# Report of The Treasurer 2009

THE UNIVERSITY of TENNESSEE

KNOXVILLE, CHATTANOOGA, MARTIN, TULLAHOMA, MEMPHIS


THE UNIVERSITY OF TENNESSEE KNOXVILLE
1794
AGRICULTURE
COMMERCE

# Brief History of the University of Tennessee

The University of Tennessee is one of the nation's oldest institutions of higher education, in operation since 1794. Two years before Tennessee achieved statehood in 1796, the legislature of the Southwest Territory—which later became Tennessee—granted a charter to Blount College, named in honor of the territorial governor, William Blount. Located in Knoxville near today's downtown area, Blount College was nonsectarian, which was unusual for an institution of higher education at that time. The university has remained nondenominational and is believed to be the oldest such institution west of the Appalachian Divide. Blount College was all male, typical for colleges of the late 18th century, a restriction that remained in force for almost a century until the first women students were admitted in 1892.

In 1807 the state legislature changed the name of Blount College to East Tennessee College, and in 1826 the 40-acre tract known as "the Hill" became part of its campus. The name of the school changed again in 1840 to East Tennessee University. But 21 years later, the Civil War forced the university to close, and its buildings were used as a hospital for Confederate troops, then later occupied by Union soldiers.

When the war ended, East Tennessee University reopened, and in 1869 the state legislature selected the university as the state's federal land-grant institution under the Morrill Act of 1862. To comply with the terms of the act, ETU broadened its offerings to include agricultural, engineering, and military science courses.

Ten years later, East Tennessee University was chosen by the legislature to be the state university of Tennessee, and its name was changed to the University of Tennessee. The university pledged itself to the service and interest of the entire state, and the state pledged its name and reputation to the university, promising the institution a vital role in the progress of the state.

Today, the university serves the people of Tennessee from locations across the state. The medical campus, founded in Nashville and acquired by the university in 1879, was moved to Memphis in 1911. The Martin campus, established in 1900 as a private institution, became part of the University of Tennessee in 1927. In 1969 the private University of Chattanooga merged with the public university to become its fourth primary campus. The University of Tennessee Space Institute, a graduate education and research center near Tullahoma, was established in 1964.

Three statewide units of the university—the Institute of Agriculture, the Institute for Public Service, and the Division of Continuing Education—extend the university beyond its various campuses to serve the entire state.

The administration of the university is headquartered in Knoxville, where the offices of the president and the central staff are located. A chancellor directs each primary campus.

Traditionally, Tennessee's governors and members of the state legislature have shown active interest in the development of the University of Tennessee by providing the support it needs to meet the increasing educational, research, and service needs of the people of Tennessee. As a result, many university programs have earned both national and global recognition.

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# Letter from the Treasurer

The financial statements on the following pages have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board. The management of the University of Tennessee is responsible for the integrity and objectivity of these financial statements.

Management believes that the university's highly developed system of internal accounting controls provides reasonable assurance that assets are protected and that transactions and events are properly recorded. Establishing sound fiscal policies and procedures and communicating them clearly, carefully selecting qualified financial staff, and implementing an extensive program of internal audits and management reviews ensure that the system of internal controls is maintained.

The financial statements herein have been audited by the State of Tennessee, Comptroller of the Treasury, Division of State Audit. The auditor's opinion is based on audit procedures described in their letter on page 3, which include understanding university systems, procedures, and internal controls and performing tests and other auditing procedures sufficient to provide reasonable assurance that the financial statements are not materially misleading nor do they contain material errors.

The statements contained in this report describe the university's overall financial condition and the financial performance for the year ended June 30, 2009. A separate publication, "Report of the Treasurer 2009 Supplemental Schedules and Appendices," contains detailed supporting schedules and appendices and is available for those who wish to make a more extensive analysis of university operations. The supporting schedules and appendices are designed to enable analysis of important items summarized or consolidated in the financial statements of this report.

Respectfully submitted,

Charles M. Peccolo

*Vice President and Treasurer*

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
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**Independent Auditor's Report**

December 23, 2009

The Honorable Phil Bredesen, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Mr. James E. Hall, Chairman
Audit Committee of the Board of Trustees
The University of Tennessee
Knoxville, Tennessee 37996-0180
and
Dr. Jan Simek, Interim President
The University of Tennessee
800 Andy Holt Tower
Knoxville, Tennessee 37996-0180

Ladies and Gentlemen:

We have audited the accompanying basic financial statements of the University of Tennessee, which is a component unit of the State of Tennessee, as of and for the year ended June 30, 2009, as listed in the table of contents. These financial statements are the responsibility of the university's management. 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., and the University of Tennessee Foundation, Inc., discretely presented component units of the university. Those financial statements were audited by other auditors whose reports thereon have been furnished to us, and our opinion, insofar as it relates to the amounts included for the University of Chattanooga Foundation, Inc., and the University of Tennessee Foundation, Inc., is based 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 generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the reports of the other auditors provide a reasonable basis for our 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, 2009, and the respective changes in financial position and cash flows thereof for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As explained in Note 2, the financial statements include investments valued at $231,007,083.78 (11.2 percent of net assets), 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.

The management's discussion and analysis and the OPEB schedule of funding progress are not a required part of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audit was conducted for the purpose of forming opinions on the basic financial statements. The schedules and charts presented outside of the basic financial statements are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

In accordance with generally accepted government auditing standards, we have also issued our report dated December 23, 2009, on our consideration of the university's internal control over financial reporting and 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 generally accepted government auditing standards and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes Jr., CPA
Director

AAH/sds

# Management's Discussion and Analysis

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 fiscal year ended June 30, 2009, with comparative information presented for the fiscal year ended June 30, 2008. 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 audited financial statements and the accompanying notes. The financial statements, notes, and this discussion are the responsibility of management.

The university has two discretely presented component units, the University of Chattanooga Foundation and the University of Tennessee Foundation. More detailed information about the university's component units is presented in Notes 22 and 23 of the financial statements. Information and analysis regarding the component units is also included in this section.

## Using This Annual Report

This report consists of three basic financial statements. The statement of net assets; the statement of revenues, expenses, and changes in net assets; and the statement of cash flows provide information on the University of Tennessee as a whole and present a long-term view of the university's finances.

### THE STATEMENT OF NET ASSETS

The statement of net assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the university. Assets and liabilities are generally measured using current values. Capital assets, however, are stated at historical cost less an allowance for depreciation.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the university's equity in property, plant, and equipment owned by the university. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are 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 assets. The final category is unrestricted net assets. Unrestricted net assets are available to the university for any lawful purpose of the institution.

The university had the following significant changes between fiscal years on the statement of net assets:

Current assets decreased between fiscal years due to a decrease in investments. Investments decreased due to losses in the capital markets and moving investment assets to certificates of deposit (cash equivalents) and the university's cash management pool.

Other assets (noncurrent assets) increased between fiscal years due to increases in cash and cash equivalents and accounts, notes, and

**Table 1. Condensed Statements of Net Assets** ($thousands)

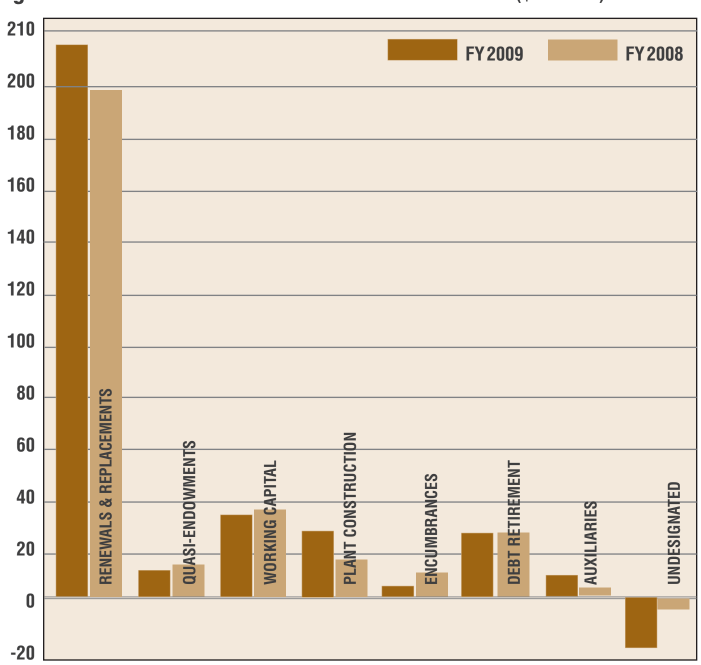
| | UT | | UC Foundation | | UT Foundation | |
|---|---|---|---|---|---|---|
| | 2009 | 2008 | 2009 | 2008 | 2009 | 2008 |
| **ASSETS:** | | | | | | |
| Current assets | $ 462,470 | $ 462,504 | $ 11,220 | $ 8,978 | $ 5,829 | $ 5,072 |
| Capital assets, net | 1,494,048 | 1,335,610 | 67,028 | 69,160 | — | — |
| Other assets | 1,058,832 | 1,144,091 | 89,563 | 118,351 | 89,393 | 88,163 |
| **TOTAL ASSETS** | 3,015,350 | 2,942,205 | 167,811 | 196,489 | 95,222 | 93,235 |
| **LIABILITIES:** | | | | | | |
| Current liabilities | 318,246 | 282,804 | 11,398 | 9,924 | 600 | 1,764 |
| Noncurrent liabilities | 638,424 | 574,383 | 83,568 | 85,044 | 648 | 553 |
| **TOTAL LIABILITIES** | 956,670 | 857,187 | 94,966 | 94,968 | 1,248 | 2,317 |
| **NET ASSETS:** | | | | | | |
| Invested in capital assets, net of related debt | 970,344 | 868,014 | — | — | — | — |
| Restricted—nonexpendable | 392,063 | 391,038 | 36,194 | 46,469 | 22,014 | 15,408 |
| Restricted—expendable | 402,260 | 541,916 | 10,924 | 8,342 | 74,730 | 74,315 |
| Unrestricted | 294,013 | 284,050 | 25,727 | 46,710 | (2,770) | 1,195 |
| **TOTAL NET ASSETS** | $ 2,058,680 | $ 2,085,018 | $ 72,845 | $ 101,521 | $ 93,974 | $ 90,918 |

grants receivable. Cash and cash equivalents increased due to a changing investment mix to adjust to activity in the capital markets. Accounts, notes, and grants receivable increased due to invoices for state capital outlay and maintenance and TSSBA debt proceeds.

The increase in net capital assets between fiscal years is a result of additions to the university's capital assets. More detailed information about the university's capital assets is presented in the Capital Assets and Debt Administration section of this report.

Noncurrent liabilities increased between fiscal years due to the issuance of bonds and/or commercial paper by the Tennessee State School Bond Authority on behalf of the university for various capital projects. More detailed information about the university's debt is presented in the Capital Assets and Debt Administration section of this report.

**Figure A. Allocations of Unrestricted Net Assets** ($millions)




The restricted-expendable net assets decreased between fiscal years as a result of the use of accumulated private dollars on scholarships and fellowships, instructional department uses, and capital projects. These funds were received in prior years and were spent in the current year.

Many of the university's unrestricted net assets have been designated or reserved for specific purposes such as repairs and replacement of capital assets, future debt service, quasi-endowments, and capital projects. Figure A (at left) shows the allocations:

Renewals and replacements increased from 2008 to 2009 due to unspent educational and general dollars with the expectation that fiscal year 2010 would be leaner.

The undesignated amount decreased from 2008 to 2009 due to an increase of approximately $19 million in the university's net OPEB obligation.

## THE STATEMENT OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS

The statement of revenues, expenses, and changes in net assets presents the operating results of the university, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered nonoperating revenues according to accounting principles generally accepted in the United States of America.

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

Net tuition and fees increased from 2008 to 2009 as a result of a 6-percent fee increase. However, this increase in tuition and fee revenue was partially offset by current and new

**Table 2. Condensed Statements of Revenues, Expenses, and Changes in Net Assets** ($thousands)

| | UT | | UC Foundation | | UT Foundation | |
|---|---|---|---|---|---|---|
| | **2009** | **2008** | **2009** | **2008** | **2009** | **2008** |
| **OPERATING REVENUES:** | | | | | | |
| Net tuition and fees | $ 255,578 | $ 239,567 | $ — | $ — | $ — | $ — |
| Grants and contracts | 397,348 | 377,475 | — | — | — | — |
| Auxiliary | 165,519 | 157,543 | — | — | — | — |
| Other | 83,868 | 88,881 | 22,454 | 14,841 | 8,287 | 31,243 |
| **TOTAL OPERATING REVENUES** | 902,313 | 863,466 | 22,454 | 14,841 | 8,287 | 31,243 |
| Operating expenses | 1,618,580 | 1,587,279 | 15,768 | 11,620 | 8,314 | 15,173 |
| **OPERATING INCOME (LOSS)** | (716,267) | (723,813) | 6,686 | 3,221 | (27) | 16,070 |
| **NONOPERATING REVENUES AND EXPENSES:** | | | | | | |
| State and local appropriations | 503,758 | 539,634 | — | — | — | — |
| Gifts | 27,439 | 21,108 | 119 | — | — | — |
| Investment income | (106,018) | 17,528 | (31,338) | (6,653) | (4,000) | 208 |
| Other revenues and expenses | 120,769 | 104,933 | (4,644) | (5,659) | — | 6,520 |
| **TOTAL NONOPERATING REVENUES AND EXPENSES** | 545,948 | 683,203 | (35,863) | (12,312) | (4,000) | 6,728 |
| **INCOME (LOSS) BEFORE OTHER REVENUES, EXPENSES, GAINS, OR LOSSES** | (170,319) | (40,610) | (29,177) | (9,091) | (4,027) | 22,798 |
| **OTHER REVENUES, EXPENSES, GAINS, OR LOSSES:** | | | | | | |
| Capital appropriations | 105,300 | 69,592 | — | — | — | — |
| Capital grants and gifts | 28,156 | 41,044 | — | — | — | — |
| Additions to permanent endowments | 9,813 | 17,812 | 501 | 766 | 7,083 | 6,628 |
| Other | 712 | 8,772 | — | — | — | — |
| **TOTAL OTHER REVENUES, EXPENSES, GAINS, OR LOSSES** | 143,981 | 137,220 | 501 | 766 | 7,083 | 6,628 |
| **INCREASE (DECREASE) IN NET ASSETS** | (26,338) | 96,610 | (28,676) | (8,325) | 3,056 | 29,426 |
| **NET ASSETS AT BEGINNING OF YEAR** | 2,085,018 | 1,988,408 | 101,521 | 109,846 | 90,918 | 61,492 |
| **NET ASSETS AT END OF YEAR** | $ 2,058,680 | $ 2,085,018 | $ 72,845 | $ 101,521 | $ 93,974 | $ 90,918 |

students receiving funds from the Tennessee Education Lottery Scholarship Program which reduces tuition and fees and is shown as grants and contracts revenue.

