Tennessee Board of Regents
Nashville State Technical Community College

For the Years Ended
June 30, 2003, and June 30, 2002

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

February 28, 2005

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. George H. Van Allen, President
Nashville State Technical Community College
120 White Bridge Road
Nashville, Tennessee 37209

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, Nashville State Technical Community College, for the years ended June 30, 2003, and June 30, 2002. You will note from the independent auditor's report that an unqualified opinion was 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 college'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/cj
04/079

State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
Nashville State Technical Community College
For the Years Ended June 30, 2003, and June 30, 2002

AUDIT OBJECTIVES

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

INTERNAL CONTROL FINDINGS

Employment Contracts Were Not Always Signed by the Employee and Properly Approved Before the Effective Date
Testwork revealed that for 16 of 38 employees whose contracts were reviewed (42.1%), 18 contracts were not signed by the employee or properly approved before the effective date of the contract.

User Authorization for Access to Computer Systems Was Not Adequately Documented, and Some Terminated Employees Still Had a User Account*
The college's Computer Services management did not have reliable documentation of authorization for users of the computer systems. For several key employees selected to test for proper authorization of computer system access, no security access forms could be located, and employees who had at least one security access form had access to one or more systems for which there was no access form. The testwork revealed that one form did not specify the type of access to be given; some forms did not contain all required signatures; and the access granted for some of the users was greater than the access requested. Also, several terminated employees still had a user account for the Student Information System.

INVESTIGATION FINDING

Management's Independent, Ongoing Assessment of Fraud Risk and Implementation of Effective Mitigating Controls, Including Ongoing Monitoring, Should Include Photography Supply Purchases and Inventory and Similar Operations at the School

On February 17, 2003, an official from the Tennessee Board of Regents notified the Division of State Audit of possible wrongdoing at the college involving the photography department chairman at that time. A review was conducted by the Investigations section of the Division of State Audit. The review concluded that, due to weaknesses in internal controls over photography supply purchases and inventory, the former chairman had personally benefited from the unauthorized sale of photographic film and paper valued at over $10,000; personally benefited from the unauthorized sale of cameras, lenses, and other items of photographic equipment; and furthermore, exercised control over a state laptop computer, a state television, and a state printer without the consent of the college. The former chairman was indicted on five counts of theft of property on June 18, 2004, in Davidson County, and that matter is still pending.

*This finding is repeated from the prior audit.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

Audit Report
Tennessee Board of Regents
Nashville State Technical Community College
For the Years Ended June 30, 2003, and June 30, 2002

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Tennessee Board of Regents
Nashville State Technical Community College
For the Years Ended June 30, 2003, and June 30, 2002

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Board of Regents, Nashville State Technical Community College. 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

In March 1963, the Tennessee General Assembly passed House Bill 633, authorizing the establishment of a statewide system of area vocational-technical schools and regional technical schools. Nashville State Technical Institute opened on White Bridge Road in the fall of 1970. Until 1983, the institute operated under the Tennessee State Board of Vocational-Education through the Tennessee Department of Education, Division of Vocational-Technical Education. The 93rd General Assembly transferred the institute to the Tennessee Board of Regents July 1, 1983.

In April 2002, the General Assembly amended Section 49-8-101, *Tennessee Code Annotated,* and changed the name of Nashville State Technical Institute to Nashville State Technical Community College. The change became effective on July 1, 2002.

The institute offers two-year, college-level programs and certificates to prepare adults for employment as technicians in career areas. The programs lead to an Associate of Applied Science degree. Also, the institute offers special programs and courses to meet the needs of industry, business, and government.

ORGANIZATION

The governance of Nashville State Technical Community College 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 college 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, 2001, through June 30, 2003, 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 years ended June 30, 2003, and June 30, 2002. Nashville State Technical Community College 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 college's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grants;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The college filed its report with the Department of Audit on May 30, 2003. A follow-up of the prior audit finding was conducted as part of the current audit.

REPEATED AUDIT FINDING

The prior audit report contained a finding concerning documentation of user authorization for access to computer systems. This finding has not been resolved and is repeated in this report.

OBSERVATIONS AND COMMENTS

Nashville State Technical Community College serves as the lead institution under agreements with the Tennessee Technology Center at Dickson and the Tennessee Technology Center at Nashville. Under these agreements, Nashville State Technical Community College performs the accounting and reporting functions for the centers. The chief administrative officer of each center is the director, who is assisted and advised by members of the faculty and administrative staff. Each director is responsible to the Chancellor of the Tennessee Board of Regents.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the college's financial statements for the years ended June 30, 2003, and June 30, 2002, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by 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. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the college's financial statements.

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

July 19, 2004

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

Dear Mr. Morgan:

We have audited the financial statements of Nashville State Technical Community College, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the years ended June 30, 2003, and June 30, 2002, and have issued our report thereon dated July 19, 2004. 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. As discussed in Note 12, during the year ended June 30, 2002, the college implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The college also implemented GASB Statement 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus*, and GASB Statement 38, *Certain Financial Statement Note Disclosures*.

<u>Compliance</u>

As part of obtaining reasonable assurance about whether the college's financial statements are free of material misstatement, we performed tests of the college's compliance with certain provisions of laws, regulations, contracts, and grants, noncompliance with which could have a direct and material effect on the determination of financial statement amounts.

However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

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

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the college's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. 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 college'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:

- Employment contracts were not always signed by the employee and properly approved before the effective date
- User authorization for access to computer systems was not adequately documented, and some terminated employees still had a user account
- Management's independent, ongoing assessment of fraud risk and implementation of effective mitigating controls, including ongoing monitoring, should include photography supply purchases and inventory and similar operations at the school

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

A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. 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 none of the reportable conditions described above is a material weakness.

The Honorable John G. Morgan
July 19, 2004
Page Three

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

This report is intended solely for the information and use of the General Assembly of the State of Tennessee 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., CPA,
Director

AAH/cj

Findings and Recommendations

1. **Employment contracts were not always signed by the employee and properly approved before the effective date**

Finding

Testwork revealed that employment contracts were not always signed by the employee and properly approved before the beginning of the contract period. For 16 of 38 employees whose contracts were reviewed (42.1%), 18 contracts were not signed by the employee or properly approved before the effective date of the contract. The 18 contracts included 7 faculty contracts, 10 adjunct contracts, and one student contract. For employee signatures, the days late ranged from one to 52 days, with an average of 13 days late. Also, one contract was not signed by the employee, and one contract was signed, but the signature was not dated. For approval signatures, the days late ranged from 6 to 51 days, with an average of 19 days late. The late approval of contracts resulted because the Human Resources Department did not require authorizing personnel to sign employee contracts before the academic semester began. All of the contracts except one were signed prior to the employees being paid. For the one contract, the employee was being transferred from one department to another, and the college provided a memo documenting the request for transfer and a memo documenting the approval, both of which were dated prior to the effective date of the contract.

If contracts are not signed by the employee and properly approved before the effective date, compensation and administrative duty issues could arise without a fully executed contract.

Recommendation

The Director of Human Resources should ensure that all full-time employment contracts are signed by the employee and properly approved by appropriate personnel before the effective date. Department heads and deans should ensure adjunct contracts are fully executed before the specific classes are initiated.

Management's Comment

Management concurs with the finding and recommendation.

The Human Resources Office has been assigned the responsibility of training the departments in properly preparing the contracts and monitoring all contracts to ensure that they have been fully executed in a timely manner.

Measures have been implemented to ensure that, when possible, contracts are signed prior to the beginning of the contract period. The vice presidents have met with deans and directors responsible for departments that initiate contracts. In addition, the Director of Human Resources has met with the deans in the Academic Affairs division to discuss options for ensuring timely receipt of signatures on adjunct contracts. In the past, the first official day of the semester was used as the effective date on adjunct contracts, rather than the day the faculty member actually commenced teaching. Beginning fall semester 2004, exact start dates were used to prevent the appearance of delayed approval. Finally, a training session was held on August 11, 2004, for department and division secretaries and others responsible for generating adjunct contracts to ensure understanding of and compliance with the new procedures.

The college will strive to have all contracts fully approved prior to actual work performance, but this may not always be possible. Full-time faculty must be fully loaded and teach the hours required in their employment agreements. Due to course cancellations, which occur the first week of classes, classes scheduled for adjunct faculty are sometimes moved to full-time faculty. Demand for classes during late registration also causes courses to be added to the schedule during the first week of classes. In these instances, a memo explaining the circumstances will be required by the Director of Human Resources.

