



Report of The Treasurer 2017



THE UNIVERSITY OF
TENNESSEE

Report of the Treasurer 2017

Brief History of the University of Tennessee

The University of Tennessee is one of the nation’s oldest institutions of higher education, in operation since 1794.

Two years before Tennessee achieved statehood in 1796, the legislature of the Southwest Territory—which later became Tennessee—granted a charter to Blount College, named in honor of the territorial governor, William Blount. Located in Knoxville near today’s downtown area, Blount College was nonsectarian, which was unusual for an institution of higher education at that time. The university has remained nondenominational and is believed to be the oldest such institution west of the Appalachian Divide. Blount College was all male, typical for colleges of the late 18th century, a restriction that remained in force for almost a century until the first female students were admitted in 1892.

In 1807 the state legislature changed the name of Blount College to East Tennessee College, and in 1826 the 40-acre tract known as “the Hill” became part of its campus. The name of the school changed again in 1840 to East Tennessee University. But 21 years later, the Civil War forced the university to close, and its buildings were used as a hospital for Confederate troops, then later occupied by Union soldiers.

When the war ended, East Tennessee University reopened, and in 1869 the state legislature selected the university as the state’s federal land-grant institution under the Morrill Act of 1862. To comply with the terms of the act, ETU broadened its offerings to include agricultural, engineering, and military science courses.

Ten years later, East Tennessee University was chosen by the legislature to be the state university of Tennessee, and its name was changed to the University of Tennessee. The university pledged itself to the service and interest of the entire state, and the state pledged its name and reputation to the university, promising the institution a vital role in the progress of the state.

Today, the university serves the people of Tennessee from locations across the state. The medical campus, founded in Nashville and acquired by the university in 1879, was moved to Memphis in 1911. The Martin campus, established in 1900 as a private institution, became part of the University of Tennessee in 1927. In 1969 the private University of Chattanooga merged with the public university to become its fourth primary campus.

The University of Tennessee Space Institute, a graduate education and research center near Tullahoma, was established in 1964.

Three statewide units of the university—the Institute of Agriculture, the Institute for Public Service, and the Division of Continuing Education—extend the university beyond its various campuses to serve the entire state.

The administration of the university is headquartered in Knoxville, where the offices of the president and the central staff are located. A chancellor directs each primary campus.

Traditionally, Tennessee’s governors and members of the state legislature have shown active interest in the development of the University of Tennessee by providing the support it needs to meet the increasing educational, research, and service needs of the people of Tennessee. As a result, many university programs have earned both national and global recognition.

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Letter from the Treasurer

The financial statements on the following pages have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board. The management of the University of Tennessee is responsible for the integrity and objectivity of these financial statements.

Management believes that the university's highly developed system of internal accounting controls provides reasonable assurance that assets are protected and that transactions and events are properly recorded. Establishing sound fiscal policies and procedures and communicating them clearly, carefully selecting qualified financial staff, and implementing an extensive program of internal audits and management reviews ensure that the system of internal controls is maintained.

The financial statements herein have been audited by the State of Tennessee, Comptroller of the Treasury, Division of State Audit. The auditor's opinion is based on audit procedures described in their letter on page 3, which include understanding university systems, procedures, and internal controls and performing tests and other auditing procedures sufficient to provide reasonable assurance that the financial statements are not materially misleading nor do they contain material errors.

The statements contained in this report describe the university's overall financial condition and the financial performance for the year ended June 30, 2017. A separate publication, "Report of the Treasurer 2017 Supplemental Schedules and Appendices," contains detailed supporting schedules and appendices and is available for those who wish to make a more extensive analysis of university operations. The supporting schedules and appendices are designed to enable analysis of important items summarized or consolidated in the financial statements of this report.

Respectfully submitted,



A handwritten signature in cursive script that reads "James R. Maples".

James R. Maples, CPA
Treasurer



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Chief of Staff

Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
Dr. Joseph A. DiPietro, President

Report on the Financial Statements

We have audited the accompanying financial statements of the University of Tennessee, which is a component unit of the State of Tennessee, and its discretely presented component units as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express opinions on these financial statements, based on our audit. We did not audit the financial statements of the University of Chattanooga Foundation, Inc.; the University of Tennessee Foundation, Inc.; and the University of Tennessee Research Foundation, Inc., discretely presented component units. Those statements were audited by other auditors, whose reports have been furnished to us. Our opinion, insofar as it relates to the amounts included for the foundations, is based solely on the reports of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University of Tennessee and its discretely presented component units as of June 30, 2017; and the respective changes in financial position; and, where applicable, cash flows thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note 3, the financial statements of the university include investments valued at \$586,601,821.39 (19% of net position), whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis; the schedule of the University of Tennessee's proportionate share of the net pension liability - Closed State and Higher Education Employee Pension Plan within TCRS; the schedule of the University of Tennessee's proportionate share of the net pension asset - State and Higher Education Employee Retirement Plan within TCRS; the schedule of the University of Tennessee's contributions- Closed State and Higher Education Employee Pension Plan within TCRS; the schedule of the University of Tennessee's contributions - State and Higher Education Employee Retirement Plan within TCRS; the schedule of the University of Tennessee's contributions for the Federal Retirement Plans administered by the U.S. Office of Personnel Management; and the other postemployment benefits schedule of funding progress be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the university's basic financial statements. The supplementary combining schedule of net position, the supplementary combining schedule of revenues, expenses, and changes in net position, and the supplementary schedule of unrestricted net position are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplementary combining schedule of net position, the supplementary combining schedule of revenues, expenses, and changes in net position, and the supplementary schedule of unrestricted net position are the responsibility of the university's management and were derived from, and relate directly to, the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the supplementary combining schedule of net position, the supplementary combining schedule of revenues, expenses, and changes in net position, and the supplementary schedule of unrestricted net position are fairly stated, in all material respects, in relation to the basic financial statements as a whole.

Other Information

Our audit was conducted for the purpose of forming opinions on the basic financial statements as a whole. The five-year summary presented outside of the basic financial statements is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 15, 2017, on our consideration of the university's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the university's internal control over financial reporting and compliance.

Deborah V. Loveless, CPA, Director
Division of State Audit
December 15, 2017

Management's Discussion and Analysis

Introduction

This section of the University of Tennessee's annual financial report presents a discussion and analysis of the financial performance of the university during the year ended June 30, 2017, with comparative information presented for the year ended June 30, 2016. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the independent auditor's report, the financial statements, and the notes to the financial statements.

The university is a component unit of the State of Tennessee and an integral part of the state's *Comprehensive Annual Financial Report (CAFR)*. The financial reporting entity for the financial statements is comprised of the university and three component units. The component units are discretely presented based on the nature and significance of their relationship to the university. The reader may refer to Note 1 for detailed information on the financial reporting entity. More detailed information about the foundations is presented in Notes 22, 23, and 24 to the financial statements. This discussion focuses on the university and does not include the foundations.

Overview of the Financial Statements

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

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

The Statement of Net Position

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

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

The statement of net position also indicates the availability of net position for expenditure by the university. Net position is divided into three major categories. The first category, net investment in capital assets, represents the university's total investment in property, plant, and equipment, net of outstanding debt obligations and deferred outflows/inflows of resources related to these capital assets. To the extent debt or deferred inflows of resources has been incurred but not yet expended for capital assets, such amounts are not included. The next category is restricted net position, which is subdivided into two categories, nonexpendable and expendable. Nonexpendable restricted net position includes endowment and similar resources whose use is limited by donors or other outside sources and, as a condition of the gift, the principal is to be maintained in perpetuity. Expendable restricted net position is available

for expenditure by the university but must be spent for purposes as determined by donors and/or external entities that have placed time or purpose restrictions on the use of the resources. The final category is unrestricted net position. Unrestricted net position is available to the university for any lawful purpose of the institution.

The following table summarizes the university's assets, liabilities, deferred outflows/inflows of resources, and net position at June 30, 2017, and June 30, 2016:

Summary of Net Position		
(in thousands of dollars)		
	<u>2017</u>	<u>2016</u>
Assets:		
Current assets	\$ 602,801	\$ 626,451
Capital assets, net	2,590,539	2,426,955
Other assets	1,818,149	1,637,544
Total assets	5,011,489	4,690,950
Deferred outflows:		
Deferred outflows	146,591	94,017
Liabilities:		
Current liabilities	356,917	370,752
Noncurrent liabilities	1,675,109	1,467,016
Total liabilities	2,032,026	1,837,768
Deferred inflows:		
Deferred inflows	12,838	35,987
Net position:		
Net investment in capital assets	1,621,977	1,560,889
Restricted – nonexpendable	522,110	507,911
Restricted – expendable	517,206	448,636
Unrestricted	451,923	393,776
Total net position	\$ 3,113,216	\$ 2,911,212

Total net position increased by \$202 million, or 6.9%, during the 2017 fiscal year. The increases were in net investment in capital assets, restricted – nonexpendable, restricted – expendable, and unrestricted. Increased net position changes are the university's objective and expectation. The discussion and analysis sections that follow address the university's net increases.

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

The statement of revenues, expenses, and changes in net position presents the results of operations for the fiscal year. Revenues and expenses are recognized when earned or incurred, regardless of when cash is received. The statement indicates whether the university's financial condition has improved or deteriorated during the fiscal year.

The statement presents the revenues received by the university, both operating and nonoperating; the expenses paid by the university, operating and nonoperating; and any other revenues, expenses, gains, or losses received or spent by the university.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the university. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the university. Nonoperating revenues are revenues received for which goods and services are not provided directly to the payor. Although the University of Tennessee is dependent upon state appropriations and gifts to fund educational and general operations, under GASB standards these funding sources are reported as nonoperating revenues, as is investment income. As a

result, the university has historically reported an excess of operating expenses over operating revenues, resulting in an operating loss. Therefore, the “increase in net position” is more indicative of overall financial results for the year.

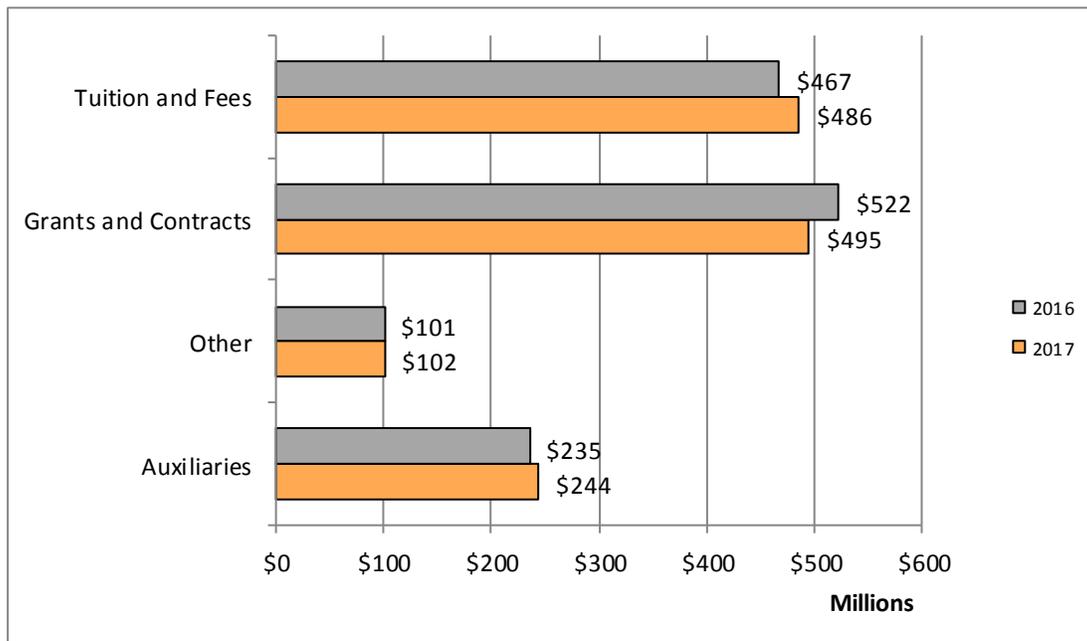
A summary of the university’s revenues, expenses, and changes in net position for the year ended June 30, 2017, and the previous year follows:

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

	<u>2017</u>	<u>2016</u>
Operating revenues	\$ 1,327,052	\$ 1,325,718
Operating expenses	2,114,461	2,011,468
Operating loss	(787,409)	(685,750)
Nonoperating revenues and expenses	835,337	729,686
Income (loss) before other revenues, expenses, gains, or losses	47,928	43,936
Other revenues, expenses, gains, or losses	144,109	156,554
Increase in net position	192,037	200,490
Net position, beginning of year	2,911,212	2,715,795
Prior-period adjustment	9,967	(5,073)
Net position, beginning of year, restated	2,921,179	2,710,722
Net position at end of year	<u>\$ 3,113,216</u>	<u>\$ 2,911,212</u>

Operating Revenues

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



Comparison of Fiscal Year 2017 to Fiscal Year 2016

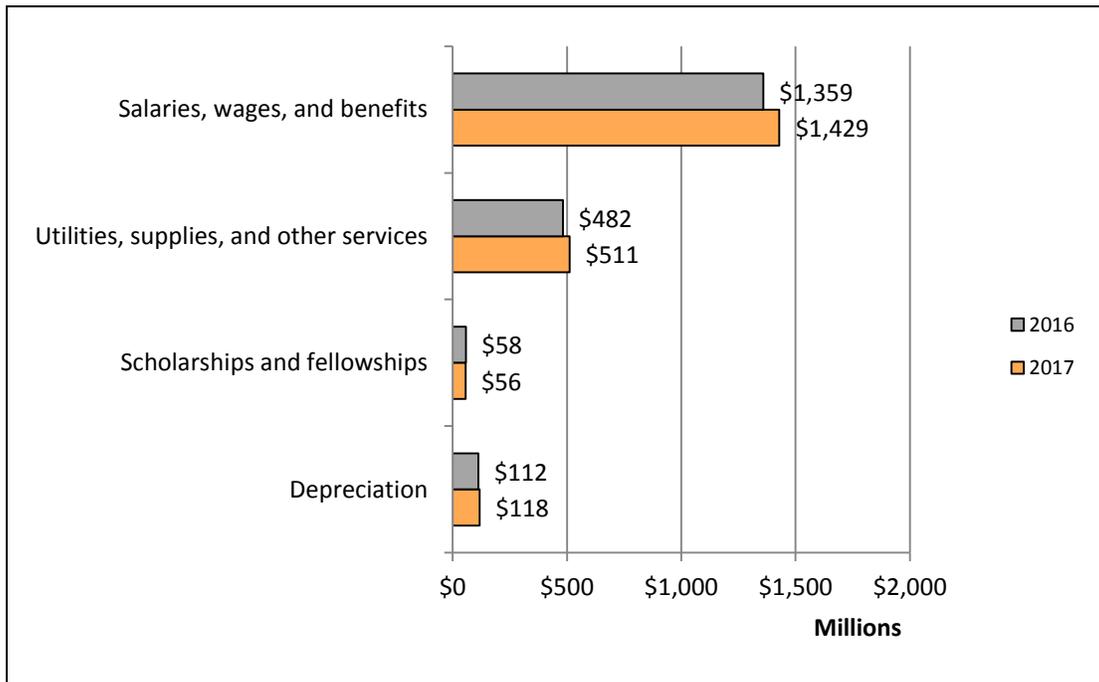
Tuition and fees increased by \$18.9 million, or 4%, primarily due to a 2.2-3% increase in tuition rates coupled with increased enrollment.

Operating grants and contracts experienced a decrease of \$27.4 million, or 5.3%. This decrease follows an unusually high 12.2% increase in fiscal year 2016. Operating grants and contracts in 2017 still exceed 2015 and 2014 levels. Overall, operating grants and contracts remain on an increasing trend.

Auxiliaries increased \$9 million, mainly due to the Knoxville Athletics department’s increased ticket sales and additional Southeastern Conference network revenues.

Operating Expenses

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



Comparison of Fiscal Year 2017 to Fiscal Year 2016

The university had the following significant changes in expenses between fiscal years:

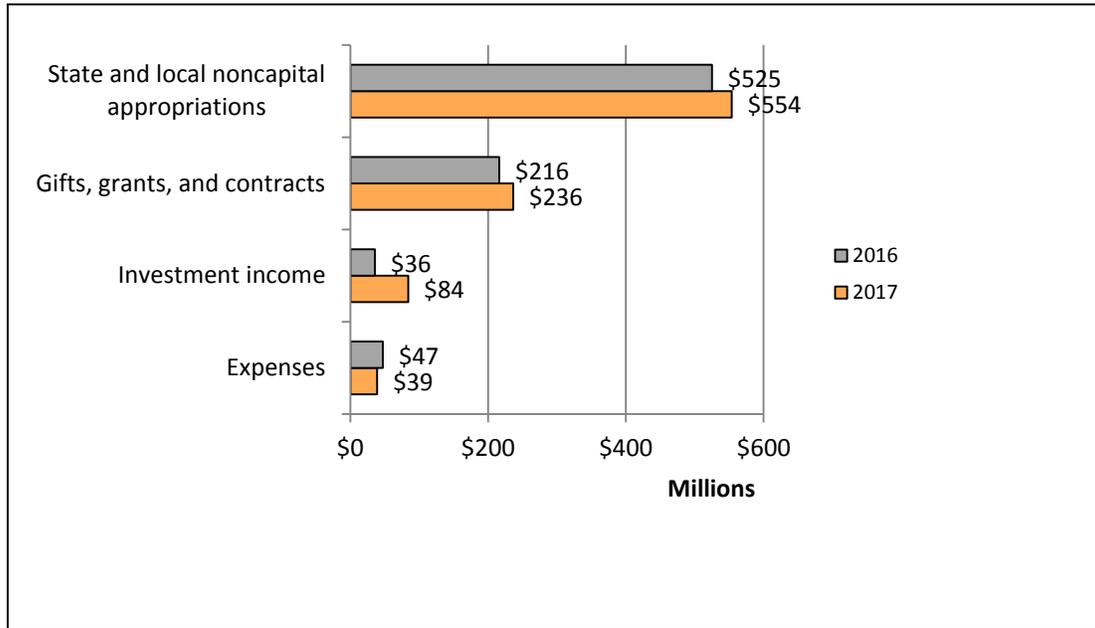
The increase in salary and benefit expenses from 2016 to 2017 is due to a 3% increase pool that each campus/unit distributed in accordance with its compensation strategy and due to increased expense for pension benefits.

Utilities, supplies, and other services increased \$29 million or 6% due to increased supplies for grants and contracts, including supplies for construction.

Scholarship and fellowship expenses decreased \$2.4 million. An increase in gross scholarships and fellowships was offset in part by increases in discounts to scholarships and fellowships related to tuition and fees.

Nonoperating Revenues and Expenses

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



Comparison of Fiscal Year 2017 to Fiscal Year 2016

In fiscal year 2017, state and local appropriations increased \$28.9 million, mostly due to THEC formula outcomes, productivity gains, and increased operating funds for nonformula units.

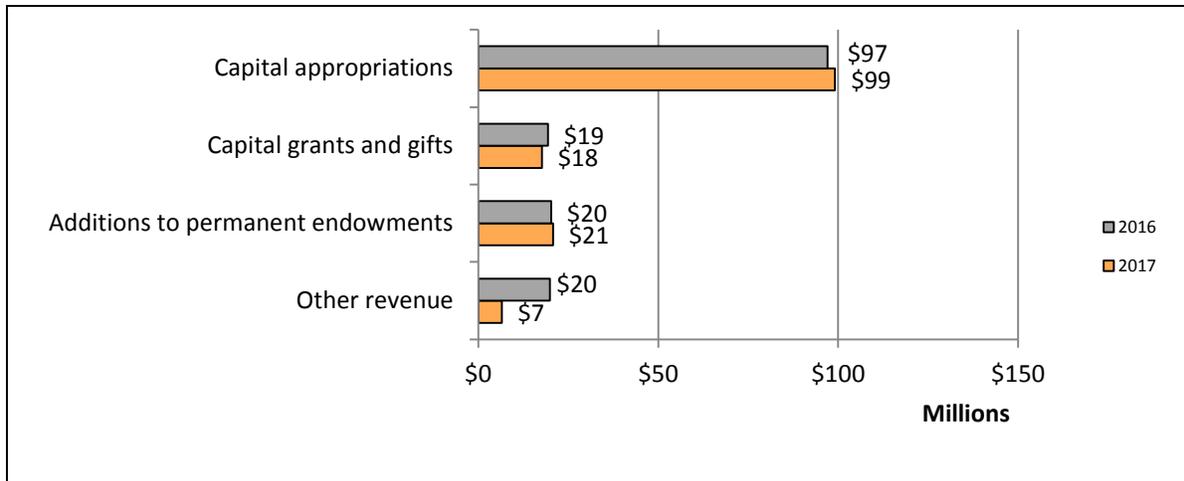
Grants and contracts increased over \$18 million because of increased nonoperating grants and contracts at the Health Science Center.

Investment income increased \$48.2 million, despite flat capital markets, due to the university's long range bond investing approach and an overall fair value upswing at June 30.

Other nonoperating expenses decreased \$8.3 million due in part to decreased interest expense on debt as a result of refinancing.

Other Revenues

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



Capital appropriations increased a modest \$2.1 million.

Additions to permanent endowments decreased \$.5 million following a significant increase in the previous year.

Other revenue decreased \$13.4 million in 2017 mostly due to a \$9.6 million decrease in insurance recoveries.

Capital Asset and Debt Administration

Capital Assets

The University of Tennessee had \$2,590,539,420.57 invested in capital assets, net of accumulated depreciation at June 30, 2017; and \$2,426,955,298.11 invested in capital assets, net of accumulated depreciation at June 30, 2016. Depreciation charges totaled \$117,924,769.24 and \$112,169,334.02 for the years ended June 30, 2017, and June 30, 2016, respectively.

