

**THE UNIVERSITY OF TENNESSEE FOUNDATION, INC.**  
**FINANCIAL STATEMENTS**  
**Year Ended June 30, 2017**  
**and**  
**INDEPENDENT AUDITOR'S REPORT**

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

**Financial Statements**

**June 30, 2017**

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## **INTRODUCTORY SECTION**

# UT FOUNDATION

## SCHEDULE OF FOUNDATION BOARD OF DIRECTORS AND OFFICIALS As of the Year Ending June 30, 2017

Ronald L. Turner, Chair

James L. Herbert, Jr.

Michael K. Littlejohn, Vice Chair

Joseph LaPorte, III

M. Steven Morris, Past Chair

Robert J. Kaplan, MD

Rickey N. McCurry, JD  
(Ex-Officio)  
President, UT Foundation, Inc.

Larry B. Martin\*

Joseph A. DiPietro, DVM  
(Ex-Officio)  
President, The University of Tennessee

Janet L. McKinley

Chancellor Steven R. Angle, PHD  
(Non-voting)  
Chancellor, The University of Tennessee  
at Chattanooga

Charles E. Moore

J. Jonathan Ayers\*

Sharon Miller Pryse (Ex-Officio)  
Trustee of The University of Tennessee

Alexis G. Bogo

Richard H. Sain

Dean Marie A. Chisholm-Burns  
(Non-voting)  
Dean, College of Pharmacy  
UT Health Science Center

Betty Ann Tanner\*

Gregory E. Cox\*

Charles A. Wagner, III

Sandra H. Fancher

Philip A. Wenk, DDS

Ronald E. Frieson

Charles E. Wharton (Ex-Officio)  
Trustee of The University of Tennessee

Dee Bagwell Haslam

James L. Wolford

Lisa N. Taylor  
Chief Financial Officer & Treasurer,  
UT Foundation, Inc.

Rachael R. LeBlanc  
Secretary & Director of Foundation  
Programs, UT Foundation, Inc.

\*Member of the Audit Committee

## **FINANCIAL SECTION**

# BROWN JAKE & McDANIEL, PC

CERTIFIED PUBLIC ACCOUNTANTS  
 2607 KINGSTON PIKE, SUITE 110  
 KNOXVILLE, TENNESSEE 37919-3336  
 865/637-8600 • fax: 865/637-8601  
 www.bjmpc.com

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, 2017, 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, 2017, 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.

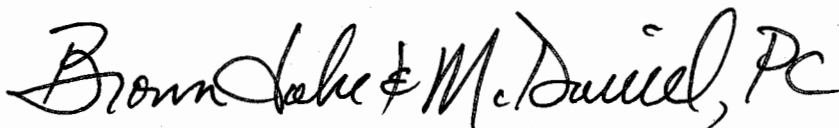
### **Other Matters**

#### *Other Information*

Our audit was conducted for the purpose of forming an opinion on the financial statements that collectively comprise the Foundation's basic financial statements. The introductory section is presented for purposes of additional analysis and is not a required part of the basic financial statements. The introductory section 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 October 31, 2017, 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.

A handwritten signature in black ink that reads "Brown Lake & McDaniel, PC". The signature is written in a cursive, flowing style.

