AUDIT REPORT

Tennessee Board of Regents

East Tennessee State University

For the Year Ended
June 30, 2014

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

Tennessee
Comptroller
of the Treasury

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January 13, 2015

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor
Dr. Brian Noland, President

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, East Tennessee State University, for the year ended June 30, 2014. 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 internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

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Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2014

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For the Year Ended June 30, 2014

Opinions on the Financial Statements

The opinions on the financial statements are unmodified.

Audit Findings

The audit report contains no findings.

STATE OF TENNESSEE
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Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor
Dr. Brian Noland, President

Report on the Financial Statements

We have audited the accompanying financial statements of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component units as of and for the year ended June 30, 2014, 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 did not audit the financial statements of East Tennessee State University Foundation and the Medical Education Assistance Corporation, discretely presented component units. Those statements were audited by other auditors, whose reports have been furnished to us. Our opinion, insofar as it relates to the amounts included for these institutions, is based solely on the reports of the other auditors. 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 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, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of East Tennessee State University and its discretely presented component units as of June 30, 2014, and the respective changes in financial position and, where applicable, cash flows thereof for the year 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 East Tennessee State University, an institution of the Tennessee Board of Regents, are intended to present the financial position, the changes in financial position, and the cash flows of only East Tennessee State University. They do not purport to, and do not, present fairly the financial position of the Tennessee Board of Regents, as of June 30, 2014, and the changes in financial position and cash flows thereof for the year 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.

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 14 and the schedule of funding progress on page 44 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 university's basic financial statements. The schedules of cash flows for both East Tennessee State University Foundation and the Medical Education Assistance Corporation on pages 45 and 46 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

Both the foundation's schedule of cash flows and the corporation's schedule of cash flows are the responsibility of the university'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 by us and other auditors. In our opinion, based on our audit and the procedures performed as described above, the information is fairly stated, in all material respects, in relation to the basic financial statements taken as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 4, 2014, on our consideration of the university'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 university's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 4, 2014

This section of East Tennessee State University's annual financial report presents a discussion and analysis of the financial performance of the university during the year ended June 30, 2014, with comparative information presented for the year ended June 30, 2013. 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 university has two discretely presented component units, the East Tennessee State University Foundation and the Medical Education Assistance Corporation (MEAC). More detailed information about the university's component units is presented in Note 20 in the notes to the financial statements. This discussion and analysis focuses on the university and does not include the foundation or MEAC.

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 university as a whole. The full scope of the university'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 university'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 university at the end of the fiscal year. To aid the reader in determining the university's ability to meet immediate and future obligations, the statement includes all assets, liabilities, deferred outflows/inflows, and net position of the university 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 university. They are also able to determine how much the university owes vendors, lenders, and others. Net position represents the difference between the university's assets and liabilities, along with the difference between deferred outflows and deferred inflows of resources, and is one indicator of the university's current financial condition.

The statement of net position also indicates the availability of net position for expenditure by the university. Net position is divided into three major categories. The first category, net investment in capital assets, represents the university'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 university but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the resources. The final category is unrestricted net position. Unrestricted net position is available to the university for any lawful purpose of the university.

The following table summarizes the university's assets, liabilities, deferred outflows/inflows, and net position at June 30, 2014, and June 30, 2013.

Summary of Net Position
(in thousands of dollars)

	2014	2013
Assets:		
Current assets	$ 27,269	$ 37,767
Capital assets, net	301,205	295,833
Other assets	115,372	105,145
Total assets	**443,846**	**438,745**
Deferred outflows of resources		
Deferred amount on debt refunding	374	410
Liabilities:		
Current liabilities	38,930	35,723
Noncurrent liabilities	172,378	173,681
Total liabilities	**211,308**	**209,404**

Net position:		
Net investment in capital assets	152,409	148,244
Restricted – nonexpendable	-	-
Restricted – expendable	5,752	6,799
Unrestricted	74,751	74,708
Total net position	**$232,912**	**$229,751**

Comparison of Fiscal Year 2014 to Fiscal Year 2013

- Current assets decreased from 2013 to 2014, primarily in current cash due to an additional $10 million investment in U.S. government agency bonds.

- In 2014, other assets increased due to an additional $10 million investment in bonds.

- Capital assets, net of depreciation, increased from 2013 to 2014 due to the completion of a student parking garage, expansion of the Center for Physical Activity, major renovations to some VA campus buildings, renovations to campus housing facilities, and construction on the campus quadrangle, net of the prior-period adjustment for the removal of the College of Medicine Cardiology Building from capital assets. See Note 16.

- In 2013, the Tennessee State School Bond Authority issued revenue bonds to advance refund three prior issues of debt, which resulted in a deferred loss of $445,000. The unamortized balance at June 30, 2014, was $374,000.

- Current liabilities increased from 2013 to 2014 due to increases in accrued liabilities for construction projects, long-term debt for capital improvements, interest payable on long-term debt, and an increase in loan funds payable to College of Medicine students.

- In 2014, noncurrent liabilities increased due to increases in long-term debt for capital improvements and increases in liabilities for compensated absences and other postemployment benefits. These increases were netted against a $2.4 million decrease in unearned revenue due to the prior-period adjustment described in Note 16.

- Net investment in capital assets increased in 2014 due to completion of the capital projects noted above.

- Unrestricted net position was relatively unchanged from 2013 to 2014.

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 university's financial condition has improved or deteriorated during the fiscal year. The statement presents the revenues received by the university, both operating and nonoperating; the expenses paid by the university, both operating and nonoperating; and any other revenues, expenses, gains, or losses received or spent by the university.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the university. 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 university. Nonoperating revenues are revenues received for which goods and services are not provided directly to the payor. Although East Tennessee State University 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 university has historically reported an excess of operating expenses over operating revenues, resulting in an operating loss. Therefore, the "increase in net position" is more indicative of overall financial results for the year.

A summary of the university's revenues, expenses, and changes in net position for the years ended June 30, 2014, and June 30, 2013, follows.

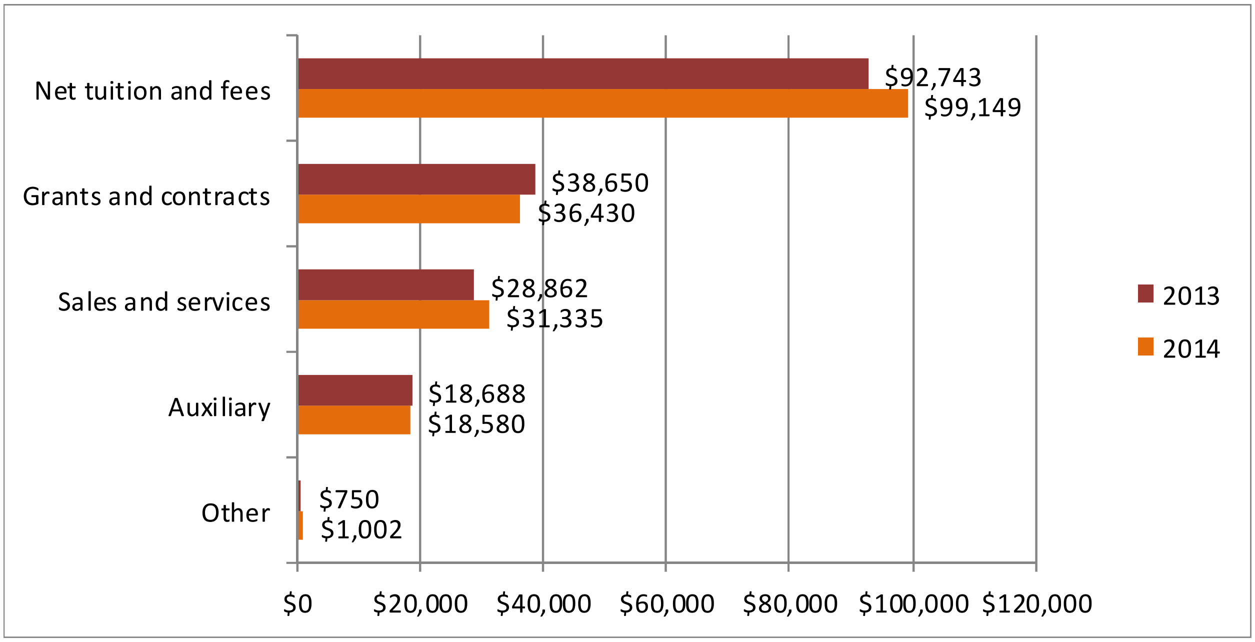
Summary of Revenues, Expenses, and Changes in Net Position
(in thousands of dollars)

	2014	2013
Operating revenues	$186,495	$179,693
Operating expenses	323,549	324,420
Operating loss	(137,054)	(144,727)
Nonoperating revenues and expenses	133,166	135,113
Income (loss) before other revenues, expenses, gains, or losses	(3,888)	(9,614)
Other revenues, expenses, gains, or losses	6,606	16,054
Increase in net position	2,718	6,440
Net position at beginning of year	229,751	223,311
Prior-period adjustment	443	-
Net position at end of year	**$232,912**	**$229,751**

Operating Revenues

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

Operating Revenues by Source
(in thousands of dollars)



Comparison of Fiscal Year 2014 to Fiscal Year 2013

- Tuition and fees increased in 2014 due to an average 4.7% fee increase, increases in course fees for health sciences, and establishment or increases in student fees related to student activities.

