

**Tennessee Board of Regents
The State University and Community College
System of Tennessee—Central Office
For the Years Ended
June 30, 1997, and June 30, 1996**

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July 2, 1998

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Charles E. Smith, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, Tennessee 37217

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the State University and Community College System of Tennessee—Central Office for the years ended June 30, 1997, and June 30, 1996. You will note from the independent auditor's report that a qualified opinion was given on the fairness of the presentation of the financial statements. The Central Office has elected not to record the liability for accrued compensated absences in its financial statements. In our opinion, accrued compensated absences should be recorded to conform with generally accepted accounting principles.

Consideration of internal control over financial reporting and tests of compliance disclosed a deficiency, which is detailed in the Results of the Audit section of this report. The Central Office's administration has responded to the audit finding; the response is included following the finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit finding.

Very truly yours,

W. R. Snodgrass
Comptroller of the Treasury

WRS/ws
98/048

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit
**The State University and Community College
System of Tennessee—Central Office**
For the Years Ended June 30, 1997, and June 30, 1996

AUDIT OBJECTIVES

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

COMPLIANCE FINDING

The Central Office Has Not Included an Evaluation of Its Internal Control in Applicable Financial Integrity Act Reports

The Tennessee Board of Regents Central Office prepares a Financial Integrity Act Report annually, which consists of a compilation of the Financial Integrity Act Reports it receives from Tennessee Board of Regents institutions. The Central Office did not include an evaluation of its own internal control in the Financial Integrity Act Report filed for 1997 (page).

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is qualified because of the omission of the liability for accrued compensated absences from the financial statements.

Audit Report
Tennessee Board of Regents
The State University and Community College
System of Tennessee—Central Office
For the Years Ended June 30, 1997, and June 30, 1996

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Tennessee Board of Regents
The State University and Community College
System of Tennessee—Central Office
For the Years Ended June 30, 1997, and June 30, 1996

INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

The State University and Community College System of Tennessee was created by the General Assembly in 1972. The system now includes six universities, 12 community colleges, two technical institutes, and 26 technology centers. The Tennessee Board of Regents is vested with the responsibility of governing the system. The Central Office provides essential centralized services and uniform procedures for the institutions in the system.

Among the Central Office’s major responsibilities are prescribing curricula and requirements for diplomas, approving operating and capital budgets, and establishing policies and procedures regarding campus life.

Effective October 1983, the Job Training Partnership Act (JTPA) replaced the Comprehensive Employment and Training Act (CETA) and redirected significant management and policy responsibilities from Washington to the governors of each state. In Tennessee, the Governor designated the State University and Community College System of Tennessee as the state education agency and recommended that the system’s two-year institutions be selected as the administrative entities by the local elected officials and private industry councils in each Job Skills Training District. Community colleges were subsequently selected in seven of the 14 districts to administer the programs funded by the act. The system’s Office of Job Training Programs manages the JTPA program and provides technical assistance to the seven

administrative entities: Walters State, Roane State, Cleveland State, Motlow State, Columbia State, Jackson State, and Dyersburg State Community Colleges.

ORGANIZATION

The governance of the State University and Community College System of Tennessee is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The chief administrative officer of the system is the chancellor.

AUDIT SCOPE

The audit was limited to the period July 1, 1995, through June 30, 1997, and was conducted in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the years ended June 30, 1997, and June 30, 1996. The State University and Community College System of Tennessee is part of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the Central Office's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grants;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Central Office filed its report with the Department of Audit on June 26, 1997. A follow-up of the prior audit finding was conducted as part of the current audit. The follow-up disclosed that the Central Office has corrected the previous audit finding concerning internal control deficiencies in the Office of Fiscal Services.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Central Office's financial statements for the years ended June 30, 1997, and June 30, 1996, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported herein under *Government Auditing Standards*. An immaterial instance of noncompliance, along with the recommendation and management's response, is included in the finding and recommendation.

