

**THE UNIVERSITY OF TENNESSEE FOUNDATION, INC.**  
**CONSOLIDATED FINANCIAL STATEMENTS**

**June 30, 2008**

**and**

**INDEPENDENT AUDITOR'S REPORT**

**The University of Tennessee Foundation, Inc.**

**Consolidated Financial Statements**

**June 30, 2008**

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## Independent Auditor's Report

To the Board of Directors of  
The University of Tennessee Foundation, Inc.  
Knoxville, Tennessee

We have audited the accompanying consolidated statement of financial position of The University of Tennessee Foundation, Inc. (a nonprofit organization) as of June 30, 2008, and the related consolidated statements of activities and cash flows for the year then ended. These consolidated financial statements are the responsibility of the Foundation's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of The University of Tennessee Foundation, Inc. as of June 30, 2008, and the changes in its net assets and its cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 15, 2008 on our consideration of the Foundation'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* and should be considered in conjunction with this report in considering the results of our audit.

*Brown Jake & McDaniel, PC*

October 15, 2008

**The University of Tennessee Foundation, Inc.**

**Consolidated Statement of Financial Position**

**June 30, 2008**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Assets:</b>				
Cash and cash equivalents	\$ 1,952,342.91	\$ 4,372,149.77	\$ 7,618.02	\$ 6,332,110.70
Accounts and interest receivable	1,506.71	232,819.30	-	234,326.01
Prepaid expenses	14,683.25	127,000.00	-	141,683.25
Cash surrender value of life insurance	-	182,531.26	-	182,531.26
Other assets	376,000.00	67,850.00	185,000.00	628,850.00
Investments	500,792.23	1,141,403.31	-	1,642,195.54
Pledges receivable (Note 2)	-	51,848,139.19	1,416,786.88	53,264,926.07
Remainder interest (Note 7)	-	15,975,737.83	-	15,975,737.83
Assets held by UT (Note 3)	-	1,034,120.79	13,799,228.25	14,833,349.04
<b>Total assets</b>	<u><u>\$ 2,845,325.10</u></u>	<u><u>\$ 74,981,751.45</u></u>	<u><u>\$ 15,408,633.15</u></u>	<u><u>\$ 93,235,709.70</u></u>
<b>Liabilities and net assets:</b>				
<b>Liabilities:</b>				
Accounts payable and accrued expenses	\$ 4,158.62	\$ 285,110.99	\$ -	\$ 289,269.61
Annuity payable	-	381,839.91	-	381,839.91
Due to UT	1,420,668.17	-	-	1,420,668.17
Note payable (Note 10)	225,684.44	-	-	225,684.44
<b>Total liabilities</b>	<u><u>1,650,511.23</u></u>	<u><u>666,950.90</u></u>	<u><u>-</u></u>	<u><u>2,317,462.13</u></u>
<b>Net assets:</b>				
Unrestricted	1,194,813.87	-	-	1,194,813.87
Temporarily restricted	-	74,314,800.55	-	74,314,800.55
Permanently restricted	-	-	15,408,633.15	15,408,633.15
<b>Total net assets</b>	<u><u>1,194,813.87</u></u>	<u><u>74,314,800.55</u></u>	<u><u>15,408,633.15</u></u>	<u><u>90,918,247.57</u></u>
<b>Total liabilities and net assets</b>	<u><u>\$ 2,845,325.10</u></u>	<u><u>\$ 74,981,751.45</u></u>	<u><u>\$ 15,408,633.15</u></u>	<u><u>\$ 93,235,709.70</u></u>

The accompanying notes are an integral part of these financial statements.

