Tennessee Comptroller of the Treasury

Financial and Compliance Audit Report

The University of Tennessee

For the Year Ended June 30, 2018

Justin P. Wilson
Comptroller of the Treasury

Division of State Audit

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TENNESSEE COMPTROLLER OF THE TREASURY

JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

March 25, 2019

The Honorable Bill Lee, Governor
Members of the General Assembly
Mr. Randy Boyd, Interim President

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the University of Tennessee, for the year ended June 30, 2018. 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
Division of State Audit

18/099

CORDELL HULL BUILDING | 425 Fifth Avenue North | Nashville, Tennessee 37243

Audit Report
University of Tennessee
For the Year Ended June 30, 2018

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Financial and Compliance Audit

The University of Tennessee

For the Year Ended June 30, 2018

Opinions on the Financial Statements

The opinions on the financial statements are unmodified.

Audit Findings

The University of Tennessee Did Not Provide Adequate Internal Controls in Three Areas, Including One Area That Was Reported in the Prior-Year Audit*
The university did not design and monitor effective internal controls in three areas. The details of this finding are confidential pursuant to Section 10-7-504(i), *Tennessee Code Annotated* (page 96).

Principal Investigators at the University of Tennessee at Knoxville 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 $669.68
The university requested and received reimbursement for unallowable costs, including a $26,300 equipment item, two Dell computers, sales tax, and payments to a subrecipient. This resulted in $669.68 of federal questioned costs (page 96).

Office of Sponsored Programs Personnel at the University of Tennessee at Knoxville and the University of Tennessee Health Science Center and Research Staff at the University of Tennessee Space Institute Did Not Always Ensure That Subrecipient Contracts Included Information Required Per Federal Regulations
We tested 40 subrecipient agreements for research and development grants at the university. All information required per 2 CFR 200.331(a) was not included in six of the agreements (page 99).

* Portions of this finding are repeated from the prior audit.

Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
Mr. Randy Boyd, Interim 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, 2018, 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the university'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, 2018; 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 75, *Accounting and Financial Reporting for Postemployment Benefits Other Than Pensions*, and Governmental Accounting Standards Board Statement 81, *Irrevocable Split Interest Agreements*, during the year ended June 30, 2018. Our opinion is not modified with respect to these matters.

As discussed in Note 3, the financial statements of the university include investments valued at $641,846,570 (20% 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 6 through 14; the schedule of the University of Tennessee's proportionate share of the net pension liability – Closed State and Higher Education Employee Pension Plan within TCRS on page 83; the schedule of the University of Tennessee's proportionate share of the net pension asset – State and Higher Education Employee Retirement Plan within TCRS on page 84; the schedule of the University of Tennessee's contributions – Closed State and Higher Education Employee Pension Plan within TCRS on page 85; the schedule of the University of Tennessee's contributions – State and Higher Education Employee Retirement Plan within TCRS on page 86; the schedule of the University of Tennessee's contributions for the Federal Retirement Plans administered by the

U.S. Office of Personnel Management on page 87; the schedule of the University of Tennessee's proportionate share of the collective total OPEB liability – Closed State Employee Group OPEB Plan on page 88; and the schedule of the University of Tennessee's proportionate share of the collective total OPEB liability – Closed Tennessee OPEB Plan on page 89 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 on page 90; the supplementary combining schedule of revenues, expenses, and changes in net position on page 91; and the supplementary schedule of unrestricted net position on page 92 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; the supplementary combining schedule of revenues, expenses, and changes in net position; and the supplementary schedule of unrestricted 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, the supplementary combining schedule of revenues, expenses, and changes in net position, and the supplementary schedule of unrestricted net position are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 21, 2018, 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
Division of State Audit
December 21, 2018

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, 2018, with comparative information presented for the year ended June 30, 2017. 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, 2018, and June 30, 2017:

Summary of Net Position
(in thousands of dollars)

	2018	**2017**
Assets:		
Current assets	$ 632,621	$ 602,801
Capital assets, net	2,736,190	2,590,539
Other assets	1,920,145	1,818,149
Total assets	5,288,956	5,011,489
Deferred outflows:		
Deferred outflows	154,520	146,591
Liabilities:		
Current liabilities	387,192	356,917
Noncurrent liabilities	1,883,455	1,675,109
Total liabilities	2,270,647	2,032,026

Deferred inflows:		
Deferred inflows	47,691	12,838
Net position:		
Net investment in capital assets	1,669,360	1,621,977
Restricted – nonexpendable	513,178	522,110
Restricted – expendable	523,781	517,206
Unrestricted	418,819	451,923
Total net position	$3,125,138	$3,113,216

Total net position increased by $12 million, or .4%, during the 2018 fiscal year. The increases were in net investment in capital assets and restricted – expendable. Restricted – nonexpendable and unrestricted both decreased due to new GASB standards. During 2018, the university implemented GASB Statement 75, *Accounting and Financial Reporting for Post-employment Benefits Other than Pensions*, and GASB Statement 81, *Irrevocable Split Interest Agreements*. See Note 22 to the financial statements. Increased net position changes are the university's objective and expectation. The discussion and analysis sections that follow address the university's net increases.

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.

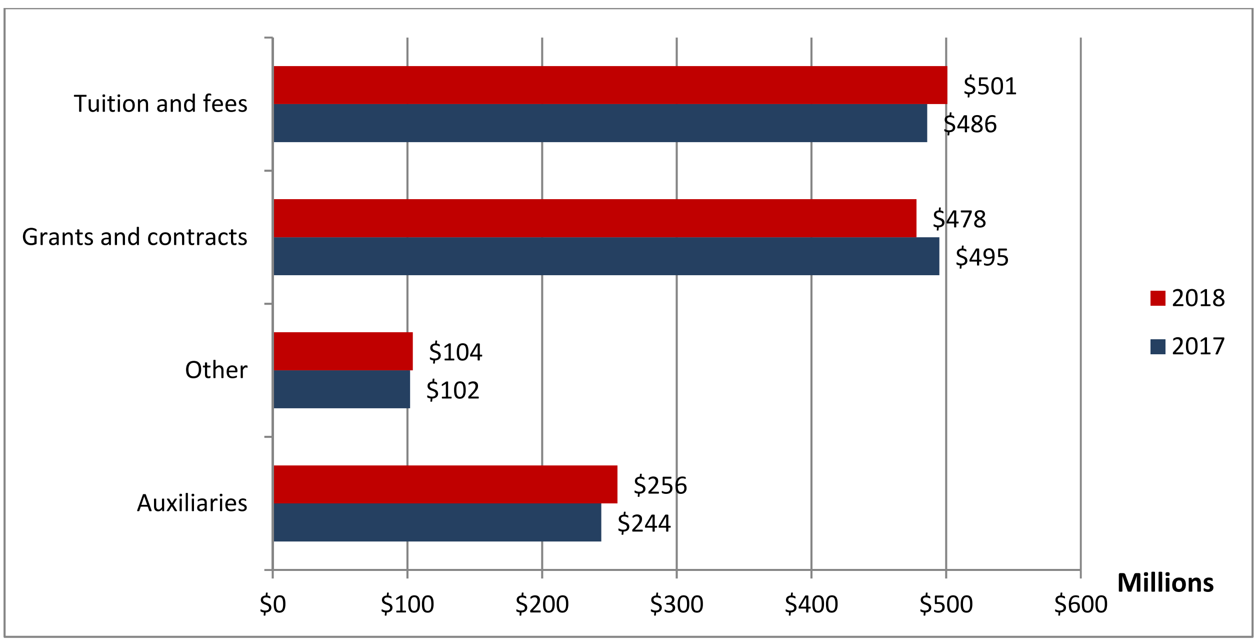
A summary of the university's revenues, expenses, and changes in net position for the year ended June 30, 2018, and the previous year follows:

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

	2018	2017
Operating revenues	$1,339,651	$1,327,052
Operating expenses	2,212,775	2,114,461
Operating loss	(873,124)	(787,409)
Nonoperating revenues and expenses	882,101	835,337
Income (loss) before other revenues, expenses, gains, or losses	8,977	47,928
Other revenues, expenses, gains, or losses	123,896	144,109
Increase in net position	132,873	192,037
Net position at beginning of year	3,113,216	2,911,212
Prior-period adjustment	-	9,967
Cumulative effect of changes in accounting principle	(120,951)	-
Net position at beginning of year, restated	2,992,265	2,921,179
Net position at end of year	$3,125,138	$3,113,216

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 2018 to Fiscal Year 2017

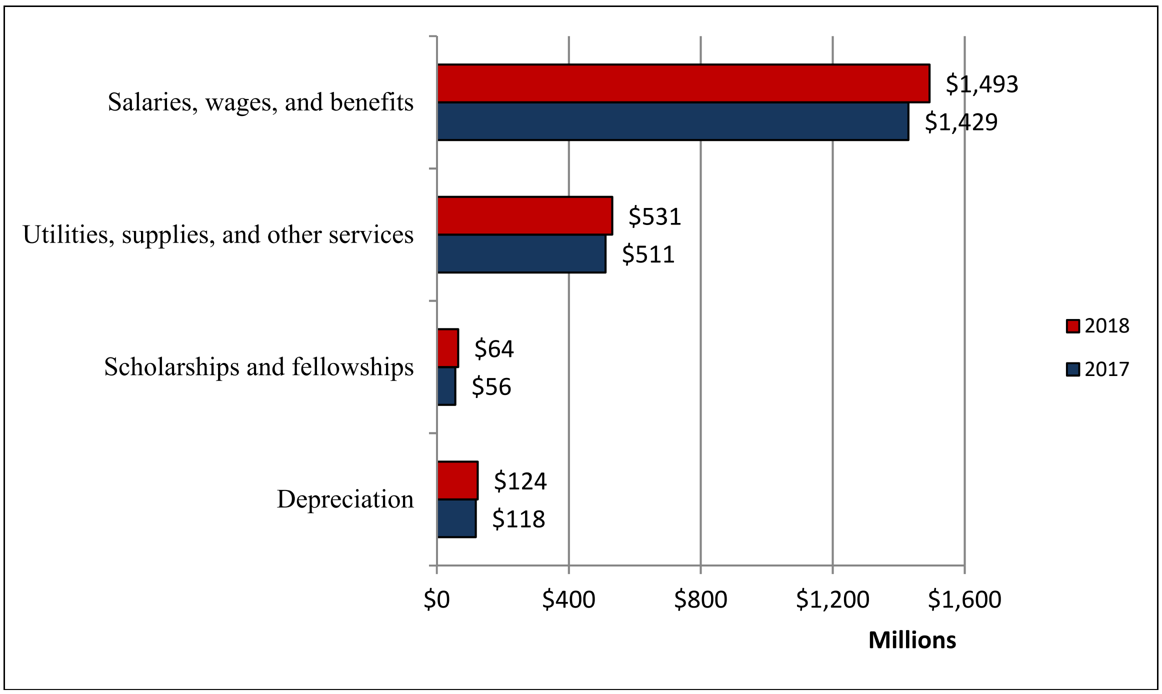
Tuition and fees increased by $15.5 million, or 3.2%, primarily due to a 2.2% to 3% increase in tuition rates coupled with increased enrollment.

Operating grants and contracts experienced a decrease of $16.6 million, or 3.4%. This decrease follows a 5.3% decrease in fiscal year 2017. Operating grants and contracts in 2018 still exceed 2015 and 2014 levels.

Auxiliaries increased $11.3 million, mainly due to the Residence Halls, Food Services, and Knoxville Athletics department's increased ticket sales 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 2018 to Fiscal Year 2017

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

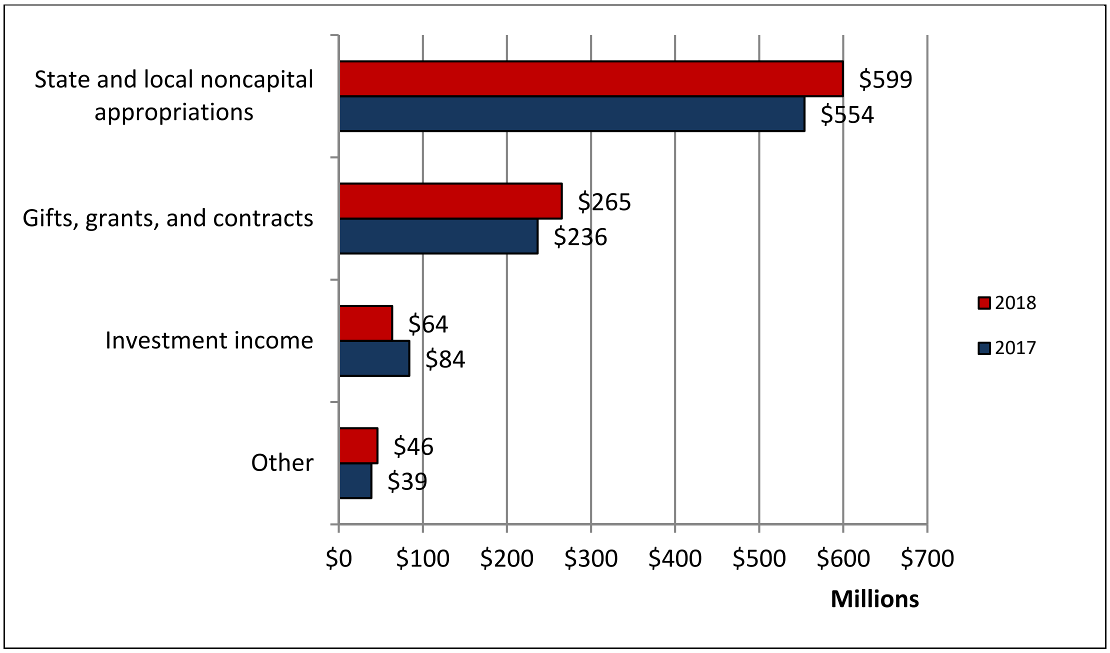
The increase in salary and benefit expenses from 2017 to 2018 is due to a 3% increase pool that each campus/unit distributed in accordance with its compensation strategy and due to increased expense for pension benefits and OPEB benefits.

Utilities, supplies, and other services increased $20.2 million, or 3.9%, due to increased supplies for grants and contracts, including supplies for construction.

Scholarship and fellowship expenses increased $8.4 million. Federal Pell grants increased $4.4 million and Tennessee Student Assistance Scholarships increased $2.9 million. Departmental gift scholarships also increased.

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 2018 to Fiscal Year 2017

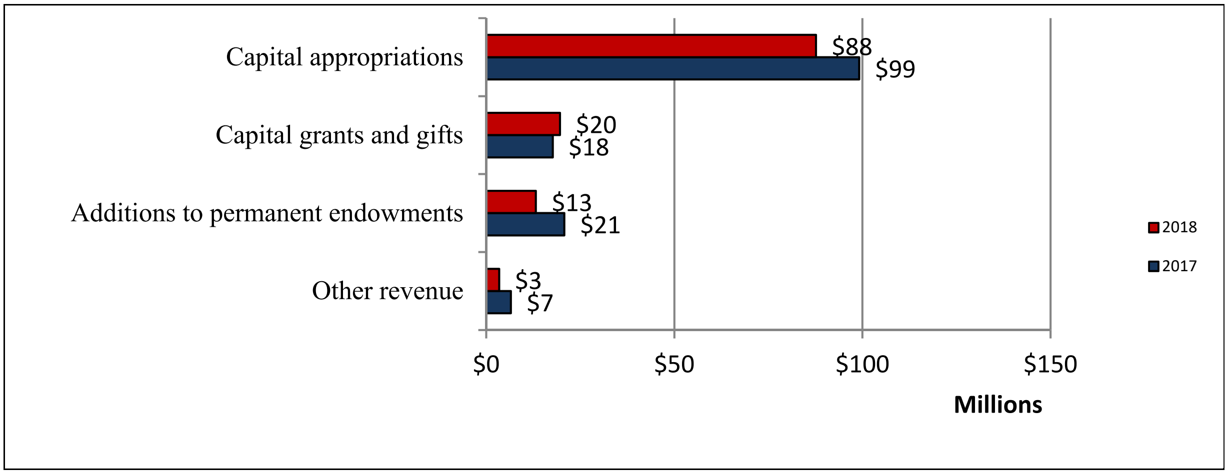
In fiscal year 2018, state and local appropriations increased $45.7 million, mostly due to THEC formula outcomes, productivity gains, and increased salary funds for nonformula units.

