STATE OF TENNESSEE

TREASURER'S REPORT

Fiscal Year Ended June 30, 2013

David H. Lillard, Jr. , State Treasurer

2013
Treasurer's Report

David H. Lillard, Jr., Treasurer
State of Tennessee

Prepared by:

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The cover and divider pages within this report feature the beautiful scenery found throughout the Great Smoky Mountains in Gatlinburg, Tennessee.

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This report is available in its entirety on the Internet at:
http://treasury.tn.gov/TreasurersAnnualReport_2013.pdf

Treasury Department, June 2014, Authorization #309208.
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LETTER OF TRANSMITTAL

STATE OF TENNESSEE

TREASURY DEPARTMENT
STATE CAPITOL
NASHVILLE, TENNESSEE 37243-0225

March 27, 2014

The Honorable Bill Haslam, Governor
The Honorable Ron Ramsey, Speaker of the Senate
The Honorable Beth Harwell, Speaker of the House of Representatives
Members of the General Assembly
Citizens of the State of Tennessee

Ladies and Gentlemen:

It is my honor to present the annual report of the Treasurer's Office for the fiscal year ended June 30, 2013, pursuant to the requirements of Section 4-4-114, Tennessee Code Annotated.

With your continued support and the outstanding employees in the Treasury Department, we have made tremendous advancements and continue to build on our existing structures to better serve the citizens of Tennessee. On the following pages, you will find more information on the activities and accomplishments of our programs.

For your convenience, the Treasurer's Report, other publications and press are located on our website at www.tn.gov/treasury. Again, thank you for your service to our State and her people.

Sincerely,

David H. Lillard, Jr.
Tennessee State Treasurer

MISSION OF THE TREASURY DEPARTMENT

Vision Statement

To be faithful stewards of the state's financial and human resources. To be passionate about achieving our mission and living by our core values.

Mission Statement

We will be a leader by providing exceptional service to our customers honestly, efficiently, and effectively.

Treasury Team Commitment

In order for us to provide exceptional service, both management and employees will foster an environment that respects, challenges, motivates, and rewards each team member. Each of us has a responsibility to develop and maintain this environment so that, together, we can achieve our mission and live by our core values.

Department Core Values

Impeccable Honesty: We will develop relationships and interact with one another and with our customers in a manner that fosters and encourages trust. We will maintain the highest ethical and professional standards in everything that we do.

Mutual Respect: We will treat everyone equitably and with honor. We will communicate in a manner that promotes open dialogue with our customers, within the department, and with our peers in state government.

Continuous Improvement: We will continually challenge ourselves to improve the level of service that we provide by being innovative, collaborative, creative, and efficient. We will work to be the best at what we do.

Shared Accountability: We will work as a team and will purposely strive to leverage the strengths and overcome the weaknesses of each team member. We will accept responsibility individually and collectively for the service that we provide to our customers.

Exceptional Service: We will be innovative in how we provide services to our customers and in how we do our work. We will be relentless in our pursuit of quality and excellence in everything that we do. We will focus not only on solving customers' problems, but also anticipating their needs.

Exemplary Leadership: We will be visionary leaders and positive role models for our peers. We strive to be highly respected both inside and outside state government.

EXECUTIVE SUMMARY

Introduction

The 2013 Treasurer's Report contains reports on various programs administered by the Treasury Department. The following comments represent a brief statement of the purpose and operations of programs administered by the department. The remainder of this report gives detailed data regarding the activities of these programs during the 2013 fiscal year.

Baccalaureate Education System Trust (BEST) and TNStars™

The Baccalaureate Education System Trust (BEST) is a Section 529 qualified tuition program that allows anyone to save for higher education cost in advance on behalf of a beneficiary. The current program open to participants for enrollment, the TNStars™ College Savings 529 Program (educational savings plan or savings plan), launched on September 18, 2012. The plan features smart and flexible investment options and, as a 529 plan, withdrawals for future qualified higher education expenses are tax free. The savings plan offers an aged-based option, where the allocation becomes more conservative as the beneficiary approaches college, 14 self-selected investment options, as well as fixed income and FDIC insured options. TNStars™ consistently offers financial incentives to Tennessee residents for enrolling in the plan, rolling over funds from other 529 plans, setting up automatic deposits and for saving for babies in their first year. TNStars™ offers the products at a competitive fee, currently 0.35 basis points for all investment options except the FDIC insured option for which there is no fee. At June 30 2013, the savings plan held net position totaling $6.7 million.

Certified Public Administrator

The University of Tennessee Institute for Public Service administers the "County Official's Certificate Training Program Act." Certain full-time county officers are eligible for an educational incentive payment if the officers have completed the continuing education requirements of the program. The UT Institute for Public Service is required to provide the Treasurer's office a listing of those officers who have successfully completed all levels of the County Officials Certificate Training Program.

Chairs of Excellence

The Chairs of Excellence Trust is a permanent trust fund authorized in 1984 to further the cause of higher 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. Since 1984, a total of 99 chairs have been created. The fair market value of the assets of the 99 chairs totaled $261.8 million at June 30, 2013. Since the inception of the program, $306.2 million of investment income has been generated. $162.3 million has been spent by the 99 chairs.

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 4,899 claims for tort, employee property damage and workers' compensation. Payments made during the year for workers' compensation, tort and employee property damage claims totaled $30.4 million. The division received 4,921 criminal injury, drunk driver and sexual assault forensic exam claims. Payments made totaled $13.3 million. Since the first payments were issued in 1982, more than $254.3 million has been paid to crime victims.

EXECUTIVE SUMMARY

CLAIMS COMMISSION

The Tennessee Claims Commission is an administrative tribunal created to determine monetary claims against the State of Tennessee. There are three commissioners, one from each grand division of the state. At June 30, 2013, the commission had 611 open claims.

DEFERRED COMPENSATION PROGRAM

The State of Tennessee Deferred Compensation Program offers state employees the opportunity to accumulate supplemental retirement income on a tax-advantaged basis. Participants may direct the investment of their deferred salary into a variety of investment products contracted for the program. During the fiscal year, the state, the University of Tennessee and Board of Regents each matched their employees' contributions to the 401 (k) plan at $50 per month. As of June 30, 2013, a total of 82,804 state and higher education employee accounts were held in the program. The market value of accumulated account balances totaled $1.81 billion.

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. At June 30, 2013, state employees utilized the plan in the following manner: 36,900 paid group medical premiums, 28,309 paid group dental premiums, 4,330 used the medical expense reimbursement account and 397 used the dependent care reimbursement account. In addition, 206 and 70 state employees utilized the parking and transportation reimbursement accounts, respectively.

INVESTMENTS

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

State Cash Management - This division 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. During 2013, investments averaged $8.5 billion, producing $14.0 million in income for an average rate of return of .18%.

Pension Fund Investments - This division manages the investments of the Tennessee Consolidated Retirement System (TCRS) which, at June 30, 2013, totaled $37.6 billion at fair market value. For the year, investment income of $3.3 billion was recognized, for a rate of return of 9.9% on a fair value basis. The Investment Division also manages investments for the Chairs of Excellence Trust and the Baccalaureate Education System Trust (Prepaid) which, at June 30, 2013, had market values of $261.8 million and $87.8 million, respectively.

OPTIONAL RETIREMENT PLAN

The Optional Retirement Plan is a defined contribution plan. Investments are participant directed selected from options offered through the plan service providers using bundled contracts. Contributions to ORP for the year ended June 30, 2013 were $95.6 million and ORP assets were $2.87 billion. There were 10,915 ORP participants at June 30, 2013.

EXECUTIVE SUMMARY

Risk Management

The Division of Risk Management is responsible for identifying the state's exposure to property and casualty risks and determining the appropriate risk control methods to protect the state against monetary loss due to unforeseen events. The division administers the state's property and casualty insurance program, including the procurement of all-risk, replacement cost property insurance for all state-owned buildings and contents, cyber liability insurance, fine arts insurance to protect all types of valuable artwork and items of antiquity, boiler insurance and inspection services for all state-owned boiler objects, fidelity and crime coverage to protect against employee dishonesty, and aviation insurance for the state's aircraft. The state procures its insurance with the aid of a qualified property and/or casualty insurance broker. Loss prevention and control services are also provided for workers' compensation and tort liability. As of July 1, 2013, the state's total insured property values were $19.2 billion.

Small and Minority-Owned Business Assistance Program

The Small and Minority-Owned Business Assistance Program is responsible for supporting outreach to new, expanding and existing businesses unable to derive benefit from conventional means of monetary resources and insight provided by traditional lenders and financial advisors. The program consists of two components: loans and program services. The loans provided must be for a specific project; however, acceptable purposes for loan proceeds can include acquisition of machinery and equipment, working capital, supplies and materials, inventory and certain other business-related activity. Program services include technical assistance, education and consulting services to facilitate support in the areas of strategy, planning and financial management. These program components are deemed essential resources that will enable and enhance growth of the State's small business segment. The principle function of the Small and Minority-Owned Business Assistance Program is to provide a significant statewide platform through a support structure that fosters the expansion of small and minority-owned businesses.

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, 2013, there were 209,567 active TCRS members: 41,856 state employees, 73,306 K-12 teachers, 77,815 political subdivision employees and 16,590 higher education employees. As of June 30, 2013, there were 127,918 retirees. TCRS paid $1.92 billion in benefits during fiscal year 2013. 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.

Unclaimed Property Division

The Unclaimed Property Division administers 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 checking accounts, savings accounts, insurance policies, utility deposits and securities. During the fiscal year, $99.7 million of unclaimed property was collected, which consisted of $92.0 million that was remitted to Treasury and $7.7 million in the sale of securities. In addition, $27.7 million was returned to owners or their heirs, local governments and other states. Since the program's inception in 1979, $912.3 million in unclaimed property has been reported to the Treasury and $294.6 million of that property has been returned to claimants.

TREASURY NUMBERS AT A GLANCE FISCAL YEAR 2013

ADMINISTRATIVE	Number of Filled Positions		235
	Payroll Expenditures	$	18,511,800
	Other Expenditures	$	7,010,900
	Total Operating Expenditures	$	25,522,700
CASH MANAGEMENT PROGRAM	General Fund Earnings	$	4,152,556
	LGIP Earnings	$	6,013,625
	Restricted Fund Earnings	$	3,847,506
	Total Cash Management Earnings	$	14,013,687
RETIREMENT PROGRAM	Retirement Benefits Paid During 2013	$	1,923,742,420
	Number of Retirees		127,918
	Number of Active Members		209,567
	Retirement Contributions Received	$	1,278,982,124
	Retirement Net Investment Income	$	3,344,589,259
CLAIMS ADMINISTRATION PROGRAM	Workers' Compensation Payments	$	25,155,334
	Workers' Compensation Claims Filed		3,078
	Employee Property Damage Payments	$	22,391
	Employee Property Damage Claims Filed		94
	Tort Payments	$	5,269,740
	Tort Claims Filed		1,616
	Criminal Injury Fund Payments	$	13,347,791
	Criminal Injury Fund Claims Filed		4,921
RISK MANAGEMENT PROGRAM	Estimated Gross Property Losses Incurred	$	2,714,648
	Total Property Values Insured	$	19,216,119,100
CHAIRS OF EXCELLENCE PROGRAM	Chairs of Excellence Investment Income	$	23,379,827
	Chairs of Excellence Expenditures	$	7,339,539
	Number of Chairs of Excellence		99
OTHER PROGRAMS	Deferred Compensation Contributions	$	153,015,924
	Deferred Compensation Accounts		82,804
	Aggregate Deferred Compensation Balances	$	1,815,163,431
	Flexible Benefits Plan Payments	$	7,058,474
	Unclaimed Property Revenues	$	99,688,998
	Unclaimed Property Payments	$	27,694,701
	BEST Prepaid Accounts		8,674
	Optional Retirement Plan Contributions	$	95,665,002
	Optional Retirement Plan Participants		10,915
FAIR VALUE OF ASSETS UNDER MANAGEMENT AT JUNE 30, 2013	Retirement Trust Fund	$	37,564,905,362
	Chairs of Excellence Trust Fund	$	261,807,326
	State Pooled Investment Fund	$	8,949,499,123
	Deferred Compensation (outside managers)	$	1,815,163,431
	Optional Retirement Plan Assets (outside managers)	$	2,878,985,978
	BEST Educational Services Plan	$	87,772,586
	TNStars College Savings Program	$	6,714,010
	Total Assets Under Management	$	51,564,847,816

EMPLOYEE BENEFITS

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, is a retirement system for state employees, higher education employees, teachers and local government employees.

Membership

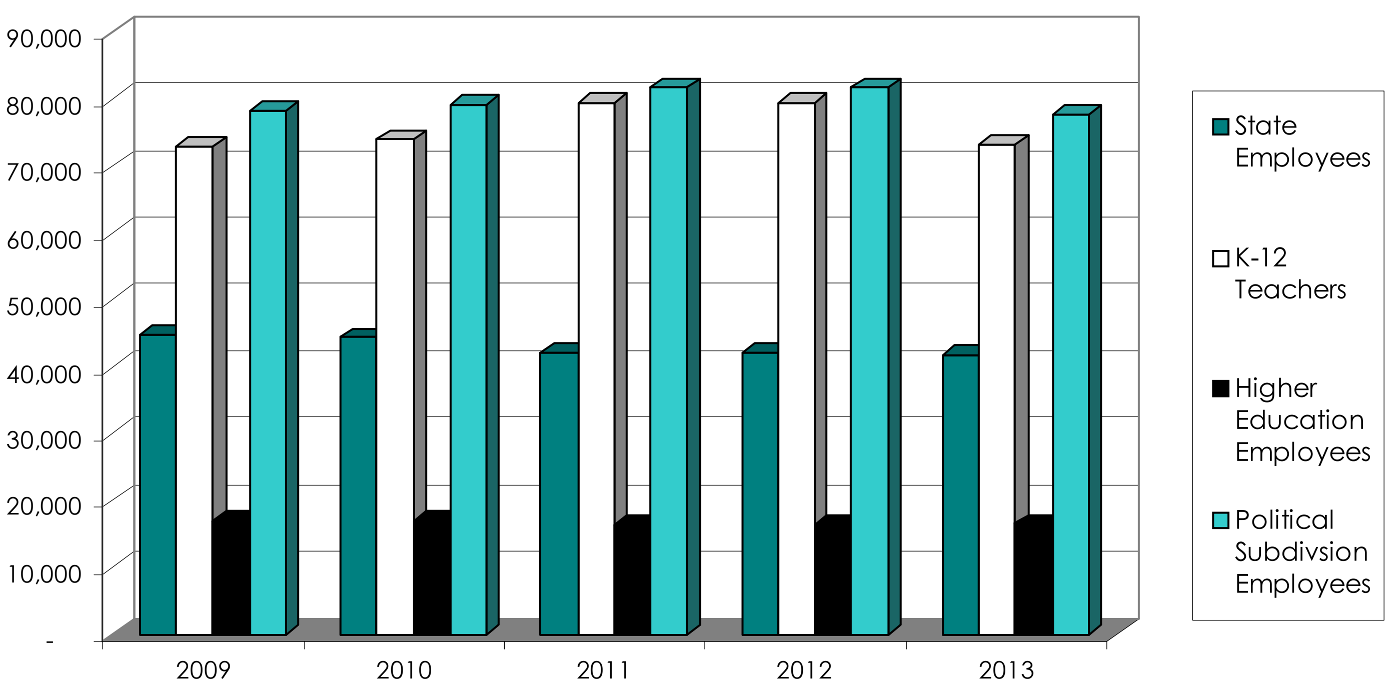
Membership in the retirement system is a condition of employment for full-time state employees, teachers, general employees in higher education and the employees of local governments that participate in TCRS. Membership is optional for certain part-time employees. Faculty employees in higher education 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. An employee joining TCRS 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, 2013, there were 209,567 active members of TCRS and 10,915 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 2009-2013



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.

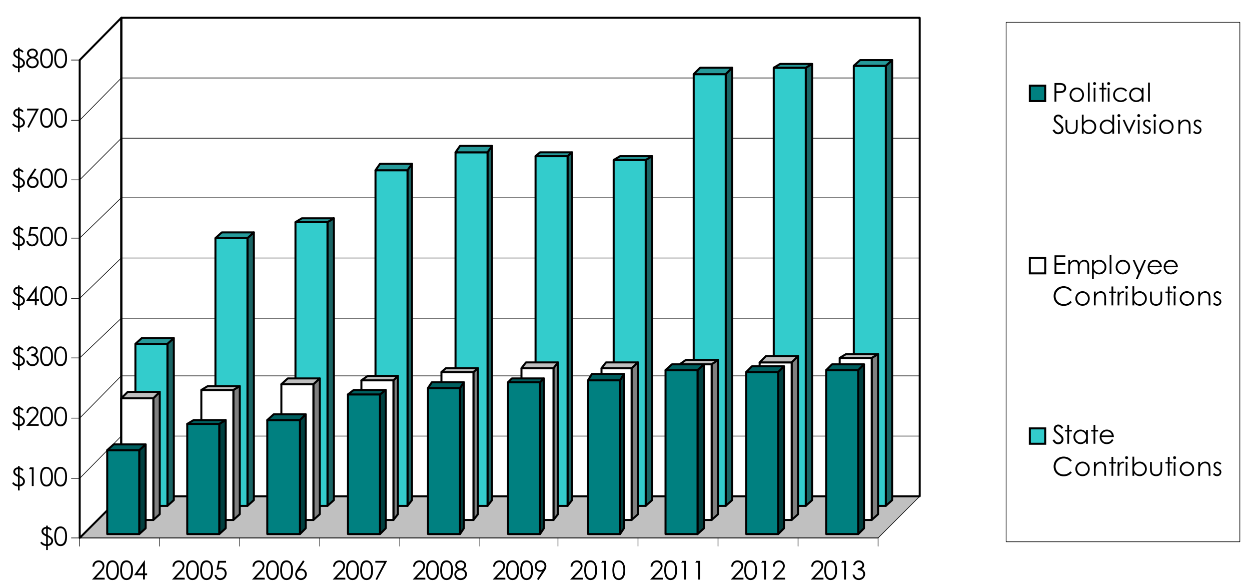
Upon termination of employment, a member may elect to withdraw his contributions and accumulated interest from the retirement system in a lump sum. By obtaining a lump sum refund, a member waives all rights and benefits in the retirement system. A vested member may leave his account balance in TCRS and 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 2013 fiscal year, 4,122 refunds totaling $39.5 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, 2013 were as follows:

• Noncontributory State and Higher Education Employees	15.03%
• K-12 Teachers	8.88%
• Political Subdivisions Individually-Determined	
• Faculty Members Electing to Participate in the ORP	10.0%*

*11% for salary above the Social Security wage base.

RETIREMENT CONTRIBUTIONS
FISCAL YEARS 2004-2013
EXPRESSED 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, 2013, 127,918 retirees were receiving monthly benefit payments. This represents a 4.4% increase over the previous 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.

A Group I benefits calculator is available on the program's Internet site: tcrs.tn.gov.

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 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 (COLA) 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% nor be less than 1%.

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

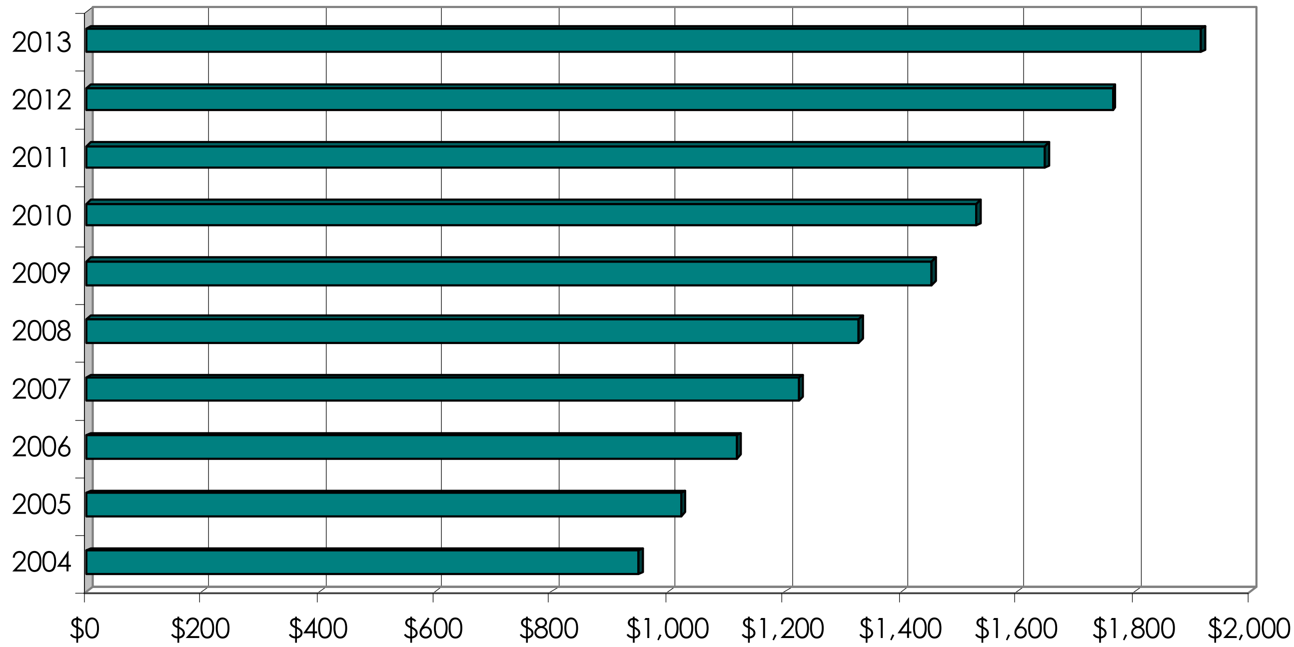
Benefits paid in fiscal year 2013 totaled $1.92 billion, an increase of $160 million over 2012 benefit payments.

During 2013, legislation was enacted creating a Hybrid pension plan for state employees and teachers hired on or after July 1, 2014. The new plan contains both a defined benefit (TCRS) and a defined contribution (401k) component. Key elements of the Hybrid plan include increasing the eligibility for retirement, requiring employee contributions, requiring employer contributions to the 401k component on behalf of the employee and controls to manage employer cost and unfunded liability. Disability benefits, death benefits and COLA will continue to be available in the new plan.

Local governments can choose any of the plans offered to state employees and teachers while customizing certain options specifically for its employees. In addition, during 2012, new plan choices were enacted specifically for local governments. For more information on all of the plans offered by TCRS, please go to the TCRS website at www.treasury.tn.gov/tcrs.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

Annual Benefit Payments
Fiscal Years 2004-2013
Expressed in Millions



TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

Tennessee's Retirement Program, TCRS and Social Security Benefits *for Calendar Year 2013*

Five-Year AFC*	Projected Annual Retirement Income	15 Years Service	% of AFC	20 Years Service	% of AFC	25 Years Service	% of AFC	30 Years Service	% of AFC	35 Years Service	% of AFC
$15,000	TCRS	$ 3,544		$ 4,725		$ 5,906		$ 7,088		$ 8,269	
	Social Security	9,840		9,840		9,840		9,840		9,840	
	Total	$13,384	89.2%	$14,565	97.1%	$15,746	105.0%	$16,928	112.9%	$18,109	120.7%
$20,000	TCRS	$ 4,725		$ 6,300		$ 7,875		$ 9,450		$11,025	
	Social Security	11,388		11,388		11,388		11,388		11,388	
	Total	$16,113	80.6%	$17,688	88.4%	$19,263	96.3%	$20,838	104.2%	$22,413	112.1%
$25,000	TCRS	$ 5,906		$ 7,875		$ 9,844		$11,813		$13,781	
	Social Security	12,936		12,936		12,936		12,936		12,936	
	Total	$18,842	75.4%	$20,811	83.2%	$22,780	91.1%	$24,749	99.0%	$26,717	106.9%
$30,000	TCRS	$ 7,088		$ 9,450		$11,813		$14,175		$16,538	
	Social Security	14,472		14,472		14,472		14,472		14,472	
	Total	$21,560	71.9%	$23,922	79.7%	$26,285	87.6%	$28,647	95.5%	$31,010	103.4%
$35,000	TCRS	$ 8,269		$11,025		$13,781		$16,538		$19,294	
	Social Security	16,020		16,020		16,020		16,020		16,020	
	Total	$24,289	69.4%	$27,045	77.3%	$29,801	85.1%	$32,558	93.0%	$35,314	100.9%
$40,000	TCRS	$ 9,450		$12,600		$15,750		$18,900		$22,050	
	Social Security	17,568		17,568		17,568		17,568		17,568	
	Total	$27,018	67.5%	$30,168	75.4%	$33,318	83.3%	$36,468	91.2%	$39,618	99.0%
$45,000	TCRS	$10,631		$14,175		$17,719		$21,263		$24,806	
	Social Security	19,116		19,116		19,116		19,116		19,116	
	Total	$29,747	66.1%	$33,291	74.0%	$36,835	81.9%	$40,379	89.7%	$43,922	97.6%
$50,000	TCRS	$11,813		$15,750		$19,688		$23,625		$27,563	
	Social Security	20,664		20,664		20,664		20,664		20,664	
	Total	$32,477	65.0%	$36,414	72.8%	$40,352	80.7%	$44,289	88.6%	$48,227	96.5%
$55,000	TCRS	$12,994		$17,325		$21,656		$25,988		$30,319	
	Social Security	22,212		22,212		22,212		22,212		22,212	
	Total	$35,206	64.0%	$39,537	71.9%	$43,868	79.8%	$48,200	87.6%	$52,531	95.5%
$60,000	TCRS	$14,175		$18,900		$23,625		$28,350		$33,075	
	Social Security	23,100		23,100		23,100		23,100		23,100	
	Total	$37,275	62.1%	$42,000	70.0%	$46,725	77.9%	$51,450	85.8%	$56,175	93.6%
$65,000	TCRS	$15,364		$20,486		$25,607		$30,728		$35,850	
	Social Security	23,820		23,820		23,820		23,820		23,820	
	Total	$39,184	60.3%	$44,306	68.2%	$49,427	76.0%	$54,548	83.9%	$59,670	91.8%
$70,000	TCRS	$16,742		$22,323		$27,904		$33,485		$39,065	
	Social Security	24,552		24,552		24,552		24,552		24,552	
	Total	$41,294	59.0%	$46,875	67.0%	$52,456	74.9%	$58,037	82.9%	$63,617	90.9%

* Average Final Compensation (AFC) is the average of the member's five highest consecutive years of salary.

This chart is based on a date of retirement in 2013. Social Security benefits have been calculated by Bryan, Pendleton, Swats & McAllister, actuarial consultants for the TCRS, utilizing the following assumptions:

(1) Retirement is taking place at age 65 in 2013;
(2) The retiree has worked a full career (TCRS plus other employers, if necessary) of 35 years or more; and
(3) Salary increases throughout the retiree's career have followed the same pattern as National Average Earnings.

The department's Internet benefits calculator allows members to receive an immediate estimate: tcrs.tn.gov

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 valuation was performed July 1, 2011 to establish the employer contribution rates effective July 1, 2012 through June 30, 2013. The system's unfunded accrued liability at July 1, 2013 was $2.66 billion. The state and teacher accrued liability is being amortized over an eight- and 13-year period, respectively. The amortization period for local governments varies by entity. A valuation was performed as of July 1, 2013 to establish new employer contribution rates effective July 1, 2014.

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 July 1, 2011 actuarial valuation of the plan:

Economic Assumptions

(1) 7.5% annual return on investments

(2) Graded salary scale reflecting plan experience

(3) 3.5% 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

(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

Participation as of June 30, 2013:

Cities	177
Counties	88
Utility Districts	68
Special School Districts	19
Joint Ventures	21
Housing Authorities	11
911 Emergency Communication Districts	47
Miscellaneous Authorities	56
Total	487

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

1972 Benefit formula improved from 1.12 percent of salary up to the SSIL to 1.5 percent of salary up to the SSIL.

1973 Annual cost-of-living increase based on the CPI with a cap of 1.5 percent adopted for retirees.

1974 Disability retirement eligibility requirement reduced from 10 years to 5 years of service.

Maximum annual cost-of-living increase raised to 3 percent.

Provision to increase retirees' benefits whenever the benefit formula is improved.

Service credit authorized for unused accumulated sick leave.

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

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

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

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

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

1981 Noncontributory retirement for state employees and higher education employees adopted. Employees' contributions, up to 5 percent, were assumed by the state.

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

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

Retirement credit for armed conflict approved.

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

1985 $22 million ad-hoc increase granted to retirees.

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

$17 million ad-hoc increase granted to retirees.

Retirement incentive for state employees.

Section 414(h) of the IRC adopted, allowing employee contributions to be made on a tax-deferred basis.

1990 Retirement incentive for state employees.

1991 3.6 percent indexing of salaries for noncontributory employees extended one year. Each succeeding year up to 1997, the 3.6 percent indexing was extended. In 1997, it was extended indefinitely.

1992 Minimum number of years required to qualify for retirement was reduced from 10 to 5 years.

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

Benefit improvement up to 5 percent authorized.

1997 Compounded COLA for retirees approved.

1998 Group 2 and 3 service requirements amended to permit service retirement with 30 years of service, regardless of age.

Group 1 and Prior Class C benefit limitations increased to 80 percent.

Mandatory retirement established with supplemental bridge benefit for all state public safety officers.

1999 Group 1 benefit maximum increased to 90 percent.

2000 Group 2 benefit maximum increased to 80 percent.

2001 Line of Duty Death Benefits adopted to guarantee a minimum $50,000 death benefit.

2005 Return to work statutes were reformed, including a temporary employment increase to 120 days.

2006 Ad-hoc increase granted to members retired prior to 1989.

2007 Public Safety Officer benefits were enhanced.

2012 New plan options offered to local governments.

2013 Hybrid plan enacted for state employees and teachers hired after July 1, 2014.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

OPTIONAL RETIREMENT PLAN

The Optional Retirement Plan is a defined contribution plan. Investments are participant directed and selected from options offered through the plan service providers using bundled contracts. ORP plan investment management and administrative services are offered by third party administrators. Contributions to ORP for the year ended June 30, 2013 were $95.6 million and ORP assets were $2.87 billion. There were 10,915 ORP participants at June 30, 2013.

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 statewide 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. In January 1987, the Internal Revenue Service took over collection of State and local government employee FICA taxes. Prior to 1987, the State and local entities turned the money over to the State Administrator who then turned the collected taxes over to the Social Security Administration by depositing the funds in the nearest Federal Reserve Bank. 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.

DEFERRED COMPENSATION PROGRAM

Deferred Compensation Program

The Deferred Compensation Program is a voluntary program designed to provide state employees with the opportunity to accumulate supplemental retirement income on a tax advantaged basis. Participants may postpone income taxes on contributions and earnings by agreeing to defer receipt of a portion of their current income until retirement. The 401(k) Plan also offers employees a designated Roth 401(k) contribution option. The contributions are made after tax and the distributions are tax advantaged subject to timing restrictions.

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. In accordance with changes to Internal Revenue Code Section 457, the state's 457 plan was converted to a trust effective January 1, 1999.

