AUDIT REPORT

Tennessee Board of Regents
Walters State Community College

For the Years Ended
June 30, 2005, and June 30, 2004

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

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STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

State Capitol
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John G. Morgan
Comptroller

November 30, 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. Wade B. McCamey, President
Walters State Community College
500 South Davy Crockett Parkway
Morristown, Tennessee 37813-6899

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, Walters State Community College, for the years ended June 30, 2005, and June 30, 2004. 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 disclosed a deficiency, which is detailed in the Results of the Audit section of this report. The college's administration has responded to the audit finding; the response is included following the finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit finding.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/sds
06/050

State of Tennessee

A u d i t   H i g h l i g h t s

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Walters State Community College
For the Years Ended June 30, 2005, and June 30, 2004

AUDIT OBJECTIVES

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

INTERNAL CONTROL FINDING

College Management and Fiscal Staff Failed to Maintain the Foundation's Accounting Records and to Prepare the Foundation's Financial Statements to Be in Compliance With New Accounting Standards, Increasing the Risks of Errors in Financial Reporting and the Possibility That Fraud, Waste, and Abuse Could Occur and Not Be Detected Timely

The management and fiscal staff of Walters State Community College failed to adequately plan for accounting changes required by the Governmental Accounting Standards Board (GASB) under GASB Statement 39. The Executive Director of College Advancement and the Director of Accounting Services failed to maintain adequate accounting records to facilitate proper financial reporting of foundation revenues and expenses. As a result, the foundation's revenues and expenses were materially misclassified on the foundation's initial Statements of Revenues, Expenses, and Changes in Net Assets for the years ended June 30, 2005, and June 30, 2004. In order to achieve fair presentation of all statements, we had to make numerous adjustments to properly categorize the revenues and expenses in accordance with GASB standards.

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

Audit Report
Tennessee Board of Regents
Walters State Community College
For the Years Ended June 30, 2005, and June 30, 2004

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Tennessee Board of Regents
Walters State Community College
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INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

The idea for Tennessee's community college system was conceived in 1957 when the state legislature ordered a study of community college programs, a study which resulted in the Pierce-Albright Report. Acting on the recommendation of the Governor and the Department of Education, the General Assembly authorized the Department of Education to establish several community colleges throughout Tennessee. Walters State Community College was established in 1967. The college first admitted students in the fall of 1970. The General Assembly vested the governance of Walters State Community College in the Tennessee Board of Regents on July 1, 1972.

ORGANIZATION

The governance of Walters State Community College 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 college is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 2003, through June 30, 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 years ended June 30, 2005, and June 30, 2004. Walters State Community College 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 college'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.

PRIOR AUDIT FINDING

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The college filed its report with the Department of Audit on April 1, 2005. A follow-up of a prior audit finding was conducted as part of the current audit.

RESOLVED AUDIT FINDING

The current audit disclosed that the college has corrected a previous audit finding concerning the failure to detect financial aid overawards.

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 control 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.

TECHNOLOGY CENTER

Walters State Community College serves as the lead institution under an agreement with the Tennessee Technology Center at Morristown. Under this agreement, Walters State Community College performs the accounting and reporting functions for the center. The chief administrative officer of the center is the director, who is assisted and advised by members of the faculty and administrative staff. The director is responsible to the Chancellor of the Tennessee Board of Regents.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the college's financial statements for the years ended June 30, 2005, and June 30, 2004, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. A reportable condition, along with our recommendation and management's response, is detailed in the finding and recommendation section of the report. 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 college's financial statements.

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

June 7, 2006

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

Dear Mr. Morgan:

We have audited the financial statements of Walters State Community College, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the years ended June 30, 2005, and June 30, 2004, and have issued our report thereon dated June 7, 2006. 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 college implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*. During the year ended June 30, 2004, the college implemented GASB Statement 39, *Determining Whether Certain Organizations Are Component Units*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the college’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. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the college's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The following reportable condition was noted:

- College management and fiscal staff failed to maintain the foundation's accounting records and to prepare the foundation's financial statements to be in compliance with new accounting standards, increasing the risks of errors in financial reporting and the possibility that fraud, waste, and abuse could occur and not be detected timely.

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

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is not a material weakness.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the college's financial statements are free of material misstatement, we performed tests of the college'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 other less significant instances of noncompliance, which we have reported to the college's management in a separate letter.

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

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/sds

FINDING AND RECOMMENDATION

College management and fiscal staff failed to maintain the foundation's accounting records and to prepare the foundation's financial statements to be in compliance with new accounting standards, increasing the risks of errors in financial reporting and the possibility that fraud, waste, and abuse could occur and not be detected timely

Management and fiscal staff of Walters State Community College failed to adequately plan for accounting changes required by the Governmental Accounting Standards Board (GASB) and to follow established fiscal procedures and relevant accounting standards to maintain and prepare the college foundation's financial records and statements. The college implemented Governmental Accounting Standards Board (GASB) Statement 39, *Determining Whether Certain Organizations Are Component Units*, for the year ended June 30, 2004. This statement required the college to report the Walters State Community College Foundation as a discretely presented component unit of the college whereby the foundation's financial statements were presented separately alongside the college's financial statements.

Based on our review and testwork, we determined that the foundation's revenues and expenses were materially misclassified on the foundation's Statements of Revenues, Expenses, and Changes in Net Assets for the years ended June 30, 2005, and June 30, 2004. In addition, as a result of these errors, the Statements of Cash Flows - Component Unit for the years ended June 30, 2005, and June 30, 2004, were materially misstated. The foundation's Statements of Cash Flows are presented as supplementary information in the college's report. In order to achieve fair presentation of all statements, we had to make numerous adjustments to properly categorize the revenues and expenses in accordance with GASB standards.

Based on our observations and discussions with management, the misclassifications occurred because of management's failure to properly plan for the implementation of GASB Statement 39. There has been ample time for this conversion. GASB Statement 39 was issued in May 2002 and was effective for financial statements for periods beginning after June 15, 2003. The college's first year of implementation was for the year ended June 30, 2004, approximately two years after the statement was issued. The Executive Director for College Advancement and the Director of Accounting Services failed to establish proper foundation revenue and expense classifications at the beginning of each fiscal year and were forced to classify the accounts after the fact, rather than on an ongoing basis. In addition, the executive director and director failed to maintain adequate accounting records to facilitate proper financial reporting of foundation revenues and expenses. Specifically, the following problems were noted:

- The Executive Director for College Advancement maintained only a cash receipts ledger and a separate cash disbursements ledger, rather than a general ledger with necessary accruals. Also, the cash transactions were not categorized as to revenue or expense classification.

- On the college's general ledger, the foundation was accounted for in an agency fund. This method provides that only fund additions and fund deductions are reported. Again, revenue and expense categories were not assigned to the transactions.

The failure to properly plan and implement accounting changes and to properly account for foundation revenues and expenses in accordance with applicable standards increases the risks that errors, fraud, waste, and abuse could occur and not be detected timely and also increases the risk of errors in financial reporting. Financial statement users including potential donors need accurate financial reports to properly evaluate the foundation's financial condition and performance.

Recommendation

Top college management, specifically the Executive Director for College Advancement and the Director of Accounting Services, should seek additional training and assistance regarding the implementation of GASB Statement 39. Specifically, the staff should ensure that a chart of accounts for revenue and expense categories is developed which will facilitate the college's compliance with GASB standards by providing the information necessary to prepare year-end financial statements. The Vice President for Business Affairs should review the year-end financial statements and supporting general ledger to ensure these problems have been corrected before the statements are published.

The Vice President for Business Affairs should also ensure that risks such as these noted in this finding are adequately identified and assessed in their documented risk assessment activities. Management should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

Management's Comment

We concur with the finding. The college foundation's accountant was promoted to Executive Director of the foundation as of July 1, 2004, thus leaving the foundation accountant's position vacant. A decision was not made until the fall of 2005 to refill the accountant's position. The foundation's accountant position was then filled in late January 2006 by a person who had been employed by the college's business office for several years and who had experience with the FRS Plus accounting system. That employee is making efforts to utilize the FRS Plus system to better meet GASB Statement 39 reporting requirements.

The college will transition to the new Banner accounting software as of July 1, 2007. Based on what we currently know of the structure of the system, we will have a chart of accounts that will allow appropriate classification of revenues and expenses to include a proper full accrual general ledger specifically for foundation activities. Therefore, based on that transition taking place July 1, 2007, for the fiscal years ending June 30, 2006, and 2007, we propose to ensure appropriate detailed documentation of transactions by preparing/maintaining a spreadsheet in support of information entered into the FRS Plus accounting system that will contain the details needed to ascertain compliance with GASB Statement 39 reporting requirements. Appropriate training will also be sought for the foundation's accountant relative to the requirements of GASB Statement 39.

We also agree to have periodic meetings between the Vice Presidents for Business Affairs and College Advancement, foundation accounting staff, and college accounting staff to review the work being done toward meeting the requirements as outlined here and to ensure that appropriate internal controls and associated risks are assessed.

