AUDIT REPORT

Tennessee Board of Regents
Tennessee Technological University

For the Year Ended
June 30, 2006

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

Comptroller of the Treasury, Division of State Audit
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STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

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

John G. Morgan
Comptroller

March 25, 2008

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable Charles W. Manning, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, Tennessee 37217
and
Dr. Robert R. Bell, President
Tennessee Technological University
Box 5007
Cookeville, Tennessee 38505

Ladies and Gentlemen:

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

Consideration of internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Results of the Audit 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,

John G. Morgan
Comptroller of the Treasury

JGM/rrp
07/045

State of Tennessee

Audit Highlights

Comptroller of the Treasury | Division of State Audit

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

AUDIT OBJECTIVES

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

AUDIT FINDINGS

INTERNAL CONTROL FINDINGS

Management Has Not Adequately Addressed the Risk of Fraud, Waste, and Abuse Associated With Procurement Cards and Actually Weakened Existing Controls by Allowing Undocumented Exceptions to the Procurement Card Policies

Management of Tennessee Technological University did not formally document the exceptions to the university's *ProCard User's Manual*, which contains policies for staff who are assigned procurement cards through the university (page 8).

Management Has Not Assessed and Mitigated the Risks Associated With Its Failure to Develop Written Policies and Procedures for Monitoring and Collecting Restricted Accounts Receivable, and as a Result, Staff Incorrectly Recorded Several Accounts Receivable Totaling $43,511

As a result of a failure to have written policies and procedures for monitoring and collecting restricted accounts receivable, grants accounting staff made numerous errors in calculating and recording restricted accounts receivable during the fiscal year (page 9).

COMPLIANCE FINDING

Management Has Not Assessed and Mitigated the Risks Associated With Its Failure to Adequately Reconcile the University's Direct Loan Records With the Loan Origination Center's Records as Required by Federal Regulations

Tennessee Technological University's Director of Financial Aid did not properly reconcile the university's direct loan records with the federal Loan Origination Center's records as required by the applicable federal regulations (page 12).

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

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

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

INTRODUCTION

POST-AUDIT AUTHORITY

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

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

BACKGROUND

Tennessee Technological University was established as Tennessee Polytechnic Institute on September 14, 1916, by the General Assembly. In 1927, the institution was raised to the status of a four-year college and empowered to grant the bachelor's degree. The administrative structure of the university was expanded in 1949 into five schools: Arts and Sciences, Agriculture and Home Economics, Business Administration, Education, and Engineering. In 1965, the five undergraduate schools were designated as colleges. By an act of the General Assembly, effective July 1, 1965, the name of the institution was officially changed to Tennessee Technological University.

ORGANIZATION

The governance of Tennessee Technological University is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The chief administrative officer of the university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

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

OBJECTIVES OF THE AUDIT

The objectives of the audit were

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

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

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

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

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

FRAUD CONSIDERATIONS

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

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

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 2006, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Reportable conditions, along with recommendations and management's responses, are detailed in the findings and recommendations section. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

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

Fairness of Financial Statement Presentation

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

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

July 17, 2007

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

Dear Mr. Morgan:

We have audited the financial statements of Tennessee Technological University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the year ended June 30, 2006, and have issued our report thereon dated July 17, 2007. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the university's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinions on the financial statements and not to provide an opinion on the internal control over financial reporting. However, we noted certain matters involving the internal control over financial reporting and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the university's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The following reportable conditions were noted:

- Management has not adequately addressed the risk of fraud, waste, and abuse associated with procurement cards and actually weakened existing controls by allowing undocumented exceptions to the procurement card policies
- Management has not assessed and mitigated the risks associated with its failure to develop written policies and procedures for monitoring and collecting restricted accounts receivable, and as a result, staff incorrectly recorded several accounts receivable totaling $43,511

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

A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe that none of the reportable conditions noted above is a material weakness.

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

Compliance and Other Matters

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

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

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

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/to

1. Management has not adequately addressed the risk of fraud, waste, and abuse associated with procurement cards and actually weakened existing controls by allowing undocumented exceptions to the procurement card policies

Finding

Management of Tennessee Technological University did not formally document the exceptions to the university's *ProCard User's Manual*, which serves as the policies for staff who are assigned procurement cards through the university. During the course of the audit, we learned about three relatively common exceptions to these policies. However, management's approval of these exceptions and the exceptions themselves are not documented in any way. We were informed of two of the three exceptions prior to our initial testwork. We were not informed of the third exception until after we noted several instances in our testwork in which the policies were not followed.

During the course of the audit, we selected 278 procurement card transactions for testwork. Of these transactions, users did not comply with the published *Procard User's Manual* in 209 (75.2%) of the transactions. However, each of these instances of noncompliance we found was allowable under the exceptions as described by the Director of Accounting.

Without clear written policies including management's approved exceptions to the policy, the university's risk of fraud, waste, and abuse related to use of the procurement cards is increased and the university is vulnerable to employees who may violate the policy, intentionally or unintentionally.

Recommendation

The Vice President for Business and Fiscal Affairs should revise the procurement card policies and include approved exceptions as necessary. The Vice President for Business and Fiscal Affairs should ensure that any departures based on the approved exceptions from the written policies are clearly documented. Those staff who have procurement cards should be adequately trained according to these policies.

In addition, the Vice President for Business and Fiscal Affairs should ensure that other risks of improper accountability, noncompliance, fraud, waste, or abuse are adequately identified and assessed in the documented risk assessment. TTU's management should implement effective controls to ensure compliance with applicable requirements and should assign staff to be responsible for ongoing monitoring of the risks and mitigating controls and take action if deficiencies occur.

Management's Comment

We concur with the finding. Management is concerned with risk associated with the procurement card program and is currently updating the Procard User's Guide to reflect the current business practices referred to in the finding. In the future, approved exceptions will be clearly documented. Management will also continue to monitor current business practices to assess the need for further modifications to the Procard program.

Current procedures will be reviewed and revised if needed to strengthen internal controls of the Procard program. Procedures currently in place to prevent and detect irregularities associated with procurement cards are below:

- Dean/Administrative Officer approval of each cardholder
- Required training for each cardholder before issuance of card
- Required training for each departmental representative
- Explanation of the Procard User's Guide at each required training
- Explanation of responsibilities for each stakeholder
- Required Employee Cardholder agreement signed after training
- Electronically encoded limits for control tools
- Online/Daily access for department review of transactions on Visa Information Management
- Monthly reconciliations of the Visa Statement to receipts by department clerical staff
- Monthly approval of Statement and backup by appropriate approving authority
- Monthly accounting report review by departmental personnel
- Monthly review of Visa Information by Administration
- Monthly cardholder communications via e-mail
- Monthly review of cardholders leaving TTU for cancellation of cards
- Random inquiries as to purpose of charges by Administration
- Random checks by Internal Audit of departmental Procard operations

2. Management has not assessed and mitigated the risks associated with its failure to develop written policies and procedures for monitoring and collecting restricted accounts receivable, and as a result, staff incorrectly recorded several accounts receivable totaling $43,511

Finding

Tennessee Technological University did not have written policies and procedures for monitoring or collecting restricted accounts receivable for the fiscal year ended June 30, 2006. Restricted accounts receivable typically include receivables from grants or contracts. In addition, the grants accounting staff made numerous errors in calculating and recording restricted accounts receivable during the fiscal year.

Management has not developed formal written policies and procedures concerning the monitoring and collection of past-due restricted accounts receivable and did not have consistent follow-up procedures in place to ensure the granting agencies were contacted when necessary for the nonpayment of invoices, discrepancies with billing, etc.

In order to determine whether accounts receivable on TTU's financial statements were valid and included all amounts still owed to the university, we tested individually significant accounts receivable. We also tested a sample of grants receivable. Most grants receivable are paid by the grantor on a reimbursement basis, or after the university has already expended the funds. As a result, if a grantor does not receive a correct invoice, the university will, more than likely, not collect the funds owed to it. During our testwork, we noted many errors on restricted receivables.

Specifically, 7 of 38 grants receivable tested (18.4%) contained errors having a net effect of a $26,718 overstatement on the overall receivables balance at June 30, 2006. These errors included billing grantors for incorrect amounts owed, billing grantors in excess of the authorized budget, recording a receivable that had previously been collected, and recording the payment of one grant as a payment received from another grantor.

Based on additional testwork on significant accounts receivable items, we found that of the four significant accounts receivable items tested, one receivable balance (25%) contained multiple errors resulting in an additional net overstatement of receivables of $16,793. These errors included billing a grantor twice for the same work performed and the failure to record payments totaling $9,918 received in November 2002 until February 2007, four years and three months after the payment was made.

The current Manager of Grants Accounting and the Associate Vice President for Business and Fiscal Affairs disclosed that the errors in the billing process were caused by the former Manager of Grants Accounting missing work on a continual basis due to health issues. Neither the former manager nor the Director of Financial Services, the immediate supervisor of the manager, ensured that the work of the former manager was completed during these absences. We did not find evidence that these errors were an attempt to commit fraud. The current Manager of Grants Accounting became aware of the problem when she assumed her responsibilities in January 2007. Shortly thereafter, the manager began trying to correct the receivable balances and did correct several before we began our testwork in this area. However, these corrections were made several months after the fiscal year-end in which the errors occurred. The current manager also agreed that policies need to be developed, and she corrected any other previously uncorrected errors we noted in our testwork as they were brought to her attention.

Lengthy delays in collection efforts reduce the likelihood of collecting all funds owed to the university. The lack of follow-up on receivable balances also allows errors in account posting to go undetected. The financial statements in this report reflect audit adjustments that were necessary for fair presentation. A strong internal control environment must be maintained to ensure that errors and fraud are detected and corrected timely.

Recommendation

The Director of Financial Services should develop formal written collection policies and procedures and ensure that staff properly records all activity in a timely manner. Grants receivable staff should make and adequately document collection efforts for all past-due accounts. For receivables that cannot be collected, staff should follow proper procedures to adjust the account balance accordingly. The Manager of Grants Accounting and the Director of Financial Services should take appropriate administrative action for the staff's failure to properly record and collect restricted receivables.

The Vice President for Business and Fiscal Affairs should ensure that risks such as these noted in this finding are adequately identified and assessed in documented risk assessment activities. The Vice President for Business and Fiscal Affairs should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely and should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

Management's Comment

We concur with the finding. Grant Accounting implemented the Research Accounting and Grants Billing Modules of the Banner ERP system. This should assist with the resolution of most issues within this finding.

Grant Accounting is in the process of reviewing and updating their policies and procedures to reflect new procedures created with the implementation of Banner ERP system. During this process, policies and procedures will be added to allow timely monitoring and collection of restricted accounts receivables and timely resolution of uncollectible receivables. The Grants Billing module includes an automated Aging Report that will be printed and reviewed monthly. Additionally, the Grants Billing module allows for automatic calculation and recording of accounts receivable, indirect costs and revenue associated with all restricted grants. This will remove the potential for manual calculation errors. Automated calculations will be monitored for accuracy on a monthly basis.

The formal risk assessments for the Financial Management areas of the university are currently scheduled to be completed in October 2008. However, the Vice President for Business and Fiscal Affairs and her staff are very cognizant of the risks involved with grants and accounts receivable and remain committed to the internal controls necessary to minimize those risks.

3. **<u>Management has not assessed and mitigated the risks associated with its failure to adequately reconcile the university's Direct Loan records with the Loan Origination Center's records as required by federal regulations</u>**

Finding

Tennessee Technological University's Director of Financial Aid did not properly reconcile the university's Direct Loan records with the federal Loan Origination Center's records. According to Part 5 of the OMB *Circular A-133 Compliance Supplement,*

> Each month, the COD [Common Origination and Disbursement] provides institutions with a School Account Statement (SAS) data file which consists of a Cash Summary, Cash Detail, and (optional at the request of the school) Loan Detail records. The school is required to reconcile these files to the institution's records.

