from student activities fees to unexpended plant funds for the women's softball field, and the amount expended from the engineering fees increased by $150,000.

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 accounting principles generally accepted in the United States of America.

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

(in thousands of dollars)

	2005	2004	2003
Operating revenues:			
Net tuition and fees	$ 84,764	$ 83,829	$ 77,606
Grants and contracts	35,765	35,514	47,201
Auxiliary	13,804	13,384	12,489
Other	19,756	18,669	14,443
Total operating revenues	154,089	151,396	151,739
Operating expenses	(311,761)	(290,182)	(280,902)
Operating income (loss)	(157,672)	(138,786)	(129,163)
Nonoperating revenues and expenses:			
State appropriations	110,384	104,505	106,141
Gifts	16,386	12,665	15,445
Grants and contracts	28,444	16,492	251
Investment income	2,801	2,343	3,675
Other revenues and expenses	(2,972)	(2,004)	(258)
Total nonoperating revenues and expenses	155,043	134,001	125,254
Income (loss) before other revenues, expenses, gains, or losses	(2,629)	(4,785)	(3,909)
Other revenues, expenses, gains, or losses:			
Capital appropriations	4,698	4,091	18,675
Capital grants and gifts	778	-	29,011
Other	(1)	(51)	(319)
Total other revenues, expenses, gains, or losses	5,475	4,040	47,367

Increase in net assets	2,846	(745)	43,458
Net assets at beginning of year	237,821	238,566	195,108
Net assets at end of year	$ 240,667	$ 237,821	$ 238,566

Total operating revenues:

- In fiscal year 2005, the increase in grants and contracts revenue is attributable to the implementation of the Hope Scholarships.
- The increase in student tuition and fees, net of scholarship allowances, in fiscal year 2004 is the result of a 12% increase in tuition.
- The decrease in grants and contracts in 2004 was a result of the reclassification of Pell and SEOG from operating to nonoperating revenue.
- Other operating revenues increased in fiscal year 2004 due to increases in athletic ticket sales.

Operating expenses:

- Operating expenses increased for fiscal year 2005 by $21 million. Of this amount, salaries and benefits increased by $12 million. This was due to a salary increase, a one-time bonus, an increase in costs for TCRS retirement and an increase in insurance costs. In addition, operating expenses increased for research by $5 million. Of this, $2.6 million was software that was a gift-in-kind.

Total nonoperating revenues and expenses:

- Nonoperating gifts increased in fiscal year 2005. This was a result of an increase of $1.2 million in gifts for athletics and gifts recorded for the FedEx Institute for Technology in the amount of $3.6 million.
- In 2004 nonoperating gifts decreased from 2003 due to vacancies in several key fund-raising positions.
- The reclassification of Pell and SEOG in 2004 to nonoperating from operating revenue resulted in the increase in other revenues and expenses.

Total other revenues, expenses, gains, or losses:

- In 2005 there was a slight increase in capital appropriations over the prior year. Two of the major projects were roof repairs and replacements and fume hood upgrades.
- For fiscal year 2004, there was a reduction of $14.5 million in state capital appropriations. This was due to the completion of the FedEx Institute of Technology.
- Capital grants and gifts for 2005 were due to capital gifts-in-kind for the FedEx Institute of Technology.
- 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)

	2005	2004	2003
Operating revenues and expenses:			
Gifts and contributions	$ 9,636	$ 5,381	$ 4,558
Operating expenses	(6,885)	(8,239)	(7,881)
Operating income (loss)	2,751	(2,858)	(3,323)
Nonoperating revenues and expenses:			
Investment income	6,238	7,858	97
Income (loss) before other revenues expenses, gains, or losses	8,989	5,000	(3,226)
Other revenues, expenses, gains, or losses:	5,052	2,275	4,759
Increase in net assets	14,041	7,275	1,533
Net assets at beginning of year	63,295	56,020	54,487
Net assets at end of year	$ 77,336	$ 63,295	$ 56,020

Gifts and contributions:

- Gifts and contributions increased in the current year due to a new pledge receivable of $4 million.
- The increase in 2004 was due to a $1 million grant from the U.S. Department of Education for the Benjamin Hooks Institute.

Operating expenses:

- For operating expenses, the increase in 2004 was due to an increase in university support and expenditures for furniture and fixtures for the FedEx Institute of Technology. That, plus a reduction in general university support, explains the reduction in operating expenses for 2005.

Investment income:

- Investment income decreased in 2005 by $1.6 million due to a reduction in the rate of return received on investments and fewer investments were held during the year.
- In 2003 stock prices stabilized and the foundation sold an appreciable amount of stock which was reinvested in 2004.

