AUDIT REPORT

Tennessee Board of Regents

Tennessee State University

For the Year Ended
June 30, 2013

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

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March 13, 2014

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor
Dr. Glenda Baskin Glover, President

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, 2013. You will note from the independent auditor's report that unmodified opinions were given on the fairness of the presentation of the financial statements.

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

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

13/062

Audit Report
Tennessee Board of Regents
Tennessee State University
For the Year Ended June 30, 2013

TABLE OF CONTENTS

	Page
Audit Highlights	1
Financial Section	
Independent Auditor's Report	2
Management's Discussion and Analysis	5
Basic Financial Statements	
Statement of Net Position	14
Statement of Revenues, Expenses, and Changes in Net Position	15
Statement of Cash Flows	16
Notes to the Financial Statements	18
Required Supplementary Information	
OPEB Schedule of Funding Progress	38
Supplementary Information	
Schedule of Cash Flows – Component Unit	39
Internal Control, Compliance, and Other Matters	
Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*	40

TABLE OF CONTENTS (Continued)

		Page
Findings and Recommendations		42
Finding 1	- Tennessee State University did not provide adequate information technology controls over the Banner computer system	42
Finding 2	- The Bursar's Office did not properly report student status changes to the contracted Perkins loan servicer, resulting in delayed conversions to repayment status for certain students	43
Finding 3	- Tennessee State University staff did not always promptly return financial aid refunds caused by unofficial withdrawals	45

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit

Tennessee Board of Regents

Tennessee State University

For the Year Ended June 30, 2013

Opinions on the Financial Statements

The opinions on the financial statements are unmodified.

Audit Findings

Tennessee State University did not provide adequate information technology controls over the Banner computer system*

As noted in the prior audit, management of the university's Communications and Information Technology Office did not design and monitor adequate internal controls over information technology related to its Banner computer system (page 42).

The Bursar's Office did not properly report student status changes to the contracted Perkins loan servicer, resulting in delayed conversions to repayment status for certain students

The Bursar's Office did not properly report status changes to the contracted Perkins loan servicer, resulting in delayed conversions to repayment status for those student borrowers who dropped below half-time enrollment without graduating (page 43).

Tennessee State University staff did not always promptly return financial aid refunds caused by unofficial withdrawals

Refunds owed to the U.S. Department of Education were not always promptly returned throughout the fiscal year (page 45).

* This finding is repeated from the prior audit.

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Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor
Dr. Glenda Baskin Glover, President

Report on the Financial Statements

We have audited the accompanying 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, 2013, as well as the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements, based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

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

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

Opinions

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

Emphasis of Matters

As discussed in Note 1, the financial statements of Tennessee State University, an institution of the Tennessee Board of Regents, are intended to present the financial position, the changes in financial position, and the cash flows of only Tennessee State University. They do not purport to, and do not, present fairly the financial position of the Tennessee Board of Regents as of June 30, 2013, and the changes in financial position and cash flows thereof for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 1, the university implemented GASB Statement 65, *Items Previously Reported as Assets and Liabilities*, during the year ended June 30, 2013. Our opinion is not modified with respect to this matter.

As discussed in Note 17, the financial statements of Tennessee State University Foundation, a discretely presented component unit of Tennessee State University, include investments valued at $2,124,777.32 (3.8% of net position of the foundation), whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 13 and the schedule of funding progress on page 38 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the university's basic financial statements. The schedule of cash flows – component unit on page 39 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The schedule of cash flows – component unit is the responsibility of the university's management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the schedule of cash flows – component unit is fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 5, 2013, on our consideration of the university's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the university's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 5, 2013

Introduction

This section of Tennessee State University's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2013, with comparative information presented for the fiscal year ended June 30, 2012. This discussion along with the financial statements and related note disclosures has been prepared by management and should be read in conjunction with the independent auditor's report, the audited financial statements, and the accompanying notes. The financial statements, notes, and this discussion are the responsibility of management.

The university has one discretely presented component unit, the Tennessee State University Foundation. More detailed information about the foundation is presented in Note 17 to the financial statements. This discussion and analysis focuses on the university and does not include the foundation.

Overview of the Financial Statements

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

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

The Statement of Net Position

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

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

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

The following table summarizes the university's assets, liabilities, deferred outflows/inflows, and net position at June 30, 2013, and June 30, 2012.

Summary of Net Position
(in thousands of dollars)

	2013	2012
Assets:		
Current assets	$ 41,699	$ 40,012
Capital assets, net	164,281	163,119
Other assets	61,023	62,677
Total Assets	267,003	265,808
Deferred Outflows of Resources:		
Deferred loss on debt refunding	97	-
Total Deferred Outflows of Resources	97	-
Liabilities:		
Current liabilities	21,878	22,584
Noncurrent liabilities	48,718	50,588
Total Liabilities	70,596	73,172

Net Position:		
Net investment in capital assets	128,935	125,143
Restricted – nonexpendable	74	74
Restricted – expendable	5,891	6,145
Unrestricted	61,604	61,274
Total Net Position	$196,504	$192,636

Comparison of FY 2013 to FY 2012

- No material variances were noted when comparing FY 2013 to FY 2012.

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

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

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

A summary of the university's revenues, expenses, and changes in net position for the year ended June 30, 2013, and June 30, 2012, follows.

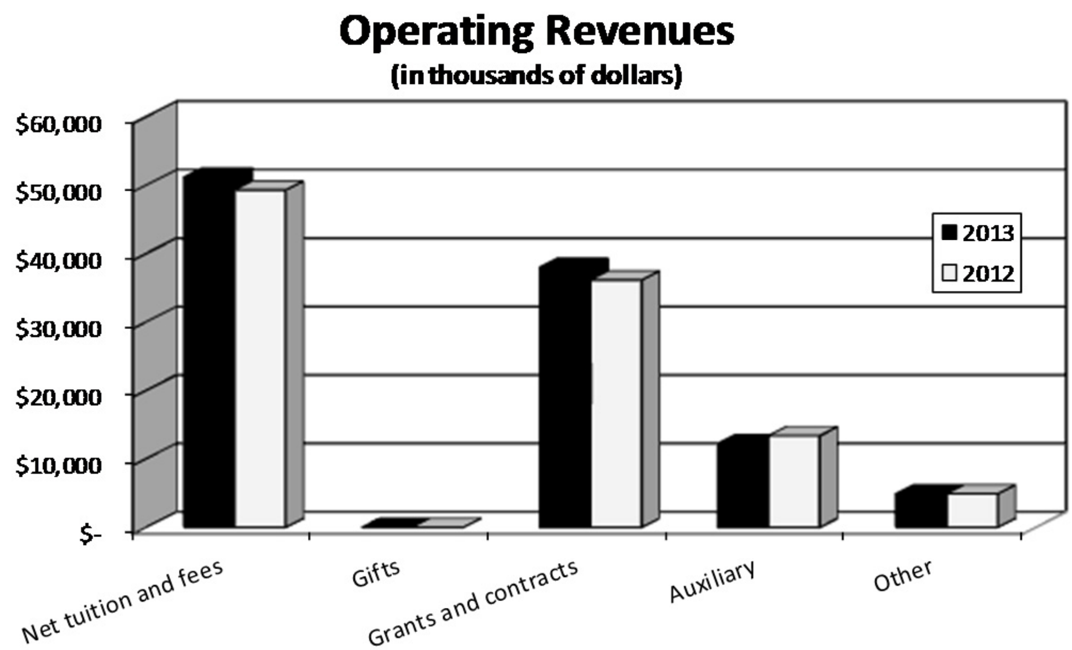
Summary of Revenues, Expenses, and Changes in Net Position
(in thousands of dollars)

	2013	2012
Operating revenues	$106,215	$103,726
Operating expenses	176,626	177,107
Operating loss	(70,411)	(73,381)
Nonoperating revenues and expenses	65,044	66,494
Loss before other revenues, expenses, gains, or losses	(5,367)	(6,887)

Other revenues, expenses, gains, or losses	9,235	6,962
Increase in net position	3,868	75
Net position at beginning of year	192,636	193,717
Prior period adjustment	-	(1,156)
Net position at end of year	$196,504	$192,636

