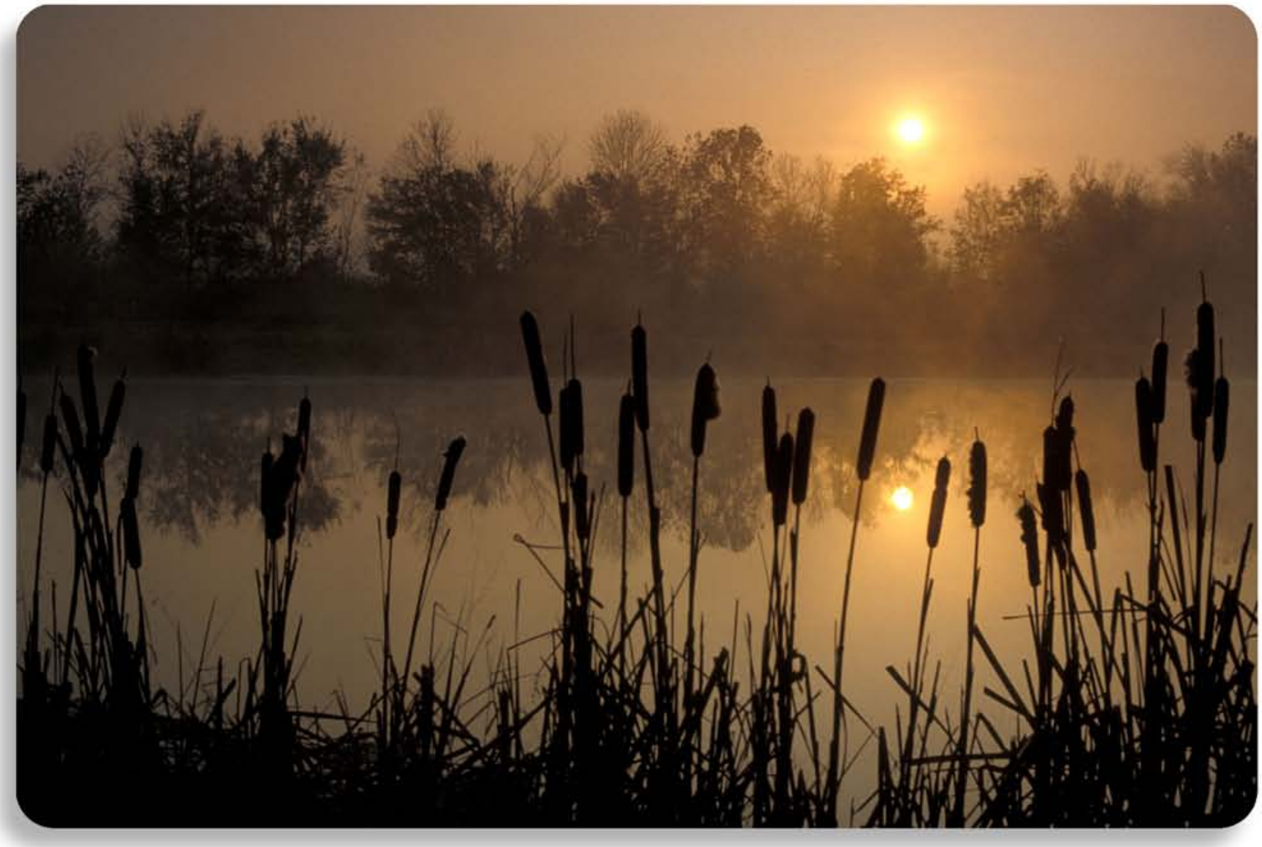
2006 Treasurer's Report
State of Tennessee
Dale Sims, Treasurer

2006 Treasurer's Report



Featuring Photos of
Scenic Tennessee State Parks
and Natural Areas

Dale Sims, Treasurer
State of Tennessee

Fiscal Year Ended June 30,2006

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Letter of Transmittal

State of Tennessee
Treasury Department
State Capitol
Nashville, Tennessee 37243

December 31, 2006

The Honorable Phil Bredesen, Governor
The Honorable John S. Wilder, Speaker of the Senate
The Honorable Jimmy Naifeh, Speaker of the House of Representatives
Members of the General Assembly
Citizens of the State of Tennessee

Ladies and Gentlemen:

Pursuant to the requirements of Section 4-4-114, *Tennessee Code Annotated*, I am pleased to transmit a report of the activity of the Treasury Department for the fiscal year ending June 30, 2006.

My staff and I appreciate your support and interest in the programs we administer and our efforts to serve all Tennesseans. We look forward to working with you to meet the challenges ahead in this new year.

Sincerely,

Dale Sims

Dale Sims

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 2006 Treasurer's Report contains reports on various programs administered by the Treasury Department, including the Baccalaureate Education System Trust, the Careers Now Program, the Chairs of Excellence Program, Claims Administration, the Tennessee Claims Commission, the Deferred Compensation Program, the Flexible Benefits Plan, Investments, Risk Management,the Small and Minority Owned Business Assistance Program, the Tennessee Consolidated Retirement System, and the Unclaimed Property Program. 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 2006 fiscal year.

Baccalaureate Education System Trust (BEST)

The Baccalaureate Education System Trust, or BEST, is a program that allows anyone to pay for higher education costs in advance on behalf of a beneficiary. BEST provides two tax-favored savings vehicles: the Prepaid College Tuition Plan and the Savings Plan. The Prepaid College Tuition Plan (Educational Services Plan), introduced in 1997, is based on the average tuition inflation at Tennessee public universities. Through the purchase of affordable tuition units, Tennesseans can pay for future tuition at today's price and ease their concerns about whether they will have enough funds to pay for their children's higher education. The Savings Plan, which was introduced in 2000, offers three Investment Options: the Managed Allocation Option, the 100% Equity Option and the Guaranteed Option. At June 30, 2006, the Prepaid College Tuition Plan held 8,682 contracts and $60.8 million in assets and the Savings Plan held 4,197 accounts and $32.3 million in net assets.

Careers NOW Program

The Careers NOW Program provides Tennessee college students the opportunity to learn more about the operations of state government and career opportunities by working in one of the three constitutional offices for a semester. Since the inception of the program in 1996, over 200 students have participated in the 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 Trust totaled $226 million fair value of net assets at June 30, 2006, and investment income was $12.5 million for the year.

Claims Administration

The Division of Claims Administration is responsible for investigating and making determinations on claims made against the state for workers' compensation by state employees, employee property damage, tort liability and criminal injury compensation. Staff support from the Division of Claims Administration also assists the Board of Claims. The Division of Claims Administration received 4,906 claims for tort, employee property damage and workers' compensation. Payments made during the year for workers' compensation, tort, and employee property damage claims totaled $24.4 million. The division received 2,511 criminal injury and drunk driver claims. Payments made to victims of criminal injuries and drunk drivers totaled $11.5 million. Since the first payments were issued in 1982, more than $164 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, 2006, the commission had 650 open claims (including claims transferred to administrative law judges).

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 $30 per month. As of June 30, 2006, a total of 72,060 state and higher education employee accounts were held in the program. The market value of accumulated account balances totaled $963.6 million.

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, 2006, 43,209 state employees were using the plan: 42,140 paid group medical premiums, 22,957 paid group dental premiums, 4,259 used the medical expense reimbursement account and 385 used the dependent care reimbursement account. The plan generated over $5.9 million in F.I.C.A. savings for the state during the 2006 fiscal year. Employees realized similar savings. The state's F.I.C.A. savings are used to fund the state wellness program and to help fund a portion of the 401(k) match for state employees.

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 2006, investments averaged $5.4 billion, producing $221.2 million in income for an average rate of return of 4.11%. The State Trust of Tennessee allows the department to use the Federal Reserve Wire Transfer System to transfer funds on a limited basis.

Pension Fund Investments - This division manages the investments of the Tennessee Consolidated Retirement System (TCRS) which, at June 30, 2006, totaled $28.8 billion at fair market value. For the year, investment income was $1.9 billion, for a rate of return of 6.9% on a fair value basis. The Investment Division also manages investments for the Chairs of Excellence Trust and the Baccalaureate Education System Trust which, at June 30, 2006, had market values of $226 million and $60.8 million, respectively.

Risk Management

The Division of Risk Management is responsible for identifying the state's exposure to property & 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/Casualty Insurance Program, including the procurement of all-risk, replacement cost property insurance for all state-

Executive Summary

owned buildings and contents, builders' risk insurance for new construction, boiler insurance and inspection services for all state-owned boiler objects, fine arts insurance designed specifically for the unique requirements of fine art objects, and a fidelity bond to protect against employee dishonesty. The State procures the finest insurance coverages, with the aid of a qualified property/casualty insurance broker. Loss prevention and control services are also provided for workers' compensation and tort liability. As of July 1, 2006, the state's total insured property values were $11.6 billion. A total of $11 million in annual aggregate deductible retentions were funded through the Risk Management Fund. The State's property insurance carrier will indemnify the State for covered losses that exceed the annual aggregate deductible amounts.

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 capitol; 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 managment. 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, 2006, there were 207,998 active TCRS members: 47,625 state employees; 68,770 K-12 teachers; 74,462 political subdivision employees; and 17,141 higher education employees. As of June 30, 2006, there were 93,434 retirees. TCRS paid $1.12 billion in benefits during fiscal year 2006. 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, $63.5 million of unclaimed property was collected, which consisted of $40.2 million that was remitted to Treasury and $23.3 million in the sale of securities. In addition, $20.7 million was returned to owners or their heirs, local governments and other states. Since the program's inception in 1979, more than $420.8 million in unclaimed property has been reported to the Treasurer and more than $135.7 million of that property has been returned to claimants.

Treasury Numbers at a Glance
Fiscal Year 2006

Administrative	Number of Filled Positions		194
	Payroll Expenditures	$	11,869,519
	Other Expenditures	$	4,604,303
	Total Administrative Expenditures	$	16,473,822
Cash Management Program	General Fund Earnings	$	69,734,177
	LGIP Earnings	$	82,719,983
	Restricted Fund Earnings	$	68,787,855
	Total Cash Management Earnings	$	221,242,015
Retirement Program	Retirement Benefits	$	1,124,190,894
	Number of Retirees		93,434
	Number of Active Members		207,998
	Retirement Contributions	$	892,190,489
	Retirement Net Investment Income	$	1,877,298,490
Claims Administration Program	Workers' Compensation Payments	$	19,920,182
	Workers' Compensation Claims Filed		3,471
	Employee Property Damage Payments	$	24,677
	Employee Property Damage Claims Filed		147
	Tort Payments	$	4,475,459
	Tort Claims Filed		1,288
	Criminal Injury Payments	$	11,464,612
	Criminal Injury Claims Filed		2,511
Risk Management Program	Estimated Gross Property Losses Incurred	$	7,690,000
	Total Property Values Insured	$	11,589,082,600
Chairs of Excellence Program	Chairs of Excellence Investment Income	$	12,471,255
	Chairs of Excellence Expenditures	$	6,915,200
	Number of Chairs of Excellence		99
Other Programs	Deferred Compensation Contributions	$	100,066,474
	Deferred Compensation Accounts		72,060
	Flexible Benefits Plan Payments	$	7,027,764
	Unclaimed Property Revenues	$	63,510,190
	Unclaimed Property Payments	$	20,727,999
	BEST Prepaid Accounts		8,682
	BEST Prepaid Contributions (net of fees)	$	6,193,944
	BEST Savings Plan Contributions	$	6,365,000
Fair Value of Assets Under Management at June 30, 2006	Retirement Trust Fund	$	28,820,635,407
	Chairs of Excellence Trust Fund	$	226,159,791
	State Pooled Investment Fund	$	6,623,557,330
	Deferred Compensation (outside managers)	$	963,550,397
	BEST Educational Services Plan	$	60,783,503
	BEST Educational Savings Plan (outside manager)	$	32,311,007
	Total Assets Under Management	$	36,726,997,435

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

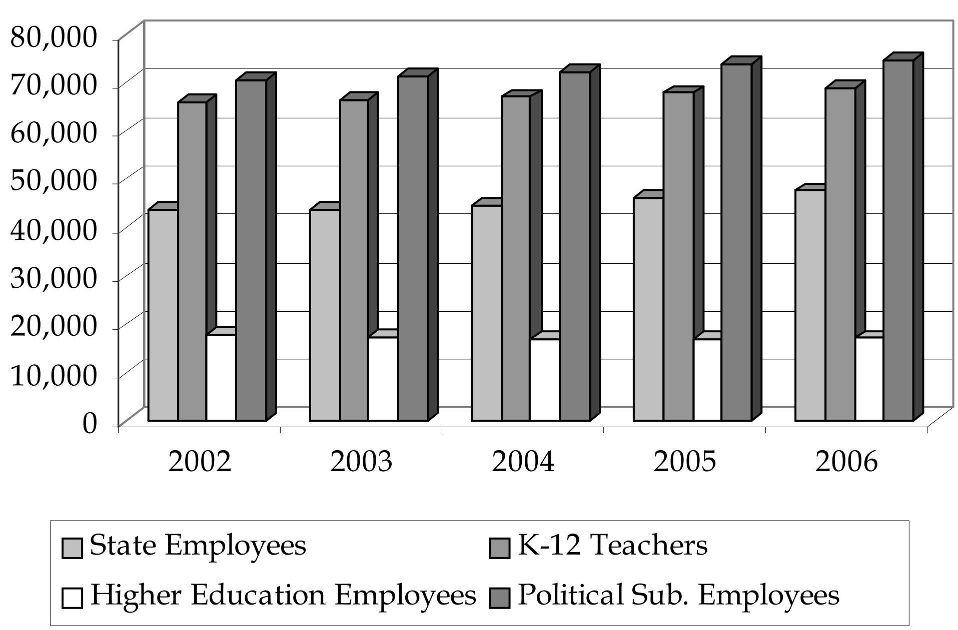
Membership in the retirement system is a condition of employment for full-time state employees, teachers, general employees in higher education, and the employees of local governments that participate in TCRS. Membership is optional for certain part-time employees. Faculty employees in higher education 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. When an employee joins TCRS, he receives an introductory letter and membership pamphlet outlining various aspects of retirement membership.

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

As of June 30, 2006, there were 207,998 active members of TCRS and 11,465 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 2002-2006



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.

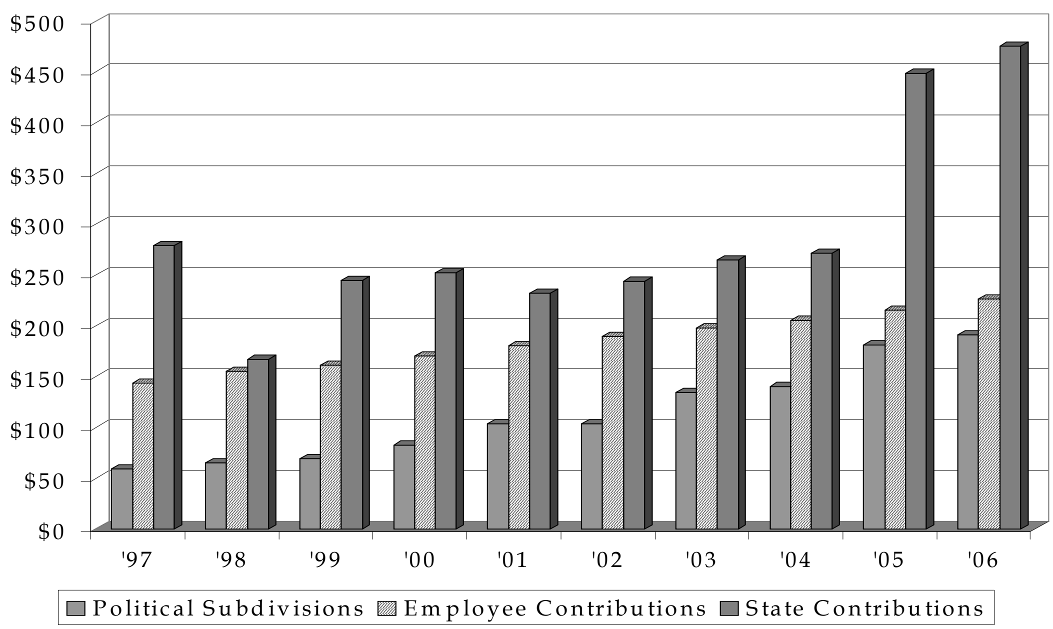
Upon termination of employment, a member may elect to withdraw his contributions and accumulated interest from the retirement system in a lump sum. By obtaining a lump sum refund, a member waives all rights and benefits in the retirement system. A vested member may leave his account balance in TCRS and 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 2006 fiscal year, 5,916 refunds totaling $34.7 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, 2006 were as follows:

Noncontributory State and Higher Education Employees	10.31%
K-12 Teachers	5.50%
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 1997-2006
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, 2006, 93,434 retirees were receiving monthly benefit payments. This represents a 4.08% 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: www.treasury.state.tn.us/tcrs.

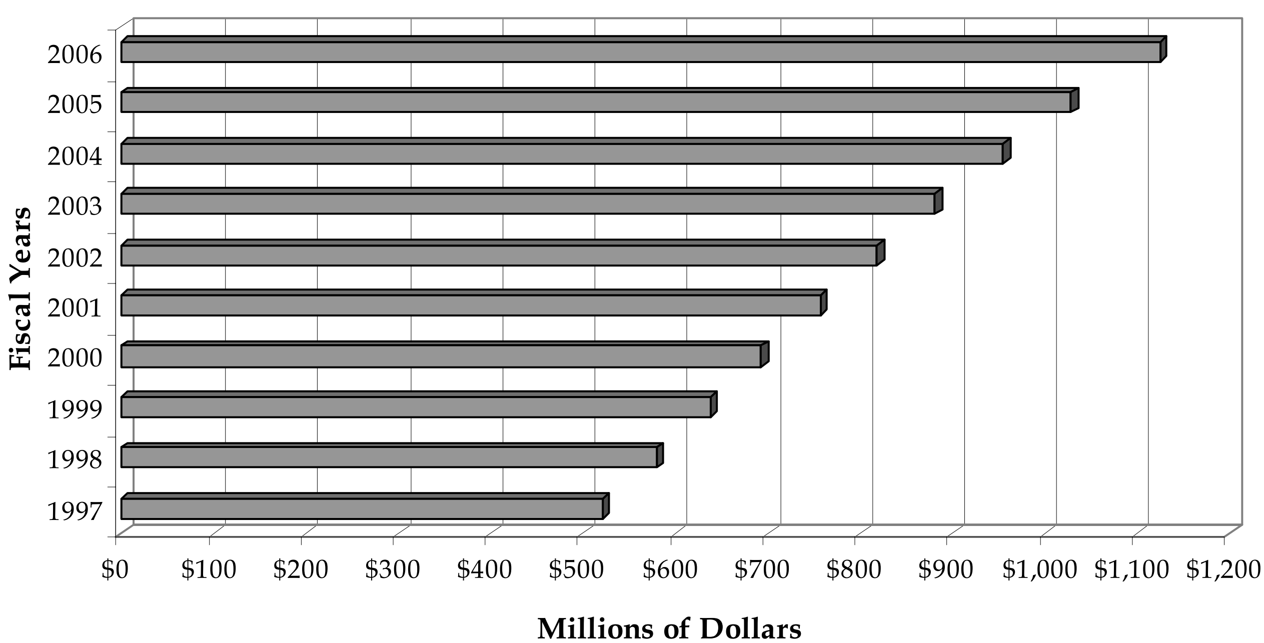
Disability benefits are available to active members with five years of service who become disabled and can not engage in gainful employment. There is no service requirement for disability benefits paid to active members whose disability is a result of an accident or injury occurring while the member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

Cost-of-living adjustments after retirement are based on the Consumer Price Index (CPI). If there is an increase in the CPI of as much as .5% in any calendar year, the retired member's benefit will be adjusted by an amount equal to the increase in the CPI, not to exceed 3% 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 2006 totaled $1,124.2 million, an increase of $89.6 million over 2005 benefit payments.

ANNUAL BENEFIT PAYMENTS
Fiscal Years 1997-2006
Expressed in Millions



Tennessee Consolidated Retirement System

TENNESSEE'S RETIREMENT PROGRAM, TCRS AND SOCIAL SECURITY BENEFITS

for Calendar Year 2006

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	9,180		9,180		9,180		9,180		9,180	
	Total	$ 12,724	84.8%	$ 13,905	92.7%	$ 15,086	100.6%	$ 16,268	108.5%	$ 17,449	116.3%
$20,000	TCRS	$ 4,725		$ 6,300		$ 7,875		$ 9,450		$ 11,025	
	Social Security	10,776		10,776		10,776		10,776		10,776	
	Total	$ 15,501	77.5%	$ 17,076	85.4%	$ 18,651	93.3%	$ 20,226	101.1%	$ 21,801	109.0%
$25,000	TCRS	$ 5,906		$ 7,875		$ 9,844		$ 11,813		$ 13,781	
	Social Security	12,372		12,372		12,372		12,372		12,372	
	Total	$ 18,278	73.1%	$ 20,247	81.0%	$ 22,216	88.9%	$ 24,185	96.7%	$ 26,153	104.6%
$30,000	TCRS	$ 7,088		$ 9,450		$ 11,813		$ 14,175		$ 16,538	
	Social Security	13,980		13,980		13,980		13,980		13,980	
	Total	$ 21,068	70.2%	$ 23,430	78.1%	$ 25,793	86.0%	$ 28,155	93.9%	$ 30,518	101.7%
$35,000	TCRS	$ 8,269		$ 11,025		$ 13,781		$ 16,538		$ 19,294	
	Social Security	15,576		15,576		15,576		15,576		15,576	
	Total	$ 23,845	68.1%	$ 26,601	76.0%	$ 29,357	83.9%	$ 32,114	91.8%	$ 34,870	99.6%
$40,000	TCRS	$ 9,450		$ 12,600		$ 15,750		$ 18,900		$ 22,050	
	Social Security	17,172		17,172		17,172		17,172		17,172	
	Total	$ 26,622	66.6%	$ 29,772	74.4%	$ 32,922	82.3%	$ 36,072	90.2%	$ 39,222	98.1%
$45,000	TCRS	$ 10,631		$ 14,175		$ 17,719		$ 21,263		$ 24,806	
	Social Security	18,768		18,768		18,768		18,768		18,768	
	Total	$ 29,399	65.3%	$ 32,943	73.2%	$ 36,487	81.1%	$ 40,031	89.0%	$ 43,574	96.8%
$50,000	TCRS	$ 11,962		$ 15,950		$ 19,937		$ 23,924		$ 27,912	
	Social Security	19,632		19,632		19,632		19,632		19,632	
	Total	$ 31,594	63.2%	$ 35,582	71.2%	$ 39,569	79.1%	$ 43,556	87.1%	$ 47,544	95.1%
$55,000	TCRS	$ 13,340		$ 17,787		$ 22,234		$ 26,681		$ 31,127	
	Social Security	20,316		20,316		20,316		20,316		20,316	
	Total	$ 33,656	61.2%	$ 38,103	69.3%	$ 42,550	77.4%	$ 46,997	85.4%	$ 51,443	93.5%
$60,000	TCRS	$ 14,718		$ 19,625		$ 24,531		$ 29,437		$ 34,343	
	Social Security	20,940		20,940		20,940		20,940		20,940	
	Total	$ 35,658	59.4%	$ 40,565	67.6%	$ 45,471	75.8%	$ 50,377	84.0%	$ 55,283	92.1%
$65,000	TCRS	$ 16,097		$ 21,462		$ 26,828		$ 32,193		$ 37,559	
	Social Security	21,528		21,528		21,528		21,528		21,528	
	Total	$ 37,625	57.9%	$ 42,990	66.1%	$ 48,356	74.4%	$ 53,721	82.6%	$ 59,087	90.9%
$70,000	TCRS	$ 17,475		$ 23,300		$ 29,124		$ 34,949		$ 40,774	
	Social Security	22,104		22,104		22,104		22,104		22,104	
	Total	$ 39,579	56.5%	$ 45,404	64.9%	$ 51,228	73.2%	$ 57,053	81.5%	$ 62,878	89.8%

* 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 2006. 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 2006;

(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: www.treasury.state.tn.us/tcrs/

ACTUARIAL VALUATION

An actuarial valuation of the TCRS is performed by an independent actuarial firm every two years. The purpose of the valuation is to determine the funding requirements for the employers participating in the TCRS. The latest valuation was performed July 1, 2005 to establish the employer contribution rates for July 1, 2006. The system's accrued liability at July 1, 2005 was $365.9 million. The accrued liability is being amortized over a 40 year period which began in 1975.

In addition to the biennial actuarial valuation, an experience study is conducted every four years for the purpose of establishing actuarial and economic assumptions to be used in the actuarial valuation process. Following are the assumptions used in the July 1, 2005 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, 2006:

Cities	173
Counties	88
Utility Districts	52
Special School Districts	19
Joint Ventures	23
Housing Authorities	11
911 Emergency Communication Districts	38
Miscellaneous Authorities	53
Total	457

Tennessee Consolidated Retirement System

MAJOR LEGISLATIVE IMPROVEMENTS

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

1973 Annual cost-of-living increase based on the CPI with a cap of 1.5% 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%.

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% 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%, 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% indexing of salaries for noncontributory employees extended one year. Each succeeding year up to 1997, the 3.6% 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% 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%.

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

1999 Group 1 benefit maximum increased to 90%.

2000 Group 2 benefit maximum increased to 80%.

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.

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. 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.

SCHEDULE OF HISTORICAL SOCIAL SECURITY CONTRIBUTION RATES

Calendar Year	Employee Rate	Employer Rate	Social Security Wage Base	Medicare Wage Base
2006	7.65%	7.65%	$ 94,200	No Limit
2005	7.65	7.65	90,000	No Limit
2004	7.65	7.65	87,900	No Limit
2003	7.65	7.65	87,000	No Limit
2002	7.65	7.65	84,900	No Limit
2001	7.65	7.65	80,400	No Limit
2000	7.65	7.65	76,200	No Limit
1999	7.65	7.65	72,600	No Limit
1998	7.65	7.65	68,400	No Limit
1997	7.65	7.65	65,400	No Limit

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 deferred basis. Participants may postpone income taxes on contributions and earnings by agreeing to defer receipt of a portion of their current income until retirement.

This program offers employees two plans. The 457 plan was implemented in the 1981-82 fiscal year and the 401(k) plan was implemented in the 1983-84 fiscal year. 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, 2006, accounts were held by 66,767 individuals in the 401(k) plan and 5,293 individuals in the 457 plan. At fiscal year end, 30,304 state employees, 8,983 University of Tennessee employees, and 10,252 Tennessee Board of Regents employees were actively contributing to the 401(k) plan and 2,215 state employees, 382 University of Tennessee employees, and 287 Tennessee Board of Regents employees were actively contributing to the 457 plan.

The program is used by state employees of all ages and salary levels. The majority of active contributors are under age 50 and earn below $35,000 per year.

IRS regulations for 2006 allow a maximum deferral in the 457 plan of 100% of compensation up to the maximum annual contribution of $15,000. The maximum deferral in the 401(k) plan is 100% of compensation up to the maximum annual contribution of $15,000. 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 2006 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 $30 per month as authorized by the General Assembly. The amount contributed by the state during the year was $9,824,290. Beginning in the 2007 fiscal year, the state match will increase to $40 per month.

