2002 2003

YEAR IN REVIEW

Report of Dr. Joseph E. Johnson, Interim President,
To the University of Tennessee Board of Trustees

YEAR IN

The University of Tennessee Annual Report 2002–2003

The University of Tennessee

The University of Tennessee is a statewide system of higher education comprising three institutions:

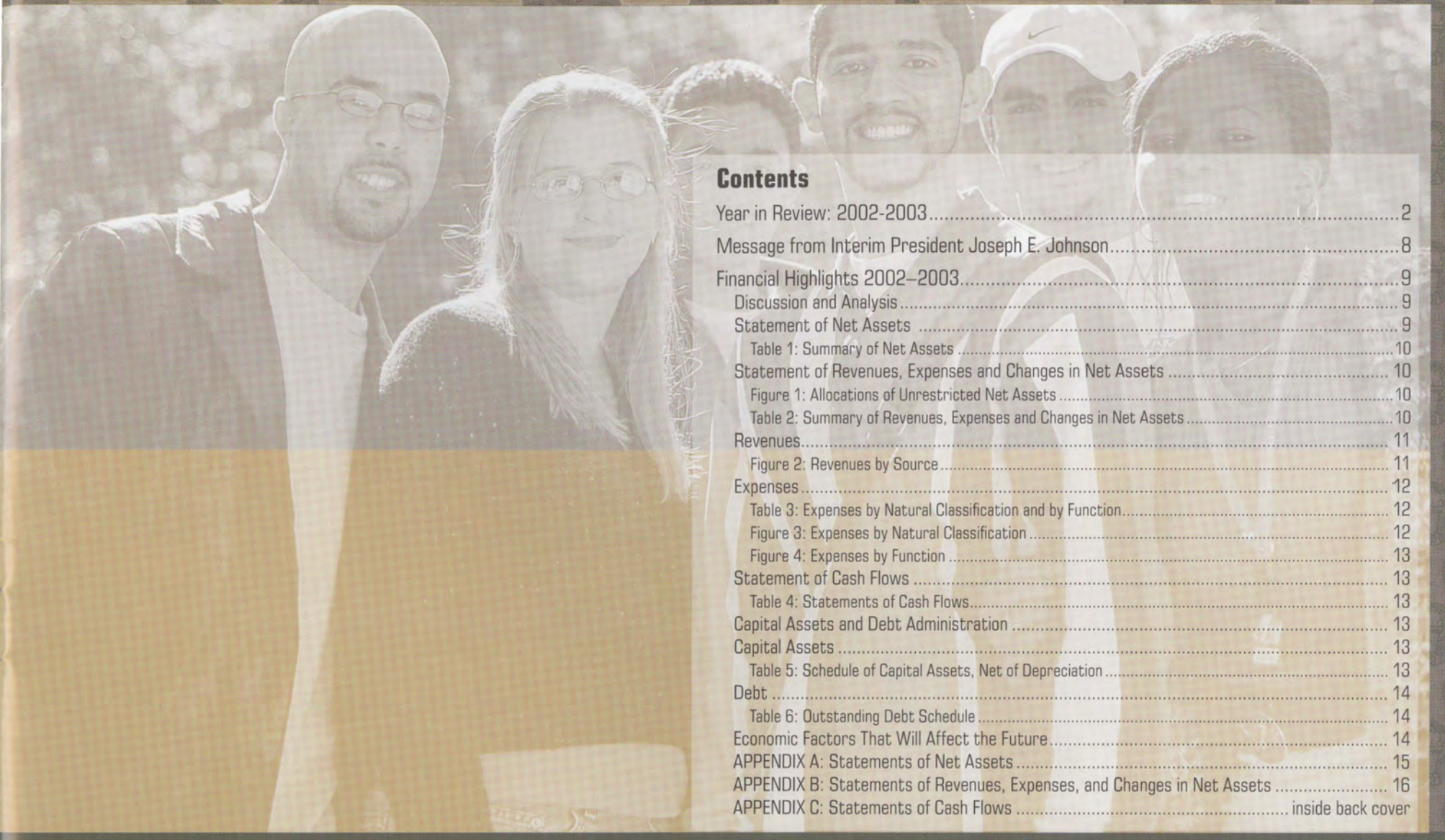
The University of Tennessee (main campus at Knoxville, Health Science Center at Memphis, Space Institute at Tullahoma, and institutes of agriculture and public service)

The University of Tennessee at Chattanooga

The University of Tennessee at Martin

The University of Tennessee is the state's flagship institution, offering comprehensive programs of undergraduate, graduate, and professional education, research, and public service throughout the state. Enrollment in the statewide university is approximately 42,000. Students come from every county in Tennessee, every state in the nation, and many foreign countries. The university holds the Carnegie Doctoral/Research-Extensive classification. The oldest and largest public institution of higher education in the state, the university was founded in Knoxville in 1794, two years before Tennessee became a state.

REVIEW



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The university's longtime partnership with Oak Ridge National Laboratory reached new heights in August when Oak Ridge, UT, and government officials broke ground for the Joint Institute for Computational Sciences on the ORNL campus.

Monday, July 1, 2002. The year began on a note of uncertainty.

With a deadlocked Tennessee General Assembly unable to agree upon a state budget, the University of Tennessee and the rest of state government was forced to cease all except essential services.

UT's new president, Dr. John Shumaker, delivered the news via e-mail that employees not deemed essential should not report to the university. The shutdown lasted until Friday, July 5, when state government and the University of Tennessee returned to normal operations.

What brought the impasse to an end was the agreement of members of the General Assembly to enact the largest sales tax increase in Tennessee history. Despite the magnitude of the increase, UT began the year with about the same amount of state funding as the year before. Much of the revenue from the increase in the sales tax already was committed to covering shortfalls in the state of Tennessee's budget.

No capital projects were funded for the university or any part of state government.

Since the university's state appropriation was insufficient to cover inflationary and other costs, the Board of Trustees was forced to increase student fees. Undergraduate students from Tennessee had to cope with a 7.5 percent increase over the previous year.

Despite the halting beginning to the new year, a lot of positive activity was occurring for the university.

UT and Oak Ridge National Laboratory added another Distinguished Scientist, Dr. Thom Dunning, and construction continued toward the 2006 opening of the Spallation Neutron Source, a mammoth facility in Oak Ridge that promises to make the Knoxville-Oak Ridge vicinity the world center for neutron research. The university's longtime partnership with Oak Ridge National Laboratory reached new heights in August when Oak Ridge, UT, and government officials broke ground for the Joint Institute for Computational Sciences on the ORNL campus.

The scope of research relationships between UT and ORNL continued to grow through partnerships in the National Transportation Research Center, the Tennessee Mouse Genome Consortium, and other joint efforts.

