Tennessee Comptroller of the Treasury

State of Tennessee

Comptroller of the Treasury

East Tennessee State University

Financial and Compliance Audit Report

For the Year Ended June 30, 2016

Justin P. Wilson, Comptroller

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January 26, 2017

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable David Gregory, Acting Chancellor
Dr. Brian Noland, President

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, East Tennessee State University, for the year ended June 30, 2016. 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 internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

Deborah V. Loveless

Deborah V. Loveless, CPA
Director

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Audit Report
Tennessee Board of Regents
East Tennessee State University
For the Year Ended June 30, 2016

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For the Year Ended June 30, 2016

Opinions on the Financial Statements

The opinions on the financial statements are unmodified.

Audit Findings

The audit report contains no findings.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
The Honorable David Gregory, Acting Chancellor
Dr. Brian Noland, President

Report on the Financial Statements

We have audited the accompanying financial statements of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component units as of and for the year ended June 30, 2016, 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 East Tennessee State University Foundation and the Medical Education Assistance Corporation, discretely presented component units. Those statements were audited by other auditors, whose reports have been furnished to us. Our opinion, insofar as it relates to the amounts included for these institutions, is based solely on the reports of the other auditors. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free 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 university's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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

Opinions

In our opinion, based on our audit and the reports of the other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of East Tennessee State University and its discretely presented component units as of June 30, 2016; 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 East Tennessee State University, 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 East Tennessee State University. They do not purport to, and do not, present fairly the financial position of the Tennessee Board of Regents, as of June 30, 2016, 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 20, the financial statements of East Tennessee State University Foundation, a discretely presented component unit of East Tennessee State University, include investments valued at $7,723,476.54 (8.2% 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. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 6 through 16; the schedule of East Tennessee State University's proportionate share of the net pension liability for the Closed State and Higher Education Employee Pension Plan within TCRS on page 57; the schedule of East Tennessee State University's proportionate share of the net pension asset for the State and Higher Education Employee Retirement Plan within TCRS on page 58; the schedule of East Tennessee State University's contributions for the Closed State and Higher Education Employee Pension Plan within TCRS on page 59; the schedule of East Tennessee State University's contributions for the State and Higher Education Employee Retirement Plan within TCRS on page 60; and the other postemployment benefits schedule of funding progress on page 61 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during the audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Supplementary Information

Our audit was conducted for the purpose of forming opinions on the financial statements that collectively comprise the university's basic financial statements. The supplementary schedules of cash flows for both the East Tennessee State University Foundation and the Medical Education Assistance Corporation on pages 62 and 63 are presented for purposes of additional analysis and are not a required part of the basic financial statements.

The supplementary schedules of cash flows for both the component units are the responsibility of the university's management and were derived from, and relate directly to, the underlying accounting and other records used to prepare the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the basic financial statements or to the basic financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America 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 16, 2016, 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 16, 2016

This section of East Tennessee State University's annual financial report presents a discussion and analysis of the financial performance of the university during the year ended June 30, 2016, with comparative information presented for the year ended June 30, 2015. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the independent auditor's report, the financial statements, and the notes to the financial statements.

The university has two discretely presented component units, the East Tennessee State University Foundation and the Medical Education Assistance Corporation (MEAC). More detailed information about the university's component units is presented in Note 20 in the notes to the financial statements. This discussion and analysis focuses on the university and does not include the foundation or MEAC.

Overview of the Financial Statements

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

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

The Statement of Net Position

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

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

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

The following table summarizes the university's assets, liabilities, deferred outflows/inflows of resources, and net position at June 30, 2016, and June 30, 2015.

Summary of Net Position
(in thousands of dollars)

	2016	2015
Assets:		
Current assets	$ 33,215	$ 26,394
Capital assets, net	293,631	295,798
Other assets	134,965	128,001
Total assets	**461,811**	**450,193**
Deferred outflows of resources		
Deferred amount on debt refunding	6,758	7,279
Deferred outflows related to pensions	11,239	8,213
Total deferred outflows	**17,997**	**15,492**
Liabilities:		
Current liabilities	45,179	38,881
Noncurrent liabilities	197,247	190,289
Total liabilities	**242,426**	**229,170**

Deferred inflows of resources		
Deferred inflows related to pensions	5,763	20,291
Total deferred inflows	**5,763**	**20,291**
Net position:		
Net investment in capital assets	159,591	156,812
Restricted – expendable	5,842	6,552
Unrestricted	66,186	52,860
Total net position	**$231,619**	**$216,224**

Comparison of Fiscal Year 2016 to Fiscal Year 2015

- ♦ Current assets increased from 2015 to 2016 due to increases in accounts receivable related to College of Medicine resident's participation agreements and implementation of a new food service contract, as well as increases in current cash for plant and quasi-endowment funds.
- ♦ Capital assets, net of depreciation, remained relatively unchanged because increases due to capital projects were offset by depreciation expense.
- ♦ In 2016, other assets increased due to increases in noncurrent cash held in plant funds for major renovation of the D.P. Culp Student Center, and construction of a new fine arts building, data center, and football stadium.
- ♦ Deferred outflows increased during the year primarily due to calculations of investment earnings and actuarial experience related to the Tennessee Consolidated Retirement System pensions for fiscal year 2015. Further information on pensions can be found in Note 11 of the financial statements.
- ♦ Current liabilities increased from 2015 to 2016 due to increases in accrued liabilities for ongoing construction projects and accounts payable related to the implementation of a new food service contract.
- ♦ In 2016, noncurrent liabilities increased primarily due to a $12.5 million increase in recorded net pension liability. Further information regarding pensions can be found in Note 11 of the financial statements.
- ♦ Net investment in capital assets remained relatively unchanged in 2016 because increases due to capital projects were offset by depreciation expense.
- ♦ Restricted expendable net position decreased with decreases in balances held for student loans and transfer of restricted scholarship funds to the ETSU Foundation.
- ♦ Unrestricted net position increased from 2015 to 2016, primarily due to increases in net tuition revenue and state appropriations.

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, both 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 East Tennessee State University 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 years ended June 30, 2016, and June 30, 2015, follows.

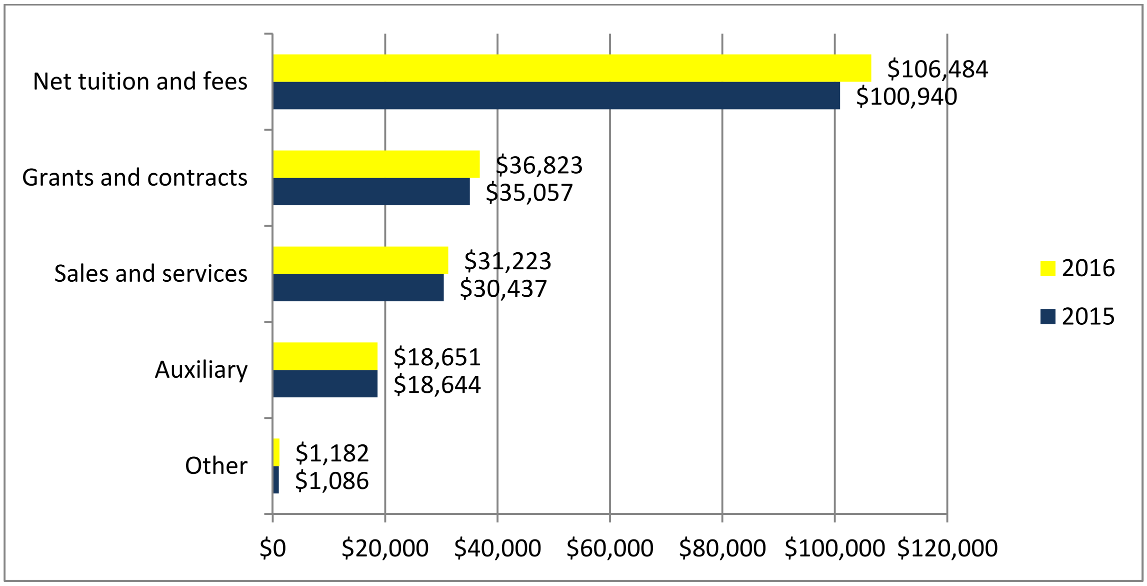
Summary of Revenues, Expenses, and Changes in Net Position
(in thousands of dollars)

	2016	2015
Operating revenues	$194,363	$186,164
Operating expenses	326,041	313,057
Operating loss	(131,678)	(126,893)
Nonoperating revenues and expenses	143,995	135,784
Income (loss) before other revenues, expenses, gains, or losses	12,317	8,891
Other revenues, expenses, gains, or losses	3,078	6,697
Increase in net position	15,395	15,588
Net position at beginning of year	216,224	232,912
Cumulative effect of change in accounting principle	-	(32,276)
Net position at beginning of year - restated	216,224	200,636
Net position at end of year	**$231,619**	**$216,224**

Operating Revenues

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

Operating Revenues by Source
(in thousands of dollars)



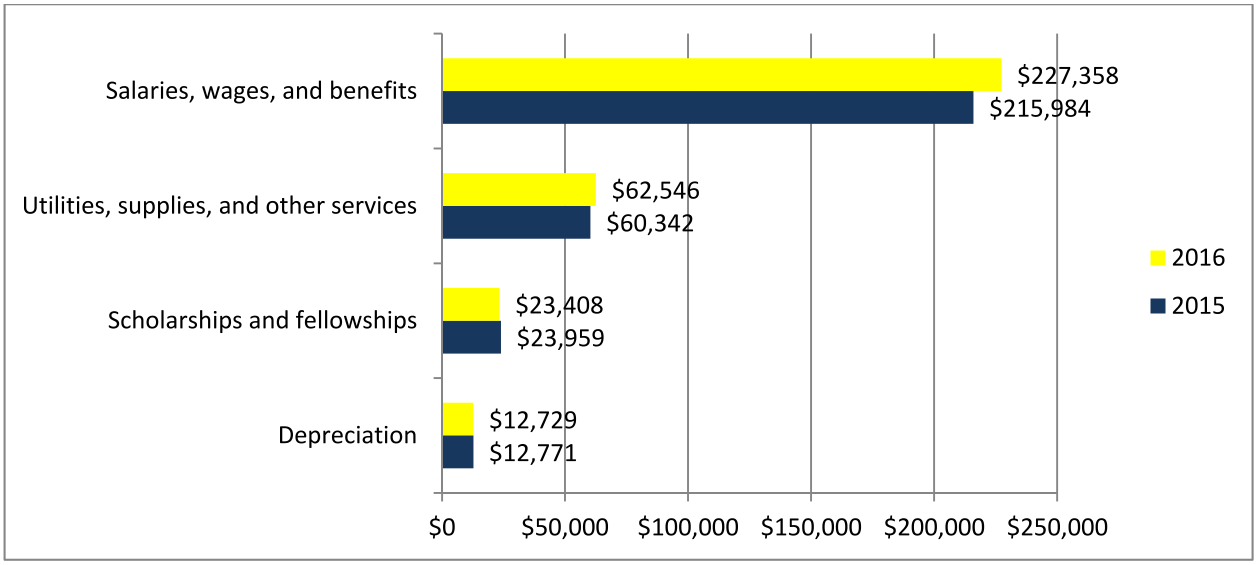
Comparison of Fiscal Year 2016 to Fiscal Year 2015

- Tuition and fees increased in 2016 due to an average 3% tuition increase, increases in other mandatory fees, and increases in graduate enrollment.
- Nongovernmental grants and contracts increased primarily due to increases in funding through private grants and contracts for an outpatient drug program and forensic services.
- Sales and services increased slightly from 2015 to 2016 due to significant increases in athletic ticket sales, game guarantees, conference revenue, and athletics advertising.
- Auxiliaries and other operating revenues remained relatively unchanged.

