AUDIT REPORT

Tennessee Board of Regents
East Tennessee State University

For the Year Ended
June 30, 2008

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

Tennessee Comptroller of the Treasury

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STATE OF TENNESSEE
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March 26, 2009

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. Paul E. Stanton, President
East Tennessee State University
Campus Box 70734
Johnson City, Tennessee 37614-0734

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, East Tennessee State University, for the year ended June 30, 2008. You will note from the independent auditor's report that unqualified opinions were given on the fairness of the presentation of the financial statements.

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

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/sds
08/096

State of Tennessee

Audit Highlights

Comptroller of the Treasury | Division of State Audit

Financial and Compliance Audit
East Tennessee State University
For the Year Ended June 30, 2008

AUDIT OBJECTIVES

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

AUDIT FINDINGS

The audit report contains no findings.

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

Audit Report
Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2008

TABLE OF CONTENTS

TABLE OF CONTENTS (CONT.)

Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2008

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Board of Regents, East 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

East Tennessee State University was established by an act of the General Assembly in 1909 as East Tennessee State Normal School. In 1924, the name was changed to East Tennessee State Teachers College; in 1930, to State Teachers College, Johnson City; and in 1943, to East Tennessee State College. In 1963, by an act of the General Assembly, East Tennessee State College was granted university status, and its name was changed to East Tennessee State University.

The university has 11 colleges and schools: the College of Arts and Sciences, the College of Business and Technology, the College of Education, the College of Medicine, the College of Nursing, the College of Pharmacy, the College of Public Health, the College of Clinical and Rehabilitative Sciences, the Honors College, the School of Continuing Studies, and the School of Graduate Studies. East Tennessee State University is officially authorized to grant 12 undergraduate and 25 graduate degrees.

ORGANIZATION

The governance of East Tennessee State University is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Executive 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, 2007, through June 30, 2008, 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 generally accepted government auditing standards. Financial statements are presented for the year ended June 30, 2008. East 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, 2008, 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 generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no significant deficiencies or material weaknesses.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported under generally accepted 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
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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

December 12, 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. Paul E. Stanton, President
East Tennessee State University
Campus Box 70734
Johnson City, Tennessee 37614-0734

Ladies and Gentlemen:

We have audited the financial statements of East 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 units as of and for the year ended June 30, 2008, and have issued our report thereon dated December 12, 2008. Our report was modified to include a reference to other auditors. During the year ended June 30, 2008, the university implemented GASB Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. 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 generally accepted government auditing standards.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting.

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 university's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the university's financial statements that is more than inconsequential will not be prevented or detected by the university's internal control.

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 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 internal control that might be significant deficiencies or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

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

Compliance and Other Matters

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

We did, however, note a less significant instance 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/sds

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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Independent Auditor's Report

December 12, 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. Paul E. Stanton, President
East Tennessee State University
Campus Box 70734
Johnson City, Tennessee 37614-0734

Ladies and Gentlemen:

We have audited the accompanying basic financial statements of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the year ended June 30, 2008, 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 audit. We did not audit the financial statements of the East Tennessee State University Foundation and the Medical Education Assistance Corporation, discretely presented component units of the university. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the East Tennessee State University Foundation and the Medical Education Assistance Corporation, is based on the reports of the other auditors.

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

As discussed in Note 1, the financial statements of East Tennessee State University, an institution of the Tennessee Board of Regents, are intended to present the financial position, the changes in financial position, and the cash flows of only East Tennessee State University. They do not purport to, and do not present fairly the financial position of the Tennessee Board of Regents, as of June 30, 2008, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tennessee Board of Regents, East Tennessee State University, and its discretely presented component units as of June 30, 2008, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 11, during the year ended June 30, 2008, the university implemented GASB Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*.

The management's discussion and analysis on pages 12 through 31 and the OPEB schedule of funding progress page on 63 are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the basic financial statements. The accompanying financial information on pages 64 and 65 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.

December 12, 2008
Page Three

In accordance with generally accepted government auditing standards, we have also issued our report dated December 12, 2008, 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 generally accepted government auditing standards and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/sds

Tennessee Board of Regents
East Tennessee State University
Management's Discussion and Analysis
June 30, 2008

This section of East Tennessee State University's report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2008, with comparative information presented for the fiscal year ended June 30, 2007. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the independent auditor's report and the audited financial statements and accompanying notes. The financial statements, notes, and this discussion are the responsibility of management.

The university has two discretely presented component units, the East Tennessee State University Foundation and the Medical Education Assistance Corporation (MEAC). More detailed information about the university's component units is presented in Note 18 to the financial statements. Information and analysis regarding the component units is also included in this section.

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 East 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.

East Tennessee State University
Condensed Statements of Net Assets
(in thousands of dollars)

	2008	2007
Assets:		
Current assets	$ 52,156	$ 43,912
Capital assets, net	225,128	201,880
Other assets	49,012	50,938
Total assets	**326,296**	**296,730**
Liabilities:		
Current liabilities	27,375	23,639
Noncurrent liabilities	99,820	75,157
Total liabilities	**127,195**	**98,796**
Net assets:		
Invested in capital assets, net of related debt	141,369	139,476
Restricted – nonexpendable	40	40
Restricted – expendable	6,800	6,159
Unrestricted	50,892	52,259
Total net assets	**$199,101**	**$197,934**

Comparison of fiscal year 2008 to fiscal year 2007

- Current assets increased from 2007 to 2008 due to the reduction in bond investments and increases in cash deposits with LGIP due to declining market interest rates on bond investments during the fiscal year.

- In 2008, other assets decreased due to decreases in long-term investments.

- Net capital assets increased from 2007 to 2008 as a result of the completion of Governor's Hall, the College of Pharmacy building, the Fossil Site Museum, and renovations to the student center and other dormitories.

- Increases in current liabilities were primarily due to increases in the current portion of long-term liabilities related to construction projects completed during the fiscal year 2008 and increases in deferred revenue due to term start dates.

- In 2008, noncurrent liabilities increased primarily due to the implementation of GASB 45 and the recognition of the post employment benefit and the incurrence of additional Tennessee State School Bond Authority (TSSBA) debt.

- Long-term liabilities (TSSBA debt) increased substantially with the debt related to the construction projects for Governor's Hall and the softball complex and renovations of other dormitories and the student center.

- Invested in capital assets increased in 2008 with the opening of Governor's Hall in the fall of 2007.

- Restricted net assets increased from 2007 to 2008 due to increases in allocations for other restricted funds for the Families First grant and the College of Nursing health clinics.

East Tennessee State University Foundation
Condensed Statements of Net Assets
(in thousands of dollars)

	2008	2007
Assets:		
Current assets	$441	$591
Capital assets, net	588	378
Other assets	66,870	67,321
Total assets	**67,899**	**68,290**
Liabilities:		
Current liabilities	163	106
Total liabilities	**163**	**106**
Net assets:		
Invested in capital assets, net of related debt	589	378
Restricted – nonexpendable	52,833	53,620
Restricted – expendable	13,174	12,535
Unrestricted	1,140	1,651
Total net assets	**$67,736**	**$68,184**

Comparison of fiscal year 2008 to fiscal year 2007

- In 2008, current assets and other assets decreased due to a reduction in pledges receivable as pledges for the College of Pharmacy have been paid.

- Net capital assets increased from 2007 to 2008 as a result of construction on the new Alumni Walkway. When completed in 2009, this asset will be transferred to the university.

- In 2008, current liabilities increased due to an increase in accounts payable.

- Unrestricted net assets decreased due to a decrease in the market value of investments during the year.

Medical Education Assistance Corporation
Condensed Statements of Net Assets
(in thousands of dollars)

	2008	2007
Assets:		
Current assets	$18,952	$15,127
Capital assets, net	2,336	723
Other assets	1,218	3,266
Total assets	**22,506**	**19,116**
Liabilities:		
Current liabilities	4,719	4,584
Noncurrent liabilities	2,064	436
Total liabilities	**6,783**	**5,020**
Net assets:		
Invested in capital assets, net of related debt	679	723
Unrestricted	15,044	13,373
Total net assets	**$15,723**	**$14,096**

Comparison of fiscal year 2008 to fiscal year 2007

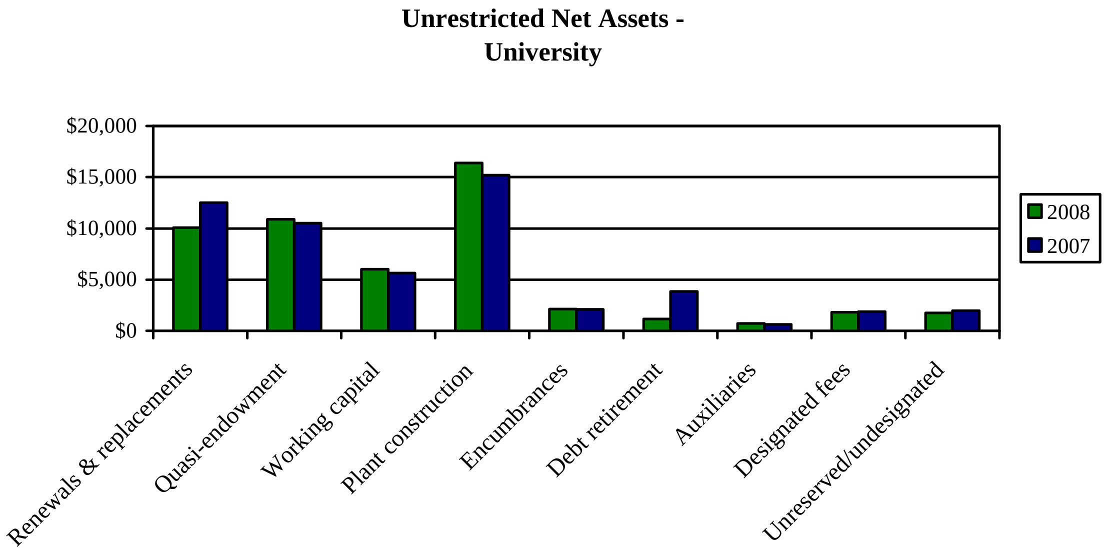
- Current assets increased from 2007 to 2008 due to increases in cash, short-term investments, and prepaid expenses and deferred changes.