PASS

July

- Employees furloughed four days by state shutdown
- Trustees vote tuition increase
- UT, Farm Bureau establish joint center

August

- Forest Products Center opens on agriculture campus
- Dr. Thom Dunning joins UT as new Distinguished Scientist
- UT, community colleges partner to train more engineers
- UT libraries ranked among nation's best
- Groundbreaking for Joint Institute for Computational Sciences in Oak Ridge

September

- Health Science Center Chancellor Bill Rice steps down
- SimCenter moves to UT Chattanooga
- Black Cultural Center opens in Knoxville
- Campus events commemorate September 11

October

- Groundbreaking for Cancer Institute in Memphis
- Jim Gibb Johnson named interim chancellor at HSC
- UT Chattanooga gets its first doctoral program
- Teacher Warranty Program begins at UT Martin

December

- Rodney Allison named UT Chattanooga football coach
- Matt Griffin becomes football coach at UT Martin

The university celebrated a new alliance with another longtime ally, the Tennessee Farm Bureau, with the opening of the joint Center for Profitable Agriculture in Spring Hill, Tennessee. Located at the Middle Tennessee Experiment Station, the center offers technical and financial assistance for the state agricultural community.

A new partnership kicked off in August when the UT College of Engineering joined forces with Northeast State Technical College in Blountville, Pellissippi State Technical Community College, Roane State Community College, and Walters State Community College to train more engineers. A National Science Foundation grant supports the program, which targets first-generation college students.

In August the *Chronicle of Higher Education* recognized UT's libraries as among the nation's best. The libraries at Knoxville, the Health Science Center in Memphis, and the Space Institute in Tullahoma were included in the recognition by the Association of Research Libraries.

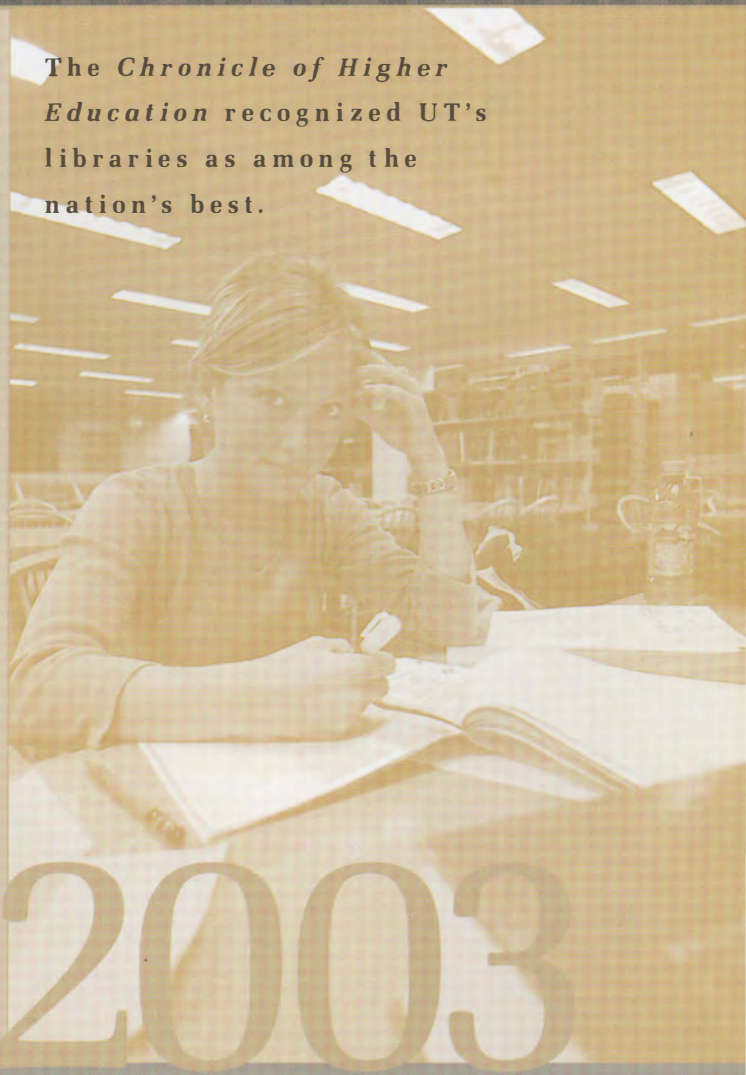
When classes began in August, the university at Knoxville had good news to report. The entering freshman class was the best ever. Dean of Admissions Richard Bayer said the 3,958 freshmen averaged 23.5 on the ACT. First-year African American student enrollment rose significantly, and the 321 African American freshmen represented 9 percent of the first-year students, compared to 7.4 percent the year before. Their average ACT scores rose almost one point compared to the previous year.

When *U.S. News & World Report* announced its university rankings in September, UT Knoxville was tied with Auburn University at 43rd among public universities, and UT Chattanooga was nationally ranked among its peers as well. Both rankings were notable considering very tight state budgets during recent years.

One of the most significant events in the university's history occurred in early September with the dedication of the Black Cultural Center at Knoxville. The new building represents the university's commitment to diversity. It was paid for by student fees.

Other new buildings that progressed during the year included UT Chattanooga's

The *Chronicle of Higher Education* recognized UT's libraries as among the nation's best.



2003 AGES

January

- UT Martin's LEAD Academy welcomes first students
- Lady Vol Basketball Coach Pat Summitt scores 800th career victory

February

- Africa Semester debuts at Knoxville

April

- UT wind ensemble performs in Carnegie Hall
- UTC and Siskin Children's Institute form chair of excellence and circle of scholars
- UTK printmaking program ranked third in nation

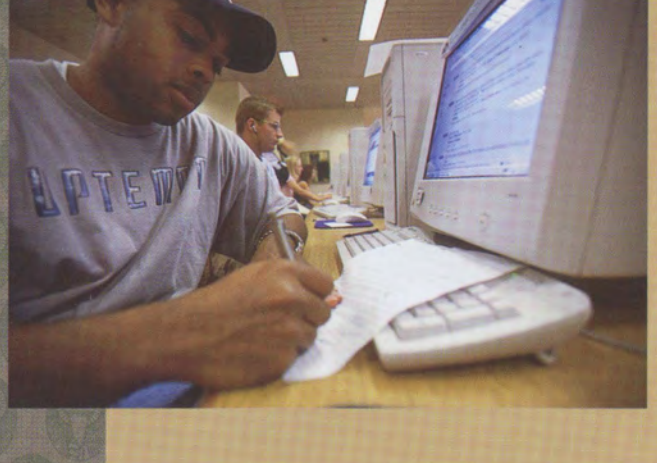
May

- Mike Hamilton named athletic director at Knoxville
- UT Martin observes 50 years of conferring degrees

June

- Trustees promote Loren Crabtree to chancellor at Knoxville
- Ned McWherter receives UT Martin's first honorary doctorate

First-year African American student enrollment rose significantly.



Engineering, Computer Science, and Mathematics Building (the last building for which UT was appropriated state bond funds) and the Student Recreation Center at Knoxville, paid for with student activity fees. On the agricultural campus at Knoxville, construction continued on the Plant Biotechnology Building, which will house more than 100 researchers and provide new technology-rich learning space for students.

Last August the new Tennessee Forest Products Center was dedicated on the agricultural campus, enhancing research and education to support Tennessee's forest products industry.

As President Shumaker spoke to student, faculty, alumni, and civic groups, the ideas fell into place to formulate a university scorecard to chart UT's yearly progress in key areas such as student and faculty achievement, research, service, and fund raising. The Board of Trustees approved the concept in October, and more detailed goals were added during the year.