Knoxville, Tennessee  
October 31, 2017

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

**Statement of Financial Position**

**June 30, 2017**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Assets:</b>				
Cash and cash equivalents	\$ -	\$ 17,880,759.99	\$ 532,984.65	\$ 18,413,744.64
Cash surrender value of life insurance	-	666,519.26	-	666,519.26
Accounts receivable	32,412.34	40.00	-	32,452.34
Note receivable	-	9,250,000.00	-	9,250,000.00
Unconditional promises to give	-	47,846,596.18	54,234,432.73	102,081,028.91
Investments	16,700,795.10	83,930,855.73	172,075,591.98	272,707,242.81
Other assets	376,000.00	656,280.00	177,700.00	1,209,980.00
<b>Total assets</b>	<b>\$ 17,109,207.44</b>	<b>\$ 160,231,051.16</b>	<b>\$ 227,020,709.36</b>	<b>\$ 404,360,967.96</b>
<b>Liabilities and net assets:</b>				
<b>Liabilities:</b>				
Accounts payable	\$ 288,710.93	\$ 76,875.00	\$ -	\$ 365,585.93
Annuities payable	-	3,576,571.21	-	3,576,571.21
Compensated absences	1,800,421.27	-	-	1,800,421.27
Notes payable	75,644.03	7,705,000.00	-	7,780,644.03
<b>Total liabilities</b>	<b>2,164,776.23</b>	<b>11,358,446.21</b>	<b>-</b>	<b>13,523,222.44</b>
<b>Net assets:</b>				
Unrestricted	14,944,431.21	-	-	14,944,431.21
Temporarily restricted	-	148,872,604.95	-	148,872,604.95
Permanently restricted	-	-	227,020,709.36	227,020,709.36
<b>Total net assets</b>	<b>14,944,431.21</b>	<b>148,872,604.95</b>	<b>227,020,709.36</b>	<b>390,837,745.52</b>
<b>Total liabilities and net assets</b>	<b>\$ 17,109,207.44</b>	<b>\$ 160,231,051.16</b>	<b>\$ 227,020,709.36</b>	<b>\$ 404,360,967.96</b>

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



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

**Statement of Activities**

**Year Ended June 30, 2017**

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
<b>Revenues:</b>				
Contributions	\$ 3,798,504.28	\$ 59,544,502.05	\$ 25,098,665.21	\$ 88,441,671.54
Interest and investment income	1,610,396.43	7,035,934.16	133,056.58	8,779,387.17
Net realized/unrealized gains and losses	5,388,878.39	442,752.17	(1,115.41)	5,830,515.15
Change in actuarial value of gift annuities	-	(231,404.70)	-	(231,404.70)
Contract with the University of Tennessee	28,798,785.00	100,000.00	-	28,898,785.00
Other	35,977.05	112.50	-	36,089.55
Net assets released from restrictions and restricted during the year	62,193,506.55	(62,409,251.71)	215,745.16	(0.00)
<b>Total revenue</b>	<b>101,826,047.70</b>	<b>4,482,644.47</b>	<b>25,446,351.54</b>	<b>131,755,043.71</b>
<b>Expenses:</b>				
<b>Program expenses:</b>				
Salary and benefits	21,133,535.97	-	-	21,133,535.97
Travel	5,359,561.91	-	-	5,359,561.91
Printing	248,822.79	-	-	248,822.79
Utilities	109,441.97	-	-	109,441.97
Maintenance	1,368,355.91	-	-	1,368,355.91
Communications	98,096.23	-	-	98,096.23
Professional services	5,803,942.77	-	-	5,803,942.77
Awards	16,866,171.96	-	-	16,866,171.96
Entertainment	403,619.42	-	-	403,619.42
Capital projects	3,648,492.33	-	-	3,648,492.33
Supplies	1,462,935.98	-	-	1,462,935.98
Other	4,690,398.71	-	-	4,690,398.71
<b>Total program expenses</b>	<b>61,193,375.95</b>	<b>-</b>	<b>-</b>	<b>61,193,375.95</b>
<b>General and administrative:</b>				
Salary and benefits	22,919,792.45	-	-	22,919,792.45
Travel	1,071,648.25	-	-	1,071,648.25
Printing	565,558.43	-	-	565,558.43
Communications	498,857.80	-	-	498,857.80
Professional services	2,254,522.45	-	-	2,254,522.45
Supplies	1,009,737.59	-	-	1,009,737.59
Entertainment	1,054,039.56	-	-	1,054,039.56
Other	2,848,624.60	-	-	2,848,624.60
<b>Total general and administrative expenses</b>	<b>32,222,781.13</b>	<b>-</b>	<b>-</b>	<b>32,222,781.13</b>
<b>Total expenses</b>	<b>93,416,157.08</b>	<b>-</b>	<b>-</b>	<b>93,416,157.08</b>
Change in net assets	8,409,890.62	4,482,644.47	25,446,351.54	38,338,886.63
Net assets at beginning of year	6,534,540.59	144,389,960.48	201,574,357.82	352,498,858.89
Net assets at end of year	<u>\$ 14,944,431.21</u>	<u>\$ 148,872,604.95</u>	<u>\$ 227,020,709.36</u>	<u>\$ 390,837,745.52</u>

