AUDIT REPORT

Tennessee Board of Regents
The University of Memphis

For the Year Ended
June 30, 2012

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY

Department of Audit

Division of State Audit

Tennessee Comptroller of the Treasury

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STATE OF TENNESSEE
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February 5, 2013

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable John G. Morgan, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 340
Nashville, Tennessee 37217
and
Dr. Shirley C. Raines, President
The University of Memphis
Memphis, Tennessee 38152

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Board of Regents, The University of Memphis, for the year ended June 30, 2012. You will note from the independent auditor's report that unqualified 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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State of Tennessee

Audit Highlights

Comptroller of the Treasury — Division of State Audit

Financial and Compliance Audit
The University of Memphis
For the Year Ended June 30, 2012

AUDIT OBJECTIVES

The objectives of the audit were to consider the university's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINIONS ON THE FINANCIAL STATEMENTS

The opinions on the financial statements are unqualified.

Audit Report
Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2012

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Tennessee Board of Regents
The University of Memphis
For the Year Ended June 30, 2012

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Board of Regents, The University of Memphis. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

In 1909, the General Assembly of Tennessee enacted a general educational law providing for the establishment and maintenance of three normal schools in the state, one of which was to be located in Memphis. On September 15, 1912, West Tennessee State Normal School opened and, in 1925, became a senior college. On July 1, 1957, the institution was designated Memphis State University, and on July 1, 1994, the name was changed to The University of Memphis.

The university is a fully accredited, comprehensive doctoral/high-research-institution of higher education. It is comprised of four schools—the Cecil C. Humphreys School of Law, the Loewenberg School of Nursing, the School of Communication Sciences and Disorders, and the School of Public Health—and six colleges: the College of Arts and Sciences; the Fogelman College of Business and Economics; the College of Education, Health, and Human Sciences; the Herff College of Engineering; the College of Communication and Fine Arts; and the University College. The University of Memphis has 24 Chairs of Excellence and 5 state-approved Centers of Excellence.

ORGANIZATION

The governance of The University of Memphis is vested in the Tennessee Board of Regents. The Governor, the Commissioner of Education, the Commissioner of Agriculture, and the Executive Director of the Tennessee Higher Education Commission serve *ex officio* on this board. The chief administrative officer of the university is the president, who is assisted and advised by members of the faculty and administrative staff.

AUDIT SCOPE

The audit was limited to the period July 1, 2011, through June 30, 2012, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Financial statements are presented for the year ended June 30, 2012. The University of Memphis is an institution of the Tennessee Board of Regents, which is an integral part of state government. As such, the Tennessee Board of Regents has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report.*

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the university's internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing opinions on the financial statements;
2. to determine compliance with certain provisions of laws, regulations, contracts, and grant agreements;
3. to determine the fairness of the presentation of the financial statements; and
4. to recommend appropriate actions to correct any deficiencies.

Although this audit was not intended to serve as an organization-wide audit as described in the Single Audit Act, as amended by the Single Audit Act Amendments of 1996, and Office of Management and Budget (OMB) Circular A-133, *Audits of States, Local Governments, and Non-Profit Organizations*, it included tests of compliance with applicable federal laws and regulations and consideration of internal control used in administering federal financial assistance programs. This audit is a segment of the organization-wide audit of the State of Tennessee, which is conducted in accordance with the Single Audit Act.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

OBSERVATIONS AND COMMENTS

MANAGEMENT'S RESPONSIBILITY FOR RISK ASSESSMENT

Auditors and management are required to assess the risk of fraud in the operations of the institution. The risk assessment is based on a critical review of operations considering what frauds could be perpetrated in the absence of adequate controls. The auditors' risk assessment is limited to the period during which the audit is conducted and is limited to the transactions that the auditors are able to test during that period. The risk assessment by management is the primary method by which the institution is protected from fraud, waste, and abuse. Since new programs may be established at any time by management or older programs may be discontinued, that assessment is ongoing as part of the daily operations of the institution.

Risks of fraud, waste, and abuse are mitigated by effective internal controls. It is management's responsibility to design, implement, and monitor effective controls in the institution. Although internal and external auditors may include testing of controls as part of their audit procedures, these procedures are not a substitute for the ongoing monitoring required of management. After all, the auditor testing is limited and is usually targeted to test the effectiveness of particular controls. Even if controls appear to be operating effectively during the time of the auditor testing, they may be rendered ineffective the next day by management override or by other circumventions that, if left up to the auditor to detect, will not be noted until the next audit engagement and then only if the auditor tests the same transactions and controls. Furthermore, since staff may be seeking to avoid auditor criticisms, they may comply with the controls during the period that the auditors are on site and revert to ignoring or disregarding the control after the auditors have left the field.

The risk assessments and the actions of management in designing, implementing, and monitoring the controls should be adequately documented to provide an audit trail both for auditors and for management, in the event that there is a change in management or staff, and to maintain a record of areas that are particularly problematic.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99, *Consideration of Fraud in a Financial Statement Audit*, promulgated by the American Institute of Certified Public Accountants, requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the university's financial statements for the year ended June 30, 2012, we considered internal control over financial reporting as a basis for designing auditing procedures for the purpose of expressing opinions on the financial statements, as required by auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance and Other Matters

The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under generally accepted government auditing standards.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered unqualified opinions on the university's financial statements.

STATE OF TENNESSEE
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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*

November 21, 2012

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable John G. Morgan, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 340
Nashville, Tennessee 37217
and
Dr. Shirley C. Raines, President
The University of Memphis
Memphis, Tennessee 38152

Ladies and Gentlemen:

We have audited the financial statements of The University of Memphis, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, and its discretely presented component unit as of and for the year ended June 30, 2012, and have issued our report thereon dated November 21, 2012. Our report was modified to include a reference to 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 generally accepted government auditing standards.

Internal Control Over Financial Reporting

Management of the university is responsible for establishing and maintaining effective internal control over financial reporting. In planning and performing our audit, we considered the university's internal control over financial reporting as a basis for designing our auditing procedures 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 over financial reporting. Accordingly, we do not express an opinion on the effectiveness of the university's internal control over financial reporting.

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.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material weaknesses, as defined above.

Compliance and Other Matters

As part of obtaining reasonable assurance about whether the university's financial statements are free of 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 generally accepted government auditing standards.

We noted certain matters that we reported to the management of The University of Memphis in a separate letter.

November 21, 2012
Page Three

This report is intended solely for the information and use of the General Assembly of the State of Tennessee, the Tennessee Board of Regents, and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

AAH/bb

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

November 21, 2012

The Honorable Bill Haslam, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
The Honorable John G. Morgan, Chancellor
Tennessee Board of Regents
1415 Murfreesboro Road, Suite 340
Nashville, Tennessee 37217
and
Dr. Shirley C. Raines, President
The University of Memphis
Memphis, Tennessee 38152

Ladies and Gentlemen:

We have audited the accompanying basic financial statements of The University of Memphis, an institution of the Tennessee Board of Regents, which is a component unit of the State of Tennessee, as of and for the year ended June 30, 2012, as listed in the table of contents. These financial statements are the responsibility of the university's management. Our responsibility is to express opinions on these financial statements, based on our audit. We did not audit the financial statements of The University of Memphis Foundation, a discretely presented component unit of the university. Those financial statements were audited by other auditors whose report thereon has been furnished to us, and our opinion, insofar as it relates to the amounts included for The University of Memphis Foundation, is based on the report of the other auditors.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in generally accepted government auditing standards. 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 includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of the other auditors provide a reasonable basis for our opinions.

As discussed in Note 1, the financial statements of The University of Memphis, an institution of the Tennessee Board of Regents, are intended to present the financial position, the changes in financial position, and the cash flows of only The University of Memphis. They do not purport to, and do not, present fairly the financial position of the Tennessee Board of Regents, as of June 30, 2012, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, based on our audit and the report of other auditors, the financial statements referred to above present fairly, in all material respects, the respective financial position of The University of Memphis, and its discretely presented component unit as of June 30, 2012, and the respective changes in financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 24, the financial statements of The University of Memphis Foundation, a discretely presented component unit of The University of Memphis, include investments valued at $31,847,251.00 (30.8 percent of net assets of the foundation), whose fair values have been estimated by management in the absence of readily determinable fair values. Management’s estimates are based on information provided by the fund managers or the general partners.

Accounting principles generally accepted in the United States of America require that the management's discussion and analysis on pages 13 through 27 and the 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 who 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.

Our audit was conducted for the purpose of forming opinions on the basic financial statements as a whole. The accompanying financial information on page 62 is presented for purposes of additional analysis and is not a required part of the basic financial statements. This information is the responsibility of the university's management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements. Such information has been subjected to the auditing procedures applied by us and the other auditors 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 financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information, based on our audit and the report of other auditors, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with generally accepted government auditing standards, we have also issued our report dated November 21, 2012, on our consideration of the university's internal control over financial reporting and 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 generally accepted government auditing standards and should be considered in assessing the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

AAH/bb

Tennessee Board of Regents
The University of Memphis
Management's Discussion and Analysis

This section of The University of Memphis's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2012, with comparative information presented for the fiscal year ended June 30, 2011. 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.

Using This Annual Report

This report consists of three basic financial statements. The Statement of Net Assets; the Statement of Revenues, Expenses, and Changes in Net Assets; and the Statement of Cash Flows provide information on the University of Memphis as a whole and present a long-term view of the university's finances.

The Statement of Net Assets

The Statement of Net Assets presents the financial position of the university at the end of the fiscal year and includes all assets and liabilities of the university. The difference between total assets and total liabilities—net assets—is an indicator of the current financial condition of the university. Assets and liabilities are generally measured using current values. One notable exception is capital assets, which are stated at historical cost less an allowance for depreciation.