- Net capital assets increased from 2007 to 2008. In September 2007, MEAC purchased the second floor of a building in Kingsport for $1,675,960. This building is used for the Kingsport Internal Medicine clinic.

- In 2008, current liabilities increased as a result of increases in other accrued expenses and also the current portion of long-term debt for the loan on the Kingsport building mentioned above.

- Long-term liabilities increased in 2008 due to the note payable of $1,675,960 for the purchase of the Kingsport clinic mentioned above.

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



Comparison of fiscal year 2008 to fiscal year 2007

- The allocations for debt retirement decreased in 2008 due to the transfer of funds to construction projects to fund increased construction costs. Other allocations remained relatively unchanged.

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.

East Tennessee State University
Condensed Statements of Revenues, Expenses, and Changes in Net Assets
(in thousands of dollars)

	2008	2007
Operating revenues:		
Net tuition and fees	$54,093	$48,896
Grants and contracts	37,573	33,310
Auxiliary	12,333	9,752
Other	22,990	22,177
Total operating revenues	**126,989**	**114,135**
Operating expenses	272,954	244,550
Operating income (loss)	**(145,965)**	**(130,415)**
Nonoperating revenues and expenses:		
State appropriations	98,619	91,709
Gifts	4,467	2,938
Grants and contracts	35,498	31,170
Investment income	3,964	3,991
Other revenues and expenses	(3,641)	(2,608)
Total nonoperating revenues and expenses	**138,907**	**127,200**
Income (loss) before other revenues, expenses, gains, or losses	**(7,058)**	**(3,215)**
Other revenues, expenses, gains, or losses:		
Capital appropriations	5,999	4,500
Capital grants and gifts	2,226	5,960
Total other revenues, expenses, gains, or losses	**8,225**	**10,460**
Increase (decrease) in net assets	**1,167**	**7,245**
Net assets at beginning of year	197,934	190,689
Net assets at end of year	**$199,101**	**$197,934**

East Tennessee State University Foundation
Condensed Statements of Revenues, Expenses, and Changes in Net Assets
(in thousands of dollars)

	2008	2007
Operating revenues and expenses:		
Operating revenues	$6,967	$4,290
Operating expenses	7,077	4,986
Operating income (loss)	**(110)**	**(696)**
Nonoperating revenues and expenses:		
Gifts	827	370
Investment income	(2,473)	6,198
Other revenues and expenses	-	261
Total nonoperating revenues and expenses	**(1,646)**	**6,829**
Income (loss) before other revenues, expenses, gains, or losses	**(1,756)**	**6,133**
Other revenues, expenses, gains, or losses:		
Capital grants and gifts	42	479
Additions to permanent endowments	1,266	3,440
Total other revenues, expenses, gains, or losses	**1,308**	**3,919**
Increase (decrease) in net assets	**(448)**	**10,052**
Net assets at beginning of year	68,184	58,132
Net assets at end of year	**$67,736**	**$68,184**

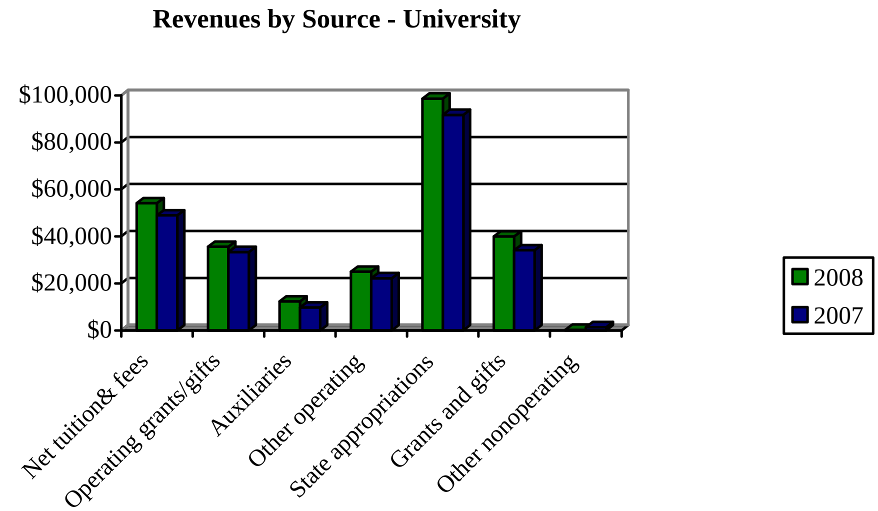
Medical Education Assistance Corporation
Condensed Statements of Revenues, Expenses, and Changes in Net Assets
(in thousands of dollars)

	2008	2007
Operating revenues and expenses:		
Operating revenues	$36,453	$34,473
Operating expenses	33,118	31,802
Operating income (loss)	**3,335**	**2,671**
Nonoperating revenues and expenses:		
Investment income	652	636
Other revenues and expenses	(2,360)	(1,501)
Total nonoperating revenues and expenses	**(1,708)**	**(865)**
Income (loss) before other revenues, expenses, gains, or losses	**1,627**	**1,806**
Increase (decrease) in net assets	**1,627**	**1,806**
Net assets at beginning of year	14,096	12,290
Net assets at end of year	**$15,723**	**$14,096**

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the university's operating activities for the years ended June 30, 2008, and June 30, 2007. Amounts are presented in thousands of dollars.

Tennessee Board of Regents
East Tennessee State University
Management's Discussion and Analysis (Cont.)
June 30, 2008

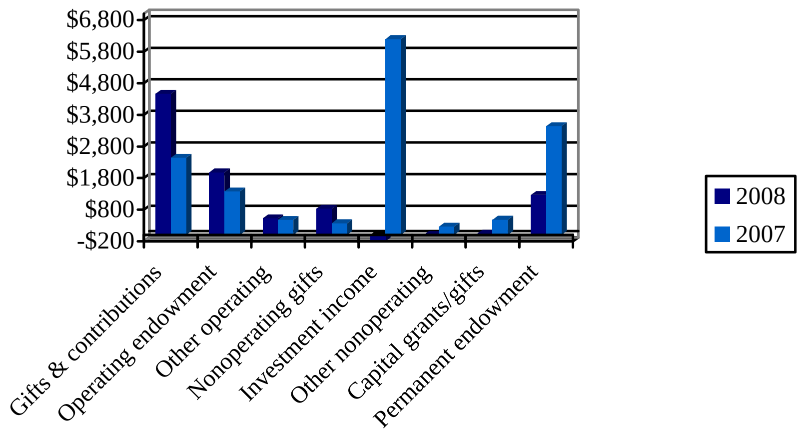


<u>Comparison of fiscal year 2008 to fiscal year 2007</u>

- Tuition and fees increased in 2008 due to a 6% fee increase and a 3% increase in enrollment.
- Both operating and nonoperating grants and contracts increased as a result of increased revenue in nursing clinics and gifts for the purchase of pianos.
- Auxiliary revenue increased due to the opening of the Gray Fossil Site Museum and the new dormitory, Governor's Hall.
- Other operating revenue increased as a result of increases in medical resident participation agreements and medical school clinic revenue.
- Noncapital state appropriations increased by $6.9 million from 2007 to 2008.
- Nonoperating gifts increased due to increases in transfers from the ETSU Foundation, including a transfer of $1.5 million for the College of Pharmacy.

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the foundation's operating activities for the years ended June 30, 2008, and June 30, 2007. Amounts are presented in thousands of dollars.

Revenues by Source - Foundation



Comparison of fiscal year 2008 to fiscal year 2007

- The increase in gifts and contributions from 2007 to 2008 is a result of increased giving to the College of Pharmacy, an increase in in-kind gifts, and one-time giving for Nursing Loans and a new cancer center.

