AUDIT REPORT

Tennessee Board of Regents
Tennessee State University

For the Year Ended
June 30, 2007

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

Donna L. Jewell, CPA, CFE
Audit Manager

Keith L. Isbell
In-Charge Auditor

Laura B. Pickett
Sheilah Pride, CFE
Diane E. Wheeler
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

September 4, 2008

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 financial and compliance audit of the Tennessee Board of Regents, Tennessee State University, for the year ended June 30, 2007. You will note from the independent auditor's report that unqualified opinions were given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report. The university's administration has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Sincerely,

John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/cj
07/111

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Tennessee State University
For the Year Ended June 30, 2007

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

INTERNAL CONTROL FINDINGS

Bank Reconciliations Were Not Prepared Timely for the Operating and the Payroll Accounts, and as a Result, Management Has Not Mitigated the Risk That Errors or Fraud Could Occur and Not Be Detected Timely
The Assistant Director of General Accounting and Accounts Payable and the Associate Vice President of Business and Finance at Tennessee State University did not ensure that the Financial Analyst III in the General Accounting Office or other appropriate personnel prepared bank reconciliations for the operating account and payroll account in a timely manner. TSU management and fiscal staff did have certain compensating controls in place which independently provided the Associate Vice President for Business and Finance with general assurance that the bank account and cash book balances were reasonable. However, management's key control to promptly prevent or detect banking and financial reporting errors depends on the staff's timely preparation of bank reconciliations (page 8).

University Management Has Not Adequately Designed Controls Governing the Review of Procurement Card Purchases and Has Not Ensured That Procurement Cardholders Followed Established Guidelines Related to the Documentation of Purchases, Resulting in Increased Risks of Fraud, Waste, and Abuse Associated With These Purchases
The Procurement Card Program Policies and Procedures Guidelines contained a critical flaw relating to key monitoring and review processes for procurement card purchases. In

addition, TSU procurement cardholders did not comply with the established university Guidelines relating to procurement card transactions. Neither the departments' supervisors nor the Director of Procurement and Business Services enforced the university's Guidelines. According to the comments received from TSU management, they have canceled the 128 procurement cards that were in use during the audit period and have issued very few new procurement cards. TSU management also stated that they revised the policies and procedures surrounding procurement cards (page 12).

The University Has Neither Implemented nor Maintained Adequate Controls Over Information Systems Security, Which Increases the Risk of Fraudulent Activity
Tennessee State University (TSU) has neither implemented nor maintained adequate controls over information systems security (page 18).

None of the significant deficiencies described above were considered material weaknesses. A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Opinions on the Financial Statements

The opinions on the financial statements are unqualified.

Audit Report
Tennessee Board of Regents
Tennessee State University
For the Year Ended June 30, 2007

TABLE OF CONTENTS

TABLE OF CONTENTS (CONT.)

Tennessee Board of Regents
Tennessee State University
For the Year Ended June 30, 2007

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Board of Regents, Tennessee State University. 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

Tennessee State University was first established as the Agricultural and Industrial State Normal School on June 19, 1912, through an act of the Tennessee General Assembly. In 1922, the institution was raised to the status of a four-year teachers' college and was empowered to grant the bachelor's degree. In August 1951, the State Board of Education granted the institution university status. The university was elevated to a land-grant university program by the State Board of Education in August 1958. The land-grant university program established a School of Agriculture and Home Economics, School of Engineering, School of Arts and Sciences, School of Education, Graduate School, Division of Business, Division of Extension and Continuing Education, and Department of Aerospace Studies. The university is supported by state and federal funds, the latter in accordance with the Morrill Act and other federal acts that provide for land-grant institutions.

ORGANIZATION

The governance of Tennessee State University 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, 2006, through June 30, 2007, 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, 2007, and for comparative purposes, the year ended June 30, 2006. Tennessee State University 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, 2007, we considered internal control over financial reporting as a basis for designing 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. Significant deficiencies, along with recommendations and management's responses, are detailed in the findings and recommendations section. 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 30, 2007

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

Dear Mr. Morgan:

We have audited the financial statements of Tennessee State University, 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, 2007, and have issued our report thereon dated November 30, 2007. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university’s internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the university’s internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the university’s internal control over financial reporting.

Our consideration of the internal control over financial reporting was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control over financial reporting that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process, or report financial data reliably in accordance with accounting principles generally accepted in the United States of America such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

The following significant deficiencies were noted:

- Bank reconciliations were not prepared timely for the operating and the payroll accounts, and as a result, management has not mitigated the risk that errors or fraud could occur and not be detected timely
- University management has not adequately designed controls governing the review of procurement card purchases and has not ensured that procurement cardholders followed established guidelines related to the documentation of purchases, resulting in increased risks of fraud, waste, and abuse associated with these purchases
- The university has neither implemented nor maintained adequate controls over information systems security, which increases the risk of fraudulent activity

These deficiencies are described in the Findings and Recommendations section of this report.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the entity's internal control.

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we believe none of the significant deficiencies described above is a material weakness.

We also 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., CPA
Director

AAH/cj
07/111

FINDINGS AND RECOMMENDATIONS

1. <u>Bank reconciliations were not prepared timely for the operating and the payroll accounts, and as a result, management has not mitigated the risk that errors or fraud could occur and not be detected timely</u>

Finding

The Assistant Director of General Accounting and Accounts Payable and the Associate Vice President of Business and Finance at Tennessee State University did not ensure that the Financial Analyst III in the General Accounting Office or other appropriate personnel prepared bank reconciliations for the operating account and the payroll account in a timely manner. The university's average daily balance in the operating account for year ended June 30, 2007, was nearly $30.1 million with outstanding checks averaging over $3.1 million at the end of each month. The payroll account does not carry a balance from month to month since the account is an imprest account; however, the average total disbursements from the payroll account for the year ended June 30, 2007, were approximately $6.5 million per month.

The university's policies, "Reconciliation of the Operating Bank Account" 5.08.17 and "Reconciliation of Payroll Bank Account" 5.08.18, state that each bank account reconciliation "will be prepared by the Financial Analyst III in General Accounting and completed by the 25th of the following month." In addition, these policies require that both the Assistant Director of General Accounting and Accounts Payable and the Director of Finance and Accounting approve the reconciliations.

Based on our testwork, we found that for 9 out of 12 months of the year ended June 30, 2007, neither management nor staff prepared the operating bank account reconciliations by the 25th day of the following month as prescribed by policy. In fact, staff prepared the operating account reconciliations from one to 68 days later than the policy requires.

The payroll account is an imprest account of the operating account. As part of established procedures, any amounts paid through the payroll account are automatically deducted by the bank from the operating account at the end of each day. The Assistant Director of General Accounting and Accounts Payable maintains separate records on each account. The payroll office staff's accounting of the payroll account reflects the total payroll funds necessary to fund a particular payroll cycle. As employees cash payroll checks or the employees' banks process direct deposit transactions, the Financial Analyst III in the business office updates the payroll records to reflect a declining balance until all payroll checks have cleared. The actual payroll bank account reflects a zero balance at the end of each day per the bank. As a result, the Financial Analyst III reconciles outstanding checks each month for the payroll account. We noted problems with each of the 12 bank reconciliations for the payroll account.

- For 5 out of 12 months of the year ended June 30, 2007, (July through November 2006) neither management nor staff prepared the payroll bank account reconciliations timely. Staff prepared the payroll bank account reconciliations during this time frame from 3 to 24 days later than the 25th of the following month.

- Neither the preparer nor the reviewers signed or dated the December 2006 reconciliation. As a result, we could not determine who had prepared or reviewed the reconciliation or if that reconciliation had been prepared and reviewed timely.

- The Financial Analyst III did not prepare the reconciliations for the period January 2007 through May 2007 until after we requested the June 2007 reconciliation. We received all payroll reconciliations in October 2007, when the Assistant Director of General Accounting and Accounts Payable finally reconciled all of the months.

In May 2007, university management submitted the risk assessment prepared for the Financial Management processes which included Cash Management to the Tennessee Board of Regents. Management responsible for these processes had identified the risk of untimely bank reconciliations in the risk assessment and also identified the risks of inappropriate staffing levels, supervision, and a lack of training for Financial Management administration. Management then assessed the level of both risks as "Moderate Impact, Moderate Probability," which requires management to perform the oversight function to ensure that the controls over timely bank reconciliations are working. However, when the positions responsible for the preparation and supervision of the bank reconciliation process were vacant, management's key mitigating controls of monitoring and supervision became ineffective, resulting in untimely bank reconciliations and increased risks of errors or fraud.

When we discussed with the Associate Vice President for Business and Finance his failure to ensure that staff performed timely reconciliations of the operating and payroll bank accounts to the university's accounting records, he agreed that untimely reconciliations are a problem. Also, according to the Associate Vice President for Business and Finance, during the audit period both employees, the employee responsible for the preparation of the bank reconciliation and the supervisor responsible for the first review of the reconciliation, left the employment of TSU. When these vacancies occurred, the Associate Vice President for Business and Finance failed to ensure that the reconciliations were prepared by the employee assigned the responsibilities or performed the reconciliations himself. These positions, Assistant Director of General Accounting and Accounts Payable and the Financial Analyst III, were vacant for approximately five and two months, respectively. In addition, the Associate Vice President for Business and Finance stated that the reconciliation for the June 2007 operating account had been started timely, but that other staff could not finalize the reconciliation because of more pressing matters related to the implementation of the new financial information system and the year-end closing procedures.

According to the Associate Vice President for Business and Finance, management and fiscal staff did have some compensating controls in place which independently provided the Associate Vice President with general assurance that the bank account and cash book balances were reasonable. To support the Associate Vice President's claims, we reviewed the supporting documentation of the compensating controls which were in place during all or parts of the audit period. We found that these compensating controls provided some assurance that a material misstatement would be detected. Specifically we found that during the entire fiscal year under audit, the Associate Vice President for Business and Finance released all wire transfers from the bank account and the Financial Analyst II reconciled supporting documentation of deposit slips to cash receipts. Beginning in April of 2007, positive pay was implemented for the bank account. Positive pay is the process of informing the bank of all checks to be paid prior to payment, thereby decreasing the likelihood that a falsified or duplicate check would clear the bank account. In addition, upon her employment in May 2007, the newly hired Assistant Director of General Accounting and Accounts Payable began performing a daily review of all transactions that were charged to the bank account. She also kept a notebook of potentially questionable bank account transactions, including the journal entries which needed to be made, and copies of e-mails sent to the bank regarding these questionable items. Although these compensating controls might detect some errors or fraud, they do not negate the necessity of performing monthly bank reconciliations timely to ensure that the university's financial reporting is free from material misstatement.

The staff's failure to perform bank reconciliations timely could prohibit or limit management's ability to prevent or detect errors in financial reporting. Also, the bank may be unwilling or unable to assist the university in correcting any bank errors that are not reported timely.

Recommendation

The President and the Vice President for Business and Finance should ensure control procedures are in place and operating effectively to ensure that all of the university's identified risks of errors and fraud are mitigated. The Associate Vice President of Business and Finance should not permit control procedures to lapse because of turnover or other staffing priorities, and when turnover occurs he should immediately reassign critical responsibilities to prevent lapses in key controls as the reliance on other compensating controls may not catch all errors or fraud. The Associate Vice President of Business and Finance should ensure that bank reconciliations are always performed timely in accordance with university policies. The President and the Vice President for Business and Finance should ensure specific staff who are assigned the responsibility for monitoring the process for preparing and reviewing bank reconciliations are indeed performing those functions to mitigate the risks of errors or fraud and the potential of material misstatement associated with bank reconciliations.

