

Notes to the Financial Statements (Continued)

U.S. Equity - This category generally consists of managers that invest primarily in equity securities of U.S. corporations. U.S. equity may include multiple styles (growth, value) and market capitalizations (small, mid, large). These investments will primarily be long-only.

International Equity - This category will generally consist of managers that invest primarily in equity securities of corporations domiciled in foreign countries. International equity may include multiple styles (growth, value) and market capitalizations (small, mid, large). These investments will primarily be long-only.

Emerging Markets - This category will generally consist of managers that invest primarily in equity securities of corporations domiciled in emerging foreign countries. Emerging markets equity may include multiple styles (growth, value) and market capitalizations (small, mid, large). These investments will primarily consist of long-only investments and hedged equity investments (long and short).

Opportunistic - This category may include any strategy that offers exceptional risk/reward opportunities. This category is designed to provide the Investment Committee with the flexibility to select investments for a relatively small part of an overall allocation, which may not fit into the other designed allocation categories.

Fixed Income - This category will generally consist of managers that invest primarily in fixed income securities of governments, government agencies, and corporations. These securities may include U.S. and foreign government bonds, corporate bonds, asset-backed securities, mortgages (residential and commercial), municipal bonds, commercial paper, money market funds, preferred stock, and closed-end funds. As the fixed income allocation is designed to provide capital preservation and liquidity, it will largely consist of investment grade securities. High yield bonds may be utilized.

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposit accounts and money market funds.

Investments

Investments are recorded on the date of contribution and are stated at fair value. Unrealized gains and losses are determined by the difference between fair values at the beginning and end of the year.

Investments held at June 30, 2017, were as follows:

	<u>Cost</u>	<u>Fair Value</u>
Money market funds	\$ 1,748,812	\$ 1,748,812
U.S. government securities	179,916	178,486
Corporate bonds	3,524,010	3,534,478
Mutual funds	39,839,598	40,200,712

Notes to the Financial Statements (Continued)

Interest in limited partnerships	69,574,365	88,660,668
Total investments	\$114,866,701	\$134,323,156

Alternative investments – The foundation had investments in limited partnerships/LLC investments. The estimated fair value of these assets was \$84,246,349 at June 30, 2017.

The foundation believes the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2017. 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 foundation's investment policy that approves the allocation of funds to various asset classes in order to ensure the proper level of diversification. These investments are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated by the foundation's investment managers using various valuation techniques and are subject to audit by the investment managers' independent accountant.

Pledges Receivable

Pledges receivable at June 30, 2017, are summarized below net of the estimated uncollectible allowance of \$619,751:

Current pledges	\$ 3,136,908
Pledges due in one to five years	6,116,118
Pledges due after five years	1,142,600
Subtotal	10,395,626
Less discount to net present value	(133,850)
Total pledges receivable, net	\$10,261,776

Capital Assets

The University of Memphis Foundation had art and historical collections valued at \$584,956 at June 30, 2017.

Endowments

The University of Memphis Foundation's endowments consist of approximately 520 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by accounting principles generally accepted in the United States of America, net position associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, is classified and reported based on the existence or absence of donor-imposed restrictions.

Notes to the Financial Statements (Continued)

Interpretation of relevant law – The Board of Trustees of the University of Memphis Foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (the Act) as adopted by Tennessee 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 University of Memphis Foundation classifies as permanently restricted net position 1) the original value of gifts donated to the permanent endowment and 2) the original value of subsequent gifts to the permanent endowment. The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net position is classified as temporarily restricted net position until the foundation appropriates those amounts for expenditure in a manner consistent with the standard of prudence prescribed by the Act. In accordance with the Act, the foundation 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 endowment fund; 3) the general economic conditions; 4) the possible effect of inflation or deflation; 5) the expected total return from income and the appreciation of investments; 6) other resources of the foundation; and 7) the investment policies of the foundation.

Composition of Endowment by Net Position Class As of June 30, 2017

	<u>Permanently Restricted</u>	<u>Temporarily Restricted</u>	<u>Unrestricted</u>	<u>Total</u>
Donor-restricted endowment funds	\$72,197,447	\$21,380,231	\$(343,559)	\$93,234,119
Board-designated endowment funds	-	-	3,735,912	3,735,912
Total funds	\$72,197,447	\$21,380,231	\$3,392,353	\$96,970,031

Changes in Endowment Net Position For the Fiscal Year Ended June 30, 2017

	<u>Permanently Restricted</u>	<u>Temporarily Restricted</u>	<u>Unrestricted</u>	<u>Total</u>
Endowment net position, beginning of year	\$68,718,760	\$15,080,916	\$3,671,800	\$87,471,476
Investment return:				
Investment income	-	(871,226)	(36,343)	(907,569)
Net appreciation (realized and unrealized)	-	10,271,286	405,006	10,676,292
Total investment return	-	9,400,060	368,663	9,768,723

