AUDIT REPORT

Tennessee Board of Regents

Northeast State Community College

For the Years Ended
June 30, 2013, and June 30, 2012

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

Deborah V. Loveless, CPA, CGFM
Director

FINANCIAL AND COMPLIANCE
Edward Burr, CPA, CGFM
Assistant Director

Robert D. Hunter, Jr., CPA, CGFM
Audit Manager

Jeffrey G. Lafever, CFE
In-Charge Auditor

Michael Campbell
Justin Daniel, CFE
Staff Auditors

INFORMATION SYSTEMS
Daniel V. Willis, CPA, CISA, CGFM
Assistant Director

Brent L. Rumbley, CPA, CISA, CFE
Audit Manager

Jeff White
In-Charge Auditor

Samuel Osborn
Devin Wayne
Staff Auditors

Gerry C. Boaz, CPA, CGFM
Technical Manager

Amy Brack
Editor

Amanda Adams
Assistant Editor

Comptroller of the Treasury, Division of State Audit
Suite 1500, James K. Polk State Office Building, 505 Deaderick Street, Nashville, TN 37243-1402
(615) 401-7897

Financial/compliance audits of colleges and universities are available online at
www.comptroller.tn.gov/sa/AuditReportCategories.asp.
For more information about the Comptroller of the Treasury, please visit our website at
www.comptroller.tn.gov.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

October 9, 2014

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor
Dr. Janice H. Gilliam, President

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, Northeast State Community College, for the years ended June 30, 2013, and June 30, 2012. You will note from the independent auditor's report that unmodified opinions were given on the fairness of the presentation of the financial statements.

Consideration of the internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Findings and Recommendations section of this report. The college's management has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

14/043

Audit Report
Tennessee Board of Regents
Northeast State Community College
For the Years Ended June 30, 2013, and June 30, 2012

TABLE OF CONTENTS

TABLE OF CONTENTS (Continued)

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit

Tennessee Board of Regents

Northeast State Community College

For the Years Ended June 30, 2013, and June 30, 2012

Opinions on the Financial Statements

The opinions on the financial statements are unmodified.

Audit Findings

As Reported in the Previous Audit, Management Needs to Improve Financial Statement Preparation and Review Procedures to Prevent Errors in Its Financial Statements*

Northeast State Community College's procedures for preparation of its financial statements, including the financial statements of its component unit, Northeast State Community College Foundation, should be improved to ensure the accuracy and proper classification of the information presented in its financial statements. This deficiency resulted in several significant reporting errors (page 46).

Northeast State Community College Did Not Provide Adequate Internal Controls in Five Specific Areas

Northeast State Community College did not design and monitor internal controls in five specific areas (page 48).

* This finding is repeated from the prior audit.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor
Dr. Janice H. Gilliam, President

Report on the Financial Statements

We have audited the accompanying financial statements of Northeast State Community College, 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 years ended June 30, 2013, and June 30, 2012, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 *Government Auditing Standards*, issued by the Comptroller General of the United States. 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 involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control.

Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinions.

Opinions

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of Northeast State Community College, and its discretely presented component unit as of June 30, 2013, and June 30, 2012, and the respective changes in financial position and, where applicable, cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 1, the financial statements of Northeast State Community College, 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 Northeast State Community College. They do not purport to, and do not, present fairly the financial position of the Tennessee Board of Regents, as of June 30, 2013, and June 30, 2012, and the changes in financial position and cash flows thereof for the years then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 1, the college implemented GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 17 and the schedule of funding progress on page 42 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, which 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.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the college's basic financial statements. The schedules of cash flows – component unit on page 43 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The schedules of cash flows – component unit are the responsibility of the college's management and were derived from, and relate directly to, the underlying accounting and other records used to prepare the basic 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 basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedules of cash flows – component unit are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated September 18, 2014, on our consideration of the college's internal control over financial reporting and on 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 *Government Auditing Standards* in considering the college's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
September 18, 2014

Tennessee Board of Regents
NORTHEAST STATE COMMUNITY COLLEGE
Management's Discussion and Analysis

Introduction

This section of Northeast State Community College's financial report presents a discussion and analysis of the financial performance of the college during the fiscal years ended June 30, 2013, and 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 financial statements, and the notes to the financial statements.

The college has one discretely presented component unit, the Northeast State Community College Foundation. More detailed information about the foundation is presented in Note 15 to the financial statements. This discussion and analysis focuses on the college and does not include the foundation.

Overview of the Financial Statements

The financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), which establishes standards for external financial reporting for public colleges and universities. The financial statements are presented on a consolidated basis to focus on the college as a whole. The full scope of the college's activities is considered to be a single business-type activity and, accordingly, is reported within a single column in the basic financial statements.

The college's financial report includes the statement of net position; the statement of revenues, expenses, and changes in net position; and the statement of cash flows. Notes to the financial statements are also presented to provide additional information that is essential to a full understanding of the financial statements.

The Statement of Net Position

The statement of net position is a point-in-time financial statement. The statement of net position presents the financial position of the college at the end of the fiscal year. To aid the reader in determining the college's ability to meet immediate and future obligations, the statement includes all assets, liabilities, deferred outflows/inflows, and net position of the college and segregates the assets and liabilities into current and noncurrent components. Current assets are those that are available to satisfy current liabilities, inclusive of assets that will be converted to cash within one year. Current liabilities are those that will be paid within one year. The statement of net position is prepared under the accrual basis of accounting; assets and liabilities are recognized when goods or services are provided or received, despite when cash is actually exchanged.

From the data presented, readers of the statement are able to determine the assets available to continue the operations of the college. They are also able to determine how much the college owes vendors, lenders, and others. Net position represents the difference between the college's assets and liabilities, along with the difference between deferred outflows and deferred inflows, and is one indicator of the college's current financial condition.

The statement of net position also indicates the availability of net position for expenditure by the college. Net position is divided into three major categories. The first category, net investment in capital assets, represents the college's total investment in property, plant, and equipment, net of outstanding debt obligations and deferred outflows/inflows of resources related to these capital assets. To the extent debt or deferred inflows of resources have been incurred but not yet expended for capital assets, such amounts are not included. The next category is restricted net position, which is subdivided into two categories, nonexpendable and expendable. Nonexpendable restricted net position includes endowment and similar resources whose use is limited by donors or other outside sources and, as a condition of the gift, the principal is to be maintained in perpetuity. Expendable restricted net position is available for expenditure by the college 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 resources. The final category is unrestricted net position. Unrestricted net position is available to the college for any lawful purpose of the college.

The following table summarizes the college's assets, liabilities, deferred outflows/inflows, and net position at June 30, 2013; June 30, 2012; and June 30, 2011:

Summary of Net Position
(in thousands of dollars)

	2013	2012	2011
Assets:			
Current assets	$12,259	$14,498	$13,446
Capital assets, net	38,160	39,118	38,553
Other assets	12,174	12,846	13,329
Total assets	**62,593**	**66,462**	**65,328**
Deferred outflows of resources:			
Deferred amount on debt refunding	20	-	-
Liabilities:			
Current liabilities	5,710	6,504	4,779
Noncurrent liabilities	2,783	2,631	2,699
Total liabilities	**8,493**	**9,135**	**7,478**
Net position:			
Net investment in capital assets	37,872	38,798	38,204
Restricted – expendable	79	87	69
Unrestricted	16,169	18,442	19,577
Total net position	**$54,120**	**$57,327**	**$57,850**

Comparison of Fiscal Year 2013 to Fiscal Year 2012

- Northeast State Community College's current assets decreased $2.2 million in fiscal year 2013, as compared to fiscal year 2012, primarily due to a decrease in a grant advance from the Tennessee Department of Economic and Community Development of $1.8 million deferred to fiscal year 2013. The grant ended June 30, 2013.

- The college's accounts receivable (also current assets) increased $391,000 in fiscal year 2013, as compared to fiscal year 2012, primarily due to unpaid student balances.

- Noncurrent assets decreased $1.6 million in fiscal year 2013, as compared to fiscal year 2012, due to a decrease in noncurrent cash of $672,000 from expenditure of plant funds for campus projects and a decrease of $958,000 in capital assets due to annual depreciation expense exceeding net additions to capital assets.

- The current liabilities decreased $794,000 in fiscal year 2013, as compared to fiscal year 2012, primarily due to a decrease in unearned grantor revenue from the Tennessee Department of Economic and Community Development of $1.8 million. Amounts due to the component unit foundation also increased $657,000, and accounts payable increased $216,000.

- The college's noncurrent liabilities increased $152,000 in fiscal year 2013, as compared to fiscal year 2012, primarily due to an increase in the college's net OPEB obligation of $90,000 and an increase in the noncurrent compensated absences liability of $76,000.

- Northeast State's unrestricted net position decreased $2.3 million in fiscal year 2013, as compared to fiscal year 2012, primarily due to a reduction in unallocated fund balance of $1.9 million due to vacant positions being filled, salary and benefit increases, and increases in working capital.

Comparison of Fiscal Year 2012 to Fiscal Year 2011

- The college's capital assets increased $565,000 in fiscal year 2012, as compared to fiscal year 2011, primarily due to the completion of the boiler project, capitalized at $529,000 in fiscal year 2012.

- The college's accounts payable in current liabilities increased $241,000 in fiscal year 2012, as compared to fiscal year 2011. This included a late year purchase of $84,000 in equipment from funds reallocated during the estimated budget process; new grant purchases of $79,000 from the Tennessee Department of Economic and Community Development Eastman Partnership grant; and other miscellaneous purchases.

- Unearned revenue in current liabilities increased $1.4 million, primarily due to the $1.8 million grant advance from the Tennessee Department of Economic and Community Development as described above.