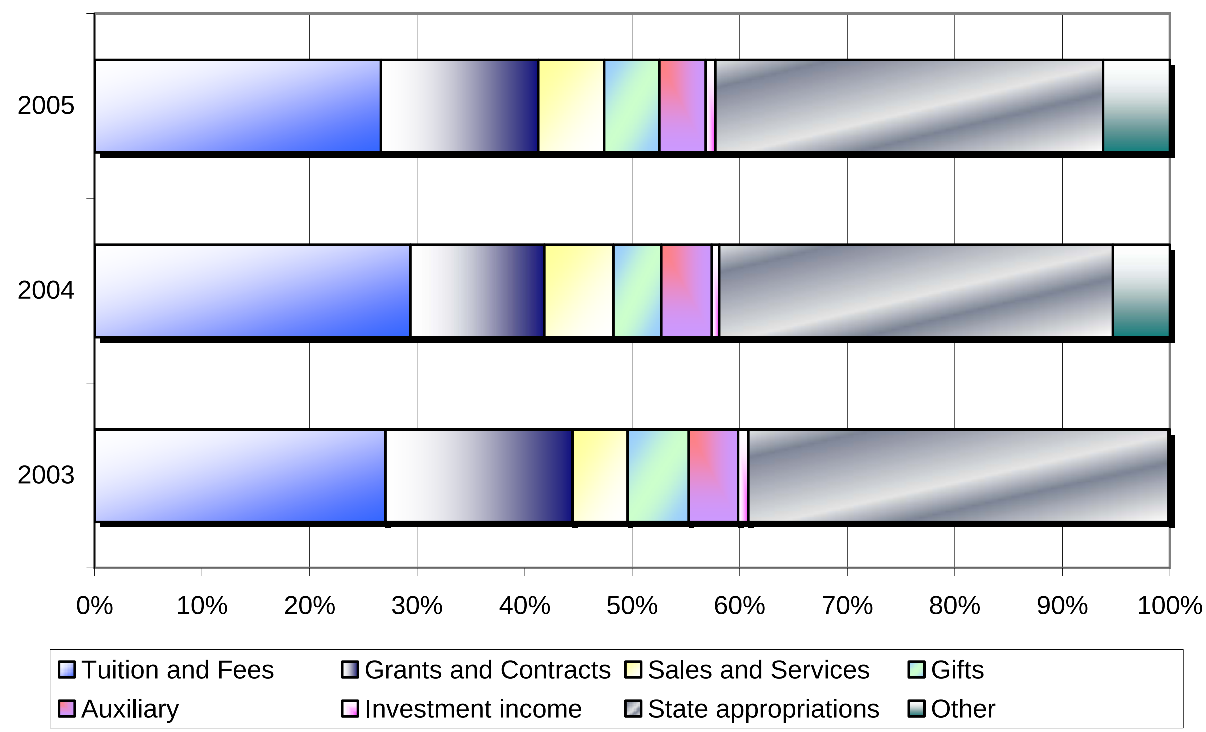
Other revenues, expenses, gains, or losses:

- In 2004, contributions to permanently endowed funds decreased due to vacancies in several key fund-raising positions. In 2005, contributions returned to expected levels.

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, 2005; June 30, 2004; and June 30, 2003 (amounts are presented in thousands of dollars).

Revenues by Source – The University



- With the advent of the Hope Scholarships in 2005, grants and contracts revenue increased, with a corresponding decrease in the percentage of overall revenue of state appropriations.

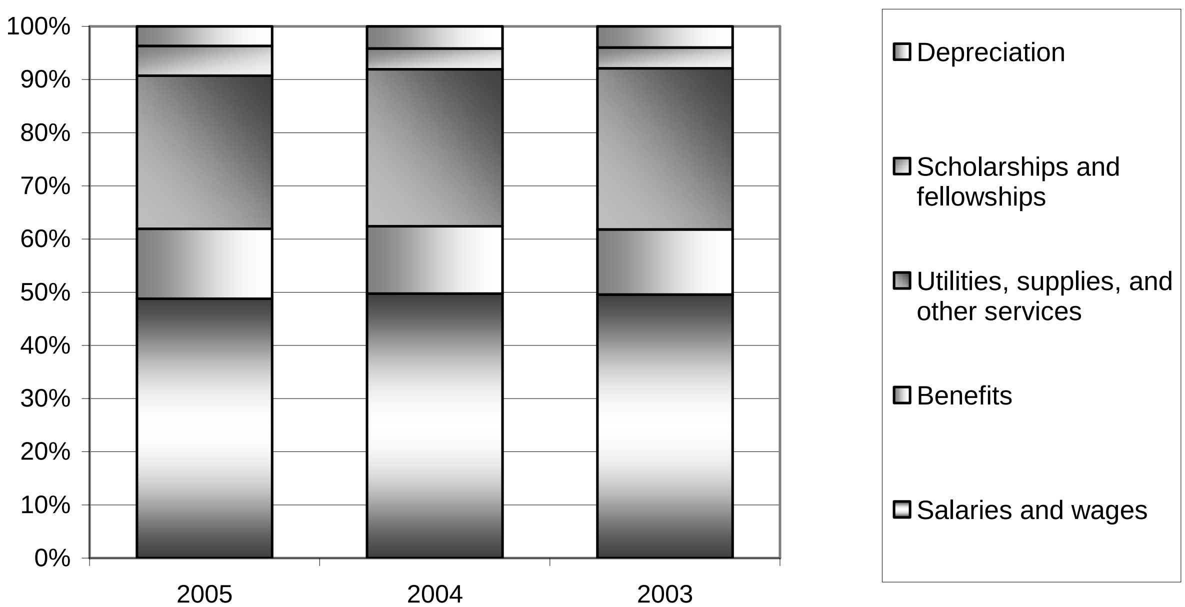
Expenses

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)

	2005	2004	2003
Operating expenses:			
Salaries and wages	$ 152,008	$ 144,567	$ 139,019
Benefits	41,172	36,864	34,445
Utilities, supplies, and other services	89,749	85,641	84,998
Scholarships and fellowships	17,361	11,372	11,033
Depreciation	11,470	11,738	11,407
Total operating expenses	$ 311,760	$ 290,182	$ 280,902

Expenses by Natural Classification - The University



- Fiscal year 2005 was the first year of the Hope Scholarship, which caused an increase in the percentage of scholarship and fellowship expenses as a portion of the total expenses of the university. There was a corresponding decrease in the percentage of salaries and wages although actual expenses increased.
- There was no significant change in expenses by natural classification for 2004.

