Report of The Treasurer 2010

THE UNIVERSITY of TENNESSEE

KNOXVILLE, CHATTANOOGA, MARTIN, TULLAHOMA, MEMPHIS

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.

Contents

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, 2010. A separate publication, "Report of the Treasurer 2010 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

Treasurer, Chief Investment Officer and Interim Chief Financial Officer

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 30, 2010

The Honorable Phil Bredesen, Governor

and Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

and Mr. James E. Hall, Chairman
Audit Committee
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, 2010, 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., the University of Tennessee Foundation, Inc., and the University of Tennessee Research 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., the University of Tennesssee Foundation, Inc., and the University of Tennessee Research 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, 2010, 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 discussed in Note 26 to the financial statements, the university began to report the University of Tennessee Research Foundation as a discretely presented component unit in the year ended June 30, 2010.

As explained in Note 2, the financial statements include investments valued at $301,308,598.97 (13.3 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 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 30, 2010, 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 considered in assessing 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, 2010, with comparative information presented for the fiscal year ended June 30, 2009. 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 is a component unit of the State of Tennessee and an integral part of the state's Comprehensive Annual Financial Report (CAFR). The financial reporting entity for the financial statements is comprised of the university and three component units. The component units are discretely presented based on the nature and significance of their relationship to the university. The reader may refer to Note 1 for detailed information on the financial reporting entity.

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. See Table 1.

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

Current assets increased between fiscal years due to increases in unrestricted fund cash and cash equivalents, restricted fund accounts receivable, and the value of quasi-endowment investments. A large cash deposit on June 30, 2010, contributed to the cash increase. Also, the university reported \$7.8 million of State Fiscal Stabilization Funds due from the state of Tennessee on June 30, 2010, with no corresponding receivable at June 30, 2009.

The increase in net capital assets between fiscal years is a result of additions to the university's capital assets. More detailed information

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

	2010	2009
ASSETS:		
Current assets	$ 497,916	$ 462,470
Capital assets, net	1,609,656	1,494,048
Other assets	1,154,605	1,058,832
TOTAL ASSETS	3,262,177	3,015,350
LIABILITIES:		
Current liabilities	301,910	318,246
Noncurrent liabilities	694,863	638,424
TOTAL LIABILITIES	996,773	956,670
NET ASSETS:		
Invested in capital assets, net of related debt	1,075,557	970,344
Restricted—nonexpendable	408,475	392,063
Restricted—expendable	419,862	402,260
Unrestricted	361,510	294,013
TOTAL NET ASSETS	$ 2,265,404	$ 2,058,680

about the university's capital assets is presented in the Capital Asset and Debt Administration section of this report.

Other (noncurrent) assets of cash and cash equivalents, investments, and capital assets increased between the fiscal years. Cash and cash equivalents increased due to a changing investment mix to adjust to activity in the capital markets. Investments increased due to increases in the book value of investments as well as increases in the market value. Noncurrent accounts, notes, and grants receivable decreased due to decreases in notes receivable and the university's state capital outlay and maintenance receivable.

Current liabilities decreased due to the reduction of a one-time American Recovery and Reinvestment Act (ARRA) repayment due to the primary government, even though accounts payable and deferred revenues increased.

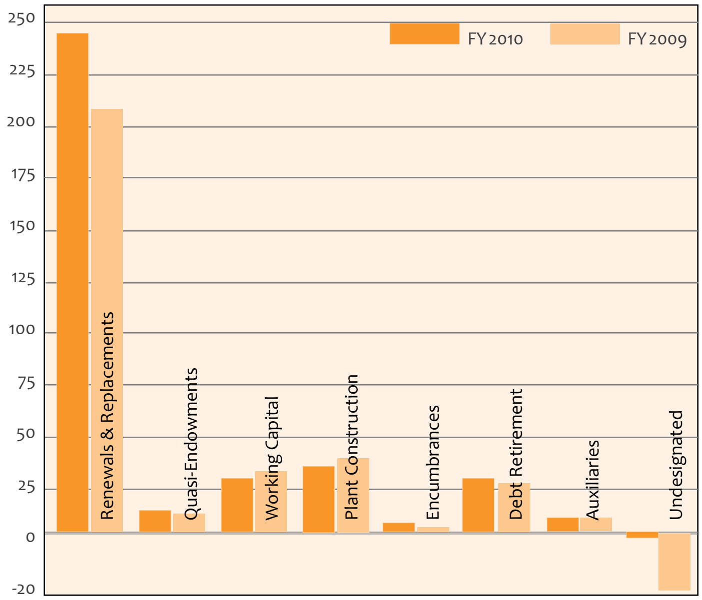
Noncurrent liabilities increased between fiscal years due to the issuance of commercial paper by the Tennessee State School Bond Authority on behalf of the university for various capital projects. More detailed information about the university's debt is presented in the Capital Asset and Debt Administration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

The restricted-expendable net assets increased between fiscal years as a result of accumulated private dollars on scholarships and fellowships, instructional department uses and other restricted purposes. These funds will be spent in future years.

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. See figure A (right).

Renewals and replacements increased for 2009 to 2010 due to unspent educational and general dollars with the expectation that fiscal years 2011 and 2012 would be leaner. The change in the designation for plant construction between fiscal years is attributable to funds set aside to fund future projects.

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



The undesignated amount increased for 2009 to 2010 due to the carryover of unspent one-time funds from the state.

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

The statement of revenues, expenses, and changes in net assets (on the next page) 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 2009 to 2010 as a result of a 9% fee increase. However, this increase in tuition and fee revenue was partially offset by current and new 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 almost stayed the same from 2009 to 2010 with the addition of ARRA awards in 2010 and the completion of the National Science Foundation (NSF) super computer grant at Knoxville in 2009.

Auxiliary revenues increased $13.3 million, primarily in men's athletics at Knoxville.

In fiscal year 2010, state appropriations decreased $27 million which represented a 5.3 % reduction in state appropriations due to lagging state tax collections.

Nonoperating gifts increased $14 million from 2009 to 2010 while capital gifts decreased $5 million for the same time period.

The increase in investment income was due to an increase in endowment income and an overall increase in the capital markets.

The decrease in capital appropriations for 2010 consisted of a decrease in state appropriations for new buildings and capital maintenance.

Additions to permanent endowments and annuity and life income trusts increased $7 million from 2009 to the 2010 fiscal year.

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

	2010	2009
OPERATING REVENUES:		
Net tuition and fees	$ 279,638	$ 255,578
Grants and contracts	395,316	397,348
Auxiliary	178,845	165,519
Other	85,009	83,868
TOTAL OPERATING REVENUES	938,808	902,313
Operating expenses	1,683,195	1,618,580
OPERATING LOSS	(744,387)	(716,267)
NONOPERATING REVENUES AND EXPENSES:		
State and local appropriations	477,120	503,758
Gifts	41,844	27,439
Investment income	117,281	(106,018)
Other	182,409	120,769
TOTAL NONOPERATING REVENUES AND EXPENSES	818,654	545,948
INCOME (LOSS) BEFORE OTHER REVENUES, EXPENSES, GAINS, OR LOSSES	74,267	(170,319)
OTHER REVENUES, EXPENSES, GAINS, OR LOSSES:		
Capital appropriations	91,550	105,300
Capital grants and gifts	23,266	28,156
Additions to permanent endowments/annuities and life income trusts	16,758	9,813
Other	883	712
TOTAL OTHER REVENUES, EXPENSES, GAINS, OR LOSSES	132,457	143,981
INCREASE (DECREASE) IN NET ASSETS	206,724	(26,338)
NET ASSETS AT BEGINNING OF YEAR	2,058,680	2,085,018
NET ASSETS AT END OF YEAR	$ 2,265,404	$ 2,058,680

REVENUES

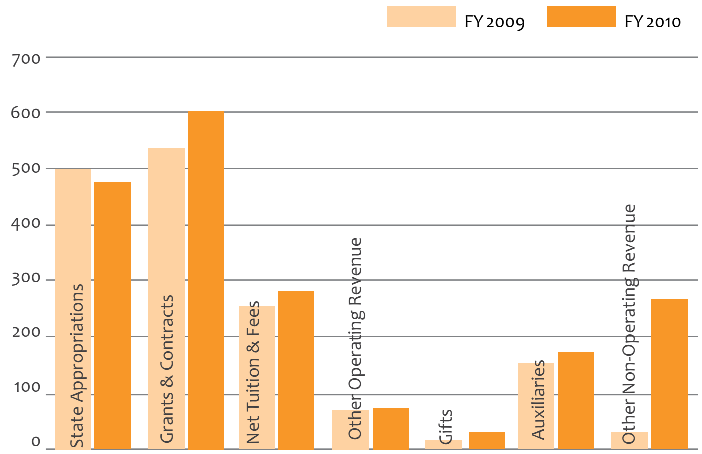
The following is a graphic illustration (Figure B) of revenues by source (both operating and nonoperating), which were used to fund the university's activities for the years ended June 30, 2010, and June 30, 2009.

For the year ended June 30, 2010, approximately seventy-one 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 in Table 3 on the next page (in thousands of dollars). The university had the following significant changes in expenses between fiscal years:

Figure B. Revenues by Source ($millions)



The decrease in salary and benefit expenses from 2009 to 2010 is a result of reductions in staff in preparation of the discontinuence of ARRA funding.

Employee benefit expenses decreased slightly between fiscal years mainly as a result of reducing the number of employees and hiring more part time employees.

Other operating expenses (utilities, supplies, and other services) increased between fiscal years due to the availability of one-time ARRA funds to fund maintenance costs and minor equipment purchases.

Scholarship expenses increased due to departments giving more aid to students compared to the previous fiscal year.

The increases in research, operation and maintenance of plant, and depreciation were due to the addition of stimulus funds.

CAPITAL ASSET AND DEBT ADMINISTRATION

Capital Assets

At June 30, 2010, the University of Tennessee had $1,609,656,277.92 invested in capital assets, net of accumulated depreciation. Depreciation charges totaled $94,157,402.38 for the current fiscal year. Details of these assets are shown below (Table 4).