Operating Revenues

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

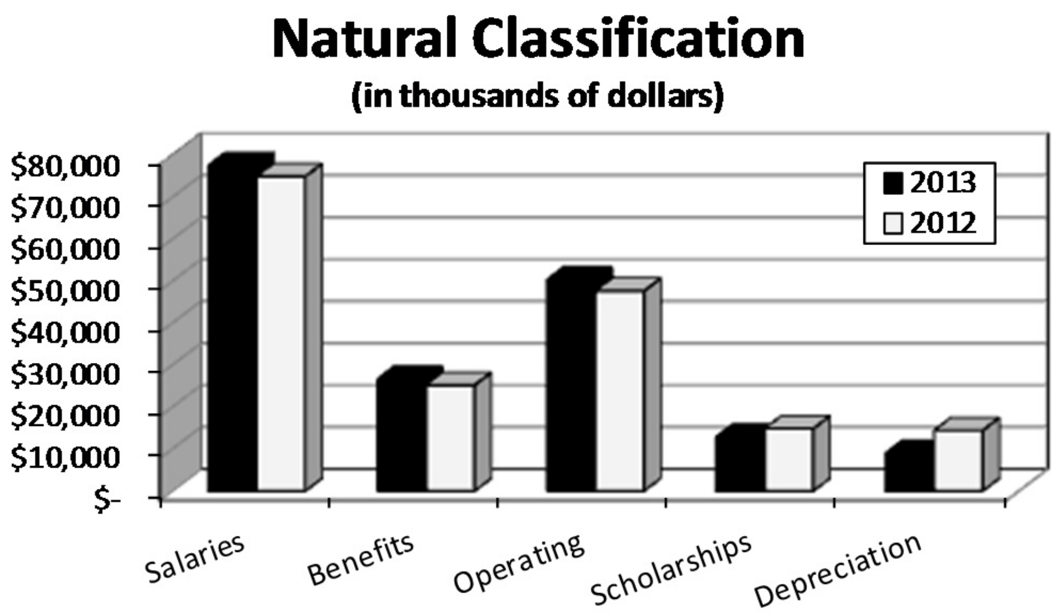


Comparison of FY 2013 to FY 2012

- A majority of the increase in grants and contracts was due to the Strengthening Instruction in the Teaching of Elementary Schools – Mathematics (SITES-M) First to the Top grant being new at the end of fiscal year 2012, but active throughout all of fiscal year 2013. Also, a few other grants had minor increases in salaries and travel, which required an increased award.

Operating Expenses

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



Comparison of FY 2013 to FY 2012

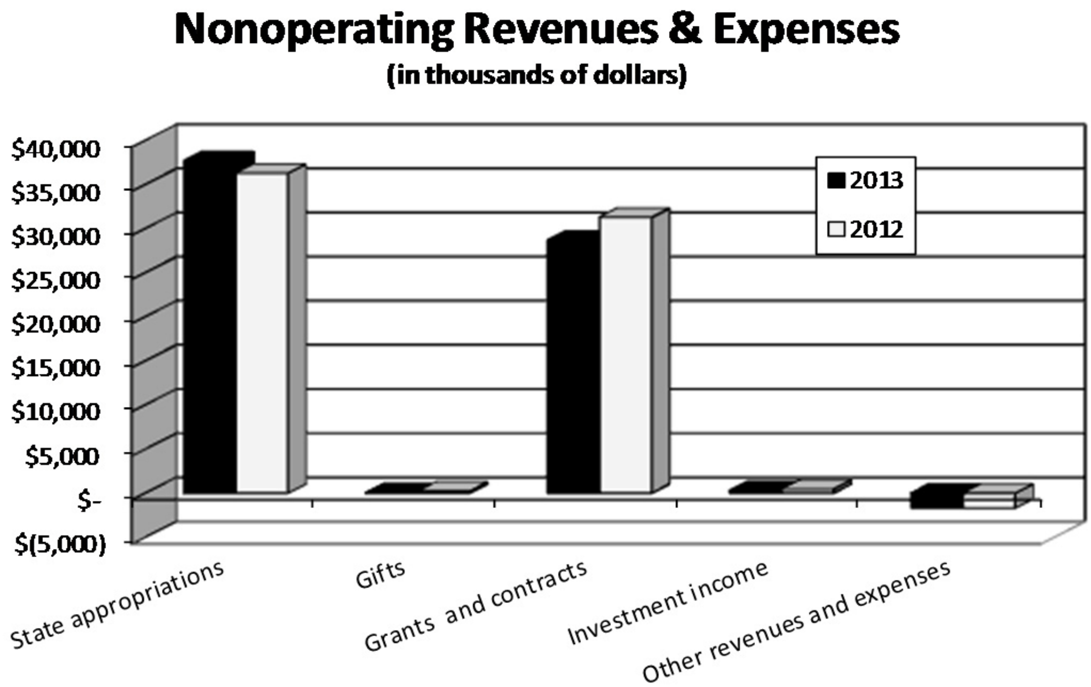
- Scholarships were reduced in fiscal year 2013 due to a drop in enrollment, therefore reducing Pell grants by approximately $2 million.

- Depreciation expenses decreased due to a change in accounting estimate regarding the useful life of periodicals, causing $5.6 million of previously undepreciated library holdings to be expensed in fiscal year 2012.

- A new full-time president and related support positions were hired during fiscal year 2013, causing an increase in institutional support salaries of approximately $900,000.

Nonoperating Revenues and Expenses

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

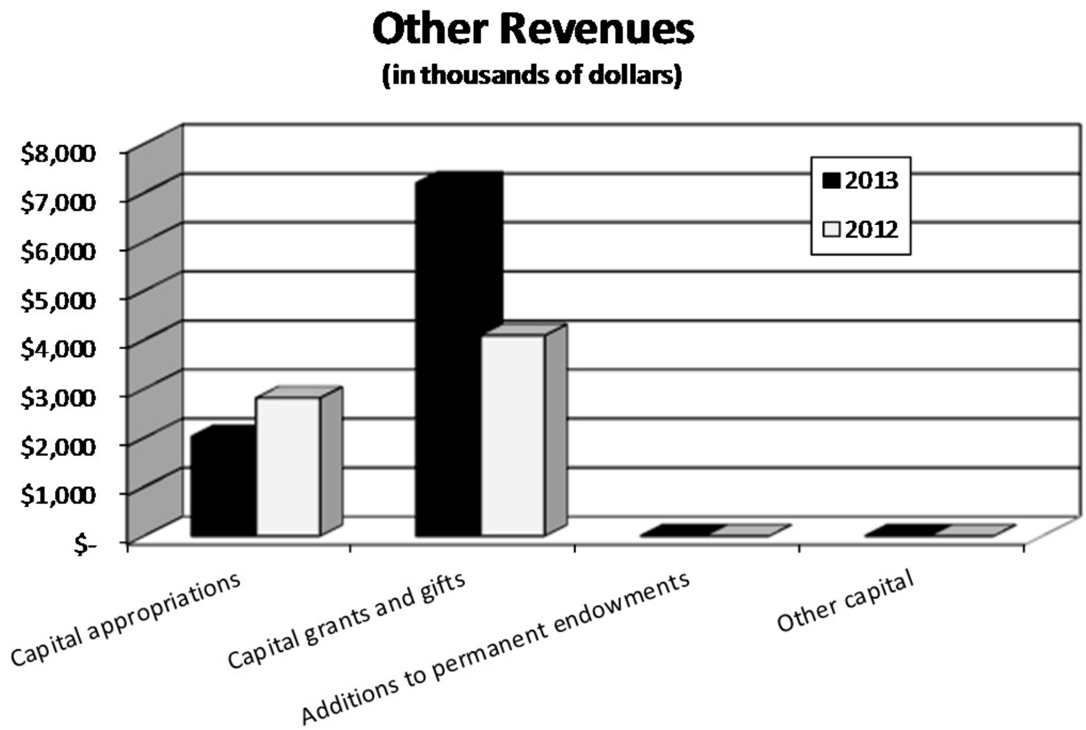


Comparison of FY 2013 to FY 2012

- Grants and contracts were reduced in fiscal year 2013 due to a drop in enrollment, therefore reducing Pell grants by approximately $2 million.

Other Revenues

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



Comparison of FY 2013 to FY 2012

- The Boswell chemistry building renovation was completed during the fiscal year, causing a drop in the amount of capital appropriations acquired.

- Capital grants and gifts were increased by $3 million to cover the construction of a new Biotech building.

Capital Assets and Debt Administration

Capital Assets

Tennessee State University had $164,281,519.11 invested in capital assets, net of accumulated depreciation of $164,345,736.39 at June 30, 2013, and $163,118,486.79 invested in capital assets, net of accumulated depreciation of $156,340,183.40 at June 30, 2012. Depreciation charges totaled $9,036,687.53 and $14,416,005.96 for the years ended June 30, 2013, and June 30, 2012, respectively.