Also at the October meeting, the trustees elevated Emerson "Eli" Fly, who served as interim president during the last half of 2001 and until Dr. Shumaker came on board in June 2002, to "full" president. Fly became UT's 21st president, and Shumaker its 22nd.

The trustees also approved UT Chattanooga's first doctorate. The new doctoral degree program is in physical therapy. UTC's former entry-level master's degree program transitioned to an entry-level doctorate degree program after several years of planning and curriculum revisions.

In October, UT Martin became the first public university in the state to offer a teacher warranty program to participating school districts. The agreement guarantees the quality of teachers who complete UTM's undergraduate teacher education programs.

The teacher warranty program gives a three-year guarantee that promises the new teachers have adequate subject matter knowledge, student relations skills, and information technology background.

UT Martin also implemented the LEAD (Leadership Education, Application and Discovery) Academy to train undergraduate students. As LEAD students progress through the academy, they are paired with faculty or staff mentors to help them develop leadership portfolios. Students work in campus and community activities and perform a culminating internship or philanthropic project.

At the Health Science Center in Memphis, Bill Rice, the long time chancellor and vice president for health affairs, announced he would step down in October. Dr. Jim Gibb Johnson, a UT veteran, took his place on an interim basis while a national search was begun for a permanent chancellor/vice president.

Also in Memphis, ground was broken for the UT Cancer Institute, which will include clinical and research facilities. The institute determined to pursue designation as a

National Cancer Institute, which would make it the only facility of that type in West Tennessee.

Early in 2003, the university announced a refocusing of the UT Space Institute at Tullahoma, which had been struggling as the result of diminishing grant support and student enrollment. The revitalization plan, formulated with a UTSI advisory group, called for a renewed emphasis on research and specific economic development goals.

University research experienced a banner year, highlighted by the official launch of the UT Research Foundation. Planning for the foundation began in 2000, with the aim of increasing UT research funding, facilitating partnerships, minimizing bureaucracy, and growing businesses and jobs based on UT research. In 2002, UT research funding grew to more than $240 million.

The UT Research Centers of Excellence, begun in 2001 with a $7.5 million special appropriation from the state and some university funds, flourished. Total cumulative return on investment was nearly $195 million. The nine centers, five in Knoxville and four in Memphis at the Health Science Center, are working in such crucial research areas as genomics, neurobiology, environmental cleanup, and food safety.

University researchers attracted several multimillion dollar grants during the year including more than $4 million to establish an international materials institute and $4 million for a construction wage survey. The Health Science Center in Memphis accomplished the rare feat of winning in one year two Specialized Center of Research grants from the National Institutes of Arthritis, Musculoskeletal, and Skin Diseases of the National Institutes of Health. The grants are for research on rheumatoid arthritis and scleroderma, a hardening of the skin that sometimes also affects the internal organs.

Institute of Agriculture researchers announced the births of ten clones of a single adult Jersey cow. The clones are part of the university's research on mastitis, an infection that costs the dairy industry billions of dollars each year.

UT Chattanooga invigorated its partnership with the city and Hamilton County last year in several ways. UTC added a major research center—the Computer Simulation and Design Center, one of just three U.S. programs on the cutting edge of computational engineering. The "SimCenter," formerly located at Mississippi State University, uses computer simulations to test land, sea, and space technology for the federal government and industry. Sixteen world-class faculty members are part of the center, which enhances job creation and economic development.

Also in Chattanooga, two downtown elementary schools, the Brown Academy and the Battle Academy, opened in fall 2002 through a partnership of UT Chattanooga, Hamilton County

UT research funding grew to more than $240 million.



UT Martin students recorded a 100 percent pass rate on the national Fundamentals of Engineering Exam.



Schools, and the UC Foundation. The schools enroll children of UTC employees, downtown workers, and neighborhood residents. Interns from UTC work with children in the classrooms.

To attract more research dollars, the university put forth a plan to launch a new Tennessee College of Public Health in cooperation with the Tennessee Board of Regents. The university also formed a Federal Relations Council to help stimulate UT's ability to capitalize on federal earmarks and grants and established a position for a fulltime UT director of federal relations in Washington, D.C.

Student accomplishments during 2002-2003 were unprecedented. A few examples include the appearance at Carnegie Hall of the Wind Ensemble from the university at Knoxville, the 98 percent pass rate of UT Martin nursing graduates on their 2002 licensure examination, the 100 percent pass rate of UT Martin engineering students on the national Fundamentals of Engineering Exam, and the victory of a law student team in the southern regional Trial Moot Court Competition. Stacy Hutchens, a graduate student in biomedical engineering at Knoxville, won a coveted National Science Foundation fellowship, while Steven Olexa, cartoonist for the UT Daily Beacon, won the Charles M. Schulz College Cartoonist Contest. Eric Hawkins, an architecture major, won first place in an international contest to design affordable housing for migrant workers in California, and Keana Davis, a biomedical engineering doctoral student at the Health Science Center, won a National Institutes of Health grant of more than $140,000.

U.S. News & World Report ranked the graduate program in printmaking at Knoxville third best among 150 graduate art programs in the nation. Other UT programs with high national rankings include pharmacy, social work, nuclear engineering, and logistics. *Chemical and Engineering News* recognized UT Chattanooga's chemistry program for excellence in the percentage of graduates who are female. UTC is second only to Bryn Mawr College, which enrolls only women.

Lady Vols Basketball Coach Pat Summitt achieved what only three coaches before her—male or female—had done when she posted her 800th career victory. The milestone came January 14 at Thompson-Boling arena in Knoxville when the Lady Vols defeated DePaul.

Both UT Chattanooga and UT Martin hired new football coaches. Rodney Allison, formerly at Clemson, is the new gridiron chief at UTC. UT Martin's new coach is Matt Griffin, who had coached at the University of Maine.

In May, Mike Hamilton was named to succeed Doug Dickey as men's athletic director at Knoxville. Hamilton was promoted from senior associate athletic director. The following month, the Board of Trustees approved the recommendation to name

Dr. Loren Crabtree to the reconstituted position of chancellor of the university at Knoxville. Dr. Henry McDonald was appointed interim vice president for research following the departure of Dr. Dwayne McCay, who went to Florida Institute of Technology as provost.

The Board of Trustees approved a rare honorary degree. Former Governor Ned McWherter received the first doctorate of leadership from UT Martin. The former governor has close ties with the Martin campus, including having donated funds to build a replica of the Governor's Office in UTM's Paul Meek Library.

Alumni and friends were extremely generous to the university during the past year. More than 91,000 alumni attended events. Gifts from alumni and other friends totaled about $118 million, a new record.