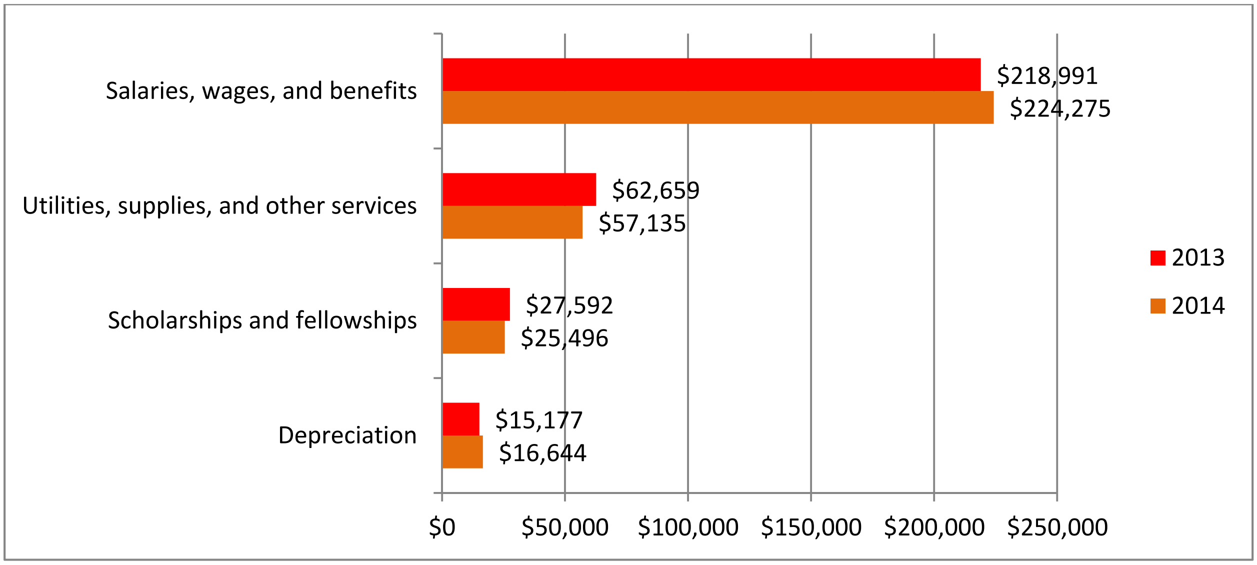
- Governmental grants and contracts decreased due to reductions in funding through federal and state grants and contracts.

- Sales and services of other activities increased due to a student fee increase for intercollegiate athletics.

Operating Expenses

Operating expenses may be reported by nature or function. The university 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 two fiscal years:

Operating Expenses – Natural Classification
(in thousands of dollars)



Comparison of Fiscal Year 2014 to Fiscal Year 2013

- Salaries increased due to a 1.5% across-the-board pay increase and an equity pay increase.
- Benefits increased due to the salary increases and with increases in insurance costs.
- Utilities, supplies, and other services decreased with decreases in professional and administrative services and supplies for renovation and construction projects.
- Scholarships decreased slightly due to decreases in enrollment.
- Depreciation increased with related increases in fixed assets.

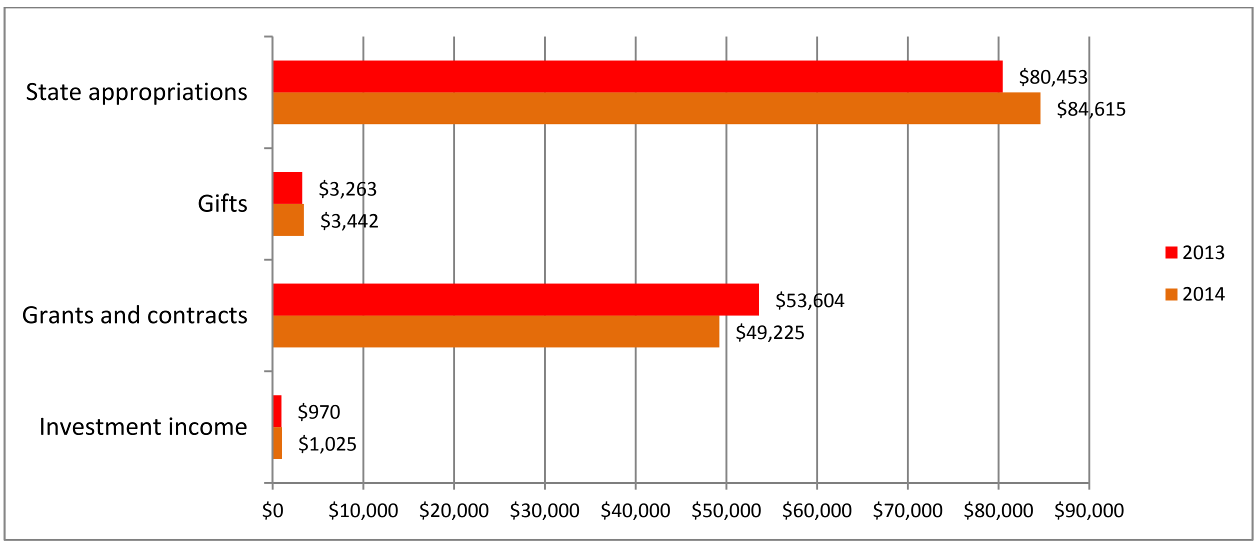
Nonoperating Revenues and Expenses

Certain revenue sources that the university 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 university's nonoperating revenues and expenses for the last two fiscal years:

Nonoperating Revenues (Expenses)
(in thousands of dollars)

	2014	2013
State appropriations	$ 84,615	$ 80,453
Gifts	3,442	3,263
Grants and contracts	49,225	53,604
Investment income	1,025	970
Interest on capital asset-related debt	(6,090)	(5,368)
Bond issuance costs	(148)	(172)
Other nonoperating revenues (expenses)	1,097	2,363
Total nonoperating revenues (expenses)	**$133,166**	**$ 135,113**

Nonoperating Revenues
(in thousands of dollars)



Comparison of Fiscal Year 2014 to Fiscal Year 2013

- State appropriations increased due to increases in funding from the state.
- Nonoperating gifts remained relatively constant.
- Nonoperating grants and contracts decreased as a result of a reduction in revenues from Tennessee Lottery scholarship and Pell grant funds related to decreases in enrollment.
- Investment income increased due to an additional $10 million investment.
- Bond issuance costs remained relatively constant.

- The other nonoperating revenues/expenses decrease is primarily a result of the prior fiscal year one-time income from an IRS refund for medical residents' FICA of $5.2 million and a related payment to the original grantors of $2.9 million, for net revenue of $2.3 million.

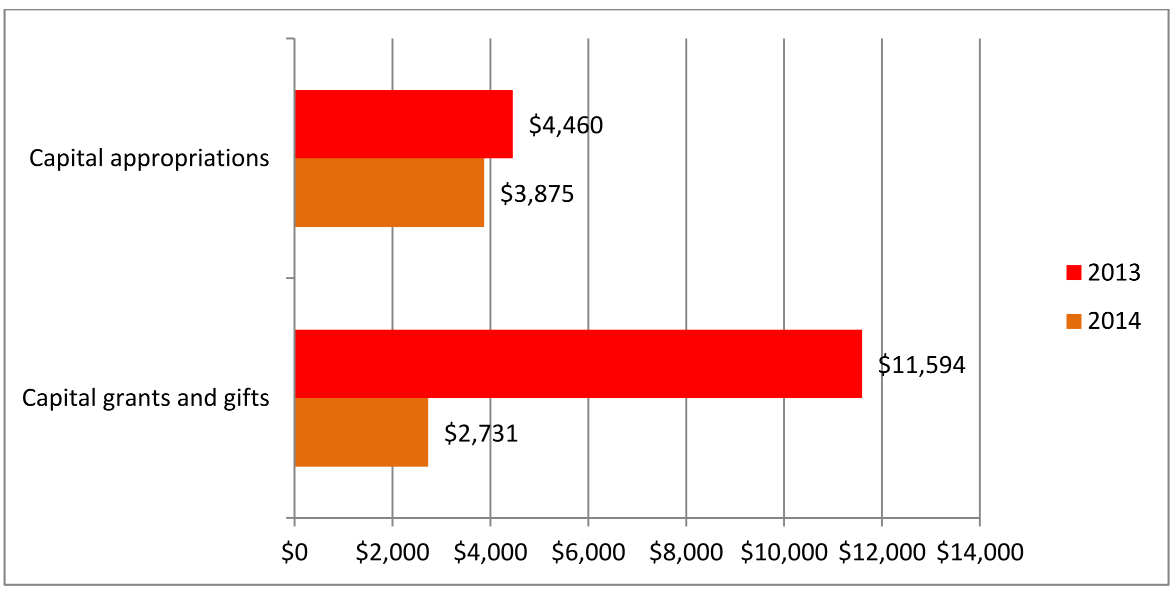
Other Revenues

This category is composed of state appropriations for capital purposes and capital grants and gifts. These amounts were as follows for the last two fiscal years:

Other Revenues
(in thousands of dollars)

	2014	2013
Capital appropriations	$3,875	$ 4,460
Capital grants and gifts	2,731	11,594
Total other revenues	**$6,606**	**$16,054**

Other Revenues
(in thousands of dollars)



Comparison of Fiscal Year 2014 to Fiscal Year 2013

- Capital appropriations remained relatively constant from 2013 to 2014.

- Capital gifts and grants decreased due to the comparatively high level of capital grants in fiscal year 2013 through the American Recovery and Reinvestment Act for the Johnson City Community Health Center, the College of Medicine Building 119 renovation, and the Brown Hall renovations.

Capital Assets and Debt Administration

Capital Assets

East Tennessee State University had $301,205,379.59 invested in capital assets, net of accumulated depreciation of $198,221,241.33 at June 30, 2014; and $295,833,353.89 invested in capital assets, net of accumulated depreciation of $182,887,211.31 at June 30, 2013. Depreciation charges totaled $16,643,710.63 and $15,177,378.00 for the years ended June 30, 2014, and June 30, 2013, respectively.

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

	2014	2013
Land	$ 16,482	$ 16,471
Land improvements & infrastructure	27,665	26,190
Buildings	237,192	208,353
Equipment	14,304	14,319
Library holdings	514	618
Intangible assets	959	1,379
Art and historical collections	24	24
Projects in progress	4,065	28,479
Total	**$301,205**	**$295,833**

Significant additions to capital assets occurred in fiscal year 2014. These additions were primarily from completion of a student parking garage, expansion of the Center for Physical Activity, major renovations to some VA campus buildings, renovations to campus housing facilities, and the campus quadrangle.

At June 30, 2014, outstanding commitments under construction contracts totaled $5,031,977.27 for various renovations and repairs of buildings and infrastructure. Future state capital outlay appropriations will fund $2,862,794.24 of these costs.

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

Debt

The university had $149,170,793.78 and $147,999,002.32 in debt outstanding at June 30, 2014, and June 30, 2013, respectively. The table below summarizes these amounts by type of debt instrument.

Schedule of Outstanding Debt
(in thousands of dollars)

	2014	2013
Revolving credit facility	$ 831	$ -
Commercial paper	-	24,833
Bonds	140,979	118,054
Unamortized bond premiums	7,361	5,112
Total	**$149,171**	**$147,999**

The Tennessee State School Bond Authority (TSSBA) issued bonds with interest rates ranging from 2% to 5% due serially until 2044 on behalf of East Tennessee State University. The university is responsible for the debt service on these bonds. The current portion of the $140,978,600.69 of bonds outstanding at June 30, 2014, is $5,265,327.10.

The ratings on debt issued by the TSSBA at June 30, 2014, were as follows:

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

More information about the university's long-term liabilities is presented in Note 8 to the financial statements.

Economic Factors That Will Affect the Future

The economic outlook for the State of Tennessee has remained unchanged during fiscal year 2014. In the 2014 fiscal year, the Tennessee Board of Regents approved an increase in fees by an average of 7% for the university. The university plans to invest $1.8 million in programs to promote student retention, progression, and graduation of ETSU students. It is hoped the economy will continue to improve, resulting in increased, or at least level, appropriations for the future.

We are not aware of any other factors, decisions, or conditions that are expected to have a significant impact on the university's financial position or results of operations.

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Statement of Net Position
June 30, 2014

	University	Component Units: East Tennessee State University Foundation	Component Units: Medical Education Assistance Corporation
Assets			
Current assets:			
Cash and cash equivalents (Notes 2 and 20)	$ 9,423,580.58	$ 67,340.09	$ 7,826,728.00
Short-term investments (Note 20)	-	-	7,313,537.00
Accounts, notes, and grants receivable (net) (Note 4)	15,695,420.13	-	3,676,347.00
Due from primary government	156,000.00	-	-
Due from the university	-	-	70,437.00
Due from component units	631,575.23	-	-
Pledges receivable (Note 20)	-	235.15	-
Inventories (at lower of cost or market)	325,825.65	-	-
Prepaid expenses	234,704.04	-	339,184.00
Accrued interest receivable	791,914.98	47,793.14	-
Other assets	9,691.70	-	-
Total current assets	27,268,712.31	115,368.38	19,226,233.00
Noncurrent assets:			
Cash and cash equivalents (Notes 2 and 20)	45,889,258.59	2,967,741.13	-
Investments (Notes 3 and 20)	62,965,740.00	93,183,256.67	3,265,000.00
Accounts, notes, and grants receivable (net) (Note 4)	6,516,487.17	-	-
Pledges receivable (Note 20)	-	634,079.79	-
Capital assets (net) (Notes 5 and 20)	301,205,379.59	206,066.00	4,889,694.00
Other assets	-	316,880.96	2,750.00
Total noncurrent assets	416,576,865.35	97,308,024.55	8,157,444.00
Total assets	443,845,577.66	97,423,392.93	27,383,677.00
Deferred Outflows of Resources			
Deferred amount on debt refunding	374,558.06	-	-
Total deferred outflows of resources	374,558.06	-	-
Liabilities			
Current liabilities:			
Accounts payable (Note 7)	2,313,977.35	69,109.91	547,723.00
Accrued liabilities	7,957,234.09	-	2,623,515.00
Due to the university	-	25,474.23	606,101.00
Due to component units	70,437.00	-	-
Student deposits	513,072.67	-	-
Unearned revenue	15,880,967.64	-	-
Compensated absences (Notes 8 and 20)	3,145,510.63	-	163,328.00
Accrued interest payable	1,128,327.89	-	-
Long-term liabilities, current portion (Notes 8 and 20)	5,265,327.10	-	41,819.00
Deposits held in custody for others	2,654,774.23	-	507,363.00
Other liabilities	-	-	189,084.00
Total current liabilities	38,929,628.60	94,584.14	4,678,933.00
Noncurrent liabilities:			
Net OPEB obligation (Note 11)	12,865,581.48	-	-
Compensated absences (Notes 8 and 20)	8,020,731.16	-	653,312.00
Long-term liabilities (Notes 8 and 20)	143,905,466.68	-	1,405,972.00
Due to grantors (Note 8)	7,586,772.13	-	-
Total noncurrent liabilities	172,378,551.45	-	2,059,284.00
Total liabilities	211,308,180.05	94,584.14	6,738,217.00
Net Position			
Net investment in capital assets	152,409,143.87	206,066.00	3,441,903.00
Restricted for:			
Nonexpendable:			
Scholarships and fellowships	-	42,455,294.82	-
Research	-	609,447.02	-
Instructional department uses	-	5,764,119.84	-
Other	-	5,185,057.67	-
Expendable:			
Scholarships and fellowships	432,427.26	13,897,705.70	-
Research	146,527.21	452,885.21	-
Instructional department uses	161,572.45	4,661,378.00	-
Loans	529,245.70	-	-
Capital projects	-	1,823,900.89	-
Debt service	2,955,806.23	-	-
Other	1,526,632.28	18,331,688.86	-
Unrestricted	74,750,600.67	3,941,264.78	17,203,557.00
Total net position	$ 232,911,955.67	$ 97,328,808.79	$20,645,460.00

