# THE UNIVERSITY OF TENNESSEE FOUNDATION, INC.

**FINANCIAL STATEMENTS**

**Year Ended June 30, 2013**

**and**

**INDEPENDENT AUDITOR'S REPORT**

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

**Financial Statements**

**June 30, 2013**

TABLE OF CONTENTS

**BROWN JAKE & McDANIEL, PC**
CERTIFIED PUBLIC ACCOUNTANTS
2607 KINGSTON PIKE, SUITE 110
KNOXVILLE, TENNESSEE 37919-3336
865/637-8600 • fax: 865/637-8601

JOE L. BROWN, CPA, CGFM, CGMA
FRANK D. McDANIEL, CPA, CGFM, CGMA
TERRY L. MOATS, CPA, CGFM, CGMA
JAMES E. BOOHER, CPA, CGMA

MEMBERS
AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS

# Independent Auditor's Report

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

## Report on the Financial Statements

We have audited the accompanying financial statements of The University of Tennessee Foundation, Inc. (a nonprofit organization), which comprise the statement of financial position as of June 30, 2013, and the related statements of activities and cash flows for the year then ended, and the related notes to the financial statements.

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

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

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

***Opinion***

In our opinion, the 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, 2013, and the changes in its net assets and its cash flows for the year then ended in accordance with accounting principles generally accepted in the United States of America.

**Other Reporting Required by *Government Auditing Standards***

In accordance with *Government Auditing Standards*, we have also issued our report dated October 18, 2013, on our consideration of The University of Tennessee Foundation, Inc.'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 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 of Tennessee Foundation, Inc.'s internal control over financial reporting and compliance.

Brown Jake & McDaniel, PC

Knoxville, Tennessee
October 18, 2013

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

**Statement of Financial Position**

**June 30, 2013**

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Assets: | | | | |
| Cash and cash equivalents | $ - | $ 11,233,109.01 | $ - | $ 11,233,109.01 |
| Cash surrender value of life insurance | - | 584,083.11 | - | 584,083.11 |
| Accounts receivable | - | 2,400.00 | - | 2,400.00 |
| Unconditional promises to give | - | 45,151,654.51 | 29,301,583.63 | 74,453,238.14 |
| Investments | 43,807,831.51 | 15,642,478.13 | 51,096,680.93 | 110,546,990.57 |
| Other assets | 376,000.00 | 6,802,763.00 | 177,700.00 | 7,356,463.00 |
| Total assets | $ 44,183,831.51 | $ 79,416,487.76 | $ 80,575,964.56 | $ 204,176,283.83 |
| Liabilities and net assets: | | | | |
| Liabilities: | | | | |
| Accounts payable | $ 755,205.22 | $ 377.12 | $ - | $ 755,582.34 |
| Annuity payable | - | 1,133,605.09 | - | 1,133,605.09 |
| Compensated absences | 1,381,254.65 | - | - | 1,381,254.65 |
| Due to University of Tennessee | 34,785,236.23 | - | - | 34,785,236.23 |
| Note payable | 150,147.68 | - | - | 150,147.68 |
| Total liabilities | 37,071,843.78 | 1,133,982.21 | - | 38,205,825.99 |
| Net assets: | | | | |
| Unrestricted | 7,111,987.73 | - | - | 7,111,987.73 |
| Temporarily restricted | - | 78,282,505.55 | - | 78,282,505.55 |
| Permanently restricted | - | - | 80,575,964.56 | 80,575,964.56 |
| Total net assets | 7,111,987.73 | 78,282,505.55 | 80,575,964.56 | 165,970,457.84 |
| Total liabilities and net assets | $ 44,183,831.51 | $ 79,416,487.76 | $ 80,575,964.56 | $ 204,176,283.83 |