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:

Operating Expenses – Natural Classification
(in thousands of dollars)



Comparison of Fiscal Year 2016 to Fiscal Year 2015

- Salaries, wages, and benefits increased in fiscal year 2016 due to a 2% across-the-board pay increase and increases in cost for health insurance and other employee benefits.
- Other operating expenses increased with maintenance and repairs services, including repairs for elevators and lighting and campus housing improvements provided by increased funding for operations.
- Scholarships and depreciation remained relatively unchanged from 2015 to 2016.

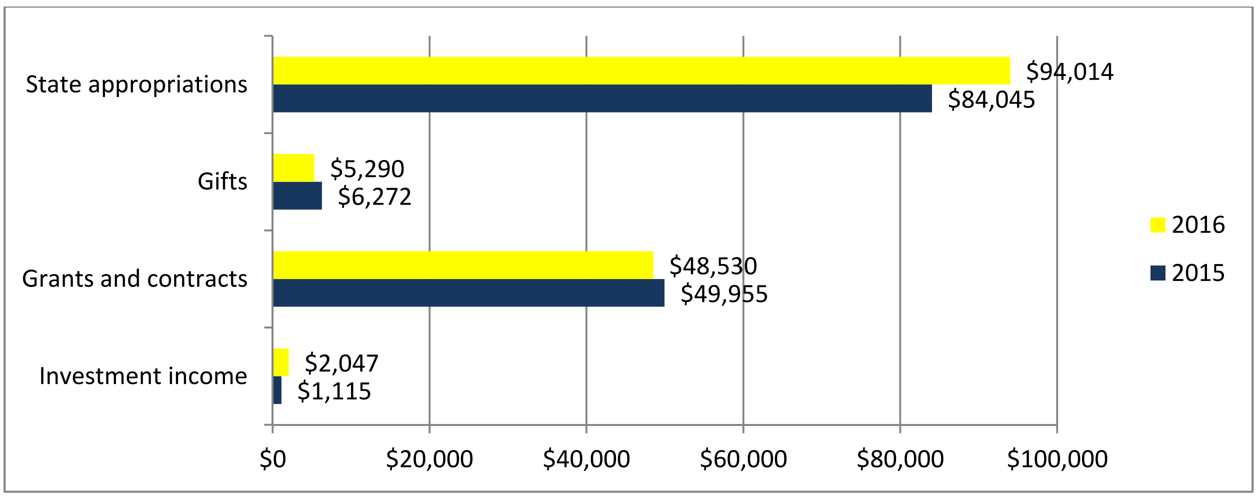
Nonoperating Revenues and Expenses

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

Nonoperating Revenues (Expenses)
(in thousands of dollars)

	2016	2015
State appropriations	$ 94,014	$ 84,045
Gifts	5,290	6,272
Grants and contracts	48,530	49,955
Investment income	2,047	1,115
Interest on capital asset-related debt	(5,432)	(5,303)
Interest on noncapital debt	(165)	(17)
Bond issuance costs	(38)	(158)
Other nonoperating revenues (expenses)	(251)	(125)
Total nonoperating revenues (expenses)	**$143,995**	**$135,784**

Nonoperating Revenues
(in thousands of dollars)



Comparison of Fiscal Year 2016 to Fiscal Year 2015

- State appropriations increased due to receiving over $9 million in increased appropriations in fiscal year 2016 for salary, benefits, and operating increases.
- Nonoperating gifts decreased from 2015 to 2016 due to a reduction in gifts from the ETSU Foundation in the current year.
- Nonoperating grants and contracts decreased due to reductions in funding through Pell grants and Tennessee Lottery grants.
- Investment income increased due to increases in rates of return for investments.
- Interest on capital asset-related debt remained relatively unchanged.
- Bond issuance costs decreased due to decreases in TSSBA bonding activity.
- Other nonoperating expenses increased as a result of loss on disposal of equipment and improvements.

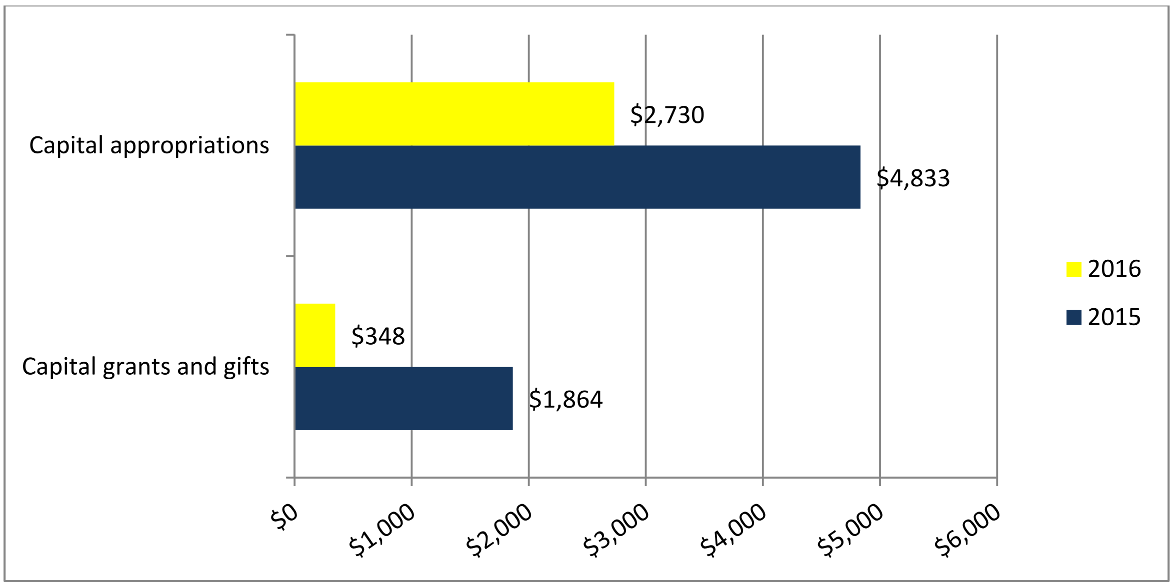
Other Revenues

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

Other Revenues
(in thousands of dollars)

	2016	2015
Capital appropriations	$2,730	$4,833
Capital grants and gifts	348	1,864
Total other revenues	**$3,078**	**$6,697**

Other Revenues
(in thousands of dollars)



Comparison of Fiscal Year 2016 to Fiscal Year 2015

- Capital appropriations decreased from 2015 to 2016 due to a decrease in state appropriations for capital projects.
- Capital gifts and grants decreased due to a $1.5 million one-time gift for the fine arts building from the ETSU Foundation in fiscal year 2015.

Capital Assets and Debt Administration

Capital Assets

East Tennessee State University had $293,631,188.37 invested in capital assets, net of accumulated depreciation of $220,915,817.33 at June 30, 2016; and $295,798,126.05 invested in capital assets, net of accumulated depreciation of $209,765,691.00 at June 30, 2015. Depreciation charges totaled $12,729,179.82 and $12,770,811.54 for the years ended June 30, 2016, and June 30, 2015, respectively.

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

	2016	2015
Land	$ 17,483	$ 16,482
Land improvements and infrastructure	23,956	25,405
Buildings	232,779	237,183
Equipment	12,812	13,613
Library holdings	323	424
Intangible assets	117	538
Art and historical collections	24	24
Projects in progress	6,137	2,129
Total	**$293,631**	**$295,798**

Capital assets, net of depreciation, decreased from 2015 to 2016 due to the disposals of improvements and equipment and depreciation of existing assets.

At June 30, 2016, outstanding commitments under construction contracts totaled $115,358,838.66 for various renovations and repairs of buildings and infrastructure. Future state capital outlay appropriations will fund approximately $31,065,978.14 of these costs.

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

Debt

The university had $146,260,529.01 and $152,470,683.74 in debt outstanding at June 30, 2016, and June 30, 2015, respectively. The table below summarizes these amounts by type of debt instrument.

Schedule of Outstanding Debt
(in thousands of dollars)

	2016	2015
Revolving credit facility	$ 3,102	$ 2,940
Bonds	127,361	132,628
Unamortized bond premiums	15,797	16,903
Total	**$146,260**	**$152,471**

The Tennessee State School Bond Authority (TSSBA) issued bonds with interest rates ranging from 0.65% to 5% due serially to 2043 on behalf of East Tennessee State University. The university is responsible for the debt service of these bonds. The current portion of the $127,361,395.06 of bonds outstanding at June 30, 2016, is $5,498,190.31.

The ratings on debt issued by the Tennessee State School Bond Authority at June 30, 2016, 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 9 to the financial statements.

Economic Factors That Will Affect the Future

The economic outlook for the State of Tennessee continues to improve. The university is receiving an approximately 6.1% increase in state appropriations in fiscal year 2017 for salary, benefits, and operating increases. This has allowed the university to have the smallest increase in maintenance fees in over 30 years. In addition, the university is beginning over $170 million in construction in the next several years, which includes major renovations to the Public Health Building and the D.P. Culp Student Center, and new construction of a fine arts center, data center, simulation center, and football stadium. These projects will fundamentally transform the campus for our students. It is hoped the economy of the state will continue to improve, providing increased funding and opportunities for our students.

The Focus on College and University Success (FOCUS) Act became effective July 1, 2016. This Act removes six universities, including East Tennessee State University, from the governance of the Tennessee Board of Regents. The universities will remain part of the State University and Community College System of Tennessee, but each will have its own local board that will provide governance, approve policies, set tuition and fee rates, and hire presidents. The Act also enhances the role of the Tennessee Higher Education Commission (THEC) by requiring THEC to provide greater coordination across the state, including capital project management, institutional mission approval, and higher education finance. The new local ETSU board is expected to convene in

April 2017. The six universities will continue under the governance of the Tennessee Board of Regents in fiscal year 2017, until the local boards are convened.

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 operations during the fiscal year.