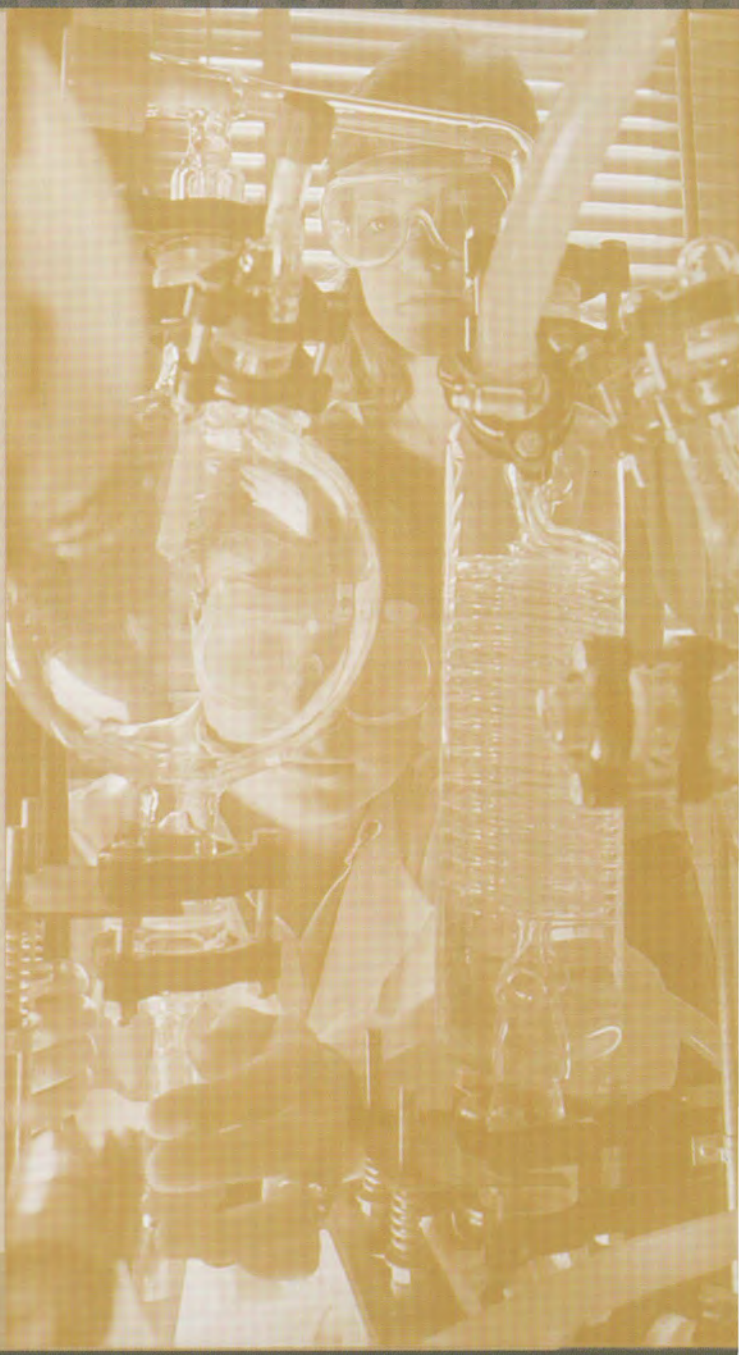
Campaigns were ongoing for certain parts of the university, and the generous gifts of alumni and friends propelled them toward their goals. The Step Up campaign for athletic facilities at Knoxville neared its goal of $44 million, and the engineering campaign at UT Chattanooga, with a goal of $10 million, also was approaching completion.

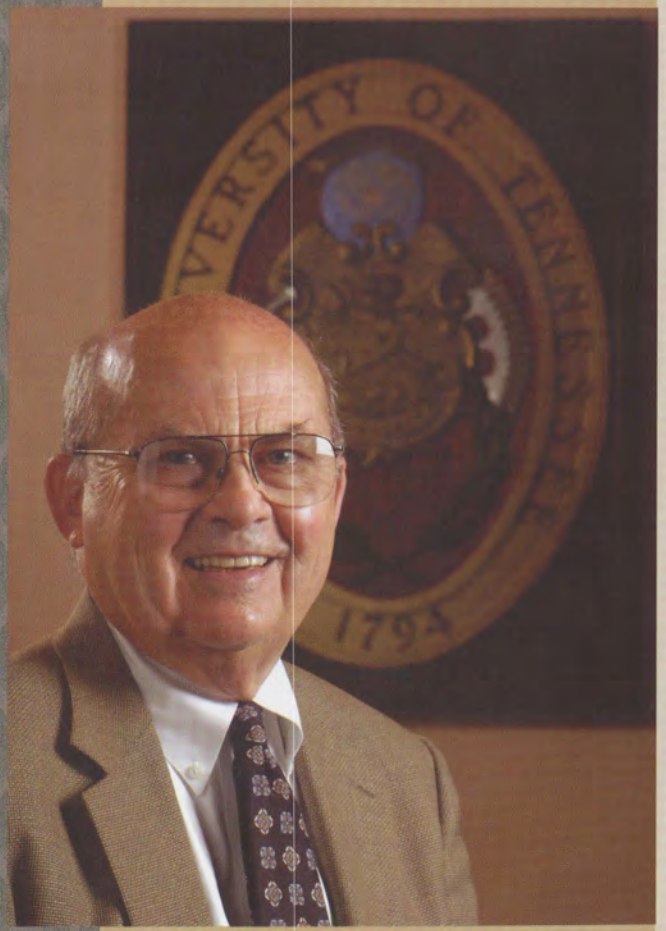
UTC funded several major initiatives from the Lupton Renaissance Fund, the largest unrestricted cash gift to public higher education in Tennessee. It was established in September 2001 with an initial gift of $25 million to the university from Chattanooga philanthropist John T. Lupton and his wife, Alice. The initiatives funded this year include the Lupton International House, an information technology degree program, a visiting scholars program, an institute for wildlife rehabilitation, a biological field station, and building updates.

Private giving took on increased importance as state budget shortages forced significant decreases in appropriations. Statewide the university cut $38 million from its budget by reducing staff, deferring maintenance, delaying equipment purchases, and other cost saving measures.

With approval of a revised mission statement for the University of Tennessee, the Board of Trustees combined previous mission statements to comply with accreditation requirements of the Southern Association of Colleges and Schools. The statement amalgamated the missions of the university at Knoxville, the Health Science Center, the institutes of agriculture and public service, and the Space Institute at Tullahoma.

The end of the 2003 year found the Shumaker presidency troubled by allegations of improper use of university resources, leading to his resignation on August 8, 2003, and the appointment of Dr. Joseph E. Johnson, UT president emeritus, as interim president.





Friends,

I never expected to find myself back in the University of Tennessee president's office, and I regret the circumstances that brought about my return. But during this period while the Board of Trustees searches for a new permanent president, I am pleased to serve as interim.

One of my responsibilities is issuing the university's traditional "annual report" on the events of the past fiscal year—July 1, 2002, through June 30, 2003. A very small amount of the activity at the university last year caused a very large amount of negative publicity. The immense amount of good work that was done received hardly any notice. In this report, we acknowledge the year's problems but intentionally focus on the oft-neglected accomplishments of UT's excellent faculty, students, staff, alumni, and other friends.

Joseph E. Johnson
Interim President
October 10, 2003
Knoxville

FINANCIAL HIGHLIGHTS

Management's Discussion and Analysis

This section of The University of Tennessee's annual financial report presents a discussion and analysis of the financial performance of the university during the fiscal year ended June 30, 2003, with comparative information presented for the fiscal year ended June 30, 2002. This discussion has been prepared by management along with the financial statements and related footnote disclosures and should be read in conjunction with them. 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 Tennessee as a whole and present a long-term view of the university's finances.