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, 2017**

Cash flows from operating activities:	
Change in net assets	\$ 38,338,886.63
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Net realized/unrealized losses	(5,830,515.15)
Non-cash contributions	(52,000.00)
Cash paid to annuitants	(505,371.39)
Change in actuarial values	231,404.70
Decrease in cash surrender value of life insurance	208.87
Increase in receivables	(30,027.34)
Decrease in unconditional promises to give	9,280,966.98
Increase in compensated absences	148,961.62
Increase in annuity payable	948,293.78
Increase in accounts payable	66,990.30
	<u>42,597,799.00</u>
Net cash provided by operating activities	
Cash flows from investing activities:	
Purchase of shares in the university's investment pools	(36,725,861.37)
Purchase of investments	(62,793,887.53)
Issuance of note receivable	(9,250,000.00)
Proceeds from sale of investments	66,847,203.22
Proceeds from sale of assets of other assets	10,530,000.00
	<u>(31,392,545.68)</u>
Net cash used by investing activities	
Cash flows from financing activities:	
Proceeds from the issuance of note payable	205,000.00
Payment of principal on note payable	(18,323.32)
	<u>186,676.68</u>
Net cash provided by financing activities	
Net increase in cash and cash equivalents	11,391,930.00
Cash and cash equivalents at beginning of year	<u>7,021,814.64</u>
Cash and cash equivalents at end of year	<u>\$ 18,413,744.64</u>
<hr/>	
Supplemental disclosures of cash flow information:	
Cash paid during the year for interest	\$ 300,012.71

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

# The University of Tennessee Foundation, Inc.

## Notes to Financial Statements

June 30, 2017

### 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, 2017, there were no interest or penalties recorded or included in its financial statements.

The University of Tennessee Foundation, Inc.

Notes to 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.

**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 or use of the proceeds from the sale of the donated asset to a specific purpose.

**Compensated Absences**

Pursuant to the Employee Services Agreement (discussed at Note 10), 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 value at the time of donation and are reported as restricted support if it is received with donor imposed restrictions.

**Donated Facilities and Services**

Donation of rent, including utilities, cleaning, security and maintenance, and technology and accounting services as provided by the University of Tennessee to the Foundation are recorded at their estimated fair values on an annual basis. The estimated value of these in-kind contributions for the year ended June 30, 2017 totaled \$2,121,864.00 and is included in unrestricted contributions and other general and administrative expense in the Statement of Activities.

**Date of Management's Review**

Subsequent events were evaluated through October 31, 2017, 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:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
Current (within one year)	\$ 11,729,695.90	\$ 4,722,445.69
Due in one to five years	29,592,751.15	38,980,623.67
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>(2,326,661.61)</u>	<u>(3,390,405.28)</u>
Total unconditional promises to give, net	<u>\$ 47,846,596.18</u>	<u>\$ 54,234,432.73</u>

The allowance for doubtful accounts at June 30, 2017 was \$729,092.44. Interest rates used in the determination of present value discounts range from 1.460% to 2.093%.

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

**3. NOTE RECEIVABLE**

During February 2017, the Foundation sold a warehouse facility in Edgefield County, SC 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.

