AUDIT REPORT

Tennessee Board of Regents
The University of Memphis

For the Year Ended
June 30, 2006

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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

Kandi Thomas, CPA, CFE
Assistant Director

Debra D. Bloomingburg, CPA, CFE
Audit Manager

Jeffrey Lafever, CFE
In-Charge Auditor

Angela M. Courtney
Benjamin V. Elliott
Seth J. Massa
Michael B. Wilbanks, CFE
Staff Auditors

Gerry Boaz, CPA
Technical Analyst

Amy Brack
Editor

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

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

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

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

John G. Morgan
Comptroller

June 7, 2007

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Charles W. Manning, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, Tennessee 37217
and
Dr. Shirley Raines, President
The University of Memphis
Memphis, Tennessee 38152

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, The University of Memphis, for the year ended June 30, 2006. You will note from the independent auditor's report that unqualified opinions were given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/ddb
06/100

State of Tennessee

Audit Highlights

Comptroller of the Treasury | Division of State Audit

Financial and Compliance Audit
The University of Memphis
For the Year Ended June 30, 2006

AUDIT OBJECTIVES

The objectives of the audit were to consider the university's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

Audit Report
Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2006

TABLE OF CONTENTS

TABLE OF CONTENTS (CONT.)

Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2006

INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

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

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

ORGANIZATION

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

AUDIT SCOPE

The audit was limited to the period July 1, 2005, through June 30, 2006, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2006, and for comparative purposes, the year ended June 30, 2005. The University of Memphis is an institution of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the university's internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

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

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

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 2006, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered unqualified opinions on the university's financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

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

November 29, 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 The University of Memphis, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the year ended June 30, 2006, and have issued our report thereon dated November 29, 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, 2006, the university implemented GASB Statement 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

However, we noted certain matters involving the internal control over financial reporting, which we have reported to the university's management in a separate letter.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the university's financial statements are free of material misstatement, we performed tests of the university's compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We did, however, note certain less significant instances of noncompliance, which we have reported to the university's management in a separate letter.

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

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/ddb

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

November 29, 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 The University of Memphis, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the years ended June 30, 2006, and June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the university's management. Our responsibility is to express opinions on these financial statements, based on our audits. We did not audit the financial statements of The University of Memphis Foundation, a discretely presented component unit of the university. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for The University of Memphis Foundation, is based on the report of the other auditors.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of many agencies, commissions, and component units of the State of Tennessee; managing the state's debt; and making loans to the state's colleges and universities from debt proceeds. Some of the boards of which the Comptroller of the Treasury serves as a member per state statutes include the State Building Commission and the Tennessee Higher Education Commission.

In our opinion, based on our audits and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tennessee Board of Regents, The University of Memphis, and its discretely presented component unit as of June 30, 2006, and June 30, 2005, 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, 2006, the university implemented GASB Statement 42, *Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries*. During the year ended June 30, 2005, the university implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*.

The management's discussion and analysis on pages 9 through 23 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the basic financial statements. The accompanying financial information on page 49 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 29, 2006, on our consideration of the university's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/ddb

The University of Memphis
Management's Discussion and Analysis
For the Years Ended June 30, 2006; June 30, 2005; and June 30, 2004

This section of The University of Memphis's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2006, with comparative information presented for the fiscal years ended June 30, 2005, and June 30, 2004. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the financial statements and notes. The financial statements, notes, and this discussion are the responsibility of management.

Using This Annual Report

This report consists of three basic financial statements. The Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows provide information on The University of Memphis as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

The Statement of Net Assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the university. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the university's equity in property, plant, and equipment owned by the university. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditure by the university but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted net assets are available to the institution for any lawful purpose of the institution.

Statement of Net Assets - The University
(in thousands of dollars)

	2006	2005	2004
Assets:			
Current assets	$ 85,703	$ 71,539	$ 65,151
Capital assets, net	230,877	223,728	218,662
Other assets	47,992	47,245	49,287
Total Assets	$ 364,572	$ 342,512	$ 333,100
Liabilities:			
Current liabilities	$ 49,945	$ 38,514	$ 38,409
Noncurrent liabilities	60,770	58,685	56,870
Total Liabilities	$ 110,715	$ 97,199	$ 95,279
Net Assets:			
Invested in capital assets, net of related debt	$ 176,039	$ 171,120	$ 165,549
Restricted - nonexpendable	3,439	3,398	3,319
Restricted - expendable	17,128	18,151	19,276
Unrestricted	57,251	52,644	49,677
Total Net Assets	$ 253,857	$ 245,313	$ 237,821

Comparison of 2006 to 2005:

- Current assets increased in 2006. On June 30 the university purchased treasury notes in the amount of $9 million, which the bank deducted from the account on July 3. This also accounted for the rise in current liabilities.

- The increase in capital assets was due to the prior period adjustment of $5 million, which added projects in progress not capitalized in the prior year. Invested in capital assets increased for that same adjustment.

Comparison of 2005 to 2004:

- For fiscal year 2005 there was no significant change in net assets, either in the asset category or the liability category.

Statement of Net Assets - The Foundation
(in thousands of dollars)

	2006	2005	2004
Assets:			
Current assets	$ 7,933	$ 9,253	$ 7,842
Noncurrent assets	82,291	69,830	58,338
Total Assets	$ 90,224	$ 79,083	$ 66,180
Liabilities:			
Current liabilities	$ 2,714	$ 1,583	$ 2,500
Noncurrent liabilities	165	165	385
Total Liabilities	$ 2,879	$ 1,748	$ 2,885
Net Assets:			
Restricted - nonexpendable	$ 40,855	$ 36,219	$ 34,563
Restricted - expendable	44,180	39,445	27,196
Unrestricted	2,310	1,671	1,536
Total Net Assets	$ 87,345	$ 77,335	$ 63,295

Comparison of 2006 to 2005:

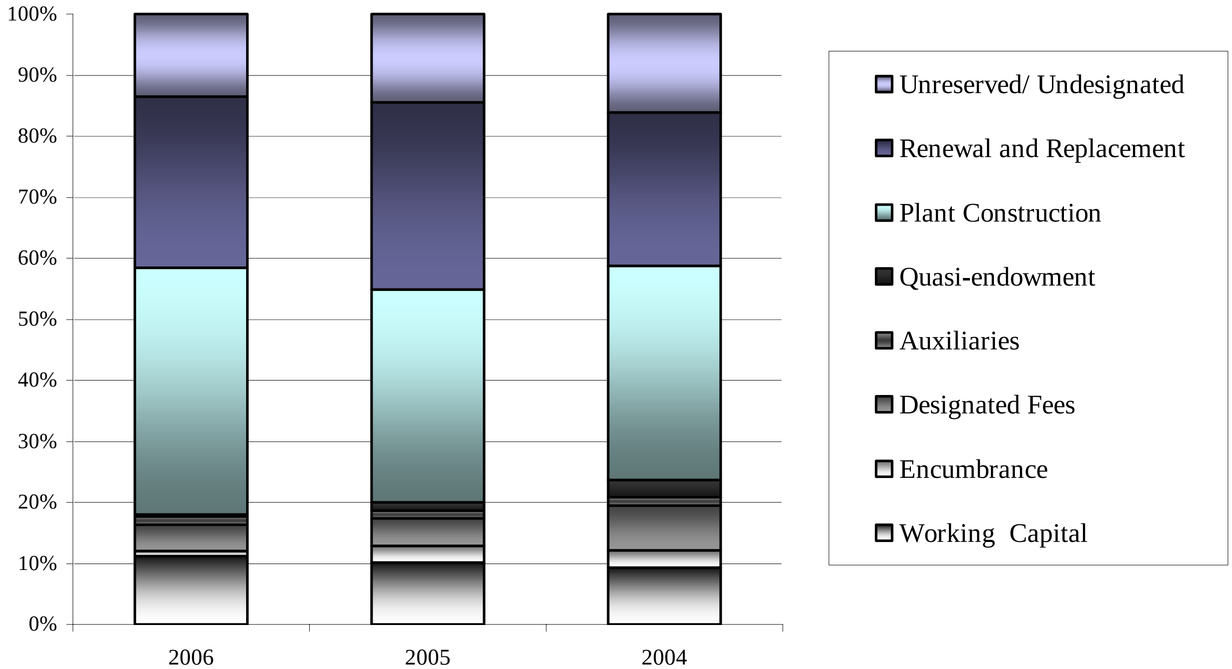
- Noncurrent assets increased $12 million in the current year primarily due to the increase in investment income.
- The increase in current liabilities was because of an increase in payables to the university at June 30.
- There was also an increase in restricted–expendable due to the increase in investment income and the increase in restricted revenue that had not yet met the requirements to be transferred to unrestricted.

