AUDIT REPORT

Tennessee Board of Regents
Tennessee State University

For the Year Ended
June 30, 2006

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

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STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

March 15, 2007

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Charles W. Manning, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, Tennessee 37217
and
Dr. Melvin N. Johnson, President
Tennessee State University
3500 John A. Merritt Boulevard
Nashville, Tennessee 37209

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, Tennessee State University, for the year ended June 30, 2006. You will note from the independent auditor's report that unqualified opinions were given on the fairness of the presentation of the financial statements.

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

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/sah
07/020

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
Tennessee State University
For the Year Ended June 30, 2006

AUDIT OBJECTIVES

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

AUDIT FINDINGS

The audit report contains no findings.

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

Audit Report
Tennessee Board of Regents
Tennessee State University
For the Year Ended June 30, 2006

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Tennessee Board of Regents
Tennessee State University
For the Year Ended June 30, 2006

INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

Tennessee State University was first established as the Agricultural and Industrial State Normal School on June 19, 1912, through an act of the Tennessee General Assembly. In 1922, the institution was raised to the status of a four-year teachers' college and was empowered to grant the bachelor's degree. In August 1951, the State Board of Education granted the institution university status. The university was elevated to a land-grant university by the State Board of Education in August 1958. The land-grant university program established a School of Agriculture and Home Economics, School of Engineering, School of Arts and Sciences, School of Education, Graduate School, Division of Business, Division of Extension and Continuing Education, and Department of Aerospace Studies. The university is supported by state and federal funds, the latter in accordance with the Morrill Act and other federal acts that provide for land-grant institutions.

ORGANIZATION

The governance of Tennessee State University 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 university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 2005, through June 30, 2006, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2006, and for comparative purposes, the year ended June 30, 2005. Tennessee State University is an institution of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

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

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

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

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

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

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

FRAUD CONSIDERATIONS

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

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

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 2006, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *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 under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

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

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT

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

November 17, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the financial statements of Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the year ended June 30, 2006, and have issued our report thereon dated November 17, 2006. 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.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion 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 reportable 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 caused by error or fraud 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 and its operation that we consider to be material weaknesses.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the university's financial statements are free of material misstatement, we performed tests of the university's 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*.

We did, however, note certain less significant instances of noncompliance, which we have reported to the university's management in a separate letter.

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

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/sah

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

November 17, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying basic financial statements of Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the years ended June 30, 2006, and June 30, 2005, as listed in the table of contents. These financial statements are the responsibility of the university's management. Our responsibility is to express opinions on these financial statements, based on our audits.

We conducted our audits 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 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 audits provide a reasonable basis for our opinions. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of many agencies, commissions, and component units of the State of Tennessee; managing the state's debt; and making loans to the state's colleges and universities from debt proceeds. Some of the boards of which the Comptroller of the Treasury serves as a member per state statutes include the State Building Commission and the Tennessee Higher Education Commission.

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Tennessee Board of Regents, Tennessee State University, and its discretely presented component unit as of June 30, 2006, and June 30, 2005, and the respective changes in financial position and cash flows thereof for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 3 to the financial statements, during the year ended June 30, 2005, the university implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*.

The management's discussion and analysis on pages 10 through 22 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the basic financial statements. The accompanying financial information on page 50 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 17, 2006, on our consideration of the university's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with

Government Auditing Standards and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/sah

TENNESSEE STATE UNIVERSITY
Management's Discussion and Analysis

This section of Tennessee State University's report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2006, with comparative information presented for the fiscal years ended June 30, 2005, and June 30, 2004. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the financial statements and notes. The financial statements, notes, and this discussion are the responsibility of management.

Using This Report

This report consists of three basic financial statements. The Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows provide information on Tennessee State University as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

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

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

Statement of Net Assets (in thousand of dollars)

	University			Component Unit		
	2006	**2005**	**2004**	**2006**	**2005**	**2004**
Assets:						
Current assets	$ 20,198	$ 26,163	$ 30,578	$ 2,518	$ 2,344	$ 2,362
Capital assets, net	167,319	156,268	152,582	-	-	-
Other assets	31,323	27,085	22,356	16,865	13,666	11,148
Total assets	**218,840**	**209,516**	**205,516**	**19,383**	**16,010**	**13,510**
Liabilities:						
Current liabilities	15,741	17,269	15,477	6	1	33
Noncurrent liabilities	39,305	35,854	34,697	-	-	-
Total liabilities	**55,046**	**53,123**	**50,174**	**6**	**1**	**33**
Net assets:						
Invested in capital assets, net of related debt	133,853	125,457	122,439	-	-	-
Restricted - nonexpendable	73	72	62	16,864	13,658	11,163
Restricted - expendable	6,700	7,826	7,708	2,483	2,309	2,227
Unrestricted	23,168	23,038	25,133	30	42	87
Total net assets	**$ 163,794**	**$ 156,393**	**$ 155,342**	**$19,377**	**$16,009**	**$13,477**

Comparison of FY 2006 to FY 2005

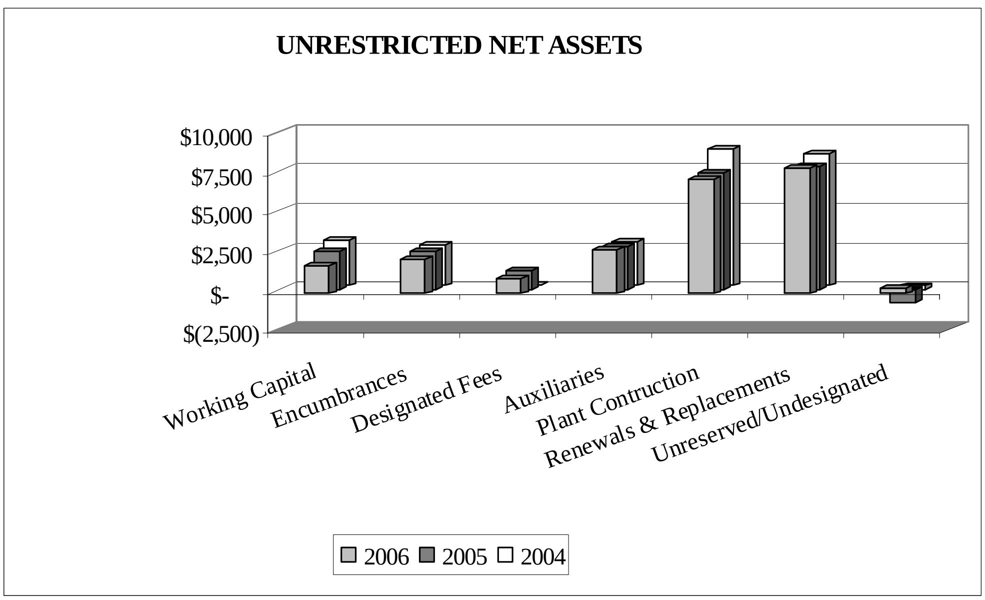
- Current assets decreased while other assets increased as the result of additional investments of the university and the purchase/construction of capital assets. See Note 3 to the financial statements for additional information on investments and Note 5 on capital assets.
- Current liabilities decreased in FY 2006 as result of a decrease in accounts payable for unexpended plant fund projects.
- Restricted - expendable net assets for FY 2006 decreased 14% due to a $2.87 million refund of remaining funds following the discontinuation of the Basic Skills - Science Materials Program.
- Net assets for the Tennessee State University (TSU) Foundation for FY 2006 increased over $3 million as a result of $1 million in state funds, over $1.1 million in gifts and contributions, and a more aggressive investment program that resulted in over $593 thousand in investment income.

Comparison of FY 2005 to FY 2004

- Current assets decreased while other assets increased as the result of a change in the investments of the university. At June 30, 2005, the university had over $10 million in other assets, investments. See Note 3 to the financial statements for additional information.

- Current liabilities increased for FY 2005 as result of an increase of $1.5 million in accounts payable.
- Net assets for the TSU Foundation for FY 2005 increased over $2.5 million as a result of $1 million in state funds and over $573 thousand in fundraising and matching funds received related to the state consent decree, $488 thousand in grants and contracts, and $462 thousand in additions to permanent endowments.
- Net assets for the TSU Foundation related to nonexpendable endowments were $13.658 million for FY 2005, an increase of over $2.4 million as a result of funds received related to the state consent decree and other endowments as noted above. Restricted expendable and unrestricted net assets were allocated differently for FY 2005 after further evaluation of the components. The restricted expendable and unrestricted net assets for FY 2004 were $2.227 million and $87 thousand, respectively.

Many of the university's unrestricted net assets have been designated or reserved for specific purposes such as: repairs and replacement of equipment and capital projects. The following graph shows the allocations (amounts are presented in thousands of dollars):



Comparison of FY 2006 to FY 2005

- The allocation for working capital decreased 28% as the result of a decrease in student accounts receivable.