Gifts, grants, and contracts increased over $28.7 million because of increased nonoperating grants and contracts at the Health Science Center.

Investment income decreased $20.4 million, due to flat capital markets, due to the university's long-range bond investing approach, and an overall fair value decrease at June 30.

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:



Capital appropriations decreased $11.5 million, as we are finishing up some of our building projects.

Additions to permanent endowments decreased $7.5 million, as most new endowments are going to the foundation.

Other revenue decreased $3.1 million in 2018 due to a decrease in one-time insurance recoveries.

Capital Asset and Debt Administration

Capital Assets

The University of Tennessee had $2,736,190,166.40 invested in capital assets, net of accumulated depreciation at June 30, 2018; and $2,590,539,420.57 invested in capital assets, net of accumulated depreciation at June 30, 2017. Depreciation charges totaled $123,649,092.90 and $117,924,769.24 for the years ended June 30, 2018, and June 30, 2017, respectively.

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

	2018	**2017**
Land	$ 82,995	$ 82,662
Land improvements and infrastructure	146,108	101,471
Buildings	1,928,399	1,692,308
Works of art/historical treasures	4,415	4,415
Equipment	113,659	117,175
Software	730	770
Library holdings	91,316	87,733
Projects in progress	368,568	504,005
Total	$2,736,190	$2,590,539

Major capital additions to land and buildings during 2017-2018 included the $105.6 million Strong Hall, $92.3 million Stokely Hall, $26.4 million Volunteer Parking Garage, $3.8 million Tom Black Track Team Building and Press Box Addition, and the $1.1 million Jewell Building purchase in Knoxville; the $31.2 million Sim Center in Memphis; and the $1.2 million Ridley 4-H Center for Profitable Agriculture in Columbia.

At June 30, 2018, outstanding commitments under construction contracts totaled $103,244,665.34 for various renovations and repairs of buildings and infrastructure. Future state capital outlay appropriations will fund $30,929,063.91 of these costs.

More detailed information about the university's capital assets is presented in Note 6 to the financial statements.

Debt

The university had $1,096,121,922.21 and $1,001,121,662.82 in debt outstanding at June 30, 2018, and June 30, 2017, respectively. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt Schedule
(in thousands of dollars)

	2018	**2017**
Bonds-current portion	$ 39,472	$ 37,632
Bonds-noncurrent	914,825	768,723
Unamortized bond premium	133,365	88,489
Revolving credit facility-noncurrent	8,460	106,278
Total debt	$1,096,122	$1,001,122

The Tennessee State School Bond Authority (TSSBA) issued bonds with interest rates ranging from .18% to 5.5% due serially to 2048 on behalf of the University of Tennessee. The university is responsible for the debt service of these bonds. The current portion of the $1,096,121,922.21 outstanding at June 30, 2018, is $39,471,997.82.

The ratings on debt issued by the Tennessee State School Bond Authority at June 30, 2018, 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 9 to the financial statements.

Economic Factors That Will Affect the Future

For fiscal year 2019, the University of Tennessee Board of Trustees has authorized individual campus fee increases from zero to 3% that are expected to generate approximately $10.3 million in new funding, net of related scholarships, with a continued projected enrollment increase. State appropriations will increase $22.8 million with 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 little improvement and 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, Treasurer, 711c Andy Holt Tower, Knoxville, Tennessee, 37996-0100.

THE UNIVERSITY OF TENNESSEE
Statement of Net Position
June 30, 2018

	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 (Notes 2 and 3)	$ 405,583,297.31	$ 26,439,442.00	$ 6,163,435.00	$ 8,392,407.00
Investments (Notes 2, 3, 23, 24, and 25)	135,845,002.13	-	-	-
Accounts, notes, and grants receivable (net) (Note 5)	62,861,978.48	8,580,137.00	15,314,186.86	8,625,595.00
Due from the primary government	16,963,091.87	-	-	-
Due from the university	-	-	-	3,696,622.00
Inventories	6,960,306.39	-	-	-
Prepaid expenses	4,407,592.95	107,381.00	-	458,480.00
Assets held by the university	-	-	4,000,000.00	-
Total current assets	632,621,269.13	35,126,960.00	25,477,621.86	21,173,104.00
Noncurrent assets:				
Cash and cash equivalents (Notes 2 and 3)	872,371,551.27	-	588,995.80	-
Investments (Notes 2, 3, 23, 24, and 25)	883,518,403.11	134,778,397.00	12,499,468.39	2,209,003.00
Investment in UT - Battelle, LLC (Note 14)	4,280,873.00	-	-	-
Accounts, notes, and grants receivable (net) (Note 5)	92,180,398.75	30,396,975.00	109,504,255.72	880,202.00
Lease payments receivable (Note 19)	45,916,930.10	-	-	-
Due from primary government	15,375,425.02	-	-	-
Net pension asset (Note 11)	2,315,823.00	-	-	-
Capital assets (net) (Notes 6, 23, and 25)	2,736,190,166.40	44,616,404.00	-	4,769,163.00
Annuities held by others	4,185,917.61	-	-	-
Assets held by the university	-	628,309.00	307,125,397.49	-
Total noncurrent assets	4,656,335,488.26	210,420,085.00	429,718,117.40	7,858,368.00
Total assets	5,288,956,757.39	245,547,045.00	455,195,739.26	29,031,472.00
Deferred outflows of resources				
Deferred amount on debt refunding	20,251,166.08	-	-	-
Deferred outflows related to pensions (Note 11)	120,103,139.00	-	-	-
Deferred outflows related to OPEB (Note 12)	14,165,373.00	-	-	-
Total deferred outflows of resources	154,519,678.08	-	-	-
Liabilities				
Current liabilities:				
Accounts payable (Note 8)	138,161,570.79	1,674,306.00	303,292.54	7,989,243.00
Accrued liabilities	63,870,995.61	-	-	-
Unearned revenue (Note 9)	68,591,289.84	57,945.00	-	1,223,237.00
Due to component unit	281,389.88	-	-	-
Deposits payable	3,627,895.89	-	-	-
Annuities and life income payable (Note 9)	3,331,110.43	-	527,680.92	-
Total other postemployment benefits obligation (Note 12)	14,165,373.00	-	-	-
Long-term liabilities, current portion (Notes 9, 23, and 24)	87,796,832.18	3,232,147.00	873,100.99	-
Deposits held in custody for others	7,365,932.94	2,094,804.81	-	-

THE UNIVERSITY OF TENNESSEE
Statement of Net Position (continued)
June 30, 2018

Due to the university	-	887,510.19	-	1,623.00
Total current liabilities	387,192,390.56	7,946,713.00	1,704,074.45	9,214,103.00
Noncurrent liabilities:				
Unearned revenue (Note 9)	15,500,438.71	-	-	870,000.00
Net pension liability (Note 11)	230,290,800.00	-	-	-
Total other postemployment benefits obligation (Note 12)	199,605,758.00	-	-	-
Long-term liabilities, noncurrent portion (Notes 9, 23, and 24)	1,089,983,591.82	69,693,825.00	884,032.39	-
Due to grantors (Note 9)	20,430,788.96	-	-	-
Annuities and life income payable (Note 9)	16,517,716.00	-	3,670,772.39	-
Deposits held in custody for component units	311,125,397.49	-	-	-
Total noncurrent liabilities	1,883,454,490.98	69,693,825.00	4,554,804.78	870,000.00
Total liabilities	2,270,646,881.54	77,640,538.00	6,258,879.23	10,084,103.00
Deferred inflows of resources				
Deferred inflows related to pensions (Note 11)	9,614,860.00	-	-	-
Deferred inflows related to OPEB (Note 12)	8,214,500.00	-	-	-
Deferred inflows related to split-interest agreements	29,861,912.30	-	-	-
Total deferred inflows of resources	47,691,272.30	-	-	-
Net position				
Net investment in capital assets	1,669,360,405.41	-	-	4,769,163.00
Restricted for:				
Nonexpendable:				
Scholarships and fellowships	221,847,195.97	22,681,526.00	66,963,265.69	-
Libraries	15,029,472.56	-	635,383.95	-
Research	42,699,934.65	-	3,455,662.22	-
Instructional department uses	154,317,849.56	67,734,259.00	99,171,966.53	-
Academic support	32,320,578.47	733,819.00	59,218,628.24	-
Other	46,962,507.91	635,652.00	28,128,652.84	-
Expendable:				
Scholarships and fellowships	119,668,998.43	1,484,641.00	10,094,166.24	-
Libraries	10,199,030.73	-	4,583.86	-
Research	76,503,685.08	-	11,771,770.81	-
Instructional department uses	126,398,015.78	6,822,404.00	13,078,533.65	-
Academic support	57,122,518.64	24,779.00	24,957,528.51	-
Loans	6,310,352.64	-	-	-
Capital projects	12,182,989.90	5,000,000.00	32,461,353.41	-
Debt service	1,262,975.87	-	-	-
Pensions	2,315,823.00	-	-	-
Other	111,816,899.39	17,177,046.00	82,032,850.06	18,573,350.00
Unrestricted	418,819,047.64	45,612,381.00	16,962,514.02	(4,395,144.00)
Total net position	$ 3,125,138,281.63	$ 167,906,507.00	$ 448,936,860.03	$ 18,947,369.00

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, 2018

	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 $230,758,306.64)	$ 501,431,489.75	$ -	$ -	$ -
Contributions	-	18,874,407.00	95,040,715.90	1,968,116.00
Investment return designated for operations	-	4,451,272.00	-	-
Federal appropriations	14,443,173.46	-	-	-
Governmental grants and contracts (Note 18)	272,410,555.64	-	27,641,761.00	-
Nongovernmental grants and contracts	205,924,544.55	-	-	7,193,323.00
Sales and services of educational departments and other activities	67,544,224.27	-	-	-
Auxiliary enterprises:				
Residential life (net of scholarship allowances of $2,247,692.25)	66,151,958.20	12,325,640.00	-	-
Food services	10,687,521.42	-	-	-
Bookstore	21,872,653.69	-	-	-
Parking	12,332,252.65	-	-	-
Athletics, including gifts of $29,294,985.27 from component units	141,723,907.67	-	-	-
Other auxiliaries	2,950,721.37	-	-	-
Interest earned on loans to students	18,478.02	-	-	-
Other operating revenues	22,159,409.80	-	257,438.54	-
Total operating revenues	1,339,650,890.49	35,651,319.00	122,939,915.44	9,161,439.00
Expenses				
Operating expenses (Note 20):				
Salaries and wages	1,113,348,956.33	-	-	-
Fringe benefits	379,881,142.32	-	-	-
Utilities, supplies, and other services	531,456,264.54	9,272,725.00	30,956,252.38	22,469,075.00
Scholarships and fellowships	64,439,069.53	-	-	-
Depreciation and amortization expense	123,649,092.90	3,194,336.00	-	1,215,139.00
Payments to or on behalf of the university (Notes 23 and 24)	-	4,451,272.00	76,239,246.48	-
Total operating expenses	2,212,774,525.62	16,918,333.00	107,195,498.86	23,684,214.00
Operating income (loss)	(873,123,635.13)	18,732,986.00	15,744,416.58	(14,522,775.00)
Nonoperating revenues (expenses)				
State and local appropriations	599,487,680.26	-	-	-
Gifts, including $30,744,305.36 from component units	45,344,527.17	-	-	-
Grants and contracts	219,796,343.39	-	-	14,255,820.00
Investment income (loss), including $7,900,111.13 from component units	63,580,655.72	4,971,535.00	12,299,731.57	(2,984,205.00)
Interest on capital asset-related debt	(40,256,168.03)	(2,537,998.00)	-	-
Other nonoperating revenues (expenses)	(5,852,078.73)	(26,344.00)	-	7,406,762.00
Net nonoperating revenues (expenses)	882,100,959.78	2,407,193.00	12,299,731.57	18,678,377.00
Income (loss) before other revenues, expenses, gains, or losses	8,977,324.65	21,140,179.00	28,044,148.15	4,155,602.00
Capital appropriations	87,647,467.68	-	-	-
Capital grants and gifts, including $12,751,116.72 from component units	19,619,044.09	-	-	-
Additions to permanent endowments	13,180,867.97	24,790,106.00	30,054,966.36	-
Other, includes $3,276,011.76 of insurance recoveries related to prior years' property damages	3,448,161.78	-	-	1,966.00
Total other revenues	123,895,541.52	24,790,106.00	30,054,966.36	1,966.00
Increase (decrease) in net position	132,872,866.17	45,930,285.00	58,099,114.51	4,157,568.00
Net position				
Net position - beginning of year	3,113,215,605.60	121,976,222.00	390,837,745.52	14,789,801.00
Cumulative effect of a change in accounting principle for GASB 75 (Note 22)	(95,219,465.74)	-	-	-
Cumulative effect of a change in accounting principle for GASB 81 (Note 22)	(25,730,724.40)	-	-	-
Net position at beginning of year, as restated	2,992,265,415.46	121,976,222.00	390,837,745.52	14,789,801.00
Net position - end of year	$ 3,125,138,281.63	$ 167,906,507.00	$ 448,936,860.03	$ 18,947,369.00

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, 2018

Cash flows from operating activities	
Tuition and fees	$ 503,782,772.40
Federal appropriations	14,443,173.46
Grants and contracts	467,180,107.73
Sales and services of educational activities and other activities	70,803,725.68
Payments to suppliers and vendors	(522,168,186.12)
Payments to employees	(1,112,053,197.25)
Payments for benefits	(388,257,451.15)
Payments for scholarships and fellowships	(64,439,069.53)
Loans issued to students	(102,345.68)
Collection of loans from students	3,837,368.57
Interest earned on loans to students	528,910.71
Changes in deposits held in custody for component units	51,050,908.47
Changes in deposits held in custody for others	(411,415.37)
Auxiliary enterprise charges:	
Residence halls	66,151,958.20
Bookstore	23,817,628.34
Food services	10,687,521.42
Parking	12,332,252.65
Athletics	141,392,066.85
Other auxiliaries	3,037,456.14
Other receipts (payments)	21,354,975.08
Net cash used by operating activities	(697,030,839.40)
Cash flows from noncapital financing activities	
State appropriations	593,140,537.18
Local appropriations	6,347,143.08
Gifts and grants for other than capital or endowment purposes	253,171,742.54
Private gifts for endowment purposes	13,180,867.97
Split-interest transactions receipts	1,421,495.69
Split-interest transactions disbursements	(3,751,008.69)
Federal student loan receipts	303,408,033.01
Federal student loan disbursements	(302,272,031.00)
Net cash balance implicitly financed (repaid)	4,091,073.04
Other noncapital financing receipts (payments)	172,150.01
Net cash provided by noncapital financing activities	868,910,002.83
Cash flows from capital and related financing activities	
Proceeds from capital debt	200,465,645.63
Capital appropriations	86,382,473.36
Capital grants and gifts received	4,426,340.09
Proceeds from sale of capital assets	86,327.38
Purchases of capital assets and construction	(256,311,296.65)
Principal paid on capital debt and leases	(41,519,730.21)
Interest paid on capital debt and leases	(65,241,429.26)
Other capital and related financing receipts (payments)	(2,416,930.68)
Net cash used by capital and related financing activities	(74,128,600.34)
Cash flows from investing activities	
Proceeds from sales and maturities of investments	1,145,807,062.38
Income on investments	51,736,888.68
Purchase of investments	(1,189,997,368.79)
Net cash provided by investing activities	7,546,582.27
Net increase in cash and cash equivalents	105,297,145.36
Cash and cash equivalents at beginning of year	1,172,657,703.22
Cash and cash equivalents at end of year	$ 1,277,954,848.58

THE UNIVERSITY OF TENNESSEE
Statement of Cash Flows (continued)
For the Year Ended June 30, 2018

Reconciliation of net operating loss to net cash used by operating activities:		
Operating loss	$	(873,123,635.13)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation and amortization expense		123,649,092.90
Change in assets, liabilities, and deferred outflows:		
Receivables, net		(5,288,315.00)
Inventories		1,159,687.11
Prepaid expenses		248,486.32
Accrued interest receivable		510,432.69
Accounts payable		7,886,267.19
Accrued liabilities		1,524,422.45
Unearned revenues		(621,099.12)
Deposits held in custody for others		(407,165.37)
Deposits held in custody for component units		51,050,908.47
Deposits		1,250,027.40
Net pension asset		(1,312,633.00)
Deferred outflows related to pensions		3,855,237.00
Net pension obligation		(9,239,766.00)
Deferred inflows related to pensions		(3,223,624.00)
Deferred outflows related to OPEB		(14,165,373.00)
OPEB obligation		(6,220,233.00)
Deferred inflows related to OPEB		22,602,308.00
Compensated absences		(900,888.20)
Loans to students		3,735,022.89
Net cash used by operating activities	$	(697,030,839.40)
Noncash investing, capital, or financing transactions		
Gifts of capital assets	$	15,192,704.00
Unrealized losses on investments	$	(8,395,527.67)

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

All university investments are reported at 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 acquisition 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 $7,172,638.03 as of June 30, 2018. 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 (asset), 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 banker's acceptances may exceed 10%. Money market funds cannot exceed 10% of the portfolio's total value. At June 30, 2018, the university's cash management investment pool consisted of $25,000.00 of demand deposits yielding money market rates, $64,921,350.00 of commercial paper, and $1,176,240,021.79 of U.S. Treasury and 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, 2018, cash and cash equivalents consisted of $11,882,659.66 in bank accounts, $1,292,975.00 of petty cash on hand, and $1,241,186,371.79 in the university's cash management investment pool.

