AUDIT REPORT

Tennessee Board of Regents
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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August 11, 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. Melvin N. Johnson, President
Tennessee State University
3500 John A. Merritt Boulevard
Nashville, Tennessee 37209

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, Tennessee State University, for the year ended June 30, 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 disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report. The university's administration has responded to the audit finding; the responses are included following the finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit finding.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/dlj
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State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

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

INTERNAL CONTROL FINDING

Neither the Associate Vice President of Business and Finance nor the Fiscal Accounts Manager for the Foundation Ensured That Amounts Were Properly Reported in the Financial Statements and Accompanying Notes to the Financial Statements, Which Resulted in Improper Reporting and Increased Risks of Possible Mismanagement of Funds
Top management of the university is responsible for the fair presentation of financial position in conformity with accounting principles generally accepted in the United States of America. However, neither the Associate Vice President of Finance and Accounting for Tennessee State University nor the Fiscal Accounts Manager for its foundation ensured that the financial statements and the accompanying notes to the financial statements were free of misstatement (page 9).

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

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

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

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

BACKGROUND

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

ORGANIZATION

The governance of Tennessee State University is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the 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. 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

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The university filed its report with the Department of Audit on December 11, 2008. A follow-up of all prior audit findings was conducted as part of the current audit.

RESOLVED AUDIT FINDINGS

The current audit disclosed that the university has corrected previous audit findings concerning timely bank reconciliations, procurement cards, and information system security.

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. A significant deficiency, along with a recommendation and management's response, is detailed in the Finding and Recommendation section. Consideration of internal control over financial reporting disclosed a material weakness.

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.

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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*

July 20, 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. Melvin N. Johnson, President
Tennessee State University
3500 John A. Merritt Boulevard
Nashville, Tennessee 37209

Ladies and Gentlemen:

We have audited the financial statements of Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the year ended June 30, 2008, and have issued our report thereon dated July 20, 2009. 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 as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the university's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the university's internal control over financial reporting.

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

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

The following significant deficiency was noted:

- Neither the Associate Vice President of Business and Finance nor the Fiscal Accounts Manager for the foundation ensured that amounts were properly reported in the financial statements and accompanying notes to the financial statements, which resulted in improper reporting and increased risks of possible mismanagement of funds

This deficiency is described in the Finding and Recommendation section of this report.

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

Our consideration of the internal control over financial reporting was for the limited purpose described in the first paragraph of this section and would not necessarily identify all deficiencies in the internal control that might be significant deficiencies and, accordingly, would not necessarily disclose all significant deficiencies that are also considered to be material weaknesses. However, we consider the significant deficiency described above to be a material weakness.

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

Compliance and Other Matters

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

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

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

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/dlj

FINDING AND RECOMMENDATION

<u>Neither the Associate Vice President of Business and Finance nor the Fiscal Accounts Manager for the foundation ensured that amounts were properly reported in the financial statements and accompanying notes to the financial statements, which resulted in improper reporting and increased risks of possible mismanagement of funds</u>

Finding

Top management of Tennessee State University (TSU) and its component unit, the Tennessee State University Foundation, are responsible for the fair presentation of financial position in conformity with accounting principles generally accepted in the United States of America. However, neither the Associate Vice President of Business and Finance for Tennessee State University nor the Fiscal Accounts Manager for its foundation ensured that the financial statements and the accompanying notes to the financial statements were free of misstatement. In addition, we noted that management's process to prepare financial reports contained a critical flaw which allowed the reporting errors to occur.

<u>Inadequate Supervisory Controls in the Financial Reporting Process</u>

Based on our review of the university's and the foundation's reporting processes, we found that inadequate supervisory controls over the reporting process allowed and exacerbated errors with financial reporting, particularly for the foundation. According to the Associate Vice President of Business and Finance, he is responsible for the university's accounting personnel and for the accounting and reporting processes related to financial statement preparation; he actually prepares the financial statements and note disclosures. The financial reporting process includes acquiring the foundation's financial information from the foundation's Fiscal Accounts Manager. However, the Associate Vice President has no supervisory control over any aspect of the foundation's operations or staff, yet he is held responsible for the accuracy and completeness of the foundation's financial statements. On June 30, 2008, the foundation's assets consisted of $34,346,897.90 in investments and associated cash. The foundation's Fiscal Accounts Manager, as in previous years, prepared a schedule at the end of the fiscal year summarizing investment transactions for the foundation's 12 brokerage accounts, and a listing of the types and amounts of investments held at year-end. Using this information, the Associate Vice President then prepared the foundation's statements and accompanying notes. Based on our review and testwork, however, we noted several reporting errors in the financial statements and notes caused by inaccurate investment information and related cash flows supplied by the foundation's Fiscal Accounts Manager. These reporting errors are discussed below.

<u>Transactions Misstated on the Foundation's Statement of Cash Flows</u>

Since the Fiscal Accounts Manager's schedule of investment activities is the primary supporting documentation for the foundation's investment activity, we performed tests to recreate the investment amounts on the schedule using the brokerage statements. Our tests were specifically designed to determine the accuracy of cash flows reported on the foundation's Statement of Cash Flows. However, as a result of our testwork, we noted several inaccuracies within the schedule. For example, for one account, we could not determine that the Fiscal Accounts Manager had recorded any investment activity after August 2007 except for the account's ending balance. In addition, he had recorded the proceeds from investment sales for July and August at the foundation's cost, instead of the actual proceeds received from the sales. For two other accounts, we noted that certain sales transactions were not included in the supporting schedule. For most of the accounts, the Fiscal Accounts Manager had entered one amount for the total of the entire year's investment activity for either the proceeds from sales or the investment purchases rather than the specific detailed activity. In these instances, we could not reconcile these amounts to the brokerage statements, nor could the Fiscal Accounts Manager provide other supporting documentation for how he obtained those amounts.

As a result of our testwork, we determined that the foundation's Fiscal Accounts Manager overstated proceeds from sales and maturities of investments by $2,875,697.16, overstated cash expended for purchases of securities by $1,560,653.52, and understated cash received from investment income items by $1,235,789.96 on his schedule of investment activities. The Associate Vice President, unaware of the inaccuracy of these amounts, prepared the foundation's Statement of Cash Flows based on these inaccuracies. We adjusted the foundation's Statement of Cash Flows for these errors.

We also noted that neither the Associate Vice President nor the Fiscal Accounts Manager properly reported unrealized investment losses on the foundation's Statement of Cash Flows. Based on our review of the Fiscal Accounts Manager's schedule and the brokerage statements, we noted that the Fiscal Accounts Manager did not include unrealized gains and losses for four of the applicable investment accounts on his schedule of investment activity. As a result, the Associate Vice President incorrectly disclosed unrealized losses of only $251,272.93, whereas we calculated unrealized losses of $948,518.06, a significant difference of $697,245.13. We adjusted the foundation's Statement of Cash Flows for this error.

When we discussed these issues with the Fiscal Accounts Manager, he stated that the brokerage account statements were complicated, but he tried to ensure that the information was entered correctly into the schedule. As discussed above, because the Fiscal Accounts Manager did not prepare or maintain accurate supporting documentation for the foundation's investment activity throughout the fiscal year and because the Associate Vice President has no authority over the Fiscal Accounts Manager or foundation operations, the foundation's statement of cash flows contained material errors.

<u>Inaccuracies in the Foundation's Investment Note Disclosures</u>

Based on our review of the foundation's investment note disclosures, we found that the Associate Vice President had not appropriately disclosed the investment classifications and related credit ratings. Specifically, we found that the Associate Vice President of Business and Finance understated corporate bonds in its portfolio by $34,798.75, overstated bond mutual funds by $1,233,686.30, overstated equity mutual funds by $676,957.20, understated exchange traded funds (ETFs) by $21,414,789.82, and overstated alternative Real Estate Investment Trusts (REITs) by $19,538,945.07, in the component unit note to the financial statements (Note 17).

We also found problems with the note disclosures (Note 17) for the foundation's credit risk. In the note, the Associate Vice President understated A-rated investments by $72,918.75, overstated B-rated investments by $38,120.00, and overstated unrated investments by $15,991,627.29.

When we discussed these problems with the Associate Vice President, he stated that these classifications and ratings were provided to him by the foundation's Fiscal Accounts Manager, and that the Associate Vice President recorded this financial information without question. The Fiscal Accounts Manager said that he had relied upon classifications presented on the statements of the various brokerage concerns. The Fiscal Accounts Manager also stated that for one brokerage in particular, several investments were classified as "Other Investment Holdings" and that he had interpreted these holdings as alternative investments and labeled them as Alternative REITS (Real Estate Investment Trusts). However, based on our review of the brokerage statements, these holdings were mostly ETFs and were not alternative REITS. The credit risk disclosure errors were largely the result of the classification errors noted above.