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

	2013	2012
Land	$ 9,525	$ 9,525
Land improvements and infrastructure	12,605	14,293
Buildings	123,699	121,354
Equipment	6,624	6,813
Library holdings	1,573	1,706
Intangible assets	953	1,192
Projects in progress	9,302	8,236
Total	$164,281	$163,119

Significant additions to capital assets occurred in fiscal year 2013 with the completion of the renovations of the Boswell chemistry building, Avon Williams Campus, and Hale Stadium. At June 30, 2013, outstanding commitments under construction contracts totaled $3,990,720.58 for various renovations and repairs of buildings and infrastructure. Future state capital outlay appropriations will fund $1,478,656.55 of these costs.

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

Debt

The university had $35,444,280.36 and $37,975,708.76 in debt outstanding at June 30, 2013, and June 30, 2012, respectively. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt
(in thousands of dollars)

	2013	2012
TSSBA bonds payable	$33,793	$33,645
Unamortized bond premium/discount	1,651	1,130
TSSBA commercial paper payable	-	3,200
Total	$35,444	$37,975

The TSSBA issued bonds with interest rates ranging from 0.35% to 5.666% due May 1, 2032, on behalf of Tennessee State University. The university is responsible for the debt service of these bonds. The current portion of the $33,793,149.46 outstanding at June 30, 2013, is $2,626,415.54.

The ratings on debt issued by the Tennessee State School Bond Authority at June 30, 2013, were as follows:

Fitch	AA+
Moody's Investor Service	Aa1

Standard & Poor's	AA

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

Economic Factors That Will Affect the Future

The fiscal year 2014 budget will include an increase in tuition and fees. The impact of the fee increase on enrollment is not known. The university is not aware of any other factors that will have a significant effect on the financial position or results of operations.

TENNESSEE STATE UNIVERSITY
Statement of Net Position
June 30, 2013

	University	Component Unit
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 17)	$ 24,612,775.81	$ 4,133,251.46
Short-term investments (Notes 3 and 17)	1,186,057.03	2,979,033.38
Accounts, notes, and grants receivable (net) (Note 4)	13,842,234.03	1,714.37
Due from university	-	19,147.88
Inventories (at lower of cost or market)	21,706.38	-
Accrued interest receivable	2,035,877.15	-
Total current assets	41,698,650.40	7,133,147.09
Noncurrent assets:		
Cash and cash equivalents (Notes 2 and 17)	45,020,816.13	2,150,168.69
Investments (Notes 3 and 17)	14,340,364.03	40,754,798.36
Accounts, notes, and grants receivable (net) (Note 4)	1,661,767.82	-
Capital assets (net) (Notes 5 and 17)	164,281,519.11	6,000,000.00
Total noncurrent assets	225,304,467.09	48,904,967.05
Total assets	267,003,117.49	56,038,114.14
DEFERRED OUTFLOWS OF RESOURCES		
Deferred loss on debt refunding (Note 7)	97,458.84	-
Total deferred outflows of resources	97,458.84	-
LIABILITIES		
Current liabilities:		
Accounts payable (Note 6)	5,019,861.15	34,241.95
Accrued liabilities	7,776,440.08	-
Due to grantors (Note 7)	72,472.68	-
Due to component unit	19,147.88	-
Unearned revenue	4,686,790.38	-
Compensated absences (Note 7)	1,044,858.99	-
Accrued interest payable	283,759.65	-
Long-term liabilities, current portion (Note 7)	2,626,415.54	-
Deposits held in custody for others	348,084.77	-
Total current liabilities	21,877,831.12	34,241.95
Noncurrent liabilities:		
Net OPEB obligation (Note 11)	7,340,925.11	-
Compensated absences (Note 7)	4,657,470.15	-
Long-term liabilities (Note 7)	32,817,864.82	-
Due to grantors (Note 7)	3,902,237.17	-
Total noncurrent liabilities	48,718,497.25	-
Total liabilities	70,596,328.37	34,241.95
NET POSITION		
Net investment in capital assets	128,934,697.59	6,000,000.00
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	24,405.41	4,977,852.67
Research	-	570,647.56
Instructional department uses	50,000.00	678,305.78
Other	-	33,997,200.44
Expendable:		
Scholarships and fellowships (Notes 8 and 17)	1,453,992.86	2,368,771.52
Research	439,770.70	27,473.31
Instructional department uses (Notes 8 and 17)	1,971,243.32	408,217.91
Loans	157,241.39	-
Other (Note 17)	1,869,245.08	6,716,996.28
Unrestricted	61,603,651.61	258,406.72
Total net position	$ 196,504,247.96	$ 56,003,872.19

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

Tennesee Board of Regents
TENNESSEE STATE UNIVERSITY
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2013

	University	Component Unit
REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of $21,765,367.40)	$ 51,135,999.72	$ -
Gifts and contributions	-	1,500,636.60
Governmental grants and contracts	36,638,038.23	-
Nongovernmental grants and contracts	1,386,501.06	-
Sales and services of educational activities	186,250.28	-
Sales and services of other activities	4,508,462.42	245,170.89
Auxiliary enterprises:		
Residential life (net of scholarship allowances of $4,460,342.34; all residential life revenues are used as security for revenue bonds; see Note 7)	5,626,903.67	-
Bookstore	217,171.34	-
Food service	5,554,551.25	-
Other auxiliaries	794,681.66	-
Interest earned on loans to students	157,423.56	-
Other operating revenues	8,873.45	-
Total operating revenues	106,214,856.64	1,745,807.49
EXPENSES		
Operating expenses (Note 15):		
Salaries and wages	77,600,209.79	-
Benefits	26,727,198.99	-
Utilities, supplies, and other services	50,356,130.10	836,946.49
Scholarships and fellowships	12,905,758.32	965,442.37
Depreciation expense	9,036,687.53	-
Payments to or on behalf of Tennessee State University (Note 17)	-	52,177.80
Total operating expenses	176,625,984.73	1,854,566.66
Operating loss	(70,411,128.09)	(108,759.17)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	37,689,604.00	-
Gifts, including $52,177.80 from component unit	54,041.20	-
Grants and contracts	28,698,006.24	1,456,954.28
Investment income (net of investment expense of $71,781.39 for the university and $203,737.36 for the component unit)	278,563.60	3,549,373.24
Interest on capital asset-related debt	(1,594,391.31)	-
Bond issuance costs	(12,699.15)	-
Other nonoperating revenues (expenses)	(69,308.52)	419.04
Net nonoperating revenues	65,043,816.06	5,006,746.56
Income (loss) before other revenues, expenses, gains, or losses	(5,367,312.03)	4,897,987.39
Capital appropriations	2,033,182.82	-
Capital grants and gifts	7,202,309.37	-
Additions to permanent endowments	-	1,191,999.38
Total other revenues	9,235,492.19	1,191,999.38
Increase in net position	3,868,180.16	6,089,986.77
NET POSITION		
Net position - beginning of year	192,636,067.80	49,913,885.42
Net position - end of year	$ 196,504,247.96	$ 56,003,872.19

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

Tennessee Board of Regents
TENNESSEE STATE UNIVERSITY
Statement of Cash Flows
For the Year Ended June 30, 2013

CASH FLOWS FROM OPERATING ACTIVITIES	
Tuition and fees	$50,840,447.33
Grants and contracts	36,239,841.30
Sales and services of educational activities	186,250.28
Sales and services of other activities	4,566,646.82
Payments to suppliers and vendors	(51,685,445.58)
Payments to employees	(77,132,693.17)
Payments for benefits	(26,122,842.44)
Payments for scholarships and fellowships	(12,905,758.32)
Loans issued to students	(722,869.36)
Collections of loans from students	556,545.06
Interest earned on loans to students	5,133.74
Auxiliary enterprise charges:	
Residence halls	5,626,903.67
Bookstore	332,744.96
Food services	5,535,620.35
Other auxiliaries	795,236.66
Other receipts (payments)	1,093,806.60
Net cash used by operating activities	(62,790,432.10)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
State appropriations	37,787,300.00
Gifts and grants received for other than capital or endowment purposes, including $52,177.80 from Tennessee State University Foundation	28,752,047.44
Federal student loan receipts	70,976,321.00
Federal student loan disbursements	(70,976,321.00)
Changes in deposits held for others	27,433.72
Net cash provided by noncapital financing activities	66,566,781.16
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES	
Proceeds from capital debt	1,519,178.01
Capital appropriations	2,033,182.82
Capital grants and gifts	6,711,272.11
Purchase of capital assets and construction	(10,261,138.80)
Principal paid on capital debt	(2,486,456.95)
Interest paid on capital debt	(1,483,123.76)
Bond issuance costs paid on new debt	(12,699.15)
Net cash used by capital and related financing activities	(3,979,785.72)
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sales and maturities of investments	9,078,390.92
Income on investments	731,523.53
Purchase of investments	(9,083,264.37)
Net cash provided by investing activities	726,650.08
Net increase in cash	523,213.42
Cash and cash equivalents - beginning of year	69,110,378.52
Cash and cash equivalents - end of year	$69,633,591.94