Participants in the program at June 30, 2006 directed the investment of their deferred salary to the Regions Bank Time Deposit Account, ING's Fixed Account, Calvert's Income Fund, State Street Bank & Trust's S&P 500 Index Fund, Fidelity Investments' Magellan Fund, Puritan Fund, OTC Portfolio, Contrafund, International Growth and Income Fund, Asset Manager, and Government Money Market Portfolio.

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.

The Internet site, www.treasury.state.tn.us/dc/, provides full information about the program. Information available through the site includes forms,

Deferred Compensation Program

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 to request additional personalized information and full account activity access.

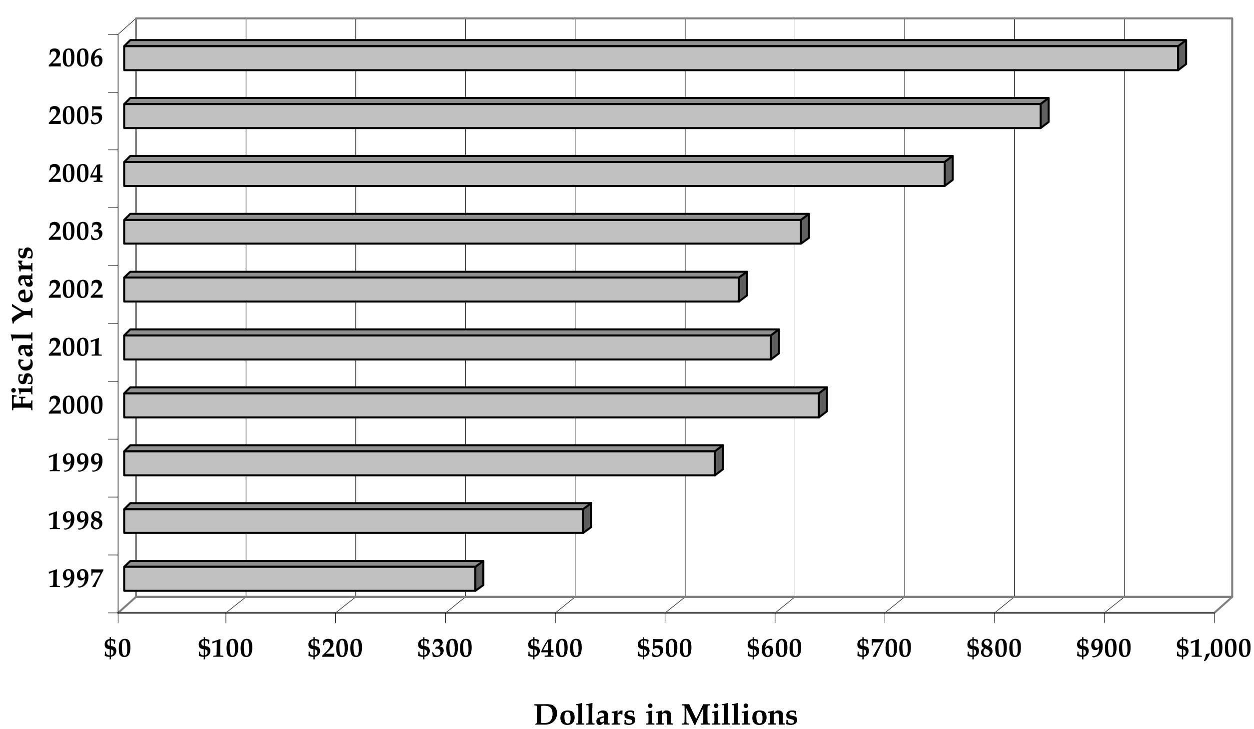
For the year ending June 30, 2006, contributions to the program totaled $100.1 million. Contributions are wired through the State Trust of Tennessee for immediate crediting.

At June 30, 2006, accumulated account balances totaled $963.6 million.

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, 2006, there were 2,430 loans outstanding from the 401(k) plan. Outstanding loan balances totaled $8.5 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, 2006, 1,027 individuals received periodic payments and 69 individuals received annuity payments from the program. In addition, 2,959 lump sum distributions and 2,506 partial lump sum distributions were issued during fiscal year 2006.

DEFERRED COMPENSATION PROGRAM ASSETS
Expressed in Millions
Fiscal Years 1997-2006



Deferred Compensation Program

DEFERRED COMPENSATION CONTRIBUTIONS AND MARKET VALUE

	Contributions Fiscal Year 2006	Market Value June 30, 2006
Plan I (457)		
ING	$ 1,858,203	$ 34,004,791
American General	18,534	662,628
Calvert	993,303	5,057,654
Fidelity	7,773,143	91,103,945
State Street	1,037,938	4,331,721
Regions Bank	691,229	14,015,918
	$ 12,372,350	$ 149,176,657
Plan II (401k)		
ING	$ 11,571,574	$ 104,154,768
Calvert	4,020,072	25,849,745
Fidelity	62,649,043	614,405,648
State Street	4,032,578	23,827,868
Regions Bank	5,420,857	46,135,711
	$ 87,694,124	$ 814,373,740
Total for both Plans	$ 100,066,474	$ 963,550,397

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 unless they elect not to participate. Use of the other benefit options requires a new election each year.

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

At June 30, 2006, a total of 43,209 state employees were enrolled in one or more of the plan's four options: 42,140 employees used the plan to pay medical insurance premiums, 22,957 paid dental insurance premiums, 4,259 used the medical expense reimbursement account, and 385 used the dependent care reimbursement account.

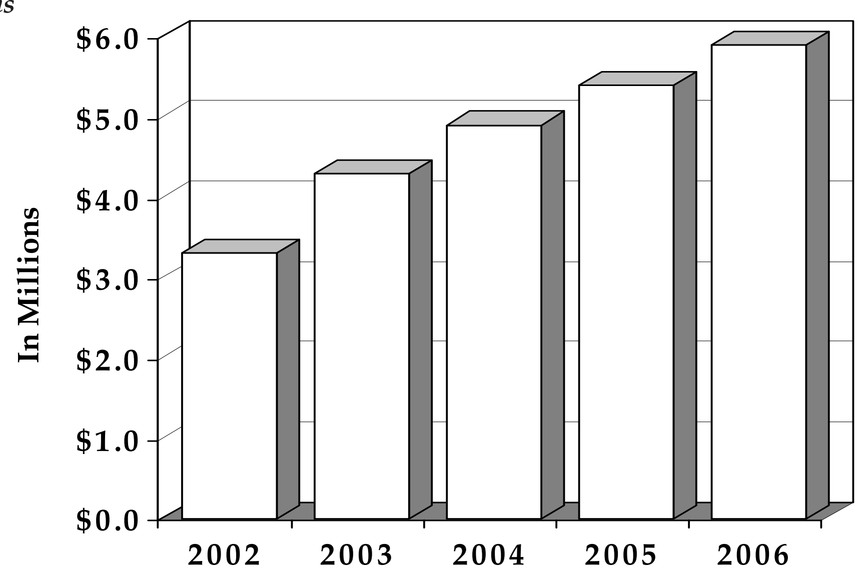
Since contributions to the plan are exempt from both employee and employer F.I.C.A. (social security) tax, employees' use of the plan creates F.I.C.A. savings for the state. In fiscal year 2006, the state's F.I.C.A. savings totaled $5.9 million. Employees realize similar savings.

Since the program began operation in January 1989, the state's F.I.C.A. savings have totaled $48.5 million. Savings exceeding the costs of administering the plan have been designated for offsetting costs of the state's wellness program, providing assistance for day care programs, funding for employee sick leave bank administration and funding matching contributions to the 401(k) plan. As of June 30, 2006, $40.7 million had been transferred to offset costs of other benefit programs.

F.I.C.A. SAVINGS TO STATE

Fiscal Years 2002-2006

Expressed in Millions



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 and money market instruments.

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

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 for TCRS. The Townsend Group serves as the real estate investment consultant.

The Bank of New York 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 4 basis points (.04%) of assets. The Wall Street Journal reported on August 27, 2001 that the average mutual fund fee was 56 basis points and that the average fee for large public pension funds was 28 basis points. The cost of 4 basis points includes the cost of personnel, operational cost, master bank custodian cost, record keeping, and the cost of external management for international equities. Commission cost for trades are capitalized.

PERFORMANCE MEASUREMENT

An independent external investment consultant, Strategic Investment Solutions, Inc., provides performance measurement for TCRS. Performance measurement is determined in conformance with the standards established by the Association for Investment Management and Research (AIMR). During the 2006 fiscal year, TCRS had a total return of 6.94%. Domestic stocks earned 9.33%, while the S&P 1500 Index was 9.23%. Domestic Bonds earned 0.50% versus the bond index of 0.80%, while international stocks earned 12.58% versus 26.56% for the EAFE Index. International bonds exceeded the benchmark 1.45% versus 1.84%. Real estate earned 24.59%.

TCRS Investments

INVESTMENT SUMMARY

As of June 30, 2006

	Domestic		International		Total	
	Fair Value	%	Fair Value	%	Fair Value	%
Fixed Income						
Government Bonds	$ 9,885,395,086	34.59%	$ 819,652,615	2.87%	$ 10,705,047,701	37.46%
Corporate Bonds	2,907,165,806	10.17%	222,839,551	0.78%	3,130,005,357	10.95%
Total Fixed Income	12,792,560,892	44.76%	1,042,492,166	3.65%	13,835,053,058	48.41%
Common Stock						
Capital Goods & Services	161,019,677	0.56%	110,009,515	0.38%	271,029,192	0.94%
Consumer Durables	95,910,888	0.34%	1,880,105	0.01%	97,790,993	0.35%
Consumer Non-Durables	1,674,576,957	5.86%	358,868,142	1.26%	2,033,445,099	7.12%
Energy	823,069,686	2.88%	149,484,642	0.52%	972,554,328	3.40%
Financial	1,699,685,660	5.95%	2,647,367,383	9.26%	4,347,053,043	15.21%
Materials & Services	1,648,466,426	5.77%	353,845,130	1.24%	2,002,311,556	7.01%
Miscellaneous Common Stock	2,024,100	0.01%	3,047,741	0.01%	5,071,841	0.02%
Real Estate Investment Trust	75,800,018	0.27%	-	0.00%	75,800,018	0.27%
Rights	-	0.00%	1,282,481	0.00%	1,282,481	0.00%
Technology	1,291,343,532	4.52%	208,261,322	0.73%	1,499,604,854	5.25%
Transportation	203,285,527	0.71%	106,572,766	0.37%	309,858,293	1.08%
Utilities	623,542,388	2.18%	244,527,786	0.86%	868,070,174	3.04%
Total Common Stock	8,298,724,859	29.05%	4,185,147,013	14.64%	12,483,871,872	43.69%
Short-Term Investments						
Commercial Paper	645,358,151	2.26%	-	0.00%	645,358,151	2.26%
Pooled Funds and Mutual Funds	41,883	0.00%	-	0.00%	41,883	0.00%
U.S. Gov't Securities	674,052,974	2.36%	-	0.00%	674,052,974	2.36%
Total Short Term Investments	1,319,453,008	4.62%	-	0.00%	1,319,453,008	4.62%
Real Estate	936,979,801	3.28%	-	0.00%	936,979,801	3.28%
Total Investments	23,347,718,560	81.71%	5,227,639,179	18.29%	28,575,357,739	100.00%
Short Term Investments classified as Cash Equivalents	(815,606,020)		-		(815,606,020)	
Total Investments as Shown on the Statement of Plan Net Assets	$22,532,112,540		$5,227,639,179		$ 27,759,751,719	

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
2006	6.9%	6.9%
2005	9.4	7.3
2004	15.0	9.3
2003	3.7	4.9
2002	(5.2)	(1.9)
2001	(4.1)	(1.6)
2000	9.5	7.9
1999	10.0	9.5
1998	17.9	15.1
1997	18.9	15.7

[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 2002-2006

Fiscal Year	TCRS Portfolio Earnings
2006	$1,877,298,490
2005	1,850,367,215
2004	2,181,853,628
2003	1,112,478,748
2002	(443,783,760)

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 60 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 2006 fiscal year, the average balance of short term investments in the Treasurer's Cash Management program was $5,396,768,493 per month and interest income of $221,242,015 was earned. This includes deposits in the Local Government Investment Pool administered by the Treasury Department.

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

The 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 90 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 the State Trust of Tennessee. Funds may also be invested in prime commercial paper and prime banker's acceptances.

At June 30, 2006, investments had an average maturity of 68 days, and an average weighted yield of 5.07%. The total balance in the State Pooled Investment Fund at June 30, 2006, $6,623,557,330 fair value, was allocated as follows: U.S. Treasury government and agency securities, 30.09%; repurchase agreements and overnight deposits, 8.41%; collateralized certificates of deposit, 34.53%; and commercial paper, 26.97%.

ADMINISTRATION OF AUTHORIZED STATE DEPOSITORY ACCOUNTS

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

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

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

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

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

STATE COLLATERAL PROGRAM

Collateral is required to secure state deposits held in authorized state depository institutions. Statute sets the required collateral level at a market value of 105 percent of the value of the deposit secured, less the amount secured by the Federal Deposit Insurance Corporation. However, if the state depository is operating with a capital-to-asset ratio of less than five percent, additional collateral with a market value of $100,000 is required. 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.

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 only healthy institutions are permitted to participate.

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

State Cash Management

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.

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 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 71 participant institutions collateralizing public funds in excess of $6.7 billion.

8-5-110 COLLATERAL

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

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

STATE CASH MANAGEMENT COMPARATIVE RETURNS

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

Fiscal Year	[1] Total Pool Funds	[2] Merrill Lynch Institutional Fund	[3] Standard & Poor's 7-Day LGIP Yield Index	[4] 90-Day Treasury (CD Equivalent Yield)
2006	4.11%	4.00%	4.00%	4.18%
2005	2.12	2.00	1.89	2.25
2004	1.11	.93	.84	.97
2003	1.64	1.41	1.29	1.31
2002	2.67	2.37	2.33	2.17

[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 period 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
2006	$ 1,759,051,167	$ 72,963,609	4.08%
2005	1,888,126,667	38,198,848	2.00%
2004	1,932,058,417	20,858,498	1.11%
2003	1,794,136,750	29,042,346	1.64%
2002	1,273,620,750	32,205,432	2.52%

Repurchase Agreements and Overnight Deposit Accounts

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2006	$ 384,561,576	$ 13,866,064	4.37%
2005	493,189,109	9,740,888	2.37%
2004	293,922,333	3,408,318	1.05%
2003	136,356,417	2,295,933	1.44%
2002	94,677,417	3,646,680	2.28%

Commercial Paper

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2006	$ 1,506,052,417	$ 64,594,383	4.24%
2005	795,684,167	18,853,258	2.37%
2004	894,287,583	9,195,815	1.02%
2003	742,144,917	10,702,937	1.47%
2002	1,240,681,750	30,544,415	2.46%

U.S. Government Securities

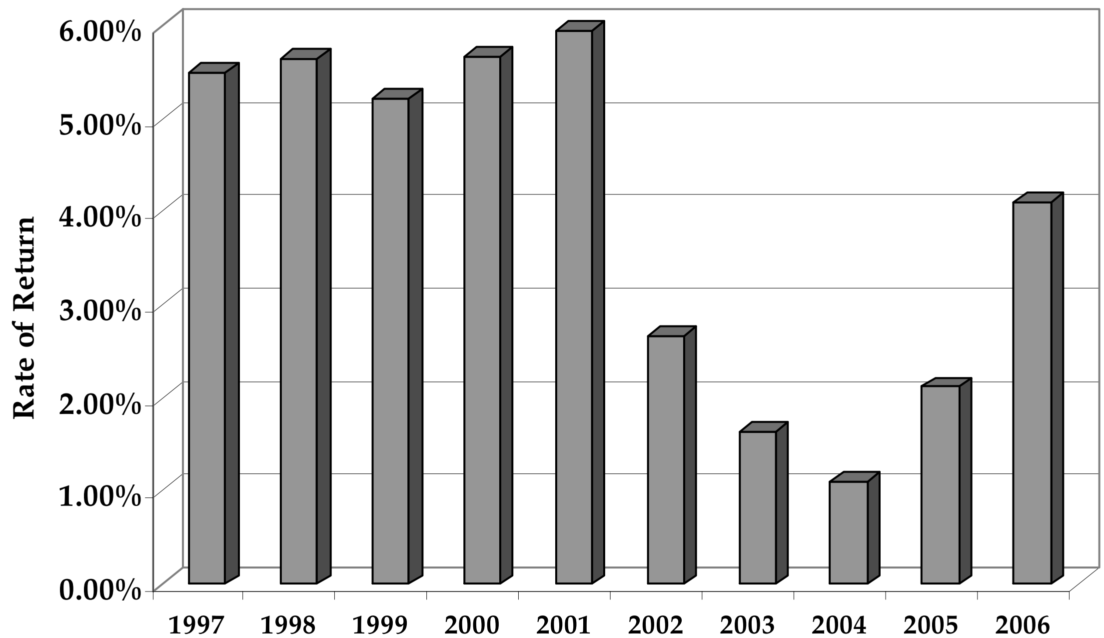
Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2006	$ 1,747,103,333	$ 69,817,959	3.99%
2005	1,254,517,917	25,938,244	2.07%
2004	906,027,583	10,863,449	1.19%
2003	890,260,833	16,329,936	1.83%
2002	1,764,991,750	52,230,461	2.92%

Total Funds

Fiscal Year	Average Total Funds Invested	Cash Management Investment Earnings	Composite Weighted Average Rate of Return
2006	$ 5,396,768,493	$ 221,242,015	4.11%
2005	4,431,517,860	92,731,238	2.12%
2004	4,026,295,916	44,326,080	1.11%
2003	3,562,898,917	58,371,152	1.64%
2002	4,373,971,667	118,626,988	2.67%

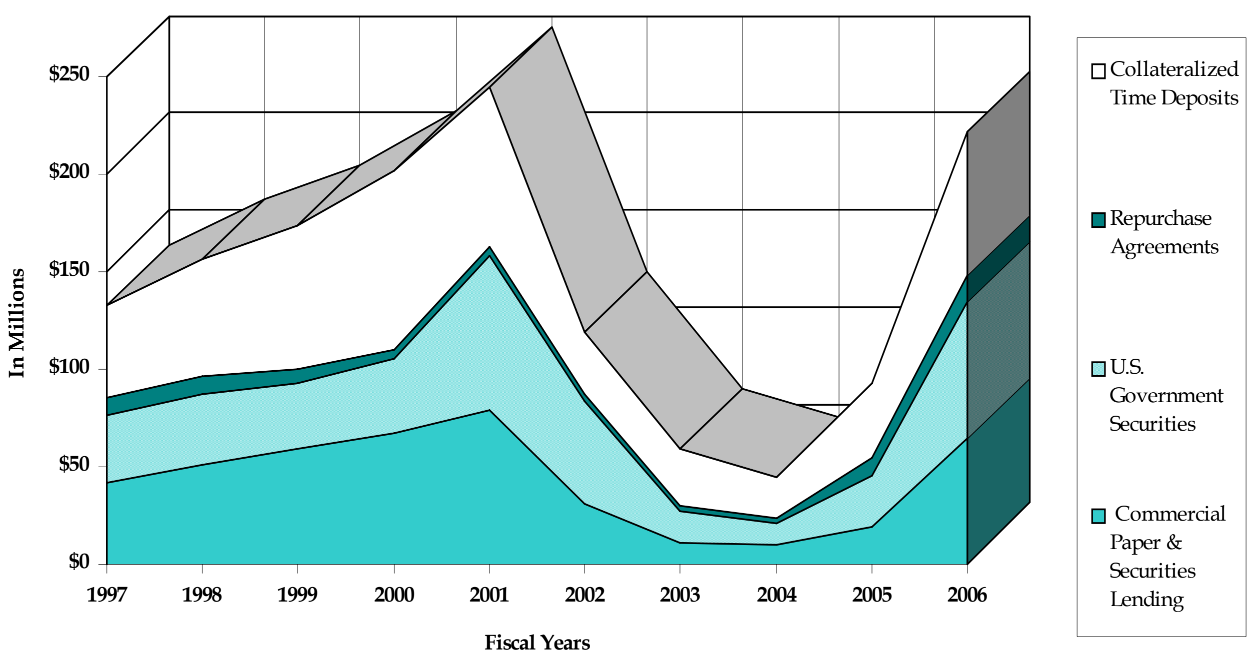
CASH MANAGEMENT INVESTMENTS COMPOSITE WEIGHTED AVERAGE RATE OF RETURN

Fiscal Years 1997-2006



ANALYSIS OF STATE CASH EARNINGS

Fiscal Years 1997-2006



State Cash Management

CASH MANAGEMENT PORTFOLIO ANALYSIS
Fiscal Year Ended June 30, 2006

Date	Current Investment Yield	Total Portfolio Yield	Avg. Days to Maturity	Portfolio Composition: Certificates of Deposit	Repurchase Agreements	U.S. Treasury Notes	U.S. Agency	Commercial Paper
July 2005	3.28%	3.26%	75	30.30%	6.84%	0.00%	34.55%	28.32%
August 2005	3.51%	3.42%	76	31.47%	5.96%	0.00%	35.20%	27.37%
September 2005	3.68%	3.56%	79	32.42%	6.02%	0.00%	31.85%	29.71%
October 2005	3.82%	3.72%	88	31.21%	6.05%	0.00%	33.62%	29.12%
November 2005	4.05%	3.87%	91	32.87%	5.99%	0.00%	34.18%	26.95%
December 2005	4.24%	4.02%	76	33.74%	6.22%	0.00%	36.35%	23.70%
January 2006	4.36%	4.18%	64	33.42%	6.22%	0.00%	35.17%	25.20%
February 2006	4.54%	4.37%	78	32.63%	5.84%	0.00%	31.25%	30.28%
March 2006	4.62%	4.50%	71	33.00%	5.29%	0.00%	29.71%	32.00%
April 2006	4.82%	4.65%	73	34.24%	5.34%	0.00%	31.35%	29.07%
May 2006	5.01%	4.83%	83	35.29%	4.99%	0.00%	31.77%	27.94%
June 2006	5.09%	4.98%	79	34.77%	5.82%	0.00%	30.53%	28.87%
Average	4.25%	4.11%	78	32.95%	5.88%	0.00%	32.96%	28.21%

MONTH	General Fund Average	General Fund Percent	LGIP Average	LGIP Percent	Other Restricted Average	Other Restricted Percent	Total Average Invested
July, 2005	$1,762,010,870	35.50%	$1,655,757,111	33.36%	$1,545,546,437	31.14%	$4,963,314,418
August, 2005	1,763,069,703	35.67%	1,572,306,476	31.81%	1,607,315,673	32.52%	4,942,691,852
September, 2005	1,779,233,769	35.60%	1,635,633,161	32.73%	1,582,455,217	31.67%	4,997,322,147
October, 2005	1,838,834,092	36.24%	1,628,338,741	32.09%	1,606,965,595	31.67%	5,074,138,428
November, 2005	1,709,431,010	34.03%	1,690,363,874	33.66%	1,622,808,683	32.31%	5,022,603,567
December, 2005	1,520,879,035	30.98%	1,733,767,251	35.32%	1,654,324,485	33.70%	4,908,970,771
January, 2006	1,495,931,094	28.90%	1,964,047,312	37.94%	1,716,787,102	33.16%	5,176,765,508
February, 2006	1,576,081,209	29.09%	2,112,036,697	38.98%	1,730,246,092	31.93%	5,418,363,998
March, 2006	1,358,283,357	23.48%	2,654,401,278	45.87%	1,773,756,461	30.65%	5,786,441,096
April, 2006	1,557,533,595	26.51%	2,501,420,585	42.57%	1,816,412,811	30.92%	5,875,366,991
May, 2006	1,981,422,530	32.23%	2,306,822,093	37.52%	1,859,787,568	30.25%	6,148,032,191
June, 2006	2,371,184,051	36.78%	2,230,142,759	34.59%	1,845,884,134	28.63%	6,447,210,944
Average	$1,726,157,860	31.99%	$1,973,753,112	36.57%	$1,696,857,521	31.44%	$5,396,768,493

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 1,800 accounts. The Department of Transportation (DOT) program has more than 600 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 mailed to participants include monthly statements and transaction confirmations. Monthly statements detail all debits and credits to the account during the month, the account's average daily balance, and interest credited. A transaction confirmation is mailed to the participant each time a deposit or withdrawal is made. Many participants rely on this documentation for daily and weekly reconciliations.

Participants earn interest on LGIP deposits based on the total portfolio return of the cash management pool, less a monthly administrative fee of five one hundredths of one percent (.05%). During the 2006 fiscal year, the average rate participants earned on their deposits after the fee reduction was 4.06%. 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, 2006

	Account Balance 7/1/2005	Net Deposits/(Withdrawals)	Interest Credited	Account Balance 6/30/2006
Cities	$ 376,252,954	$ 276,515,414	$ 21,902,805	$ 674,671,173
Counties	448,455,780	96,333,213	19,911,963	564,700,956
Commitments to D.O.T.	44,853,188	(600,337)	1,843,279	46,096,130
Educational Institutions	480,109,487	80,640,202	26,627,034	587,376,723
Community Health Agencies	7,248,086	(588,733)	257,794	6,917,147
Other	281,136,243	11,205,596	12,177,108	304,518,947
	$ 1,638,055,738	$ 463,505,355	$ 82,719,983	$ 2,184,281,076

State Cash Management

STATE TRUST OF TENNESSEE

The State Trust of Tennessee, a not-for-profit corporation chartered in the State of Tennessee in 1979, enables the Treasury Department to hold limited membership in the Federal Reserve Bank System. Being a limited member of the Federal Reserve gives the Treasury Department access to the Federal Reserve Wire System, which is used to send, receive, transfer and control funds movement expediently under the Treasurer's management.

Due to restrictions imposed upon state-owned trust companies by the Federal Reserve Board, the State Trust of Tennessee is limited in the number of daily outgoing wire transfers and may not settle ACH transactions through its account at the Federal Reserve.

The restrictions require the State Trust of Tennessee to contract with an agent bank to execute these transactions. AmSouth Bank of Tennessee in Nashville serves as the Trust's agent for the period July 1, 2004 through June 30, 2009.

The State Trust is an associate member of the Regional Check Clearinghouse. Approximately 85% of all check items presented for redemption are processed through the clearinghouse .

STATE TRUST OF TENNESSEE FEDERAL RESERVE BANK TRANSACTIONS
Fiscal Year 2006

	Transaction Type	Number	Amount
(1)	Wire Disbursements	1,010	$ 20,809,974,051
(2)	Wire Receipts	5,829	21,859,537,938
(3)	Security Disbursements	177	5,159,333,673
(4)	Security Receipts	125	4,104,301,133
(5)	Check Redemptions	6,942,772	59,680,169,706
	Total	**6,949,913**	**$ 111,613,316,501**

Explanation of Transaction Types:

(1) Disbursements of cash for the purpose of non-Fed eligible securities, settlement wires to agent bank, and other nonrecurring wires.