Operating grants and contracts increased by $27 million from 2008 to 2009 primarily due to the National Science Foundation super computer grant at Knoxville.

Auxiliary revenues increased $7.9 million, primarily in residence halls with the addition of Volunteer Hall and Laurel Apartments in Knoxville.

In fiscal year 2009, state appropriations and local appropriations decreased $36 million which represented a 7.6 percent reduction in state appropriations due to lagging state wide sales tax collections.

Nonoperating gifts increased $6 million from 2008 to 2009, while capital gifts decreased $13 million for the same time period.

The decrease in investment income was due to a decline in the capital markets.

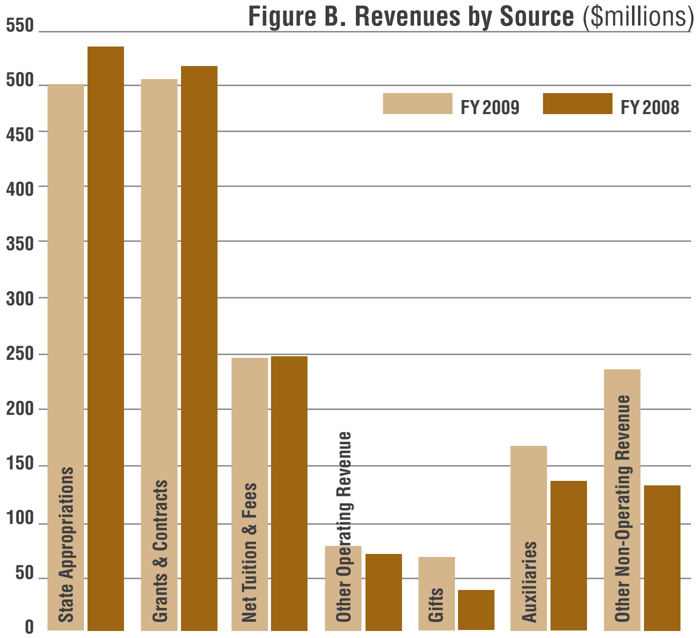
The increase in capital appropriations for 2009 consisted primarily of the one time payment from the state to build the demonstration biofuels facility.

Additions to permanent endowments decreased $8 million from 2008 to the 2009 fiscal year.

## REVENUES

The following figure is a graphic illustration of revenues by source (both operating and nonoperating), which were used to fund the university's activities for the years ended June 30, 2009, and June 30, 2008.

For the year ended June 30, 2009, approximately eighty percent of UT's revenue was attributed to state and local appropriations, grants and contracts, and tuition and fees.




## EXPENSES

Operating expenses can be displayed in two formats, natural classification and functional classification. Both formats are displayed below in Table 3.

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

The increase in salary expenses from 2008 to 2009 is due to the buyout of coach's contracts and the hiring of a new football staff as well as an increase in faculty and graduate assistants.

Employee benefit expenses decreased slightly between fiscal years mainly as a result of hiring more part-time employees and the retirement and replacing of older employees who typically have higher benefit costs.

Operating expenses increased between fiscal years due to increases in utility costs, maintenance, student awards, and equipment purchases.

Scholarship expenses increased slightly between fiscal years.

**Table 3. Expenses by Natural and Functional Classifications** ($thousands)

| | 2009 NATURAL CLASSIFICATION | | | | | |
|---|---|---|---|---|---|---|
| **2009 FUNCTIONAL CLASSIFICATION** | SALARIES | BENEFITS | UTILITIES, SUPPLIES, AND OTHER SERVICES | SCHOLARSHIPS | DEPRECIATION | TOTAL |
| Instruction | $ 363,898 | $ 106,524 | $ 56,851 | $ — | $ — | $ 527,273 |
| Research | 112,906 | 31,812 | 61,597 | — | — | 206,315 |
| Public service | 71,506 | 27,105 | 32,326 | — | — | 130,937 |
| Academic support | 68,934 | 25,554 | 18,607 | — | — | 113,095 |
| Student services | 37,765 | 14,078 | 23,398 | — | — | 75,241 |
| Institutional support | 72,439 | 26,724 | — | — | — | 99,163 |
| Operation and maintenance of plant | 32,852 | 15,866 | 66,316 | — | — | 115,034 |
| Scholarships | 3,345 | 18,700 | 17,234 | 32,505 | — | 71,784 |
| Auxiliary | 44,437 | 12,130 | 64,723 | — | — | 121,290 |
| Independent operations | 53,699 | 20,981 | — | — | — | 74,680 |
| Depreciation | — | — | — | — | 83,768 | 83,768 |
| Total expenses | $ 861,781 | $ 299,474 | $ 341,052 | $ 32,505 | $ 83,768 | $ 1,618,580 |

| | 2008 NATURAL CLASSIFICATION | | | | | |
|---|---|---|---|---|---|---|
| **2008 FUNCTIONAL CLASSIFICATION** | SALARIES | BENEFITS | UTILITIES, SUPPLIES, AND OTHER SERVICES | SCHOLARSHIPS | DEPRECIATION | TOTAL |
| Instruction | $ 357,325 | $ 108,863 | $ 57,977 | $ — | $ — | $ 524,165 |
| Research | 113,900 | 32,390 | 57,826 | — | — | 204,116 |
| Public service | 69,811 | 26,592 | 37,295 | — | — | 133,698 |
| Academic support | 67,657 | 25,391 | 18,265 | — | — | 111,313 |
| Student services | 35,884 | 13,632 | 23,055 | — | — | 72,571 |
| Institutional support | 69,774 | 26,689 | 4,085 | — | — | 100,548 |
| Operation and maintenance of plant | 32,248 | 15,863 | 51,462 | — | — | 99,573 |
| Scholarships | 3,078 | 18,057 | 16,597 | 28,304 | — | 66,036 |
| Auxiliary | 36,789 | 11,708 | 72,877 | — | — | 121,374 |
| Independent operations | 57,726 | 23,598 | — | — | — | 81,324 |
| Depreciation | — | — | — | — | 72,561 | 72,561 |
| Total expenses | $ 844,192 | $ 302,783 | $ 339,439 | $ 28,304 | $ 72,561 | $ 1,587,279 |

Figure C. Operating Expenses by Natural Classification ($thousands)

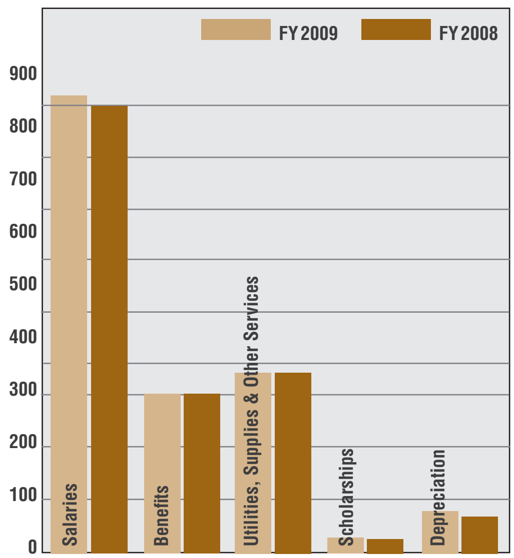
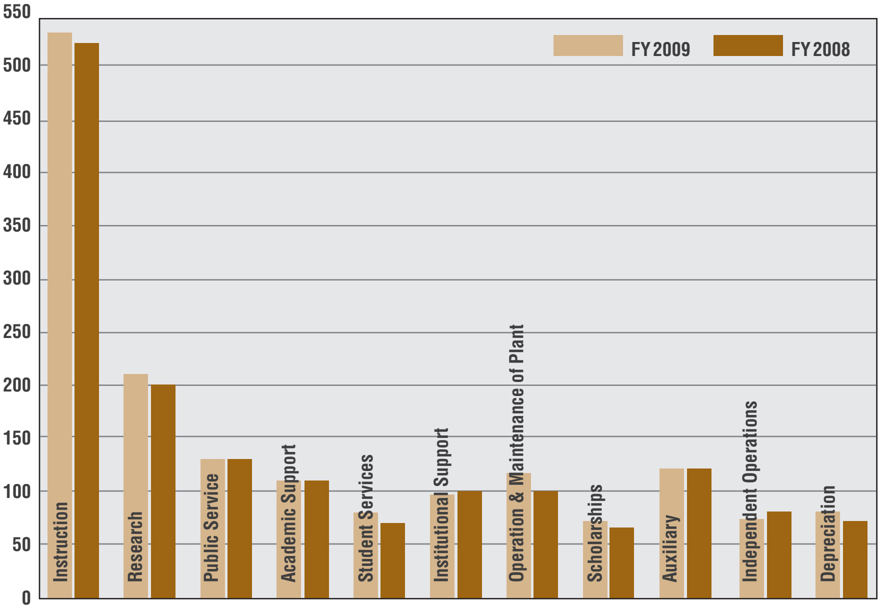



Figure D. Operating Expenses by Functional Classification ($thousands)




The increases in all functional areas were due to additional staff that were hired, pay supplements, and increased operating expenses.

## CAPITAL ASSETS AND DEBT ADMINISTRATION

### Capital Assets

At June 30, 2009, the University of Tennessee had $1,494,047,655.29 invested in capital assets, net of accumulated depreciation. Depreciation charges totaled $83,767,547.81 for the current fiscal year. Details of these assets are shown in Table 4 (below).

**Table 4. Schedule of Capital Assets, Net of Depreciation ($thousands)**

| | 2009 | 2008 |
|---|---|---|
| Land | $ 56,741 | $ 53,866 |
| Land improvements & infrastructure | 25,862 | 27,478 |
| Buildings | 981,313 | 815,018 |
| Works of art/historical treasures | 528 | 510 |
| Equipment | 147,527 | 112,323 |
| Software | 1,705 | 529 |
| Library holdings | 68,583 | 65,943 |
| Projects in progress | 211,789 | 259,942 |
| Total | $ 1,494,048 | $ 1,335,609 |

Major capital additions for UT during 2008-2009 include the $17.0 million Baker Center, the $10.5 million Clement Hall Renovation, the $39.8 million Haslam Building, the $20.5 million Laurel Apartments Renovation, and the $10.7 million Hess Hall Renovation in Knoxville; the $3.2 million Athletic Training Facility and $3.0 million Boiler Replacement at Chattanooga; the $28.0 million Student Housing—Phase II, the $3.3 million Business Administration Building Upgrade, and the $2.5 million Elam Center HVAC Improvements in Martin; and the $4.7 million Capital Equipment Replacement at Memphis.

For the next fiscal year, the state has approved no capital outlay appropriations and $4.6 million in capital maintenance appropriations for UT. These approved new projects are the UT Knoxville Electrical Distribution Systems Improvements—Phase II, UT Martin—Connection of Campus Chilled Water Loops, and the University-Wide Facilities Assessment. In addition, there are various construction and improvement projects at all campuses. More detailed information about the university's capital assets is presented in Note 5 to the financial statements.

### Debt

At June 30, 2009, the university had $518,267,035.38 in debt outstanding. Table 5 (below) summarizes these amounts by type of debt instrument.

**Table 5. Outstanding Debt Schedule ($thousands)**

| | 2009 | 2008 |
|---|---|---|
| Bonds—current portion | $ 24,635 | $ 17,551 |
| Bonds—noncurrent | 372,867 | 321,446 |
| Commercial paper—noncurrent | 120,742 | 122,968 |
| Total TSSBA authorized debt | $ 518,244 | $ 461,965 |
| Notes—current portion | 12 | 35 |
| Notes—noncurrent portion | 11 | — |
| Total debt | $ 518,267 | $ 462,000 |

The university retired more than $18.3 million in bonds and notes in fiscal year 2008-2009. The Tennessee State School Bond Authority (TSSBA), in addition to its authority to issue bonds and notes to finance capital projects, has the responsibility for approving all long-term debt of the university. TSSBA debt currently is rated AA by Standard & Poor. More detailed information about the university's long-term liabilities is presented in Note 7 to the financial statements.

The Tennessee State School Bond Authority issued two new bond series—2008B and 2009A in 2008-2009 in the net amount of $99.2 million for the benefit of the university. There are five projects included in the 2008B bond series: Hess Hall Renovation—$4.9 million and Laurel Apartments Renovation—$12.2 million at Knoxville; the Wellness Center— $20.6 million at Chattanooga; and the Electrical Power Generation Upgrade—$4.9 million and the New Student Housing at Martin. There are four projects included in the 2009A bonds: the Haslam (Glocker) Technology— $6.3 million and the Basketball Practice Facility at Knoxville; the Vet School Large Animal Clinic Expansion— $5.0 million; and the Athletic Training Facility— $.8 million at Martin.

## ECONOMIC FACTORS THAT WILL AFFECT THE FUTURE

For fiscal year 2010, the University of Tennessee Board of Trustees has authorized an individual campus fee increase of 9 percent that is expected to generate approximately $26 million in new funding, net of related scholarships, with a continued projected enrollment increase. The university has been awarded over $92 million in State Fiscal Stabilization Fund state education stimulus money for FY 2010. The university has also been awarded over 28 million in stimulus fund, competitive grants and contracts. The capital markets remain unstable which will affect the university's investment income.