Tennessee Board of Regents
TENNESSEE STATE UNIVERSITY
Statement of Cash Flows (Continued)
For the Year Ended June 30, 2013

Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	$ (70,411,128.09)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Depreciation expense	9,036,687.53
Other adjustments (Note 16)	58,404.00
Change in assets, liabilities, and deferrals:	
Receivables, net	(1,708,364.11)
Inventories	3,311.62
Prepaid items	24,926.21
Other assets	1,084,785.27
Accounts payable	(551,748.77)
Accrued liabilities	482,061.02
Unearned revenue	(1,141,042.05)
Compensated absences	519,193.14
Due to grantors	72,472.68
Loans to students	(241,938.43)
Other	(18,052.12)
Net cash used by operating activities	$ (62,790,432.10)

Noncash investing, capital, and financing activities	
Gifts in-kind - capital	$ 434,025.97
Loss on disposal of capital assets	$ (61,418.95)

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

Note 1. Summary of Significant Accounting Policies

Reporting Entity

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

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

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 its 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 17 for more detailed information about the component unit and how to obtain the report.

Basis of Presentation

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

Basis of Accounting

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

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

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

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

Cash Equivalents

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

Inventories

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

Compensated Absences

The university's employees accrue annual and sick leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time.

The amount of the liabilities for annual leave and compensatory time and their related benefits are reported in the statement of net position. There is no liability for unpaid accumulated sick leave since the university's policy is to pay this only if the employee dies or is absent because of illness, injury, or related family death.

Capital Assets

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

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

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

Net Position

The university's net position is classified as follows:

Net investment in capital assets – This represents the university's total investment in capital assets, net of accumulated depreciation and net of outstanding debt obligations and deferred outflows/inflows of resources related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of net investment in capital assets.

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

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

Unrestricted net position – Unrestricted net position represents resources derived from student tuition and fees; state appropriations; sales and services of educational departments and other activities; and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university and may be used at the university's discretion to meet current expenses for any purpose. The auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

Scholarship Discounts and Allowances

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

Accounting Change

The university implemented GASB Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the university was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

Early Implementation of Accounting Pronouncement

In March 2012, GASB issued Statement No. 65, *Items Previously Reported as Assets and Liabilities*. This statement establishes accounting and financial reporting standards that reclassify, as deferred outflows of resources or deferred inflows of resources, certain items that were previously reported as assets and liabilities; it also recognizes, as outflows of resources or inflows of resources, certain items that were previously reported as assets and liabilities. The provisions of this statement are effective for financial statements for periods beginning after December 15, 2012. However, the university has elected to implement the provisions of this statement for fiscal year 2013.

Note 2. Cash

This classification includes demand deposits and petty cash on hand. At June 30, 2013, cash consisted of $12,165,519.61 in bank accounts; $3,700.00 of petty cash on hand; $15,377,108.50 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer; $1,774,419.95 in LGIP deposits for capital projects; and $40,312,843.88 in a money market account.

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

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

Note 3. Investments

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

At June 20, 2013, the university had the following investments and maturities:

Investment Type	Fair Value	Investment Maturities (in Years) Less than 1	1 to 5	6 to 10	More than 10
U.S. Treasury notes	$ 639,115.42	$ -	$ 639,115.42	$ -	$ -
U.S. agencies	7,717,178.28	195,044.31	1,996,050.00	5,526,083.97	-
Government mortgage backed securities	6,765,688.38	753,079.92	2,303,363.25	1,152,955.69	2,556,289.52
Certificates of deposit	404,438.98	404,438.98	-	-	-
Total investments	$15,526,421.06	$1,352,563.21	$4,938,528.67	$6,679,039.66	$2,556,289.52

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. 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 by Standard and Poor's, Moody's Investors Service, and/or Fitch Ratings and are presented below using the Standard and Poor's rating scale.

Tennessee Board of Regents policy restricts investments in bankers' acceptances and commercial paper. The policy requires that prime bankers' acceptances must be issued by domestic banks with a minimum AA rating or foreign banks with a AAA long-term debt rating by a majority of the ratings services that have rated the issuer. Prime bankers' acceptances are required to be eligible for purchase by the Federal Reserve System. To be eligible, the original maturity must not be more than 270 days, and it must 1) arise out of the current shipment of goods between countries or with the United States, or 2) arise out of storage within the United States of goods that are under contract of sale or are expected to move into the channel of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods.

The policy requires that prime commercial paper shall be limited to that of corporations that meet the following criteria: 1) Senior long-term debt, if any, should have a minimum rating of A1 or equivalent, and short-term debt should have a minimum rating of A1 or equivalent, as provided by a majority of the rating services that rate the issuer. If there is no long-term debt rating, the short-term debt rating must be A1 by all rating services (minimum of two). 2) The rating should be based on the merits of the issuer or guarantee by a nonbank. 3) A financial review should be made to ascertain the issuer's financial strength to cover the debt. 4)

Commercial paper of a banking institution should not be purchased. Prime commercial paper shall not have a maturity that exceeds 270 days.

At June 30, 2013, the university's investments were rated as follows:

		Credit Quality Rating		
Investment Type	Fair Value	AAA	AA	Unrated
LGIP	$17,151,528.45	$ -	$ -	$17,151,528.45
U.S. agencies	5,464,150.00	-	5,464,150.00	-
Government mortgage-backed securities	6,765,688.38	192,114.73	6,573,573.65	-
Total	$29,381,366.83	$192,114.73	$12,037,723.65	$17,151,528.45

Concentration of Credit Risk

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

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

Issuer	Percentage of Total Investments June 30, 2013
Federal National Mortgage Association	32.88%
Federal Home Loan Bank	17.63%
Federal Home Loan Mortgage Corporation	28.26%

Note 4. Receivables

Receivables at June 30, 2013, included the following:

Student accounts receivable	$ 6,584,369.42
Grants receivable	10,559,880.82
Notes receivable	16,908.90
Other receivables	431,939.11
Subtotal	17,593,098.25
Less allowance for doubtful accounts	(3,736,790.00)
Total receivables	$13,856,308.25

Federal Perkins Loan Program funds at June 30, 2013, included the following:

Perkins loans receivable	$ 5,541,349.21
Less allowance for doubtful accounts	(3,893,655.61)
Total	$1,647,693.60

Note 5. Capital Assets

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 9,525,009.24	$ -	$ -	$ -	$ 9,525,009.24
Land improvements and infrastructure	48,986,002.13	-	-	-	48,986,002.13
Buildings	218,096,450.24	-	7,631,598.84	260,855.00	225,467,194.08
Equipment	27,623,959.84	1,287,912.81	-	332,168.10	28,579,704.55
Library holdings	4,311,959.56	275,214.80	-	499,530.39	4,087,643.97
Intangible assets	2,679,599.36	-	-	-	2,679,599.36
Projects in progress	8,235,689.82	8,698,011.19	(7,631,598.84)	-	9,302,102.17
Total	319,458,670.19	10,261,138.80	-	1,092,553.49	328,627,255.50
Less accumulated depreciation amortization:					
Land improvements and infrastructure	34,693,252.41	1,687,280.48	-	-	36,380,532.89
Buildings	96,742,506.75	5,287,280.12	-	260,855.00	101,768,931.87
Equipment	20,811,386.99	1,414,971.26	-	270,749.15	21,955,609.10
Library holdings	2,605,394.56	408,764.34	-	499,530.39	2,514,628.51
Intangible assets	1,487,642.69	238,391.33	-	-	1,726,034.02
Total	156,340,183.40	9,036,687.53	-	1,031,134.54	164,345,736.39
Capital assets, net	$163,118,486.79	$1,224,451.27	$ -	$ 61,418.95	$164,281,519.11