Fairness of Financial Statement Presentation

The Central Office has elected not to accrue the liability for compensated absences. Since this accounting practice is contrary to generally accepted accounting principles, the Division of State Audit has rendered a qualified opinion on the Central Office's financial statements.

**Report on Compliance and on Internal Control
Over Financial Reporting Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

March 13, 1998

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the financial statements of the State University and Community College System of Tennessee—Central Office, which is a part of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the years ended June 30, 1997, and June 30, 1996, and have issued our report thereon dated March 13, 1998. Our report was qualified because the college omitted the liability for accrued compensated absences from the balance sheets. We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

As part of obtaining reasonable assurance about whether the Central Office financial statements are free of material misstatement, we performed tests of the Central Office compliance with certain provisions of laws, regulations, contracts, and grants, 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

The Honorable W. R. Snodgrass
March 13, 1998
Page Two

instances of noncompliance that are required to be reported herein under *Government Auditing Standards*.

We did, however, note an immaterial instance of noncompliance that we have included in the Finding and Recommendation section of this report. We also noted certain other, less significant, instances of noncompliance that we have reported to the Central Office's management in a separate letter.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Central Office's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting that we consider to be material weaknesses.

However, we noted certain matters involving the internal control over financial reporting that we have reported to the Central Office's management in a separate letter.

This report is intended for the information of the General Assembly of the State of Tennessee and management. However, this report is a matter of public record, and its distribution is not limited.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/ws

FINDING AND RECOMMENDATION

The Central Office has not included an evaluation of its internal control in applicable Financial Integrity Act Reports

Finding

The Tennessee Board of Regents Central Office did not include an evaluation of its internal control in the Financial Integrity Act Report filed for 1997. Section 9-18-104, *Tennessee Code Annotated*, stipulates:

By December 31 of each year, the head of each executive agency shall...prepare and transmit to the commissioner of finance and administration and the comptroller of the treasury a report which states that:

- (1) The agency's systems of internal accounting and administrative control fully comply with the requirements specified in this chapter;
- or
- (2) The agency's systems of internal accounting and administrative control do not fully comply with such requirements.

The Tennessee Board of Regents Central Office prepares a Financial Integrity Act Report annually, which consists of a compilation of the Financial Integrity Act Reports it receives from Tennessee Board of Regents institutions. Each year, an area of emphasis is selected for the reports. In 1996, the area of emphasis selected for the Tennessee Board of Regents Financial Integrity Act Reports was the student accounts receivables process. This area of emphasis did not apply to the Central Office because it does not process student receivables. However, the area of emphasis evaluated in the 1997 Financial Integrity Act Report for the Tennessee Board of Regents, the travel process, pertained to the Central Office. Therefore, the Central Office's internal controls over the travel process should have been evaluated and included in the report.

Recommendation

The Financial Integrity Act Coordinator should ensure that the internal controls of the Central Office are evaluated and documented when applicable areas of emphasis are examined in the Financial Integrity Act Report. The results of this evaluation should be included in the Financial Integrity Act Report along with the results from Tennessee Board of Regents institutions.

Management's Comment

Independent Auditor's Report

March 13, 1998

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the State University and Community College System of Tennessee—Central Office, which is a part of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of June 30, 1997, and June 30, 1996, and the related statements of changes in fund balances and current funds revenues, expenditures, and other changes for the years then ended. These financial statements are the responsibility of the Central Office's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with generally accepted auditing standards 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described in Note 2 to the financial statements, the Central Office has omitted the liability for accrued compensated absences from the accompanying balance sheets which should be included to conform with generally accepted accounting principles.

