STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY

THE UNIVERSITY OF TENNESSEE

Financial and Compliance Audit Report

For the Year Ended June 30, 2015

Justin P. Wilson, Comptroller

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STATE OF TENNESSEE
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February 16, 2016

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the University of Tennessee, for the year ended June 30, 2015. You will note from the independent auditor's report that unmodified opinions were given on the fairness of the presentation of the financial statements.

Consideration of the internal control over financial reporting and tests of compliance disclosed certain deficiencies, which are detailed in the Findings and Recommendations section of this report. The university's management has responded to the audit findings; the responses are included following each finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit findings.

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

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Audit Report

The University of Tennessee

For the Year Ended June 30, 2015

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The University of Tennessee

For the Year Ended June 30, 2015

Opinions on the Financial Statements

The opinions on the financial statements are unmodified.

Audit Findings

The University Did Not Provide Adequate Internal Controls in Eight Specific Areas
The college did not design and monitor internal controls in eight specific areas. The details of this finding are confidential pursuant to Section 10-7-504(i), *Tennessee Code Annotated* (page 79).

Principal Investigators at the University of Tennessee Institute of Agriculture and the University of Tennessee Health Science Center Did Not Ensure That Obligations Charged to Federal Awards Were Allowable Under Federal Research and Development Grants, Resulting in Federal Questioned Costs of $12,114
The university requested and received reimbursement for unallowable costs, including student tuition and fees, an iMac computer, and copy machine rental charges. This resulted in $12,114 of federal questioned costs (page 79).

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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Independent Auditor's Report

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

Report on the Financial Statements

We have audited the accompanying financial statements of the University of Tennessee, which is a component unit of the State of Tennessee, and its discretely presented component units as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

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

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

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

Opinions

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of the University of Tennessee, and its discretely presented component units as of June 30, 2015, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note 22, the university implemented Governmental Accounting Standards Board Statement 68, *Accounting and Financial Reporting for Pensions – an Amendment of GASB Statement No. 27;* and Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*, during the year ended June 30, 2015. Our opinion is not modified with respect to this matter.

As discussed in Note 2, the financial statements of the university include investments valued at $473,924,550.44 (17.5 percent of net position), whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 13, the schedule of funding progress on page 71, the schedule of the University of Tennessee's proportionate share of the net pension liability for the Closed State and Higher Education Employee Pension Plan within TCRS on page 72, the schedule of the University of Tennessee's contributions for the Closed State and Higher Education Employee Pension Plan within TCRS on page 73, and the schedule of the University of Tennessee's contributions for the State and Higher Education Employee Retirement Plan within TCRS on page 74 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

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

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

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 16, 2015, on our consideration of the university's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the university's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 16, 2015

THE UNIVERSITY OF TENNESSEE
Management's Discussion and Analysis

Introduction

This section of the University of Tennessee's annual financial report presents a discussion and analysis of the financial performance of the university during the year ended June 30, 2015, with comparative information presented for the year ended June 30, 2014. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the independent auditor's report, the financial statements, and the notes to the financial statements.

The university is a component unit of the State of Tennessee and an integral part of the state's *Comprehensive Annual Financial Report (CAFR)*. The financial reporting entity for the financial statements is comprised of the university and three component units. The component units are discretely presented based on the nature and significance of their relationship to the university. The reader may refer to Note 1 for detailed information on the financial reporting entity. More detailed information about the foundations is presented in Notes 23, 24, and 25 to the financial statements. This discussion focuses on the university and does not include the foundations.

Overview of the Financial Statements

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

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

The Statement of Net Position

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

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

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

The following table summarizes the university's assets, liabilities, deferred outflows/inflows of resources, and net position at June 30, 2015, and June 30, 2014:

Summary of Net Position
(in thousands of dollars)

	2015	2014
Assets:		
Current assets	$ 626,914	$ 549,736
Capital assets, net	2,216,173	2,104,873
Other assets	1,498,276	1,436,970
Total assets	4,341,363	4,091,579
Deferred outflows:		
Deferred outflows	77,731	5,911
Liabilities:		
Current liabilities	376,841	345,458
Noncurrent liabilities	1,199,564	939,233
Total liabilities	1,576,405	1,284,691

Deferred inflows:		
Deferred inflows	126,894	-
Net position:		
Net investment in capital assets	1,468,677	1,431,939
Restricted – nonexpendable	486,451	470,815
Restricted – expendable	457,605	481,693
Unrestricted	303,062	428,352
Total net position	$2,715,795	$2,812,799

Total net position decreased by $97.0 million, or 3.4%, during the 2015 fiscal year. The increases were in net investment in capital assets and restricted – nonexpendable; the decreases were in restricted – expendable and unrestricted. The university's initial recognition of its net pension liability was the most significant cause of the decrease in net position. During 2015, the university implemented GASB Statement 68, *Accounting and Financial Reporting for Pensions*, and GASB Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date.* See Note 22 to the financial statements.

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

The statement of revenues, expenses, and changes in net position presents the results of operations for the fiscal year. Revenues and expenses are recognized when earned or incurred, regardless of when cash is received. The statement indicates whether the university's financial condition has improved or deteriorated during the fiscal year. The statement presents the revenues received by the university, both operating and nonoperating; the expenses paid by the university, operating and nonoperating; and any other revenues, expenses, gains, or losses received or spent by the university.

Generally speaking, operating revenues are received for providing goods and services to the various customers and constituencies of the university. Operating expenses are those expenses paid to acquire or produce the goods and services provided in return for the operating revenues, and to carry out the mission of the university. Nonoperating revenues are revenues received for which goods and services are not provided directly to the payor. Although the University of Tennessee is dependent upon state appropriations and gifts to fund educational and general operations, under GASB standards these funding sources are reported as nonoperating revenues, as is investment income. As a result, the university has historically reported an excess of operating expenses over operating revenues, resulting in an operating loss. Therefore, the "increase in net position" is more indicative of overall financial results for the year.

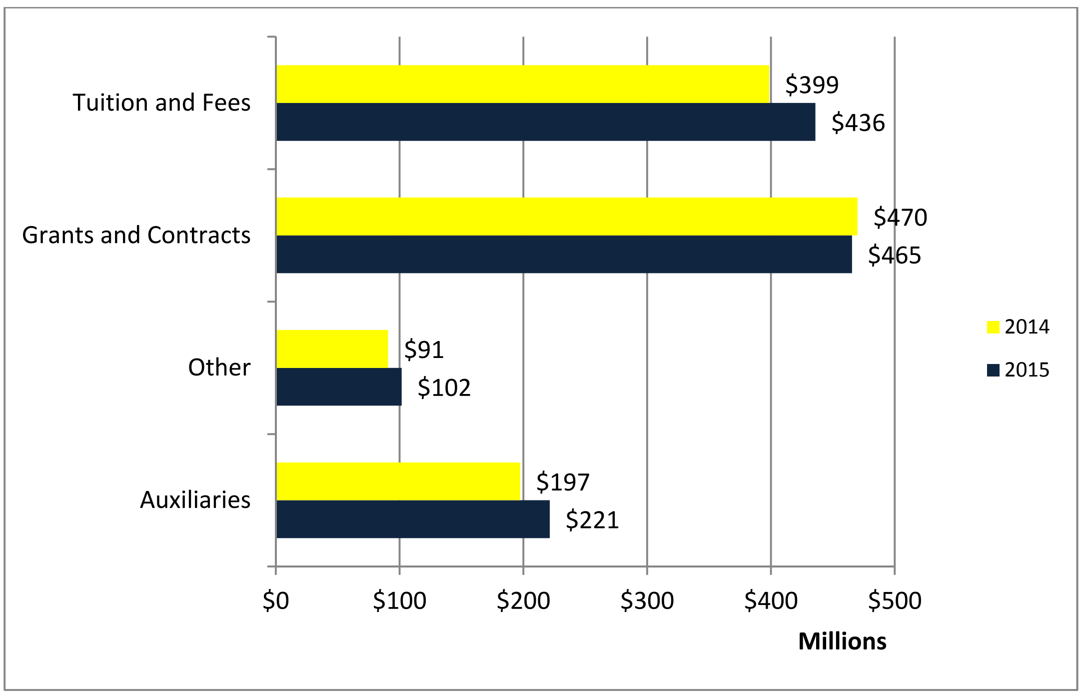
A summary of the university's revenues, expenses, and changes in net position for the year ended June 30, 2015, and the previous year follows:

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

	2015	2014
Operating revenues	$1,224,210	$1,156,488
Operating expenses	1,938,112	1,959,532
Operating loss	(713,902)	(803,044)
Nonoperating revenues and expenses	722,256	795,812
Income (loss) before other revenues, expenses, gains, or losses	8,354	(7,232)
Other revenues, expenses, gains, or losses	96,485	117,897
Increase in net position	104,839	110,665
Net position at beginning of year, restated 2015	2,610,956	2,702,134
Net position at end of year	$2,715,795	$2,812,799

Operating Revenues

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



Comparison of Fiscal Year 2015 to Fiscal Year 2014

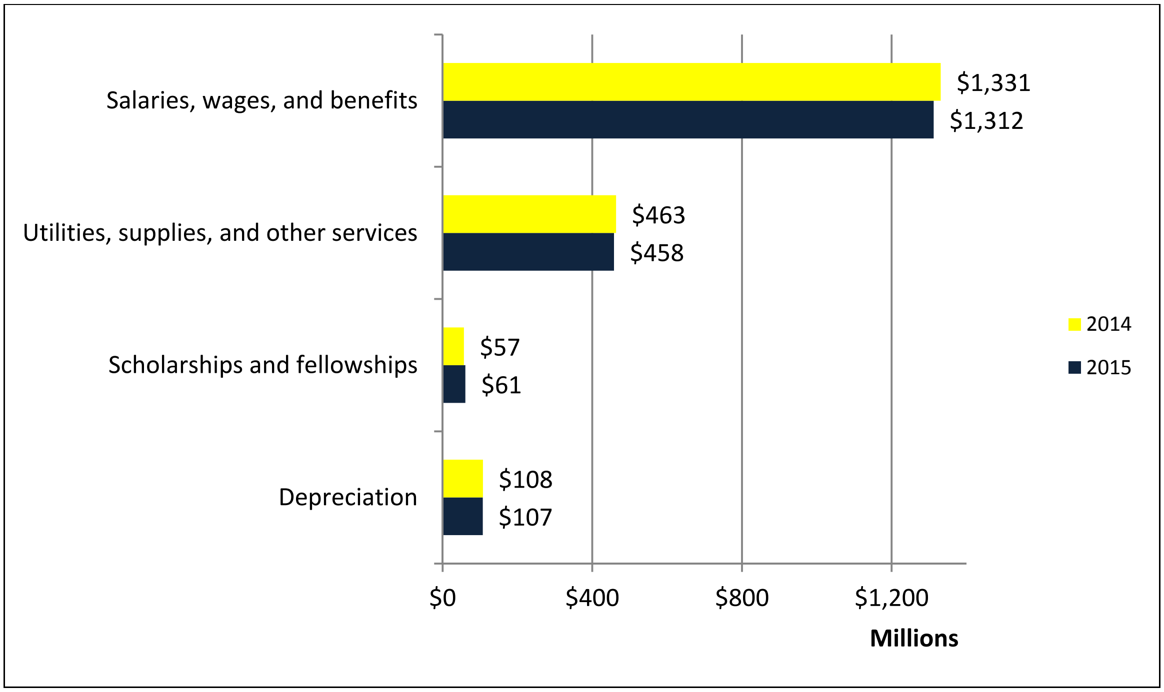
Tuition and fees increased by $37.4 million, or 9.4%, primarily due to a 5% to 6% increase in tuition rates.

Operating grants and contracts experienced a decrease of $4.4 million, or 1%, due to a decrease in sponsored projects.

Auxiliaries increased $23.8 million, mainly due to the Knoxville Athletics Department's new Nike contract and additional Southeastern Conference network revenues.

Operating Expenses

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



Comparison of Fiscal Year 2015 to Fiscal Year 2014

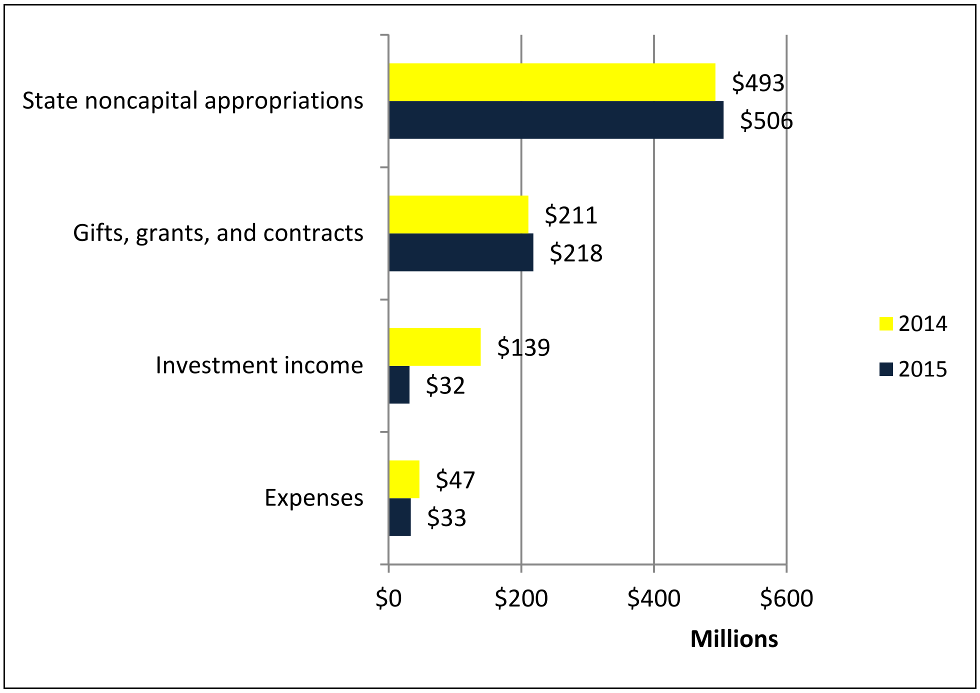
The university had the following significant changes in expenses between fiscal years:

The decrease in salary and benefit expenses from 2014 to 2015 is a result of the university's implementation of GASB Statement 68 and GASB Statement 71 and the related pension entries.

Scholarship and fellowship expenses increased $4 million, driven by an overall increase in gross scholarships and fellowships. The gross increase was offset by a $6.2 million increase in discounts to scholarships and fellowships related to tuition and fees.