Note 6. Accounts Payable

Accounts payable at June 30, 2013, included the following:

Vendors payable	$4,320,496.52
Other payables	699,364.63
Total accounts payables	$5,019,861.15

Note 7. Long-term Liabilities

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

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
TSSBA debt:					
Bonds	$33,645,524.78	$4,022,218.00	$ 3,874,593.32	$33,793,149.46	$2,626,415.54
Unamortized bond premium/discount	1,130,183.98	696,960.01	176,013.09	1,651,130.90	-
Commercial paper	3,200,000.00	-	3,200,000.00	-	-
Subtotal	37,975,708.76	4,719,178.01	7,250,606.41	35,444,280.36	2,626,415.54
Other liabilities:					
Compensated absences	5,183,136.00	3,419,821.94	2,900,628.80	5,702,329.14	1,044,858.99
Due to grantors	3,902,237.17	72,472.68	-	3,974,709.85	72,472.68
Subtotal	9,085,373.17	3,492,294.62	2,900,628.80	9,677,038.99	1,117,331.67
Total long-term liabilities	$47,061,081.93	$8,211,472.63	$10,151,235.21	$45,121,319.35	$3,743,747.21

TSSBA Debt – Bonds

Bonds, with interest rates ranging from 0.35% to 5.666%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to May 1, 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; see Note 9 for further details. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net position is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $530,473.56 at June 30, 2013.

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

Year Ending June 30	Principal	Interest	Total
2014	$ 2,626,415.54	$ 1,682,946.86	$ 4,309,362.40
2015	2,670,414.60	1,570,551.64	4,240,966.24
2016	2,505,948.05	1,448,583.92	3,954,531.97
2017	2,626,169.06	1,327,241.18	3,953,410.24
2018	2,343,214.94	1,202,789.56	3,546,004.50
2019 – 2023	11,088,690.09	4,215,657.74	15,304,347.83
2024 – 2028	8,094,196.38	1,590,909.42	9,685,105.80
2029 – 2032	1,838,100.80	235,580.51	2,073,681.31
Total	$ 33,793,149.46	$13,274,260.83	$ 47,067,410.29

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

Refunding of Debt

On August 1, 2012, the state issued $1,510,453.66 in revenue bonds with an average interest rate of 0.91% to advance refund $1,388,136.37 of outstanding Series 2004B and Series 2006A bonds with an average interest rate of 4.3%. The net proceeds of $1,506,478.86 (after payment of $3,974.80 in underwriter's fees and issuance costs) were deposited with an escrow agent to provide for all future debt service payments on the Series 2004B and Series 2006A bonds. As a result, the Series 2004B and Series 2006A bonds are considered to be defeased, and the liability for those bonds has been removed from the university's long-term liabilities.

Although the advance refunding resulted in the recognition of a deferred loss of $108,744.03 to be amortized over nine years, the university in effect reduced its aggregate debt service payments by $129,948.86 over nine years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $105,140.39.

Note 8. 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 these 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, investment income on the invested endowments has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years or returned to corpus (depending on the endowment involved). At June 30, 2013, net appreciation of $44,087.46 is available to be spent, of which $2,455.62 is included in restricted net position expendable for scholarships and fellowships, and $41,631.84 is included in restricted net position expendable for instructional departmental uses.

Note 9. Pledged Revenues

The university has pledged certain revenues and fees, including state appropriations, to repay $33,793,149.46 in revenue bonds issued from December 1989 to August 2012 (see Note 7 for further detail). Proceeds from the bonds provided financing for Avon Williams Campus improvements; chiller replacement; dormitory renovations; energy savings and performance contracts; student housing/apartments; research and sponsored programs; and student housing fire suppression. The bonds are payable through 2032. Annual principal and interest payments on the bonds are expected to require 3.18% of available revenues. The total principal and interest remaining to be paid on the bonds is $47,067,410.29. Principal and interest paid for the current year and total available revenues were $4,235,977.70 and $133,128,150.04, respectively.

Note 10. Pension Plans

Defined Benefit Plans

Tennessee Consolidated Retirement System

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

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

Funding Policy – Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 15.03% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2013; June 30, 2012; and June 30, 2011, were $4,284,542.47; $4,191,277.07; and $4,078,956.87, respectively. Contributions met the requirements for each year.

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 by the Federal Employees Retirement System 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 by 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 was required to contribute 7% of covered payroll to the CSRS plan, and employees were required to contribute 7% of covered payroll. Contributions to CSRS for the year ended June 30, 2013, were $38,792.20, which consisted of $19,396.10 from the university and $19,396.10 from the employees. Contributions for the year ended June 30, 2012, were $45,370.20, which consisted of $22,685.10 from the university and $22,685.10 from the employees. Contributions for the year ended June 30, 2011, were $42,711.56, which consisted of $21,355.78 from the university and $21,355.78 from the employees. Contributions met the requirements for each year.

Defined Contribution Plans

Optional Retirement Plans

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

Funding Policy – Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contributions made by the university to the plans were $3,561,753.59 for the year ended June 30, 2013, and $3,544,088.19 for the year ended June 30, 2012. Contributions met the requirements for each year.

Note 11. Other Postemployment Benefits

Health care is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program that provides postemployment health insurance benefits to eligible university retirees. This program includes two plans available to higher education employees—the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer, defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Section 8-27-101, *Tennessee Code Annotated*. Prior to reaching age 65, all members have the option of choosing between the standard or partnership preferred provider organization plan for health care benefits. Subsequent to age 65, members who are also in the state's retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. The state makes on-behalf payments to the Medicare Supplement Plan for the university's eligible retirees; see Note 16. The plans are reported in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Special Funding Situation

The State of Tennessee is legally responsible for contributions to the Medicare Supplement Plan, which covers the retirees of other governmental entities, including Tennessee State University. The state is the sole contributor for the university retirees who participate in the Medicare Supplement Plan and, therefore, is acting as the employer.

Funding Policy

The premium requirements of members of the State Employee Group Plan are established and may be amended by the insurance committee. The plan is self-insured and financed on a pay-as-you-go basis, with the risk shared equally among the participants. The plan's claims liabilities are periodically computed using actuarial and statistical techniques to establish premium rates. The plan's administrative costs are allocated to plan participants. In accordance with Section 8-27-205(b), *Tennessee Code Annotated*, retirees in the State Employee Group Plan pay the same base premium, adjusted for years of service, as active employees. Retirees with 30 years of service are subsidized 80%; retirees with 20 years of service but less than 30 years of service, 70%; and retirees with less than 20 years of service, 60%. Retirees in the Medicare Supplement Plan have flat-rate premium subsidies based on years of service. Retirees with 30 years of service receive $50 per month; retirees with 20 years of service but less than 30 years of service, $37.50; and retirees with 15 years of service but less than 20 years of service, $25.

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

Annual required contribution (ARC)	$1,729,000.00
Interest on the net OPEB obligation	275,938.14
Adjustment to the ARC	(292,903.09)
Annual OPEB cost	1,712,035.05

Amount of contribution	(1,269,563.48)
Increase in net OPEB obligation	442,471.57
Net OPEB obligation – beginning of year	6,898,453.54
Net OPEB obligation – end of year	$7,340,925.11

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2013	State Employee Group Plan	$1,712,035.05	74.2%	$7,340,925.11
June 30, 2012	State Employee Group Plan	$1,696,904.04	79.2%	$6,898,453.54
June 30, 2011	State Employee Group Plan	$2,287,964.77	52.4%	$6,545,095.28

Funded Status and Funding Progress

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

State Employee Group Plan	
Actuarial valuation date	July 1, 2011
Actuarial accrued liability (AAL)	$13,336,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$13,336,000.00
Actuarial value of assets as a percentage of the AAL	0.0%
Covered payroll (active plan members)	$71,294,387.91
UAAL as percentage of covered payroll	18.7%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress, presented as required supplementary information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions

Calculations are based on the types of benefits provided under the terms of the substantive plan at the time of each valuation and on the pattern of sharing of costs between the employer and plan members to that point. Actuarial calculations reflect a long-term perspective. Consistent with that perspective, actuarial methods and assumptions used include techniques that are designed to reduce short-term volatility in actuarial accrued liabilities and the actuarial value of assets.

In the July 1, 2011, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4% investment rate of return (net of administrative expenses) and an annual health care cost trend rate of 9.25% initially. The rate decreased to 8.75% in fiscal year 2013 and then reduces by decrements to an ultimate rate of 5% in fiscal year 2021. All rates include a 2.5% inflation assumption, which also represents the projected salary increase. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007.