- The college's compensated absences in current liabilities increased $153,000 in fiscal year 2012, as compared to fiscal year 2011, primarily due to the addition of new eligible employees. Additionally, the June 30, 2012, compensated absences liability is based on salary increases in 2012, including a 3% state salary increase and a 1% college salary increase.

- The college's noncurrent liabilities decreased only $68,000 in fiscal year 2012, as compared to fiscal year 2011. The net OPEB obligation increased $82,000, with noncurrent unearned revenue decreasing $94,000, noncurrent compensated absences decreasing $26,000, and noncurrent bonds payable decreasing $30,000.

- Net investment in capital assets increased $594,000 in fiscal year 2012, as compared to fiscal year 2011, primarily due to the completion of the boiler project capitalized at $529,000 in fiscal year 2012.

- The college's unrestricted net position decreased $1.1 million in fiscal year 2012, as compared to fiscal year 2011, primarily due to a decrease in the contingency reserve of $490,000 in fiscal year 2012. Additionally, a decrease of $483,000 in construction project fund balances was primarily due to boiler project expenses of $472,000 in fiscal year 2012.

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

The statement of revenues, expenses, and changes in net position presents the results of operations for the fiscal year. Revenues and expenses are recognized when earned or incurred, regardless of when cash is received. The statement indicates whether the college's financial condition has improved or deteriorated during the fiscal year. The statement presents the revenues received by the college, both operating and nonoperating; the expenses paid by the college, operating and nonoperating; and any other revenues, expenses, gains, or losses received or spent by the college.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the college. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the college. Nonoperating revenues are revenues received for which goods and services are not provided directly to the payor. Although Northeast State Community College is dependent upon state appropriations and gifts to fund educational and general operations, under GASB standards these funding sources are reported as nonoperating revenues, as is investment income. As a result, the college has historically reported an excess of operating expenses over operating revenues, resulting in an operating loss. Therefore, the "increase (decrease) in net position" is more indicative of overall financial results for the year.

A summary of the college's revenues, expenses, and changes in net position for the year ended June 30, 2013, and the two previous years, follows:

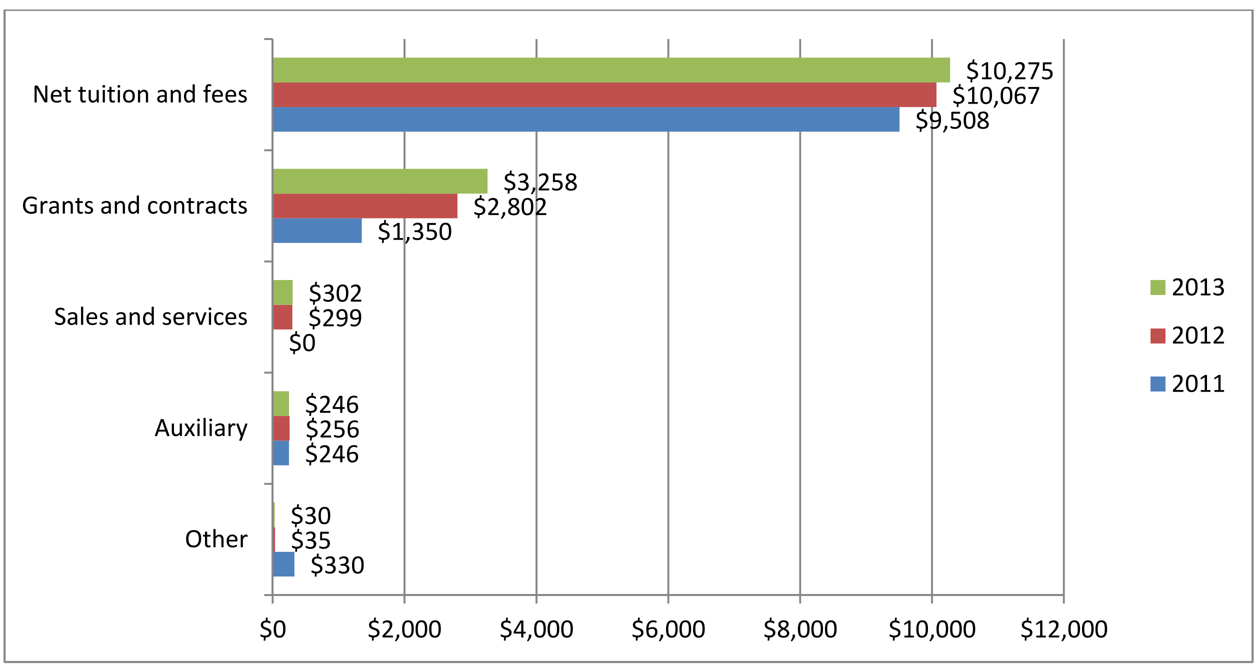
Summary of Revenues, Expenses, and Changes in Net Position
(in thousands of dollars)

	2013	2012	2011
Operating revenues	$14,110	$13,460	$11,434
Operating expenses	47,924	44,632	42,100
Operating loss	(33,814)	(31,172)	(30,666)
Nonoperating revenues and expenses	30,279	29,741	34,015
Income (loss) before other revenues, expenses, gains, or losses	(3,535)	(1,431)	3,349
Other revenues, expenses, gains, or losses	328	908	536
Increase (decrease) in net position	(3,207)	(523)	3,885
Net position at beginning of year	57,327	57,850	53,965
Net position at end of year	$54,120	$57,327	$57,850

Operating Revenues

The following summarizes the operating revenues by source that were used to fund operating activities for the last three fiscal years:

Operating Revenues by Source
(in thousands of dollars)



Comparison of Fiscal Year 2013 to Fiscal Year 2012

- Northeast State's operating revenues increased by $208,000 in student tuition and fees (net of scholarship allowances) in fiscal year 2013, as compared to fiscal year 2012. This was primarily due to a 4.2% tuition rate increase in fiscal year 2013, offset with a small enrollment decrease.

- Operating grants and contracts also increased $456,000 in fiscal year 2013, as compared to fiscal year 2012, primarily due to revenues funding the final year close-out expenses of a five-year grant from the Tennessee Department of Economic and Community Development that ended June 30, 2013.

Comparison of Fiscal Year 2012 to Fiscal Year 2011

- Northeast State's tuition and fees increased $559,000 in fiscal year 2012, as compared to fiscal year 2011, primarily due to a 9.5% tuition rate increase. The college's tuition rate increase was offset by an enrollment decrease of approximately 4.4% in fall semester 2011 and an enrollment decrease of 2.8% in spring semester 2012.

- Operating grants and contracts increased $1.4 million in fiscal year 2012, as compared to fiscal year 2011, due to the grant with the Tennessee Department of Economic and Community Development.

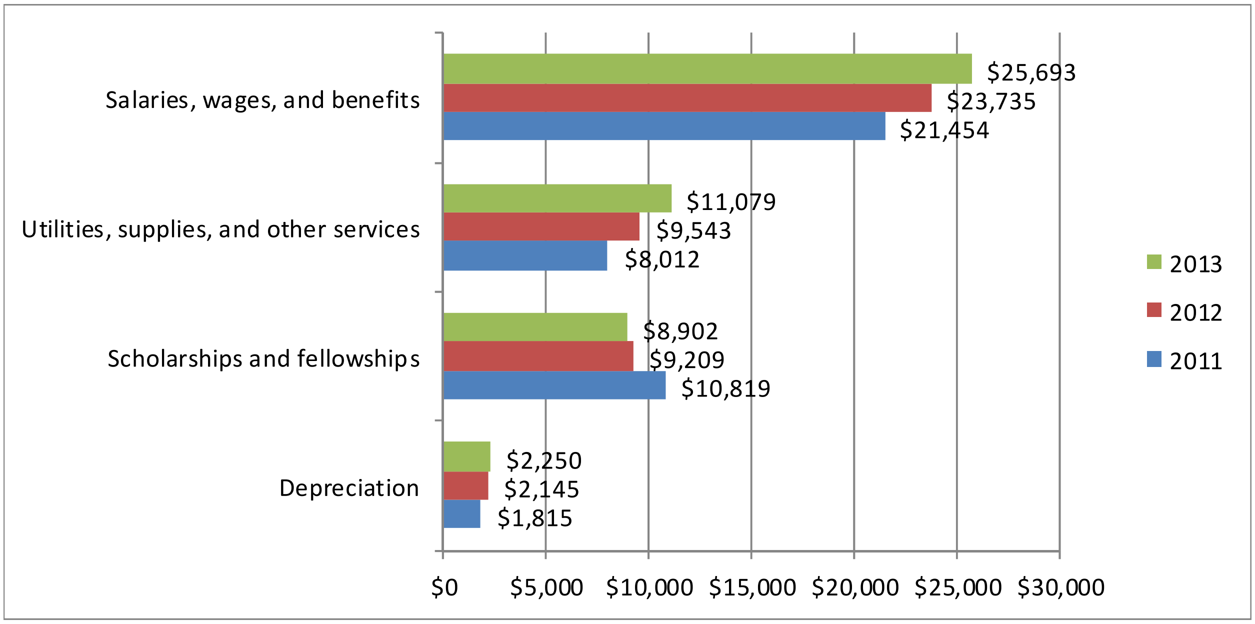
Operating Expenses

Operating expenses may be reported by nature or function. The college has chosen to report the expenses in their natural classification on the statement of revenues, expenses, and changes in net position and has displayed the functional classification in the notes to the financial statements. The following summarizes the operating expenses by natural classifications for the last three fiscal years:

Natural Classification
(in thousands of dollars)

	2013	**2012**	**2011**
Salaries and wages	$18,405	$17,022	$15,432
Benefits	7,288	6,713	6,022
Utilities, supplies, and other services	11,079	9,543	8,012
Scholarships and fellowships	8,902	9,209	10,819
Depreciation expense	2,250	2,145	1,815
Total	$47,924	$44,632	$42,100

Expenses - Natural Classification
(in thousands of dollars)



Comparison of Fiscal Year 2013 to Fiscal Year 2012

- Northeast State's salaries and wages increased $1.4 million in fiscal year 2013, as compared to fiscal year 2012, due to an across-the-board, one-time bonus payment of $1,000 to eligible employees, for a total of $338,000. This bonus was in lieu of a permanent increase and in anticipation of the college's implementation of its salary plan. Other increases included a 2.5% across-the-board state salary increase of approximately $327,000 and vacant positions were filled.

