



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY**



**ENDOWMENT FOR EDUCATIONAL EXCELLENCE
TENNESSEE STATE UNIVERSITY FOUNDATION**

Financial and Compliance Audit Report

For the Year Ended June 30, 2017

Justin P. Wilson, Comptroller



Division of State Audit

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JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

January 16, 2019

The Honorable Bill Haslam, Governor
Members of the General Assembly
Dr. Glenda Baskin Glover, President

Ladies and Gentlemen:

Transmitted herewith is the report on the Endowment for Educational Excellence at the Tennessee State University Foundation for the year ended June 30, 2017. You will note from the independent auditor's report that an unmodified opinion was given on the fairness of the presentation of the financial statements.

Consideration of the internal control over financial reporting and tests of compliance disclosed a certain deficiency, which is detailed in the Finding and Recommendation section of this report. The foundation's management has responded to the audit finding; the response is included following the finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit finding.

Sincerely,

A handwritten signature in black ink that reads "Deborah V. Loveless".

Deborah V. Loveless, CPA, Director
Division of State Audit

18/088

Audit Report
Endowment for Educational Excellence
Tennessee State University Foundation
For the Year Ended June 30, 2017

TABLE OF CONTENTS

	<u>Page</u>
Audit Highlights	1
Financial Section	
Independent Auditor's Report	2
Management's Discussion and Analysis	5
Basic Financial Statements	
Statement of Net Position	10
Statement of Revenues, Expenses, and Changes in Net Position	11
Statement of Cash Flows	12
Notes to the Financial Statements	13
Internal Control, Compliance, and Other Matters	
Independent Auditor's Report on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With Generally Accepted Auditing Standards	19
Finding and Recommendation	
Finding - As noted in the prior audit, management needs to improve procedures for preparing and reviewing financial statements and the accompanying notes	21
Observation and Comment	
Background Information on the Endowment for Educational Excellence	24

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Financial and Compliance Audit

Endowment for Educational Excellence

Tennessee State University Foundation

For the Year Ended June 30, 2017

Opinion on the Financial Statements

The opinion on the financial statements is unmodified.

Audit Finding

As noted in the prior audit, management needs to improve procedures for preparing and reviewing financial statements and the accompanying notes.

We noted numerous errors in the trust's financial statements and accompanying notes (page 21).



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Chief of Staff

Independent Auditor's Report

The Honorable Bill Haslam, Governor
Members of the General Assembly
Dr. Glenda Baskin Glover, President

Report on the Financial Statements

We have audited the accompanying financial statements of the Endowment for Educational Excellence at the Tennessee State University Foundation as of and for the year ended June 30, 2017, 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 an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

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

and the 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 opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the respective financial position of the Endowment for Educational Excellence at the Tennessee State University Foundation as of June 30, 2017, and the respective 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.

Emphasis of Matters

As discussed in Note 1, the financial statements of the Endowment for Educational Excellence are intended to present the financial position, the changes in financial position, and the cash flows of only that portion of the Tennessee State University Foundation's activity that is attributable to the transactions of the Endowment for Educational Excellence. They do not purport to, and do not, present fairly the financial position of the Tennessee State University Foundation, as of June 30, 2017, 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 4, the financial statements of the Endowment for Educational Excellence at the Tennessee State University Foundation include investments valued at \$6,418,154.60 (13.7% of net position of the trust), whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 5 through 9 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 16, 2018, on our consideration of the foundation'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 foundation's internal control over financial reporting and compliance.

A handwritten signature in black ink that reads "Deborah V. Loveless". The signature is written in a cursive style with a large, stylized 'D' and 'L'.

Deborah V. Loveless, CPA, Director
Division of State Audit
October 16, 2018

ENDOWMENT FOR EDUCATIONAL EXCELLENCE

Tennessee State University Foundation

Management's Discussion and Analysis

Introduction

This section of Tennessee State University Endowment for Educational Excellence trust's annual financial report presents a discussion and analysis of the financial performance of the trust during the fiscal year ended June 30, 2017, with comparative information presented for the fiscal year ended June 30, 2016. This discussion has been prepared by management along with the financial statements and related note disclosures and should be read in conjunction with the independent auditor's report, the audited financial statements, and the accompanying notes. The financial statements, notes, and this discussion are the responsibility of management.