Note 12. Insurance-related Activities

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

The university participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the year ended June 30, 2013, is presented in the *Tennessee Comprehensive Annual Financial Report (*CAFR*)*. The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml. Since the 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, 2013, the Risk Management Fund held $108.5 million in cash designated for payment of claims.

At June 30, 2013, the scheduled coverage for the university was $565,124,600.00 for buildings and $84,374,900.00 for contents.

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

Note 13. Commitments and Contingencies

Sick Leave

The university records the cost of sick leave when paid. The dollar amount of unused sick leave was $30,566,725.38 at June 30, 2013.

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 $225,157.85, and expenses for personal property were $586,701.00 for the year ended June 30, 2013. All operating leases are cancelable at the lessee's option.

Construction in Progress

At June 30, 2013, outstanding commitments under construction contracts totaled $3,990,720.58 for the new Bio Tech building, Gentry storm drainage, electrical system upgrades, Hankle Hall renovations, and Hale Stadium renovations, of which $1,478,656.55 will be funded by future state capital outlay appropriations.

Litigation

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

Note 14. Chairs of Excellence

The university had $5,226,338.98 on deposit at June 30, 2013, with the State Treasurer for its Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

Note 15. Natural Classification With Functional Classifications

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

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$37,570,169.89	$12,287,476.83	$11,431,123.66	$ 1,375,301.57	$ -	$ 62,664,071.95
Research	7,302,125.53	2,428,221.40	3,834,121.07	559,289.67	-	14,123,757.67
Public service	5,444,167.48	2,225,489.07	2,186,699.92	2,715.06	-	9,859,071.53
Academic support	5,608,757.83	1,848,812.84	3,679,837.92	85,478.00	-	11,222,886.59
Student services	7,828,887.69	2,645,337.29	4,388,880.86	2,755,489.54	-	17,618,595.38
Institutional support	8,616,785.72	3,155,626.38	6,970,015.98	14,562.00	-	18,756,990.08
Maintenance & operation	3,268,714.07	1,479,864.25	8,909,846.52	-	-	13,658,424.84
Scholarships & fellowships	-	-	25,883.94	7,909,511.22	-	7,935,395.16
Auxiliary	1,960,601.58	656,370.93	8,929,720.23	203,411.26	-	11,750,104.00
Depreciation	-	-	-	-	9,036,687.53	9,036,687.53
Total	$77,600,209.79	$26,727,198.99	$50,356,130.10	$12,905,758.32	$9,036,687.53	$176,625,984.73

Expenses initially incurred by the academic support function as a result of providing internal services to the other functional classifications were allocated to the other functional areas by reducing the academic support function's operating expenses by the total amount of salaries, benefits, and operating expenses incurred in the provision of these services, and allocating this amount to the other functional areas' operating expenses on the basis of usage. As a result of this process, expenses totaling $468,721.29 were reallocated from academic support to the other functional areas.

Note 16. On-behalf Payments

During the year ended June 30, 2013, the State of Tennessee made payments of $58,404.00 on behalf of the university for retirees participating in the Medicare Supplement Plan. The Medicare Supplement Plan is a postemployment benefit health care plan and is discussed further in Note 11. The plan is reported in the *Tennessee Comprehensive Annual Financial Report*. That report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Note 17. 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 20-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2013, the foundation made distributions of $52,177.80 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Betsy Jackson, Executive Director, 3500 John A. Merritt Boulevard, Nashville, TN 37209.

Cash and Cash Equivalents

In addition to demand deposits and petty cash on hand, this classification includes instruments that are readily convertible to known amounts of cash and that have original maturities of three months or less. At June 30, 2013, cash and cash equivalents consisted of $3,758,444.23 in bank accounts and $2,524,975.92 in money market accounts.

Investments

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

At June 30, 2013, the foundation had the following investments and maturities:

Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10	No Maturity Date
		Investment Maturities (in Years)				
U.S. Treasury	$ 3,344,674.60	$ -	$ 131,108.36	$ 3,213,566.24	$ -	$ -
U.S. agencies	928,173.19	-	928,173.19	-	-	-
Corporate stocks	16,993,295.92	-	-	-	-	16,993,295.92
Corporate bonds	6,853,085.92	1,729,244.14	3,652,350.21	1,471,491.57	-	-
Mutual bond funds	3,427,537.77	-	-	-	-	3,427,537.77
Mutual equity funds	3,086,861.69	-	-	-	-	3,086,861.69
Foreign stock	2,237,094.66	-	-	-	-	2,237,094.66
Foreign mutual funds	3,134,498.71	-	-	-	-	3,134,498.71
Government mortgage-backed securities	728,877.05	-	-	83,147.70	645,729.35	-
Collateralized mortgage obligations	874,954.91	-	83,058.40	444,036.39	347,860.12	-
Real estate investment trusts	2,124,777.32	-	-	-	-	2,124,777.32
Total investments	$43,733,831.74	$1,729,244.14	$4,794,690.16	$5,212,241.90	$993,589.47	$31,004,066.07

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 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. Securities are rated using Standard and Poor's, Moody's Investor Service, and/or Fitch Ratings and are presented below using the Standard and Poor's rating scale. The foundation has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations.

At June 30, 2013, the foundation's investments were rated as follows:

Investment Type	Fair Value	AAA	AA	A	BBB	Unrated
			Credit Quality Rating			
U.S. agencies	$ 928,173.19	$ -	$ 928,173.19	$ -	$ -	$ -
Corporate bonds	6,853,085.92	252,244.33	665,301.26	5,130,950.98	804,589.35	-
Mutual bond funds	3,427,537.77	-	-	-	-	3,427,537.77
Government mortgage-backed securities	728,877.05	-	728,877.05	-	-	-
Collateralized mortgage obligations	874,954.91	509,036.14	365,918.77	-	-	-
Total	$12,812,628.84	$761,280.47	$2,688,270.27	$5,130,950.98	$804,589.35	$3,427,537.77

Alternative Investments

The foundation has investments in Real Estate Investment Trusts (REITS). The estimated fair value of these assets is $2,124,777.32 at June 30, 2013.

The foundation believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2013. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the foundation's investment policy. These investments are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated using various valuation techniques.

The value of shares for Inland America is estimated to be the offering of $6.93 per share (ignoring purchase price discounts for certain categories of purchasers). This estimated value may not reflect the actual market value for these shares on any given date.

The value of shares for Behringer Harvard is estimated to be the offering of $4.01 per share (ignoring purchase price discounts for certain categories of purchasers). This estimated value may not reflect the actual market value for these shares on any given date.

Capital Assets

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Dr. Bobby Jones television show audio and video collection	$ 6,000,000.00	$ -	$ -	$ -	$6,000,000.00

Endowments

If a donor has not provided specific instructions to the foundation, the foundation's policies and procedures permit the foundation 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 its 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 that is spent is required to be spent for the purposes for which the endowment was established.

General Endowment – 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, 3.8% of the fair market value's three-year rolling average has been authorized for expenditure. The remaining amount, if any, is reinvested in the endowment. At June 30, 2013, net appreciation of $388,168.78 is available to be spent, of which $349,370.47 is included in restricted net position expendable for scholarships and fellowships; $14,331.10 is included in restricted net position expendable for instructional departmental uses; and $24,467.21 is included in restricted net position expendable for other.

Consent Decree Endowment – According to the established agreement within the Consent Decree, the budget committee may appropriate for distribution each year from Consent Decree Endowment Funds, an amount up to 75% of the interest and dividend income. The remainder is to be reinvested in the corpus of the fund. At June 30, 2013, net appreciation of $662,920.29 is available to be spent, all of which is included in restricted net position expendable for other.

Title III Endowment – According to the established agreement between the foundation and the Tennessee State University Title III Program, an amount up to 50% of the interest and dividend income may be allocated for distribution annually. The remainder is to be reinvested in the corpus of the fund. At June 30, 2013, net appreciation of $697,192.87 is available to be spent, all of which is included in restricted net position expendable for other.