As of June 30, 2013, accounts were held by 76,572 individuals in the 401(k) plan and 6,232 individuals in the 457 plan. At fiscal year end, 29,832 state employees, 9,604 University of Tennessee employees, 11,176 Tennessee Board of Regents, and 219 Local Government employees were actively contributing to the 401(k) plan and 2,311 state employees, 739 University of Tennessee employees, 427 Tennessee Board of Regents, and 16 Local Government employees were actively contributing to the 457 plan.

The program is used by state employees of all ages and salary levels. The majority of active contributors are under age 47 and earn below $42,000 per year.

IRS regulations for 2013 allow a maximum deferral in the 457 plan of 100% of compensation up to the maximum annual contribution of $17,500. The maximum deferral in the 401(k) plan is 100% of compensation up to the maximum annual contribution of $17,500. Participants who also use a 403(b) plan are subject to additional limits. Participants age 50 and older are eligible to make additional deferrals.

During the 2013 fiscal year, the state, the Tennessee Board of Regents and the University of Tennessee each matched their employees' contributions to the 401(k) plan at $50 per month as authorized by the General Assembly. The amount contributed by the state during the year was $28.6 million. Employees contributed $124.4 million.

Participants in the program at June 30, 2013 directed the investment of their deferred salary to the Nationwide Bank Account, Allianz NFJ Large Cap Institutional Fund, Calvert Income Fund, Columbia Acorn Z Fund, Columbia Midcap Value Z Fund, DFA International Value Fund, Fidelity Contra Fund, Fidelity International Discovery Fund, Fidelity OTC Portfolio Fund, Fidelity Puritan Fund, Fidelity Stock Selector Small Cap, Invesco Van Kampen Small Cap Value Fund, Vanguard Institutional Index Fund, Vanguard Total Bond Market Index, and the ING Fixed Account. A self directed brokerage account option provides access to additional mutual funds.

Enrollment and record keeping services for the program are provided by Great-West Retirement Services. The use of an unbundled arrangement enables participants to receive an objective presentation of the investment products, to avoid the sales fees traditionally associated with bundled products and to receive consolidated account statements and benefit estimates. All of the products available for new enrollment are offered without sales fees, surrender fees, mortality and expense risk fees or minimum deposit requirements.

Participants receive a quarterly statement showing their 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 handbook for participants, several booklets on special topics, investment seminars around the state, plus a voice response telephone system and an Internet account access system which provide participants with immediate access to account balances and account transactions 24 hours a day. Online statements are available upon request.

The Internet site, www.tn.gov/treasury/dc, provides full information about the program. Information available through the site includes forms, participation information and illustrations, descriptions of the investment choices and historical performance figures, an interactive benefit calculator, complete information for participants who may be approaching retirement age or considering withdrawing funds from the program, an e-mail address for participants

DEFERRED COMPENSATION PROGRAM

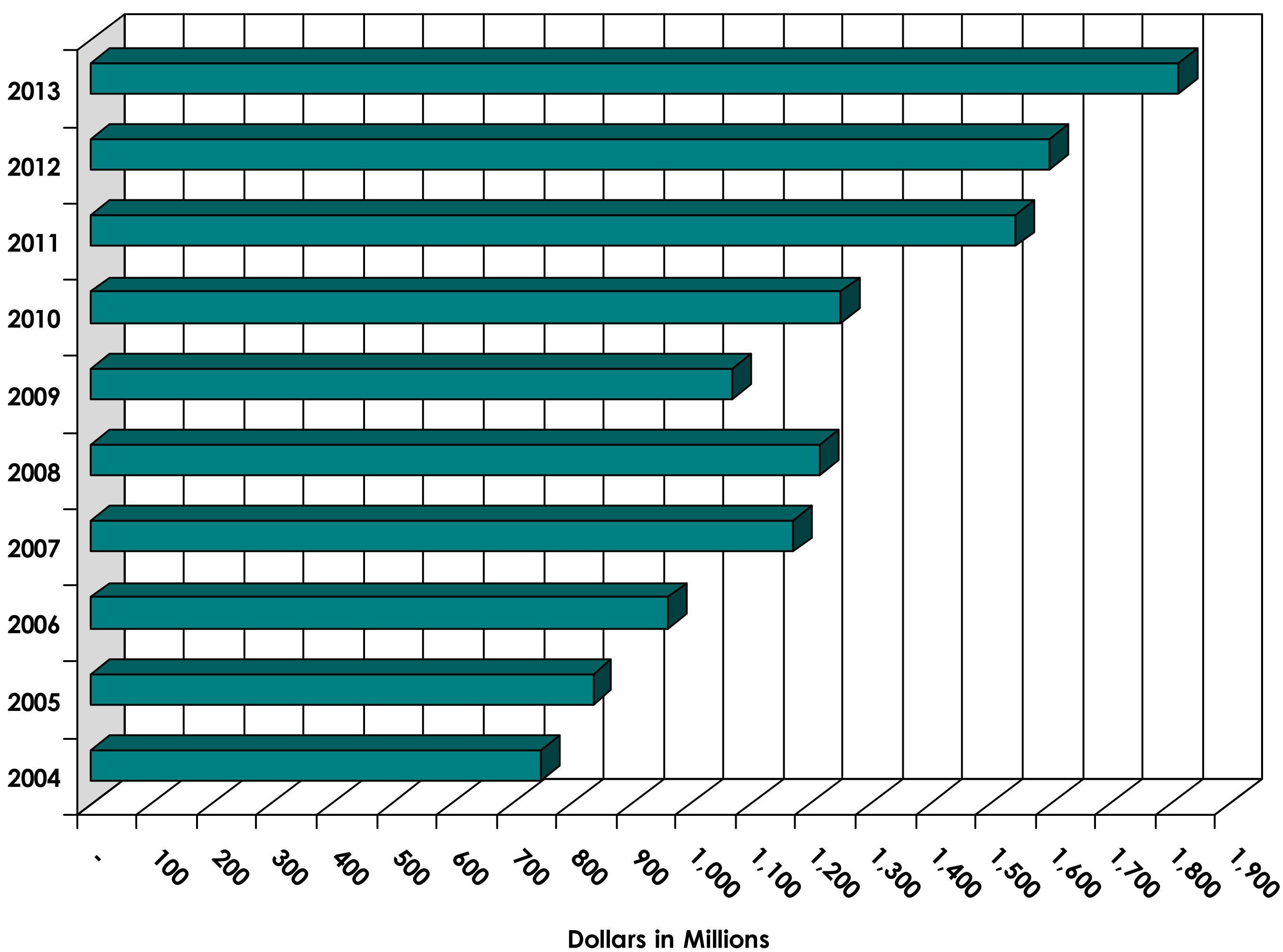
to request additional personalized information and full account activity access.

For the year ending June 30, 2013, contributions to the program totaled $153 million. Contributions are wired for immediate crediting. At June 30, 2013, accumulated account balances totaled $1.81 billion.

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, 2013, there were 10,335 loans outstanding from the 401(k) plan. Outstanding loan balances totaled $28.8 million.

Benefits from the program may be distributed in periodic payments, in an annuity or in a lump sum. During the year ended June 30, 2013, there were 9,037 periodic payments made from the program. Members may choose monthly, quarterly, semi-annual or annual payments. In addition, 6,888 lump-sum distributions and 7,701 partial lump-sum distributions were issued during fiscal year 2013.

Deferred Compensation Program Assets
Expressed in Millions
Fiscal Years 2004-2013



DEFERRED COMPENSATION PROGRAM

DEFERRED COMPENSATION CONTRIBUTIONS AND MARKET VALUE
FISCAL YEAR 2013

	Contributions FY 2012-2013	Market Value June 30, 2013
Plan I (457)		
ING	$ 3,325,136	$ 53,275,078
American General	5,549	371,293
Calvert	760,945	8,834,047
Fidelity	7,056,372	115,101,656
Nationwide	1,403,688	18,810,144
Vanguard	7,118,544	43,353,996
Dimenensional	435,380	2,677,084
TD Ameritrade SDB MM	0	12,298
TD Ameritrade SDB Securities Bal	0	295,928
	$ 20,105,614	$ 242,731,524
Plan II (401K)		
ING	$ 20,872,769	$ 272,530,263
Calvert	4,072,296	49,177,246
Fidelity	56,256,933	922,333,351
Nationwide	11,947,632	122,489,704
Vanguard	25,874,534	193,061,769
Dimensional	1,899,886	10,318,703
TD Ameritrade SDB MM	0	761,353
TD Ameritrade SDB Securities Bal	0	1,759,518
Loan Repayment	11,986,260	0
	$ 132,910,310	$ 1,572,431,907
Total for Both Plans	**$ 153,015,924**	**$ 1,815,163,431**

FLEXIBLE BENEFITS PLAN

Flexible Benefits Plan

The Flexible Benefits Plan is an optional benefit plan that 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. 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.

Effective January 1, 2009, the Flexible Benefits Plan offers employees the opportunity to open transportation and parking flexible benefits accounts as authorized by Section 132 of the Internal Revenue Code. These accounts benefit employees by allowing them to designate an amount, up to the established limitations, to be withheld from their paychecks as a pre-tax benefit. These deductions are exempt from Federal Income and Social Security taxes. Participation in this program will result in the employee having a lower tax obligation during each calendar year in which they participate.

Unlike medical and dependent care flexible benefits accounts, there is no requirement for new employees to enroll within 30 days of being hired and there is no annual enrollment period for existing employees. An employee may enroll in a transportation account and/or a parking account at any time during employment. Transportation and parking flexible benefits accounts can be terminated at any time by the employee.

At June 30, 2013, over 36,000 state employees were enrolled in one or more of the plan's four Section 125 options: 36,900 employees used the plan to pay medical insurance premiums, 28,309 paid dental insurance premiums, 4,330 used the medical expense reimbursement account and 397 used the dependent care reimbursement account. In addition, 206 and 70 state employees participated in the parking and transportation reimbursement accounts, respectively.

INVESTMENTS

TCRS INVESTMENTS

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, real estate, private equity 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 the investment policy for TCRS funds is subject to the approval of the Board of Trustees. From time to time, the TCRS Investment Division engages outside investment managers to manage a limited number of asset classes or subclasses. Pursuant to *Tennessee Code Annotated*, Section 8-37-114, in any such procurement, the Investment Division invites emerging investment managers to be among those entities providing proposals. During the fiscal year 2012-2013, no assets were under the control of emerging investment managers.

The Investment Advisory Council established in *Tennessee Code Annotated*, Section 8-37-108 provides 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.

To assist in the fiduciary responsibility for managing the TCRS portfolio, Strategic Investment Solutions, Inc. serves as the general investment consultant and strategic lending consultant for TCRS. The Townsend Group serves as the real estate investment consultant. Cambridge Associates serves as the private equity consultant to the fund.

Northern Trust Company is the Master Trust Bank for TCRS which provides safekeeping and accounting services for the investment portfolio.

Cost of Investment Operation

The administrative cost to operate the investment program for TCRS is less than four basis points (.04%) of assets. The cost of four basis points includes the cost of personnel, operational cost, master bank custodian cost and record keeping. Commission cost for trades are capitalized. Recent peer comparisons of investment management fees and expenses indicate the investment program is managed very cost effectively.

Performance Measurement

An independent external investment consultant, Strategic Investment Solutions, Inc., provides performance measurement for TCRS. During the 2013 fiscal year, TCRS had a total return of 9.92%. Domestic stocks gained 20.39%, while the S&P 1500 Index gained 21.13%. Domestic bonds lost 0.81% versus the bond benchmark of -2.79%. International stocks gained 17.90% versus a gain of 18.62% for the MSCI EAFE IMI Index. Real estate gained 10.11% versus 10.52% for the NCREIF index.

TCRS INVESTMENTS

INVESTMENT SUMMARY
AS OF JUNE 30, 2013

	Domestic		International		Total	
	Fair Value	%	Fair Value	%	Fair Value	%
Fixed Income						
Government Bonds	$ 4,485,532,613	12.02%	$ 0	0.00%	$ 4,485,532,613	12.02%
Corporate Bonds	3,807,693,944	10.20%	0	0.00%	3,807,693,944	10.20%
Municipal/Provincial Bonds	149,676,753	0.40%	0	0.00%	149,676,753	0.40%
Total Bonds	8,442,903,309	22.63%	0	0.00%	8,442,903,309	22.63%
Lehman Brothers Escrow Adjustment	3,656,250	0.01%	0	0.00%	3,656,250	0.01%
Asset Backed	638,468,285	1.71%	0	0.00%	638,468,285	1.71%
Commercial Mortgage Backed	398,696,159	1.07%	0	0.00%	398,696,159	1.07%
Government Agencies	201,384,222	0.54%	0	0.00%	201,384,222	0.54%
Government Mortgage Backed Securites	3,494,250,573	9.36%	0	0.00%	3,494,250,573	9.36%
Non-Government CMOs	160,647,845	0.43%	0	0.00%	160,647,845	0.43%
Preferred Stock	27,652,900	0.07%	32,268,505	0.09%	59,921,405	0.16%
Total Fixed Income	13,367,659,543	35.82%	32,268,505	0.09%	13,399,928,048	35.91%
Common Stock						
Consumer Discretionary	1,539,647,038	4.13%	870,515,483	2.33%	2,410,162,521	6.46%
Consumer Staples	1,234,349,188	3.31%	540,050,166	1.45%	1,774,399,354	4.76%
Energy	1,217,208,638	3.26%	602,383,076	1.61%	1,819,591,715	4.88%
Financials	1,966,011,005	5.27%	1,610,112,199	4.31%	3,576,123,204	9.58%
Healthcare	1,578,633,379	4.23%	670,154,062	1.80%	2,248,787,441	6.03%
Industrials	1,331,009,179	3.57%	923,422,055	2.47%	2,254,431,234	6.04%
Information Technology	2,138,791,483	5.73%	368,947,449	0.99%	2,507,738,932	6.72%
Materials	423,762,063	1.14%	583,294,327	1.56%	1,007,056,390	2.70%
Rights/Warrants	0	0.00%	99,087	0.00%	99,087	0.00%
Telecommunication Services	0	0.00%	215,695,332	0.58%	215,695,332	0.58%
Utilities	427,997,811	1.15%	115,702,050	0.31%	543,699,861	1.46%
Miscellaneous/Unclassified	443,952,103	1.19%	480,838,121	1.29%	924,790,224	2.48%
Equity Exchange Traded Fund	279,359,192	0.75%	1,448,905,402	3.88%	1,728,264,594	4.63%
Stapled Securities	0	0.00%	27,357,686	0.07%	27,357,686	0.07%
Total Common Stock	12,580,721,082	33.72%	8,457,476,492	22.67%	21,038,197,574	56.38%
Short-Term Investments						
Commercial Paper	644,339,198	1.73%	0	0.00%	644,339,198	1.73%
Pooled Funds and Mutual Funds	3,007,331	0.01%	0	0.00%	3,007,331	0.01%
Short-Term Bills and Notes	116,333,752	0.31%	0	0.00%	116,333,752	0.31%
Total Short-Term Investments	763,680,280	2.05%	0	0.00%	763,680,280	2.05%
Real Estate	1,839,897,653	4.93%	0	0.00%	1,839,897,653	4.93%
Private Equities	272,739,387	0.73%	0	0.00%	272,739,387	0.73%
Total Investments	28,824,697,945	77.25%	8,489,744,997	22.75%	37,314,442,942	100.00%
Derivatives and Options	31,250		0		0	
Short-Term Investments Classified as Cash Equivalents	(688,800,114)		0		(688,800,114)	
Total Investments as Shown on the Statement of Plan Net Position	$ 28,135,929,081		$ 8,489,744,997		$ 36,625,674,079	

This schedule classifies Canadian investments as domestic securities, convertible bonds as fixed income securities and preferred stock as fixed income securities. For investment purposes convertible bonds and preferred stock are considered equity securities. Accordingly, the asset allocation percentages in this schedule will vary from the investment consultant's asset allocation percentages.

TCRS INVESTMENTS

TCRS Investments Benchmark Analysis

Fiscal Year	(1) Public Fund Index Median Total Return	(2) TCRS Total Return
2013	12.0%	9.9%
2012	1.1%	5.6%
2011	21.6%	19.6%
2010	13.5%	10.2%
2009	(17.9)%	(15.3)%
2008	(4.7)%	(1.2)%
2007	14.1 %	13.2 %
2006	6.9 %	6.9 %
2005	9.4 %	7.3 %
2004	15.0 %	9.3 %

(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.

Summary of TCRS Earnings
Fiscal Years 2009-2013

Fiscal Year	TCRS Portfolio Earnings
2013	$ 3,344,589,259
2012	1,800,063,989
2011	5,528,753,502
2010	2,692,345,919
2009	(4,858,486,179)

STATE CASH MANAGEMENT

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 more than 80 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 2013 fiscal year, the average balance of short term investments in the Treasurer's Cash Management program was $8,269,366,273 per month and interest income of $14,013,687 was earned for the fiscal year. 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 current investment policy for the State Pooled Investment Fund was established to follow SEC Rule 2a-7-like guidelines for a money market fund. The maximum maturity of any security can not exceed 397 days and the weighted average maturity must be 120 days or less.

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 U.S. or any of its agencies and repurchase agreements against obligations of the U.S. or its agencies. Securities underlying repurchase agreements must be book-entry and delivered to a third party custodian in the name of the State Treasurer. Funds may also be invested in prime commercial paper and prime banker's acceptances.

At June 30, 2013, investments had an average maturity of 113 days and an average weighted yield of .15%. The total balance in the State Pooled Investment Fund at June 30, 2013, $9,147,991,506 fair value, was allocated as follows: U.S. Treasury government and agency securities, 76.71%; overnight deposits, 8.58%; collateralized certificates of deposit, 5.53% and commercial paper, 9.18%.

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 operating account 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

STATE CASH MANAGEMENT

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 improves controls over cash balances. 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. Alternatively, a financial institution may pledge collateral via the collateral pool. The types of investment instruments which are eligible to be pledged as collateral are listed in this report on page 25.

The state of the economy and the financial environment have 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 that 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.

Collateral Pool

The operation of a collateral pool for banks is authorized by Tennessee Code Annotated, Section 9-4-501, et seq. 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 program risk is minimized.

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 level assigned to the participant by the Board.

The Board has established three different collateral pledge levels: 115 percent, 100 percent and 90 percent. The pledge level is based on financial criteria set by the Collateral Pool Board with the financially strongest institutions being eligible for the lowest pledge level. In March 2009, the Collateral Pool Board voted to suspend the 90% pledge level until further notice. Under the Collateral Pool, should a financial institution default with insufficient collateral to cover public deposits, then the other financial institutions must make up the difference on a pro rata basis. Accordingly, public funds are not at risk in the Collateral Pool.

All collateral transactions for the pool are monitored and processed through the Treasury Department using uniform statewide procedures. In addition, Treasury Department staff monitors all pool activity through the monthly, quarterly and annual reports required to be submitted by pool participants or obtained from third party sources.

The Collateral Pool provides collateral for both state funds and local government funds for those institutions participating in the pool. The Collateral Pool serves as a significant administrative advantage for local governments. Under the Collateral Pool, the Treasurer, rather than the local government, is responsible for

STATE CASH MANAGEMENT

monitoring the pledge level; pricing collateral; reconciling collateral monthly with the trustee custodian; monitoring collateral; pledging, releasing and substituting collateral and maintaining a trustee custodian relationship.

Currently, the Collateral Pool has 94 participant institutions collateralizing public funds in excess of $8.3 billion.

STATE TRUST

The State Trust of Tennessee, a not-for-profit corporation chartered in the State of Tennessee in 1979, continues to be utilized to obtain check clearing services through the Federal Reserve Bank with a check redemption volume of 1,171,100 during fiscal year 2013 at an estimated savings of $100,000.

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 three of these indicators.

Fiscal Year	(1) Total Pool Funds	(2) Merrill Lynch Institutional Fund	(3) Standard & Poor's 7-Day LGIP Yield Index	(4) 90-Day Treasury (CD Equivalent Yield)
2013	.18%	.08%	.08%	.07%
2012	.17%	.05%	.09%	.05%
2011	.26%	.16%	.14%	.11%
2010	.40%	.16%	.39%	.12%
2009	1.66%	1.67%	1.33%	.64%

(1) Investment return on total portfolio.
(2) This index most closely resembles the structures and objectives of the total cash portfolio.
(3) Index is for LGIP benchmark pools rated AAAm & AAm by S&P.
(4) This approximates the reinvestment yield for new funds for the period.

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

Collateralized Time Deposits

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2013	$ 421,966,000	$ 1,234,553	0.30%
2012	500,355,667	1,411,747	0.29%
2011	772,436,583	2,478,112	0.33%
2010	1,636,994,750	11,438,313	0.62%
2009	2,618,880,250	47,806,706	1.82%

Repurchase Agreements and Overnight Deposit Accounts

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2013	$ 994,965,305	$ 1,671,077	0.21%
2012	950,980,388	1,522,199	0.29%
2011	871,447,388	2,703,893	0.30%
2010	643,502,305	1,061,207	0.30%
2009	367,930,650	2,860,837	1.03%

Commercial Paper

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2013	$ 764,026,167	$ 997,068	0.10%
2012	876,477,417	731,024	0.07%
2011	1,524,625,250	2,384,177	0.16%
2010	1,302,143,334	2,167,028	0.17%
2009	1,476,756,250	16,759,612	1.02%

U.S. Government Securities

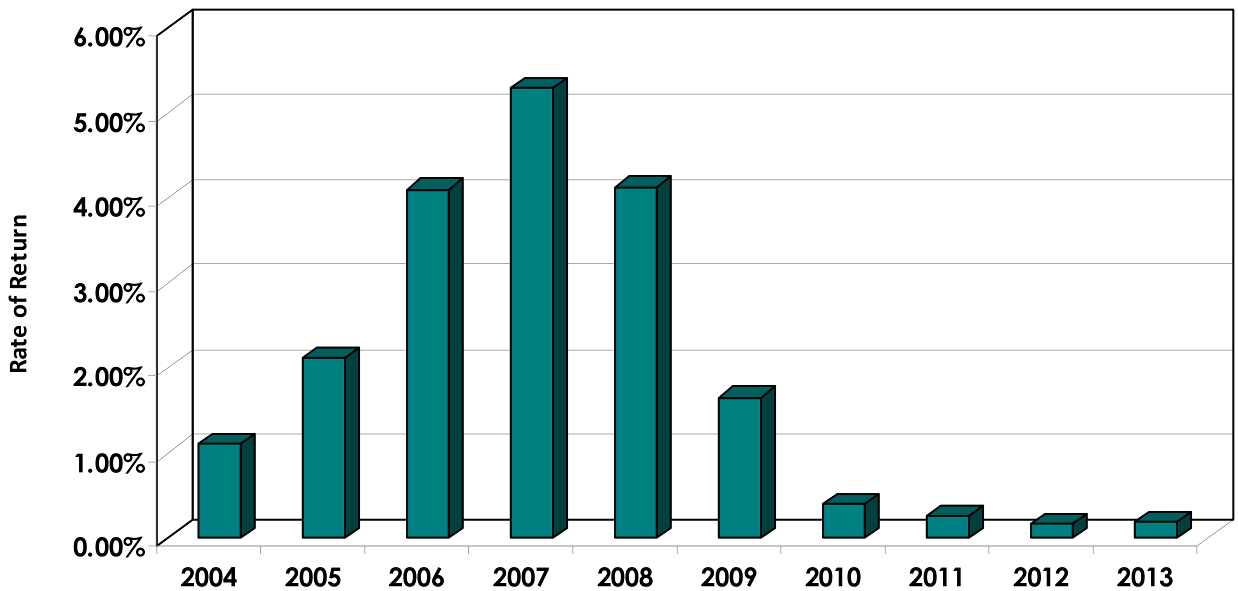
Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2013	$ 6,181,850,833	$ 10,110,989	0.18%
2012	5,483,522,167	8,469,904	0.16%
2011	3,787,816,250	10,373,163	0.28%
2010	3,284,981,083	12,298,843	0.38%
2009	2,847,377,750	52,443,415	1.89%

Total Funds

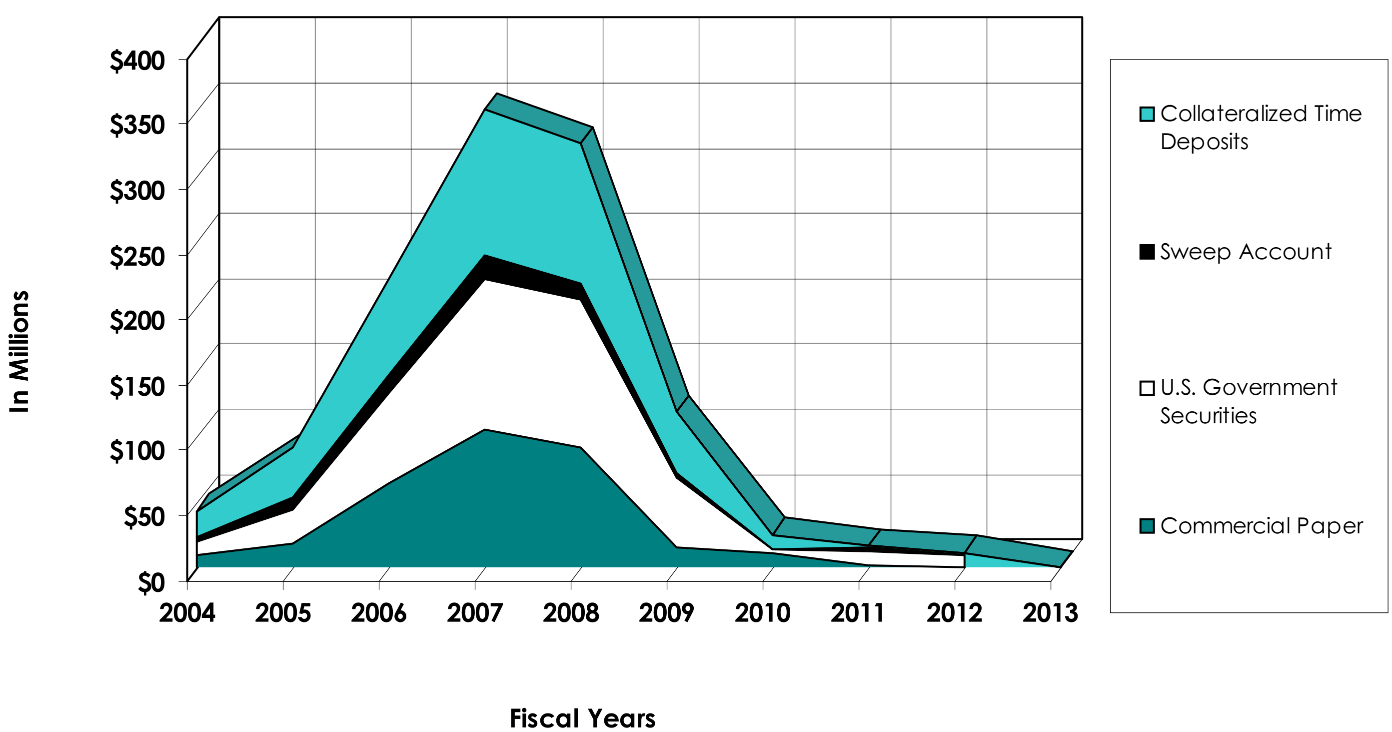
Fiscal Year	Average Total Funds Invested	Cash Management Investment	Composite Weighted Average Rate of
2013	$ 8,362,808,305	$ 14,013,687	0.18%
2012	7,811,335,639	12,134,874	0.17%
2011	6,956,325,471	17,939,345	0.26%
2010	6,867,621,472	26,965,391	0.40%
2009	7,310,944,900	119,870,570	1.66%

STATE CASH MANAGEMENT

Cash Management Investments Composite Weighted Average Rate of Return
Fiscal Years 2004-2013



Analysis of State Cash Earnings
Fiscal Years 2004-2013



STATE CASH MANAGEMENT

Cash Management Portfolio Analysis
Fiscal Year Ended June 30, 2013

				Portfolio Composition				
Date	Current Investment Yield	Total Portfolio Yield	Average Days to Maturity	Certificates of Deposit	Sweep	U.S. Treasury Notes	U.S. Agency	Commercial Paper
July, 2012	0.10%	0.18%	116	6.11%	12.06%	30.38%	41.61%	9.84%
August, 2012	0.09%	0.19%	109	5.93%	12.63%	27.99%	44.48%	8.96%
September, 2012	0.11%	0.19%	109	5.97%	12.45%	26.90%	45.01%	9.67%
October, 2012	0.10%	0.20%	113	5.15%	13.14%	26.75%	47.05%	7.92%
November, 2012	0.12%	0.20%	111	5.17%	12.89%	20.01%	49.77%	12.16%
December, 2012	0.11%	0.20%	112	4.63%	11.68%	23.36%	49.49%	10.84%
January, 2013	0.08%	0.19%	110	4.48%	10.94%	29.44%	45.28%	9.86%
February, 2013	0.08%	0.19%	114	4.03%	11.67%	29.05%	45.78%	9.48%
March, 2013	0.10%	0.18%	113	3.99%	9.04%	28.37%	48.00%	10.59%
April, 2013	0.10%	0.17%	113	3.88%	7.61%	25.47%	50.16%	12.89%
May, 2013	0.09%	0.16%	116	5.13%	6.11%	29.58%	49.74%	9.44%
June, 2013	0.08%	0.15%	114	5.53%	8.58%	29.14%	47.56%	9.18%
Average	0.10%	0.18%	113	5.00%	10.73%	27.20%	46.99%	10.07%

	General Fund		LGIP		Other Restricted		Total Average
Month	Average	Percent	Average	Percent	Average	Percent	Invested
July 2012	$3,190,016,297	38.32%	$3,089,858,516	37.11%	$2,045,756,845	24.57%	$8,325,631,658
August 2012	3,343,415,695	39.69%	2,925,149,894	34.73%	2,154,929,252	25.58%	8,423,494,841
September 2012	3,269,136,196	39.14%	2,882,782,225	34.52%	2,200,104,189	26.34%	8,352,022,610
October 2012	3,292,867,196	40.36%	2,848,151,732	34.91%	2,017,155,153	24.73%	8,158,174,081
November 2012	3,026,527,253	37.96%	2,914,208,658	36.55%	2,031,678,011	25.48%	7,972,413,922
December 2012	3,089,326,431	38.45%	2,984,642,529	37.15%	1,960,550,082	24.40%	8,034,519,042
January 2013	2,902,254,223	34.99%	3,305,084,404	39.84%	2,087,626,994	25.17%	8,294,965,621
February 2013	2,772,171,235	33.08%	3,450,822,355	41.18%	2,156,998,596	25.74%	8,379,992,186
March 2013	2,683,430,017	30.62%	3,972,252,417	45.32%	2,109,141,738	24.06%	8,764,824,172
April 2013	2,893,982,021	32.43%	3,881,372,308	43.49%	2,149,413,889	24.08%	8,924,768,218
May 2013	3,318,139,981	35.22%	3,855,015,867	40.92%	2,248,579,846	23.87%	9,421,735,694
June 2013	3,591,278,080	37.30%	3,564,058,948	37.02%	2,472,499,261	25.68%	9,627,836,289
Average	$3,114,378,719	36.40%	$3,306,116,654	38.64%	$2,136,202,821	24.97%	$8,556,698,195

STATE CASH MANAGEMENT

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 in excess of 2,650 accounts. The Department of Transportation (DOT) program has more than 765 active accounts.

