

AUDIT REPORT

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

**For the Year Ended
June 30, 2011**



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**

**Department of Audit
Division of State Audit**



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www.comptroller1.state.tn.us/sa/AuditReportCategories.asp.
For more information about the Comptroller of the Treasury, please visit our website at
www.comptroller1.state.tn.us/.



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

**SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-1402
PHONE (615) 401-7897
FAX (615) 532-2765**

February 6, 2012

The Honorable Bill Haslam, Governor
and

Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and

The Honorable John G. Morgan, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 340
Nashville, Tennessee 37217

and

Dr. Portia Holmes Shields, President
Tennessee State University
3500 John A. Merritt Boulevard
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, 2011. 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 resulted in no audit findings.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/jgl
12/042

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, 2011

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

The audit report contains no findings.

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, 2011

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**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
For the Year Ended June 30, 2011**

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.
-

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

SUITE 1500
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NASHVILLE, TENNESSEE 37243-1402
PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

January 11, 2012

The Honorable Bill Haslam, Governor
and

Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and

The Honorable John G. Morgan, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 340
Nashville, Tennessee 37217

and

Dr. Portia Holmes Shields, President
Tennessee State University
3500 John A. Merritt Boulevard
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, 2011. 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, the changes in financial position, and the cash flows of only 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, 2011, 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, 2011, and the respective changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3, the financial statements of the Endowment for Educational Excellence of the Tennessee State University Foundation include investments valued at \$1,935,753.02 (5.62 percent of net assets of the foundation), whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners.

The management's discussion and analysis on pages 4 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,



Arthur A. Hayes, Jr., CPA
Director

AAH/jgl

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

This section of the Tennessee State University Endowment for Educational Excellence trust's annual financial report presents a discussion and analysis of the financial performance of the trust during the fiscal year ended June 30, 2011, with comparative information presented for the fiscal year ended June 30, 2010. 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 Tennessee State University 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, 2011	June 30, 2010
Assets		
Current assets	\$ 810	\$ 724
Noncurrent assets	33,615	28,389
Total assets	34,425	29,113
Net assets		
Restricted - nonexpendable	29,987	28,389
Restricted - expendable	4,438	724
Total net assets	\$ 34,425	\$ 29,113

Comparison of FY 2011 to FY 2010

- Current assets increased due to endowment income being distributed to expendable funds during FY 2011.
- Noncurrent assets increased due to the market value of investments drastically increasing during the 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 nonoperating revenues and expenses.

**Changes in Net Assets
(in thousands of dollars)**

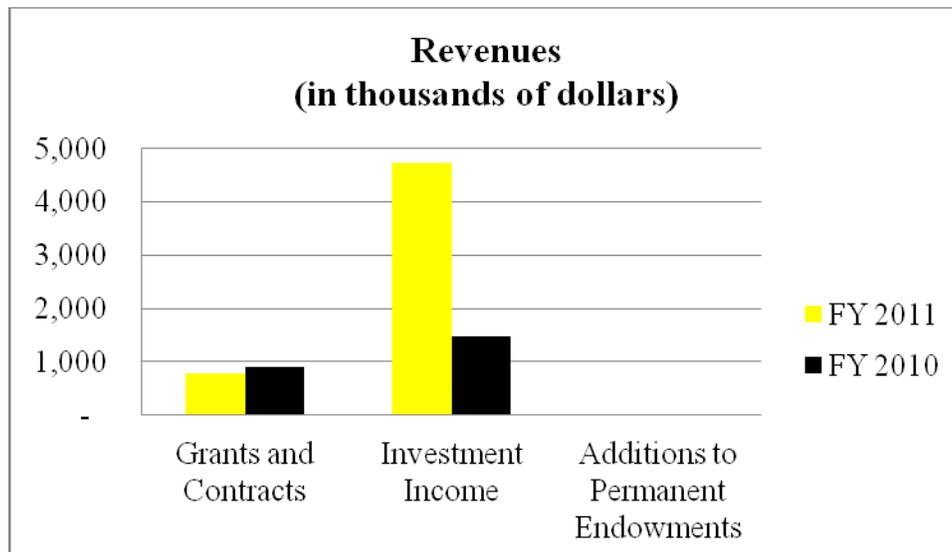
	2011	2010
Operating expenses	\$ 189	\$ 188
Operating loss	(189)	(188)

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

Nonoperating revenues		
Grants and contracts	773	901
Investment income	4,727	1,475
Total nonoperating revenues	5,500	2,376
Income before other revenues	5,311	2,188
Other revenues		
Additions to permanent endowments	1	-
Total other revenues	1	-
Increase in net assets	5,312	2,188
Net assets at beginning of year	29,113	26,925
Net assets at end of year	\$ 34,425	\$ 29,113

Revenues

The following is a graphic illustration of revenues by source, which were used to fund the trust's operating activities for the years ended June 30, 2011, and June 30, 2010 (amounts are presented in thousands of dollars).