## REQUESTS FOR INFORMATION

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

# Statement of Net Assets

**JUNE 30, 2009**

| | THE UNIVERSITY OF TENNESSEE | UNIVERSITY OF CHATTANOOGA FOUNDATION INC. | THE UNIVERSITY OF TENNESSEE FOUNDATION INC. |
|---|---|---|---|
| **ASSETS** | | | |
| **Current assets:** | | | |
| Cash and cash equivalents (Note 2) | $ 284,910,102.12 | $ 10,741,951.00 | $ 4,217,296.78 |
| Investments (Notes 2, 22, and 23) | 82,285,813.02 | | 38,396.86 |
| Accounts, notes, and grants receivable (net) (Note 4) | 84,690,781.51 | 459,725.00 | 1,489,884.14 |
| Inventories | 8,082,629.28 | | 67,850.00 |
| Prepaid expenses and deferred charges | 2,500,873.05 | 18,180.00 | 15,615.16 |
| Total current assets | 462,470,198.98 | 11,219,856.00 | 5,829,042.94 |
| **Noncurrent assets:** | | | |
| Cash and cash equivalents (Note 2) | 442,688,504.80 | | 4,394,051.65 |
| Investments (Notes 2, 22, and 23) | 438,523,593.00 | 86,817,126.00 | 18,412,965.80 |
| Investment in UT–Battelle LLC (Note 14) | 4,524,510.00 | | |
| Accounts, notes, and grants receivable (net) (Note 4) | 123,690,218.63 | 1,104,369.00 | 52,095,495.42 |
| Lease payments receivable (Note 18) | 48,737,131.86 | | |
| Capital assets (net) (Notes 5 and 22) | 1,494,047,655.29 | 67,027,435.00 | |
| Prepaid expenses and deferred charges | 668,260.23 | 451,622.00 | |
| Assets held by the university | | 1,190,144.00 | 14,490,933.08 |
| Total noncurrent assets | 2,552,879,873.81 | 156,590,696.00 | 89,393,445.95 |
| Total assets | $ 3,015,350,072.79 | $ 167,810,552.00 | $ 95,222,488.89 |
| **LIABILITIES** | | | |
| **Current liabilities:** | | | |
| Accounts payable (Note 7) | $ 89,217,582.90 | $ 5,534,471.00 | $ 1,560.71 |
| Accrued liabilities | 44,129,357.82 | | |
| Deferred revenue | 73,781,780.08 | 1,169,986.00 | |
| Due to primary government | 32,179,500.00 | | |
| Deposits payable | 5,444,443.65 | | |
| Annuities payable | 1,220,653.16 | | 32,395.00 |
| Long-term liabilities, current portion (Notes 8, 22, and 23) | 66,314,174.11 | 1,550,000.00 | 14,386.52 |
| Deposits held in custody for others | 5,958,216.29 | 1,844,364.48 | |
| Due to the university | | 1,299,159.52 | 551,864.03 |
| Total current liabilities | 318,245,708.01 | 11,397,981.00 | 600,206.26 |
| **Noncurrent liabilities:** | | | |
| Deferred revenue (Note 8) | 15,500,438.71 | | |
| Long-term liabilities, noncurrent portion (Notes 8, 22, and 23) | 566,424,424.99 | 83,567,757.00 | 197,567.93 |
| Due to grantors (Note 8) | 35,904,119.49 | | |
| Annuities payable (Note 8) | 6,104,215.22 | | 450,499.22 |
| Deposits held in custody for component units | 14,490,933.08 | | |
| Total noncurrent liabilities | 638,424,131.49 | 83,567,757.00 | 648,067.15 |
| Total liabilities | $ 956,669,839.50 | $ 94,965,738.00 | $ 1,248,273.41 |
| **NET ASSETS** | | | |
| Invested in capital assets, net of related debt | $ 970,344,096.95 | | |
| Restricted: | | | |
| Nonexpendable: | | | |
| Scholarships and fellowships | 173,182,675.04 | $ 11,903,008.00 | $ 7,178,794.89 |
| Libraries | 13,282,108.88 | | 243,009.36 |
| Research | 17,708,429.74 | | 252,778.82 |
| Instructional department uses | 126,511,406.03 | 24,252,240.00 | 1,808,170.97 |
| Academic support | 27,581,880.44 | 38,828.00 | 8,085,177.90 |
| Other | 33,796,688.63 | | 4,446,584.78 |
| Expendable: | | | |
| Scholarships and fellowships | 66,794,257.92 | 442,859.00 | 19,209,678.33 |
| Libraries | 5,095,743.54 | | 58,915.14 |
| Research | 64,377,924.00 | | 803,089.15 |
| Instructional department uses | 58,572,581.51 | 2,365,521.00 | 221,241.74 |
| Academic support | 31,331,327.01 | 9,055.00 | 19,091,223.31 |
| Loans | 9,966,489.55 | | |
| Capital projects | 90,042,551.41 | 5,000,000.00 | 27,281,899.02 |
| Debt service | 668,260.23 | | |
| Other | 75,411,069.56 | 3,106,346.00 | 8,064,061.78 |
| Unrestricted (Note 9) | 294,012,742.85 | 25,726,957.00 | (2,770,409.71) |
| Total net assets | $ 2,058,680,233.29 | $ 72,844,814.00 | $ 93,974,215.48 |

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

# Statement of Revenues, Expenses, and Changes in Net Assets

## FOR THE YEAR ENDED JUNE 30, 2009

| | THE UNIVERSITY OF TENNESSEE | UNIVERSITY OF CHATTANOOGA FOUNDATION INC. | THE UNIVERSITY OF TENNESSEE FOUNDATION INC. |
|---|---|---|---|
| **REVENUES** | | | |
| **Operating revenues:** | | | |
| Student tuition and fees (net of scholarship allowances of $122,887,845.55) | $ 255,578,126.41 | | |
| Contributions | | $ 5,218,990.00 | $ 8,116,371.08 |
| Investment return designated for operations | | 8,182,340.00 | |
| Federal appropriations | 13,967,056.41 | | |
| Governmental grants and contracts | 248,434,965.32 | | |
| Non-governmental grants and contracts | 148,912,676.41 | | |
| Sales and services of educational departments | 50,804,991.75 | | |
| Auxiliary enterprises: | | | |
| Residential life (net of scholarship allowances of $3,332,738.41; all revenues are used as security for varying revenue bonds; see Note 8) | 44,608,951.98 | 9,052,759.00 | |
| Food services | 4,196,714.42 | | |
| Bookstore | 20,370,743.71 | | |
| Parking | 9,258,619.19 | | |
| Athletics | 79,769,467.41 | | |
| Other auxiliaries | 7,314,833.72 | | |
| Interest earned on loans to students | 48,666.23 | | |
| Other operating revenues | 19,047,186.99 | | 170,936.02 |
| Total operating revenues | $ 902,312,999.95 | $ 22,454,089.00 | $ 8,287,307.10 |
| **EXPENSES** | | | |
| **Operating expenses (Note 20):** | | | |
| Salaries and wages | $ 861,780,703.35 | | |
| Fringe benefits | 299,474,885.32 | | |
| Utilities, supplies, and other services | 341,052,631.59 | $ 4,386,913.00 | $ 1,828,042.96 |
| Scholarships and fellowships | 32,504,687.15 | | |
| Depreciation expense | 83,767,547.81 | 3,199,211.00 | |
| Payments to or on behalf of the university (Notes 22 and 23) | | 8,182,340.00 | 6,485,914.99 |
| Total operating expenses | 1,618,580,455.22 | 15,768,464.00 | 8,313,957.95 |
| Operating income (loss) | $ (716,267,455.27) | $ 6,685,625.00 | $ (26,650.85) |
| **NONOPERATING REVENUES (EXPENSES)** | | | |
| State and local appropriations | $ 503,758,286.86 | | |
| Gifts (includes $14,668,254.99 from component units) | 27,439,477.71 | $ 119,479.00 | |
| Grants and contracts | 142,217,070.58 | | |
| Investment income (loss) | (106,018,115.22) | (31,338,565.00) | $ (4,000,575.15) |
| Interest on capital asset - related debt | (18,681,250.27) | (4,594,903.00) | |
| Other nonoperating revenues (expenses) | (2,766,840.79) | (49,139.00) | |
| Net nonoperating revenues (expenses) | 545,948,628.87 | (35,863,128.00) | (4,000,575.15) |
| Income (loss) before other revenues, expenses, gains, or losses | (170,318,826.40) | (29,177,503.00) | (4,027,226.00) |
| Capital appropriations | 105,300,040.17 | | |
| Capital grants and gifts | 28,155,643.07 | | |
| Additions to permanent endowments | 9,318,609.95 | 500,918.00 | 7,083,193.91 |
| Additions to annuity and life income trusts | 494,756.52 | | |
| Other | 711,816.41 | | |
| Total other revenues | 143,980,866.12 | 500,918.00 | 7,083,193.91 |
| Increase (decrease) in net assets | $ (26,337,960.28) | $ (28,676,585.00) | $ 3,055,967.91 |
| **NET ASSETS** | | | |
| Net assets at beginning of year | 2,085,018,193.57 | 101,521,399.00 | 90,918,247.57 |
| Net assets at end of year | $ 2,058,680,233.29 | $ 72,844,814.00 | $ 93,974,215.48 |

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

# Statement of Cash Flows FOR THE YEAR ENDED JUNE 30, 2009

## CASH FLOWS FROM OPERATING ACTIVITIES

| | | |
|---|---|---|
| Tuition and fees | $ | 256,450,460.00 |
| Federal appropriations | | 13,967,056.41 |
| Grants and contracts | | 395,821,904.67 |
| Sales and services of educational activities | | 52,393,629.86 |
| Payments to suppliers and vendors | | (348,319,856.83) |
| Payments to employees | | (867,044,568.75) |
| Payments for benefits | | (283,889,325.51) |
| Payments for scholarships and fellowships | | (32,504,687.15) |
| Loans issued to students | | (2,561,272.51) |
| Collection of loans from students | | 3,402,522.54 |
| Interest earned on loans to students | | 528,728.54 |
| Auxiliary enterprise charges: | | |
| Residence halls | | 44,608,951.98 |
| Bookstore | | 20,370,743.71 |
| Food service | | 4,196,714.42 |
| Parking | | 9,258,619.19 |
| Athletics | | 80,986,610.86 |
| Other auxiliaries | | 7,157,042.82 |
| Hospital | | 2,778,347.27 |
| Other receipts (payments) | | 19,422,368.63 |
| Net cash provided (used) by operating activities | $ | (622,976,009.85) |

## CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

| | | |
|---|---|---|
| State appropriations | | 499,067,224.00 |
| Local appropriations | | 4,971,452.86 |
| Gifts and grants for other than capital or endowment purposes | | 213,087,335.20 |
| Private gifts for endowment purposes | | 9,813,366.47 |
| Split-interest transactions receipts | | 586,038.90 |
| Split-interest transactions disbursements | | (2,954,744.62) |
| Federal student loan receipts | | 217,231,960.00 |
| Federal student loan disbursements | | (217,231,960.00) |
| Changes in deposits held for others | | (239,188.23) |
| Net cash balance implicitly financed (repaid) | | 2,556,682.83 |
| Other noncapital receipts (payments) | | 2,031,144.65 |
| Net cash provided (used) by noncapital financing activities | $ | 728,919,312.06 |

## CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

| | | |
|---|---|---|
| Proceeds from capital debt | | 70,019,105.63 |
| Capital appropriations | | 99,762,857.08 |
| Capital grants and gifts received | | 28,155,643.07 |
| Proceeds from sale of capital assets | | 485,725.88 |
| Purchase of capital assets and construction | | (240,961,118.33) |
| Principal paid on capital debt and leases | | (26,402,877.87) |
| Interest paid on capital debt and leases | | (20,102,905.05) |
| Other capital and related financing receipts (payments) | | 196,807.72 |
| Net cash provided (used) by capital and related financing activities | $ | (88,846,761.87) |

## CASH FLOWS FROM INVESTING ACTIVITIES

| | | |
|---|---|---|
| Proceeds from sales and maturities of investments | | 167,910,369.32 |
| Income on investments | | 53,962,451.17 |
| Purchase of investments | | (138,821,948.66) |
| Net cash provided (used) by investing activities | $ | 83,050,871.83 |
| Net increase (decrease) in cash and cash equivalents | | 100,147,412.17 |
| Cash and cash equivalents at beginning of year | | 627,451,194.75 |
| Cash and cash equivalents at end of year | $ | 727,598,606.92 |

## RECONCILIATION OF NET OPERATING LOSS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES

| | | |
|---|---|---|
| Operating loss | $ | (716,267,455.27) |
| Adjustments to reconcile operating loss to net cash provided (used) by operating activities: | | |
| Depreciation expense | | 83,767,547.81 |
| Changes in assets and liabilities: | | |
| Receivables, net | | 929,411.87 |
| Inventories | | 619,271.31 |
| Prepaid expenses and deferred charges | | 516,297.49 |
| Accrued interest receivable | | 480,062.31 |
| Accounts payable | | (8,524,015.95) |
| Accrued liabilities | | 12,692,956.32 |
| Deferred revenue | | 2,618,975.23 |
| Deposits | | 1,720,950.91 |
| Compensated absences | | (2,371,261.91) |
| Other additions (deductions): | | |
| Loans to students | | 841,250.03 |
| Net cash provided (used) by operations | $ | (622,976,009.85) |

## NONCASH TRANSACTIONS

| | |
|---|---|
| Gifts of capital assets | — |
| Unrealized loss on investments | (165,157,015.04) |
| Loss on disposal of capital assets | (2,798,593.41) |

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

## Note 1: Summary of Significant Accounting Policies

### A. 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 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, the University of Tennessee at Chattanooga, and the University of Tennessee at Martin. The University of Tennessee comprises the University of Tennessee Knoxville campus; the University of Tennessee Health Science Center, including the Memphis campus, the Memorial Research Center at Knoxville, Clinical Education Centers at Chattanooga and Knoxville, Family Practice Centers at Jackson, Knoxville, and Memphis; the University of Tennessee Space Institute at Tullahoma; 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 Institute for Public Service, which includes the County Technical Assistance Service and the Municipal Technical Advisory Service; and the University-Wide Administration. The university is governed by a board of 23 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. See Notes 22 and 23 for more detailed information about the component units and how to obtain their reports.

### B. BASIS OF PRESENTATION
The financial statements have been prepared in conformity 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).

### C. 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.

Private-sector standards of accounting and financial reporting issued before December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board (GASB). The university has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The university has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

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

### D. CASH EQUIVALENTS
This classification includes instruments that are readily convertible to known amounts of cash.

### E. 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.

### F. INVESTMENTS
The university reports investments in commercial paper at amortized cost. The university had no investments in commercial paper at June 30, 2009. All other investments are reported at fair value or estimated fair value.
The university holds investments in limited partnerships, limited companies, corporations, and limited liability corporations, which are carried at estimated fair value provided by

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

### G. CAPITAL ASSETS

Capital assets, which include property, plant, equipment, software, and library holdings, are reported in the statement of net assets at historical cost or at fair value at date of donation, less accumulated depreciation. The costs of normal maintenance and repairs that do not add to the value of the asset 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 buildings, 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 percent of the book value of the building.

These assets, with the exception of land, are depreciated using the straight-line method over the estimated useful lives of the assets, which range from 5 to 40 years.

### H. ACCOUNTS PAYABLE

Included in accounts payable are checks payable in the amount of $11,124,768.42 as of June 30, 2009. 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.

### I. 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 assets.

### J. NET ASSETS

The institution's net assets are classified as follows:

**Invested in capital assets, net of related debt.** This represents the institution's total investment in capital assets, net of outstanding debt obligations 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 invested in capital assets, net of related debt.