Comparison of FY 2005 to FY 2004

- The allocation for working capital decreased 16% as the result of a decrease in student accounts receivable, net.
- The allocation for renewals and replacements decreased in FY 2005 as a result of the use of reserves for the purchase of equipment, including over $694,000 for the purchase of computer equipment related to the conversion of the administrative software, and over $500,000 for noncapital expenses for needed residence hall repairs.
- The allocation for plant construction decreased in FY 2005 as a result of the use of reserves for construction projects rather than issuing additional debt.

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

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

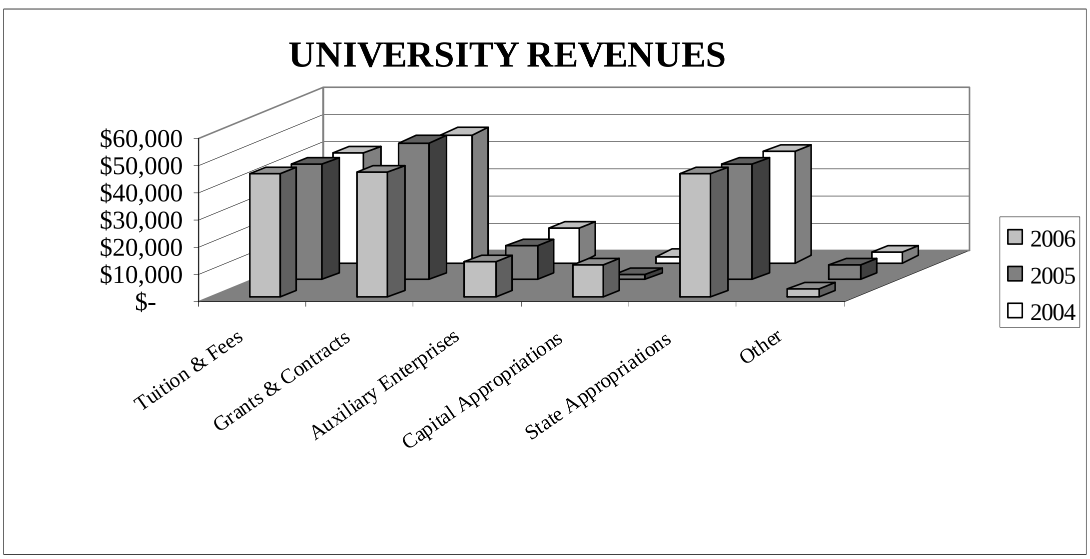
Statement of Revenues, Expenses, and Changes in Net Assets (in thousand of dollars)

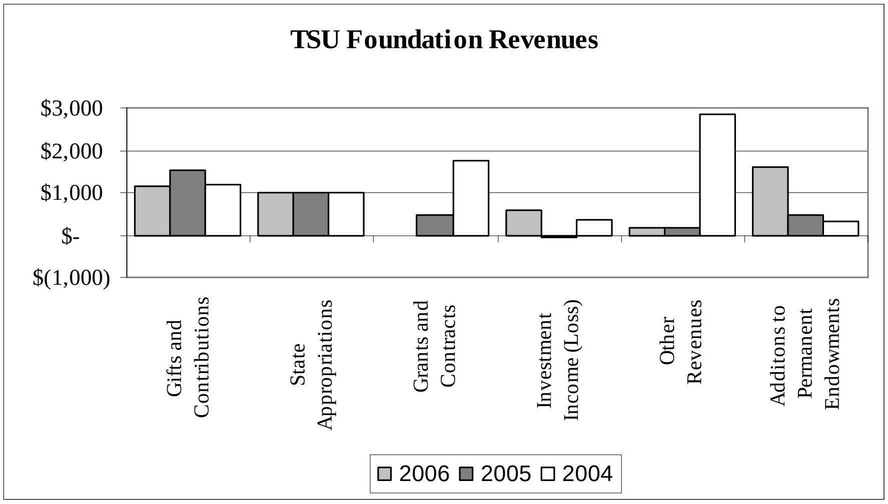
	University			Component Unit		
	2006	**2005**	**2004**	**2006**	**2005**	**2004**
Operating revenues:						
Net tuition and fees	$ 45,018	$ 42,272	$ 40,230	$ -	$ -	$ -
Gifts and contributions	-	-	-	919	968	1,179
Grants and contracts	30,149	29,360	34,578	-	-	-
Auxiliary	12,695	12,220	12,444	-	-	-
Other	2,564	2,429	2,649	178	172	119
Total operating revenues	**90,426**	**86,281**	**89,901**	**1,097**	**1,140**	**1,298**
Operating expenses	152,980	151,795	145,792	1,150	1,140	1,135
Operating income (loss)	(62,554)	(65,514)	(55,891)	(53)	-	163
Nonoperating revenues and expenses:						
State appropriations	44,939	42,305	40,621	1,000	1,000	1,000
Gifts	732	1,121	943	215	574	-
Grants and contracts	14,941	16,921	12,384	-	487	1,763
Investment income	1,859	898	496	594	(5)	352
Other nonoperating revenues and expenses	(4,627)	(763)	(2,630)	-	14	2,738
Total nonoperating revenues and expenses	**57,844**	**60,482**	**51,814**	**1,809**	**2,070**	**5,853**

Income (loss) before other revenues, expenses, gains, or losses	**(4,710)**	**(5,032)**	**(4,077)**	**1,756**	**2,070**	**6,016**
Other revenues, expenses, gains, or losses:						
Capital appropriations	11,745	1,863	2,431	-	-	-
Capital grants and gifts	393	3,973	951	-	-	-
Additions to permanent Endowments	-	-	-	1,612	462	325
Other	(27)	247	-	-	-	-
Total other revenues, expenses, gains, or losses	**12,111**	**6,083**	**3,382**	**1,612**	**462**	**325**
Increase (decrease) in net assets	**7,401**	**1,051**	**(695)**	**3,368**	**2,532**	**6,341**
Net assets at beginning of year	**156,393**	**155,342**	**156,037**	**16,009**	**13,477**	**7,136**
Net assets at end of year	**$163,794**	**$156,393**	**$155,342**	**$19,377**	**$16,009**	**$13,477**

Revenues

The following are graphic illustrations of revenues by source (both operating and nonoperating), which were used to fund the university's and its component unit's operating activities for the years ended June 30, 2006; June 30, 2005; and June 30, 2004 (amounts are presented in thousands of dollars).





Comparison of FY 2006 to FY 2005

- Net tuition and fees increased $2.7 million as the result of an increase in the cost of attendance.
- Gifts for the university decreased 35% due to a decrease in funds received from nongovernmental organizations.
- Investment income increased as a result of more funds invested for the entire fiscal year and a more aggressive investment strategy employed by the university.
- Other nonoperating revenues decreased due to the discontinuation of the Science Materials Program in Basic Skills and the allocation of the remaining funds to the participating counties.
- Additions to the permanent fund increased in FY 2006 for the TSU Foundation as a result of a more aggressive investment strategy employed by the foundation.

Comparison of FY 2005 to FY 2004

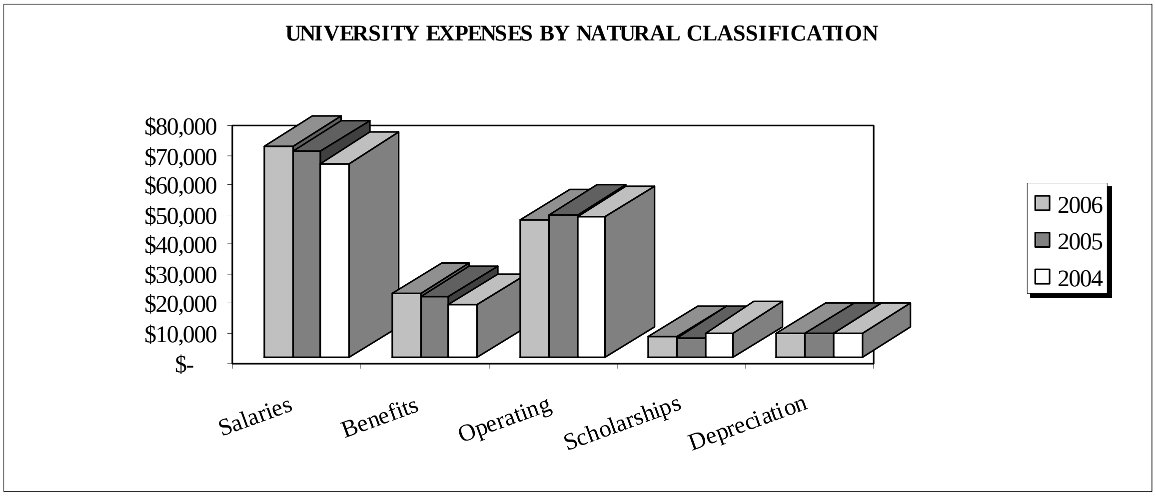
- Net tuition and fees increased $2 million as the result of an increase in the cost of attendance and an increase in enrollment.
- Operating grants and contracts for FY 2005 decreased due to grants awarded to the Basic Skills program that were not renewed.
- Nonoperating grants and contracts increased 37% for FY 2005 due to the reclassification of Hope and TSAC grants to nonoperating.
- Capital appropriations decreased 23% due to additional appropriations in FY 2004 for the Avon Williams renovation project funded through the consent decree.

