

THE UNIVERSITY OF TENNESSEE FOUNDATION, INC.
FINANCIAL STATEMENTS
Year Ended June 30, 2018
and
INDEPENDENT AUDITOR'S REPORT

The University of Tennessee Foundation, Inc.

Financial Statements

June 30, 2018

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INTRODUCTORY SECTION

The University of Tennessee Foundation, Inc.

Schedule of Board of Directors and Officials

June 30, 2018

Board of Directors:

Ronald L. Turner, Chair
Michael K. Littlejohn, Vice Chair
Joseph A. DiPietro
Hans N. Airee
J. Jonathan Ayers
Alexis G. Bogo
Christopher B. Bollinger
Keith S. Carver
Phillip A. Clendenin
Gregory E. Cox
Kimberley W. Cross
Robert F. Decosimo
Robert S. Dooley
Kimbrough L. Dunlap, III
Ronald Frieson
James L. Herbert, Jr.
Joseph LaPorte, III
Kathy W. Ledbetter
Charles E. Moore
Sharon J. Pryse
Richard H. Sain
Betty Ann Turner
Charles A. Wagner, III
Philip A. Wenk
Charles E. Wharton

Officers:

Kerry Witcher, Interim President and CEO
Lisa N. Taylor, Treasurer and CFO
Rachael R. LeBlanc, Secretary

FINANCIAL SECTION

BROWN JAKE & McDANIEL, PC

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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, 2018, 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, 2018, 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 as a whole. The introductory section is presented for purposes of additional analysis and is not a required part of the financial statements. The introductory section has not been subjected to the auditing procedures applied in the audit of the 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, 2018, 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 solely 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 effectiveness of The University of Tennessee Foundation, Inc.'s 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 31, 2018

The University of Tennessee Foundation, Inc.

Statement of Financial Position

June 30, 2018

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Assets:				
Cash and cash equivalents	\$ -	\$ 6,163,435.00	\$ -	\$ 6,163,435.00
Cash surrender value of life insurance	-	588,995.80	-	588,995.80
Accounts receivable	4,672.66	-	-	4,672.66
Unconditional promises to give	-	75,397,986.58	49,415,783.34	124,813,769.92
Investments	18,630,236.80	95,684,572.95	207,980,076.13	322,294,885.88
Other assets	376,000.00	776,280.00	177,700.00	1,329,980.00
Total assets	<u>\$ 19,010,909.46</u>	<u>\$ 178,611,270.33</u>	<u>\$ 257,573,559.47</u>	<u>\$ 455,195,739.26</u>
Liabilities and net assets:				
Liabilities:				
Accounts payable	\$ 291,262.06	\$ 12,030.48	\$ -	\$ 303,292.54
Annuity payable	-	4,198,453.31	-	4,198,453.31
Compensated absences	1,702,393.84	-	-	1,702,393.84
Note payable	54,739.54	-	-	54,739.54
Total liabilities	<u>2,048,395.44</u>	<u>4,210,483.79</u>	<u>-</u>	<u>6,258,879.23</u>
Net assets:				
Unrestricted	16,962,514.02	-	-	16,962,514.02
Temporarily restricted	-	174,400,786.54	-	174,400,786.54
Permanently restricted	-	-	257,573,559.47	257,573,559.47
Total net assets	<u>16,962,514.02</u>	<u>174,400,786.54</u>	<u>257,573,559.47</u>	<u>448,936,860.03</u>
Total liabilities and net assets	<u>\$ 19,010,909.46</u>	<u>\$ 178,611,270.33</u>	<u>\$ 257,573,559.47</u>	<u>\$ 455,195,739.26</u>

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

The University of Tennessee Foundation, Inc.