STATE OF TENNESSEE
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Independent Auditor's Report

June 7, 2006

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 Walters State Community College, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the years ended June 30, 2005, and June 30, 2004, as listed in the table of contents. These financial statements are the responsibility of the college's management. Our responsibility is to express opinions on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member on 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 on 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, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tennessee Board of Regents, Walters State Community College, 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 college implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*. During the year ended June 30, 2004, the college implemented GASB Statement 39, *Determining Whether Certain Organizations Are Component Units*.

The management's discussion and analysis on pages 14 through 33 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the basic financial statements. The accompanying financial information on page 60 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 June 7, 2006, on our consideration of the college'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/sds

Management's Discussion and Analysis

This section of Walters State Community College's annual financial report presents a discussion and analysis of the financial performance of the college 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.

The college has a discretely presented component unit, the Walters State Community College Foundation. More detailed information about the college's component unit is presented in Note 13 of the financial statements. Information and analysis regarding the component unit are also included in this section.

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 Walters State Community College as a whole and present a long-term view of the college's finances.

The Statement of Net Assets

The statement of net assets presents the financial position of the college at the end of the fiscal year and includes all assets and liabilities of the college. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the college. 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 college's equity in property, plant, and equipment owned by the college. 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 college 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.

Institution
Statements of Net Assets
(in thousands of dollars)

	2005	2004	2003
Assets:			
Current assets	$ 7,974	$ 7,147	$14,734
Capital assets, net	38,026	38,086	38,605
Other assets	3,063	2,599	6,323
Total assets	**49,063**	**47,832**	**59,662**
Liabilities:			
Current liabilities	4,413	3,383	14,937
Noncurrent liabilities	1,213	1,326	1,424
Total liabilities	**5,626**	**4,709**	**16,361**
Net Assets:			
Invested in capital assets, net of related debt	37,574	37,549	37,988
Restricted – expendable	40	114	256
Unrestricted	5,823	5,460	5,057
Total net assets	**$43,437**	**$43,123**	**$43,301**

Significant Differences Between FY 2005 and FY 2004

- Current assets increased due to the recognition of the issuance of $452,200 in commercial paper to purchase capital software.
- Current assets also increased because there was approximately a $400,000 increase in cash equivalents carried at the lead institution for the Tennessee Technology Center at Morristown.
- The increase in current liabilities is mainly attributed to an increase in deposits held in custody for others ($400,000) and an increase in accounts payable (approximately $440,000).

Significant Differences Between FY 2004 and FY 2003

- The college’s current assets and current liabilities decreased due to the implementation of Governmental Accounting Standards Board (GASB) Statement Number 39. Walters State Community College Foundation assets were no longer reported in the college’s agency funds.
- The college’s decrease in capital assets can be attributed to $1.8 million of depreciation expense netted against $1.3 million of capital asset additions.

- The college's decrease in restricted expendable net assets is due to a decrease in grants received associated with the Workforce Investment Act.

Component Unit
Statements of Net Assets
(in thousands of dollars)

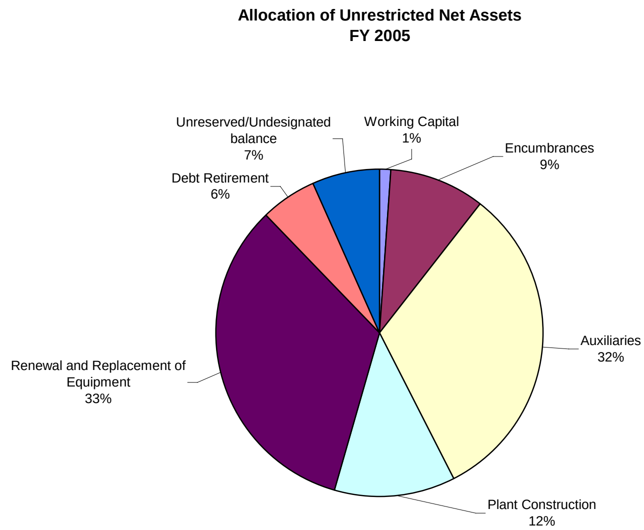
	2005	2004
Assets:		
Current assets	$ 2,918	$ 2,352
Capital assets, net	965	974
Other assets	8,494	8,257
Total assets	**12,377**	**11,583**
Liabilities:		
Current liabilities	27	27
Total liabilities	**27**	**27**
Net assets:		
Invested in capital assets	965	974
Restricted – nonexpendable	8,443	8,070
Restricted – expendable	2,804	2,376
Unrestricted	138	136
Total net assets	**$12,350**	**$11,556**

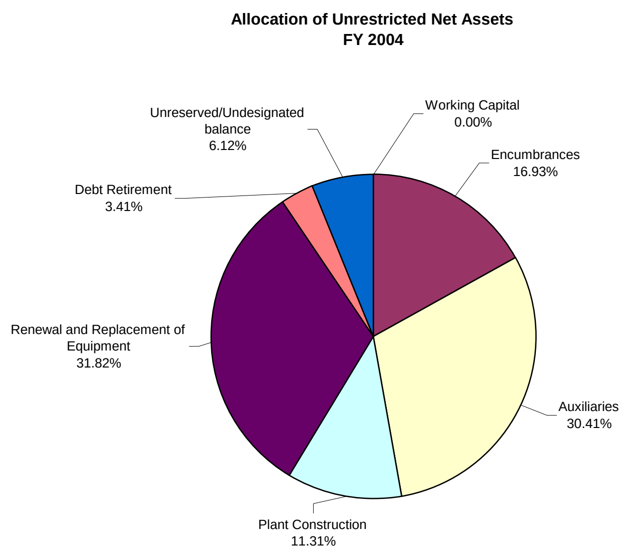
Financial statements in accordance with accounting principles generally accepted in the United States were not prepared for the Walters State Community College Foundation for FY 2003 as this was prior to the implementation of GASB Statement 39 and the foundation's transactions were accounted for in the college's agency funds.

Significant Differences Between FY 2005 and FY 2004

- The foundation received gifts which resulted in an increase in restricted expendable and restricted nonexpendable funds.

Many of the college's unrestricted net assets have been designated or reserved for specific purposes such as: repairs and replacement of equipment, future debt service, and capital projects. The following graphs show the allocations:





Significant Differences Between FY 2005 and FY 2004

- The allocation for encumbrances decreased due to establishing an earlier cut-off of purchasing at year end.
- The allocation for debt retirement increased due to anticipated SCT Banner expenses.
- The increase in the allocation for auxiliaries is related to bookstore operations.

- There were no material changes in the foundation's unreserved, undesignated fund balance.

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 college, 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.

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

	2005	2004	2003
Operating revenues:			
Net tuition and fees	$ 5,762	$ 5,627	$ 4,744
Grants and contracts	4,100	4,744	11,105
Auxiliary	2,248	2,269	2,125
Other	987	1,113	1,182
Total operating revenues	13,097	13,753	19,156
Operating expenses	38,914	36,655	36,055
Operating loss	(25,817)	(22,902)	(16,899)
Nonoperating revenues and expenses:			
State appropriations	16,780	15,821	16,045
Gifts	166	101	133
Grants & contracts	7,857	6,308	-
Investment income	191	89	139
Other revenues and expenses	(31)	(166)	(590)
Total nonoperating revenues and expenses	24,963	22,153	15,727
Income (loss) before other revenues, expenses, gains, or losses	(854)	(749)	(1,172)
Other revenues, expenses, gains, or losses:			
Capital appropriations	1,154	541	2,198
Capital grants and gifts	6	33	21
Other	8	(3)	(4)
Total other revenues, expenses, gains, or losses	1,168	571	2,215
Increase (decrease) in net assets	314	(178)	1,043
Net assets at beginning of year	43,123	43,301	42,258
Net assets at end of year	$43,437	$43,123	$43,301

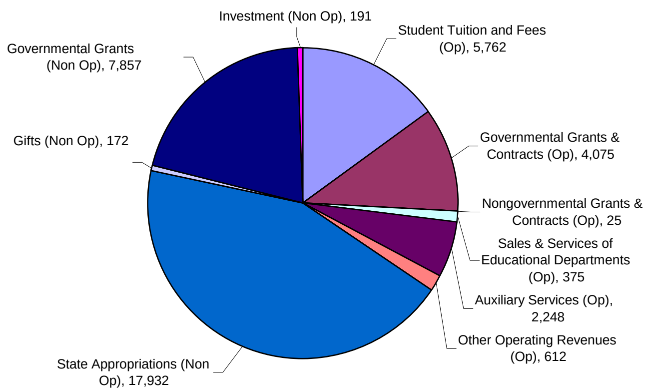
Component Unit
Statements of Revenues, Expenses, and Changes in Net Assets
(in thousands of dollars)

	2005	2004
Operating revenues:		
Gifts	$ 617	$ 304
Endowment income per spending plan	210	225
Other	177	209
Total operating revenues	1,004	738
Operating expenses	685	690
Operating gain	319	48
Nonoperating revenues and expenses:		
Investment income	227	423
Other revenues and expenses	82	78
Total nonoperating revenues and expenses	309	501
Income (loss) before other revenues, expenses, gains, or losses	628	549
Other revenues, expenses, gains, or losses:		
Additions to permanent endowments	166	41
Other	-	(602)
Total other revenues, expenses, gains, or losses	166	(561)
Increase (decrease) in net assets	794	(12)
Net assets at beginning of year	11,556	11,568
Net assets at end of year	$12,350	$11,556

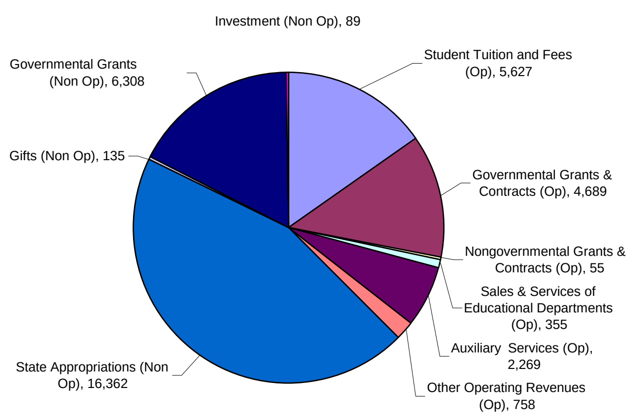
Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which are used to fund the college's operating activities for the year ended June 30, 2005, the year ended June 30, 2004, and the year ended June 30, 2003. Amounts are presented in thousands of dollars.