Notes to the Financial Statements (Continued)

Contributions	2,489,107	196,087	-	2,685,194
Appropriations of endowment assets for expenditure	-	(2,375,465)	(1,589,477)	(3,964,942)
Other changes				
Investment deficiencies reclassified to unrestricted net assets	-	(941,367)	941,367	-
Modifications of restrictions	989,580	20,000	-	1,009,580
Endowment net position, end of year	\$72,197,447	\$21,380,231	\$3,392,353	\$96,970,031

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 foundation is required to retain in a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, deficiencies of this nature are reported in unrestricted net position. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of permanently restricted contributions and/or continued appropriation for fees and previously approved budgeted expenditures. At June 30, 2017, deficiencies of this nature totaled \$343,559.

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 organization 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 Trustees, the endowment assets are invested in a manner that is intended to produce consistent long-term growth of capital without undue exposure to risk.

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 restraints.

Spending policy and how the investment objectives relate to spending policy – The foundation has a policy of budgeting for expenditure each year a percentage of its endowment funds' average fair value over the prior 12 quarters through the fiscal year-end one year preceding the fiscal year in which the expenditure is planned. For fiscal year 2017, this percentage was 4%. In establishing this policy, the foundation considered the long-term expected return on its endowment funds. Accordingly, over the long-term, the foundation expects the current spending policy to allow for endowment growth. This is consistent with the foundation's objective to maintain the purchasing

Notes to the Financial Statements (Continued)

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.

Concentrations of Risk

Although the foundation has a policy to maintain a diversified investment portfolio, its investments are subject to market and credit risks which may be affected by economic developments in a specific geographic region or industry.

Approximately 24% of the foundation's contributions receivable balance at June 30, 2017, was due from two donors.

Interfund Advances

The foundation has agreed to advance up to \$7.6 million to a foundation fund as an interfund advance benefiting the Athletic Department of the University of Memphis at a 2.2% annual interest rate for the purpose of providing financial support to allow the Athletic Department to undertake construction of a basketball practice facility in advance of receiving payment of donor funding commitments. The advance is to be repaid in full not later than June 30, 2020, and is secured by certain future collections of receivables and other collections related to certain foundation funds benefiting the Athletic Department. No advances had been made as of June 30, 2017.

Support From the University of Memphis

During fiscal year 2017, under the terms of the foundation's operating agreement with the University of Memphis, the university paid certain payroll and benefit costs amounting to \$29,031 for university personnel who also performed services supporting the foundation. In accordance with the operating agreement, in fiscal year 2017, the university also provided the foundation with office space valued at \$15,000. These support costs contractually paid by the university, and totaling \$44,031, are reflected in the foundation's statement of revenues, expenses, and changes in net position as university support, with a like amount included in expenses.

THE UNIVERSITY OF MEMPHIS
Required Supplementary Information
Schedule of the University of Memphis' Proportionate Share of the Net
Pension Liability
Closed State and Higher Education Employee Pension Plan Within TCRS

	Proportion of the Net Pension Liability	Proportionate Share of the Net Pension Liability	Covered Payroll	Proportionate Share of the Net Pension Liability as a Percentage of Its Covered Payroll	Plan Fiduciary Net Position as a Percentage of the Total Pension Liability
2017	2.053060%	\$37,459,409	\$50,178,303.00	77.68%	87.96%
2016	1.964990%	25,334,267	51,310,490.00	49.37%	91.26%
2015	2.010010%	13,868,034	54,942,068.00	25.24%	95.11%

- 1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.
- 2) This is a 10-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until 10 years of information are available.

THE UNIVERSITY OF MEMPHIS
Required Supplementary Information
Schedule of the University of Memphis' Proportionate Share of the Net
Pension Asset
State and Higher Education Employee Retirement Plan Within TCRS

	<u>2017</u>	<u>2016</u>
University's proportion of the net pension asset	2.497908%	2.108964
University's proportionate share of the net pension asset	\$ 210,436	\$ 58,650
University's covered payroll	\$7,702,818	\$2,296,586
University's proportionate share of the net pension asset as a percentage of its covered payroll	2.73%	2.55%
Plan fiduciary net position as a percentage of the total pension liability	130.56%	142.55%

- 1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.
- 2) This is a 10-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until 10 years of information are available.