Comparison of 2005 to 2004:

- Other assets increased in 2005 due to the increase of $9 million in investments.
- In fiscal year 2005 current liabilities decreased significantly. This was primarily the result of a decrease in payables to the university at the end of the fiscal year.
- There was an increase in restricted–expendable in 2005. Of the increase, $5.5 million was due to investment income and an additional $5 million increase in restricted revenue that had not yet met the requirements to be transferred to unrestricted.

Many of the university's unrestricted net assets have been designated or reserved for specific purposes such as: repairs and replacement of equipment, future debt service, quasi-endowments, capital projects, and student loans. The following graph shows the allocations:

Allocation of Unrestricted Net Assets - The University



Comparison of 2006 to 2005:

- The percentages in each category for fiscal year 2006 were consistent with the prior year, with no substantial changes.

Comparison of 2005 to 2004:

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

- Quasi-endowment funds decreased from 3% of the total to 1%. This was a result of the transfer of $675,000 to the unexpended plant fund for the construction of a women's softball field from the Intercollegiate Athletics Quasi-Endowment Fund.

- Designated fees decreased from 7% to 4% in fiscal year 2005. An amount of $350,000 was transferred from student activities fees to unexpended plant funds for the women's softball field, and the amount expended from the engineering fees increased by $150,000.

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

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

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

	2006	2005	2004
Operating revenues:			
Net tuition and fees	$ 94,358	$ 84,764	$ 83,829
Grants and contracts	41,713	35,765	35,514
Auxiliary	14,918	13,804	13,384
Other	15,823	19,756	18,669
Total operating revenues	$ 166,812	$ 154,089	$ 151,396
Operating expenses	$ (327,117)	$ (307,115)	$ (290,182)
Operating loss	$ (160,305)	$ (153,026)	$ (138,786)
Nonoperating revenues and expenses:			
State appropriations	$ 112,445	$ 110,384	$ 104,505
Gifts	11,023	16,386	12,665
Grants and contracts	31,207	28,444	16,492
Investment income	4,785	2,801	2,343
Other revenues and expenses	1,712	(2,972)	(2,004)
Total nonoperating revenues and expenses	$ 161,172	$ 155,043	$ 134,001
Income (loss) before other revenues, expenses, gains or losses	$ 867	$ 2,017	$ (4,785)
Other revenues, expenses, gains, or losses:			
Capital appropriations	$ 7,806	$ 4,698	$ 4,091
Capital grants and gifts	401	778	-
Other	(529)	(1)	(51)
Total other revenues, expenses, gains, or losses	$ 7,678	$ 5,475	$ 4,040
Increase in net assets	8,545	7,492	(745)
Net asset at beginning of year	245,313	237,821	238,566
Net assets at end of year	$ 253,858	$ 245,313	$ 237,821

Comparison of 2006 to 2005:

Total operating revenues:

- Net tuition and fees increased in 2006 due to a 12.5% increase in tuition.

- There was an increase in grants and contracts in the current year. This was due to the receipt of several large grants in 2006 and to the increase in expenditures on current grants related to salaries and benefits and the related facilities and administrative costs.

- Other operating revenue was down $4 million in 2006 primarily because athletic revenue was $2 million less than 2005 and $1.5 million in licensing revenue was reclassified to nonoperating.

Nonoperating revenues and expenses:

- Gifts were down in fiscal year 2006 because of the one-time gift of $3.6 million for the FedEx Institute of Technology recorded in 2005.

- Other revenues and expenses increased in the current year. TSAC and Hope Scholarships increased by $3 million. Licensing revenue of $1.5 million was reclassified from operating revenues.

Other revenues, expenses, gains, or losses:

- In 2006 there was an increase in capital appropriations due to a $4.5 million appropriation for the Cecil C. Humphries School of Law for the Heating, Ventilation and Air Conditioning System.

- The other loss this year was directly related to a recognized loss on the disposal of equipment made obsolete by the university's conversion to Banner.

<u>Comparison of 2005 to 2004:</u>

Total operating revenues:

- In fiscal year 2005, the increase in grants and contracts revenue is attributable to the implementation of the Hope Scholarships.

Operating expenses:

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

Total nonoperating revenues and expenses:

- Nonoperating gifts increased in fiscal year 2005. This was a result of an increase of $1.2 million in gifts for athletics and gifts recorded for the FedEx Institute for Technology in the amount of $3.6 million.

Total other revenues, expenses, gains, or losses:

- In 2005 there was a slight increase in capital appropriations over the prior year. Two of the major projects were roof repairs and replacements and fume hood upgrades.

- Capital grants and gifts for 2005 were due to capital gifts in kind for the FedEx Institute of Technology.

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

	2006	2005	2004
Operating revenues and expenses:			
Gifts and Contributions	$ 8,842	$ 9,636	$ 5,381
Other operating revenues	22	-	-
Operating expenses	(7,955)	(6,885)	(8,239)
Operating loss	$ 909	$ 2,751	$ (2,858)
Nonoperating revenues and expenses:			
Investment income	$ 7,114	$ 6,238	$ 7,858
Income (loss) before other revenues, expenses, gains or losses	$ 8,023	$ 8,989	$ 5,000
Other revenues, expenses, gains, or losses:	$ 1,987	$ 5,052	$ 2,275
Increase in net assets	$ 10,010	$ 14,041	$ 7,275
Net assets at beginning year	77,336	63,295	56,020
Net assets at end of year	$ 87,346	$ 77,336	$ 63,295

Comparison of 2006 to 2005:

Operating expenses:

- The foundation increased support to the university in the current year, with $1 million more in support of the Millington campus project and $750,000 additional to athletic support.

Investment income:

- An increase in market value of investments accounts for the increase in investment income for fiscal year 2006.

Comparison of 2005 to 2004:

Gifts and contributions:

- Gifts and contributions increased in 2005 due to a new pledge receivable of $4 million.

Operating expenses:

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

Investment income:

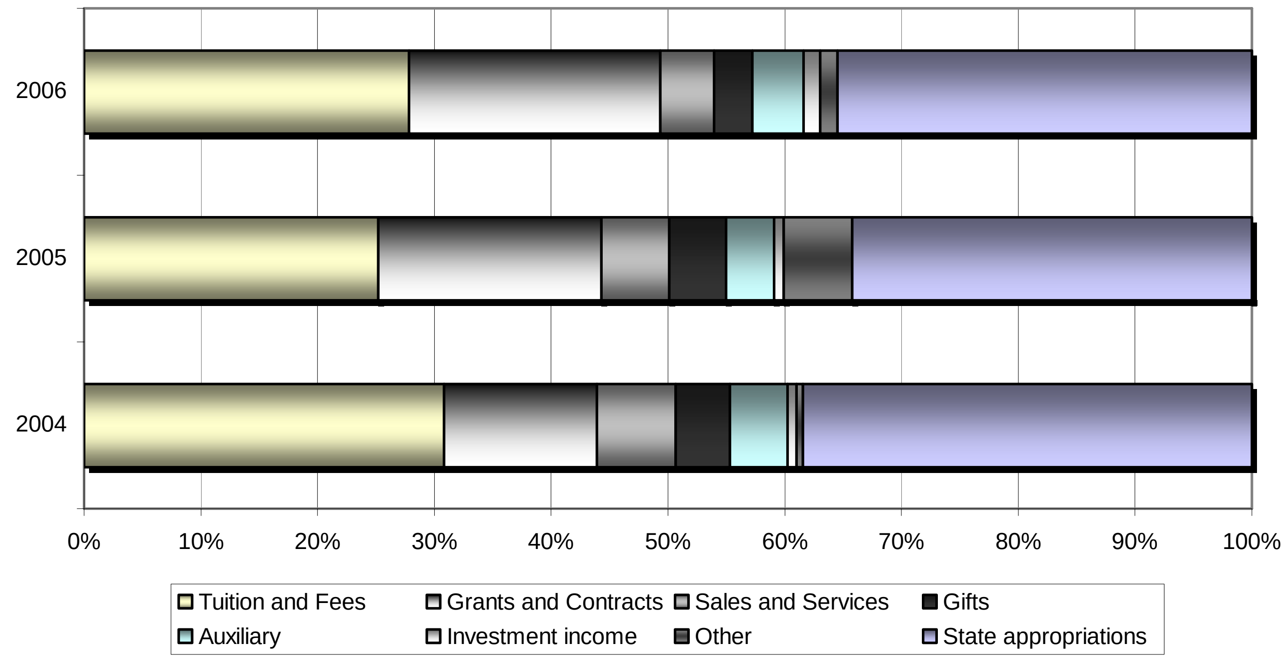
- Investment income decreased in 2005 by $1.6 million due to a reduction in the rate of return received on investments and fewer investments were held during the year.

