



JASON E. MUMPOWER  
*Comptroller*

## Independent Auditor's Report

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

### Report on the Audit of the Financial Statements

#### *Opinion*

We have audited the accompanying balance sheet of the Chairs of Excellence Trust, a permanent fund of the State of Tennessee, as of June 30, 2023; the related statement of revenues, expenditures, and changes in fund balance for the year then ended; and the related notes to the financial statements, which collectively comprise the Chairs of Excellence Trust's basic financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Chairs of Excellence Trust Fund as of June 30, 2023, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

#### *Basis of Opinion*

We conducted our audit in accordance with auditing standards generally accepted in the United States of America (GAAS) and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of the Chairs of Excellence Trust and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audit. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of trustees of the Chairs of Excellence Trust. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Chairs of Excellence Trust.

## *Responsibilities of Management for the Financial Statements*

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

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the Chairs of Excellence Trust's ability to continue as a going concern for twelve months beyond the financial statement date, including any currently known information that may raise substantial doubt shortly thereafter.

## *Auditor's Responsibility for the Audit of the Financial Statements*

Our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion.

Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS and *Government Auditing Standards* will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the financial statements.

In performing an audit in accordance with GAAS and *Government Auditing Standards*, we

- exercise professional judgment and maintain professional skepticism throughout the audit.
- identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Chairs of Excellence Trust's internal control. Accordingly, no such opinion is expressed.
- evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.

- conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about the Chairs of Excellence Trust's ability to continue as a going concern for a reasonable period of time.

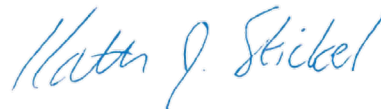
We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control-related matters that we identified during the audit.

### *Emphasis of Matter*

As discussed in Note A.1., the financial statements present only the Chairs of Excellence Trust, a permanent fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2023, and the changes in financial position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

### *Other Reporting Required by Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2023, on our consideration of the Chairs of Excellence Trust's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Chairs of Excellence Trust's internal control over financial reporting and compliance.



Katherine J. Stickel, CPA, CGFM, Director  
Division of State Audit  
December 12, 2023

# Chairs of Excellence Program

## Chairs of Excellence Balance Sheet June 30, 2023

### ASSETS

Cash and Cash Equivalents	\$	7,035,310
Receivables		
Due from Colleges and Universities		1,756,415
Investment Income Receivable		1,506,424
Total Receivables		3,262,839
Investments at Fair Value		
Government Securities		92,626,843
Corporate Securities		23,690,060
Investment in Exchange Traded Equity Fund		300,126,080
Total Investments		416,442,983
TOTAL ASSETS	\$	426,741,132

### LIABILITIES AND FUND BALANCES

#### LIABILITIES

Due to Colleges and Universities	\$	3,346,663
Due to the Academic Scholars Fund		2,721,826
Due to the General Fund		12
TOTAL LIABILITIES		6,068,501

#### FUND BALANCES

Nonspendable Corpus		104,361,888
Restricted		316,310,743
TOTAL FUND BALANCES		420,672,631
TOTAL LIABILITIES AND FUND BALANCES	\$	426,741,132

See accompanying Notes to the Financial Statements

# Chairs of Excellence Program

## Chairs of Excellence Statement of Revenues, Expenditures, and Changes in Fund Balance For the Year Ended June 30, 2023

### REVENUES

Investment Income	\$	46,847,174
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TOTAL REVENUES		<u>46,847,174</u>
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### EXPENDITURES

University of Tennessee		5,616,587
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State University and Community College System		5,325,501
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Administrative Cost		<u>318,419</u>
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TOTAL EXPENDITURES		<u>11,260,507</u>
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NET CHANGE IN FUND BALANCE		35,586,667
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FUND BALANCES, BEGINNING OF YEAR		<u>385,085,964</u>
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FUND BALANCES, END OF YEAR	\$	<u><u>420,672,631</u></u>
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*See accompanying Notes to the Financial Statements*

Chairs of Excellence  
Notes to the Financial Statements  
For Fiscal Year Ended June 30, 2023

## **A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

### **1. Reporting Entity**

The Chairs of Excellence (COE) Trust forms an integral part of the primary government and has been included as a permanent fund in the *Tennessee Annual Comprehensive Financial Report*. That report is available on the state's website at <https://www.tn.gov/finance/rd-doa/fa-acffin-ar.html>.

### **2. Measurement Focus and Basis of Accounting**

The accompanying financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB), using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when they become both measurable and available, and expenditures are recognized when the related fund liability is incurred. Interest associated with the current fiscal year is considered to be available if received in six months.

