# AUDIT REPORT

**Tennessee Board of Regents**

## The University of Memphis

**For the Year Ended**
**June 30, 2014**

## STATE OF TENNESSEE

**COMPTROLLER OF THE TREASURY**

**Department of Audit**

**Division of State Audit**

Tennessee Comptroller of the Treasury

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January 20, 2015

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

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, The University of Memphis, for the year ended June 30, 2014. You will note from the independent auditor's report that unmodified opinions were given on the fairness of the presentation of the financial statements.

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

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

14/081

**Audit Report**
**Tennessee Board of Regents**
# The University of Memphis
**For the Year Ended June 30, 2014**

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State of Tennessee

# Audit Highlights

Comptroller of the Treasury                    Division of State Audit

Financial and Compliance Audit

**Tennessee Board of Regents**

## The University of Memphis

For the Year Ended June 30, 2014

### Opinions on the Financial Statements

The opinions on the financial statements are unmodified.

### Audit Findings

**Purchasing procedures at The University of Memphis are inadequate**
Purchasing procedures at the university are inadequate and do not offer proper segregation of duties, which is an essential part of any internal control structure (page 47).

**The University of Memphis did not provide adequate internal controls in one specific area**
The university did not design and monitor internal controls in one specific area. Inconsistent implementation of internal controls increases the risk of fraud or error (page 50).

STATE OF TENNESSEE
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## Independent Auditor's Report

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

## Report on the Financial Statements

We have audited the accompanying financial statements of The University of Memphis, an institution of the Tennessee Board of Regents, 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, 2014, and the related notes to the financial statements, which collectively comprise the basic financial statements as listed in the table of contents.

### *Management's Responsibility for the Financial Statements*

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

### *Auditor's Responsibility*

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

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

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

***Opinions***

In our opinion, based on our audit and the report of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of Memphis and its discretely presented component unit as of June 30, 2014, and the respective changes in financial position and, where applicable, cash flows thereof for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

***Emphasis of Matters***

As discussed in Note 1, the financial statements of The University of Memphis, an institution of the Tennessee Board of Regents, are intended to present the financial position, the changes in financial position, and the cash flows of only The University of Memphis. They do not purport to, and do not, present fairly the financial position of the Tennessee Board of Regents, as of June 30, 2014, and the changes in financial position and cash flows thereof for the year then ended, in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note 21, the financial statements of The University of Memphis Foundation, a discretely presented component unit of The University of Memphis, include investments valued at $86,220,045 (63 percent of net position of the foundation), whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners. Our opinion is not modified with respect to this matter.

***Other Matters***

*Required Supplementary Information*

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 13 and the schedule of funding progress on page 42 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

*Supplementary Information*

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the university's basic financial statements. The schedule of cash flows – component unit on page 43 is presented for purposes of additional analysis and is not a required part of the basic financial statements.

The schedule of cash flows – component unit is the responsibility of the university's management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America by us and other auditors. In our opinion, based on our audit and the procedures performed as described above, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

## Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 5, 2014, on our consideration of the university's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the university's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 5, 2014

# Tennessee Board of Regents
# THE UNIVERSITY OF MEMPHIS
# Management's Discussion and Analysis
# For the Year Ended June 30, 2014

## Introduction

This section of The University of Memphis's financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2014, with comparative information presented for the fiscal year ended June 30, 2013. 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 notes. The financial statements, notes, and this discussion are the responsibility of management.

The university has one discretely presented component unit, The University of Memphis Foundation. More detailed information about the foundation is presented in Note 21 to the financial statements. This discussion and analysis focuses on the university and does not include the foundation.

## Overview of the Financial Statements

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

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

### The Statement of Net Position

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

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

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

The following table summarizes the university's assets, liabilities, deferred outflows/inflows of resources, and net position at June 30, 2014, and June 30, 2013.

**Summary of Net Position**
**(in thousands of dollars)**

| | 2014 | 2013 |
|---|---|---|
| Assets: | | |
| Current assets | $ 62,711 | $ 89,341 |
| Capital assets, net | 438,406 | 417,898 |
| Other assets | 124,638 | 97,464 |
| Total Assets | 625,755 | 604,703 |
| Deferred Outflows of Resources: | | |
| Deferred amount on debt refunding | 211 | 231 |
| Total Deferred Outflows of Resources | 211 | 231 |
| Liabilities: | | |
| Current liabilities | 53,259 | 46,045 |
| Noncurrent liabilities | 136,716 | 128,400 |
| Total Liabilities | 189,975 | 174,445 |

| | | |
|---|---|---|
| Net Position: | | |
| Net investment in capital assets | 325,022 | 312,893 |
| Restricted – nonexpendable | 3,820 | 3,806 |
| Restricted – expendable | 9,685 | 9,302 |
| Unrestricted | 97,464 | 104,488 |
| Total Net Position | $435,991 | $430,489 |

Comparison of FY 2014 to FY 2013

- Current assets decreased primarily due to the reclassification of investments not needed for normal operating expenses within one year to other noncurrent assets.

- Capital assets increased primarily due to the additional expenditures incurred in the construction of the Community Health Building ($13 million) and the new student housing facility ($8 million).

- Current liabilities increased due to $3.5 million accrued expenses for the Community Health Building and the timing of bank transfers for the June 30 payroll tax deposits.

- Noncurrent liabilities increased primarily due to the addition of $8.6 million in commercial paper/revolving credit facility to fund the New Student Housing.

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

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

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

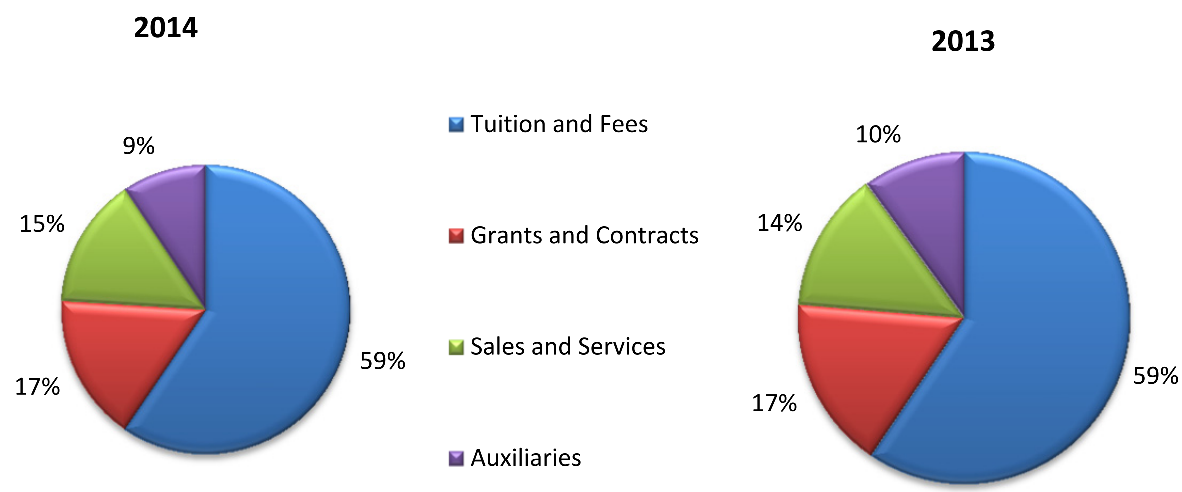
A summary of the university's revenues, expenses, and changes in net position for the year ended June 30, 2014, and June 30, 2013, follows.

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

| | 2014 | 2013 |
|---|---|---|
| Operating revenues | $227,227 | $223,364 |
| Operating expenses | 421,775 | 416,970 |
| Operating loss | (194,548) | (193,606) |
| Nonoperating revenues and expenses | 183,691 | 182,587 |
| Loss before other revenues, expenses, gains, or losses | (10,857) | (11,019) |
| Other revenues, expenses, gains, or losses | 16,359 | 19,428 |
| Increase in net position | 5,502 | 8,409 |
| Net position at beginning of year | 430,489 | 422,080 |
| Net position at end of year | $435,991 | $430,489 |

Operating Revenues

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




Comparison of FY 2014 to FY 2013

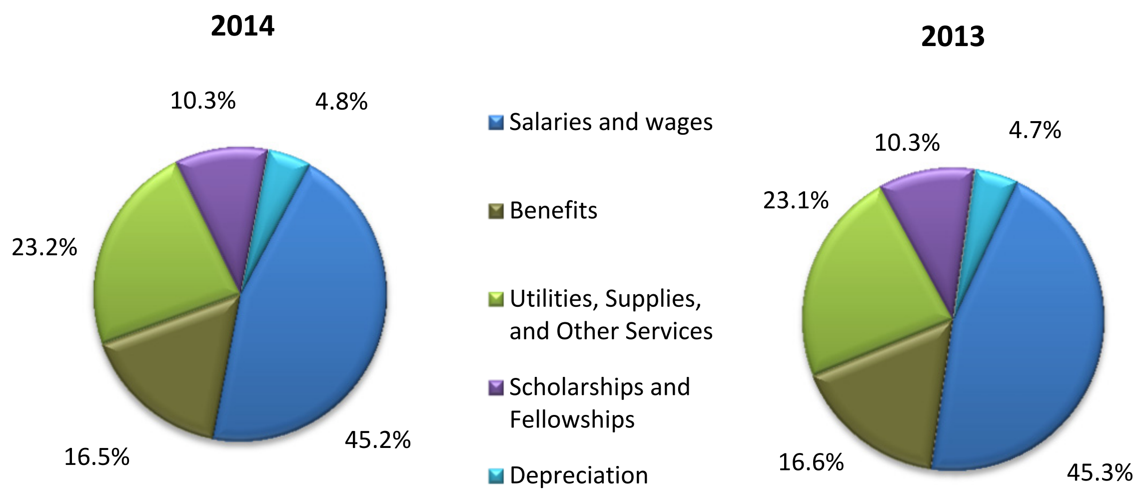
- Tuition and fee revenues increased by $2.4 million, primarily due to a 6% increase in student fees that was offset by a 4% decline in enrollment.