The carrying amount of the university's deposits was $11,907,659.66, and the bank balance was $6,349,558.42.

Additionally, the university maintains custodial accounts at First Tennessee Bank and BNY Mellon for funds contractually managed by independent investment counsel. In accordance with the custody agreements, First Tennessee Bank and BNY Mellon placed cash equivalents totaling $23,592,842.13 at June 30, 2018, 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, 2018, 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 pooled investment vehicles – bonds represent a weighted average maturity of the individual bonds in the respective fund. As of June 30, 2018, 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							
Commercial paper	$ 64,921,350.00	$ 64,921,350.00	$ -	$ -	$ -	$ -	$ 64,896,684.73
U.S. Treasury	100,917,941.69	26,939,499.49	49,063,002.20	24,915,440.00	-	-	103,044,634.83
U.S. agencies	1,075,322,080.10	68,369,314.46	713,409,481.79	240,283,959.08	53,259,324.77	-	1,098,557,398.12
	1,241,161,371.79	160,230,163.95	762,472,483.99	265,199,399.08	53,259,324.77	-	1,266,498,717.68
Investments							
Debt Securities							
U.S. Treasury	208,876.30	-	3,187.50	-	205,688.80	-	199,387.66
U.S. agencies	18,575.85	-	-	18,575.85	-	-	14,942.10
Corporate bonds	441,352.60	-	182,588.30	101,726.30	157,038.00	-	444,360.20
Pooled investment vehicles-bonds	68,801,994.94	-	18,947,665.63	47,991,198.17	1,043,519.98	819,611.16	70,716,268.43
	69,470,799.69	-	19,133,441.43	48,111,500.32	1,406,246.78	819,611.16	71,374,958.39
		$160,230,163.95	$781,605,925.42	$313,310,899.40	$54,665,571.55	$819,611.16	
Other Investments							
Corporate stocks:							
Domestic	20,127,941.17						14,088,392.40
International	5,286,372.04						5,396,944.02
Pooled investment vehicles-equity	343,388,825.79						294,530,311.49
Alternative investments:							
Pooled investment vehicles-real estate	56,839,300.24						43,293,729.36
Private capital investments	282,400,326.09						273,128,918.18
Hedge funds	231,554,042.66						188,855,083.57
Real estate gifts	2,975,796.87						3,264,797.47
Assets with trustees	7,311,638.28						6,987,420.73
Other	8,362.41						16,303.56
Total investments and cash equivalents	2,260,524,777.03						2,167,435,576.85
Less: cash equivalents	1,241,161,371.79						1,266,498,717.68
Total investments	$1,019,363,405.24						$ 900,936,859.17

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, 2018, were rated by Moody's Investors Service, Standard & Poor's, and/or Fitch Ratings and are reported below using Moody's rating scale.

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. As of June 30, 2018, the institution's investments were rated as follows:

Rated Debt Instruments	Fair Value	Aaa	Aa1	Aa2	Aa3	A1
Cash management pool						
Commercial paper	$ 64,921,350.00	$ 64,921,350.00	$ -	$ -	$ -	$ -
U.S. agencies	1,075,322,080.10	557,271,063.04	-	42,637,326.00	-	-
Investments						
U.S. agencies	18,575.85	18,575.85	-	-	-	-
Corporate bonds	441,352.60	-	-	-	-	-
Pooled investment vehicles - bonds	68,801,994.94	-	-	-	-	-
Money market funds in custodial accounts	23,592,842.13	-	-	-	-	-

Rated Debt Instruments	A2	A3	Baa1	Baa2	Baa3	B1
Cash management pool						
Commercial paper	-	-	-	-	-	-
U.S. agencies	-	-	-	-	-	-
Investments						
U.S. agencies	-	-	-	-	-	-
Corporate bonds	203,444.30	-	-	103,180.00	84,978.30	49,750.00
Pooled investment vehicles - bonds	-	-	-	-	-	-
Money market funds in custodial accounts	-	-	-	-	-	-

Rated Debt Instruments	Unrated
Cash management pool	
Commercial paper	-
U.S. agencies	475,413,691.06
Investments	
U.S. agencies	-
Corporate bonds	-
Pooled investment vehicles - bonds	68,801,994.94
Money market funds in custodial accounts	23,592,842.13

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, 2018, the university had $7,311,638.28 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 $5,286,372.04 invested in foreign corporate equities at June 30, 2018.

Alternative Investments

In its Consolidated Investment Pool, as part of its endowment assets, the university has investments in 108 limited partnerships, limited companies, corporations, and limited liability corporations (LLCs).

The estimated fair value of these assets is $570,793,668.99 at June 30, 2018.

Total capital contributions less returns of capital equal $505,277,731.11 at June 30, 2018.

The university believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2018. 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 (real estate assets, private capital investments, 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. Fair Value Measurement

The university categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. The university has the following recurring fair value measurements as of June 30, 2018:

	June 30, 2018	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments In Entities That Calculate NAV Per Share
Investments and Cash Equivalents by Fair Value Level					
Debt securities					
U.S. Treasury	$ 101,126,817.99	$ -	$ 101,126,817.99	$ -	$ -
U.S. agencies	1,075,340,655.95	-	1,075,340,655.95	-	-
Corporate bonds	441,352.60	-	441,352.60	-	-
Corporate commercial paper	64,921,350.00	-	64,921,350.00	-	-
Total debt securities	1,241,830,176.54				
Equity securities					
Common stock	25,298,518.21	25,285,402.21	-	13,116.00	-
Preferred stock – public	115,795.00	39,495.00	76,300.00	-	-
Total equity securities	25,414,313.21				
Pooled investment vehicles (exchange traded funds; open-end and closed-end)	129,568,153.13	129,568,153.13	-	-	-
Pooled investment vehicles (other open-end funds with published values)	211,569,766.59	211,569,766.59	-	-	-
Other assets	10,295,797.56	43,772.56	-	10,252,025.00	-
Private capital investments					
Private equity	90,162,206.04	-	-	90,162,206.04	-
Private credit/debt	67,261,094.95	-	-	67,261,094.95	-
Private real assets	120,493,973.85	-	-	120,493,973.85	-
Private, other	4,483,051.25	-	-	4,483,051.25	-
Total private capital investments	282,400,326.09				
Investments measured at the net asset value (NAV)					
Pooled investment vehicles (other open-end funds)	127,892,201.25	-	-	-	127,892,201.25
Hedge funds, long/short equity	51,444,618.44	-	-	-	51,444,618.44
Hedge funds, credit	50,242,336.45	-	-	-	50,242,336.45
Hedge funds, diversified	129,867,087.77	-	-	-	129,867,087.77
Total NAV investments	359,446,243.91				
Total investments and cash equivalents valued at fair value	**$2,260,524,777.03**				

Debt Securities

The fair value of the majority of the Debt Securities category at June 30, 2018, was determined based on Level 2 inputs. The university utilizes third-party pricing services and guidance provided by custodians and trading counterparties for fair value estimates of these investments. In addition, it takes into account the nature of the securities, trading activity, and availability of comparable securities in the marketplace.

Equity Securities and Pooled Investment Vehicles (Exchange – Traded or With Published Values)

These investment categories are comprised of common stock, preferred stock, limited partnerships, and funds, all of which are exchange-traded or with published values. The fair value of these assets at June 30, 2018, was primarily determined based on Level 1 inputs due to the transparent pricing provided by a securities exchange or published values.

Other Assets

With one exception, Level 3 inputs were utilized for the fair value calculations of this investment category, which contains real estate holdings of $2,975,796.86, separately invested portfolios of $7,267,865.72, and an annuity valued at $8,362.42. Real estate was valued using various appraisal estimates, while the separately invested portfolios are managed externally for the benefit of the university. Pricing for the latter was provided by third parties. The annuity is priced by the sponsoring entity. This category additionally includes $43,772.56 of money market investments/cash equivalents held by a counterparty classified as Level 1 input.

Private Capital Investments

The fair value of the Private Capital category at June 30, 2018, was determined based on Level 3 inputs. Valuation methods such as the income method and/or multiple analysis are examples of those commonly utilized by managers to determine the fair value of these assets and are typically unobservable to the university.

The university's private capital investments have $188,674,487.00 of unfunded commitments at June 30, 2018.

Investments Measured at Net Asset Value (NAV)

The university holds shares or interests in investment companies or vehicles for which the fair value is measured on a recurring basis using net asset value per share (or its equivalent). This category is a combination of open-end mutual funds and hedge funds. The open-end fund holdings implement strategies that are primarily net long or long-only investments in a variety of markets including the global equity markets, foreign sovereign and corporate bonds, real estate, and energy. The hedge fund holdings are divided into three sub-categories. The first is Long/Short Equity, a strategy that typically invests in common stock by both buying shares and selling shares short. These strategies work across the global equity markets. The second category, entitled Credit, focuses almost exclusively on fixed income instruments, which can include various types of bonds, derivatives, and loans. These strategies also invest in multiple jurisdictions around the world. The final category, Diversified, is comprised of strategies that often overlap in approach and frequently employ more than one strategy within a single vehicle.

NAV Investments – General Redemption Terms

The table below provides a summary of the liquidity terms and conditions of those investments with values measured using net asset value.

	Fair Value	Redemption Frequency	Redemption Notice Required
Hedge funds, credit	$50,242,336.45	Quarterly – Annually	45 days – 120 days
Hedge funds, diversified	$129,867,087.77	Monthly, Quarterly, Annually	3 days – 90 days
Hedge funds, long/short equity	$51,444,618.44	Quarterly, Annually	30 days – 90 days
Open-end funds	$127,892,201.25	Daily, Monthly, Quarterly, Semi-annually	1 day – 90 days

As of fiscal year end, $19.7 million of the investments measured as NAV were still within the initial lock-up period.

Annuities and Life Income Payable

The university's liability under split interest agreements (annuities and life income payable) is also reported at fair value. The valuation of the liability is based on unobservable inputs (level 3 of the fair value hierarchy). The university has split interest agreements that allow donors to make contributions that provide for certain payments to specified beneficiaries during their lifetime. The amount payable to the donors is recorded at the present value of the estimated future payments to be made under these agreements.

Note 4. 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, 4.5% of a six-year moving average of the fair value of endowment investments has been authorized for expenditure. In fiscal year 2016, the university began transitioning to a seven-year moving average, by adding one year's value to the moving average calculation. This transition will be complete with fiscal year 2019. In addition, the board approved imposing both a maximum and minimum distribution rate on each year's calculation. Beginning in fiscal year 2016, the maximum and minimum distribution rates are 6% and 3%, respectively, of the previous calendar year's fair value. The remaining amount after distributions, 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, 2018, net appreciation of $149,226,613.68 is available to be spent, of which $146,119,565.34 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 $3.4080660 at June 30, 2018. Income distributed was $0.15019 per share in 2018, or $41,534,972.31.

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 2018 and the three and five years then ended was 8.10%, 5.10%, and 6.60%, 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 $180,215.92 for 2018.

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 2018 amounted to $1,289,470.01.

Note 5. Accounts, Notes, and Grants Receivable

Accounts, notes, and grants receivable included the following at June 30, 2018:

Student accounts receivable	$ 21,316,995.35
Grants receivable	86,152,176.97
Notes receivable	2,625,312.57
Pledges receivable	3,044,675.20
Due from component units	887,510.19
Other receivables	37,282,156.48
Subtotal	151,308,826.76
Less allowance for doubtful accounts	(9,499,297.30)
Total	$141,809,529.46

Pledges receivable are promises of private donations that are reported as accounts receivable and revenue, net of an estimated uncollectible allowance of $611,324.67.

Federal Perkins Loan Program funds included the following at June 30, 2018:

Perkins Loans receivable	$20,442,452.13
Less allowance for doubtful accounts	(7,209,604.36)
Total	$13,232,847.77

Note 6. Capital Assets

Capital asset activity for the year ended June 30, 2018, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 82,662,512.46	$ 332,622.95	$ -	$ -	$ 82,995,135.41
Land improvements & infrastructure	182,097,373.28	10,280,220.38	42,415,292.16	-	234,792,885.82
Buildings	2,716,553,362.19	32,341,038.34	278,770,934.79	(3,388,199.23)	3,024,277,136.09
Works of art/ historical treasures	4,414,950.77	-	-	-	4,414,950.77
Equipment	391,855,111.99	24,162,482.23	-	(16,089,859.68)	399,927,734.54
Software	30,834,960.19	308,902.57	-	(112,568.00)	31,031,294.76
Library holdings	155,717,750.29	19,199,222.19	-	(13,905,141.56)	161,011,830.92
Projects in progress	504,005,461.72	187,731,420.64	(321,186,226.95)	(1,982.830.33)	368,567,825.08
Total	4,068,141,482.89	274,355,909.30	-	(35,478,598.80)	4,307,018,793.39
Less accumulated depreciation/amortization:					
Land improvements & infrastructure	(80,626,831.48)	(8,057,570.72)	-	-	(88,684,402.20)
Buildings	(1,024,245,063.74)	(73,204,978.77)	-	1,571,796.81	(1,095,878,245.70)
Equipment	(274,680,335.73)	(26,421,684.92)	-	14,833,021.86	(286,268,998.79)
Software	(30,065,105.79)	(348,966.12)	-	112,568.00	(30,301,503.91)
Library holdings	(67,984,725.58)	(15,615,892.37)	-	13,905,141.56	(69,695,476.39)
Total	(1,477,602,062.32)	(123,649,092.90)	-	30,422,528.23	(1,570,828,626.99)
Capital assets, net	$ 2,590,539,420.57	$ 150,706,816.40	$ -	$ (5,056,070.57)	$2,736,190,166.40

Note 7. 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 $12,726,790.68 for the year ended June 30, 2018. All operating leases are cancelable at the lessee’s option.

Note 8. Accounts Payable

Accounts payable at June 30, 2018, included the following:

Vendors payable	$106,796,852.33
Payroll deductions payable	24,813,183.40
Due to State of Tennessee	6,551,535.06
Total	$138,161,570.79

Note 9. Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2018, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Long-term liabilities:					
Bonds	$ 806,354,896.64	$307,206,912.90	$159,264,615.13	$ 954,297,194.41	$39,471,997.82
Unamortized bond premium	88,488,799.78	57,215,923.72	12,340,219.62	133,364,503.88	-
Revolving credit facility	106,277,966.40	11,496,442.90	109,314,185.38	8,460,223.92	-
Total TSSBA indebtedness	1,001,121,662.82	375,919,279.52	280,919,020.13	1,096,121,922.21	39,471,997.82
Compensated absences	82,559,389.99	47,423,946.16	48,324,834.36	81,658,501.79	48,324,834.36
Total long-term liabilities	1,083,681,052.81	423,343,225.68	329,243,854.49	1,177,780,424.00	87,796,832.18
Other long-term liabilities:					
Unearned revenue	84,712,827.67	67,970,190.72	68,591,289.84	84,091,728.55	68,591,289.84
Due to grantors	33,326,155.35	997,272.53	13,892,638.92	20,430,788.96	-
Annuities payable and life income payable	19,235,598.83	963,704.85	350,477.25	19,848,826.43	3,331,110.43
Total other long-term liabilities	$ 137,274,581.85	$ 69,931,168.10	$ 82,834,406.01	$ 124,371,343.94	$71,922,400.27

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 2048 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 10 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, 2018, was $982,656,400.58. The unspent bond proceeds at June 30, 2018, was $28,359,206.17.