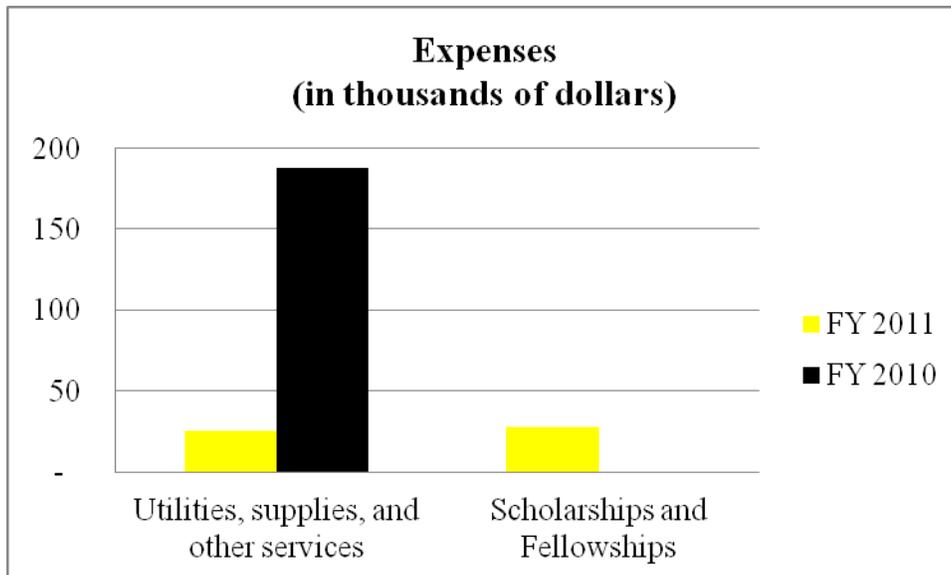
**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Management's Discussion and Analysis (Cont.)**

Comparison of FY 2011 to FY 2010

- Grants and contracts decreased because a smaller amount of funding was received from Title III.
- Investment income drastically increased due to market increases for investments throughout the fiscal year.

Expenses

The following is a graphic illustration of expenses by natural classification for the years ended June 30, 2011, and June 30, 2010 (amounts are presented in thousands of dollars).



Comparison of FY 2011 to FY 2010

- Utilities, supplies, and other services expenses were reduced due to added spending for scholarships and fellowships.

Economic Factors That Will Affect the Future

Due to Standard & Poor's reducing the rating of the U.S. Government, market confidence is expected to decline, resulting in a reduction of investment income in the coming year(s).

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

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:

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

**TENNESSEE BOARD OF REGENTS
 ENDOWMENT FOR EDUCATIONAL EXCELLENCE
 TENNESSEE STATE UNIVERSITY FOUNDATION
 STATEMENT OF NET ASSETS
 JUNE 30, 2011**

	<u>June 30, 2011</u>
ASSETS	
Current assets:	
Cash and cash equivalents (Note 2)	\$ 670,558.77
Short-term investments (Note 3)	139,011.35
Total current assets	809,570.12
Noncurrent assets:	
Cash and cash equivalents (Note 2)	2,287,213.52
Investments (Note 3)	31,328,338.01
Total noncurrent assets	33,615,551.53
Total assets	34,425,121.65
NET ASSETS	
Restricted for:	
Nonexpendable	29,986,997.55
Expendable (Note 4)	4,438,124.10
Total net assets	\$ 34,425,121.65

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

**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, 2011**

	<u>Year Ended June 30, 2011</u>
EXPENSES	
Operating expenses	
Utilities, supplies, and other services	\$ 160,803.42
Scholarships and fellowships	28,768.00
Total operating expenses	189,571.42
Operating loss	(189,571.42)
NONOPERATING REVENUES	
Grants and contracts	772,780.00
Investment income	4,727,422.19
Net nonoperating revenues	5,500,202.19
Income before other revenues	5,310,630.77
Additions to permanent endowments	1,250.00
Total other revenues	1,250.00
Increase in net assets	5,311,880.77
NET ASSETS	
Net assets - beginning of year	29,113,240.88
Net assets - end of year	\$ 34,425,121.65

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

**TENNESSEE BOARD OF REGENTS
 ENDOWMENT FOR EDUCATIONAL EXCELLENCE
 TENNESSEE STATE UNIVERSITY FOUNDATION
 STATEMENT OF CASH FLOWS
 FOR THE YEAR ENDED JUNE 30, 2011**

CASH FLOWS FROM OPERATING ACTIVITIES

Payments on behalf of Tennessee State University	\$ (160,803.42)
Payments for scholarships and fellowships	(28,768.00)
Net cash used by operating activities	<u>(189,571.42)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

Gifts and grants received for other than capital or endowment purposes	772,780.00
Private gifts for endowment purposes	1,250.00
Net cash provided by noncapital financing activities	<u>774,030.00</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from sales and maturities of investments	5,994,038.88
Income on investments	782,490.40
Purchases of investments	(7,761,308.79)
Net cash used by investing activities	<u>(984,779.51)</u>

Net decrease in cash	(400,320.93)
Cash at beginning of year	3,358,093.22
Cash at end of year	<u>\$ 2,957,772.29</u>

Reconciliation of operating loss to net cash used by operating activities:

Operating loss	\$ (189,571.42)
Net cash used by operating activities	<u>\$ (189,571.42)</u>

Noncash investing, capital, or financing transactions

Unrealized gains/losses on investments	\$ 3,370,976.25
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The notes to the financial statements are an integral part of these financial statements.