**The University of Tennessee Foundation, Inc.**

**Consolidated Statement of Activities**

**Year Ended June 30, 2008**

	<u>Unrestricted</u>	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>	<u>Total</u>
Revenues:				
Contributions	\$ 161,287.39	\$ 28,556,908.94	\$ 6,627,973.34	\$ 35,346,169.67
Interest and investment income	327,770.09	46,682.43	461,041.37	835,493.89
Net realized/unrealized gains and losses	(444.19)	(101,672.47)	(1,169,100.58)	(1,271,217.24)
Change in actuarial value of remainder interest	-	643,644.71	-	643,644.71
Student housing	2,522,094.20	-	-	2,522,094.20
Gain on disposition of capital asset (Note 6)	6,520,579.50			6,520,579.50
Other	2,800.00	-	-	2,800.00
Net assets released from restrictions	<u>9,791,264.69</u>	<u>(9,878,970.44)</u>	<u>87,705.75</u>	<u>-</u>
Total revenue	<u>19,325,351.68</u>	<u>19,266,593.17</u>	<u>6,007,619.88</u>	<u>44,599,564.73</u>
Expenses:				
Grants and scholarships	471,656.16	-	-	471,656.16
General and administrative	9,689,451.68	-	-	9,689,451.68
Student housing	<u>5,012,000.23</u>	<u>-</u>	<u>-</u>	<u>5,012,000.23</u>
Total expenses	<u>15,173,108.07</u>	<u>-</u>	<u>-</u>	<u>15,173,108.07</u>
Change in net assets	4,152,243.61	19,266,593.17	6,007,619.88	29,426,456.66
Net assets at beginning of year	<u>(2,957,429.74)</u>	<u>55,048,207.38</u>	<u>9,401,013.27</u>	<u>61,491,790.91</u>
Net assets at end of year	<u><u>\$ 1,194,813.87</u></u>	<u><u>\$ 74,314,800.55</u></u>	<u><u>\$ 15,408,633.15</u></u>	<u><u>\$ 90,918,247.57</u></u>

The accompanying notes are an integral part of these financial statements.

**The University of Tennessee Foundation, Inc.**

**Consolidated Statement of Cash Flows**

**Year Ended June 30, 2008**

Cash flows from operating activities:	
Change in net assets	\$ 29,426,456.66
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Depreciation and amortization	1,876,280.51
Gain on disposition of capital assets	(6,520,579.50)
Net realized/unrealized gains	1,271,217.24
Non-cash contribution	(185,000.00)
Change in actuarial value of donated asset	(643,644.71)
Increase in receivable	(182,716.00)
Increase in prepaid expenses	(122,127.00)
Increase in cash surrender value	(182,531.26)
Increase in pledge receivable	(19,029,684.61)
Increase in Due to UT	2,172,004.05
Decrease in other assets	170,311.96
Decrease in deferred revenue	(160,137.94)
Increase in annuity payable	381,839.91
Increase in accounts payable and accrued expenses	<u>190,052.80</u>
Net cash provided by operating activities	<u>8,461,742.11</u>
Cash flows from investing activities:	
Purchase of shares in the university's investment pool	(6,276,313.07)
Redemption of investments	2,505,785.96
Additions and purchases of capital assets	(140,278.97)
Proceeds from sale of capital assets	55,353,176.54
Investments	<u>(1,117,425.38)</u>
Net cash used for investing activities	<u>50,324,945.08</u>
Cash flows from financing activities:	
Payment of principal on bond and note payable	<u>(58,993,103.44)</u>
Net cash used for financing activities	<u>(58,993,103.44)</u>
Net decrease in cash and cash equivalents	(206,416.25)
Cash and cash equivalents at beginning of year	<u>6,538,526.95</u>
Cash and cash equivalents at end of year	\$ <u><u>6,332,110.70</u></u>
Supplemental disclosures of cash flow information:	
Cash paid during the year for interest	\$ 1,200,743.39

The accompanying notes are an integral part of these financial statements.

**The University of Tennessee Foundation, Inc.**

**Notes to Consolidated Financial Statements**

**June 30, 2008**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

**Organization and Nature of Activities**

The University of Tennessee Foundation, Inc. (the "Foundation") 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 "University"). The Foundation was established to provide flexibility for the University in carrying out its mission of teaching, research, and public research. The Foundation receives contributions from individuals, corporations, alumni, and other donors.