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

	2010	2009
Land	$ 60,121	$ 56,741
Land improvements & infrastructure	25,255	25,862
Buildings	1,093,497	981,313
Works of art/historical treasures	528	528
Equipment	145,876	147,527
Software	8,168	1,705
Library holdings	70,692	68,583
Projects in progress	205,519	211,789
Total	$ 1,609,656	$ 1,494,048

Major capital additions for UT during 2009-2010 include the $84 million Neyland Stadium Improvements, $27.8 million Thompson-Boling Arena Improvements, the $1.9 million Alpha Tau Omega Fraternity House, the $2.1 million Sigma Nu Fraternity House, and the $3.2 million Humes Hall Renovation in Knoxville; the $16.5 million Recreation/Wellness Facility and the $1.9 million Brehm Building Addition in Martin; the $28.4 million Regional Bio-Containment Laboratory Basic/Clinical Sciences Building in Memphis; and the $25.1 million Wellness Center in Chattanooga.

For the next fiscal year, the state has approved $21.14 million in capital maintenance appropriations for UT. These approved new projects are the Electrical Distribution System Improvements Phase III and the Humanities and McClung Tower HVAC at Knoxville; the Metropolitan Building Repairs and HVAC at Chattanooga; the Molecular Science Building Window and HVAC at Memphis; Roof Replacements at Martin; The East Tennessee Research and Education Center Improvements at the Institute of Agriculture; the Main Academic Building Improvements at the Space Institute; and the University-Wide Facilities Assessment Phase III. 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.

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

	2010 NATURAL CLASSIFICATION					
	SALARIES	BENEFITS	UTILITIES, SUPPLIES, AND OTHER SERVICES	SCHOLARSHIPS	DEPRECIATION	TOTAL
2010 Functional Classification						
Instruction	$ 362,847	$ 103,476	$ 59,659	$ —	$ —	$ 525,982
Research	125,759	32,926	76,364	—	—	235,049
Public service	67,506	23,849	33,519	—	—	124,874
Academic support	65,812	23,082	18,435	—	—	107,329
Student services	39,129	13,393	23,265	—	—	75,787
Institutional support	71,514	25,226	—	—	—	96,740
Operation and maintenance of plant	32,789	14,976	93,702	—	—	141,467
Scholarships	3,857	19,903	18,846	45,389	—	87,995
Auxiliary	40,075	12,197	72,179	—	—	124,451
Independent operations	50,418	18,945	—	—	—	69,363
Depreciation	—	—	—	—	94,158	94,158
Total expenses	$ 859,706	$ 287,973	$ 395,969	$ 45,389	$ 94,158	$ 1,683,195

	2009 NATURAL CLASSIFICATION					
	SALARIES	BENEFITS	UTILITIES, SUPPLIES, AND OTHER SERVICES	SCHOLARSHIPS	DEPRECIATION	TOTAL
2009 Functional Classification						
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

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

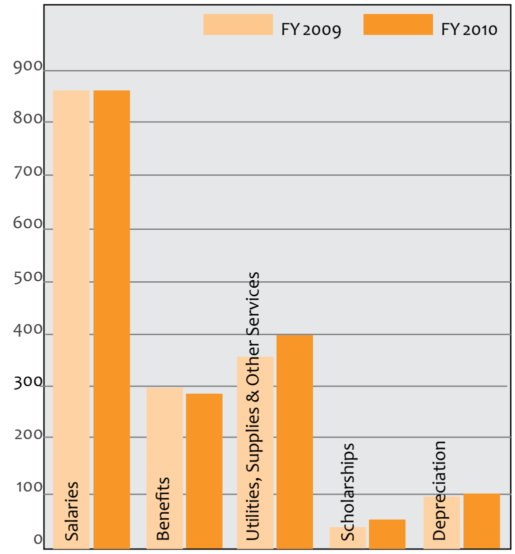
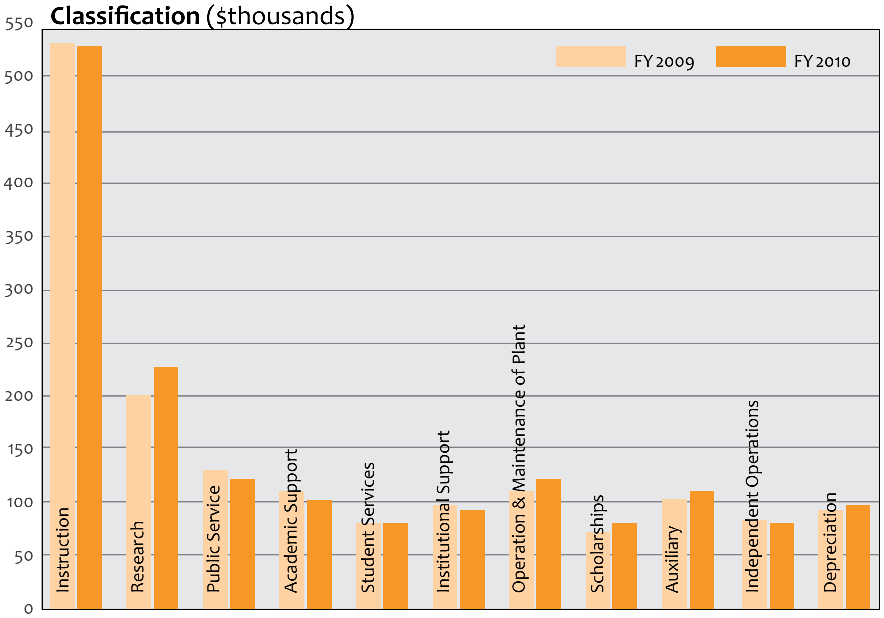


Figure D. Operating Expenses by Functional Classification ($thousands)



Debt

At June 30, 2010, the university had $545,168,021.16 in debt outstanding. Table 5 summarizes these amounts by type of debt instrument.

Table 5. Outstanding Debt Schedule ($thousands)

	2010	2009
Bonds—current portion	$ 22,299	$ 24,635
Bonds—noncurrent	359,731	372,867
Commercial paper—noncurrent	163,126	120,742
Total TSSBA authorized debt	$ 545,156	$ 518,244
Notes—current portion	12	12
Notes—noncurrent portion	-	11
Total debt	$ 545,168	$ 518,267

The university retired more than $24.6 million in bonds and notes in fiscal year 2009-2010. 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 currently is rated AA by Standard & Poor. More detailed information about the university's long-term liabilities is presented in Note 8 to the financial statements.

ECONOMIC FACTORS THAT WILL AFFECT THE FUTURE

For fiscal year 2011, the University of Tennessee Board of Trustees has authorized an individual campus fee increase of 9% that is expected to generate approximately $26 million in new funding, net of related scholarships, with a continued projected enrollment increase. State appropriations will continue to be reduced; however, the university has been awarded over $58 million in one-time nonrecurring state appropriations for fiscal year 2011. The university has also been awarded over $113 million in stimulus, 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, 711 Andy Holt Tower, Knoxville, Tennessee, 37996-0100.

Statement of Net Assets

JUNE 30, 2010

	THE UNIVERSITY OF TENNESSEE	UNIVERSITY OF CHATTANOOGA FOUNDATION INC.	UNIVERSITY OF TENNESSEE FOUNDATION INC.	THE UNIVERSITY OF TENNESSEE RESEARCH FOUNDATION INC.
ASSETS				
Current assets:				
Cash and cash equivalents (Note 2)	$292,637,388.46	$8,765,958.00	$1,123,891.50	$1,979,491.00
Investments (Notes 2, 23, 24 and 25)	91,019,415.59		1,702,334.53	
Accounts, notes, and grants receivable (net) (Note 4)	96,335,902.24	443,151.00	3,251,309.92	3,256,714.00
Due from primary government	7,856,242.91			
Inventories	7,404,705.16		67,850.00	
Prepaid expenses and deferred charges	2,662,754.93	43,564.00	17,503.41	44,085.00
Total current assets	497,916,409.29	9,252,673.00	6,162,889.36	5,280,290.00
Noncurrent assets:				
Cash and cash equivalents (Note 2)	499,425,231.05		1,893,799.03	
Investments (Notes 2, 23, 24, and 25)	482,361,269.94	89,113,278.00	18,167,702.10	312,842.00
Investment in UT–Battelle LLC (Note 14)	4,218,718.42			
Accounts, notes, and grants receivable (net) (Note 4)	119,309,321.94	734,599.00	59,111,143.10	3,005,873.00
Lease payments receivable (Note 18)	48,411,561.76			
Capital assets (net) (Notes 5, 23 and 25)	1,609,656,277.92	64,473,717.00		58,148,760.00
Prepaid expenses and deferred charges	878,376.47	433,441.00		
Assets held by the university		470,956.00	28,573,426.13	
Total noncurrent assets	2,764,260,757.50	155,225,991.00	107,746,070.36	61,467,475.00
Total assets	$3,262,177,166.79	$164,478,664.00	$113,908,959.72	$66,747,765.00
LIABILITIES				
Current liabilities:				
Accounts payable (Note 7)	$96,882,718.65	$1,714,733.00	$20,488.63	$4,402,988.00
Accrued liabilities	43,049,447.02			
Deferred revenue	82,404,721.34	97,659.00		877,302.00
Due to primary government	871,200.00			
Deposits payable	4,694,329.47			
Annuities payable	1,224,734.60		41,551.04	
Long-term liabilities, current portion (Notes 8, 23, and 24)	68,260,828.12	1,630,000.00	15,015.88	
Deposits held in custody for others	4,521,695.24	1,900,307.47		
Due to the university		784,423.53	6,969.19	
Total current liabilities	301,909,674.44	6,127,123.00	84,024.74	5,280,290.00
Noncurrent liabilities:				
Deferred revenue (Note 8 and 25)	15,500,438.71			20,689,717.00
Long-term liabilities, noncurrent portion (Notes 8, 23, and 24)	608,938,741.59	82,013,796.00	183,776.76	704,922.00
Due to grantors (Note 8)	36,066,487.07			
Annuities payable (Note 8)	5,784,480.00		581,460.80	
Deposits held in custody for component units	28,573,426.13			
Total noncurrent liabilities	694,863,573.50	82,013,796.00	765,237.56	21,394,639.00
Total liabilities	$996,773,247.94	$88,140,919.00	$849,262.30	$26,674,929.00
NET ASSETS				
Invested in capital assets, net of related debt	$1,075,557,484.49			$36,581,741.00
Restricted:				
Nonexpendable:				
Scholarships and fellowships	181,920,462.79	$12,288,922.00	$8,946,611.14	
Libraries	13,570,256.54		245,059.36	
Research	18,153,935.54		284,551.55	
Instructional department uses	131,916,050.15	24,912,316.00	7,987,672.12	
Academic support	27,784,493.84	89,442.00	11,619,991.11	
Other	35,129,678.86	112,553.00	12,887,270.46	
Expendable:				
Scholarships and fellowships	80,148,790.16	465,416.00	19,572,331.58	
Libraries	7,175,273.48		194,204.26	
Research	62,323,841.00		1,984,401.92	
Instructional department uses	70,616,269.74	2,506,358.00	282,012.11	
Academic support	32,301,697.10	9,712.00	20,473,633.54	
Loans	10,125,064.47			
Capital projects	67,453,333.55	5,000,000.00	16,787,829.13	
Debt service	1,364,603.62			
Other	88,353,067.50	2,801,213.00	13,922,761.44	
Unrestricted (Note 9)	361,509,616.02	28,151,813.00	(2,128,632.30)	3,491,095.00
Total net assets	$2,265,403,918.85	$76,337,745.00	$113,059,697.42	$40,072,836.00