Net assets are divided into three major categories. The first category, invested in capital assets, net of related debt, provides the university's equity in property, plant, and equipment owned by the university. The next asset category is restricted net assets, which is divided into two categories, nonexpendable and expendable. The corpus of nonexpendable restricted resources is only available for investment purposes. Expendable restricted net assets are 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 assets. The final category is unrestricted net assets. Unrestricted net assets are available to the institution for any lawful purpose of the institution.

Net Assets - The University
(in thousands of dollars)

	FY 2012	FY 2011
Assets:		
Current assets	$ 102,887	$ 94,111
Capital assets, net	405,942	384,364
Other assets	97,711	106,941
Total Assets	**606,540**	**585,416**
Liabilities:		
Current liabilities	54,356	49,845
Noncurrent liabilities	130,104	131,506
Total Liabilities	**184,460**	**181,351**
Net Assets:		
Invested in capital assets, net of related debt	298,286	274,084
Restricted - nonexpendable	3,759	3,737
Restricted - expendable	8,775	8,451
Unrestricted	111,260	117,793
Total Net Assets	**$ 422,080**	**$ 404,065**

Comparison of FY 2012 to FY 2011

- On December 16, 2011, the State of Tennessee acquired the assets of Lambuth University for use by the Tennessee Board of Regents (TBR). The University of Memphis was given authority to assume control of all assets and to operate the Lambuth Campus as a branch of the University of Memphis. Capital assets, net of related debt increased primarily due to the acquisition of the Lambuth Campus, including $480,000 in land, $27,820,600 in buildings, $643,316 in improvements, $77,000 in equipment, and $1,918,348 in library holdings.

Net Assets - The Foundation
(in thousands of dollars)

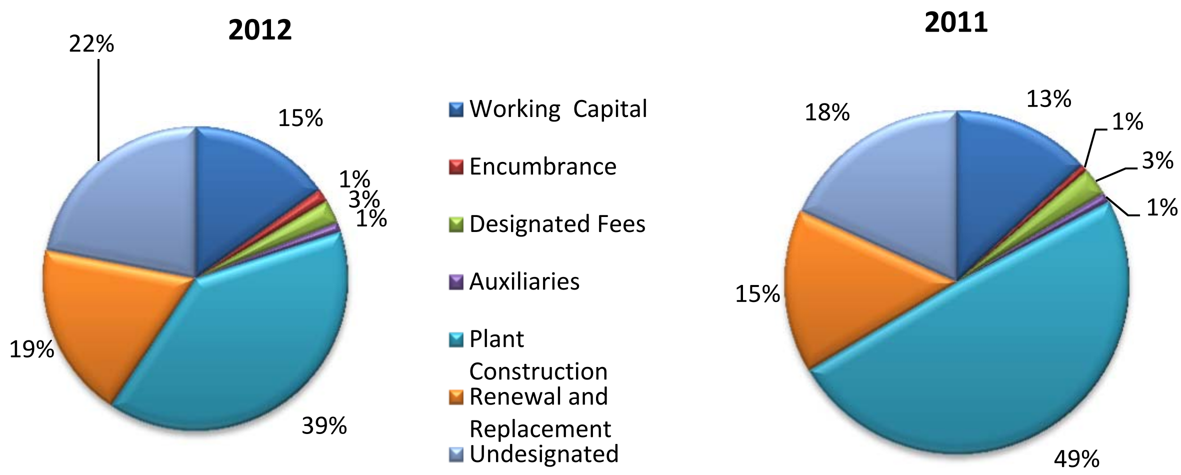
	FY 2012	FY 2011
Assets:		
Current assets	$ 4,072	$ 4,260
Noncurrent assets	110,190	108,216
Total Assets	**114,262**	**112,476**
Liabilities:		
Current liabilities	10,787	10,324
Total Liabilities	**10,787**	**10,324**
Net Assets:		
Restricted - nonexpendable	56,066	53,494
Restricted - expendable	39,882	39,229
Unrestricted	7,527	9,429
Total Net Assets	**$ 103,475**	**$ 102,152**

Comparison of FY 2012 to FY 2011

- Unrestricted net assets decreased principally due to the reclassification of a negative amount from restricted-expendable to unrestricted, representing the total amount by which the fair values of certain donor-restricted endowment funds were below the amounts required to be retained permanently in accordance with FASB 117-1, *Endowments of Not-for-Profit Organizations: Net Asset Classification of Funds Subject to an Enacted Version of the Uniform Prudent Management of Institutional Funds Act, and Enhanced Disclosures for All Endowment Funds*.

Many of the university's unrestricted net assets have been designated for specific purposes such as repairs and replacement of equipment, future debt service, quasi-endowments, capital projects, and student loans. The following graph shows the allocations:

Allocation of Net Assets – The University



Comparison of FY 2012 to FY 2011

- Undesignated net assets increased primarily due to funds accumulated for handling the transition from the time (FY 2009 - FY 2011) when federal stimulus and State non-recurring funds were available to supplant the state base reductions to future years when such funds are significantly reduced or totally eliminated from the university's budget. This is in accordance with the university's five-year financial plan implemented in FY 2010 as part of the State of Tennessee budget process.

- Renewal and replacement net assets increased as a result of funds accumulated to fund anticipated costs associated with the Enterprise Resource Planning system and Information Technology infrastructure.

- The decrease in plant construction net assets is primarily due to completion of renovation projects previously funded with local and non-recurring State funds as well as the utilization of one-time funds to transition to reduced State appropriations.

The Statement of Revenues, Expenses, and Changes in Net Assets

The Statement of Revenues, Expenses, and Changes in Net Assets presents the operating results of the university, as well as the nonoperating revenues and expenses. Annual state appropriations, while budgeted for operations, are considered non-operating revenues according to accounting principles generally accepted in the United States of America.

Changes in Net Assets - The University
(in thousands of dollars)

	FY 2012	FY 2011
Operating revenues:		
Net tuition and fees	$ 125,075	$ 113,442
Grants and contracts	42,146	42,148
Auxiliary	21,705	19,987
Other	30,925	26,984
Total operating revenues	**219,851**	**202,561**
Operating expenses	**(427,176)**	**(392,579)**
Operating loss	**(207,325)**	**(190,018)**
Nonoperating revenues and expenses:		
State appropriations	100,584	126,188
Gifts	23,323	18,825
Investment income	2,195	2,300
Other revenues and expenses	64,044	72,602
Total nonoperating revenues and expenses	**190,146**	**219,915**
Income (loss) before other revenues, expenses, gains or losses	**(17,179)**	**29,897**
Other revenues, expenses, gains or losses:		
Capital appropriations	2,953	1,209
Capital grants and gifts	34,625	15,241
Other	16	8
Total other revenues, expenses, gains or losses	**37,594**	**16,458**

Increase in net assets	20,415	46,355
Net asset at beginning of year	404,065	357,710
Prior period adjustment	(2,400)	-
Net assets at end of year	**$ 422,080**	**$ 404,065**

Comparison of FY 2012 to FY 2011

- State appropriations for operations (recurring and non-recurring) decreased by $25.6 million or 20% in FY 2012, while capital appropriations increased for various roof replacements.
- Gifts increased primarily due to the university's capital campaign.
- Other nonoperating revenues and expenses decreased due to federally funded State Fiscal Stabilization Funds (SFSF) that were available in FY 2011. No SFSF funds were available in FY 2012.
- Capital grants and gifts increased primarily due to the acquisition of the Lambuth Campus.

Changes in Net Assets - The Foundation
(in thousands of dollars)

	FY 2012	FY 2011
Operating revenues and expenses:		
Gifts and contributions	$ 23,774	$ 17,642
Operating expenses	(24,222)	(23,248)
Operating loss	**(448)**	**(5,606)**
Nonoperating revenues and expenses:		
Investment income	483	9,586
Other nonoperating revenues (expenses)	(436)	169
Total nonoperating revenues and expenses	**47**	**9,755**

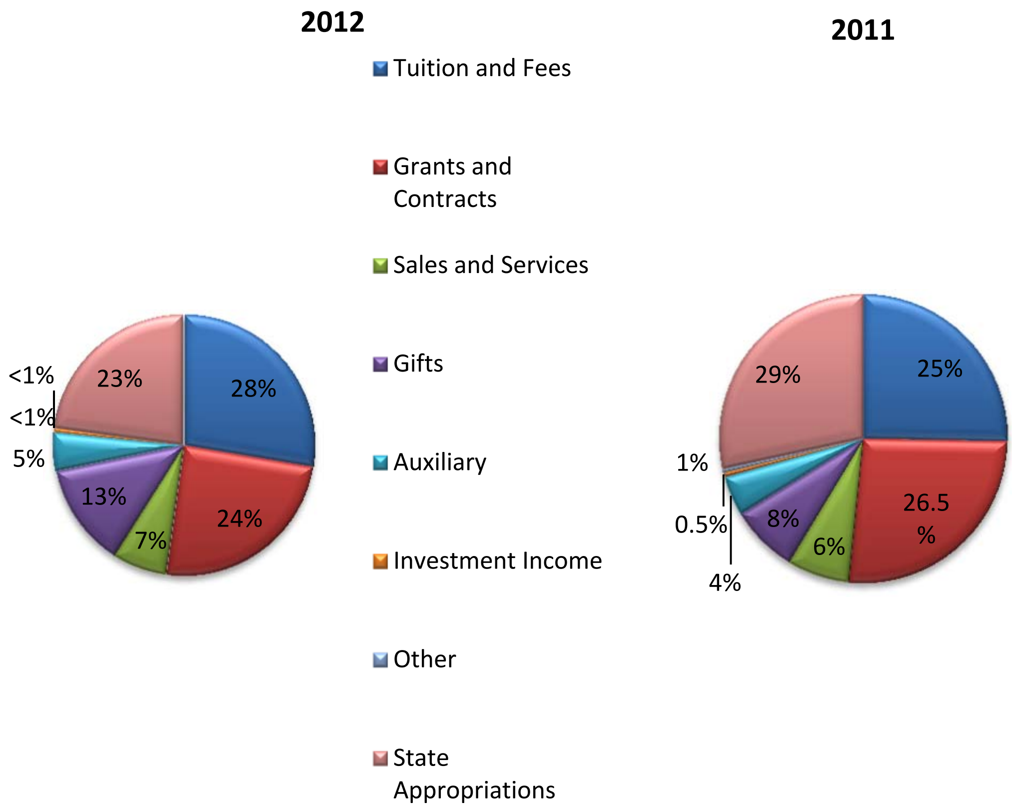
Income (loss) before other revenues, expenses, gains or losses	**(401)**	**4,149**
Other revenues, expenses, gains or losses	**1,724**	**1,516**
Increase in net assets	**1,323**	**5,665**
Net assets at beginning of year	**102,152**	**96,487**
Net assets at end of year	**$ 103,475**	**$ 102,152**

Comparison of FY 2012 to FY 2011

- The increase in gifts and contributions is principally the result of the university's centennial capital campaign.
- The decrease in investment income is principally due to difficult financial markets.
- The increase in other revenues, expenses, gains or losses is due to a higher level of permanently restricted gifts.