Local governments which enter into agreements with the 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.

An electronic banking system allows participants to access their accounts in a secure Internet application. Thus, participants are able to communicate their instructions by telephone, telefax, or the Internet.

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 to participants are available online, including 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 available 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 total portfolio return of the cash management pool, less a monthly administrative fee of five one hundredths of one percent (.05%). During the 2013 fiscal year, the average rate participants earned on their deposits after the fee reduction was .13%. Other activity is shown on the following schedule by participant group.

Local Government Investment Pool Schedule of Activity by Entity Type
Fiscal Year Ended June 30, 2013

	Account Balance 6/30/2012	Net Deposits/(Withdrawals) FY 2013	Interest Credited FY 2013	Account Balance 6/30/2013
Cities	$ 1,105,693,873	$ 283,896,653	$1,519,377	$ 1,391,109,903
Counties	495,408,766	(54,103,157)	709,269	442,014,878
Commitments to D.O.T.	40,434,999	(11,073,835)	48,530	29,409,694
Educational Institutions	961,201,810	(4,130,656)	1,397,013	958,468,167
Bond Finance	85,764,826	(70,634,975)	55,577	15,185,428
Other	475,910,006	(14,020,422)	2,283,859	464,173,443
Total	**$ 3,164,414,280**	**$ 129,933,608**	**$ 6,013,625**	**$ 3,300,361,513**

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
LARGEST HOLDINGS

LARGEST STOCK HOLDINGS
AS OF JUNE 30, 2013
BY FAIR VALUE

Shares	Security Name	Fair Value
3,932,794	Exxon Mobil Corp Com	$ 355,327,938
771,860	Apple Inc Com Stk	305,718,309
6,004,068	Microsoft Corp Com	207,320,468
1,708,077	Chevron Corp Com	202,133,832
4,529,636	Wells Fargo & Co New Com Stk	186,938,078
8,029,786	General Electric Co	186,210,737
210,997	Google Inc Cl A	185,755,429
3,399,697	JP Morgan Chase & Co Com	179,470,005
2,030,480	Johnson & Johnson Com USD1	174,337,013

LARGEST BOND HOLDINGS
AS OF JUNE 30, 2013
BY FAIR VALUE

Par Value	Security Name	Yield	Maturity	Moody's Rating	Fair Value
$ 137,100,000	United States Treasury Index Linked Bond	2.34%	01/15/26	Aaa	$ 185,501,691
139,900,000	United States Treasury Index Linked Note	2.34%	01/15/16	Aaa	176,048,348
158,800,000	United States Treasury Note	0.64%	07/15/21	Aaa	169,101,391
135,000,000	United States Treasury Note	1.33%	07/15/20	Aaa	156,373,562
166,770,000	United States Treasury Note	1.75%	05/15/23	Aaa	156,190,445
137,000,000	United States Treasury Note	1.20%	01/15/21	Aaa	155,760,161
100,000,000	United States Treasury Infl Index Bond	2.93%	01/15/25	Aaa	146,969,277
139,500,000	United States Treasury Note	2.63%	11/15/20	Aaa	145,352,444
107,000,000	United States Treasury Note	1.48%	01/15/20	Aaa	125,372,266
127,785,000	United States Treasury Bond	3.13%	02/15/43	Aaa	119,279,375

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.

Moody's rates securities as follows:

Aaa	Best Quality
Aa	High Quality
A	Upper Medium Quality
Baa	Medium Quality
NR	Not Rated

STATE CASH PORTFOLIO
AS OF JUNE 30, 2013

DESCRIPTION	Maturity	Yield to Maturity	Par Value	Fair Value
U.S. TREASURY AND AGENCY OBLIGATIONS				
FAMC	08/15/13	0.22%	$ 100,000,000	$ 99,996,000
FAMC	08/16/13	0.06%	50,000,000	49,998,000
FAMC	09/25/13	0.19%	50,000,000	49,995,000
FAMC	09/26/13	0.19%	25,000,000	24,997,500
FAMC	09/30/13	0.23%	100,000,000	100,022,000
FAMC	11/01/13	0.20%	50,000,000	49,988,000
FAMC	12/03/13	0.18%	65,000,000	64,974,650
FAMC	01/31/14	0.17%	50,000,000	49,970,500
FAMC	02/27/14	0.18%	50,000,000	49,963,000
FAMC	05/01/14	0.19%	50,000,000	49,987,500
Federal Home Loan Bank	07/03/13	0.02%	95,000,000	95,000,000
Federal Home Loan Bank	07/08/13	0.02%	100,000,000	100,000,000
Federal Home Loan Bank	07/11/13	0.35%	39,700,000	39,702,382
Federal Home Loan Bank	07/11/13	0.35%	100,000,000	100,006,000
Federal Home Loan Bank	07/31/13	0.06%	75,000,000	74,998,500
Federal Home Loan Bank	08/07/13	0.06%	110,000,000	109,996,700
Federal Home Loan Bank	08/28/13	0.50%	84,000,000	84,047,880
Federal Home Loan Bank	08/28/13	0.50%	25,070,000	25,084,290
Federal Home Loan Bank	09/06/13	0.25%	92,000,000	92,018,400
Federal Home Loan Bank	11/01/13	0.10%	34,000,000	33,995,580
Federal Home Loan Bank	11/14/13	0.29%	75,000,000	75,041,250
Federal Home Loan Bank	11/15/13	0.29%	82,000,000	82,045,920
Federal Home Loan Bank	12/04/13	0.30%	27,800,000	27,818,626
Federal Home Loan Bank	12/18/13	0.17%	50,000,000	50,005,500
Federal Home Loan Bank	03/05/14	0.18%	41,750,000	41,741,650
Federal Home Loan Bank	03/14/14	0.17%	69,000,000	68,980,680
Federal Home Loan Bank	03/18/14	0.18%	100,000,000	99,979,000
Federal Home Loan Bank	04/15/14	0.17%	50,000,000	49,982,000
Federal Home Loan Bank	04/15/14	0.17%	100,000,000	99,964,000
Federal Home Loan Bank	04/22/14	0.17%	95,000,000	94,962,950
Federal Home Loan Bank	06/17/14	0.16%	25,000,000	24,984,000
Federal Home Loan Bank	06/18/14	5.25%	73,750,000	77,344,575
FFCB Discount Notes	07/24/13	0.25%	75,000,000	75,005,250
FFCB Discount Notes	09/04/13	0.22%	50,000,000	50,007,000
FFCB Discount Notes	09/04/13	0.22%	100,000,000	100,014,000
FFCB Discount Notes	10/22/13	0.20%	49,250,000	49,258,865
FFCB Discount Notes	01/15/14	0.20%	50,000,000	50,005,500
FFCB Discount Notes	02/14/14	0.18%	50,000,000	49,965,000
FFCB Discount Notes	03/26/14	0.18%	100,000,000	99,978,000
FHLMC Note .010	12/17/13	0.10%	66,000,000	65,972,280

(continued)

STATE CASH PORTFOLIO
AS OF JUNE 30, 2013

DESCRIPTION	Maturity	Yield to Maturity	Par Value	Fair Value
FHLMC Note .060	08/15/13	0.06%	$ 75,000,000	$ 74,997,000
FHLMC Note .150	09/13/13	0.15%	100,000,000	99,992,000
FHLMC Note .375	04/28/14	0.38%	35,000,000	35,044,800
FHLMC Note .375	04/28/14	0.38%	57,755,000	57,828,926
FHLMC Note 2.500	04/23/14	2.50%	50,000,000	50,936,500
FHLMC Note 4.500	07/15/13	4.50%	48,740,000	48,823,345
FNMA Discount Notes	07/15/13	0.10%	77,000,000	76,999,230
FNMA Discount Notes	08/15/13	0.12%	100,000,000	99,996,000
FNMA Discount Notes	08/15/13	0.14%	50,000,000	49,998,000
FNMA Discount Notes	08/21/13	0.06%	41,500,000	41,498,340
FNMA Discount Notes	09/13/13	0.12%	100,000,000	99,992,000
FNMA Discount Notes	10/15/13	0.09%	84,100,000	84,087,385
FNMA Discount Notes	10/31/13	0.16%	67,000,000	66,988,610
FNMA Discount Notes	12/18/13	0.75%	50,212,000	50,359,121
FNMA Discount Notes	02/05/14	2.75%	70,202,000	71,292,939
FNMA Discount Notes	04/15/14	4.13%	22,776,000	23,477,273
FNMA Discount Notes	05/15/14	2.50%	51,487,000	52,509,017
IBRD Discount Note	04/11/14	0.21%	82,000,000	81,997,540
IBRD Discount Note	05/09/14	0.20%	37,000,000	36,998,341
IBRD Discount Note	05/09/14	0.20%	100,000,000	100,000,000
INTL BK FOR RECON	07/15/13	0.13%	30,000,000	29,999,700
INTL BK FOR RECON	09/13/13	0.14%	100,000,000	99,992,000
INTL BK FOR RECON	10/15/13	0.11%	138,000,000	137,979,300
INTL BK FOR RECON	11/05/13	0.11%	100,000,000	99,975,000
US Treasury Bills	07/18/13	0.03%	100,000,000	99,999,000
US Treasury Bills	08/22/13	0.04%	50,000,000	49,998,000
US Treasury Notes	07/15/13	1.00%	50,000,000	50,017,500
US Treasury Notes	07/15/13	1.00%	100,000,000	100,035,000
US Treasury Notes	07/15/13	1.00%	52,000,000	52,018,200
US Treasury Notes	07/15/13	1.00%	50,000,000	50,017,500
US Treasury Notes	07/15/13	1.00%	50,000,000	50,017,500
US Treasury Notes	07/31/13	0.38%	100,000,000	100,023,000
US Treasury Notes	08/15/13	0.75%	100,000,000	100,082,000
US Treasury Notes	08/15/13	0.75%	69,000,000	69,056,580
US Treasury Notes	09/30/13	3.13%	50,000,000	50,375,000
US Treasury Notes	09/30/13	3.13%	100,000,000	100,750,000
US Treasury Notes	10/15/13	0.50%	86,000,000	86,097,180
US Treasury Notes	10/15/13	0.50%	50,000,000	50,056,500
US Treasury Notes	10/15/13	0.50%	50,000,000	50,056,500
US Treasury Notes	10/15/13	0.50%	50,000,000	50,056,500
US Treasury Notes	11/15/13	0.50%	125,000,000	125,180,000

(continued)

STATE CASH PORTFOLIO
AS OF JUNE 30, 2013

DESCRIPTION	Maturity	Yield to Maturity	Par Value	Fair Value
US Treasury Notes	11/15/13	0.50%	$ 30,000,000	$ 30,043,200
US Treasury Notes	11/15/13	0.50%	120,000,000	120,172,800
US Treasury Notes	11/15/13	0.50%	50,000,000	50,072,000
US Treasury Notes	11/15/13	4.25%	68,000,000	69,043,800
US Treasury Notes	11/15/13	4.25%	107,000,000	108,642,450
US Treasury Notes	11/30/13	0.25%	90,000,000	90,053,100
US Treasury Notes	01/15/14	1.00%	72,000,000	72,340,560
US Treasury Notes	01/31/14	0.25%	50,000,000	50,037,000
US Treasury Notes	01/31/14	1.75%	100,000,000	100,945,000
US Treasury Notes	02/15/14	1.25%	100,000,000	100,688,000
US Treasury Notes	02/15/14	1.25%	50,000,000	50,344,000
US Treasury Notes	04/30/14	0.25%	100,000,000	100,066,000
US Treasury Notes	05/31/14	0.25%	100,000,000	100,059,000
US Treasury Notes	05/31/14	2.25%	50,000,000	50,937,500
US Treasury Notes	06/15/14	0.75%	61,000,000	61,321,470
US Treasury Notes	06/30/14	2.63%	50,000,000	51,207,000
US Treasury Notes	07/15/14	0.63%	27,000,000	27,118,260
TOTAL U.S. TREASURY AND AGENCY OBLIGATIONS			**$ 6,799,092,000**	**$ 6,816,487,396**
CERTIFICATES OF DEPOSIT				
Bank of Crockett, Bells	07/01/13	0.20%	$ 2,600,000	$ 2,600,000
Bank of Crockett, Bells	07/11/13	0.20%	1,100,000	1,100,000
Bank of Crockett, Bells	07/12/13	0.20%	700,000	700,000
Bank of Crockett, Bells	07/17/13	0.20%	1,000,000	1,000,000
Bank of Crockett, Bells	08/12/13	0.20%	3,500,000	3,500,000
Bank of Gleason	07/30/13	0.30%	300,000	300,000
Bank of Gleason	10/08/13	0.30%	750,000	750,000
Bank of Gleason	10/18/13	0.30%	350,000	350,000
Bank of Gleason	12/10/13	0.30%	2,000,000	2,000,000
Bank of Halls	07/11/13	0.20%	490,000	490,000
Bank of Halls	08/23/13	0.20%	1,960,000	1,960,000
Bank of Jackson	07/26/13	0.20%	2,500,000	2,500,000
BB&T, Knoxville	07/12/13	0.30%	100,000,000	100,000,000
BB&T, Knoxville	08/09/13	0.30%	100,000,000	100,000,000
BB&T, Knoxville	03/25/14	0.30%	75,000,000	75,000,000
Carrol Bank and Trust, Bradford	10/04/13	0.30%	90,000	90,000
Citizens State Bank, Jasper	07/09/13	0.30%	200,000	200,000
Citizens State Bank, Jasper	07/09/13	0.30%	100,000	100,000
Civic Bank & Trust, Nashville	07/16/13	0.25%	1,000,000	1,000,000
Commerce Union Bank, Springfield	12/20/13	0.30%	1,500,000	1,500,000
Community First Bank & Trust, Columbia	07/05/13	0.30%	1,000,000	1,000,000

(continued)

STATE CASH PORTFOLIO
AS OF JUNE 30, 2013

DESCRIPTION	Maturity	Yield to Maturity	Par Value	Fair Value
Community First Bank & Trust, Columbia	07/08/13	0.20%	$ 2,000,000	$ 2,000,000
Community First Bank & Trust, Columbia	08/05/13	0.20%	3,000,000	3,000,000
Community First Bank & Trust, Columbia	08/16/13	0.30%	500,000	500,000
Community First Bank & Trust, Columbia	11/01/13	0.30%	500,000	500,000
Community First Bank & Trust, Columbia	11/08/13	0.30%	1,000,000	1,000,000
Community First Bank & Trust, Columbia	11/26/13	0.30%	500,000	500,000
First Citizens National Bank, Dyersburg	11/29/13	0.30%	20,000,000	20,000,000
First Citizens National Bank, Dyersburg	11/29/13	0.30%	3,000,000	3,000,000
First Tennessee Bank National Association, Memphis	07/15/13	0.20%	100,000,000	100,000,000
First Volunteer Bank, Jamestown	07/01/13	0.30%	500,000	500,000
First Volunteer Bank, Jamestown	07/01/13	0.30%	200,000	200,000
First Volunteer Bank, Jamestown	07/01/13	0.30%	500,000	500,000
First Volunteer Bank, Jamestown	07/01/13	0.30%	450,000	450,000
First Volunteer Bank, Jamestown	07/01/13	0.30%	300,000	300,000
First Volunteer Bank, Jamestown	07/01/13	0.30%	500,000	500,000
Gates Banking and Trust Company	07/05/13	0.20%	250,000	250,000
Gates Banking and Trust Company	07/08/13	0.20%	500,000	500,000
Gates Banking and Trust Company	07/12/13	0.20%	500,000	500,000
Gates Banking and Trust Company	07/22/13	0.20%	250,000	250,000
Gates Banking and Trust Company	07/26/13	0.20%	400,000	400,000
Gates Banking and Trust Company	08/12/13	0.20%	750,000	750,000
Gates Banking and Trust Company	08/16/13	0.20%	1,500,000	1,500,000
Gates Banking and Trust Company	08/23/13	0.20%	1,000,000	1,000,000
Gates Banking and Trust Company	08/23/13	0.20%	1,250,000	1,250,000
Landmark Community, Collierville	07/02/13	0.20%	10,000,000	10,000,000
Landmark Community, Collierville	07/02/13	0.20%	6,000,000	6,000,000
Landmark Community, Collierville	07/05/13	0.20%	4,000,000	4,000,000
Landmark Community, Collierville	07/05/13	0.20%	3,000,000	3,000,000
Landmark Community, Collierville	07/05/13	0.20%	3,000,000	3,000,000
Landmark Community, Collierville	07/05/13	0.20%	6,000,000	6,000,000
Newport Federal Bank	08/13/13	0.30%	300,000	300,000
Newport Federal Bank	08/13/13	0.30%	95,000	95,000
Newport Federal Bank	11/29/13	0.30%	500,000	500,000
Newport Federal Bank	11/29/13	0.30%	500,000	500,000
Patriot Bank, Millington	07/05/13	0.20%	3,500,000	3,500,000
Patriot Bank, Millington	07/26/13	0.20%	2,750,000	2,750,000
Patriot Bank, Millington	07/26/13	0.20%	3,500,000	3,500,000
Putnam 1st Mercantile Bank, Cookeville	10/30/13	0.30%	1,000,000	1,000,000
Security Bank, Dyersburg	07/11/13	0.20%	1,000,000	1,000,000
Security Bank, Dyersburg	07/17/13	0.20%	3,000,000	3,000,000
Tennessee State Bank, Gatlinburg	07/03/13	0.20%	10,000,000	10,000,000

(continued)

STATE CASH PORTFOLIO
AS OF JUNE 30, 2013

DESCRIPTION	Maturity	Yield to Maturity	Par Value	Fair Value
The Coffee County Bank, Manchester	08/13/13	0.30%	$ 240,000	$ 240,000
The Farmers & Merchants Bank, Dyer	07/02/13	0.25%	2,000,000	2,000,000
The First National Bank of McMinnville	07/12/13	0.20%	3,000,000	3,000,000
The First National Bank of McMinnville	08/16/13	0.20%	4,000,000	4,000,000
TNBank, Oak Ridge	08/15/13	0.25%	1,000,000	1,000,000
TNBank, Oak Ridge	08/27/13	0.25%	1,000,000	1,000,000
Wayne County Bank, Waynesboro	08/30/13	0.30%	500,000	500,000
Wayne County Bank, Waynesboro	11/29/13	0.30%	900,000	900,000
TOTAL CERTIFICATES OF DEPOSIT			**$ 506,275,000**	**$ 506,275,000**
OVERNIGHT DEPOSIT ACCOUNTS				
First Tennessee Bank - Overnight Deposit Account	07/01/13	0.10%	$ 174,543,904	$ 174,543,904
First Tennessee Bank - Overnight Deposit Account	07/01/13	0.42%	110,037,974	110,037,974
Regions Bank - Overnight Deposit Account:	07/01/13	0.15%	502,176,630	502,176,630
TOTAL OVERNIGHT DEPOSIT ACCOUNTS			**$ 786,758,507**	**$ 786,758,507**

DESCRIPTION	Rating	Maturity	Par Value	Fair Value
COMMERCIAL PAPER				
BNP	A1	07/01/13	$ 440,000,000	$ 439,998,900
GENERAL ELECTRIC C	A1	07/02/13	100,000,000	99,996,889
NARCO	A1	07/06/13	50,000,000	49,996,250
NARCO	A1	07/08/13	50,000,000	49,995,417
Pepsi	A1	07/04/13	50,000,000	49,998,264
Pepsi	A1	07/05/13	50,000,000	49,996,986
Toyota	A1	07/07/13	50,000,000	49,995,556
UPS	A1	07/03/13	50,000,000	49,999,958
TOTAL COMMERCIAL PAPER			**$ 840,000,000**	**$ 839,978,219**
TOTAL STATE CASH PORTFOLIO			**$ 8,932,125,507**	**$ 8,949,499,123**

BACCALAUREATE EDUCATION SYSTEM TRUST PORTFOLIO

BACCALAUREATE EDUCATION SYSTEM TRUST
AS OF JUNE 30, 2013

Fixed Exchange Traded Funds	**Units**	**Fair Value**
Vanguard Total Bond Market	632,200	$ 51,132,336
Total Fixed Exchange Traded Funds		**$ 51,132,336**

Equity Exchange Traded Funds	**Units**	**Fair Value**
Northern Institutional Fund	907,040	$ 907,040
Ishares MSCI EAFE	150,150	8,615,607
Vanguard Index S&P 500	335,200	24,603,680
Total Equity Exchange Traded Funds		**$ 34,126,327**
TOTAL PORTFOLIO		**$ 85,258,663**

CHAIRS OF EXCELLENCE LARGEST HOLDINGS

LARGEST BOND HOLDINGS
AS OF JUNE 30, 2013
BY FAIR VALUE

Par Value	Security Name	Yield at Market	Maturity	Moody's Quality Rating	Fair Value
$ 4,036,556	FNMA POOL #AB4686	3.35%	03/01/42	NR	$ 4,129,518
2,000,000	GEN ELEC CAP CORP 5.875% DUE 01-14-2038	5.26%	01/14/38	A	2,201,510
2,000,000	Resolution Fdg Corp Fed Book Entry Cpn	1.32%	04/15/17	NR	1,908,640
2,370,000	US Treasury Index Linked Bonds	1.13%	01/15/26	Aaa	3,206,703
2,200,000	US Treasury Index Linked Notes	1.87%	01/15/22	Aaa	2,214,010
2,000,000	US Treasury Notes	-3.78%	04/15/15	Aaa	2,199,708
3,300,000	US Treasury Notes	-1.23%	04/15/16	Aaa	3,566,145
3,200,000	US Treasury Notes	0.59%	01/15/20	Aaa	3,749,451
2,100,000	US Treasury Notes	1.05%	03/31/17	Aaa	2,276,530
2,400,000	US Treasury Notes	1.33%	11/30/17	Aaa	2,507,813

A complete portfolio listing is available upon request.

Exchange Traded Funds	Units	Fair Value
Vanguard S&P 500 Index	1,473,000	$ 108,118,200
Ishares MSCI EAFE	616,050	35,348,949
Total Exchange Traded Fund		$ 143,467,149

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.

Moody's rates securities as follows:

Aaa	Best Quality
Aa	High Quality
A	Upper Medium Quality
Baa	Medium Quality
NR	Not Rated

PROGRAMS

BACCALAUREATE EDUCATION SYSTEM TRUST

Baccalaureate Education System Trust

Tennessee Code Annotated, Title 49, Chapter 7, Part 8 sets forth the Tennessee Baccalaureate Education System Trust (BEST) Act. The Act creates a tuition program, as an agency and instrumentality of the State of Tennessee, under which parents and other interested persons may assist students in saving for tuition cost of attending colleges and universities. The tuition program is known as the BEST Program and is comprised of two types of tuition plans: an educational services plan (prepaid plan) called the BEST Prepaid Plan and an educational savings plan (savings plan) called the TNStars™ College Savings 529 Program. The BEST prepaid Plan began accepting contracts and contributions in June, 1997. On November 22, 2010, the BEST Board voted to stop selling units in the BEST Prepaid Plan. The remaining participants in the program receive the yearly increases in the weighted average tuition. At June 30, 2013, the prepaid plan held net position totaling $87.8 million. The TNStars™ College Savings 529 Program was launched in September 2012.

The federal guidelines for the 529 plans are contained in Section 529 of the Internal Revenue Code. The requirements for participation and administration of the Prepaid College Tuition Plan are contained in *Chapter 1700-5-1* of the *Official Compilation of the Rules and Regulations of the State of Tennessee*. The requirements for participation in the TNStars™ College Savings 529 Program are contained in *Chapter 1700-5-4 of the Official Compilation of the Rules and Regulations of the State of Tennessee*.

Both programs offer several favorable tax benefits to participants. Accounts are exempt from all federal, state and local taxes if used for qualified education expenses. In addition, earnings on any distribution used to pay for qualified higher education expenses are exempt from taxation. Qualified expenses include tuition, fees, supplies, books, room and board and supplies and equipment required for enrollment or attendance. Monies saved in the plans may be used at any accredited higher education institution – in-state or out-of-state, public or private. The funds may also be used at vocational, technical schools, professional and graduate schools. Participants do not have to choose a specific school when they enroll in either program. The maximum account limit for a beneficiary in both programs is $235,000.

TNStars™ College Savings 529 Program

The TNStars™ College Savings 529 Program is the State of Tennessee's educational savings plan. Recognizing the need for a highly-skilled workforce and the role that higher education plays in achieving that goal, the State of Tennessee has developed the TNStars™ College Savings 529 Program, a program of the Tennessee Treasury Department.

The TNStars™ College Savings 529 Program is designed to make college savings easy. The savings plan offers parents and other relatives a low-cost way to save for children's college expenses with attractive investment options, incentives for Tennessee residents and special tax advantages.

The savings plan offers an age-based track where the allocation becomes more conservative as the child approaches college. The savings plan also offers individual investment options including domestic and international equities, balanced fund options, fixed income options and an FDIC insured option. The underlying funds for each of the options are from a range of fund companies including Vanguard, DFA, Primecap, Great West and First Tennessee Bank. The savings plan offers the products at a competitive fee of 0-35 basis points. At June 30, 2013, the savings plan held net position totaling $6.7 million.

Interested parties and participants may utilize the TNStars™ College Savings 529 Program website for information and to enroll and maintain their accounts online. The program website is www.tnstars.com. Questions or comments about the program may be emailed through this site or interested parties may call 855-3TN-STAR (386-7827).

BACCALAUREATE EDUCATION SYSTEM TRUST

Enrollment Fiscal Year	Unit Payout	Administrative Fee	Actuarial Soundness	Unit Price (Aug. 1-Dec. 31)	Adjustment for Purchases after December 31*	Unit Price (Jan. 1-July 31)
1997	$ 21.64	$ 2.11	$ -	$ 23.75	$ -	$ 23.75
1998	21.64	2.11	-	23.75	-	23.75
1999	25.00	1.75	-	26.75	1.25	28.00
2000	27.08	1.92	-	29.00	1.25	30.25
2001	29.58	1.92	-	31.50	1.50	33.00
2002	33.51	0.99	-	34.50	2.35	36.85
2003	35.98	1.02	-	37.00	1.40	38.40
2004	40.70	1.30	-	42.00	1.60	43.60
2005	43.15	2.10	3.71	48.96	1.84	50.80
2006	47.71	2.28	4.07	54.06	2.03	56.09
2007	49.72	2.98	4.24	56.94	2.14	59.08
2008	53.79	3.13	4.56	61.48	2.15	63.63
2009	56.93	3.87	4.86	65.66	2.05	67.71
2010	61.20	3.90	5.22	70.32	2.20	72.52
2011	65.57	5.68	5.59	76.84	2.40	79.24
2012	72.15	-	-	-	-	-
2013	76.88	-	-	-	-	-
2014	81.11	-	-	-	-	-

*Adjustment equal to 1/2 earnings rate assumption.
On November 22, 2010, the BEST Board of Trustees voted to stop selling units in the plan.

CERTIFIED PUBLIC ADMINISTRATOR EDUCATIONAL INCENTIVE PAYMENT PROGRAM

CERTIFIED PUBLIC ADMINISTRATOR

The University of Tennessee Institute for Public Service administers the "County Official's Certificate Training Program Act." Certain full-time county officials are eligible for an educational incentive payment if the officials have completed the continuing education requirements of the program. The UT Institute for Public Service is required to provide the Treasurer's office a listing of those officers who have successfully completed all levels of the County Officials Certificate Training Program. The educational incentive payments are issued by the State Treasurer. The State Treasurer must issue such payments no later than October 31 of each year. The program began in 1998.

The following table sets out the number of county officials receiving payment in October 2012:

County Official	Number Receiving Payment
Register of Deeds	56
Trustee	54
Clerk & Master	50
County Clerk	45
Circuit Court Clerk	42
County Mayor/County Executive	30
Assessor of Property	29
Chief Administrative Officer of Highways	12
Sheriff	5
Criminal Court Clerk	2
Juvenile Court Clerk	2
General Sessions Court Clerk	1
Probate Court Clerk	0
Total	328

The table below sets out a five-year history of recipients to receive educational incentive payments. The payment amount is determined by the number of eligible recipients and the appropriation amount in the annual state budget.

Fiscal Year Ended June 30	Recipients	Amount Paid Per Recipient	Total Payments
2013	328	$ 1,242	$ 407,376
2012	299	1,362	407,238
2011	332	1,223	406,036
2010	312	1,500	468,000
2009	287	1,500	430,500

COUNTY PROVIDED INCENTIVE PAYMENT

Each county is encouraged and authorized to provide in its annual budget for payment of an annual educational incentive to certain employees who attain the designation of a "certified public administrator" in an amount not to exceed $3,000 less any incentive payment made by the State Treasurer. Such payments shall be paid by the county by October 31 of each year. The County Mayors shall provide to the State Treasurer the amount of any educational incentive paid by the county and the number of persons receiving such incentive. Summary information is provided below:

Number of counties that provided an incentive	7
Number of counties that did not provide an incentive	41
Number of counties that did not provide information	47
Total	95
Total amount of incentives paid	$106,520
Total number of recipients	101
Average incentive payment	$ 1,055

CHAIRS OF EXCELLENCE TRUST

CHAIRS OF EXCELLENCE TRUST

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 (corpus) made by a private donor and a matching amount by the state, thus creating a chair. A chair is authorized to spend 4% of the 3-year average market value of the chair. However, the corpus can not be spent.

Since the beginning of the program in 1984, there have been 99 chairs created, with state appropriations totaling $44 million and matching contributions totaling $55.9 million.