The Honorable W. R. Snodgrass
March 13, 1998
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In our opinion, except for the effects of not including the liability for accrued compensated absences in the accompanying balance sheets, as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of the State University and Community College System of Tennessee—Central Office, as of June 30, 1997, and June 30, 1996, and the changes in fund balances and the current funds revenues, expenditures, and other changes for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated March 13, 1998, on our consideration of the Central Office's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Sincerely,

Arthur A. Hayes, Jr., CPA, Director
Division of State Audit

AAH/ws

TENNESSEE BOARD OF REGENTS
THE STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
BALANCE SHEETS
JUNE 30, 1997, AND JUNE 30, 1996

ASSETS	June 30, 1997	June 30, 1996	LIABILITIES AND FUND BALANCES	June 30, 1997	June 30, 1996
Current funds:			Current funds:		
Unrestricted:			Unrestricted:		
General:			General:		
Cash (Note 3)	\$ 484,213.38	\$ 577,683.41	Liabilities:		
Accounts receivable	322,065.02	30,624.65	Accounts payable	\$ 2,559.46	\$ 3,016.21
Inventories	-	9,434.58	Accrued liabilities	7,276.00	14,615.99
Prepaid expenses	1,317.41	2,989.17	Total liabilities	9,835.46	17,632.20
Other assets	600.00	600.00	Fund balances:		
			Nondiscretionary allocations:		
			Allocation for working capital	324,032.43	43,698.40
			Allocation for encumbrances	140,148.43	54,024.62
			Allocation for designated appropriations	183,791.00	227,379.50
			Discretionary allocation:		
			Allocation for subsequent budget	122,800.00	219,400.00
			Unallocated	27,588.49	59,197.09
			Total fund balances	798,360.35	603,699.61
Total unrestricted	808,195.81	621,331.81	Total unrestricted	808,195.81	621,331.81
Restricted:			Restricted:		
Cash (Note 3)	208,684.19	7,944.84	Liabilities:		
Accounts and grants receivable	179,945.56	319,304.50	Accounts payable	12,833.11	5,691.69
			Fund balances	375,796.64	321,557.65
Total restricted	388,629.75	327,249.34	Total restricted	388,629.75	327,249.34
Total current funds	\$ 1,196,825.56	\$ 948,581.15	Total current funds	\$ 1,196,825.56	\$ 948,581.15
Endowment and similar funds			Endowment and similar funds:		
Cash (Note 3)	\$ 947,475.08	\$ 944,617.72	Fund balances:		
Investments (Note 4)	632,262.17	588,176.68	Endowment	\$ 1,088,558.05	\$ 1,041,615.20
Total endowment and similar funds	\$ 1,579,737.25	\$ 1,532,794.40	Quasi-endowment-unrestricted	491,179.20	491,179.20
			Total endowment and similar funds	\$ 1,579,737.25	\$ 1,532,794.40
Plant funds:			Plant funds:		
Renewals and replacements:			Renewals and replacements:		
Cash (Note 3)	\$ 1,515,537.11	\$ 1,380,059.92	Fund balance:		
Total renewals and replacements	1,515,537.11	1,380,059.92	Unrestricted	\$ 1,515,537.11	\$ 1,380,059.92
Investment in plant:			Total renewals and replacements	1,515,537.11	1,380,059.92
Equipment	1,681,733.73	1,648,765.62	Investment in plant:		
Total investment in plant	1,681,733.73	1,648,765.62	Fund balance:		
Total plant funds	\$ 3,197,270.84	\$ 3,028,825.54	Net investment in plant	1,681,733.73	1,648,765.62
			Total investment in plant	1,681,733.73	1,648,765.62
			Total plant funds	\$ 3,197,270.84	\$ 3,028,825.54
Agency funds:			Agency funds:		
Cash (Note 3)	\$ 1,740,075.46	\$ 1,417,176.52	Accounts payable	\$ 271,554.42	\$ 854,485.76
Accounts receivable	164,485.76	161,822.31	Accrued liabilities	-	177,460.34
Total agency funds	\$ 1,904,561.22	\$ 1,578,998.83	Deposits held in custody for others	1,633,006.80	547,052.73
			Total agency funds	\$ 1,904,561.22	\$ 1,578,998.83

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

TENNESSEE BOARD OF REGENTS
THE STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENT OF CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 1997