Copies of the complete Report of the Treasurer 2003 are available from the Office of the Treasurer, 301 Andy Holt Tower, University of Tennessee, Knoxville, Tennessee 37996.

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. Capital assets, however, 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 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 university for any lawful purpose of the institution.

Table 1: **Summary of Net Assets**

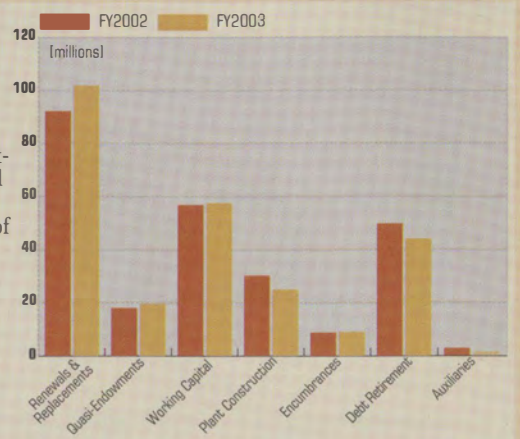
(x 1,000)	2003	2002
Assets:		
Current assets	$ 311,931	$ 315,277
Capital assets, net	943,877	835,381
Other assets	828,919	792,255
Total Assets	**$ 2,084,727**	**$ 1,959,913**
Liabilities:		
Current liabilities	$ 233,459	$ 210,003
Noncurrent liabilities	289,881	282,716
Total Liabilities	**$ 523,340**	**$ 492,719**
Net Assets:		
Invested in capital assets, net of related debt	$ 730,451	$ 653,532
Restricted – expendable	298,644	294,189
Restricted – nonexpendable	316,191	294,865
Unrestricted	216,101	226,609
Total Net Assets	**$ 1,561,387**	**$ 1,467,195**

Material assets consist of cash and cash equivalents; investments; accounts, notes, and grants receivable; and capital assets. Decreases in current assets can be found in cash and cash equivalents, investments, and inventories. Increases in current assets are in accounts, notes, and grants receivable. Increases in noncurrent assets can be found in cash and cash equivalents; accounts, notes, and grants receivable; and capital assets. Decreases in noncurrent assets can be found in investments.

Material liabilities include long-term bonded debt, compensated absences, accounts payable, accrued liabilities, and deferred revenue. The current portion of compensated absences increased, shifting the liability from noncurrent to current.

Figure 1:
Unrestricted Net Assets

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



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 nonoperating revenues according to generally accepted accounting principles.

Table 2: **Summary of Revenues, Expenses and Changes in Net Assets**

(x 1,000)	2003	2002
Operating revenues:		
Net tuition and fees	$ 192,977	$ 189,143
Auxiliary	123,724	120,549
Grants and contracts	356,451	343,616
Other	81,214	128,829
Total operating revenues	**$ 754,366**	**$ 782,137**
Operating expenses	$1,315,836	$1,273,972
Operating loss	**$ (561,470)**	**$ (491,835)**
Nonoperating revenues and expenses:		
State and local appropriations	$ 423,816	$ 419,793
Gifts	67,281	50,851
Investment income, gains, or (losses)	42,407	(3,104)
Other	32,039	26,760
Total nonoperating revenues	**$ 565,543**	**$ 494,300**
Income (loss) before other revenues, expenses, gains, or losses	**$ 4,073**	**$ 2,465**
Other revenues, expenses, gains, or losses:		
Capital appropriations	$ 32,584	$ 34,102
Capital grants and gifts	47,165	8,859
Additions to permanent endowments	12,341	23,128
Other	(1,971)	986
Total other revenues, expenses, gains, or losses	**$ 90,119**	**$ 67,075**
Increase (decrease) in net assets	**$ 94,192**	**$ 69,540**
Net assets at beginning of year	$1,467,195	$2,284,168
Cumulative effect of changes in accounting principle		(886,513)
Net assets at end of year	**$ 1,561,387**	**$ 1,467,195**

The increase in tuition and fees is primarily due to a 7.5 percent increase in fees for the 2003 academic year. Operating grants and contracts increased by $13 million due to a general increase in federal and private grants and contracts, offsetting a decrease in state grants and contracts. The largest increases were in grants from the Department of Health and Human Services and the new Bowld Hospital leased employees agreement. Other operating income decreased due to the transfer of the Bowld Hospital operations to Methodist Healthcare–Memphis Hospitals.

In fiscal year 2003, nonoperating gifts increased substantially due to a single gift totaling $11.2 million. The gain on investments was due to an increase of endowment income and a significant reduction of the previous year's capital market decline.

The increase in capital grants and gifts for 2003 consisted of the donation of several buildings at the Memphis campus. Additions to permanent endowments decreased due to reduced levels of new gifts to endowments for the 2003 fiscal year.

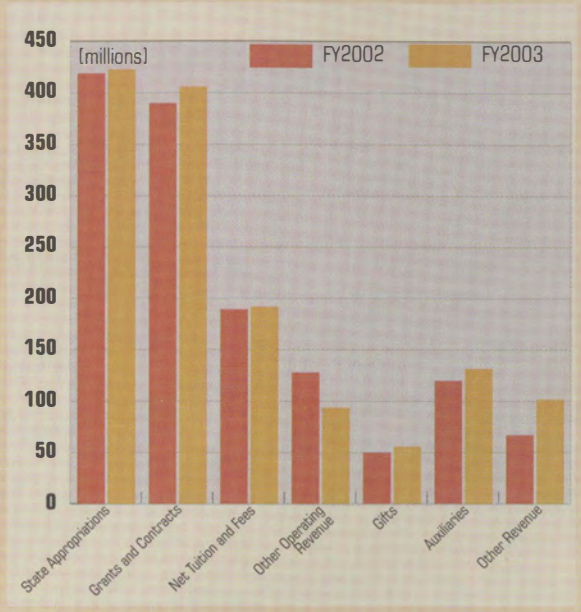
Total operating expenses increased approximately $42 million in fiscal year 2003 primarily due to increased salaries and wages and staff benefits. The university intentionally attempted to bring faculty and staff salaries to a more competitive level. In addition to the staff benefits related to salary increases, health insurance premiums increased 25percent in fiscal year 2003.

Revenues

The graph below illustrates revenues by source (both operating and nonoperating), which were used to fund the university's activities for the years ended June 30, 2003, and June 30, 2002.

Approximately 70 percent of UT's revenue is attributed to state appropriations, grants and contracts, and tuition and fees

Figure 2:
Revenues by Source—2002 and 2003



Expenses

Operating expenses can be displayed in two formats, natural classification and functional classification. Both are displayed ar right.