Other revenues, expenses, gains, or losses:

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

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which are used to fund the university's operating activities for the years ended June 30, 2006; June 30, 2005; and June 30, 2004.



Comparison of 2006 to 2005:

- The increase in tuition and fees in fiscal year 2006 reflects the 12.5% increase in tuition for the university.

- Grants and contracts revenue was up in the current year overall, with a $3 million increase in revenue from Hope and TSAC Scholarships.

Comparison of 2005 to 2004:

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

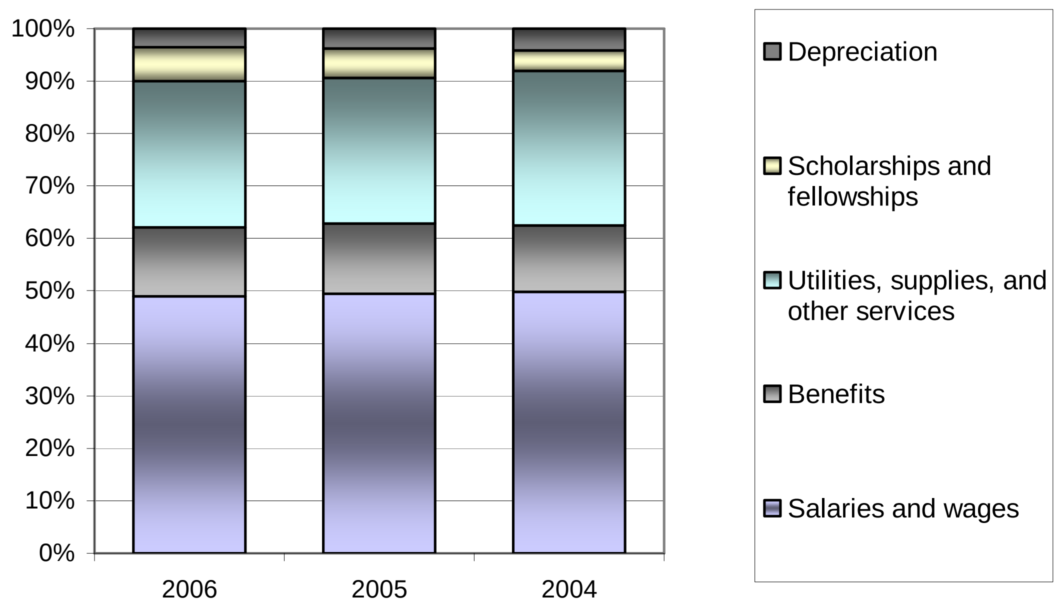
Expenses

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

Natural Classification - The University
(in thousands of dollars)

	2006	2005	2004
Operating Expenses:			
Salaries and wages	$ 160,104	$ 152,009	$ 144,567
Benefits	43,186	41,172	36,864
Utilities, supplies, and other services	91,111	85,103	85,641
Scholarships and fellowships	20,982	17,361	11,372
Depreciation	11,734	11,470	11,738
Total Operating Expenses	$ 327,117	$ 307,115	$ 290,182

Expenses by Natural Classification - The University



Comparison of 2006 to 2005:

- Salaries, wages, and benefits increased in fiscal year 2006, but remained steady as a percentage of total expenses. The rise in the gas and electricity costs was a factor in utilities, supplies, and other services being higher than fiscal year 2005. Hope and TSAC scholarships accounted for the rise in scholarships and fellowships. Overall, expenses rose by 7% in 2006, the same percentage of increase as in 2005.

Comparison of 2005 to 2004:

- Fiscal year 2005 was the first year of the Hope scholarship, which caused an increase in the percentage of scholarship and fellowship expenses as a portion of the total expenses of the university. There was a corresponding decrease in the percentage of salaries and wages although actual expenses increased.

Natural Classification - The Foundation
(in thousands of dollars)

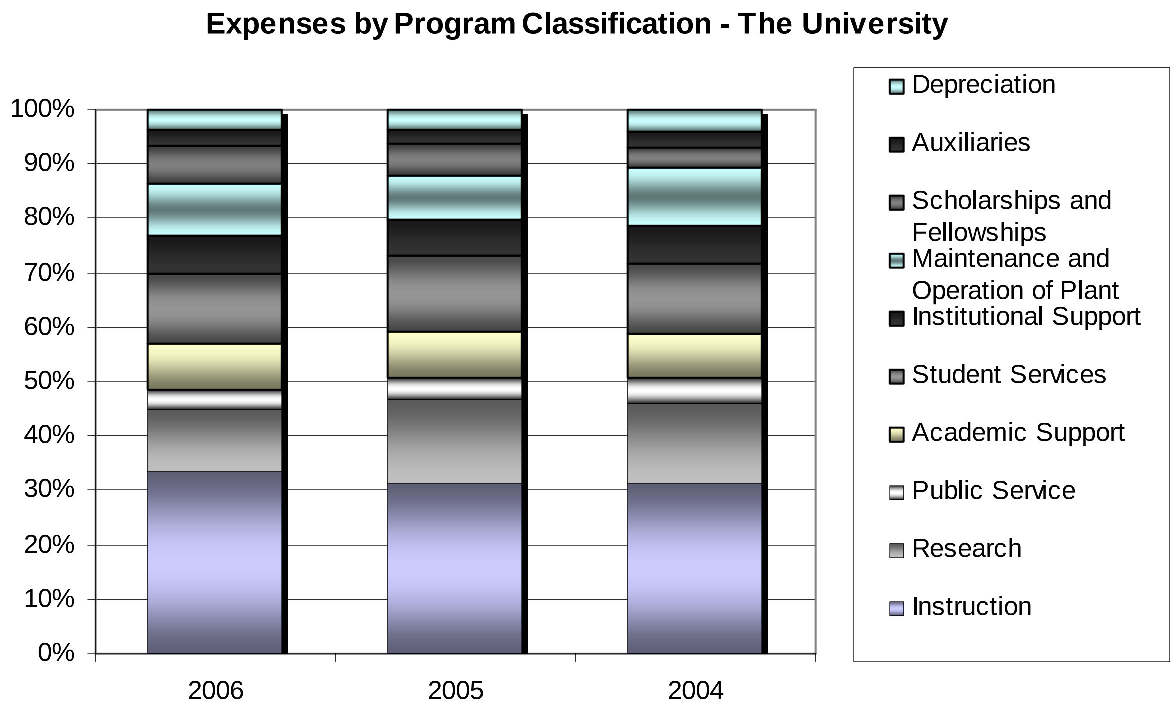
	2006	2005	2004
Operating Expenses:			
Utilities, supplies, and other services	$ 1,477	$ 6	$ 1,504
Payment to or on behalf of the University	6,478	6,879	6,735
Total Operating Expenses	$ 7,955	$ 6,885	$ 8,239

- Payments to the university increased in 2006 in two major areas: $1 million more in support of the Millington campus project and $750,000 additional to athletic support.

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

Program Classification - The University
(in thousands of dollars)

	2006	2005	2004
Operating Expenses:			
Instruction	$ 111,082	$ 95,970	$ 91,087
Research	38,080	47,086	42,560
Public Service	12,781	12,769	13,475
Academic Support	28,283	26,106	23,804
Student Services	43,253	43,126	37,343
Institutional Support	22,888	20,086	19,747
Maintenance and Operation of Plant	27,453	24,854	30,922
Scholarships and Fellowships	20,982	17,361	11,372
Auxiliaries	10,581	8,287	8,134
Depreciation	11,734	11,470	11,738
Total Operating Expenses	$ 327,117	$ 307,115	$ 290,182



Comparison of 2006 to 2005:

- The total of instruction and research is consistent with the prior year; however, the mix of faculty time spent on research changed.