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

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2014

		Component Units	
	University	East Tennessee State University Foundation	Medical Education Assistance Corporation
Revenues			
Operating revenues:			
Student tuition and fees (net of scholarship allowances of $38,209,589.06)	$ 99,148,742.89	$ -	$ -
Gifts and contributions	-	2,152,417.61	-
Governmental grants and contracts	27,906,621.75	-	734,260.00
Nongovernmental grants and contracts	8,523,664.51	-	-
Sales and services of educational activities	22,690,930.77	-	-
Sales and services of other activities	8,643,639.23	-	-
Net patient revenues	-	-	36,304,715.00
Auxiliary enterprises:			
Residential life (net of scholarship allowances of $212,457.17; all residential life revenues are used as security for revenue bonds; see Note 9)	14,117,430.38	-	-
Bookstore	320,999.90	-	-
Food service	620,084.44	-	-
Wellness facility	1,427,946.14	-	-
Other auxiliaries	2,093,634.57	-	-
Interest earned on loans to students	224,684.54	-	-
Other operating revenues, foundation revenues including $533,661.00 from MEAC	776,827.60	1,095,950.09	756,480.00
Total operating revenues	186,495,206.72	3,248,367.70	37,795,455.00
Expenses			
Operating expenses (Note 15):			
Salaries and wages	163,166,361.45	-	23,462,889.00
Benefits	61,108,148.93	-	2,282,597.00
Utilities, supplies, and other services	57,135,461.66	2,715,191.09	7,139,502.00
Scholarships and fellowships	25,495,500.74	1,595,367.16	-
Depreciation expense	16,643,710.63	-	601,201.00
Gifts of capital assets to and payments to or on behalf of East Tennessee State University (Note 20)	-	1,044,696.70	-
Total operating expenses	323,549,183.41	5,355,254.95	33,486,189.00
Operating income (loss)	(137,053,976.69)	(2,106,887.25)	4,309,266.00
Nonoperating Revenues (Expenses)			
State appropriations	84,615,448.50	-	-
Gifts, including $903,157.31 from ETSU Foundation and $2,343,954.00 from MEAC	3,442,071.72	-	-
Grants and contracts	49,224,621.19	-	-
Investment income (net of investment expense for the component units of $117,524.00)	1,025,233.59	12,280,932.46	80,591.00
Interest on capital asset-related debt	(6,089,566.06)	-	(89,274.00)
Bond issuance costs	(148,318.02)	-	-
Payments to or on behalf of East Tennessee State University or ETSU Foundation (Note 20)	-	-	(2,877,615.00)
Other nonoperating revenues (expenses) (Note 18)	1,096,362.84	10,517.07	(3,227.00)
Net nonoperating revenues (expenses)	133,165,853.76	12,291,449.53	(2,889,525.00)
Income (loss) before other revenues, expenses, gains, or losses	(3,888,122.93)	10,184,562.28	1,419,741.00
Capital appropriations	3,874,518.53	-	-
Capital grants and gifts, university gifts including $141,539.39 from ETSU Foundation	2,731,426.87	653,319.95	-
Additions to permanent endowments	-	3,711,517.61	-
Total other revenues	6,605,945.40	4,364,837.56	-
Increase in net position	2,717,822.47	14,549,399.84	1,419,741.00
Net position - beginning of year	229,751,173.94	82,779,408.95	19,225,719.00
Prior-period adjustment (Note 16)	442,959.26	-	-
Net position - end of year	$ 232,911,955.67	$ 97,328,808.79	$ 20,645,460.00

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

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Statement of Cash Flows
For the Year Ended June 30, 2014

Cash Flows from Operating Activities	
Tuition and fees	$ 98,786,915.67
Grants and contracts	35,311,092.01
Sales and services of educational activities	23,169,220.09
Sales and services of other activities	8,643,639.23
Payments to suppliers and vendors	(56,257,532.06)
Payments to employees	(162,704,918.47)
Payments for benefits	(60,420,058.83)
Payments for scholarships and fellowships	(25,494,009.67)
Loans issued to students	(1,456,894.25)
Collection of loans from students	1,461,638.67
Interest earned on loans to students	110,887.58
Auxiliary enterprise charges:	
Residence halls	13,989,413.26
Bookstore	333,360.23
Food services	555,304.07
Wellness facility	1,427,946.14
Other auxiliaries	2,118,582.70
Other receipts (payments)	897,211.60
Net cash used by operating activities	(119,528,202.03)
Cash Flows from Noncapital Financing Activities	
State appropriations	84,452,700.00
Gifts and grants received for other than capital or endowment purposes	52,510,692.91
Federal student loan receipts	101,008,877.50
Federal student loan disbursements	(100,176,797.00)
Changes in deposits held for others	69,321.96
Principal paid on noncapital debt	(600,699.93)
Interest paid on noncapital debt	(61,955.09)
Other noncapital financing receipts (payments)	1,338,922.20
Net cash provided by noncapital financing activities	138,541,062.55
Cash Flows from Capital and Related Financing Activities	
Proceeds from capital debt	36,177,323.40
Capital appropriations	3,874,518.53
Capital grants and gifts received	2,589,887.08
Purchases of capital assets and construction	(23,213,829.69)
Principal paid on capital debt	(34,015,747.04)
Interest paid on capital debt	(6,231,708.21)
Bond issue costs paid on new debt issue	(148,318.02)
Net cash used by capital and related financing activities	(20,967,873.95)
Cash Flows from Investing Activities	
Proceeds from sales and maturities of investments	27,002,172.22
Income on investments	1,062,788.78
Purchase of investments	(37,003,063.47)
Net cash used by investing activities	(8,938,102.47)
Net decrease in cash	(10,893,115.90)
Cash - beginning of year	66,205,955.07
Cash - end of year	$ 55,312,839.17

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Statement of Cash Flows (continued)
For the Year Ended June 30, 2014

Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(137,053,976.69)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense		16,643,710.63
Other adjustments		162,748.50
Change in assets and liabilities:		
Receivables, net		(567,757.41)
Inventories		(25,327.28)
Prepaid expenses		89,532.79
Other assets		(113,796.96)
Accounts payable		(421,298.07)
Accrued liabilities		479,945.39
Net OPEB obligation		262,903.20
Unearned revenues		651,036.15
Deposits		(49,482.44)
Compensated absences		288,431.74
Due to grantors		120,384.00
Loans to students		4,744.42
Net cash used by operating activities	$	(119,528,202.03)
Noncash investing, capital, or financing transactions		
Gifts of capital assets	$	141,539.79
Unrealized losses on investments	$	(35,631.25)
Gain on disposal of capital assets	$	707,440.65

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

Note 1. Summary of Significant Accounting Policies

Reporting Entity

The university is a part of the State University and Community College System of Tennessee (Tennessee Board of Regents). This system is a component unit of the State of Tennessee because the state appoints a majority of the system's governing body and provides significant financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

The financial statements present only that portion of the Tennessee Board of Regents' activities that is attributable to the transactions of East Tennessee State University.

The East Tennessee State University Foundation and the Medical Education Assistance Corporation are considered component units of the university. Although the university does not control the timing or amount of receipts from these organizations, the majority of resources, or income thereon, that these organizations hold and invest are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation and the corporation can only be used by, or for the benefit of, the university, these organizations are considered component units of the university and are discretely presented in the university's financial statements. See Note 20 for more detailed information about the component units and how to obtain their reports.

Basis of Presentation

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

The university 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; (3) sales and services of auxiliary enterprises, net of scholarship discounts and allowances; and (4) interest on institutional loans. 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 university's policy to determine whether to use restricted or unrestricted resources first, depending upon existing facts and circumstances.

Inventories

Inventories are valued at the lower of cost or market. Items are maintained on an average cost or first-in, first-out basis.

Compensated Absences

The university's employees accrue annual and sick leave at varying rates, depending upon 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 university's policy is to pay this only if the employee dies or is absent because of illness, injury, or related family death.

Capital Assets

Capital assets, which include property, plant, equipment, library holdings, and intangible assets, are reported in the statement of net 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. The capitalization threshold for art, historical treasures/collections, and similar assets is set at $5,000.

These assets, with the exception of works of art and historical treasures/collections deemed inexhaustible and land, are depreciated/amortized using the straight-line method over the estimated useful lives, which range from 5 to 40 years.

Net Position

The university's net position is classified as follows:

Net investment in capital assets – This represents the university'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 university 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 university and may be used at the university'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 university and the amount that is paid by the student and/or third parties making payments on the student's behalf. Certain governmental grants, such as Pell grants, and other federal, state, or nongovernmental programs are recorded as either operating or nonoperating revenues in the university's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the university has recorded a scholarship discount and allowance.

Note 2. Cash

This classification includes demand deposits and petty cash on hand. At June 30, 2014, cash consists of $1,856,091.01 in bank accounts, $51,000.00 of petty cash on hand, $50,042,345.75 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer, $3,354,702.41 in LGIP deposits for capital projects, and $8,700 held by the State Treasurer for the benefit of the university.