(2) Receipt of cash for payment of interest and principal for non-Fed eligible securities, concentration of cash deposited in local banks, drawdown of Federal funds, and Local Government Investment Pool (LGIP) deposits.

(3) Disbursement of cash against the receipt of Fed eligible securities (U.S. Government securities held in book-entry form by the Federal Reserve Bank).

(4) Receipt of cash against the disbursement of Fed eligible securities.

(5) Redemption of warrants, drafts, and checks issued by the state.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
LARGEST HOLDINGS

LARGEST STOCK HOLDINGS
as of June 30, 2006
by Fair Value

Shares	Security Name	Fair Value
4,280,694	Exxon Mobil Corporation	$262,620,577
6,983,000	General Electric Company	230,159,680
3,471,000	Citigroup Incorporated	167,441,040
3,147,508	Bank of America Corporation	151,395,135
6,385,200	Microsoft Corporation	148,775,160
2,565,200	Procter & Gamble Company	142,625,120
2,032,800	Johnson & Johnson	121,805,376
5,046,420	Pfizer Incorporated	118,439,477
1,477,100	Altria Group Incorporated	108,463,453
2,324,955	JP Morgan Chase & Company	97,648,110

LARGEST BOND HOLDINGS
as of June 30, 2006
by Fair Value

Par Value	Security Name	Yield	Maturity	Moody's Quality Rating	Fair Value
400,000,000	United States Treasury Infl Index Note	2.91%	07/15/12	Aaa	$461,487,583
400,000,000	United States Treasury Infl Index Note	2.94	01/15/16	Aaa	387,691,222
300,000,000	United States Treasury Infl Index Note	3.22	01/15/12	Aaa	356,510,340
293,403,907	FNMA Mortgage Pool #725424	5.70	04/01/34	NR	283,046,749
260,000,000	United States Treasury Note	3.96	05/15/13	Aaa	237,829,800
175,000,000	United States Treasury Bond	6.26	02/15/21	Aaa	220,199,219
200,000,000	United States Treasury Bond	5.28	02/15/31	Aaa	203,454,000
200,000,000	United States Infl. Treasury Index Note	0.93	04/15/10	Aaa	200,612,091
200,000,000	United States Infl. Treasury Index Note	1.98	07/15/15	Aaa	196,538,822
160,000,000	United States Treasury Bond	6.26	05/15/16	Aaa	185,262,400

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, 2006

Description	Rating	Maturity	Yield to Maturity	Par Value	Fair Value
U.S. TREASURY AND AGENCY OBLIGATIONS					
Farmer Mac	Aaa	10/25/06	4.22%	$ 50,000,000	$ 49,813,000
Federal Home Loan Bank	Aaa	07/21/06	3.86	121,475,000	121,323,156
Federal Home Loan Bank	Aaa	08/01/06	4.02	50,000,000	49,937,500
Federal Home Loan Bank	Aaa	08/15/06	4.86	37,440,000	37,358,006
Federal Home Loan Bank	Aaa	08/18/06	4.03	75,000,000	74,859,750
Federal Home Loan Bank	Aaa	09/29/06	4.10	50,000,000	49,844,000
Federal Home Loan Bank	Aaa	10/02/06	4.59	74,500,000	73,871,220
Federal Home Loan Bank	Aaa	05/09/07	5.20	50,000,000	49,844,000
Federal Home Loan Bank	Aaa	06/19/07	5.38	50,000,000	49,890,500
FFCB Discount Notes	Aaa	08/02/06	4.06	24,000,000	23,896,800
FFCB Discount Notes	Aaa	09/11/06	4.00	8,000,000	7,918,400
FFCB Discount Notes	Aaa	09/15/06	5.26	50,000,000	49,460,000
FFCB Discount Notes	Aaa	09/29/06	5.32	25,000,000	24,680,000
FFCB Discount Notes	Aaa	10/24/06	4.44	12,000,000	11,803,200
FFCB Discount Notes	Aaa	11/01/06	5.11	35,100,000	34,482,240
FFCB Discount Notes	Aaa	12/15/06	5.14	25,000,000	24,397,500
FFCB Discount Notes	Aaa	01/16/07	4.94	24,175,000	23,481,178
FFCB Discount Notes	Aaa	02/15/07	5.20	10,000,000	9,670,000
FFCB Discount Notes	Aaa	03/15/07	4.99	10,000,000	9,629,000
FFCB Discount Notes	Aaa	04/02/07	5.23	25,000,000	24,007,500
FFCB Discount Notes	Aaa	05/01/07	5.25	15,000,000	14,341,500
FHLMC Note 2.375	Aaa	02/15/07	5.25	75,000,000	73,570,500
FHLMC Note 2.750	Aaa	10/15/06	5.11	50,000,000	49,625,000
FHLMC Note 2.875	Aaa	12/15/06	5.13	50,000,000	49,422,000
FHLMC Note 3.625	Aaa	09/15/06	4.54	45,875,000	45,702,969
FHLMC Note 3.625	Aaa	02/15/07	5.09	94,523,000	93,422,752
FHLMC Note 3.750	Aaa	11/15/06	4.89	50,000,000	49,693,000
FHLMC Note 3.750	Aaa	11/15/06	5.01	4,990,000	4,959,811
FHLMC Note 5.000	Aaa	03/07/07	5.00	50,000,000	49,780,500
FHLMC Note 5.150	Aaa	04/09/07	5.15	50,000,000	49,840,000
FHLMC Note 5.340	Aaa	06/27/07	5.34	50,000,000	49,870,500
FNMA Discount Notes	Aaa	07/03/06	4.84	31,950,000	31,941,516
FNMA Discount Notes	Aaa	07/03/06	4.84	35,245,000	35,235,640
FNMA Discount Notes	Aaa	07/03/06	4.15	13,000,000	12,997,097
FNMA Discount Notes	Aaa	07/03/06	4.18	60,000,000	59,986,483
FNMA Discount Notes	Aaa	07/19/06	4.93	50,000,000	49,885,000
FNMA Discount Notes	Aaa	08/01/06	4.96	60,918,000	60,660,960
FNMA Discount Notes	Aaa	08/01/06	4.96	39,262,000	39,096,336
FNMA Discount Notes	Aaa	10/02/06	4.99	25,237,500	24,919,991
FNMA Note 2.625	Aaa	11/15/06	4.98	67,294,000	66,621,060
FNMA Note 3.050	Aaa	10/13/06	4.76	50,000,000	49,672,000
FNMA Note 3.125	Aaa	07/15/06	4.07	50,000,000	49,953,000
FNMA Note 3.250	Aaa	07/12/06	4.52	50,057,000	50,025,965
FNMA Note 4.000	Aaa	02/28/07	5.26	135,099,000	133,748,010
TOTAL U.S. TREASURY AND AGENCY OBLIGATIONS				**$ 2,010,140,500**	**$ 1,995,138,540**

(continued)

STATE CASH PORTFOLIO AS OF JUNE 30, 2006

	Maturity	Yield to Maturity	Par Value	Fair Value
CERTIFICATES OF DEPOSIT				
Community Bank & Trust, Ashland City	11/07/06	5.15%	$1,000,000	$ 1,000,000
Community Bank & Trust, Ashland City	11/07/06	5.15	2,000,000	2,000,000
Community Bank & Trust, Ashland City	07/18/06	4.50	1,000,000	1,000,000
Community Bank & Trust, Ashland City	09/15/06	4.90	1,000,000	1,000,000
Bank of Crockett, Bells	11/10/06	5.15	200,000	200,000
Bank of Crockett, Bells	12/01/06	5.15	300,000	300,000
First South Bank, Bolivar	09/08/06	4.90	2,142,700	2,142,700
Bank of Bradford	09/01/06	4.75	100,000	100,000
People's Bank and Trust Company, Byrdstown	07/21/06	4.50	100,000	100,000
People's Bank and Trust Company, Byrdstown	08/08/06	4.75	100,000	100,000
People's Bank and Trust Company, Byrdstown	08/18/06	4.75	100,000	100,000
People's Bank and Trust Company, Byrdstown	12/15/06	5.30	100,000	100,000
People's Bank and Trust Company, Byrdstown	08/11/06	4.75	200,000	200,000
People's Bank and Trust Company, Byrdstown	11/14/06	5.15	500,000	500,000
People's Bank and Trust Company, Byrdstown	08/25/06	4.75	200,000	200,000
Citizens Bank, Carthage	09/26/06	4.90	6,000,000	6,000,000
Citizens Bank, Carthage	09/29/06	4.90	2,000,000	2,000,000
Cumberland Bank, Carthage	07/25/06	4.50	500,000	500,000
Cumberland Bank, Carthage	09/05/06	4.90	2,000,000	2,000,000
Cumberland Bank, Carthage	11/03/06	5.10	3,000,000	3,000,000
Cumberland Bank, Carthage	07/31/06	5.00	7,000,000	7,000,000
Cumberland Bank, Carthage	11/03/06	5.10	2,000,000	2,000,000
Cumberland Bank, Carthage	11/17/06	5.15	5,000,000	5,000,000
Cumberland Bank, Carthage	09/15/06	5.20	5,000,000	5,000,000
First State Bank, Chapel Hill	12/12/06	5.15	200,000	200,000
First Tennessee Bank National Association, Chattanooga	09/18/06	5.20	20,000,000	20,000,000
Legends Bank, Clarksville	09/19/06	4.90	1,000,000	1,000,000
Legends Bank, Clarksville	09/19/06	4.90	1,000,000	1,000,000
Legends Bank, Clarksville	07/18/06	4.85	1,000,000	1,000,000
Legends Bank, Clarksville	08/18/06	4.85	1,000,000	1,000,000
Bank of Cleveland	12/15/06	5.30	5,000,000	5,000,000
Bank of Cleveland	11/03/06	5.10	5,000,000	5,000,000
People's Bank, Clifton	11/03/06	5.10	500,000	500,000
Community First Bank & Trust, Columbia	12/22/06	5.40	3,000,000	3,000,000
Community First Bank & Trust, Columbia	09/08/06	4.90	2,000,000	2,000,000
Community First Bank & Trust, Columbia	09/08/06	4.90	1,000,000	1,000,000
First Farmers and Merchants Bank, Columbia	08/18/06	4.75	10,000,000	10,000,000
First Farmers and Merchants Bank, Columbia	07/19/06	5.00	10,000,000	10,000,000
Community National Bank, Dayton	11/28/06	5.15	2,000,000	2,000,000
Community National Bank, Dayton	09/01/06	4.75	950,000	950,000
Community National Bank, Dayton	07/14/06	4.50	1,000,000	1,000,000
Tristar Bank, Dickson	09/22/06	4.90	500,000	500,000
Tristar Bank, Dickson	12/19/06	5.30	500,000	500,000
The Farmers & Merchants Bank, Dyer	07/14/06	4.90	1,500,000	1,500,000
First Citizens National Bank, Dyersburg	12/01/06	5.15	3,000,000	3,000,000
First Citizens National Bank, Dyersburg	12/01/06	5.15	20,000,000	20,000,000
Security Bank, Dyersburg	08/15/06	4.75	300,000	300,000
Security Bank, Dyersburg	12/12/06	5.15	1,000,000	1,000,000
Security Bank, Dyersburg	08/15/06	4.75	500,000	500,000
Franklin National Bank	09/05/06	4.90	10,000,000	10,000,000
Tennessee Commerce Bank, Franklin	07/25/06	4.50	500,000	500,000
Tennessee Commerce Bank, Franklin	12/26/06	5.40	750,000	750,000

(continued)

State Cash Portfolio as of June 30, 2006

	Maturity	Yield to Maturity	Par Value	Fair Value
Tennessee Commerce Bank, Franklin	09/29/06	4.90%	500,000	500,000
Tennessee Commerce Bank, Franklin	12/26/06	5.40	200,000	200,000
Tennessee Commerce Bank, Franklin	11/14/06	5.15	1,500,000	1,500,000
Tennessee Commerce Bank, Franklin	09/29/06	4.90	1,000,000	1,000,000
Tennessee Commerce Bank, Franklin	09/29/06	4.90	500,000	500,000
Tennessee Commerce Bank, Franklin	10/20/06	5.00	2,500,000	2,500,000
Friendship Bank	12/15/06	5.30	525,000	525,000
Friendship Bank	12/15/06	5.30	1,550,000	1,550,000
Friendship Bank	12/15/06	5.30	50,000	50,000
Friendship Bank	07/03/06	4.50	375,000	375,000
Friendship Bank	12/08/06	5.15	1,500,000	1,500,000
Gates Banking and Trust Company	09/05/06	4.90	500,000	500,000
Gates Banking and Trust Company	10/06/06	5.00	500,000	500,000
Gates Banking and Trust Company	10/06/06	5.00	500,000	500,000
Gates Banking and Trust Company	11/07/06	5.15	350,000	350,000
Gates Banking and Trust Company	08/25/06	4.75	450,000	450,000
Tennessee State Bank, Gatlinburg	10/24/06	5.00	20,000,000	20,000,000
Tennessee State Bank, Gatlinburg	09/07/06	4.75	10,000,000	10,000,000
Trust One Bank, Germantown	08/08/06	4.90	2,000,000	2,000,000
Trust One Bank, Germantown	08/08/06	4.90	2,000,000	2,000,000
Trust One Bank, Germantown	08/08/06	4.90	2,000,000	2,000,000
Trust One Bank, Germantown	10/16/06	5.15	3,000,000	3,000,000
Trust One Bank, Germantown	07/07/06	4.75	3,000,000	3,000,000
Trust One Bank, Germantown	07/07/06	4.75	4,000,000	4,000,000
Trust One Bank, Germantown	08/08/06	4.90	1,000,000	1,000,000
Trust One Bank, Germantown	10/16/06	5.15	1,000,000	1,000,000
Trust One Bank, Germantown	10/16/06	5.15	1,000,000	1,000,000
Trust One Bank, Germantown	10/16/06	5.15	3,000,000	3,000,000
Trust One Bank, Germantown	09/08/06	5.10	6,000,000	6,000,000
Bank of Gleason	10/24/06	5.10	300,000	300,000
Bank of Gleason	08/15/06	4.75	200,000	200,000
Bank of Gleason	12/15/06	5.30	350,000	350,000
Bank of Gleason	08/11/06	4.75	1,000,000	1,000,000
Bank of Gleason	08/11/06	4.75	1,000,000	1,000,000
Bank of Halls	08/08/06	4.75	200,000	200,000
Bank of Halls	08/22/06	4.75	200,000	200,000
Bank of Halls	08/29/06	4.75	700,000	700,000
Bank of Halls	09/22/06	4.90	400,000	400,000
Bank of Halls	10/13/06	5.00	300,000	300,000
Citizens Bank, Hartsville	08/29/06	5.00	1,000,000	1,000,000
Citizens Bank, Hartsville	08/29/06	5.00	1,200,000	1,200,000
Citizens Bank, Hartsville	09/22/06	5.25	1,000,000	1,000,000
Clayton Bank & Trust, Henderson	08/08/06	4.75	1,000,000	1,000,000
Clayton Bank & Trust, Henderson	12/08/06	5.15	2,000,000	2,000,000
American Security Bank and Trust Company, Hendersonville	09/01/06	4.75	200,000	200,000
American Security Bank and Trust Company, Hendersonville	10/03/06	4.90	200,000	200,000
American Security Bank and Trust Company, Hendersonville	09/12/06	4.90	500,000	500,000
American Security Bank and Trust Company, Hendersonville	09/19/06	4.90	500,000	500,000
Bancorpsouth, Jackson	11/21/06	5.15	7,500,000	7,500,000
Bancorpsouth, Jackson	09/29/06	4.90	2,000,000	2,000,000
Bancorpsouth, Jackson	11/21/06	5.15	15,000,000	15,000,000
Bancorpsouth, Jackson	08/09/06	4.85	10,000,000	10,000,000
Bancorpsouth, Jackson	08/04/06	4.65	40,000,000	40,000,000
Bancorpsouth, Jackson	09/29/06	4.90	1,000,000	1,000,000

(continued)

State Cash Portfolio as of June 30, 2006

	Maturity	Yield to Maturity	Par Value	Fair Value
Bancorpsouth, Jackson	09/29/06	4.90	7,500,000	7,500,000
Bank of Jackson	08/04/06	4.65	500,000	500,000
Bank of Jackson	08/04/06	4.65	1,000,000	1,000,000
Bank of Jackson	07/18/06	4.50	1,000,000	1,000,000
Bank of Jackson	08/15/06	4.75	500,000	500,000
First Volunteer Bank of Tennessee, Jamestown	10/10/06	5.00	500,000	500,000
First Volunteer Bank of Tennessee, Jamestown	09/22/06	4.90	200,000	200,000
First Volunteer Bank of Tennessee, Jamestown	09/22/06	4.90	500,000	500,000
First Volunteer Bank of Tennessee, Jamestown	09/22/06	4.90	450,000	450,000
First Volunteer Bank of Tennessee, Jamestown	09/22/06	4.90	300,000	300,000
First Volunteer Bank of Tennessee, Jamestown	09/22/06	4.90	500,000	500,000
Progressive Savings Bank, FSB, Jamestown	07/03/06	4.50	300,000	300,000
Citizens State Bank, Jasper	09/05/06	4.90	100,000	100,000
Citizens State Bank, Jasper	09/05/06	4.90	200,000	200,000
Citizens State Bank, Jasper	08/18/06	4.75	200,000	200,000
Bankeast, Knoxville	10/17/06	5.00	10,000,000	10,000,000
BB& T, Knoxville	08/22/06	5.00	40,000,000	40,000,000
BB& T, Knoxville	07/07/06	4.50	75,000,000	75,000,000
BB& T, Knoxville	07/28/06	5.00	20,000,000	20,000,000
BB& T, Knoxville	10/23/06	5.00	100,000,000	100,000,000
Citizens Bank of Lafayette	09/01/06	4.75	500,000	500,000
Citizens Bank of Lafayette	07/11/06	4.50	100,000	100,000
Citizens Bank of Lafayette	08/01/06	4.65	250,000	250,000
Citizens Bank of Lafayette	09/01/06	4.75	100,000	100,000
United Community Bank, Lenoir City	12/19/06	5.30	500,000	500,000
United Community Bank, Lenoir City	08/11/06	4.75	500,000	500,000
The Coffee County Bank, Manchester	10/13/06	5.00	95,000	95,000
First State Bank, Martin	07/03/06	4.50	1,500,000	1,500,000
Planters Bank of Tennessee, Maury City	11/14/06	5.15	200,000	200,000
The First National Bank of McMinnville	07/19/06	4.90	5,000,000	5,000,000
The First National Bank of McMinnville	07/07/06	4.50	2,300,000	2,300,000
Cadence Bank, Memphis	11/22/06	5.15	2,500,000	2,500,000
Cadence Bank, Memphis	11/14/06	5.15	2,000,000	2,000,000
Cadence Bank, Memphis	11/17/06	5.15	2,000,000	2,000,000
Cadence Bank, Memphis	08/01/06	4.65	5,000,000	5,000,000
Cadence Bank, Memphis	12/15/06	5.30	1,000,000	1,000,000
Cadence Bank, Memphis	12/05/06	5.15	5,000,000	5,000,000
Cadence Bank, Memphis	10/24/06	5.10	2,000,000	2,000,000
Cadence Bank, Memphis	07/19/06	4.90	3,000,000	3,000,000
Cadence Bank, Memphis	12/01/06	5.15	5,000,000	5,000,000
Cadence Bank, Memphis	08/04/06	4.65	5,000,000	5,000,000
Cadence Bank, Memphis	12/22/06	5.40	3,000,000	3,000,000
First Tennessee Bank National Association, Memphis	08/18/06	4.75	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	09/01/06	4.75	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	08/16/06	5.00	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	08/24/06	5.00	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	09/26/06	5.25	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	09/20/06	5.20	20,000,000	20,000,000
Independent Bank, Memphis	09/15/06	4.90	3,000,000	3,000,000
Independent Bank, Memphis	12/15/06	5.30	2,000,000	2,000,000
Independent Bank, Memphis	10/24/06	5.10	2,000,000	2,000,000
Independent Bank, Memphis	11/22/06	5.15	500,000	500,000
Independent Bank, Memphis	12/15/06	5.30	2,000,000	2,000,000
Independent Bank, Memphis	09/15/06	4.90	5,000,000	5,000,000

(continued)

STATE CASH PORTFOLIO AS OF JUNE 30, 2006

	Maturity	Yield to Maturity	Par Value	Fair Value
Independent Bank, Memphis	07/21/06	4.50	2,000,000	2,000,000
Independent Bank, Memphis	09/27/06	5.25	4,000,000	4,000,000
Independent Bank, Memphis	11/22/06	5.15	5,000,000	5,000,000
Independent Bank, Memphis	09/08/06	5.00	1,000,000	1,000,000
MemphisFirst Community Bank	11/14/06	5.15	2,000,000	2,000,000
Paragon National Bank, Memphis	12/19/06	5.30	1,000,000	1,000,000
Patriot Bank, Millington	12/15/06	5.30	1,000,000	1,000,000
Patriot Bank, Millington	09/12/06	4.90	1,000,000	1,000,000
AmSouth Bank, Nashville	11/07/06	5.15	100,000,000	100,000,000
AmSouth Bank, Nashville	07/28/06	4.65	50,000,000	50,000,000
AmSouth Bank, Nashville	07/28/06	4.65	50,000,000	50,000,000
AmSouth Bank, Nashville	11/03/06	5.10	100,000,000	100,000,000
Bank of America, NA, Nashville	08/01/06	5.00	100,000,000	100,000,000
Bank of America, NA, Nashville	08/01/06	5.00	100,000,000	100,000,000
Bank of America, NA, Nashville	08/01/06	5.00	100,000,000	100,000,000
Bank of Nashville	12/01/06	5.15	5,000,000	5,000,000
Bank of Nashville	12/12/06	5.15	5,000,000	5,000,000
Capital Bank & Trust Company, Nashville	09/15/06	4.90	2,000,000	2,000,000
Capital Bank & Trust Company, Nashville	07/11/06	4.50	1,000,000	1,000,000
Capital Bank & Trust Company, Nashville	08/08/06	4.75	5,000,000	5,000,000
Capital Bank & Trust Company, Nashville	07/21/06	4.50	2,000,000	2,000,000
Capital Bank & Trust Company, Nashville	12/26/06	5.40	3,500,000	3,500,000
Capital Bank & Trust Company, Nashville	11/22/06	5.15	3,000,000	3,000,000
Capital Bank & Trust Company, Nashville	09/15/06	4.90	5,000,000	5,000,000
Capital Bank & Trust Company, Nashville	09/22/06	4.90	3,000,000	3,000,000
Capital Bank & Trust Company, Nashville	07/03/06	4.50	2,500,000	2,500,000
Capital Bank & Trust Company, Nashville	12/08/06	5.15	4,000,000	4,000,000
Capital Bank & Trust Company, Nashville	08/11/06	4.75	3,000,000	3,000,000
Capital Bank & Trust Company, Nashville	12/01/06	5.15	3,000,000	3,000,000
Capital Bank & Trust Company, Nashville	12/12/06	5.15	1,000,000	1,000,000
Fifth Third Bank, Nashville	08/22/06	5.00	10,000,000	10,000,000
Fifth Third Bank, Nashville	09/29/06	4.90	25,000,000	25,000,000
Fifth Third Bank, Nashvill	08/04/06	4.65	5,000,000	5,000,000
Fifth Third Bank, Nashville	08/10/06	4.85	10,000,000	10,000,000
Fifth Third Bank, Nashville	10/13/06	5.00	10,000,000	10,000,000
Fifth Third Bank, Nashville	08/08/06	4.75	10,000,000	10,000,000
Fifth Third Bank, Nashvill	08/10/06	4.85	15,000,000	15,000,000
Fifth Third Bank, Nashville	09/29/06	4.90	25,000,000	25,000,000
Fifth Third Bank, Nashville	09/22/06	5.25	25,000,000	25,000,000
Fifth Third Bank, Nashville	09/29/06	4.90	10,000,000	10,000,000
Fifth Third Bank, Nashville	09/22/06	5.25	10,000,000	10,000,000
Fifth Third Bank, Nashville	09/29/06	4.90	25,000,000	25,000,000
Fifth Third Bank, Nashville	10/06/06	5.00	25,000,000	25,000,000
First Tennessee Bank National Association, Nashville	09/01/06	5.00	20,000,000	20,000,000
Pinnacle National Bank, Nashville	07/28/06	4.65	5,000,000	5,000,000
Pinnacle National Bank, Nashville	10/31/06	5.10	5,000,000	5,000,000
Pinnacle National Bank, Nashville	09/29/06	4.90	5,000,000	5,000,000
Pinnacle National Bank, Nashville	10/20/06	5.00	10,000,000	10,000,000
Pinnacle National Bank, Nashville	09/29/06	4.90	5,000,000	5,000,000
Pinnacle National Bank, Nashville	11/10/06	5.15	5,000,000	5,000,000
Pinnacle National Bank, Nashville	12/22/06	5.40	5,000,000	5,000,000
Pinnacle National Bank, Nashville	08/25/06	4.75	5,000,000	5,000,000
Pinnacle National Bank, Nashville	11/22/06	5.15	5,000,000	5,000,000
Pinnacle National Bank, Nashville	08/04/06	4.65	10,000,000	10,000,000

(continued)