The university's debt service requirements to maturity for all bonds payable at June 30, 2018, are as follows:

Year Ending June 30	Principal	Interest
2019	$ 39,471,997.82	$ 44,415,140.07
2020	41,078,865.82	42,750,876.99
2021	37,233,747.55	41,089,140.44
2022	37,867,879.45	39,495,496.38
2023	38,854,838.23	37,813,287.92
2024-2028	193,595,559.67	162,995,014.54
2029-2033	192,775,654.01	118,289,582.21
2034-2038	176,557,491.15	74,992,159.39
2039-2043	150,627,910.04	35,811,925.59
2044-2048	74,592,456.84	7,408,379.40
	$982,656,400.58	$605,061,002.93
Unspent bond proceeds	(28,359,206.17)	
TSSBA debt - bonds	$954,297,194.41	

TSSBA Debt – Revolving Credit Facility

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 $8,460,223.92 at June 30, 2018.

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 September 13, 2017, the Tennessee State School Bond Authority issued two new series of bonds, 2017 Refunding Series B and 2017 Refunding Series C (federally taxable). The 2017B bonds consisted of $64,762,059.80 in revenue bonds with an average interest rate of 5% to advance refund $81,677,712.71 of outstanding 2007C, 2010A, 2012A, and 2013A Series bonds with an average interest rate of 4.4%. The net proceeds of $87,260,303.44 (after payment of $173,431.64 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 2007C, 2010A, 2012A, and 2013A Series bonds are considered to be defeased, and the liability for those bonds has been removed from the university's long-term liabilities. The 2017C bonds consisted of $13,607,679.00 in revenue bonds with an average interest rate of 3.3% to advance refund $13,281,344.40 of outstanding 2010B Series bonds with an average interest rate of 4.9%. The net proceeds of $14,587,221.19 (after payment of $38,192.99 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 2010B bonds are considered to be defeased, and the liability for those bonds has been removed from the university's long-term liabilities.

The 2017 Series B advance refunding resulted in the recognition of a deferred gain of $2,023,755.33 to be amortized over the next 23 years. The university in effect reduced its aggregate debt service payments by $22,496,633.49 over the next 23 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $18,279,273.73. The 2017 Series C advance refunding resulted in the recognition of a deferred loss of $1,305,876.79 to be amortized over the next 23 years. The university in effect reduced its aggregate debt service payments by $2,973,119.26 over the next 23 years and obtained an economic gain (difference between the present values of the old and new debt service payments) of $2,008,269.09.

Note 10. Pledged Revenues

The University of Tennessee has pledged certain revenues and fees, including state appropriations, to repay $954,297,194.41 in revenue bonds issued from January 2007 to September 2017. Proceeds from the bonds provided financing for construction and renovation projects. The bonds are payable through 2048. (See Note 9 for further details.) Annual principal and interest payments on the bonds are expected to require 5.34% of available revenues. The total principal and interest remaining to be paid on the bonds is $1,559,358,197.34. Principal and interest paid for the current year and total available revenues were $81,863,478.91 and $1,534,433,848.68, respectively. The amount of principal and interest paid for the current year does not include debt of $94,959,057.11 defeased through a bond refunding in 2018.

Note 11. 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.state.tn.us/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 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 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, 2018, to the Closed State and Higher Education Employee Pension Plan were $55,639,354, which is

18.86% 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, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension liability – At June 30, 2018, the university reported a liability of $230,290,800 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2017, 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, 2017, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2017, measurement date, the university's proportion was 12.868287%. The proportion measured as of June 30, 2016, was 13.12809%.

Pension expense – For the year ended June 30, 2018, the university recognized a pension expense of $48,151,332.

Deferred outflows of resources and deferred inflows of resources – For the year ended June 30, 2018, 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	$ 18,226,800	$6,721,085
Net difference between projected and actual earnings on pension plan investments	841,693	-
Changes in assumptions	39,215,680	-
Changes in proportion of net pension liability	2,530,378	2,684,921
University's contributions subsequent to the measurement date of June 30, 2017	55,639,354	-
Total	$116,453,905	$9,406,006

Deferred outflows of resources, resulting from the university's employer contributions of $55,639,354 subsequent to the measurement date, will be recognized as a decrease in net pension liability in the year ending June 30, 2019. 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 Ending June 30	
2019	$6,696,912
2020	$38,678,109
2021	$18,927,689
2022	$(12,894,165)

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 the June 30, 2017, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.5%
Salary increases	Graded salary ranges from 8.72% to 3.46% based on age, including inflation, averaging 4%
Investment rate of return	7.25%, net of pension plan investment expenses, including inflation
Cost-of-living adjustment	2.25%

Mortality rates were developed by the actuary using the results of the actuarial experience study performed for the period July 1, 2012, through June 30, 2016, and were adjusted for expected future improvements in life expectancy. Mortality assumptions utilize the RP-2014 industry standard base table adjusted for TCRS experience, with mortality improvement projected 6 years beyond each actuarial valuation date.

The actuarial assumptions used in the June 30, 2017, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2012, through June 30, 2016. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

Changes in assumptions – In 2017, the following assumptions were changed: decreased inflation rate from 3% to 2.5%; decreased the investment rate of return from 7.5% to 7.25%; decreased the cost-of-living adjustment from 2.5% to 2.25%; decreased salary growth graded ranges from an average of 4.25% to an average of 4%; and modified mortality assumptions to reflect current experience and anticipated mortality improvements.

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, 2016, actuarial experience study. This return was selected from a range of values developed using historical market returns and future capital market projections. The future capital market projections were produced using a building-block method in which a best-estimate of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) is developed for each major asset class. These best-estimates are combined to produce the future capital market projection by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation of 2.5%. The best-estimates of geometric real rates of return and the TCRS investment policy target asset allocation 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	5.69%	31%
Developed market international equity	5.29%	14%
Emerging market international equity	6.36%	4%
Private equity and strategic lending	5.79%	20%
U.S. fixed income	2.01%	20%
Real estate	4.32%	10%
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 7.25% based on a comparison of historical market returns and future capital market projections.

Discount rate – The discount rate used to measure the total pension liability was 7.25%. 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 proportionate share of net pension liability to changes in the discount rate – The following presents the university's proportionate share of the net pension liability calculated using the discount rate of 7.25%, as well as what the university's proportionate share of the net pension liability would be if it were calculated using a discount rate that is 1 percentage point lower (6.25%) or 1 percentage point higher (8.25%) than the current rate:

	1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
University's proportionate share of the net pension liability	$474,450,297	$230,290,800	$25,010,873

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.state.tn.us/tcrs.

Payable to the Pension Plan

At June 30, 2018, the university reported a payable of $4,580,957.91 for the outstanding amount of legally required contributions to the pension plan required for the year ended June 30, 2018.

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 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 multiplying the member's highest five consecutive years' average compensation by 1% multiplied by the member's years of service credit. A reduced early retirement is available at age 60 with 5 years of service credit or pursuant to the rule of 80 in which a member's age and service credit total 80. 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 employee contributions, plus any accumulated interest.

Contributions – 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. University employees contribute 5% of their salary to the State and Higher Education Employee Retirement Plan. 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% in aggregate for all 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, 2018, to the State and Higher Education Employee Retirement Plan were $3,336,552, which is 3.72% 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 Assets, Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension asset – At June 30, 2018, the university reported an asset of $2,315,823 for its proportionate share of the net pension asset. The net pension asset was measured as of June 30, 2017, and the total pension liability used to calculate the net pension asset was determined by an actuarial valuation as of that date. The university's proportion of the net pension asset was based on a projection of the university's contributions during the year ended June 30, 2017, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2017, measurement date, the university's proportion was 11.166788%. At the June 30, 2016, measurement date, the university's proportion was 11.908035%.

Pension expense – For the year ended June 30, 2018, the university recognized a pension expense of $946,176.

Deferred outflows of resources and deferred inflows of resources – For the year ended June 30, 2018, 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	$ 87,268	$ 86,654
Net difference between projected and actual earnings on pension plan investments	-	119,567
Change in assumptions	164,609	-
Changes in proportion of net pension asset	60,805	2,633
University's contributions subsequent to the measurement date of June 30, 2017	3,336,552	-
Total	$3,649,234	$208,854

Deferred outflows of resources, resulting from the university's employer contributions of $3,336,552 subsequent to the measurement date, will be recognized as a decrease in net pension liability in the year ending June 30, 2019. 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 Ending June 30	
2019	$ 197
2020	$ 197
2021	$ (4,306)
2022	$ (28,354)
2023	$ 21,825
Thereafter	$114,269

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

Actuarial assumptions – The total pension asset as of the June 30, 2017, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	2.5%
Salary increases	Graded salary ranges from 8.72% to 3.46% based on age, including inflation, averaging 4%
Investment rate of return	7.25%, net of pension plan investment expenses, including inflation
Cost-of-living adjustment	2.25%

Mortality rates were developed by the actuary using the results of the actuarial experience study performed for the period July 1, 2012, through June 30, 2016, and were adjusted for expected future improvements in life expectancy. Mortality assumptions utilize the RP-2014 industry standard base table adjusted for TCRS experience, with generational mortality improvement.

The actuarial assumptions used in the June 30, 2017, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2012, through June 30, 2016. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

Changes in assumptions – In 2017, the following assumptions were changed: decreased the inflation rate from 3% to 2.5%; decreased the investment rate of return from 7.5% to 7.25%; decreased the cost-of-living adjustment from 2.5% to 2.25%; decreased salary growth graded ranges from an average of 4.25% to an average of 4%; and modified mortality assumptions to reflect current experience and anticipated mortality improvements.

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, 2016, actuarial experience study. This return was selected from a range of values developed using historical market returns and future capital market projections. The future capital market projections were produced using a building-block method in which a best-estimate of expected real rates of return (expected returns, net of pension plan investment expense and inflation) is developed for each major asset class. These best-estimates are combined to produce the future capital market projection by weighting the expected future real rates of return by the target asset allocation percentage and by adding expected inflation of 2.5%. The best-estimates of geometric real rates of return and the TCRS investment policy target asset allocation 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	5.69%	31%
Developed market international equity	5.29%	14%
Emerging market international equity	6.36%	4%
Private equity and strategic lending	5.79%	20%
U.S. fixed income	2.01%	20%
Real estate	4.32%	10%
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 7.25% based on a comparison of historical market returns and future capital market projections.

Discount rate – The discount rate used to measure the total pension liability was 7.25%. 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 proportionate share of net pension asset to changes in the discount rate – The following presents the university's proportionate share of the net pension asset calculated using the discount rate of 7.25%, as well as what the university's proportionate share of the net pension asset would be if it were calculated using a discount rate that is 1 percentage point lower (6.25%) or 1 percentage point higher (8.25%) than the current rate:

	1% Decrease (6.25%)	Current Discount Rate (7.25%)	1% Increase (8.25%)
University's proportionate share of the net pension asset	$(289,624)	$(2,315,823)	$(3,827,068)

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.state.tn.us/tcrs.

Payable to the Pension Plan

At June 30, 2018, the university reported a payable of $527,688 for the outstanding amount of legally required contributions to the pension plan required for the year ended June 30, 2018.

Total Defined Benefit Pension Expense

The total pension expense for the year ended June 30, 2018, for all state government defined benefit pension plans was $49,097,508.

Federal Retirement

Plan description – The University of Tennessee 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, 1987, and the Federal Employees Retirement System (FERS) for participants employed after December 31, 1986. The U.S. Office of Personnel Management manages both systems. 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. There were 146 employees in Federal Retirement Programs in 2018, 24 in CSRS and 122 in FERS. Both systems provide retirement, death, and disability benefits, as well as annual cost-of-living adjustments, to plan members and their beneficiaries. Benefits are based on high three-year average salary and years of service. CSRS employees can retire with five years of service at age 62, at age 60 with 20 years of service, or at 55 with 30 years of service. FERS employees can retire with 10 years of service at a minimum retirement age from 55 to 57 depending on year of birth. For both plans, former employees who leave the job before becoming eligible for retirement can either ask that their retirement contributions be returned or wait until age requirements are met to receive monthly benefits, provided years of service requirements have been met. Benefit estimates are available at https://www.opm.gov/retirement-services/fers-information/computation/.

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, 2018, were $252,718.62, which consisted of $129,340.53 from the university and $123,378.09 from the employees. At June 30, 2018, the university reported a payable of $9,836.18 for the outstanding amount of legally required contributions to the CSRS pension plan required for the year ended June 30, 2018.

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 to FERS for the year ended June 30, 2018, were $2,325,833.57, which consisted of $1,669,673.93 from the university and $656,159.64 from the employees. At June 30, 2018, the university reported a payable of $100,331.20 for the outstanding amount of legally required contributions to the FERS pension plan required for the year ended June 30, 2018.

Defined Contribution Plans

Optional Retirement Plans (ORP)

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 25, Part 2, 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. Pension expense equaled the required contributions made to the ORP and were $48,363,388.68 for the year ended June 30, 2018, and $47,664,353.97 for the year ended June 30, 2017. 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 $6,249,578.35 for fiscal year 2018, and $7,642,103.59 for fiscal year 2017. 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 $1,176,555.81 in fiscal year 2018, and $1,147,847.02 in fiscal year 2017. 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 the *Internal Revenue Code* (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 is 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 Chapter 259 of the *Public Acts of 2013,* employees hired after June 30, 2014, are automatically enrolled in the state's 401(k) plan if they elect to be in the TCRS pension 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, 2018, contributions totaling $26,127,996.62 were made by employees participating in the 401(k) plan, and the university recognized pension expense of $10,550,333.36 for employer contributions. During the year ended June 30, 2017, contributions totaling $24,293,328.80 were made by employees participating in the 401(k) plan, and the university recognized pension expense of $9,029,995.93 for employer contributions.

Note 12. Other Postemployment Benefits

Closed State Employee Group OPEB Plan

General information about the OPEB plan

Plan description – Employees of the university, who were hired prior to July 1, 2015, and choose coverage, are provided with pre-65 retiree health insurance benefits through the closed State Employee Group OPEB Plan (EGOP) administered by the Tennessee Department of Finance and Administration. This plan is considered to be single-employer defined benefit plan that is used to provide postemployment benefits other than pensions (OPEB). This plan is closed to the employees of all participating employers that were hired on or after July 1, 2015. The employers participating in this plan include the State of Tennessee (primary government), the Tennessee Student Assistance Corporation, the Tennessee Housing Development Agency, the University of Tennessee, and the institutions that make up the State University and Community College System.

Benefits provided – The EGOP is offered to provide health insurance coverage to eligible retired and disabled participants and is the only postemployment benefit provided to eligible pre-65 participants. Benefits are established and amended by an insurance committee created by Title 8, Chapter 27, Section 201, *Tennessee Code Annotated*. All retirees and disabled employees of the primary government and certain component units, who are eligible and choose coverage, and who have not yet reached the age of 65 are enrolled in this plan. All members have the option of choosing between the partnership promise, no partnership promise, standard preferred provider organization (PPO) plan or the wellness health savings consumer-driven health plan (CDHP) for healthcare benefits. Retired plan members receive the same plan benefits as active employees, at a blended premium rate that considers the cost of active employees. This creates an implicit subsidy for the retirees. The retirees' cost is then directly subsidized by the employers, based on years of service. Therefore, retirees with 30 years of service are subsidized 80%; 20 but less than 30 years, 70%; and less than 20 years, 60%. No subsidy is provided to retirees in the health savings CDHP plan. This plan is funded on a pay-as-you-go basis and there are no assets accumulating in a trust that meets the criteria of paragraph 4 of GASB Statement 75.

Annually, an insurance committee, created in accordance with Title 8, Chapter 27, Section 201, *Tennessee Code Annotated*, establishes the required payments to the plan by member employers and employees. Active members of the Employee Group Insurance Plan and pre-age 65 retired members of the EGOP pay the same rate. Claims liabilities of the plans are periodically computed using actuarial and statistical techniques to establish premium rates.

