AUDIT REPORT

Tennessee Board of Regents
State University and Community College
System of Tennessee – Central Office

For the Years Ended
June 30, 2009, and 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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For more information about the Comptroller of the Treasury, please visit our website at www.tn.gov/comptroller/.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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DIVISION OF STATE AUDIT
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May 20, 2010

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the State University and Community College System of Tennessee – Central Office, for the years ended June 30, 2009, and June 30, 2008. You will note from the independent auditor's report that unqualified opinions were given on the fairness of the presentation of the financial statements.

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

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/vdn
09/088

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
Tennessee Board of Regents
State University and Community College
System of Tennessee – Central Office
For the Years Ended June 30, 2009, and June 30, 2008

AUDIT OBJECTIVES

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

AUDIT FINDINGS

The audit report contains no findings.

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

Audit Report
Tennessee Board of Regents
State University and Community College
System of Tennessee – Central Office
For the Years Ended June 30, 2009, and June 30, 2008

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INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the State University and Community College System of Tennessee – Central Office. 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

The State University and Community College System of Tennessee was created by the General Assembly in 1972. The system now includes 6 universities, 13 community colleges, and 26 technology centers. The Tennessee Board of Regents is vested with the responsibility of governing the system. The Central Office provides essential centralized services and uniform procedures for the institutions in the system. Among the Central Office's major responsibilities are prescribing curricula and requirements for diplomas, approving operating and capital budgets, and establishing policies and procedures regarding campus life.

ORGANIZATION

The governance of the State University and Community College System of Tennessee – Central Office 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 system is the chancellor.

AUDIT SCOPE

The audit was limited to the period July 1, 2007, through June 30, 2009, 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 years ended June 30, 2009, and June 30, 2008. The State University and Community College System of Tennessee – Central Office is a part 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 Central Office'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.

PRIOR AUDIT FINDING

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 Central Office filed its report with the Department of Audit on May 12, 2009. A follow-up of the prior audit finding was conducted as part of the current audit.

The current audit disclosed that the Central Office has corrected the previous audit finding concerning documentation of information system access priveleges, alignment of such privileges with user job requirements, and inadequate controls over accounts payable within the information system.

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 Central Office. 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 Central Office 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 Central Office.

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 Central Office. 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 Central Office's financial statements for the years ended June 30, 2009, and June 30, 2008, we considered internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance and Other Matters

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.

Fairness of Financial Statement Presentation

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

STATE OF TENNESSEE
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DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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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*

April 19, 2010

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

Ladies and Gentlemen:

We have audited the financial statements of the State University and Community College System of Tennessee – Central Office, a part of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the years ended June 30, 2009, and June 30, 2008, and have issued our report thereon dated April 19, 2010. During the year ended June 30, 2008, the Central Office 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 Central Office'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 Central Office's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the Central Office's internal control over financial reporting.

A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the Central Office'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 Central Office's financial statements that is more than inconsequential will not be prevented or detected by the entity's internal control.

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

Our consideration of 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 or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above. However, we noted certain matters involving the internal control over financial reporting, which we have reported to the Central Office's management in a separate letter.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the Central Office's financial statements are free of material misstatement, we performed tests of the Central Office'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.

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/vdn

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

April 19, 2010

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

Ladies and Gentlemen:

We have audited the accompanying basic financial statements of the State University and Community College System of Tennessee – Central Office, a part of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the years ended June 30, 2009, and June 30, 2008, as listed in the table of contents. These financial statements are the responsibility of the Central Office'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 the State University and Community College System of Tennessee, a part of the Tennessee Board of Regents, are intended to present the financial position, the changes in financial position, and the cash flows of only the Central Office. They do not purport to, and do not, present fairly the financial position of the Tennessee Board of Regents, as of June 30, 2009, and June 30, 2008, and the changes in its financial position and cash flows for the years 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 State University and Community College System of Tennessee – Central Office, as of June 30, 2009, and 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 Central Office implemented GASB Statement 45, *Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions.*

The management's discussion and analysis on pages 10 through 21 and the schedule of funding progress on page 40 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.

In accordance with generally accepted government auditing standards, we have also issued our report dated April 19, 2010, on our consideration of the Central Office'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/vdn

Tennessee Board of Regents
State University and Community College
System of Tennessee – Central Office
Management's Discussion and Analysis

This section of the Central Office's report presents a discussion and analysis of the financial performance of the Central Office during the fiscal years ended June 30, 2009, and 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. The financial statements, notes, and this discussion are the responsibility of management.

Using This Annual Report

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

The Statement of Net Assets

The Statement of Net Assets presents the financial position of the Central Office at the end of the fiscal year and includes all assets and liabilities of the Central Office. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the Central Office. 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 Central Office's equity in property, plant, and equipment owned by the Central Office. 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 Central Office 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 Central Office for any lawful purpose of the Central Office.

**Central Office
Net Assets (in thousands of dollars)**

	2009	2008	2007
Assets:			
Current assets	$ 7,820	$ 6,117	$ 4,383
Capital assets, net	616	733	713
Other assets	8,449	5,858	5,130
Total Assets	**16,885**	**12,708**	**10,226**
Liabilities:			
Current liabilities	5,000	3,739	2,298
Noncurrent liabilities	1,710	1,218	698
Total Liabilities	**6,710**	**4,957**	**2,996**
Net Assets:			
Invested in capital assets	616	733	713
Restricted – nonexpendable	534	474	474
Restricted – expendable	3,779	2,262	1,330
Unrestricted	5,246	4,282	4,713
Total Net Assets	**$ 10,175**	**$ 7,751**	**$ 7,230**

Comparison of FY 2009 to FY 2008

- Current assets increased because of an increase in cash held for others in agency funds and an increase in unrestricted and restricted cash resulting from spending reduction efforts in 2009.

