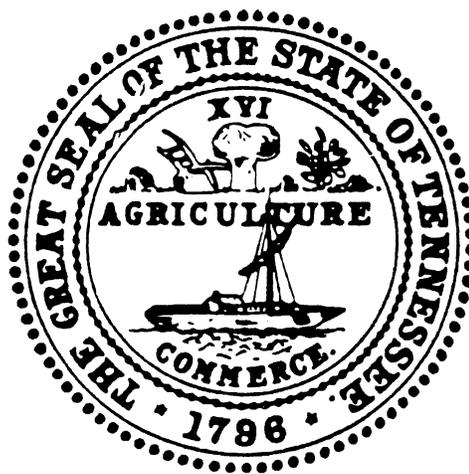


# AUDIT REPORT

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

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***

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Comptroller of the Treasury, Division of State Audit  
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[www.comptroller.state.tn.us/sa/reports/index.html](http://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](http://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

March 15, 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. Melvin N. Johnson, President  
Tennessee State University  
3500 John A. Merritt Boulevard  
Nashville, Tennessee 37209

Ladies and Gentlemen:

Transmitted herewith is the report on the Endowment for Educational Excellence at the Tennessee State University Foundation for the year ended June 30, 2006. The audit was conducted under the requirements of the trust agreement which established the endowment. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Sincerely,

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

John G. Morgan  
Comptroller of the Treasury

JGM/sah  
07/041



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

**SUITE 1500  
JAMES K. POLK STATE OFFICE BUILDING  
NASHVILLE, TENNESSEE 37243-0264  
PHONE (615) 401-7897  
FAX (615) 532-2765**

**Independent Auditor's Report**

December 15, 2006

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

Dear Mr. Morgan:

We have audited the accompanying statement of net assets of the Endowment for Educational Excellence at the Tennessee State University Foundation as of June 30, 2006, and the related statement of revenues, expenses, and changes in net assets for the year then ended. These financial statements are the responsibility of the foundation's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

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

The Honorable John G. Morgan  
December 15, 2006  
Page Two

As discussed in Note 1, the financial statements of the Endowment for Educational Excellence are intended to present the financial position and the changes in financial position of only that portion of the Tennessee State University Foundation's activities that is attributable to the transactions of the endowment. They do not purport to, and do not, present fairly the financial position of the Tennessee State University Foundation as of June 30, 2006, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Endowment for Educational Excellence at the Tennessee State University Foundation as of June 30, 2006, and the changes in financial position for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 3 through 5 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.

Sincerely,

A handwritten signature in black ink that reads "Arthur A. Hayes, Jr." The signature is written in a cursive style with a prominent initial "A".

Arthur A. Hayes, Jr., CPA  
Director

AAH/sah

## **Management's Discussion and Analysis**

This section of Tennessee State University Foundation's Endowment for Educational Excellence trust's report presents a discussion and analysis of the financial performance of the trust during the fiscal year ended June 30, 2006, with comparative information presented for the fiscal year ended June 30, 2005. 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 Report**

This report consists of two basic financial statements. The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets provide information on Tennessee State University Foundation's Endowment for Educational Excellence trust as a whole and present a long-term view of the trust's finances.

### **The Statement of Net Assets**

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

Net assets are report as restricted net assets, which are 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 trust 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.

### Statement of Net Assets (in thousands of dollars)

	June 30, 2006	June 30, 2005
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 310	\$ 147
Total current assets	310	147
Noncurrent assets:		
Cash and cash equivalents	5,235	3,307
Investments	9,350	8,284
Total noncurrent assets	14,585	11,591
<b>Total assets</b>	<b>14,895</b>	<b>11,738</b>
<b>NET ASSETS</b>		
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	14,585	11,591
Expendable:		
Scholarships and fellowships	310	-
Other	-	147
<b>Total net assets</b>	<b>\$ 14,895</b>	<b>\$ 11,738</b>

- Current assets and restricted expendable net assets increased as the result of investment income of over \$188,000 in expendable accounts received in FY 2006.
- Noncurrent assets and nonexpendable net assets for the current fiscal year increased over \$2.9 million as a result of \$1 million received in state funds, over \$111 thousand received in gifts, and a more aggressive investment program that resulted in over \$306 thousand received in investment income and over \$1.5 million in gains in the value of the investments in FY 2006.