Total OPEB Liability

Proportionate share – The university's proportionate share of the collective total OPEB liability related to the EGOP was $213.77 million. At the June 30, 2017, measurement date, the university's proportion of the collective total OPEB liability was 15.922879%, representing the first-time presentation of the proportion. The university's proportion of the collective total OPEB liability was based on a projection of the long-term share of contributions to the OPEB plan relative to the projected share of contributions of all participating employers, actuarially determined. The collective total OPEB liability was determined by an actuarial valuation with a valuation date of June 30, 2017, and a measurement date of June 30, 2017.

Actuarial assumptions – The collective total OPEB liability in the June 30, 2017, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

Inflation	2.25%
Salary increases	Graded salary ranges from 3.44% to 8.72% based on age, including inflation, averaging 4%.
Healthcare cost trend rates	7.5% for 2018, decreasing annually to an ultimate rate of 3.83% for 2050 and later years.
Retiree's share of benefit-related costs	Members are required to make monthly contributions in order to maintain their coverage. For the purpose of this valuation, a weighted average has been used with weights derived from the current distribution of members among plans offered.

Unless noted otherwise, the actuarial demographic assumptions used in the June 30, 2017, valuations were the same as those employed in the July 1, 2017, pension actuarial valuation of the Tennessee Consolidated Retirement System (TCRS). These assumptions were developed by TCRS based on the results of an actuarial experience study for the period July 1, 2012, through June 30, 2016. The demographic assumptions were adjusted to more closely reflect actual and expected future experience. Mortality tables are used to measure the probabilities of participants dying before and after retirement. The mortality rates employed in this valuation are taken from the RP-2014 Healthy Participant Mortality Table for Annuitants for non-disabled post-retirement mortality, with mortality improvement projected to all future years using Scale MP-2016. Post-retirement tables are Blue Collar and adjusted with a 2% load for males and a -3% load for females.

Mortality rates for impaired lives are the same as those used by TCRS and are taken from a gender-distinct table published in the IRS Ruling 96-7 for disabled lives with a 10% load.

Discount rate – The discount rate used to measure the total OPEB liability was 3.56%. This rate reflects the interest rate derived from yields on 20-year, tax-exempt general obligation municipal bonds, prevailing on the measurement date, with an average rating of AA/Aa as shown on the Fidelity 20-Year Municipal GO AA index.

Changes in assumptions – The discount rate was changed from 2.92% as of the beginning of the measurement period to 3.56% as of June 30, 2017. This change in assumption decreased the total OPEB liability.

Sensitivity of the proportionate share of the collective total OPEB liability to changes in the discount rate – The following presents the university's proportionate share of the collective total OPEB liability of the EGOP, as well as what the proportionate share of the collective total OPEB liability would be if it were calculated using a discount rate that is 1 percentage point lower (2.56%) or 1 percentage point higher (4.56%) than the current rate (expressed in thousands):

	1% Decrease (2.56%)	Current Discount Rate (3.56%)	1% Increase (4.56%)
University's proportionate share of the collective total OPEB liability	$228,606	$213,771	$199,868

Sensitivity of the proportionate share of the collective total OPEB liability to changes in the healthcare cost trend rate – The following presents the university's proportionate share of the collective total OPEB liability of the EGOP, as well as what the proportionate share of the collective total OPEB liability would be if it were calculated using a healthcare cost trend rate that is 1 percentage point lower (6.5% decreasing to 2.83%) or 1 percentage point higher (8.5% decreasing to 4.83%) than the current rate (expressed in thousands):

	1% Decrease (6.5% decreasing to 2.83%)	Healthcare Cost Trend Rates (7.5% decreasing to 3.83%)	1% Increase (8.5% decreasing to 4.83%)
University's proportionate share of the collective total OPEB liability	$192,443	$213,771	$238,783

OPEB Expense and Deferred Outflows of Resources and Deferred Inflows of Resources Related to OPEB

OPEB expense – For the year ended June 30, 2018, the university recognized OPEB expense of $16.38 million.

Deferred outflows of resources and deferred inflows of resources – For the year ended June 30, 2018, the university reported deferred outflows of resources and deferred inflows of resources related to OPEB paid by the EGOP from the following sources (expressed in thousands):

	Deferred Outflows of Resources	Deferred Inflows of Resources
Changes in assumptions	$ -	$8,215
Payments subsequent to the measurement date	14,165	-
Total	$14,165	$8,215

Deferred outflows of resources, resulting from the university's employer payments of $14.16 million subsequent to the measurement date, will be recognized as a decrease in total OPEB liability in the year ending June 30, 2019. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to OPEB will be recognized in OPEB expense as follows (expressed in thousands):

Year Ending June 30	
2019	$(1,174)
2020	$(1,174)
2021	$(1,174)
2022	$(1,174)
2023	$(1,174)
Thereafter	$(2,345)

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

Closed Tennessee OPEB Plan

General Information About the OPEB Plan

Plan description – Employees of the university, who were hired prior to July 1, 2015, and choose coverage, are provided with post-65 retiree health insurance benefits through the closed Tennessee OPEB Plan (TNP) administered by the Tennessee Department of Finance and Administration. This plan is considered to be a multiple-employer defined benefit plan that is used to provide postemployment benefits other than pensions (OPEB). However, for accounting purposes, this plan will be treated as a single-employer plan. This plan is closed to the employees of all participating employers that were hired on or after July 1, 2015. The State of Tennessee (primary government), as well as the Tennessee Student Assistance Corporation, the Tennessee Housing Development Agency, the University of Tennessee, and the institutions that make up the State University and Community College System also participate in this plan. This plan also serves eligible post-65 retirees of employers who participate in the state-administered Teacher Group Insurance and Local Government Insurance Plans.

Benefits provided – The TNP is offered to help fill most of the coverage gaps created by Medicare and is the only postemployment benefit provided to eligible post-65 retired and disabled employees of participating employers. This plan does not include pharmacy. In accordance with Title 8, Chapter 27, Section 209, *Tennessee Code Annotated*, benefits are established and amended by cooperation of insurance committees created by Sections 8-27-201, 301, and 701 *Tennessee Code Annotated*. Retirees and disabled employees of the state, component units, local education agencies, and certain local governments who have reached the age of 65, are Medicare-eligible, and also receive a benefit from the Tennessee Consolidated Retirement System may participate in this plan. All plan members receive the same plan benefits at the same premium rates. Many retirees receive direct subsidies toward their premium cost; however, participating employers determine their own policy in this regard. The primary government contributes to the premiums of component unit retirees based on years of service. Therefore, retirees with 30 years of service receive $50 per month; 20 but less than 30 years, $37.50; and 15 but less than 20 years, $25. The university does not provide any subsidies for retirees in the TNP. The primary government paid $1.08 million for OPEB as the benefits came due during the reporting period. This plan is funded on a pay-as-you-go basis and there are no assets accumulating in a trust that meets the criteria of paragraph 4 of GASB Statement 75.

In accordance with Title 8, Chapter 27, Part 209, *Tennessee Code Annotated*, the state insurance committees established by Sections 8-27-201, 301, and 701 *Tennessee Code Annotated,* determine the required payments to the plan by member employers and employees. Claims liabilities of the plan are periodically computed using actuarial and statistical techniques to establish premium rates. Administrative costs are allocated to plan participants.

Total OPEB Liability and OPEB Expense

Proportionate share – The primary government is entirely responsible for the TNP OPEB liability associated with the university's employees. The primary government's proportionate share of the total OPEB liability associated with the university was $31.3 million. At the June 30, 2017, measurement date, the proportion of the collective total OPEB liability associated with the university was 17.67%, representing the first-time presentation of this proportion. The proportion of the collective total OPEB liability associated with the university was based on a projection of the long-term share of contributions to the OPEB plan relative to the projected share of contributions of all participating employers, actuarially determined. The collective total OPEB liability was determined by an actuarial valuation with a valuation date of June 30, 2017, and measurement date of June 30, 2017.

Actuarial assumptions – The total OPEB liability in the June 30, 2017, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement, unless otherwise specified:

Inflation	2.25%
Salary increases	Graded salary ranges from 3.44% to 8.72% based on age, including inflation, averaging 4%
Healthcare cost trend rates	The premium subsidies provided to retirees in the Closed Tennessee OPEB Plan are assumed to remain unchanged for the entire projection; therefore, trend rates are not applicable.

Unless noted otherwise, the actuarial demographic assumptions used in the June 30, 2017, valuations were the same as those employed in the July 1, 2017, pension actuarial valuation of the Tennessee Consolidated Retirement System (TCRS). These assumptions were developed by TCRS based on the results of an actuarial experience study for the period July 1, 2012, through June 30, 2016. The demographic assumptions were adjusted to more closely reflect actual and expected future experience. Mortality tables are used to measure the probabilities of participants dying before and after retirement. The mortality rates employed in this valuation are taken from the RP-2014 Healthy Participant Mortality Table for Annuitants for non-disabled post-retirement mortality, with mortality improvement projected to all future years using Scale MP-2016. Post-retirement tables are Blue Collar and adjusted with a 2% load for males and a -3% load for females. Mortality rates for impaired lives are the same as those used by TCRS and are taken from a gender-distinct table published in the IRS Ruling 96-7 for disabled lives with a 10% load.

Discount rate – The discount rate used to measure the total OPEB liability was 3.56%. This rate reflects the interest rate derived from yields on 20-year, tax-exempt general obligation municipal bonds, prevailing on the measurement date, with an average rating of AA/Aa as shown on the Fidelity 20-Year Municipal GO AA index.

Changes in assumptions – The discount rate was changed from 2.92% as of the beginning of the measurement period to 3.56% as of June 30, 2017. This change in assumption decreased the total OPEB liability.

Sensitivity of the proportionate share of the collective total OPEB liability to changes in the discount rate – The following presents the primary government's proportionate share of the university's related collective total OPEB liability, as well as what the proportionate share of the collective total OPEB liability would be if it were calculated using a discount rate that is 1 percentage point lower (2.56%) or 1 percentage point higher (4.56%) than the current rate (expressed in thousands). The university does not report a proportionate share of the OPEB liability for employees in the TNP.

	1% Decrease (2.56%)	Current Discount Rate (3.56%)	1% Increase (4.56%)
Primary government's share of the collective total OPEB liability	$35,456	$31,316	$27,798

OPEB expense – For the year ended June 30, 2018, the primary government recognized OPEB expense of $1.34 million for employees of the university participating in the TNP.

Total OPEB Expense

The total OPEB expense for the year ended June 30, 2018, was $17.72 million, which consisted of OPEB expense of $16.38 million for the EGOP and $1.34 million paid by the primary government for the TNP.

Note 13. 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, 2018. The financial statements of the university include as expenses 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, 2018, the amounts held in trust totaled $160,711,748.62 at fair value.

Note 14. 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 $4,280,873.00 at June 30, 2018. 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, 2017, was $4,031,217.76.

During the year ended June 30, 2018, the university had expenses of $26,961,127.14 under contracts with UT-Battelle. Amounts receivable from UT-Battelle under these contracts totaled $3,717,461.40 at June 30, 2018. 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 2018 fiscal year, the university remitted another $16,041,596.00 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 15. 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 liability, and workers' compensation. By statute, the maximum liability for general liability, automobile liability, and professional medical malpractice liability is $300,000 per person and $1,000,000 per occurrence. 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, crime and fidelity coverage on the state's officials and employees, and cyber liability coverage. 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 $7.5 million for perils other than earthquake and flood. Purchased insurance coverage is responsible for losses exceeding the $7.5 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. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the year ended June 30, 2018, is presented in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/fa/fa-accounting-financial/fa-accfin-cafr.html. At June 30, 2018, the RMF held $189 million in cash designated for payment of claims.

At June 30, 2018, the scheduled coverage for the university was $6,859,580,488 for buildings and $1,313,778,662 for contents.

The university also carries commercial insurance policies for losses related to catastrophic auto, cyber, crime, aviation, and fine arts.

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 16. 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, 2018, were $103,244,665.34, of which $30,929,063.91 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 $352,658,672.85 at June 30, 2018.

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 $3,632,044.88 as of June 30, 2018, 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 existing lawsuits and the possibility exists of additional litigation. It is not possible to estimate the extent of any losses resulting from these lawsuits.

Mold Remediation

After fiscal year end, mold was discovered in several university dormitories on the Knoxville campus. The amount of associated liabilities is believed to be between $6 and $9 million.

Note 17. 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 19.) 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 $41,171,696.05 in 2018, 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 18. 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 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 2018, the university provided the foundation direct support of $19,948,429.00 and endowment assessment fees of $7,693,332.00.

A separate affiliation agreement provides that the University of Chattanooga Foundation receives 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 $21,709,757.79 in fiscal year 2018, 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 19. 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 17. 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. There was no annual lease payment made to the university during the year ended June 30, 2018.

The university recorded a lease payment receivable in the amount of $36,650,624.97 at June 30, 2018, 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, 2018
Total minimum lease payments to be received	$40,772,932.87
Less: unearned income	(4,122,307.90)
Net investment in direct financing lease	$36,650,624.97

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 $9,266,305.13 at June 30, 2018:

Total minimum lease payments to be received	$11,287,529.56
Less: unearned income	(2,021,224.43)
Net investment in direct financing lease	$ 9,266,305.13

Year Ending June 30	Minimum Lease Payments to Be Received	Interest	Principal
2019	$ 1,365,645.82	$ 414,787.83	$ 950,857.99
2020	1,367,560.68	372,224.55	995,336.13
2021	1,369,559.64	327,670.29	1,041,889.35
2022	1,371,646.46	281,032.18	1,090,614.28
2023	1,373,827.24	232,212.99	1,141,614.25
2024-2027	4,439,289.72	393,296.59	4,045,993.13
	$11,287,529.56	$2,021,224.43	$9,266,305.13

Note 20. Natural Classification With Functional Classifications

The university's operating expenses for the year ended June 30, 2018, are as follows:

Functional Classification	Salaries	Benefits	Utilities, Supplies, and Other Services	Scholarships	Depreciation	Total
			Natural Classification			
Instruction	$ 447,505,117.90	$131,725,558.72	$ 97,147,216.72	$ -	$ -	$ 676,377,893.34
Research	175,846,312.61	46,828,394.86	79,173,283.89	-	-	301,847,991.36
Public service	78,028,226.15	29,042,611.90	35,696,561.70	-	-	142,767,399.75
Academic support	103,585,122.94	35,524,031.60	55,526,475.82	-	-	194,635,630.36
Student services	49,631,457.92	17,881,729.81	28,646,393.19	-	-	96,159,580.92
Institutional support	88,516,364.21	29,911,204.79	31,590,542.98	-	-	150,018,111.98
Maintenance and operation	48,123,356.95	21,846,573.49	105,581,141.35	-	-	175,551,071.79
Scholarships and fellowships	3,689,515.75	34,132,967.79	-	64,439,069.53	-	102,261,553.07
Auxiliary	73,343,286.84	15,830,423.66	98,094,648.89	-	-	187,268,359.39
Independent operations	45,080,195.06	17,157,645.70	-	-	-	62,237,840.76
Depreciation	-	-	-	-	123,649,092.90	123,649,092.90
Total expenses	$1,113,348,956.33	$379,881,142.32	$531,456,264.54	$64,439,069.53	$123,649,092.90	$2,212,774,525.62

Note 21. On-behalf Payments

During the year ended June 30, 2018, the State of Tennessee made payments of $1,077,650.11 on behalf of the university for retirees participating in the Closed Tennessee OPEB Plan. The Closed Tennessee OPEB Plan is a postemployment benefit healthcare plan and is discussed further in Note 12.

Note 22. Cumulative Effect of a Change in Accounting Principle

During fiscal year 2018, the university implemented GASB Statement 75, *Accounting and Financial Reporting for Post-employment Benefits Other than Pensions.* This statement establishes standards for the measurement, recognition, and display of the total OPEB liability and related expenses, deferred inflows, deferred outflows, note disclosures, and required supplementary information. The implementation of GASB Statement 75 resulted in a cumulative adjustment to beginning net position of $95,219,465.74.

During fiscal year 2018, the university implemented GASB Statement 81, *Irrevocable Split Interest Agreements*. This statement established standards for the measurement and recognition of assets, liabilities, and deferred inflows of resources related to irrevocable split interest agreements. The implementation of GASB Statement 81 resulted in a cumulative adjustment to beginning net position of $25,730,724.40.