Statement of Activities

Year Ended June 30, 2018

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Revenues:				
Contributions	\$ 1,272,111.29	\$ 93,768,604.61	\$ 30,054,966.36	\$ 125,095,682.26
Interest and investment income	2,513,984.68	8,421,434.26	256,036.64	11,191,455.58
Net realized/unrealized gains and losses	-	1,364,892.17	(146.91)	1,364,745.26
Change in actuarial value of gift annuity	-	(256,469.27)	-	(256,469.27)
Contract with the University of Tennessee	27,641,761.00	-	-	27,641,761.00
Other	257,438.54	-	-	257,438.54
Net assets released from restrictions and restricted during the year	77,528,286.16	(77,770,280.18)	241,994.02	0.00
Total revenue	109,213,581.67	25,528,181.59	30,552,850.11	165,294,613.37
Expenses:				
Program expenses				
Salary and benefits	10,816,391.54	-	-	10,816,391.54
Travel	7,651,326.89	-	-	7,651,326.89
Printing	238,872.95	-	-	238,872.95
Utilities	82,208.72	-	-	82,208.72
Maintenance	1,449,923.94	-	-	1,449,923.94
Communications	132,449.04	-	-	132,449.04
Professional Services	4,996,497.22	-	-	4,996,497.22
Awards	22,153,105.58	-	-	22,153,105.58
Entertainment	370,652.23	-	-	370,652.23
Capital Projects	13,822,785.95	-	-	13,822,785.95
Supplies	3,307,470.59	-	-	3,307,470.59
Other	11,587,726.70	-	-	11,587,726.70
Total program expenses	76,609,411.35	-	-	76,609,411.35
General and administrative				
Salary and benefits	21,611,730.36	-	-	21,611,730.36
Travel	896,853.21	-	-	896,853.21
Printing	678,814.67	-	-	678,814.67
Communications	433,487.02	-	-	433,487.02
Professional Services	1,698,104.31	-	-	1,698,104.31
Supplies	1,319,015.12	-	-	1,319,015.12
Entertainment	976,600.87	-	-	976,600.87
Other	2,971,481.95	-	-	2,971,481.95
Total general and administrative expenses	30,586,087.51	-	-	30,586,087.51
Total expenses	107,195,498.86	-	-	107,195,498.86
Change in net assets	2,018,082.81	25,528,181.59	30,552,850.11	58,099,114.51
Net assets at beginning of year	14,944,431.21	148,872,604.95	227,020,709.36	390,837,745.52
Net assets at end of year	\$ 16,962,514.02	\$ 174,400,786.54	\$ 257,573,559.47	\$ 448,936,860.03

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, 2018

Cash flows from operating activities:	
Change in net assets	\$ 58,099,114.51
Adjustments to reconcile change in net assets to net cash provided by operating activities:	
Net realized/unrealized gains and losses	(1,364,745.26)
Non-cash contributions	(120,000.00)
Cash paid to annuitants	(480,787.00)
Change in actuarial values	256,469.27
Decrease in cash surrender value of life insurance	77,523.46
Decrease in receivables	27,779.68
Increase in unconditional promises to give	(22,732,741.01)
Decrease in accounts payable	(62,293.39)
Increase in annuity payable	846,199.83
Decrease in compensated absences	(98,027.43)
	34,448,492.66
Cash flows from investing activities:	
Purchase of shares in the university's investment pools	(43,296,757.54)
Purchase of investments	(85,851,004.67)
Proceeds from note receivable	9,250,000.00
Proceeds from sale of investments	80,924,864.40
	(38,972,897.81)
Cash flows from financing activities:	
Payment of principal on note payable	(7,725,904.49)
	(7,725,904.49)
Net decrease in cash and cash equivalents	(12,250,309.64)
Cash and cash equivalents at beginning of year	18,413,744.64
Cash and cash equivalents at end of year	\$ 6,163,435.00
<hr/>	
Supplemental disclosures of cash flow information:	
Cash paid during the year for interest	\$ 186,287.43

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

The University of Tennessee Foundation, Inc.**Notes to Financial Statements****June 30, 2018****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, 2018, 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 Employment 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, 2018 totaled \$2,191,929.00 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, 2018, 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)	\$ 11,036,587.21	\$ 4,272,926.99
Due in one to five years	60,519,417.85	38,830,590.53
Due after five years	<u>9,374,414.48</u>	<u>10,759,759.82</u>
	80,930,419.54	53,863,277.34
Less discounts to net present value	<u>(5,532,432.96)</u>	<u>(4,447,494.00)</u>
Total unconditional promises to give, net	<u>\$ 75,397,986.58</u>	<u>\$ 49,415,783.34</u>

The allowance for doubtful accounts at June 30, 2018 was \$894,109.92. Interest rates used in the determination of present value discounts range from 2.598% to 2.836%.

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

3. NOTE RECEIVABLE

The Note Receivable executed in February 2017 in order to provide seller financing to the buyer of a warehouse facility in Edgefield, SC was paid in full on January 31, 2018.

The University of Tennessee Foundation, Inc.