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements
June 30, 2011**

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 Foundation 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.

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 18-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; any vacancy in its membership shall be filled in the same way. The entire membership of the board of trustees shall not exceed twenty-five (25) in number and a minimum of eight (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 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, 2011**

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 (GASB). 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.

All other activity is nonoperating in nature and includes (1) federal grant funds from the U.S. Department of Education under the Title III Strengthening Historically Black Colleges and Universities Program, (2) investment income, and (3) gifts.

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

The Endowment for Educational Excellence's net assets are classified as follows:

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

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2011**

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.

NOTE 2. CASH AND CASH EQUIVALENTS

At June 30, 2011, cash and cash equivalents consists of \$1,774,571.70 in bank accounts and \$1,183,200.59 in money markets.

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, 2011, the endowment had the following investments and maturities:

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2011**

Investment Maturities (in Years)

<u>Investment Type</u>	<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	\$2,507,474.90	\$ -	\$ 713,703.69	\$ 1,793,771.21	\$ -	\$ -
U.S. agencies	887,756.19	84,084.44	803,671.75	-	-	-
Corporate stocks	13,858,747.19	-	-	-	-	13,858,747.19
Corporate bonds	5,717,136.62	54,926.91	3,513,705.71	2,148,504.00	-	-
Mutual equity funds	70,080.48	-	-	-	-	70,080.48
Foreign stock	1,957,206.08	-	-	-	-	1,957,206.08
International mutual funds	2,530,223.49	-	-	-	-	2,530,223.49
Mortgage backed securities	971,350.30	-	-	77,167.74	894,182.56	-
Collateralized mortgage obligations	1,022,966.78	-	663,071.96	28,397.91	331,496.91	-
Rights & warrants	8,654.31	-	-	8,654.31	-	-
Real estate investment trusts	1,935,753.02	-	-	-	-	1,935,753.02
Money market accounts	1,183,200.59	-	-	-	-	1,183,200.59
Savings account	295,624.20	-	-	-	-	295,624.20
Less cash and cash equivalents:						
Money market accounts	(1,183,200.59)	-	-	-	-	(1,183,200.59)
Savings account	(295,624.20)	-	-	-	-	(295,624.20)
Total	<u>\$ 31,467,349.36</u>	<u>\$ 139,011.35</u>	<u>\$ 5,694,153.11</u>	<u>\$ 4,056,495.17</u>	<u>\$ 1,225,679.47</u>	<u>\$ 20,352,010.26</u>

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 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

**Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2011**

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 interest 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 investment policy states that fixed income securities must be rated BBB or higher at the time of purchase, with an average portfolio rating of an A. Asset backed securities, mortgage backed securities, and collateralized mortgage obligations should have an AA rating or higher at the time of purchase. Unrated bonds may be purchased, but shall not exceed 20% of the portfolio. As of June 30, 2011, the endowment's investments were rated as follows:

Investment Type	Fair Value	Credit Quality Rating				
		AAA	AA	A	BBB	Unrated
U.S. agencies	\$ 887,756.19	\$ 887,756.19	\$ -	\$ -	\$ -	\$ -
Corporate bonds	5,717,136.62	192,327.80	560,607.56	4,265,335.76	698,865.50	-
Collateralized mortgage obligations	<u>1,022,966.78</u>	<u>1,022,966.78</u>	-	-	-	-
Total	<u>\$ 7,627,859.59</u>	<u>\$ 2,103,050.77</u>	<u>\$ 560,607.56</u>	<u>\$ 4,265,335.76</u>	<u>\$ 698,865.50</u>	<u>\$ -</u>

Alternative Investments

The endowment has investments in Real Estate Investment Trusts (REITS). The estimated fair value of these assets is \$1,935,753.02 at June 30, 2011.

The endowment believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2011. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the foundation's investment policy. These investments are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated using various valuation techniques.

Tennessee Board of Regents
Endowment for Educational Excellence
Tennessee State University Foundation
Notes to the Financial Statements (Cont.)
June 30, 2011

The value of shares for Inland American is estimated to be the offering of \$8.03 per share (ignoring purchase price discounts for certain categories of purchasers). This estimated value may not reflect the actual market value of these shares on any given date.

The value of shares for Behringer Harvard is estimated to be the offering of \$4.55 per share (ignoring purchase price discounts for certain categories of purchasers). This estimated value may not reflect the actual market value of these shares on any given date.

NOTE 4. ENDOWMENTS

Under the spending plan established by the foundation, Consent Decree Funds utilize 75% of the net earnings for expenditure. The remaining amount of 25% is reinvested in the endowment. Also, Title III Funds utilize 50% of the net earnings for expenditures. The remaining amount of 50% is reinvested in the endowment. At June 30, 2011, net appreciation of \$670,558.77 is available to be spent, all of which is included in expendable restricted net assets. Of this amount, \$171,390.04 is available from Consent Decree funds, and \$499,168.73 is available from Title III Funds.