FIVE-YEAR HISTORY
FISCAL YEARS 2009-2013

Fiscal Year	Investment Income/(Loss)	Total Spending of the Chairs	Asset Balance
2013	$23,379,827	$7,129,665	$261,807,326
2012	10,300,357	7,108,557	245,745,038
2011	34,346,000	6,561,577	243,105,645
2010	22,324,590	6,937,327	215,665,629
2009	(28,334,670)	7,441,722	200,843,198

ANNUALIZED INVESTMENT RETURN

	1 Year	5 Years	10 Years
Domestic Equity	20.29 %	6.98%	7.29%
International Equity	17.40 %	(0.85)%	-
Fixed Income	(0.81)%	5.55%	4.56%
Short-Term	0.01 %	0.47%	1.97%
Total Portfolio	9.09 %	5.22%	5.61%

CHAIRS OF EXCELLENCE TRUST

Authorized Chairs of Excellence

The University of Tennessee

Chattanooga

- Cline COE in Rehabilitation Technology
- COE in Judaic Studies
- Frierson COE in Business Leadership
- Harris COE in Business
- Lyndhurst COE in Arts Education
- McKee COE in Learning
- Miller COE in Management and Technology
- Sun Trust Bank COE in the Humanities
- Unum COE in Applied Mathematics
- West COE in Communications and Public Affairs

Knoxville

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

Martin

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

Memphis

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

Space Institute

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

CHAIRS OF EXCELLENCE TRUST

Authorized Chairs of Excellence

Tennessee Board of Regents

Austin Peay State University

Acuff COE in Creative Arts
APSU Foundation Chair of Free Enterprise
Harper/James and Bourne COE in Business
Reuther COE in Nursing

East Tennessee State University

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

Middle Tennessee State University

Adams COE in Health Care Services
Jones Chair of Free Enterprise
Jones COE in Urban and Regional Planning
Miller COE in Equine Health
Miller COE in Equine Reproductive Physiology
Murfree Chair of Dyslexic Studies
National Healthcorp COE in Nursing
Russell COE in Manufacturing Excellence
Seigenthaler Chair of First Amendment Studies

Tennessee State University

COE in Banking and Finance
Frist COE in Business Administration

Tennessee Technological University

Mayberry Chair of Business Administration
Owen Chair of Business Administration

University of Memphis

Arthur Andersen Company Alumni COE in Accounting
Bornblum COE in Judaic Studies
COE in Art History
COE in English Poetry
COE in Free Enterprise Management
Federal Express COE in Management Information Systems
Feinstone COE in Molecular Biology
Fogelman COE in Real Estate
Hardin COE in Combinatorics
Hardin COE in Economics/Managerial Journalism
Herff COE in Biomedical Engineering
Herff COE in Computer Engineering
Herff COE in Law
Lowenberg COE in Nursing
Moss COE in Philosophy
Moss COE in Psychology
Moss COE in Urban Education
Plough COE in Audiology and Speech Language Pathology
Sales and Marketing Executives of Memphis COE in Sales
Shelby County Government COE in International Economics
Sparks COE in International Relations
Thompson-Hill COE in Accounting
Wang COE in International Business
Wunderlich COE in Finance

CLAIMS AGAINST THE STATE

Claims Against The State

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 Risk Management 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.

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 also handles all employee property damage claims and tort claims. 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. For claims occurring on or after July 1, 2005, worker's compensation claim disputes are filed with the Department of Labor and Workforce Development's Benefit Review Conference program for possible resolution without litigation.

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, 100% of all 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 allows the state to negotiate further savings off workers' compensation medical bills after the mandated fee schedule reduction, which became required on January 1, 2006. Currently, the state has obtained approximately 48% savings off billed charges as a result of the fee schedule, plus an additional 4% savings (after fee schedule reduction) as a result of the preferred provider arrangement.

In 2013, the Division of Claims Administration implemented a Pharmacy Network Program for state employees and higher education employees. The Pharmacy Network Program is designed to generate savings relative to pharmacy expenses in the following manner: (1) using economy of scale to obtain discounts beyond the fee schedule; (2) performing utilization review; (3) encouraging equivalent use of lower cost generic drugs; (4) encouraging lower cost home deliveries of medication; and (5) monitoring for abuse/misuse of both employee and medical prescribers. The results of savings with this program will be provided in 2014.

During fiscal year 2013, the Division of Claims Administration received 4,788 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 2013 fiscal year, the Board took action on one claim. 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 Risk Management Fund.

CLAIMS AGAINST THE STATE

CLAIMS AND PAYMENT ACTIVITY
FISCAL YEAR 2013

Claims Activity	Payments Made
Worker's Compensation Claims	
Death Payments	$ 224,643
Medical Payments	14,111,115
Temporary Disability	3,535,887
Permanent Disability	7,283,689
Subtotal	25,155,334
Employee Property Damage	22,391
Tort Claims	
Death Payments	1,934,531
Bodily Injury Payments	2,223,003
Property Damage Payments	1,112,205
Subtotal	5,269,739
Total Claims Against the State	**$ 30,447,464**

FIVE-YEAR CLAIMS HISTORY
FISCAL YEARS 2009-2013

Fiscal Year	Amount of Claims Paid
2013	$ 30,447,464
2012	34,186,267
2011	31,249,686
2010	29,732,845
2009	29,502,257

CLAIMS FILED BY PROGRAM
FISCAL YEARS 2009-2013

Fiscal Year	Workers' Compensation	Employee Property Damage	Tort	Total
2013	3,078	94	1,616	4,788
2012	3,127	89	1,683	4,899
2011	3,296	132	1,708	5,136
2010	3,360	119	1,766	5,245
2009	3,431	117	1,289	4,837

CRIMINAL INJURIES COMPENSATION FUND

Criminal Injuries Compensation Fund

The Criminal Injuries Compensation Fund ("Fund") provides financial assistance to crime victims through two types of programs. The funding for the programs includes 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. Jurors may also elect to donate their jury service reimbursement to the fund.

Criminal Injuries Compensation Program

Payments made under the Criminal Injuries Compensation Program are intended to defray the costs of medical services, loss of earnings, burial costs and other pecuniary losses to either an innocent victim of a crime or to the dependents of a deceased victim. Applications for Criminal Injuries Compensation are filed with the Division of Claims Administration. During the 2013 fiscal year, 2,611 new claims were filed.

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 transferred to the Tennessee Claims Commission. Eligible payments are issued promptly and are payable directly to the service provider if the bill is unpaid, to the victim for out-of-pocket expenses and, if appropriate, his or her attorney. On average, the division renders a decision on claims within 59 days.

During the 2013 fiscal year, the Division of Claims Administration made payments to victims of crime totaling $13.3 million.

Victims of drunk drivers are also paid from the Criminal Injuries Compensation Fund. When the proximate cause of a death or injury is the operator's intoxication as prohibited by T.C.A. Section 55-10-401, the victim's death or injury is eligible for compensation, not to exceed a maximum award of $30,000 plus attorney's fees.

Since the first claims were paid in 1982, the program has awarded a total of more than $254.3 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 Injuries Compensation Program by printing and distributing informative brochures explaining the program. Public awareness efforts and the use of victim assistance coordinators in each judicial district have also aided in providing the public with information about the benefits provided through the Criminal Injuries Compensation Fund.

Sexual Assault Forensic Exam Reimbursement

In 2007, the General Assembly amended the Criminal Injuries Compensation Act to provide payment for services related to sexual assault forensic examinations. The Fund provides reimbursement to a facility that performs sexual assault forensic exams on victims of certain sexually-oriented crimes. Facilities must bill the Fund (not the victim) and cannot seek any additional payment from the victim after payment by the Fund. Payment is up to $750 for such services for crimes occurring on or after July 1, 2007. During the 2013 fiscal year, 2,310 forensic claims were filed. On average, the division renders a decision within 40 days.

CRIMINAL INJURIES COMPENSATION FUND

SOURCES OF FUNDS
FISCAL YEARS 2011-2013

	2011		2012		2013	
Source	**Amount**	**Percentage**	**Amount**	**Percentage**	**Amount**	**Percentage**
Fines	$ 6,369,594	50%	$ 6,353,236	45%	$ 6,474,210	41%
Federal Funds	3,848,000	29%	4,991,000	35%	5,650,000	36%
Probation Fees	2,353,382	18%	2,321,596	16%	2,261,368	15%
Bond Forfeitures	464,817	4%	569,550	4%	1,210,601	8%
Other	27,034	0%	20,163	0%	19,991	0%
Total	**$ 13,062,827**	**100%**	**$ 14,255,545**	**100%**	**$ 15,616,170**	**100%**

CLAIMS PAID BY CRIME OR CLAIM TYPE
FISCAL YEAR 2013

Crime or Claim Type	Number Paid	Percentage of Total Claims	Amount Paid	Percentage of Total Paid
Assault	844	19.2%	$ 5,640,133	42.3%
Child Sexual Abuse	316	7.2%	774,555	5.8%
Homicide	300	6.8%	2,636,188	19.7%
Robbery by Force	221	5.0%	1,366,295	10.2%
Adult Sexual Assault	155	3.5%	432,340	3.2%
DUI	46	1.0%	247,820	1.9%
Hit and Run	35	0.8%	307,958	2.3%
Vehicular (Non-DUI)	17	0.4%	164,418	1.2%
Child Physical Abuse	5	0.1%	29,644	0.2%
Arson	2	0.0%	28,467	0.2%
Kidnapping	1	0.0%	1,977	0.0%
Subtotal	1,942	44.0%	$ 11,629,795	87.0%
Forensic Exam	2,458	56.0%	1,717,997	13.0%
Grand Total	**4,400**	**100.0%**	**$ 13,347,792**	**100.0%**

CRIMINAL INJURIES COMPENSATION FUND

NEW CLAIMS FILED
FISCAL YEAR 2013

Crime or Claim Type	Number Filed
Assault	1,114
Homicide	424
Child Sexual Abuse	404
Robbery by Force	220
Adult Sexual Assault	210
DUI	78
Hit and Run	73
Vehicular (non-DUI)	51
Child Physical Abuse	17
Other	17
Kidnapping	2
Stalking	1
Subtotal	2,611
Forensic Exams	2,310
Grand Total	**4,921**

CLAIMS DENIED
FISCAL YEAR 2013

Criminal Injuries Claims Reason Type	Number Denied	Percentage
Contributory Behavior	297	24.4%
Insufficient Documentation	217	17.8%
Failure to Cooperate/Prosecute	189	15.5%
Collateral Resource Covered Loss(es)	123	10.1%
Insufficient Proof of a Crime	70	5.8%
Loss(es) Less than $100	63	5.2%
Ineligible Crime	53	4.4%
Late Filing of Claim	47	3.9%
Ineligible Claimant	46	3.8%
Other	44	3.6%
Ineligible Loss(es)	28	2.3%
No Collateral Resource Information	17	1.4%
Late Reporting of Crime	11	0.9%
Passenger with Drunk Driver	9	0.7%
Crime Not Reported	2	0.2%
Claim Not Signed or Notarized	1	0.1%
Total Denial Reasons	**1,217**	**100.0%**

In fiscal year 2013, 965 criminal injuries claims were denied. Some claims are denied for more than one reason.

CLAIMS COMMISSION

CLAIMS COMMISSION

The Claims Commission is an administrative tribunal created under Tennessee Code Annotated, Section 9-8-301, *et seq.*, to hear money damages claims against the state based on the acts or omissions of state employees in 22 statutory categories. Most notably, the Commission has jurisdiction over claims in tort (e.g. negligent care, custody and control of persons, property or animals; professional malpractice; negligent operation or maintenance of a motor vehicle; dangerous conditions on state maintained highways or state controlled real property); claims for breach of a written contract; claims for recovery of taxes paid under protest to the Department of Commerce and Insurance; state workers compensation claims and criminal injuries compensation claims. As a condition for the waiver of the state's sovereign immunity, state employees are immunized from liability for state law claims for acts or omissions within the scope of their employment, except for willful, malicious or criminal acts. Claims are payable from the Risk Management Fund.

Damages for tort claims falling within the Commission's jurisdiction are limited to $300,000 per claimant or $1,000,000 per occurrence. There is no limitation on awards for breach of contract. The maximum award for criminal injuries compensation claims is $30,000.

There are three Claims Commissioners, each of whom hears cases arising in his or her grand division. The current Commissioners are:

Nancy Miller-Herron, Western Division (Dresden)
Robert N. Hibbett, Middle Division (Nashville)
William Shults, Eastern Division (Newport)

As required by Tennessee Code Annotated, Section 9-8-302, each of the Commissioners was appointed by the Governor and confirmed by the General Assembly. In addition, the Commissioners have been residents of Tennessee for more than five years, have been residents of their respective grand divisions for more than one year, have practiced law for more than one year and do not maintain a private law practice.

The Commissioners' terms end as follows: The Eastern Division on June 30, 2017, the Middle Division on June 30, 2019 and the Western Division on June 30, 2015.

The Claims Commission has a Clerk's office in Nashville that serves all three grand divisions. The Clerk is manager and custodian of the official record of claims appealed or transferred from the Division of Claims Administration. The clerk is responsible for the management of the Commission's docket, receipt and filing of pleadings, preparation and filing of the appellate record in the cases before the Tennessee Court of Appeals and the Tennessee Supreme Court, responding to case inquiries from litigants and communicating with other state agencies on behalf of the Commission. In addition, the clerk acts as an administrative liaison between the Treasury Department and the Claims Commission.

The Claims Commission is attached to the Department of Treasury for administrative purposes. The Treasury Department processes financial and personnel transactions on behalf of the Commission. The department also provides information technology support and other administrative support to the Commission.

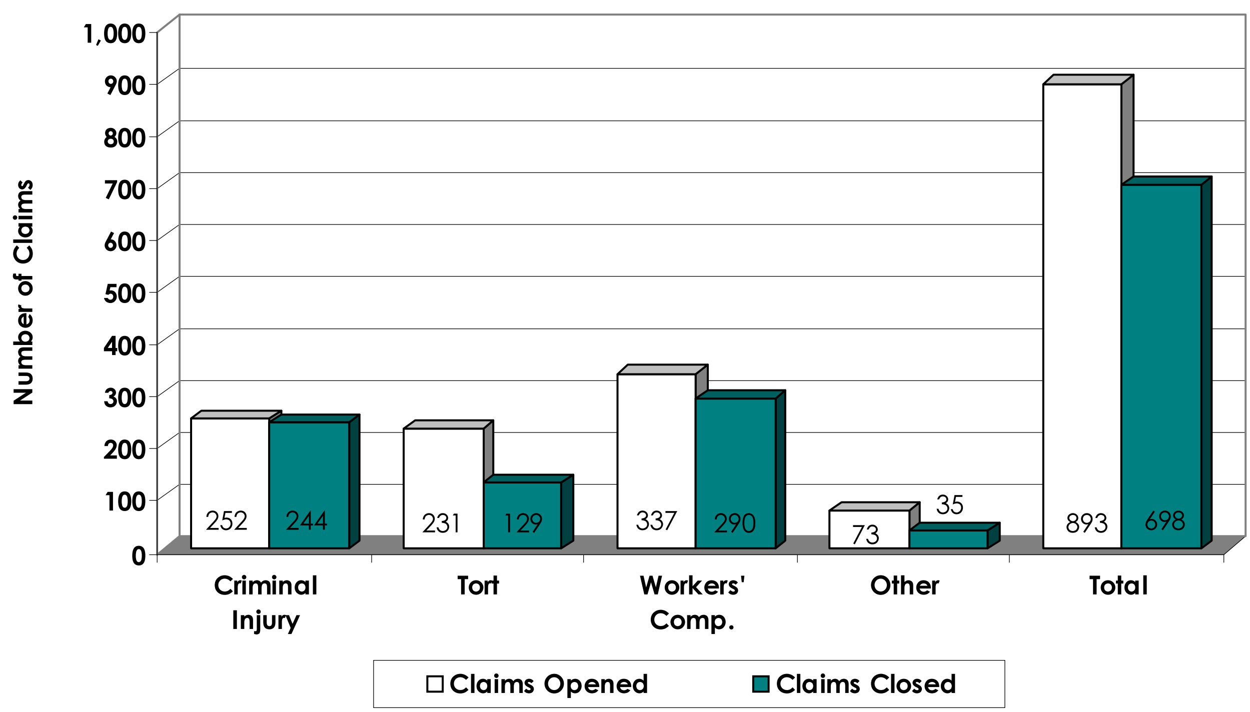
CLAIMS COMMISSION'S OPERATION

Except for claims for the recovery of taxes, which are initiated by filing with the clerk of the Claims Commission, claims are commenced by filing a notice of claim with the Division of Claims Administration or in the case of workers' compensation actions with the third party administrator. If the claim is denied, it may be appealed to the Claims Commission. Claims upon which no action is taken within 90 days automatically transfer to the Commission.

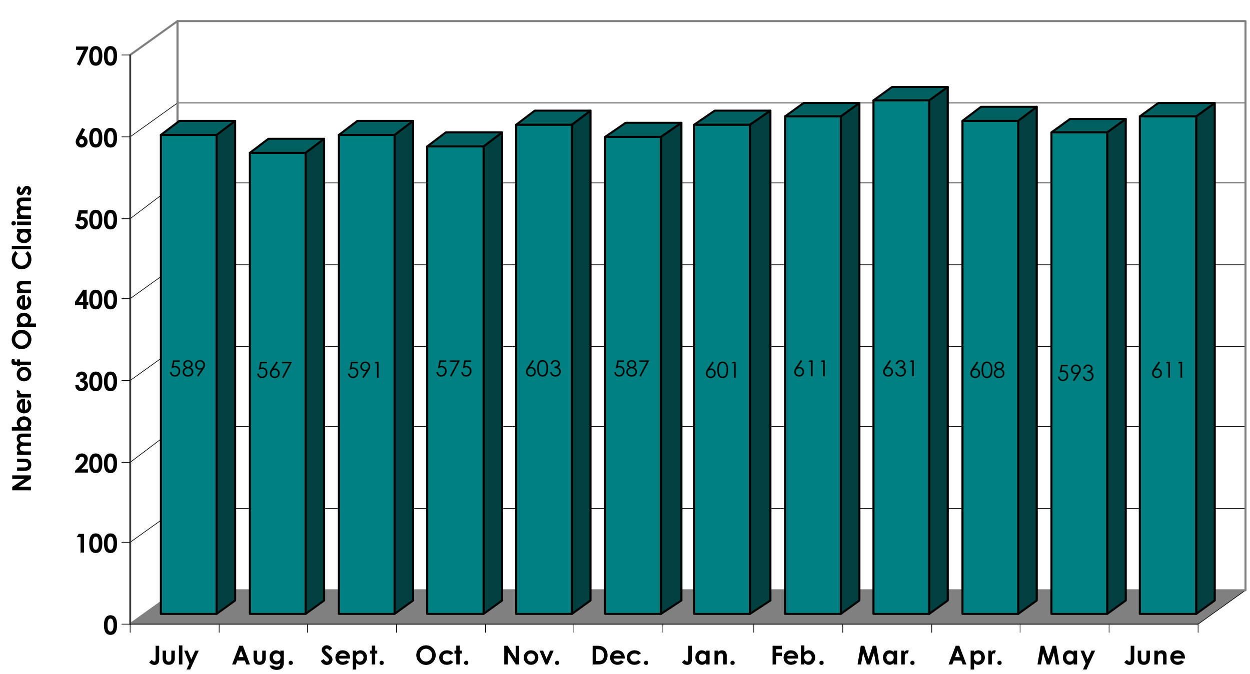
The state is represented before the Commission by the Office of the Attorney General or his delegatee. The Commission maintains two separate dockets: a regular docket consisting of claims with a monetary value of more than $25,000 and a small claims docket for claim of $25,000 and under. The Tennessee Rules of Civil Procedure are applicable. Commissioners are required to make written findings of fact and conclusions of law in all regular docket claims. At the request of two Commissioners, the Commission can sit en banc to decide any matter in which there is a disagreement among Commissioners. Decisions in regular docket claims may be appealed to the Tennessee Court of Appeals and workers' compensation cases may be appealed to the Tennessee Supreme Court. Judgments rendered against the state in the Claims Commission are paid by the Division of Claims Administration.

CLAIMS COMMISSION

Number of Claims Opened and Number of Dispositions By Claim Type
Fiscal Year 2013



Claims Commission Open Claims
Fiscal Year 2013



RISK MANAGEMENT

Division of Risk Management

The Division of Risk Management identifies and analyzes the state's exposure to property and casualty risks and implements certain risk management techniques to mitigate the state's exposure to loss. The state funds various levels of risk retention through the Risk Management Fund.

The state contracts with private insurance brokers to research the insurance marketplace and target only those insurance carriers with the highest A.M. Best ratings, which are capable and willing to provide competitive insurance quotes for the state's various lines of coverage. The lines of insurance coverage that the state acquires include property, builders' risk, aviation, fidelity and crime, boiler and machinery and fine arts. Fiscal year 2012-2013 premium costs for all lines of property and casualty coverage amounted to $5.4 million.

The state's primary level of property insurance limits was increased to $750 million. Flood coverage remained at $50 million, including properties in 100-year flood zones. Earthquake limits, once again, remained at $50 million for all zones except the New Madrid area, where limits were $25 million. The state, however, was able to purchase excess earthquake in the amount of $25 million, providing a total of $50 million coverage for New Madrid zones. The state's annual aggregate deductible is $10 million for property. The perils of earthquake and flood are a $10 million per occurrence deductible each. As of July 1, 2013, total insured property values were $19.2 billion.

Cyber Liability Insurance is a new line of coverage effective July 1, 2013. This policy provides coverage for UT, TBR and general government. The premium is $220,000 with a maximum limit of $5 million for the entire policy period. The policy has coverage for privacy breach response costs, customer notification, expenses, customer support and credit monitoring expense. Other lines of coverage are security and privacy liability, privacy regulatory defense and penalties, multi-media liability, network asset protection, cyber extortion and cyber terrorism.

Boiler and Machinery insurance is procured to protect the state's 2,400 boiler objects. This policy performs two major functions: (1) provides boiler breakdown coverage and (2) assumes the responsibility for jurisdictional inspections on all pressure vessels. Certified inspectors evaluate all boiler objects on a scheduled basis to ensure the safe operation of the objects which, in turn, will prevent loss to human life and property. This loss prevention program has proven very effective with results showing no major incidents within the past ten years.

To protect the state from financial loss due to employee dishonesty, a fidelity and crime policy is obtained. Coverage limits are provided in the amount of $3 million per occurrence. A policy endorsement is added to extend coverage to treasurers and tax collectors.

At June 30, 2013, seven state agencies had 54 aircraft where hull insurance and liability insurance coverage quotes were obtained. The purchase of hull insurance is a business decision made by each agency for each aircraft. Liability insurance is purchased for every aircraft. The level of liability coverage varies for each aircraft and is generally based on type of aircraft, usage and size as measured by the number of seats.

In case of losses, Risk Management administers the claims process for all lines of coverage. The division coordinates the activities of the insurance carrier, independent adjusters, state facility managers and state agency contacts. For emergency situations, a restoration company is under state contract to provide immediate response to prevent costly damages. A detailed property inventory (schedule) provides the current insurable values for both buildings and contents. Agency deductibles vary according to the type of claim: (1) Property - $25,000, (2) Cyber - $500,000, (3) Boiler - $10,000, (4) Fine Arts - $0 and (5) Fidelity and Crime - $100,000. If a loss exceeds the agency deductible, loss costs are paid from the Risk Management Fund until the state's annual aggregate deductibles are satisfied. Any remaining costs are the responsibility of the insurance carriers up to their policy limits.

The prevention and control of losses are important in managing the state's risks. In fiscal year 2012-2013, risk management staff conducted loss prevention surveys at approximately 65 locations. A total of 202 buildings were inspected for fire/life safety hazards. During these inspections, safety violations were recorded and corrective action reports were submitted to the agencies with recommendations for safety code compliance. Follow up for correction of safety violations is performed timely.

RISK MANAGEMENT

STATE PROPERTY
SUMMARY OF KEY POINTS
FISCAL YEAR 2012-2013

Insurance Coverage Information:	
Insured Property Values	$ 19,216,119,100
Primary Property Limits (Per Occurrence)	750,000,000
Annual Aggregate Deductibles:	
Property	$ 10,000,000
Earthquake (Per Occurrence)	10,000,000
Flood (Per Occurrence)	10,000,000

Financing of Estimated Property Losses:	
Cumulative Agency Deductibles (Agency Obligation)	$ 725,000
Risk Management Fund Obligation	1,989,648
Total Property Losses	$ 2,714,648

The amount of coverage, the level of the deductibles, the selection of the insurance companies to provide coverage and the amount of the insurance premium are reviewed and approved annually by the Board of Claims, which is our oversight committee.

SMALL AND MINORITY-OWNED BUSINESS ASSISTANCE PROGRAM

Small and Minority-Owned Business (SMOB) Assistance Program

Chapter 830 of the Tennessee Public Acts of 2004 created within the Treasury Department the Small and Minority-Owned Business Assistance Program (SMOB). Chapter 830 required the Department by rule to develop an assistance program for small and minority-owned businesses, as defined in TCA 65-5-113, which will include loans, technical assistance, consulting and educational services. The legislative intent is for the department to use the assistance provided by this program to support outreach to new, expanding and existing businesses in Tennessee that do not have reasonable access to capital markets and traditional commercial lending facilities.

The SMOB Program replaced the Small and Minority-Owned Telecommunications Business Assistance Program that was administered by the Department of Economic and Community Development. The Telecommunications Program provided loan guarantees to qualifying businesses. With all program obligations met, the program has been phased out. Whereas the Telecommunications Program focused on a specific facet of industry, the SMOB Program was designed to perpetuate growth on a less restrictive continuum.

The principle function of the SMOB Program is to provide a significant statewide platform through a support structure that fosters the expansion of small and minority-owned businesses in Tennessee. SMOB consists of two components: loans (including lines of credit) and program services. The loans provided must be for a specific project. Acceptable purposes for loan proceeds include:

- acquisition of machinery and equipment
- working capital
- supplies and materials
- inventory
- certain other business-related activity

There are certain types of businesses that are deemed ineligible to receive assistance from the SMOB Program. Ineligible businesses include:

- churches
- non-profit organizations
- insurance companies
- real estate contractors
- real estate developers
- night clubs and any similar entertainment-oriented business
- businesses that do not create or provide jobs
- businesses not incorporated or located in Tennessee.

The Treasury Department handles the daily operation of the program and oversees activities of the lenders who make the loans to the businesses that qualify for participation in the program.

Lenders for the SMOB Program are:

- Chattanooga Neighborhood Enterprises
- East Tennessee Development District
- Nashville Minority Business Development Loan Fund
- Pathway Lending
- South Central Tennessee Development District
- Tri-State Bank of Memphis

Interested parties may utilize SMOB's website, located at www.tn.gov/treasury/smob, to learn about the program.

OUTSTANDING LOANS AS OF JUNE 30, 2013

Race	Male	Female	Number of Loans	Total Loans By Race
African-American	$ 621,241	$ 730,365	30	$ 1,351,606
White	302,501	211,135	16	513,636
Other	58,104	117,050	4	175,154
Total Loans	$ 981,846	$ 1,058,550	50	$ 2,040,396

Unclaimed Property Division

The Treasury Department has administered the Uniform Disposition of Unclaimed Property Act since it was enacted in 1978. Administration 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 property that 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 time, normally five years, and if the holder cannot locate the owner. Once property is delivered, the Treasurer utilizes various techniques to locate the owners. There is no time limit on claiming this property.

During the period July 1, 2012 through June 30, 2013, $92.0 million of cash property was turned over to the Treasurer. This includes $35.8 million remitted by third party audit organizations from out-of-state non-reporting holders for Tennessee residents. An additional $7.7 million in proceeds from stock sales was recognized as revenue.

Entities with property to report to Tennessee's Unclaimed Property Division obtain forms, instructions, free software, and other valuable data from the Internet web site. Many entities have expressed their appreciation for this easy access to reporting tools.

The Treasurer utilizes various methods to locate owners of unclaimed property. Initially notification to the last known address of each owner is sent. If no response is received, additional search efforts are made through Department of Labor and Workforce Development records, telephone directories, drivers' license records, external locate research tool, and other sources. Finally the names of owners and last known addresses are advertised in newspapers throughout the state.

In addition, a searchable database of the owners' names is available on the division's Internet site: www.treasury.tn.gov/unclaim. In addition the owners' names are available on the national website Missing Money at: www.missingmoney.com. The records of unclaimed property owners are also available for viewing by the public in the Unclaimed Property office.

During the period July 1, 2012 through June 30, 2013, $27.7 million of cash property was returned by the Unclaimed Property Division to the owners or their heirs, local governments and reciprocal states.

Any local government in Tennessee that 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, $1.2 million was refunded to 32 local governments.

Tennessee has reciprocal agreements with other unclaimed property programs in other states to exchange property held by one state for owners with a last known address in the other state. Tennessee received $250,000 for residents or former residents in exchange for $3.2 million paid to other states' unclaimed property offices.

Since the program began operations in 1979, $912.3 million in unclaimed property has been reported to the Treasurer and $294.6 million has been returned to owners, heirs, local governments and reciprocal states.

After all location techniques are employed, the Unclaimed Property Division is able to return approximately 60% of property that is turned over with an owner's name.