Nonoperating Revenues and Expenses

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



Comparison of Fiscal Year 2015 to Fiscal Year 2014

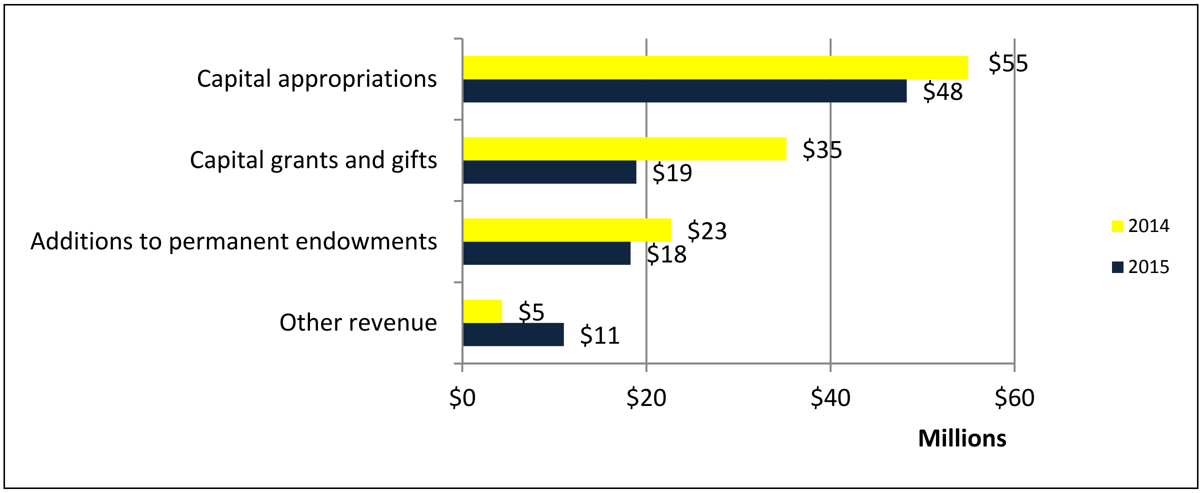
In fiscal year 2015, state and local appropriations increased $13.2 million, mostly due to THEC formula outcomes productivity gains.

Nonoperating gifts increased $7.2 million from 2014 to 2015 as departments continue to spend their gift funds.

The decrease in investment income was due to a decrease in endowment income as a result of an overall decrease in the capital markets.

Other Revenues

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



The $6.7 million decrease in capital appropriations was due to the completion of several state-appropriated projects and less capital construction and maintenance for 2015.

Capital grants and gifts decreased by $16.3 million. In the previous year, gifted property valued at $3.5 million was received, as well as $6.7 million in grants to be used to fund the construction of the Joint Institute for Advanced Materials Building. No large capital grants or gifts were received in 2015.

Additions to permanent endowments decreased $4.4 million from the previous year. In 2014, a single large donation was received to fund four separate endowments. No such donation was received in 2015.

Other revenue increased $6 million in 2015 due to two insurance recovery payments.

Capital Asset and Debt Administration

Capital Assets

The University of Tennessee had $2,216,172,638.22 invested in capital assets, net of accumulated depreciation at June 30, 2015; and $2,104,873,162.92 invested in capital assets, net of accumulated depreciation at June 30, 2014. Depreciation charges totaled $107,313,493.09 and $107,887,997.85 for the years ended June 30, 2015, and June 30, 2014, respectively.

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

	2015	2014
Land	$ 75,389	$ 73,953
Land improvements & infrastructure	99,246	49,899
Buildings	1,384,555	1,311,249
Works of art/historical treasures	3,878	3,878
Equipment	118,451	123,551
Software	1,210	3,166
Library holdings	83,225	81,044
Projects in progress	450,219	458,133
Total	$2,216,173	$2,104,873

Major capital additions for UT during 2014-2015 include the $59 million Fred D. Brown, Jr., Residence Hall, the $4.7 million Metro Building Upgrade, the $14.9 million Fine Arts Building Renovation, and the $975,000 Greenhouse and Laboratory.

At June 30, 2015, outstanding commitments under construction contracts totaled $293,571,555.54 for various renovations and repairs of buildings and infrastructure. Future state capital outlay appropriations will fund $85,225,030.73 of these costs.

More detailed information about the university's capital assets is presented in Note 5 to the financial statements.

Debt

The university had $785,801,185.62 and $691,578,891.59 in debt outstanding at June 30, 2015, and June 30, 2014, respectively. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt Schedule
(in thousands of dollars)

	2015	2014
Bonds-current portion	$ 32,365	$ 29,360
Bonds-noncurrent	646,402	543,916
Unamortized bond premium	99,173	30,754
Revolving credit facility-noncurrent	7,861	87,549
Total Debt	$785,801	$691,579

The Tennessee State School Bond Authority (TSSBA) issued bonds with interest rates ranging from .18% to 5.5% due serially to 2046 on behalf of the University of Tennessee. The university is responsible for the debt service of these bonds. The current portion of the $678,767,239.77 outstanding at June 30, 2015, is $32,365,110.49.

The ratings on debt issued by the Tennessee State School Bond Authority at June 30, 2015, were as follows:

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

More detailed information about the university’s long-term liabilities is presented in Note 8 to the financial statements.

Economic Factors That Will Affect the Future

For fiscal year 2016, the University of Tennessee Board of Trustees has authorized individual campus fee increases of 3.0% that are expected to generate approximately $34.8 million in new funding, net of related scholarships, with a continued projected enrollment increase. State appropriations will increase $24.4 million with salary increases, formula funding increases, and increased operating funds for nonformula units. The university continues to be successful in competing for grants and contracts. The capital markets have shown improvement but remain potentially unstable, which could affect the university’s investment income.

Requests for Information

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

THE UNIVERSITY OF TENNESSEE
Statement of Net Position
June 30, 2015

	The University of Tennessee	University of Chattanooga Foundation, Inc.	The University of Tennessee Foundation, Inc.	The University of Tennessee Research Foundation, Inc.
Assets				
Current assets:				
Cash and cash equivalents (Note 2)	$ 379,739,759.58	$ 2,994,760.00	$ 17,922,508.28	$ 4,342,181.00
Investments (Notes 2, 23, 24, and 25)	113,961,748.58	-	10,025,735.33	-
Accounts, notes, and grants receivable (net) (Note 4)	117,542,612.17	1,553,096.00	7,403,216.13	1,327,616.00
Due from the primary government	5,051,125.00	-	-	-
Due from the university	-	-	-	3,604,698.00
Inventories	7,178,711.56	-	-	15,602.00
Prepaid expenses	3,440,742.78	80,915.00	-	132,885.00
Assets held by the university	-	-	42,539,851.81	-
Total current assets	626,914,699.67	4,628,771.00	77,891,311.55	9,422,982.00
Noncurrent assets:				
Cash and cash equivalents (Note 2)	579,510,340.00	-	630,377.74	1,073,814.00
Investments (Notes 2, 23, 24, and 25)	758,076,990.39	136,913,563.00	7,254,614.08	167,980.00
Investment in UT - Battelle, LLC (Note 13)	4,925,516.00	-	-	-
Accounts, notes, and grants receivable (net) (Note 4)	102,772,277.17	761,443.00	99,461,580.40	-
Lease payments receivable (Note 18)	45,649,651.94	-	-	-
Due from primary government	7,340,915.44	-	-	-
Capital assets (net) (Notes 5, 23, and 25)	2,216,172,638.22	50,998,820.00	-	51,558,462.00
Prepaid expenses	-	362,234.00	-	-
Assets held by the university	-	238,708.00	109,750,890.03	-
Total noncurrent assets	3,714,448,329.16	189,274,768.00	217,097,462.25	52,800,256.00
Total assets	4,341,363,028.83	193,903,539.00	294,988,773.80	62,223,238.00
Deferred outflows of resources				
Deferred amount on debt refunding (Note 8)	26,525,707.15	-	-	-
Deferred outflows related to pensions (Note 10)	51,205,087.00	-	-	-
Total deferred outflows of resources	77,730,794.15	-	-	-
Liabilities				
Current liabilities:				
Accounts payable (Note 7)	116,245,925.35	1,749,781.00	368,662.44	1,250,244.00
Accrued liabilities	56,930,735.29	-	-	-
Unearned revenue (Notes 8 and 25)	113,146,853.80	72,677.00	-	2,076,986.00
Due to component unit	518,929.07	-	-	-
Deposits payable	2,995,018.66	-	-	-
Annuities and life income payable (Note 8)	2,954,564.96	-	239,312.92	-
Long-term liabilities, current portion (Notes 8, 23, 24, and 25)	76,660,816.81	2,090,000.00	750,466.11	1,110,471.00
Deposits held in custody for others	7,387,891.27	-	-	-

Due to the university	-	2,650,672.00	-	-
Total current liabilities	376,840,735.21	6,563,130.00	1,358,441.47	4,437,701.00
Noncurrent liabilities:				
Net OPEB obligation (Note 11)	100,041,516.55	-	-	-
Net pension obligation (Note 10)	88,069,402.00	-	-	-
Unearned revenue (Notes 8 and 25)	15,500,438.71	-	-	16,943,918.00
Long-term liabilities, noncurrent portion (Notes 8, 23, 24, and 25)	787,706,629.10	73,178,945.00	831,815.21	735,400.00
Due to grantors (Note 8)	36,228,970.70	-	-	-
Annuities and life income payable (Note 8)	19,725,896.87	-	1,592,448.68	-
Deposits held in custody for component units	152,290,741.84	-	-	-
Total noncurrent liabilities	1,199,563,595.77	73,178,945.00	2,424,263.89	17,679,318.00
Total liabilities	1,576,404,330.98	79,742,075.00	3,782,705.36	22,117,019.00
Deferred inflows of resources				
Deferred inflows related to pensions (Note 10)	126,894,330.00	-	-	-
Total deferred inflows of resources	126,894,330.00	-	-	-
Net position				
Net investment in capital assets	1,468,677,027.52	-	-	33,478,055.00
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	210,072,211.32	21,099,023.00	40,715,334.04	-
Libraries	15,861,462.43	-	408,744.63	-
Research	33,955,207.66	-	2,864,171.96	-
Instructional department uses	148,000,579.19	38,674,361.00	70,612,052.34	-
Academic support	31,407,486.77	684,501.00	36,161,990.84	-
Other	47,154,553.72	84,489.00	13,764,776.51	-
Expendable:				
Scholarships and fellowships	129,532,702.60	873,939.00	10,382,029.10	-
Libraries	11,897,337.89	-	5,632.24	-
Research	54,751,164.98	-	8,989,280.39	-
Instructional department uses	95,828,622.72	6,215,033.00	16,144,145.92	-
Academic support	43,536,222.95	42,365.00	20,061,284.16	-
Loans	7,421,171.87	-	-	-
Capital projects	19,705,782.21	5,000,000.00	28,185,473.01	-
Debt service	67,205.12	-	-	-
Other	94,864,681.45	4,020,381.00	32,432,290.66	-
Unrestricted	303,061,741.60	37,467,372.00	10,478,862.64	6,628,164.00
Total net position	$ 2,715,795,162.00	$ 114,161,464.00	$ 291,206,068.44	$ 40,106,219.00

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

THE UNIVERSITY OF TENNESSEE
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2015

	The University of Tennessee	University of Chattanooga Foundation, Inc.	The University of Tennessee Foundation, Inc.	The University of Tennessee Research Foundation, Inc.
Revenues				
Operating revenues:				
Student tuition and fees (net of scholarship allowances of $193,911,455.64)	$ 435,927,726.92	$ -	$ -	$ -
Contributions	-	4,076,184.00	50,641,462.04	2,470,500.00
Investment return designated for operations	-	7,155,854.00	-	-
Federal appropriations	19,037,888.66	-	-	-
Governmental grants and contracts (Note 17)	244,563,605.67	-	25,621,306.36	-
Nongovernmental grants and contracts	220,875,192.08	-	-	4,344,878.00
Sales and services of educational departments and other activities	58,008,519.21	-	-	-
Auxiliary enterprises:				
Residential life (net of scholarship allowances of $2,537,523.58; all revenues are used as security for revenue bonds; see Note 8)	59,380,433.40	11,877,519.00	-	-
Bookstore	22,515,398.70	-	-	-
Food services	6,896,147.28	-	-	-
Parking	10,604,521.50	-	-	-
Athletics, including gifts of $28,014,432.98 from component units	118,709,951.49	-	-	-
Other auxiliaries	3,126,907.35	-	-	-
Interest earned on loans to students	40,394.97	-	-	-
Other operating revenues	24,522,819.99	-	147,706.12	-
Total operating revenues	1,224,209,507.22	23,109,557.00	76,410,474.52	6,815,378.00
Expenses				
Operating expenses (Note 19):				
Salaries and wages	1,000,703,378.65	-	-	-
Benefits	311,226,448.39	-	-	-
Utilities, supplies, and other services	458,076,175.70	4,219,753.00	27,502,252.74	10,325,885.00
Scholarships and fellowships	60,792,352.56	-	-	-
Depreciation and amortization expense	107,313,493.09	3,065,113.00	-	3,753,490.00
Payments to or on behalf of the university (Notes 23 and 24)	-	7,155,854.00	46,519,483.20	-
Total operating expenses	1,938,111,848.39	14,440,720.00	74,021,735.94	14,079,375.00
Operating income (loss)	(713,902,341.17)	8,668,837.00	2,388,738.58	(7,263,997.00)
Nonoperating revenues (expenses)				
State and local appropriations	505,977,593.63	-	-	-
Gifts, including $20,552,283.61 from component units	33,091,338.76	-	-	-
Grants and contracts	185,073,471.91	-	-	4,973,045.00
Investment income (loss), including $3,526,775.27 from component units	31,527,631.81	(1,627,076.00)	(42,259.17)	(380,608.00)
Interest on capital asset-related debt	(26,064,546.24)	(4,075,304.00)	-	(261,284.00)
Other nonoperating revenues (expenses)	(7,349,292.30)	(818,039.00)	-	-
Net nonoperating revenues (expenses)	722,256,197.57	(6,520,419.00)	(42,259.17)	4,331,153.00
Income (loss) before other revenues, expenses, gains, or losses	8,353,856.40	2,148,418.00	2,346,479.41	(2,932,844.00)
Capital appropriations	48,282,507.77	-	-	-
Capital grants and gifts, including $1,581,845.34 from the component units	18,899,289.66	-	859,180.00	-
Additions to permanent endowments	18,277,168.99	2,567,120.00	63,692,599.99	-
Other	11,026,348.89	-	-	902,813.00
Total other revenues	96,485,315.31	2,567,120.00	64,551,779.99	902,813.00
Increase (decrease) in net position	104,839,171.71	4,715,538.00	66,898,259.40	(2,030,031.00)
Net position				
Net position - beginning of year	2,812,798,512.29	108,726,833.00	224,307,809.04	42,136,250.00
Cumulative effect of a change in accounting principle (Notes 22 and 23)	(201,842,522.00)	719,093.00	-	-
Net position at beginning of year, as restated	2,610,955,990.29	109,445,926.00	224,307,809.04	42,136,250.00
Net position - end of year	$ 2,715,795,162.00	$ 114,161,464.00	$ 291,206,068.44	$ 40,106,219.00

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

THE UNIVERSITY OF TENNESSEE
Statement of Cash Flows
For the Year Ended June 30, 2015