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 49-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, 2018, the foundation expended $4,451,272.00 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 1,685 bedrooms in 456 units and 666 parking spaces.

Investments

A summary of foundation investments at June 30, 2018, is as follows:

Mutual funds	$ 54,548,737
Limited partnerships	68,449,250
Total	$122,997,987

The foundation also has investments, restricted by the terms of the revenue bonds described below, totaling $11,780,410.

Property and Equipment

A summary of foundation property and equipment at June 30, 2018, is as follows:

Land	$ 8,241,032
Buildings	76,213,552
Furniture, fixtures, and equipment	7,841,414
	92,295,998
Accumulated depreciation	(47,679,594)
Total	$44,616,404

Revenue Bonds Payable

During November 2015, the Health, Educational, and Housing Facility Board of the City of Chattanooga issued series 2015 tax-exempt revenue refunding bonds totaling $65,895,000. The LLC is the borrower on the Series 2015 bonds. The proceeds of the refunding bonds were primarily used to retire early the two series of tax-exempt revenue bonds issued in 2005. The two series of tax-exempt revenue bonds issued during May 2005 totaling $91,510,000 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, 2018, consist of the following:

Series 2015 revenue refunding bonds, interest rates fixed at 3.0% to 5.0% payable semi-annually, annual redemption payments due through October 1, 2035	$61,565,000
Plus: unamortized premium	4,834,374
Less: unamortized bond issuance costs	(723,402)
Total	$65,675,972

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

Year Ending June 30	
2019	$2,305,000
2020	2,370,000
2021	2,460,000
2022	2,580,000
2023	2,710,000
Thereafter	49,140,000
Total	$61,565,000

Loan Payable

In January 2018, the foundation entered into a $7,250,000 non-revolving line of credit with a bank. The line of credit expired on June 1, 2018, and converted to a term loan at that time. The loan bears interest at 3.61%, and is payable beginning on July 1, 2018, in monthly installments of $97,803. All unpaid principal and interest is due at maturity of May 31, 2025. The outstanding balance at June 30, 2018, was $7,250,000. Principal payments for the next five years and thereafter are as follows:

Year Ending June 30	
2019	$ 927,147
2020	961,176
2021	996,455
2022	1,117,444
2023	1,158,458
Thereafter	2,089,320
Total	$7,250,000

Fair Value Measurement

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, 2018	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:				
International funds	$ 32,706,271	$32,706,271	$ -	$ -
Index funds	20,679,434	20,679,434	-	-
Fixed income	151,884	151,884	-	-
Short-term bond funds	1,011,148	1,011,148	-	-
Total mutual funds	54,548,737	54,548,737	-	-
U.S. Treasury money market fund	11,780,410	11,780,410	-	-
Total assets at fair value	66,329,147	66,329,147	-	-
Total investments measured at net asset value (1) (2)	68,449,250	-	-	-
Total assets	134,778,397	66,329,147	-	-

Liabilities:				
Deposits received for the benefit of others	2,407,898	2,407,898	-	-
Total liabilities	$ 2,407,898	$ 2,407,898	$ -	$ -

(1) In accordance with Subtopic 820-10, the limited partnerships that were measured at net asset value per share (or its equivalent) have not been classified in the fair value hierarchy. The fair value amount presented in this table is intended to permit reconciliation of the fair value hierarchy to the line item presented in the statement of net position.

(2) Limited partnership investments have investment strategies which include investments in private debt financing, emerging and global equity markets, long and short positions primarily in residential and commercial mortgage backed securities, senior secured debt, public and private oil and gas companies, direct origination and secondary market first and second mortgage liens, commercial real estate, equity-based partnerships, and transportation and infrastructure. These investments also include certain restrictions on the foundation's contributed capital. These restrictions include lock ups and withdrawal restrictions. Lock up restrictions range from 12 to 36 months. Withdrawal restrictions range from no withdrawals being allowed until termination of partnership to monthly and quarterly withdrawals with 30 to 90 days' notice. At June 30, 2018, the foundation had outstanding commitments of $15,856,212.

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.

<u>Interpretation of Relevant Law</u>

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, 2018. 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	$ (21,059)	$1,791,056	$91,785,256	$ 93,555,253
Board-designated funds	59,843,581	-	-	59,843,581
	$59,822,522	$1,791,056	$91,785,256	$153,398,834

Changes in endowment net assets for the fiscal year ended June 30, 2018, are as follows:

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$58,068,566	$1,229,706	$64,010,300	$123,308,572
Investment income	646,755	632,835	-	1,279,590
Net realized and unrealized gains	3,741,018	-	4,302,049	8,043,067
Contributions	50,620	-	24,790,106	24,840,726
Appropriations	(920,066)	(1,315,686)	-	(2,235,752)
Transfers	(1,764,371)	1,244,201	(1,317,199)	(1,837,369)
Endowment net assets, end of year	$59,822,522	$1,791,056	$91,785,256	$153,398,834

At June 30, 2018, 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 $45,750 as of June 30, 2018. 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 $225,000 to the university during the LLC's fiscal year ended June 30, 2018. 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, 2018, deposits held at the university on behalf of the LLC were $628,309.

Contingencies

From time to time the foundation's subsidiaries may be 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.

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 22 active board members and four 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, 2018, the foundation expended $76,239,246.48 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, 1525 University Avenue, Knoxville, Tennessee 37921-4848.

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 18.

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	$11,036,587.21	$ 4,272,926.99
Pledges due in one to five years	60,519,417.85	38,830,590.53
Pledges due after five years	9,374,414.48	10,759,759.82
	80,930,419.54	53,863,277.34
Less discounts to net present value	(5,532,432.96)	(4,447,494.00)
Total pledges receivable, net	$75,397,986.58	$49,415,783.34

The allowance for doubtful accounts at June 30, 2018, was $894,109.92.

Note Receivable

The note receivable executed in February 2017, in order to provide seller financing to the buyer of a warehouse facility in Edgefield County, South Carolina, was paid in full on January 31, 2018.

Investments and Assets Held by the University of Tennessee

Investments held at June 30, 2018, were as follows:

	Fair Value	Cost
Endowment assets held by the University of Tennessee:		
Debt securities	$ 12,107,934.96	$ 14,009,688.25
Corporate stock – domestic	3,723,768.24	2,736,044.96
Corporate stock – international	515,505.84	548,458.92
Pooled investment vehicles – equity	68,590,601.19	66,184,424.56
Alternative investments:		
Pooled investment vehicles – real estate	12,263,841.70	10,526,397.75
Private capital investments	60,839,182.44	66,304,104.82
Hedge funds	49,960,891.69	45,918,052.26
Total endowment assets held by university	208,001,726.06	206,227,171.52
Endowment assets held by the foundation:		
Cash	268,196.15	268,196.15
Equities	1,844,401.43	1,627,082.98
Total endowment assets held by the foundation	2,112,597.58	1,895,279.13
Total endowment funds	210,114,323.64	208,122,450.65

Other investments:		
Liquid investments held by the university:		
Cash management pool	99,123,671.43	99,123,671.43
Other liquid investments	4,000,000.00	4,000,000.00
Total liquid investments held by university	103,123,671.43	103,123,671.43
Liquid investments at financial institution	5.00	5.00
Gift annuity program:		
Cash	11,684.85	11,684.85
Equities	4,952,320.94	4,454,843.03
Fixed income	4,092,880.02	4,176,985.87
Total gift annuity program	9,056,885.81	8,643,513.75
Total investments	$322,294,885.88	$319,889,640.83

Also reported as investments on the statement of net position are other gift assets totaling $1,329,980.00.

At June 30, 2018, 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, permanently restricted unconditional promises to give, and other assets. The majority of the foundation's invested endowment funds are invested in the University of Tennessee Consolidated Investment Pool. 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 $206,227,171.52 and $208,001,726.06, which resulted in a cumulative unrealized gain of $1,774,554.54. Three endowments are separately invested by the foundation. The cost and fair value for these endowments was $1,895,279.13 and $2,112,597.58, which resulted in a cumulative unrealized gain of $217,318.45. All endowments at the foundation are donor-restricted. Endowment earnings transferred to the university were $7,900,111.13 for fiscal year 2018.

The foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result, the foundation classifies permanently restricted net assets as (1) the original value of gifts to the endowment, (2) the original value of subsequent gifts to the endowment, 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	$ -	$873,075.37	$227,020,709.36	$227,893,784.73
Contributions received	-	-	241,994.02	241,994.02
Transfers to endowments	-	-	30,054,966.36	30,054,966.36
Investment earnings	-	7,937,596.02	256,036.64	8,193,632.66
Fair value adjustment	-	1,223,687.25	(146.91)	1,223,540.34
Disbursements	-	(7,900,111.13)	-	(7,900,111.13)
Ending balance	$ -	$2,134,247.51	$257,573,559.47	$259,707,806.98

From time to time, the fair value of assets associated with individual donor-restricted endowment funds may fall below the level that the donor or UPMIFA requires the foundation to retain as a fund of perpetual duration. In accordance with GAAP, deficiencies of this nature are reported in unrestricted net assets.

The foundation uses the university's spending policy. Historically, the university has calculated its spending policy distributions by taking 4.5% of a three-year fair value average each December 31. In fiscal year 2016, the university began transitioning to a seven-year moving average, by adding one year's value to the moving average calculation. This transition will be complete beginning with fiscal year 2019.

The assets are to be managed in a manner that will meet the long-term investment objective, while at the same time attempting to limit the volatility in year-to-year spending.

The university's Investment Advisory Committee believes that investing in securities with higher return expectations outweighs their short-term volatility risk. As a result, the majority of assets will be invested in equity or equity-like securities. Fixed income securities and other low volatility strategies (e.g., absolute return hedge funds) will be used to lower the short-term volatility of the portfolio and to provide stability, especially during periods of negative equity markets. Cash is not a strategic asset of the portfolio, but is a residual to the investment process and used to meet short-term liquidity needs.

Disciplined management of the asset allocation is necessary and desirable. Diversification of investments among assets that are not similarly affected by economic, political, or social developments is highly desirable. The general policy shall be to diversify investments so as to provide a balance that will enhance total return, while avoiding undue risk concentrations in any single asset or investment category

Fair Value Measurement

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:				
University	$72,997,874.11	$ 99,732,990.77	$138,394,532.60	$311,125,397.48
Foundation	7,076,608.37	4,092,880.03	-	11,169,488.40
Total	$80,074,482.48	$103,825,870.80	$138,394,532.60	$322,294,885.88

The foundation does not hold any Level 3 investments directly; therefore, the schedule of annual financial activities for Level 3 investments represents investments held by the university measured at their value on a recurring basis from reliance on Level 3 inputs for determining their fair value:

Beginning balance	$107,362,506.22
Total realized and unrealized gains and losses included in earnings	4,506,306.22
Purchases, issuances, and settlements	26,525,720.16
Ending balance	$138,394,532.60

Notes 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, 2018, was $54,739.55. Future maturities of this note are as follows:

Year ending June 30	
2019	$21,904.07
2020	22,951.46
2021	9,884.02
Total	$54,739.55

The foundation purchased a warehouse facility in Edgefield County, South Carolina, at an appraised value of $11,000,000 on April 29, 2016, with a loan of $7,500,000 at 3.77%, with interest only payments until maturity on November 15, 2017. The note was restated in February 2017. The foundation issued another note payable in February 2017. The note payable totaled $205,000 and bore interest of 4% payable monthly. Both notes were paid in full on January 31, 2018.

Concentration of Credit Risk

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

The foundation has a master repurchase agreement with the financial institution, where at the end of each day, cash is invested in overnight securities, and the securities are repurchased by the bank the next day. The foundation purchases the securities in its name. The Repurchase Agreement Account is not insured by FDIC insurance, but rather the financial institution provides the securities purchased as the underlying security for the Repurchase Agreement Account. The Repurchase Agreement Account as of June 30, 2018, totaled $5,607,574.15, and is reported in cash and cash equivalents on the statement of net position.

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, a wholly owned for-profit subsidiary of the University of Tennessee Research Foundation, was formed in 2008. The subsidiary provides a vehicle to leverage state and federal funding with private research and development investments, strategic partnerships and collaborations to further research, economic development, and clean energy objectives. The subsidiary owns a demonstration scale cellulosic ethanol biorefinery in Vonore, Tennessee that is being leased to Genera Energy, Inc., to produce high quality agricultural fibers and compostable products.

Space Institute Research Corporation (SIRC), a wholly owned nonprofit subsidiary of the University of Tennessee Research Foundation, was formed in 2011 and renamed SIRC on June 2, 2017. The management of the property, activities, and affairs of SIRC is vested in its board of directors. The board is composed of seven voting directors. As of June 30, 2018, SIRC had total assets of $71,323 and no revenue for the year then ended.

The Cherokee Farm Development Corporation (CFDC), a wholly owned nonprofit subsidiary of the University of Tennessee Research Foundation, was formed on October 19, 2011. 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, 2018, CFDC had total assets of $1,345,406 and total revenue of $761,624 for the year then ended.

Cherokee Farm Properties, Inc., (CFPI), a wholly owned for-profit subsidiary of Cherokee Farm Development Corporation, was formed on May 28, 2014. The management of the property, activities, and affairs of CFPI is vested in its board of directors. The board is composed of three voting directors. As of June 30, 2018, CFPI had total assets of $1,253,296 and total revenue of $53,261 for the year then ended.

Collaborative Composite Solutions Corporation (CCS), a nonprofit subsidiary of the University of Tennessee Research Foundation, CCS's sole corporate member, was formed on August 1, 2014, and renamed as CCS on July 28, 2015. The subsidiary's primary purpose is coordinating and supporting all activities proposed to meet the intent and requirements of the Department of Energy's funding opportunity announcement DE-FOA-000977. These activities include selecting, sponsoring, and auditing research and development projects that increase energy efficiency, decrease greenhouse gas emissions, and aid economic development in the United States. The management of the property, activities, and affairs of CCS is vested in its board of directors. The board is composed of 14 voting directors, one of whom is a representative of UTRF, and another representing the University of Tennessee. As of June 30, 2018, CCS had total assets of $11,480,751 and total revenue of $14,132,463 for the year then ended.

Clinical Trials Network of Tennessee (CTN2), a wholly owned nonprofit subsidiary of the University of Tennessee Research Foundation, was formed on December 8, 2017. The management of the property, activities, and affairs of CTN2 is vested in its board of directors. The board is composed of 10 voting directors. As of June 30, 2018, CTN2 had total assets of $171,926 and no revenue for the year then ended.

Principles of Consolidation

The foundation's consolidated financial statements include the foundation's accounts and the accounts of its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated in consolidation, and the increase in net assets is reduced by the portion of earnings attributable to noncontrolling interests.

Investment in Subsidiaries

Subsidiaries are consolidated until the company ceases to have control. TennEra ceased to have control of Genera Energy, Inc., and Prisma Renewable Composites, LLC. When the company loses control of a subsidiary, a gain or loss is recognized in profit or loss and is calculated as the difference between the aggregate of the fair value of the consideration received and the fair value of any retained interest at the date when control is lost and the previous carrying amount of the assets and liabilities of the subsidiary and any noncontrolling interest. The fair value of any investment retained in the former subsidiaries at the date when control is lost is regarded as the cost on initial recognition of an investment in the subsidiaries. Genera and Prisma were deconsolidated as of July 1, 2017.

Impairment of Long-Lived Assets

During the prior year, TennEra determined the biorefinery to be impaired by $28,389,725. In December 2017, TennEra sold equipment in the biorefinery to Genera Energy, Inc., for $112,500. This resulted in a reduction of $1,510,158 in the original impairment. The remaining impairment of $26,879,567 is considered as part of accumulated depreciation at June 30, 2018. A loss of $3,330,530 was recorded on the sale of equipment during the year ended June 30, 2018. Management reevaluated this impairment in 2018 and determined no additional impairment was necessary.