	Current Funds			Plant Funds	
	Unrestricted	Restricted	Endowment and Similar Funds	Renewals and Replacements	Investment In Plant
REVENUES AND OTHER ADDITIONS					
Unrestricted current fund revenues	\$ 6,243,330.20	\$ -	\$ -	\$ -	\$ -
Federal grants and contracts	-	261,982.07	-	-	-
State grants and contracts	-	402,005.44	-	-	90,272.92
Private gifts, grants, and contracts	-	-	2,857.36	-	-
Investment income	-	9,844.87	-	61,880.25	-
Endowment income	-	54,063.58	44,085.49	-	-
Expended for plant facilities (including \$87,960.58 charged to current fund expenditures)	-	-	-	-	170,461.64
Other (Note 7)	-	-	-	-	26,300.00
Total revenues and other additions	6,243,330.20	727,895.96	46,942.85	61,880.25	287,034.56
EXPENDITURES AND OTHER DEDUCTIONS					
Education and general expenditures	5,892,169.46	648,903.47	-	-	-
Indirect cost recoveries	-	23,040.00	-	-	-
Refunds to grantors	-	1,713.50	-	-	-
Expended for plant facilities (including noncapitalized expenditures of \$402.00)	-	-	-	82,903.06	-
Disposal of plant facilities	-	-	-	-	247,585.45
Other	-	-	-	-	6,481.00
Total expenditures and other deductions	5,892,169.46	673,656.97	-	82,903.06	254,066.45
TRANSFERS AMONG FUNDS - ADDITIONS (DEDUCTIONS)					
Nonmandatory:					
Renewals and replacements	(156,500.00)	-	-	156,500.00	-
Total transfers	(156,500.00)	-	-	156,500.00	-
Net increase for the year	194,660.74	54,238.99	46,942.85	135,477.19	32,968.11
Fund balances at beginning of year	603,699.61	321,557.65	1,532,794.40	1,380,059.92	1,648,765.62
Fund balances at end of year	\$ 798,360.35	\$ 375,796.64	\$ 1,579,737.25	\$ 1,515,537.11	\$ 1,681,733.73

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

TENNESSEE BOARD OF REGENTS
THE STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
STATEMENT OF CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 1996

	Current Funds			Plant Funds		
	Unrestricted	Restricted	Endowment and Similar Funds	Unexpended	Renewals and Replacements	Investment In Plant
REVENUES AND OTHER ADDITIONS						
Unrestricted current fund revenues	\$ 6,763,173.40	\$ -	\$ -	\$ -	\$ -	\$ -
Federal grants and contracts	-	495,453.33	-	-	-	-
State grants and contracts	-	452,751.73	-	-	-	11,312.00
Private gifts, grants, and contracts	-	2,000.00	53,438.52	-	-	-
Investment income	-	889.84	-	3,450.05	32,846.51	-
Endowment income	-	54,520.39	9,450.79	-	-	-
Expended for plant facilities (including \$198,842.15 charged to current fund expenditures)	-	-	-	-	-	377,596.07
Total revenues and other additions	6,763,173.40	1,005,615.29	62,889.31	3,450.05	32,846.51	388,908.07
EXPENDITURES AND OTHER DEDUCTIONS						
Education and general expenditures	6,254,664.21	869,432.07	-	-	-	-
Indirect cost recoveries	-	27,000.65	-	-	-	-
Expended for plant facilities (including noncapitalized expenditures of \$7,119.72)	-	-	-	-	185,873.64	-
Disposal of plant facilities	-	-	-	-	-	23,843.34
Withdrawal from extraordinary maintenance pool	-	-	-	137,439.44	-	-
Total expenditures and other deductions	6,254,664.21	896,432.72	-	137,439.44	185,873.64	23,843.34
TRANSFERS AMONG FUNDS - ADDITIONS (DEDUCTIONS)						
Nonmandatory:						
Unrestricted current funds	889.84	(889.84)	-	-	-	-
Renewals and replacements	(781,903.44)	-	-	(3,450.05)	785,353.49	-
Total transfers	(781,013.60)	(889.84)	-	(3,450.05)	785,353.49	-
Net increase (decrease) for the year	(272,504.41)	108,292.73	62,889.31	(137,439.44)	632,326.36	365,064.73
Fund balances at beginning of year	876,204.02	213,264.92	1,469,905.09	137,439.44	747,733.56	1,283,700.89
Fund balances at end of year	\$ 603,699.61	\$ 321,557.65	\$ 1,532,794.40	\$ -	\$ 1,380,059.92	\$ 1,648,765.62