### 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 trust, as well as the nonoperating revenues and expenses.

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

	2006	2005
Operating expenses	\$ 25	\$ 48
<b>Operating loss</b>	<b>(25)</b>	<b>(48)</b>
<b>Nonoperating revenues and expenses:</b>		
State appropriations	1,000	1,488
Gifts	112	312
Investment income	494	285

Other nonoperating revenues and expenses	<u>1,576</u>	<u>451</u>
<b>Total nonoperating revenues and expenses</b>	<b><u>3,182</u></b>	<b><u>2,536</u></b>
<b>Increase in net assets</b>	<b>3,157</b>	<b>2,488</b>
<b>Net assets at beginning of year</b>	<b><u>11,738</u></b>	<b><u>9,250</u></b>
<b>Net assets at end of year</b>	<b><u>\$ 14,895</u></b>	<b><u>\$ 11,738</u></b>

### Revenues

- State appropriations decreased since no private gifts were submitted for matching during the FY 2006 fiscal year.
- Gifts for the trust decreased due to a decrease in funds received from nongovernmental organizations.
- Investment income increased as a result of more funds invested for the entire fiscal year and a more aggressive investment strategy employed by the trust.
- Other nonoperating revenues increased due to an increase in the gains and the value of the investments held by the trust.

### **Economic Factors That Will Affect the Future**

After a series of court orders during the past 25 years, the parties in the Geier Desegregation Case reached an agreement in September 2006 to bring an end to the lawsuit. The agreement allowed for an additional \$40 million to be allocated to Tennessee State University. The use of the funds will be determined by the university. As much as \$30 million of these funds may be invested in the Endowment for Educational Excellence over the next five years.

### **Requests for Information**

This financial report is designed to provide a general overview of the trust's finances for all those with an interest in the trust's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to:

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

**TENNESSEE BOARD OF REGENTS  
 ENDOWMENT FOR EDUCATIONAL EXCELLENCE  
 TENNESSEE STATE UNIVERSITY FOUNDATION  
 STATEMENT OF NET ASSETS  
 JUNE 30, 2006**

**ASSETS**

## Current assets:

Cash and cash equivalents (Note 2)	\$ 309,929.91
Total current assets	<u>309,929.91</u>

## Noncurrent assets:

Cash and cash equivalents (Note 2)	5,234,753.56
Investments (Note 3)	<u>9,350,701.00</u>
Total noncurrent assets	<u>14,585,454.56</u>
Total assets	<u><u>14,895,384.47</u></u>

**NET ASSETS**

## Restricted for:

## Nonexpendable:

Scholarships and fellowship:	14,585,454.56
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## Expendable:

Scholarships and fellowships (Note 4)	<u>309,929.91</u>
Total net assets	<u><u>\$ 14,895,384.47</u></u>

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

**TENNESSEE BOARD OF REGENTS  
 ENDOWMENT FOR EDUCATIONAL EXCELLENCE  
 TENNESSEE STATE UNIVERSITY FOUNDATION  
 STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS  
 FOR THE YEAR ENDED JUNE 30, 2006**

**EXPENSES**

## Operating expenses:

Utilities, supplies, and other services	\$ 25,000.00
Total operating expenses	<u>25,000.00</u>
Operating loss	<u>(25,000.00)</u>

**NONOPERATING REVENUES (EXPENSES)**

State appropriations	1,000,000.00
Gifts	111,824.78
Investment income	494,308.90
Other nonoperating revenues (expenses)	<u>1,576,031.41</u>
Net nonoperating revenues	<u>3,182,165.09</u>
Increase in net assets	<u>3,157,165.09</u>

**NET ASSETS**

Net assets - beginning of year	11,738,219.38
Net assets - end of year	\$ <u><u>14,895,384.47</u></u>

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

**Tennessee Board of Regents**  
**Endowment for Educational Excellence**  
**Tennessee State University Foundation**  
**Notes to the Financial Statements**  
**June 30, 2006**

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**NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Reporting Entity**

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

Tennessee State University Foundation is a legally separate, tax-exempt organization supporting Tennessee State University. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The 10-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. The size of the board shall be determined by the majority vote of its members, and any vacancy in its membership shall be filled in the same way. The entire membership of the Board of Trustees shall not exceed twenty-five (25) in number and a minimum of eight (8). All trustees shall serve until the expiration of their respective terms and until their respective successors are selected and qualified. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, which the foundation holds and invests, is restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

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

**Basis of Presentation**

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

**Tennessee Board of Regents  
Endowment for Educational Excellence  
Tennessee State University Foundation  
Notes to the Financial Statements (Cont.)  
June 30, 2006**

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**Basis of Accounting**

The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded when a liability is incurred, regardless of the timing of related cash flows. Grants and similar items are recognized as revenue as soon as all eligibility requirements imposed by the provider have been met.