THE UNIVERSITY OF MEMPHIS
Required Supplementary Information
Schedule of the University of Memphis' Contributions
Closed State and Higher Education Employee Pension Plan Within TCRS

	Contractually Determined Contributions	Contributions in Relation to Contractually Determined Contribution	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a Percentage of Covered Payroll
2017	\$6,995,147.00	\$6,995,147.00	\$ -	\$46,572,217.98	15.02%
2016	7,530,918.00	7,530,918.00	-	50,105,908.18	15.03%
2015	7,709,639.43	7,709,639.43	-	51,295,006.19	15.03%
2014	8,253,251.00	8,253,251.00	-	54,942,068.00	15.02%
2013	8,364,880.00	8,364,880.00	-	55,654,558.48	15.03%
2012	8,338,696.00	8,338,696.00	-	55,926,867.74	14.91%
2011	8,072,256.00	8,072,256.00	-	54,139,877.46	14.91%
2010	6,859,296.00	6,859,296.00	-	52,682,763.13	13.02%
2009	7,075,176.00	7,075,176.00	-	54,340,827.11	13.02%
2008	7,851,078.00	7,851,078.00	-	57,643,741.56	13.62%

THE UNIVERSITY OF MEMPHIS
Required Supplementary Information
Schedule of the University of Memphis' Contributions
State and Higher Education Employee Retirement Plan Within TCRS

	<u>2017</u>	<u>2016</u>	<u>2015</u>
Contractually determined contribution	\$ 483,152	\$283,442	\$ 92,517
Contributions in relation to the contractually determined contribution	483,152	283,442	92,517
Contribution deficiency (excess)	\$ -	\$ -	\$ -
Covered payroll	\$12,356,829	\$7,702,818	\$2,390,611
Contributions as a percentage of covered payroll	3.91%	3.68%	3.87%

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

THE UNIVERSITY OF MEMPHIS
Required Supplementary Information
Other Postemployment Benefits Schedule of Funding Progress

Actuarial Valuation Date	Plan	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c]
July 1, 2015	State Employee Group Plan	\$ -	\$23,805,000.00	\$23,805,000.00	0%	\$128,486,748.24	18.53%
July 1, 2013	State Employee Group Plan	\$ -	\$23,897,000.00	\$23,897,000.00	0%	\$125,308,379.00	19.07%
July 1, 2011	State Employee Group Plan	\$ -	\$30,832,000.00	\$30,832,000.00	0%	\$118,128,155.00	26.10%

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

THE UNIVERSITY OF MEMPHIS
Supplementary Schedule of Cash Flows - Component Unit
For the Year Ended June 30, 2017

Cash flows from operating activities	
Gifts and contributions	\$ 23,768,436.00
Sales and services of other activities	708,590.00
Payments to suppliers and vendors	(15,354,804.00)
Payments to the University of Memphis	(19,878,974.00)
Net cash used for operating activities	(10,756,752.00)
Cash flows from noncapital financing activities	
Private gifts for endowment purposes	2,489,107.00
Other non-capital financial receipts (payments)	(23,835.00)
Net cash provided by noncapital financing activities	2,465,272.00
Cash flows from investing activities	
Proceeds from sales and maturities of investments	96,405,516.00
Income on investments	2,443,530.00
Purchases of investments	(89,483,120.00)
Net cash provided by investing activities	9,365,926.00
Net increase in cash and cash equivalents	1,074,446.00
Cash and cash equivalents - beginning of year	314,948.00
Cash and cash equivalents - end of year	\$ 1,389,394.00
Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	\$ (19,096,035.00)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Gifts in-kind	44,031.00
Changes in assets and liabilities:	
Receivables	8,417,555.00
Accounts payable	735,875.00
Due to the UOM	(844,810.00)
Accrued liabilities	(13,368.00)
Net cash used by operating activities	\$ (10,756,752.00)
Noncash investing, capital, or financing transactions	
Unrealized gains on investments	\$ 10,818,040.00



STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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505 DEADERICK STREET
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**Independent Auditor's Report on Internal Control Over Financial Reporting
and on Compliance and Other Matters Based on an Audit of
Financial Statements Performed in Accordance With
*Government Auditing Standards***

The Honorable Bill Haslam, Governor
Members of the General Assembly
Dr. M. David Rudd, President

We have audited the financial statements of the University of Memphis, an institution of the State University and Community College System of Tennessee, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the university's basic financial statements, and have issued our report thereon dated December 5, 2017. We conducted our audit in accordance with the auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Our report includes a reference to other auditors who audited the financial statements of the University of Memphis Foundation, as described in our report on the University of Memphis's financial statements. This report does not include the results of other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the university's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinions on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the university's internal control. Accordingly, we do not express an opinion on the effectiveness of the university's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. *A material weakness* is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented, or detected and corrected on a timely basis. *A significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.