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 university's capital projects are made by the State of Tennessee's Department of Finance and Administration. The university's estimated local share of the cost of each project is held in a separate LGIP account. As expenses are incurred, 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 university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

Note 3. Investments

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

As of June 30, 2014, the university had the following investments and maturities:

		Investment Maturities (In Years)	
Investment Type	Fair Value	Less than 1	1 to 5
U.S. agency obligations	$62,965,740.00	$16,016,980.00	$46,948,760.00

Interest Rate Risk

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

Credit Risk

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

Tennessee Board of Regents policy restricts investments in banker's acceptances and commercial paper. The policy requires that prime banker's acceptances must be issued by domestic banks with a minimum AA rating or foreign banks with a AAA long-term debt rating by a majority of the ratings services that have rated the issuer. Prime banker's acceptances are required to be eligible for purchase by the Federal Reserve System. To be eligible, the original maturity must not be more than 270 days, and it must 1) arise out of the current shipment of goods between countries or with the United States, or 2) arise out of storage within the United States of goods 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.

The 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.

At June 30, 2014, the university's investments were rated as follows:

		Credit Quality Rating	
Investment Type	Fair Value	AA	Unrated
LGIP	$ 53,397,048.16	$ -	$53,397,048.16
U.S. agency obligations	62,965,740.00	62,965,740.00	-
Total	$116,362,788.16	$62,965,740.00	$53,397,048.16

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the university's investment in a single issuer. Tennessee Board of Regents policy restricts investments in banker's acceptances, commercial paper, and money market mutual funds. The policy limits banker's acceptances to not exceed 20% of the total investments on the date of acquisition and limits the combined amount of banker's acceptances and commercial paper to not exceed 35% of the total investments at the date of acquisition. The amount invested in any one bank shall not exceed 5% of total investments on the date of acquisition. Additionally, no more than 5% of total investments at the date of acquisition may be invested in the commercial paper of a single issuer. The policy further limits the total holdings of an issuer's commercial paper to not more than 2% of the issuing corporation's total outstanding commercial paper. Tennessee Board of Regents policy limits investments in money market mutual funds to not exceed 10% of total investments on the date of acquisition.

More than 5% of the university's investments were invested in the following single issuers:

Issuer	Percentage of Total Investments
	June 30, 2014
Federal Home Loan Bank (FHLB) obligations	46%
Federal National Mortgage Association (FNMA) obligations	6%
Federal Home Loan Mortgage Corporation (FHLMC) obligations	37%
Federal Farm Credit Bank (FFCB) obligations	11%

Note 4. Receivables

Receivables at June 30, 2014, included the following:

Student accounts receivable	$ 6,658,960.65
Grants receivable	6,026,365.67
Notes receivable	345,750.76
Clinic receivables	540,486.83
Medical Resident Participation Agreement receivable	3,848,961.72
Other receivables	1,952,319.05
Subtotal	19,372,844.68
Less allowance for doubtful accounts	3,420,411.24
Total	$15,952,433.44

Federal Perkins Loan Program funds at June 30, 2014, included the following:

Perkins loans receivable	$8,370,240.96
Less allowance for doubtful accounts	2,110,767.10
Total	$6,259,473.86

Note 5. Capital Assets

Capital asset activity for the year ended June 30, 2014, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 16,471,470.07	$ 50,250.00	$ -	$ 40,000.00	$ 16,481,720.07
Land improvements and infrastructure	44,684,398.24	-	3,759,217.26	-	48,443,615.50
Buildings	342,219,379.19	1,624,750.00	40,987,539.74	580,499.00	384,251,169.93
Equipment	37,785,763.31	2,793,373.33	-	308,428.69	40,270,707.95
Library holdings	1,666,203.92	44,600.80	-	253,679.28	1,457,125.44
Intangible assets	4,433,400.78	-	-	-	4,433,400.78
Art & historical collections	23,500.00	-	-	-	23,500.00
Projects in progress	29,859,643.01	18,952,495.24	(44,746,757.00)	-	4,065,381.25
Total	477,143,758.52	23,465,469.37	-	1,182,606.97	499,426,620.92
Less accum. depreciation/amortization:					
Land improvements and infrastructure	18,494,314.63	2,284,814.92	-	-	20,779,129.55
Buildings	136,454,219.27	11,010,501.90	-	406,126.11	147,058,595.06
Equipment	23,466,690.77	2,779,856.30	-	280,242.22	25,966,304.85
Library holdings	1,048,274.78	147,715.50	-	253,679.28	942,311.00
Intangible assets	3,054,078.86	420,822.01	-	-	3,474,900.87
Total	182,517,578.31	16,643,710.63	-	940,047.61	198,221,241.33
Capital assets, net	$294,626,180.21	$ 6,821,758.74	$ -	$ 242,559.36	$301,205,379.59

Note 6. Capital Leases

The university has entered into an Enhanced Use Lease Agreement with the United States Department of Veterans Affairs (VA) for certain real property, including land and several buildings, at the Veterans Affairs Medical Center in Johnson City, Tennessee. The lease is for a period of 35 years. In lieu of lease payments, the university has assumed responsibility for all capital and recurring costs of maintaining the property covered by the agreement.

In conjunction with the lease, the university entered into a memorandum of agreement with the Department of Veterans Affairs to construct a building (the Basic Science Building) with joint funding from the State of Tennessee and the federal government. In accordance with the memorandum of agreement, the state provided $18 million to the federal government for its share of the total construction costs ($34,195,153.41). The Basic Science Building is included under the provisions of the Enhanced Use Lease Agreement. The university is renovating several other buildings on the VA campus as funds become available.

The university's leasing of the Basic Science Building and the other buildings on the VA campus will constitute a capital lease agreement. The lease term is substantially equal to the estimated useful life of the leased property. Accordingly, the university has capitalized the cost of the buildings at $62,808,479.51. At June 30, 2014, the buildings are reported at $44,222,351.76, net of accumulated depreciation of $18,586,127.75.

Note 7. Accounts Payable

Accounts payable at June 30, 2014, included the following:

Vendors payable	$1,790,897.13
Unapplied student payments	32,890.57
Other payables	490,189.65
Total accounts payables	$2,313,977.35

Note 8. Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2014, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$118,054,044.53	$27,566,813.74	$4,642,257.58	$140,978,600.69	$5,265,327.10
Unamortized bond premium	5,112,453.61	2,602,008.93	353,554.77	7,360,907.77	-
Commercial paper	24,832,504.18	5,141,685.21	29,974,189.39	-	-
Revolving credit facility	-	831,285.32	-	831,285.32	-
Subtotal	147,999,002.32	36,141,793.20	34,970,001.74	149,170,793.78	5,265,327.10
Other liabilities:					
Compensated absences	10,877,810.05	6,691,872.16	6,403,440.42	11,166,241.79	3,145,510.63
Due to grantors	7,466,388.13	120,384.00	-	7,586,772.13	-
Subtotal	18,344,198.18	6,812,256.16	6,403,440.42	18,753,013.92	3,145,510.63
Total long-term liabilities	$166,343,200.50	$42,954,049.36	$41,373,442.16	$167,923,807.70	$8,410,837.73

TSSBA Debt – Bonds

Bonds, with interest rates ranging from 2% to 5%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2044 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations; see Note 9 for further details. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net position is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $4,228,545.00 at June 30, 2014.

Debt service requirements to maturity for the university's portion of TSSBA bonds at June 30, 2014, are as follows:

Year Ending June 30	Principal	Interest	Total
2015	$ 5,265,327.10	$ 6,763,168.98	$ 12,028,496.08
2016	5,233,638.60	6,550,828.86	11,784,467.46
2017	5,478,023.93	6,314,926.80	11,792,950.73
2018	5,727,748.94	6,085,487.50	11,813,236.44
2019	5,983,478.28	5,826,539.47	11,810,017.75
2020-2024	32,363,848.58	24,635,366.90	56,999,215.48
2025-2029	28,969,677.02	16,935,639.25	45,905,316.27
2030-2034	24,395,587.90	10,332,675.70	34,728,263.60
2035-2039	18,920,180.97	4,847,230.71	23,767,411.68
2040-2044	8,641,089.37	982,232.45	9,623,321.82
Total	$140,978,600.69	$89,274,096.62	$230,252,697.31

TSSBA Debt – Revolving Credit Facility

The Tennessee State School Bond Authority (TSSBA) receives loans from the revolving credit facility to finance the costs of various capital projects during the construction phase. When projects are placed in service, TSSBA issues long-term, fixed-rate debt to finance the project over its useful payback period and repays the revolving credit facility debt. The amount issued for projects at the university was $831,285.32 at June 30, 2014.

Prior to March 20, 2014, TSSBA issued short-term debt in the form of commercial paper. Since March 20, 2014, TSSBA has used the revolving credit facility.