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

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

**Statement of Activities**

**Year Ended June 30, 2013**

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Revenues: | | | | |
| Contributions | $ 1,943,144.51 | $ 49,580,181.00 | $ 14,794,491.91 | $ 66,317,817.42 |
| Interest and investment income | 246,315.67 | 1,902,206.88 | 90,826.81 | 2,239,349.36 |
| Net realized/unrealized gains and losses | 2,066,860.07 | 111,943.83 | - | 2,178,803.90 |
| Change in actuarial value of gift annuity | - | (55,557.95) | - | (55,557.95) |
| Contract with the University of Tennessee | 22,936,152.00 | - | - | 22,936,152.00 |
| Other | 203,268.40 | - | - | 203,268.40 |
| Net assets restricted or released from restrictions | 47,359,622.85 | (47,476,364.13) | 116,741.28 | (0.00) |
| Total revenues | 74,755,363.50 | 4,062,409.63 | 15,002,060.00 | 93,819,833.13 |
| Expenses: | | | | |
| Program expenses: | | | | |
| Salary and benefits | 11,143,937.39 | - | - | 11,143,937.39 |
| Travel | 731,840.58 | - | - | 731,840.58 |
| Printing | 221,368.01 | - | - | 221,368.01 |
| Utilities | 1,856,247.18 | - | - | 1,856,247.18 |
| Maintenance | 866,315.44 | - | - | 866,315.44 |
| Communications | 177,034.76 | - | - | 177,034.76 |
| Professional services | 6,783,010.83 | - | - | 6,783,010.83 |
| Awards | 7,243,473.09 | - | - | 7,243,473.09 |
| Entertainment | 211,074.63 | - | - | 211,074.63 |
| Capital projects | 10,759,966.95 | - | - | 10,759,966.95 |
| Supplies | 2,555,628.39 | - | - | 2,555,628.39 |
| Other | 4,386,553.66 | - | - | 4,386,553.66 |
| Total program expenses | 46,936,450.91 | - | - | 46,936,450.91 |
| General and administrative expenses: | | | | |
| Salary and benefits | 18,288,208.39 | - | - | 18,288,208.39 |
| Travel | 913,240.70 | - | - | 913,240.70 |
| Printing | 351,523.31 | - | - | 351,523.31 |
| Communications | 422,765.99 | - | - | 422,765.99 |
| Professional services | 1,220,385.97 | - | - | 1,220,385.97 |
| Supplies | 773,479.93 | - | - | 773,479.93 |
| Entertainment | 372,426.53 | - | - | 372,426.53 |
| Other | 588,767.26 | - | - | 588,767.26 |
| Total general and administrative expenses | 22,930,798.08 | - | - | 22,930,798.08 |
| Total expenses | 69,867,248.99 | - | - | 69,867,248.99 |
| Change in net assets | 4,888,114.51 | 4,062,409.63 | 15,002,060.00 | 23,952,584.14 |
| Net assets at beginning of year | 2,223,873.22 | 74,220,095.92 | 65,573,904.56 | 142,017,873.70 |
| Net assets at end of year | $ 7,111,987.73 | $ 78,282,505.55 | $ 80,575,964.56 | $ 165,970,457.84 |