Our consideration of internal control was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies. Given these limitations, during our audit we did not identify any deficiencies that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the university's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

Purpose of This Report

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the results of that testing, and not to provide an opinion on the effectiveness of the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.



Deborah V. Loveless, CPA
Director
December 5, 2017

Financial Report

For the year ended June 30, 2017



Report on 2017 Annual Audit

Audit Committee

March 7, 2018
University Center





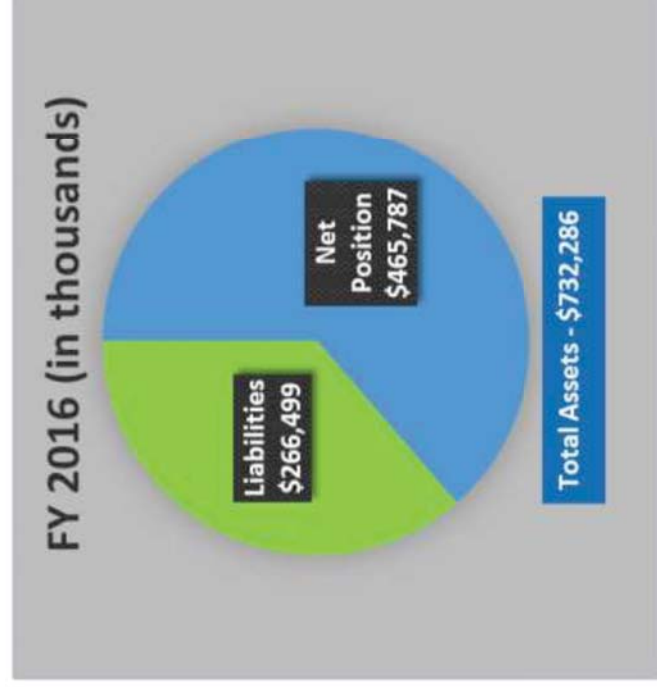
Annual Financial Statements and Internal Control Audit



Annual Audit Result

- Financial Statements are prepared in accordance with Generally Accepted Accounting Principles applicable to governmental colleges and universities as prescribed by GASB (Governmental Accounting Standards Board)
- Annual audits are conducted by the Tennessee State Comptroller's Office.
 - University is included in the State of Tennessee Consolidated Financials
 - Includes A-133 audit (audits of non-federal entities receiving federal funds). Report will be included in State's single audit reporting package
- Audit for FYE June 30, 2017 has been completed with an **Unmodified Audit Opinion**. There were **No findings**.

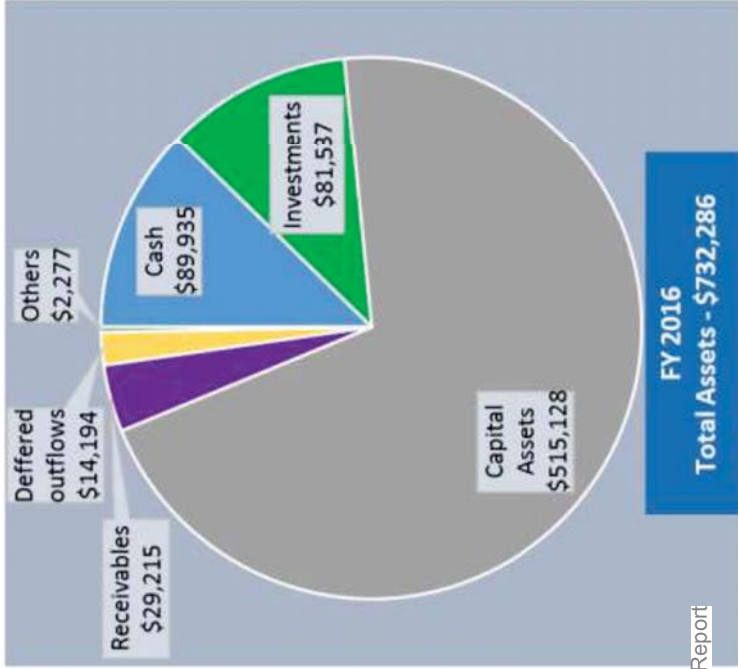
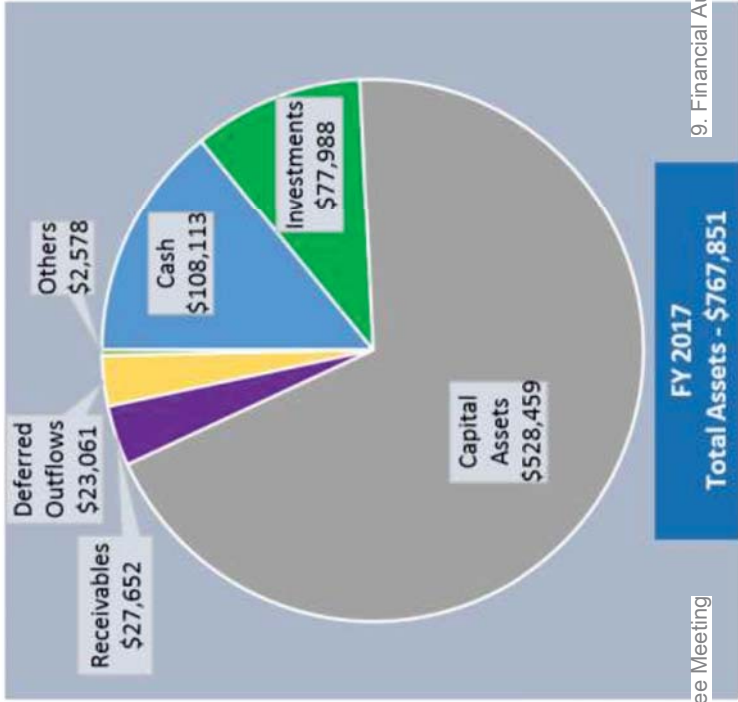
Comparative Financial Statement Summaries FYE June 30 2017 and 2016