### **3. Cash and Cash Equivalents**

Cash and cash equivalents includes cash and short term investments with a maturity date within three months of the acquisition date. Cash management pools are included as cash. Cash received that cannot be immediately invested in securities, or that is needed for operations, is invested in either the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer or a short-term, open-end mutual fund under the contractual arrangement for master custody services and invested in the State Street Government Money Market Fund.

### **4. Method Used to Value Investments**

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

The fair value of assets held at June 30, 2023, represents the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Assets held are categorized for fair value measurement within the fair value hierarchy established by Generally Accepted Accounting Principles (GAAP). The hierarchy is based on the valuation inputs used to measure the fair value of the asset and give the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements).

- Level 1 - Unadjusted quoted prices for identical assets or liabilities in active markets that can be accessed at the measurement date.
- Level 2 - Quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; assets or liabilities that have a bid-ask spread price

in an inactive dealer market, brokered market and principal-to-principal market; and Level 1 assets or liabilities that are adjusted.

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

Investments where fair value is measured using the Net Asset Value (“NAV”) per share have no readily determinable fair value and have been determined to be calculated consistent with FASB principles for investment companies.

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

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

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

US Treasury Bills, Bonds, Notes and Futures classified in Level 1 are valued using last reported sales prices quoted in active markets that can be accessed at the measurement date. Debt and debt derivative securities classified in Level 2 are valued using a bid-ask spread price from multiple independent brokers, dealers, or market principals, which are known to be actively involved in the market. Level 3 debt securities are valued using proprietary information, a single pricing source, or other unobservable inputs related to similar assets or liabilities.

# Chairs of Excellence Program

## Investments Measured at Fair Value For Fiscal Year Ended June 30, 2023 *Expressed in Thousands*

Investments at Fair Value Level	GAAP Hierarchy Level 1	GAAP Hierarchy Level 2	GAAP Hierarchy Level 3	Total Assets
Exchange Traded Equity Funds	\$ 300,126			\$ 300,126
Government Agencies		\$ 885		885
Government Asset Backed		1,703		1,703
Government Bonds	34,879			34,879
Government Mortgage Backed		22,243		22,243
Index Linked Government Bonds	32,417			32,417
Municipals		500		500
CMO			\$ 940	940
Corporate Asset Backed		700	1,363	2,063
Corporate Bonds		20,687		20,687
<b>TOTAL INVESTMENTS AT FAIR VALUE</b>	<b>\$ 367,422</b>	<b>\$ 46,718</b>	<b>\$ 2,303</b>	<b>\$ 416,443</b>
Cash and Cash Equivalents				7,035
Other Receivables				1,756
Investment Income Receivable				1,507
<b>TOTAL FINANCIAL STATEMENT ASSETS</b>				<b>\$ 426,741</b>

### 5. Fund Balances

Non-spendable fund balance includes amounts that cannot be spent because they are legally or contractually required to be maintained intact. The COE Trust's non-spendable corpus consists of funds provided by contributions from the state, colleges and universities, and private sources. Restricted fund balance includes amounts that are restricted for specific purposes stipulated by external resource providers, constitutionally, or through enabling legislation. The COE Trust's restricted fund balance consists of investment income that must be used for funding the Chairs of Excellence program.

### B: DEPOSITS AND INVESTMENTS

State statute authorizes the funds of the COE Trust to be commingled for investment with other trust funds and other funds subject to investment by the State Treasurer. The COE Trust does not maintain its own bank accounts but utilizes the State Pooled Investment Fund (SPIF) for its operating cash needs. The SPIF is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee.



# Chairs of Excellence Program

The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements and various U.S. Treasury and Agency obligations. The SPIF is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities.

State statute also authorizes the Board of Trustees of the COE Trust to adopt an investment policy for the trust in accordance with the laws, guidelines and policies that govern investments by the Tennessee Consolidated Retirement System. The State Treasurer is responsible for the investment of trust funds in accordance with the policy established by the trustees. The investment policy of the COE Trust requires that public funds, capital gains on public funds, and all current income exceeding withdrawals be invested in fixed income securities. Private contributions may be invested in equity securities, including domestic and foreign common stocks, preferred stocks and convertible bonds. Subsequent to the initial funding of a chair, funds may be transferred from the equity corpus to the fixed income corpus but not from the fixed income corpus to the equity corpus. During the year ended June 30, 2023, the COE Trust's equity investments were within the overall limits on equity securities per statutory and policy provisions. As of June 30, 2023, the COE Trust had the following investments (expressed in thousands):

