AUDIT REPORT

Tennessee Board of Regents
Middle Tennessee State University

For the Year Ended
June 30, 2012

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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STATE OF TENNESSEE
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January 31, 2013

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. Sidney A. McPhee, President
Middle Tennessee State University
110 Cope Administration Building
Murfreesboro, Tennessee 37132

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, Middle Tennessee State University, for the year ended June 30, 2012. You will note from the independent auditor's report that unqualified opinions were given on the fairness of the presentation of the financial statements.

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

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

DVL/sp
12/081

State of Tennessee

A u d i t H i g h l i g h t s

Comptroller of the Treasury | Division of State Audit

Financial and Compliance Audit
Middle Tennessee State University
For the Year Ended June 30, 2012

AUDIT OBJECTIVES

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

AUDIT FINDINGS

The audit report contains no findings.

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

Audit Report
Tennessee Board of Regents
Middle Tennessee State University
For the Year Ended June 30, 2012

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Tennessee Board of Regents
Middle Tennessee State University
For the Year Ended June 30, 2012

INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

Middle Tennessee State University was first established in 1911 as Middle Tennessee State Normal School in Murfreesboro, Tennessee. In 1925, when the General Assembly provided for three teachers' colleges — one in each of the grand divisions — Middle Tennessee State Normal School became Middle Tennessee State Teachers' College and gained the power to grant the Bachelor of Science degree. The college's name was changed to Middle Tennessee State College by an act of the legislature in 1943 and to Middle Tennessee State University by a special legislative act in 1965. The university is composed of nine colleges: Basic and Applied Sciences, Behavioral and Health Sciences, Business, Education, Graduate Studies, University College, Liberal Arts, Mass Communication, and University Honors.

ORGANIZATION

The governance of Middle Tennessee State University is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Executive Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The chief administrative officer of the university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 2011, through June 30, 2012, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Financial statements are presented for the year ended June 30, 2012. Middle Tennessee State University is an institution of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the university's internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing opinions on the financial statements;

2. to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements;

3. to determine the fairness of the presentation of the financial statements; and

4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

PRIOR AUDIT FINDINGS

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 institution. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the institution is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the institution.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the institution. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, promulgated by the American Institute of Certified Public Accountants, requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 2012, we considered internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance and Other Matters

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under generally accepted government auditing standards.

Fairness of Financial Statement Presentation

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

STATE OF TENNESSEE
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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*

November 20, 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. Sidney A. McPhee, President
Middle Tennessee State University
110 Cope Administration Building
Murfreesboro, Tennessee 37132

Ladies and Gentlemen:

We have audited the financial statements of Middle Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the year ended June 30, 2012, and have issued our report thereon dated November 20, 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 university is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the university's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the university's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the university's internal control over financial reporting.

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 university'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 Middle Tennessee State University 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/sp

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

November 20, 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. Sidney A. McPhee, President
Middle Tennessee State University
110 Cope Administration Building
Murfreesboro, Tennessee 37132

Ladies and Gentlemen:

We have audited the accompanying basic financial statements of Middle Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the year ended June 30, 2012, as listed in the table of contents. These financial statements are the responsibility of the university's management. Our responsibility is to express opinions on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of Middle Tennessee State University, an institution of the Tennessee Board of Regents, are intended to present the financial position, the changes in financial position, and the cash flows of only Middle Tennessee State University. They do not purport to, and do not, present fairly the financial position of the Tennessee Board of Regents, as of June 30, 2012, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Middle Tennessee State University, and its discretely presented component unit as of June 30, 2012, 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 20, the financial statements of Middle Tennessee State University Foundation, a discretely presented component unit of Middle Tennessee State University, include investments valued at $11,488,273 (14 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.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 11 through 28 and the schedule of funding progress on page 60 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board who considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of

America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Our audit was conducted for the purpose of forming opinions on the basic financial statements as a whole. The accompanying financial information on page 61 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information is the responsibility of the university's management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with generally accepted government auditing standards, we have also issued our report dated November 20, 2012, on our consideration of the university's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with generally accepted government auditing standards and should be considered in assessing the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/sp

This section of Middle Tennessee State University's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2012, with comparative information presented for the fiscal year ended June 30, 2011. 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 Middle Tennessee State University as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

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

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

Middle Tennessee State University
Net Assets
(in thousands of dollars)

	2012	2011
Assets		
Current assets	$ 90,136	$ 92,766
Capital assets, net	391,669	360,963
Other assets	94,806	93,072
Total Assets	**576,611**	**546,801**
Liabilities		
Current liabilities	46,797	47,483
Noncurrent liabilities	229,489	203,768
Total Liabilities	**276,286**	**251,251**
Net Assets		
Invested in capital assets, net of related debt	178,024	172,779
Restricted – expendable	4,825	5,240
Restricted – nonexpendable	798	815
Unrestricted	116,678	116,716
Total Net Assets	**$ 300,325**	**$ 295,550**

The university had the following significant changes between fiscal years on the Statement of Net Assets:

- ♦ The increase in net capital assets, along with the corresponding increase in invested in capital assets (net of related debt), between fiscal years is a result of additions to the university's capitalized assets. Detailed information about the university's capital assets is presented in the Capital Asset and Debt Administration section of this report.

- ♦ Noncurrent liabilities increased due to the issuance of commercial paper by the Tennessee State School Bond Authority (TSSBA) on behalf of the university for various capital projects. Detailed information about the university's debt is presented in the Capital Asset and Debt Administration section of this report.

- ♦ The remaining allocations remained relatively unchanged.

Component Unit
Net Assets
(in thousands of dollars)

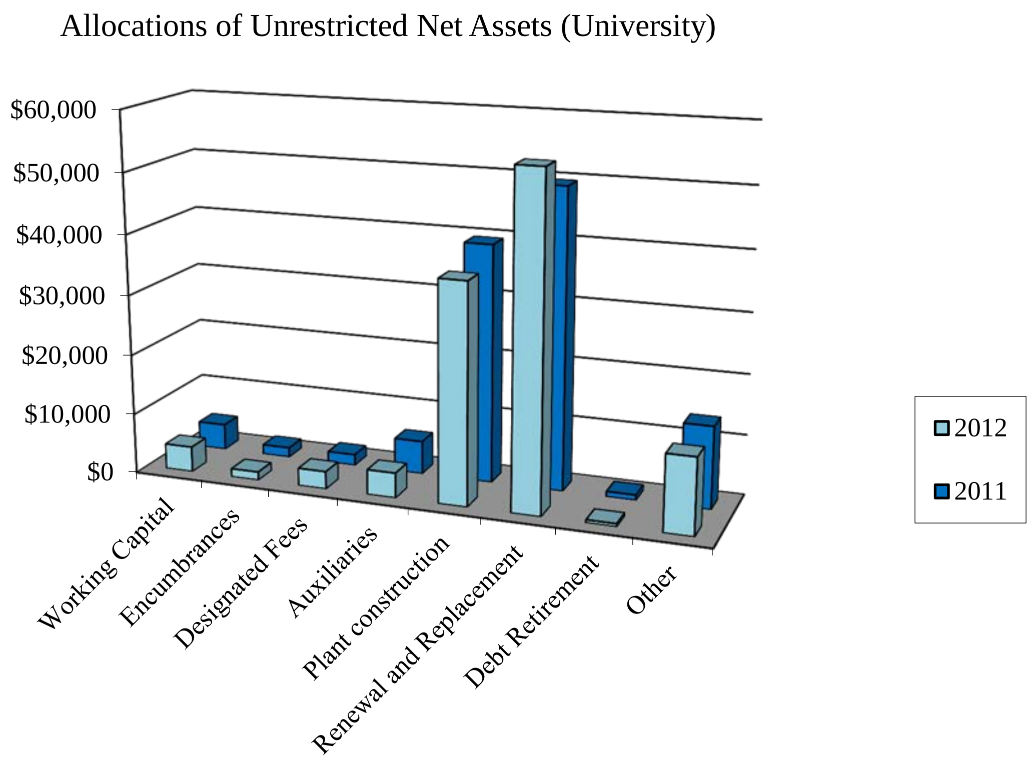
	2012	2011
Assets		
Current assets	$ 3,362	$ 1,253
Capital assets, net	18,240	18,558
Other assets	63,512	54,591
Total Assets	**85,114**	**74,402**
Liabilities		
Current liabilities	1,196	474
Total Liabilities	**1,196**	**474**
Net Assets		
Invested in capital assets	18,240	18,558
Restricted - expendable	33,575	25,151
Restricted - nonexpendable	31,184	29,818
Unrestricted	919	401
Total Net Assets	**$ 83,918**	**$ 73,928**

The component unit had the following significant changes between fiscal years on the Statement of Net Assets:

- Other assets rose as a result of an increase in non-endowment gifts, specifically, a $9 million pledge receivable from a single MTSU alum. The recent fundraising success is attributed to an increase in enrollment and in the number of graduates each year. The growth in the university's alumni base, along with improvements in the nation's economy, has boosted fundraising activities. As a result of the fundraising success, restricted-expendable net assets also increased between fiscal years.

- Unrestricted net assets increased mainly due to the sale of property to the university. The proceeds from the sales of 1902 Greenland Drive and 2739 Middle TN Blvd were approximately $271,000. Also, approximately $132,000 was reallocated back to unrestricted that had previously been allocated to certain discretionary accounts.

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



- Allocations for plant construction decreased due to the spending of project funding set aside for local capital projects. These projects were funded in the previous fiscal year with non-recurring operating appropriations from the state but not completed until the current fiscal year.