Net position increased by \$35.6 million, of which \$17 million was due to investments in capital projects and \$18.6 million increase in unrestricted funds. The \$18.6 million increase in unrestricted funds was primarily due to the \$17 million increase in capital projects and \$1.6 million increase in unrestricted funds.

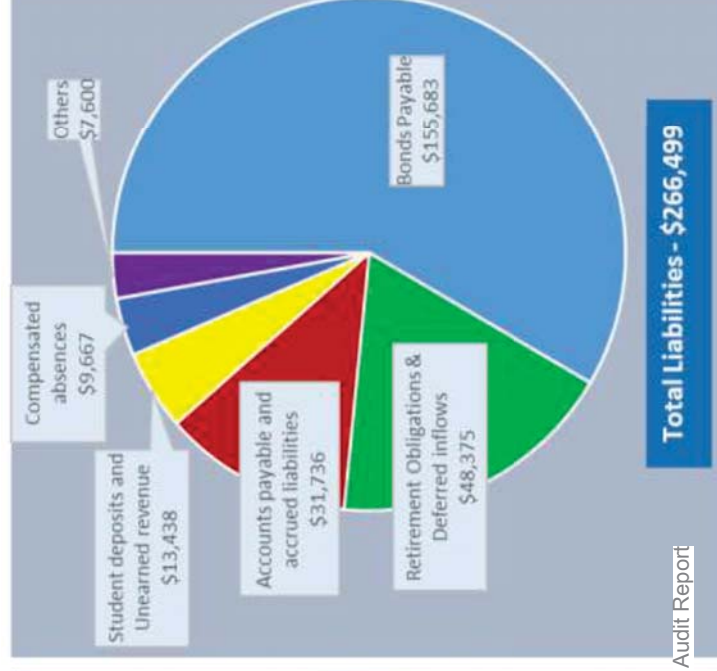
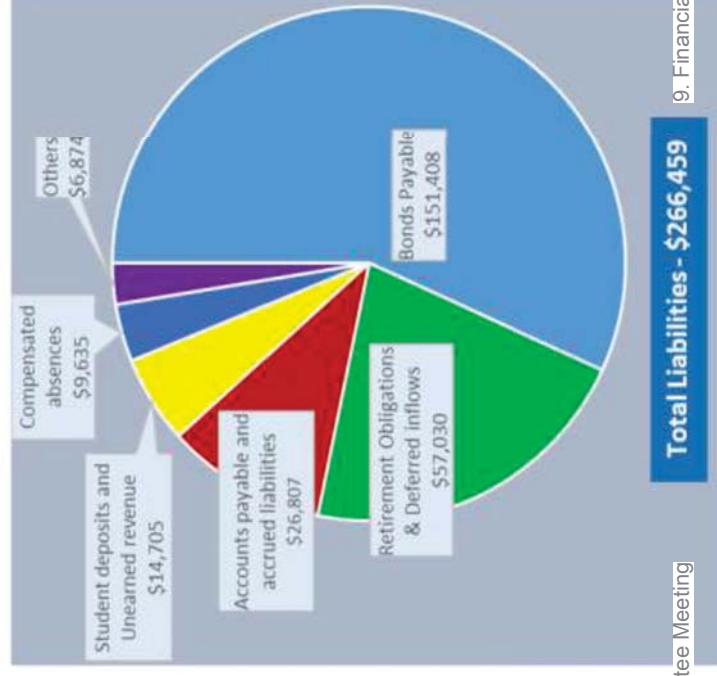
Comparative Financial Statement Summaries FYE June 30 2017 and 2016