**Nonexpendable restricted net assets.** Nonexpendable restricted net assets consist 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 assets.** Expendable restricted net assets include resources in which the university is legally or contractually obligated to spend resources in accordance with restrictions imposed by external third parties.

**Unrestricted net assets.** Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and the sales and services of educational departments, 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.

### K. 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 assets. 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.

### L. 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 percent of the portfolio in total and that no more than 10 percent of the portfolio's value be in the commercial paper of a single issuer. In addition, banker's acceptances cannot exceed 20 percent of the portfolio's value and no one bank's acceptances may exceed 10 percent. Money market funds cannot exceed 10 percent of the portfolio's total value.

**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 that are readily convertible to known amounts of cash.

At June 30, 2009, cash and cash equivalents consisted of $115,693,564.21 in bank accounts, $1,473,879.00 of petty cash on hand, $505,300,000.00 of certificates of deposit, and $103,525,830.40 in the university's cash management investment pool.

The carrying amount of the university's deposits was $620,993,564.21 and the bank balance including accrued interest was $622,413,277.04.

**Table 2.1. Investment Maturities (in years)**

| Investment Type | Fair Value | Less than 1 | 1 to 5 | 6 to 10 | 10+ | Cost |
|---|---|---|---|---|---|---|
| **Cash Management Pool Cash Equivalents Debt Securities** | | | | | | |
| U.S. Treasury | $ 28,446,320.00 | $ 28,446,320.00 | | | | $ 28,001,101.73 |
| U.S. Agencies | 75,079,510.40 | 75,079,510.40 | | | | 73,378,850.12 |
| | $ 103,525,830.40 | $ 103,525,830.40 | | | | $ 101,379,951.85 |
| **Investments** | | | | | | |
| Debt Securities | | | | | | |
| U.S. Treasury | $ 2,561,386.78 | | $ 1,074,242.70 | $ 669,065.44 | $ 818,078.64 | $ 2,212,967.15 |
| U.S. Agencies | 6,865,577.50 | $ 90,741.60 | 1,034,338.90 | 3,989,454.00 | 1,751,043.00 | 6,401,005.49 |
| Corporate Bonds | 26,249,804.54 | 2,718,547.75 | 14,216,548.25 | 8,893,617.29 | 421,091.25 | 25,908,650.79 |
| Municipal Bonds | 3,724,364.45 | | 1,749,525.00 | 647,156.25 | 1,327,683.20 | 3,976,927.93 |
| Mortgages and Notes | 335,640.66 | | 335,640.66 | | | 322,745.78 |
| Bond Mutual Funds | 36,039,438.51 | | 8,085,291.00 | 33,640.82 | 27,920,506.69 | 39,853,315.67 |
| | $ 75,776,212.44 | $ 2,809,289.35 | $ 26,495,586.51 | $ 14,232,933.80 | $ 32,238,402.78 | $ 78,675,612.81 |
| | | $ 106,335,119.75 | $ 26,495,586.51 | $ 14,232,933.80 | $ 32,238,402.78 | |
| **Other Investments** | | | | | | |
| Corporate Stocks: | | | | | | |
| Domestic | $ 55,748,713.79 | | | | | $ 65,392,148.62 |
| International | 2,699,376.09 | | | | | 2,975,599.79 |
| Mutual Funds—Equity | 144,323,345.32 | | | | | 198,789,794.25 |
| Alternative Investments: | | | | | | |
| Real Estate Investments | 21,605,482.57 | | | | | 34,322,396.98 |
| Private Equity | 76,755,330.00 | | | | | 97,895,649.19 |
| Hedge Funds | 90,689,781.93 | | | | | 97,499,081.01 |
| Natural Resources | 41,956,489.28 | | | | | 48,380,456.98 |
| Real Estate Gifts | 6,167,700.87 | | | | | 7,058,720.67 |
| Assets with Trustees | 5,086,973.73 | | | | | 5,634,562.47 |
| Total Investments and Cash Equivalents | $ 624,335,236.42 | | | | | $ 738,003,974.62 |
| Less: Cash Equivalents | 103,525,830.40 | | | | | 101,379,951.85 |
| Total Investments | $ 520,809,406.02 | | | | | $ 636,624,022.77 |

Additionally, the university maintains custodial accounts at First Tennessee Bank and Citigroup for funds contractually managed by independent investment counsel. In accordance with the custody agreements, First Tennessee Bank and Citigroup placed cash equivalents totaling $1,605,333.31 at June 30, 2009, 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, 2009, all university deposits were adequately secured as required by state statute.

### Investments

Investments in commercial paper are reported at amortized cost. All other investments are reported at fair value, including those securities with a maturity date of one year or less. As of June 30, 2009, the university had the investments and maturities shown in Table 2.1 (facing page).

### 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, 2009, were rated by Moody's.

The university is authorized by statute to invest funds in accordance with University of Tennessee investment policies. Funds, other than endowment and annuity and life income funds, may be invested in collateralized Tennessee bank or savings and loan association certificates of deposit, U. S. Treasury obligations, U.S. government agency obligations, 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

| **Table 2.2. Rated Debt Instruments** | Fair Value | Aaa | Aa1 | Aa2 | Aa3 | A1 |
|---|---|---|---|---|---|---|
| **Cash Management Pool** | | | | | | |
| U.S. Treasury | $ 28,446,320.00 | $ 28,446,320.00 | | | | |
| U.S. Agencies | 75,079,510.40 | 75,079,510.40 | | | | |
| **Investments** | | | | | | |
| U.S. Treasury | $ 2,561,386.78 | $ 2,512,714.78 | | | | |
| U.S. Agencies | 6,865,577.50 | 6,865,577.50 | | | | |
| Corporate Bonds | 26,249,804.54 | 1,138,827.00 | | $ 2,401,069.25 | $ 1,811,025.25 | $ 3,903,229.00 |
| Municipal Bonds | 3,724,364.45 | | $ 35,088.90 | 965,182.50 | 1,818,784.75 | 197,354.00 |
| Mutual Funds—Bonds | 36,039,438.51 | 24,019,317.07 | | 9,629,685.67 | | |
| Mortgages and Notes | 335,640.66 | | | | | |

| **Table 2.2. Rated Debt Instruments (*continued*)** | A2 | A3 | Baa1 | Baa2 | Baa3 | Ba2 | Unrated |
|---|---|---|---|---|---|---|---|
| **Cash Management Pool** | | | | | | | |
| U.S. Treasury | | | | | | | |
| U.S. Agencies | | | | | | | |
| **Investments** | | | | | | | |
| U.S. Treasury | | | | | | | $ 48,672.00 |
| U.S. Agencies | | | | | | | |
| Corporate Bonds | $ 7,126,333.00 | $ 3,344,707.00 | $ 1,740,768.50 | $ 3,572,502.25 | $ 1,126,775.50 | | 84,567.79 |
| Municipal Bonds | | | 399,690.80 | | | | 308,263.50 |
| Mutual Funds–Bonds | 43,584.12 | | | 2,229,468.77 | | $ 117,382.38 | |
| Mortgages and Notes | | | | | | | 335,640.66 |

no investment policy limiting its investment choice based on ratings issued by nationally recognized statistical rating agencies. As of June 30, 2009, the institution's investments were rated as shown in Table 2.2 (below).

### 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, 2009, the university had $5,086,973.73 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. More than five percent of the university's investments are invested in the single issuer shown in Table 2.3.

**Table 2.3**

| Issuer | Fair Value | Percent of Total Investments/Cash Equivalents |
|---|---|---|
| Federal Home Loan Bank | $ 63,979,267.90 | 10.25 percent |

### 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 $2,699,376.09 invested in foreign corporate equities at June 30, 2009.

### Alternative Investments

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

These investments include forty private equity funds, three real estate funds, fourteen natural resource funds, and seventeen hedge funds. The estimated fair value of these assets is $231,007,083.78 at June 30, 2009.

Total capital contributions less returns of capital equal $278,097,584.16 at June 30, 2009.

The university believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2009. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the university's investment policy that approves the allocation of funds to various asset classes in order to ensure the proper level of diversification within the endowment pool. These investments (private equity, real assets, natural resources, and hedge funds) are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated by the general partner of each limited partnership or manager of each corporate entity using various valuation techniques.

The methods and assumptions used in estimating fair value varies 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 assets, subsequent rounds of capital financings that include new investors for private/venture equity, and asset confirmations from brokers and fund administrators for hedge funds.

## Note 3: Endowment, Annuity, and Life Income Agreements

There are two categories of university assets that 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 its contribution 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, five percent of a three-year moving average of the fair value of endowment investments has been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income. At June 30, 2009, net appreciation of $24,391,002.06 is available to be spent, of which $24,026,322.97 is restricted for scholarships and fellowships, libraries, instructional department uses, academic support, and other purposes. The per-unit fair value for participating endowments was $2.721628 at June 30, 2009. Income distributed was $.20101 per share in 2009, or $34,178,993.63.

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 2009 and the three and five years then ended was (24.2) percent, (5.2) percent, and 1.6 percent, 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 $849,721.65 for 2009.

Annuity and life income amounts held in trust are separately invested entities requiring detailed accounting to reflect specific compliance with 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 2009 amounted to $1,941,607.71.

## Note 4: Accounts, Notes, and Grants Receivable

Accounts, notes, and grants receivable at June 30, 2009, included those listed in Table 4.1.

**Table 4.1**

| | | |
|---|---|---|
| Student accounts receivable | $ | 8,984,837.69 |
| Grants receivable | | 55,691,096.14 |
| Notes receivable | | 3,731,907.98 |
| Pledges receivable | | 43,982,467.68 |
| State capital outlay and maintenance receivable | | 16,151,394.39 |
| TSSBA debt proceeds receivable | | 11,947,855.33 |
| Due from component units | | 1,851,023.55 |
| Other receivables | | 57,969,992.80 |
| Subtotal | $ | 200,310,575.56 |
| Less allowance for doubtful accounts | | (23,713,013.63) |
| Total | $ | 176,597,561.93 |

Pledges receivable are promises of private donations that are reported as accounts receivable, and revenue, net of an estimated uncollectible allowance of $8,796,493.54.

Federal Perkins Loan Program funds at June 30, 2009, included those listed in Table 4.2.

**Table 4.2.**

| | | |
|---|---|---|
| Perkins loans receivable | $ | 31,783,438.21 |
| Less allowance for doubtful accounts | | — |
| Total | $ | 31,783,438.21 |

# Note 5: Capital Assets

Capital asset activity for the year ended June 30, 2009, was as shown in Table 5.1.

**Table 5.1. Capital asset activity, year ended June 30, 2009**

| | Beginning Balance | Additions | Transfers | Reductions | Ending Balance |
|---|---|---|---|---|---|
| Land | $ 53,866,428.87 | $ 3,183,130.31 | $ — | $ (308,499.00) | $ 56,741,060.18 |
| Land improvements & infrastructure | 67,875,444.65 | 426,349.99 | 900,461.98 | — | 69,202,256.62 |
| Buildings | 1,426,272,605.86 | 27,277,437.58 | 180,992,822.33 | (1,738,004.20) | 1,632,804,861.57 |
| Works of Art/Historical Treasures | 509,510.24 | 18,000.00 | — | — | 527,510.24 |
| Equipment | 274,988,560.65 | 64,769,557.87 | — | (10,466,445.08) | 329,291,673.44 |
| Software | 20,032,550.22 | 1,696,298.66 | — | (307,696.50) | 21,421,152.38 |
| Library holdings | 111,972,894.67 | 13,883,764.85 | — | (8,407,838.64) | 117,448,820.88 |
| Projects in progress | 259,941,984.41 | 133,740,554.86 | (181,893,284.31) | (,01) | 211,789,254.95 |
| Total | $ 2,215,459,979.57 | $ 244,995,094.12 | $ — | $ (21,228,483.43) | $ 2,439,226,590.26 |
| | | | | | |
| **Less accumulated depreciation:** | | | | | |
| Land improvements & infrastructure | (40,396,957.87) | (2,943,660.86) | — | — | (43,340,618.73) |
| Buildings | (611,254,276.64) | (40,620,805.64) | — | 382,778.31 | (651,492,303.97) |
| Equipment | (162,664,877.58) | (28,440,696.15) | — | 9,341,248.32 | (181,764,325.41) |
| Software | (19,503,929.40) | (519,462.98) | — | 307,041.25 | (19,716,351.13) |
| Library holdings | (46,030,252.19) | (11,242,922.18) | — | 8,407,838.64 | (48,865,335.73) |
| **Total accumulated depreciation** | $ (879,850,293.68) | $ (83,767,547.81) | — | $ 18,438,906.52 | $ (945,178,934.97) |
| Capital assets, net | $ 1,335,609,685.89 | $ 161,227,546.31 | $ — | $ (2,789,576.91) | $ 1,494,047,655.29 |

# Note 6: Operating Leases

The university has entered into various operating leases for buildings and equipment. It is expected that in the normal course of business, such leases will continue to be required. Net expenses for rentals under leases were $8,454,722.56 for the year ended June 30, 2009.

The following is a schedule of future minimum rental payments required under noncancelable operating leases that have initial or remaining lease terms of more than one year at June 30, 2009. Only one such lease is currently in effect. Annual payments on this particular lease fluctuate in direct proportion to changes in the Consumer Price Index as required by contractual agreement. The schedule in Table 6.1 (below) is calculated based on the April 2009 Consumer Price Index (213.24).

**Table 6.1. Year Ending June 30**

| | |
|---|---|
| 2010 | $ 13,207.00 |
| 2011 | 13,207.00 |
| 2012 | 13,207.00 |
| Total minimum payments required | $ 39,621.00 |

# Note 7: Accounts Payable

Accounts payable as of June 30, 2009, included the those in listed in Table 7.1.

