AUDIT REPORT

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

For the Years Ended
June 30, 2011, and June 30, 2010

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

Tennessee
Comptroller
of the Treasury

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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May 15, 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

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, 2011, and June 30, 2010. 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/ard
12/053

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, 2011, and June 30, 2010

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.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

Audit Report
Tennessee Board of Regents
State University and Community College
System of Tennessee – Central Office
For the Years Ended June 30, 2011, and June 30, 2010

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Tennessee Board of Regents
State University and Community College System of Tennessee – Central Office
For the Years Ended June 30, 2011, and June 30, 2010

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, 2009, through June 30, 2011, 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, 2011, and June 30, 2010. 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 FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the 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, 2011, and June 30, 2010, we considered internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing an opinion 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 an unqualified opinion on the Central Office's financial statements.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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 4, 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

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, 2011, and June 30, 2010, and have issued our report thereon dated April 4, 2012. 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

Management of the Central Office is responsible for establishing and maintaining effective 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 opinion 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 *deficiency in internal control* 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 and correct misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, 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.

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

We noted certain matters that we reported to the management of the State University and Community College System of Tennessee – Central Office in a separate letter.

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

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/ard

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

April 4, 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

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, 2011, and June 30, 2010, as listed in the table of contents. These financial statements are the responsibility of the college's management. 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 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 opinion.

As discussed in Note 1, the financial statements of the State University and Community College System of Tennessee – Central Office, 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, 2011, and June 30, 2010, 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, 2011, and June 30, 2010, 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.

The management's discussion and analysis on pages 9 through 19 and the schedule of funding progress on page 38 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 4, 2012, 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 considered in assessing the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/ard

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, 2011, and June 30, 2010, with comparative information presented for the fiscal year ended June 30, 2009. 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 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)

	2011	2010	2009
Assets:			
Current assets	$ 6,990	$ 6,721	$ 7,820
Capital assets, net	426	427	616
Other assets	17,091	11,753	8,449
Total assets	**24,507**	**18,901**	**16,885**
Liabilities:			
Current liabilities	3,237	3,304	5,000
Noncurrent liabilities	2,278	1,954	1,710
Total liabilities	**5,515**	**5,528**	**6,710**
Net assets:			
Invested in capital assets	426	427	616
Restricted – nonexpendable	534	534	534
Restricted – expendable	7,918	4,934	3,779
Unrestricted	10,114	7,748	5,246
Total net assets	**$ 18,992**	**$ 13,643**	**$ 10,175**

Comparison of FY 2011 to FY 2010

- Other assets increased as a result of renewal and replacement funds held for Regents Online Degree Program (RODP) and for computer replacement and unspent restricted funds held for Access Diversity programs.
- The increase in noncurrent liabilities resulted from an increase in the OPEB liability.
- Restricted, expendable net assets increased from 2010 to 2011 for unspent Access and Diversity program funds.
- Unrestricted net assets increased from 2010 to 2011 because of funds held in Renewal and Replacement funds for future computer equipment purchases.

Comparison of FY 2010 to FY 2009

- Current assets decreased due to a decrease in cash held for others in agency funds and a decrease in restricted cash needed to cover current obligations. Unrestricted cash decreased because funds were transferred to Renewals and Replacements for future computer equipment purchases.

- The decrease in capital assets resulted from reduced equipment purchases in 2010 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 Diversity programs.

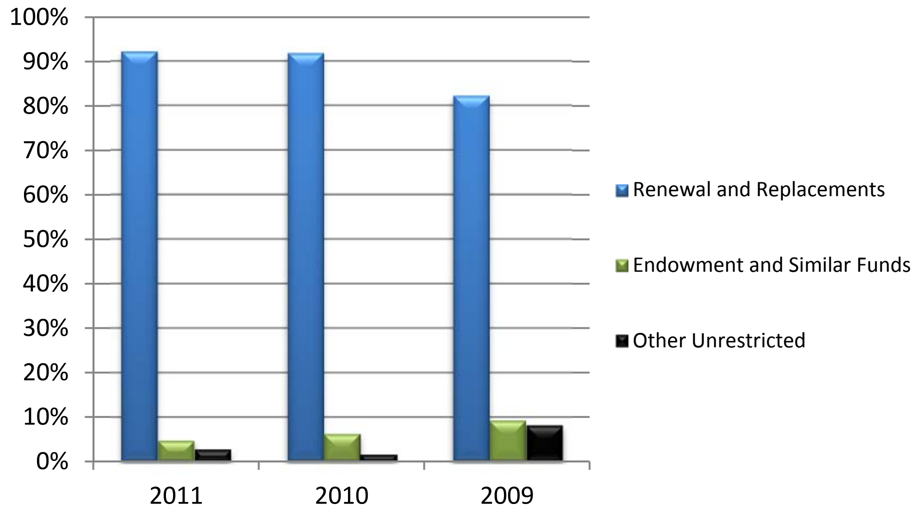
- Current liabilities decreased from 2009 to 2010 as an amount due to the primary government in 2009 did not occur in 2010. Restricted fund accounts payable also decreased due to timing of payments to vendors.