- Sales and services increased by $2.7 million, primarily due to increased athletic conference distributions from the American Athletic Conference, as compared to prior year Conference USA distributions.

- Auxiliary revenues decreased due a decline in enrollment, which resulted in a $550,000 decrease in student housing revenue and $140,000 for parking services. Conversion of a building from rental property operations to educational use caused a $400,000 decline in rental property revenues.

Operating Expenses

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



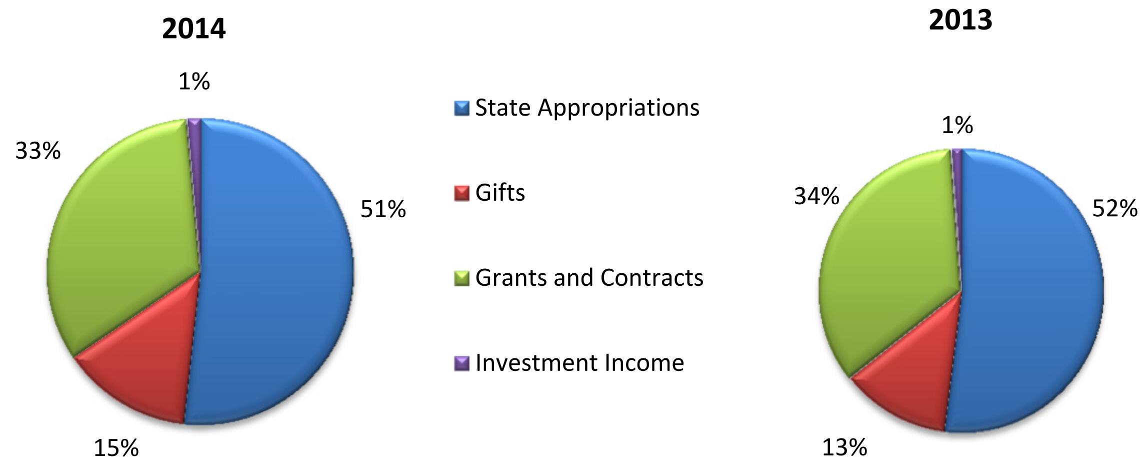

Comparison of FY 2014 to FY 2013

- Salaries, wages and benefits expenses increased due to a 1.5% across-the-board pay raise effective July 1, 2013.

- Depreciation expense increased due to the acquisition of the Defense Audit Building and elevator modernization improvements.

Nonoperating Revenues and Expenses

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



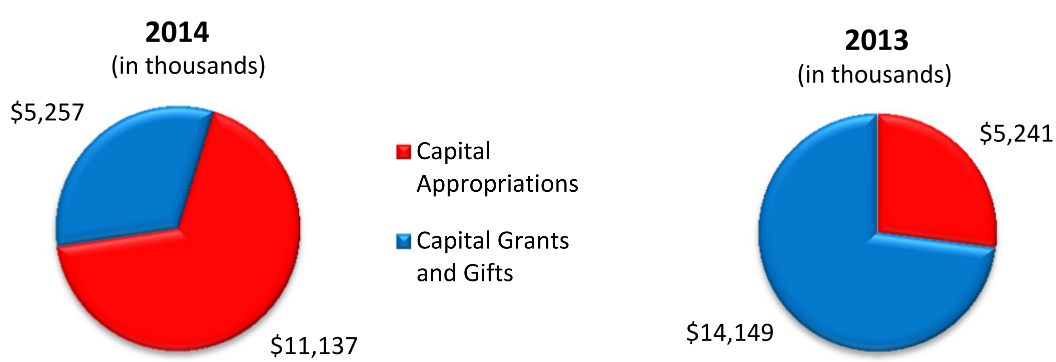

Comparison of FY 2014 to FY 2013

- Private gifts increased due to the reclassification of $2.5 million in funds from The University of Memphis Foundation that were previously classified as private grants and contracts.

- Investment income increased by $570,000, due to better market returns from chairs of excellence endowments and investments in treasuries.

Other Revenues

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




Comparison of FY 2014 to FY 2013

- Capital appropriations increased by $6 million, primarily for the Community Health Building, underground utility upgrades, and elevator modernization projects.

- Capital grants and gifts decreased due to the acquisition of the Defense Audit Building, valued at $9 million, that the university received from the United States government and recorded in FY 2013.

## Capital Assets and Debt Administration

Capital Assets

The University of Memphis had $438 million invested in capital assets, net of accumulated depreciation of $218 million at June 30, 2014; and $418 million invested in capital assets, net of accumulated depreciation of $201 million at June 30, 2013. Depreciation charges totaled $20 million and $19.4 million for the years ended June 30, 2014, and June 30, 2013, respectively.

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

| | 2014 | 2013 |
|---|---|---|
| Land | $ 18,895 | $ 18,575 |
| Land improvements and infrastructure | 54,174 | 51,287 |
| Buildings | 301,389 | 299,147 |
| Equipment | 14,100 | 15,393 |
| Library holdings | 6,063 | 6,664 |
| Intangible assets | 3,574 | 4,378 |
| Art and historical collections | 645 | - |
| Projects in progress | 39,566 | 22,454 |
| Total | $438,406 | $417,898 |

Significant additions to capital assets in FY 2014 were the construction in progress for the Community Health Building on the Park Avenue Campus and a New Student Housing facility on the main campus.

At June 30, 2014, outstanding commitments under construction contracts totaled $80 million for various renovations and repairs of buildings and infrastructure, as well as new building construction. Future state capital outlay appropriations will fund $29 million of these costs.

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

Debt

The university had $113.6 million and $105.2 million in debt outstanding at June 30, 2014, and June 30, 2013, respectively. The table below summarizes these amounts by type of debt instrument.

**Outstanding Debt**
**(in thousands of dollars)**

| | 2014 | 2013 |
|---|---|---|
| TSSBA bonds payable | $ 94,869 | $ 96,420 |
| TSSBA commercial paper payable/revolving credit facility | 13,503 | 2,684 |
| GO commercial paper | 3,954 | 4,085 |
| Capital lease | 1,262 | 2,047 |
| Total | $113,588 | $105,236 |

The Tennessee State School Bond Authority (TSSBA) issued bonds with interest rates ranging from 0.18% to 5.63% due in 2040 on behalf of The University of Memphis. The university is responsible for the debt service of these bonds. The current portion of the $94.8 million outstanding at June 30, 2014, is $4.1 million.

The TSSBA issued revolving credit facility with variable interest rates on behalf of The University of Memphis. The university is responsible for the debt service of these obligations. The outstanding amount at June 30, 2014, is $13.5 million.

The Tennessee State Funding Board issued General Obligation commercial paper with variable interest rates on behalf of The University of Memphis. The university is responsible for the debt service of these obligations. The outstanding amount at June 30, 2014, is $4 million.

The university has a capital lease agreement for the campus-wide data network equipment and services. This agreement has an imputed interest rate of 5.517% due December 31, 2015. The current portion of the $1.3 million outstanding at June 30, 2014, is $829,736.

The ratings on debt issued by the TSSBA at June 30, 2014, were as follows:

| | |
|---|---|
| Fitch | AA+ |
| Moody's Investor Service | Aa1 |
| Standard & Poor's | AA |

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

## Economic Factors That Will Affect the Future

In May 2014, Dr. M. David Rudd began his leadership role at The University of Memphis as the 12th president. He has outlined several key initiatives to improved recruitment, retention, access, completion, and overall student success, as well as efficiency improvements. We expect these initiatives, over time, to positively impact both enrollment trends and state appropriation outcomes. Also, the university's continued focus on the development of online courses and the expansion of course offerings at The University of Memphis Lambuth Campus provide significant opportunities for enrollment and revenue growth.

The university’s state appropriation was reduced for FY 2015 by $343,500, or 0.4%, from the previous year. Although the current year reduction is relatively small, the cumulative effects of state appropriation reductions are driving the university's effort to reduce the overall budget through restructuring where opportunities exist, position attritions, as well as continuing efficiency initiatives. The university reduced its base operating budget by $15 million in FY 2014 and plans to further reduce the expenditure base budget by an additional $5 million over the next few years. The university opted to reduce the budget in lieu of increasing tuition to students, which enabled tuition to be held flat for FY 2015. We continue to remain cognizant of the impact future tuition increases may have on our students and are committed to minimize tuition increases to the greatest extent possible.

We are not aware of any other factors, decisions, or conditions that are expected to have a significant impact on the financial position or results of operation during this fiscal year.