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, 2010

	THE UNIVERSITY OF TENNESSEE	UNIVERSITY OF CHATTANOOGA FOUNDATION INC.	THE UNIVERSITY OF TENNESSEE FOUNDATION INC.	THE UNIVERSITY OF TENNESSEE RESEARCH FOUNDATION INC.
REVENUES				
Operating revenues:				
Student tuition and fees (net of scholarship allowances of $133,828,939.95)	$279,638,186.40			
Contributions		$140,728.00	$7,398,023.89	$1,591,419.00
Investment return designated for operations		6,257,230.00		
Federal appropriations	14,373,631.61			
Governmental grants and contracts	251,208,333.29			
Non-governmental grants and contracts	144,107,857.53			3,685,454.00
Sales and services of educational departments	50,282,136.52			
Auxiliary enterprises:				
Residential life (net of scholarship allowances of $1,539,267.73; all revenues are used as security for varying revenue bonds; see Note 8)	48,545,699.19	9,758,115.00		
Food services	4,472,115.62			
Bookstore	19,039,020.54			
Parking	10,916,671.92			
Athletics	90,063,988.46			
Other auxiliaries	5,806,975.96			
Interest earned on loans to students	40,932.57			
Other operating revenues	20,311,577.14		182,938.83	
Total operating revenues	$938,807,126.75	$16,156,073.00	$7,580,962.72	5,276,873.00
EXPENSES				
Operating expenses (Note 20):				
Salaries and wages	$859,706,314.61			$1,753,488.00
Fringe benefits	287,973,220.27			275,888.00
Utilities, supplies, and other services	395,968,588.85	$3,647,931.00	$1,054,257.41	5,532,367.00
Scholarships and fellowships	45,389,227.32			
Depreciation expense	94,157,402.38	3,151,533.00		486,206.00
Payments to or on behalf of the university (Notes 23 and 24)		6,257,230.00	9,666,750.64	
Total operating expenses	1,683,194,753.43	13,056,694.00	10,721,008.05	8,047,949.00
Operating income (loss)	$(744,387,626.68)	$3,099,379.00	$ (3,140,045.33)	$(2,771,076.00)
NONOPERATING REVENUES (EXPENSES)				
State and local appropriations	$477,120,357.29			
Gifts (includes $15,923,980.64 from component units)	41,844,163.52			
Grants and contracts	208,739,758.15			$2,404,726.00
Investment income (loss)	117,280,608.03	$4,306,614.00	$2,595,074.49	28,198.00
Interest on capital asset - related debt	(19,983,123.60)	(4,507,940.00)		
Other nonoperating revenues (expenses)	(6,347,623.33)	(76,767.00)		(4,831.00)
Net nonoperating revenues (expenses)	818,654,140.06	(278,093.00)	2,595,074.49	2,428,093.00
Income (loss) before other revenues, expenses, gains, or losses	74,266,513.38	2,821,286.00	(544,970.84)	(342,983.00)
Capital appropriations	91,550,040.10			
Capital grants and gifts	23,265,763.50			30,238,763.00
Additions to permanent endowments	16,226,287.37	671,645.00	19,630,452.78	
Additions to annuity and life income trusts	532,038.89			
Other	883,042.32			382,044.00
Total other revenues	132,457,172.18	671,645.00	19,630,452.78	30,620,807.00
Increase (decrease) in net assets	$206,723,685.56	$3,492,931.00	$19,085,481.94	$30,277,824.00
NET ASSETS				
Net assets at beginning of year	2,058,680,233.29	72,844,814.00	93,974,215.48	9,795,012.00
Net assets at end of year	$2,265,403,918.85	$76,337,745.00	$113,059,697.42	$40,072,836,.00

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

Statement of Cash Flows FOR THE YEAR ENDED JUNE 30, 2010

CASH FLOWS FROM OPERATING ACTIVITIES

Tuition and fees	$280,159,214.97
Federal appropriations	14,373,631.61
Grants and contracts	395,943,040.77
Sales and services of educational activities	46,029,480.88
Payments to suppliers and vendors	(412,589,987.83)
Payments to employees	(860,624,238.79)
Payments for benefits	(269,840,907.18)
Payments for scholarships and fellowships	(45,389,227.32)
Loans issued to students	(2,480,559.49)
Collection of loans from students	3,735,251.46
Interest earned on loans to students	559,874.83
Auxiliary enterprise charges:	
Residence halls	48,545,699.19
Bookstore	19,039,020.54
Food service	4,472,115.62
Parking	10,916,671.92
Athletics	88,115,519.11
Other auxiliaries	5,218,143.25
Hospital	8,365.57
Other receipts (payments)	18,823,779.08
Net cash provided (used) by operating activities	$(654,985,111.81)

CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES

State appropriations	$471,022,904.72
Local appropriations	5,183,652.57
Gifts and grants for other than capital or endowment purposes	238,523,307.46
Private gifts for endowment purposes	16,226,287.37
Split-interest transactions receipts	587,860.51
Split-interest transactions disbursements	(2,656,896.64)
Federal student loan receipts	242,368,402.75
Federal student loan disbursements	(242,368,402.75)
Changes in deposits held for others	(1,679,131.29)
Net cash balance implicitly financed (repaid)	(4,198,937.76)
Other noncapital receipts (payments)	1,415,081.21
Net cash provided (used) by noncapital financing activities	$724,424,128.15

CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES

Proceeds from capital debt	$54,965,376.37
Capital appropriations	95,038,802.61
Capital grants and gifts received	23,265,763.50
Proceeds from sale of capital assets	1,635,744.05
Purchase of capital assets and construction	(217,139,547.79)
Principal paid on capital debt and leases	(27,727,134.37)
Interest paid on capital debt and leases	(20,193,239.84)
Other capital and related financing receipts (payments)	(970,914.29)
Net cash provided (used) by capital and related financing activities	$(91,125,149.76)

CASH FLOWS FROM INVESTING ACTIVITIES

Proceeds from sales and maturities of investments	$199,607,529.78
Income on investments	81,457,249.57
Purchase of investments	(194,914,633.34)
Net cash provided (used) by investing activities	86,150,146.01
Net increase (decrease) in cash and cash equivalents	64,464,012.59
Cash and cash equivalents at beginning of year	727,598,606.92
Cash and cash equivalents at end of year	$792,062,619.51

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

Operating loss	$(744,387,626.68)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:	
Depreciation expense	94,157,402.38
Changes in assets and liabilities:	
Receivables, net	(14,986,331.15)
Inventories	677,924.12
Prepaid expenses and deferred charges	(161,881.88)
Accrued interest receivable	518,942.26
Accounts payable	(17,145,448.82)
Accrued liabilities	15,369,738.12
Deferred revenue	8,622,941.26
Deposits	(750,114.18)
Compensated absences	1,844,650.79
Other additions (deductions):	
Loans to students	1,254,691.97
Net cash provided (used) by operations	$(654,985,111.81)

NONCASH TRANSACTIONS

Gifts of capital assets	$363,243.00
Unrealized loss on investments	35,505,996.56
Loss on disposal of capital assets	$(4,310,201.06)

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 is comprised of 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 26 members, including one student and one faculty member, all either ex officio or appointed by the Governor, who also serves as chairman. The president is the chief executive officer of the university system.

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

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 prior to 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) non-operating 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 which 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, 2010. 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 assets or materially extend the assets' useful lives are not capitalized.

A capitalization threshold of $100,000 is used for buildings, land improvements, and infrastructure. Equipment and software are capitalized when the unit acquisition cost is $5,000 or greater and the estimated useful life is one year or more. The capitalization threshold for additions and improvements to 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% 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 $6,925,830.66 as of June 30, 2010. 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% of the portfolio in total and that no more than 10% of the portfolio's value be in the commercial paper of a single issuer. In addition, banker's acceptances cannot exceed 20% of the portfolio's value and no one banker's acceptance may exceed 10%. Money market funds cannot exceed 10% of the portfolio's total value. At June 30, 2010, the university's cash management investment pool consisted of $593,050,000.00 of certificates of deposits and $174,000.00 of demand deposits yielding money market rates.