In addition, the Associate Vice President inappropriately included non-debt-related investments in this note. Since credit risk applies to debt securities, the Associate Vice President should not have included the investments originally listed as real estate investment trusts and the majority of the investments originally listed as alternative real estate investment trusts in this disclosure. Even though an investment advisor is used by the foundation and investments are held by an investment firm, the management of the university and its foundation bears the responsibility for the completeness and accuracy of the financial statements, including the note disclosures.

We reclassified these investments in Note 17 for the audit report.

Inaccuracy With the Foundation's Endowment Note

The Associate Vice President for Business and Finance incorrectly reported the amount of appreciation from endowments that was available to be spent by the foundation. In the unaudited note to the university's financial statements for the foundation (Note 17), the Associate Vice President reported, "At June 30, 2008, net appreciation of $31,253,941.22 is available to be spent, of which $31,253,941.22 is included in restricted net assets expendable for scholarships and fellowships." However, this entire amount represented the corpus of the endowment, which is the portion which cannot be spent, instead of the appropriate amount of appreciation that is available to be spent by the foundation. When we discussed this matter with the Associate Vice President, he stated that he had written the note incorrectly and had picked up the wrong number. He also provided us with the correct amount and appropriate documentation supporting the correct amount. Based on these conversations and our review, the note should have read as follows: "At June 30, 2008, net appreciation of $382,315.97 is available to be spent, of which $292,844.95 is included in restricted net assets expendable for scholarships and fellowships, and $89,471.02 is included in restricted net assets expendable for other."

Problem Noted With University Expenses

In addition to the problems noted with the foundation's financial reporting, we also found a problem with the university's financial reporting. Based on our review of TSU's Statement of Revenues, Expenses and Changes in Net Assets, we noted that the majority of expenses recorded in one expense account were misclassified on the statement. Specifically, the Associate Vice President of Business and Finance understated expenses for scholarships and fellowships and overstated expenses for utilities, supplies and other services by $1,339,934.45. We reclassified this account on the university's Statement of Revenues, Expenses and Changes in Net Assets as follows:

Category	Original	Restated	Difference
Utilities, supplies and other services	$52,340,013.31	$51,000,078.86	($1,339,934.45)
Scholarships and fellowships	4,066,140.87	5,406,075.32	$1,339,934.45
Total expenses difference			0.00

When we discussed this reporting error with the Associate Vice President, he stated that this error had occurred largely due to the university's conversion to the Banner information system. The university implemented Banner Finance at the beginning of fiscal year 2008. However, the university did not implement Banner Student until fiscal year 2009. As a result, for fiscal year 2008 only, certain scholarship transactions were entered into Banner Finance via a feed from the older, and now former, Student Information System. This feed directed these scholarship transactions to accounts that would ultimately be classified as utilities, supplies and other services on the financial statements. According to the Associate Vice President, now that the university uses the Banner Student information system, this reporting error should not occur in the future.

In May 2006, university management submitted to the Tennessee Board of Regents the Risk Assessment prepared for the university as a whole. In May 2007, university management submitted to the Tennessee Board of Regents the Risk Assessment prepared for the financial management process. Management identified within the financial management assessment the risk of inaccurate financial reporting and the risk that closing entries would not be recorded or classified in accordance with applicable accounting standards. For these items, management's intention is to monitor through supervision controls, such as reconciliations and journal entry review, and to monitor through execution controls, such as journal entry preparation. However, the Vice President of Business and Finance and the Associate Vice President of Business and Finance did not detect the reporting errors noted above during their review.

In summary, these reporting errors resulted in material misstatements to the foundation's note disclosures, the foundation's Supplementary Schedule of Cash Flows, and a significant classification error in the university's Statement of Revenues, Expenses, and Changes in Net Assets. Because management relies on the financial statements to make critical financial decisions, management decisions based upon flawed financial reporting may not be in the best interest of the university or its foundation. Furthermore, when staff responsible for recording complex investment activity do not maintain appropriate supporting documentation throughout the year, there is an increased risk for reporting errors and possible mismanagement of funds. Also, the failure of top management to create a proper internal control environment with appropriate supervisory roles intact increases the risk that similar errors will continue in the future.

Recommendation

Because of the exponential growth of investment assets managed by the TSU Foundation over the last few years, and in order to institute adequate internal controls, the President, in conjunction with the Vice President of Business and Finance and the Vice President for Development, should consider changing the method of recording the foundation's investment balances and transactions, and should ensure proper supervisory control of both the foundation's and the university's accounting functions. Rather than recording summarized investment transactions at year-end, and then entering them into the Banner system en masse, accounting personnel should analyze investment transactions and balances on a monthly or quarterly basis, and record them promptly in the university's Banner accounting system. Supervisory personnel should then reconcile the transactions and balances recorded in the accounting system to the various brokerage statements on a timely basis. Supervisory personnel should note and correct any inaccuracies identified as a result of these monthly recordings and reconciliations in a timely manner.

When new business processes or new information systems are implemented, those members of TSU management most responsible for the implementation should ensure that the new process is working as intended and that any electronic data automatically transferred into another information system is transferred completely and correctly and that adequate internal controls are still in place.

The President and Vice President of Business and Finance should ensure that all accounting staff seek technical advice when instructions or tasks are not understood. They should carefully and thoughtfully review the financial statements and related notes. The Vice President of Business and Finance should ensure that the amounts reported in the financial ledgers are accurate, that all notes to the financial statements are accurate at year-end and in agreement with the respective amounts in the financial statements, and that all financial reporting is done in accordance with generally accepted accounting principles. The President and Vice President of Business and Finance should assign specific staff the responsibility for monitoring the process for preparing year-end entries and, ultimately, for preparing the financial statements and related notes, to mitigate the risk of errors or fraud, waste, or abuse, and the potential of material misstatement associated with financial reporting.

The President and Vice President of Business and Finance should ensure that steps are taken to improve coordination among all staff and management involved in requesting, approving, executing, and reviewing accounting entries and transactions. Management should continue to evaluate risks and include them in documented risk assessment activities. Management should ensure that staff who are responsible for the design and implementation of internal controls to adequately mitigate those risks and to prevent and detect exceptions in a timely manner are continually evaluating those controls. Management should ensure that staff who are responsible for ongoing monitoring for compliance with all requirements are indeed monitoring and taking prompt action when exceptions occur. All controls and control activities, including monitoring, should be adequately documented.

Management's Comment

Management concurs with the finding and concurs in part with the recommendation.

The President, in conjunction with the Vice President for Business and Finance and the Vice President for University Relations and Development, will ensure that transactions related to the investment assets managed by the Tennessee State University Foundation are analyzed and recorded in the Banner system on a monthly basis. The Fiscal Accounts Manager for the Foundation currently prepares a monthly reconciliation of the various brokerage statements. Those reconciliations will now be reviewed and approved by the Executive Director of the Foundation. In addition, the accounting entries supported by the reconciliation will be initiated by the Fiscal Accounts Manager on a monthly basis instead of at year-end and will be approved by both the Executive Director of the Foundation and the Associate Vice President for Business and Finance. After the transactions have been entered, the Fiscal Accounts Manager will ensure Banner reconciles to the brokerage statements.

The Foundation Board selected a new investment advisor on April 1, 2009, to assist the Board with its policy statement, to select money managers, and to provide guidance and educational sessions on investments and investment-related issues. The investment advisor will provide the security ratings for Foundation investments to the Fiscal Accounts Manager to assist in the preparation of the Notes to the Financial Statements.

Management most responsible for implementation of any new process or system will make every reasonable effort to ensure that the new process or system is working as intended and that adequate internal controls are in place.

The President and Vice President for Business and Finance have assigned specific staff the responsibility of monitoring the year-end process, including preparing the financial statements and related notes. We recognize that errors may occur, and during year-end closing and reporting for future periods, everything practicable will be done to ensure that items are displayed properly in the unaudited financial statements. However, given the limited time allowed to close the fiscal year and complete the unaudited statements, the possibility of undetected errors and mistakes cannot be completely eliminated.

Management will continue to evaluate the risks and include them in documented risk assessment activities. The President, the Vice President for Business and Finance, and the Vice President for University Relations and Development and their staffs are very cognizant of the risks involved with financial reporting and remain committed to the establishment of internal controls necessary to minimize risks.