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

**Notes to Financial Statements  
(Continued)**

**4. INVESTMENTS**

Investments held at June 30, 2017 were as follows:

	Fair Value	Cost
Endowment funds:		
Held by the University:		
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	31,808,260.00	31,558,875.00
Total held by the University	<u>171,509,580.22</u>	<u>170,830,672.02</u>
Held by the Foundation:		
Cash	224,835.89	224,835.89
Equities	1,214,251.24	1,069,077.41
Total 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>
Other investments:		
Liquid investments held by the University:		
Cash Management Pool (cash equivalents, debt securities and U.S. agencies)	85,564,908.87	85,564,908.87
FTN Public Funds account	3,000,000.00	3,000,000.00
Total liquid investments held by the University	<u>88,564,908.87</u>	<u>88,564,908.87</u>
Liquid investments at financial institution	<u>3,512,250.97</u>	<u>3,512,250.97</u>
Gift annuity program:		
Cash	26,117.16	26,117.16
Equities	4,255,104.31	3,874,393.85
Fixed Income	3,400,194.15	3,419,469.05
Total gift annuity program	<u>7,681,415.62</u>	<u>7,319,980.06</u>
Total investments	<u>\$ 272,707,242.81</u>	<u>\$ 271,521,725.22</u>

At June 30, 2017, 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

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

**Notes to Financial Statements  
(Continued)**

**4. INVESTMENTS (Continued)**

evaluated on a regular basis and are susceptible to revisions as more information becomes available.

**Endowment Funds**

The Foundation's endowment funds consist of cash, investments held by the University, investments held by the Foundation, permanently restricted unconditional promises to give and other assets. 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 cost and fair value for these endowment funds were \$170,830,672.02 and \$171,509,580.22, which resulted in a cumulative unrealized gain of \$678,908.20. Two endowments are separately invested by the Foundation. The cost and fair value for these endowments was \$1,293,913.30 and \$1,439,087.13, which resulted in a cumulative unrealized gain of \$145,173.83. 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 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 until the endowment is vested in the CIP. Below is a schedule of endowments by fund type:

	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
Transfer to endowments	-	-	215,745.16	215,745.16
Investment earnings	4,567.29	6,740,605.54	133,056.58	6,878,229.41
Net gain/loss	5,267,147.84	897,486.59	(1,115.41)	6,163,519.02
Disbursements	(4,567.29)	(6,765,016.76)	-	(6,769,584.05)
Ending balance	<u>\$ 0.00</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 University of Tennessee Foundation, Inc.**

**Notes to Financial Statements  
(Continued)**

**4. INVESTMENTS (Continued)**

**Endowment Funds (Continued)**

Historically, the University had calculated its spending policy distributions by taking 4.5% of a three year market average each December 31. Beginning in fiscal year 2016, the University began the transition 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.

Endowment Funds investments held by the University were as follows at June 30, 2017:

Debt Securities (including Pooled Inv. Vehicles - Bonds)	12.39%
Corporate Stock – Domestic	1.17%
Corporate Stock – International	0.23%
Pooled Investment Vehicles – Equity	33.44%
Alternative Investments:	
Pooled Investment Vehicles – Real Estate	5.76%
Private Capital Investments	28.46%
Hedge Funds	<u>18.55%</u>
Total Endowment Funds investments held by the University	<u>100.00%</u>

The Investment Advisory Committee is responsible for adopting the provisions of the Investment Advisory Committee Charter. This responsibility includes advising the Treasurer on the investment strategy, asset allocations, and spending rates; the hiring and firing of investment managers, 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

**The University of Tennessee Foundation, Inc.****Notes to Financial Statements  
(Continued)****4. INVESTMENTS (Continued)****Endowment Funds (Continued)**

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, 2017 was \$911,399,532.18.

The total cost of the CIP at June 30, 2017 was \$808,983,555.50.

**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. As of June 30, 2017, the Foundation has executed 63 gift annuity contracts totaling \$7,578,546.23 with five 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, 2017 was \$7,681,415.62 which resulted in a cumulative unrealized gain of \$361,435.56. The investments consist of cash, equity index funds, and fixed income funds.