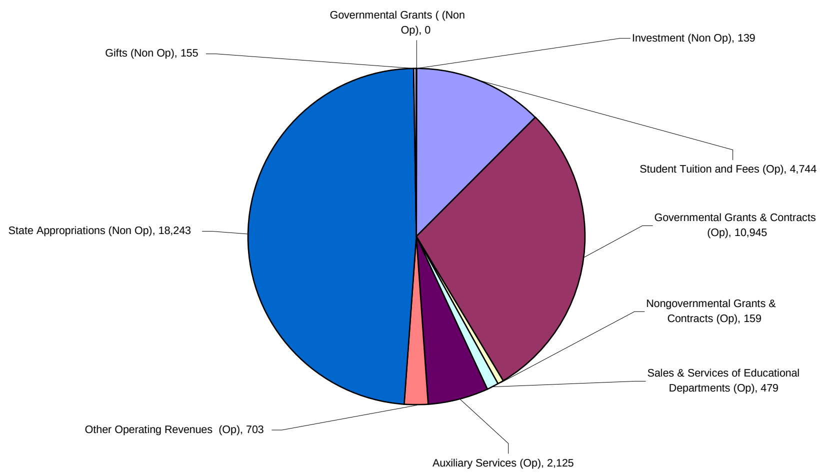
Revenue by Source
FY 2005
(in thousands)



Revenue by Source
FY 2004
(in thousands)



Revenue by Source
FY 2003
(in thousands)



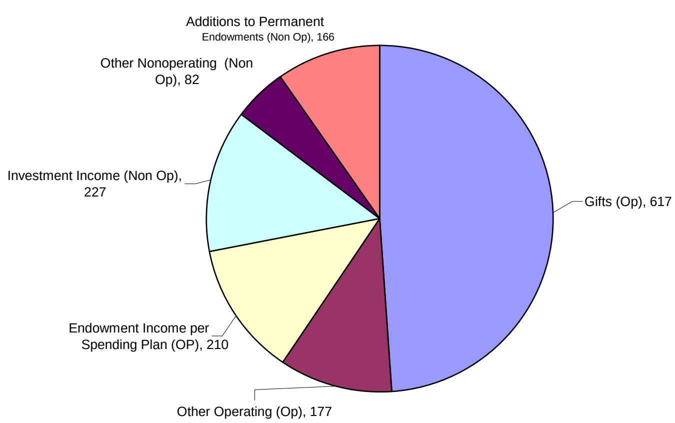
Significant Differences Between FY 2005 and FY 2004

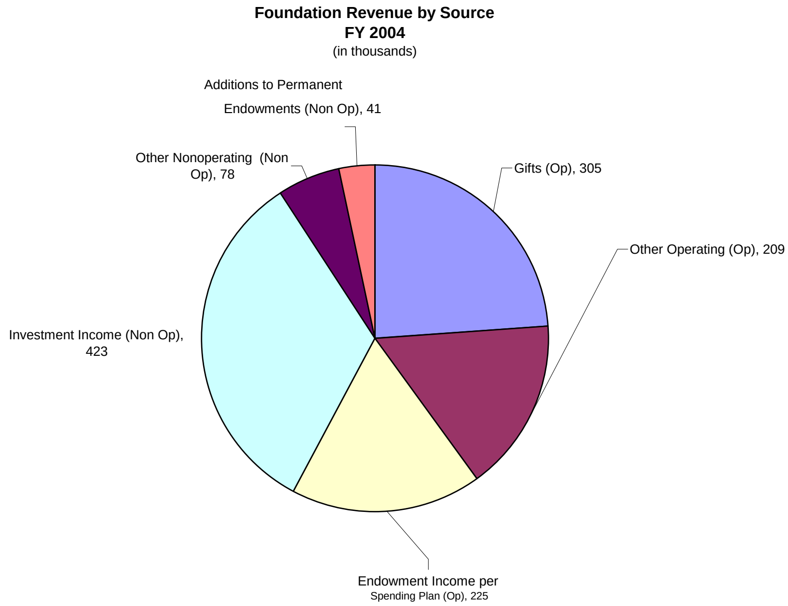
- The college's increase in tuition and fees primarily resulted from a 7% maintenance fee increase effective for the fall 2004 semester.
- The reduction in the operating governmental grants and contracts is due to a reduction in contracts with the federal government under the Workforce Investment Act.
- The increase in the nonoperating governmental grants is because 2005 was the first year of the Tennessee Lottery scholarship program.
- The investment income increase is due to increasing interest rates.

Significant Differences Between FY 2004 and FY 2003

- The college's increase in tuition and fees primarily resulted from a 14% maintenance fee increase effective for the fall 2003 semester.
- The college's decrease in nongovernmental grants and contracts (operating) resulted from the elimination of funds from the college's foundation to support the operations of the Sevierville campus.
- The college's decrease in sales & services of educational departments resulted primarily from the closing of the college's Early Learning Center at 6/30/2003.
- The college's increase in auxiliary revenues resulted from increased sales to students.
- The college's decrease in other operating revenues resulted from fewer activities and associated concession sales at the college's Expo Center.
- The college's decrease in state appropriations resulted from a 9% reduction in base state appropriations due to a lack of adequate state revenue.
- The college's gift revenue declined due to fewer private gifts received.
- The college's capital appropriations declined due to the completion or progression of ongoing state funded projects.
- The college's difference in operating grants and contracts and nonoperating grants and contracts is due to the change in recognition of $6.3 million of federal Pell grants from operating to nonoperating revenue, conforming to GASB 34/35 requirements.

Foundation Revenue by Source
FY 2005
(in thousands)





Significant Differences Between FY 2005 and FY 2004

- Gifts and contributions increased for FY 2005 while other operating revenues decreased.

Expenses

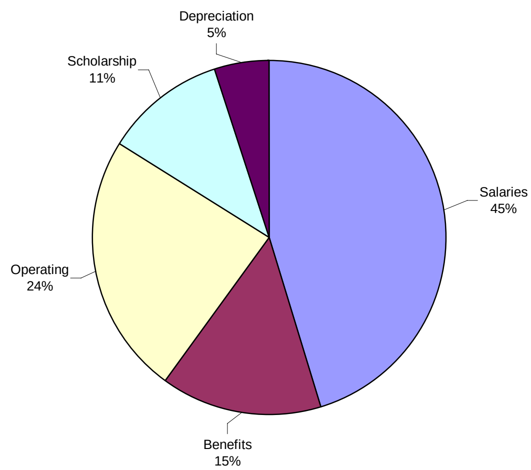
Operating expenses can be displayed in two formats, natural classification and program classification. Both formats are displayed below.

Natural Classification for Institution

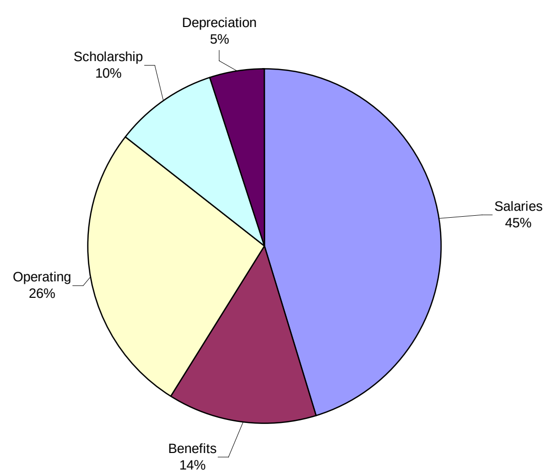
Operating Expenses by Natural Classification

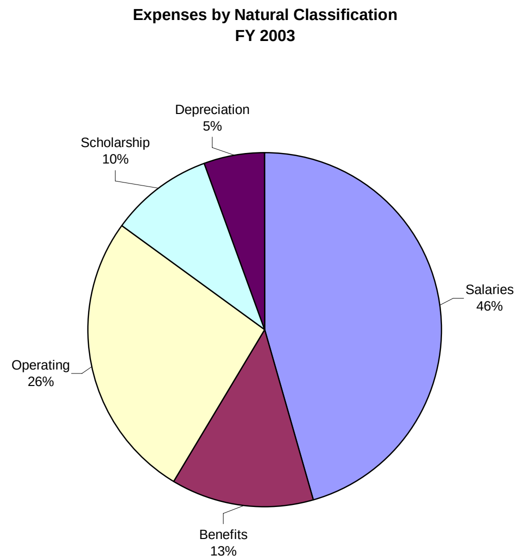
	Salaries	Benefits	Other Operating	Scholarship	Depreciation
FY 2005	$17,573,535	$5,725,166	$9,397,839	$4,282,321	$1,935,308
FY 2004	16,634,468	4,991,494	9,708,976	3,495,185	1,825,424
FY 2003	16,476,547	4,754,973	9,529,061	3,502,774	1,791,340

Expenses by Natural Classification
FY 2005



Expenses by Natural Classification
FY 2004





Significant Differences Between FY 2005 and FY 2004

- A 4% cost of living pay raise and a one-time 1% bonus caused the salaries and benefits to increase.
- The college's contribution rate to the Tennessee Consolidated Retirement System rose from 7.29% to 10.54%, thus also increasing benefit expense.
- The 7% tuition increase and more students receiving scholarships, including Pell grants, resulted in an increase in scholarships.
- The reduction in other operating expenses is the direct result of a planned reduction due to revenue shortfalls.
- The additions to buildings and equipment without comparable retirements results in an increase to depreciation.