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Independent Auditor's Report

July 20, 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. Melvin N. Johnson, President
Tennessee State University
3500 John A. Merritt Boulevard
Nashville, Tennessee 37209

Ladies and Gentlemen:

We have audited the accompanying basic financial statements of Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the 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 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 provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of 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 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, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tennessee Board of Regents, Tennessee State University, and its discretely presented component unit as of June 30, 2008, and the respective changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 15, 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 18 through 31 and the schedule of funding progress on page 58 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 page 59 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with generally accepted government auditing standards, we have also issued our report dated July 20, 2009, 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.

Arthur A. Hayes, Jr., CPA
Director

AAH/dlj

Tennessee Board of Regents
Tennessee State University
Management's Discussion and Analysis
For the Year Ended June 30, 2008

This section of Tennessee State University's report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 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, the audited financial statements, and the accompanying notes to the financial statements. The financial statements, notes, and this discussion are the responsibility of management.

Using This Annual Report

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

The Statement of Net Assets

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

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

Net Assets (in thousands of dollars)

	INSTITUTION		COMPONENT UNIT	
	2008	2007	2008	2007
ASSETS:				
Current assets	$ 25,018	$ 23,904	$ 3,072	$ 3,477
Capital assets, net	176,900	177,050	-	-
Other assets	42,553	36,499	31,275	30,205
TOTAL ASSETS	**244,471**	**237,453**	**34,347**	**33,682**
LIABILITIES:				
Current liabilities	17,256	17,342	20	14
Noncurrent liabilities	48,900	44,349	-	-
TOTAL LIABILITIES	**66,156**	**61,691**	**20**	**14**
NET ASSETS:				
Invested in capital assets, net of related debt	136,142	138,658	-	-
Restricted - Nonexpendable	75	73	31,254	30,204
Restricted - Expendable	7,350	7,772	2,928	3,351
Unrestricted	34,748	29,259	145	113
TOTAL NET ASSETS	**$ 178,315**	**$ 175,762**	**$ 34,327**	**$ 33,668**

Comparison of Fiscal Year 2008 to Fiscal Year 2007 - University

- Other Assets increased with the allocation of Cash and Cash Equivalents for future plant construction and renovation projects.

- Noncurrent Liabilities increased over $2.5 million due to a change in accounting for the recording of an accrued liability for Postemployment health care ($2.1 million) and the increase in long-term debt related to capital assets (see Note 6).

- Invested in capital assets, net of related debt decreased with the increase in long-term debt related to capital assets (see Note 6).

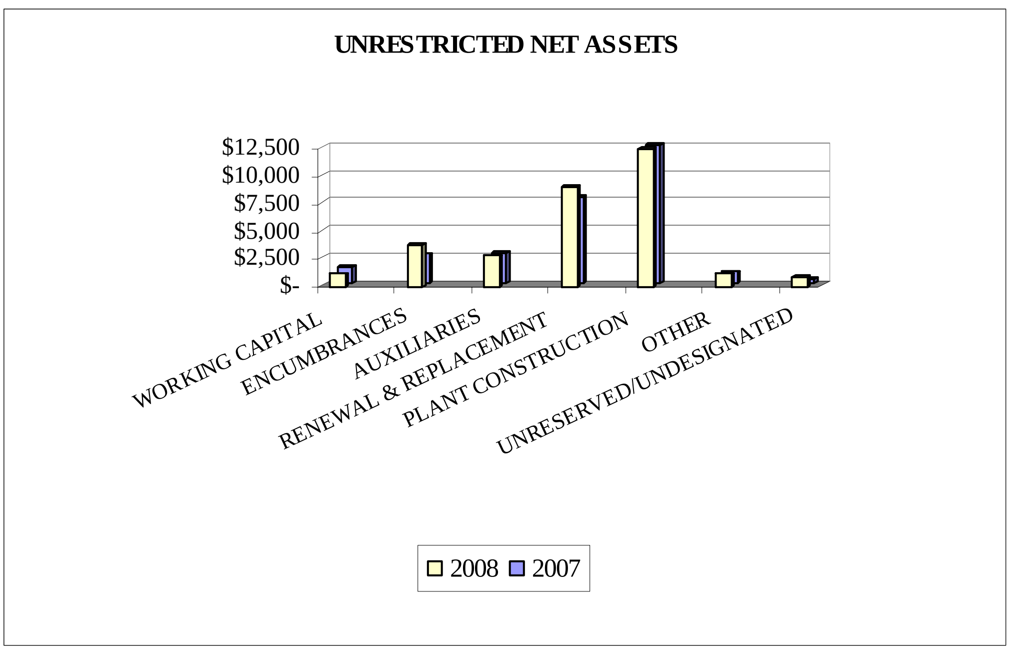
- Unrestricted Net Assets increased due to an additional $2 million allocated for a potential decline in enrollment and an additional $3 million for capital-related projects.

Comparison of Fiscal Year 2008 to Fiscal Year 2007 – TSU Foundation

- Current Assets decreased due to a decrease in expendable restricted funds available.

- Unrestricted Net Assets increased as unrestricted revenues exceeded unrestricted expenditures by $33 thousand.

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



Comparison of Fiscal Year 2008 to Fiscal Year 2007 - University

- Unrestricted Assets for Renewal and Replacement and Plant Construction increased over $4.0 million for current projects including the Hankel Renovation, and future capital projects and renovations.

- The Allocation for Working Capital decreased 20% as the result of a decrease in students Accounts Receivable due to accounts determined to be uncollectible.

- The Allocation for Encumbrances increased 45% as a result of delays in processing of purchase requests due to the implementation of a new financial system and a new purchasing system.

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 non-operating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered non-operating revenues according to accounting principles generally accepted in the United States of America.

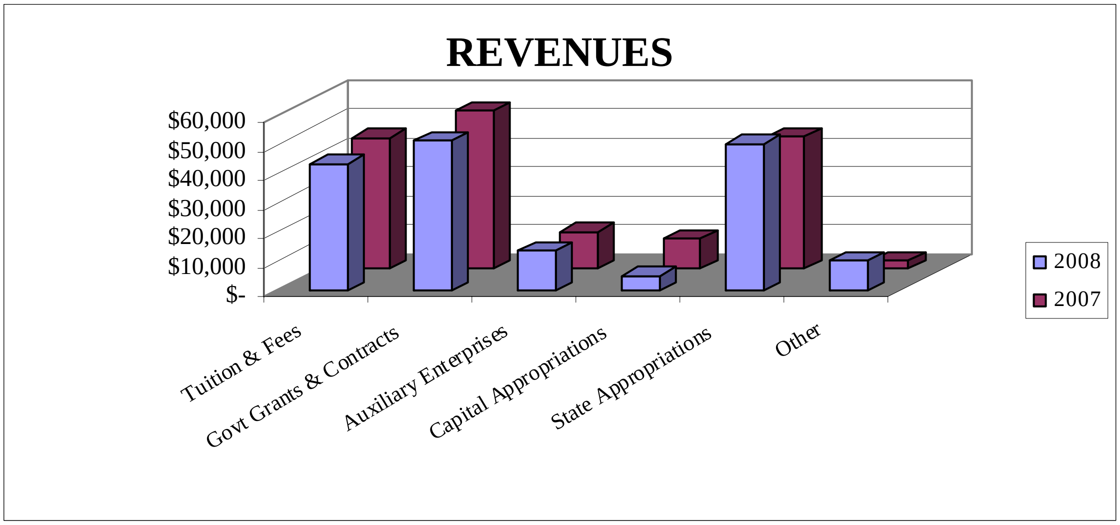
Revenues, Expenses, and Changes in Net Assets (in thousands of dollars)