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

- Restricted, expendable net assets increased from 2009 to 2010 for unspent Access and Diversity program funds.

- Unrestricted net assets increased from 2009 to 2010 because of funds held in Renewal and Replacement funds for future computer equipment purchases.

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



<u>Comparison of FY 2011 to FY 2010</u>

- Renewals and Replacements increased because revenues increased in 2011 and the additional funds were held for future computer equipment purchases.

- Other unrestricted net assets increased due to an increase in the allocation for working capital and funds necessary to cover the compensated absences and OPEB liabilities.

<u>Comparison of FY 2010 to FY 2009</u>

- Renewals and Replacements increased because revenues increased in 2010 and the additional funds were held for future computer equipment purchases.

- Other unrestricted net assets decreased due to a decrease in the allocation for working capital and undesignated balance.

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

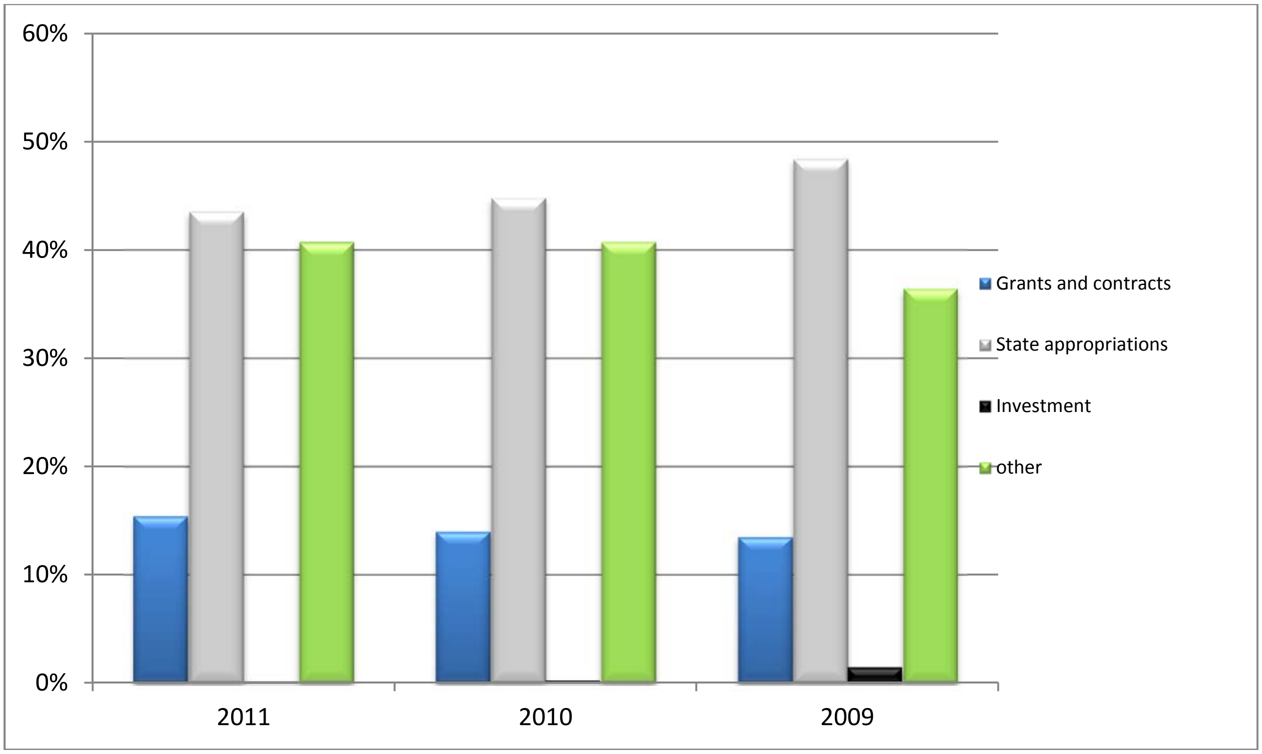
The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the Central Office, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered non-operating revenues according to accounting principles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

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

	2011	2010	2009
Operating revenues:			
Grants and contracts	$ 5,991	$ 4,808	$ 4,370
Other	15,004	13,961	11,761
Total operating revenues	**20,995**	**18,769**	**16,131**
Operating expenses	31,481	30,753	29,830
Operating loss	**(10,486)**	**(11,984)**	**(13,699)**
Non-operating revenues and expenses:			
State appropriations	15,758	15,341	15,629
Investment income	81	111	493
Other revenues and expenses	(4)	-	1
Total non-operating revenues and expenses	**15,835**	**15,452**	**16,123**
Increase in net assets	**5,349**	**3,468**	**2,424**
Net assets at beginning of year	13,643	10,175	7,751
Net assets at end of year	**$ 18,992**	**$ 13,643**	**$ 10,175**

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, 2011; June 30, 2010; and June 30, 2009.