Cash flows from operating activities	
Tuition and fees	$ 442,676,030.95
Federal appropriations	19,037,888.66
Grants and contracts	476,646,735.16
Sales and services of educational departments and other activities	59,630,735.79
Payments to suppliers and vendors	(457,633,659.37)
Payments to employees	(997,646,713.66)
Payments for benefits	(345,566,702.41)
Payments for scholarships and fellowships	(60,792,352.56)
Loans issued to students	(3,901,835.68)
Collection of loans from students	4,372,056.93
Interest earned on loans to students	607,187.19
Auxiliary enterprise charges:	
Residence halls	59,400,500.57
Bookstore	18,247,244.07
Food services	6,896,147.28
Parking	10,604,521.50
Athletics	122,149,138.17
Other auxiliaries	2,152,830.70
Other receipts (payments)	24,412,706.49
Net cash used by operating activities	(618,707,540.22)
Cash flows from noncapital financing activities	
State appropriations	500,003,117.63
Local appropriations	5,974,476.00
Gifts and grants received for other than capital or endowment purposes	228,270,522.48
Private gifts for endowment purposes	18,277,168.99
Split-interest transactions receipts	1,763,913.01
Split-interest transactions disbursements	(1,901,307.89)
Federal student loan receipts	293,879,673.75
Federal student loan disbursements	(294,280,720.00)
Changes in deposits held for others	(3,891,168.50)
Net cash balance implicitly financed (repaid)	(739,322.96)
Other noncapital financing receipts (payments)	11,026,348.89
Net cash provided by noncapital financing activities	758,382,701.40
Cash flows from capital and related financing activities	
Proceeds from capital debt	39,906,460.70
Capital appropriations	55,437,405.38
Capital grants and gifts received	18,899,289.66
Proceeds from sale of capital assets	251,849.76
Purchases of capital assets and construction	(212,807,526.44)
Principal paid on capital debt and leases	(30,840,429.31)
Interest paid on capital debt and leases	(26,599,048.90)
Other capital and related financing receipts (payments)	(800,254.75)
Net cash used by capital and related financing activities	(156,552,253.90)
Cash flows from investing activities	
Proceeds from sales and maturities of investments	487,449,908.11
Income on investments	31,972,268.53
Purchase of investments	(428,197,582.15)
Net cash provided by investing activities	91,224,594.49
Net increase in cash and cash equivalents	74,347,501.77
Cash and cash equivalents - beginning of year	884,902,597.81
Cash and cash equivalents - end of year	$ 959,250,099.58

THE UNIVERSITY OF TENNESSEE
Statement of Cash Flows (continued)
For the Year Ended June 30, 2015

Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(713,902,341.17)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation and amortization expense		107,313,493.09
Pension expense		13,121,210.00
Change in assets, liabilities, and deferred outflows:		
Receivables, net		1,910,850.03
Inventories		(531,020.99)
Prepaid items		710,481.24
Accrued interest receivable		566,792.22
Accounts payable		405,423.33
Accrued liabilities		3,596,076.46
Unearned revenues		11,047,843.15
Deposits		4,584,306.66
Deferred outflows related to pensions		(51,205,087.00)
Net OPEB obligation		5,922,702.33
Compensated absences		(2,718,490.82)
Loans to students		470,221.25
Net cash used by operating activities	$	(618,707,540.22)

Noncash investing, capital, or financing transactions		
Gifts of capital assets	$	4,342,340.90
Unrealized losses on investments	$	(41,324,047.46)
Loss on disposal of capital assets	$	(6,014,534.89)

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

Note 1. Summary of Significant Accounting Policies

Reporting Entity

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

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

The University of Chattanooga Foundation, Inc., and the University of Tennessee Foundation, Inc., are considered component units of the university. Although the university does not control the timing or amount of receipts from the foundations, the majority of resources, or income thereon, that the foundations hold and invest are restricted to the activities of the university by the donors. Because these restricted resources held by the foundations can only be used by, or for the benefit of, the university, the foundations are considered component units of the university and are discretely presented in the university's financial statements. The University of Tennessee Research Foundation, Inc., is also considered a component unit of the university because the university's board of trustees approves the foundation's administrative budget and funds the foundation's administrative costs. It is also discretely presented in the university's financial statements. See notes 23, 24, and 25 for more detailed information about the component units and how to obtain their reports.

Basis of Presentation

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

Basis of Accounting

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

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

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

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

Cash Equivalents

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

Inventories

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

Investments

The university reports investments in commercial paper at amortized cost. At June 30, 2015, the university had no investments in commercial paper. All other investments are reported at fair value or estimated fair value.

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

Capital Assets

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

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

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

Accounts Payable

Included in accounts payable are checks payable in the amount of $2,203,543.10 as of June 30, 2015. These amounts represent the sum of checks written in excess of the university's checking account balance because of the use of a controlled disbursement account. In this way, the university maximizes interest income by transferring from an investment account only funds necessary to cover the checks that clear the bank daily.

Pensions

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

Compensated Absences

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

Net Position

The institution's net position is classified as follows:

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

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

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

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

Scholarship Discounts and Allowances

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

Income Taxes

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

Note 2. Deposits and Investments

Investment Policy

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

University policy also requires that commercial paper not exceed 35% of the portfolio in total and that no more than 10% of the portfolio's value be in the commercial paper of a single issuer. In addition, banker's acceptances cannot exceed 20% of the portfolio's value and no one bank's acceptances may exceed 10%. Money market funds cannot exceed 10% of the portfolio's total value. At June 30, 2015, the university's cash management investment pool consisted of $152,000,000.00 of certificates of deposit, $46,325,000.00 of demand deposits yielding money market rates, and $741,919,474.52 of U.S. government agency obligations.

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

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

Cash and Cash Equivalents

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

At June 30, 2015, cash and cash equivalents consisted of $12,956,428.63 in bank accounts, $1,725,146.55 of petty cash on hand, and $940,244,474.52 in the university's cash management investment pool.

The carrying amount of the university's deposits was $211,281,428.63, and the bank balance was $207,170,367.31.

Additionally, the university maintains custodial accounts at First Tennessee Bank and Hilliard Lyons for funds contractually managed by independent investment counsel. In accordance with the custody agreements, First Tennessee Bank and Hilliard Lyons placed cash equivalents totaling $4,324,049.88 at June 30, 2015, in money market mutual funds.

Custodial Credit Risk – Deposits

The custodial credit risk for deposits is the risk that in the event of a bank failure, the university's deposits may not be recovered. As stated earlier, state statutes require that all university deposits be in a qualified depository and secured through direct collateralization or participation in the State Collateral Pool. As of June 30, 2015, all university deposits were adequately secured as required by state statute.

Investments

All investments are reported at fair value, including those securities with a maturity date of one year or less. Where applicable, maturities reported for bond mutual funds represent a weighted average maturity of the individual bonds in the respective fund. As of June 30, 2015, the university had the following investments and maturities:

Investment Type	Fair Value	Less Than 1	1 to 5	6 to 10	10+	Unknown	Cost
		Investment Maturities (In Years)					
Cash Management Pool							
Cash Equivalents							
Debt Securities							
U.S. agencies	$741,919,474.52	$ -	$315,942,631.48	$336,132,549.45	$89,844,293.59	$ -	$740,202,321.92
	741,919,474.52	-	315,942,631.48	336,132,549.45	89,844,293.59	-	740,202,321.92
Investments							
Debt Securities							
U.S. Treasury	4,760,976.69	-	1,163,584.78	3,597,391.91	-	-	4,509,126.69
U.S. agencies	5,254,375.10	2,033,340.00	866,545.50	1,607,036.00	747,453.60	-	5,062,359.05
Corporate bonds	12,170,157.72	1,086,908.75	8,955,884.85	1,936,874.68	190,489.44	-	11,800,310.65
Municipal bonds	2,221,901.30	1,129,724.60	355,943.00	736,233.70	-	-	2,212,413.85
Mortgages and notes	15,246.23	15,246.23	-	-	-	-	15,246.23
Bond mutual funds	106,738,260.63	90,576.03	17,920,836.71	42,100,265.40	2,767,506.84	43,859,075.65	105,516,961.40
	131,160,917.67	4,355,795.61	29,262,794.84	49,977,801.69	3,705,449.88	43,859,075.65	129,116,417.87
		$4,355,795.61	$345,205,426.32	$386,110,351.14	$93,549,743.47	$43,859,075.65	
Other Investments							
Corporate stocks:							
Domestic	23,497,790.47						15,300,143.56
International	4,694,708.15						4,410,808.58
Mutual funds - equity	227,947,846.48						224,935,008.99
Alternative investments:							
Private equity	116,449,427.77						100,558,047.43
Natural resources	92,486,942.00						80,645,971.06
Hedge funds	233,088,491.45						174,472,051.79
Real estate investments	31,899,689.22						23,252,551.76
Real estate gifts	3,269,496.87						4,295,888.37
Assets with trustees	7,543,428.89						8,364,446.86
Total investments and cash equivalents	1,613,958,213.49						1,505,553,658.19
Less: cash equivalents	741,919,474.52						740,202,321.92
Total investments	$872,038,738.97						$765,351,336.27

Interest Rate Risk

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

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university's debt investments as of June 30, 2015, were rated by Moody's.

The university is authorized by statute to invest funds in accordance with University of Tennessee investment policies. Funds, other than endowment and annuity and life income funds, may be invested in collateralized Tennessee bank or savings and loan association certificates of deposit, U.S. Treasury obligations, U.S. government agency obligations and repurchase agreements of those securities, highest quality commercial paper, prime bankers' acceptances, and money market mutual funds meeting certain criteria. Endowment and life income funds can be invested in equity securities and various other securities given prudent diversification. The university has no investment policy limiting its investment choice based on ratings issued by nationally recognized statistical rating agencies. Where applicable, credit ratings reported for mutual funds represent the average credit rating of the individual securities in the respective fund. As of June 30, 2015, the institution's investments were rated as follows:

Rated Debt Instruments	Fair Value	Aaa	Aa1	Aa2	Aa3	A1
Cash management pool						
U.S. agencies	$741,919,474.52	$570,358,584.32	-	-	$35,131,238.45	-
Investments						
U.S. agencies	5,254,375.10	5,254,375.10	-	-	-	-
Corporate bonds	12,170,157.72	-	-	388,192.00	374,473.30	1,047,358.52
Municipal bonds	2,221,901.30	-	355,943.00	389,306.25	736,233.70	-
Mutual funds – bonds	106,738,260.63	88,577.94	-	35,673,290.57	-	2,756,485.62
Mortgages and notes	15,246.23	-	-	-	-	-
Money market funds in custodial accounts	4,324,049.88	-	-	-	-	-

Rated Debt Instruments	A2	A3	Baa1	Baa2	Baa3	Ba1
Cash management pool						
U.S. agencies	-	-	-	-	-	-
Investments						
U.S. agencies	-	-	-	-	-	-
Corporate bonds	948,846.00	3,579,076.25	3,858,650.00	1,817,147.05	108,789.60	-
Municipal bonds	-	-	-	-	-	-
Mutual funds – bonds	6,078,438.24	-	-	2,767,506.84	-	179,196.48
Mortgages and notes	-	-	-	-	-	-
Money market funds in custodial accounts	-	-	-	-	-	-

Rated Debt Instruments	Ba2	Ba3	B2	Unrated
Cash management pool				
U.S. agencies	-	-	-	136,429,651.75
Investments				
U.S. agencies	-	-	-	-
Corporate bonds	47,625.00	-	-	-
Municipal bonds	-	-	-	740,418.35
Mutual funds – bonds	17,535,302.27	266,996.72	814,206.16	40,578,259.79
Mortgages and notes	-	-	-	15,246.23
Money market funds in custodial accounts	-	-	-	4,324,049.88

Custodial Credit Risk – Investments

Custodial credit risk is the risk that, in the event of a failure of the counterparty, the university will not be able to recover the value of the investment or collateral securities that are in possession of an outside party. At June 30, 2015, the university had $7,543,428.89 of uninsured and unregistered investments held by a counterparty but not in the school's name.

Concentration of Credit Risk

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

Foreign Currency Risk

Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of a deposit or investment. The university has $4,694,708.15 invested in foreign corporate equities and $13,817,897.59 invested in foreign corporate bonds at June 30, 2015.

Alternative Investments

In its Consolidated Investment Pool, as part of its endowment assets, the university has investments in 94 limited partnerships, limited companies, corporations, and limited liability corporations (LLCs).

These investments include 44 private equity funds, 3 real estate funds, 25 natural resource funds, and 22 hedge funds. The estimated fair value of these assets is $473,924,550.44 at June 30, 2015.

Total capital contributions less returns of capital equal $378,928,622.04 at June 30, 2015.

The university believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2015. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the university's investment policy that approves the allocation of funds to various asset classes in order to ensure the proper level of diversification within the endowment pool. These investments (private equity, real estate assets, natural resources, and hedge funds) are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated by the general partner of each limited partnership or manager of each corporate entity using various valuation techniques.

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

Note 3. Endowment, Annuity, and Life Income Agreements

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

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

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

The university chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the university, four and a half percent of a three-year moving average of the fair value of endowment investments has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income. At June 30, 2015, net appreciation of $168,879,285.16 is available to be spent, of which $165,378,011.38 is restricted for scholarships and fellowships, libraries, instructional department uses, academic support, research, and other purposes. The per unit fair value for participating endowments was $3.503637 at June 30, 2015. Income distributed was $0.14695 per share in 2015, or $33,080,576.76.

The university's Consolidated Investment Pool is invested to maximize total return rather than current income consistent with provisions of the Uniform Prudent Management of Institutional Funds Act adopted by the State of Tennessee in 2007. The total return for fiscal year 2015 and the three and five years then ended was 1.0%, 10.1%, and 9.6%, respectively.

All endowments not invested as part of the Consolidated Investment Pool are separately invested to observe requirements or limitations imposed by donors. Income earned and distributed on separately invested endowments amounted to $230,645.36 for 2015.

Annuity and life income amounts held in trust are separately invested entities requiring detailed accounting to reflect specific compliance with the terms of each trust and applicable federal regulations. The investment objectives as reflected in each agreement vary widely since they are affected by the age, income level, and needs of the beneficiaries as well as motives and objectives of the donors. Interest, dividend, rent, and royalty income realized on these funds for 2015 amounted to $1,711,758.46.

Note 4. Accounts, Notes, and Grants Receivable

Accounts, notes, and grants receivable included the following at June 30, 2015:

Student accounts receivable	$ 16,822,279.42
Grants receivable	54,754,512.08
Notes receivable	2,967,223.19
Pledges receivable	16,386,903.27
TSSBA debt proceeds receivable	64,541,186.08
Due from component units	2,650,672.00
Other receivables	49,256,101.76
Subtotal	207,378,877.80
Less allowance for doubtful accounts	(15,595,132.27)
Total	$191,783,745.53

Pledges receivable are promises of private donations that are reported as accounts receivable and revenue, net of an estimated uncollectible allowance of $3,277,380.65.