STATE CASH PORTFOLIO AS OF JUNE 30, 2006

	Maturity	Yield to Maturity	Par Value	Fair Value
Pinnacle National Bank, Nashville	09/08/06	4.90	5,000,000	5,000,000
Pinnacle National Bank, Nashville	09/05/06	4.90	5,000,000	5,000,000
U S Bank, Nashville	10/13/06	5.00	100,000,000	100,000,000
U S Bank, Nashville	09/01/06	5.00	25,000,000	25,000,000
U S Bank, Nashville	07/07/06	4.50	25,000,000	25,000,000
U S Bank, Nashville	10/17/06	5.00	25,000,000	25,000,000
U S Bank, Nashville	08/22/06	4.75	25,000,000	25,000,000
U S Bank, Nashville	08/28/06	5.00	50,000,000	50,000,000
U S Bank, Nashville	08/09/06	5.00	100,000,000	100,000,000
U S Bank, Nashville	08/09/06	5.00	50,000,000	50,000,000
U S Bank, Nashville	12/15/06	5.30	50,000,000	50,000,000
U S Bank, Nashville	07/07/06	5.25	50,000,000	50,000,000
U S Bank, Nashville	09/22/06	4.90	50,000,000	50,000,000
Newport Federal Bank	07/20/06	4.50	95,000	95,000
Newport Federal Bank	08/01/06	4.65	500,000	500,000
Newport Federal Bank	07/20/06	4.50	300,000	300,000
Newport Federal Bank	08/01/06	4.65	500,000	500,000
Community Trust & Banking Company, Ooltewah	10/03/06	4.90	500,000	500,000
Community Trust & Banking Company, Ooltewah	11/14/06	5.15	500,000	500,000
First National Bank of Pikeville	09/05/06	4.90	300,000	300,000
First National Bank of Pulaski	12/05/06	5.15	300,000	300,000
First National Bank of Pulaski	12/05/06	5.15	700,000	700,000
First National Bank of Pulaski	12/12/06	5.15	300,000	300,000
First National Bank of Pulaski	12/15/06	5.30	1,000,000	1,000,000
First National Bank of Pulaski	12/12/06	5.15	1,000,000	1,000,000
First National Bank of Pulaski	12/15/06	5.30	1,000,000	1,000,000
First National Bank of Pulaski	12/08/06	5.15	500,000	500,000
First National Bank of Pulaski	12/08/06	5.15	300,000	300,000
First National Bank of Pulaski	07/03/06	4.50	2,000,000	2,000,000
First National Bank of Pulaski	12/05/06	5.15	500,000	500,000
First National Bank of Pulaski	12/01/06	5.15	2,000,000	2,000,000
First National Bank of Pulaski	07/11/06	4.50	6,000,000	6,000,000
Bank of Ripley	09/01/06	5.00	100,000	100,000
Bank of Ripley	08/09/06	5.00	150,000	150,000
Bank of Ripley	10/17/06	5.00	200,000	200,000
Bank of Ripley	08/11/06	5.00	100,000	100,000
Bank of Ripley	08/09/06	5.00	100,000	100,000
The Hardin County Bank, Savannah	08/01/06	4.65	1,000,000	1,000,000
Merchants & Planters Bank, Toone	08/04/06	4.65	425,000	425,000
Merchants & Planters Bank, Toone	08/15/06	4.65	500,000	500,000
Bancorpsouth, Trenton	09/29/06	4.90	1,500,000	1,500,000
Citizens City & County Bank, Trenton	09/05/06	4.90	95,000	95,000
First State Bank, Union City	08/25/06	4.75	1,000,000	1,000,000
First State Bank, Union City	12/26/06	5.40	1,000,000	1,000,000
First State Bank, Union City	11/17/06	5.15	1,500,000	1,500,000
First State Bank, Union City	10/10/06	5.00	1,000,000	1,000,000
First State Bank, Union City	12/01/06	5.15	1,500,000	1,500,000
First State Bank, Union City	12/26/06	5.40	2,500,000	2,500,000
Wayne County Bank, Waynesboro	08/01/06	4.65	500,000	500,000
Wayne County Bank, Waynesboro	09/01/06	4.75	900,000	900,000
TOTAL CERTIFICATES OF DEPOSIT	**$**		**2,285,152,700**	**$ 2,285,152,700**

STATE CASH PORTFOLIO AS OF JUNE 30, 2006

	Maturity	Yield to Maturity	Par Value	Fair Value
OVERNIGHT DEPOSIT ACCOUNTS				
AmSouth Bank - Overnight Deposit Account:	7/1/06	5.37%	$ 556,255,611	$ 556,255,611
TOTAL OVERNIGHT DEPOSIT ACCOUNTS			**$ 556,255,611**	**$ 556,255,611**

	Rating	Maturity	Par Value	Fair Value
COMMERCIAL PAPER				
AIG	A1	07/27/06	$50,000,000	$49,811,681
American Express	A1	07/14/06	50,000,000	49,909,181
American Express	A1	08/07/06	50,000,000	49,732,778
American General	A1	07/25/06	25,000,000	24,912,500
American General	A1	07/12/06	25,000,000	24,961,500
Bear Stearns	A1	07/05/06	15,000,000	14,991,583
Bear Stearns	A1	07/11/06	35,000,000	34,951,000
Bear Stearns Co	A1	08/14/06	50,000,000	49,675,500
Cargill Global	A1	07/06/06	25,000,000	24,982,500
Cargill Global	A1	07/07/06	75,000,000	74,936,625
Citigroup	A1	07/12/06	25,000,000	24,961,347
Citigroup	A1	07/17/06	25,000,000	24,943,444
Citigroup	A1	07/10/06	25,000,000	24,968,500
Citigroup	A1	07/13/06	25,000,000	24,957,750
G E	A1	07/03/06	340,000,000	339,900,833
H S B C	A1	07/03/06	250,000,000	249,927,083
Koch	A1	07/19/06	25,000,000	24,934,500
Koch	A1	07/25/06	25,000,000	24,912,667
Koch	A1	07/26/06	25,000,000	24,909,028
Koch	A1	07/28/06	25,000,000	24,901,563
Merrill Lynch	A1	07/21/06	50,000,000	49,855,833
Merrill Lynch	A1	08/08/06	50,000,000	49,722,917
MetLife	A1	07/18/06	100,000,000	99,761,528
Morgan Stanley	A1	07/13/06	50,000,000	49,912,000
Morgan Stanley	A1	07/17/06	50,000,000	49,882,889
Prudential	A1	07/03/06	250,000,000	249,927,083
Toyota	A1	08/02/06	50,000,000	49,766,666
TOTAL COMMERCIAL PAPER			**$1,790,000,000**	**$1,787,010,479**
TOTAL STATE CASH PORTFOLIO			**$6,641,548,811**	**$6,623,557,330**

BACCALAUREATE EDUCATION SYSTEM TRUST PORTFOLIO
as of June 30, 2006

Mutual Funds	Units	Fair Value
State Street S&P 500 Index Fund	263,413	$ 14,492,166
State Street Lehman Aggregate Index	3,318,844	39,895,827
JP Morgan Prime Money Market Premier	6,415,553	6,415,553
TOTAL MUTUAL FUND		**$ 60,803,546**
TOTAL PORTFOLIO		**$ 60,803,546**

Chairs of Excellence Largest Holdings

LARGEST BOND HOLDINGS
as of June 30, 2006
by Fair Value

Par Value	Security Name	Yield At Market	Maturity	Moody's Quality Rating	Fair Value
24,000,000	United States Treasury Note	4.72%	11/15/15	Aaa	$ 22,860,000
10,000,000	United States Treasury Infl Index Note	2.12	01/15/16	Aaa	9,692,281
6,000,000	United States Treasury Infl Index Note	3.22	01/15/12	Aaa	7,130,207
6,927,069	FNMA Mortgage Pool #878727	5.72	12/01/35	NR	6,290,508
5,800,000	Federal Home Loan Bank Discount Note	5.11	07/13/06	Aaa	5,787,722
5,652,669	FNMA Mortgage Pool #745250	5.19	01/01/21	NR	5,207,010
5,000,000	Federal Natl Mtge Assn Debenture	6.22	06/15/09	Aaa	5,125,000
5,000,000	FNMA Mortgage Pool #867662	6.47	05/01/36	NR	5,022,167
5,070,000	FNMA Mortgage Pool #839272	5.79	09/01/35	NR	4,271,237
4,000,000	United States Treasury Note	5.02	08/15/11	Aaa	3,987,960

A complete portfolio listing is available upon request

Mutual Funds	Units	Fair Value
State Street S&P 500 Index Fund	1,386,174	$ 76,263,169
State Street MCSI EAFE Index Fund	2,868,332	45,351,194
JP Morgan Prime MSCI Money Market Premier	3,277,838	3,277,838
TOTAL MUTUAL FUND		**$124,892,201**

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

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: the BEST Savings Plan and the BEST Prepaid College Tuition Plan.

The BEST program offers several favorable tax benefits to its participants. BEST contracts are exempt from all state and local taxes. In addition, earnings on any distribution used to pay for qualified higher education expenses are exempt from taxation. The maximum account limit for a beneficiary in the BEST program is $235,000.

BEST PREPAID COLLEGE TUITION PLAN

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

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

Qualified expenses include tuition, fees, supplies, books, room and board, and equipment required for enrollment or attendance. The units may be used at any accredited higher education institution — in-state or out-of-state, public or private. They may also be used at vocational and technical schools or professional and graduate schools. Participants do not have to choose a specific school when they enroll in the program.

Interested parties and participants may utilize BEST's website, located at www.treasury.state.tn.us/best, to learn about the program. The site provides full information about BEST. The site also features the contract application, which can be downloaded, completed, and mailed to the BEST office. Questions or comments to BEST staff can be e-mailed through this site. Also available to participants in the program is telephone access to account balances and activity 24 hours a day.

BEST SAVINGS PLAN

Anyone interested in investing for a college education can open an account on a child's behalf in the Savings Plan. There are no residency requirements. The account can be used to pay for qualified higher education expenses at any eligible college, university, trade or vocational school, or other post-secondary institution in the State of Tennessee or anywhere in the country, and at certain schools abroad. Qualified

Baccalaureate Education System Trust

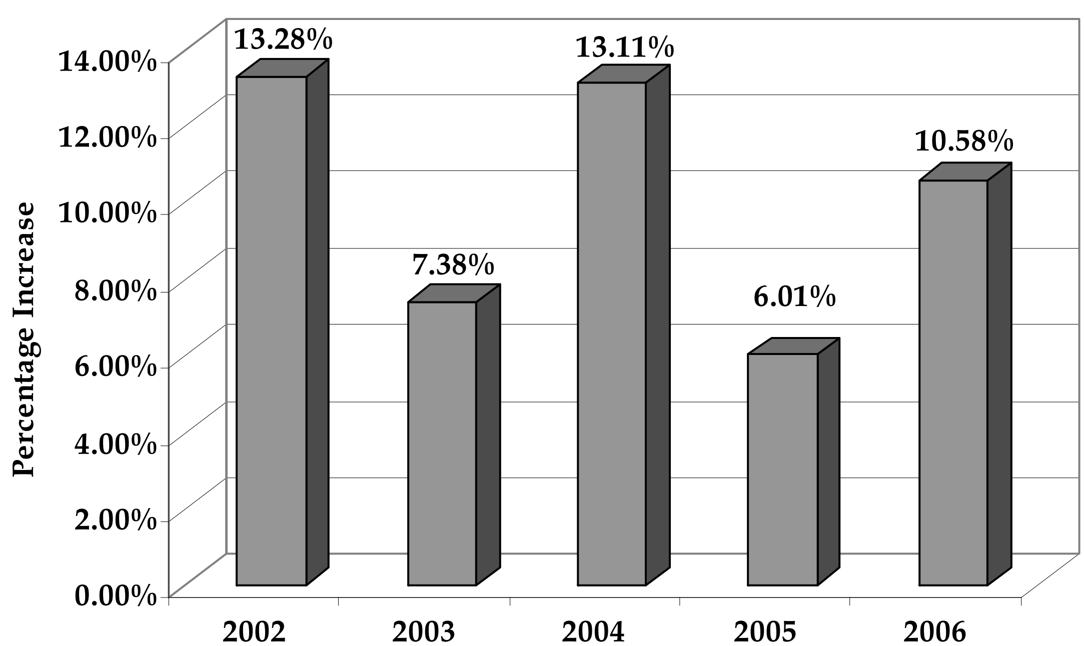
expenses include tuition, fees, supplies, books, certain room and board expenses, and equipment required for enrollment or attendance.

TIAA-CREF Tuition Financing, Inc. (TFI) manages the savings plan investments, and its affiliate company, Teachers Advisors, Inc., provides investment advisory services. TFI is part of TIAA-CREF, a New York-based financial services organization with more than 80 years experience and over $270 billion in assets under management.

The BEST Savings Plan offers three contribution choices: the Managed Allocation Option, the 100% Equity Option and the Guaranteed Option. These choices vary in their investment strategy and degree of risk. In the Managed Allocation Option, beneficiaries are grouped according to date of birth and contributions are allocated among equity, bond and money market investments in varying percentages depending on the beneficiary's time horizon. The 100% Equity Option, available since April 2002, consists of a blend of TIAA-CREF Institutional Growth and Income Fund and the TIAA-CREF Institutional International Fund. The allocation mix for this option does not change to reflect the age of the beneficiary, unlike the Managed Allocation Option. The Guaranteed Option, which was launched in 2005, allows contributions to be allocated to a vehicle that guarantees the Plan, but not account owners or the beneficiary. The annual interest rate from July 1, 2005 until June 30, 2006 was 3.1%.

The Savings Plan began accepting contracts and contributions in March 2000. At June 30, 2006, there were 4,197 contracts with assets totaling $32.3 million.

PREPAID TUITION PLAN
WEIGHTED AVERAGE TUITION AND FEE INCREASE
Fiscal Years 2002-2006



Baccalaureate Education System Trust

PREPAID TUITION PLAN
History of Per Unit Payout, Prices and Fees

Enrollment Fiscal Year	Unit Payout	Administrative Fee	Actuarial Soundness	Unit Price (Aug. 1-Dec. 31)	Adjustment for Purchases after Dec. 31*	Unit Price (Jan. 1-July 31)
1997	$21.64	$2.11	$0.00	$23.75	$0.00	$23.75
1998	21.64	2.11	0.00	23.75	0.00	23.75
1999	25.00	1.75	0.00	26.75	1.25	28.00
2000	27.08	1.92	0.00	29.00	1.25	30.25
2001	29.58	1.92	0.00	31.50	1.50	33.00
2002	33.51	0.99	0.00	34.50	2.35	36.85
2003	35.98	1.02	0.00	37.00	1.40	38.40
2004	40.70	1.30	0.00	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

*** Adjustment equal to 1/2 earnings rate assumption (1/2 of 7.5 percent)**

BEST SAVINGS PLAN ACTIVITY
Fiscal Years 2002-2006
Expressed in Thousands

Best Savings Plan Activity	2002	2003	2004	2005	2006
Total Cumulative Assets	$4,375	$8,826	$18,346	$25,564	$32,311
Contributions	$2,915	$4,295	$9,088	$6,361	$6,365
Redemptions	$85	$317	$797	$828	$1,660

BEST SAVINGS PLAN ACTIVITY
Fiscal Years 2002-2006
Account Activity

Best Savings Plan Activity	2002	2003	2004	2005	2006
New Accounts	590	781	985	457	593
Total Cumulative Accounts	1,370	2,152	3,137	3,604	4,197

Careers NOW Program

CAREERS NOW PROGRAM

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

Since the program's inception in 1996, over 200 students have been selected to participate. New classes begin each spring and summer semester.

The goal of the program is to develop a pool of students who, upon graduation, will be candidates for career positions in one of the three constitutional offices. Twenty percent of our students have been hired in full time positions in the three constitutional offices and throughout state government. The students receive hands on work experience and the participating institutions and constitutional offices jointly facilitate the development of a detailed curriculum to meet the academic commitment made to higher education institutions.

Careers NOW is designed to offer students a combination of practical work experience and formal training, while giving them the opportunity to see the challenges of public service. In addition to their daily work responsibilities, students attend seminars, visit state agencies, complete written work assignments, engage in opportunities to increase their overall understanding and knowledge of Tennessee state government, and research a current government issue for their special project. Past projects selected by students have included voter registration and election issues, Internet voting, prisons and capital punishment, and higher education issues.

To be eligible for the program, students must be classified as juniors, seniors, or graduate students and have a "B" average or better. Major fields of study may include Accounting, Business Administration, Computer Science, Economics, English, Finance, Geoscience, History, Journalism, Law, Library Science, Management Information Systems, Marketing, Math, Political Science, Public Administration, Public Relations, Social Science, and related fields. Previously, students have been required to be enrolled in a college or university located within Tennessee.

Applicants have come from Austin Peay State University, East Tennessee State University, Fisk University, David Lipscomb University, Middle Tennessee State University, Rhodes College, Tennessee State University, Tennessee Technological University, University of Memphis, University of Tennessee at Martin, University of Tennessee at Knoxville, University of the South, Carson Newman College and Vanderbilt University. The majority of the participants have been Business or Accounting majors and have come from Middle Tennessee State University, Tennessee State University and Tennessee Technological University. Approximately 39 percent of the student participants have been minorities and 38 percent of the students have come from Tennessee State University.

The Careers NOW Program accepts Tennessee residents who are attending out-of-state colleges and universities including University of North Alabama, St. Louis University, Furman University, Centre College and Samford University. The expectation is that the program will benefit from a broadened base of experience and that the students will benefit from the opportunity to gain experience in state government leading to permanent employment opportunities in their home state of Tennessee.

Current program information, assignment descriptions, and program application forms are available on the Internet at www.treasury.state. tn.us/now.

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 start 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 2002-2006

Fiscal Year	Investment Income	Total Spending of the Chairs	Asset Balance
2006	$ 12,471,255	$ 6,689,303	$ 226,159,791
2005	11,749,363	6,032,346	220,507,071
2004	16,953,010	6,862,657	214,975,481
2003	10,738,917	6,918,216	205,242,941
2002	(9,865,712)	7,249,649	201,610,876

ANNUALIZED INVESTMENT RETURN

	1 Year	5 Years	10 Years
Equity	8.64%	2.57%	8.18%
Fixed Income	(0.97)	4.23	5.84
Short-Term	4.25	2.31	3.99
Total Portfolio	5.63	3.80	7.02

AUTHORIZED CHAIRS OF EXCELLENCE

THE UNIVERSITY OF TENNESSEE

Chattanooga

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

Knoxville

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

Chairs of Excellence Trust

Lincoln COE in Physics
Hunger COE in Environmental Studies

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

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

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

TENNESSEE BOARD OF REGENTS

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

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

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

Tennessee State University
Frist COE in Business Administration
COE in Banking & Finance

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

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

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 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 occuring 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, 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 40% savings off billed charges as a result of the fee schedule, plus an additional 7% savings (after fee schedule reduction) as a result of the preferred provider arrangement.

The Division of Claims Administration also handles all employee property damage claims and tort claims.

During fiscal year 2006, the Division of Claims Administration received 4,906 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 2006 fiscal year, the Board took action on a total of five claims. 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 2006

Claims Activity	Claims Filed	Payments Made
Workers' Compensation Claims	3,471	
Death Payments		$ 362,168
Medical Payments		10,645,745
Temporary Disability		1,661,706
Permanent Disability		7,250,563
Total Workers' Comensation Payments		19,920,182
Employee Property Damage	147	24,677
Tort Claims	1,288	
Death Payments		1,088,114
Bodily Injury Payments		2,671,663
Property Damage Payments		715,682
Total Tort Claims Payments		4,475,459
Total Claims Payments	4,906	$ 24,420,318

FIVE YEAR CLAIMS HISTORY
Fiscal Years 2002-2006

Fiscal Year	Claims Filed	Amount of Claims Paid
2006	4,906	$24,420,318
2005	5,409	28,975,152
2004	5,825	27,705,099
2003	5,909	29,054,420
2002	6,074	28,116,511

Victims' Compensation Program

VICTIMS' COMPENSATION PROGRAM

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

Applications for Criminal Injury Compensation are filed with the Division of Claims Administration. During the 2006 fiscal year, 2,511 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 Injury Compensation Fund. If the division cannot process a claim within 90 days, then the claim is referred 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 57 days.

Federal funding assistance for the program has aided in allowing prompt claim payment.

During the 2006 fiscal year, the Division of Claims Administration made payments to victims of crime totaling $11.5 million. This total includes supplemental payments made on previously approved claims.

Victims of drunk drivers are also paid from the Criminal Injury 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 in the same manner as criminal injury 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 $164 million to crime victims.

The Division of Claims Administration has made an effort to educate members of the public of the existence and benefits of the Criminal Injury Compensation Program by printing and distributing informative brochures explaining the program. Public awareness efforts and the use of victim assistance coordinators in each judicial district have also aided in providing the public with information about the availability of criminal injury compensation.

SOURCES OF FUNDS
Fiscal Years 2004-2006

	2004		2005		2006	
Source	**Amount**	**Percentage**	**Amount**	**Percentage**	**Amount**	**Percentage**
Privilege Taxes	$ 4,640,805	36%	$ 4,358,617	39%	$ 4,351,199	39%
Federal Funds	4,971,000	39%	3,167,000	29%	3,177,000	29%
Probation Fees	2,025,173	16%	2,063,006	19%	2,107,481	19%
Parole Fees	599,897	4%	668,880	6%	764,503	7%
Bond Forfeitures	506,848	4%	515,005	5%	339,176	3%
Other	80,869	1%	191,431	2%	365,429	3%
Total	**$ 12,824,592**	**100%**	**$ 10,963,939**	**100%**	**$ 11,104,788**	**100%**

VICTIMS' COMPENSATION PROGRAM

CLAIMS PAID BY CRIME TYPE
Fiscal Year 2006

Crime Type	Number Paid	Percentage of Total Claims	Amount Paid	Percentage of Total Paid
Assault	756	42.2%	$ 5,779,099	50.4%
Homicide	316	17.7%	2,822,162	24.6%
Child Sexual Abuse	307	17.1%	757,661	6.6%
Adult Sexual Assault	168	9.4%	468,442	4.1%
Robbery by Force	152	8.5%	905,552	7.9%
DUI	63	3.5%	549,213	4.8%
Vehicular (non DUI)	22	1.2%	167,362	1.5%
Child Physical Abuse	4	0.2%	5,321	0.0%
Arson	1	0.1%	8,608	0.1%
Kidnapping	2	0.1%	1,192	0.0%
Total	**1,791**	**100%**	**$ 11,464,612**	**100.0%**

NEW CLAIMS FILED
Fiscal Year 2006

Crime Type	Number Filed
Assault	1,017
Child Sexual Abuse	462
Homicide	428
Adult Sexual Assault	213
Robbery by Force	170
Vehicular (Non DUI)	96
DUI	84
Other	21
Child Physical Abuse	8
Kidnapping	5
Arson	4
Terrorism	3
Total	**2,511**

CLAIMS DENIED BY REASON
Fiscal Year 2006

Reason Type	Number Denied	Percentage
Insufficient Documentation	177	18%
Contributory Behavior	172	18%
Collateral Resource Covered Loss(es)	157	16%
Failure to Cooperate/Prosecute	114	12%
Ineligible Crime	109	12%
Ineligible Claimant	51	5%
Other	36	4%
Ineligible Loss(es)	31	3%
Insufficient Proof of a Crime	31	3%
Late Filing of Claim	30	3%
Late Reporting of Crime	22	2%
Passenger with Drunk Driver	16	2%
No Report of Crime	9	1%
Loss(es) Less than $100	9	1%
Total	964	100%

In fiscal year 2006, 784 claims were denied. Some claims are denied for more than one reason.

CLAIMS COMMISSION

Section 9-8-301 of *Tennessee Code Annotated* establishes the Tennessee Claims Commission as the administrative tribunal to determine monetary claims against the state. The commission has three commissioners, one from each grand division of the state. The three commissioners, who are appointed by the Governor and confirmed by the General Assembly, serve staggered eight-year terms.

The commission has a central office in Nashville with an administrative clerk and an administrative services assistant. The commission is attached to the Treasury Department for administrative purposes.

The commission adjudicates claims involving tax recovery, state workers' compensation, and alleged negligence by state officials or agencies (e.g., negligent care, custody, or control of persons, personal property, or animals; professional malpractice; negligent operation or maintenance of a motor vehicle; and dangerous conditions on state-maintained highways or state controlled real property). These claims are payable from the Risk Management Fund. Damages are limited to $300,000 per claimant and $1,000,000 per occurrence. In addition, the commission awards compensation to victims of crime through the Criminal Injury Compensation Fund, and the Claims Commission has jurisdiction to review final decisions of the Secretary of State, denying a charitable gaming annual event application as provided for under *Tennessee Code Annotated*, Section 3-17-104(h)(l). The Treasury Department's Division of Claims Administration is responsible for paying all claims.

CLAIMS PROCESSING

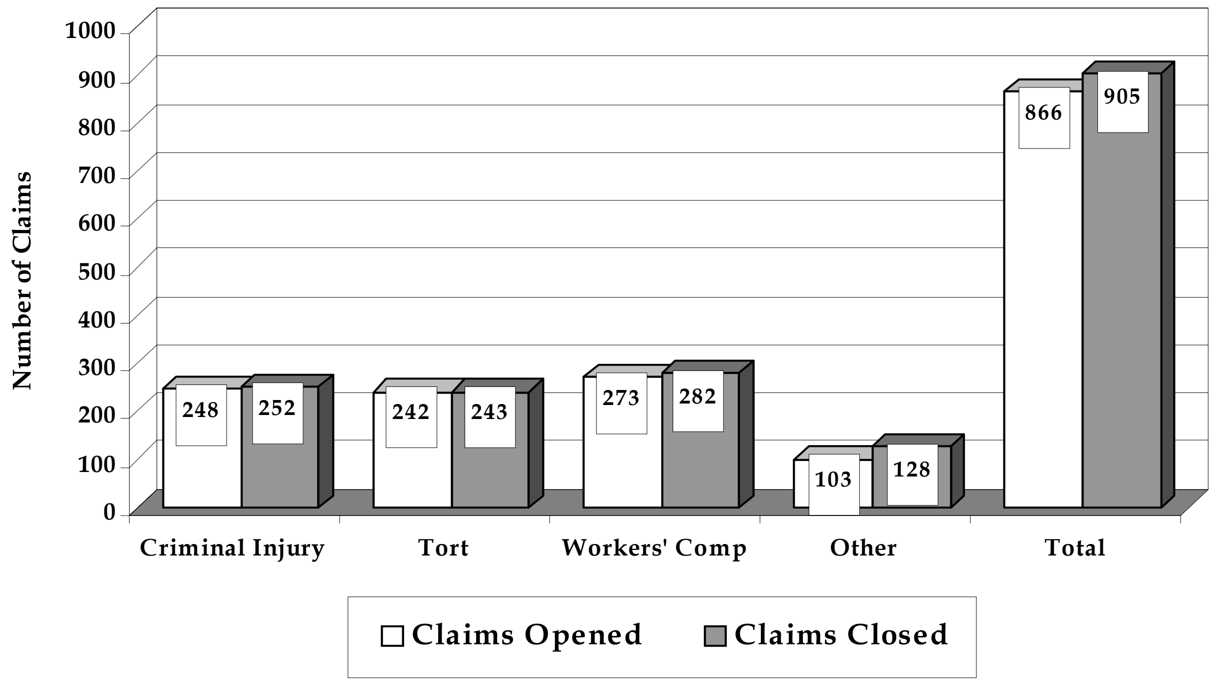
The vast majority of claims are first filed with the Division of Claims Administration. Claims involving taxes are filed directly with the Claims Commission, and claims involving workers' compensation are filed directly with a third-party administrator.

Both the Division of Claims Administration and the third party administrator have 90 days to accept or deny a claim before the claim is automatically transferred to the commission. Claimants can appeal both entities' decisions to the Claims Commission.