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 trust as a whole. The full scope of the trust'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 trust'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 trust at the end of the fiscal year. To aid the reader in determining the trust's ability to meet immediate and future obligations, the statement includes all assets, liabilities, and net position of the trust 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 trust. They are also able to determine how much the trust owes vendors, lenders, and others. Net position represents the difference between the trust's assets and liabilities, and is one indicator of the trust's current financial condition.

The statement of net position also indicates the availability of net position for expenditure by the trust. Net position is reported as 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 trust 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 following table summarizes the trust's assets, liabilities, and net position at June 30, 2017, and June 30, 2016.

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

	<u>2017</u>	<u>2016</u>
Assets:		
Current assets	\$ 524	\$ 1,234
Noncurrent assets	46,234	41,092
Total assets	46,758	42,326
Net Position:		
Restricted – nonexpendable	45,826	40,464
Restricted – expendable	932	1,862
Total net position	\$46,758	\$42,326

Comparison of Fiscal Year 2017 to Fiscal Year 2016

- Nonexpendable net position increased due to the growth in the investment market, and expendable net position decreased due to the need for scholarship funding.

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 trust's financial condition has improved or deteriorated during the fiscal year. The statement presents the revenues received by the trust, both operating and nonoperating; the expenses paid by the trust, operating and nonoperating; and any other revenues, expenses, gains, or losses received or spent by the trust.

Generally speaking, operating expenses are those expenses paid to acquire or produce the goods and services to carry out the mission of the trust. Nonoperating revenues are revenues received for which goods and services are not provided directly to the payor. Although the trust is dependent upon 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 trust 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.

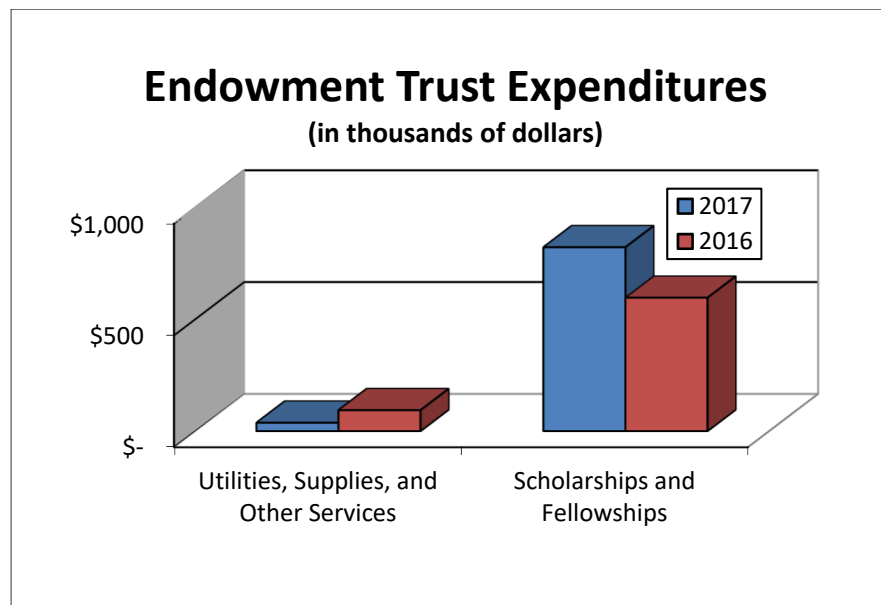
A summary of the trust’s revenues, expenses, and changes in net position for the year ended June 30, 2017, and June 30, 2016, follows.