Federal Perkins Loan Program funds included the following at June 30, 2015:

Perkins Loans receivable	$28,531,143.81
Less allowance for doubtful accounts	-
Total	$28,531,143.81

Note 5. Capital Assets

Capital asset activity for the year ended June 30, 2015, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 73,953,284.50	$ 1,776,131.61	$ -	$ (340,000.00)	$ 75,389,416.11
Land improvements & infrastructure	110,162,573.47	1,045,065.74	53,799,888.21	-	165,007,527.42
Buildings	2,173,878,329.62	10,094,304.11	120,426,200.71	(3,824,211.59)	2,300,574,622.85
Works of art/ historical treasures	3,878,450.77	-	-	-	3,878,450.77
Equipment	396,087,940.07	25,692,242.59	-	(46,454,917.24)	375,325,265.42
Software	30,431,395.81	193,548.99	-	(111,852.90)	30,513,091.90
Library holdings	143,458,810.82	16,563,768.29	-	(12,129,031.28)	147,893,547.83
Projects in progress	458,133,164.34	169,262,441.95	(174,226,088.92)	(2,950,737.04)	450,218,780.33
Total	3,389,983,949.40	224,627,503.28	-	(65,810,750.05)	3,548,800,702.63
Less accumulated depreciation/amortization:					
Land improvements & infrastructure	(60,263,964.33)	(5,497,570.06)	-	-	(65,761,534.39)
Buildings	(862,629,219.18)	(57,143,883.79)	-	3,753,006.74	(916,020,096.23)
Equipment	(272,537,218.39)	(28,143,077.12)	-	43,805,613.71	(256,874,681.80)
Software	(27,265,686.61)	(2,146,124.90)	-	108,563.43	(29,303,248.08)
Library holdings	(62,414,697.97)	(14,382,837.22)	-	12,129,031.28	(64,668,503.91)
Total	(1,285,110,786.48)	(107,313,493.09)	-	59,796,215.16	(1,332,628,064.41)
Capital assets, net	$2,104,873,162.92	$117,314,010.19	$ -	$ (6,014,534.89)	$2,216,172,638.22

Note 6. Operating Leases

The university has entered into various operating leases for buildings and equipment. It is expected that in the normal course of business, such leases will continue to be required. Net expenses for rentals under leases were $9,515,786.60 for the year ended June 30, 2015. All operating leases are cancelable at the lessee’s option.

Note 7. Accounts Payable

Accounts payable at June 30, 2015, included the following:

Vendors payable	$ 90,227,869.62
Payroll deductions payable	21,694,736.84
Due to State of Tennessee	4,323,318.89
Total	$116,245,925.35

Note 8. Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2015, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Long-term liabilities:					
Bonds	$573,275,798.99	$499,056,606.82	$393,565,166.04	$678,767,239.77	$32,365,110.49
Unamortized bond premium	30,754,222.12	71,580,797.65	3,162,068.77	99,172,951.00	-
Revolving credit facility	87,548,870.48	10,663,208.25	90,351,083.88	7,860,994.85	-
Total TSSBA indebtedness	691,578,891.59	581,300,612.72	487,078,318.69	785,801,185.62	32,365,110.49
Compensated absences	81,284,751.13	41,577,215.50	44,295,706.34	78,566,260.29	44,295,706.32
Total long-term liabilities	772,863,642.72	622,877,828.22	531,374,025.03	864,367,445.91	76,660,816.81
Other long-term liabilities:					
Unearned revenue	117,599,449.36	124,194,696.95	113,146,853.80	128,647,292.51	113,146,853.80
Due to grantors	35,613,934.13	936,412.88	321,376.31	36,228,970.70	-
Annuities payable and life income payable	23,901,934.59	312,009.36	1,533,482.12	22,680,461.83	2,954,564.96
Total other long-term liabilities	$177,115,318.08	$125,443,119.19	$115,001,712.23	$187,556,725.04	$116,101,418.76

TSSBA Debt – Bonds

Bonds, with interest rates ranging from .18% to 5.50%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2046 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations. (See Note 9 for further details.) The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net position is shown net of assets held by the authority in the debt service reserve, capitalized interest, and unexpended debt proceeds. The total bonded indebtedness at June 30, 2015, was $888,627,343.27. The debt service reserve amount at June 30, 2015, was $13,272,646.36, and unspent debt proceeds were $196,587,457.14.

The university's debt service requirements to maturity for all bonds payable at June 30, 2015, are as follows:

Year Ending June 30	Principal	Interest
2016	$ 32,365,110.49	$ 38,178,188.83
2017	36,485,681.96	37,235,965.27
2018	37,631,970.91	35,976,418.00
2019	38,454,494.02	34,401,664.89
2020	36,970,905.22	32,724,306.29
2021-2025	170,506,238.48	142,136,990.90
2026-2030	170,467,106.33	104,706,709.78
2031-2035	148,967,531.96	67,484,998.34
2036-2040	124,384,817.29	36,155,322.67
2041-2045	83,059,317.31	11,094,254.00
2046	9,334,169.30	233,354.23
	$888,627,343.27	$540,328,173.20

Less:	
Debt service reserve fund	(13,272,646.36)
Unspent bond proceeds	(196,587,457.14)
TSSBA debt - bonds	$678,767,239.77

TSSBA Debt – Revolving Credit Facility and Commercial Paper

The Tennessee State School Bond Authority (TSSBA) receives loans from the revolving credit facility to finance the costs of various capital projects during the construction phase. When projects are placed in service, TSSBA issues long-term, fixed-rate debt to finance the project over its useful payback period and repays the revolving credit facility debt. The amount issued for projects at the university was $7,860,994.85 at June 30, 2015.

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

Refunding of Debt

On August 27, 2014, the Tennessee State School Bond Authority issued two new series of bonds, 2014 Series A (federally taxable) and 2014 Refunding Series B. The 2014A bonds consisted of $15,475,176.49 in revenue bonds with an average interest rate of 2.94% to advance refund $14,703,624.00 of outstanding 2005 A Series bonds with an average interest rate of 4.96%. The net proceeds of $15,429,069.99 (after payment of $39,057.81 in underwriter's fees and issuance costs) were deposited with an escrow agent to provide for all future debt service payments on the bonds. As a result, the 2005 A Series bonds are considered to be defeased, and the liability for those bonds has been removed from the university's long-term liabilities. The 2014B bonds consisted of $113,464,159.56 in revenue bonds with an average interest rate of 4.98% to current and advance refund $123,241,044.08 of outstanding 2006A, 2007A, 2008A, and 2008B Series bonds with an average interest rate of 4.77%. The net proceeds of $136,236,971.13 (after payment of $280,429.56 in underwriter's fees and issuance costs) were deposited with an escrow agent to provide for all future debt service payments on the bonds. As a result, the 2006A, 2007A, 2008A, and 2008B Series bonds are considered to be defeased, and the liability for those bonds has been removed from the university's long-term liabilities.

The 2014 Series A advance refunding resulted in the recognition of a deferred loss of $725,445.99 to be amortized over the next 15 years. The university in effect reduced its aggregate debt service payments by $1,921,798.05 over the next 15 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $1,399,709.45. The 2014 Series B current and advance refunding resulted in the recognition of a deferred loss of $12,995,927.05 to be amortized over the next 23 years. The university in effect reduced its aggregate debt service payments by $16,334,126.00 over the next 23 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $12,112,433.22.

On May 7, 2015, the Tennessee State School Bond Authority issued two new series of bonds, 2015 Series A (federally taxable) and 2015 Series B. The 2015A bonds consisted of $14,245,584.53 in revenue bonds with an average interest rate of 2.16% to advance refund $13,065,834.90 of outstanding 2007 C Series bonds with an average interest rate of 5%. The net proceeds of $14,215,918.59 (after payment of $29,665.94 in underwriter's fees and issuance costs) were deposited with an escrow agent to provide for all future debt service payments on the bonds. As a result, the 2007 C Series bonds are considered to be defeased, and the liability for those bonds has been removed from the university's long-term liabilities. The 2015B bonds consisted of $53,403,482.04 in revenue bonds with an average interest rate of 5% to advance refund $60,444,301.49 of outstanding 2008A, 2008B, and 2010A Series bonds with an average interest rate of 4.59%. The net proceeds of $66,720,453.79 (after payment of $111,256.73 in underwriter's fees and issuance costs) were deposited with an escrow agent to provide for all future debt service payments on the bonds. As a result, the 2008A, 2008B, and 2010A Series bonds are considered to be defeased, and the liability for those bonds has been removed from the university's long-term liabilities.

The 2015 Series A advance refunding resulted in the recognition of a deferred loss of $1,150,083.69 to be amortized over the next 10 years. The university in effect reduced its aggregate debt service payments by $1,475,344.43 over the next 10 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $1,131,098.48. The 2015 Series B advance refunding resulted in the recognition of a deferred loss of $6,276,152.30 to be amortized over the next 22 years. The university in effect reduced its aggregate debt service payments by $9,692,216.19 over the next 22 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $6,698,976.56.

Note 9. Pledged Revenues

The university has pledged certain revenues and fees, including state appropriations, to repay $678,767,239.77 in revenue bonds issued from January 2007 to June 2015. Proceeds from the bonds provided financing for construction and renovation projects. The bonds are payable through 2046. (See Note 8 for further details.) Annual principal and interest payments on the bonds are expected to require 4.10% of available revenues. The total principal and interest remaining to be paid on the bonds is $1,219,095,412.97. Principal and interest paid for the current year and total available revenues were $55,557,858.91 and $1,355,254,582.55, respectively. The amount of principal and interest paid for the current year does not include debt of $211,454,804.47 defeased through a bond refunding in the current year.

Note 10. Pension Plans

Defined Benefit Plans

Closed State and Higher Education Employee Pension Plan

General Information about the Pension Plan

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

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

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

Average of member's highest compensation for 5 consecutive years (up to Social Security integration level)	x	1.50%	x	Years of Service Credit	x	105%
Plus:						
Average of member's highest compensation for 5 consecutive years (over the Social Security integration level)	x	1.75%	x	Years of Service Credit	x	105%

A reduced early retirement benefit is available at age 55 and vested. Members are vested with five years of service credit. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10% and include projected service credits. A variety of death benefits are available under various eligibility criteria. Member and beneficiary annuitants are entitled to automatic cost of living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to the 2nd of July of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3%, and applied to the current benefit. No COLA is granted if the change in the CPI is less than 0.5%. A 1% COLA is granted if the CPI change is between 0.5% and 1%. A member who leaves employment may withdraw employee contributions, plus any accumulated interest.

Contributions – Contributions for state employees and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. The university's employees are non-contributory, as are most members in the Closed State and Higher Education Employee Pension Plan. State and higher education agencies make employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. By law, employer contributions for the Closed State and Higher Education Employee Pension Plan are required to be paid. Employer contributions by the university for the year ended June 30, 2015, to the Closed State and Higher Education Employee Pension Plan were $50,692,652.00, which is 15.03% of covered payroll. The employer rate is expected to finance the costs of benefits earned by members during the year and the cost of administration, as well as an amortized portion of any unfunded liability.

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

Pension liability – At June 30, 2015, the university reported a liability of $88,069,402.00 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2014, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The university's proportion of the net pension liability was based on a projection of the university's contributions during the year ended June 30, 2014, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2014, measurement date, the university's proportion was 12.764631%, representing the first time presentation of this proportion.

Pension expense – For the year ended June 30, 2015, the university recognized a pension expense of $13,121,211.00.

Deferred outflows of resources and deferred inflows of resources – For the year ended June 30, 2015, the university reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ -	$ 18,999,006.00
Net difference between projected and actual earnings on pension plan investments	-	107,895,324.00
The university's contributions subsequent to the measurement date of June 30, 2014	50,692,652.00	-
Total	$50,692,652.00	$126,894,330.00

Deferred outflows of resources, resulting from the university's employer contributions of $50,692,653.80 subsequent to the measurement date will be recognized as a decrease in net pension liability in the year ended June 30, 2016. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30	
2016	$(31,723,582.50)
2017	(31,723,582.50)
2018	(31,723,582.50)
2019	(31,723,582.50)

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

Actuarial assumptions – The total pension liability as of June 30, 2014, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

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

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

The actuarial assumptions used in the June 30, 2014, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2008, through June 30, 2012. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

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

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

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

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

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

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
University's net pension liability (asset)	$302,067,867.00	$88,069,402.00	$(92,061,482.00)

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

Payable to the Pension Plan

At June 30, 2015, the university reported a payable of $3,974,847.70 for the outstanding amount of legally required contributions to the pension plan required for the year ended June 30, 2015.

State and Higher Education Employee Retirement Plan

General Information about the Pension Plan

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

Benefits provided – Title 8, Chapters 34-37, *Tennessee Code Annotated* establishes the benefit terms and can be amended only by the Tennessee General Assembly. Members of the State and Higher Education Employee Retirement Plan are eligible to retire at age 65 with 5 years of service credit or pursuant to the rule of 90 in which the member's age and service credit total 90. Members are entitled to receive unreduced service retirement benefits, which are determined by a formula using the member's highest five consecutive year average compensation and the member's years of service credit. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10% and include projected service credits. A variety of death benefits are available under various eligibility criteria. Member and beneficiary annuitants are entitled to automatic cost of living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to July 2 of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3%, and applied to the current benefit. No COLA is granted if the change in the CPI is less than 0.5%. A 1% COLA is granted if the CPI change is between 0.5% and 1%. A member who leaves employment may withdraw their employee contributions, plus any accumulated interest. Under the State and Higher Education Employee Retirement Plan, benefit terms and conditions, including COLA, can be adjusted on a prospective basis. Moreover, there are defined cost controls and unfunded liability controls that provide for the adjustment of benefit terms and conditions on an automatic basis.

<u>Contributions</u> – Contributions for state and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. Employees contribute 5% of their salary. The higher education institutions make employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. Per the statutory provisions governing the TCRS, the employer contribution rate cannot be less than 4% for all aggregate employee groups, except in years when the maximum funded level, approved by the TCRS Board of Trustees, is reached. By law, employer contributions for the State and Higher Education Employee Retirement Plan are required to be paid. Employer contributions by the university for the year ended June 30, 2015, to the State and Higher Education Employee Retirement Plan were $512,435.00, which is 3.87% of covered payroll. The employer rate, when combined with member contributions, is expected to finance the costs of benefits earned by members during the year and the cost of administration, as well as an amortized portion of any unfunded liability.

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

<u>Pension liabilities</u> – Since the measurement date is June 30, 2014, which is prior to the July 1, 2014, inception of the State and Higher Education Employee Retirement Plan, there is not a net pension liability to report at June 30, 2015.

<u>Pension expense</u> – Since the measurement date is June 30, 2014, the university did not recognize a pension expense at June 30, 2015.

<u>Deferred outflows of resources and deferred inflows of resources</u> – For the year ended June 30, 2015, the university reported deferred outflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
The university's contributions subsequent to the measurement date of June 30, 2014	$512,435.00	$ -

The university's employer contributions of $512,435.00 reported as pension related deferred outflows of resources, subsequent to the measurement date, will be recognized as a reduction in net pension liability in the year ended June 30, 2016.

Payable to the Pension Plan

At June 30, 2015, the university reported a payable of $155,399.59 for the outstanding amount of legally required contributions to the pension plan required for the year ended June 30, 2015.