Comparison of FY 2011 to FY 2010

- State appropriations increased due to increased legislative appropriations. For 2011, nonrecurring appropriations replaced State Fiscal Stabilization Funds.
- Revenue from grants and contracts increased from adding new private grants.
- Other income increased from the addition of the Community College Implementation Fee, an increase in the Total Quality Initiative Fee, and an increase in the system charge.

Comparison of FY 2010 to FY 2009

- State appropriations decreased due to declines in overall state revenues.
- Other income increased due to an increase in RODP revenues and an increase in system charges to the institutions.
- Investment income decreased due to a significant fall in interest rates.

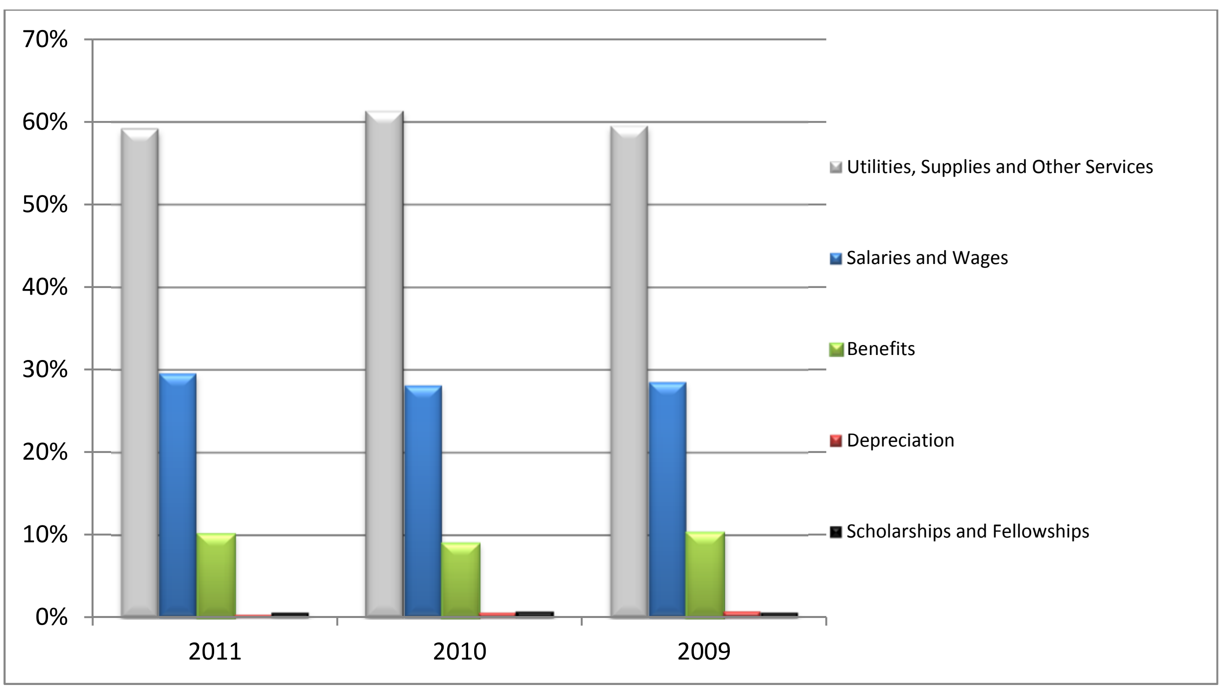
Expenses

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)

	2011	2010	2009
Salaries and wages	$ 9,323	$ 8,666	$ 8,528
Benefits	3,191	2,769	3,077
Utilities, supplies, and other services	18,641	18,876	17,777
Scholarships and fellowships	195	241	202
Depreciation	131	201	246
Total operating expenses	**$ 31,481**	**$ 30,753**	**$ 29,830**



Comparison of FY 2011 to FY 2010

- An increase in operating expenses resulted from an increase in compensated absences expense, the addition of the Community College Implementation costs, and increased spending for the eLearning program.
- The increase in salaries and benefits was the result of new positions and increased costs for capital management assistance positions that were previously contracted.
- Decrease in depreciation from 2010 to 2011 was caused by the aging of current equipment and no significant purchases of equipment in 2011.