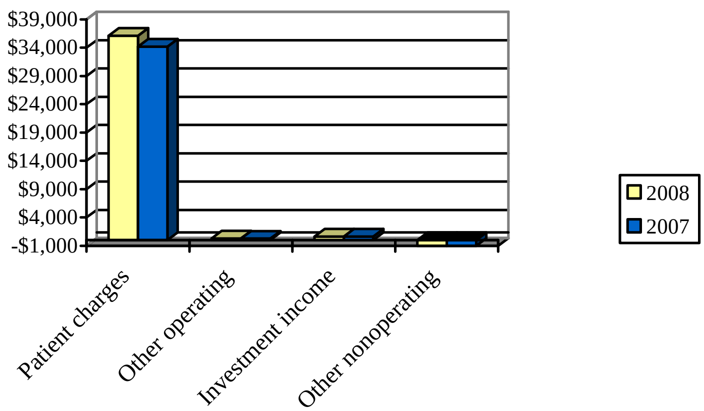
- Investment income decreased from 2007 to 2008 due to large unrealized losses due to market fluctuations.

- Additions to permanent endowments decreased due to a large gift received from the estate of James H. Quillen during 2007.

- Capital grants and gifts decreased from 2007 to 2008 due to one time gifts received in 2007 for the Alumni Walkway.

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the MEAC's operating activities for the years ended June 30, 2008, and June 30, 2007. Amounts are presented in thousands of dollars.

Revenues by Source - MEAC



Comparison of fiscal year 2008 to fiscal year 2007

- Net operating revenues increased 5% in fiscal year 2008. Patient service revenue increased in 2008 primarily due to increased productivity.
- Interest income remained consistent with prior year and only increased 2.6%.

Expenses

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

University
Natural Classification

	2008	2007
Salaries	$ 139,114	$ 129,142
Benefits	48,246	40,209
Other operating	55,911	48,190
Scholarships	18,936	17,783
Depreciation	10,747	9,226
Total expenses	**$ 272,954**	**$ 244,550**

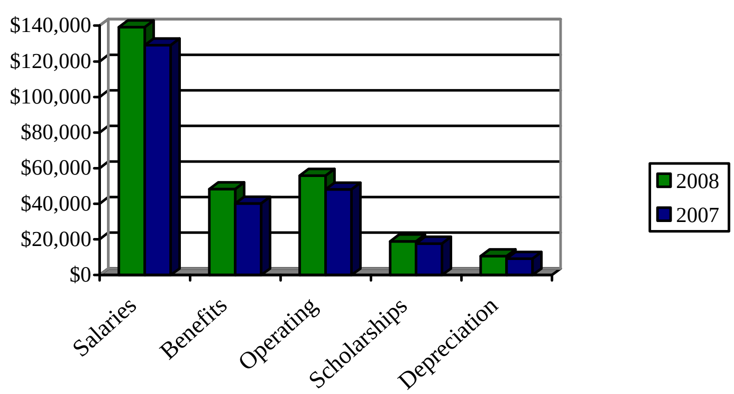
Foundation
Natural Classification

	2008	2007
Other operating	$ 1,979	$ 2,110
Scholarships	977	805
Depreciation	3	3
Payments to or on behalf of ETSU	4,118	2,068
Total expenses	**$7,077**	**$4,986**

MEAC
Natural Classification

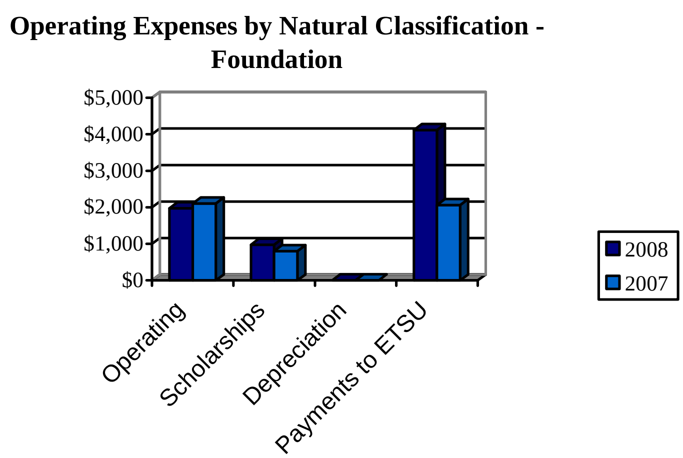
	2008	2007
Salaries	$21,701	$20,778
Benefits	1,881	1,810
Other operating	9,286	8,990
Depreciation	250	224
Total expenses	**$33,118**	**$31,802**

Operating Expenses by Natural Classification - University



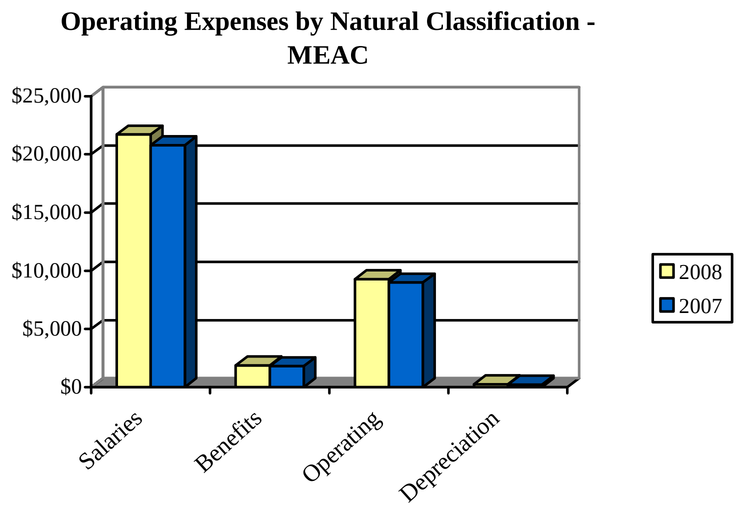
Comparison of fiscal year 2008 to fiscal year 2007

- Salaries increased due to a 3% across-the-board pay raise, equity pay adjustments, and an ETSU bonus paid in the fall.
- Benefits increased as a result of increases in the state health insurance premiums and the recognition of other post employment benefits.
- Other operating expenses increased slightly, primarily due to increases in energy and fuel costs for utilities and travel.
- Scholarships increased along with increased enrollment.
- Depreciation expense increased from 2007 to 2008 with the capitalization of the new dormitory, the natural history museum, and the College of Pharmacy building.



Comparison of fiscal year 2008 to fiscal year 2007

- Payments to or on behalf of ETSU increased due to payments made on behalf of the College of Pharmacy as it began its second year of operation, special gifts given for Nursing Loans and a new cancer center, an increase in gifts in-kind transferred to the university, and an increase in the payout rate on endowments.



<u>Comparison of fiscal year 2008 to fiscal year 2007</u>

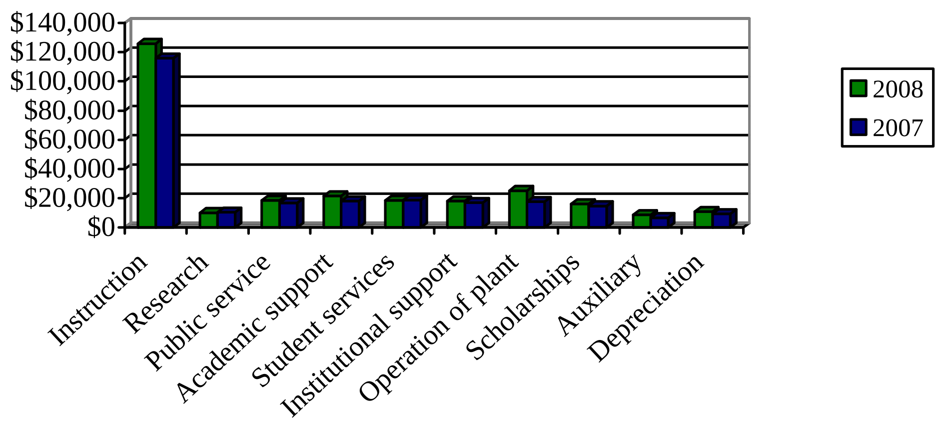
- In fiscal year 2008, physician compensation increased 4% over the prior year. As a result of increased staffing and salary increases, non-physician compensation also increased 5% in 2008.

- Supplies expense increased steadily in 2008, while expenses for malpractice insurance and purchased services remained consistent with the prior year.

University
Program Classification
(in thousands of dollars)

	2008	2007
Instruction	$125,784	$115,796
Research	10,037	10,364
Public service	18,466	16,805
Academic support	21,500	18,001
Student services	18,547	18,661
Institutional support	17,984	16,925
Operation and maintenance of plant	25,193	17,558
Scholarships	16,072	14,629
Auxiliary	8,624	6,585
Depreciation	10,747	9,226
Total expenses	**$272,954**	**$244,550**

Operating Expenses by Program Classification - University



Comparison of fiscal year 2008 to fiscal year 2007

- Instruction is the largest expenditure area for the university. Increases in instruction were due in part to the 3% across-the-board pay raise, equity pay adjustments, and a bonus paid in the fall of 2007.