Property and Equipment

Property and equipment consist of the following major classifications at June 30, 2018:

Office furniture and equipment	$ 140,226
Less accumulated depreciation	(135,346)
Total	4,880
TennEra	
Land	64,044
Buildings	36,979,029
Machinery and equipment	921,439
Furniture and fixtures	43,587
Less accumulated depreciation	(33,836,557)
Total TennEra	4,171,542
Cherokee Farm	
Office furniture and equipment	1,739
Less accumulated depreciation	(1,739)
Total Cherokee Farm	-
Collaborative Composite Solutions Corporation	
Equipment	402,072
Software – member portal	263,735
Less accumulated depreciation	(73,066)
Total Collaborative Composite Solutions Corporation	592,741
Total	$4,769,163

Depreciation expense for the foundation and its subsidiaries totaled $1,215,139 for the year ended June 30, 2018.

Note Receivable From Sale of Biomass Innovation Park

In May 2016, TennEra sold its Biomass Innovation Park to Genera Energy, Inc., for $1,850,000. A promissory note for $1,600,000 was issued and payable in quarterly installments beginning in August 2016 with the note maturing in May 2021. Interest accrues on the unpaid balance at 5% per year. The note is secured by a pledge of 89,000 shares of Class M stock of Genera Energy, Inc. No payments were paid to TennEra during the year ended June 30, 2018. The balance of the note receivable, including accrued interest, is $880,202 at June 30, 2018.

Fair Value Measurement

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.

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, 2018.

Marketable Equity Securities

The fair value of marketable equity securities is based on quoted prices times the number of the shares held by the foundation at June 30, 2018.

Investments in Genera Energy, Inc., and Prisma Renewable Composites, LLC

Investments which consist of TennEra's remaining noncontrolling investment in the deconsolidated subsidiaries is recorded at fair value on a recurring basis based primarily on fair value measurements provided by management utilizing Level 3 inputs in accordance with GAAP. There is no current active market for these investments such that the determination of fair value requires significant judgment and estimation. The investments are measured at fair value using an internal enterprise valuation prepared by management. The valuation resulted in a loss on investments of $3,023,621.

The following table provides the assets carried at fair value measured on a recurring basis as of June 30, 2018:

Assets:	Level 1	Level 2	Level 3	Total
Registered investment companies	$ 11,816	$ -	$ -	$ 11,816
Marketable equity securities	110,181	-	-	110,181
Genera Energy, Inc.	-	-	27,000	27,000
Prisma Renewable Composites, LLC	-	-	850,061	850,061
Total	$121,997	$ -	$877,061	$999,058

The foundation also has $9,945 of investments (equity securities) for which there is no readily determinable fair value and has invested $1,200,000 in Cherokee Farm Properties, Inc. 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.

Deconsolidation of Subsidiaries

Genera Energy, Inc., was deconsolidated as of July 1, 2017. Due to various transactions with a third-party investor, TennEra effectively lost control and ultimately retained 1.5% ownership in Genera at June 30, 2018. Accordingly, TennEra derecognized related assets, liabilities, and other interests in Genera. TennEra did not receive any consideration in conjunction with the deconsolidation.

Prisma Renewable Composites, LLC, was deconsolidated as of July 1, 2017. On June 18, 2018, Prisma issued ownership units representing 81.2987% on a fully diluted basis to other investors. This reduced Prisma's ownership to 18.7013%. Accordingly, TennEra, LLC, has deconsolidated the related assets, liabilities, and other interests in Prisma as of July 1, 2017, as the related assets and liabilities of Prisma from July 1, 2017, through June 18, 2018, were determined to be immaterial to TennEra. TennEra did not receive any consideration in the deconsolidation of Prisma.

Gain on deconsolidation of subsidiaries for the year ended June 30, 2018:

	Genera	Prisma
Fair value of interest retained	$ 27,000	$850,061
Less: net assets deconsolidated	(6,424,132)	6,905
Gain on deconsolidation of subsidiaries	$6,451,132	$843,156

A gain on deconsolidation of subsidiaries totaling $7,294,288 is reported as other nonoperating revenue.

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

	Proportion of the Net Pension Liability	Proportionate Share of the Net Pension Liability	Covered Payroll	Proportionate Share of the Net Pension Liability as a Percentage of Its Covered Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2018	12.868287%	$230,290,800	$308,432,979	74.66%	88.88%
2017	13.12809%	$239,530,566	$320,282,715	74.78%	87.96%
2016	12.930334%	$166,708,520	$337,276,466	49.43%	91.26%
2015	12.764631%	$88,069,402	$348,719,634	25.26%	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 10-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 10 years of information is available.

THE UNIVERSITY OF TENNESSEE

Required Supplementary Information
Schedule of University of Tennessee's Proportionate Share of the Net Pension Asset
State and Higher Education Employee Retirement Plan Within TCRS

	Proportion of the Net Pension Asset	Proportionate Share of the Net Pension Asset	Covered Payroll	Proportionate Share of the Net Pension Asset as a Percentage of Its Covered Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Asset
2018	11.166788%	$2,315,823	$62,718,322	3.69%	131.51%
2017	11.908035%	$1,003,190	$36,688,424	2.73%	130.56%
2016	11.730576%	$362,224	$13,241,214	2.46%	142.55%

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 10-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 10 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

	Contractually Determined Contributions	Contributions in Relation to Contractually Determined Contributions	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a Percentage of Covered Payroll
2018	$55,639,354	$55,639,354	$ -	$295,027,604	18.86%
2017	46,326,637	46,326,637	-	308,432,979	15.02%
2016	48,138,492	48,138,492	-	320,282,715	15.03%
2015	50,692,652	50,692,652	-	337,276,466	15.03%
2014	52,412,536	52,412,536	-	348,719,634	15.03%
2013	47,508,571	47,508,571	-	316,091,623	15.03%
2012	44,814,906	44,814,906	-	300,569,457	14.91%
2011	43,343,861	43,343,861	-	290,703,293	14.91%
2010	37,266,850	37,266,850	-	286,227,727	13.02%
2009	37,963,758	37,963,758	-	291,580,323	13.02%

To correspond with the reporting date, the amounts presented were determined as of June 30 of the stated fiscal year.

THE UNIVERSITY OF TENNESSEE
Required Supplementary Information
Schedule of University of Tennessee's Contributions
State and Higher Education Employee Retirement Plan Within TCRS

	Contractually Determined Contributions	Contributions in Relation to Contractually Determined Contributions	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a Percentage of Covered Payroll
2018	$3,336,552	$3,336,552	$ -	$89,602,479	3.72%
2017	2,283,615	2,283,615	-	62,718,322	3.64%
2016	1,419,842	1,419,842	-	36,688,424	3.87%
2015	512,435	512,435	-	13,241,214	3.87%

1) This is a 10-year schedule; however, contributions to this plan began in 2015. Years will be added to this schedule in future years until 10 years of information is available.

2) To correspond with the reporting date, the amounts presented were determined as of June 30 of the stated fiscal year.

THE UNIVERSITY OF TENNESSEE
Required Supplementary Information
Schedule of University of Tennessee's Contributions
Federal Retirement Plans Administered by the U.S. Office of Personnel Management

Civil Service Retirement System

2018	$129,341
2017	169,500
2016	196,496
2015	230,096
2014	282,875
2013	302,616
2012	321,989
2011	339,588
2010	411,179
2009	540,494

Federal Employees Retirement System

2018	$1,669,674
2017	1,639,831
2016	1,586,644
2015	1,492,262
2014	1,455,815
2013	1,478,574
2012	1,439,573
2011	1,380,360
2010	1,360,281
2009	1,392,006

THE UNIVERSITY OF TENNESSEE
Required Supplementary Information
Schedule of University of Tennessee's Proportionate Share of the Collective Total OPEB Liability
Closed State Employee Group OPEB Plan
(dollar amount in thousands)

	2018
University's proportion of the collective total OPEB liability	15.922879%
University's proportionate share of the collective total OPEB liability	$213,771
University's covered-employee payroll	$707,387
University's proportionate share of the collective total OPEB liability as a percentage of its covered-employee payroll	30.22%

1) There are no assets accumulating in a trust that meets the criteria in paragraph 4 of GASB Statement 75 related to this OPEB plan.
2) This is a 10-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 10 years of information is available.
3) The amounts reported for each fiscal year were determined as of the prior fiscal year-end.

THE UNIVERSITY OF TENNESSEE
Required Supplementary Information
Schedule of University of Tennessee's Proportionate Share of the Collective Total OPEB Liability
Closed Tennessee OPEB Plan
(dollar amount in thousands)

	2018
University's proportion of the collective total OPEB liability	0.0%
University's proportionate share of the collective total OPEB liability	$ -
Primary government's proportionate share of the collective total OPEB liability	$ 31,316
Total OPEB liability associated with the university	$ 31,316
University's covered-employee payroll	$800,789
University's proportionate share of the collective total OPEB liability as a percentage of its covered-employee payroll	0.0%

1) There are no assets accumulating in a trust that meets the criteria in paragraph 4 of GASB Statement 75 related to this OPEB plan.

2) This is a 10-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 10 years of information is available.

3) The amounts reported for each fiscal year were determined as of the prior fiscal year-end.

THE UNIVERSITY OF TENNESSEE
Supplementary Combining Schedule of Net Position
June 30, 2018

	Knoxville	Chattanooga	Martin	Health Science Center	Other Units	Total University
Assets						
Current assets:						
Cash and cash equivalents	$ 167,684,672.98	$ 24,269,979.20	$ 13,002,620.33	$ 30,885,053.42	$ 169,740,971.38	$ 405,583,297.31
Investments	74,334,596.01	1,647,245.61	5,930,830.95	26,301,535.61	27,630,793.95	135,845,002.13
Accounts, notes, and grants receivable (net)	31,389,431.13	8,919,344.49	3,094,782.80	12,630,559.94	23,790,951.99	79,825,070.35
Inventories	4,987,786.80	77,861.90	525,630.66	1,162,058.73	206,968.30	6,960,306.39
Prepaid expenses	3,660,824.29	158,982.49	215,401.33	450,671.21	(78,286.37)	4,407,592.95
Total current assets	282,057,311.21	35,073,413.69	22,769,266.07	71,429,878.91	221,291,399.25	632,621,269.13
Noncurrent assets:						
Cash and cash equivalents	563,711,171.11	69,763,988.68	30,925,019.49	107,484,909.89	100,486,462.10	872,371,551.27
Investments	435,506,250.08	20,942,937.36	26,109,788.51	158,170,293.88	251,255,923.89	891,985,193.72
Accounts, notes, and grants receivable (net)	57,497,231.75	5,685,739.85	4,788,826.63	46,930,352.40	38,570,603.24	153,472,753.87
Capital assets (net)	1,963,905,497.69	302,797,694.79	135,326,493.13	289,620,895.01	44,539,585.78	2,736,190,166.40
Net pension asset	1,186,523.00	216,144.00	93,634.00	675,111.00	144,411.00	2,315,823.00
Total noncurrent assets	3,021,806,673.63	399,406,504.68	197,243,761.76	602,881,562.18	434,996,986.01	4,656,335,488.26
Total assets	3,303,863,984.84	434,479,918.37	220,013,027.83	674,311,441.09	656,288,385.26	5,288,956,757.39
Deferred outflows of resources						
Deferred amount on debt refunding	8,947,153.80	2,873,312.83	5,106,835.44	2,616,806.32	707,057.69	20,251,166.08
Deferred outflows related to pensions	60,495,421.70	9,988,100.97	6,241,144.84	25,270,598.50	18,107,872.99	120,103,139.00
Deferred outflows related to OPEB	7,031,941.00	1,283,088.00	863,001.00	3,702,449.00	1,284,894.00	14,165,373.00
Total deferred outflows of resources	76,474,516.50	14,144,501.80	12,210,981.28	31,589,853.82	20,099,824.68	154,519,678.08
Liabilities						
Current liabilities:						
Accounts payable	51,017,314.53	6,641,615.92	2,166,159.68	16,305,161.54	62,031,319.12	138,161,570.79
Accrued liabilities	27,252,329.93	5,950,036.44	3,807,418.81	3,123,428.46	23,737,781.97	63,870,995.61
Unearned revenue	50,609,220.39	8,169,372.49	1,958,040.39	7,694,994.57	159,662.00	68,591,289.84
Due to component unit	-	-	-	-	281,389.88	281,389.88
Deposits payable	1,022,403.11	1,556,273.18	376,511.49	541,914.78	130,793.33	3,627,895.89
Annuities and life income payable	-	-	-	-	3,331,110.43	3,331,110.43
Total other postemployment benefits obligation	7,031,941.00	1,283,088.00	863,001.00	3,702,449.00	1,284,894.00	14,165,373.00
Long-term liabilities, current portion	51,523,752.89	7,061,601.86	4,088,363.17	21,049,646.85	4,073,467.41	87,796,832.18
Deposits held in custody for others	5,205,528.29	62,041.05	18,044.36	205,066.87	1,875,252.37	7,365,932.94
Total current liabilities	193,662,490.14	30,724,028.94	13,277,538.90	52,622,662.07	96,905,670.51	387,192,390.56
Noncurrent liabilities:						
Unearned revenue	-	-	-	-	15,500,438.71	15,500,438.71
Net pension obligation	101,203,139.19	18,209,292.00	12,233,008.00	46,734,527.00	51,910,833.81	230,290,800.00
Total other postemployment benefits obligation	99,099,437.00	18,073,866.00	12,159,579.00	52,149,805.00	18,123,071.00	199,605,758.00
Long-term liabilities, noncurrent portion	806,123,779.63	115,826,356.88	67,833,765.90	86,908,602.07	13,291,087.34	1,089,983,591.82
Due to grantors	10,378,665.97	1,430,575.00	2,043,529.46	6,578,018.53	-	20,430,788.96
Annuities and life income payable	-	-	-	-	16,517,716.00	16,517,716.00
Deposits held in custody for component units	-	-	-	-	311,125,397.49	311,125,397.49
Total noncurrent liabilities	1,016,805,021.79	153,540,089.88	94,269,882.36	192,370,952.60	426,468,544.35	1,883,454,490.98
Total liabilities	1,210,467,511.93	184,264,118.82	107,547,421.26	244,993,614.67	523,374,214.86	2,270,646,881.54
Deferred inflows of resources						
Deferred inflows related to pensions	3,224,585.86	1,287,734.00	862,489.00	2,436,930.00	1,803,121.14	9,614,860.00
Deferred inflows related to OPEB	4,043,998.00	762,306.00	503,549.00	2,210,522.00	694,125.00	8,214,500.00
Deferred inflows related to split-interest agreements	-	-	-	-	29,861,912.30	29,861,912.30
Total deferred inflows of resources	7,268,583.86	2,050,040.00	1,366,038.00	4,647,452.00	32,359,158.44	47,691,272.30
Net position						
Net investment in capital assets	1,152,301,643.39	188,886,128.09	71,628,186.62	212,004,862.03	44,539,585.28	1,669,360,405.41
Restricted for:						
Nonexpendable (permanent endowments)	339,986,756.86	18,134,974.27	20,472,011.91	130,307,407.22	4,276,388.86	513,177,539.12
Expendable for other	252,949,699.46	9,101,672.69	15,354,358.75	188,111,273.29	36,192,143.87	501,709,148.06
Expendable for pensions	1,186,523.00	216,144.00	93,634.00	675,111.00	144,411.00	2,315,823.00
Expendable for loans	2,457,260.98	1,089,438.09	740,971.19	2,022,682.38	-	6,310,352.64
Expendable for capital projects	11,805,274.26	16,712.45	223,773.46	134,870.65	2,359.07	12,182,989.89
Expendable for debt service	1,095,301.30	-	167,674.57	-	-	1,262,975.87
Unrestricted	400,819,946.30	44,865,191.76	14,629,939.35	(76,995,978.33)	35,499,948.56	418,819,047.64
Total net position	$ 2,162,602,405.55	$ 262,310,261.35	$ 123,310,549.85	$ 456,260,228.24	$ 120,654,836.64	$ 3,125,138,281.63

THE UNIVERSITY OF TENNESSEE
Supplementary Combining Schedule of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2018