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

	<u>2017</u>	<u>2016</u>
Operating expenses	\$ 860	\$ 691
Operating loss	(860)	(691)
Nonoperating revenues (expenses)	5,292	(1,975)
Increase (decrease) in net position	4,432	(2,666)
Net position at beginning of year	42,326	44,992
Net position at end of year	\$46,758	\$42,326

Operating Expenses

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

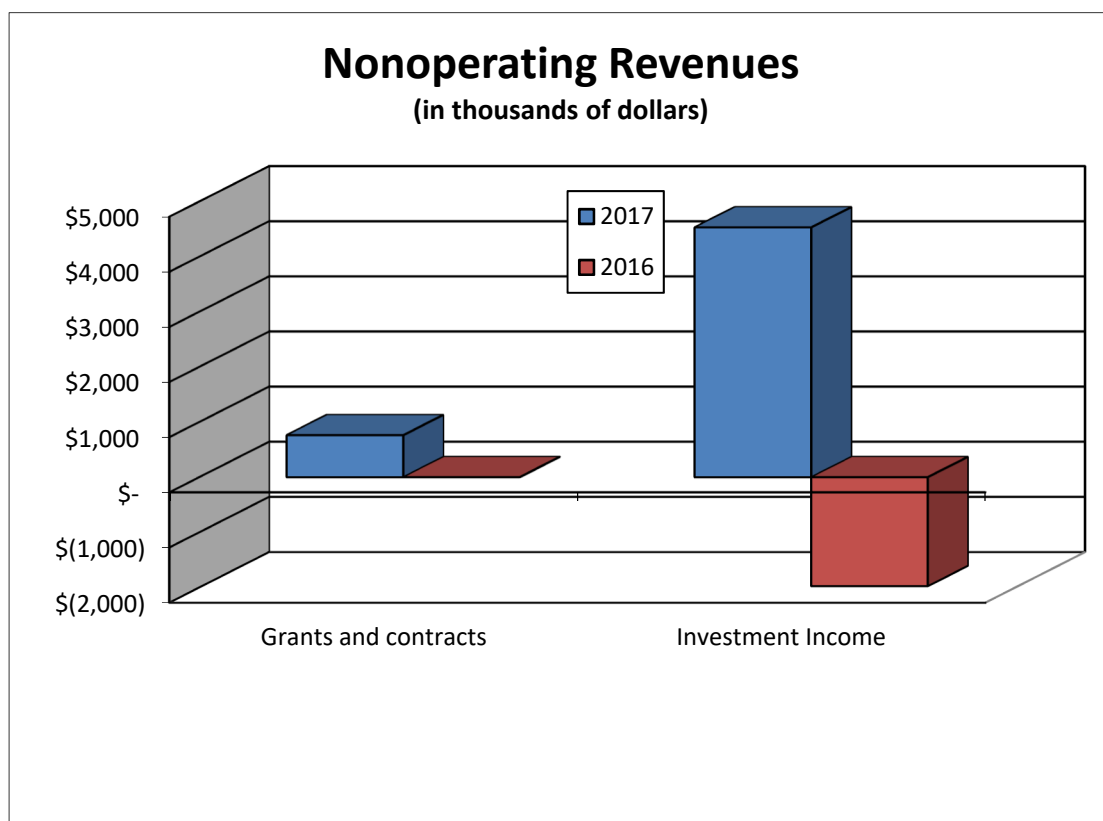


Comparison of Fiscal Year 2017 to Fiscal Year 2016

- Scholarships and fellowships were able to increase in fiscal year 2017 due to an increase in grants received from the federal government. Therefore, additional income was set aside for scholarships.

Nonoperating Revenues and Expenses

Certain revenue sources that the trust relies on to provide funding for operations, including certain grants, contracts, and investment income, are defined by the GASB as nonoperating. The trust had no nonoperating expenses in the last two fiscal years. The following summarizes the trust's nonoperating revenues for the last two fiscal years:



Comparison of Fiscal Year 2017 to Fiscal Year 2016

- Title III federal grant payments were received in fiscal year 2017 that were not received in 2016.
- Investment income increased due to negative market fluctuations in fiscal year 2016, while large increases in the market occurred during 2017.