- Allocations for renewal and replacement increased as a result of debt service fees collected in the current fiscal year over the amount needed to pay the current year's principal and interest payments for the new student union building. These accumulated reserves will be used in future periods to partially fund the construction of a student services building adjacent to the new student union.

- The remaining allocations remained relatively unchanged.

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

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

Middle Tennessee State University
Changes in Net Assets
(in thousands of dollars)

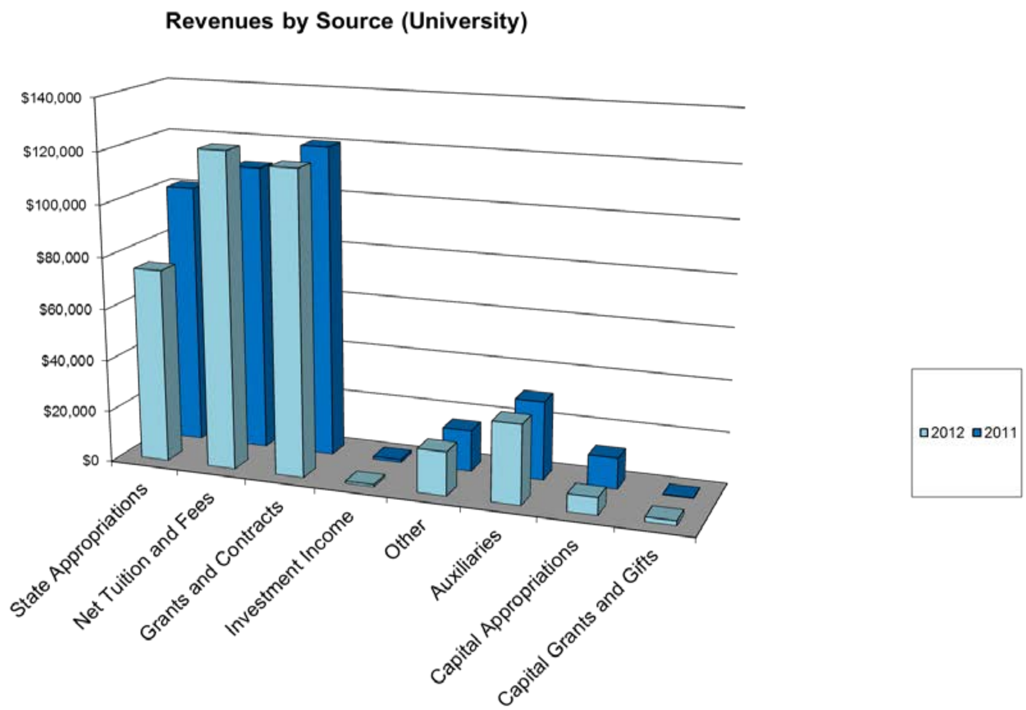
	2012	2011
Operating revenues		
Net tuition and fees	$ 122,021	$ 110,695
Auxiliaries	30,716	30,475
Grants and contracts	32,341	30,779
Other	15,453	14,685
Total operating revenues	**200,531**	**186,634**
Operating expenses	355,444	329,675
Operating loss	**(154,913)**	**(143,041)**
Nonoperating revenues and expenses		
State appropriations	74,924	100,986
Gifts	1,398	1,244
Grants and contracts	84,983	89,605
Investment income	864	1,095
Other revenues and expenses	(7,535)	(8,449)
Total nonoperating revenues and expenses	**154,634**	**184,481**
Income (loss) before other revenues, expenses, gains, or losses	**(279)**	**41,440**
Other revenues, expenses, gains, or losses		
Capital appropriations	6,844	12,031
Capital grants and gifts	1,867	237
Total revenues, expenses, gains, or losses	**8,711**	**12,286**
Increase in net assets	**8,432**	**53,708**
Net assets at beginning of year	295,550	241,842
Prior period adjustment	(3,657)	-
Net assets at end of year	**$ 300,325**	**$ 295,550**

Component Unit
Changes in Net Assets
(in thousands of dollars)

	2012	2011
Operating revenues		
Gifts	$ 16,281	$ 8,159
Endowment income	1,464	1,256
Grants and contracts	4	17
Other	51	59
Total operating revenues	**17,800**	**9,491**
Operating expenses	8,193	4,879
Operating income	**9,607**	**4,612**
Nonoperating revenues and expenses		
Investment income	(1,506)	4,054
Other revenues and expenses	(14)	(59)
Total nonoperating revenues and expenses	**(1,520)**	**3,995**
Income before other revenues, expenses, gains, or losses	**8,087**	**8,607**
Other revenues, expenses, gains, or losses		
Capital grants and gifts	625	148
Additions to permanent endowments	1,278	747
Total revenues, expenses, gains, or losses	**1,903**	**895**
Increase in net assets	**9,990**	**9,502**
Net assets at beginning of year	73,928	64,426
Net assets at end of year	**$ 83,918**	**$ 73,928**

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which are used to fund the university's operating activities for the years ended June 30, 2012, and June 30, 2011 (amounts are presented in thousands of dollars).



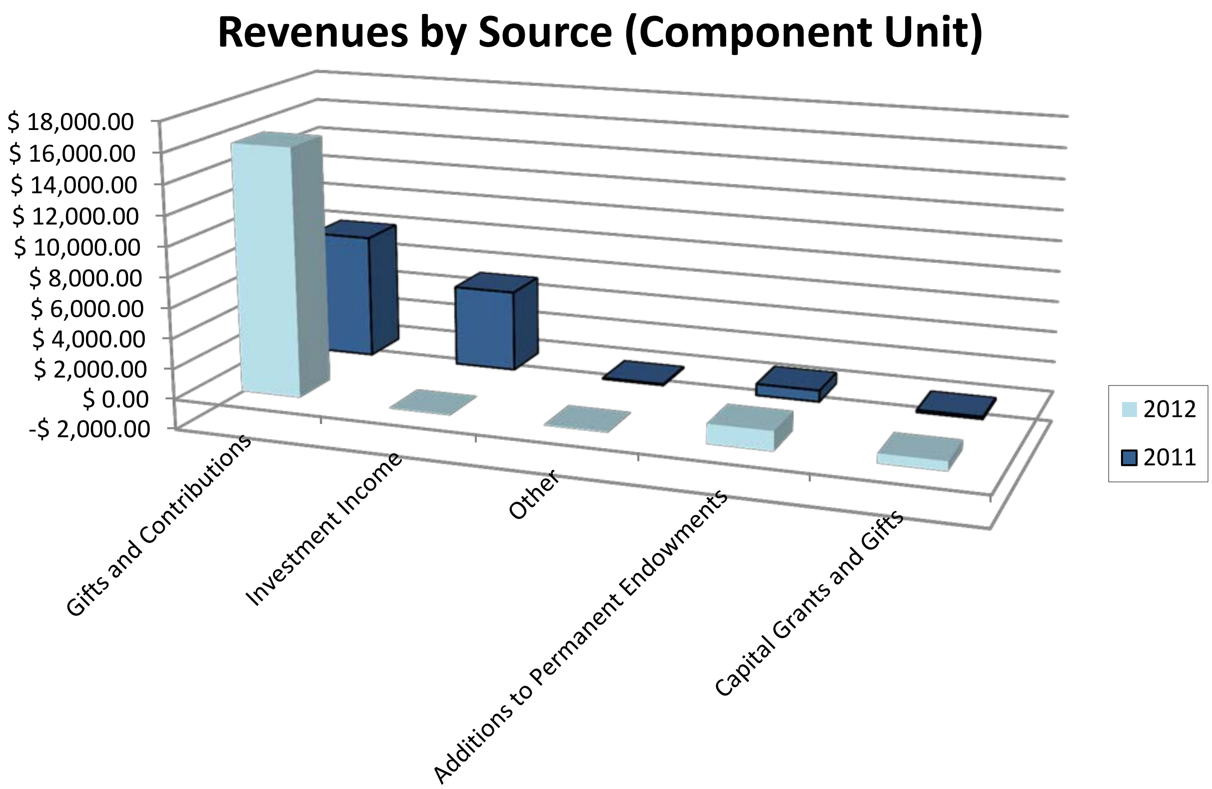
The university had the following significant changes in revenues between fiscal years:

- State appropriations decreased for the year as a result of one-time non-recurring funding provided by the State of Tennessee in the previous fiscal year. This funding was provided as a temporary measure while schools planned for permanent reductions in base budgets. In 2010-11, the university received non-recurring operating appropriations in the amount of $17.6 million and $5.5 million under the Maintenance of Effort (MOE) state-funded program.

- Tuition and fees increased due to a 9.8% fee increase for the 2011-12 academic year.

- Non-operating grants and contracts decreased mainly as a result of receiving less State Fiscal Stabilization Funds (SFSF) under the American Recovery and Reinvestment Act (ARRA) in 2011-12 than in the previous fiscal year. Federal aid awards showed declines during the year due to funding cuts in two grant programs. See the Expenses by Natural Classification section for additional details of these programs.

- Capital appropriation revenue for both fiscal years was composed mainly of appropriations for the college of education building. Since a significant amount of this building was under construction during the 2010-11 fiscal year, this would have been the year in which most of the appropriations were recorded. The building was finished early within the 2011-12 fiscal year.



The component unit had the following significant changes in revenues between fiscal years:

- Gifts increased during the fiscal year as a result of growth in fundraising opportunities. Funds from private support systems generated over $8 million during the fiscal year, which exceeds our national peers by more than 40 percent. The recent fundraising success is attributed in part to an increase in university graduates, thereby resulting in a larger alumni base. Improvements in the nation's economy, led by a recovering labor market, should open new outlets for future fundraising opportunities.

- The decrease in investment income resulted from unrealized losses due to weak market conditions during the fiscal year.