- Benefits increased $575,000 in fiscal year 2013, as compared to fiscal year 2012, due to benefits increases associated with the across-the-board, one-time bonus payment of $1,000 to eligible employees. Other increases included a 2.5% across-the-board state salary increase, increases in insurance premiums, and vacant positions were filled.

- The college's utilities, supplies, and other services increased $1.5 million in fiscal year 2013, as compared to fiscal year 2012, primarily due to increases in travel, supplies, and furniture for new off-campus sites in the amount of $898,000 and purchases of new software in the amount of $225,000, including Sciquest and PeopleAdmin.

- Scholarships and fellowships decreased $307,000 in fiscal year 2013, as compared to fiscal year 2012, primarily due to a decrease in student headcount of 1.3% and a related decrease in full-time equivalent (FTE) enrollment of approximately 5.7%.

Comparison of Fiscal Year 2012 to Fiscal Year 2011

- Northeast State's salaries and wages increased $1.6 million (a 10.3% increase) in fiscal year 2012, as compared to fiscal year 2011, due to a 3% state-funded salary increase to all full-time employees (effective July 1, 2011) for approximately $390,000; a 1% college-funded salary increase to all full-time employees (effective January 1, 2012) for approximately $88,000; and a $500 service award to all full-time employees for approximately $135,000. Additionally, vacant positions were filled, and part-time positions were added. In fiscal year 2011, the American Recovery and Reinvestment Act (ARRA) State Fiscal Stabilization funding provided $655,000 for salaries and wages. These positions were added to the college in fiscal year 2012.

- The college's benefits increased $691,000 in fiscal year 2012, as compared to fiscal year 2011, due to benefits associated with the 3% salary increase in July 2011, the 1% salary increase in January 2012, the $500 service bonus, additional full-time employees, and increases in insurance premiums.

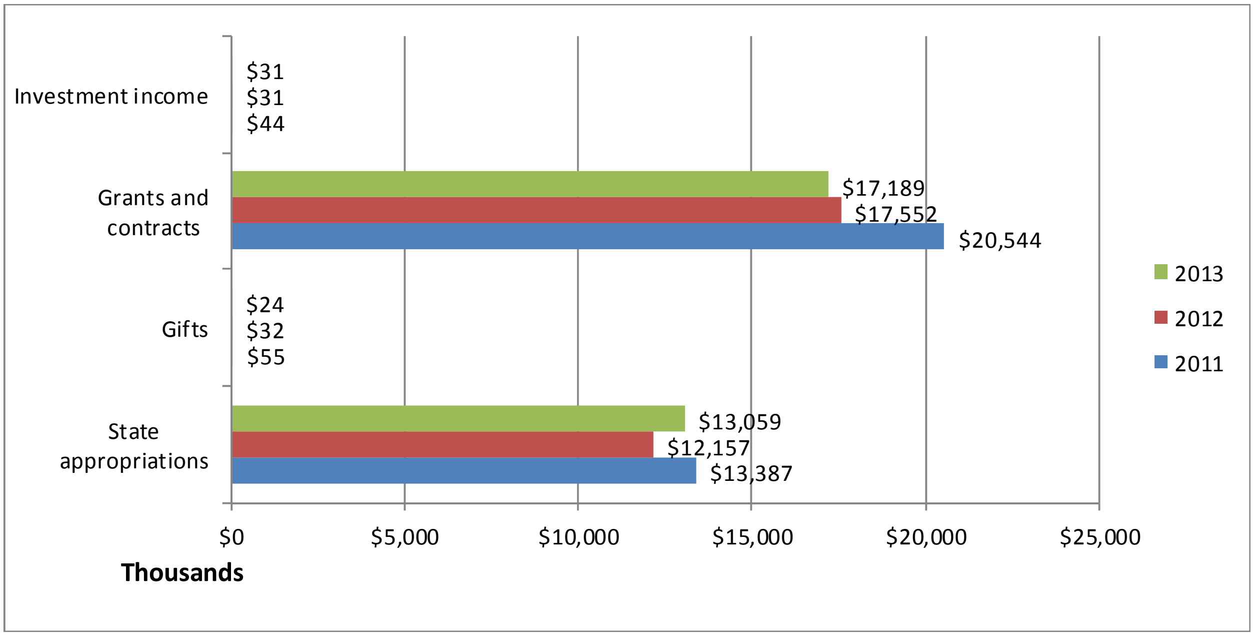
- Utilities, supplies, and other services increased $1.5 million in fiscal year 2012, as compared to fiscal year 2011, primarily due to $1 million spent in 2012 on the Tennessee Department of Economic and Community Development Eastman Partnership grant, $164,000 for foundation stabilization of campus buildings, and $172,000 for roof replacement of the faculty office building.

- The college's depreciation expense increased $330,000 in fiscal year 2012, as compared to fiscal year 2011, primarily due to a change in accounting estimate in fiscal year 2012. 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 depreciation adjustment of $142,000. Additionally, equipment depreciation increased $171,000 due to additions of new capital assets in fiscal year 2012.

Nonoperating Revenues and Expenses

Certain revenue sources that the college relies on to provide funding for operations, including state noncapital appropriations, certain gifts and grants, and investment income, are defined by GASB as nonoperating. Nonoperating expenses include capital financing costs and other costs related to capital assets. The following summarizes the college's nonoperating revenues and expenses for the last three fiscal years:

Nonoperating Revenues and Expenses
(in thousands of dollars)



Comparison of Fiscal Year 2013 to Fiscal Year 2012

- The college's state appropriations increased $902,000 in fiscal year 2013, as compared to fiscal year 2012, due to the final year hold-harmless phase-in of the new funding formula, new appropriations due to the new formula outcomes, and to fund the state across-the-board salary increase of 2.5% and increases in insurance premiums.

- Grants and contracts decreased $363,000 in fiscal year 2013, as compared to fiscal year 2012, due to a decrease in student headcount of 1.3% and a related decrease in FTE enrollment of approximately 5.7%. This resulted in a decrease in Federal Pell grants.

Comparison of Fiscal Year 2012 to Fiscal Year 2011

- The college's state appropriations in nonoperating revenues decreased $1.2 million in fiscal year 2012, as compared to fiscal year 2011, due to the state providing one-time appropriations in lieu of ARRA State Fiscal Stabilization Funds in fiscal year 2011 in the amount of $1.8 million, in addition to Maintenance of Effort funding of $644,000. These reductions are offset by an increase in state appropriations of approximately $1.2 million due to the new funding formula and hold-harmless phase-in.

- Nonoperating grants and contracts decreased $3 million in fiscal year 2012, as compared to fiscal year 2011. This is primarily due to a $1.5 million decrease in Federal Pell expenditures largely due to the Department of Education end of year-round Pell awards. Additionally, nonoperating grants and contracts decreased $1.3 million due to the availability of ARRA State Fiscal Stabilization Funds in fiscal year 2011.

Other Revenues

This category is composed of state appropriations for capital purposes, capital grants and gifts, and additions to permanent endowments. These amounts were as follows for the last three fiscal years:

Other Revenues
(in thousands of dollars)

Comparison of Fiscal Year 2013 to Fiscal Year 2012

- Northeast State's capital appropriations decreased $180,000 in fiscal year 2013, as compared to fiscal year 2012, due to the completion of the college's roof replacement on the Faculty Office Building funded through capital appropriations in fiscal year 2012.

- Capital grants and gifts decreased $400,000 in fiscal year 2013, as compared to fiscal year 2012, primarily due to a decrease in gifts to the college of $280,000. In 2012, the Regional Center for Advanced Manufacturing received one-time gifts of new equipment. Additionally, a grant, ending June 30, 2012, from the United States Department of Labor, made one-time purchases of equipment in the amount of $138,000.

Comparison of Fiscal Year 2012 to Fiscal Year 2011

- Capital appropriations increased $352,000 in fiscal year 2012, as compared to fiscal year 2011, due to projects funded through capital appropriations, including $164,000 for foundation stabilization of several campus buildings and $172,000 for roof replacement of the Faculty Office Building.

Capital Assets and Debt Administration

Capital Assets

Northeast State Community College had $38,159,601.91 invested in capital assets, net of accumulated depreciation of $21,071,322.47 at June 30, 2013; and $39,118,142.56 invested in capital assets, net of accumulated depreciation of $18,970,297.94 at June 30, 2012. Depreciation charges totaled $2,249,979.05 and $2,145,288.87 the years ended June 30, 2013, and June 30, 2012, respectively.

Summary of Capital Assets, Net of Depreciation
(in thousands of dollars)

	2013	2012	2011
Land	$ 2,029	$ 2,029	$ 2,029
Land improvements & infrastructure	2,606	2,872	2,222
Buildings	28,119	28,752	29,779
Equipment	4,442	4,379	3,116
Library holdings	418	424	607
Intangible assets	373	548	723
Projects in progress	173	114	77
Total	$38,160	$39,118	$38,553

Significant reductions to capital assets occurred in fiscal year 2013. These reductions were from annual depreciation ($2.2 million). The annual depreciation amount is offset by building additions of $414,000, due to completion of the James Pierce Atrium Renovation project. Equipment additions also totaled $746,000.

At June 30, 2013, outstanding commitments under construction contracts totaled $1,266,000 for various renovations and repairs of buildings and infrastructure. Future state capital outlay appropriations will fund $1,133,000 of these costs.

