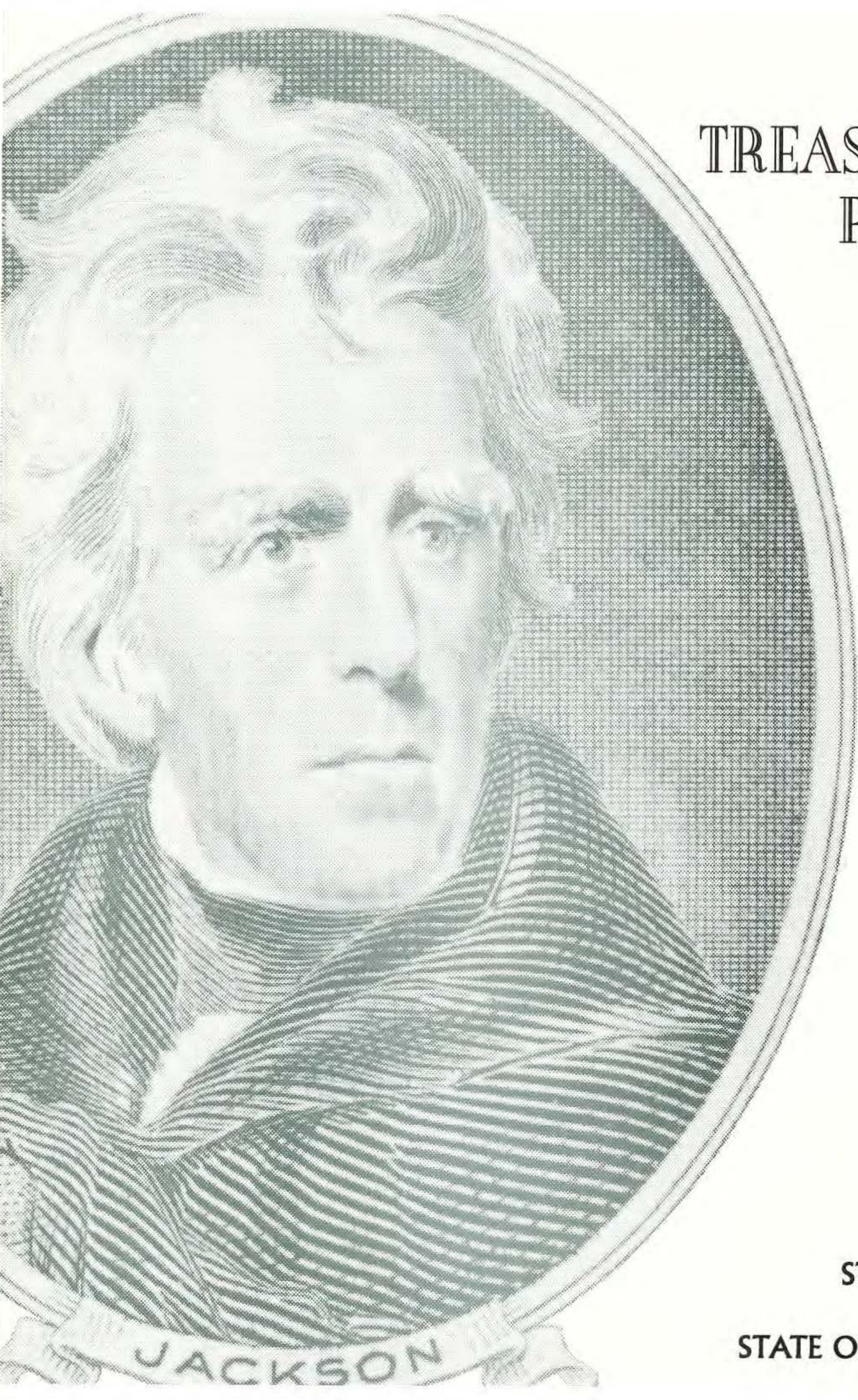
1997 TREASURER'S REPORT



STEVE ADAMS
TREASURER
STATE OF TENNESSEE

1997

Treasurer's Report

Steve Adams, Treasurer

State of Tennessee

Fiscal Year Ended
June 30, 1997

Tennessee: Home to Three Presidents

Top: Andrew Jackson's home in Hermitage

Center: James K. Polk's home in Columbia

Right: Andrew Johnson's home in Greeneville

Table of Contents

LETTER OF TRANSMITTAL

State of Tennessee
Treasury Department
State Capitol
Nashville, Tennessee 37243

December 31, 1997

To the Governor, Members of the General Assembly,
and Citizens of the State of Tennessee:

It is an honor to again have an opportunity to present the Treasurer's Report. This publication represents a summary of the activity of the Treasury Department for the fiscal year ended June 30, 1997. During this time, with your support and the help of an outstanding staff, we have continued to strive for excellence in the administration of the programs for which we are responsible.

As you read through the following pages, I feel that you will be pleased with our performance and accomplishments. Of special note, this publication includes our premiere report on the activity of the Baccalaureate Education System Trust program which was officially launched this year. The BEST program provides an option for our citizens to save for higher education. The program has been very well received by Tennesseans and the members of the General Assembly are to be applauded for creating this savings vehicle. Also during the year, the department developed a comprehensive Internet site designed to provide citizens of the state and public employees with information concerning the programs we administer.

The months ahead will present numerous challenges to us as public servants and the demands for government services by our citizens will only increase. As State Treasurer and as a Tennessean, I look forward to working with you to meet these demands. My staff and I are committed to providing professional financial management and programs responsive to the needs of public employees and taxpayers of the state.

Sincerely,

Steve Adams

EXECUTIVE SUMMARY

INTRODUCTION

The 1997 Treasurer's Report contains reports on various programs administered by the Treasury Department, including Investments, the Tennessee Consolidated Retirement System, the Deferred Compensation Program, the Flexible Benefits Plan, Claims Administration, Risk Management, the Unclaimed Property Program, the Chairs of Excellence Program, the Baccalaureate Education System Trust, and the Careers Now Program. The following comments represent a brief recap of the purpose and operations of each program administered by the department. The remainder of this report gives detailed data regarding these programs' activities during the 1996-97 fiscal year.

INVESTMENTS

The Investment Division has the responsibility for investing all funds under management of the Treasury Department.

State Cash Management - This section manages the State Pooled Investment Fund which includes the state's cash, the various dedicated reserves and trust funds of the state, and the Local Government Investment Pool. Investments during 1996-97 averaged $2.39 billion, producing $132.26 million in income for an average rate of return of 5.50%. Local governments participating in the Local Government Investment Pool received $83.0 million in interest at a net rate averaging 5.34%. The State Trust of Tennessee allows the Treasury Department to use the Federal Reserve Wire Transfer System to transfer funds on a limited basis.

Pension Fund Investments - This section manages the investments of the Tennessee Consolidated Retirement System (TCRS) which at June 30, 1997 totaled $18.5 billion at fair value. For the year, investments produced $2.5 billion in income for a realized rate of return of 15.7% on a fair value basis. This section also manages investments for the Chairs of Excellence Trust which at June 30, 1997 totaled $184 million at fair value.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

The Tennessee Consolidated Retirement System provides retirement coverage to state employees, higher education employees, teachers, and employees of political subdivisions that have elected to participate in the plan. As of June 30, 1997, there were 179,171 active TCRS members: 41,657 state employees; 59,035 K-12 teachers; 58,656 political subdivision employees; and 19,823 higher education employees. As of June 30, 1997, there were 66,662 retirees. TCRS paid out $521 million in benefits during fiscal year 1996-97. The state of Tennessee is responsible for the pension liability for state employees and higher education employees and funds a significant portion of the retirement liability for teachers through the BEP. Each participating political subdivision is responsible for the liability of its employees. Activities during 1996-97 included 4,712 retirements, 4,632 refunds, approximately 7,900 estimates provided to members, and approximately 5,800 requests to purchase prior service. TCRS received its eighth consecutive Certificate of Achievement for Excellence in Financial Reporting from the Government Finance Officers Association for its June 30, 1996 Comprehensive Annual Financial Report.

Executive Summary

Deferred Compensation Program

The State of Tennessee Deferred Compensation Program offers state employees the opportunity to accumulate supplemental retirement income on a tax deferred basis. Participants may direct the investment of their deferred salary into a variety of investment products contracted for the program. During the 1996-97 fiscal year, the state and the University of Tennessee each matched their employees' contributions to the 401(k) plan at $20 per month. As of June 30, 1997, 35,491 state and higher education employees had accounts in the program. The market value of accumulated account balances totaled $321 million, an increase of $76 million during the year.

Flexible Benefits Plan

The State of Tennessee Flexible Benefits Plan is an optional benefit plan which enables state employees to pay for certain expenses with before-tax dollars. Employees may use the plan to pay group medical and dental insurance premiums, out-of-pocket medical expenses, and dependent care expenses. At June 30, 1997, there were 37,055 state employees using the plan: 36,604 paid medical premiums, 12,325 paid dental premiums, 2,380 used the medical expense reimbursement account and 335 used the dependent care reimbursement account. The plan generated over $2.2 million in F.I.C.A. savings for the state during the 1996-97 fiscal year.

Claims Administration

The Division of Claims Administration is responsible for investigating and making determinations on claims made against the state for workers' compensation by state employees, employee property damage, tort liability, and criminal injury compensation. Staff support from the Division of Claims Administration also assists the Board of Claims. The Division of Claims Administration received 6,498 claims for tort, employee property damage, and workers' compensation. The Board of Claims took action on eight matters regarding claims and insurance, and 1,541 victims of criminal injury and drunk driver claims were approved for payment. Payments made during the year for workers' compensation, tort, and employee property damage claims totaled $16.9 million. Payments made to victims of criminal injuries and drunk drivers totaled $6 million. Since the first payments were issued in 1982, over $85 million has been paid to crime victims.

Division of Risk Management

The Division of Risk Management is responsible for administering the state's Property/Casualty Insurance Program, including the procurement of boiler insurance and employee fidelity bond coverage. All state-owned buildings and contents are provided all-risk, replacement cost coverage for the limits of liability listed in the state's Property Insurance Schedule. On July 1, 1996, the total scheduled values were $8.1 billion. The State Reserve for Casualty Losses, in the amount of $5 million, provides a self-insured retention for the payment of property claims. Excess property coverage is procured from an independent insurance carrier to provide claim payments in excess of the retention, should losses exceed $5 million in a given fiscal year. A $5,000 per occurrence deductible is assumed by the department, agency, or institution experiencing a loss. In fiscal year 1996-97, the premium cost for total property coverage without the $5 million retention was estimated to be $8.5 million. The actual cost of the program for the same period was $2.2 million, providing a savings to the state of approximately $6.3 million.

Executive Summary

Unclaimed Property Program

The Unclaimed Property Division is responsible for the administration of the state's Uniform Disposition of Unclaimed Property Act. Under this act, the state provides one centralized location for the owners of abandoned property, or their heirs, to turn to when searching for forgotten assets. The types of property covered by this act are primarily cash property such as bank accounts, insurance policies, utility deposits, etc. During the fiscal year, $16.4 million of unclaimed property was turned over to the Treasurer and $5.7 million was returned to owners or their heirs. Since the program began in 1978, over $130.2 million in unclaimed property has been reported to the Treasurer and over $37.3 million of that property has been returned to the owners or their heirs.

Chairs of Excellence

The Chairs of Excellence Trust is a nonexpendable trust fund authorized in 1984 to further the cause of education in Tennessee. The funding of the program is provided through contributions made by a private donor and a matching amount by the state, thus, creating a chair. Income from the chair is used to offset the cost of retaining a nationally or regionally recognized scholar at a state college or university who teaches in a specified academic area. During the 1997 fiscal year, two chairs were created with matching contributions totaling $1,423,000. Since 1984, a total of 95 chairs have been created. The Trust totaled $184 million fair value at June 30, 1997 and produced income of $13.7 million during the year.

Baccalaureate Education System Trust

The Tennessee Baccalaureate Education System Trust, or BEST, is a prepaid college tuition savings program that allows anyone to pay for higher education tuition in advance on behalf of a beneficiary. Through the purchase of affordable tuition units, Tennesseans can pay for future tuition at today's price and ease their concerns about whether they will have enough funds to pay for their children's higher education. Flexibility is a key component of the program by allowing participants to determine when and how much to save, and by providing multiple payment options and unlimited school choices. In addition, state college savings programs provide favorable tax benefits to participants. The BEST program began accepting contributions in June 1997.

Careers Now Program

The Careers Now Program provides Tennessee college students the opportunity to learn more about the operations of state government and career opportunities in state government by working in one of the three constitutional offices for a semester. The program has had 40 students since it began in January 1996.

Bond Refunding Trust

The Treasurer has been appointed Refunding Trustee for the Tennessee Local Development Authority (TLDA), for the Tennessee State School Bond Authority, and for the Funding Board of the State of Tennessee in connection with the sale of bonds issued to refund, in advance of maturity, bonds and notes previously issued by the TLDA, School Bond Authority, and Funding Board. The Treasurer has established a Refunding Trust Fund for the benefit of the holders of the refunded bonds. A portion of the proceeds of the refunding bonds were used to acquire direct general obligations of the United States of America or obligations which are unconditionally guaranteed by the United States of America as to principal and interest. The assets of the Refunding Trust Fund totaled $78.9 million at fair value on June 30, 1997.

Treasury Numbers at a Glance
Fiscal Year 1996-97

Administrative	Number of Filled Positions		162
	Payroll Expenditures	$	6,261,250
	Other Expenditures	$	3,353,769
	Total Administrative Expenditures	$	9,615,019
Cash Management Program	General Fund Earnings	$	12,232,580
	LGIP Earnings	$	83,885,800
	Restricted Fund Earnings	$	37,145,689
	Total Cash Management Earnings	$	132,264,069
Retirement Program	Retirement Benefits	$	521,339,327
	Number of Retirees		66,662
	Number of Active Members		179,171
	Retirement Contributions	$	481,240,583
	Retirement Investment Earnings	$	2,514,952,816
	Retirement Refunds	$	23,833,152
Claims Administration Program	Workers' Compensation Payments	$	11,605,270
	Workers' Compensation Claims Filed		4,181
	Employee Property Damage Payments	$	31,206
	Employee Property Damage Claims Filed		245
	Tort Claims Payments	$	5,285,727
	Tort Claims Filed		2,072
	Criminal Injury Payments	$	6,066,472
	Criminal Injury Claims Filed		2,053
	Claims Award Fund Revenue	$	37,785,914
Risk Management Program	Property Values Insured	$	8,097,557,000
	Total Cost of Program	$	2,152,527
	Savings to the State over Private Insurance Rates	$	6,349,908
Chairs of Excellence Program	Chairs of Excellence Contributions	$	1,423,000
	Chairs Of Excellence Investment Earnings	$	13,718,733
	Chairs of Excellence Expenses	$	7,002,508
	Total Number of Chairs of Excellence		95
Other Programs	Deferred Compensation Contributions	$	38,883,505
	State Matching Contributions	$	4,359,140
	Deferred Compensation Participants		35,491
	Flexible Benefits Plan Payments	$	3,807,057
	FICA Savings Generated from Flex Plan	$	2,269,211
	Unclaimed Property Revenues	$	16,398,500
	Unclaimed Property Payments	$	5,695,016
Fair Value of Assets Under Management at 6/30/97	Retirement Trust Fund	$	18,519,341,433
	Chairs of Excellence Trust Fund	$	183,633,114
	State Pooled Investment Fund	$	2,693,152,795
	Cash in Banks	$	37,045,997
	Deferred Compensation (outside managers)	$	321,923,631
	Bond Refunding Trust	$	78,940,501
	Total Assets Under Management	$	21,830,235,918

PROGRAM ADMINISTRATION

ANDREW JACKSON

Andrew Jackson became the seventh President of the United States in 1829. Jackson was born on March 15, 1767 in the Waxhaw settlement in South Carolina. His father died a few days before he was born and his mother and two brothers all died from illness during the American Revolution. Jackson began his military career at age 13 when he joined a Revolutionary War regiment. Captured by the British, he was seriously wounded for refusing to polish a British officer's boots. After the war, he lived with neighbors and relatives until he finished school. He became a lawyer in North Carolina and accepted a job as a public prosecutor in the Western District which was later to become the state of Tennessee. He served on the committee which drafted Tennessee's Constitution and served as Tennessee's first representative in the U.S. House of Representatives from 1796-1797. He was appointed a Superior Court Judge and Major General of the Tennessee militia. During the War of 1812, he became a U.S. Major General and won the greatest victory of the war at the Battle of New Orleans. His life was filled with controversy and he was involved in several duels over the years. He lost his first run for President in 1824 against John Quincy Adams, but was elected in landslide victories in 1828 and 1832. He was the first president to be the target of an assassination attempt, but both pistols shot at him misfired. During his term, he established the veto as an unqualified prerogative of the presidency, eliminated the Second Bank of the United States, and eliminated the national debt for the first time. He lived to be 78 and died peacefully at home on June 8, 1845. He is buried on the grounds of his Nashville home, The Hermitage.

State Cash Management

The state of Tennessee receives revenues from many sources such as taxes, licenses, fees, and the federal government. As these monies are collected, they are deposited into one of the 175 financial institutions in Tennessee that have contracted with the state to serve as depositories. Under the state Constitution, the state may not spend more money on its programs than it has collected in revenues. Consequently, at any point in time the state has a sizable sum of money collected but not yet spent. These monies are invested by the Treasury Department until needed to pay for state expenses, payroll, or benefit program disbursements.

During the 1996-97 fiscal year, the average balance of short term investments in the Treasurer's Cash Management program was $2,390,862,834 per month and interest income of $132,264,069 was earned. This includes deposits in the Local Government Investment Pool administered by the Treasury Department.

The State Funding Board sets the investment policy for the state. The State Funding Board is composed of the Governor, Commissioner of Finance and Administration, Comptroller, Secretary of State, and Treasurer. The foremost investment objective of the State Pooled Investment Fund is safety of principal, followed by liquidity and then yield.

The Governmental Accounting Standards Board recently issued a statement which impacted the investment policy for the State Pooled Investment Fund. The previous policy provided for investments in instruments which could mature in as much as five years, provided that the average maturity of the portfolio was one year or less. The new investment policy reduces the maximum maturity to 396 days with an average maturity for the entire portfolio being less than 90 days.

Funds may be invested in collateralized certificates of deposit with authorized Tennessee financial institutions; bills, notes and bonds of the U.S. Treasury; other obligations guaranteed as to principal and interest by the United States or any of its agencies; and repurchase agreements against obligations of the United States or its agencies. Securities underlying repurchase agreements must be book-entry and delivered to the State Trust of Tennessee. Funds may also be invested in prime commercial paper and prime banker's acceptances.

At June 30, 1997, investments had an average maturity of 60 days, and an average weighted yield of 5.65%. The total balance in the State Pooled Investment Fund at June 30, 1997 ($2,698,350,000 par value) was allocated as follows: U.S. Treasury government and agency securities, 25.54%; repurchase agreements, 5.84%; collateralized certificates of deposit, 34.22%; and commercial paper, 34.40%.

STATE CASH MANAGEMENT

STATE CASH MANAGEMENT COMPARATIVE RETURNS

In order to ensure that state investment returns reflect current market conditions, several market indicators are carefully monitored. Among these are rates reported daily in the Wall Street Journal, rates on U.S. Treasury securities and institutional money market funds. The following table illustrates state returns compared with two of these indicators.

Fiscal Year	[1]Total Pool Funds	[2]Merrill Lynch Institutional Fund	[3]New Pool Funds	[4]90 Day Treasury (CD Equivalent Yield)
1996-97	5.50%	5.25%	5.40%	5.17%
1995-96	5.69	5.49	5.60	5.29
1994-95	5.34	5.33	5.47	5.45
1993-94	4.04	3.30	3.41	3.42
1992-93	4.39	3.29	3.21	3.11

[1]Investment return on total portfolio.
[2]This index most closely resembles the structures and objectives of the total cash portfolio.
[3]Investment return on funds invested during the year.
[4]This approximates the reinvestment period for new funds.

ADMINISTRATION OF AUTHORIZED STATE DEPOSITORY ACCOUNTS

The Cash Management Division is responsible for the administration of the state's bank accounts in Tennessee financial institutions designated as authorized state depositories. Taxpayers and state agencies can deposit certain tax funds due to the state directly to any Treasurer's account at any authorized state depository.

The four most significant functions of administering the accounts are: (1) authorizing the state depository to accept state funds; (2) cash concentration; (3) collateralizing deposits; and (4) monitoring collateral and deposits. Financial institutions' requests to become authorized state depositories are received in Cash Management, reviewed, and forwarded to the appropriate state officials for consideration and approval.

The Cash Management Division is responsible for the cash concentration and management of all state depository accounts. Cash Management staff inquire on the balances of bank accounts and concentrate available funds into the State Trust to meet liquidity and investment needs. Account balances are drawn to the floor and concentrated by Fed wire or Automated Clearinghouse (ACH) transactions. The account floor is the minimum amount required by the financial institution for that particular account to earn interest. All of these state accounts are interest bearing.

Changes in branch banking laws and bank ownership due to mergers and acquisitions have brought about a need to quickly identify the parent bank, holding company and affiliate trustee custodians for state depositories. The ability to access and update this information on a database enhances the ability to monitor deposits and collateral based on appropriate bank ownership.

This same database is accessed for current account information for balance inquiry and cash concentration. It automates the link from balance inquiry to cash concentration by generating an ACH transaction. This automation provides more time to inquire on more accounts. The account balance floors are automatically compared to the balances entered to calculate ACH transaction amounts.

STATE COLLATERAL PROGRAM

Collateral is required to secure state deposits held in authorized state depository institutions. Statute sets the required collateral level at a market value of 105 percent of the value of the deposit secured, less the amount secured by the Federal Deposit Insurance Corporation. However, if the state depository is operating with a capital-to-asset ratio of less than five percent, additional collateral with a market value of $100,000 is required. The types of investment instruments which are eligible to be pledged as collateral are listed in this report.

The state of the economy and the financial environment has increased the importance of monitoring collateral. Cash Management staff review collateral daily, weekly, and monthly. Any collateral deficiencies at authorized state depository institutions are reported to the Funding Board monthly. Reasons for under-collateralization include market price volatility of the security pledged, unexpected high deposits to an account, interest accruals, capital-to-asset ratios falling below five percent, and principal paydowns on asset backed securities which have been pledged as collateral.

Collateral is held by an authorized trustee custodian in the name of the state of Tennessee. Treasury staff must authorize the receipt, release, and substitution of all collateral.

8-5-110 COLLATERAL

Tennessee Code Annotated, Section 8-5-110 designates the Treasurer as the custodian of all negotiable instruments deposited with the state or any department thereof, and requires the Treasurer to be exclusively responsible for the safekeeping thereof.

Cash Management personnel work directly with the personnel of the state agencies to accept and release collateral held in accordance with their specific instructions. Other state agencies cooperating with the Treasurer in this regard include the Department of Health, the Department of Environment and Conservation, the Department of Commerce and Insurance, the Department of Transportation, and the Department of Financial Institutions. Reports of collateral transactions, holdings, and maturities are regularly shared with these departments.

STATE CASH MANAGEMENT

COLLATERAL POOL

Legislation passed in March 1990 – "The Collateral Pool for Public Deposits Act" – authorized the formation of a collateral pool for banks. The Collateral Pool operates under the jurisdiction of the Collateral Pool Board, which is comprised of four bankers and three government members representing state and local government divisions. The Collateral Pool Board has established rules and procedures that provide a low amount of risk and a high degree of efficiency for participating institutions.

While participation in the Collateral Pool is voluntary, participation is subject to application to and approval by the Collateral Pool Board. The Board has established minimum financial performance levels for applicants which must be met to ensure that only healthy institutions are permitted to participate.

All public funds held by a pool participant are collateralized based on a collateral target calculated each month by the participant. The collateral target is based on the aggregate average balance of all public funds for the month multiplied by the pledge percentage assigned to the participant by the Board.

All collateral transactions for the pool are monitored and processed through the Treasury Department using uniform state-wide procedures. In addition, Treasury Department staff monitors all pool activity through the monthly, quarterly, and annual reports required to be submitted by pool participants.

The Collateral Pool began operations on November 1, 1995 with 13 banks participating. Only banks were initially eligible to participate in the pool, but in the spring of 1996, legislation was passed to allow thrift institutions to participate in the Collateral Pool. The Collateral Pool Board began accepting applications from thrift institutions on August 29, 1996.

Currently, the Collateral Pool has 44 participant institutions collateralizing public funds in excess of $2.1 billion and representing over 9,000 public fund accounts.

SECURITIES ACCEPTABLE AS COLLATERAL FOR STATE DEPOSITS

1. U.S. Treasury Bills

2. U.S. Treasury Notes & Bonds

3. Federal Housing Administration (FHA) debentures

4. Government National Mortgage Associations (GNMA)*

5. Farm Credit System (FCS)
   a. Federal Land Bank Bond (FLBB)
   b. Farm Credit Systemwide Bonds (FCSB)
   c. Farm Credit Systemwide Discount Notes (FCDN)
   d. Farm Credit Systemwide Floating Rate Notes (FCFR)

6. Federal Home Loan Banks
   a. Bonds (FHLB)
   b. Discount Notes (FHDN)
   c. Floating Rate Notes (FHFR)

7. Federal Home Loan Mortgage Corporation (FHLMC)*
   a. Mortgage-Backed Participation Certificates and Adjustable Rate Securities (FMPC, FMAR)
   b. Discount Notes (FMDN)

8. Federal National Mortgage Association (FNMA)*
   a. Bonds, Debentures, Secondary Market Debt Obligations (FNSM)
   b. Discount Notes (FNDN)
   c. Floating Rate Notes (FNFR)
   d. Mortgage-Backed Pass-Through Certificates (FNRF)
   e. Residential Financing Securities (FNRF)
   f. Adjustable Rate Mortgage-Backed Bonds (FNAR)

9. Student Loan Marketing Association (SLMA)
   a. Discount Notes (SLDN)
   b. Fixed Rate Notes (SLMN)
   c. Floating Rate Notes (SLFR)
   d. Bonds (SLBD)

10. Tennessee Valley Authority Bonds and Notes (TVA)

11. Collateralized Mortgage Obligations (CMOs) and Real Estate Mortgage Investment Conduits (REMICs) that are direct obligations of a U.S. agency or FNMA/FHLMC, except that the "residual" class/tranche of such securities will not be acceptable. Sufficient excess securities should be pledged to allow for the periodic reduction of principal.

12. Certain Tennessee Municipal Bonds as specified in T.C.A. Section 9-4-103.

13. Surety Bonds issued by insurance companies meeting certain requirements, including licensure under the laws of Tennessee.