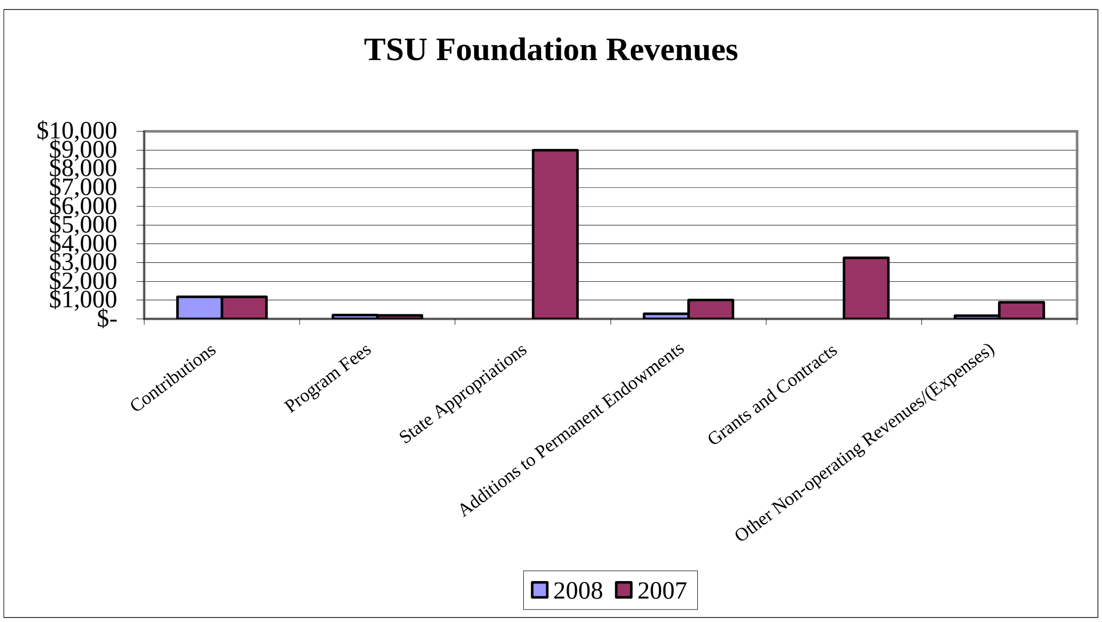
	INSTITUTION		COMPONENT UNIT	
	2008	2007	2008	2007
Operating revenues:				
Net tuition and fees	$ 43,596	$ 45,332	$ -	$ -
Gifts and contributions	-	-	1,169	1,196
Grants and contracts	31,713	35,794	-	-
Auxiliary	13,808	12,773	-	-
Other	4,397	2,736	200	192
Total operating revenue	**93,514**	**96,635**	**1,369**	**1,388**
Operating expenses	167,979	161,206	1,146	930
Operating income (loss)	**(74,465)**	**(64,571)**	**223**	**458**

Nonoperating revenues and expenses:				
State appropriations	50,552	45,387	-	9,000
Gifts	85	835	-	264
Grants and Contracts	19,341	16,252	-	3,259
Investment income	2,642	2,945	172	351
Other revenues and expenses	(2,001)	(1,668)	-	(49)
Total nonoperating revenues and expenses	**70,619**	**63,751**	**172**	**12,285**
Income (loss) before other revenues expenses, gains, or losses	**(3,846)**	**(820)**	**395**	**13,283**
Other revenues, expenses, gains, or losses				
Capital appropriations	5,225	10,332	-	-
Capital grants and gifts	1,216	2,546	-	-
Additions to permanent endowments	-	-	264	1,008
Other	(42)	(90)	-	-
Total other revenues, expenses, gains, or losses	**6,399**	**12,788**	**264**	**1,008**
Increase in net assets	**2,553**	**11,968**	**659**	**14,291**
Net assets at beginning of period	**175,762**	**163,794**	**33,668**	**19,377**
Net assets at end of year	**$ 178,315**	**$ 175,762**	**$ 34,327**	**$ 33,668**

REVENUES

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


REVENUES
$60,000
$50,000
$40,000
$30,000
$20,000
$10,000
$-
Tuition & Fees
Govt Grants & Contracts
Auxiliary Enterprises
Capital Appropriations
State Appropriations
Other
2008
2007


TSU Foundation Revenues
$10,000
$9,000
$8,000
$7,000
$6,000
$5,000
$4,000
$3,000
$2,000
$1,000
$-
Contributions
Program Fees
State Appropriations
Additions to Permanent Endowments
Grants and Contracts
Other Non-operating Revenues/(Expenses)
2008
2007

Comparison of Fiscal Year 2008 to Fiscal Year 2007 – University

- Net tuition and fees decreased due to a decrease in enrollment and an increase in the scholarship allowance when compared to 2007.
- Grants and Contracts for the university decreased due to over $3.2 million in Title III funds for the match of the funds related to the Consent Decree settlement received in 2007.
- Capital Appropriations decreased 49% with a $5.5 million decline in expenses in fiscal year 2008 for the Avon Williams Campus renovation as the project neared completion.

Comparison of Fiscal Year 2008 to Fiscal Year 2007 – TSU Foundation

- State Appropriations for the Foundation decreased $8.0 million, and Grants and Contracts decreased over $3.2 million compared to one-time funds received from the Consent Decree settlement in 2007.
- Additions to Permanent Endowments for Fiscal Year 2007 erroneously included Investment Income distributions. Additions/gifts to the Permanent Endowment for Fiscal Year 2008 and Fiscal Year 2007 were each over $264 thousand.

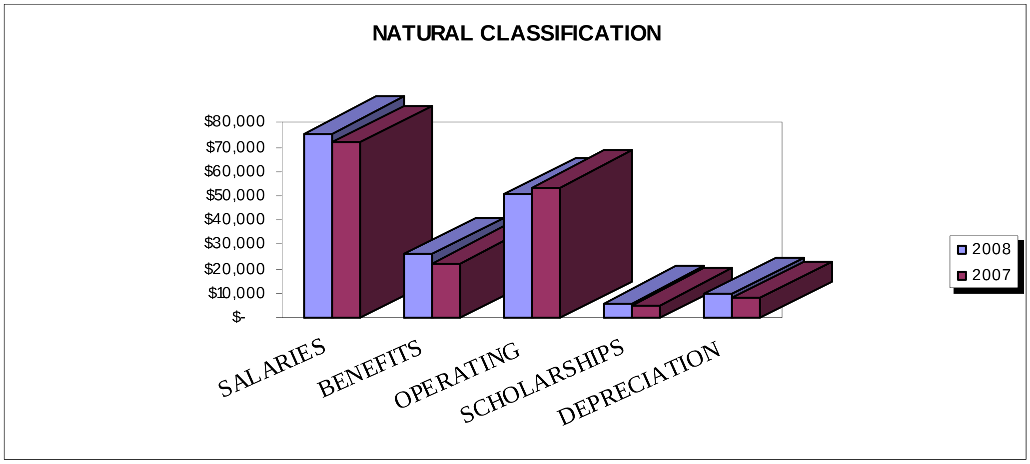
EXPENSES

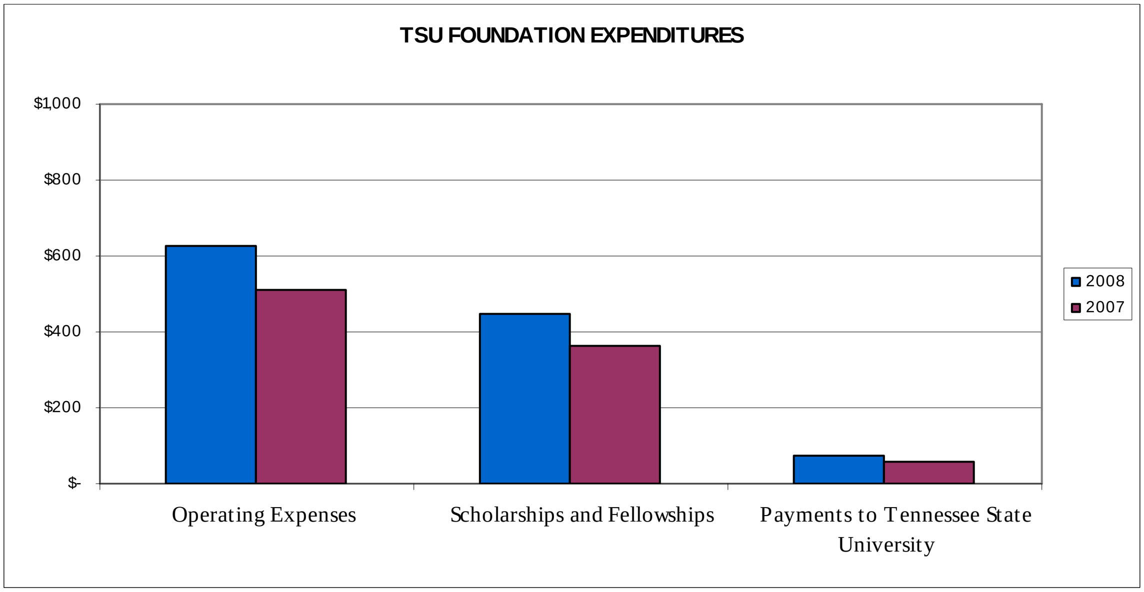
Operating expenses can be displayed in two formats, natural classification and program classification. Both formats are displayed below.