Management should continue to evaluate risks and include them in documented risk assessment activities. Management should ensure staff who are responsible for the design and implementation of internal controls to adequately mitigate those risks and to prevent and detect exceptions timely are continually evaluating those controls. Management should ensure staff who are responsible for ongoing monitoring for compliance with all requirements are indeed monitoring and taking prompt action when exceptions occur. All controls and control activities, including monitoring, should be adequately documented.

Management's Comment

We concur with the finding and recommendation with the clarifications noted below.

University policies related to bank reconciliations will be revised to properly reflect the reconciliation process as performed with the new financial system. The new policy will require all reconciliations be performed timely to ensure any banking errors are noted and communicated to appropriate banking personnel within the bank's required sixty days. The payroll reconciliation will also be consolidated into the operating reconciliation.

The number of days late for the operating account reconciliation were as follows: 22, 1, 7, 16, 3, 4, 19, 4, and 68. With the exception of the month of June (68 days), the average number of days late was only 9.5 days and all were within the 60 days allowed by the bank to question any errors.

As provided in the university policies referenced in the finding, the reconciliation cannot be performed until the monthly closing process is complete. The June reconciliation was provided to the auditors on October 1, 2007, one week following our final close of the books on September 24, 2007. As noted in the finding, the Assistant Director reviewed all bank transactions for the month of June on a daily basis, which identified bank transactions that required additional information, accounting entries, or were determined to be errors.

As noted in the finding, the payroll bank account is an imprest account of the operating account. Although the average disbursement from the payroll account was $6.5 million, only an average of $55,000, or less than 1%, of the disbursements were checks. Regions Bank processes the direct deposit transactions based upon a file submitted by the university. Checks are processed when submitted for payment by the employee. Although not prepared in accordance with the university policy, the payroll reconciliations prepared for the period July 2006 through December 2006 were still within the sixty days allowed by the bank to correct any noted errors.

Although not prepared as separate reconciliations, the payroll reconciliations for January 2007 through June 2007 were performed as part of the operating account reconciliations. The operating account reconciliation cannot be properly prepared without the payroll reconciliation.

Auditor's Comment

Even with some level of compensating controls in place, management's key control to promptly prevent or detect banking and financial reporting errors depends on the staff's timely preparation of bank reconciliations.

2. University management has not adequately designed controls governing the review of procurement card purchases and has not ensured that procurement cardholders followed established guidelines related to the documentation of purchases, resulting in increased risks of fraud, waste, and abuse associated with these purchases

Finding

Tennessee State University (TSU) implemented a Procurement Card Program in 1998. The purpose of this program was to establish a more efficient, cost-effective method of purchasing and paying for small dollar transactions. In order to establish the procedures for this program, TSU management created the Procurement Card Program Policies and Procedures Guidelines (the Guidelines). However, we noted that these Guidelines, originally designed by the Director of Procurement and Business Services and others, contained a critical flaw relating to key monitoring and review processes for procurement card purchases. In addition, we also found that TSU procurement cardholders did not comply with the established university Guidelines relating to procurement card transactions and that neither the departments' supervisors nor the Director of Procurement and Business Services enforced the university's Guidelines.

During the year ended June 30, 2007, there were approximately 170 cards issued by the university with an average of approximately 145 procurement card transactions per month (1,740 transactions annually). The total population of the transactions on the credit card statements for July 2006 through June 2007 was $202,335.33, with monthly charges ranging from approximately $10,000 to $35,000. Although this was not material to the university as a whole, without adequate controls, the university's risks of fraud, waste, and abuse related to unauthorized, imprudent, and inappropriate transactions was increased.

Flaw in Critical Control

Based on our review of the process, we found flaws in the design of critical controls which have exacerbated the problems with the procurement card transactions. The Director of Procurement and Business Services and others who originally developed the Guidelines have placed the main responsibility for reviewing the appropriateness of purchases made by cardholders at the individual department level, rather than assigning review responsibilities to the Procurement and Business Services Department. This, in and of itself, may not have been a problem if the department heads were actually reviewing these purchases. However, we found that the departmental verifier—the individual assigned to reconciling the card statement with the receipts, invoices, and procurement log—was usually a bookkeeper or secretary who lacked the authority to require cardholders to provide adequate receipts and lacked the knowledge to determine the necessity and propriety of procurement card transactions. In addition, the Director of Procurement and Business Services and his staff have not provided adequate procurement card training for verifiers and have not required the department heads to actually review the signed procurement card statements and attached receipts. In addition, we found that the Director of Procurement and Business Services and his staff have not held department heads accountable for discrepancies within their department. The Director of Procurement and Business Services has agreed that this is a problem and has agreed with our assessment of the cause.

Procurement Card Guidelines Not Followed

Inadequate Purchase Documentation

We reviewed 100 procurement card purchases to determine the adequacy of supporting documentation. For 60 of these 100 transactions, we reviewed the documentation to ensure purchase invoices were not split to avoid bidding requirements. In addition, we reviewed additional transactions to search for unusual or potentially questionable purchases and expanded our testwork as necessary. During our testwork, we found the following errors:

- For 8 of 100 purchases (8%), neither the departments' staff nor the cardholders maintained documentation supporting the cardholders' purchases (totaling $1,665.88). Based on the procurement card statements, cardholders made these purchases from computer stores, office supply stores, and pharmaceutical companies. In an effort to expand our testwork, we also requested that university staff provide six additional invoices/receipts for our review; however, department management failed to locate the additional invoices/receipts (totaling $831.28). Based on our review of the procurement card statements, cardholders made these purchases from pharmaceutical companies, contractors, and general merchandise stores. According to the procurement card Guidelines, cardholders must obtain receipts and all sales tickets, receipts, letters, memos, forms, or any related document associated with the purchases made with the procurement card. The Guidelines also require this documentation to be retained with the department files for seven years from the date of the transaction. When we asked the cardholders why they did not have the required documentation for their purchases, we were told that some of the documentation may have been lost in a recent office move. In addition, cardholders stated that it was difficult to keep track of all documentation for purchases. We informed the Director of Internal Audit of this matter and provided him with a list of these instances for follow-up.

- Of the 92 remaining purchases tested, cardholders did have appropriate receipts for their purchases; however, nine cardholders made 13 purchases (14%) which were specifically prohibited by the Guidelines (entire purchases totaling $3,213.04). These purchases included construction and renovation items, personal items such as a footstool ($34.23) and tissues ($12.97), gifts, computers, computer-related items, hazardous material, emergency preventive maintenance, and repair materials. When we expanded our testwork and reviewed other transactions outside our sample, we found 15 additional purchases which were prohibited by the Guidelines (totaling $1,474.00). These purchases included computer-related items and personal items such as a greeting card ($3.61). We again asked cardholders why they violated the Guidelines and were told that the Guidelines were too complex and listed too many items as prohibited items. Based on our review, we determined that the purchases for construction and renovation items, computers, computer-related items, hazardous material, emergency preventive maintenance, and repair materials were allowed under the current university purchasing policies but were specifically prohibited by the procurement card Guidelines. The purchases for the personal items were specifically prohibited by both the purchasing policy and the procurement Guidelines. We informed the Director of Internal Audit of this matter and provided him with a list of these instances for follow-up.

Cardholder Logs

The University's Procurement Card Program Policies and Procedures Guidelines require cardholders to "record purchases, maintain the Procurement Card Purchase Log and reconcile with the monthly summary billing statement for accuracy of charges." Cardholders are also required to present this log, along with supporting documentation, to departmental recordkeepers for review, reconciliation, and storage. The log contains information such as the cardholder name, card number, accounting period, order date, received date, item description, quantity of purchase, dollar amount, and whether the charge was disputed. There is also a signature line with the following attestation: "I certify that all purchases listed on this log, unless noted disputed, are true and correct to the best of my knowledge and were made for official University purposes. All goods and services have been received and payment is authorized."

Based on our detailed review of the 100 procurement card transactions noted above, we noted the following problems with the cardholders' logs:

- For 3 of 100 purchases totaling $332.47 (3%), the cardholder did not maintain a Procurement Card Purchase Log for the related purchases. We asked the cardholders why they did not prepare or maintain the logs and were told that it was too much paperwork, that the reasons for the log were not explained thoroughly enough during training, and that the log was not an efficient use of time.

- For 17 of the remaining 97 purchases (18%), the cardholder prepared a log but did not document the purchase on the log (purchases totaling $4,698.46). When asked why these purchases were not documented on the log, the cardholders could not provide an explanation.

- For 71 of the 80 purchases tested for which the cardholder kept a log and recorded the purchase on the log (89%), the cardholders did not correctly record all required details of the purchase in the log ($14,928.38 total) as required in the Guidelines. We made this determination based on a comparison of the receipt and the log. In fact, we found that in many of these instances, cardholders were preparing an alternate version of the log rather than using the form prescribed in the Guidelines. The alternate logs did not include the details required by the Guidelines such as the order date, the quantity purchased, and the cost per unit, nor did they provide the cardholders' assertions that the purchases were valid and university-related. When asked why alternative logs were used, one cardholder stated that she had not received sufficient blank copies of the prescribed log forms, and as a result, she created her own version of the log. However, the log as described in the Guidelines is available on the university's website.

- The 80 purchases for which the cardholder kept a log and recorded the purchase on the log correlate to 55 different cardholder logs prepared by 31 separate cardholders. In our review of these 55 logs, we found that cardholders did not sign 34 of the logs (62%) before payment was made (purchases tested totaling $14,457.72). Of these 34 logs, 5 were signed after we requested the logs for our testwork. Thus, it is apparent that the cardholders' attestations that all purchases are true and correct and made for university purposes were not made until after payment had been made for these purchases. The range of time between the actual purchases until the cardholders attested that purchases were proper ranged from 3 to 11 months after the purchase had been made. We informed the Director of Internal Audit of this matter and provided him with a list of these instances for follow-up.

- For 30 of the logs tested (55%), the verifiers did not document the logs that were reconciled to the monthly statement (purchases tested totaled $11,134.65). Of these 30 logs, 5 were signed as reconciled after we requested them. A cardholder also backdated an additional log in our presence. We then informed the Director of Internal Audit of this matter and provided him with a list of these instances for follow-up. In many of these instances, the cardholders had created their own form of a log instead of using the log required by the Guidelines. These alternate logs often did not contain the same information including signatures and the attestation that the purchases were made for official university purposes.

<u>Procurement Guidelines Not Adequately Enforced</u>

Although the Guidelines state, "Use of the Procurement Card that is NOT in accordance with the guidelines established for this Program may result in: (1) lost [*sic*] of card privileges, (2) personal liability, (3) suspension, (4) written reprimand, or (5) termination, in the case of fraudulent use," many of the problems noted above were made by a small number of cardholders with little or no repercussions from the Director of Procurement and Business Services. If the Director and the individual departments' supervisors consistently held cardholders responsible for noncompliance with the Guidelines, we believe the errors noted above would have been considerably lower.