In addition, the U.S. Department of Education's *Direct Loan School Guide*, Chapter 9, states,

> The school is required to reconcile the information on the DLSAS [Direct Loan School Account Statement] report to its internal records on a monthly basis.
>
> The first step in monthly reconciliation is to compare the ending cash balance, cash receipts, excess cash, and disbursement totals from the DLSAS cash summary to each corresponding total in the school's Direct Loan System and business office system.
>
> If the school's internal systems match all the totals on the DLSAS cash summary, the reconciliation has been successfully completed. If the cash balances do not match, the school must continue with the reconciliation process.

Based on our interviews with the Director of Financial Aid, we found that the Director did not fully perform these reconciliations, nor did he ensure that other staff members performed these reconciliations completely. According to the Director, neither he nor his financial aid staff performed the reconciliations because he and the Associate Director of Financial Aid were unaware of the federal guidelines requiring the reconciliations. After reviewing each of the 12 monthly reconciliations within the audit period, we determined that the Director of Financial Aid reconciled the cash receipts but did not reconcile the ending cash balance, excess cash, and disbursement totals.

The Director of Financial Aid initially agreed he should have performed the reconciliations; however, he later refuted the finding and claimed that the Title IV Training Officer at the U.S. Department of Education stated the reconciliation he was performing was sufficient. We contacted the Title IV Training Officer; however, the Training Officer did not recall telling the Director that the reconciliations were sufficient and further emphasized that each cash item on the Cash Summary report should be reconciled to the institution's records as provided for in the guideline requirements.

The Financial Aid Director's failure to fully familiarize himself and staff with the federal regulations and to ensure that staff reconcile these files could result in the loss of Direct Loan funds to the school because of costly errors recorded in the school's or Loan Origination Center's records. Performing monthly reconciliations and retaining all supporting documentation allow financial aid staff to continue to ensure that all Direct Loan funds are received and disbursements to students are made timely and for the correct amounts.

Recommendation

The Director of Financial Aid should familiarize himself with the federal regulations and ensure that the personnel perform the reconciliations as outlined in the *Direct Loan School Guide*, Chapter 9, which includes reconciling all cash items included on the Cash Summary Direct Loan School Account Statement report to the university's records. If any items on this report do not agree, financial aid staff should then investigate the differences by reconciling the Cash Detail records.

The Director of Financial Aid in conjunction with the Executive Director of Enrollment Management should ensure that risks such as these noted in this finding are adequately identified and assessed in their documented risk assessment activities. The Director of Financial Aid and the Executive Director of Enrollment Management should identify specific staff to be responsible for the design and implementation of internal controls to prevent and detect exceptions timely. The Director of Financial Aid and the Executive Director of Enrollment Management should also identify staff to be responsible for ongoing monitoring for compliance with all requirements and taking prompt action should exceptions occur.

Management's Comment

We concur with the finding. The current and former Directors of Financial Aid over the past 10 years have studiously kept abreast of federal aid regulations that include, but are not limited to, the Federal Direct Loan Program and the varying interpretations of said regulations. The current and former Directors' interpretation of the regulations covering monthly reconciliations led them to perform the reconciliations in the manner that they did for the past nine years. When the current Director was presented with a differing interpretation of the regulations, an all-inclusive reconciliation process was presented to the State Auditors in July 2007, and it was deemed appropriate for meeting this new interpretation of the Federal Regulations governing monthly reconciliation of the Direct Loan program. We would also add that the Office of Financial Aid has completed the annual reconciliation of the Direct Loan program on time and in accordance with all governing regulations without incidence.

In addition to a more inclusive reconciliation process, which includes a review of all data included on the monthly SAS reports, the Office of Financial Aid completed a risk assessment in October 2007 to address the reconciliation issue and other areas of concern that may present themselves in the future. A monitoring plan was developed and includes identifying who is responsible for monitoring compliance and taking action on exceptions.

The Director takes great care in understanding and interpreting federal regulations, apprising himself of every opportunity to attend training events and understand new interpretations. He also understands that different entities may choose to interpret federal regulations differently on a yearly basis and can adjust to those new interpretations effectively and without delay. The current Director of Financial Aid has been actively involved in the financial aid profession just short of twenty years and the integrity of the system of checks and balances is of his utmost consideration and is not taken unconscientiously.

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Independent Auditor's Report

July 17, 2007

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

Dear Mr. Morgan:

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

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinions. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of many agencies, commissions, and component units of the State of Tennessee; managing the state's debt; and making loans to the state's colleges and universities from debt proceeds. Some of the boards of which the Comptroller of the Treasury serves as a member per state statutes include the State Building Commission and the Tennessee Higher Education Commission.

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

As discussed in notes 2 and 3, during the year ended June 30, 2005, the university implemented GASB Statement 40, *Deposit and Investment Risk Disclosures*.

The management's discussion and analysis on pages 18 through 40 is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming opinions on the basic financial statements. The accompanying financial information on page 71 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 17, 2007, on our consideration of the university's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/to

Tennessee Board of Regents
Tennessee Technological University
Management's Discussion and Analysis
June 30, 2006, and June 30, 2005

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

Using This Annual Report

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

The Statement of Net Assets

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

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

Tennessee Board of Regents
Tennessee Technological University
Management's Discussion and Analysis (Cont.)
June 30, 2006, and June 30, 2005

University's Net Assets
(in thousands of dollars)

	2006	2005	2004
Assets:			
Current assets	$ 12,599	$ 13,590	$ 12,484
Capital assets, net	53,760	47,349	46,027
Other assets	17,563	12,143	12,481
Total assets	**$ 83,922**	**$ 73,082**	**$ 70,992**
Liabilities:			
Current liabilities	$ 10,129	$ 9,418	$ 8,976
Noncurrent liabilities	20,954	16,207	16,595
Total liabilities	**$ 31,083**	**$ 25,625**	**$ 25,571**
Net assets:			
Invested in capital assets, net of unrelated debt	$ 37,155	$ 35,032	$ 33,757
Restricted – nonexpendable	236	620	719
Restricted – expendable	5,987	3,959	2,692
Unrestricted	9,461	7,846	8,253
Total net assets	**$ 52,839**	**$ 47,457**	**$ 45,421**

- Total assets of the university increased by 15% from 2005 to 2006. The increase can be attributed primarily to additional investments in capital assets, which increased by 14%, with the greatest increase being land improvements and infrastructure. In addition, other assets increased by 45%, mainly caused by the 46% increase in noncurrent cash attributed to an increase in noncurrent liabilities and LGIP for capital projects, and the 102% increase in noncurrent investments due to more long-term investments being purchased. All other increases and decreases were minor.

- Total assets of the university increased by 3% from 2004 to 2005. The increase can be attributed primarily to changes in capital assets, which increased by 3% with the major increase being construction in progress; current cash increased by 11% and accounts, notes and grants receivable increased by 8% because of increases in student receivables, grants receivables, and student loans; noncurrent cash was up 5%; while noncurrent investments decreased 28% due to fewer investments. All other increases and decreases were minor.

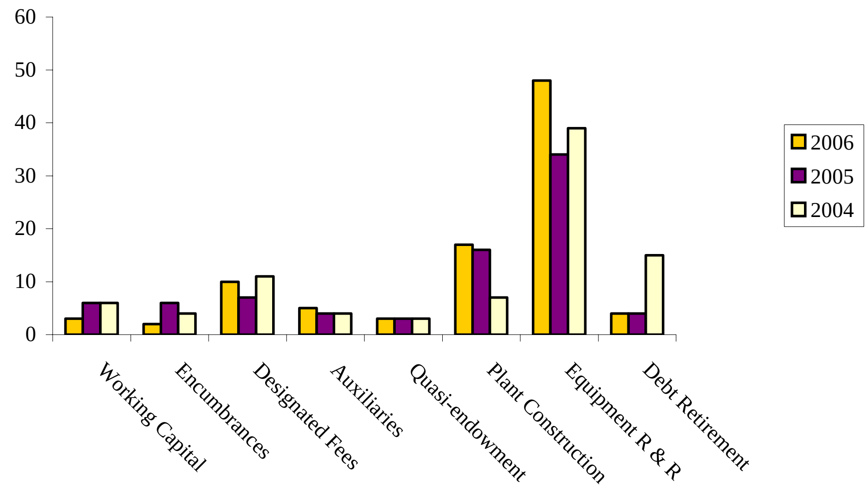
- In keeping with the university's mission, the consumption of assets provided for the continuation of high-quality instruction in the university's undergraduate, master's, specialist, and doctoral degree-granting programs. Assets were also used to continue the mission of research, scholarly activities, and public service, with emphasis on community and economic development.

- The university's total liabilities increased by 21% from 2005 to 2006. Noncurrent liabilities increased by 29% primarily as a result of bonds and commercial paper payable financing of administrative software and emergency generators. An increase of 8% in the current liabilities is attributable to increased payables related to various capital projects including a new ERP system (Banner); a new Science, Technology, Engineering and Mathematics building (STEM); and a Residential Housing Fire Safety project.
- The university's increase in liabilities from 2004 to 2005 was slight — 0.21%.
- The increase in net assets of 11% from 2005 to 2006 includes additional investment in capital projects. Cost containment measures taken by the university resulted in a 21% increase in unrestricted net assets. Funds accumulated to service debt were expended during 2006 to reduce outstanding debt for the ERP system, resulting in a 19% reduction in expendable debt service funds. Increases in restricted expendable for capital assets can be attributed to increased funding for the Nursing and Health Services building. All other fluctuations in net assets were minor.
- Restricted, nonexpendable net assets decreased in 2004, 2005, and 2006 as a result of endowments being moved to the foundation.

Many of the university's unrestricted net assets have been designated for specific purposes such as repairs and replacement of equipment, future debt service, quasi-endowments, and capital projects. The following graph shows the allocations:

Unrestricted Net Assets

(in hundred thousands)



- Funds designated for renewal and replacement of equipment increased by 39% in 2006 compared to 2005, primarily due to the Fire Alarm Upgrade project in progress. Funds designated for new plant construction increased by 6% in 2006 compared to 2005, primarily due to the STEM Center project.

- Designated fees increased by 37%. The university can use these funds only for the specific purposes approved by the Tennessee Board of Regents.

- Undesignated funds increased by 245% in 2006 compared to 2005, primarily from cost containment efforts implemented by the university.

- Funds designated for encumbrances decreased by 65% as a result of fewer computer equipment encumbrances. Funds designated for working capital decreased by 48% in FY2006 as a result of a decrease in student accounts receivable and receivables related to auxiliary enterprise activities.

- Unrestricted net assets decreased from 2004 to 2005 by 5%. The renewal and replacement of equipment decreased 11%, debt retirement dropped by 76%, designated fees decreased 33%, and encumbrances increased by 77%. All other changes were minor. The renewal and replacement decrease was due to a large transfer from renewals and replacements to the Housing Fire and Safety project; the debt retirement decrease was due to the debt reduction of two projects—the H&PE Convocation Center debt was paid off and the University Recreation/Fitness Center's debt was paid down by approximately $506,000; the designated fees decrease was due to computer equipment purchases using the technology access fees; and the encumbrances increased because some of those computer purchases had not yet been made as of the end of the fiscal year.