Economic Factors That Will Affect the Future

The trust is not aware of any factors that will have a significant effect on the financial position or results of operations.

ENDOWMENT FOR EDUCATIONAL EXCELLENCE
Tennessee State University Foundation
Statement of Net Position
June 30, 2017

Assets

Current assets:

Cash and cash equivalents (Notes 2 and 3)	\$ 524,330.14
Total current assets	524,330.14

Noncurrent assets:

Cash and cash equivalents (Notes 2 and 3)	652,364.36
Investments (Notes 4 and 5)	45,581,360.43
Total noncurrent assets	46,233,724.79
Total assets	46,758,054.93

Net position

Restricted for:

Nonexpendable	45,825,964.60
Expendable	932,090.33
Total net position	\$ 46,758,054.93

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

ENDOWMENT FOR EDUCATIONAL EXCELLENCE
Tennessee State University Foundation
Statement of Revenues, Expenses, and Changes in Net Position
For the Year Ended June 30, 2017

Expenses

Utilities, supplies, and other services	\$ 37,500.00
Scholarships and fellowships	822,750.99
Total operating expenses	860,250.99

Operating loss	(860,250.99)
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Nonoperating revenues

Grants and contracts	760,983.56
Investment income (net of investment expense of \$196,670.38)	4,530,748.88
Total nonoperating revenues	5,291,732.44

Increase in net position	4,431,481.45
Net position - beginning of year	42,326,573.48
Net position - end of year	\$ 46,758,054.93

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

ENDOWMENT FOR EDUCATIONAL EXCELLENCE
Tennessee State University Foundation
Statement of Cash Flows
For the Year Ended June 30, 2017

Cash flows from operating activities	
Payments to suppliers and vendors	\$ (37,500.00)
Payments for scholarships and fellowships	(822,750.99)
Net cash used for operating activities	(860,250.99)
Cash flows from noncapital financial activities	
Gifts and grants received for other than capital or endowment purposes	760,983.56
Net cash provided for operating activities	760,983.56
Cash flows from investing activities	
Proceeds from sales and maturities of investments	1,850,000.00
Income on investments	665,715.58
Purchases of investments	(4,354,107.35)
Net cash used by investing activities	(1,838,391.77)
Net decrease in cash and cash equivalents	(1,937,659.20)
Cash and cash equivalents - beginning of year	3,114,353.70
Cash and cash equivalents - end of year	\$ 1,176,694.50
Reconciliation of operating loss to net cash used by operating activities:	
Operating loss	\$ (860,250.99)
Net cash used by operating activities	\$ (860,250.99)
Noncash investing, capital, or financing transactions	
Unrealized gains on investments	\$ 3,684,728.63

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

ENDOWMENT FOR EDUCATIONAL EXCELLENCE
Tennessee State University Foundation
Notes to the Financial Statements
June 30, 2017

Note 1. Summary of Significant Accounting Policies

Reporting Entity

Pursuant to the consent decree entered into on January 5, 2001, in settlement of the *Geier v. Sundquist* lawsuit, the Tennessee State University Foundation Endowment for Educational Excellence trust was established. This trust was created by the Tennessee Board of Regents and is operated exclusively for the educational purposes of Tennessee State University. The Tennessee State University Foundation is the trustee of these funds and, in accordance with the trust agreement, delegates actual management of the trust assets to professional investment managers.

The Tennessee State University Foundation is a legally separate, tax-exempt organization supporting 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 19-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. The size of the board shall be determined by the majority votes of its members; any vacancy in its membership shall be filled in the same way. The entire membership of the board of trustees shall not exceed 25 in number and shall have a minimum of 8. All trustees shall serve until the expiration of their respective terms and until their respective successors are selected and qualified. 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 is 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.

These financial statements present only that portion of the Tennessee State University Foundation's activities that is attributable to the transactions of the Endowment for Educational Excellence.

Basis of Presentation

The financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board (GASB).

Basis of Accounting

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

Notes to the Financial Statements (Continued)

similar items are recognized as revenue as soon as all of the provider's eligibility requirements have been met.