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

	<u>2017</u>	<u>2016</u>
Land	\$ 82,662	\$ 81,611
Land improvements & infrastructure	101,471	105,020
Buildings	1,692,308	1,606,831
Works of art/historical treasures	4,415	3,896
Equipment	117,175	116,585
Software	770	643
Library holdings	87,733	85,275
Projects in progress	504,005	427,094
Total	<u>\$ 2,590,539</u>	<u>\$ 2,426,955</u>

Major capital additions to land and buildings during 2016-2017 included the \$58.5 million Phase I West Campus Redevelopment (Orange and White Halls), the \$17.8 million Facilities Services Complex, and the \$3.2 million Sorority Lodges.

At June 30, 2017, outstanding commitments under construction contracts totaled \$252,207,930.16 for various renovations and repairs of buildings and infrastructure. Future state capital outlay appropriations will fund \$73,694,234.70 of these costs.

More detailed information about the university's capital assets is presented in Note 6 to the financial statements.

Debt

The university had \$1,001,121,662.82 and \$901,487,804.29 in debt outstanding at June 30, 2017, and June 30, 2016, respectively. The table below summarizes these amounts by type of debt instrument.

	<u>2017</u>	<u>2016</u>
Bonds-current portion	\$ 37,632	\$ 36,486
Bonds-noncurrent	768,723	753,555
Unamortized bond premium	88,489	93,800
Revolving credit facility-noncurrent	106,278	17,647
Total Debt	<u>\$ 1,001,122</u>	<u>\$ 901,488</u>

The Tennessee State School Bond Authority (TSSBA) issued bonds with interest rates ranging from .18% to 5.5% due serially to 2046 on behalf of the University of Tennessee. The university is responsible for the debt service of these bonds. The current portion of the \$1,001,121,662.82 outstanding at June 30, 2017, is \$37,631,970.91.

The ratings on debt issued by the Tennessee State School Bond Authority at June 30, 2017, were as follows:

Fitch	AA+
Moody's Investor Service	Aa1
Standard & Poor's	AA+

More detailed information about the university's long-term liabilities is presented in Note 9 to the financial statements.

Economic Factors That Will Affect the Future

For fiscal year 2018, the University of Tennessee Board of Trustees has authorized individual campus fee increases of 1.8% that are expected to generate approximately \$11.4 million in new funding, net of related scholarships, with a continued projected enrollment increase. State appropriations will increase \$36 million with formula funding increases and increased operating funds for nonformula units. The university continues to be successful in competing for grants and contracts. The capital markets have shown little improvement and remain potentially unstable, which could affect the university's investment income.

Requests for Information

This financial report is designed to provide a general overview of the university's finances for all those with an interest in the university's finances. Questions concerning any of the information provided in the report or requests for additional information should be directed to Ms. Aldena Phillips, Controller, 201 Andy Holt Tower, Knoxville, Tennessee, 37996-0100.

THE UNIVERSITY OF TENNESSEE

STATEMENT OF NET POSITION

June 30, 2017

	<u>THE UNIVERSITY OF TENNESSEE</u>	<u>UNIVERSITY OF CHATTANOOGA FOUNDATION, INC.</u>	<u>THE UNIVERSITY OF TENNESSEE FOUNDATION, INC.</u>	<u>THE UNIVERSITY OF TENNESSEE RESEARCH FOUNDATION, INC.</u>
ASSETS				
Current assets:				
Cash and cash equivalents (Notes 2 and 3)	\$ 377,413,425.59	\$ 4,279,354.00	\$ 14,901,493.67	\$ 7,921,375.00
Investments (Notes 2, 3, 22, 23, and 24)	130,520,792.15		3,512,250.97	
Accounts, notes, and grants receivable (net) (Note 5)	63,608,142.91	332,979.00	16,484,593.93	9,654,749.00
Due from primary government	18,482,441.36			
Due from the university				3,846,496.00
Inventories	8,119,993.50			
Prepaid expenses	4,656,079.27	127,356.00		260,114.00
Assets held by the university			3,000,000.00	
Total current assets	<u>602,800,874.78</u>	<u>4,739,689.00</u>	<u>37,898,338.57</u>	<u>21,682,734.00</u>
Noncurrent assets:				
Cash and cash equivalents (Notes 2 and 3)	795,244,277.63		4,178,770.23	
Investments (Notes 2, 3, 22, 23, and 24)	830,947,448.35	136,383,174.00	10,330,482.82	1,335,191.00
Investment in UT - Battelle, LLC (Note 14)	5,072,520.00			
Accounts, notes, and grants receivable (net) (Note 5)	127,952,718.00	6,163,900.00	94,878,887.32	
Lease payments receivable (Note 19)	43,818,486.03			
Due from primary government	14,110,430.70			
Net pension asset (Note 11)	1,003,190.00			
Capital assets (net) (Notes 6, 22, and 24)	2,590,539,420.57	47,046,999.00		11,168,315.00
Assets held by the university		745,440.00	257,074,489.02	
Total noncurrent assets	<u>4,408,688,491.28</u>	<u>190,339,513.00</u>	<u>366,462,629.39</u>	<u>12,503,506.00</u>
Total assets	<u>\$ 5,011,489,366.06</u>	<u>\$ 195,079,202.00</u>	<u>\$ 404,360,967.96</u>	<u>\$ 34,186,240.00</u>
DEFERRED OUTFLOWS OF RESOURCES				
Deferred amount on debt refunding	22,632,122.43			
Deferred outflows related to pensions (Note 11)	123,958,376.00			
Total deferred outflows of resources	<u>\$ 146,590,498.43</u>			
LIABILITIES				
Current liabilities:				
Accounts payable (Note 8)	\$ 128,389,205.36	\$ 1,491,533.00	\$ 365,585.93	\$ 9,099,862.00
Accrued liabilities	62,346,573.16			
Unearned revenue (Note 9)	69,212,388.96	63,776.00		919,302.00
Due to component unit	194,249.63			
Deposits payable	2,377,868.49			
Annuities and life income payable (Note 9)	3,030,682.83		435,753.04	
Long-term liabilities, current portion (Notes 9, 22, 23, and 24)	83,593,254.66	2,210,000.00	921,114.72	5,204,145.00
Deposits held in custody for others	7,773,098.31	1,892,165.88		
Due to the university		1,372,134.12		
Total current liabilities	<u>356,917,321.40</u>	<u>7,029,609.00</u>	<u>1,722,453.69</u>	<u>15,223,309.00</u>
Noncurrent liabilities:				
Unearned revenue (Note 9)	15,500,438.71			886,030.00
Net pension liability (Note 11)	239,530,566.00			
Net Other Postemployment Benefits obligation (Note 12)	110,384,090.26			
Long-term liabilities, noncurrent portion (Notes 9, 22, 23, and 24)	1,000,087,798.15	66,073,371.00	8,659,950.58	3,287,100.00
Due to grantors (Note 9)	33,326,155.35			
Annuities and life income payable (Note 9)	16,204,916.00		3,140,818.17	
Deposits held in custody for component units	260,074,489.02			
Total noncurrent liabilities	<u>1,675,108,453.49</u>	<u>66,073,371.00</u>	<u>11,800,768.75</u>	<u>4,173,130.00</u>
Total liabilities	<u>\$ 2,032,025,774.89</u>	<u>\$ 73,102,980.00</u>	<u>\$ 13,523,222.44</u>	<u>\$ 19,396,439.00</u>
DEFERRED INFLOWS OF RESOURCES				
Deferred inflows related to pensions (Note 11)	\$ 12,838,484.00			
NET POSITION				
Net investment in capital assets	\$ 1,621,977,071.38			\$ 11,168,315.00
Restricted:				
Nonexpendable:				
Scholarships and fellowships	226,714,363.18	\$ 21,559,733.00	\$ 58,524,535.82	
Libraries	16,552,205.73		576,456.64	
Research	43,349,647.09		3,302,116.87	
Instructional department uses	152,557,718.73	41,189,706.00	85,625,816.76	
Academic support	33,365,796.21	698,145.00	50,896,523.44	
Other	49,570,550.45	562,716.00	28,095,259.83	
Expendable:				
Scholarships and fellowships	120,697,481.62	1,161,045.00	10,180,392.50	
Libraries	11,277,271.85		2,171.41	
Research	65,623,882.56		9,372,486.38	
Instructional department uses	121,877,171.61	5,788,375.00	12,335,436.39	
Academic support	58,639,319.21	27,541.00	22,772,595.73	
Loans	6,395,591.88			
Capital projects	16,455,549.18	5,000,000.00	34,467,735.34	
Debt service	1,615,137.44			
Pensions	1,003,190.00			
Other	113,620,817.90	4,614,083.00	59,741,787.20	18,111,540.00
Unrestricted	451,922,839.58	41,374,878.00	14,944,431.21	(14,490,054.00)
Total net position	<u>\$ 3,113,215,605.60</u>	<u>\$ 121,976,222.00</u>	<u>\$ 390,837,745.52</u>	<u>\$ 14,789,801.00</u>

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

THE UNIVERSITY OF TENNESSEE
STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET POSITION
For the Year Ended June 30, 2017

	<u>THE UNIVERSITY OF TENNESSEE</u>	<u>UNIVERSITY OF CHATTANOOGA FOUNDATION, INC.</u>	<u>THE UNIVERSITY OF TENNESSEE FOUNDATION, INC.</u>	<u>THE UNIVERSITY OF TENNESSEE RESEARCH FOUNDATION, INC.</u>
REVENUES				
Operating revenues:				
Student tuition and fees (net of \$ 211,757,061.91 of scholarship allowances)	\$ 485,931,085.92			
Contributions		\$ 3,585,138.00	\$ 63,343,006.33	\$ 3,293,774.00
Investment return designated for operations		7,662,001.00		
Federal appropriations	13,493,050.35			
Governmental grants and contracts (Note 18)	268,342,209.00		28,898,785.00	
Non-governmental grants and contracts	226,605,825.34			2,193,884.00
Sales and services of educational departments and other activities	64,832,141.68			
Auxiliary enterprises:				
Residential life (net of scholarship allowances of \$ 2,104,703.68)	60,995,537.18	12,040,260.00		
Food services	8,598,224.79			
Bookstore	23,711,030.18			
Parking	11,899,496.64			
Athletics (includes gifts of \$ 30,214,451.80 from component units)	137,408,716.67			
Other auxiliaries	1,761,101.87			
Interest earned on loans to students	27,163.21			
Other operating revenues	23,446,126.99		36,089.55	
Total operating revenues	<u>\$ 1,327,051,709.82</u>	<u>\$ 23,287,399.00</u>	<u>\$ 92,277,880.88</u>	<u>\$ 5,487,658.00</u>
EXPENSES				
Operating expenses (Note 20):				
Salaries and wages	\$ 1,066,643,293.54			
Fringe benefits	362,602,133.11			
Utilities, supplies, and other services	511,271,077.45	\$ 5,439,743.00	\$ 32,222,781.13	\$ 23,847,759.00
Scholarships and fellowships	56,019,129.43			
Depreciation and amortization expense	117,924,769.24	3,090,136.00		3,232,769.00
Payments to or on behalf of the university (Notes 22 and 23)		7,662,000.00	61,193,375.95	
Total operating expenses	<u>2,114,460,402.77</u>	<u>16,191,879.00</u>	<u>93,416,157.08</u>	<u>27,080,528.00</u>
Operating income (loss)	<u>\$ (787,408,692.95)</u>	<u>\$ 7,095,520.00</u>	<u>\$ (1,138,276.20)</u>	<u>\$ (21,592,870.00)</u>
NONOPERATING REVENUES (EXPENSES)				
State and local appropriations	\$ 553,770,258.43			
Gifts (including gifts totaling \$ 28,709,002.98 from component units)	34,450,576.53			\$ 18,184,829.00
Grants and contracts	202,005,945.46			
Investment income (loss) (includes investment income of \$ 6,719,509.41 from component units)	83,959,037.46	\$ 7,236,907.00	\$ 14,378,497.62	240,404.00
Interest on capital asset - related debt	(34,078,448.85)	(2,606,176.00)		
Interest on noncapital debt				(1,069,894.00)
Other nonoperating revenues (expenses)	(4,770,962.72)	128,729.00		(14,218,746.00)
Net nonoperating revenues (expenses)	<u>835,336,406.31</u>	<u>4,759,460.00</u>	<u>14,378,497.62</u>	<u>3,136,593.00</u>
Income (loss) before other revenues, expenses, gains, or losses	<u>47,927,713.36</u>	<u>11,854,980.00</u>	<u>13,240,221.42</u>	<u>(18,456,277.00)</u>
Capital appropriations	99,139,719.15			
Capital grants and gifts (including gifts from component units totaling \$ 3,212,411.76)	17,685,204.33			
Additions to permanent endowments	20,750,598.21	1,584,917.00	25,098,665.21	
Other (including \$ 6,648,577.43 of insurance recoveries related to prior years' property damages.)	6,533,528.39			1,966.00
Total other revenues	<u>144,109,050.08</u>	<u>1,584,917.00</u>	<u>25,098,665.21</u>	<u>1,966.00</u>
Increase (decrease) in net position	<u>\$ 192,036,763.44</u>	<u>\$ 13,439,897.00</u>	<u>\$ 38,338,886.63</u>	<u>\$ (18,454,311.00)</u>
NET POSITION				
Net position at beginning of year	2,911,211,988.08	108,536,325.00	352,498,858.89	33,244,112.00
Prior-period adjustment (Note 25)	9,966,854.08			
Net position at beginning of year, as restated	<u>2,921,178,842.16</u>	<u>108,536,325.00</u>	<u>352,498,858.89</u>	<u>33,244,112.00</u>
Net position at end of year	<u>\$ 3,113,215,605.60</u>	<u>\$ 121,976,222.00</u>	<u>\$ 390,837,745.52</u>	<u>\$ 14,789,801.00</u>

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

THE UNIVERSITY OF TENNESSEE
STATEMENT OF CASH FLOWS
For the Year Ended June 30, 2017

CASH FLOWS FROM OPERATING ACTIVITIES

Tuition and fees	\$ 484,134,509.26
Federal appropriations	13,493,050.35
Grants and contracts	484,388,446.73
Sales and services of educational activities and other activities	64,051,338.25
Payments to suppliers and vendors	(514,977,265.78)
Payments to employees	(1,064,394,830.60)
Payments for benefits	(361,794,760.03)
Payments for scholarships and fellowships	(56,019,129.43)
Loans issued to students	(1,365,136.56)
Collection of loans from students	4,419,710.19
Interest earned on loans to students	507,166.57
Auxiliary enterprise charges:	
Residence halls	60,995,032.18
Bookstore	23,433,001.75
Food service	8,598,224.79
Parking	11,899,496.64
Athletics	136,698,296.14
Other auxiliaries	1,876,719.14
Other receipts (payments)	22,888,051.82
Net cash provided (used) by operating activities	<u>\$ (681,168,078.59)</u>

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State appropriations	547,516,593.00
Local appropriations	6,253,665.43
Gifts and grants for other than capital or endowment purposes	235,338,632.27
Private gifts for endowment purposes	20,750,598.21
Split-interest transactions receipts	1,250,706.42
Split-interest transactions disbursements	(1,903,873.92)
Federal student loan receipts	303,248,267.04
Federal student loan disbursements	(304,082,529.00)
Changes in deposits held for others	37,530,050.47
Net cash balance implicitly financed (repaid)	(3,105,059.31)
Other noncapital receipts (payments)	(553,271.05)
Net cash provided (used) by noncapital financing activities	<u>\$ 842,243,779.56</u>

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Proceeds from capital debt	108,164,255.66
Capital appropriations	95,047,067.72
Capital grants and gifts received	12,102,632.96
Proceeds from sale of capital assets	124,579.56
Purchase of capital assets and construction	(278,533,844.80)
Principal paid on capital debt and leases	(39,958,168.95)
Interest paid on capital debt and leases	(40,553,901.69)
Other capital and related financing receipts (payments)	13,540,344.66
Net cash provided (used) by capital and related financing activities	<u>\$ (130,067,034.88)</u>

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from sales and maturities of investments	458,795,872.07
Income on investments	13,340,909.82
Purchase of investments	(486,772,325.65)
Net cash provided (used) by investing activities	<u>\$ (14,635,543.76)</u>

Net increase (decrease) in cash and cash equivalents	16,373,122.33
Cash and cash equivalents at beginning of year	1,156,284,580.89
Cash and cash equivalents at end of year	<u>\$ 1,172,657,703.22</u>

RECONCILIATION OF NET OPERATING LOSS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES

Operating loss	\$ (787,408,692.95)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:	
Depreciation and amortization expense	117,924,769.24
Changes in assets, liabilities, and deferred outflows:	
Receivables, net	(3,503,029.39)
Inventories	(279,734.20)
Prepaid expenses	(1,446,353.70)
Accrued interest receivable	480,003.36
Accounts payable	(2,019,211.27)
Accrued liabilities	2,645,250.52
Unearned revenue	(10,938,998.04)
Deposits	(87,241.29)
Net pension asset	(676,966.00)
Deferred outflows related to pensions	(54,508,208.00)
Net pension obligation	72,822,046.00
Deferred inflows related to pensions	(23,147,963.00)
Net OPEB obligation	4,471,085.17
Compensated absences	1,450,591.33
Other additions (deductions):	
Loans to students	3,054,573.63
Net cash provided (used) by operations	<u>\$ (681,168,078.59)</u>

Noncash investing, capital, or financing transactions

Gifts of capital assets	\$ 5,582,571.37
Unrealized gain (loss) on investments	\$ 12,634,469.12
Loss on disposal of capital assets	\$ (8,125,571.61)

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

THE UNIVERSITY OF TENNESSEE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2017

Note 1: Summary of Significant Accounting Policies

A. Reporting Entity

The university is a component unit of the State of Tennessee because the state appoints the majority of the university's governing body and provides significant financial support. The university is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

The University of Tennessee System is comprised of the University of Tennessee Knoxville, including the Space Institute at Tullahoma; the University of Tennessee at Chattanooga; the University of Tennessee at Martin; the University of Tennessee Health Science Center, including the Memphis campus, the Memorial Research Center at Knoxville, Clinical Education Centers at Chattanooga and Knoxville, and Family Practice Centers at Jackson, Knoxville, and Memphis; the University of Tennessee Institute of Agriculture, including the College of Agriculture at Knoxville, the Agricultural Experiment Stations, the Agricultural Extension Service, and the College of Veterinary Medicine at Knoxville; the University of Tennessee Institute for Public Service, which includes the County Technical Assistance Service and the Municipal Technical Advisory Service; and the University of Tennessee University-Wide Administration. The University of Tennessee's Knoxville, Chattanooga, Martin, and Health Science Center campuses are each accredited by the Southern Association of Colleges and Schools (SACS). The university is governed by a board of 26 members, including one student and one faculty member, all either *ex officio* or appointed by the Governor, who also serves as chairman. The president is the chief executive officer of the university system.

The University of Chattanooga Foundation, Inc., and the University of Tennessee Foundation, Inc., are considered component units of the university. Although the university does not control the timing or amount of receipts from the foundations, the majority of resources, or income thereon that the foundations hold and invest are restricted to the activities of the university by the donors. Because these restricted resources held by the foundations can only be used by, or for the benefit of, the university, the foundations are considered component units of the university and are discretely presented in the university's financial statements. The University of Tennessee Research Foundation, Inc., is also considered a component unit of the university because the university's board of trustees approves the foundation's administrative budget and funds the foundation's administrative costs. It is also discretely presented in the university's financial statements. See notes 22, 23, and 24 for more detailed information about the component units and how to obtain their reports.

B. Basis of Presentation

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

C. Basis of Accounting

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

Amounts reported as operating revenues include 1) tuition and fees, net of scholarship discounts and allowances; 2) federal appropriations; 3) certain federal, state, local, and private grants and contracts; 4) sales and services of educational departments and other activities; 5) sales and services of auxiliary enterprises, net of scholarship discounts and allowances; and 6) other sources of revenue. Operating expenses include 1) salaries and wages;

THE UNIVERSITY OF TENNESSEE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2017

2) employee benefits; 3) scholarships and fellowships; 4) depreciation and amortization expense; and 5) utilities, supplies, and other services.

All other activity is nonoperating in nature. This activity includes: 1) state and local appropriations for operations; 2) investment income; 3) interest on capital asset-related debt; 4) nonoperating grants and contracts; and 5) gifts.

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

D. Cash Equivalents

This classification includes instruments which are readily convertible to known amounts of cash.

E. Inventories

Inventories are valued at the lower of cost or market, based on the retail, specific identification, average cost, or first-in, first-out basis.

F. Investments

All university investments are reported at fair value.

The university holds investments in limited partnerships, limited companies, corporations, and limited liability corporations which are carried at estimated fair value provided by the management of these funds. The purpose of this alternative investment class is to increase portfolio diversification and reduce risk due to the low correlation with other asset classes. Methods for determining estimated fair values include discounted cash flows and estimates provided by general partners and fund managers. Because these investments are not readily marketable, the estimated fair value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. The estimated fair values are reviewed and evaluated by the university.

G. Capital Assets

Capital assets, which include property, plant, equipment, works of art, historical treasures/collections, software, and library holdings, are reported in the statement of net position at historical cost or at acquisition value at date of donation, less accumulated depreciation/amortization. The costs of normal maintenance and repairs that do not add to the value of the assets or materially extend the assets' useful lives are not capitalized.

A capitalization threshold of \$100,000 is used for buildings, land improvements, and infrastructure. Equipment and software are capitalized when the unit acquisition cost is \$5,000 or greater and the estimated useful life is one year or more. The capitalization threshold for additions and improvements to infrastructure and land improvements is also \$100,000. The capitalization threshold for additions and improvements to buildings is \$100,000 provided that amount exceeds 20% of the book value of the building.

These assets, with the exception of works of art and historical treasures/collections deemed inexhaustible and land, are depreciated/amortized using the straight-line method over the estimated useful lives, which range from 5 to 40 years.