- Scholarships and fellowships increased with the Hope and TSAC scholarships.

Comparison of 2005 to 2004:

- Two million dollars of the increase in student services related to intercollegiate athletics.

- Scholarships and fellowships increased as a result of the Hope Scholarship.

The Statement of Cash Flows

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

Statement of Cash Flows - The University
(in thousands of dollars)

	2006	2005	2004
Cash provided (used) by:			
Operating activities	$ (140,337)	$ (139,367)	$ (127,167)
Noncapital financing activities	160,309	157,126	136,082
Capital and related financing activities	(12,190)	(14,962)	(15,983)
Investing activities	6,784	(6,686)	5,143
Net increase (decrease) in cash	$ 14,566	$ (3,889)	$ (1,925)
Cash, beginning of year	$ 43,111	$ 47,000	$ 48,925
Cash, end of year	$ 57,677	$ 43,111	$ 47,000

Comparison of 2006 to 2005:

Capital and related financing activities:

- In fiscal year 2006 the university had $5 million of proceeds from capital debt, which decreased the cost of net financing activities.

Investing activities:

- On June 30, 2006, the university purchased commercial paper in the amount of $10 million, which the bank did not deduct until July 3, 2006. This resulted in increased cash at the end of the year.

There was no significant change in the university's liquidity in the current year.

Comparison of 2005 to 2004:

Capital and related financing activities:

- In fiscal year 2005 the use of cash for capital and related financing activities decreased due to a reduction in spending for capital projects.

Investing activities:

- The use of cash for investing activities increased in 2005 due to the increase in purchasing of investments.

Capital Assets and Debt Administration

Capital Assets

The University of Memphis had $230.9 million invested in capital assets, net of accumulated depreciation of $152.9 million at June 30, 2006; $223.7 million invested in capital assets, net of accumulated depreciation of $144.8 million at June 30, 2005; and $218.7 million invested in capital assets, net of accumulated depreciation of $136.7 million at June 30, 2004. Depreciation charges totaled $11.7 million, $11.5 million, and $11.7 million for the years ended June 30, 2006; June 30, 2005; and June 30, 2004, respectively. Details of these assets are shown below.

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

	2006	2005	2004
Land	$ 15,738	$ 15,738	$ 15,715
Land improvements	2,555	2,921	3,287
Buildings	134,000	139,247	144,346
Equipment	11,094	13,581	11,156
Library holdings	15,417	15,098	14,752
Software	3,311	-	-
Projects in progress	48,761	37,143	29,406
Total	$ 230,876	$ 223,728	$ 218,662

<u>*Comparison of 2006 to 2005:*</u>

- In fiscal year 2006 the university began the capitalization of software.
- Projects in progress increased in the current year due to the prior period adjustment of $9.5 million.

<u>*Comparison of 2005 to 2004:*</u>

- There was no significant change in capital assets, net of depreciation for fiscal year 2005.

A primary capital project planned for 2007 is the replacement of the University Student Center, with an expected cost of $42.3 million. The principal source of funding will be Tennessee State School Bond Authority bonds, repaid by student debt service fees and local funding.

The university has also budgeted $41.2 million for the relocation of the Cecil C. Humphreys School of Law. The principal source of funding will be state appropriations.

Twenty and one-half million dollars has been budgeted in 2007 for the renovation of West Hall, a student housing facility to be funded by Tennessee State School Bond Authority bonds, and repaid by student debt service fees.

More detailed information about the university's capital assets is presented in Note 5 to the financial statement.

Debt

The university had $54.8 million, $52.6 million, and $53.1 million in debt outstanding at June 30, 2006; June 30, 2005; and June 30, 2004, respectively. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt - The University
(in thousands of dollars)

	2006	2005	2004
Bonds Payable	$ 49,619	$ 49,585	$ 51,668
Commercial Paper	5,219	3,023	1,444
Total	$ 54,838	$ 52,608	$ 53,112

There were no significant changes in outstanding debt in either fiscal year 2006 or fiscal year 2005. More detailed information about the university's long-term liabilities is presented in Note 6 to the financial statements.

Economic Factors That Will Affect the Future

The university has implemented a 4.1% increase in student fees for 2007. Recent increases in student fees have not significantly impacted enrollment, with enrollment holding steady for the past 10 years.

Requests for Information

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

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF NET ASSETS
JUNE 30, 2006, AND JUNE 30, 2005

	Institution		Component Unit	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
ASSETS				
Current assets:				
Cash and cash equivalents (Notes 2 and 17)	$ 17,225,596.07	$ 7,028,611.06	$ 6,705,637.00	$ 5,953,133.00
Short-term investments (Notes 3 and 17)	41,016,980.00	40,661,415.00	-	-
Accounts, notes, and grants receivable (net) (Note 4)	23,992,063.92	22,501,573.32	-	-
Pledges receivable (net) (Note 17)	-	-	1,219,126.00	3,276,286.00
Inventories	468,695.00	487,412.43	-	-
Prepaid expenses and deferred charges	2,654,935.70	598,978.29	-	10,353.00
Accrued interest receivable	344,515.15	261,319.10	8,354.00	13,714.00
Total current assets	85,702,785.84	71,539,309.20	7,933,117.00	9,253,486.00
Noncurrent assets:				
Cash and cash equivalents (Notes 2 and 17)	40,450,657.02	36,082,182.47	-	-
Investments (Notes 3 and 17)	-	2,282,281.25	72,750,127.00	63,905,545.00
Accounts, notes, and grants receivable (net) (Note 4)	7,541,633.84	8,880,462.62	-	-
Pledges receivable (net) (Note 17)	-	-	9,451,095.00	5,841,693.00
Capital assets (net) (Note 5)	230,876,851.38	223,728,136.40	-	-
Other assets	-	-	90,153.00	83,118.00
Total noncurrent assets	278,869,142.24	270,973,062.74	82,291,375.00	69,830,356.00
Total assets	364,571,928.08	342,512,371.94	90,224,492.00	79,083,842.00
LIABILITIES				
Current liabilities:				
Accounts payable	14,582,888.54	8,954,884.41	2,084,981.00	1,067,137.00
Accrued liabilities	19,454,582.42	14,800,059.62	145,380.00	152,490.00
Student deposits	438,573.57	540,922.36	-	-
Deferred revenue	9,219,253.32	9,077,345.55	483,536.00	363,680.00
Compensated absences (Note 6)	1,999,059.46	1,829,620.29	-	-
Accrued interest payable	425,635.15	407,036.34	-	-
Long-term liabilities, current portion (Note 6)	3,291,377.66	2,550,436.53	-	-
Deposits held in custody for others	533,718.54	353,833.54	-	-
Total current liabilities	49,945,088.66	38,514,138.64	2,713,897.00	1,583,307.00
Noncurrent liabilities:				
Notes payable (Note 17)	-	-	165,000.00	165,000.00
Compensated absences (Note 6)	6,372,051.41	5,794,115.25	-	-
Long-term liabilities (Note 6)	51,546,143.47	50,057,701.45	-	-
Due to grantors (Note 6)	2,851,319.41	2,833,659.32	-	-
Total noncurrent liabilities	60,769,514.29	58,685,476.02	165,000.00	165,000.00
Total liabilities	110,714,602.95	97,199,614.66	2,878,897.00	1,748,307.00
NET ASSETS				
Invested in capital assets, net of related debt	176,039,330.25	171,119,998.42	-	-
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	1,304,578.56	1,315,361.24	-	-
Other	2,133,974.30	2,082,682.23	40,855,220.00	36,219,015.00
Expendable:				
Scholarships and fellowships	1,327,563.90	1,299,017.97	-	-
Research	981,997.97	1,094,548.90	-	-
Instructional department uses	2,152,104.17	2,112,661.32	-	-
Loans	2,960,611.97	2,735,650.57	-	-
Capital projects	2,323,382.56	2,503,131.85	-	-
Debt service	6,081,340.44	7,319,659.41	-	-
Other	1,301,699.33	1,085,917.30	44,179,986.00	39,444,881.00
Unrestricted (Note 8)	57,250,741.68	52,644,128.07	2,310,389.00	1,671,639.00
Total net assets	$ 253,857,325.13	$ 245,312,757.28	$ 87,345,595.00	$ 77,335,535.00