2. <u>User authorization for access to computer systems was not adequately documented, and some terminated employees still had a user account</u>

Finding

As noted in the prior audit, the college's Computer Services management did not have reliable documentation of authorization for users of the Systems and Computer Technology (SCT) computer systems. These systems used by the Tennessee Board of Regents' schools include the Financial Records System, Human Resource System, and Student Information System.

Management concurred with the prior audit finding and stated, "Effective October 2002, management implemented a quarterly review [by departmental management staff] of the ZBA110 security report." However, auditor review of several ZBA110 security reports revealed that although there was evidence of management review, the report does not show which screens the users have access to or the type of access granted. Therefore, the department heads were only able to request that terminated employees' access be deleted and were not able to confirm that each user had the correct access. Management also stated that ". . . the Director of Computer Services uses the terminal checkout form to determine if someone is leaving the college. If so, the director e-mails access terminations to the help desk so that a task removing access is generated and sent to the systems group." However, auditor review revealed that several terminated employees still had a user account for the Student Information System (SIS).

Seventeen key employees were selected to test for proper authorization of computer system access. For 8 of the 17 employees selected (47%), no security access forms could be located. In addition, 6 of the 9 employees who had at least one security access form (67%) had access to one or more systems for which there was no access form. The testwork on those 9 users revealed the following:

- one of 9 forms (11%) did not specify the type of access to be given;
- 4 of 9 forms (44%) did not contain all required signatures; and
- the access granted for 5 of 9 users (56%) was greater than the access requested.

In addition, a comparison of a listing of employees terminated since July 1, 2001, to current ZBA110 reports revealed that 7 of 428 terminated employees (2%) still had a user account for SIS.

Management is responsible for appropriate maintenance and ongoing monitoring of procedures for effective authorization of user access to the college's computer systems. The failure to properly maintain access authorization forms and to timely remove terminated employees' access increases the possibility that access to sensitive systems and information may be granted to ineligible individuals and that authorization may be granted to employees in excess of what is warranted for their job responsibilities.

Recommendation

Computer Services management should ensure that all users have authorization forms, and Computer Services management should maintain proper documentation of all changes and updates. Computer Services management should also ensure prompt removal of access for all terminated employees. The ongoing monitoring of forms, procedures, and employee status/access should be documented, including any problems noted and how they were resolved.

Management's Comment

Management concurs with the finding and recommendation.

User access authorization was not being tracked and documented properly. Several steps to correct this problem have already been taken.

1. A thorough, initial scrubbing of accounts took place by sending a list of all users who have access to the responsible individuals. Any person who should no longer have any access was identified and removed from the system.

2. Next, a second list was sent which detailed the specific access each authorized user had. The responsible individuals made any necessary changes and signed the listings.

3. In the stage currently underway, the listings are being compared to actual user access authorization forms on file. The authorized changes are filed with the users' documentation. Any user without initial authorization forms is recreating the form with the correct access and signatures.

4. Human Resources is communicating directly with the Help Desk whenever an employee is no longer employed. A process has been developed to ensure no data is lost, but the user account is disabled and later deleted, as appropriate.

5. Once per quarter, a list of all authorized users (similar to step 1) is being sent to the responsible individuals to determine if someone who left was missed.

6. Finally, a process has been developed whereby no access changes will be made without the express, written (or e-mailed) approval of the responsible individual or their designee.

Management is confident these new procedures will allow the Computer Services Division to ensure the safety and security of the databases, and only permit appropriate and approved levels of access.

3. <u>Management's independent, ongoing assessment of fraud risk and implementation of effective mitigating controls, including ongoing monitoring, should include photography supply purchases and inventory and similar operations at the school</u>

Finding

On February 17, 2003, an official from the Tennessee Board of Regents notified the Division of State Audit of possible wrongdoing at Nashville State Technical Community College involving the photography department chairman at that time. The matter had been initially reviewed by the college's internal auditor, who concluded that excessive amounts of high-quality photographic paper and film had been purchased by the college through purchasing requests made by the former chairman. Additionally, the internal auditor confirmed that several students and a former faculty member had written checks to the former chairman for film, photographic paper, camera lenses, and other photographic equipment. The Division of State Audit, in conjunction with the District Attorney General of the Twentieth Judicial District (Davidson County) reviewed this matter for the period January 1998 through May 2003. The former chairman had been employed in the college's photography department since 1973. However, the starting point of January 1998 was chosen for this review after consideration of the statute of limitations and the availability of documentation. During this review, weaknesses in internal controls over inventory and purchasing were noted.

The review determined that the former photography department chairman was able to effect unauthorized purchases of photographic film and paper totaling over $10,000 because as the department chair, he was not required to seek further approvals from college staff for purchases under $500. The majority of the unauthorized purchases involved orders for professional, high-quality specialty paper and were ordered through a vendor in New York City. The price of some specialty paper ordered by the chairman was over seven dollars for a single sheet of eight-by-ten-inch paper. Paper of this quality would have been used occasionally for student exhibits but would not appear necessary for the instruction provided to students. Under the college's policy at that time, the department chairman's signature was the only approval required for limited purchase orders (LPOs). Most of the relevant LPOs appeared to be in the chairman's handwriting. The review determined that a large portion of the photographic paper was then sold at a discount to photography students without the college's knowledge or consent. The former chairman then endorsed the checks from the students and deposited many of these checks into his personal bank account. The college's accounting records for the photography department for the period January 1998 through May 2003 were reviewed, and no miscellaneous deposits or deposits made by the former chairman were found.

Although neither the film nor the paper had identifiable serial numbers, the descriptions taken from many of the students' checks matched the size, brand, and sometimes the specific characteristics of the specialty paper ordered by the former chairman. Only an immaterial amount of specialty paper remained in the department's inventory. Additionally, the dates that the film and paper were received at the college were close to the dates of the students' checks, with the dates on the students' checks being the same as the date the items were received or up to two weeks afterward. The students who were interviewed made the same statements generally, that the former chairman had told them he had a friend through which he could obtain film and specialty paper at a discount. Many of the photography students were buying the specialty paper for their personal use, at what they considered a substantial discount. From the presently available information, none of the students involved knew that the former chairman was not paying for the items but rather that the items were being purchased through the college's system. The improper purchases effected by the former chairman were not detected until a faculty member brought information forward regarding the sale of supplies to students, and several students came forward with canceled checks written to the former chairman.

As long as these improper requests remained under $500 and the purchases were within the department's budget, the business office processed the LPOs without question. Even purchase orders submitted by the former chairman for purchases over $500 were approved by the department's dean and purchasing staff without question as the items ordered appeared to be reasonable for the operation of a photography department. Had the department dean compared all items purchased within the fiscal year by the photography department with what the college was actually supplying the students (which was only the chemicals in the film processing labs), the purchases for film, paper, and film processing would have appeared suspect. The internal auditor in her initial review of this matter for the period July 1, 2002, through March 7, 2003, noted that although the students were responsible for supplying their own paper and film, the former chairman ordered 82 boxes of various types of photographic paper, including a large portion of specialty paper, which appeared excessive. In addition, the internal auditor found that the college also paid for the processing of 322 rolls of film at a total of nearly $2,000 and 260 rolls of film at a total over $1,000. After determining that the photography department had only minimal needs for purchasing film and processing, the internal auditor concluded that these costs were also excessive.

For budget purposes, all of these items were considered supplies and were included in the same operating expenditure line item of the department's budget. This expenditure line included excessive amounts for film, film processing, and photographic paper, all of which were to be supplied by the students. However, budget approvers (college deans) did not have the details of specific expenditures under the operating expenditures needed to determine that purchases were excessive or unnecessary. To illustrate the excessive nature of the former chairman's purchases, in the last fiscal year the chairman was employed at the college (the chairman retired in May 2003, shortly after the review began), the total expenditures for supplies was $61,804. The total expenditures for supplies for the fiscal year ended June 30, 2004, was $26,864, a difference of $34,940.

Finally, because the college's policy did not require small-dollar purchases (under $1,000) to be recorded as inventory regardless of whether the items were considered sensitive in nature, the whereabouts of items such as cameras, lenses, and other photographic equipment were not monitored. Thus, during routine year-end physical inventories, the fact that photographic equipment was actually missing was not determined by the college's administrators. Because of the concern that equipment might have been sold or removed from the campus, a physical inventory of photography and various electronic equipment held in the photography department rooms and labs was conducted by the Division of State Audit and purchasing staff on May 14, 2003. Upon comparing cameras, camera lenses, and other photographic and electronic equipment purchased by the college's photography department to that inventory, it was determined that 198 items representing costs of $55,471 were unaccounted for. These costs did not include photographic film or paper. The former chairman retired from state service in May 2003. The chairman's attorney declined our office's request to interview the former chairman regarding these improper purchases and missing inventory. In the summer of 2003, the former chairman returned a significant amount of photographic equipment that had been removed from the campus. In August 2003, a search of the former chairman's personal residence, pursuant to a search warrant, recovered a laptop computer, a television, and a printer that were apparently purchased with state funds. These items had been removed from the campus. The laptop was listed on the college's inventory and was marked with State of Tennessee ID C48794. The college's records showed this laptop as being last assigned to the library's media center. Neither an equipment loan form nor a proper recording of the assignment of this laptop to a staff member was found, according to the college's purchasing staff.