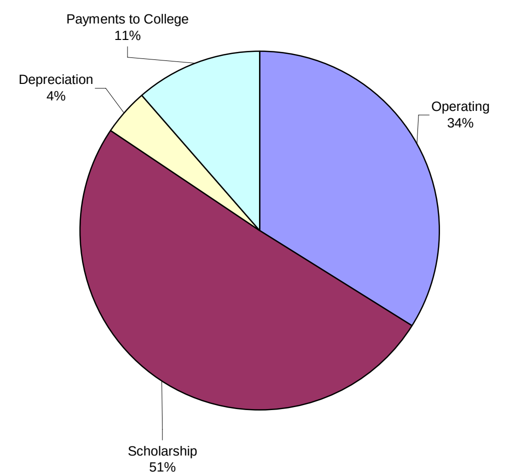
Significant Differences Between FY 2004 and FY 2003

- Salaries and benefits increased primarily due to filling some vacant positions and an increase in the health insurance premium rate.
- Other operating costs increased primarily due to the increasing costs of instructional and operating supplies.
- Scholarship expenses decreased due to fewer awards being made to students.

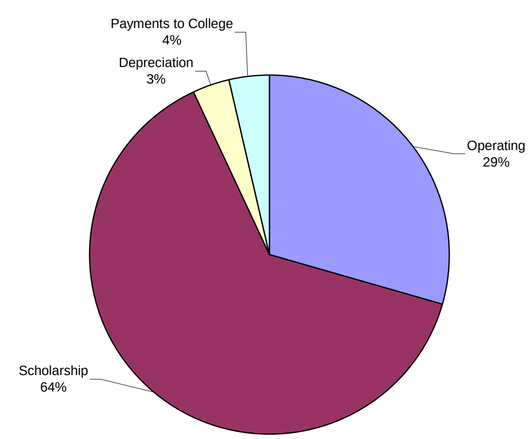
Natural Classification for Component Unit
Operating Expenses by Natural Classification

	Other Operating	Scholarship	Depreciation	Payments to College
FY 2005	231,729	346,838	27,508	78,491
FY 2004	203,459	438,909	22,534	25,423
FY 2003	466,770	288,393	25,713	-

Foundation Expenses by Natural Classification
FY 2005



Foundation Expenses by Natural Classification
FY 2004

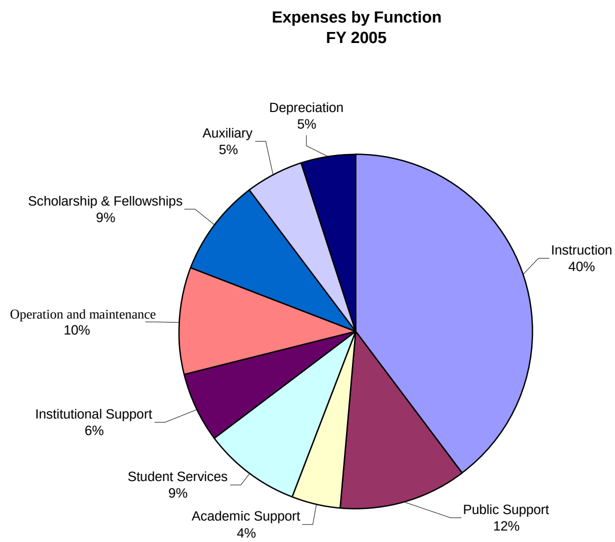


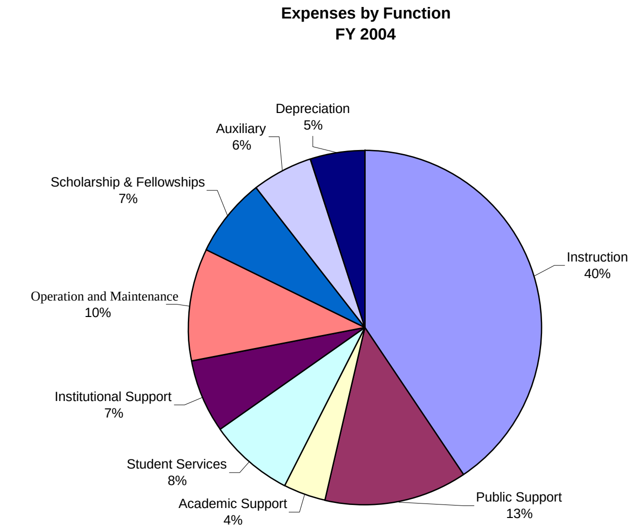
Significant Differences Between FY 2005 and FY 2004

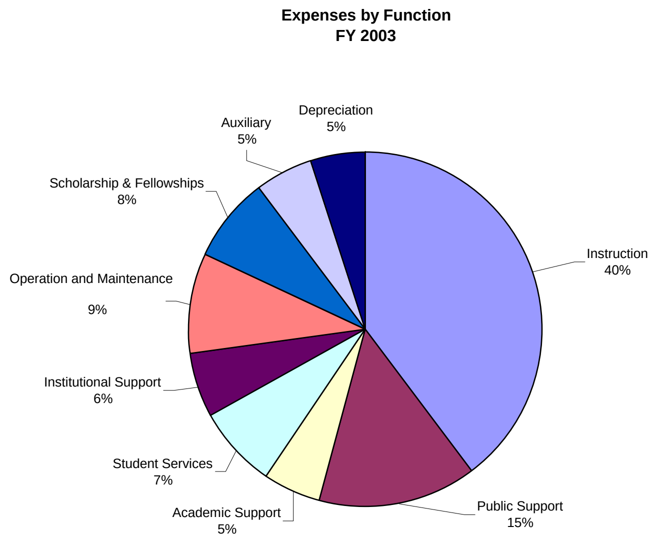
- Scholarship awards decreased by $92,071.00 in 2005.
- Additional payments totaling $53,068.00 were made to the college in 2005.

Program Classification
Operating Expenses by Function

	FY 2005	FY 2004	FY 2003
Instruction	$15,414,674	$14,907,939	$14,327,665
Public Support	4,615,303	4,734,240	5,242,707
Academic Support	1,651,082	1,389,821	1,834,613
Student Services	3,497,519	2,925,575	2,693,964
Institutional Support	2,452,464	2,398,357	2,125,378
Operation and Maintenance	3,850,995	3,789,289	3,280,414
Scholarships & Fellowships	3,479,909	2,651,231	2,865,007
Auxiliary	2,016,916	2,033,672	1,893,607
Depreciation	1,935,307	1,825,424	1,791,339







Significant Differences Between FY 2005 and FY 2004

- Instructional, Academic Support, Student Service, Institutional Support, and Operation and Maintenance expenses increased primarily due to a 4% cost of living raise and a one-time 1% bonus.

- Public Support expenses decreased due to fewer contracts taken by the Workforce Investment Act segment of the college.
- Scholarships and Fellowships expenses increased due to the first-time issuance of Tennessee Lottery scholarships.
- Depreciation expense increased due to the addition of depreciable facilities and equipment.

Significant Differences Between FY 2004 and FY 2003

- Instructional expenses increased due to an increase in health insurance premium rates, the filling of some vacant faculty positions, and the inflationary cost of instructional supplies.
- Public Support expenses decreased due to fewer events and associated concession sales at the Expo Center and less training offered to local businesses and industries.
- Academic Support expenses decreased primarily due to the reorganization of some departments and the closing of the Early Learning Center at June 30, 2003.
- Student Services expenses increased primarily due to a change in the methodology of allocating salaries and benefits for athletics as the result of a change in a TBR athletics policy and the filling of a counseling position.
- Institutional Support expenses increased due to the purchase of equipment, the payout of terminal annual leave for retiring employees, and certain adjustments required to conform to GASB 34/35.
- Operation and Maintenance expenses increased due to more areas of the campus needing routine maintenance and repairs and a significant recarpeting project being completed.
- Scholarships and Fellowships expenses decreased due to fewer awards being made to students.
- Auxiliary expenses increased due to the inflationary costs of merchandise for resale.
- Depreciation expense increased due to the addition of depreciable facilities and equipment.