Land improvements and infrastructure increased $650,000 in fiscal year 2012, as compared to fiscal year 2011, primarily due to the completion of a boiler project of $529,000 funded through local funds. Other improvement and infrastructure projects completed in fiscal year 2012 included telecommunications wiring for voice-over IP of $142,000 and parking and paving of $132,000.

Equipment increased $1.3 million in fiscal year 2012, as compared to fiscal year 2011, primarily due to new equipment purchases of $463,000 from student technology access fees. Other large equipment increases include $383,000 in equipment donations for use at the Regional Center for Advanced Manufacturing and $107,000 from unexpended plant and renewal and replacement funds.

Library holdings decreased $183,000 in fiscal year 2012, as compared to fiscal year 2011, primarily due to a change in accounting estimate in fiscal year 2012. 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 depreciation adjustment of $142,000.

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

Debt

The college had $307,827.10 and $320,443.50 in debt outstanding at June 30, 2013, and June 30, 2012, respectively. The table below summarizes these amounts by type of debt instrument.

Schedule of Outstanding Debt
(in thousands of dollars)

	2013	2012	2011
Bonds payable	$267	$320	$349
Unamortized bond premium	41	-	-
Total	$308	$320	$349

The Tennessee State School Bond Authority (TSSBA) issued bonds with interest rates ranging from 4% to 5% due serially until 2021 on behalf of Northeast State Community College. The college is responsible for the debt service on these bonds. The current portion of the $266,718.50 outstanding at June 30, 2013, is $31,217.50.

The ratings on debt issued by the TSSBA at June 30, 2013, were as follows:

Fitch	AA+
Moody's Investor Service	Aa1
Standard & Poor's	AA

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

Economic Factors That Will Affect the Future

Northeast State Community College continues to pursue its long-range plan to expand facilities through new construction, renovated construction, and leased facilities at off-campus sites. State and local capital appropriations have been allocated in support of the construction costs. The college recently expanded course offerings to a new campus location in Bristol, Tennessee, and plans to add a new location in Johnson City, Tennessee. This will provide an off-campus location in all of the college's service delivery area.

The college is committed to implementing a salary study adjustment at a cost of approximately $1.5 million over the next several years. Past cost containment measures and prudent use of recurring resources will provide the funding to implement.

The college's management believes that the financial position of the college remains strong. A 3% tuition increase in fiscal year 2014, as well as the implementation of continued cost containment measures, will allow the college to remain committed to providing increased access to higher education for the citizens of its service region.

Tennessee Board of Regents
NORTHEAST STATE COMMUNITY COLLEGE
Statements of Net Position
June 30, 2013, and June 30, 2012

	Northeast State Community College		Component Unit - Northeast State Community College Foundation	
	June 30, 2013	June 30, 2012	June 30, 2013	June 30, 2012
ASSETS				
Current assets:				
Cash (Notes 2, 3, and 15)	$ 8,415,484.15	$ 11,044,341.51	$ 800,198.16	$ 1,269,887.96
Short-term investments (Note 15)	-	-	4,192,202.54	2,916,992.56
Accounts and grants receivable (net) (Note 4)	3,797,898.97	3,407,183.12	-	1,550.00
Due from component unit	17,938.00	-	-	-
Due from the college	-	-	657,391.18	-
Due from primary government	-	16,200.00	-	-
Pledges receivable (net) (Note 15)	-	-	39,892.47	22,821.67
Inventories	13,921.72	20,720.88	-	-
Prepaid expenses	14,018.91	9,264.55	-	-
Total current assets	12,259,261.75	14,497,710.06	5,689,684.35	4,211,252.19
Noncurrent assets:				
Cash (Notes 2, 3, and 15)	12,174,054.09	12,846,273.12	-	-
Investments (Note 15)	-	-	4,016,417.28	3,968,179.21
Pledges receivable (net) (Note 15)	-	-	9,458.14	19,037.77
Capital assets (net) (Notes 5 and 15)	38,159,601.91	39,118,142.56	2,989,640.53	3,064,228.10
Other assets	-	-	17,530.62	10,638.41
Total noncurrent assets	50,333,656.00	51,964,415.68	7,033,046.57	7,062,083.49
Total assets	62,592,917.75	66,462,125.74	12,722,730.92	11,273,335.68
DEFERRED OUTFLOWS OF RESOURCES				
Deferred amount on debt refunding	20,095.76	-	-	-
Total deferred outflows of resources	20,095.76	-	-	-
LIABILITIES				
Current liabilities:				
Accounts payable (Note 6)	1,286,715.46	1,071,123.57	139.68	108,480.52
Accrued liabilities	1,422,410.74	1,362,883.96	-	-
Due to grantors	1,576.00	-	-	-
Due to the college	-	-	17,938.00	-
Due to the component unit	657,391.18	-	-	-
Unearned revenue	856,094.78	2,629,375.06	-	-
Compensated absences (Note 7)	297,965.07	277,928.22	-	-
Long-term liabilities, current portion (Note 7)	31,217.50	29,959.00	-	-
Deposits held in custody for others	1,156,232.52	1,133,200.72	-	-
Total current liabilities	5,709,603.25	6,504,470.53	18,077.68	108,480.52
Noncurrent liabilities:				
Net OPEB obligation (Note 10)	1,711,756.51	1,621,447.11	-	-
Compensated absences (Note 7)	794,476.10	718,628.57	-	-
Long-term liabilities (Note 7)	276,609.60	290,484.50	-	-
Total noncurrent liabilities	2,782,842.21	2,630,560.18	-	-
Total liabilities	8,492,445.46	9,135,030.71	18,077.68	108,480.52
NET POSITION				
Net investment in capital assets	37,871,870.58	38,797,699.06	2,989,640.53	3,064,228.10
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	-	-	4,031,624.48	3,987,216.98
Expendable:				
Scholarships and fellowships	27,670.85	28,032.48	4,587,012.88	3,802,622.97
Instructional department uses	46,831.78	54,063.19	105,578.23	80,061.28
Loans	-	-	718.02	5,325.94
Other	4,711.45	4,711.45	667,858.98	6,427.94
Unrestricted	16,169,483.39	18,442,588.85	322,220.12	218,971.95
Total net position	$ 54,120,568.05	$ 57,327,095.03	$ 12,704,653.24	$ 11,164,855.16

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

Tennessee Board of Regents
NORTHEAST STATE COMMUNITY COLLEGE
Statements of Revenues, Expenses, and Changes in Net Position
For the Years Ended June 30, 2013, and June 30, 2012

	Northeast State Community College		Component Unit - Northeast State Community College Foundation	
	Year Ended June 30, 2013	Year Ended June 30, 2012	Year Ended June 30, 2013	Year Ended June 30, 2012
REVENUES				
Operating revenues:				
Student tuition and fees (net of scholarship allowances of $8,588,650.03 for the year ended June 30, 2013, and $8,908,029.08 for the year ended June 30, 2012)	$ 10,275,443.13	$ 10,067,225.52	$ -	$ -
Gifts and contributions	-	-	496,577.27	429,158.78
Endowment income per spending plan	-	-	286,577.60	174,309.01
Governmental grants and contracts	3,256,750.70	2,794,642.39	657,114.22	158,411.22
Nongovernmental grants and contracts	1,742.50	7,526.01	-	-
Sales and services of educational activities	47,535.33	52,327.39	3,025.16	1,997.64
Sales and services of other activities	254,001.54	246,449.57	-	-
Auxiliary enterprises:				
Bookstore	230,133.16	240,786.61	-	-
Food service	15,417.60	15,811.91	-	-
Other operating revenues	29,516.94	35,156.00	-	-
Total operating revenues	14,110,540.90	13,459,925.40	1,443,294.25	763,876.65
EXPENSES				
Operating expenses (Note 13):				
Salaries and wages	18,405,425.14	17,021,959.73	-	-
Benefits	7,287,748.57	6,712,616.16	-	-
Utilities, supplies, and other services	11,078,823.82	9,543,404.01	102,002.37	51,290.60
Scholarships and fellowships	8,901,715.75	9,208,860.81	498,733.85	664,862.64
Depreciation expense	2,249,979.05	2,145,288.87	74,587.57	74,587.57
Gifts of capital assets and payments to or on behalf of Northeast State Community College (Note 15)	-	-	145,173.04	418,471.00
Total operating expenses	47,923,692.33	44,632,129.58	820,496.83	1,209,211.81
Operating income (loss)	(33,813,151.43)	(31,172,204.18)	622,797.42	(445,335.16)
NONOPERATING REVENUES (EXPENSES)				
State appropriations	13,059,344.50	12,157,338.49	-	-
Gifts (college gifts include $24,173.04 from component unit in 2013 and $31,713.00 in 2012)	24,173.04	31,713.00	-	-
Grants and contracts	17,189,098.99	17,551,553.47	-	-
Investment income (for component unit, net of investment expense of $7,445.43 in 2013 and $6,663.23 in 2012)	30,656.81	31,149.23	757,131.16	32,617.33
Interest on capital asset-related debt	(9,524.74)	(14,365.09)	-	-
Bond issuance costs	(748.97)	-	-	-
Other nonoperating revenues (expenses)	(13,900.35)	(17,075.57)	-	9,427.05
Net nonoperating revenues	30,279,099.28	29,740,313.53	757,131.16	42,044.38
Income (loss) before other revenues, expenses, gains, or losses	(3,534,052.15)	(1,431,890.65)	1,379,928.58	(403,290.78)
Capital appropriations	206,525.17	387,475.19	-	-
Capital grants and gifts (college gifts include $121,000.00 from component unit in 2013 and $386,758.00 in 2012)	121,000.00	521,278.00	121,000.00	383,258.00
Additions to permanent endowments	-	-	38,869.50	482,225.60
Total other revenues	327,525.17	908,753.19	159,869.50	865,483.60
Increase (decrease) in net position	(3,206,526.98)	(523,137.46)	1,539,798.08	462,192.82
NET POSITION				
Net position - beginning of year	57,327,095.03	57,850,232.49	11,164,855.16	10,702,662.34
Net position - end of year	$ 54,120,568.05	$ 57,327,095.03	$ 12,704,653.24	$ 11,164,855.16