	Knoxville	Chattanooga	Martin	Health Science Center	Other Units	Total University
Revenues						
Operating revenues:						
Gross tuition and fees	$ 469,976,850.13	$ 113,557,113.91	$ 59,353,000.37	$ 89,199,151.48	$103,680.50	$ 732,189,796.39
Less: tuition discount and allowances	(146,078,154.12)	(47,346,970.47)	(29,152,545.05)	(8,180,637.00)	-	(230,758,306.64)
Net student tuition and fees	323,898,696.01	66,210,143.44	30,200,455.32	81,018,514.48	103,680.50	501,431,489.75
Federal appropriations	14,443,173.46	-	-	-	-	14,443,173.46
Governmental grants and contracts	170,870,408.08	5,625,035.05	4,008,172.65	84,567,385.95	7,339,553.91	272,410,555.64
Nongovernmental grants and contracts	49,291,004.97	1,264,650.96	1,409,663.55	109,248,736.67	44,710,488.40	205,924,544.55
Sales and services of educational departments and other activities	32,492,552.71	5,059,738.44	4,041,214.26	25,950,718.86	-	67,544,224.27
Auxiliary enterprises:						
Residential life	49,084,910.77	10,146,038.32	6,920,409.11	600.00	-	66,151,958.20
Food services	9,095,548.57	1,077,495.92	434,239.29	80,237.64	-	10,687,521.42
Bookstore	20,661,881.45	710,979.56	499,792.68	-	-	21,872,653.69
Parking	7,646,261.07	2,767,204.43	581,037.97	1,337,749.18	-	12,332,252.65
Athletics	141,288,966.78	434,940.89	-	-	-	141,723,907.67
Other auxiliaries	2,329,696.41	298,508.71	34,985.89	287,530.36	-	2,950,721.37
Interest earned on loans to students	14,958.38	6.00	-	3,513.64	-	18,478.02
Other operating revenues	13,472,160.65	337,584.57	844,777.87	902,450.11	6,602,436.60	22,159,409.80
Total operating revenues	834,590,219.31	93,932,326.29	48,974,748.59	303,397,436.89	58,756,159.41	1,339,650,890.49
Expenses						
Operating expenses:						
Salaries and wages	583,136,612.78	90,872,578.61	52,059,665.71	315,891,072.74	71,389,026.49	1,113,348,956.33
Benefits	209,729,937.95	32,928,708.16	19,836,689.89	91,846,432.39	25,539,373.93	379,881,142.32
Utilities, supplies, and other services	295,487,650.58	45,681,467.00	29,682,845.84	146,615,851.32	13,988,449.80	531,456,264.54
Scholarships and fellowships	40,429,206.57	9,459,546.66	9,868,228.68	4,558,930.62	123,157.00	64,439,069.53
Depreciation and amortization expense	82,755,939.87	9,827,354.37	6,798,498.23	21,319,999.95	2,947,300.48	123,649,092.90
Total operating expenses	1,211,539,347.75	188,769,654.80	118,245,928.35	580,232,287.02	113,987,307.70	2,212,774,525.62
Operating income (loss)	(376,949,128.44)	(94,837,328.51)	(69,271,179.76)	(276,834,850.13)	(55,231,148.29)	(873,123,635.13)
Nonoperating revenues (expenses)						
State and local appropriations	332,462,337.69	52,706,390.00	33,644,813.00	156,363,318.96	24,310,820.61	599,487,680.26
Gifts	10,945,445.58	1,389,125.50	1,985,300.15	28,780,642.86	2,244,013.08	45,344,527.17
Grants and contracts	88,634,832.06	39,869,591.20	26,736,391.42	64,555,528.71	-	219,796,343.39
Investment income	31,379,748.42	4,612,495.15	2,507,827.01	12,559,609.82	12,520,975.32	63,580,655.72
Interest on capital asset - related debt	(29,484,007.45)	(4,865,782.07)	(2,656,230.98)	(2,892,697.75)	(357,449.78)	(40,256,168.03)
Other nonoperating revenues (expenses)	(3,073,451.94)	(176,353.44)	(190,273.16)	(2,363,940.03)	(48,060.16)	(5,852,078.73)
Net nonoperating revenues (expenses)	430,864,904.36	93,535,466.34	62,027,827.44	257,002,462.57	38,670,299.07	882,100,959.78
Income (loss) before other revenues, expenses, gains, or losses	53,915,775.92	(1,301,862.17)	(7,243,352.32)	(19,832,387.56)	(16,560,849.22)	8,977,324.65
Capital appropriations	53,253,070.12	11,676,972.60	4,897,126.19	16,418,445.31	1,401,853.46	87,647,467.68
Capital grants and gifts	19,282,102.76	136,753.86	200,187.47	-	-	19,619,044.09
Additions to permanent endowments	8,876,019.36	2,869,060.31	419,641.72	970,964.63	45,181.95	13,180,867.97
Other	(17,937.96)	6,500.00	108,873.69	203,778.97	3,146,947.08	3,448,161.78
Total other revenues	81,393,254.28	14,689,286.77	5,625,829.07	17,593,188.91	4,593,982.49	123,895,541.52
Increase (decrease) in net position	135,309,030.20	13,387,424.60	(1,617,523.25)	(2,239,198.65)	(11,966,866.73)	132,872,866.17
Net position						
Net position - beginning of year	2,074,555,941.11	257,551,007.13	130,729,711.81	483,398,614.38	166,980,331.17	3,113,215,605.60
Cumulative effect of a change in accounting principle for GASB 75	(47,262,565.76)	(8,628,170.38)	(5,801,638.71)	(24,899,187.49)	(8,627,903.40)	(95,219,465.74)
Cumulative effect of a change in accounting principle for GASB 81	-	-	-	-	(25,730,724.40)	(25,730,724.40)
Net position - beginning of year, restated	2,027,293,375.35	248,922,836.75	124,928,073.10	458,499,426.89	132,621,703.37	2,992,265,415.46
Net position - end of year	$ 2,162,602,405.55	$ 262,310,261.35	$ 123,310,549.85	$ 456,260,228.24	$ 120,654,836.64	$ 3,125,138,281.63

THE UNIVERSITY OF TENNESSEE
Supplementary Schedule of Unrestricted Net Position
June 30, 2018

Working capital	$	29,104,516.00
Revolving funds		24,571,945.17
Encumbrances		3,436,957.48
Auxiliaries		10,324,634.68
Unallocated Educational & General		56,306,803.85
Reappropriations		11,890,693.33
Quasi-endowments		14,107,006.45
Plant construction		138,317,754.57
Renewal and replacement funds		513,791,711.09
Debt service		45,609,602.88
		847,461,625.50
Investment in plant, interest payable		(8,381,080.19)
Undesignated deficit		(420,261,497.67)
Total	$	418,819,047.64

Unrestricted net position includes funds that have been designated for specific purposes.

Justin P. Wilson
Comptroller

Jason E. Mumpower
Chief of Staff

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
Mr. Randy Boyd, Interim 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, 2018, 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 21, 2018. 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

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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 in internal control 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 three areas, including one area that was reported in the prior year audit.

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 certain immaterial instances 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
Division of State Audit
December 21, 2018

Findings and Recommendations

1. <u>The University of Tennessee did not provide adequate internal controls in three areas, including one area that was reported in the prior-year audit</u>

<u>Finding</u>

The university did not design and monitor effective internal controls in three areas. We observed two conditions at the Knoxville campus that were in violation of university or campus policies or industry-accepted best practices. We also observed one system-wide condition that affected both the Knoxville campus and Martin campus, where management implemented controls that were not sufficient. The control deficiency at the Martin campus was repeated from the prior-year audit.

Ineffective implementation of internal controls increases the likelihood of errors, data loss, and unauthorized access to college information. 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 the related criteria, causes, and our specific recommendations for improvement.

<u>Recommendation</u>

Management should ensure that these conditions are corrected by promptly developing and consistently implementing internal controls in these areas. 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 this finding, and we are implementing the recommendations.

2. <u>Principal investigators at the University of Tennessee at Knoxville 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 $669.68</u>

<u>Condition</u>

The university requested and received reimbursement for unallowable costs at the time of payment. We tested 108 randomly selected transactions charged to federal research and development grants and contracts for the period July 1, 2017, through April 30, 2018. We found that 5 of the 108 transactions (4.6%) were unallowable. These unallowable costs were (1) a Guava easyCyte System purchased without obtaining prior approval from the grantor, (2) two Dell computers charged as direct costs without justification being included in the grant proposal, (3) sales taxes charged for purchase of supplies, and (4) payments made to a subrecipient for a subaward with the University of Kentucky without obtaining prior approval from the agency for the subaward.

The Guava easyCyte System was purchased under grant number R00DK100736 for $26,300.00 at the University of Tennessee at Knoxville. A Dell computer was charged to grant number R01MH059839 at a cost of $4,386.70 plus facilities and administrative charges of $1,688.88 at the University of Tennessee Health Science Center. Another Dell computer was charged to Cooperative Agreement 1041877 at a cost of $2,561.00 plus facilities and administrative charges of $1,254.89 at the University of Tennessee at Knoxville. Sales tax was paid under grant number R01AR064354 on a purchase of supplies in the amount of $446.45 plus facilities and administrative costs of $223.23 at the University of Tennessee Health Science Center. Subrecipient payments were made to the University of Kentucky under contract number W81XWH-15-1-0023 in the amount of $109,488.69 with associated facilities and administrative costs of $12,500.00 at the University of Tennessee Health Science Center.

None of these costs were questioned with the exception of the $446.45 of sales tax and associated facilities and administrative costs of $223.23, as the university was able to obtain retroactive approval of these costs from the grantor or in the case of the Dell computers, statements from the principal investigators that the computers were essential to the project. However, likely questioned costs related to this condition, exceed $25,000.

Criteria

Equipment

According to Title 2, *Code of Federal Regulations* (CFR), Part 200, Section 439,

> Capital expenditures for special purpose equipment are allowable as direct costs, provided that items with a unit cost of $5,000 or more have the prior written approval of the Federal awarding agency or pass-through entity.

General Purpose Computer Supplies

According to 2 CFR 200.453,

> 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.

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. . . ." No justification or approval was obtained by the appropriate office prior to the purchases. Thus, there was no documentation prior to purchase that the cost of the computers were essential and allocable to the project.

Sales tax

According to 2 CFR 200.470,

> Taxes that a governmental unit is legally required to pay are allowable.

University policy states, “The university is exempt from federal excise taxes, state sales tax on tangible personal property, and other state taxes. Procurement should ensure that this is communicated to the vendor and if applicable, a copy of the university’s tax exemption certificate should be provided at the time of purchase to ensure that tax is not charged.” Sales tax was paid on supplies purchased under the federal award despite the university being exempt. Therefore, this cost is considered unallowable.

Subcontract

According to the terms and conditions for contract number W81XWH-15-1-0023,

> Recipients shall request prior written approval from the USAMRAA Grants Officer for the subaward, transfer, or contracting out of any work not approved under the original award.

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

University of Tennessee, Knoxville (UTK)

The University of Tennessee, Knoxville (UTK) concurs that a Dell computer was purchased on a federal award without the prior approval required by the university's fiscal policy. We also concur that a piece of equipment was purchased on a federal award without the prior approval from the awarding agency as required by 2 CFR 200.439. UTK disagrees with the classification of these purchases as unallowable. UTK obtained after the fact approval from the sponsor for the equipment purchase and per the Expanded Authority Approval process for the purchase of the Dell computer.

University of Tennessee Health Science Center (UTHSC)

UTHSC concurs that a Dell computer was purchased on a federal award without the prior approval required by the university's fiscal policy. The department purchased a replacement computer, which was integral to the project. The department has provided an acceptable justification relating to the purchase.

UTHSC also concurs that payment was made on a subaward prior to receiving formal approval from the federal agency. This is a CDMRP funded subaward issued by UTHSC to St. Jude. When the St. Jude PI transferred to the University of Kentucky, we informed both the CDMRP program officer and the grants management specialist that we needed permission to issue a subaward to the University of Kentucky. Although there were initial conversations and requests for follow-up to the CDMRP subsequent to the initial request, we were not given official permission to issue the subaward to the University of Kentucky prior to UTHSC being reimbursed for the expenditures on the subaward by the CDMRP.

UTHSC also concurs that sales tax was paid on a purchase of supplies.

3. **Office of Sponsored Programs personnel at the University of Tennessee at Knoxville and the University of Tennessee Health Science Center and Research staff at the University of Tennessee Space Institute did not always ensure that subrecipient contracts included information required per federal regulations**

Condition

We tested 40 randomly selected subrecipient agreements for research and development grants at the University of Tennessee. All required information was not included in six of the agreements. In two of the agreements, one at Knoxville and one at the Health Science Center, the subrecipient's unique entity identifier was not included. In two of the agreements, both at the Health Science Center, there was no requirement that the subrecipient permit the pass-through entity (the university) and auditors to have access to subrecipient records and financial statements. In two of the agreements, one at Knoxville and one at the University of Tennessee Space Institute, there was no requirement that the subrecipient permit auditors to have access to subrecipient records and financial statements. The requirement that the university would have access was included.

Criteria

The *Code of Federal Regulations*, Title 2, Part 200, Subpart D, paragraph 200.331(a), stated that the subaward must include the "subrecipient's unique entity identifier" and "a requirement that the subrecipient permit the pass-through entity and auditors to have access to the subrecipient's records and financial statements as necessary for the pass-through entity to meet the requirements of this part…."

Cause

Per university files, the Offices of Sponsored Programs had obtained the subrecipients' DUNS numbers (considered the unique entity identifier) prior to award and saw no reason to include it in the subaward agreement. The other requirement as to auditor and pass-through entity access to subrecipient records was excluded due to oversight.

Effect

Without the inclusion of the subrecipient's identifying number in the written subaward, there is no written representation by the subrecipient as to its correct identifying number, and this is required by federal regulations. Without guaranteed access to subrecipient financial records, the university and impacted auditors cannot perform their required monitoring and audit functions.

Recommendation

The Offices of Sponsored Programs at Knoxville and the Health Science Center and Research staff at the UT Space Institute should ensure that all subawards contain the above information, as required in the *Code of Federal Regulations*.

Management's Comment

University of Tennessee, Knoxville (UTK)

The University of Tennessee, Knoxville (UTK) concurs that the subaward agreement to Rutgers, Attachment 3B was not included in the UT copy which contained the DUNS number for Rutgers. We agree that a complete copy should have been filed in the university system. We have updated the copy in the UT records to include this completed attachment.

UTK does not concur that the subaward agreements to Texas A&M Engineering (UTSI) and Resources for the Future (Knoxville) did not ensure that subrecipient contracts included information required per federal regulations. The subaward agreements were created using the Federal Demonstration Partnership (FDP) form available at the time. The FDP, which includes ten federal agencies, is a cooperative initiative program whose purpose is to reduce administrative burdens associated with research grants and contracts. As part of their effort to reduce administrative burden, the FDP created subaward template forms used by over 400 universities.

FDP did not have an updated form on the website when the subaward was issued since they were making changes to all of their forms to reflect *Uniform Guidance*. The FDP subaward form version available at the time of the subaward referenced "OMB Circular A-133," which provided records access for the Prime Recipient (which we consider to include auditors working on our behalf as our authorized representatives) to audit information of our subrecipient. Additionally, Uniform Guidance incorporated A-133 as one of the circulars incorporated into the overall CFR document. The rights to audit remain the same as what A-133 allowed even though the Uniform Guidance used different phrasing. The 200.336 section of *Uniform Guidance* requires access of the records of non-federal entities to the Federal agency, Inspector General, the Comptroller General of the United States, and the pass-through entity or any of their authorized representatives.

University of Tennessee Health Science Center (UTHSC)

UTHSC concurs that the standard subcontract agreements contain the appropriate language to include the DUNS number in a standard attachment, but the attachment was not included in the final uploaded subaward.

UTHSC also concurs that the clause regarding access to subrecipient records was not included in two subawards.

The Offices of Sponsored Programs at Knoxville and the Health Science Center and Research staff at the UT Space Institute will add a review step to be sure that all subawards contain all required numbers and records access, as required in the *Code of Federal Regulations*.

Auditor's Comment

As to the use of Federal Demonstration Partnership (FDP) templates, the FDP website states, "the FDP makes no representation or warranties regarding the suitability of these templates for use on any federal or non-federal sponsored projects. The pass-through entity (PTE) is responsible for ensuring all required terms and conditions flow down to a subrecipient. All users utilize these templates at their own risk." The university is correct that this was a time of transition, in that this was just after the *Uniform Guidance* was effective. However, at this time, the CFR cite referenced above was in effect. The subrecipient agreements in question should have included a requirement that the subrecipient permit auditors to have access to subrecipient records and financial statements.