

AUDIT REPORT

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

For the Year Ended
June 30, 2009



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit
Division of State Audit



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

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May 21, 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

and

Dr. Melvin N. Johnson, President
Tennessee State University
3500 John A. Merritt Blvd.
Nashville, Tennessee 37209

Ladies and Gentlemen:

Transmitted herewith is the report on the Endowment for Educational Excellence at Tennessee State University Foundation, for the year ended June 30, 2009. The audit was conducted under the requirements of the trust agreement, which established the endowment. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies. These deficiencies, along with the response of Tennessee State University management, are included in the audit report for the fiscal year ended June 30, 2009, of Tennessee State University and its discretely presented component unit, the Tennessee State University Foundation, of which the Endowment for Educational Excellence is a significant part. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of these deficiencies.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/fd
10/037

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
Endowment for Educational Excellence
Tennessee State University Foundation
For the Year Ended June 30, 2009

AUDIT OBJECTIVES

The objectives of the audit were to determine that disbursements of trust income by Tennessee State University were made in compliance with the trust agreement, to determine the fairness of the presentation of the financial statements, and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

This report contains no audit findings. However, during our audit of Tennessee State University (TSU) for the year ended June 30, 2009, including the Tennessee State University Foundation, of which the Endowment for Educational Excellence is a significant portion, we discovered certain significant deficiencies related to financial reporting for investments. These deficiencies, along with the response of the TSU management responsible for the TSU Foundation, are included in the TSU audit report dated January 27, 2010. The financial statements and the accompanying notes included in this report reflect any changes made necessary by the errors noted during that audit.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

Audit Report
Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
For the Year Ended June 30, 2009

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**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
For the Year Ended June 30, 2009**

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to determine that disbursements of trust income by Tennessee State University were made in compliance with the trust agreement;
 2. to determine the fairness of the presentation of the financial statements; and
 3. to recommend appropriate actions to correct any deficiencies.
-

OBSERVATIONS AND COMMENTS

ISSUES NOTED DURING THE AUDIT OF TENNESSEE STATE UNIVERSITY

During our audit of Tennessee State University (TSU) for the year ended June 30, 2009, including the Tennessee State University Foundation, of which the Endowment for Educational Excellence is a significant portion, we discovered certain significant deficiencies related to financial reporting for investments. These deficiencies, along with the response of the TSU management responsible for the TSU Foundation, are included in the TSU audit report dated January 27, 2010. The financial statements and the accompanying notes included in this report reflect any changes made necessary by the errors noted during that audit.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Compliance With Trust Agreement

The results of our tests of disbursements of trust income by Tennessee State University disclosed no instances of noncompliance with the Trust Agreement.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the endowment's financial statements.



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

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Independent Auditor's Report

March 31, 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
and

Dr. Melvin N. Johnson, President
Tennessee State University
3500 John A. Merritt Blvd.
Nashville, Tennessee 37209

Ladies and Gentlemen:

We have audited the accompanying basic financial statements of the Endowment for Educational Excellence at the Tennessee State University Foundation as of and for the year ended June 30, 2009. These financial statements are the responsibility of those charged with management of the foundation. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Note 1, the financial statements of the Endowment for Educational Excellence are intended to present the financial position and the changes in financial position of that portion of the Tennessee State University Foundation's activities that is attributable to the transactions of the endowment. They do not purport to, and do not, present fairly the financial position of the Tennessee State University Foundation as of June 30, 2009, and the changes in its financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Endowment for Educational Excellence of the Tennessee State University Foundation as of June 30, 2009, and the respective changes in financial position for the year then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis on pages 5 through 8 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Sincerely,

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

Arthur A. Hayes, Jr., CPA
Director

AAH/fd

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Management's Discussion and Analysis**

This section of Tennessee State University Foundation's Endowment for Educational Excellence trust's report presents a discussion and analysis of the financial performance of the trust during the fiscal year ended June 30, 2009, with comparative information presented for the June 30, 2008, fiscal year. 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 two basic financial statements. The Statement of Net Assets and the Statement of Revenues, Expenses, and Changes in Net Assets provide information on Tennessee State University Foundation's Endowment for Educational Excellence trust as a whole and present a long-term view of the trust's finances.

The Statement of Net Assets

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

Net assets are reported as restricted net assets, which are divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are available for expenditure by the trust but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets.