The trust 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 expenses include (1) utilities, supplies, and other services and (2) scholarships and fellowships.

All other activity is nonoperating in nature and includes (1) federal grant funds from the U.S. Department of Education, under the Title III Strengthening Historically Black Colleges and Universities Program; (2) investment income; and (3) gifts.

Cash Equivalents

This classification includes instruments that are readily convertible to known amounts of cash and have original maturities of three months or less.

Net Position

The Endowment for Educational Excellence's net position is classified as follows:

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 trust is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties. The trust agreement does provide for spending a portion of the income, as discussed in Note 6. Spending decisions are to be made by the budget committee established in the trust agreement through the preparation of an annual budget.

Note 2. Cash and Cash Equivalents

In addition to demand deposits, 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, 2017, cash and cash equivalents consisted of \$524,330.14 in bank accounts and \$652,364.36 in money market accounts.

Notes to the Financial Statements (Continued)

Note 3. Deposits

The trust's cash is held in the bank accounts of the Tennessee State University Foundation. At June 30, 2017, \$6,007,425.87 of the foundation's bank balance of \$6,781,584.01 in accounts related to the trust was uninsured and uncollateralized. The bank balance includes \$1,200,737.08 of the trust's cash.

Note 4. Investments

The trust is authorized to invest funds in accordance with its policies. 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 trust 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, 2017, the trust had the following debt investments and maturities:

Investment Type	Fair Value	Investment Maturities (in Years)				No Maturity Date
		Less Than 1	1 to 5	6 to 10		
U.S. Treasury	\$ 3,181,711.41	\$941,339.58	\$1,808,918.69	\$ 431,453.14	\$	-
Collateralized mortgage obligations	479,254.01	-	479,254.01	-		-
Corporate bonds	3,262,374.30	638,199.39	1,600,064.61	1,024,110.30		-
Foreign bond funds	350,095.50	-	301,307.93	48,787.57		-
Mutual bond funds	4,244,040.78	-	-	-		4,244,040.78
Total debt investments	\$11,517,476.00	\$1,579,538.97	\$4,189,545.24	\$1,504,351.01		\$4,244,040.78

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The foundation is authorized to invest funds in accordance with the trust agreement. Under the trust agreement, the foundation is authorized to invest and reinvest the property of the trust in any kind of investment specifically including, but not limited to, domestic or foreign government obligations of any kind; domestic or foreign securities, bonds, mortgage participants and shares of investment trusts, investment companies, money market funds, and mutual funds (including market or index funds); options to purchase or sell domestic or foreign securities or domestic or foreign government obligations of any kind; and interest in partnerships, so long as such investments are made with the care of a fiduciary. Securities are rated using Standard and

Notes to the Financial Statements (Continued)

Poor's, Moody's Investors Service, and/or Fitch Ratings and are presented below using the Standard and Poor's rating scale. The trust has no investment policy limiting its investment choices based on ratings issued by nationally recognized statistical rating organizations.

At June 30, 2017, the trust's investments were rated as follows:

Investment Type	Balance	Credit Quality Rating				
		AAA	AA	A	BBB	Unrated
Collateralized mortgage obligations	\$ 479,254.01	\$ -	\$ 479,254.01	\$ -	\$ -	\$ -
Corporate bonds	3,262,374.30	100,272.34	330,227.13	1,483,271.28	1,348,603.55	-
Foreign bonds	350,095.50	350,095.50	-	-	-	-
Mutual bond funds	4,244,040.78	-	-	-	-	4,244,040.78
Total	\$8,335,764.59	\$450,367.84	\$809,481.14	\$1,483,271.28	\$1,348,603.55	\$4,244,040.78

Alternative Investments

The trust had investments in hedge funds and Real Estate Investment Trusts (REITs). The estimated fair value of these assets was \$6,418,154.60 at June 30, 2017. The largest portion is invested in hedge funds. The estimated fair value of these assets was \$4,817,450.74.

The trust believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2017. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the trust's investment policy. These investments are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated using various valuation techniques.