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

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

University's Changes in Net Assets
(in thousands of dollars)

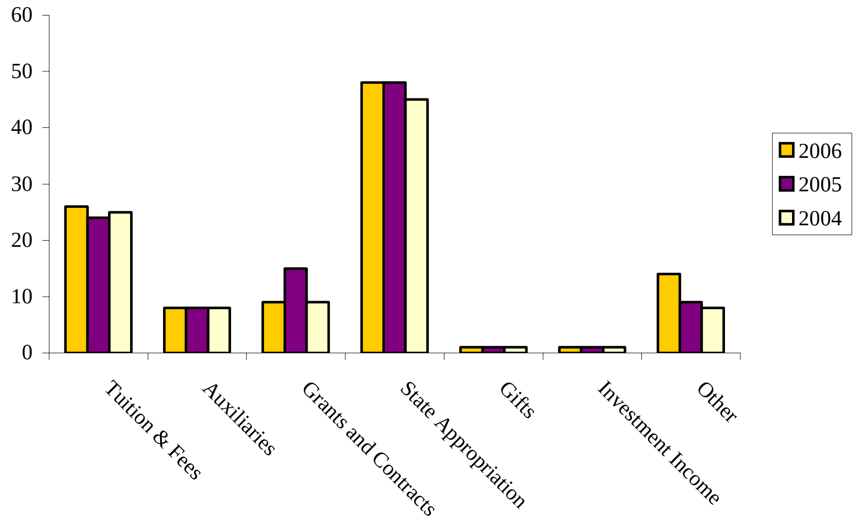
	2006	2005	2004
Operating revenues:			
Net tuition and fees	$ 26,170	$ 24,230	$ 25,313
Grants and contracts	9,251	8,238	8,647
Auxiliary	9,020	8,539	8,093
Other	4,441	3,794	4,071
Total operating revenues	**$ 48,882**	**$ 44,801**	**$ 46,124**
Operating expenses	114,983	108,214	100,395
Operating loss	**$ (66,101)**	**$ (63,413)**	**$ (54,271)**

Nonoperating revenues and expenses:			
State appropriations	$ 48,503	$ 47,869	$ 44,729
Gifts	695	749	708
Investment income	1,059	755	441
Other nonoperating revenues and (expenses)	13,649	12,399	5,156
Total nonoperating revenues and expenses	**$63,906**	**$ 61,772**	**$ 51,034**
Loss before other revenues, expenses, gains or losses	**$(2,195)**	**$ (1,641)**	**$ (3,237)**
Other revenues, expenses, gains or losses:			
Capital appropriations	$ 6,952	$ 2,477	$ 339
Capital grants and gifts	532	1,183	1,061
Additions to permanent endowments	93	17	18
Total other revenues, expenses, gains or losses	**$ 7,577**	**$ 3,677**	**$ 1,418**
Increase (decrease) in net assets	**$ 5,382**	**$ 2,036**	**$ (1,819)**
Net assets at beginning of year	**$ 47,457**	**$45,421**	**$ 47,240**
Net Assets at end of year	**$ 52,839**	**$47,457**	**$ 45,421**

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the university's operating activities for the years ended June 30, 2006; June 30, 2005; and June 30, 2004.

Revenues by Source
(in millions)



- During fiscal year 2006, revenues increased by 9%. State capital appropriations increased by $4,475,000 to support new capital construction and major maintenance projects on campus. A 9.7% fee increase netted an 8% increase in tuition and fees revenues in fiscal year 2006 compared to fiscal year 2005. The university also increased sales and services of educational activities by 24%, accounting for a significant portion of the increase in other operating revenues, and grants and contracts by 12% in fiscal year 2006 compared to fiscal year 2005. The capital campaign to raise funding for the new nursing building was substantially completed during fiscal year 2005, resulting in a 7% decrease in private gifts designated for capital projects during fiscal year 2006. Capital grants and gifts decreased by 55% due primarily to the funding of the nursing building switching from the foundation to state capital appropriations. All other sources of revenue experienced slight changes.
- The university's revenues increased by 12% from 2004 to 2005. This increase can be attributed to a 46% increase in grants and contracts, included in operating and nonoperating revenues, and a 7% increase in state appropriations. The university experienced a decrease in net tuition and fees of 4% due to the scholarship allocation increasing for lottery scholarships. All other sources experienced slight changes.

Expenses

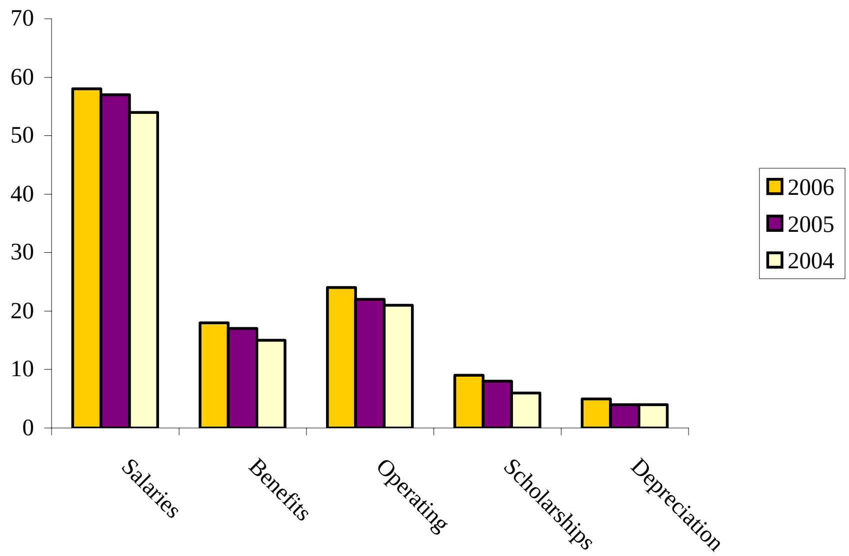
Operating expenses can be displayed in two formats, natural classification and program classification. Both formats are displayed below.

Natural Classification

University's Operating Expenses - Natural Classification
(in thousands of dollars)

	2006	2005	2004
Salaries	$ 58,477	$ 57,141	$ 53,790
Benefits	18,036	17,227	15,153
Operating	24,443	21,529	21,353
Scholarships	9,400	8,263	6,007
Depreciation	4,627	4,054	4,092
	$ 114,983	$ 108,214	$ 100,395

Operating Expenses - Natural Classification
(in millions)

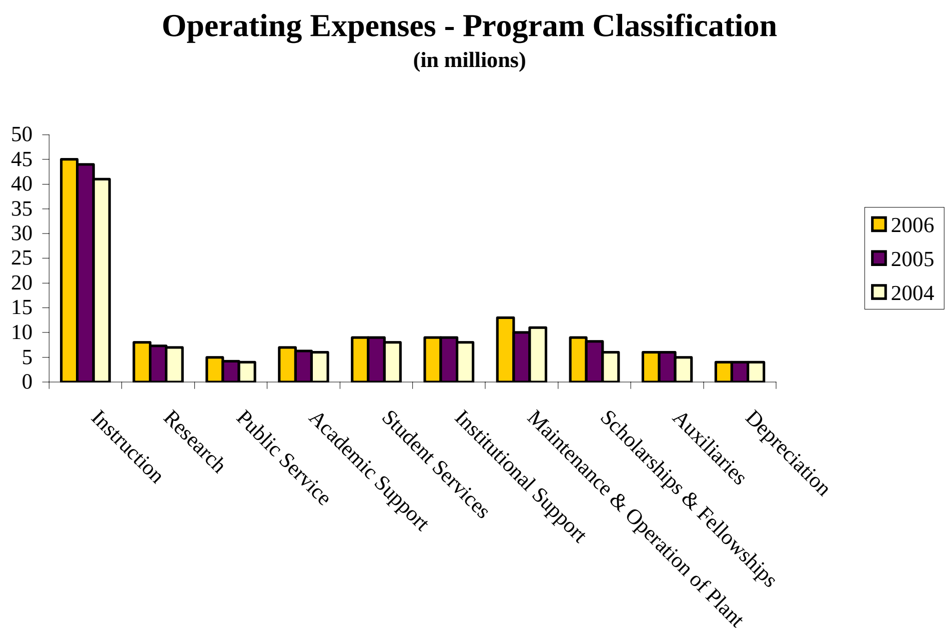


- The university expenses increased from 2005 to 2006 by 6%. Operating expenses, scholarships, and depreciation all increased by 14%. Scholarship increases were a result of fee increases and an increased number of students receiving awards. Utilities expenses were the primary driver of increased operating expenses. Depreciation expense increased due to the addition of additional capital assets and completed projects being transferred from projects in progress. All other increases were minor.
- Expenses increased from 2004 to 2005 by 8%. Salaries increased by 6%, and benefits rose by 14% due to insurance and retirement increases. Scholarships increased by 38% due to lottery scholarships. Only minor changes occurred in other areas.

Program Classification

Program Classification of Operating Expenses
(in thousands of dollars)

	2006	2005	2004
Instruction	$ 44,831	$ 44,045	$ 40,741
Research	7,732	7,330	6,818
Public service	4,952	4,213	4,041
Academic support	6,658	6,392	5,738
Student services	9,474	9,191	8,378
Institutional support	8,908	8,744	7,968
Maintenance & operations	12,542	10,190	11,159
Scholarships & fellowships	9,401	8,263	6,007
Auxiliaries	5,858	5,792	5,453
Depreciation	4,627	4,054	4,092
Total expenses	$ 114,983	$ 108,214	$ 100,395



- From 2005 to 2006, the university had an overall 6% increase in expenses. Maintenance and operation of plant had a 23% increase in expenses due to utility inflation. Public service increased by 18% due to increased expenses in community services. Scholarships and depreciation had increases of 14%. Scholarship increases were a result of fee increases and an increased number of students receiving awards. Depreciation expense increased due to the addition of additional capital assets and completed projects being transferred from projects in progress. All other changes were minor.

- From 2004 to 2005, the university had an overall 8% increase in expenses. A 38% increase for scholarships and fellowships was the only category that showed a significant change.

The Statement of Cash Flows

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

University's Cash Flows
(in thousands of dollars)

	2006	2005	2004
Cash provided (used) by:			
Operating activities	$ (60,499)	$ (59,696)	$ (51,332)
Noncapital financing activities	63,636	61,671	51,174
Capital and related financing activities	441	(2,462)	(3,257)
Investing activities	(1,156)	1,683	1,032
Net increase (decrease) in cash	$ 2,422	$ 1,196	$ (2,383)
Cash, beginning of year	16,309	15,113	17,496
Cash, end of year	$ 18,731	$ 16,309	$ 15,113

- Increases in cash were the result of proceeds from tuition and fees, increases in proceeds from noncapital grants and contracts, and sales and services of educational activities.
- Decreases were primarily the result of purchases of capital assets, payments to suppliers and vendors, federal student loan disbursements, payments to employees (including benefits), payments on capital debt, and purchase of investments.
- The cash flow of the university is highly dependent on two major sources—tuition and fees and state appropriations.
- The net increase in cash and cash equivalents amounted to $2,422,000 and $1,196,000 at June 30, 2006, and 2005, respectively.
- The net decrease in cash and cash equivalents amounted to $2,383,000 at June 30, 2004.
- For informational purposes, the following liquidity ratios are being provided:

	2006	2005	2004
Current Ratio	1.208	1.443	1.391
Quick Ratio	1.158	1.381	1.328

The university's liquidity decreased slightly as of June 30, 2006. As a rule of thumb, an adequate current ratio is 2:1; the university's is 1.208:1. Although not an adequate ratio, approximately 66% of current assets are cash and investments that can readily be converted to cash to pay current liabilities.

The university's liquidity improved slightly as of June 30, 2005. The university's current ratio was 1.443:1 at June 30, 2005. Although not an adequate ratio, approximately 68% of current assets were cash and investments that can readily be converted to cash to pay current liabilities.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2006, Tennessee Technological University had $53,760,000 invested in capital assets, net of accumulated depreciation of $82,694,000. Depreciation charges totaled $4,627,000 for the current fiscal year. At June 30, 2005, the university had $47,349,000 invested in capital assets, net of accumulated depreciation of $79,798,000. Depreciation charges totaled $4,054,000 for the last fiscal year. At June 30, 2004, the university had $46,027,000 invested in capital assets, net of accumulated depreciation of $77,345,000. Depreciation charges for 2004 totaled $4,092,000. Details of these assets are shown below.