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Statement of Net Position
June 30, 2016

	University	Component Units: East Tennessee State University Foundation	Component Units: Medical Education Assistance Corporation
Assets			
Current assets:			
Cash and cash equivalents (Notes 2 and 20)	$ 12,863,045.01	$ 1,128,837.08	$ 6,982,159.00
Short-term investments (Note 20)	-	-	5,123,256.00
Accounts, notes, and grants receivable (net) (Note 5)	13,206,324.35	-	4,929,877.00
Due from primary government	4,167,943.35	-	-
Due from component units	545,131.32	-	-
Inventories (at lower of cost or market)	147,065.71	-	-
Prepaid expenses	1,246,722.66	-	342,471.00
Accrued interest receivable	1,028,914.21	29,824.39	-
Other assets	9,691.70	-	-
Total current assets	33,214,838.31	1,158,661.47	17,377,763.00
Noncurrent assets:			
Cash and cash equivalents (Notes 2 and 20)	64,576,141.93	1,341,840.69	-
Investments (Notes 3, 4, and 20)	64,129,270.00	87,329,193.61	6,284,163.00
Accounts, notes, and grants receivable (net) (Note 5)	6,198,797.36	-	-
Net pension asset (Note 11)	60,758.00	-	-
Pledges receivable (Note 20)	-	4,619,888.51	-
Capital assets (net) (Notes 6 and 20)	293,631,188.37	21,486.00	4,203,055.00
Other assets	-	12,117.66	-
Total noncurrent assets	428,596,155.66	93,324,526.47	10,487,218.00
Total assets	461,810,993.97	94,483,187.94	27,864,981.00
Deferred outflows of resources			
Deferred amount on debt refunding	6,758,464.77	-	-
Deferred outflows related to pensions (Note 11)	11,238,190.00	-	-
Total deferred outflows of resources	17,996,654.77	-	-
Liabilities			
Current liabilities:			
Accounts payable (Note 8)	4,664,240.80	57,551.31	571,325.00
Investments purchased	1,000,000.00	-	-
Accrued liabilities	9,601,627.21	-	3,183,156.00
Due to primary government	740,694.22	-	-
Due to the university	-	213,645.48	331,485.84
Student deposits	521,396.21	-	-
Unearned revenue	16,099,235.51	-	-
Compensated absences (Notes 9 and 20)	3,325,837.70	-	179,330.00
Accrued interest payable	1,014,890.45	-	-
Long-term liabilities, current portion (Note 9)	5,498,190.31	-	-
Deposits held in custody for others	2,712,296.74	-	580,537.00
Other liabilities	-	-	101,636.16
Total current liabilities	45,178,409.15	271,196.79	4,947,470.00
Noncurrent liabilities:			
Net OPEB obligation (Note 12)	13,253,924.40	-	-
Net pension liability (Note 11)	26,681,350.00	-	-
Compensated absences (Notes 9 and 20)	8,747,483.16	-	717,320.00
Long-term liabilities (Note 9)	140,762,338.70	-	-
Due to grantors (Note 9)	7,802,160.13	-	-
Total noncurrent liabilities	197,247,256.39	-	717,320.00
Total liabilities	242,425,665.54	271,196.79	5,664,790.00
Deferred inflows of resources			
Deferred inflows related to pensions (Note 11)	5,762,737.00	-	-
Total deferred inflows of resources	5,762,737.00	-	-
Net position			
Net investment in capital assets	159,590,890.83	21,486.00	4,203,055.00
Restricted for:			
Nonexpendable:			
Scholarships and fellowships	-	40,854,816.50	-
Research	-	690,432.28	-
Instructional department uses	-	5,447,787.53	-
Other	-	4,866,462.53	-
Expendable:			
Scholarships and fellowships	126,031.29	13,453,244.33	-
Research	262,854.42	330,932.01	-
Instructional department uses	224,105.63	4,232,066.61	-
Loans	335,006.03	-	-
Capital projects	-	5,773,291.50	-
Debt service	2,927,210.92	-	-
Other	1,967,202.85	15,655,257.02	-
Unrestricted	66,185,944.23	2,886,214.84	17,997,136.00
Total net position	$ 231,619,246.20	$ 94,211,991.15	$ 22,200,191.00

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

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2016

		Component Units	
	University	East Tennessee State University Foundation	Medical Education Assistance Corporation
Revenues			
Operating revenues:			
Student tuition and fees (net of scholarship allowances of $44,935,971.23)	$ 106,483,509.67	$ -	$ -
Gifts and contributions	-	3,567,399.37	-
Governmental grants and contracts	25,562,448.57	-	768,590.00
Nongovernmental grants and contracts	11,261,018.09	-	-
Sales and services of educational activities	21,697,822.59	-	-
Sales and services of other activities	9,524,871.63	-	-
Net patient revenues	-	-	41,783,471.00
Auxiliary enterprises:			
Residential life (net of scholarship allowances of $247,934.04)	14,064,378.15	-	-
Bookstore	329,612.69	-	-
Food service	684,515.58	-	-
Wellness facility	1,419,774.52	-	-
Other auxiliaries	2,152,491.13	-	-
Interest earned on loans to students	201,517.08	-	-
Other operating revenues, foundation revenues including $414,000.00 from MEAC	981,311.03	1,512,138.07	758,419.00
Total operating revenues	194,363,270.73	5,079,537.44	43,310,480.00
Expenses			
Operating expenses (Note 16):			
Salaries and wages	168,562,471.03	-	28,118,126.00
Benefits	58,795,000.29	-	2,450,961.00
Utilities, supplies, and other services	62,546,217.51	3,082,149.77	8,841,688.00
Scholarships and fellowships	23,408,204.90	1,899,870.42	-
Depreciation expense	12,729,179.82	-	461,690.00
Payments to or on behalf of East Tennessee State University (Note 20)	-	2,672,626.53	-
Total operating expenses	326,041,073.55	7,654,646.72	39,872,465.00
Operating income (loss)	(131,677,802.82)	(2,575,109.28)	3,438,015.00
Nonoperating revenues (expenses)			
State appropriations	94,013,850.00	-	-
Gifts, including $2,460,693.17 from ETSU Foundation and $2,127,139.00 from MEAC	5,289,774.10	-	-
Grants and contracts	48,530,025.38	-	-
Investment income (net of investment expense for the component units of $146,615.00)	2,047,382.06	(2,637,543.50)	81,632.00
Interest on capital asset-related debt	(5,432,542.12)	-	-
Interest on noncapital debt	(164,686.80)	-	-
Bond issuance costs	(38,601.42)	-	-
Payments to or on behalf of East Tennessee State University or ETSU Foundation (Note 20)	-	-	(2,541,139.00)
Other nonoperating revenues (expenses)	(250,508.01)	-	300.00
Net nonoperating revenues (expenses)	143,994,693.19	(2,637,543.50)	(2,459,207.00)
Income (loss) before other revenues, expenses, gains, or losses	12,316,890.37	(5,212,652.78)	978,808.00
Capital appropriations	2,730,515.99	-	-
Capital grants and gifts, university gifts including $211,933.36 from ETSU Foundation	347,611.99	12,000.00	-
Additions to permanent endowments	-	1,463,818.29	-
Total other revenues	3,078,127.98	1,475,818.29	-
Increase in net position	15,395,018.35	(3,736,834.49)	978,808.00
Net position - beginning of year	216,224,227.85	97,948,825.64	21,221,383.00
Net position - end of year	$ 231,619,246.20	$ 94,211,991.15	$ 22,200,191.00

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

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Statement of Cash Flows
For the Year Ended June 30, 2016

Cash flows from operating activities		
Tuition and fees	$	105,711,443.97
Grants and contracts		36,821,106.73
Sales and services of educational activities		19,637,638.95
Sales and services of other activities		9,524,871.63
Payments to suppliers and vendors		(59,527,863.48)
Payments to employees		(165,374,733.90)
Payments for benefits		(62,378,477.03)
Payments for scholarships and fellowships		(23,401,742.21)
Loans issued to students		(1,329,242.28)
Collection of loans from students		1,751,504.14
Interest earned on loans to students		88,258.54
Auxiliary enterprise charges:		
Residence halls		14,091,280.42
Bookstore		330,078.01
Food services		744,191.51
Wellness facility		1,419,774.52
Other auxiliaries		2,134,216.64
Other receipts (payments)		1,087,994.03
Net cash used by operating activities		(118,669,699.81)
Cash flows from noncapital financing activities		
State appropriations		93,836,400.00
Gifts and grants received for other than capital or endowment purposes		53,819,799.48
Federal student loan receipts		99,706,824.00
Federal student loan disbursements		(99,678,712.00)
Changes in deposits held for others		283,048.95
Principal paid on noncapital debt		(623,353.24)
Interest paid on noncapital debt		(288,649.27)
Other noncapital financing receipts (payments)		54,477.95
Net cash provided by noncapital financing activities		147,109,835.87
Cash flows from capital and related financing activities		
Capital grants and gifts received		339,611.99
Purchases of capital assets and construction		(8,105,379.05)
Principal paid on capital debt		(7,081,992.35)
Interest paid on capital debt		(5,903,348.46)
Bond issue costs paid on new debt issue		(38,601.42)
Net cash used by capital and related financing activities		(20,789,709.29)
Cash flows from investing activities		
Proceeds from sales and maturities of investments		32,016,072.78
Income on investments		1,651,486.49
Purchase of investments		(32,004,318.75)
Net cash provided by investing activities		1,663,240.52
Net increase in cash		9,313,667.29
Cash - beginning of year		68,125,519.65
Cash - end of year	$	77,439,186.94

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Statement of Cash Flows (continued)
For the Year Ended June 30, 2016

Reconciliation of operating loss to net cash used by operating activities:		
Operating loss	$	(131,677,802.82)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Noncash operating expenses		15,484,214.80
Change in assets, liabilities, deferred outflows, and deferred inflows:		
Receivables, net		(3,074,355.34)
Inventories		133,159.88
Prepaid expenses		(394,138.03)
Other assets		(113,258.54)
Accounts payable		938,202.35
Accrued liabilities		3,504,598.02
Net pension asset		(60,758.00)
Deferred outflows related to pensions		(3,024,290.41)
Net pension liability		12,598,467.00
Deferred inflows related to pensions		(14,528,511.00)
Net OPEB obligation		220,881.25
Unearned revenues		81,585.29
Deposits		11,886.06
Compensated absences		701,474.82
Due to grantors		106,683.00
Loans to students		422,261.86
Net cash used by operating activities	$	(118,669,699.81)

Noncash investing, capital, or financing transactions		
Gifts of capital assets	$	8,000.00
Unrealized gains on investments	$	352,404.03
Loss on disposal of capital assets	$	(304,985.96)
Purchases of capital assets and construction with TSSBA proceeds	$	1,733,708.06
Purchases of capital assets and construction with capital appropriations	$	1,021,591.97

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 East Tennessee State University.

The East Tennessee State University Foundation and the Medical Education Assistance Corporation are considered component units of the university. Although the university does not control the timing or amount of receipts from these organizations, the majority of resources, or income thereon, that these organizations hold and invest are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation and the corporation can only be used by, or for the benefit of, the university, these organizations are considered component units of the university and are discretely presented in the university's financial statements. See Note 20 for more detailed information about the component units and how to obtain their reports.

Basis of Presentation

The university and its component units' 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 internal activity has 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 at the lower of cost or market. Items are maintained on an average cost or first-in, first-out basis.

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 acquisition value at date of donation, less accumulated depreciation/amortization. The costs of normal maintenance and repairs that do not add to the value of the 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 60 years.

Pensions

For purposes of measuring the net pension liability (asset), deferred outflows of resources and deferred inflows of resources related to pensions, and pension expense, information about the fiduciary net position of the Closed State and Higher Education Employee Pension Plan and the State and Higher Education Employee Retirement Plan in the Tennessee Consolidated Retirement System (TCRS) and additions to/deductions from the plans' fiduciary net positions have been determined on the same basis as they are reported by the TCRS. For this purpose, benefits (including refunds of employee contributions) are recognized when due and payable in accordance with the benefit terms of the Closed State and Higher Education Employee Pension Plan and the State and Higher Education Employee Retirement Plan. Investments are reported at fair value.