14. Standby Letters of Credit from approved Federal Home Loan Banks.

** Pass through securities must reflect current paid down values and be kept up to date.*

STATE CASH MANAGEMENT

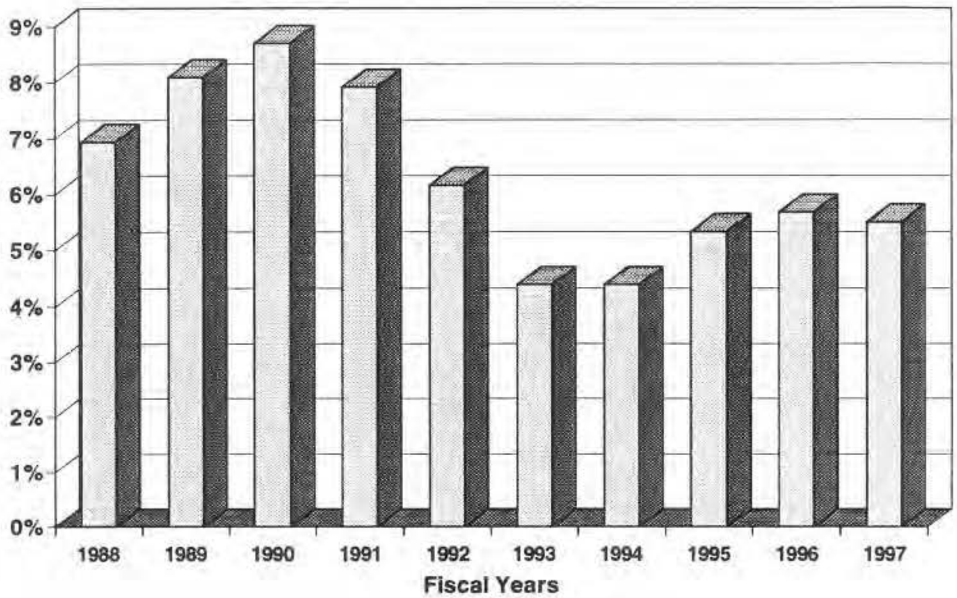
HISTORICAL ANALYSIS OF STATE CASH INVESTMENTS

Fiscal Year	*Average Amount Invested*	*Amount Earned*	*Rate of Return*
		Collateralized Time Deposits	
1996-97	$ 848,697,167	$ 46,917,097	5.53%
1995-96	835,888,333	49,605,934	5.89%
1994-95	743,203,083	39,498,384	5.34%
1993-94	524,944,000	18,544,812	3.54%
1992-93	367,934,460	14,855,742	4.03%
		Repurchase Agreements	
1996-97	$ 180,228,167	$ 9,743,171	5.37%
1995-96	176,878,167	9,988,181	5.62%
1994-95	172,311,500	9,375,039	5.46%
1993-94	154,941,333	5,181,537	3.31%
1992-93	222,356,489	7,138,186	3.17%
		Commercial Paper	
1996-97	$ 739,561,917	$ 41,056,244	5.55%
1995-96	591,118,167	33,556,447	5.65%
1994-95	533,771,250	29,866,669	5.60%
1993-94	371,247,833	13,478,983	3.64%
1992-93	351,223,148	11,857,182	3.38%
		U.S. Government Securities	
1996-97	$ 622,375,583	$ 34,547,557	5.45%
1995-96	655,638,667	35,684,775	5.46%
1994-95	692,287,167	34,534,311	5.07%
1993-94	1,082,046,750	47,245,264	4.54%
1992-93	1,022,595,573	49,207,450	5.07%
		Securities Lending Income	
1996-97	N/A	$ 0	N/A
1995-96	N/A	0	N/A
1994-95	N/A	487,467	N/A
1993-94	N/A	1,525,111	N/A
1992-93	N/A	1,425,030	N/A

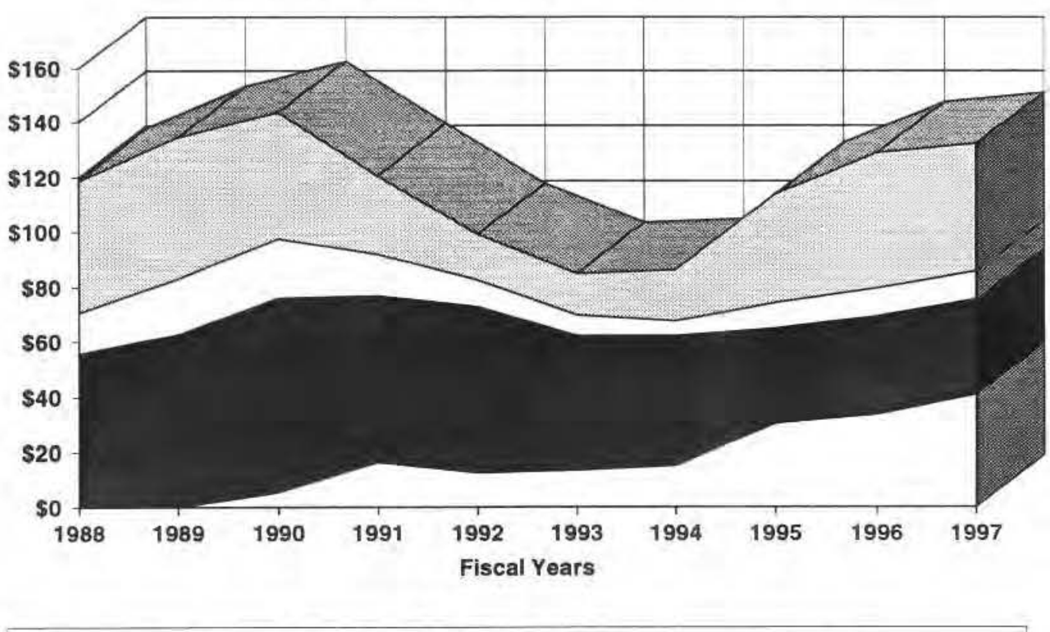
Total Funds

Fiscal Year	*Average Total Funds Invested*	*Total Cash Management Earnings*	*Composite Weighted Average Rate of Return*
1996-97	$ 2,390,862,834	$ 132,264,069	5.50%
1995-96	2,259,523,334	128,835,337	5.69%
1994-95	2,141,573,000	113,761,870	5.34%
1993-94	2,133,179,916	85,975,707	4.04%
1992-93	1,964,109,670	84,483,590	4.39%

CASH MANAGEMENT INVESTMENTS
COMPOSITE WEIGHTED AVERAGE RATE OF RETURN 1988-1997



ANALYSIS OF STATE CASH EARNINGS 1988-1997



State Cash Management

Cash Management Portfolio Analysis
Fiscal Year Ended June 30, 1997

Date	Current Investment Yield	Total Portfolio Yield	Avg. Days to Maturity	*Portfolio Composition* Time Deposits	Repurchase Agreements	U.S. Treasury Notes	U.S. Agencies	Commercial Paper
07/96	5.41%	5.50%	109	33.16%	7.64%	9.44%	19.97%	29.79%
08/96	5.33%	5.50%	105	30.84%	5.22%	8.03%	27.22%	28.69%
09/96	5.32%	5.50%	94	33.02%	6.61%	8.39%	22.82%	29.16%
10/96	5.36%	5.47%	83	34.98%	6.30%	7.94%	21.91%	28.87%
11/96	5.38%	5.45%	69	35.29%	7.48%	6.66%	20.24%	30.33%
12/96	5.40%	5.47%	66	36.89%	9.57%	6.83%	14.16%	32.55%
01/97	5.33%	5.44%	61	36.33%	9.93%	6.59%	14.65%	32.50%
02/97	5.29%	5.42%	66	37.25%	7.66%	6.75%	17.77%	30.57%
03/97	5.41%	5.46%	76	40.05%	7.00%	6.83%	13.56%	32.56%
04/97	5.47%	5.54%	70	36.93%	9.91%	6.27%	14.86%	32.03%
05/97	5.54%	5.60%	71	36.34%	6.07%	4.78%	20.26%	32.55%
06/97	5.52%	5.63%	65	36.09%	7.61%	4.73%	19.48%	32.09%
Dollar Weighted Avg.	5.40%	5.50%	78	35.60%	7.58%	6.94%	18.91%	30.97%

Date	*General Fund* Average	Percent	*LGIP* Average	Percent	*Other Restricted* Average	Percent	*Total Invested*
07/96	$ 476,339,467	19.15%	$ 1,444,586,285	58.09%	$ 566,157,248	22.76%	$ 2,487,083,000
08/96	529,333,163	20.19%	1,511,051,633	57.64%	581,109,204	22.17%	2,621,494,000
09/96	370,487,610	14.77%	1,542,430,897	61.48%	595,845,493	23.75%	2,508,764,000
10/96	199,592,875	8.22%	1,540,340,424	63.41%	689,104,701	28.37%	2,429,038,000
11/96	125,300,025	5.54%	1,527,501,032	67.49%	610,261,943	26.97%	2,263,063,000
12/96	125,020,751	5.60%	1,500,779,214	67.20%	607,305,035	27.20%	2,233,105,000
01/97	64,362,720	2.81%	1,603,715,693	70.13%	618,763,587	27.06%	2,286,842,000
02/97	4,553,133	0.20%	1,603,173,914	71.96%	620,405,953	27.84%	2,228,133,000
03/97	(86,732,985)	-3.94%	1,688,335,378	76.66%	600,847,607	27.28%	2,202,450,000
04/97	118,849,683	5.00%	1,639,468,983	68.90%	620,942,334	26.10%	2,379,261,000
05/97	344,128,881	13.70%	1,554,714,889	61.89%	613,188,230	24.41%	2,512,032,000
06/97	461,283,855	18.17%	1,488,802,382	58.63%	589,002,763	23.20%	2,539,089,000
Avg.	$ 227,709,932	9.52%	$ 1,553,741,727	64.99%	$ 609,411,175	25.49%	$ 2,390,862,834

LOCAL GOVERNMENT INVESTMENT POOL

Tennessee municipalities, counties, school districts, utility districts, community service agencies, local government units, and political subdivisions can deposit monies with the Treasurer to be invested in the state cash management investment pool. Of course, these local governments can invest their monies directly in the money market if they so desire. However, by allowing their dollars to be invested by the state they eliminate the complexities of managing day to day investment and collateral relationships with banks and/or securities dealers.

This allows cash managers who have previously been limited either by the relatively small amount of funds available for investment or the complexities of today's investment environment to take advantage of the volume and expertise of the Treasurer's cash management program.

The Local Government Investment Pool began operations in November of 1980. Participation in the LGIP program currently stands at 783 active accounts, representing 272 local government units. In addition, 313 accounts are active in the Department of Transportation program.

Local governments which enter into agreements with the Department of Transportation (DOT) often establish an LGIP account to fund the local matching portion of a highway project grant. These DOT accounts are available to provide the local match to the specific highway project in a timely manner while earning interest for the local government. In a similar fashion, the Tennessee Board of Regents schools provide their matching portion of Capital Projects funds while earning interest for the benefit of the Board of Regents school.

The Treasurer's Office has installed a facsimile copy machine to assist participants of the LGIP in communicating their instructions regarding deposits, transfers or withdrawals of funds. Thus, participants have the choice of communicating these instructions by telephone or telecopier.

In addition, voice mail telephone service has been provided to permit LGIP participants to give telephone transaction instructions while staff is busy on other telephone lines. Voice mail permits an increase in productivity while holding costs constant.

LGIP reports mailed to participants include monthly statements and transaction confirmations. Monthly statements detail all debits and credits to the account during the month, the account's average daily balance, and interest credited. A transaction confirmation is mailed to the participant each time a deposit or withdrawal is made. Many participants rely on this documentation for daily and weekly reconciliations.

Participants earn interest on LGIP deposits based on the average rate of interest earned on the investments acquired for the entire cash management pool each month. This average earnings rate is reduced each month by six one hundredths of one percent (.06%) as an administrative fee for participating in the LGIP program. During the 1996-97 fiscal year, the average rate participants earned on their deposits after the fee reduction was 5.34%.

Other activity is shown on the following schedule by participant group.

STATE CASH MANAGEMENT

LOCAL GOVERNMENT INVESTMENT POOL
SCHEDULE OF ACTIVITY BY ENTITY TYPE

FISCAL YEAR ENDED JUNE 30, 1997

	Account Balance 7/1/96	Net Deposits/Withdrawals FY 1996-97	Net Interest Credited FY 1996-97	Account Balance 6/30/97
Cities	$ 267,093,169	$ (27,458,491)	$ 13,992,099	$ 253,626,777
Counties	535,873,860	(61,168,926)	31,683,319	506,388,253
Commitments to D.O.T.	29,546,760	16,863,368	1,814,777	48,224,905
Educational Institutions	335,159,642	8,953,509	25,518,300	369,631,451
Community Service Agencies	5,781,540	1,071,295	371,811	7,224,646
Restricted Accounts	946,747	(59,887)	50,073	936,933
Other	151,215,686	32,871,370	9,523,392	193,610,448
TOTAL	$ 1,325,617,404	$ (28,927,762)	$ 82,953,771	$ 1,379,643,413

STATE TRUST OF TENNESSEE

The State Trust of Tennessee, a not-for-profit corporation, was chartered in the state of Tennessee on April 20, 1979 and began operations in December 1980. The State Trust has enabled the Treasury Department to gain limited membership in the Federal Reserve Bank System. Being a limited member of the Federal Reserve gives the Treasury Department access to the Federal Reserve Wire System, which is used to send, receive, transfer and control funds movement expediently under the Treasurer's management.

Due to restrictions imposed upon state-owned trust companies by the Federal Reserve Board, the State Trust of Tennessee is limited in the number of daily outgoing wire transfers and can no longer settle ACH transactions through its account at the Federal Reserve.

The restrictions required the State Trust of Tennessee to contract with an agent bank to execute these transactions. SunTrust Bank in Nashville began serving as the Trust's agent on July 1, 1994.

The State Trust became an associate member of the Nashville Clearinghouse on April 1, 1994. Approximately 85% of all check items presented for redemption are processed through the clearinghouse.

STATE TRUST OF TENNESSEE FEDERAL RESERVE BANK TRANSACTIONS
FISCAL YEAR 1996-97

Transaction Type	Number	Amount
(1) Wire Disbursements	1,021	$ 3,394,781,079
(2) Wire Receipts	7,011	11,907,111,882
(3) Security Disbursements	1,176	42,806,231,308
(4) Security Receipts	1,165	42,952,833,480
(5) Check Redemptions	6,193,244	6,540,026,581
TOTAL	6,203,617	$ 107,600,984,330

Explanation of Transaction Types:

(1) Disbursements of cash for the purpose of non-Fed eligible securities, settlement wires to agent bank, and other non-recurring wires.
(2) Receipt of cash for payment of interest and principal for non-Fed eligible securities, concentration of cash deposited in local banks, drawdown of Federal funds, and Local Government Investment Pool (LGIP) deposits.
(3) Disbursement of cash against the receipt of Fed eligible securities (U.S. Government securities held in book-entry form by the Federal Reserve Bank).
(4) Receipt of cash against the disbursement of Fed eligible securities.
(5) Redemption of warrants, drafts, and checks issued by the state.

TCRS Investments

Investment objectives for the TCRS Investment Division are to obtain the highest available return on investments consistent with the preservation of principal, while maintaining sufficient liquidity to react to the changing environment and to pay beneficiaries in a timely manner.

TCRS Investment Division's policies and strategies serve to benefit plan members in several ways. The emphasis on a conservative asset allocation and high quality securities helps to ensure the soundness of the system and the ability to provide the needed funds upon a member's retirement.

Funds in the retirement system are actively managed with a diversified portfolio of high-quality domestic and international bonds, domestic and international stocks, and money market instruments.

The investment authority for TCRS is set out in *Tennessee Code Annotated*, Section 8-37-104(a), which provides that, with certain specific exceptions, investments of TCRS assets are subject to the same terms, conditions, and limitations imposed on domestic life insurance companies. It further provides that investment policy for TCRS funds is subject to the approval of the Board of Trustees.

An Investment Advisory Council was established by the Consolidated Retirement Act of 1972 to provide policy guidance to the Board of Trustees and the investment staff. The current Advisory Council is comprised of senior investment professionals from within the state of Tennessee. All members hold the Chartered Financial Analyst designation.

Effective January 1, 1998, State Street Bank will begin providing Master Trust Custodial services to TCRS. The master custodian provides safekeeping and accounting services.

Initiatives

The TCRS assets continue to grow at a rapid pace. The TCRS Investment Division continuously monitors how to best manage these assets in a changing investment environment. During the fiscal 1996-97 year, the TCRS established an additional equity portfolio with a fundamental analysis discipline. The new portfolio has successfully complimented the styles of the existing equity portfolios. In addition, the TCRS completed an asset allocation study during the past year. As a result of this study, the TCRS received legislative approval to invest in real estate.

A major initiative for the TCRS Investment Division will be developing an investment policy and strategy for real estate and successfully implementing investments in this new asset class.

SUMMARY OF RETIREMENT FUND INVESTMENTS

	June 30, 1997	*June 30, 1996*
	Fair Value	**Fair Value**
Domestic Securities:		
Government Bonds	$ 5,491,015,999	$ 4,902,951,139
Corporate Bonds	3,389,392,600	3,177,512,851
Corporate Stocks	5,539,624,045	4,977,670,919
Total Domestic Securities	$14,420,032,644	$13,058,134,909
International Securities:		
Government Bonds	$ 1,216,381,373	$ 890,090,344
Corporate Bonds	323,917,513	264,545,689
Corporate Stocks	1,560,789,329	1,007,259,825
Total International Securities	$ 3,101,088,215	$ 2,161,895,858
Short-Term Securities	$ 875,251,761	$ 667,732,900
Total Investments	$18,396,372,620	$15,887,763,667

TCRS Investments

TCRS Investments Benchmark Analysis

Fiscal Year	[1]Public Fund Index Median Total Return	[2]TCRS Total Return	[3]Yield To Maturity on New Bonds
1996-97	18.9%	15.7%	6.7%
1995-96	15.8	12.8	6.2
1994-95	15.4	12.8	7.3
1993-94	1.6	0.5	5.9
1992-93	13.2	15.1	6.5
1991-92	12.1	13.7	8.2
1990-91	7.9	7.8	8.7
1989-90	10.4	11.6	9.0
1988-89	14.2	15.3	9.4
1987-88	1.9	2.0	9.2

[1]This index most closely resembles the structure and objectives of TCRS.

[2]This is the time weighted method used to calculate returns and is the most accurate way to measure performance.

[3]This is the yield to maturity on bonds acquired with new funds during each fiscal year.

Summary of TCRS Earnings
Fiscal Years 1992-93 Through 1996-97

Fiscal Year	TCRS Portfolio Earnings[1]
1996-97	$ 2,514,952,816
1995-96	1,806,673,555
1994-95	930,425,055
1993-94	1,229,683,543
1992-93	1,137,466,939

[1]Beginning with fiscal year 1995-96, TCRS portfolio earnings include unrealized appreciation on investments.

Tennessee Consolidated Retirement System

The Tennessee Consolidated Retirement System (TCRS) was established July 1, 1972. Prior to this date, there were seven different public employee retirement systems. The TCRS, a defined benefit plan which is qualified under 401(a) of the Internal Revenue Code (IRC), is a retirement system for state employees, higher education employees, teachers, and local government employees.

Membership

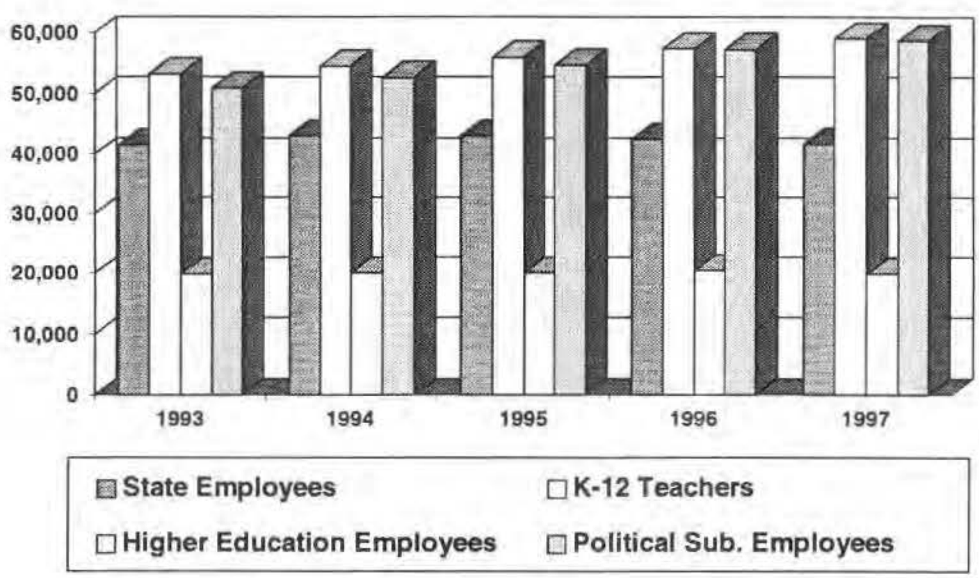
Membership in the retirement system is a condition of employment for full-time state employees, teachers, general employees in higher education, and the employees of local governments that participate in TCRS. Membership is optional for certain part-time employees. Faculty employees in higher education may participate in either TCRS or an Optional Retirement Program (ORP), which is a defined contribution plan designed for faculty employees in institutions of higher education. When an employee joins TCRS, he receives an introductory letter and membership pamphlet outlining various aspects of retirement membership.

State employees and teachers become vested after five years of service. Political subdivision members attain vested status upon completion of 10 years unless five year vesting has been authorized. A vested member is guaranteed a retirement benefit once the age requirements are met.

As of June 30, 1997, there were 179,171 active members of TCRS and 10,262 higher education employees participating in the ORP.

Since July 1, 1976, all new members of the TCRS except state judges have been classified as Group I members. State judges have been permitted to enroll in Group IV since September 1, 1990. From July 1, 1972 to June 30, 1976, all employees were classified as Group I, with the exception of state policemen, wildlife officers, firemen and policemen who were classified as Group II, and judges and elected officials who were classified as Group III. Members of seven superseded systems are permitted to retain their original rights and benefits.

Active Members Fiscal Years 1993-1997



TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

CONTRIBUTIONS

The funding of retirement benefits is financed by member contributions, employer contributions, and the earnings of the invested assets. Effective July 1, 1981, the employee contributions of certain state employees and higher education employees were assumed by the state. Local governments can also adopt these noncontributory provisions for their employees. Group I K-12 teachers and contributory local government employees contribute to TCRS at the rate of 5% of gross salary. Employee contribution rates vary for superseded classifications.

Effective January 1, 1987, all state employees and teachers who contribute a portion of their income to the retirement system became covered by Section 414(h) of the Internal Revenue Code. Under 414(h), payment of federal income tax on an employee's retirement contributions is deferred until these contributions are withdrawn in the form of a refund or monthly benefit payments. Political subdivisions may pass a resolution adopting Section 414(h) coverage for their employees.

Upon termination of employment, a member may elect to withdraw his contributions and accumulated interest from the retirement system in a lump sum. By obtaining a lump sum refund, a member waives all rights and benefits in the retirement system. A vested member may leave his account balance in TCRS and apply for benefits upon meeting the age requirements. A non-vested member who terminates employment may only leave his account balance in TCRS for up to seven years. During the 1996-97 fiscal year, 4,632 refunds totaling $23.8 million were issued.

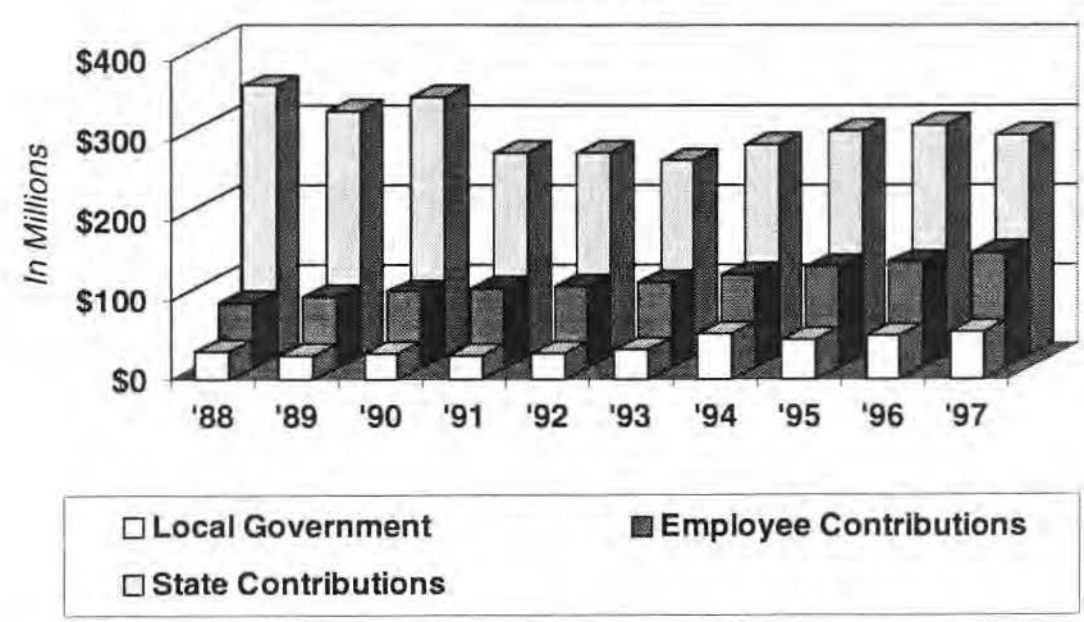
The contribution rate for the employers participating in the retirement system is determined by a biennial actuarial valuation performed by an independent actuarial firm. The contribution rates include funding for the basic benefit, the cost-of-living increase provisions, and amortization of the accrued liability over a 40 year period which began in July of 1975. The employer contribution rates for the year ending June 30, 1997 were as follows:

Noncontributory State and Higher Education Employees	7.36%
K-12 Teachers	6.50%
Political Subdivisions	Individually Determined
Faculty Members Electing to Participate in the ORP	10.00%*

*11% for salary above the social security wage base.

RETIREMENT CONTRIBUTIONS FISCAL YEARS 1988-1997

IN MILLIONS



Tennessee Consolidated Retirement System

Retirement Benefits

The benefits provided by TCRS are designed, when combined with the benefit payable from social security, to allow career employees to maintain their standard of living at retirement.

As of June 30, 1997, 66,662 retirees were receiving monthly benefit payments. This represents an increase of over 2,600 retirees during the year.