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

TENNESSEE BOARD OF REGENTS
 THE STATE UNIVERSITY AND COMMUNITY COLLEGE SYSTEM OF TENNESSEE - CENTRAL OFFICE
 STATEMENT OF CURRENT FUNDS REVENUES, EXPENDITURES, AND OTHER CHANGES
 FOR THE YEAR ENDED JUNE 30, 1997

	<u>Unrestricted</u>	<u>Restricted</u>	<u>Total</u>
<u>REVENUES</u>			
State appropriations	\$ 3,087,800.00	\$ -	\$ 3,087,800.00
Federal grants and contracts	23,040.00	243,989.81	267,029.81
State grants and contracts	35,000.00	348,257.56	383,257.56
Endowment income	28,884.90	56,656.10	85,541.00
Investment income	789,929.24	-	789,929.24
Chargebacks to institutions	1,612,700.04	-	1,612,700.04
Capital projects savings	657,709.15	-	657,709.15
Other sources	8,266.87	-	8,266.87
Total current revenues	<u>6,243,330.20</u>	<u>648,903.47</u>	<u>6,892,233.67</u>
<u>EXPENDITURES AND TRANSFERS</u>			
Educational and general expenditures:			
Institutional support	5,635,011.46	592,247.37	6,227,258.83
Operation and maintenance of plant	252,588.00	-	252,588.00
Scholarships and fellowships	4,570.00	56,656.10	61,226.10
Total educational and general	<u>5,892,169.46</u>	<u>648,903.47</u>	<u>6,541,072.93</u>
Nonmandatory transfers:			
Renewals and replacements	156,500.00	-	156,500.00
Total nonmandatory transfers	<u>156,500.00</u>	<u>-</u>	<u>156,500.00</u>
Total expenditures and transfers	<u>6,048,669.46</u>	<u>648,903.47</u>	<u>6,697,572.93</u>
<u>OTHER TRANSFERS AND ADDITIONS (DEDUCTIONS)</u>			
Excess of restricted receipts over transfers to revenues	-	78,992.49	78,992.49
Indirect cost recoveries	-	(23,040.00)	(23,040.00)
Refunds to grantors	-	(1,713.50)	(1,713.50)
Net increase in fund balances	<u>\$ 194,660.74</u>	<u>\$ 54,238.99</u>	<u>\$ 248,899.73</u>

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

Tennessee Board of Regents
The State University and Community College
System of Tennessee—Central Office
Notes to the Financial Statements
June 30, 1997, and June 30, 1996

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

REPORTING ENTITY

The State University and Community College System of Tennessee—Central Office is part of the Tennessee Board of Regents, which is a component unit of the State of Tennessee because the state appoints a majority of its governing body and provides financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

BASIS OF PRESENTATION

The financial statements of the Central Office have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Central Office uses the AICPA College Guide model for accounting and financial reporting.

BASIS OF ACCOUNTING

The financial statements of the Central Office have been prepared on the accrual basis, except that depreciation on plant assets is not recorded. All restricted resources are recorded as additions to the fund balances of the appropriate fund groups. Restricted current resources are then recorded as revenues during the period in which they are expended. The statement of current funds revenues, expenditures, and other changes is a statement of financial activities of current funds related to the current reporting period. It does not purport to present the results of operations or the net income or loss for the period, as would a statement of income or a statement of revenues and expenses.