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

	2006	2005	2004
Land	$ 1,258	$ 1,258	$ 1,258
Land improvements & infrastructure	6,365	1,407	1,554
Buildings	29,941	30,013	31,871
Equipment	4,937	4,793	4,574
Library holdings	4,766	4,688	4,698
Projects in progress	6,493	5,190	2,072
Total capital assets, net of depreciation	$ 53,760	$ 47,349	$ 46,027

For fiscal year 2006, the university had ten projects that increased capital assets $8,650,600. The Emergency Generators, Housing Fire Safety Upgrade, Nursing and Health Services Building, Bruner Electrical Upgrade, and Banner ERP projects were the largest. Another $2,406,700 in equipment and library holdings was capitalized during the year.

The university had five projects in progress that increased capital assets $3,121,900 in fiscal year 2005. The Fire Alarm System Upgrade, Nursing & Health Services Building, Mechanical

System Upgrade, and Banner ERP projects were the largest of the projects in progress. Another $2,291,500 in equipment and library holdings was capitalized during the year.

The university had three projects in progress, along with the completion of a new residence hall that increased capital assets during fiscal year 2004. These were the primary factors in this increase and were financed through the Tennessee State School Bond Authority and private donations. An elevator for the Joe L. Evins Appalachian Center for Crafts was also installed and funded with state appropriations.

The university plans to complete approximately $14,703,000 in capital expenditures during the next fiscal year. The following details the projects, amounts, and funding source:

Project	Amount (in thousands of dollars)	Source of Funding
ADA Modifications	$ 120	State appropriations
Nursing & Health Services Building	8,000	Federal grant, state appropriations, private
Fire Alarm Replacement	900	State appropriations
Central Cooling Deficiency-Phase II	500	State appropriations
Central Cooling Deficiency-Phase III	830	State appropriations
Bruner Electrical Upgrade	100	State appropriations
Housing Fire Safety Upgrade	1,000	Housing revenues, local funds
STEM Building	1,000	Private donations
Johnson Hall Renovations	13	Private
Waterproofing Patio & Masonry	500	State appropriations
Craft Center Reroof-Gallery/Admin	200	State appropriations
Bryan Fine Arts Auditorium Lights	300	State appropriations
Hyder-Burks Acoustics	600	State appropriations
Banner ERP	640	Local

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

Debt

At June 30, 2006; June 30, 2005; and June 30, 2004, the university had $16,605,091; $12,316,662; and $12,270,325 in debt outstanding, respectively. The table below summarizes these amounts by type of debt instrument.

Debt Instrument	Amount (in thousands of dollars) 2006	2005	2004
Bonds payable	$ 12,067	$ 11,651	$ 12,270
Commercial paper	4,538	666	-
Total outstanding debt	$ 16,605	$ 12,317	$ 12,270

In fiscal year 2006, the university acquired an additional $4,909,800 in commercial paper, of which $4,538,100 was related to the Emergency Generators project and $371,700 was related to the Banner ERP project. Total commercial paper for the Banner ERP Project was refinanced with five-year bonds. Another $720,500 of debt was retired.

In fiscal year 2005, the university acquired $665,800 in commercial paper related to the Banner ERP project. New debt acquired from bond refunding was $864,340. Debt of $1,483,800 was retired.

In fiscal year 2004, the university acquired $5,217,000 in new bond debt for the new residence hall. Debt totaling $728,000 was retired during the year.

The university's bond ratings through the Tennessee State School Bond Authority are AA as issued by Fitch, AA- as issued by Standard & Poor's, and Aa3 as issued by Moody's Investor's Service.

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

Economic Factors That Will Affect the Future of the University

The university's 2006-07 budget will be improved slightly due to a 4.1% increase in fees along with a slight improvement in state appropriations.

TENNESSEE TECHNOLOGICAL UNIVERSITY FOUNDATION

The Statement of Net Assets

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

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

Component Unit's Net Assets
(in thousands of dollars)

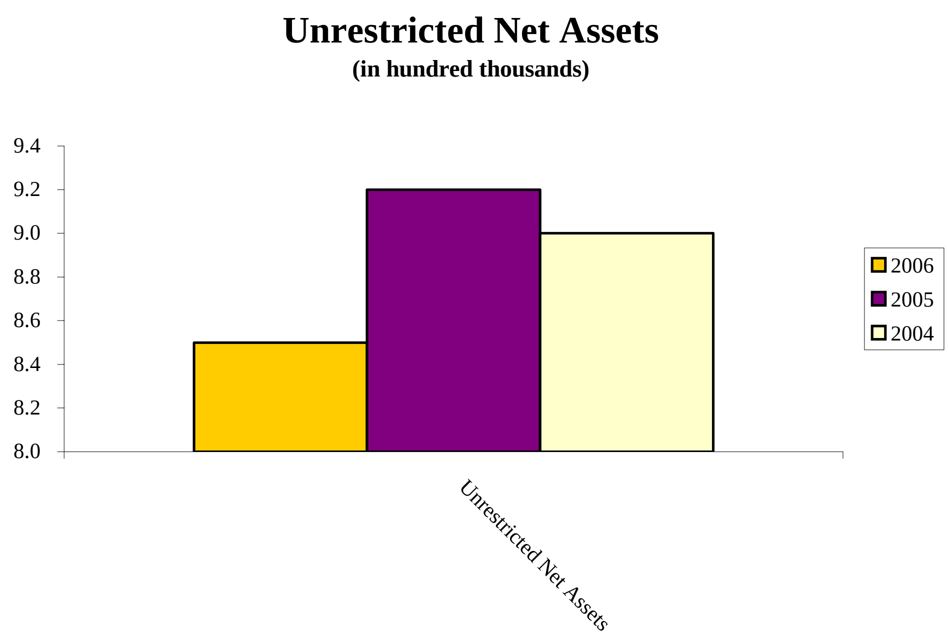
	2006	2005	2004
Assets:			
Current assets	$ 893	$ 978	$ 543
Capital assets, net	349	342	342
Other assets	43,813	38,073	31,965
Total assets	**$ 45,055**	**$ 39,393**	**$ 32,850**
Net Assets:			
Invested in capital assets	$ 349	$ 342	$ 342
Restricted - nonexpendable	31,215	30,091	25,866
Restricted - expendable	12,641	8,040	5,742
Unrestricted	850	920	900
Total net assets	**$ 45,055**	**$ 39,393**	**$ 32,850**

- Total assets increased by 14% from 2005 to 2006. Investments increased by 10%, restricted cash and cash equivalents increased by 19%, and a gift of land valued at

$1,300,000 significantly increased noncurrent assets. The increase in restricted, expendable assets resulted from an increase in gifts for capital projects. Major gifts include land of $1,300,000 and other restricted capital gifts totaling $1,913,600.

- Current assets decreased by 9% from 2005 to 2006 due to the maturity of a short-term investment and subsequent reinvestment of the funds in longer term investments.
- Total assets increased by 20% from 2004 to 2005. Investments increased by 29%, while cash and cash equivalents in permanent endowments decreased by 7%. Other assets increased due to the purchase of investments.
- Current assets increased by 80% from 2004 to 2005 due to an increase in gifts and investment income for unrestricted purposes, and a reclassification to short-term investments. Both nonexpendable and expendable restricted net assets increased as a result of greater investment earnings and additional gifts from donors which included additions to permanent endowments of $1,676,000 as well as a restricted capital gift of $703,800.
- In keeping with the foundation's mission, the consumption of assets provided assistance to the university's annual and capital purposes. Assets were also used to award students, faculty, staff, alumni, and friends of the university.

The foundation's unrestricted net assets have not been designated for specific purposes. Funds are available for use as priorities arise during the year.



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

The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the foundation, as well as the nonoperating revenues and expenses.

Component Unit's Changes in Net Assets
(in thousands of dollars)

	2006	2005	2004
Operating revenues:			
Gifts	$ 1,649	$ 1,692	$ 1,225
Sales and services of educational activities	934	1,066	912
Endowment income	1,455	1,248	857
Other	445	126	26
Total operating revenues	**$ 4,483**	**$ 4,132**	**$ 3,020**

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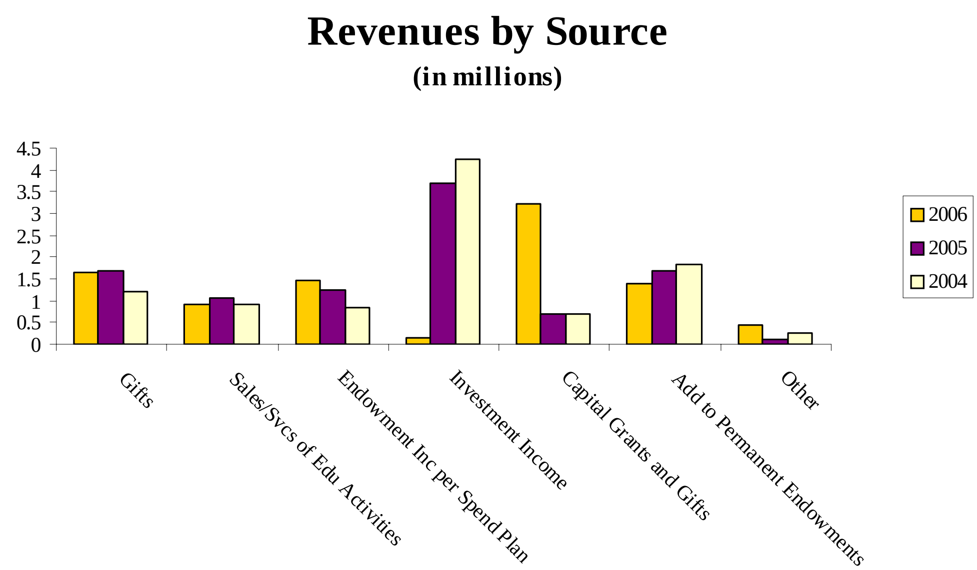
Operating expenses	3,143	3,685	3,141
Operating income (loss)	**$1,340**	**$ 447**	**$ (121)**
Nonoperating revenues and expenses:			
Investment income	$ 138	$ 3,716	$ 4,241
Loss on disposal of capital assets	(419)	-	-
Total nonoperating revenues and expenses	**$ (281)**	**$ 3,716**	**$ 4,241**
Income (Loss) before other revenues, expenses, gains or losses	**$ 1,059**	**$ 4,163**	**$ 4,120**
Other revenues, expenses, gains or losses:			
Capital grants and gifts	$ 3,214	$ 704	$ 712
Additions to permanent endowments	1,389	1,676	1,820
Total other revenues, expenses, gains or losses	**$ 4,603**	**$ 2,380**	**$ 2,532**
Increase (decrease) in net assets	**$ 5,662**	**$ 6,543**	**$ 6,652**
Net assets at beginning of year	**$ 39,393**	**$ 32,850**	**$26,198**
Net assets at end of year	**$ 45,055**	**$ 39,393**	**$32,850**

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which are used to fund the foundation's operating activities for the years ended June 30, 2006; June 30, 2005; and June 30, 2004.



- Operating revenue increased by 8% in 2006 over 2005. Operating gifts decreased by 3%, and sales and services of educational activities decreased by 12% due to less project income. With the increase of permanent endowments and interest rate hikes during the year, the endowment income per the spending plan increased by 17%. Nonoperating revenues decreased 108% due to the return of capital assets to the TTU Agricultural Foundation and the decrease in fair market value of investments held. Total other revenue increased by 93%, mainly due to successful fund raising efforts for capital projects. The end result was an increase in net assets for the year of 14%.
- Operating revenue increased by 37% in 2005 over 2004. Operating gifts increased by 38% with a major gift going to this designation. Sales and services of educational activities increased by 17% from project income. Endowment income per the spending plan increased by 46% due to an increase in permanent endowments last year and increased investment income over expenses. Other revenue increased by 385% due to increased transfer to the foundation from the university. Total gifts increased by 8% with increased fund raising success. Nonoperating revenue decreased by 12%, because of a drop in the total financial gains of investments.