**Fair Value Measures**

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:

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

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

**Notes to Financial Statements  
(Continued)**

**4. INVESTMENTS (Continued)**

**Fair Value Measures (Continued)**

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 held by the University	\$ 60,117,796.00	\$ 92,594,186.87	\$ 107,362,506.22	\$ 260,074,489.09
Investments held by the Foundation	9,232,559.57	3,400,194.15	-	12,632,753.72
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 Foundation does not hold any Level 3 investments directly, therefore; the schedule of annual financial activities for Level 3 investments represents investments held by the University measured at their fair value on a recurring basis from reliance on Level 3 inputs for determining their fair value.

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

**5. OTHER ASSETS**

During the year, the Foundation received one contribution of real property totaling \$52,000.00. At June 30, 2017, the Foundation held the same gift property: real estate located in Union County, Tennessee appraised at \$52,000.00. The Foundation sold two pieces of property during the fiscal year.

One of the properties sold during the fiscal year was an office and warehouse facility located in South Carolina valued at \$11,000,000.00 at the time of acquisition in the prior fiscal year. The acquisition was facilitated with financing from a note payable in the amount of \$7,500,000.00 from a local credit union. The property was sold in February 2017 at a sales price of \$10,250,000.00. UTFI provided seller financing to the buyer in the amount of \$9,250,000.00 at an annual interest rate of 4% (See Note 3 above). The note receivable to the buyer calls for interest only payments until the maturity date of September 1, 2019. The

**The University of Tennessee Foundation, Inc.****Notes to Financial Statements  
(Continued)****5. OTHER ASSETS (Continued)**

original note payable executed by UTFI with the local credit union was restated to assist UTFI with the seller financing (see Note 9 below).

The Foundation has received and continues to hold the following gift property located in Tennessee in prior years: residential property in Sequatchie County appraised at \$60,000.00, twenty subdivision lots in Grainger County appraised at \$35,000.00, commercial property in Monroe County appraised at \$1,700.00, residential property in Monroe County appraised at \$279,680.00, two residential lots in Knox County appraised at \$177,700.00, residential property in Roane County appraised at \$64,900.00, residential property in Memphis appraised at \$35,000.00, residential property in Cumberland County appraised at \$20,000.00, residential property in Madison County appraised at \$30,000.00, and other property in Weakley County and Obion County appraised at \$376,000.00. In addition, the Foundation holds residential property in Landrum, SC appraised at \$78,000.00.

**6. OFFICE SPACE AND SERVICES AGREEMENTS**

The Foundation entered into a lease agreement with the University during the fiscal year ending June 30, 2016 for office space and services (parking, mail services, interior maintenance and custodial services, exterior maintenance to facilities and parking areas, security, etc.) at 1525 and 1610 University Avenue. The new agreement required the Foundation and the University of Tennessee Alumni Association to fund the purchase of furniture, fixtures and equipment not to exceed \$315,000.00 for the new leased facilities. The University committed to assist with these expenditures by contributing \$117,880.00 from their capital campaign funds. The new agreement term is for the life of the facilities in perpetuity until the Foundation voluntarily vacates the facilities or the Foundation and the University mutually agree upon other office space and services arrangements. The agreement requires payments in the amount of \$1,668.00 per month or \$20,016.00 annually. The agreement stipulates there will not be an increase in the annual amount for the initial five years of the agreement. The total rent expense paid to the University during the fiscal year ending June 30, 2017 totaled \$20,016.00.

**7. 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, 2017 were \$148,872,604.95.

Permanently restricted net assets are available for scholarships or other academic purposes. Total permanently restricted net assets at June 30, 2017 were \$227,020,709.36.