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 college’s ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Institution
Statements of Cash Flows
(in thousands of dollars)

	2005	**2004**	**2003**
Cash provided (used) by:			
Operating activities	($23,289)	($20,410)	($14,754)
Noncapital financing activities	25,147	20,502	16,019
Capital and related financing activities	(786)	(820)	77
Investing activities	191	89	139
Net increase (decrease) in cash	1,263	(639)	1,481
Cash, beginning of year	8,535	9,174	7,693
Cash, end of year	$ 9,798	$ 8,535	$ 9,174

Significant Differences Between FY 2005 and FY 2004

- The college's increase in cash used by operating activities is due to the 4% cost of living pay raise and the one-time 1% bonus and the related increase in benefits.
- Cash provided by noncapital financing activities increased due to students receiving additional Pell grants because of a 7% increase in tuition as well as 2005 being the first year students received the Tennessee Lottery scholarships. This resulted in a $1.5 million increase in nonoperating grant receipts. Cash receipts from state appropriations also increased approximately $1 million.

Significant Differences Between FY 2004 and FY 2003

- The college's increase in cash used by operating activities and cash provided by noncapital financing activities is due to the reclassification of $6.3 million in federal Pell grants from operating to nonoperating activities per GASB 34/35.

Liquidity

- Walters State Community College experienced an increase in liquidity during fiscal year 2004-2005.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2005, Walters State Community College had $38,026,390.01 invested in capital assets, net of accumulated depreciation of $18,298,698.26. Depreciation charges totaled $1,935,307.81 for the current fiscal year. Details of these assets are shown below.

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

	2005	2004	2003
Land	$ 555	$ 555	$ 555
Land improvements & infrastructure	610	662	643
Buildings	33,584	34,425	35,765
Equipment	1,682	1,393	1,377
Library holdings	152	151	122
Projects in progress	1,443	899	143
Totals	$38,026	$38,085	$38,605

Significant Differences Between FY 2005 and FY 2004

Projects in progress increased due to renovations to campus buildings and the implementation of the new SCT Banner computer system. The Tennessee State School Bond Authority (TSSBA) issued commercial paper to fund the computer system. The renovation projects are funded by capital appropriations from the state.

Significant Differences Between FY 2004 and FY 2003

The most significant increase in capital assets was in the area of projects in progress where three major projects were initiated or continued during the year: the Humanities Safety Project, the Defensive and Tactical Driving Course Project, and the Auditorium/Gymnasium Project. These projects are funded by capital appropriations from the state.

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

	2005	**2004**
Land	$168	$168
Buildings	797	675
Projects in progress	-	130

Significant Differences Between FY 2005 and FY 2004

The Greeneville Center was completed and amounts were transferred from the projects in progress category to the buildings category. Capital expenditures are funded by donations to the foundation.

The college has several capital projects in process that will be continued during 2005-06 and one new project that will be initiated in 2005-06, all of which are funded through capital appropriations from the state. The capital projects that will continue include the College Center Renovation, College Center Safety Corrections, ADA Improvements, College Center Auditorium/Gym Safety Corrections, Campus Amenities/Improvements, and Humanities Safety Corrections. The capital project that will be initiated in 2005-06 is the Defensive and Tactical Driving/Public Safety Building Renovations project. More detailed information about the college's capital assets is presented in Note 5 to the financial statements.

Debt

At June 30, 2005, the college had $452,200.00 in debt outstanding. The table below summarizes the college's debt at each year end.

College Outstanding Debt

	Commercial Paper
FY 2005	452,200.00
FY 2004	535,977.08
FY 2003	616,377.08

The Tennessee State School Bond Authority authorized the issuance of commercial paper for Walters State Community College to finance various capital projects. In January 2005, the issuance of $452,200 was made for the purchase of SCT Banner software as part of the implementation of the system-wide Enterprise Resource Planning project to provide new administrative computing hardware and software. Although the college only paid interest on the commercial paper for this project during 2004-05, the first principle payment will be due in

January 2006. Additional commercial paper will be issued during 2005-06 for the purchase of hardware and implementation/training costs, as additional phases of the project are implemented.

With respect to the commercial paper that has existed since 1997 for the Public Safety facility, an $80,400 principal payment made in 2004-05 was the last payment that the college will make toward the retirement of that debt. Another capital project was approved and funded for 2005-06 to make improvements to the Public Safety facility. Included in the funding was an amount to pay off the original commercial paper obligation. At June 30, 2005, the Tennessee State School Bond Authority removed the remaining $455,577.08 of debt associated with the 1997 project. More detailed information about the college's long-term liabilities is presented in Note 6 to the financial statements.

Economic Factors That Will Affect the Future

The Governor's budget as approved by the legislature for higher education for the FY 2005-2006 was funded at a slight increase over the past several years. The budget also included funding for employee benefits for health insurance premium increases and an increase in the state-funded 401K match. Although the state of Tennessee authorized a 3% across-the-board salary increase, only 2% will be funded by the state. The other 1% will be funded from student fees. The college's governing board increased student maintenance fees 10% for 2005-06 with the additional revenue being used to fund an additional up to 2% across-the-board salary increase and a 1% salary bonus and to fill some needed vacant positions. Overall, the budget prospects for Walters State for the 2005-06 fiscal year are more optimistic than experienced during the past three fiscal 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 college's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to Dr. Rosemary Jackson or Roger Beverly at Walters State Community College, 500 South Davy Crockett Parkway, Morristown, Tennessee 37813-6899.

TENNESSEE BOARD OF REGENTS
WALTERS STATE COMMUNITY COLLEGE
STATEMENTS OF NET ASSETS
JUNE 30, 2005, AND JUNE 30, 2004

	Walters State Community College		Component Unit - Walters State Community College Foundation	
	June 30, 2005	June 30, 2004	June 30, 2005	June 30, 2004
ASSETS				
Current assets:				
Cash and cash equivalents (Notes 2, 3, and 13)	$ 6,735,615.78	$ 5,935,586.06	$ 2,881,745.44	$ 2,304,525.27
Accounts, notes, and grants receivable (net) (Note 4)	571,920.15	568,052.06	14,535.00	8,740.00
Pledges receivable (net) (Note 13)	-	-	21,637.56	38,537.56
Inventories	646,927.51	630,720.18	-	-
Prepaid expenses and deferred charges	19,426.04	11,212.01	-	-
Other assets	274.62	1,694.00	-	-
Total current assets	7,974,164.10	7,147,264.31	2,917,918.00	2,351,802.83
Noncurrent assets:				
Cash and cash equivalents (Notes 2, 3, and 13)	3,062,783.90	2,599,732.01	-	-
Investments (Note 13)	-	-	8,422,549.59	8,166,780.02
Pledges receivable (net) (Note 13)	-	-	71,869.01	90,695.00
Capital assets (net) (Notes 5 and 13)	38,026,390.01	38,085,624.71	964,975.36	973,739.25
Total noncurrent assets	41,089,173.91	40,685,356.72	9,459,393.96	9,231,214.27
Total assets	49,063,338.01	47,832,621.03	12,377,311.96	11,583,017.10
LIABILITIES				
Current liabilities:				
Accounts payable	690,691.60	249,171.45	27,498.00	27,233.77
Accrued liabilities	1,524,068.87	1,475,610.36	-	-
Deferred revenue	439,745.44	357,366.20	-	-
Compensated absences (Note 6)	394,419.65	337,065.73	-	-
Deposits held in custody for others	1,298,054.66	900,320.01	-	-
Other liabilities	65,937.07	63,549.51	-	-
Total current liabilities	4,412,917.29	3,383,083.26	27,498.00	27,233.77
Noncurrent liabilities:				
Compensated absences (Note 6)	760,922.43	790,314.32	-	-
Long-term liabilities (Note 6)	452,200.00	535,977.08	-	-
Total noncurrent liabilities	1,213,122.43	1,326,291.40	-	-
Total liabilities	5,626,039.72	4,709,374.66	27,498.00	27,233.77
NET ASSETS				
Invested in capital assets, net of related debt	37,574,190.01	37,549,647.63	964,975.36	973,739.25
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	-	-	5,229,729.77	5,054,447.83
Other	-	-	3,213,162.56	3,015,255.95
Expendable:				
Scholarships and fellowships	30,421.18	26,376.92	431,464.50	388,850.88
Instructional department uses	5,703.72	5,298.71	-	-
Capital projects	-	-	1,719,350.86	1,364,729.67
Other	3,710.44	82,310.99	652,758.75	622,987.33
Unrestricted (Note 7)	5,823,272.94	5,459,612.12	138,372.16	135,772.42
Total net assets	$ 43,437,298.29	$ 43,123,246.37	$ 12,349,813.96	$ 11,555,783.33

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

TENNESSEE BOARD OF REGENTS
WALTERS STATE COMMUNITY COLLEGE
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2005, AND JUNE 30, 2004