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

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

**Statement of Cash Flows**

**Year Ended June 30, 2013**

| | |
|---|---|
| Cash flows from operating activities: | |
| Change in net assets | $ 23,952,584.14 |
| Adjustments to reconcile change in net assets to net cash provided by operating activities: | |
| Non-cash contributions | (614,600.00) |
| Cash paid to annuitants | (113,164.02) |
| Net realized/unrealized gains and losses | (2,178,803.90) |
| Change in actuarial values | 55,557.95 |
| Increase in cash surrender value of life insurance | (116,544.57) |
| Decrease in accounts receivable | 591,322.59 |
| Decrease in prepaid expenses | 4,835.83 |
| Increase in unconditional promises to give | (1,857,245.36) |
| Increase in accounts payable | 477,674.70 |
| Increase in annuity payable | 298,560.29 |
| Increase in compensated absences | 142,057.53 |
| Increase in due to the University of Tennessee | 34,782,854.98 |
| Net cash provided by operating activities | 55,425,090.16 |
| Cash flows from investing activities: | |
| Purchase of shares in the University's investment pool | (10,589,503.46) |
| Purchase of investments | (57,367,869.46) |
| Proceeds from sale of investments | 17,400,870.21 |
| Proceeds from sale of assets | 577,205.52 |
| Net cash used by investing activities | (49,979,297.19) |
| Cash flows from financing activities: | |
| Payment of principal on note payable | (16,550.54) |
| Net cash used by financing activities | (16,550.54) |
| Net increase in cash and cash equivalents | 5,429,242.43 |
| Cash and cash equivalents at beginning of year | 5,803,866.58 |
| Cash and cash equivalents at end of year | $ 11,233,109.01 |
| Supplemental disclosures of cash flow information: | |
| Cash paid during the year for interest | $ 10,729.46 |

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

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

**Notes to Financial Statements**

**June 30, 2013**

## 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") and 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. The Foundation also conducts the development and alumni affairs operations for the University.

### 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. The Foundation reports 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.

### 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.

### Income Tax Status

The Foundation is exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. In addition, the Foundation qualifies for the charitable contribution deduction under Section 170(b)(1)(A) and has been classified as an organization other than a private foundation under Section 509(a)(1).

The Foundation follows the provisions of FASB ASC 740-10-25. Under this standard, an organization must recognize that tax benefit associated with tax taken for tax return purposes when it is more likely than not the position will be sustained. The implementation of this standard has had no impact on the Foundation's financial statements. The Foundation does not believe there are any material uncertain tax positions and, accordingly, it will not recognize any liability for unrecognized tax benefits. For the year ended June 30, 2013, there were no interest or penalties recorded or included in its financial statements.

## 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.

### Unconditional Promises to Give

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

### Investments

Investments are recorded on the date of contribution and are stated at fair value. Fair values are determined by national securities exchanges, other active markets, or assumptions utilized by asset managers. 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.

### Other Assets - Property

Purchased property is capitalized at cost. Donations of property are recorded as contributions at their estimated fair value as determined by appraisal. Such donations are reported as unrestricted contributions unless the donor has restricted the donated asset to a specific purpose.

### Compensated Absences

Pursuant to the Employment Services Agreement (discussed at Note 9), the Foundation leases employees from the University for the development and alumni affairs operations.

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

**Notes to Financial Statements (Continued)**

## 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

### Compensated Absences (Continued)

These employees accrue annual leave at varying rates, depending on length of service. 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. The amount of these liabilities and their related benefits are reported in the statement of financial position.

### 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.

### Date of Management's Review

Subsequent events were evaluated through October 18, 2013, which is the date the financial statements were available to be issued.

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

**Notes to Financial Statements**
**(Continued)**

## 2. UNCONDITIONAL PROMISES TO GIVE

Unconditional promises to give are summarized below, net of the allowance for doubtful accounts:

| | Temporarily Restricted | Permanently Restricted |
|---|---|---|
| Current (within one year) | $ 7,034,644.51 | $ 2,477,625.67 |
| Due in one to five years | 25,677,315.27 | 21,542,777.54 |
| Due after five years | 13,891,346.54 | 6,448,013.40 |
| | 46,603,306.32 | 30,468,416.61 |
| Less discounts to net present value | (1,451,651.81) | (1,166,832.98) |
| Total unconditional promises to give, net | $ 45,151,654.51 | $ 29,301,583.63 |

The allowance for doubtful accounts at June 30, 2013 was $594,236.20. Interest rates used in the determination of present value discounts range from 0.508% to 2.014%.

Temporarily restricted unconditional promises to give includes two gifts of a remainder interest in certain limited liability companies (LLC):

The first LLC consists of a fee simple interest in a warehouse in South Carolina. The Foundation's remainder interest was valued at $7,740,000 at the time of contribution in December 2002, with the interest vesting on January 1, 2021. The value reported by the Foundation will be the present value of this amount until the vesting date. The interest rate used in the determination of present value is 4.00%. The present value of the remainder interest at June 30, 2013 was $5,767,543.99.