Beginning in February of 2007, the Director of Procurement and Business Services began taking a more active role in reviewing departments with continuing card issues. Specifically, in February 2007, he began performing an in-depth review of those individuals who had been identified in prior audits as problematic. In this review, the Director reviews an individual's charges for an extended time period, usually several months, in order to determine whether the cardholder is using the card for its intended purpose and within policy. In addition, according to the Director of Procurement and Business Services, he is now holding cardholders fully responsible for questionable purchases and purchasing practices; however, until we perform another audit, we cannot determine the effectiveness relative to this change in monitoring the procurement card transactions. In fact, we were able to review several summaries of these reviews, which revealed similar problems to those noted in this finding. As a result of these reviews according to the Director, he has taken disciplinary action including the removal of card privileges and the request for reimbursement when appropriate against those individuals who were not complying with the Guidelines.

Although the university is not scheduled to prepare its detailed risk assessment on the Purchasing process until May 2009, certain risks were identified in the detailed risk assessment for the Accounts Payable sub-process which was included in the risk assessment for the Financial Management major process. University management submitted this Risk Assessment to the Tennessee Board of Regents in May 2007. TSU management identified the risks of improper approval for payment and inadequate or nonexistent supporting documentation for expenses in the Risk Assessment. Management assessed the level of both identified risks as "Low Impact, Moderate Probability," which requires unit heads to ensure that they are using supervisory controls to monitor the execution of controls in their area.

Recommendation

The President and the Vice President for Business and Finance should reassess the operation of the university's procurement card system and policies and ensure that cardholders and various departmental personnel are following established Guidelines which include maintaining adequate supporting documentation and proper monitoring and review of procurement card purchases. Specifically, the department head who has the authority over the purchases within his or her department should ultimately review and approve the purchases. If the current departmental verifier/reconciler is responsible for gathering information supporting purchases, he or she should be given the authority to compel the cardholder to provide that documentation. In addition, the Guidelines should be updated to require training on the procurement card Guidelines for all departmental verifiers and to give this individual more authority when requesting documents from the cardholder. There should be a zero-tolerance policy for unauthorized or improper purchases or for circumventing the procurement card or purchasing policies. Disciplinary action should be taken immediately when cardholders do not follow the established Guidelines. Department heads should be held accountable for departmental discrepancies and should hold their employees fully accountable for all deviations from the procurement card Guidelines.

The President and the Vice President for Business and Finance should consider changes to centralize procurement card documentation storage to allow for oversight and review by those outside of the cardholders' originating departments.

Management should continue to evaluate risks and include them in documented risk assessment activities. Management should ensure staff who are responsible for the design and implementation of internal controls to adequately mitigate those risks and to prevent and detect exceptions timely are continually evaluating those controls. Management should ensure staff who are responsible for ongoing monitoring for compliance with all requirements are indeed monitoring and taking prompt action when exceptions occur. All controls and control activities, including monitoring, should be adequately documented.

Management's Comment

We concur.

On April 18, 2008, 126 of 128 total procurement cards were cancelled and all records were requested from cardholders for final review. The remaining two cards have now also been cancelled. All records are in the process of being reviewed by Procurement and Business Services. Any discrepancies noted will be reported to division heads for appropriate written corrective and/or disciplinary action. Procurement and Business Services will maintain a file of action taken.

Eight new cards were ordered in April: one for the Office of the President; one for the Provost and Executive Vice President; five for the Vice Presidents; and one for the Assistant Vice President for Procurement and Business Services. The Provost and Executive Vice President as well as three Vice Presidents chose not to accept the cards and those cards have been voided, leaving a total of four (4) cards issued, instead of the 128 previously outstanding.

Significantly reducing the number of cards, and having the cards assigned to a higher level of administration will increase the level of control over the cards and related records and reduce the risks associated with the cards. Division heads are not directly responsible for the procurement cards and their related records.

In addition to fewer cards and higher-level oversight, policies and procedures have also been revised as follows:

(1) All receipts must now be attached to a Procurement Card Purchase Request Form and submitted to Finance and Accounting after each purchase for audit and entry as accounts payable. Finance and Accounting will continue to pay the monthly procurement card statements and will now be responsible for reconciling them to the established payables. Logs maintained by division heads will be requested by Finance and Accounting as needed to perform these audits and reconciliations. Receipts requiring corrective action will be forwarded to the Assistant Vice President for Procurement and Business Services for follow-up with the appropriate division head.

(2) Purchases of computer-related items are allowed on procurement cards, but computer purchases are still not allowed.

These policy and procedure revisions were effective April 18, 2008, and will be reflected on the university's Procurement and Business Services website by June 30, 2008.

Training is required for both the cardholder and his/her designee responsible for recordkeeping. Corrective or disciplinary action will be taken immediately when a cardholder does not follow established guidelines. The Vice President for Business and Finance will continue to evaluate risks related to procurement cards in the university's documented risk assessment tool. The Vice President for Business and Finance will ensure that controls and compliance are being monitored and documented.

3. <u>The university has neither implemented nor maintained adequate controls over information systems security, which increases the risk of fraudulent activity</u>

Finding

Tennessee State University (TSU) has neither implemented nor maintained adequate controls over information systems security. The university's various information systems contain extensive student, vendor, and employee data. The auditors observed significant conditions that violated best practices for information security controls during an examination of systems implemented at TSU.

The wording of this finding does not identify specific vulnerabilities that could allow someone to exploit the university's systems. Disclosing those vulnerabilities could present a potential security risk by providing readers with information that might be confidential pursuant to Section 10-7-504(i), *Tennessee Code Annotated*. We provided the TBR and the university with detailed information regarding the specific vulnerabilities we identified as well as our recommendations for improvement.

Recommendation

The President and the Vice President for Technology and Administrative Services along with the Associate Vice President for Communication and Information Technologies should ensure controls over information systems access are adequately designed, implemented, and maintained.

Management should continue to evaluate risks and include them in documented risk assessment activities. Management should ensure staff who are responsible for the design and implementation of internal controls to adequately mitigate those risks and to prevent and detect exceptions timely are continually evaluating those controls. Management should ensure staff who are responsible for ongoing monitoring for compliance with all requirements are indeed monitoring and taking prompt action when exceptions occur. All controls and control activities, including monitoring, should be adequately documented.

Management's Comment

We concur. University management has established procedures to address the areas identified in the audit.

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 30, 2007

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 Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the years ended June 30, 2007, and June 30, 2006, 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 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, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tennessee Board of Regents, Tennessee State University, and its discretely presented component unit as of June 30, 2007, and June 30, 2006, 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.

The management's discussion and analysis on pages 22 through 35 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 62 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 30, 2007, 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/cj

Tennessee Board of Regents
Tennessee State University
Management's Discussion and Analysis
For the Year Ended June 30, 2007

This section of Tennessee State University's report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2007, with comparative information presented for the fiscal years ended June 30, 2006, and June 30, 2005. This discussion has been prepared by management along with the financial statements and accompanying note disclosures and should be read in conjunction with the independent auditor's report, the audited financial statements, and notes to the financial statements. The financial statements, notes, and this discussion are the responsibility of management.

Using This 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 Tennessee State University 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.

Net Assets (in thousands of dollars)

	University			Component Unit		
	2007	**2006**	**2005**	**2007**	**2006**	**2005**
Assets:						
Current assets	$ 23,904	$ 20,198	$ 26,163	$ 3,477	$ 2,518	$ 2,344
Capital assets, net	177,050	167,319	156,268	-	-	-
Other assets	36,499	31,323	27,085	30,733	16,865	13,666
Total assets	**237,453**	**218,840**	**209,516**	**34,210**	**19,383**	**16,010**
Liabilities:						
Current liabilities	17,342	15,741	17,269	14	6	1
Noncurrent liabilities	44,349	39,305	35,854	-	-	-
Total liabilities	**61,691**	**55,046**	**53,123**	**14**	**6**	**1**
Net assets:						
Invested in capital assets, net of related debt	138,658	133,853	125,457	-	-	-
Restricted - nonexpendable	73	73	72	30,732	16,864	13,658
Restricted - expendable	7,772	6,700	7,826	3,351	2,483	2,309
Unrestricted	29,259	23,168	23,038	113	30	42
Total net assets	**$ 175,762**	**$ 163,794**	**$ 156,393**	**$34,196**	**$19,377**	**$16,009**

<u>Comparison of FY 2007 to FY 2006 – TSU</u>

- Current assets increased with the increase in accounts and grants receivable of over $861 thousand and an increase in cash and cash equivalents required to pay current obligations.

- Capital assets increased as the result of the purchase/construction of capital assets. See Note 5 on capital assets for more detail.

- Other assets increased with the allocation of an additional $5.8 million in cash and cash equivalents for future plant construction, and an increase of over $1.2 million in grants receivables related to construction projects.

- Current liabilities increased with the increase in the bonds and notes payable currently due and an increase in deferred revenue related to student fees related to future terms. See Note 6 for additional information on long-term liabilities.

- Noncurrent liabilities increased as a result of additional funding obtained for capital assets. See Note 6 for additional information on long-term liabilities.

- Restricted - expendable net assets for FY 2007 increased with the funding received for Consent Decree programs ($711 thousand) and Biotech Labs ($749 thousand).

- Unrestricted net assets for plant construction increased with the allocation of an additional $5.8 million for future plant construction, and an increase of over $1.2 million in grants receivables related to construction projects.

<u>Comparison of FY 2007 to FY 2006 – TSU Foundation</u>

- The Tennessee State University (TSU) Foundation's current assets, restricted - expendable net assets, and unrestricted net assets increased with the receipt of over $1.1 million in non-endowment related gifts and contributions and over $879 thousand in investment income.

- Other assets and restricted - nonexpendable net assets for the current fiscal year increased as a result of $9 million in state funds and almost $3.3 million in Title III funding received for the Endowment for Educational Excellence, and over $1 million in investment gains and income.

<u>Comparison of FY 2006 to FY 2005 – TSU</u>

- Current assets decreased while other assets increased as the result of additional investments of the university and the purchase/construction of capital assets. See Note 3 of the financial statements for additional information on investments and Note 5 on capital assets.

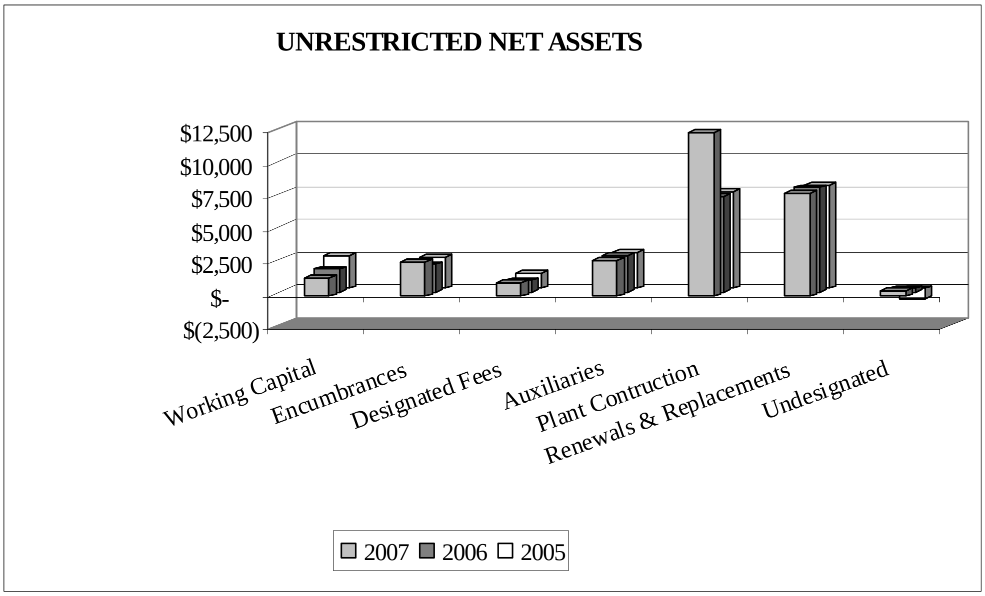
- Current liabilities decreased in FY 2006 as result of a decrease in accounts payable for unexpended plant fund projects.