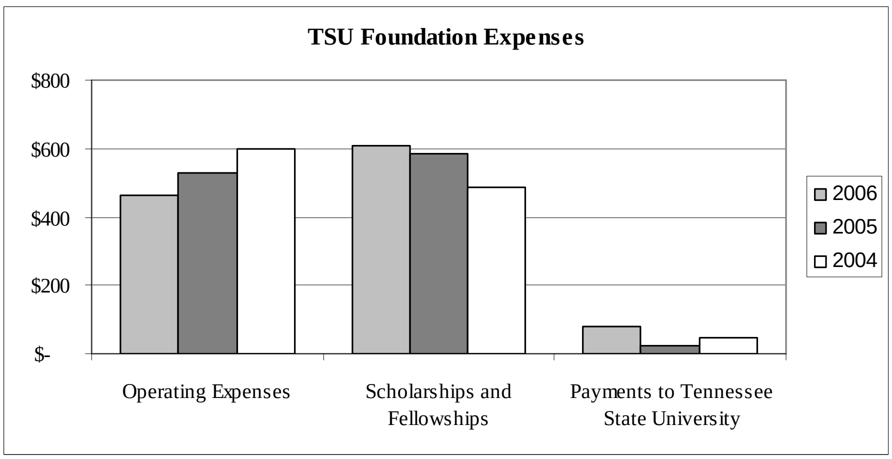
- Capital grants increased 318% due to additional grants in FY 2005 including $1.8 million for the Distance Learning Center.
- Contributions in FY 2005 for the TSU Foundation increased as a result of additional matching funds received for the consent decree.
- Grants and contracts decreased in FY 2005 for the TSU Foundation as a result of matching funds received in 2004 from Title III funds for monies raised during 2003.
- Other operating revenues decreased in FY 2005 for the TSU Foundation in comparison to FY 2004 due to the $2.414 million in scholarships initially awarded through the TSU Foundation in prior fiscal years that were assumed by the university in FY 2004.
- Other nonoperating revenues decreased 99.5% in FY 2005 for the TSU Foundation in comparison to FY 2004 due to the $2.414 million in scholarships initially awarded through the TSU Foundation in prior fiscal years that were assumed by the university in FY 2004.

Expenses

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

	University			Component Unit		
Natural Classification	**2006**	**2005**	**2004**	**2006**	**2005**	**2004**
Salaries	$ 70,950	$ 69,316	$ 65,365	$ -	$ -	$ -
Benefits	21,342	20,459	17,461	-	-	-
Operating	46,131	47,784	47,190	464	527	601
Scholarships	6,633	6,554	8,160	606	588	487
Payments to TSU	-	-	-	80	25	47
Depreciation	7,924	7,682	7,616	-	-	-
Total expenses	**$152,980**	**$151,795**	**$145,792**	**$1,150**	**$1,140**	**$1,135**





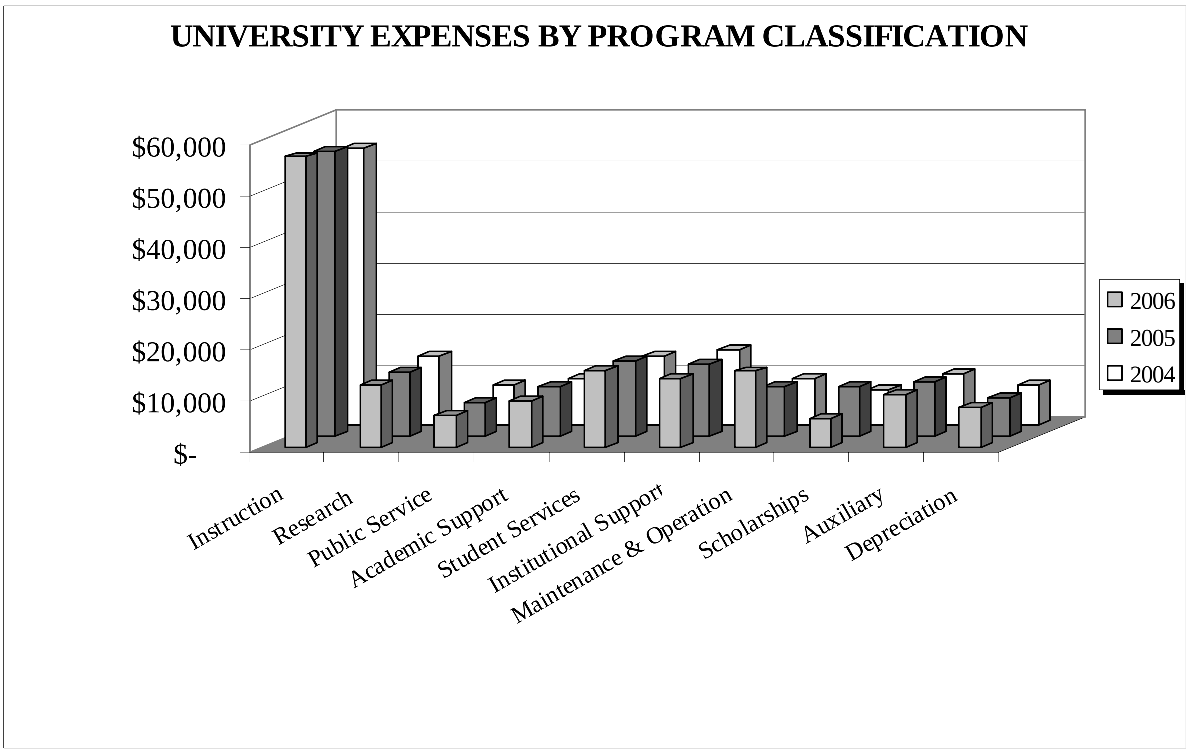
<u>Comparison of FY 2006 to FY 2005</u>

- Scholarships increased due to the number of students receiving Pell, Hope, and TSAC awards.

<u>Comparison of FY 2005 to FY 2004</u>

- Salaries for the university increased over $3.9 million due to a 3% across-the-board increase in salaries and two across-the-board one-time bonuses.
- Benefits increased due to the salary increases noted above and an increase in the retirement and insurance rates.

Program Classification	University 2006	2005	2004
Instruction	$ 57,102	$ 55,881	$ 54,244
Research	12,238	12,675	13,489
Public service	6,378	6,656	7,698
Academic support	9,184	9,726	9,120
Student services	15,334	14,820	13,298
Institutional support	13,746	14,226	14,767
Maintenance and operation	15,043	9,854	9,029
Scholarships	5,651	9,711	6,683
Auxiliary	10,380	10,564	9,848
Depreciation	7,924	7,682	7,616
Total expenses	**$ 152,980**	**$ 151,795**	**$ 145,792**



Comparison of FY 2006 to FY 2005

- Scholarships decreased due to the number of students receiving Pell, Hope, and TSAC awards.

Comparison of FY 2005 to FY 2004

- The increase in instruction is a result of the salary increases noted above and an increase in the purchase of equipment and technology.
- Public service decreased as a result of a decrease in restricted agricultural-related expenses.
- Academic support increased as a result of the salary increases noted above and an increase in the purchase of library materials and technology.
- The increase in student services is a result of the salary increases noted above and the increase in purchases related to athletics.

The Statement of Cash Flows

The Statement of Cash Flows provides information about cash receipts and cash payments during the year. This statement also assists users in assessing the university's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Statement of Cash Flows (in thousand of dollars)

	University		
	2006	**2005**	**2004**
Cash provided (used) by:			
Operating activities	$(53,045)	$(56,789)	$(46,277)
Noncapital financing activities	57,639	60,916	53,586
Capital and related financing activities	(4,167)	(7,702)	(4,449)
Investing activities	(690)	(9,198)	(62)
Net increase (decrease) in cash	**(263)**	**(12,773)**	**2,798**
Cash, beginning of year	27,869	40,642	37,844
Cash, end of year	**$ 27,606**	**$ 27,869**	**$ 40,642**

Comparison of FY 2006 to FY 2005

- Cash provided by investing activities increased as a result of more funds invested for the entire fiscal year, rather than the purchase of investments during the year, at higher rates and a more aggressive investment strategy employed by the university.
- Cash provided by noncapital financing activities decreased because fewer gifts and grants were received and also because the university had to return $2.9 million for the Science Material Management program which was discontinued.

- Cash used by capital and related financing activities decreased for FY 2006 due to a $3.6 million decrease in the capital gifts and grants received and related capital expenditures.