Federal Retirement

Plan description – The university contributes to the Federal Retirement Program, a cost-sharing, multiple-employer, defined benefit pension plan administered by the Civil Service Retirement System (CSRS) for participants employed prior to January 1, 1984, and by the Federal Employees Retirement System (FERS) for participants employed after December 31, 1983. Both systems provide retirement, death, and disability benefits, as well as annual cost-of-living adjustments, to plan members and their beneficiaries. All regular full-time employees of the University of Tennessee Agricultural Extension Service who hold federal appointments for 51% or more of their time are required to participate in either one of the two Federal Retirement Programs. For both systems, benefit provisions are established in federal statutes. Federal statutes are amended by the U.S. Congress.

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

Funding policy – Participating employees, with some exceptions, are required by federal statute to contribute 7.0% of covered salaries to the CSRS plan. The university is currently required to contribute 7.0%. Contributions to CSRS for the year ended June 30, 2015, were $442,263.52, which consisted of $230,095.79 from the university and $212,167.73 from the employees; contributions for the year ended June 30, 2014, were $542,802.20, which consisted of $282,874.46 from the university and $259,927.74 from the employees; and contributions for the year ended June 30, 2013, were $582,486.86, which consisted of $302,615.78 from the university and $279,871.08 from the employees. Contributions met the requirements for each year.

Federal statute requires employees participating in FERS to contribute 0.8% of their salaries to the Basic Benefit Plan. The university is required to contribute 13.2%. In addition, the university is required to contribute 1% of each participant's salary to the Thrift Savings Plan plus up to an additional 4% depending upon employees' contributions, which can range from 0 to 10% of their salaries. Contributions for the Basic Benefit Plan were $1,158,705.53 for the year ended June 30, 2015, which consisted of $67,923.05 from employees and $1,090,782.48 from the university; $1,112,172.39 for the year ended June 30, 2014, which consisted of $70,119.12 from employees and $1,042,053.27 from the university; and $1,131,626.95 for the year ended June 30, 2013, which consisted of $71,372.55 from employees and $1,060,254.40 from the university. Contributions for the Thrift Savings Plan were $1,003,698.50 for the year ended June 30, 2015, which consisted of $602,218.50 from employees and $401,480.00 from the university; $1,030,559.00 for the year ended June 30, 2014, which consisted of $616,797.00 from employees and $413,762.00 from the university; and $1,031,993.00 for the year ended June 30, 2013, which consisted of $613,673.00 from employees and $418,320.00 from the university. Contributions met the requirements for each year.

Defined Contribution Plans

Optional Retirement Plans

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

Funding policy – For employees employed prior to July 1, 2014, plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. For employees hired after June 30, 2014, plan members will contribute 5% to the ORP and the university will contribute 9% of the employee's base salary. The required contributions made to the ORP were $44,888,633.25 for the year ended June 30, 2015, and $46,089,434.04 for the year ended June 30, 2014. Contributions met the requirements for each year.

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

Joint Contributory Retirement System Plan A (JCRS-A)

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

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

Funding Policy – Plan members are noncontributory. The university's contributions for JCRS-A members were calculated using the base salary amounts of $12,869,740.91 for fiscal year 2015, and $16,380,647.38 for fiscal year 2014. Contribution requirements are established and amended by state statute. The contributions are included in the ORP amounts. University contributions to fund the state supplemental benefit totaled $1,934,321.89 in fiscal year 2015, and $2,461,198.48 in fiscal year 2014. Contributions met the requirements for each year.

Deferred Compensation Plans

Employees are offered three deferred compensation plans. The university, through the State of Tennessee, provides two plans, one established pursuant to IRC, Section 457 and the other pursuant to IRC, Section 401(k). The third plan is administered by the university and was established in accordance with IRC, Section 403(b). The plans are outsourced to third party vendors and the administrative costs assessed by the vendors of these plans are the responsibility of plan participants. Section 401(k), Section 403(b), and Section 457 plan assets remain the property of the contributing employees; therefore, they are not presented in the accompanying financial statements. IRC Sections 401(k), 403(b), and 457 establish participation, contribution, and withdrawal provisions for the plans. Participation in the 403(b) and the 457 plans are voluntary for employees. The university provides up to a $50 monthly employer match for employees who participate in the state's 401(k) plan. Employees hired before July 1, 2014, voluntarily participate in the state's 401(k) plan. Pursuant to Public Chapter No. 259 of *Public Acts of 2013*, employees hired after June 30, 2014, are automatically enrolled in the state's 401(k) plan and contribute 2% of their salary, with the employer contributing an additional non-matching 5%. Employees may opt out of the 2% auto enrollment. Such contribution rates may only be amended by the Tennessee General Assembly. There are certain automatic cost controls and unfunded liability controls in the defined benefit plan where the employees participate that may impact the non-matching 5% employer contribution to the 401(k) plan.

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

During the year ended June 30, 2015, contributions totaling $21,968,325.52 were made by employees participating in the plan, and the university recognized pension expense of $6,211,291.35 for employer contributions. During the year ended June 30, 2014, contributions totaling $21,001,124.72 were made by employees participating in the plan, with contributions of $5,560,121.19 made by the university.

Note 11. Other Postemployment Benefits

Healthcare is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program that provides postemployment health insurance benefits to eligible university retirees. This program includes two plans available to higher education employees—the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Section 8-27-201, *Tennessee Code Annotated*, for the State Employee Group Plan and Section 8-27-701, *Tennessee Code Annotated*, for the Medicare Supplement Plan. Prior to reaching age 65, all members have the option of choosing between the standard or partnership preferred provider organization plan for healthcare benefits. Subsequent to age 65, members who are also in the state's retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. The state makes on-behalf payments to the Medicare Supplement Plan for the university's eligible retirees; see Note 20. The plans are reported in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Special Funding Situation

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

Funding Policy

The premium requirements of members of the State Employee Group Plan are established and may be amended by the insurance committee. The plan is self-insured and financed on a pay-as-you-go basis with the risk shared equally among the participants. The plan's claims liabilities are periodically computed using actuarial and statistical techniques to establish premium rates. The plan's administrative costs are allocated to plan participants. Retirees in the State Employee Group Plan pay the same base premium, adjusted for years of service, as active employees. Retirees with 30 years of service are subsidized 80%; retirees with 20 years of service but less than 30 years of service, 70%; and retirees with less than 20 years of service, 60%. Retirees in the Medicare Supplement Plan have flat-rate premium subsidies based on years of service. Retirees with 30 years of service receive $50 per month; retirees with 20 years of service but less than 30 years of service, $37.50; and retirees with 15 years of service but less than 20 years of service, $25.

University's Annual OPEB Cost and Net OPEB Obligation
State Employee Group Plan

Annual required contribution (ARC)	$20,877,000.00
Interest on the net OPEB obligation	3,765,000.00
Adjustment to the ARC	(3,668,000.00)
Annual OPEB cost	20,974,000.00
Amount of contribution	(15,051,297.67)
Increase in net OPEB obligation	5,922,702.33
Net OPEB obligation – beginning of year	94,118,814.22
Net OPEB obligation – end of year	$100,041,516.55

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2015	State Employee Group Plan	$20,974,000.00	71.76%	$100,041,516.55
June 30, 2014	State Employee Group Plan	$20,258,000.00	68.30%	$94,118,814.22
June 30, 2013	State Employee Group Plan	$24,912,000.00	55.09%	$87,696,118.55

Funded Status and Funding Progress

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

State Employee Group Plan

Actuarial valuation date	July 1, 2013
Actuarial accrued liability (AAL)	$193,052,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$193,052,000.00
Actuarial value of assets as a percentage of the AAL	0.0%
Covered payroll (active plan members)	$691,825,061.00
UAAL as percentage of covered payroll	27.9%

Actuarial valuations involve estimates of the value of reported amounts and assumptions about the probability of events far into the future, and actuarially determined amounts are subject to continual revision as actual results are compared to past expectations and new estimates are made about the future. The schedule of funding progress, presented as Required Supplementary

Information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

Actuarial Methods and Assumptions

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

In the July 1, 2013, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4% investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 7.5% initially. The rate decreased to 7.0% in fiscal year 2015 and then reduces by decrements to an ultimate rate of 4.19% in fiscal year 2044. All rates include a 2.5% inflation assumption. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007. Payroll is assumed to grow at a rate of 3.0%.

Note 12. Chairs of Excellence

Since fiscal year 1985, the Tennessee General Assembly has appropriated $22 million to a Chairs of Excellence Endowment for the University of Tennessee. The appropriations provided that the Chairs of Excellence Endowment be established as an irrevocable trust with the State Treasurer and required the university to match the appropriation on a dollar-for-dollar basis. The university has fully matched 50 chairs as of June 30, 2015. The financial statements of the university include as expenditures the amounts expended in the current year to match the state appropriations. The university's statement of net position does not include the amounts held in trust by the State Treasurer. At June 30, 2015, the amounts held in trust totaled $137,599,699.13 at fair value.

Note 13. Joint Ventures

UT-Battelle

The university is a participant in a joint venture with Battelle Memorial Institute for the sole purpose of management and operation of the Oak Ridge National Laboratory (ORNL) for the U.S. Department of Energy. Each entity has a 50% interest in the venture, each having provided an initial investment of $125,000.00. The university's equity interest was $4,925,516.00 at June 30, 2015. The university and Battelle each receive a 50% distribution of the ORNL management fee after shared expenses are deducted. The fee distribution to the university for the year ended September 30, 2014, was $3,800,521.24.

During the year ended June 30, 2015, the university had expenses of $22,504,986.13 under contracts with UT-Battelle. Amounts receivable from UT-Battelle under these contracts totaled $1,960,405.12 at June 30, 2015. To review the audit report of UT-Battelle, please contact the Controller's Office, The University of Tennessee, 201 Andy Holt Tower, Knoxville, Tennessee 37996-0100.

UT Le Bonheur Pediatric Specialists

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

Both the university and Methodist Healthcare provided an advance to the joint venture in the 2011 fiscal year so that the faculty practice group could begin its operations. In addition, the university and Methodist Healthcare have agreed to guarantee the losses of ULPS equally and provide cash on a monthly basis to meet the operating needs of ULPS. During the 2015 fiscal year, the university remitted another $9,759,490.00 for these purposes.

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

Note 14. Insurance-related Activities

It is the policy of the state not to purchase commercial insurance for the risks associated with casualty losses for general liability, automobile liability, professional medical malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund (RMF). The state purchases commercial insurance for real property, builder's risk (for construction projects starting prior to July 1, 2012), and crime and fidelity coverage on the state's officials and employees. The contractor is responsible for acquiring builder's risk insurance for all construction projects after June 30, 2012; thus, builder's risk is no longer covered by the RMF. For property coverage, the deductible for an individual state agency is the first $25,000 of losses. The RMF is responsible for property losses for the annual aggregate deductible of $10 million for perils other than earthquake and flood. Purchased insurance coverage is responsible for losses exceeding the $10 million annual aggregate deductible. For earthquake and flood, there is a deductible of $10 million per occurrence. The maximum insurance coverage is $750 million per year for perils other than earthquake and flood. The maximum flood insurance coverage is $50 million per occurrence, except there is only $25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is $50 million per occurrence. The amounts of settlements have not exceeded insurance coverage for each of the three past fiscal years.

The university participates in the RMF. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the year ended June 30, 2015, is presented in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml. Since the university participates in the Risk Management Fund, it is subject to the liability limitations established by statute. The maximum liability for general liability, automobile liability, and medical malpractice liability is $300,000 per person and $1,000,000 per occurrence. Claims are paid through the state's Risk Management Fund. At June 30, 2015, the Risk Management Fund held $127.9 million in cash designated for payment of claims.

At June 30, 2015, the scheduled coverage for the university was $5,045,355,800 for buildings and $1,201,649,900 for contents.

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

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

Note 15. Commitments and Contingencies

Construction Commitment

The university has contractual obligations for the construction of new buildings and additions to and renovations of existing buildings. The outstanding commitments under such contracts at June 30, 2015, were $293,571,555.54, of which $85,225,030.73 of these costs will be funded by future state capital outlay appropriations.

Sick Leave

The university records the cost of sick leave when paid. The dollar amount of unused sick leave was $284,517,503.00 at June 30, 2015.

Grants and Contracts

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

Nonvested Equipment

Equipment in the possession of the university valued at $2,001,188.88 as of June 30, 2015, is not reflected in the financial statements. This equipment was purchased with restricted grant and contract funds and other funds, and title has not yet transferred to the university.

Litigation

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

Note 16. Lease and Transfer of UT Memorial Research Center and Hospital

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

Lease and Transfer Agreement

Pursuant to the enabling legislation, *Tennessee Code Annotated*, Section 49-9-112 and Section 49-9-1301 et seq., UHS leased from the university the real property of the existing hospital and the Graduate School of Medicine. (See also Note 18.) The term of the lease is 50 years. The university also transferred to UHS all operating assets of the hospital. The consideration for the lease of the real property and transfer of the operating assets was payment by UHS of (a) a sum sufficient to economically defease all of the debt issued by the Tennessee State School Bond Authority in the amount of $149,080,353.69, (b) $25,000,000.00 paid to the university at closing, and (c) a variable lease obligation of $50,000,000.00 to be paid to the university over 20 years. UHS assumed all prior hospital liabilities, known or unknown. In 2019, the university and UHS have agreed to negotiate an annual lease payment for the remaining 30 years of the lease.

Employee Services Agreement

UHS has leased from the university all hospital employees as of the date of closing. UHS has paid to the university the amounts incurred by the university to pay the direct expenses relating to the hospital employees, including wages, salaries, and fringe benefits. These payroll expenses on behalf of UHS, totaling $51,029,419.30 in 2015, are reported as operating expenses in the statement of revenues, expenses, and changes in net position. An equal amount of operating revenue is reported in the nongovernmental grants and contracts category. The term of the Employee Services Agreement is 50 years. All persons who began service at the hospital after the date the Employee Services Agreement was signed are employees of UHS and not university employees.

Affiliation Agreement

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

Note 17. Transfer of Development Operations to the University of Tennessee Foundation

On July 1, 2011, the university transferred its Development and Alumni Affairs operations to the University of Tennessee Foundation, Inc., a not-for-profit component unit created in 2001 to support the University of Tennessee. The foundation supports the university's educational, research, and public activities by securing and administering private funds to support programs beyond the scope of the university's general budget. (See also Note 24.) Pursuant to the University of Tennessee Board of Trustees' approval and the enabling legislation, *Tennessee Code Annotated*, Section 49-9-113, the university and the foundation signed an Affiliation and Services Agreement and an Employee Services Agreement to effect the transfer.

Affiliation and Services Agreements

The university and the foundation agreed that all gifts, unless directed otherwise by the donor or given in support of the University of Tennessee at Chattanooga, be deposited into the foundation bank account and that the university pay the foundation direct support and a 100 basis point endowment assessment fee as compensation for performing the fundraising function. The direct support amount is to be reviewed annually, and the foundation President and Chief Executive Officer, who is also the university's Vice President for Development and Alumni Affairs, coordinates fundraising goals and objectives of the foundation with the university. For fiscal year 2015, the university provided the foundation direct support of $18,912,634.36 and endowment assessment fees of $6,676,172.07.