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Management's Discussion and Analysis (Cont.)**

Net Assets (in thousands of dollars)

	June 30, 2009	June 30, 2008
Assets		
Current assets	\$ 913	\$ 613
Noncurrent assets	<u>26,012</u>	<u>27,521</u>
Total assets	26,925	28,134
Liabilities		
Current liabilities	<u>-</u>	<u>75</u>
Total liabilities	-	75
Net assets		
Restricted – nonexpendable	26,012	27,446
Restricted – expendable	<u>913</u>	<u>613</u>
Total net assets	<u>\$ 26,925</u>	<u>\$ 28,059</u>

Comparison of FY 2009 to FY 2008

- Current assets and expendable net assets increased due to an increase in the Endowment income distribution to expendable funds.
- Noncurrent assets decreased due to the decline in market value of the investments; however, that decrease was offset by the receipt of over \$2 million in Title III funds received but not yet invested at the end of the fiscal year.

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

The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the trust, as well as the non-operating revenues and expenses.

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Management's Discussion and Analysis (Cont.)**

Changes in Net Assets (in thousands of dollars)

	2009	2008
Operating expenses	\$ <u>412</u>	\$ <u>75</u>
Operating loss	(412)	(75)
Nonoperating revenues and expenses:		
Investment income	(2,750)	263
Other	<u>2,028</u>	<u>(168)</u>
Total nonoperating revenues and expenses	<u>(722)</u>	<u>95</u>
Increase (decrease) in net assets	(1,134)	20
Net assets at beginning of period	<u>28,059</u>	<u>28,039</u>
Net assets at end of period	<u>\$ 26,925</u>	<u>\$ 28,059</u>

Comparison of FY 2009 to FY 2008

- Operating expenses increased with the increase of scholarships awarded of \$392 thousand for FY09.
- Other non-operating revenues/expenses increased as a result of Title III funds received from the state.
- Investment income decreased due to a decrease in the value of the investments held by the trust.

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Management's Discussion and Analysis (Cont.)**

Economic Factors That Will Affect the Future

General market conditions deteriorated during fiscal year ended June 30, 2009, and are expected to deteriorate further, which may adversely impact investment returns. In an attempt to dampen any negative impact from these deteriorating conditions, the endowment trustee is exploring different options with investment advisors.

Requests for Information

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

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

**TENNESSEE BOARD OF REGENTS
 ENDOWMENT FOR EDUCATIONAL EXCELLENCE
 TENNESSEE STATE UNIVERSITY FOUNDATION
 STATEMENT OF NET ASSETS
 JUNE 30, 2009**

ASSETS

Current assets:

Cash and cash equivalents (Note 2)	\$ 912,568.81
Total current assets	<u>912,568.81</u>

Noncurrent assets:

Cash and cash equivalents (Note 2)	3,204,423.26
Investments (Note 3)	<u>22,808,090.43</u>
Total noncurrent assets	<u>26,012,513.69</u>
Total assets	<u><u>26,925,082.50</u></u>

NET ASSETS

Restricted for:

Nonexpendable	26,012,513.69
Expendable	<u>912,568.81</u>
Total net assets	<u>\$ <u>26,925,082.50</u></u>

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

**TENNESSEE BOARD OF REGENTS
 ENDOWMENT FOR EDUCATIONAL EXCELLENCE
 TENNESSEE STATE UNIVERSITY FOUNDATION
 STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
 FOR THE YEAR ENDED JUNE 30, 2009**

EXPENSES

Operating expenses:

Scholarships	\$ 392,000.00
Utilities, supplies and other services	20,000.00
Total operating expenses	<u>412,000.00</u>
Operating loss	<u>(412,000.00)</u>

NONOPERATING REVENUES (EXPENSES)

Investment income	(2,750,283.24)
Grants and contracts	2,026,136.00
Other nonoperating revenues (expenses)	<u>2,250.00</u>
Net nonoperating revenues (expenses)	<u>(721,897.24)</u>
Decrease in net assets	(1,133,897.24)

NET ASSETS

Net assets - beginning of year	<u>28,058,979.74</u>
Net assets - end of year	<u>\$ 26,925,082.50</u>

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

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements
June 30, 2009**

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

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 18-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. The size of the board is determined by the majority vote of its members, and any vacancy in its membership is filled in the same way. The entire membership of the Board of Trustees cannot exceed twenty-five (25) in number and must have a minimum of eight (8). All trustees serve until the expiration of their respective terms and until their respective successors are selected and qualified. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, which the foundation holds and invests, is restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

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

Basis of Presentation

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

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2009**

Basis of Accounting

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

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

Operating expenses for the endowment include (1) utilities, supplies, and other services and (2) scholarships and fellowships to students. All other activity of the endowment is non-operating in nature and includes (1) investment income, and (2) grants.