Revenues

The following is an illustration of revenues by source (both operating and nonoperating), which are used to fund the university's operating activities for the years ended June 30, 2012, and June 30, 2011 (amounts are presented in thousands of dollars).



Comparison of FY 2012 to FY 2011

- State appropriations for operations decreased by $25.6 million, or 20%, from FY 2011 due primarily to the elimination of the non-recurring and maintenance of effort funds associated with the Federal Stimulus funding in FY 2010 and FY 2011. Additional decreases were a result of a 2% overall base appropriation reduction and the phased-in removal of the hold harmless provision of THEC's new funding formula model. Capital appropriations increased for various roof replacement projects.

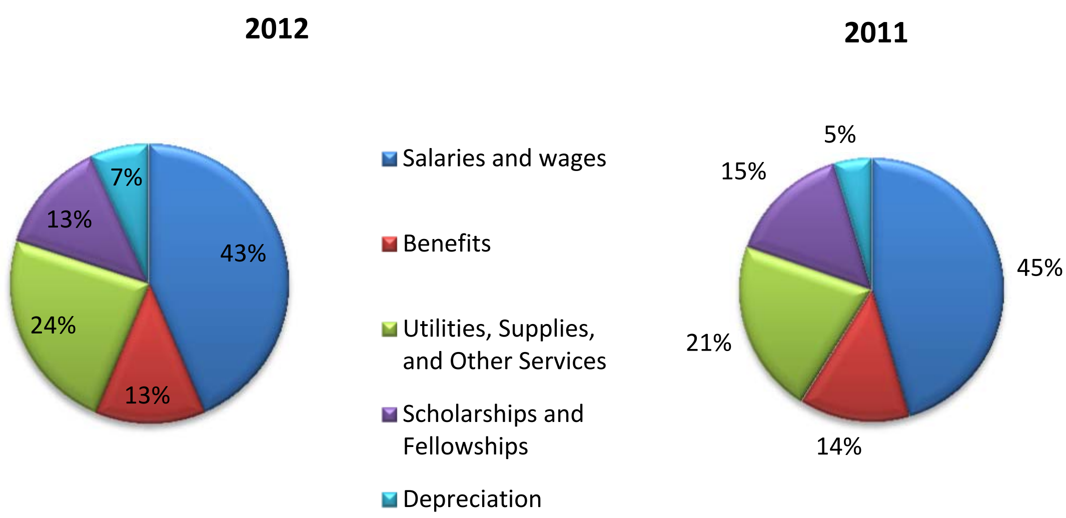
- Gifts increased primarily due to the acquisition of the Lambuth Campus, valued at $31.5 million. In addition, non-capital gifts increased due to funds raised as a result of the ongoing Centennial Campaign.

<u>Expenses</u>

Operating expenses can be displayed in two formats, natural classification and program classification. Both formats are displayed below.

Expenses by Natural Classification - The University
(in thousands of dollars)

	FY 2012	FY 2011
Operating Expenses:		
Salaries and wages	$ 185,937	$ 178,295
Benefits	54,767	53,281
Utilities, Supplies, and Other Services	100,988	83,613
Scholarships and Fellowships	56,455	59,057
Depreciation	29,029	18,333
Total Operating Expenses	$ 427,176	$ 392,579



<u>Comparison of FY 2012 to FY 2011</u>

- Operating costs (utilities, supplies, and other services) increased by $17 million, primarily due to the reclassification of library periodicals from capital library holdings to expenses, contractual obligations related to athletic staffing transitions, maintenance and repairs for the Lambuth Campus, and expenses paid by the foundation on behalf of the university.

- Depreciable assets totaling $42.5 million, including $31.5 million for the Lambuth Campus, were capitalized, increasing depreciation expense. In addition, periodicals that were previously capitalized as library holdings were determined to be more appropriately expensed. The estimated useful life of periodicals was decreased from 10 to 0 years, resulting in a $21.9 million reduction in library holdings and an additional depreciation expense of $10.9 million, net of accumulated depreciation.

Natural Classification - The Foundation
(in thousands of dollars)

		FY 2012		FY 2011
Operating Expenses:				
Scholarships and fellowships	$	9,017	$	8,547
Payment to or on behalf of the university		15,205		14,701
Total Operating Expenses	**$**	**24,222**	**$**	**23,248**

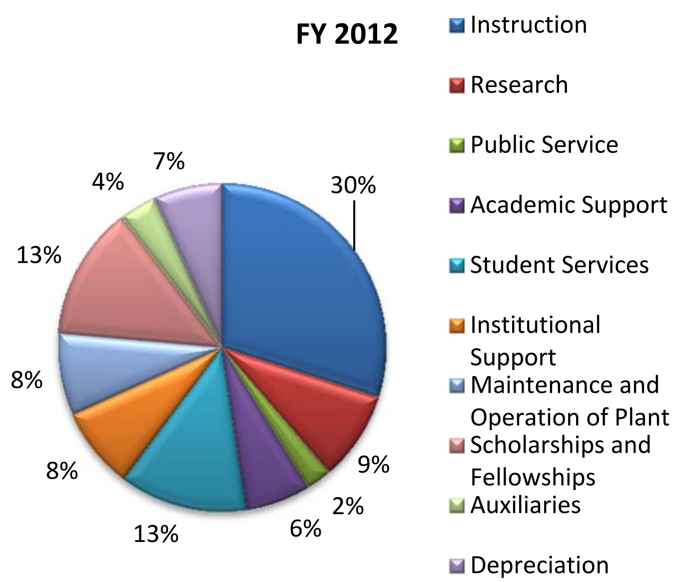
Comparison of FY 2012 to FY 2011

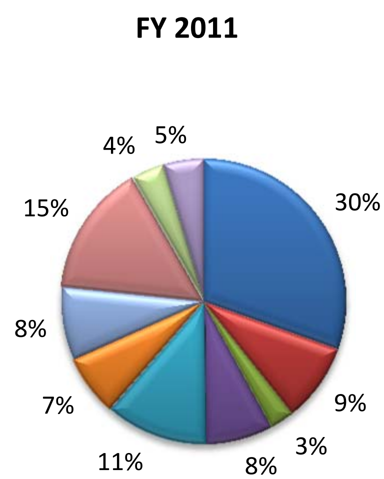
- Total operating expenses increased principally due to increases for scholarships and fellowships, professional services, departmental enrichment, and special projects, partially offset by a decrease in construction expense.

Expenses by Program Classification - The University

(in thousands of dollars)

	FY 2012	FY 2011
Operating Expenses:		
Instruction	$ 127,763	$ 119,445
Research	37,556	34,905
Public service	10,781	10,784
Academic support	27,181	30,219
Student services	54,028	45,668
Institutional support	34,443	27,247
Maintenance and operation of plant	34,537	32,600
Scholarships and fellowships	56,455	59,057
Auxiliaries	15,403	14,321
Depreciation	29,029	18,333
Total Operating Expenses	**$ 427,176**	**$ 392,579**





Comparison of FY 2012 to FY 2011

- Student services expenses increased primarily due to contractual obligations related to athletic staffing transitions.
- Institutional support expenses increased due to a legal judgment against the university.
- The decrease in academic support and corresponding increase in the other functions are due to the allocation of computer services. This computer allocation credits academic support in the salaries, benefits, and operating expense categories, and transfers the expense to all the other functions.
- The increase in depreciation expense is due to a change in accounting estimate for periodicals previously capitalized as library holdings, now determined to be more appropriately expensed. The write-off of periodicals resulted in an additional depreciation expense of $10.9 million.

Capital Assets and Debt Administration

Capital Assets

The University of Memphis had $406 million invested in capital assets, net of accumulated depreciation of $183.7 million at June 30, 2012; and $384 million invested in capital assets, net of accumulated depreciation of $183.3 million at June 30, 2011. Depreciation charges totaled $29 million and $18.3 million for the years ended June 30, 2012, and June 30, 2011, respectively. Details of these assets are shown below.

Schedule of Capital Assets, Net of Depreciation - the University
(in thousands of dollars)

	FY 2012	FY 2011
Land	$ 18,487	$ 17,937
Land improvements	49,417	47,562
Buildings	296,891	269,375
Equipment	14,719	13,286
Library holdings	6,997	16,388
Intangible assets	5,119	5,938

Projects in progress	14,312	13,878
Total	$ 405,942	$ 384,364

- The university capitalized $31.5 million in capital assets from the acquisition of the Lambuth Campus.

- Library holdings decreased by $10.9 million due to a change in accounting estimate to expense periodicals beginning in FY 2012.

Planned capital activities for FY 2013 include a new student housing facility (local funds $53 million), a 1,000-car parking garage on Norriswood (local funds $22.1 million), and research facilities improvements (local funds $1.1 million). Plans also include the acquisition of properties for expansion purposes funded through General Obligation Bonds, as well as local funds.