- Academic support increased with increases in library database access costs and increased salaries.

- Increases in operation of plant are due to increased energy costs, increases in group insurance expenses, and increased wages.

- Increases in auxiliary expenses are a result of the operation of the Natural History Museum at the Gray Fossil Site.

- Depreciation expense increased from 2007 to 2008 with the capitalization of the new dormitory, the natural history museum, and the College of Pharmacy building.

- Expenditures in other areas did not change materially from 2007 to 2008.

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.

University
Condensed Statements of Cash Flows
(in thousands of dollars)

	2008	2007
Cash provided (used) by		
Operating activities	$(123,718)	$(128,071)
Noncapital financing activities	138,735	126,010
Capital and related financing activities	(7,624)	(6,681)
Investing activities	17,032	7,491
Net increase (decrease) in cash	**24,425**	**(1,251)**
Cash, beginning of year	34,233	35,484
Cash, end of year	**$58,658**	**$34,233**

Comparison of fiscal year 2008 to fiscal year 2007

- The cash position of the university increased by $24,425,000 during the fiscal year ended June 30, 2008, primarily due to the reduction in bond investments which caused a corresponding increase in cash.
- In 2008, cash used by operating activities reflected increases in expenditures for scholarships, salaries, and benefits.
- During 2008, noncapital financing sources increased due to increases in state appropriations, federal student loan receipts, and gifts from the ETSU Foundation.
- Capital financing activities increased from 2007 to 2008 due to increases in debt resulting from capital construction projects.

Capital Assets and Debt Administration

Capital Assets

The university had $225.1 million in capital assets, net of accumulated depreciation at June 30, 2008, and $201.8 million in capital assets, net of accumulated depreciation at June 30, 2007. Depreciation charges totaled $10.7 million and $9.2 million for the years ended June 30, 2008, and June 30, 2007, respectively. Details of these assets are shown below and in Note 5.

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

	2008	2007
Land	$ 24,164	$ 23,844
Land improvements & infrastructure	17,390	14,550
Buildings	151,774	110,270
Equipment	9,642	8,090
Library holdings	4,934	5,559
Software	3,118	3,030
Projects in progress	14,106	36,537
Total capital assets, net	**$225,128**	**$201,880**

Comparison of fiscal year 2008 to fiscal year 2007

- In 2008, buildings increased from the capitalization of the new dormitory, Governor's Hall, the Gray Fossil Site Museum, and the College of Pharmacy building. Construction in progress continues for a new dormitory which will be occupied in fall 2009. Software increased along with the implementation of the new administrative system.

The foundation had $588 thousand in capital assets, net of accumulated depreciation at June 30, 2008, and $378 thousand in capital assets, net of accumulated depreciation at June 30, 2007. Depreciation charges totaled $3 thousand and $3 thousand for the years ended June 30, 2008, and June 30, 2007, respectively. Details of these assets are shown below and in Note 18.

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

	2008	2007
Land	$ 49	$ 49
Buildings	243	246
Equipment	9	9
Projects in progress	287	74
Total capital assets, net	**$588**	**$378**

Comparison of fiscal year 2008 to fiscal year 2007

- Projects in progress increased due to construction of the new Alumni Walkway. When completed in 2009, it will be transferred to the university.

MEAC had $2,335,928 in capital assets, net of accumulated depreciation at June 30, 2008, and $723 thousand in capital assets, net of accumulated depreciation at June 30, 2007. Depreciation charges totaled $250 thousand and $224 thousand for the years ended June 30, 2008, and June 30, 2007, respectively. Details of these assets are shown below and in Note 18.

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

	2008	2007
Land	$18	$18
Buildings and leasehold improvements	1,836	172
Equipment	482	533
Total capital assets, net	**$2,336**	**$723**

Comparison of fiscal year 2008 to fiscal year 2007

- In 2008, net investment in capital assets increased due to the purchase of the second floor of a building in Kingsport for $1,675,960 in September 2007.

Debt

The university had $84 million and $62 million in debt outstanding at June 30, 2008, and June 30, 2007, respectively. The table below summarizes these amounts by type of debt instrument.

University
Outstanding Debt Schedule
(in thousands of dollars)

	2008	2007
Commercial paper	$19,298	$29,059
Notes	200	250
Loans	1,689	1,820
Bonds	62,572	31,274
Total debt	**$83,759**	**$62,403**

Comparison of fiscal year 2008 to fiscal year 2007

- In 2008, bonds increased related to the new dormitory, housing renovations, the student center renovations, and the new soccer facility.

The Tennessee State School Bond Authority (TSSBA) must authorize all capital long-term debt on behalf of the university. TSSBA currently is rated as AA by Standard & Poor. More detailed information about the university's long-term liabilities is presented in Note 7 to the financial statements.

Economic Factors That Will Affect the Future

As with many states, the economic outlook for the State of Tennessee does not look good. During fiscal year 2008, the state experienced a large decrease in state tax collections. As a result, the appropriations for higher education for fiscal year 2009 were reduced by 5%. For the university, this resulted in a reduction of 5.7% for the General Academic Campus and a 2% reduction for the College of Medicine and Family Medicine units. Despite the reduction, the Tennessee Board of Regents limited the fee increase to 6% resulting in a reduction of operating funds for the university. In addition, employees received no salary increases for fiscal year 2009. If state revenues continue to decline or do not improve, it is possible the university will be facing future impoundment of funds and/or further reductions in appropriations.

We are not aware of any other factors, decisions, or conditions that are expected to have a significant impact on the financial position or results of operations during the fiscal year.

Requests for Information

This financial report is designed to provide a general overview of the university'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 information should be directed to Dr. David Collins, Vice President for Finance and Administration, P. O. Box 70601, Johnson City, TN 37614.

Exhibit A

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF NET ASSETS
JUNE 30, 2008

		Component Units	
	East Tennessee State University	East Tennessee State University Foundation	Medical Education Assistance Corporation
ASSETS			
Current assets:			
Cash and cash equivalents (Notes 2, 3, and 18)	$ 31,705,881.74	$ 392,700.07	$ 8,355,927.00
Short-term investments (Note 18)	-	-	6,000,000.00
Accounts, notes, and grants receivable (net) (Note 4)	19,139,024.37	5,395.83	4,201,376.00
Pledges receivable (net) (Note 18)	-	42,747.12	-
Inventories	470,039.38	-	-
Prepaid expenses and deferred charges	402,111.23	-	395,325.00
Accrued interest receivable	426,147.39	-	-
Other assets	12,531.70	-	-
Total current assets	52,155,735.81	440,843.02	18,952,628.00
Noncurrent assets:			
Cash and cash equivalents (Notes 2, 3, and 18)	26,951,921.58	3,259,244.82	-
Investments (Notes 3 and 18)	14,033,396.00	59,124,061.16	1,000,000.00
Accounts, notes, and grants receivable (net) (Note 4)	8,026,676.22	-	217,946.00
Pledges receivable (net) (Note 18)	-	3,776,836.93	-
Capital assets (net) (Notes 5 and 18)	225,128,347.42	588,519.38	2,335,928.00
Other assets	-	709,313.10	-
Total noncurrent assets	274,140,341.22	67,457,975.39	3,553,874.00
Total assets	326,296,077.03	67,898,818.41	22,506,502.00
LIABILITIES			
Current liabilities:			
Accounts payable	5,648,418.07	162,533.02	611,306.00
Accrued liabilities	4,135,330.10	-	2,914,864.00
Student deposits	651,639.70	-	-
Deferred revenue	9,279,284.34	-	64,928.00
Compensated absences (Notes 7 and 18)	2,612,467.62	-	108,913.00
Accrued interest payable	599,235.02	-	-
Long-term liabilities, current portion (Notes 7 and 18)	2,615,791.93	-	28,384.00
Deposits held in custody for others	1,833,099.83	-	279,756.00
Other liabilities	-	-	710,616.00
Total current liabilities	27,375,266.61	162,533.02	4,718,767.00
Noncurrent liabilities:			
Compensated absences (Notes 7 and 18)	7,780,840.22	-	435,652.00
Long-term liabilities (Notes 7 and 18)	81,143,681.44	-	1,628,805.00
Due to grantors (Note 7)	7,440,376.64	-	-
Net OPEB obligation (Notes 7 and 11)	3,454,735.00	-	-
Total noncurrent liabilities	99,819,633.30	-	2,064,457.00
Total liabilities	127,194,899.91	162,533.02	6,783,224.00
NET ASSETS			
Invested in capital assets, net of related debt	141,368,874.05	588,519.38	678,739.00
Restricted for:			
Nonexpendable:			
Scholarships and fellowships	39,930.08	43,000,113.96	-
Research	-	685,620.41	-
Instructional department uses	-	5,556,993.42	-
Other	-	3,589,844.85	-
Expendable:			
Scholarships and fellowships	397,338.90	1,839,489.57	-
Research	205,009.23	937,543.28	-
Instructional department uses	371,686.64	2,111,097.55	-
Loans	1,905,574.55	-	-
Capital projects	-	412,399.63	-
Debt service	2,095,479.94	-	-
Other	1,825,110.45	7,874,180.35	-
Unrestricted (Note 9)	50,892,173.28	1,140,482.99	15,044,539.00
Total net assets	$ 199,101,177.12	$ 67,736,285.39	$ 15,723,278.00