Expenses

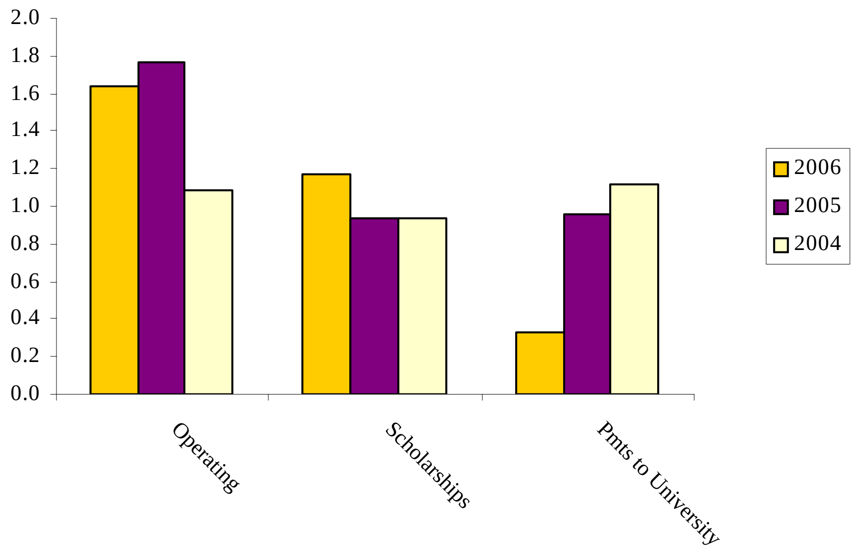
The Natural Classification method for displaying operating expenses is shown below.

Natural Classification

Operating Expenses - Natural Classification
(in thousands of dollars)

	2006	2005	2004
Operating	$ 1,641	$ 1,777	$ 1,080
Scholarships	1,173	947	939
Payments to university	329	961	1,122
	$ 3,143	$ 3,685	$ 3,141

Operating Expenses - Natural Classification
(in millions)



- Total operating expenses decreased by 15% during 2006. Transfers to the university for capital projects decreased 66%, accounting for the primary difference. Scholarship expenses increased 23%, due to an increase in the spending plan.
- In 2005, operating revenue, investment income, and a spending plan increase allowed for an increase in operating expenses of 17% over 2004. Transfers to the university in 2005 were down 32% for the new Nursing Building from 2004.

The Statement of Cash Flows

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

Component Unit's Cash Flows
(in thousands of dollars)

	2006	2005	2004
Cash provided (used) by:			
Operating activities	$ 1,377	$ 698	$ (53)
Noncapital financing activities	970	1,676	1,820
Capital and related financing activities	1,870	451	535
Investing activities	(2,700)	(3,092)	794
Net increase (decrease) in cash	$ 1,517	$ (267)	$ 3,096
Cash, beginning of year	8,985	9,252	6,156
Cash, end of year	$10,502	$ 8,985	$ 9,252

- For 2006, increases in cash were the result of material funding in project income, operating gifts, elevated spending plan, investment income, sale and maturities of investments, additions to permanent endowments, transfers from the university, and gifts for capital projects.
- For 2005, increases in cash were the result of material funding in project income, operating gifts, elevated spending plan, investment income, sale and maturities of investments, additions to permanent endowments, transfers from the university, and gifts for new capital projects.
- For 2004, increases in cash were the result of material increases in investment income, additions to permanent endowments, elevated spending plan, project income, and gifts for the nursing building.
- For 2006, decreases were primarily the result of payments of scholarships, purchase of investments, payments to suppliers and vendors, payments to the university, and the return of capital assets to the TTU Agricultural Foundation.
- For 2005, decreases were primarily the result of payments of scholarships, purchase of investments, payments to suppliers and vendors, and payments to the university.

- For 2004, decreases were primarily the result of payments of scholarships, payments for the purchase of investments, purchase of land, payments to suppliers and vendors, and payments to the university.
- The cash flow of the foundation is highly dependent on two major sources—gifts and investment transactions.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2006, Tennessee Technological University Foundation had $349,000 invested in capital assets, made up entirely of land. At June 30, 2005, and June 30, 2004, the foundation had $342,000 invested in capital assets. Details of these assets are shown below and in Note 16.

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

	2006	2005	2004
Land	$ 349	$ 342	$ 342
Total Capital Assets, net of depreciation	$ 349	$ 342	$ 342

- During 2006, the foundation purchased land valued at $7,000.
- During 2005, there were no changes in capital assets for the foundation.

Economic Factors That Will Affect the Future of the Foundation

The construction bid for the university's new Nursing & Health Services Building exceeded the bid target established for the project by approximately $2,000,000, reflecting the market conditions in the construction industry. The foundation has pledged significant financial resources to allow the university to proceed with construction of the new building. The foundation anticipates that the resources will come from a combination of private donations, proceeds from the sale of donated land, and increased returns on other investments. However, should the foundation be unsuccessful in raising funds to support the Nursing & Health Services Building construction, it will be necessary for the foundation to use a large portion of its unrestricted resources.

The performance of the foundation's near cash investments continues to improve as a result of the increases in interest rates by the Federal Reserve.

Requests for Information

This financial report is designed to provide a general overview of the university's finances for all those with an interest in the university's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to Linda Maxwell, Associate Vice President for Business & Fiscal Affairs, Tennessee Technological University, P.O. Box 5037, Cookeville, TN 38505.

Exhibit A

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

	Tennessee Technological University		Component Unit Tennessee Technological University Foundation	
	June 30, 2006	June 30, 2005	June 30, 2006	June 30, 2005
ASSETS				
Current assets:				
Cash and cash equivalents (Notes 2 and 16)	$ 8,390,837.07	$ 9,246,160.03	$ 801,128.81	$ 817,289.78
Short-term investments (Notes 3 and 16)	-	-	-	101,266.00
Accounts, notes, and grants receivable (net) (Note 4)	3,613,692.76	3,717,687.81	-	1,500.00
Inventories (at lower of cost or market)	299,531.25	305,401.35	-	-
Prepaid expenses and deferred charges	226,905.77	275,380.06	-	-
Accrued interest receivable	68,202.65	45,518.23	92,227.92	58,123.16
Total current assets	12,599,169.50	13,590,147.48	893,356.73	978,178.94
Noncurrent assets:				
Cash and cash equivalents (Notes 2 and 16)	10,340,242.30	7,063,026.62	9,700,507.81	8,168,140.80
Investments (Notes 3 and 16)	4,327,560.19	2,137,545.46	32,797,266.93	29,891,424.22
Accounts, notes, and grants receivable (net) (Note 4)	2,895,902.79	2,942,612.10	1,500.00	-
Capital assets (net) (Notes 5 and 16)	53,760,111.46	47,349,184.24	348,864.28	342,064.28
Other assets	-	-	1,313,300.00	13,300.00
Total noncurrent assets	71,323,816.74	59,492,368.42	44,161,439.02	38,414,929.30
Total assets	83,922,986.24	73,082,515.90	45,054,795.75	39,393,108.24
LIABILITIES				
Current liabilities:				
Accounts payable	3,461,498.94	2,470,423.02	-	-
Accrued liabilities	2,389,740.38	2,281,672.06	-	-
Student deposits	131,605.46	133,613.17	-	-
Deferred revenue	2,098,920.33	2,089,168.51	-	-
Compensated absences (Note 6)	904,992.00	881,619.42	-	-
Accrued interest payable	104,540.33	90,132.29	-	-
Long-term liabilities, current portion (Note 6)	733,056.81	1,179,880.05	-	-
Deposits held in custody for others	282,239.66	270,438.99	-	-
Other liabilities	22,657.05	21,001.33	-	-
Total current liabilities	10,129,250.96	9,417,948.84	-	-
Noncurrent liabilities:				
Compensated absences (Note 6)	2,136,882.89	2,053,924.47	-	-
Long-term liabilities (Note 6)	15,872,033.80	11,136,782.22	-	-
Due to grantors (Note 6)	2,945,444.50	3,016,177.58	-	-
Total noncurrent liabilities	20,954,361.19	16,206,884.27	-	-
Total liabilities	31,083,612.15	25,624,833.11	-	-
NET ASSETS				
Invested in capital assets, net of related debt	37,155,020.85	35,032,521.97	348,864.28	342,064.28
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	235,872.50	619,760.76	21,242,418.89	20,538,432.29
Research	-	-	388,690.64	385,674.41
Instructional department uses	-	-	2,684,086.58	2,634,879.82
Other	-	-	6,900,255.66	6,532,004.00
Expendable:				
Scholarships and fellowships (Note 7)	281,224.09	150,805.58	3,804,190.77	3,630,267.81
Research	193,791.66	269,272.15	17,957.51	15,239.92
Instructional department uses (Note 7)	423,049.59	432,054.21	929,863.32	1,019,188.89
Loans (Note 7)	769,233.79	781,896.23	-	-
Capital projects	2,206,049.14	-	4,128,783.08	488,030.58
Debt service	938,027.41	1,151,734.30	-	-
Other (Note 7)	1,175,806.55	1,173,637.99	3,760,249.50	2,887,021.86
Unrestricted (Notes 7 and 8)	9,461,298.51	7,845,999.60	849,435.52	920,304.38
Total net assets	$ 52,839,374.09	$ 47,457,682.79	$ 45,054,795.75	$ 39,393,108.24

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

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

	Tennessee Technological University		Component Unit Tennessee Technological University Foundation	
	Year Ended June 30, 2006	Year Ended June 30, 2005	Year Ended June 30, 2006	Year Ended June 30, 2005
REVENUES				
Operating revenues:				
Student tuition and fees (net of scholarship allowances of $15,564,515.92 for the year ended June 30, 2006, and $14,314,767.64 for the year ended June 30, 2005)	$ 26,170,468.79	$ 24,230,768.36	$ -	$ -
Gifts and contributions	-	-	1,648,754.76	1,691,544.48
Endowment income	-	-	1,454,966.86	1,248,380.14
Governmental grants and contracts	8,771,675.97	7,686,934.72	-	-
Nongovernmental grants and contracts	479,301.94	550,886.35	-	-
Sales and services of educational departments	3,702,507.38	2,995,306.60	934,250.10	1,065,856.77
Auxiliary enterprises:				
Residential life (net of scholarship allowances of $46,004.73 the year ended June 30, 2006, and $28,283.27 for the year ended June 30, 2005; all residential life revenues are used as security for revenue bonds; see Note 6)	6,629,283.28	6,479,557.62	-	-
Bookstore	250,000.00	252,708.46	-	-
Food service (net of scholarship allowances of $366,494.66 for the year ended June 30, 2006, and $340,713.25 for the ended June 30, 2005; all food service revenues are used as security for revenue bonds; see Note 6)	458,366.67	203,947.61	-	-
Wellness facility (net of scholarship allowances of $3,740.02 for the year ended June 30, 2006, and $9,159.54 for the year ended June 30, 2005; all wellness facility revenues are used as security for revenue bonds; see Note 6)	904,533.88	925,831.98	-	-
Other auxiliaries	777,920.88	676,811.70	-	-
Interest earned on loans to students	31,200.73	33,338.09	-	-
Other operating revenues	706,841.79	765,335.36	445,494.42	126,108.02
Total operating revenues	48,882,101.31	44,801,426.85	4,483,466.14	4,131,889.41
EXPENSES				
Operating expenses (Note 15):				
Salaries and wages	58,476,605.34	57,141,320.35	-	-
Benefits	18,035,833.69	17,226,797.16	-	-
Utilities, supplies, and other services	24,443,354.70	21,529,304.98	1,641,648.44	1,776,752.25
Scholarships and fellowships	9,400,581.41	8,262,782.45	1,172,828.41	947,461.17
Depreciation expense	4,627,003.36	4,054,125.10	-	-
Payments to or on behalf of Tennessee Technological University (Note 16)	-	-	329,019.38	961,030.70
Total operating expenses	114,983,378.50	108,214,330.04	3,143,496.23	3,685,244.12
Operating income (loss)	(66,101,277.19)	(63,412,903.19)	1,339,969.91	446,645.29
NONOPERATING REVENUES (EXPENSES)				
State appropriations	48,502,920.00	47,869,300.00	-	-
Gifts, including $291,312.18 from component unit for the year ended June 30, 2006, and $257,850.30 for the year ended June 30, 2005	695,137.46	748,872.41	-	-
Grants and contracts	14,714,735.45	13,135,268.00	-	-
Investment income (net of investment expense for the component unit of $219,125.60 for the year ended June 30, 2006, and $181,599.50 for the year ended June 30, 2005)	1,059,255.84	754,649.03	138,491.15	3,716,387.20
Interest on capital asset-related debt	(669,947.49)	(555,544.17)	-	-
Bond issuance costs	(9,749.04)	(10,702.85)	-	-
Other nonoperating revenues (expenses)	(386,794.10)	(169,647.98)	(419,454.44)	-
Net nonoperating revenues	63,905,558.12	61,772,194.44	(280,963.29)	3,716,387.20
Income (loss) before other revenues, expenses, gains, or losses	(2,195,719.07)	(1,640,708.75)	1,059,006.62	4,163,032.49