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

Exhibit B

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

	Institution		Component Unit	
	Year Ended June 30, 2006	Year Ended June 30, 2005	Year Ended June 30, 2006	Year Ended June 30, 2005
REVENUES				
Operating revenues:				
Student tuition and fees (net of scholarship allowances of $19,868,691.00 for the year ended June 30, 2006, and $17,343,968.00 for the ended June 30, 2005)	$ 94,357,753.19	$ 84,764,214.67	$ -	$ -
Gifts and contributions	-	-	8,841,846.68	9,635,543.00
Governmental grants and contracts	34,263,109.29	33,012,546.31	-	-
Nongovernmental grants and contracts	7,449,883.41	2,752,294.67	-	-
Sales and services of educational departments	15,573,567.79	19,479,678.57	-	-
Auxiliary enterprises:				
Residential life (net of scholarship allowances of $139,137.00 the year ended June 30, 2006, $127,009.00 for the year ended June 30, 2005)	9,053,598.72	8,188,627.49	-	-
Bookstore	641,880.92	626,511.87	-	-
Food service	524,314.30	329,138.25	-	-
Other auxiliaries	4,698,010.10	4,659,783.51	-	-
Interest earned on loans to students	249,625.82	275,944.93	-	-
Other operating revenues	-	-	21,684.44	-
Total operating revenues	166,811,743.54	154,088,740.27	8,863,531.12	9,635,543.00
EXPENSES				
Operating expenses (Note 15):				
Salaries and wages	160,103,948.41	152,008,388.55	-	-
Benefits	43,186,431.23	41,172,244.06	-	-
Utilities, supplies, and other services	91,111,213.94	85,103,046.02	1,476,754.12	5,685.00
Scholarships and fellowships	20,981,536.98	17,361,074.18	-	-
Depreciation expense	11,733,918.20	11,469,764.21	-	-
Payments to or on behalf of The University of Memphis	-	-	6,478,118.00	6,878,967.00
Total operating expenses	327,117,048.76	307,114,517.02	7,954,872.12	6,884,652.00
Operating income (loss)	(160,305,305.22)	(153,025,776.75)	908,659.00	2,750,891.00
NONOPERATING REVENUES (EXPENSES)				
State appropriations	112,444,600.00	110,384,300.00	-	-
Gifts (including $6,478,118.00 from The University of Memphis Foundation for the fiscal year ended June 30, 2006, and $6,878,967.00 in the fiscal year ended June 30, 2005)	11,022,735.49	16,385,524.89	-	-
Grants and contracts	31,206,778.57	28,443,815.25	-	-
Investment income	4,785,334.14	2,801,053.60	7,114,441.00	6,238,081.00
Interest on capital asset-related debt	(2,630,745.54)	(2,833,832.53)	-	-
Bond issuance expense	(30,749.81)	(883,958.02)	-	-
Other nonoperating revenues (expenses)	4,373,442.15	745,807.78	-	-
Net nonoperating revenues	161,171,395.00	155,042,710.97	7,114,441.00	6,238,081.00
Income (loss) before other revenues, expenses, gains, or losses	866,089.78	2,016,934.22	8,023,100.00	8,988,972.00
Capital appropriations	7,806,424.44	4,697,913.97	-	-
Capital grants and gifts	401,350.00	778,570.00	-	-
Additions to permanent endowments	-	-	1,986,960.00	5,051,856.00
Other	(529,296.37)	(1,483.18)	-	-
Total other revenues	7,678,478.07	5,475,000.79	1,986,960.00	5,051,856.00
Increase in net assets	8,544,567.85	7,491,935.01	10,010,060.00	14,040,828.00
NET ASSETS				
Net assets - beginning of year	245,312,757.28	237,820,822.27	77,335,535.00	63,294,707.00
Net assets - end of year	$ 253,857,325.13	$ 245,312,757.28	$ 87,345,595.00	$ 77,335,535.00

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

Exhibit C

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

	Year Ended June 30, 2006	Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 95,612,276.76	$ 83,434,997.25
Grants and contracts	40,466,266.05	36,778,752.43
Sales and services of educational activities	14,231,390.28	19,308,534.13
Payments to suppliers and vendors	(79,898,753.94)	(84,719,072.13)
Payments to employees	(163,072,616.96)	(152,628,179.95)
Payments for benefits	(39,507,510.43)	(38,039,200.76)
Payments for scholarships and fellowships	(22,626,737.98)	(17,361,074.18)
Loans issued to students and employees	(1,919,877.07)	(1,894,073.22)
Collection of loans from students and employees	1,769,658.21	1,519,581.30
Interest earned on loans to students	249,625.82	275,944.93
Auxiliary enterprise charges:		
Residence halls	8,613,508.60	8,387,830.66
Bookstore	641,880.92	626,511.87
Food services	524,314.30	342,448.86
Other auxiliaries	4,579,488.20	4,600,018.15
Net cash used by operating activities	(140,337,087.24)	(139,366,980.66)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	112,450,400.00	110,423,300.00
Gifts and grants received for other than capital purposes, including $6,478,118.00 from The University of Memphis Foundation for the fiscal year ended June 30, 2006, and $6,878,967.00 for the fiscal year ended June 30, 2005)	43,754,717.18	45,919,053.30
Private gifts for endowment purposes	-	1,225.00
Federal student loan receipts	76,991,355.00	75,473,456.00
Federal student loan disbursements	(76,991,355.00)	(75,473,456.00)
Changes in deposits held for others	179,885.00	(37,199.18)
Other noncapital financing receipts (payments)	3,923,509.07	819,233.04
Net cash provided by noncapital financing activities	160,308,511.25	157,125,612.16
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	7,442,556.46	2,221,801.67
Capital appropriations	7,806,424.44	4,697,913.97
Proceeds from sale of capital assets	25,489.53	23,918.92
Purchases of capital assets and construction	(19,608,637.13)	(15,381,543.35)
Principal paid on capital debt and leases	(5,213,173.31)	(2,725,752.49)
Interest paid on capital debt and leases	(2,612,146.73)	(2,914,864.08)
Bond issue cost paid on new debt issue	(30,749.81)	(883,958.02)
Net cash provided (used) by capital and related financing activities	(12,190,236.55)	(14,962,483.38)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	442,132,441.02	30,726,314.75
Income on investments	4,857,555.85	2,988,725.29
Purchase of investments	(440,205,724.77)	(40,400,910.36)
Net cash provided by investing activities	6,784,272.10	(6,685,870.32)
Net increase in cash and cash equivalents	14,565,459.56	(3,889,722.20)
Cash and cash equivalents - beginning of year	43,110,793.53	47,000,515.73
Cash and cash equivalents - end of year (Notes 2 and 17)	$ 57,676,253.09	$ 43,110,793.53

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

	Year Ended June 30, 2006	Year Ended June 30, 2005
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (160,305,305.22)	$ (153,025,776.75)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	11,733,918.20	11,469,764.21
Salvage sales credited to sales and services	(25,489.53)	-
Change in assets and liabilities:		
Receivables, net	(1,379,216.56)	785,160.10
Inventories	18,717.43	(64,896.12)
Prepaid/deferred items	(2,055,957.41)	(153,574.82)
Accounts payable	6,226,549.75	1,482,208.74
Accrued liabilities	4,654,522.80	(465,060.69)
Deferred revenue	150,146.76	(98,645.72)
Deposits	(102,348.79)	(23,503.63)
Compensated absences	747,375.33	727,344.02
Net cash used by operating activities	$ (140,337,087.24)	$ (139,366,980.66)
Noncash transactions		
Gifts in-kind	$ 1,684,530.46	$ 4,966,684.10
Gifts in-kind - capital	$ 401,350.00	$ 778,570.00
Unrealized gains/losses on investments	$ 602,826.25	$ (70,614.22)
Loss on disposal of capital assets	$ (529,296.37)	$ (25,402.10)
Bad debt expense	$ 597,766.03	$ -

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The university is a part of the State University and Community College System of Tennessee (Tennessee Board of Regents). This system is a component unit of the State of Tennessee because the state appoints a majority of the system's governing body and provides financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

The University of Memphis Foundation is considered a component unit of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements. See Note 17 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 (GAAP) applicable to governmental colleges and universities engaged in business-type activities as prescribed by the Governmental Accounting Standards Board (GASB).

Basis of Accounting

For financial statement purposes, the university is considered a special-purpose government engaged only in business-type activities. Accordingly, the financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met. All significant interfund transactions have been eliminated.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The university has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The university has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

Amounts reported as operating revenues include (1) tuition and fees, net of waivers and discounts; (2) 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 university 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) bond issuance costs; (4) interest on capital asset-related debt; (5) certain grants and contracts; and (6) gifts and nonexchange transactions.