**Table 7.1**

| | |
|---|---|
| Vendors payable | $ 69,469,908.60 |
| Payroll deductions payable | 19,747,674.30 |
| Total | $ 89,217,582.90 |

# Note 8: Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2009, was as shown in Table 8.1.

**Table 8.1**

| | Beginning Balance | Additions | Reductions | Ending Balance | Current Portion |
|---|---|---|---|---|---|
| **Long-term liabilities** | | | | | |
| Bonds | $ 338,997,327.11 | $ 89,073,369.60 | $ 30,569,159.34 | $ 397,501,537.37 | $ 24,634,618.65 |
| Commercial paper | 122,968,123.28 | 76,367,780.13 | 78,593,919.52 | 120,741,983.89 | — |
| Total TSSBA indebtedness | $ 461,965,450.39 | $ 165,441,149.73 | $ 109,163,078.86 | $ 518,243,521.26 | $ 24,634,618.65 |
| Notes | 34,701.99 | — | 11,187.87 | 23,514.12 | 11,640.59 |
| Capital lease obligations | 2,710,120.13 | — | 702,799.91 | 2,007,320.22 | 824,327.12 |
| Net OPEB obligation | 19,923,248.24 | 18,885,739.14 | — | 38,808,987.38 | — |
| Compensated absences | 76,026,518.02 | 38,472,325.84 | 40,843,587.74 | 73,655,256.12 | 40,843,587.75 |
| Total long-term liabilities | $ 560,660,038.77 | $ 222,799,214.71 | $ 150,720,654.38 | $ 632,738,599.10 | $ 66,314,174.11 |
| **Other noncurrent liabilities** | | | | | |
| Deferred revenue | 15,500,438.71 | — | — | 15,500,438.71 | |
| Due to grantors | 35,367,779.86 | 830,015.31 | 293,675.68 | 35,904,119.49 | |
| Annuities payable | 6,995,645.00 | 329,223.38 | 1,220,653.16 | 6,104,215.22 | |
| Totals | $ 618,523,902.34 | $ 223,958,453.40 | $ 152,234,983.22 | $ 690,247,372.52 | |

### TSSBA DEBT—BONDS

Bonds, with interest rates ranging from 1.3 percent to 7.15 percent, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2038 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. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net assets is shown net of assets held by the authority in the debt service reserve, capitalized interest, unexpended debt proceeds, and unaccreted bonds payable. The total bonded indebtedness at June 30, 2009, was $427,405,549.49. The debt service reserve amount at June 30, 2009, was $12,914,931.33, the capitalized interest was $99,571.24, and unspent debt proceeds were $16,753,223.86. Unaccreted bonds payable at June 30, 2009, were $136,285.69.

Included in the total outstanding indebtedness is a $75,093 note with Chattanooga Agricultural Credit Association. The 5-year note is for the construction of a farm building at UT—Martin. This note carries an interest rate of 4 percent and is due semi-annually to July 1, 2011. The outstanding balance at June 30, 2009, is $23,514.12.

The university's debt service requirements (TSSBA and the 5-year note) to maturity for all bonds and notes payable at June 30, 2009, are shown in Table 8.2.

**Table 8.2**

| Year ending June 30: | Principal | Administrative Fees |
|---|---|---|
| 2010 | $ 24,646,259.24 | $ 20,088,068.40 |
| 2011 | 22,310,509.94 | 19,153,202.86 |
| 2012 | 21,531,070.20 | 18,266,941.57 |
| 2013 | 21,241,076.53 | 17,399,212.29 |
| 2014 | 21,765,628.33 | 16,409,167.03 |
| 2015–2019 | 89,341,098.99 | 69,040,279.13 |
| 2020–2024 | 90,606,497.06 | 47,311,884.54 |
| 2025–2029 | 68,826,077.77 | 26,929,697.33 |
| 2030–2034 | 50,067,309.34 | 11,736,091.12 |
| 2035–2038 | 17,093,536.21 | 2,174,566.26 |
| | $ 427,429,063.61 | $ 248,509,110.53 |

### TSSBA DEBT—COMMERCIAL PAPER

The Tennessee State School Bond Authority issues commercial paper to finance the costs of various capital projects during their construction phase. When projects are placed in service, long-term, fixed-rate debt is issued by TSSBA to finance the project over its useful payback period and the commercial paper is redeemed. The amount issued for projects at the university was $120,741,983.89 at June 30, 2009.

For the commercial paper program, the Tennessee State School Bond Authority maintains an interest rate reserve fund. The university contributes amounts to the reserve fund based on the amounts drawn. The principal of the reserve will be contributed to pay off notes or credited back to the university when the notes are converted to bonds. The interest earned on the reserve is used to pay interest due during the month.

More detailed information regarding the bonds and commercial paper 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 *http://tn.gov.comptroller/bf/tssbacafr.htm*.

### CAPITAL LEASE OBLIGATIONS

The university leases certain items of equipment accounted for as capital leases. The capitalized cost of the assets under lease at June 30, 2009, was $3,126,282.87. Accumulated amortization of the leased assets at June 30, 2009, was $1,118,962.65.

Future minimum lease payments under capital leases at June 30, 2009, are as shown in Table 8.3.

**Table 8.3. Year ending June 30:**

| | | |
|---|---|---|
| 2010 | $ | 824,327.12 |
| 2011 | | 679,628.71 |
| 2012 | | 679,628.71 |
| Total | $ | 2,183,584.54 |
| Less: amount representing interest | | (176,264.32) |
| Present value of minimum lease payments | $ | 2,007,320.22 |

## Note 9: Unrestricted Net Assets

Unrestricted net assets include funds that have been designated for specific purposes. These purposes include those listed in Table 9.1.

**Table 9.1. As of June 30, 2009**

| | | |
|---|---|---|
| Working capital | $ | 34,560,968.41 |
| Encumbrances | | 4,287,498.47 |
| Auxiliaries | | 8,086,491.32 |
| Quasi-endowments | | 10,207,650.93 |
| Plant construction | | 24,994,794.25 |
| Renewal and replacement of capital assets | | 207,219,813.64 |
| Debt retirement | | 24,169,918.53 |
| Undesignated | | (19,514,392.70) |
| Total | $ | 294,012,742.85 |

## Note 10: Pledged Revenues

The University of Tennessee has pledged certain revenues and fees, including state appropriations, to repay $397,501,537.37 in revenue bonds issued from May 1976 to April 2009. Proceeds from the bonds provided financing for construction and renovation projects. The bonds are payable through 2038. Annual principal and interest payments on the bonds are expected to require 3.53 percent of available revenues. The total principal and interest remaining to be paid on the bonds is $675,913,479.68. Principal and interest paid for the current year and total available revenues were $45,143,964.64 and $1,279,887,297.84, respectively.

## NOTE 11: PENSION PLANS

### A. DEFINED BENEFIT PLANS

### 1. Tennessee Consolidated Retirement System

#### Plan Description

The University of Tennessee contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing multiple-employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, Tennessee Code Annotated, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly. The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report is available on the state's website at *http://www.tn.gov/treasury/tcrs/index.html*.

#### Funding Policy

Plan members are noncontributory. The university is required to contribute at an actuarially determined rate. The current rate is 13.02 percent of annual covered payroll.

Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2009, 2008, and 2007, were $37,963,757.88, $39,356,714.98, and $37,574,415.22, respectively. Contributions met the requirements for each year.

### 2. Federal Retirement Program

#### 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 before January 1, 1984, and the Federal Employees Retirement System (FERS) for participants employed after December 31, 1983. Both systems provide retirement, death, and disability benefits, as well as annual cost-of-living adjustments, to plan members and their beneficiaries. All regular full-time employees of the University of Tennessee Agricultural Extension Service who hold federal appointments for 51 percent or more of their time are required to participate in either one of the two Federal Retirement Programs. For both systems, benefit provisions are established in federal statutes. Federal statutes are amended by the U.S. Congress.

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

#### Funding Policy

Participating employees, with some exceptions, are required by federal statute to contribute 7.0 percent of covered salaries to the CSRS plan. The university is currently required to contribute 7.0 percent. Contributions to CSRS for the year ended June 30, 2009, were $1,050,294.31, which consisted of $540,493.79 from the university and $509,800.52 from the employees; contributions for the year ended June 30, 2008, were $1,157,970.84, which consisted of $597,028.11 from the university and $560,942.73 from the employees; and contributions for the year ended June 30, 2007, were $1,184,643.44, which consisted of $610,128.50 from the university and $574,514.94 from the employees.

Federal statute requires employees participating in FERS to contribute 0.8 percent of their salaries to the Basic Benefit Plan. The university is required to contribute 11.2 percent. In addition, the university is required to contribute 1 percent of each participant's salary to the Thrift Savings Plan plus up to an additional 4 percent depending upon employees' contributions, which can range from 0 to 10 percent of their salaries. Contributions for the Basic Benefit Plan were $1,050,561.11 for the year ended June 30, 2009, which consisted of $70,037.34 from employees and $980,523.77 from the university; $1,049,011.37 for the year ended June 30, 2008, which consisted of $69,934.30 from employees and $979,077.07 from the university; and $1,013,260.65 for the year ended June 30, 2007, which consisted of $67,551.28 from employees and $945,709.37 from the university. Contributions for the Thrift Savings Plan were $1,065,023.00 for the year ended June 30, 2009, which consisted of $653,541.00 from employees and $411,482.00 from the university; $1,083,359.00 for the year ended June 30, 2008, which consisted of $671,460.00 from employees and $411,899.00 from the university; and $1,052,295.00 for the year ended June 30, 2007, which consisted of $655,004.00 from employees and $397,291.00 from the university. Contributions met the requirements for each year.

## B. DEFINED CONTRIBUTION PLANS

### 1. Optional Retirement Plans (ORP)

#### Plan Description

The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association-College Retirement Equities Fund (TIAA-CREF), Aetna Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in 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 contributes an amount equal to 10 percent of the employee's base salary below the social security wage base and 11 percent above the social security wage base. Contribution requirements are established and amended by state statute. The contribution made by the university to the plans for the year ended June 30, 2009, was $40,895,926.05 and for the year ended June 30, 2008, was $40,350,986.48. Contributions met the requirements for each year.

### 2. 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 Aetna, TIAA–CREF, or VALIC, they may also, under certain circumstances, receive a supplementary benefit from the State of Tennessee. Plan provisions are established by Tennessee Code Annotated, Chapter 35, Part 4. 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 $32,362,289.10 for fiscal year 2009, and $35,357,200.98 for fiscal year 2008. 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 $4,211,189.80 in fiscal year 2009, and $4,817,586.81 in fiscal year 2008. Contributions met the requirements for each year.

## C. DEFERRED COMPENSATION PLANS

The University of Tennessee offers its employees three deferred compensation plans. The university, through the State of Tennessee, provides two plans, one established pursuant to 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).

These plans, available to all university employees, permit them to defer a portion of their salaries to future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All costs of administering and funding these plans, with the exclusion of the $50 monthly university match for the Section 401(k) plan, are the responsibility of plan participants.

Since Section 457 and 401(k) plan assets remain the property of the contributing employees and a third party administrator is used to administer the plan assets, they are not presented in the State of Tennessee financial statements. In fiscal year 2009, the university provided a $50 monthly match from unrestricted funds for employees making a minimum monthly contribution of $50 to the Section 401(k) plan. During the year ended June 30, 2009, contributions totaling $17,655,079.08 were made by employees participating in the plan, with a related match of $5,564,617.39 made by the university. During the year ended

June 30, 2008, contributions totaling $17,711,558.01 were made by employees participating in the plan, with a related match of $5,562,078.86 made by the university. In accordance with the IRC, employee contributions through the 403(b) plan remain the assets of the employee. In addition, the amounts withheld from employees are remitted directly to third-party administrators. Therefore, these employee contributions are not reflected in the university's financial statements.

## Note 12: Other Post-Employment Benefits

Healthcare is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program that provides postemployment health insurance benefits to eligible university retirees. This program includes two plans—the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Tennessee Code Annotated (TCA) Section 8-27-201 for the state plan and TCA 8-27-701 for the Medicare Supplement Plan. Before reaching age 65, retirees may participate in the State Employee Group Plan. Members of this plan have the option of choosing a preferred provider organization (PPO), point of service (POS), or health maintenance organization (HMO) plan for healthcare benefits. Subsequent to age 65, retirees who are also in the state's retirement system may participate in the Medicare Supplement Plan that does not include pharmacy. The state makes on-behalf payments to the Medicare Supplement Plan for the university's eligible retirees; see Note 21. The plans are reported in the Tennessee Comprehensive Annual Financial Report. That report is available on the state's website *http://tennessee.gov/finance/act/cafr.html*, or by calling 615-741-2140.

### SPECIAL FUNDING SITUATION

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

### FUNDING POLICY

The premium requirements of members of the State Employee Group Plan are established and may be amended by the insurance committee. The plan is self-insured and financed on a pay-as-you-go basis with the risk shared equally among the participants.

Claims liabilities of the plan are periodically computed using actuarial and statistical techniques to establish premium rates. Administrative costs of the plan are allocated to participants. Retirees in the State Employee Group Plan pay the same base premium as active employees in the plan adjusted for years of service. Retirees with 30 years of service pay 20 percent of the total premium. Retirees with 20 but less than 30 years of service pay 30 percent of the total premium. Retirees with less than 20 years of service pay 40 percent of the total premium.

**Table 12.1. Annual OPEB Cost and Net OPEB Obligation**

| | | State Employee Group Plan |
|---|---|---|
| Annual Required Contribution (ARC) | $ | 30,980,000.00 |
| Interest on Net OPEB Obligation | | 897,000.00 |
| Adjustment to the ARC | | (873,000.00) |
| Annual OPEB Cost | $ | 31,004,000.00 |
| Amount of Contribution | | (12,118,260.86) |
| Increase/Decrease in Net OPEB Obligation | $ | 18,885,739.14 |
| Net OPEB Obligation—beginning of year | | 19,923,248.24 |
| Net OPEB Obligation—end of year | $ | 38,808,987.38 |

**Table 12.2**

| Year End | Plan | Annual OPEB Cost | Percentage of Annual OPEB Cost Contributed | Net OPEB Obligation at Year-end |
|---|---|---|---|---|
| June 30, 2009 | State Employee Group Plan | $ 31,004,000.00 | 39.09 % | $ 38,808,987.38 |

### FUNDED STATUS AND FUNDING PROGRESS

The funded status of the university's portion of the State Employee Group Plan as of July 1, 2007, was as shown in Table 12.3.

**Table 12.3**

| Actuarial valuation date | | July 1, 2007 |
|---|---|---|
| Actuarial accrued liability (AAL) | $ | 294,669,000.00 |
| Actuarial value of plan assets | | 0.00 |
| Unfunded actuarial accrued liability (UAAL) | $ | 294,669,000.00 |
| Actuarial value of assets as a percent of the AAL | | 0% |
| Covered payroll (active plan members) | $ | 616,687,517.00 |
| UAAL as percentage of covered payroll | | 47.8% |

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

The schedule of funding progress, presented as Required Supplementary Information following the notes to the financial statements, presents multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

### ACTUARIAL METHODS AND ASSUMPTIONS

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

In the July 1, 2007, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4.5 percent investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 7 percent initially, increased to 11 percent in the second year and then reduced by decrements to an ultimate rate of 5 percent after 12 years. Both rates include a 3 percent inflation assumption. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007.