H. Accounts Payable

Included in accounts payable are checks payable in the amount of \$3,081,564.99 as of June 30, 2017. These amounts represent the sum of checks written in excess of the university's checking account balance because of the use of a controlled disbursement account. In this way, the university maximizes interest income by transferring from an investment account only funds necessary to cover the checks that clear the bank daily.

THE UNIVERSITY OF TENNESSEE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2017

I. Pensions

For purposes of measuring the net pension liability (asset), deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Closed State and Higher Education Employee Pension Plan and the State and Higher Education Employee Retirement Plan in the Tennessee Consolidated Retirement System (TCRS) and additions to/deductions from the plans' fiduciary net positions have been determined on the same basis as they are reported by the TCRS. For this purpose, benefits (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms of the Closed State and Higher Education Employee Pension Plan and the State and Higher Education Employee Retirement Plan. Investments are reported at fair value.

J. Compensated Absences

The university's employees accrue annual leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time. Generally, all permanent full-time employees and certain part-time employees are entitled to accrue and carry forward calendar year maximums of 42 days annual vacation leave, except nine-month faculty members who do not accrue annual leave. The amount of these liabilities and their related benefits are reported in the statement of net position. There is no liability for unpaid accumulated sick leave since the university's policy is to pay this only when an employee dies or is absent because of illness or injury.

K. Net Position

The institution's net position is classified as follows:

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

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

EXPENDABLE RESTRICTED NET POSITION: Expendable restricted net position includes resources in which the university is legally or contractually obligated to spend resources in accordance with restrictions imposed by external third parties.

UNRESTRICTED NET POSITION: Unrestricted net position represents resources derived from student tuition and fees, state appropriations, the sales and services of educational departments and other activities, and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the institution, and may be used at the discretion of the institution to meet current expenses for any purpose.

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

THE UNIVERSITY OF TENNESSEE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2017

M. Income Taxes

The university, as a public corporation and an instrumentality of the State of Tennessee, is exempt from federal income taxes under Section 115 of the *Internal Revenue Code*. Contributions to the university are deductible by donors as provided under Section 170 of the *Internal Revenue Code*.

Note 2: DEPOSITS AND INVESTMENTS

Investment Policy

Cash Management Investment Pool - The University of Tennessee maintains a cash management investment pool that is available for use by all fund groups. State statutes and university investment policies authorize the university's cash management pool to invest in collateralized Tennessee bank or savings and loan association certificates of deposit, U.S. Treasury obligations, U.S. government agency obligations, repurchase agreements of those securities, highest quality commercial paper, prime bankers' acceptances, and money market mutual funds meeting certain criteria.

University policy also requires that commercial paper not exceed 35% of the portfolio in total and that no more than 10% of the portfolio's value be in the commercial paper of a single issuer. In addition, banker's acceptances cannot exceed 20% of the portfolio's value and no one banker's acceptances may exceed 10%. Money market funds cannot exceed 10% of the portfolio's total value. At June 30, 2017, the university's cash management investment pool consisted of \$18,325,000 of demand deposits yielding money market rates and \$1,133,192,562.79 of U.S. treasury and government agency obligations.

Investments – The university's assets subject to long-term investment (endowments and annuity and life income assets) use various external managers and funds consistent with investment objectives for those invested assets. A significant part of these assets is the university's Consolidated Investment Pool, which is a carefully crafted portfolio of broadly diversified asset classes.

Deposits – University policy and state statute require that university funds be deposited into authorized commercial banks and savings and loan associations. State statutes also require that these financial institutions pledge securities as collateral to secure university time and demand deposits. To facilitate the pledge requirement, financial institutions can elect to either participate in the State of Tennessee Collateral Pool for Public Deposits administered by the State Treasurer or pledge securities with a third party.

Cash and Cash Equivalents

In addition to petty cash and demand deposits, this classification includes instruments which are readily convertible to known amounts of cash.

At June 30, 2017, cash and cash equivalents consisted of \$15,651,242.36 in bank accounts, \$1,237,734.40 of petty cash on hand, and \$1,151,517,562.79 in the university's cash management investment pool.

The carrying amount of the university's deposits was \$33,976,242.36, and the bank balance was \$41,321,796.16.

Additionally, the university maintains custodial accounts at First Tennessee Bank and BNY Mellon for funds contractually managed by independent investment counsel. In accordance with the custody agreements, First Tennessee Bank and BNY Mellon placed cash equivalents totaling \$4,251,163.67 at June 30, 2017, in money market mutual funds.

Custodial Credit Risk – Deposits

The custodial credit risk for deposits is the risk that in the event of a bank failure, the university's deposits may not be recovered. As stated earlier, state statutes require that all university deposits be in a qualified depository and secured

THE UNIVERSITY OF TENNESSEE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2017

through direct collateralization or participation in the State Collateral Pool. As of June 30, 2017, all university deposits were adequately secured as required by state statute.

Investments

All investments are reported at fair value, including those securities with a maturity date of one year or less. Where applicable, maturities reported for pooled investment vehicles - bonds, represent a weighted average maturity of the individual bonds in the respective fund. As of June 30, 2017, the university had the following investments and maturities:

Investment Maturities (In Years)

Investment Type	Fair Value	Less Than 1	1 to 5	6 to 10	10+	Unknown	Cost
<u>Cash Management</u>							
<u>Pool</u>							
<u>Cash Equivalents</u>							
<u>Debt Securities</u>							
U.S. Treasury	\$ 35,024,874.40	\$ 252,617.50	\$ 10,011,700.00	\$ 24,760,556.90			\$ 35,466,807.42
U.S. Agencies	1,098,167,688.39	82,404,790.32	638,633,552.48	303,538,159.57	\$ 73,591,186.02		1,101,764,865.21
	<u>\$ 1,133,192,562.79</u>	<u>\$ 82,657,407.82</u>	<u>\$ 648,645,252.48</u>	<u>\$ 328,298,716.47</u>	<u>\$ 73,591,186.02</u>		<u>\$ 1,137,231,672.63</u>
<u>Investments</u>							
<u>Debt Securities</u>							
U.S. Treasury	\$ 7,155,791.65	\$ 213,468.00	\$ 5,508,803.61	\$ 1,433,520.04			\$ 7,233,178.82
U.S. Agencies	1,619,065.10		1,599,866.00		\$ 19,199.10		1,586,974.80
Corporate Bonds	12,116,266.25	3,852,602.25	6,616,688.35	1,449,339.25	197,636.40		12,157,069.75
Municipal Bonds	1,369,459.35		1,369,459.35				1,366,384.00
Pooled Investment Vehicles-Bonds	93,291,416.58		1,681,232.69	64,840,404.32	1,201,030.52	\$ 25,568,749.05	90,590,272.99
	<u>\$ 115,551,998.93</u>	<u>\$ 4,066,070.25</u>	<u>\$ 16,776,050.00</u>	<u>\$ 67,723,263.61</u>	<u>\$ 1,417,866.02</u>	<u>\$ 25,568,749.05</u>	<u>\$ 112,933,880.36</u>
		<u>\$ 86,723,478.07</u>	<u>\$ 665,421,302.48</u>	<u>\$ 396,021,980.08</u>	<u>\$ 75,009,052.04</u>	<u>\$ 25,568,749.05</u>	
<u>Other Investments</u>							
Corporate Stocks:							
Domestic	\$ 18,040,376.16						\$ 13,090,549.79
International	5,618,405.62						5,534,911.27
Pooled Investment Vehicles-Equity	336,762,318.51						288,405,731.97
Alternative Investments:							
Pooled Investment Vehicles-Real Estate	53,480,558.51						42,618,614.76
Private Capital Investments	234,444,063.00						232,884,521.17
Hedge Funds	187,070,552.93						149,449,806.36
Real Estate Gifts	3,165,896.87						3,958,888.37
Assets With Trustees	7,325,707.55						7,051,195.19
Other	8,362.42						16,303.56
Total Investments & Cash Equivalents	<u>\$2,094,660,803.29</u>						<u>\$ 1,993,176,075.43</u>
Less: Cash Equivalents	<u>1,133,192,562.79</u>						<u>1,137,231,672.63</u>
Total Investments	<u>\$ 961,468,240.50</u>						<u>\$ 855,944,402.80</u>

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Interest Rate Risk

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

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university's debt investments as of June 30, 2017, were rated by Moody's Investors Service, Standard & Poor's, and /or Fitch Ratings and are reported below using Moody's rating scale.

The university is authorized by statute to invest funds in accordance with University of Tennessee investment policies. Funds, other than endowment and annuity and life income funds, may be invested in collateralized Tennessee bank or savings and loan association certificates of deposit, U. S. Treasury obligations, U.S. government agency obligations and repurchase agreements of those securities, highest quality commercial paper, prime bankers' acceptances, and money market mutual funds meeting certain criteria. Endowment and life income funds can be invested in equity securities and various other securities given prudent diversification. The university has no investment policy limiting its investment choice based on ratings issued by nationally recognized statistical rating agencies. As of June 30, 2017, the institution's investments were rated as follows:

Rated Debt Instruments	Fair Value	Aaa	Aa1	Aa2	Aa3	A1
<u>Cash Management Pool:</u>						
U.S. Agencies	\$1,098,167,688.39	\$552,075,652.09				
<u>Investments:</u>						
U.S. Agencies	\$ 1,619,065.10	\$ 1,619,065.10				
Corporate Bonds	12,116,266.25			\$ 361,473.00		\$ 1,769,095.55
Municipal Bonds	1,369,459.35	313,932.00			\$ 730,550.10	324,977.25
Pooled Investment Vehicles - Bonds	93,291,416.58					
Money Market Funds in Custodial Accounts	4,251,163.67					

Rated Debt Instruments (continued)	A2	A3	Baa1	Baa2	Baa3	B2
<u>Cash Management Pool</u>						
U.S. Agencies						
<u>Investments:</u>						
U.S. Agencies						
Corporate Bonds	\$ 1,286,988.50	\$ 2,802,410.00	\$ 4,036,107.50	\$ 1,474,974.90	\$ 30,103.80	\$ 50,625.00
Municipal Bonds						
Pooled Investment Vehicles - Bonds						
Money Market Funds in Custodial Accounts						

Rated Debt Instruments (continued)	Unrated
<u>Cash Management Pool:</u>	
U.S. Agencies	\$546,092,036.30
<u>Investments:</u>	
U.S. Agencies	
Corporate Bonds	304,488.00
Municipal Bonds	
Pooled Investment Vehicles - Bonds	93,291,416.58
Money Market Funds in Custodial Accounts	4,251,163.67

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Custodial Credit Risk – Investments

Custodial credit risk is the risk that, in the event of a failure of the counterparty, the university will not be able to recover the value of the investment or collateral securities that are in possession of an outside party. At June 30, 2017, the university had \$7,325,707.55 of uninsured and unregistered investments held by a counterparty but not in the school's name.

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the university's investment in a single issuer. Other than the restrictions placed on the cash management investment pool described in the investment policies above, the university places no limit on the amount the university may invest in any one issuer.

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of a deposit or investment. The university has \$5,618,405.62 invested in foreign corporate equities and \$15,926,108.90 invested in foreign corporate bonds at June 30, 2017.

Alternative Investments

In its Consolidated Investment Pool, as part of its endowment assets, the university has investments in ninety-seven limited partnerships, limited companies, corporations, and limited liability corporations (LLCs).

The estimated fair value of these assets is \$474,995,174.44 at June 30, 2017.

Total capital contributions less returns of capital equal \$424,952,942.29 at June 30, 2017.

The university believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2017. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the university's investment policy that approves the allocation of funds to various asset classes in order to ensure the proper level of diversification within the endowment pool. These investments (real estate assets, private capital investments, and hedge funds) are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated by the general partner of each limited partnership or manager of each corporate entity using various valuation techniques.

The methods and assumptions used in estimating fair value vary based upon the asset class, but uniformly all start with the latest audited financial statements for the funds. Most funds issue audited financial statements on a calendar year basis. Using those audited fair values as a beginning point, valuations are adjusted for net capital activity and marketplace considerations to ascertain the reasonableness of estimated fair values provided by the fund managers. Marketplace activity includes subsequent independent appraisals for real estate assets, subsequent rounds of capital financings that include new investors for private/venture equity, and asset confirmations from brokers and fund administrators for hedge funds.

Note 3: Fair Value Measurements

The university categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America.

The university has the following recurring fair value measurements as of June 30, 2017:

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	6/30/2017	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments in Entities That Calculate NAV per share
Investments and cash equivalents by fair value level					
Debt securities					
U.S. Treasury	\$ 42,180,666.05		\$ 42,180,666.05		
U.S. agencies	1,099,786,753.49		1,099,786,753.49		
Municipal bonds	1,369,459.35		1,369,459.35		
Corporate bonds	12,116,266.25		12,040,057.85	\$ 76,208.40	
Total debt securities	\$ 1,155,453,145.14				
Equity securities					
Common stock	\$ 23,541,091.78	\$ 20,695,922.38	\$ 2,665,956.00	179,213.40	
Preferred stock, public	117,690.00	40,380.00		77,310.00	
Total equity securities	\$ 23,658,781.78				
Pooled investment vehicles (exchange traded funds; open-end and closed-end)	\$ 115,930,247.26	115,930,247.26			
Pooled investment vehicles (other open-end funds with published values)	\$ 202,516,840.88	202,516,840.88			
Other assets	\$ 10,499,966.84			10,499,966.84	
Private capital investments					
Private equity	75,534,195.00			75,534,195.00	
Private credit/debt	57,632,367.00			57,632,367.00	
Private real assets	97,422,886.00			97,422,886.00	
Private, other	3,854,615.00			3,854,615.00	
Total private capital investments	\$ 234,444,063.00				
Investments measured at the net asset value (NAV)					
Pooled investment vehicles (other open-end funds)	\$ 165,087,205.46				\$ 165,087,205.46
Hedge funds, long/short equity	33,368,659.85				33,368,659.85
Hedge funds, credit	48,589,198.17				48,589,198.17
Hedge funds, diversified	105,112,694.91				105,112,694.91
Total NAV Investments	\$ 352,157,758.39				
Total investments and cash equivalents valued at fair value	\$ 2,094,660,803.29				

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Debt Securities

The fair value of the majority of the Debt Securities category at June 30, 2017, was determined based on Level 2 inputs. The university utilizes third-party pricing services and guidance provided by custodians and trading counterparties for fair value estimates of these investments. In addition, it takes into account the nature of the securities, trading activity, and availability of comparable securities in the marketplace.

Equity Securities and Pooled Investment Vehicles (Exchange – Traded or With Published Values)

These investment categories are comprised of common stock, preferred stock, limited partnerships, and funds, all of which are exchange-traded or with published values. The fair value of these assets at June 30, 2017, was primarily determined based on Level 1 inputs due to the transparent pricing provided by a securities exchange or published values.

Other Assets

Level 3 inputs were utilized for the fair value calculations of this investment category, which contains real estate holdings of \$3,165,896.87, separately invested portfolios of \$7,325,707.55, and an annuity valued at \$8,362.42. Real estate was valued using various appraisal estimates, while the separately invested portfolios are managed externally for the benefit of the university. Pricing for the latter was provided by third parties. The annuity is priced by the sponsoring entity.

Private Capital Investments

The fair value of the Private Capital category at June 30, 2017, was determined based on Level 3 inputs. Valuation methods such as the income method and/or multiple analysis are examples of those commonly utilized by managers to determine the fair value of these assets and are typically unobservable to the university.

The university's private capital investments have \$187,023,804.56 of unfunded commitments at June 30, 2017.

Investments Measured at Net Asset Value (NAV)

The university holds shares or interests in investment companies or vehicles for which the fair value is measured on a recurring basis using net asset value per share (or its equivalent). This category is a combination of open-end mutual funds and hedge funds. The open-end fund holdings implement strategies that are primarily net long or long-only investments in a variety of markets including the global equity markets, municipal debt, foreign sovereign and corporate bonds, investment-grade U.S. debt, real estate, and energy. The hedge fund holdings are divided into three sub-categories. The first is Long/Short Equity, a strategy that typically invests in common stock by both buying shares and selling shares short. These strategies work across the global equity markets. The second category, entitled Credit, focuses almost exclusively on fixed income instruments, which can include various types of bonds, derivatives, and loans. These strategies also invest in multiple jurisdictions around the world. The final category, Diversified, is comprised of strategies that often overlap in approach and frequently employ more than one strategy within a single vehicle.

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NAV Investments General Redemption Terms

The table below provides a summary of the liquidity terms and conditions of those investments with values measured using net asset value.

	Fair Value	Redemption Frequency	Redemption Notice Required
Hedge Funds, Credit	\$ 48,589,198.17	Quarterly – Annually	45 days – 120 days
Hedge Funds, Diversified	\$105,112,694.91	Monthly, Quarterly, Annually	3 days – 90 days
Hedge Funds, Long-short Equity	\$ 33,368,659.85	Quarterly, Semi-Annually, Annually	30 days – 75 days
Open-end Funds	\$165,087,205.46	Daily, Semi-monthly, Monthly, Quarterly	1 day – 90 days

As of fiscal year-end, none of the investments measured at NAV were still within the initial lock-up period.

Note 4: Endowment, Annuity, and Life Income Agreements

There are two categories of university assets which are subject to long-term investment: endowments and amounts held in trust under annuity and life income agreements. The investment of these funds is governed by the gift instrument and the investment policies established by the Board of Trustees.

Effective July 1, 1954, the university adopted the policy of investing endowment assets over which it had full investment discretion (and on which the donor or governing gift instrument does not require separate investment) in a Consolidated Investment Pool. This pooling of investments affords closer supervision of the investment portfolio and provides, regardless of size, the advantages of participation in a well-diversified portfolio of domestic and international equities, private equity, bonds, real estate, and hedge funds. All contributing endowments participate in the income and capital appreciation of the Pool on a per-share basis commensurate with their contributions to the Pool. New endowments purchase shares in the Pool at the end of each month at the then current fair value per share, determined by valuing the Pool at month end fair value and dividing by the number of pool units outstanding.

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

The university chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the university, four and a half percent of a five-year moving average of the fair value of endowment investments has been authorized for expenditure. In fiscal year 2016, the university began transitioning to a seven-year moving average, by adding one year's value to the moving average calculation. This transition will be complete with fiscal year 2019. In addition, the board approved imposing both a maximum and minimum distribution rate on each year's calculation. Beginning in fiscal year 2016, the maximum and minimum distribution rates are 6% and 3%, respectively, of the previous calendar year's market value. The remaining amount after distributions, 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, 2017, net appreciation of \$143,641,974.04 is available to be spent, of which \$140,662,884.53 is restricted for scholarships and fellowships, libraries, instructional department uses, academic support, research, and other purposes. The per unit fair value for participating endowments was \$3.3771205 at June 30, 2017. Income distributed was \$0.15017 per share in 2017, or \$39,195,682.29.

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The university's Consolidated Investment Pool is invested to maximize total return rather than current income consistent with provisions of the Uniform Prudent Management of Institutional Funds Act adopted by the State of Tennessee in 2007. The total return for fiscal year 2017 and the three and five years then ended was 9.9%, 2.7%, and 7.4%, respectively.

All endowments not invested as part of the Consolidated Investment Pool are separately invested to observe requirements or limitations imposed by donors. Income earned and distributed on separately invested endowments amounted to \$242,445.86 for 2017.

Annuity and life income amounts held in trust are separately invested entities requiring detailed accounting to reflect specific compliance with the terms of each trust and applicable federal regulations. The investment objectives as reflected in each agreement vary widely since they are affected by the age, income level, and needs of the beneficiaries as well as motives and objectives of the donors. Interest, dividend, rent, and royalty income realized on these funds for 2017 amounted to \$1,443,649.47

Note 5: Accounts, Notes, and Grants Receivable

Accounts, notes, and grants receivable included the following at June 30, 2017:

Student accounts receivable	\$ 19,600,262.58
Grants receivable	76,062,849.30
Notes receivable	2,790,286.26
Pledges receivable	4,875,106.98
TSSBA debt proceeds receivable	36,738,574.74
Due from component units	1,372,134.12
Other receivables	<u>39,972,605.70</u>
Subtotal	\$ 181,411,819.68
Less allowance for doubtful accounts	<u>(13,860,408.55)</u>
Total	<u>\$ 167,551,411.13</u>

Pledges receivable are promises of private donations that are reported as accounts receivable, and revenue, net of an estimated uncollectible allowance of \$975,021.39

Federal Perkins Loan Program funds included the following at June 30, 2017:

Perkins loans receivable	\$ 24,009,449.78
Less allowance for doubtful accounts	<u>-</u>
Total	<u>\$ 24,009,449.78</u>

THE UNIVERSITY OF TENNESSEE
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Note 6: Capital Assets

Capital asset activity for the year ended June 30, 2017, was as follows:

	Beginning <u>Balance</u>	<u>Additions</u>	<u>Transfers</u>	<u>Reductions</u>	Ending <u>Balance</u>
Land	\$ 81,610,929.83	\$ 1,059,195.00	\$ -	\$ (7,612.37)	\$ 82,662,512.46
Land improvements & infrastructure	178,213,625.80	1,700.00	3,882,047.48	-	182,097,373.28
Buildings	2,567,002,076.13	14,835,569.03	141,688,151.14	(6,972,434.11)	2,716,553,362.19
Works of Art/ Historical Treasures	3,896,450.77	518,500.00	-	-	4,414,950.77
Equipment	387,826,257.21	30,289,084.09	-	(26,260,229.31)	391,855,111.99
Software	30,743,387.23	546,708.56	-	(455,135.60)	30,834,960.19
Library holdings	151,637,056.57	17,655,710.07	-	(13,575,016.35)	155,717,750.29
Projects in progress	<u>427,093,983.67</u>	<u>222,481,676.67</u>	<u>(145,570,198.62)</u>	<u>-</u>	<u>504,005,461.72</u>
Total	<u>\$ 3,828,023,767.21</u>	<u>\$ 287,388,143.42</u>	<u>\$ -</u>	<u>\$ (47,270,427.74)</u>	<u>\$ 4,068,141,482.89</u>
Less accumulated depreciation/amortization:					
Land improvements & infrastructure	(73,193,284.76)	(7,433,546.72)	-	-	(80,626,831.48)
Buildings	(960,171,124.14)	(67,822,186.40)	-	3,748,246.80	(1,024,245,063.74)
Equipment	(271,241,197.55)	(27,072,879.32)	-	23,633,741.14	(274,680,335.73)
Software	(30,100,832.16)	(398,445.36)	-	434,171.73	(30,065,105.79)
Library holdings	<u>(66,362,030.49)</u>	<u>(15,197,711.44)</u>	<u>-</u>	<u>13,575,016.35</u>	<u>(67,984,725.58)</u>
Total	<u>\$(1,401,068,469.10)</u>	<u>\$(117,924,769.24)</u>	<u>\$ -</u>	<u>\$ 41,391,176.02</u>	<u>\$ (1,477,602,062.32)</u>
Capital assets, net	<u>\$ 2,426,955,298.11</u>	<u>\$ 169,463,374.18</u>	<u>\$ -</u>	<u>\$ (5,879,251.72)</u>	<u>\$ 2,590,539,420.57</u>

Note 7: Operating Leases

The university has entered into various operating leases for buildings and equipment. It is expected that in the normal course of business, such leases will continue to be required. Net expenses for rentals under leases were \$10,037,307.54 for the year ended June 30, 2017. All operating leases are cancelable at the lessee's option.