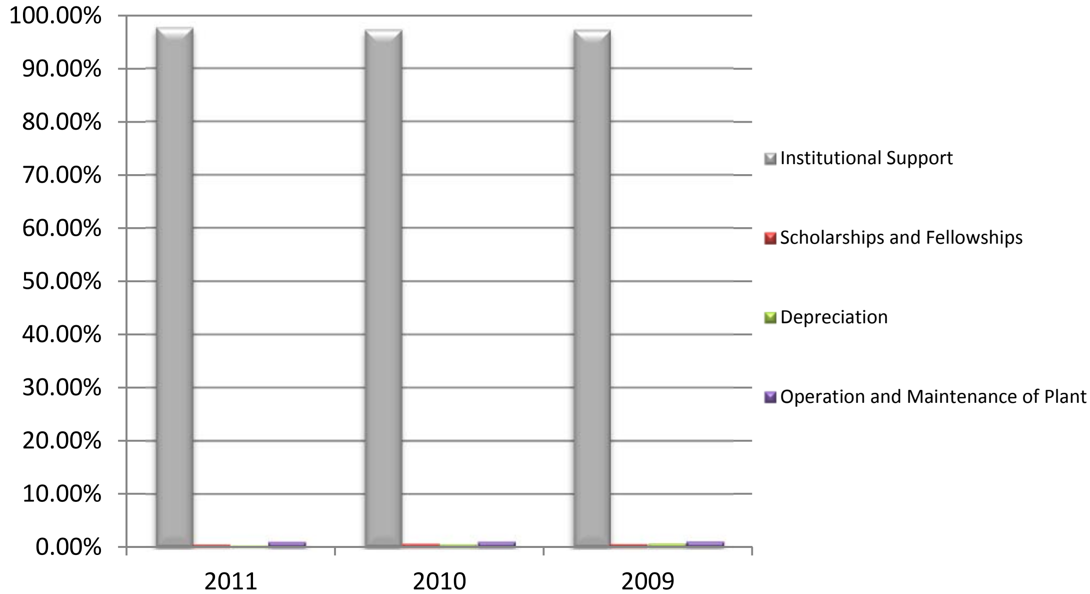
Comparison of FY 2010 to FY 2009

- An increase in operating expenses resulted from growth of the online degree programs.
- A decrease in the OPEB expense resulted in the decrease in benefits expenses from 2009 to 2010. In addition, a two-month group insurance holiday offset the FY 2010 health insurance increases and resulted in a decrease in total group insurance costs.
- An increase in spending for scholarships and fellowships was due to scholarship payments for the Jones scholarship and new scholarship payments for Access Diversity programs.
- Decrease in depreciation from 2009 to 2010 was caused by the aging of current equipment and no significant new purchases of equipment in 2010.

Program Classification

Central Office
Operating Expenses (in thousands of dollars)

	2011	2010	2009
Institutional support	$ 30,799	$ 29,955	$ 29,025
Operation of maintenance and plant	356	356	357
Scholarships and fellowships	195	241	202
Depreciation	131	201	246
Total operating expenses	**$ 31,481**	**$ 30,753**	**$ 29,830**



<u>Comparison of FY 2011 to FY 2010</u>

- The increase in institutional support resulted from salaries and benefits for new positions and increased cost for previously contracted capital management assistance positions.

- A decrease in scholarship spending was due to reduced funding for Access Diversity scholarships and Floyd scholarships.

- The decrease in depreciation from 2010 to 2011 was caused by the aging of equipment and no significant purchases of equipment in 2011.

<u>Comparison of FY 2010 to FY 2009</u>

- Increases in institutional support from 2009 to 2010 resulted from additional TQI programs, costs of the employee voluntary buyout program, and additional Access and Diversity grant spending.

- An increase in spending for scholarships and fellowships was due to scholarship payments for the Jones scholarship and new scholarship payments for Access Diversity programs.

- The decrease in depreciation from 2009 to 2010 was caused by the aging of current equipment and no significant computer purchases in 2010.

Capital Assets

Capital Assets

The Central Office had $425,889.61 invested in capital assets, net of accumulated depreciation of $1,205,653.27 at June 30, 2011; $426,589.63 invested in capital assets, net of accumulated depreciation of $1,171,847.15 at June 30, 2010; and $616,255.01 invested in capital assets, net of accumulated depreciation of $970,428.17 at June 30, 2009. Depreciation charges totaled $130,539.43, $201,418.98, and $246,072.75 for the years ended June 30, 2011; June 30, 2010; and June 30, 2009, respectively. Details of these assets are shown below.

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

	2011	2010	2009
Equipment	426	427	616

The Central Office made no significant changes to equipment in 2011 or 2010; the decrease was largely due to the increase in depreciation for the 2011 and 2010 fiscal year.