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

Cash Equivalents

This classification includes instruments 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. All items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

The university's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. The amount of these liabilities and their related benefits are reported in the statement of net assets.

Capital Assets

Capital assets, which include property, plant, equipment, library holdings, and software, are reported in the statement of net assets at historical cost or at fair value at date of donation, less accumulated depreciation. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's useful life are not capitalized.

A capitalization threshold of $100,000 is used for buildings, and $50,000 is used for infrastructure. Equipment is capitalized when the unit acquisition cost is $5,000 or greater. The capitalization threshold for additions and improvements to buildings and land is set at $50,000. The capitalization threshold for software is set at $100,000.

These assets, with the exception of land, are depreciated/amortized using the straight-line method over the estimated useful lives, which range from 5 to 40 years.

Net Assets

The university's net assets are classified as follows:

Invested in capital assets, net of related debt - This represents the university's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

Nonexpendable restricted net assets - Nonexpendable restricted net assets consist of endowment and similar type funds in which donors or other outside sources have stipulated, as a condition of the gift instrument, that the principal is to be maintained inviolate and in perpetuity, and invested for the purpose of producing present and future income, which may be expendable or added to principal.

Expendable restricted net assets - Expendable restricted net assets include resources which the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net assets - Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university, and may be used at the discretion of the university to meet current expenses for any purpose. The auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

Scholarship Discounts and Allowances

Student tuition and fee revenues, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the university and the amount that is paid by the student and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state, or nongovernmental programs are recorded as either operating or nonoperating revenues in the university's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the university has recorded a scholarship discount and allowance.

NOTE 2. CASH AND CASH EQUIVALENTS

At June 30, 2006, cash and cash equivalents consisted of $22,659,609.16 in bank accounts, $72,290.00 of petty cash on hand, $9,469,751.83 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, $6,090,081.34 in LGIP deposits for capital projects, and $19,384,520.76 in commercial paper. At June 30, 2005, cash and cash equivalents consisted of $9,211,771.77 in bank accounts, $72,815.00 of petty cash on hand, $18,297,737.63 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, $3,240,048.83 in LGIP deposits for capital projects, and $12,288,420.30 in commercial paper.

LGIP deposits for capital projects - Payments related to the university's capital projects are made by the State of Tennessee's Department of Finance and Administration. The university's estimated local share of the cost of each project is held in a separate Local Government Investment Pool (LGIP) account. As expenses are incurred, funds are withdrawn from the LGIP account by the Tennessee Board of Regents and transferred to the Department of Finance and Administration. The funds in the account are not available to the university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

NOTE 3. INVESTMENTS

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

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

At June 30, 2006, the university had the following investments and maturities.

		Investment Maturities (in Years)	
Investment Type	Fair Value	Less than 1	1 to 5
US Treasury Notes	$40,816,980.00	$40,816,980.00	$ -
Commercial paper	19,384,520.76	19,384,520.76	-
Certificates of deposit	200,000.00	200,000.00	-
Less amounts reported as cash and cash equivalents:			
Commercial paper	(19,384,520.76)	(19,384,520.76)	-
Total	$41,016,980.00	$41,016,980.00	$ -

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

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

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

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool (LGIP). The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified. Securities are rated using Standard and Poor's, Moody's, and/or Fitch and are presented below using the Standard and Poor's rating scale. The university has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations.

At June 30, 2006, the university's investments were rated as follows:

		Credit Quality Rating		
Investment Type	Fair Value	AA	A	Unrated
LGIP	$15,559,833.17	$ -	$ -	$15,559,833.17
Commercial paper	19,384,520.76	9,694,325.38	9,690,195.38	-
Total	$34,944,353.93	$9,694,325.38	$9,690,195.38	$15,559,833.17

At June 30, 2005, the university's investments were rated as follows:

		Credit Quality Rating		
Investment Type	Fair Value	AA	A	Unrated
LGIP	$18,297,737.63	$ -	$ -	$18,297,737.63
Commercial paper	12,288,420.30	8,193,546.47	4,094,873.83	-
Total	$30,586,157.93	$8,193,546.47	$4,094,873.83	$18,297,737.63

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2006	June 30, 2005
Student accounts receivable	$ 7,731,328.92	$ 8,506,101.53
Grants receivable	11,551,317.72	9,880,313.89
Notes receivable	1,532,553.85	1,691,815.77
State appropriation receivable	237,800.00	243,600.00
Other receivables	14,409,258.44	14,360,685.17
Subtotal	35,462,258.93	34,682,516.36
Less allowance for doubtful accounts	(6,930,270.57)	(6,309,378.52)
Total receivables	$ 28,531,988.36	$ 28,373,137.84

Federal Perkins Loan Program funds included the following:

	June 30, 2006	June 30, 2005
Perkins loans receivable	$ 3,533,181.37	$ 3,568,739.10
Less allowance for doubtful accounts	(531,471.97)	(559,841.00)
Total	$ 3,001,709.40	$ 3,008,898.10

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land	$ 15,738,489.06	$ -	$ -	$ 15,738,489.06
Land improvements and infrastructure	14,693,216.80	-	-	14,693,216.80
Buildings	227,083,002.73	-	-	227,083,002.73
Equipment	42,229,091.60	3,335,327.02	4,137,507.27	41,426,911.35
Library holdings	31,686,874.33	3,586,109.07	2,601,093.69	32,671,889.71
Software	-	3,455,367.58	-	3,455,367.58
Projects in progress	37,143,097.65	11,618,331.42	-	48,761,429.07
Total	368,573,772.17	21,995,135.09	6,738,600.96	383,830,306.30

Less accum. depreciation:				
Land improvements and infrastructure	11,772,418.70	365,724.02	-	12,138,142.72
Buildings	87,836,108.60	5,246,637.97	-	93,082,746.57
Equipment	28,648,414.15	2,709,745.66	1,025,005.36	30,333,154.45
Library holdings	16,588,694.32	3,267,188.97	2,601,093.69	17,254,789.60
Software	-	144,621.58	-	144,621.58
Total accum. Depreciation	144,845,635.77	11,733,918.20	3,626,099.05	152,953,454.92
Capital assets, net	$223,728,136.40	$10,261,216.89	$3,112,501.91	$230,876,851.38

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

	Beginning Balance	Additions	Reductions	Ending Balance
Land	$ 15,715,332.50	$ 23,156.56	$ -	$ 15,738,489.06
Land improvements and infrastructure	14,693,216.80	-	-	14,693,216.80
Buildings	226,865,182.99	217,819.74	-	227,083,002.73
Equipment	37,980,706.11	5,068,374.00	819,988.51	42,229,091.60
Library holdings	30,706,005.11	3,514,783.37	2,533,914.15	31,686,874.33
Projects in progress	29,405,509.93	7,737,587.72	-	37,143,097.65
Total	355,365,953.44	16,561,721.39	3,353,902.66	368,573,772.17
Less accum. depreciation:				
Land improvements and infrastructure	11,406,498.74	365,919.96	-	11,772,418.70
Buildings	82,518,914.68	5,317,193.92	-	87,836,108.60
Equipment	26,825,037.66	2,617,962.90	794,586.41	28,648,414.15
Library holdings	15,953,921.04	3,168,687.43	2,533,914.15	16,588,694.32
Total accum. depreciation	136,704,372.12	11,469,764.21	3,328,500.56	144,845,635.77
Capital assets, net	$ 218,661,581.32	$ 5,091,957.18	$ 25,402.10	$223,728,136.40

NOTE 6. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2006, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$ 49,585,424.61	$ 2,494,646.50	$ 2,461,373.31	$ 49,618,697.80	$ 3,291,377.66
Commercial paper	3,022,713.37	4,947,909.96	2,751,800.00	5,218,823.33	-
Subtotal	52,608,137.98	7,442,556.46	5,213,173.31	54,837,521.13	3,291,377.66
Other liabilities:					
Compensated absences	7,623,735.54	6,715,844.23	5,968,468.90	8,371,110.87	1,999,059.46
Due to grantors	2,833,659.32	75,080.76	57,420.67	2,851,319.41	-
Subtotal	10,457,394.86	6,790,924.99	6,025,889.57	11,222,430.28	1,999,059.46
Total long-term liabilities	$ 63,065,532.84	$ 14,233,481.45	$ 11,239,062.88	$ 66,059,951.41	$ 5,290,437.12

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

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$ 51,668,047.80	$ 643,129.30	$ 2,725,752.49	$ 49,585,424.61	$ 2,550,436.53
Commercial paper	1,444,041.00	1,578,672.37	-	3,022,713.37	-
Subtotal	53,112,088.80	2,221,801.67	2,725,752.49	52,608,137.98	2,550,436.53
Other liabilities:					
Compensated absences	6,896,391.52	6,055,572.78	5,328,228.76	7,623,735.54	1,829,620.29
Due to grantors	2,689,000.83	147,854.48	3,195.99	2,833,659.32	-
Subtotal	9,585,392.35	6,203,427.26	5,331,424.75	10,457,394.86	1,829,620.29
Total long-term liabilities	$ 62,697,481.15	$ 8,425,228.93	$ 8,057,177.24	$ 63,065,532.84	$ 4,380,056.82

TSSBA Debt - Bonds

Bonds, with interest rates ranging from 3% to 7.15%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2032 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net assets is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $124,289.21 at June 30, 2006, and $213,352.45 at June 30, 2005. Unexpended debt proceeds were $253,000.00 at June 30, 2006.