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

Tennessee Board of Regents
NORTHEAST STATE COMMUNITY COLLEGE
Statements of Cash Flows
For the Years Ended June 30, 2013, and June 30, 2012

	Year Ended June 30, 2013	Year Ended June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 9,509,188.21	$ 11,119,226.75
Grants and contracts	2,457,242.32	3,136,239.67
Sales and services of educational activities	58,019.70	52,327.39
Sales and services of other activities	254,001.54	246,449.57
Payments to suppliers and vendors	(11,175,941.00)	(9,365,771.56)
Payments to employees	(18,250,013.98)	(17,913,973.80)
Payments for benefits	(7,189,994.67)	(5,580,397.92)
Payments for scholarships and fellowships	(8,901,715.75)	(9,130,683.48)
Auxiliary enterprise charges:		
Bookstore	232,586.62	237,349.55
Food services	15,097.87	15,732.68
Other receipts (payments)	29,793.90	(121,995.73)
Net cash used by operating activities	(32,961,735.24)	(27,305,496.88)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	13,068,100.00	12,153,077.48
Gifts and grants received for other than capital or endowment purposes	17,226,991.03	17,727,011.14
Federal student loan receipts	7,333,480.50	6,797,909.16
Federal student loan disbursements	(7,216,839.00)	(6,955,977.00)
Changes in deposits held for others	23,031.80	(54,900.34)
Net cash provided by noncapital financing activities	30,434,764.33	29,667,120.44
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	276,609.60	-
Capital appropriations	206,525.17	350,201.99
Capital grants and gifts received	-	138,020.00
Purchases of capital assets and construction	(968,301.59)	(2,344,388.18)
Principal paid on capital debt	(309,321.77)	(28,751.50)
Interest paid on capital debt	(9,524.73)	(14,594.34)
Bond issue costs paid on new debt issue	(748.97)	-
Net cash used by capital and related financing activities	(804,762.29)	(1,899,512.03)
CASH FLOWS FROM INVESTING ACTIVITIES		
Income on investments	30,656.81	31,149.23
Net cash provided by investing activities	30,656.81	31,149.23
Net increase (decrease) in cash	(3,301,076.39)	493,260.76
Cash - beginning of year	23,890,614.63	23,397,353.87
Cash - end of year	$ 20,589,538.24	$ 23,890,614.63

Tennessee Board of Regents
NORTHEAST STATE COMMUNITY COLLEGE
Statements of Cash Flows (Continued)
For the Years Ended June 30, 2013, and June 30, 2012

	Year Ended June 30, 2013	Year Ended June 30, 2012
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (33,813,151.43)	$ (31,172,204.18)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	2,249,979.05	2,145,288.87
Other adjustments	7,444.50	6,861.01
Change in assets and liabilities:		
Receivables, net	(539,014.35)	(92,827.66)
Inventories	6,799.16	(2,211.27)
Prepaid expenses	(4,754.36)	(3,479.70)
Accounts payable	656,668.95	257,743.58
Accrued liabilities	59,526.78	24,435.84
Net OPEB obligation	90,309.40	82,194.52
Unearned revenue	(1,773,280.28)	1,322,655.55
Compensated absences	95,884.38	126,046.56
Due to grantors	1,576.00	-
Other	276.96	-
Net cash used by operating activities	$ (32,961,735.24)	$ (27,305,496.88)
Noncash investing, capital, or financing transactions		
Gifts of capital assets	$ 121,000.00	$ 383,258.00
Loss on disposal of capital assets	$ (13,900.35)	$ (17,075.57)

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

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The college 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 Northeast State Community College.

The Northeast State Community College Foundation is considered a component unit of the college. Although the college 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 college by its donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the college, the foundation is considered a component unit of the college and is discretely presented in the college's financial statements. See Note 15 for more detailed information about the component unit and how to obtain the report.

Basis of Presentation

The college's financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America 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 college 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 of the provider's eligibility requirements have been met. All significant interfund transactions have been eliminated.

The college has classified its revenues and expenses as either operating or nonoperating according to the following criteria: Operating revenues and expenses are those that have the characteristics of exchange transactions. Operating revenues include (1) tuition and fees, net of scholarship discounts and allowances; (2) certain federal, state, local, and private grants and contracts; and (3) sales and services of auxiliary enterprises. Operating expenses include (1) salaries and wages; (2) employee benefits; (3) utilities, supplies, and other services; (4) scholarships and fellowships; and (5) depreciation.

Nonoperating revenues and expenses include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other activities that are defined as nonoperating by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*, and GASB Statement 34, such as state appropriations and investment income.

When both restricted and unrestricted resources are available for use, it is the college's policy to determine which to use first, depending upon existing facts and circumstances.

Inventories

Inventories are valued at the lower of cost or market on a first-in, first-out basis.

Compensated Absences

The college'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 position. There is no liability for unpaid accumulated sick leave since the college'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 position 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 Position

The college's net position is classified as follows:

<u>Net investment in capital assets</u> – This represents the college's total investment in capital assets, net of accumulated depreciation and net of outstanding debt obligations and deferred

outflows/inflows of resources 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 net investment in capital assets.

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

Expendable restricted net position – Expendable restricted net position includes resources that the college is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net position – Unrestricted net position represents resources derived from student tuition and fees; state appropriations; sales and services of educational departments and other activities; and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the college and may be used at the college's discretion 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, as well as certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net position. Scholarship discounts and allowances are the difference between the stated charge for goods and services provided by the college 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 college's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the college has recorded a scholarship discount and allowance.

Accounting Change

The college implemented GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the college was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets. Amounts on the statement of net position and statement of revenues, expenses, and changes in net position, have been restated for comparative purposes for the year ended June 30, 2012.

Early Implementation of Accounting Pronouncement

In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities; it also recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. However, the college has elected to implement the provisions of this statement for fiscal year 2013. Amounts on the statement of net position and statement of revenues, expenses, and changes in net position have been restated for comparative purposes for the year ended June 30, 2012.

Note 2. Cash

This classification includes demand deposits and petty cash on hand. At June 30, 2013, cash consisted of $966,167.98 in bank accounts, $1,700.00 of petty cash on hand, $15,121,446.05 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer, and $4,500,224.21 in LGIP deposits for capital projects. At June 30, 2012, cash consisted of $2,590,256.55 in bank accounts, $1,450.00 of petty cash on hand, $20,824,691.61 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer, and $474,216.47 in LGIP deposits for capital projects.

The college has deposits in the LGIP, which is administered by the State Treasurer. The LGIP is part of the State Pooled Investment Fund. The fund's required risk disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at www.treasury.tn.gov.

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

Note 3. Investments

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The college is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies which are backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool.

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

Tennessee Board of Regents policy requires that prime commercial paper shall be limited to that of corporations that meet the following criteria: 1) Senior long-term debt, if any, should have a minimum rating of A1 or equivalent, and short-term debt should have a minimum rating of A1 or equivalent, as provided by a majority of the rating services that rate the issuer. If there is no long-term debt rating, the short-term debt rating must be A1 by all rating services (minimum of two). 2) The rating should be based on the merits of the issuer or 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.

As of June 30, 2013, and June 30, 2012, the college's investments consisted entirely of investments in the Local Government Investment Pool. The fair value of these investments was $19,621,670.26 at June 30, 2013, and $21,298,908.08 at June 30, 2012. LGIP investments are not rated by nationally recognized statistical ratings organizations. The LGIP is part of the State Pooled Investment Fund. The fund's required risk disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at www.treasury.tn.gov.

Note 4. Receivables

Receivables included the following:

	June 30, 2013	June 30, 2012
Student accounts receivable	$3,403,828.85	$2,909,842.87
Grants receivable	371,332.39	557,115.56
Other receivables	48,518.76	79,791.26
Subtotal	3,823,680.00	3,546,749.69
Less allowance for doubtful accounts	(25,781.03)	(139,566.57)
Total receivables	$3,797,898.97	$3,407,183.12

Note 5. Capital Assets

Capital asset activity for the year ended June 30, 2013, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 2,028,771.64	$ -	$ -	$ -	$2,028,771.64
Land improvements and infrastructure	4,041,129.59	-	-	-	4,041,129.59
Buildings	41,544,605.01	394,035.39	20,100.00	-	41,958,740.40
Equipment	7,787,207.26	744,229.52	-	60,968.42	8,470,468.36
Library holdings	949,199.16	87,670.52	-	101,886.45	934,983.23
Intangible assets	1,623,453.29	-	-	-	1,623,453.29
Projects in progress	114,074.55	93,071.62	(20,100.00)	13,668.30	173,377.87
Total	58,088,440.50	1,319,007.05	-	176,523.17	59,230,924.38
Less accumulated depreciation/amortization:					
Land improvements and infrastructure	1,168,949.38	267,016.22	-	-	1,435,965.60
Buildings	12,792,686.32	1,047,140.38	-	-	13,839,826.70
Equipment	3,407,958.30	667,264.54	-	47,068.07	4,028,154.77
Library holdings	525,229.40	93,498.32	-	101,886.45	516,841.27
Intangible assets	1,075,474.54	175,059.59	-	-	1,250,534.13
Total	18,970,297.94	2,249,979.05	-	148,954.52	21,071,322.47
Capital assets, net	$39,118,142.56	$ (930,972.00)	$ -	$27,568.65	$38,159,601.91