Natural Classification - The Foundation
(in thousands of dollars)

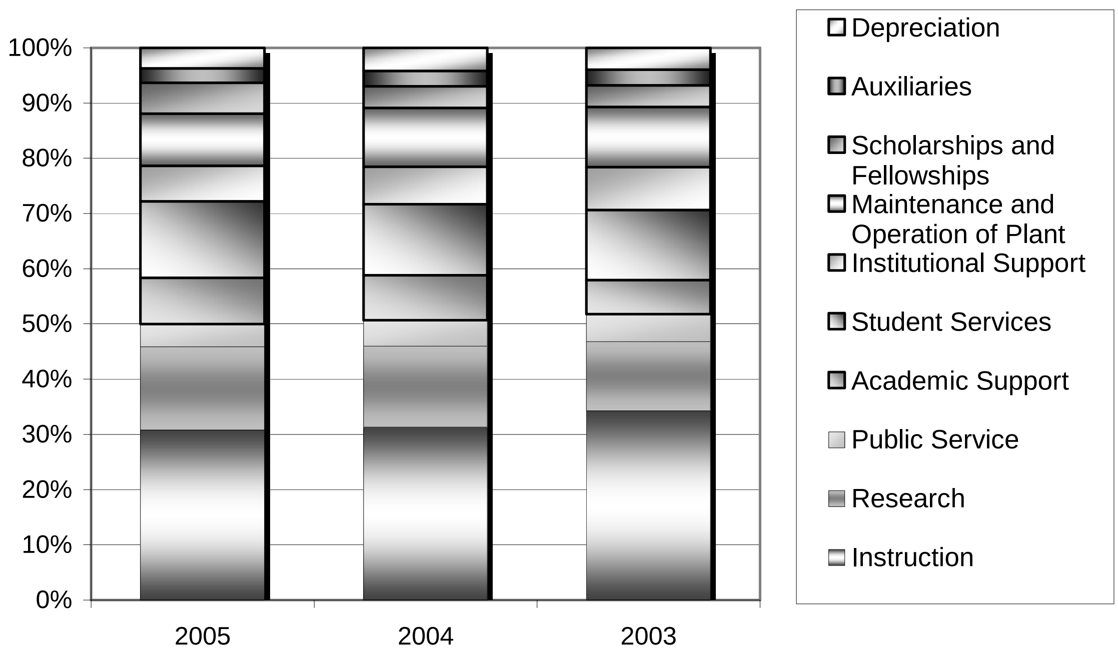
	2005	2004	2003
Operating expenses:			
Utilities, supplies, and other services	$ 6	$ 1,504	$ 2,416
Payment to or on behalf of the university	6,879	6,735	5,465
Total operating expenses	$ 6,885	$ 8,239	$ 7,881

- For payments to or on behalf of the university, the increase in 2004 was due to an increase in university support and expenditures for furniture and fixtures for the FedEx Institute of Technology.

Program Classification - The University
(in thousands of dollars)

	2005	2004	2003
Operating expenses:			
Instruction	$ 95,970	$ 91,087	$ 96,144
Research	47,086	42,560	35,162
Public service	12,769	13,475	13,980
Academic support	26,106	23,804	17,397
Student services	43,125	37,343	36,469
Institutional support	20,086	19,747	20,843
Maintenance and operation of plant	29,501	30,922	30,509
Scholarships and fellowships	17,361	11,372	11,033
Auxiliaries	8,287	8,134	7,958
Depreciation	11,470	11,738	11,407
Total operating expenses	$ 311,761	$ 290,182	$ 280,902

Expenses by Program Classification - The University



- 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 have increased both in fiscal year 2004 and fiscal year 2005.

- Two million dollars of the increase in student services is related to intercollegiate athletics. There was an increase of $800,000 in football expenses, $500,000 in basketball expenses, and $200,000 in expenses for the first year of the women's softball program.
- Scholarships and fellowships increased as a result of the Hope Scholarship.

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)

	2005	2004	2003
Cash provided (used) by:			
Operating activities	$ (144,013)	$ (127,167)	$ (113,938)
Noncapital financing activities	157,126	136,082	123,358
Capital and related financing activities	(10,316)	(15,983)	(15,523)
Investing activities	(6,686)	5,143	3,720
Net increase (decrease) in cash	(3,889)	(1,925)	(2,383)
Cash, beginning of year	47,000	48,925	51,308
Cash, end of year	$ 43,111	$ 47,000	$ 48,925

Cash flow from operating activities:

- The change in cash flow from operating activities in 2005 was not significant.
- In fiscal year 2004 there was a 14% increase in tuition, resulting in an additional $5.8 million to the university. In addition, the reclassification of Pell and SEOG to nonoperating resulted in a decrease in cash for operating activities in the amount of $16 million.

Noncapital financing activities:

- In fiscal year 2004 Pell and SEOG reclassification accounted for the largest increase—$16 million.

Capital and related financing activities:

- In fiscal year 2005 the use of cash for capital and related financing activities decreased due to a reduction in spending for capital projects.
- In fiscal year 2004 the increase in the use of cash was primarily attributable to the decrease in proceeds from capital debt.

Investing activities:

- The use of cash for investing activities increased in 2005 due to the increase in purchasing of investments.
- In fiscal year 2004 reductions in the holding periods of investments resulted in increases in the proceeds from sales and maturities of investments net of purchases.
- There was no significant change in the university's liquidity in the current year.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2005, the university had $219 million invested in capital assets, net of accumulated depreciation of $144.8 million. Depreciation charges totaled $11.5 million for fiscal year 2005, $11.7 million for fiscal year 2004, and $11.4 million for fiscal year 2003. Details of these assets are shown below.

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

	2005	2004	2003
Land	$ 15,738	$ 15,715	$ 15,298
Land improvements	2,921	3,287	3,653
Buildings	139,247	144,346	130,000
Equipment	13,581	11,156	11,773
Library holdings	15,098	14,752	14,126
Projects in progress	32,497	29,406	42,203
Total	$ 219,082	$ 218,662	$ 217,053

- There was no significant change in capital assets, net of depreciation for the current year.
- In fiscal year 2004 the increase in buildings was a result of the completion of the FedEx Institute of Technology at $19.3 million.

The primary capital project planned for 2006 is the replacement of the University Student Center, with an expected cost of $42.3 million. The principal source of funding will be Tennessee State School Bond Authority bonds, repaid by student debt service fees. More detailed information about the university's capital assets is presented in Note 6 to the financial statements.