	Walters State Community College		Component Unit - Walters State Community College Foundation	
	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 $4,738,156.32 for the year ended June 30, 2005, and $4,407,315.85 for the year ended June 30, 2004)	$ 5,762,475.37	$ 5,626,742.26	$ -	$ -
Gifts and contributions	-	-	616,670.58	304,972.61
Endowment income per spending plan	-	-	210,396.87	224,666.19
Governmental grants and contracts	4,075,467.58	4,688,762.95	-	-
Nongovernmental grants and contracts	24,840.96	55,429.22	-	-
Sales and services of educational departments	375,247.40	355,117.98	-	-
Auxiliary enterprises:				
Bookstore	2,226,240.99	2,251,792.47	-	-
Food service	7,679.68	7,262.63	-	-
Other	14,167.27	10,173.97	-	-
Other operating revenues	611,591.74	757,980.96	177,100.73	208,679.89
Total operating revenues	13,097,710.99	13,753,262.44	1,004,168.18	738,318.69
EXPENSES				
Operating expenses (Note 12):				
Salaries and wages	17,573,535.04	16,634,468.15	-	-
Benefits	5,725,165.85	4,991,494.35	-	-
Utilities, supplies, and other services	9,397,839.63	9,708,975.71	231,729.33	203,459.02
Scholarships and fellowships	4,282,320.87	3,495,184.59	346,837.80	438,909.16
Depreciation expense	1,935,307.81	1,825,424.39	27,507.77	22,533.87
Payments to or on behalf of Walters State Community College	-	-	78,491.27	25,423.00
Total operating expenses	38,914,169.20	36,655,547.19	684,566.17	690,325.05
Operating income (loss)	(25,816,458.21)	(22,902,284.75)	319,602.01	47,993.64
NONOPERATING REVENUES (EXPENSES)				
State appropriations	16,779,700.00	15,821,000.00	-	-
Gifts (college gifts include $78,491.27 from component unit in 2005)	166,235.68	101,405.75	-	-
Grants and contracts	7,856,556.68	6,308,343.84	-	-
Investment income (for component unit, net of investment expense of $33,220.15 in 2005 and $32,699.03 in 2004)	191,492.73	89,343.75	227,117.35	422,778.59
Interest on capital asset-related debt	(12,436.93)	(4,493.57)	-	-
Other nonoperating revenues (expenses)	(18,913.88)	(162,280.68)	81,802.90	78,461.89
Net nonoperating revenues	24,962,634.28	22,153,319.09	308,920.25	501,240.48
Income (loss) before other revenues, expenses, gains, or losses	(853,823.93)	(748,965.66)	628,522.26	549,234.12
Capital appropriations	1,154,490.74	541,106.81	-	-
Capital grants and gifts (college gifts include $25,423.00 from component unit in 2004)	5,754.00	33,660.00	-	-
Additions to permanent endowments	-	-	165,508.37	41,085.00
Other	7,631.11	(3,318.59)	-	(602,165.57)
Total other revenues	1,167,875.85	571,448.22	165,508.37	(561,080.57)
Increase (decrease) in net assets	314,051.92	(177,517.44)	794,030.63	(11,846.45)
NET ASSETS				
Net assets - beginning of year	43,123,246.37	43,300,763.81	11,555,783.33	11,567,629.78
Net assets - end of year	$ 43,437,298.29	$ 43,123,246.37	$ 12,349,813.96	$ 11,555,783.33

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

Exhibit C

TENNESSEE BOARD OF REGENTS
WALTERS STATE COMMUNITY COLLEGE
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2005, AND JUNE 30, 2004

	Year Ended June 30, 2005	Year Ended June 30, 2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 5,779,958.28	$ 5,610,492.73
Grants and contracts	4,181,890.65	4,822,644.07
Sales and services of educational activities	375,247.40	355,117.98
Payments to suppliers and vendors	(8,933,539.28)	(9,253,798.90)
Payments to employees	(17,620,911.59)	(16,566,386.68)
Payments for benefits	(5,602,792.76)	(4,897,059.74)
Payments for scholarships and fellowships	(4,282,320.87)	(3,495,184.59)
Auxiliary enterprise charges:		
Bookstore	2,199,744.95	2,239,198.53
Food services	6,584.89	7,282.20
Other	14,167.27	10,173.97
Other receipts	592,378.67	757,980.96
Net cash used by operating activities	(23,289,592.39)	(20,409,539.47)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	16,784,500.00	15,821,600.00
Gifts and grants received for other than capital or endowment purposes	7,982,358.84	6,399,639.65
Federal student loan receipts	9,817.31	-
Federal student loan disbursements	(8,942.31)	-
Changes in deposits held for others	398,004.05	(1,557,445.99)
Other noncapital financing payments	(18,913.88)	(162,280.68)
Net cash provided by noncapital financing activities	25,146,824.01	20,501,512.98
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	452,200.00	-
Capital appropriations	1,153,041.28	537,788.22
Proceeds from sale of capital assets	19,213.07	-
Purchases of capital assets and construction	(1,861,238.54)	(1,272,615.83)
Principal paid on capital debt and leases	(535,977.08)	(80,400.00)
Interest paid on capital debt and leases	(12,436.93)	(4,493.57)
Other capital and related financing payments	(444.54)	-
Net cash used by capital and related financing activities	(785,642.74)	(819,721.18)
CASH FLOWS FROM INVESTING ACTIVITIES		
Income on investments	191,492.73	89,343.75
Net cash provided by investing activities	191,492.73	89,343.75
Net increase (decrease) in cash	1,263,081.61	(638,403.92)
Cash - beginning of year	8,535,318.07	9,173,721.99
Cash - end of year	$ 9,798,399.68	$ 8,535,318.07

TENNESSEE BOARD OF REGENTS
WALTERS STATE COMMUNITY COLLEGE
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2005, AND JUNE 30, 2004

	Year Ended June 30, 2005	Year Ended June 30, 2004
Reconciliation of operating loss to net cash used by operating activities		
Operating loss	$ (25,816,458.21)	$ (22,902,284.75)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	1,935,307.81	1,825,424.39
Gifts in-kind	41,849.00	7,040.00
Other adjustment	(19,213.07)	-
Change in assets and liabilities:		
Receivables, net	(10,783.43)	38,628.51
Inventories	(16,207.33)	(177,053.49)
Prepaid/deferred items	(6,794.65)	690,441.14
Accounts payable	441,520.15	(53,103.10)
Accrued liabilities	48,458.51	169,256.40
Deferred revenue	82,379.24	10,854.46
Compensated absences	27,962.03	(8,003.39)
Other	2,387.56	(10,739.64)
Net cash used by operating activities	$ (23,289,592.39)	$ (20,409,539.47)
Noncash transactions		
Gifts in-kind	$ 41,849.00	$ 7,040.00
Gifts of capital assets	5,754.00	33,660.00

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The college 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*.

The Walters State Community College Foundation is considered a component unit of the college. Although the college 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 college by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the college, the foundation is considered a component unit of the college and is discretely presented in the college's financial statements. See Note 13 for more detailed information about the component unit and how to obtain the 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 college's, including its component unit's, assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows.

Basis of Accounting

For financial statement purposes, the college 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 college has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The college 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) certain 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 college include (1) salaries and wages; (2) employee benefits; (3) utilities, supplies, and other services; (4) scholarships and fellowships; and (5) depreciation.

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

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

Cash and Cash Equivalents

Cash equivalents for the component unit include: short-term, highly liquid investments that are readily convertible to known amounts of cash and have original maturities of three months or less.

Inventories

Inventories are valued at the lower of cost or market. Textbooks included in the inventory are recorded on a first-in, first-out basis. All other items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

The college'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.

Under a contract with the Tennessee Department of Labor and Workforce Development, the college is a service provider for the Local Workforce Investment Area in workforce investment area two of the State of Tennessee. The title to all the equipment purchased by the college under the provisions of the Workforce Investment Act resides with the U.S. government. Therefore, this equipment is not included in the college's capital assets.

Net Assets

The college's net assets are classified as follows:

Invested in capital assets, net of related debt - This represents the college'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 college 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 college, and may be used at the discretion of the college 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 college 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 college's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the college has recorded a scholarship discount and allowance.

NOTE 2. CASH

This classification includes demand deposits and petty cash on hand. At June 30, 2005, cash consisted of $245,276.94 in bank accounts, $9,645.00 of petty cash on hand, and $9,543,477.74 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer. At June 30, 2004, cash consisted of $237,660.26 in bank accounts, $10,145.00 of petty cash on hand, and $8,287,512.81 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer.

NOTE 3. DEPOSITS

During the year ended June 30, 2005, the college 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 college's name.

Some of the college'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 college's deposits in financial institutions participating in the collateral pool was $240,449.62, and the bank balance including accrued interest was $747,698.65. The bank balance was insured. At June 30, 2004, the carrying amount of the college's deposits in financial institutions participating in the collateral pool was $214,422.33, and the bank balance including accrued interest was $806,742.16. 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 college's deposits was $245,276.94, and the bank balance including accrued interest was $752,525.97. The entire bank balance was insured. At June 30, 2004, the carrying amount of the college's deposits was $237,660.26 and the bank balance including accrued interest was $829,980.09. The entire bank balance was insured.

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 college. Category 1 consists of deposits that are insured or collateralized with securities held by the college or by its agent in the college's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the college'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 college's name.