Comparison of FY 2005 to FY 2004

- Cash used by operating activities increased over $10.5 million due to an increase in the cost of salaries and benefits paid by the university.
- Cash provided by noncapital financing activities increased due to more state appropriations being received, a significant increase in gifts and grants due to the reclassification of Pell and SEOG as nonoperating, and significant decrease in other noncapital financing receipts (payments).
- Cash provided by capital and related financing activities increased by over $3.2 million due to an increase in the purchase of capital assets and construction costs.
- Cash used by investing activities increased by over $9.1 million as a result of the purchase of over $10 million in investments. Please see Note 3 to the financial statements for additional information.

Capital Assets and Debt Administration

Capital Assets

The university had $167,319,169.22 invested in capital assets, net of accumulated depreciation of $116,416,637.47 at June 30, 2006; $156,267,304.33 invested in capital assets, net of accumulated depreciation of $109,470,607.53 at June 30, 2005; and $152,581,619.90 invested in capital assets, net of accumulated depreciation of $103,269,697.69 at June 30, 2004. Depreciation charges totaled $7,923,855.15, $7,681,782.97, and $7,616,162.97 for the years ended June 30, 2006; June 30, 2005; and June 30, 2004, respectively. Details of these assets are shown below.

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

	2006	2005	2004
Land	$ 9,525	$ 9,525	$ 9,525
Land improvements and infrastructure	12,352	14,253	15,543
Buildings	90,580	93,386	97,134
Equipment	6,351	6,356	5,600
Library holdings	7,285	6,567	5,587
Projects in progress	41,226	26,181	19,193
Total capital assets, net of depreciation	**$ 167,319**	**$ 156,268**	**$ 152,582**

Comparison of FY 2006 to FY 2005

- Projects in progress include the Research and Sponsored Programs Building, Avon Williams Campus renovations, North Campus Project, the Performance Arts Building, Agriculture I. T. Center, the Energy Savings program, and three automatic photoelectric telescopes being built in Arizona.

Comparison of FY 2005 to FY 2004

- The library is fully automated with the purchase of additional on-line databases. The library purchased over $2 million in databases and library books during FY 2005. With depreciation and the write-off of old library books, the net increase in value was just under $1 million.
- Equipment increased 14% for FY 2005 with the purchase of over $2 million in equipment. With depreciation and surplus of equipment, the net increase in value was over $700 thousand.
- Projects in progress included the North Campus Project, the Research and Sponsored Programs building, Agriculture I. T. Center, and the Energy Savings program.

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

Debt

The university had $33,465,760.10, $30,810,464.64, and $30,142,235.20 in debt outstanding at June 30, 2006; June 30, 2005; and June 30, 2004, respectively. The table below summarizes these amounts by type of debt instrument.

Schedule of Debt (in thousands of dollars)

	2006	**2005**	**2004**
Bonds	$ 29,419	$ 28,269	$ 29,762
Commercial paper	4,047	2,542	380
Total	**$ 33,466**	**$ 30,811**	**$ 30,142**

Over $3.6 million in commercial paper was issued by the Tennessee State School Bond Authority (TSSBA) during FY 2006, $3.2 million for the Research and Sponsored Programs Building and $445 thousand for the Student Housing Fire Suppression Retrofit. The Standard & Poor's rating for TSSBA is AA- with a stable outlook.

More detailed information about the university's long-term liabilities is presented in Note 6 to the financial statements.

Economic Factors That Will Affect the Future

The Tennessee Board of Regents approved a 4.1% increase in maintenance and tuition fees for the 2006-07 academic year. The cost for students to attend the university exceeds the amount of financial aid available per student. This requires students to resort to alternative means of financing the cost of attending the university. The impact that will have on enrollment is unknown. The university is not aware of any other factors that will have a significant effect on the financial position or results of operations.

Requests for Information

This financial report is designed to provide a general overview of the institution's finances for all those with an interest in the university's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to:

Mrs. Cynthia B. Brooks
Vice President for Business and Finance
Tennessee State University
3500 John A. Merritt Boulevard
Nashville, Tennessee 37209

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENTS OF NET ASSETS
JUNE 30, 2006, AND JUNE 30, 2005

	Tennessee State University		Component Unit Tennessee State University Foundation	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
ASSETS				
Current assets:				
Cash and cash equivalents (Notes 2 and 16)	$ 11,264,067.79	$ 14,799,136.69	$ 2,518,261.65	$ 2,313,389.76
Short-term investments (Notes 3 and 16)	285,697.70	275,313.78	-	-
Accounts, notes, and grants receivable (net) (Note 4)	7,066,966.31	9,582,812.57	-	-
Pledges receivable (net) (Note 16)	-	-	-	31,000.00
Inventories (at lower of cost or market)	38,816.27	38,892.33	-	-
Accrued interest receivable	1,542,094.12	1,467,010.47	-	-
Total current assets	20,197,642.19	26,163,165.84	2,518,261.65	2,344,389.76
Noncurrent assets:				
Cash and cash equivalents (Notes 2 and 16)	16,342,093.10	13,069,459.72	5,678,425.86	3,780,926.81
Investments (Notes 3 and 16)	12,419,992.60	10,538,421.15	11,185,974.75	9,885,164.72
Accounts, notes, and grants receivable (net) (Note 4)	2,561,185.79	3,477,319.57	-	-
Capital assets (net) (Note 5)	167,319,169.22	156,267,304.33	-	-
Total noncurrent assets	198,642,440.71	183,352,504.77	16,864,400.61	13,666,091.53
Total assets	218,840,082.90	209,515,670.61	19,382,662.26	16,010,481.29
LIABILITIES				
Current liabilities:				
Accounts payable	1,664,317.05	3,290,593.56	5,655.05	757.89
Accrued liabilities	7,265,186.76	6,991,922.33	-	-
Student deposits	1,164,654.91	1,077,209.91	-	-
Deferred revenue	2,505,815.36	2,635,366.67	-	-
Compensated absences (Note 6)	1,260,185.75	1,005,859.93	-	-
Accrued interest payable	266,438.69	236,649.40	-	-
Long-term liabilities, current portion (Notes 6 and 15)	1,044,550.13	1,511,386.78	-	-
Deposits held in custody for others	114,731.40	112,733.95	-	-
Other liabilities	455,440.36	407,583.20	-	-
Total current liabilities	15,741,320.41	17,269,305.73	5,655.05	757.89
Noncurrent liabilities:				
Compensated absences (Note 6)	3,586,088.73	3,592,348.94	-	-
Long-term liabilities (Notes 6 and 15)	32,421,209.97	29,299,077.86	-	-
Due to grantors (Note 6)	3,297,205.01	2,962,319.94	-	-
Total noncurrent liabilities	39,304,503.71	35,853,746.74	-	-
Total liabilities	55,045,824.12	53,123,052.47	5,655.05	757.89
NET ASSETS				
Invested in capital assets, net of related debt	133,853,409.12	125,456,839.69	-	-
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	72,592.10	72,041.48	16,864,211.13	13,657,722.03
Expendable:				
Scholarships and fellowships (Note 16)	374,746.07	153,790.71	1,820,549.78	1,422,114.46
Research	899,429.29	881,844.30	15,804.41	13,744.41
Instructional department uses (Note 7)	2,034,511.94	3,794,927.41	83,372.33	157,466.15
Loans	866,070.58	845,859.37	-	-
Other (Note 16)	2,525,237.15	2,149,739.25	563,312.74	715,837.00
Unrestricted (Note 8)	23,168,262.53	23,037,575.93	29,756.82	42,839.35
Total net assets	$ 163,794,258.78	$ 156,392,618.14	$ 19,377,007.21	$ 16,009,723.40