Debt

At June 30, 2005, the university had $52.6 million in debt outstanding. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt - The University
(in thousands of dollars)

	2005	2004	2003
Bonds payable	$ 49,585	$ 51,668	$ 54,445
Commercial paper	3,023	1,444	1,363
Total	$ 52,608	$ 53,112	$ 55,808

There were no significant changes in outstanding debt. More detailed information about the University's long-term liabilities is presented in Note 7 to the financial statements.

Economic Factors That Will Affect the Future

The university implemented a 12.5% increase in student fees for 2006. Recent increases in student fees have not significantly impacted enrollment, with enrollment steady for the past 10 years.

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; The University of Memphis; Administration Building, Room 276; Memphis, TN 38152-3370.

Exhibit A

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF NET ASSETS
JUNE 30, 2005, AND JUNE 30, 2004

	Institution		Component Unit	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
ASSETS				
Current assets:				
Cash and cash equivalents (Notes 2, 3 and 17)	$ 7,028,611.06	$ 17,036,560.20	$ 5,953,133.00	$ 5,624,885.00
Short-term investments (Note 4)	40,661,415.00	23,941,327.77	-	-
Accounts, notes, and grants receivable (net) (Note 5)	22,501,573.32	22,856,418.86	-	-
Pledges receivable (net) (Note 17)	-	-	3,276,286.00	2,191,490.00
Inventories (at lower of cost or market)	487,412.43	422,516.31		
Prepaid expenses and deferred charges	598,978.29	445,403.47	10,353.00	9,878.00
Accrued interest receivable	261,319.10	448,990.79	13,714.00	15,236.00
Total current assets	71,539,309.20	65,151,217.40	9,253,486.00	7,841,489.00
Noncurrent assets:				
Cash and cash equivalents (Notes 2 and 3)	36,082,182.47	29,963,955.53	-	-
Investments (Notes 4 and 17)	2,282,281.25	9,327,772.87	63,905,545.00	54,899,135.00
Accounts, notes, and grants receivable (net) (Note 5)	8,880,462.62	9,995,114.67	-	-
Pledges receivable (net) (Note 17)	-	-	5,841,693.00	3,361,263.00
Capital assets (net) (Note 6)	219,081,847.43	218,661,581.32	-	-
Other assets	-	-	83,118.00	77,901.00
Total noncurrent assets	266,326,773.77	267,948,424.39	69,830,356.00	58,338,299.00
Total assets	337,866,082.97	333,099,641.79	79,083,842.00	66,179,788.00
LIABILITIES				
Current liabilities:				
Accounts payable	8,954,884.41	6,582,555.37	1,067,137.00	2,424,633.00
Accrued liabilities	14,800,059.62	15,265,120.31	152,490.00	37,883.00
Student deposits	540,922.36	564,425.99	-	-
Deferred revenue	9,077,345.55	9,290,136.09	363,680.00	37,500.00
Compensated absences (Note 7)	1,829,620.29	1,657,714.88	-	-
Accrued interest payable	407,036.34	488,067.89	-	-
Long-term liabilities, current portion (Note 7)	5,573,149.90	4,169,793.47	-	-
Deposits held in custody for others	353,833.54	391,032.72	-	-
Total current liabilities	41,536,852.01	38,408,846.72	1,583,307.00	2,500,016.00
Noncurrent liabilities:				
Note payable	-	-	165,000.00	225,000.00
Compensated absences (Note 7)	5,794,115.25	5,238,676.64	-	-
Long-term liabilities (Note 7)	47,034,988.08	48,942,295.33	-	-
Due to grantors (Note 7)	2,833,659.32	2,689,000.83	-	-
Other liabilities	-	-	-	160,065.00
Total noncurrent liabilities	55,662,762.65	56,869,972.80	165,000.00	385,065.00
Total liabilities	97,199,614.66	95,278,819.52	1,748,307.00	2,885,081.00
NET ASSETS				
Invested in capital assets, net of related debt	166,473,709.45	165,549,492.52	-	-
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	1,315,361.24	2,185,417.51	-	-
Other	2,082,682.23	1,133,339.10	36,219,015.00	34,563,328.00
Expendable:				
Scholarships and fellowships	1,299,017.97	1,603,128.54	-	-
Research	1,094,548.90	1,412,782.53	-	-
Instructional department uses	2,112,661.32	2,114,339.70	-	-
Loans	2,735,650.57	2,840,713.37	-	-
Capital projects	2,503,131.85	1,669,266.06	-	-
Debt service	7,319,659.41	8,578,563.36	-	-
Other	1,085,917.30	1,056,784.69	39,444,881.00	27,196,278.00
Unrestricted (Note 9)	52,644,128.07	49,676,994.89	1,671,639.00	1,535,101.00
Total net assets	$ 240,666,468.31	$ 237,820,822.27	$ 77,335,535.00	$ 63,294,707.00