Table 3: **Expenses by Natural Classification and by Function** (x 1,000)

2003 Natural Classification

2003 Functional Clasification	SALARIES	BENEFITS	UTILITIES, SUPPLIES AND OTHER SERVICES	SCHOLARSHIPS	DEPRECIATION	TOTAL
Instruction	$ 289,078	$ 68,378	$ 51,741			**$ 409,197**
Research	101,628	27,803	56,388			**185,819**
Public Service	67,284	22,443	33,887			**123,614**
Academic Support	53,339	14,509	15,196			**83,044**
Student Services	27,102	7,904	17,036			**52,042**
Institutional Support	53,503	15,876	3,571			**72,950**
Operation and Maintenance of Plant	26,236	8,917	39,735			**74,888**
Scholarships	3,043	23,768	11,318	$ 4,651		**42,780**
Auxiliary	30,235	7,240	59,516			**96,991**
Hospital	6,816	1,844	12,217			**20,877**
Independent Operations	75,176	21,475				**96,651**
Depreciation					$ 56,983	**56,983**
Total Expenses	**$ 733,440**	**$ 220,157**	**$ 300,605**	**$ 4,651**	**$ 56,983**	**$ 1,315,836**

2002 Natural Classification

2002 Functional Clasification	SALARIES	BENEFITS	UTILITIES, SUPPLIES AND OTHER SERVICES	SCHOLARSHIPS	DEPRECIATION	TOTAL
Instruction	$ 275,198	$ 66,427	$ 50,983			**$ 392,608**
Research	87,489	18,011	51,277			**156,777**
Public service	64,132	15,839	35,379			**115,350**
Academic support	49,270	13,541	12,374			**75,185**
Student services	24,898	6,354	16,273			**47,525**
Institutional support	51,158	14,768	443			**66,369**
Operation and maintenance of plant	24,593	7,900	36,708			**69,201**
Scholarships	2,752	21,637	11,052	$7,816		**43,257**
Auxiliary	29,431	7,556	59,876			**96,863**
Hospital	19,829	4,743	40,969			**65,541**
Independent operations	72,456	18,693				**91,149**
Depreciation					$54,147	**54,147**
Total expenses	**$ 701,206**	**$ 195,469**	**$ 315,334**	**$ 7,816**	**$ 54,147**	**$ 1,273,972**

Figure 3: **Expenses by Natural Classification**

At June 30, 2003, approximately 72 percent of operating expenses are attributed to salaries and benefits. Utilities, supplies, and other services represent 23 percent of total operating expenses. Scholarships and depreciation represent the remaining 5 percent of operating expenses.

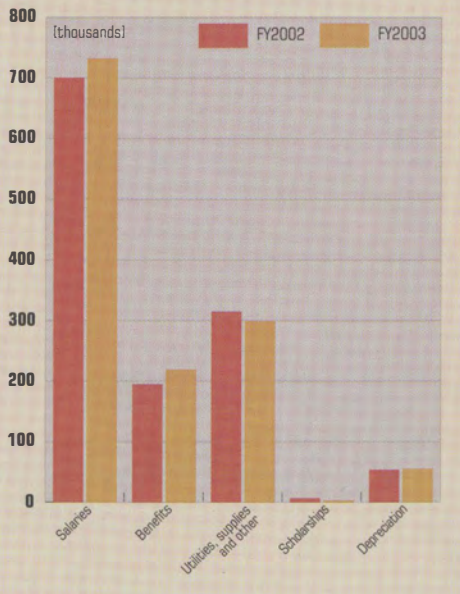
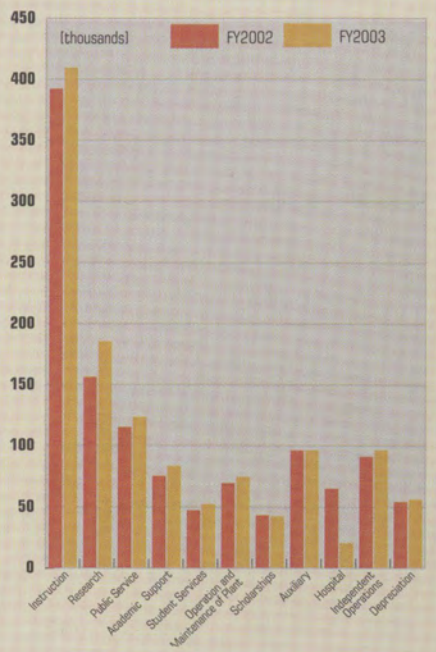


Figure 4:
Expenses by Function

For the year ended June 30, 2003, 55 percent of operating expenses by function is attributable to instruction, research, and public service. The percentages for the remaining functional areas range from two to eight percent of total operating expenses.



Statement of Cash Flows

The statement of cash flows provides information about cash receipts and cash payments during the year. This statement also assists users in assessing the university's ability to generate net cash flows, its ability to meet its obligations as they come due, and its need for external financing.

Table 4: **Statements of Cash Flows**

(x 1,000)	2003	2002
Cash provided (used) by:		
Operating activities	$ (487,276)	$ (440,257)
Noncapital financing activities	524,428	477,018
Investing activities	68,479	16,603
Capital and related financing activities	(65,550)	(72,273)
Net increase (decrease) in cash	**$ 40,081**	**$ (18,909)**
Cash, beginning of year	**$ 369,837**	**$ 388,746**
Cash, end of year	**$ 409,918**	**$ 369,837**

Material sources of cash included state appropriations, tuition and fees, and grants and contracts. Material uses of cash are reflected in payments to suppliers and vendors, payments to employees, payments for benefits, and the purchase of capital assets and construction.

The net increase in cash and cash equivalents amounted to $40,081,653 for the year ended June 30, 2003. The net decrease in cash and cash equivalents amounted to $18,908,968 for the year ended June 30, 2002.

Capital Assets and Debt Administration

Capital Assets

At June 30, 2003, the University of Tennessee had $943,877,229.62 invested in capital assets, net of accumulated depreciation. Depreciation charges totaled $56,983,060.02 for the current fiscal year. Details of these assets are shown below.

Table 5: **Schedule of Capital Assets, Net of Depreciation**

(x 1,000)	2003	2002
Land	$ 48,358	$ 45,102
Land improvements & infrastructure	30,314	29,508
Buildings	595,986	527,410
Equipment	99,158	93,922
Software	11,176	10,883
Library holdings	49,666	46,333
Projects in progress	109,219	99,223
Total	**$ 943,877**	**$ 852,381**

Major capital additions for UT during 2002-2003 include the $28.9 million Plant Sciences Biotech Building at the Agriculture campus, the $11 million Alumni Memorial Building, and the $2 million Black Cultural Center, all in Knoxville, and the $1.7 million Hunter Hall HVAC Improvements project in Chattanooga.

For the next fiscal year, the state has approved more than $7.7 million in capital maintenance appropriations for UT. Some of these approved projects include the roof replacements of several buildings in Knoxville, a fire alarm systems upgrade project in Martin, and Central Energy Plant Improvements in Memphis and Chattanooga. More detailed information about the university's capital assets is presented in Note 5 to the financial statements.

Debt

At June 30, 2003, the university had $215,734,197 in debt outstanding. The table below summarizes these amounts by type of debt instrument.

Table 6: **Outstanding Debt Schedule**

(x 1,000)	2003	2002
Bonds-current portion	$ 13,851	$ 13,506
Bonds-noncurrent	183,723	181,401
Commercial paper-noncurrent	18,160	7,457
Total TSSBA authorized debt	**$ 215,734**	**$ 202,364**
Notes-current portion		**10**
Total Debt	**$ 215,734**	**$ 202,374**

The university retired more than $16.2 million in bonds and notes in fiscal year 2002-2003. The Tennessee State School Bond Authority (TSSBA), in addition to its authority to issue bonds and notes to finance capital projects, has responsibility for approving all long-term debt of the university. TSSBA currently is rated as AA- by Standard & Poor.