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

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

Cash and Cash Equivalents

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

At June 30, 2010, cash and cash equivalents consisted of $196,830,618.23 in bank accounts, $1,440,357.80 in petty cash on hand, and $593,050,000.00 in certificates of deposit.

The carrying amount of the university's deposits was $789,880,618.23 and the bank balance was $793,912,984.81.

Additionally, the university maintains custodial accounts at First Tennessee Bank and Hilliard Lyons for funds contractually managed by independent investment counsel. In accordance with the custody agreements, First Tennessee Bank and Hilliard Lyons placed cash equivalents totaling $741,643.48 at June 30, 2010, 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, 2010, 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, 2010, the university had the investments and maturities as shown on Table 2.1.

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, 2010, 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 no investment policy limiting its investment choice based on ratings issued by nationally recognized statistical rating agencies. As of June 30, 2010, the institution's investments were rated as shown in Table 2.2.

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, 2010, the university had $5,653,632.90 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. At June 30, 2010, there was no single issuer with whom the university had more than five percent of its invested funds.

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 $1,828,194.37 invested in foreign corporate equities and $298,785.00 invested in foreign corporate bonds at June 30, 2010.

Table 2.1. Investment Maturities (in years)						
Investment Type	**Fair Value**	**Less than 1**	**1 to 5**	**6 to 10**	**10+**	**Cost**
Debt Securities						
U.S. Treasury	$ 2,992,667.95	$ 591,779.74	$ 911,753.65	$ 624,546.85	$ 864,587.71	$ 2,573,173.48
U.S Agencies	7,138,586.21	77,620.82	1,751,442.34	3,377,541.30	1,931,981.75	6,303,660.81
Corporate Bonds	20,455,275.08	2,647,051.25	8,973,285.38	8,834,938.45		19,462,326.84
Muncipal Bonds	3,664,050.40		1,214,388.00	710,612.50	1,739,049.90	3,603,399.20
Mortgages and Notes	299,455.92		299,455.92			288,633.62
Bond Mutual Funds	32,350,139.56			27,203,425.72	5,146,713.84	32,215,836.70
	$ 66,900,175.12	$ 3,316,451.81	$ 13,150,325.29	$ 40,751,064.82	$ 9,682,333.20	$ 64,447,030.65
Other Investments						
Corporate Stocks:						
Domestic	$ 35,239,346.25					$ 38,711,259.21
International	1,828,194.37					2,293,615.47
Mutual Funds—Equity	158,081,037.05					201,772,043.70
Alternative Investments:						
Real Estate Investments	21,178,209.98					35,822,396.98
Private Equity	88,963,507.24					104,428,524.89
Hedge Funds	131,164,869.76					131,465,202.98
Natural Resources	60,002,011.99					59,580,084.40
Real Estate Gifts	4,369,700.87					5,795,220.67
Assets with Trustees	5,653,632.90					6,228,048.22
Total Investments	$ 573,380,685.53					$ 651,543,427.17

Table 2.2. Rated Debt Instruments	Fair Value	Aaa	Aa1	Aa2	Aa3	A1
Investments						
U.S. Agencies	7,138,586.21	7,138,586.21				
Corporate Bonds	20,455,275.08	1,041,285.00		1,346,488.00	678,206.25	2,636,807.75
Municipal Bonds	3,664,050.40		444,544.80	1,308,854.50	777,461.20	187,984.00
Mutual Funds—Bonds	32,350,139.56	20,484,754.83		9,376,757.88		
Mortgages and Notes	299,455.92					
Money Market Funds in Custodial Accounts	741,643.48		741,643.48			

Table 2.2. Rated Debt Instruments (*continued*)	A2	A3	Baa1	Baa2	Baa3	Ba2	Unrated
Investments							
U.S. Agencies							
Corporate Bonds	4,985,902.75	3,222,178.82	2,102,650.96	3,346,659.50	1,018,508.95		76,587.10
Municipal Bonds			429,510.40				515,695.50
Mutual Funds–Bonds	472,782.12			1,897,298.45		118,546.28	
Mortgages and Notes							299,455.92S

Alternative Investments

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

These investments include forty private equity funds, four real estate funds, sixteen natural resource funds, and twenty-one hedge funds. The estimated fair value of these assets is $301,308,598.97 at June 30, 2010.

Total capital contributions less returns of capital equal $332,296,209.25 at June 30, 2010.

The university believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2010. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the university's investment policy that approves the allocation of funds to various asset classes in order to ensure the proper level of diversification within the endowment pool. These investments (private equity, real estate assets, natural resources, and hedge funds) are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated by the general partner of each limited partnership or manager of each corporate entity using various valuation techniques.

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

Note 3: Endowment, Annuity, and Life Income Agreements

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

Effective July 1, 1954, the university adopted the policy of investing endowment assets over which it had full investment discretion (and on which the donor or governing gift instrument does not require separate investment) in a Consolidated Investment Pool. This pooling of investments affords closer supervision of the investment portfolio and provides, regardless of size, the advantages of participation in a well-diversified portfolio of domestic and international equities, private equity, bonds, real estate, and hedge funds. All contributing endowments participate in the income and capital appreciation of the Pool on a per-share basis commensurate with 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, 2010, net appreciation of $52,309,432.16 is available to be spent, of which $51,320,207.39 is restricted for scholarships and fellowships, libraries, instructional department uses, academic support, and other purposes. The per unit fair value for participating endowments was $2.888155 at June 30, 2010. Income distributed was $.18755 per share in 2010, or $33,395,297.31.

The university's consolidated investment pool is invested to maximize total return rather than current income consistent with provisions of the Uniform Prudent Management of Institutional Funds Act adopted by the State of Tennessee in 2007. The total return for fiscal year 2010 and the three and five years then ended was 13.3%, (7.0)%, and 2.0%, 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 $692,536.13 for 2010.

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 2010 amounted to $1,706,899.71.

Note 4: Accounts, Notes, and Grants Receivable

Accounts, notes, and grants receivable included the following at June 30, 2010:

Table 4.1

Student accounts receivable	$ 5,864,340.11
Grants receivable	69,982,773.18
Notes receivable	3,307,395.01
Pledges receivable	52,077,611.37
State capital outlay and maintenance receivable	12,662,631.88
TSSBA debt proceeds receivable	10,876,284.23
Due from component units	791,392.72
Other receivables	48,574,867.68
Subtotal	$204,137,296.18
Less allowance for doubtful accounts	(19,394,116.74)
Total	$184,743,179.44

Pledges receivable are promises of private donations that are reported as accounts receivable, and revenue, net of an estimated uncollectible allowance of $10,415,522.27.

Federal Perkins Loan Program funds at June 30, 2010, included those listed in Table 4.2.

Table 4.2.

Perkins loans receivable	$30,902,044.74
Less allowance for doubtful accounts	—
Total	$30,902,044.74

Note 5: Capital Assets

Capital asset activity for the year ended June 30, 2010, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 56,741,060.18	$ 3,379,751.49	$ —	$ —	$ 60,120,811.67
Land improvements & infrastructure	69,202,256.62	2,142,672.38	188,629.06	—	71,533,558.06
Buildings	1,632,804,861.57	31,821,730.01	127,812,670.17	(5,400,238.72)	1,787,039,023.03
Works of Art/Historical Treasures	527,510.24	—	—	—	527,510.24
Equipment	329,291,673.44	33,732,728.40	—	(13,874,682.71)	349,149,719.13
Software	21,421,152.38	4,291,602.17	2,829,513.76	(19,690.00)	28,522,578.31
Library holdings	117,448,820.88	13,786,032.85	—	(9,606,503.05)	121,628,350.68
Projects in progress	211,789,254.95	124,563,201.69	(130,830,812.99)	(2,838.75)	205,518,804.90
Total	$2,439,226,590.26	$ 13,717,718.99	$ —	$(28,903,953.23)	$2,624,040,356.02
Less accumulated depreciation:					
Land improvements & infrastructure	(43,340,618.73)	(2,937,799.29)	—	—	(46,278,418.02)
Buildings	(651,492,303.97)	(45,543,046.19)	—	3,493,970.50	(693,541,379.66)
Equipment	(181,764,325.41)	(33,347,851.90)	—	11,838,754.88	(203,273,422.43)
Software	(19,716,351.13)	(651,165.98)	—	13,030.82	(20,354,486.29)
Library holdings	(48,865,335.73)	(11,677,539.02)	—	9,606,503.05	(50,936,371.70)
Total accumulated depreciation	$ (945,178,934.97)	$(94,157,402.38)	—	$ 24,952,259.25	$(1,014,384,078.10)
Capital assets, net	$1,494,047,655.29	$119,560,316.61	$ —	$ (3,951,693.98)	$ 1,609,656,277.92

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 $7,653,221.49 for the year ended June 30, 2010.

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, 2010. 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 below is calculated based on the April 2010 Consumer Price Index (218.01).