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

Employee Services Agreement

The foundation has paid to the university the amounts incurred by the university to pay the direct expenses relating to the Development and Alumni Affairs employees, including wages, salaries, and fringe benefits. These payroll expenses on behalf of the foundation, totaling $20,364,346.49 in fiscal year 2015, are reported as operating expenses in the statement of revenues, expenses, and changes in net position. An equal amount of operating revenue is reported in the nongovernmental grants and contracts category.

Note 18. Capital Leases of Real Property

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

The university has leased the real property of the UT Memorial Research Center and Hospital to UHS for a term of 50 years. This lease is pursuant to the Lease and Transfer Agreement described in Note 16. This lease is classified as a direct financing lease. The guaranteed lease payment of $50 million will be paid by UHS in annual payments through 2020. The amount of the annual payments will equal the lesser of (1) 20% of the hospital's net operating profit for the applicable calendar year; or (2) $3 million or the greater amount resulting from the application of an index, as specified in the agreement. The payment of $50 million is guaranteed by March 15, 2021. In 2019, the university and UHS have agreed to negotiate an annual lease payment for the remaining 30 years of the lease. An annual lease payment to the university during the year ended June 30, 2015, totaled $3,195,587.00.

The university recorded a lease payment receivable in the amount of $33,778,262.32 at June 30, 2015, which represents the net present value of the guaranteed $50 million discounted at 5.75%. The minimum lease payments to be received amount has been adjusted upward to reflect a contractually required adjustment to the final required lease payment.

	June 30, 2015
Total minimum lease payments to be received	$45,149,230.39
Less: unearned income	(11,370,968.07)
Net investment in direct financing lease	$33,778,262.32

Capital Lease of Real Property to Memphis Mental Health Institute

On November 5, 2005, the university entered into a facility lease agreement with the Tennessee Department of Mental Health and Substance Abuse Services (TDMHSAS) to provide a new building to house the Memphis Mental Health Institute. The building is a joint project of the university, Methodist Healthcare, the Shelby County Health Care Authority (the MED), the State of Tennessee, and Shelby County. This lease is classified as a direct financing lease. The guaranteed lease payments will be paid by TDMHSAS in semiannual payments through 2027. The amount of the semiannual payments will equal the amount to retire the debt from the construction project and any other project costs incurred by the university in excess of the funds contributed by Methodist Healthcare and the MED. During the term of the lease, TDMHSAS will be responsible for all operational and maintenance costs associated with the facility.

The university recorded a lease payment receivable in the amount of $11,871,389.62 at June 30, 2015:

Total minimum lease payments to be received	$15,373,754.60
Less: unearned income	(3,502,364.98)
Net investment in direct financing lease	$11,871,389.62

Year Ending June 30	Minimum Lease Payments to Be Received	Interest	Principal
2016	$ 1,360,362.08	$ 531,399.28	$ 828,962.80
2017	1,362,051.36	494,292.40	867,758.96
2018	1,363,811.62	455,448.89	908,362.73
2019	1,365,645.82	414,787.83	950,857.99
2020	1,367,560.68	372,224.55	995,336.13
2021-2025	6,869,642.34	1,149,645.31	5,719,997.03
2026-2027	1,684,680.70	84,566.72	1,600,113.98
	$15,373,754.60	$3,502,364.98	$11,871,389.62

Note 19. Natural Classification With Functional Classifications

The university’s operating expenses for the year ended June 30, 2015, are as follows:

Functional Classification	Salaries	Benefits	Natural Classification Utilities, Supplies, and Other Services	Scholarships	Depreciation	Total
Instruction	$ 439,628,997.77	$117,150,457.46	$ 86,687,020.49	$ -	$ -	$ 643,466,475.72
Research	136,298,774.15	31,945,817.37	67,998,463.62	-	-	236,243,055.14
Public service	67,273,675.69	22,343,143.02	32,266,722.17	-	-	121,883,540.88
Academic support	87,938,912.12	26,904,366.98	41,291,459.86	-	-	156,134,738.96
Student services	44,407,928.40	14,613,367.20	26,674,085.93	-	-	85,695,381.53
Institutional support	75,823,072.82	22,460,851.41	28,298,008.45	-	-	126,581,932.68
Maintenance and operation	43,140,495.62	16,530,516.81	92,105,736.03	-	-	151,776,748.46
Scholarships and fellowships	3,288,710.44	30,560,236.67	1,076,068.62	60,792,352.56	-	95,717,368.29
Auxiliary	51,007,759.73	12,407,148.88	81,678,610.53	-	-	145,093,519.14
Independent operations	51,895,051.91	16,310,542.59	-	-	-	68,205,594.50
Depreciation	-	-	-	-	107,313,493.09	107,313,493.09
Total expenses	$1,000,703,378.65	$311,226,448.39	$458,076,175.70	$60,792,352.56	$107,313,493.09	$1,938,111,848.39

Note 20. On-behalf Payments

During the year ended June 30, 2015, the State of Tennessee made payments of $1,168,062.50 on behalf of the university for retirees participating in the Medicare Supplement Plan. The Medicare Supplement Plan is a postemployment benefit healthcare plan and is discussed further in Note 11. The plan is reported in the *Tennessee Comprehensive Annual Financial Report*. That report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Note 21. Voluntary Retirement Incentive Program

The University of Tennessee at Chattanooga (UTC) offered the 2015 UTC Voluntary Retirement Incentive Program for staff in fiscal year 2015 as a proactive measure designed to promote efficient alignment of demand (e.g., student demand) with campus resources. Eighty-two approved staff participated in the program. Severance pay of $2,286,140.34 was paid the month following separation date.

The Program was open to full-time employees who met the certain retirement eligibility criteria within the Tennessee Consolidated Retirement System (TCRS), the Joint Contributory Retirement System (JCRS-A), or the Optional Retirement Program (ORP). UTC reserved the right to limit the number of participants in this program and the right to discontinue this program at any time, without notice. The incentive pay offered was 50% of the employee's annualized base salary, paid in a lump sum after the effective retirement date. See www.utc.edu/human-resources/benefits/2015-utc-voluntary-retirement-incentive-program/ for further details.

Note 22. Cumulative Effect of a Change in Accounting Principle

During fiscal year 2015, the university implemented GASB Statement 68, *Accounting and Financial Reporting for Pensions,* and GASB Statement 71, *Pension Transition for Contributions Made Subsequent to the Measurement Date*. These statements establish standards for the measurement, recognition, and display of the net pension liability and related expenses, deferred outflows and deferred inflows of resources, note disclosures, and required supplementary information. The implementation of these statements resulted in a cumulative adjustment to beginning net position of ($201,842,522.00). This cumulative adjustment does not include related deferred outflows and deferred inflows of resources.

Note 23. Component Unit – University of Chattanooga Foundation

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

The University of Chattanooga Foundation, Inc., is a legally separate, tax-exempt organization supporting the University of Tennessee at Chattanooga. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of the University of Tennessee at Chattanooga. The 48-member board of trustees of the foundation is self-perpetuating and consists of friends of the University of Tennessee at Chattanooga. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the University of Tennessee at Chattanooga, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2015, the foundation expended $7,155,854.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from the University of Chattanooga Foundation, Development Office, Department 6806, 615 McCallie Avenue, Chattanooga, TN 37403-2598.

Organization and Nature of Activities

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

Principles of Consolidation

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

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

CDFI is the sole member of its subsidiary, the LLC. The LLC was formed to own and develop an elementary school in downtown Chattanooga and student housing at the university. The student housing consists of 1,737 bedrooms in 451 units and 666 parking spaces.

Investments

A summary of foundation investments at June 30, 2015, is as follows:

Mutual funds	$ 66,878,125
Limited partnerships	57,455,153
Other	10
Total	$124,333,288

The foundation also has investments, restricted by the terms of the revenue bonds described below, totaling $12,580,275.

Property and Equipment

A summary of foundation property and equipment at June 30, 2015, is as follows:

Land	$ 8,391,732
Buildings	75,527,391
Furniture, fixtures, and equipment	5,546,876
	89,465,999
Accumulated depreciation	(38,467,179)
Total	$50,998,820

Revenue Bonds Payable

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

Revenue bonds payable at June 30, 2015, consist of the following:

Series 2005A revenue refunding bonds, interest rates fixed at 5.0% to 5.125% payable semi-annually, annual redemption payments due through October 1, 2035	$57,880,000
Series 2005B revenue refunding bonds, interest rates fixed at 5.5% to 6.0% payable semi-annually, annual redemption payments due through October 1, 2035	18,600,000
	76,480,000
Less: unamortized discount	(1,211,055)
Total	$75,268,945

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

Year Ending June 30	
2016	$ 2,090,000
2017	2,200,000
2018	2,310,000
2019	2,430,000
2020	2,555,000
Thereafter	64,895,000
Total	$76,480,000

Fair Value Measurements

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

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

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

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

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

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

	Balance as of June 30, 2015	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Other Unobservable Inputs (Level 3)
Assets:				
Mutual funds	$ 66,878,125	$66,146,649	$ 731,476	$ -
Guaranteed investment contracts	4,554,675	-	4,554,675	-
Commercial paper	1,156,144	1,156,144	-	-
Treasury obligations fund	6,869,456	6,869,456	-	-
Limited partnerships	57,455,153	-	-	57,455,153
Other	10	10	-	-
Total assets	136,913,563	74,172,259	5,286,151	57,455,153
Liabilities:				
Deposits received for the benefit of others	2,650,672	2,650,672	-	-
Total liabilities	$ 2,650,672	$2,650,672	$ -	$ -

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

	Limited Partnerships
Beginning balance	$54,480,223
Total realized and unrealized gains and losses included in earnings	2,327,567
Purchases, sales, and other	647,363
Ending balance	$57,455,153

Endowments

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

Interpretation of Relevant Law

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

1. The duration and preservation of the fund.

2. The purposes of the foundation and the donor-restricted endowment fund.

3. General economic conditions.

4. The possible effect of inflation and deflation.

5. The expected total return from income and the appreciation of investments.

6. Other resources of the foundation.

7. The investment policies of the foundation.

Endowment net assets by type of fund consist of the following at June 30, 2015. Due to GASB reformatting, temporarily restricted net assets are reported as expendable restricted net position, and permanently restricted net assets are reported as nonexpendable restricted net position on the statement of net position.

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted funds	$ (38,360)	$1,450,130	$60,542,374	$ 61,954,144
Board-designated funds	58,652,550	-	-	58,652,550
	$58,614,190	$1,450,130	$60,542,374	$120,606,694

Changes in endowment net assets for the fiscal year ended June 30, 2015, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$57,580,042	$1,524,981	$57,406,351	$116,511,374
Investment income	1,518,996	573,985	-	2,092,981
Net appreciation	2,078,858	-	2,192,324	4,271,182
Contributions	10,800	-	2,567,120	2,577,920
Appropriations	(2,530,383)	(2,336,085)	-	(4,866,468)
Transfers	(44,123)	1,687,249	(1,623,421)	19,705
Endowment net assets, end of year	$58,614,190	$1,450,130	$60,542,374	$120,606,694

At June 30, 2015, permanently restricted net assets consist of the portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA. Temporarily restricted net assets consist of the portion of perpetual endowment funds subject to a time restriction under UPMIFA. The temporarily restricted net assets also have purpose restrictions.

Funds With Deficiencies

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the foundation to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature that are reported in unrestricted net assets were $38,360 as of June 30, 2015. These deficiencies resulted from unfavorable market fluctuations that occurred shortly after the investment of new permanently restricted contributions and continued appropriation for certain programs that was deemed prudent by the board of trustees.

Return Objectives and Risk Parameters

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

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

Strategies Employed for Achieving Objectives

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

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

Related-party Transactions

CDFI, the LLC, and the university have executed a management agreement which allows the university to assume management responsibilities related to the LLC's student housing. The LLC paid management fees of $222,917 to the university during the LLC's fiscal year ended June 30, 2015. As a matter of convenience, cash balances needed for student housing operations are held at the university, and operating expenses are paid from these funds. At June 30, 2015, deposits held at the university on behalf of the LLC were $238,708.

During the year ended June 30, 2015, CDFI contributed proceeds from the sale of the property to the foundation in the amount of $713,674.

Contingencies

CDFI is involved in certain claims arising from normal business activities. Management believes that the financial position of CDFI will not be materially affected by the outcome of these proceedings.

Cumulative Effect of a Change in Accounting Principle

In 2015, the LLC, the subsidiary of the foundation as described above, changed its fiscal year end to June 30 to coincide with the foundation's year end. In all prior years, the LLC's fiscal year ended July 31. The foundation's beginning consolidated net position was increased by $719,093 due to this change in the subsidiary's fiscal year end. In accordance with FASB Accounting Standards Codification (ASC) Topic 810, this change is presented as a change in accounting principle.

Note 24. Component Unit – University of Tennessee Foundation

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

The University of Tennessee Foundation is a legally separate, tax-exempt organization supporting the University of Tennessee. The foundation acts as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The foundation has 19 active board members and three ex-officio members. The board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2015, the foundation expended $46,519,483.20 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from the University of Tennessee Foundation, Suite 100, UT Conference Center Building, 600 Henley Street, Knoxville, TN 37996.

Organization and Nature of Activities

The University of Tennessee Foundation, Inc., is a not-for-profit organization exempt from federal income tax under Section 501(c)(3) of the *Internal Revenue Code*. The foundation was formed to support the University of Tennessee. The foundation was established to provide fund raising support for the university in carrying out its mission of teaching, research, and public service. The foundation receives contributions from individuals, corporations, alumni, and other donors. The foundation also conducts the development and alumni affairs operations for the university. See also Note 17.

Pledges Receivable

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

	Temporarily Restricted	Permanently Restricted
Current pledges	$ 3,995,370.55	$ 3,407,839.33
Pledges due in one to five years	37,940,734.42	36,420,928.38
Pledges due after five years	9,748,952.43	20,966,230.16
	51,685,057.40	60,794,997.87
Less discounts to net present value	(1,788,127.32)	(3,827,137.67)
Total pledges receivable, net	$49,896,930.08	$56,967,860.20

The allowance for doubtful accounts at June 30, 2015, was $696,279.80.

Investments and Assets Held by the University of Tennessee

Investments held at June 30, 2015, were as follows:

	Fair Value	Cost
Endowment assets held by the University of Tennessee:		
Cash	$ 1,379,830.79	$ 1,379,830.79
U.S. equity	2,836,979.66	1,893,781.70
International equity	27,367,320.80	30,213,444.09
Fixed income	15,108,134.92	16,546,101.88
Alternative investments:		
Private equity	15,529,343.42	14,954,771.77
Natural resources	12,333,778.81	11,993,491.54
Real estate investments	4,254,046.06	3,458,068.38
Hedge funds	30,941,455.57	25,947,100.02
Total endowment assets held by university	109,750,890.03	106,386,590.17
Endowment assets held by the foundation:		
Cash	81,196.94	81,196.94
Equities	1,074,474.25	859,816.21
Total endowment assets held by the foundation	1,155,671.19	941,013.15
Total endowment funds	110,906,561.22	107,327,603.32
Gift annuity program:		
Cash	87,769.16	86,494.16
Equities	2,239,469.30	2,176,092.28
Fixed income	1,847,124.43	1,885,174.91
Total gift annuity program	4,174,362.89	4,147,761.35
Other investments		
Other investments held by university	42,539,851.81	42,539,851.81
Other investments	10,025,735.33	10,025,735.33
Total other investments	52,565,587.14	52,565,587.14
Total investments	$167,646,511.25	$164,040,951.81

Also reported as investments on the statement of net position are other gift assets totaling $1,924,580.00.