The Central Office has no immediate plans for significant capital expenditures for fiscal year 2012.

More detailed information about the Central Office's capital assets is presented in Note 5 to the financial statements.

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 earnings. The continuing decline in state sales tax collections could have a negative impact on future state appropriations funding.

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, 2011, AND JUNE 30, 2010

	June 30, 2011	June 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 3)	$ 5,905,133.50	$ 5,670,158.21
Accounts and grants receivable (net) (Note 4)	915,647.95	1,033,281.48
Due from primary government	166,522.44	12,155.01
Prepaid expenses and deferred charges	2,825.23	4,987.19
Other assets	175.00	175.00
Total current assets	6,990,304.12	6,720,756.89
Noncurrent assets:		
Cash and cash equivalents (Notes 2 and 3)	17,090,683.18	11,753,286.31
Capital assets (net) (Note 5)	425,889.61	426,589.63
Total noncurrent assets	17,516,572.79	12,179,875.94
Total assets	24,506,876.91	18,900,632.83
LIABILITIES		
Current liabilities:		
Accounts payable	1,230,893.91	686,923.54
Accrued liabilities	122,788.99	113,216.43
Compensated absences (Note 6)	319,994.82	317,321.35
Deposits held in custody for others	1,563,073.76	2,186,478.71
Total current liabilities	3,236,751.48	3,303,940.03
Noncurrent liabilities:		
Net OPEB obligation (Notes 6 and 10)	1,470,231.00	1,239,127.00
Compensated absences (Note 6)	808,010.53	714,929.80
Total noncurrent liabilities	2,278,241.53	1,954,056.80
Total liabilities	5,514,993.01	5,257,996.83
NET ASSETS		
Invested in capital assets	425,889.61	426,589.63
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	534,042.85	534,042.85
Expendable:		
Scholarships and fellowships (Note 7)	2,530.74	7,475.16
Other	7,915,719.32	4,926,913.94
Unrestricted (Notes 7 and 8)	10,113,701.38	7,747,614.42
Total net assets	$ 18,991,883.90	$ 13,642,636.00

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, 2011, AND JUNE 30, 2010

	Year Ended June 30, 2011	Year Ended June 30, 2010
REVENUES		
Operating revenues:		
Governmental grants and contracts	$ 5,019,074.71	$ 4,807,513.29
Nongovernmental grants and contracts	971,640.00	-
Regents On-line Degree Program fees	7,439,306.05	6,949,846.80
Fees from TBR institutions	7,409,503.00	6,817,603.00
Other operating revenues	155,491.04	193,831.97
Total operating revenues	20,995,014.80	18,768,795.06
EXPENSES		
Operating expenses (Note 13):		
Salaries and wages	9,323,345.47	8,665,924.98
Benefits	3,191,081.21	2,769,299.38
Utilities, supplies, and other services	18,640,707.58	18,875,713.47
Scholarships and fellowships	195,013.91	240,606.66
Depreciation expense	130,539.43	201,418.98
Total operating expenses	31,480,687.60	30,752,963.47
Operating loss	(10,485,672.80)	(11,984,168.41)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	15,758,223.00	15,341,359.00
Investment income	81,270.43	110,689.46
Other nonoperating revenues/(expenses)	(4,572.73)	-
Net nonoperating revenues	15,834,920.70	15,452,048.46
Increase in net assets	5,349,247.90	3,467,880.05
NET ASSETS		
Net assets - beginning of year	13,642,636.00	10,174,755.95
Net assets - end of year	$ 18,991,883.90	$ 13,642,636.00

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

Exhibit C

TENNESSEE BOARD OF REGENTS
STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2011, AND JUNE 30, 2010

	Year Ended June 30, 2011	Year Ended June 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES		
Grants and contracts	$ 5,963,589.65	$ 4,196,090.81
Payments to suppliers and vendors	(18,249,494.96)	(19,158,378.66)
Payments to employees	(9,242,197.84)	(8,671,035.75)
Payments for benefits	(2,930,875.08)	(2,529,290.35)
Payments for scholarships and fellowships	(195,013.91)	(242,214.30)
Regents On-line Degree Program fees	7,439,306.05	6,949,846.80
Fees from TBR institutions	7,409,503.00	6,817,603.00
Other receipts (payments)	155,491.04	193,831.97
Net cash used by operating activities	(9,649,692.05)	(12,443,546.48)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	15,742,600.00	15,341,100.00
Changes in deposits held for others	(467,394.08)	(597,483.87)
Net cash provided by noncapital financing activities	15,275,205.92	14,743,616.13
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets and construction	(134,412.14)	(11,783.60)
Net cash used by capital and related financing activities	(134,412.14)	(11,783.60)
CASH FLOWS FROM INVESTING ACTIVITIES		
Income on investments	81,270.43	110,689.46
Net cash provided by investing activities	81,270.43	110,689.46
Net increase in cash and cash equivalents	5,572,372.16	2,398,975.51
Cash - beginning of year	17,423,444.52	15,024,469.01
Cash - end of year	$ 22,995,816.68	$ 17,423,444.52

Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (10,485,672.80)	$ (11,984,168.41)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation	130,539.43	201,418.98
Other adjustments (Note 14)	4,923.00	5,159.00
Changes in assets and liabilities:		
Receivables, net	(34,255.96)	164,777.52
Prepaid and deferred items	2,161.96	(1,608.71)
Accounts payable	396,181.56	(281,564.12)
Accrued liabilities	9,572.56	(58,772.04)
OPEB	231,104.00	294,542.00
Compensated absences	95,754.20	(6,030.70)
Due to primary government	-	(777,300.00)
Net cash used by operating activities	$ (9,649,692.05)	$ (12,443,546.48)

Noncash investing, capital, and financing activities		
Loss on disposal of capital assets	$ (4,572.73)	$ -

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, 2011, and June 30, 2010

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:

Invested in capital assets - This represents the Central Office total investment in capital 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 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

This classification includes demand deposits and petty cash on hand. At June 30, 2011, cash consisted of $682,991.21 in bank accounts, $100.00 of petty cash on hand, and $22,312,725.47 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer. At June 30, 2010, cash consisted of $1,705,445.23 in bank accounts, $100.00 of petty cash on hand, and $15,717,899.29 in LGIP.

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).

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. Prime banker's acceptances are required to be eligible for purchase by the Federal Reserve

System. To be eligible, the original maturity must not be more than 270 days, and it must 1) arise out of the current shipment of goods between countries or with the United States, or 2) arise out of storage within the United States of goods under contract of sale or expected to move into the channel or trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods.

Tennessee Board of Regents policy requires that prime commercial paper shall be limited to that of corporations that meet the following criteria: 1) Senior long-term debt, if any, should have a minimum rating of A1 or equivalent, and short-term debt should have 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 rating must be A1 by all rating services (minimum of two). 2) The rating should be based on the merits of the issuer or guaranteed by a nonbank. 3) A financial review should be made to ascertain the issuer's financial strength to cover the debt. 4) Commercial paper of a banking institution should not be purchased. Prime commercial paper shall not have a maturity that exceeds 270 days.

As of June 30, 2011, and June 30, 2010, the Cental Office's investments consisted entirely of investments in the Local Government Investment Pool. The fair value of these investments was $22,312,725.47 at June 30, 2011, and $15,717,899.29 at June 30, 2010. LGIP investments are not rated by nationally recognized statistical ratings organizations. The LGIP is part of the State Pooled Investment Fund. The fund's required risks disclosures are presented in the *State of Tennessee's Treasurer's Report*.

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2011	June 30, 2010
Grants receivable	$723,759.34	$ 851,001.71
State appropriation receivable	15,200.00	4,500.00
Other receivables	176,688.61	177,779.77
Total receivables	$915,647.95	$1,033,281.48

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2011, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Equipment	$ 1,598,436.78	$ 134,412.14	$ 101,306.04	$ 1,631,542.88
Less accumulated depreciation	1,171,847.15	130,539.43	96,733.31	1,205,653.27
Capital assets, net	$ 426,589.63	$ 3,872.71	$ 4,572.73	$ 425,889.61

Capital asset activity for the year ended June 30, 2010, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Equipment	$ 1,586,653.18	$ 11,783.60	$ -	$ 1,598,436.78
Less accumulated depreciation	970,428.17	201,418.98	-	1,171,847.15
Capital assets, net	$ 616,225.01	$ (189,635.38)	$ -	$ 426,589.63

NOTE 6. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2011, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Other liabilities:					
Compensated absences	$ 1,032,251.15	$ 700,560.88	$ 604,806.68	$ 1,128,005.35	$ 319,994.82
Net OPEB obligation	1,239,127.00	231,104.00	-	1,470,231.00	-
Total long-term liabilities	$ 2,271,378.15	$ 931,664.88	$ 604,806.68	$ 2,598,236.35	$ 319,994.82

Long-term liabilities activity for the year ended June 30, 2010, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Other liabilities:					
Compensated absences	$ 1,038,281.85	$ 608,847.44	$ 614,878.14	$ 1,032,251.15	$ 317,321.35
Net OPEB obligation	944,585.00	294,542.00	-	1,239,127.00	-
Total long-term liabilities	$ 1,982,866.85	$ 903,389.44	$ 614,878.14	$ 2,271,378.15	$ 317,321.35

NOTE 7. 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 the earnings, the Central Office is required to consider its long-term and short-term needs, present and anticipated financial requirements, expected 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.