- Restricted - expendable net assets for FY 2006 decreased 14% due to a $2.87 million refund of remaining funds following the discontinuation of the Basic Skills - Science Materials Program.

<u>Comparison of FY 2006 to FY 2005 – TSU Foundation</u>

- Net assets for the TSU Foundation for FY 2006 increased over $3 million as a result of $1 million in state funds, over $1.1 million in gifts and contributions, and a more aggressive investment program that resulted in over $593 thousand in investment income.

Many of the university's unrestricted net assets have been designated for specific purposes such as repairs and replacement of equipment and capital projects. The following graph shows the allocations (amounts are presented in thousands of dollars):



<u>Comparison of FY 2007 to FY 2006</u>

- The allocation for plant construction increased as a result of construction ongoing on campus improvements, auxiliary enterprise campus improvements, and the Clement Hall renovation.

<u>Comparison of FY 2006 to FY 2005</u>

- The allocation for working capital decreased 28% as the result of a decrease in student accounts receivable, net, due to accounts determined to be uncollectible.

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

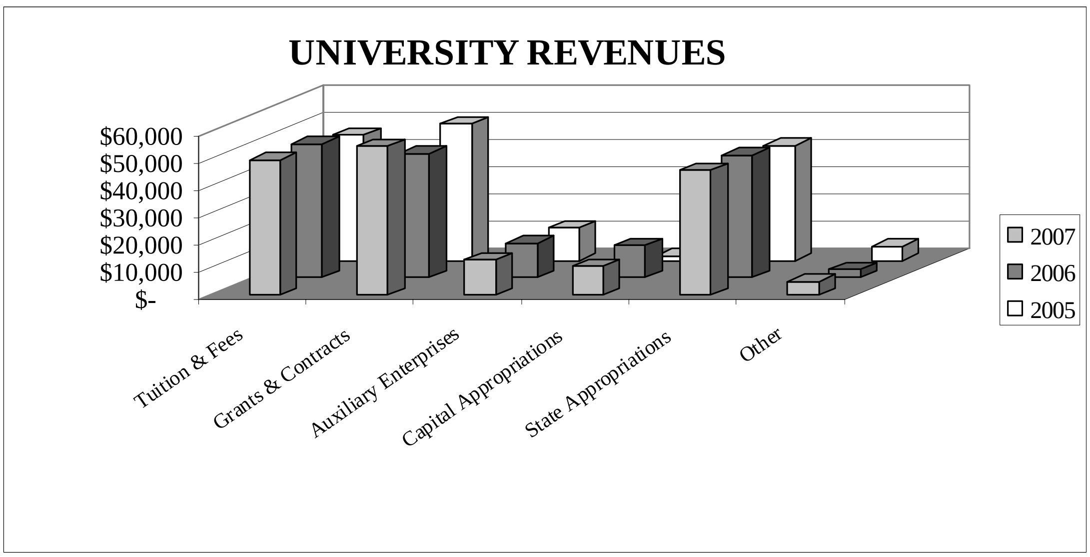
The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the university, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to accounting principles generally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

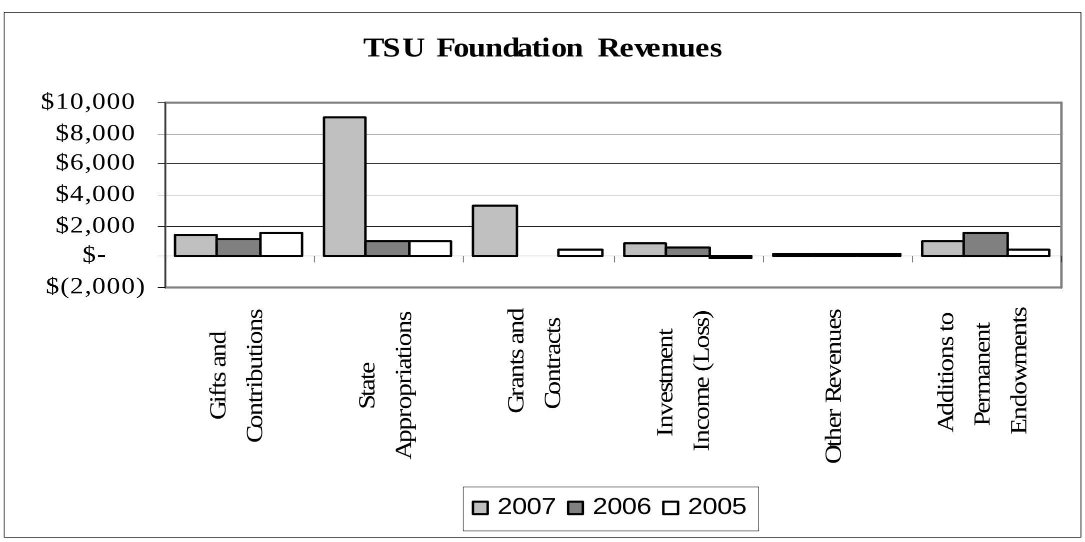
Revenues, Expenses, and Changes in Net Assets (in thousands of dollars)

	University			Component Unit		
	2007	**2006**	**2005**	**2007**	**2006**	**2005**
Operating revenues:						
Net tuition and fees	$ 45,332	$ 45,018	$ 42,272	$ -	$ -	$ -
Gifts and contributions	-	-	-	1,196	919	968
Grants and contracts	35,794	30,149	29,360	-	-	-
Auxiliary	12,773	12,695	12,220	-	-	-
Other	2,736	2,564	2,429	192	178	172
Total operating revenues	**96,635**	**90,426**	**86,281**	**1,388**	**1,097**	**1,140**
Operating expenses	161,206	152,980	151,795	930	1,150	1,140
Operating income (loss)	(64,571)	(62,554)	(65,514)	458	(53)	-
Nonoperating revenues and expenses:						
State appropriations	45,387	44,939	42,305	9,000	1,000	1,000
Gifts	835	732	1,121	264	215	574
Grants and contracts	16,252	14,941	16,921	3,259	-	487
Investment income	2,945	1,859	898	879	594	(5)
Other nonoperating revenues and expenses	(1,668)	(4,627)	(763)	(49)	-	14
Total nonoperating revenues and expenses	**63,751**	**57,844**	**60,482**	**13,353**	**1,809**	**2,070**
Income (loss) before other revenues, expenses, gains, or losses	**(820)**	**(4,710)**	**(5,032)**	**13,811**	**1,756**	**2,070**
Other revenues, expenses, gains, or losses:						
Capital appropriations	10,332	11,745	1,863	-	-	-
Capital grants and gifts	2,546	393	3,973	-	-	-
Additions to permanent endowments	-	-	-	1,008	1,612	462
Other	(90)	(27)	247	-	-	-
Total other revenues, expenses, gains, or losses	**12,788**	**12,111**	**6,083**	**1,008**	**1,612**	**462**
Increase in net assets	**11,968**	**7,401**	**1,051**	**14,819**	**3,368**	**2,532**
Net assets at beginning of year	**163,794**	**156,393**	**155,342**	**19,377**	**16,009**	**13,477**
Net assets at end of year	**$175,762**	**$163,794**	**$156,393**	**$34,196**	**$19,377**	**$16,009**

Revenues

The following are graphic illustrations of revenues by source (both operating and nonoperating), which were used to fund the university's and its component unit's operating activities for the years ended June 30, 2007; June 30, 2006; and June 30, 2005 (amounts are presented in thousands of dollars).





Comparison of FY 2007 to FY 2006 – TSU

- Grants and contracts for the university increased due to an additional $2.2 million for construction related programs; $1.2 million for Pell, Hope, and TSAC grants; and over $3.2 million in Title III funds for the match of the funds related to the Consent Decree settlement.

Comparison of FY 2007 to FY 2006 – TSU Foundation

- State appropriations for the foundation increased $8 million, and grants and contracts increased over $3.2 million due to funds received from the Consent Decree settlement.

Comparison of FY 2006 to FY 2005 – TSU

- Net tuition and fees increased $2.7 million as the result of an increase in the cost of attendance.

- Gifts for the university decreased 35% 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 university.

- Other nonoperating revenues decreased due to the discontinuation of the Science Materials Program in Basic Skills and the allocation of the remaining funds to the participating counties.

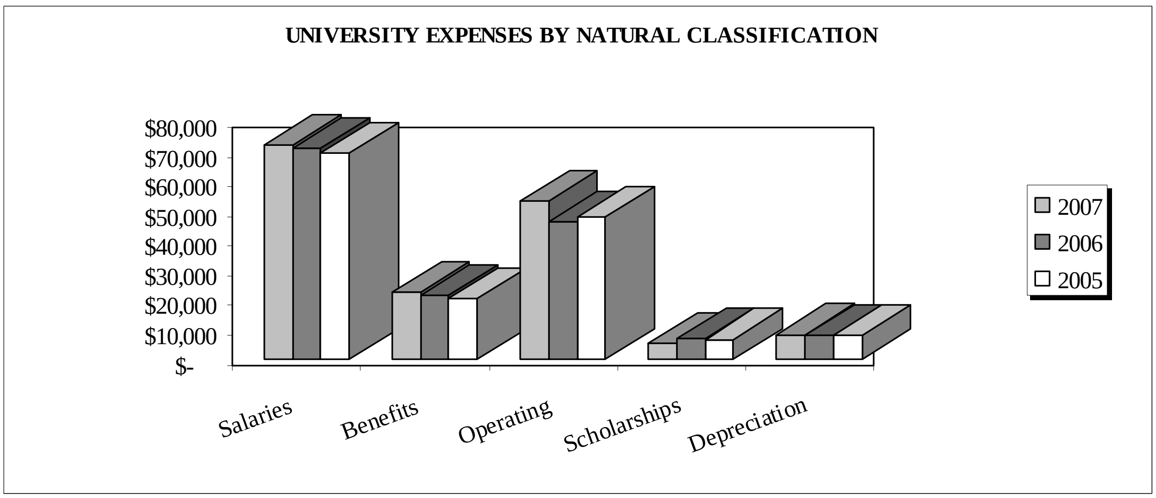
Comparison of FY 2006 to FY 2005 – TSU Foundation

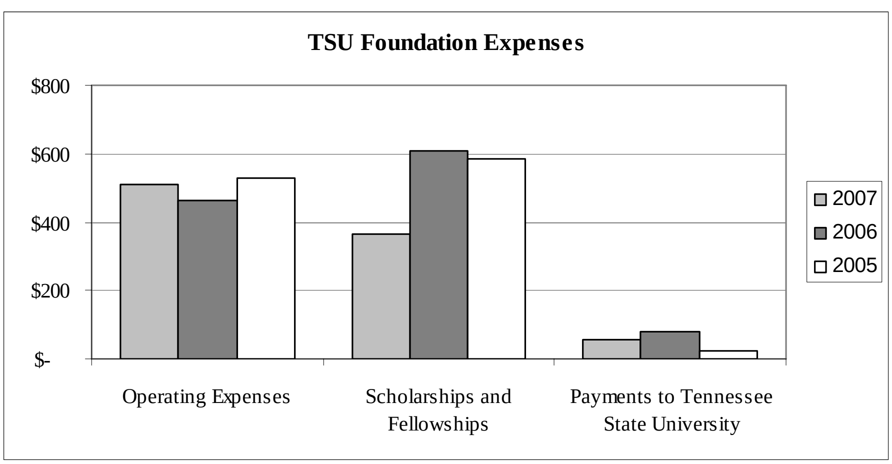
- Additions to the permanent fund increased in FY 2006 for the TSU Foundation as a result of a more aggressive investment strategy employed by the foundation.