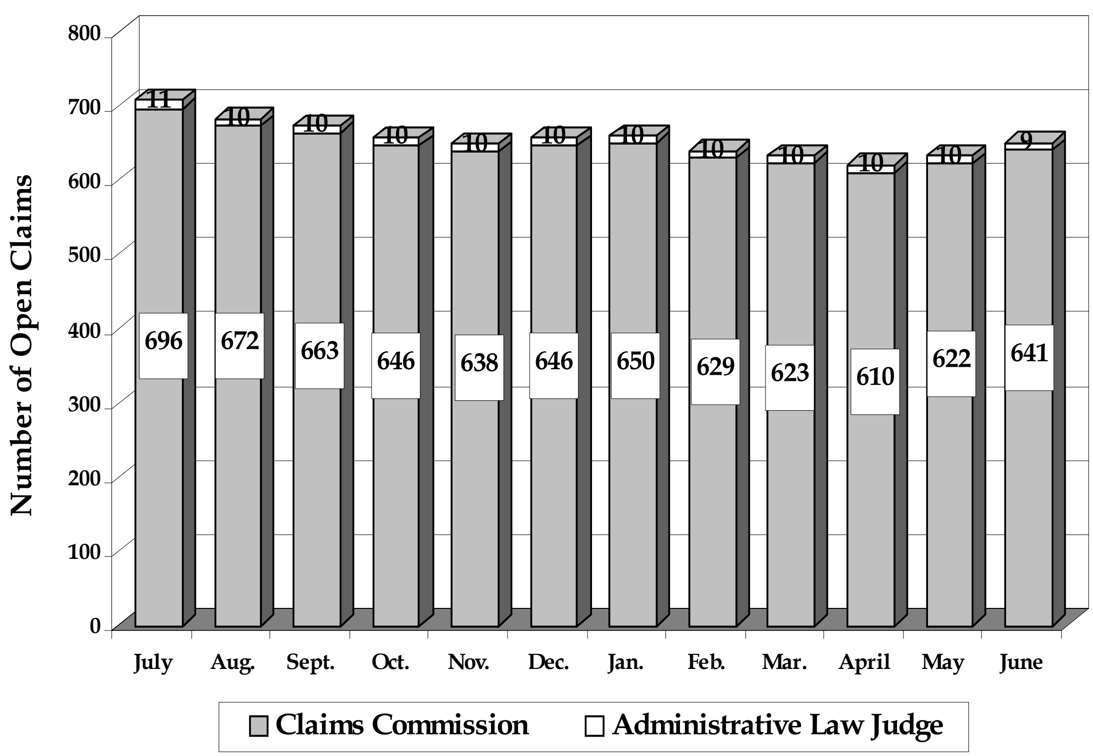
The commission has two separate dockets: a regular docket for claims greater than $15,000 and a small claims docket for claims under that amount. Commission decisions on regular docket claims can be appealed to the Tennessee Court of Appeals or, in the case of tax and workers' compensation claims, to the Tennessee Supreme Court. Small docket claims cannot be appealed, but such claims can be moved to the regular docket (at the discretion of either party) before a hearing is held.

Claims Commission

NUMBER OF CLAIMS OPENED AND NUMBER OF DISPOSITIONS BY CLAIM TYPE
(Including Dispositions by Administrative Law Judges)
Fiscal Year 2006



CLAIMS COMMISSION AND ADMINISTRATIVE LAW JUDGE OPEN CLAIMS
Fiscal Year 2006



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 a private Insurance Broker, to research the insurance marketplace, and target insurance carriers, which are capable and willing to provide competitive insurance quotes, for the State's various lines of coverage. An RFP process is used to select a broker, which provides the best overall proposal based on independent technical and cost ratings. Fiscal year 2006 was the final year of a five-year contract with insurance broker, Marsh USA. A new RFP was issued in February, 2006, with a new contract awarded April 12, 2006, to Willis of Tennessee, Inc.

In fiscal year 2006, hurricane Katrina, as well as other catastrophic events, brought a halt to a recovering property/casualty market. Capacity for catastrophic coverage had greatly diminished within the major reinsurance companies, which in turn, had a trickle down effect on the primary insurance carriers. Most carriers had very little capacity to write this coverage at all. With West Tennessee sitting on the New Madrid fault, the State's broker was facing a tremendous challenge. The State's property insurance limits remained at $250 million per occurrence. Earthquake and flood coverage limits also remained at the same level as the previous year at $50 million each, with the exception of the higher risk zones, that carry reduced limits (Ex. earthquake drops from $50M to $25M in New Madrid Zone 2). These catastrophic coverages were available due to the fact that the State's property insurance was procured through a non-admitted carrier, which generally has more flexibility. The State's annual aggregate deductibles were once again negotiated at $5 million for property, and $5 million for earthquake and flood combined. As of July 1, 2005, total insured property values were $11.6 billion. Total premium costs for all lines of property and fidelity coverages amounted to $1,910,138.

The Builders' Risk Insurance Program provides coverage for building construction projects approved by the State Building Commission. The policy provides all-risk coverage for the state agency, general contractor and all subcontractors for the duration of the construction project. In fiscal year 2006, 227 Builders' Risk Insurance Certificates were issued for new projects approved by the State Building Commission. In addition, since all certificates are written for a one-year term, all on-going projects extending beyond July 1, were issued a renewal insurance certificate, to maintain uninterrupted coverage. Coverage limits remained at $25 million per location and $30 million per occurrence. Projects exceeding these limits, may require the purchase of additional insurance. In fiscal year 2006, one project exceeded the stated limits. The insurance carrier waived the additional premium.

Boiler insurance must be provided to ensure protection for all of the state's 2,314 boiler objects. A boiler insurance policy is purchased from a private insurance carrier, which is not only responsible for the insurance coverage, but must also provide a boiler inspection service. Certified inspectors evaluate all boiler objects on a regularly scheduled basis to ensure the safe operation of these systems. This loss prevention program has proven very effective with results showing no major incidents within the past five years.

In order to protect the state from financial loss due to employee dishonesty, Risk Management procures a fidelity bond. Fidelity coverage is provided in the amount of $1 million per incident/aggregate for all state employees.

Risk Management administers the claims process for all lines of coverage. A claim form is completed and submitted to the insurance carrier, which generally assigns the claim to General Adjustment Bureau (GAB), an independent adjusting service. GAB works directly with Risk Management, to resolve all claims issues. For emergency situations (Ex. water damage) a restoration company, Servpro, is

Risk Management

under contract with the State, and will respond quickly 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: Property ($25,000), Builders' Risk ($10,000) (contractor's responsibility), Boiler ($10,000), Fine Arts (0), Fidelity & Crime ($100,000). If a loss exceeds the agency deductible, then 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 carrier.

The prevention and control of losses is an important part of managing the state's risks. In an effort to increase the number of loss control inspections, internal staff are conducting safety inspections, and assisting State Agencies with safety programs. A fire/life safety check-list is now accessible through the web, which allows agencies to provide self-inspection reports to Risk Management. To address worker's compensation losses, Risk Management has been analyzing loss information provided by the states third party administrator. This information has been the basis for developing loss control initiatives, including an early return-to-work pilot project, work-site safety evaluations, workstation ergonomics, and safety training.

STATE PROPERTY
Summary of Key Points
Fiscal Year 2006

Insurance Coverage Information		
Insured Property Values	$	11,589,082,600
Property Limits Per Occurrence	$	250,000,000
Annual Aggregate Deductibles:		
Property	$	5,000,000
Earthquake & Flood Combined		5,000,000
Builders' Risk		1,000,000
Financing of Estimated Property Losses:		
Cumulative Agency Deductibles (Agency Obligation)	$	225,000
FEMA Recovery		3,200,000
Insurance Company Obligation		2,313,761
Risk Management Fund Obligation		1,951,302
Total Property Losses	$	7,690,063

Small and Minority-Owned Business Assistance Program

SMALL AND MINORITY-OWNED BUSINESS ASSISTANCE PROGRAM

Chapter 830 of the Tennessee Public Acts of 2004 created within the Treasury Department the Small and Minority-Owned Business Assistance Program. Chapter 830 required the Department to develop by rule an assistance program for small and minority-owned businesses, as defined in TCA 65-5-112, which will include loans, technical assistance and services, and 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.

As part of the developmental process, the Department held hearings around the state, worked with members of the legislature and other state and private agencies to prepare and develop the rules governing the program. The Proposed Rules were filed in the Department of State on June 30, 2006 and became effective October 27, 2006. Implementation of the program will include the competitive selection of an organization to provide program management services and the competitive selection of qualified organizations that will be responsible for originating and servicing loans.

The Small and Minority-Owned Business Assistance Program replaced the Small and Minority Owned Telecommunications Business Assistance Program that was administered by the Department of Econonmic and Community Development. The Telecommunications Program provided loan guarantees to qualifying businesses. At June 30, 2006 there were eight outstanding loan guarantees totaling $1,040,290. These loans are scheduled to mature at various dates extending to 2008.

The Telecommunications Program focused on a specific facet of industry. The Small and Minority-Owned Business Assistance Program is designed to perpetuate growth on a less restrictive continuum.

In addition to the provision of loan proceeds and technical assistance, this program will be inclusive of program services such as financial counseling, assistance with the packaging of loan proposals, developing strategies for omproved cash flow management, implementing internal financial managment systems, strategic planning and identifying procurement with state, federal and local government systems.

Unclaimed Property Division

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, 2005 through June 30, 2006, $40.2 million of cash property was turned over to the Treasurer. This includes $2.2 million remitted by third party audit organizations from out-of-state non-reporting holders for Tennessee residents. An additional $23.3 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 advertises owners' names and last known addresses in newspapers throughout the state. Another location method used is to send notification to the last known address of each owner. If no response is received, additional search efforts are made through Department of Labor and Workforce Development records, telephone directories, drivers' license records, and other sources.

In addition, a searchable database of the owners' names is available on the division's Internet site: www.treasury.state.tn.us/unclaim. This site logged 2.6 million visitors at June 30, 2006, an increase of 513,000 for the fiscal year. The records of unclaimed property owners are also available for viewing by the public in the Unclaimed Property office.

During the period July 1, 2005 through June 30, 2006, $20.7 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, $517,761 was refunded to 21 local governments.

Tennessee has reciprocal agreements with other states' unclaimed property programs to exchange property held by one state for owners with a last known address in the other state. Tennessee received $1.4 million for residents or former residents in exchange for $1.1 million paid to other states' unclaimed property offices.

Since the program began operations in 1979, $420.8 million in unclaimed property has been reported to the Treasurer and $135.7 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 57% of property that is turned over with an owner's name.

UNCLAIMED PROPERTY DIVISION

METHODS USED TO RETURN PROPERTY
Fiscal Year 2006

Location Method	Number of Accounts	Value of Claims	Average Claim Value
Website Inquiries	7,687	$ 7,376,369	$ 960
Staff or Other Outreach	412	5,450,656	13,230
Mailings to Last Known Address	3,110	2,028,762	652
Holder Referral or Reimbursement	642	1,683,166	2,622
Independent Locator	93	1,153,830	12,407
Advertisement and Television	1,350	868,455	643
Match with Dept. of Labor and Workforce Records	1,862	595,971	320
Total Claim Payments	15,156	$19,157,209	$ 1,264
Interstate Exchanges	44	1,053,029	
Refunds to Local Governments	21	517,761	
Total Payments	**15,221**	**$20,727,999**	

SOURCES OF UNCLAIMED PROPERTY
Fiscal Years 2002-2006

	2006	2005	2004	2003	2002
Financial Institutions	29%	37%	28%	30%	29%
Insurance Companies	21%	20%	29%	18%	15%
Corporations, Transportation, Colleges, Retailers	19%	11%	19%	20%	13%
Cities and Counties	8%	5%	5%	7%	4%
Escheat and Other	6%	7%	7%	7%	12%
Utilities	6%	5%	6%	8%	7%
Hospitals and Health Care	4%	3%	2%	3%	2%
Securities and Brokerage Firms	4%	8%	1%	2%	14%
Other States	3%	4%	3%	5%	4%
Total	100%	100%	100%	100%	100%

ACTIVITY
Fiscal Years 2002-2006

	2006	2005	2004	2003	2002
Number of Holders Reporting	5,251	5,228	4,784	4,675	4,051
Number of Properties Received	290,254	226,918	294,446	180,539	212,592
Cash Received	$40,233,068	$40,397,209	$37,425,232	$35,395,003	$30,606,072
Number of Shares Received	1,685,649	489,767	830,379	521,971	443,158
Value of Shares Sold	$23,277,122	$8,908,304	$3,455,735	$2,410,387	$4,228,504
Number of Claims Paid	15,221	16,504	14,742	14,282	12,911
Claims Paid	$20,727,999	$17,560,720	$13,043,761	$12,727,784	$9,728,782
Shares Paid	348,525	265,790	308,569	105,681	146,577

ADMINISTRATION

Statutory Duties of the State Treasurer

BOARDS AND COMMISSIONS

	Tennessee Code Annotated Section
Advisory Council on Workers' Compensation	50-6-121
Baccalaureate Education System Trust Board	49-7-804
Collateral Pool Board	9-4-506
Board of Claims	9-8-101
State Board of Equalization	4-3-5101
Tennessee Consolidated Retirement System Board of Trustees	8-34-302
Chairs of Excellence Endowment Trust	49-7-501
Commission to Purchase Surplus Federal Property	12-1-103
Council on Pensions & Insurance	3-9-101
State Funding Board	9-9-101
Public Records Commission	10-7-302
Sick Leave Bank Board	8-50-903
State Building Commission	4-15-101
State Capitol Commission	4-8-301
State Insurance Committee	8-27-101
Local Government Insurance Committee	8-27-207
Local Education Insurance Committee	8-27-301
State Library and Archives Management Board	10-1-102
Tennessee State School Bond Authority	49-3-1204
State Trust of Tennessee	9-4-806
Tennessee Child Care Facilities Corporation Board	4-37-103
Tennessee Higher Education Commission	49-7-204
Tennessee Housing Development Agency	13-23-106
Tennessee Local Development Authority	4-31-103
Tennessee Sports Hall of Fame	4-3-5403
Tennessee Student Assistance Corporation	49-4-202
Tuition Guaranty Fund Board	49-7-2018
Workers Compensation Insurance Fund Board	50-6-604
Victims of Crime State Coordinating Council	40-38-401
Catastrophic Injuries Fund Commission	29-20-408
Industrial Finance Corporation Board	4-17-405
Tennessee Industrial Development Authority	13-16-301
Advisory Committee to the Trustees of the Fisk University Stieglitz Collection Art Endowment Fund	4-20-201
Access Improvement Project Committee	54-2-207
Advisory Board to Establish Compensation for the Use of the Right-of-Way for Underground Fiber Optic Cable Facilities	54-16-112
Appeals from Gift Tax Appraisals Board	67-8-116

ADMINISTRATION

Baccalaureate Education System Trust	49-7-801, et seq.
Board of Claims	9-8-101, et seq.
Chairs of Excellence Trust	49-7-501 — 49-7-502
Collateral Pool	9-4-501 — 9-4-523
Collateral Program	9-4-101 — 9-4-105
Council on Pensions and Insurance	3-9-101
Criminal Injury Compensation Fund	29-13-101, et seq.
Deferred Compensation	8-25-101, et seq.
Escheat	31-6-101, et seq.
Flexible Benefits Plan	8-25-501
Investment Advisory Council	8-37-108
Investment of State Idle Cash Funds	9-4-602
Local Government Investment Pool	9-4-704
Old Age and Survivors Insurance Agency	8-38-101, et seq.
Pooled Investment Fund	9-4-704
Receipt and Disbursement of Public Funds	8-5-106 — 8-5-111; 9-4-301, et seq.
Small and Minority-Owned Business Assistance Program	65-5-213
State Cash Management	9-4-106 — 9-4-108; 9-4-401 — 9-4-409
State Treasurer's Office	8-5-101, et seq.
State Trust of Tennessee	9-4-801, et seq.
Tennessee Claims Commission	9-8-301, et seq.
Tennessee Consolidated Retirement System and Miscellaneous Systems	Title 8, Chptrs. 34, 35, 36, 37 & 39
Unclaimed Property	66-29-101, et seq.
Victims of Drunk Drivers Compensation Fund	40-24-107

Executive Staff Directory

Treasurer's Office		
Treasurer	Dale Sims	(615) 741-2956
Executive Assistant	Janice H. Cunningham	(615) 741-2956
Staff Assistant to the Treasurer	Nathan Burton	(615) 741-2956
Human Resource Director	Ann Taylor-Tharpe	(615) 741-2956
Investments		
Assistant to the Treasurer	Ed Hennessee, CFP	(615) 532-1167
Chief Investment Officer	Thomas Milne, CFA	(615) 532-1157
Equity Director	Michael Keeler, CFA	(615) 532-1165
Senior Equity Portfolio Manager	Jeremy Conlin, CLU, ChFC, CFA	(615) 532-1152
Senior Equity Portfolio Manager	Jim Robinson, CFA	(615) 532-1177
Senior Equity Portfolio Manager	Roy Wellington, CFA	(615) 532-1151
Fixed Income Director	Andy Palmer, CFA	(615) 532-1183
Senior Fixed Income Portfolio Manager	Terry Davis, CFA	(615) 253-5416
Real Estate Director	Peter Katseff	(615) 532-1160
Senior Short-Term Portfolio Manager	Randy Graves, CPA-inactive	(615) 532-1154
Cash Management and Short-Term Investments Manager	Tim McClure, CCM	(615) 532-1166
Retirement Administration		
TCRS Director	Jill Bachus, CPA	(615) 741-7063
TCRS Assistant Director	Velva Booker	(615) 741-7063
TCRS Director of Deferred Compensation	Beth Chapman, CPA	(615) 741-7063
Publications Editor	Shirley Chatman	(615) 741-7063
Web Developer	Rick Mullins	(615) 741-7063
General Counsel	Mary Roberts-Krause, JD	(615) 741-7063
Counsel	Vernon G. Bush, JD	(615) 741-7063
Director of Old Age and Survivors Insurance	Mary E. Smith	(615) 741-7063
Manager of Counseling Services	Donna Finley	(615) 741-1971
Manager of Member Services	Fred Marshall, CPA	(615) 741-1971
Manager of Financial Services	Jamie Wayman, CPA	(615) 253-4913
Other Divisions		
Assistant to the Treasurer	Rick DuBray, CPA	(615) 253-5764
Director of Accounting	Kim Morrow, CPA	(615) 532-3840
Assistant Director of Accounting	Connie Gibson, CPA	(615) 532-8051
Director of Fiscal Services	Brian Derrick, CPA	(615) 532-8552
Assistant to the Treasurer	Newton Molloy III, CDP	(615) 532-8035
Director of Computer Operations	Sam Baker, CCP, CDP	(615) 532-8026
Director of Internal Audit	Britt Wood, CPA	(615) 253-2018
Assistant to the Treasurer	Steven Curry, CPA-inactive, CEBS, CCM	(615) 532-8045
Director of Risk Management	Steve Gregory	(615) 741-1009
Manager Small Minority Business Program	Jaye Chavis	(615) 253-6661
Manager BEST Program	LaKesha Page	(615) 532-5888
Director of Unclaimed Property	John Gabriel	(615) 253-5354
Assistant Director Unclaimed Property Program	Kellie Williamson	(615) 253-535
Director of Claims Administration	Anne Adams	(615) 741-9957
Manager of Criminal Injury Claims	Amy Dunlap	(615) 741-9962
East Tennessee Claims Commissioner	William O. Shults, JD	(423) 623-9270
Middle Tennessee Claims Commissioner	Stephanie Reevers, JD	(615) 253-1626
West Tennessee Claims Commissioner	Nancy Miller-Herron, JD	(731) 364-2440
Administrative Clerk, Claims Commission	Marsha Richeson	(615) 532-5385

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

Treasury Staff

Adams, Anne
Alexander, Mary
Anderson, Sandra
Arnett, Ron
Arnold, Sandra
Atkins, Janice[10]
Aymett, Ron[25]
Bachus, Jill[25]
Baker, Linda
Baker, Sam
Baker, Sherry
Bandy, Gregory
Battle, Keevia
Bauer, David
Baumgartel, Karen
Birthrong, Peggy
Booker, Velva
Brown, Alex
Brown, Brenda
Brown, Buffy
Burns, Bobby
Burton, Nathan
Bush, Vernon[25]
Butterfield, Keith
Campbell, Heath
Carr, Brenda
Cavender, William
Chandler, Jerry
Chapman, Beth
Chatman, Shirley[20]
Chavis III, Jordan
Coleman, Alva
Conlin, Jeremy
Cook, Melanie
Costa, Delcinia
Cotter, Liddye
Couch, Janie
Crews, Daniel
Culberson, Cavandrea
Cunningham, Janice
Curry, Steve
Curtis, Karen
Curtis, Shawn
Daniel, Ted
Daniels, Ruth
Darrell, Pat
Davidson, Vivian
Davis, Amanda
Davis, Melissa
Davis, Terry[5]
Denney, Pam
Derrick, Brian
Dills, Larissa
Dorse, Bridget
DuBray, Rick
Dunlap, Amy
Edmundson, Ray
Enss, Jon
Esaka, Cassandra
Esters, Adrienne
Faehr, Karin
Farmer, Sharon
Finley, Donna
Fisher, Peggy
Fohl, Jamie
Fredin, Cort[5]
Freeman, Jerry
Fuller, Charlotte
Fuqua, Monica[20]
Gabriel, John[10]
Gaines, Doug
Gatewood, Ann
Gentry, Bernard
Gibson, Connie
Graves, Randy
Gray, Tammy
Green, Carrie
Green, Janice
Greene, Barbara[30]
Gregory, Nikki
Gregory, Steve[20]
Griffin, Delores
Hall, Sherry
Hargrove, Kathy
Harris, Sharon
Hart, Tracy
Hartley, Kerry[5]
Hedges, Matthew
Hennessee, Ed
Herron, Nancy-Miller
Hill, Sarah
Hurt, Sandra
Hyder, Patti
Jacobsen, Mark
Javner, Donnie
Jennette, Angela
Johnson, Roxanne[5]
Johnson, Tawana
Jones, Chris
Jordan, Tom
Katseff, Peter
Keeler, Michael
Kelly, Nolan
King, Jenny
Ladd, George
LaMontagne, Carrie
Li, Liren
Mackey, Wanda
Maddox, Teresa
Majors, Vallie
Marshall, Fred[10]
Mason, Justin
McAdams, Keniqua
McClure, Tim
McDade, Joshua
McMillan, Bruce
Mercier, Brenda
Miller, Henry[25]
Milne, Tom[10]
Molloy, Newt
Moore, Crystal
Morgan, Prentice
Morrow, Kim
Moses, Gail
Moulder, Michael
Mullins, Rick
Myers, Barbara
Myers, Rhonda[10]
Myles, Alicia
Nale, Erica
Newberry, Lori
Norment, Christy
Oakley, Heather
O'Leary, Candy
O'Saile, Mandy
Oliphant, Sarah
Otts, Kimberly
Oyster, David
Padgett, Wendy
Page, LaKesha[5]
Palmer, Andy
Parlow, Yvonne
Parton, Floyd
Pinson, Marian[10]
Pritchett, Brad
Picunko, Jesse
Redmond, William
Reevers, Stephanie
Reynolds, Ian
Richeson, Marsha
Riley, Carla[10]
Roberts-Krause, Mary
Roberts, Rachel
Robinson, Mia
Robinson, Jim
Rochelle, Dawn
Sabin, Stephanie
Sanders, Sharon[5]
Sanders, Teresa
Sanford, Letha
Schults, Bill
Scott, Tammie
Sewell, Sandra[30]
Sims, Dale
Singleton, David
Skinner, Jamie
Smith, Anita
Smith, Brett
Smith, Kimberly
Smith, Mary
Smith, Robert
Spears, Michele Johnson
Swanson, Ben
Taylor-Tharpe, Ann
Thompson, Jamie Lynn
Thomas, Issac
Tucker, Anthonio
Veach, Johnny
Vinson, Maxine
Wagner, Malinda[20]
Wakefield, Mark
Washington, Tracey
Wayman, Jamie
Wellington, Roy
Whaley, Kimberly
Wheeler, Shirley[30]
White, Emily
Whitworth, Deborah
Wilkins, Natasha
Williams, Teresa
Williamson, Kellie[10]
Willocks, Dianne
Wilson, Martha
Wilson, Shirley
Wimmer, Genera
Wood, Britt
Woodrum, Angela
Wooten, Jennifer

[5] Received 5-year service award in 2006
[10] Received 10-year service award in 2006
[15] Received 15-year service award in 2006
[20] Received 20-year service award in 2006
[25] Received 25-year service award in 2006
[30] Received 30-year service award in 2006
[35] Received 35-year service award in 2006

Treasury Internet Services

Program	Internet Site Features	Internet Address
Services to the Public		
BEST	Program information, rate information, contracts, forms and newsletters	www.treasury.state.tn.us/best
Careers NOW	Program information, calendar, campus contacts, job descriptions and applications	www.treasury.state.tn.us/now
Criminal Injury Compensation Program	Frequently asked questions, application and forms, links to victims' programs nationwide and victims' organizations	www.treasury.state.tn.us/injury
Unclaimed Property Program	Search for unclaimed property, claim forms, program information, links to other states' programs, holder reporting information, forms, instructions and free software	www.treasury.state.tn.us/unclaim
Tenn. Claims Comm.	Information, contacts, rules and statutes	www.treasury.state.tn.us/claims
Government Services		
Local Government Investment Pool	Information, forms, operations manual, newsletters, past rates, portfolio and investment policy	www.treasury.state.tn.us/lgip
OASI/Social Security	Information, FICA rates, law and forms	www.treasury.state.tn.us/oasi
Risk Management Program	Program and claim process information, frequently asked questions, property insurance report search, safety check lists, agency loss control reports and employee safety information	www.treasury.state.tn.us/risk
Tort Reporting (GTLA)	Information, rules and reporting templates	www.treasury.state.tn.us/risk/tort
Workers' Compensation Program	Information on reporting accidents and filing claims, eligibility criteria, glossary, explanation of benefits and provider directory	www.treasury.state.tn.us/wc
Public Employee Benefit Programs		
Deferred Compensation Program	Account access (inquiry, transfers, allocation changes), participation and investment information, benefit projection calculator, withdrawal information and forms	www.treasury.state.tn.us/dc
Flexible Benefits Plan	Program information and forms	www.treasury.state.tn.us/flex
Optional Retirement Program	Program information, forms, company contacts and product information	www.treasury.state.tn.us/orp
Tennessee Consolidated Retirement System	Program information, benefits calculator, publications, newsletters, forms, annual report, frequently asked questions, political subdivision option search and retirement planning information	www.treasury.state.tn.us/tcrs
Other		
About the Treasurer	Statutory duties and biographical information	www.treasury.state.tn.us/about.html
Annual Report	Treasurer's Report on-line	www.treasury.state.tn.us/ann-report.htm
Bank Collateral Pool	Program information, forms and participants	www.treasury.state.tn.us/bank
Map to Treasury Offices	Directions to Treasury offices	www.treasury.state.tn.us/map.gif

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 37243-0264
PHONE (615) 401-7897 / FAX (615) 532-2765

December 11, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of fiduciary net assets of the Baccalaureate Education System Trust, Educational Services Plan, a private-purpose trust fund of the State of Tennessee, as of June 30, 2006, and June 30, 2005, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and serving as a member of the board of the Baccalaureate Education System Trust.