For the Floyd Endowment, the Central Office chooses to spend only a portion of the investment income each year. Under the spending plan established by the board, expenses are limited to one new four-year scholarship awarded each year, and funding three previously awarded scholarships. The scholarships expenses are limited to the following: 1) the cost of in-state tuition and fees, 2) room and board (or a commuting allowance), 3) a stipend of $500 per year, and 4) a $500 annual book allowance. The remaining amount, if any, is retained to be used in future years. At June 30, 2011, net appreciation of $25,184.62 is available to be spent and is included in unrestricted net assets. At June 30, 2010, net appreciation of $45,289.35 is available to be spent and is included in unrestricted net assets.

Scholarship expenses for the Jones Endowment are at the direction of the Jones Companies. At June 30, 2011, net appreciation of $2,530.74 is included in restricted net assets expendable for scholarships and fellowships. At June 30, 2010, net appreciation of $7,475.16 is available to be spent and is included in restricted net assets expendable for scholarships and fellowships.

NOTE 8. UNRESTRICTED NET ASSETS

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

	June 30, 2011	June 30, 2010
Working capital	$ 217,627.34	$ 33,325.65
Encumbrances	46,178.63	16,846.25
Quasi-endowment	491,179.20	491,179.20
Renewal and replacement of equipment	9,337,775.84	7,125,547.62
Undesignated	20,940.37	80,715.70
Total	$10,113,701.38	$7,747,614.42

NOTE 9. 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. treasury.tn.gov.

Funding Policy - Plan members are noncontributory. The Central Office is required to contribute an actuarially determined rate. The current rate is 14.91% 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, 2011, 2010, and 2009 were $739,318.12, $689,526.40, and $635,332.47. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans

Plan Description - 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.

Funding Policy - 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 contributions made by the Central Office to the plans were $335,589.47 for the year ended June 30, 2011, and $334,585.21 for the year ended June 30, 2010. Contributions met the requirements for each year.

NOTE 10. 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 available to higher education employees—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 8-27-101, *Tennessee Code Annotated.* Prior to reaching age 65, retirees may participate in the State Employee Group Plan. In previous fiscal years, prior to reaching the age of 65, all members had the option of choosing a preferred provider organization (PPO), point of service (POS), or health maintenance organization (HMO) plan for healthcare benefits. However, as of January 1, 2011, the insurance plan structure was changed and as a result, all members now have the option of choosing between the standard or partnership preferred provider organization plan for healthcare benefits. Subsequent to age 65, retirees who are also in the state's retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. The state makes on-behalf payments to the Medicare supplement plan for the Central Office's eligible retirees; see Note 14. The plans are reported in the State of Tennessee's *Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at http://tn.gov/finance/act/cafr.shtml.

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 plan participants. In accordance with Section 8-27-205(b), *Tennessee Code Annotated*, 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 are subsidized 80 percent; 20 but less than 30 years, 70 percent; and less than 20 years, 60 percent. Retired employees who are 65 years of age or older have flat rate premium subsidies based on years of service. Retirees with 30 years of service receive $50 per month; 20 but less than 30 years, $37.50; and 15 but less than 20 years, $25.

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

	2011	2010
Annual required contribution (ARC)	$ 360,000	$ 398,000
Interest on the net OPEB obligation	55,761	42,506
Adjustment to the ARC	(52,817)	(40,262)
Annual OPEB cost	362,944	400,244
Amount of contribution	(131,840)	(105,702)
Increase in net OPEB obligation	231,104	294,542
Net OPEB obligation – beginning of year	1,239,127	944,585
Net OPEB obligation – end of year	$1,470,231	$1,239,127

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2011	State Employee Group Plan	$362,944	36.3%	$1,470,231
June 30, 2010	State Employee Group Plan	$400,244	26.4%	$1,239,127
June 30, 2009	State Employee Group Plan	$589,572	20.5%	$944,585

Funded Status and Funding Progress

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

State Employee Group Plan

Actuarial valuation date	July 1, 2010	July 1, 2009
Actuarial accrued liability (AAL)	$4,713,000	$5,695,000
Actuarial value of plan assets	-	-
Unfunded actuarial accrued liability (UAAL)	$4,713,000	$5,695,000

Actuarial value of assets as a percentage of the AAL	0.00%	0.00%
Covered payroll (active plan members)	$8,513,566	$8,197,659
UAAL as percentage of covered payroll	55.4%	69.5%

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, 2010, 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 10 percent in fiscal year 2011. The rate decreases to 9.5 percent in fiscal year 2012, and then is reduced by decrements of 0.5 percent per year to an ultimate rate of 5 percent in fiscal year 2021. All rates include a 3 percent inflation assumption. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007.