During this review, the college's administration took corrective actions to strengthen internal controls over purchasing, the foremost being that the authority for approvals at the department-head level on LPOs additionally require approval from the appropriate dean. Furthermore, additional training was given by the Division of State Audit staff to the college's purchasing staff and those individuals approving department purchases.

The review concluded that the former chairman had personally benefited from the unauthorized sale of photographic film and paper valued at over $10,000; personally benefited from the unauthorized sale of cameras, lenses, and other items of photographic equipment; and furthermore, exercised control over a state laptop computer, a state television, and a state printer without the effective consent of the college. The former chairman was indicted on five counts of theft of property on June 18, 2004, in Davidson County, and that matter is still pending.

Recommendation

The information developed in this finding demonstrates that the area in question is one susceptible to fraud. Statement on Auditing Standards No. 99 promulgated by the American Institute of Certified Public Accountants, in response to recent scandals involving fraud, reiterates the essential and central role that management plays in the protection and safeguarding of assets for which the entity is responsible. And these responsibilities are even greater in the governmental sector, where the assets and operations are carried out on behalf of the taxpayers rather than traditional investors.

Although the importance of auditors in the detection of fraud is obvious, it is also obvious that management is solely in the position to prevent fraud in the first place. And, with regard to detection, management is in place every day the entity is operating, hopefully utilizing effective internal controls to identify unusual transactions or other matters that are inconsistent with the control procedures. Of course, if the controls are not adequately designed to flag such improper transactions or operations, then the controls are inadequate. And if circumvention of effective controls is tolerated or not noted by management, then the controls are rendered ineffective even if they are properly designed. These issues are uniquely within the scope of authority of management. If, through laxity in supervision or by inattention to detail, management fails to respond to internal control problems, then there are no consequences for circumventing the controls and staff soon realize that they are not bound by them.

Internal controls, by their very nature, are susceptible to override or ineffective execution at any time. Hence, to assure effective controls, it is necessary for management to have an ongoing process for evaluating the effectiveness of the controls and for determining if there are any weaknesses in the controls that need to be corrected.

Likewise, if a transaction is handled in an inappropriate manner or the controls are otherwise circumvented, it is essential that management take steps to assure themselves that they will be notified of such actions promptly and that management is vigilant for evidence of such actions through measures such as reviewing exception reports generated by computers.

When there is evidence of such actions, management should immediately determine the facts and take appropriate action. If the facts suggest that fraud may have taken place, management should also immediately notify this office pursuant to state law.

In the broader context of these overarching principles, the college's Vice President of Finance and Administrative Services should monitor the implementation of purchase order approvals on an ongoing basis and make any needed recommendations. The Vice President should also consider this area and others with similar assets and operations to be vulnerable to the risk of fraud and should take steps to document those areas and the measures taken to mitigate those risks, including regular monitoring activities.

College deans should request detailed expenditure reports from departments that purchase any specialty items or items that are considered sensitive (electronic and photographic equipment, for example) or otherwise subject to conversion for personal use by the individuals purchasing the items. The necessity and frequency of such purchases from vendors should be determined.

In light of the significant value of the photography department's collection of smaller sensitive equipment, the Vice President should consider a system of checks and balances whereby the department head or individual instructors would be held personally accountable for these items. Good internal controls and officials' duty to safeguard state assets require inventory records to be maintained on sensitive items with periodic reconciliations to physical inventory counts. Any discrepancies in these inventory counts should be investigated promptly. Any irregularities should be reported immediately to this office, pursuant to state law.

The Vice President should share this finding with all deans and department chairs and obtain written assurances that they have properly monitored their operations to detect and prevent similar abuses in their areas of responsibility.

The Vice President should continue to provide training to all deans and department chairs to ensure that staff address the types of abuses noted in this finding and ensure that staff properly monitor these activities and promptly report any unusual activities, including departures from or exceptions to relevant policies and procedures to Internal Audit.

Management's Comment

Management concurs with the finding and recommendations. Effective July 1, 2004, management changed the purchasing authorities to require Dean/Director approval as well as departmental approval on all limited purchase orders.

1) The Vice President of Finance and Administrative Services will review all existing purchasing authorizations and making recommendations to other Vice Presidents in areas where authorization controls can be strengthened. This review will be completed no later than January 31, 2005.

2) Meetings are currently being held with the academic Deans to determine areas that could be vulnerable to the risk of fraud. A master list of all sensitive consumable supplies that are susceptible to theft for business use will be developed in December 2004. The list will be reviewed, updated and distributed campus wide in June of each calendar year.

3) Departmental Coordinators will be required to complete a sensitive consumable supply report on all items purchased from the sensitive consumable supply list. This report details the courses which use the supply item, enrollment in the courses, and details of the purchases made during the semester. Attached to the form will be the course syllabus describing the supply items that the student is required to purchase. The Dean of the area will be responsible for reviewing and approving the reports. A copy of the approval report

will be given to the Vice President of Finance and Administrative Services so that spot audits can be performed ensuring that all sensitive items have been reported. These reports will be compiled each semester.

4) For sensitive minor equipment, Departmental Coordinators will be required to complete a report each semester that details the classes that use the sensitive minor equipment and the details of all purchases made during the semester. Because sensitive minor equipment is not a consumable supply item, the Departmental Coordinator must also detail the reason the item must be purchased. Because reasons for the purchase are given, the Dean will easily be able to ascertain when losses have occurred and implement stricter controls.

5) Effective January 1, 2005, all departments are being instructed to create log forms to document the location of sensitive minor equipment at all times. Departments will be required to perform a sensitive minor equipment inventory on an annual basis. Business Office personnel will perform spot audits of the inventories. Any discrepancies will be reported to the proper authorities.

6) The finding will be shared with all Deans and Directors in December 2004. Statements of assurance from the Deans and Directors will be requested annually. Training in fraud prevention and abuse will occur in June of each year. In addition, the Director of Human Resources will notify all newly hired Deans and Directors to establish an appointment with the Vice President of Finance to receive new hire fraud and abuse training.

7) The college has for a number of years sent out e-mail reminders annually telling employees how to report fraud and abuse. In addition to the e-mail reminders, the Internal Auditor has sent out an e-mail and is establishing a prominent web site on the functions of Internal Audit, including investigation of fraud and abuse.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

July 19, 2004

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

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of Nashville State Technical Community College, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These financial statements are the responsibility of the college's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Board of Regents, Nashville State Technical Community College, as of June 30, 2003, and June 30, 2002, and the revenues, expenses, and changes in net assets and the cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 12, during the year ended June 30, 2002, the college implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments,* and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The college also implemented GASB Statement 37, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments: Omnibus,* and GASB Statement 38, *Certain Financial Statement Note Disclosures*.

The management's discussion and analysis on pages 19 through 30 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated July 19, 2004, on our consideration of the college's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants. 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/cj

Nashville State Technical Community College
Management's Discussion and Analysis
For the Years Ended June 30, 2003, and June 30, 2002

This section of Nashville State Technical Community College's annual financial report presents a discussion and analysis of the financial performance of the college during the fiscal years ended June 30, 2003, and June 30, 2002. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the financial statements and notes. The financial statements, notes, and this discussion are the responsibility of management.

Using This 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 Nashville State Technical Community College as a whole and present a long-term view of the college's finances.

The Statement of Net Assets

The Statement of Net Assets presents the financial position of the college at the end of the fiscal year and includes all assets and liabilities of the college. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the college. 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 college's equity in property, plant, and equipment owned by the college. 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 college but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the assets. The final category is unrestricted net assets. Unrestricted net assets are available to the institution for any lawful purpose of the institution.