NATURAL CLASSIFICATION	UNIVERSITY		COMPONENT UNIT	
(in thousands of dollars)	2008	2007	2008	2007
SALARIES	$ 75,773	$ 72,162	$ -	$ -
BENEFITS	26,215	22,366	-	-
OPERATING	51,000	53,378	625	510
SCHOLARSHIPS	5,406	5,153	448	363
PAYMENTS TO TSU	-	-	73	57

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

DEPRECIATION	9,586	8,147	-	-
TOTAL	**$ 167,980**	**$ 161,206**	**$ 1,146**	**$ 930**





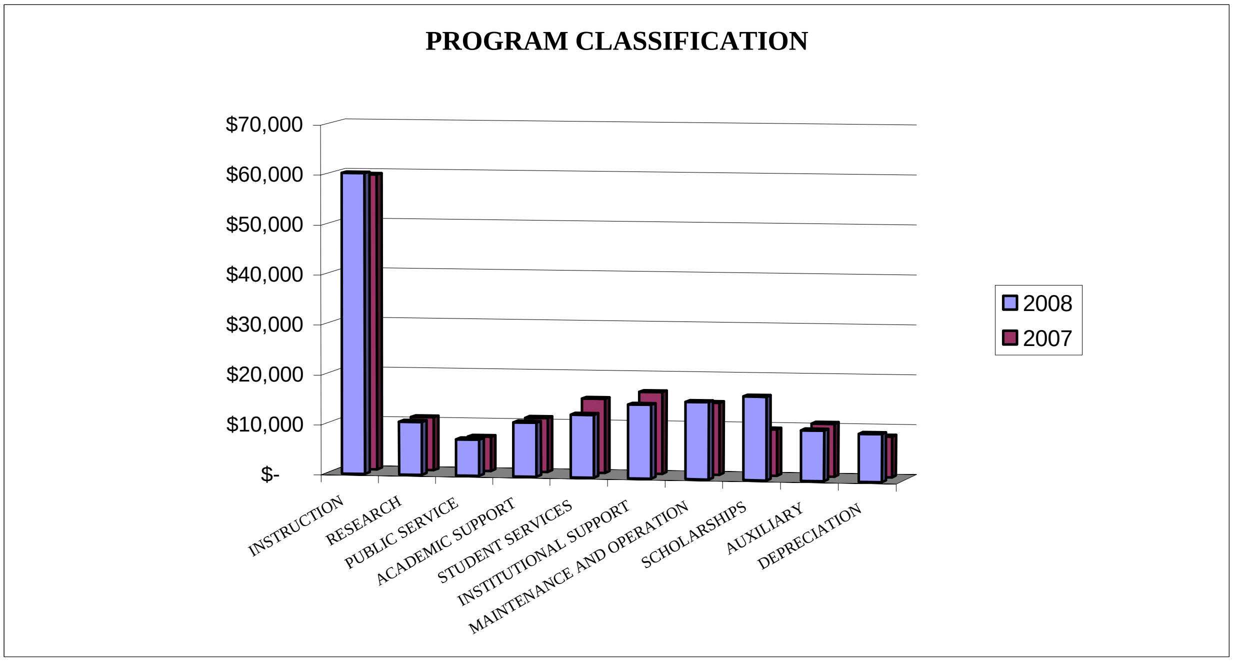
Comparison of Fiscal Year 2008 to Fiscal Year 2007 – University

- Salaries increased with the university's salary plan being in place for the full fiscal year.
- Benefits increased with the change in accounting principle related to Postemployment Benefits (See Note 10).
- Operating expenses decreased due to a large decrease in expenditures for Professional and Administrative services.
- Depreciation expenses increased with the initial depreciation expense for $48 million in projects moved from Projects in Progress to Buildings (completed projects).

Comparison of Fiscal Year 2008 to Fiscal Year 2007 – TSU Foundation

- Operating Expenses increased and payments to TSU increased as additional funds were made available for use to support the university.
- Scholarship expenditures increased due to the hold on the awarding of new scholarships being released by the Foundation Board membership.

PROGRAM CLASSIFICATION	**UNIVERSITY**	
(in thousands of dollars)	**2008**	**2007**
INSTRUCTION	$ 60,284	$ 59,327
RESEARCH	10,600	10,615
PUBLIC SERVICE	7,236	6,873
ACADEMIC SUPPORT	10,799	10,803
STUDENT SERVICES	12,522	14,871
INSTITUTIONAL SUPPORT	14,711	16,386
MAINTENANCE AND OPERATION	15,429	14,391
SCHOLARSHIPS	16,706	9,248
AUXILIARY	10,107	10,545
DEPRECIATION	9,586	8,147
TOTAL	**$ 167,980**	**$ 161,206**



Comparison of Fiscal Year 2008 to Fiscal Year 2007

- Public Service increased with an additional state appropriation designated for the Cooperative Extension Program.

- Research decreased as a result of the reduction in funding from NASA and NSF.

- Institutional Support decreased with the one-time Title III expenditures noted above in fiscal year 2007.

- Scholarships increased and Student Services decreased due to the change in the allocation of Scholarship Allowance. In fiscal year 2007, the allowance was allocated to the Scholarship function. For fiscal year 2008, the allowance was allocated to the individual functions.

- Depreciation expenses increased with the initial depreciation expense for $48 million in projects moved from Projects in Progress to Buildings (completed projects).

- Maintenance and Operations increased due to an increase in utilities and an increase in non-capital expenditures for maintenance and repairs of university property.

The Statement of Cash Flows

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

Cash Flows (in thousands of dollars)

	University	
	2008	**2007**
Cash provided (used) by:		
Operating activities	(62,146)	(55,755)
Non-capital financing activities	69,964	62,472
Capital and related financing activities	(3,041)	(3,108)
Investing activities	2,710	3,144
Net increase in cash	**7,487**	**6,753**
Cash, beginning of the year	34,359	27,606
Cash, end of the year	**41,846**	**34,359**

Comparison of Fiscal Year 2008 to Fiscal Year 2007

- Cash provided by operating activities decreased as a result of increased use of cash for payments to employees and payments of benefits.

- Cash provided from Non-capital financing activities increased with the additional receipt of Grants and Contracts for student aid and additional state appropriations.

- Cash provided by investing activities decreased as a result of lower investment rates available.

- The university's liquidity improved during the year.

Capital Assets and Debt Administration

Capital Assets

The university had $176,900,454.78 invested in capital assets, net of accumulated depreciation of $132,275,353.17 at June 30, 2008; and $177,049,621.73 invested in capital assets, net of accumulated depreciation of $123,522,576.24 at June 30, 2007. Depreciation charges totaled $9,585,634.75 and $8,147,467.78 for the years ended June 30, 2008, and June 30, 2007, respectively. Details of these assets are shown below.

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

	2008	2007
Land	$ 9,525	$ 9,525
Land Improvements	10,731	11,147
Buildings	132,333	88,372
Equipment	5,343	6,037
Library Holdings	7,809	7,121
Software	2,179	2,048
Projects In Progress	8,980	52,800
Net Capital Assets	$ 176,900	$ 177,050

Projects in progress during the fiscal year 2008 included the renovation of the Avon Williams campus, installation of fire sprinkler systems in student housing, energy savings and performance contracting, and window replacements. The Avon Williams renovation, Research and Sponsored Programs building, and the final phase of the North Campus Project were completed during fiscal year 2008. Work will continue on the fire sprinkler systems and energy savings and performance contracting during fiscal year 2009. These projects are funded by TSSBA. More detailed information about the university's capital assets is presented in Note 5 to the financial statements.

Debt

The university had $40,758,052.65 and $38,392,019.02 in debt outstanding at June 30, 2008, and June 30, 2007, respectively. The table below summarizes these amounts by type of debt instrument.

Schedule of Debt (in thousands of dollars)

	2008	2007
Bonds	$ 36,661	$ 37,467
Commerical Paper	4,097	925
Total	$ 40,758	$ 38,392

The university converted $775 thousand in Commercial Paper to Bonds during fiscal year 2008 for the Avon Williams project. An additional amount of over $3.94 million was issued in Commercial Paper for the Research and Sponsored Projects building, the Student Housing Fire Safety upgrade, and the Energy Savings Performance Contract. Additional information about the university's long-term liabilities is presented in Note 6 to the financial statements. The Standard & Poor's rating for TSSBA was AA with a stable outlook.

Economic Factors That Will Affect the Future

The Tennessee Board of Regents approved a 6.0% increase in maintenance and tuition fees for the 2008-09 academic year. The cost for students to attend the university exceeds the amount of financial aid available per student. This requires students to resort to alternative means of financing the cost of attending the university. The enrollment for the Fall 2008 semester is expected to decline; however, the exact impact is unknown. The university is not aware of any other factors that will have a significant effect on the financial position or results of operations.