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 2,028,771.64	$ -	$ -	$ -	$ 2,028,771.64
Land improvements and infrastructure	3,237,354.14	746,387.13	57,388.32	-	4,041,129.59
Buildings	41,544,605.01	-	-	-	41,544,605.01
Equipment	6,382,515.99	1,798,470.18	-	393,778.91	7,787,207.26
Library holdings	1,487,496.83	88,814.32	-	627,111.99	949,199.16
Intangible assets	1,623,453.29	-	-	-	1,623,453.29
Projects in progress	77,488.32	93,974.55	(57,388.32)	-	114,074.55
Total	56,381,685.22	2,727,646.18	-	1,020,890.90	58,088,440.50
Less accumulated depreciation/amortization:					
Land improvements and infrastructure	1,015,626.41	153,322.97	-	-	1,168,949.38
Buildings	11,765,266.67	1,027,419.65	-	-	12,792,686.32
Equipment	3,266,738.18	517,923.46	-	376,703.34	3,407,958.30
Library holdings	880,778.19	271,563.20	-	627,111.99	525,229.40

Intangible assets	900,414.95	175,059.59	-	-	1,075,474.54
Total	17,828,824.40	2,145,288.87	-	1,003,815.33	18,970,297.94
Capital assets, net	$38,552,860.82	$ 582,357.31	$ -	$ 17,075.57	$39,118,142.56

The fiscal year 2012 decrease in library holdings is partly 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 ten years to zero years, resulting in an adjustment of $349,563.81.

Note 6. Accounts Payable

Accounts payable included the following:

	June 30, 2013	June 30, 2012
Vendors payable	$1,231,871.05	$1,067,864.81
Other payables	54,844.41	3,258.76
Total accounts payable	$1,286,715.46	$1,071,123.57

Note 7. Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2013, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
TSSBA debt:					
Bonds	$ 320,443.50	$ -	$ 53,725.00	$ 266,718.50	$ 31,217.50
Unamortized bond premium	-	47,960.03	6,851.43	41,108.60	-
Subtotal	320,443.50	47,960.03	60,576.43	307,827.10	31,217.50
Other liabilities:					
Compensated absences	996,556.79	690,286.89	594,402.51	1,092,441.17	297,965.07
Subtotal	996,556.79	690,286.89	594,402.51	1,092,441.17	297,965.07
Total long-term liabilities	$1,317,000.29	$738,246.92	$654,978.94	$1,400,268.27	$329,182.57

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

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
TSSBA debt:					
Bonds	$ 349,195.00	$ -	$ 28,751.50	$ 320,443.50	$ 29,959.00
Subtotal	349,195.00	-	28,751.50	320,443.50	29,959.00
Other liabilities:					
Compensated absences	870,510.23	684,573.02	558,526.46	996,556.79	277,928.22
Subtotal	870,510.23	684,573.02	558,526.46	996,556.79	277,928.22
Total long-term liabilities	$1,219,705.23	$684,573.02	$587,277.96	$1,317,000.29	$307,887.22

TSSBA Debt – Bonds

Bonds, with interest rates ranging from 4.0% to 5.0%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2021 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the college, including state appropriations; see Note 8 for further details.

Debt service requirements to maturity for the college's portion of TSSBA bonds at June 30, 2013, are as follows:

Year Ending June 30	Principal	Interest	Total
2014	$ 31,217.50	$13,023.75	$ 44,241.25
2015	28,687.00	11,416.46	40,103.46
2016	30,199.00	9,963.23	40,162.23
2017	31,792.00	8,433.36	40,225.36
2018	33,467.00	6,822.83	40,289.83
2019 – 2021	111,356.00	9,934.04	121,290.04
Total	$266,718.50	$59,593.67	$326,312.17

Refunding of Debt

On August 12, 2012, the state issued $235,501.00 in revenue bonds with an average interest rate of 5.0% to advance refund $259,267.00 of outstanding 2006A bonds with an average interest rate of 4.225%. The net proceeds of $282,712.06 (including a premium of $47,960.03 and after payment of $748.97 in underwriter's fees and issuance costs) were deposited with an escrow agent to provide for all future debt service payments on the 2006A bonds. As a result, the 2006A bonds are considered to be defeased, and the liability for those bonds has been removed from the college's long-term liabilities.

Although the advance refunding resulted in the recognition of a deferred outflow of $23,445.06 to be amortized over the next nine years, the college in effect reduced its aggregate debt service payments by $25,463.53 over the next nine years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $20,612.18.

Note 8. Pledged Revenues

The college has pledged certain revenues and fees, including state appropriations, to repay $266,718.50 in revenue bonds issued from June 2006 to August 2012 (see Note 7 for further detail). Proceeds from the bonds provided financing for Energy Savings and Performance Contracts. The bonds are payable through 2021. Annual principal and interest payments on the bonds are expected to require .13% of available revenues. The total principal and interest remaining to be paid on the bonds at June 30, 2013, is $326,312.17. Principal and interest paid for fiscal year 2013 and total available revenues were $42,985.87 and $32,639,067.23, respectively. Principal and interest paid for fiscal year 2012 and total available revenues were $43,345.84 and $31,933,971.34, respectively.

Note 9. Pension Plans

Defined Benefit Plans

Tennessee Consolidated Retirement System

Plan Description – The college 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.

Funding Policy – Plan members are noncontributory. The college is required to contribute an actuarially determined rate. The current rate is 15.03% of annual covered payroll. Contribution requirements for the college are established and may be amended by the TCRS' Board of Trustees. The college's contributions to TCRS for the years ended June 30, 2013; June 30, 2012; and June 30, 2011, were $1,589,301.97, $1,452,310.61, and $1,283,425.61, respectively. Contributions met the requirements for each year.

Defined Contribution Plans

Optional Retirement Plans

Plan Description – The college contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund, ING Life Insurance and

Annuity Company, and Variable Annuity Life Insurance Company. 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 college 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 college to the plans were $491,093.36 for the year ended June 30, 2013, and $451,458.32 for the year ended June 30, 2012. Contributions met the requirements for each year.

Note 10. Other Postemployment Benefits

Health care 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 college 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 plan for health care 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 college's eligible retirees; see Note 14. The plans are reported in the *Tennessee 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, which covers the retirees of other governmental entities, including Northeast State Community College. The state is the sole contributor for the college retirees who 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. The plan's claims liabilities are periodically computed using actuarial and statistical techniques to establish premium rates. The plan's administrative costs 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, adjusted for years of service, as active employees. 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 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.

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

	2013	2012
Annual required contribution (ARC)	$ 494,000.00	$ 490,000.00
Interest on the net OPEB obligation	64,857.88	61,570.10
Adjustment to the ARC	(68,845.41)	(65,355.49)
Annual OPEB cost	490,012.47	486,214.61
Amount of contribution	(399,703.07)	(404,020.09)
Increase in net OPEB obligation	90,309.40	82,194.52
Net OPEB obligation – beginning of year	1,621,447.11	1,539,252.59
Net OPEB obligation – end of year	$1,711,756.51	$1,621,447.11

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2013	State Employee Group Plan	$490,012.47	81.6%	$1,711,756.51
June 30, 2012	State Employee Group Plan	$486,214.61	83.1%	$1,621,447.11
June 30, 2011	State Employee Group Plan	$506,206.71	62.8%	$1,539,252.59

Funded Status and Funding Progress

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

	State Employee Group Plan
Actuarial valuation date	July 1, 2011
Actuarial accrued liability (AAL)	$3,627,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$3,627,000.00
Actuarial value of assets as a percentage of the AAL	0.00%
Covered payroll (active plan members)	$12,968,901.91
UAAL as percentage of covered payroll	28%

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% investment rate of return (net of administrative expenses) and an annual health care cost trend rate of 9.25% initially. The rate decreased to 8.75% in fiscal year 2013 and then reduces by decrements to an ultimate rate of 5% in fiscal year 2021. All rates include a 2.5% inflation assumption, which also represents the projected salary increase. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007.

Note 11. Insurance-related Activities

It is the policy of the state not to purchase commercial insurance for the risks 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 college participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the college based on a percentage of the college'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, 2013, is presented in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml. Since the college 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 college 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, 2013, the Risk Management Fund held $108.5 million in cash designated for payment of claims. At June 30, 2012, the Risk Management Fund held $97.2 million in cash designated for payment of claims.

At June 30, 2013, the scheduled coverage for the college was $71,039,900 for buildings and $32,170,900 for contents. At June 30, 2012, the scheduled coverage for the college was $75,260,100 for buildings and $32,170,900 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 college 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 college based on estimates of the ultimate cost of claims, including the cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

Note 12. Commitments and Contingencies

Sick Leave

The college records the cost of sick leave when paid. The dollar amount of unused sick leave was $4,499,090.39 at June 30, 2013, and $4,307,445.91 at June 30, 2012.

Operating Leases

The college 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 $66,360.24 and expenses for personal property were $47,639.28 for the year ended June 30, 2013. The amount for personal property operating leases for the year ended June 30, 2012, was $35,911.22. The college also had two operating leases for buildings with the Northeast State Community College Foundation. See Note 15 for details. All operating leases are cancelable at the lessee's option.

Construction in Progress

At June 30, 2013, outstanding commitments under construction contracts totaled $1,265,952.97 for the Technical Education Complex, of which $1,133,056.57 will be funded by future state capital outlay appropriations.

Litigation

The college is not involved in any lawsuits.