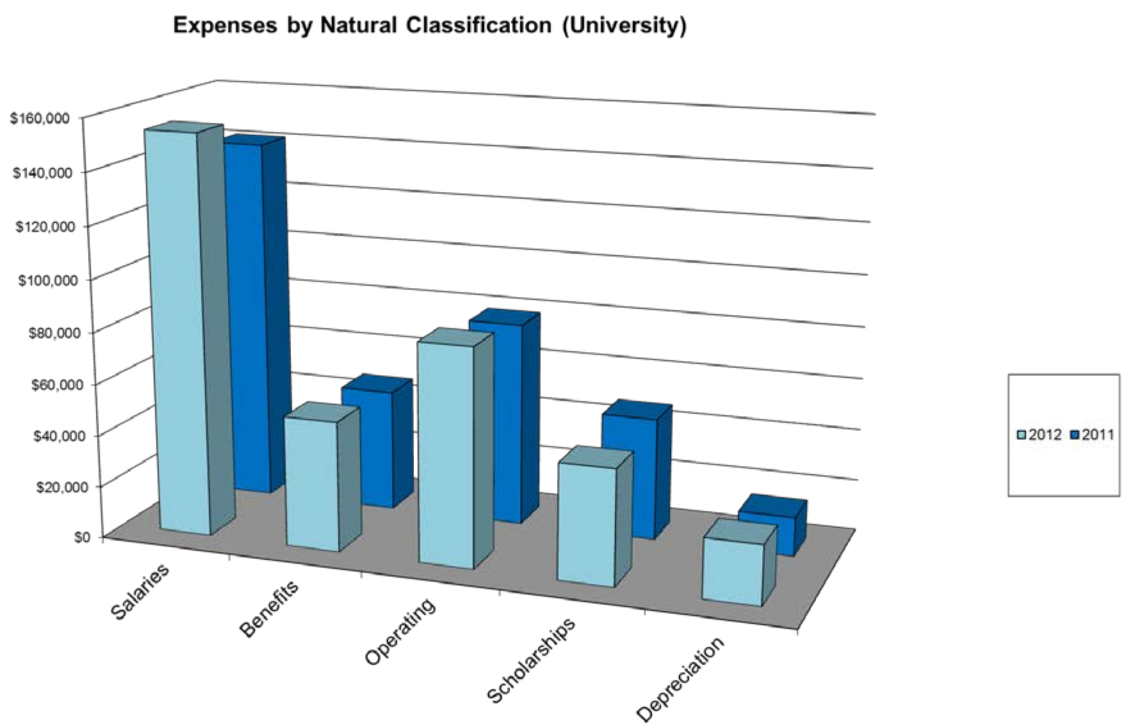
- Revenues in other areas remained relatively unchanged during the fiscal year.

Expenses

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

Middle Tennessee State University
Natural Classification
(in thousands)

	2012	2011
Salaries	$ 154,174	$ 141,306
Benefits	50,309	47,231
Operations	83,737	78,885
Scholarships	44,374	47,208
Depreciation	22,850	15,045
TOTAL	**$ 355,444**	**$ 329,675**



The university had the following significant changes in expenses between fiscal years:

- Several events affected salaries and wage expense during the 2011-12 fiscal year. In July 2011, university employees received a 3% cost of living allowance salary increase, and a $1,000 bonus, prorated for regular part-time employees, in October 2011. In January 2012, the TBR-approved market study went into effect to bring employee salaries and wages, below the current market minimum, in line with the market minimum.

- Operating expenses rose primarily due to the completion of building projects and routine expenses. The university experienced increases in the areas of utilities due to new and renovated buildings placed into use, and maintenance expense related to buildings, software, and equipment. In addition to maintenance, expenses rose due to changes in the accounting of periodicals purchased by the Walker Library. The university also realized an increase in write-offs of student account balances.

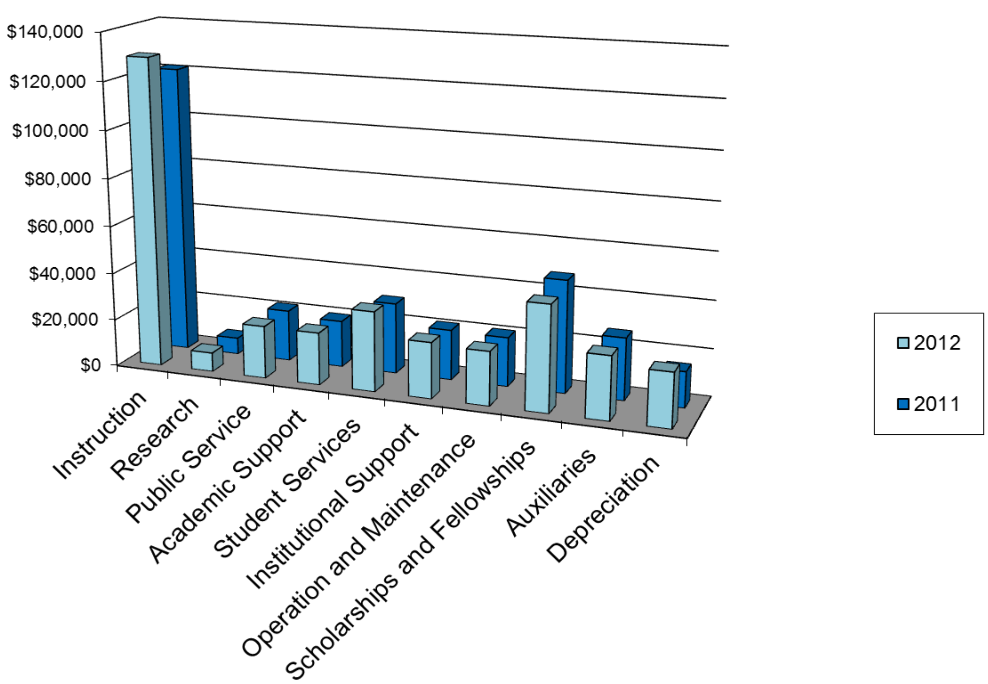
- Scholarship expense declined slightly due to changes by Congress in federal aid programs. Amendments to the Higher Education Opportunity Act of 2008 did not provide funding to reauthorize the federal ACG and SMART grant programs. As a result, no awards were made to students during the fiscal year.

- Depreciation expense rose sharply on the basis of changes in the university's accounting for library holdings, specifically periodicals. Based on new guidance, the university will no longer capitalize the purchase of periodicals. As a result, the university expensed the remaining book value of all periodicals during the fiscal year.

Middle Tennessee State University
Program Classification
(in thousands of dollars)

	2012	2011
Instruction	$ 129,741	$ 121,151
Research	7,986	6,984
Public Service	22,146	21,637
Academic Support	22,035	19,713
Student Services	33,593	29,859
Institutional Support	23,512	21,203
Operation and Maintenance	22,655	20,766
Scholarships and Fellowships	44,374	47,208
Auxiliaries	26,552	26,109
Depreciation	22,850	15,045
TOTAL	$ 355,444	$ 329,675

Expenses by Program Classification (University)



The university had the following significant changes in program expenses between fiscal years:

- Instruction expenses increased during the year primarily in the area of salaries and benefits. Specifically, faculty salaries rose 7% as a result of the 3% cost of living adjustment, and the salaries and wage market study, as discussed in the previous section. Although overall instructional expenses increased, operating expenses, such as consumable supplies and travel, declined during the fiscal year.

- Student services expenses rose during the year as a result of increases to salaries and benefits. Routine maintenance on student facilities, software, and grounds also increased during the year.

- Scholarship expenses decreased as a result of changes in federal aid programs. As stated in the previous section, federal funding for the ACG and National SMART grant programs was not reauthorized by Congress. As a result, no students were awarded these grants during the fiscal year.

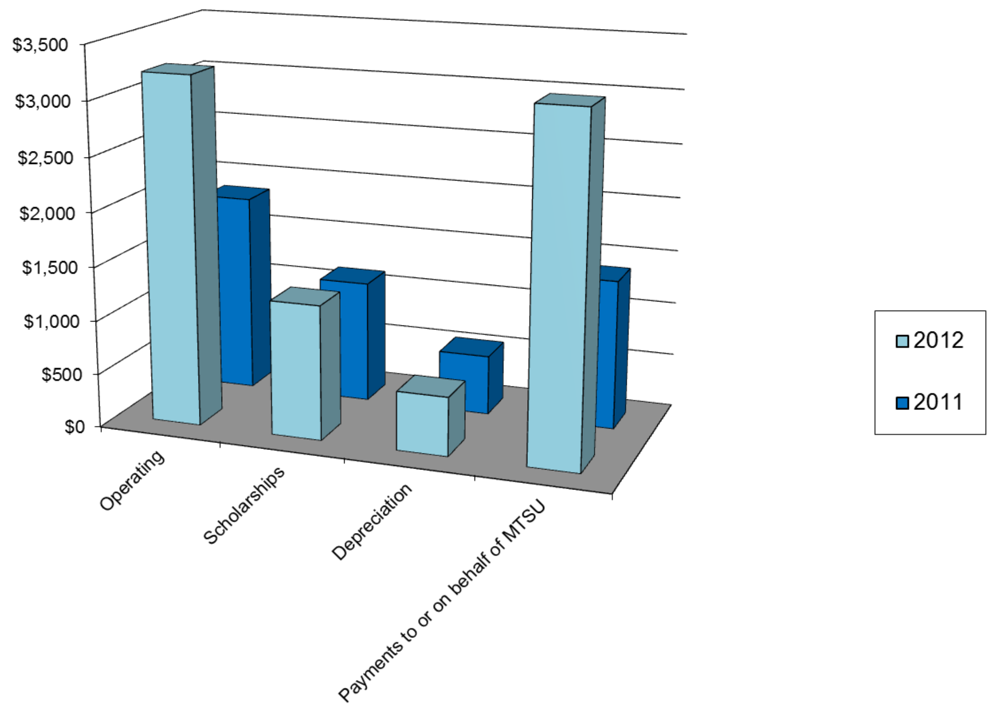
- Depreciation expense increased as a result of changes in the accounting treatment of the purchase of periodicals. The university will no longer capitalize periodicals, but will expense these items in the year purchased.