Group I state employees and teachers become eligible to retire from the TCRS at age 60 with five years of service or at any age with 30 years of service. State employees and teachers become vested after five years of service. Political subdivision members attain vested status upon completion of 10 years unless five year vesting has been authorized. Retirement benefits are based on the average of the member's five highest consecutive years of salary and the years of creditable service. A reduced retirement benefit is available to vested members at age 55 or upon completion of 25 years of service.

Disability benefits are available to active members with five years of service who become disabled and can not engage in gainful employment. There is no service requirement for disability benefits paid to active members whose disability is a result of an accident or injury occurring while the member was in the performance of duty.

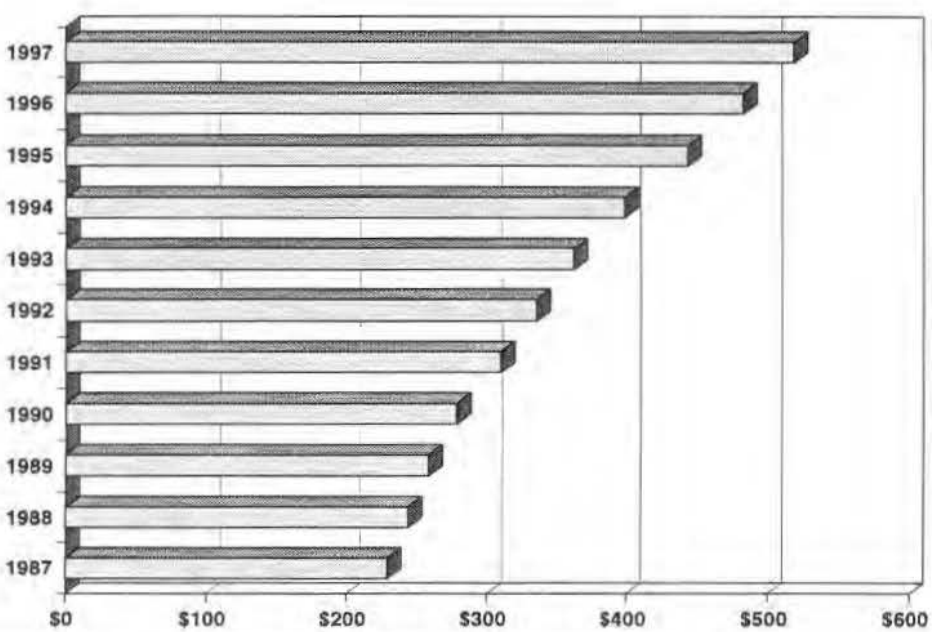
Cost-of-living adjustments after retirement are based on the Consumer Price Index (CPI). If there is an increase in the CPI of as much as .5% in any calendar year, the retired member's benefit will be adjusted by an amount equal to the increase in the CPI, not to exceed 3%.

Certain death benefits are available to the beneficiary(s) of a member who dies prior to retirement. At retirement, a member can select an optional benefit which is actuarially reduced so that his beneficiary may continue to receive a benefit after his death.

Benefits paid in fiscal year 1996-97 totaled \$521.3 million, an increase of \$39.3 million over 1995-96 benefit payments.

Annual Benefit Payments Fiscal Years 1988-1997

In Millions



TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

TENNESSEE'S RETIREMENT PROGRAM

TCRS AND SOCIAL SECURITY BENEFITS

SAMPLE CALCULATIONS FOR CALENDAR YEAR 1997

Five Year Average Final Compensation			20 Years			25 Years			30 Years	
$15,000	TCRS	$	4,725		$	5,906		$	7,088	
	Social Security		8,184			8,184			8,184	
	Total	$	12,909	(86.1%)	$	14,090	(93.9%)	$	15,272	(101.8%)
$20,000	TCRS	$	6,300		$	7,875		$	9,450	
	Social Security		9,852			9,852			9,852	
	Total	$	16,152	(80.8%)	$	17,727	(88.6%)	$	19,302	(96.5%)
$25,000	TCRS	$	7,875		$	9,844		$	11,813	
	Social Security		11,520			11,520			11,520	
	Total	$	19,395	(77.6%)	$	21,364	(85.5%)	$	23,333	(93.3%)
$30,000	TCRS	$	9,576		$	11,976		$	14,364	
	Social Security		13,152			13,152			13,152	
	Total	$	22,728	(75.8%)	$	25,128	(83.8%)	$	27,516	(91.7%)
$35,000	TCRS	$	11,412		$	14,268		$	17,124	
	Social Security		14,064			14,064			14,064	
	Total	$	25,476	(72.8%)	$	28,332	(80.9%)	$	31,188	(89.1%)
$40,000	TCRS	$	13,248		$	16,560		$	19,872	
	Social Security		14,580			14,580			14,580	
	Total	$	27,828	(69.6%)	$	31,140	(77.9%)	$	34,452	(86.1%)
$45,000	TCRS	$	15,084		$	18,864		$	22,632	
	Social Security		14,988			14,988			14,988	
	Total	$	30,072	(66.8%)	$	33,852	(75.2%)	$	37,620	(83.6%)

This chart is based on a date of retirement in 1997. Social Security benefits have been calculated by Bryan, Pendleton, Swats & McAllister, actuarial consultants for the TCRS, utilizing the following assumptions: (1) retirement took place at age 65 in 1997; (2) the retiree worked a full career (TCRS plus other employers, if necessary) of 35 years or more, and; (3) salary increases throughout the retiree's career followed the same pattern as National Average Earnings.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

ACTUARIAL VALUATION

An actuarial valuation of the TCRS is performed by an independent actuarial firm every two years. The purpose of the valuation is to determine the funding requirements for the employers participating in the TCRS. The latest valuation was performed June 30, 1997 to establish employer contribution rates. The system's accrued liability at June 30, 1997 is $111.2 million. The accrued liability is being amortized over a 40 year period which began in 1975.

In addition to the biennial actuarial valuation, an experience study is conducted every four years for the purpose of establishing actuarial and economic assumptions to be used in the actuarial valuation process. Following are the assumptions used in the June 30, 1997 actuarial valuation of the plan:

Economic Assumptions

(1) 7.5% annual return on investments
(2) 5.5% salary increases annually
(3) 4.5% annual increase in social security wage base

Actuarial Assumptions

(1) Pre-Retirement mortality based on age and sex
(2) Post-Retirement mortality based on age and sex
(3) Disability rate based on age
(4) Turnover rate based on age and length of service
(5) Retirement age distribution based on age and service

POLITICAL SUBDIVISIONS

Political subdivisions may participate in the TCRS if the chief governing body passes a resolution authorizing coverage and accepting the liability associated with the coverage. Each political subdivision is responsible for the retirement cost of its employees and, in addition to employer contributions, pays the TCRS a fee for TCRS administration.

Political Subdivision Participation
as of June 30, 1997

Cities	134
Counties	84
Utility Districts	29
Special School Districts	20
Joint Ventures	23
Miscellaneous Organizations	18
Regional Libraries	12
911 Emergency Communication Districts	23
Housing Authorities	10
Development Agencies	12
Total	365

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

MAJOR LEGISLATIVE IMPROVEMENTS

1972 The benefit formula was improved from 1.12% of salary up to the Social Security Integration Level (SSIL) to 1.5% of salary up to the SSIL.

1973 An annual cost-of-living increase, based on the Consumer Price Index (CPI) with a cap of 1.5% was adopted for retirees.

1974 Disability retirement eligibility requirement was reduced from 10 years to five years of service.

The minimum benefit was increased from $5.34 to $7.00 per month per year of service.

The maximum annual cost-of-living increase was raised from 1.5% to 3%.

A provision was made to increase retirees' benefits whenever the benefit formula is improved.

Service credit was authorized for unused accumulated sick leave.

1976 Service retirement eligibility requirements were reduced from age 65 or 35 years of service to age 60 or 30 years of service.

Early retirement eligibility requirements were reduced from age 60 or 30 years of service to age 55.

1978 A bonus cost-of-living increase was granted to retirees at a lump-sum cost of $15.3 million.

An optional retirement plan was established for teachers in the Board of Regents system.

1980 Death benefits for members dying in-service with 10 years of service was improved by offering a 100% joint and survivor annuity of the member's accrued benefit for the spouse.

1981 Non-contributory retirement for state employees and higher education employees was adopted. The employees' contributions–up to 5%–were assumed by the state. Salaries of employees in active service on the date these provisions were adopted were indexed by 3.6%. Subsequent legislation has continued this indexing each year since.

1983 An actuarially reduced retirement benefit at any age with 25 years of service was authorized.

1984 Credit for out-of-state service for the purpose of determining retirement eligibility was authorized.

Part-time employees were permitted to participate in TCRS and members were allowed to establish credit for previous part-time employment.

The minimum benefit was increased from $7 to $8 per month per year of service.

Retirement credit for armed conflict military service was approved.

1985 An ad hoc increase was granted to retirees at a lump-sum cost of $22 million.

Death benefits for spouse and children were provided when member's death is in the line of duty.

1987 Service credit for half of peacetime military service was made available.

Another ad hoc increase to retirees was provided at a lump-sum cost of $17 million.

A retirement incentive program was offered for state employees retiring during a 90-day window.

Section 414(h) of the IRC was adopted to provide that employee contributions are made on a tax-deferred basis.

1989 Retirement service credit for members receiving worker's compensation due to a temporary disability was made available.

1990 A retirement incentive program was offered for state employees retiring during a 120-day window.

1991 The Board of Trustees was authorized to designate additional vendors for the optional retirement plan for higher education employees.

1992 The minimum number of years required to qualify for retirement was reduced from 10 to five years.

Disability and death benefits were made available to inactive, vested members.

1993 Salary portability for service in different classifications was authorized effective Jan. 1, 1994.

A 5% benefit improvement was authorized effective January 1, 1994.

1996 An installment payment plan for prior service was authorized.

3.6% indexing of salaries for noncontributory employees was extended for an additional year.

1997 Compounding of future cost of living adjustments and catch up adjustments were authorized.

3.6% indexing of salaries for noncontributory employees was extended permanently.

Tennessee Consolidated Retirement System

Social Security

The Old Age & Survivors Insurance Agency (OASI) administers Section 218 of the federal Social Security Act for Tennessee public employees. This section relates to coverage agreements and modifications as well as to coverage determinations.

Prior to 1951, social security coverage was not available to public employees. Amendments to the Social Security Act made in 1950 allowed certain groups of state and local government employees who were not covered by an employer-sponsored retirement plan to voluntarily participate in social security. Amendments made in 1954 allowed coverage for public employees who were covered by an employer-sponsored retirement plan if federal referendum requirements are met.

The Tennessee Master Agreement was executed on August 16, 1951. It provided full social security coverage (retirement, survivors, disability, and hospital insurance) to public employees who were not covered by an employer-sponsored retirement plan. A modification to the agreement, effective January 1, 1956, provided social security coverage to employees serving in positions which were then covered by the Tennessee State Retirement System and the Tennessee Teachers' Retirement System. After the Tennessee Consolidated Retirement System was established July 1, 1972, a state-wide social security coverage referendum was held among eligible employees.

The 1985 Budget Reconciliation Act mandated Medicare hospital insurance coverage for public employees hired after March 31, 1986 who do not have full social security coverage. The Omnibus Budget Reconciliation Act of 1990 (OBRA) generally mandated full social security coverage for state and local government employees who are not covered by an employer-sponsored retirement plan.

Effective in 1991, separate wage bases were implemented for social security and Medicare and separate reporting of withholding was required. Since 1991, the social security tax rate has been 6.20% each for employers and employees and the Medicare (hospital insurance) rate has been 1.45% each.

Schedule of Historical Social Security Contribution Rates

Calendar Year	*Employee Rate*	*Employer Rate*	*Social Security Wage Base*	*Medicare Wage Base*
1998	7.65%	7.65%	$ 68,400	No Limit
1997	7.65	7.65	65,400	No Limit
1996	7.65	7.65	62,700	No Limit
1995	7.65	7.65	61,200	No Limit
1994	7.65	7.65	60,600	No Limit
1993	7.65	7.65	57,600	$ 135,000
1992	7.65	7.65	55,500	130,200
1991	7.65	7.65	53,400	125,000
1990	7.65	7.65	51,300	51,300
1989	7.51	7.51	48,000	48,000

DEFERRED COMPENSATION

The Deferred Compensation Program is a voluntary program designed to provide state employees with the opportunity to accumulate supplemental retirement income on a tax deferred basis. Participants may postpone income taxes on contributions and earnings by agreeing to defer receipt of a portion of their current income until retirement.

This program offers employees two plans. The 457 plan was implemented in the 1981-82 fiscal year and the 401(k) plan was implemented in the 1983-84 fiscal year.

As of June 30, 1997, 35,491 employees had accounts in the program: approximately 89% had accounts in the 401(k) plan only, 8% had accounts in both plans, and 3% had accounts in the 457 plan only. At June 30, 18,610 state employees, 5,998 University of Tennessee employees, and 5,389 Tennessee Board of Regents employees were actively contributing to the 401(k) plan and 1,453 state employees, 100 University of Tennessee employees, and eight Tennessee Board of Regents employees were actively contributing to the 457 plan.

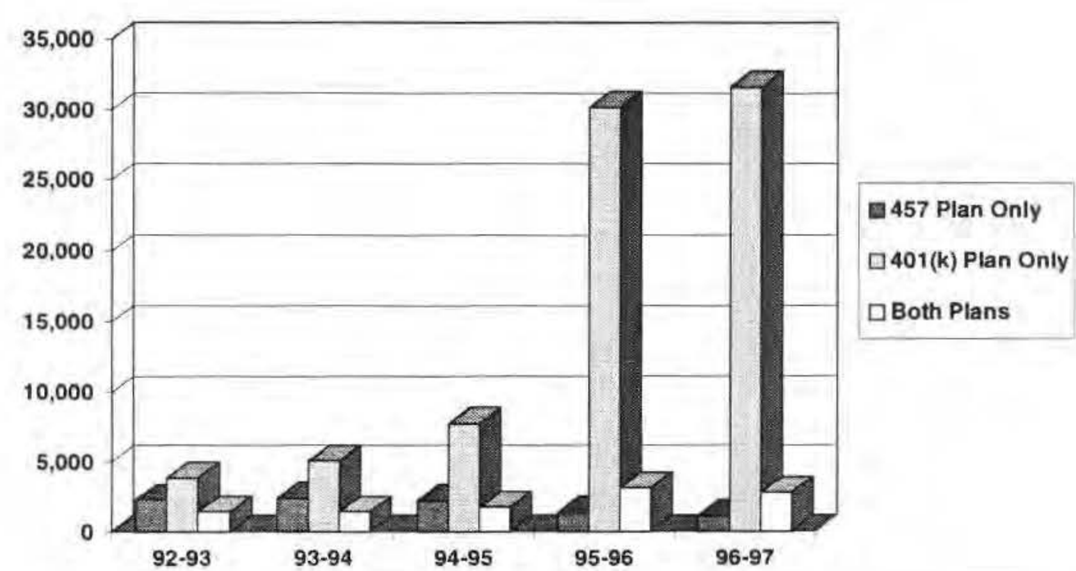
The program is used by state employees of all ages and salary levels. The majority are under age 50 and earn below $35,000 per year. At June 30, 1997, the average monthly deferral among state employee participants was $111 and the average monthly deferral among higher education employee participants was $78.

IRS regulations for 1997 allow a maximum deferral in the 457 plan of 25% of taxable salary up to the maximum annual contribution of $7,500. The maximum deferral in the 401(k) plan is 20% of taxable salary for most members, up to the maximum annual contribution of $9,500. Participants who use more than one tax-deferred savings plan are subject to additional limits.

During the 1996-97 fiscal year, the state and the University of Tennessee each matched their employees' contributions to the 401(k) plan at $20 per month as authorized by the General Assembly. The amount contributed by the state during the year was $4,359,140.

Participants in the program may direct the investment of their deferred salary to Union Planters Time Deposit Account, Aetna's Fixed Account, Calvert's Income Fund, and Fidelity Investments' Magellan Fund, Puritan Fund, OTC Portfolio, Contrafund, International Growth and Income

PARTICIPANTS 1993 - 1997



Deferred Compensation

Fund, Asset Manager, and Government Money Market Portfolio. Contributions are wired through the State Trust of Tennessee for immediate crediting.

Enrollment and recordkeeping services for the program are provided by Security First Group. The use of an "unbundled" arrangement enables participants to use a wide variety of investment products without the fees or sales pressures traditionally associated with "bundled" products and to receive consolidated account statements and benefit estimates.

Participants in the program receive a quarterly statement showing contributions and earnings during the quarter. In addition, once a year, participants receive a special statement projecting their account balance to a variety of retirement ages and showing the monthly income those account balances might provide. The program provides a variety of communication and education materials and services, including a comprehensive Internet site, a video, a voice response telephone system, a handbook for participants, several booklets on special topics, and investment seminars around the state.

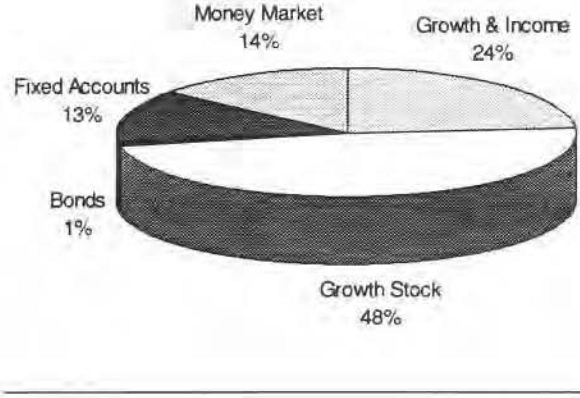
For the year ending June 30, 1997, contributions to the program totaled $43,242,645. At June 30, 1997, accumulated account balances totaled $321,923,631. As illustrated below, at June 30, 1997, participants were investing 87% of new deferrals and 74% of accumulated assets in variable mutual funds. Distribution of these funds among the investment providers is shown on the following page.

Benefits from the program may be distributed in periodic payments, in an annuity, or in a lump sum. At June 30, 1997, there were 346 individuals receiving periodic payments and 191 individuals receiving annuity payments from the program. The majority of retirees elect to withdraw funds in a lump sum.

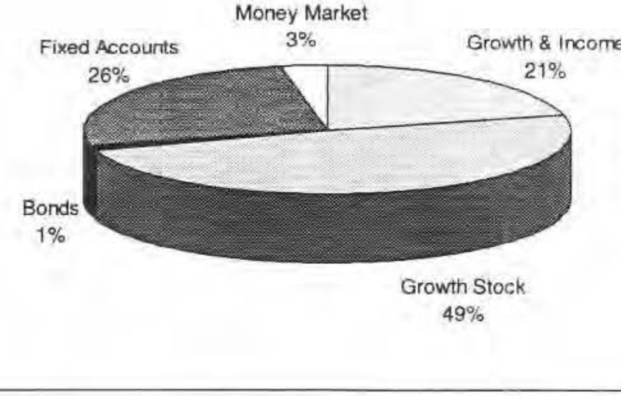
Under the loan program offered in the 401(k) plan, active employees who have accumulated $4,000 or more in their 401(k) account may borrow up to half of their account value. Participants repay principal and interest to their 401(k) account through salary deduction. Taxes continue to be deferred while funds accumulated in the plan are in loan status. As of June 30, 1997, there were 415 loans outstanding from the 401(k) plan. Outstanding loan balances totaled $1.8 million.

Distribution of Deferred Compensation Assets
By Investment Category
June 30, 1997

Contributions



Assets



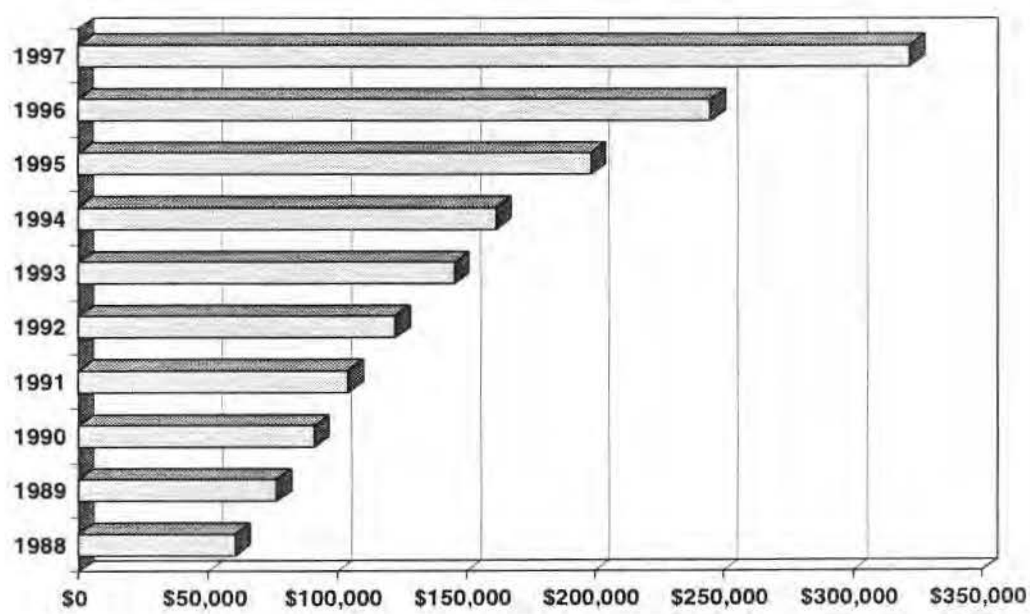
DEFERRED COMPENSATION

DEFERRED COMPENSATION CONTRIBUTIONS AND ASSETS

	Contributions		*Market Value of Account Balances*	
	FY 1996-97	**FY 1995-96**	**June 30, 1997**	**June 30, 1996**
Plan I: 457				
Aetna - Closed Contract	$ 0	$ 0	$ 19,888,499	$ 19,184,136
Aetna - New Contract	534,817	588,195	13,219,644	11,125,492
American General	53,078	59,775	988,523	983,807
Calvert Group	41,796	55,295	494,565	444,883
Fidelity Investments	2,334,890	2,562,010	62,967,168	48,458,233
Great West	0	141,921	3,544,555	5,105,240
Union Planters	557,807	640,417	14,670,926	15,174,443
TOTAL 457	$ 3,522,388	$ 4,047,613	$ 115,773,880	$ 100,476,234
Plan II: 401(k)				
Aetna - Closed Contract	$ 0	$ 0	$ 10,439,932	$ 10,575,409
Aetna - New Contract	4,113,296	3,372,615	19,748,200	15,491,754
Calvert Group	559,816	450,861	1,833,225	1,314,240
Fidelity Investments	32,430,254	21,996,257	157,282,585	100,598,120
Great West	0	305,676	3,253,414	4,691,108
Union Planters	2,616,891	2,037,878	13,592,395	12,027,764
TOTAL 401(k)	$ 39,720,257	$ 28,163,287	$ 206,149,751	$ 144,698,395
GRAND TOTAL	$ 43,242,645	$ 32,210,900	$ 321,923,631	$ 245,174,629

PROGRAM ASSETS 1988-1997

IN THOUSANDS



Flexible Benefits Plan

The Flexible Benefits Plan is an optional benefit plan which enables state employees to pay for certain expenses with tax-free salary. Authorized under Section 125 of the Internal Revenue Code, this plan allows employees to avoid income tax and social security tax on the portion of the upcoming year's salary they agree to set aside for that year's (1) group medical insurance premiums, (2) group dental insurance premiums, (3) out-of-pocket medical expenses, and (4) dependent care expenses.

In exchange for its favorable tax treatment, the plan must comply with specific rules set forth by the Internal Revenue Code and Regulations. Employees must decide what they will purchase through the plan and how much they will spend before the year begins. State employees enrolled in a group health or dental insurance program are automatically enrolled in the insurance premium portion of the plan unless they elect not to participate. Use of the other benefit options requires a new election each year.

Enrollment in the plan is for a full calendar year. Enrollments may not be changed after the year has begun unless the employee experiences a change in family status and reports that change promptly. Employees must use the amounts set aside in each category for corresponding expenses incurred during the year and any amount not used by the employee must be subject to forfeiture.

Tennessee's Flexible Benefits Plan, or "cafeteria" plan was implemented January 1, 1989. The Treasury Department took over administration of the program effective January 1, 1992.

At June 30, 1997, 37,055 state employees were enrolled in one or more of the plan's four options: 36,604 employees used the plan to pay medical insurance premiums, 12,325 paid dental insurance premiums, 2,380 used the medical expense reimbursement account, and 335 used the dependent care reimbursement account.

Since contributions to the plan are exempt from both employee and employer F.I.C.A. (social security) tax, employees' use of the plan creates F.I.C.A. savings for the state. In fiscal year 1996-97, the state's F.I.C.A. savings totaled $ 2,269,211. Since the program began operation in January 1989, the state's F.I.C.A. savings have totaled $14,906,835. Savings exceeding the costs of administering the plan have been designated for offsetting costs of the state's wellness program, providing assistance for day care programs, and funding matching contributions to the 401(k) plan. As of June 30, 1997, $9,608,065 had been transferred to offset costs of other benefit programs.

Claims Against the State

The Division of Claims Administration processes claims filed against the state for the negligent operation of motor vehicles or machinery; negligent care, custody and control of persons or property; professional malpractice; workers' compensation claims by state employees; dangerous conditions on state maintained highways and bridges; and nuisances created or maintained by the state. The Division of Claims Administration operates in conjunction with the Attorney General's Office and the Tennessee Claims Commission in this claims process.

The Division of Claims Administration contracts with a third party administrator for the processing of workers' compensation claims. The division's staff monitors the work done by the third party administrator and acts as a liaison between state employees and the third party administrator.

The division contracts with a managed care organization which has established a workers' compensation preferred provider network for medical treatment for injured state employees. Currently, 85% of state employees have access to this network. The managed care organization also provides case management services such as pre-certification for inpatient hospital care, bill review, large case management and other services to manage the costs of workers' compensation claims. The use of a preferred provider network has enabled the state to obtain approximately 33% savings off billed charges on workers' compensation medical bills.

The Division of Claims Administration also handles all employee property damage claims and tort claims up to a certain monetary limit.

During fiscal year 1996-97, the Division of Claims Administration received 6,498 claims falling within these categories (including workers' compensation claims filed with the third party administrator).

In order for a claim to be acted upon by the Division of Claims Administration, notice must be filed with the division. The division then has 90 days to make a determination on the claim. If the division is unable to act, the claim is automatically referred to the Tennessee Claims Commission. This process ensures that claims will be processed in a timely fashion.

This division also provides staff support to the Board of Claims. The Board of Claims has the authority to hear claims which do not fall within the jurisdiction of the Tennessee Claims Commission. During the 1996-97 fiscal year, the Board took action on a total of eight matters regarding claims and insurance. The Board also reviews and approves the purchase of insurance policies by the state and makes recommendations to the Commissioner of Finance and Administration and the General Assembly regarding the required funding for the Claims Award Fund.