Hedge Fund Managers (Strategic) Ltd.

The fund was purchased for the purpose of diversifying the investment portfolio against volatility in the market. The fund was valued at \$4,817,450.74 as of June 30, 2017. The estimated value may not reflect the actual market value for these shares on any given date.

InvenTrust Properties

The value of shares for InvenTrust Properties is estimated to be \$3.29 per share (ignoring purchase price discounts for certain categories of purchasers). The estimated value may not reflect the actual market value for these shares on any given date. The fund was valued at \$612,897.26 as of June 30, 2017.

Notes to the Financial Statements (Continued)

TIER REIT, Inc.

The value of shares for Tier REIT, Inc. is estimated to be the offering of \$18.48 per share (ignoring purchase price discounts for certain categories of purchasers). The estimated value may not reflect the actual market value for these shares on any given date. The fund was valued at \$441,045.18 as of June 30, 2017.

Highlands REIT, Inc.

The value of shares for Highland REIT, Inc. is estimated to be \$0.35 per share (ignoring purchase price discounts for certain categories of purchasers). The estimated value may not reflect the actual market value for these shares on any given date. The fund was valued at \$70,268.48 as of June 30, 2017.

Xenia Hotels and Resorts, Inc.

The value of shares held for Xenia Hotels and Resorts, Inc. (Ticker XHR) is \$19.37 per share as sold on the New York Stock Exchange as of June 30, 2017. The fund was valued at \$476,492.94 as of June 30, 2017.

Note 5. Fair Value Measurement

The trust categorizes its fair value measurements within the fair value hierarchy established by generally accepted accounting principles. The trust has the following recurring fair value measurements as of June 30, 2017:

	<u>June 30, 2017</u>	Quoted Prices in Active Markets for Identical Assets (<u>Level 1</u>)	Significant Other Observable Inputs (<u>Level 2</u>)	Significant Unobservable Inputs <u>Level 3</u>	Investments Measured at the Net Asset Value (<u>NAV</u>)
Assets by Fair Value Level					
Debt securities					
U.S. Treasuries	\$ 3,181,711.41	\$ 3,181,711.41	\$ -	\$ -	\$ -
Corporate bonds	3,262,374.30	-	3,262,374.30	-	-
Mutual bond funds	4,244,040.78	4,244,040.78	-	-	-
Collateralized mortgage obligations					
	479,254.01	-	479,254.01	-	-
Foreign bonds	350,095.50	350,095.50	-	-	-
Total debt securities	11,517,476.00	7,775,847.69	3,741,628.31	-	-
Equity securities					
Mutual equity funds					
	27,645,729.83	27,645,729.83	-	-	-
Equity REITs	1,600,703.86	-	1,600,703.86	-	-

Notes to the Financial Statements (Continued)

Hedge funds	4,817,450.74	-	-	-	4,817,450.74
Total equity securities	34,063,884.43	27,645,729.83	1,600,703.86	-	4,817,450.74
Total assets at fair value	\$45,581,360.43	\$35,421,577.52	\$5,342,332.17	\$ -	\$4,817,450.74

Assets and liabilities classified in Level 1 of the fair value hierarchy are valued using prices quoted in active markets for those securities. Assets classified in Level 2 of the fair value hierarchy are valued in consultation with fund managers.

The valuation method for assets measured at the net asset value per share (or its equivalent) is presented on the following table.

	<u>Fair Value</u>	<u>Unfunded Commitments</u>	<u>Redemption Frequency (if currently eligible)</u>	<u>Redemption Notice Period</u>
Assets and Liabilities Measured at the NAV				
Hedge Fund Managers (Strategic) Ltd.	\$4,817,450.74	N/A	Quarterly (on redemption dates – January 1, April 1, July 1, and October 1- which begin on or after the first anniversary of the purchase of shares being redeemed)	At least 91 days prior to the applicable valuation date (the day preceding the applicable redemption date)

Objective of investment – The fund’s investment objective is to target attractive long-term risk-adjusted absolute returns with lower volatility than the broad equity markets. To achieve its objective, the fund will (directly or indirectly) allocate its assets to, or will invest in entities managed by, a relatively concentrated portfolio of investment managers that may employ a broad range of alternative investment strategies, including, without limitation, strategies within one or more of the following four hedge fund sectors: the equity long/short sector, the relative value sector, the event driven sector, and the tactical trading sector. In addition, the fund may allocate assets to advisors that use investment strategies not within one of the hedge fund sectors referenced above.