Requests for Information

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

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

Exhibit A

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

	Tennessee State University	Component Unit Tennessee State University Foundation
	June 30, 2008	June 30, 2008
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 17)	$ 13,403,408.16	$ 3,072,030.56
Short-term investments (Note 3)	1,077,440.58	-
Accounts, notes, and grants receivable (net) (Note 4)	8,968,048.68	-
Inventories	36,011.67	-
Prepaid expenses and deferred charges	150.00	-
Accrued interest receivable	1,532,356.28	-
Total current assets	25,017,415.37	3,072,030.56
Noncurrent assets:		
Cash and cash equivalents (Notes 2 and 17)	28,443,585.72	1,945,041.77
Investments (Notes 3 and 17)	11,606,789.01	29,329,825.57
Accounts, notes, and grants receivable (net) (Note 4)	2,502,539.63	-
Capital assets (net) (Note 5)	176,900,454.78	-
Total noncurrent assets	219,453,369.14	31,274,867.34
Total assets	244,470,784.51	34,346,897.90
LIABILITIES		
Current liabilities:		
Accounts payable	2,107,378.94	20,111.53
Accrued liabilities	6,488,461.05	-
Student deposits	1,238,994.41	-
Deferred revenue	4,434,333.18	-
Compensated absences (Note 6)	741,816.77	-
Accrued interest payable	308,172.12	-
Long-term liabilities, current portion (Note 6)	1,733,401.94	-
Deposits held in custody for others	147,573.45	-
Other liabilities	55,809.00	-
Total current liabilities	17,255,940.86	20,111.53
Noncurrent liabilities:		
Net OPEB Obligation (Notes 6 and 10)	2,001,090.08	-
Compensated absences (Note 6)	4,453,880.41	-
Long-term liabilities (Note 6)	39,024,650.71	-
Due to grantors (Note 6)	3,420,051.52	-
Total noncurrent liabilities	48,899,672.72	-
Total liabilities	66,155,613.58	20,111.53
NET ASSETS		
Invested in capital assets, net of related debt	136,142,402.13	-
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	74,824.66	31,253,941.22
Expendable:		
Scholarships and fellowships (Notes 7 and 17)	1,217,846.67	1,954,316.39
Research	1,153,739.86	14,055.72
Instructional department uses (Note 7)	2,532,195.87	170,498.36
Loans	845,859.52	-
Other (Note 17)	1,600,711.48	788,547.77
Unrestricted (Note 8)	34,747,590.74	145,426.91
Total net assets	$ 178,315,170.93	$ 34,326,786.37

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

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

	Tennessee State University	Component Unit Tennessee State University Foundation
	Year Ended June 30, 2008	Year Ended June 30, 2008
REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of $17,461,603.30)	$ 43,596,097.23	$ -
Gifts and contributions	-	1,169,606.01
Governmental grants and contracts	31,062,169.03	-
Nongovernmental grants and contracts	651,188.87	-
Sales and services of educational departments	4,037,104.48	-
Auxiliary enterprises:		
Residential life (net of scholarship allowances of $818,969.97; all residential life revenues are used as security for revenue bonds; see Note 6)	7,976,532.91	-
Bookstore	526,118.82	-
Food service	4,512,959.11	-
Other auxiliaries	792,545.93	-
Other operating revenues	359,583.34	199,948.75
Total operating revenues	93,514,299.72	1,369,554.76
EXPENSES		
Operating expenses (Note 14):		
Salaries and wages	75,773,075.97	-
Benefits	26,214,512.53	-
Utilities, supplies, and other services	51,000,078.86	625,076.00
Scholarships and fellowships	5,406,075.32	448,514.69
Depreciation expense	9,585,634.75	-
Payments to or on behalf of Tennessee State University (Note 17)	-	72,642.06
Total operating expenses	167,979,377.43	1,146,232.75
Operating income (loss)	(74,465,077.71)	223,322.01

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

	Tennessee State University	Component Unit Tennessee State University Foundation
	Year Ended June 30, 2008	Year Ended June 30, 2008
NONOPERATING REVENUES (EXPENSES)		
State appropriations	50,551,800.00	-
Gifts, including $72,642.06 from component unit	84,953.50	-
Grants and contracts	19,341,108.02	-
Investment income	2,642,040.60	171,622.61
Interest on capital asset-related debt	(1,917,223.61)	-
Bond issuance costs	(65,882.58)	-
Other nonoperating revenues (expenses)	(17,448.06)	-
Net nonoperating revenues (expenses)	70,619,347.87	171,622.61
Income (loss) before other revenues, expenses, gains, or losses	(3,845,729.84)	394,944.62
Capital appropriations	5,225,096.10	-
Capital grants and gifts	1,215,976.82	-
Additions to permanent endowments	-	264,255.00
Other capital	(42,336.72)	-
Total other revenues	6,398,736.20	264,255.00
Increase in net assets	2,553,006.36	659,199.62
NET ASSETS		
Net assets - beginning of year	175,762,164.57	33,667,586.75
Net assets - end of year	$ 178,315,170.93	$ 34,326,786.37

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

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

	Year Ended June 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES	
Tuition and fees	$ 43,402,936.23
Grants and contracts	34,771,222.42
Sales and services of educational activities	4,348,939.12
Payments to suppliers and vendors	(51,546,551.62)
Payments to employees	(77,233,711.40)
Payments for benefits	(24,419,781.45)
Payments for scholarships and fellowships	(5,406,075.32)
Loans issued to students and employees	(632,439.91)
Collection of loans from students and employees	531,887.71
Interest earned on loans to students	68,328.79
Auxiliary enterprise charges:	
Residence halls	7,844,424.91
Bookstore	526,118.82
Food services	4,512,959.11
Other auxiliaries	782,722.11
Other receipts (payments)	303,027.96
Net cash used by operating activities	(62,145,992.52)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State appropriations	50,509,600.00
Gifts and grants received for other than capital or endowment purposes, including $72,642.06 from Tennessee State University Foundation for the year ended June 30, 2008	19,426,061.52
Changes in deposits held for others	25,848.49
Other noncapital financing receipts (payments)	2,256.54
Net cash provided by noncapital financing activities	69,963,766.55
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Proceeds from capital debt	4,164,362.41
Capital appropriations	5,146,397.97
Capital grants and gifts received	1,555,831.03
Purchases of capital assets and construction	(9,478,804.52)
Principal paid on capital debt	(2,417,289.52)
Interest paid on capital debt and lease	(1,925,678.84)
Bond issue costs paid on new debt issue	(85,587.18)
Net cash used by capital and related financing activities	(3,040,768.65)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sales and maturities of investments	12,768,234.35
Income on investments	2,841,328.01
Purchase of investments	(12,899,126.65)
Net cash provided by investing activities	2,710,435.71
Net increase in cash and cash equivalents	7,487,441.09
Cash and cash equivalents - beginning of year	34,359,552.79
Cash and cash equivalents - end of year	$ 41,846,993.88

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

	Year Ended June 30, 2008
Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	$ (74,465,077.71)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation expense	9,585,634.75
Change in assets and liabilities:	
Receivables, net	652,066.27
Inventories	2,804.60
Prepaid/deferred items	(150.00)
Accounts payable	(560,625.27)
Accrued liabilities	720,408.57
Deferred revenue	1,619,411.10
Deposits	(14,850.00)
Compensated absences	130,904.20
Due to grantors	183,480.97
Net cash used by operating activities	$ (62,145,992.52)
Noncash transactions	
Unrealized gains/losses on investments	$ 95,938.94

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 financial statements present only that portion of the Tennessee Board of Regents' activities that is attributable to the transactions of Tennessee State University.

The Tennessee State University Foundation is considered a component unit of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements. See Note 17 for more detailed information about the component unit and how to obtain the report.

Basis of Presentation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) applicable to governmental colleges and universities engaged in business-type activities as prescribed by the Governmental Accounting Standards Board (GASB).

Basis of Accounting

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

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

Amounts reported as operating revenues include (1) tuition and fees, net of waivers and discounts; (2) certain federal, state, local, and private grants and contracts; (3) sales and services of auxiliary enterprises; and (4) other sources of revenue. Operating expenses for the university include (1) salaries and wages; (2) employee benefits; (3) utilities, supplies, and other services; (4) scholarships and fellowships; and (5) depreciation.

All other activity is nonoperating in nature and includes (1) state appropriations for operations; (2) investment income; (3) bond issuance costs; (4) interest on capital asset-related debt; (5) certain grants and contracts; and (6) gifts and nonexchange transactions.