The second LLC consists of an office building in Connecticut. The Foundation's remainder interest was valued at $22,440,000 at the time of contribution in September 2003, with the interest vesting on January 1, 2025. The value reported by the Foundation has been the present value, using an interest rate of 4.20%. During the year, the Foundation entered into an agreement to sell its interest in this property. The sale closed on September 26, 2013. The present value of the remainder interest at June 30, 2013 has been adjusted to the net sales proceeds received by the Foundation, $2,864,920.60.

Permanently restricted promises to give are consider endowment funds by the Foundation.

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

**Notes to Financial Statements (Continued)**

## 3. INVESTMENTS

Investments held at June 30, 2013 were as follows:

| | Fair Value | Book Value |
|---|---|---|
| Endowment funds: | | |
| Held by the University: | | |
| Cash | $ 1,612,261.28 | $ 1,612,261.28 |
| US Equity | 4,472,689.80 | 3,606,762.51 |
| International Equity | 10,612,361.08 | 13,312,191.78 |
| Fixed Income | 3,118,818.06 | 3,457,518.55 |
| Alternative Investments: | | |
| Private Equity | 8,100,731.22 | 7,995,221.91 |
| Natural Resources | 8,511,775.77 | 7,950,721.06 |
| Real Estate Investments | 1,498,695.71 | 1,174,620.45 |
| Hedge Funds | 12,633,047.66 | 11,216,288.19 |
| Total held by the University | 50,560,380.58 | 50,325,585.74 |
| Held by the Foundation: | | |
| Cash | 168,575.51 | 168,575.51 |
| Equities | 615,264.40 | 538,816.55 |
| Mutual funds | 74,360.40 | 63,703.13 |
| Total held by the Foundation | 858,200.31 | 771,095.19 |
| Total endowment funds | 51,418,580.89 | 51,096,680.93 |
| Other investments: | | |
| Gift annuity program: | | |
| Cash | 15,062.83 | 15,062.83 |
| Equities | 1,567,120.51 | 1,349,186.95 |
| Fixed Income | 1,226,716.78 | 1,220,265.12 |
| Total gift annuity program | 2,808,900.12 | 2,584,514.90 |
| Managed funds: | | |
| Cash | 2,543,720.33 | 2,543,720.33 |
| Mutual funds | 53,775,789.23 | 54,049,541.10 |
| Total managed funds | 56,319,509.56 | 56,593,261.43 |
| Total other investments | 59,128,409.68 | 59,177,776.33 |
| Total investments | $ 110,546,990.57 | $ 110,274,457.26 |

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

**Notes to Financial Statements**
**(Continued)**

## 3. INVESTMENTS (Continued)

At June 30, 2013, the fair values of investments in 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.

### Endowment Funds

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 (CIP). 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 book value and fair value for these endowment funds were $50,325,585.74 and $50,560,380.58, which resulted in a cumulative unrealized gain of $234,794.84. One endowment is separately invested by the Foundation. The book value and fair value for this endowment was $771,095.19 and $858,200.31, which resulted in a cumulative unrealized gain of $87,105.12. All endowments at the Foundation are donor restricted. Endowment earnings transferred to the University were $1,817,202.76 for fiscal year 2013.

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, 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, (3) accumulations to the endowment made in accordance with the gift instrument, and (4) the endowment is vested in the CIP. Below is a schedule of endowments by fund type:

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Beginning balance | $ (2,340,611.94) | $ 31,466.05 | $ 65,396,204.56 | $ 63,087,058.67 |
| Contributions received | - | - | 14,794,491.91 | 14,794,491.91 |
| Transfers to endowments | - | - | 116,741.28 | 116,741.28 |
| Investment earnings | 3,376.48 | 1,830,706.27 | 90,826.81 | 1,924,909.56 |
| Net gain/loss | 2,340,611.94 | 342,831.90 | - | 2,683,443.84 |
| Disbursements | (3,376.48) | (1,872,636.67) | - | (1,876,013.15) |
| Ending balance | $ (0.00) | $ 332,367.55 | $ 80,398,264.56 | $ 80,730,632.11 |

## 3. INVESTMENTS (Continued)

### Endowment Funds (Continued)

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. During the year, these deficiencies were covered by an increase in the market value of endowment funds.