Note 6. Endowments

Under the established spending plans, the budget committee may appropriate for distribution each year from Consent Decree Endowment funds, an amount up to 75% of the interest and dividend income. The budget committee may also appropriate an amount up to 50% of the interest and dividend income of Title III funds. The remaining funds are to be reinvested in the corpus of the fund. At June 30, 2017, net appreciation of \$932,090.33 is available to be spent, all of which is included in restricted net position expendable for other. Of this amount, \$240,596.00 is available from Consent Decree funds, and \$691,494.33 is available from Title III funds.



JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Chief of Staff

**Independent Auditor's Report on Internal Control Over Financial Reporting
Based on an Audit of Financial Statements Performed
in Accordance With Generally Accepted Auditing Standards**

The Honorable Bill Haslam, Governor
Members of the General Assembly
Dr. Glenda Baskin Glover, President

We have audited the financial statements of the Endowment for Educational Excellence at the Tennessee State University Foundation as of and for the year ended June 30, 2017, and the related notes to the financial statements, which collectively comprise the trust's basic financial statements, and have issued our report thereon dated October 16, 2018. We conducted our audit in accordance with the auditing standards generally accepted in the United States of America.

Internal Control Over Financial Reporting

In planning and performing our audit of the financial statements, we considered the foundation'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 opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we do not express an opinion on the effectiveness of the entity'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; therefore, material weaknesses or significant deficiencies may exist that were not identified. However, we identified the following deficiency in internal control that we consider to be a material weakness:

- As noted in the prior audit, management needs to improve procedures for preparing and reviewing financial statements and the accompanying notes.

This deficiency is described in the Finding and Recommendation section of this report.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the trust's financial statements are free from material misstatement, we performed tests of its compliance with certain provisions of the trust agreement, 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*.

Tennessee State University Foundation's Responses to Finding

The foundation's response to the finding identified in our audit is included in the Finding and Recommendation section of this report. The foundation's response was not subjected to the auditing procedures applied in the audit of the financial statements, and, accordingly, we express no opinion on it.

Purpose of This Report

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



Deborah V. Loveless, CPA, Director
Division of State Audit
October 16, 2018

Finding and Recommendation

As noted in the prior audit, management needs to improve procedures for preparing and reviewing financial statements and the accompanying notes

Condition

As noted in the prior audit, management's procedures for preparing the trust's financial statements and accompanying notes to the financial statements are not adequate to ensure the accuracy, proper classification, and disclosure of information. Management responded to the prior audit finding by obtaining additional training and implementing additional review of financial statement preparation. However, reporting errors continued.

Cause

The Director of Fiscal Affairs for Institutional Advancement prepared the financial statements and accompanying notes for the trust. The former Director of General Accounting and Financial Reporting reviewed the financial statements and accompanying notes. The Director of Fiscal Affairs for Institutional Advancement stated that rushing to meet financial reporting deadlines resulted in a lack of attention necessary to ensure compliance with accounting principles. Also, the Director of Fiscal Affairs for Institutional Advancement first prepared the trust's financial statements and notes in 2016, and is still relatively new to preparing this information.

Criteria

Management is responsible for the preparation and fair presentation of the trust's financial statements and accompanying notes 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 of material misstatement.

Effect

This weakness resulted in the following significant reporting errors in the trust's financial statements and notes:

Financial Statements

- Cash on the statement of net position; investment income on the statement of expenses, revenues, and changes in net position; and ending cash on the statement of cash flows were overstated by \$24,042.58. The Director of Fiscal Affairs for Institutional Advancement could not explain this variance.
- On the statement of net position, restricted nonexpendable net position was overstated, and restricted expendable net position was understated by \$407,760.19. According to the terms of the trust agreement, when the foundation's budget committee allocates income funds to be used for the Endowment for Educational Excellence, those funds

should be reclassified as expendable restricted net position. However, the funds were not reclassified at June 30, 2017.