As discussed in Note A.1., the financial statements referred to above present only the Baccalaureate Education System Trust, Educational Services Plan, a private-purpose trust fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2006, and June 30, 2005, 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the Baccalaureate Education System Trust, Educational Services Plan, of the State of Tennessee as of June 30, 2006, and June 30, 2005, and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2006, on our consideration of the Baccalaureate Education System Trust, Educational Services Plan's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Baccalaureate Education System Trust, Educational Services Plan
Comparative Statements of Fiduciary Net Assets
June 30, 2006 and June 30, 2005

ASSETS	June 30, 2006	June 30, 2005
Cash and cash equivalents	$ 6,367,546	$ 4,778,697
Receivables		
Contributions receivable	8,575	8,966
Investment income receivable	24,209	432,039
Investments sold	0	60,409
Investments, at fair value		
Government securities	0	38,933,237
Investment in fixed income index fund	39,895,827	0
Investment in equity index fund	14,492,166	13,339,019
TOTAL ASSETS	60,788,323	57,552,367
LIABILITIES		
Investments purchased	0	60,410
Other investment payable	4,820	817
TOTAL LIABILITIES	4,820	61,227
NET ASSETS HELD IN TRUST FOR PLAN PARTICIPANTS	$ 60,783,503	$ 57,491,140

See accompanying Notes to the Financial Statements

Baccalaureate Education System Trust, Educational Services Plan
Comparative Statements of Changes in Fiduciary Net Assets
For the Years Ended June 30, 2006 and June 30, 2005

ADDITIONS	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
Contributions	$ 6,193,944	$ 7,135,633
Investment income		
Net increase (decrease) in fair value of investments	(1,600,940)	807,827
Interest and dividend income	2,760,189	1,503,211
Less: Investment expense	(11,842)	(3,191)
Net investment income	1,147,407	2,307,847
Administrative fees	332,411	353,049
TOTAL ADDITIONS	7,673,762	9,796,529
DEDUCTIONS		
Refunds	503,502	564,389
Payments	3,557,595	2,782,007
Administrative cost	320,302	354,124
TOTAL DEDUCTIONS	4,381,399	3,700,520
CHANGE IN NET ASSETS	3,292,363	6,096,009
NET ASSETS HELD IN TRUST FOR PLAN PARTICIPANTS		
BEGINNING OF YEAR	57,491,140	51,395,131
END OF YEAR	$ 60,783,503	$ 57,491,140

See accompanying Notes to the Financial Statements

Baccalaureate Education System Trust, Educational Services Plan
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity
The Tennessee Baccalaureate Education System Trust Fund (BEST), Educational Services Plan (ESEP) is an integral part of the primary government and 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 flow of economic resources measurement focus and the accrual basis of accounting. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

3. Cash and Cash Equivalents
Cash and Cash Equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. 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. The classification of cash and cash equivalents also includes cash invested in a short-term, open-end mutual fund, 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
During the year ended June 30, 2005, the ESEP adopted the provisions of Statement No. 40 of the Governmental Accounting Standards Board *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3*. The adoption of this statement requires the ESEP to provide certain additional disclosures, as well as modify other disclosures relating to investment and deposit risks, including credit risk, custodial credit risk, concentrations of credit risk, interest rate risk and foreign currency risk.

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'

(continued)

Baccalaureate Education System Trust, Educational Services Plan
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. Prior to the adoption of the current investment policy on December 14, 2004, allowable investments also included obligations of the State of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). 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.

As of June 30, 2006 and June 30, 2005, the ESEP had the following investments:

Expressed in Thousands

Investment Type	Fair Value As of June 30, 2006	United States Treasury	Credit Quality Rating AAA
Debt Investments			
U.S. Government			
U.S. Treasuries	$0	$0	
U.S. Agencies	0		$0
Mortgage Backed			
Government Pass-through	0		0
Total Debt Investments	$0	$0	$0
Other Investments			
Commingled Funds			
U.S. Equity	14,492		
U.S. Fixed Income	39,896		
Money Market Funds	6,416		
Total Other Investments	$60,804		
Total Investments	$60,804		
Less: Investments Classified as Cash Equivalents on the Statements of Fiduciary Net Assets	(6,416)		
Total Investments as Shown on Statement of Fiduciary Net Assets	$54,388		

Expressed in Thousands

Investment Type	Fair Value As of June 30, 2005	United States Treasury	Credit Quality Rating AAA
Debt Investments			
U.S. Government			
U.S. Treasuries	$14,175	$14,175	
U.S. Agencies	9,866		$9,866
Mortgage Backed			
Government Pass-through	14,892		14,892
Total Debt Investments	$38,933	$14,175	$24,758
Other Investments			
Commingled Funds			
U.S. Equity	$13,339		
Money Market Funds	4,920		
Total Other Investments	$18,259		
Total Investments	$57,192		
Less: Investments Classified as Cash Equivalents on the Statements of Fiduciary Net Assets	(4,920)		
Total Investments as Shown on Statement of Fiduciary Net Assets	$52,272		

(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 ESEP's investments in fixed income securities as of June 30, 2006 and June 30, 2005 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 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.

As noted above, the ESEP does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash purposes. Required risk disclosures relative to the State Pooled Investment Fund are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298.

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. As of June 30, 2006 and June 30, 2005, the ESEP had the following investment amounts and percentages of total investments, 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, 2006		June 30, 2005	
Issuer Organization	Fair Value	Percentage	Fair Value	Percentage
Federal Home Loan Banks	N/A	N/A	$ 14,892,188	26.04%
Federal National Mortgage Assoc.	N/A	N/A	$ 9,865,625	17.25%

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 fixed income portfolio is benchmarked against the Lehman Government/Corporate Intermediate 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 ESEP had the following investments and effective duration at June 30, 2006 and June 30, 2005.

(continued)

Baccalaureate Education System Trust, Educational Services Plan
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

Expressed in Thousands

Investment Type	Fair Value As of June 30, 2006	Effective Duration (years)
Debt Investments		
U.S. Government		
U.S. Treasuries	$0	0.00
U.S. Agencies	0	0.00
Mortgage Backed		
Government Pass-through	0	0.00
Total Debt Investments	$0	0.00

Expressed in Thousands

Investment Type	Fair Value As of June 30, 2005	Effective Duration (years)
Debt Investments		
U.S. Government		
U.S. Treasuries	$14,175	3.39
U.S. Agencies	9,866	2.25
Mortgage Backed		
Government Pass-through	14,892	1.57
Total Debt Investments	$38,933	2.40

Note: Securities included in the United States Treasury categories above consist of obligations of the U.S. government and are not considered to have credit risk.

C. DESCRIPTION OF THE EDUCATIONAL SERVICES PLAN

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 may enter into a contract with the BEST Board of Trustees to purchase tuition units on behalf of a beneficiary. Each tuition unit purchased entitles 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 is determined annually by the BEST Board of Trustees with the assistance of an actuary to maintain the plan's financial soundness. 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 assets held in trust for plan participants were $18,192,516 less at June 30, 2006, and $12,672,703 less at June 30, 2005, than the amounts needed to fund the outstanding tuition units at their weighted average tuition unit prices in effect at the respective dates.

Tennessee Code Annotated, Title 49, Chapter 7, Part 8, also created the Tennessee Baccalaureate Education System Trust, Educational Savings Plan. The plan administration and custody and investment of plan assets for the Educational Savings Plan are not performed by the State Treasurer and thus, the accompanying financial statements do not include the net assets and activities relating to the Educational Savings Plan.

Chairs of Excellence Independent Auditor's Report

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT / DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897 / FAX (615) 532-2765

December 11, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying balance sheets of the Chairs of Excellence, a permanent fund of the State of Tennessee, as of June 30, 2006, and June 30, 2005, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and serving as a member of the board of the Chairs of Excellence Trust.

As discussed in Note A.1., the financial statements referred to above 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, 2006, and June 30, 2005, 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.

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, 2006, and June 30, 2005, 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2006, on our consideration of the Chairs of Excellence's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

CHAIRS OF EXCELLENCE
COMPARATIVE BALANCE SHEETS
JUNE 30, 2006 AND JUNE 30, 2005

	June 30, 2006	June 30, 2005
ASSETS		
Cash and cash equivalents	$ 8,879,532	$ 6,270,076
Investments, at fair value		
Government securities	86,969,505	75,210,747
Corporate securities	15,633,140	31,378,444
Investment in equity mutual fund	121,614,333	110,936,449
Total investments	224,216,978	217,525,640
Receivables		
Due from colleges and universities	635,710	654,371
Investment income receivable	1,817,057	1,505,459
Total receivables	2,452,767	2,159,830
TOTAL ASSETS	$ 235,549,277	$ 225,955,546
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Due to colleges and universities	$ 1,923,006	$ 2,222,939
Due to the Academic Scholars Fund	3,184,277	3,219,457
Investments purchased	4,266,547	0
Other investment payable	15,656	6,079
TOTAL LIABILITIES	9,389,486	5,448,475
FUND BALANCES		
Reserved for non-expendable corpus	99,929,963	99,833,298
Unreserved	126,229,828	120,673,773
TOTAL FUND BALANCES	226,159,791	220,507,071
TOTAL LIABILITIES AND FUND BALANCES	$ 235,549,277	$ 225,955,546

See accompanying Notes to the Financial Statements

CHAIRS OF EXCELLENCE
COMPARATIVE STATEMENTS OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES
FOR THE YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
REVENUES		
Investment income	$ 12,471,255	$ 11,749,363
Contributions from private sources	96,665	149,410
TOTAL REVENUES	12,567,920	11,898,773
EXPENDITURES		
University of Tennessee	3,453,129	3,108,029
Tennessee Board of Regents	3,236,174	2,924,317
Academic Scholars Fund	43,019	158,136
Administrative cost	182,878	176,701
TOTAL EXPENDITURES	6,915,200	6,367,183
EXCESS OF REVENUES OVER EXPENDITURES	5,652,720	5,531,590
FUND BALANCES, BEGINNING OF YEAR	220,507,071	214,975,481
FUND BALANCES, END OF YEAR	$ 226,159,791	$ 220,507,071

See accompanying Notes to the Financial Statements

Chairs of Excellence
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

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 flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this basis, revenues are recorded when they become both measurable and available, and expenditures are recognized when the related fund liability is incurred. The COE Trust follows the State of Tennessee's revenue recognition period, in which taxes and fees are considered to be available if received in the first sixty days of the new year. Federal grants, departmental services, and interest associated with the current fiscal year are all considered to be available if received in twelve months. All other revenue items are considered to be measurable and available only when cash is received by the COE Trust.

3. **Cash and Cash Equivalents** - Cash and cash equivalents by definition, includes cash and short term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. Cash received by the COE Trust that cannot be immediately invested in securities, or that is needed for operations, is invested in the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer. 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. 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 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. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade date basis.

5. **Fund Balances** - The reserve for non-expendable corpus includes funds provided by contributions from the state, colleges and universities and private sources.

6. **Restatement** – In April 2005, the General Assembly passed legislation that clarified the definition of income that could be spent by a chair. The trustees of the COE Trust made further revisions to the trust agreement and policies effective July 1, 2005 whereby only original contributions, or corpus are reserved and cannot be spent by the chair. As a result of these changes, an amount of $106,975,796

(continued)

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006 AND JUNE 30, 2005

that was previously classified at June 30, 2005 as reserved for non-expendable corpus has been reclassified as unreserved.

The portion of the fund balance that was classified as reserved for expendable income on the June 30, 2005 Balance Sheet has been restated to unreserved. This portion of fund balance was restated because the restrictions on the use of these resources are not more narrow than the purpose of the COE trust itself.

7. **Adoption of New Accounting Pronouncement –** During the year ended June 30, 2005, the COE Trust adopted the provisions of Statement No. 40 of the Governmental Accounting Standards Board *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3.* The adoption of this statement requires the COE Trust to provide certain additional disclosures, as well as modify other disclosures relating to investment and deposit risks, including credit risk, custodial credit risk, concentrations of credit risk, interest rate risk and foreign currency risk.

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. Prior to the adoption of the current investment policy on December 14, 2004, allowable investments also included obligations of the State of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). 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 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.

(continued)

Chairs of Excellence
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

As of June 30, 2006 and June 30, 2005, the COE Trust had the following investments:

Expressed in Thousands

Investment Type	Fair Value As of June 30, 2006	United States Treasury/Agency	Credit Quality Ratings				
			AAA	AA	A	BBB	Not Rated
Debt Investments							
U.S. Government							
U.S. Treasuries	$26,848	$26,848					
U.S. Government TIPS	19,953	19,953					
U.S. Agencies	11,939		$11,939				
Mortgage Backed							
Government Pass-through	28,229	4,498					$23,731
Corporate							
Corporate Bonds	13,205		2,023	$4,889	$6,293		
Corporate Asset Backed	1,447			489	499	$459	
Private Placements	539				539		
Yankee Bonds	442					442	
ShortTerm							
Agencies	5,788						5,788
Total Debt Investments	$108,390	$51,299	$13,962	$5,378	$7,331	$901	$29,519

Investment Type	Fair Value As of June 30, 2006
Other Investments	
Equity	
U.S.	$76,263
Non - U.S. Equity	45,351
Commingled Funds	
Money Market Funds	3,278
Total Other Investments	$124,892
Total Investments	$233,282
Less: Investments Classified as Cash Equivalents on Balance Sheet	(9,066)
Total Investments as Shown on Balance Sheet	$224,216

Expressed in Thousands

Investment Type	Fair Value As of June 30, 2005	United States Treasury/Agency	Credit Quality Ratings				
			AAA	AA	A	BBB	Not Rated
Debt Investments							
U.S. Government							
U.S. Treasuries	$41,126	$41,126					
U.S. Agencies	24,581		$24,581				
Mortgage Backed							
Government Pass-through	9,504	5,956					$3,548
Corporate							
Corporate Bonds	18,236		5,453	$1,576	$11,207		
Corporate Asset Backed	13,142			2,966	7,979	$2,197	
Total Debt Investments	$106,589	$47,082	$30,034	$4,542	$19,186	$2,197	$3,548

Investment Type	Fair Value As of June 30, 2005
Other Investments	
Equity	
U.S.	$110,937
Commingled Funds	
Money Market Funds	6,400
Total Other Investments	$117,337
Total Investments	$223,926
Less: Investments Classified as Cash Equivalents on Balance Sheet	(6,400)
Total Investments as Shown on Balance Sheet	$217,526

Note: Securities included in the United States Treasury/Agency categories above consist of obligations of the U.S. government, or obligations explicitly guaranteed by the U. S. government and are not considered to have credit risk. Securities that are in the Not Rated categories are implicitly guaranteed by the U.S. government but are not rated by Standard and Poor's or Moody's.

(continued)

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006 AND JUNE 30, 2005

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, 2006 and June 30, 2005 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 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. Required risk disclosures relative to the State Pooled Investment Fund are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298.

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, 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, 2006		June 30, 2005	
Issuer Organization	Fair Value	Percentage	Fair Value	Percentage
Federal Home Loan Mortgage Corporation	N/A	N/A	$14,198,208	6.34%
Federal National Mortgage Association	$30,437,840	13.06%	$13,930,252	6.22%

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

(continued)

does not specifically address limits on investment maturities. The fixed income portfolio is benchmarked against the Lehman Government/Corporate Intermediate 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, 2006 and June 30, 2005.

Expressed in Thousands

Investment Type	Fair Value As of June 30, 2006	Effective Duration (years)
Debt Investments		
U.S. Government		
U.S. Treasuries	$26,848	7.00
U.S. TIPS	19,953	7.35
U.S. Agencies	11,939	2.25
Mortgage Backed		
Government Pass-through	28,229	4.19
Corporate		
Corporate Bonds	13,205	2.66
Corporate Asset Backed	1,447	2.30
Private Placements	539	3.64
Yankee Bonds	442	12.31
Short Term		
Agencies	5,788	0.04
Total Debt Investments	$108,390	4.85

Expressed in Thousands

Investment Type	Fair Value As of June 30, 2005	Effective Duration (years)
Debt Investments		
U.S. Government		
U.S. Treasuries	$41,126	4.08
U.S. Agencies	24,581	3.17
Mortgage Backed		
Government Pass-through	9,504	3.06
Corporate		
Corporate Bonds	18,236	4.23
Corporate Asset Backed	13,142	2.66
Total Debt Investments	$106,589	3.63

(continued)

Chairs of Excellence
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

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 sub account for that Chair. The awarding college or university must provide matching contributions, of which at least 50 percent of the funds are from private contributions.

   As of June 30, 2006, 99 Chairs have been established with matching contributions received totaling $55,929,963. Total contributions to the COE Trust totaled $99,929,963 as of June 30, 2006. This includes $44,000,000 from the State, $10,321,300 from Colleges and Universities, and $45,608,663 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 37243-0264
PHONE (615) 401-7897 / FAX (615) 532-2765

December 11, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying balance sheets of the Criminal Injuries Compensation Fund, a special revenue fund of the State of Tennessee, as of June 30, 2006, and June 30, 2005, and the related statements of revenues, expenditures, and changes in fund balances and revenues, expenditures, and changes in fund balances (budget and actual) for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

As discussed in Note A.1., the financial statements referred to above 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, 2006, and June 30, 2005, and the changes in its financial position and budgetary comparisons for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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, 2006, and June 30, 2005, and the changes in its financial position and budgetary comparisons for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2006, on our consideration of the Criminal Injuries Compensation Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Criminal Injuries Compensation Fund
Comparative Balance Sheets
June 30, 2006 and June 30, 2005

	June 30, 2006	June 30, 2005
ASSETS		
Cash	$ 9,485,341	$ 10,832,381
Accounts receivable	401,514	361,607
TOTAL ASSETS	$ 9,886,855	$ 11,193,988
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Accounts payable	$ 171,136	$ 174,863
Claims liability	6,579,809	7,527,989
TOTAL LIABILITIES	6,750,945	7,702,852
FUND BALANCES		
Reserved for victims of drunk drivers (see Note B.1)	1,738,764	1,622,009
Unreserved	1,397,146	1,869,127
TOTAL FUND BALANCES	3,135,910	3,491,136
TOTAL LIABILITIES AND FUND BALANCES	$ 9,886,855	$ 11,193,988

See accompanying Notes to the Financial Statements

Criminal Injuries Compensation Fund
Comparative Statements of Revenues, Expenditures, and Changes in Fund Balances
For the Years Ended June 30, 2006 and June 30, 2005

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
REVENUES		
State		
Taxes	$ 4,351,199	$ 4,358,617
Fees	2,871,984	2,731,886
Federal	3,177,000	3,167,000
Interest income	362,985	189,173
Other	341,620	517,263
TOTAL REVENUES	11,104,788	10,963,939
EXPENDITURES		
Claim payments	10,516,432	10,831,702
Victims' coalition grant	100,000	100,000
District Attorneys General grant	164,400	164,400
Administrative cost	679,182	756,426
TOTAL EXPENDITURES	11,460,014	11,852,528
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(355,226)	(888,589)
FUND BALANCES, BEGINNING OF YEAR	3,491,136	4,379,725
FUND BALANCES, END OF YEAR	$ 3,135,910	$ 3,491,136

See accompanying Notes to the Financial Statements

Criminal Injuries Compensation Fund
Comparative Statements of Revenues, Expenditures, and Changes in Fund Balances Budget and Actual (Budgetary Basis) For the Years Ended June 30, 2006 and June 30, 2005

	For the Year Ended June 30, 2006			For the Year Ended June 30, 2005		
	Original Budget	Final Budget	Actual (Budgetary Basis)	Original Budget	Final Budget	Actual (Budgetary Basis)
SOURCES OF FINANCIAL RESOURCES						
FUND BALANCES, BEGINNING OF YEAR	$ 3,491,136	$ 3,491,136	$ 3,491,136	$ 4,379,725	$ 4,379,725	$ 4,379,725
REVENUES						
Taxes	5,772,100	5,772,100	4,351,199	5,772,100	5,772,100	4,358,617
Fees	3,100,000	3,100,000	2,871,984	3,100,000	3,100,000	2,731,886
Federal	3,200,400	3,200,400	3,177,000	3,168,000	3,168,000	3,167,000
Interest income	0	0	362,985	0	0	189,173
Other	602,000	602,000	341,620	602,000	602,000	517,263
TOTAL SOURCES OF FINANCIAL RESOURCES	16,165,636	16,165,636	14,595,924	17,021,825	17,021,825	15,343,664
USES OF FINANCIAL RESOURCES						
EXPENDITURES						
Claim payments	12,500,000	12,500,000	10,516,432	11,865,600	11,865,600	10,831,702
Victims' coalition grant	0	0	100,000	0	0	100,000
District Attorneys General grant	0	0	164,400	0	0	164,400
Administrative cost	776,500	776,500	679,182	776,500	776,500	756,426
TOTAL USES OF FINANCIAL RESOURCES	13,276,500	13,276,500	11,460,014	12,642,100	12,642,100	11,852,528
FUND BALANCES, END OF YEAR	$ 2,889,136	$ 2,889,136	$ 3,135,910	$ 4,379,725	$ 4,379,725	$ 3,491,136

See accompanying Notes to the Financial Statements

Criminal Injuries Compensation Fund
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Criminal Injuries Compensation Fund is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as a special revenue fund. The Criminal Injuries Compensation Program (CIC) is funded through privilege and litigation taxes assessed in courts against certain criminal defendants upon conviction, fees levied against parolees, probationers and employed releasees, proceeds from sales of illegal contraband and 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 flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recorded when they become both measurable and available, and expenditures are recognized at the time the fund liabilities are incurred. For revenue recognition purposes, taxes and fees are considered to be available if received in the first sixty days of the new year. Federal grants, departmental services, and interest associated with the current fiscal year are all considered to be available if received in twelve months. All other revenue items are considered to be measurable and available only when cash is received by the Criminal Injuries Compensation Fund.

3. Cash

The primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash. Cash deposited in the Criminal Injuries Compensation Fund is pooled with the State Pooled Investment Fund (SPIF), administered by the State Treasurer, which is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. Prior to the adoption of the current investment policy on December 14, 2004, allowable investments also included obligations of the State of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The SPIF is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The SPIF has not obtained a credit quality rating from a nationally recognized ratings agency. Risk disclosures relative to the SPIF are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298.

4. Budgetary Process

Legislation requires that annual budgets be adopted for special revenue funds. The CIC budget is included in the budget presented by the Governor to the General Assembly at the beginning of each annual legislative session. The General Assembly enacts the budget by passing specific

(continued)

appropriations which may not exceed estimated revenues. The CIC 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.

5. **Reclassification**
The portion of fund balance that was reported as reserved for future benefits on the June 30, 2005 Balance Sheet has been reclassified as unreserved. This portion of fund balance was reclassified because the restrictions on the use of these resources are not more narrow than the purpose of the Criminal Injuries Compensation Fund itself.

B. OTHER ACCOUNTING DISCLOSURES

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

Flexible Benefits Plan
Independent Auditor's Report

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT / DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897 / FAX (615) 532-2765

December 11, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of fiduciary net assets of the Flexible Benefits Plan, an employee benefit trust fund of the State of Tennessee, as of June 30, 2006, and June 30, 2005, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

As discussed in Note A.1., the financial statements referred to above present only the Flexible Benefits Plan, an employee benefit trust fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2006, and June 30, 2005, 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the Flexible Benefits Plan of the State of Tennessee as of June 30, 2006, and June 30, 2005, and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2006, on our consideration of the Flexible Benefits Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Flexible Benefits Plan
Comparative Statements of Fiduciary Net Assets
June 30, 2006 and June 30, 2005

	June 30, 2006	June 30, 2005
ASSETS		
Cash	$ 3,412,426	$ 3,200,093
Due from other funds	246,495	249,019
TOTAL ASSETS	3,658,921	3,449,112
LIABILITIES		
Accounts payable	128,571	97,097
Due to other funds	193,425	119,680
TOTAL LIABILITIES	321,996	216,777
NET ASSETS		
Held in trust for employee benefit programs	$ 3,336,925	$ 3,232,335

See accompanying Notes to the Financial Statements

Flexible Benefits Plan
Comparative Statements of Changes in Fiduciary Net Assets
For the Years Ended June 30, 2006 and June 30, 2005

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
ADDITIONS		
Employee contributions	$ 7,113,229	$ 6,696,990
FICA savings	5,920,975	5,446,750
TOTAL ADDITIONS	13,034,204	12,143,740
DEDUCTIONS		
Employee reimbursements	7,027,764	6,616,196
Employee benefit programs		
Deferred compensation match	4,912,145	3,127,255
Wellness program	500,048	424,575
Employee daycare assistance	69,953	62,731
Sick leave bank administration	101,861	91,300
Total employee benefit programs	5,584,007	3,705,861
Administrative fees	317,843	337,022
TOTAL DEDUCTIONS	12,929,614	10,659,079
CHANGE IN NET ASSETS	104,590	1,484,661
NET ASSETS, BEGINNING OF YEAR	3,232,335	1,747,674
NET ASSETS, END OF YEAR	$ 3,336,925	$ 3,232,335

See accompanying Notes to the Financial Statements

Flexible Benefits Plan
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Flexible Benefits Plan is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* 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 calendar plan year except in the event of a corresponding change in the participant's family status. Contributions to the plan not withdrawn by the end of the plan year are forfeited to the state and are used for defraying administrative costs, in accordance with *IRS Proposed Regulation* 1.125-2 (Q7).

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.

3. Cash

The primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash. Cash deposited in the Flexible Benefits Plan is pooled with the State Pooled Investment Fund (SPIF), administered by the State Treasurer, which is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. Prior to the adoption of the current investment policy on December 14, 2004, allowable investments also included obligations of the State of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The SPIF is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The SPIF has not obtained a credit quality rating from a nationally recognized ratings agency. Risk disclosures relative to the SPIF are presented in the *Tennessee Comprehensive Annual Financial Report.* That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298.

(continued)

Flexible Benefits Plan
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

B. OTHER ACCOUNTING DISCLOSURES

1. The FICA savings generated by the Flexible Benefits Plan are used by the State for other employee benefit programs. During the years ended June 30, 2006 and June 30, 2005 the following amounts were paid or transferred to other State funds for these employee benefit programs:

Program	FY 2006	FY 2005
Deferred Compensation Contribution Match	$4,912,145	$3,127,255
State Wellness Program	500,048	424,575
State Day Care Assistance	69,953	62,731
Sick Leave Bank	101,861	91,300

2. Due from other funds consists of dependent care and medical reimbursement deposits from the accrued payroll at June 30 for the following funds:

	FY 2006	FY 2005
Due from General Fund	$196,330	$198,928
Due from Internal Service Fund	11,726	10,964
Due from Enterprise Fund	4,059	3,810
Due from Special Revenue Fund	8,955	10,135
Due from Highway Fund	15,742	16,012
Due from Education Trust Fund	9,683	9,170

3. Due to other funds consists of deferred compensation match payments from the accrued payroll at June 30 for the following funds:

	FY 2006	FY 2005
Due to General Fund	$156,398	$95,925
Due to Internal Service Fund	4,356	2,870
Due to Enterprise Fund	1,060	640
Due to Special Revenue Fund	5,411	3,535
Due to Highway Fund	21,973	13,995
Due to Education Trust Fund	4,227	2,715

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 37243-0264
PHONE (615) 401-7897 / FAX (615) 532-2765

December 11, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of the Risk Management Fund, an internal service fund of the State of Tennessee, as of June 30, 2006, and June 30, 2005, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; approving settlements against the state; and serving as a member of the Board of Claims.