UNCLAIMED PROPERTY DIVISION

METHODS USED TO RETURN PROPERTY
FISCAL YEAR 2013

Location Method	Value of Claims	Number of Accounts	Average Claim Value
Website Inquiries	$12,055,501	9,130	$1,320
Mailings to Last Known Address	4,267,856	6,084	701
Holder Referral or Reimbursement	2,763,948	521	5,305
Advertisement and Television	1,629,736	3,871	421
Independent Locator	1,368,884	66	20,741
Staff or Other Outreach	1,188,239	84	14,146
Match with Dept. of Labor and Work Force Records	40,742	56	728
Total Claim Payments	$23,314,906	19,812	$1,177
Interstate Exchanges	3,173,322	45	
Refunds to Local Governments	1,206,473	32	
Total Payments	**$27,694,701**	**19,889**	

SOURCES OF UNCLAIMED PROPERTY
FISCAL YEARS 2009-2013

	2013	2012	2011	2010	2009
Insurance Companies	49%	22%	16%	19%	25%
Financial Institutions	18%	30%	27%	23%	19%
Retailers, Services, Telecommunications, Colleges	14%	19%	10%	14%	15%
Cities and Counties	8%	5%	8%	8%	5%
Hospitals and Health Care	3%	5%	5%	4%	4%
Corporations, Transportation, Manufacturing, Natural Resources	3%	7%	15%	18%	16%
Utilities	2%	4%	6%	7%	5%
Securities and Brokerage Firms	2%	7%	10%	3%	5%
Other States, Escheat and Other	1%	1%	3%	4%	6%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

ACTIVITY
FISCAL YEARS 2009-2013

	2013	2012	2011	2010	2009
Number of Holders Reporting	7,177	7,236	7,577	6,931	5,999
Number of Properties Received	563,506	498,009	529,502	543,412	319,466
Cash Received (not including shares sold)	$92,029,270	$56,866,754	$60,128,207	$50,158,392	$50,998,037
Number of Shares Received	3,578,919	3,682,696	13,412,891	1,859,331	2,224,055
Value of Shares Sold	$ 7,659,728	$ 8,189,532	$11,408,829	$13,659,794	$ 9,148,704
Number of Claims Paid	19,889	14,800	18,884	19,446	21,543
Cash Paid	$27,694,701	$20,726,913	$23,661,977	$23,648,637	$23,252,511
Shares Paid	343,116	150,722	234,684	254,547	270,135

ADMINISTRATION

STATUTORY DUTIES OF THE STATE TREASURER

Boards and Commissions	Tennessee Code Annotated Section
Access Improvement Project Committee*	54-2-207
Advisory Board to Establish Compensation for Use of the Right-of-Way for Underground Fiber Optic Cable Facilities	54-16-112
Advisory Committee to the Trustees of the Fisk University Stieglitz Collection Art Endowment Fund	4-20-201
Advisory Council on Workers' Compensation	50-6-121
Appeals from Gift Tax Appraisals Board	67-8-116
Baccalaureate Education System Trust Board	49-7-804
Board of Claims	9-8-101
Catastrophic Injuries Fund Commission	29-20-408
Chairs of Excellence Endowment Trust	49-7-501
Collateral Pool Board	9-4-506
Commission to Purchase Surplus Federal Property	12-1-103
Council on Pensions & Insurance	3-9-101
Employee Misclassification Advisory Task Force	50-6-919
Governor's Commission on Crime Victims Assistance	Ex. Order 10 of 2003
Local Education Insurance Committee	8-27-301
Local Government Insurance Committee	8-27-207
Public Records Commission	10-7-302
Sick Leave Bank Board	8-50-903
State Board of Equalization	4-3-5101
State Building Commission	4-15-101
State Capitol Commission	4-8-301
State Funding Board	9-9-101
State Insurance Committee	8-27-101
State Protest Committee	4-56-103
State Trust of Tennessee	9-4-806
Tennessee Consolidated Retirement System Board of Trustees	8-34-302
Tennessee Financial Literacy Commission	49-6-1703
Tennessee Higher Education Commission	49-7-204
Tennessee Housing Development Agency	13-23-106
Tennessee Industrial Development Authority*	13-16-301
Tennessee Industrial Finance Corporation*	4-17-405
Tennessee Local Development Authority	4-31-103
Tennessee Sports Hall of Fame	4-3-5403
Tennessee State School Bond Authority	49-3-1204
Tennessee Student Assistance Corporation	49-4-202
Tuition Guaranty Fund Board	49-7-2018
Volunteer Public Education Trust	49-3-401, et seq.
Workers Compensation Insurance Fund Board	50-6-604

**Repealed by 2013 Public Acts*

STATUTORY DUTIES OF THE STATE TREASURER (CONTINUED)

ADMINISTRATION	TENNESSEE CODE ANNOTATED SECTION
Advisory Council on Workers' Compensation	50-6-121, et seq.
Baccalaureate Education System Trust	49-7-801, et seq.
Board of Claims	9-8-101, et seq.
Chairs of Excellence Trust	49-7-501—49-7-503
Collateral Pool	9-4-501—9-4-523
Collateral Program	9-4-101—9-4-108
Council on Pensions and Insurance	3-9-101—3-9-104
Criminal Injury Compensation Fund	29-13-101, et seq.
Deferred Compensation	8-25-101, et seq.; 8-25-301, et seq.
Determinations of Reasonableness of Charter School Denials*	49-13-108
Escheat	31-6-101, et seq.
Flexible Benefits Plan	8-25-501—8-25-502
Intermediate-Term Investment Fund	9-4-608
Investment Advisory Council	8-37-108
Investment of State Idle Cash Funds	9-4-602
Local Government Investment Pool	9-4-704—9-4-707
Old Age and Survivors Insurance Agency	8-38-101, et seq.
Pooled Investment Fund	9-4-603
Receipt and Disbursement of Public Funds	8-5-106—8-5-111; 9-4-301, et seq.
Small and Minority-Owned Business Assistance Program	65-5-113
State Cash Management	9-4-106—9-4-108; 9-4-401—9-4-409
State Treasurer's Office	4-3-2401, et seq.; 8-5-101, et seq.
State Trust of Tennessee	9-4-801, et seq.
Tennessee Claims Commission	9-8-301, et seq.
Tennessee Consolidated Retirement System and Miscellaneous Systems	Title 8, Chptrs. 34, 35, 36, 37 & 39
Tennesssee Interagency Cash Flow Committee	9-4-610
Tennessee Financial Literacy Program	49-6-1701, et seq.
Unclaimed Property	66-29-101, et seq.
Victims of Drunk Drivers Compensation Fund	40-24-107

Repealed by 2013 Public Acts

EXECUTIVE STAFF DIRECTORY

Treasurer's Office	
Treasurer	David H. Lillard, Jr., JD, LLM in Taxation
Chief of Staff	Joy Harris
Special Assistant to the Treasurer	Mary Beth Franklyn
Assistant Director of Human Resources	Tim Joyce
Director of Communications	Blake Fontenay
Executive Assistant	Heather Sczepczenski
Legal, Compliance and Internal Audit	
Assistant Treasurer	Christy Allen, JD
Director of Internal Audit	Andrew Furlong, CPA, CFE
Investments and Deferred Compensation	
Assistant Treasurer	Bill Abney, JD, LLM
Chief Investment Officer	Michael Brakebill, CFA, CAIA
Deputy CIO and Fixed Income Director	Andy Palmer, CFA
Senior Fixed Income Manager	Thomas Kim, CFA
Equity Director	Michael Keeler, CFA
Senior Equity Portfolio Manager	Jim Robinson, CFA
Senior Equity Portfolio Manager	Roy Wellington, CFA
Real Estate Director	Jeanpierre Rachmaninoff, CPA-inactive
Director of Short-Term Investments	Tim McClure, CCM
Director of Private Equity	Daniel Crews, CFA
Director of Deferred Compensation	Kaci Lantz, CFP®
Retirement Administration and Program Services	
First Deputy Treasurer	Steve Curry, CPA-inactive, CEBS, CCM
Senior Director of Program Services	Steve Summerall
Assistant Director of Program Services	Joshua Stites
Director of Treasury Outreach	Amanda Staggs
TCRS Director	Jill Bachus, CPA, CGFM
TCRS Assistant Director	Jamie Wayman, CPA, CEBS
Counseling Services Manager	Candy O'Leary
Member Benefits Manager	Erica Nale
Financial Services Manager	Amy Tower
Assistant Director of Concord	Fred Marshall, CPA
Small and Minority-Owned Business Program Manager	Jaye Chavis
Director of College Savings	LaKesha Page
Director of Unclaimed Property	John Gabriel
Assistant Director Unclaimed Property	Kellie Williamson
Director of Claims Administration and Risk Management	Rodney Escobar
Criminal Injury Program Manager	Amy Dunlap
East Tennessee Claims Commissioner	William O. Shults, JD
Middle Tennessee Claims Commissioner	Robert Hibbett, JD
West Tennessee Claims Commissioner	Nancy Miller-Herron, JD
Claims Commission Clerk	Paula Swanson
Support Services	
Second Deputy Treasurer	Rick DuBray, CPA
Director of Accounting	Kim Morrow, CPA
Deputy Director of Accounting	Brian Derrick, CPA
Assistant Director of Accounting	Kevin Bradley, CPA, AAP
Director of Management Services	Kerry Hartley, CPA
Director of Information Systems	Tim Sundell
Assistant Director of Information Systems	David Bauer

The Treasurer is housed on the 1st floor of the State Capitol Building.
Divisions are housed on the 13th, 14th and 15th floors of the Andrew Jackson Building.

TREASURY INTERNET SERVICES

SERVICES TO THE PUBLIC		
BEST	Program information, rate information, contracts, forms and newsletters	http://treasury.tn.gov/best
Claims Commission	Program information, contacts, rules and statutes	http://treasury.tn.gov/claims/index.html
Criminal Injury Compensation Program	Program information, forms, links to victims' programs nationwide and victims' organizations	http://treasury.tn.gov/injury/index.html
Small and Minority-Owned Business Program	Program information, rules and legislation	http://treasury.tn.gov/smob/index.html
Tennessee Financial Literacy Commission	Program information, clearinghouse of financial resources	http://treasury.tn.gov/FinLit/index.html
TNStars 529 College Savings Program	Program information, investment options, forms, savings calculator, videos, employer resources, FAQs	http://www.tnstars.com/
Unclaimed Property	Search for unclaimed property, program information, links to other states' programs, holder reporting information, forms, instructions and free software	http://treasury.tn.gov/unclaim/index.html
GOVERNMENT SERVICES		
Bank Collateral Pool	Program information, forms and participants	http://treasury.tn.gov/bank/index.html
Local Government Investment Pool	Information, forms, operations manual, newsletters, past rates, portfolio and investment policy	http://treasury.tn.gov/lgip/index.html
OASI/Social Security	Information, FICA rates, law and forms	http://treasury.tn.gov/oasi/index.html

TREASURY INTERNET SERVICES (CONTINUED)

PUBLIC EMPLOYEE BENEFIT PROGRAMS		
Deferred Compensation	Account access, program information, benefit projection calculator and forms	http://treasury.tn.gov/dc/index.html
Flexible Benefits Plan	Program information and forms	http://treasury.tn.gov/flex/index.html
Optional Retirement Program	Program information, forms, company contacts and product information	http://treasury.tn.gov/orp/index.html
Risk Management	Program and claim process information, property insurance report search, safety check lists, loss control reports and employee safety information/videos	http://treasury.tn.gov/risk/index.html
Tennessee Consolidated Retirement System	Program information, benefits calculator, newsletters, forms, annual report, frequently asked questions and retirement planning information	http://treasury.tn.gov/tcrs/index.html
WORKERS' COMPENSATION		
Advisory Council on Workers' Compensation	Program information, reports, video minutes/meetings and public notices	http://treasury.tn.gov/claims/wcadvisory.html
Workers' Compensation for State Employees Only	Program information, reporting accidents, filing claims, eligibility criteria and provider directory	http://treasury.tn.gov/wc/index.html
OTHER		
About the Treasurer	Statutory duties and biographical information	http://treasury.tn.gov/about.html
Annual Report	Treasurer's Report on-line	http://treasury.tn.gov/TreasurersAnnualReport_2013.pdf
Tennessee Financial Literacy Commission	Program information and resolutions	http://treasury.tn.gov/FinLit/index.html

FINANCIAL STATEMENTS

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES 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 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

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

Report on the Financial Statements

We have audited the accompanying statements of fiduciary net position of the Baccalaureate Education System Trust, Educational Services Plan, a private-purpose trust fund of the State of Tennessee, as of June 30, 2013, and June 30, 2012, the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, which collectively comprise the Baccalaureate Education System Trust, Educational Services Plan's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of the Baccalaureate Education System Trust. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Baccalaureate Education System Trust, Educational Services Plan.

(CONTINUED)

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Baccalaureate Education System Trust, Educational Services Plan of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in fiduciary net position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Baccalaureate Education System Trust, Educational Services Plan, a private-purpose trust fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2013, on our consideration of the Baccalaureate Education System Trust, Educational Services Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Baccalaureate Education System Trust, Educational Services Plan's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 12, 2013

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2013 AND JUNE 30, 2012

	June 30, 2013	June 30, 2012
ASSETS		
Cash and cash equivalents	$ 1,821,912	$ 1,057,970
Receivables		
Investment income receivable	172,914	11
Investments sold	1,530,073	0
Investments, at fair value		
Investment in fixed income index fund	51,132,336	59,757,402
Investment in equity index fund	33,219,287	31,916,209
TOTAL ASSETS	87,876,522	92,731,592
LIABILITIES		
Accounts payable	103,936	48,473
Other investment payable	0	9,304
TOTAL LIABILITIES	103,936	57,777
NET POSITION RESTRICTED FOR PLAN PARTICIPANTS	$ 87,772,586	$ 92,673,815

See accompanying Notes to the Financial Statements.

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

	For the Year Ended June 30, 2013	For the Year Ended June 30, 2012
ADDITIONS		
Investment income		
Net increase in fair value of investments	$ 4,239,455	$ 834,271
Interest and dividend income	1,340,818	1,355,067
Less: Investment expense	(15,854)	(38,339)
Net investment income	5,564,419	2,150,999
TOTAL ADDITIONS	5,564,419	2,150,999
DEDUCTIONS		
Refunds	1,369,911	1,069,230
Payments	8,819,676	8,476,846
Administrative cost	276,061	453,805
TOTAL DEDUCTIONS	10,465,648	9,999,881
CHANGE IN NET POSITION	(4,901,229)	(7,848,882)
NET POSITION, BEGINNING OF YEAR	92,673,815	100,522,697
NET POSITION, END OF YEAR	$ 87,772,586	$ 92,673,815

See accompanying Notes to the Financial Statements.

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2013 AND JUNE 30, 2012

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Tennessee Baccalaureate Education System Trust Fund (BEST), Educational Services Plan (ESEP) is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the BEST has been included in the *Tennessee Comprehensive Annual Financial Report* as a private-purpose 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 financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

3. **Cash and Cash Equivalents -** Cash and Cash Equivalents includes cash and short-term investments with a maturity date within three months of the acquisition date. Cash management pools are included as cash. Cash received by the ESEP that cannot be invested immediately in securities, or that is needed for operations, is invested in the State Pooled Investment Fund administered by the State Treasurer or a short-term, open-end mutual fund, Northern Institutional Government Portfolio, under the contractual arrangements for master custody services.

4. **Method Used to Value Investments** - Investments are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price. The fair value of investments in open-end mutual funds is based on the share price. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments and interest and dividend income. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.

5. **Adoption of New Accounting Pronouncement** - The ESEP implemented the Governmental Accounting Standards Board's Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the ESEP was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

B. DEPOSITS AND INVESTMENTS

In accordance with State statute, the ESEP assets may be invested in any instrument, obligation, security or property that constitutes a legal investment for assets of the Tennessee Consolidated Retirement System (TCRS). In addition, the assets of the ESEP may be pooled for investment purposes with the assets of the TCRS or any other assets under the custody of the State Treasurer. The authority for investing the assets of the ESEP 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. The ESEP does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State 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, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund (SPIF) is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 97-104 of this report.

(*CONTINUED*)

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

Credit Risk - The ESEP does not currently own specific fixed income securities, but chooses to invest in index funds that replicate the Barclays Aggregate Index. At June 20, 2013, the ESEP had $51,132,336 invested in the Vanguard Total Bond Market Index Fund. At June 30, 2012, the ESEP had $59,757,402 invested in the SSgA US Aggregate Bond Index Fund.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings for the ESEP's investments in fixed income securities as of June 30, 2013 and June 30, 2012 are not available since neither the Vanguard Total Bond Market Index Fund nor the SSgA US Aggregate Bond Index Fund are rated; however the average rating is AA for the Barclays Aggregate securities which is the basis for the Vanguard Total Bond Market Index Fund and SSgA US Aggregate Index at June 30, 2013 and June 30, 2012, respectively. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally recognized credit ratings agency. The Northern Institutional Government Portfolio had a credit quality rating of AAA at June 30, 2013 and June 30, 2012.

The ESEP's investment policy states that the trust may acquire securities which are rated within the four highest grades at the time of acquisition by any of the recognized rating agencies. In addition, the policy requires that only the highest quality short-term debt issues, including commercial paper with ratings of A1 or P1, may be purchased. The policy further states that index funds may be utilized as an alternative to selecting individual securities.

Interest Rate Risk - Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The investment policy for the ESEP states that bonds generally will be purchased and held to maturity, but when necessary, the portfolio will be actively managed in times of volatile interest rate swings to shorten the average maturity and protect principal value. The average duration for the Vanguard Total Bond Market Index Fund was 5.49 years at June 30, 2013. The effective duration for the SSgA US Aggregate Bond Index Fund was 5.05 years at June 30, 2012. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price.

C. <u>DESCRIPTION OF THE EDUCATIONAL SERVICES PLAN</u>

The Tennessee Baccalaureate Education System Trust, Educational Services Plan, administered by the State Treasurer, was 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 and other costs of attending colleges and universities. Under the program, a purchaser entered into a contract with the BEST Board of Trustees to purchase tuition units on behalf of a beneficiary. Each tuition unit purchased entitled the beneficiary to an amount no greater than 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 purchase price of the tuition unit was determined annually by the BEST Board of Trustees with the assistance of an actuary to maintain the plan's financial soundness. The BEST Board of Trustees voted to discontinue selling new prepaid units of tuition as of November 22, 2010 due to the rising cost of tuition. This action had no effect on units purchased prior to that date. Refunds and tuition payments are guaranteed only to the extent that ESEP program funds are available and neither the State of Tennessee nor the BEST Board of Trustees is liable for any amount in excess of available program funds. The net position restricted for plan participants was $4,790,417 more at June 30, 2013, and $5,622,945 more at June 30, 2012, than the amounts needed to fund the outstanding tuition units at their weighted average tuition unit prices in effect at the respective dates.

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 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

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

Report on the Financial Statements

We have audited the accompanying balance sheets of the Chairs of Excellence, a permanent fund of the State of Tennessee, as of June 30, 2013, and June 30, 2012, the related statements of revenues, expenditures, and changes in fund balances for the years then ended, and the related notes to the financial statements, which collectively comprise the Chairs of Excellence's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of the Chairs of Excellence. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Chairs of Excellence.

(CONTINUED)

CHAIRS OF EXCELLENCE
INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Chairs of Excellence of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in financial position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Chairs of Excellence, a permanent fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2013, on our consideration of the Chairs of Excellence's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Chairs of Excellence's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 12, 2013

CHAIRS OF EXCELLENCE
BALANCE SHEETS
JUNE 30, 2013 AND JUNE 30, 2012

	June 30, 2013	June 30, 2012
ASSETS		
Cash and cash equivalents	$ 9,018,826	$ 11,748,236
Investments, at fair value		
Government securities	80,887,286	82,853,089
Corporate securities	36,320,227	38,838,657
Investment in exchange traded equity fund	143,467,150	118,855,078
Total investments	260,674,663	240,546,824
Receivables		
Due from colleges and universities	82,000	315,000
Investments sold	2,044,698	0
Investment income receivable	1,507,820	858,507
Total receivables	3,634,518	1,173,507
TOTAL ASSETS	$273,328,007	$253,468,567
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Due to colleges and universities	$ 1,816,154	$ 1,953,124
Due to the Academic Scholars Fund	4,548,817	4,585,220
Investments purchased	5,155,710	1,185,185
TOTAL LIABILITIES	11,520,681	7,723,529
FUND BALANCES		
Nonspendable corpus	99,956,963	99,934,963
Restricted	161,850,363	145,810,075
TOTAL FUND BALANCES	261,807,326	245,745,038
TOTAL LIABILITIES AND FUND BALANCES	$273,328,007	$253,468,567

See accompanying Notes to the Financial Statements.

CHAIRS OF EXCELLENCE
STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

	For the Year Ended June 30, 2013	For the Year Ended June 30, 2012
REVENUES		
Investment income	$ 23,379,827	$ 10,300,357
Contributions from private sources	22,000	5,000
TOTAL REVENUES	23,401,827	10,305,357
EXPENDITURES		
University of Tennessee	3,658,873	3,626,598
Tennessee Board of Regents	3,470,792	3,481,959
Academic Scholars Fund	-	360,170
Administrative cost	209,874	197,237
TOTAL EXPENDITURES	7,339,539	7,665,964
EXCESS OF REVENUES OVER EXPENDITURES	16,062,288	2,639,393
FUND BALANCES, BEGINNING OF YEAR	245,745,038	243,105,645
FUND BALANCES, END OF YEAR	$261,807,326	$245,745,038

See accompanying Notes to the Financial Statements.

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Chairs of Excellence (COE) Trust forms an integral part of the primary government and has been included as a permanent fund in the *Tennessee 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), using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when they become both measurable and available, and expenditures are recognized when the related fund liability is incurred. Interest associated with the current fiscal year is considered to be available if received in six months.

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

4. **Method Used to Value Investments** - Investments are reported at fair value. For fair value reporting, securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. The fair value of investments in open-end mutual funds and exchange traded funds is based on the share price. Investment income includes realized and unrealized appreciation (depreciation) in the fair value of investments, and interest and dividend income. Securities and securities transactions are recorded in the financial statements on tradedate basis.

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

B. DEPOSITS AND INVESTMENTS

State statute authorizes the funds of the COE Trust to be commingled for investment with other trust funds and other funds subject to investment by the State Treasurer. The COE Trust does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State 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 and various U.S. Treasury and Agency obligations. The State 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.

(*CONTINUED*)

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

State statute also authorizes the Board of Trustees of the COE Trust to adopt an investment policy for the trust in accordance with the laws, guidelines and policies that govern investments by the Tennessee Consolidated Retirement System. The State Treasurer is responsible for the investment of trust funds in accordance with the policy established by the trustees. The investment policy of the COE Trust requires that public funds, capital gains on public funds, and all current income exceeding withdrawals be invested in fixed income securities. Private contributions may be invested in equity securities, including domestic and foreign common stocks, preferred stocks and convertible bonds. Subsequent to the initial funding of a chair, funds may be transferred from the equity corpus to the fixed income corpus but not from the fixed income corpus to the equity corpus.

State statutes governing the COE Trust investments and the COE Trust's investment policy authorize the COE Trust to invest in certain Exchange Traded Funds ("ETFs"). By way of reference to the state statutes governing investments for the Tennessee Consolidated Retirement System, which in turn reference the state statutes governing investments for domestic life insurance companies, the COE Trust's investment policy and state statutes governing investments for the COE Trust require ETFs to be considered an equity interest in a business entity for the purpose of determining compliance with the policy and statutes' investment restrictions. As a result of this reference, a one-percent (1%) limitation on the percentage of assets that can be invested in a single business entity exists for the COE Trust. While the COE Trust's investment policy provides for the investment in certain ETFs as an effective and efficient alternative to selecting individual securities for the equity portfolio, the COE Trust's investment in two ETFs did exceed the one-percent (1%) limitation on the percentage of assets that can be invested in a single business entity, as referenced within the domestic life insurance statutes. At June 30, 2013, 13% of COE's total assets were invested in one equity ETF (an ETF that replicates all the stocks in the MSCI EAFE index), and 40% of its total assets were invested in another equity ETF (an ETF that replicates all the stocks in the S&P 500 index). During the year ended June 30, 2013, the COE Trust's equity investments were within the overall limits on equity securities per statutory and policy provisions.

As of June 30, 2013 and June 30, 2012, the COE Trust had the following investments (expressed in thousands):

(*CONTINUED*)

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

Investment Type	Fair Value as of June 30, 2013	U.S. Treasury/ Agency (1)	Credit Quality Ratings AAA	AA	A	BBB	BB	CCC	Not Rated
Debt Investments									
U.S. Government Agencies	$ 5,728	$ 2,312		$ 3,416					
U.S. Government TIPS	27,214	27,214							
U.S. Government Treasuries	6,192	6,192							
Municipal Bonds	4,358		$ 549	2,745	$ 1,064				
Government Asset Backed	2,817	2,817							
Government Mortgage Backed	34,577	1,055							$33,522 (2)
Corporate Asset Backed	1,020		138		882				
Corporate Bonds	32,590		1,618	1,953	12,968	$14,175	$1,064		812
Corporate Mortgage Backed	2,711		2,269					$ 442	
Total Debt Investments	$117,207	$39,590	$4,574	$ 8,114	$14,914	$14,175	$1,064	$ 442	$34,334
Other Investments									
Commingled Funds									
U.S. Equity	$108,118								
Non - U.S. Equity	35,349								
Money Market Mutual Funds (rated AAA)	8,393								
Total Other Investments	$151,860								
Total Investments	$269,067								
Less: Investments Classified as Cash Equivalents on Balance Sheet	(8,393)								
Total Investments as Shown on Balance Sheet	$260,674								

(1) Includes obligations of the U.S. government or obligations explicitly guaranteed by the U. S. government.

(2) Includes securities that are implicitly guaranteed by the U.S. government but are not rated by Standard and Poor's or Moody's.

Investment Type	Fair Value as of June 30, 2012	U.S. Treasury/ Agency (1)	Credit Quality Ratings AAA	AA	A	BBB	BB	CCC	Not Rated
Debt Investments									
U.S. Government Agencies	$ 5,314	$ 2,348		$ 2,966					
U.S. Government TIPS	28,480	28,480							
U.S. Government Treasuries	14,599	14,599							
Municipal Bonds	3,626		$ 584	2,525	$ 517				
Government Asset Backed	991	991							
Government Mortgage Backed	29,843	3,250							$26,593 (2)
Corporate Asset Backed	261		261						
Corporate Bonds	33,797		1,640	3,304	11,280	$16,569			1,004
Corporate Mortgage Backed	4,781		2,650	1,656				$ 475	
Total Debt Investments	$121,692	$49,668	$5,135	$10,451	$11,797	$16,569	$ 0	$ 475	$27,597
Other Investments									
Commingled Funds									
U.S. Equity	$ 89,937								
Non - U.S. Equity	28,918								
Money Market Mutual Funds (rated AAA)	11,851								
Total Other Investments	$130,706								
Total Investments	$252,398								
Less: Investments Classified as Cash Equivalents on Balance Sheet	(11,851)								
Total Investments as Shown on Balance Sheet	$240,547								

(1) Includes obligations of the U.S. government or obligations explicitly guaranteed by the U. S. government.

(2) Includes securities that are implicitly guaranteed by the U.S. government but are not rated by Standard and Poor's or Moody's.

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings for the COE Trust's investments in fixed income securities as of June 30, 2013 and June 30, 2012 are included in the above schedule. Securities are rated using Standard and Poor's and/or Moody's and are presented above using the Standard and Poor's rating scale. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally recognized credit ratings agency. The Northern Institutional Government Portfolio has a credit quality rating of AAA at June 30, 2013 and June 30, 2012.

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

As noted above, the COE Trust does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash purposes. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 97-104 of this report.

Concentration of Credit Risk - A concentration of investments in any one single issuer of debt securities presents a greater risk for loss in the event that the issuer fails on its obligations. The COE Trust had the following investment amounts and percentages of total investments at June 30, 2013 or June 30, 2012, in organizations representing five percent or more of total investments, excluding those organizations whose issues are explicitly guaranteed by the United States government, and investments in mutual funds, external investment pools, and other pooled investments:

	June 30, 2013		June 30, 2012	
Issuer Organization	**Fair Value**	**Percentage**	**Fair Value**	**Percentage**
Federal National Mortgage Association	$ 22,311,895	8.56%	$20,558,296	8.55%
Federal Home Loan Mortgage Corporation	11,381,669	5.13%	8,746,807	3.64%

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

Interest Rate Risk - Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The investment policy for the COE Trust states that the maturity of its debt securities may range from short-term instruments, including investments in the State Pooled Investment Fund, to long-term bonds, with consideration of liquidity needs. However, the policy does not specifically address limits on investment maturities. The fixed income portfolio is benchmarked against the Barclays Aggregate Index and tends to have a duration within a tight range around that index. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price. The COE Trust had the following investments and effective duration at June 30, 2013 and June 30, 2012 (expressed in thousands).

(*CONTINUED*)

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

Debt Investments
(Expressed in Thousands)

Investment Type	Fair Value as of June 30, 2013	Effective Duration (years)
Debit Investments		
U.S. Government Agencies	$ 5,728	4.20
U.S. Government TIPS	27,214	8.37
U.S. Government Treasuries	6,192	4.12
Municipal Bonds	4,358	7.11
Government Asset Backed	2,817	5.91
Government Mortgage Backed	34,577	4.62
Corporate Asset Backed	1,020	4.67
Corporate Bonds	32,590	6.82
Corporate Mortgage Backed	2,711	1.02
Total Debt Investments	$ 117,207	6.10

Investment Type	Fair Value as of June 30, 2012	Effective Duration (years)
Debit Investments		
U.S. Government Agencies	$5,314	3.62
U.S. Government TIPS	28,480	8.53
U.S. Government Treasuries	14,599	8.48
Municipal Bonds	3,626	7.53
Government Asset Backed	991	4.39
Government Mortgage Backed	29,843	1.23
Corporate Asset Backed	261	0.00
Corporate Bonds	33,797	6.24
Corporate Mortgage Backed	4,781	1.44
Total Debt Investments	$121,692	5.52

Asset Backed Securities - The COE Trust invests in collateralized mortgage obligations (CMOs) which are mortgage backed securities. These securities are based on cash flows from interest and principal payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. The fair value of CMOs at June 30, 2013 was $2,711,000 of which $1,083,196 were CMOs that are generally more sensitive to interest rate changes. The fair value of CMOs at June 30, 2012 was $4,780,616 of which $2,585,576 were CMOs that are generally more sensitive to interest rate changes.

C. OTHER ACCOUNTING DISCLOSURES

1. **Chairs of Excellence Endowment Trust -** The COE Trust is authorized by the 94th General Assembly to further the cause of education in Tennessee. The COE Trust is administered by the State Treasurer. The Trust is set up into two general accounts which equally divide any state appropriations: one for the University of Tennessee and one for the Tennessee Board of Regents. As each Chair is designated, a portion of the appropriation is transferred to a subaccount 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, 2013, 99 Chairs have been established with matching contributions received totaling $55,956,963. Total contributions to the COE Trust totaled $99,956,963 as of June 30, 2013. This includes $44,000,000 from the State, $10,321,300 from Colleges and Universities, and $45,635,663 from private contributions.

2. **Academic Scholars Fund** - 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 domestic fixed income securities.

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 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

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

Report on the Financial Statements

We have audited the accompanying balance sheet of the Criminal Injuries Compensation Fund, a special revenue fund of the State of Tennessee, as of June 30, 2013, the related statements of revenues, expenditures, and changes in fund balance and revenues, expenditures, and changes in fund balance (budget and actual) for the year then ended, and the related notes to the financial statements, which collectively comprise the Criminal Injuries Compensation Fund's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 of the State of Tennessee as of June 30, 2013, and the changes in financial position and the budgetary comparison thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

(CONTINUED)

CRIMINAL INJURIES COMPENSATION FUND
INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Criminal Injuries Compensation Fund, a special revenue fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2013, and the changes in its financial position and the budgetary comparison for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2013, on our consideration of the Criminal Injuries Compensation Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Criminal Injuries Compensation Fund's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 12, 2013

CRIMINAL INJURIES COMPENSATION FUND
BALANCE SHEET
JUNE 30, 2013

ASSETS	
Cash	$ 9,534,887
Accounts receivable	486,289
Due from federal government	5,650,000
TOTAL ASSETS	$ 15,671,176
LIABILITIES AND FUND BALANCE	
LIABILITIES	
Accounts payable	$ 245,586
Claims liability	6,705,024
TOTAL LIABILITIES	6,950,610
FUND BALANCE	
Committed for victims of drunk drivers (see Note B.2)	739,445
Committed for compensation under the Criminal Injuries Compensation Act	7,981,121
TOTAL FUND BALANCE	8,720,566
TOTAL LIABILITIES AND FUND BALANCE	$ 15,671,176

See accompanying Notes to the Financial Statements.

CRIMINAL INJURIES COMPENSATION FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEAR ENDED JUNE 30, 2013

REVENUES	
State	
Fines	$6,474,210
Fees	2,261,368
Federal	5,650,000
Interest income	14,354
Other	1,216,238
TOTAL REVENUES	15,616,170
EXPENDITURES	
Claim payments	12,968,986
Victims' coalition grant	100,000
Administrative cost	1,120,132
TOTAL EXPENDITURES	14,189,118
EXCESS OF REVENUES OVER EXPENDITURES	1,427,052
OTHER FINANCING USE	
Transfer to General Fund for District Attorneys General Grant	249,900
NET CHANGE IN FUND BALANCE	1,177,152
FUND BALANCE, BEGINNING OF YEAR	8,821,672
Prior Period Adjustment (Note B.3)	(1,278,258)
FUND BALANCE, BEGINNING OF YEAR RESTATED	7,543,414
FUND BALANCE, END OF YEAR	$8,720,566

See accompanying Notes to the Financial Statements.