**Tennessee Board of Regents**
**THE UNIVERSITY OF MEMPHIS**
**Statement of Net Position**
**June 30, 2014**

| | University | Component Unit |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash (Notes 2 and 21) | $ 35,673,225.73 | $ 417,950.00 |
| Accounts, notes, and grants receivable (net) (Note 4) | 14,548,498.58 | - |
| Due from primary government | 205,100.00 | - |
| Due from component unit | 10,538,850.00 | - |
| Pledges receivable (net) (Note 21) | - | 4,371,777.00 |
| Inventories (at lower of cost or market) | 582,862.71 | - |
| Prepaid expenses | 867,541.81 | - |
| Accrued interest receivable | 294,545.47 | 72,887.00 |
| Total current assets | 62,710,624.30 | 4,862,614.00 |
| Noncurrent assets: | | |
| Cash (Note 2) | 66,305,681.73 | - |
| Investments (Notes 3 and 21) | 53,848,586.50 | 134,146,310.00 |
| Accounts, notes, and grants receivable (net) (Note 4) | 4,480,739.11 | - |
| Pledges receivable (net) (Note 21) | - | 8,168,055.00 |
| Capital assets (net) (Notes 5 and 21) | 438,406,089.69 | 596,227.00 |
| Other assets | 2,500.00 | 339,364.00 |
| Total noncurrent assets | 563,043,597.03 | 143,249,956.00 |
| Total assets | 625,754,221.33 | 148,112,570.00 |
| | | |
| **Deferred Outflows of Resources** | | |
| Deferred amount on debt refunding | 211,482.73 | - |
| Total deferred outflows of resources | 211,482.73 | - |
| | | |
| **Liabilities** | | |
| Current liabilities: | | |
| Accounts payable (Note 6) | 12,091,964.02 | 354,815.00 |
| Accrued liabilities | 19,445,153.16 | 151,945.00 |
| Student deposits | 1,514,287.50 | - |
| Unearned revenue | 10,327,174.07 | - |
| Compensated absences (Note 8) | 2,626,166.63 | - |
| Accrued interest payable | 729,977.02 | - |
| Long-term liabilities, current portion (Note 8) | 4,979,530.56 | - |
| Deposits held in custody for others | 1,008,364.11 | - |
| Voluntary buyout plan liability (Note 20) | 536,536.67 | - |
| Due to the university | - | 10,538,850.00 |
| Total current liabilities | 53,259,153.74 | 11,045,610.00 |
| Noncurrent liabilities: | | |
| Net OPEB obligation (Note 12) | 16,194,749.96 | - |
| Compensated absences (Note 8) | 7,168,580.85 | - |
| Long-term liabilities (Note 8) | 108,608,745.94 | - |
| Due to grantors (Note 8) | 4,480,739.11 | - |
| Voluntary buyout plan liability (Note 20) | 262,771.72 | - |
| Total noncurrent liabilities | 136,715,587.58 | - |
| Total liabilities | 189,974,741.32 | 11,045,610.00 |
| | | |
| **Net Position** | | |
| Net investment in capital assets | 325,021,496.33 | 596,227.00 |
| Restricted for: | | |
| Nonexpendable: | | |
| Scholarships and fellowships | 1,476,383.58 | 29,105,127.00 |
| Instructional department uses | - | 21,248,442.00 |
| Other | 2,343,663.88 | 14,071,232.00 |
| Expendable: | | |
| Scholarships and fellowships (Note 9) | 968,585.04 | 13,319,512.00 |
| Research | 2,285,051.83 | 5,092,756.00 |
| Instructional department uses (Note 9) | 1,923,706.72 | 13,143,850.00 |
| Loans (Note 9) | 2,996,822.73 | - |
| Capital projects | 193,974.11 | 13,976,293.00 |
| Other (Note 9) | 1,316,894.98 | 17,749,235.00 |
| Unrestricted | 97,464,383.54 | 8,764,286.00 |
| Total net position | $ 435,990,962.74 | $ 137,066,960.00 |

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

**Tennessee Board of Regents**
**THE UNIVERSITY OF MEMPHIS**
**Statement of Revenues, Expenses, and Changes in Net Position**
**For the Year Ended June 30, 2014**

| | University | Component Unit |
|---|---|---|
| **Revenues** | | |
| Operating revenues: | | |
| Student tuition and fees (net of scholarship allowances of $48,175,670.09) | $ 135,149,562.76 | $ - |
| Gifts and contributions | - | 26,793,326.00 |
| Governmental grants and contracts | 33,574,742.98 | - |
| Nongovernmental grants and contracts | 3,753,926.76 | - |
| Sales and services of educational activities | 4,502,937.54 | - |
| Sales and services of other activities | 28,790,572.85 | 1,142,532.00 |
| Auxiliary enterprises: | | |
| Residential life (net of scholarship allowances of $276,610.65; all residential life revenues are used as security for revenue bonds; see Note 8) | 14,567,705.57 | - |
| Bookstore | 731,455.89 | - |
| Food service | 1,033,966.00 | - |
| Other auxiliaries | 4,976,685.76 | - |
| Interest earned on loans to students | 145,750.32 | - |
| Total operating revenues | 227,227,306.43 | 27,935,858.00 |
| **Expenses** | | |
| Operating expenses (Note 17): | | |
| Salaries and wages | 190,874,467.82 | - |
| Benefits | 69,378,508.88 | - |
| Utilities, supplies, and other services | 98,097,645.96 | 129,596.00 |
| Scholarships and fellowships | 43,360,712.08 | - |
| Depreciation expense | 20,063,933.25 | - |
| Payments to or on behalf of The University of Memphis (Note 21) | - | 28,099,529.00 |
| Total operating expenses | 421,775,267.99 | 28,229,125.00 |
| Operating loss | (194,547,961.56) | (293,267.00) |
| **Nonoperating Revenues (Expenses)** | | |
| State appropriations | 97,460,669.33 | - |
| Gifts | 25,991,748.11 | - |
| Grants and contracts | 62,184,784.00 | - |
| Investment income (net of investment expense of $44,044.32 for the university and $48,588.00 for the component unit) | 2,752,246.85 | 15,124,558.00 |
| Interest on capital asset-related debt | (4,248,406.41) | - |
| Other nonoperating revenues (expenses) | (450,276.90) | - |
| Net nonoperating revenues (expenses) | 183,690,764.98 | 15,124,558.00 |
| Income (loss) before other revenues, expenses, gains, or losses | (10,857,196.58) | 14,831,291.00 |
| Capital appropriations | 11,136,590.33 | - |
| Capital grants and gifts | 5,256,609.22 | - |
| Bond issuance costs | (50,755.95) | |
| Additions to permanent endowments | 16,719.95 | 3,854,750.00 |
| Total other revenues | 16,359,163.55 | 3,854,750.00 |
| Increase in net position | 5,501,966.97 | 18,686,041.00 |
| Net position - beginning of year | 430,488,995.77 | 118,380,919.00 |
| Net position - end of year | $ 435,990,962.74 | $ 137,066,960.00 |

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

# Statement of Cash Flows
For the Year Ended June 30, 2014

| | |
|---|---|
| **Cash Flows From Operating Activities** | |
| Tuition and fees | $134,334,095.23 |
| Grants and contracts | 37,873,458.79 |
| Sales and services of educational activities | 4,149,015.60 |
| Sales and services of other activities | 29,896,663.53 |
| Payments to suppliers and vendors | (96,352,102.91) |
| Payments to employees | (189,808,444.79) |
| Payments for benefits | (67,718,884.28) |
| Payments for scholarships and fellowships | (43,360,712.08) |
| Loans issued to students | (1,217,664.77) |
| Collection of loans from students | 924,006.06 |
| Interest earned on loans to students | 384,916.09 |
| Auxiliary enterprise charges: | |
| Residence halls | 14,921,396.75 |
| Bookstore | 731,455.89 |
| Food services | 1,033,966.00 |
| Other auxiliaries | 5,053,378.42 |
| Net cash used by operating activities | (169,155,456.47) |
| **Cash Flows From Noncapital Financing Activities** | |
| State appropriations | 97,055,900.00 |
| Gifts and grants received for other than capital or endowment purposes | 88,231,877.18 |
| Private gifts for endowment purposes | 16,719.95 |
| Federal student loan receipts | 122,977,664.00 |
| Federal student loan disbursements | (122,977,664.00) |
| Changes in deposits held for others | 138,311.88 |
| Other noncapital financing receipts (payments) | (26,719.95) |
| Net cash provided by noncapital financing activities | 185,416,089.06 |
| **Cash Flows From Capital and Related Financing Activities** | |
| Proceeds from capital debt | 13,838,449.64 |
| Capital appropriations | 11,136,590.33 |
| Capital grants and gifts received | 3,500,000.00 |
| Proceeds from sale of capital assets | 8,415.42 |
| Purchases of capital assets and construction | (34,964,036.18) |
| Principal paid on capital debt and lease | (5,247,555.75) |
| Interest paid on capital debt and lease | (4,528,353.71) |
| Bond issue costs paid on new debt issue | (50,755.95) |
| Net cash used by capital and related financing activities | (16,307,246.20) |
| **Cash Flows From Investing Activities** | |
| Proceeds from sales and maturities of investments | 28,701,664.81 |
| Income on investments | 2,774,150.41 |
| Purchase of investments | (42,870,883.21) |
| Net cash used by investing activities | (11,395,067.99) |
| Net decrease in cash and cash equivalents | (11,441,681.60) |
| Cash and cash equivalents - beginning of year | 113,420,589.06 |
| Cash and cash equivalents - end of year | $101,978,907.46 |