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

Debt

The university had $107.6 million and $113.6 million in debt outstanding at June 30, 2012, and June 30, 2011, respectively. The table below summarizes these amounts by type of debt instrument.

Outstanding Debt - The University
(in thousands of dollars)

	FY 2012	FY 2011
TSSBA Bonds Payable	$ 100,507	$ 105,651
TSSBA Commercial Paper	88	-
GO Commercial Paper	4,271	4,363
Capital Lease	2,790	3,494
Total	$ 107,656	$ 113,508

The ratings on debt issued by the Tennessee State School Bond Authority at June 30, 2012, were as follows:

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

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

Economic Factors That Will Affect the Future

The state's revenue collections indicate a very slow economic recovery in Tennessee, but the impact this will have on future funding both in operating appropriation and future building projects is not clear. For the fifth consecutive year, the university's base state appropriations will be reduced. The impact of the reduction for FY 2013 is $1.8 million, or 2.2%, from the previous year. Since FY 2008, the university has sustained a cumulative State appropriation reduction of $43.5 million, or 35%, by FY 2013. However, the Governor recently completed a "listening tour" of Tennessee aimed at studying the issues around higher education in Tennessee. The expectation is that higher education will be a prime area of focus during the upcoming legislative session, with an emphasis on the financial burden of higher education on students.

To compensate for the reduction in state appropriations, the university will utilize FY 2012 operating carry forward funds to transition to reduced State appropriations in accordance with the university's five-year financial plan, which includes budget reductions, restructuring, position attritions, voluntary buyouts, and tuition increases. The university has implemented an 8.2% increase in student fees for FY 2013. We remain cognizant of the impact future tuition increases may have on our students and are striving to minimize future increases to the greatest extent possible. The FY 2012 acquisition of the university of Memphis Lambuth Campus and the FY 2013 entrance into the Big East Conference provide a significant opportunity for enrollment and revenue growth.

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

Requests for Information

This financial report is designed to provide a general overview of the institution's finances for all those with an interest in the university's finances. Questions concerning any of the information provided in this report or requests for additional financial information should be directed to Libby Shelton, Controller, Administration Building, Room 275, Memphis, Tennessee 38152.

Exhibit A

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF NET ASSETS
JUNE 30, 2012

	University	Component Unit
ASSETS		
Current assets:		
Cash and cash equivalents (Notes 2 and 24)	$ 37,909,692.69	$ 1,685,469.00
Short-term investments (Note 3)	31,116,405.90	-
Accounts, notes, and grants receivable (net) (Note 4)	32,258,753.15	-
Due from primary government	189,000.00	-
Pledges receivable (net) (Note 24)	-	2,351,871.00
Inventories (at lower of cost or market)	591,059.81	-
Prepaid expenses and deferred charges	305,366.19	-
Accrued interest receivable	516,993.45	34,948.00
Total current assets	102,887,271.19	4,072,288.00
Noncurrent assets:		
Cash and cash equivalents (Note 2)	69,611,754.74	-
Investments (Notes 3 and 24)	23,720,292.50	104,805,254.00
Accounts, notes, and grants receivable (net) (Note 4)	4,375,802.18	-
Pledges receivable (net) (Note 24)	-	4,515,659.00
Capital assets (net) (Note 5)	405,942,525.88	-
Other assets	2,500.00	869,021.00
Total noncurrent assets	503,652,875.30	110,189,934.00
Total assets	606,540,146.49	114,262,222.00
LIABILITIES		
Current liabilities:		
Accounts payable (Note 6)	7,672,054.60	10,553,722.00
Accrued liabilities	23,776,538.97	233,795.00
Student deposits	1,192,917.04	-
Deferred revenue	12,106,490.44	-
Compensated absences (Note 8)	2,535,620.62	-
Accrued interest payable	775,999.55	-
Long-term liabilities, current portion (Note 8)	4,736,360.62	-
Deposits held in custody for others	729,410.46	-
Voluntary buyout program liability (Note 22)	830,223.44	-
Total current liabilities	54,355,615.74	10,787,517.00
Noncurrent liabilities:		
Net OPEB obligation (Note 13)	14,710,395.49	-
Compensated absences (Note 8)	6,899,975.41	-
Long-term liabilities (Note 8)	102,920,408.86	-
Due to grantors (Note 8)	4,375,802.18	-
Voluntary buyout program liability (Note 22)	1,197,658.31	-
Total noncurrent liabilities	130,104,240.25	-
Total liabilities	184,459,855.99	10,787,517.00
NET ASSETS		
Invested in capital assets, net of related debt	298,285,756.40	-
Restricted for:		
Nonexpendable:		
Scholarships and fellowships	1,482,492.77	23,604,498.00
Instructional department uses	-	8,587,166.00
Other	2,277,014.87	23,874,819.00
Expendable:		
Scholarships and fellowships (Note 9)	1,291,903.09	6,852,025.00
Research	1,316,466.49	-
Instructional department uses (Note 9)	1,433,632.39	12,229,144.00
Loans (Note 9)	2,688,706.76	-
Capital projects	370,673.81	5,484,778.00
Debt service	391.90	-
Other (Note 9)	1,673,276.21	15,315,483.00
Unrestricted (Note 10)	111,259,975.81	7,526,792.00
Total net assets	$ 422,080,290.50	$ 103,474,705.00

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

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEAR ENDING JUNE 30, 2012

	University	Component Unit
REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of $50,161,108.51)	$ 125,074,632.91	$ -
Gifts and contributions	-	23,773,788.00
Governmental grants and contracts	35,918,018.08	-
Non-governmental grants and contracts	6,228,243.21	-
Sales and services of educational activities	5,469,980.81	-
Sales and services of other activities	25,303,798.63	-
Auxiliary enterprises:		
Residential life (net of scholarship allowances of $241,229.31 - all residential life revenues are used as security for revenue bonds, see Note 8)	15,273,590.06	-
Bookstore	682,791.59	-
Food service	1,095,021.28	-
Other auxiliaries	4,654,011.01	-
Interest earned on loans to students	151,373.62	-
Total operating revenues	219,851,461.20	23,773,788.00
EXPENSES		
Operating expenses (Note 18):		
Salaries and wages	185,936,933.63	-
Benefits	54,766,811.60	-
Utilities, supplies, and other services	100,988,333.24	-
Scholarships and fellowships	56,454,879.19	9,017,034.00
Depreciation expense	29,029,318.86	-
Payments to or on behalf of The University of Memphis (Note 24)	-	15,204,902.00
Total operating expenses	427,176,276.52	24,221,936.00
Operating loss	(207,324,815.32)	(448,148.00)
NONOPERATING REVENUES (EXPENSES)		
State appropriations	100,583,991.72	-
Gifts	23,322,775.93	-
Grants and contracts	68,935,491.49	-
Investment income (net of investment expense $55,011.51 for the university and $162,156.00 for the component unit)	2,195,450.57	483,274.00
Interest on capital asset-related debt	(4,671,147.02)	-
Other non-operating revenues/(expenses)	(220,412.44)	(436,290.00)
Net nonoperating revenues	190,146,150.25	46,984.00
Loss before other revenues, expenses gains, or losses	(17,178,665.07)	(401,164.00)
Capital appropriations	2,952,965.54	-
Capital grants and gifts	34,624,621.60	-
Additions to permanent endowments	16,382.85	$ 1,724,086.00
Total other revenues	37,593,969.99	1,724,086.00
Increase in net assets	20,415,304.92	1,322,922.00
NET ASSETS		
Net Assets -beginning of year	404,064,841.37	102,151,783.00
Prior period adjustment (Note 19)	(2,399,855.79)	-
Net Assets - end of year	$ 422,080,290.50	$ 103,474,705.00

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

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDING JUNE 30, 2012

CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$	125,278,384.60
Grants and contracts		41,330,887.79
Sales and services of educational activities		6,696,823.84
Sales and services of other activities		22,364,088.53
Payments to suppliers and vendors		(97,602,060.93)
Payments to employees		(184,220,825.36)
Payments for benefits		(53,285,690.38)
Payments for scholarships and fellowships		(56,454,879.19)
Loans issued to students		(697,907.05)
Collection of loans from students		501,635.30
Interest earned on loans to students		151,373.62
Auxiliary enterprise charges:		
Residence halls		15,356,135.52
Bookstore		682,791.59
Food services		1,095,021.28
Other auxiliaries		4,694,787.71
Net cash used by operating activities		(174,109,433.13)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
State appropriations		100,368,784.93
Gifts and grants received for other than capital or endowment purposes		93,203,106.18
Private gifts for endowment purposes		16,382.85
Federal student loan receipts		136,510,463.00
Federal student loan disbursements		(136,510,463.00)
Changes in deposits held for others		236,563.22
Other non-capital financing receipts (payments)		(27,826.43)
Net cash provided by non-capital financing activities		193,797,010.75
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Capital - state appropriation		2,952,965.54
Proceeds from sale of capital assets		16,292.21
Purchase of capital assets and construction		(16,877,778.45)
Principal paid on capital debt and lease		(5,072,193.88)
Interest paid on capital debt and lease		(4,683,819.52)
Net cash used by capital and related financing activities		(23,664,534.10)
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		26,169,583.90
Income on investments		2,203,918.96
Purchase of investments		(37,383,067.14)
Net cash used by investing activities		(9,009,564.28)
Net decrease in cash and cash equivalents		(12,986,520.76)
Cash and cash equivalents - beginning of year		120,507,968.19
Cash and cash equivalents - end of year	$	107,521,447.43

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDING JUNE 30, 2012

RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES

Operating loss	$	(207,324,815.32)
Adjustments to reconcile operating loss to net cash used by operating activities:		
Depreciation expense		29,029,318.86
Other adjustments (Note 21)		207,106.79
Change in assets and liabilities:		
Receivables, net		(3,476,971.34)
Inventories		78,149.16
Prepaid/deferred items		1,118,190.52
Accounts payable		1,676,780.19
Accrued liabilities		1,621,795.75
Deferred revenues		1,524,015.47
Deposits		208,443.93
Compensated absences		291,814.54
Other		936,738.32
Net cash used by operating activities	$	(174,109,433.13)

Non-cash investing, capital, and financing transactions

Gifts in-kind - capital	$	34,624,621.60
Loss on disposal of capital assets	$	(125,004.75)

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

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

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

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

The University of Memphis Foundation is considered a component unit of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, that the foundation holds and invests are restricted to the activities of the university by 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. See Note 24 for more detailed information about the component unit and how to obtain the report.