The University calculates its spending policy by taking 4.5% of a three year market average each December 31.

The University's overall, long-term investment objective of the CIP is to achieve an annualized total return (net of fees and expenses), through appreciation and income, greater than the rate of inflation (as measured by the broad, domestic Consumer Price Index) plus any spending, thus protecting the assets against inflation.

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.

Actual asset allocations were as follows at June 30, 2013:

| | |
|---|---|
| Cash | 2.8% |
| US Equity | 8.9% |
| International Equity | 21.0% |
| Fixed Income | 6.2% |
| Alternative Investments: | |
| Private Equity | 16.0% |
| Natural Resources | 16.8% |
| Real Estate Investments | 3.0% |
| Hedge Funds | 25.3% |

## 3. INVESTMENTS (Continued)

### Endowment Funds (Continued)

The Investment Advisory Committee is responsible for adopting the provisions of this Charter. This responsibility includes advising the Treasurer on the investment strategy, asset allocations, and spending rates; custodians and investment consultants; and monitoring performance of the investment portfolio on a regular basis (at least quarterly). The Committee will maintain sufficient knowledge about the portfolio and its managers so as to be reasonably assured of their compliance with the Policy and Charter. The committee is comprised of the President of the University of Tennessee, Chair of the Finance and Administration Committee of the Board of Trustees, the Treasurer, Chief Financial Officer, President of the University of Tennessee Foundation, a Member of the University of Tennessee Foundation board of directors, and four at large members elected by the committee. The plan consultant is Fund Evaluation Group headquartered in Cincinnati, Ohio.

The total fair value for the CIP at June 30, 2013 was $671,788,173.04

The total book value for the CIP at June 30, 2013 was $597,827,718.38

### Gift Annuity

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, 2013, the Foundation has executed 34 gift annuity contracts totaling $2,554,995.75 with three annuity contracts maturing. The funds are held in trust at First Tennessee Bank and invested. The fair value for the invested gift annuities and reserve at June 30 was $2,808,900.12 which resulted in a cumulative unrealized gain of $224,385.22. The investments consist of cash, equity index funds, and fixed income funds.

The Foundation follows the provisions of FASB ASC 820-10, which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements.

FASB ASC 820-10 establishes a framework for measuring fair value and a three-level hierarchy for fair value measurements based upon the inputs to value the assets and liabilities. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable. Observable inputs reflect market–derived or market-based information obtained from independent sources while unobservable inputs reflect estimates about market data based on the best available information in the circumstances. The three levels are defined as follows:

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

**Notes to Financial Statements**
**(Continued)**

## 3. INVESTMENTS (Continued)

### Fair Value Measures

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 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:

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Investments | $ 75,457,205.37 | $ 4,345,534.84 | $ 30,744,250.36 | $ 110,546,990.57 |

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

| | |
|---|---|
| Beginning balance | $ 22,913,810.52 |
| Total realized and unrealized gains and losses included in earnings | 8,508,399.45 |
| Purchases, issuances and settlements | (677,959.62) |
| Ending balance | $ 30,744,250.35 |

## 4. OTHER ASSETS

During the year, the Foundation received four contributions of real property totaling $614,600.00. The Foundation sold four pieces of property during the fiscal year. At June 30, 2013, the Foundation held the following gift property received during the year: real estate located in Memphis, TN appraised at $35,000.00.

