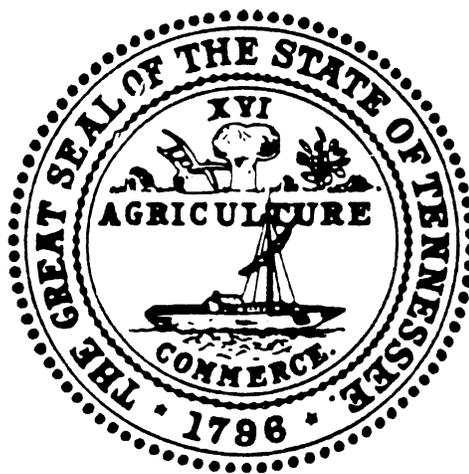


AUDIT REPORT

Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation

For the Year Ended June 30, 2005



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

August 31, 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. Melvin N. Johnson, President
Tennessee State University
3500 John A. Merritt Boulevard
Nashville, Tennessee 37209

Ladies and Gentlemen:

Transmitted herewith is the report on the Endowment for Educational Excellence at the Tennessee State University Foundation for the year ended June 30, 2005. The audit was conducted under the requirements of the trust agreement which established the endowment. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Sincerely,

A handwritten signature in black ink that reads "John G. Morgan".

John G. Morgan
Comptroller of the Treasury

JGM/sah
06/081



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT**

**SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
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Independent Auditor's Report

June 2, 2006

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

Dear Mr. Morgan:

We have audited the accompanying statement of net assets of the Endowment for Educational Excellence at the Tennessee State University Foundation as of June 30, 2005, and the related statement of revenues, expenses, and changes in net assets for the year then ended. These financial statements are the responsibility of the foundation's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The Honorable John G. Morgan
June 2, 2006
Page Two

As discussed in Note 1, the financial statements of the Endowment for Educational Excellence are intended to present the financial position and the changes in financial position of only that portion of the Tennessee State University Foundation's activities that is attributable to the transactions of the endowment. They do not purport to, and do not, present fairly the financial position of the Tennessee State University Foundation as of June 30, 2005, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Endowment for Educational Excellence at the Tennessee State University Foundation as of June 30, 2005, and the changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis 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. The foundation has not presented the management's discussion and analysis section for the endowment that accounting principles generally accepted in the United States of America require to supplement, although not to be part of, the basic financial statements.

Sincerely,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." in a cursive script.

Arthur A. Hayes, Jr., CPA
Director

AAH/sah

**TENNESSEE BOARD OF REGENTS
 ENDOWMENT FOR EDUCATIONAL EXCELLENCE
 TENNESSEE STATE UNIVERSITY FOUNDATION
 STATEMENT OF NET ASSETS
 JUNE 30, 2005**

ASSETS

Current assets:

Cash and cash equivalents (Notes 2 and 3)	\$ 146,756.06
Total current assets	<u>146,756.06</u>

Noncurrent assets:

Cash and cash equivalents (Notes 2 and 3)	3,307,639.23
Investments (Note 4)	<u>8,283,824.09</u>
Total noncurrent assets	<u>11,591,463.32</u>
Total assets	<u><u>11,738,219.38</u></u>

NET ASSETS

Restricted for:

Nonexpendable:

Scholarships and fellowship:	11,591,463.32
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Expendable:

Other	146,756.06
Total net assets	\$ <u><u>11,738,219.38</u></u>

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

**TENNESSEE BOARD OF REGENTS
 ENDOWMENT FOR EDUCATIONAL EXCELLENCE
 TENNESSEE STATE UNIVERSITY FOUNDATION
 STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 FOR THE YEAR ENDED JUNE 30, 2005**

EXPENSES

Operating expenses:

Utilitites, supplies, and other services	\$ 23,248.23
Scholarships and fellowships	25,000.00
Total operating expenses	<u>48,248.23</u>
Operating loss	<u>(48,248.23)</u>

NONOPERATING REVENUES (EXPENSES)

State appropriations	1,487,677.08
Gifts	312,726.04
Investment income	284,840.98
Other nonoperating revenues (expenses)	<u>450,754.74</u>
Net nonoperating revenues	<u>2,535,998.84</u>
Increase in net assets	<u>2,487,750.61</u>

NET ASSETS

Net assets - beginning of year (Note 6)	<u>9,250,468.77</u>
Net assets - end of year	<u>\$ <u>11,738,219.38</u></u>

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

Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements
June 30, 2005

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

Pursuant to the consent decree entered into on January 5, 2001, in settlement of the Geier v. Sundquist lawsuit, the Tennessee State University Endowment for Educational Excellence trust was established. This trust was created by the Tennessee Board of Regents and is operated exclusively for the educational purposes at Tennessee State University. The Tennessee State University Foundation is the trustee of these funds and, in accordance with the trust agreement, delegates the actual management of the endowment assets to professional investment managers. These assets are the property of the state of Tennessee.

Tennessee State University Foundation is a legally separate, tax-exempt organization supporting Tennessee State University. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The 16-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. The size of the board shall be determined by the majority vote of its members, and any vacancy in its membership shall be filled in the same way. The entire membership of the Board of Trustees shall not exceed twenty-five (25) in number and a minimum of eight (8). All trustees shall serve until the expiration of their respective terms and until their respective successors are selected and qualified. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, which the foundation holds and invests, is restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

The financial statements present only that portion of the Tennessee State University Foundation's activities that is attributable to the transactions of the Endowment for Educational Excellence.