Composition of Assets (in thousands)



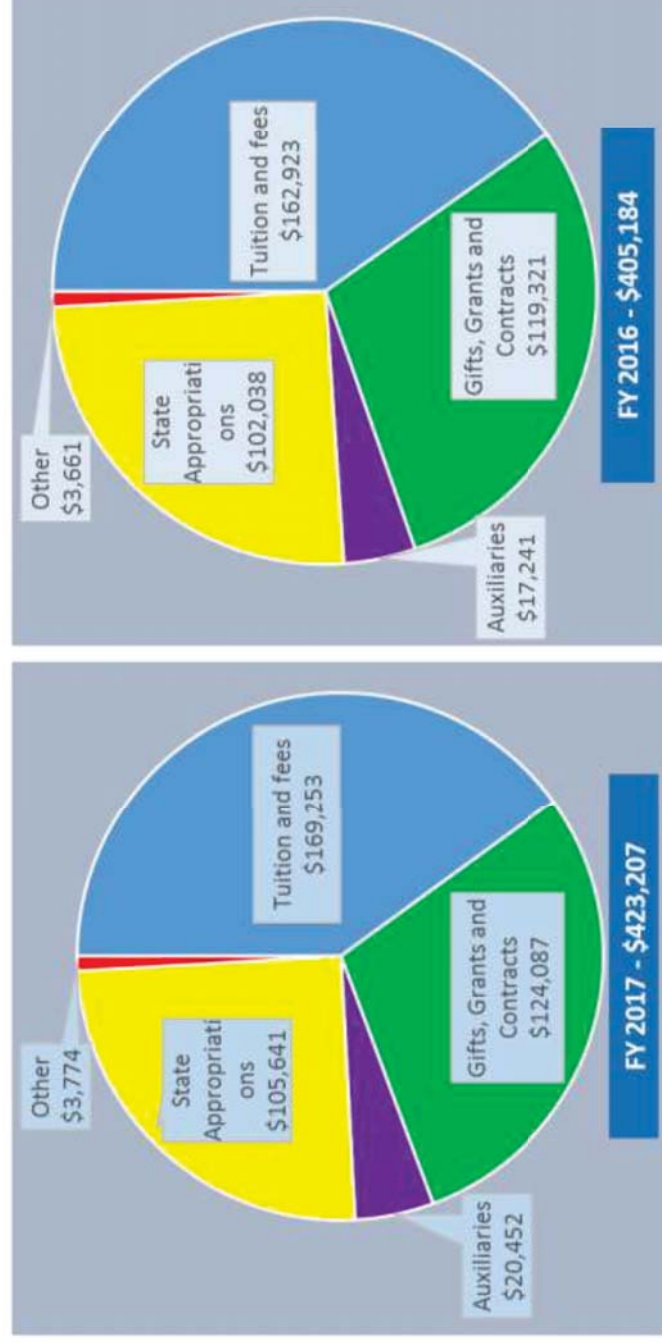
Comparative Financial Statement Summaries FYE June 30 2017 and 2016

Composition of Liabilities (in thousands)