Cash Equivalents

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

Net Assets

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

Expendable restricted net assets - Expendable restricted net assets include resources which the endowment is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties. The trust agreement does provide for spending a portion of the income, as discussed in Note 4. Spending decisions are to be made by the Budget Committee established in the trust agreement through the preparation of an annual budget.

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2009**

NOTE 2. CASH AND CASH EQUIVALENTS

At June 30, 2009, cash and cash equivalents consisted of \$3,022,650.02 in bank and \$1,094,342.05 in capital management account money funds.

NOTE 3. INVESTMENTS

The endowment 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, *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.

As of June 30, 2009, the endowment had the following investments and maturities.

Investment Maturities in Years

	<u>Fair Value</u>	<u>Less than 1</u>	<u>1 to 5</u>	<u>6 to 10</u>	<u>More than 10</u>	<u>No maturity date</u>
U.S. Treasury	\$ 353,950.01	\$202,143.02	\$ -	\$104,811.33	\$ 46,995.66	\$ -
U.S. agencies	272,540.86	-	272,540.86	-	-	-
Corporate stocks	689,235.90	-	-	-	-	689,235.90
Corporate bonds	884,570.44	-	423,782.86	374,094.15	86,693.43	-
Mutual bond funds	8,608,074.48	-	-	-	-	8,608,074.48
Mutual funds (equity, international, and ETFs)	8,323,121.27	-	-	-	-	8,323,121.27
Other:						
Mortgage backed securities	868,924.82	-	-	82,951.73	785,973.09	-
REITS	2,807,672.65	-	-	-	-	2,807,672.65
Money market accounts	1,091,233.10	-	-	-	-	1,091,233.10
Savings accounts	3,108.95	-	-	-	-	3,108.95
Less amounts reported as cash and cash equivalents:						
Money market accounts	(1,091,233.10)	-	-	-	-	(1,091,233.10)
Savings accounts	(3,108.95)	-	-	-	-	(3,108.95)
Total	<u>\$22,808,090.43</u>	<u>\$202,143.02</u>	<u>\$696,323.72</u>	<u>\$561,857.21</u>	<u>\$919,662.18</u>	<u>\$20,428,104.30</u>

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2009**

Interest Rate Risk. Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt instrument. The endowment does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value 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 foundation is authorized to invest the endowment funds in accordance with the trust agreement. Under the trust agreement, the foundation is authorized to invest and reinvest the property of the trust in any kind of real and/or personal property and any kind of investment specifically including, but not limited to, domestic or foreign government obligations of any kind; domestic or foreign securities of any kind including, but not limited to, preferred or common stocks, bonds, mortgage participations and shares of investment trusts, investment companies, money market funds, and mutual funds (including market or index funds); options to purchase or sell domestic or foreign securities or domestic or foreign government obligations of any kind; and interests in partnerships, so long as such investments are made with the care of a fiduciary. Securities are rated using Standard and Poor's, Moody's, and/or Fitch's and are presented below using the Standard and Poor's rating scale. The endowment has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations. As of June 30, 2009, the endowment's investments were rated as follows:

<u>Investment Type</u>	<u>Fair Value</u>	<u>AAA</u>	<u>AA</u>	<u>A</u>	<u>B</u>	<u>Unrated</u>
U.S. agencies	\$ 272,540.86	\$272,540.86	\$ -	\$ -	\$ -	\$ -
Corporate bonds	884,570.44		121,834.14	674,868.94	87,867.36	-
Mutual bond funds	8,608,074.48	-	-	-	-	8,608,074.48
Mortgage-backed securities	<u>868,924.82</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>868,924.82</u>
Total	<u>\$10,634,110.60</u>	<u>\$272,540.86</u>	<u>\$121,834.14</u>	<u>\$674,868.94</u>	<u>\$87,867.36</u>	<u>\$9,476,999.30</u>

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2009**

NOTE 4. ENDOWMENT INCOME

The trust agreement requires that at least 25% of the annual income be added to the corpus and stipulates approved and prohibited uses of the other 75%. The grant agreement for the Title III program requires that 50% of the income be added to the corpus and has provisions on the allowable uses of the other 50%. As of June 30, 2009, net appreciation of \$912,568.81 is available to be spent, all of which is included in expendable restricted net assets expendable.