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

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

	Tennessee State University		Component Unit Tennessee State University Foundation	
	Year Ended June 30, 2006	Year Ended June 30, 2005	Year Ended June 30, 2006	Year Ended June 30, 2005
REVENUES				
Operating revenues:				
Student tuition and fees (net of scholarship allowances of $14,829,063.58 for the year ended June 30, 2006, and $15,232,358.85 for the year ended June 30, 2005)	$ 45,018,004.93	$ 42,271,658.10	$ -	$ -
Gifts and contributions	-	-	918,706.15	967,575.19
Governmental grants and contracts	30,149,197.69	29,360,548.43	-	-
Sales and services of educational departments	2,309,304.96	2,123,916.78	-	-
Auxiliary enterprises:				
Residential life (net of scholarship allowances of $839,045.39 for the year ended June 30, 2006, and $1,100,053.14 for the year ended June 30, 2005; all residentail life revenues are used as security for revenue bonds; see Note 6)	7,249,332.68	6,941,649.02	-	-
Bookstore	121,209.88	205,905.94	-	-
Food service	4,396,311.33	4,208,889.19	-	-
Other auxiliaries	928,306.27	863,507.78	-	-
Other operating revenues	254,367.01	305,135.53	178,318.08	172,359.68
Total operating revenues	90,426,034.75	86,281,210.77	1,097,024.23	1,139,934.87
EXPENSES				
Operating expenses (Note 14):				
Salaries and wages	70,949,834.64	69,316,385.56	-	-
Benefits	21,342,128.61	20,458,443.31	-	-
Utilities, supplies, and other services	46,131,518.71	47,784,365.48	464,165.10	527,276.00
Scholarships and fellowships	6,632,729.81	6,554,372.52	605,975.24	587,814.60
Depreciation expense	7,923,855.15	7,681,782.97	-	-
Payments to or on behalf of Tennessee State University (Note 16)	-	-	80,102.97	24,899.00
Total operating expenses	152,980,066.92	151,795,349.84	1,150,243.31	1,139,989.60
Operating loss	(62,554,032.17)	(65,514,139.07)	(53,219.08)	(54.73)
NONOPERATING REVENUES (EXPENSES)				
State appropriations	44,938,933.87	42,304,789.26	1,000,000.00	1,000,000.00
Gifts, including $80,102.97 from component for the year ended June 30, 2006, and $24,899.00 for the year ended June 30, 2005	732,285.22	1,120,824.51	214,669.78	573,728.10
Grants and contracts	14,941,384.15	16,921,714.42	-	487,677.08
Investment income	1,859,101.23	897,841.66	593,564.34	(4,731.83)
Interest on capital asset-related debt	(1,547,735.93)	(1,526,924.75)	-	-
Bond issuance costs	(76,628.77)	-	-	-
Other nonoperating revenues (expenses)	(3,002,523.98)	763,496.53	-	13,780.46
Net nonoperating revenues	57,844,815.79	60,481,741.63	1,808,234.12	2,070,453.81
Income (loss) before other revenues, expenses, gains, or losses	(4,709,216.38)	(5,032,397.44)	1,755,015.04	2,070,399.08
Capital appropriations	11,745,123.83	1,862,945.46	-	-
Capital grants and gifts	393,237.83	3,972,720.84	-	-
Additions to permanent endowments	-	-	1,612,268.77	461,706.94
Other capital	(27,504.64)	247,179.23	-	-
Total other revenues	12,110,857.02	6,082,845.53	1,612,268.77	461,706.94
Increase in net assets	7,401,640.64	1,050,448.09	3,367,283.81	2,532,106.02
NET ASSETS				
Net assets - beginning of year	156,392,618.14	155,342,170.05	16,009,723.40	13,477,617.38
Net assets - end of year	$ 163,794,258.78	$ 156,392,618.14	$ 19,377,007.21	$ 16,009,723.40

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

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

	Year Ended June 30, 2006	Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 45,723,308.98	$ 42,906,534.22
Grants and contracts	31,948,236.79	27,992,583.76
Sales and services of educational activities	2,239,333.69	2,226,574.85
Payments to suppliers and vendors	(48,039,830.10)	(46,582,232.14)
Payments to employees	(70,481,798.52)	(69,208,246.04)
Payments for benefits	(21,239,388.97)	(20,438,411.83)
Payments for scholarships and fellowships	(6,421,738.06)	(6,554,372.52)
Loans issued to students and employees	(693,851.68)	(734,355.20)
Collection of loans from students and employees	762,524.01	880,892.91
Interest earned on loans to students	74,918.30	159,054.57
Auxiliary enterprise charges:		
Residence halls	7,428,060.92	6,977,157.11
Bookstore	121,209.88	205,905.94
Food services	4,396,311.33	4,208,889.19
Other auxiliaries	884,012.20	865,901.46
Other receipts (payments)	254,367.01	305,135.53
Net cash used by operating activities	(53,044,324.22)	(56,788,988.19)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	44,934,133.87	42,331,789.26
Gifts and grants received for other than capital purposes, including $80,102.97 from Tennessee State University Foundation for the year ended June 30, 2006, and $24,899.00 for the year ended June 30, 2005	15,644,567.37	18,022,931.93
Federal student loan receipts	1,577,025.81	43,529,693.19
Federal student loan disbursements	(1,547,923.81)	(43,510,086.19)
Changes in deposits held for others	1,997.45	(83,077.98)
Other noncapital financing receipts (payments)	(2,970,425.50)	624,676.02
Net cash provided by noncapital financing activities	57,639,375.19	60,915,926.23
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	6,236,150.86	2,251,195.06
Capital appropriations	11,745,123.83	1,862,945.46
Capital grants and gifts received	1,348,957.37	2,412,516.57
Proceeds from sale of capital assets	-	104,865.00
Purchases of capital assets and construction	(18,241,365.10)	(11,372,811.17)
Principal paid on capital debt	(3,657,484.17)	(1,582,965.62)
Interest paid on capital debt	(1,517,946.64)	(1,540,945.49)
Bond issue costs paid on new debt issue	(86,809.47)	-
Other capital and related financing receipts (payments)	6,201.24	163,255.23
Net cash used by capital and related financing activities	(4,167,172.08)	(7,701,944.96)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	5,038,994.62	3,639,587.46
Income on investments	1,201,640.96	752,501.87
Purchases of investments	(6,930,949.99)	(13,589,996.74)
Net cash used by investing activities	(690,314.41)	(9,197,907.41)
Net decrease in cash and cash equivalents	(262,435.52)	(12,772,914.33)
Cash and cash equivalents - beginning of year	27,868,596.41	40,641,510.74
Cash and cash equivalents - end of year	$ 27,606,160.89	$ 27,868,596.41

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

	Year Ended June 30, 2006	Year Ended June 30, 2005
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (62,554,032.17)	$ (65,514,139.07)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	7,923,855.15	7,681,782.97
Change in assets and liabilities:		
Receivables, net	2,718,332.38	(1,319,477.54)
Inventories	76.06	66.09
Accounts payable	(1,626,276.51)	1,529,215.73
Accrued liabilities	334,305.34	155,852.13
Deferred revenue	(129,551.31)	279,295.75
Deposits	87,445.00	102,807.00
Compensated absences	248,065.61	295,608.75
Loans to students and employees	(46,543.77)	-
Net cash used by operating activities	$ (53,044,324.22)	$ (56,788,988.19)
Noncash transactions		
Gifts in-kind	$ 4,559.66	$ -
Unrealized loss on investments	$ (582,376.62)	$ (300,989.66)
Loss on disposal of capital assets	$ (35,296.44)	$ -
Trade-in allowance	$ 10,550.00	$ -

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 financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

The Tennessee State University Foundation is considered a component unit of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements. See Note 16 for more detailed information about the component unit and how to obtain the report.

Basis of Presentation

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

Basis of Accounting

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

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

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

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

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

Cash Equivalents

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

Inventories

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

Compensated Absences

The university's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. The amount of these liabilities and their related benefits are reported in the statement of net assets.

Capital Assets

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

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 software is set at $100,000.

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

Net Assets

The university's net assets are classified as follows:

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

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

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

<u>Unrestricted net assets</u> - Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university, and may be used at the discretion of the university to meet current expenses for any purpose. The

auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

Scholarship Discounts and Allowances

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

NOTE 2. CASH

At June 30, 2006, cash consisted of $16,172,091.52 in bank accounts, $4,550.00 of petty cash on hand, $10,942,639.01 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $486,880.36 in LGIP deposits for capital projects. At June 30, 2005, cash consisted of $17,631,053.74 in bank accounts, $5,525.00 of petty cash on hand, $8,347,324.98 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $1,884,692.69 in LGIP deposits for capital projects.

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 Local Government Investment Pool (LGIP) account. As expenses are incurred, funds are withdrawn from the LGIP account by the Tennessee Board of Regents and transferred to the Department of Finance and Administration. The funds in the account are not available to the university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

NOTE 3. INVESTMENTS

During the year ended June 30, 2005, the university implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*. That statement modified the custodial credit risk disclosures of GASB Statement 3 to limit required disclosures to investment securities that are uninsured, are not registered in the name of the university, and are held by either (a) the counterparty or (b) the counterparty's trust department or agent but not in the university's name.

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, 2006, the university had the following investments and maturities.

		Investment Maturities (in Years)		
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10
U.S. agencies:				
Federal National Mortgage Association	$ 4,748,608.00	$1,480,198.00	$3,153,583.00	$114,827.00
Federal Home Register	303,287.00	-	303,287.00	-
Federal Home Loan Mortgage Corporation	156,685.00	-	156,685.00	-
Federal Home Loan Banks	5,525,487.00	2,078,835.00	3,446,652.00	-
Federal Home Loan Mortgage Association	1,614,502.00	-	1,614,502.00	-
Certificates of deposit	357,121.30	-	357,121.30	-
Total	$12,705,690.30	$3,559,033.00	$9,031,830.30	$114,827.00

At June 30, 2005, the university had the following investments and maturities.