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

Note 9. Pledged Revenues

The university has pledged certain revenues and fees, including state appropriations, to repay $140,978,600.69 in revenue bonds issued from June 2005 to November 2013 (see Note 8 for further detail). Proceeds from the bonds provided financing for construction and renovation projects. The bonds are payable through 2044. Annual principal and interest payments on the bonds are expected to require 3.83% of available revenues. The total principal and interest remaining to be paid on the bonds is $230,252,697.31. Principal and interest paid for the current year and total available revenues were $10,716,882.94 and $279,737,501.15, respectively.

Note 10. Pension Plans

<u>Defined Benefit Plan</u>

Tennessee Consolidated Retirement System

<u>Plan Description</u> – The State of Tennessee provides a pension plan that covers state and higher education employees. That plan is a part of the Public Employee Retirement Plan, an agent 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 the Public Employee Retirement Plan. That report is available on the state's website at www.treasury.tn.gov/tcrs.

<u>Funding Policy</u> – Plan members are noncontributory. The university is required to contribute at an actuarially determined rate. The current rate is 15.03% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees.

<u>Annual Pension Cost</u> – For the year ending June 30, 2014, the university's contributions equaled the annual pension cost of $8,383,209.85.

Trend Information

Year Ended	Annual Pension Cost (APC)	Percentage of APC Contributed	Net Pension Obligation
June 30, 2014	$8,383,209.85	100%	$0
June 30, 2013	$8,044,873.15	100%	$0
June 30, 2012	$7,674,153.32	100%	$0

Additional Information – Information about the funded status of the plan as of the most recent valuation date, information about the actuarial methods and assumptions used in the valuations, and required supplementary information is available in the *Tennessee Comprehensive Annual Financial Report*. A copy of that report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Defined Contribution Plans

Optional Retirement Plans

Plan Description – The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund, 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 university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contributions made by the university to the plans were $8,678,947.84 for the year ended June 30, 2014, and $8,357,420.17 for the year ended June 30, 2013. Contributions met the requirements for each year.

Note 11. Other Postemployment Benefits

Healthcare is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program which provides postemployment health insurance benefits to eligible university retirees. This program includes two plans available to higher education employees—the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Section 8-27-101, *Tennessee Code Annotated*, for the State Employee Group Plan and Section 8-27-701, *Tennessee Code Annotated*, for the Medicare Supplement Plan. 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 university's eligible retirees; see Note 19. 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 East Tennessee State University. The state is the sole contributor for the university 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. 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.

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

Annual Required Contribution (ARC)	$ 2,815,000.00
Interest on the net OPEB obligation	504,107.13
Adjustment to the ARC	(491,121.87)
Annual OPEB cost	2,827,985.26
Amount of contribution	(2,565,082.06)
Increase in net OPEB obligation	262,903.20
Net OPEB obligation – beginning of year	12,602,678.28
Net OPEB obligation – end of year	$12,865,581.48

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2014	State Employee Group Plan	$2,827,985.26	90.7%	$12,865,581.48
June 30, 2013	State Employee Group Plan	$3,454,205.84	74.1%	$12,602,678.28

June 30, 2012	State Employee Group Plan	$3,421,884.15	80.1%	$11,708,566.60

Funded Status and Funding Progress

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

Actuarial valuation date	July 1, 2013
Actuarial accrued liability (AAL)	$22,189,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$22,189,000.00
Actuarial value of assets as a percentage of the AAL	0%
Covered payroll (active plan members)	$108,619,569.26
UAAL as percentage of covered payroll	20.4%

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, 2013, 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 healthcare cost trend rate of 7.5% initially. The rate decreased to 7% in fiscal year 2015 and then reduces by decrements to an ultimate rate of 4.19% in fiscal year 2044. All rates include a 2.5% inflation assumption. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007. Payroll is assumed to grow at a rate of 3%.

Note 12. Chairs of Excellence

The university had $26,441,983.39 on deposit at June 30, 2014, with the State Treasurer for its Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

Note 13. Insurance-related Activities

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

The university participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the year ended June 30, 2014, 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 university participates in the Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq. Claims are paid through the state's Risk Management Fund. At June 30, 2014, the Risk Management Fund held $116.3 million in cash designated for payment of claims.

At June 30, 2014, the scheduled coverage for the university was $874,842,700 for buildings and $174,801,400 for contents.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state, with the risk retained by the state. The university participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on estimates of the ultimate cost of claims, including the costs of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

Note 14. Commitments and Contingencies

Sick Leave

The university records the cost of sick leave when paid. The dollar amount of unused sick leave was $56,678,527.30 at June 30, 2014.

Operating Leases

The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $539,320.88 for the year ended June 30, 2014. All operating leases are cancelable at the lessee's option.

Construction in Progress

At June 30, 2014, outstanding commitments under construction contracts totaled $5,031,977.27 for roof replacements, exterior upgrades at the College of Medicine, athletic facilities improvements, housing renovations, and various other projects, of which $2,862,794.24 will be funded by future state capital outlay appropriations.

Litigation

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

Note 15. Natural Classification With Functional Classifications

The university's operating expenses for the year ended June 30, 2014, are as follows:

Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
			Natural Classification			
Instruction	$ 97,523,642.31	$33,801,911.48	$16,042,690.03	$ 1,063,187.95	$ -	$148,431,431.77
Research	4,801,609.89	1,437,219.98	3,476,831.26	6,878.06	-	9,722,539.19
Public service	11,983,803.24	4,607,284.78	5,285,025.13	67,477.94	-	21,943,591.09
Academic support	16,142,201.88	6,769,473.46	4,060,860.65	168,098.14	-	27,140,634.13
Student services	11,113,376.01	4,822,850.72	5,836,747.17	1,614,034.77	-	23,387,008.67
Institutional support	13,563,342.72	5,533,167.07	1,694,922.45	86,190.57	-	20,877,622.81
Operation & maintenance of plant	6,096,373.19	3,398,049.94	12,032,911.09	-	-	21,527,334.22
Scholarships & fellowships	-	-	701,821.58	22,361,330.96	-	23,063,152.54
Auxiliary	1,942,012.21	738,191.50	8,003,652.30	128,302.35	-	10,812,158.36
Depreciation	-	-	-	-	16,643,710.63	16,643,710.63
Total	$163,166,361.45	$61,108,148.93	$57,135,461.66	$25,495,500.74	$16,643,710.63	$323,549,183.41

Note 16. Prior-period Adjustment

During the year ended June 30, 2014, the university performed additional analysis and identified an error in previously issued financial statements. A capital lease, as described in Note 20 for component unit MEAC (the Medical Education Assistance Corporation) had previously been reported as a prepaid operating lease for MEAC and as a capital asset and unearned revenue for the university. As a result, total beginning net position for the university had been overstated by $61,995.48. Additionally, it was determined that the university had not been notified of invoices for four capital projects and related state appropriations for two of those projects. Total net position was understated by $504,954.74. The net result of the two prior-period adjustments is an increase in net position of $442,959.26. The June 30, 2013, statement of net position was restated as follows:

	Original	Adjustment	Restated
Assets:			
Current assets	$ 37,767,281.16	$ -	$ 37,767,281.16
Capital assets, net	295,833,353.89	(1,207,173.68)	294,626,180.21
Other assets	105,144,192.20	-	105,144,192.20
Total assets	438,744,827.25	(1,207,173.68)	437,537,653.57
Deferred outflows of resources:			
Deferred amount on bond refunding	410,088.26	-	410,088.26
Total deferred outflows	410,088.26	-	410,088.26
Liabilities:			
Current liabilities	35,722,600.44	777,227.75	36,499,828.19
Noncurrent liabilities	173,681,141.13	(2,427,360.69)	171,253,780.44
Total liabilities	209,403,741.57	(1,650,132.94)	207,753,608.63

Net position:			
Net investment in capital assets	148,244,439.83	(1,207,173.68)	147,037,266.15
Restricted nonexpendable	-	-	-
Restricted expendable	6,798,986.89	-	6,798,986.89
Unrestricted	74,707,747.22	1,650,132.94	76,357,880.16
Total net position	$229,751,173.94	$ 442,959.26	$230,194,133.20

Note 17. Affiliated Entity Not Included

The East Tennessee State University Research Foundation is a private, nonprofit foundation with the university as the sole beneficiary. The Research Foundation is controlled by a board independent of the university. The financial records, investments, and other financial transactions are handled external to the university, and these amounts are not included in the university's financial report. As reported in the foundation's most recently audited financial report, at June 30, 2014, the assets of the foundation totaled $1,858,836.00, liabilities were $9,360.00, and the net position amounted to $1,849,476.00.