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

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2008

		Component Units	
	East Tennessee State University	East Tennessee State University Foundation	Medical Education Assistance Corporation
REVENUES			
Operating revenues:			
Student tuition and fees (net of scholarship allowances of $24,402,408.28)	$ 54,092,955.90	$ -	$ -
Gifts and contributions	-	4,462,368.48	-
Endowment income per spending plan	-	1,978,364.40	-
Governmental grants and contracts	26,206,407.27	-	-
Nongovernmental grants and contracts	11,366,580.19	-	-
Sales and services of educational departments	21,706,138.72	-	-
Patient charges	-	-	36,133,694.00
Auxiliary enterprises:			
Residential life (net of scholarship allowances of $105,852.12; all residential life revenues are used as security for revenue bonds; see Note 7)	8,699,434.70	-	-
Bookstore	499,999.97	-	-
Food service	485,553.85	-	-
Wellness facility (all revenues are used as security for revenue bonds; see Note 7)	1,029,735.81	-	-
Other auxiliaries	1,618,390.87	-	-
Interest earned on loans to students	142,324.73	-	-
Other operating revenues	1,141,487.37	525,758.77	319,407.00
Total operating revenues	126,989,009.38	6,966,491.65	36,453,101.00
EXPENSES			
Operating expenses (Note 15):			
Salaries and wages	139,113,759.37	-	21,700,987.00
Benefits	48,246,060.43	-	1,881,330.00
Utilities, supplies, and other services	55,911,152.14	1,978,731.31	9,285,763.00
Scholarships and fellowships	18,936,479.52	977,415.94	-
Depreciation expense	10,746,802.28	2,950.00	249,992.00
Payments to or on behalf of East Tennessee State University (Note 18)	-	4,117,804.14	-
Total operating expenses	272,954,253.74	7,076,901.39	33,118,072.00
Operating income (loss)	(145,965,244.36)	(110,409.74)	3,335,029.00
NONOPERATING REVENUES (EXPENSES)			
State appropriations	98,619,077.00	-	-
Gifts (university gifts include $3,011,029.08 from ETSU Foundation and $1,434,372.00 from MEAC)	4,466,755.60	827,484.00	-
Grants and contracts	35,498,004.96	-	-
Investment income (for the component units, net of investment expense of $118,205.00)	3,964,857.98	(2,473,672.10)	652,704.00
Interest on capital asset-related debt	(3,055,394.02)	-	-
Payments to or on behalf of East Tennessee State University or East Tennessee State University Foundation (Note 18)	-	-	(2,261,856.00)
Other nonoperating revenues (expenses)	(586,040.40)	-	(98,034.00)
Net nonoperating revenues (expenses)	138,907,261.12	(1,646,188.10)	(1,707,186.00)
Income (loss) before other revenues, expenses, gains, or losses	(7,057,983.24)	(1,756,597.84)	1,627,843.00
Capital appropriations	5,999,408.45	-	-
Capital gifts and grants (university gifts include $1,106,775.06 from ETSU Foundation)	2,225,838.27	42,768.42	-
Additions to permanent endowments	-	1,266,434.90	-
Total other revenues	8,225,246.72	1,309,203.32	-
Increase (decrease) in net assets	1,167,263.48	(447,394.52)	1,627,843.00
NET ASSETS			
Net assets - beginning of year	197,933,913.64	68,183,679.91	14,095,435.00
Net assets - end of year	$ 199,101,177.12	$ 67,736,285.39	$ 15,723,278.00

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

Exhibit C

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2008

CASH FLOWS FROM OPERATING ACTIVITIES	
Tuition and fees	$ 55,930,417.18
Grants and contracts	41,069,413.69
Sales and services of educational activities	21,619,549.60
Payments to suppliers and vendors	(55,541,641.02)
Payments to employees	(138,061,005.06)
Payments for benefits	(44,549,970.37)
Payments for scholarships and fellowships	(18,843,361.23)
Loans issued to students and employees	(907,871.02)
Collection of loans from students and employees	1,783,310.26
Interest earned on loans to students	183,556.62
Auxiliary enterprise charges:	
Residence halls	8,784,841.76
Bookstore	496,667.23
Food services	481,535.39
Wellness facility	1,029,735.81
Other auxiliaries	1,627,742.17
Other receipts	1,178,787.42
Net cash used by operating activities	(123,718,291.57)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State appropriations	98,561,300.00
Gifts and grants received for other than capital or endowment purposes	39,720,603.05
Federal student loan receipts	55,816,481.14
Federal student loan disbursements	(55,302,561.80)
Changes in deposits held for others	(60,315.27)
Net cash provided by noncapital financing activities	138,735,507.12
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Proceeds from capital debt	55,777,656.02
Capital appropriations	5,999,408.45
Capital grants and gifts received	1,119,063.21
Purchases of capital assets and construction	(33,508,861.56)
Principal paid on capital debt and leases	(34,421,586.28)
Interest paid on capital debt and leases	(2,908,530.86)
Bond issue costs paid on new debt issue	317,811.12
Other capital and related payments	1,060.00
Net cash used by capital and related financing activities	(7,623,979.90)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sales and maturities of investments	30,807,038.46
Income on investments	4,022,224.64
Purchase of investments	(17,797,345.00)
Net cash provided by investing activities	17,031,918.10
Net increase in cash and cash equivalents	24,425,153.75
Cash - beginning of year	34,232,649.57
Cash - end of year	$ 58,657,803.32

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2008

Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(145,965,244.36)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense		10,746,802.28
Change in assets and liabilities:		
Receivables, net		3,994,349.77
Inventories		(5,579.69)
Prepaid expenses and deferred charges		152,517.74
Other assets		40,831.89
Accounts payable		442,980.37
Accrued liabilities		3,795,865.14
Deferred revenue		1,086,395.99
Deposits		142,810.42
Compensated absences		937,239.59
Due to grantors		37,300.05
Loans to students and employees		875,439.24
Net cash used by operating activities	$	(123,718,291.57)
Noncash transactions		
Gifts in-kind	$	244,157.51
Gifts of capital assets	$	1,106,755.06
Unrealized gains on investments	$	183,971.07
Loss on disposal of capital assets	$	(660,754.01)

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 East Tennessee State University Foundation and the Medical Education Assistance Corporation are considered component units of the university. Although the university does not control the timing or amount of receipts from these organizations, the majority of resources, or income thereon, that these organizations hold and invest are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation and the corporation can only be used by, or for the benefit of, the university, these organizations are considered component units of the university and are discretely presented in the university's financial statements. See Note 18 for more detailed information about the component units and how to obtain their reports.

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.

Inventories

Inventories are valued at the lower of cost or market. Items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

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

Capital Assets

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

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

These assets, with the exception of land, are depreciated 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 discount 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 students' 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, 2008, cash consists of $6,619,926.99 in bank accounts, $48,000.00 of petty cash on hand, $46,340,319.38 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, $5,640,856.95 in LGIP deposits for capital projects, and $8,700.00 held by the State Treasurer for the benefit of the university.

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

NOTE 3. INVESTMENTS

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.

As of June 30, 2008, the university had the following investments and maturities.

		Investment Maturities (in Years)	
Investment Type	Fair Value	Less than 1	1 to 5
U. S. agency obligations	$14,033,396.00	$1,996,880.00	$12,036,516.00

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. TBR policy restricts investments in banker's acceptances and commercial paper. The policy requires that prime banker's acceptances 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 rating 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 the 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, 2008, the university's investments were rated as follows:

Investment Type	Fair Value	Credit Quality Rating AAA	Credit Quality Rating Unrated
LGIP	$51,981,176.33	$ -	$51,981,176.33
U. S. agency obligations	14,033,396.00	14,033,396.00	-
Total	$66,014,572.33	$14,033,396.00	$51,981,176.33

Concentration of credit risk - The Tennessee Board of Regents (TBR) policy restricts investments in banker's acceptances, commercial paper, and money market mutual funds. The policy limits banker's acceptances to not exceed 20% of total investments on the date of acquisition and limits the combined amount of banker's acceptances and commercial paper to not exceed 35% of total investments at the date of acquisition. Additionally, no more than 5% of total investments at the date of acquisition may be invested in the commercial paper of a single issuer. The policy further limits the total holdings of an issuer's commercial paper to not more than 2% of the issuing corporation's total outstanding commercial paper. TBR policy limits investments in money market mutual funds to not exceed 10% of total investments on the date of acquisition. More than 5% of the university's investments were invested in the following single issuers:

Issuer	Percentage of Total Investments June 30, 2008
Federal Home Loan Mortgage Corporation (FHLM) obligations	14.3%
Federal Home Loan Banks (FHLB) obligations	85.7%