## 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, 2009. The financial statements of the university include as expenditures the amounts expended in the current year to match the state appropriations. The university's statement of net assets does not include the amounts held in trust by the State Treasurer. At June 30, 2009, the amounts held in trust totaled $93,294,808.60 at fair value.

## Note 14: Joint Venture

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 percent interest in the venture, each having provided an initial investment of $125,000.00. The university's equity interest was $4,524,510.23 at June 30, 2009. The university and Battelle each receive a 50 percent distribution of the ORNL management fee after shared expenses are deducted. The fee distribution for the year ended September 30, 2008, to the university was $3,399,510.23.

During the year ended June 30, 2009, the university had expenses of $18,381,006.00 under contracts with UT-Battelle. Amounts receivable from UT–Battelle under these contracts totaled $2,291,109.00 at June 30, 2009. 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.

## Note 15: Insurance-related Activities

It is the policy of the state not to purchase commercial insurance for the risks of losses for general liability, automobile liability, professional malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Risk Management Fund. The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The amounts of settlements have not exceeded insurance coverage for each of the past three fiscal years. The Risk Management Fund is also responsible for claims for damages to state owned property up to the amount of the property insurance aggregate deductible amount. The insurance policy deductibles vary from $25,000 per occurrence, depending on the type of coverage, to an aggregate of $5 million.

The university participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the years ended June 30, 2009, and June 30, 2008, are presented in the Tennessee Comprehensive Annual Financial Report. The CAFR is available on the state's website at *http://tn.gov/finance/act/cafr.html*. Since the university participates in the Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, Tennessee Code Annotated, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in Tennessee Code Annotated, Section 50-6-101 et seq. Claims are paid through the state's Risk Management Fund. At June 30, 2008, the Risk Management Fund held $123.9 million in cash and cash equivalents designated for payment of claims. At June 30, 2009, the scheduled coverage for the university was $4,304,613,300 for buildings and $1,096,252,300 for contents.

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

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

# Note 16: Contingencies and Commitments

### A. 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, 2009, were $110,220,223.50.

### B. SICK LEAVE

The university records the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent due to illness or injury, there is no liability for sick leave at June 30, 2009. The amount of unused sick leave was $253,099,069.62 at June 30, 2009.

### C. 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.

### D. NONVESTED EQUIPMENT

Equipment in the possession of the university valued at $3,360,869.58 as of June 30, 2009, 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.

### E. LITIGATION

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

# Note 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 18.) The term of the lease is 50 years. The university also transferred to UHS all operating assets of the hospital. The consideration for the lease of the real property and transfer of the operating assets was payment by UHS of a) a sum sufficient to economically defease all of the debt issued by the Tennessee State School Bond Authority in the amount of $149,080,353.69, b) $25,000,000.00 paid to the university at closing, and c) a variable lease obligation of $50,000,000.00 to be paid to the university over 20 years.

UHS assumed all prior hospital liabilities, known or unknown. In 2019, the university and UHS have agreed to negotiate an annual lease payment for the remaining 30 years of the lease.

Employee Services Agreement—UHS has leased from the university all hospital employees as of the date of closing. UHS has paid to the university the amounts incurred by the university to pay the direct expenses relating to the hospital employees, including wages, salaries, and fringe benefits. These payroll expenses on behalf of UHS, totaling $73,736,266.99 in 2009, are reported as operating expenses in the statement of revenues, expenses, and changes in net assets. An equal amount of operating revenue is reported in the non-governmental 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 service 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: 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 2019. The amount of the annual payments will equal the lesser of (1) 20 percent 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 December 31, 2019. In 2019, the university and UHS have agreed to negotiate an annual lease payment for the remaining 30 years of the lease. The university did not receive a lease payment in fiscal year 2009.

The university recorded a lease payment receivable in the amount of $32,615,156.04 at June 30, 2009, which represents the net present value of the guaranteed $50 million discounted at 5.75 percent. The minimum lease payments to be received amount has been adjusted upward to reflect a contractually required adjustment to the final required lease payment.

**Table 18.1. As of June 30, 2009**

| | | |
|---|---|---|
| Total minimum lease payments to be received | $ | 55,237,837.33 |
| Less: unearned income | | (22,622,681.29) |
| Net investment in direct financing lease | $ | 32,615,156.04 |

### 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 Developmental Disabilities (TDMHDD) to provide a new building to house the Memphis Mental Health Institute. The building is a joint project of the university, Methodist Healthcare, Shelby County Health Care Authority (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 TDMHDD 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, TDMHDD will be responsible for all operational and maintenance costs associated with the facility (see Tables 18.2 and 18.3).The university recorded a lease payment receivable in the amount of $16,121,975.82 at June 30, 2009:

**Table 18.2**

| June 30, 2009 | | |
|---|---|---|
| Total minimum lease payments to be received | $ | 23,504,050.31 |
| Less: Unearned income | | (7,382,074.49) |
| Net investment in direct financing lease | $ | 16,121,975.82 |

**Table 18.3.**

| Year Ended June 30 | Minimum lease payments to be received | Interest | Principal |
|---|---|---|---|
| 2010 | $ 1,351,551.38 | $ 721,668.37 | $ 629,883.01 |
| 2011 | 1,352,874.66 | 693,472.90 | 659,401.76 |
| 2012 | 1,354,253.50 | 663,956.08 | 690,297.42 |
| 2013 | 1,355,690.26 | 633,056.29 | 722,633.97 |
| 2014 | 1,357,185.02 | 600,709.01 | 756,476.01 |
| 2015–2019 | 6,810,611.76 | 2,462,775.25 | 4,347,836.51 |
| 2020–2024 | 6,858,706.60 | 1,394,250.89 | 5,464,455.71 |
| 2025–2027 | 3,063,177.13 | 212,185.70 | 2,850,991.43 |
| | $ 23,504,050.31 | $ 7,382,074.49 | $ 16,121,975.82 |

# Note 19: Agreements with Methodist Healthcare

On November 1, 2002, the university transferred management and operations of its hospital located in Memphis to Methodist Healthcare (Methodist), a Tennessee non-profit corporation. The transfer of the hospital management and operations from the university to Methodist was accomplished through three main agreements: the Management Agreement, the Employee Services Agreement, and the Affiliation Agreement. Each of these agreements is summarized as follows.

**Management Agreement.** The university and Methodist entered into a management agreement whereby Methodist managed the operations of William F. Bowld Hospital from November 1, 2002, until July 24, 2004, the date all services comprising the hospital were relocated to Methodist University Hospital. The William F. Bowld Hospital was closed and the building was demolished.

**Employee Services Agreement.** Methodist leased from the university all hospital employees as of the date of closing.

Methodist 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 Methodist, totaling $122,224.47 in 2009, are reported as operating expenses in the statement of revenues, expenses, and changes in net assets. An equal amount of operating revenue is reported in the non-governmental grants and contracts category. The term of the Employee Services Agreement is from the effective date until there are no longer leased employees.

All persons who began service at the hospital after the date the employee service agreement was signed are employees of Methodist and not university employees.

**Affiliation Agreement.** The university and Methodist entered into a Master Affiliation Agreement dated March 18, 2002, wherein Methodist agreed to support the continuous development and improvement of the medical education, research, and public service programs of the university. The university and Methodist agreed that Methodist Central Hospital (renamed

Methodist University Hospital) and LeBonheur Children's Medical Center (also a Methodist Hospital) will be the principal private teaching hospitals for the university in the Shelby County area.

The university shall be entitled to reimbursement for its expenses associated with the graduate medical education program rendered under this agreement including the costs of coverage under the Tennessee Claims Commission Act and defense costs. The university will cooperate, support, and assist in seeking adequate reimbursement from Medicare and the State of Tennessee for graduate medical education. The costs of providing residents and medical faculty supervision at Methodist will be paid by the university and the pro rata costs will be reimbursed by Methodist based upon the actual costs associated with the program at Methodist. Specific financial arrangements for residents and faculty will be negotiated annually and incorporated annually by addendum into this Master Affiliation Agreement as part of the Methodist annual budgeting process. The annual addendum will specify the numbers of faculty and residents to be provided along with the costs to be annually reimbursed under this agreement.

## Note 20: Natural Classifications with Functional Classifications

The university's operating expenses by functional classification for the year ended June 30, 2009, are as shown in Table 20.1.

**Table 20.1**

| | Natural Classification | | | | | |
|---|---|---|---|---|---|---|
| | Salaries | Benefits | Utilities, Supplies, and Other Services | Scholarships | Depreciation | Total |
| **Functional Classification** | | | | | | |
| Instruction | $ 363,897,940.52 | $ 106,523,662.29 | $ 56,850,637.87 | $ — | $ — | $ 527,272,240.68 |
| Research | 112,906,045.06 | 31,811,635.26 | 61,597,605.75 | — | — | 206,315,286.07 |
| Public Service | 71,506,312.99 | 27,104,780.94 | 32,325,630.64 | — | — | 130,936,724.57 |
| Academic Support | 68,934,202.84 | 25,554,130.57 | 18,606,581.56 | — | — | 113,094,914.97 |
| Student Services | 37,764,749.19 | 14,077,975.46 | 23,398,380.05 | — | — | 75,241,104.70 |
| Institutional Support | 72,438,721.85 | 26,723,826.00 | — | — | — | 99,162,547.85 |
| Operation and Maintenance of Plant | 32,852,183.49 | 15,866,676.48 | 66,315,914.55 | — | — | 115,034,774.52 |
| Scholarships and Fellowships | 3,344,499.85 | 18,699,994.66 | 17,234,460.09 | 32,504,687.15 | — | 71,783,641.75 |
| Auxiliary | 44,436,924.17 | 12,130,098.75 | 64,723,421.08 | — | — | 121,290,444.00 |
| Independent Operations | 53,699,123.39 | 20,982,104.91 | — | — | — | 74,681,228.30 |
| Depreciation | — | — | — | — | 83,767,547.81 | 83,767,547.81 |
| Total Expenses | $ 861,780,703.35 | $ 299,474,885.32 | $ 341,052,631.59 | $ 32,504,687.15 | $ 83,767,547.81 | $1,618,580,455.22 |

## Note 21: On-Behalf Payments

During the year ended June 30, 2009, the State of Tennessee made payments of $839,534.00 on behalf of the university for retirees participating in the Medicare Supplement Plan. The Medicare Supplement Plan is a post employment benefit healthcare plan and is discussed further in Note 12. The plan is reported in the Tennessee Comprehensive Annual Financial Report. That report is available on the state's website at *http://tennessee.gov/finance/act/cafr.html*.

## Note 22: 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, including FASB Statement No. 117, Financial Reporting for Non-Profit Organizations. As such, certain revenue recognition criteria and presentation features are different from revenue recognition criteria and presentation features as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements of this foundation have been reformatted into a GASB format and are reported in a separate column to the right of the university's statements.

The University of Chattanooga Foundation Inc., is a legally separate, tax-exempt organization supporting the University of Tennessee at Chattanooga. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of the University of Tennessee at Chattanooga. The 48-member board of trustees of the foundation is self-perpetuating and consists of friends of 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, 2009, the foundation expended $8,182,340.00 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

University of Chattanooga Foundation Inc. is a supporting organization under the provisions of Section 509(a)(3) 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. The foundation and CDFI have fiscal years that end on June 30.

The LLC's fiscal year ends on July 31 in order to reflect the operating cycle of collegiate student housing. The impact of any intervening transactions during the 1-month period between fiscal year ends is not significant. At June 30, 2009, the foundation's statement of net assets reflects $1,190,144 of LLC deposits held at the university that were not actually transferred to the university until July 2009.

CDFI was formed by the foundation during 2001 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 first phase of the student housing, consisting of 455 bedrooms in 149 units, was completed and leased to students in August 2001. The second phase of the student housing, consisting of 584 bedrooms in 158 units, was completed and leased to students in August 2002. The third and final phase of the student housing, consisting of 576 bedrooms in 144 units, was completed and leased to students in October 2004.

### INVESTMENTS

A summary of foundation investments at June 30, 2009, is as shown in Table 22.1.

**Table 22.1**

| | | |
|---|---|---|
| Equity securities (cost of $53,248,001) | $ | 41,412,164 |
| Debt securities (cost of $8,985,013) | | 9,016,148 |
| Real estate | | 1,800,700 |
| Limited partnerships | | 26,864,474 |
| Other | | 12,768 |
| Total | $ | 79,106,254 |

The foundation also has investments restricted by the terms of the revenue bonds described below totaling $7,710,872.

## PROPERTY AND EQUIPMENT

A summary of foundation property and equipment at June 30, 2009, is as shown in Table 22.2.

**Table 22.2**

| | | |
|---|---|---|
| Land | $ | 8,241,032 |
| Buildings | | 74,808,884 |
| Furniture, fixtures, and equipment | | 4,309,328 |
| | | 87,359,244 |
| Accumulated depreciation | | (20,331,809) |
| Total | $ | 67,027,435 |

## REVENUE BONDS PAYABLE

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

Revenue bonds payable at June 30, 2009, consist those shown in Table 22.3.

**Table 22.3**

| | | |
|---|---|---|
| Series 2005A revenue refunding bonds, interest rates fixed at 5.0 percent to 5.125 percent payable semi-annually, annual redemption payments due through October 1, 2035 | $ | 66,080,000 |
| Series 2005B revenue refunding bonds, interest rates fixed at 5.5 percent to 6.0 percent payable semi-annually, annual redemption payments due through October 1, 2035 | | 20,980,000 |
| | | 87,060,000 |
| Less: unamortized discount | | (1,942,243) |
| | $ | 85,117,757 |

Sinking fund requirements for scheduled redemptions of the revenue bonds for the next 5 years and thereafter are shown in Table 22.4.

**Table 22.4**

| Year Ended | | |
|---|---|---|
| June 30, 2010 | $ | 1,550,000 |
| June 30, 2011 | | 1,630,000 |
| June 30, 2012 | | 1,715,000 |
| June 30, 2013 | | 1,800,000 |
| June 30, 2014 | | 1,895,000 |
| Thereafter | | 78,470,000 |
| | $ | 87,060,000 |

## RESTRICTED CASH AND CASH EQUIVALENTS

The revenue bonds described above restrict the use of certain cash and cash equivalents at June 30, 2009, as shown in Table 22.5.

**Table 22.5**

| | | |
|---|---|---|
| Renewal and replacement reserves | $ | 298,747 |
| Restricted for debt service payments | | 2,741,746 |
| Total | $ | 3,040,493 |

## FAIR VALUE MEASUREMENTS

As of July 1, 2008, the foundation adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements, (SFAS 157), which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements. SFAS 157 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements.