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

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2005, AND JUNE 30, 2004

	Institution		Component Unit	
	Year Ended June 30, 2005	Year Ended June 30, 2004	Year Ended June 30, 2005	Year Ended June 30, 2004
REVENUES				
Operating revenues:				
Student tuition and fees (net of scholarship allowances of $17,343,968.00 for the year ended June 30, 2005, and $11,988,831.00 for the year ended June 30, 2004)	$ 84,764,214.67	$ 83,828,648.78	$ -	$ -
Gifts and contributions	-	-	9,635,543.00	5,381,075.00
Governmental grants and contracts	33,012,546.31	30,859,976.63	-	-
Nongovernmental grants and contracts	2,752,294.67	4,654,987.48	-	-
Sales and services of educational departments	19,479,678.57	18,354,317.29	-	-
Auxiliary enterprises:				
Residential life (net of scholarship allowances of $127,009.00 for the year ended June 30, 2005, and $88,616.00 for the year ended June 30, 2004)	8,188,627.49	7,972,053.37	-	-
Bookstore	626,511.87	1,279,357.23	-	-
Food service	329,138.25	288,784.76	-	-
Other auxiliaries	4,659,783.51	3,843,403.78	-	-
Interest earned on loans to students	275,944.93	315,077.19	-	-
Total operating revenues	154,088,740.27	151,396,606.51	9,635,543.00	5,381,075.00
EXPENSES				
Operating expenses:				
Salaries and wages	152,008,388.55	144,566,864.96	-	-
Benefits	41,172,244.06	36,864,312.87	-	-
Utilities, supplies, and other services	89,749,334.99	85,640,829.08	5,685.00	1,504,162.00
Scholarships and fellowships	17,361,074.18	11,371,897.55	-	-
Depreciation expense	11,469,764.21	11,738,268.57	-	-
Payments to or on behalf of the University	-	-	6,878,967.00	6,734,897.00
Total operating expenses	311,760,805.99	290,182,173.03	6,884,652.00	8,239,059.00
Operating loss	(157,672,065.72)	(138,785,566.52)	2,750,891.00	(2,857,984.00)
NONOPERATING REVENUES (EXPENSES)				
State appropriations	110,384,300.00	104,505,200.00	-	-
Gifts	16,385,524.89	12,664,829.42	-	-
Grants and contracts	28,443,815.25	16,491,902.75	-	-
Investment income (net of investment expense for the institution of $53,415.18 ended June 30, 2005, and $25,543.07 for the year ended June 30, 2004; and for the component unit of $204,223.00 for the year ended June 30, 2005 and $188,284.00 for the year ended June 30, 2004)	2,801,053.60	2,342,864.34	6,238,081.00	7,857,442.00
Interest on capital asset-related debt	(2,833,832.53)	(3,019,868.78)	-	-
Bond issuance expense	(883,958.02)	-	-	-
Other nonoperating revenues (expenses)	745,807.78	1,015,827.81	-	-
Net nonoperating revenues	155,042,710.97	134,000,755.54	6,238,081.00	7,857,442.00
Loss before other revenues, expenses, gains, or losses	(2,629,354.75)	(4,784,810.98)	8,988,972.00	4,999,458.00
Capital appropriations	4,697,913.97	4,091,362.95	-	-
Capital grants and gifts	778,570.00	-	-	-
Additions to permanent endowments	-	-	5,051,856.00	2,275,198.00
Other	(1,483.18)	(51,657.37)	-	-
Total other revenues	5,475,000.79	4,039,705.58	5,051,856.00	2,275,198.00
Increase (decrease) in net assets	2,845,646.04	(745,105.40)	14,040,828.00	7,274,656.00
NET ASSETS				
Net assets - beginning of year	237,820,822.27	238,565,927.67	63,294,707.00	56,020,051.00
Net assets - end of year	$ 240,666,468.31	$ 237,820,822.27	$ 77,335,535.00	$ 63,294,707.00

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, 2005, AND JUNE 30, 2004

	FY 2005	FY 2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 83,434,997.25	$ 82,452,162.92
Grants and contracts	36,778,752.43	35,569,474.45
Sales and services of educational activities	19,308,534.13	18,382,283.84
Payments to suppliers and vendors	(89,365,361.10)	(85,828,178.47)
Payments to employees	(152,628,179.95)	(143,639,283.50)
Payment for benefits	(38,039,200.76)	(36,300,498.73)
Payments for scholarships and fellowships	(17,361,074.18)	(11,371,897.55)
Loans issued to students and employees	(1,894,073.22)	(1,412,380.23)
Collection of loans from students and employees	1,519,581.30	1,731,336.98
Interest earned on loans to students	275,944.93	-
Auxiliary enterprise charges		
Residence halls	8,387,830.66	7,856,977.44
Bookstore	626,511.87	1,279,357.23
Food services	342,448.86	273,940.15
Other auxiliaries	4,600,018.15	3,840,136.55
Net cash flows provided (used) by operating activities	(144,013,269.63)	(127,166,568.92)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	110,423,300.00	104,459,300.00
Gifts and grants received for other than capital or endowment purposes, including $6,878,967.00 from The University of Memphis Foundation for the fiscal year ended June 30, 2005, and $6,734,897.00 for the fiscal year ended June 30, 2004	45,919,053.30	30,548,729.53
Private gifts for endowment purposes	1,225.00	7,525.00
Federal student loan receipts	75,473,456.00	69,098,687.00
Federal student loan disbursements	(75,473,456.00)	(69,098,687.00)
Changes in deposits held for others	(37,199.18)	(32,162.88)
Other noncapital financing receipts (payments)	819,233.04	1,098,433.95
Net cash flows provided (used) by noncapital financing activities	157,125,612.16	136,081,825.60
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	2,221,801.67	126,908.42
Capital - state appropriations	4,697,913.97	4,091,362.95
Proceeds from sale of capital assets	23,918.92	38,000.00
Purchase of capital assets and construction	(10,735,254.38)	(14,368,246.75)
Principal paid on capital debt and lease	(2,725,752.49)	(2,823,209.91)
Interest paid on capital debt and lease	(2,914,864.08)	(3,047,889.63)
Bond issue cost paid on new debt issue	(883,958.02)	-
Net cash flows provided (used) by capital and related financing activities	(10,316,194.41)	(15,983,074.92)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	30,726,314.75	39,336,377.13
Income on investments	2,988,725.29	2,847,338.34
Purchase of investments	(40,400,910.36)	(37,040,266.35)
Net cash provided (used) by investing activities	(6,685,870.32)	5,143,449.12
Net increase (decrease) in cash and cash equivalents	(3,889,722.20)	(1,924,369.12)
Cash and cash equivalents - beginning of year	47,000,515.73	48,924,884.85
Cash and cash equivalents - end of year (Notes 2 and 17)	$ 43,110,793.53	$ 47,000,515.73