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

	Tennessee Technological University		Component Unit Tennessee Technological University Foundation	
	Year Ended June 30, 2006	Year Ended June 30, 2005	Year Ended June 30, 2006	Year Ended June 30, 2005
Capital appropriations	6,951,805.18	2,476,631.44	-	-
Capital grants and gifts, including $37,707.20 from component unit for the year ended June 30, 2006, and $703,180.40 for the year ended June 30, 2005	532,212.71	1,183,098.00	3,213,632.43	703,748.73
Additions to permanent endowments	93,392.48	17,520.04	1,389,048.46	1,675,833.25
Total other revenues	7,577,410.37	3,677,249.48	4,602,680.89	2,379,581.98
Increase in net assets	5,381,691.30	2,036,540.73	5,661,687.51	6,542,614.47
NET ASSETS				
Net assets - beginning of year	47,457,682.79	45,421,142.06	39,393,108.24	32,850,493.77
Net assets - end of year	$ 52,839,374.09	$ 47,457,682.79	$ 45,054,795.75	$ 39,393,108.24

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

Exhibit C

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

	Year Ended June 30, 2006	Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 26,358,833.52	$ 23,812,717.15
Grants and contracts	8,965,465.28	8,245,524.37
Sales and services of educational activities	3,650,382.49	2,966,148.76
Payments to suppliers and vendors	(23,484,579.71)	(21,341,120.96)
Payments to employees	(58,302,382.31)	(57,027,938.36)
Payments for benefits	(17,926,034.38)	(16,988,090.93)
Payments for scholarships and fellowships	(9,400,581.41)	(8,262,782.45)
Loans issued to students and employees	(967,746.52)	(1,077,071.50)
Collection of loans from students and employees	746,365.93	617,069.42
Interest earned on loans to students	26,720.07	32,754.48
Auxiliary enterprise charges:		
Residence halls	6,648,899.83	6,479,882.81
Bookstore	249,999.96	252,708.46
Food services	549,331.17	221,456.69
Wellness facility	900,949.65	930,947.64
Other auxiliaries	787,490.20	678,471.04
Other receipts (payments)	697,375.11	763,440.28
Net cash used by operating activities	(60,499,511.12)	(59,695,883.10)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	48,504,720.00	47,877,700.00
Gifts and grants received for other than capital or endowment purposes, including $291,312.18 from Tennessee Technological University Foundation for the year ended June 30, 2006, and $257,850.30 for the year ended June 30, 2005	15,394,099.17	13,883,331.42
Private gifts for endowment purposes	93,392.48	17,520.04
Federal student loan receipts	18,148,009.00	16,430,466.00
Federal student loan disbursements	(18,179,503.00)	(16,427,016.00)
Changes in deposits held for others	33,454.82	20,722.83
Other noncapital financing receipts (payments)	(357,815.16)	(132,330.12)
Net cash provided by noncapital financing activities	63,636,357.31	61,670,394.17
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	5,744,329.14	1,530,140.00
Capital appropriations	6,951,805.18	2,476,631.44
Capital grants and gifts received, including $37,707.20 from Tennessee Technological University Foundation for the year ended June 30, 2006, and $450,000.00 for the year ended June 30, 2005	494,871.67	919,417.60
Purchases of capital assets and construction	(10,611,691.45)	(5,328,141.74)
Principal paid on capital debt	(1,455,900.80)	(1,483,803.11)
Interest paid on capital debt	(655,539.45)	(565,192.51)
Bond issue costs paid on new debt issue	(9,749.04)	(10,702.85)
Other capital and related financing receipts (payments)	(17,316.41)	(437.41)
Net cash provicded (used) by capital and related financing activities	440,808.84	(2,462,088.58)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	656,332.66	936,006.65
Income on investments	1,187,905.03	747,116.88
Purchases of investments	(3,000,000.00)	-
Net cash provided (used) by investing activities	(1,155,762.31)	1,683,123.53

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

	Year Ended June 30, 2006	Year Ended June 30, 2005
Net increase in cash and cash equivalents	2,421,892.72	1,195,546.02
Cash and cash equivalents - beginning of year	16,309,186.65	15,113,640.63
Cash and cash equivalents - end of year	$ 18,731,079.37	$ 16,309,186.65
Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$ (66,101,277.19)	$ (63,412,903.19)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense	4,627,003.36	4,054,125.10
Gifts in-kind	44,537.35	24,566.88
Change in assets and liabilities:		
Receivables, net	134,772.56	(325,036.14)
Inventories	5,870.10	(14,681.93)
Prepaid/deferred items	65,081.18	17,215.80
Accounts payable	569,434.52	35,981.87
Accrued liabilities	94,746.62	177,929.48
Deferred revenue	(38,489.81)	(204,582.95)
Deposits	980.48	6,083.75
Compensated absences	106,331.00	116,498.39
Due to grantors	(70,733.08)	18,662.70
Loans to students and employees	62,231.79	(189,742.86)
Net cash used by operating activities	$ (60,499,511.12)	$ (59,695,883.10)
Noncash transactions		
Gifts in-kind	$ 37,341.04	$ 24,566.88
Gifts in-kind - capital	$ 44,537.35	$ 263,680.40
Unrealized gains/losses on investments	$ (153,652.61)	$ 11,843.71
Loss on disposal of capital assets	$ (19,317.70)	$ (37,317.86)
Trade-in allowance	$ 8,681.12	$ -
Bad debt expense	$ (92,468.68)	$ -
Loan fund cancellations and write-offs	$ (291,637.11)	$ -

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

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

Basis of Presentation

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

Basis of Accounting

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

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

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

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

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

Cash Equivalents

This classification includes instruments 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 on an average cost or first-in, first-out basis.

Compensated Absences

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

Capital Assets

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

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

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

Net Assets

The university's net assets are classified as follows:

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

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

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

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

Scholarship Discounts and Allowances

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

NOTE 2. CASH

At June 30, 2006, cash consisted of $3,923,226.80 in bank accounts, $26,265.00 of petty cash on hand, $11,808,558.25 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer, and $2,973,029.32 in LGIP deposits for capital projects. At June 30, 2005, cash consisted of $3,320,357.51 in bank accounts, $27,053.00 of petty cash on hand, $12,284,108.65 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer, and $677,667.49 in LGIP deposits for capital projects.

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

During the year ended June 30, 2005, the university implemented GASB Statement 40, Deposit and Investment Risk Disclosures. That statement modified the custodial credit risk disclosures of GASB Statement 3 to limit required disclosures to deposits that are not covered by depository insurance and are (a) uncollateralized, (b) collateralized with securities held by the pledging financial institution, or (c) collateralized with securities held by the pledging financial institution's trust department or agent but not in the university's name.

The university's deposits in the Local Government Investment Pool (LGIP) are administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and required risk disclosures are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 3. INVESTMENTS

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

All investments permitted to be reported at fair value under GASB Statement 31 are reported at fair value, including those with a maturity date of one year or less at the time of purchase.

At June 30, 2006, the university had the following investments and maturities.

		Investment Maturities (in Years)			
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10
U.S. Government Securities	$4,320,076.26	$ -	$288,961.06	$138,005.18	$3,893,110.02
Collateralized mortgage obligations	7,483.93	-	-	-	7,483.93
Total	$4,327,560.19	$ -	$288,961.06	$138,005.18	$3,900,593.95

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

		Investment Maturities (in Years)			
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10
U.S. Government Securities	$2,126,769.37	$ -	$371,338.72	$348,832.05	$1,406,598.60
Collateralized mortgage obligations	10,776.09	-	-	-	10,776.09
Total	$2,137,545.46	$ -	$371,338.72	$348,832.05	$1,417,374.69

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

Credit risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool (LGIP). The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified. The university has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations.

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

Investment Type	Fair Value	Not rated
Local Government Investment Pool	$11,808,558.25	$11,808,558.25
Collateralized mortgage obligations	7,483.93	7,483.93
	$11,816,042.18	$11,816,042.18

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

Investment Type	Fair Value	Not rated
Local Government Investment Pool	$12,284,108.65	$12,284,108.65
Collateralized mortgage obligations	10,776.09	10,776.09
	$12,294,884.74	$12,294,884.74

Investments of the university's endowment and similar funds are composed of the following:

	Carrying Value June 30, 2006	Carrying Value June 30, 2005
U.S. government securities	$ 29,354.50	$ 38,930.55
Collateralized mortgage obligations	7,483.93	10,776.09
Local Government Investment Pool	507,192.23	868,688.59
	$544,030.66	$918,395.23

Assets of endowments are pooled on a fair value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of the calendar quarter within which the transaction takes place. Of the total units at June 30, 2006—each having a fair value of $1.121151—225,984.42 units were owned by endowments, 6,485.28 units were owned by term endowments, and 252,773.31 units were owned by quasi-endowments. Of the total units at June 30, 2005—each having a fair value of $1.008922—618,138.08 units were owned by endowments, 5,728.32 units were owned by term endowments, and 286,407.57 units were owned by quasi-endowments.

The following tabulations summarize changes in relationships between cost and fair values of the pooled assets:

FY 2006

	Pooled Assets		Net Gains	Fair Value
	Fair Value	Cost	(Losses)	Per Unit
End of year	$544,030.66	$542,677.62	$1,353.04	$1.121151
Beginning of year	$918,395.23	$915,462.33	2,932.90	1.008922
				$0.112229
Unrealized net loss			(1,579.86)	
Realized net gains			-	
Total net loss			$(1,579.86)	

The average annual earnings per unit, exclusive of net losses, were $0.03853 for the year ended June 30, 2006.

FY 2005

	Pooled Assets		Net Gains	Fair Value
	Fair Value	Cost	(Losses)	Per Unit
End of year	$ 918,395.23	$ 915,462.33	$2,932.90	$ 1.008922
Beginning of year	$1,055,471.19	$1,051,465.67	4,005.52	1.014024
				$(0.005102)
Unrealized net loss			(1,072.62)	
Realized net gains			-	
Total net loss			$(1,072.62)	

The average annual earnings per unit, exclusive of net losses, were $0.024348 for the year ended June 30, 2005.