Statement of Net Assets
(in thousands of dollars)

	2003	2002
Assets:		
Current assets	$ 8,676	$ 6,152
Capital assets, net	16,017	16,240
Other assets	5,656	4,925
Total assets	**30,349**	**27,317**
Liabilities:		
Current liabilities	6,271	5,433
Noncurrent liabilities	343	141
Total liabilities	**6,614**	**5,574**
Net assets:		
Invested in capital assets, net of related debt	15,927	16,143
Restricted – nonexpendable	4	4
Restricted – expendable	344	397
Unrestricted	7,460	5,199
Total net assets	**$23,735**	**$21,743**

- Total liabilities at June 30, 2003, represent 22% of total assets, which increased slightly from June 30, 2002 (20%). The college maintains the ability to satisfactorily meet long-term obligations as disclosed in the financial statement notes.

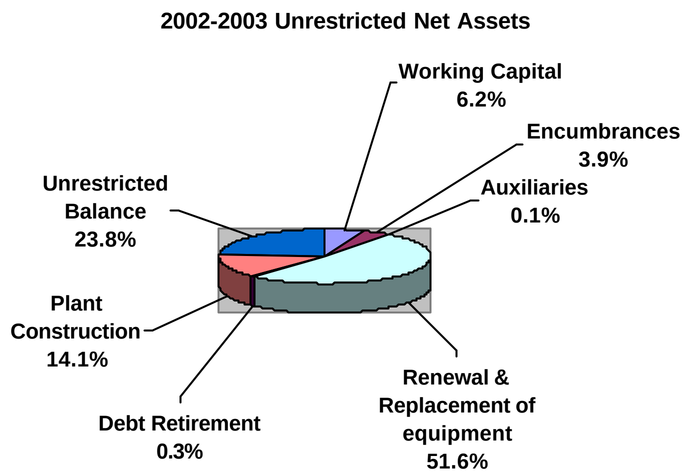
- Current cash and cash equivalents at June 30, 2003, represent 81% of current assets and 23% of total assets, compared to 75% of current assets and 17% of total assets at June 30, 2002. Most of the increase was the result of more funds being invested in the Local Government Investment Pool.

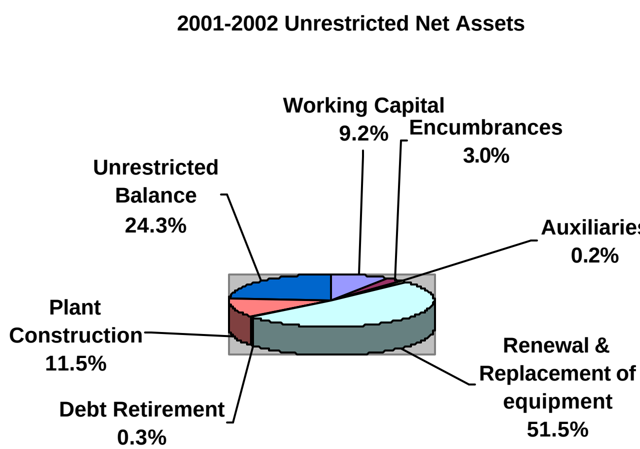
- At June 30, 2003, current liabilities represent 95% of total liabilities. The three largest components are deposits held in custody for others, accrued liabilities, and deferred revenue. At June 30, 2002, current liabilities represent 97% of total liabilities. The three largest components are compensated absences, accrued liabilities, and deposits held in custody for others.

- TSSBA bonds issued to replace the main campus chiller represent 24% of the college's noncurrent liabilities at June 30, 2003. The remaining 76% is attributable to compensated absences. At June 30, 2002, the TSSBA bonds represent 64% of the college's long-term liabilities, with the remaining 36% attributable to compensated absences.

- The increase in unrestricted net assets was primarily due to: (1) a $1.2 million transfer from current funds to renewals and replacements; (2) a $0.5 million transfer from current funds to unexpended plant; and (3) a $0.5 million increase in discretionary allocations and unallocated amounts.

Many of the college's unrestricted net assets have been designated or reserved for specific purposes such as: repairs and replacement of equipment, future debt service, and capital projects. The following graphs show the allocations:





- There were no material changes in the components of unrestricted net assets during fiscal year 2002-2003.

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 college, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to generally accepted accounting principles.

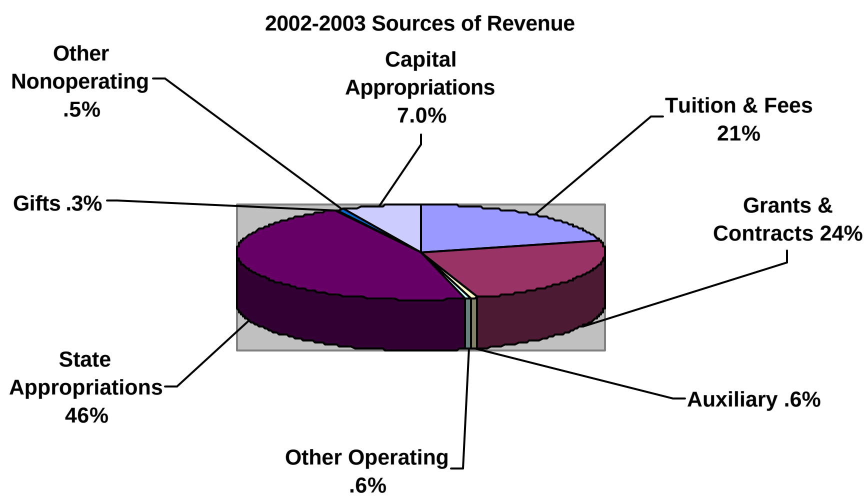
Statement of Revenues, Expenses, and Changes in Net Assets
(in thousands of dollars)

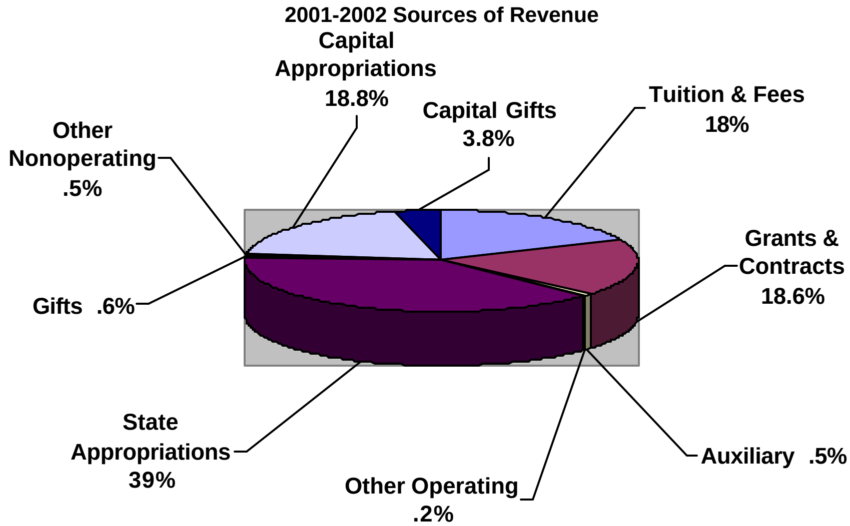
	2003	2002
Operating revenues:		
Net tuition and fees	$ 5,967	$ 5,820
Grants and contracts	6,979	6,028
Auxiliary	179	171
Other	167	76
Total operating revenues	**13,292**	**12,095**
Operating expenses	26,871	24,323
Operating loss	**(13,579)**	**(12,228)**
Nonoperating revenues and expenses:		
State appropriations	13,231	12,658
Gifts	94	205
Investment income	141	163
Other nonoperating revenues and expenses	(8)	(1)
Total nonoperating revenues and expenses	**13,458**	**13,025**
Income (loss) before other revenues, expenses, gains, or losses	**(121)**	**797**
Other revenues, expenses, gains, or losses:		
Capital appropriations	2,105	6,082
Capital grants and gifts	-	1,237
Other	8	-
Total other revenues, expenses, gains, or losses	**2,113**	**7,319**
Increase in net assets	**1,992**	**8,116**

Net assets at beginning of year, as originally reported	21,743	26,207
Cumulative effect of changes in accounting principle	-	(12,579)
Net assets at beginning of year, as restated	**21,743**	**13,627**
Net assets at end of year	**$23,735**	**$21,743**

Revenues

The following is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the college's operating activities for the years ended June 30, 2003, and June 30, 2002 (amounts are presented in thousands of dollars).





- The college is highly dependent on state appropriations as a revenue source. State appropriations represented 46% of total revenue in fiscal year 2003 and 39% in fiscal year 2002.

- Grants and contracts represent 24% of total revenue in fiscal year 2003 and 18.6% in fiscal year 2002. The largest component of grants and contracts is federal funding in the form of student financial aid.

- Student tuition and fees represent 21% of total revenue in fiscal year 2003 and 18% in fiscal year 2002.