Tennessee Board of Regents
TENNESSEE STATE UNIVERSITY
Required Supplementary Information
OPEB Schedule of Funding Progress
Unaudited

Actuarial Valuation Date	Plan	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c)]
July 1, 2011	State Employee Group Plan	$ -	$13,336,000	$13,336,000	0%	$71,294,388	18.71%
July 1, 2010	State Employee Group Plan	$ -	$20,747,000	$20,747,000	0%	$71,599,111	28.98%
July 1, 2009	State Employee Group Plan	$ -	$22,568,000	$22,568,000	0%	$72,648,998	31.06%

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

Supplementary Information
TENNESSEE STATE UNIVERSITY
Supplementary Schedule of Cash Flows - Component Unit
For the Year Ended June 30, 2013

CASH FLOWS FROM OPERATING ACTIVITIES	
Gifts and contributions	$1,500,636.60
Sales and services of other activities	245,170.89
Payments to suppliers and vendors	(850,356.83)
Payments for scholarships and fellowships	(965,442.37)
Payments to Tennessee State University	(52,177.80)
Other receipts (payments)	(1,103,933.15)
Net cash used by operating activities	(1,226,102.66)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Gifts and grants received for other than capital or endowment purposes	1,456,954.28
Private gifts for endowment purposes	1,191,999.38
Other noncapital financing receipts (payments)	419.04
Net cash provided by noncapital financing activities	2,649,372.70
CASH FLOWS FROM INVESTING ACTIVITIES	
Proceeds from sales and maturities of investments	8,067,531.49
Income on investments	1,026,808.38
Purchases of investments	(12,745,876.61)
Other investing receipts (payments)	341.02
Net cash used by investing activities	(3,651,195.72)
Net decrease in cash	(2,227,925.68)
Cash and cash equivalents - beginning of year	8,511,345.83
Cash and cash equivalents - end of year	$6,283,420.15
Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	$ (108,759.17)
Adjustments to reconcile operating loss to net cash provided by operating activities:	
Change in assets, liabilities, and deferrals:	
Accounts receivable	(1,057.57)
Other assets	(19,147.88)
Accounts payable	(12,352.77)
Other	(1,084,785.27)
Net cash used by operating activities	$ (1,226,102.66)
Noncash investing, capital, and financing activities	
Unrealized gains on investments	$2,190,046.65

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
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Independent Auditor's Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable John G. Morgan, Chancellor
Dr. Glenda Baskin Glover, President

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, 2013, and the related notes to the financial statements, which collectively comprise the university's basic financial statements, and have issued our report thereon dated December 5, 2013. We conducted our audit in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

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

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A *material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected, on a timely basis. A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies, and, therefore, material weaknesses or significant deficiencies may exist that were not identified. Given these limitations, during our audit we did not identify any deficiencies that we consider to be material weaknesses. We did identify certain deficiencies in internal control, as described below, that we consider to be a significant deficiency:

- Tennessee State University did not provide adequate information technology controls over the Banner computer system.

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

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the university's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We did, however, note certain immaterial instances of noncompliance that we have included in the Findings and Recommendations section of this report.

Tennessee State University's Responses to Findings

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

Purpose of This Report

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

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 5, 2013

Findings and Recommendations

1. Tennessee State University did not provide adequate information technology controls over the Banner computer system

Finding

As noted in the prior audit, management of the university's Communications and Information Technology Office did not design and monitor adequate internal controls over information technology related to its Banner computer system. We observed two conditions that were in violation of university policy and/or industry-accepted best practices. One of these conditions is repeated from the prior audit. The lack of proper information technology controls across the university's computing environment increases the risk of unauthorized system activity, including fraud or error.

The wording of this finding does not identify specific vulnerabilities that could allow someone to exploit the university's systems. Disclosing those vulnerabilities could present a potential security risk by providing readers with information that might be confidential, pursuant to Section 10-7-504(i), *Tennessee Code Annotated.* We provided the university with detailed information regarding the two conditions we identified, as well as our recommendations for improvement.

Recommendation

The Vice President for Administration should ensure that these two conditions are remedied by the prompt development and implementation of effective information technology controls. In addition, the Vice President should ensure that the risks associated with this finding are adequately identified and assessed in the university's documented risk assessment. The Vice President should implement effective controls to ensure compliance with applicable requirements; assign staff to be responsible for ongoing monitoring of the risks and mitigating controls; and take action if deficiencies occur.

Management's Comment

We concur. The Vice President for Administration will ensure that the two conditions that were identified as being in violation of university policy and/or industry-accepted best practices are remedied by internal controls that will be developed and fully implemented no later than June 1, 2014. The risks associated with this finding will be adequately identified and assessed in the university's documented risk assessment no later than May 2014. The Vice President will ensure ongoing compliance and monitoring by staff and will take appropriate action if deficiencies occur.

2. The Bursar's Office did not properly report student status changes to the contracted Perkins loan servicer, resulting in delayed conversions to repayment status for certain students

Finding

The Bursar's Office did not properly report status changes to the contracted Perkins loan servicer, resulting in delayed conversions to repayment status for those student borrowers who dropped below half-time enrollment without graduating.

The Federal Perkins Loan Fund is a revolving loan fund established by a one-time federal contribution and a matching institutional contribution. The fund is fully administered by the institution, with all principal and interest payments going back into the fund for the use of future borrowers. According to 34 CFR 674.31(b)(2)(i)(B), "[The repayment period for Perkins loans] begins 9 months after the borrower ceases to be at least a half-time regular student at an institution of higher education." The Bursar's Office at Tennessee State University (TSU) is responsible for collecting payments made towards Perkins loans, a task which has been contracted to University Accounting Systems (UAS). UAS does not have access to the university's information system and therefore relies on TSU to update it of the student status of loan holders. TSU generally notifies UAS of impending graduations in October (for December graduates) and April (for May graduates), which allows for timely conversions to repayment status of graduating borrowers. However, UAS was not notified timely for those students with status changes for reasons other than graduation, including withdrawing from the university without graduating or dropping courses mid-term to carry less than a half-time load. As described below, TSU did not notify UAS until after the spring semester of the academic year, even for changes that happened during the fall semester.

Our discussions with the TSU loan supervisor revealed that for efficiency reasons, status changes for non-graduates are only reported to the servicer after the end of the spring term for both the previous fall and spring terms. Even then, as described below, TSU provided incorrect separation dates.

When TSU staff prepared the status change documentation to be sent to UAS in June 2013, they printed a report of enrolled borrowers from the UAS online system. TSU staff determined students' statuses by writing the number of registered hours at the beginning of the preceding spring and fall semesters beside each name on the report. If a student did not register for a term, staff drew a line on the printout and wrote the final date of the previous non-summer term as the separation date, without considering whether the student actually completed all of the courses for which he or she was registered at the beginning of that term. The loan supervisor stated that the printout with handwritten additions was mailed to UAS for its staff to manually enter into its system. She stated that she kept a copy for herself and reviewed it after it was mailed, but did not initial the document anywhere to indicate it had been reviewed.

The loan supervisor stated that the summer term is completely excluded from the status determination, because "borrowers are not required to register for summer courses" to stay out of repayment status. Chapter 4 of the *Financial Aid Handbook* states that the borrower is entitled to nine consecutive months for an initial grace period, and the summer term generally lasts approximately two-and-a-half months. The loan supervisor pointed out that summer graduates participate in the fall graduation ceremony, and UAS would be notified of that graduation along with all other fall graduates. If a borrower completed at least a half-time load during the summer term and did not graduate or take any courses during the fall term, UAS would be notified to begin the grace period at the end of the spring term, effectively reducing the borrower's grace period by up to two-and-a-half months. Conversely, if a borrower completed at least a half-time load during the summer term and graduated in the fall but did not take fall classes, UAS would be notified to begin the grace period at the end of the fall term, effectively giving the borrower a 13-month grace period.

Testwork revealed that for 6 of 25 records of student borrowers tested (24%) who dropped below half-time status, TSU did not notify UAS of the status change for an average of 140 days after it happened, and gave UAS incorrect dates to begin the grace periods of the six borrowers.

- Three of these borrowers dropped below half-time status in early November 2012 and did not register for any classes in the spring, summer, or fall of 2013. UAS was notified on June 21, 2013, of a December 15, 2012, separation date, and retroactively started the grace period on December 15 instead of the applicable November date. Effectively, these borrowers will be allowed a 10-month grace period instead of the allowed 9 months.
- For two of those borrowers, UAS was notified on October 31, 2012, of a December 15, 2012, planned graduation date. One of them dropped below half-time status on September 24, 2012, and the other dropped below half-time status on November 9, 2012. Only one of the students actually graduated, and neither of them registered for classes in the spring, summer, or fall of 2013. Those two borrowers will effectively be allowed a 12-month and a 10-month grace period, respectively.
- One borrower registered for a full-time schedule in spring 2013 but never paid or showed up for any classes. The university has officially recorded his withdrawal date as February 5. This student has not registered for summer or fall 2013 classes. For the June 21, 2013, status determination, the worker handwrote the separation date as December 15, 2013**,** rather than the correct date of December 15, 2012. UAS did not question the date because it is commonly told in advance of planned graduations, although it typically receives those notices via a mid-term email. This borrower is effectively being given a 19-month grace period.