**Notes to Financial Statements
(Continued)**

4. INVESTMENTS

Investments held at June 30, 2018 were as follows:

	<u>Fair Value</u>	<u>Cost</u>
Endowment funds:		
Held by the University:		
Debt Securities	\$ 12,107,934.96	\$ 14,009,688.25
Corporate Stock - Domestic	3,723,768.24	2,736,044.96
Corporate Stock -International	515,505.84	548,458.92
Pooled Investment Vehicles - Equity	68,590,601.19	66,184,424.56
Alternative Investments:		
Pooled Investment Vehicles - Real Estate	12,263,841.70	10,526,397.75
Private Capital Investments	60,839,182.44	66,304,104.82
Hedge Funds	49,960,891.69	45,918,052.26
Total held by the University	<u>208,001,726.06</u>	<u>206,227,171.52</u>
Held by the Foundation:		
Cash	268,196.15	268,196.15
Equities	1,844,401.43	1,627,082.98
Total held by the Foundation	<u>2,112,597.58</u>	<u>1,895,279.13</u>
Total endowment funds	<u>210,114,323.64</u>	<u>208,122,450.65</u>
Other investments:		
Liquid investments held by the University:		
Cash Management Pool (cash equivalents, debt securities and U.S. agencies)	99,123,671.43	99,123,671.43
FTN Public Funds account	4,000,000.00	4,000,000.00
Total liquid investments held by the University	<u>103,123,671.43</u>	<u>103,123,671.43</u>
Liquid investments at financial institution	<u>5.00</u>	<u>5.00</u>
Gift annuity program:		
Cash	11,684.85	11,684.85
Equities	4,952,320.94	4,454,843.03
Fixed Income	4,092,880.02	4,176,985.87
Total gift annuity program	<u>9,056,885.81</u>	<u>8,643,513.75</u>
Total investments	<u>\$ 322,294,885.88</u>	<u>\$ 319,889,640.83</u>

At June 30, 2018, 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 \$206,227,171.52 and \$208,001,726.06, which resulted in a cumulative unrealized gain of \$1,774,554.54. Three endowments are separately invested by the Foundation. The cost and fair value for these endowments was \$1,895,279.13 and \$2,112,597.58, which resulted in a cumulative unrealized gain of \$217,318.45. All endowments at the Foundation are donor restricted. Endowment earnings transferred to the University were \$7,900,111.13 for fiscal year 2018.

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	\$ -	\$ 873,075.37	\$ 227,020,709.36	\$ 227,893,784.73
Transfer to endowments	-	-	241,994.02	241,994.02
Contributions Received	-	-	30,054,966.36	30,054,966.36
Investment earnings	-	7,937,596.02	256,036.64	8,193,632.66
Net real/unreal gain/loss	-	1,223,687.25	(146.91)	1,223,540.34
Disbursements	-	(7,900,111.13)	-	(7,900,111.13)
Ending balance	<u>\$ -</u>	<u>\$ 2,134,247.51</u>	<u>\$ 257,573,559.47</u>	<u>\$ 259,707,806.98</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, 2018:

Debt Securities (including Pooled Inv. Vehicles - Bonds)	5.82%
Corporate Stock – Domestic	1.79%
Corporate Stock – International	0.25%
Pooled Investment Vehicles – Equity	32.98%
Alternative Investments:	
Pooled Investment Vehicles – Real Estate	5.90%
Private Capital Investments	29.25%
Hedge Funds	<u>24.01%</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, 2018 was \$976,330,854.46.

The total cost of the CIP at June 30, 2018 was \$846,808,042.24.

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, 2018, the Foundation has executed 69 gift annuity contracts totaling \$9,092,577.69 with six 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, 2018 was \$9,056,885.81 which resulted in a cumulative unrealized gain of \$413,372.06. 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:

	<u>Level 1</u>	<u>Level 2</u>	<u>Level 3</u>	<u>Total</u>
Investments held by the University	\$ 72,997,874.11	\$ 99,732,990.77	\$ 138,394,532.60	\$ 311,125,397.48
Investments held by the Foundation	7,076,608.37	4,092,880.02	-	11,169,488.39
Total investments	<u>\$ 80,074,482.48</u>	<u>\$ 103,825,870.79</u>	<u>\$ 138,394,532.60</u>	<u>\$ 322,294,885.87</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	\$ 107,362,506.22
Total realized and unrealized gains and losses included in earnings	4,506,306.22
Net purchases, issuances, settlements and other	<u>26,525,720.16</u>
Ending balance	<u>\$ 138,394,532.60</u>

5. OTHER ASSETS

During the year, the Foundation received one contribution of real property totaling \$120,000.00. At June 30, 2018, the Foundation held the same gift property: real estate located in Campbell County, Tennessee appraised at \$120,000.00.

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, residential property in Union County appraised at \$52,000.00, and other property in Weakley County and Obion County appraised

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

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, 2018 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, 2018 were \$174,400,786.54.