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/inflows of resources related to those capital assets. To the extent debt has been incurred but not yet expended for capital assets, such amounts are not included as a component of net investment in capital assets.

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

Expendable restricted net position – Expendable restricted net position includes resources 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; sales and services of 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, 2016, cash consisted of $5,189,302.17 in bank accounts, $55,000.00 of petty cash on hand, $69,093,248.52 in the Local Government Investment Pool (LGIP) administered by the State Treasurer, and $3,101,636.25 in LGIP deposits for capital projects.

The LGIP is part of the State Pooled Investment Fund. There are no minimum or maximum limitations on withdrawals with the exception of a 24-hour notification period for withdrawals of $5 million or more. 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

In accordance with GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools,* as amended, investments are reported at fair value, including those with a maturity date of one year or less at the time of purchase, unless otherwise noted.

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.

At June 30, 2016, the university had the following investments and maturities.

		Investment Maturities (In Years)	
Investment Type	Fair Value	Less than 1	1 to 5
U.S. agency obligations	$64,129,270.00	3,002,340.00	$61,126,930.00

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. 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, 2016, the university's investments were rated as follows:

Investment Type	Balance	Credit Quality Rating AA	Unrated
LGIP	$ 72,194,884.77	$ -	$72,194,884.77
U.S. agency obligations	64,129,270.00	64,129,270.00	-
Total	$136,324,154.77	$64,129,270.00	$72,194,884.77

Concentration of Credit Risk

Concentration of credit risk is the risk of loss attributed to the magnitude of the university's investment in a single issuer. Tennessee Board of Regents policy restricts investments in bankers' acceptances, commercial paper, and money market mutual funds. The policy limits bankers' acceptances to not exceed 20% of the total investments on the date of acquisition and limits the combined amount of bankers' acceptances and commercial paper to not exceed 35% of the total investments at the date of acquisition. The amount invested in any one bank shall not exceed 5% of total investments on the date of acquisition. Additionally, no more than 5% of total investments at the date of acquisition may be invested in the commercial paper of a single issuer. The policy further limits the total holdings of an issuer's commercial paper to not more than 2% of the issuing corporation's total outstanding commercial paper. Tennessee Board of Regents policy limits investments in money market mutual funds to not exceed 10% of total investments on the date of acquisition.

More than 5% of the university's investments were invested in the following single issuers:

Issuer	Percentage of Total Investments June 30, 2016
Federal Home Loan Bank (FHLB) obligations	13%
Federal National Mortgage Association (FNMA) obligations	16%
Federal Home Loan Mortgage Corporation (FHLMC) obligations	52%
Federal Farm Credit Bank (FFCB) obligations	19%

Note 4. Fair Value Measurement

The university categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. The university has the following recurring fair value measurements as of June 30, 2016.

	June 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)
Assets by Fair Value Level		
Debt securities		
U.S. agency obligations	$64,129,270.00	$64,129,270.00
Total debt securities	$64,129,270.00	$64,129,270.00
Total assets at fair value	$64,129,270.00	$64,129,270.00

Assets classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities.

Note 5. Receivables

Receivables at June 30, 2016, included the following:

Student accounts receivable	$ 6,801,356.38
Grants receivable	2,596,750.03
Notes receivable	497,072.90
Clinic receivables	726,663.37
Medical Resident Participation Agreement receivable	3,025,485.72
Other receivables	3,221,731.61
Subtotal	16,869,060.01
Less allowance for doubtful accounts	2,647,121.51
Total receivables	$14,221,938.50

Federal Perkins Loan Program funds at June 30, 2016, included the following:

Perkins loans receivable	$7,755,176.29
Less allowance for doubtful accounts	2,571,993.08
Total	$5,183,183.21

Note 6. Capital Assets

Capital asset activity for the year ended June 30, 2016, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$ 16,481,720.07	$1,001,900.00	$ -	$ -	$ 17,483,620.07
Land improvements and infrastructure	48,443,615.50	-	847,255.00	222,111.30	49,068,759.20
Buildings	391,439,008.84	-	2,844,599.64	-	394,283,608.48
Equipment	41,301,040.05	2,145,039.37	-	1,534,459.02	41,911,620.40
Library holdings	1,312,119.40	21,004.79	-	127,469.13	1,205,655.06
Intangible assets	4,433,400.78	-	-	-	4,433,400.78
Art and historical collections	23,500.00	-	-	-	23,500.00
Projects in progress	2,129,412.41	7,699,283.94	(3,691,854.64)	-	6,136,841.71
Total	505,563,817.05	10,867,228.10	-	1,884,039.45	514,547,005.70
Less accumulated depreciation/amortization:					
Land improvements and infrastructure	23,038,818.95	2,229,406.35	-	155,358.19	25,112,867.11
Buildings	154,255,944.39	7,247,982.12	-	-	161,503,926.51
Equipment	27,687,528.26	2,708,495.62	-	1,296,226.17	29,099,797.71
Library holdings	887,676.52	122,473.75	-	127,469.13	882,681.14
Intangible assets	3,895,722.88	420,821.98	-	-	4,316,544.86
Total	209,765,691.00	12,729,179.82	-	1,579,053.49	220,915,817.33
Capital assets, net	$295,798,126.05	$ (1,861,951.72)	$ -	$ 304,985.96	$293,631,188.37

Note 7. Capital Leases

The university has entered into an Enhanced Use Lease Agreement with the United States Department of Veterans Affairs (VA) for certain real property, including land and several buildings, at the Veterans Affairs Medical Center in Johnson City, Tennessee. The lease is for a period of 35 years. In lieu of lease payments, the university has assumed responsibility for all capital and recurring costs of maintaining the property covered by the agreement.

In conjunction with the lease, the university entered into a memorandum of agreement with the Department of Veterans Affairs to construct a building (the Basic Science Building) with joint funding from the State of Tennessee and the federal government. In accordance with the memorandum of agreement, the state provided $18 million to the federal government for its share of the total construction costs ($34,195,153.41). The Basic Science Building is included under the provisions of the Enhanced Use Lease Agreement. The university is renovating several other buildings on the VA campus as funds become available.

The university's leasing of the Basic Science Building and the other buildings on the VA campus will constitute a capital lease agreement. The lease term is substantially equal to the estimated useful life of the leased property. Accordingly, the university has capitalized the cost of the buildings at $64,738,171.26. At June 30, 2016, the buildings are reported at $41,869,271.06, net of accumulated depreciation of $22,868,900.20.

Note 8. Accounts Payable

Accounts payable at June 30, 2016, included the following:

Vendors payable	$3,729,514.31
Unapplied student payments	27,504.01
Other payables	907,222.48
Total accounts payable	$4,664,240.80

Note 9. Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2016, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$132,627,481.08	$ -	$5,266,086.02	$127,361,395.06	$5,498,190.31
Unamortized bond premium	16,902,859.97	-	1,105,727.18	15,797,132.79	-
Revolving credit facility	2,940,342.69	2,600,918.04	2,439,259.57	3,102,001.16	-
Subtotal	152,470,683.74	2,600,918.04	8,811,072.77	146,260,529.01	5,498,190.31
Other liabilities:					
Compensated absences	11,371,846.04	7,839,748.55	7,138,273.73	12,073,320.86	3,325,837.70
Due to grantors	7,695,477.13	106,683.00	-	7,802,160.13	-
Subtotal	19,067,323.17	7,946,431.55	7,138,273.73	19,875,480.99	3,325,837.70
Total long-term liabilities	$171,538,006.91	$10,547,349.59	$15,949,346.50	$166,136,010.00	$8,824,028.01

TSSBA Debt – Bonds

Bonds, with interest rates ranging from 0.35% to 5%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially to 2043 and are secured by pledges of the facilities' revenues to which they relate and certain other revenues and fees of the university, including state appropriations; see Note 10 for further details. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net position is shown net of assets held by the authority in the debt service reserve and net of unexpended debt proceeds. The reserve amount was $2,326,438.23 at June 30, 2016.

Debt service requirements to maturity for the university's portion of TSSBA bonds at June 30, 2016, are as follows:

Year Ending June 30	Principal	Interest	Total
2017	$ 5,498,190.31	$ 5,976,390.23	$ 11,474,580.54
2018	4,726,316.75	5,791,758.17	10,518,074.92
2019	4,606,290.88	5,525,339.26	10,131,630.14
2020	6,038,950.53	5,234,006.77	11,272,957.30
2021	6,255,403.63	4,963,430.19	11,218,833.82
2022-2026	31,698,829.25	20,504,879.35	52,203,708.60
2027-2031	26,248,769.90	13,410,016.24	39,658,786.14
2032-2036	22,105,971.13	7,484,437.25	29,590,408.38
2037-2041	15,418,807.21	2,729,788.85	18,148,596.06
2042-2043	4,763,865.47	326,512.14	5,090,377.61
Total	$127,361,395.06	$71,946,558.45	$199,307,953.51

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 total outstanding loans from the revolving credit facility for the university were $2,390,083.51 at June 30, 2016. In addition, the university has expended $711,917.65 on projects that TSSBA has not yet withdrawn from 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.

Note 10. Pledged Revenues

The university has pledged certain revenues and fees, including state appropriations, to repay $127,361,395.06 in revenue bonds issued from January 2007 to April 2015 (see Note 9 for further detail). Proceeds from the bonds provided financing for construction and renovation projects. The bonds are payable through 2043. Annual principal and interest payments on the bonds are expected to require 4.55% of available revenues. The total principal and interest remaining to be paid on the bonds is $199,307,953.51. Principal and interest paid for the current year and total available revenues were $13,887,854.11 and $304,981,082.59, respectively.

Note 11. Pension Plans

<u>Defined Benefit Plans</u>

Closed State and Higher Education Employee Pension Plan

General Information About the Pension Plan

<u>Plan description</u> – State employees and higher education employees with membership in the Tennessee Consolidated Retirement System (TCRS) before July 1, 2014, are provided with pensions through the Closed State and Higher Education Employee Pension Plan. This plan is a component of the Public Employee Retirement Plan, an agent, multiple-employer defined benefit pension plan. The Closed State and Higher Education Employee Pension Plan stopped accepting new membership on June 30, 2014, but will continue providing benefits to existing members and retirees. Beginning July 1, 2014, a new agent defined benefit retirement plan, the State and Higher Education Employee Retirement Plan, became effective for state employees and higher education employees hired on or after July 1, 2014.

The TCRS was created by state statute under Title 8, Chapters 34-37, *Tennessee Code Annotated*. The TCRS Board of Trustees is responsible for the proper operation and administration of all employer pension plans in the TCRS. The Tennessee Treasury Department, an agency in the legislative branch of state government, administers the plans of the TCRS. The TCRS issues a publicly available financial report that can be obtained at www.treasury.tn.gov/tcrs.

