



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 K-12 Mental Health 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 K-12 Mental Health 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 K-12 Mental Health 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 K-12 Mental Health 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 K-12 Mental Health Trust. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the K-12 Mental Health 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 K-12 Mental Health 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 K-12 Mental Health 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 K-12 Mental Health 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 K-12 Mental Health 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 K-12 Mental Health 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 K-12 Mental Health Trust's internal control over financial reporting and compliance.



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

K-12 Mental Health Trust Fund

K-12 Mental Health Endowment Trust Balance Sheet June 30, 2023

ASSETS

Cash and Cash Equivalents	\$	14,415,670
Receivables		
Investment Income Receivable		2,988,706
Total Receivables		2,988,706
Investments at Fair Value		
Government Securities		101,900,970
Corporate Securities		127,272,615
Total Investments		229,173,585
TOTAL ASSETS	\$	246,577,961

LIABILITIES AND FUND BALANCE

TOTAL LIABILITIES		0
FUND BALANCE		
Nonspendable Corpus		225,000,000
Restricted		21,577,961
TOTAL FUND BALANCE		246,577,961
TOTAL LIABILITIES AND FUND BALANCE	\$	246,577,961

See accompanying Notes to the Financial Statements

K-12 Mental Health Trust Fund

K-12 Mental Health Endowment Trust Statement of Revenues, Expenditures, and Changes in Fund Balance For the Year Ended June 30, 2023

REVENUES

Investment Income (Loss)	\$ (6,261,409)
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TOTAL REVENUES	<u>(6,261,409)</u>
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EXPENDITURES

Administrative Cost	<u>186,227</u>
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TOTAL EXPENDITURES	<u>186,227</u>
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DEFICIENCY OF REVENUES OVER EXPENDITURES	(6,447,636)
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NET CHANGE IN FUND BALANCE	(6,447,636)
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FUND BALANCE, BEGINNING OF YEAR	<u>253,025,597</u>
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FUND BALANCE, END OF YEAR	<u>\$ 246,577,961</u>
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See accompanying Notes to the Financial Statements

K-12 Mental Health Trust Fund
Notes to the Financial Statements
For Fiscal Year Ended June 30, 2023

A: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The K-12 Mental Health 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 the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer.

4. Method Used to Value Investments

Investments are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price. 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.

K-12 Mental Health Trust Fund

- 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.

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.

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 Investments
Government Bonds	\$ 44,560			\$ 44,560
Government Mortgage Backed		\$ 57,341		57,341
Corporate Asset Backed			\$ 76,684	76,684
Corporate Bonds		50,589		50,589
TOTAL INVESTMENTS AT FAIR VALUE	\$ 44,560	\$ 107,930	\$ 76,684	\$ 229,174
Cash and Cash Equivalents				14,415
Investment Income Receivable				2,989
TOTAL FINANCIAL STATEMENT ASSETS				\$ 246,578

5. Fund Balances

The K-12 Mental Health Endowment consist of 90% of the initial deposit into the trust. Non-spendable fund balance includes amounts that cannot be spent because they are legally or contractually required to be maintained intact. The K-12 Mental Health Special Reserve consist of 10% of the initial deposit. Restricted fund balance includes amounts that are restricted for specific purposes stipulated by external resource providers, constitutionally, or through enabling legislation. The K-12 Trust's restricted fund balance may be subject to allocation and/or distribution in accordance with the K-12 Endowment agreement, includes all amounts transferred to the fund except the initial deposit constituting the corpus, and any income from investments.

B: DEPOSITS AND INVESTMENTS

State statute authorizes the funds of the K-12 Trust to be commingled for investment with other trust funds and other funds subject to investment by the State Treasurer. The K-12 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. 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 K-12 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 K-12 Trust allows for the fund assets to be invested in investment grade fixed income securities as well as non-rated or non-investment grade, fixed income investments as defined in the policy. Investment in equities is not permitted however, shares received as a result of a bankruptcy or reorganization of an issuer's debt will be disposed of in a commercially reasonable time frame. During the year ended June 30, 2023, the K-12 Trust held no equity investments.

K-12 Mental Health Trust Fund

As of June 30, 2023, the K-12 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
A	\$ 14,553	6.35%
BB	917	0.40%
BBB	105,914	46.22%
Not Rated	63,230	27.59%
 Total Debt Investments	 184,614	
 Government Agencies and Obligations*	 44,560	
Total Fixed Income Securities	229,174	
 Equity	 0	
 Total Investments as Shown on Statements	 \$ 229,174	

*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 K-12 Trust's investments in fixed income securities as of June 30, 2023, are included in the above schedule. Securities are rated using Nationally Recognized Statistical Rating Organizations (NRSRO) and are presented above. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally recognized credit ratings agency.

The K-12 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 K-12 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 K-12 Trust had the following 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.

Issuer Organization	June 30, 2023 Fair Value	Percentage
Federal Home Loan Mortgage Corporation	\$ 25,675,546	11.20%
Federal National Mortgage Association	\$ 31,665,534	13.82%

The K-12 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 K-12 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. 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 K-12 Trust had the following investments and effective duration at June 30, 2023 (expressed in thousands).

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)
Government Fixed Income		
Government Bonds	\$ 44,560	14.88
Government Mortgage Backed	57,341	7.19
Corporate Fixed Income		
Corporate Asset Backed	76,684	0.41
Corporate Bonds	50,589	10.85
Total Debt Investments	\$ 229,174	7.23

C: OTHER ACCOUNTING DISCLOSURES

K-12 Mental Health Endowment Trust

The K-12 Mental Health Trust Fund Act was established by *Chapter No. 595 of the Public Acts of 2021* for the purpose of providing mental health supports to students in primary and secondary schools in this state. The Act created the K-12 Mental Health Endowment Trust which consists of the K-12 Mental Health Endowment Account and the K-12 Mental Health Special Reserve Account. *Tennessee Code Annotated, Section 49-3-502*, provides that the principal of the Trust shall not be expended for any purpose. The Trust's principal is \$225,000,000.00 and is the non-spendable corpus amount of the K-12 Trust. Investment income, subsequent deposits, and transfers to the K-12 Trust will be credited to the K-12 Mental Health Special Reserve Account that is to be used only for mental or behavioral health services or treatment for kindergarten through grade 12 students in the state of Tennessee.