CRIMINAL INJURIES COMPENSATION FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL (BUDGETARY BASIS) FOR THE YEAR ENDED JUNE 30, 2013

	Original Budget	Final Budget	Actual (Budgetary Basis)
REVENUES			
Fines	$7,074,500	$7,074,500	$6,474,210
Fees	2,353,400	2,353,400	2,261,368
Federal	6,200,000	6,200,000	5,650,000
Interest income	0	0	14,354
Other	472,100	472,100	1,216,238
TOTAL REVENUES	16,100,000	16,100,000	15,616,170
EXPENDITURES			
Claim payments	14,650,100	14,650,100	12,968,986
Victims' coalition grant	100,000	100,000	100,000
Administrative cost	1,100,000	1,100,000	1,120,132
TOTAL EXPENDITURES	15,850,100	15,850,100	14,189,118
EXCESS OF REVENUES OVER EXPENDITURES	249,900	249,900	1,427,052
OTHER USES OF FINANCIAL RESOURCES			
Transfer to General Fund for District Attorneys General Grant	249,900	249,900	249,900
NET CHANGE IN FUND BALANCE	0	0	1,177,152
FUND BALANCE, BEGINNING OF YEAR	8,821,672	8,821,672	8,821,672
Prior Period Adjustment (Note B.3)	(1,278,258)	(1,278,258)	(1,278,258)
FUND BALANCE, BEGINNING OF YEAR, RESTATED	7,543,414	7,543,414	7,543,414
FUND BALANCE, END OF YEAR	$7,543,414	$7,543,414	$8,720,566

See accompanying Notes to the Financial Statements.

CRIMINAL INJURIES COMPENSATION FUND NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2013

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Criminal Injuries Compensation Fund (CICF) 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 is funded through fines assessed in courts against certain criminal defendants upon conviction, fees levied against parolees and probationers, proceeds from bond forfeitures in felony cases, donations from individuals serving as jurors, interest income 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.

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 current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when they become both measurable and available and expenditures are recognized at the time the fund liabilities are incurred. For revenue recognition purposes, fines and bond forfeitures are considered to be available if received in the first sixty days of the new fiscal year. Federal grants, departmental services and interest associated with the current fiscal year are all considered to be available if received in six months. All other revenue items are considered to be measurable and available only when cash is received by the Criminal Injuries Compensation Fund.

   Generally, the CICF receives both restricted and committed resources. Restricted funds are those that are restricted for specific purposes stipulated by external resource providers, constitutionally or through enabling legislation. Committed funds can only be used for specific purposes as a result of constraints imposed by the Tennessee General Assembly-the fund's highest level of decision-making authority. Committed amounts cannot be used for any other purpose unless the Tennessee General Assembly removes those constraints by taking the same type of action (i.e., legislation). When both the restricted and other fund balance resources are available for use, it is the policy for the fund to use the restricted resources first, followed by the committed amounts.

3. **Cash** - The Criminal Injuries Compensation Fund does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State 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 and various U.S. Treasury and Agency obligations. The State 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 State Pooled Investment Fund is not rated by a nationally recognized statistical ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 97-104 of this report.

4. **Budgetary Process** - Legislation requires that annual budgets be adopted for special revenue funds. The proposed CICF budget is included in the budget proposal presented by the Governor to the General Assembly at the beginning of each annual legislative session. The CICF annual budget is prepared on the modified accrual basis of accounting. Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes or administrative intradepartmental transfers, may be affected with certain executive and legislative branch approval. Only the legislature may transfer appropriations between departments.

CRIMINAL INJURIES COMPENSATION FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013

B. OTHER ACCOUNTING DISCLOSURES

1. **Due from Federal Government** - The receivable shown on the Balance Sheets as due from federal government includes funds for a grant awarded to the CICF under the Victims of Crime Act Formula Grant Program by the Department of Justice, Office of Justice Programs.

2. **Committed Fund Balance** - A portion of the fund balance has been committed for the Victims of Drunk Drivers Compensation Fund (VDDC) which is included in the Criminal Injuries Compensation Fund. A requirement of the CICF and VDDC combination is that a reserve be established annually for an amount equal to three times the awards paid for VDDC during the prior fiscal year. *Chapter 761 of the Public Acts of 1992* discusses the fund combination as well as the VDDC reserve requirement.

3. **Prior Period Adjustment** - During the year ended June 30, 2013, the method of calculating the accrued liability for claims was revised to include incurred but not reported claims and to revise the estimated percentage of payments for claims received. As a result, fund balance at June 30, 2012, was decreased by $1,278,258.

4. **Transfer to General Fund** - In accordance with the section 41, item 16 of Public Chapter 1029, of the 107th General Assembly of the State of Tennessee, a grant was awarded to the District Attorneys General for domestic violence prevention and drug enforcement activities from the CICF.

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 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

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

Report on the Financial Statements

We have audited the accompanying statements of fiduciary net position of the Flexible Benefits Plan, an employee benefit trust fund of the State of Tennessee, as of June 30, 2013, and June 30, 2012, the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, which collectively comprise the Flexible Benefits Plan's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Flexible Benefits Plan of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in fiduciary net position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

(CONTINUED)

FLEXIBLE BENEFITS PLAN
INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Flexible Benefits Plan, an employee benefit trust fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2013, on our consideration of the Flexible Benefits Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Flexible Benefits Plan's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 12, 2013

FLEXIBLE BENEFITS PLAN
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2013 AND JUNE 30, 2012

	June 30, 2013	June 30, 2012
ASSETS		
Cash	$1,012,710	$ 947,492
Contributions receivable	231,250	269,093
TOTAL ASSETS	1,243,960	1,216,585
LIABILITIES		
Accounts payable	63,072	3,077
TOTAL LIABILITIES	63,072	3,077
NET POSITION		
Restricted for employees' flexible benefits	$1,180,888	$1,213,508

See accompanying Notes to the Financial Statements.

FLEXIBLE BENEFITS PLAN
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

	June 30, 2013	June 30, 2012
ADDITIONS		
Employee contributions	$7,184,359	$ 8,060,267
TOTAL ADDITIONS	7,184,359	8,060,267
DEDUCTIONS		
Employee reimbursements	7,058,474	8,051,268
Administrative cost	158,505	270,838
TOTAL DEDUCTIONS	7,216,979	8,322,106
CHANGE IN NET POSITION	(32,620)	(261,839)
NET POSITION, BEGINNING OF YEAR	1,213,508	1,475,347
NET POSITION, END OF YEAR	$1,180,888	$ 1,213,508

See accompanying Notes to the Financial Statements.

FLEXIBLE BENEFITS PLAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Flexible Benefits Plan is made available to state employees as an employee benefit. This plan is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the Flexible Benefits Plan is included in the *Tennessee Comprehensive Annual Financial Report (CAFR)* as an employee benefit 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 plan year except in the event of a corresponding change in the participant's family status. Participants may claim expenses incurred through March 15th following the end of the plan year. Any contributions to the plan not withdrawn are forfeited to the state and are used for defraying administrative costs. In calendar year 2009, the state added reimbursement accounts for transportation and parking expenses in accordance with *Internal Revenue Code Section 132*. These plans operate in much the same manner as the *Section 125* plans in that employees may elect to direct a portion of their salary tax-exempt to pay for transportation or parking expenses. However, there are no restrictions on time of enrollment or account changes and any contributions not used will be rolled forward to the following year instead of forfeited.

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 financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned, and expenses are recorded at the time liabilities are incurred.

3. **Cash** - The Flexible Benefits Plan does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State 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, and various U.S. Treasury and Agency obligations. The State 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 State Pooled Investment Fund is not rated by a nationally recognized statistical ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 97-104 of this report.

4. **Participant Contribution Forfeitures and Plan Administration** - Participant contributions not reimbursed to participants and forfeited to the plan for the latest closed plan year are transferred to the Treasury Department and applied toward funding a portion of the plan administrative cost. The remaining administrative costs for the plan are recovered directly from funds of the participating employer agencies. The amount forfeited is reflected on the Statement of Changes in Fiduciary Net Position as administrative cost.

5. **Adoption of New Accounting Pronouncement** - The Flexible Benefits Plan implemented the Governmental Accounting Standards Board's Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on Flexible Benefits Plan was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

RISK MANAGEMENT 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 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

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

Report on the Financial Statements

We have audited the accompanying statements of net position of the Risk Management Fund, an internal service fund of the State of Tennessee, as of June 30, 2013, and June 30, 2012, the related statements of revenues, expenses, and changes in fund net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Risk Management Fund's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the Board of Claims. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Risk Management Fund.

(CONTINUED)

RISK MANAGEMENT FUND
INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Risk Management Fund of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Risk Management Fund, an internal service fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in its financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2013, on our consideration of the Risk Management Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Risk Management Fund's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 12, 2013

RISK MANAGEMENT FUND
STATEMENTS OF NET POSITION
JUNE 30, 2013 AND JUNE 30, 2012

	June 30, 2013	June 30, 2012
ASSETS		
Current assets		
Cash	$ 108,502,659	$ 97,219,518
Due from federal government	10,695,883	9,794,547
Total current assets	119,198,542	107,014,065
Noncurrent assets		
Due from federal government	0	901,336
TOTAL ASSETS	119,198,542	107,915,401
LIABILITIES		
Current liabilities		
Accounts payable	872,339	861,570
Unearned revenue	8,000	8,000
Claims liability	31,286,133	34,094,841
Total current liabilities	32,166,472	34,964,411
Noncurrent liabilities		
Claims liability	65,117,000	63,885,662
TOTAL LIABILITIES	97,283,472	98,850,073
NET POSITION - UNRESTRICTED	$ 21,915,070	$ 9,065,328

See accompanying Notes to the Financial Statements.

RISK MANAGEMENT FUND
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

	For the Year Ended June 30, 2013	For the Year Ended June 30, 2012
OPERATING REVENUES		
Casualty premiums	$47,100,700	$42,692,300
Property premiums	10,267,900	8,280,300
TOTAL OPERATING REVENUES	57,368,600	50,972,600
OPERATING EXPENSES		
Torts		
Death	1,934,531	1,365,833
Bodily injury	2,223,003	4,825,608
Property damage	1,112,205	877,673
Total Torts	5,269,739	7,069,114
Workers' Compensation		
Death	224,643	188,932
Medical	14,111,115	15,642,340
Temporary disability	3,535,887	4,065,553
Permanent disability	7,283,689	7,201,501
Total Workers' Compensation	25,155,334	27,098,326
Property Damage		
Employee property	22,391	18,827
State owned property	807,818	9,010,276
Total Property Damage	830,209	9,029,103
Property insurance premiums	5,356,668	4,813,658
Professional/Administrative	8,699,562	9,542,107
Reduction of accrued liability	(682,860)	(1,732,301)
TOTAL OPERATING EXPENSES	44,628,652	55,820,007
OPERATING GAIN/(LOSS)	12,739,948	(4,847,407)
NON-OPERATING REVENUES		
Grant revenue	0	323,375
Interest income	107,194	114,318
Taxes	2,600	2,215
TOTAL NON-OPERATING REVENUES	109,794	439,908
CHANGE IN NET POSITION	12,849,742	(4,407,499)
NET POSITION, BEGINNING OF YEAR	9,065,328	13,472,827
NET POSITION, END OF YEAR	$21,915,070	$ 9,065,328

See accompanying Notes to the Financial Statements.

RISK MANAGEMENT FUND
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

	For the Year Ended June 30, 2013	For the Year Ended June 30, 2012
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from premiums	$ 57,368,600	$ 51,059,200
Receipts for insurance proceeds	0	296,308
Payments for claims	(32,016,631)	(47,827,151)
Payments for administrative expenses	(8,821,954)	(9,201,438)
Payments for insurance premiums	(5,356,668)	(4,862,150)
NET CASH FROM OPERATING ACTIVITIES	11,173,347	(10,535,231)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Taxes received	2,600	2,215
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES	2,600	2,215
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	107,194	114,318
NET CASH FROM INVESTING ACTIVITIES	107,194	114,318
NET INCREASE/(DECREASE) IN CASH	11,283,141	(10,418,698)
CASH, BEGINNING OF YEAR	97,219,518	107,638,216
CASH, END OF YEAR	$ 108,502,659	$ 97,219,518
RECONCILIATION OF OPERATING INCOME/(LOSS) TO NET CASH FROM OPERATING ACTIVITIES		
OPERATING INCOME/(LOSS)	$ 12,739,948	$ (4,847,407)
ADJUSTMENTS TO RECONCILE OPERATING INCOME/(LOSS) TO NET CASH FROM OPERATING ACTIVITIES		
Changes in assets and liabilities		
Decrease in accounts receivable	0	86,600
Increase (decrease) in accounts payable	10,769	(27,300)
Decrease in claims liability	(1,577,370)	(5,747,124)
TOTAL ADJUSTMENTS	(1,566,601)	(5,687,824)
NET CASH FROM OPERATING ACTIVITIES	$ 11,173,347	$ (10,535,231)

See accompanying Notes to the Financial Statements.

RISK MANAGEMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Risk Management Fund (RMF) 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 financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The RMF distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from the services provided by the RMF. The principal operating revenue of the RMF consists of charges to its customers for insurance premiums. Operating expenses include claims expenses, insurance premiums, administrative expenses and the current charge to the accrued liability. Revenues and expenses not resulting from the services provided by the RMF are reported as nonoperating revenues and expenses.

3. **Cash** - The Risk Management Fund does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State 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, and various U.S. Treasury and Agency obligations. The State 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 State Pooled Investment Fund is not rated by a nationally recognized ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 97-104 of this report.

4. **Adoption of New Accounting Pronouncement** - The RMF implemented the Governmental Accounting Standards Board's Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the RMF was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

B. OTHER ACCOUNTING DISCLOSURES

1. **Risk Management** - It is the policy of the state not to purchase commercial insurance for the risks associated with casualty losses for general liability, automobile liability, professional medical malpractice liability, and workers' compensation. By statute, the maximum liablilty for general liability, automobile liability, and medical malpractice liability is $300,000 per person and $1 million per occurrence. 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 RMF. The state purchases commercial insurance for real property, builder's risk (for construction projects starting prior to July 1, 2012) and crime and fidelity coverage on the state's officials and employees. The contractor is responsible for acquiring builder's risk insurance for all construction projects after June 30, 2012, thus builder's risk is no longer covered by the RMF. For property coverage, the deductible for an individual state agency is the first $25,000 of losses. The RMF is responsible for property losses for the annual aggregate deductible of $10 million for perils other than earthquake and flood. Purchased insurance coverage is responsible for losses exceeding the $10 million annual aggregate

(CONTINUED)

RISK MANAGEMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

deductible. For earthquake and flood, there is a deductible of $10 million per occurrence. The maximum insurance coverage is $750 million per year for perils other than earthquake and flood. The maximum flood insurance coverage is $50 million per occurrence, except there is only $25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is $50 million per occurence. Settled claims resulting from these risks have not exceeded maximum commercial insurance coverage in any of the past three fiscal years. All agencies and authorities of the state participate in the RMF, except for the Dairy Promotion Board and the Certified Cotton Growers' Organization. The Tennessee Education Lottery Corporation participates in the RMF for general liability purposes but is responsible for its own worker's compensation coverage.

The RMF 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. The present value of the casualty liability as actuarially determined was $89,292,000 (discounted at 1.0%) at June 30, 2013 and $90,030,000 (discounted at 1.5%) at June 30, 2012. The accrued liability for incurred property losses was $7,111,133 at June 30, 2013 and $7,950,503 at June 30, 2012. The changes in the balances of the claims liabilities during fiscal years 2012 and 2013 were as follows:

Fiscal Year	Beginning Claims Liability	Current Year Claims and Changes in Estimates	Claim Payments	Ending Claims Liability
2013	$97,980,503	$30,572,422	($32,149,792)	$96,403,133
2012	$103,727,627	$41,464,242	($47,211,366)	$97,980,503

The RMF held $108.5 million in cash at June 30, 2013 and $97.2 million in cash at June 30, 2012 that is designated for payment of these claims.

The RMF 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.

2. **Receivable** - The receivables shown on the Statement of Net Position as due from federal government include funds to be received from the Federal Emergency Management Agency for property losses that were classified as a disaster.

3. **Insurance Proceeds** - The State suffered a large loss as the result of a flood in May 2010. The state's insurance company provided an advance payment of $7.5 million in fiscal year 2011 and $5 million in fiscal year 2010 to assist the State in its recovery efforts. The flood losses are estimated to be approximately $16.8 million and the insurance company is responsible for the flood losses exceeding the $5 million deductible. These proceeds are passed on to state agencies as costs related to these losses are incurred. As of June 30, 2013, $9.0 million has been paid to state agencies for flood losses from insurance proceeds.

STATE POOLED INVESTMENT 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 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

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

Report on the Financial Statements

We have audited the accompanying statements of fiduciary net position of the State Pooled Investment Fund as of June 30, 2013, and June 30, 2012, the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, which collectively comprise the State Pooled Investment Fund's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the State Funding Board. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the State Pooled Investment Fund.

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STATE POOLED INVESTMENT FUND
INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the State Pooled Investment Fund of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in fiduciary net position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the State Pooled Investment Fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2013, on our consideration of the State Pooled Investment Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State Pooled Investment Fund's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 12, 2013

STATE POOLED INVESTMENT FUND
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2013 AND JUNE 30, 2012

	JUNE 30, 2013	JUNE 30, 2012
ASSETS		
Cash and cash equivalents	$ 2,475,926,454	$ 2,310,018,504
Short-term investments, at amortized cost	6,410,991,115	5,793,426,563
Investment receivable	194,107,545	101,157,466
Accrued income receivable	11,230,006	21,849,832
TOTAL ASSETS	9,092,255,120	8,226,452,365
LIABILITIES AND NET POSITION		
NET POSITION RESTRICTED FOR POOL PARTICIPANTS	$ 9,092,255,120	$ 8,226,452,365

See accompanying Notes to the Financial Statements.

STATE POOLED INVESTMENT FUND
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

	FOR THE YEAR ENDED JUNE 30, 2013	FOR THE YEAR ENDED JUNE 30, 2012
OPERATIONS		
Investment income	$ 14,013,687	$ 12,134,874
Expenses		
Administrative fee	4,133,505	3,867,738
Custodian and banking services fees	31,999	49,193
Total expenses	4,165,504	3,916,931
NET INVESTMENT INCOME	9,848,183	8,217,943
CAPITAL SHARE TRANSACTIONS (DOLLAR AMOUNTS AND NUMBER OF SHARES ARE THE SAME)		
Shares sold	39,778,319,120	39,327,120,570
Less shares redeemed	38,922,364,548	38,360,279,642
INCREASE FROM CAPITAL SHARE TRANSACTIONS	855,954,572	966,840,928
TOTAL INCREASE IN NET POSITION	865,802,755	975,058,871
NET POSITION, BEGINNING OF YEAR	8,226,452,365	7,251,393,494
NET POSITION, END OF YEAR	$ 9,092,255,120	$ 8,226,452,365

See accompanying Notes to the Financial Statements.

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The State Pooled Investment Fund (SPIF) is an external investment pool sponsored by the State of Tennessee. The external portion of the State Pooled Investment Fund, consisting of funds belonging to entities outside of the State of Tennessee Financial Reporting Entity, has been included as a separate investment trust fund in the *Tennessee Comprehensive Annual Financial Report*. The internal portion, consisting of funds belonging to the State and its component units, has been included in the various participating funds and component units 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) using the 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 and Cash Equivalents** - This classification includes deposits in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the State.

4. **Method Used to Report Investments and Participant Shares** - The SPIF is not registered with the Securities and Exchange Commission (SEC) as an investment company but, through its investment policy adopted by the Funding Board of the State of Tennessee (Funding Board), operates in a manner consistent with the SEC's Rule 2a7 of the *Investment Company Act of 1940*. Rule 2a7 allows SEC registered mutual funds to use amortized cost to report net assets in computing share prices. Likewise, the SPIF uses amortized cost accounting measures to report investments and share prices. During the fiscal years ended June 30, 2013 and June 30, 2012, the State had not obtained or provided any legally binding guarantees to support the value of participant shares. The State of Tennessee has not obtained a credit quality rating for the SPIF from a nationally recognized credit ratings agency.

5. **Adoption of New Accounting Pronouncement** - The SPIF implemented the Governmental Accounting Standards Board's Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the SPIF was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

B. DEPOSITS AND INVESTMENTS

The State Pooled Investment Fund is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board. The current resolution of the Funding Board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, 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, repurchase agreements for obligations of the United States or its agencies, and securities lending agreements whereby securities may be loaned for a fee. Investments in derivative type securities and investments of high risk are prohibited.

At June 30, 2013 and June 30, 2012, the principal amount of certificates of deposit in state depositories was $506,275,000 and $606,560,000 respectively. Interest rates on certificates of deposit held at June 30, 2013 ranged from 0.20% to 0.30% and at June 30, 2012 ranged from 0.20% to 0.30%. The days to maturity on certificates of deposit ranged from 7 to 270 days at June 30, 2013, and from 14 to 271 days at June 30, 2012.

As of June 30, 2013 and June 30, 2012, the SPIF had the following investments:

(CONTINUED)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

Investments
(Expressed in Thousands)

2013

Investment Type	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity	U.S. Treasury(1)	Carrying Amount Credit Quality Ratings			
							AAA	AA	A1(2)	Not Rated (3)
Cash Equivalents and Short-term Investments:										
U.S. Government Agencies	$4,349,368,434	$4,349,560,296	$4,342,092,000	.02% - 5.25%	12 - 397		$1,008,635,251	$1,823,391,093		$1,517,342,090
U.S. Government Treasuries	2,466,870,824	2,466,927,100	2,457,000,000	.03% - 4.25%	56 - 397	$2,466,870,824				
Commercial Paper	839,978,220	839,978,220	840,000,000	.015% - 0.15%	3 - 45				$839,978,220	
Total Cash Equivalents and Short-term Investments	$7,656,217,478	$7,656,465,616	$7,639,092,000			$2,466,870,824	$1,008,635,251	$1,823,391,093	$839,978,220	$1,517,342,090
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Position	(1,561,501,363)									
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Position	316,275,000									
Short-term investments as shown on Statement of Fiduciary Net Position	$6,410,991,115									

(1) Includes obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government.

(2) A1 is the highest rating category for commercial paper.

(3) Includes securities that are implicitly guaranteed by the U.S. government, but are not rated by Standard and Poor's or Moody's.

2012

Investment Type	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity	U.S. Treasury(1)	Carrying Amount Credit Quality Ratings			
							AAA	AA	A1(2)	Not Rated (3)
Cash Equivalents and Short-term Investments:										
U.S. Government Agencies	$3,576,657,290	$3,576,432,226	$3,568,519,000	0.00% - 5.13%	32 - 397		$49,998,398	$2,032,893,472		$1,493,765,420
U.S. Government Treasuries	2,329,353,055	2,329,280,930	2,315,000,000	0.03% - 4.38%	27 - 397	$2,329,353,055				
Commercial Paper	777,982,873	777,984,650	778,000,000	0.04% - 0.20%	3 - 42				$777,982,873	
Total Cash Equivalents and Short-term Investments	$6,683,993,218	$6,683,697,806	$6,661,519,000			$2,329,353,055	$49,998,398	$2,032,893,472	$777,982,873	$1,493,765,419
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Position	(1,254,341,655)									
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Position	363,775,000									
Short-term investments as shown on Statement of Fiduciary Net Position	$5,793,426,563									

(1) Includes obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government.

(2) A1 is the highest rating category for commercial paper.

(3) Includes securities that are implicitly guaranteed by the U.S. government, but are not rated by Standard and Poor's or Moody's.

(CONTINUED)

STATE POOLED INVESTMENT FUND NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2013 AND JUNE 30, 2012

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings for the SPIF's investments in debt securities as of June 30, 2013 and June 30, 2012 are included in the above schedule. Securities are rated using Standard and Poor's and/or Moody's and are presented above using the Standard and Poor's rating scale. State statutes provide a process for financial institutions desiring to act as state depositories to be approved by the State Treasurer. Statutes also provide for the Commissioner of Financial Institutions to advise, on a timely basis, the Treasurer and the Commissioner of Finance and Administration of the condition of each state bank and state chartered savings and loan association, including his recommendations regarding its condition and safety as a state depository. Similar provisions apply to federally chartered banks and savings and loan associations designated as state depositories. This process ensures that institutions whose financial status is uncertain are monitored for collateral sufficiency. All certificates of deposit are required by policy to be placed directly with state depositories. All repurchase agreements are done with primary dealers in government securities which have executed a master repurchase agreement with the State. The SPIF's investment policy requires a AAA credit quality rating for the purchase of obligations of instrumentalities that are not fully guaranteed by the United States government. Prime banker's acceptances must be issued by domestic banks with a minimum AA long-term debt rating or foreign banks with a AAA long-term debt rating by a majority of the rating services that have rated the issuer. The short-term debt rating must be at least A1 or the equivalent by all of the rating services that rate the issuer. Commercial paper should be rated in the highest tier by all rating agencies that rate the paper. Commercial paper on a credit rating agency's negative credit watch list cannot be purchased under the investment policy. The policy requires that a credit analysis report on the corporation be prepared prior to acquisition of the commercial paper.

Concentration of Credit Risk - A concentration of investments in any one single issuer of debt securities presents a greater risk for loss in the event that the issuer fails on its obligations. An objective stated in the SPIF's investment policy is that the investment portfolio will be diversified to avoid incurring unreasonable and avoidable risks regarding specific security types or individual financial institutions. Acquisitions are monitored by policy to assure that no more than twenty percent (20%) of the book value of the pool, at the date of acquisition, is invested in a single United States government agency security and that such acquisition does not cause the SPIF's aggregate United States government agency holdings to exceed fifty percent (50%) of the total book value of the pool on such date. In addition, the SPIF's investment policy limits the book value of prime banker's acceptances to five percent (5%) of the total book value of the pool and limits such investments in any one commercial bank to the lesser of five percent (5%) of the portfolio's book value or $25 million. Prime commercial paper investments are limited to five percent (5%) of the total portfolio book value invested in any one single issuing corporation and the total holdings of an issuer's paper should not represent more than five percent (5%) of the issuing corporation's total outstanding commercial paper, with the maximum amount of a specific corporation's commercial paper limited to $100 million, not including commercial paper maturing on the next business day. The SPIF held $141,000,000 of commercial paper from one corporation from September 26, 2012 through September 27, 2012, $180,000,000 of commercial paper from one corporation from September 28, 2012 through October 3, 2012 and $120,000,000 of commercial paper from one corporation from April 15, 2013 through May 2, 2013, in violation of the investment policy. Prime commercial paper shall not exceed forty percent (40%) of the total pool's book value. The SPIF had the following investment amounts and percentages of total investments, in organizations representing five percent (5%) or more of total investments, excluding those organizations whose issues are explicitly guaranteed by the United States government, and investments in mutual funds, external investment pools, and other pooled investments:

(CONTINUED)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

June 30,2013		
Issuer Organization	Carrying Amount	Percentage of Total Investments
Federal Home Loan Banks	$ 1,547,793,126	20.22%
Federal Farm Credit Banks	1,063,957,364	13.90%
Federal National Mortgage Association	633,110,530	8.27%
International Bank for Reconstruction and Development	586,887,337	7.67%
Federal Home Loan Mortgage Corporation	517,687,293	6.76%
BNP	439,998,900	5.75%

June 30,2012		
Issuer Organization	Carrying Amount	Percentage of Total Investments
Federal Home Loan Banks	$ 1,444,171,300	21.60%
Federal Home Loan Mortgage Corporation	1,428,535,195	21.37%
BNP	349,996,500	5.24%

Interest Rate Risk - Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The SPIF's investment policy with respect to maturity states that the dollar weighted average maturity of the pool shall not exceed one hundred twenty (120) days and that no investment may be purchased with a remaining maturity of greater than three hundred ninety seven (397) calendar days. At June 30, 2013, the weighted average maturity of the pool was one hundred thirteen (113) days. At June 30, 2012, the weighted average maturity of the pool was one hundred twenty four (124) days, which was in violation of the investment policy. The SPIF was in compliance with the policy at June 28, 2012 but was over the limit due to large outflows at year end. The weighted average maturity for the pool returned to one hundred twenty (120) days on July 5, 2012. In addition, it is the intent of the Funding Board that the fair value of the SPIF not deviate more than one-half percent (0.5%) from amortized cost. If it does, actions may include, but not be limited to, selling securities whose fair value substantially deviates from amortized cost, and investing in securities with ninety (90) days or less to maturity. Agency variable rate notes are permitted by investment policy provided they are indexed to treasury bill, commercial paper, federal funds, LIBOR or the prime rates. It is the intent of the Funding Board that variable rate notes must move in the same direction as general money market rates. Prime banker's acceptances must have an original maturity of not more than two hundred seventy (270) days to be eligible for purchase, with the intent to hold to maturity. Prime commercial paper shall not have a maturity that exceeds one hundred eighty (180) days, and individual repurchase agreement transactions shall not have a maturity that exceeds ninety (90) days.

As of June 30, 2013 and June 30, 2012, the SPIF portfolio had the following weighted average maturities on debt investments:

(CONTINUED)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

June 30, 2013		
Investment Type	**Carrying Amount**	**Weighted Average Maturity (Months)**
U.S. Government Agencies	$4,349,368,434	4.72
U.S. Government Treasuries	2,466,870,824	4.80
Commercial Paper	839,978,220	0.35
Total Debt Investments	$7,656,217,478	4.27
Total SPIF Portfolio	$8,947,459,042	3.77

June 30, 2012		
Investment Type	**Carrying Amount**	**Weighted Average Maturity (Months)**
U.S. Government Agencies	$3,576,657,290	5.47
U.S. Government Treasuries	2,329,353,055	5.44
Commercial Paper	777,982,873	0.21
Total Debt Investments	$6,683,993,218	4.84
Total SPIF Portfolio	$8,213,012,133	4.13

C. OTHER ACCOUNTING DISCLOSURES

Description of the State Pooled Investment Fund - The State Pooled Investment Fund is established by *Tennessee Code Annotated*, Section 9-4-603 "for the purpose of receiving and investing any money in the custody of any officer or officers of the state unless prohibited by statute to be invested." Participants in the SPIF include the general fund of the State and any department or agency of the State which is required by court order, contract, state or federal law or federal regulation to receive interest on invested funds and which are authorized by the State Treasurer to participate in the SPIF. In addition, funds in the State of Tennessee Local Government Investment Pool (LGIP) are consolidated with the SPIF for investment purposes only. The SPIF, as noted in A.4 above, is not registered as an investment company with the SEC. The primary oversight responsibility for the investment and operations of the SPIF rests with the Funding Board.

Investment in the SPIF by local governments and certain state agencies is optional and participants may invest any amount for any length of time in the SPIF. However, some deposits made to the LGIP are contractually required and 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.

An average rate of return is calculated on the investments made each month in the SPIF and is used to credit earnings to LGIP participants and the State departments and agencies required to earn interest. The State's general fund is credited with the residual earnings. Accordingly, participants' shares are sold and redeemed at a value equal to the amount of the principal plus accrued earnings while investments are reported at amortized cost. For the fiscal years ending June 30, 2013 and June 30, 2012, an administrative fee of .05 percent was charged against each participant's average daily balance to provide funding for administrative expenses to operate the SPIF.