- Gifts to the college represent a relatively minor portion of revenues. The college exists in a difficult gift market. The college has chosen to pursue cost recoveries from grants and contracts to augment inadequate gift donations.

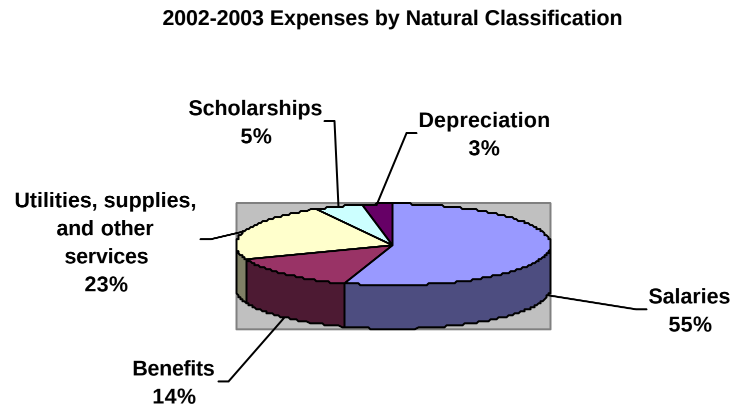
- Capital appropriations decreased since the bulk of the construction on the Cookeville Center was done in fiscal year 2002.

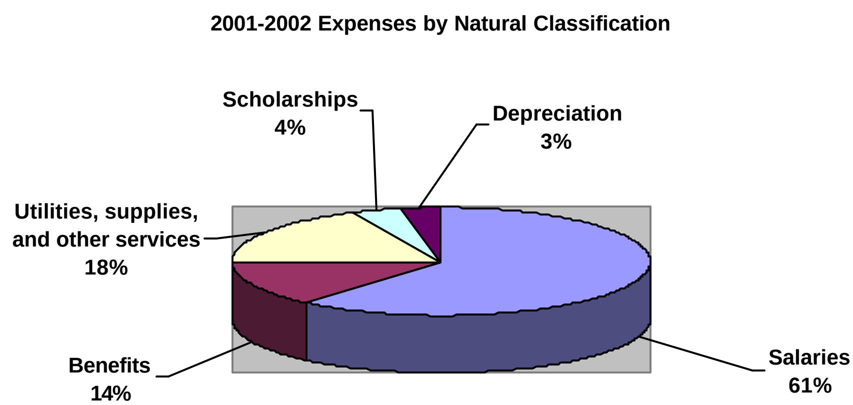
Expenses

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

Natural Classification

Operating Expenses	2003	2002
Salaries	$14,567	$14,834
Benefits	3,881	3,473
Utilities, supplies, and other services	6,158	4,479
Scholarships	1,396	877
Depreciation	869	660
Total	$26,871	$24,323





- The largest expense was salaries, representing 55% of the total operating expenses for fiscal year 2003. This was down slightly from 61% reported in fiscal year 2002.

- A hiring freeze implemented in response to a state appropriation reduction of 5% resulted in reduced salary expense.

- The combined salary and benefit expenses for fiscal year 2003 represented 69% of operating expenses compared to 75% in fiscal year 2002.

- The utilities, supplies, and other expenses classification includes such items as printing, utilities, classroom and office supplies, and maintenance costs.

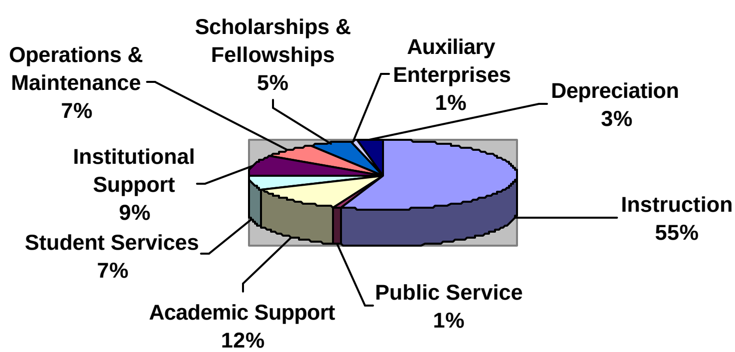
- Buildings were the largest depreciation expense representing 68% of the total depreciation in fiscal year 2003 and 49% in fiscal year 2002.

- Federal grants represent the largest component of the scholarship percentage.

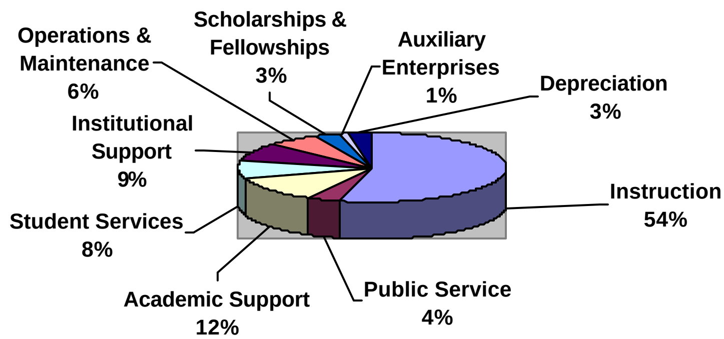
Program Classification

Operating Expenses	2003	2002
Instruction	$14,676	$13,169
Public service	495	857
Academic support	3,161	3,017
Student services	1,981	1,953
Institutional support	2,547	2,197
Operations and maintenance	1,804	1,734
Scholarships and fellowships	1,335	734
Auxiliary enterprises	3	2
Depreciation	869	660
Total	$26,871	$24,323

2002-2003 Expenses by Program Classification



2001-2002 Expenses by Program Classification



- The largest program expense is instruction. This represents instructional salaries, benefits, and supplies used in the classrooms and laboratories. Most of the increase in instruction was due to increased expenses for supplies, most of which were for the Cookeville building project.

- General administrative expenses for the college include the program functions of student services, institutional support, academic support, and public service, which combined total 29% of operating expenses for fiscal year 2003 and 33% for fiscal year 2002.

- Operations and maintenance expenses include utilities, custodial supplies, and general maintenance support. Of the 7% for fiscal year 2003, utilities make up 28%. Of the 6% for fiscal year 2002, utilities make up 25%.

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 college's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Statement of Cash Flows
(in thousands of dollars)

	2003	2002
Cash provided (used) by:		
Operating activities	($12,494)	($12,120)
Noncapital financing activities	14,121	12,926
Capital and related financing activities	1,447	148
Investing activities	141	163
Net increase in cash	**3,215**	**1,117**
Cash, beginning of year	**9,511**	**8,394**
Cash, end of year	**$12,726**	**$9,511**

- The largest factor contributing to the college's improved cash flow was a student maintenance fee increase of 7.5% for fiscal year 2003 and 15% for fiscal year 2002.

- Interest rates paid by the Local Government Investment Pool declined during fiscal years 2003 and 2002, resulting in an interest income decline of approximately $22,600 for fiscal year 2003, and $203,800 for fiscal year 2002.

- The primary source of the college's cash flow is state appropriations, which decreased approximately $3.2 million in fiscal year 2003, compared to an increase of $3.8 million in fiscal year 2002. Of the 2002 increase, approximately 90% was for capital projects funding for Cookeville.

- The cash position of the college improved 34% between fiscal years 2003 and 2002 and 13% between fiscal years 2002 and 2001.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2003, the college had $16,017,407.92 invested in capital assets, net of accumulated depreciation of $10,860,820.92. At June 30, 2002, the college had $16,240,499.53 invested in capital assets, net of accumulated depreciation of $10,095,442.26. Depreciation charges totaled $868,804.65 for fiscal year 2003 and $659,925.41 for fiscal year 2002. Details of these assets are shown below.

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

	2003	**2002**
Land	$1,340	$1,340
Land improvements and infrastructure	565	535
Buildings	13,233	6,046
Equipment	552	372
Library holdings	327	336
Projects in progress	-	7,611
Total	$16,017	$16,240

- During fiscal year 2002, a land donation was made from the City of Cookeville to house the Don Sundquist campus.

- Land improvements during fiscal year 2003 include the parking areas to the Don Sundquist campus.

- During fiscal year 2002, the college replaced the main chiller at a total cost of $369,538.86. This project was funded with appropriations of $262,282.86, bond financing of $97,962.50, and prior-year state appropriations of $9,293.00. The utility savings realized from the chiller will fund the annual debt payment, estimated to be $16,200.00.

- The increase in buildings for fiscal year 2003 is due to the completion of the Don Sundquist campus.