- The decrease in capital assets resulted from reduced equipment purchases in 2009, the retirement of old equipment items, and depreciation.

- Other assets increased as a result of an increase in noncurrent cash, including renewal and replacement funds and restricted funds held for Access and Diversity programs.

- Current liabilities - Based upon guidance provided by the Tennessee Recovery Act Management Office, the total allotment of FY 2008-09 State Fiscal Stabilization Funds (SFSF) in the amount of $777,300 was drawn down and receipted as of June 30, 2009. It was subsequently determined that institutions would not lose the availability of funds not drawn down at June 30, 2009, and SFSF of $777,300 were returned on July 13, 2009, and are included on the Statement of Net Assets as Due to Primary Government. In addition, agency funds accounts payable increased more than $500,000 and deposits held in custody for others increased significantly.

- The increase in noncurrent liabilities resulted from a significant increase in the OPEB liability.

- Restricted, expendable net assets increased from 2008 to 2009 for unspent Access and Diversity program funds.

- Unrestricted net assets increased from 2008 to 2009 because of funds held in Renewal and Replacement funds for future computer equipment purchases.

<u>Comparison of FY 2008 to FY 2007</u>

- Current assets increased because of an increase in cash held for others in agency funds and because of cost-cutting efforts to reduce cash outlays.

- The increase in capital assets resulted from equipment purchases in 2008.

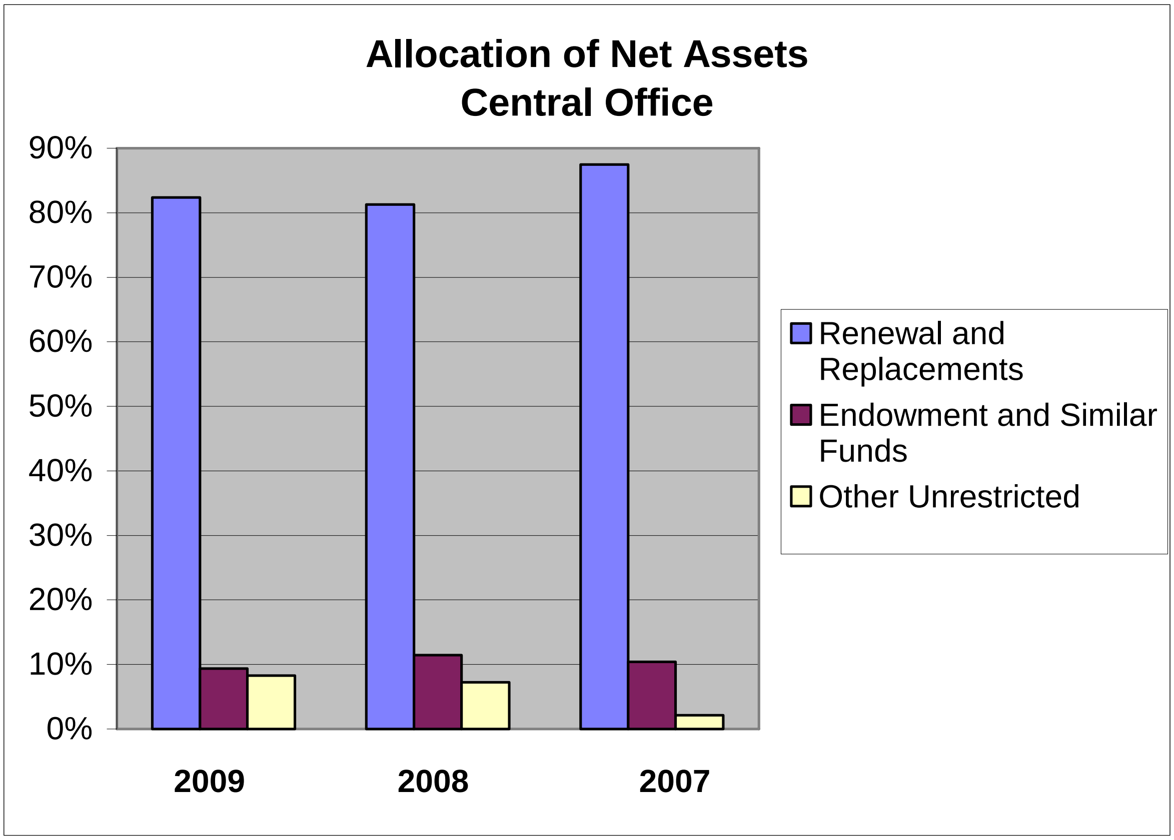
- The increase in current liabilities is due to increases in deposits held in custody for others for the Tennessee Technology Centers and accrued liabilities for employee benefits resulting from timing differences.

- Restricted, expendable net assets increased from 2007 to 2008 for the Access and Diversity programs.

- Unrestricted net assets decreased from 2007 to 2008 because of large expenses incurred for the OPEB liability and legal settlements for employment related cases.

- Noncurrent liabilities increased due to an increase in the compensated absences liability and the OPEB liability.

Many of the Central Office's unrestricted net assets have been designated or reserved for specific purposes such as repairs and replacement of equipment and quasi-endowments. The following graph shows the allocations:



<u>Comparison of FY 2009 to FY 2008</u>

- Renewals and Replacements increased because of spending reduction efforts in 2009 and funds held for future computer equipment purchases.

- Other unrestricted net assets increased because of unspent Regents On-line Degree Program funds in 2009.

<u>Comparison of FY 2008 to FY 2007</u>

- Other unrestricted net assets decreased because of large expenses incurred in 2008 for the OPEB liability, increased compensated absences liability, and legal settlement costs.