Table 6.1. Year Ending June 30

2011	$ 13,497.00
2012	13,497.00
Total minimum payments required	$ 26,994.00

Note 7: Accounts Payable

Accounts payable included the following:

Table 7.1	June 30, 2010
Vendors payable	$ 76,528,260.71
Payroll deductions payable	20,354,457.94
Total	$ 96,882,718.65

Note 8: Long-Term Liabilities

Long-term liability activity for the year ended June 30, 2010, was as follows:

Table 8.1

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Long-term liabilities					
Bonds	$ 397,501,537.37	$ 2,717,667.55	$ 18,189,455.07	$ 382,029,749.85	$ 22,298,636.41
Commercial paper	120,741,983.89	44,867,259.83	2,483,000.00	163,126,243.72	—
Total TSSBA indebtedness	$ 518,243,521.26	$ 47,584,927.38	$ 20,672,455.07	$ 545,155,993.57	$ 22,298,636.41
Notes	23,514.12	—	11,486.53	12,027.59	12,027.59
Capital lease obligations	2,007,320.22	—	734,314.87	1,273,005.35	679,628.71
Net OPEB obligation	38,808,987.38	26,523,000.00	10,073,351.08	55,258,636.30	—
Compensated absences	73,655,256.12	47,115,186.19	45,270,535.41	75,499,906.90	45,270,535.41
Total long-term liabilities	$ 632,738,599.10	$ 121,223,113.57	$ 76,762,142.96	$ 677,199,569.71	$ 68,260,828.12
Other noncurrent liabilities					
Deferred revenue	15,500,438.71	—	—	15,500,438.71	
Due to grantors	35,904,119.49	845,960.93	683,593.35	36,066,487.07	
Annuities payable	6,104,215.22	904,999.38	1,224,734.60	5,784,480.00	
Totals	$ 690,247,372.52	$122,974,073.88	$ 78,670,470.91	$ 734,550,975.49	

TSSBA DEBT – BONDS

Bonds, with interest rates ranging from 1.3% to 7.15%, 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. (See Note 10 for further details.) The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net 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, 2010, was $402,770,930.84. The debt service reserve amount at June 30, 2010, was $10,429,931.33, the capitalized interest was $3,189.38, and unspent debt proceeds were $10,308,060.28. There were no unaccreted bonds payable at June 30, 2010.

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% and is due semi-annually to July 1, 2011. The outstanding balance at June 30, 2010, is $12,027.59.

The university's debt service requirements (TSSBA and the 5-year note) to maturity for all bonds and notes payable at June 30, 2010, are shown in table 8.2.

Table 8.2

Year ending June 30:	Principal	Administrative Fees
2011	$ 22,310,664.00	$ 19,153,473.72
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	17,582,654.39	15,467,675.10
2016-2020	90,884,298.02	64,808,309.22
2021-2025	87,719,822.92	42,937,906.59
2026-2030	64,144,504.24	23,553,790.50
2031-2035	43,257,495.04	9,169,596.73
2036-2038	12,345,744.76	1,255,240.24
	$ 402,782,958.43	$ 228,421,312.99

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 $163,126,243.72 at June 30, 2010.

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, 2010, was $3,126,282.87. Accumulated amortization of the leased assets at June 30, 2010, was $1,719,455.58.

Future minimum lease payments under capital leases at June 30, 2010, are as follows:

Table 8.3. Year ending June 30:

2011	$	679,628.71
2012		679,628.71
Total	$	1,359,257.42
Less: amount representing interest		(86,252.07)
Present value of minimum lease payments	$	1,273,005.35

Note 9: Unrestricted Net Assets

Unrestricted net assets include funds that have been designated for specific purposes. These purposes include the following:

Table 9.1. As of June 30, 2010

Working capital	$	32,406,185.68
Encumbrances		5,726,956.03
Auxiliaries		7,710,038.29
Quasi-endowments		11,687,331.37
Plant construction		33,330,066.57
Renewal and replacement of capital assets		244,092,429.35
Debt retirement		26,472,098.05
Undesignated		84,510.68
Total	$	361,509,616.02

Note 10: Pledged Revenues

The University of Tennessee has pledged certain revenues and fees, including state appropriations, to repay $382,029,749.85 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 3.32% of available revenues. The total principal, interest and administrative fees remaining to be paid on the bonds is $631,191,617.94. Principal and interest paid for the current year and total available revenues were $43,867,323.25 and $1,319,455,625.17, 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% 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, 2010, 2009, and 2008, were $37,266,850.27, $37,963,757.88, and $39,356,714.98, 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 prior to 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% or more of their time are required to participate in either one of the two Federal Retirement Programs. For both systems, benefit provisions are established in federal statutes. Federal statutes are amended by the U.S. Congress.

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

Funding Policy
Participating employees, with some exceptions, are required by federal statute to contribute 7.0% of covered salaries to the CSRS plan. The university is currently required to contribute 7.0%.

Contributions to CSRS for the year ended June 30, 2010, were $795,846.34, which consisted of $411,178.79 from the university and $384,667.55 from the employees; contributions 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; and 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.

Federal statute requires employees participating in FERS to contribute 0.8% of their salaries to the Basic Benefit Plan. The university is required to contribute 11.2%. In addition, the university is required to contribute 1% of each participant's salary to the Thrift Savings Plan plus up to an additional 4% depending upon employees' contributions, which can range from 0 to 10% of their salaries. Contributions for the Basic Benefit Plan were $1,027,500.74 for the year ended June 30, 2010, which consisted of $68,500.09 from employees and $959,000.65 from the university; $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; and $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. Contributions for the Thrift Savings Plan were $994,264.00 for the year ended June 30, 2010, which consisted of $592,984.00 from employees and $401,280.00 from the university; $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; and $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. 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), ING 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% of the employee's base salary below the social security wage base and 11% 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, 2010, was $40,627,517.44 and for the year ended June 30, 2009, was $40,895,926.05. 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 ING, 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 $28,923,540.87 for fiscal year 2010, and $32,362,289.10 for fiscal year 2009. 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 $3,765,844.24 in fiscal year 2010, and $4,211,189.80 in fiscal year 2009. 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 2010, 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, 2010, contributions totaling $17,928,489.64 were made by employees participating in the plan, with a related match of $5,499,232.59 made by the university. 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. 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 which 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 Section 8-27-101, Tennessee Code Annotated. Prior to 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 (CAFR). The CAFR is available on the state's website http://tennessee.gov/finance/act/cafr.html.

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 plan members are established and may be amended by the insurance committee. The plans are self-insured and financed on a pay-as-you-go basis with the risk shared equally among the participants.

Claims liabilities of the State Employee Group Plan are periodically computed using actuarial and statistical techniques to establish premium rates. Administrative costs of the plan are allocated to participants. In accordance with Section 8-27-205(b), Tennessee Code Annotated, retirees not eligible for Medicare pay a percentage of the total state premium under the State Employee Group Plan based on years of service, leaving a portion of retiree premiums effectively subsidized by contributions to the State Employee Group Plan for active employees. Retirees with 30 years of service pay 20% of the total premium under the State Employee Group Plan. Retirees with 20 years but less than 30 years of service pay 30% of the total premium under the State Employee Group Plan. Retirees 55 and older with less than 20 years but more than 10 years of service pay 40% of the total premium under the State Employee Group Plan. The university contributed $10,073,351.08 to the State Employee Group Plan for retiree insurance. Retiree contributions totaled $2,256,769.84.

Table 12.1. Annual OPEB Cost and Net OPEB Obligation

		State Employee Group Plan
Annual Required Contribution (ARC)	$	26,431,000.00
Interest on Net OPEB Obligation		1,746,000.00
Adjustment to the ARC		(1,654,000.00)
Annual OPEB Cost		$26,523,000.00
Amount of Contribution		(10,073,351.08)
Increase/Decrease in Net OPEB Obligation		16,449,648.92
Net OPEB Obligation—beginning of year		38,808,987.38
Net OPEB Obligation—end of year	$	55,258,636.30

Table 12.2. Annual OPEB Cost and Net OPEB Obligation

YEAR END	PLAN	ANNUAL OPEB COST	PERCENTAGE OF ANNUAL OPEB COST CONTRIBUTED	NET OPEB OBLIGATION AT YEAR-END
June 30, 2008	State Employee Group Plan	$30,603,000.00	34.90%	$19,923,248.24
June 30, 2009	State Employee Group Plan	$31,004,000.00	39.09%	$38,808,987.38
June 30, 2010	State Employee Group Plan	$26,523,000.00	37.98%	$55,258,636.30

FUNDED STATUS AND FUNDING PROGRESS

The funded status of the university's portion of the State Employee Group Plan as of July 1, 2009, was as follows:

Table 12.3. State Employee Group Plan

Actuarial valuation date	July 1, 2009
Actuarial accrued liability (AAL)	$269,772,000.00
Actuarial value of plan assets	0.00
Unfunded actuarial accrued liability (UAAL)	$269,772,000.00
Actuarial value of assets as a percent of the AAL	0%
Covered payroll (active plan members)	$628,383,463.00
UAAL as percentage of covered payroll	42.9%

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

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

ACTUARIAL METHODS AND ASSUMPTIONS

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

In the July 1, 2009, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4.5% investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 6% initially, increased to 10% in the second year, and then reduced by decrements to an ultimate rate of 5% in fiscal year 2021.

Both rates include a 3% 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, 2010. 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, 2010, the amounts held in trust totaled $99,984,245.05 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% interest in the venture, each having provided an initial investment of $125,000.00. The university's equity interest was $4,218,718.42 at June 30, 2010. The university and Battelle each receive a 50% distribution of the ORNL management fee after shared expenses are deducted. The fee distribution for the year ended September 30, 2009, to the university was $3,093,718.42.

During the year ended June 30, 2010, the university had expenses of $20,084,881.00 under contracts with UT-Battelle. Amounts receivable from UT-Battelle under these contracts totaled $2,104,126.00 at June 30, 2010. 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, 2010, and June 30, 2009, 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, 2010, the Risk Management Fund held $114.5 million in cash and cash equivalents designated for payment of claims. At June 30, 2010, the scheduled coverage for the university was $4,382,301,800 for buildings and $1,135,988,000 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 seven 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, 2010, were $111,107,821.47.

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, 2010. The amount of unused sick leave was $258,337,569.00 at June 30, 2010.

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 $3,062,194.09 as of June 30, 2010, 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 twenty 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 $67,981,815.44 in 2010, 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% 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. An annual lease payment to the university during the year ended 6/30/2010, totaled $2,763,348.00.

The university recorded a lease payment receivable in the amount of $32,919,468.95 at June 30, 2010, which represents the net present value of the guaranteed $50 million discounted at 5.75%. The minimum lease payments to be received amount has been adjusted upward to reflect a contractually required adjustment to the final required lease payment.

Table 18.1. As of June 30, 2010

Total minimum lease payments to be received	$53,925,797.96
Less: unearned income	(21,006,329.01)
Net investment in direct financing lease	$32,919,468.95

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.