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 37243-1402

PHONE (615) 401-7897
FAX (615) 532-2765

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

Report on the Financial Statements

We have audited the accompanying statements of plan net position of the Tennessee Consolidated Retirement System, pension trust funds of the State of Tennessee, as of June 30, 2013, and June 30, 2012, the related statements of changes in plan net position for the years then ended, and the related notes to the financial statements, which collectively comprise the Tennessee Consolidated Retirement System's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of trustees of the Tennessee Consolidated Retirement System. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Tennessee Consolidated Retirement System.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net position of the Tennessee Consolidated Retirement System as of June 30, 2013, and June 30, 2012, and the changes in plan net position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Emphasis of Matters

As discussed in Note A.1., the financial statements present only the Tennessee Consolidated Retirement System, pension trust funds, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2013, and June 30, 2012, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note C, the financial statements of the Tennessee Consolidated Retirement System include investments valued at $2,112,637,040 (5.62 percent of net position) whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis on pages 105 through 109 and the schedules of funding progress and employer contributions on page 128 be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

Other Information

Our audits were conducted for the purpose of forming an opinion on the basic financial statements as a whole. The actuarial balance sheet on page 129 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 do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 12, 2013, on our consideration of the Tennessee Consolidated Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Tennessee Consolidated Retirement System's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 12, 2013

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

The Management of the Tennessee Consolidated Retirement System (TCRS) provides this discussion and analysis as an overview of the TCRS' financial activities for the fiscal years ended June 30, 2013 and June 30, 2012. This section should be read in conjunction with the Independent Auditor's Report, the audited financial statements, and the accompanying notes.

FINANCIAL HIGHLIGHTS

- The plan net position (total assets minus total liabilities) of the TCRS at June 30, 2013 was $37.6 billion, increasing $2.7 billion (7.6 percent) from the plan net position at June 30, 2012. The net position is restricted for future benefit obligations.
- The TCRS relies upon contributions from employees and employers, along with investment income, to meet the funding requirements of an actuarially determined accrued liability. As of July 1, 2011, the date of the latest actuarial valuation, the TCRS' funded ratio was 92.1 percent for the SETHEEPP group and 89.2 percent for the PSPP group.
- Contribution revenue for fiscal year 2013 totaled $1,278,982,124 an increase of one percent compared to fiscal year 2012.
- Net investment income for fiscal year 2013 was $3,344,589,259. During fiscal year 2013, the TCRS received an investment return on its portfolio of 9.9 percent, compared to 5.6 percent for fiscal year 2012.
- Total benefits and refunds paid for fiscal year 2013 were $1,963,260,297 – representing an increase of 8.5 percent over fiscal year 2012 total benefits and refunds paid of $1,809,901,340.
- Total administrative expenses for fiscal year 2013 were $8,178,696 – representing an increase of 14.1 percent from fiscal year 2012 administrative expenses of $7,166,606.

OVERVIEW OF THE FINANCIAL STATEMENTS

The TCRS financial statements consist of the *Statement of Plan Net Position* (on pages 112 through 113), the *Statement of Changes in Plan Net Position* (on pages 114 through 115), and the *Notes to the Financial Statements* (on pages 116 through 129). In addition, *Required Supplementary Information* is presented, which includes this *Management's Discussion and Analysis,* as well as the schedules on pages 130 through 131.

The *Statement of Plan Net Position* and the *Statement of Changes in Plan Net Position* report information about the plan net position (total assets in excess of total liabilities) as of the end of the fiscal year and the changes in the plan net position during the fiscal year. These statements include all assets and liabilities using the accrual basis of accounting. Under the accrual basis of accounting, the current year's revenues and expenses are included in the financial activity, regardless of when cash is received or paid. The difference between the total assets and total liabilities on the *Statement of Plan Net Position*, or net position restricted for pension benefits, provides a measurement of the financial position of the TCRS as of the end of the fiscal year. The *Statement of Changes in Plan Net Position* provides information on the activities that caused the financial position to change during the fiscal year. Over time, increases or decreases in the plan net position of the TCRS are one indicator of whether the system's financial health is improving or deteriorating.

In addition to the two basic financial statements, the reader should also review the *Schedules of Funding Progress* and the *Schedules of Employer Contributions* to gain an understanding of the funded status of the TCRS over

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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM MANAGEMENT'S DISCUSSION AND ANALYSIS FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

time. This information provides an indication of the TCRS' ability to meet both current and future benefit payment obligations. The *Notes to the Financial Statements* are also essential to the reader's understanding of the financial statements and provide additional information regarding the TCRS, such as descriptions of the plans administered by the TCRS, including contribution and benefit provisions, and information about the accounting policies and investment activities.

ANALYSIS OF ASSETS, LIABILITIES AND PLAN NET POSITION

At June 30, 2013, the TCRS had plan net position (total assets in excess of total liabilities) of $37.6 billion, an increase of $2.7 billion (7.6 percent) from $34.9 billion at June 30, 2012, following the fiscal year 2012 increase of nearly $1.2 billion (3.7 percent) from the $33.7 billion of plan net position as of June 30, 2011. The assets of the TCRS consist primarily of investments. The increase in plan assets is primarily the result of investment return for the year since contributions stayed at the same level. Condensed financial information comparing the TCRS' plan net position for the past three fiscal years follows:

PLAN NET POSITION

	June 30, 2013	June 30, 2012	FY13 - FY12 Percentage Change	June 30, 2011	FY12 - FY11 Percentage Change
ASSETS					
Cash and cash equivalents	$732,917,328	$426,627,425	71.8 %	$414,134,562	3.0 %
Member and employer receivables	105,368,164	107,108,579	(1.6) %	99,604,471	7.5 %
Investment receivables	1,851,534,173	1,044,714,969	77.2 %	1,431,331,905	(27.0) %
Short-term securities	74,880,166	19,781,452	278.5 %	0	-- %
Long-term investments	36,550,793,912	34,272,630,084	6.6 %	33,220,879,536	3.2 %
Capital assets	21,887,170	11,426,938	91.5 %	1,896,671	502.5 %
TOTAL ASSETS	39,337,380,913	35,882,289,447	9.6 %	35,167,847,145	2.0 %
LIABILITIES					
Death benefits, refunds and other payables	50,816,303	10,193,417	398.5 %	8,544,407	19.3 %
Investment payables	1,721,659,248	959,323,058	79.5 %	1,495,994,494	(35.9) %
TOTAL LIABILITIES	1,772,475,551	969,516,475	82.8 %	1,504,538,901	(35.6) %
NET POSITION RESTRICTED FOR PENSION BENEFITS	$37,564,905,362	$34,912,772,972	7.6 %	$33,663,308,244	3.7 %

ANALYSIS OF REVENUES AND EXPENSES

Employer contribution rates for the TCRS changed during fiscal year 2013 resulting in a 1.0 percent increase in contributions from fiscal year 2012 to fiscal year 2013. Employer contribution rates for the TCRS did not change during fiscal year 2012; therefore, the slight change of 0.8 percent in contributions from fiscal year 2011 to fiscal year 2012 was due to changes in salary. Gross investment income for fiscal year 2013 increased $1.5 billion (84.5 percent) over fiscal year 2012 compared to fiscal year 2012 when gross investment income decreased $3.7 billion (67.0 percent) from investment income for fiscal year 2011.

Investment expenses for fiscal year 2013 increased $5.1 million (15.9 percent) due to the increase in portfolio market value during the year. Investment expenses for fiscal year 2012 increased a slight $166 thousand (0.5

(CONTINUED)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

percent). Although market conditions continued to show improvement in fiscal year 2012 which resulted in an overall gain to the TCRS investment portfolio of 5.61 percent and net investment income of $1.8 billion, the return was not as high as the prior fiscal year.

Total benefits and refunds paid during the year ended June 30, 2013 were $1,963,260,297, an increase of 8.5 percent over fiscal year 2012 total benefits and refunds paid which can be attributed to an increase in retirees and a 3.0% cost of living adjustment. Total benefits and refunds paid during the year ended June 30, 2012 were $1,809,901,340, an increase of 7.2 percent over fiscal year 2011 total benefits and refunds paid. The increase in benefit expenses for fiscal year 2012 is attributed to 1.5 percent in cost of living adjustments awarded to retirees on July 1, 2011, as well as more retirees being added to payroll than removed during this fiscal year. Total refunds paid increased $4.5 million (12.81 percent) in fiscal year 2012 from fiscal year 2011 and could be attributed to the weak economy where more terminated members are choosing to withdraw from the system instead of leaving the funds invested.

Administrative expenses for the year ended June 30, 2013 were $8,178,696, an increase of 14.1 percent from fiscal year 2012 administrative expenses. The increase was primarily due to the first phase of the new pension administration system being implemented in the last quarter of fiscal year 2012. The first full year of amortization of software development costs was recognized in fiscal year 2013. Administrative expenses for the year ended June 30, 2012 were $7,166,606, a slight increase of 0.14 percent over fiscal year 2011 administrative expenses.

Condensed financial information comparing the TCRS' revenues and expenses for the past three fiscal years follows:

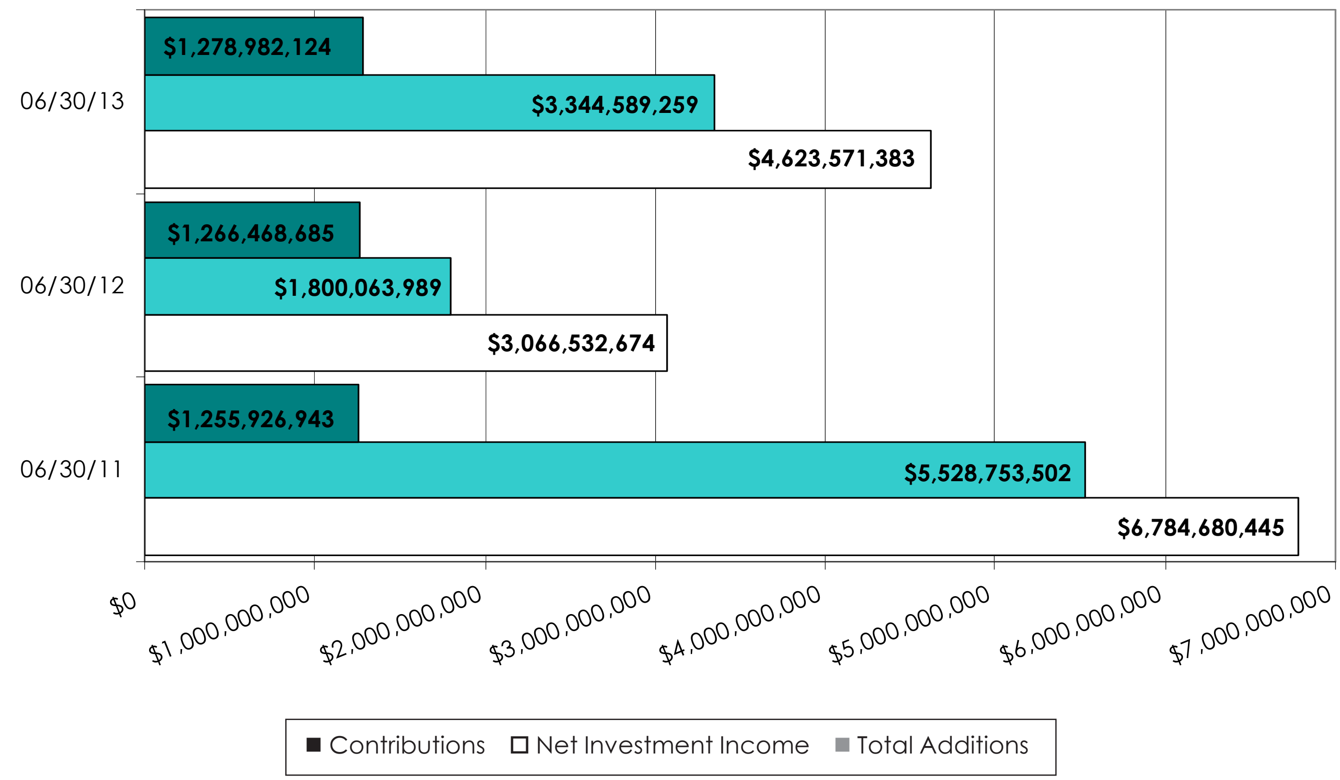
CHANGES IN PLAN NET POSITION

	For the Year Ended June 30, 2013	For the Year Ended June 30, 2012	FY13 - FY12 Percentage Change	For the Year Ended June 30, 2011	FY12 - FY11 Percentage Change
ADDITIONS					
Contributions	$ 1,278,982,124	$ 1,266,468,685	1.0 %	$ 1,255,926,943	0.8 %
Investment income					
Net appreciation in fair value of investments	2,334,383,940	825,366,874	182.8 %	4,597,653,001	(82.0) %
Interest, dividends and other investment income	1,047,724,725	1,007,076,475	4.0 %	963,313,744	4.5 %
Less: Investment expense	(37,519,406)	(32,379,360)	15.9 %	(32,213,243)	0.5 %
Net investment income	3,344,589,259	1,800,063,989	85.8 %	5,528,753,502	(67.4) %
TOTAL ADDITIONS	4,623,571,383	3,066,532,674	50.8 %	6,784,680,445	(54.8) %
DEDUCTIONS					
Annuity benefits	1,918,686,339	1,763,605,581	8.8 %	1,647,372,937	7.1 %
Death benefits	5,056,081	6,204,207	(18.5) %	5,498,139	12.8 %
Refunds	39,517,877	40,091,552	(1.4) %	35,539,393	12.8 %
Administrative expenses	8,178,696	7,166,606	14.1 %	7,156,822	0.1 %
TOTAL DEDUCTIONS	1,971,438,993	1,817,067,946	8.5 %	1,695,567,291	7.2 %
NET INCREASE	2,652,132,390	1,249,464,728	112.3 %	5,089,113,154	(75.4) %
NET POSITION RESTRICTED FOR PENSION BENEFITS					
BEGINNING OF YEAR	34,912,772,972	33,663,308,244	3.7 %	28,574,195,090	17.8 %
END OF YEAR	$ 37,564,905,362	$ 34,912,772,972	7.6 %	$ 33,663,308,244	3.7 %

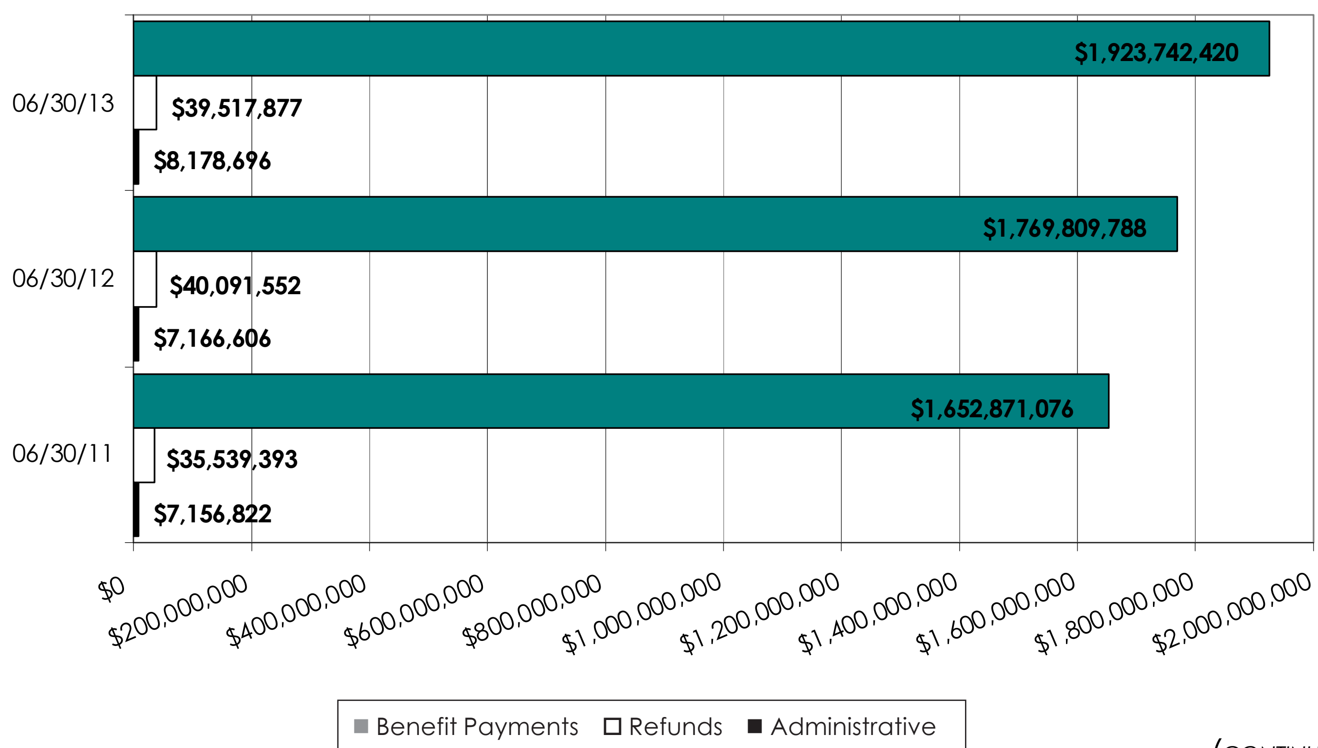
(CONTINUED)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

REVENUES BY TYPE



EXPENSES BY TYPE



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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

For the year ended June 30, 2013 the portfolio delivered a return of 9.92 percent which exceeded the actuarial required return by 2.42 percent. The return of the portfolio for the 2013 fiscal year was satisfying on an absolute basis, but it underperformed most peers in a reversal of its superior relative performance for the 2012 fiscal year. The primary driver of the change in relative performance was the lower risk strategic posture of the fund versus peers which led it to exceptional results in 2012 and then commensurately weaker relative results in 2013.

The strong results for risky assets in the 2013 fiscal year were exemplified by the 20.39 percent return for the U.S. Equity portfolio and the 17.90 percent return for the International Equity portfolio. In a reversal from the 2012 fiscal year, bond returns were poor and the U.S. Fixed Income portfolio lost a modest 0.81 percent versus a gain of 15.63 percent in the prior year. Treasury Inflation Protected Securities (TIPS) lost 5.28 percent which was also a reversal of the 12.22 percent gain they delivered in 2012.

The investment environment in 2013 was defined by a move into higher risk assets from lower risk assets. Investors sought to escape rising interest rates and also aimed to participate in stronger future economic growth than previously anticipated. Actual economic growth rates and corporate earnings were muted, which means that valuation expansion was the key driver of equity returns.

An actuarial valuation was performed as of July 1, 2011. The employer contribution rates determined in this valuation are effective July 1, 2012 through June 30, 2014. The required contributions to the plan increased primarily due to (1) investment returns being less than the actuarial earnings assumption and (2) members and retirees living longer. An actuarial experience study based on data as of June 30, 2012 was completed and adopted by the Board of Trustees during fiscal year 2013.

In December 2010, TCRS contracted with Deloitte Consulting, LLC, to provide a new pension administration system to replace the retirement information system. The new pension administration system, referred to as Concord, will replace five separate operating systems with one integrated web-based system that will greatly improve the level of service we provide to our members and employers. The multi-year Concord project will be implemented in three major phases: document imaging, retired payroll, and active member. The first and second phases of Concord have been implemented by the end of fiscal year 2013. Software development costs have been capitalized and are being amortized over the useful life of the system as each phase is implemented. The third and final phase will be implemented during fiscal year 2014.

During the 2013 legislative session, a new pension plan for state employees, higher education and K-12 public school teachers hired on or after June 30, 2014 was enacted into law. Members and retirees currently enrolled in TCRS will remain in the legacy plan. The new hybrid plan contains elements of a defined benefit plan and a defined contribution plan. The goals of the new plan were to provide a sufficient retirement benefit to members, a long term sustainable pension plan, and an affordable plan to employers. The new plan contains provisions to control employer cost and unfunded liability.

CONTACTING THE TCRS

This report is designed to provide a financial overview of the TCRS to state legislators, members of the Board of Trustees of the TCRS, state officials, participating employers and any other interested parties. Questions or requests for additional information regarding the financial information presented in this report may be addressed in writing to the Tennessee Treasury Department, Consolidated Retirement System, 502 Deaderick Street, Nashville, TN 37243-0201.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
STATEMENTS OF PLAN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

Expressed in Thousands	**State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)**	**Political Subdivisions Pension Plan (PSPP)**
ASSETS		
Cash and cash equivalents	$ 594,870	$ 138,047
Receivables		
Member receivable	21,879	5,490
Employer receivable	57,248	20,752
Accrued interest receivable	73,005	16,942
Accrued dividends receivable	48,110	11,164
Real estate income receivable	1,129	262
Derivative instruments receivable	837,403	194,326
Investments sold	543,151	126,042
Total receivables	1,581,925	374,978
Investments, at fair value		
Short-term securities	60,776	14,104
Government securities	6,801,041	1,578,237
Corporate securities	4,075,011	945,639
Corporate stocks	17,075,653	3,962,545
Derivative instruments	25	6
Private equities	221,369	51,370
Real estate	1,493,353	346,545
Total investments	29,727,228	6,898,446
Capital assets (net)	17,765	4,122
TOTAL ASSETS	31,921,788	7,415,593
LIABILITIES		
Accounts payable		
Death benefits and refunds payable	1,338	1,369
Retiree insurance premium payable	6,285	1,459
Other	54	0
Investments purchased	544,371	126,326
Derivative instruments payable	846,267	196,383
Due to other funds	32,719	7,592
Other investment payables	6,747	1,566
TOTAL LIABILITIES	1,437,781	334,695
NET POSITION RESTRICTED FOR PENSION BENEFITS	$ 30,484,007	$ 7,080,898

See accompanying Notes to the Financial Statements.

(CONTINUED)

June 30, 2013 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2012 Total
$ 732,917	$ 348,330	$ 78,297	$ 426,627
27,369	21,313	6,001	27,314
78,000	56,430	23,364	79,794
89,947	79,795	17,936	97,731
59,274	42,658	9,588	52,246
1,391	680	153	833
1,031,729	319,335	71,779	391,114
669,193	410,516	92,275	502,791
1,956,903	930,727	221,096	1,151,823
74,880	16,152	3,630	19,782
8,379,278	6,736,847	1,514,288	8,251,135
5,020,650	4,627,801	1,040,222	5,668,023
21,038,198	15,374,082	3,455,739	18,829,821
31	531	119	650
272,739	142,025	31,924	173,949
1,839,898	1,101,467	247,585	1,349,052
36,625,674	27,998,905	6,293,507	34,292,412
21,887	9,330	2,097	11,427
39,337,381	29,287,292	6,594,997	35,882,289
2,707	1,475	1,537	3,012
7,744	5,678	1,276	6,954
54	227	0	227
670,697	467,947	105,184	573,131
1,042,650	308,316	69,303	377,619
40,311	0	0	0
8,313	7,000	1,573	8,573
1,772,476	790,643	178,873	969,516
$37,564,905	$28,496,649	$6,416,124	$34,912,773

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
STATEMENTS OF CHANGES IN PLAN NET POSITION
FOR THE YEARS ENDED JUNE 30, 2013 AND JUNE 30, 2012

Expressed in Thousands	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)
ADDITIONS		
Contributions		
Member contributions	$ 196,792	$ 71,765
Employer contributions	735,886	274,539
Total contributions	932,678	346,304
Investment income		
Net appreciation in fair value of investments	1,899,653	434,731
Interest	380,175	87,002
Dividends	402,619	92,138
Real estate income, net of operating expenses	69,813	15,977
Total investment income	2,752,260	629,848
Less: Investment expense	(30,532)	(6,987)
Net investment income	2,721,728	622,861
TOTAL ADDITIONS	3,654,406	969,165
DEDUCTIONS		
Annuity benefits	1,639,031	279,655
Death benefits	3,051	2,006
Refunds	19,520	19,998
Administrative expense	5,446	2,732
TOTAL DEDUCTIONS	1,667,048	304,391
NET INCREASE	1,987,358	664,774
NET POSITION RESTRICTED FOR PENSION BENEFITS		
BEGINNING OF YEAR	28,496,649	6,416,124
END OF YEAR	$30,484,007	$7,080,898

See accompanying Notes to the Financial Statements.

(CONTINUED)

For the Year Ended June 30, 2013 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	For the Year Ended June 30, 2012 Total
$ 268,557	$ 194,180	$ 69,576	$ 263,756
1,010,425	731,352	271,361	1,002,713
1,278,982	925,532	340,937	1,266,469
2,334,384	675,639	149,728	825,367
467,177	414,344	91,816	506,160
494,757	353,064	78,237	431,301
85,790	56,987	12,628	69,615
3,382,108	1,500,034	332,409	1,832,443
(37,519)	(26,384)	(5,995)	(32,379)
3,344,589	1,473,650	326,414	1,800,064
4,623,571	2,399,182	667,351	3,066,533
1,918,686	1,509,512	254,093	1,763,605
5,057	4,515	1,689	6,204
39,518	22,575	17,517	40,092
8,178	4,751	2,416	7,167
1,971,439	1,541,353	275,715	1,817,068
2,652,132	857,829	391,636	1,249,465
34,912,773	27,638,820	6,024,488	33,663,308
$37,564,905	$28,496,649	$6,416,124	$ 34,912,773

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012

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 pension trust funds 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 financial statements have been prepared using the flow of 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 of time for which the contributions are assessed. 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. **Cash and Cash Equivalents** - Cash and cash equivalents include cash and short-term investments with a maturity date within three months of the acquisition date. Cash management pools are included as cash. Cash received by the TCRS that cannot be invested immediately in securities, or that is needed for operations, is invested in the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer. The classification of cash and cash equivalents also includes cash invested in a short-term, open-end mutual fund under the contractual arrangement for master custody services.

4. **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. The fair value of real estate investments is determined at least every three years by qualified independent appraisers who are members of the Appraisal Institute and internally by real estate advisors for those years when independent appraisals are not performed. The fair value of private equity investments is determined by the fund managers using various methodologies as applicable under Generally Accepted Accounting Principles. In many cases, these valuations are additionally reviewed by advisory boards comprised of a subgroup of the fund's investors. These valuations are audited on an annual basis by independent accounting firms engaged by the private equity fund managers. Investment income includes 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. Real estate transactions are recorded in the financial statements at the time of closing.

5. **Capital Assets** - Capital assets consist of internally generated computer software in development and the first two phases of internally generated computer software, which are reported at historical cost, less any applicable amortization. Capital assets are defined by the state as assets with an initial individual cost of $5,000 or more and an estimated useful life in excess of two years. Software in development at June 30, 2012 and June 30, 2013 was valued at $9,749,457 and $10,319,868,

(*CONTINUED*)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

respectively. Software in development will be amortized using the straight line method over the ten year estimated life of the system once a phase is implemented. The first and second phases of the computer software had been implemented at June 30, 2013 and amortization has been initiated. The computer software was valued at $1,677,480 and $11,567,302 at June 30, 2012 and June 30, 2013, respectively. Amortization expense was $43,012 in fiscal year 2012 and $430,046 in fiscal year 2013.

6. **Adoption of New Accounting Pronouncement -** The TCRS implemented the Governmental Accounting Standards Board's Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the TCRS was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

At July 1, 2011, the date of the latest actuarial valuation, the membership of each plan consisted of the following:

	SETHEEPP	PSPP
Retirees and beneficiaries currently receiving benefits	83,041	33,544
Terminated members entitled to but not receiving benefits	22,867	9,758
Current active members	135,588	79,488
Total	241,496	122,790
Number of participating employers	140	503

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. Compounded 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 except that (a) no COLA is granted if the CPI is less than one-half percent; (b) a COLA of 1 percent will be granted if the CPI increases between one-half percent and one percent; and (c) 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. Ad hoc increases may only be authorized by the General Assembly. Public safety officers receive an additional supplemental benefit that is paid from age 60 to age 62.

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.

(CONTINUED)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

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 position of the plan is 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, 2013, the plan's Member Reserve and Employer Reserve were fully funded with balances of $3.76 billion and $26.73 billion, respectively. At June 30, 2012, the plan's Member Reserve and Employer Reserve were fully funded with balances of $3.75 billion and $24.75 billion, 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 (COLA) are the same as provided by SETHEEPP except that the local government may elect (a) to provide no COLA benefits or (b) to provide COLA benefits under a non-compounding basis rather than the compounded basis applicable under SETHEEPP. 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 position of the plan is 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, 2013, the plan's Member Reserve

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and Employer Reserve were fully funded with balances of $1.2 billion and $5.88 billion, respectively. At June 30, 2012, the plan's Member Reserve and Employer Reserve were fully funded with balances of $1.15 billion and $5.27 billion, respectively.

C. DEPOSITS AND INVESTMENTS

State statute authorizes the TCRS to maintain cash, not exceeding ten percent of the total amount of funds in the retirement system, on deposit in one or more banks, savings and loan associations or trust companies that are qualified as state depositories. The TCRS does not utilize its own bank accounts but invests in the State Pooled Investment Fund for the initial deposit of funds and for its operating cash needs. The State 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 and various U.S. Treasury and Agency obligations. The State 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.

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

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

c. Within the restrictions in (a) and (b) above, an amount not to exceed twenty-five percent (25 percent) 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, provided that such percentage may be increased by the board with the subsequent approval of the council on pensions and insurance.

d. Within the restrictions in (a) and (b) above, funds may be invested in Canadian securities which are substantially of the same kinds, classes and investment grades as those otherwise eligible for investment.

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

f. The total sum invested in real estate shall not exceed ten percent (10 percent) of the market value of total assets.

g. The total sum invested in private equities shall not exceed ten percent (10 percent) of the market value of total assets.

State statute also authorizes the TCRS to invest in forward contracts to hedge its foreign currency exposure and to purchase or sell domestic equity index futures contracts for the purpose of asset allocation relating to the domestic equity portfolio. The total amount of the financial futures contract obligation shall not

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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

exceed ten percent (10 percent) of the market value of total assets. Gross exposure to approved fixed income financial instruments will be limited to 10% of the market value of the System's total assets for risk mitigating positions and 10% for risk positions. Position sizes will be measured by notional amounts. Options will be measured in their notional equivalents.

Title to real property invested in by the TCRS is held by real estate investment holding companies.

As of June 30, 2013 and June 30, 2012, the TCRS had the following investments:

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

Investments
(Expressed in Thousands)

2013

Investment Type	Fair Value as of June 30, 2013	U.S. Treasury/ Agency (1)	Credit Quality Ratings									
			AAA	AA	A	BBB	BB	B	CCC	CC	D	A1(3)	Not Rated
Debt Investments													
U.S. Govt. Agencies	$ 201,383		$ 18,065	$178,317									$ 5,001
U.S. Govt. Inflation Indexed	2,796,073	$2,796,073											
U.S. Govt. Treasuries, Notes and Bonds	1,672,391	1,672,391											
U.S. Govt. Asset Backed	56,918	56,918											
Municipal Bonds	149,678		2,197	95,804	$ 51,677								
Govt. Mortgage Backed	3,485,764	412,972		12,739									3,060,053 (2)
Comm. Mortgage Backed	398,696		328,998	67,111		$ 2,587							
Corporate CMO's	160,649				544			$ 1,335	$104,360	$24,389	$30,021		
Corporate Bonds	3,807,694		64,851	78,132	1,013,124	2,267,916	$336,402	17,648					29,621
Corporate Asset Backed	590,035		378,969	97,032	43,287	40,635	15,276				7,837		6,999
Non-U.S. Govt./Sovereign	17,068					17,068							
Short-Term Comm. Paper	644,339											$644,339	
Short-Term Bills and Notes	116,334												116,334
Total Debt Investments	$14,097,022	$4,938,354	$793,080	$529,135	$1,108,632	$2,328,206	$351,678	$18,983	$104,360	$24,389	$37,858	$644,339	$3,218,008
Other Investments													
U.S. Equity	$13,386,439												
Non-U.S. Equity	7,711,681												
Derivatives	31												
Real Estate	1,839,898												
Private Equities	272,739												
Money Market Funds (not rated)	3,007												
Escrow Claim	3,656												
Total Other Investments	$23,217,451												
Total Investments	$37,314,473												
Less: Short-Term Investments Classified as Cash Equivalents on the Statements of Plan Net Position	(688,800)												
Total Investments as Shown on Statements of Plan Net Position	$36,625,673												

(1) Includes obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government.