Debt service requirements to maturity for the university's portion of TSSBA bonds at June 30, 2006, are as follows:

Year Ending June 30	Principal	Interest	Total
2007	$ 3,291,377.66	$ 2,507,266.78	$ 5,798,644.44
2008	3,199,223.50	2,337,172.63	5,536,396.13
2009	3,652,801.09	2,147,284.20	5,800,085.29
2010	3,882,244.30	1,946,302.83	5,828,547.13
2011	1,900,152.10	1,727,881.99	3,628,034.09
2012-2016	7,691,790.12	7,532,892.14	15,224,682.26
2017-2021	8,872,861.89	5,611,786.47	14,484,648.36
2022-2026	8,603,298.87	3,436,916.89	12,040,215.76
2027-2031	8,368,553.53	1,109,474.43	9,478,027.96
2032	156,394.74	8,210.70	164,605.44
	$ 49,618,697.80	$ 28,365,189.06	$ 77,983,886.86

TSSBA Debt - Commercial Paper

The Tennessee State School Bond Authority issues commercial paper to finance the costs of various capital projects during their construction phase. When projects are placed in service, long-term, fixed-rate debt is issued by TSSBA to finance the project over its useful payback period and the commercial paper is redeemed. The amount issued for projects at the university was $5,218,823.33 at June 30, 2006, and $3,022,713.37 at June 30, 2005.

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

More detailed information regarding the bonds and commercial paper can be found in the notes to the financial statements in the financial report for the Tennessee State School Bond Authority. That report may be obtained by writing to the Director of Bond Finance, Suite 1600, James K. Polk Building, Nashville, Tennessee 37243-0273, or by calling (615) 401-7872.

NOTE 7. ENDOWMENTS

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

The university chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the university, 4.75% of a three-year moving average of the fair value of endowment investment has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income or is returned to corpus in accordance with the terms of the endowment agreement. At June 30, 2006, net appreciation of $1,341,788.49 is available to be spent, of which $125,348.68 is included in restricted net assets expendable for scholarships and fellowships, $1,195,435.42 is included in restricted net assets expendable for instructional departmental uses and $21,004.39 is included in restricted net assets expendable for other. At June 30, 2005, net appreciation of $6,101,132.37 is available to be spent, all of which is included in restricted net assets expendable for specific purposes as determined by the terms of the endowment.

NOTE 8. UNRESTRICTED NET ASSETS

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

	June 30, 2006	June 30, 2005
Working capital	$ 6,420,049.06	$ 5,338,789.16
Encumbrances	478,599.82	1,459,060.43
Designated fees	2,464,543.18	2,332,945.05
Auxiliaries	752,847.05	696,448.32
Quasi-endowment	217,639.51	722,639.51

Plant construction	23,111,361.70	18,323,379.85
Renewal and replacement of equipment	16,100,744.32	16,157,506.44
Unreserved/undesignated	7,704,957.04	7,613,359.31
Total	$ 57,250,741.68	$ 52,644,128.07

NOTE 9. PENSION PLANS

A. Defined Benefit Plans

1. Tennessee Consolidated Retirement System

Plan Description - The university contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing, multiple-employer, defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee 37243-0230, or by calling (615) 741-8202.

Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 10.31% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2006, 2005, and 2004, were $5,776,544.21, $5,260,425.70, and $3,503,862.94. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

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

Funding Policy - Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans was $8,136,761.74 for the year ended June 30, 2006, and $7,879,469.14 for the year ended June 30, 2005. Contributions met the requirements for each year.

NOTE 10. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible university retirees. This benefit is provided and administered by the State of Tennessee. The university assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 11. INSURANCE-RELATED ACTIVITIES

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

The university participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the years ended June 30, 2006, and June 30, 2005, are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140. Since the university participates in the Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated,* Section 50-6-101 et seq. Claims are paid through the state's Risk Management Fund. At June 30, 2006, the Risk Management Fund held $133.2 million in cash and cash equivalents designated for payment of claims. 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, 2006, the scheduled coverage for the university was $534,490,800.00 for buildings and $309,600,600.00 for contents. At June 30, 2005, the scheduled coverage for the university was $523,805,900.00 for buildings and $304,103,100.00 for contents.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The university participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The dollar amount of unused sick leave was $68,219,794.08 at June 30, 2006, and $62,811,766.85 at June 30, 2005.

Operating Leases - The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $1,587,091.89 and for personal property were $93,889.28 for the year ended June 30, 2006. Comparative amounts for the year ended June 30, 2005, were $1,280,481.89 and $375,135.62. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2006, outstanding commitments under construction contracts totaled $8,943,504.40 for University Center Renovation, Carpenter Hall, Richardson and Rawls Fire Safety, Drainage Correction, Fume Hood Replacement, and roof repair and replacements, of which $1,375,435.20 will be funded by future state capital outlay appropriations.

Contract - In December 2004, the Tennessee Board of Regents system entered into a contract with SungardSCT for the purchase of a comprehensive enterprise resource planning system. The contract includes a multi-year phase-in of administrative software for financial, human resource, and student systems. The university's outstanding liability for this contract is estimated as $4,022,752.79 at June 30, 2006.

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

NOTE 13. CHAIRS OF EXCELLENCE

The university had $59,890,590.33 on deposit at June 30, 2006, and $58,643,290.92 on deposit at June 30, 2005, with the State Treasurer for the university's Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

NOTE 14. FUNDS HELD IN TRUST BY OTHERS

The university is a beneficiary under the VanVleet, the Mike Driver, the Pope M. Farrington, the C.M. Gooch, and the Herbert Herff trusts. The underlying assets are not considered assets of the university and are not included in the university's financial statements. The university received $1,135,166.47 from these funds during the year ended June 30, 2006, and $790,532.92 during the year ended June 30, 2005.

NOTE 15. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2006, are as follows:

			Natural Classification			
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 75,462,788.56	$ 18,638,071.78	$ 16,980,944.15	$ -	$ -	$ 111,081,804.49
Research	22,189,126.67	4,431,874.28	11,458,965.57	-	-	38,079,966.52
Public service	5,664,326.42	1,522,329.28	5,594,431.78	-	-	12,781,087.48
Academic support	16,953,025.21	5,330,274.68	6,000,071.15	-	-	28,283,371.04
Student services	15,413,352.09	4,766,262.46	23,073,551.40	-	-	43,253,165.95
Institutional support	13,443,727.37	4,377,044.72	5,067,142.04	-	-	22,887,914.13
Operation & maintenance	9,096,468.95	3,630,459.19	14,726,020.07	-	-	27,452,948.21
Scholar. & fellow.	-	-	-	20,981,536.98	-	20,981,536.98

Auxiliary	1,881,133.14	490,114.84	8,210,087.78	-	-	10,581,335.76
Depreciation	-	-	-	-	11,733,918.20	11,733,918.20
Total	$160,103,948.41	$ 43,186,431.23	$ 91,111,213.94	$ 20,981,536.98	$ 11,733,918.20	$ 327,117,048.76