		Investment Maturities (in Years)		
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10
U.S. agencies:				
Federal National Mortgage Association	$ 3,326,081.67	$ -	$3,164,372.50	$161,709.17
Federal Home Register	571,610.88	-	571,610.88	-
Federal Home Loan Mortgage Corporation	543,130.00	543,130.00	-	-
Federal Home Loan Banks	4,396,710.00	323,700.00	4,073,010.00	-

Federal Home Loan Mortgage Association	1,639,465.00	-	1,639,465.00	-
Certificates of deposit	336,737.38	336,737.38	-	-
Total	$10,813,734.93	$1,203,567.38	$9,448,458.38	$161,709.17

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; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool (LGIP). The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified. Securities are rated using Standard and Poor's, Moody's and/or Fitch and are presented below using the Standard and Poor's rating scale. The university has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations.

At June 30, 2006, the university's investments were rated as follows:

Investment Type	Fair Value	Credit Quality Rating AAA	Unrated
LGIP	$11,429,519.37	$ -	$11,429,519.37
U.S. agencies:			
Federal National Mortgage Association	4,748,608.00	4,748,608.00	-
Federal Home Register	303,287.00	303,287.00	-
Federal Home Loan Mortgage Corporation	156,685.00	156,685.00	-
Federal Home Loan Bank	5,525,487.00	5,525,487.00	-
Federal Home Loan Mortgage Association	1,614,502.00	1,614,502.00	-
Certifcates of deposit	357,121.30	-	357,121.30
Total	$24,135,209.67	$12,348,569.00	$11,786,640.67

At June 30, 2005, the university's investments were rated as follows:

Investment Type	Fair Value	Credit Quality Rating AAA	Unrated
LGIP	$10,232,017.67	$ -	$10,232,017.67
U.S. agencies:			
Federal National Mortgage Association	3,326,081.67	3,326,081.67	-
Federal Home Register	571,610.88	571,610.88	-
Federal Home Loan Mortgage Corporation	543,130.00	543,130.00	-
Federal Home Loan Bank	4,396,710.00	4,396,710.00	-
Federal Home Loan Mortgage Association	1,639,465.00	1,639,465.00	-
Certifcates of deposit	336,737.38	-	336,737.38
Total	$21,045,752.60	$10,476,997.55	$10,568,755.05

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2006	June 30, 2005
Student accounts receivable	$ 3,479,283.35	$ 3,976,062.20
Grants receivable	4,536,178.59	6,231,722.02
Notes receivable	453,223.89	455,291.90
State appropriation receivable	152,400.00	147,600.00
Other receivables	1,447,618.54	2,276,996.81
Subtotal	10,068,704.37	13,087,672.93
Less allowance for doubtful accounts	2,373,100.86	1,929,124.96
Total receivables	$ 7,695,603.51	$11,158,547.97

Federal Perkins Loan Program funds included the following:

	June 30, 2006	June 30, 2005
Perkins loans receivable	$16,764,606.84	$16,070,012.34
Less allowance for doubtful accounts	14,832,058.25	14,168,428.17
Total	$ 1,932,548.59	$ 1,901,584.17

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2006, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 9,525,009.24	$ -	$ -	$ -	$ 9,525,009.24
Land improvements and infrastructure	39,779,531.74	-	475,000.00	2,017,176.47	38,237,355.27
Buildings	156,966,583.97	2,017,176.48	-	-	158,983,760.45
Equipment	23,013,775.35	1,785,707.58	-	825,342.11	23,974,140.82
Library holdings	10,271,891.61	1,939,174.60	-	421,156.13	11,789,910.08
Projects in progress	26,181,119.95	15,519,510.88	(475,000.00)	-	41,225,630.83
Total	265,737,911.86	21,261,569.54	-	3,263,674.71	283,735,806.69
Less accum. depreciation:					
Land improvements and infrastructure	25,527,169.73	1,167,568.45	-	809,037.86	25,885,700.32
Buildings	63,580,937.98	4,822,205.68	-	-	68,403,143.66
Equipment	16,657,599.24	1,744,838.84	-	779,495.67	17,622,942.41
Library holdings	3,704,900.58	1,221,106.63	-	421,156.13	4,504,851.08
Total accum. depreciation	109,470,607.53	8,955,719.60	-	2,009,689.66	116,416,637.47
Capital assets, net	$156,267,304.33	$12,305,849.94	$ -	$1,253,985.05	$167,319,169.22

Capital asset activity for the year ended June 30, 2005, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 9,525,009.24	$ -	$ -	$ -	$ 9,525,009.24
Land improvements and infrastructure	39,779,531.74	-	-	-	39,779,531.74
Buildings	156,966,583.97	-	-	-	156,966,583.97
Equipment	21,738,149.43	2,229,249.07	-	953,623.15	23,013,775.35
Library holdings	8,649,226.48	2,050,393.88	-	427,728.75	10,271,891.61
Projects in progress	19,192,816.73	6,988,303.22	-	-	26,181,119.95
Total	255,851,317.59	11,267,946.17	-	1,381,351.90	265,737,911.86
Less accum. depreciation:					

Land improvements and infrastructure	24,236,747.93	1,290,421.80	-	-	25,527,169.73
Buildings	59,832,059.42	3,748,878.56	-	-	63,580,937.98
Equipment	16,138,223.01	1,572,520.61	-	1,053,144.38	16,657,599.24
Library holdings	3,062,667.33	1,069,962.00	-	427,728.75	3,704,900.58
Total accum. depreciation	103,269,697.69	7,681,782.97	-	1,480,873.13	109,470,607.53
Capital assets, net	$152,581,619.90	$ 3,586,163.20	$ -	$ (99,521.23)	$156,267,304.33

NOTE 6. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2006, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$28,268,727.57	$2,676,142.83	$1,526,359.61	$29,418,510.79	$1,044,550.13
Commercial paper	2,541,737.07	3,636,636.80	2,131,124.56	4,047,249.31	-
Subtotal	30,810,464.64	6,312,779.63	3,657,484.17	33,465,760.10	1,044,550.13
Other liabilities:					
Compensated absences	4,598,208.87	3,167,416.66	2,919,351.05	4,846,274.48	1,260,185.75
Due to grantors	2,962,319.94	355,920.49	21,035.42	3,297,205.01	-
Subtotal	7,560,528.81	3,523,337.15	2,940,386.47	8,143,479.49	1,260,185.75
Total long-term liabilities	$38,370,993.45	$9,836,116.78	$6,597,870.64	$41,609,239.59	$2,304,735.88

Long-term liabilities activity for the year ended June 30, 2005, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$29,762,259.54	$ 89,433.65	$1,582,965.62	$28,268,727.57	$1,511,386.78
Commercial paper	379,975.66	2,161,761.41	-	2,541,737.07	-
Subtotal	30,142,235.20	2,251,195.06	1,582,965.62	30,810,464.64	1,511,386.78

Other liabilities:					
Compensated absences	4,302,600.12	2,473,427.74	2,177,818.99	4,598,208.87	1,005,859.93
Due to grantors	2,639,030.06	342,262.33	18,972.45	2,962,319.94	-
Subtotal	6,941,630.18	2,815,690.07	2,196,791.44	7,560,528.81	1,005,859.93
Total long-term liabilities	$37,083,865.38	$5,066,885.13	$3,779,757.06	$38,370,993.45	$2,517,246.71

TSSBA Debt - Bonds

Bonds, with interest rates ranging from 4% to 6.9%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2032 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. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net assets is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $547,480.00 at June 30, 2006, and $992,680.00 at June 30, 2005. Unexpended debt proceeds were $218,875.44 at June 30, 2006.

Debt service requirements to maturity for the university's portion of TSSBA bonds at June 30, 2006, are as follows:

Year Ending June 30	Principal	Interest	Total
2007	$ 1,044,550.13	$ 1,436,725.19	$ 2,481,275.32
2008	1,274,515.62	1,418,807.44	2,693,323.06
2009	1,318,849.04	1,388,124.56	2,706,973.60
2010	1,352,478.56	1,356,471.78	2,708,950.34
2011	1,511,033.14	1,243,115.06	2,754,148.20
2012-2016	8,252,698.17	5,089,231.12	13,341,929.29
2017-2021	6,153,906.72	3,136,051.07	9,289,957.79
2022-2026	4,502,835.91	1,737,683.27	6,240,519.18
2027-2031	3,504,929.38	584,529.99	4,089,459.37
2032	502,714.12	26,392.44	529,106.56
	$29,418,510.79	$17,417,131.92	$46,835,642.71

TSSBA Debt - Commercial Paper

The Tennessee State School Bond Authority issues commercial paper to finance the costs of various capital projects during their construction phase. When projects are placed in service, long-term, fixed-rate debt is issued by TSSBA to finance the project over its useful payback period and the commercial paper is redeemed. The amount issued for projects at the university was $4,047,249.31 at June 30, 2006, and $2,541,737.07 at June 30, 2005.