**Tennessee Board of Regents**
**THE UNIVERSITY OF MEMPHIS**
**Statement of Cash Flows (continued)**
**For the Year Ended June 30, 2014**

| | |
|---|---|
| **Reconciliation of operating loss to net cash used by operating activities:** | |
| Operating loss | $ (194,547,961.56) |
| Adjustments to reconcile operating loss to net cash used by operating activities: | |
| Depreciation expense | 20,063,933.25 |
| Other adjustments (Note 19) | 199,669.50 |
| Change in assets and liabilities: | |
| Receivables, net | 2,848,465.41 |
| Inventories | 10,962.88 |
| Prepaid items | (572,085.54) |
| Accounts payable | 2,454,856.40 |
| Accrued liabilities | 332,185.93 |
| Unearned revenues | (645,643.95) |
| Deposits | 135,897.05 |
| Compensated absences | 177,750.58 |
| Other | 386,513.58 |
| Net cash used by operating activities | $ (169,155,456.47) |

| | |
|---|---|
| **Noncash investing, capital, or financing transactions** | |
| Gifts in-kind - capital | $ 1,756,609.22 |
| Loss on disposal of capital assets | $ (306,923.02) |

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

## Note 1. Summary of Significant Accounting Policies

### Reporting Entity

The university is a part of the State University and Community College System of Tennessee (Tennessee Board of Regents). This system is a component unit of the State of Tennessee because the state appoints a majority of the system's governing body and provides significant financial support; the system is discretely presented in the *Tennessee Comprehensive Annual Financial Report*.

The financial statements present only that portion of the Tennessee Board of Regents' activities that is attributable to the transactions of The University of Memphis.

The University of Memphis Foundation is considered a component unit 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 its 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. See Note 21 for more detailed information about the component unit and how to obtain the report.

### Basis of Presentation

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

### Basis of Accounting

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

The university has classified its revenues and expenses as either operating or nonoperating according to the following criteria: Operating revenues and expenses are those that have the characteristics of exchange transactions. Operating revenues include (1) tuition and fees, net of scholarship discounts and allowances; (2) certain federal, state, local, and private grants and contracts; (3) sales and services of auxiliary enterprises; and (4) interest on institutional loans. Operating expenses include (1) salaries and wages; (2) employee benefits; (3) utilities, supplies, and other services; (4) scholarships and fellowships; and (5) depreciation.

Nonoperating revenues and expenses include activities that have the characteristics of nonexchange transactions, such as gifts and contributions, and other activities that are defined as nonoperating by GASB Statement 9, *Reporting Cash Flows of Proprietary and Nonexpendable Trust Funds and Governmental Entities that Use Proprietary Fund Accounting*, and GASB Statement 34, such as state appropriations and investment income.

When both restricted and unrestricted resources are available for use, it is the university's policy to determine which to use first, depending upon existing facts and circumstances.

**Inventories**

Inventories are valued on an average cost basis or lower of cost or market.

**Compensated Absences**

The university's employees accrue annual and sick leave at varying rates, depending on length of service or classification. Some employees also earn compensatory time.

The amount of the liabilities for annual leave and compensatory time and their related benefits are reported in the statement of net position. There is no liability for unpaid accumulated sick leave since the university's policy is to pay this only if the employee dies or is absent because of illness, injury, or related family death.

**Capital Assets**

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

A capitalization threshold of $100,000 is used for buildings, and $50,000 is used for infrastructure. Equipment is capitalized when the unit acquisition cost is $5,000 or greater. The capitalization threshold for additions and improvements to buildings and land is set at $50,000. The capitalization threshold for intangible assets is set at $100,000. The capitalization threshold for art, historical treasures/collections, and similar assets is set at $5,000.

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

### Net Position

The university's net position is classified as follows:

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

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

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

Unrestricted net position – Unrestricted net position represents resources derived from student tuition and fees; state appropriations; sales and services of educational departments and other activities; and auxiliary enterprises. These resources are used for transactions relating to the educational and general operations of the university and may be used at the university's discretion to meet current expenses for any purpose. The auxiliary enterprises are substantially self-supporting activities that provide services for students, faculty, and staff.

### Scholarship Discounts and Allowances

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

## Note 2. Cash

This classification includes demand deposits and petty cash on hand. At June 30, 2014, cash consisted of $8,539,673.21 in bank accounts, $38,320.00 of petty cash on hand, $88,394,772.63 in the Local Government Investment Pool (LGIP) administered by the State Treasurer, and $5,006,141.62 in LGIP deposits for capital projects.

The LGIP is part of the State Pooled Investment Fund. The fund's required risk disclosures are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at www.treasury.tn.gov.

LGIP deposits for capital projects – Payments related to the university's capital projects are made by the State of Tennessee's Department of Finance and Administration. The university's estimated local share of the cost of each project is held in a separate LGIP account. As expenses are incurred, the Tennessee Board of Regents withdraws funds from the LGIP account and transfers them to the Department of Finance and Administration. The funds in the account are not available to the university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

## Note 3. Investments

All investments permitted to be reported at fair value under GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, as amended, are reported at fair value, including those with a maturity date of one year or less at the time of purchase.

At June 30, 2014, the university had the following investments and maturities:

| | | Investment Maturities (in Years) | |
|---|---|---|---|
| Investment Type | Fair Value | Less than 1 | 1 to 5 |
| U.S. Treasury notes | $51,648,736.50 | $7,518,179.50 | $44,130,557.00 |
| Commercial paper | 1,999,850.00 | 1,999,850.00 | - |
| Certificates of deposit | 200,000.00 | 200,000.00 | - |
| Total investments | $53,848,586.50 | $9,718,029.50 | $44,130,557.00 |

### 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 is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; bankers' acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified. Securities are rated by Standard and Poor's, Moody's Investors Service, and/or Fitch Ratings and are presented below using the Standard and Poor's rating scale.

Tennessee Board of Regents policy restricts investments in bankers' acceptances and commercial paper. The policy requires that prime bankers' acceptances must be issued by domestic banks with a minimum AA rating or foreign banks with a AAA long-term debt rating by a majority of the ratings services that have rated the issuer. Prime bankers' acceptances are required to be eligible for purchase by the Federal Reserve System. To be eligible, the original maturity must not be more than 270 days, and it must 1) arise out of the current shipment of goods between countries or with the United States, or 2) arise out of storage within the United States of goods that are under contract of sale or are expected to move into the channel of trade within a reasonable time and that are secured throughout their life by a warehouse receipt or similar document conveying title to the underlying goods.

The policy requires that prime commercial paper shall be limited to that of corporations that meet the following criteria: 1) Senior long-term debt, if any, should have a minimum rating of A1 or equivalent, and short-term debt should have a minimum rating of A1 or equivalent, as provided by a majority of the rating services that rate the issuer. If there is no long-term debt rating, the short-term debt rating must be A1 by all rating services (minimum of two). 2) The rating should be based on the merits of the issuer or guarantee by a nonbank. 3) A financial review should be made to ascertain the issuer's financial strength to cover the debt. 4) Commercial paper of a banking institution should not be purchased. Prime commercial paper shall not have a maturity that exceeds 270 days.

At June 30, 2014, the university's investments were rated as follows:

| | | Credit Quality Rating | |
|---|---|---|---|
| Investment Type | Fair Value | A+ | Unrated |
| LGIP | $93,400,914.25 | $ - | $93,400,914.25 |
| Commercial paper | 1,999,850.00 | 1,999,850.00 | - |
| Total | $95,400,764.25 | $1,999,850.00 | $93,400,914.25 |

## Note 4. Receivables

Receivables at June 30, 2014, included the following:

| | |
|---|---|
| Student accounts receivable | $ 8,701,150.57 |
| Grants receivable | 7,830,640.70 |
| Notes receivable | 781,793.49 |
| Intercollegiate athletics receivables | 1,261,896.77 |
| Rents receivable | 1,490,952.23 |
| Other receivables | 2,377,819.52 |
| Subtotal | 22,444,253.28 |
| Less allowance for doubtful accounts | (7,607,686.34) |
| Total receivables | $14,836,566.94 |

Federal Perkins Loan Program funds at June 30, 2014, included the following:

| | |
|---|---|
| Perkins loans receivable | $4,721,194.76 |
| Less allowance for doubtful accounts | (528,524.01) |
| Total | $4,192,670.75 |