- Expenditures in other areas remained relatively unchanged.

Component Unit
Natural Classification
(in thousands)

	2012	2011
Operations	$ 3,226	$ 1,799
Scholarships	1,252	1,137
Depreciation	547	555
Payments to or on behalf of MTSU	3,168	1,388
TOTAL	**$ 8,193**	**$ 4,879**

Expenses by Natural Classification (Component Unit)



The component unit had the following significant change in expenses between fiscal years:

- Operating expenses increased during the year as a result of recording in-kind expenses related to non-cash donations, mainly a donation made to the Albert Gore Research Center. The increase is also attributable to a contribution made by a donor and used for the renovation of the women's basketball offices.

- Payments to or on behalf of MTSU for the component unit rose during the fiscal year primarily due to the transfer of $1.8 million for Floyd Club Level Stadium renovations.

- Expenditures in other areas remained relatively unchanged.

Capital Asset and Debt Administration

Capital Assets - University

Middle Tennessee State University had $391.7 million invested in capital assets, net of accumulated depreciation of $193.9 million at June 30, 2012; and $361.0 million invested in capital assets, net of accumulated depreciation of $188.8 million at June 30, 2011. Depreciation charges totaled $22.9 million and $15.0 million for the years ended June 30, 2012, and June 30, 2011, respectively. Details of these assets are shown below.

Middle Tennessee State University
Schedule of Capital Assets, Net of Depreciation
(in thousands)

	2012	2011
Land	$ 12,607	$ 12,344
Land improvements and infrastructure	40,048	17,123
Buildings	219,929	170,705
Equipment	20,409	18,854
Library holdings	2,478	8,448
Intangible assets	1,703	2,201
Projects in progress	94,495	131,288
Total	**$ 391,669**	**$ 360,963**

Highlights of the information presented on the Schedule of Capital Assets for the university are as follows:

- Improvements to land and infrastructure rose sharply during the 2011 – 12 fiscal year. A substantial part of this change was represented by the completion of the current phase of the university's parking and transportation project. The current phase included a new entrance on the north side of campus and new bus lanes to improve traffic management. In addition to the parking and transportation project, the university completed work on a new energy management system and an interoperable digital radio system.
- During the fiscal year, buildings increased due to the completion of several major projects. In July, construction was completed on the 87,322 sq. ft. state-of-the-art College of Education Building. The building was open for use in the fall. Other projects completed during the year were the renovation of Corlew and Deere dormitories and upgrades to Tucker Theater.

- As discussed in the previous section, there was a steep decline in library holdings due to depreciating the net book value of all periodicals.

- Projects in progress declined during the fiscal year due to the completion of several major improvements to land, infrastructure, and building projects as stated above. Although there was a decrease in this category, several additions were made for the following projects: the new science building, the student services building, two new parking garages, and the student union building. The student union building will be completed during the 2012 – 13 fiscal year.

Major capital expenditures are to be expected during the next fiscal year. The State of Tennessee approved the university's request for capital appropriations necessary to begin construction on the $147 million science building. The new 250,000 sq. ft. facility represents one of the most significant investments made toward the enhancement of science and technology education in Tennessee. Ground breaking for this capital project was held in May 2012, and the project is scheduled to be completed by the spring of 2015.

Noteworthy capital projects in progress include the new student union building, the student services building, and two parking garages located in the Holmes Building lot and adjacent to the Health, Wellness, and Recreation Center. These three projects have capital budgets in excess of $104 million and are mainly funded through the issuance of TSSBA commercial paper.

In addition, capital appropriations will allow the university to fund renovation projects such as the Walker Library roof replacement project, updates to Murphy Center HVAC units, phase 2 of the university's underground electrical systems upgrade, and updates to the University's water and sewer system.

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

Capital Assets – Component Unit

The component unit had $18.2 million invested in capital assets, net of accumulated depreciation of $5.5 million at June 30, 2012; and $18.6 million invested in capital assets, net of accumulated depreciation of $4.9 million at June 30, 2011. Depreciation charges totaled $.5 million and $.6 million for the years ended June 30, 2012, and June 30, 2011, respectively. Details of these assets are shown below.

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

	2012	2011
Land	$ 2,903	$ 2,341
Land improvements and infrastructure	674	724
Buildings	14,658	15,488
Equipment	5	5
Total	$ 18,240	$ 18,558

Categories presented on the Schedule of Capital Assets for the component unit remained relatively unchanged between fiscal years. There was a small rise in land due to a donation of land in the Eagleville community during the fiscal year. The land is valued at $625,000.

More detailed information about the component unit's capital assets is presented in Note 20 to the financial statements.

Debt

The university had $219.6 million and $198.1 million in debt outstanding at June 30, 2012, and June 30, 2011, respectively. The table below summarizes these amounts by type of debt instrument (in thousands of dollars).

Middle Tennessee State University
Outstanding Debt Schedule
(in thousands)

	2012	2011
TSSBA bonds	$ 145,254	$ 152,696
TSSBA commercial paper	74,339	45,392
Total debt	**$ 219,593**	**$ 198,088**

TSSBA did not issue any new bonds for capital projects during the fiscal year; however, the university did record unamortized bond premiums and discounts on previous bond issues during the fiscal year. More detailed information is presented in Note 17 regarding unamortized bond premiums and discounts.

Additional commercial paper was issued on behalf of the university for the following major projects: renovations of various university housing facilities, construction of a new Student Union facility, and construction of new university parking garages.

The ratings on debt issued by the Tennessee State School Bond Authority at June 30, 2012, were as follows: Fitch rating of AA+, Moody's Investor's rating of Aa1, and Standard & Poor's rating of AA.

More detailed information about the university's long-term liabilities is presented in Note 7 to the financial statements.

Economic Factors That Will Affect the Future

The final state budget as proposed by Governor Haslam and subsequently approved by the state legislature included both an additional higher education state funding reduction of 2.1% and some enhancement funds to cover improvements under the THEC Outcomes Based Funding Formula. This combination of incremental increases and reduction resulted in only a small budget increase for 2012-13.

The Governor's budget included $126,650,000 for construction of the new Science Building. The approved budget for the Science Building included a matching funds component of $18,750,000. This project was approved by the state legislature in the final state appropriation. Funding of the match will be handled with local funds, private donations, and some student fees. Capital maintenance funds totaling $5,320,000 were approved for the university as well.

The 2012-13 budget also included a 2.5% Cost of Living Allowance (COLA) salary increase for state employees. As in previous years, the state appropriation did not fully fund higher education's increase and the university will be required to fund a portion of this salary increase.

The Tennessee Board of Regents approved a 6.8% tuition increase at its June 2012 meeting for the university. New funds from this increase will replace part of the reduced state appropriations, cover some inflationary cost, cover the university's portion of the state 2.5% salary increase, fund a TBR Business Intelligence Strategy, and provide funds for new tenure track faculty positions.

We are not aware of any other factors, decisions, or conditions that are expected to have a significant impact on the financial position or results of operation during this fiscal year.

Requests for Information

This financial report is designed to provide a general overview of the institution's finances for all those with an interest in the university's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to Alan Thomas, Controller and Executive Director of Finance Technology and Compliance, Middle Tennessee State University, CAB 211, Murfreesboro, TN 37132.

Exhibit A

TENNESSEE BOARD OF REGENTS
MIDDLE TENNESSEE STATE UNIVERSITY
STATEMENTS OF NET ASSETS
JUNE 30, 2012

	Middle Tennessee State University	Component Unit Middle Tennessee State University Foundation
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 20)	$ 63,488,186.85	$ 2,003,942.78
Accounts, notes, and grants receivable (net) (Note 4)	24,080,583.58	-
Due from primary government	346,000.00	-
Pledges receivable (net) (Note 20)	-	1,327,248.67
Inventories	849,125.47	-
Prepaid expenses and deferred charges	1,337,001.09	2,154.13
Accrued interest receivable	34,847.90	29,029.99
Total current assets	90,135,744.89	3,362,375.57
Noncurrent assets:		
Cash and cash equivalents (Notes 2 and 20)	91,499,447.93	14,004,903.44
Investments (Notes 3 and 20)	725,597.81	39,911,313.25
Accounts, notes, and grants receivable (net) (Note 4)	2,581,178.08	-
Pledges receivable (net) (Note 20)	-	9,595,682.68
Capital assets (net) (Notes 5 and 20)	391,669,416.52	18,239,683.08
Total noncurrent assets	486,475,640.34	81,751,582.45
Total assets	576,611,385.23	85,113,958.02
LIABILITIES		
Current liabilities:		
Accounts payable (Note 6)	6,094,324.00	1,195,694.19
Accrued liabilities	19,096,193.78	-
Student deposits	906,456.07	-
Deferred revenue	8,973,091.94	-
Compensated absences (Note 7)	1,883,588.05	-
Accrued interest payable	1,176,868.57	-
Long-term liabilities, current portion (Note 7)	7,885,938.12	-
Deposits held in custody for others	780,654.14	-
Total current liabilities	46,797,114.67	1,195,694.19
Noncurrent liabilities:		
Net OPEB obligation (Note 12)	10,813,534.32	-
Compensated absences (Note 7)	4,499,521.47	-
Long-term liabilities (Note 7)	211,707,459.11	-
Due to grantors (Note 7)	2,468,394.05	-
Total noncurrent liabilities	229,488,908.95	-
Total liabilities	276,286,023.62	1,195,694.19
NET ASSETS		
Invested in capital assets, net of related debt	178,023,688.35	18,239,683.08
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	10,900.00	27,754,662.43
Research	-	949,078.35
Instructional department uses	-	2,455,273.57
Other	787,180.47	25,245.99
Expendable:		
Scholarships and fellowships (Note 8)	77,296.59	10,134,891.38
Research	72,622.93	162,448.71
Instructional department uses	223,455.61	8,467,344.83
Loans (Note 8)	1,874,624.26	-
Capital projects	-	12,535,796.91
Debt service	354,745.35	-
Other	2,222,274.11	2,274,910.13
Unrestricted (Note 9)	116,678,573.94	918,928.45
Total net assets	$ 300,325,361.61	$ 83,918,263.83