Note 18. Insurance Recoveries

The university sustained damage to various buildings on campus and some of the equipment they contained due to several unrelated events, a water line break, a sewer line break, and two instances of water lines freezing and breaking. The impairment of all assets involved was temporary and no impairment loss was recognized. An insurance recovery for the capital damage in the amount of $388,922.20 was received in fiscal year 2014. The insurance recovery is classified as other nonoperating revenue in the statement of revenues, expenses, and changes in net position.

Note 19. On-behalf Payments

During the year ended June 30, 2014, the State of Tennessee made payments of $162,748.50 on behalf of the university for retirees participating in the Medicare Supplement Plan. The Medicare Supplement Plan is a postemployment benefit healthcare plan and is discussed further in Note 11. 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 20. Component Units

EAST TENNESSEE STATE UNIVERSITY FOUNDATION

The East Tennessee State University Foundation is a legally separate, tax-exempt organization supporting East Tennessee State University. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The 30-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2014, the foundation made distributions of $1,044,696.70 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Dr. David D. Collins, Vice President for Finance and Administration, P.O. Box 70601, Johnson City, TN 37614.

Cash and Cash Equivalents

In addition to demand deposits and petty cash on hand, this classification includes instruments that are readily convertible to known amounts of cash and that have original maturities of three months or less. At June 30, 2014, cash and cash equivalents consists of $99,541.22 in bank accounts, $2,682,046.00 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $253,494.00 in cash held by others.

The Local Government Investment Pool is part of the State Pooled Investment Fund. The fund's required risks disclosures are presented in the *State of Tennessee's Treasurer's Report.* That report is available on the state's website at www.treasury.tn.gov.

Investments

The foundation is authorized to invest funds in accordance with its board of directors' policies. All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase.

At June 30, 2014, the foundation had the following investments and maturities:

		Investment Maturities (in Years)				
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10	Unknown
Corporate bonds	$ 4,898,434.00	$1,060,405.00	$3,838,029.00	$ -	$ -	$ -
Bond mutual funds	18,306,270.00	950,156.00	6,715,630.00	3,271,526.00	7,368,958.00	-
Equity mutual funds	67,492,224.67					
Certificates of deposit	2,486,328.00					
Total	$93,183,256.67					

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt investment. In order to reduce the exposure to interest rate risk, the foundation will set limits regarding the weighted average maturity for each direct investment pool. In the case of federal securities, the weighted average of all investments should be less than three years.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Securities are rated using Standard and Poor's, Moody's Investor Service, and/or Fitch Ratings and are presented below using the Standard and Poor's rating scale. The foundation's policy is to limit all direct investments to securities with an investment rating of no less than A as rated by Moody's and A as rated by Standard and Poor's.

At June 30, 2014, the foundation's investments were rated as follows:

		Credit Quality Rating				
Investment Type	Fair Value	AAA	AA	A	BBB or Less	Unrated
LGIP	$ 2,682,046.00	$ -	$ -	$ -	$ -	$2,682,046.00
Corporate bonds	4,898,434.00	-	2,547,186.00	2,351,248.00	-	-
Bond mutual funds	18,306,270.00	9,861,974.00	2,386,963.00	2,740,101.00	3,317,232.00	-
Total	$25,886,750.00	$9,861,974.00	$4,934,149.00	$5,091,349.00	$3,317,232.00	$2,682,046.00

Investments of endowment and similar funds are composed of the following:

	June 30, 2014
Mutual funds	$68,496,641.00
Corporate bonds	4,898,434.00
Cash held by others	253,494.00
Certificates of deposit	239,621.00
Total	$73,888,190.00

Assets of endowment funds are pooled on a fair value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of the calendar quarter within which the transaction takes place. Of the total units at June 30, 2014, each having a fair value of $1.1300189213, 61,512,419.59 units were owned by endowments, and 234,507.85 units were owned by quasi-endowments.

The following tabulation summarizes changes in relationships between cost and fair values of the pooled assets for the year ended June 30, 2014:

	Pooled Assets			Fair
			Net Gains	Value
	Fair Value	Cost	(Losses)	Per Unit
End of year	$93,183,256.67	$82,384,910.76	$10,798,345.91	$1.1300189213
Beginning of year	$78,425,369.07	$75,872,206.94	2,553,162.13	$1.1400842819
Unrealized net gains			8,245,183.78	
Realized net gains			2,187,349.00	
Total net gains			$10,432,532.78	

The average annual earnings per unit, exclusive of net gains, were $0.024 for the year ended June 30, 2014.

Pledges Receivable

Pledges receivable at June 30, 2014, are summarized below, net of the allowance for doubtful accounts:

Current pledges	$296,049.00
Pledges due in one to five years	347,974.00
Pledges due after five years	1,410.00
Subtotal	645,433.00
Less discounts to net present value	11,118.06
Total pledges receivable, net	$634,314.94

Capital Assets

Capital asset activity for the year ended June 30, 2014, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land	$ -	$196,580.00	$ -	$196,580.00
Buildings	59,000.00	-	-	59,000.00
Equipment	9,486.00	-	-	9,486.00
Total	68,486.00	196,580.00	-	256,066.00
Less accumulated depreciation:				
Buildings	59,000.00	-	-	59,000.00
Capital assets, net	$ 9,486.00	$196,580.00	$ -	$206,066.00

Endowments

The ETSU Foundation's endowment consists of 504 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the board of directors to function as endowments. As required by GAAP, net position associated with endowment funds, including funds designated by the board of directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of relevant law – The Board of Directors of the ETSU Foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (the Act) as adopted by Tennessee as requiring preservation of the historical dollar value of the original gift. As a result of this interpretation, the ETSU Foundation classifies as nonexpendable restricted net position (a) the original value of gifts donated to the nonexpendable endowment, (b) the original value of subsequent gifts to the nonexpendable endowment, and (c) accumulations to the nonexpendable 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 nonexpendable restricted net position is classified as expendable restricted net position until those amounts are appropriated for expenditure by the foundation in a manner consistent with the standard of prudence prescribed by the Act. In accordance with the Act, the foundation considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

1. the duration and preservation of the fund,
2. the purposes of the foundation and the endowment fund,
3. general economic conditions,
4. the possible effect of inflation or deflation,
5. the expected total return from income and the appreciation of investments,
6. other resources of the foundation, and
7. the investment policies of the foundation.

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, as well as board-designated funds. Under this policy, as approved by the board of directors, the endowment assets are invested in a manner that is intended to produce results that, over the long term, will achieve a total return equivalent to or greater than the foundation's financial requirements over the time horizon. The foundation expects its endowment funds, over time, to provide an average rate of return of approximately 7% annually. Actual returns in any given year may vary from this amount.

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

Spending policy and how the investment objectives relate – The foundation has a policy of appropriating for distribution each year 2% to 4% of the average quarterly balance for the three preceding calendar years, depending on the amount of reserve for each endowment. In establishing this policy, the foundation considered the long-term expected return on its endowment. Accordingly, over the long term, the foundation expects the current spending policy to allow its endowment to grow at an average of 3% annually. This is consistent with the foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term, as well as to provide additional real growth through new gifts and investment return.

At June 30, 2014, net appreciation of $13,921,948.01 is available to be spent, of which $6,334,069.14 is included in restricted net position expendable for scholarships and fellowships, $95,337.40 is included in restricted net position expendable for research, $806,951.66 is included in restricted net position expendable for instructional departmental uses, and $6,685,589.81 is included in restricted net position expendable for other purposes.

Prior-period Adjustment

In prior years, if endowment net appreciation at June 30 exceeded 20% of the permanent fund balance, such funds were added to permanent fund balance as appreciation and included in restricted nonexpendable net position on the statement of net position. It was determined that the net appreciation should be included in restricted expendable net position. As a result of this error, net position has been restated as of June 30, 2013:

	Original	Adjustment	Restated
Restricted for nonexpendable:			
Scholarships and fellowships	$40,200,430.32	$(2,894,768.97)	$37,305,661.35
Research	606,342.14	(57,168.00)	549,174.14
Instructional departmental uses	5,526,163.39	(466,292.63)	5,059,870.76
Other	4,931,657.87	(201,430.92)	4,730,226.95
Expendable:			
Scholarships and fellowships	9,364,691.44	2,894,768.98	12,259,460.42
Research	446,746.59	57,168.00	503,914.59
Instructional departmental uses	3,886,260.62	466,292.63	4,352,553.25
Other	15,221,656.36	201,430.91	15,423,087.27

MEDICAL EDUCATION ASSISTANCE CORPORATION

The Medical Education Assistance Corporation (MEAC) is a legally separate, tax-exempt organization supporting East Tennessee State University. MEAC acts primarily as a physicians' practice group to supplement the resources that are available to the university in support of its medical education programs. The 15-member board of MEAC is self-perpetuating and consists of the department chairs from Quillen College of Medicine, a representative from East Tennessee State University's Office of the President, a representative from the Tennessee Board of Regents, and at-large faculty from the Quillen College of Medicine. Although the university does not control the timing or amount of receipts from MEAC, the residual income that MEAC earns is restricted to supporting medical education. Because these restricted resources held by MEAC can only be used by, or for the benefit of, the university, MEAC is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2014, MEAC made distributions of $2,877,615 to or on behalf of ETSU or the ETSU Foundation for both restricted and unrestricted purposes. Complete financial statements for MEAC can be obtained from Russell Lewis, Executive Director, P.O. Box 699, Mountain Home, TN 37684.

