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TNStars Financial Statement 2019

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JUSTIN P. WILSON
Comptroller

JASON E. MUMPOWER
Deputy Comptroller

Independent Auditor's Report

Members of the General Assembly
Members of the Board of Trustees
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying statement of fiduciary net position of the TNStars College Savings 529 Program, Educational Savings Plan (ESP), a private-purpose trust fund of the State of Tennessee, as of June 30, 2019, the related statement of changes in fiduciary net position for the year then ended, and the related notes to the financial statements, which collectively comprise the TNStars College Savings 529 Program's basic financial statements.

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 from 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. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of trustees of the College Savings Trust Fund Program. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the TNStars College Savings 529 Program.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the TNStars College Savings 529 Program as of June 30, 2019, and the changes in fiduciary net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1, the financial statements present only the TNStars College Savings 529 Program, a private-purpose trust fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2019, and the changes in financial position 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.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 13, 2019, on our consideration of the TNStars College Savings 529 Program's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts 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 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 TNStars College Savings 529 Program's internal control over financial reporting and compliance.



Deborah V. Loveless, CPA, Director
Division of State Audit
December 13, 2019

TNStars
College Savings 529 Plan
Statement of Fiduciary Net Position
June 30, 2019

ASSETS

Cash and cash equivalents	\$	8,696,165
Investments at Fair Value		
Investment in Mutual Funds (Fixed Income)		13,918,050
Investment in Mutual Funds (Blended)		59,861,287
Investment in Mutual Funds (Equity)		77,779,658
Total Investments at Fair Value		151,558,995
TOTAL ASSETS	\$	160,255,160
LIABILITIES		
TOTAL LIABILITIES		0
NET POSITION - RESTRICTED FOR PLAN PARTICIPANTS	\$	160,255,160

See accompanying Notes to the Financial Statements

TNStars
College Savings 529 Plan
Statement of Changes in Fiduciary Net Position
For Fiscal Year Ended June 30, 2019

ADDITIONS

Contributions	\$	29,454,690
Investment Income		8,442,054
Transfers from General Fund (TIPS)		117,300

TOTAL ADDITIONS		38,014,044
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DEDUCTIONS

Withdrawals		8,533,090
Administrative cost		237,595

TOTAL DEDUCTIONS		8,770,685
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CHANGE IN NET POSITION		29,243,359
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NET POSITION - RESTRICTED FOR PLAN PARTICIPANTS

BEGINNING OF YEAR		131,011,801
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END OF YEAR	\$	160,255,160
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See accompanying Notes to the Financial Statements

TNStars
College Savings 529 Plan
Notes to the Financial Statements
For Fiscal Year Ended June 30, 2019

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The TNStars College Savings 529 Program, Educational Savings Plan (ESP) is included in the State of Tennessee financial reporting entity. Because of the state's fiduciary responsibility, the ESP has been included in the *Tennessee Comprehensive Annual Financial Report* as a private-purpose trust fund. That report is available on the state's website at www.tn.gov/finance/rd-doa/fa-acffin-cafr.html.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). 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 at the time liabilities are incurred regardless of the timing of related cash flows.

3. Cash and Cash Equivalents

Cash and cash equivalents include cash and short term investments with a maturity date within three months of the acquisition date. Cash management pools are included as cash. Cash received that cannot be immediately invested in securities, or that is needed for operations, is invested in the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer.

4. Method Used to Value Investments

Investments are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price. The fair value of investments in open-end mutual funds is based on the share price. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments and interest and dividend income. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.

The fair value of assets held at June 30, 2019, represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Assets held are categorized for fair value measurement within the fair value hierarchy established by Generally Accepted Accounting Principles (GAAP). The hierarchy is based on the valuation inputs used to measure the fair value of the asset and give the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

- Level 1 - Unadjusted quoted prices for identical assets or liabilities in active markets that can be accessed at the measurement date.
- Level 2 - Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; assets or liabilities that have a bid-ask spread price in an inactive dealer market, brokered market and principal-to-principal market; and Level 1 assets or liabilities that are adjusted.

- Level 3 - Valuations derived from valuation techniques in which significant inputs are unobservable.