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

Exhibit B

TENNESSEE BOARD OF REGENTS
MIDDLE TENNESSEE STATE UNIVERSITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 2012

	Middle Tennessee State University	Component Unit Middle Tennessee State University Foundation
REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of $54,908,170.26)	$ 122,021,025.17	$ -
Gifts and contributions	-	16,280,728.41
Endowment income	-	1,464,188.90
Governmental grants and contracts	31,617,421.23	-
Nongovernmental grants and contracts	723,156.16	3,753.20
Sales and services of educational departments	765,563.25	-
Sales and services of other activities	14,345,753.49	-
Auxiliary enterprises:		
Residential life (net of scholarship allowances of $4,348,230.14; all residential life revenues are used as security for revenue bonds; see Note 7)	9,660,805.01	-
Bookstore (net of scholarship allowances of $2,534,898.96; all bookstore revenues are used as security for revenue bonds; see Note 7)	5,623,647.22	-
Food service	1,360,043.00	-
Wellness facility (net of scholarship allowances of $953,724.36; all wellness facility revenues are used as security for revenue bonds; see Note 7)	2,136,691.84	-
Other auxiliaries	11,934,969.67	-
Interest earned on loans to students	98,415.91	-
Other operating revenues	243,422.51	51,583.13
Total operating revenues	200,530,914.46	17,800,253.64
EXPENSES		
Operating expenses (Note 16):		
Salaries and wages	154,173,839.31	-
Benefits	50,309,345.88	-
Utilities, supplies, and other services	83,737,467.28	3,226,441.27
Scholarships and fellowships	44,373,788.81	1,251,643.55
Depreciation expense	22,849,908.78	546,930.13
Payments to or on behalf of MTSU (Note 20)		3,167,746.03
Total operating expenses	355,444,350.06	8,192,760.98
Operating income (loss)	(154,913,435.60)	9,607,492.66
NONOPERATING REVENUES (EXPENSES)		
State appropriations	74,924,252.30	-
Gifts, including $1,340,925.96 from component unit	1,398,070.41	-
Grants and contracts	84,982,682.95	-
Investment income (net of investment expense of $10,499.28 for the university and $123,858.58 for the component unit)	864,153.32	(1,506,682.44)
Interest on capital asset-related debt	(6,846,052.69)	-
Other nonoperating expenses	(688,789.98)	(13,999.53)
Net nonoperating revenues	154,634,316.31	(1,520,681.97)
Income (loss) before other revenues, expenses, gains, or losses	(279,119.29)	8,086,810.69
Capital appropriations	6,844,135.01	-
Capital grants and gifts, including $1,826,820.07 from component unit	1,866,820.07	625,000.00
Additions to permanent endowments	-	1,277,921.43
Total other revenues	8,710,955.08	1,902,921.43
Increase in net assets	8,431,835.79	9,989,732.12
NET ASSETS		
Net assets - beginning of year	295,549,754.73	73,928,531.71
Prior period adjustment (Note 17)	(3,656,228.91)	-
Net assets - end of year	$ 300,325,361.61	$ 83,918,263.83

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

TENNESSEE BOARD OF REGENTS
MIDDLE TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2012

CASH FLOWS FROM OPERATING ACTIVITIES	
Tuition and fees	$ 120,744,140.64
Grants and contracts	31,665,771.87
Sales and services of educational activities	776,170.36
Sales and services of other activities	13,785,442.19
Payments to suppliers and vendors	(85,954,893.66)
Payments to employees	(152,309,698.37)
Payments for benefits	(47,846,066.46)
Payments for scholarships and fellowships	(44,373,788.81)
Loans issued to students	(75,815.22)
Collection of loans from students	146,642.78
Interest earned on loans to students	99,913.25
Auxiliary enterprise charges:	
Residence halls	9,580,019.15
Bookstore	6,958,267.24
Food services	1,310,281.65
Wellness facility	2,117,939.84
Other auxiliaries	11,865,917.50
Other receipts (payments)	168,422.51
Net cash used by operating activities	(131,341,333.54)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State appropriations	74,771,891.56
Gifts and grants received for other than capital or endowment purposes, including $1,340,925.96 from component unit	86,381,474.75
Federal student loan receipts	129,570,875.05
Federal student loan disbursements	(129,971,065.51)
Changes in deposits held for others	(30,821.85)
Other non-capital financing receipts (payments)	139,293.26
Net cash provided by noncapital financing activities	160,861,647.26
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Proceeds from capital debt	29,646,258.03
Capital appropriations	6,844,135.01
Capital grants and gifts received, including $57,597.62 from component unit	97,597.62
Purchase of capital assets and construction	(52,537,067.56)
Principal paid on capital debt	(7,757,661.14)
Interest paid on capital debt	(7,205,750.41)
Other capital and related financing receipts (payments)	(78,395.80)
Net cash used by capital and related financing activities	(30,990,884.25)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sales and maturities of investments	1,241,899.00
Income on investments	870,565.26
Purchase of investments	(1,218,383.09)
Net cash provided by investing activities	894,081.17
Net decrease in cash and cash equivalents	(576,489.36)
Cash and cash equivalents - beginning of year	155,564,124.14
Cash and cash equivalents - end of year	$ 154,987,634.78

TENNESSEE BOARD OF REGENTS
MIDDLE TENNESSEE STATE UNIVERSITY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED JUNE 30, 2012

Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(154,913,435.60)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense		22,849,908.78
Other adjustments (Note 18)		159,460.74
Change in assets and liabilities:		
Receivables, net		(1,744,856.55)
Inventories		1,618,833.06
Prepaid/deferred items		888,200.38
Other assets		1,497.34
Accounts payable		(2,467,569.54)
Accrued liabilities		4,027,870.80
Deferred revenue		(1,841,703.74)
Deposits		122,763.61
Compensated absences		114,943.35
Due to grantors		(86,418.61)
Loans to students		(70,827.56)
Net cash used by operating activities	$	(131,341,333.54)
Noncash investing, capital, and financing activities		
Gifts in-kind - capital	$	1,821,110.45
Unrealized gains on investments	$	23,527.77
Loss on disposal of capital assets	$	(750,162.88)
Trade-in allowance	$	475.44

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The university is a part of the State University and Community College System of Tennessee (Tennessee Board of Regents). This system is a component unit of the State of Tennessee because the state appoints a majority of the system's governing body and provides 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 Middle Tennessee State University.

The Middle Tennessee State University Foundation is considered a component unit of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements. See Note 20 for more detailed information about the component unit and how to obtain the report.

Basis of Presentation

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

Basis of Accounting

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

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

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

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

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

Cash Equivalents

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

Inventories

Inventories are valued at the lower of cost or market. Textbooks included in the inventory are recorded on a weighted average basis. All other items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

The university's employees accrue annual and sick leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. The amount of the liabilities for annual leave and compensatory time and their related benefits are reported in the statement of net assets. There is no liability for unpaid accumulated sick leave since the university's policy is to pay this only if the employee dies or is absent because of illness, injury, or related family death.

Capital Assets

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

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

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

Net Assets

The university's net assets are classified as follows:

<u>Invested in capital assets, net of related debt</u> - This represents the university's total investment in capital assets, net of outstanding debt obligations related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of invested in capital assets, net of related debt.

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

<u>Expendable restricted net assets</u> - Expendable restricted net assets include resources which the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

<u>Unrestricted net assets</u> - Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions

relating to the educational and general operations of the university, and may be used at the discretion of the university to meet current expenses for any purpose. The auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

Scholarship Discounts and Allowances

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

NOTE 2. CASH AND CASH EQUIVALENTS

In addition to demand deposits and petty cash on hand, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less. At June 30, 2012, cash and cash equivalents consisted of $75,953,005.33 in bank accounts, $33,015.00 of petty cash on hand, $69,611,668.92 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer, $9,328,362.87 in LGIP deposits for capital projects, and $61,582.66 in a money market account.

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

NOTE 3. INVESTMENTS

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

At June 30, 2012, the university had the following investments and maturities.

		Investment Maturities (in Years)			
Investment Type	Fair Value	Less than 1	1 to 5	More than 10	No Maturity Date
Corporate bonds	$ 212,153.50	$ 50,028.50	$ 50,172.00	$ 111,953.00	$ -
Corporate stock	36,972.70	-	-	-	36,972.70
Mutual bond funds	352,874.53	-	-	-	352,874.53
Mutual equity funds	123,597.08	-	-	-	123,597.08
Total	$ 725,597.81	$ 50,028.50	$ 50,172.00	$ 111,953.00	$ 513,444.31

Interest Rate Risk

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

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; banker's acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified. Securities are rated using Standard and Poor's, Moody's, and/or Fitch and are presented below using the Standard and Poor's rating scale.