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2005, AND JUNE 30, 2004

	FY 2005	FY 2004
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income (loss)	$ (157,672,065.72)	$ (138,785,566.52)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:		
Depreciation expense	11,469,764.21	11,738,268.57
Change in assets and liabilities		
Receivables, net	785,160.10	497,567.05
Inventories	(64,896.12)	29,012.99
Prepaid/deferred items	(153,574.82)	186,871.64
Other assets	-	17,939.32
Accounts payable	1,482,208.74	(2,433,606.51)
Accrued liabilities	(465,060.69)	998,911.25
Deferred revenues	(98,645.72)	383,396.96
Deposits	(23,503.63)	1,687.85
Compensated absences	727,344.02	198,948.48
Net cash provided (used) by operating activities	$ (144,013,269.63)	$ (127,166,568.92)
Gifts in-kind	$ 4,966,684.10	$ 258,795.15
Gifts in-kind - capital	$ 778,570.00	$ -
Unrealized gain/losses on investments	$ (70,614.22)	$ 105,699.83
Loss on disposal of capital assets	$ 25,402.10	$ 51,657.37

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, 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 and nonexchange transactions.

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 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, library holdings, and software, 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. The capitalization threshold for software is set at $100,000.

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, 2005, cash and cash equivalents consisted of $9,211,771.77 in bank accounts, $72,815.00 of petty cash on hand, $18,297,737.63 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, $3,240,048.83 in LGIP deposits for capital projects, and $12,288,420.30 in commercial paper. 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.

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

During the year ended June 30, 2005, the university implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*. That statement modified the custodial credit risk disclosures of GASB Statement 3 to limit required disclosures to deposits that are not covered by depository insurance and are (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the university's name.

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, 2005, the carrying amount of the university's deposits in financial institutions participating in the collateral pool was $9,211,771.77, and the bank balance including accrued interest was $11,666,187.34. The bank balance was insured. 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.

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.

At June 30, 2005, the carrying amount of the university's deposits was $9,411,771.77, and the bank balance including accrued interest was $11,868,830.39. The entire bank balance of $11,868,830.39 was insured or collateralized.

For the year ended June 30, 2004, 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.

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 required risk disclosures 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

During the year ended June 30, 2005, the university implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*. That statement modified the custodial credit risk disclosures of GASB Statement 3 to limit required disclosures to investment securities that are uninsured, are not registered in the name of the university, and are held by either (a) the counterparty or (b) the counterparty's trust department or agent but not in the university's name.

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.

At June 30, 2005, the university had the following investments and maturities.

		Investment Maturities (in Years)	
Investment Type	Fair Value	Less than 1	1 to 5
U.S. Treasury notes	$ 42,743,696.25	$ 40,661,415.00	$ 2,082,281.25
Commercial paper	12,288,420.30	12,288,420.30	-
Certificates of deposit	200,000.00	-	200,000.00
Less amounts classified as cash equivalents	(12,288,420.30)	(12,288,420.30)	-
Total	$ 42,943,696.25	$ 40,661,415.00	$ 2,282,281.25

Interest rate risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of debt investment. The university does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit risk - 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 (LGIP). 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 university has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations. At June 30, 2005, the university's investments were rated as follows by nationally recognized statistical rating organizations:

Investment Type	Moody's	Standard and Poor's	Fitch	Fair Value
LGIP	unrated	unrated	unrated	$ 18,297,737.63
Commercial paper	P-l	A-1+	F1	2,048,712.48
Commercial paper	P-l	A-1+		6,144,833.99
Commercial paper	P-l	A-1	F1	2,047,424.95
Commercial paper	P-l	A-1	F1+	2,047,448.88

Custodial credit risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the university will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The university does not have a policy for custodial credit risk. At June 30, 2005, the university had no uninsured and unregistered investments.

Concentration of credit risk - The university places no limit on the amount the university may invest in any one issuer. At June 30, 2005, the university did not have more than 5% invested in any single issuer.

Foreign currency risk - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The university places no limit on the amount the university may invest in foreign currency. At June 30, 2005, the university had no exposure to foreign currency risk.

The university's investments at June 30, 2004, 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
Category 1:	
U.S. government securities	$ 31,071,399.25
Commercial paper	3,996,412.50
Investments not susceptible to credit risk categorization:	
Certificates of deposit classified as investments	200,000.00
Amount classified as cash equivalents	(1,998,711.11)
Total	$ 33,269,100.64

NOTE 5. RECEIVABLES

Receivables included the following:

	June 30, 2005	June 30, 2004
Student accounts receivable	$ 8,506,101.53	$ 7,830,521.16
Grants receivable	9,880,313.89	10,144,155.94
Notes receivable	1,691,815.77	1,938,025.90
State appropriation receivable	243,600.00	282,600.00
Other receivables	14,360,685.17	16,108,532.52
Subtotal	34,682,516.36	36,303,835.52
Less allowance for doubtful accounts	(6,309,378.52)	(6,070,181.34)
Total receivables	$ 28,373,137.84	$ 30,233,654.18

Federal Perkins Loan Program funds included the following:

	June 30, 2005	June 30, 2004
Perkins loans receivable	$ 3,568,739.10	$ 3,236,465.21
Less allowance for doubtful accounts	(559,841.00)	(618,585.86)
Total	$ 3,008,898.10	$ 2,617,879.35