Expenses

Operating expenses can be displayed in two formats, natural classification and program classification. Both formats are displayed below (in thousands of dollars).

Natural Classification	University 2007	University 2006	University 2005	Component Unit 2007	Component Unit 2006	Component Unit 2005
Salaries	$ 72,162	$ 70,950	$ 69,316	$ -	$ -	$ -
Benefits	22,366	21,342	20,459	-	-	-
Operating	53,378	46,131	47,784	510	464	527
Scholarships	5,153	6,633	6,554	363	606	588
Payments to TSU	-	-	-	57	80	25
Depreciation	8,147	7,924	7,682	-	-	-
Total expenses	**$161,206**	**$152,980**	**$151,795**	**$930**	**$1,150**	**$1,140**





Comparison of FY 2007 to FY 2006 – TSU

- Salaries increased with the implementation of the university salary plan.
- Operating expenditures increased with the increase in grant and contract expenditures with funding through Title III, Pell, Hope, and TSAC grants.

Comparison of FY 2007 to FY 2006 – TSU Foundation

- Operating expenses increased and payments to TSU decreased because payments on behalf of the university were made through the foundation rather than transferring the funding to the university.
- Scholarship expenditures decreased due to a hold being placed on the awarding of new scholarships as a result of several changes in the foundation board membership.

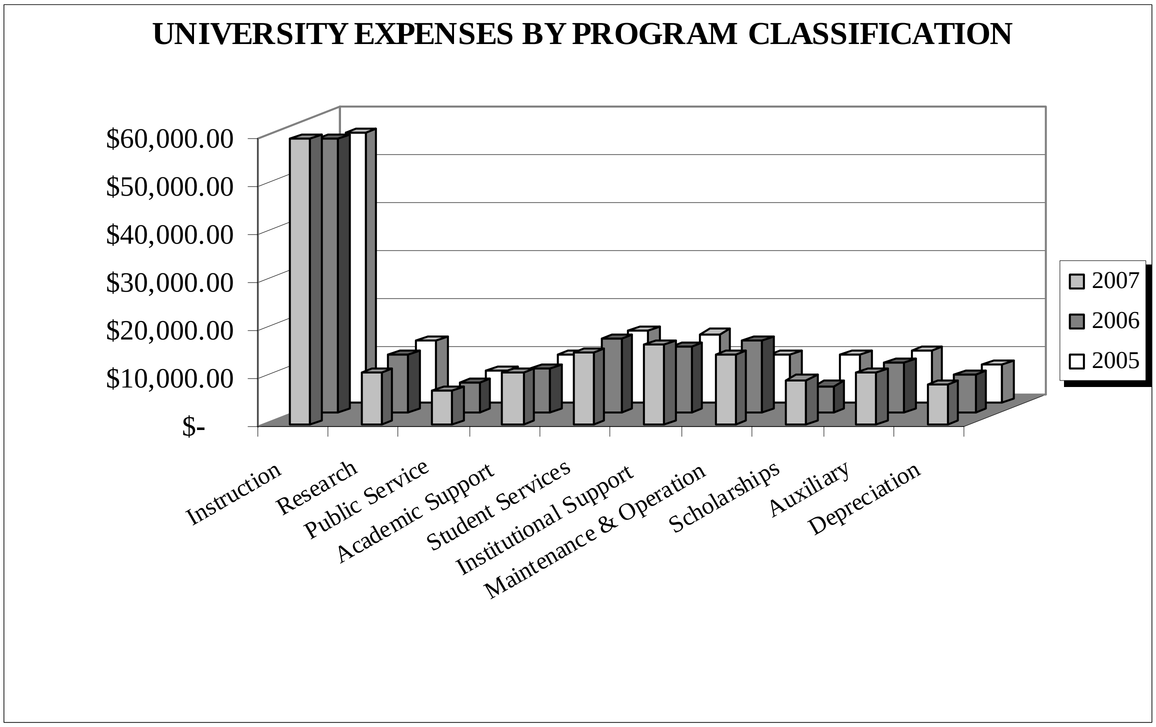
Comparison of FY 2006 to FY 2005 – TSU

- Scholarships increased due to the number of students receiving Pell, Hope, and TSAC awards.

Comparison of FY 2006 to FY 2005 – TSU Foundation

- Payments to TSU increased to support one-time expenses related to the installation of a new president for the university.

	University		
Program Classification	**2007**	**2006**	**2005**
Instruction	$ 59,327	$ 57,102	$ 55,881
Research	10,615	12,238	12,675
Public service	6,873	6,378	6,656
Academic support	10,803	9,184	9,726
Student services	14,871	15,334	14,820
Institutional support	16,386	13,746	14,226
Maintenance and operation	14,391	15,043	9,854
Scholarships	9,248	5,651	9,711
Auxiliary	10,545	10,380	10,564
Depreciation	8,147	7,924	7,682
Total expenses	**$ 161,206**	**$ 152,980**	**$ 151,795**



Comparison of FY 2007 to FY 2006

- Research decreased as a result of the reduction in funding from NASA and National Science Foundation (NSF).
- Institutional support increased with the Title III expenditures noted above.
- Scholarships increased due to the increase in the number of students receiving Pell, Hope, and TSAC awards.

Comparison of FY 2006 to FY 2005

- Scholarships decreased due to an increase in the calculation for scholarship allowances.

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.

Cash Flows (in thousands of dollars)

	University		
	2007	**2006**	**2005**
Cash provided (used) by:			
Operating activities	$(55,755)	$(53,045)	$(56,789)
Noncapital financing activities	62,472	57,639	60,916
Capital and related financing activities	(3,108)	(4,167)	(7,702)
Investing activities	3,144	(690)	(9,198)
Net increase (decrease) in cash	**6,753**	**(263)**	**(12,773)**
Cash, beginning of year	27,606	27,869	40,642
Cash, end of year	**$ 34,359**	**$ 27,606**	**$ 27,869**

<u>Comparison of FY 2007 to FY 2006</u>

- Cash provided by investing activities increased as a result of more funds invested for the entire fiscal year.
- Cash provided from noncapital financing activities increased with the additional receipt of grants and contracts as noted above.
- Cash provided by capital and related financing activities for the university increased for FY 2007 due to an increase in the proceeds from capital debt.
- The university's liquidity improved during the year.

Comparison of FY 2006 to FY 2005

- Cash provided by investing activities increased as a result of more funds invested for the entire fiscal year, rather than the purchase of investments during the year, at higher rates and a more aggressive investment strategy employed by the university.

- Cash provided by noncapital financing activities for the university decreased for FY 2006 because fewer gifts and grants were received and also because the university had to return $2.9 million for the Science Material Management program, which was discontinued.

- Cash used by capital and related financing activities decreased for FY 2006 due to a $3.6 million decrease in the capital gifts and grants received and related capital expenditures.

Capital Assets and Debt Administration

Capital Assets

The university had $177,049,621.73 invested in capital assets, net of accumulated depreciation of $123,522,576.24 at June 30, 2007; $167,319,169.22 invested in capital assets, net of accumulated depreciation of $116,416,637.47 at June 30, 2006; and $156,267,304.33 invested in capital assets, net of accumulated depreciation of $109,470,607.53 at June 30, 2005. Depreciation charges totaled $8,147,467.78 $7,923,855.15, and $7,681,782.97 for the years ended June 30, 2007; June 30, 2006; and June 30, 2005, respectively. Details of these assets are shown below.

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

	2007	2006	2005
Land	$ 9,525	$ 9,525	$ 9,525
Land improvements and infrastructure	11,147	12,352	14,253
Buildings	88,372	90,580	93,386
Equipment	6,037	6,351	6,356
Library holdings	7,121	7,285	6,567
Software	2,048	-	-
Projects in progress	52,800	41,226	26,181
Total capital assets, net of depreciation	**$ 177,050**	**$ 167,319**	**$ 156,268**

Projects in progress during FY 2007 included the Research and Sponsored Programs Building, the renovation of the Avon Williams campus, installation of fire sprinkler systems in student housing, and continued work on the final phase of the North Campus Project. More detailed information about the university's capital assets is presented in Note 5 to the financial statements.

Debt

The university had $38,392,019.02, $33,465,760.10, and $30,810,464.64 in debt outstanding at June 30, 2007; June 30, 2006; and June 30, 2005, respectively. The table below summarizes these amounts by type of debt instrument.

Schedule of Debt (in thousands of dollars)

	2007	2006	2005
Bonds	$ 37,467	$ 29,419	$ 28,269
Commercial paper	925	4,047	2,542
Total	**$ 38,392**	**$ 33,466**	**$ 30,811**

The university converted over $4 million in commercial paper to bonds issued by the Tennessee State School Bond Authority (TSSBA) during FY 2007 for the Research and Sponsored Programs Building and the Student Housing Fire Suppression Retrofit Project. An additional amount of over $924 thousand was issued by TSSBA in commercial paper for these two projects and the Avon Williams Campus renovation. Over $9.2 million in bonds were issued by TSSBA during the current fiscal year for TSU. The Standard & Poor's rating for TSSBA is AA- with a stable outlook. 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 Tennessee Board of Regents approved a 6% increase in maintenance and tuition fees for the 2007-08 academic year. The cost for students to attend the university exceeds the amount of financial aid available per student. This requires students to resort to alternative means of financing the cost of attending the university. The impact that will have on enrollment is unknown. The university is not aware of any other factors that will have a significant effect on the financial position or results of operations.