Tennessee Board of Regents policy restricts investments in banker's acceptances and commercial paper. The policy requires that prime banker's acceptances must be issued by domestic banks with a minimum AA rating or foreign banks with a AAA long-term debt rating by a majority of the ratings services that have rated the issuer. 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 of 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.

The policy requires that prime commercial paper 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 guarantee 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.

At June 30, 2012, the university's investments were rated as follows:

		Credit Quality Rating			
Investment Type	Fair Value	A	A-	AA-	Unrated
LGIP	$ 78,940,031.79	$ -	$ -	$ -	$ 78,940,031.79
Corporate bonds	212,153.50	56,292.00	55,661.00	100,200.50	-
Mutual bond funds	352,874.53	-	-	-	352,874.53
Total	$ 79,505,059.82	$ 56,292.00	$ 55,661.00	$ 100,200.50	$ 79,292,906.32

Custodial Credit Risk

For an investment, custodial credit risk is the risk that, in the event of the failure of the counterparty, the university will not be able to recover the value of its investments or collateral securities that are in the possession of an outside party. The university does not have a policy for custodial credit risk. At June 30, 2012, the university had

$725,597.81 of uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent but not in the university's name.

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2012
Student accounts receivable	$ 6,934,491.93
Grants receivable	14,214,642.85
Notes receivable	199,732.68
Other receivables	4,448,177.05
Subtotal	25,797,044.51
Less allowance for doubtful accounts	(1,716,460.93)
Total receivables	$24,080,583.58

Federal Perkins Loan Program funds included the following:

	June 30, 2012
Perkins loans receivable	$ 3,420,808.87
Less allowance for doubtful accounts	(839,630.79)
Total	$ 2,581,178.08

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2012, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 12,344,247.20	$ 262,377.05	$ -	$ -	$ 12,606,624.25
Land improvements and infrastructure	41,362,292.72	-	25,879,683.80	-	67,241,976.52
Buildings	289,976,533.00	453,850.00	57,837,218.02	2,609,470.09	345,658,130.93
Equipment	49,878,088.14	6,185,942.79	-	1,436,622.24	54,627,408.69
Library holdings	20,294,582.76	480,195.49	-	14,401,336.49	6,373,441.76
Intangible assets	4,611,425.27	-	-	-	4,611,425.27
Projects in progress	131,287,760.47	46,923,924.68	(83,716,901.82)	-	94,494,783.33
Total	549,754,929.56	54,306,290.01	-	18,447,428.82	585,613,790.75
Less accumulated depreciation/ amortization:					
Land improvements and infrastructure	24,239,471.11	2,954,113.04	-	-	27,193,584.15
Buildings	119,270,986.38	8,388,825.60	-	1,930,942.78	125,728,869.20
Equipment	31,024,531.13	4,558,767.18	-	1,365,462.11	34,217,836.20
Library holdings	11,846,528.77	6,450,270.98	-	14,401,336.49	3,895,463.26
Intangible assets	2,410,689.44	497,931.98	-	-	2,908,621.42
Total	188,792,206.83	22,849,908.78	-	17,697,741.38	193,944,374.23
Capital assets, net	$360,962,722.73	$ 31,456,381.23	$ -	$ 749,687.44	$391,669,416.52

The increase in accumulated depreciation for library holdings is due to a change in accounting estimate. During fiscal year 2012, it was determined that periodicals are more appropriately expensed. The estimated useful life of periodicals was decreased from 10 years to 0 years, resulting in a current-year adjustment of $13,555,376.89.

NOTE 6. ACCOUNTS PAYABLE

Accounts payable included the following:

	June 30, 2012
Vendors payable	$ 5,835,149.41
Unapplied student payments	247,615.85

Other payables	11,558.74
Total accounts payable	$ 6,094,324.00

NOTE 7. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2012, was as follows:

	Restated Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$147,157,697.14	$ 699,652.31	$ 7,757,661.14	$140,099,688.31	$ 7,885,938.12
Unamortized bond premium	5,537,815.89	-	382,892.78	5,154,923.11	-
Commercial paper	45,392,180.09	28,946,605.72	-	74,338,785.81	-
Subtotal	198,087,693.12	29,646,258.03	8,140,553.92	219,593,397.23	7,885,938.12
Other liabilities:					
Compensated absences	6,268,166.17	3,332,664.13	3,217,720.78	6,383,109.52	1,883,588.05
Due to grantors	2,554,812.66	498,681.00	585,099.61	2,468,394.05	-
Subtotal	8,822,978.83	3,831,345.13	3,802,820.39	8,851,503.57	1,883,588.05
Total long-term liabilities	$206,910,671.95	$33,477,603.16	$11,943,374.31	$228,444,900.80	$9,769,526.17

TSSBA Debt - Bonds

Bonds, with interest rates ranging from 2% to 5.5%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2038 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations; see Note 10 for further details. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net assets is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $7,288,940.36 at June 30, 2012. Unexpended debt proceeds were $9,999.63 at June 30, 2012.

Debt service requirements to maturity for the university's portion of TSSBA bonds at June 30, 2012, are as follows:

Year Ending June 30	Principal	Interest	Total
2013	7,885,938.12	6,893,920.82	14,779,858.94
2014	7,998,668.47	6,545,780.08	14,544,448.55
2015	8,192,971.62	6,202,099.23	14,395,070.85
2016	8,383,267.30	5,855,691.68	14,238,958.98
2017	8,795,666.91	5,457,912.16	14,253,579.07
2018-2022	45,562,197.12	21,044,152.49	66,606,349.61
2023-2027	37,933,617.77	10,431,293.08	48,364,910.85
2028-2032	10,880,248.93	2,953,986.08	13,834,235.01
2033-2037	4,467,112.07	1,057,117.25	5,524,229.32
2038	-	58,195.44	58,195.44
Total	$ 140,099,688.31	$ 66,500,148.31	$ 206,599,836.62

TSSBA Debt - Commercial Paper

The Tennessee State School Bond Authority issues commercial paper to finance the costs of various capital projects during their construction phase. When projects are placed in service, long-term, fixed-rate debt is issued by TSSBA to finance the project over its useful payback period and the commercial paper is redeemed. The amount issued for projects at the university was $74,338,785.81 at June 30, 2012.

For the commercial paper program, the Tennessee State School Bond Authority maintains an interest rate reserve fund. The university contributes amounts to the reserve fund based on the amounts drawn. The principal of the reserve will be contributed to pay off notes or credited back to the university when the notes are converted to bonds. The interest earned on the reserve is used to pay interest due during the month.

More detailed information regarding the bonds and commercial paper can be found in the notes to the financial statements in the financial report for the Tennessee State School Bond Authority. That report is available on the state's website at www.comptroller.tn.gov/tssba/cafr.asp.

NOTE 8. ENDOWMENTS

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

The university chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the university, all interest earnings have been authorized for expenditure. At June 30, 2012, net appreciation of $15,831.61 is available to be spent, of which $13.47 is included in restricted net assets expendable for scholarships and fellowships, and $15,818.14 is included in restricted net assets expendable for loans.

NOTE 9. UNRESTRICTED NET ASSETS

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

	June 30, 2012
Working capital	$ 4,215,387.71
Encumbrances	1,362,257.50
Designated fees	2,901,358.05
Auxiliaries	4,138,025.10
Plant construction	36,374,837.81
Renewal and replacement of equipment	54,586,303.70
Debt retirement	482,333.96
Undesignated	12,618,070.11
Total	$ 116,678,573.94

NOTE 10. PLEDGED REVENUES

The university has pledged certain revenues and fees, including state appropriations, to repay $140,099,688.31 in revenue bonds issued from March 2004 to September 2010 *(*see Note 7 for further detail). Proceeds from the bonds provided financing for the following projects: construction of a cogeneration plant; the Wood/Stegall development facility; a printing services building; Greek Row housing; demolition at 1403 East Main Street; dormitory and family housing upgrades; student health, wellness, and recreation facility upgrades; purchase of the Woodfin property; purchase of Steinway pianos; purchase of a new fleet of airplanes for the Aerospace Department; energy savings and performance contracts; parking and transportation projects; football stadium enhancements; baseball stadium improvements; and purchase of the Ingram Building. The bonds are payable through 2038. Annual principal and interest payments on the bonds are expected to require less than 4.8% of available revenues. The total principal and interest remaining to be paid on the bonds is $206,599,836.62. Principal and interest paid for the current year and total available revenues were $14,880,368.36 and $308,229,542.11, respectively.

NOTE 11. PENSION PLANS

A. Defined Benefit Plans

Tennessee Consolidated Retirement System

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

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report is available on the state's website at www.treasury.tn.gov/tcrs/index.html.

Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 14.91% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2012, 2011, and 2010 were $7,481,791.25, $6,714,529.05, and $5,982,087.97. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans

Plan Description - The university 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 university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contributions made by the university to the plans were $8,429,029.55 for the year ended June 30, 2012, and $7,885,925.09 for the year ended June 30, 2011. Contributions met the requirements for each year.

NOTE 12. OTHER POSTEMPLOYMENT 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 university 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, all members have the option of choosing between the standard or partnership preferred provider organization (PPO) plan for healthcare benefits. Subsequent to age 65, members who are also in the state's retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. The state makes on-behalf payments to the Medicare supplement plan for the university's eligible retirees; see Note 18. 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 www.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 Middle Tennessee State University. The state is the sole contributor for the university 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%; retirees with 20 years of service but less than 30 years of service, 70%; and retirees with less than 20 years of service, 60%. Retirees in the Medicare Supplement Plan have flat-rate premium subsidies based on years of service. Retirees 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; retirees with 20 years of service but less than 30 years of service, $37.50; and retirees with 15 years of service but less than 20 years of service, $25.