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

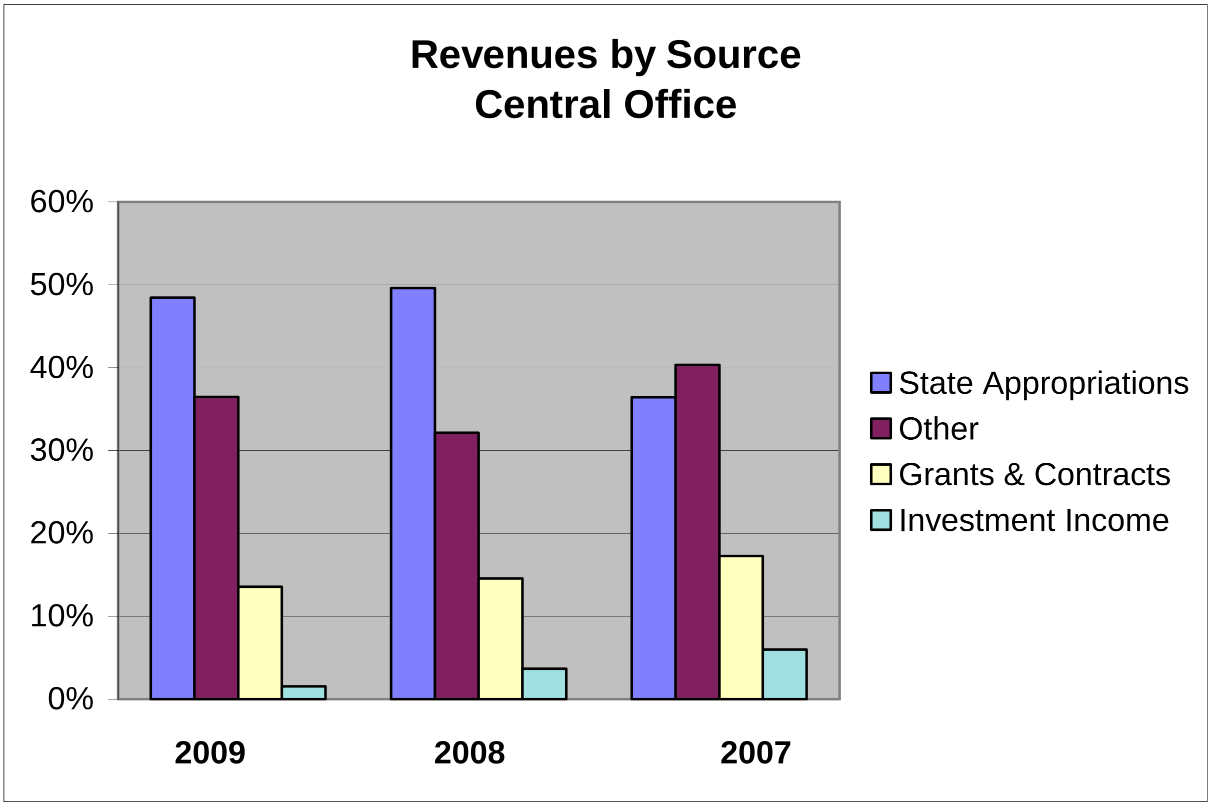
The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the Central Office, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered non-operating revenues according to accounting principles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

Central Office
Changes in Net Assets (in thousands of dollars)

	2009	2008	2007
Operating revenues:			
Grants and contracts	$ 4,370	$ 4,777	$ 3,839
Other	11,761	10,559	8,959
Total operating revenues	**16,131**	**15,336**	**12,798**
Operating expenses	29,830	32,312	19,966
Operating loss	**(13,699)**	**(16,976)**	**(7,168)**
Non-operating revenues and expenses:			
State appropriations	15,629	16,288	8,101
Investment income	493	1,208	1,330
Other non-operating revenues (expenses)	1	-	8
Total non-operating revenues and expenses	**16,123**	**17,496**	**9,439**
Income before other revenues, expenses, gains, or losses	**2,424**	**520**	**2,271**
Other revenues, expenses, gains, or losses:			
Other – Capital Revenues	-	1	-
Total other revenues, expenses, gains, or losses	**-**	**1**	**-**
Increase in net assets	**2,424**	**521**	**2,271**
Net assets at beginning of year	7,751	7,230	4,959
Net assets at end of year	**$ 10,175**	**$ 7,751**	**$ 7,230**

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which are used to fund the Central Office's operating activities for the years ended June 30, 2009; June 30, 2008; and June 30, 2007.



<u>Comparison of FY 2009 to FY 2008</u>

- State appropriations decreased due to decreased legislative appropriations.
- Other income increased due to an increase in Regents Online Degree Program revenues and an increase in system charges to the institutions.
- Investment income decreased due to a significant fall in interest rates.

Comparison of FY 2008 to FY 2007

- State appropriations increased due to increased appropriations for Access and Diversity programs.
- Other income increased largely due to an increase in Regents Online Degree Program revenues and an increase in system charges to the institutions.
- An increase in grants and contracts from 2007 to 2008 resulted from additional funds received for the consent decree programs.
- Investment income decreased due to a fall in interest rates and the timing of revenues and expenses.