The primary function of the Division of Claims Administration, Board of Claims, and Tennessee Claims Commission is to provide an avenue for persons who have been damaged by the state to be heard and, if appropriate, compensated for their loss or damage. All claims are paid through the Claims Award Fund. This fund is supported by premiums paid by each state department, agency and institution. The required funding is based upon an actuarial study which reflects risk assessment and estimated losses.

Claims Against the State

Claims and Payment Activity Fiscal Year 1996-97

	Claims Filed	Payments Made
Workers' Compensation Claims	4,181	
Death Payments		$ 242,775
Medical Payments		5,614,756
Assault Injury Payments		0
Temporary Disability (Lost Time)		1,349,207
Permanent Disability		4,398,532
Subtotal		$ 11,605,270
Employee Property Damage	245	$ 31,206
Tort Claims	2,072	
Death Payments		$ 940,248
Bodily Injury Payments		3,397,800
Property Damage Payments		947,679
Subtotal		$ 5,285,727
TOTAL	6,498	$ 16,922,203

VICTIMS COMPENSATION PROGRAM

Assisting persons who are innocent victims of crime is the purpose of the Criminal Injury Compensation Program. Payments made under the Criminal Injury Compensation Program are intended to defray the costs of medical services, loss of earnings, burial costs, and other pecuniary losses to either the victim of a crime or to the dependents of deceased victims. This program is funded through privilege taxes assessed in courts against criminal defendants and other offenders upon conviction, fees levied against parolees and probationers, the proceeds of bond forfeitures in felony cases, and a federal grant.

Applications for Criminal Injuries Compensation are filed with the Division of Claims Administration. The division's staff reviews the application and obtains supporting information from the appropriate District Attorney's Office to determine eligibility for payment from the Criminal Injuries Compensation fund. If the division cannot process a claim within 90 days, then the claim is referred to the Tennessee Claims Commission.

During the 1996-97 fiscal year, the Division of Claims Administration made payments on 1,541 criminal injury claims for a total of $6,066,472. Payments are issued promptly to the victim and, if appropriate, his or her attorney. Federal funding assistance for the program has aided in allowing prompt claim payment.

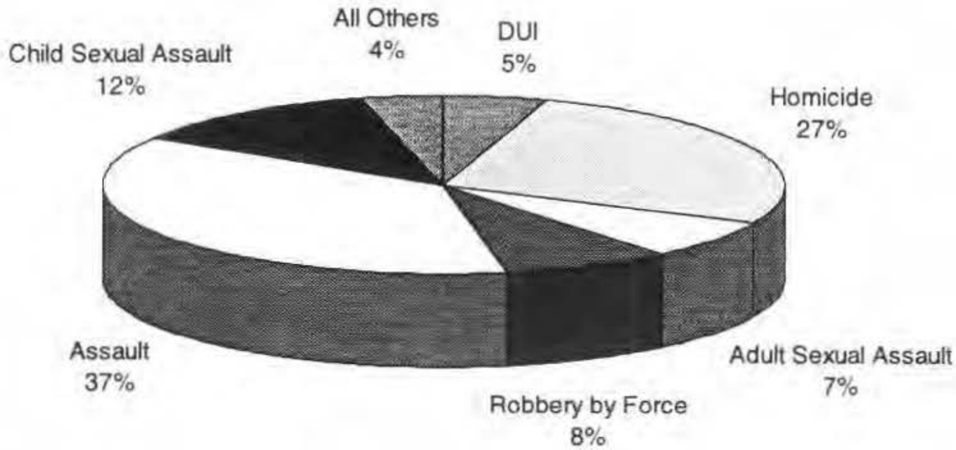
Victims of drunk drivers are also paid from the Criminal Injury Compensation Fund. Identical monetary benefits are available to both drunk driver and criminal injury victims. When the proximate cause of a death or injury is the operator's intoxication as prohibited by T.C.A. 55-10-401, the victim's death or injury is eligible for compensation in the same manner as criminal injury compensation, not to exceed a maximum award of $7,000 per claim plus attorney fees for injuries occurring on or after July 1, 1992. A supplemental award of up to $3,000 was available for crimes occurring during the 1996-97 fiscal year.

Since the first claims were paid in 1982, the program has awarded a total of over $85 million to crime victims. The Division of Claims Administration has made an effort to educate members of the public of the existence and benefits of the Criminal Injury Compensation Program by printing and distributing informative brochures explaining the program. Public awareness programs and the use of victim assistance coordinators in each judicial district have also aided in providing the public with information about the availability of criminal injury compensation.

VICTIMS COMPENSATION PROGRAM

VICTIMS COMPENSATION AWARDS
PAID DURING FISCAL YEAR 1996-97

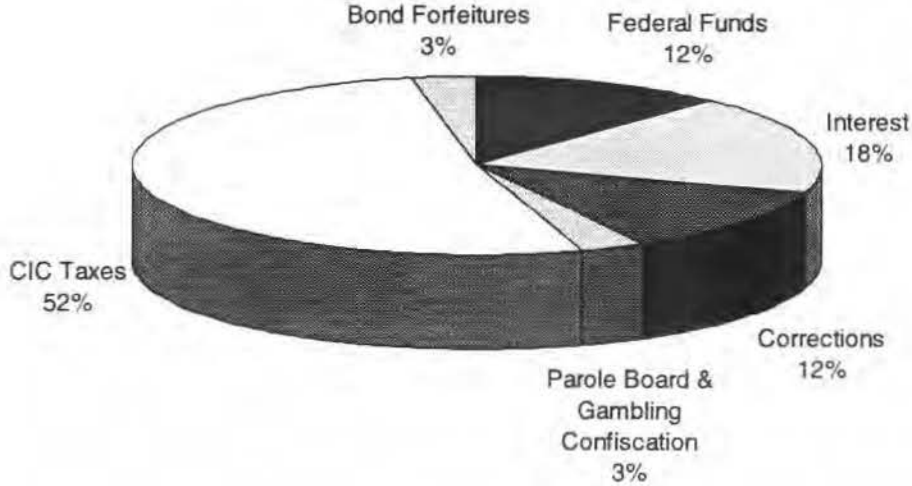
PERCENTAGE OF AWARDS BASED ON CRIME CLASSIFICATION



During fiscal year 1996-97, there were 1,541 awards totaling $6,066,472. Of that amount, $322,557 can be attributed to claims involving DUI with the remaining $5,743,915 related to all other crime types. The average award for all types was $3,937.

SOURCES OF FUNDS

VICTIMS OF CRIMINAL INJURY



Division of Risk Management

The Division of Risk Management administers a variety of insurance programs for the state. The Property/Casualty Insurance Program provides all-risk, replacement cost coverage, including flood and earthquake, for all state-owned buildings and contents. This is accomplished through a $5 million self-insured retention — a property/casualty reserve fund appropriated for the payment of property claims within a given fiscal year — and an excess property insurance policy purchased from a private carrier.

All property exposures are thoroughly inspected and evaluated to determine appropriate rates for premium development and allocation of premium costs to the various departments. As of July 1, 1996, the state's property values exceeded $8.0 billion. The premium cost for excess property coverage and fidelity bond amounted to $495,570. This translates to an annual rate of .0061 cents per $100 of coverage.

The Builders' Risk Insurance Program provides property insurance coverage for building construction or renovation projects which have been approved by the State Building Commission. The Division of Risk Management reviews all construction contracts and insurance specifications and issues builders' risk policies providing all-risk coverage for the state agency, contractor and subcontractors for the duration of the project.

Boiler insurance must be provided to ensure protection for all state-owned boiler objects. A boiler insurance policy is purchased from a private insurance carrier which is not only responsibile for the insurance coverage, but must also provide a boiler inspection service. Certified inspectors evaluate all boiler objects on a regularly scheduled basis to ensure the safe operation of these systems. This loss prevention program has proven very effective with results showing no major incidents within the past five years.

In order to protect the state from financial loss due to employee dishonesty, the Division of Risk Management procures an Honesty Blanket Position and Faithful Performance Blanket Position Bond. This bond is provided by the excess property insurance carrier and is negotiated as part of the property insurance package. Fidelity coverage is provided in the amount of $1 million per incident for 29 scheduled employees and $100,000 per incident for all remaining state employees.

The Division of Risk Management also has the responsibility to investigate and process all property, boiler, and fidelity bond claims. A detailed property inventory schedule is maintained which provides the insurable values for both buildings and contents in the event a loss occurs. There is a $5,000 deductible per occurrence which must be assumed by the individual departments. Documented losses above the deductible amount are indemnified by the property/casualty reserve fund, through an allotment revision process. Should this reserve fund become completely exhausted within a given fiscal year, the excess property policy would provide the primary fund resource for claim payments.

During fiscal year 1996-97, a total of 161 claims were reported. Of this number, 136 did not exceed the $5,000 deductible and were closed with no action. The remaining 25 incurred losses amounted to $1,727,156, with a net loss to the fund of $1,602,156. With a manual premium for first dollar coverage of $8.5 million, the state's pure property loss ratio would be 18.8%. Since the generally expected standard in the insurance industry for loss ratio break-even is approximately 48%, the state's property loss experience remains at an excellent level.

DIVISION OF RISK MANAGEMENT

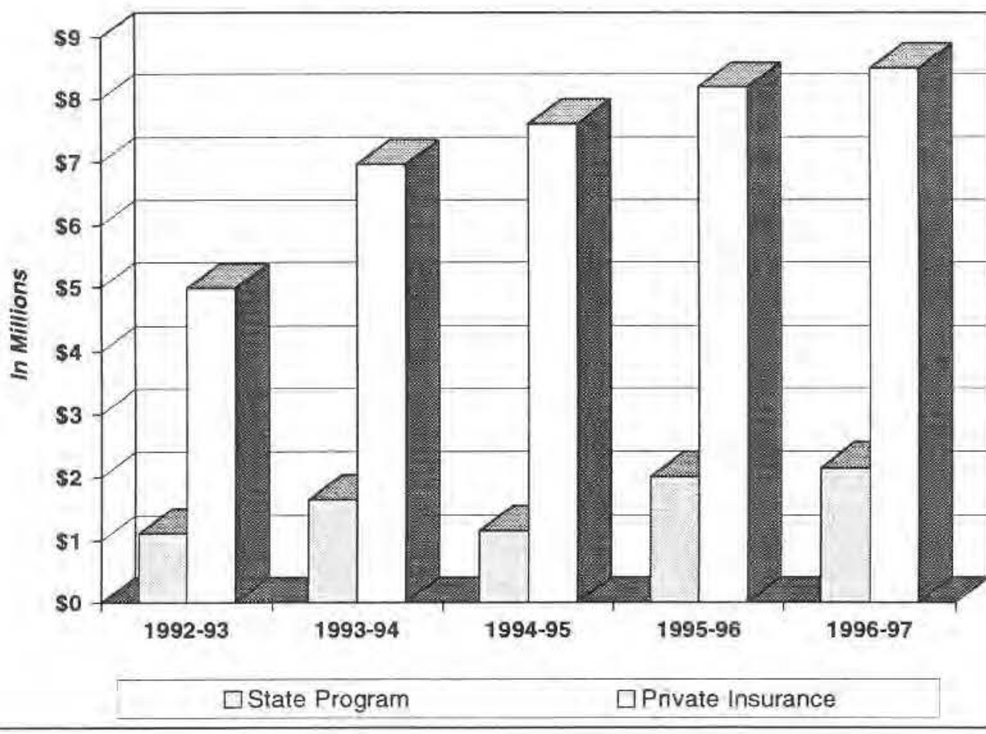
The prevention and control of losses continues to be an item of growing importance in the area of state risk management. Effective July 1, 1995, the Division of Risk Management initiated a statewide fire/life safety inspection program. This in-depth inspection process targets high risk state-owned facilities in an effort to prevent extensive loss to property and human life. The individual departments are issued detailed safety reports which outline all safety hazards and provide recommendations for corrective action. Also, with the continuing rise in workers compensation and tort liability loss costs, the Division of Risk Management will expand its loss control program in an effort to mitigate the growth in these areas.

COST OF PROPERTY/CASUALTY PROGRAM VERSUS PRIVATE INSURANCE FISCAL YEAR 1996-97

[1]Premium - Excess Property & Bond Coverage	$ 495,570
Premium - Boiler Insurance Coverage	54,801
Total Premium	550,371
Net Incurred Losses	1,602,156
Total Cost of State Program	2,152,527
[2]Private Insurance Premium Cost at Manual Rates with No State Retention	8,502,435
Net Savings to State	$ 6,349,908

[1] Based on July 1, 1996 values totaling $8,097,557,000
[2] Estimated based on July 1, 1996 values at .105 cents per $100 of coverage. Rates provided by Royal Insurance Company.

FISCAL YEARS 1992-93 THROUGH 1996-97



UNCLAIMED PROPERTY

The Treasury Department has administered the Uniform Disposition of Unclaimed Property Act since it was enacted in 1978. Administration of this act is carried out by the Unclaimed Property Division which operates the program in a manner designed to return unclaimed property to the rightful owner.

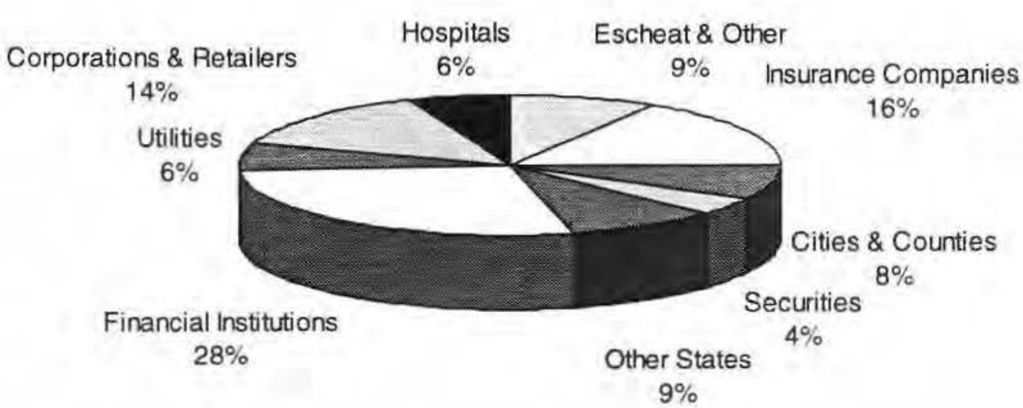
The Unclaimed Property Act provides that cash property which an organization or individual is holding for another person will be delivered to the Treasurer for custody if the holder of the property has had no contact with the owner for a period of five years and if the holder cannot locate the owner. Once property is delivered, the Treasurer advertises the owner's name and last known address in order to locate the owners. Since the program began operations in 1979, $130.2 million in unclaimed property has been reported to the Treasurer and $37.3 million (29%) has been returned to owners or heirs.

During the period July 1, 1996 through June 30, 1997, $16,398,500 of cash property was turned over to the Treasurer. This includes $1,321,472 in cash and stock remitted by third party audit organizations from out-of-state non-reporting holders for Tennessee residents. The chart below illustrates the sources of cash collections for fiscal year 1996-97.

In addition to advertising the property, the Treasurer makes several other efforts to locate the rightful owner. Another location method used is to send notification to the last known address of each owner. If no response is received, additional search efforts are made through employment security records, telephone directories, drivers' license records, and other sources. In addition, the records of unclaimed property owners are available for viewing by the public in the Unclaimed Property office. All property turned over to the Treasurer is held in trust for the rightful owner or his heirs in perpetuity, thereby allowing the owners or their heirs to make claims on it at anytime.

During the period July 1, 1996 through June 30, 1997, $5,695,016 of cash property was returned by the Unclaimed Property Division to the owners or their heirs. An analysis of the methods used to return this property is shown on the next page.

SOURCES OF UNCLAIMED PROPERTY



Unclaimed Property

Methods Used To Return Property
July 1, 1996 - June 30, 1997

Location Method	Number of Accounts	Value of Claims	Percentage of Claim Value
Postcards	2,816	$ 1,265,783	26%
Independent Locator	409	924,995	19
Advertisement	1,860	681,575	14
Telephone Directory	265	584,207	12
Holder Referral	505	535,522	11
Other	438	486,846	10
Employment Security & Dept. of Safety Match	827	340,786	7
Legislator Listings	125	48,683	1
Total Claim Payments	7,245	$ 4,868,397	100%
Refunds to Local Governments	12	$ 234,998	
Interstate Exchanges	36	591,621	
Total Payments	7,293	$ 5,695,016	

Any local government in Tennessee which turns over unclaimed property to the state may request that the property be returned to the local government for safekeeping after it has been held by the state for 18 months. This fiscal year, $234,998 was refunded to 12 local governments.

Tennessee has reciprocal agreements with other states' unclaimed property programs to exchange property held by one state for owners with a last known address in the other state. During this fiscal year, Tennessee exchanged unclaimed property with 36 states. Tennessee received $1,475,865 for residents or former residents and paid $591,621 to other states' unclaimed property offices.

Chairs of Excellence

The Chairs of Excellence (COE) Trust provides funds with which state colleges and universities are able to contract with persons of regional or national prominence to teach in specified academic areas. The program is open to all state four-year colleges and universities, and the UT Space Institute.

The funding of the program is provided through contributions made by a private donor and a matching amount by the state, thus, creating a chair. Income from the fixed income portion of the trust is used to fund required expenditures for the chair. All other funds, including equity income and profit/loss, become part of the corpus of the fund for use in supporting the trust in future years.

Since the start of the program in 1984, there have been 95 chairs created, with state appropriations totaling $44,000,000 and matching contributions totaling $53,194,206. For the year ending June 30, 1997, investment income totaled $13,718,733 with expenditures of $6,465,583.

The University of Tennessee

Chattanooga

Miller COE in Management & Technology
Sun Trust Bank COE in the Humanities
Provident Life & Accident Ins. Co. COE in Applied Math
West COE in Communications & Public Affairs
COE in Judaic Studies
Cline COE in Rehabilitation Technology
Frierson COE in Business Leadership
Harris COE in Business
Lyndhurst COE in Arts Education

Knoxville

Racheff Chair of Ornamental Horticulture
Racheff Chair of Material Science & Engineering
COE in English
Condra COE in Computer Integrated Engineering & Manufacturing
Condra COE in Power Electronics Applications
Pilot COE in Management
Holly COE in Political Economy
Schmitt COE in History
COE in Science, Technology & Medical Writing
Shumway COE in Romance Languages
Goodrich COE in Civil Engineering
Clayton Homes COE in Finance
COE in Policy Studies
Blasingame COE in Agricultural Policy Studies
Lincoln COE in Physics
Hunger COE in Environmental Studies

Martin

Hendrix COE in Free Enterprise & Economics
Dunagan COE in Banking
Parker COE in Food & Fiber Industries

Memphis

Van Vleet COE in Microbiology & Immunology
Van Vleet COE in Pharmacology
Van Vleet COE in Biochemistry
Van Vleet COE in Virology
Muirhead COE in Pathology
COE in Obstetrics & Gynecology
LeBonheur COE in Pediatrics
Crippled Children's Hospital COE in Biomedical Engineering
Plough COE in Pediatrics
Gerwin COE in Physiology
Hyde COE in Rehabilitation
Dunavant COE in Pediatrics
First Tennessee Bank COE in Pediatrics
Federal Express COE in Pediatrics
Semmes-Murphey COE in Neurology
Bronstein COE in Cardiovascular Physiology
Goodman COE in Medicine
LeBonheur COE in Pediatrics (II)
Soloway COE in Urology

Space Institute

Boling COE in Space Propulsion
* H. H. Arnold COE in Computational Mechanics

Chairs of Excellence

Tennessee Board of Regents

Austin Peay State University
- Acuff COE in Creative Arts
- Harper/James and Bourne COE in Business
- The Foundation Chair of Free Enterprise
- Reuther COE in Nursing

East Tennessee State University
- Quillen COE of Medicine in Geriatrics & Gerontology
- AFG Industries COE in Business & Technology
- Harris COE in Business
- Long Chair of Surgical Research
- Dishner COE in Medicine
- Quillen COE in Teaching and Learning
- Basler COE for Integration of Arts, Rhetoric, and Sciences
- Leeanne Brown and Universities Physicians Group COE in General Pediatrics

Middle Tennessee State University
- Seigenthaler Chair of First Amendment Studies
- Jones Chair of Free Enterprise
- Adams COE in Health Care Services
- National Healthcorp COE in Nursing
- Russell COE in Manufacturing Excellence
- Murfree Chair of Dyslexic Studies
- Miller COE in Equine Health
- Miller COE in Equine Reproductive Physiology

Tennessee State University
- Frist COE in Business Administration

Memphis State University
- COE in Molecular Biology
- Herff COE in Law
- Fogelman COE in Real Estate
- Sales & Marketing Executives of Memphis COE in Sales
- COE in Accounting
- Arthur Andersen Company Alumni COE in Accounting
- Moss COE in Philosophy
- Wunderlich COE in Finance
- Herff COE in Biomedical Engineering
- Bornblum COE in Judaic Studies
- Shelby County Government COE in International Economics
- Wang COE in International Business
- COE in Free Enterprise Management
- COE in English Poetry
- Herff COE in Computer Engineering
- Lowenberg COE in Nursing
- COE in Art History
- Federal Express COE in Mgmt. Info. Systems
- Moss COE in Psychology
- Moss COE in Education
- Hardin COE in Combinatorics
- Hardin COE in Economics/Managerial Journalism
- *Sparks COE in International Relations

Tennessee Technological University
- Owen Chair of Business Administration
- Mayberry Chair of Business Administration

* Chair established during fiscal year 1996-97.

BACCALAUREATE EDUCATION SYSTEM TRUST

The Baccalaureate Education System Trust, or BEST, is a prepaid college tuition savings program that allows anyone to pay for higher education tuition in advance on behalf of a beneficiary. The BEST program was created under T.C.A. Section 49-7-8 to make higher education more affordable for the citizens of Tennessee.

Tuition and mandatory fees may be purchased in increments known as tuition units. One tuition unit represents a value of one percent of the weighted average undergraduate tuition at Tennessee's four-year public universities plus an amount to cover administration and actuarial soundness of the program. The cost for one academic year of tuition at the average-priced, four-year undergraduate Tennessee public university will be covered by roughly 100 tuition units. Higher education institutions that cost more than the average Tennessee four-year public university will require more units; those that cost less will require fewer units.

Anyone who wants to set up a tuition prepayment plan for a child can participate. The person who opens the account or the child must be a resident of Tennessee when the tuition account is opened. There is no age limit for enrollment; however, tuition units must be on account with BEST for at least two years prior to use. Flexibility is a key component of the program by allowing participants to determine when and how much to save and by providing multiple payment options.

The tuition units may be used for tuition and fees at any accredited higher education institution— in-state or out-of-state, public or private. The units may also be used at vocational and technical schools or professional and graduate schools. Participants do not have to choose a specific school when they enroll in the program.

The BEST program also offers favorable tax benefits to its participants. Federal income tax on the appreciation of tuition units is deferred until the units are used. In addition, the tax is assessed at the child's rate, rather than the parent's rate. BEST contracts are exempt from all state and local taxes.

The Baccalaureate Education System Trust began accepting contracts and contributions in June 1997.

Careers Now Program

College students in Tennessee have the opportunity to learn more about the operation of state government and the various career opportunities in state government through the Careers Now Program. Students in the program work in one of the three constitutional offices for a semester. The Treasurer, the Comptroller of the Treasury, and the Secretary of State work together to match opportunities with students' interests.

The Careers Now Program's first class of 12 students began in January 1996. Since the program's inception, six classes with a total of 40 students have been selected to participate from a total of 112 applicants.

Applicants have come from Austin Peay State University, East Tennessee State University, Fisk University, David Lipscomb University, Middle Tennessee State University, Tennessee State University, Rhodes College, Tennessee Technology Center, University of Memphis Law School, University of Tennessee at Martin, University of Tennessee at Knoxville Law School, and Vanderbilt University. The majority of the participants have been Business or Accounting majors and have come from Middle Tennessee State University, Tennessee State University and Tennessee Technology Center. Thirty eight percent of the student participants have been minorities.

The goal of the program is to develop a pool of students who, upon graduation, will be candidates for career positions in one of the three constitutional offices. Thus far, ten students have received job offers from the state following their participation in the program.

The students receive hands on work experience and the participating institutions and constitutional offices jointly facilitate the development of a detailed curriculum to meet the academic commitment made to higher education institutions.

Careers Now is designed to offer students a combination of practical work experience and formal training, while giving them the opportunity to see the challenges of public service. In addition to their daily work responsibilities, students attend seminars, visit other state agencies, complete written work assignments or special projects, and engage in other opportunities to increase their overall understanding and knowledge of Tennessee state government.