(2) Includes securities that are implicitly guaranteed by the U.S. government, but are not rated by Standard and Poor's or Moody's.

(3) A1 is the highest rating category for commercial paper.

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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

Investments
(Expressed in Thousands)

2012

Investment Type	Fair Value as of June 30, 2012	.S. Treasury/ Agency (1)	Credit Quality Ratings										
			AAA	AA	A	BBB	BB	B	CCC	CC	D	A1(3)	Not Rated
Debt Investments													
U.S. Govt. Agencies	$ 188,455		$ 19,332	$169,123									
U.S. Govt. Inflation Indexed	2,654,938	$2,654,938											
U.S. Govt. Treasuries, Notes and Bonds	1,558,334	1,558,334											
U.S. Govt. Asset Backed	76,372	76,372											
Municipal Bonds	155,316		2,336	99,328	$ 53,652								
Govt. Mortgage Backed	3,291,737	271,967		13,277									$3,006,493 (2)
Comm. Mortgage Backed	268,585		176,255	92,330									
Corporate CMO's	232,639		33,643					$43,223	$121,425	$24,197	$10,151		
Corporate Bonds	4,349,054		109,541	95,364	1,182,495	$2,675,562	$211,398	26,616		738			47,340
Corporate Asset Backed	782,669		573,571	98,607	35,353	24,745	1,291		8,020				41,082
Non-U.S. Govt./Sovereign	325,983		113,408	212,575									
Short-Term Comm. Paper	113,853											$113,853	
Short-Term Bills and Notes	304,269												304,269
Total Debt Investments	$14,302,204	$4,561,611	$1,028,086	$780,604	$1,271,500	$2,700,307	$212,689	$69,839	$129,445	$24,935	$10,151	$113,853	$3,399,184
Other Investments													
U.S. Equity	$12,887,225												
Non-U.S. Equity	5,974,207												
Derivatives	650												
Real Estate	1,349,052												
Private Equities	173,949												
Money Market Funds (not rated)	4,375												
Escrow Claim	3,468												
Total Other Investments	$20,392,926												
Total Investments	$34,695,130												
Less: Short-Term Investments Classified as Cash Equivalents on the Statements of Plan Net Position	(402,718)												
Total Investments as Shown on Statements of Plan Net Position	$34,292,412												

(1) Includes obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government.

(2) Includes securities that are implicitly guaranteed by the U.S. government, but are not rated by Standard and Poor's or Moody's.

(3) A1 is the highest rating category for commercial paper.

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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings for the TCRS' investments in fixed income securities as of June 30, 2013 and June 30, 2012 are included in the above schedule. Securities are rated using Standard and Poor's and/or Moody's and are presented above using the Standard and Poor's rating scale. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally recognized credit ratings agency.

The TCRS' investment policy specifies that bond issues subject for purchase are investment grade bonds rated in the four highest ratings by one of the recognized rating agencies. In addition, the policy states that private placements that do not have an active secondary market shall be thoroughly researched from a credit standpoint and shall be viewed by TCRS' investment staff as having the credit quality rating equivalent of an AA rating on a publicly traded issue. For short-term investments, the TCRS' investment policy provides for the purchase of only the highest quality debt issues. Commercial paper should be rated in the highest tier by all rating agencies which rate the paper, with a minimum of two ratings required. Commercial paper cannot be purchased if a rating agency has the commercial paper on a negative credit watch. The investment policy also requires preparation of a credit analysis report on the corporation prior to purchasing commercial paper.

As noted above, the TCRS does not utilize its own bank accounts but invests in the State Pooled Investment Fund for its operating cash purposes. Required risk disclosures relative to the State Pooled Investment Fund are presented in the *State of Tennessee Treasurer's Report*. That report is available on the state's website at http://www.tn.gov/treasury/.

Concentration of Credit Risk - A concentration of investments in any one single issuer of debt securities presents a greater risk for loss in the event that the issuer fails on its obligations. The TCRS had the following investment amounts and percentages of plan net position, in organizations representing five percent or more of plan net position, excluding those organizations whose issues are explicitly guaranteed by the United States government, and investments in mutual funds, external investment pools, and other pooled investments:

	June 30, 2013		June 30, 2012	
Issuer Organization	**Fair Value**	**Percentage**	**Fair Value**	**Percentage**
Federal National Mortgage Association	$2,131,504,198	5.67%	$1,932,517,086	5.54%

The TCRS' investment policy limits the maximum amount of a specific corporation's commercial paper that can be purchased to $100 million. There are no specific investment policies that limit investment in any one issuer.

Interest Rate Risk - Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The TCRS' investment policy does not specifically address limits on investment maturities. The fixed income portfolio, however, is benchmarked against the Citigroup Broad Investment Grade Index and tends to have a duration within a range around that index. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price. The TCRS had the following investments and effective duration at June 30, 2013 and June 30, 2012.

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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

Debt Investments

(Expressed in Thousands)

Investment Type	Fair Value as of June 30, 2013	Effective Duration (years)
Debt Investments		
Government Agencies	$201,383	8.64
Government Bonds	1,689,459	13.10
Government Inflation Indexed	2,796,073	8.64
Government Mortgage Backed	3,485,765	4.62
Government Asset Backed	56,918	5.48
Municipal Bonds	149,678	10.02
Collateralized Mortgage Obligations (CMO)	160,649	1.73
Commercial Mortgage Backed	398,696	2.00
Corporate Asset Backed Securities	590,035	1.60
Corporate Bonds	3,807,694	8.16
Short Term Commercial Paper	644,339	0.03
Short Term Bills & Notes	116,334	0.63
Total Debt Investments	$14,097,023	7.03

Investment Type	Fair Value as of June 30, 2012	Effective Duration (years)
Debt Investments		
Government Agencies	$215,919	8.63
Government Bonds	1,856,853	12.08
Government Inflation Indexed	2,654,938	8.82
Government Mortgage Backed	3,291,737	1.38
Government Asset Backed	76,372	5.06
Municipal Bonds	155,316	10.97
Collateralized Mortgage Obligations (CMO)	232,639	3.40
Commercial Mortgage Backed	268,585	2.22
Corporate Asset Backed Securities	782,669	1.52
Corporate Bonds	4,349,054	6.91
Short Term Commercial Paper	113,853	0.19
Short Term Bills & Notes	304,269	0.13
Total Debt Investments	$14,302,204	6.09

Asset-Backed Securities – The TCRS invests in various collateralized mortgage obligations (CMOs) which are mortgage-backed securities. These securities are based on cash flows from interest and principal payments on underlying mortgages and could therefore be more sensitive to prepayments by mortgagees as a result of a decline in interest rates. The fair value of CMOs at June 30, 2013 was $559,344,004 of which $326,396,099 were CMOs that are generally more sensitive to interest rate changes. The fair value of CMOs at June 30, 2012 was $501,224,120 of which $341,027,671 were CMOs that are generally more sensitive to interest rate changes.

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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

Foreign Currency Risk - Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The TCRS' investment policy limits the asset allocation for international investments to twenty-five percent of total assets. The TCRS' exposure to foreign currency risk at June 30, 2013 and June 30, 2012 was as follows:

Foreign Currency-Denominated Investments
(Expressed in Thousands)

Currency	Total Fair Value June 30, 2013	Fixed Income	Equity	Cash
Australian Dollar	$ 281,116	$ 0	$ 280,971	$ 145
British Pound Sterling	917,788	0	916,850	938
Canadian Dollar	1,553,299	1,467	1,548,611	3,221
Danish Krone	78,322	0	78,304	18
Euro Currency	1,179,772	0	1,154,129	25,643
Hong Kong Dollar	127,953	0	127,700	253
Japanese Yen	1,152,368	0	1,144,096	8,272
New Israeli Shekel	14,616	0	14,571	45
New Zealand Dollar	7,434	0	7,373	61
Norwegian Krone	45,473	0	45,351	122
Singapore Dollar	85,610	0	85,360	250
Swedish Krona	111,727	0	111,672	55
Swiss Franc	412,766	0	412,751	15
Total	$5,968,244	$ 1,467	$5,927,739	$39,038

Currency	Total Fair Value June 30, 2012	Fixed Income	Equity	Cash
Australian Dollar	$ 285,935	$ 0	$ 285,556	$ 379
British Pound Sterling	945,058	36,073	908,427	558
Canadian Dollar	1,543,638	8,430	1,535,028	180
Danish Krone	76,389	0	76,373	16
Euro Currency	1,066,157	63,906	968,412	33,839
Hong Kong Dollar	106,932	0	106,775	157
Japanese Yen	1,145,912	212,575	927,031	6,306
New Israeli Shekel	14,916	0	14,819	97
New Zealand Dollar	6,410	0	6,337	73
Norwegian Krone	46,034	13,429	32,603	2
Singapore Dollar	67,835	0	67,753	82
Swedish Krona	93,496	0	93,286	210
Swiss Franc	318,426	0	317,464	962
Total	$5,717,138	$ 334,413	$5,339,864	$42,861

(CONTINUED)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

Custodial Credit Risk – Custodial Credit Risk for deposits is the risk that in the event of a bank failure, the TCRS' deposits may not be returned to TCRS. The TCRS does not have an explicit policy with regards to Custodial Credit Risk for deposits. As of June 30, 2013 and June 30, 2012, the TCRS had uninsured and uncollateralized cash deposits of $39,038,045 and $42,861,324, respectively in foreign currency held by our master custodian, Northern Trust, in Northern Trust's name. These deposits were used for investments pending settlement.

Derivatives – The TCRS may buy or sell fixed income and equity index futures contracts for the purposes of making asset allocation changes in an efficient and cost effective manner and to improve liquidity. Gains (losses) on futures hedge losses (gains) produced by any deviation from the TCRS' target allocation. The gains and losses resulting from daily fluctuations in the fair value of the outstanding futures contract are settled daily, on the following day, and a receivable or payable is established for any unsettled gain or loss as of the financial statement date. At year end, the TCRS was under contract for fixed income and equity index futures and the resulting payable is reflected in the financial statements at fair value.

The international securities expose the TCRS to potential losses due to a possible rise in the value of the US dollar. The TCRS investment managers can reduce foreign currency exposure by selling foreign currency forward contracts, at agreed terms and for future settlement, usually within a year. The manager will reverse the contract by buying the foreign currency before the settlement date. A gain (loss) on this transaction pair will hedge a loss (gain) on the currency movement of the international security. The TCRS can sell up to 80% of its foreign currency exposure into US dollars. Foreign currency forward contracts expose the TCRS to foreign currency risk as they are denominated in foreign currency. Any unrealized gain on foreign currency forward contracts has been reflected in the financial statements as an investment. The notional amount of the foreign currency forward contracts has been reflected in the financial statements as a receivable and a payable. Any unrealized loss on foreign currency forward contracts has been included in the payable established for the contracts.

The TCRS is authorized to invest in To Be Announced (TBA) mortgage backed securities similar to the foreign currency forward contracts. The TCRS enters into agreements to purchase pools of mortgage backed securities prior to the actual security being identified. The TCRS will roll this agreement prior to settlement date to avoid taking delivery of the security. Any unrealized gain on TBA mortgage backed securities has been reflected in the financial statements as an investment. Any unrealized loss on TBA mortgage backed securities has been included in the payable established for the mortgages. The notional amounts of these agreements have been included in the financial statements as a receivable and a payable. The TCRS invests in these derivatives to adjust its exposure to mortgage coupon risk and to replicate the return on mortgage backed securities portfolios without actually purchasing the security.

The TCRS is authorized to enter into option contracts and any income earned on option contracts has been included in investment income in the financial statements. At year end, the TCRS was under contract for options and the resulting payable is reflected in the financial statements at fair value.

The fair value balances and notional amounts of derivative instruments outstanding at June 30, 2013 and June 30, 2012, classified by type, and the changes in fair value of derivative instrument types for the year ended as reported in the financial statements are as follows:

(CONTINUED)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

Derivative Summary
(Expressed in Thousands)

	Changes in Fair Value		Fair Value at June 30, 2013			
	Financial Statement Classification	Amount	Financial Statement Classification	Amount	Notional Amount	Currency
Foreign Currency Forward Contracts		$ (29)		$ (29)	35,685	CHF
		23		23	21,212	DKK
		183		183	25,750	EUR
		286		286	8,212	GBP
		(12)		(12)	0	HKD
		(906)		(906)	14,899,846	JPY
		10		10	0	SGD
	Investment Income	$ (445)	Derivative Instruments Payable	$ (445)		
Futures Contracts	Investment Income	$ (51,331)	Derivative Instruments Receivable	$ 6,153	$ 1,248,457	
Options Contracts	Investment Income	$ (221)	Derivative Instruments	$ 31	$ 31	
TBA Mortgage Backed Securities		$ (10,476)	Derivative Instruments Payable	$ (10,476)	$ 473,078	

	Changes in Fair Value		Fair Value at June 30, 2012			
	Financial Statement Classification	Amount	Financial Statement Classification	Amount	Notional Amount	Currency
Foreign Currency Forward Contracts		$ (360)		$ (360)	11,210	AUD
		(248)		(248)	18,710	EUR
		120		120	1,489,342	JPY
	Investment Income	$ (488)	Derivative Instruments Payable	$ (488)		
Futures Contracts	Investment Income	$ (5,479)	Derivative Instruments Payable	$ (2,393)	$ 1,520,747	
Options Contracts	Investment Income	$ (9)	Derivative Instruments	$ 2	$ 2	
TBA Mortgage Backed Securities		$ 648	Derivative Instruments	$ 648	$ 324,377	

The fair values of foreign currency forward contracts are estimated based on the present value of their estimated future cash flows. Futures, Options and TBA mortgage backed securities are exchange traded and their price is based on quoted market prices at year end. It is the TCRS policy to conduct derivative transactions through the custodian bank and high quality money center banks or brokerage firms. The credit risk of foreign currency forward contracts is managed by limiting the term of the forward contracts and restricting the trading to high quality banks. The credit risk of futures contracts is managed by maintaining a daily variation margin.

(CONTINUED)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

Alternative Investments - The TCRS has investments in private equity funds and real estate with an estimated fair value of $2,112,637,040 and $1,523,000,878 at June 30, 2013 and June 30, 2012, respectively. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material.

D. COMMITMENTS

Standby Commercial Paper Purchase Agreement - The TCRS has agreed to serve as standby commercial paper purchaser for commercial paper issued by the Funding Board of the State of Tennessee. By serving as a standby commercial paper purchaser, the TCRS receives an annual fee of 25 basis points on the $350 million maximum issuance under this agreement during times when both Moody's and Standard and Poor's investment ratings assigned to the State of Tennessee's general obligation bonds are Aaa and AAA respectively, 40 basis points during times when either Moody's or Standard and Poor's has assigned ratings of Aa and AA respectively, or 75 basis points during times when either Moody's or Standard and Poor's has assigned ratings lower than Aa and AA respectively. In the unlikely event that the TCRS would be called upon to purchase the commercial paper, the TCRS would receive interest at a rate equal to prime plus 75 basis points during the first 30 consecutive days, plus an additional 50 basis points for each consecutive 30 days thereafter, up to a maximum rate allowed by state law.

Pending Real Estate Items – At June 30, 2013 the TCRS had unfunded commitments of $70,077,563 for pending real estate purchases. At June 30, 2012 the TCRS had unfunded commitments of $113,088,500 for pending real estate purchases.

Alternative Investments – The TCRS had unfunded commitments of $773.9 million and $581.3 million in limited partnerships as of June 30, 2013 and June 30, 2012, respectively.

E. FUNDED STATUS AND FUNDING PROGRESS

The funded status of each plan as of July 1, 2011, the most recent actuarial valuation date, is as follows (dollar amounts in thousands):

SCHEDULES OF FUNDING PROGRESS

(Expressed in Thousands)

	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Frozen Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
SETHEEPP	$ 30,118,178	$ 32,707,625	$ 2,589,447	92.08%	$ 6,058,348	42.74%
PSPP	$ 6,562,604	$ 7,361,707	$ 799,103	89.15%	$ 2,354,939	33.93%

The TCRS uses the Frozen Entry Age actuarial cost method to calculate the annual required contribution (ARC). Effective July 1, 2011, the TCRS reestablished unfunded accrued liabilities for all groups.

The required schedule of funding progress immediately following the notes to the financial statements is intended to present multiyear trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

(CONTINUED)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013 AND JUNE 30, 2012 (CONTINUED)

Additional information as of the latest actuarial valuation follows:

	SETHEEPP	PSPP
Valuation Date	July 1, 2011	July 1, 2011
Actuarial cost method	Frozen Entry Age	Frozen Entry Age
Amortization method	Level Dollar	Level Dollar
Remaining amortization period	Teachers - 6 years; State - 9 years; closed period	9 years weighted average; (1) closed period
Asset valuation method	5-year moving market average for FYE on or before June 30, 2007	5-year moving market average for FYE on or before June 30, 2007
	10-year moving market average for FYE after June 30, 2007	10-year moving market average for FYE after June 30, 2007
Actuarial assumptions:		
Investment rate of return	7.50%	7.50%
Projected salary increases	4.75% (2)	4.75% (2)
Included inflation at	3.00%	3.00%
Cost-of-living adjustments	2.50%	2.50%
Increase in Social Security wage base	3.50%	3.50%

(1) An actuarial valuation is performed on each political subdivision participating in the Political Subdivision Pension Plan. Each political subdivision selects the period over which their unfunded accrued liability is amortized, not to exceed 30 years. The weighted average amortization period for all plans is presented above.

(2) Uniform rate that approximates the effect of a graded salary scale.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION
SCHEDULES OF FUNDING PROGRESS AND EMPLOYER CONTRIBUTIONS

SCHEDULES OF FUNDING PROGRESS
Expressed in Thousands

	Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Frozen Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
SETHEEPP	7/1/2011	$30,118,178	$32,707,625	$2,589,447	92.08%	$6,058,348	42.74%
	7/1/2009	$26,335,199	$29,054,966	$2,719,767	90.64%	$6,054,528	44.92%
	7/1/2007	$26,214,995	$27,240,151	$1,025,156	96.24%	$5,742,866	17.85%
PSPP	7/1/2011	$ 6,562,604	$ 7,361,707	$ 799,103	89.15%	$2,354,939	33.93%
	7/1/2009	$ 5,304,455	$ 6,143,775	$ 839,320	86.34%	$2,282,082	36.78%
	7/1/2007	$ 4,897,974	$ 5,475,620	$ 577,646	89.45%	$2,081,964	27.75%

The schedule of funding progress is intended to present multi-year trend information about whether the actuarial value of plan assets is increasing or decreasing over time relative to the actuarial accrued liability for benefits.

SCHEDULES OF EMPLOYER CONTRIBUTIONS
Expressed in Thousands

	SETHEEPP		PSPP	
Year Ended June 30	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
2013	$735,886	100.00%	$274,539	100.00%
2012	731,352	100.00%	271,361	100.00%
2011	721,759	100.00%	273,781	100.00%
2010	578,403	100.00%	258,324	100.00%
2009	583,985	100.00%	252,926	100.00%
2008	593,412	100.00%	244,847	100.00%

An actuarial valuation of the TCRS is performed every two years with the next valuation scheduled to be effective July 1, 2013.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
ACTUARIAL BALANCE SHEET

ACTUARIAL BALANCE SHEET
as of July 1, 2011

	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEPP)	Political Subdivision Pension Plan (PSPP)	Total
ASSETS			
Present assets creditable to			
Employer accumulation fund	$ 26,411,200,293	$ 5,461,751,471	$ 31,872,951,764
Members' accumulation fund	3,706,978,263	1,100,852,325	4,807,830,588
Total present assets	30,118,178,556	6,562,603,796	36,680,782,352
Present value of prospective contributions payable to:			
Employer accumulation fund			
Normal	2,179,663,929	886,440,557	3,066,104,486
Accrued liability	2,589,446,292	799,102,966	3,388,549,258
Total employer accumulation	4,769,110,221	1,685,543,523	6,454,653,744
Member's accumulation fund	1,836,350,124	582,617,580	2,418,967,704
Total prospective contributions	6,605,460,345	2,268,161,103	8,873,621,448
TOTAL ASSETS	$ 36,723,638,901	$ 8,830,764,899	$ 45,554,403,800
LIABILITIES			
Present value of prospective benefits payable on account of:			
Present retired members and beneficiaries	15,941,291,810	2,560,587,467	18,501,879,277
Present active members	20,028,868,907	6,013,575,239	26,042,444,146
Former members	753,478,184	256,602,193	1,010,080,377
TOTAL LIABILITIES	$ 36,723,638,901	$ 8,830,764,899	$ 45,554,403,800

TNSTARS COLLEGE SAVINGS 529 PROGRAM
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 37243-1402

PHONE (615) 401-7897
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Members of the General Assembly
Members of the Board of Trustees
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying statement of fiduciary net position of the Tennessee Stars 529 College Savings Plan, a private-purpose trust fund of the State of Tennessee, as of June 30, 2013, the related statement of changes in fiduciary net position for the year then ended, and the related notes to the financial statements, which collectively comprise the Tennessee Stars 529 College Savings Plan's basic financial statements.

Management's Responsibility for the Financial Statements

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

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of the Tennessee Stars 529 College Savings Plan. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Tennessee Stars 529 College Savings Plan.

(CONTINUED)

TNSTARS COLLEGE SAVINGS 529 PROGRAM
INDEPENDENT AUDITOR'S REPORT (CONTINUED)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Tennessee Stars 529 College Savings Plan of the State of Tennessee as of June 30, 2013, and the changes in fiduciary net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Tennessee Stars 529 College Savings Plan, a private-purpose trust fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2013, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with G*overnment Auditing Standards*, we have also issued our report dated December 12, 2013, on our consideration of the Tennessee Stars 529 College Savings Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Tennessee Stars 529 College Savings Plan's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 12, 2013

TNSTARS COLLEGE SAVINGS 529 PROGRAM
STATEMENT OF FIDUCIARY NET POSITION
JUNE 30, 2013

ASSETS	
Cash	$ 53,395
Receivables	
Contributions receivable	2,370
Investments, at fair value	
Investment in money market account	324,744
Investment in mutual funds (fixed income)	350,522
Investment in mutual funds (blended)	3,012,170
Investment in mutual funds (equity)	3,034,860
TOTAL ASSETS	6,778,061
LIABILITIES	
Due to General Fund	63,857
Accounts payable	194
TOTAL LIABILITIES	64,051
NET POSITION - RESTRICTED FOR PLAN PARTICIPANTS	$6,714,010

See accompanying Notes to the Financial Statements.

TNSTARS COLLEGE SAVINGS 529 PROGRAM
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION
JUNE 30, 2013

ADDITIONS	
Contributions	$6,239,932
Investment income	
Net increase in fair value of investments	208,962
Interest and dividend income	70,810
Total investment income	279,772
Transfers from the General Fund (Incentives)	203,200
TOTAL ADDITIONS	6,722,904
DEDUCTIONS	
Withdrawals	8,894
TOTAL DEDUCTIONS	8,894
CHANGE IN NET POSITION	6,714,010
NET POSITION - RESTRICTED FOR PLAN PARTICIPANTS	
BEGINNING OF YEAR	0
END OF YEAR	$6,714,010

See accompanying Notes to the Financial Statements.

TNSTARS COLLEGE SAVINGS 529 PROGRAM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** – The TN Stars College Savings 529 Plan, Educational Savings Plan (ESP) is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the ESP has been included in the *Tennessee Comprehensive Annual Financial Report* as a private-purpose 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 financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

3. **Cash** – The ESP does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State 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 and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund (SPIF) is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 97-104 of this report.

4. **Method Used to Value Investments** – Investments are reported at fair value. Securities traded on a national exchange are valued at the last reported sales price. The fair value of investments in open-end mutual funds is based on the share price. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments and interest and dividend income. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.

5. **Transfer from the General Fund** – At June 30, 2013 the TNStars 529 Plan had a deficit in cash of $10,462. This is a result of net daily cash outflows exceeding daily cash inflows. On this date TNStars sent, via EFT, $63,857 to the investment custodian. Also on this day, TNStars issued debit EFT transactions to plan participant's financial institutions for $63,857. The debit EFT transactions would settle with the State on July 1, 2013 or the next business day. To eliminate the deficit cash position, the State General Fund transferred $63,857 to TNStars on June 30, 2013. The resulting settlement of the debit transactions on July 1, 2013 would transfer the funds back to the General Fund.

B. DEPOSITS AND INVESTMENTS

In accordance with State statute, the ESP assets may be invested in any instrument, obligation, security or property that constitutes a legal investment for assets of the Tennessee Consolidated Retirement System (TCRS). In addition, the assets of the ESP may be pooled for investment purposes with the assets of the TCRS or any other assets under the custody of the State Treasurer. The authority for investing the assets of the ESP is vested in the Baccalaureate Education System Trust (BEST) Board of Trustees (the "Board") and the responsibility for implementing the investment policy established by the Board is delegated to the State Treasurer.

Recognizing that plan participants may have an investment horizon ranging from a few months to more than twenty years, the ESP has selected a group of investment products that have an investment risk profile ranging from conservative to aggressive. The investment products selected are evaluated based on a

TNSTARS COLLEGE SAVINGS 529 PROGRAM NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2013

number of factors including but not limited to fees, investment performance, investment strategy, any available ratings of the products and suitability of products for participants. It is the responsibility of the ESP to provide products to plan participants; however it is the participants who select the options that suit their individual investment needs.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations with regard to debt. The ESP does not currently own specific fixed income securities, but provided options to plan participants to invest in mutual funds that invest in fixed income securities. Mutual funds with 100% allocations in fixed income securities are considered to be fixed income investments. At June 30, 2013, $350,522 was invested in fixed income securities in four publicly traded open ended mutual funds. These funds are not specifically rated by any rating agency; however, the underlying securities of the funds have an average credit quality rating of Baa or better. An additional $324,743 is invested in a money market account which is FDIC insured and is not considered to be exposed to credit risk. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally recognized credit ratings agency.

The ESP also provided options to plan participants to invest in Blended mutual funds that have some portion of their assets invested in fixed income securities. The range of percentages of fixed income securities were 33%, 60% and 80% for the 3 investment options. At June 30, 2013 approximately $1,530,132 of the total $3,012,170 invested in publicly traded open ended blended mutual funds were invested in fixed income securities. These funds are not specifically rated by any rating agency; however, the underlying securities of the funds have an average credit rating of Baa or better.

The ESP's investment policy states that the trust may acquire securities which are rated within the four highest grades at the time of acquisition by any of the recognized rating agencies. The policy further states that index funds may be utilized as an alternative to selecting individual securities.

Interest Rate Risk – Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. As such, the ESP does not have a policy regarding the management of interest rate risk in periods of volatile interest rates. The weighted average maturity (WAM) for the fixed income investments that ESP utilizes was 7.44 years at June 30, 2013. Additionally, for the blended mutual funds with fixed income components, the approximate portion of investments in fixed income had a weighted average maturity of 8.41 years at June 30, 2013. Weighted average maturity is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the average time to maturity weighted for all investments as a percentage of the investment's full price.

Currency Risk – Currency risk is the risk that changes in the market prices of one currency against another will adversely affect the fair value of investments. Currency risk can be minimized through the use of hedges in the foreign currency markets of the nation where the investments originated. The ESP provides investment products for participants to select; however, it is the participant that is responsible for selecting an option(s) that best suits their investment needs. As such, the ESP does not have a policy regarding the management of currency risk.

At June 30, 2013, approximately $208,380 were invested in international fixed income securities with assets denominated in currencies other than U.S. dollars. The investments were hedged by the fund's company. Additionally, approximately $204,487 were invested in international equity securities with assets denominated in currencies other than U.S. dollars. The investments were not hedged by the fund's company.

TNSTARS COLLEGE SAVINGS 529 PROGRAM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2013

C. DESCRIPTION OF THE EDUCATIONAL SAVINGS PLAN

The Tennessee Stars College Savings 529 Plan (TNStars), Educational Savings Plan (ESP), administered by the State Treasurer, was created under Tennessee Code Annotated, Title 49, Chapter 7, Part 8 and is designed to help people save for the costs of education after high school. The ESP is administered by the Baccalaureate Education System Trust (BEST) Board of Trustees (the "Board"). The Board has the authority to appoint an ESP manager, adopt rules to implement and administer the ESP and establish investment policies for the ESP, to invest moneys of the trust in investments determined by the Board to be appropriate and to administer the funds of the Trust Fund. The ESP called TNStars began operations on September 18, 2012.

When opening an account, the owner may select two types of investment options, the Aged-Based Option and the Self Selected Investment Option. Within the Aged-Based Option, contributions are allocated among five age bands, based on the age of the beneficiary. Each Age Band is invested in specific Dimensional Fund Advisors (DFA) or Vanguard mutual funds from our slate of investment options ("an Underlying Fund"). The Age Bands become more conservatively invested as the beneficiary ages. The Self Selected Investment Option allows owners to invest in any underlying Fund. The list of investment options or underlying funds is listed below:

Portfolio	Fund Name	Ticker Symbol	Age Band Option (yrs.)
Equity	DFA Enhanced U.S. Large Company Portfolio Institutional Class	DFELX	0-4
	Vanguard 500 Index Signal Shares	VIFSX	
	Maxim American Century Growth Fund	MXGRX	
	PRIMECAP Odyssey Aggressive Growth Fund	POAGX	
	Vanguard Mid-Cap Growth Investor Shares	VMGRX	
	DFA Large Cap International Portfolio Institutional Class	DFALX	
Blended	Vanguard Wellington Investor Shares	VWENX	5-10
	Vanguard LifeStrategy Conservative Growth Fund	VSCGX	11-14
	Vanguard Life Strategy Income Fund	VASIX	15-17
Fixed Income	DFA Inflation-Protected Securities Portfolio Institutional Class	DIPSX	
	Vanguard Total Bond Market Signal Shares	VBTSX	18+
	Vanguard Intermediate-Term Investment-Grade Fund Admiral Shares	VFIDX	
	Vanguard Intermediate-Term Treasury Admiral Shares	VFIUX	
	FDIC Insured Money Market Fund		

Participants in the ESP can make withdrawals at any time after contributions have been invested for 60 days. Withdrawals used for qualifying higher educational expenses receive certain tax incentives; additionally those not used for qualifying higher educational expenses receive certain tax penalties based on the participant's individual circumstances.

The ESP is operated by an amount appropriated to the ESP by the State of Tennessee. It is the intent of the ESP to collect asset based fees from the participants in the ESP. No fees were collected from participants during fiscal year 2013. From those appropriations certain incentives were provided to qualifying participants. Those funds are presented in the financial statements as Transfers from General Fund (Incentives).