- Equipment increases for fiscal year 2003 include the purchase of one automobile, a piano, and computer equipment with a unit value greater than $5,000. The only major equipment purchase for fiscal year 2002 was for a CNC milling machine for the engineering technologies program at a cost of $47,500.

The college plans the following for the upcoming year: renovation of science labs, upgrades to the electrical system in the Clement Building, and the possible renovation of off-campus space for classroom usage. More detailed information about the college's capital assets is presented in Note 6 to the financial statements**.**

Debt

At June 30, 2003, the college had $90,201.70 in debt outstanding. At June 30, 2002, the college had $97,962.50 in debt outstanding. The debt was for bonds issued by the Tennessee State School Bond Authority to finance a portion of the chiller replacement project. The state bond fund rating as of July 1, 2003, was AA by Standard and Poor's. More detailed information about the college's long-term liabilities is presented in Note 7 to the financial statements.

Economic Factors That Will Affect the Future

The college is highly dependent upon state appropriations to offset operating losses. State appropriations were reduced 5% during the 2002-2003 fiscal year. A permanent reduction of 9% was effected July 1, 2003; long-term improvement of state appropriations is unlikely.

The Tennessee Board of Regents approved a 14.5% fee increase effective fall semester 2003. The fee increase will lessen the impact of the appropriation reduction.

The Tennessee Board of Regents approved a 100% technology access fee increase effective fall semester 2003. The fee increase will ensure that classroom technology equipment remains current despite the permanent appropriation reduction.

Inadequate capital financing for space expansion to serve the college's growing population severely limits the college's ability to serve the citizens of the service delivery area. The most noticeable space deficiencies are in student services, faculty offices, and physical education, which all fall below 50% of the standard. Although the college has been recommended for additional space by the Tennessee Higher Education Commission, funding in the near future is highly unlikely due to funding constraints.

Requests for Information

This financial report is designed to provide a general overview of the college's finances for all those with an interest in the college's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to Dr. George Van Allen, President, Nashville State Technical Community College, 120 White Bridge Road, Nashville, Tennessee 37209.

Exhibit A

TENNESSEE BOARD OF REGENTS
NASHVILLE STATE TECHNICAL COMMUNITY COLLEGE
STATEMENTS OF NET ASSETS
JUNE 30, 2003, AND JUNE 30, 2002

	June 30, 2003	June 30, 2002
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 3)	$ 7,070,634.02	$ 4,586,288.81
Short-term investments (Notes 3 and 4)	165,915.37	160,869.48
Accounts, notes, and grants receivable (net) (Note 5)	1,261,175.61	1,253,865.52
Prepaid expenses and deferred charges	178,639.90	151,322.13
Total current assets	8,676,364.90	6,152,345.94
Noncurrent assets:		
Cash and cash equivalents (Notes 2 and 3)	5,655,796.79	4,924,979.25
Capital assets (net) (Note 6)	16,017,407.92	16,240,499.53
Total noncurrent assets	21,673,204.71	21,165,478.78
Total assets	30,349,569.61	27,317,824.72
LIABILITIES		
Current liabilities:		
Accounts payable	604,347.39	427,750.08
Accrued liabilities	838,772.94	800,677.80
Deferred revenue	616,140.31	530,169.65
Compensated absences (Note 7)	378,022.07	536,542.22
Accrued interest payable	754.59	826.54
Long-term liabilities, current portion (Note 7)	8,253.77	7,760.80
Deposits held in custody for others	3,638,249.96	2,941,276.40
Other liabilities	186,840.59	188,574.36
Total current liabilities	6,271,381.62	5,433,577.85
Noncurrent liabilities:		
Compensated absences (Note 7)	260,877.14	50,568.45
Long-term liabilities (Note 7)	81,947.93	90,201.70
Total noncurrent liabilities	342,825.07	140,770.15
Total liabilities	6,614,206.69	5,574,348.00
NET ASSETS		
Invested in capital assets, net of related debt	15,927,206.22	16,142,537.03
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	4,739.67	4,739.67
Expendable:		
Scholarships and fellowships	4,375.54	5,018.47
Instructional department uses	186,231.50	239,561.44
Other	153,074.48	152,824.26
Unrestricted (Note 8)	7,459,735.51	5,198,795.85
Total net assets	$ 23,735,362.92	$ 21,743,476.72

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

Exhibit B

TENNESSEE BOARD OF REGENTS
NASHVILLE STATE TECHNICAL COMMUNITY COLLEGE
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

	Year Ended June 30, 2003	Year Ended June 30, 2002
REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of $3,162,280.37 for the year ended June 30, 2003, and $2,475,806.88 for the year ended June 30, 2002)	$ 5,967,195.82	$ 5,820,073.93
Governmental grants and contracts	6,441,514.92	5,264,259.79
Nongovernmental grants and contracts	537,621.48	764,293.24
Sales and services of educational departments	3,766.06	1,719.07
Auxiliary enterprises:		
Bookstore	179,129.39	170,801.26
Other operating revenues	162,681.50	74,422.05
Total operating revenues	13,291,909.17	12,095,569.34
EXPENSES		
Operating expenses (Note 15):		
Salaries and wages	14,567,061.04	14,834,327.93
Benefits	3,880,937.22	3,473,159.58
Utilities, supplies, and other services	6,158,419.95	4,479,367.71
Scholarships and fellowships	1,396,210.99	877,071.53
Depreciation expense	868,804.65	659,925.41
Total operating expenses	26,871,433.85	24,323,852.16
Operating loss	(13,579,524.68)	(12,228,282.82)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	13,231,170.00	12,657,770.00
Gifts	94,518.00	204,814.60
Investment income	140,830.72	163,422.97
Interest on capital asset-related debt	(4,181.36)	(826.54)
Other nonoperating revenues (expenses)	(4,405.52)	-
Net nonoperating revenues	13,457,931.84	13,025,181.03
Income (loss) before other revenues, expenses, gains, or losses	(121,592.84)	796,898.21
Capital appropriations	2,105,718.24	6,082,424.27
Capital grants and gifts	-	1,236,854.95
Other	7,760.80	-
Total other revenues	2,113,479.04	7,319,279.22
Increase in net assets	1,991,886.20	8,116,177.43
NET ASSETS		
Net assets - beginning of year, as originally reported	21,743,476.72	26,206,538.26
Cumulative effects of changes in accounting principle (Note 12)		
Adoption of capitalization criteria for buildings and additions	-	(2,844,417.58)
Adoption of depreciation for capital assets	-	(9,583,722.06)
Deferred revenue recognition	-	(151,099.33)
Net assets - beginning of year, as restated	21,743,476.72	13,627,299.29
Net assets - end of year	$ 23,735,362.92	$ 21,743,476.72

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

Exhibit C

TENNESSEE BOARD OF REGENTS
NASHVILLE STATE TECHNICAL COMMUNITY COLLEGE
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

	Year Ended June 30, 2003	Year Ended June 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 5,944,504.23	$ 5,757,471.11
Grants and contracts	7,003,820.44	5,958,910.10
Sales and services of educational activities	3,766.06	1,709.07
Payments to suppliers and vendors	(6,020,124.39)	(4,445,720.78)
Payments to employees	(14,505,267.30)	(15,050,985.36)
Payments for benefits	(3,858,228.65)	(3,497,901.30)
Payments for scholarships and fellowships	(1,404,442.27)	(1,091,500.12)
Auxiliary enterprise charges:		
Bookstore	179,129.39	170,801.26
Other receipts (payments)	162,681.50	77,300.58
Net cash used by operating activities	(12,494,160.99)	(12,119,915.44)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	13,312,170.00	12,526,870.00
Gifts and grants received for other than capital or endowment purposes	94,518.00	204,814.60
Federal student loan receipts	4,611,991.87	3,512,448.40
Federal student loan disbursements	(4,611,991.87)	(3,512,448.40)
Changes in deposits held for others	711,213.24	194,320.71
Other noncapital financing receipts	3,355.28	-
Net cash provided by noncapital financing activities	14,121,256.52	12,926,005.31
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	-	97,962.50
Capital - state appropriations	2,105,718.24	6,082,424.27
Purchases of capital assets and construction	(645,713.04)	(6,032,347.82)
Principal paid on capital debt	(7,760.80)	-
Interest paid on capital debt	(5,007.90)	-
Net cash provided by capital and related financing activities	1,447,236.50	148,038.95
CASH FLOWS FROM INVESTING ACTIVITIES		
Income on investments	140,830.72	163,422.97
Net cash provided by investing activities	140,830.72	163,422.97
Net increase in cash and cash equivalents	3,215,162.75	1,117,551.79
Cash and cash equivalents - beginning of year	9,511,268.06	8,393,716.27
Cash and cash equivalents - end of year	$ 12,726,430.81	$ 9,511,268.06

Exhibit C (Cont.)