Statutory Duties of the State Treasurer

Boards and Commissions

	Tennessee Code Annotated Section
Baccalaureate Education System Trust Board	49-7-801, et seq.
Bank Collateral Pool Board	9-4-501, et seq.
Board of Claims	9-8-101, et seq.
Board of Equalization	4-3-5101
Board of Trustees of the Tennessee Consolidated Retirement System	8-34-301 - 8-34-319
Chairs of Excellence Trust	49-7-501 - 49-7-502
Commission to Purchase Federal Property	12-1-103
Council on Pensions and Insurance	3-9-101
Defense Counsel Commission	8-42-101 -8-42-108
Funding Board	9-9-101
National Resources Trust Fund	11-14-304
Public Records Commission	10-7-302
Sick Leave Bank Board	8-50-903
State Building Commission	4-15-101
State Capitol Commission	4-8-301, et seq.
State Insurance Committee	8-27-101
State Library and Archives Management Board	10-1-101, et seq.
State School Bond Authority	49-3-1204
State Teacher Insurance Comm.	8-27-301
State Trust of Tennessee	9-4-801, et seq.
Tennessee Child Care Loan Guarantee Board	4-37-101, et seq.
Tennessee Competitive Export Corp.	13-27-104
Tennessee Higher Education Commission	49-7-201, et seq.
Tennessee Housing Development Agency	13-23-106
Tennessee Local Development Authority	4-31-103
Tennessee Sports Hall of Fame	4-3-5402
Tennessee Student Assistance Corp.	49-4-202
Tennessee Tomorrow	4-17-405
Tuition Guaranty Fund Board	49-7-2018
Volunteer Public Education Trust	49-3-401, et seq.
Workers Compensation Fund Board	50-6-604

Administration

	Tennessee Code Annotated Section
Baccalaureate Education System Trust	49-7-801, et seq.
Board of Claims	9-8-101, et seq.
Chairs of Excellence Trust	49-7-501 - 49-7-502
Collateral Pool	9-4-501 - 9-4-523
Collateral Program	9-4-101 - 9-4-105
Council on Pensions and Insurance	3-9-101
Criminal Injury Compensation Fund	29-13-101, et seq.
Defense Counsel Commission	9-8-107
Deferred Compensation	8-25-101, et seq.
Escheat	31-6-101, et seq.
Flexible Benefits Plan	8-25-305
Investment Advisory Council	8-37-108
Investment of State Idle Cash Funds	9-4-602
Local Government Investment Pool	9-4-704
Old Age and Survivors Insurance Agency	8-38-101, et seq.
Pooled Investment Fund	9-4-704
Receipt and Disbursement of Public Funds	8-5-106 - 8-5-111; 9-4-301, et seq.
State Cash Management	9-4-106 - 9-4-108; 9-4-401 - 9-4-409
State Treasurer's Office	8-5-101, et seq.
State Trust of Tennessee	9-4-801, et seq.
Tennessee Consolidated Retirement System and Miscellaneous Systems	Title 8, Chptrs. 34, 35, 36, 37 & 39
Unclaimed Property	66-29-101, et seq.
Victims of Drunk Drivers Compensation Fund	40-24-107

Executive Staff Directory

Treasurer's Office		
Treasurer	Steve Adams, CPA	(615) 741-2956
Executive Assistant	Dale Sims	(615) 741-2956
Executive Assistant	Janice Cunningham	(615) 741-2956
Director of Personnel	Ann Taylor-Tharpe	(615) 741-2956
Staff Assistant to the Treasurer	Rhonda Hicks, CPA	(615) 532-8552
Investments		
Chief Investment Officer	Tom Milne, CFA	(615) 532-1157
Senior Fixed Income Portfolio Manager	Jeff Bronnenburg, CFA, CPA	(615) 532-1182
Fixed Income Portfolio Manager	Leighton Shantz	(615) 532-1183
Senior Short-Term Portfolio Manager	Randy Graves, CPA	(615) 532-1154
Senior Equity Portfolio Manager	Jeremy Conlin	(615) 532-1152
Senior Equity Portfolio Manager	Jim Robinson, CFA	(615) 532-1177
Director of Equities	Michael Keeler, CFA	(615) 532-1165
Senior Portfolio Manager	Roy Wellington, CFA	(615) 532-1151
Retirement Administration		
Director of TCRS	Steve Curry, CEBS, CPA	(615) 741-7063
Assistant Director of TCRS	Ed Hennessee, CFP	(615) 741-7063
Director of Deferred Compensation, Research and Publications	Deana Reed Hannah	(615) 741-7063
Publications Officer	Janice Reilly	(615) 741-7063
General Counsel	Mary Roberts-Krause, JD	(615) 741-7063
Director of Old Age and Survivors Insurance	Mary E. Smith	(615) 741-7902
Manager of Counseling Services	Donna Finley	(615) 741-1971
Manager of Member Services	Velva Booker	(615) 741-1971
Manager of Financial Services	Connie Gibson, CPA	(615) 741-4913
Other Divisions		
Director of Accounting	Rick DuBray, CPA	(615) 532-3840
Director of Baccalaureate Education System Trust	Jill Bachus, CPA	(615) 532-8045
Director of Careers Now Program	Diana Collins	(615) 532-2992
Director of Claims Administration and Unclaimed Property	Susan Clayton	(615) 741-2734
Director of Computer Operations	Sam Baker, CCP, CDP	(615) 532-8026
Director of Information Systems	Newton Molloy, III, CDP	(615) 532-8035
Director of Internal Audit	Beth Chapman, CPA	(615) 532-1164
Director of Management Services	Grady Martin	(615) 741-4985
Director of Risk Management	Steve Gregory	(615) 741-9076
East Tennessee Claims Commissioner	Michael Lacy, JD	(423) 854-5330
Middle Tennessee Claims Commissioner	William Baker, JD	(615) 792-7471
West Tennessee Claims Commissioner	Martha Brasfield, JD	(901) 475-2532
Executive Administrative Assistant, Claims Commission	Margie Douglas	(615) 741-0741
Budget Officer	Wendy Padgett	(615) 741-4985

The Treasurer is housed on the 1st floor of the State Capitol Building.
Divisions are housed on the 9th, 10th, 11th, and 13th floors of the Andrew Jackson Building.

Investment Portfolios

James K. Polk

James Knox Polk became the 11th President of the United States in 1845. Polk was born November 2, 1795 in Mecklenburg County, North Carolina. He moved to Duck River, Tennessee with his family in 1806. He practiced law in Columbia and was elected to the state legislature. He was elected to the U.S. House of Representatives in 1825 and became Chairman of the Committee on Ways and Means in 1833. Beginning in 1835, he served as Speaker of the House of Representatives for two consecutive terms. While in the House, he was a friend and ally of his fellow Tennessean, Andrew Jackson. He was elected and served a two-year term as Governor of Tennessee in 1839, but was defeated in his races for reelection in 1841 and 1843. When he was nominated for President in 1844, he was not widely known outside the state, making him the first "dark horse" candidate to win the presidency. Polk narrowly defeated Whig Candidate Henry Clay in the race, despite the fact that his home state of Tennessee gave its electoral votes to Clay. During his term of office, the Mexican War was fought and a large area of land was added to the United States, stretching from the Rocky Mountains to the Pacific Ocean, including what is now California. Just a few months after leaving office, he died June 15, 1849 in Nashville, Tennessee. Polk is buried on the grounds of the Tennessee State Capitol.

STATE CASH PORTFOLIO

	Rating	Maturity	Yield to Maturity	Par Value	Fair Value
U. S. TREASURY AND AGENCY OBLIGATIONS					
FEDERAL HOME LOAN BANK DISCOUNT NOTES	AAA	08/04/97	5.17	$44,000,000	$43,780,000
FEDERAL HOME LOAN BANK DISCOUNT NOTES	AAA	07/18/97	4.81	50,000,000	49,880,000
FEDERAL HOME LOAN BANK DISCOUNT NOTES	AAA	08/15/97	5.28	50,000,000	49,665,000
FEDERAL HOME LOAN MORTGAGE CORP NOTES	AAA	07/07/97	4.12	67,670,000	67,615,864
FEDERAL HOME LOAN MORTGAGE CORP NOTES	AAA	07/17/97	4.88	19,250,000	19,205,725
FEDERAL HOME LOAN MORTGAGE CORP NOTES	AAA	07/14/97	4.64	49,500,000	49,410,900
FEDERAL HOME LOAN MORTGAGE CORP NOTES	AAA	07/09/97	4.40	50,000,000	49,945,000
FEDERAL HOME LOAN MORTGAGE CORP NOTES	AAA	08/15/97	5.28	39,815,000	39,548,240
FEDERAL NATIONAL MORTGAGE ASSOC. NOTES	AAA	07/03/97	2.40	50,000,000	49,990,000
FEDERAL NATIONAL MORTGAGE ASSOC. NOTES	AAA	09/05/97	5.37	50,000,000	49,505,000
FEDERAL NATIONAL MORTGAGE ASSOC. NOTES	AAA	07/15/97	4.81	80,000,000	79,840,000
FEDERAL NATIONAL MORTGAGE ASSOC. NOTES	AAA	09/30/98	6.03	20,000,000	19,742,000
UNITED STATES TREASURY NOTES	AAA	02/28/98	5.75	30,000,000	29,877,000
UNITED STATES TREASURY NOTES	AAA	11/30/97	5.60	30,000,000	29,970,000
UNITED STATES TREASURY NOTES	AAA	07/15/97	6.78	30,000,000	30,018,000
UNITED STATES TREASURY NOTES	AAA	08/15/97	5.34	30,000,000	30,039,000
TOTAL U. S. TREASURY AND AGENCY OBLIGATIONS				***$690,235,000***	***$688,031,729***
CERTIFICATES OF DEPOSIT					
BANK OF ALAMO		12/19/97	5.65	$1,000,000	$1,000,000
BANK OF ALAMO		12/29/97	5.80	1,000,000	1,000,000
BANK OF ALAMO		11/14/97	5.60	2,000,000	2,000,000
BANK OF CROCKETT, BELLS		01/09/98	5.75	200,000	200,000
PEOPLES BANK, BENTON		01/30/98	5.60	100,000	100,000
PEOPLES BANK, BENTON		02/13/98	5.60	200,000	200,000
BANK OF BRADFORD		09/30/98	5.80	100,000	100,000
TWIN CITIES FEDERAL, BRISTOL		01/20/98	5.60	500,000	500,000
TWIN CITIES FEDERAL, BRISTOL		04/17/98	5.60	500,000	500,000
TWIN CITIES FEDERAL, BRISTOL		11/28/97	5.60	240,000	240,000
PEOPLES BANK & TRUST, BYRDSTOWN		03/23/98	5.60	100,000	100,000
PEOPLES BANK & TRUST, BYRDSTOWN		01/09/98	5.75	100,000	100,000
PEOPLES BANK & TRUST, BYRDSTOWN		03/06/98	5.75	100,000	100,000
PEOPLES BANK & TRUST, BYRDSTOWN		02/20/98	5.75	100,000	100,000
PEOPLES BANK & TRUST, BYRDSTOWN		03/18/98	5.75	200,000	200,000
PEOPLES BANK & TRUST, BYRDSTOWN		12/15/97	5.75	200,000	200,000
PEOPLES BANK & TRUST, BYRDSTOWN		07/17/98	5.70	100,000	100,000

(Continued)

STATE CASH PORTFOLIO

	Maturity	Yield to Maturity	Par Value	Fair Value
CUMBERLAND BANK, CARTHAGE	08/28/98	5.80	90,000	90,000
CUMBERLAND BANK, CARTHAGE	12/12/97	5.65	500,000	500,000
CUMBERLAND BANK, CARTHAGE	07/14/98	5.80	1,000,000	1,000,000
FIRST STATE BANK, CHAPEL HILL	08/14/98	5.80	200,000	200,000
SUNTRUST BANK, CHATTANOOGA	11/26/97	5.50	10,000,000	10,000,000
SUNTRUST BANK, CHATTANOOGA	08/25/98	5.80	10,000,000	10,000,000
SUNTRUST BANK, CHATTANOOGA	09/09/97	5.35	10,000,000	10,000,000
SUNTRUST BANK, CHATTANOOGA	09/03/98	5.80	10,000,000	10,000,000
SUNTRUST BANK, CHATTANOOGA	07/15/98	5.80	10,000,000	10,000,000
FARMERS & MERCHANTS, CLARKSVILLE	06/26/98	6.00	100,000	100,000
FIRST FEDERAL , CLARKSVILLE	05/18/98	6.10	3,000,000	3,000,000
FIRST FEDERAL, CLARKSVILLE	04/28/98	6.10	2,000,000	2,000,000
FIRST FEDERAL, CLARKSVILLE	08/21/98	5.80	100,000	100,000
HERITAGE BANK, CLARKSVILLE	08/15/97	5.50	400,000	400,000
FIRST CITIZENS BANK, CLEVELAND	11/26/97	5.50	3,000,000	3,000,000
FIRST CITIZENS BANK, CLEVELAND	09/26/97	5.50	2,000,000	2,000,000
FIRST FARMERS BANK, COLUMBIA	07/07/97	5.50	5,000,000	5,000,000
FIRST BANK POLK CO, COPPERHILL	12/12/97	5.60	4,300,000	4,300,000
FIRST STATE BANK, COVINGTON	11/21/97	5.60	2,000,000	2,000,000
RHEA CO NAT'L BANK, DAYTON	09/18/98	5.80	1,200,000	1,200,000
PEOPLES BANK, DICKSON	10/16/98	5.80	500,000	500,000
PEOPLES BANK, DICKSON	10/16/98	5.80	500,000	500,000
FIRST CITIZENS BANK, DYERSBURG	03/24/98	5.60	2,000,000	2,000,000
FIRST CITIZENS, DYERSBURG	08/22/97	5.60	2,000,000	2,000,000
FIRST CITIZENS, DYERSBURG	02/26/98	5.60	2,000,000	2,000,000
FIRST CITIZENS, DYERSBURG	07/25/97	5.50	4,000,000	4,000,000
FIRST CITIZENS, DYERSBURG	10/30/97	5.60	5,000,000	5,000,000
FIRST CITIZENS, DYERSBURG	02/10/98	5.50	2,000,000	2,000,000
FIRST CITIZENS, DYERSBURG	11/18/97	5.50	2,000,000	2,000,000
FIRST CITIZENS, DYERSBURG	11/18/97	5.50	1,000,000	1,000,000
CITIZENS BANK, GAINESBORO	10/02/98	5.80	300,000	300,000
JACKSON BANK & TRUST, GAINESBORO	02/27/98	5.75	2,500,000	2,500,000
JACKSON BANK & TRUST, GAINESBORO	05/12/98	6.10	500,000	500,000
JACKSON BANK & TRUST, GAINESBORO	12/10/97	5.50	250,000	250,000
JACKSON BANK & TRUST, GAINESBORO	05/08/98	6.10	500,000	500,000
JACKSON BANK & TRUST, GAINESBORO	03/30/98	5.60	500,000	500,000
JACKSON BANK & TRUST, GAINESBORO	11/10/98	5.80	1,000,000	1,000,000

(Continued)

STATE CASH PORTFOLIO

	Maturity	Yield to Maturity	Par Value	Fair Value
GATES BANKING AND TRUST	10/27/98	5.80	450,000	450,000
FIRST NATIONAL BANK, GATLINBURG	01/23/98	5.50	4,000,000	4,000,000
FIRST NATIONAL BANK, GATLINBURG	01/07/98	5.50	5,000,000	5,000,000
FIRST NATIONAL BANK, GATLINBURG	11/26/97	5.50	4,000,000	4,000,000
TRUST ONE BANK, GERMANTOWN	02/17/98	5.60	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	03/17/98	5.60	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	04/17/98	5.60	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	01/16/98	5.50	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	12/16/97	5.60	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	11/18/97	5.60	1,500,000	1,500,000
TRUST ONE BANK, GERMANTOWN	12/16/97	5.60	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	01/16/98	5.50	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	11/18/97	5.60	1,500,000	1,500,000
TRUST ONE BANK, GERMANTOWN	02/17/98	5.60	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	03/17/98	5.60	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	04/17/98	5.60	2,000,000	2,000,000
BANK OF GLEASON	02/20/98	5.75	350,000	350,000
BANK OF GLEASON	07/17/98	5.80	300,000	300,000
BANK OF GLEASON	12/23/97	5.60	200,000	200,000
BANK OF HALLS	08/14/98	5.80	300,000	300,000
BANK OF HALLS	02/06/98	5.80	200,000	200,000
BANK OF HALLS	07/24/98	5.70	200,000	200,000
BANK OF HALLS	04/06/98	5.70	700,000	700,000
BANK OF HALLS	11/24/97	5.60	400,000	400,000
CITIZENS BANK, HARTSVILLE	12/02/97	5.50	500,000	500,000
CHESTER CO BANK, HENDERSON	01/16/98	5.50	100,000	100,000
FIRST CITIZENS BANK, HOHENWALD	02/13/98	5.75	1,000,000	1,000,000
FIRST CITIZENS BANK, HOHENWALD	01/16/98	5.60	1,000,000	1,000,000
VOLUNTEER BANK, JACKSON	02/27/98	5.60	2,500,000	2,500,000
VOLUNTEER BANK, JACKSON	09/16/97	5.25	2,500,000	2,500,000
FENTRESS COUNTY BANK, JAMESTOWN	07/07/98	5.80	500,000	500,000
FENTRESS COUNTY BANK, JAMESTOWN	2/23/97	5.60	200,000	200,000
FENTRESS COUNTY BANK, JAMESTOWN	09/11/98	5.80	500,000	500,000
FENTRESS COUNTY BANK, JAMESTOWN	07/17/98	5.80	450,000	450,000
FENTRESS COUNTY BANK, JAMESTOWN	10/27/98	5.80	300,000	300,000
FENTRESS COUNTY BANK, JAMESTOWN	11/25/97	5.60	500,000	500,000
PROGRESSIVE SAVINGS, JAMESTOWN	03/05/98	5.80	300,000	300,000

(Continued)

STATE CASH PORTFOLIO

	Maturity	Yield to Maturity	Par Value	Fair Value
CITIZENS STATE BANK, JASPER	04/07/98	5.60	100,000	100,000
CITIZENS STATE BANK, JASPER	04/10/98	5.60	200,000	200,000
CITIZENS STATE BANK, JASPER	01/23/98	5.60	200,000	200,000
MARION BANK & TRUST, JASPER	12/16/97	5.60	300,000	300,000
MARION BANK & TRUST, JASPER	09/16/97	5.50	1,200,000	1,200,000
MARION BANK & TRUST, JASPER	12/16/97	5.60	1,000,000	1,000,000
SUNTRUST BANK, JOHNSON CITY	12/03/97	5.50	7,000,000	7,000,000
SUNTRUST BANK, JOHNSON CITY	12/15/97	5.50	10,000,000	10,000,000
SUNTRUST BANK, JOHNSON CITY	01/07/98	5.50	4,500,000	4,500,000
FIRST STATE BANK, KENTON	01/02/98	5.60	5,000,000	5,000,000
FIRST STATE BANK, KENTON	01/02/98	5.60	3,000,000	3,000,000
FIRST UNION BANK, KINGSPORT	02/20/98	5.75	1,050,000	1,050,000
NATIONAL BANK OF COMMERCE, KNOXVILLE	12/22/97	5.60	2,000,000	2,000,000
NATIONAL BANK OF COMMERCE, KNOXVILLE	04/21/98	5.60	10,000,000	10,000,000
NATIONAL BANK OF COMMERCE, KNOXVILLE	08/08/97	5.35	10,000,000	10,000,000
SUNTRUST BANK OF EAST TENNESSEE	01/30/98	5.50	10,000,000	10,000,000
SUNTRUST BANK, KNOXVILLE	01/07/98	5.60	20,000,000	20,000,000
SUNTRUST BANK, KNOXVILLE	01/21/98	5.50	15,000,000	15,000,000
SUNTRUST BANK, KNOXVILLE	12/03/97	5.50	5,000,000	5,000,000
SUNTRUST BANK, KNOXVILLE	12/03/97	5.50	5,000,000	5,000,000
SUNTRUST BANK, KNOXVILLE	01/14/98	5.50	10,000,000	10,000,000
SUNTRUST BANK, KNOXVILLE	01/30/98	5.50	10,000,000	10,000,000
SUNTRUST BANK, KNOXVILLE	01/14/98	5.50	10,000,000	10,000,000
SUNTRUST BANK, KNOXVILLE	01/21/98	5.50	10,000,000	10,000,000
CITIZENS BANK, LAFAYETTE	02/03/98	5.60	500,000	500,000
CITIZENS BANK, LAFAYETTE	12/15/97	5.80	100,000	100,000
CITIZENS BANK, LAFAYETTE	01/02/98	5.65	250,000	250,000
CITIZENS BANK, LAFAYETTE	11/04/98	5.80	100,000	100,000
FIRST BANK OF EAST TN, LA FOLLETTE	01/12/98	5.80	100,000	100,000
FIRST CENTRAL BANK, LENOIR CITY	01/23/98	5.60	500,000	500,000
FIRST CENTRAL BANK, LENOIR CITY	02/05/98	5.80	500,000	500,000
FIRST NATIONAL BANK, LENOIR CITY	03/27/98	5.75	200,000	200,000
FIRST NATIONAL BK, LENOIR CITY	01/28/98	5.75	300,000	300,000
FIRST NATIONAL LOUDON CO, LENOIR CTY	12/19/97	5.80	100,000	100,000
COFFEE CO BANK, MANCHESTER	12/19/97	5.60	280,000	280,000
COFFEE CO BANK, MANCHESTER	08/07/98	5.80	350,000	350,000
CITY STATE BANK, MARTIN	10/30/98	5.80	1,500,000	1,500,000

(Continued)

STATE CASH PORTFOLIO

	Maturity	Yield to Maturity	Par Value	Fair Value
CITY STATE BANK, MARTIN	12/12/97	5.60	1,100,000	1,100,000
CITY STATE BANK, MARTIN	01/30/98	5.80	1,000,000	1,000,000
PLANTERS BANK, MAURY CITY	07/17/98	5.80	200,000	200,000
BOATMENS BANK, MEMPHIS	02/13/98	5.80	10,000,000	10,000,000
BOATMENS BANK, MEMPHIS	11/28/97	5.60	10,000,000	10,000,000
BOATMENS BANK, MEMPHIS	12/12/97	5.60	5,000,000	5,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	03/27/98	5.75	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	08/05/97	5.60	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	10/10/97	5.60	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	01/08/98	5.80	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	09/02/98	5.80	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	02/26/98	5.80	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	10/23/98	5.80	500,000	500,000
FIRST COMMERCIAL BANK, MEMPHIS	01/14/98	5.50	1,000,000	1,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	11/10/97	5.60	20,000,000	20,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	04/17/98	6.10	25,000,000	25,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	06/01/98	5.70	20,000,000	20,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	05/01/98	5.60	25,000,000	25,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	02/13/98	5.75	25,000,000	25,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	02/26/98	5.75	15,000,000	15,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	03/12/98	5.75	25,000,000	25,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	10/03/97	5.50	25,000,000	25,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	12/22/97	5.60	30,000,000	30,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	04/21/98	5.60	25,000,000	25,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	01/02/98	5.65	10,000,000	10,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	06/05/98	5.70	25,000,000	25,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	03/05/98	5.75	15,000,000	15,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	03/18/98	5.75	25,000,000	25,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	01/22/98	5.80	25,000,000	25,000,000
SOUTHTRUST BANK, MEMPHIS	06/12/98	5.70	1,000,000	1,000,000
SOUTHTRUST BANK, MEMPHIS	12/26/97	5.80	1,000,000	1,000,000
SOUTHTRUST BANK, MEMPHIS	07/30/98	5.70	2,000,000	2,000,000
TENN BANK AND TRUST, MEMPHIS	12/10/97	5.50	2,000,000	2,000,000
TENNESSEE BANK & TRUST, MEMPHIS	08/20/97	5.50	1,900,000	1,900,000
UNION PLANTERS, MEMPHIS	01/26/98	5.50	5,000,000	5,000,000
TENNESSEE BANK & TRUST, MILLINGTON	12/19/97	5.50	1,200,000	1,200,000
TENNESSEE BANK & TRUST, MILLINGTON	08/13/97	5.50	2,000,000	2,000,000

(Continued)

STATE CASH PORTFOLIO

	Maturity	Yield to Maturity	Par Value	Fair Value
TENNESSEE BANK & TRUST, MILLINGTON	07/09/97	5.50	1,000,000	1,000,000
TENNESSEE BANK & TRUST, MILLINGTON	07/02/97	5.50	500,000	500,000
TENNESSEE BANK & TRUST, MILLINGTON	07/18/97	5.50	2,000,000	2,000,000
BANK OF GREEN HILLS, NASHVILLE	10/07/98	5.80	95,000	95,000
FIRST AMERICAN NATIONAL BANK, NASHVILLE	01/02/98	5.50	25,000,000	25,000,000
FIRST AMERICAN NATIONAL BANK, NASHVILLE	01/21/98	5.50	50,000,000	50,000,000
FIRST AMERICAN NATIONAL BANK, NASHVILLE	12/17/97	5.50	20,000,000	20,000,000
FIRST AMERICAN NATIONAL BANK, NASHVILLE	12/17/97	5.50	30,000,000	30,000,000
NATIONAL BANK OF COMMERCE, NASHVILLE	12/22/97	5.60	5,000,000	5,000,000
NATIONAL BANK OF COMMERCE, NASHVILLE	08/08/97	5.35	10,000,000	10,000,000
SOUTHTRUST BANK, NASHVILLE	03/10/98	5.60	4,000,000	4,000,000
SOUTHTRUST BANK, NASHVILLE	02/24/98	5.60	10,000,000	10,000,000
SOUTHTRUST BANK, NASHVILLE	02/20/98	5.60	3,000,000	3,000,000
SOUTHTRUST BANK, NASHVILLE	02/20/98	5.60	2,800,000	2,800,000
SOUTHTRUST BANK, NASHVILLE	03/13/98	5.60	4,000,000	4,000,000
SOUTHTRUST BANK, NASHVILLE	01/30/98	5.50	6,000,000	6,000,000
SOUTHTRUST BANK, NASHVILLE	01/20/98	5.60	3,500,000	3,500,000
SOUTHTRUST BANK, NASHVILLE	01/28/98	5.50	2,000,000	2,000,000
SOUTHTRUST BANK, NASHVILLE	01/28/98	5.75	15,000,000	15,000,000
THE BANK OF NASHVILLE	10/10/97	5.60	2,500,000	2,500,000
SECURITY BANK, NEWBERN	07/09/97	6.10	350,000	350,000
SECURITY BANK, NEWBERN	07/11/97	6.10	300,000	300,000
SECURITY BANK, NEWBERN	07/16/97	5.50	500,000	500,000
NEWPORT FEDERAL SAVINGS & LOAN	06/23/98	6.00	95,000	95,000
NEWPORT FEDERAL SAVINGS & LOAN	09/29/98	5.80	500,000	500,000
NEWPORT FEDERAL SAVINGS & LOAN	06/23/98	6.00	300,000	300,000
UNION PLANTERS BANK, OBION	09/25/98	5.80	200,000	200,000
FIRST NATIONAL BANK, ONEIDA	07/03/98	5.80	500,000	500,000
FIRST NATIONAL BANK, ONEIDA	08/28/98	5.80	500,000	500,000
FIRST NATIONAL BANK, PIKEVILLE	12/12/97	5.60	300,000	300,000
COMMUNITY BANK, PULASKI	01/09/98	5.60	790,000	790,000
COMMUNITY BANK, PULASKI	07/06/98	5.70	790,000	790,000
COMMUNITY BANK, PULASKI	01/16/98	5.75	795,000	795,000
COMMUNITY BANK, PULASKI	10/16/98	5.80	750,000	750,000
COMMUNITY BANK, PULASKI	02/19/98	5.75	1,000,000	1,000,000
FIRST NATIONAL BANK, PULASKI	08/14/98	5.80	300,000	300,000
FIRST NATIONAL BANK, PULASKI	02/06/98	5.75	300,000	300,000

(Continued)