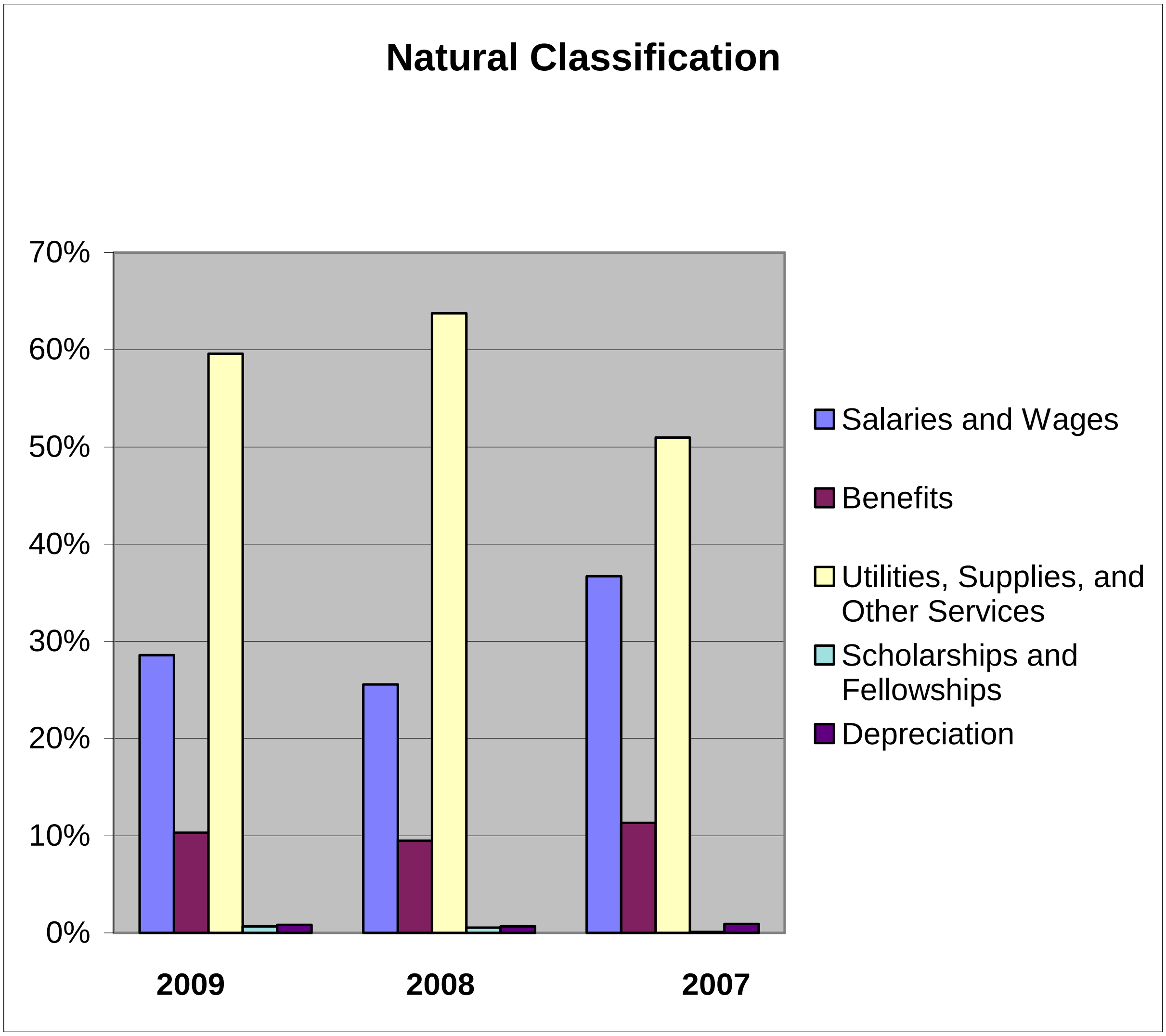
Expenses

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

Natural Classification

Central Office
Operating Expenses (in thousands of dollars)

	2009	2008	2007
Salaries and Wages	$ 8,528	$ 8,259	$ 7,326
Benefits	3,077	3,068	2,260
Utilities, Supplies, and Other Services	17,777	20,600	10,179
Scholarships and Fellowships	202	173	17
Depreciation	246	212	184
Total Operating Expenses	**$ 29,830**	**$ 32,312**	**$ 19,966**



Comparison of FY 2009 to FY 2008

- A decrease in operating expenses from 2008 to 2009 resulted from decreased expenses during the current economic slowdown, and there were no costs of legal settlements for the 2009 year.

- An increase in spending for scholarships and fellowships was due to an additional Floyd scholarship award in 2009 and increased spending for Jones scholarships.

- The increase in depreciation from 2008 to 2009 was caused by reduced purchases for the replacement of equipment and the aging of current equipment.

Comparison of FY 2008 to FY 2007

- An increase in operating expenses from 2007 to 2008 resulted from increased expenses for the Access and Diversity programs and costs of legal settlements.

- Increased salary and benefit costs resulted from additional positions and general salary increases.