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2005, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 15,715,332.50	$ 23,156.56	$ -	$ -	$ 15,738,489.06
Land improvements and infrastructure	14,693,216.80	-	-	-	14,693,216.80
Buildings	226,865,182.99	217,819.74	-	-	227,083,002.73
Equipment	37,980,706.11	5,068,374.00	-	819,988.51	42,229,091.60
Library holdings	30,706,005.11	3,514,783.37	-	2,533,914.15	31,686,874.33
Projects in progress	29,405,509.93	3,091,298.75	-	-	32,496,808.68
Total	355,365,953.44	11,915,432.42	-	3,353,902.66	363,927,483.20
Less accum. depreciation:					
Land improvements and infrastructure	11,406,498.74	365,919.96	-	-	11,772,418.70
Buildings	82,518,914.68	5,317,193.92	-	-	87,836,108.60
Equipment	26,825,037.66	2,617,962.90	-	794,586.41	28,648,414.15
Library holdings	15,953,921.04	3,168,687.43	-	2,533,914,15	16,588,694.32
Total accum. depreciation	136,704,372.12	11,469,764.21	-	3,328,500.56	144,845,635.77
Capital assets, net	$ 218,661,581.32	$ 445,668.21	$ -	$ 25,402.10	$ 219,081,847.43

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

NOTE 7. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2005, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Bonds	$ 51,668,047.80	$ 643,129.30	$ 2,725,752.49	$ 49,585,424.61	$2,550,436.53
Commercial paper	1,444,041.00	1,578,672.37	-	3,022,713.37	3,022,713.37
Subtotal	53,112,088.80	2,221,801.67	2,725,752.49	52,608,137.98	5,573,149.90
Other liabilities:					
Compensated absences	6,896,391.52	6,055,572.78	5,328,228.76	7,623,735.54	1,829,620.29
Due to grantors	2,689,000.83	147,854.48	3,195.99	2,833,659.32	-
Subtotal	9,585,392.35	6,203,427.26	5,331,424.75	10,457,394.86	1,829,620.29
Total long-term liabilities	$ 62,697,481.15	$ 8,425,228.93	$ 8,057,177.24	$ 63,065,532.84	$7,402,770.19

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

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 $213,352.45 at June 30, 2005, and $270,768.89 at June 30, 2004.

Debt service requirements to maturity for bonds payable at June 30, 2005, are as follows:

Year Ending June 30	Principal	Interest	Total
2006	$ 2,550,436.53	$ 2,442,575.98	$ 4,993,012.51
2007	2,714,288.16	2,406,519.73	5,120,807.89
2008	2,871,177.50	2,250,350.35	5,121,527.85
2009	3,049,991.59	2,083,703.76	5,133,695.35
2010	3,253,298.30	1,906,834.77	5,160,133.07
2011-2015	7,836,036.75	7,882,485.29	15,718,522.04
2016-2020	8,438,337.69	6,028,530.57	14,466,868.26
2021-2025	8,662,551.83	3,868,543.70	12,531,095.53
2026-2030	10,117,952.77	1,609,085.46	11,727,038.23
2031-2032	91,353.49	24,207.72	115,561.21
	$ 49,585,424.61	$ 30,502,837.33	$ 80,088,261.94

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 $3,022,713.37 at June 30, 2005, and $1,444,041.00 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 8. 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 to be used in future years when the amount computed using the spending plan exceeds the investment income. At June 30, 2005, net appreciation of $6,101,132.37 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, 2004, net appreciation 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.

NOTE 9. 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, 2005	June 30, 2004
Working capital	$ 5,338,789.16	$ 4,643,645.50
Encumbrances	1,459,060.43	1,378,163.42
Designated fees	2,332,945.05	3,630,348.77
Auxiliaries	696,448.32	673,610.76
Quasi-endowment	722,639.51	1,447,639.51
Plant construction	18,323,379.85	17,407,718.92
Renewal and replacement of equipment	16,157,506.44	12,500,780.92
Unreserved/undesignated	7,613,359.31	7,995,087.09
Total	$ 52,644,128.07	$ 49,676,994.89

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 10.54% 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, 2005, 2004, and 2003, were $5,260,425.70, $3,503,862.94, and $3,398,360.32. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund (TIAA-CREF), Aetna Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in the TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated.* State statutes are amended by the Tennessee General Assembly.

Funding Policy - Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans was $7,879,469.14 for the year ended June 30, 2005, and $7,480,968.15 for the year ended June 30, 2004. 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

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. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the years ended June 30, 2005, and June 30, 2004, 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. 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, 2005, the Risk Management Fund held $114.4 million in cash and cash equivalents designated for payment of claims. At June 30, 2004, the Risk Management fund held $101.1 million in cash and cash equivalents designated for payment of claims.

At June 30, 2005, the scheduled coverage for the university was $523,805,900.00 for buildings and $304,103,100.00 for contents. At June 30, 2004, the scheduled coverage for the university was $480,013,400.00 for buildings and $293,254,100.00 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 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 $62,811,766.85 at June 30, 2005, and $59,428,498.93 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 $1,280,481.89 and for personal property were $375,135.62 for the year ended June 30, 2005. Comparative amounts for the year ended June 30, 2004, were $1,441,762.36 and $633,206.73. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2005, outstanding commitments under construction contracts totaled $12,583,350.15 for Drainage Corrections, Fume Hood

Replacement, Carpenter Hall, University Center Renovations, and Richardson and Rawls Fire Safety of which $4,494,848.77 will be funded by future state capital outlay appropriations.

Contract - In December 2004, the Tennessee Board of Regents system entered into a contract with SungardSCT for the purchase of a comprehensive enterprise resource planning system. The contract includes a multi-year phase-in of administrative software for financial, human resource, and student systems. The university's outstanding liability for this contract is estimated as $5,161,787.00 at June 30, 2005.

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 $58,643,290.92 on deposit at June 30, 2005, and $57,102,602.46 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 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 $790,532.92 from these funds during the year ended June 30, 2005, and $956,539.74 during the year ended June 30, 2004.