SFAS 157 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.

Table 22.6 (below) presents the recorded amount of assets and liabilities measured at fair value on a recurring basis:.

**Table 22.6**

| | | Balance as of June 30, 2009 | | Quoted Prices in Active Markets For Identical Assets (Level 1) | | Significant Other Observable Inputs (Level 2) | | Significant Other Unobservable Inputs (Level 3) |
|---|---|---|---|---|---|---|---|---|
| **ASSETS** | | | | | | | | |
| Equity securities | $ | 41,412,164 | $ | 41,358,050 | $ | 54,114 | $ | — |
| Debt securities | | 9,016,148 | | 27,168 | | 8,988,980 | | — |
| Real estate | | 1,800,700 | | — | | 1,800,700 | | — |
| Limited partnerships | | 26,864,474 | | — | | — | | 26,864,474 |
| Other | | 12,768 | | — | | 12,768 | | — |
| Total assets | $ | 79,106,254 | $ | 41,385,218 | $ | 10,856,562 | $ | 26,864,474 |
| **LIABILITIES** | | | | | | | | |
| Deposits received for the benefit of University of Tennessee at Chattanooga | $ | 3,143,524 | $ | — | $ | 3,143,524 | $ | — |
| Total liabilities | $ | 3,143,524 | $ | — | $ | 3,143,524 | $ | — |

Table 22.7 (below) presents additional information about assets and liabilities measured at fair value on a recurring basis by reliance on Level 3 inputs to determine fair value.

| **Table 22.7. Limited Partnerships** | | |
|---|---|---|
| Beginning balance | $ | 33,134,127 |
| Total realized and unrealized gains and losses | | |
| included in earnings | | (7,520,061) |
| Purchases, issuances, and settlements | | 1,250,408 |
| Ending balance | $ | 26,864,474 |

## ENDOWMENTS

The foundation's endowment consists of approximately 280 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Directors 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 Directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

**Interpretation of Relevant Law.** The Board of Directors of the foundation have 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 at June 30, 2009 consist of those shown in Table 22.8 (below). Due to GASB reformatting, temporarily restricted net assets are reported as expendable restricted net assets and permanently restricted net assets are reported as nonexpendable restricted net assets on the statement of net assets.

**Table 22.8**

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Donor-restricted funds | $ (1,658,572) | $ 1,247,997 | $ 36,194,076 | $ 35,783,501 |
| Board-designated funds | 47,483,930 | — | — | 47,483,930 |
| | $ 45,825,358 | $ 1,247,997 | $ 36,194,076 | $ 83,267,431 |

Changes in endowment net assets for the fiscal year ended June 30, 2009:

**Table 22.9**

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Endowment net assets, beginning of year | $ 62,711,880 | $ 1,124,867 | $ 46,687,687 | $ 110,524,434 |
| Investment income | (630,638) | 1,110,496 | (1,809,691) | (1,329,833) |
| Net depreciation | (11,769,269) | — | (9,635,600) | (21,404,869) |
| Contributions | 349,887 | — | 500,918 | 850,805 |
| Appropriations | (3,414,370) | (1,997,719) | — | (5,412,089) |
| Transfers | (1,422,132) | 1,010,353 | 450,762 | 38,983 |
| Endowment net assets, end of year | $ 45,825,358 | $ 1,247,997 | $ 36,194,076 | $ 83,267,431 |

Descriptions of endowment amounts classified as permanently restricted net assets and temporarily restricted net assets:

**Table 22.10. 2009 Permanently Restricted Net Assets**

| | |
|---|---|
| The portion of perpetual endowment funds that is required to be retained permanently either by explicit donor stipulation or by UPMIFA | $ 36,194,076 |
| Total endowment funds classified as permanently restricted net assets | $ 36,194,076 |

**Table 22.11. 2009 Temporarily Restricted Net Assets**

| | |
|---|---|
| The portion of perpetual endowment funds subject to a time restriction under UPMIFA | $ 1,247,997 |
| Total endowment funds classified as temporarily restricted net assets | $ 1,247,997 |

**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 $1,658,572 as of June 30, 2009. 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 Directors.

**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 a donor-specified period(s) as well as board-designated funds. Under this policy, as approved by the Board of Directors, 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 percent 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 percent of each endowment fund's average balance for the last twelve 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.

### CONTINGENCIES AND SUBSEQUENT EVENT

CDFI is involved in certain claims arising from normal business activities. A liability is recorded when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated.

During the years ended June 30, 2009, and June 30, 2008, CDFI has been actively involved in a 2005 lawsuit related to the construction of student housing at the university. The plaintiff brought action against the developer of the student housing for breach of contract and other claims. The plaintiff filed a contractor's lien against CDFI's real property and sought permission to foreclose on its lien in this litigation. During the year ended June 30, 2008, Hamilton County Chancery court ruled that the plaintiff was entitled to approximately $2.7 million plus post-judgment interest until the payment is made or the date of foreclosure. The Court also ruled that two of the student housing buildings are subject to foreclosure if the payment is not made. During July 2009, this litigation was settled with total payments to the plaintiff of $2,976,630, which includes approximately $107,000 to be paid from the LLC's cash balances. CDFI's accrued liability of $2,874,500 at June 30, 2009, is sufficient to cover the remainder of the settlement.

### NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The foundation's operating expenses by functional classification for the year ended June 30, 2009, are shown in Table 22.12

**Table 22.12 University of Chattanooga Foundation**

| | Natural Classification | | | |
|---|---|---|---|---|
| | Utilities, Supplies, and Other Services | Payments to or on Behalf of UT | Depreciation | Total |
| **Functional Classification** | | | | |
| Academic programs | $ — | $ 1,450,464 | $ — | $ 1,450,464 |
| Professorships | — | 650,379 | — | 650,379 |
| Faculty development | — | 162,883 | — | 162,883 |
| Scholarships | — | 2,105,286 | — | 2,105,286 |
| Chancellor's discretionary | — | 71,720 | — | 71,720 |
| Other | — | 3,741,608 | — | 3,741,608 |
| Rental expenses | 3,578,508 | — | — | 3,578,508 |
| Administrative and investment fees | 303,274 | — | — | 303,274 |
| Legal | 473,792 | — | — | 473,792 |
| Tax and audit | 31,339 | — | — | 31,339 |
| Depreciation | — | — | 3,199,211 | 3,199,211 |
| Total Expenses | $ 4,386,913 | $ 8,182,340 | $ 3,199,211 | $ 15,768,464 |

# Note 23: Component Unit—University of Tennessee Foundation

The University of Tennessee Foundation Inc., is a private non-profit organization that reports under Financial Accounting Standards Board (FASB) standards, including FASB Statement No. 117, Financial Reporting for Non-Profit Organizations. 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 13 active board members and two 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, 2009, the foundation expended $6,485,914.99 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from the University of Tennessee Foundation, Suite 100, UT Conference Center Building, 600 Henley Street, Knoxville, TN 37996.

## ORGANIZATION AND NATURE OF ACTIVITIES

The University of Tennessee Foundation Inc., is a not-for-profit organization exempt from federal income tax under Section 501(c)(3) of the Internal Revenue Code. The foundation was formed to support the University of Tennessee. The foundation was established to provide flexibility 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.

## PLEDGES RECEIVABLE

Pledges receivable (reported as accounts, notes, and grants receivable on the statement of net assets) are summarized in Table 23.1 (below) net of the allowance for doubtful accounts.

**Table 23.1**

| | Temporarily Restricted | Permanently Restricted |
|---|---|---|
| Current pledges | $ 1,385,803.98 | $ 101,380.16 |
| Pledges due in 1 to 5 years | 34,871,980.91 | 3,625,842.91 |
| Pledges due after 5 years | 17,420,513.21 | 1,534,194.17 |
| | 53,678,298.10 | 5,261,417.24 |
| Less discounts to net present value | (4,906,458.75) | (450,577.03) |
| Total pledges receivable, net | $ 48,771,839.35 | $ 4,810,840.21 |

The allowance for doubtful accounts at June 30, 2009, was $111,237.07.

## INVESTMENTS AND ASSETS HELD BY THE UNIVERSITY OF TENNESSEE

Investments held at June 30, 2009, were as shown in Table 23.2.

**Table 23.2**

| | Market Value | Cost Basis |
|---|---|---|
| **Assets Held by the University of Tennessee** | | |
| U.S. equity | $ 3,376,387.42 | $ 4,289,087.56 |
| International equity | 2,753,277.29 | 3,497,539.21 |
| Fixed income | 2,506,931.42 | 3,184,601.50 |
| Alternative investments: | | |
| Private equity | 1,622,984.50 | 2,061,707.33 |
| Natural resources | 1,289,693.04 | 1,638,321.00 |
| Real estate | 666,582.92 | 846,772.65 |
| Other alternative investments | 2,275,076.49 | 2,890,071.88 |
| Total assets held by university | 14,490,933.08 | 18,408,101.13 |
| **Gift Annuity** | | |
| Equities | 676,919.98 | 879,780.26 |
| Fixed income | 369,582.43 | 376,654.00 |
| Cash equivalents | 36,782.77 | 36,782.77 |
| | 1,083,285.18 | 1,293,217.03 |
| Other investments | 6,001.86 | 5,882.25 |
| Total | $ 15,580,220.12 | $ 19,707,200.41 |

Also reported as investments on the statement of net assets are other gift assets totaling $17,362,075.62, including remainder interests of $16,646,675.62 as described herein.

At June 30, 2009, 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

All foundation endowments are invested in the University of Tennessee Consolidated Investment Pool. The endowments are invested according to the policies of the university. Investment pool earnings for the foundation endowments are provided to the university to be used as stipulated in the endowment agreements. The book value and market value for the endowments invested were $18,408,101.13 and $14,490,933.08, which resulted in a cumulative unrealized loss of $3,917,168.05. All endowments at the foundation are donor restricted. Endowment pool earnings transferred to the university were $820,854.69 for fiscal year 2009.

The foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (UPMIFA) as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result, the foundation classifies permanently restricted net assets as (1) the original value of gifts to the endowment, (2) the original value of subsequent gifts to the endowment, (3) accumulations to the endowment made in accordance with the gift instrument, and

(4) the endowment is vested in the university's Consolidated Investment Pool. Other endowments that are not classified as permanently restricted are classified as temporarily restricted net assets. Table 23.4 (below) shows a schedule of endowments by fund type. Due to the GASB reformatting, temporarily restricted net assets are reported as expendable restricted net assets, and permanently restricted net assets are reported as nonexpendable restricted net assets on the statement of net assets.

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 $3,917,168.05 at June 30, 2009. 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 were deemed prudent.

**Table 23.4**

| | Unrestricted | Temporarily Restricted | Permanently Restricted | Total |
|---|---|---|---|---|
| Beginning balance | $ — | $ 1,034,120.79 | $ 13,799,228.25 | $ 14,833,349.04 |
| Contributions pooled | — | 392,865.64 | 3,684,728.89 | 4,077,594.53 |
| Investment earnings | — | 63,113.77 | 825,469.95 | 888,583.72 |
| Market value adjustment | (3,917,168.05) | — | — | (3,917,168.05) |
| Contributions not pooled | — | — | (10,000.00) | (10,000.00) |
| Disbursements | — | — | (820,854.69) | (820,854.69) |
| Transfer | — | (93,474.18) | (467,097.29) | (560,571.47) |
| Ending balance | $ (3,917,168.05) | $ 1,396,626.02 | $ 17,011,475.11 | $ 14,490,933.08 |

The foundation uses the university's spending policy. The university calculates its spending policy by taking 5 percent of a 3-year market average each December 31.

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

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

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

Disciplined management of the asset allocation is necessary and desirable. Diversification of investments among assets that are not similarly affected by economic, political, or social developments is highly desirable. The general policy shall be to diversify investments so as to provide a balance that will enhance total return, while avoiding undue risk concentrations in any single asset or investment category. To ensure broad diversification, the asset allocation will be set with the target percentages and within the ranges shown in Table 23.5 (below).

**Table 23.5**

| Asset Category | Target (%) | Range (%) |
|---|---|---|
| U.S. equity | 25 | 15–40 |
| International equity | 20 | 10–30 |
| Fixed income | 13 | 10–30 |
| Private equity | 12 | 0–15 |
| Natural resources | 8 | 0–15 |
| Real estate | 7 | 0–15 |
| Other alternative investments | 15 | 0–20 |

Investment type—see above for target allocations. Actual allocations at June 30, 2009, were as shown in Table 23.6.

**Table 23.6**

| | |
|---|---|
| U.S. equity | 23.3% |
| International equity | 19.0% |
| Fixed income | 17.3% |
| Private equity | 11.2% |
| Natural resources | 8.9% |
| Real estate | 4.6% |
| Other alternative investments | 15.7% |

## FAIR VALUE MEASURES

As of July 1, 2008, the foundation adopted Statement of Financial Accounting Standards No. 157, Fair Value Measurements, (SFAS 157), which defines fair value, establishes a framework for measuring fair value under accounting principles generally accepted in the United States, and enhances disclosures about fair value measurements.

SFAS 157 establishes a framework for measuring fair value and a three-level hierarchy for fair value measurements based upon the inputs to value the assets and liabilities. The classification of assets and liabilities within the hierarchy is based on whether the inputs to the valuation methodology used for measurement are observable or unobservable. Observable inputs reflect market-derived or market-based information obtained from independent sources while unobservable inputs reflect estimates about market data based on the best available information in the circumstances. The three levels are defined as follows:

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

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

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

Table 23.7 (below) presents the recorded amount of assets and liabilities measured at fair value.

**Table 23.7**

| | Level 1 | Level 2 | Level 3 | Total |
|---|---|---|---|---|
| Investments | $7,436,062.90 | $2,289,820.27 | $5,854,336.95 | $15,580,220.12 |

Table 23.7 (below) presents additional information about assets and liabilities measured at fair value on a recurring basis by reliance on Level 3 inputs to determine fair value.

**Table 23.7**

| | |
|---|---|
| Beginning balance | $ 7,276,389.56 |
| Total realized and unrealized gains and losses included in earnings | (1,931,383.44) |
| Purchases, issuances, and settlements | 509,330.83 |
| Ending balance | $ 5,854,336.95 |

## MORTGAGE NOTE PAYABLE

The foundation was gifted property in Weakley and Obion counties in Tennessee. The property and its contents were appraised at $376,000.00 with an attached mortgage note of $259,330.41. The property will be used and overseen by the University of Tennessee at Martin. Payment on the note, which began in January 2006, is $2,000.00 per month with the note maturing in December 2020. The note has a 4.68 percent interest rate. For the fiscal year ended June 30, 2009, the note principal was reduced by $13,729.99 with an additional $10,270.01 of interest being paid. The balance of the note payable at June 30, 2009, was $211,954.45. Future maturities of this note are shown in Table 23.8.