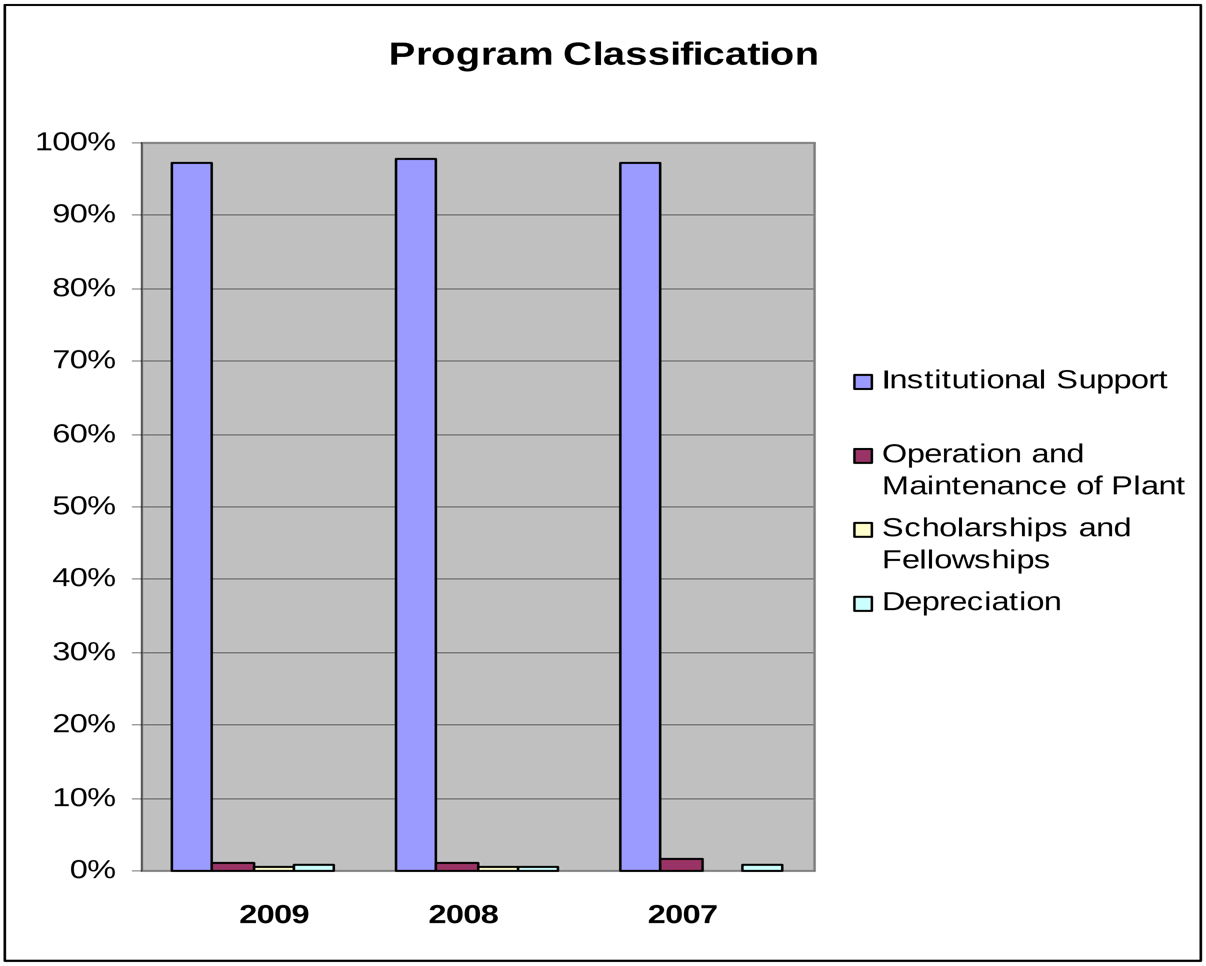
- The increase in scholarship and fellowship expenses was for payments for the Washington Center internship program.

- The increase in depreciation was due to the first full year of depreciation on the phone system and other various equipment items.

Program Classification

Central Office
Operating Expenses (in thousands of dollars)

	2009	2008	2007
Institutional Support	$ 29,025	$ 31,573	$ 19,411
Operation of Maintenance and Plant	357	354	354
Scholarships and Fellowships	202	173	17
Depreciation	246	212	184
Total Operating Expenses	**$ 29,830**	**$ 32,312**	**$ 19,966**



<u>Comparison of FY 2009 to FY 2008</u>

- Decreases in institutional support from 2008 to 2009 resulted from decreased Access and Diversity grant spending and from general decreases in spending due to poor economic conditions.

- An increase in spending for scholarships and fellowships was due to an additional Floyd scholarship award in 2009 and increased spending for Jones scholarships.

- The increase in depreciation from 2008 to 2009 is caused by reduced purchases for replacement of equipment and the aging of current equipment.

Comparison of FY 2008 to FY 2007

- Increases in institutional support from 2007 to 2008 resulted mostly from increased grant expenses for the Access and Diversity programs.
- The increase in Scholarship and Fellowship expenses was for payments for the Washington Center internship program.
- The increase in depreciation was due to the first full year of depreciation on the phone system and other various equipment items.

Capital Assets

The Central Office had $616,255.01 invested in capital assets, net of accumulated depreciation of $970,428.17 at June 30, 2009; $732,658.32 invested in capital assets, net of accumulated depreciation of $835,200.46 at June 30, 2008; and $713,023.51 invested in capital assets, net of accumulated depreciation of $794,658.38 at June 30, 2007. Depreciation charges totaled $246,072.75, $212,045.37, and $183,608.81 for the years ended June 30, 2009; June 30, 2008; and June 30, 2007, respectively. Details of these assets are shown below.

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

	2009	2008	2007
Equipment	616	733	713

The Central Office purchased vehicles to replace an aging fleet and made some upgrades to equipment, causing the increase in assets for 2008.

The central office made no significant changes to equipment in 2009; the decrease was largely due to the increase in depreciation for the 2009 fiscal year.

The Central Office has no immediate plans for significant capital expenditures for fiscal year 2010.

Economic Factors That Will Affect the Future

We are not aware of economic factors that are expected to have a significant impact on the financial position or results of operations in the future. Economic factors will continue to affect investment income earnings.

Requests for Information

This financial report is designed to provide a general overview of the Central Office's finances for all those with an interest in the Central Office's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to Dale Sims, Vice Chancellor for Business and Finance, Tennessee Board of Regents, 1415 Murfreesboro Road, Suite 350, Nashville, TN 37217.

Exhibit A

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENTS OF NET ASSETS
JUNE 30, 2009, AND JUNE 30, 2008