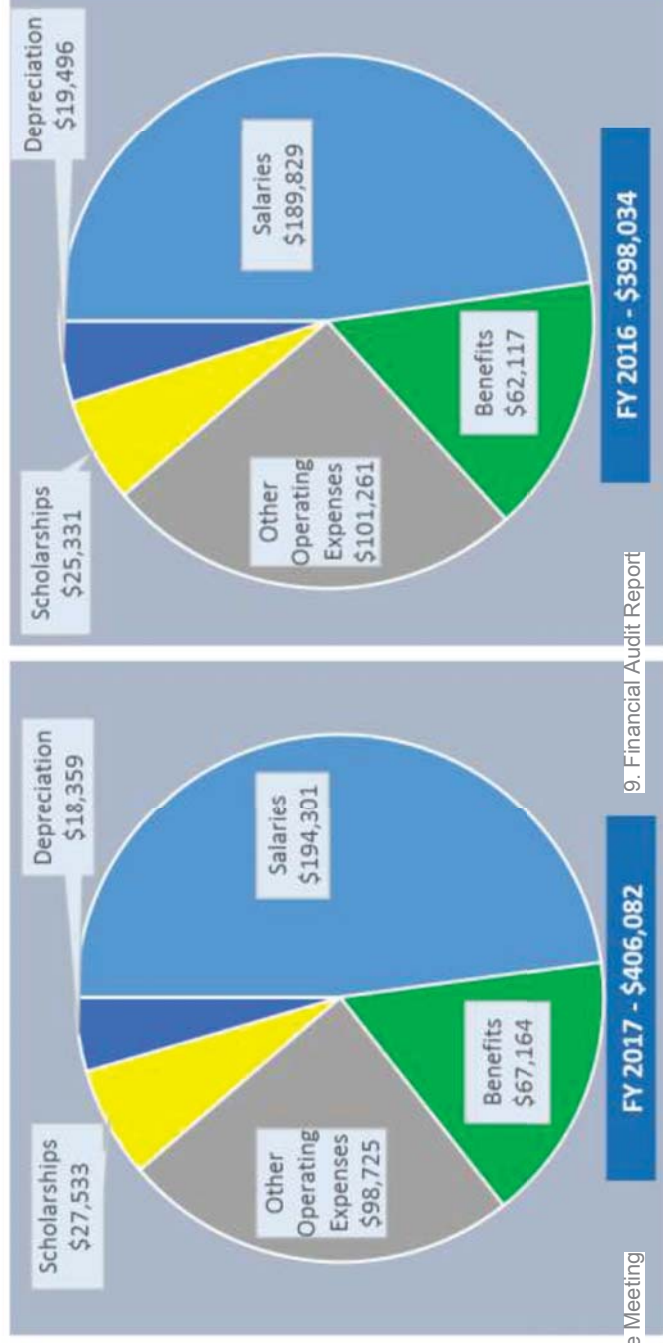
Comparative Financial Statement Summaries FYE June 30 2017 and 2016

Sources Of Revenue* (in thousands)



Comparative Financial Statement Summaries FYE June 30 2017 and 2016

Operating Expenses





Composite Financial Index Analysis

What is the Composite Financial Index (CFI)?

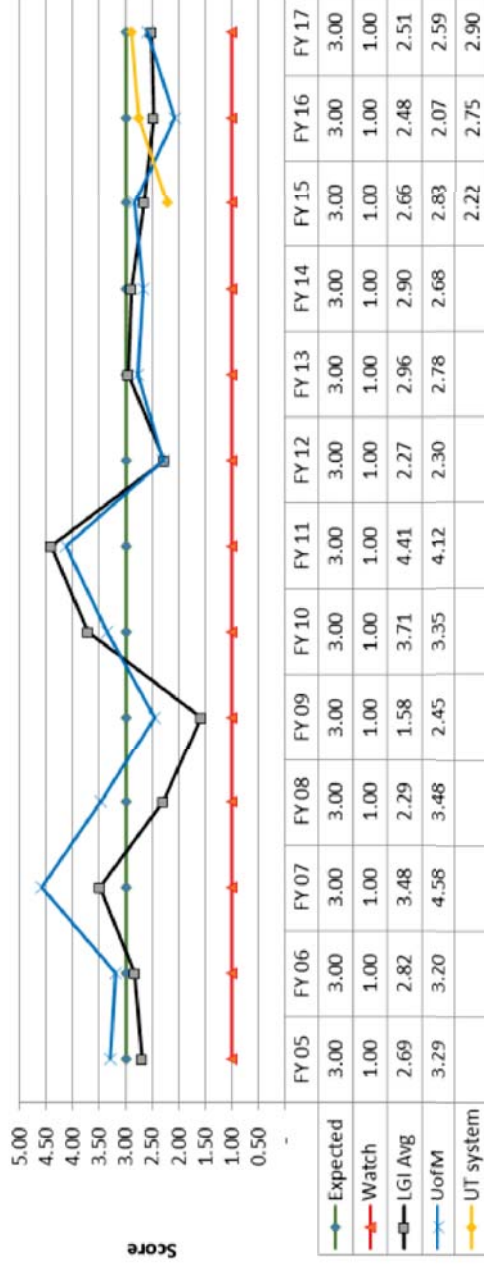
- The CFI score is based on a blended weighted value of four core ratios.
 - The weighting and scoring system is based on analysis of a wide range of institutions.
 - Scores for public universities tend to be lower than their private peers.
- The CFI is most useful for evaluating institution specific trends (e.g. five-year historical performance) in meeting financial and strategic goals.
- The CFI, as a single metric, provides a useful summary assessment of financial health in that weaknesses in certain areas can be offset by strength in others.
- The CFI only measures the financial component of institutional health and must be viewed in the overall context of an institution's activities.
 - (e.g. two institutions with the same CFI score may not have equal overall health if one is investing in its mission while the other is not)