Economic Factors That Will Affect the Future

For fiscal year 2004, the University of Tennessee Board of Trustees has authorized a fee increase of 9 percent that is expected to generate approximately $19 million in new funding net of related scholarships. The university sustained a 5 percent state appropriation budget reduction in fiscal year 2003 followed by a 9 percent cut for fiscal year 2004. The university received additional state appropriations to fund health insurance premium increases for fiscal year 2004.

Appendix A: **Statements of Net Assets**

For the Years Ended June 30, 2003, and June 30, 2002

	Year Ended June 30, 2003	Year Ended June 30, 2002
ASSETS		
Current assets:		
Cash and cash equivalents (Note 2)	$ 149,506,729.33	$ 158,661,157.27
Investments (Note 2)	49,693,424.57	50,067,193.46
Accounts, notes and grants receivable (net) (Note 4)	100,933,143.95	92,987,084.86
Inventories	8,051,167.21	10,117,661.10
Prepaid expenses and deferred charges	3,746,806.01	3,443,491.06
Total current assets	**311,931,271.07**	**315,276,587.75**
Noncurrent assets:		
Cash and cash equivalents (Note 2)	260,411,983.16	211,175,901.67
Investments (Note 2)	374,272,838.43	398,534,574.00
Investment in UT-Battelle, LLC (Note 12)	2,043,045.23	1,789,206.24
Accounts, notes, and grants receivable (net) (Note 4)	173,426,660.16	164,305,023.16
Lease payments receivable (Note 16)	18,675,783.73	16,272,083.36
Capital assets (net) (Note 5)	943,877,229.62	852,381,537.22
Prepaid expenses and deferred charges	88,803.41	178,486.68
Total noncurrent assets	**1,772,796,343.74**	**1,644,636,812.33**
TOTAL ASSETS	**$2,084,727,614.81**	**$1,959,913,400.08**
LIABILITIES		
Current liabilities:		
Accounts payable	$ 69,876,639.28	$62,242,891.07
Accrued liabilities	33,943,551.77	34,720,912.03
Deferred revenue	64,219,889.64	63,148,100.33
Deposits payable	6,098,535.71	4,045,375.64
Annuities payable	1,332,314.59	1,619,887.96
Long-term liabilities, current portion (Note 7)	50,012,220.41	37,434,754.17
Deposits held in custody for others	7,975,831.88	6,791,205.53
Total current liabilities	**233,458,983.28**	**210,003,126.73**
Noncurrent liabilities:		
Deferred revenue (Note 7)	15,500,438.71	15,500,438.71
Long-term liabilities, noncurrent portion (Note 7)	229,479,360.87	224,129,364.69
Due to grantors (Note 7)	36,320,989.59	34,507,427.06
Annuities payable (Note 7)	8,580,703.69	8,578,451.55
Total noncurrent liabilities	**289,881,492.86**	**282,715,682.01**
TOTAL LIABILITIES	**$ 523,340,476.14**	**$ 492,718,808.74**

NET ASSETS		
Invested in capital assets, net of related debt	$ 730,451,305.11	$ 653,531,666.90
Restricted:		
Nonexpendable:		
Scholarships and fellowships	130,901,070.13	121,490,322.81
Libraries	12,705,596.83	12,751,472.70
Research	16,495,388.54	9,867,940.34
Instructional department uses	103,184,308.66	50,648,145.62
Academic support	25,442,049.41	
Other	27,463,145.24	100,108,419.51
Expendable:		
Scholarships and fellowships	76,395,468.44	90,834,768.15
Libraries	3,931,251.13	4,046,989.13
Research	56,600,655.69	32,480,248.62
Instructional department uses	67,482,202.40	37,500,480.72
Academic support	37,956,565.60	
Loans	8,102,948.61	8,346,883.77
Capital projects	8,843,290.02	3,464,394.12
Debt service	388,651.34	592,815.76
Other	38,942,341.74	114,920,718.49
Unrestricted (Note 19)	216,100,899.78	226,609,324.70
TOTAL NET ASSETS	**$1,561,387,138.67**	**$1,467,194,591.34**

The notes to the financial statements are an integral part of this statement and may be found in the University of Tennessee Report of the Treasurer (see page 9).

Appendix B: **Statements of Revenues, Expenses, and Changes in Net Assets**

For the Years Ended June 30, 2003, and June 30, 2002

	Year Eded June 30, 2003	Year Ended June 30, 2002
REVENUES		
Operating revenues:		
Student tuition and fees (net of scholarship allowances of $39,341,406.75 for the year ended June 30, 2003, and $31,687,598.45 for the year ended June 30, 2002)	$ 192,976,707.52	$ 189,142,951.97
Federal appropriations	11,839,019.95	13,760,809.80
Governmental grants and contracts	186,473,181.70	189,090,028.66
Nongovernmental grants and contracts	169,977,983.18	154,525,909.50
Sales and services of educational departments	39,343,533.55	37,554,072.87
Auxiliary enterprises:		
Residential life (net of scholarship allowances of $1,010,832.18 for the year ended June 30, 2003, and $986,407.82 for the year ended June 30, 2002; all revenues are used as security for varying revenue bonds; see Note 7)	29,043,875.15	29,485,142.09
Food services	2,755,073.44	2,661,886.18
Bookstore	19,662,412.44	20,407,597.39
Parking	8,070,559.06	7,669,470.48
Athletics	58,485,696.62	54,586,749.14
Other auxiliaries	5,706,130.08	5,738,310.24
Hospital	16,462,146.60	57,814,869.56
Interest earned on loans to students	75,425.90	82,818.70
Other operating revenues	13,494,313.49	19,616,431.68
Total operating revenues	**$ 754,366,058.68**	**$ 782,137,048.26**
EXPENSES		
Operating expenses:		
Salaries and wages	$ 733,440,402.53	$ 701,206,933.17
Fringe benefits	220,157,170.03	195,469,039.04
Utilities, supplies, and other services	300,605,152.29	315,333,196.68
Scholarships and fellowships	4,650,947.67	7,816,121.78
Depreciation expense	56,983,060.02	54,146,985.75
Total operating expenses	**1,315,836,732.54**	**1,273,972,276.42**
Operating income (loss)	**$ (561,470,673.86)**	**$ (491,835,228.16)**

NONOPERATING REVENUES (EXPENSES)		
State and local appropriations	$423,816,452.04	$419,792,940.89
Gifts	67,281,587.48	50,851,804.57
Grants and contracts	50,525,720.79	46,905,377.96
Investment income (loss)	42,406,799.02	(3,104,052.28)
Interest on capital asset - related debt	(11,592,333.70)	(9,757,152.23)
Bond issuance costs	.....	(434,669.40)
Other nonoperating expenses	(6,894,216.53)	(9,954,658.64)
Net nonoperating revenues	**$ 565,544,009.10**	**$ 494,299,590.87**
Income before other revenues, expenses, gains, or losses	4,073,335.24	2,464,362.71
Capital appropriations	32,583,739.37	34,102,220.31
Capital grants and gifts	47,165,410.96	8,859,062.66
Additions to permanent endowments	12,341,823.96	23,127,540.82
Additions to annuity and life income trusts	1,774,230.20	811,482.57
Other	(3,745,992.40)	174,973.67
Total other revenues	**$ 90,119,212.09**	**$ 67,075,280.03**
Increase in net assets	**$ 94,192,547.33**	$ **69,539,642.74**
NET ASSETS		
Net assets at beginning of year	$1,467,194,591.34	$2,284,168,171.87
Cumulative effect of changes in accounting principle (Note 21)	.....	(886,513,223.27)
Net assets at beginning of year, as restated	1,467,194,591.34	1,397,654,948.60
Net assets at end of year	**$ 1,561,387,138.67**	**$1,467,194,591.34**

The notes to the financial statements are an integral part of this statement and may be found in the University of Tennessee Report of the Treasurer (see page 9).