<u>Benefits provided</u> – Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes the benefit terms and can be amended only by the Tennessee General Assembly. Members of the Closed State and Higher Education Employee Pension Plan are eligible to retire with an unreduced benefit at age 60 with 5 years of service credit or after 30 years of service credit regardless of age. Benefits are determined using the following formula:

Average of member's highest compensation for 5 consecutive years (up to Social Security integration level)	x	1.50%	x	Years of Service Credit	x	105%
Plus:						
Average of member's highest compensation for 5 consecutive years (over the Social Security integration level)	x	1.75%	x	Years of Service Credit	x	105%

A reduced early retirement benefit is available at age 55 and vested. Members are vested with five years of service credit. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10% and include projected service credits. A variety of death benefits are available under various eligibility criteria. Member and beneficiary annuitants are entitled to automatic cost-of-living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to July 2 of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3%, and applied to the current benefit. No COLA is granted if the change in the CPI is less than 0.5%. A 1% COLA is granted if the CPI change is between 0.5% and 1%. A member who leaves employment may withdraw employee contributions, plus any accumulated interest.

Contributions – Contributions for state employees and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. The university's employees are non-contributory, as are most members in the Closed State and Higher Education Employee Pension Plan. State and higher education agencies make employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. By law, employer contributions for the Closed State and Higher Education Employee Pension Plan are required to be paid. Employer contributions by the university for the year ended June 30, 2016, to the Closed State and Higher Education Employee Pension Plan were $7,784,757, which is 15.03% of covered payroll. The employer rate is expected to finance the costs of benefits earned by members during the year and the cost of administration, as well as an amortized portion of any unfunded liability.

Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension liability – At June 30, 2016, the university reported a liability of $26,681,350 for its proportionate share of the net pension liability. The net pension liability was measured as of June 30, 2015, and the total pension liability used to calculate the net pension liability was determined by an actuarial valuation as of that date. The university's proportion of the net pension liability was based on a projection of the university's contributions during the year ended June 30, 2015, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2015, measurement date, the university's proportion was 2.069473%. The proportion measured as of June 30, 2014, was 2.041149%.

Pension expense – For the year ended June 30, 2016, the university recognized a pension expense of $2,964,432.

Deferred outflows of resources and deferred inflows of resources – For the year ended June 30, 2016, the university reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ 2,823,323.00	$2,310,169.00
Net difference between projected and actual earnings on pension plan investments	-	3,429,963.00
Changes in proportion of net pension liability	381,588.00	-
University's contributions subsequent to the measurement date of June 30, 2015	7,784,757.00	-
Total	$10,989,668.00	$5,740,132.00

Deferred outflows of resources, resulting from the university's employer contributions of $7,784,757 subsequent to the measurement date, will be recognized as a decrease in net pension liability in the year ending June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30	
2017	$(1,919,606)
2018	(1,919,606)
2019	(1,919,607)
2020	3,223,598

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

<u>Actuarial assumptions</u> – The total pension liability as of June 30, 2015, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0%
Salary increases	Graded salary ranges from 8.97% to 3.71% based on age, including inflation, averaging 4.25%
Investment rate of return	7.5%, net of pension plan investment expenses, including inflation
Cost-of-living adjustment	2.5%

Mortality rates were based on actual experience from the June 30, 2012, actuarial experience study adjusted for some of the expected future improvement in life expectancy.

The actuarial assumptions used in the June 30, 2015, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2008, through June 30, 2012. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees in conjunction with the June 30, 2012, actuarial experience study by considering the following three techniques: (1) the 25-year historical return of the TCRS at June 30, 2012; (2) the historical market returns of asset classes from 1926 to 2012 using the TCRS investment policy asset allocation; and (3) capital market projections that were utilized as a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Four sources of capital market projections were blended and utilized in the third technique. The blended capital market projection established the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding inflation of 3%. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Long-term Expected Real Rate of Return	Target Allocation
U.S. equity	6.46%	33%
Developed market international equity	6.26%	17%
Emerging market international equity	6.40%	5%
Private equity and strategic lending	4.61%	8%
U.S. fixed income	0.98%	29%
Real estate	4.73%	7%
Short-term securities	0.00%	1%
		100%

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees as 7.5% based on a blending of the three factors described above.

Discount rate – The discount rate used to measure the total pension liability was 7.5%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current rate and that contributions from all state and higher education agencies will be made at the actuarially determined contribution rate in accordance with the funding policy of the TCRS Board of Trustees and as required to be paid by state statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of the net pension liability (asset) to changes in the discount rate – The following presents the university's proportionate share of the net pension liability (asset) calculated using the discount rate of 7.5%, as well as what the university's proportionate share of the net pension liability (asset) would be if it were calculated using a discount rate that is 1 percentage point lower (6.5%) or 1 percentage point higher (8.5%) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
University's net pension liability (asset)	$62,518,473	$26,681,350	$(3,522,444)

Pension plan fiduciary net position – Detailed information about the pension plan's fiduciary net position is available in a separately issued TCRS financial report at www.treasury.tn.gov/tcrs.

Payable to the Pension Plan

At June 30, 2016, the university reported a payable of $671,452.04 for the outstanding amount of legally required contributions to the pension plan required for the year ended June 30, 2016.

State and Higher Education Employee Retirement Plan

General Information About the Pension Plan

Plan description – State employees and higher education employees with membership in the Tennessee Consolidated Retirement System (TCRS) before July 1, 2014, are provided with pensions through the Closed State and Higher Education Employee Pension Plan, an agent plan within the Public Employee Retirement Plan administered by the TCRS. TCRS is a multiple-employer pension plan. The Closed State and Higher Education Employee Pension Plan was closed effective June 30, 2014, and covers employees hired before July 1, 2014. Employees hired after June 30, 2014, are provided with pensions through a legally separate plan referred to as the State and Higher Education Employee Retirement Plan, an agent plan within the Public Employee Retirement Plan administered by the TCRS. The TCRS was created by state statute under Title 8, Chapters 34-37, *Tennessee Code Annotated*.

Benefits provided – Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes the benefit terms and can be amended only by the Tennessee General Assembly. Members of the State and Higher Education Employee Retirement Plan are eligible to retire at age 65 with 5 years of service credit or pursuant to the rule of 90 in which the member's age and service credit total 90. Members are entitled to receive unreduced service retirement benefits, which are determined by a formula multiplying the member's highest five consecutive years' average compensation by 1% multiplied by the member's years of service credit. A reduced early retirement is available at age 60 with 5 years of service credit or pursuant to the rule of 80 in which a member's age and service credit total 80. Service-related disability benefits are provided regardless of length of service. Five years of service is required for non-service-related disability eligibility. The service-related and non-service-related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10% and include projected service credits. A variety of death benefits are available under various eligibility criteria.

Member and beneficiary annuitants are entitled to automatic cost-of-living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to July 2 of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at 3%, and applied to the current benefit. No COLA is granted if the change in the CPI is less than 0.5%. A 1% COLA is granted if the CPI change is between 0.5% and 1%. A member who leaves employment may withdraw employee contributions, plus any accumulated interest. Under the State and Higher Education Employee Retirement Plan, benefit terms and conditions, including COLAs, can be adjusted on a prospective basis. Moreover, there are defined cost controls and unfunded liability controls that provide for the adjustment of benefit terms and conditions on an automatic basis.

Contributions – Contributions for state and higher education employees are established in the statutes governing the TCRS and may only be changed by the Tennessee General Assembly. University employees contribute 5% of their salary to the State and Higher Education Employee Retirement Plan. The higher education institutions make employer contributions at the rate set by the Board of Trustees as determined by an actuarial valuation. Per the statutory provisions governing the TCRS, the employer contribution rate cannot be less than 4% for all aggregate employee groups, except in years when the maximum funded level, approved by the TCRS Board of Trustees, is reached. By law, employer contributions for the State and Higher Education Employee Retirement Plan are required to be paid. Employer contributions by the university for the year ended June 30, 2016, to the State and Higher Education Employee Retirement Plan were $244,997, which is 3.87% of covered payroll. The employer rate is 3.87% of covered payroll except for any salaries derived from federal funds, where the employer rate is 2%. The employer rate, when combined with member contributions, is expected to finance the costs of benefits earned by members during the year and the cost of administration, as well as an amortized portion of any unfunded liability.

Pension Liabilities (Assets), Pension Expense, and Deferred Outflows of Resources and Deferred Inflows of Resources Related to Pensions

Pension asset – At June 30, 2016, the university reported an asset of $60,758 for its proportionate share of the net pension asset. The net pension asset was measured as of June 30, 2015, and the total pension asset used to calculate the net pension asset was determined by an actuarial valuation as of that date. The university's proportion of the net pension asset was based on a projection of the university's contributions during the year ended June 30, 2015, to the pension plan relative to the contributions of all participating state and higher education agencies. At the June 30, 2015, measurement date, the university's proportion was 2.184792%, representing the first-time presentation of this proportion.

Pension expense – For the year ended June 30, 2016, the university recognized a pension expense of $50,396.

Deferred outflows of resources and deferred inflows of resources – For the year ended June 30, 2016, the university reported deferred outflows of resources and deferred inflows of resources related to pensions from the following sources:

	Deferred Outflows of Resources	Deferred Inflows of Resources
Differences between expected and actual experience	$ -	$22,605.00
Net difference between projected and actual earnings on pension plan investments	3,525.00	-
University's contributions subsequent to the measurement date of June 30, 2015	244,997.00	-
Total	$248,522.00	$22,605.00

Deferred outflows of resources, resulting from the university's employer contributions of $244,997 subsequent to the measurement date, will be recognized as a decrease in net pension liability in the year ending June 30, 2017. Other amounts reported as deferred outflows of resources and deferred inflows of resources related to pensions will be recognized in pension expense as follows:

Year Ended June 30	
2017	$(1,945)
2018	(1,945)
2019	(1,945)
2020	(1,944)
2021	(2,826)
Thereafter	(8,475)

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

Actuarial assumptions – The total pension asset as of the June 30, 2015, actuarial valuation was determined using the following actuarial assumptions, applied to all periods included in the measurement:

Inflation	3.0%
Salary increases	Graded salary ranges from 8.97% to 3.71% based on age, including inflation, averaging 4.25%
Investment rate of return	7.5%, net of pension plan investment expenses, including inflation
Cost-of-living adjustment	2.5%

Mortality rates were based on actual experience from the June 30, 2012, actuarial experience study adjusted for some of the expected future improvement in life expectancy.

The actuarial assumptions used in the June 30, 2015, actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2008, through June 30, 2012. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees in conjunction with the June 30, 2012, actuarial experience study by considering the following three techniques: (1) the 25-year historical return of the TCRS at June 30, 2012; (2) the historical market returns of asset classes from 1926 to 2012 using the TCRS investment policy asset allocation; and (3) capital market projections that were utilized as a building-block method in which best-estimate ranges of expected future real rates of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Four sources of capital market projections were blended and utilized in the third technique. The blended capital market projection established the long-term expected rate of return by weighting the expected future real rates of return by the target asset allocation percentage and by adding inflation of 3%. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

Asset Class	Long-term Expected Real Rate of Return	Target Allocation
U.S. equity	6.46%	33%
Developed market international equity	6.26%	17%
Emerging market international equity	6.40%	5%
Private equity and strategic lending	4.61%	8%
U.S. fixed income	0.98%	29%
Real estate	4.73%	7%
Short-term securities	0.00%	1%
		100%

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees as 7.5% based on a blending of the three factors described above.