The university'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	$ 63,887,968.98	$ 15,553,525.91	$ 16,528,174.97	$ -	$ -	$ 95,969,669.86
Research	28,721,984.95	6,576,046.44	11,787,777.19	-	-	47,085,808.58
Public service	6,427,076.63	1,661,215.79	4,681,083.28	-	-	12,769,375.70
Academic support	15,844,904.10	5,017,557.23	5,243,180.79	-	-	26,105,642.12
Student services	14,107,171.97	4,437,378.90	24,581,113.71	-	-	43,125,664.58
Institutional support	12,528,760.76	3,979,661.50	3,577,653.82	-	-	20,086,076.08
Operation & maintenance	8,678,837.48	3,482,997.78	12,692,645.42	-	-	24,854,480.68
Scholar. & fellow.	-	-	-	17,361,074.18	-	17,361,074.18
Auxiliary	1,811,683.68	463,860.51	6,011,416.84	-	-	8,286,961.03
Depreciation	-	-	-	-	11,469,764.21	11,469,764.21
Total	$152,008,388.55	$ 41,172,244.06	$ 85,103,046.02	$ 17,361,074.18	$ 11,469,764.21	$ 307,114,517.02

NOTE 16. PRIOR-YEAR RESTATEMENTS

In the prior year, the commercial paper payable was not accurately allocated between current and noncurrent long-term liabilities. The following amounts have been restated to comply with the requirements of Financial Accounting Standards Board Statement No. 6, *Classification of Short-term Obligations Expected to be Refinanced*.

	Original Amount	Increase/(Decrease)	Restated Amount
Statement of net assets:			
Long-term liabilities, current	$5,573,149.90	$(3,022,713.37)	$2,550,436.53
Long-term liabilities, noncurrent	$47,034,988.08	$3,022,713.37	$50,057,701.45

The university included a prior period adjustment in the June 30, 2006, financial statements to capitalize construction in progress projects that were incorrectly expensed during the fiscal year ended June 30, 2005. The following amounts have been restated to reflect this prior period adjustment.

	Original Amount	Increase/(Decrease)	Restated Amount
Statement of net assets:			
Capital assets (net)	$219,081,847.43	$4,646,288.97	$223,728,136.40

Invested in capital assets, net of related debt	$166,473,709.45	$4,646,288.97	$171,119,998.42
Statement of revenues, expenses, and changes in net assets:			
Utilities, supplies, and other services	$89,749,334.99	($4,646,288.97)	$85,103,046.02
Statement of cash flows:			
Payments to suppliers and vendors	($89,365,361.10)	$4,646,288.97	($84,719,072.13)
Purchases of capital assets and construction	($10,735,254.38)	($4,646,288.97)	($15,381,543.35)

NOTE 17. COMPONENT UNIT

The University of Memphis Foundation is a legally separate, tax-exempt organization supporting The University of Memphis. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The 40-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

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

During the year ended June 30, 2006, the foundation made distributions of $6,478,118.00 to or on behalf of the university for both restricted and unrestricted purposes. During the year ended June 30, 2005, the foundation made distributions of

$6,878,967.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Mr. Larry Bunch, Managing Director; 110 Billy Mac Jones Building; Memphis, Tennessee 38152-3750.

Cash and cash equivalents - Cash and cash equivalents consists of demand deposit accounts and money market funds. Of the bank balances of deposits at June 30, 2006, $100,000.00 was insured by FDIC and $6,605,637.00 was not insured. Of the bank balances of deposits at June 30, 2005, $100,000.00 was insured by FDIC and $5,853,133.00 was not insured.

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

Investments held at June 30, 2006, were as follows:

	Cost	Market Value
Mutual funds	$ 50,645,031.00	$ 57,237,304.00
U.S. government, foreign, and other bonds	222,104.00	216,308.00
Interest in limited partnerships	11,361,796.00	14,699,302.00
Donated real and personal property	597,213.00	597,213.00
Total investments	$ 62,826,144.00	$ 72,750,127.00

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

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

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

	June 30, 2006	June 30, 2005
Current pledges	$ 4,907,386.00	$ 3,334,290.00
Pledges due in one to five years	5,970,397.00	6,071,429.00
Pledges due after five years	527,600.00	194,100.00
Subtotal	11,405,383.00	9,599,819.00
Less discount to net present value	(622,162.00)	(421,837.00)
Less allowance for uncollectible contributions	(113,000.00)	(60,003.00)
Total pledges receivable, net	$ 10,670,221.00	$ 9,117,979.00

Long-term liabilities - Long-term liabilities at June 30, 2006, consisted of the following:

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

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

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

Notes payable - The note payable to Christ Is Our Salvation Foundation (C.I.O.S.) is non-interest bearing. During the year ended June 30, 2004, C.I.O.S. requested repayment of the note according to the terms of the agreement. According to the agreement, the foundation is not obligated to repay the note at a rate greater than the rate at which the foundation receives repayments from the University of Memphis on loans made to students that were funded with C.I.O.S. loan proceeds. The balance owed by the foundation was $135,000.00 at June 30, 2006, and $165,000.00 at June 30, 2005.

The note payable to donors to assist the University of Memphis Law School in preparing for a capital campaign is non-interest bearing. The foundation can borrow up to $100,000 under this loan agreement. Repayment of the note will be made only when adequate funds have been raised through the capital campaign and are available to repay the entire note and only upon written request by the Dean of the University of Memphis Law School. The balance owed by the foundation was $30,000.00 at June 30, 2006.

Endowments - If a donor has not provided specific instructions to the foundation, the foundation's policies and procedures permit it 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.

The foundation chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the foundation, expenditures equal to 4% to 6% of the foundations' balance of income producing assets at the beginning of the year have been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income. At June 30, 2006, net appreciation of $22,033,009.19 is available to be spent, of which $10,545,502.41 is included in restricted net assets expendable for scholarships and fellowships, $372,281.49 is included in restricted net assets expendable for research, $5,899,661.56 is included in restricted net assets expendable for instructional departmental uses, $627,078.15 is included in restricted net assets expendable for capital projects, $4,308,645.81 is included in restricted net assets expendable for other, and $279,839.77 is included in unrestricted net assets. At June 30, 2005, net appreciation of $19,171,843.65 is available to be spent, of which $8,703,690.54 is included in restricted net assets expendable for scholarships and fellowships, $235,593.72 is included in restricted net assets expendable for research, $4,591,728.26 is included in restricted net assets expendable for instructional departmental uses, $1,777,498.82 is included in restricted net assets expendable for capital projects, $3,626,981.57 is included in restricted net assets expendable for other, and $236,350.74 is included in unrestricted net assets.

SUPPLEMENTARY INFORMATION
TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF CASH FLOWS - COMPONENT UNIT
FOR THE YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

	Year Ended June 30, 2006	Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$ 7,659,460.68	$ 6,396,497.00
Payments to suppliers and vendors	(3,342,212.87)	(51,618.00)
Payments to The University of Memphis	(3,848,607.25)	(8,241,680.00)
Other operating revenue	21,684.44	-
Net cash provided (used) by operating activities	490,325.00	(1,896,801.00)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes	1,986,960.00	5,051,856.00
Other noncapital financing receipts (payments)	-	(60,000.00)
Net cash provided (used) by noncapital financing activities	1,986,960.00	4,991,856.00
CASH FLOWS FROM INVESTING ACTIVITIES		
Income on investments	7,119,801.00	6,239,603.00
Purchases of investments	(8,844,582.00)	(9,006,410.00)
Net cash provided (used) by investing activities	(1,724,781.00)	(2,766,807.00)
Net increase (decrease) in cash and cash equivalents	752,504.00	328,248.00
Cash and cash equivalents - beginning of year	5,953,133.00	5,624,885.00
Cash and cash equivalents - end of year (Note 17)	$ 6,705,637.00	$ 5,953,133.00
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ 908,659.00	$ 2,750,891.00
Adjustments to reconcile operating loss to net cash used by operating activities:		
Change in assets and liabilities:		
Receivables, net	(1,302,242.00)	(3,565,226.00)
Prepaid/deferred items	10,353.00	(475.00)
Other assets	(7,035.00)	(5,217.00)
Accounts payable	767,844.00	(1,357,496.00)
Accrued liabilities	(7,110.00)	114,607.00
Deferred revenues	119,856.00	326,180.00
Other liabilities	-	(160,065.00)
Net cash used by operating activities	$ 490,325.00	$ (1,896,801.00)
Noncash transactions		
Unrealized gains (losses) on investments	$ 1,555,707.00	$ (2,082,137.10)
Bad debt expense	$ 108,434.00	$ -