As discussed in Note A.1., the financial statements referred to above present only the Risk Management Fund, an internal service fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2006, and June 30, 2005, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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, 2006, and June 30, 2005, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2006, on our consideration of the Risk Management Fund's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Risk Management Fund
Comparative Statements of Net Assets
June 30, 2006 and June 30, 2005

	June 30, 2006	June 30, 2005
ASSETS		
Cash	$ 133,255,401	$ 114,389,430
TOTAL ASSETS	133,255,401	114,389,430
LIABILITIES		
Current liabilities		
Accounts payable	535,628	1,272,685
Deferred revenue	6,000	6,000
Claims liability	28,216,362	30,086,042
Total current liabilities	28,757,990	31,364,727
Noncurrent liabilities		
Claims liability	55,249,996	61,004,293
TOTAL LIABILITIES	84,007,986	92,369,020
NET ASSETS - UNRESTRICTED	$ 49,247,415	$ 22,020,410

See accompanying Notes to the Financial Statements

Risk Management Fund
Comparative Statements of Revenues, Expenses, and Changes in Fund Net Assets
For the Years Ended June 30, 2006 and June 30, 2005

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
OPERATING REVENUES		
Casualty premiums	$ 47,518,100	$ 45,913,900
Property premiums	6,023,600	5,254,500
TOTAL OPERATING REVENUES	53,541,700	51,168,400
OPERATING EXPENSES		
Torts		
Death	1,088,114	2,729,946
Bodily injury	2,671,663	4,310,817
Property damage	715,682	775,807
Total Torts	4,475,459	7,816,570
Workers' Compensation		
Death	362,168	304,040
Medical	10,645,745	12,423,094
Temporary disability	1,661,706	1,497,685
Permanent disability	7,250,563	6,911,648
Total Workers' Compensation	19,920,182	21,136,467
Property Damage		
Employee property	24,677	22,115
State owned property	3,744,345	1,365,183
Total Property Damage	3,769,022	1,387,298
Property insurance premiums	1,985,685	1,832,835
Professional/Administrative	8,549,073	8,833,894
Reduction of accrued liability	(7,623,977)	(1,466,625)
TOTAL OPERATING EXPENSES	31,075,444	39,540,439
OPERATING INCOME	22,466,256	11,627,961
NON-OPERATING REVENUES		
Interest income	4,757,524	2,204,686
Taxes	3,225	3,525
TOTAL NON-OPERATING REVENUES	4,760,749	2,208,211
CHANGE IN NET ASSETS	27,227,005	13,836,172
NET ASSETS, BEGINNING OF YEAR	22,020,410	8,184,238
NET ASSETS, END OF YEAR	$ 49,247,415	$ 22,020,410

See accompanying Notes to the Financial Statements

Risk Management Fund
Comparative Statements of Cash Flows
For the Years Ended June 30, 2006 and June 30, 2005

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from premiums	$ 53,541,700	$ 51,305,755
Payments for claims	(28,964,291)	(29,533,008)
Payments for administrative expenses	(8,545,256)	(8,796,663)
Payments for insurance premiums	(1,926,931)	(1,854,141)
NET CASH FROM OPERATING ACTIVITIES	14,105,222	11,121,943
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Taxes received	3,225	3,525
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES	3,225	3,525
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	4,757,524	2,204,686
NET CASH FROM INVESTING ACTIVITIES	4,757,524	2,204,686
NET INCREASE IN CASH	18,865,971	13,330,154
CASH, BEGINNING OF YEAR	114,389,430	101,059,276
CASH, END OF YEAR	$133,255,401	$114,389,430
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
OPERATING INCOME	$ 22,466,256	$ 11,627,961
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
Changes in assets and liabilities		
Decrease in accounts receivable	0	137,355
Increase (decrease) in accounts payable	(737,057)	824,252
Decrease in deferred revenue	0	(1,000)
Decrease in claims liability	(7,623,977)	(1,466,625)
TOTAL ADJUSTMENTS	(8,361,034)	(506,018)
NET CASH FROM OPERATING ACTIVITIES	$ 14,105,222	$ 11,121,943

See accompanying Notes to the Financial Statements

Risk Management Fund
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

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 RMF generally follows private sector standards of accounting and financial reporting issued prior to December 1, 1989, to the extent that these standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. 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. 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 primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash. Cash deposited in the RMF is pooled with the State Pooled Investment Fund (SPIF), administered by the State Treasurer, which is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. Prior to the adoption of the current investment policy on December 14, 2004, allowable investments also included obligations of the State of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The SPIF is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The SPIF has not obtained a credit quality rating from a nationally recognized ratings agency. Risk disclosures relative to the SPIF are presented in the *Tennessee Comprehensive Annual Financial Report.* That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298.

B. OTHER ACCOUNTING DISCLOSURES

1. Risk Management

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

(continued)

Risk Management Fund
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The RMF is also responsible for claims for damages to state owned property up to the amount of the property insurance aggregate deductible amount. The insurance policy deductibles vary from $25,000 per occurrence, depending on the type of coverage, to an aggregate of $5 million. 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 $81,121,245 (discounted at 3.50%) at June 30, 2006 and $84,897,635 (discounted at 3.50%) at June 30, 2005. The accrued liability for incurred property losses was $2,345,113 at June 30, 2006 and $6,192,700 at June 30, 2005. The changes in the balances of the claims liabilities during fiscal years 2005 and 2006 were as follows:

Fiscal Year	Beginning Claims Liability	Current Year Claims and Changes in Estimates	Claim Payments	Ending Claims Liability
2005-06	$91,090,335	$20,540,686	$(28,164,663)	$83,466,358
2004-05	$92,556,960	$28,873,710	$(30,340,335)	$91,090,335

At June 30, 2006, the RMF held $133.2 million in cash 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.

Small and Minority-Owned Business Assistance Program Fund
Independent Auditor's Report

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT / DIVISION OF STATE AUDIT
SUITE 1500, JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897 / FAX (615) 532-2765

December 11, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying balance sheets of the Small and Minority-Owned Business Assistance Program, a special revenue fund of the State of Tennessee, as of June 30, 2006, and June 30, 2005, and the related statements of revenues, expenditures, and changes in fund balances and revenues, expenditures, and changes in fund balances (budget and actual) for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

As discussed in Note A.1., the financial statements referred to above present only the Small and Minority-Owned Business Assistance Program, 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, 2006, and June 30, 2005, and the changes in its financial position and budgetary comparisons for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Small and Minority-Owned Business Assistance Program of the State of Tennessee as of June 30, 2006, and June 30, 2005, and the changes in its financial position and budgetary comparisons for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2006, on our consideration of the Small and Minority-Owned Business Assistance Program's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Small and Minority-Owned Business Assistance Program Fund
Comparative Balance Sheets
June 30, 2006 and June 30, 2005

	June 30, 2006	June 30, 2005
ASSETS		
Cash	$ 11,794,577	$ 11,326,168
TOTAL ASSETS	$ 11,794,577	$ 11,326,168
LIABILITIES AND FUND BALANCE		
FUND BALANCES		
Unreserved	$ 11,794,577	$ 11,326,168
TOTAL FUND BALANCES	11,794,577	11,326,168
TOTAL LIABILITIES AND FUND BALANCES	$ 11,794,577	$ 11,326,168

See accompanying Notes to the Financial Statements

Small and Minority-Owned Business Assistance Program Fund
Comparative Statements of Revenues, Expenditures and Changes in Fund Balance
For the Years Ended June 30, 2006 and June 30, 2005

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
REVENUES		
Interest income	$ 468,431	$ 231,927
TOTAL REVENUES	468,431	231,927
EXPENDITURES		
Loan guarantee payments	0	118,112
Administrative cost	22	27
TOTAL EXPENDITURES	22	118,139
EXCESS OF REVENUES OVER EXPENDITURES	468,409	113,788
FUND BALANCES, BEGINNING OF YEAR	11,326,168	11,212,380
FUND BALANCES, END OF YEAR	$ 11,794,577	$ 11,326,168

See accompanying Notes to the Financial Statements

Small and Minority-Owned Business Assistance Program Fund
Statement of Revenues, Expenditures and Changes in Fund Balance
Budget and Actual (Budgetary Basis) for the Years Ended June 30, 2006 and June 30, 2005

	For the Year Ended June 30, 2006			For the Year Ended June 30, 2005		
	Original Budget	Final Budget	Actual (Budgetary Basis)	Original Budget	Final Budget	Actual (Budgetary Basis)
SOURCES OF FINANCIAL RESOURCES						
FUND BALANCES, BEGINNING OF YEAR	$11,326,168	$11,326,168	$ 11,326,168	$11,212,380	$11,212,380	$11,212,380
REVENUES						
Interest income	80,100	80,100	468,431	80,100	80,100	231,927
TOTAL SOURCES OF FINANCIAL RESOURCES	11,406,268	11,406,268	11,794,599	11,292,480	11,292,480	11,444,307
USES OF FINANCIAL RESOURCES						
EXPENDITURES						
Loan guarantee payments	80,100	80,100	0	80,100	518,212	118,112
Administrative cost	0	0	22	0	0	27
TOTAL USES OF FINANCIAL RESOURCES	80,100	80,100	22	80,100	518,212	118,139
FUND BALANCES, END OF YEAR	$11,326,168	$11,326,168	$ 11,794,577	$11,212,380	$10,774,268	$11,326,168

See accompanying Notes to the Financial Statements

Small and Minority-Owned Business Assistance Program Fund
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity**
The Small and Minority-Owned Business Assistance Program Fund (the Fund) is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as a special revenue fund.

2. **Measurement Focus and Basis of Accounting**
The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recorded when they become both measurable and available, and expenditures are recognized at the time the fund liabilities are incurred. For revenue recognition purposes, interest income associated with the current fiscal year is considered to be available if received in twelve months.

3. **Cash**
The state's accounting policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash. Cash deposited in the Small and Minority-Owned Business Assistance Program is pooled with the State Pooled Investment Fund (SPIF), administered by the State Treasurer, which is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements and various U.S. Treasury and Agency obligations. Prior to the adoption of the current investment policy on December 14, 2004, allowable investments also included obligations of the State of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The SPIF is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The SPIF has not obtained a credit quality rating from a nationally recognized ratings agency. Required risk disclosures relative to the State Pooled Investment Fund are presented in the *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298.

4. **Budgetary Process**
Legislation requires that annual budgets be adopted for special revenue funds. The Small and Minority-Owned Business Assistance Program Fund's budget is included in the budget presented by the Governor to the General Assembly at the beginning of each annual legislative session. The General Assembly enacts the budget by passing specific appropriations which may not exceed estimated revenues. The Fund's 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.

(continued)

Small and Minority-Owned Business Assistance Program Fund
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

5. **Reclassification**
   The fund balance that was reported as reserved for small and minority-owned businesses on the June 30, 2005 Balance Sheet has been reclassified as unreserved. This fund balance was reclassified because the restrictions on the use of these resources are not more narrow than the purpose of the Small and Minority-owned Business Assistance Program Fund itself.

B. OTHER ACCOUNTING DISCLOSURES

1. **Small and Minority-Owned Business Assistance Program -** The Small and Minority-owned Business Assistance Program, administered by the State Treasurer, was established by *Chapter 830 of the Public Acts of 2004* to support the outreach to new, expanding, and existing businesses in Tennessee that do not have reasonable access to capital markets and traditional commercial lending facilities. The Fund is supported from funds remaining in the former Small and Minority-Owned Telecommunications Business Assistance Program Fund, and interest income earned on the Fund. Payments are made in support of the assistance program for small and minority-owned businesses, and may include loans and loan guarantees, technical assistance and services, and consulting and educational services.

2. **Commitments –** As of June 30, 2006, the Fund was under loan guarantee obligations for the aggregate amount of $1,040,290 in the event of loan defaults.

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 37243-0264
PHONE (615) 401-7897 / FAX (615) 532-2765

December 11, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of fiduciary net assets of the State Pooled Investment Fund as of June 30, 2006, and June 30, 2005, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and serving as a member of the board of the State Trust of Tennessee and the State Funding Board.

As discussed in Note A.1., the financial statements referred to above 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, 2006, and June 30, 2005, 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the State Pooled Investment Fund of the State of Tennessee as of June 30, 2006, and June 30, 2005, and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2006, on our consideration of the State Pooled Investment Fund's internal control over financial reporting and 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

STATE POOLED INVESTMENT FUND
COMPARATIVE STATEMENTS OF FIDUCIARY NET ASSETS
JUNE 30, 2006 AND JUNE 30, 2005

	June 30, 2006	June 30, 2005
ASSETS		
Cash and cash equivalents	$ 3,027,096,548	$ 1,901,594,492
Short-term investments, at amortized cost	3,394,281,562	2,698,016,627
Accrued income receivable	37,334,560	16,271,535
TOTAL ASSETS	6,458,712,670	4,615,882,654
LIABILITIES AND NET ASSETS		
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS	$ 6,458,712,670	$ 4,615,882,654

STATE POOLED INVESTMENT FUND
COMPARATIVE STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2006 AND JUNE 30, 2005

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005
OPERATIONS		
Investment income	$ 221,242,015	$ 92,731,239
Expenses		
Administrative fee	2,660,973	2,116,526
Custodian and banking services fees	105,101	136,238
Total expenses	2,766,074	2,252,764
NET INVESTMENT INCOME	218,475,941	90,478,475
CAPITAL SHARE TRANSACTIONS (DOLLAR AMOUNTS AND NUMBER OF SHARES ARE THE SAME)		
Shares sold	33,453,314,191	31,894,568,410
Less shares redeemed	31,828,960,116	31,765,029,283
INCREASE FROM CAPITAL SHARE TRANSACTIONS	1,624,354,075	129,539,127
TOTAL INCREASE IN NET ASSETS	1,842,830,016	220,017,602
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS		
BEGINNING OF YEAR	4,615,882,654	4,395,865,052
END OF YEAR	$ 6,458,712,670	$ 4,615,882,654

See accompanying Notes to the Financial Statements

State Pooled Investment Fund
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

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 flow of economic resources measurement focus and the accrual basis of accounting. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

3. **Cash 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, 2006 and June 30, 2005, 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 –** During the year ended June 30, 2005, the SPIF adopted the provisions of Statement No. 40 of the Governmental Accounting Standards Board *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3.* The adoption of this statement requires the SPIF to provide certain additional disclosures, as well as modify other disclosures relating to investment and deposit risks, including credit risk, custodial credit risk, concentrations of credit risk, interest rate risk and foreign currency risk.

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. Prior to the adoption of

(continued)

State Pooled Investment Fund
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

the current investment policy on December 14, 2004, allowable investments also included obligations of the State of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b).

At June 30, 2006 and June 30, 2005, the principal amount of certificates of deposit in state depositories was $2,285,152,700 and $1,482,642,700 respectively. Interest rates on certificates of deposit held at June 30, 2006 ranged from 4.50% to 5.40% and at June 30, 2005 ranged from 2.60% to 3.30%. The days to maturity on certificates of deposit ranged from 29 to 268 days at June 30, 2006 and 45 to 181 days at June 30, 2005.

As of June 30, 2006 and June 30, 2005, the SPIF had the following investments:

June 30, 2006 Investment Type	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity	Carrying Amount Credit Quality Ratings AAA	A1	Not Rated
Cash Equivalents and Short-Term Investments:								
U.S. Government Agencies	$1,998,609,279	$1,995,138,540	$2,010,140,500	1.98% to 5.38%	82 to 396 days	$482,606,948	$0	$1,516,002,331
Commercial Paper	1,787,010,479	1,787,010,479	1,790,000,000	5.03% to 5.31%	3 to 45 days		1,787,010,479	
Total Cash Equivalents and Short-Term Investments	3,785,619,758	$3,782,149,019	$3,800,140,500			$482,606,948	$1,787,010,479	$1,516,002,331
Less: Short-Term Investments Classified as Cash Equivalents on Statement of Fiduciary Net Assets	(1,886,340,896)							
Add: Certificates of Deposit Classified as Short-Term Investments on Statement of Fiduciary Net Assets	1,495,002,700							
Short-Term Investments as shown on Statement of Fiduciary Net Assets	$3,394,281,562							

June 30, 2005 Investment Type	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity	Carrying Amount Credit Quality Ratings AAA	A1	Not Rated
Cash Equivalents and Short-Term Investments:								
U.S. Government Agencies	$1,706,825,171	$1,704,543,185	$1,714,500,367	1.88% to 5.25%	35 to 396 days	$731,778,790	$248,369,167	$726,677,214
Commercial Paper	1,270,827,478	1,270,878,411	1,271,623,000	3.04% to 3.45%	1 to 36 days		1,270,827,478	
Total Cash Equivalents and Short-Term Investments	2,977,652,649	$2,975,421,596	$2,986,123,367			$731,778,790	$1,519,196,645	$726,677,214
Less: Short-Term Investments Classified as Cash Equivalents on Statement of Fiduciary Net Assets	(1,561,553,722)							
Add: Certificates of Deposit Classified as Short-Term Investments on Statement of Fiduciary Net Assets	1,281,917,700							
Short-Term Investments as shown on Statement of Fiduciary Net Assets	$2,698,016,627							

Note: Securities in the "Not Rated" category consist of U.S. Agency securities that are implicitly guaranteed by the U.S. government and are not rated by Standard and Poor's or Moody'

(continued)

STATE POOLED INVESTMENT FUND NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2006 AND JUNE 30, 2005

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, 2006 and June 30, 2005 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 forty percent (40%) 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. 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)

June 30, 2006

Issuer Organization	Carrying Amount	Percentage of Total Investments
Federal National Mortgage Association	$665,170,220	17.57%
Federal Home Loan Mortgage Corporation	517,096,775	13.66
Federal Home Loan Banks	508,304,762	13.43
General Electric Capital Corporation	339,900,833	8.98
Federal Agriculture Mortgage Corporation	308,037,521	8.14
HSBC	249,927,083	6.60

June 30, 2005

Issuer Organization	Carrying Amount	Percentage of Total Investments
Federal National Mortgage Association	$805,223,906	27.04%
Federal Home Loan Banks	651,110,952	21.87
Prudential Funding	199,981,389	6.72
Bear Stearns	149,843,625	5.03

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 ninety (90) days and that no investment may be purchased with a remaining maturity of greater than three hundred ninety seven (397) calendar days. In addition, it is the intent of the Funding Board that the market value of the SPIF not deviate more than 0.5 percent from amortized cost. If it does, actions may include, but not be limited to, selling securities whose market 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.

(continued)

State Pooled Investment Fund
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

As of June 30, 2006 and June 30, 2005, the SPIF portfolio had the following weighted average maturities on debt investments:

June 30, 2006 **Investment Type**	**Carrying Amount**	**Weighted Average Maturity (Months)**
U.S. Government Agencies	$1,998,609,279	4.33
Commercial Paper	1,787,010,479	0.40
Aggregate Portfolio	$3,785,619,758	2.47

June 30, 2005 **Investment Type**	**Carrying Amount**	**Weighted Average Maturity (Months)**
U.S. Government Agencies	$1,706,825,171	4.97
Commercial Paper	1,270,827,478	0.27
Aggregate Portfolio	2,977,652,649	2.96

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, 2006 and June 30, 2005, 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 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

December 11, 2006

The Honorable John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, Tennessee 37243

Dear Mr. Morgan:

We have audited the accompanying statements of plan net assets of the Tennessee Consolidated Retirement System as of June 30, 2006, and June 30, 2005, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Tennessee Consolidated Retirement System's management. 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 of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. 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; approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

As discussed in Note A.1., the financial statements present only the Tennessee Consolidated Retirement System, pension trust funds 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, 2006, and June 30, 2005, 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.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Tennessee Consolidated Retirement System as of June 30, 2006, and June 30, 2005, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The management's discussion and analysis and the schedules of funding progress and employer contributions on pages 109 through 113 and 127 through 129 are not required parts of the basic financial statements but are supplementary information required by accounting principles generally accepted in the United States of America. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements. The actuarial balance sheet on page 130 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements and, accordingly, we express no opinion on it.

(continued)

Tennessee Consolidated Retirement System
Independent Auditor's Report (continued)

The Honorable John G. Morgan
December 11, 2006
Page 2

In accordance with *Government Auditing Standards*, we have also issued our report dated December 11, 2006, 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, 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 the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Years Ended June 30, 2006 & June 30, 2005

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, 2006 and June 30, 2005.

FINANCIAL HIGHLIGHTS

- The plan net assets (total assets minus total liabilities) of the TCRS at June 30, 2006 were $28.8 billion, increasing over $1.6 billion (5.9 percent) from the plan net assets at June 30, 2005. The net assets are held in trust to meet 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, 2005, the date of the latest actuarial valuation, the TCRS' funded ratio was 99.8 percent for the SETHEEPP group and 92.7 percent for the PSPP group.
- Contribution revenue for fiscal year 2006 totaled $892,190,489 – an increase of 5.6 percent compared to fiscal year 2005.
- Net investment income for fiscal year 2006 was $1,877,298,490. During fiscal year 2006, the TCRS received an investment return on its portfolio of 6.9 percent, compared to 7.3 percent for fiscal year 2005.
- Total benefits and refunds paid for fiscal year 2006 were $1,158,901,860 – an increase of 9.4 percent over fiscal year 2005 total benefits and refunds paid of $1,059,732,300.
- Total administrative expenses for fiscal year 2006 were $6,213,597 – an increase of 8.1 percent over fiscal year 2005 administrative expenses of $5,746,030.

OVERVIEW OF THE FINANCIAL STATEMENTS

The TCRS financial statements consist of the *Statement of Plan Net Assets* (on pages 114 through 115), the *Statement of Changes in Plan Net Assets* (on pages 116 through 117), and the *Notes to the Financial Statements* (on pages 118 through 126). In addition, *Required Supplementary Information* is presented, which includes this *Management's Discussion and Analysis,* as well as the schedules and notes on pages 127 through 129.

The *Statement of Plan Net Assets* and the *Statement of Changes in Plan Net Assets* report information about the plan net assets (total assets in excess of total liabilities) as of the end of the fiscal year and the changes in those plan net assets 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 Assets*, or net assets held in trust 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 Assets* 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 assets 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*, the *Schedules of Employer Contributions* and the accompanying *Notes to Required Supplementary Information* to gain an understanding of the funded status of the TCRS over 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 important 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.

(continued)

Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Years Ended June 30, 2006 & June 30, 2005 (continued)

ANALYSIS OF ASSETS, LIABILITIES AND PLAN NET ASSETS

At June 30, 2006, the TCRS had plan net assets (total assets in excess of total liabilities) of $28.8 billion, an increase of over $1.6 billion (5.9 percent) from $27.2 billion at June 30, 2005. The assets of the TCRS consist primarily of investments. During fiscal year 2006, the domestic and international equity portfolios realized positive returns, thus contributing to $1.88 billion in net investment income. Condensed financial information comparing the TCRS' plan net assets for the past three fiscal years is presented below.

PLAN NET ASSETS

	June 30, 2006	June 30, 2005	FY06 - FY05 Percentage Change	June 30, 2004	FY05 - FY04 Percentage Change
ASSETS					
Cash and cash equivalents	$ 826,611,111	$ 804,694,718	2.7 %	$ 1,287,694,472	(37.5) %
Member and employer receivables	71,671,617	59,611,297	20.2 %	52,655,042	13.2 %
Investment income receivables	172,541,678	168,791,063	2.2 %	136,353,991	23.8 %
Investments sold	33,287,736	28,751,524	15.8 %	84,576,463	(66.0) %
Foreign currency receivable	19,732,929	177,749,703	(88.9) %	46,030,024	286.2 %
Short-term securities	503,846,988	231,988,352	117.2 %	564,645,773	(58.9) %
Long-term investments	27,255,904,731	25,968,351,692	5.0 %	23,486,279,358	10.6 %
TOTAL ASSETS	28,883,596,790	27,439,938,349	5.3 %	25,658,235,123	6.9 %
LIABILITIES					
Death benefits, refunds and other payables	2,319,549	6,721,778	(65.5) %	2,350,420	186.0 %
Investments purchased	38,344,946	41,541,888	(7.7) %	20,722,128	100.5 %
Other investment payables	2,563,959	2,295,936	11.7 %	2,127,641	7.9 %
Foreign currency payable	19,732,929	173,116,862	(88.6) %	46,518,682	272.1 %
TOTAL LIABILITIES	62,961,383	223,676,464	(71.9) %	71,718,871	211.9 %
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 28,820,635,407	$ 27,216,261,885	5.9 %	$ 25,586,516,252	6.4 %

ANALYSIS OF REVENUES AND EXPENSES

The increase in contributions for fiscal year 2006 of $47 million (5.6 percent) is attributable to increased salaries. Employer contribution rates did change effective for fiscal year 2005 resulting in a $228 million (37.1 percent) increase over fiscal year 2004. As mentioned in the Analysis of Assets, Liabilities and Plan Net Assets section above, the continued market progress contributed to positive net investment income. Net investment income for the year ended June 30, 2006 totaled $1,877,298,490, an increase of $26.9 million versus fiscal year 2005. Net investment income for the year ended June 30, 2005 totaled $1,850,367,215, a decrease of $331 million versus fiscal year 2004. The TCRS portfolio earned 6.94 percent during fiscal year 2006 and 7.26 percent during fiscal year 2005.

Total benefits and refunds paid during the year ended June 30, 2006 were $1,158,901,860 an increase of 9.4 percent over fiscal year 2005 total benefits and refunds paid. Total refunds and benefits paid during the year ended June 30, 2005 of $1,059,732,300 increased 7.7 percent over fiscal year 2004 total benefits and refunds paid. The increase in benefit expenses can be attributed to 3.0 percent and 1.9 percent cost of living adjustments awarded to retirees on July 1, 2005 and July 1, 2004, respectively. In addition, more retirees were added to payroll than removed during these fiscal years.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2006 & JUNE 30, 2005 (CONTINUED)

In addition, administrative expenses for the year ended June 30, 2006 were $6,213,597, an increase of 8.1 percent over fiscal year 2005 administrative expenses. This increase was primarily due to the additional expense of the biennial actuarial study performed in fiscal year 2006. Administrative expenses for fiscal year 2005 of $5,746,030 increased 3.8 percent over administrative expenses for fiscal year 2004.