Not accurately reporting student status changes to the loan servicer could result in a delayed initiation of the loan repayment process. Sending unreviewed status changes to the loan servicer further increases the risk that the loan repayment process will not begin timely. That delay will not only prevent funds from returning to the program for the use of other prospective Perkins loan borrowers, but it will also unnecessarily increase the amount of interest the borrower will ultimately have to pay.

Recommendation

University management and the bursar should ensure that all student status changes for Federal Perkins Loan borrowers are reported to the loan servicer accurately and within 30 days to allow the servicer to convert the loan to repayment status, in compliance with federal regulations. The process used to document and communicate the changes should decrease the risk of data reproduction or other errors so that the servicer can accurately determine the start of grace periods and the subsequent repayment period. The Registrar's Office already has a process in place to notify the National Student Loan Data System within 30 days if it discovers that a student receiving a loan either did not enroll or ceased to be enrolled on at least a half-time basis, to satisfy enrollment reporting compliance requirements. The bursar should consider establishing a channel of communication with the Registrar's Office to obtain that information and should report it to the loan servicer in a more timely manner.

Management's Comment

We concur with the finding and recommendations. A report is being developed by Information Technology to list students who have Perkins loans who have either withdrawn or have ceased to be enrolled on at least a half-time basis. Beginning February 3, 2014, the Bursar's Office will review these reports weekly and communicate the names of these students to UAS within the 30 days allowed. Monthly clearinghouse reports from UAS will be reconciled with information in Banner and the weekly reports. The loan manager will approve these monthly reviews, and UAS will be notified immediately of differences.

3. Tennessee State University staff did not always promptly return financial aid refunds caused by unofficial withdrawals

Finding

Refunds owed to the U.S. Department of Education (ED) were not always promptly returned throughout the fiscal year. The *Code of Federal Regulations*, Title 34, Section 668.22, states the percentage of Title IV grant or loan assistance that has been earned by the student is 100%, if the student's withdrawal date occurs after completion of 60% of the payment period (or period of enrollment for a program that is measured in credit hours). The unearned amount of Title IV assistance to be returned is calculated by subtracting the amount of Title IV assistance earned by the student from the amount of Title IV aid that was disbursed to the student as of the date of the institution's determination that the student withdrew. An institution must return the amount of Title IV funds for which it is responsible as soon as possible but no later than 45 days after the date of the institution's determination that the student withdrew.

According to the Tennessee State University (TSU) Director of Financial Aid, the return of Title IV aid to ED is a joint effort between the Records Office and the Financial Aid Office. Students who officially withdraw from the university must complete a withdrawal form and have it signed by appropriate personnel in the Counseling Center, Financial Aid Office, and Residence

Life (if the student resided in student housing). After these required signatures are obtained, the form is taken to the Records Office, where the date of withdrawal is entered into the student information system by Records Office personnel. The registrar stated that the time frame for entry is less than 24 hours on average but can be as high as 48 hours during registration time when the office is flooded with student activity. When a student unofficially withdraws by not attending class, the date the student stopped attending classes is entered into the system by his or her individual professor. The Information Technology (IT) staff ran a daily report in spring 2013 that identified the withdrawn students, both officially and unofficially, and sent it to personnel in both the Records and Financial Aid offices. The report was run weekly during the fall 2012 semester, with the parameters for the reports set by Records Office personnel. The individual responsible for return calculations in the Financial Aid Office used the information included in the reports to determine if a return of Title IV aid calculation was required.

We tested 13 students who withdrew during the audit period and received Title IV aid. Of the 13 students tested, we identified 7 students who withdrew prior to completion of 60% of the enrollment period, requiring TSU personnel to perform Return of Title IV Funds calculations. For four of the seven student withdrawal calculations tested (57%), the refunds of amounts owed to ED were not performed within the 45-day time frame. Refunds ranging from $873 to $3,589 were 88 to 267 days late.

When we discussed this issue with TSU staff, we received differing reasons for the problem. According to the Financial Aid Office, during the fall semester of 2012, the former Technical Manager in the Financial Aid Office was responsible for performing Return of Title IV Funds calculations. Three of the four late refunds noted were for students who withdrew during the fall semester. The former Technical Manager performed one of the three calculations timely; however, the calculation was incorrect, resulting in only about one-third of the funds being refunded to ED timely.

After the Technical Manager's resignation in January 2013, the Loan Manager audited the former Technical Manager's work. This audit revealed several return calculations that were not performed. Return calculations were subsequently performed by the Loan Manager, and the required refunds were sent to the Department of Education. The Loan Manager took over responsibility for performing the Return of Title IV Funds calculations in the spring of 2013. For the one spring refund that was late, the Loan Manager stated that the student's professor did not report that the student stopped attending class until after the 60% earning point of the semester. As a result, the Financial Aid Office was not aware of the student's unofficial withdrawal timely.

When we discussed this issue with the Financial Aid Office, the Associate Director of Financial Aid Operations stated he believes the returns were not made to the Department of Education in a timely manner because the daily report run by the Records Office identifying withdrawals was not properly monitored by the Registrar's Office. The Associate Director stated that he believes the parameters set for the report did not extend throughout the enrollment period and caused all withdrawals after a certain point to not appear on the daily (formerly weekly) reports. However, the Registrar stated that the report was designed to identify withdrawals occurring from the first day of classes until the last day of classes in the semester. The Registrar provided us with a copy of the request for the spring 2013 semester to personnel in the IT department and the subsequent confirmation from IT personnel that the withdrawal report would run from the beginning until the end of the semester. Computer issues prevented the Registrar from providing us with the fall 2012 request and confirmation that the report was running from the first to the last day of the semester.

Because of the inconsistencies between the two offices related to the cause of this issue and the Registrar's confirmation email from the IT Department that the withdrawal report ran the entire spring semester, we decided to test an additional sample of 25 students who withdrew before the 60% earnings period during the fall 2012 semester. We found that 18 of 25 calculations were not performed timely (68%), 15 of which were not performed until the spring 2013 semester. When originally asked, the Loan Manager stated that she had to perform no more than five returns in the spring that should have been performed in the fall by the former Technical Manager. Students earned all financial aid funds beginning October 31 during the fall semester of 2012. We were able to verify that return calculations were being performed through December 2012 for students that withdrew up until October 8. Return calculations tested for students who withdrew after October 8 were not performed until the spring 2013 semester. We were unable to support or dispute the Financial Aid Office's claim that the report stopped running at some point.

Not returning funds to ED in a timely manner could result in penalties being assessed against the university by the federal grantors.

Recommendation

Personnel in all offices involved in the Return of Title IV Funds process should perform their respective steps of the process to ensure that all funds are returned to the appropriate programs within the time frames specified by federal regulations. Personnel from the Financial Aid Office and the Records Office should discuss what information is needed from the information system and work with IT personnel to ensure that the relevant information is retrieved when needed. In addition, all professors should be reminded of the importance of timely reporting of unofficial withdrawals. Because the work of multiple departments is needed to ensure timely refunds to the federal government, communication among these departments should improve to ensure that the correct information is distributed to all required parties.

Management's Comment

We concur with the finding and recommendations. The following plan has already been implemented to ensure compliance:

> Records – Each semester, the Records Office publishes the dates for students to officially withdraw with a grade of "W." Records also sends reminders to the faculty a minimum of twice each semester regarding their responsibility for coding students throughout the semester as "attending," "never attended," or "stopped attending," and noting applicable

dates. Students who never attended or stopped attending are considered unofficially withdrawn.

Information Technology – On a daily basis, Information Technology distributes to Financial Aid, the Bursar's Office, and the Records Office a report of students who have officially and unofficially withdrawn.

Financial Aid – On a daily basis, the Office of Financial Aid calculates the amount of federal aid required to be returned based on attendance, adjusts accounts accordingly, and notifies the students of the adjustments. Funds are returned to the U.S. Department of Education within thirty (30) days of the adjustment.

These actions mitigate the risk that applicable refunds are not returned to the Department of Education within the allowable time period.