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

Cash Equivalents

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

Inventories

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

Compensated Absences

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

Capital Assets

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

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

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

Net Assets

The university's net assets are classified as follows:

<u>Invested in capital assets, net of related debt</u> - 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.

<u>Nonexpendable restricted net assets</u> - 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.

<u>Expendable restricted net assets</u> - 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.

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

Scholarship Discounts and Allowances

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

NOTE 2. CASH

At June 30, 2008, cash consisted of $4,639,580.51 in bank accounts, $5,050.00 of petty cash on hand, $36,456,411.25 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer, and $745,952.12 in LGIP deposits for capital projects.

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

NOTE 3. INVESTMENTS

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

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

		Investment Maturities (in Years)			
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10
U. S. Agencies	$12,302,782.51	$ 768,929.70	$ 9,127,185.54	$ 1,248,005.31	$ 1,158,661.96
Certificates of deposit	381,447.08	381,447.08	-	-	-
Total	$12,684,229.59	$1,150,376.78	$ 9,127,185.54	$ 1,248,005.31	$ 1,158,661.96

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

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; banker's acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool (LGIP). The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified. Securities are rated using Standard and Poor's, Moody's, and/or Fitch and are presented below using the Standard and Poor's rating scale. Tennessee Board of Regents policy restricts investments in banker's acceptances 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 ratings services that have rated the issuer. The policy further requires that commercial paper must be issued by corporations with a minimum rating of A1 or equivalent as provided by a majority of the rating services that rate the issuer. If there is no long-term debt rating, the short-term debt must be rated A1 by all rating services (minimum of two). Commercial paper of a banking institution must not be purchased.

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

		Credit Quality Rating	
Investment Type	Fair Value	AAA	Unrated
LGIP	$ 37,202,363.37	$ -	$ 37,202,363.37
U. S. Agencies	12,302,782.51	11,817,203.91	485,578.60
Total	$ 49,505,145.88	$ 11,817,203.91	$ 37,687,941.97

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2008
Student accounts receivable	$ 3,028,229.77
Grants receivable	6,811,282.95
Notes receivable	58,955.37
State appropriation receivable	282,598.13
Other receivables	449,717.75
Subtotal	10,630,783.97
Less allowance for doubtful accounts	(1,603,779.92)
Total receivables	$ 9,027,004.05

Federal Perkins Loan Program funds included the following:

	June 30, 2008
Perkins loans receivable	$ 18,256,745.03
Less allowance for doubtful accounts	(15,813,160.77)
Total	$ 2,443,584.26

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	$ 9,525,009.24	$ -	$ -	$ -	$ 9,525,009.24
Land improvements and infrastructure	38,237,355.27	-	806,453.99	-	39,043,809.26
Buildings	160,472,924.64	-	48,943,271.22	-	209,416,195.86
Equipment	24,862,126.62	1,002,687.91	-	458,777.51	25,406,037.02
Library holdings	12,399,278.38	2,142,044.96	-	416,417.03	14,124,906.31
Software	2,275,741.87	403,857.49	-	-	2,679,599.36
Projects in progress	52,799,761.95	5,930,214.16	(49,749,725.21)	-	8,980,250.90
Total	300,572,197.97	9,478,804.52	-	875,194.54	309,175,807.95
Less accumulated depreciation:					
Land improvements and infrastructure	27,090,951.64	1,221,758.24	-	-	28,312,709.88
Buildings	72,100,793.79	4,982,762.88	-	-	77,083,556.67
Equipment	18,824,905.33	1,654,534.04	-	416,440.79	20,062,998.58
Library holdings	5,278,351.29	1,454,132.35	-	416,417.03	6,316,066.61
Software	227,574.19	272,447.24	-	-	500,021.43
Total accumulated depreciation	123,522,576.24	9,585,634.75	-	832,857.82	132,275,353.17
Capital assets, net	$177,049,621.73	$(106,830.23)	$ -	$ 42,336.72	$176,900,454.78

NOTE 6. 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:					
TSSBA debt:					
Bonds	$37,467,304.31	$ 835,835.17	$1,642,289.52	$36,660,849.96	$1,733,401.94
Commercial paper	924,714.71	3,947,487.98	775,000.00	4,097,202.69	-
Subtotal	38,392,019.02	4,783,323.15	2,417,289.52	40,758,052.65	1,733,401.94
Other liabilities:					
Compensated absences	5,064,792.98	2,599,403.81	2,468,499.61	5,195,697.18	741,816.77

Due to grantors	3,236,570.55	198,592.96	15,111.99	3,420,051.52	-
Net OPEB obligation	-	2,001,090.08	-	2,001,090.08	-
Subtotal	8,301,363.53	4,799,086.85	2,483,611.60	10,616,838.78	741,816.77
Total long-term liabilities	$46,693,382.55	$9,582,410.00	$4,900,901.12	$51,374,891.43	$2,475,218.71

TSSBA Debt - Bonds

Bonds, with interest rates ranging from 3.60% to 6.90%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2032 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net assets is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $275,000.00 at June 30, 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	$ 1,733,401.94	$ 1,772,414.19	$ 3,505,816.13
2010	1,509,038.11	1,724,444.40	3,233,482.51
2011	1,904,809.94	1,622,478.02	3,527,287.96
2012	1,995,671.60	1,541,363.77	3,537,035.37
2013	2,066,004.39	1,455,933.32	3,521,937.71
2014 – 2018	10,287,695.48	5,812,142.11	16,099,837.59
2019 – 2023	8,364,525.30	3,471,635.84	11,836,161.14
2024 – 2028	6,961,602.40	1,449,525.14	8,411,127.54
2029-2032	1,838,100.80	235,580.51	2,073,681.31
Total	$ 36,660,849.96	$ 19,085,517.30	$ 55,746,367.26

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 $4,097,202.69 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 7. ENDOWMENTS

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

The university chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the university, a scholarship is awarded to a student whose residence is in the county specified by the donor, if it has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income. At June 30, 2008, net appreciation of $39,940.51 is available to be spent, of which $1,321.59 is included in restricted net assets expendable for scholarships and fellowships and $38,618.92 is available to be spent for instructional department uses.

NOTE 8. UNRESTRICTED NET ASSETS

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

	June 30, 2008
Working capital	$ 1,117,640.51
Encumbrances	3,821,101.13
Designated fees	1,100,170.37
Auxiliaries	2,766,203.68
Plant construction	16,049,247.51
Renewal and replacement of equipment	9,014,934.49
Undesignated	878,293.05
Total	$ 34,747,590.74

NOTE 9. PENSION PLANS

A. Defined Benefit Plans

1. Tennessee Consolidated Retirement System

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

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

Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 13.62% 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 $4,089,428.71, $3,928,524.36, and $2,676,782.60. Contributions met the requirements for each year.

2. Federal Retirement Program

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

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

Funding Policy - Participating employees and the university are required to contribute to the CSRS plan. Contribution requirements are established and may be amended by federal statutes. The university was required to contribute 7% of covered payroll to the CSRS plan, and employees were required to contribute 7% of covered payroll. Contributions to CSRS for the year ended June 30, 2008, were $57,048.80, which consisted of $28,524.40 from the university and $28,524.40 from the employees. Contributions for the year ended June 30, 2007, were $55,393.80, which consisted of $27,996.90 from the university and $27,396.90 from the employees. Contributions for the year ended June 30, 2006, were $73,637.13, which consisted of $36,818.56 from the university and $36,818.57 from the employees. Contributions 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 $4,777,916.81 for the year ended June 30, 2008, and $3,777,032.64 for the year ended June 30, 2007. Contributions met the requirements for each year.

NOTE 10. OTHER POST-EMPLOYMENT BENEFITS

Healthcare is the only "other post-employment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program which provides post-employment 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 Title 8, Chapter 27, Part 101, *Tennessee Code Annotated*. 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 state makes on-behalf payments to the Medicare supplement plan for the university's eligible retirees; see Note 16. The plans are reported in the *Tennessee Comprehensive Annual Financial Report*. That report 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 Section 8-27-205 (b), *Tennessee Code Annotated*, retirees not eligible for Medicare pay a percentage of the total state premium under the State Employee Group Plan based on years of service, leaving a portion of retiree premiums effectively subsidized by contributions to the State Employee Group Plan for active employees. Retirees with 30 years of service pay 20% of the total premium under the State Employee Group Plan. Retirees with 20 but less than 30 years of service pay 30% of the total premium under the State Employee Group 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 Employee Group Plan. Contributions for the State Employee Group Plan for the year ended June 30, 2008, were $19,771,904.86, which consisted of $10,054,945.64 from the university and $9,716,959.22 from the employees.