Basis of Presentation

The university financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America (GAAP) 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 eligibility requirements imposed by the provider have been met. All significant interfund transactions have been eliminated.

Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The university has the option of following private-sector guidance issued subsequent to November 30, 1989, subject to the above limitation. The university has elected not to follow private-sector guidance issued subsequent to November 30, 1989.

Amounts reported as operating revenues include (1) tuition and fees, net of waivers and discounts; (2) certain federal, state, local, and private grants and contracts; (3) sales and services of auxiliary enterprises; and (4) other sources of revenue. Operating expenses for the university include (1) salaries and wages; (2) employee benefits; (3) utilities, supplies, and other services; (4) scholarships and fellowships; and (5) depreciation.

All other activity is nonoperating in nature and includes (1) state appropriations for operations; (2) investment income; (3) bond issuance costs; (4) interest on capital asset-related debt; (5) certain grants and contracts; and (6) gifts and nonexchange transactions.

When both restricted and unrestricted resources are available for use, generally it is the university's policy to use the unrestricted resources first.

Cash Equivalents

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

Inventories

Inventories are valued at the lower of cost or market. All other 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 assets. 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, and intangible assets, are reported in the statement of net assets at historical cost or at fair value at date of donation, less accumulated depreciation/amortization. The costs of normal maintenance and repairs that do not add to the value of the asset or materially extend the asset's useful life are not capitalized.

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

These assets, with the exception of land, are depreciated/amortized using the straight-line method over the estimated useful lives, which range from 5 to 40 years.

Net Assets

The university's net assets are classified as follows:

Invested in capital assets, net of related debt - This represents the university's total investment in capital assets, net of outstanding debt obligations 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 invested in capital assets, net of related debt.

Nonexpendable restricted net assets - Nonexpendable restricted net assets consist 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 assets - Expendable restricted net assets include resources which the university is legally or contractually obligated to spend in accordance with restrictions imposed by external third parties.

Unrestricted net assets - Unrestricted net assets represent resources derived from student tuition and fees, state appropriations, and sales and services of educational departments 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 discretion of the university 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, and certain other revenues from students, are reported net of scholarship discounts and allowances in the statement of revenues, expenses, and changes in net assets. 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 AND CASH EQUIVALENTS

In addition to demand deposits and petty cash on hand, this classification includes instruments which are readily convertible to known amounts of cash and which have original maturities of three months or less. At June 30, 2012, cash and cash equivalents consisted of $8,805,176.05 in bank accounts, $55,820.00 of petty cash on hand, $93,479,455.60 in the State of Tennessee Local Government Investment Pool (LGIP) administered by the State Treasurer, and $5,180,995.78 in LGIP deposits for capital projects.

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, funds are withdrawn from the LGIP account by the Tennessee Board of Regents and transferred to the Department of Finance and Administration. The funds in the account are not available to the university for any other purpose until the project is completed and the Tennessee Board of Regents releases any remaining funds.

NOTE 3. INVESTMENTS

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

At June 30, 2012, the university had the following investments and maturities.

		Investment Maturities (in Years)	
Investment Type	Fair Value	Less than 1	1 to 5
U.S. Treasury notes	$ 52,387,328.40	$ 28,667,035.90	$ 23,720,292.50
Commercial paper	2,249,370.00	2,249,370.00	-
Certificates of deposit	200,000.00	200,000.00	-
Total	$ 54,836,698.40	$ 31,116,405.90	$ 23,720,292.50

Interest Rate Risk

Interest rate risk is the risk that changes in interest rates will adversely affect the fair value of a debt investment. The university does not have a formal investment policy that limits investment maturities as a means of managing its exposure to fair value losses arising from increasing interest rates.

Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The university is authorized by statute to invest funds in accordance with Tennessee Board of Regents policies. Under the current policy, funds other than endowments may be invested only in obligations of the United States or its agencies backed by the full faith and credit of the United States; repurchase agreements for United States securities; certificates of deposit in banks and savings and loan associations; banker's acceptances; commercial paper; money market mutual funds; and the State of Tennessee Local Government Investment Pool. The policy requires that investments of endowments in equity securities be limited to funds from private gifts or other sources external to the university and that endowment investments be prudently diversified. Securities are rated using Standard and Poor's, Moody's, and/or Fitch and are presented below using the Standard and Poor's rating scale.

Tennessee Board of Regents policy restricts investments in banker's acceptances and commercial paper. The policy requires that prime banker's 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 banker's 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 under contract of sale or 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 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, 2012, the university's investments were rated as follows:

		Credit Quality Rating	
Investment Type	Fair Value	A+	Unrated
LGIP	$ 98,660,451.38	$ -	$ 98,660,451.38
Commercial paper	2,249,370.00	2,249,370.00	-
Total	$ 100,909,821.38	$ 2,249,370.00	$ 98,660,451.38

NOTE 4. RECEIVABLES

Receivables included the following:

	June 30, 2012
Student accounts receivable	$11,034,636.95
Grants receivable	10,993,181.96
Notes receivable	1,344,873.95
Other receivables	17,738,962.60
Subtotal	41,111,655.46
Less allowance for doubtful accounts	(8,865,648.24)
Total receivables	$32,246,007.22

Federal Perkins Loan Program funds included the following:

	June 30, 2012
Perkins loans receivable	$ 4,917,072.12
Less allowance for doubtful accounts	(528,524.01)
Total	$ 4,388,548.11

NOTE 5. CAPITAL ASSETS

Capital asset activity for the year ended June 30, 2012, was as follows:

	Beginning Balance	Additions	Transfers	Reductions	Ending Balance
Land	$17,937,399.36	$ 549,152.57	$ -	$ -	$ 18,486,551.93
Land improvements and infrastructure	66,325,515.60	4,186,241.55	1,293,546.85	-	71,805,304.00
Buildings	388,054,835.13	30,891,923.72	6,041,925.58	-	424,988,684.43
Equipment	36,554,122.38	4,148,198.02	-	3,501,555.29	37,200,765.11
Library holdings	36,010,038.05	3,189,847.93	-	25,292,234.48	13,907,651.50

Intangible assets:					
Easement	1,200,000.00	-	-	-	1,200,000.00
Software	7,755,586.38	63,088.99	-	-	7,818,675.37
Projects in progress	13,878,150.16	7,769,749.66	(7,335,472.43)	-	14,312,427.39
Total	567,715,647.06	50,798,202.44	-	28,793,789.77	589,720,059.73
Less accumulated depreciation/ amortization:					
Land improvements and infrastructure	18,763,628.21	3,624,776.86	-	-	22,388,405.07
Buildings	118,680,036.57	9,417,849.19	-	-	128,097,885.76
Equipment	23,268,278.39	2,524,311.38	-	3,311,024.79	22,481,564.98
Library holdings	19,622,032.91	12,580,367.34	-	25,292,234.48	6,910,165.77
Intangible assets:					
Software	3,017,498.18	882,014.09	-	-	3,899,512.27
Total	183,351,474.26	29,029,318.86	-	28,603,259.27	183,777,533.85
Capital assets, net	$384,364,172.80	$21,768,883.58	$ -	$ 190,530.50	$405,942,525.88

The increase in accumulated depreciation for library holdings is due to a change in accounting estimate. During fiscal year 2012, it was determined that periodicals are more appropriately expensed. The estimated useful life of periodicals was decreased from 10 years to 0 years, resulting in a current-year adjustment of $21,961,928.93.

NOTE 6. ACCOUNTS PAYABLE

Accounts payable included the following:

	June 30, 2012
Vendors payable	$ 4,512,333.37
Construction project payments	608,313.72
Other payables	2,551,407.51
Total accounts payable	$ 7,672,054.60

NOTE 7. CAPITAL LEASES

The university has capital lease agreements for the campus wide data network equipment and services. These agreements have beginning and ending dates ranging from January 1, 2011, to December 31, 2015, and an imputed interest rate of 5.517%. Asset balances were $2,866,911.80 at June 30, 2012, net of accumulated depreciation of $1,228,676.49. The following is a schedule by years of future minimum lease payments under capital leases together with the present value of the net minimum lease payments at June 30, 2012:

Year Ending June 30	
2013	$ 878,591.28
2014	878,591.28
2015	878,591.28
2016	439,295.64
Total minimum lease payments	3,075,069.48
Less amount representing interest	(284,480.28)
Present value of net minimum lease payments	$ 2,790,589.20

NOTE 8. LONG-TERM LIABILITIES

Long-term liabilities activity for the year ended June 30, 2012, was as follows:

	Restated Beginning Balance	Additions	Reductions	Ending Balance	Current Portion
Payables:					
TSSBA debt:					
Bonds	$100,574,338.43	$ -	$ 4,081,144.97	$ 96,493,193.46	$ 3,993,119.30
Unamortized bond premium	5,076,819.00	-	1,062,354.27	4,014,464.73	-
Commercial paper	-	87,868.89	-	87,868.89	-
General obligation debt:					
Commercial paper	4,363,280.17	161,794.00	254,420.97	4,270,653.20	-
Capital lease obligations	3,494,025.37	-	703,436.17	2,790,589.20	743,241.32
Subtotal	113,508,462.97	249,662.89	6,101,356.38	107,656,769.48	4,736,360.62

Other liabilities:					
Compensated absences	9,143,781.49	5,537,062.37	5,245,247.83	9,435,596.03	2,535,620.62
Due to grantors	4,357,454.46	44,964.29	26,616.57	4,375,802.18	-
Subtotal	13,501,235.95	5,582,026.66	5,271,864.40	13,811,398.21	2,535,620.62
Total long-term liabilities	$127,009,698.92	$5,831,689.55	$11,373,220.78	$121,468,167.69	$7,271,981.24

TSSBA Debt - Bonds

Bonds, with interest rates ranging from 2% to 7%, were issued by the Tennessee State School Bond Authority (TSSBA). The bonds are due serially until 2040 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 11 for further details. The bonded indebtedness with the Tennessee State School Bond Authority included in long-term liabilities on the statement of net assets is shown net of assets held by the authority in the debt service reserve and unexpended debt proceeds. The reserve amount was $4,750,591.97 at June 30, 2012.