The college 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. RECEIVABLES

Receivables included the following:

	June 30, 2005	June 30, 2004
Student accounts receivable	$313,874.53	$178,437.87
Grants receivable	233,334.41	334,036.25
State appropriation receivable	38,100.00	42,900.00
Other receivables	144,437.90	96,189.75
Subtotal	729,746.84	651,563.87
Less allowance for doubtful accounts	157,826.69	83,511.81
Total receivables	$571,920.15	$568,052.06

NOTE 5. CAPITAL ASSETS

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 555,293.11	$ -	$ -	$ -	$ 555,293.11
Land improvements and infrastructure	1,059,129.89	-	-	-	1,059,129.89
Buildings	47,533,376.25	-	676,513.76	-	48,209,890.01
Equipment	4,333,285.75	651,046.49	-	190,257.48	4,794,074.76
Library holdings	262,777.11	31,200.64	-	30,891.46	263,086.29
Projects in progress	899,480.03	1,220,647.94	(676,513.76)	-	1,443,614.21
Total	54,643,342.14	1,902,895.07	-	221,148.94	56,325,088.27
Less accum. depreciation:					
Land improvements and infrastructure	397,614.16	51,857.08	-	-	449,471.24
Buildings	13,107,700.77	1,518,526.77	-	-	14,626,227.54
Equipment	2,940,191.76	335,526.17	-	163,435.52	3,112,282.41
Library holdings	112,210.74	29,397.79	-	30,891.46	110,717.07
Total accum. depreciation	16,557,717.43	1,935,307.81	-	194,326.98	18,298,698.26
Capital assets, net	$38,085,624.71	$ (32,412.74)	$ -	$ 26,821.96	$38,026,390.01

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 555,293.11	$ -	$ -	$ -	$ 555,293.11
Land improvements and infrastructure	988,702.89	70,427.00	-	-	1,059,129.89
Buildings	47,438,818.21	94,558.04	-	-	47,533,376.25
Equipment	4,195,231.58	329,529.03	-	191,474.86	4,333,285.75
Library holdings	236,278.62	58,300.41	-	31,801.92	262,777.11
Projects in progress	142,552.89	756,927.14	-	-	899,480.03
Total	53,556,877.30	1,309,741.62	-	223,276.78	54,643,342.14
Less accum. depreciation:					
Land improvements and infrastructure	345,757.08	51,857.08	-	-	397,614.16
Buildings	11,673,738.22	1,433,962.55	-	-	13,107,700.77
Equipment	2,818,053.99	310,146.84	-	188,009.07	2,940,191.76
Library holdings	114,554.74	29,457.92	-	31,801.92	112,210.74
Total accum. depreciation	14,952,104.03	1,825,424.39	-	219,810.99	16,557,717.43
Capital assets, net	$38,604,773.27	$(515,682.77)	$ -	$ 3,465.79	$38,085,624.71

NOTE 6. 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:					
Commercial paper	$ 535,977.08	$ 452,200.00	$ 535,977.08	$ 452,200.00	$ -
Other liabilities:					
Compensated absences	1,127,380.05	944,839.91	916,877.88	1,155,342.08	394,419.65
Total long-term liabilities	$1,663,357.13	$1,397,039.91	$1,452,854.96	$1,607,542.08	$394,419.65

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

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Commercial paper	$ 616,377.08	$ -	$ 80,400.00	$ 535,977.08	$ -
Other liabilities:					
Compensated absences	1,135,383.44	918,442.25	926,445.64	1,127,380.05	337,065.73
Total long-term liabilities	$1,751,760.52	$918,442.25	$1,006,845.64	$1,663,357.13	$337,065.73

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 college was $452,200.00 at June 30, 2005, and $535,977.08 at June 30, 2004.

For the commercial paper program, the Tennessee State School Bond Authority maintains an interest rate reserve fund. The college 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 college when the notes are converted to bonds. The interest earned on the reserve is used to pay interest due during the month.

NOTE 7. 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	$ 69,266.92	$ (5,032.06)
Encumbrances	544,838.52	926,027.54
Auxiliaries	1,860,924.70	1,658,052.52
Plant construction	699,102.68	618,570.52
Renewal and replacement of equipment	1,929,952.29	1,740,585.98
Debt retirement	334,865.67	186,502.82
Unreserved/undesignated	384,322.16	334,904.80
Total	$5,823,272.94	$5,459,612.12

NOTE 8. PENSION PLANS

A. Defined Benefit Plan

Tennessee Consolidated Retirement System

Plan Description - The college 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 college is required to contribute an actuarially determined rate. The current rate is 10.54% of annual covered payroll. Contribution requirements for the college are established and may be amended by the TCRS' Board of Trustees. The college's contributions to TCRS for the years ended June 30, 2005, 2004, and 2003 were $1,207,980.27, $801,824,36, and $787,832.48. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The college 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 college 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 college to the plans was $435,103.44 for the year ended June 30, 2005, and $407,084.02 for the year ended June 30, 2004. Contributions met the requirements for each year.

NOTE 9. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible college retirees. This benefit is provided and administered by the State of Tennessee. The college 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 10. 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 damage 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 college participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the college based on a percentage of the college'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 college 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 college 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 college was $49,930,720 for buildings and $20,640,900 for contents. At June 30, 2004, the scheduled coverage for the college was $50,509,100 for buildings and $20,909,800 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 college 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 college 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 11. COMMITMENTS AND CONTINGENCIES

Sick Leave - The college 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 $6,132,048.72 at June 30, 2005, and $6,522,059.04 at June 30, 2004.

Operating Leases - The college 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 $197,385.96 and for personal property were $78,333.60 for the year ended June 30, 2005. Amounts for the year ended June 30, 2004, were $210,259.46 and $72,379.74. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2005, outstanding commitments under construction contracts totaled $3,760,102.58 for the College Center renovation, the College Center Safety Correction project, the Accessibility Adaptation project, the

Auditorium/Gymnasium project, and the Humanities Safety Correction project, of which $3,760,102.58 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 college's outstanding liability for this contract is estimated as $1,359,028.00 at June 30, 2005.

NOTE 12. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

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

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 9,558,192.90	$2,811,187.04	$2,746,465.46	$ 298,828.95	$ -	$15,414,674.35
Public service	1,450,847.83	514,164.70	2,650,290.39	-	-	4,615,302.92
Academic support	1,436,138.84	485,595.35	(303,502.00)	32,850.00	-	1,651,082.19
Student services	1,605,718.75	543,189.63	943,939.53	404,670.50	-	3,497,518.41
Institutional support	1,974,658.48	697,606.74	(235,131.65)	15,330.00	-	2,452,463.57
Operation & maintenance	1,383,188.35	605,085.01	1,862,721.20	-	-	3,850,994.56
Scholarships & fellowships	-	-	(50,731.79)	3,530,641.42	-	3,479,909.63
Auxiliary	164,789.89	68,337.38	1,783,788.49	-	-	2,016,915.76
Depreciation	-	-	-	-	1,935,307.81	1,935,307.81
Total	$17,573,535.04	$5,725,165.85	$9,397,839.63	$4,282,320.87	$1,935,307.81	$38,914,169.20

The institution'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	$9,478,672.95	$2,538,034.07	$2,577,444.16	$313,787.74	$ -	$14,907,938.92
Public service	1,289,812.56	442,433.48	3,001,993.84	-	-	4,734,239.88
Academic support	1,344,875.50	413,156.63	(392,529.61)	24,318.00	-	1,389,820.52
Student services	1,265,598.65	396,430.19	907,596.91	355,949.00	-	2,925,574.75
Institutional support	1,866,035.92	641,193.80	(124,337.67)	15,465.00	-	2,398,357.05
Operation & maintenance	1,239,961.74	499,530.03	2,047,734.76	2,062.00	-	3,789,288.53
Scholarships & fellowships	-	-	(130,309.70)	2,781,540.85	-	2,651,231.15
Auxiliary	149,510.83	60,716.15	1,821,383.02	2,062.00	-	2,033,672.00
Depreciation	-	-	-	-	1,825,424.39	1,825,424.39
Total	$16,634,468.15	$4,991,494.35	$9,708,975.71	$3,495,184.59	$1,825,424.39	$36,655,547.19

NOTE 13. COMPONENT UNIT

The Walters State Community College Foundation is a legally separate, tax-exempt organization supporting Walters State Community College. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the college in support of its programs. The 141-member board of the foundation is self-perpetuating and consists of graduates and friends of the college. Although the college 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 college by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the college, the foundation is considered a component unit of the college and is discretely presented in the college's financial statements.

During the year ended June 30, 2005, the foundation made distributions of $78,491.27 to or on behalf of the college for both restricted and unrestricted purposes. During the year ended June 30, 2004, the foundation made distributions of $25,423.00 to or on behalf of the college for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Mr. Henry Drinnon, c/o Walters

State Community College Foundation, 500 South Davy Crockett Parkway, Morristown, TN 37813.

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 $1,271,578.78 in bank accounts, $500.00 of petty cash on hand, $1,251,555.69 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $358,110.97 in money market mutual funds and cash equivalents held by investment management firms. At June 30, 2004, cash and cash equivalents consisted of $1,286,982.08 in bank accounts, $601,833.49 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $415,709.70 in money market mutual funds and cash equivalents held by investment management firms.