NOTE 16. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2005, are as follows:

Functional Classification	Natural Classification Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 63,887,968.98	$ 15,553,525.91	$ 16,528,174.97	$ -	$ -	$95,969,669.86
Research	28,721,984.95	6,576,046.44	11,787,777.19	-	-	47,085,808.58
Public service	6,427,076.63	1,661,215.79	4,681,083.28	-	-	12,769,375.70
Academic support	15,844,904.10	5,017,557.23	5,243,180.79	-	-	26,105,642.12
Student services	14,107,171.97	4,437,378.90	24,581,113.71	-	-	43,125,664.58
Institutional support	12,528,760.76	3,979,661.50	3,577,653.82	-	-	20,086,076.08
Operation & maintenance	8,678,837.48	3,482,997.78	17,338,934.39	-	-	29,500,769.65
Scholar. & fellow.	-	-	-	17,361,074.18	-	17,361,074.18
Auxiliary	1,811,683.68	463,860.51	6,011,416.84	-	-	8,286,961.03
Depreciation	-	-	-	-	11,469,764.21	11,469,764.21
Total	$ 152,008,388.55	$ 41,172,244.06	$ 89,749,334.99	$ 17,361,074.18	$ 11,469,764.21	$311,760,805.99

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

Functional Classification	Natural 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	-	-	18,474,723.76
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 & maintenance	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

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 forty-member 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 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.

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 reformatting, 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, 2005, the foundation made distributions of $6,878,967.00 to or on behalf of the university for both restricted and unrestricted purposes. During the year ended June 30, 2004, the foundation made distributions of $6,734,897.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Mr. Larry Bunch, Managing Director; 110 Billy Mac Jones Building; Memphis, Tennessee 38152-3750.

Cash and cash equivalents - Cash and cash equivalents consists of demand deposit accounts and money market funds. Of the bank balances of deposits at June 30, 2005, $100,000.00 was insured by FDIC and $5,853,133.00 was not insured. Of the bank balances of deposits at June 30, 2004, $100,000 was insured by FDIC and $5,524,885.00 was not insured.

Investments - Investments are reported at fair value. Donated investments are recorded on the date of donation and are stated at fair value. Unrealized gains and losses are determined by the difference between fair values at the beginning and end of the year.

Investments held at June 30, 2005, were as follows:

	Cost	Market Value
Mutual funds	$ 46,174,621.00	$ 52,681,525.00
U.S. government, foreign, and other bonds	217,305.00	218,507.00
Donated real and personal property	735,430.00	735,430.00
Interest in limited partnerships	8,357,607.00	10,270,083.00
Total investments	$ 55,484,963.00	$ 63,905,545.00

Investments held at June 30, 2004, were as follows:

	Cost	Market Value
Mutual funds	$ 42,873,351.00	$ 46,503,483.00
U.S. government, foreign, and other bonds	384,704.00	389,917.00
Donated real and personal property	323,880.00	323,880.00
Interest in limited partnerships	6,955,347.00	7,681,855.00
Total investments	$ 50,537,282.00	$ 54,899,135.00

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

	June 30, 2005	June 30, 2004
Current pledges	$ 3,334,290.00	$ 2,191,490.00
Pledges due in one to five years	6,071,429.00	3,334,954.00
Pledges due after five years	194,100.00	286,600.00
Subtotal	9,599,819.00	5,813,044.00
Less allowance for uncollectible contributions	(60,003.00)	(28,060.00)
Less discounts to net present value	(421,837.00)	(232,231.00)
Total pledges receivable, net	$ 9,117,979.00	$ 5,552,753.00

Long-term liabilities - Long-term liabilities at June 30, 2005, consisted of the following:

	Ending Balance	Current Portion
Payables:		
Notes	$ 165,000.00	$ -

Long-term liabilities at June 30, 2004, consisted of the following:

	Ending Balance	Current Portion
Payables:		
Notes	$ 225,000.00	$ -

Notes 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 repayment 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
STATEMENTS OF CASH FLOWS - COMPONENT UNIT
FOR THE YEARS ENDED JUNE 30, 2005, AND JUNE 30, 2004

	FY 2005	FY 2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$ 6,396,497.00	$ 5,307,990.00
Payments to suppliers and vendors	(51,618.00)	(1,601,735.00)
Payments to the University of Memphis	(8,241,680.00)	(5,709,476.00)
Net cash flows provided (used) by operating activities	(1,896,801.00)	(2,003,221.00)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes	5,051,856.00	2,275,198.00
Other noncapital financing receipts (payments)	(60,000.00)	-
Net cash flows provided (used) by noncapital financing activities	4,991,856.00	2,275,198.00
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Other capital and related financing receipts (payments)	-	35,000.00
Net cash flows provided (used) by capital and related financing activities	-	35,000.00
CASH FLOWS FROM INVESTING ACTIVITIES		
Income on investments	6,239,603.00	7,852,726.00
Purchase of investments	(9,006,410.00)	(17,132,616.00)
Net cash provided (used) by investing activities	15,246,013.00	24,985,342.00
Net increase (decrease) in cash and cash equivalents	18,341,068.00	25,292,319.00
Cash and cash equivalents - beginning of year	5,624,885.00	14,597,798.00
Cash and cash equivalents - end of year (Notes 2 and 17)	$ 23,965,953.00	$ 39,890,117.00
RECONCILIATION OF OPERATING INCOME (LOSS) TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating income (loss)	$ 2,750,891.00	$ (2,857,984.00)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:		
Change in assets and liabilities		
Receivables, net	(3,565,226.00)	(73,085.00)
Prepaid/deferred items	(475.00)	4,691.00
Other assets	(5,217.00)	-
Accounts payable	(1,357,496.00)	1,025,421.00
Accrued liabilities	114,607.00	(94,594.00)
Deferred revenues	326,180.00	-
Other liabilities	(160,065.00)	(7,670.00)
Net cash provided (used) by operating activities	$ (1,896,801.00)	$ (2,003,221.00)
Non-cash transactions		
Unrealized gain/losses on investments	$ (2,082,137.10)	$ 61,793.00