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:

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

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENTS OF NET ASSETS
JUNE 30, 2007, AND JUNE 30, 2006

	Tennessee State University		Component Unit Tennessee State University Foundation	
	June 30, 2007	June 30, 2006	June 30, 2007	June 30, 2006
ASSETS				
Current assets:				
Cash and cash equivalents (Notes 2 and 15)	$ 14,036,969.71	$ 11,264,067.79	$ 3,477,411.44	$ 2,518,261.65
Short-term investments (Notes 3 and 15)	300,806.56	285,697.70	-	-
Accounts, notes, and grants receivable (net) (Note 4)	7,928,930.13	7,066,966.31	-	-
Inventories (at lower of cost or market)	38,816.27	38,816.27	-	-
Accrued interest receivable	1,599,059.94	1,542,094.12	-	-
Total current assets	23,904,582.61	20,197,642.19	3,477,411.44	2,518,261.65
Noncurrent assets:				
Cash and cash equivalents (Notes 2 and 15)	20,322,583.08	16,342,093.10	2,924,323.20	5,678,425.86
Investments (Notes 3 and 15)	12,148,236.94	12,419,992.60	27,808,291.47	11,185,974.75
Accounts, notes, and grants receivable (net) (Note 4)	4,028,515.74	2,561,185.79	-	-
Capital assets (net) (Note 5)	177,049,621.73	167,319,169.22	-	-
Total noncurrent assets	213,548,957.49	198,642,440.71	30,732,614.67	16,864,400.61
Total assets	237,453,540.10	218,840,082.90	34,210,026.11	19,382,662.26
LIABILITIES				
Current liabilities:				
Accounts payable	2,094,231.71	1,664,317.05	13,835.77	5,655.05
Accrued liabilities	7,775,578.01	7,265,186.76	-	-
Student deposits	1,253,844.41	1,164,654.91	-	-
Deferred revenue	2,814,922.08	2,505,815.36	-	-
Compensated absences (Note 6)	759,669.43	1,260,185.75	-	-
Accrued interest payable	308,110.31	266,438.69	-	-
Long-term liabilities, current portion (Note 6)	1,584,504.95	1,044,550.13	-	-
Deposits held in custody for others	121,724.96	114,731.40	-	-
Other liabilities	629,581.50	455,440.36	-	-
Total current liabilities	17,342,167.36	15,741,320.41	13,835.77	5,655.05
Noncurrent liabilities:				
Compensated absences (Note 6)	4,305,123.55	3,586,088.73	-	-
Long-term liabilities (Note 6)	36,807,514.07	32,421,209.97	-	-
Due to grantors (Note 6)	3,236,570.55	3,297,205.01	-	-
Total noncurrent liabilities	44,349,208.17	39,304,503.71	-	-
Total liabilities	61,691,375.53	55,045,824.12	13,835.77	5,655.05
NET ASSETS				
Invested in capital assets, net of related debt	138,657,602.71	133,853,409.12	-	-
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	73,306.98	72,592.10	30,732,614.67	16,864,211.13
Expendable:				
Scholarships and fellowships (Notes 7 and 15)	483,509.10	374,746.07	2,328,068.76	1,820,549.78
Research	1,988,247.65	899,429.29	13,955.72	15,804.41
Instructional department uses (Note 7)	2,529,622.21	2,034,511.94	126,403.43	83,372.33
Loans	854,346.59	866,070.58	-	-
Other	1,916,756.49	2,525,237.15	882,263.62	563,312.74
Unrestricted (Note 8)	29,258,772.84	23,168,262.53	112,884.14	29,756.82
Total net assets	$ 175,762,164.57	$ 163,794,258.78	$ 34,196,190.34	$ 19,377,007.21

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

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2007, AND JUNE 30, 2006

	Tennessee State University		Component Unit Tennessee State University Foundation	
	Year Ended June 30, 2007	Year Ended June 30, 2006	Year Ended June 30, 2007	Year Ended June 30, 2006
REVENUES				
Operating revenues:				
Student tuition and fees (net of scholarship allowances of $15,204,591.45 for the year ended June 30, 2007, and $14,829,063.58 for the year ended June 30, 2006)	$ 45,332,412.73	$ 45,018,004.93	$ -	$ -
Gifts and contributions	-	-	1,195,808.07	918,706.15
Governmental grants and contracts	35,793,622.54	30,149,197.69	-	-
Sales and services of educational departments	2,412,523.66	2,309,304.96	-	-
Auxiliary enterprises:				
Residential life (net of scholarship allowances of $1,161,924.58 for the year ended June 30, 2007, and $839,045.39 for the year ended June 30, 2006; all residential life revenues are used as security for revenue bonds; see Note 6)	7,219,615.99	7,249,332.68	-	-
Bookstore	253,153.05	121,209.88	-	-
Food service	4,359,190.13	4,396,311.33	-	-
Other auxiliaries	940,604.44	928,306.27	-	-
Other operating revenues	323,557.68	254,367.01	191,920.79	178,318.08
Total operating revenues	96,634,680.22	90,426,034.75	1,387,728.86	1,097,024.23
EXPENSES				
Operating expenses (Note 14):				
Salaries and wages	72,161,355.65	70,949,834.64	-	-
Benefits	22,366,172.57	21,342,128.61	-	-
Utilities, supplies, and other services	53,378,073.75	46,131,518.71	509,701.09	464,165.10
Scholarships and fellowships	5,153,269.57	6,632,729.81	362,724.30	605,975.24
Depreciation expense	8,147,467.78	7,923,855.15	-	-
Payments to or on behalf of Tennessee State University (Note 15)	-	-	57,185.42	80,102.97
Total operating expenses	161,206,339.32	152,980,066.92	929,610.81	1,150,243.31
Operating income (loss)	(64,571,659.10)	(62,554,032.17)	458,118.05	(53,219.08)
NONOPERATING REVENUES (EXPENSES)				
State appropriations	45,386,666.74	44,938,933.87	9,000,000.00	1,000,000.00
Gifts, including $57,185.42 from component unit for the year ended June 30, 2007, and $80,102.97 for the year ended June 30, 2006	835,127.83	732,285.22	264,323.38	214,669.78
Grants and contracts	16,252,413.70	14,941,384.15	3,259,354.58	-
Investment income	2,944,671.35	1,859,101.23	879,221.73	593,564.34
Interest on capital asset-related debt	(1,667,656.91)	(1,547,735.93)	-	-
Bond issuance costs	-	(76,628.77)	-	-
Other nonoperating revenues (expenses)	-	(3,002,523.98)	(49,381.91)	-
Net nonoperating revenues	63,751,222.71	57,844,815.79	13,353,517.78	1,808,234.12
Income (loss) before other revenues, expenses, gains, or losses	(820,436.39)	(4,709,216.38)	13,811,635.83	1,755,015.04
Capital appropriations	10,332,279.54	11,745,123.83	-	-
Capital grants and gifts	2,545,930.86	393,237.83	-	-
Additions to permanent endowments	-	-	1,007,547.30	1,612,268.77
Other capital	(89,868.22)	(27,504.64)	-	-
Total other revenues	12,788,342.18	12,110,857.02	1,007,547.30	1,612,268.77
Increase in net assets	11,967,905.79	7,401,640.64	14,819,183.13	3,367,283.81
NET ASSETS				
Net assets - beginning of year	163,794,258.78	156,392,618.14	19,377,007.21	16,009,723.40
Net assets - end of year	$ 175,762,164.57	$ 163,794,258.78	$ 34,196,190.34	$ 19,377,007.21

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

Exhibit C

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2007, AND JUNE 30, 2006

	Year Ended June 30, 2007	Year Ended June 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 45,826,458.36	$ 45,723,308.98
Grants and contracts	34,356,923.18	31,948,236.79
Sales and services of educational activities	2,443,062.29	2,239,333.69
Payments to suppliers and vendors	(52,844,937.52)	(48,039,830.10)
Payments to employees	(71,417,779.91)	(70,481,798.52)
Payments for benefits	(22,202,948.63)	(21,239,388.97)
Payments for scholarships and fellowships	(5,153,269.57)	(6,421,738.06)
Loans issued to students and employees	(854,889.66)	(693,851.68)
Collection of loans from students and employees	748,827.89	762,524.01
Interest earned on loans to students	64,201.30	74,918.30
Auxiliary enterprise charges:		
Residence halls	7,417,011.32	7,428,060.92
Bookstore	253,153.05	121,209.88
Food services	4,359,190.13	4,396,311.33
Other auxiliaries	926,460.94	884,012.20
Other receipts (payments)	323,557.68	254,367.01
Net cash used by operating activities	(55,754,979.15)	(53,044,324.22)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	45,377,366.74	44,934,133.87
Gifts and grants received for other than capital purposes, including $57,185.42 from Tennessee State University Foundation for the year ended June 30, 2007, and $80,102.97 for the year ended June 30, 2006	17,087,541.53	15,644,567.37
Federal student loan receipts	26,261.00	1,577,025.81
Federal student loan disbursements	(26,261.00)	(1,547,923.81)
Changes in deposits held for others	6,993.56	1,997.45
Other noncapital financing receipts (payments)	-	(2,970,425.50)
Net cash provided by noncapital financing activities	62,471,901.83	57,639,375.19
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	10,466,607.66	6,236,150.86
Capital appropriations	10,332,279.54	11,745,123.83
Capital grants and gifts received	1,231,101.02	1,348,957.37
Purchases of capital assets and construction	(17,978,252.44)	(18,241,365.10)
Principal paid on capital debt	(5,529,884.81)	(3,657,484.17)
Interest paid on capital debt	(1,629,734.08)	(1,517,946.64)
Bond issue costs paid on new debt issue	-	(86,809.47)
Other capital and related financing receipts (payments)	-	6,201.24
Net cash used by capital and related financing activities	(3,107,883.11)	(4,167,172.08)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	5,514,394.32	5,038,994.62
Income on investments	2,887,705.53	1,201,640.96
Purchases of investments	(5,257,747.52)	(6,930,949.99)
Net cash provided (used) by investing activities	3,144,352.33	(690,314.41)
Net increase (decrease) in cash and cash equivalents	6,753,391.90	(262,435.52)
Cash and cash equivalents - beginning of year	27,606,160.89	27,868,596.41
Cash and cash equivalents - end of year	$ 34,359,552.79	$ 27,606,160.89

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2007, AND JUNE 30, 2006

	Year Ended June 30, 2007	Year Ended June 30, 2006
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (64,571,659.10)	$ (62,554,032.17)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	8,147,467.78	7,923,855.15
Change in assets and liabilities:		
Receivables, net	(863,059.40)	2,718,332.38
Inventories	-	76.06
Accounts payable	429,914.66	(1,626,276.51)
Accrued liabilities	627,646.72	334,305.34
Deferred revenue	309,106.72	(129,551.31)
Deposits	89,189.50	87,445.00
Compensated absences	218,518.50	248,065.61
Loans to students and employees	(142,104.53)	(46,543.77)
Net cash used by operating activities	$ (55,754,979.15)	$ (53,044,324.22)
Noncash transactions		
Gifts in-kind		$ 4,559.66
Unrealized gain (loss) on investments	$ 36,948.26	$ (582,376.62)
Loss on disposal of capital assets		$ (35,296.44)
Trade-in allowance		$ 10,550.00

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 Tennessee State University 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 15 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 restricted 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 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

At June 30, 2007, cash consisted of $24,572,309.59 in bank accounts, $5,550.00 of petty cash on hand, $9,448,865.07 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer, and $332,828.13 in LGIP deposits for capital projects. At June 30, 2006, cash consisted of $16,172,091.52 in bank accounts, $4,550.00 of petty cash on hand, $10,942,639.01 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $486,880.36 in LGIP deposits for capital projects.

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 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

All investments permitted to be reported at fair value under GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, are reported at fair value, including those with a maturity date of one year or less at the time of purchase.