The university recorded a lease payment receivable in the amount of $15,492,092.81 at June 30, 2010:

Table 18.2

Year Ended June 30	Minimum lease payments to be received	Interest	Principal
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	1,358,740.88	566,846.85	791,894.03
2016-2020	6,819,431.56	2,268,152.94	4,551,278.62
2021-2025	6,869,642.34	1,149,645.33	5,719,997.01
2026-2027	1,684,680.70	84,566.71	1,600,113.99
	$22,152,498.92	$6,660,406.11	$15,492,092.81

Table 18.3. As of June 30, 2010

Total minimum lease payments to be received	$22,152,498.9
Less: unearned income	(6,660,406.11)
Net investment in direct financing lease	$15,492,092.81

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 and leased all the University's Memphis hospital employees under agreements with Methodist through February 20, 2009, when the last employee separated from the university. The terms of the Employee Services Agreement ended April 29, 2009, with receipt of the final reimbursement for leased employees from Methodist.

Note 20: Natural Classifications with Functional Classifications

The university's operating expenses by functional classification for the year ended June 30, 2010, are as follows:

Table 20.1

	Natural Classification					
	Salaries	Benefits	Utilities, Supplies, and Other Services	Scholarships	Depreciation	Total
Functional Classification						
Instruction	$362,846,989.14	$103,475,895.58	$59,659,342.02	$ —	$ —	$525,982,226.74
Research	125,758,647.15	32,926,409.55	76,363,439.06	—	—	235,048,495.76
Public Service	67,506,250.16	23,849,040.65	33,518,779.23	—	—	124,874,070.04
Academic Support	65,812,500.70	23,082,366.38	18,434,980.79	—	—	107,329,847.87
Student Services	39,128,943.05	13,392,474.94	23,264,940.88	—	—	75,786,358.87
Institutional Support	71,514,162.18	25,225,953.51	—	—	—	96,740,115.69
Operation and Maintenance of Plant	32,789,227.53	14,976,191.55	93,702,111.61	—	—	141,467,530.69
Scholarships and Fellowships	3,857,017.87	19,902,801.80	18,845,695.09	45,389,227.32	—	87,994,742.08
Auxiliary	40,074,512.44	12,197,080.76	72,179,300.17	—	—	124,450,893.37
Independent Operations	50,418,064.39	18,945,005.55	—	—	—	69,363,069.94
Depreciation	—	—	—	—	94,157,402.38	94,157,402.38
Total Expenses	$859,706,314.61	$287,973,220.27	$395,968,588.85	$45,389,227.32	$ 94,157,402.38	$1,683,194,753.43

Note 21: On-Behalf Payments

During the year ended June 30, 2010, the State of Tennessee made payments of $882,558.98 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: Voluntary Retirement Incentive Program

The University of Tennessee's Institute of Agriculture offered the 2010 Voluntary Retirement Incentive Program for staff in fiscal year 2010 as a strategy to assist the university in addressing budgetary constraints due to state appropriation reversions and potential budget reductions in the forthcoming fiscal year. Seventy approved staff participated in the program. Severance pay was paid the month following separation date.

The incentive pay offered was four months' base salary, paid in a lump sum after the effective retirement date. Participants had the option to request a temporary part-time, post-retirement appointment pursuant to Tennessee Code Annotated Section 8-36-805.

For the fiscal year ended June 30, 2010, expenses for the program and other retirement incentive lump sum payments were $2,509,476.09.

Note 23: Component Unit – University of Chattanooga Foundation

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

The University of Chattanooga Foundation, Inc., is a legally separate, tax-exempt organization supporting the University of Tennessee at Chattanooga. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of the

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

During the year ended June 30, 2010, the foundation expended $6,257,230.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from the University of Chattanooga Foundation, Development Office, Department 6806, 615 McCallie Avenue, Chattanooga, TN 37403-2598.

ORGANIZATION AND NATURE OF ACTIVITIES

The foundation is a 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 one month period between fiscal year ends is not significant. At June 30, 2010, the foundation's statement of net assets reflects $470,956 of LLC deposits held at the university which were not actually transferred to the university until July 2010.

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

CDFI is the sole member of its subsidiary, the LLC. The LLC was formed to own and develop an elementary school in downtown Chattanooga and student housing at the university. The student housing consists of 1,649 bedrooms in 451 units and 666 parking spaces.

INVESTMENTS

A summary of foundation investments at June 30, 2010, is as follows:

Table 23.1

Equity securities (cost of $12,641,727)	$	12,563,619
Mutual funds (cost of $41,489,895)		37,999,439
Real estate		1,800,700
Limited partnerships		29,659,592
Other		13,277
Total	$	82,036,627

The foundation also has investments restricted by the terms of the revenue bonds described below totaling $7,076,651.

PROPERTY AND EQUIPMENT

A summary of foundation property and equipment at June 30, 2010, is as follows:

Table 23.2

Land	$	8,241,032
Buildings		74,915,812
Furniture, fixtures, and equipment		4,705,995
		87,862,839
Accumulated depreciation		(23,389,122)
Total	$	$64,473,717

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, 2010, consist of the following:

Table 23.3

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	$	64,875,000
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		20,635,000
		85,510,000
Less: unamortized discount		(1,866,204)
	$	83,643,796

Sinking fund requirements for scheduled redemptions of the revenue bonds for the next 5 years and thereafter are as follows:

Year Ended	
June 30, 2011	$ 1,630,000
June 30, 2012	1,715,000
June 30, 2013	1,800,000
June 30, 2014	1,895,000
June 30, 2015	1,990,000
Thereafter	76,480,000
	$ 85,510,000

RESTRICTED CASH AND CASH EQUIVALENTS

The revenue bonds described above restrict the use of certain cash and cash equivalents at June 30, 2010, as follows:

Renewal and replacement reserves	$ 186,832
Restricted for debt service payments	2,870,778
Surplus	1,162,432
Total	$ 4,220,042

FAIR VALUE MEASUREMENTS

The foundation has adopted FASB Accounting Standards Codification (ASC) Topic 820 (previously Statement of Financial Accounting Standards No. 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. FASB ASC Topic 820 applies under other accounting pronouncements that require or permit fair value measurements and does not require any new fair value measurements.

The table below (Table 23.6) presents the recorded amount of assets and liabilities measured at fair value on a recurring basis.

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

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

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

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

The table below (Table 23.7) 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. Limited Partnerships

Beginning balance	$ 26,864,474
Total realized and unrealized gains and losses included in earnings	3,022,063
Purchases, issuances, and settlements	(226,945)
Ending balance	$ 29,659,592

Table 23.6

	Balance as of June 30, 2010	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	$ 12,563,619	$ 12,563,619	$ —	$ —
Mutual funds	37,999,439	25,219,606	12,779,833	—
Guaranteed investment contracts	5,494,402	—	5,494,402	—
Money market accounts	1,582,249	1,582,249	—	—
Real estate	1,800,700	—	1,800,700	—
Limited partnerships	29,659,592	—	—	29,659,592
Other	13,277	13,277	—	—
Total assets	$ 89,113,278	$ 39,378,751	$ 20,074,935	$ 29,659,592
LIABILITIES				
Deposits received for the benefit of University of Tennessee at Chattanooga	$ 2,684,731	$ —	$ 2,684,731	$ —
Total liabilities	$ 2,684,731	$ —	$ 2,684,731	$ —

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 consist of the following at June 30, 2010. Due to GASB reformatting, temporarily restricted net assets are reported as expendable restricted net assets and permanently restricted net assets are reported as non-expendable restricted net assets on the statement of net assets.

Table 23.8

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Donor-restricted funds	$(1,058,300)	$1,285,017	$37,403,233	$37,629,950
Board-designated funds	46,588,594	—	—	46,588,594
	$45,530,294	$1,285,017	$37,403,233	$84,218,544

Changes in endowment net assets for the fiscal year ended June 30, 2010:

Table 23.9

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Endowment net assets, beginning of year	$45,825,358	$1,247,997	$36,194,076	$83,267,431
Investment income (loss)	(847,120)	535,300	(1,337,544)	(1,649,364)
Net appreciation	6,161,424	—	5,682,196	11,843,620
Contributions	46,958	—	671,645	718,603
Appropriations	(7,936,067)	(1,992,094)	—	(9,928,161)
Transfers	2,279,741	1,493,814	(3,807,140)	(33,585)
Endowment net assets, end of year	$45,530,294	$1,285,017	$37,403,233	$84,218,544

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

Table 23.10. 2010 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	$	37,403,233
Total endowment funds classified as permanently restricted net assets	$	37,403,233

Table 23.11. 2010 Temporarily Restricted Net Assets

The portion of perpetual endowment funds subject to a time restriction under UPMIFA	$	1,285,017
Total endowment funds classified as temporarily restricted net assets	$	1,285,017

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 $1,058,300 as of June 30, 2010. 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.

RELATED PARTY TRANSACTIONS

CDFI, the LLC, and the university executed a management agreement which became effective January 1, 2009. This agreement allowed the university to assume management responsibilities related to the student housing. As a matter of convenience, cash balances needed for student housing operations are held at the university, and operating expenses are paid from these funds.

CONTINGENCIES

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

During the year ended June 30, 2010, CDFI settled 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 July 2009, this litigation was settled with total payments to the plaintiff of $2,976,630, which included approximately $107,000 paid from the LLC's cash balances. The remainder of the settlement was contributed to CDFI by the foundation.

NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The foundation's operating expenses by functional classification for the year ended June 30, 2010, are as follows:

Table 23.12 University of Chattanooga Foundation

	NATURAL CLASSIFICATION			
	UTILITIES, SUPPLIES, AND OTHER SERVICES	PAYMENTS TO OR ON BEHALF OF UT	DEPRECIATION	TOTAL
Functional Classification				
Academic programs	$ —	$1,655,308	$ —	$1,655,308
Professorships	—	604,794	—	604,794
Faculty development	—	203,054	—	203,054
Scholarships	—	2,061,596	—	2,061,596
Chancellor's discretionary	—	189,433	—	189,433
Other	—	1,543,045	—	1,543,045
Rental expenses	3,011,321	—	—	3,011,321
Administrative and investment fees	244,860	—	—	244,860
Legal	142,839	—	—	142,839
Tax, bad debt and audit	248,911	—	—	248,911
Depreciation	—	—	3,151,533	3,151,533
Total Expenses	$3,647,931	$6,257,230	$3,151,533	$13,056,694

Note 24: 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. 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, 2010, the foundation expended $9,666,750.64 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from the University of Tennessee Foundation, Suite 100, UT Conference Center Building, 600 Henley Street, Knoxville, TN 37996.

ORGANIZATION AND NATURE OF ACTIVITIES

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

PLEDGES RECEIVABLE

Pledges receivable (reported as accounts, notes, and grants receivable on the statement of net assets) are summarized in Table 24.1 net of the allowance for doubtful accounts:

Table 24.1

	Temporarily Restricted	Permanently Restricted
Current pledges	$2,925,795.04	$ 233,410.17
Pledges due in 1 to 5 years	31,921,562.01	12,806,703.38
Pledges due after 5 years	11,227,290.54	7,118,588.54
	46,074,647.59	20,158,702.09
Less discounts to net present value	(2,512,999.45)	(1,450,001.92)
Total pledges receivable, net	$43,561,648.14	$18,708,700.17

The allowance for doubtful accounts at June 30, 2010, was $192,734.38.

INVESTMENTS AND ASSETS HELD BY THE UNIVERSITY OF TENNESSEE

Investments held at June 30, 2010, were as follows:

Table 24.2

	Market Value	Cost Basis
Assets Held by the University of Tennessee		
U.S. equity	$ 3,624,968.04	$ 4,525,483.71
International equity	3,624,993.22	4,955,129.28
Fixed income	1,895,378.71	1,871,513.04
Cash equivalents	332,937.62	332,937.62
Certificate of deposit	7,350,000.00	7,350,000.00
Alternative investments:		
Private equity	3,557,375.00	4,271,617.74
Natural resources	2,399,294.54	2,413,989.44
Real estate	846,851.00	1,451,405.93
Other alternative investments	4,941,628.10	4,678,270.99
Total assets held by university	28,573,426.23	31,850,347.75
Gift Annuity		
Equities	944,403.93	992,511.14
Fixed income	461,624.53	484,904.43
Cash equivalents	9,529.02	9,529.02
Total gift annuity	1,415,557.48	1,486,944.59
Other investments	166,776.95	270,328.33
Total other investments	166,776.95	270,328.33
Total	$30,155,760.66	$33,607,620.67

Also reported as investments on the statement of net assets are other gift assets totaling $942,400 and remainder interests of $17,345,302.10 as described herein.

At June 30, 2010, 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 $24,505,816.94 and $21,228,895.42, which resulted in a cumulative unrealized loss of $3,276,921.52. All endowments at the foundation are donor restricted. Endowment pool earnings transferred to the university were $1,058,851.64 for fiscal year 2010.

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. Below is 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 (Table 24.3).

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 $3,276,921.52 at June 30, 2010. 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.

The foundation uses the university's spending policy. The university calculates its spending policy by taking 5% of a three 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 following target percentages and within the ranges in Table 24.4 on the following page.

Table 24.3

	Unrestricted	Temporarily Restricted	Permanently Restricted	Total
Beginning balance	$(3,917,168.05)	$1,396,626.02	$17,011,475.11	$14,490,933.08
Contributions pooled	—	366,395.98	5,747,004.51	6,113,400.49
Investment earnings	—	68,118.06	1,064,453.61	1,132,571.67
Market value adjustment	640,246.53	—	—	640,246.53
Contributions not pooled	—	—	(89,404.71)	(89,404.71)
Disbursements	—	—	(1,058,851.64)	(1,058,851.64)
Transfer	—	(320,673.98)	320,673.98	—
Ending balance	$(3,276,921.52)	$1,510,466.08	$22,995,350.86	$21,228,895.42

Table 24.4

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 were as follows at June 30, 2010:

Table 24.5

U.S. equity	17.1%
International equity	17.1%
Fixed income	8.9%
Private equity	16.8%
Natural resources	11.3%
Real estate	4.0%
Cash	1.5%
Other alternative investments	23.3%

FAIR VALUE MEASURES

The foundation has adopted FASB Accounting Standards Codification (ASC) Topic 820 (previously Statement of Financial Accounting Standards No. 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.

FASB ASC Topic 820 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 24.6 presents the recorded amount of assets and liabilities measured at fair value:

Table 24.6

	Level 1	Level 2	Level 3	Total
Investments	$9,884,431.57	$8,526,180.45	$11,745,148.64	$30,155,760.66

The table 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 24.7

Beginning balance	$ 5,854,336.95
Total realized and unrealized gains and losses included in earnings	3,723,576.61
Purchases, issuances, and settlements	2,167,235.08
Ending balance	$11,745,148.64

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% interest rate. For the fiscal year ended June 30, 2010, 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, 2010, was $198,792.64. Future maturities of this note are as follows:

Table 24.8
Year ended June 30:

2011	$	15,015.88
2012		15,733.89
2013		16,486.24
2014		17,274.56
2015		18,100.58
2016–2020		104,343.63
2021		11,837.86
Total	$	198,792.64

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, 2010. The foundation has not experienced any 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%. The present value of the remainder interest at June 30, 2010, was $5,127,325.61.

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%. The present value at June 30, 2010, was $12,217,976.49.

NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The foundation's operating expenses by functional classification for the year ended June 30, 2010, are as follows:

Table 24.9

	Utilities, Supplies, and Other Services	Payments to or on Behalf of UT	Total
Functional Classification			
Program expenses	$ 806,348.43	$9,551,953.68	$10,358,302.11
General and administrative	247,908.98	114,796.96	362,705.94
Total expenses	$1,054,257.41	$9,666,750.64	$10,721,008.05

Note 25: Component Unit – University of Tennessee Research Foundation

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

The University of Tennessee Research Foundation is a legally separate, tax-exempt organization supporting the University of Tennessee. The foundation was created as The UT Research Corporation (UTRC) in 1934 and incorporated in January, 1935. The foundation's stated purpose is, in conjunction with the university, to grow the University of Tennessee research enterprise; harvest, manage, and market University of Tennessee intellectual property; encourage and support entrepreneurial education and ventures by faculty, staff, students, and commercial partners/affiliates of the University of Tennessee; and to contribute to the well being of the State of Tennessee through economic development. In April 2003, UTRC was renamed and reorganized to the University of Tennessee Research Foundation (UTRF). Roles were redefined and the scope was expanded to include a new emphasis on entrepreneurship and economic development for technology transfer activities. A new set of bylaws and Board of Directors were established. The foundation has 7 voting directors and 3 nonvoting directors. Because the university's board of trustees approves the foundation's administrative budget, the foundation is considered fiscally dependent on the university. Therefore, the research foundation is considered a component unit of the university and is discretely presented in the university's financial statements. See also Note 26.

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

ORGANIZATION AND NATURE OF ACTIVITIES

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

Genera Energy LLC, (the subsidiary), a wholly-owned subsidiary of the University of Tennessee Research Foundation, was formed on February 28, 2008. The subsidiary is in the business of developing a pilot-scale biorefinery and state of the art research and development facility, in collaboration with DuPont Danisco Cellulosic Ethanol, LLC (DDCE), for cellulosic ethanol using non-food biomass feedstocks to prove the technology and commercial viability of producing cellulosic ethanol, primarily in the State of Tennessee. The project will utilize the University of Tennessee's expertise in cellulosic feedstock production and research, as well as its work with Tennessee farmers, to develop the first dedicated cellulosic energy crop supply chain utilizing switchgrass. The subsidiary also promotes, supports, and carries out the commercialization of research outcomes and the transfer of research generated products, ideas, processes, and other technology related to renewable energies to agricultural, commercial, and industrial enterprises.

The State of Tennessee has provided $40.7 million towards the construction of the pilot-scale biorefinery and related switchgrass utilization and demonstration facilities.

During the fiscal year ended June 30, 2010, the subsidiary (Genera Energy LLC) changed its name to Genera Biofuels

LLC and elected to be treated as a member-managed LLC. The member (UTRF) established a new director-managed LLC, Genera Energy LLC, and contributed its equity of Genera Biofuels LLC to Genera Energy LLC. As a result, Genera Biofuels LLC became a wholly owned subsidiary of Genera Energy LLC. Genera Energy LLC formed three additional wholly-owned subsidiaries, which are member-managed LLC's, Genera Solar Solutions LLC, Genera Biomass LLC and Genera Capital LLC.

PRINCIPLES OF CONSOLIDATION

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

PROPERTY AND EQUIPMENT

Property and equipment consist of the following major classifications at June 30, 2010:

Table 25.1

Research Foundation	
Office furniture and equipment	$142,998
Less accumulated depreciation	(53,663)
Ending balance	$89,335
Genera	
Land	$168,537
Buildings	36,979,029
Leasehold improvements	60,451
Machinery and equipment	16,143,905
Furniture and fixtures	146,228
Vehicles	80,966
Construction in progress	4,947,475
	58,526,591
Less accumulated depreciation	(473,762)
	58,052,829
Ending balance	$58,142,164

Depreciation expense for the foundation and its subsidiary totaled $486,206 for the year ended June 30, 2010. Intangible assets totaling $6,596 are also reported as capital assets on the statement of net assets.

DEFERRED REVENUE

During the years ended June 30, 2010, and June 30, 2009, the foundation capitalized $19,309,711 and $2,622,852 of costs related to the construction of a pilot-scale biorefinery which were incurred by DDCE. Based on an agreement with DDCE, these and future unreimbursed costs incurred by DDCE on this project were capitalized in exchange for DDCE's future use of a portion of the biorefinery facility. An amount equal to DDCE's total construction cost was recorded as deferred revenue through completion of the biorefinery. The total amount of deferred revenue is expected to be recognized over the life of a proposed lease between the subsidiary and DDCE. As of June 30, 2010, the proposed lease was to be for ten years with three possible five-year extensions. Accordingly, deferred revenue will be amortized to revenue over the twenty-five years beginning January 28, 2010, the date when DDCE first occupied their portion of the facility. Revenue of $365,544 was recognized in fiscal year 2010.