Note 13. Natural Classification With Functional Classifications

The college's operating expenses for the year ended June 30, 2013, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 9,407,469.47	$3,209,766.15	$ 4,774,665.55	$ -	$ -	$17,391,901.17
Public service	8,166.24	4,245.64	287,408.23	-	-	299,820.11
Academic support	2,616,501.04	1,191,034.98	14,370.50	-	-	3,821,906.52
Student services	2,450,466.28	1,065,069.92	1,366,793.26	-	-	4,882,329.46
Institutional support	2,789,870.90	1,153,018.26	812,173.69	-	-	4,755,062.85
Maintenance & operation	1,132,951.21	664,613.62	3,823,412.59	-	-	5,620,977.42
Scholarships & fellowships	-	-	-	8,901,715.75	-	8,901,715.75
Depreciation	-	-	-	-	2,249,979.05	2,249,979.05
Total	$18,405,425.14	$7,287,748.57	$11,078,823.82	$8,901,715.75	$2,249,979.05	$47,923,692.33

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

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 9,255,099.18	$3,075,066.88	$ 4,200,518.19	$ -	$ -	$16,530,684.25
Public service	-	-	50,146.72	-	-	50,146.72
Academic support	2,276,916.22	1,044,839.07	(90,367.31)	-	-	3,231,387.98
Student services	2,195,194.42	1,010,956.34	1,274,422.67	-	-	4,480,573.43
Institutional support	2,244,907.72	949,495.83	860,166.91	-	-	4,054,570.46
Maintenance & operation	1,049,842.19	632,258.04	3,248,516.83	-	-	4,930,617.06
Scholarships & fellowships	-	-	-	9,208,860.81	-	9,208,860.81
Depreciation	-	-	-	-	2,145,288.87	2,145,288.87
Total	$17,021,959.73	$6,712,616.16	$9,543,404.01	$9,208,860.81	$2,145,288.87	$44,632,129.58

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 $1,128,287.38 for the year ended June 30, 2013, and $1,006,438.48 for the year ended June 30, 2012, were reallocated from academic support to the other functional areas and caused academic support operating expenses to appear as a negative amount in the 2012 schedule above.

Note 14. On-behalf Payments

During the year ended June 30, 2013, the State of Tennessee made payments of $7,444.50 on behalf of the college for retirees participating in the Medicare Supplement Plan. The amount for the year ended June 30, 2012, was $6,861.01. The Medicare Supplement Plan is a postemployment benefit health care plan and is discussed further in Note 10. The plan is reported in the *Tennessee Comprehensive Annual Financial Report*. That report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Note 15. Component Unit

The Northeast State Community College Foundation is a legally separate, tax-exempt organization supporting Northeast State Community College. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the college in support of its programs. The 48-member board of the foundation is self-perpetuating and consists of graduates and friends of the college. Although the college 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 college by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the college, the foundation is considered a component unit of the college and is discretely presented in the college'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 college's financial statements for these differences.

During the year ended June 30, 2013, the foundation made distributions of $145,173.04 to or on behalf of the college for both restricted and unrestricted purposes. During the year ended June 30, 2012, the foundation made distributions of $418,471.00 to or on behalf of the college for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Dr. Steven R. Campbell, Chief Financial Officer, Northeast State Community College, P. O. Box 246, Blountville, TN 37617-0246.

Fair-value Measurements

The foundation reports certain assets at fair value. Fair value has been determined using quoted prices in active markets for identical assets 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 (Level 2), or significant unobservable inputs (Level 3). The following table categorizes the recurring fair-value measurements for assets at June 30, 2013, and at June 30, 2012.

	Total Fair Value at June 30, 2013	Quoted Prices Level 1	Significant Other Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Mutual equity funds	$4,708,138.47	$4,708,138.47	$ -	$ -
Mutual bond funds	3,500,481.35	3,500,481.35	-	-
Total assets	$8,208,619.82	$8,208,619.82	$ -	$ -

	Total Fair Value at June 30, 2012	Quoted Prices Level 1	Significant Other Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Mutual equity funds	$3,879,977.61	$3,879,977.61	$ -	$ -
Mutual bond funds	3,005,194.16	3,005,194.16	-	-
Total assets	$6,885,171.77	$6,885,171.77	$ -	$ -

Cash

Cash consists of demand deposit accounts and Tennessee Local Government Investment Pool (LGIP) deposits. The bank balances of deposits at June 30, 2013, and June 30, 2012, were entirely insured.

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, 2013, were as follows*:*

	Cost	Fair Value
Mutual equity funds	$3,962,690.56	$4,708,138.47
Mutual bond funds	3,478,775.67	3,500,481.35
Total investments	$7,441,466.23	$8,208,619.82

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

	Cost	Fair Value
Mutual equity funds	$3,848,904.13	$3,879,977.61
Mutual bond funds	2,967,875.76	3,005,194.16
Total investments	$6,816,779.89	$6,885,171.77

Pledges Receivable

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

	June 30, 2013	June 30, 2012
Current pledges	$39,892.47	$22,821.67
Pledges due in one to five years	15,207.20	19,037.77
Subtotal	55,099.67	41,859.44
Less allowance for doubtful accounts	(5,749.06)	-
Total pledges receivable, net	$49,350.61	$41,859.44

Capital Assets

Capital assets at June 30, 2013, and June 30, 2012, were as follows:

	June 30, 2013	June 30, 2012
Land	$ 318,160.00	$ 318,160.00
Buildings	2,959,587.53	2,959,587.53
Total	3,277,747.53	3,277,747.53
Less accumulated depreciation:		
Buildings	288,107.00	213,519.43
Total	288,107.00	213,519.43
Capital assets, net	$2,989,640.53	$3,064,228.10

Endowments

The Northeast State Community College Foundation’s endowments consist of approximately 82 individual funds established for a variety of purposes. Its endowment includes only donor-restricted endowment funds and no funds designated by the Board of Trustees to function as endowments. As required by accounting principles generally accepted in the United States of America, net position 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.

<u>Interpretation of relevant law</u> – The Board of Trustees of the Northeast State Community College 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 donor-restricted endowment fund absent explicit donor stipulations to the contrary. As a result of this interpretation, the Northeast State Community College Foundation classifies as permanently restricted net position (1) the original value of gifts donated to the permanent endowment; (2) the original value of subsequent gifts to the permanent endowment; and (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. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net position is classified as temporarily restricted net position until the foundation appropriates those amounts for expenditure 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 Position Class
As of June 30, 2013

	Permanently Restricted	Temporarily Restricted	Unrestricted	Total
Donor-restricted endowment funds	$4,403,124.48	$4,280,955.17	$ -	$8,684,079.65

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

	Permanently Restricted	Temporarily Restricted	Unrestricted	Total
Donor-restricted endowment funds	$4,364,416.98	$3,558,260.28	$ -	$7,922,677.26

Permanently restricted funds include a building and land valued at $371,500.00 at June 30, 2013, and $377,200.00 at June 30, 2012, which were purchased with contributions designated for the purchase with the stipulation that if the building and land were sold later that the proceeds would be used to endow a scholarship in the donor's name.

Changes in Endowment Net Position
for the Fiscal Year Ended June 30, 2013

	Permanently Restricted	Temporarily Restricted	Unrestricted	Total
Endowment net position, beginning of year	$4,364,416.98	$3,558,260.28	$ -	$7,922,677.26
Investment return:				
Investment income	-	218,472.09	-	218,472.09
Net appreciation (realized and unrealized)	-	659,279.35	-	659,279.35
Total investment return	-	877,751.44	-	877,751.44
Contributions	38,869.50	3,695.45	-	42,564.95
Appropriations of endowment assets for expenditure	-	(138,852.00)	-	(138,852.00)
Transfers	5,538.00	(19,900.00)	-	(14,362.00)
Other	(5,700.00)	-	-	(5,700.00)
Endowment net position, end of year	$4,403,124.48	$4,280,955.17	$ -	$8,684,079.65

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

	Permanently Restricted	Temporarily Restricted	Unrestricted	Total
Endowment net position, beginning of year	$3,881,314.03	$3,568,357.32	$ -	$7,449,671.35
Investment return:				
Investment income	-	94,684.71	-	94,684.71
Net appreciation (realized and unrealized)	-	(10,014.41)	-	(10,014.41)
Total investment return	-	84,670.30	-	84,670.30
Contributions	482,225.60	17,169.96	-	499,395.56
Appropriations of endowment assets for expenditure	-	(163,200.00)	-	(163,200.00)
Transfers	6,577.35	51,262.70	-	57,840.05
Other	(5,700.00)	-	-	(5,700.00)
Endowment net position, end of year	$4,364,416.98	$3,558,260.28	$ -	$7,922,677.26

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 donor-specified periods. 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 achieve a balanced return of current income and growth of principal; emphasize long-term growth of principal, while avoiding excessive risk; and strive to achieve returns in excess of the rate of inflation, as defined by the Consumer Price Index. The foundation expects its endowment funds, over time, to equal or better the appropriate benchmark for the equity portion of the fund (such as the Standard & Poor's 500 Index) net of fees and to equal or better the appropriate benchmark for the fixed income portion (such as Lehman Brothers Government/Corporate Bond Index and the Morgan Stanley Capital International EAFE Index) net of fees, 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 an emphasis on equity-based and fixed-income investments to provide a balance that will enhance total return while avoiding undue risk concentration in any single asset class or investment category.

Spending policy and how the investment objectives relate – The foundation has a policy of appropriating for distribution each year 80% of all realized investment earnings (interest, dividends, and realized changes in the value of investments) for regular endowment funds. 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 regular endowment funds to grow at an average of 20% of their current annual realized earnings. 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.

Leases Between the Foundation and College

The Northeast State Community College Foundation owns two buildings in the Kingsport Academic Village. They are the Regional Center for Advanced Manufacturing (RCAM) at 305 West Main Street and the Pal Barger Regional Center for Automotive Programs (RCAP) at 337 West Center Street. The RCAM was gifted to the foundation in September 2009. It has been leased to Northeast State Community College for academic programs since that time at $39,000 per year. In December 2008, the RCAP was purchased by the foundation using a donor-restricted donation for that purpose. A retail business continued to lease this space from the foundation through August 2010. When the lease with this retail business ended, the foundation entered a lease agreement with Northeast State Community College at a lease rate of $80,000 per year. The college also uses this building for academic purposes.