To the extent that current funds are used to finance plant assets, the funds are accounted for as (1) expenditures, for normal replacement of movable equipment and library holdings and (2) nonmandatory transfers, for all other cases.

Tennessee Board of Regents
The State University and Community College
System of Tennessee—Central Office
Notes to the Financial Statements (Cont.)
June 30, 1997, and June 30, 1996

FUND ACCOUNTING

To ensure observance of limitations and restrictions placed on the use of the resources available, the Central Office maintains accounts in accordance with the principles of fund accounting. With this procedure, resources for various purposes are classified for accounting and reporting purposes into funds for specified activities or objectives. Separate accounts are maintained for each fund; however, in the accompanying financial statements, funds with similar characteristics have been combined into fund groups. Accordingly, all financial transactions have been recorded and reported by fund group.

Within each fund group, fund balances restricted by outside sources are so indicated and are distinguished from unrestricted funds which are allocated to specific purposes by the governing board. Externally restricted funds may be used only in accordance with the purposes established by the source of such funds and contrast with unrestricted funds over which the governing board retains full control to use in achieving any of its institutional purposes.

All gains and losses arising from the sale, collection, or other disposition of investments and other noncash assets are accounted for in the fund that owned such assets. Ordinary income derived from investments, receivables, and the like is accounted for in the fund owning such assets, except for income derived from investments of endowment and similar funds. This income is accounted for in the fund to which it is restricted or, if unrestricted, as revenues in unrestricted current funds. All other unrestricted revenue is accounted for in the unrestricted current funds. Restricted gifts, grants, appropriations, endowment income, and other restricted resources are accounted for in the appropriate restricted funds. Restricted current funds are reported as revenues and expenditures when expended for current operating purposes.

Current Funds

Unrestricted current funds consist of those funds over which the Central Office retains full control for use in achieving any of its authorized institutional purposes. Restricted current funds are externally restricted and may be used only in accordance with the purposes established by their source.

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Endowment and Similar Funds

Endowment funds are subject to the restrictions of gift instruments requiring in perpetuity that the principal be invested and only the income be used. Although quasi-endowment funds have been established by the governing board for the same purposes as endowment funds, any portion of quasi-endowment funds may be expended.

Plant Funds

The plant funds group consists of (1) funds set aside for the acquisition of physical properties for institutional purposes, (2) funds set aside for the renewal and replacement of institutional properties, and (3) funds expended for, and thus invested in, institutional properties.

Agency Funds

In handling these funds, the Central Office acts solely as an agent; consequently, transactions of these funds do not affect the Central Office's operating statements.

INVENTORIES

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

ALLOCATION FOR WORKING CAPITAL

The unrestricted fund balance is allocated for the amount of working capital. "Working capital" is defined as the total of all petty cash, accounts receivable, inventories, and prepaid expenses in the unrestricted fund at the balance sheet date.

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PLANT ASSETS

The physical plant and equipment are stated at cost at date of purchase or at fair value at date of donation. Depreciation on the physical plant and equipment is not recorded.

NOTE 2. COMPENSATED ABSENCES

The Central Office's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. Generally accepted accounting principles require that certain accrued compensated absences and related benefits, the effects of which are material to the financial statements, be recorded as earned. The Central Office's policy is to record such benefits as paid. The recognition of this liability for accrued compensated absences and related benefits would have increased the liabilities of the unrestricted current fund by \$500,664.81 at June 30, 1997, and \$558,470.48 at June 30, 1996, decreased the unrestricted current fund expenditures by \$57,805.67 for the year ended June 30, 1997, and increased the unrestricted current fund expenditures by \$42,885.15 for the year ended June 30, 1996.