Note 8: Accounts Payable

Accounts payable included the following:

	<u>June 30, 2017</u>
Vendors payable	\$ 101,632,807.24
Payroll deductions payable	21,473,223.46
Due to State of Tennessee	<u>5,283,174.66</u>
Total	<u>\$ 128,389,205.36</u>

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Note 9: Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2017, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Long-term liabilities:					
Bonds	\$ 790,040,663.57	\$ 52,799,915.03	\$ 36,485,681.96	\$ 806,354,896.64	\$ 37,631,970.91
Unamortized bond premium	93,799,602.68	-	5,310,802.90	88,488,799.78	-
Revolving credit facility	<u>17,647,538.04</u>	<u>92,102,915.35</u>	<u>3,472,486.99</u>	<u>106,277,966.40</u>	<u>-</u>
Total TSSBA indebtedness	<u>\$ 901,487,804.29</u>	<u>\$ 144,902,830.38</u>	<u>\$ 45,268,971.85</u>	<u>\$ 1,001,121,662.82</u>	<u>\$ 37,631,970.91</u>
Compensated absences	81,108,798.66	47,411,875.08	45,961,283.75	82,559,389.99	45,961,283.75
Total long-term liabilities	<u>\$ 982,596,602.95</u>	<u>\$ 192,314,705.46</u>	<u>\$ 91,230,255.60</u>	<u>\$ 1,083,681,052.81</u>	<u>\$ 83,593,254.66</u>
Other long-term liabilities:					
Unearned revenue	\$ 105,618,679.79	\$ 48,306,536.84	\$ 69,212,388.96	\$ 84,712,827.67	\$ 69,212,388.96
Due to grantors	36,111,251.66	1,158,893.57	3,943,989.88	33,326,155.35	-
Annuities payable and life income payable	<u>20,271,278.83</u>	<u>226,031.03</u>	<u>1,261,711.03</u>	<u>19,235,598.83</u>	<u>3,030,682.83</u>
Total other long-term liabilities	<u>\$ 162,001,210.28</u>	<u>\$ 49,691,461.44</u>	<u>\$ 74,418,089.87</u>	<u>\$ 137,274,581.85</u>	<u>\$ 72,243,071.79</u>

TSSBA Debt – Bonds

Bonds, with interest rates ranging from .18% to 5.50%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2046 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. (See Note 10 for further details.) The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net position is shown net of assets held by the authority in the debt service reserve, capitalized interest, and unexpended debt proceeds. The total bonded indebtedness at June 30, 2017, was \$819,776,550.80. The debt service reserve amount at June 30, 2017, was \$13,129,193.50, and unspent debt proceeds were \$292,460.66.

The university's debt service requirements to maturity for all bonds payable at June 30, 2017, are as follows:

<u>Year ending June 30:</u>	<u>Principal</u>	<u>Interest</u>
2018	\$ 37,631,970.91	\$ 35,976,418.00
2019	38,454,494.00	34,401,664.89
2020	36,970,905.22	32,724,306.29
2021	32,925,164.95	31,260,324.74
2022	33,356,959.05	29,875,622.14
2023-2027	172,677,827.87	127,411,576.14
2028-2032	164,714,363.33	89,559,678.66
2033-2037	139,283,649.86	54,088,517.49
2038-2042	114,029,028.49	25,138,925.85
2043-2046	<u>49,732,187.12</u>	<u>4,476,984.90</u>
	<u>\$ 819,776,550.80</u>	<u>\$ 464,914,019.10</u>
Less:		
Debt service reserve fund	(13,129,193.50)	
Unspent bond proceeds	<u>(292,460.66)</u>	
TSSBA debt-bonds	<u>\$ 806,354,896.64</u>	

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TSSBA Debt - Revolving Credit Facility

The Tennessee State School Bond Authority (TSSBA) receives loans from the revolving credit facility to finance the costs of various capital projects during the construction phase. When projects are placed in service, TSSBA issues long-term, fixed-rate debt to finance the project over its useful payback period and repays the revolving credit facility debt. The amount issued for projects at the university was \$106,277,966.40 at June 30, 2017.

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

Note 10: Pledged Revenues

The University of Tennessee has pledged certain revenues and fees, including state appropriations, to repay \$806,354,896.64 in revenue bonds issued from January 2007 to June 2016. Proceeds from the bonds provided financing for construction and renovation projects. The bonds are payable through 2046. (See Note 9 for further details.) Annual principal and interest payments on the bonds are expected to require 5.06% of available revenues. The total principal and interest remaining to be paid on the bonds is \$1,271,268,915.74. Principal and interest paid for the current year and total available revenues were \$73,721,647.60 and \$1,455,669,011.70, respectively.

NOTE 11: PENSION PLANS

A. Defined Benefit Plans

1. Tennessee Consolidated Retirement System

Closed State and Higher Education Employee Pension Plan

General Information about the Pension Plan

Plan Description

State employees and higher education employees with membership in the Tennessee Consolidated Retirement System (TCRS) before July 1, 2014, are provided with pensions through the Closed State and Higher Education Employee Pension Plan. This plan is a component of the Public Employee Retirement Plan, an agent, multiple-employer defined benefit pension plan. The Closed State and Higher Education Employee Pension Plan stopped accepting new membership on June 30, 2014, but will continue providing benefits to existing members and retirees. Beginning July 1, 2014, a new agent defined benefit retirement plan, the State and Higher Education Employee Retirement Plan, became effective for state employees and higher education employees hired on or after July 1, 2014.

The TCRS was created by state statute under Title 8, Chapters 34-37, *Tennessee Code Annotated*. The TCRS Board of Trustees is responsible for the proper operation and administration of all employer pension plans in the TCRS. The Tennessee Treasury Department, an agency in the legislative branch of state government, administers the plans of the TCRS. The TCRS issues a publicly available financial report that can be obtained at www.treasury.tn.gov/tcrs.

Benefits Provided

Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes the benefit terms and can be amended only by the Tennessee General Assembly. Members of the Closed State and Higher Education Employee Pension Plan are eligible to retire with an unreduced benefit at age 60 with 5 years of service credit or after 30 years of service credit regardless of age. Benefits are determined using the following formula:

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Average of Member's Highest Compensation for 5 Consecutive Years (up to Social Security Integration Level)	x	1.50%	x	Years of Service	x	105%	Credit
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Plus:

Average of Member's Highest Compensation for 5 Consecutive Years (over the Social Security Integration Level)	x	1.75%	x	Years of Service	x	105%	Credit
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A reduced early retirement benefit is available at age 55 and vested. Members are vested with five years of service credit. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10 percent and include projected service credits. A variety of death benefits are available under various eligibility criteria. Member and beneficiary annuitants are entitled to automatic cost of living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to the 2nd of July of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3 percent, and applied to the current benefit. No COLA is granted if the change in the CPI is less than one-half percent. A one percent COLA is granted if the CPI change is between one-half percent and one percent. A member who leaves employment may withdraw their employee contributions, plus any accumulated interest.

Contributions

Contributions for state employees and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. The university's employees are non-contributory, as are most members in the Closed State and Higher Education Employee Pension Plan. State and higher education agencies make employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. By law, employer contributions for the Closed State and Higher Education Employee Pension Plan are required to be paid. Employer contributions by the university for the year ended June 30, 2017, to the Closed State and Higher Education Employee Pension Plan were \$46,326,637, which is 15.02 percent of covered payroll. The employer rate, when combined with member contributions, is expected to finance the costs of benefits earned by members during the year, the cost of administration, as well as an amortized portion of any unfunded liability.

Pension Liabilities, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension Liability

At June 30, 2017, the university reported a liability of \$239,530,566 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2016, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The university's proportion of the net pension liability was based on a projection of the university's contributions during the year ended June 30, 2016, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2016, measurement date, the university's proportion was 13.12809 percent. At the June 30, 2015, measurement date, the university's proportion was 12.930334 percent.

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Pension Expense

For the year ended June 30, 2017, the university recognized a pension expense of \$42,574,390.

Deferred Outflows of Resources and Deferred Inflows of Resources

For the year ended June 30, 2017, the university reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 13,432,712	\$ 12,727,668
Net difference between projected and actual earnings on pension plan investments	57,929,873	-
Changes in proportion of Net Pension Liability	3,795,566	-
The university's contributions subsequent to the measurement date of June 30, 2016	<u>46,326,637</u>	<u>-</u>
Total	<u>\$ 121,484,788</u>	<u>\$ 12,727,668</u>

Deferred outflows of resources, resulting from the university's employer contributions of \$46,326,637 subsequent to the measurement date will be recognized as a decrease in net pension liability in the year ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30:	
2018	\$ 4,325,088
2019	4,325,088
2020	36,951,965
2021	16,828,342

In the table above, positive amounts will increase pension expense, while negative amounts will decrease pension expense.

Actuarial Assumptions

The total pension liability as of the June 30, 2016, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0 percent
Salary increases	Graded salary ranges from 8.97 to 3.71 percent based on age, including inflation, averaging 4.25 percent
Investment rate of return	7.5 percent, net of pension plan investment expenses, including inflation
Cost-of-living adjustment	2.5 percent

Mortality rates were based on the June 30, 2012, actuarial experience study adjusted for some of the expected future improvement in life expectancy.

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The actuarial assumptions used in the June 30, 2016, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2008, through June 30, 2012. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees in conjunction with the June 30, 2012, actuarial experience study by considering the following three techniques: (1) the 25-year historical return of the TCRS at June 30, 2012; (2) the historical market returns of asset classes from 1926 to 2012 using the TCRS investment policy asset allocation; and (3) capital market projections that were utilized as a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Four sources of capital market projections were blended and utilized in the third technique. The blended capital market projection established the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding inflation of 3 percent. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

<u>Asset Class</u>	<u>Long-Term Expected Real Rate of Return</u>	<u>Target Allocation</u>
U.S. equity	6.46%	33%
Developed market international equity	6.26%	17%
Emerging market international equity	6.40%	5%
Private equity and strategic lending	4.61%	8%
U.S. fixed income	0.98%	29%
Real estate	4.73%	7%
Short-term securities	0.00%	1%
		<u>100%</u>

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees as 7.5 percent based on a blending of the three factors described above.

Discount Rate

The discount rate used to measure the total pension liability was 7.5 percent. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current rate and that contributions from all state and higher education agencies will be made at the actuarially determined contribution rate in accordance with the funding policy of the TCRS Board of Trustees and as required to be paid by state statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the Proportionate Share of the Net Pension Liability to Changes in the Discount Rate

The following presents the university's proportionate share of the net pension liability calculated using the discount rate of 7.5 percent, as well as what the university's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1-percentage-point lower (6.5 percent) or 1-percentage-point higher (8.5 percent) than the current rate:

	<u>1% Decrease (6.5%)</u>	<u>Current Discount Rate (7.5%)</u>	<u>1% Increase (8.5%)</u>
The university's proportionate share of the net pension liability	\$ 470,725,895	\$ 239,530,566	\$ 44,579,786

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Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in a separately issued TCRS financial report at www.treasury.tn.gov/tcrs.

Payable to the Pension Plan

At June 30, 2017, the university reported a payable of \$ 3,995,521.66 for the outstanding amount of legally required contributions to the pension plan required for the year ended June 30, 2017.

State and Higher Education Employee Retirement Plan

General Information about the Pension Plan

Plan Description

State employees and higher education employees with membership in the Tennessee Consolidated Retirement System (TCRS) before July 1, 2014, are provided with pensions through the Closed State and Higher Education Employee Pension Plan, an agent plan within the Public Employee Retirement Plan administered by the TCRS. TCRS is a multiple-employer pension plan. The Closed State and Higher Education Employee Pension Plan was closed effective June 30, 2014, and covers employees hired before July 1, 2014. Employees hired after June 30, 2014, are provided with pensions through a legally separate plan referred to as the State and Higher Education Employee Retirement Plan, an agent plan within the Public Employee Retirement Plan administered by the TCRS. The TCRS was created by state statute under Title 8, Chapters 34-37, *Tennessee Code Annotated*.

Benefits Provided

Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes the benefit terms and can be amended only by the Tennessee General Assembly. Members of the State and Higher Education Employee Retirement Plan are eligible to retire at age 65 with 5 years of service credit or pursuant to the rule of 90 in which the member's age and service credit total 90. Members are entitled to receive unreduced service retirement benefits, which are determined by a formula multiplying the member's highest five consecutive year average compensation by 1.0 percent multiplied by the member's years of service credit. A reduced early retirement benefit is available at age 60 with 5 years of service credit or pursuant to the rule of 80 in which a member's age and service credit total 80. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10 percent and include projected service credits. A variety of death benefits are available under various eligibility criteria.

Member and beneficiary annuitants are entitled to automatic cost-of-living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to the 2nd of July of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3 percent, and applied to the current benefit. No COLA is granted if the change in the CPI is less than one-half percent. A one percent COLA is granted if the CPI change is between one-half percent and one percent. A member who leaves employment may withdraw their employee contributions, plus any accumulated interest. Under the State and Higher Education Employee Retirement Plan, benefit terms and conditions, including COLA, can be adjusted on a prospective basis. Moreover, there are defined cost controls and unfunded liability controls that provide for the adjustment of benefit terms and conditions on an automatic basis.

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Contributions

Contributions for state employees and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. University employees contribute 5% of their salary to the State and Higher Education Employee Retirement Plan. The higher education institutions make employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. Per the statutory provisions governing the TCRS, the employer contribution rate cannot be less than 4% for all aggregate employee groups, except in years when the maximum funded level, approved by the TCRS Board of Trustees, is reached. By law, employer contributions for the State and Higher Education Employee Retirement Plan are required to be paid. Employer contributions by the university for the year ended June 30, 2017, to the State and Higher Education Employee Retirement Plan were \$ 2,283,615, which is 3.64 percent of covered payroll. The employer rate is 3.94% of covered payroll except for any salaries derived from federal funds where the employer rate is 1.13%. The employer rate, when combined with member contributions, is expected to finance the costs of benefits earned by members during the year and the cost of administration, as well as an amortized portion of any unfunded liability.

Pension Assets, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension Asset

At June 30, 2017, the university reported an asset of \$1,003,190 for its proportionate share of the net pension asset. The net pension asset was measured as of June 30, 2016, and the total pension asset used to calculate the net pension asset was determined by an actuarial valuation as of that date. The university's proportion of the net pension asset was based on a projection of the university's contributions during the year ended June 30, 2016, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2016, measurement date, the university's proportion was 11.908035 percent. At the June 30, 2015, measurement date, the university's proportion was 11.730576 percent.

Pension Expense

For the year ended June 30, 2017, the university recognized a pension expense of \$561,271.

Deferred Outflows of Resources and Deferred Inflows of Resources

For the year ended June 30, 2017, the university reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	<u>Deferred Outflows of Resources</u>	<u>Deferred Inflows of Resources</u>
Differences between expected and actual experience	\$ 72,988	\$ 107,807
Net difference between projected and actual earnings on pension plan investments	116,985	-
Changes in proportion of Net Pension Asset		3,009
The university's contributions subsequent to the measurement date of June 30, 2016	<u>2,283,615</u>	-
Total	<u>\$ 2,473,588</u>	<u>\$ 110,816</u>

Deferred outflows of resources, resulting from the university's employer contributions of \$2,283,615 subsequent to the measurement date, will be recognized as a decrease in net pension liability in the year

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ended June 30, 2018. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30:	
2018	\$ 23,794
2019	23,794
2020	23,794
2021	18,991
2022	(6,653)
Thereafter	(4,563)

In the previous table, positive amounts will increase pension expense, while negative amounts will decrease pension expense.

Actuarial Assumptions

The total pension asset as of the June 30, 2016, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0 percent
Salary increases	Graded salary ranges from 8.97 to 3.71 percent based on age, including inflation, averaging 4.25 percent
Investment rate of return	7.5 percent, net of pension plan investment expenses, including inflation
Cost-of-living adjustment	2.5 percent

Mortality rates were customized based on the June 30, 2012, actuarial experience study and included an adjustment for expected future improvement in life expectancy.

The actuarial assumptions used in the June 30, 2016, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2008, through June 30, 2012. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees in conjunction with the June 30, 2012, actuarial experience study by considering the following three techniques: (1) the 25-year historical return of the TCRS at June 30, 2012; (2) the historical market returns of asset classes from 1926 to 2012 using the TCRS investment policy asset allocation; and (3) capital market projections that were utilized as a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Four sources of capital market projections were blended and utilized in the third technique. The blended capital market projection established the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding inflation of 3 percent. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Long-Term Expected Real Rate of Return	Target Allocation
U.S. equity	6.46%	33%
Developed market international equity	6.26%	17%
Emerging market international equity	6.40%	5%
Private equity and strategic lending	4.61%	8%
U.S. fixed income	0.98%	29%
Real estate	4.73%	7%
Short-term securities	0.00%	1%
		100%

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The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees as 7.5 percent based on a blending of the three factors described above.

Discount Rate

The discount rate used to measure the total pension asset was 7.5 percent. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current rate and that contributions from the all state and higher education agencies will be made at the actuarially determined contribution rate in accordance with the funding policy of the TCRS Board of Trustees and as required to be paid by state statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension asset.

Sensitivity of the proportionate share of the net pension asset to changes in the discount rate

The following presents the university's proportionate share of the net pension asset calculated using the discount rate of 7.5 percent, as well as what University of Tennessee's proportionate share of the net pension asset would be if it were calculated using a discount rate that is 1-percentage-point lower (6.5 percent) or 1-percentage-point higher (8.5 percent) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
University's proportionate share of the net pension asset	\$119,967	\$1,003,190	\$1,664,861

Pension Plan Fiduciary Net Position

Detailed information about the pension plan's fiduciary net position is available in a separately issued TCRS financial report at www.treasury.tn.gov/tcrs.

Payable to the Pension Plan

At June 30, 2017, the university reported a payable of \$367,371.94 for the outstanding amount of legally required contributions to the pension plan required for the year ended June 30, 2017.

Total Defined Benefit Pension Expense

The total pension expense for the year ended June 30, 2017, for all state and local government defined benefit pension plans was \$43,135,661.00.

2. Federal Retirement Program

Plan Description

The University of Tennessee contributes to the Federal Retirement Program, a cost-sharing, multiple-employer, defined benefit pension plan administered by the Civil Service Retirement System (CSRS) for participants employed prior to January 1, 1987, and the Federal Employees Retirement System (FERS) for participants employed after

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December 31, 1986. U.S. Office of Personnel Management manages both systems. All regular full-time employees of the University of Tennessee Agricultural Extension Service who hold federal appointments for 51% or more of their time are required to participate in either one of the two Federal Retirement Programs. For both systems, benefit provisions are established in federal statutes. Federal statutes are amended by the U.S. Congress. There were 152 employees in Federal Retirement Programs in 2016, 30 in CSRS and 122 in FERS. Both systems provide retirement, death, and disability benefits, as well as annual cost-of-living adjustments, to plan members and their beneficiaries. Benefits are based on high 3-year average salary and years of service. CSRS employees can retire with 5 years of service at age 62, at age 60 with 20 years of service, or at 55 with 30 years of service. FERS employees can retire with 10 years of service at a minimum retirement age from 55-57 depending on year of birth. For both plans, former employees who leave the job before becoming eligible for retirement can either ask that their retirement contributions be returned or wait until age requirements are met to receive monthly benefits, provided years of service requirements have been met. Benefit estimates are available at: <https://www.opm.gov/retirement-services/fers-information/computation/>.

CSRS and FERS issue publicly available financial reports that include financial statements and required supplementary information. These reports may be obtained by writing to the Office of Personnel Management, Retirement Information Office, P.O. Box 45, Boyers, PA 16017-0045, or by calling (202) 606-0500.

Funding Policy

Participating employees, with some exceptions, are required by federal statute to contribute 7.0% of covered salaries to the CSRS plan. The university is currently required to contribute 7.0%. Contributions to CSRS for the year ended June 30, 2017, were \$329,374.46, which consisted of \$169,500.25 from the university and \$159,874.21 from the employees. At June 30, 2017, the university reported a payable of \$12,721.19 for the outstanding amount of legally required contributions to the CSRS pension plan for the year ended June 30, 2017.