Both of these leases are operating leases. For these leases, total rental expense to the college and revenue for the foundation were $119,000.00 for the year ended June 30, 2013. For these leases, total rental expense to the college and revenue for the foundation were $119,000.00 for the year ended June 30, 2012. These leases are cancelable at the lessee's option.

Tennessee Board of Regents
Northeast State Community College
Required Supplementary Information
OPEB Schedule of Funding Progress

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	$ -	$3,627,000.00	$3,627,000.00	0%	$12,968,901.91	28.0%
July 1, 2010	State Employee Group Plan	$ -	$4,408,000.00	$4,408,000.00	0%	$11,158,761.99	39.5%
July 1, 2009	State Employee Group Plan	$ -	$4,725,000.00	$4,725,000.00	0%	$10,052,854.52	47.0%

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

Tennessee Board of Regents
NORTHEAST STATE COMMUNITY COLLEGE
Supplementary Information
Schedules of Cash Flows - Component Unit
For the Years Ended June 30, 2013, and June 30, 2012

	Year Ended June 30, 2013	Year Ended June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$ 425,403.49	$ 407,061.22
Grants and contracts	-	34,068.21
Sales and services of educational activities	2,753.20	2,145.36
Payments to suppliers and vendors	(77,279.96)	(478,764.61)
Payments for scholarships and fellowships	(589,276.37)	(556,382.12)
Payments to Northeast State Community College	-	(77,669.01)
Amounts refunded to grantors	-	(377,536.33)
Net cash used by operating activities	(238,399.64)	(1,047,077.28)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Gifts and grants received for other than capital or endowment purposes	48,449.13	-
Private gifts for endowment purposes	-	481,617.47
Net cash provided by noncapital financing activities	48,449.13	481,617.47
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Purchase of capital assets and construction	-	(294,950.53)
Other capital and related financing receipts	-	6,026.08
Net cash used by capital and related financing activities	-	(288,924.45)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	27,419.83	141,349.15
Income on investments	286,276.29	216,940.75
Purchases of investments	(593,435.41)	(837,293.06)
Net cash used by investing activities	(279,739.29)	(479,003.16)
Net decrease in cash	(469,689.80)	(1,333,387.42)
Cash - beginning of year	1,269,887.96	2,603,275.38
Cash - end of year	$ 800,198.16	$ 1,269,887.96
Reconciliation of operating income (loss) to net cash used by operating activities:		
Operating income (loss)	$ 622,797.42	$ (445,335.16)
Adjustments to reconcile operating income (loss) to net cash used by operating activities:		
Depreciation expense	74,587.57	74,587.57
Gifts of capital assets to the college	121,000.00	383,258.00
Endowment income per spending plan	(286,577.60)	(174,309.01)
Change in assets and liabilities:		
Receivables, net	(672,911.98)	19,797.66
Accounts payable	(90,402.84)	(395,959.56)
Unearned revenue	-	(501,879.34)
Other assets	(6,892.21)	(7,237.44)
Net cash used by operating activities	$ (238,399.64)	$ (1,047,077.28)
Noncash investing, capital, or financing transactions		
Gifts of capital assets	$ 121,000.00	$ 383,258.00
Unrealized gains (losses) on investments	$ 698,761.71	$ (10,014.41)

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's 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*

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor
Dr. Janice H. Gilliam, President

We have audited the financial statements of Northeast State Community College, 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 years ended June 30, 2013, and June 30, 2012, and the related notes to the financial statements, which collectively comprise the college's basic financial statements, and have issued our report thereon dated September 18, 2014. We conducted our audit in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the college's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances 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 college's internal control. Accordingly, we do not express an opinion on the effectiveness of the college's internal control.

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 entity's financial statements will not be prevented, or detected and corrected on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we identified the following deficiencies in internal control that we consider to be material weaknesses:

- As reported in the previous audit, management needs to improve financial statement preparation and review procedures to prevent errors in its financial statements.

- Northeast State Community College did not provide adequate internal controls in five specific areas.

These deficiencies are described in the Findings and Recommendations section of this report.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the college's financial statements are free from 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 *Government Auditing Standards*.

Northeast State Community College's Responses to Findings

The college's responses to the findings identified in our audit are included in the Findings and Recommendations section of this report. The college's responses were not subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly, we express no opinion on them.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
September 18, 2014

Findings and Recommendations

1. <u>As reported in the previous audit, management needs to improve financial statement preparation and review procedures to prevent errors in its financial statements</u>

Finding

Northeast State Community College's procedures for preparation of its financial statements, including the financial statements of its component unit, Northeast State Community College Foundation, should be improved to ensure the accuracy and proper classification of information presented in its financial statements. A similar finding was reported in the previous audit.

The former Business Manager prepared the college's financial statements with assistance from other staff members. A Financial Analyst, with assistance from the Chief Financial Analyst, prepared the foundation's financial statements. The statements were reviewed by the college's Chief Financial Analyst as well as the Chief Financial Officer. The current weakness resulted in the following significant reporting errors:

- On the college's 2012 statement of revenues, expenses, and changes in net position, the Business Manager understated scholarship allowances by $1,359,469.74 because she did not update an item used in the calculation of the allowance. Instead, a prior-year amount was used. Although the reported allowances were $7,548,559.34, the correct amount was $8,908,029.08. As a result, student tuition and fees and scholarship and fellowship expense were overstated by $1,359,469.74. The audited statement was corrected.

- In Note 14 in the college's 2012 financial report, the amount of expenses reallocated from academic support to other functional areas was incorrectly reported as $1,940,040.79 rather than $1,006,438.48. Instead of only displaying data processing expenses reallocated from academic support, the former Business Manager incorrectly included all data processing allocations for fiscal year 2012. The audited note was corrected.

- In Note 15 in the college's 2013 financial report and Note 16 in the college's 2012 financial report, the foundation's endowment funds were labeled as board-designated endowment funds rather than donor-restricted endowment funds by the Financial Analyst who prepares the foundation's financial statements. There were $8,684,079.65 of donor-restricted funds incorrectly labeled at June 30, 2013, and $7,922,677.26 of donor-restricted funds incorrectly labeled at June 30, 2012. The note in the audit report was corrected.

The reporting errors described above were oversights by the Business Manager, Financial Analyst, and assisting staff. In addition, the review process was not thorough enough to detect these errors. While improvements have been made since the previous audit, controls over financial reporting for the college still have not operated effectively.

Recommendation

The Chief Financial Officer should ensure that staff members accounting for college and foundation transactions and preparing the college and foundation financial statements have adequate knowledge of reporting requirements to perform their responsibilities, and that they perform their duties with appropriate care and attention. Scholarship allowance calculations should be carefully done and reviewed by the preparer and other staff members. Similarly, due care should be given to the preparation of footnote disclosures. The financial statement review process should be thorough enough to detect misstatements such as the ones described above.

Management's Comment

We concur with the finding and recommendation. Management has provided additional training to key staff. Two of our staff members attended the Tennessee Board of Regents financial statement seminar on May 21, 2014. Our new Director of Fiscal Services has completed the first year of SACUBO's College Business Management Institute in Lexington, Kentucky.

- For the 2014 fiscal year, the scholarship allowance calculation has been prepared and rechecked by another staff member to ensure the accuracy of this calculation. Any variances were investigated.

- Special care will be taken in reallocating expenses from academic support to other functional areas. Fiscal year 2012 was the first reporting year for this information; the subsequent year we determined a better method of reallocating and failed to notify State Audit of the change. In the future, we will communicate with State Audit at the beginning of the audit process.

- For the 2014 fiscal year, the foundation's endowment funds have been changed and labeled as donor-restricted endowment funds. This terminology will be presented in future note disclosures.

The Chief Financial Officer and the Chief Financial Analyst will conduct thorough reviews of the reported amounts on the financial statements and in the notes. The accounting staff has been instructed to discuss any items that are questionable as to how they should be recorded and classified. Our goal for the Finance Division is to have sufficient time for a quality review process to ensure any errors are detected prior to submission to the Tennessee Board of Regents. We appreciate State Audit's comments about the improvements they noticed from fiscal year 2012 to fiscal year 2013. With the auditor's suggestions, we anticipate that more improvements will be noticed within future periods.

2. Northeast State Community College did not provide adequate internal controls in five specific areas

Finding

Northeast State Community College did not design and monitor internal controls in specific areas. We observed five conditions in violation of college policies and/or industry-accepted best practices. Inconsistent implementation of internal controls increases the risk of fraud or error.

The details of these findings are confidential pursuant to Section 10-7-504(i), *Tennessee Code Annotated.* We provided the college with detailed information regarding the specific conditions we identified, as well as our recommendations for improvement.

Recommendation

Management should ensure that these conditions are remedied by the prompt development and consistent implementation of internal controls. Management should implement effective controls to ensure compliance with applicable requirements; assign staff to be responsible for ongoing monitoring of the risks and mitigating controls; and take action if deficiencies occur.

Management's Comment

We concur with the finding and recommendation. The college is implementing additional internal controls over the specific areas noted during the audit. The controls will be in place by October 1, 2014.

Observations and Comments

College of Applied Technology

Northeast State Community College serves as the lead institution under an agreement with the Tennessee College of Applied Technology at Elizabethton. Under this agreement, Northeast State Community College performs the accounting and reporting functions for this college. The chief administrative officer of the college is the director, who is assisted and advised by members of the faculty and administrative staff. The director is responsible to the Chancellor of the Tennessee Board of Regents. Prior to July 1, 2013, these workforce training schools were named Tennessee Technology Centers.