**Financial Statement Presentation**

The Foundation has adopted Statement of Financial Accounting Standards (SFAS) No. 117, "Financial Statements of Not-for-Profit Organizations." Under SFAS No. 117, the Foundation is required to report information regarding its financial position and activities according to three classes of net assets: unrestricted net assets, temporarily restricted net assets, and permanently restricted net assets.

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Foundation and two single member limited liability companies created by the Foundation. The names of the limited liability companies are Volunteer Student Housing, LLC and Martin Student Housing, LLC. The limited liability companies were created to own student housing facilities adjacent to the University of Tennessee at Knoxville campus and University of Tennessee at Martin campus. All significant intercompany balances and transactions have been eliminated in the consolidation.

**Basis of Presentation**

The financial statements have been prepared on the accrual basis of accounting, and accordingly, reflect all significant receivables, payables, and other liabilities.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

**The University of Tennessee Foundation, Inc.**

**Notes to Consolidated Financial Statements  
(continued)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Cash and Cash Equivalents**

Cash and cash equivalents consist of demand deposit accounts and other instruments that are readily convertible to cash.

**Capital Assets**

Donations of property and equipment are recorded as contributions at their estimated fair value. Such donations are reported as unrestricted contributions unless the donor has restricted the donated asset to a specific purpose.

**Investments**

Investments are recorded on the date of contribution and are stated at market value. Market values are determined by national securities exchanges. Unrealized gains and losses are determined by the difference between market values at the beginning and end of the year. These amounts are included in the change in net assets in the accompanying statement of activities.

The Foundation's policy regarding investment income and realized and unrealized gains and losses for temporarily and permanently restricted assets is to record such revenues as unrestricted support to the extent that restrictions are met in the same reporting period.

**Pledges Receivable**

Unconditional pledges, less an allowance for doubtful accounts, are recognized as contribution revenue in the period received and as an asset. Conditional pledges are recognized when the conditions on which they depend are substantially met. Unconditional pledges that are expected to be collected within one year are recorded at net realizable value. Unconditional pledges that are expected to be collected in future years are recorded at the present value of their estimated future cash flow.

**The University of Tennessee Foundation, Inc.**

**Notes to Consolidated Financial Statements  
(continued)**

**1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)**

**Contributions**

Contributions received are recorded as unrestricted, temporarily restricted, or permanently restricted support depending on the existence or nature of any donor restrictions.

The Foundation reports gifts of cash, donated property, and all other assets as unrestricted support unless explicit donor stipulations limit the use of the donated assets. When a donor restriction expires, that is, when the stipulated time restriction ends or purpose restriction is accomplished, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the statement of activities as net assets released from restrictions.

Donated gifts are recorded at fair market value at the time of donation and are reported as restricted support if it is received with donor imposed restrictions.

**2. PLEDGES RECEIVABLE**

Pledges receivable are summarized below, net of the allowance for doubtful accounts:

	Temporarily Restricted	Permanently Restricted
Current pledges	\$ 643,349.50	\$ 97,986.83
Pledges due in one to five years	39,136,570.46	1,310,828.58
Pledges due after five years	<u>19,189,458.11</u>	<u>121,320.00</u>
	58,969,378.07	1,530,135.41
Less discounts to net present value	<u>7,121,238.88</u>	<u>113,348.53</u>
Total pledges receivable, net	<u><u>\$ 51,848,139.19</u></u>	<u><u>\$ 1,416,786.88</u></u>

The allowance for doubtful accounts at June 30, 2008 was \$64,849.17.