NOTE 3. DEPOSITS

The Central Office's deposits are in financial institutions which participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

NOTE 4. INVESTMENTS

The Central Office is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies

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backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the Central Office and that endowment investments be prudently diversified

The Central Office's only investments are endowment funds that are invested in mutual funds and equivalent type investments. At June 30, 1997, the carrying amount of these investments was \$632,262.17 and the market value was \$655,979.17. At June 30, 1996, the carrying amount of these investments was \$588,176.68 and the market value was \$607,736.50.

NOTE 5. PENSION PLANS

A. Defined Benefit Plan

During the year ended June 30, 1997, the Central Office implemented GASB Statement 27, "Accounting for Pensions by State and Local Government Employers." In accordance with that statement, at transition it was determined that a pension liability or asset does not exist for this plan.

Tennessee Consolidated Retirement System

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

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report

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may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee, 37243-0230, or by calling (615) 741-8202, extension 139.

Funding Policy - Plan members are noncontributory. The Central Office is required to contribute an actuarially determined rate. The current rate is 7.36% of annual covered payroll. Contribution requirements for the Central Office are established and may be amended by the TCRS' Board of Trustees. The Central Office's contributions to TCRS for the years ended June 30, 1997, 1996, and 1995, were \$239,283.94 , \$189,380.80 , and \$162,765.29. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The Central Office contributes to three defined contribution plans: Teachers Insurance and Annuity Association—College Retirement Equities Fund (TIAA-CREF), Aetna Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in the TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly.

Funding Policy - Plan members are noncontributory. The Central Office contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the Central Office to the plans for the year ended June 30, 1997, was \$82,059.30 , which represented 10% of the covered payroll, and for the year ended June 30, 1996, was \$86,115.81, which represented 10% of the covered payroll. Contributions met the requirements for each year.

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NOTE 6. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible Central Office retirees. This benefit is provided and administered by the State of Tennessee. The Central Office assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*.

NOTE 7. OTHER ADDITIONS

Other additions on the Statement of Changes in Fund Balances for the year ended June 30, 1997, consist of \$26,300 received for vehicles traded in on new vehicle purchases.

NOTE 8. INSURANCE-RELATED ACTIVITIES

The state purchases commercial insurance for real property losses above \$5 million per year and surety bond coverage on the state's officials and employees. In the past three fiscal years, the state has not had any claims filed with the commercial insurer. A designation for casualty losses in the amount of \$5 million has been established in the state's general fund to provide for any property losses not covered by the commercial insurance.

At June 30, 1997, the scheduled coverage for the Central Office was \$1,500,000.00 for contents. At June 30, 1996, the scheduled coverage was \$982,000.00 for contents.

The state has set aside assets for claim settlement in an internal service fund, the Claims Award Fund. This fund services all claims for risk of loss to which the state is exposed, including general liability, automotive liability, professional malpractice, and workers' compensation. The Central Office participates in the Claims Award Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the Central Office based on a percentage of the Central Office's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An

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actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Since the Central Office participates in the Claims Award Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the Central Office for bodily injury and property damage is limited to \$300,000 per person and \$1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq. Claims are paid through the state's Claims Award Fund.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The Central Office participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the Central Office based on estimates of the ultimate cost of claims 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 9. COMMITMENTS AND CONTINGENCIES

Sick Leave - The Central Office records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The dollar amount of unused sick leave was \$2,070,524.48 at June 30, 1997, and \$2,300,983.02 at June 30, 1996.

Operating Leases - The Central Office has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenditures under operating leases for real property were \$236,089.60 for the year ended June 30, 1997. The amount for the year ended June 30, 1996, was \$241,556.04. All operating leases are cancelable at the lessee's option.

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

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NOTE 10. TENNESSEE FOREIGN LANGUAGE INSTITUTE

Section 49-50-1306(b), *Tennessee Code Annotated*, states that the Tennessee Foreign Language Institute shall be attached to the Tennessee Board of Regents for administrative purposes. The institute's financial records, investments, and other financial transactions are handled by the Central Office, and the assets and the liabilities of the institute are included in the agency funds on the Central Office's balance sheet.