Debt service requirements to maturity for the university's portion of TSSBA bonds at June 30, 2012, are as follows:

Year Ending June 30	Principal	Interest	Total
2013	$ 3,993,119.30	$ 4,595,664.44	$ 8,588,783.74
2014	4,015,577.40	4,420,475.65	8,436,053.05
2015	4,091,731.59	4,259,350.63	8,351,082.22
2016	4,275,673.23	4,081,823.61	8,357,496.84
2017	4,476,900.52	3,881,451.58	8,358,352.10
2018 – 2022	24,617,823.77	16,210,130.55	40,827,954.32
2023 – 2027	26,006,867.63	10,196,968.35	36,203,835.98
2028 – 2032	15,457,356.11	4,209,853.35	19,667,209.46
2033 – 2038	6,863,983.30	1,699,136.08	8,563,119.38
2038 – 2040	2,694,160.61	337,520.00	3,031,680.61
Total	$ 96,493,193.46	$ 53,892,374.24	$150,385,567.70

TSSBA Debt - Commercial Paper

The Tennessee State School Bond Authority issues commercial paper to finance the costs of various capital projects during their construction phase. When projects are placed in service, long-term, fixed-rate debt is issued by TSSBA to finance the project over its useful payback period and the commercial paper is redeemed. The amount issued for projects at the university was $87,868.89 at June 30, 2012.

For the commercial paper program, the Tennessee State School Bond Authority maintains an interest rate reserve fund. The university contributes amounts to the reserve fund based on the amounts drawn. The principal of the reserve will be contributed to pay off notes or credited back to the university when the notes are converted to bonds. The interest earned on the reserve is used to pay interest due during the month.

More detailed information regarding the bonds and commercial paper can be found in the notes to the financial statements in the financial report for the Tennessee State School Bond Authority. That report is available on the state's website at www.comptroller.state.tn.gov/tssba/cafr.asp.

General Obligation Debt - Commercial Paper

The Tennessee State Funding Board issues commercial paper for the purpose of, among other things, acquisition of certain sites and existing structures for expansion purposes for the TBR on the behalf of the university. The amount outstanding for projects at the university was $4,270,653.20 at June 30, 2012. More detailed information regarding the commercial paper can be found in the notes to the financial statements in the financial report for the Tennessee State Funding Board included in the *Tennessee Comprehensive Annual Financial Report,* which is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

NOTE 9. ENDOWMENTS

If a donor has not provided specific instructions to the university, state law permits the university to authorize for expenditure the net appreciation (realized and unrealized) of the investments of endowment funds. When administering its power to spend net appreciation, the university is required to consider the university's long-term and short-term needs, present and anticipated financial requirements, expected total return on its investments, price-level trends, and general economic conditions.

Any net appreciation spent is required to be spent for the purposes for which the endowment was established.

The university chooses to spend only a portion of the investment income (including changes in the value of investments) each year. Under the spending plan established by the university, all interest earnings have been authorized for expenditure. The remaining amount, if any, is retained to be used in future years when the amount computed using the spending plan exceeds the investment income. Five of the endowment accounts require any interest generated in excess of expenses be reapplied to the principal. At June 30, 2012, net appreciation of $171,960.62 is available to be spent, of which $94,925.65 is included in restricted net assets expendable for scholarships and fellowships, $363.45 is included in restricted net assets expendable for instructional departmental uses, $64,577.65 is included in restricted net assets expendable for loans, and $12,093.87 is included in restricted net assets expendable for other.

NOTE 10. UNRESTRICTED NET ASSETS

Unrestricted net assets include funds that have been designated for specific purposes. The unrestricted net assets are composed of the following:

	June 30, 2012
Working capital	$16,774,132.92
Encumbrances	1,545,410.07
Designated fees	2,812,275.31
Auxiliaries	1,117,646.77
Plant construction	43,746,523.64
Renewal and replacement of equipment	20,792,954.22
Undesignated	24,471,032.88
Total	$111,259,975.81

NOTE 11. PLEDGED REVENUES

The university has pledged certain revenues and fees, including state appropriations, to repay $96,493,193.46 in revenue bonds issued from May, 1976 to May, 2011 (see Note 8 for further detail). Proceeds from the bonds provided financing for construction and renovation of various facilities as well as building systems and equipment. The bonds are payable through 2040. Annual principal and interest payments on the bonds are expected to require 1.94% of available revenues. The total principal and interest remaining to be paid on the bonds is $150,385,567.70. Principal and interest paid for the current year and total available revenues were $8,823,195.61 and $357,283,240.48, respectively.

NOTE 12. PENSION PLANS

A. Defined Benefit Plans

Tennessee Consolidated Retirement System

Plan Description - The university contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing, multiple-employer, defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS). TCRS provides retirement, death, and disability benefits as well as annual cost-of-living adjustments to plan members and their beneficiaries. Title 8, Chapters 34-37, *Tennessee Code Annotated*, establishes benefit provisions. State statutes are amended by the Tennessee General Assembly.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report is available on the state's website at www.treasury.tn.gov/tcrs.

Funding Policy - Plan members are noncontributory. The university is required to contribute an actuarially determined rate. The current rate is 14.91% of annual covered payroll. Contribution requirements for the university are established and may be amended by the TCRS' Board of Trustees. The university's contributions to TCRS for the years ended June 30, 2012, 2011, and 2010 were $8,338,695.98, $8,072,255.73, and $6,859,295.76. Contributions met the requirements for each year.

B. Defined Contribution Plans

Optional Retirement Plans

Plan Description - The university contributes to three defined contribution plans: Teachers Insurance and Annuity Association–College Retirement Equities Fund (TIAA-CREF), ING Life Insurance and Annuity Company, and Variable Annuity Life Insurance Company (VALIC). These plans are administered by the Tennessee Department of the Treasury. Each plan provides retirement benefits to faculty and staff who are exempt from the overtime provisions of the Fair Labor Standards Act and who waive membership in the TCRS. Benefits depend solely on amounts contributed to the plan plus investment earnings. Plan provisions are established by state statute in Title 8, Chapter 35, Part 4, *Tennessee Code Annotated.* State statutes are amended by the Tennessee General Assembly.

Funding Policy - Plan members are noncontributory. The university contributes an amount equal to 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Contribution requirements are established and amended by state statute. The contributions made by the university to the plans were $9,692,300.76 for the year ended June 30, 2012, and $9,265,201.83 for the year ended June 30, 2011. Contributions met the requirements for each year.

NOTE 13. OTHER POSTEMPLOYMENT BENEFITS

Healthcare is the only "other postemployment benefit" (OPEB) provided to employees. The State of Tennessee administers a group health insurance program which provides postemployment health insurance benefits to eligible university retirees. This program includes two plans available to higher education employees—the State Employee Group Plan and the Medicare Supplement Plan. For accounting purposes, the plans are agent multiple-employer defined benefit OPEB plans. Benefits are established and amended by an insurance committee created by Section 8-27-101, *Tennessee Code Annotated*. Prior to reaching age 65, all members have the option of choosing between the standard or partnership preferred provider organization (PPO) plan for healthcare benefits. Subsequent to age 65, members who are also in the state's retirement system may participate in a state-administered Medicare supplement that does not include pharmacy. The state makes on-behalf payments to the Medicare supplement plan for the university's eligible retirees; see Note 21. The plans are reported in the State of Tennessee's *Comprehensive Annual*

Financial Report (CAFR). The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

Special Funding Situation

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

Funding Policy

The premium requirements of members of the State Employee Group Plan are established and may be amended by the insurance committee. The plan is self-insured and financed on a pay-as-you-go basis with the risk shared equally among the participants. Claims liabilities of the plan are periodically computed using actuarial and statistical techniques to establish premium rates. Administrative costs of the plan are allocated to plan participants. In accordance with Section 8-27-205(b), *Tennessee Code Annotated*, retirees in the State Employee Group Plan pay the same base premium as active employees in the plan adjusted for years of service. 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 who are 65 years of age or older have flat-rate premium subsidies based on years of service. Retirees with 30 years of service receive $50 per month; retirees with 20 years of service but less than 30 years of service, $37.50; and retirees with 15 years of service but less than 20 years of service, $25.