Permanently restricted net assets are available for scholarships or other academic purposes. Total permanently restricted net assets at June 30, 2018 were \$257,573,559.47.

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, 2018:

	<u>Temporarily Restricted</u>	<u>Permanently Restricted</u>
Other	\$ 16,720,412.86	\$ 21,421,846.80
Academic Support	24,957,528.51	59,218,628.24
Library	4,583.86	635,383.95
Research	11,771,770.81	3,455,662.22
Instruction	13,078,533.65	99,171,966.53
Public Service	3,277,554.58	482,452.32
Institutional Support	22,111,256.67	6,224,353.72
Student Services	867,751.80	-
Athletics	1,707,603.86	2,260,541.83
Capital Projects	32,461,353.41	-
Physical Plant	39,055,874.15	-
Scholarships and Fellowships	<u>8,386,562.38</u>	<u>64,702,723.86</u>
Net Assets	<u>\$ 174,400,786.54</u>	<u>\$ 257,573,559.47</u>

8. CONCENTRATION OF CREDIT RISK

The Foundation had concentrated its credit risk for cash and temporary investments by maintaining deposits at a financial institution, which may at times exceed amounts covered by insurance provided by the U.S. Federal Deposit Insurance Corporation (FDIC).

The Foundation has a master repurchase agreement with the financial institution 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, 2018 totaled \$5,607,574.15 and this amount is included in cash and cash equivalents in the Statement of Financial 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 \$3,095.51.

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

2019	\$ 21,904.07
2020	22,951.46
2021	<u>9,884.01</u>
Total	<u>\$ 54,739.54</u>

The Note Payable executed during the Foundation's fiscal year ending June 30, 2016 and restated in February 2017 in order 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 was paid off on January 31, 2018. Total interest charged to expense during the year was \$178,945.89.

The Note Payable executed 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 was paid off on January 31, 2018. Total interest charged to expense during the year was \$ 4,246.03.

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.

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 2018, the University provided the Foundation direct support of \$19,948,429.00 and endowment assessment fees of \$7,693,332.00.

The University of Tennessee Foundation, Inc.**Notes to Financial Statements
(Continued)****10. DEVELOPMENT AND ALUMNI AFFAIRS OPERATIONS (Continued)**

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 \$21,611,730.36.

INTERNAL CONTROL AND COMPLIANCE SECTION

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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, 2018, 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, 2018.

Internal Control over Financial Reporting

In planning and performing our audit of the financial statements, we considered The University of Tennessee Foundation, Inc.'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 University of Tennessee Foundation, Inc.'s internal control. Accordingly, we do not express an opinion on the effectiveness of The University of Tennessee Foundation, Inc.'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 and therefore, material weaknesses or significant deficiencies may exist that have not been identified. We did identify certain deficiencies in internal control, described below that we consider to be material weaknesses.

2018-001 Investment Disclosures

Criteria: The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to gather certain information related to fair value measurements for disclosure in the notes to the financial statements. Specifically, for Level 3 fair value measurements, a reconciliation from the opening balances to the closing balances with separate disclosure of changes during the period attributable to (a) total gains or losses for the period recognized in the change in net assets and the line item(s) in the statement of activities in which such gains or losses are recognized; (b) purchases, sales, issues, and settlements, with each type disclosed separately.

Condition: The Foundation has invested in the University of Tennessee Consolidated Investment Pool. These investments include Level 3 fair value measurements requiring disclosure in the financial statements.

Cause: Management has been unable to obtain adequate information from the University of Tennessee Consolidated Investment Pool related to these disclosures and has made some estimates of the reconciliation activity based on assumptions and limited information.

Effect: The information reported in the financial statements may not be a true representation of the actual activity in Level 3 fair value measurements.

Management's Response: The items in 2018-001 are accurate statements. Prior to fiscal year 2017, I was provided information on activity by asset category by the investment office of the University of Tennessee that allowed the completion of the required Level 3 disclosures. For fiscal years 2017 and 2018, I was provided the information only in totality for the consolidated investment pool and not by asset category. Upon requesting the information, I was advised that the report including the pertinent information was no longer prepared.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether The University of Tennessee Foundation, Inc.'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*.

The University of Tennessee Foundation, Inc.'s Response to Findings

The University of Tennessee Foundation, Inc.'s response to the findings identified in our audit is described above. The University of Tennessee Foundation, Inc.'s response was not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on it.

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 organization'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 organization's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

Brown Jake & McDaniel, PC

Knoxville, Tennessee
October 31, 2018

The University of Tennessee Foundation, Inc.

Summary Schedule of Prior Audit Findings

June 30, 2018

There were no prior year findings.