Federal statute requires employees participating in FERS to contribute 0.8% of their salaries to the Basic Benefit Plan. The university is required to contribute 13.2%. In addition, the university is required to contribute 1% of each participant's salary to the Thrift Savings Plan plus up to an additional 4% depending upon employees' contributions, which can range from 0 to 10% of their salaries. Contributions to FERS for the year ended June 30, 2017, were \$2,319,987.77, which consisted of \$1,639,831.43 from the university and \$680,156.34 from the employees. At June 30, 2017, the university reported a payable of \$102,550.34 for the outstanding amount of legally required contributions to the FERS pension plan required for the year ended June 30, 2017.

B. Defined Contribution Plans

1. Optional Retirement Plans (ORP)

Plan Description

The university contributes to the Optional Retirement Plan (ORP). The ORP, administered by the Tennessee Treasury Department, is a defined contribution plan. The ORP was established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated*. This statute also sets out the plan provisions. The plan provisions are amended by the Tennessee General Assembly. The ORP was designed to provide benefits at retirement to faculty and staff who are exempt from the overtime provision of the Fair Labor Standards Act and who waive membership in the TCRS. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings.

Funding Policy

For employees employed prior to July 1, 2014, plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to social security wage base and 11% above the social security wage base. For employees hired after June 30, 2014, plan members will contribute 5% to the ORP, and the

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university will contribute 9% of the employee's base salary. Pension expense equaled the required contributions made to the ORP and were \$47,664,353.97 for the year ended June 30, 2017, and \$46,719,427.83 for the year ended June 30, 2016. Contributions met the requirements for each year.

Members are immediately 100% vested in the employer contributions made pursuant to the ORP. The Treasury Department has selected three investment vendors who offer a variety of investment products in which members are responsible for selecting how the contributions are invested. Each member makes the decision when to reallocate future contributions or when to transfer funds from one investment product to another. Funds are held by the investment vendor in the name of the member, not in the name of the State of Tennessee. The State of Tennessee has no discretion over these funds other than to make the initial contributions. Accordingly, the State of Tennessee is not acting in a trustee capacity, nor does it have a fiduciary responsibility for the funds held by the investment vendors.

2. Joint Contributory Retirement System Plan A (JCRS-A)

Plan Description

The Joint Contributory Retirement System Plan A (JCRS-A) is a defined contribution plan with minimum benefits and is administered by the Tennessee Consolidated Retirement System and TIAA-CREF. Employees who were enrolled in the Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF) before July 1977 are members of JCRS-A. Enrollment in this plan for new employees has been closed since July 1977.

Although JCRS-A members participate in the optional retirement plans described above, they may also, under certain circumstances, receive a supplementary benefit from the State of Tennessee. Plan provisions are established by Title 8, Chapter 35, Part 4, *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly.

Funding Policy

Plan members are noncontributory. The university's contributions for JCRS-A members were calculated using the base salary amounts of \$7,642,103.59 for fiscal year 2017, and \$10,118,296.81 for fiscal year 2016. Contribution requirements are established and amended by state statute. The contributions are included in the ORP amounts. University contributions to fund the state supplemental benefit totaled \$1,147,847.02 in fiscal year 2017, and \$1,520,779.72 in fiscal year 2016. Contributions met the requirements for each year.

3. Deferred Compensation Plans

Employees are offered three deferred compensation plans. The university, through the State of Tennessee, provides two plans, one established pursuant to the *Internal Revenue Code* (IRC), Section 457, and the other pursuant to IRC, Section 401(k). The third plan is administered by the university and was established in accordance with IRC, Section 403(b). The plans are outsourced to third party vendors, and the administrative costs assessed by the vendors of these plans are the responsibility of plan participants. Section 401(k), Section 403(b), and Section 457 plan assets remain the property of the contributing employees; therefore, they are not presented in the accompanying financial statements. IRC Sections 401(k), 403(b), and 457 establish participation, contribution, and withdrawal provisions for the plans. Participation in the 403(b) and the 457 plans are voluntary for employees. The university provides up to a \$50 monthly employer match for employees who participate in the state's 401(k) plan. Employees hired before July 1, 2014, voluntarily participate in the state's 401(k) plan. Pursuant to Chapter 259 of the *Public Acts of 2013*, employees hired after June 30, 2014, are automatically enrolled in the state's 401(k) plan and contribute 2% of their salary, with the employer contributing an additional non-matching 5%. Employees may opt out of the 2% auto enrollment. Such contribution rates may only be amended by the Tennessee General Assembly. There are certain automatic cost controls and unfunded liability controls in the defined benefit plan where the employees participate that may impact the non-matching 5% employer contribution to the 401(k) plan.

Employees are immediately vested in both the employee and employer contributions in all plans. The IRC establishes maximum limits that an employee can contribute to these plans. The employee may increase, decrease, or stop contributions at any time for all three plans.

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During the year ended June 30, 2017, contributions totaling \$24,293,328.80 were made by employees participating in the 401(k) plan, and the university recognized pension expense of \$9,029,995.93 for employer contributions. During the year ended June 30, 2016, contributions totaling \$22,636,968.05 were made by employees participating in the 401(k) plan, and the university recognized pension expense of \$7,413,475.25 for employer contributions.

Note 12: Other Postemployment Benefits

Healthcare is the only “other postemployment benefit” (OPEB) provided to employees. The State of Tennessee administers a group health insurance program which provides postemployment health insurance benefits to eligible university retirees. This program includes two plans available to higher education employees – the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Section 8-27-201, *Tennessee Code Annotated*, for the State Employee Group Plan and for the Medicare Supplement Plan. The State Employee Group Plan covers retirees until they reach the age of 65. Members have the option of choosing between the standard or partnership preferred provider organization plan for healthcare benefits. Subsequent to age 65, members who are also in the state’s retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. Employees hired on or after July 1, 2015, are not eligible to continue insurance coverage at retirement in either the Employee Group Plan or the Medicare Supplement Plan. The state makes on-behalf payments to the Medicare Supplement Plan for the university’s eligible retirees; see Note 21. The plans are reported in the *Tennessee Comprehensive Annual Financial Report (CAFR)*. The CAFR is available on the state’s website at www.tn.gov/finance/fa-accfin-cafr.

Special Funding Situation

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

Funding Policy

The premium requirements of members of the State Employee Group Plan are established and may be amended by the insurance committee. The plan is self-insured and financed on a pay-as-you-go basis with the risk shared equally among the participants. The plan’s claims liabilities are periodically computed using actuarial and statistical techniques to establish premium rates. The plan’s administrative costs are allocated to plan participants. Retired members pay the same base premium, adjusted for years of service, as active employees. Retirees with 30 years of service are subsidized 80%; retirees with 20 years of service but less than 30 years of service, 70%; and retirees with less than 20 years of service, 60%.

Retirees in the Medicare Supplement Plan have flat-rate premium subsidies based on years of service. Retirees with 30 years of service receive \$50 per month; retirees with 20 years of service but less than 30 years of service, \$37.50; and retirees with 15 years of service but less than 20 years of service, \$25.

Annual OPEB Cost and Net OPEB Obligation

	State Employee Group Plan
Annual Required Contribution (ARC)	\$ 21,246,000.00
Interest on Net OPEB Obligation	3,972,000.00
Adjustment to the ARC	(3,988,000.00)
Annual OPEB Cost	\$ 21,230,000.00
Amount of Contribution	(16,758,914.83)
Increase/Decrease in Net OPEB Obligation	\$ 4,471,085.17
Net OPEB Obligation – beginning of year	105,913,005.09
Net OPEB Obligation – end of year	\$ 110,384,090.26

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Year End	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
6/30/2015	State Employee Group Plan	\$ 20,974,000.00	71.76%	\$ 100,041,516.55
6/30/2016	State Employee Group Plan	\$ 20,536,000.00	71.41%	\$ 105,913,005.09
6/30/2017	State Employee Group Plan	\$ 21,230,000.00	78.94%	\$ 110,384,090.26

Funded Status and Funding Progress

The funded status of the university's portion of the State Employee Group Plan as of July 1, 2015, was as follows:

	State Employee Group Plan
Actuarial valuation date	July 1, 2015
Actuarial accrued liability (AAL)	\$ 189,285,000.00
Actuarial value of plan assets	0.00
Unfunded actuarial accrued liability (UAAL)	\$ 189,285,000.00
Actuarial value of assets as a % of the AAL	0%
Covered payroll (active plan members)	\$ 724,441,524.65
UAAL as percentage of covered payroll	26.1%

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

Actuarial Methods and Assumptions

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

In the July 1, 2015, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 3.75 percent investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 6.5 percent initially. The rate decreased to 6 percent in fiscal year 2016, and then reduces by decrements to an ultimate rate of 4.7 percent in fiscal year 2050. All rates include a 2.5 percent inflation assumption. Premium subsidies in the Medicare Supplement plan are projected to remain unchanged and, consequently, trend rates are not applicable. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007. Payroll is assumed to grow at a rate of 3 percent.

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Note 13: Chairs of Excellence

Since fiscal year 1985, the Tennessee General Assembly has appropriated \$22 million to a Chairs of Excellence Endowment for the University of Tennessee. The appropriations provided that the Chairs of Excellence Endowment be established as an irrevocable trust with the State Treasurer and required the university to match the appropriation on a dollar-for-dollar basis. The university has fully matched 50 chairs as of June 30, 2017. The financial statements of the university include as expenses the amounts expended in the current year to match the state appropriations. The university's statement of net position does not include the amounts held in trust by the State Treasurer. At June 30, 2017, the amounts held in trust totaled \$152,220,061.05 at fair value.

Note 14: Joint Ventures

UT-Battelle

The university is a participant in a joint venture with Battelle Memorial Institute for the sole purpose of management and operation of the Oak Ridge National Laboratory (ORNL) for the U. S. Department of Energy. Each entity has a 50% interest in the venture, each having provided an initial investment of \$125,000.00. The university's equity interest was \$5,072,520 at June 30, 2017. The university and Battelle each receive a 50% distribution of the ORNL management fee after shared expenses are deducted. The fee distribution to the university for the year ended September 30, 2016, was \$3,947,529.53.

During the year ended June 30, 2017, the university had expenses of \$27,172,387.51 under contracts with UT-Battelle. Amounts receivable from UT-Battelle under these contracts totaled \$2,337,424.21 at June 30, 2017. To review the audit report of UT-Battelle, please contact the Controller's Office, The University of Tennessee, 201 Andy Holt Tower, Knoxville, Tennessee 37996-0100.

UT Le Bonheur Pediatric Specialists

The university is a participant in a joint venture with Methodist Healthcare – Memphis Hospitals, Le Bonheur Children's Hospital, for the sole purpose of governance, management, and support of the UT Le Bonheur Pediatric Specialists, Inc. (ULPS), a nonprofit faculty group practice comprised of pediatric physicians holding hospital privileges at Le Bonheur who are employed as UT Health Science Center faculty members. The practice group was incorporated on September 9, 2010, and began operations in January 2011.

Both the university and Methodist Healthcare provided an advance to the joint venture in the 2011 fiscal year so that the faculty practice group could begin its operations. In addition, the university and Methodist Healthcare have agreed to guarantee the losses of ULPS equally and provide cash on a monthly basis to meet the operating needs of ULPS. During the 2017 fiscal year, the university remitted another \$14,828,893.00 for these purposes.

To review the audit report of UT Le Bonheur Pediatric Specialists, Inc., please contact the Controller's Office, The University of Tennessee, 201 Andy Holt Tower, Knoxville, Tennessee 37996-0100.

Note 15: Insurance-Related Activities

It is the policy of the state not to purchase commercial insurance for the risks associated with casualty losses for general liability, automobile liability, professional medical malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund (RMF). The state purchases commercial insurance for real property, builder's risk (for construction projects starting prior to July 1, 2012), and crime and fidelity coverage on the state's officials and employees, and cyber liability coverage. The contractor is responsible for acquiring builder's risk insurance for all construction projects after June 30, 2012; thus builder's risk is no longer covered by the Risk Management Fund. For property coverage, the deductible for an individual state agency is the first \$25,000 of losses. The RMF is responsible

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for property losses for the annual aggregate deductible of \$7.5 million for perils other than earthquakes and flood. Purchased insurance coverage is responsible for losses exceeding the \$7.5 million annual aggregate deductible. For earthquake and flood, there is a deductible of \$10 million per occurrence. The maximum insurance coverage is \$750 million per year for perils other than earthquake and flood. The maximum flood insurance coverage is \$50 million per occurrence, except there is only \$25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is \$50 million per occurrence. The amounts of settlements have not exceeded insurance coverage for each of the three past fiscal years.

The university participates in the RMF. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the year ended June 30, 2017, is presented in the *Tennessee Comprehensive Annual Financial Report (CAFR)*. The CAFR is available on the state's website at www.tn.gov/finance/article/fa-accfin-cafr. Since the university participates in the Risk Management Fund, it is subject to the liability limitations established by statute. The maximum liability for general liability, automobile liability, and medical malpractice liability is \$300,000 per person and \$1,000,000 per occurrence. Claims are paid through the state's Risk Management Fund. At June 30, 2017, the Risk Management Fund held \$167 million in cash designated for payment of claims.

At June 30, 2017, the scheduled coverage for the university was \$5,758,627,004 for buildings and \$1,242,093,873 for contents.

The university also carries commercial insurance for losses related to hired and non-owned automobiles, losses related to railroad protection, and losses related to six university-owned aircraft. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years.

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

Note 16: Commitments and Contingencies

A. Construction Commitment

The university has contractual obligations for the construction of new buildings and additions to and renovations of existing buildings. The outstanding commitments under such contracts at June 30, 2017, were \$252,207,930.16, of which \$73,694,234.70 of these costs will be funded with future state capital outlay appropriations.

B. Sick Leave

The university records the cost of sick leave when paid. The dollar amount of unused sick leave was \$351,867,326.31 at June 30, 2017.

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C. Grants and Contracts

The university receives grants and contracts from various federal and state agencies to fund research and other activities. The costs, both direct and indirect, charged to these grants and contracts are subject to audit and disallowance by the granting agency. The university administration believes that any disallowance or adjustments would not have a material effect on the university's financial position.

D. Nonvested Equipment

Equipment in the possession of the university valued at \$3,937,769.31 as of June 30, 2017, is not reflected in the financial statements. This equipment was purchased with restricted grant and contract funds and other funds, and title has not yet transferred to the university.

E. Litigation

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

Note 17: Lease and Transfer of UT Memorial Research Center and Hospital

On July 29, 1999, the university transferred ownership and control of its hospital located in Knoxville to University Health Systems, Inc., (UHS), an independent, private, not-for-profit organization operating under its own *Internal Revenue Code*, Section 501(c)(3) designation. The lease and transfer of the hospital from the university to UHS was accomplished through three main agreements: the Lease and Transfer Agreement, the Employee Services Agreement, and the Affiliation Agreement. Each of these agreements is summarized below.

Lease and Transfer Agreement – pursuant to the enabling legislation, *Tennessee Code Annotated*, Section 49-9-112 and Section 49-9-1301 et seq., UHS leased from the university the real property of the existing hospital and the Graduate School of Medicine. (See also Note 19.) The term of the lease is 50 years. The university also transferred to UHS all operating assets of the hospital. The consideration for the lease of the real property and transfer of the operating assets was payment by UHS of a) a sum sufficient to economically defease all of the debt issued by the Tennessee State School Bond Authority in the amount of \$149,080,353.69, b) \$25,000,000.00 paid to the university at closing, and c) a variable lease obligation of \$50,000,000.00 to be paid to the university over twenty years. UHS assumed all prior hospital liabilities, known or unknown. In 2019, the university and UHS have agreed to negotiate an annual lease payment for the remaining 30 years of the lease.

Employee Services Agreement – UHS has leased from the university all hospital employees as of the date of closing. UHS has paid to the university the amounts incurred by the university to pay the direct expenses relating to the hospital employees, including wages, salaries, and fringe benefits. These payroll expenses on behalf of UHS, totaling \$43,720,272.03 in 2017, are reported as operating expenses in the statement of revenues, expenses, and changes in net position. An equal amount of operating revenue is reported in the nongovernmental grants and contracts category. The term of the Employee Services Agreement is 50 years. All persons who began service at the hospital after the date the Employee Service Agreement was signed are employees of UHS and not university employees.

Affiliation Agreement – the university and UHS agreed that UHS will continue to support the Graduate School of Medicine by providing appropriate facilities and resources of the hospital to the faculty and students at the Graduate School of Medicine. UHS agreed to pay the university \$1,500,000 at closing for the benefit of the Graduate School of Medicine. In addition, UHS must pay monthly to the university, for the benefit of the Graduate School of Medicine, the government funding, direct and indirect medical education funds, TennCare medical education funds, and other medical education funds received by UHS for the benefit of the Graduate School of Medicine. The amount payable by UHS shall be reduced by a) the fair market rental value of the space provided to the Graduate School of Medicine; b) the fair market value of the information system, telecommunication, network infrastructure, and human

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resource services provided by UHS to the Graduate School of Medicine; and c) retroactive adjustments made by payers to the graduate medical education payments.

Note 18: Transfer of Development Operations to the University of Tennessee Foundation

On July 1, 2011, the university transferred its Development and Alumni Affairs operations to the University of Tennessee Foundation, Inc., a not-for-profit component unit created to support the University of Tennessee. The foundation supports the university's educational, research, and public activities by securing and administering private funds to support programs beyond the scope of the university's general budget. (See also Note 23.) Pursuant to the University of Tennessee Board of Trustees' approval and the enabling legislation, *Tennessee Code Annotated*, Section 49-9-113, the university and the foundation signed an Affiliation and Services Agreement and an Employee Services Agreement to effect the transfer.

Affiliation and Services Agreements – the university and the foundation agreed that all gifts, unless directed otherwise by the donor or given in support of the University of Tennessee at Chattanooga, be deposited into the foundation bank account and that the university pay the foundation direct support and a 100 basis point endowment assessment fee as compensation for performing the fundraising function. The direct support amount is to be reviewed annually, and the foundation President and Chief Executive Officer, who is also the university's Vice President for Development and Alumni Affairs, coordinates fundraising goals and objectives of the foundation with the university. For fiscal year 2017, the university provided the foundation direct support of \$21,677,181.00 and endowment assessment fees of \$7,121,604.00.

A separate affiliation agreement provides that the University of Chattanooga Foundation receives all private gifts in support of the University of Tennessee at Chattanooga unless otherwise directed by the donor.

Employee Services Agreement – the foundation has paid to the university the amounts incurred by the university to pay the direct expenses relating to the Development and Alumni Affairs employees, including wages, salaries, and fringe benefits. These payroll expenses on behalf of the foundation, totaling \$22,770,830.83 in fiscal year 2017, are reported as operating expenses in the statement of revenues, expenses, and changes in net position. An equal amount of operating revenue is reported in the nongovernmental grants and contracts category.

Note 19: Capital Leases of Real Property

Capital Lease of Real Property to University Health Systems, Inc.

The university has leased the real property of the UT Memorial Research Center and Hospital to UHS for a term of 50 years. This lease is pursuant to the Lease and Transfer Agreement described in Note 17. This lease is classified as a direct financing lease. The guaranteed lease payment of \$50 million will be paid by UHS in annual payments through 2020. The amount of the annual payments will equal the lesser of 1) 20% of the hospital's net operating profit for the applicable calendar year; or 2) \$3 million or the greater amount resulting from the application of an index, as specified in the agreement. The payment of \$50 million is guaranteed by March 15, 2021. In 2019, the university and UHS have agreed to negotiate an annual lease payment for the remaining 30 years of the lease. An annual lease payment to the university during the year ended June 30, 2017, totaled \$1,010,213.00.

The university recorded a lease payment receivable in the amount of \$33,643,818.17 at June 30, 2017, which represents the net present value of the guaranteed \$50 million discounted at 5.75%. The minimum lease payments to be received amount has been adjusted upward to reflect a contractually required adjustment to the final required lease payment.

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June 30, 2017

Total minimum lease payments to be received	\$ 40,323,736.38
Less: unearned income	<u>(6,679,918.21)</u>
Net investment in direct financing lease	<u>\$ 33,643,818.17</u>

Capital Lease of Real Property to Memphis Mental Health Institute

On November 5, 2005, the university entered into a facility lease agreement with the Tennessee Department of Mental Health and Substance Abuse Services (TDMHSAS) to provide a new building to house the Memphis Mental Health Institute. The building is a joint project of the university, Methodist Healthcare, Shelby County Health Care Authority (The MED), the State of Tennessee, and Shelby County. This lease is classified as a direct financing lease. The guaranteed lease payments will be paid by TDMHSAS in semiannual payments through 2027.

The amount of the semiannual payments will equal the amount to retire the debt from the construction project and any other project costs incurred by the university in excess of the funds contributed by Methodist Healthcare and the MED. During the term of the lease, TDMHSAS will be responsible for all operational and maintenance costs associated with the facility.