Discount rate – The discount rate used to measure the total pension asset was 7.5%. The projection of cash flows used to determine the discount rate assumed that employee contributions will be made at the current rate and that contributions from all state and higher education agencies will be made at the actuarially determined contribution rate in accordance with the funding policy of the TCRS Board of Trustees and as required to be paid by state statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make projected future benefit payments of current active and inactive members. Therefore, the long-term expected rate of return on pension plan investments was applied to all periods of projected benefit payments to determine the total pension asset.

Sensitivity of the net pension liability (asset) to changes in the discount rate – The following presents the university's proportionate share of the net pension liability (asset) calculated using the discount rate of 7.5%, as well as what the university's proportionate share of the net pension liability (asset) would be if it were calculated using a discount rate that is 1 percentage point lower (6.5%) or 1 percentage point higher (8.5%) than the current rate:

	1% Decrease (6.5%)	Current Discount Rate (7.5%)	1% Increase (8.5%)
University's net pension liability (asset)	$(23,870)	$(60,758)	$(88,365)

Pension plan fiduciary net position – Detailed information about the pension plan's fiduciary net position is available in a separately issued TCRS financial report at www.treasury.tn.gov/tcrs.

Payable to the Pension Plan

At June 30, 2016, the university reported a payable of $36,574.14 for the outstanding amount of legally required contributions to the pension plan required for the year ended June 30, 2016.

Total Defined Benefit Pension Expense

The total pension expense for the year ended June 30, 2016, for all state and local government defined benefit pension plans was $3,014,828.

Defined Contribution Plans

Optional Retirement Plans

Plan description – The university contributes to the Optional Retirement Plan (ORP). The ORP, administered by the Tennessee Treasury Department, is a defined contribution plan. The ORP was established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated*. This statute also sets out the plan provisions. The plan provisions are amended by the Tennessee General Assembly. The ORP was designed to provide benefits at retirement to faculty and staff who are exempt from the overtime provision of the Fair Labor Standards Act and who waive membership in the TCRS. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings.

Funding policy – For employees employed prior to July 1, 2014, plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. For employees hired after June 30, 2014, plan members will contribute 5% to the ORP and the university will contribute 9% of the employee's base salary. Pension expense equaled the required contributions made to the ORP and were $7,947,909.21 for the year ended June 30, 2016, and $7,605,476.87 for the year ended June 30, 2015. Contributions met the requirements for each year.

Members are immediately 100% vested in the employer contributions made pursuant to the ORP. The Treasury Department has selected three investment vendors who offer a variety of investment products in which members are responsible for selecting how the contributions are invested. Each member makes the decision when to reallocate future contributions or when to transfer funds from one investment product to another. Funds are held by the investment vendor in the name of the member, not in the name of the State of Tennessee. The State of Tennessee has no discretion over these funds other than to make the initial contributions. Accordingly, the State of Tennessee is not acting in a trustee capacity, nor does it have a fiduciary responsibility for the funds held by the investment vendors.

Deferred Compensation Plans

Employees are offered three deferred compensation plans. The university, through the State of Tennessee, provides two plans, one established pursuant to the *Internal Revenue Code* (IRC), Section 457, and the other pursuant to IRC, Section 401(k). The third plan is administered by the university and was established in accordance with IRC, Section 403(b). The plans are outsourced to third-party vendors, and the administrative costs assessed by the vendors of these plans are the responsibility of plan participants. Section 401(k), Section 403(b), and Section 457 plan assets remain the property of the contributing employees; therefore, they are not presented in the accompanying financial statements. Sections 401(k), 403(b), and 457 establish participation, contribution, and withdrawal provisions for the plans. Participation in the 403(b) and the 457 plans is voluntary for employees. The university provides up to a $50 monthly employer match for employees who participate in the state’s 401(k) plan. Employees hired before July 1, 2014, voluntarily participate in the state’s 401(k) plan. Pursuant to Chapter 259 of the Public Acts of 2013, employees hired after June 30, 2014, are automatically enrolled in the state’s 401(k) plan and contribute 2% of their salary, with the employer contributing an additional non-matching 5%. Employees may opt out of the 2% auto enrollment. Such contribution rates may only be amended by the Tennessee General Assembly. There are certain automatic cost controls and unfunded liability controls in the defined benefit plan where the employees participate that may impact the non-matching 5% employer contribution to the 401(k) plan.

Employees are immediately vested in both the employee and employer contributions in all plans. The IRC establishes maximum limits that an employee can contribute to these plans. The employee may increase, decrease, or stop contributions at any time for all three plans.

During the year ended June 30, 2016, contributions totaling $3,073,928.93 were made by employees participating in the 401(k) plan, and the university recognized pension expense of $1,243,868.71 for employer contributions. During the year ended June 30, 2015, contributions totaling $2,829,199.23 were made by employees participating in the 401(k) plan and the university recognized pension expense of $1,012,878.59 for employer contributions.

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 that 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 8-27-201, *Tennessee Code Annotated*, for the State Employee Group Plan and for the Medicare Supplement Plan. The State Employee Group Plan covers retirees until they reach the age of 65. 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. Employees hired on or after July 1, 2015, are not eligible to continue insurance coverage at retirement in either the Employee Group Plan or the Medicare Supplement Plan. The state makes on-behalf payments to the Medicare Supplement Plan for the university's eligible retirees; see Note 18. 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/article/fa-accfin-cafr.

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 East Tennessee State University. 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 plan members are established and may be amended by the insurance committee. The plans are self-insured and financed on a pay-as-you-go basis with the risk shared equally among the participants. 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. Retired members 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)	$ 2,985,000.00
Interest on the net OPEB obligation	488,739.12
Adjustment to the ARC	(490,701.93)
Annual OPEB cost	2,983,037.19
Amount of contribution	(2,762,155.94)
Increase in net OPEB obligation	220,881.25
Net OPEB obligation – beginning of year	13,033,043.15
Net OPEB obligation – end of year	$13,253,924.40

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2016	State Employee Group Plan	$2,983,037.19	92.6%	$13,253,924.40
June 30, 2015	State Employee Group Plan	$2,930,256.14	94.3%	$13,033,043.15
June 30, 2014	State Employee Group Plan	$2,827,985.26	90.7%	$12,865,581.48

Funded Status and Funding Progress

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

Actuarial valuation date	July 1, 2015
Actuarial accrued liability (AAL)	$23,133,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$23,133,000.00
Actuarial value of assets as a percentage of the AAL	0%
Covered payroll (active plan members)	$113,801,678.67
UAAL as percentage of covered payroll	20.3%

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, 2015, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 3.75% investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 6.5% initially. The rate decreased to 6% in fiscal year 2016 and then reduces by decrements to an ultimate rate of 4.7% in fiscal year 2050. All rates include a 2.5% inflation assumption. Premium subsidies in the Medicare Supplement Plan are projected to remain unchanged, and, consequently, trend rates are not applicable. 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%.

Note 13. Chairs of Excellence

The university had $26,608,803.56 on deposit at June 30, 2016, 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 14. 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 (RMF). 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 RMF. For property coverage, the deductible for an individual state agency is the first $25,000 of losses. The RMF is responsible for property losses for the annual aggregate deductible of $10 million for perils other than earthquake 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 RMF. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. 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, 2016, is presented in the *Tennessee Comprehensive Annual Financial Report* (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/article/fa-accfin-cafr. Since the university participates in the RMF, it is subject to the liability limitations established by statute. The maximum liability for general liability, automobile liability, and medical malpractice liability is $300,000 per person and $1,000,000 per occurrence. Claims are paid through the state's RMF. At June 30, 2016, the RMF held $142.9 million in cash designated for payment of claims.

At June 30, 2016, the scheduled coverage for the university was $852,166,780 for buildings and $175,543,000 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 costs 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 15. Commitments and Contingencies

Sick Leave

The university records the cost of sick leave when paid. The dollar amount of unused sick leave was $60,067,133.53 at June 30, 2016.

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 $571,355.79 for the year ended June 30, 2016. All operating leases are cancelable at the lessee's option.

Construction in Progress

At June 30, 2016, outstanding commitments under construction contracts totaled $115,358,838.66 for construction and renovation projects, of which $31,065,978.14 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 16. Natural Classification With Functional Classifications

The university's operating expenses for the year ended June 30, 2016, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 99,328,423.86	$32,583,442.64	$15,067,190.09	$ -	$ -	$146,979,056.59
Research	5,190,843.75	1,583,779.86	3,134,196.42	-	-	9,908,820.03
Public service	12,849,889.32	4,305,648.38	6,788,897.60	-	-	23,944,435.30
Academic support	17,302,439.47	6,599,483.38	4,725,817.16	-	-	28,627,740.01
Student services	12,281,981.35	5,126,370.77	7,897,248.79	-	-	25,305,600.91
Institutional support	12,140,847.18	4,376,644.78	2,310,244.51	-	-	18,827,736.47
Maintenance & operation	7,505,040.65	3,516,840.87	15,466,120.59	-	-	26,488,002.11
Scholarships & fellowships	-	-	-	23,408,204.90	-	23,408,204.90
Auxiliary	1,963,005.45	702,789.61	7,156,502.35	-	-	9,822,297.41
Depreciation	-	-	-	-	12,729,179.82	12,729,179.82
Total	$168,562,471.03	$58,795,000.29	$62,546,217.51	$23,408,204.90	$12,729,179.82	$326,041,073.55

Note 17. Affiliated Entity Not Included

The East Tennessee State University Research Foundation is a private, nonprofit foundation with the university as the sole beneficiary. The 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 foundation's most recently audited financial report, at June 30, 2016, the assets of the foundation totaled $946,091, liabilities were $38,011, and the net position amounted to $908,080.

Note 18. On-Behalf Payments

During the year ended June 30, 2016, the State of Tennessee made payments of $177,450.00 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 *Tennessee Comprehensive Annual Financial* Report (CAFR). That report is available on the state's website at www.tn.gov/finance/article/fa-accfin-cafr.

Note 19. Subsequent Event

The Focus on College and University Success (FOCUS) Act became effective July 1, 2016. This Act removes six universities, including East Tennessee State University, from the governance of the Tennessee Board of Regents. The universities will remain part of the State University and Community College System of Tennessee, but each will have its own local board that will provide governance, approve policies, set tuition and fee rates, and hire presidents. The Act also enhances the role of the Tennessee Higher Education Commission (THEC) by requiring THEC to provide greater coordination across the state, including capital project management, institutional mission approval, and higher education finance. During the period of transition (July 1, 2016, until the local boards are convened), the six universities will continue under the governance of the Tennessee Board of Regents. Each university will submit proposals to the Southern Association of Colleges and Schools Council on Colleges (SACSCOC) for substantive change of governance during fall 2016. The SACSCOC will meet during December 2016 to consider those proposals.

Note 20. Component Units

EAST TENNESSEE STATE UNIVERSITY FOUNDATION

The East Tennessee State University Foundation is a legally separate, tax-exempt organization supporting East Tennessee State University. The foundation acts primarily as a fund-raising organization to supplement the resources that are available to the university in support of its programs. The 30-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.

During the year ended June 30, 2016, the foundation made distributions of $2,672,626.53 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from Dr. David D. Collins, Vice President for Finance and Administration, P.O. Box 70601, Johnson City, TN 37614.