**The University of Tennessee Foundation, Inc.**

**Notes to Consolidated Financial Statements  
(continued)**

**3. ASSETS HELD BY THE UNIVERSITY OF TENNESSEE**

All Foundation endowments are invested in the University of Tennessee Consolidated Investment Pool. The endowments are invested according to the policies of the University. Investment pool earnings for the Foundation endowments are provided to the University to be used as stipulated in the endowment agreements. The book value and market value for the endowments invested were \$14,265,159.55 and \$14,833,349.04, which resulted in a cumulative unrealized gain of \$568,189.49. Endowment pool earnings transferred to the University were \$450,456.16 for fiscal year 2008.

**4. OPERATING LEASES**

The Foundation has entered into a five-year lease for farmland in Martin, Tennessee. The lease terminates in December 2010. Minimum lease payments are \$15,000.00 per year over the term of the lease. Total accrued lease expense was \$15,000.00 for the year ended June 30, 2008. The Foundation has subleased the land to the University. The sublease is a five-year term and terminates in December 2010. The Foundation will receive \$2,800.00 per year as compensation for the sublease. Total accrued lease revenue at June 30, 2008, was \$2,800.00.

The Foundation entered into a lease agreement on July 1, 2005, with the University of Tennessee for office space. Minimum lease payments are \$17,792.00 per year over the lease term with the lease ending June 30, 2010.

The Foundation entered into a lease agreement on February 9, 2007 for office space in Atlanta, Georgia for the University's Development Office. The office space has been donated for use by a third party. The annual market value for the lease is \$14,100. The donated expense at June 30, 2008 was \$14,100.00.

**5. RESTRICTED NET ASSETS**

Temporarily restricted net assets are available for scholarships or other academic purposes, a housing project, support for University construction, artwork, and contributions for the farm lease payment. Total temporarily restricted net assets at June 30, 2008, were \$74,314,800.55.

Permanently restricted net assets are available for scholarships or other academic purposes. Total permanently restricted net assets at June 30, 2008, were \$15,408,633.15.

**The University of Tennessee Foundation, Inc.**

**Notes to Consolidated Financial Statements  
(continued)**

**6. KNOXVILLE PLACE**

On January 30, 2008, Knoxville Place was sold by Volunteer Student Housing, LLC to the University of Tennessee for the bonds outstanding less funds held in reserve by the Trustee. As a result of the sale, the bonds issued by the Health, Educational and Housing Facility Board of the County of Knox, Tennessee to fund the acquisition, construction, and equipping of Knoxville Place were paid in full. The housing facility will be owned and operated by the University as part of its Knoxville campus student housing. The gain on sale on the Statement of Activities is due to the sale of depreciated assets and expense recognition of the remaining underwriter's discount, bond costs, and letter of credit costs.

**7. REMAINDER INTEREST**

In December 2002, a donor conveyed to the Foundation a remainder interest in a limited liability company. The asset of the limited liability company is a fee simple interest in a warehouse in South Carolina. The remainder interest was appraised at \$7,740,000.00 with the interest vesting on January 1, 2021. The value on the Consolidated Statement of Financial Position will be the present value calculation until the vesting date. The IRS discount rate for December 2002 used in determining the present value was 4%. The present value of the remainder interest at June 30, 2008 was \$4,740,500.75.

In September 2003, a donor conveyed to the Foundation another remainder interest in a limited liability company. The asset of this limited liability company is an office building in Connecticut. The remainder interest was appraised at \$22,440,000.00 with the interest vesting on January 1, 2025. The value on the Consolidated Statement of Financial Position will be the present value calculation until the vesting date. The IRS discount rate for September 2003 was 4.20%. The present value at June 30, 2008 was \$11,235,237.08.