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

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

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

**Cash Equivalents**

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

**Net Assets**

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

Expendable restricted net assets - Expendable restricted net assets include resources which the foundation is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties. The trust agreement does provide for spending a portion of the income, as discussed in Note 4. Spending decisions are to

**Tennessee Board of Regents  
Endowment for Educational Excellence  
Tennessee State University Foundation  
Notes to the Financial Statements (Cont.)  
June 30, 2006**

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

**NOTE 2. CASH AND CASH EQUIVALENTS**

At June 30, 2006, cash and cash equivalents consisted of \$309,929.91 in bank accounts and \$5,234,753.56 in capital management account money funds.

**NOTE 3. INVESTMENTS**

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 endowment had the following investments and maturities.

Investment Type	Fair Value	Less than 1	Investment Maturities (in Years)			No Maturity Date
			1 to 5	6 to 10	More than 10	
U.S. Treasury	\$ 318,739.30	\$ -	\$ 48,531.25	\$ -	\$270,208.05	\$ -
U.S. agencies	564,464.55	-	514,331.45	50,133.10	-	-
Corporate stocks	705,019.81	-	-	-	-	705,019.81
Corporate bonds	2,579,317.71	273,363.31	1,925,042.82	380,911.58	-	-
Mutual funds	2,224,470.81	-	-	-	-	2,224,470.81
Other:						
Mortgage backed securities	198,073.26	-	-	-	198,073.26	-
Equity stock	7,411.53	-	-	-	-	7,411.53
Real estate shares	1,328,253.58	-	-	-	-	1,328,253.58
Real estate holdings	1,424,950.45	-	-	-	-	1,424,950.45
Money funds and short-term Investments	5,234,753.56	-	-	-	-	5,234,753.56
Less amount reported as cash and cash equivalents:						
Other:						
Money funds and short-term investments	<u>(5,234,753.56)</u>	-	-	-	-	<u>(5,234,753.56)</u>
Total	<u>\$9,350,701.00</u>	<u>\$273,363.31</u>	<u>\$2,487,905.52</u>	<u>\$431,044.68</u>	<u>\$468,281.31</u>	<u>\$5,690,106.18</u>

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

**Tennessee Board of Regents  
Endowment for Educational Excellence  
Tennessee State University Foundation  
Notes to the Financial Statements (Cont.)  
June 30, 2006**

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The foundation is authorized to invest the endowment funds in accordance with the trust agreement. Under the trust agreement, the foundation is authorized to invest and reinvest the property of the trust in any kind of real and/or personal property and any kind of investment specifically including, but not limited to, domestic or foreign government obligations of any kind; domestic or foreign securities of any kind including, but not limited to, preferred or common stocks, bonds, mortgage participations and shares of investment trusts, investment companies, money market funds, and mutual funds (including market or index funds); options to purchase or sell domestic or foreign securities or domestic or foreign government obligations of any kind; and interests in partnerships, so long as such investments are made with the care of a fiduciary. 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 foundation has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations. At June 30, 2006, the endowment's investments were rated as follows:

<u>Investment Type</u>	<u>Fair Value</u>	<u>Credit Quality Ratings</u>				
		<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>BBB</u>	<u>Unrated</u>
U.S. agencies	\$ 564,464.55	\$514,331.45	\$ 50,133.10	\$ -	\$ -	\$ -
Corporate bonds	2,579,317.71	91,511.99	228,237.27	2,095,326.09	164,242.36	-
Mutual funds	2,224,470.81	-	-	-	-	2,224,470.81
Mortgage backed securities	<u>198,073.26</u>	-	-	-	-	<u>198,073.26</u>
<b>Total</b>	<b><u>\$5,566,326.33</u></b>	<b><u>\$605,843.44</u></b>	<b><u>\$278,370.37</u></b>	<b><u>\$2,095,326.09</u></b>	<b><u>\$164,242.36</u></b>	<b><u>\$2,422,544.07</u></b>

Concentration of credit risk - The foundation places no limit on the amount it may invest in any one issuer. More than 5% of the endowment's investments were invested in the following single issuers at June 30, 2006.

<u>Issuer</u>	<u>Percentage of Total Investments</u>
AmSouth Bank	22.5%
Charles Schwab International	51.2%
Diversified Trends	10.8%
Man-Glenwood	5.6%

**Tennessee Board of Regents  
Endowment for Educational Excellence  
Tennessee State University Foundation  
Notes to the Financial Statements (Cont.)  
June 30, 2006**

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**NOTE 4. ENDOWMENT INCOME**

The trust agreement requires that at least 25% of the annual income be added to the corpus and stipulates approved and prohibited uses of the other 75%. The grant agreement for the Title III program requires that 50% of the income be added to the corpus and has provisions on the allowable uses of the other 50%. As of June 30, 2006, net appreciation of \$309,929.91 is available to be spent and is included in restricted net assets expendable for scholarships and fellowships.