FAIR VALUE MEASUREMENTS

Per FASB Accounting Standards Codification (ASC) Topic 820, fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A valuation hierarchy has been established for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels. Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on management's assumptions used to measure assets and liabilities at fair value. A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement.

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

Registered Investment Companies - The fair value of registered investment companies (mutual funds) is based on quoted net asset values of the shares held by the foundation at June 30, 2010.

Marketable Equity Securities - The fair value of marketable equity securities is based on quoted prices times the number of the shares held by the foundation at June 30, 2010.

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

At June 30, 2010, the foundation had no liabilities carried at fair value subject to remeasurement on a recurring basis. The following table provides the assets carried at fair value measured on a recurring basis as of June 30, 2010:

Table 25.2. Assets at Fair Value

June 30, 2010	Level 1	Level 2	Level 3	Level 4
Registered investment companies	$6,559	—	—	$6,559
Marketable equity securities	81,106	—	—	81,106
Total	$87,665	—	—	$87,665

The foundation also has $225,177 of investments (equity securities) for which there is no readily determinable market value. These investments are valued at cost, as management believes that any variance in valuation from historical cost would not be material to the operations of the foundation.

SUBSEQUENT EVENTS

Subsequent to June 30, 2010, the company received a grant from the U.S. Department of Energy in the amount of $4,799,758 for the development of a bulk-format system to harvest, store, and deliver high tonnage, low-moisture switchgrass feedstock.

Also subsequent to June 30, 2010, under terms of its grant with the Department of Economic and Community Development to develop the Solar Farm in Haywood County, Tennessee, the foundation has entered into a subcontract for the construction of the array and utility. The subcontract calls for UTRF to make payments of $21,217,767, which amount will be amortized into income as the contract is funded.

NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The foundation's operating expenses by functional classification for the year ended June 30, 2010, are as follows:

Table 25.3. Natural Classification

Functional Classification	Salary and Benefits	Utilities, Supplies, and Other Services	Depreciation	Total
Research Support	$1,181,251	$4,439,054	$ —	$5,620,305
Research	848,125	1,093,313	—	1,941,305
Decpreciation	—	—	486,206	486,206
Total Expenses	$2,209,376	$5,532,367	$486,206	$8,047,949

Note 26: Change in Reporting Entity

The university has not presented the University of Tennessee Research Foundation as a component unit in prior years as it was not considered material in relation to the university's operations. Because the university's board of trustees approves the foundation's administrative budget, the foundation is considered fiscally dependent on the university. Therefore, the research foundation is considered a component unit of the university and is discretely presented in the university's financial statements for the year ended June 30, 2010.

The University of Tennessee
Required Supplementary Information
Schedule of Funding Progress
For the Year Eneded June 30, 2010

Actuarial Valuation Date	Plan	Actuarial Value of Assets (A)	Actuarial Accrued Liability (AAL) (B)	Unfunded AAL (UAAL) (B-A)	Funded Ratio (A/B)	Covered Payroll (C)	UAAL as a Percentage of Covered Payroll ((B-A)/(C))
July 1, 2007	State Employee Group Plan	$ —	$294,669,000.00	$294,669,000.00	0%	$616,687,517.00	47.8%
July 1, 2009	State Employee Group Plan	$ —	$269,772,000.00	$269,772,000.00	0%	$628,383,463.00	42.9%

One additional year will be reported as data becomes available.

The University of Tennessee
5-Year Summary

	FY 2010	FY 2009	FY 2008	FY 2007	FY 2006
OPERATING REVENUES (,000)					
Net tuition and fees	$ 279,638	$ 255,578	$ 239,567	$ 231,621	$ 232,960
Net auxiliary	178,845	165,519	157,543	160,502	134,466
Grants and contracts	395,316	397,348	377,475	383,659	377,289
Other (federal appropriations, sales and services, etc.)	85,008	83,868	88,881	75,266	70,797
Total operating revenues	$ 938,807	$ 902,313	$ 863,466	$ 851,048	$ 815,512
OPERATING EXPENSES (,000)					
Salaries and wages	$ 859,706	$ 861,781	$ 844,192	$ 807,688	$ 782,220
Fringe benefits	287,973	299,475	302,783	268,094	244,398
Utilities, supplies, and other services	395,969	341,053	339,439	334,174	305,824
Scholarships and fellowships	45,389	32,504	28,304	30,400	24,534
Depreciation expense	94,157	83,767	72,561	68,469	68,158
Total operating expenses	$ 1,683,194	$ 1,618,580	$ 1,587,279	$ 1,508,825	$ 1,425,134
Operating income (loss)	$ (744,387)	$ (716,267)	$ (723,813)	$ (657,777)	$ (609,622)
NONOPERATING REVENUES AND EXPENSES (,000)					
State and local appropriations	$ 477,120	$ 503,758	$ 539,634	$ 492,810	$ 459,279
Gifts	41,844	27,439	21,108	65,725	36,339
Investment income, gains, (losses)	97,297	(106,018)	17,528	175,091	110,939
Other	202,392	120,770	104,933	98,546	61,830
Total nonoperating revenues	$ 818,653	$ 545,949	$ 683,203	$ 832,172	$ 668,387
OTHER REVENUES, EXPENSES, GAINS OR LOSSES					
Capital appropriations	91,551	105,300	69,592	32,834	24,579
Capital grants and gifts	23,266	28,156	41,044	22,875	18,284
Additions to permanent endowments	16,758	9,813	17,812	17,827	36,029
Other	883	712	8,772	905	10,206
Total other revenues, expenses, gains or losses	$ 132,458	$ 143,981	$ 137,220	$ 74,441	$ 89,098
Increase (decrease) in net assets	$ 206,724	$ (26,338)	$ 96,610	$ 248,836	$ 147,863
Cash	$ 792,063	$ 727,599	$ 627,451	$ 564,094	$ 488,559
NET ASSETS					
Invested in capital assets, net of related debt	$ 1,075,557	$ 970,344	$ 868,014	$ 773,979	$ 750,758
Restricted expendable	419,862	402,260	541,286	588,963	432,796
Restricted nonexpendable	408,475	392,063	391,668	379,343	358,337
Unrestricted	361,510	294,013	284,050	246,123	197,681
Total net assets	$ 2,265,404	$ 2,058,680	$ 2,085,018	$ 1,988,408	$ 1,739,572
STUDENT LOANS					
Notes receivable	$ 34,209	$ 35,127	$ 35,933	$ 34,133	$ 34,632
Loans issued (by year)	1,822	1,748	1,729	2,560	2,674
ENDOWMENTS (,000)					
Market value	$ 519,756	$ 470,068	$ 646,927	$ 697,947	$ 585,445
LIFE INCOME FUNDS					
Market value	$ 30,903	$ 32,293	$ 42,451	$ 57,722	$ 53,134
CAPITAL ASSET AND DEBT ADMINISTRATION (,000)					
Capital assets, net of depreciation	$ 1,609,656	$ 1,494,048	$ 1,335,610	$ 1,128,100	$ 1,024,534
Total debt	$ 518,267	$ 518,244	$ 461,965	$ 351,626	$ 278,257

5-Year Summary *(continued)*

	FY 2010	FY 2009	FY 2008	FY 2007	FY 2006
General Data					
Total enrollment	48,603	47,821	46,691	44,796	43,686
Knoxville	27,144	27,769	27,308	26,560	26,292
Chattanooga	10,526	9,807	9,557	8,923	8,656
Martin	8,096	7,574	7,171	6,888	6,478
Memphis	2,837	2,671	2,655	2,425	2,260
Degrees granted	10,074	9,503	8,949	8,826	8,836
Full-time employees	11,034	11,112	11,991	11,942	12,054
Full-time faculty	2,948	3,294	3,166	2,864	2,853
% Tenured (based on those eligible for tenure)	53.1%	51.5%	48.0%	53.9%	51.9%
Total private gifts (,000)	$ 109,097	$ 101,452	$ 106,800	$ 98,267	$ 110,663
Academic-year student fees (Knoxville)					
In state	$ 3,425	$ 3,125	$ 5,932	$ 5,622	$ 5,290
Out of state (additional)	$ 6,898	$ 6,329	$ 11,945	$ 11,266	$ 10,770
State appropriation/FTE	$ 6,874	$ 7,884	$ 8,551	$ 7,873	$ 7,472
Instruction	$ 525,982	$ 527,273	$ 524,165	$ 489,890	$ 462,831
Research	235,049	206,315	204,116	198,105	197,131
Public service	124,874	130,937	133,698	128,002	126,454
Academic support	107,330	113,095	111,313	101,815	94,388
Student services	75,786	75,241	72,571	66,282	62,266
Institutional support	96,740	99,163	100,548	86,091	80,647
Op/maint physical plant	141,468	115,034	99,573	103,055	90,225
Scholarships/fellowships	87,995	71,784	66,036	64,761	59,717
Auxiliary enterprises	124,451	121,290	121,374	119,236	99,710
Hospitals	-	-	-	-	197
Independent operations	69,363	74,680	81,324	83,019	83,410
Depreciation	94,157	83,768	72,561	68,469	68,159
Total	$ 1,683,195	$ 1,618,580	$ 1,587,279	$ 1,508,725	$ 1,425,135

Administration of the University of Tennessee FROM JULY 1, 2009 THROUGH JUNE 30, 2010

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.

SENIOR ADMINISTRATIVE OFFICERS

Chancellors

FINANCIAL STAFF, UNIVERSITY ADMINISTRATION

FINANCIAL STAFF, CAMPUSES AND UNITS