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2006	June 30, 2005
Student accounts receivable	$ 414,907.44	$ 603,262.09
Grants receivable	2,463,069.32	2,325,089.39
Notes receivable	129,791.30	140,389.83

State appropriation receivable	208,000.00	209,800.00
Other receivables	586,604.47	636,605.08
Subtotal	3,802,372.53	3,915,146.39
Less allowance for doubtful accounts	(188,679.77)	(197,458.58)
Total receivables	$3,613,692.76	$3,717,687.81

Federal Perkins Loan Program funds included the following:

	June 30, 2006	June 30, 2005
Perkins loans receivable	$3,004,585.84	$3,066,063.12
Less allowance for doubtful accounts	(108,683.05)	(123,451.02)
Total	$2,895,902.79	$2,942,612.10

NOTE 5. CAPITAL ASSETS

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 1,257,868.94	$ -	$ -	$ -	$ 1,257,868.94
Land improvements and infrastructure	6,138,368.92	5,367,556.39	-	-	11,505,925.31
Buildings	87,181,071.78	43,192.54	1,937,174.81	-	89,161,439.13
Equipment	15,835,497.77	1,277,457.60	-	688,826.16	16,424,129.21
Library holdings	11,544,665.75	1,129,210.35	-	1,062,242.66	11,611,633.44
Projects in progress	5,189,987.70	3,239,831.40	(1,937,174.81)	-	6,492,644.29
Total	127,147,460.86	11,057,248.28	-	1,751,068.82	136,453,640.32

Less accum. depreciation:					
Land improvements and infrastructure	4,731,700.15	409,452.30	-	-	5,141,152.45
Buildings	57,167,879.39	2,051,888.14	-	-	59,219,767.53
Equipment	11,042,383.76	1,113,720.13	-	669,508.46	11,486,595.43
Library holdings	6,856,313.32	1,051,942.79	-	1,062,242.66	6,846,013.45
Total accum. depreciation	79,798,276.62	4,627,003.36	-	1,731,751.12	82,693,528.86
Capital assets, net	$ 47,349,184.24	$ 6,430,244.92	$ -	$ 19,317.70	$ 53,760,111.46

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 1,257,868.94	$ -	$ -	$ -	$ 1,257,868.94
Land improvements and infrastructure	6,138,368.92	-	-	-	6,138,368.92
Buildings	87,181,071.78	-	-	-	87,181,071.78
Equipment	15,213,809.40	1,255,228.75	-	633,540.38	15,835,497.77
Library holdings	11,509,032.55	1,036,239.79	-	1,000,606.59	11,544,665.75
Projects in progress	2,072,045.40	3,121,893.16	-	3,950.86	5,189,987.70
Total	123,372,196.99	5,413,361.70	-	1,638,097.83	127,147,460.86
Less accum. depreciation:					
Land improvements and infrastructure	4,583,894.81	147,805.34	-	-	4,731,700.15
Buildings	55,309,871.88	1,858,007.51	-	-	57,167,879.39
Equipment	10,639,886.15	1,002,670.99	-	600,173.38	11,042,383.76
Library holdings	6,811,278.65	1,045,641.26	-	1,000,606.59	6,856,313.32
Total accum. depreciation	77,344,931.49	4,054,125.10	-	1,600,779.97	79,798,276.62
Capital assets, net	$46,027,265.50	$1,359,236.60	$ -	$ 37,317.86	$ 47,349,184.24

NOTE 6. LONG-TERM LIABILITIES

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

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$11,650,862.27	$ 834,582.00	$ 418,420.95	$12,067,023.32	$ 733,056.81
Commercial paper	665,800.00	4,909,747.14	1,037,479.85	4,538,067.29	-
Subtotal	12,316,662.27	5,744,329.14	1,455,900.80	16,605,090.61	733,056.81
Other liabilities:					
Compensated absences	2,935,543.89	1,707,827.23	1,601,496.23	3,041,874.89	904,992.00
Due to grantors	3,016,177.58	-	70,733.08	2,945,444.50	-
Subtotal	5,951,721.47	1,707,827.23	1,672,229.31	5,987,319.39	904,992.00
Total long-term liabilities	$18,268,383.74	$7,452,156.37	$3,128,130.11	$22,592,410.00	$1,638,048.81

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

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$12,270,325.38	$ 864,340.00	$1,483,803.11	$11,650,862.27	$ 514,080.05
Commercial paper	-	665,800.00	-	665,800.00	665,800.00
Subtotal	12,270,325.38	1,530,140.00	1,483,803.11	12,316,662.27	1,179,880.05
Other liabilities:					
Compensated absences	2,819,045.50	1,755,729.48	1,639,231.09	2,935,543.89	881,619.42
Due to grantors	2,997,514.88	18,662.70	-	3,016,177.58	-
Subtotal	5,816,560.38	1,774,392.18	1,639,231.09	5,951,721.47	881,619.42
Total long-term liabilities	$18,086,885.76	$3,304,532.18	$3,123,034.20	$18,268,383.74	$2,061,499.47

TSSBA Debt - Bonds

Bonds, with interest rates ranging from 2.25% to 5.00%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2032 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net assets is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $13,062.40 at June 30, 2006, and $13,062.40 at June 30, 2005. Unexpended debt proceeds were $95,659.09 at June 30, 2005.

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

Year Ending June 30	Principal	Interest	Total
2007	$ 733,056.81	$ 543,559.81	$ 1,276,616.62
2008	756,024.02	519,509.27	1,275,533.29
2009	788,279.46	491,317.18	1,279,596.64
2010	818,888.09	462,446.74	1,281,334.83
2011	533,332.51	428,582.50	961,915.01
2012-2016	1,904,108.56	1,861,615.84	3,765,724.40
2017-2021	2,423,238.18	1,373,727.26	3,796,965.44
2022-2026	2,258,180.07	767,294.57	3,025,474.64
2027-2031	1,500,978.36	336,506.24	1,837,484.60
2032	350,937.26	18,424.20	369,361.46
	$12,067,023.32	$6,802,983.61	$18,870,006.93

TSSBA Debt - Commercial Paper

The Tennessee State School Bond Authority issues commercial paper to finance the costs of various capital projects during their construction phase. When projects are placed in service, long-term, fixed-rate debt is issued by TSSBA to finance the project over its useful payback period and the commercial paper is redeemed. The amount issued for projects at the university was $4,538,067.29 at June 30, 2006, and $665,800.00 at June 30, 2005.

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

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

NOTE 7. ENDOWMENTS

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

The university 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 university, only realized gains have been authorized for expenditure. Percentage amounts retained are based upon donor requirements and have been authorized for expenditure. At June 30, 2006, net appreciation of $24,973.26 is available to be spent, of which $5,457.33 is included in restricted net assets expendable for scholarships and fellowships, $6,264.45 is included in restricted net assets expendable for instructional department uses, $1,456.37 is included in restricted net assets expendable for loans, $2,339.43 is included in restricted net assets expendable for other, and $9,455.68 is included in unrestricted net assets. At June 30, 2005, net appreciation of $34,595.92 is available to be spent, of which $11,122.82 is included in restricted net assets expendable for scholarships and fellowships, $15,470.90 is included in restricted net assets expendable for instructional department uses, $790.24 is included in restricted net assets expendable for loans, $1,218.21 is included in restricted net assets expendable for other, and $5,993.75 is included in unrestricted net assets.

NOTE 8. UNRESTRICTED NET ASSETS

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

	June 30, 2006	June 30, 2005
Working capital	$ 335,719.10	$ 646,389.86
Encumbrances	214,105.74	616,032.04
Designated fees	1,007,178.67	736,083.29
Auxiliaries	471,888.42	445,851.42
Quasi-endowment	274,807.32	265,351.64
Plant construction	1,656,847.98	1,556,681.48
Renewal and replacement of equipment	4,791,218.35	3,434,850.62
Debt retirement	380,864.49	371,886.88
Undesignated	328,668.44	(227,127.63)
Total	$9,461,298.51	$7,845,999.60

NOTE 9. PENSION PLANS

A. Defined Benefit Plan

Tennessee Consolidated Retirement System

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

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee Department of the Treasury, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, Tennessee 37243-0230, or by calling (615) 741-8202.

Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 10.31% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2006, 2005, and 2004 were $2,394,517.74, $2,368,211.39, and $1,557,443.97. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

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

Funding Policy - Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans was $2,855,872.71 for the year ended June 30, 2006, and $2,815,472.25 for the year ended June 30, 2005. Contributions met the requirements for each year.

NOTE 10. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible university retirees. This benefit is provided and administered by the State of Tennessee. The university assumes no liability for retiree health care programs. Information related to this plan is available at the statewide level in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

NOTE 11. INSURANCE-RELATED ACTIVITIES

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

The university participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the years ended June 30, 2006, and June 30, 2005, are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee

Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140. Since the university participates in the Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated,* Section 50-6-101 et seq. Claims are paid through the state's Risk Management Fund. At June 30, 2006, the Risk Management Fund held $133.2 million in cash and cash equivalents designated for payment of claims. At June 30, 2005, the Risk Management fund held $114.4 million in cash and cash equivalents designated for payment of claims.

At June 30, 2006, the scheduled coverage for the university was $234,298,900 for buildings and $94,817,300 for contents. At June 30, 2005, the scheduled coverage for the university was $230,195,100 for buildings and $92,500,200 for contents.

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

NOTE 12. COMMITMENTS AND CONTINGENCIES

Sick Leave - The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent because of illness, injury, or related family death, there is no liability for sick leave at June 30. The dollar amount of unused sick leave was $24,763,445.22 at June 30, 2006, and $23,531,032.68 at June 30, 2005.

Operating Leases - The university has entered into various operating leases for equipment. Such leases will probably continue to be required. Expenses under operating leases were $307,445.43 for the year ended June 30, 2006, and $238,270.29

for the year ended June 30, 2005. All operating leases are cancelable at the lessee's option.

Construction in Progress - At June 30, 2006, outstanding commitments under construction contracts totaled $19,546,000.00, of which $14,223,700.00 will be funded by future capital outlay appropriations. The two largest projects, amounting to $18,594,600.00, are the Nursing and Health Sciences Building and the Fire Alarm Upgrade project.

Contract - In December 2004, the Tennessee Board of Regents system entered into a contract with SungardSCT for the purchase of a comprehensive enterprise resource planning system. The contract includes a multi-year phase-in of administrative software for financial, human resource, and student systems. The university's outstanding liability for this contract is estimated as $2,037,046.86 at June 30, 2006.

Litigation - The university is involved in a lawsuit, which is not expected to have a material effect on the accompanying financial statements.

NOTE 13. CHAIRS OF EXCELLENCE

The university had $5,030,106.76 on deposit at June 30, 2006, and $4,974,056.01 on deposit at June 30, 2005, with the State Treasurer for the university's Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

NOTE 14. FUNDS HELD IN TRUST BY OTHERS

The university is a beneficiary under the CTC Charitable Lead Trust, Odom Family Trust, Odom Tennessee Tech Charitable Lead Trust, and the William Jenkins Estate Account. The underlying assets are not considered assets of the university and are not included in the university's financial statements. The university received $118,909.53 from these funds during the year ended June 30, 2006, and $102,803.41 from the CTC Charitable Lead Trust, Odom Family Trust, and Odom Tennessee Tech Charitable Lead Trust during the year ended June 30, 2005. The William Jenkins Estate Account was added during the year ended June 30, 2006.