**Credit Quality Distribution for Securities with Credit Exposure  
as a Percentage of Total Investments  
For Fiscal Year Ended June 30, 2023  
*Expressed in Thousands***

Rating	Fair Value	Percentage of Total Investments
AAA	\$ 916	0.22%
AA	2,629	0.63%
A	6,844	1.64%
BBB	12,799	3.07%
Not Rated	22,907	5.50%
 Total Debt Investments	 46,095	
 Government Agencies and Obligations*	 70,222	
Total Fixed Income Securities	116,317	
 Equity	 300,126	
 Total Investments as Shown on Statements	 \$ 416,443	

\*Includes obligations of the US Government or obligations explicitly guaranteed by the US Government.

## Credit Risk

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings for the COE Trust's investments in fixed income securities as of June 30, 2023, are included in the above schedule. Securities are rated using Standard and Poor's and/or Moody's and are presented above using the Standard and Poor's rating scale. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally recognized credit ratings agency. The State Street Government Money Market Fund is not rated at June 30, 2023.

The COE Trust's investment policy states that the majority of investments should be placed in high quality debt securities to produce adequate income with minimal risk. In addition, for short-term investments, the investment policy states that only the highest quality short-term debt issues should be purchased.

As noted above, the COE Trust does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash purposes. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented in the State Pooled Investment Fund Report. That report is available on the state's website at <https://treasury.tn.gov>.

## Concentration of Credit Risk

A concentration of investments in any one single issuer of debt securities presents a greater risk for loss in the event that the issuer fails on its obligations. The COE Trust did not have any investment amounts and percentages of total investments at June 30, 2023, in organizations representing five percent or more of total investments, excluding those organizations whose issues are explicitly guaranteed by the United States government, and investments in mutual funds, external investment pools, and other pooled investments.

The COE Trust's investment policy does not specifically address limitations on investing in any one issuer.

## Interest Rate Risk

Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The investment policy for the COE Trust states that the maturity of its debt securities may range from short-term instruments, including investments in the State Pooled Investment Fund, to long-term bonds, with consideration of liquidity needs. However, the policy does not specifically address limits on investment maturities. The fixed income portfolio is benchmarked against the Barclays Aggregate Index and tends to have a duration within a tight range around that index. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price. The COE Trust had the following investments and effective duration at June 30, 2023 (expressed in thousands).

# Chairs of Excellence Program

## Distribution of Fixed Income Securities by Type and Effective Duration For Fiscal Year Ended June 30, 2023 *Expressed in Thousands*

Investment Type	Fair Value	Effective Duration (Years)
U.S. Government Agencies	\$ 885	5.87
U.S. Government Inflation Indexed	32,417	6.70
U.S. Government Bonds	34,879	9.24
Municipal Bonds	500	0.24
Government Asset Backed	1,703	5.98
Government Mortgage Backed	22,243	5.46
Corporate Asset Backed	2,063	0.15
Corporate Bonds	20,687	3.96
Corporate Mortgage Backed	940	1.10
Total Debt Investments	\$ 116,317	6.53

### Asset Backed Securities

The COE Trust invests in collateralized mortgage obligations (CMOs) which are mortgage-backed securities. These securities are based on cash flows from interest and principal payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagors, which may result from a decline in interest rates. The fair value of CMOs at June 30, 2023, was \$940,109 and the total amount were CMOs that are generally more sensitive to interest rate changes.

### C: OTHER ACCOUNTING DISCLOSURES

**1. Chairs of Excellence Endowment Trust** - The COE Trust is authorized by the 94th General Assembly to further the cause of education in Tennessee. The COE Trust is administered by the State Treasurer. The Trust is set up into two general accounts which equally divide any state appropriations: one for the University of Tennessee and one for the State University and Community College System. As each Chair is designated, a portion of the appropriation is transferred to a sub account for that Chair. The awarding college or university must provide matching contributions, of which at least 50 percent of the funds are from private contributions.

One hundred Chairs have been established with matching contributions received totaling \$58,461,888 as of June 30, 2023. Total contributions to the COE Trust totaled \$104,361,888 as of June 30, 2023. This includes \$45,900,000 from the State, \$10,321,300 from Colleges and Universities, and \$48,140,588 from private contributions as of June 30, 2023.

**2. Other Funds** - Funds from the Academic Scholars Fund are combined with the COE Trust for investment purposes only. This fund's general account receives only the income earned on its principal and does not receive any COE Trust state contributions or appropriations. The fund is invested in domestic fixed income securities.