	June 30, 2009	June 30, 2008
ASSETS		
Current assets:		
Cash (Note 2)	$ 6,575,608.28	$ 5,371,780.05
Accounts and grants receivable (net) (Note 4)	1,241,106.97	739,943.21
Prepaid expenses and deferred charges	3,378.48	5,210.22
Other assets	175.00	175.00
Total current assets	7,820,268.73	6,117,108.48
Noncurrent assets:		
Cash (Note 2)	8,448,860.73	5,857,692.40
Capital assets (net) (Note 5)	616,225.01	732,658.32
Total noncurrent assets	9,065,085.74	6,590,350.72
Total assets	16,885,354.47	12,707,459.20
LIABILITIES		
Current liabilities:		
Accounts payable (Note 6)	1,480,966.54	601,741.55
Accrued liabilities	171,988.47	402,476.24
Due to primary government	777,300.00	-
Deferred revenue	-	54,812.23
Compensated absences (Note 7)	272,325.20	315,873.55
Deposits held in custody for others	2,297,476.66	2,363,721.09
Total current liabilities	5,000,056.87	3,738,624.66
Noncurrent liabilities:		
Net OPEB obligation (Notes 7 and 11)	944,585.00	475,929.00
Compensated absences (Note 7)	765,956.65	742,221.61
Total noncurrent liabilities	1,710,541.65	1,218,150.61
Total liabilities	6,710,598.52	4,956,775.27
NET ASSETS		
Invested in capital assets	616,225.01	732,658.32
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	534,042.85	474,295.88
Expendable:		
Other adjustments (Note 17)	17,159.30	68,402.77
Other	3,761,181.13	2,193,658.52
Unrestricted (Notes 8 and 9)	5,246,147.66	4,281,668.44
Total net assets	$ 10,174,755.95	$ 7,750,683.93

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

Exhibit B

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2009, AND JUNE 30, 2008

	Year Ended June 30, 2009	Year Ended June 30, 2008
REVENUES		
Operating revenues:		
Governmental grants and contracts	$ 4,369,934.86	$ 4,777,136.77
Other operating revenues	11,760,946.58	10,558,583.94
Total operating revenues	16,130,881.44	15,335,720.71
EXPENSES		
Operating expenses (Note 14):		
Salaries and wages	8,527,546.29	8,258,796.08
Benefits	3,076,713.03	3,067,699.88
Utilities, supplies, and other services	17,777,018.59	20,600,610.46
Scholarships and fellowships	202,089.00	173,268.90
Depreciation expense	246,072.75	212,045.37
Total operating expenses	29,829,439.66	32,312,420.69
Operating loss	(13,698,558.22)	(16,976,699.98)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	15,629,059.00	16,288,100.00
Investment income	492,945.25	1,208,086.32
Other non-operating revenues/(expenses)	625.99	-
Net nonoperating revenues	16,122,630.24	17,496,186.32
Income before other revenues, expenses, gains, or losses	2,424,072.02	519,486.34
Other capital	-	1,049.67
Total other revenues	-	1,049.67
Increase in net assets	2,424,072.02	520,536.01
NET ASSETS		
Net assets - beginning of year	7,750,683.93	7,230,147.92
Net assets - end of year	$ 10,174,755.95	$ 7,750,683.93

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

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2009, AND JUNE 30, 2008

	Year Ended June 30, 2009	Year Ended June 30, 2008
CASH FLOWS FROM OPERATING ACTIVITIES		
Grants and contracts	$ 4,492,279.89	$ 5,220,055.32
Payments to suppliers and vendors	(17,261,797.86)	(20,899,786.09)
Payments to employees	(8,544,337.23)	(8,182,929.18)
Payments for benefits	(2,836,408.17)	(2,266,729.30)
Payments for scholarships and fellowships	(202,164.89)	(173,268.90)
Other receipts (payments)	11,760,946.58	10,558,583.94
Net cash used by operating activities	(12,591,481.68)	(15,744,074.21)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	15,629,300.00	16,287,000.00
Change in deposits held for others	393,246.44	1,155,037.59
Net cash provided by noncapital financing activities	16,022,546.44	17,442,037.59
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchases of capital assets	(137,325.50)	(253,271.26)
Proceeds from sale of capital assets	8,312.05	22,640.75
Net cash used by capital and related financing activities	(129,013.45)	(230,630.51)
CASH FLOWS FROM INVESTING ACTIVITIES		
Income on investments	492,945.25	1,208,086.32
Net cash provided by investing activities	492,945.25	1,208,086.32
Net increase in cash	3,794,996.56	2,675,419.19
Cash - beginning of year	11,229,472.45	8,554,053.26
Cash - end of year	$ 15,024,469.01	$ 11,229,472.45
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (13,698,558.22)	$ (16,976,699.98)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	246,072.75	212,045.37
Other adjustments (Note 17)	5,159.00	-
Change in assets and liabilities:		
Receivables, net	(461,245.89)	250,084.47
Prepaid/deferred items	1,831.74	(254.10)
Accounts payable	374,416.25	(160,024.68)
Accrued liabilities	238,168.23	787,314.54
Deferred revenues	(54,812.23)	53,937.23
Compensated absences	(19,813.31)	89,522.94
Due to primary government	777,300.00	-
Net cash used by operating activities	$ (12,591,481.68)	$ (15,744,074.21)
Noncash transactions		
Gain on disposal of capital assets	$ -	$ 1,049.67

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

Tennessee Board of Regents
State University and Community College
System of Tennessee – Central Office
Notes to the Financial Statements
June 30, 2009, and June 30, 2008

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Central Office 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 significant 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 the Central Office.

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 Central Office 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 Central Office has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The Central Office has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

Amounts reported as operating revenues include certain federal, state, local, and private grants and contracts, and other sources of revenue. Operating expenses for the Central Office 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 state appropriations for operations and investment income.

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

Compensated Absences

The Central Office'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 equipment, 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.

Equipment is capitalized when the unit acquisition cost is $5,000 or greater. Equipment is depreciated using the straight-line method over the estimated useful lives, which range from 5 to 10 years.

Net Assets

The Central Office's net assets are classified as follows:

<u>Invested in capital assets</u> - This represents the Central Office's total investment in capital assets.

<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.

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

Unrestricted net assets - Unrestricted net assets represent resources derived from state appropriations and system charges to the institutions. These resources are used for transactions relating to the educational and general operations of the Central Office, and may be used at the discretion of the Central Office to meet current expenses for any purpose.