Core Ratios of the CFI

Core Ratios	Calculation	Description
Primary Reserve Ratio (income statement leverage)	$\frac{\text{Expendable Net Assets}}{\text{Total Expenses}}$	<ul style="list-style-type: none"> Are resources sufficient and flexible enough to support the mission? Measures the ability to fund operations with expendable financial reserves
Viability Ratio (balance sheet leverage)	$\frac{\text{Expendable Net Assets}}{\text{Long Term Debt}}$	<ul style="list-style-type: none"> Are debt resources managed strategically to advance the mission? Measures the ability to pay off long-term debt with expendable financial reserves
Return on Net Assets Ratio (financial resource growth)	$\frac{\text{Change in Net Assets}}{\text{Total Net Assets}}$	<ul style="list-style-type: none"> Does asset performance and management support the strategic direction? Measures the ability of net asset growth to support strategic initiatives
Net Operating Revenues Ratio (operating performance)	$\frac{\text{Operating Income (loss) + Net Non operating Revenues}}{\text{Total Operating + Non Operating Revenues}}$	<ul style="list-style-type: none"> Does operating results indicate that the institution is living within available resources? Measures the impact of operations on the three other core ratios

CFI Score – What is UM’s Overall Financial Health?

Composite Financial Index



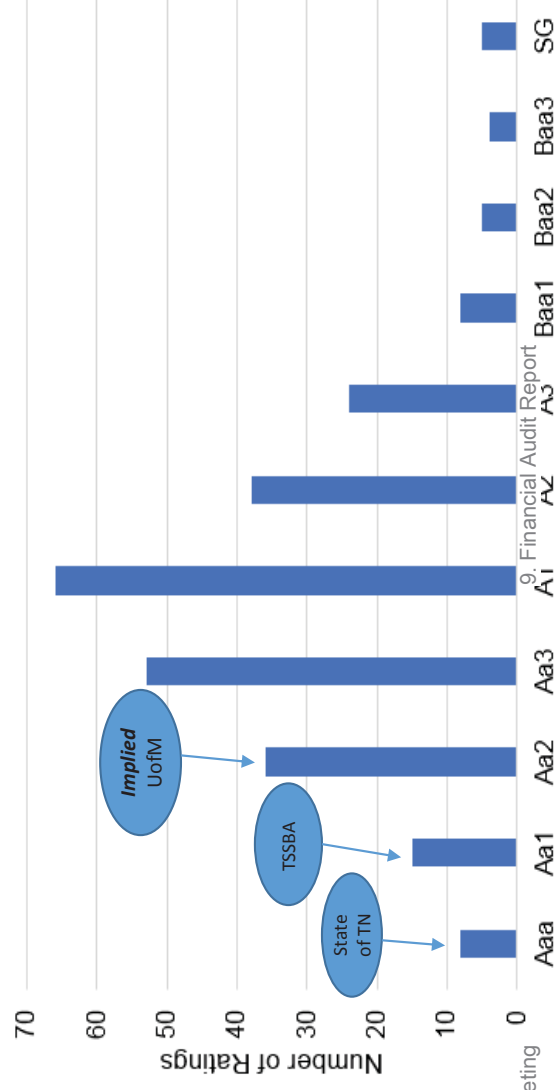
- The University’s CFI Score has exceeded the LGL average in FY2017 and FY2015. FY2016 results were slightly below the LGL average, primarily as a result of the impact of fluctuations in capital appropriations, capital gifts, as well as investment performance declines experienced by the Foundation.
- Note – the median for public university CFI scores declined from 1.2 in 2015 to .1 in 2016, inclusive of the impact of GASB 68.¹ The University’s cores were substantially better at 2.83 and 2.07 over the same period and 2.59 in FY2017.



Moody's Scorecard Analysis

Moody's Rating Distribution (Public Universities)

- The analysis of the University's financial health is based on a comparison of the University's credit to other Moody's rated public universities. The distribution of Moody's rated public universities is provided below with Aaa representing the highest rating.
- Note: **TSSBA is rated Aa1**. TSSBA's rating is, in part, based on the TSSBA's ability to intercept revenues to pay debt service, as well as the strength of the [State of Tennessee's Aaa rating](#).
- Based on the University of Memphis' FY17 performance, our consultants applied the methodology to determine an **implied rating of Aa2**. This is an improvement from the implied rating of Aa3 based on FY16 performance.



10. Additional Committee Business

Presented by Carol Roberts

11. Adjournment

Presented by Carol Roberts

12. Executive Session

Presented by Alan Graf

12.1. Investigative Reports

Presented by Vicki Deaton

12.2. Litigation Update

Presented by Melanie Murry