Where inputs used in the measurement of fair value fall into different levels of the hierarchy, fair value of the instrument in its entirety is categorized based on the lowest level input that is significant to the valuation. This assessment requires professional judgement and as such management developed a fair value committee that worked in conjunction with our custodian and investment professionals to make these valuations. All assets held were valued individually and aggregated into classes so to be represented in the table below.

Short-term securities generally include investments in money market-type securities reported at cost plus accrued interest.

Equity and equity derivative securities classified in Level 1 are valued using last reported sales prices quoted in active markets that can be accessed at the measurement date.

Investments Measured at Fair Value
For Fiscal Year Ended June 30, 2019
Expressed in Thousands

Investments	GAAP Hierarchy Level 1
EQUITY INVESTMENTS	
DFA Large Cap International I	\$ 4,243
DFS US Small Cap I	2,235
PRIMECAP Odyssey Aggressive Growth	32,970
DFA US Large Cap Value I	17,151
Vanguard Institutional Index I	21,181
	77,780
FIXED INCOME INVESTMENTS	
DFA Inflation-Protected Securities I	1,012
Vanguard Interm-Term Investment-Grade Adm	1,915
Vanguard Interm-Term Treasury Adm	1,142
Vanguard Total Bond Market Index I	9,849
	13,918
BLENDED INVESTMENTS	
Vanguard LifeStrategy Cnsrv Growth Inv	16,084
Vanguard LifeStrategy Income Inv	11,675
Vanguard Wellington Admiral	32,102
	59,861
TOTAL INVESTMENTS AT FAIR VALUE	151,559
Cash and Cash Equivalents	8,696
TOTAL FINANCIAL STATEMENT ASSETS	\$ 160,255

B. DEPOSITS AND INVESTMENTS

In accordance with State statute, the ESP assets may be invested in any instrument, obligation, security or property that constitutes a legal investment for assets of the Tennessee Consolidated Retirement System (TCRS) or any other investment deemed appropriate by the Board. The authority for investing the assets of the ESP is vested in the Baccalaureate Education System Trust (BEST) Board of Trustees (the “Board”) and the responsibility for implementing the investment policy established by the Board is delegated to the State Treasurer.

Recognizing that plan participants may have an investment horizon ranging from a few months to more than twenty years, the ESP has selected a group of investment products that have an investment risk profile ranging from conservative to aggressive. The investment products selected are evaluated based on a number of factors including but not limited to fees, investment performance, investment strategy, any available ratings of the products, and suitability of products for participants. It is the responsibility of the ESP to provide products to plan participants; however it is the participants who select the options that suit their individual investment needs.

The TNStars College Savings 529 Program had deposits in the State Pooled Investment Fund. The State Pooled Investment Fund is not rated by a nationally recognized statistical ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented in the State Pooled Investment Fund Report. That report is available on the state’s website at www.treasury.tn.gov.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations with regard to debt. The ESP does not currently own specific fixed income securities, but provided options to plan participants to invest in mutual funds that invest in fixed income securities. Mutual funds with 100% allocations in fixed income securities are considered to be fixed income investments while mutual funds with some portion of their assets invested in fixed income securities are considered blended investments. At June 30, 2019, these funds were not specifically rated by any rating agency; however the underlying securities of the funds had an average credit quality rating of Baa (4th highest) or better. At June 30, 2019, 27% of all the plan assets, as well as \$8,578,865 in a money market account classified as cash equivalents, was invested in fixed income securities. Those plan investments in the money market account are FDIC insured and are not considered to be exposed to credit risk. The investment policy of the ESP does not specifically address credit risk.

Interest Rate Risk

Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The ESP provides investment products for participants to select, however it is the participant that is responsible for selecting an option(s) that best suits their investment needs. As such, the ESP does not have a policy regarding the management of interest rate risk in periods of volatile interest rates. Duration is a measure of a debt investment’s exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment’s full price. Presented below is a statement of Effective Duration as of June, 30, 2019.