The Foundation has received gift property in Tennessee in prior years: residential property in Knox County appraised at $85,000.00, residential property in Sequatchie County appraised at

## 4. OTHER ASSETS (Continued)

$60,000.00, 20 subdivision lots in Grainger County appraised at $35,000.00, commercial property in Monroe County appraised at $1,700.00, 2 residential lots in Knox County appraised at $177,700.00, residential property in Roane County appraised at $100,000.00, artwork and studio in Memphis appraised at $286,056.00, cabin in Scott County appraised at $549,999.00, and other property in Weakley County and Obion County appraised at $376,000.00. The Foundation has received commercial gift property in Burnsville, North Carolina in prior years appraised at $550,000.00. Private stock was donated in a prior year valued at $5,000,008.00.

## 5. OPERATING LEASES

The Foundation entered into a lease agreement on July 1, 2010, with the University for office space. Minimum lease payments are $20,016.00 per year over the lease term with the lease ending June 30, 2015 with a 5 year option.

## 6. RESTRICTED NET ASSETS

Temporarily restricted net assets are available for scholarships or other academic purposes, real estate, support for University construction, artwork, and contributions for the farm lease payment. Total temporarily restricted net assets at June 30, 2013 were $78,282,505.55.

Permanently restricted net assets are available for scholarships or other academic purposes. Total permanently restricted net assets at June 30, 2013 were $80,575,964.56.

## 7. 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 Foundation has not experienced any losses in this account and believes it is not exposed to any significant credit risk to cash.

## 8. NOTE PAYABLE

Note payable, dated January 2006, due in monthly installments of principal and interest of $2,000.00. This note bears interest at 4.68%. This note is secured by real property in Weakley County and Obion County, Tennessee. Total interest charged to expense during the year was $10,729.46.

## 8. NOTE PAYABLE (Continued)

Future maturities of this note are as follows:

| | |
|---|---|
| 2014 | $ 15,865.58 |
| 2015 | 18,100.58 |
| 2016 | 18,966.10 |
| 2017 | 19,873.00 |
| 2018 - 2021 | 77,342.42 |
| Total | $150,147.68 |

## 9. DEVELOPMENT AND ALUMNI AFFAIRS OPERATIONS

On July 1, 2011, the University transferred its development and alumni affairs operations to the Foundation. Pursuant to the University's Board of Trustees and the Foundation's Board of Directors 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 affect the transfer.

Affiliation and Services Agreement – the University and the Foundation agreed that all gifts, unless directed otherwise by the donor, be deposited into the Foundation bank account and that the University pay the Foundation direct support and a 100 basis point endowment assessment fee (less investment expenses) as compensation for performing the fundraising function. The direct support amount is to be reviewed every two years, and the Foundation President and Chief Executive Officer coordinates fundraising goals and objectives of the Foundation with the University. For FY 2013, the university provided the Foundation direct support of $17,623,515.00 and endowment assessment fees of $5,312,637.00.

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 totaled $18,288,208.39.

**BROWN JAKE & McDANIEL, PC**
CERTIFIED PUBLIC ACCOUNTANTS
2607 KINGSTON PIKE, SUITE 110
KNOXVILLE, TENNESSEE 37919-3336
865/637-8600 • fax: 865/637-8601

JOE L. BROWN, CPA, CGFM, CGMA
FRANK D. McDANIEL, CPA, CGFM, CGMA
TERRY L. MOATS, CPA, CGFM, CGMA
JAMES E. BOOHER, CPA, CGMA

MEMBERS
AMERICAN INSTITUTE OF
CERTIFIED PUBLIC ACCOUNTANTS

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

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

We have audited, in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of The University of Tennessee Foundation, Inc. (a nonprofit organization), which comprise the statement of financial position as of June 30, 2013, and the related statements of activities, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 18, 2013.

**Internal Control Over Financial Reporting**

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

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

Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

**Compliance and Other Matters**

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

**Purpose of this Report**

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

Brown Jake & McDaniel, PC

Knoxville, Tennessee
October 18, 2013