Annual OPEB Cost and Net OPEB Obligation

	State Employee Group Plan
Annual Required Contribution (ARC)	$3,094,000.00
Interest on the Net OPEB Obligation	-
Adjustment to the ARC	-
Annual OPEB Cost	3,094,000.00
Amount of Contribution	(1,092,909.92)
Increase (decrease) in Net OPEB Obligation	2,001,090.08
Net OPEB Obligation – Beginning of Year	-
Net OPEB Obligation – End of Year	$2,001,090.08

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2008	State Employee Group Plan	$3,094,000.00	35.3%	$2,001,090.98

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

	State Employee Group Plan
Actuarial valuation date	July 1, 2007
Actuarial accrued liability (AAL)	$26,258,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$26,258,000.00
Actuarial value of assets as a percentage of the AAL	0.00%
Covered payroll (active plan members)	$92,730,202.17
UAAL as percentage of covered payroll	28.3%

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 multi-year 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 percent investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 7 percent initially, increased to 11 percent in the second year and then reduced by decrements to an ultimate rate of 5 percent after 12 years. Both rates include a 3 percent 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 11. INSURANCE-RELATED ACTIVITIES

It is the policy of the state not to purchase commercial insurance for the risks of losses for general liability, automobile liability, professional malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund. The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The amount of settlements has not exceeded insurance coverage for each of the three past 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 $422,335,276.00 for buildings and $84,474,843.00 for contents.

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

NOTE 12. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The dollar amount of unused sick leave was $31,732,150.96 at June 30, 2008.

Operating Leases - The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $87,758.77 and for personal property were $21,628.83 for the year ended June 30, 2008. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2008, outstanding commitments under construction contracts totaled $1,553,955.68 for ADA Improvements, Agriculture I.T., Avon Williams Campus Improvements, Power Plant Mechanical Upgrade, Agricultural Extension Center, Research and Sponsored Programs building, Clement Hall/Allied Health Upgrade, Elliott Hall Exhibition, Student Housing Fire Suppression, and several building improvements, of which $906,395.91 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 13. CHAIRS OF EXCELLENCE

The university had $4,285,551.82 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 the financial statements.

NOTE 14. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

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

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$37,414,958.55	$11,914,648.92	$10,171,465.64	$ 782,768.01	$ -	$ 60,283,841.12
Research	5,792,727.54	1,779,661.46	2,942,385.31	85,204.24	-	10,599,978.55
Public service	3,991,186.04	1,721,105.49	1,506,743.27	16,516.98	-	7,235,551.78
Academic support	5,955,042.60	2,120,031.62	2,681,699.90	42,064.74	-	10,798,838.86
Student services	7,642,137.70	2,661,846.11	1,119,352.34	1,098,904.73	-	12,522,240.88
Institutional support	9,734,828.55	3,838,785.51	1,130,481.41	6,918.68	-	14,711,014.15
Operation & maintenance	3,362,473.22	1,563,897.65	10,502,460.22	-	-	15,428,831.09
Scholar. & fellow.	7,954.64	3,223.97	13,495,483.57	3,199,623.94	-	16,706,286.12
Auxiliary	1,871,767.13	611,311.80	7,450,007.20	174,074.00	-	10,107,160.13
Depreciation	-	-	-	-	9,585,634.75	9,585,634.75
Total	$75,773,075.97	$26,214,512.53	$51,000,078.86	$5,406,075.32	$9,585,634.75	$167,979,377.43

NOTE 15. 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.

NOTE 16. ON-BEHALF PAYMENTS

During the year ended June 30, 2008, the State of Tennessee made payments of $56,555.38 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 10. The plan is reported in the *Tennessee Comprehensive Annual Financial Report*. That report is available on the state's website at http://tennessee.gov/finance/act/cafr.html.

NOTE 17. COMPONENT UNIT

The Tennessee State University Foundation is a legally separate, tax-exempt organization supporting Tennessee State University. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The 15-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. The size of the board shall be determined by the majority votes of its members, and any vacancy in its membership shall be filled in the same way. The entire membership of the Board of Trustees shall not exceed 25 in number and a minimum of 8. All trustees shall serve until the expiration of their respective terms and until their respective successors are selected and qualified. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2008, the foundation made distributions of $72,642.06 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Mr. Shereitte Stokes, Vice-President for University Relations and Development, 3500 John A. Merritt Boulevard, Nashville, TN 37209.

Cash and cash equivalents - In addition to demand deposits and petty cash on hand, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less. At June 30, 2008, cash and cash equivalents consisted of $1,929,520.72 in bank accounts and $3,087,551.61 in money market accounts.

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. Treasury	$ 549,645.37	$ 234,560.33	$157,616.40	$157,468.64	$ -	$ -
U.S. agencies	272,176.71	-	272,176.71	-	-	-
Corporate stocks	1,367,570.36	-	-	-	-	1,367,570.36
Corporate bonds	1,271,924.99	79,489.20	694,597.61	345,731.96	152,106.22	-
Exchange traded funds	21,414,789.82	-	-	-	-	21,414,789.82
Other:						
Mortgage-backed securities	1,538,677.56	-	-	92,591.35	1,446,086.21	-
REITS	2,915,040.76	-	-	-	-	2,915,040.76
Money market accounts	3,087,551.61	-	-	-	-	3,087,551.61
Savings accounts	3,081.75	-	-	-	-	3,081.75
Less amounts reported as cash and cash equivalents:						
Money market accounts	(3,087,551.61)	-	-	-	-	(3,087,551.61)
Savings accounts	(3,081.75)	-	-	-	-	(3,081.75)
Total	$29,329,825.57	$ 314,049.53	$1,124,390.72	$595,791.95	$1,598,192.43	$25,697,400.94

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

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Securities are rated using Standard and Poor's, Moody's, and/or Fitch and are presented below using the Standard and Poor's rating scale. The foundation has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations.

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

		Credit Quality Rating				
Investment Type	Fair Value	AAA	AA	A	B	Unrated
U.S. agencies	$ 272,176.71	$272,176.71	$ -	$ -	$ -	$ -
Corporate bonds	1,271,924.99	76,547.20	422,251.43	616,989.43	156,136.93	-
Exchange traded funds	7,696,044.84	-	-	-	-	7,696,044.84
Collateralized mortgage obligation	1,538,677.56	-	-	-	-	1,538,677.56
Total	$10,778,824.10	$348,723.91	$422,251.43	$616,989.43	$156,136.93	$9,234,722.40

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

At June 30, 2008, more than 5% of the foundation's investments were invested in the following single issuers:

Issuer	Percentage of Total Investments
Charles Schwab	64%
Regions Morgan Keegan	25%
Inland American	5%

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

The foundation chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the foundation, the cost of operating Tennessee State University including general operating costs and maintenance costs, and costs for administrating and managing the endowment fun has been authorized for expenditure. For Title III funds, the foundation must reinvest a minimum of 50% of the annual income generated by the fund. For the Consent Decree Fund, the foundation must reinvest a minimum of 25% of the annual income and may spend up to 75% of the annual income generated by the fund with all disbursement decisions made by the sole discretion of the Budget Committee established by the Trust Agreement. At June 30, 2008, net appreciation of $382,315.97 is available to be spent, of which $292,844.95 is included in restricted net assets expendable for scholarships and fellowships, and $89,471.02 is included in restricted net assets expendable for other.

Tennessee Board of Regents
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)]
7/01/2007	State Employee Group Plan	$ 0.00	$26,258,000.00	$26,258,000.00	0.00%	$92,730,202.17	28.3%

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
SUPPLEMENTARY SCHEDULE OF CASH FLOWS - COMPONENT UNIT
FOR THE YEAR ENDED JUNE 30, 2008

		Year Ended June 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$	1,169,606.01
Payments to suppliers and vendors		(618,800.24)
Payments for scholarships and fellowships		(448,514.69)
Payments to Tennessee State University		(72,642.06)
Other receipts (payments)		199,948.75
Net cash provided by operating activities		229,597.77
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes		264,255.00
Net cash provided by noncapital financing activities		264,255.00
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		37,426,637.76
Income on investments		1,129,908.20
Purchases of investments		(40,435,061.04)
Net cash used by investing activities		(1,878,515.08)
Net decrease in cash and cash equivalents		(1,384,662.31)
Cash and cash equivalents - beginning of year		6,401,734.64
Cash and cash equivalents - end of year	$	5,017,072.33
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	223,322.01
Adjustments to reconcile operating income to net cash provided by operating activities:		
Accounts payable		6,275.76
Net cash provided by operating activities	$	229,597.77
Noncash transactions		
Unrealized losses on investments	$	(948,518.06)