The university recorded a lease payment receivable in the amount of \$10,174,667.86 at June 30, 2017:

Total minimum lease payments to be received	\$ 12,651,341.16
Less: unearned income	<u>(2,476,673.30)</u>
Net investment in direct financing lease	<u>\$ 10,174,667.86</u>

Year Ended June 30	Minimum Lease Payments to be received	Interest	Principal
2018	\$ 1,363,811.62	\$ 455,448.89	\$ 908,362.73
2019	1,365,645.82	414,787.83	950,857.99
2020	1,367,560.68	372,224.55	995,336.13
2021	1,369,559.64	327,670.29	1,041,889.35
2022	1,371,646.46	281,032.18	1,090,614.28
2023-2027	5,813,116.94	625,509.56	5,187,607.38
	<u>\$12,651,341.16</u>	<u>\$2,476,673.30</u>	<u>\$10,174,667.86</u>

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Note 20: Natural Classifications with Functional Classifications

The university's operating expenses by functional classification for the year ended June 30, 2017, are as follows:

NATURAL CLASSIFICATION

<u>FUNCTIONAL CLASSIFICATION</u>	<u>Salaries</u>	<u>Benefits</u>	<u>Utilities, Supplies, and Other Services</u>	<u>Scholarships</u>	<u>Depreciation</u>	<u>Total</u>
Instruction	\$ 465,291,236.00	\$ 135,623,480.56	\$ 94,984,473.46	\$ -	\$ -	\$ 695,899,190.02
Research	138,161,881.93	34,360,589.13	72,846,896.28	-	-	245,369,367.34
Public Service	75,740,303.66	27,558,786.42	35,862,739.31	-	-	139,161,829.39
Academic Support	99,814,865.78	33,468,711.27	51,704,730.31	-	-	184,988,307.36
Student Services	47,871,796.22	17,201,362.93	28,994,451.92	-	-	94,067,611.07
Institutional Support	83,591,984.10	29,107,882.14	24,356,755.10	-	-	137,056,621.34
Operation and Maintenance of Plant	45,580,695.85	19,703,757.20	106,371,699.09	-	-	171,656,152.14
Scholarships and Fellowships	4,067,607.56	33,028,054.02	939,923.27	56,019,129.43	-	94,054,714.28
Auxiliary	58,357,065.90	14,399,261.55	95,209,408.71	-	-	167,965,736.16
Independent Operations	48,165,856.54	18,150,247.89	-	-	-	66,316,104.43
Depreciation	-	-	-	-	<u>117,924,769.24</u>	<u>117,924,769.24</u>
Total Expenses	<u>\$ 1,066,643,293.54</u>	<u>\$ 362,602,133.11</u>	<u>\$ 511,271,077.45</u>	<u>\$ 56,019,129.43</u>	<u>\$117,924,769.24</u>	<u>\$ 2,114,460,402.77</u>

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Note 21: On-Behalf Payments

During the year ended June 30, 2017, the State of Tennessee made payments of \$ 1,231,825.00 on behalf of the university for retirees participating in the Medicare Supplement Plan. The Medicare Supplement Plan is a postemployment benefit healthcare plan and is discussed further in Note 12. The plan is reported in the Tennessee *Comprehensive Annual Financial Report* (CAFR). That report is available on the state's website at www.tn.gov/finance/fa-acffin-cafr.

Note 22: Component Unit – University of Chattanooga Foundation

The University of Chattanooga Foundation, Inc., is a private nonprofit organization that reports under Financial Accounting Standards Board (FASB) standards. As such, certain revenue recognition criteria and presentation features are different from revenue recognition criteria and presentation features as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements of this foundation have been reformatted into a GASB format and are reported in a separate column to the right of the university's statements.

The University of Chattanooga Foundation, Inc., is a legally separate, tax-exempt organization supporting the University of Tennessee at Chattanooga. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of the University of Tennessee at Chattanooga. The 49-member board of trustees of the foundation is self-perpetuating and consists of friends of the University of Tennessee at Chattanooga. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the University of Tennessee at Chattanooga, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2017, the foundation expended \$7,662,000.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from the University of Chattanooga Foundation, Development Office, Department 6806, 615 McCallie Avenue, Chattanooga, TN 37403-2598.

Organization and Nature of Activities

The foundation is a tax exempt organization under the provisions of Section 509(a)(1) of the *Internal Revenue Code*, dedicated to supporting excellence in higher education through special projects for the University of Tennessee at Chattanooga. Proposals for special projects are submitted by the chancellor of the university and approved by the foundation's board of trustees and the University of Tennessee board of trustees.

Principles of Consolidation

The consolidated financial statements of the foundation include the accounts of the foundation and its subsidiaries, Campus Development Foundation, Inc. (CDFI) and CDFI Phase I, LLC (the LLC). All material intercompany accounts and transactions have been eliminated in consolidation.

CDFI was formed by the foundation to engage in charitable, scientific, and educational projects within the meaning of Section 501 (c)(3) of the *Internal Revenue Code*. The projects include, but are not limited to, the acquisition of real property and the construction, management, and operation of dormitories for students of the university. The directors of CDFI are appointed by the executive committee of the foundation.

CDFI is the sole member of its subsidiary, the LLC. The LLC was formed to own and develop an elementary school in downtown Chattanooga and student housing at the university. The student housing consists of 1,748 bedrooms in 456 units and 666 parking spaces.

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Investments

A summary of foundation investments at June 30, 2017, is as follows:

Mutual funds	\$ 64,731,001
Limited partnerships	<u>60,271,565</u>
Total	<u>\$125,002,566</u>

The foundation also has investments restricted by the terms of the revenue bonds described below, totaling \$11,380,608.

Property and Equipment

A summary of foundation property and equipment at June 30, 2017, is as follows:

Land	\$ 8,241,032
Buildings	76,192,526
Furniture, fixtures, and equipment	<u>7,098,699</u>
	91,532,257
Accumulated depreciation	<u>(44,485,258)</u>
Total	<u>\$ 47,046,999</u>

Revenue Bonds Payable

During November 2015, the Health, Educational, and Housing Facility Board of the City of Chattanooga issued series 2015 tax-exempt revenue refunding bonds totaling \$65,895,000. The LLC is the borrower on the Series 2015 bonds. The proceeds of the refunding bonds were primarily used to retire early the two series of tax-exempt revenue bonds issued in 2005. The two series of tax-exempt revenue bonds issued during May 2005 totaling \$91,510,000 were primarily used to retire early the three series of tax-exempt revenue bonds issued in 2000 and 2001. The 2000 and 2001 bonds were used to acquire land, fund construction of the student housing, and develop an elementary school near the student housing.

Revenue bonds payable at June 30, 2017, consist of the following:

Series 2015 revenue refunding bonds, interest rates fixed at 3.0% to 5.0% payable semi-annually, annual redemption payments due through October 1, 2035	\$ 63,775,000
Plus: unamortized premium	5,301,703
Less: unamortized bond issuance costs	<u>(793,332)</u>
	<u>\$ 68,283,371</u>

Sinking fund requirements for scheduled redemptions of the revenue bonds for the next five years and thereafter are as follows:

<u>Year Ended</u>	
June 30, 2018	2,210,000
June 30, 2019	2,305,000
June 30, 2020	2,370,000
June 30, 2021	2,460,000
June 30, 2022	2,580,000
Thereafter	<u>51,850,000</u>
	<u>\$ 63,775,000</u>

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Fair Value Measurements

The foundation reports under FASB Accounting Standards Codification (ASC) Topic 820, which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and prescribes disclosures about fair value measurements.

FASB ASC Topic 820 requires the categorization of assets and liabilities into three levels based upon the assumptions (inputs) used to value the assets or liabilities. Level 1 provides the most reliable measure of fair value, whereas Level 3 generally requires significant management judgment. The three levels are defined as follows:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the foundation has the ability to access.

Level 2 - Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect management's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The table below presents the recorded amount of assets and liabilities measured at fair value on a recurring basis:

	Balance as of June 30, 2017	Quoted Prices in Active Markets For Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets:				
Mutual funds	\$ 64,731,001	\$ 63,858,107	\$ 872,894	\$ -
U.S. Treasury money market fund	11,380,608	11,380,608	-	-
Limited partnerships	<u>60,271,565</u>	<u>-</u>	<u>-</u>	<u>60,271,565</u>
Total assets	<u>\$ 136,383,174</u>	<u>\$ 75,238,715</u>	<u>\$ 872,894</u>	<u>\$ 60,271,565</u>
Liabilities:				
Deposits received for the benefit of others	<u>\$ 2,502,687</u>	<u>\$ 2,502,687</u>	<u>\$ -</u>	<u>\$ -</u>
Total liabilities	<u>\$ 2,502,687</u>	<u>\$ 2,502,687</u>	<u>\$ -</u>	<u>\$ -</u>

The table below presents additional information about assets measured at fair value on a recurring basis by reliance on Level 3 inputs to determine fair value.

	<u>Limited Partnerships</u>
Beginning balance	\$ 54,761,907
Total realized and unrealized gains and losses included in earnings	2,245,402
Purchases, sales, and other	<u>3,264,256</u>
Ending balance	<u>\$ 60,271,565</u>

Endowments

The foundation's endowment consists of approximately 300 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the board of trustees to function as endowments. As required by accounting principles generally accepted in the United States of America (GAAP), net assets associated with endowment funds, including funds designated by the board of trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

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Interpretation of Relevant Law - The board of trustees of the foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, the foundation classifies as permanently restricted net assets (a) the original value of gifts donated to the permanent endowment, (b) the original value of subsequent gifts to the permanent endowment, and (c) accumulations to the permanent endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets until those amounts are appropriated for expenditure by the organization in a manner consistent with the standard of prudence prescribed by UPMIFA. In accordance with UPMIFA, the organization considers the following factors in making a determination to appropriate or accumulate donor-restricted endowment funds:

- (1) The duration and preservation of the fund.
- (2) The purposes of the foundation and the donor-restricted endowment fund.
- (3) General economic conditions.
- (4) The possible effect of inflation and deflation.
- (5) The expected total return from income and the appreciation of investments.
- (6) Other resources of the foundation.
- (7) The investment policies of the foundation.

Endowment net assets by type of fund consist of the following at June 30, 2017. Due to GASB reformatting, temporarily restricted net assets are reported as expendable restricted net position and permanently restricted net assets are reported as nonexpendable restricted net position on the statement of net position.

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted funds	\$ (45,750)	\$ 1,229,706	\$ 64,010,300	\$ 65,194,256
Board-designated funds	<u>58,114,316</u>	<u>-</u>	<u>-</u>	<u>58,114,316</u>
	<u>\$ 58,068,566</u>	<u>\$ 1,229,706</u>	<u>\$ 64,010,300</u>	<u>\$ 123,308,572</u>

Changes in endowment net assets for the fiscal year ended June 30, 2017, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	\$ 53,670,468	\$ 1,464,444	\$ 57,938,625	\$ 113,073,537
Investment income (loss)	817,414	769,398	-	1,586,812
Net appreciation	6,183,653	-	7,006,757	13,190,410
Contributions	52,563	-	1,584,917	1,637,480
Appropriations	(2,971,412)	(3,067,752)	-	(6,039,164)
Transfers	<u>315,880</u>	<u>2,063,616</u>	<u>(2,519,999)</u>	<u>(140,503)</u>
Endowment net assets, end of year	<u>\$ 58,068,566</u>	<u>\$ 1,229,706</u>	<u>\$ 64,010,300</u>	<u>\$ 123,308,572</u>

At June 30, 2017, permanently restricted net assets consist of the portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA. Temporarily restricted net assets consist of the portion of perpetual endowment funds subject to a time restriction under UPMIFA. The temporarily restricted net assets also have purpose restrictions.

Funds with Deficiencies - From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or UPMIFA requires the foundation to retain as a fund of

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perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were \$45,750 as of June 30, 2017. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the board of trustees.

Return Objectives and Risk Parameters - The foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets.

Endowment assets include those assets of donor-restricted funds that the foundation must hold in perpetuity or for donor-specified periods as well as board-designated funds. Under this policy, as approved by the board of trustees, the endowment assets are invested in a manner that is intended to produce results that exceed the price and yield results of the consumer price index while assuming a moderate level of investment risk. The foundation expects its endowment funds, over time, to provide an average annual rate of return of approximately 6 percent above the rate of inflation. Actual returns in any given year may vary from this amount.

Strategies Employed for Achieving Objectives - To satisfy its long-term rate-of-return objectives, the foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk constraints.

The foundation has a policy of appropriating for distribution each year 4.5 percent of each endowment fund's average balance for the last 12 quarters. In establishing this policy, the foundation considered the long-term expected return on its endowment. Accordingly, over the long term, the foundation expects the current spending policy to allow its endowment to grow. This is consistent with the foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

Related Party Transactions

CDFI, the LLC, and the university have executed a management agreement which allows the university to assume management responsibilities related to the LLC's student housing. The LLC paid management fees of \$225,000 to the university during the LLC's fiscal year ended June 30, 2017. As a matter of convenience, cash balances needed for student housing operations are held at the university, and operating expenses are paid from these funds. At June 30, 2017, deposits held at the university on behalf of the LLC were \$745,440.

Contingencies

From time to time the foundation's subsidiaries may be involved in certain claims arising from normal business activities. Management believes that the financial position of CDFI will not be materially affected by the outcome of these proceedings.

Note 23: Component Unit – University of Tennessee Foundation

The University of Tennessee Foundation, Inc., is a private nonprofit organization that reports under Financial Accounting Standards Board (FASB) standards. As such, certain revenue recognition criteria and presentation features are different from revenue recognition criteria and presentation features as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements of this foundation have been reformatted into a GASB format and are reported in a separate column to the right of the university's statements.

The University of Tennessee Foundation is a legally separate, tax-exempt organization supporting the University of Tennessee. The foundation acts as a fund-raising organization to supplement the resources that are available to the

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university in support of its programs. The foundation has 22 active board members and four ex-officio members. The board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2017, the foundation expended \$61,193,375.95 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from the University of Tennessee Foundation, 1525 University Avenue, Knoxville, TN 37921-4848.

Organization and Nature of Activities

The University of Tennessee Foundation, Inc., is a not-for-profit organization exempt from federal income tax under Section 501(c)(3) of the *Internal Revenue Code*. The foundation was formed to support the University of Tennessee. The foundation was established to provide fund raising support for the university in carrying out its mission of teaching, research, and public service. The foundation receives contributions from individuals, corporations, alumni, and other donors. The foundation also conducts the development and alumni affairs operations for the university. See also Note 18.

PLEDGES RECEIVABLE

Pledges receivable (reported as accounts, notes, and grants receivable on the statement of net position) are summarized below net of the allowance for doubtful accounts:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
Current pledges	\$ 11,729,695.90	\$ 4,722,445.69
Pledges due in one to five years	29,592,751.15	38,980,623.67
Pledges due after five years	<u>8,850,810.74</u>	<u>13,921,768.65</u>
	50,173,257.79	57,624,838.01
Less discounts to net present value	<u>(2,326,661.60)</u>	<u>(3,390,405.28)</u>
Total pledges receivable, net	<u>\$ 47,846,596.19</u>	<u>\$ 54,234,432.73</u>

The allowance for doubtful accounts at June 30, 2017, was \$729,092.44.

NOTE RECEIVABLE

During February 2017, the foundation sold a warehouse facility in Edgefield County, South Carolina, which was acquired during the fiscal year ending June 30, 2016. To facilitate the sale to the buyer and allow the purchaser to find a suitable buyer or tenant for the warehouse facility, the foundation executed a note receivable totaling \$9,250,000.00 of the \$10,250,000.00 facility selling price. The note receivable bears an annual interest rate of 4% payable monthly to the foundation. There are no required principal payments until the note matures on September 1, 2019.

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INVESTMENTS AND ASSETS HELD BY THE UNIVERSITY OF TENNESSEE

Investments held at June 30, 2017, were as follows:

	Fair Value	Cost
Endowment assets held by the University of Tennessee:		
Debt Securities	\$ 21,245,103.35	\$ 22,815,047.68
Corporate Stock – Domestic	2,011,524.00	1,985,648.00
Corporate Stock – International	403,003.00	397,820.00
Pooled Investment Vehicles – Equity	57,346,702.08	56,276,523.13
Alternative Investments:		
Pooled Investment Vehicles – Real Estate	9,878,445.79	8,999,647.21
Private Capital Investments	48,816,542.00	48,797,111.00
Hedge funds	<u>31,808,260.00</u>	<u>31,558,875.00</u>
Total endowment assets held by University of Tennessee	<u>171,509,580.22</u>	<u>170,830,672.02</u>
Endowment assets held by the foundation		
Cash	224,835.89	224,835.89
Equities	<u>1,214,251.24</u>	<u>1,069,077.41</u>
Total endowment assets held by the foundation	<u>1,439,087.13</u>	<u>1,293,913.30</u>
Total endowment funds	<u>172,948,667.35</u>	<u>172,124,585.32</u>
Gift annuity program		
Cash	26,117.16	26,117.16
Equities	4,255,104.31	3,874,393.85
Fixed income	<u>3,400,194.15</u>	<u>3,419,469.05</u>
Total gift annuity program	<u>7,681,415.62</u>	<u>7,319,980.06</u>
Other investments		
Other investments held by the University of Tennessee	88,564,908.87	88,564,908.87
Other investments	<u>3,512,250.97</u>	<u>3,512,250.97</u>
Total other investments	<u>92,077,159.84</u>	<u>92,077,159.84</u>
Total investments	<u>\$ 272,707,242.81</u>	<u>\$ 271,521,725.22</u>

Also reported as investments on the statement of net position are other gift assets totaling \$1,209,980.00.

At June 30, 2017, the fair values of alternative investments are based on valuations for which a readily determinable fair value does not exist. These investments are not listed on national exchanges or over-the-counter markets, and quoted market prices are not available. The fair value of these investments is estimated based on a review of all available information provided by fund managers and general partners. These estimates are evaluated on a regular basis and are susceptible to revisions as more information becomes available.

Endowments

The foundation's endowment funds consist of investments held by the university, investments held by the foundation, and permanently restricted unconditional promises to give. The majority of the foundation's invested endowment funds are invested in the University of Tennessee Consolidated Investment Pool. These funds are invested according to the policies of the university. A portion of the earnings from these funds are provided to the university to be used as stipulated in the endowment agreements. The cost and fair value for these endowments invested were \$170,830,672.02 and \$171,509,580.22, which resulted in a cumulative unrealized gain of \$678,908.20. Two endowments with a fair value of \$1,439,087.13 are separately invested. All endowments at the foundation are donor restricted. Endowment earnings transferred to the university were \$6,719,509.41 for fiscal year 2017.

The foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds

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absent explicit donor stipulations to the contrary. As a result, the foundation classifies permanently restricted net assets as (1) the original value of gifts to the endowment, (2) the original value of subsequent gifts to the endowment, and (3) accumulations to the endowment made in accordance with the gift instrument until the endowment is vested in the university's Consolidated Investment Pool. Below is a schedule of endowments by fund type. Due to the GASB reformatting, temporarily restricted net assets are reported as expendable restricted net position, and permanently restricted net assets are reported as nonexpendable restricted net position on the statement of net position.

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Beginning balance	\$ (5,267,147.84)	\$ -	\$ 201,574,357.82	\$ 196,307,209.98
Contributions received	-	-	25,098,665.21	25,098,665.21
Transfers to endowments	-	-	215,745.16	215,745.16
Investment earnings	4,567.29	6,740,605.54	133,056.58	6,878,229.41
Fair value adjustment	5,267,147.84	897,486.59	(1,115.41)	6,163,519.02
Disbursements	<u>(4,567.29)</u>	<u>(6,765,016.76)</u>	-	<u>(6,769,584.05)</u>
Ending balance	<u>\$ -</u>	<u>\$ 873,075.37</u>	<u>\$ 227,020,709.36</u>	<u>\$ 227,893,784.73</u>

From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the donor or UPMIFA requires the foundation to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets.

The foundation uses the university's spending policy. Historically, the university has calculated its spending policy distributions by taking 4.5% of a three-year fair value average each December 31. In fiscal year 2016, the university began transitioning to a seven-year moving average, by adding one year's value to the moving average calculation. This transition will be complete beginning with fiscal year 2019.

The assets are to be managed in a manner that will meet the long-term investment objective, while at the same time attempting to limit the volatility in year-to-year spending.

The university's Investment Advisory Committee believes that investing in securities with higher return expectations outweighs their short-term volatility risk. As a result, the majority of assets will be invested in equity or equity-like securities. Fixed income securities and other low volatility strategies (e.g., absolute return hedge funds) will be used to lower the short-term volatility of the portfolio and to provide stability, especially during periods of negative equity markets. Cash is not a strategic asset of the portfolio, but is a residual to the investment process and used to meet short-term liquidity needs.

Disciplined management of the asset allocation is necessary and desirable. Diversification of investments among assets that are not similarly affected by economic, political, or social developments is highly desirable. The general policy shall be to diversify investments so as to provide a balance that will enhance total return, while avoiding undue risk concentrations in any single asset or investment category.

Fair Value Measurements

The foundation reports under FASB Accounting Standards Codification (ASC) Topic 820, which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and prescribes disclosures about fair value measurements.

FASB ASC Topic 820 requires the categorization of assets and liabilities into three levels based upon the assumptions (inputs) used to value the assets or liabilities. Level 1 provides the most reliable measure of fair value, whereas Level 3 generally requires significant management judgment. The three levels are defined as follows:

Level 1 – Quoted prices (unadjusted) in active markets for identical assets or liabilities that the foundation has the ability to access.

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Level 2 – Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3 – Significant unobservable inputs that reflect management’s own assumptions about the assumptions that market participants would use in pricing an asset or liability.

The table below presents the recorded amount of assets measured at fair value on a recurring basis:

Investments:	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
University	\$ 60,117,796.00	\$ 92,594,186.87	\$ 107,362,506.22	\$ 260,074,489.09
Foundation	<u>9,232,559.57</u>	<u>3,400,194.15</u>	<u>-</u>	<u>12,632,753.72</u>
Total Investments	<u>\$ 69,350,355.57</u>	<u>\$ 95,994,381.02</u>	<u>\$ 107,362,506.22</u>	<u>\$ 272,707,242.81</u>

The table below presents additional information about assets measured at fair value on a recurring basis by reliance on Level 3 inputs to determine fair value.

Beginning balance	\$ 80,217,639.76
Total realized and unrealized gains and losses included in earnings	5,350,468.94
Purchases, issuances, and settlements	<u>21,794,397.52</u>
Ending balance	<u>\$ 107,362,506.22</u>

NOTES PAYABLE

The foundation was gifted property in Weakley and Obion counties in Tennessee. The property and its contents were appraised at \$376,000.00 with an attached mortgage note of \$259,330.41. The property will be used and overseen by the University of Tennessee at Martin. Payment on the note, which began in January 2006, is \$2,000.00 per month. The note has a 4.68% interest rate. The balance of the note payable at June 30, 2017, was \$75,644.03. Future maturities of this note are as follows:

Year ended June 30:

2018	\$ 20,904.48
2019	21,904.07
2020	22,951.46
2021	<u>9,884.02</u>
Total	<u>\$ 75,644.03</u>

The foundation purchased the warehouse facility in Edgefield County, South Carolina at an appraised value of \$11,000,000 on April 29, 2016, with a loan of \$7,500,000 at 3.77%, with interest only payments until maturity on November 15, 2017. The note was restated in February 2017 and is due in full at maturity on September 15, 2019. The foundation issued another note payable in February 2017. The note payable totaled \$205,000 and bears interest at 4% payable monthly. The note payable matures on September 15, 2019.