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).

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2005**

Basis of Accounting

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.

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 foundation has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The foundation has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

Operating expenses for the endowment include (1) utilities, supplies, and other services and (2) scholarships and fellowships.

All other activity of the endowment is nonoperating in nature and includes (1) state appropriations provided as a part of the consent decree, (2) federal grant funds from the U.S. Department of Education under the Title III Strengthening Historically Black Colleges and Universities Program, (3) investment income, and (4) gifts.

Cash Equivalents

This classification includes instruments which are readily convertible to known amounts of cash and have original maturities of three months or less.

Net Assets

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 foundation is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties. The trust agreement does provide for spending a portion of the income, as discussed in Note 5. Spending decisions are to

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2005**

be made by the Budget Committee established in the trust agreement through the preparation of an annual budget.

NOTE 2. CASH AND CASH EQUIVALENTS

At June 30, 2005, cash and cash equivalents consisted of \$703,904.26 in bank accounts and \$2,750,491.03 in capital management account money funds.

NOTE 3. DEPOSITS

At June 30, 2005, the carrying amount of the endowment's portion of the foundation's deposits was \$703,904.26, and the bank balance was \$745,276.60.

NOTE 4. INVESTMENTS

The trust agreement requires that the foundation delegate the actual management of the endowment assets to one or more professional investment managers, which are to be selected on the basis of demonstrated performance, management philosophy, investment style, and fees. The foundation is authorized to invest the endowment funds in accordance with the trust agreement. Under the trust agreement, the foundation is authorized to invest and reinvest the property of the trust in any kind of real and/or personal property and any kind of investment specifically including, but not limited to, domestic or foreign government obligations of any kind; domestic or foreign securities of any kind including, but not limited to, preferred or common stocks, bonds, mortgage participations and shares of investment trusts, investment companies, money market funds, mutual funds (including market or index funds); options to purchase or sell domestic or foreign securities or domestic or foreign government obligations of any kind; and interests in partnerships, so long as such investments are made with the care of a fiduciary.

All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase.

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

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2005**

<u>Investment Type</u>	<u>Fair Value</u>	<u>Investment Maturities (in Years)</u>			
		<u>Less than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	<u>More than 10</u>
U.S. Treasury notes	\$ 49,273.45	\$ -	\$ 49,273.45	\$ -	\$ -
U.S. Treasury bills	56,973.78	56,973.78	-	-	-
U.S. Treasury bonds	621,814.91	-	58,407.64	124,978.02	438,429.25
Federal Home Loan Banks	205,339.25	49,758.00	155,581.25	-	-
Federal Home Loan Mortgage Corporation	239,566.45	49,496.10	138,513.20	51,557.15	-
Federal National Mortgage Corporation	280,704.30	49,199.00	231,505.30	-	-
Corporate stocks	1,934,625.41	-	-	-	1,934,625.41
Corporate bonds	2,137,808.84	-	944,666.96	1,193,141.88	-
Mutual funds	1,322,815.96	-	-	-	1,322,815.96
Mortgage backed securities	254,840.39	-	-	-	254,840.39
Equity stock	14,199.90	-	-	-	14,199.90
Real estate holdings	<u>1,165,861.45</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>1,165,861.45</u>
Total	<u>\$8,283,824.09</u>	<u>\$205,426.88</u>	<u>\$1,577,947.80</u>	<u>\$1,369,677.05</u>	<u>\$5,130,772.36</u>

Interest rate risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt investment. Based on the annual cash flow needs of the foundation and its growth objective, each portfolio wishes to produce an average annual total return of at least 7% or 4% plus inflation as measured by the Consumer Price Index.

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

<u>Investment Type</u>	<u>Moody's</u>	<u>Standard and Poor's</u>	<u>Fitch</u>	<u>Fair Value</u>
Federal Home Loan Banks	AAA	AAA	AAA	\$ 205,339.25
Federal Home Loan Mortgage Corporation	AAA	AAA	AAA	\$ 239,566.45
Federal National Mortgage Corporation	AAA	AAA	AAA	\$ 280,704.30
Corporate bonds by category: (Ratings are highest and lowest.)				

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2005**

Banking/financial/investment services	Aaa	AAA	AA+	\$ 834,886.67
	Baa2	BBB	BBB	
Communication/technology	A1	A+	A+	\$ 136,510.21
	Baa2	BBB+	BBB+	
Retail	Aa2	AA	AA	\$ 69,970.35
	A2	A+	A+	
Utilities	A1	A+	A+	\$ 68,734.44
	Baa1	BBB	BBB+	
Other	Aa3	A+	A+	\$ 311,450.15
	Baa2	BBB	BBB	
Westcore Plus Bond Fund	unrated	unrated	unrated	\$ 716,257.02
Mutual funds	unrated	unrated	unrated	\$1,322,815.96

NOTE 5. ENDOWMENT INCOME

The trust agreement requires that at least 25% of the annual income be added to the corpus and stipulates approved and prohibited uses of the other 75%. The grant agreement for the Title III program requires that 50% of the income be added to the corpus and has provisions on the allowable uses of the other 50%. As of June 30, 2005, net appreciation of \$146,756.06 is available to be spent and is included in restricted net assets expendable for other.

NOTE 6. PRIOR-YEAR RESTATEMENT

The net assets at beginning of year were increased by \$88,889.46 to reflect investment income for the year ended June 30, 2004, related to the endowment.