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

More detailed information regarding the bonds and commercial paper can be found in the notes to the financial statements in the financial report for the Tennessee State School Bond Authority. That report may be obtained by writing to the Director of Bond Finance, Suite 1600, James K. Polk Building, Nashville, Tennessee 37243-0273, or by calling (615) 401-7872.

NOTE 7. ENDOWMENTS

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

The university chooses to spend only a portion of the investment income each year. Under the spending plan established by the university, a scholarship is awarded to a student whose residence is in the county specified by the donor, if it has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income. At June 30, 2006, investment income of $1,767.69 is available to be spent, which is included in restricted net assets expendable for instructional department uses. At June 30, 2005, investment income of $1,141.28 is available to be spent, which is included in restricted net assets expendable for instructional department uses.

NOTE 8. UNRESTRICTED NET ASSETS

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

	June 30, 2006	June 30, 2005
Working capital	$ 1,758,810.71	$ 2,457,428.74
Encumbrances	2,145,551.86	2,405,177.76
Designated fees	921,699.19	1,190,540.95
Auxiliaries	2,766,203.68	2,575,475.57
Plant construction	7,291,573.23	7,373,643.42
Renewal and replacement of equipment	7,973,257.30	7,831,826.96
Unreserved/undesignated	311,166.56	(796,517.47)
Total	$23,168,262.53	$23,037,575.93

NOTE 9. PENSION PLANS

A. Defined Benefit Plans

1. Tennessee Consolidated Retirement System

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

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

Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 10.31% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2006, 2005, and 2004 were $2,676,782.60, $2,918,090.21, and $1,908,272.45. Contributions met the requirements for each year.

2. Federal Retirement Program

Plan Description - The university contributes to the Federal Retirement Program, a cost-sharing, multiple-employer, defined benefit pension plan administered by the Civil Service Retirement System (CSRS) for participants employed prior to January 1, 1984, and the Federal Employees Retirement System (FERS) for participants employed after December 31, 1983. Both systems provide retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. All regular full-time employees of the Tennessee State University Agricultural Extension Service who hold federal appointments for 51% or more of their time are required to participate in either one of the two Federal Retirement Programs. For both systems, benefit provisions are established in federal statutes. Federal statutes are amended by the U.S. Congress. All of the university's extension employees currently participate in CSRS.

The CSRS issues a publicly available financial report that includes financial statements and required supplementary information. The report may be obtained by writing to the Office of Personnel Management, Retirement Information Office, P. O. Box 45, Boyers, Pennsylvania 16017-0045, or by calling (202) 606-0500.

Funding Policy - Participating employees and the university are required to contribute to the CSRS plan. Contribution requirements are established and may be amended by federal statutes. The university is currently required to contribute 7% of covered payroll to the CSRS plan, and employees are required to contribute 7% of covered payroll. Contributions to CSRS for the year ended June 30, 2006, were $73,637.13, which consisted of $36,818.56 from the university and $36,818.57 from the employees. Contributions to CSRS for the year ended June 30, 2005, were $73,788.36, which consisted of $38,321.09 from the university and $35,467.27 from the employees. Contributions for the year ended June 30, 2004, were $71,197.35, which consisted of $36,415.63 from the university and $34,781.72 from the employees. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The university 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 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 contribution made by the university to the plans was $3,481,321.09 for the year ended June 30, 2006, and $3,608,520.89 for the year ended June 30, 2005. Contributions met the requirements for each year.

NOTE 10. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible university retirees. This benefit is provided and administered by the State of Tennessee. The university 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*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 11. INSURANCE-RELATED ACTIVITIES

It is the policy of the state not to purchase commercial insurance for the risks of losses for general liability, automobile liability, professional malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund. The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The Risk Management Fund is also responsible for claims for damages to state-owned property up to the amount of the property insurance aggregate deductible amount. The insurance policy deductibles vary from $25,000 per occurrence, depending on the type of coverage, to an aggregate of $7.5 million.

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 years ended June 30, 2006, and June 30, 2005, are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140. 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, 2006, the Risk Management Fund held $133.2 million in cash and cash equivalents designated for payment of claims. At June 30, 2005, the Risk Management fund held $114.4 million in cash and cash equivalents designated for payment of claims.

At June 30, 2006, the scheduled coverage for the university was $289,942,800 for buildings and $62,342,700 for contents. At June 30, 2005, the scheduled coverage for the university was $263,045,300 for buildings and $33,242,540 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 that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

NOTE 12. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university 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 $31,260,034.92 at June 30, 2006, and $29,765,867.63 at June 30, 2005.

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 $236,656.87 and for personal property were $306,091.61 for the year ended June 30, 2006. Comparative amounts for the year ended June 30, 2005, were $190,471.97 and $185,019.48. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2006, outstanding commitments under construction contracts totaled $8,207,311.21 for the following projects: new Performing Arts Building, north campus improvements, ADA improvements, Agriculture I.T. Center, Avon Williams campus improvements, Power Plant mechanical upgrade, Harned Hall Lab upgrade, LRC bathrooms upgrade, Agriculture Extension Center, McCord and Harned Halls upgrade (Life Science renovation), electrical distribution system, Clement Hall/Allied Health upgrade, residence halls reroofing, and Elliott Hall Exhibition, of which $7,715,917.58 will be funded by future state capital outlay appropriations.

Contract - In December 2004, the Tennessee Board of Regents system entered into a contract with SungardSCT for the purchase of a comprehensive enterprise resource planning system. The contract includes a multi-year phase-in of administrative software for financial, human resource, and student systems. The university's outstanding liability for this contract is estimated as $1,714.475.00 at June 30, 2006.

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

NOTE 13. CHAIRS OF EXCELLENCE

The university had $3,970,325.09 on deposit at June 30, 2006, and $3,683,477.33 on deposit at June 30, 2005, with the State Treasurer for the university's Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

NOTE 14. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses by functional classification for the year ended June 30, 2006, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 34,882,934.34	$ 9,647,076.79	$10,360,112.89	$2,211,797.86	$ -	$ 57,101,921.88
Research	5,730,464.12	1,678,070.61	4,549,518.19	280,107.87	-	12,238,160.79
Public service	3,753,208.60	1,300,289.92	1,240,223.71	84,360.25	-	6,378,082.48

Academic support	5,669,220.42	1,780,074.12	1,625,839.22	109,000.82	-	9,184,134.58
Student services	6,700,774.01	1,968,810.55	4,448,969.54	2,215,132.90	-	15,333,687.00
Institutional support	9,247,266.72	3,097,985.54	1,389,501.73	10,853.00	-	13,745,606.99
Operation & maintenance	3,052,793.06	1,272,949.51	10,717,716.31	-	-	15,043,458.88
Scholar. & fellow.	4,346.80	901.67	4,099,941.76	1,546,275.11	-	5,651,465.34
Auxiliary	1,908,826.57	595,969.90	7,699,695.36	175,202.00	-	10,379,693.83
Depreciation	-	-	-	-	7,923,855.15	7,923,855.15
Total	$70,949,834.64	$21,342,128.61	$46,131,518.71	$6,632,729.81	$7,923,855.15	$152,980,066.92

The university's operating expenses by functional classification for the year ended June 30, 2005, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 33,587,335.76	$ 9,166,990.79	$11,897,190.59	$1,229,218.53	$ -	$ 55,880,735.67
Research	5,720,966.86	1,699,366.62	4,954,356.59	300,433.16	-	12,675,123.23
Public service	3,875,579.83	1,179,042.51	1,581,574.15	19,744.62	-	6,655,941.11
Academic support	5,303,409.89	1,605,530.85	2,785,601.47	31,884.25	-	9,726,426.46
Student services	6,620,757.93	1,946,472.65	5,071,066.46	1,181,920.38	-	14,820,217.42
Institutional support	9,377,340.15	3,149,556.84	1,691,785.92	7,194.54	-	14,225,877.45
Operation & maintenance	2,979,536.62	1,151,193.24	5,722,865.84	-	-	9,853,595.70
Scholar. & fellow.	-	-	6,043,311.77	3,667,997.71	-	9,711,309.48
Auxiliary	1,851,458.52	560,289.81	8,036,612.69	115,979.33	-	10,564,340.35
Depreciation	-	-	-	-	7,681,782.97	7,681,782.97
Total	$69,316,385.56	$20,458,443.31	$47,784,365.48	$6,554,372.52	$7,681,782.97	$151,795,349.84

NOTE 15. PRIOR-YEAR RESTATEMENT

In the prior year, the commercial paper payable was not accurately allocated between current and noncurrent long-term liabilities. The following amounts have been restated to comply with the requirements of Financial Accounting Standards Board Statement No. 6, *Classification of Short-term Obligations Expected to be Refinanced*.