**Table 23.8**
**Year ended June 30:**

| | |
|---|---|
| 2010 | $ 14,386.52 |
| 2011 | 15,074.44 |
| 2012 | 15,795.25 |
| 2013 | 16,550.54 |
| 2014 | 17,341.93 |
| 2015–2019 | 99,970.25 |
| 2020–2021 | 32,835.52 |
| Total | $ 211,954.45 |

## CONCENTRATION OF CREDIT RISK

The foundation had concentrated its credit risk for cash by maintaining deposits at a bank, which may at times exceed amounts covered by insurance provided by the U. S. Federal Deposit Insurance Corporation (FDIC). No amount was at risk at June 30, 2009. The foundation has not experienced any such losses in this account and believes it is not exposed to any significant credit risk to cash.

## REMAINDER INTEREST

The amounts described below are reported as investments on the statement of net assets.

In December 2002, a donor conveyed to the foundation a remainder interest in a limited liability company. The asset of the limited liability company is a fee simple interest in a warehouse in South Carolina. The remainder interest was appraised at $7,740,000.00 with the interest vesting on January 1, 2021. The value on the foundation's Statement of Financial Position will be the present value calculation until the vesting date. The IRS discount rate for December 2002 used in determining the present value was 4 percent. The present value of the remainder interest at June 30, 2009, was $4,930,120.78.

In September 2003, a donor conveyed to the foundation another remainder interest in a limited liability company. The asset of this limited liability company is an office building in Connecticut. The remainder interest was appraised at $22,440,000.00 with the interest vesting on January 1, 2025. The value on the foundation's Statement of Financial Position will be the present value calculation until the vesting date. The IRS discount rate for September 2003 was 4.20 percent. The present value at June 30, 2009, was $11,716,554.84.

## NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The foundation's operating expenses by functional classification for the year ended June 30, 2009, are as shown in Table 23.9.

**Table 23.9**

| | Utilities, Supplies, and Other Services | Payments to or on Behalf of UT | Total |
|---|---|---|---|
| **Functional Classification** | | | |
| Program expenses | $ 1,584,830.78 | $ 6,370,983.84 | $ 7,955,814.62 |
| General and administrative | 243,212.18 | 114,931.15 | 358,143.33 |
| Total expenses | $ 1,828,042.96 | $ 6,485,914.99 | $ 8,313,957.95 |

# The University of Tennessee 5-Year Summary

| | FY 2009 | FY 2008 | FY 2007 | FY 2006 | FY 2005 |
|---|---|---|---|---|---|
| **OPERATING REVENUES (,000)** | | | | | |
| Net tuition and fees | $ 255,578 | $ 239,567 | $ 231,621 | $ 232,960 | $ 210,613 |
| Net auxiliary | 165,519 | 157,543 | 160,502 | 134,466 | 129,304 |
| Grants and contracts | 397,348 | 377,475 | 383,659 | 377,289 | 391,942 |
| Other (federal appropriations, sales and services, etc.) | 83,868 | 88,881 | 75,266 | 70,797 | 68,095 |
| Total operating revenues | $ 902,313 | $ 863,466 | $ 851,048 | $ 815,512 | $ 799,954 |
| **OPERATING EXPENSES (,000)** | | | | | |
| Salaries and wages | $ 861,781 | $ 844,192 | $ 807,688 | $ 782,220 | $ 764,122 |
| Fringe benefits | 299,475 | 302,783 | 268,094 | 244,398 | 244,008 |
| Utilities, supplies, and other services | 341,053 | 339,439 | 334,174 | 305,824 | 303,079 |
| Scholarships and fellowships | 32,504 | 28,304 | 30,400 | 24,534 | 21,833 |
| Depreciation expense | 83,767 | 72,561 | 68,469 | 68,158 | 67,320 |
| Total operating expenses | $ 1,618,580 | $ 1,587,279 | $ 1,508,825 | $ 1,425,134 | $ 1,400,362 |
| Operating income (loss) | $ (716,267) | $ (723,813) | $ (657,777) | $ (609,622) | $ (600,408) |
| **NONOPERATING REVENUES AND EXPENSES (,000)** | | | | | |
| State and local appropriations | $ 503,758 | $ 539,634 | $ 492,810 | $ 459,279 | $ 446,293 |
| Gifts | 27,439 | 21,108 | 65,725 | 36,339 | 24,104 |
| Investment income, gains, (losses) | (106,018) | 17,528 | 175,091 | 110,939 | 90,272 |
| Other | 120,770 | 104,933 | 98,546 | 61,830 | 50,993 |
| Total nonoperating revenues | $ 545,949 | $ 683,203 | $ 832,172 | $ 668,387 | $ 611,662 |
| **OTHER REVENUES, EXPENSES, GAINS OR LOSSES** | | | | | |
| Capital appropriations | 105,300 | 69,592 | 32,834 | 24,579 | 15,137 |
| Capital grants and gifts | 28,156 | 41,044 | 22,875 | 18,284 | 12,556 |
| Additions to permanent endowments | 9,813 | 17,812 | 17,827 | 36,029 | 15,032 |
| Other | 712 | 8,772 | 905 | 10,206 | (5,423) |
| Total other revenues, expenses, gains or losses | $ 143,981 | $ 137,220 | $ 74,441 | $ 89,098 | $ 37,302 |
| Increase (decrease) in net assets | $ (26,338) | $ 96,610 | $ 248,836 | $ 147,863 | $ 48,556 |
| Cash | $ 727,599 | $ 627,451 | $ 564,094 | $ 488,559 | $ 494,770 |
| **NET ASSETS** | | | | | |
| Invested in capital assets, net of related debt | $ 970,344 | $ 868,014 | $ 773,979 | $ 750,758 | $ 713,142 |
| Restricted expendable | 402,260 | 541,286 | 588,963 | 432,796 | 348,315 |
| Restricted nonexpendable | 392,063 | 391,668 | 379,343 | 358,337 | 335,859 |
| Unrestricted | 294,013 | 284,050 | 246,123 | 197,681 | 194,393 |
| Total net assets | $ 2,058,680 | $ 2,085,018 | $ 1,988,408 | $ 1,739,572 | $ 1,591,709 |
| **STUDENT LOANS** | | | | | |
| Notes receivable | $ 35,127 | $ 35,933 | $ 34,133 | $ 34,632 | $ 35,211 |
| Loans issued (by year) | 1,748 | 1,729 | 2,560 | 2,674 | 2,210 |
| **ENDOWMENTS (,000)** | | | | | |
| Market value | $ 470,068 | $ 646,927 | $ 697,947 | $ 585,445 | $ 503,657 |
| **LIFE INCOME FUNDS** | | | | | |
| Market value | $ 32,293 | $ 42,451 | $ 57,722 | $ 53,134 | $ 51,327 |
| **CAPITAL ASSET AND DEBT ADMINISTRATION (,000)** | | | | | |
| Capital assets, net of depreciation | $ 1,494,048 | $ 1,335,610 | $ 1,128,100 | $ 1,024,534 | $ 963,077 |
| Total debt | $ 518,244 | $ 461,965 | $ 351,626 | $ 278,257 | $ 248,123 |

# 5-Year Summary (*continued*)

| | FY 2009 | FY 2008 | FY 2007 | FY 2006 | FY 2005 |
|---|---|---|---|---|---|
| **GENERAL DATA** | | | | | |
| Total enrollment | 47,821 | 46,691 | 44,796 | 43,686 | 42,579 |
| Knoxville | 27,769 | 27,308 | 26,560 | 26,292 | 25,653 |
| Chattanooga | 9,807 | 9,557 | 8,923 | 8,656 | 8,689 |
| Martin | 7,574 | 7,171 | 6,888 | 6,478 | 6,098 |
| Memphis | 2,671 | 2,655 | 2,425 | 2,260 | 2,139 |
| Degrees granted | 9,503 | 8,949 | 8,826 | 8,836 | 8,885 |
| Full-time employees | 11,112 | 11,991 | 11,942 | 12,054 | 11,758 |
| Full-time faculty | 3,294 | 3,166 | 2,864 | 2,853 | 2,565 |
| % Tenured (based on those eligible for tenure) | 51.5% | 48.0% | 53.9% | 51.9% | 58.2% |
| Total private gifts (,000) | $ 101,452 | $ 106,800 | $ 98,267 | $ 110,663 | $ 80,543 |
| Academic-year student fees (Knoxville) | | | | | |
| In state | $ 3,125 | $ 5,932 | $ 5,622 | $ 5,290 | $ 4,748 |
| Out of state (additional) | $ 6,329 | $ 11,945 | $ 11,266 | $ 10,770 | $ 9,530 |
| State appropriation/FTE | $ 7,884 | $ 8,551 | $ 7,873 | $ 7,472 | $ 7,380 |
| | | | | | |
| Instruction | $ 527,273 | $ 524,165 | $ 489,890 | $ 462,831 | $ 443,704 |
| Research | 206,315 | 204,116 | 198,105 | 197,131 | 203,725 |
| Public service | 130,937 | 133,698 | 128,002 | 126,454 | 124,241 |
| Academic support | 113,095 | 111,313 | 101,815 | 94,388 | 89,250 |
| Student services | 75,241 | 72,571 | 66,282 | 62,266 | 60,901 |
| Institutional support | 99,163 | 100,548 | 86,091 | 80,647 | 76,093 |
| Op/maint physical plant | 115,034 | 99,573 | 103,055 | 90,225 | 93,516 |
| Scholarships/fellowships | 71,784 | 66,036 | 64,761 | 59,717 | 51,546 |
| Auxiliary enterprises | 121,290 | 121,374 | 119,236 | 99,710 | 101,753 |
| Hospitals | - | - | - | 197 | 1,447 |
| Independent operations | 74,680 | 81,324 | 83,019 | 83,410 | 86,865 |
| Depreciation | 83,768 | 72,561 | 68,469 | 68,159 | 67,321 |
| Total | $ 1,618,580 | $ 1,587,279 | $ 1,508,725 | $ 1,425,135 | $ 1,400,362 |

# Administration of the University of Tennessee

**FROM JULY 1, 2008 THROUGH JUNE 30, 2009**

## Board of Trustees

**The Board of Trustees, governs the University of Tennessee. The governor, who also serves as chair of the board, appoints board members. The board meets at least three times a year, and its sessions are open to the public.**

**GOVERNOR PHIL BREDESEN, CHAIR**, Ex officio as governor of the State of Tennessee

**JAMES L. MURPHY III, VICE-CHAIR**, Fifth District

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**ANNE HOLT BLACKBURN**, Seventh District

**WILLIAM Y. CARROLL**, First District

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**TYLER S. FORREST (UT CHATTANOOGA)**, Nonvoting student trustee

**JOHN N. FOY**, Hamilton County

**D. CRAWFORD GALLIMORE**, Weakley County

**KEN GIVENS**, Ex officio as commissioner of agriculture of the State of Tennessee

**MONICE MOORE HAGLER**, Shelby County

**JAMES E. HALL**, Third District

**DOUGLAS A. HORNE**, Second District

**ANDREA J. LOUGHRY**,Sixth district

**BRITTANY A. MCGRUDER (UT MARTIN)**, Voting student trustee

**VERBIE PREVOST, (UT CHATTANOOGA)**, Nonvoting faculty trustee

**RICHARD G. RHODA**, Ex officio nonvoting member as executive director of the Tennessee Higher Education Commission

**KARL A. SCHLEDWITZ**, Shelby County

**JAN SIMEK**, Ex officio as interim president of the University of Tennessee

**JOHN J. SCHOMMER (UT MARTIN)**, Voting faculty trustee

**DON C. STANSBERRY JR.**, Fourth District

**ROBERT S. TALBOTT**, Knox County

**BETTY ANN TANNER**, Eighth District

**TIMOTHY K. WEBB**, Ex officio as commissioner of education of the State of Tennessee

**CHARLES E. WHARTON**, Anderson, Bedford, Coffee, Franklin, Lincoln, Moore, and Warren counties

### SENIOR ADMINISTRATIVE OFFICERS

**JAN SIMEK**, Interim president

**SYLVIA S. DAVIS**, Vice-president for strategic planning and operations

**JOSEPH A. DIPIETRO**, Vice-president for agriculture

**HANK DYE**, Vice-president for public and government relations

**LINDA HENDRICKS**, Chief human resources officer

**BONNIE YEGIDIS**, Vice-president for academic affairs and student success

**MARY JINKS**, Vice-president of public service

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**CATHERINE S. MIZELL**, General counsel and secretary

**HENRY NEMCIK**, Vice-president for development and alumni affairs

**MARK PAGANELLI**, Executive director of Audit and Consulting Services

**CHARLES M. PECCOLO**, Treasurer and chief investment officer

**THEOTIS ROBINSON**, Vice-president for equity and diversity

**GARY W. ROGERS**, Senior vice-president and chief financial officer

### Chancellors

**ROGER G. BROWN**, Chancellor of the University of Tennessee at Chattanooga

**JIMMIE G. CHEEK**, Chancellor of the University of Tennessee Knoxville

**TOM RAKES**, Chancellor of the University of Tennessee at Martin

**HERSHEL P. WALL**, Chancellor of the University of Tennessee Health Science Center

### FINANCIAL STAFF, UNIVERSITY ADMINISTRATION

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**CHARLES M. PECCOLO**, Treasurer and chief investment officer

**ROBERT C. CHANCE**, Director of payrolls

**TIMOTHY F. MAPES**, assistant treasurer

**RON MAPLES**, Controller

**MARY MCDONALD**, Director of contracts

**JUDY MCGHEE**, Director of risk management

**MARK PAGANELLI**, Executive director of Audit and Consulting Services

**CINDY STOCKDALE**, Director of accounts payable

**JERRY WADE**, Director of purchasing

**NEAL WORMSLEY**, Director of IRIS

### FINANCIAL STAFF, CAMPUSES AND UNITS

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**CHRIS CIMINO**, Vice-chancellor of finance and administration, UT Knoxville

**RICHARD L. BROWN JR.**, Vice-chancellor of finance and operations, UT Chattanooga

**ANTHONY FERRARA**, Vice-chancellor of finance and operations, UT Health Science Center

**AL HOOTEN**, Vice-chancellor of finance and administration, UT Martin

**RON LOEWEN**, Budget director, UT Institute for Public Service