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2008
Student accounts receivable	$ 5,346,823.41
Grants receivable	10,193,831.39
Notes receivable	894,536.74
State appropriation receivable	266,977.00
Other receivables	5,119,183.37
Subtotal	21,821,351.91
Less allowance for doubtful accounts	1,876,613.22
Total receivables	$19,944,738.69

Federal Perkins Loan Program funds included the following:

	June 30, 2008
Perkins loans receivable	$8,693,934.90
Less allowance for doubtful accounts	1,472,973.00
Total	$7,220,961.90

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2008, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 23,843,741.53	$ 319,861.60	$ -	$ -	$ 24,163,603.13
Land improvements and infrastructure	23,708,698.78	-	3,929,003.19	-	27,637,701.97
Buildings	201,640,954.16	-	48,157,379.83	1,905,262.11	247,893,071.88
Equipment	28,690,928.69	3,539,071.59	-	3,011,736.58	29,218,263.70
Library holdings	13,004,300.36	704,272.37	-	1,837,467.47	11,871,105.26

Software	3,640,215.15	437,427.67	-	-	4,077,642.82
Projects in progress	36,537,024.96	29,655,388.44	(52,086,383.02)	-	14,106,030.38
Total	331,065,863.63	34,656,021.67	-	6,754,466.16	358,967,419.14
Less accum. depreciation:					
Land improvements and infrastructure	9,158,822.09	1,088,956.20	-	-	10,247,778.29
Buildings	91,370,941.06	6,140,530.14	-	1,393,028.19	96,118,443.01
Equipment	20,600,746.03	1,838,965.72	-	2,863,216.49	19,576,495.26
Library holdings	7,445,596.61	1,328,449.45	-	1,837,467.47	6,936,578.59
Software	609,875.80	349,900.77	-	-	959,776.57
Total accum. depreciation	129,185,981.59	10,746,802.28	-	6,093,712.15	133,839,071.72
Capital assets, net	$201,879,882.04	$23,909,219.39	$ -	$ 660,754.01	$225,128,347.42

NOTE 6. CAPITAL LEASES

The university has entered into an Enhanced Use Lease Agreement with the United States Department of Veterans Affairs for certain real property, including land and several buildings, at the Veterans Affairs Medical Center in Johnson City, Tennessee. The lease is for a period of 35 years. In lieu of lease payments, the university has assumed responsibility for all capital and recurring costs of maintaining the property covered by the agreement.

In conjunction with the lease, the university entered into a memorandum of agreement with the Department of Veterans Affairs to construct a new building (the Basic Science Building) with joint funding from the State of Tennessee and the federal government. In accordance with the memorandum of agreement, the state provided $18 million to the federal government for its share of the total construction costs ($34,195,153.41). The Basic Science Building is also included under the provisions of the Enhanced Use Lease Agreement.

The university is renovating several other buildings on the VA campus as funds become available. During the 2008 fiscal year, the university completed renovation on Building 7 to be used by the College of Pharmacy. The cumulative capitalized cost of this renovation was $6,033,952.91.

The university's leasing of the Basic Science Building and the other buildings on the VA campus will constitute a capital lease agreement. The lease term is substantially equal to the estimated useful life of the leased property. Accordingly, the university has capitalized the cost of the buildings at $47,634,934.51. At June 30, 2008, the buildings are reported at $39,478,973.41, net of accumulated depreciation of $8,155,961.10.

NOTE 7. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2008, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Note	$ 249,999.88	$ -	$ 50,000.04	$ 199,999.84	$ 50,000.00
Loan	1,819,951.24	-	130,793.19	1,689,158.05	140,144.91
TSSBA debt:					
Bonds	31,273,810.13	33,026,532.10	1,727,870.68	62,572,471.55	2,425,647.02
Commercial paper	29,059,642.38	22,751,123.92	32,512,922.37	19,297,843.93	-
Subtotal	62,403,403.63	55,777,656.02	34,421,586.28	83,759,473.37	2,615,791.93
Other liabilities:					
Compensated absences	9,456,068.25	6,120,691.69	5,183,452.10	10,393,307.84	2,612,467.62
Due to grantor	7,403,076.59	37,300.05	-	7,440,376.64	-
Net OPEB obligation	-	3,454,735.00	-	3,454,735.00	-
Subtotal	16,859,144.84	9,612,726.74	5,183,452.10	21,288,419.48	2,612,467.62
Total long-term liabilities	$79,262,548.47	$65,390,382.76	$39,605,038.38	$105,047,892.85	$5,228,259.55

Note Payable

The Tennessee Board of Regents, on behalf of the university, borrowed funds for the renovation of the Memorial Athletic Medical Center ("BucSports"). The note bears an annually adjusted interest rate equal to the average Local Government Investment Pool rate for the previous year, a face amount of $500,000.00, a minimum annual debt service of $50,000.00 plus interest with payments due annually to 2012. The balance owed by the university was $199,999.84 at June 30, 2008.

Debt service requirements to maturity for the note payable at June 30, 2008, are as follows:

Year Ending June 30	Principal	Interest	Total
2009	$ 50,000.00	$10,000.00	$ 60,000.00
2010	50,000.00	7,500.00	57,500.00
2011	50,000.00	5,000.00	55,000.00
2012	49,999.84	2,500.00	52,499.84
	$199,999.84	$25,000.00	$224,999.84

Loan Payable

The Tennessee General Assembly earmarked in Section 41, Item 41 of Chapter 563 of the Public Acts of 1989 the amount of $3,000,000 from the funds appropriated in Section 1, Title 111-25 of Chapter 563 of the Public Acts of 1989 for the East Tennessee State University Clinical Education Facility. These funds were intended to be an interest-bearing loan from the General Fund to the Tennessee Board of Regents on behalf of East Tennessee State University. The loan bears an interest rate of 7.15%, has a principal amount of $3,000,000.00, a minimum annual debt service of $260,919.73 and a due date of January 1, 2017. The balance owed by the university was $1,689,158.05 at June 30, 2008.

Debt service requirements to maturity for the loan payable at June 30, 2008, are as follows:

Year Ending June 30	Principal	Interest	Total
2009	$ 140,144.91	$120,774.82	$ 260,919.73
2010	150,165.27	110,754.46	260,919.73
2011	160,902.09	100,017.64	260,919.73
2012	172,406.59	88,513.14	260,919.73
2013	184,733.66	76,186.07	260,919.73
2014 - 2018	880,805.53	162,873.20	1,043,678.73
	$1,689,158.05	$659,119.33	$2,348,277.38

TSSBA Debt - Bonds

Bonds, with interest rates ranging from 3.0% to 5.125%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially until 2037 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 $21,941.24 at June 30, 2008. There were no unexpended debt proceeds at June 30, 2008.

Debt service requirements to maturity for the university's portion of TSSBA bonds at June 30, 2008, are as follows:

Year Ending June 30	Principal	Interest	Total
2009	$ 2,425,647.02	$ 2,746,368.88	$ 5,172,015.90
2010	2,526,748.80	2,649,763.46	5,176,512.26
2011	2,189,740.83	2,546,495.61	4,736,236.44
2012	2,281,906.39	2,458,237.24	4,740,143.63
2013	2,274,537.86	2,373,166.45	4,647,704.31
2014-2018	12,143,463.60	10,370,544.80	22,514,008.40
2019-2023	13,829,882.98	7,548,499.04	21,378,382.02
2024-2028	11,716,188.86	4,566,794.96	16,282,983.82
2029-2033	8,478,376.23	2,250,089.91	10,728,466.14
2034-2037	4,705,978.98	528,611.23	5,234,590.21
	$62,572,471.55	$38,038,571.58	$100,611,043.13

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 $19,297,843.93 at June 30, 2008.

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 37243-1402, or by calling (615) 401-7872.

NOTE 8. ENDOWMENTS

If a donor has not provided specific instructions to the university, state law permits the university to authorize for expenditure the earnings of the investments of endowment funds. When administering its power to spend these earnings, 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 earnings spent are 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 each year. Under the spending plan established by the university, the total income 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.

The university's endowment and quasi-endowment assets are invested to produce only interest income. For the fiscal year ended June 30, 2008, the university's endowments and quasi-endowments earned interest income totaling $435,055.60. The university retained $312,627.52 for expenditure in future years, of which $204.50 is restricted to specific purposes.

NOTE 9. UNRESTRICTED NET ASSETS

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

	June 30, 2008
Working capital	$ 6,022,158.51
Encumbrances	2,107,856.71
Designated fees	1,816,207.45
Auxiliaries	705,732.56
Quasi-endowment	10,878,481.78
Plant construction	16,386,593.60
Renewal and replacement of equipment	9,565,255.46
Debt retirement	1,142,178.43
Unreserved/undesignated	2,267,708.78
Total	$50,892,173.28

NOTE 10. PENSION PLANS

A. Defined Benefit Plan

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 13.62% 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, 2008, 2007, and 2006, were $6,372,126.18, $6,067,796.51, and $3,989,407.94. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

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

Funding Policy - Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans was $6,819,497.22 for the year ended June 30, 2008, and $6,316,304.76 for the year ended June 30, 2007. Contributions met the requirements for each year.