Cash and Cash Equivalents

In addition to demand deposits and petty cash on hand, this classification includes instruments that are readily convertible to known amounts of cash and that have original maturities of three months or less. At June 30, 2016, cash and cash equivalents consisted of $218,051.66 in bank accounts, $1,221,273.29 in the Local Government Investment Pool (LGIP) administered by the State Treasurer, and $1,031,352.82 in cash held by others.

The LGIP is part of the State Pooled Investment Fund. There are no minimum or maximum limitations on withdrawals with the exception of a 24-hour notification period for withdrawals of $5 million or more. 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.

Investments

In accordance with GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, as amended, investments are reported at fair value, including those with a maturity date of one year or less at the time of purchase, unless otherwise noted. All investments are valued at fair value except certificates of deposit, which are valued at cost, and insurance contracts, measured at cash surrender value. The foundation is authorized to invest funds in accordance with its board of directors' policies.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt investment. In order to reduce the exposure to interest rate risk, the foundation will set limits regarding the weighted average maturity for each direct investment pool. In the case of federal securities, the weighted average of all investments should be less than three years.

At June 30, 2016, the foundation had the following investments and maturities:

		Investment Maturities (in Years)			
Investment Type	Reported Value	Less than 1	1 to 5	6 to 10	More than 10
Corporate bonds	$ 3,209,442.60	$761,674.72	$2,447,767.88	$ -	$ -
Mutual bond funds	14,555,312.00	31,105.00	2,737,964.00	3,759,308.00	8,026,935.00
Total debt investments	$17,764,754.60	$792,779.72	$5,185,731.88	$3,759,308.00	$8,026,935.00
Non-Fixed Income Investments					
Mutual equity funds	66,542,452.84				
Real estate funds	81,043.39				
Certificates of deposit	2,521,357.00				
Cash surrender value of life insurance	349,685.78				
Real estate	69,900.00				
Total investments	$87,329,193.61				

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Securities are rated using Standard and Poor's, Moody's Investor Service, and/or Fitch Ratings and are presented below using the Standard and Poor's rating scale. The foundation's policy is to limit all direct investments to securities with an investment rating of no less than A as rated by Moody's and A as rated by Standard and Poor's.

At June 30, 2016, the foundation's investments were rated as follows:

		Credit Quality Rating				
Investment Type	Reported Value	AAA	AA	A	BBB or Less	Unrated
LGIP	$ 1,221,273.29	$ -	$ -	$ -	$ -	$1,221,273.29
Corporate bonds	3,209,442.60	-	-	211,823.22	1,585,464.64	1,412,154.74
Bond mutual funds	14,555,312.00	9,619,501.29	301,794.82	1,140,974.33	3,493,041.56	-
Total	$18,986,027.89	$9,619,501.29	$301,794.82	$1,352,797.55	$5,078,506.20	$2,633,428.03

Investments of the foundation's endowment and similar funds are composed of the following at June 30, 2016:

	Reported Value
Mutual funds	$65,095,477.67
Corporate bonds	3,209,442.60
Deposits held by others	13,650.87
Certificates of deposit	266,222.15
Land	69,900.00
Total	$68,654,693.29

Assets of endowments are pooled on a fair-value basis, with each individual fund subscribing to or disposing of units on the basis of the fair value per unit at the beginning of the calendar quarter within which the transaction takes place. Of the total units at March 31, 2016, each having a fair value of $.09926638089, 64,800,102.65 units were owned by endowments, and 127,422.78 units were owned by quasi-endowments.

The following tabulation summarizes changes in relationships between cost and fair values of the pooled assets for the year ended June 30, 2016:

	Pooled Assets			
	Fair Value	Cost	Net Gains (Losses)	Fair Value Per Unit
End of year	$86,979,507.83	$86,447,124.34	$ 532,383.49	$0.9926638089
Beginning of year	$90,452,238.40	$85,275,845.35	5,176,393.05	$1.1417575585
Unrealized net losses			(4,644,009.56)	
Realized net losses			(465,614.46)	
Total net losses			$(5,109,624.02)	

The average annual earnings per unit, exclusive of net gains (losses), were $0.029 for the year ended June 30, 2016.

Fair Value Measurement

The foundation categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. The foundation has the following recurring fair value measurements as of June 30, 2016:

	June 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments Measured at the Net Asset Value (NAV)
Assets by Fair Value Level					
Debt securities					
Corporate bonds	$ 3,209,442.60	$ 3,209,442.60	$ -	$ -	$ -
Mutual bond funds	14,555,312.00	14,555,312.00	-	-	-
Total debt securities	17,764,754.60	17,764,754.60	-	-	-
Equity securities					
Mutual equity funds	66,542,452.84	58,818,976.30	-	-	7,723,476.54
Total equity securities	66,542,452.84	58,818,976.30	-	-	7,723,476.54
Other assets					
Real estate funds	81,043.39	-	-	-	81,043.39
Real estate	69,900.00	-	-	69,900.00	-
Total other assets	150,943.39	-	-	69,900.00	81,043.39
Total assets at fair value	**$84,458,150.83**	**$76,583,730.90**	**$ -**	**$69,900.00**	**$7,804,519.93**

Assets classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Assets classified in Level 3 are valued using realtor market analysis.

Required disclosures for assets measured at the net asset value per share are shown below.

Commingled equity funds are considered to be commingled in nature. Each is valued at the net asset value of units held at the end of the period based on the fair value of the underlying investments. Real estate funds measured at NAV are in the liquidation stage and expect to be fully liquidated in fiscal year 2017 at their net asset value.

	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Assets Measured at the NAV				
Commingled equity funds:				
Vontobel Asset Management, Inc.	$2,699,123.54	-	Monthly	15 days
Copper Rock Capital Partners, LLC	$2,531,769.00	-	Monthly	10 days
Thompson, Siegal, & Walmsley, LLC	$2,492,584.00	-	Monthly	30 days
Real estate funds	$81,043.39	-	Daily	None

Pledges Receivable

Pledges receivable at June 30, 2016, are summarized below, net of the allowance for doubtful accounts:

Current pledges	$ 936,216.66
Pledges due in one to five years	3,080,698.72
Pledges due after five years	870,220.00
Subtotal	4,887,135.38
Less discount to net present value	267,246.87
Total pledges receivable, net	$4,619,888.51

Capital Assets

Capital asset activity for the year ended June 30, 2016, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Buildings	$59,000.00	$ -	$ -	$ -	$59,000.00
Equipment	9,486.00	-	-	-	9,486.00
Other assets	-	12,000.00	-	-	12,000.00
Total	68,486.00	12,000.00	-	-	80,486.00
Less accumulated depreciation:					
Buildings	59,000.00	-	-	-	59,000.00
Total	59,000.00	-	-	-	59,000.00
Capital assets, net	$ 9,486.00	$12,000.00	$ -	$ -	$21,486.00

Endowments

The ETSU Foundation's endowment consists of 527 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the board of directors to function as endowments. As required by GAAP, net position associated with endowment funds, including funds designated by the board of directors to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of relevant law – The Board of Directors of the ETSU Foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (the Act) as adopted by Tennessee as requiring preservation of the historical dollar value of the original gift. As a result of this interpretation, the ETSU Foundation classifies as nonexpendable restricted net position (a) the original value of gifts donated to the nonexpendable endowment, (b) the original value of subsequent gifts to the nonexpendable endowment, and (c) accumulations to the nonexpendable endowment made in accordance with the direction of the applicable donor gift instrument at the time the accumulation is added to the fund. The remaining portion of the donor-restricted endowment fund that is not classified in nonexpendable restricted net position is classified as expendable restricted net position until those amounts are appropriated for expenditure by the foundation 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.

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 donor-specified periods, as well as board-designated funds. Under this policy, as approved by the board of directors, the endowment assets are invested in a manner that is intended to produce results that, over the long term, will achieve a total return equivalent to or greater than the foundation’s financial requirements over the time horizon. The foundation expects its endowment funds, over time, to provide an average rate of return of approximately 7% annually. Actual returns in any given year may vary from this amount.

Strategies employed for achieving objectives – To satisfy its long-term rate-of-return objectives, the foundation relies on a total return strategy in which investment returns are achieved through both capital appreciation (realized and unrealized) and current yield (interest and dividends). The foundation targets a diversified asset allocation that places a greater emphasis on equity-based investments to achieve its long-term return objectives within prudent risk restraints.

Spending policy and how the investment objectives relate – The foundation has a policy of appropriating for distribution each year 3% to 5% of the average quarterly balance for the three preceding calendar years, depending on the amount of reserve for each endowment. In establishing this policy, the foundation considered the long-term expected return on its endowment. Accordingly, over the long term, the foundation expects the current spending policy to allow its endowment to grow at an average of 4% annually. 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.

At June 30, 2016, net appreciation of $12,944,937.22 is available to be spent, of which $5,588,855.71 is included in restricted net position expendable for scholarships and fellowships, $84,234.68 is included in restricted net position expendable for research, $704,851.95 is included in restricted net position expendable for instructional departmental uses, and $6,566,994.88 is included in restricted net position expendable for other purposes.

Prior-period Restatement

In prior years, land received as an endowment gift was included in capital assets on the statement of net position. During audit review, it was determined that the land should be included in investments and restricted nonexpendable net position – other. In addition, the cash surrender value of life insurance was classified as other assets instead of investments. As a result of these errors, the statement of net position was restated to reflect these corrections at June 30, 2015:

	As Previously Stated	As Restated	Effect of Correction
Assets			
Noncurrent assets:			
Other assets	$ 321,411.00	$ -	$(321,411.00)
Investments	90,452,238.40	90,970,229.40	517,991.00
Capital assets (net)	206,066.00	9,486.00	(196,580.00)
Net position			
Net investment in capital assets	206,066.00	9,486.00	(196,580.00)
Restricted for nonexpendable:			
Other	4,922,540.31	5,119,120.31	196,580.00

MEDICAL EDUCATION ASSISTANCE CORPORATION

The Medical Education Assistance Corporation (MEAC) is a legally separate, tax-exempt organization supporting East Tennessee State University. MEAC acts primarily as a physicians' practice group to supplement the resources that are available to the university in support of its medical education programs. The 15-member board of MEAC is self-perpetuating and consists of the department chairs from Quillen College of Medicine, a representative from East Tennessee State University's Office of the President, a representative from the Tennessee Board of Regents, and at-large faculty from the Quillen College of Medicine. Although the university does not control the timing or amount of receipts from MEAC, the residual income that MEAC earns is restricted to supporting medical education. Because these restricted resources held by MEAC can only be used by, or for the benefit of, the university, MEAC is considered a component unit of the university and is discretely presented in the university's financial statements.

During the year ended June 30, 2016, MEAC made distributions of $2,541,139 to or on behalf of ETSU or the ETSU Foundation for both restricted and unrestricted purposes. Complete financial statements for MEAC can be obtained from Russell Lewis, Executive Director, P.O. Box 699, Mountain Home, TN 37684.

Cash

At June 30, 2016, cash consisted of $6,894,780 in bank accounts, $2,300 of petty cash on hand, and $85,079 in the Local Government Investment Pool (LGIP) administered by the State Treasurer.

The LGIP is part of the State Pooled Investment Fund. There are no minimum or maximum limitations on withdrawals with the exception of a 24-hour notification period for withdrawals of $5 million or more. 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.