Deposits - At June 30, 2005, the carrying amount of the foundation's deposits was $1,661,578.78, and the bank balance including accrued interest was $1,661,578.78. Of the bank balance, $1,155,761.58 was uninsured.

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 foundation. Category 1 consists of deposits that are insured or collateralized with securities held by the foundation or by its agent in the foundation's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the foundation'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 foundation's name.

At June 30, 2004, the carrying amount of the foundation's deposits was $1,676,982.08, and the bank balance including accrued interest was $1,676,982.08. Of the bank balance, $547,603.89 was category 1, and $1,129,378.19 was category 3.

The foundation 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.

Investments - The foundation is authorized to invest funds in accordance with its board of directors' policies. All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase. Certificates of deposit have been included with other deposits above to determine the custodial credit risk.

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

		Investment Maturities (in Years)			
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10
U. S. Treasury notes	$420,768.52	$199,913.69	$220,854.83	$ -	$ -
Federal Home Loan Bank (FHLB) obligations	988,685.56	-	487,872.06	302,625.50	198,188.00
Federal Home Loan Mortgage Corporation (FHLM) obligations	401,463.61	226,623.44	75,304.17	99,536.00	-
Federal National Mortgage Association (FNMA) obligations	98,873.14	48,062.50	-	50,810.64	-
Tennessee Valley Authority obligations	184,127.42	-	184,127.42	-	-
Corporate bonds	2,341,272.73	248,315.52	1,138,250.31	954,706.90	-
Certificates of deposit	390,000.00				
Cash surrender value of life insurance	65,867.85				
Corporate stock	2,733,928.45				
Mutual funds	1,155,673.28				
Amount reported as cash and cash equivalents	(358,110.97)				
Total	$8,422,549.59				

Interest rate risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt investment. The foundation 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 foundation's investment policy (guideline #5) states that fixed income investments will be limited to the issues which fall within the highest four ratings by Moody's and/or Standard & Poor's. At June 30, 2005, the foundation's investments were rated as follows by a nationally recognized statistical rating organization (Moody's):

Investment Type	Fair Value	AAA	A1	A2	A3	Aa1
LGIP	$1,251,555.69	$ -	$ -	$ -	$ -	$ -
Federal Home Loan Bank (FHLB) obligations	988,685.56	988,685.56	-	-	-	-
Federal Home Loan Mortgage Corporation (FHLM) obligations	401,463.61	401,463.61	-	-	-	-
Federal National Mortgage Association (FNMA) obligations	98,873.14	98,873.14	-	-	-	-
TVA obligations	184,127.42	184,127.42	-	-	-	-
Corporate bonds	2,341,272.73	206,172.06	397,728.87	377,548.44	173,830.17	105,529.50
Mutual funds–bonds	502,918.30	-	-	-	-	-
Money market funds	488,211.95	-	-	-	-	-

Investment Type	Aa2	Aa3	Baa2	Unrated
LGIP	-	-	-	$1,251,555.69
Federal Home Loan Bank (FHLB) obligations	-	-	-	-
Federal Home Loan Mortgage Corporation (FHLM) obligations	-	-	-	-
Federal National Mortgage Association (FNMA) obligations	-	-	-	-
TVA obligations	-	-	-	-
Corporate bonds	242,347.74	551,938.95	108,212.80	177,964.20
Mutual funds–bonds	-	-	-	502,918.30
Money market funds	-	-	-	488,211.95

Custodial credit risk - For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the foundation will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The foundation does not have a policy for custodial credit risk. At June 30, 2005, the foundation had $7,153,619.70 of uninsured and unregistered investments for which the securities are held by the counterparty.

Concentration of credit risk - The foundation's investment policy (guideline #4) states that the investment portfolio should be invested in such manner as to provide adequate diversification. No one holding shall exceed 5% of the value of that portion of the account in the hands of the investment manager, except upon approval by the investment committee of the board of trustees. The provision shall not apply to securities issued by the U.S. Government and its agencies whose securities are backed by the full faith and credit of the federal government. At June 30, 2005, more than 5% of the foundation's investments were invested in the following single issuer:

Issuer	Percentage of Total Investments
Federal Home Loan Bank (FHLB) obligations	11.3%

Foreign currency risk - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment. The foundation's investment policy (guideline #7) states that no foundation portfolio shall include options, futures, derivatives, commodities, or foreign investments. At June 30, 2005, the foundation had no exposure to foreign currency risk.

The foundation's investments at June 30, 2004, are categorized below to indicate the level of risk assumed by the foundation at year-end. Category 1 consists of insured or registered investments or investments for which the securities are held by the foundation or its agent in the foundation's name. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the foundation'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 foundation's name.

Category 1:	
Corporate stocks	$12,947.76
Category 3:	
U.S. government securities	2,133,930.99
Corporate bonds	2,220,432.19
Corporate stocks	2,568,470.83
Investments not susceptible to credit risk categorization:	
Mutual funds	1,190,592.29
Cash surrender value of life insurance	66,115.66
Certificates of deposit classified as investments	390,000.00
Amount classified as cash equivalents	(415,709.70)
Total	$8,166,780.02

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

	June 30, 2005	June 30, 2004
Current pledges	$21,637.56	$38,537.56
Pledges due in one to five years	58,267.69	69,125.25
Pledges due after five years	14,400.00	22,600.00
Subtotal	94,305.25	130,262.81
Less discounts to net present value	(798.68)	(1,030.25)
Total pledges receivable, net	$93,506.57	$129,232.56

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 168,000.00	$ -	$ -	$ -	$ 168,000.00
Buildings	814,875.00	18,743.88	130,473.12	-	964,092.00
Projects in progress	130,473.12	-	(130,473.12)	-	-
Total	1,113,348.12	18,743.88	-	-	1,132,092.00
Less accum. depreciation:					
Buildings	139,608.87	27,507.77	-	-	167,116.64
Total accum. depreciation	139,608.87	27,507.77	-	-	167,116.64
Capital assets, net	$ 973,739.25	$(8,763.89)	$ -	$ -	$964,975.36

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$168,000.00	$ -	$ -	$ -	$168,000.00
Buildings	517,000.00	297,875.00	-	-	814,875.00
Projects in progress	-	130,473.12	-	-	130,473.12
Total	685,000.00	428,348.12	-	-	1,113,348.12
Less accum. depreciation:					
Buildings	117,075.00	22,533.87	-	-	139,608.87
Total accum. depreciation	117,075.00	22,533.87	-	-	139,608.87
Capital assets, net	$567,925.00	$405,814.25	$ -	$ -	$973,739.25

Long-term liabilities

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

	Beginning Balance	Additions	Reductions	Ending Balance
Payables:				
Notes	$58,095.00	$ -	$58,095.00	$ -

Endowments - If a donor has not provided specific instructions to the foundation, state law permits the foundation 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 foundation is required to consider the foundation'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.

It is the foundation's policy to allocate for spending the total of interest and dividends earned and received less fees for the year ending June 30. Realized and unrealized gains are not allocated to individual accounts but retained as a market value adjustment fund.

TENNESSEE BOARD OF REGENTS
WALTERS STATE COMMUNITY COLLEGE
SUPPLEMENTARY INFORMATION
STATEMENTS OF CASH FLOWS - COMPONENT UNIT
FOR THE YEARS ENDED JUNE 30, 2005, AND JUNE 30, 2004

	Year Ended June 30, 2005	Year Ended June 30, 2004
CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$ 646,601.57	$ 270,325.05
Endowment income per spending plan	210,396.87	224,666.19
Payments to suppliers and vendors	(231,729.33)	(234,320.25)
Payments for scholarships and fellowships	(346,837.80)	(438,909.16)
Payments to Walters State Community College	(78,227.04)	(25,423.00)
Other receipts	177,100.73	208,679.89
Net cash provided by operating activities	377,305.00	5,018.72
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes	165,508.37	41,085.00
Other noncapital financing receipts	81,802.90	78,461.89
Net cash provided by noncapital financing activities	247,311.27	119,546.89
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets	-	2,397,834.43
Purchases of capital assets and construction	(18,743.88)	(428,348.12)
Principal paid on capital debt and lease	-	(58,095.00)
Net cash provided (used) by capital and related financing activities	(18,743.88)	1,911,391.31
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	-	109,076.34
Income on investments	59,141.73	417,640.66
Purchases of investments	(87,793.95)	(1,169,869.72)
Net cash used by investing activities	(28,652.22)	(643,152.72)
Net increase in cash and cash equivalents	577,220.17	1,392,804.20
Cash and cash equivalents at beginning of year	2,304,525.27	911,721.07
Cash and cash equivalents at end of year	$ 2,881,745.44	$ 2,304,525.27
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$ 319,602.01	$ 47,993.64
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense	27,507.77	22,533.87
Change in assets and liabilities:		
Receivables, net	29,930.99	(34,647.56)
Accounts payable	264.23	(30,861.23)
Net cash provided by operating activities	$ 377,305.00	$ 5,018.72
Noncash transactions		
Unrealized gains on investments	$ 181,313.76	$ 216,845.40