At June 30, 2015, the fair values of alternative investments are based on valuations for which a readily determinable fair value does not exist. These investments are not listed on national exchanges or over-the-counter markets, and quoted market prices are not available. The fair value of these investments is estimated based on a review of all available information provided by fund managers and general partners. These estimates are evaluated on a regular basis and are susceptible to revisions as more information becomes available.

Endowments

The foundation's endowment funds consist of investments held by the university, investments held by the foundation, and permanently restricted unconditional promises to give. The majority of the foundation's invested endowment funds are invested in the University of Tennessee Consolidated Investment Pool. These funds are invested according to the policies of the university. A portion of the earnings from these funds is provided to the university to be used as stipulated in the endowment agreements. The cost and fair value for these endowments invested were $106,386,590.17 and $109,750,890.03, which resulted in a cumulative unrealized gain of $3,364,299.86. One endowment with a fair value of $1,155,671.19 is separately invested. All endowments at the foundation are donor-restricted. Endowment earnings transferred to the university were $3,526,775.27 for fiscal year 2015.

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, and (3) accumulations to the endowment made in accordance with the gift instrument until the endowment is vested in the university's Consolidated Investment Pool. Below is a schedule of endowments by fund type. Due to the GASB reformatting, temporarily restricted net assets are reported as expendable restricted net position, and permanently restricted net assets are reported as nonexpendable restricted net position on the statement of net position.

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Beginning balance	$ -	$6,815,265.90	$100,173,848.62	$106,989,114.52
Contributions received	-	-	63,692,599.99	63,692,599.99
Transfers to endowments	-	(45,912.39)	545,851.83	499,939.44
Investment earnings	3,581.24	3,554,790.16	114,197.60	3,672,569.00
Market value adjustment	-	(3,132,069.57)	572.28	(3,131,497.29)
Disbursements	(3,581.24)	(3,666,450.73)	-	(3,670,031.97)
Ending balance	$ -	$3,525,623.37	$164,527,070.32	$168,052,693.69

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 foundation uses the university's spending policy. The university calculates its spending policy by taking 4.5% of a three-year fair value average each December 31.

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 allocations (excluding separately invested assets) were as follows at June 30, 2015:

Cash	1.1%
U.S. equity	2.6%
International equity	25.0%
Fixed income	13.8%
Alternative investments	
Private equity	14.1%
Natural resources	11.2%
Real estate investments	3.9%
Hedge funds	28.3%

Fair Value Measurements

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

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

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

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

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

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

	Level 1	Level 2	Level 3	Total
Investments	$87,632,636.05	$16,955,251.35	$63,058,623.85	$167,646,511.25

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

Beginning balance	$41,678,836.38
Total realized and unrealized gains and losses included in earnings	4,688,016.63
Purchases, issuances, and settlements	16,691,770.84
Ending balance	$63,058,623.85

Mortgage Note Payable

The foundation was gifted property in Weakley and Obion counties in Tennessee. The property and its contents were appraised at $376,000.00 with an attached mortgage note of $259,330.41. The property will be used and overseen by the University of Tennessee at Martin. Payment on the note, which began in January 2006, is $2,000.00 per month. The note has a 4.68% interest rate. The balance of the note payable at June 30, 2015, was $113,081.66. Future maturities of this note are as follows:

Year ending June 30:	
2016	$ 15,866.28
2017	19,873.00
2018	20,823.27
2019	21,818.97
2020	22,862.29
2021	11,837.85
Total	$113,081.66

Concentration of Credit Risk

The foundation has concentrated its credit risk for cash by maintaining deposits at a 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.

Note 25. Component Unit – University of Tennessee Research Foundation

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

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

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

Organization and Nature of Activities

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

TennEra, LLC, (the subsidiary), a wholly owned subsidiary of the University of Tennessee Research Foundation, is in the business of developing and operating a pilot-scale biorefinery and state-of-the-art research and development facility, in collaboration with DuPont Danisco Cellulosic Ethanol, LLC, (DDCE) for cellulosic ethanol using non-food biomass feedstocks to prove the technology and commercial viability of producing cellulosic ethanol, primarily in the State of Tennessee. The project utilizes the University of Tennessee's expertise in cellulosic feedstock production and research, as well as its work with Tennessee farmers, to develop the first dedicated cellulosic energy crop supply chain utilizing switchgrass. The subsidiary also promotes, supports, and carries out the commercialization of research outcomes and the transfer of research-generated products, ideas, processes, and other technology related to renewable energies to agricultural, commercial, and industrial enterprises.

TennEra LLC's financial statements include the activity of subsidiary, Genera Energy, Inc., LLC, a majority owned subsidiary of TennEra. TennEra, LLC, contracts with Genera Energy, Inc., LLC, for the overall management authority and responsibility to operate the Biomass Innovation Park and to complete TennEra, LLC's contractual obligations toward the University of Tennessee Research Foundation's State Biofuel Initiative.

The Center for Advanced Scientific Support and Engineering Technology (ASSET.TN) is also a wholly owned nonprofit subsidiary of the University of Tennessee Research Foundation. The management of the property, activities, and affairs of ASSET.TN is vested in its board of directors. The board is composed of nine voting directors. As of June 30, 2015, ASSET.TN had total assets of $257,270 and total revenues of $48,185 for the year then ended.

The Cherokee Farm Development Corporation (CFDC) is another wholly owned nonprofit subsidiary of the University of Tennessee Research Foundation. The management of the property, activities, and affairs of CFDC is vested in its board of directors. The board is composed of five voting directors. As of June 30, 2015, CFDC had total assets of $138,202 and total revenue of $629,095 for the year then ended.

The Institute for Advanced Composites Manufacturing Innovation (IACMI), a nonprofit subsidiary of the University of Tennessee Research Foundation, IACMI's sole corporate member, was formed on August 1, 2014, and renamed as Collaborative Composite Solutions Corporation (CCS) on July 28, 2015. The management of the property, activities, and affairs of IACMI will be vested in its board of directors. The board is composed of 13 voting directors, one of whom is a representative of UTRF, and another representing the University of Tennessee. As of June 30, 2015, IACMI had total assets of $431,075 and total revenue of $562,810 for the year then ended.

Principles of Consolidation

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

Property and Equipment

Property and equipment consist of the following major classifications at June 30, 2015:

Office furniture and equipment	$ 167,863
Less accumulated depreciation	(132,685)
Total	35,178
TennEra	
Land	1,892,141
Buildings	40,065,041
Leasehold improvements	91,506
Machinery and equipment	26,431,591
Furniture and fixtures	325,818
Vehicles	175,438
Construction in progress	7,792
Less accumulated depreciation	(17,885,997)
Total TennEra	51,103,330

Cherokee Farm		
Office furniture and equipment	$	1,739
Less accumulated depreciation		(796)
Total Cherokee Farm		943
Total		$51,139,451

Depreciation expense for the foundation and its subsidiaries totaled $3,753,490 for the year ended June 30, 2015. Intangible assets totaling $419,011 are also reported as capital assets on the statement of net position.

Unearned Revenue

Based on an agreement with DDCE, all unreimbursed costs incurred by DDCE on the construction of the pilot-scale biorefinery were recorded as unearned revenue. The total amount of unearned revenue is expected to be recognized over the life of a lease between the company and DDCE, by which DDCE will be granted the use of a portion of the biorefinery facility. As of June 30, 2010, the lease was to be for ten years with three possible five-year extensions. Accordingly, revenue will be recognized over a period of 25 years beginning January 28, 2010, the date which DDCE first occupied its portion of the facility. Unearned revenue in conjunction with this lease was $17,646,231 at June 30, 2015. Revenue of $901,084 was recognized in fiscal year 2015.

Long-term Liabilities, Current

Genera Energy, Inc., has obtained a revolving credit facility which matures on December 3, 2017. Genera Energy, Inc., was in violation of a provision as of June 30, 2015. Genera management believes they were in compliance with covenants at their fiscal year end, March 31, 2015, but due to noncompliance as of TennEra's year end, the debt was classified as a current liability on the financial statements.

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

Included in current long-term liabilities are costs related to obtaining debt financing. These costs are deferred and amortized over the life of the related debt. In 2015, Genera Energy, Inc., capitalized approximately $672,000 of debt issue costs, which included the fair market value of warrants issued related to obtaining financing. Total amortization expense was approximately $110,000 for the year ended June 30, 2015.

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

Revolving credit facility:	
Initial loan	$1,500,000
Non-refundable modification fee	15,000
Payment in kind and accrued interest	44,552
Amortization	110,021
Debt issuance costs paid	(673,763)
Total revolving credit facility	995,810
Subordinated convertible promissory note, including interest	114,661
Note payable, net of issuance costs	$1,110,471

Estimated future amortization expenses as of June 30, 2015, are:

2016	$233,268
2017	233,268
2018	97,206

Fair Value Measurements

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

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

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

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

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

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

Registered Investment Companies

The fair value of registered investment companies (mutual funds) is based on quoted net asset values of the shares held by the foundation at June 30, 2015.

Marketable Equity Securities

The fair value of marketable equity securities is based on quoted prices times the number of shares held by the foundation at June 30, 2015.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the foundation believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table provides the assets (liabilities) carried at fair value measured on a recurring basis as of June 30, 2015:

Assets:	Level 1	Level 2	Level 3	Total
Registered investment companies	$ 10,038	$ -	$ -	$ 10,038
Marketable equity securities	147,997	-	-	147,997
Derivative liabilities	-	-	(735,400)	(735,400)
Total	$158,035	$ -	$(735,400)	$(577,365)

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

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

Actuarial Valuation Date	Plan	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
July 1, 2013	State Employee Group Plan	$ -	$193,052,000	$193,052,000	0%	$691,825,061	27.9%
July 1, 2011	State Employee Group Plan	$ -	$242,451,000	$242,451,000	0%	$685,300,649	35.4%
July 1, 2010	State Employee Group Plan	$ -	$240,150,000	$240,150,000	0%	$628,383,463	38.2%

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

The University of Tennessee

Required Supplementary Information

Schedule of University of Tennessee's Proportionate Share of the Net Pension Liability

Closed State and Higher Education Employee Pension Plan within TCRS

	2014
University's proportion of the net pension liability	12.764631%
University's proportionate share of the net pension liability	$ 88,069,402
University's covered-employee payroll	$ 348,719,634
University's proportionate share of the net pension liability as a percentage of its covered-employee payroll	25.26%
Plan fiduciary net position as a percentage of the total pension liability	95.11%

1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.

2) This is a ten-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until ten years of information is available.

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

	2014	2015
Contractually determined contribution	$ 52,412,536	$ 50,692,652
Contributions in relation to the contractually determined contribution	52,412,536	50,692,652
Contribution deficiency (excess)	$ -	$ -
Covered-employee payroll	$348,719,634	$337,276,466
Contributions as a percentage of covered-employee payroll	15.03%	15.03%

This is a ten-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future fiscal years until ten years of information is available.

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

	2015
Contractually determined contribution	$ 512,435
Contributions in relation to the contractually determined contribution	512,435
Contribution deficiency (excess)	$ -
Covered-employee payroll	$13,241,214
Contributions as a percentage of covered-employee payroll	3.87%

This is a ten-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future fiscal years until ten years of information is available.

THE UNIVERSITY OF TENNESSEE
Supplementary Combining Schedule of Net Position
June 30, 2015

	Knoxville	Chattanooga	Martin	Health Science Center	Other Units	Total University
Assets						
Current assets:						
Cash and cash equivalents	$ 139,977,308.21	$ 17,719,137.53	$ 12,053,133.72	$ 89,896,006.48	$ 120,094,173.64	$ 379,739,759.58
Investments	61,194,453.99	1,508,252.53	5,558,948.52	15,987,965.89	29,712,127.65	113,961,748.58
Accounts, notes, and grants receivable (net)	32,656,857.55	7,192,204.86	4,243,742.72	34,865,907.33	43,635,024.71	122,593,737.17
Due from/due to other campuses	47,001.57	-	(47,001.57)	-	-	-
Inventories	4,877,640.85	88,554.71	545,236.63	1,376,284.91	290,994.46	7,178,711.56
Prepaid expenses	2,898,142.47	204,857.21	200,175.57	234,501.96	(96,934.43)	3,440,742.78
Total current assets	241,651,404.64	26,713,006.84	22,554,235.59	142,360,666.57	193,635,386.03	626,914,699.67
Noncurrent assets:						
Cash and cash equivalents	269,518,095.38	49,519,508.55	31,270,572.05	88,844,763.22	140,357,400.80	579,510,340.00
Investments	405,309,929.58	17,908,204.54	26,083,140.11	144,776,849.89	168,924,382.27	763,002,506.39
Accounts, notes, and grants receivable (net)	107,095,633.84	11,947,798.80	6,560,723.74	4,845,671.57	25,313,016.60	155,762,844.55
Capital assets (net)	1,478,290,489.75	222,855,755.41	137,602,168.33	254,368,441.53	123,055,783.20	2,216,172,638.22
Total noncurrent assets	2,260,214,148.55	302,231,267.30	201,516,604.23	492,835,726.21	457,650,582.87	3,714,448,329.16
Total assets	2,501,865,553.19	328,944,274.14	224,070,839.82	635,196,392.78	651,285,968.90	4,341,363,028.83
Deferred outflows of resources						
Deferred amount on debt refunding	14,196,820.23	3,501,549.80	5,770,507.06	2,089,836.71	966,993.35	26,525,707.15
Deferred outflows related to pensions	21,945,981.00	4,207,466.00	2,676,315.00	10,722,864.00	11,652,461.00	51,205,087.00
Total deferred outflows of resources	36,142,801.23	7,709,015.80	8,446,822.06	12,812,700.71	12,619,454.35	77,730,794.15
Liabilities						
Current liabilities:						
Accounts payable	50,226,881.42	2,789,990.82	1,940,924.92	17,142,553.34	44,145,574.85	116,245,925.35
Accrued liabilities	23,564,124.62	4,285,444.61	2,872,537.67	2,479,440.23	23,729,188.16	56,930,735.29
Unearned revenue	50,972,637.26	6,529,408.41	2,138,037.92	49,040,041.90	4,466,728.31	113,146,853.80
Due to component unit	-	-	-	-	518,929.07	518,929.07
Deposits payable	729,836.13	969,963.79	388,392.34	869,635.76	37,190.64	2,995,018.66
Annuities and life income payable	-	-	-	-	2,954,564.96	2,954,564.96
Long-term liabilities, current portion	40,073,216.43	5,536,558.55	4,000,307.18	18,974,185.56	8,076,549.09	76,660,816.81
Deposits held in custody for others	2,254,206.79	25,126.92	3,813.07	317,623.80	4,787,120.69	7,387,891.27
Total current liabilities	167,820,902.65	20,136,493.10	11,344,013.10	88,823,480.59	88,715,845.77	376,840,735.21
Noncurrent liabilities:						
Unearned revenue	-	-	-	-	15,500,438.71	15,500,438.71
Net pension obligation	36,668,946.00	6,893,389.00	5,050,165.00	17,465,489.00	21,991,413.00	88,069,402.00
Net OPEB obligation	41,050,976.92	9,092,350.27	6,280,587.86	25,285,326.10	18,332,275.40	100,041,516.55
Long-term liabilities, noncurrent portion	558,800,174.14	46,846,381.10	69,313,929.37	91,732,014.60	21,014,129.89	787,706,629.10
Due to grantors	18,423,217.92	2,757,939.07	4,109,457.58	10,938,356.13	-	36,228,970.70
Annuities and life income payable	-	-	-	-	19,725,896.87	19,725,896.87
Deposits held in custody for component units	-	-	-	-	152,290,741.84	152,290,741.84
Total noncurrent liabilities	654,943,314.98	65,590,059.44	84,754,139.81	145,421,185.83	248,854,895.71	1,199,563,595.77
Total liabilities	822,764,217.63	85,726,552.54	96,098,152.91	234,244,666.42	337,570,741.48	1,576,404,330.98
Deferred inflows of resources						
Deferred inflows related to pensions	54,352,312.00	10,415,468.00	6,651,503.00	26,446,402.00	29,028,645.00	126,894,330.00
Net position						
Net investment in capital assets	921,677,358.58	179,289,934.59	72,949,797.26	171,704,154.12	123,055,782.97	1,468,677,027.52
Restricted for:						
Nonexpendable (permanent endowments)	300,901,132.12	14,836,097.27	19,742,864.27	113,072,700.24	37,898,707.19	486,451,501.09
Expendable for other	229,141,684.00	17,193,328.33	15,271,940.00	112,912,289.24	55,891,491.02	430,410,732.59
Expendable for loans	2,796,488.32	1,054,386.09	771,532.70	2,798,764.76	-	7,421,171.87
Expendable for capital projects	17,754,229.09	-	1,434,315.40	456,104.91	61,132.81	19,705,782.21
Expendable for debt service	67,205.12	-	-	-	-	67,205.12
Unrestricted	188,553,727.56	28,137,523.12	19,597,556.34	(13,625,988.20)	80,398,922.78	303,061,741.60
Total net position	$ 1,660,891,824.79	$ 240,511,269.40	$ 129,768,005.97	$ 387,318,025.07	$ 297,306,036.77	$ 2,715,795,162.00