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

Annual required contribution (ARC)	$	3,468,000.00
Interest on the net OPEB obligation		400,903.11
Adjustment to the ARC		(425,551.01)

Annual OPEB cost	3,443,352.10
Amount of contribution	(2,652,395.44)
Increase in net OPEB obligation	790,956.66
Net OPEB obligation – beginning of year	10,022,577.66
Net OPEB obligation – end of year	$ 10,813,534.32

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2012	State Employee Group Plan	$3,443,352.10	77.0%	$10,813,534.32
June 30, 2011	State Employee Group Plan	$3,909,888.85	57.7%	$10,022,577.66
June 30, 2010	State Employee Group Plan	$4,299,921.48	41.6%	$8,370,476.42

Funded Status and Funding Progress

The funded status of the university's portion of the State Employee Group Plan as of July 1, 2011, was as follows:

	State Employee Group Plan
Actuarial valuation date	July 1, 2011
Actuarial accrued liability (AAL)	$27,510,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$27,510,000.00
Actuarial value of assets as a percentage of the AAL	0.0%
Covered payroll (active plan members)	$119,509,425.68
UAAL as percentage of covered payroll	23.0%

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 Required Supplementary Information 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, 2011, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4 percent investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 9.25 percent in fiscal year 2012. The rate decreases to 8.75 percent in fiscal year 2013, and then reduces by decrements to an ultimate rate of 5 percent in fiscal year 2021. All rates include a 2.5 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 13. INSURANCE-RELATED ACTIVITIES

It is the policy of the state not to purchase commercial insurance for the risks associated with casualty losses for general liability, automobile liability, professional medical 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, builder's risk (for construction projects starting prior to July 1, 2012) and crime and fidelity coverage on the state's officials and employees. The contractor is responsible for acquiring builder's risk insurance for all construction projects after June 30, 2012; thus, builder's risk is no longer covered by the Risk Management Fund. For property coverage, the deductible for an individual state agency is the first $25,000 of losses. The Risk Management Fund is responsible for property losses for the annual aggregate deductible of $10 million for perils other than earthquakes and flood. Purchased insurance coverage is responsible for losses exceeding the $10 million annual aggregate deductible. For earthquake and flood, there is a deductible of $10 million per occurrence. The maximum insurance coverage is $750 million per year for perils other than earthquake and flood. The maximum flood insurance coverage is $50 million per occurrence, except there is only $25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is $50 million per occurrence. The amounts of settlements have not exceeded insurance coverage for each of the three past fiscal years.

The university participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the year ended June 30, 2012, are presented in the *Tennessee Comprehensive Annual Financial Report*. The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml. Since the university participates in the Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq. Claims are paid through the state's Risk Management Fund. At June 30, 2012, the Risk Management Fund held $97.2 million in cash and cash equivalents designated for payment of claims.

At June 30, 2012, the scheduled coverage for the university was $923,905,900.00 for buildings and $321,365,800.00 for contents.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The university participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on estimates of the ultimate cost of claims, 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 14. COMMITMENTS AND CONTINGENCIES

Sick Leave

The university records the cost of sick leave when paid. The dollar amount of unused sick leave was $56,942,590.25 at June 30, 2012.

Operating Leases

The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $459,200.97 and for personal property were $60,194.08 for the year ended June 30, 2012. All operating leases are cancelable at the lessee's option.

Construction in Progress

At June 30, 2012, outstanding commitments under construction contracts totaled $52,517,234.23 for major projects including parking and transportation improvements; life safety renovations; domestic water and sewer updates; Saunders Fine Arts HVAC; campus lighting; Tucker Theatre renovations; underground electrical update; the College of Education building; systems replacement; dorm renovations; several buildings' roof replacement and Campus Rec roof replacement; safety code corrections; improvements to the dairy farm; steam line replacement; mass communication renovations; physical plant upgrades; ADA adaptations; Todd Hall air quality upgrades; several buildings' envelope repair; the conference center; the new parking garages; science facilities improvements; renovations to the Cope Administration Building; planning for a Concrete Industry building; and the new Student Union, of which $7,946,257.22 will be funded by future state capital outlay appropriations.

Litigation

The university is involved in several lawsuits, none of which are expected to have a material effect on the accompanying financial statements.

NOTE 15. CHAIRS OF EXCELLENCE

The university had $23,740,390.92 on deposit at June 30, 2012, with the State Treasurer for its Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

NOTE 16. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses for the year ended June 30, 2012, are as follows:

Functional Classification	Natural Classification					
	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 88,344,418.94	$ 26,492,463.45	$ 14,903,894.00	$ -	$ -	$ 129,740,776.39
Research	4,113,097.25	1,109,650.45	2,763,194.26	-	-	7,985,941.96
Public service	8,110,357.96	2,577,464.67	11,458,256.90	-	-	22,146,079.53
Academic support	14,739,267.87	5,285,959.79	2,009,699.47	-	-	22,034,927.13
Student services	14,740,974.23	5,005,922.89	13,846,390.71	-	-	33,593,287.83
Institutional support	11,829,563.65	4,944,651.09	6,737,550.28	-	-	23,511,765.02
Maintenance & operation	4,982,472.82	2,280,091.60	15,392,729.45	-	-	22,655,293.87
Scholarships & fellowships	-	-	-	44,373,788.81	-	44,373,788.81
Auxiliary	7,313,686.59	2,613,141.94	16,625,752.21	-	-	26,552,580.74
Depreciation	-	-	-	-	22,849,908.78	22,849,908.78
Total	$ 154,173,839.31	$ 50,309,345.88	$ 83,737,467.28	$ 44,373,788.81	$ 22,849,908.78	$ 355,444,350.06

Expenses initially incurred by the academic support function as a result of providing internal services to the other functional classifications were allocated to the other functional areas by reducing the academic support function's operating expenses by the total amount of salaries, benefits, and operating expenses incurred in the provision of these services, and allocating this amount to the other functional areas' operating expenses on the basis of usage. As a result of this process, expenses totaling $8,633,197.70 were reallocated from academic support to the other functional areas.

NOTE 17. PRIOR-YEAR ADJUSTMENT

In the year ended June 30, 2012, the university began amortizing TSSBA bond premiums and discounts greater than $100,000 over the life of the bonds. Prior issuances were reviewed for materiality. The university identified 15 projects with bond premiums exceeding the $100,000 threshold. Unamortized premiums and discounts of $3,656,228.91 at June 30, 2011 were recorded. As a result, invested in capital assets, net of related debt, was reduced by $3,656,228.91 at June 30, 2011.

NOTE 18. ON-BEHALF PAYMENTS

During the year ended June 30, 2012, the State of Tennessee made payments of $159,460.74 on behalf of the university for retirees participating in the Medicare Supplement Plan. The Medicare Supplement Plan is a postemployment benefit healthcare plan and is discussed further in Note 12. The plan is reported in the *Tennessee Comprehensive Annual Financial Report*. That report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

NOTE 19. SUBSEQUENT EVENT

The university submitted its official notice of intent to withdraw from the Sun Belt Conference no later than June 30, 2013. If the university elects to withdraw effective June 30, 2013, it may be liable for a payment of $1,000,000 above and beyond forfeited rebates or revenue sharing per Conference bylaws.

On November 28, 2012, the university signed a New Member Agreement to join Conference USA effective no later than July 1, 2014. The university will pay an Initiation Fee of $2,000,000, payable in four annual installments of $500,000 with the first installment due on December 31, 2012. It is anticipated the final three installment payments will be a reduction in conference revenue sharing.

At this time, the Sun Belt Conference payment and the loss in rebates or revenue sharing have yet to be determined.

NOTE 20. COMPONENT UNIT

The Middle Tennessee State University Foundation is a legally separate, tax-exempt organization supporting Middle 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 34-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

The foundation is a nonprofit organization that reports under Financial Accounting Standards Board (FASB) standards. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. With the exception of necessary presentation adjustments, no modifications have been made to the foundation's financial information in the university's financial statements for these differences.

During the year ended June 30, 2012, the foundation made distributions of $3,167,746.03 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Joe Bales, Vice President for Development and University Relations, MTSU, 1301 East Main Street, Murfreesboro, TN 37132.

Fair Value Measurements

The foundation reports certain assets and liabilities at fair value. Fair value has been determined using quoted prices in active markets for identical assets and liabilities that are accessible at the measurement date (Level 1), inputs other than quoted market prices included in Level 1 that are directly or indirectly observable for the asset or liability (Level 2), or significant unobservable inputs (Level 3). The following table categorizes the recurring fair value measurements for assets and liabilities at June 30, 2012.

	Total Fair Value at June 30, 2012	Quoted Prices Level 1	Significant Other Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Cash equivalents	$ 1,467,053.47	$ 1,467,053.47	$ -	$ -
Investments	39,911,313.25	23,208,892.67	2,416,016.24	14,286,404.34
Pledges receivable	10,922,931.35	-	-	10,922,931.35
Total assets	$ 52,301,298.07	$ 24,675,946.14	$ 2,416,016.24	$ 25,209,335.69

The following table reconciles beginning and ending balances of all assets and liabilities valued using Level 3 inputs.