STATE CASH PORTFOLIO

	Maturity	Yield to Maturity	Par Value	Fair Value
FIRST NATIONAL BANK, PULASKI	02/12/98	5.75	300,000	300,000
FIRST NATIONAL BANK, PULASKI	02/12/98	5.75	500,000	500,000
FIRST NATIONAL BANK, PULASKI	02/06/98	5.75	700,000	700,000
FIRST NATIONAL BANK, PULASKI	01/21/98	5.75	1,000,000	1,000,000
FIRST NATIONAL BANK, PULASKI	08/14/98	5.80	1,000,000	1,000,000
BANK OF RIPLEY	02/13/98	5.60	100,000	100,000
BANK OF RIPLEY	01/09/98	5.60	100,000	100,000
BANK OF RIPLEY	11/18/97	5.60	150,000	150,000
BANK OF RIPLEY	03/27/98	5.60	200,000	200,000
BANK OF RIPLEY	01/20/98	5.60	100,000	100,000
FIRST UNION BANK, ROGERSVILLE	12/12/97	5.75	1,600,000	1,600,000
FIRST UNION BANK, ROGERSVILLE	12/12/97	5.75	1,650,000	1,650,000
BANK OF SHARON	10/23/98	5.80	1,000,000	1,000,000
BANK OF SHARON	06/03/98	6.10	1,000,000	1,000,000
BANK OF SHARON	08/18/98	5.80	1,000,000	1,000,000
SOMERVILLE BANK AND TRUST	08/21/98	5.80	200,000	200,000
FIRST BANK RHEA CO, SPRING CITY	08/08/97	5.35	900,000	900,000
MERCHANTS & PLANTERS BANK, TOONE	08/14/98	5.80	200,000	200,000
MERCHANTS & PLANTERS BANK, TOONE	02/13/98	5.75	200,000	200,000
MERCHANTS & PLANTERS BANK, TOONE	08/28/98	5.80	100,000	100,000
MERCHANTS & PLANTERS BANK, TOONE	09/25/98	5.80	100,000	100,000
AMERICAN CITY BANK, TULLAHOMA	08/01/97	5.50	500,000	500,000
FIRST STATE BANK, UNION CITY	02/13/98	5.60	3,000,000	3,000,000
FIRST STATE BANK, UNION CITY	02/13/98	5.60	2,000,000	2,000,000
WAYNE COUNTY BANK, WAYNESBORO	03/03/98	5.60	900,000	900,000
THE WHITEVILLE BANK	08/21/98	5.80	500,000	500,000
THE WHITEVILLE BANK	05/15/98	6.10	350,000	350,000
THE WHITEVILLE BANK	09/25/98	5.80	400,000	400,000
THE WHITEVILLE BANK	05/15/98	6.10	500,000	500,000
THE WHITEVILLE BANK	06/19/98	6.00	600,000	600,000
THE WHITEVILLE BANK	07/03/98	6.00	700,000	700,000
THE WHITEVILLE BANK	07/24/98	5.80	300,000	300,000
THE WHITEVILLE BANK	10/22/97	5.75	500,000	500,000
THE WHITEVILLE BANK	08/14/98	5.80	300,000	300,000
BANK OF COMMERCE, WOODBURY	12/26/97	5.65	2,000,000	2,000,000
TOTAL CERTIFICATES OF DEPOSIT			*$920,175,000*	*$920,175,000*

(Continued)

STATE CASH PORTFOLIO

	Rating	Maturity	Yield to Maturity	Par Value	Fair Value
REPURCHASE AGREEMENTS					
EASTBRIDGE - OVERNIGHT		07/01/97	5.90	$73,125,000	$73,125,000
EASTBRIDGE - OVERNIGHT		07/01/97	5.90	63,875,000	63,875,000
EASTBRIDGE - TSSBA		07/01/97	5.38	5,000,000	5,000,000
SUNTRUST BANK		07/01/97	5.44	15,000,000	15,000,000
TOTAL REPURCHASE AGREEMENTS				*$157,000,000*	*$157,000,000*
COMMERCIAL PAPER					
BLOCK FINANCIAL CORP	A1	08/04/97	5.62	$50,000,000	$49,736,500
CORP ASSET SECURITIZATION AUSTR.	A1	07/31/97	5.65	19,000,000	18,911,333
CORPORATE ASSET SECUR. AUSTR.	A1	07/08/97	5.63	30,000,000	29,967,217
CORPORATE RECEIVABLES CORP	A1	07/15/97	5.60	50,000,000	49,891,694
CORPORATE RECEIVABLES CORP	A1	07/22/97	5.60	50,000,000	49,837,250
EIGER CORP	A1	08/01/97	5.61	50,000,000	49,759,750
FORD MOTOR CREDIT EUROPE	A1	07/07/97	5.59	50,000,000	49,953,750
KOCH INDUSTRIES	A1	07/09/97	5.52	50,000,000	49,938,889
MEC FINANCE USA, INC.	A1	07/02/97	5.62	15,000,000	14,997,667
MERRILL LYNCH & CO., INC.	A1	07/08/97	5.57	50,000,000	49,946,042
MERRILL LYNCH & CO., INC.	A1	07/29/97	5.61	50,000,000	49,783,389
MITSUBISHI ELECTRIC FINANCE AMER	A1	09/03/97	5.69	21,186,000	20,974,328
MITSUBISHI INTERNATIONAL CORP	A1	07/02/97	5.63	32,736,000	32,730,908
MITSUI & CO., (USA) INC.	A1	07/08/97	5.64	18,000,000	17,980,400
MITSUI & CO., INC.	A1	08/05/97	5.64	20,000,000	19,891,306
MITSUI & CO., INC.	A1	08/04/97	5.64	20,000,000	19,894,411
PHH CORPORATION	A1	08/01/97	5.60	50,000,000	49,760,611
PREFERRED REC FUNDING CORP	A1	07/08/97	5.58	35,000,000	34,962,297
RECEIVABLES CAPITAL CORP	A1	07/25/97	5.60	41,888,000	41,732,735
SHEFFIELD RECEIVABLES	A1	07/03/97	5.61	25,000,000	24,992,222
SHEFFIELD RECEIVABLES	A1	07/14/97	5.61	25,000,000	24,949,444
SHEFFIELD RECEIVABLES CORP	A1	07/07/97	5.58	41,130,000	41,091,955
SUMITOMO CORP OF N AMERICA	A1	07/15/97	5.63	20,000,000	19,956,600
SUMITOMO CORP OF N AMERICA	A1	07/31/97	5.62	30,000,000	29,860,500
WMX TCEHNOLOGIES, INC.	A1	07/10/97	5.77	37,000,000	36,947,090
WMX TECHNOLOGIES, INC.	A1	09/03/97	5.73	50,000,000	49,497,778
TOTAL COMMERCIAL PAPER				*$930,940,000*	*$927,946,066*
TOTAL PORTFOLIO				*$2,698,350,000*	*$2,693,152,795*

TCRS Portfolio
Largest Stock Holdings By Fair Value

	Shares	Stock	Fair Value
1	2,836,000	GENERAL ELECTRIC CO	$184,340,000
2	2,269,000	COCA COLA CO	154,292,000
3	1,086,000	MICROSOFT CORP	137,243,250
4	1,997,000	EXXON CORP	122,316,250
5	2,269,500	PHILIP MORRIS CO	100,425,375
6	961,000	MERCK AND COMPANY	98,322,793
7	1,696,000	ROYAL DUTCH PETROLEUM CO N Y	92,220,000
8	641,000	INTEL CORPORATION	90,902,133
9	629,000	PROCTER AND GAMBLE	88,846,250
10	1,228,000	JOHNSON AND JOHNSON	79,052,500

TCRS Portfolio
Largest Bond Holdings By Fair Value

	Par	Bond	Yield	Maturity	Rating	Fair Value
1	289,265,000	U. S. TREASURY NOTES	6.63%	04/30/2002	AAA	$291,932,023
2	245,400,000	U. S. TREASURY BONDS	8.13%	08/15/2019	AAA	279,947,412
3	169,440,000	U. S. TREASURY BONDS	11.63%	11/15/2004	AAA	219,529,853
4	200,000,000	U. S. TREASURY NOTES	6.38%	05/15/2000	AAA	200,718,000
5	100,000,000	CONVERSION STK	9.50%	04/18/2005	A	189,699,736
6	125,000,000	U. S. TREASURY BONDS	12.00%	08/15/2013	AAA	175,957,500
7	167,000,000	FNMA POOL	8.00%	06/01/2027	AAA	170,704,060
8	129,660,000	U. S. TREASURY BONDS	9.25%	02/15/2016	AAA	162,216,329
9	153,235,000	U. S. TREASURY NOTES	6.25%	06/30/1998	AAA	153,904,637
10	127,685,000	U. S. TREASURY BONDS	8.13%	05/15/2021	AAA	146,159,743

A complete portfolio listing is available upon request.

Chairs of Excellence Portfolio
Largest Stock Holdings By Fair Value

	Shares	Stock	Fair Value
1	25,000	CATERPILLAR, INC	$2,684,375
2	18,000	PROCTER AND GAMBLE CO	2,542,500
3	36,000	COCA COLA CO	2,448,000
4	16,000	INTEL CORPORATION	2,269,008
5	31,000	BANK BOSTON CORP	2,243,625
6	32,600	GENERAL ELECTRIC CO	2,119,000
7	32,000	COLGATE PALMOLIVE CO	2,088,000
8	45,000	SAFEWAY, INC	2,075,625
9	51,000	GAP, INC	1,982,625
10	32,000	EXXON CORPORATION	1,960,000

Chairs of Excellence Portfolio
Largest Bond Holdings By Fair Value

	Par	Bond	Yield	Maturity	Rating	Fair Value
1	10,000,000	TENNESSEE VALLEY AUTHORITY	8.05%	07/15/2024	AAA	$10,054,500
2	7,000,000	U. S. TREASURY NOTES	6.25%	10/31/1996	AAA	6,967,170
3	5,000,000	FORD CAPITAL	10.13%	11/15/2000	A+	5,485,050
4	5,254,829	SMALL BUSINESS ADMINISTRATION	8.33%	09/10/2001	AAA	5,459,767
5	5,000,000	COOPERATIVE UTILITY TR BIG ELEC	9.50%	02/15/2017	N/R	5,331,700
6	5,000,000	GNMA GTD REMIC	7.50%	10/16/2022	AAA	5,085,870
7	5,000,000	AT&T CAP CORP MTN	5.97%	02/27/1998	BBB	4,999,200
8	5,000,000	GENERAL MOTORS ACCEP CORP MTN	6.25%	01/06/2000	A-	4,967,800
9	4,950,000	GNMA POOL	7.50%	09/15/2026	AAA	4,963,910
10	4,923,701	GNMA POOL	7.50%	01/01/2027	AAA	4,942,165

A complete portfolio listing is available upon request.

Key to Ratings

All ratings presented are from Moody's Investors Service with the exception of some of the government agency securities. Moody's does not rate these securities. Standard & Poor's does provide ratings for the securities (AAA is Standard & Poor's highest rating). Government Securities are not rated per se' but are considered the best quality securities. By policy, TCRS considers convertible bonds as an equity investment, thus the ratings of the convertible bonds are not as large a factor when an investment decision is made. As a result, some of the convertible bond ratings are lower than other TCRS bond investments. In accordance with generally accepted accounting principles, the convertible bonds are classified as corporate bonds for financial reporting purposes.

Moody's rates securities as follows:

Aaa .... Best Quality
Aa .... High Quality
A .... Upper Medium Quality
Baa .... Medium Quality

Moody's applies numerical modifiers in each rating classification as follows:

1 .... Higher End
2 .... Mid-range
3 .... Lower End

NR indicates the security is not rated by Moody's.

FINANCIAL STATEMENTS

LOCAL GOVERNMENT INVESTMENT POOL
TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
DEFERRED COMPENSATION
FLEXIBLE BENEFITS PLAN
CLAIMS AWARD FUND
CRIMINAL INJURIES FUND
BACCALAUREATE EDUCATION SYSTEM TRUST
CHAIRS OF EXCELLENCE
BOND REFUNDING

ANDREW JOHNSON

Andrew Johnson became the 17th president of the United States on April 15, 1865 following the assasination of President Abraham Lincoln. He served out Lincoln's term during the tumultuous Reconstruction era but never ran for president himself. Johnson was born December 29, 1808 in Raleigh, North Carolina. A tailor by trade, he served as Mayor of Greeneville, then as a state representative. He was elected to the U.S. Congress in 1842 and served five terms before being elected Governor of Tennessee in 1852. He became a U.S. Senator in 1856 and was serving in the Senate at the outbreak of the War Between the States. Disagreeing with Tennessee's secession, Johnson left Tennessee temporarily until President Lincoln appointed him as military governor. When Abraham Lincoln ran for reelection in 1864, Johnson became his running mate. Johnson died July 31, 1875 in Carter's Station, Tennessee and is buried in what is now known as Andrew Johnson National Cemetery in Greene County, Tennessee.

Local Government Investment Pool
Independent Auditor's Report

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol Building
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the Local Government Investment Pool, as of June 30, 1997, and June 30, 1996, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Local Government Investment Pool as of June 30, 1997, and June 30, 1996, and the changes in fund balances for the years then ended in conformity with generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the financial statements, taken as a whole. The accompanying supplementary schedule of cash receipts and disbursements following the notes to the financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the Local Government Investment Pool's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr.

Arthur A. Hayes Jr., CPA
Director, Division of State Audit

Local Government Investment Pool
Comparative Balance Sheets
June 30, 1997 and June 30, 1996

	June 30, 1997	June 30, 1996
ASSETS		
Cash	$ 1,381,063,624	$ 1,326,120,685
Due from State General Fund	434,589	1,643,359
Due from State Special Revenue Fund	0	39,226
Due from State Education Trust Fund	34,061	265,142
Due from State Highway Fund	17,731	0
Advance to Baccalaureate Education System Trust Fund	527,918	0
Total Assets	$ 1,382,077,923	$ 1,328,068,412
LIABILITIES AND FUND BALANCES		
LIABILITIES:		
Member Deposits	$ 1,181,988,509	$ 1,131,049,291
Due to State Capital Projects Fund	867,116	822,106
Due to State College and University Fund	189,019,249	188,562,488
Due to State Community Services Agencies	6,822,269	4,258,188
Due to Tennessee State Veterans' Homes Board	946,270	928,519
Total Liabilities	1,379,643,413	1,325,620,592
FUND BALANCES, UNRESERVED	2,434,510	2,447,820
TOTAL LIABILITIES AND FUND BALANCES	$ 1,382,077,923	$1,328,068,412

See accompanying Notes to the Financial Statements.

Local Government Investment Pool
Comparative Statements of Revenues, Expenditures and Changes in Fund Balances
For the Years Ended June 30, 1997 and June 30, 1996

	For the Year Ended June 30, 1997	For the Year Ended June 30, 1996
REVENUES:		
Interest Income from Pooled Investment Fund	$ 83,885,800	$ 79,195,869
EXPENDITURES:		
Interest on Deposits	82,953,771	78,345,704
Administrative Cost	945,339	951,639
Total Expenditures	83,899,110	79,297,343
Deficiency of Revenues Under Expenditures	(13,310)	(101,474)
FUND BALANCES, JULY 1	2,447,820	2,549,294
FUND BALANCES, JUNE 30	$ 2,434,510	$ 2,447,820

See accompanying Notes to the Financial Statements.

LOCAL GOVERNMENT INVESTMENT POOL
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997 AND JUNE 30, 1996

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Local Government Investment Pool (LGIP) forms an integral part of the primary government and has been included as an expendable trust fund in the *Tennessee Comprehensive Annual Financial Report*.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The LGIP is accounted for on the modified accrual basis of accounting and the flow of current financial resources measurement focus. Under this basis, revenues are recorded when they become both measurable and available and expenditures are recognized at the time liabilities are incurred.

3. Cash

Monies deposited in the LGIP are invested in the Pooled Investment Fund administered by the State Treasurer. The Pooled Investment Fund 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The Pooled Investment Fund 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. The Pooled Investment Fund's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1997 and June 30, 1996.

B. DESCRIPTION OF THE LOCAL GOVERNMENT INVESTMENT POOL

The Local Government Investment Pool was authorized by the 91st General Assembly to enable local governments and other political subdivisions to participate with the state in providing maximum opportunities for the investment of public funds. LGIP participants can invest any amount for any length of time in the pool. Transfer procedures for making deposits to the pool or withdrawals therefrom specify that an immediate credit process be used, i.e. wire transfers or correspondent banking transactions.

An average rate of return is calculated on the investment made each month from such pool and is used to credit LGIP participants with earnings. An administrative fee of .06 percent was charged against each participant's average daily LGIP balance to provide for recovery of administrative cost. This fee may be changed as the ratio of administrative cost to the pool balance changes.

Some deposits made to the LGIP are contractually committed to the State Department of Transportation (DOT). The only withdrawals allowed from these accounts are to pay the DOT in accordance with progress billings for construction projects contracted between the entity and the DOT.

Some deposits are committed to Community Services Agencies, the Tennessee State Veterans' Homes Board, the State College and University Fund and to the State Capital Projects Fund. Withdrawals from these accounts require authorization by the administering agencies.

The advance from the LGIP to the Baccalaureate Education System Trust (BEST) Fund in Fiscal Year 1997 was authorized by Chapter 1083 of the *Public Acts of the 99th General Assembly* for the purpose of covering implementation and other costs for the BEST program.

Local Government Investment Pool
Comparative Schedules of Cash Receipts and Disbursements
For the Years Ended June 30, 1997 and June 30, 1996

	July 1, 1996 through June 30, 1997	July 1, 1995 through June 30, 1996
CASH BALANCES, JULY 1	$ 1,326,120,685	$ 1,281,063,828
Add Cash Receipts:		
Member Deposits	3,096,772,517	3,196,647,309
Interest Income from Pooled Investment Fund	83,885,800	79,195,869
Total Cash Receipts	3,180,658,317	3,275,843,178
Deduct Cash Disbursements:		
Member Withdrawals	3,124,242,121	3,229,834,682
Advance to Baccalaureate Education System Trust Fund	527,918	0
Administrative Cost	945,339	951,639
Total Cash Disbursements	3,125,715,378	3,230,786,321
CASH BALANCES, JUNE 30	$ 1,381,063,624	$ 1,326,120,685

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
INDEPENDENT AUDITOR'S REPORT

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol Building
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying statement of plan net assets of the Tennessee Consolidated Retirement System, as of June 30, 1997, and the related statement of changes in plan net assets for the year then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Consolidated Retirement System as of June 30, 1997, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

As discussed in the notes to required supplementary information, the TCRS has not presented the schedule of employer contributions that the GASB has determined is necessary to supplement, although not required to be part of, the basic financial statements.

As discussed in Note A.3., TCRS implemented GASB Statement 25, "Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans" and GASB Statement 28, "Accounting and Financial Reporting for Securities Lending Transactions."

Our audit was conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary schedule of actuarial balances is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the system's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes Jr., CPA
Director, Division of State Audit

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
STATEMENT OF PLAN NET ASSETS
AS OF JUNE 30, 1997 WITH COMPARATIVE TOTALS FOR JUNE 30, 1996

Expressed in Thousands	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 1997 Total	June 30, 1996 Total
ASSETS:				
Cash	$ 24,959	$ 2,415	$ 27,374	$ 4,087
Receivables:				
Member Contributions Receivable	11,557	2,312	13,869	13,401
Employer Contributions Receivable	21,508	4,335	25,843	28,918
Accrued Interest Receivable	137,622	19,555	157,177	142,231
Accrued Dividends Receivable	8,926	1,268	10,194	11,160
Other Investment Receivable	3,177	451	3,628	522
Investments Sold	33,521	4,763	38,284	104,192
Total Receivables	216,311	32,684	248,995	300,424
Investments, at fair value				
Short-term Securities	766,362	108,890	875,252	667,733
Domestic Securities:				
Government Bonds	4,807,877	683,139	5,491,016	4,902,951
Corporate Bonds	2,967,717	421,676	3,389,393	3,177,513
Corporate Stocks	4,850,437	689,187	5,539,624	4,977,671
International Securities:				
Government Bonds	1,065,051	151,330	1,216,381	890,090
Corporate Bonds	283,619	40,299	323,918	264,546
Corporate Stocks	1,366,611	194,178	1,560,789	1,007,260
Total Investments	16,107,674	2,288,699	18,396,373	15,887,764
Invested Securities Lending Collateral	306,400	43,535	349,935	1,865,389
TOTAL ASSETS	16,655,344	2,367,333	19,022,677	18,057,664
LIABILITIES:				
Retired Payroll Payable	13,225	1,890	15,115	14,721
Warrants Payable	209	226	435	456
Accounts Payable:				
Death Benefits and Refunds Payable	1,173	778	1,951	1,470
Other	16	1	17	16
Due to State General Fund	0	0	0	72
Investments Purchased	117,031	16,629	133,660	101,361
Other Investment Payables	1,946	277	2,223	2,002
Securities Lending Collateral	306,400	43,535	349,935	1,865,389
TOTAL LIABILITIES	440,000	63,336	503,336	1,985,487
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (Schedules of funding progress for the plans are presented on page 76)	$ 16,215,344	$ 2,303,997	$18,519,341	$16,072,177

See accompanying Notes to the Financial Statements.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
STATEMENT OF CHANGES IN PLAN NET ASSETS
FOR THE YEAR ENDED JUNE 30, 1997 WITH COMPARATIVE TOTALS FOR JUNE 30, 1996

Expressed in Thousands	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	For the Year Ended June 30, 1997 Total	For the Year Ended June 30, 1996 Total
ADDITIONS				
Contributions:				
Member contributions	$ 110,697	$ 32,959	$ 143,656	$ 133,603
Employer contributions	278,417	59,167	337,584	345,100
Total contributions	389,114	92,126	481,240	478,703
Investment income:				
Net appreciation in fair value of investments	1,499,296	212,126	1,711,422	1,081,839
Interest	596,369	84,368	680,737	595,590
Dividends	110,218	15,593	125,811	129,290
Total investment income	2,205,883	312,087	2,517,970	1,806,719
Less: Investment expense	7,632	1,088	8,720	4,715
Net income from investing activities	2,198,251	310,999	2,509,250	1,802,004
Securities lending activities:				
Securities lending income	76,749	10,858	87,607	107,580
Less: Securities lending expense	71,753	10,151	81,904	102,910
Net income from securities lending activities	4,996	707	5,703	4,670
Net investment income	2,203,247	311,706	2,514,953	1,806,674
Total additions	2,592,361	403,832	2,996,193	2,285,377
DEDUCTIONS				
Annuity benefits:				
Retirement benefits	346,192	49,478	395,670	365,465
Survivor benefits	21,829	3,120	24,949	23,204
Disability benefits	11,578	1,655	13,233	11,812
Cost of living	73,751	10,540	84,291	78,322
Death benefits	2,395	801	3,196	3,225
Refunds	11,444	12,389	23,833	20,722
Administrative expense	2,221	1,636	3,857	3,911
Total deductions	469,410	79,619	549,029	506,661
NET INCREASE	2,122,951	324,213	2,447,164	1,778,716
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS				
BEGINNING OF YEAR	14,092,392	1,979,785	16,072,177	14,293,461
END OF YEAR	$ 16,215,343	$ 2,303,998	$ 18,519,341	$ 16,072,177

See accompanying Notes to the Financial Statements.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

The Tennessee Consolidated Retirement System (TCRS) administers two defined benefit pension plans - State Employees, Teachers and Higher Education Employees Pension Plan (SETHEEPP) and Political Subdivisions Pension Plan (PSPP). Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to members of that plan, in accordance with the terms of the plan.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The TCRS is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the TCRS has been included as a pension trust fund in the *Tennessee Comprehensive Annual Financial Report*.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The TCRS follows all applicable GASB pronouncements, as well as applicable private sector pronouncements issued on or before November 30, 1989. The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Plan member contributions are recognized in the period in which the contributions are due. Plan employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

3. Changes in Accounting Principles

Effective July 1, 1996, the TCRS adopted Statement Number 25 of the Governmental Accounting Standards Board (GASB), *Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans*. The provisions of this statement require retroactive restatement of financial information to July 1, 1995 as comparative information for Fiscal Year 1996 is presented. The effect of the change in accounting principle on the TCRS' previously reported net assets held in trust for pension benefits (fund balance) is as follows (expressed in thousands):

	Net assets held in trust for pension benefits (fund balance) as previously reported	Adjustments from Implementation of GASB No. 25	Net assets held in trust for pension benefits as restated
June 30, 1995	$13,171,549	$1,121,912	$14,293,461
June 30, 1996	$14,738,658	$1,333,519	$16,072,177

The restatement of the TCRS' 1996 financial statements resulted in an increase in the Fiscal Year 1996 investment income of $211,607,000 due to the requirement to report investments at fair value. Requirements for disclosures regarding pension benefit obligation were eliminated by GASB Statement Number 25.

Effective July 1, 1996, the TCRS also adopted Statement Number 28 of the Governmental Accounting Standards Board, *Accounting and Financial Reporting for Securities Lending Transactions*. GASB Statement Number 28 requires that securities loaned and cash collateral, as well as investments made with cash collateral, be reported as assets on the statement of plan net assets with a corresponding liability for the collateral received. In addition, the statement requires that the costs of securities lending transactions be reported separately from the income from securities lending transactions on the statement of changes in plan net assets. Totals on the Statement of Plan Net Assets as of June 30, 1996 and the Statement of Changes in Plan Net Assets for the period of July 1, 1995 through June 30, 1996 have been restated for comparative purposes. There is no effect on net assets or on net investment income resulting from the restatement.

(Continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

4. **Cash**

Cash and cash equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. In addition, under the policy, short-term securities otherwise defined as cash equivalents, that are in portfolios where the primary purpose is to facilitate the placement of funds in long-term investments, are classified as investments.

Cash received by the TCRS that cannot be invested immediately in securities is invested in the Pooled Investment Fund administered by the State Treasurer. The Pooled Investment Fund 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated, Section 9-4-602(b)*. The Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned to brokers for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The Pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1997 and June 30, 1996. The classification of Cash also includes cash held in a custody account by Mellon Trust Company under a contractual arrangement for master custody services. Cash balances with the custodial agent are not classified into the credit risk categories established by Statement Number 3 of the Governmental Accounting Standards Board as the custody account relationship does not meet the definition for either a deposit with a financial institution or a security.

5. **Method Used to Value Investments**

Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Investments that do not have an established market are reported at estimated fair values. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.

6. **Receivables**

Receivables primarily consist of interest which is recorded when earned. The receivables for contributions as of June 30, 1997 consist of $6.6 million due from other funds within the state and $33.0 million due from other governments.

B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

At June 30, 1997, the date of the latest actuarial valuation, the membership of each plan consisted of the following:

	SETHEEPP	PSPP
Retirees and beneficiaries currently receiving benefits	48,834	17,828
Terminated members entitled to but not receiving benefits	10,681	2,393
Current active members	120,515	58,656
Total	180,030	78,877
Number of participating employers	142	365

(Continued)

Tennessee Consolidated Retirement System
Notes to the Financial Statements
June 30, 1997

State Employees, Teachers and Higher Education Employees Pension Plan

Plan Description
SETHEEPP is a cost-sharing, multiple employer defined benefit pension plan that covers the employees of the state, teachers with Local Education Agencies (LEA's) and higher education employees. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan on or after July 1, 1979 are vested after five years of service. Members joining prior to July 1, 1979 are vested after four years of service. Cost of living adjustments (COLA) are provided each July based on the percentage change in the Consumer Price Index (CPI) during the previous calendar year. No COLA is granted if the CPI increases less than one percent. The maximum annual COLA is capped at three percent. Benefit provisions are established by state statute found in Title Eight, Chapters 34 through 37 of the *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly.