**8. GIFT ANNUITIES**

The Foundation entered into a two-year agreement with The Benefits Group (TBG) for commercial gift annuities on November 19, 2002. Under the agreement, a donor can provide funds to the Foundation for a gift annuity and an annuity agreement would be signed between the donor and the Foundation. TBG is then contacted and completes the annuity contract with an insurance company (commercial annuity) with the contract also signed by the Foundation. The insurance company makes the annuity payments to the donor not the Foundation. Part of the gift annuity donation is sent to the insurance company to fund the annuity payments. The remaining annuity gift amount is sent to the University for the purpose specified in the annuity agreement. The commercial annuity purchased by the Foundation is insurance and is subject to regulation by the Tennessee Commissioner of

**The University of Tennessee Foundation, Inc.**

**Notes to Consolidated Financial Statements  
(continued)**

**8. GIFT ANNUITIES (Continued)**

Commerce and Insurance and is protected by an insurance guaranty association. The Foundation has no liability under this arrangement since the commercial annuity is purchased. No gift annuities were performed under this arrangement in the fiscal year.

In May 2008, the Foundation launched its own gift annuity program. The Foundation has placed \$500,766.11 as a reserve for the annuity program. By June 30, 2008, the Foundation executed seven gift annuity contracts totaling \$562,500.00. The funds are held in trust at First Tennessee Bank and invested. The market value for the invested gift annuities and reserve at June 30 was \$1,040,074.72 which resulted in an unrealized loss of \$25,479.04. The investments consist of cash, equity index funds, and fixed income funds.

**9. CONCENTRATION OF CREDIT RISK**

The Foundation had concentrated its credit risk for cash by maintaining deposits at bank, which may at times exceed amounts covered by insurance provided by the U.S. Federal Deposit Insurance Corporation (FDIC). The amount at risk at June 30, 2008 was \$12,619.47. The Foundation has not experienced any such losses in this account and believes it is not exposed to any significant credit risk to cash.

**10. OTHER GIFTS, NOTE PAYABLE AND INVESTMENTS**

The Foundation was gifted property in Weakley and Obion, Tennessee counties. 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 with the note maturing in December 2020. The note has a 4.68% interest rate. For the fiscal ended June 30, 2008, the note principal was reduced by \$13,103.44 with an additional \$10,896.56 of interest being paid. The balance of the note payable at June 30, 2008 was \$225,684.44. Future maturities of this note are as follows:

2009	\$ 13,729.99
2010	14,386.52
2011	15,074.44
2012	15,795.25
2013	16,550.54
2014 - 2018	95,408.14
2019 - 2021	<u>54,739.56</u>
Total	<u>\$225,684.44</u>

**The University of Tennessee Foundation, Inc.**

**Notes to Consolidated Financial Statements  
(continued)**

**10. OTHER GIFTS, NOTE PAYABLE AND INVESTMENTS (Continued)**

A gift of \$350,000.00 was made in December 2005 to assist in the renovation of an auditorium at the University of Tennessee, Memphis campus. The funds are to be invested per donor instructions in commodities and U.S. Treasury Bills. The market value at June 30, 2008 consisted of:

Cash	\$ 264,416.65
Open trade equity	1,737.50
U.S. Treasury Bill	275,000.00
Net market value of options	<u>1,737.50</u>
 Total	 <u>\$ 550,249.20</u>

The Foundation bears no risk in these investments beyond the original amount of the gift.

REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING  
AND ON COMPLIANCE AND OTHER MATTERS  
BASED ON AN AUDIT OF FINANCIAL STATEMENTS PERFORMED  
IN ACCORDANCE WITH *GOVERNMENT AUDITING STANDARDS*

To the Board of Directors of  
The University of Tennessee Foundation, Inc.  
Knoxville, Tennessee

We have audited the consolidated financial statements of The University of Tennessee Foundation, Inc. as of and for the year ended June 30, 2008, and have issued our report thereon dated October 15, 2008. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Internal Control Over Financial Reporting

In planning and performing our audit, we considered The University of Tennessee Foundation, Inc.'s internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements and not to provide an opinion on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

Compliance and Other Matters

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

This report is intended for the information of management, Board of Directors and government regulatory agencies and is not intended to be and should not be used by anyone other than these specified parties.

*Brown J. & McDaniel, PC*

CERTIFIED PUBLIC ACCOUNTANTS

October 15, 2008