The University of Tennessee does not discriminate on the basis of race, sex, color, religion, national origin, age, disability, or veteran status in provision of education programs and services or employment opportunities and benefits. This policy extends to both employment by and admission to the University. • The University does not discriminate on the basis of race, sex, or disability in the education programs and activities pursuant to the requirements of Title VI of the Civil Rights Act of 1964, Title IX of the Education Amendments of 1972, Section 504 of the Rehabilitation Act of 1973, and the Americans with Disabilities Act (ADA) of 1990. • Inquiries and charges of violation concerning Title VI, Title IX, Section 504, ADA, the Age Discrimination in Employment Act (ADEA), or any of the other above referenced policies should be directed to the Office of Equity and Diversity, 1840 Melrose Avenue, Knoxville TN 37996-3560; telephone (865) 974-2498 (TTY available). Requests for accommodation of a disability should be directed to the ADA Coordinator at the Office of Human Resources Management, 600 Henley Street, Knoxville TN 37996-4125. • PA#E17-0405-002-010-04 • A project of the University of Tennessee Office of Public Relations, (865) 974-2225. Revisions: 6676

Appendix C: **Statements of Cash Flows**

For the Years Ended June 30, 2003, and June 30, 2002

	Year Ended June 30, 2003	Year Ended June 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Tuition and fees	$ 194,780,479.56	$ 189,281,671.03
Federal appropriations	10,589,019.95	13,760,809.80
Grants and contracts	358,498,584.90	333,499,903.17
Sales and services of educational activities	32,858,045.76	44,579,120.00
Payments to suppliers and vendors	(296,806,191.23)	(325,459,746.84)
Payments to employees	(734,101,158.75)	(693,931,502.51)
Payments for benefits	(215,705,943.80)	(190,025,977.97)
Payments for scholarships and fellowships	(4,650,947.67)	(21,285,322.62)
Loans issued to students	(5,486,336.91)	(5,632,359.39)
Collection of loans from students	6,880,849.31	5,077,750.49
Interest earned on loans to students	679,023.62	800,168.82
Auxiliary enterprise charges:		
Residence halls	29,043,875.15	30,917,997.01
Bookstore	19,662,412.44	24,512,571.63
Food service	2,755,073.44	2,981,467.22
Parking	8,070,559.06	8,543,972.18
Athletics	54,564,926.51	53,717,774.43
Other auxiliaries	5,706,130.08	6,284,683.76
Hospital	30,313,526.82	54,798,356.37
Other receipts (payments)	15,071,797.34	27,321,715.35
Net cash provided (used) by operating activities	**$ (487,276,274.42)**	**$ (440,256,948.07)**
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
State appropriations	$ 423,521,491.35	$ 411,372,497.00
Local appropriations	3,889,155.69	3,871,848.89
Gifts and grants for other than capital or endowment purposes	80,261,170.41	73,281,681.11
Private gifts for endowment purposes	14,116,054.16	20,780,921.37
Split-interest transactions receipts	2,265,898.77	3,793,928.77
Split-interest transactions disbursements	(2,922,067.60)	(3,630,549.03)
Federal student loan receipts	130,428,115.18	117,823,747.00
Federal student loan disbursements	(130,428,115.18)	(117,823,747.00)
Changes in deposits held for others	986,267.52	(2,863,304.06)
Net cash balance implicitly financed (repaid)	6,056,682.07	(29,326,447.36)
Other noncapital receipts (payments)	(3,745,992.40)	(262,554.08)
Net cash provided (used) by noncapital financing activities	**$ 524,428,659.97**	**$ 477,018,022.61**
CASH FLOWS FROM CAPITAL AND RELATED FINANCING ACTIVITIES		
Proceeds from capital debt	$ 30,916,551.79	$ 21,593,783.49
Capital appropriations	39,681,113.52	29,884,165.40
Capital grants and gifts received	47,165,410.96	4,871,265.30
Proceeds from sale of capital assets	1,130,918.32	1,085,999.17
Purchase of capital assets and construction	(155,880,014.78)	(101,670,770.44)
Principal paid on capital debt and leases	(16,237,301.28)	(17,919,300.85)
Interest paid on capital debt and leases	(11,352,492.59)	(8,848,537.01)
Deposit with trustee	-	373,749.29
Other capital and related financing receipts (payments)	(974,166.98)	(1,643,821.31)
Net cash provided (used) by capital and related financing activities	**$ (65,549,981.04)**	**$ (72,273,466.96)**
CASH FLOWS FROM INVESTING ACTIVITIES		
Proceeds from sales and maturities of investments	$ 153,051,212.19	$ 90,349,133.87
Interest on investments	43,044,443.13	38,704,585.56
Purchase of investments	(127,616,406.28)	(112,450,295.55)
Net cash provided (used) by investing activities	**$ 68,479,249.04**	**$ 16,603,423.88**
Net increase (decrease) in cash and cash equivalents	**40,081,653.55**	**(18,908,968.54)**
Cash and cash equivalents at beginning of year	**369,837,058.94**	**388,746,027.48**
Cash and cash equivalents at end of year	**$ 409,918,712.49**	**$ 369,837,058.94**
RECONCILIATION OF NET OPERATING LOSS TO NET CASH PROVIDED (USED) BY OPERATING ACTIVITIES		
Operating loss	$(561,470,673.86)	$(491,835,228.16)
Adjustments to reconcile operating loss to net cash provided (used) by operating activities:		
Depreciation expense	56,983,060.02	54,146,985.75
Other adjustments		472,827.11
Changes in assets and liabilities:		
Receivables, net	5,169,083.43	(14,618,397.39)
Inventories	2,066,493.89	(706,745.03)
Prepaid expenses and deferred charges	(303,314.95)	(802,529.73)
Accrued interest receivable	603,597.72	717,350.12
Accounts payable	1,927,360.63	(12,958,195.29)
Accrued liabilities	(777,360.26)	15,730,038.07
Deferred revenue	1,071,789.31	5,151,799.28
Deposits	2,053,160.07	532,046.97
Compensated absences	4,567,830.27	4,467,709.13
Other additions:		
Loans to students	832,699.31	(554,608.90)
Net cash provided (used) by operations	**$ (487,276,274.42)**	**$ (440,256,948.07)**

The notes to the financial statements are an integral part of this statement and may be found in the University of Tennessee Report of the Treasurer (see page 9).



YEAR IN REVIEW

THE UNIVERSITY of TENNESSEE