THE UNIVERSITY OF TENNESSEE
Supplementary Combining Schedule of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2015

	Knoxville	Chattanooga	Martin	Health Science Center	Other Units	Total University
Revenues						
Operating revenues:						
Gross tuition and fees	$ 384,593,842.29	$ 104,665,139.32	$ 61,680,157.58	$ 78,900,043.37	$ -	$ 629,839,182.56
Less: tuition discount and allowances	(116,009,033.79)	(43,727,176.97)	(28,643,579.30)	(5,531,665.58)	-	(193,911,455.64)
Net student tuition and fees	268,584,808.50	60,937,962.35	33,036,578.28	73,368,377.79	-	435,927,726.92
Federal appropriations	9,508.66	-	-	-	19,028,380.00	19,037,888.66
Governmental grants and contracts	125,879,553.99	7,953,807.90	2,502,709.49	73,052,618.02	35,174,916.27	244,563,605.67
Nongovernmental grants and contracts	27,342,378.89	2,328,847.63	1,348,707.96	125,360,529.17	64,494,728.43	220,875,192.08
Sales and services of educational departments and other activities	21,305,082.70	5,594,657.18	3,780,153.80	19,677,961.48	7,650,664.05	58,008,519.21
Auxiliary enterprises:						
Residential life	42,916,918.62	9,173,990.16	7,285,290.64	4,233.98	-	59,380,433.40
Food services	5,021,725.40	1,112,139.70	655,200.42	107,081.76	-	6,896,147.28
Bookstore	20,900,348.85	1,019,994.43	595,055.42	-	-	22,515,398.70
Parking	6,811,844.37	2,028,150.83	538,736.43	1,225,789.87	-	10,604,521.50
Athletics	118,141,819.75	568,131.74	-	-	-	118,709,951.49
Other auxiliaries	2,908,793.19	140,892.09	12,567.89	64,654.18	-	3,126,907.35
Interest earned on loans to students	30,961.55	6.00	-	9,427.42	-	40,394.97
Other operating revenues	12,846,054.96	245,198.91	718,299.61	2,499,169.96	8,214,096.55	24,522,819.99
Total operating revenues	652,699,799.43	91,103,778.92	50,473,299.94	295,369,843.63	134,562,785.30	1,224,209,507.22
Expenses						
Operating expenses:						
Salaries and wages	449,716,344.34	83,718,632.93	48,805,929.47	280,688,391.47	137,774,080.44	1,000,703,378.65
Benefits	151,079,527.77	27,441,817.72	16,685,883.62	72,827,651.59	43,191,567.69	311,226,448.39
Utilities, supplies, and other services	239,904,343.65	40,345,233.31	23,004,849.27	115,972,853.88	38,848,895.59	458,076,175.70
Scholarships and fellowships	33,923,538.70	10,399,459.28	9,990,839.44	4,833,649.02	1,644,866.12	60,792,352.56
Depreciation and amortization expense	65,594,810.05	8,591,413.75	6,090,956.89	17,934,180.69	9,102,131.71	107,313,493.09
Total operating expenses	940,218,564.51	170,496,556.99	104,578,458.69	492,256,726.65	230,561,541.55	1,938,111,848.39
Operating income (loss)	(287,518,765.08)	(79,392,778.07)	(54,105,158.75)	(196,886,883.02)	(95,998,756.25)	(713,902,341.17)
Nonoperating revenues (expenses)						
State and local appropriations	220,081,272.12	39,321,256.26	27,396,375.75	136,487,784.43	82,690,905.07	505,977,593.63
Gifts	6,090,794.92	5,565,356.29	1,949,243.37	11,816,560.15	7,669,384.03	33,091,338.76
Grants and contracts	85,535,726.00	39,102,468.41	28,971,681.25	31,456,196.25	7,400.00	185,073,471.91
Investment income	3,868,680.09	5,256,838.75	520,294.75	2,023,588.70	19,858,229.52	31,527,631.81
Interest on capital asset - related debt	(19,021,738.95)	(1,443,009.13)	(2,371,058.82)	(2,993,142.63)	(235,596.71)	(26,064,546.24)
Other nonoperating revenues (expenses)	(2,922,329.91)	(422,881.47)	(206,645.09)	(2,355,573.89)	(1,441,861.94)	(7,349,292.30)
Net nonoperating revenues (expenses)	293,632,404.27	87,380,029.11	56,259,891.21	176,435,413.01	108,548,459.97	722,256,197.57
Income (loss) before other revenues, expenses, gains, or losses	6,113,639.19	7,987,251.04	2,154,732.46	(20,451,470.01)	12,549,703.72	8,353,856.40
Capital appropriations	28,531,911.33	8,516,390.53	2,443,431.65	5,365,071.85	3,425,702.41	48,282,507.77
Capital grants and gifts	17,113,610.88	168,000.00	1,043,905.23	68,839.25	504,934.30	18,899,289.66
Additions to permanent endowments	11,773,695.88	155,757.95	668,910.82	5,371,343.25	307,461.09	18,277,168.99
Other	267,852.90	3,102.00	111,000.00	153,177.98	10,491,216.01	11,026,348.89
Total other revenues	57,687,070.99	8,843,250.48	4,267,247.70	10,958,432.33	14,729,313.81	96,485,315.31
Increase in net position	63,800,710.18	16,830,501.52	6,421,980.16	(9,493,037.68)	27,279,017.53	104,839,171.71
Net position						
Net position - beginning of year	1,682,492,199.61	239,912,637.88	134,359,910.81	437,988,325.75	318,045,438.24	2,812,798,512.29
Cumulative effect of a change in accounting principle	(85,401,085.00)	(16,231,870.00)	(11,013,885.00)	(41,177,263.00)	(48,018,419.00)	(201,842,522.00)
Net position - beginning of year, restated	1,597,091,114.61	223,680,767.88	123,346,025.81	396,811,062.75	270,027,019.24	2,610,955,990.29
Net position - end of year	$ 1,660,891,824.79	$ 240,511,269.40	$ 129,768,005.97	$ 387,318,025.07	$ 297,306,036.77	$ 2,715,795,162.00

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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*

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

We have audited the financial statements of the University of Tennessee, which is a component unit of the State of Tennessee, and its discretely presented component units as of and for the year ended June 30, 2015, and the related notes to the financial statements, which collectively comprise the university's basic financial statements, and have issued our report thereon dated December 16, 2015. We conducted our audit 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. Our report includes a reference to other auditors who audited the financial statements of the University of Chattanooga Foundation, Inc.; the University of Tennessee Foundation, Inc.; and the University of Tennessee Research Foundation, Inc., as described in our report on the University of Tennessee's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the university'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 opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the university's internal control. Accordingly, we do not express an opinion on the effectiveness of the university'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 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 were not identified. Given these limitations, during our audit we did not identify any deficiencies that we consider to be material weaknesses. We did identify a deficiency in internal control, as described below, that we consider to be a significant deficiency.

- The University of Tennessee did not provide adequate internal controls in eight specific areas.

This deficiency is described in the Findings and Recommendations section of this report.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the university'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*.

We did, however, note an immaterial instance of noncompliance that we have included in the Findings and Recommendations section of this report.

The University of Tennessee's Responses to Findings

The university's responses to the findings identified in our audit are included in the Findings and Recommendations section of this report. The university's responses were not subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly, we express no opinion on them.

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

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 16, 2015

Findings and Recommendations

1. <u>The university did not provide adequate internal controls in eight specific areas</u>

<u>Finding</u>

The university did not design and monitor effective internal controls in eight areas. We observed five conditions at the Chattanooga campus, one condition at the Knoxville campus, and two conditions at the Health Science Center that were in violation of university or campus policies and/or industry-accepted best practices. Inconsistent implementation of internal controls increases the risk of fraud or error.

The details of this finding are confidential pursuant to Section 10-7-504(i), *Tennessee Code Annotated.* We provided the university with detailed information regarding the specific conditions we identified, as well as our recommendations for improvement.

<u>Recommendation</u>

Management should ensure that these conditions are remedied by the prompt development and consistent implementation of internal controls. Management should implement effective controls to ensure compliance with applicable requirements; assign staff to be responsible for ongoing monitoring of the risks and mitigating controls; and take action if deficiencies occur.

<u>Management's Comment</u>

We concur with the finding and recommendation.

2. <u>Principal investigators at the University of Tennessee Institute of Agriculture and the University of Tennessee Health Science Center did not ensure that obligations charged to federal awards were allowable under federal research and development grants, resulting in federal questioned costs of $12,114</u>

<u>Condition</u>

The university requested and received reimbursement for unallowable costs. We tested 117 randomly selected transactions charged to federal research and development grants and contracts for the period July 1, 2014, through April 30, 2015. We found that 3 of the 117 transactions (2.6%) were unallowable. These unallowable costs were (1) student tuition and fees paid by the grant in lieu of wages although the student did not perform work under the specific project during the associated time period, (2) an iMac computer charged as a direct cost without justification being included in the grant proposal, and (3) copy machine rental charged as direct costs without justification being included in the grant proposal.

Student fees of $6,756 were charged to grant number G11AP20107 at the University of Tennessee Institute of Agriculture. The computer was charged to grant number 5U01AA016662 at the University of Tennessee Health Science Center at a cost of $1,939.00 plus facilities and administration charges of $969.50. The copy machine rental was charged to grant number 5U01DK048411 at the University of Tennessee Health Science Center and totaled $1,633 plus facilities and administration charges of $816.50.

Our test of a sample of $2,741,506 from a total population of $128,659,620 resulted in total federal questioned costs of $12,114.

Criteria

Student Fees

According to 2 CFR 200.E466,

> …tuition remission and other forms of compensation paid as, or in lieu of, wages to students performing necessary work are allowable provided that: (1) The individual is conducting activities necessary to the Federal award. . . .

Computer

According to 2 CFR 200.E453,

> In the specific case of computing devices, charging as direct costs is allowable for devices that are essential and allocable, but not solely dedicated, to the performance of a Federal award.

However, university policy states, "If these items are proposed as direct costs, acceptable justification will be required to be included in the proposal submitted to the sponsor. If not previously approved in the proposal budget by the sponsor, purchases made after award will require prior justification and approval from the designated pre or post award campus or institute office. . . ." The grant proposal states that "any computer related supplies or software will be provided by UTHSC," and no justification or approval was obtained by the appropriate office prior to the purchase. Thus, there was no documentation that the cost of the computer was essential and allocable. The principal investigator agreed that the iMac should not have been purchased under this grant.

Copy machine rental

According to 2 CFR 200, Appendix III,

> Items such as office supplies, postage, local telephone costs, and memberships must normally be treated as indirect (F&A) costs.

Per university policy, "If these items are proposed as direct costs, they must be specifically identified in the sponsor's approved proposal budget and budget justification." A general purpose cost justification form is available if the item is not mentioned in the proposal and budget. The most recent proposal states that "two professional grade copy machines and two fax machines are available for use in the office. . . ." There was no mention in the proposal of the rental of the copy machines being charged to the grant. Also, no justification form was submitted and approved prior to costs being incurred.

Cause

Departmental bookkeepers, principal investigators, and grant accountants did not comply with federal requirements and university policy and did not properly monitor charges to these research and development grants.

Effect

Charging unallowable costs to federal programs could result in penalties from the grantor or loss of subsequent grant awards.

Recommendation

Management should ensure that departmental bookkeepers, principal investigators, and grant accountants have the knowledge and expertise to monitor and account for federal grant and contract awards in accordance with award agreements, federal regulations, and university policy.

Although the risks noted in this finding were identified and assessed in management's risk assessment activities, management should reassess the design, implementation, and monitoring of controls to prevent noncompliance.

Management's Comment

We concur with the finding and recommendation. The unallowable expenditures were discussed with employees involved, and unallowable grant expenses were corrected.

Through its hiring and continuing education processes, the university works diligently to ensure that responsible employees, including bookkeepers, principal investigators, and grant accountants, have the knowledge and expertise to monitor and account for federal grant and contract awards in accordance with award agreements, federal regulations, and university policy. These particular compliance requirements will be emphasized in future compliance training. Also, the design, implementation, and monitoring of controls to prevent noncompliance for these risks is being reassessed and will be incorporated in each campus's upcoming risk assessments.