## Note 5. Capital Assets

Capital asset activity for the year ended June 30, 2014, was as follows:

| | Beginning Balance | Additions | Transfers | Reductions | Ending Balance |
|---|---|---|---|---|---|
| Land | $18,574,815.93 | $ 319,900.00 | $ - | $ - | $ 18,894,715.93 |
| Land improvements and infrastructure | 77,596,592.47 | 206,949.51 | 6,970,160.52 | - | 84,773,702.50 |
| Buildings | 437,320,510.40 | 736,813.05 | 11,778,244.01 | - | 449,835,567.46 |
| Equipment | 39,633,631.12 | 2,648,880.99 | | 2,364,217.26 | 39,918,294.85 |
| Library holdings | 14,258,012.50 | 1,020,848.64 | - | 1,355,581.81 | 13,923,279.33 |
| Intangible assets: | | | | | |
| Easement | 1,200,000.00 | - | - | - | 1,200,000.00 |
| Software | 7,975,115.72 | - | - | - | 7,975,115.72 |
| Art and historical collections | - | 645,027.00 | - | - | 645,027.00 |
| Projects in progress | 22,454,443.52 | 35,859,865.15 | (18,748,404.53) | - | 39,565,904.14 |
| Total | 619,013,121.66 | 41,438,284.34 | - | 3,719,799.07 | 656,731,606.93 |

| | | | | | |
|---|---|---|---|---|---|
| Less accumulated depreciation/amortization: | | | | | |
| Land improvements | | | | | |
| and infrastructure | 26,309,975.71 | 4,290,033.21 | - | - | 30,600,008.92 |
| Buildings | 138,173,653.34 | 10,272,904.55 | - | - | 148,446,557.89 |
| Equipment | 24,240,747.44 | 3,075,135.93 | - | 1,497,765.12 | 25,818,118.25 |
| Library holdings | 7,593,737.08 | 1,622,117.45 | - | 1,355,581.81 | 7,860,272.72 |
| Intangible assets: | | | | | |
| Software | 4,796,817.35 | 803,742.11 | - | - | 5,600,559.46 |
| Total | 201,114,930.92 | 20,063,933.25 | - | 2,853,346.93 | 218,325,517.24 |
| Capital assets, net | $417,898,190.74 | $21,374,351.09 | $ - | $ 866,452.14 | $438,406,089.69 |

## Note 6. Accounts Payable

Accounts payable at June 30, 2014, included the following:

| | |
|---|---|
| Vendors payable | $ 6,703,719.72 |
| Construction projects payments | 4,164,772.37 |
| Other payables | 1,223,471.93 |
| Total accounts payables | $12,091,964.02 |

## Note 7. Capital Leases

The university has capital lease agreements for the campus-wide data network equipment and services. This agreement has beginning and ending dates ranging from January 1, 2011, to December 31, 2015, with an imputed interest rate of 5.517%. This lease agreement includes a purchase option at the end of the initial or any renewal term to purchase all or part of the equipment for one dollar ($1.00) together with any accrued but unpaid late charges. If a written notice to purchase or surrender the equipment is not submitted at least 90 days before the end of the initial term, the lease will automatically renew for an additional three-month term and thereafter renew for successive one-month terms until the equipment is delivered or purchased. During such renewals the amount of each rental payment remains the same.

Asset balances at June 30, 2014, were $1,228,676.48, net of accumulated depreciation of $2,866,911.81. The following is a schedule by years of future minimum lease payments under capital leases, together with the present value of the net minimum lease payment at June 30, 2014:

| Year Ending June 30 | |
|---|---|
| 2015 | $ 878,591.28 |
| 2016 | 439,295.64 |
| Total minimum lease payments | 1,317,886.92 |

| | |
|---|---|
| Less amount representing interest and exacter costs | (55,837.94) |
| Present value of net minimum lease payments | $1,262,048.98 |

## Note 8. Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2014, was as follows:

| | Beginning Balance | Additions | Reductions | Ending Balance | Current Portion |
|---|---|---|---|---|---|
| Payables: | | | | | |
| TSSBA debt: | | | | | |
| Bonds | $ 92,254,454.99 | $ 2,438,252.29 | $ 4,006,044.80 | $ 90,686,662.48 | $4,149,794.17 |
| Unamortized bond premium/discount | 4,165,272.98 | 300,170.43 | 283,129.01 | 4,182,314.40 | - |
| Commercial paper | 2,684,093.68 | - | 2,684,093.68 | - | - |
| Revolving credit facility | - | 16,212,601.32 | 2,709,903.63 | 13,502,697.69 | - |
| General obligation debt: | | | | | |
| Commercial paper | 4,084,674.95 | 309,942.00 | 440,064.00 | 3,954,552.95 | - |
| Capital lease obligations | 2,047,347.88 | - | 785,298.90 | 1,262,048.98 | 829,736.39 |
| Subtotal | 105,235,844.48 | 19,260,966.04 | 10,908,534.02 | 113,588,276.50 | 4,979,530.56 |
| Other liabilities: | | | | | |
| Compensated absences | 9,616,996.90 | 5,858,704.10 | 5,680,953.52 | 9,794,747.48 | 2,626,166.63 |
| Due to grantors | 4,419,582.60 | 70,147.25 | 8,990.74 | 4,480,739.11 | - |
| Subtotal | 14,036,579.50 | 5,928,851.35 | 5,689,944.26 | 14,275,486.59 | 2,626,166.63 |
| Total long-term liabilities | $119,272,423.98 | $25,189,817.39 | $16,598,478.28 | $127,863,763.09 | $7,605,697.19 |

### TSSBA Debt – Bonds

Bonds, with interest rates ranging from 0.18% to 5.63%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2040 and are secured by pledges of the facilities' revenues to which they relate and by certain other revenues and fees of the university, including state appropriations; see Note 10 for further details. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net position is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $4,750,591.97 at June 30, 2014. Unexpended debt proceeds were $23,947.98 at June 30, 2014.

Debt service requirements to maturity for the university's portion of TSSBA bonds at June 30, 2014, are as follows:

| Year Ending June 30 | Principal | Interest | Total |
|---|---|---|---|
| 2015 | $ 4,149,794.17 | $ 4,319,209.61 | $ 8,469,003.78 |
| 2016 | 4,329,506.82 | 4,140,857.65 | 8,470,364.47 |
| 2017 | 4,527,911.37 | 3,943,344.41 | 8,471,255.78 |
| 2018 | 4,724,737.52 | 3,757,715.17 | 8,482,452.69 |
| 2019 | 4,933,452.40 | 3,554,081.17 | 8,487,533.57 |
| 2020 – 2024 | 26,327,197.82 | 14,171,880.54 | 40,499,078.36 |
| 2025 – 2029 | 28,139,066.19 | 7,996,209.53 | 36,135,275.72 |
| 2030 – 2034 | 6,800,889.62 | 2,834,915.57 | 9,635,805.19 |
| 2035 – 2039 | 5,312,106.57 | 1,121,986.70 | 6,434,093.27 |
| 2040 | 1,442,000.00 | 57,680.00 | 1,499,680.00 |
| Total | $90,686,662.48 | $45,897,880.35 | $136,584,542.83 |

**TSSBA Debt – Revolving Credit Facility**

The Tennessee State School Bond Authority (TSSBA) receives loans from the revolving credit facility to finance the costs of various capital projects during the construction phase. When projects are placed in service, TSSBA issues long-term, fixed-rate debt to finance the project over its useful payback period and repays the revolving credit facility debt. The amount issued for projects at the university was $13,502,697.69 at June 30, 2014.

Prior to March 20, 2014, the TSSBA issued short-term debt in the form of commercial paper. Since March 20, 2014, the TSSBA has used the revolving credit facility.

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

**General Obligation Debt – Commercial Paper**

The Tennessee State Funding Board issues commercial paper for the purpose of, among other things, acquisition of certain sites and existing structures for Tennessee Board of Regents expansion purposes on behalf of the university. The amount outstanding for projects at the university was $3,954,552.95 at June 30, 2014. More detailed information regarding the commercial paper can be found in the notes to the financial statements in the *Tennessee Comprehensive Annual Financial Report*, which is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

## Note 9. Endowments

If a donor has not provided specific instructions to the university, state law permits the university to authorize for expenditure 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 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, all interest earnings have 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. Five of the endowment accounts require any interest generated in excess of expenses be reapplied to the principal. At June 30, 2014, net appreciation of $172,324.94 is available to be spent, of which $94,134.16 is included in restricted net position expendable for scholarships and fellowships, $867.49 is included in restricted net position expendable for instructional departmental uses, $64,862.76 is included in restricted net position expendable for loans, and $12,460.53 is included in restricted net position expendable for other.

## Note 10. Pledged Revenues

The university has pledged certain revenues and fees, including state appropriations, to repay $90,686,662.48 in revenue bonds issued from November 1985 to November 2013 (see Note 8 for further detail). Proceeds from the bonds provided financing for construction and renovation of various facilities, as well as building systems and equipment. The bonds are payable through 2040. Annual principal and interest payments on the bonds are expected to require 1.78% of available revenues. The total principal and interest remaining to be paid on the bonds is $136,584,542.83. Principal and interest paid for the current year and total available revenues were $8,412,221.49 and $362,220,719.23, respectively.

## Note 11. Pension Plans

### Defined Benefit Plans

### Tennessee Consolidated Retirement System

Plan Description – The State of Tennessee provides a pension plan that covers state and higher education employees. That plan is a part of the Public Employee Retirement Plan, an agent 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 the Public Employee Retirement Plan. That report is available on the state's website at www.treasury.tn.gov/tcrs.

Funding Policy – Plan members are noncontributory. The university is required to contribute at an actuarially determined rate. The current rate is 15.03% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees.

Annual Pension Cost – For the year ended June 30, 2014, the university's contributions equaled the annual pension cost of $8,255,630.19.