Superseded Systems and Certain Employment Classifications
Members of superseded systems that became members of the TCRS at consolidation in 1972, have their rights preserved to the benefits of the superseded system, if the benefit from the superseded plan exceeds that provided by the Group 1 (teachers and general employees) TCRS formula. Likewise, public safety employees and officials of TCRS Groups 2, 3 and 4 are entitled to the benefits of those formulas, if better than the Group 1 benefits.

Contributions and Reserves
Effective July 1, 1981, the plan became noncontributory for most state and higher education employees. The contribution rate for teachers is five percent of gross salary. The employers contribute a set percentage of their payrolls, determined by an actuarial valuation. *Tennessee Code Annotated Title Eight, Chapter 37* provides that the contribution rates be established and may be amended by the Board of Trustees of the TCRS. The administrative budget for the plan is approved through the state of Tennessee's annual budget process. Funding for the administrative budget is included in employer contributions.

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve. At June 30, 1997, the plan's Member Reserve and Employer Reserve were fully funded, with balances of $2,141.0 million and $14,074.3 million, respectively.

Political Subdivisions Pension Plan

Plan Description
PSPP is an agent multiple-employer defined benefit pension plan that covers the employees of participating political subdivisions of the state of Tennessee. Employee class differentiations are not made under PSPP. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan prior to July 1, 1979 are vested after four years of service. Members joining on or after July 1, 1979 are vested upon completion of 10 years of service, unless five years vesting is authorized by resolution of the chief governing body. Cost of living adjustments, if adopted by a political subdivision, are provided each July based on the percentage change in the Consumer Price Index (CPI) during the previous calendar year. No COLA is granted if the CPI increases less than one percent. The maximum annual COLA is capped at three percent.

(Continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

Benefit provisions are established and amended by state statute. Pursuant to Article Two, Section 24 of the *Constitution of the State of Tennessee*, the state cannot mandate costs on local governments. Any benefit improvement may be adopted by the governing body of a governmental entity participating in the TCRS.

Contributions and Reserves
Political subdivisions may elect contributory or noncontributory retirement for their employees. The contribution rate for contributory employees of political subdivisions is five percent of gross salary. The employers contribute a set percentage of their payrolls, equal to at least, the percentage determined by an actuarial valuation. State statute provides that the contribution rates be established and may be amended by the Board of Trustees of the TCRS. The administrative budget for the plan is approved through the state's annual budget process. Funding for the administrative budget is included in employer contributions.

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve. At June 30, 1997, the plan's Member Reserve and Employer Reserve were fully funded, with balances of $425.7 million and $1,878.3 million, respectively.

C. INVESTMENTS

State statute authorizes the TCRS to invest in bonds, debentures, preferred stock and common stock, and in other good and solvent securities subject to the approval of the Board of Trustees and further subject to the following restrictions:

a. The total sum invested in common and preferred stocks shall not exceed seventy-five percent (75%) of the total of the funds of the retirement system.

b. The total sum invested in notes and bonds or other fixed income securities exceeding one year in maturity shall not exceed seventy-five percent (75%) of the total funds of the retirement system.

c. Within the restrictions in (a) and (b) above, an amount not to exceed fifteen percent (15%) of the total of the funds of the retirement system may be invested in securities of the same kinds, classes, and investment grades as those otherwise eligible for investment in various approved foreign countries.

d. The total amount of securities loaned under a securities lending program cannot exceed thirty percent (30%) of total assets.

e. Private Placements are limited to 15% of the total fixed income portfolio.

The TCRS may also invest in multifamily residential real estate through direct equity investment vehicles including, but not limited to, sole proprietorships and joint ventures.

The TCRS maintains a portfolio of short-term investments in order to actively manage all funds waiting to be placed in a more permanent investment. These short-term investments may include U.S. Treasury obligations, commercial paper, medium-term corporate notes, promissory notes and repurchase agreements.

The TCRS investment securities are categorized on the following page according to the level of custodial credit risk associated with the custodial arrangements at year-end. Category 1 includes investments that are insured or registered, or for which the securities are held by the TCRS or its agent in the name of the TCRS. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the name of the TCRS. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by the counterparty's trust department or agent, but not in the name of the TCRS.

(Continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

(Expressed in Thousands)	Fair Value June 30, 1997	Fair Value June 30, 1996
Investments - Category 1		
Short-term Securities		
Commercial Paper	$ 749,460	$ 544,910
Medium-term Corporate Notes	0	96,321
U. S. Government Securities	125,792	26,502
Repurchase Agreements	0	0
Long-term Investments		
Domestic Securities		
Government Bonds - not on loan	5,443,664	3,272,842
Government Bonds - on loan for securities collateral	0	103,880
Corporate Bonds	3,296,759	3,087,494
Corporate Stocks	5,458,081	4,923,099
International Securities		
Government Bonds	1,195,959	747,381
Corporate Bonds	323,918	264,546
Corporate Stocks	1,319,756	889,184
Total Investments - Category 1	17,913,389	13,956,159
Investments - Category 2	0	0
Investments - Category 3		
Short-term securities lending collateral investments held by custodian bank	349,935	1,865,389
Margin Deposit on Futures Contracts		
Domestic Government Bonds	19,036	0
Total Investments - Category 3	368,971	1,865,389
Investments - Not Categorized		
Investments held by broker-dealers under securities on loan contracts for cash collateral		
Domestic Securities		
Government Bonds	0	1,513,180
Corporate Bonds	78,986	90,019
Corporate Stocks	63,265	29,944
International Securities		
Government Bonds	0	87,658
Corporate Stocks	192,304	110,798
Unsettled Investment Acquisitions		
Domestic Securities		
Government Bonds	28,316	13,049
Corporate Bonds	13,648	0
Corporate Stocks	18,278	24,628
International Securities		
Government Bonds	20,422	55,051
Corporate Stocks	48,729	7,278
	463,948	1,931,605
Total Investments and invested securities lending collateral	$ 18,746,308	$ 17,753,153

(Continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

Securities Lending

The TCRS is authorized by its investment policy, as adopted by the Board of Trustees, to enter into collateralized securities lending agreements whereby the TCRS loans its debt and equity securities for a fee to a select few of the highest quality securities firms and banks. Loans must be limited so the total amount on loan does not exceed 30 percent of the TCRS' assets. The TCRS' custodian bank manages the lending program and maintains the collateral on behalf of the TCRS. The borrower may deliver collateral to the lending agent in the form of cash or bonds, notes, and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies or by the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Student Loan Marketing Association and other United States government sponsored corporations or enterprises. Cash received as collateral may be reinvested by the lending agent in accordance with the investment policy, as further restricted under the TCRS securities lending agreement. Collateral securities cannot be pledged or sold unless the borrower defaults.

The loaned securities are initially collateralized at 102 percent of their fair value for domestic securities and 105 percent for international. Collateral is marked-to-market daily and additional collateral is pledged by the borrower if the fair value of the collateral subsequently falls below 100 percent for domestic securities and 105 percent for international. At year-end, the TCRS had no credit risk exposure to borrowers because the amounts the TCRS owed the borrowers exceeded the amounts the borrowers owed the TCRS.

Although there is no specific policy for matching the maturities of the collateral investments and the securities loans, all securities on loan can be terminated on demand by either the TCRS or the borrower and at June 30, 1997, substantially all cash collateral was invested in overnight or on-demand investments with a weighted-average term to maturity of four days.

As of June 30, 1997, the fair value of securities on loan to brokers was $334,555,819, and the fair value of collateral pledged for the securities on loan was $349,934,991. The TCRS securities lending income, net of expenses, was $5,703,225 for the year ended June 30, 1997.

Financial Instruments with Off-Balance Sheet Risk

The TCRS is a party to financial instruments with off-balance sheet risk used in the normal course of business to generate earnings and reduce its own exposure to fluctuations in market conditions. The TCRS is authorized by statute to engage in forward contracts to exchange different currencies at a specified future date and rate and in domestic stock index futures contracts. These contracts involve elements of custodial credit, market and legal risk in excess of amounts recognized in the Statement of Plan Net Assets as of June 30, 1997. The TCRS may purchase or sell domestic stock index futures contracts for the purposes of making asset allocation changes and improving liquidity. Futures contracts are limited to the S&P 500 Index, the S&P Midcap 400 Index and the Russell 2000 Index. The contractual or notional amounts express the extent of the TCRS' involvement in these instruments and do not represent exposure to credit loss. The credit risk on forward and futures contracts is controlled through limits and monitoring procedures. Market risk, the risk that changing market conditions may make a financial instrument less valuable, is controlled through limitations on the use of such instruments. Legal risk is controlled through the use of only authorized instruments and brokers.

The allowable currencies for hedging purposes are limited by policy of the Board of Trustees to the currencies of those countries otherwise authorized for investment. At June 30, 1997, there were 22 forward exchange contracts outstanding at a total notional amount of $371,633,497 and a fair value of $374,833,463.

At June 30, 1997, the notional amount of futures contracts was $426,325,000 at a fair value of $445,125,000. The changes in fair value of outstanding futures contracts are settled daily.

The TCRS is also authorized by investment policy to engage in the issuance of options. Activity is limited to selling covered call options. The TCRS had no options outstanding at June 30, 1997.

(Continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

D. COMMITMENTS

The TCRS has agreed to serve as standby note purchaser for notes issued by the Funding Board of the State of Tennessee. By serving as a standby note purchaser, the TCRS receives an annual fee of 7.5 basis points on the $250 million maximum issuance under this agreement. In the unlikely event that the TCRS would be called upon to purchase the notes, the TCRS would receive interest at a rate equal to prime plus 75 basis points. Moody's Investors Services, Inc. and Standard and Poor's have given these notes of the Funding Board ratings of M1G1/VM1G1 and SP-1+/A-1+, respectively.

E. OTHER NOTE DISCLOSURES

The financial statements include summarized comparative information in total for the prior fiscal year ended June 30, 1996. Such information for the prior year does not include sufficient, comparative detail by plan to constitute a presentation in conformity with generally accepted accounting principles but has been presented for informational purposes.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF FUNDING PROGRESS

Expressed in Thousands

Actuarial Valuation Date	Actuarial Value of Assets (a)	Actuarial Accrued Liability (AAL) Frozen Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
SETHEEPP						
6/30/97	15,671,678	15,782,850	111,172	99.30%	3,810,231	2.92%
PSPP						
6/30/97	2,226,891	2,247,787	20,896	99.07%	1,145,963	1.82%

Information according to the parameters for measuring pension expenditures,expense and related actuarially determined disclosure information, as required by GASB, is available beginning with the current, transition year.

See accompanying Notes to Required Supplementary Information.

(Continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO REQUIRED SUPPLEMENTARY INFORMATION
JUNE 30, 1997

An actuarial valuation of the TCRS is performed every two years. The June 30, 1995 valuation determined the employer contribution rate for the year ended June 30, 1997. Therefore, the Schedule of Employer Contributions, in accordance with the parameters of GASB Statement Number 25, is not available for the year ended June 30, 1997, but will be available for future years.

The information presented in the required supplementary Schedules of Funding Progress was determined as part of the actuarial valuations as of June 30, 1997. Additional information as of the latest actuarial valuation follows.

	SETHEEPP	PSPP
Valuation Date	06/30/97	06/30/97
Actuarial cost method	Frozen Entry Age	Frozen Entry Age
Amortization method	Level Dollar	Level Dollar
Remaining amortization period	18 years closed period	(1) closed period
Asset valuation method	5-year Moving Market Average	5-year Moving Market Average
Actuarial assumptions:		
Investment rate of return	7.5%	7.5%
Projected salary increases	5.5%	5.5%
Includes inflation at	(2)	(2)
Cost-of-living adjustments	3%	3%
Increase in Social Security wage base	4.5%	4.5%

(1) The length of the amortization period varies by individual political subdivision but does not exceed 20 years.

(2) No explicit assumption is made regarding the portion attributable to the effect of inflation on salaries.

Tennessee Consolidated Retirement System
Actuarial Balance Sheet
As of June 30, 1997

	Political Subdivisions	State	Total
ASSETS			
Present Assets Creditable To:			
Employer Accumulation Fund	$ 1,800,448,644	$ 13,529,975,707	$ 15,330,424,351
Members' Accumulation Fund	426,442,166	2,141,702,347	2,568,144,513
Total Present Assets	2,226,890,810	15,671,678,054	17,898,568,864
Present Value Of Prospective Contributions Payable To:			
Employer Accumulation Fund:			
Normal	395,991,011	1,928,526,419	2,324,517,430
Accrued Liability	20,895,955	111,172,072	132,068,027
Total Employer Accumulation	416,886,966	2,039,698,491	2,456,585,457
Members' Accumulation Fund:	238,234,111	1,105,935,845	1,344,169,956
Total Prospective Contributions	655,121,077	3,145,634,336	3,800,755,413
Total Assets	2,882,011,887	18,817,312,390	21,699,324,277
LIABILITIES			
Present Value Of Prospective Benefits Payable On Account Of:			
Present retired members and Beneficiaries	743,565,148	5,456,072,528	6,199,637,676
Present active members	2,096,342,374	13,156,059,038	15,252,401,412
Former members	42,104,365	205,180,824	247,285,189
Total Liabilities	$ 2,882,011,887	$ 18,817,312,390	$ 21,699,324,277

UNAUDITED

IRC Section 457 Deferred Compensation
Independent Auditor's Report

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol Building
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the IRC Section 457 Deferred Compensation Plan as of June 30, 1997, and June 30, 1996, and the related statement of changes in assets and liabilities for the year ended June 30, 1997. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the IRC Section 457 Deferred Compensation Plan as of June 30, 1997, and June 30, 1996, and the changes in assets and liabilities for the year ended June 30, 1997, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the Deferred Compensation Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr., CPA
Director, Division of State Audit

IRC Section 457 Deferred Compensation Comparative Balance Sheets June 30, 1997 and June 30, 1996

ASSETS	June 30, 1997	June 30, 1996
Investments Held by Vendors		
AEtna	$ 33,108,143	$ 30,309,628
American General	988,523	983,807
Calvert Group	494,565	444,883
Fidelity Investments	62,967,168	48,458,233
Great West	3,544,555	5,105,240
Union Planters	14,670,926	15,174,443
Total Investments	115,773,880	100,476,234
Due from Other Funds for		
AEtna	20,083	22,341
American General	2,083	4,633
Calvert Group	1,594	2,495
Fidelity Investments	103,473	103,898
Union Planters	17,062	25,308
Total Receivables	144,295	158,675
TOTAL ASSETS	$ 115,918,175	$ 100,634,909
LIABILITIES		
Amounts Held in Custody for Others	$ 115,918,175	$ 100,634,909

See accompanying Notes to the Financial Statements.

IRC Section 457 Deferred Compensation Statement of Changes in Assets and Liabilities For the Year Ended June 30, 1997

ASSETS	Balance July 1, 1996	Additions	Deductions	Balance June 30, 1997
Investments, at Market	$ 100,476,234	$ 33,103,097	$ 17,805,451	$ 115,773,880
Due from Other Funds	158,675	144,295	158,675	144,295
Total Assets	$ 100,634,909	$ 33,247,392	$ 17,964,126	$ 115,918,175
LIABILITIES				
Amounts Held in Custody for Others	$ 100,634,909	$ 33,247,392	$ 17,964,126	$ 115,918,175

See accompanying Notes to the Financial Statements.

IRC Section 457 Deferred Compensation Notes to the Financial Statements, June 30, 1997 and June 30, 1996

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Deferred Compensation Plan is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as an agency fund.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) using the modified accrual basis of accounting. The agency fund is custodial in nature and does not measure results of operations or have a measurement focus.

B. OTHER ACCOUNTING DISCLOSURES

1. The state offers its employees a deferred compensation plan created in accordance with Internal Revenue Code Section 457. The plan, available to all state employees, permits them to defer a portion of their salary until future years. The deferred compensation is not available to employees until termination, retirement, death, or unforeseeable emergency. All costs of administering and funding the plan are the responsibility of plan participants.

2. All amounts of compensation deferred under the plan, all property and rights purchased with those amounts, and all income attributable to those amounts, property, or rights are (until paid or made available to the employee or other beneficiary) solely the property and rights of the state, (without being restricted to the provisions of benefits under the plan), subject only to the claims of the state's general creditors. Participants' rights under the plan are equal to those of general creditors of the state in an amount equal to the fair value of the deferred account for each participant.

3. It is the opinion of the state's legal counsel that the state has no liability for losses under the plan, but does have the duty of due care that would be required of an ordinary prudent investor. The state believes that it is unlikely that it will use the assets to satisfy the claims of general creditors in the future.

4. The deferred compensation investments are not required to be classified into the custodial risk categories specified by the Governmental Accounting Standards Board because the investments are in pools or mutual funds where the specific securities related to the plan cannot be identified.

Flexible Benefits Plan
Independent Auditor's Report

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol Building
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the Flexible Benefits Plan as of June 30, 1997, and June 30, 1996, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Flexible Benefits Plan as of June 30, 1997, and June 30, 1996, and the changes in fund balances for the years then ended in conformity with generally accepted accounting principles.

Our audits were performed for the purpose of forming an opinion on the financial statements, taken as a whole. The accompanying supplementary schedule of cash receipts and disbursements following the notes to the financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the Flexible Benefits Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes Jr., CPA
Director, Division of State Audit

FLEXIBLE BENEFITS PLAN
COMPARATIVE BALANCE SHEETS
JUNE 30, 1997 AND JUNE 30, 1996

	June 30, 1997	June 30, 1996
Assets		
Cash	$ 2,826,104	$ 5,795,682
Due from Other Funds	1,599	1,533
Total Assets	$ 2,827,703	$ 5,797,215
Liabilities and Fund Balances		
Liabilities:		
Warrants Payable	$ 3,917	$ 7,619
Accounts Payable	76,316	75,616
Dependent Care Deposits	130,610	166,166
Medical Reimbursement Deposits	78,819	30,024
Due to Other Funds	63,440	55,274
Total Liabilities	353,102	334,699
Fund Balances, Reserved for Employee Benefits	2,474,601	5,462,516
Total Liabilities and Fund Balances	$ 2,827,703	$ 5,797,215

See accompanying Notes to the Financial Statements.

FLEXIBLE BENEFITS PLAN
COMPARATIVE STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEARS ENDED JUNE 30, 1997 AND JUNE 30, 1996

	For the Year Ended June 30, 1997	For the Year Ended June 30, 1996
Revenues:		
FICA Savings	$ 2,269,211	$ 2,225,925
Flexible Benefit Forfeiture	7,785	12,050
Total Revenues	2,276,996	2,237,975
Expenditures:		
Deferred Compensation Match	4,359,140	2,179,810
Administrative Fees	205,345	221,658
Employee Benefit Program	53,525	48,012
Total Expenditures	4,618,010	2,449,480
Deficiency of Revenues under Expenditures	(2,341,014)	(211,505)
Other Financing Uses:		
Operating Transfer to:		
General Fund	(172,857)	(147,516)
Internal Service Fund	(474,044)	(425,162)
Deficiency of Revenues under Expenditures and Other Financing Uses	(2,987,915)	(784,183)
Fund Balances, July 1	5,462,516	6,246,699
Fund Balances, June 30	$ 2,474,601	$ 5,462,516

See accompanying Notes to the Financial Statements.

FLEXIBLE BENEFITS PLAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997 AND JUNE 30, 1996

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Flexible Benefit Plan is part of the primary government and has been included in the Tennessee Comprehensive Annual Financial Report as an expendable trust fund. The state offers its employees a cafeteria plan created in accordance with Internal Revenue Code Section 125. The plan is available on an optional basis to all state employees. Through the plan, employees may elect to direct a portion of their salary to pay for certain benefits. Benefits which may be purchased through the plan include state group medical insurance, state group dental insurance, out-of-pocket medical expenses and/or dependent care expenses. Because elections must be filed before the salary or the benefits are received and because salary directed to the plan may not be withdrawn by participants for any other purpose, salary directed to the plan is exempt from federal income tax and social security tax. Elections made by employees may not be changed during the calendar plan year except in the event of a corresponding change in the participant's family status. Contributions to the plan not withdrawn by the end of the plan year are forfeited to the state and are used for funding other employee benefit programs as specified in the state appropriations' bill.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recorded when they become both measurable and available, and expenditures are recognized at the time the fund liabilities are incurred.

3. Cash

Cash deposited in the Flexible Benefit Plan is pooled with the Pooled Investment Fund, administered by the State Treasurer, which 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The Pooled Investment Fund 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. The Pool's custodial credit risk is presented in the Tennessee Comprehensive Annual Financial Report for the years ended June 30, 1997, and June 30, 1996.

FLEXIBLE BENEFITS PLAN
COMPARATIVE SCHEDULE OF CASH RECEIPTS AND DISBURSEMENTS
FOR THE YEARS ENDED JUNE 30, 1997 AND JUNE 30, 1996

	July 1, 1996 through June 30, 1997	July 1, 1995 through June 30, 1996
Cash Balances, July 1	$ 5,795,682	$ 6,407,499
Add Cash Receipts:		
Plan Deposits	3,101,362	3,077,588
FICA Savings	2,269,102	2,225,957
Total Cash Receipts	5,370,464	5,303,545
Deduct Cash Disbursements:		
Plan Withdrawals	3,087,073	3,055,278
Deferred Compensation Match	4,350,440	2,022,210
Transfer to General Fund	172,857	147,516
Transfer to Internal Service Fund	474,044	425,162
Administrative Fees	205,345	221,658
Employee Benefit Program	50,283	43,538
Total Cash Disbursements	8,340,042	5,915,362
Cash Balances, June 30	$ 2,826,104	$ 5,795,682

Claims Award Fund
Independent Auditor's Report

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol Building
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the Claims Award Fund as of June 30, 1997, and June 30, 1996, and the related statements of revenues, expenses, and changes in retained earnings and cash flows for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Claims Award Fund as of June 30, 1997, and June 30, 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the Claims Award Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes Jr., CPA
Director, Division of State Audit

CLAIMS AWARD FUND
COMPARATIVE BALANCE SHEETS
JUNE 30, 1997 AND JUNE 30, 1996

	June 30, 1997	June 30, 1996
Assets		
Cash	$ 93,935,853	$ 79,514,539
Total Assets	$ 93,935,853	$ 79,514,539
Liabilities and Equity		
Liabilities:		
Warrants Payable	$ 102,567	$ 126,047
Checks Payable	201,538	312,536
Accounts Payable	473,634	567,777
Claims Liability	53,461,703	51,610,052
Total Liabilities	54,239,442	52,616,412
Equity		
Retained Earnings, Reserved for Claims	39,696,411	26,898,127
Total Liabilities and Equity	$ 93,935,853	$ 79,514,539

See accompanying Notes to the Financial Statements.

Claims Award Fund
Comparative Statements of Revenues, Expenses and Changes in Retained Earnings
For the Years Ended June 30, 1997 and June 30, 1996

	For the Year Ended June 30, 1997	For the Year Ended June 30, 1996
Operating Revenues:		
Insurance Premiums	$ 32,217,086	$ 32,815,880
Operating Expenses:		
Torts		
Death	940,248	613,000
Bodily Injury	3,397,800	1,380,256
Property Damage	947,679	829,534
Total Torts	5,285,727	2,822,790
Workers' Compensation		
Death	242,775	262,660
Medical	5,614,756	6,407,653
Assault Injury	0	20,424
Temporary Disability	1,349,207	1,252,921
Permanent Disability	4,398,532	4,117,436
Total Workers' Compensation	11,605,270	12,061,094
Employee Property Damage	31,206	28,555
Professional/Administrative	6,213,776	6,154,809
Addition to (Reduction in) Actuarial Liability	1,851,651	(3,403,683)
Total Operating Expenses	24,987,630	17,663,565
Operating Income	7,229,456	15,152,315
Nonoperating Revenues:		
Interest Income	5,565,728	4,964,601
Taxes	3,100	4,430
Total Nonoperating Revenues	5,568,828	4,969,031
Net Income	12,798,284	20,121,346
Retained Earnings, July 1	26,898,127	6,776,781
Retained Earnings, June 30	$ 39,696,411	$ 26,898,127

See accompanying Notes to the Financial Statements.

Claims Award Fund
Comparative Statements of Cash Flows
For the Years Ended June 30, 1997 and June 30, 1996

	For the Year Ended June 30, 1997	For the Year Ended June 30, 1996
Cash Flows from Operating Activities:		
Operating Income	$ 7,229,456	$ 15,152,315
Adjustments to Reconcile Operating Income to Net Cash Provided by Operating Activities:		
Change in Assets and Liabilities:		
Decrease in Accounts Receivable	0	55,800
Decrease in Warrants Payable	(23,480)	(20,196)
Decrease in Checks Payable	(110,998)	(23,495)
Increase (Decrease) in Accounts Payable	(94,143)	413,739
Increase (Decrease) in Claims Liability	1,851,651	(3,403,683)
Total Adjustments	1,623,030	(2,977,835)
Net Cash Provided by Operating Activities	8,852,486	12,174,480
Cash Flows from Noncapital Financing Activities:		
Taxes	3,100	4,430
Net Cash Provided by Noncapital Financing Activities	3,100	4,430
Cash Flows from Investing Activities:		
Interest on Pooled Investment Fund	5,565,728	4,964,601
Net Cash Provided by Investing Activities	5,565,728	4,964,601
Net Increase in Cash	14,421,314	17,143,511
Cash at July 1	79,514,539	62,371,028
Cash at June 30	$ 93,935,853	$ 79,514,539

See accompanying Notes to the Financial Statements

CLAIMS AWARD FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997 AND JUNE 30, 1996

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Claims Award Fund is part of the primary government and has been included in the Tennessee Comprehensive Annual Financial Report as an internal service fund.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Claims Award Fund follows all applicable GASB pronouncements as well as applicable private sector pronouncements issued on or before November 30, 1989. The Claims Award Fund uses the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

3. Cash

Cash deposited in the Claims Award Fund is pooled with the Pooled Investment Fund, administered by the State Treasurer, which is authorized by 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The Pooled Investment Fund 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. The Pool's custodial credit risk is presented in the Tennessee Comprehensive Annual Financial Report for the years ended June 30, 1997, and June 30, 1996.

B. OTHER ACCOUNTING DISCLOSURES

1. Risk Management

It is the policy of the state not to purchase commercial insurance for the risks of losses for general liability, automobile liability, professional malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the Claims Award Fund (CAF).