Cash

At June 30, 2014, cash consisted of $7,739,520 in bank accounts, $2,400 of petty cash on hand, and $84,808 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer.

The Local Government Investment Pool is part of the State Pooled Investment Fund. The fund's required risks disclosures are presented in the *State of Tennessee's Treasurer's Report.* That report is available on the state's website at www.treasury.tn.gov.

Investments

The corporation is authorized to invest funds in accordance with its board of directors' policies. The corporation's investments at June 30, 2014, consisted of certificates of deposit with original maturities greater than three months.

<u>Credit Risk</u> – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. MEAC has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations. At June 30, 2014, MEAC had no rated investments, as deposits in LGIP are unrated.

Receivables

Receivables at June 30, 2014, included the following:

Patient accounts receivable, net	$2,567,397
Other receivables	1,108,950
Total	$3,676,347

Capital Assets

Capital asset activity for the year ended June 30, 2014, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land	$ 18,150	$ -	$ -	$ 18,150
Buildings	4,902,488	-	-	4,902,488
Leasehold improvements	652,043	27,366	-	679,409
Equipment	4,290,299	159,840	147,523	4,302,616
Total	9,862,980	187,206	147,523	9,902,663
Less accumulated depreciation:				
Buildings	732,492	150,351	-	882,843
Leasehold improvements	447,397	62,263	-	509,660
Equipment	3,372,775	388,587	140,896	3,620,466
Total accumulated depreciation	4,552,664	601,201	140,896	5,012,969
Capital assets, net	$5,310,316	($413,995)	$ (6,627)	$4,889,694

Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2014, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Note payable	$1,488,778	$ -	$40,987	$1,447,791	$ 41,819
Compensated absences	768,328	48,312	-	816,640	163,328
Total long-term liabilities	$2,257,106	$48,312	$40,987	$2,264,431	$205,147

Notes Payable

MEAC has an obligation with Bank of Tennessee collateralized by 4 Sheridan Square, Unit 2, Kingsport, TN 37660. The note bears interest at 5.99% and calls for monthly principal and interest installments of $10,855, with a balloon payment at maturity on January 28, 2016.

Debt service requirements associated with the note payable are as follows:

Year Ending June 30	Principal	Interest	Total
2015	$ 41,819	$ 88,440	$ 130,259
2016	1,405,972	46,997	1,452,969
Total	$1,447,791	$135,437	$1,583,228

Capital Lease Between MEAC and the University

In 2008, MEAC entered into an agreement to lease a clinical education building from the university for 30 years at a rate equivalent to the cost of construction of the building, which was $2,942,255. The entire lease obligation was paid in 2009 upon the completion of construction. The agreement is currently being treated as a capital lease. Because there is no remaining obligation, no capital lease obligation has been reported by MEAC and no capital lease receivable has been reported by the university.

In prior years, MEAC had reported the lease as a prepaid operating lease. MEAC's June 30, 2013, statement of net position was restated as follows to correctly report the lease agreement as a capital lease:

	Original	Adjustment	Restated
Assets:			
Current assets	$15,925,404	$ (98,075)	$15,827,329
Capital assets, net	2,784,881	2,525,435	5,310,316
Other assets	6,535,671	(2,427,360)	4,108,311
Total assets	25,245,956	-	25,245,956
Liabilities:			
Current liabilities	3,956,005	-	3,956,005
Noncurrent liabilities	2,064,232	-	2,064,232
Total liabilities	6,020,237	-	6,020,237
Net position:			
Net investment in capital assets	1,296,103	2,525,435	3,821,538
Unrestricted	17,929,616	(2,525,435)	15,404,181
Total net position	$19,225,719	$ -	$19,225,719

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
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, 2013	State Employee Group Plan	$ -	$22,189,000.00	$22,189,000.00	0%	$108,619,569.00	20.43%
July 1, 2011	State Employee Group Plan	$ -	$28,137,000.00	$28,137,000.00	0%	$100,388,162.00	28.03%
July 1, 2010	State Employee Group Plan	$ -	$39,835,000.00	$39,835,000.00	0%	$97,197,256.00	40.98%

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

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Supplementary Schedule of Cash Flows - East Tennessee State University Foundation
For the Year Ended June 30, 2014

Cash Flows from Operating Activities	
Gifts and contributions	$ 1,945,454.65
Payments to suppliers and vendors	(2,510,026.42)
Payments for scholarships and fellowships	(1,838,737.65)
Payments to or on behalf of ETSU	(932,442.70)
Other receipts (payments)	1,095,950.09
Net cash used by operating activities	(2,239,802.03)
Cash Flows from Noncapital Financing Activities	
Private gifts for endowment purposes	3,711,517.61
Net cash provided by noncapital financing activities	3,711,517.61
Cash Flows from Capital and Related Financing Activities	
Capital grants and gifts received	456,739.95
Net cash provided by capital and related financing activities	456,739.95
Cash Flows from Investing Activities	
Proceeds from sales and maturities of investments	41,541,009.90
Income on investments	4,088,989.25
Purchases of investments	(48,117,075.09)
Net cash used by investing activities	(2,487,075.94)
Net decrease in cash and cash equivalents	(558,620.41)
Cash and cash equivalents - beginning of year	3,593,701.63
Cash and cash equivalents - end of year	$ 3,035,081.22

Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	$ (2,106,887.25)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Change in assets and liabilities:	
Receivables	179,495.22
Accounts payable	(312,410.00)
Net cash used by operating activities	$ (2,239,802.03)
Noncash investing, capital, or financing transactions	
Unrealized gains on investments	$ 8,245,183.78
Transfers of capital assets to the university	$ (141,539.79)

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Supplementary Schedule of Cash Flows - Medical Education Assistance Corporation
For the Year Ended June 30, 2014

Cash Flows from Operating Activities	
Collections from patient charges	$ 36,435,107.00
Grants and contracts	734,260.00
Payments to employees	(23,309,404.00)
Payments for benefits	(2,282,597.00)
Payments to suppliers and vendors	(7,032,623.00)
Other receipts (payments)	1,348,105.00
Net cash provided by operating activities	5,892,848.00
Cash Flows from Noncapital Financing Activities	
Payments to or on behalf of ETSU or ETSU Foundation	(2,877,615.00)
Net cash used by noncapital financing activities	(2,877,615.00)
Cash Flows from Capital and Related Financing Activities	
Purchases of capital assets and construction	(187,206.00)
Principal paid on note payable	(40,987.00)
Interest paid on note payable	(89,274.00)
Net cash used by capital and related financing activities	(317,467.00)
Cash Flows from Investing Activities	
Proceeds from sales and maturities of investments	6,324,313.00
Income on investments	80,591.00
Purchases of investments	(6,470,226.00)
Other investing receipts (payments)	3,400.00
Net cash used by investing activities	(61,922.00)
Net increase in cash	2,635,844.00
Cash - beginning of year	5,190,884.00
Cash - end of year	$ 7,826,728.00

Reconciliation of operating gain to net cash provided by operating activities:	
Operating gain	$ 4,309,266.00
Adjustments to reconcile operating gain to net cash provided by operating activities:	
Depreciation expense	601,201.00
Changes in assets and liabilities:	
Receivables	358,234.00
Prepaid items	(64,383.00)
Accounts payable	101,682.00
Accrued liabilities	174,755.00
Due to the university	311,312.00
Compensated absences	48,311.00
Deposits	52,470.00
Net cash provided by operating activities	$ 5,892,848.00

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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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. Brian Noland, President

We have audited the financial statements of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component units as of and for the year ended June 30, 2014, and the related notes to the financial statements, which collectively comprise the university's basic financial statements, and have issued our report thereon dated December 4, 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. Our report includes a reference to other auditors who audited the financial statements of the East Tennessee State University Foundation and the Medical Education Assistance Corporation, as described in our report on East Tennessee State University's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the university'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 university's internal control. Accordingly, we do not express an opinion on the effectiveness of the university'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 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. Given these limitations, during our audit we did not identify any deficiencies that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the university'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*.

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
December 4, 2014