Trend Information

| Year Ended | Annual Pension Cost (APC) | Percentage of APC Contributed | Net Pension Obligation |
|---|---|---|---|
| June 30, 2014 | $8,255,630.19 | 100% | $0 |
| June 30, 2013 | $8,364,880.14 | 100% | $0 |
| June 30, 2012 | $8,338,695.98 | 100% | $0 |

Additional Information – Information about the funded status of the plan as of the most recent valuation date, information about the actuarial methods and assumptions used in the valuations, and required supplementary information is available in the *Tennessee Comprehensive Annual Financial Report*. A copy of that report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

## Defined Contribution Plans

### Optional Retirement Plans

Plan Description – The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund, ING Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company. 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 the 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, Section 8-35-4, *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 up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contributions made by the university to the plans were $10,408,480.40 for the year ended June 30, 2014, and $9,999,571.70 for the year ended June 30, 2013. Contributions met the requirements for each year.

## Note 12. Other Postemployment 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 available to higher education employees—the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Section 8-27-101, *Tennessee Code Annotated,* for the State Employee Group Plan and Section 8-27-701, *Tennessee Code Annotated,* for the Medicare Supplement Plan. Prior to reaching age 65, all members have the option of choosing between the standard or partnership preferred provider organization plan for healthcare benefits. Subsequent to age 65, members who are also in the state's retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. The state makes on-behalf payments to the Medicare Supplement Plan for the university's eligible retirees; see Note 19. The plans are reported in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

### Special Funding Situation

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

### Funding Policy

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

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

| | |
|---|---|
| Annual required contribution (ARC) | $ 3,052,000.00 |
| Interest on the net OPEB obligation | 632,329.46 |
| Adjustment to the ARC | (616,041.33) |
| Annual OPEB cost | 3,068,288.13 |
| Amount of contribution | (2,681,774.55) |
| Increase in net OPEB obligation | 386,513.58 |
| Net OPEB obligation – beginning of year | 15,808,236.38 |
| Net OPEB obligation – end of year | $16,194,749.96 |

| Year-end | Plan | Annual OPEB Cost | Percentage of Annual OPEB Cost Contributed | Net OPEB Obligation at Year-end |
|---|---|---|---|---|
| June 30, 2014 | State Employee Group Plan | $3,068,288.13 | 87.40% | $16,194,749.96 |
| June 30, 2013 | State Employee Group Plan | $3,791,824.96 | 71.05% | $15,808,236.38 |
| June 30, 2012 | State Employee Group Plan | $3,757,128.53 | 75.07% | $14,710,395.49 |

**Funded Status and Funding Progress**

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

State Employee Group Plan

| | |
|---|---|
| Actuarial valuation date | July 1, 2013 |
| Actuarial accrued liability (AAL) | $23,897,000.00 |
| Actuarial value of plan assets | - |
| Unfunded actuarial accrued liability (UAAL) | $23,897,000.00 |
| Actuarial value of assets as a percentage of the AAL | 0.0% |
| Covered payroll (active plan members) | $125,308,378.95 |
| UAAL as percentage of covered payroll | 19.07% |

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

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

**Actuarial Methods and Assumptions**

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

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

## Note 13. Insurance-related Activities

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

The university participates in the 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 year ended June 30, 2014, is presented in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml. Since the university participates in the Risk Management Fund, it is subject to the liability limitations 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, 2014, the Risk Management Fund held $116.3 million in cash designated for payment of claims.

At June 30, 2014, the scheduled coverage for the university was $1,380,107,400.00 for buildings and $368,243,700.00 for contents.

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 14. Commitments and Contingencies

### Sick Leave

The university records the cost of sick leave when paid. The dollar amount of unused sick leave was $79,235,643.75 at June 30, 2014.

### Operating Leases

The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $2,206,511.02 and expenses for personal property were $811,321.85 for the year ended June 30, 2014. All operating leases are cancelable at the lessee's option.

### Construction in Progress

At June 30, 2014, outstanding commitments under construction contracts totaled $79,641,623.10 for land acquisition program; Community Health Facility, Biochemistry, and Biology Facility; new student housing; housing sprinkler upgrades; various roof replacements; access and security updates; underground utility updates; women's softball; and Lambuth Campus improvements, of which $28,962,164.47 will be funded by future state capital outlay appropriations.

**Litigation**

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

## Note 15. Chairs of Excellence

The university had $75,370,455.22 on deposit at June 30, 2014, with the State Treasurer for its Chairs of Excellence program. These funds are held in trust by the state and are not included in the financial statements.

## Note 16. Funds Held in Trust by Others

The university is a beneficiary under the Herbert Herff, Van Vleet, Mike Driver, Pope M. Farrington, and C.M. Gooch trust funds. The underlying assets are not considered assets of the university and are not included in the university's financial statements. The university received $1,194,832.37 from these funds during the year ended June 30, 2014.

## Note 17. Natural Classification With Functional Classifications

The university's operating expenses for the year ended June 30, 2014, are as follows:

| | Natural Classification | | | | | |
|---|---|---|---|---|---|---|
| Functional Classification | Salaries | Benefits | Other Operating | Scholarships | Depreciation | Total |
| Instruction | $ 90,226,444.42 | $ 33,120,615.74 | $18,847,799.22 | $ - | $ - | $ 142,194,859.38 |
| Research | 23,599,470.43 | 8,616,561.48 | 11,852,282.41 | - | - | 44,068,314.32 |
| Public service | 5,416,660.51 | 1,496,100.55 | 3,578,913.39 | - | - | 10,491,674.45 |
| Academic support | 16,897,424.28 | 5,792,781.24 | 4,819,098.30 | - | - | 27,509,303.82 |
| Student services | 23,410,847.81 | 8,070,484.20 | 25,716,346.08 | - | - | 57,197,678.09 |
| Institutional support | 17,358,303.74 | 6,369,275.76 | 6,959,249.86 | - | - | 30,686,829.36 |
| Maintenance & operation | 11,165,263.84 | 5,155,803.72 | 14,062,219.98 | - | - | 30,383,287.54 |
| Scholarships & fellowships | - | - | - | 43,360,712.08 | - | 43,360,712.08 |
| Auxiliary | 2,800,052.79 | 756,886.19 | 12,261,736.72 | - | - | 15,818,675.70 |
| Depreciation | - | - | - | - | 20,063,933.25 | 20,063,933.25 |
| Total | $ 190,874,467.82 | $ 69,378,508.88 | $98,097,645.96 | $ 43,360,712.08 | $ 20,063,933.25 | $ 421,775,267.99 |

Expenses initially incurred by the academic support function as a result of providing internal services to the other functional classifications were allocated to the other functional areas by reducing the academic support function's operating expenses by the total amount of salaries, benefits, and operating expenses incurred in the provision of these services, and allocating this amount to the other functional areas' operating expenses on the basis of usage. As a result of this process, expenses totaling $10,065,759.22 were reallocated from academic support to the other functional areas.

## Note 18. Affiliated Entity Not Included

The University of Memphis Research Foundation is a private, nonprofit foundation with the university as the sole beneficiary. The University of Memphis Research Foundation is controlled by a board independent of the university. The financial records, investments, and other financial transactions are handled external to the university, and these amounts are not included in the university's financial report. As reported in the Research Foundation's most recently audited financial report, at June 30, 2013, the assets of the foundation totaled $3,941,116.00, liabilities were $913,547.00, and the net position amounted to $3,027,569.00.

## Note 19. On-behalf Payments

During the year ended June 30, 2014, the State of Tennessee made payments of $199,669.50 on behalf of the university for retirees participating in the Medicare Supplement Plan. The Medicare Supplement Plan is a postemployment benefit healthcare plan and is discussed further in Note 12. The plan is reported in the *Comprehensive Annual Financial Report*. That report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

## Note 20. Voluntary Buyout Program

The university implemented a Voluntary Buyout Plan beginning in fiscal year 2011 as a strategy to assist the university in addressing budgetary constraints due to several years of state appropriation reductions and potential budget reductions in the forthcoming fiscal years. The university had 26 employees participate in the Voluntary Buyout Program with 15 terminating by June 30, 2011; 7 terminating by June 30, 2012; and 4 terminating by June 30, 2013.

Participants will receive 150% of their institutional base salary calculated on the date of separation, to be paid over a three-year time period in three equal annual installments. As of June 30, 2014, expenses for salary payout of Voluntary Buyout Plan were $2,557,541.96. Accrued expenses for severance pay were $674,028.39 at June 30, 2014.

The university implemented a Reduction In Force (RIF) plan in fiscal year 2014 where positions were eliminated or changed to require different skills. Severance benefits for employees who lost their positions due to the RIF included a payment of $3,200.00 and tuition assistance at any State of Tennessee public higher education institution for two years. At June 30, 2014, severance payments were paid to 62 employees in the amount of $198,400.00. Accrued expenses for educational assistance were $125,280.00 at June 30, 2014.

## Note 21. Component Unit

The University of Memphis Foundation is a legally separate, tax-exempt organization supporting The University of Memphis. The foundation accepts and manages private support to The University of Memphis to supplement the resources that are available to the university in support of its programs. The approximately 40-member 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.