NOTE 2. CASH

At June 30, 2009, cash consisted of $1,827,379.64 in bank accounts, $100.00 of petty cash on hand, and $13,196,989.37 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer. At June 30, 2008, cash consisted of $1,875,111.92 in bank accounts, $100.00 of petty cash on hand, and $9,354,260.53 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer.

NOTE 3. INVESTMENTS

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The Central Office 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 which are 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 Central Office and that endowment investments be prudently diversified. Securities are rated using Standard and Poor's, Moody's, and/or Fitch's rating agencies. 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 rating services that have rated the issuer. The policy further requires that commercial paper must be issued by corporations with a minimum rating of A1 or equivalent as provided by 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. As of June 30, 2009, and June 30, 2008, the Central Office's investments consisted entirely of investments in the Local Government Investment Pool. The fair value of these investments was $13,196,989.37 at June 30, 2009, and $9,354,260.53 at June 30, 2008. LGIP investments are not rated by nationally recognized statistical ratings organizations.

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2009	June 30, 2008
Grants receivable	$1,046,029.96	$400,953.04
State appropriation receivable	9,400.00	38,500.00
Other receivables	185,677.01	300,490.17
Total receivables	$1,241,106.97	$739,943.21

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2009, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Equipment	$1,567,858.78	$ 137,325.50	$118,531.10	$1,586,653.18
Less accumulated depreciation	835,200.46	246,072.75	110,845.04	970,428.17
Capital assets, net	$ 732,658.32	$(108,747.25)	$ 7,686.06	$ 616,225.01

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

	Beginning Balance	Additions	Reductions	Ending Balance
Equipment	$1,507,681.89	$254,662.84	$194,485.95	$1,567,858.78
Less accumulated depreciation	794,658.38	212,045.37	171,503.29	835,200.46
Capital assets, net	$ 713,023.51	$ 42,617.47	$ 22,982.66	$ 732,658.32

NOTE 6. ACCOUNTS PAYABLE

Accounts payable included the following:

	June 30, 2009	June 30, 2008
Payable to suppliers and vendors	$ 915,345.35	$540,929.10
Payable to member institutions	565,621.19	60,812.45
Total accounts payable	$1,480,966.54	$601,741.55

NOTE 7. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2009, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Other liabilities:					
Compensated absences	$ 1,058,095.16	$ 561,695.78	$ 581,509.09	$ 1,038,281.85	$ 272,325.20
Net OPEB obligation	475,929.00	468,656.00	-	944,585.00	-
Total long-term liabilities	$ 1,534,024.16	$ 1,030,351.78	$ 581,509.09	$ 1,982,866.85	$ 272,325.20

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

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Other liabilities:					
Compensated absences	$ 968,572.22	$ 677,802.85	$ 588,279.91	$ 1,058,095.16	$ 315,873.55
Net OPEB obligation	-	475,929.00	-	475,929.00	-
Total long-term liabilities	$ 968,572.22	$ 1,153,731.85	$ 588,279.91	$ 1,534,024.16	$ 315,873.55

NOTE 8. ENDOWMENTS

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

The Central Office chooses to spend only a portion of the investment income each year. Under the spending plan established by the board, expenditures are limited to one new four-year scholarship awarded each year, and funding three previously awarded scholarships. Allowable scholarship expenditures are limited to the following: the cost of in-state tuition and fees, room and board (or a commuting allowance), a stipend of $500 per year, and a $500 annual book allowance. The remaining amount, if any, is retained for use in future years. At June 30, 2009, net appreciation of $99,301.22 is available to be spent, of which $17,159.30 is included in restricted net assets expendable for scholarships and fellowships, and $82,141.92 is included in unrestricted net assets. At June 30, 2008, net appreciation of $167,912.82 is available to be spent, of which $68,402.77 is included in restricted net assets expendable for scholarships and fellowships and $99,510.05 is included in unrestricted net assets.

NOTE 9. 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, 2009	June 30, 2008
Working capital	$ 79,633.51	$ 173,863.42
Encumbrances	3,841.94	119,580.48
Quasi-endowment	491,179.20	491,179.20
Renewal and replacement of equipment	4,321,348.46	3,480,225.95
Undesignated	350,144.55	16,819.39
Total	$5,246,147.66	$4,281,668.44

NOTE 10. PENSION PLANS

A. Defined Benefit Plan

Tennessee Consolidated Retirement System

Plan Description - The Central Office 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 is available on the state's website at http://www.state.tn.us/treasury/tcrs/index.html.

<u>Funding Policy</u> - Plan members are noncontributory. The Central Office is required to contribute an actuarially determined rate. The current rate is 13.02% of annual covered payroll. Contribution requirements for the Central Office are established and may be amended by the TCRS' Board of Trustees. The Central Office's contributions to TCRS for the years ended June 30, 2009, 2008, and 2007 were $635,332.47, $698,339.27, and $618,431.98. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

<u>Plan Description</u> - The Central Office contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund (TIAA-CREF), ING 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.

<u>Funding Policy</u> - Plan members are noncontributory. The Central Office 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 Central Office to the plans was $298,381.58 for the

year ended June 30, 2009, and $282,674.29 for the year ended June 30, 2008. Contributions met the requirements for each year.

NOTE 11. OTHER POST-EMPLOYMENT BENEFITS

Healthcare is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program which provides postemployment health insurance benefits to eligible Central Office retirees. This program includes two plans – the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Section 8-27-201, *Tennessee Code Annotated,* for the State Employee Group Plan and Section 8-27-701, *Tennessee Code Annotated,* for the Medicare Supplement Plan. Prior to reaching age 65, retirees may participate in the State Employee Group Plan. Members of this plan 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, retirees who are also in the state's retirement system may participate in the Medicare Supplement Plan that does not include pharmacy. The state makes on-behalf payments to the Medicare supplement plan for the Central Office'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, or by calling (615) 741-2140.