CONCENTRATION OF CREDIT RISK

The foundation had concentrated its credit risk for cash and liquid investments by maintaining deposits at banks and a credit union, which may at times exceed amounts covered by insurance provided by the U.S. Federal Deposit Insurance Corporation (FDIC) or by the U.S. National Credit Union Administration (NCUA). The credit union has provided the foundation excess deposit insurance coverage for cash or liquid investment amounts exceeding the NCUA account coverage limits. The foundation has not experienced any losses in these accounts and believes it is not exposed to any significant credit risk to cash or liquid investments.

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The foundation has a master repurchase agreement with a bank where at the end of each day cash is invested in overnight securities and the securities are repurchased by the bank the next day. The foundation purchases the securities in its name. The Repurchase Agreement Account with the bank is not insured by FDIC insurance, but rather the bank provides the securities purchased as the underlying security for the Repurchase Agreement Account. The Repurchase Agreement Account with the bank as of June 30, 2017, totaled \$18,007,028.37, and is reported in cash and cash equivalents on the statement of net position.

Note 24: Component Unit – University of Tennessee Research Foundation

The University of Tennessee Research Foundation, Inc., is a private nonprofit organization that reports under Financial Accounting Standards Board (FASB) standards. As such, certain revenue recognition criteria and presentation features are different from revenue recognition criteria and presentation features as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements of this foundation have been reformatted into a GASB format and are reported in a separate column to the right of the university's statements.

The University of Tennessee Research Foundation is a legally separate, tax-exempt organization supporting the University of Tennessee. The foundation was created as the UT Research Corporation (UTRC) in 1934 and incorporated in January 1935. The foundation's stated purpose is, in conjunction with the university, to grow the University of Tennessee research enterprise; harvest, manage, and market University of Tennessee intellectual property; encourage and support entrepreneurial education and ventures by faculty, staff, students, and commercial partners/affiliates of the University of Tennessee; and to contribute to the well being of the State of Tennessee through economic development. In April 2003, UTRC was renamed and reorganized to the University of Tennessee Research Foundation (UTRF). Roles were redefined and the scope was expanded to include a new emphasis on entrepreneurship and economic development for technology transfer activities. A new set of bylaws and board of directors were established. The foundation has 7 voting directors and 3 nonvoting directors. Because the university's board of trustees approves and funds the foundation's administrative budget, the foundation is considered fiscally dependent on the university, and there is a financial benefit/ burden relationship between the two entities. Therefore, the research foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

Complete financial statements for the research foundation can be obtained from the University of Tennessee Research Foundation, Suite 211, UT Conference Center Building, 600 Henley Street, Knoxville, TN 37996-4122.

Organization and Nature of Activities

The University of Tennessee Research Foundation, Inc., is a not-for-profit organization exempt from federal income tax under Section 501(c)(3) of the *Internal Revenue Code*. The foundation was formed to promote research and hold and manage the university's intellectual property. The foundation was established to protect, manage, and commercialize university inventions and intellectual property; grow the university research enterprise; develop and support an entrepreneurial culture; and contribute to state and regional economic development.

TennEra, LLC, (the subsidiary), a wholly owned for-profit subsidiary of the University of Tennessee Research Foundation, provides a vehicle to leverage state and federal funding with private research and development investments, strategic partnerships, and collaborations to further research, economic development, and clean energy objectives. The subsidiary focuses on researching and developing biomass based activities including integrated biomass supply chain solutions as well as entering strategic partnerships to support the bioenergy industry. The project utilizes the University of Tennessee's expertise in cellulosic feedstock production and research, as well as its work with Tennessee farmers, to develop the first dedicated cellulosic energy crop supply chain utilizing switchgrass.

TennEra, LLC's financial statements include the activity of subsidiary, Genera Energy, Inc. (GEI) a majority owned subsidiary of TennEra. TennEra, LLC, contracts with Genera Energy, Inc., for the overall management authority and responsibility to operate the Biomass Innovation Park and to complete TennEra, LLC's contractual obligations

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toward the University of Tennessee Research Foundation's State Biofuel Initiative. During the year ended June 30, 2016, the Biomass Innovation Park owned by TennEra, LLC, was sold to GEI.

Space Institute Research Corporation (SIRC, formerly Center for Advanced Scientific Support and Engineering Technology or ASSET.TN) is also a wholly owned nonprofit subsidiary of the University of Tennessee Research Foundation. It was formed in 2011 and renamed as SIRC on June 2, 2017. The management of the property, activities, and affairs of SIRC is vested in its board of directors. The board is composed of seven voting directors. As of June 30, 2017, SIRC had total assets of \$163,751 and total revenue of \$50,456 for the year then ended.

The Cherokee Farm Development Corporation (CFDC) is another wholly owned nonprofit subsidiary of the University of Tennessee Research Foundation. The management of the property, activities, and affairs of CFDC are vested in its board of directors. The board is composed of five voting directors. As of June 30, 2017, CFDC had total assets of \$1,362,277 and total revenue of \$332,423 for the year then ended.

Cherokee Farm Properties, Inc. (CFPI), a wholly owned for-profit subsidiary of Cherokee Farm Development Corporation, was formed on May 28, 2014. The management of the property, activities, and affairs of CFPI will be vested in its board of directors. The board is composed of three voting directors. As of June 30, 2017, CFPI had total assets of \$1,200,075 and total revenue of \$60 for the year then ended.

The Institute for Advanced Composites Manufacturing Innovation, a nonprofit subsidiary of the University of Tennessee Research Foundation, its sole corporate member, was formed on August 1, 2014, and renamed as Collaborative Composite Solutions Corporation (CCS) on July 28, 2015. CCS's primary purpose is coordinating and supporting all activities proposed to meet the intent and requirements of the Department of Energy's (DOE) funding opportunity announcement DE-FOA-000977. These activities include selecting, sponsoring, and auditing research and development projects that increase energy efficiency, decrease greenhouse gas emissions, and aid economic development in the United States. The management of the property, activities, and affairs of CCS is vested in its board of directors. The board is composed of fourteen voting directors, one of whom is a representative of UTRF, and another representing the University of Tennessee. As of June 30, 2017, CCS had total assets of \$12,552,957 and total revenue of \$18,097,270 for the year then ended.

Principles of Consolidation

The foundation has entered into related agreements with the university and TennEra, LLC, whereby the foundation has undertaken to provide the subsidiary with working capital advances for its operational needs. The extent of the foundation's commitment is contingent upon its own ability to obtain additional funding from existing sources from which to make these advances. According to terms of the agreements, repayment of the operational funding by the subsidiary to the foundation is required only upon the occurrence of, and in preference to, other capital distributions. No interest accrues on the advances. Because the parties contemplate capital distributions only as the consequence of a general liquidation of the subsidiary, these advances have been treated as investments in the subsidiary on the books of the foundation and as equity capital on the books of the subsidiary. These amounts eliminate upon consolidation. The foundation's consolidated financial statements include the foundation's accounts and the accounts of its wholly owned subsidiaries. All intercompany balances and transactions were eliminated in consolidation, and the increase in net position was reduced by the portion of earnings attributable to noncontrolling interests.

Impairment of Long-Lived Assets

In December 2015, DuPont Cellulosic Ethanol, LLC, (DCE) cancelled a lease agreement with TennEra to lease its biorefinery plant and equipment. Accordingly, TennEra evaluated the ongoing value of the biorefinery plant and equipment. TennEra determined that the biorefinery, with a carrying value of \$40 million, had been impaired. TennEra had recorded an impairment of \$15,445,000 at June 30, 2016. During 2017, TennEra had an appraisal of the biorefinery and determined an additional impairment of \$12,944,725. The total impairment of the biorefinery at June 30, 2017, was \$28,389,725. Management will reevaluate this impairment in 2018.

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Property and Equipment

Property and equipment consist of the following major classifications at June 30, 2017:

Office furniture and equipment	\$ 143,090
Less accumulated depreciation	(135,855)
Total	<u>7,235</u>
<u>TennEra</u>	
Land	349,762
Buildings	37,264,641
Leasehold improvements	929
Machinery and equipment	22,527,295
Furniture and fixtures	227,980
Vehicles	18,906
Less impairment of assets	(28,389,725)
Less accumulated depreciation	<u>(21,537,663)</u>
Total TennEra	<u>10,462,125</u>
<u>Cherokee Farm</u>	
Office furniture and equipment	1,739
Less accumulated depreciation	<u>(1,491)</u>
Total Cherokee Farm	<u>248</u>
<u>Collaborative Composite Solutions Corporation</u>	
Equipment	402,072
Work in progress – member portal	213,465
Less accumulated depreciation	<u>(8,986)</u>
Total Collaborative Composite Solutions Corporation	<u>606,551</u>
Total	<u>\$ 11,076,159</u>

Depreciation expense for the foundation and its subsidiaries totaled \$3,232,769 for the year ended June 30, 2017. Intangible assets totaling \$92,156 are also reported as capital assets on the statement of net position.

Long-term Liabilities

Notes Payable

On December 3, 2014, GEI obtained a revolving credit facility which was to mature on December 3, 2017. Borrowing availability was based on eligible collateral up to a maximum of \$4,000,000 with interest payable at prime plus 7.75% plus payment in-kind interest of 5%. Loan requests were subject to a minimum of \$500,000. An early termination prepayment fee applied based on a declining scale of 4% if paid on or after the 12th month after the closing date and on or prior to the 18th month after the closing date to 0% if paid upon maturity date. Additionally, GEI was required to pay a monthly administrative fee of \$1,500. The credit facility was secured by all assets of GEI. The lender was also issued stock warrants in conjunction with the credit facility.

On May 13, 2016, the revolving credit facility was amended. The borrower acknowledged that as of April 4, 2016, the existing obligation under the original revolving credit facility was \$1,824,823. On or after April 4, 2016, the existing obligations shall not be included for purposes of calculating the borrowing base, the exposure, or the aggregate commitments. Borrowing availability is based on eligible collateral up to a maximum base of \$2,300,000 with interest payable at prime plus 9.75% plus payment in-kind interest of 5%. Loan requests are subject to a minimum of \$50,000. GEI shall also pay a liquidation preference in an amount equal to the sum of 50% of the advances made on or after April 4, 2016, minus the aggregate amount of interest and fees paid exclusive of the existing obligation. The foregoing amount shall be paid on the earlier to occur of the facility termination date of December 3, 2017, or the occurrence of a qualified financing event. The liquidation preference was amended per the October 25, 2016, amendment of the credit facility to no longer accrue equal to the sum of 50% of the advances made on or after April 4, 2016. The credit facility is secured by all assets of GEI including the Biomass

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Innovation Park. The stock warrants issued to the lender were also amended. Costs of \$312,528 were incurred to amend the revolving credit facility and were expensed.

On October 25, 2016, the revolving credit facility was amended for failure of GEI to achieve one or more funding milestones that had replaced various financial covenants. The revolving credit facility may make advances at their sole discretion to GEI for short term working capital needs up to \$1,000,000. Also, for each dollar of discretionary advances paid to GEI, TennEra will reduce the outstanding principal balance of the promissory note for the BIP by an amount equal to 50% of the amount advanced.

On April 27, 2017, the revolving credit facility was amended to include discretionary advances up to \$1,300,000 which includes discretionary advances of \$1,000,000 per the amendment on October 25, 2016.

The total balance outstanding on the revolving credit facility was \$5,148,630 as of June 30, 2017. The balance outstanding includes \$356,607 of payment in-kind accrued interest.

On November 21, 2014, GEI issued a 7.25 % subordinated note for \$110,007 to a former employee in exchange for 52,635 shares of Class M common stock, which was repurchased at \$2.09 per share. Additionally, in connection with the common stock repurchase, GEI issued warrants. The subordinated note is convertible into shares of common stock. The note is subject to certain automatic conversion triggers as defined in the promissory note. The initial maturity date was December 31, 2015, with annual automatic extension as long as the note remains subordinated to the revolving credit facility. A commitment fee of 4% of the principal balance is due upon extension. The balance of the note was \$151,138 as of June 30, 2017.

On March 1, 2017, GEI issued a subordinated convertible line of credit promissory note for \$250,000 at an interest rate of 5% per year. Unless converted, principal and unpaid accrued interest shall be payable upon demand at any time after 18 months from March 1, 2017. If GEI issues equity securities in a transaction or series of related transactions resulting in aggregate gross commitments of at least \$7,000,000, then the note and any accrued but unpaid interest will automatically convert into the same class of equity securities issued pursuant to the qualified equity financing. If prior to the qualified equity financing, GEI closes a debt financing transaction resulting in aggregate gross commitments of at least \$30,000,000, then the note and any unpaid accrued interest will automatically convert into Class A Common Shares pursuant to the qualified debt financing. If the note has not been previously converted upon the maturity date, the note and any unpaid accrued interest will automatically convert into Class A Common Shares based on a per share price equal to 90% of the valuation cap price. The subordinated convertible line of credit is included in long term liabilities of \$250,000 at June 30, 2017.

Included in notes payable are costs related to obtaining debt financing in December 2014. These costs are deferred and amortized over the life of the related debt. In 2015, GEI capitalized approximately \$672,000 of debt issue costs, which included the fair market value of warrants issued related to obtaining financing. Total amortization expense was approximately \$238,000 for the year ended June 30, 2017.

Notes payable, net of issuance costs, consist of the following:

Beginning balance as of July 1, 2016	\$ 2,917,222
Advances	1,800,000
Payment in kind and accrued interest	215,804
Subordinated convertible line of credit promissory note	250,000
Interest for subordinated convertible promissory note	28,497
Interest for subordinated convertible line of credit promissory note	4,178
Amortization	<u>238,444</u>
Note payable, net of issuance costs as of June 30, 2017	<u>\$ 5,454,145</u>

THE UNIVERSITY OF TENNESSEE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2017

Estimated future amortization expenses as of June 30, 2017 are:

2018 \$ 99,801

Fair Value Measurements

The foundation reports under FASB Accounting Standards Codification (ASC) Topic 820, which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and prescribes disclosures about fair value measurements.

FASB ASC Topic 820 requires the categorization of assets and liabilities into three levels based upon the assumptions (inputs) used to value the assets or liabilities. Level 1 provides the most reliable measure of fair value, whereas Level 3 generally requires significant management judgment. The three levels are defined as follows:

Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities that the foundation has the ability to access.

Level 2 - Significant other observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities in active markets, quoted prices in markets that are not active, and other inputs that are observable or can be corroborated by observable market data.

Level 3 - Significant unobservable inputs that reflect management's own assumptions about the assumptions that market participants would use in pricing an asset or liability.

Following is a description of the valuation methodologies used for assets measured at fair value.

Registered Investment Companies

The fair value of registered investment companies (mutual funds) is based on quoted net asset values of the shares held by the foundation at June 30, 2017.

Marketable Equity Securities

The fair value of marketable equity securities is based on quoted prices times the number of the shares held by the foundation at June 30, 2017.

The following table provides the assets (liabilities) carried at fair value measured on a recurring basis as of June 30, 2017:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Registered investment companies	\$ 11,111	\$ -	\$ -	\$ 11,111
Marketable equity securities	114,135	-	-	114,135
Derivative liabilities	-	-	(2,237,100)	(2,237,100)
	<u>\$ 125,246</u>	<u>\$ -</u>	<u>\$ (2,237,100)</u>	<u>\$ (2,111,854)</u>

The foundation also has \$9,945 of investments (equity securities) for which there is no readily determinable market value and has invested \$1,200,000 in Cherokee Farm Properties, Inc. These investments are valued at cost, as management believes that any variance in valuation from historical cost would not be material to the operations of the foundation.

Sale of Biomass Innovation Park and Pulp Business Opportunity Purchase

In May 2016, TennEra sold its Biomass Innovation Park (BIP) to GEI for \$1,850,000; GEI paid \$250,000 at closing and issued a promissory note, payable quarterly beginning in August 2016, and maturing May 2021, to

THE UNIVERSITY OF TENNESSEE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2017

TennEra for the remaining balance of \$1,600,000. Interest accrues on the unpaid balance at 5% per year. The note is secured by a pledge of 89,000 shares of Class M stock of GEI. TennEra recorded an impairment on the sale of the assets of \$5,315,494. During the year ended June 30, 2017, GEI paid TennEra \$135,668. Furthermore, TennEra agreed to reduce the outstanding principal balance of the promissory note by an amount equal to 50% of the amount advanced to GEI from the revolving credit facility. During the year ended June 30, 2017, the promissory note was reduced \$650,000 leaving a balance including accrued interest of \$842,839 at June 30, 2017. An additional \$50,000 owed from GEI to TennEra at June 30, 2016 in connection with the property transaction remaining unpaid at June 30, 2017. TennEra has recorded a contribution to GEI in the amount of \$700,000 for the year ended June 30, 2017.

In addition to the sale of the BIP, GEI and Prisma Renewable Composites, LLC (Prisma) entered into a pulp business opportunity purchase agreement. The pulp business opportunity is defined as the business, services, operations, and tangible and intangible assets of Genera related to the research, development, communication, manufacture, marketing, sale, support, and other use and commercial exploration of pulp products which are defined as products derived from pulping biomass including 1) market pulp, 2) molded pulp products, and 3) coproducts and byproducts of the pulping process including pelletized solid biofuel, bio-based absorbent products, soil amendments, and enhanced animal bedding products. At closing, Genera paid Prisma \$200,000. In addition, Genera is responsible for paying success fees to Prisma.

In addition to the pulp business agreement, Genera and Prisma also entered into a joint development agreement for overall development and commercialization of the pulp business opportunity in May 2016. Under the joint agreement, Genera shall pay Prisma a development program fee of \$192,000 payable in monthly installments of \$16,000 for twelve months with the first note due May 2016. Subsequent to year end, monthly payments were reduced to \$9,200. The agreement was terminated after the January 2017 payment. GEI paid Prisma \$74,452 for the year ended June 30, 2017.

Note 25: Prior-period adjustment

The net position at June 30, 2016, is restated to correct a combined understatement of grants and contracts revenues of \$9,966,854.08. The university incorrectly reported the following prior revenues: governmental grants and contracts by \$853,132.50, non-governmental grants and contracts by \$6,754,873.23, and nonoperating grants and contracts by \$2,358,848.35 at June 30, 2016. As a result, for the year ended June 30, 2017, beginning net position has been increased by \$9,966,854.08.

Note 26: Subsequent events

In September 2017, the Tennessee State School Bond Authority (TSSBA) issued additional bonded indebtedness, of which \$ 215,707,981 was for university projects. This issuance increased the university's TSSBA indebtedness by \$111,674,713, as the issuance repaid \$104,033,268 of revolving credit facility debt related to these projects existing at June 30, 2017.

The University of Tennessee
Required Supplementary Information
Schedule of the University of Tennessee's Proportionate Share of the Net Pension Liability
Closed State and Higher Education Employee Pension Plan within TCRS

	<u>2017</u>	<u>2016</u>	<u>2015</u>
University's proportion of the net pension liability	13.12809%	12.930334%	12.764631%
University's proportionate share of the net pension liability	\$239,530,566	\$166,708,520	\$88,069,402
University's covered payroll	\$320,282,715	\$337,276,466	\$348,719,634
University's proportionate share of the net pension liability as a percentage of its covered payroll	74.78%	49.43%	25.26%
Plan fiduciary net position as a percentage of the total pension liability	87.96%	91.26%	95.11%

- 1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.
- 2) This is a ten-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until ten years of information is available.

Schedule of University of Tennessee's
Proportionate Share of the Net Pension Asset
State and Higher Education Employee Retirement Plan within TCRS

	<u>2017</u>	<u>2016</u>
University's proportion of the net pension asset	11.908035%	11.730576%
University's proportionate share of the net pension asset	\$ 1,003,190	\$ 326,224
University's covered payroll	36,688,424	13,241,214
University's proportionate share of the net pension asset as a percentage of its covered payroll	2.73%	2.46%
Plan fiduciary net position as a percentage of the total pension asset	130.56%	142.55%

- 1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.
- 2) This is a 10-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future fiscal years until 10 years of information is available.

The University of Tennessee
Required Supplementary Information
Schedule of University of Tennessee's Contributions
Closed State and Higher Education Employee Pension Plan Within TCRS

	Contractually Determined Contributions	Contributions in Relation to Contractually Determined Contribution	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a Percentage of Covered Payroll
2017	\$46,326,637	\$46,326,637	\$ -	\$ 308,432,979	15.02%
2016	48,138,492	48,138,492	-	320,282,715	15.03%
2015	50,692,652	50,692,652	-	337,276,466	15.03%
2014	52,412,536	52,412,536	-	348,719,634	15.03%
2013	47,508,571	47,508,571	-	316,091,623	15.03%
2012	44,814,906	44,814,906	-	300,569,457	14.91%
2011	43,343,861	43,343,861	-	290,703,293	14.91%
2010	37,266,850	37,266,850	-	286,227,727	13.02%
2009	37,963,758	37,963,758	-	291,580,323	13.02%
2008	39,356,715	39,356,715	-	288,962,665	13.62%

Schedule of University of Tennessee's Contributions
State and Higher Education Employee Retirement Plan within TCRS

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually required contribution	\$ 2,283,615	\$ 1,419,842	\$ 512,435
Contributions in relation to the contractually determined contribution	2,283,615	1,419,842	512,435
<u>Contribution deficiency (excess)</u>	<u>\$ -</u>	<u>\$ -</u>	<u>\$ -</u>
Covered payroll	\$62,718,322	\$ 36,688,424	\$13,241,214
Contributions as a percentage of covered payroll	3.64%	3.87%	3.87%

This is a ten-year schedule; however, contributions to this plan began in 2015. Years will be added to this schedule in future fiscal years until ten years of information is available.