NOTE 15. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

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

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$30,780,788.63	$ 8,563,969.48	$ 5,486,547.44	$ -	$ -	$ 44,831,305.55
Research	4,305,463.76	948,519.48	2,477,674.83	-	-	7,731,658.07
Public service	2,160,079.23	614,889.08	2,176,913.06	-	-	4,951,881.37
Academic support	5,639,840.87	1,848,865.08	(831,180.90)	-	-	6,657,525.05
Student services	4,438,815.68	1,492,516.68	3,543,222.09	-	-	9,474,554.45
Institutional support	5,698,570.74	2,140,284.86	1,069,491.78	-	-	8,908,347.38
Operation & maintenance	3,395,514.18	1,707,683.33	7,438,973.77	-	-	12,542,171.28
Scholar. & fellow.	-	-	-	9,400,581.41	-	9,400,581.41
Auxiliary	2,057,532.25	719,105.70	3,081,712.63	-	-	5,858,350.58
Depreciation	-	-	-	-	4,627,003.36	4,627,003.36
Total	$58,476,605.34	$18,035,833.69	$24,443,354.70	$9,400,581.41	$4,627,003.36	$114,983,378.50

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

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$29,557,528.04	$ 8,087,630.94	$ 6,400,061.02	$ -	$ -	$ 44,045,220.00
Research	4,191,322.34	892,407.06	2,246,013.34	-	-	7,329,742.74
Public service	2,050,177.76	553,134.50	1,609,346.72	-	-	4,212,658.98
Academic support	5,721,511.90	1,857,193.86	(1,186,994.76)	-	-	6,391,711.00
Student services	4,322,791.46	1,462,852.89	3,405,317.16	-	-	9,190,961.51
Institutional support	5,826,411.66	2,010,431.70	907,528.03	-	-	8,744,371.39
Operation & maintenance	3,405,332.15	1,648,847.80	5,135,942.20	-	-	10,190,122.15
Scholar. & fellow.	-	-	-	8,262,782.45	-	8,262,782.45
Auxiliary	2,066,245.04	714,298.41	3,012,091.27	-	-	5,792,634.72
Depreciation	-	-	-	-	4,054,125.10	4,054,125.10
Total	$57,141,320.35	$17,226,797.16	$21,529,304.98	$8,262,782.45	$4,054,125.10	$108,214,330.04

NOTE 16. COMPONENT UNIT

The Tennessee Technological University Foundation is a legally separate, tax-exempt organization supporting Tennessee Technological 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 25-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, 2006, the foundation made distributions of $329,019.38 to or on behalf of the university for both restricted and unrestricted purposes. During the year ended June 30, 2005, the foundation made distributions of $961,030.70 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Tennessee Technological University, Office of the Vice President for Business and Fiscal Affairs, P.O. Box 5037, Cookeville, Tennessee 38505.

<u>Cash and cash equivalents</u> - At June 30, 2006, cash and cash equivalents consisted of $6,251,817.64 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer and $4,249,818.98 in custodial accounts of the investment managers of the foundation. At June 30, 2005, cash and cash equivalents consisted of $3,309,704.90 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer and $5,675,725.68 in custodial accounts of the investment managers of the foundation.

<u>Deposits</u> - The foundation also has deposits in the Local Government Investment Pool administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The Pooled Investment Fund's investment policy and required risk disclosures are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37242-0298, or by calling (615) 741-2140.

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

At June 30, 2006, the foundation had the following investments and maturities.

		Investment Maturities (in Years)				
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10	No Maturity Date
U.S. Treasury	$ 95,752.95	$ -	$ -	$ 12,457.13	$ 83,295.82	$ -
U.S. agencies	2,745,475.40	-	2,205,230.30	236,137.49	304,107.61	-
Corporate stocks	25,050,532.63	-	-	-	-	25,050,532.63
Corporate bonds	2,652,542.14	-	867,935.00	1,651,978.89	132,628.25	-
Mutual funds	16,514.59	-	-	-	-	16,514.59
Other:						
Hedge fund	2,236,449.22	-	-	-	-	2,236,449.22
Total	$32,797,266.93	$ -	$3,073,165.30	$1,900,573.51	$520,031.68	$27,303,496.44

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

		Investment Maturities (in Years)				
Investment Type	Fair Value	Less than 1	1 to 5	6 to 10	More than 10	No Maturity Date
U.S. Treasury	$ 117,617.28	$ -	$ -	$ 12,504.43	$105,112.85	$ -
U.S. agencies	1,836,836.21	-	1,152,493.64	346,293.88	338,048.69	-
Corporate stocks	24,203,755.63	-	-	-	-	24,203,755.63
Corporate bonds	1,700,871.25	101,266.00	487,973.75	974,074.00	137,557.50	-
Mutual funds	19,347.11	-	-	-	-	19,347.11
Other:						
Hedge funds	2,114,262.74	-	-	-	-	2,114,262.74
Total	$29,992,690.22	$101,266.00	$1,640,467.39	$1,332,872.31	$580,719.04	$26,337,365.48

Alternative Investment – The foundation has an investment in the Silver Capital Fund (Offshore) Ltd. (the "Fund") hedge fund. The estimated fair value of this investment was $2,236,449.22 at June 30, 2006, and $2,114,262.74 at June 30, 2005.

The Fund was formed under the laws of the Cayman Islands on April 30, 2004, with operations commencing on June 1, 2004, for the purpose of trading and investing in securities. The Fund invests only in publicly tradable securities listed on a national securities exchange or reported on the NASDAQ national market. The Fund received an unqualified opinion on its June 30, 2006, audited financial statements. The foundation believes that the reported amounts for this alternative investment are a reasonable estimate of fair value at each year end. The fair value for the Fund is estimated monthly by BISYS Hedge Fund Services Limited based on the month end closing price listed for each individual investment within the fund.

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

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

		Credit Quality Rating				
Investment Type	Fair Value	AAA	AA	A	BBB	Unrated
LGIP	$ 6,251,817.64	$ -	$ -	$ -	$ -	$6,251,817.64
U.S. agencies	2,745,475.40	2,745,475.40	-	-	-	-
Corporate bonds	2,652,542.14	-	663,842.83	1,347,616.06	225,511.25	415,572.00
Mutual funds	16,514.59	-	-	-	-	16,514.59
Total	$11,666,349.77	$2,745,475.40	$663,842.83	$1,347,616.06	$225,511.25	$6,683,904.23

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

		Credit Quality Rating				
Investment Type	Fair Value	AAA	AA	A	BBB	Unrated
LGIP	$3,309,704.90	$ -	$ -	$ -	$ -	$3,309,704.90
U.S. agencies	1,836,836.21	1,836,836.21	-	-	-	-
Corporate bonds	1,700,871.25	-	303,740.00	636,994.00	240,625.50	519,511.75
Mutual funds	19,347.11	-	-	-	-	19,347.11
Total	$6,866,759.47	$1,836,836.21	$303,740.00	$636,994.00	$240,625.50	$3,848,563.76

Investments of the foundation's endowment and similar funds are composed of the following:

	Carrying Value June 30, 2006	Carrying Value June 30, 2005
U.S. Treasury	$ 69,953.92	$ 90,106.60
U.S. agencies	2,745,475.40	1,836,836.21
Local Government Investment Pool	6,251,817.64	3,309,704.90
Investment manager custodial accounts	4,248,520.96	5,675,559.08
Corporate stocks	24,531,671.19	23,703,203.58
Corporate bonds	2,652,542.14	1,700,871.25
Hedge funds	2,236,449.22	2,114,262.74
	$42,736,430.47	$38,430,544.36

Assets of endowments are pooled on a fair value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of the calendar quarter within which the transaction takes place. Of the total units at June 30, 2006—each having a fair value of $105.244911—352,656.035632 units were owned by endowments, 48,890.90565 units were owned by operation accounts, and 4,519.537618 units were owned by quasi-endowments. Of the total units at June 30, 2005—each having a fair value of $109.64962—308,242.4593 units were owned by endowments, 39,288.1043 units were owned by operation accounts, and 2,954.3867 units were owned by quasi-endowments.

The following tabulations summarize changes in relationships between cost and fair values of the pooled assets:

FY 2006	Pooled Assets		Net Gains	Fair Value
	Fair Value	Cost	(Losses)	Per Unit
End of year	$42,736,430.47	$41,295,130.24	$ 1,441,300.23	$105.244911
Beginning of year	$38,430,544.39	$35,233,421.98	3,197,122.41	109.649628
				$ (4.404717)
Unrealized net losses			(1,755,822.18)	
Realized net gains			-	
Total net losses			$(1,755,822.18)	

The average annual earnings per unit, exclusive of net losses, were $8.090680 for the year ended June 30, 2006.

FY 2005

	Pooled Assets			Fair Value
	Fair Value	Cost	Net Gains (Losses)	Per Unit
End of year	$38,430,544.36	$35,233,421.98	$ 3,197,122.38	$109.649628
Beginning of year	$31,857,729.45	$29,371,324.25	2,486,405.20	110.025075
				$ (0.375447)
Unrealized net gains			710,717.78	
Realized net gains			-	
Total net gains			$ 710,717.78	

The average annual earnings per unit, exclusive of net gains, were $12.127984 for the year ended June 30, 2005.

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$342,064.28	$ 6,800.00	$ -	$ -	$348,864.28

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

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$342,064.28	$ -	$ -	$ -	$342,064.28

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

The foundation chooses to spend only a portion of the investment income (including changes in the fair value of investments) each year. Under the spending plan established by the foundation, a percentage (as defined by the foundation) of the book value of an endowment, or a percentage of the actual earnings as designated by the donor, has been authorized for expenditure. The remaining amount, if any, becomes part of the permanent endowment.

NOTE 17. SUBSEQUENT EVENT

On April 30, 2007, the foundation invested an additional $2,500,000 in the Silver Capital Fund (Offshore) Ltd. hedge fund.

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

	Year Ended June 30, 2006	Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$ 1,534,709.99	$ 1,639,350.14
Endowment income per spending plan	1,454,966.86	1,248,380.14
Sales and services of educational activities	934,250.10	1,065,856.77
Payments to suppliers and vendors	(1,527,603.67)	(1,726,057.91)
Payments for scholarships and fellowships	(1,172,828.41)	(947,461.17)
Payments to Tennessee Technological University	(291,678.34)	(707,850.30)
Other receipts (payments)	445,494.42	126,108.02
Net cash provided by operating activities	1,377,310.95	698,325.69
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes	1,389,048.46	1,675,833.25
Other noncapital financing receipts (payments)	(419,454.44)	-
Net cash provided by noncapital financing activities	969,594.02	1,675,833.25
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital grants and gifts received	1,913,632.43	463,217.81
Purchases of capital assets and construction	(44,141.04)	(12,649.48)
Net cash provided by capital and related financing activities	1,869,491.39	450,568.33
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	19,503,152.76	12,096,189.82
Income on investments	142,288.95	266,404.82
Purchases of investments	(22,345,632.03)	(15,454,193.29)
Net cash used by investing activities	(2,700,190.32)	(3,091,598.65)
Net increase (decrease) in cash and cash equivalents	1,516,206.04	(266,871.38)
Cash and cash equivalents - beginning of year	8,985,430.58	9,252,301.96
Cash and cash equivalents - end of year	$ 10,501,636.62	$ 8,985,430.58

Reconciliation of operating income to net cash provided by operating activities:

Operating income	$ 1,339,969.91	$ 446,645.29
Adjustments to reconcile operating income to net cash provided by operating activities:		
Gifts in-kind	37,341.04	253,180.40
Change in assets and liabilities:		
Receivables, net	-	(1,500.00)
Net cash provided by operating activities	$ 1,377,310.95	$ 698,325.69

Noncash transactions

Gifts in-kind	$ 114,044.77	$ 52,194.34
Gifts in-kind - capital	$ 1,300,000.00	$ 240,530.92
Unrealized gains/losses on investments	$ (1,770,527.25)	$ 692,778.38