At June 30, 2007, the university had the following investments and maturities:

		Investment Maturities (in Years)			
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10
U.S. agencies	$12,075,951.27	$2,379,621.50	$9,209,678.72	$ -	$486,651.05
Certificates of deposit	373,092.23	373,092.23	-	-	-
Total	$12,449,043.50	$2,752,713.73	$9,209,678.72	$ -	$486,651.05

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	6 to 10	More than 10
U.S. agencies	$12,348,569.00	$3,559,033.00	$8,674,709.00	$114,827.00	$ -
Certificates of deposit	357,121.30	-	357,121.30	-	-
Total	$12,705,690.30	$3,559,033.00	$9,031,830.30	$114,827.00	$ -

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; banker's 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. Tennessee Board of Regents policy restricts investments in banker's acceptances that must be issued by domestic banks with a minimum AA rating or foreign banks with a AAA long-term debt rating by a majority of the ratings services that have rated the issuer. The policy further requires that commercial paper must be issued by corporations with a minimum rating of A1 or equivalent as provided by a majority of the rating services that rate the issuer. If there is no long-term debt rating, the short-term debt must be rated A1 by all rating services (minimum of two). Commercial paper of a banking institution must not be purchased.

At June 30, 2007, the university's investments were rated as follows:

		Credit Quality Rating	
Investment Type	Fair Value	AAA	Unrated
LGIP	$ 9,781,693.20	$ -	$9,781,693.20
U.S. agencies	12,075,951.27	12,075,951.27	-
Total	$21,857,644.47	$12,075,951.27	$9,781,693.20

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

		Credit Quality Rating	
Investment Type	Fair Value	AAA	Unrated
LGIP	$11,429,519.37	$ -	$11,429,519.37
U.S. agencies	12,348,569.00	12,348,569.00	-
Total	$23,778,088.37	$12,348,569.00	$11,429,519.37

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2007	June 30, 2006
Student accounts receivable	$ 3,259,714.81	$ 3,479,283.35
Grants receivable	5,708,777.86	4,536,178.59
Notes receivable	455,531.10	453,223.89
State appropriation receivable	161,700.00	152,400.00
Other receivables	2,548,657.92	1,447,618.54
Subtotal	12,134,381.69	10,068,704.37
Less allowance for doubtful accounts	2,262,265.32	2,373,100.86
Total receivables	$ 9,872,116.37	$ 7,695,603.51

Federal Perkins Loan Program funds included the following:

	June 30, 2007	June 30, 2006
Perkins loans receivable	$17,621,887.84	$16,764,606.84
Less allowance for doubtful accounts	15,536,558.34	14,832,058.25
Total	$ 2,085,329.50	$ 1,932,548.59

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2007, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 9,525,009.24	$ -	$ -	$ -	$ 9,525,009.24
Land improvements and infrastructure	38,237,355.27	-	-	-	38,237,355.27
Buildings	158,983,760.45	-	1,489,164.19	-	160,472,924.64
Equipment	23,974,140.82	1,081,194.03	430,400.00	623,608.23	24,862,126.62
Library holdings	11,789,910.08	1,127,621.23	-	518,252.93	12,399,278.38

Software	-	-	2,275,741.87	-	2,275,741.87
Projects in progress	41,225,630.83	15,769,437.18	(4,195,306.06)	-	52,799,761.95
Total	283,735,806.69	17,978,252.44	-	1,141,861.16	300,572,197.97
Less accum. depreciation:					
Land improvements and infrastructure	25,885,700.32	1,205,251.32	-	-	27,090,951.64
Buildings	68,403,143.66	3,697,650.13	-	-	72,100,793.79
Equipment	17,622,942.41	1,765,841.97	-	563,879.05	18,824,905.33
Library holdings	4,504,851.08	1,291,753.14	-	518,252.93	5,278,351.29
Software	-	227,574.19	-	-	227,574.19
Total accum. depreciation	116,416,637.47	8,188,070.75	-	1,082,131.98	123,522,576.24
Capital assets, net	$167,319,169.22	$ 9,790,181.69	$ -	$ 59,729.18	$177,049,621.73

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 9,525,009.24	$ -	$ -	$ -	$ 9,525,009.24
Land improvements and infrastructure	39,779,531.74	-	475,000.00	2,017,176.47	38,237,355.27
Buildings	156,966,583.97	2,017,176.48	-	-	158,983,760.45
Equipment	23,013,775.35	1,785,707.58	-	825,342.11	23,974,140.82
Library holdings	10,271,891.61	1,939,174.60	-	421,156.13	11,789,910.08
Projects in progress	26,181,119.95	15,519,510.88	(475,000.00)	-	41,225,630.83
Total	265,737,911.86	21,261,569.54	-	3,263,674.71	283,735,806.69
Less accum. depreciation:					
Land improvements and infrastructure	25,527,169.73	1,167,568.45	-	809,037.86	25,885,700.32
Buildings	63,580,937.98	4,822,205.68	-	-	68,403,143.66
Equipment	16,657,599.24	1,744,838.84	-	779,495.67	17,622,942.41
Library holdings	3,704,900.58	1,221,106.63	-	421,156.13	4,504,851.08
Total accum. depreciation	109,470,607.53	8,955,719.60	-	2,009,689.66	116,416,637.47
Capital assets, net	$156,267,304.33	$12,305,849.94	$ -	$1,253,985.05	$167,319,169.22

NOTE 6. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2007, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$29,418,510.79	$ 9,531,429.02	$1,482,635.50	$37,467,304.31	$1,584,504.95
Commercial paper	4,047,249.31	924,714.71	4,047,249.31	924,714.71	-
Subtotal	33,465,760.10	10,456,143.73	5,529,884.81	38,392,019.02	1,584,504.95
Other liabilities:					
Compensated absences	4,846,274.48	2,898,211.61	2,679,693.11	5,064,792.98	759,669.43
Due to grantors	3,297,205.01	166,401.26	227,035.72	3,236,570.55	-
Subtotal	8,143,479.49	3,064,612.87	2,906,728.83	8,301,363.53	759,669.43
Total long-term liabilities	$41,609,239.59	$13,520,756.60	$8,436,613.64	$46,693,382.55	$2,344,174.38

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	$28,268,727.57	$ 2,676,142.83	$1,526,359.61	$29,418,510.79	$1,044,550.13
Commercial paper	2,541,737.07	3,636,636.80	2,131,124.56	4,047,249.31	-
Subtotal	30,810,464.64	6,312,779.63	3,657,484.17	33,465,760.10	1,044,550.13
Other liabilities:					
Compensated absences	4,598,208.87	3,167,416.66	2,919,351.05	4,846,274.48	1,260,185.75
Due to grantors	2,962,319.94	355,920.49	21,035.42	3,297,205.01	-
Subtotal	7,560,528.81	3,523,337.15	2,940,386.47	8,143,479.49	1,260,185.75
Total long-term liabilities	$38,370,993.45	$ 9,836,116.78	$6,597,870.64	$41,609,239.59	$2,304,735.88

TSSBA Debt - Bonds

Bonds, with interest rates ranging from 4% to 6.9%, 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 $275,000.00 at June 30, 2007, and $547,480.00 at June 30, 2006. Unexpended debt proceeds were $32,484.44 at June 30, 2007, and $218,875.44 at June 30, 2006.

Debt service requirements to maturity for the university's portion of TSSBA bonds at June 30, 2007, are as follows:

Year Ending June 30	Principal	Interest	Total
2008	$ 1,584,504.95	$ 1,805,190.42	$ 3,389,695.37
2009	1,675,815.87	1,759,556.84	3,435,372.71
2010	1,450,867.78	1,712,090.23	3,162,958.01
2011	1,860,795.34	1,595,883.64	3,456,678.98
2012	1,949,808.30	1,516,529.97	3,466,338.27
2013-2017	10,295,433.97	6,203,947.56	16,499,381.53
2018-2022	8,389,466.10	3,867,852.37	12,257,318.47
2023-2027	7,352,734.20	1,831,804.68	9,184,538.88
2028-2032	2,907,877.80	380,974.41	3,288,852.21
	$37,467,304.31	$20,673,830.12	$58,141,134.43

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 $924,714.71 at June 30, 2007, and $4,047,249.31 at June 30, 2006.

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, a scholarship is awarded to a student whose residence is in the county specified by the donor, if it has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income. At June 30, 2007, net appreciation of $38,601.56 is available to be spent, of which $37,680.90 is included in restricted net assets expendable for instructional departmental uses and $920.66 is included in restricted net assets expendable for scholarships and fellowships. At June 30, 2006, net appreciation of $34,380.51 is available to be spent, of which $33,997.86 is included in restricted net assets expendable for instructional departmental uses and $382.65 is included in restricted net assets expendable for scholarships and fellowships.

NOTE 8. UNRESTRICTED NET ASSETS

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

	June 30, 2007	June 30, 2006
Working capital	$ 1,405,459.74	$ 1,758,810.71
Encumbrances	2,642,040.89	2,145,551.86
Designated fees	1,034,293.74	921,699.19
Auxiliaries	2,766,203.68	2,766,203.68
Plant construction	13,119,214.85	7,291,573.23
Renewal and replacement of equipment	7,869,539.93	7,973,257.30
Undesignated	422,020.01	311,166.56
Total	$29,258,772.84	$23,168,262.53

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 13.66% 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, 2007, 2006, and 2005 were $3,928,524.36, $2,676,782.60, and $2,918,090.21. Contributions met the requirements for each year.

2. Federal Retirement Program

Plan Description - The university contributes to the Federal Retirement Program, a cost-sharing, multiple-employer, defined benefit pension plan administered by the Civil Service Retirement System (CSRS) for participants employed prior to January 1, 1984, and the Federal Employees Retirement System (FERS) for participants employed after December 31, 1983. Both systems provide retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. All regular full-time employees of the Tennessee State University Agricultural Extension Service who hold federal appointments for 51% or more of their time are required to participate in either one of the two Federal Retirement Programs. For both systems, benefit provisions are established in federal statutes. Federal statutes are amended by the U.S. Congress. All of the university's extension employees currently participate in CSRS.

The CSRS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the Office of Personnel Management, Retirement Information Office, P. O. Box 45, Boyers, Pennsylvania 16017-0045, or by calling (202) 606-0500.

Funding Policy - Participating employees and the university are required to contribute to the CSRS plan. Contribution requirements are established and may be amended by federal statutes. The university is currently required to contribute 7% of covered payroll to the CSRS plan, and employees are required to contribute 7% of covered payroll. Contributions to CSRS for the year ended June 30, 2007, were $55,393.80, which consisted of $27,996.90 from the university and $27,396.90 from the employees. Contributions for the year ended June 30, 2006, were $73,637.13, which consisted of $36,818.56 from the university and $36,818.57 from the employees. Contributions for the year ended June 30, 2005, were $73,788.36, which consisted of $38,321.09 from the university and $35,467.27 from the employees. 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 $3,777,032.64 for the year ended June 30, 2007, and $3,481,321.09 for the year ended June 30, 2006. 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 $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, 2007, and June 30, 2006, 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, 2007, the Risk Management Fund held $116.7 million in cash and cash equivalents designated for payment of claims. 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, 2007, the scheduled coverage for the university was $289,328,000 for buildings and $64,969,100 for contents. At June 30, 2006, the scheduled coverage for the university was $289,942,800 for buildings and $62,342,700 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 $31,174,320.88 at June 30, 2007, and $31,260,034.92 at June 30, 2006.