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

Annual required contribution (ARC)	$ 3,791,000.00
Interest on the net OPEB obligation	550,946.28
Adjustment to the ARC	(584,817.75)
Annual OPEB cost	3,757,128.53
Amount of contribution	(2,820,390.21)
Increase in net OPEB obligation	936,738.32
Net OPEB obligation – beginning of year	13,773,657.17
Net OPEB obligation – end of year	$ 14,710,395.49

Year-end	Plan	Annual OPEB Cost	Percentage of Annual OPEB Cost Contributed	Net OPEB Obligation at Year-end
June 30, 2012	State Employee Group Plan	$3,757,128.53	75.07%	$14,710,395.49
June 30, 2011	State Employee Group Plan	$4,463,886.32	54.28%	$13,773,657.17
June 30, 2010	State Employee Group Plan	$4,908,874.53	39.90%	$11,732,798.56

Funded Status and Funding Progress

The funded status of the university's portion of the State Employee Group Plan as of July 1, 2011, was as follows:

State Employee Group Plan	
Actuarial valuation date	July 1, 2011
Actuarial accrued liability (AAL)	$30,832,000.00
Actuarial value of plan assets	-
Unfunded actuarial accrued liability (UAAL)	$30,832,000.00
Actuarial value of assets as a percentage of the AAL	0.00%
Covered payroll (active plan members)	$118,128,155.32
UAAL as percentage of covered payroll	26.10%

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, 2011, actuarial valuation, the Projected Unit Credit actuarial cost method was used. The actuarial assumptions included a 4 percent investment rate of return (net of administrative expenses) and an annual healthcare cost trend rate of 9.25 percent in fiscal year 2012. The rate decreases to 8.75 percent in fiscal year 2013, and then reduces by decrements to an ultimate rate of 5 percent in fiscal year 2021. All rates include a 2.5 percent inflation assumption. The unfunded actuarial accrued liability is being amortized as a level percentage of payroll on a closed basis over a 30-year period beginning with July 1, 2007.

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. The state purchases commercial insurance for real property and builder's risk (for construction projects starting prior to July 1, 2012) and crime and fidelity on the state's officials and employees. The contractor is responsible for acquiring builder's risk insurance for all construction projects after June 30, 2012, thus builder's risk is no longer covered by the Risk Management Fund. For property coverage, the deductible for an individual state agency is the first $25,000 of losses. The Risk Management Fund is responsible property losses for the annual aggregate deductible of $10 million for perils other than earthquakes and flood. Purchased insurance coverage is responsible for losses exceeding the $10 million 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 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 last three years.

The university participates in the Risk Management Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on a percentage of the university's expected loss costs, which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of fiscal year-end to determine the fund liability and premium allocation. Information regarding the determination of the claims liabilities and the changes in the balances of the claims liabilities for the year ended June 30, 2012, are presented in the *Tennessee Comprehensive Annual Financial Report*. The CAFR is available on the state's website at www.tn.gov/finance/act/cafr.shtml. Since the university participates in the Risk Management Fund, it is subject to the liability limitations under the provisions of the Tennessee Claims Commission Act, *Tennessee Code Annotated*, Section 9-8-101 et seq. Liability for negligence of the university for bodily injury and property damage is limited to $300,000 per person and $1,000,000 per occurrence. The limits of liability under workers' compensation are set forth in *Tennessee Code Annotated*, Section 50-6-101 et seq. Claims are paid through the state's Risk Management Fund. At June 30, 2012, the Risk Management Fund held $97.2 million in cash and cash equivalents designated for payment of claims.

At June 30, 2012, the scheduled coverage for the university was $1,366,895,800.00 for buildings and $319,842,900.00 for contents.

The state has also set aside assets in the Employee Group Insurance Fund, an internal service fund, to provide a program of health insurance coverage for the employees of the state with the risk retained by the state. The university participates in the Employee Group Insurance Fund. The fund allocates the cost of providing claims servicing and claims payment by charging a premium to the university based on estimates of the ultimate cost of claims, including the cost of claims that have been reported but not settled and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims.

NOTE 15. COMMITMENTS AND CONTINGENCIES

Sick Leave

The university records the cost of sick leave when paid. The dollar amount of unused sick leave was $77,088,036.25 at June 30, 2012.

Operating Leases

The university has entered into various operating leases for buildings and equipment. Such leases will probably continue to be required. Expenses under operating leases for real property were $2,137,930.55 and for personal property were $738,731.66 for the year ended June 30, 2012. All operating leases are cancelable at the lessee's option.

Construction in Progress

At June 30, 2012, outstanding commitments under construction contracts totaled $9,286,790.48 for New Student Housing, Community Health Facility, Biochemistry and Biology Faculty, Access and Security Update, Drainage Corrections, Various Roof Replacements, Engineering Complex HVAC, South Hall Fire Safety Upgrades, Railroad Pedestrian Improvements, and Field House Renovations, of which $2,111,697.76 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. CHAIRS OF EXCELLENCE

The university had $65,403,105.24 on deposit at June 30, 2012, 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 17. FUNDS HELD IN TRUST BY OTHERS

The university is a beneficiary under the Herbert Herff, Van Vleet, Mike Driver, Pope M. Farrington, and C.M. Gooch trusts. The underlying assets are not considered assets of the university and are not included in the university's financial statements. The university received $1,172,511.42 from these funds during the year ended June 30, 2012.

NOTE 18. NATURAL CLASSIFICATIONS WITH FUNCTIONAL CLASSIFICATIONS

The university's operating expenses for the year ended June 30, 2012, are as follows:

	Natural Classification					
Functional Classification	Salaries	Benefits	Other Operating	Scholarships	Depreciation	Total
Instruction	$ 88,679,106.63	$ 22,204,252.75	$ 16,880,616.16	$ -	$ -	$ 127,763,975.54
Research	21,874,301.07	3,660,026.79	12,021,746.07	-	-	37,556,073.93
Public service	6,296,937.15	1,428,761.58	3,054,878.69	-	-	10,780,577.42
Academic support	15,867,346.47	6,007,348.79	5,305,911.97	-	-	27,180,607.23
Student services	21,762,322.66	7,049,145.90	25,216,253.33	-	-	54,027,721.89
Institutional support	16,868,324.33	6,684,778.44	10,890,368.11	-	-	34,443,470.88
Maintenance & operation	11,892,179.00	7,036,685.27	15,607,722.14	-	-	34,536,586.41
Scholarships & fellowships	-	-	-	56,454,879.19	-	56,454,879.19
Auxiliary	2,696,416.32	695,812.08	12,010,836.77	-	-	15,403,065.17
Depreciation	-	-	-	-	29,029,318.86	29,029,318.86
Total	$ 185,936,933.63	$ 54,766,811.60	$ 100,988,333.24	$ 56,454,879.19	$ 29,029,318.86	$427,176,276.52

Expenses initially incurred by the academic support function as a result of providing internal services to the other functional classifications were allocated to the other functional areas by reducing the academic support function's operating expenses by the total amount of salaries, benefits, and operating expenses incurred in the provision of these services, and allocating this amount to the other functional areas' operating expenses on the basis of usage. As a result of this process, expenses totaling $8,920,552.80 were reallocated from academic support to the other functional areas.

NOTE 19. PRIOR-YEAR ADJUSTMENT

In the year ended June 30, 2012, the university began amortizing TSSBA bond premiums and discounts greater than $100,000 over the life of the bonds. Prior issuances were reviewed for materiality. The university identified five projects with bond premiums exceeding the $100,000 threshold. Unamortized premiums of $2,399,855.79 at June 30, 2011 were recorded. As a result, invested in capital assets, net of related debt, was reduced by $2,399,855.79.

NOTE 20. AFFILIATED ENTITY NOT INCLUDED

The University of Memphis Research Foundation is a private, nonprofit foundation with the university as the sole beneficiary. The University of Memphis Research Foundation is controlled by a board independent of the university. The financial records, investments, and other financial transactions are handled external to the university and these amounts are not included in the university's financial report. As reported in the foundation's most recently audited financial report, at June 30, 2011, the assets of the foundation totaled $3,574,584, liabilities were $495,873, and the net assets amounted to $3,078,711.

NOTE 21. ON-BEHALF PAYMENTS

During the year ended June 30, 2012, the State of Tennessee made payments of $207,106.79 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 13. The plan is reported in the *Tennessee Comprehensive Annual Financial Report*. That report is available on the state's website at www.tn.gov/finance/act/cafr.shtml.

NOTE 22. VOLUNTARY BUYOUT PROGRAM

The university implemented a Voluntary Buyout Plan in fiscal year 2011 as a strategy to assist the university in addressing budgetary constraints due to several years of state appropriation reductions and potential budget reductions in the forthcoming fiscal years. The university had 22 employees participate in the Voluntary Buyout Plan with 15 terminating by June 30, 2011, and 7 terminating by June 30, 2012.

Each participant will receive 150% of their institutional base salary calculated on the date of separation, to be paid over a three-year time period in three equal annual installments.

As of June 30, 2012, expenses for payout of accrued annual leave, compensatory time, or worked holidays for the Voluntary Buyout Plan and Post-Retirement Service Program were $603,293.45. Accrued expenses for severance pay were $2,027,881.75 at June 30, 2012.

NOTE 23. SUBSEQUENT EVENTS

The university submitted its official notice of intent to withdraw from Conference USA effective July 1, 2013. The university will owe Conference USA $500,000.00, plus any loss of television rights fees as a result of the member's withdrawal, during the five year period immediately subsequent to the effective date of the member's withdrawal, with that amount reduced by the value of any NCAA basketball fund units earned through the 2013 season. At this time, any potential loss in fees for television rights has not yet been determined. The university and the Conference have agreed that the university has accumulated $5,084,713 in basketball credits earned over the last five years, but that any additional basketball fund units earned for the 2012-2013 season may not be determined until April of 2013. It is anticipated that the credits earned will be sufficient to offset the withdrawal fee.

On February 7, 2012, the university signed a Membership Expansion Agreement to join the Big East Conference effective July 1, 2013. The university will pay a one-time entry fee of $2,500,000, payable in five installments of $500,000, with the first installment due on June 30, 2014.

NOTE 24. COMPONENT UNIT

The University of Memphis Foundation is a legally separate, tax-exempt organization supporting The University of Memphis. 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 approximately 40-member board of the foundation is self-perpetuating and consists of graduates and friends of the university. Although the university does not control the timing or amount of receipts from the foundation, the majority of resources, or income thereon, which the foundation holds and invests are restricted to the activities of the university by the donors. Because these restricted resources held by the foundation can only be used by, or for the benefit of, the university, the foundation is considered a component unit of the university and is discretely presented in the university's financial statements.