Expressed in Thousands

Fund Name	Fair Value as of June 30, 2019	Effective Duration (Years)
Blended		
Vanguard LifeStrategy Cnsrv Growth Inv	\$ 16,084,279	6.58
Vanguard LifeStrategy Income Inv	11,675,150	6.58
Vanguard Wellington Admiral	32,101,858	7.09
Fixed Income		
DFA Inflation-Protected Securities I	\$ 1,012,136	7.31
Vanguard Intermediate-Term Investment-Grade Adm	1,915,458	5.45
Vanguard Intermediate-Term Treasury Adm	1,141,782	5.31
Vanguard Total Bond Market Index I	9,848,674	6.00

C. DESCRIPTION OF THE EDUCATIONAL SAVINGS PLAN

The TNStars College Savings 529 Program, Educational Savings Plan (ESP), administered by the State Treasurer, was created under *Tennessee Code Annotated*, Title 49, Chapter 7, Part 8 and is designed to help people save for the costs of education after high school. The ESP is administered by the Baccalaureate Education System Trust (BEST) Board of Trustees (the “Board”). The Board has the authority to appoint an ESP manager, adopt rules to implement and administer the ESP and establish investment policies for the ESP, to invest moneys of the trust in investments determined by the Board to be appropriate and to administer the funds of the Trust Fund. The ESP called TNStars began operations on September 18, 2012.

When opening an account, the owner may select two types of investment options, the Aged-Based Option and the Self Selected Investment Option. Within the Aged-Based Option, contributions are allocated among five age bands, based on the age of the beneficiary. Each Age Band is invested in specific Dimensional Fund Advisors (DFA) or Vanguard mutual funds from our slate of investment options (“an Underlying Fund”). The Age Bands become more conservatively invested as the beneficiary ages. The Self Selected Investment Option allows owners to invest in any underlying Fund. The list of investment options or underlying funds is listed below:

Type	Fund Name	Ticker Symbol
Equity	DFA Large Cap International I	DFALX
	DFS US Small Cap I	DFSTX
	PRIMECAP Odyssey Aggressive Growth	POAGX
	Vanguard Mid Cap Growth Inv*	VMGRX
	DFA US Large Cap Value I	DFLVX
	Vanguard Institutional Index I	VINIX
	Blended	Vanguard LifeStrategy Cnsrv Growth Inv
Vanguard LifeStrategy Income Inv		VASIX
Vanguard Wellington Admiral		VWENX
Fixed Inc	DFA Inflation-Protected Securities I	DIPSX
	Vanguard Interm-Term Investment-Grade Adm	VFIDX
	Vanguard Interm-Term Treasury Adm	VFIUX
	Vanguard Total Bond Market Index I	VBTIX

*This investment option was closed in September 2018.

Participants in the ESP can make withdrawals at any time after contributions have been invested for 21 days. Withdrawals used for qualifying higher educational expenses receive certain tax incentives; additionally those not used for qualifying higher educational expenses receive certain tax penalties based on the participant's individual circumstances.

Pursuant to state statute, the Board may establish an incentive plan or plans to encourage Tennessee residents to participate in TNStars. Such plans may include, but are not limited to, matching contributions using state funds and shall be restricted to Tennessee residents only. There were no promotional incentives during fiscal year 2019. In addition, for fiscal year ended June 30, 2019, the Board authorized the program to subsidize, using state appropriations, the program management fee and the estimated underlying mutual fund expense so that the total annual asset-based fee, after subsidy, for any account does not exceed 35 basis points. As a result, state appropriations from the General Fund covered subsidies in the amount of \$83,785 for the year ended June 30, 2019.

D. OTHER ACCOUNTING DISCLOSURES

Third Party Administration

Effective February 26, 2018, the State contracted with Ascensus College Savings Recordkeeping Services, LLC for the provision of recordkeeping services for the ESP.

Cash Transfer

At June 30, 2019, the ESP had uninvested cash of \$117,300, which was transferred from the General Fund to TNStars to be used to fund the Tennessee Investments Preparing Scholars (TIPS) program. The TIPS funding was invested in August 2019.

Unit Valuation

Each account owner's interest in an investment option is evidenced by a whole or fractional unit. The value of a unit in an investment option is calculated daily based on the fair market value of the underlying investment assets, adjusted for the net effects of transactions such as accrued administrative fees, contribution and withdrawal requests approved but not processed, or investment income that has not yet been reinvested. This value, known as the net asset value, is divided by the total number of units outstanding to determine the net asset value per unit. The value of an account owner's interest in an investment option is determined by multiplying the number of units owned by the net asset value per unit.