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 $207,731.68 and for personal property were $81,279.34 for the year ended June 30, 2007. Comparative amounts for the year ended June 30, 2006, were $236,656.87 and $306,091.61. All operating leases are cancelable at the lessee’s option.

Construction in Progress - At June 30, 2007, outstanding commitments under construction contracts totaled $3,141,754.88 for ADA improvements, Agriculture I.T. Center, Avon Williams campus improvements, Power Plant mechanical upgrade, Agriculture Extension Center, Research and Sponsored Programs Building, McCord and Harned Halls upgrade, electrical distribution system, Clement Hall/Allied Health upgrade, Elliott Hall Exhibition, student housing fire suppression, and several buildings improvements, of which $1,468,116.52 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 was $1,024,626.00 at June 30, 2007, and $1,714,475.00 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 $4,464,260.35 on deposit at June 30, 2007, and $3,970,325.09 on deposit at June 30, 2006, 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. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2007, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$35,496,819.63	$ 9,868,520.66	$12,796,962.66	$1,164,524.21	$ -	$ 59,326,827.16
Research	5,885,392.14	1,704,959.40	2,910,188.28	114,121.91	-	10,614,661.73
Public service	3,745,059.15	1,447,927.50	1,653,621.35	26,891.91	-	6,873,499.91
Academic support	5,697,983.06	1,781,330.45	3,270,173.10	53,838.33	-	10,803,324.94
Student services	6,930,897.68	2,258,106.40	4,612,918.26	1,069,496.27	-	14,871,418.61
Institutional support	9,277,973.36	3,289,476.45	3,808,918.12	9,331.87	-	16,385,699.80
Operation & maintenance	3,173,251.52	1,403,838.76	9,813,970.14	-	-	14,391,060.42
Scholar. & fellow.	5,211.00	398.63	6,588,784.20	2,653,454.15	-	9,247,847.98
Auxiliary	1,948,768.11	611,614.32	7,922,537.64	61,610.92	-	10,544,530.99
Depreciation	-	-	-	-	8,147,467.78	8,147,467.78
Total	$72,161,355.65	$22,366,172.57	$53,378,073.75	$5,153,269.57	$8,147,467.78	$161,206,339.32

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	$34,882,934.34	$ 9,647,076.79	$10,360,112.89	$2,211,797.86	$ -	$ 57,101,921.88
Research	5,730,464.12	1,678,070.61	4,549,518.19	280,107.87	-	12,238,160.79
Public service	3,753,208.60	1,300,289.92	1,240,223.71	84,360.25	-	6,378,082.48
Academic support	5,669,220.42	1,780,074.12	1,625,839.22	109,000.82	-	9,184,134.58
Student services	6,700,774.01	1,968,810.55	4,448,969.54	2,215,132.90	-	15,333,687.00
Institutional support	9,247,266.72	3,097,985.54	1,389,501.73	10,853.00	-	13,745,606.99
Operation & maintenance	3,052,793.06	1,272,949.51	10,717,716.31	-	-	15,043,458.88
Scholar. & fellow.	4,346.80	901.67	4,099,941.76	1,546,275.11	-	5,651,465.34
Auxiliary	1,908,826.57	595,969.90	7,699,695.36	175,202.00	-	10,379,693.83
Depreciation	-	-	-	-	7,923,855.15	7,923,855.15
Total	$70,949,834.64	$21,342,128.61	$46,131,518.71	$6,632,729.81	$7,923,855.15	$152,980,066.92

NOTE 15. COMPONENT UNIT

The 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 14-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 25 in number with a minimum of 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, 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.

During the year ended June 30, 2007, the foundation made distributions of $57,185.42 to or on behalf of the university for both restricted and unrestricted purposes. During the year ended June 30, 2006, the foundation made distributions of $80,102.97 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Mr. Shereitte Stokes, Vice President for University Relations and Development, 3500 John A. Merritt Boulevard, Nashville, Tennessee 37209.

Cash and cash equivalents - In addition to demand deposits and petty cash on hand, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less. At June 30, 2007, cash and cash equivalents consisted of $1,411,430.61 in bank accounts and $4,990,304.03 in capital management account money funds and short-term investments. At June 30, 2006, cash and cash equivalents consisted of $969,376.50 in bank accounts, $189.48 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $7,227,121.53 in capital management money funds and short-term investments.

Investments - The foundation is authorized to invest funds in accordance with its board of directors' policies. All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase.

At June 30, 2007, the foundation had the following investments and maturities.

		Investment Maturities (in Years)				
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10	No Maturity Date
U.S. Treasury	$ 2,124,240.72	$ 49,648.45	$1,773,503.43	$228,764.82	$ 72,324.02	$ -
U.S. agencies	1,014,405.65	49,628.70	267,100.13	-	697,676.82	-
Corporate stocks	2,901,962.16	-	-	-	-	2,901,962.16
Corporate bonds	853,228.79	218,416.72	511,260.47	106,154.96	17,396.64	-
Mutual bond funds	6,983,840.28	-	-	-	-	6,983,840.28
Mutual equity funds	11,201,421.87	-	-	-	-	11,201,421.87
Real estate investments	2,729,192.00	-	-	-	-	2,729,192.00
Money funds and short-term investments	4,990,304.03	-	-	-	-	4,990,304.03
Less amount reported as cash and cash equivalents: Money funds and short-term investments	(4,990,304.03)	-	-	-	-	(4,990,304.03)
Total	$27,808,291.47	$317,693.87	$2,551,864.03	$334,919.78	$787,397.48	$23,816,416.31

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

Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10	No Maturity Date
		Investment Maturities (in Years)				
U.S. Treasury	$ 318,739.30	$ -	$ 48,531.25	$ -	$270,208.05	$ -
U.S. agencies	603,649.79	-	553,516.69	50,133.10	-	-
Corporate stocks	705,019.81	-	-	-	-	705,019.81
Corporate bonds	3,208,371.04	323,287.61	2,478,990.60	406,092.83	-	-
Mutual funds	2,462,110.31	-	-	-	-	2,462,110.31
Other:						
Fixed income CDs	111,162.16	37,487.76	73,674.40	-	-	-
Mortgage backed securities	198,073.26	-	-	-	198,073.26	-
Equity stock	7,411.53	-	-	-	-	7,411.53
Real estate shares	1,900,991.30	-	-	-	-	1,900,991.30
Real estate holdings	1,670,446.25	-	-	-	-	1,670,446.25
Money funds and short-term investments	7,227,121.53	-	-	-	-	7,227,121.53
Less amount reported as cash and cash equivalents:						
Money funds and short-term investments	(7,227,121.53)	-	-	-	-	(7,227,121.53)
Total	$11,185,974.75	$360,775.37	$3,154,712.94	$456,225.93	$468,281.31	$6,745,979.20

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

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. 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, 2007, the foundation's investments were rated as follows:

Investment Type	Fair Value	AAA	AA	A	BBB	Unrated
			Credit Quality Rating			
U.S. Treasury	$ 2,124,240.72	$2,074,592.27	$ -	$ -	$ -	$ 49,648.45
U.S. agencies	1,014,405.65	316,728.83	-	-	-	697,676.82
Corporate bonds	853,228.79	85,960.74	319,805.58	309,587.15	137,875.32	-
Mutual bond funds	6,983,840.28	-	-	-	-	6,983,840.28
Mutual equity funds	11,201,421.87	-	-	-	-	11,201,421.87
Total	$22,177,137.31	$2,477,281.84	$319,805.58	$309,587.15	$137,875.32	$18,932,587.42

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

Investment Type	Fair Value	Credit Quality Rating AAA	AA	A	BBB	Unrated
LGIP	$ 189.48	$ -	$ -	$ -	$ -	$ 189.48
U.S. agencies	603,649.79	553,516.69	50,133.10	-	-	-
Corporate bonds	3,208,371.04	91,511.99	328,807.12	2,623,809.57	164,242.36	-
Mutual funds	2,462,110.31	-	-	-	-	2,462,110.31
Mortgage backed securities	198,073.26	-	-	-	-	198,073.26
Total	$6,472,393.88	$645,028.68	$378,940.22	$2,623,809.57	$164,242.36	$2,660,373.05

Concentration of credit risk - The foundation places no limit on the amount it may invest in any one issuer.

At June 30, 2007, more than 5% of the foundation's investments were invested in the following single issuers:

Issuer	Percentage of Total Investments
Regions (AmSouth) Bank	25.0%
Charles Schwab International	60.7%
Diversified Trends	6.0%

At June 30, 2006, more than 5% of the foundation's investments were invested in the following single issuers:

Issuer	Percentage of Total Investments
AmSouth Bank	24.5%
Charles Schwab International	51.1%
Diversified Trends	10.1%
Inland American	5.2%
Man-Glenwood	5.2%

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, the cost of administering and managing the endowment fund has been authorized for expenditure. For Title III funds, the foundation must reinvest a minimum of 50% of the annual income generated by the fund. For the Consent Decree fund, the foundation must reinvest a minimum of 25% of the annual income and may spend up to 75% of the annual income generated by the fund with all disbursement decisions made at the sole discretion of the Budget Committee established by the trust agreement. At June 30, 2007, net appreciation of $687,930.12 is available to be spent, which is included in restricted net assets expendable for scholarships and fellowships. At June 30, 2006, net appreciation of $309,929.91 is available to be spent, which is included in restricted net assets expendable for scholarships and fellowships.

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
SUPPLEMENTARY INFORMATION
STATEMENTS OF CASH FLOWS - COMPONENT UNIT
FOR THE YEARS ENDED JUNE 30, 2007, AND JUNE 30, 2006

	Year Ended June 30, 2007	Year Ended June 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$ 1,195,808.07	$ 949,706.15
Payments to suppliers and vendors	(501,520.37)	(459,267.94)
Payments for scholarships and fellowships	(362,724.30)	(605,975.24)
Payments to Tennessee State University	(57,185.42)	(80,102.97)
Other receipts (payments)	191,920.79	178,318.08
Net cash provided (used) by operating activities	466,298.77	(17,321.92)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	9,000,000.00	1,000,000.00
Grants and contracts for endowment purposes	3,259,354.58	-
Private gifts for endowment purposes	264,323.38	214,669.78
Net cash provided by noncapital financing activities	12,523,677.96	1,214,669.78
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	9,190,534.47	4,883,872.80
Income on investments	879,221.73	593,564.34
Purchases of investments	(24,854,685.80)	(4,444,649.57)
Other investing receipts (payments)	-	(127,764.49)
Net cash provided (used) by investing activities	(14,784,929.60)	905,023.08
Net increase (decrease) in cash and cash equivalents	(1,794,952.87)	2,102,370.94
Cash and cash equivalents - beginning of year	8,196,687.51	6,094,316.57
Cash and cash equivalents - end of year	$ 6,401,734.64	$ 8,196,687.51
Reconciliation of operating loss to net cash used by operating activities:		
Operating income (loss)	$ 458,118.05	$ (53,219.08)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Change in assets and liabilities:		
Receivables, net	-	31,000.00
Accounts payable	8,180.72	4,897.16
Net cash provided (used) by operating activities	$ 466,298.77	$ (17,321.92)