Special Funding Situation

The State of Tennessee is legally responsible for contributions to the Medicare Supplement Plan that covers the retirees of other governmental entities, including the Central Office. The state is the sole contributor for the Central Office retirees that participate in the Medicare Supplement Plan and, therefore, is acting as the employer.

Funding Policy

The premium requirements of members of the State Employee Group Plan are established and may be amended by the insurance committee. The plan is 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. Administrative costs of the plan are allocated to participants. Retirees in the State Employee Group Plan pay the same base premium as active employees in the plan adjusted for years of service. Retirees with 30 years of service pay 20% of the total premium. Retirees with 20 but less than 30 years of service pay 30% of the total premium. Retirees with less than 20 years of service pay 40% of the total premium.

Central Office's Annual OPEB Cost and Net OPEB Obligation
State Employee Group Plan

	2009	2008
Annual required contribution (ARC)	$ 589,000.00	$ 577,000.00
Interest on the net OPEB obligation	21,417.00	-
Adjustment to the ARC	(20,845.00)	-
Annual OPEB cost	589,572.00	577,000.00
Amount of contribution	(120,916.00)	(101,071.00)
Increase (decrease) in net OPEB obligation	468,656.00	475,929.00
Net OPEB obligation – beginning of year	475,929.00	-
Net OPEB obligation – end of year	$ 944,585.00	$ 475,929.00

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2009	State Employee Group Plan	$589,572.00	20.5%	$944,585.00
June 30, 2008	State Employee Group Plan	$577,000.00	17.5%	$475,929.00

Funded Status and Funding Progress

The funded status of the Central Office's portion of the State Employee Group Plan as of July 1, 2007, was as follows:

State Employee Group Plan

Actuarial valuation date	July 1, 2007
Actuarial accrued liability (AAL)	$9,385,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$9,385,000.00
Actuarial value of assets as a percentage of the AAL	0.00%
Covered payroll (active plan members)	$8,258,796.00
UAAL as percentage of covered payroll	113.6%

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

Actuarial Methods and Assumptions

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

In the July 1, 2007, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4.5 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 12. INSURANCE-RELATED ACTIVITIES

It is the policy of the state not to purchase commercial insurance for the risks of losses for general liability, automobile liability, professional malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund. The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The amounts of settlements have not exceeded insurance coverage for each of the past three fiscal years. The Risk Management Fund is also responsible for claims for damages to state-owned property up to the amount of the property insurance aggregate deductible amount. The insurance policy deductibles vary from $25,000 per occurrence, depending on the type of coverage, to an aggregate of $5 million.

The Central Office participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the Central Office based on a percentage of the Central Office'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, 2009, and June 30, 2008, are presented in the *Tennessee Comprehensive Annual Financial Report*. The CAFR is available on the state's website at http://tennessee.gov/finance/act/cafr.html. Since the Central Office 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 Central Office 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, 2009, the Risk Management Fund held $127.0 million in cash and cash equivalents designated for payment of claims. 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, 2009, the scheduled coverage for the Central Office was $2,000,000 for contents. At June 30, 2008, the scheduled coverage for the Central Office was $2,000,000 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 Central Office 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 Central Office based on estimates of the ultimate cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

NOTE 13. COMMITMENTS AND CONTINGENCIES

Sick Leave

The Central Office 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 $3,320,285.36 at June 30, 2009, and $3,664,322.90 at June 30, 2008.

Operating Leases

The Central Office has entered into various operating leases for storage/office space and equipment. Such leases will probably continue to be required. Expenses under operating leases for storage/office space were $603,727.80 and for equipment were $2,426.25 for the year ended June 30, 2009. The amount for storage/office space for the year ended June 30, 2008, was $603,825.40. All operating leases are cancelable at the lessee’s option.

Litigation

The Central Office is involved in several lawsuits, most of which are not expected to have a material effect on the accompanying financial statements. A contingent liability of $300,000 was recorded at June 30, 2008 for a litigation settlement related to an employment issue.

NOTE 14. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The Central Office's operating expenses by functional classification for the year ended June 30, 2009, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Institutional support	$ 8,527,546.29	$ 3,076,713.03	$ 17,420,587.27	$ -	$ -	$ 29,024,846.59
Maintenance & operations	-	-	356,431.32	-	-	356,431.32
Scholarships & fellowships	-	-	-	202,089.00	-	202,089.00
Depreciation	-	-	-	-	246,072.75	246,072.75
Total	$ 8,527,546.29	$ 3,076,713.03	$ 17,777,018.59	$ 202,089.00	$ 246,072.75	$ 29,829,439.66

The Central Office'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
Institutional support	$ 8,258,796.08	$ 3,067,699.88	$ 20,246,519.14	$ -	$ -	$ 31,573,015.10
Maintenance & Operations	-	-	354,091.32	-	-	354,091.32
Scholarships & fellowships	-	-	-	173,268.90	-	173,268.90
Depreciation	-	-	-	-	212,045.37	212,045.37
Total	$ 8,258,796.08	$ 3,067,699.88	$ 20,600,610.46	$ 173,268.90	$ 212,045.37	$ 32,312,420.69

NOTE 15. CHANGE IN ACCOUNTING PRINCIPLE

During the year ended June 30, 2008, the Central Office implemented 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, 2009, the State of Tennessee made payments of $5,159.00 on behalf of the Central Office for retirees participating in the Medicare Supplement Plan. The amount for the year ended June 30, 2008, was $1,613.18. The Medicare Supplement Plan is a postemployment benefit healthcare plan and is discussed further in Note 11. 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.

Tennessee Board of Regents
State University and Community College System of Tennessee – Central Office
Required Supplementary Information
OPEB Schedule of Funding Progress
Unaudited

Actuarial Valuation Date	Plan	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c)]
July 1, 2007	State Employee Group Plan	$ -	$9,385,000	$9,385,000	0%	$8,258,796	113.6%