The University of Tennessee
Required Supplementary Information
Schedule of University of Tennessee's Contributions
Federal Retirement Plans Administered by the U.S. Office of Personnel Management

Civil Service Retirement System

2017	\$169,500
2016	196,496
2015	230,096
2014	282,875
2013	302,616
2012	321,989
2011	339,588
2010	411,179
2009	540,494
2008	597,028

Federal Employees Retirement System

2017	\$1,639,831
2016	1,586,644
2015	1,492,262
2014	1,455,815
2013	1,478,574
2012	1,439,573
2011	1,380,360
2010	1,360,281
2009	1,392,006
2008	1,390,977

**The University of Tennessee
Required Supplementary Information
OPEB Schedule of Funding Progress**

Actuarial Valuation Date	Plan	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
July 1, 2015	State Employee Group Plan	\$ -	\$189,285,000	\$189,285,000	0%	\$724,441,525	26.1%
July 1, 2013	State Employee Group Plan	\$ -	\$193,052,000	\$193,052,000	0%	\$691,825,061	27.9%
July 1, 2011	State Employee Group Plan	\$ -	\$242,451,000	\$242,451,000	0%	\$685,300,649	35.4%

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

THE UNIVERSITY OF TENNESSEE
SUPPLEMENTARY COMBINING SCHEDULE OF NET POSITION
June 30, 2017

	Knoxville	Chattanooga	Martin	Health Science Center	Other Units	Total University
ASSETS						
Current assets:						
Cash and cash equivalents	\$ 143,097,949.36	\$ 27,752,113.31	\$ 13,257,828.08	\$ 33,192,525.22	\$ 160,113,009.62	\$ 377,413,425.59
Investments	70,727,671.90	1,453,789.58	5,452,651.34	25,808,536.98	27,078,142.35	130,520,792.15
Accounts, notes, and grants receivable (net)	31,351,955.50	8,201,395.05	3,037,107.75	12,356,464.71	27,143,661.26	82,090,584.27
Inventories	5,816,050.01	96,770.96	543,587.78	1,269,682.66	393,902.09	8,119,993.50
Prepaid expenses	4,046,065.98	307,714.68	269,358.67	264,082.76	(231,142.82)	4,656,079.27
Total current assets	<u>255,039,692.75</u>	<u>37,811,783.58</u>	<u>22,560,533.62</u>	<u>72,891,292.33</u>	<u>214,497,572.50</u>	<u>602,800,874.78</u>
Noncurrent assets:						
Cash and cash equivalents	486,692,766.82	49,007,754.04	32,460,559.66	130,230,283.06	96,852,914.05	795,244,277.63
Investments	423,659,247.43	18,041,637.99	25,504,433.92	155,410,371.90	213,404,277.11	836,019,968.35
Accounts, notes, and grants receivable (net)	86,831,845.66	17,093,531.93	4,980,754.64	44,989,142.59	31,986,359.91	185,881,634.73
Capital assets (net)	1,848,196,656.61	269,076,325.83	139,628,377.42	286,204,006.83	47,434,053.88	2,590,539,420.57
Net pension asset	515,705.00	90,978.00	33,780.00	306,201.00	56,526.00	1,003,190.00
Total noncurrent assets	<u>2,845,896,221.52</u>	<u>353,310,227.79</u>	<u>202,607,905.64</u>	<u>617,140,005.38</u>	<u>389,734,130.95</u>	<u>4,408,688,491.28</u>
Total assets	<u>\$ 3,100,935,914.27</u>	<u>\$ 391,122,011.37</u>	<u>\$ 225,168,439.26</u>	<u>\$ 690,031,297.71</u>	<u>\$ 604,231,703.45</u>	<u>\$ 5,011,489,366.06</u>
DEFERRED OUTFLOWS OF RESOURCES						
Deferred amount on debt refunding	\$ 11,865,629.14	\$ 3,070,313.78	\$ 5,120,879.92	\$ 1,781,596.68	\$ 793,702.91	\$ 22,632,122.43
Deferred outflows related to pensions	62,537,812.70	10,266,007.97	6,415,750.84	25,950,338.50	18,788,465.99	123,958,376.00
Total deferred outflows of resources	<u>\$ 74,403,441.84</u>	<u>\$ 13,336,321.75</u>	<u>\$ 11,536,630.76</u>	<u>\$ 27,731,935.18</u>	<u>\$ 19,582,168.90</u>	<u>\$ 146,590,498.43</u>
LIABILITIES						
Current liabilities:						
Accounts payable	\$ 48,087,214.07	\$ 11,775,517.57	\$ 1,564,458.71	\$ 17,796,575.20	\$ 49,165,439.81	\$ 128,389,205.36
Accrued liabilities	25,585,141.78	4,811,975.32	3,705,982.00	2,904,600.81	25,338,873.25	62,346,573.16
Unearned revenue	47,685,908.79	7,304,708.04	2,175,988.40	11,646,870.48	398,913.25	69,212,388.96
Due to component unit	-	-	-	-	194,249.63	194,249.63
Deposits payable	949,396.66	994,889.67	400,253.81	13,976.28	19,352.07	2,377,868.49
Annuities and life income payable	-	-	-	-	3,030,682.83	3,030,682.83
Long-term liabilities, current portion	50,240,456.80	5,491,255.89	4,095,143.09	20,084,208.93	3,682,189.95	83,593,254.66
Deposits held in custody for others	5,133,848.06	51,047.36	3,813.07	271,635.62	2,312,754.20	7,773,098.31
Total current liabilities	<u>177,681,966.16</u>	<u>30,429,393.85</u>	<u>11,945,639.08</u>	<u>52,717,867.32</u>	<u>84,142,454.99</u>	<u>356,917,321.40</u>
Noncurrent liabilities:						
Unearned revenue	-	-	-	-	15,500,438.71	15,500,438.71
Net pension obligation	106,057,670.19	18,925,589.00	12,652,149.00	48,589,776.00	53,305,381.81	239,530,566.00
Net other postemployment benefits obligation	54,789,587.24	10,002,290.62	6,725,605.29	28,864,625.51	10,001,981.60	110,384,090.26
Long-term liabilities, noncurrent portion	740,865,000.50	83,213,810.61	69,910,591.38	90,792,408.75	15,305,986.91	1,000,087,798.15
Due to grantors	16,469,519.05	2,800,350.91	3,732,676.46	10,323,608.93	-	33,326,155.35
Annuities and life income payable	-	-	-	-	16,204,916.00	16,204,916.00
Deposits held in custody for component units	-	-	-	-	260,074,489.02	260,074,489.02
Total noncurrent liabilities	<u>918,181,776.98</u>	<u>114,942,041.14</u>	<u>93,021,022.13</u>	<u>178,570,419.19</u>	<u>370,393,194.05</u>	<u>1,675,108,453.49</u>
Total liabilities	<u>\$ 1,095,863,743.14</u>	<u>\$ 145,371,434.99</u>	<u>\$ 104,966,661.21</u>	<u>\$ 231,288,286.51</u>	<u>\$ 454,535,649.04</u>	<u>\$ 2,032,025,774.89</u>
DEFERRED INFLOWS OF RESOURCES						
Deferred inflows related to pensions	\$ 4,919,671.86	\$ 1,535,891.00	\$ 1,008,697.00	\$ 3,076,332.00	\$ 2,297,892.14	\$ 12,838,484.00
NET POSITION						
Net investment in capital assets	\$ 1,106,587,695.70	\$ 189,327,872.35	\$ 73,834,665.73	\$ 204,792,784.22	\$ 47,434,053.38	\$ 1,621,977,071.38
Restricted:						
Nonexpendable (permanent endowments)	330,224,632.50	15,331,161.22	20,094,734.64	128,981,577.12	27,478,175.91	522,110,281.39
Expendable for other	244,780,171.24	12,460,547.14	14,860,295.21	181,709,881.19	37,925,050.01	491,735,944.79
Expendable for pensions	515,705.00	90,978.00	33,780.00	306,201.00	56,526.00	1,003,190.00
Expendable for loans	2,480,075.02	1,078,660.09	740,971.19	2,095,885.58	-	6,395,591.88
Expendable for capital projects	16,053,474.20	-	374,938.33	27,136.65	-	16,455,549.18
Expendable for debt service	1,426,857.75	-	188,279.69	-	-	1,615,137.44
Unrestricted	372,487,329.70	39,261,788.33	20,602,047.02	(34,514,851.38)	54,086,525.87	451,922,839.54
Total net position	<u>\$ 2,074,555,941.11</u>	<u>\$ 257,551,007.13</u>	<u>\$ 130,729,711.81</u>	<u>\$ 483,398,614.38</u>	<u>\$ 166,980,331.17</u>	<u>\$ 3,113,215,605.60</u>

THE UNIVERSITY OF TENNESSEE
SUPPLEMENTARY COMBINING SCHEDULE OF REVENUES, EXPENSES AND
CHANGES IN NET POSITION
FOR THE YEAR ENDED JUNE 30, 2017

	Knoxville	Chattanooga	Martin	Health Science Center	Other Units	Total University
REVENUES						
Operating revenues:						
Gross tuition and fees	\$ 443,490,885.41	\$ 109,813,489.76	\$ 58,326,360.56	\$ 86,057,412.10	\$ -	\$ 697,688,147.83
Less: tuition discount and allowances	(134,166,423.99)	(43,370,877.25)	(26,492,574.28)	(7,727,186.39)	-	(211,757,061.91)
Net student tuition and fees	309,324,461.42	66,442,612.51	31,833,786.28	78,330,225.71	-	485,931,085.92
Federal appropriations	13,493,050.35	-	-	-	-	13,493,050.35
Governmental grants and contracts	169,051,367.42	5,468,845.22	3,443,002.21	81,548,082.34	8,830,911.81	268,342,209.00
Non-governmental grants and contracts	55,503,133.92	3,282,293.71	1,584,370.03	117,480,476.50	48,755,551.18	226,605,825.34
Sales and services of educational departments and other activities	31,463,969.40	6,703,964.97	4,057,717.42	22,606,489.89	-	64,832,141.68
Auxiliary enterprises:						
Residential life	44,609,515.66	9,750,833.42	6,632,317.22	2,870.88	-	60,995,537.18
Food services	7,197,166.88	1,099,752.77	267,050.79	34,254.35	-	8,598,224.79
Bookstore	22,474,373.84	736,052.65	500,603.69	-	-	23,711,030.18
Parking	7,380,130.46	2,654,896.17	552,892.18	1,311,577.83	-	11,899,496.64
Athletics	136,998,361.49	410,355.18	-	-	-	137,408,716.67
Other auxiliaries	1,571,740.11	124,288.78	36,213.73	28,859.25	-	1,761,101.87
Interest earned on loans to students	22,032.90	6.00	-	5,124.31	-	27,163.21
Other operating revenues	13,977,265.42	275,630.31	622,170.48	3,044,101.80	5,526,958.98	23,446,126.99
Total operating revenues	\$ 813,066,569.27	\$ 96,949,531.69	\$ 49,530,124.03	\$ 304,392,062.86	\$ 63,113,421.97	\$ 1,327,051,709.82
EXPENSES						
Operating expenses:						
Salaries and wages	\$ 554,099,495.43	\$ 88,876,750.41	\$ 49,864,371.07	\$ 302,474,359.61	\$ 71,328,317.02	\$ 1,066,643,293.54
Fringe benefits	197,029,853.34	32,380,233.82	18,787,047.35	86,098,720.16	28,306,278.44	362,602,133.11
Utilities, supplies, and other services	281,260,067.24	45,424,335.83	31,887,104.73	131,418,858.65	21,280,711.00	511,271,077.45
Scholarships and fellowships	33,762,610.35	9,041,178.69	8,785,092.15	4,296,050.24	134,198.00	56,019,129.43
Depreciation and amortization expense	79,300,126.72	9,689,369.77	6,479,828.60	19,217,590.48	3,237,853.67	117,924,769.24
Total operating expenses	1,145,452,153.08	185,411,868.52	115,803,443.90	543,505,579.14	124,287,358.13	2,114,460,402.77
Operating income (loss)	\$ (332,385,583.81)	\$ (88,462,336.83)	\$ (66,273,319.87)	\$ (239,113,516.28)	\$ (61,173,936.16)	\$ (787,408,692.95)
NONOPERATING REVENUES (EXPENSES)						
State and local appropriations	\$ 303,938,199.00	\$ 47,528,308.00	\$ 31,869,551.01	\$ 147,407,314.34	\$ 23,026,886.08	\$ 553,770,258.43
Gifts	1,488,803.26	3,255,006.30	2,431,171.73	26,677,998.75	597,596.49	34,450,576.53
Grants and contracts	86,255,259.90	37,371,523.50	25,454,560.76	52,924,601.30	-	202,005,945.46
Investment income (loss)	47,146,000.60	7,547,358.12	3,069,327.28	17,191,848.55	9,004,502.91	83,959,037.46
Interest on capital asset - related debt	(25,740,132.13)	(1,867,724.97)	(2,849,764.15)	(3,217,336.26)	(403,491.34)	(34,078,448.85)
Other nonoperating revenues (expenses)	(4,192,975.62)	(19,077.42)	(73,528.35)	(441,716.45)	(43,664.88)	(4,770,962.72)
Net nonoperating revenues (expenses)	408,895,155.01	93,815,393.53	59,901,318.28	240,542,710.23	32,181,829.26	835,336,406.31
Income (loss) before other revenues, expenses, gains, or losses	76,509,571.20	5,353,056.70	(6,372,001.59)	1,429,193.95	(28,992,106.90)	47,927,713.36
Capital appropriations	60,308,478.83	4,891,568.37	5,166,128.22	27,303,427.58	1,470,116.15	99,139,719.15
Capital grants and gifts	17,100,504.52	90,800.00	308,425.46	185,474.35	-	17,685,204.33
Additions to permanent endowments	8,431,108.41	136,099.95	170,791.75	11,937,778.66	74,819.44	20,750,598.21
Other	(871,465.82)	135,260.00	115,359.50	92,855.86	7,061,518.85	6,533,528.39
Total other revenues	84,968,625.94	5,253,728.32	5,760,704.93	39,519,536.45	8,606,454.44	144,109,050.08
Increase (decrease) in net position	\$ 161,478,197.14	\$ 10,606,785.02	\$ (611,296.66)	\$ 40,948,730.40	\$ (20,385,652.46)	\$ 192,036,763.44
NET POSITION						
Net position at beginning of year	1,912,404,856.13	246,911,620.63	131,341,008.47	433,991,058.05	186,563,444.80	2,911,211,988.08
Prior-period adjustment	672,887.84	32,601.48	-	8,458,825.93	802,538.83	9,966,854.08
Net position at beginning of year, as restated	1,913,077,743.97	246,944,222.11	131,341,008.47	442,449,883.98	187,365,983.63	2,921,178,842.16
Net position at end of year	\$ 2,074,555,941.11	\$ 257,551,007.13	\$ 130,729,711.81	\$ 483,398,614.38	\$ 166,980,331.17	\$ 3,113,215,605.60

THE UNIVERSITY OF TENNESSEE
SUPPLEMENTARY SCHEDULE OF UNRESTRICTED NET POSITION
June 30, 2017

Working capital	\$ 30,269,858.63
Revolving funds	14,434,335.48
Encumbrances	4,427,732.69
Auxiliaries	9,871,217.65
Reappropriations	12,232,440.99
Quasi-endowments	13,964,619.78
Plant construction	54,607,375.11
Renewal and replacement funds	553,567,335.67
Debt service	32,630,909.76
	<u>726,005,825.76</u>
Investment in plant, interest payable	(6,161,640.86)
Undesignated deficit	(267,921,345.32)
	<u><u>\$ 451,922,839.58</u></u>

Unrestricted net position includes funds that have been designated for specific purposes.

THE UNIVERSITY OF TENNESSEE FIVE YEAR SUMMARY

(Dollars Are Expressed in Thousands of Dollars Except on Student Fees)

For the Fiscal Year	2016-2017	2015-2016	2014-2015	2013-2014	2012-2013
Operating revenues					
Net tuition and fees	\$ 485,931	\$ 467,020	\$ 435,928	\$ 398,555	\$ 376,325
Net auxiliary	244,374	235,415	221,233	197,426	189,480
Grants and contracts	494,948	522,376	465,439	469,872	464,799
Other (federal appropriations, sales and services, etc.)	101,799	100,907	101,610	90,635	92,274
Total operating revenues	\$ 1,327,052	\$ 1,325,718	\$ 1,224,210	\$ 1,156,488	\$ 1,122,878
Operating expenses					
Salaries and wages	\$ 1,066,643	\$ 1,030,271	\$ 1,000,703	\$ 986,831	\$ 949,628
Fringe benefits	362,602	328,711	311,226	344,307	334,184
Utilities, supplies, and other services	511,271	481,949	458,076	463,481	431,580
Scholarships and fellowships	56,019	58,368	60,792	57,025	68,757
Depreciation expense	117,925	112,169	107,315	107,888	108,247
Total operating expenses	\$ 2,114,460	\$ 2,011,468	\$ 1,938,112	\$ 1,959,532	\$ 1,892,396
Operating income (loss)	\$ (787,408)	\$ (685,750)	\$ (713,902)	\$ (803,044)	\$ (769,518)
Non operating revenues and expenses					
State and local appropriations	\$ 553,770	\$ 524,871	\$ 505,978	\$ 492,784	\$ 453,943
Gifts	34,451	32,291	33,091	25,930	40,800
Investment income, gains, (losses)	83,959	35,748	31,528	138,913	107,895
Other	163,156	136,776	151,659	138,185	158,584
Total non operating revenues	\$ 835,336	\$ 729,686	\$ 722,256	\$ 795,812	\$ 761,222
Other revenues, expenses, gains or losses					
Capital appropriations	\$ 99,140	\$ 97,052	\$ 48,283	\$ 54,964	\$ 58,462
Capital grants and gifts	17,685	19,347	18,899	35,209	25,090
Additions to permanent endowments	20,751	20,217	18,277	22,702	14,408
Other	6,533	19,938	11,026	5,022	2,439
Total other revenues, expenses, gains or losses	\$ 144,109	\$ 156,554	\$ 96,485	\$ 117,897	\$ 100,399
Increase (decrease) in net assets	\$ 192,037	\$ 200,490	\$ 104,839	\$ 110,665	\$ 92,104
Cash	\$ 1,172,658	\$ 1,156,285	\$ 959,250	\$ 884,903	\$ 846,301
Net assets:					
Invested in capital assets, net of related debt	\$ 1,621,977	\$ 1,560,889	\$ 1,468,677	\$ 1,431,939	\$ 1,407,126
Restricted expendable	517,206	448,636	457,605	481,693	429,668
Restricted nonexpendable	522,110	507,911	486,451	470,815	442,343
Unrestricted	451,923	393,776	303,062	428,352	422,997
Total net assets	\$ 3,113,216	\$ 2,911,212	\$ 2,715,795	\$ 2,812,799	\$ 2,702,134
Student loans					
Notes receivable	\$ 26,326	\$ 29,413	\$ 31,015	\$ 31,466	\$ 31,719
Loans issued (by year)	1,124	1,905	2,256	2,492	2,414
Endowments					
Market value	\$ 754,617	\$ 698,057	\$ 727,341	\$ 732,094	\$ 632,678
Life income funds					
Market value	\$ 25,731	\$ 22,708	\$ 21,554	\$ 25,493	\$ 23,960
Capital asset and debt administration					
Capital assets, net of depreciation	\$ 2,590,539	\$ 2,426,955	\$ 2,216,173	\$ 2,104,873	\$ 2,024,634
Total debt	\$ 1,001,122	\$ 901,488	\$ 785,801	\$ 691,579	\$ 633,014
General data					
Total enrollment	49,879	49,136	49,098	49,127	49,244
Knoxville	28,321	27,845	27,410	27,171	27,018
Chattanooga	11,587	11,388	11,670	11,674	11,660
Martin	6,772	6,827	7,042	7,423	7,751
Memphis	3,199	3,076	2,976	2,859	2,815
Degrees granted	11,741	11,565	11,285	11,152	11,182
Full-time employees	12,835	12,541	12,068	11,853	12,927
Full-time faculty	3,794	3,716	3,218	3,132	3,133
% tenured (based on those eligible for tenure)	41.7%	43.9%	50%	52%	52.1%
Total private gifts	\$ 221,158	\$ 240,261	\$ 303,347	\$ 179,788	\$ 116,949
Academic year student fees (Knoxville)					
Instate	\$ 12,498	\$ 12,436	\$ 10,276	\$ 9,684	\$ 9,092
Out of state (additional)	\$ 18,190	\$ 18,190	\$ 18,190	\$ 18,190	\$ 18,190
Instruction	\$ 695,899	\$ 659,968	\$ 643,466	\$ 649,389	\$ 608,402
Research	245,369	237,816	236,243	244,974	256,885
Public service	139,162	135,316	121,884	122,635	127,181
Academic support	184,988	168,777	156,135	149,830	138,188
Student services	94,067	88,775	85,695	82,885	84,203
Institutional support	137,057	139,062	126,582	128,095	116,897
Op/maint physical plant	171,656	145,852	151,777	166,730	134,898
Scholarships/fellowships	94,055	95,020	95,717	89,942	100,626
Auxiliary enterprises	167,966	162,160	145,094	142,278	139,087
Independent operations	66,316	66,553	68,206	74,886	77,781
Depreciation	117,925	112,169	107,313	107,888	108,247
Total	\$ 2,114,460	\$ 2,011,468	\$ 1,938,112	\$ 1,959,532	\$ 1,892,395

Administration of The University of Tennessee from July 1, 2016 through June 30, 2017

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