CAF services claims for risk of loss to which the state is exposed including general liability, automobile liability, professional malpractice, and workers' compensation. All agencies and authorities of the state participate in CAF, except for the Board of Professional Responsibility, The Dairy Promotion Board, Women's Suffrage, Certified Cotton Growers' Organization, and TN 200. CAF allocates the cost of providing claims servicing and claims payment by charging a premium to each agency based on a percentage of each organization's expected loss costs which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of each fiscal year end to determine the fund liability and premium allocation.

CAF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. At June 30, 1997, the present value of these liabilities discounted at 5.82% was $53,461,703. Changes in the balances of claims liabilities during fiscal years 1997 and 1996 were as follows:

(Continued)

Claims Award Fund
Notes to the Financial Statements
June 30, 1997 and June 30, 1996

	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year End
1996-1997	$51,610,052	$18,773,854	$(16,922,203)	$53,461,703
1995-1996	$55,013,735	$11,508,756	$(14,912,439)	$51,610,052

At June 30, 1997, CAF held $93.9 million in cash designated for payment of these claims.

Criminal Injuries Compensation Fund
Independent Auditor's Report

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol Building
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the Criminal Injuries Compensation Fund as of June 30, 1997, and June 30, 1996, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Criminal Injuries Compensation Fund as of June 30, 1997, and June 30, 1996, and the changes in fund balances for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the Criminal Injuries Compensation Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes Jr., CPA
Director, Division of State Audit

Criminal Injuries Compensation Fund
Comparative Balance Sheets
June 30, 1997 and June 30, 1996

	June 30, 1997	June 30, 1996
Assets		
Cash	$ 51,594,585	$ 43,317,887
Accounts Receivable	647,723	1,584,581
Total Assets	$ 52,242,308	$ 44,902,468
Liabilities and Fund Balances		
Liabilities:		
Warrants Payable	$ 570,230	$ 597,209
Accounts Payable	152,839	293,500
Claims Liability	6,075,383	7,324,191
Total Liabilities	6,798,452	8,214,900
Fund Balances:		
Reserved for Future Benefits	44,476,185	35,863,447
Reserved for Victims of Drunk Drivers	967,671	824,121
Total Fund Balances	45,443,856	36,687,568
Total Liabilities and Fund Balances	$ 52,242,308	$ 44,902,468

See accompanying Notes to the Financial Statements.

CRIMINAL INJURIES COMPENSATION FUND
COMPARATIVE STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEARS ENDED JUNE 30, 1997 AND JUNE 30, 1996

	For the Year Ended June 30, 1997	For the Year Ended June 30, 1996
Revenues:		
State		
Taxes	$ 7,567,806	$ 8,351,298
Fines	2,026,830	1,666,674
Federal	1,578,000	2,086,000
Interest Income	2,499,253	2,146,591
Total Revenues	13,671,889	14,250,563
Expenditures:		
Claim Payments	4,817,664	4,345,354
Administrative Cost - Public Awareness Program	97,937	0
Total Expenditures	4,915,601	4,345,354
Excess of Revenues Over Expenditures	8,756,288	9,905,209
Fund Balances, July 1	36,687,568	26,782,359
Fund Balances, June 30	$ 45,443,856	$ 36,687,568

See accompanying Notes to the Financial Statements.

Criminal Injuries Compensation Fund
Notes to the Financial Statements
June 30, 1997 and June 30, 1996

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Criminal Injuries Compensation Fund is part of the primary government and has been included in the Tennessee Comprehensive Annual Financial Report as a special revenue fund. The Criminal Injuries Compensation Program (CIC) is funded through privilege taxes assessed in courts against certain criminal defendants upon conviction, fees levied against parolees, probationers and employed releasees, the proceeds from sales of illegal contraband and bond forfeitures in felony cases, and a federal grant. Payments made under the CIC program are intended to defray the costs of medical services, loss of earnings, burial costs, and other pecuniary losses to either the victim of a crime or to the dependents of deceased victims. According to state statute, the CIC program can only compensate victims to the extent funds are available within the program. State funds cannot be utilized for claim payments.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recorded when they become both measurable and available, and expenditures are recognized at the time the fund liabilities are incurred.

3. Cash

Cash deposited in the Criminal Injuries Compensation Fund is pooled with the Pooled Investment Fund, administered by the State Treasurer, which is authorized by 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The Pooled Investment Fund 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. The Pool's custodial credit risk is presented in the Tennessee Comprehensive Annual Financial Report for the years ended June 30, 1997, and June 30, 1996.

B. OTHER ACCOUNTING DISCLOSURES

Reserves

The Victims of Drunk Drivers Compensation Fund (VDDC) is a part of the Criminal Injuries Compensation Fund. A requirement of the CIC and VDDC combination is that a reserve be established annually for an amount equal to three times the awards paid for VDDC during the fiscal year. Chapter 761 of the Public Acts of 1992 discusses the fund combination as well as the VDDC reserve requirement.

Baccalaureate Education System Trust

Independent Auditor's Report

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol Building
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheet of the Baccalaureate Education System Trust as of June 30, 1997, and the related statement of revenues, expenditures, and changes in fund balances for the year then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Baccalaureate Education System Trust as of June 30, 1997, and the changes in fund balance for the year then ended in conformity with generally accepted accounting principles.

Our audit was performed for the purpose of forming an opinion on the financial statements, taken as a whole. The accompanying supplementary schedule of cash receipts and disbursements following the notes to the financial statements, is presented for purposes of additional analysis and is not a required part of the financial statements. Such information has been subjected to the auditing procedures applied in the audit of the financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the Baccalaureate Education System Trust's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes Jr., CPA
Director, Division of State Audit

BACCALAUREATE EDUCATION SYSTEM TRUST
BALANCE SHEET
JUNE 30, 1997

		June 30,1997
ASSETS		
Cash	$	163,215
Short-term Investments (Amortized Cost)		126,078
Total Assets	$	289,293
LIABILITIES AND FUND BALANCE		
LIABILITIES:		
Accounts payable	$	78,837
Advance from State of Tennessee Local Government Investment Pool		527,918
Total Liabilities		606,755
FUND BALANCE, UNRESERVED		(317,462)
TOTAL LIABILITIES AND FUND BALANCE	$	289,293

See accompanying Notes to the Financial Statements.

BACCALAUREATE EDUCATION SYSTEM TRUST
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCE
FOR THE YEAR ENDED JUNE 30, 1997

		For the Year Ended June 30, 1997
REVENUES:		
Contributions	$	183,553
Investment Income		165
Administrative Fees		26,738
Total Revenues		210,456
EXPENDITURES:		
Administrative Cost		527,918
Deficiency of Revenues Under Expenditures		(317,462)
FUND BALANCE, JULY 1		0
FUND BALANCE, JUNE 30	$	(317,462)

See accompanying Notes to the Financial Statements.

BACCALAUREATE EDUCATION SYSTEM TRUST
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Tennessee Baccalaureate Education System Trust Fund (BEST), which began operating in June, 1997, is an integral part of the primary government and has been included in the Tennessee Comprehensive Annual Financial Report as an expendable trust fund.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The BEST is accounted for on the modified accrual basis of accounting and the flow of current financial resources measurement focus. Under this basis, revenues are recorded when they become both measurable and available and expenditures are recognized at the time liabilities are incurred.

3. Cash

The classification of Cash and Cash Equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash. In addition, short-term securities in portfolios where the primary purpose is to facilitate the placement of funds in long-term investments are classified as investments. Cash received by the BEST that cannot be invested immediately in securities is invested in the Pooled Investment Fund administered by the State Treasurer. The Pooled Investment Fund 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned to brokers for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The Pool's custodial credit risk is presented in the Tennessee Comprehensive Annual Financial Report for the year ended June 30, 1997.

B. INVESTMENTS

The authority for investing the assets of the BEST is vested in its Board of Trustees and the responsibility for implementing the investment policy established by the Board is delegated to the State Treasurer. In accordance with the investment policy, the BEST assets may be invested in any instrument, obligation, security or property that constitutes a legal investment for assets of the Tennessee Consolidated Retirement System.

The classification of Short-term Investments includes funds invested in a portfolio of short-term securities maintained by the Tennessee Consolidated Retirement System. These short-term securities may include U.S. Treasury obligations, commercial paper, medium-term corporate notes, promissory notes and repurchase agreements.

The BEST investment securities are categorized according to the level of custodial credit risk associated with the custodial arrangements at year-end. Category 1 consists of investments that are insured or registered, or for which securities are held by the BEST or its agent in the name of the BEST. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the name of the BEST. Category 3 consists of uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent, but not in the name of the BEST. At June 30, 1997, the BEST investments, which consist of commercial paper at book value and market value of $126,078, are considered Category 1 investments.

BACCALAUREATE EDUCATION SYSTEM TRUST
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997

C. DESCRIPTION OF THE BEST

The Tennessee Baccalaureate Education System Trust is created under Tennessee Code Annotated, Title 49, Chapter 7, Part 8 for the purpose of improving higher education in the State of Tennessee by assisting students or their families to pay in advance, a portion of the tuition costs of attending colleges and universities. Under the program, a purchaser may enter into a contract with BEST to purchase tuition units on behalf of a beneficiary. Each tuition unit purchased entitles the beneficiary to an amount equal to one percent of the weighted average tuition of Tennessee's four-year public universities during the academic term in which it is used, however, the tuition unit or equivalent funds may be used at any accredited public or private, in-state or out-of-state institution. The price of the tuition unit is determined annually by the BEST Board of Trustees.

D. OTHER ACCOUNTING DISCLOSURES

The advance from the Local Government Investment Pool to the BEST was authorized by Chapter 1083 of the Public Acts of the 99th General Assembly for the purpose of covering implementation and other costs for the BEST program.

BACCALAUREATE EDUCATION SYSTEM TRUST
SCHEDULE OF CASH RECEIPTS AND DISBURSEMENTS
FOR THE YEAR ENDED JUNE 30, 1997

	July 1, 1996 through June 30, 1997
Cash Balance, July 1	$ 0
Add Cash Receipts:	
Contributions	183,553
Administrative Fees	26,738
Investment Income	165
Advance from State of Tennessee Local Government Investment Pool	527,918
Total Cash Receipts	738,374
Deduct Cash Disbursements:	
Administrative Cost	449,081
Investment Purchases	126,078
Total Cash Disbursements	575,159
Cash Balance, June 30	$ 163,215

CHAIRS OF EXCELLENCE
INDEPENDENT AUDITOR'S REPORT

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol Building
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the Chairs of Excellence as of June 30, 1997, and June 30, 1996, and the related statements of revenues, expenses, and changes in fund balances and cash flows for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Chairs of Excellence as of June 30, 1997, and June 30, 1996, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

As discussed in Note A.4. to the financial statements, Chairs of Excellence implemented GASB Statement 28, "Accounting and Financial Reporting for Securities Lending Transactions."

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the Chairs of Excellence's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes Jr., CPA
Director, Division of State Audit

CHAIRS OF EXCELLENCE
COMPARATIVE BALANCE SHEETS
JUNE 30, 1997 AND JUNE 30, 1996

	June 30, 1997	June 30, 1996
ASSETS		
Investments:		
Short-term Investments (Amortized Cost)	$ 10,339,976	$ 9,699,519
Long-term Investments:		
Domestic Securities:		
Government Bonds (Amortized Cost)	57,151,246	54,407,053
Corporate Bonds (Amortized Cost)	22,460,526	39,532,816
Corporate Stocks (Cost)	60,878,509	33,661,781
International Securities:		
Corporate Bonds (Amortized Cost)	5,675,599	5,814,360
Corporate Stocks (Cost)	897,694	940,900
Total Investments	157,403,550	144,056,429
Invested Securities Lending Collateral	0	6,347,510
Receivables:		
Due From College and University Fund	366,000	358,000
Investment Income Receivable	1,387,783	1,672,417
Investments Sold	0	4,866,844
Total Receivables	1,753,783	6,897,261
Total Assets	$ 159,157,333	$ 157,301,200
LIABILITIES AND FUND BALANCES		
Liabilities:		
Due to College and University Fund	$1,798,956	$1,677,492
Due to the Academic Scholars Fund	3,720,861	3,783,485
Due to State General Fund	35,519	29,941
Securities Lending Collateral	0	6,347,510
Total Liabilities	5,555,336	11,838,428
Fund Balances:		
Endowment Reserve	148,447,774	141,932,496
Special Reserve	5,154,223	3,530,276
Total Fund Balances	153,601,997	145,462,772
TOTAL LIABILITIES & FUND BALANCES	$ 159,157,333	$ 157,301,200

See accompanying Notes to the Financial Statements.

Chairs of Excellence
Comparative Statements of Revenues, Expenses and Changes in Fund Balances
For the Years Ended June 30, 1997 and June 30, 1996

	For the Year Ended June 30, 1997	For the Year Ended June 30, 1996
OPERATING REVENUES:		
Investment Income	$ 13,567,562	$ 13,004,059
Securities Lending Income	151,171	443,999
Contributions from Private Sources	1,423,000	2,104,328
Total Operating Revenues	15,141,733	15,552,386
OPERATING EXPENSES:		
Payments to the University of Tennessee	3,129,879	2,826,270
Payments to the Tennessee Board of Regents	3,335,704	3,105,542
Interest Payments to the Academic Scholars Fund	264,826	320,880
Securities Lending Expense	137,809	419,399
Administrative Cost	134,290	117,343
Total Operating Expenses	7,002,508	6,789,434
NET INCOME	8,139,225	8,762,952
FUND BALANCES, JULY 1	145,462,772	136,699,820
FUND BALANCES, JUNE 30	$ 153,601,997	$ 145,462,772

See accompanying Notes to the Financial Statements.

CHAIRS OF EXCELLENCE
COMPARATIVE STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 1997 AND JUNE 30, 1996

	For the Year Ended June 30, 1997	For the Year Ended June 30, 1996
CASH FLOWS FROM OPERATING ACTIVITIES:		
NET INCOME	$ 8,139,225	$ 8,762,952
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH USED BY OPERATING ACTIVITIES:		
Investment Income	(13,720,192)	(13,329,803)
Securities Lending Income	(151,171)	(443,999)
Securities Lending Expense	137,809	419,399
Net Amortization	152,630	325,745
Interest Paid to the Academic Scholars Fund	264,826	320,880
Changes in Assets and Liabilities:		
Increase in Due From College and University Fund	(8,000)	(158,000)
Increase in Due to College & University Fund	121,464	268,030
Increase (Decrease) in Due to Academic Scholars Fund	(62,624)	136,498
Increase in Due to State General Fund	5,578	6,584
NET CASH USED BY OPERATING ACTIVITIES	(5,120,455)	(3,691,714)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Investment Income Received	8,911,391	9,375,526
Securities Lending Income Received	183,234	424,137
Securities Lending Expenses Paid	(168,703)	(400,182)
Proceeds from Sales and Maturities of Investments	129,058,733	177,648,016
Purchase of Investments	(132,599,374)	(183,034,903)
Interest Paid to the Academic Scholars Fund	(264,826)	(320,880)
NET CASH PROVIDED BY INVESTING ACTIVITIES	5,120,455	3,691,714
NET INCREASE/DECREASE IN CASH	0	0
CASH AT JULY 1	0	0
CASH AT JUNE 30	$ 0	$ 0

NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES:

At June 30, 1997, the Chairs of Excellence Trust had no unsettled investment purchases or unsettled investment sales. At June 30, 1996, the Chairs of Excellence Trust had no unsettled investment purchases and unsettled investment sales of $4,866,844.

See accompanying Notes to the Financial Statements.

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997 AND JUNE 30, 1996

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 nonexpendable trust fund in the Tennessee Comprehensive Annual Financial Report.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The COE Trust follows all applicable GASB pronouncements as well as applicable private-sector pronouncements issued on or before November 30, 1989. The financial statements have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

3. Cash

Cash and cash equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. In addition, under the policy, short-term securities otherwise defined as cash equivalents, that are in portfolios where the primary purpose is to facilitate the placement of funds in long-term investments, are classified as investments.

Cash received by the COE Trust that cannot be immediately invested in securities is invested in the Pooled Investment Fund administered by the State Treasurer. The Pooled Investment Fund 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned to brokers for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The pool's custodial credit risk is presented in the Tennessee Comprehensive Annual Financial Report for the years ended June 30, 1997, and June 30, 1996.

4. Change in Accounting Principle

Effective July 1, 1996, the COE Trust adopted Statement Number 28 of the Governmental Accounting Standards Board, Accounting and Financial Reporting for Securities Lending Transactions. GASB Statement Number 28 requires that securities loaned and cash collateral, as well as investments made with cash collateral, be reported as assets on the balance sheet with a corresponding liability for the collateral received. In addition, the statement requires that the costs of securities lending transactions be reported on the statement of revenues, expenses, and changes in fund balance. The Balance Sheet as of June 30, 1996 and the Statement of Revenues, Expenses and Changes in Fund Balance for the period of July 1, 1995 through June 30, 1996 have been restated under the provisions of GASB Statement Number 28 for comparative purposes. There is no effect on net assets or on net investment income resulting from the restatement.

5. Method Used to Value Investments

Equity securities are reported at cost subject to adjustment for market declines judged to be other than temporary. Fixed-income securities are reported at amortized cost with discounts or premiums amortized using the effective interest rate method, subject to adjustment for market declines judged to be other than temporary. Investment income is recognized as earned. Gains and losses on sales and exchanges of fixed income and equity securities are recognized on the transaction date.

6. Fund Balance

The Endowment Reserve includes funds provided by contributions from the state, colleges and universities and private sources, as well as gains and losses from fixed income and equity investments. The income from both fixed and equity investments that is not used to meet current needs is distributed to the Special Reserve. At the discretion of the Board of Trustees of the COE Trust, the Special Reserve may be used for future nonrecurring expenses or to supplement corpus or income.

(Continued)

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997 AND JUNE 30, 1996

B. INVESTMENTS

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 equity corpus to the fixed income corpus but not from the fixed income corpus to the equity corpus.

The classification of Short-term Investments includes funds invested in a portfolio of short-term investments maintained by the Tennessee Consolidated Retirement System. These short-term investments may include U.S. Treasury obligations, commercial paper, medium-term corporate notes, promissory notes and repurchase agreements.

The COE Trust investment securities in the following chart are categorized according to the level of custodial credit risk associated with the custodial arrangements at year-end. Category 1 includes investments that are insured or registered, or for which securities are held by the COE Trust or its agent in the name of the COE Trust. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the name of the COE Trust. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent but not in the name of the COE Trust.

	June 30, 1997		June 30, 1996	
	Book Value	Fair Value	Book Value	Fair Value
Investments - Category 1:				
Short-term Investments:				
Commercial Paper	$ 10,339,976	$ 10,339,976	$ 9,699,519	$ 9,699,519
Long-term Investments:				
Domestic Securities:				
Government Bonds	57,151,246	58,102,265	49,375,945	49,815,708
Corporate Bonds	22,460,526	22,176,880	39,183,421	39,156,613
Corporate Stock	60,878,509	86,075,783	33,241,714	41,335,875
International Securities:				
Corporate Bonds	5,675,599	5,660,710	5,814,360	5,771,219
Corporate Stock	897,694	1,277,500	940,900	1,263,750
	157,403,550	183,633,114	138,255,859	147,042,684
Investments - Category 2	0	0	0	0
Investments - Category 3				
Short-term securities lending collateral investments held by custodian bank	0	0	6,347,510	6,347,510
Investments - Not Categorized:				
Investments held by broker-dealers under securities on loan contracts:				
Domestic Securities				
Government Bonds	0	0	5,031,108	5,003,900
Corporate Bonds	0	0	349,395	343,315
Corporate Stock	0	0	420,067	840,510
Total Investments and Invested Securities Lending Collateral	$ 157,403,550	$ 183,633,114	$ 150,403,939	$ 159,577,919

(Continued)

CHAIRS OF EXCELLENCE NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 1997 AND JUNE 30, 1996

The COE Trust is authorized by its investment policy, as adopted by the Board of Trustees of the COE Trust, to enter into collateralized securities lending agreements whereby the Trust loans its debt and equity securities for a fee to a select few of the highest quality securities firms and banks. Loans must be limited so the total amount on loan does not exceed 30 percent of the Trust's assets. The Trust's custodian bank manages the lending program and maintains collateral on behalf of the COE Trust. The borrower may deliver collateral to the lending agent in the form of cash or bonds, notes, and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies or by the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Student Loan Marketing Association and other United States government sponsored corporations or enterprises. Cash received as collateral may be reinvested by the lending agent in accordance with the investment policy, as further restricted under the COE securities lending agreement. Collateral securities cannot be pledged or sold unless the borrower defaults.

The loaned securities are initially collateralized at 102 percent of their fair value for domestic securities and 105 percent for international. Collateral is marked-to-market daily and additional collateral is pledged by the borrower if the fair value of the collateral subsequently falls below 100 percent for domestic securities and 105 percent for international. Although there is no specific policy for matching the maturities of collateral investments and the securities loans, the securities on loan can be terminated on demand by either the COE Trust or the borrower.

As of June 30, 1997, the COE Trust had no securities on loan. The securities lending income, net of expenses, was $13,362 for the year ended June 30, 1997.

C. OTHER ACCOUNTING DISCLOSURES

1. **Chairs of Excellence Endowment Trust**
   The COE Trust is a nonexpendable trust fund authorized by the 94th General Assembly to further the cause of education in Tennessee. 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 Tennessee Board of Regents. 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.

   As of June 30, 1997, 95 Chairs have been established with matching contributions received totaling $53,194,206. This is an increase of 2 Chairs and $1,423,000 since June 30, 1996. Total contributions to the COE Trust totaled $97,194,206 as of June 30, 1997. This includes $44,000,000 from the State, $10,321,300 from Colleges and Universities, and $42,872,906 from private contributions.

2. Funds from the Academic Scholars Fund are combined with the COE Trust for investment purposes only. The Academic Scholars Fund general account receives only the income earned on its principal and does not receive any COE Trust state contributions or appropriations. These funds are invested in fixed income securities.

BOND REFUNDING
INDEPENDENT AUDITOR'S REPORT

STATE OF TENNESSEE

COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 741-3697

December 17, 1997

The Honorable W. R. Snodgrass
Comptroller of the Treasury
State Capitol Building
Nashville, Tennessee 37243

Dear Mr. Snodgrass:

We have audited the accompanying balance sheets of the Bond Refunding Trust as of June 30, 1997, and June 30, 1996, and the related statement of changes in assets and liabilities for the year ended June 30, 1997. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bond Refunding Trust as of June 30, 1997, and June 30, 1996, and the changes in assets and liabilities for the year ended June 30, 1997, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 1997, on our consideration of the Bond Refunding Trust's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr.

Arthur A. Hayes Jr., CPA
Director, Division of State Audit

Bond Refunding
Comparative Balance Sheets
June 30, 1997 and June 30, 1996

	June 30, 1997	June 30, 1996
ASSETS		
Cash	$ 621	$ 109,212
Investments (amortized cost)	80,863,961	81,346,459
Accrued Interest Receivable	49,292	71,233
Total Assets	$ 80,913,874	$ 81,526,904
LIABILITIES		
Amounts Held in Custody for Others	$ 80,913,874	$ 81,526,904

See accompanying Notes to the Financial Statements.

Bond Refunding
Statement of Changes in Assets and Liabilities
For the Year Ended June 30, 1997

	Balance July 1, 1996	Additions	Deductions	Balance June 30, 1997
ASSETS				
Cash	$ 109,212	$154,994,562	$155,103,153	$ 621
Investments	81,346,459	78,558,196	79,040,694	80,863,961
Accrued Interest Receivable	71,233	49,292	71,233	49,292
Total Assets	$ 81,526,904	$233,602,050	$234,215,080	$ 80,913,874
LIABILITIES				
Amounts Held in Custody for Others	$ 81,526,904	$ 75,202,890	$ 75,815,920	$ 80,913,874

See accompanying Notes to the Financial Statements.

BOND REFUNDING
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1997 AND JUNE 30, 1996

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Bond Refunding Fund forms an integral part of the primary government and has been included as an agency fund in the Tennessee Comprehensive Annual Financial Report.

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The agency fund is custodial in nature and does not measure results of operations or have a measurement focus.

B. CASH

Cash held by the trustee is pooled with the Pooled Investment Fund administered by the State Treasurer which is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee (Funding Board). The current resolution of the Funding 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The Pooled Investment Fund 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. The Pooled Investment Fund's custodial credit risk is presented in the Tennessee Comprehensive Annual Financial Report for the years ended June 30, 1997 and June 30, 1996.

C. INVESTMENTS

The investments held by the trustee at year-end are shown below. The trust is restricted by the Tennessee Local Development Authority's, the Tennessee State School Bond Authority's and the Funding Board's Bond Resolutions to investing in direct general obligations of, or obligations the payment of the principal and interest of which are unconditionally guaranteed by, the United States of America, which are non-callable at the option of the issuer. All securities are held in the state's account with the Federal Reserve Bank.

U.S. Government Securities	
Carrying Amount	**Fair Value**
$80,863,962	$78,890,588

D. OTHER ACCOUNTING DISCLOSURES

The State Treasurer has been designated as a trustee for the Tennessee Local Development Authority, the Tennessee State School Bond Authority and for the Funding Board pursuant to various refunding trust agreements. Refunding bonds are issued to take advantage of lower interest rates and the proceeds resulting from the advance refundings are held by the trustee in an irrevocable trust to provide for the debt service payments and call premiums at the redemption dates. In 1987, an irrevocable trust was established to provide for the payment of the remaining outstanding State Loan Program revenue bonds issued in 1985 to refinance loans to Johnson City, Tennessee. In February, 1996, the Funding Board issued refunding bonds of $190,965,000 to refund: (1) $26,385,000 of the General Purpose bonds dated August 1, 1980 maturing on and after March 1, 1997, (2) $98,000,000 of the General Purpose bonds dated May 1, 1986 maturing on and after April 1, 1997, (3) $23,000,000 of the General Purpose bonds dated June 15, 1989 maturing on and after June 1, 2000 and (4) $50,000,000 of the General Purpose bonds dated June 15, 1991 maturing on and after June 1, 2002.

In March 1996, the 1980 refunded bonds were redeemed and in April 1996, the 1986 refunded bonds were redeemed. The 1989 refunded bonds will be redeemed in June 1999 and the 1991 refunded bonds will be redeemed in June 2001.

In September, 1996, the Tennessee State School Bond Authority authorized the issuance of 1996 Series A Higher Educational Facilities Bonds for the purpose of refunding notes issued for various projects and in October, 1996, an irrevocable trust was established for the refunding. The refunded notes were redeemed in November, 1996.

Treasury Department; December 1997; Authorization No. 309084; 500 copies. This public document was printed at a cost of $8.28 per copy.