NOTE 11. OTHER POST-EMPLOYMENT BENEFITS

Healthcare is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program that provides postemployment health insurance benefits to eligible university retirees. This program includes two plans available to higher education employees - the State Employee Group Plan and the Medicare Supplement Plan. Both plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by *Tennessee Code Annotated* (TCA) Section 8-27-101. Prior to reaching age 65, all members have the option of choosing a preferred provider organization (PPO), point of service (POS), or health maintenance organization (HMO) plan for healthcare benefits. Subsequent to age 65, members who are also in the state's retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. The plans are reported in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at http://tennessee.gov/finance/act/cafr.html.

Funding Policy - The premium requirements of plan members are established and may be amended by the insurance committee. The plans are self-insured and financed on a pay-as-you-go basis with the risk shared equally among the participants. Claims liabilities of the plan are periodically computed using actuarial and statistical techniques to establish premium rates. In accordance with TCA 8-27-205(b), retirees not eligible for Medicare pay a percentage of the total state premium under the state plan based on years of service, leaving a portion of retiree premiums effectively subsidized by contributions to the state plan for active employees. Retirees with 30 years of service pay 20% of the total premium under the state plan. Retirees with 20 but less than 30 years of service pay 30% of the total premium under the state plan. Retirees 55 and older with less than 20 but more than 10 years of service pay 40% of the total premium under the state plan. Contributions for the state plan for the year ended June 30, 2008, were $20,515,030.60 which consisted of $16,898,673.16 from the university and $3,616,357.44 from the employees.

Annual OPEB Cost and Net OPEB Obligation

	State Plan
Annual required contribution (ARC)	$5,295,000.00
Interest on the net OPEB obligation	-
Adjustment to the ARC	-
Annual OPEB cost	5,295,000.00

Amount of contribution	(1,840,265.00)
Increase/decrease in net OPEB obligation	3,454,735.00
Net OPEB obligation – beginning of year	-
New OPEB obligation – end of year	$ 3,454,735.00

Year-End	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-End
June 30, 2008	State Plan	$5,295,000.00	34.8%	$3,454,735.00

Funded Status and Funding Progress - The funded status of the plan as of June 30, 2008, was as follows:

	State Plan
Actuarial valuation date	July 1, 2007
Actuarial accrued liability (AAL)	$47,831,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$47,831,000.00
Actuarial value of assets as a % of the AAL	0%
Covered payroll (active plan members)	$97,727,873.49
UAAL as percentage of covered payroll	48.9%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress, presented as RSI following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions - Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. Actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

In the July 1, 2007, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4.5% investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 7% initially, increased to 11% in the second year, and then reduced by decrements to an ultimate rate of 5% after twelve years. Both rates include a 3% inflation assumption. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007.

NOTE 12. 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 amounts of settlements have not exceeded insurance coverage for each of the past three fiscal years. 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, 2008, and June 30, 2007, 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 Rosa L. Parks Avenue, Nashville, Tennessee 37243-1102, 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, 2008, the Risk Management Fund held $123.9 million in cash and cash equivalents designated for payment of claims.

At June 30, 2008, the scheduled coverage for the university was $625,424,900 for buildings and $157,007,100 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 13. COMMITMENTS AND CONTINGENCIES

<u>Sick Leave</u> - 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 $45,012,847.00 at June 30, 2008.

<u>Operating Leases</u> - The university has entered into various operating leases for buildings. Such leases will probably continue to be required. Expenses under operating leases for real property were $448,669.93 for the year ended June 30, 2008. All operating leases are cancelable at the lessee's option.

<u>Construction in Progress</u> - At June 30, 2008, outstanding commitments under construction contracts totaled $39,906,214.71 for the Energy Performance Enhancements project, the Pharmacy College Renovation project, the Housing Renovations project, the Softball Field Construction project, the Main Campus Apartments Phase II project, the Cardiology Building project, the Brown Hall Structural

Repairs project, and various other projects, of which $1,662,767.36 will be funded by future state capital outlay appropriations.

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

NOTE 14. CHAIRS OF EXCELLENCE

The university had $21,430,214.37 on deposit at June 30, 2008, 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 these financial statements.

NOTE 15. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2008, are as follows:

Functional Classification	Natural Classification Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 83,516,272.96	$25,582,551.32	$14,811,061.97	$1,874,251.50	$ -	$125,784,137.75
Research	4,276,216.90	1,924,656.13	3,777,315.06	58,440.45	-	10,036,628.54
Public service	10,833,737.94	3,697,204.54	3,894,633.41	39,959.66	-	18,465,535.55
Academic support	12,525,836.16	4,706,222.44	3,987,702.12	280,200.45	-	21,499,961.17
Student services	8,463,898.13	3,241,831.78	5,426,622.41	1,415,035.84	-	18,547,388.16
Institutional support	11,942,358.97	5,028,529.65	869,536.11	144,019.04	-	17,984,443.77
Operation & maintenance of plant	6,010,092.22	3,546,799.20	15,636,294.68	-	-	25,193,186.10
Scholarships & fellowships	2,985.00	77.54	1,090,261.31	14,979,057.58	-	16,072,381.43
Auxiliary	1,542,361.09	518,187.83	6,417,725.07	145,515.00	-	8,623,788.99
Depreciation	-	-	-	-	10,746,802.28	10,746,802.28
Total	$139,113,759.37	$48,246,060.43	$55,911,152.14	$18,936,479.52	$10,746,802.28	$272,954,253.74

NOTE 16. AFFILIATED ENTITY NOT INCLUDED

The East Tennessee State University Research Foundation is a private, nonprofit foundation with the university as the sole beneficiary. The foundation's financial transactions are not included in the university's financial report. As reported in the Research Foundation's most recently audited financial report, at June 30, 2008, the assets of the Research Foundation totaled $1,094,517.25, liabilities were $718,861.32, and the net assets amounted to $375,955.93.

NOTE 17. ON-BEHALF PAYMENTS

During the year ended June 30, 2008, the State of Tennessee made payments of $138,424.24 on behalf of the university for retirees participating in the Medicare Supplement Plan. The Medicare Supplement Plan is a postemployment benefit healthcare plan and is discussed further in Note 11. The plan is reported in the State of Tennessee Comprehensive Annual Financial Report (CAFR). The CAFR is available on the state's website at http://tennessee.gov/finance/act/cafr.html.

NOTE 18. COMPONENT UNITS

East Tennessee State University Foundation

The East Tennessee State University Foundation is a legally separate, tax-exempt organization supporting East 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 30-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2008, the foundation made distributions of $4,117,804.14 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Dr. David D. Collins, Vice President for Finance and Administration, P. O. Box 70601, Johnson City, TN 37614.

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, 2008, cash and cash equivalents consisted of $139,359.99 in bank accounts, $3,070,537.48 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $442,047.42 in cash held by others.

As described above, the foundation has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The Pooled Investment Fund's investment policy and required risks disclosures are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Rosa L. Parks Avenue, Nashville, Tennessee 37242-1102, or by calling (615) 741-2140.

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

At June 30, 2008, 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. agency obligations	$ 2,010,820.00	$ -	$2,010,820.00	$ -	$ -	$ -
Bond mutual funds	13,105,653.19	1,149,952.00	4,439,395.00	5,558,192.19	1,958,114.00	-
Equity mutual funds	44,007,587.97	-	-	-	-	44,007,587.97
Total	$59,124,061.16	$1,149,952.00	$6,450,215.00	$5,558,192.19	$1,958,114.00	$44,007,587.97

Interest rate risk - Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt investment. In order to reduce its exposure to interest rate risk, the foundation will set limits regarding the weighted average maturity for each direct investment pool. In the case of U.S. federal securities, the weighted average of all investments should be less than three years.

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 policy is to limit all direct investments to securities with an investment rating of no less than Aaa as rated by Moody's and AAA as rated by Standard and Poor's.

At June 30, 2008, the foundation's investments were rated as follows:

		Credit Quality Rating				
Investment Type	Fair Value	AAA	AA	A	BBB or Less	Unrated
LGIP	$ 3,070,537.48	$ -	$ -	$ -	$ -	$ 3,070,537.48
U. S. agency obligations	2,010,820.00	2,010,820.00	-	-	-	-
Bond mutual funds	13,105,653.19	9,340,998.19	1,259,736.00	1,261,040.00	1,243,879.00	-
Total	$18,187,010.67	$11,351,818.19	$1,259,736.00	$ 1,261,040.00	$1,243,879.00	$ 3,070,537.48

Investments of the foundation's endowment and similar funds are composed of the following:

	Carrying Value June 30, 2008
LGIP	$ 444,834.62
U.S. agency obligations	2,010,820.00
Mutual funds	50,617,167.93
	$53,072,822.55

Assets of endowment funds are pooled on a fair value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of the calendar quarter within which the transaction takes place. Of the total units at June 30, 2008, each having a fair value of $1.1136779515, 47,787,622 units were owned by endowments, and 826,981 units were owned by quasi-endowments.