TENNESSEE BOARD OF REGENTS
NASHVILLE STATE TECHNICAL COMMUNITY COLLEGE
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

		Year Ended June 30, 2003		Year Ended June 30, 2002
Reconciliation of operating loss to net cash used by operating activities:				
Operating loss	$	(13,579,524.68)	$	(12,228,282.82)
Adjustments to reconcile operating loss to net cash used by operating activities:				
Depreciation expense		868,804.65		659,925.41
Change in assets and liabilities:				
Receivables, net		(80,364.41)		(193,625.87)
Prepaid/deferred items		(27,317.77)		92,860.75
Accounts payable		148,012.29		44,642.51
Accrued liabilities		(118,830.33)		107,578.92
Deferred revenue		85,970.66		93,574.31
Compensated absences		209,088.60		3,916.21
Other		-		(700,504.86)
Net cash used by operating activities	$	(12,494,160.99)	$	(12,119,915.44)
Noncash transactions				
In-kind gifts - capital items	$	-	$	1,236,854.95

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

Tennessee Board of Regents
Nashville State Technical Community College
Notes to the Financial Statements
June 30, 2003, and June 30, 2002

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The college 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*.

Basis of Presentation

The financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB). In June 1999, the GASB issued Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* This was followed in November 1999 by GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. The financial statement presentation required by those statements provides a comprehensive, entity-wide perspective of the college's assets, liabilities, net assets, revenues, expenses, changes in net assets, and cash flows, and replaces the fund-group perspective previously required.

Significant accounting changes made in order to comply with the new requirements include (1) adoption of depreciation on capital assets and (2) reporting summer school revenues and expenses between fiscal years rather than in one fiscal year.

Basis of Accounting

For financial statement purposes, the college 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 college has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The college 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) 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 college include (1) salaries and wages; (2) employee benefits; (3) scholarships and fellowships; (4) depreciation; and (5) utilities, supplies, and other services.

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; and (5) gifts.

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

Compensated Absences

The college'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, and library holdings, 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.

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

Under a contract with the Tennessee Department of Labor and Workforce Development, the college is a service provider for the Local Workforce Investment Area in workforce investment areas 8 and 9 of the State of Tennessee. The title to all the equipment purchased by the college under the provisions of the Workforce Investment Act resides with the U.S. government. Therefore, this equipment is not included in the college's capital assets.

Nashville State Technical Community College Foundation

The college is the sole beneficiary of the Nashville State Technical Community College Foundation. A board independent of the college controls this private, nonprofit foundation. The college handles the financial records, investments, and other financial transactions, and the assets and liabilities of the foundation are included on the college's statement of net assets.

Net Assets

The college's net assets are classified as follows:

Invested in capital assets, net of related debt – This represents the college'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 college 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 college, and may be used at the discretion of the college 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 college 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 college's financial statements. To the extent that revenues from such programs are used to satisfy tuition and fees and other student charges, the college has recorded a scholarship discount and allowance.

NOTE 2. CASH

This classification includes demand deposits and petty cash on hand. At June 30, 2003, cash consisted of $837,874.80 in bank accounts, $1,700.00 of petty cash on hand, and $11,886,856.01 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer. At June 30, 2002, cash consisted of $435,307.64 in bank accounts, $1,500.00 of petty cash on hand, and $9,074,460.42 in the State of Tennessee Local Government Investment Pool administered by the State Treasurer.

NOTE 3. DEPOSITS

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

At June 30, 2003, the carrying amount of the college's deposits in financial institutions participating in the collateral pool was $837,874.80, and the bank balance was $1,128,510.99. The bank balance was insured. At June 30, 2002, the carrying amount of the college's deposits in financial institutions participating in the collateral pool was $435,307.64, and the bank was $863,485.76. The bank balance was insured.

The laws of the State of Tennessee require that collateral be pledged to secure all uninsured deposits. Tennessee Board of Regents policies require that the market value of collateral pledged equal 115%, 100%, or 90% of the uninsured deposits at financial institutions participating in the collateral pool and 105% of the uninsured deposits at all other financial institutions. The pledge level for financial institutions participating in the collateral pool is based on financial criteria set by the Collateral Pool Board with the financially strongest institutions being eligible for the lowest pledge level.

Deposits with financial institutions are required to be categorized to indicate the level of risk assumed by the college. Category 1 consists of deposits that are insured or collateralized with securities held by the college or by its agent in the college's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the college's name. Category 3 deposits are uncollateralized. This category includes any bank balance that is collateralized with securities held by the pledging financial institution or by its trust department or agent but not in the college's name.

At June 30, 2003, the carrying amount of the college's deposits was $943,434.90, and the bank balance including accrued interest was $1,234,071.09. The bank balance was category 1.

At June 30, 2002, the carrying amount of the college's deposits was $537,136.53, and the bank balance including accrued interest was $965,314.65. The bank balance was category 1.

The college also has deposits in the Local Government Investment Pool (LGIP) administered by the State Treasurer. The LGIP is part of the Pooled Investment Fund. The fund's investment policy and custodial credit risk 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 4. INVESTMENTS

The college is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the college and that endowment investments be prudently diversified. The Nashville State Technical Community College 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. Certificates of deposit have been included with other deposits in Note 3 to determine the adequacy of collateral security pledge.

The foundation's investments are shown below.

	June 30, 2003	June 30, 2002
Investments not susceptible to credit risk categorization:		
Mutual funds	$ 60,355.27	$ 59,040.59
Certificates of deposit classified as investments	105,560.10	101,828.89
Total	$ 165,915.37	$160,869.48

NOTE 5. RECEIVABLES

Receivables included the following:

	June 30, 2003	June 30, 2002
Student accounts receivable	$ 550,568.07	$ 520,270.40
Grants receivable	583,001.11	607,685.15
Pledges receivable	12,127.00	11,025.96
State appropriation receivable	49,900.00	-
Other receivables	117,579.43	170,063.01
Subtotal	1,313,175.61	1,309,044.52
Less allowance for doubtful accounts	(52,000.00)	(55,179.00)

Total receivables	$ 1,261,175.61	$ 1,253,865.52

Pledges receivable are promises of private donations that are reported as accounts receivable and revenue, net of the estimated uncollectible allowance of $255.00 at June 30, 2003, and $379.00 at June 30, 2002.

NOTE 6. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$1,339,640.00	$ -	$ 500.00	$ -	$1,340,140.00
Land improvements and infrastructure	1,049,843.19	81,446.91	-	-	1,131,290.10
Buildings	13,294,123.70	165,302.98	7,610,175.18	-	21,069,601.86
Equipment	2,356,131.44	333,670.55	-	46,188.11	2,643,613.88
Library holdings	685,528.28	65,292.60	-	57,237.88	693,583.00
Projects in progress	7,610,675.18	-	(7,610,675.18)	-	-
Total	26,335,941.79	645,713.04	-	103,425.99	26,878,228.84
Less accum. depreciation:					
Land improvements and infrastructure	514,401.77	52,348.58	-	-	566,750.35
Buildings	7,248,361.71	587,690.70	-	-	7,836,052.41
Equipment	1,983,569.74	153,683.28	-	46,188.11	2,091,064.91
Library holdings	349,109.04	75,082.09	-	57,237.88	366,953.25
Total accum. depreciation	10,095,442.26	868,804.65	-	103,425.99	10,860,820.92
Capital assets, net	$16,240,499.53	$ (223,091.61)	$ -	$ -	$16,017,407.92

Capital asset activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 402,740.00	$936,900.00	$ -	$ -	$1,339,640.00
Land improvements and infrastructure	680,304.83	369,538.36	-	-	1,049,843.19
Buildings	12,994,168.75	299,954.95	-	-	13,294,123.70
Equipment	2,341,031.60	99,050.06	-	83,950.22	2,356,131.44
Library holdings	675,699.99	74,083.28	-	64,254.99	685,528.28
Projects in progress	2,111,706.06	5,498,969.12	-	-	7,610,675.18

Total	19,205,651.23	7,278,495.77	-	148,205.21	26,335,941.79
Less accum. depreciation:					
Land improvements and Infrastructure	462,988.63	51,413.14	-	-	514,401.77
Buildings	6,924,067.29	324,294.42	-	-	7,248,361.71
Equipment	1,858,280.44	209,239.52	-	83,950.22	1,983,569.74
Library holdings	338,385.70	74,978.33	-	64,254.99	349,109.04
Total accum. depreciation	9,583,722.06	659,925.41	-	148,205.21	10,095,442.26
Capital assets, net	$ 9,621,929.17	$6,618,570.36	$ -	$ -	$16,240,499.53