- In the statement of cash flows, the Director of Fiscal Affairs for Institutional Advancement used the investment statements from the investment manager of the foundation's general endowment instead of the statements used by the investment manager for the Endowment for Educational Excellence to complete the cash flows from investing activities section. This resulted in proceeds from sales and maturities of investments being understated by \$116,451.89, income on investments being overstated by \$3,889,075.88, and purchase of investments being overstated by \$3,460,448.59. In order to make the statement balance, the Director of Fiscal Affairs for Institutional Advancement included an indicated balance of \$288,132.82.
- In the statement of cash flows, unrealized gains of \$3,684,728.63 were not reported in the noncash section.

Notes

- In the cash and cash equivalents note, \$3,149.37 was listed as funds held in a savings account. This same account was also included in the total of funds held in money market accounts. It should have only been included as a money market account.
- In the deposits note, the uninsured and uncollateralized deposits total was overstated by \$271,008.00. The Director of Fiscal Affairs for Institutional Advancement did not consider FDIC coverage for two investment accounts in his calculation for uninsured and uncollateralized deposits.
- The trust's investments note contained the following errors:
 - ❖ In the investment maturities table, the amounts maturing in the various years were reported combined for U.S. Treasury and corporate bonds rather than separately as required.
 - ❖ In the credit quality rating table, foreign bonds valued at \$350,095.50 were omitted.

The audited financial statements and notes were corrected for the errors noted above.

Recommendation

As noted in the prior audit, management should institute procedures that ensure the accuracy, proper classification, and disclosure of information presented in the trust's financial statements and accompanying notes. The procedures should address the preparation of the trust's financial statements and notes and the subsequent review process. Management should perform adequate reviews on the statements and the notes to mitigate the risk of errors. All personnel involved in the financial statement process should have adequate knowledge of reporting requirements. Without the appropriate knowledge of reporting requirements, appropriate due care, and an adequate review process, management's risk of financial reporting errors is high.

Management's Comment

We concur. To ensure the accuracy, proper classification, and disclosure of information presented in the financial statements and accompanying notes, the Associate Vice President for Accounting and Payroll will ensure year-end checklists are updated to reflect all required entries noted in the Tennessee Board of Regents' annual Financial Reporting Update. In addition, the Vice President for Business and Finance will review the checklist and the final statements and notes to ensure completion and accuracy.

The Vice President for Research and Institutional Advancement and the Vice President for Business and Finance will meet by January 31, 2019, to clearly define the accounting duties and responsibilities assigned to foundation personnel; establish timeframes for the preparation and review of financial data; and develop procedures to ensure the accurate and timely completion of the foundation's statements and notes. The Vice President for Research and Institutional Advancement will ensure that accurate and timely financial statement information is disseminated to the university as outlined in the foundation's accounting duties and responsibilities document drafted in the prior year. The Vice President for Business and Finance and the Vice President for Research and Institutional Advancement will meet with university and foundation staff quarterly to discuss progress and to ensure all targeted deadlines are being met. The Vice President for Business and Finance will provide a final review of the financial statements and notes at year-end. In addition, the Vice President for Business and Finance will search for relevant financial recording and reporting training to be provided for university and foundation accounting staff who are involved in financial statement preparation.

Observation and Comment

The Tennessee State University Foundation is the trustee of funds for the Endowment for Educational Excellence, which was established pursuant to the consent decree entered into on January 5, 2001, in settlement of the *Geier v. Sundquist* lawsuit. This trust was created by the Tennessee Board of Regents and is operated exclusively for the educational purposes of Tennessee State University. The trust agreement requires that an annual audit of trust funds be performed. The Division of State Audit conducts this audit after completing the audit of the university and the foundation.