NOTE 11. INSURANCE-RELATED ACTIVITIES

It is the policy of the state not to purchase commercial insurance for the risks of losses for general liability, automobile liability, professional malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund. The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The 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, 2011, and June 30, 2010, are presented in the *Tennessee Comprehensive Annual Financial Report*. The CAFR is available on the state's website at http://tn.gov/finance/act/cafr.shtml. 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, 2011, the Risk Management Fund held $107.6 million in cash and cash equivalents designated for payment of claims. At June 30, 2010, the Risk Management Fund held $114.5 million in cash and cash equivalents designated for payment of claims.

At June 30, 2011, the scheduled coverage for the Central Office was $2,000,000 for contents. At June 30, 2010, 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, including the cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Sick Leave

The 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 $3,682,314.54 at June 30, 2011, and $3,217,454.72 at June 30, 2010.

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 $639,717.80 and for equipment were $3,425.06 for the year ended June 30, 2011. The amounts for the year ended June 30, 2010, were $614,794.46 and $1,991.00. All operating leases are cancelable at the lessee's option.

NOTE 13. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The Central Office's operating expenses for the year ended June 30, 2011, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Institutional support	$ 9,323,345.47	$ 3,191,081.21	$ 18,284,276.26	$ -	$ -	$ 30,798,702.94
Maintenance & operation	-	-	356,431.32	-	-	356,431.32
Scholarships & fellowships	-	-	-	195,013.91	-	195,013.91
Depreciation	-	-	-	-	130,539.43	130,539.43
Total	$ 9,323,345.47	$ 3,191,081.21	$ 18,640,707.58	$ 195,013.91	$ 130,539.43	$ 31,480,687.60

The Central Office's operating expenses for the year ended June 30, 2010, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Institutional Support	$ 8,665,924.98	$ 2,769,299.38	$ 18,519,282.15	$ -	$ -	$ 29,954,506.51
Operation & maintenance	-	-	356,431.32	-	-	356,431.32
Scholarships & fellowships	-	-	-	240,606.66	-	240,606.66
Depreciation	-	-	-	-	201,418.98	201,418.98
Total	$ 8,665,924.98	$ 2,769,299.38	$ 18,875,713.47	$ 240,606.66	$ 201,418.98	$ 30,752,963.47

NOTE 14. ON-BEHALF PAYMENTS

During the year ended June 30, 2011, the State of Tennessee made payments of $4,923.00 on behalf of the Central Office for retirees participating in the Medicare Supplement Plan. The amount for the year ended June 30, 2010, was $5,159. The Medicare Supplement Plan is a postemployment benefit healthcare plan and is discussed further in Note 10. The plan is reported in the *Tennessee Comprehensive Annual Financial Report*. That report is available on the state's website at http://tn.gov/finance/act/cafr.shtml.

NOTE 15. VOLUNTARY BUYOUT PROGRAM

The Central Office implemented a Voluntary Buyout Plan in fiscal year 2010 as a strategy to assist the Central Office in addressing budgetary constraints due to several years of state appropriation reductions and potential budget reductions in the forthcoming fiscal years. The Central Office had four employees participate in the Voluntary Buyout Plan with all four terminating by September 30, 2009.

Severance pay was payable the month of the employee separation date. Severance pay included:

- Base severance payment equal to three times the employee's monthly rate of pay in effect on July 1, 2009.
- Service payment of $500 for each full or partial year of state service as of September 30, 2009.
- Amount equivalent to the employee's next longevity payment based on his/her years of creditable state service.
- Amount equal to six months of the Central Office's portion of monthly health insurance premium.

Severance pay included tuition assistance of $5,400 per year and a maximum of $10,800 for two years to be used at entities governed by Tennessee Board of Regents or the University of Tennessee Board of Trustees. These included technology centers, community colleges, and state universities. The tuition assistance had to be used after January 1, 2010, and before January 1, 2012. The benefit was to be used for the participant, could not be transferred to a dependent, and was not redeemable for the cash equivalent. As of June 30, 2010, expenses for the Voluntary Buyout Plan were $206,608.75.

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, 2010	State Employee Group Plan	$ -	$4,713,000	$4,713,000	0%	$8,513,566	55.36%
July 1, 2009	State Employee Group Plan	$ -	$5,695,000	$5,695,000	0%	$8,197,659	69.47%
July 1, 2007	State Employee Group Plan	$ -	$9,385,000	$9,385,000	0%	$8,258,796	113.64%

The amount reported here for covered payroll relates to the fiscal year in which the valuations were performed.