	Original Amount	Increase/(Decrease)	Restated Amount
Statement of net assets:			
Long-term liabilities, current	$ 4,053,123.85	$(2,541,737.07)	$ 1,511,386.78
Long-term liabilities, noncurrent	$26,757,340.79	$ 2,541,737.07	$29,299,077.86

NOTE 16. COMPONENT UNIT

The Tennessee State University Foundation is a legally separate, tax-exempt organization supporting 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 10-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. The size of the board shall be determined by the majority vote of its members, and any vacancy in its membership shall be filled in the same way. The entire membership of the Board of Trustees shall not exceed 25 in number with a minimum of 8. All trustees shall serve until the expiration of their respective terms and until their respective successors are selected and qualified. 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, 2006, the foundation made distributions of $80,102.97 to or on behalf of the university for both restricted and unrestricted purposes. During the year ended June 30, 2005, the foundation made distributions of $24,899.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Mr. Shereitte Stokes, Vice President for University Relations and Development, 3500 John A. Merritt Boulevard, Nashville, Tennessee 37209.

<u>Cash and cash equivalents</u> - At June 30, 2006, cash and cash equivalents consisted of $969,376.50 in bank accounts, $189.48 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $7,227,121.53 in capital management account money funds and short-term investments. At June 30, 2005, cash and cash equivalents consisted of $2,754,769.07 in bank accounts, $37,897.59 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $3,301,649.91 in capital management account money funds.

<u>Investments</u> - 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.

Tennessee Board of Regents
Tennessee State University
Notes to the Financial Statements (Cont.)
June 30, 2006, and June 30, 2005

At June 30, 2006, 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	No Maturity Date
U.S. Treasury	$ 318,739.30	$ -	$ 48,531.25	$ -	$270,208.05	$ -
U.S. agencies	603,649.79	-	553,516.69	50,133.10	-	-
Corporate stocks	705,019.81	-	-	-	-	705,019.81
Corporate bonds	3,208,371.04	323,287.61	2,478,990.60	406,092.83	-	-
Mutual funds	2,462,110.31	-	-	-	-	2,462,110.31
Other:						
Fixed income CDs	111,162.16	37,487.76	73,674.40	-	-	-
Mortgage backed securities	198,073.26	-	-	-	198,073.26	-
Equity stock	7,411.53	-	-	-	-	7,411.53
Real estate shares	1,900,991.30	-	-	-	-	1,900,991.30
Real estate holdings	1,670,446.25	-	-	-	-	1,670,446.25
Money funds and short-term investments	7,227,121.53	-	-	-	-	7,227,121.53
Less amount reported as cash and cash equivalents:						
Other:						
Money funds and short-term investments	(7,227,121.53)	-	-	-	-	(7,227,121.53)
Total	$11,185,974.75	$360,775.37	$3,154,712.94	$456,225.93	$468,281.31	$6,745,979.20

At June 30, 2005, 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	No Maturity Date
U.S. Treasury	$ 728,062.14	$ 56,973.78	$ 107,681.09	$124,978.02	$438,429.25	$ -
U.S. agencies	806,427.68	189,021.10	565,849.43	51,557.15	-	-
Corporate stocks	1,934,625.41	-	-	-	-	1,934,625.41
Corporate bonds	2,728,524.85	50,836.00	1,098,603.86	504,025.01	-	1,075,059.98
Mutual funds	1,893,612.02	-	-	-	-	1,893,612.02
Other:						
Fixed income CDs	150,395.57	36,910.09	113,485.48	-	-	-
Mortgage backed securities	254,840.39	-	-	-	254,840.39	-
Equity stock	14,199.90	-	-	-	-	14,199.90
Real estate holdings	1,374,476.76	-	-	-	-	1,374,476.76
Money funds	3,301,649.91	-	-	-	-	3,301,649.91
Less amount reported as cash and cash equivalents:						
Other:						
Money funds	(3,301,649.91)	-	-	-	-	(3,301,649.91)
Total	$9,885,164.72	$333,740.97	$1,885,619.86	$680,560.18	$693,269.64	$6,291,974.07

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 foundation does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value lossess 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. Securities are rated using Standard and Poor's, Moody's, and/or Fitch and are presented below using the Standard and Poor's rating scale. The foundation has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations.

At June 30, 2006, the foundation's investments were rated as follows:

		Credit Quality Ratings				
Investment Type	Fair Value	AAA	AA	A	BBB	Unrated
LGIP	$ 189.48	$ -	$ -	$ -	$ -	$ 189.48
U.S. agencies	603,649.79	553,516.69	50,133.10	-	-	-
Corporate bonds	3,208,371.04	91,511.99	328,807.12	2,623,809.57	164,242.36	-
Mutual funds	2,462,110.31	-	-	-	-	2,462,110.31
Mortgage backed securities	198,073.26	-	-	-	-	198,073.26
Total	$6,472,393.88	$645,028.68	$378,940.22	$2,623,809.57	$164,242.36	$2,660,373.05

At June 30, 2005, the foundation's investments were rated as follows:

		Credit Quality Ratings				
Investment Type	Fair Value	AAA	AA	A	BBB	Unrated
LGIP	$ 37,897.59	$ -	$ -	$ -	$ -	$ 37,897.59
U.S. agencies	806,427.68	806,427.68	-	-	-	-
Corporate bonds	2,728,524.85	97,312.12	341,764.85	1,037,727.15	176,660.75	1,075,059.98
Mutual funds	1,893,612.02	-	-	-	-	1,893,612.02
Mortgage backed securities	254,840.39	-	-	-	-	254,840.39
Total	$5,721,302.53	$903,739.80	$341,764.85	$1,037,727.15	$176,660.75	$3,261,409.98

Concentration of credit risk - The foundation places no limit on the amount it may invest in any one issuer.

More than 5% of the foundation's investments were invested in the following single issuers at June 30, 2006.

Issuer	Percentage of Total Investments
AmSouth Bank	24.5%
Charles Schwab International	51.1%
Diversified Trends	10.1%
Inland American	5.2%
Man-Glenwood	5.2%

More than 5% of the foundation's investments were invested in the following single issuers at June 30, 2005.

Issuer	Percentage of Total Investments
AmSouth Bank	38.8%
Charles Schwab International	42.0%
Diversified Trends	12.5%
Man-Glenwood	6.7%

Pledges Receivable - Pledges receivable are summarized below. At June 30, 2005, all were considered to be collectible.

	June 30, 2006	June 30, 2005
Current pledges	$ -	$31,000.00
Less discount to net present value	(-)	(-)
Total pledges receivable	$ -	$31,000.00

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

The foundation chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the foundation, the cost of operating Tennessee State University including general operating costs and maintenance costs, and the cost of administering and managing the endowment fund has been authorized for expenditure. For Title III funds, the foundation must reinvest a minimum of 50% of the annual income generated by the fund. For the Consent Decree fund, the foundation must reinvest a minimum of 25% of the annual income and may spend up to 75% of the annual income generated by the fund with all disbursement decisions made at the sole discretion of the Budget Committee established by the trust agreement. At June 30, 2006, net appreciation of $309,929.91 is available to be spent, which is included in restricted net assets expendable for scholarships and fellowships. At June 30, 2005, net appreciation of $146,756.06 is available to be spent, which is included in restricted net assets expendable for other.

TENNESSEE BOARD OF REGENTS
TENNESSEE STATE UNIVERSITY
SUPPLEMENTARY INFORMATION
STATEMENTS OF CASH FLOWS - COMPONENT UNIT
FOR THE YEARS ENDED JUNE 30, 2006, AND JUNE 30, 2005

	Year Ended June 30, 2006	Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$ 949,706.15	$ 967,575.19
Payments to suppliers and vendors	(459,267.94)	(559,004.68)
Payments for scholarships and fellowships	(605,975.24)	(587,814.60)
Payments to Tennessee State University	(80,102.97)	(24,899.00)
Other receipts (payments)	178,318.08	172,359.68
Net cash used by operating activities	(17,321.92)	(31,783.41)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	1,000,000.00	1,000,000.00
Gifts and grants received for other than capital purposes	-	487,677.08
Private gifts for endowment purposes	214,669.78	573,728.10
Other noncapital financing receipts (payments)	-	470,755.57
Net cash provided by noncapital financing activities	1,214,669.78	2,532,160.75
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	4,883,872.80	16,377,706.50
Income on investments	593,564.34	10,796.57
Purchases of investments	(4,444,649.57)	(20,286,394.95)
Other investing receipts (payments)	(127,764.49)	-
Net cash provided (used) by investing activities	905,023.08	(3,897,891.88)
Net increase (decrease) in cash and cash equivalents	2,102,370.94	(1,397,514.54)
Cash and cash equivalents - beginning of year	6,094,316.57	7,491,831.11
Cash and cash equivalents - end of year	$ 8,196,687.51	$ 6,094,316.57
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (53,219.08)	$ (54.73)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Change in assets and liabilities:		
Receivables, net	31,000.00	-
Accounts payable	4,897.16	(31,728.68)
Net cash used by operating activities	$ (17,321.92)	$ (31,783.41)