	Beginning Balance	Total Gains/(Losses), Realized and Unrealized	Purchases, Issuances, and Settlements	Transfers In/(Out) of Level 3	Ending Balance
Assets:					
Investments	$ 13,654,625.25	$ 131,779.09	$ 500,000.00	$ -	$ 14,286,404.34
Pledges receivable	1,308,534.89	9,614,396.46	-	-	10,922,931.35
Total assets	$ 14,963,160.14	$ 9,746,175.55	$ 500,000.00	$ -	$ 25,209,335.69

All gains and losses, both realized and unrealized, have been reported on the statement of revenues, expenses, and changes in net assets as investment income. Of this total, $(1,147,352.23) is attributable to the change in unrealized gains or losses relating to those assets and liabilities still held at June 30, 2012.

Cash and Cash Equivalents

Cash and cash equivalents consists of demand deposit accounts, a State of Tennessee Local Government Investment Pool account administered by the state treasurer, and money market funds. Uninsured bank balances at June 30, 2012, totaled $8,265,368.97.

Investments

Investments are recorded on the date of contribution and are stated at fair value. Unrealized gains and losses are determined by the difference between fair values at the beginning and end of the year.

Investments held at June 30, 2012, were as follows:

	Cost	Fair Value
U. S. Treasury	$ 1,355,067.22	$ 1,597,690.22
Certificates of deposit	77,299.35	77,648.74
Corporate stocks	3,800,508.99	4,101,359.75
Bonds	3,013,358.34	2,338,367.50
Mutual equity funds	8,461,511.12	11,960,196.96
Mutual bond funds	4,131,710.77	4,149,747.80
Equity trust	1,000,000.00	1,050,140.00
Cash surrender value of life insurance	N/A	349,757.94
Real estate investment trust	2,500,000.00	2,798,131.34
Alternative investments	7,519,169.00	11,488,273.00
Total investments	$ 31,858,624.79	$ 39,911,313.25

Alternative investments - The foundation has investments in offshore hedge fund-of-funds. The estimated fair value of these assets is $11,488,273.00 at June 30, 2012.

The foundation believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2012. 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 that approves the allocation of funds to various asset classes in order to ensure the proper level of diversification. These investments are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated using various valuation techniques. Each offshore hedge fund-of-funds owned by the foundation has an annual independent CPA firm audit. Hedge fund values are determined by using monthly reports received directly from the hedge fund-of-funds managers, as well as from the foundation's registered investment advisors and/or investment custodian.

Pledges Receivable

Pledges receivable are summarized below net of the allowance for doubtful accounts.

	June 30, 2012
Current pledges	$ 1,327,248.67
Pledges due in one to five years	4,536,759.92
Pledges due after five years	5,067,566.65
Subtotal	10,931,575.24
Less discount to net present value	(8,643.89)
Total pledges receivable, net	$ 10,922,931.35

Capital Assets

Capital asset activity for the year ended June 30, 2012, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 2,341,197.28	$ 665,565.73	$ -	$ 103,825.99	$ 2,902,937.02
Land improvements and Infrastructure	1,009,439.46	-	-	-	1,009,439.46
Buildings	20,134,880.40	1,755,115.66	-	2,096,888.04	19,793,108.02
Equipment	5,976.12	14,106.79	-	14,106.79	5,976.12
Total	23,491,493.26	2,434,788.18	-	2,214,820.82	23,711,460.62
Less accumulated depreciation:					
Land improvements and Infrastructure	285,085.70	50,471.98	-	-	335,557.68
Buildings	4,647,559.01	495,860.54	-	8,544.31	5,134,875.24
Equipment	747.01	597.61	-	-	1,344.62
Total	4,933,391.72	546,930.13	-	8,544.31	5,471,777.54
Capital assets, net	$ 18,558,101.54	$ 1,887,858.05	$ -	$ 2,206,276.51	$ 18,239,683.08

Endowments

The Middle Tennessee State University Foundation's endowment consists of approximately 550 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of relevant law - The Board of Trustees of the Middle Tennessee State University Foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (the Act) as adopted by Tennessee as requiring the preservation of the fair value of the original gift, as of the gift date, of the endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the Middle Tennessee State University Foundation classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment; (2) the original value of subsequent gifts to the permanent endowment; (3) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund; and (4) the portion of the investment return that is added to the fund's principal. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the foundation in a manner consistent with the standard of prudence prescribed by the Act. In accordance with the Act, the foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds: (1) the duration and preservation of the fund; (2) the purposes of the foundation and the endowment fund; (3) general economic conditions; (4) the possible effect of inflation or deflation; (5) the expected total return from income and the appreciation of investments; (6) other resources of the foundation; and (7) the investment policies of the foundation.

Composition of Endowment by Net Asset Class
As of June 30, 2012

	Permanently Restricted	Temporarily Restricted	Unrestricted	Total
Donor-restricted endowment funds	$ 31,184,260.34	$ 3,002,313.79	$ (13,752.82)	$ 34,172,821.31
Board-designated endowment funds	-	5,835,273.73	121,483.08	5,956,756.81
Total funds	$ 31,184,260.34	$ 8,837,587.52	$ 107,730.26	$ 40,129,578.12

Changes in Endowment Net Assets
for the Fiscal Year Ended June 30, 2012

	Permanently Restricted	Temporarily Restricted	Unrestricted	Total
Endowment net assets, beginning of year	$ 29,818,142.66	$ 10,633,178.32	$ 105,807.41	$ 40,557,128.39
Investment return:				
Investment income	13,903.24	800,512.27	2,655.36	817,070.87
Net appreciation (realized and unrealized)	-	(801,839.18)	5,804.76	(796,034.42)
Total investment return	13,903.24	(1,326.91)	8,460.12	21,036.45
Contributions	1,277,921.43	38,704.12	-	1,316,625.55
Expenses	-	(402,297.71)	(1,281.89)	(403,579.60)
Appropriations of endowment assets for expenditure	-	(1,460,803.37)	(3,385.53)	(1,464,188.90)
Transfers	74,293.01	30,133.07	(1,869.85)	102,556.23
Endowment net assets, end of Year	$ 31,184,260.34	$ 8,837,587.52	$ 107,730.26	$ 40,129,578.12

Funds with deficiencies - From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the foundation is required to retain in a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, deficiencies of this nature are reported in unrestricted net assets. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of permanently restricted contributions and/or continued appropriation for fees and previously approved budgeted expenditures. At June 30, 2012, deficiencies of this nature totaled $219,587.76.

Return objectives and risk parameters - The foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period(s) as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce results that provide for adequate long-term purchasing power preservation, as well as current scholarship and other institutional support as appropriate. The foundation expects its endowment funds, over time, to provide an average rate of return of approximately 9 percent annually. Actual returns in any given year may vary from this amount.

Strategies employed for achieving objectives - To satisfy its long-term rate-of-return objectives, the foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk restraints.

Spending policy and how the investment objectives relate - The foundation has a policy of appropriating for distribution each year 4.5% of the three-year rolling average total fair market value of the endowment. Payout policy is determined by the foundation year-to-year, and in a year of significantly declining investment values, the board may choose to not make an annual payout to preserve the future purchasing and payout power of the endowment. In establishing this policy, the foundation considered the long-term expected return on its endowment. Accordingly, over the long-term, the foundation expects the current spending policy to allow its endowment to grow at an average of 3.5 percent annually. This is consistent with the foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

Tennessee Board of Regents
Middle Tennessee State University
Required Supplementary Information
OPEB Schedule of Funding Progress
Unaudited

Actuarial Valuation Date	Plan	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c)]
July 1, 2011	State Employee Group Plan	$0.00	$27,510,000	$27,510,000	0.00	$119,509,426	23.02%
July 1, 2010	State Employee Group Plan	$0.00	$35,594,000	$35,594,000	0.00	$110,803,754	32.12%
July 1, 2009	State Employee Group Plan	$0.00	$38,764,000	$38,764,000	0.00	$117,734,804	32.92%

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

TENNESSEE BOARD OF REGENTS
MIDDLE TENNESSEE STATE UNIVERSITY
SUPPLEMENTARY INFORMATION
SCHEDULE OF CASH FLOWS - COMPONENT UNIT
FOR THE YEAR ENDED JUNE 30, 2012

CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$	6,111,705.76
Grants and contracts		3,753.20
Payments to suppliers and vendors		(2,478,316.51)
Payments for scholarships and fellowships		(1,251,643.55)
Payments to MTSU		(1,398,523.58)
Other receipts (payments)		51,583.13
Net cash provided by operating activities		1,038,558.45
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes		1,832,547.62
Net cash provided by noncapital financing activities		1,832,547.62
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from sale of capital assets		432,906.99
Purchase of capital assets and construction		(1,809,788.18)
Net cash used by capital and related financing activities		(1,376,881.19)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		2,534,261.06
Income on investments		823,279.54
Purchases of investments		(5,976,237.78)
Other investing receipts (payments)		(9,852.46)
Net cash used by investing activities		(2,628,549.64)
Net decrease in cash and cash equivalents		(1,134,324.76)
Cash and cash equivalents - beginning of year		17,143,170.98
Cash and cash equivalents - end of year	$	16,008,846.22
Reconciliation of operating income to net cash provided by operating activities:		
Operating income	$	9,607,492.66
Adjustments to reconcile operating income to net cash provided by operating activities:		
Depreciation expense		546,930.13
Endowment income per spending plan		(1,464,188.90)
Changes in assets and liabilities:		
Receivables, net		(10,169,022.65)
Prepaid/deferred items		26,347.86
Accounts payable		721,776.90
Other		1,769,222.45
Net cash provided by operating activities	$	1,038,558.45
Noncash investing, capital, and financing activities		
Unrealized losses on investments	$	(1,147,352.23)
Loss on disposal of capital assets	$	(4,147.07)
Capital assets transferred to MTSU	$	(1,769,222.45)