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

During the year ended June 30, 2012, the foundation made distributions of $15,204,902.00 to or on behalf of the university for both restricted and unrestricted purposes. Complete financial statements for the foundation can be obtained from the Managing Director, University of Memphis Foundation, 635 Normal Street, Memphis, Tennessee, 38152-3750, or online at http://www.memphis.edu/foundation/statements.php.

Fair Value Measurements

The foundation reports certain assets and liabilities at fair value. Fair value has been determined using quoted prices in active markets for identical assets and liabilities that are accessible at the measurement date (Level 1), inputs other than quoted market prices included in Level 1 that are directly or indirectly observable for the asset or liability (Level 2), or significant unobservable inputs (Level 3). The following table categorizes the recurring fair value measurements for assets and liabilities at June 30, 2012.

	Total Fair Value at June 30, 2012	Quoted Prices Level 1	Significant Other Inputs Level 2	Significant Unobservable Inputs Level 3
Assets:				
Money market funds	$ 780,029.00	$ 780,029.00	$ -	$ -
Limited partnerships and LLCs	36,191,386.00	-	4,344,135.00	31,847,251.00
Common/collective trust fund – international equity	5,926,140.00	-	5,926,140.00	-

Mutual funds	61,691,062.00	61,691,062.00	-	-
U.S. government Securities	155,157.00	-	155,157.00	-
Corporate bonds	61,480.00	-	61,480.00	-
Total assets	$ 104,805,254.00	$ 62,471,091.00	$ 10,486,912.00	$ 31,847,251.00

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

Limited Partnership and LCC Investments

Balances, beginning of year	$27,686,976.00
Purchases	5,113,059.00
Sales	(1,683,482.00)
Unrealized gains	730,698.00
Balances, end of year	$31,847,251.00

All gains and losses, both realized and unrealized, have been reported on the statement of revenues, expenses, and changes in net assets as investment income. Of this total, $730,698.00 is attributable to the change in unrealized gains or losses relating to those assets and liabilities still held at June 30, 2012.

The following is a description of the categories of Limited Partnership and LLC Investments used for Level 3 assets measured at fair value.

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

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

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

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

Cash and Cash Equivalents

Cash and cash equivalents consist of demand deposit accounts. The bank balances of deposits at June 30, 2012, were entirely insured.

Investments

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

Investments held at June 30, 2012, were as follows:

	Cost	Fair Value
Money market funds	$ 780,029.00	$ 780,029.00
Limited partnerships and LLCs	32,099,639.00	36,191,386.00
Common/collective trust fund	2,336,126.00	5,926,140.00
Mutual funds	61,066,029.00	61,691,062.00
U.S. government securities	154,986.00	155,157.00
Corporate bonds	60,831.00	61,480.00
Total investments	$ 96,497,640.00	$104,805,254.00

Alternative investments - The foundation has investments in certain limited partnerships and other investments. The estimated fair value of these assets is $31,847,251.00 at June 30, 2012.

The foundation believes that the carrying amount of its alternative investments is a reasonable estimate of fair value as of June 30, 2012. Because these investments are not readily marketable, the estimated value is subject to uncertainty and therefore may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. These investments are made in accordance with the foundation's investment policy that approves the allocation of funds to various asset classes in order to ensure the proper level of diversification.

These investments are designed to enhance diversification and provide reductions in overall portfolio volatility. These fair values are estimated using various valuation techniques.

Pledges Receivable

Pledges receivable are summarized below net of the allowance for doubtful accounts.

		June 30, 2012
Current pledges	$	3,125,562.00
Pledges due in one to five years		4,301,033.00
Pledges due after five years		281,250.00
Subtotal		7,707,845.00
Less discount to net present value		(66,624.00)
Less allowance for uncollectible pledges receivable		(773,691.00)
Total pledges receivable, net	$	6,867,530.00

Endowments

The University of Memphis Foundation's endowment consists of over 400 individual funds established for a variety of purposes. Its endowment includes both donor-restricted endowment funds and funds designated by the Board of Trustees to function as endowments. As required by GAAP, net assets associated with endowment funds, including funds designated by the Board of Trustees to function as endowments, are classified and reported based on the existence or absence of donor-imposed restrictions.

Interpretation of relevant law - The Board of Trustees of The University of Memphis Foundation has interpreted the Uniform Prudent Management of Institutional Funds Act (the Act) as adopted by Tennessee as requiring the preservation of the fair value of the original gift as of the gift date of the donor-restricted endowment funds absent explicit donor stipulations to the contrary. As a result of this interpretation, The University of Memphis Foundation classifies as permanently restricted net assets (1) the original value of gifts donated to the permanent endowment; and (2) the original value of subsequent gifts to the permanent endowment The remaining portion of the donor-restricted endowment fund that is not classified in permanently restricted net assets is classified as temporarily restricted net assets 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.

Composition of Endowment by Net Asset Class
As of June 30, 2012

	Permanently Restricted	Temporarily Restricted	Unrestricted	Total
Donor-restricted endowment funds	$56,066,483.00	$11,007,963.00	$ (2,091,263.00)	$ 64,983,183.00
Board-designated endowment funds	-	-	4,753,707.00	4,753,707.00
Total funds	$56,066,483.00	$11,007,963.00	$ 2,662,444.00	$ 69,736,890.00

Changes in Endowment Net Assets
for the Fiscal Year Ended June 30, 2012

	Permanently Restricted	Temporarily Restricted	Unrestricted	Total
Endowment net assets, beginning of year	$ 53,494,392.00	$ 13,156,471.00	$ 4,218,308.00	$ 70,869,171.00
Investment return:				
Investment income	-	(567,019.00)	(48,149.00)	(615,168.00)
Net appreciation (realized and unrealized)	-	(490,169.00)	(42,674.00)	(532,843.00)
Total investment return	-	(1,057,188.00)	(90,823.00)	(1,148,011.00)
Contributions	1,964,883.00	47,356.00	-	2,012,239.00
Appropriations of endowment assets for expenditure	-	(2,339,647.00)	(255,300.00)	(2,594,947.00)
Other changes:				
Investment deficiencies reclassed to unrestricted net assets	-	1,209,741.00	(1,209,741.00)	-
Modifications of restrictions	607,208.00	(8,770.00)	-	598,438.00
Endowment net assets, end of year	$ 56,066,483.00	$ 11,007,963.00	$ 2,662,444.00	$ 69,736,890.00

All of the permanently restricted endowment funds are required to be retained permanently either by explicit donor stipulation or the Act. The portion of the temporarily restricted endowment funds subject to time and purpose restrictions was $11,007,963.00 as of June 30, 2012. There were no temporarily restricted endowment funds only subject to time restrictions as of June 30, 2012.

Funds with deficiencies - From time to time, the fair value of assets associated with individual donor restricted endowment funds may fall below the level that the foundation is required to retain in a fund of perpetual duration. In accordance with accounting principles generally accepted in the United States of America, deficiencies of this nature are reported in unrestricted net assets. These deficiencies resulted from unfavorable market fluctuations that occurred after the investment of permanently restricted contributions and/or continued appropriation for fees and previously approved budgeted expenditures. At June 30, 2012, deficiencies of this nature totaled $2,091,263.00.

Return objectives and risk parameters - The foundation has adopted investment and spending policies for endowment assets that attempt to provide a predictable stream of funding to programs supported by its endowment while seeking to maintain the purchasing power of the endowment assets. Endowment assets include those assets of donor-restricted funds that the organization must hold in perpetuity or for a donor-specified period as well as board-designated funds. Under this policy, as approved by the Board of Trustees, the endowment assets are invested in a manner that is intended to produce consistent long-term growth of capital without undue exposure to risk.

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 budgeting for expenditure each year a percentage of its endowment funds' average fair value over the prior 12 quarters through the fiscal year-end one year preceding the fiscal year in which the expenditure is planned. For fiscal year 2012, this percentage was 4.75%. In establishing this policy, the foundation considered the long-term expected return on its endowment. Accordingly, over the long-term, the foundation expects the current spending policy to allow for endowment growth. This is consistent with the foundation's objective to maintain the purchasing power of the endowment assets held in perpetuity or for a specified term as well as to provide additional real growth through new gifts and investment return.

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

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, 2011	State Employee Group Plan	$ -	$30,832,000	$30,832,000	0.00%	$118,128,155	26.10%
July 1, 2010	State Employee Group Plan	$ -	$42,006,000	$42,006,000	0.00%	$116,448,047	36.07%
July 1, 2009	State Employee Group Plan	$ -	$46,310,000	$46,310,000	0.00%	$125,869,761	36.79%

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

TENNESSEE BOARD OF REGENTS
THE UNIVERSITY OF MEMPHIS
SUPPLEMENTARY INFORMATION
SCHEDULE OF CASH FLOWS - COMPONENT UNIT
FOR THE YEAR ENDED JUNE 30, 2012

CASH FLOWS FROM OPERATING ACTIVITIES		
Gifts and contributions	$	23,632,432.00
Payments for scholarships		(8,963,512.00)
Payments to The University of Memphis		(14,805,049.00)
Net cash used by operating activities		(136,129.00)
CASH FLOWS FROM NON-CAPITAL FINANCING ACTIVITIES		
Private gifts for endowment purposes		1,724,086.00
Other noncapital financing receipts (payments)		(429,962.00)
Net cash provided by non-capital financing activities		1,294,124.00
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments		58,618,138.00
Income on investments		1,123,998.00
Purchase of investments		(60,062,284.00)
Net cash used by investing activities		(320,148.00)
Net increase in cash and cash equivalents		837,847.00
Cash and cash equivalents - beginning of year		847,622.00
Cash and cash equivalents - end of year	$	1,685,469.00
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Operating loss	$	(448,148.00)
Change in assets and liabilities:		
Receivables, net		(141,356.00)
Accounts payable		410,085.00
Accrued liabilities		53,522.00
Other assets		(10,232.00)
Net cash used by operating activities	$	(136,129.00)
Non-cash investing, capital, and financing transactions		
Unrealized losses on investments	$	(864,652.00)