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

**Notes to Financial Statements  
(Continued)**

**7. RESTRICTED NET ASSETS (Continued)**

Temporarily restricted and permanently restricted net assets consisted of the following categories as of June 30, 2017:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
Other	\$ 21,935,066.93	\$ 19,977,121.97
Academic Support	22,772,595.74	50,896,523.44
Library	2,171.41	576,456.64
Research	9,372,486.38	3,302,116.87
Instruction	12,335,436.39	85,625,816.76
Public Service	3,187,580.99	11,035.47
Institutional Support	22,730,035.06	8,107,102.39
Student Services	733,755.45	-
Athletics	2,684,438.20	1,692,009.83
Capital Projects	34,467,735.34	-
Physical Plant	11,155,348.76	-
Scholarships and Fellowships	<u>7,495,954.30</u>	<u>56,832,525.99</u>
Net Assets	<u>\$ 148,872,604.95</u>	<u>\$ 227,020,709.36</u>

**8. CONCENTRATION OF CREDIT RISK**

The Foundation had concentrated its credit risk for cash and temporary investments by maintaining deposits at two financial institutions, 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). One of the financial institutions has provided the Foundation excess deposit insurance coverage for cash or liquid investment amounts exceeding the normal account coverage limits. The Foundation has not experienced any losses in this account and believes it is not exposed to any significant credit risk to cash.

The Foundation has a master repurchase agreement with one of the financial institutions where at the end of each day cash is invested in overnight securities and the securities are repurchased the next day. The Foundation purchases the securities in its name. The Repurchase Agreement Account is not insured by FDIC insurance, but rather the financial institution provides the securities purchased as the underlying security for the Repurchase Agreement Account. The Repurchase Agreement Account as of June 30, 2017 totaled \$18,007,028.37 and this amount is included in cash and cash equivalents in the Statement of Net Position.

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

**Notes to Financial Statements  
(Continued)**

**9. NOTES PAYABLE**

The Note Payable, dated January 2006, is secured by real property in Weakley County and Obion County, Tennessee. Payments are due in monthly installments of principal and interest of \$2,000.00. This note bears interest at 4.68%. Total interest charged to expense during the year was \$3,676.68.

Maturities of this note in each future fiscal year are as follows:

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 Note Payable executed during the Foundation's fiscal year ending June 30, 2016 to a credit union totaling \$7,500,000.00 (dated April 29, 2016, bearing interest at 3.77% annum, and originally due in full at maturity on November 15, 2017) was restated in February 2017 as a result of the sale of the underlying collateral with a commitment for seller financing. This note payable was used to finance the purchase of the sole interest in an LLC whose only asset was an office and warehouse facility in Edgefield County, South Carolina. The restated note payable bears the same annual interest rate and is due in full at maturity on September 15, 2019. The Foundation is required to pay accrued interest monthly until the maturity date. Total interest charged to expense during the year was \$293,595.21. The note payable is secured with a money market cash account with the credit union totaling \$3,512,250.97.

The Foundation issued a note payable in February 2017 to a commercial/industrial realty company which assisted the Foundation with the sale of the Edgefield County, South Carolina facility discussed above. The note payable totaled \$205,000.00 and bears annual interest at 4.0% payable monthly. The note payable matures on September 15, 2019 to the realty company in conjunction with the maturity of the Foundation's financing note receivable to the facility buyer discussed in Note 3.

**10. 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.

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

**Notes to Financial Statements  
(Continued)**

**10. DEVELOPMENT AND ALUMNI AFFAIRS OPERATIONS (Continued)**

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 2017, the University provided the Foundation direct support of \$21,677,182.00 and endowment assessment fees of \$7,121,604.00.

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 \$22,919,792.45.

**INTERNAL CONTROL AND COMPLIANCE SECTION**



**BROWN JAKE & McDANIEL, PC**

**CERTIFIED PUBLIC ACCOUNTANTS**  
**2607 KINGSTON PIKE, SUITE 110**  
**KNOXVILLE, TENNESSEE 37919-3336**  
**865/637-8600 • fax: 865/637-8601**  
**www.bjmpc.com**

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

MEMBERS  
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**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, 2017, 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 31, 2017.

**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.

A handwritten signature in black ink that reads "Brian Robert McDaniel, PC". The signature is written in a cursive style with a large, stylized initial "B".

Knoxville, Tennessee  
October 31, 2017

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

**Summary Schedule of Prior Audit Findings**

There were no prior year findings.