NOTE 7. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2003, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Bonds	$ 97,962.50	$ -	7,760.80	$ 90,201.70	$ 8,253.77
Other liabilities:					
Compensated absences	587,110.67	654,475.44	602,686.90	638,899.21	378,022.07
Total long-term liabilities	$ 685,073.17	$ 654,475.44	$ 610,447.70	$ 729,100.91	$386,275.84

Long-term liabilities activity for the year ended June 30, 2002, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
Bonds	$ -	$ 97,962.50	$ -	$ 97,962.50	$ 7,760.80
Other liabilities:					
Compensated absences	583,194.46	546,389.83	542,473.62	587,110.67	536,542.22
Total long-term liabilities	$ 583,194.46	$ 644,352.33	$ 542,473.62	$ 685,073.17	$544,303.02

Bonds Payable

Bond issues, with interest rates ranging from 4% to 5% for Tennessee State School Bond Authority bonds, are due serially to May 1, 2012, and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the college, including state appropriations. The bonded indebtedness with the Tennessee State School Bond Authority reported on the statement of net assets is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds.

Debt service requirements to maturity for bonds payable at June 30, 2003, are as follows:

Year Ending June 30	Principal	Interest	Total
2004	$ 8,253.77	$ 4,314.78	$ 12,568.55
2005	8,600.43	3,984.64	12,585.07
2006	9,004.65	3,597.62	12,602.27
2007	9,450.38	3,169.90	12,620.28
2008	9,894.55	2,744.62	12,639.17
2009-2012	44,997.92	5,767.20	50,765.12
	$ 90,201.70	$ 23,578.76	$ 113,780.46

NOTE 8. UNRESTRICTED NET ASSETS

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

	June 30, 2003	June 30, 2002
Working capital	$ 462,476.49	$ 479,168.18
Encumbrances	290,255.48	156,653.27
Auxiliaries	8,600.00	8,400.00
Plant construction	1,055,244.83	600,887.31
Renewal and replacement of equipment	3,846,065.88	2,676,175.15
Debt retirement	20,457.84	16,200.00
Unreserved/undesignated	1,776,654.99	1,261,311.94
Total	$ 7,459,735.51	$ 5,198,795.85

NOTE 9. ENDOWMENTS

If a donor has not provided specific instructions to the college, state law permits the college to authorize for expenditure the earnings of the investments of endowment funds. When administering its power to spend the earnings, the college is required to consider the college'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 earnings spent are required to be spent for the purposes for which the endowment was established.

The college chooses to spend only a portion of the investment income each year. Under the spending plan established by the college, interest earned on funds invested in LGIP has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income. At June 30, 2003, investment income of $75.79 is available to be spent. At June 30, 2002, $105.67 is available to be spent. These amounts are included in restricted net assets expendable for scholarships and fellowships.

NOTE 10. PENSION PLANS

A. Defined Benefit Plan

Tennessee Consolidated Retirement System

Plan Description - The college 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 college is required to contribute an actuarially determined rate. The current rate is 7.29% of annual covered payroll. Contribution requirements for the college are established and may be amended by the TCRS' Board of Trustees. The college's contributions to TCRS for the years ended June 30, 2003, 2002, and 2001 were $518,742.20, $446,641.56, and $448,568.86. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans (ORP)

Plan Description - The college 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 college 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 college to the plans was $485,141.29 for the year ended June 30, 2003, and $487,314.19 for the year ended June 30, 2002. Contributions met the requirements for each year.

NOTE 11. OTHER POST-EMPLOYMENT BENEFITS

The State of Tennessee administers a group health insurance program which provides post-employment health insurance benefits to eligible college retirees. This benefit is provided and administered by the State of Tennessee. The college 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 12. CUMULATIVE EFFECTS OF CHANGES IN ACCOUNTING PRINCIPLE

During the year ended June 30, 2002, the college implemented GASB Statement 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*, and GASB Statement 35, *Basic Financial Statements—and Management's Discussion and Analysis—for Public Colleges and Universities*. As a result of this implementation, the college was required to make changes in certain accounting principles, specifically the (1) adoption of capitalization criteria of $100,000 and $50,000 for buildings and additions, respectively; (2) adoption of depreciation on capital assets; and (3) recording of certain summer semester revenues between fiscal years rather than in the fiscal year in which the semester was predominantly conducted. The cumulative effects of these changes on net assets are shown below:

Adoption of capitalization criteria for buildings and additions	$(2,844,417.58)
Adoption of depreciation on capital assets	$(9,583,722.06)
Deferred revenue recognition	$ (151,099.33)

NOTE 13. INSURANCE-RELATED ACTIVITIES

The state purchases commercial insurance for real property losses above $5 million per year and surety bond coverage on the state's officials and employees. In the past three fiscal years, the state has had no claims filed with the commercial insurer. Designations for casualty losses in the amount of $3.271 million for incurred losses at

June 30, 2003, and $5 million for deductibles and $1.356 million for incurred losses at June 30, 2002, were established in the state's general fund to provide for any property losses not covered by the commercial insurance.

At June 30, 2003, the scheduled coverage for the college was $31,555,400 for buildings and $17,443,500 for contents. At June 30, 2002, the scheduled coverage for the college was $32,561,600 for buildings and $16,773,500 for contents.

The state has set aside assets for claim settlement in an internal service fund, the Claims Award Fund. This fund services all claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. The college participates in the Claims Award Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the college based on a percentage of the college'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. Since the college participates in the Claims Award Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the college for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq. Claims are paid through the state's Claims Award Fund.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The college 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 college 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 14. COMMITMENTS AND CONTINGENCIES

Sick Leave - The college 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 $4,403,110.96 at June 30, 2003, and $3,129,478.21 at June 30, 2002.

Operating Leases - The college has entered into various operating leases for equipment. Such leases will probably continue to be required. Expenses under operating leases were $56,585.04 for the year ended June 30, 2003, and $65,993.72 for the year ended June 30, 2002. The following is a schedule of future minimum rental payments required under noncancelable operating leases that have initial or remaining lease terms of more than one year at June 30, 2003:

Year Ending June 30	
2004	$10,402.40

Construction in Progress - At June 30, 2003, outstanding commitments under construction contracts totaled $168,169.50 for capital improvements, which will be funded by future state capital outlay appropriations.

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

NOTE 15. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The college's operating expenses by functional classification for the year ended June 30, 2003, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$8,664,853.16	$2,201,491.29	$3,655,054.83	$ 155,039.75	$ -	$ 14,676,439.03
Public service	351,584.86	81,843.16	61,767.98	-	-	495,196.00
Academic support	2,276,457.06	554,731.16	313,013.44	25,875.00	-	3,161,076.66
Student services	1,126,388.41	383,626.83	451,906.10	18,975.00	-	1,980,896.34
Institutional support	1,616,076.76	487,590.63	433,409.02	9,700.50	-	2,546,776.91
Operation & maint.	540,700.79	171,654.15	1,091,825.90	-	-	1,804,180.84

Scholar. & fellow.	-	-	148,771.00	1,186,620.74	-	1,335,391.74
Auxiliary	-	-	2,671.68	-	-	2,671.68
Depreciation	-	-	-	-	868,804.65	868,804.65
Total	$14,567,061.04	$ 3,880,937.22	$6,158,419.95	$1,396,210.99	$868,804.65	$ 26,871,433.85

The college's operating expenses by functional classification for the year ended June 30, 2002, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$8,927,191.55	$ 2,001,802.60	$ 2,084,418.34	$ 155,135.14	$ -	$ 13,168,547.63
Public service	474,517.78	114,807.96	268,067.76	-	-	857,393.50
Academic support	2,260,529.66	415,576.79	334,751.78	5,645.50	-	3,016,503.73
Student services	1,171,106.29	344,207.22	419,223.27	18,289.44	-	1,952,826.22
Institutional support	1,471,901.00	417,438.68	299,673.33	8,366.00	-	2,197,379.01
Operation & maint.	529,081.65	179,326.33	1,025,917.23	-	-	1,734,325.21
Scholar. & fellow.	-	-	44,827.00	689,635.45	-	734,462.45
Auxiliary	-	-	2,489.00	-	-	2,489.00
Depreciation	-	-	-	-	659,925.41	659,925.41
Total	$14,834,327.93	$3,473,159.58	$4,479,367.71	$877,071.53	$659,925.41	$24,323,852.16