The foundation is a nonprofit organization that reports under Financial Accounting Standards Board (FASB) standards. As such, certain revenue recognition criteria and presentation features are different from GASB revenue recognition criteria and presentation features. With the exception of necessary presentation adjustments, no modifications have been made to the foundation's financial information in the university's financial statements for these differences.

During the year ended June 30, 2014, the foundation made distributions of $28,099,529.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from the Managing Director, University of Memphis Foundation, 635 Normal Street, Memphis, Tennessee, 38152-3750, or online at http://www.memphis.edu/foundation/statements.php.

### Fair-value Measurements

The foundation reports certain assets and liabilities at fair value. Fair value has been determined using quoted prices in active markets for identical assets and liabilities that are accessible at the measurement date (Level 1), inputs other than quoted market prices included in Level 1 that are directly or indirectly observable for the asset or liability (Level 2), or significant unobservable inputs (Level 3). The following table categorizes the recurring fair-value measurements for assets at June 30, 2014.

| | Total Fair Value at June 30, 2014 | Quoted Prices Level 1 | Significant Other Inputs Level 2 | Significant Unobservable Inputs Level 3 |
|---|---|---|---|---|
| Assets: | | | | |
| Money market funds | $ 2,020,025.00 | $ 2,020,025.00 | $ - | $ - |
| Limited partnerships and LLCs | 91,016,384.00 | 2,783,799.00 | 2,012,540.00 | 86,220,045.00 |
| Mutual funds | 37,373,886.00 | 37,373,886.00 | - | - |
| U.S. government securities | 196,616.00 | - | 196,616.00 | - |
| Corporate bonds | 3,539,399.00 | - | 3,539,399.00 | - |
| Total assets | $134,146,310.00 | $42,177,710.00 | $ 5,748,555.00 | $86,220,045.00 |

The following table reconciles beginning and ending balances of all assets valued using Level 3 inputs.

| | Beginning Balance | Total Gains/(Losses), Realized and Unrealized | Purchases | Sales or Distributions | Ending Balance |
|---|---|---|---|---|---|
| Assets: | | | | | |
| Limited partnerships and LLCs | $34,394,180.00 | $11,161,350.00 | $67,155,037.00 | $26,490,522.00 | $86,220,045.00 |

All gains and losses, both realized and unrealized, have been reported on the statement of revenues, expenses, and changes in net position as investment income. Of this total, $5,435,730 is attributable to the change in unrealized gains or losses relating to those assets still held at June 30, 2014.

The following is a description of categories of limited partnership and limited liability company (LLC) investments used for Level 3 assets measured at fair value:

*Hedged Equity:* This category consists of funds of funds that make long and short position equity investments. The bulk of the investment is subject to semi-annual or annual redemption.

*Hedged Absolute Return:* This category consists of a multi-manager, absolute return hedge fund of funds. The fund seeks to maintain low correlations and betas to the Barclays Aggregate Bond and S&P 500 indices. The fund caps its manager investments at 35. The fund is subject to annual redemption.

*Private Equity:* This category consists of partnerships that invest primarily in U.S.-based private companies. These investments cannot be voluntarily redeemed and are subject to sale based on market demand.

*Real Assets:* This category consists of investment partnerships and funds that invest primarily in U.S. and foreign commercial real estate and natural resources. Some investments in this category allow quarterly redemption, but distributions during periods of illiquidity are restricted by gate restraints.

*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.

**Cash**

The foundation recognizes all demand deposit accounts as cash. All money market funds are considered to be investments and no amounts are classified as cash or cash equivalents. Cash is insured by the FDIC to $250,000. The remaining cash balance is uninsured and uncollateralized.

**Investments**

Investments are recorded on the date of acquisition 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, 2014, were as follows:

| | Cost | Fair Value |
|---|---|---|
| Money market funds | $ 2,020,025.00 | $ 2,020,025.00 |
| Limited partnerships and LLCs | 77,902,472.00 | 91,016,384.00 |
| Mutual funds | 36,864,335.00 | 37,373,886.00 |
| U.S. government securities | 199,779.00 | 196,616.00 |

| | | |
|---|---|---|
| Corporate bonds | 3,536,389.00 | 3,539,399.00 |
| Total investments | $120,523,000.00 | $134,146,310.00 |

Alternative Investments – The foundation has investments in limited partnerships and LLCs that are classified for fair value measurement purposes as Level 3. The estimated fair value of these assets is $86,220,045.00 at June 30, 2014.

The foundation believes the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2014. 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 accountants.

**Pledges Receivable**

Pledges receivable at June 30, 2014, are summarized below, net of the allowance for doubtful accounts:

| | |
|---|---|
| Current pledges | $ 4,747,359.00 |
| Pledges due in one to five years | 8,585,329.00 |
| Pledges due after five years | 317,500.00 |
| Subtotal | 13,650,188.00 |
| Less allowance for uncollectible pledges receivable | (900,998.00) |
| Less discount to net present value | (209,358.00) |
| Total pledges receivable, net | $12,539,832.00 |

**Capital Assets**

The University of Memphis Foundation had art and historical collections valued at $596,227.00 at June 30, 2014.

**Endowments**

The University of Memphis Foundation's endowment accounts consist of approximately 470 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, are classified and reported based on the existence or absence of donor-imposed restrictions.

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) 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, 2014**

| | Permanently Restricted | Temporarily Restricted | Unrestricted | Total |
|---|---|---|---|---|
| Donor-restricted endowment funds | $64,424,801.00 | $22,261,708.00 | $ (245,938.00) | $86,440,571.00 |
| Board-designated endowment funds | - | - | 5,553,834.00 | 5,553,834.00 |
| Total funds | $64,424,801.00 | $22,261,708.00 | $5,307,896.00 | $91,994,405.00 |

**Changes in Endowment Net Position for the Fiscal Year Ended June 30, 2014**

| | Permanently Restricted | Temporarily Restricted | Unrestricted | Total |
|---|---|---|---|---|
| Endowment net position, beginning of year | $60,476,299.00 | $14,629,690.00 | $3,954,441.00 | $79,060,430.00 |
| Investment return: | | | | |
| Investment income (loss) | - | (1,238,984.00) | (88,496.00) | (1,327,480.00) |
| Net appreciation (realized and unrealized) | - | 12,585,115.00 | 824,339.00 | 13,409,454.00 |
| Total investment return | - | 11,346,131.00 | 735,843.00 | 12,081,974.00 |
| Contributions | 3,854,750.00 | 276,486.00 | - | 4,131,236.00 |

| | | | | |
|---|---|---|---|---|
| Appropriation of endowment assets for expenditure | - | (3,004,656.00) | (181,741.00) | (3,186,397.00) |
| Other changes: | | | | |
| Investment deficiencies reclassed to unrestricted net position | - | (799,353.00) | 799,353.00 | - |
| Modifications of restrictions | 93,752.00 | (186,590.00) | - | (92,838.00) |
| Endowment net position, end of year | $64,424,801.00 | $22,261,708.00 | $5,307,896.00 | $91,994,405.00 |

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, 2014, deficiencies of this nature totaled $245,938.00.

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, 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. The foundation's total return objective for its endowment funds is a total return over a market cycle of at least 6% over the inflation rate. A market cycle shall generally be considered to be a three- to five-year period. Actual returns may vary from the total return objective.

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 – The foundation has a policy of appropriating for distribution each year a percentage of its endowment funds' average fair value over the prior twelve quarters through the fiscal year-end one year preceding the fiscal year in which the expenditure is planned. For fiscal year 2014, this percentage was 3.75%. 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 for endowment growth. 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.

**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 27% of the foundation's pledge receivable balance at June 30, 2014, was due from two donors.

**Contingency**

The foundation has been named as a defendant in an ongoing civil lawsuit involving injuries to an individual. Although the ultimate outcome of the litigation is uncertain at this time, in the opinion of management after consultation with counsel, the ultimate outcome of this lawsuit will not have a material adverse effect upon the financial position of the foundation.