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

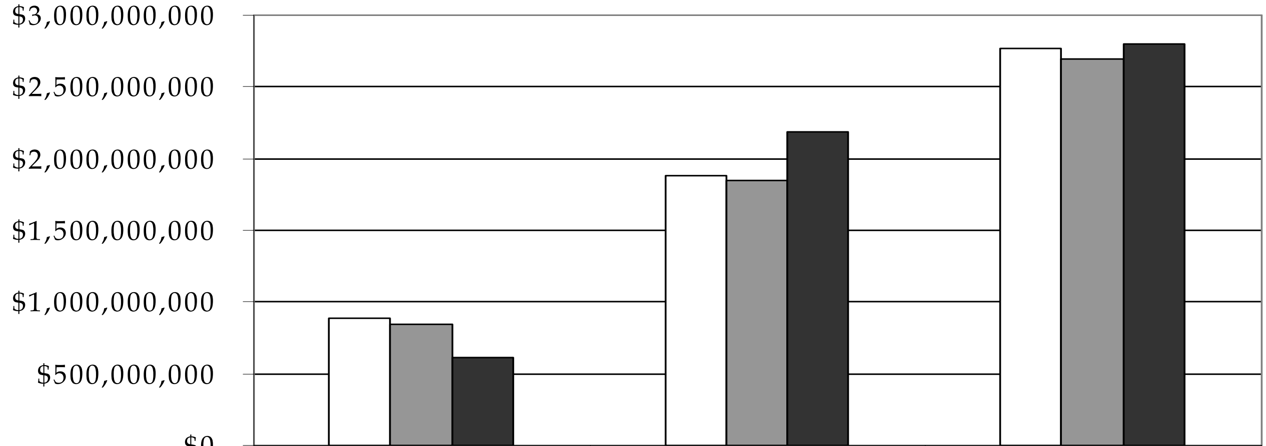
CHANGES IN PLAN NET ASSETS

	For the Year Ended June 30, 2006	For the Year Ended June 30, 2005	FY06 - FY05 Percentage Change	For the Year Ended June 30, 2004	FY05 - FY04 Percentage Change
ADDITIONS					
Contributions	$ 892,190,489	$ 844,856,748	5.6 %	$ 616,089,783	37.1 %
Investment income					
Net appreciation in fair value of investments	893,530,576	938,346,880	(4.8) %	1,310,811,851	(28.4) %
Interest, dividends and other investment income	1,002,725,069	927,714,221	8.1 %	885,509,528	4.8 %
Less: Investment expense	(18,957,155)	(15,693,886)	20.8 %	(14,467,751)	8.5 %
Net investment income	1,877,298,490	1,850,367,215	1.5 %	2,181,853,628	(15.2) %
TOTAL ADDITIONS	2,769,488,979	2,695,223,963	2.8 %	2,797,943,411	(3.7) %
DEDUCTIONS					
Annuity benefits					
Retirement benefits	843,183,130	775,283,016	8.8 %	716,339,066	8.2 %
Survivor benefits	53,991,908	50,388,267	7.2 %	46,416,539	8.6 %
Disability benefits	25,808,859	24,626,014	4.8 %	23,590,867	4.4 %
Cost of living	195,538,793	173,707,939	12.6 %	163,627,253	6.2 %
Death benefits	5,668,204	4,911,365	15.4 %	4,477,589	9.7 %
Refunds	34,710,966	30,815,699	12.6 %	29,925,762	3.0 %
Administrative expenses	6,213,597	5,746,030	8.1 %	5,534,441	3.8 %
TOTAL DEDUCTIONS	1,165,115,457	1,065,478,330	9.4 %	989,911,517	7.6 %
NET INCREASE	1,604,373,522	1,629,745,633	(1.6) %	1,808,031,894	(9.9) %
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS					
BEGINNING OF YEAR	27,216,261,885	25,586,516,252	6.4 %	23,778,484,358	7.6 %
END OF YEAR	$ 28,820,635,407	$ 27,216,261,885	5.9 %	$ 25,586,516,252	6.4 %

(continued)

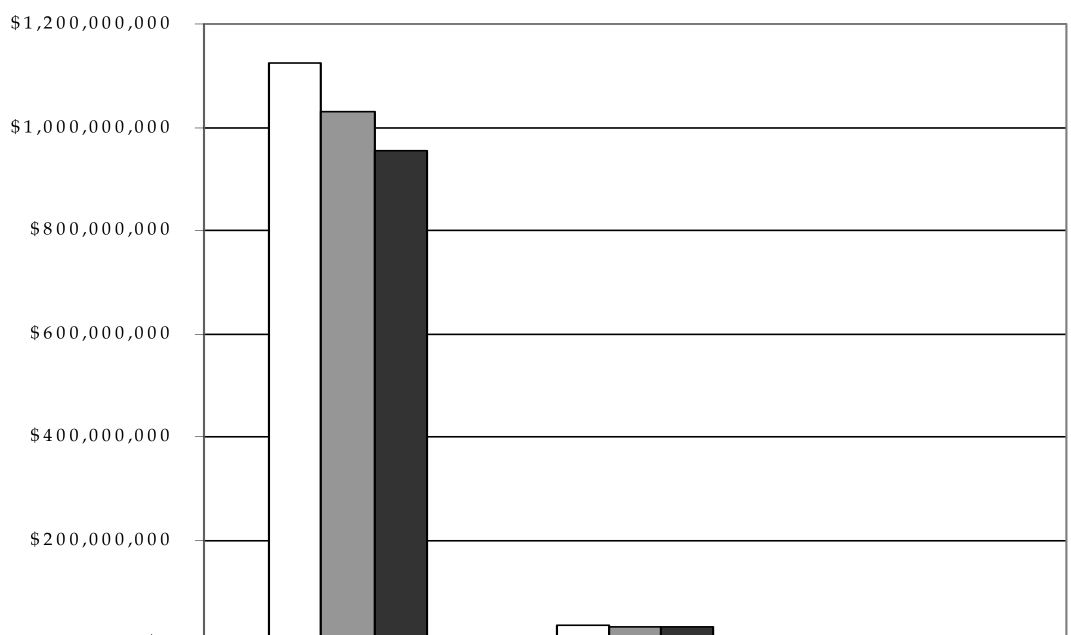
Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Years Ended June 30, 2006 & June 30, 2005 (continued)

REVENUES BY TYPE



	Contributions	Net Investment Income	Total Additions
Year Ended 6/30/06	$892,190,489	$1,877,298,490	$2,769,488,979
Year Ended 6/30/05	$844,856,748	$1,850,367,215	$2,695,223,963
Year Ended 6/30/04	$616,089,783	$2,181,853,628	$2,797,943,411

EXPENSES BY TYPE



	Benefit Payments	Refunds	Administrative
Year Ended 6/30/06	$1,124,190,894	$34,710,966	$6,213,597
Year Ended 6/30/05	$1,028,916,601	$30,815,699	$5,746,030
Year Ended 6/30/04	$954,451,314	$29,925,762	$5,534,441

(continued)

Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Years Ended June 30, 2006 & June 30, 2005 (continued)

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

For the year ended June 30, 2006, the domestic and international stock portfolios remained strong with 9.33% and 28.87% returns respectively. The S&P 1500 index, TCRS' domestic equity benchmark, reported a 9.23 % increase for the fiscal year ended June 30, 2006. This followed a domestic equity return during fiscal year 2005 for TCRS of 7.25%, which closely matched the 7.24% growth in the index. The international equity market, as represented by the EAFE index, grew 26.56% in fiscal year 2006 contrasting with a 14.13% growth in fiscal year 2005. The domestic bond market, as measured by the Citigroup Broad Investment Grade index, had a negative return of .80% for the year ended June 30, 2006. This represented a deterioration of domestic fixed income performance from the 6.8% return during fiscal year 2005. The real estate portfolio earned 24.59% for the year ended June 30, 2006 which is in excess of the NCREIF index benchmark of 20.19%.

Broad equity market strength was realized during 2005 and 2006, although several indices have not yet fully recovered from the weak period from 2000 to 2003. The strong stock market has offset an under-performing bond market.

The employer contribution rate increased July 1, 2004 for most of the employers participating in TCRS. Since the actuarial valuations are conducted every two years, the higher contribution levels continued for the fiscal year ended June 30, 2006. With the asset smoothing method utilized for valuation purposes that recognized only a portion of the underperformance of investment income, continued upward pressure on the employer rate was realized in the actuarial valuation performed effective July 1, 2005. With TCRS being such a strongly funded plan, investment returns falling short of the 7.5% earnings assumption will cause continued upward pressure on future employer contribution rates.

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, 10th Floor Andrew Jackson Building, Nashville, TN 37243-0230.

Tennessee Consolidated Retirement System
Comparative Statements of Plan Net Assets
As of June 30, 2006 and June 30, 2005

Expressed in Thousands	**State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)**	**Political Subdivisions Pension Plan (PSPP)**
ASSETS		
Cash and cash equivalents	$ 700,553	$ 126,058
Receivables		
Member receivable	18,553	4,800
Employer receivable	31,931	16,388
Accrued interest receivable	127,526	22,947
Accrued dividends receivable	17,536	3,156
Real estate income receivable	1,166	210
Foreign currency receivable	16,724	3,009
Investments sold	28,212	5,076
Total receivables	241,648	55,586
Investments, at fair value		
Short-term securities	427,010	76,837
Government securities	9,072,529	1,632,519
Corporate securities	2,652,679	477,326
Corporate stocks	10,580,082	1,903,790
Real estate	794,090	142,890
Total investments	23,526,390	4,233,362
TOTAL ASSETS	24,468,591	4,415,006
LIABILITIES		
Accounts payable		
Death benefits and refunds payable	1,646	589
Other	85	0
Investments purchased	32,498	5,848
Foreign currency payable	16,723	3,009
Other investment payables	2,173	391
TOTAL LIABILITIES	53,125	9,837
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (Schedules of funding progress for the plan are presented on page 35.)	$24,415,466	$4,405,169

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

June 30, 2006 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2005 Total
$ 826,611	$ 685,337	$ 119,358	$ 804,695
23,353	15,057	3,750	18,807
48,319	28,637	12,167	40,804
150,473	123,300	21,474	144,774
20,692	19,264	3,355	22,619
1,376	1,191	207	1,398
19,733	151,385	26,365	177,750
33,288	24,487	4,265	28,752
297,234	363,321	71,583	434,904
503,847	197,578	34,410	231,988
10,705,048	9,953,162	1,733,442	11,686,604
3,130,005	2,147,044	373,929	2,520,973
12,483,872	9,603,998	1,672,632	11,276,630
936,980	412,332	71,812	484,144
27,759,752	22,314,114	3,886,225	26,200,339
28,883,597	23,362,772	4,077,166	27,439,938
2,235	928	1,880	2,808
85	3,913	0	3,913
38,346	35,380	6,162	41,542
19,732	147,439	25,678	173,117
2,564	1,956	340	2,296
62,962	189,616	34,060	223,676
$ 28,820,635	$ 23,173,156	$ 4,043,106	$ 27,216,262

Tennessee Consolidated Retirement System
Comparative Statements of Changes in Plan Net Assets
For the Years Ended June 30, 2006 and June 30, 2005

Expressed in Thousands	**State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)**	**Political Subdivisions Pension Plan (PSPP)**
ADDITIONS		
Contributions		
Member contributions	$ 166,984	$ 59,327
Employer contributions	474,879	191,000
Total contributions	641,863	250,327
Investment income		
Net appreciation in fair value of investments	758,789	134,741
Interest	594,856	105,627
Dividends	223,813	39,742
Real estate income, net of operating expenses	32,854	5,833
Total investment income	1,610,312	285,943
Less: Investment expense	(16,098)	(2,859)
Net investment income	1,594,214	283,084
TOTAL ADDITIONS	2,236,077	533,411
DEDUCTIONS		
Annuity benefits		
Retirement benefits	726,109	117,074
Survivor benefits	46,495	7,497
Disability benefits	22,225	3,584
Cost of living	173,624	21,915
Death benefits	4,227	1,441
Refunds	17,751	16,960
Administrative expense	3,336	2,877
TOTAL DEDUCTIONS	993,767	171,348
NET INCREASE	1,242,310	362,063
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
BEGINNING OF YEAR	23,173,156	4,043,106
END OF YEAR	$ 24,415,466	$ 4,405,169

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

For the Year Ended June 30, 2006 TOTAL	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	For the Year Ended June 30, 2005 TOTAL
$ 226,311	$ 160,686	$ 54,921	$ 215,607
665,879	448,154	181,096	629,250
892,190	608,840	236,017	844,857
893,530	800,850	137,497	938,347
700,483	547,898	94,067	641,965
263,555	217,309	37,309	254,618
38,687	26,569	4,562	31,131
1,896,255	1,592,626	273,435	1,866,061
(18,957)	(13,394)	(2,300)	(15,694)
1,877,298	1,579,232	271,135	1,850,367
2,769,488	2,188,072	507,152	2,695,224
843,183	668,340	106,943	775,283
53,992	43,437	6,951	50,388
25,809	21,229	3,397	24,626
195,539	154,522	19,186	173,708
5,668	3,731	1,180	4,911
34,711	15,329	15,487	30,816
6,213	3,008	2,738	5,746
1,165,115	909,596	155,882	1,065,478
1,604,373	1,278,476	351,270	1,629,746
27,216,262	21,894,680	3,691,836	25,586,516
$ 28,820,635	$ 23,173,156	$ 4,043,106	$ 27,216,262

Tennessee Consolidated Retirement System
Notes to the Financial Statements
June 30, 2006 and June 30, 2005

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 by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. 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. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis. Real estate transactions are recorded in the financial statements at the time of closing.

5. **Adoption of New Accounting Pronouncement** – During the year ended June 30, 2005, the TCRS adopted the provisions of Statement No. 40 of the Governmental Accounting Standards Board *Deposit and Investment Risk Disclosures – an amendment of GASB Statement No. 3.* The adoption of this statement requires the TCRS to provide certain additional disclosures, as well as modify other disclosures relating to investment and deposit risks, including credit risk, custodial credit risk, concentrations of credit risk, interest rate risk and foreign currency risk.

(continued)

B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

At July 1, 2005, the date of the latest actuarial valuation, the membership of each plan consisted of the following:

	SETHEEPP	PSPP
Retirees and beneficiaries currently receiving benefits	64,537	25,235
Terminated members entitled to but not receiving benefits	19,468	7,129
Current active members	130,998	73,737
Total	215,003	106,101
Number of participating employers	140	444

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; (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.

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

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve. At June 30, 2006, the plan's Member Reserve and Employer Reserve were fully funded with balances of $3,274.9 million and $21,140.6 million, respectively. At June 30, 2005, the plan's Member Reserve and Employer Reserve were fully funded with balances of 3,167.8 million and $20,005.3 million, respectively.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006 AND JUNE 30, 2005 (CONTINUED)

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 assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve. At June 30, 2006, the plan's Member Reserve and Employer Reserve were fully funded with balances of $848.9 million and $3,556.3 million, respectively. At June 30, 2005, the plan's Member Reserve and Employer Reserve were fully funded with balances of $795.4 million and $3,247.7 million, 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. Prior to the adoption of the current investment policy on December 14, 2004, allowable investments also included obligations of the State of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The State Pooled

(continued)

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 fifteen percent (15 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 five percent (5 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 stock 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 exceed five percent (5 percent) of the market value of total assets.

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

As of June 30, 2006 and June 30, 2005, the TCRS had the following investments:

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2006 AND JUNE 30, 2005 (CONTINUED)

Investments

(Expressed in Thousands)

Investment Type	Fair Value as of 6/30/2006	U.S. Treasury/ Agency (1)	Credit Quality Ratings AAA	AA	A	BBB	BB	(2) A1	(3) Not Rated
Debt Investments									
U.S. Govt. Treas., Notes, Bonds	$ 2,178,187	$ 2,178,187							
U.S. Govt. TIPS	2,206,484	2,206,484							
U.S. Govt. Agencies	1,949,366		$ 1,949,366						
Mortg.-Backed Govt. Pass-Thru	3,554,902	376,348							$ 3,178,554
Mortg.-Backed Corp. Pass-Thru	291,774		291,774						
Govt. CMO's	24,922		24,922						
Corporate CMO's	78,291		78,291						
Corporate Bonds	1,869,589		47,475	$ 244,534	$ 851,741	$ 712,725	$ 13,114		
Corporate Asset-Backed	103,095		59,040			44,055			
Corporate Private Placements	209,510		14,608	74,267	24,182	96,453			
Yankee Bonds	61,113				8,968	52,145			
Supranationals	154,220		154,220						
Non-U.S. Govt./Sovereign	791,186		406,126	75,682	309,378				
Non-U.S. Corporate	362,414		282,100	9,566	31,579	39,169			
Short-Term Commercial Paper	645,358							$ 645,358	
Short-Term Agencies	674,053								674,053
Total Debt Investments	$ 15,154,464	$ 4,761,019	$ 3,307,922	$ 404,049	$ 1,225,848	$ 944,547	$ 13,114	$ 645,358	$ 3,852,607
Other Investments									
U.S. Equity	$ 8,266,427								
Non-U.S. Equity	4,217,445								
Real Estate	936,980								
Money Market Funds	42								
Total Other Investments	$ 13,420,894								
Total Investments	$ 28,575,358								
Less: Short-Term Investments Classified as Cash Equivalents on the Statements of Plan Net Assets	(815,606)								
Total Investments as Shown on Statements of Plan Net Assets	$ 27,759,752								

(1) Includes obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government and are not considered to have credit risk.

(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 & Poor's or Moody's.

Investment Type	Fair Value as of 6/30/2005	U.S. Treasury/ Agency (1)	Credit Quality Ratings AAA	AA	A	BBB	BB	(2) A1	(3) Not Rated
Debt Investments									
U.S. Govt. Treas., Notes, Bonds	$ 4,299,553	$ 4,299,553							
U.S. Govt. TIPS	1,539,429	1,539,429							
U.S. Govt. Agencies	1,712,743		$ 1,712,743						
Mortg.-Backed Govt. Pass-Thru	3,589,366	409,117							$ 3,180,249
Corporate Bonds	1,933,308		80,495	$ 267,782	$ 1,066,627	$ 518,404			
Corporate Asset-Backed	16,685					16,685			
Corporate Private Placements	150,081		9,996	69,988	27,705	42,392			
Yankee Bonds	39,780				9,641	30,139			
Supranationals	107,804		95,713	12,091					
Non-U.S. Govt./Sovereign	533,423		354,114	74,956	104,353				
Non-U.S. Corporate	285,405		172,592	9,941	51,310	51,562			
Short-Term Commercial Paper	493,731							$ 493,731	
Short-Term Agencies	543,891								543,891
Total Debt Investments	$ 15,245,199	$ 6,248,099	$ 2,425,653	$ 434,758	$ 1,259,636	$ 659,182	$0	$ 493,731	$ 3,724,140
Other Investments									
U.S. Equity	$ 7,588,283								
Non-U.S. Equity	3,688,347								
Real Estate	484,144								
Money Market Funds	27								
Total Other Investments	$ 11,760,801								
Total Investments	$ 27,006,000								
Less: Short-Term Investments Classified as Cash Equivalents on the Statements of Plan Net Assets	(805,661)								
Total Investments as Shown on Statements of Plan Net Assets	$ 26,200,339								

(1) Includes obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government and are not considered to have credit risk.

(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 & Poor's or Moody's.

(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, 2006 and June 30, 2005 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 *Tennessee Comprehensive Annual Financial Report*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298.

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 assets in organizations representing five percent or more of plan net assets, 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, 2006		June 30, 2005	
Issuer Organization	**Fair Value**	**Percentage**	**Fair Value**	**Percentage**
Federal Home Loan Mortgage Corp.	$2,279,598,268	7.91%	$1,988,470,907	7.31%
Federal National Mortgage Assoc.	2,899,810,512	10.06%	2,629,912,338	9.66%

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.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM NOTES TO THE FINANCIAL STATEMENTS JUNE 30, 2006 AND JUNE 30, 2005 (CONTINUED)

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 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 TCRS had the following investments and effective duration at June 30, 2006 and June 30, 2005.

Debt Investments

(Expressed in Thousands)

Investment Type	Fair Value As of June 30, 2006	Effective Duration (years)
Debt Investments		
U.S. Government Treasuries, Notes, Bonds	$ 2,178,187	7.96
U.S. Government TIPS	2,206,484	8.14
U.S. Government Agencies	1,949,366	2.32
Mortgage-Backed Government Pass-through	3,554,902	4.15
Mortgage-Backed Corporate Pass-through	291,774	7.03
Government CMO's	24,922	3.44
Corporate CMO's	78,291	0.95
Corporate Bonds	1,869,589	5.53
Corporate Asset-Backed	103,095	4.02
Private Placements	209,510	5.45
Yankee Bonds	61,113	8.04
Supranationals	154,220	2.69
Non-U.S. Government/Sovereign	791,186	7.18
Non-U.S. Corporate	362,414	4.63
Short-Term Commercial Paper	645,358	0.03
Short-Term Agencies	674,053	0.45
Total Debt Investments	$ 15,154,464	5.10

Investment Type	Fair Value As of June 30, 2005	Effective Duration (years)
Debt Investments		
U.S. Government Treasuries, Notes, Bonds	$ 4,299,553	3.87
U.S. Government TIPS	1,539,429	4.00
U.S. Government Agencies	1,712,743	2.63
Mortgage-Backed Government Pass-through	3,589,366	2.84
Corporate Bonds	1,933,308	5.63
Corporate Asset-Backed	16,685	2.16
Private Placements	150,081	3.45
Yankee Bonds	39,780	8.03
Supranationals	107,804	3.43
Non-U.S. Government/Sovereign	533,423	6.95
Non-U.S. Corporate	285,405	6.29
Short-Term Commercial Paper	493,731	0.03
Short-Term Agencies	543,891	0.17
Total Debt Investments	$ 15,245,199	3.63

(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, 2006 and June 30, 2005 was as follows:

Foreign Currency-Denominated Investments

(Expressed in Thousands)

Currency	Total Fair Value June 30, 2006	Fixed Income	Equity	Cash
Australian Dollar	$ 205,373	$ 19,017	$ 186,007	$ 349
British Pound Sterling	1,043,531	77,253	956,063	10,215
Canadian Dollar	20,916		20,916	
Danish Krone	58,116		58,116	
Euro Currency	1,579,366	309,856	1,269,504	6
Hong Kong Dollar	137,048		137,048	
Japanese Yen	1,652,118	636,366	1,013,653	2,099
New Zealand Dollar	8,714		8,714	
Norwegian Krone	28,692		28,692	
Singapore Dollar	41,624		41,509	115
Swedish Krona	150,111		150,111	
Swiss Franc	238,851		238,851	
Total	$ 5,164,460	$ 1,042,492	$ 4,109,184	$ 12,784

Currency	Total Fair Value June 30, 2005	Fixed Income	Equity	Cash
Australian Dollar	$ 209,165	$ 12,039	$ 197,008	$ 118
British Pound Sterling	990,301	78,452	911,846	3
Canadian Dollar	5,690		5,690	
Danish Krone	73,101		73,101	
Euro Currency	1,436,934	263,623	1,173,275	36
Hong Kong Dollar	88,767		87,638	1,129
Japanese Yen	1,240,158	447,300	792,359	499
New Zealand Dollar	5,552		5,552	
Norwegian Krone	29,000		29,000	
Singapore Dollar	34,482		34,378	104
Swedish Krona	121,748		121,748	
Swiss Franc	209,949		209,949	
Total	$ 4,444,847	$ 801,414	$ 3,641,544	$ 1,889

Derivatives - 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. The fair value of foreign currency forward contracts outstanding as of June 30, 2006 and June 30, 2005 has been reflected in the financial statements.

(continued)

Tennessee Consolidated Retirement System
Notes to the Financial Statements
June 30, 2006 and June 30, 2005 (continued)

Asset-Backed Securities – The TCRS 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 TCRS invests in these securities primarily to enhance returns by taking advantage of opportunities available in this sector of the securities markets. The fair value of CMOs at June 30, 2006 was $103,212,549. There were no CMOs securities held at June 30, 2005.

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 7.5 basis points on the $250 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, and 12 basis points during times when either Moody's or Standard and Poor's has assigned ratings other than Aaa and AAA 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, 2006, the TCRS had unfunded commitments of $131,460,280 for pending real estate purchases. There were no pending real estate purchases at June 30, 2005.

Tennessee Consolidated Retirement System
Required Supplementary Information
Schedules of Funding Progress

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	07/01/05	$ 23,627,161	$ 23,666,967	$ 39,806	99.83%	$5,245,989	0.76%
	07/01/03	22,099,252	22,151,745	52,493	99.76%	4,773,297	1.10%
	07/01/01	20,760,989	20,842,216	81,227	99.61%	4,451,452	1.82%
PSPP	07/01/05	4,124,013	4,450,127	326,114	92.67%	1,890,968	17.25%
	07/01/03	3,605,529	3,923,475	317,946	91.90%	1,731,135	18.37%
	07/01/01	3,187,990	3,528,137	340,147	90.36%	1,545,593	22.01%

The SETHEEPP is comprised of a number of employee groups. However, the unfunded liability of $39.8 million at July 1, 2005 is attributable to one employee group: State Judges and Attorneys General employed prior to July 1, 1972. The PSPP represents 444 participating entities at July 1, 2005. The unfunded liability of $326.1 million is attributable to 369 of the 444 entities.

See accompanying Notes to Required Supplementary Information

Tennessee Consolidated Retirement System
Required Supplementary Information
Schedules of Employer Contributions

SCHEDULES OF EMPLOYER CONTRIBUTIONS
Expressed in Thousands

	SETHEEPP		PSPP	
Year Ended June 30	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
2006	$474,879	100%	$191,000	100%
2005	448,154	100%	181,096	100%
2004	271,298	100%	139,808	100%
2003	264,320	100%	134,014	100%
2002	243,498	100%	103,374	100%
2001	232,149	100%	103,681	100%

An actuarial valuation of the TCRS is performed every two years with the next valuation scheduled to be effective July 1, 2007.

See accompanying Notes to Required Supplementary Information

Tennessee Consolidated Retirement System
Notes to Required Supplementary Information
As of June 30, 2006 and June 30, 2005

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the July 1, 2005 actuarial valuation follows.

	SETHEEPP	**PSPP**
Valuation Date	July 1, 2005	July 1, 2005
Actuarial cost method	Frozen Entry Age	Frozen Entry Age
Amortization method	Level Dollar	Level Dollar
Remaining amortization period	10 years closed period	(1) closed period
Asset valuation method	5-year Moving Market Average	5-year Moving Market Average
Actuarial assumptions:		
Investment rate of return	7.50%	7.50%
Projected salary increases	4.75% (3)	4.75% (3)
Includes inflation at	(2)	(2)
Cost-of-living adjustments	3.00%	3.00%
Increase in Social Security wage base	3.50%	3.50%

(1) The length of the amortization period varies by political subdivision, not to exceed 30 years.

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

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

Tennessee Consolidated Retirement System
Actuarial Balance Sheet

ACTUARIAL BALANCE SHEET
as of July 1, 2005

	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEPP)	Political Subdivision Pension Plan (PSPP)	Total
ASSETS			
Present assets creditable to			
Employer accumulation fund	$ 20,459,800,667	$ 3,326,998,155	$ 23,786,798,822
Members' accumulation fund	3,167,360,134	797,014,927	3,964,375,061
Total present assets	23,627,160,801	4,124,013,082	27,751,173,883
Present value of prospective contributions payable to			
Employer accumulation fund			
Normal	4,165,622,264	1,468,074,118	5,633,696,382
Accrued liability	39,806,610	326,114,462	365,921,072
Total employer accumulation	4,205,428,874	1,794,188,580	5,999,617,454
Members' accumulation fund	1,428,090,406	472,497,795	1,900,588,201
Total prospective contributions	5,633,519,280	2,266,686,375	7,900,205,655
TOTAL ASSETS	$ 29,260,680,081	$ 6,390,699,457	$ 35,651,379,538
LIABILITIES			
Present value of prospective benefits payable on account of			
Present retired members and beneficiaries	$ 10,599,479,029	$ 1,563,938,839	$ 12,163,417,868
Present active members	18,145,343,942	4,680,372,225	22,825,716,167
Former members	515,857,110	146,388,393	662,245,503
TOTAL LIABILITIES	$ 29,260,680,081	$ 6,390,699,457	$ 35,651,379,538

UNAUDITED

This report is available in its entirety on the Internet at:
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