The following tabulations summarize changes in relationships between cost and fair values of the pooled assets:

FY 2008

	Pooled Assets		Net Gains	Fair Value
	Fair Value	Cost	(Losses)	Per Unit
End of year	$59,124,061.16	$59,173,674.99	$ (49,613.83)	$1.1136779515
Beginning of year	$52,354,642.80	$44,368,639.02	7,986,003.78	$1.1495561238
Unrealized net losses			(8,035,617.61)	
Realized net gains			5,561,504.18	
Total net losses			$ (2,474,113.43)	

The average annual earnings per unit, exclusive of net gains, were $.037 for the year ended June 30, 2008.

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

	June 30, 2008
Current pledges	$1,126,198
Pledges due in two to six years	2,668,500
Pledges due after six years	440,305
Subtotal	4,235,003
Less allowance for doubtful accounts	41,562
Subtotal	4,193,441
Less discounts to net present value	373,857
Total pledges receivable, net	$3,819,584

Capital assets - Capital asset activity for the year ended June 30, 2008, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land	$ 49,200.00	$ -	$ -	$ 49,200.00
Buildings	299,000.00	-	-	299,000.00
Equipment	9,486.00	-	-	9,486.00
Projects in progress	73,604.10	213,279.28	-	286,883.38
Total	431,290.10	213,279.28	-	644,569.38
Less accum. depreciation:				
Buildings	53,100.00	2,950.00	-	56,050.00
Total accum. depreciation	53,100.00	2,950.00	-	56,050.00
Capital assets, net	$378,190.10	$210,329.28	$ -	$588,519.38

Endowments - If a donor has not provided specific instructions to East Tennessee State University 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 that is 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, an amount equal to 2%, 3%, or 4%, depending on the amount of reserves, of a three year moving average of market values 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, 2008, net appreciation of $1,978,364.40 is available to be spent, of which $1,610,190.79 is included in restricted net assets expendable for scholarships and fellowships, $25,718.74 is included in restricted net assets expendable for research, $208,123.93 is included in restricted net assets expendable for instructional departmental uses, and $134,330.94 is included in restricted net assets expendable for other purposes.

Medical Education Assistance Corporation

Medical Education Assistance Corporation (MEAC) is a legally separate, tax-exempt organization supporting East Tennessee State University. MEAC acts primarily as a physicians' practice group to supplement the resources that are available to the university in support of its medical programs. The 15-member board of MEAC is self-perpetuating and consists of the departmental chairs from Quillen College of Medicine, a representative from East Tennessee State University's Business and Finance Department, a representative from the Tennessee Board of Regents, and at-large faculty from the Quillen College of Medicine. Although the university does not control the timing or amount of receipts from MEAC, the residual income that MEAC earns is restricted to supporting medical education. Because these restricted resources held by MEAC can only be used by, or for the benefit of, the university, MEAC is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2008, MEAC made distributions of $1,434,372.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for MEAC can be obtained from Russell Lewis, Executive Director, P.O. Box 699, Mountain Home, Tennessee 37684.

<u>Cash</u> - At June 30, 2008, cash consisted of $5,597,691.00 in bank accounts, $2,035.00 of petty cash on hand, and $2,756,201.00 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer.

At described above, the corporation has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The Pooled Investment Fund's investment policy and required risks disclosures are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Rosa L. Parks Avenue, Nashville, Tennessee 37242-1102, or by calling (615) 741-2140.

<u>Investments</u> - The corporation is authorized to invest funds in accordance with its board of directors' policies. The corporation's investments at June 30, 2008, consisted of certificates of deposit with original maturities greater than three months.

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. MEAC has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations. At June 30, 2008, MEAC had no rated investments, as deposits in LGIP are unrated.

Capital assets - Capital asset activity for the year ended June 30, 2008, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land	$ 18,150	$ -	$ -	$ 18,150
Leasehold improvements	307,564	-	-	307,564
Buildings	186,976	1,704,970	-	1,891,946
Equipment	2,857,584	157,834	122,167	2,893,251
Total	3,370,274	1,862,804	122,167	5,110,911
Less accumulated depreciation:				
Leasehold improvements	293,829	3,924	-	297,753
Buildings	28,580	37,069	-	65,649
Equipment	2,324,749	208,999	122,167	2,411,581
Total accumulated depreciation	2,647,158	249,992	122,167	2,774,983
Capital assets, net	$ 723,116	$1,612,812	$ -	$2,335,928

Long-term liabilities - Long-term liabilities activity for the year ended June 30, 2008, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Note payable	$ -	$1,675,960	$18,771	$1,657,189	$ 28,384
Compensated absences	545,203	-	638	544,565	108,913
Total long-term liabilities	$545,203	$1,675,960	$19,409	$2,201,754	$137,297

NOTE 19. CHANGE IN ACCOUNTING PRINCIPLE

The university has implemented the Governmental Accounting Standards Board's Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions*. This statement establishes standards for the measurement, recognition, and display of OPEB expense and related liabilities, note disclosures, and required supplementary information. The statement was implemented prospectively with a zero net OPEB obligation at transition.

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
REQUIRED SUPPLEMENTARY INFORMATION
OPEB SCHEDULE OF FUNDING PROGRESS
UNAUDITED

Actuarial Valuation Date	Plan	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
July 1, 2007	State Employee Group Plan	$ -	$ 47,831,000.00	$ 47,831,000.00	0%	$ 97,727,873.49	48.9%

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
SUPPLEMENTARY INFORMATION
SCHEDULE OF CASH FLOWS - EAST TENNESSEE STATE UNIVERSITY FOUNDATION
FOR THE YEAR ENDED JUNE 30, 2008

CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$	3,742,170.31
Endowment income per spending plan		1,978,364.40
Payments to suppliers and vendors		(1,730,861.94)
Payments for scholarships and fellowships		(878,515.94)
Payments to or on behalf of East Tennessee State University		(3,238,274.26)
Other receipts		525,758.77
Net cash provided by operating activities		398,641.34
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Gifts and grants received for other than capital or endowment purposes		827,484.00
Private gifts for endowment purposes		1,266,434.90
Net cash provided by noncapital financing activities		2,093,918.90
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital grants and gifts received		42,768.42
Purchases of capital assets and construction		(213,279.28)
Net cash used by capital and related financing activities		(170,510.86)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		37,956,838.10
Income on investments		5,599,384.69
Purchases of investments		(52,761,874.07)
Net cash used by investing activities		(9,205,651.28)
Net decrease in cash and cash equivalents		(6,883,601.90)
Cash and cash equivalents - beginning of year		10,535,546.79
Cash and cash equivalents - end of year	$	3,651,944.89
Reconciliation of operating loss to net cash provided by operating activities:		
Operating loss	$	(110,409.74)
Adjustments to reconcile operating loss to net cash provided by operating activities:		
Depreciation expense		2,950.00
Change in assets and liabilities:		
Receivables, net		449,828.76
Accounts payable		83,312.32
Deferred revenue		(27,040.00)
Net cash provided by operating activities	$	398,641.34
Noncash transactions		
Gifts in-kind	$	1,142,986.93
Unrealized losses on investments	$	(8,035,617.61)
Transfer of capital assets to ETSU	$	(901,319.29)

TENNESSEE BOARD OF REGENTS
EAST TENNESSEE STATE UNIVERSITY
SUPPLEMENTARY INFORMATION
SCHEDULE OF CASH FLOWS - MEDICAL EDUCATION ASSISTANCE CORPORATION
FOR THE YEAR ENDED JUNE 30, 2008

CASH FLOWS FROM OPERATING ACTIVITIES	
Collections from patient charges	$ 33,766,859.00
Payments to suppliers and vendors	(6,706,576.00)
Payments to employees	(21,765,340.00)
Payments for benefits	(1,881,330.00)
Other receipts	159,265.00
Net cash provided by operating activities	3,572,878.00
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Other noncapital financing payments	(2,261,856.00)
Net cash used by noncapital financing activities	(2,261,856.00)
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Proceeds from capital debt	1,675,960.00
Purchase of capital assets and construction	(1,862,803.00)
Principal paid on capital debt	(18,771.00)
Interest paid on capital debt	(98,484.00)
Net cash used by capital and related financing activities	(304,098.00)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sales and maturities of investments	1,000,000.00
Income on investments	652,704.00
Other investing receipts	48,424.00
Net cash provided by investing activities	1,701,128.00
Net increase in cash	2,708,052.00
Cash - beginning of year	5,647,875.00
Cash - end of year	$ 8,355,927.00
Reconciliation of operating income to net cash provided by operating activities:	
Operating income	$ 3,335,029.00
Adjustments to reconcile operating income to net cash provided by operating activities:	
Depreciation expense	249,992.00
Change in assets and liabilities:	
Receivables, net	(45,819.00)
Prepaid expenses and deferred charges	(187,049.00)
Accounts payable	(118,930.00)
Deferred revenues	(9,822.00)
Compensated absences	(64,352.00)
Other	413,829.00
Net cash provided by operating activities	$ 3,572,878.00