# Tennessee Board of Regents
# The University of Memphis
## Required Supplementary Information
## OPEB Schedule of Funding Progress

| Actuarial Valuation Date | Plan | Actuarial Value of Assets (a) | Actuarial Accrued Liability (AAL) (b) | Unfunded AAL (UAAL) (b-a) | Funded Ratio (a/b) | Covered Payroll (c) | UAAL as a Percentage of Covered Payroll [(b-a)/c)] |
|---|---|---|---|---|---|---|---|
| July 1, 2013 | State Employee Group Plan | $ - | $23,897,000 | $23,897,000 | 0% | $125,308,379 | 19.07% |
| July 1, 2011 | State Employee Group Plan | $ - | $30,832,000 | $30,832,000 | 0% | $118,128,155 | 26.10% |
| July 1, 2010 | State Employee Group Plan | $ - | $42,006,000 | $42,006,000 | 0% | $116,448,047 | 36.07% |

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

**Tennessee Board of Regents**
**THE UNIVERSITY OF MEMPHIS**
**Supplementary Schedule of Cash Flows - Component Unit**
**For the Year Ended June 30, 2014**

| | |
|---|---|
| **Cash Flows From Operating Activities** | |
| Gifts and contributions | $ 28,174,260.00 |
| Sales and services of other activities | 1,142,532.00 |
| Payments to suppliers and vendors | (8,738,227.00) |
| Payments to The University of Memphis | (20,154,424.00) |
| Net cash provided by operating activities | 424,141.00 |
| **Cash Flows From Noncapital Financing Activities** | |
| Private gifts for endowment purposes | 3,854,750.00 |
| Other non-capital financial receipts (payments) | (157,326.00) |
| Net cash provided by noncapital financing activities | 3,697,424.00 |
| **Cash Flows From Investing Activities** | |
| Proceeds from sales and maturities of investments | 200,524,167.00 |
| Income on investments | 597,312.00 |
| Purchases of investments | (205,509,968.00) |
| Net cash used by investing activities | (4,388,489.00) |
| Net decrease in cash and cash equivalents | (266,924.00) |
| Cash and cash equivalents - beginning of year | 684,874.00 |
| Cash and cash equivalents - end of year | $ 417,950.00 |
| **Reconciliation of operating loss to net cash provided by operating activities:** | |
| Operating loss | $ (293,267.00) |
| Adjustments to reconcile operating loss to net cash used by operating activities: | |
| Changes in assets and liabilities: | |
| Receivables | $ 1,380,934.00 |
| Due to The University of Memphis | 267,644.00 |
| Accounts payable | (920,030.00) |
| Accrued liabilities | (11,140.00) |
| Net cash provided by operating activities | $ 424,141.00 |
| **Noncash investing, capital, or financing transactions** | |
| Unrealized gains (losses) on investments | $ (1,873,069.00) |

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
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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
The Honorable John G. Morgan, Chancellor
Dr. M. David Rudd, President

We have audited the financial statements of The University of Memphis, an institution of the Tennessee Board of Regents, 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, 2014, 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, 2014. 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's financial statements. This report does not include the results of the other auditors' testing of internal control over financial reporting or compliance and other matters that are reported on separately by those auditors.

## Internal Control Over Financial Reporting

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

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

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

- Purchasing procedures at The University of Memphis are inadequate.
- The University of Memphis did not provide adequate internal controls in one specific area.

These deficiencies are described in the Findings and Recommendations section of this report.

## Compliance and Other Matters

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

## The University of Memphis's Responses to Findings

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

## Purpose of This Report

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

Deborah V. Loveless, CPA
Director
December 5, 2014

**Findings and Recommendations**

**1. Purchasing procedures at The University Of Memphis are inadequate**

**Background**

TigerBuy is an automated purchasing system used by The University of Memphis since 2008. Departments within the university are authorized to perform their own purchasing through TigerBuy for items with a cost of $5,000 or less. This includes the requisitioning, approving, and receiving functions. Although the university does not have a written policy regarding the proper segregation of duties, a sound internal control structure requires the person approving a requisition to be different from the person initiating the requisition. The TigerBuy system allows the same person to complete both functions. Management stated that if requisitions exceed $5,000 or include items with certain account codes (e.g., software leases, consulting services, and other professional or administrative services), the approved requisition is forwarded to the Office of Procurement and Contract Services for actual procurement to ensure compliance with State of Tennessee and Tennessee Board of Regents competitive bidding requirements and other related requirements.

**Condition**

We obtained from the TigerBuy vendor the records of all 16,339 purchase orders executed in TigerBuy during the year ended June 30, 2014. These records indicated who initiated each purchase, who approved the purchase, and who received the purchased goods and/or services. Based on these records, in 32% of the cases, the person who approved the requisition was the same person who initiated it. Thus, $15 million of the $36 million of goods and services purchased through the TigerBuy system were initiated and approved by the same individual.

Larger requisitions routed through the Office of Procurement and Contract Services were not exempt from this lack of segregation of duties. There were 173 cases, totaling $9,231,728, of purchases over $10,000 routed through the Office of Procurement and Contract Services that were initiated and approved by the same person. According to Procurement and Contract Services personnel, they perform no further approval functions when they receive these requisitions that have been approved at the department level.

Testwork on 15 individual purchase orders, each in excess of $100,000, revealed additional problems with the procurement process. The personnel initiating and approving requisitions did not always have adequate knowledge of the proper coding for the items purchased. We discovered 10 items of equipment (each in excess of the $5,000 equipment capitalization threshold), totaling $182,340, that should have been capitalized but were instead expensed. When we asked the person who requisitioned, approved, and coded the purchase about her process, she admitted that she did not know the nature of the items she was purchasing, but was initiating the purchase for someone else in the department.

**Criteria**

A proper segregation of duties is an essential part of any internal control structure. To prevent fraudulent purchases, different individuals should be responsible for initiating and approving purchases and for verifying the receipt of goods or services. To prevent or to detect and correct accounting and reporting errors, knowledgeable individuals should be in charge of coding disbursements. A proper review and supervision of the coding process should be in place.

**Cause**

Management did not establish appropriate written policies for purchases made through the TigerBuy system. In addition, available application controls (e.g., such as edits to prevent one person initiating and approving a single transaction) were not used. Management also did not ensure that proper account code classifications were used on requisitions and approved purchase orders prior to their execution.

**Effect**

A lack of written policies may cause confusion for staff members who are unsure of the proper procedures for purchasing. By not enforcing application controls within the TigerBuy system, the purchasing function could result in wasteful or fraudulent purchases. The coding of purchase requisitions by unqualified persons, along with the absence of appropriate review and supervision, caused misclassifications of items purchased and the failure to capitalize some equipment purchases.

**Recommendation**

Management should ensure that different people initiate and approve purchasing transactions and verify the receipt of goods or services. University staff should work with the TigerBuy vendor to determine how these controls may be included in the system itself. Also, management should ensure that purchase requisitions are reviewed by people who are qualified to ensure use of the proper account code for the item being purchased, so that purchased items are appropriately capitalized and tagged as required.

**Management's Comment**

We do not concur that the issues noted rise to the level of a significant deficiency; however, we do understand the auditor's concerns with the university's purchasing procedures and agree that we should investigate the merits of implementing additional compensating controls. Management has fully evaluated the risk involved with the procurement process in the past and it was determined from a cost-benefit perspective that the policies do not result in a material risk to our financial system. Additional segregation of duties would cause operational disruptions with the user departments. Management had accepted the lower level of risk that is present in our analysis of this process. In addition, there is a level of compensating controls in place with our budget review process. It is important to note that zero risk cannot be achieved in any financial system and management must balance reasonableness, cost, and operational efficiency in the evaluation of controls.

Throughout the purchasing process, many individuals are involved in the examination and oversight of each transaction, diminishing the risk of misappropriation. It is our belief the university has mitigating controls in place to offset the concerns noted. These mitigating factors include budgetary controls and oversight thereof, among others.

Procurement Services personnel review purchases equal or greater than $5,000. This process includes a review for justified business purpose and that all procurement policies and legal requirements have been followed. Purchases of at least $10,000 but less than $50,000 require written, telephone, or electronic bids from a minimum of 3 qualified bidders. These purchases are reviewed by Procurement Services prior to issuance of a University Purchases Order. Purchases of $50,000 or more require a formal bidding process led by Procurement Services personnel where sealed bids for the purchase are submitted to Procurement Services for an evaluation prior to issuance of a University Purchase Order. Due to the legislative requirements for competitive quotes or sealed bids, there are generally several levels of university personnel that are involved in developing and analyzing the quote/bid specification documents. Additionally, in most purchases involving a significant expenditure, a budget allocation request has been made that is approved at the dean or vice president level.

In addition, UM policy 1303, Authorized Signatures for Financial Transactions, grants by position title the authority of Financial Managers and Designees to approve certain financial transactions. The policy specifically states that it is the responsibility of each financial manager to control all financial transactions against assigned organizations to ensure that they conform to university policy. Further per UM Guideline BF10191 (Purchasing Methods), purchase requisition procedures require each authorized ordering department personnel to be responsible for ensuring that all purchases are for official university use and in support of the university's mission, and determining that all items to be purchased are necessary. UM1640, Reporting Fraud, Waste, or Abuse of University Resources, outlines procedures for reporting fraud. A complete "Guide to Procurement and Contract Services" (http://bf.memphis.edu/bfguide/pur.php) policy and procedure manual is accessible on the UM Procurement Services website. This electronic purchasing manual includes two university policies and ten guidelines that provide detailed guidance on purchasing procedures. Furthermore, Tigerbuy training is required prior to obtaining access to the TigerBuy purchasing system.

Regarding the 15 purchase orders tested in the audit, the ten equipment items that were misclassified as supplies rather than equipment were on the same purchase order and a result of human mistake on the part of both the requisitioner/approver and Procurement Services Buyer. There were no misclassifications noted on the other 14 purchase orders tested. The university considers this to be an isolated incident.

We do appreciate the recommendations on approaches to further strengthen internal controls in this area. As a result, we will study the current purchasing policies and procedures and will implement cost-effective changes to increase controls where deemed appropriate.

## 2. The University of Memphis did not provide adequate internal controls in one specific area

### Finding

The university did not design and monitor internal controls in one specific area. We observed a condition in violation of university policies and/or industry-accepted best practices. Inconsistent implementation of internal controls increases the risk of fraud or error.

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

### Recommendation

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

### Management's Comment

We concur a limited number of instances were identified in one specific area in which existing internal controls may be strengthened. We will conduct a thorough review of policies and controls associated with this and implement controls as deemed appropriate.