Investments

In accordance with GASB Statement 31, *Accounting and Financial Reporting for Certain Investments and External Investment Pools*, as amended, investments are reported at fair value, including those with a maturity date of one year or less at the time of purchase, unless otherwise noted. The corporation is authorized to invest funds in accordance with its board of directors' policies. The corporation's investments at June 30, 2016, consisted of $6,405,419 of certificates of deposit reported at cost and $5,002,000 of U.S. agency obligations reported at fair value. The certificates of deposit and U.S. agency obligations had original maturities greater than three months.

Interest Rate Risk – Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt investment. MEAC 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.

At June 30, 2016, MEAC had the following debt investments and maturities:

		Investment Maturities (In Years)	
Investment Type	Fair Value	Less than 1	1 to 5
U.S. agency obligations	$5,002,000	$1,000,000	$4,002,000
Total debt investments	$5,002,000	$1,000,000	$4,002,000

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Securities are rated using the Standard and Poor's rating scale. MEAC has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations.

At June 30, 2016, the corporation's investments were rated as follows:

Investment Type	Balance	Credit Quality Rating AA	Credit Quality Rating Unrated
LGIP	$ 85,079	$ -	$85,079
U.S. agency obligations	5,002,000	5,002,000	-

Concentration of Credit Risk - Concentration of credit risk is the risk of loss attributed to the magnitude of the corporation's investment in a single issuer. The corporation places no limit on the amount it may invest in any one issuer.

At June 30, 2016, more than 5% of the corporation's investments were invested in the following single issuers:

Issuer	Percentage of Total Investments
Federal Home Loan Bank (FHLB) obligations	17%
Federal Home Loan Mortgage Corporation (FHLMC) obligations	9%
Federal National Mortgage Association (FNMA) obligations	9%
Federal Farm Credit Bank (FFCB) obligations	9%

Fair Value Measurement

MEAC categorizes its fair value measurements within the fair value hierarchy established by accounting principles generally accepted in the United States of America. MEAC has the following recurring fair value measurements as of June 30, 2016:

	June 30, 2016	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Investments Measured at the Net Asset Value (NAV)
Assets by Fair Value Level					
Debt securities					
U.S. agency obligations	$5,002,000	$ -	$5,002,000	$ -	$ -
Total debt securities	$5,002,000	$ -	$5,002,000	$ -	$ -

Assets classified in Level 2 of the fair value hierarchy are valued using the spread above risk-free yield curve. As the yields for the risk-free yield curve and the spreads for these securities are observable market inputs, the fair values of U.S. government agency debt securities are included in the Level 2 hierarchy. Valuations are obtained from a third-party pricing service for investment securities.

Receivables

Receivables at June 30, 2016, included the following:

Patient accounts receivable, net	$3,004,338
Other receivables	1,925,539
Total	$4,929,877

Capital Assets

Capital asset activity for the year ended June 30, 2016, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance
Land	$ 18,150	$ -	$ -	$ 18,150
Buildings	4,902,488	67,010	-	4,969,498
Leasehold improvements	710,078	53,288	-	763,366
Equipment	4,366,653	47,741	59,830	4,354,564
Total	9,997,369	168,039	59,830	10,105,578
Less accumulated depreciation:				
Buildings	1,033,195	154,819	-	1,188,014
Leasehold improvements	565,048	76,462	-	641,510
Equipment	3,902,420	230,409	59,830	4,072,999
Total	5,500,663	461,690	59,830	5,902,523
Capital assets, net	$4,496,706	($293,651)	$ -	$4,203,055

Long-term Liabilities

Long-term liabilities activity for the year ended June 30, 2016, was as follows:

	Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Compensated absences	$847,638	$49,012	$ -	$896,650	$179,330
Total long-term liabilities	$847,638	$49,012	$ -	$896,650	$179,330

Capital Lease Between MEAC and the University

In 2008, MEAC entered into an agreement to lease a clinical education building from the university for 30 years at a rate equivalent to the cost of construction of the building, which was $2,942,255. The entire lease obligation was paid in 2009 upon the completion of construction. The agreement is currently being treated as a capital lease. Because there is no remaining obligation, no capital lease obligation has been reported by MEAC, and no capital lease receivable has been reported by the university.

Tennessee Board of Regents

EAST TENNESSEE STATE UNIVERSITY

Required Supplementary Information

Schedule of East Tennessee State University's Proportionate Share of the Net Pension Liability

Closed State and Higher Education Employee Pension Plan Within TCRS

	2016	2015
University's proportion of the net pension liability	2.069473%	2.041149%
University's proportionate share of the net pension liability	$26,681,350	$14,082,883
University's covered payroll	$54,038,562	$55,762,565
University's proportionate share of the net pension liability as a percentage of its covered payroll	49.37%	25.26%
Plan fiduciary net position as a percentage of the total pension liability	91.26%	95.11%

1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.

2) This is a ten-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until ten years of information are available.

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Required Supplementary Information
Schedule of East Tennessee State University's Proportionate Share of the Net Pension Asset
State and Higher Education Employee Retirement Plan Within TCRS

	2016
University's proportion of the net pension asset	2.184792%
University's proportionate share of the net pension asset	$60,758
University's covered payroll	$2,379,157
University's proportionate share of the net pension asset as a percentage of its covered payroll	2.55%
Plan fiduciary net position as a percentage of the total pension asset	142.55%

1) To correspond with the measurement date, the amounts presented were determined as of June 30 of the prior fiscal year.

2) This is a ten-year schedule; however, the information in this schedule is not required to be presented retroactively. Years will be added to this schedule in future years until ten years of information are available.

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Required Supplementary Information
Schedule of East Tennessee State University's Contributions
Closed State and Higher Education Employee Pension Plan Within TCRS

	Contractually Determined Contributions	Contributions in Relation to Contractually Determined Contribution	Contribution Deficiency (Excess)	Covered Payroll	Contributions as a Percentage of Covered Payroll
2016	$7,784,757	$7,784,757	$ -	$51,794,799	15.03%
2015	8,121,767	8,121,767	-	54,038,562	15.03%
2014	8,381,113	8,381,113	-	55,762,565	15.03%
2013	8,044,873	8,044,873	-	53,525,437	15.03%
2012	7,674,153	7,674,153	-	51,469,841	14.91%
2011	7,186,331	7,186,331	-	48,198,060	14.91%
2010	6,074,138	6,074,138	-	46,652,366	13.02%
2009	6,187,233	6,187,233	-	47,520,989	13.02%
2008	6,372,126	6,372,126	-	46,785,067	13.62%
2007	6,057,797	6,057,797	-	44,477,214	13.62%

Tennessee Board of Regents

EAST TENNESSEE STATE UNIVERSITY

Required Supplementary Information

Schedule of East Tennessee State University's Contributions

State and Higher Education Employee Retirement Plan Within TCRS

	2016	2015
Contractually determined contribution	$ 244,997	$ 92,133
Contributions in relation to the contractually determined contribution	244,997	92,133
Contribution deficiency (excess)	$ -	$ -
Covered payroll	$6,330,672	$2,379,157
Contributions as a percentage of covered payroll	3.87%	3.87%

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

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Required Supplementary Information
Other Postemployment Benefits Schedule of Funding Progress

Actuarial Valuation Date	Plan	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll [(b-a)/c)]
July 1, 2015	State Employee Group Plan	$ -	$23,133,000	$23,133,000	0%	$113,801,679	20.33%
July 1, 2013	State Employee Group Plan	$ -	$22,189,000	$22,189,000	0%	$108,619,569	20.43%
July 1, 2011	State Employee Group Plan	$ -	$28,137,000	$28,137,000	0%	$100,388,162	28.03%

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

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Supplementary Schedule of Cash Flows - East Tennessee State University Foundation
For the Year Ended June 30, 2016

Cash flows from operating activities	
Gifts and contributions	$ 4,205,006.56
Payments to suppliers and vendors	(2,938,773.09)
Payments for scholarships and fellowships	(1,776,588.51)
Payments to or on behalf of ETSU	(2,672,626.53)
Other receipts (payments)	1,512,138.07
Net cash used by operating activities	(1,670,843.50)
Cash flows from noncapital financing activities	
Private gifts for endowment purposes	1,463,818.29
Net cash provided by noncapital financing activities	1,463,818.29
Cash flows from investing activities	
Proceeds from sales and maturities of investments	22,800,004.04
Income on investments	2,038,392.52
Purchases of investments	(23,829,154.29)
Net cash provided by investing activities	1,009,242.27
Net increase in cash and cash equivalents	802,217.06
Cash and cash equivalents - beginning of year	1,668,460.71
Cash and cash equivalents - end of year	$ 2,470,677.77
Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	$ (2,575,109.28)
Adjustments to reconcile operating loss to net cash used by operating activities:	
Change in assets and liabilities:	
Receivables	720,402.44
Accounts payable	183,863.34
Net cash used by operating activities	$ (1,670,843.50)
Noncash investing, capital, or financing transactions	
Gifts of capital assets	$ 12,000.00
Unrealized losses on investments	$ (4,644,009.56)

Tennessee Board of Regents
EAST TENNESSEE STATE UNIVERSITY
Supplementary Schedule of Cash Flows - Medical Education Assistance Corporation
For the Year Ended June 30, 2016

Cash flows from operating activities	
Collections from patient charges	$ 41,629,856.00
Payments to employees	(27,775,937.00)
Payments for benefits	(2,450,961.00)
Payments to suppliers and vendors	(9,113,550.00)
Other receipts (payments)	744,507.00
Net cash provided by operating activities	3,033,915.00
Cash flows from noncapital financing activities	
Payments to or on behalf of ETSU or ETSU Foundation	(2,541,139.00)
Net cash used by noncapital financing activities	(2,541,139.00)
Cash flows from capital and related financing activities	
Purchases of capital assets and construction	(168,039.00)
Net cash used by capital and related financing activities	(168,039.00)
Cash flows from investing activities	
Proceeds from sales and maturities of investments	6,265,000.00
Income on investments	81,632.00
Purchases of investments	(8,295,304.00)
Other investing receipts (payments)	300.00
Net cash used by investing activities	(1,948,372.00)
Net decrease in cash	(1,623,635.00)
Cash - beginning of year	8,605,794.00
Cash - end of year	$ 6,982,159.00

Reconciliation of operating gain to net cash provided by operating activities:	
Operating gain	$ 3,438,015.00
Adjustments to reconcile operating gain to net cash provided by operating activities:	
Depreciation expense	461,690.00
Changes in assets and liabilities:	
Receivables	(945,384.00)
Prepaid expenses	(61,719.00)
Accounts payable	(92,835.00)
Accrued liabilities	293,177.00
Due to the university	(26,744.00)
Compensated absences	49,012.00
Deposits held in custody for others	9,268.00
Other liabilities	(90,565.00)
Net cash provided by operating activities	$ 3,033,915.00

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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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 David Gregory, Acting Chancellor
Dr. Brian Noland, President

We have audited the financial statements of East Tennessee State University, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component units as of and for the year ended June 30, 2016, 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 16, 2016. 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 East Tennessee State University Foundation and the Medical Education Assistance Corporation, as described in our report on East Tennessee State 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. Given these limitations, during our audit we did not identify any deficiencies that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

Compliance and Other Matters

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

Purpose of This Report

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

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 16, 2016