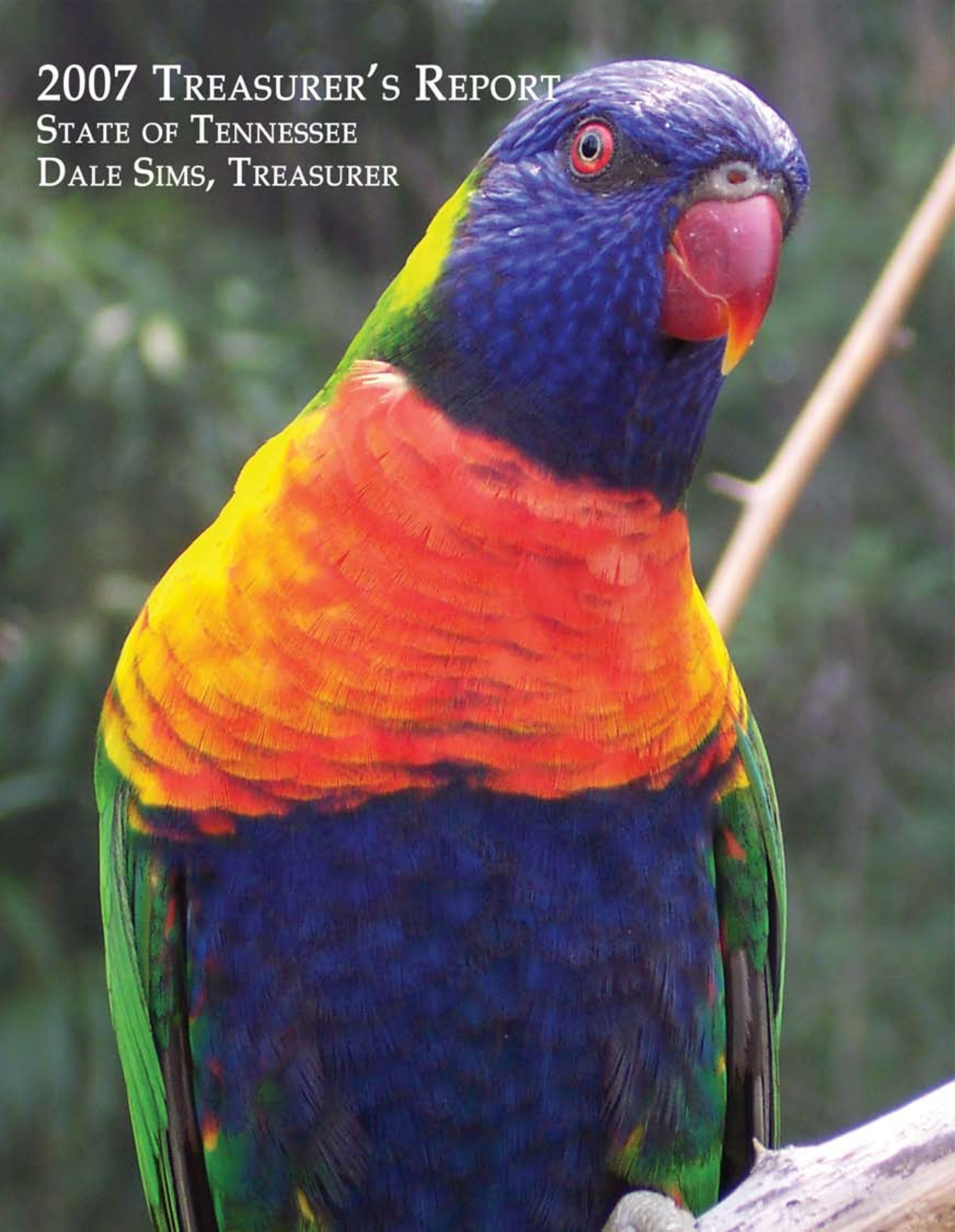
2007 Treasurer's Report
State of Tennessee
Dale Sims, Treasurer



2007 Treasurer's Report

Featuring Photos From

Chattanooga Zoo
Knoxville Zoo
Nashville Zoo
Memphis Zoo

Dale Sims, Treasurer
State of Tennessee

Fiscal Year Ended June 30, 2007

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The cover features a Lorakeet at the Nashville Zoo.

The photograph was taken by
Amycity Nichols, Treasury Department.

This report is available in its entirety on the Internet at:
www.treasury.state.tn.us/ann-report.htm.

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LETTER OF TRANSMITTAL

State of Tennessee
Treasury Department
State Capitol
Nashville, Tennessee 37243

December 31, 2007

The Honorable Phil Bredesen, Governor
The Honorable Ron Ramsey, 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, 2007.

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 2007 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 2007 fiscal year.

Baccalaureate Education System Trust (BEST)

The Baccalaureate Education System Trust, BEST, is a Section 529 qualified tuition 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 weighted average tuition inflation increases at Tennessee's four-year 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 offers three investment options: the Managed Allocation Option, the 100% Equity Option, and the guaranteed option. At June 30, 2007, the Prepaid College Tuition Plan held 8,826 contracts and $95.6 million in assets and the Savings Plan held 4,974 contracts and $43.8 million in 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 250 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 $252 million fair value of net assets at June 30, 2007, and investment income was $33.2 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 4,856 claims for tort, employee property damage and workers' compensation. Payments made during the year for workers' compensation, tort, and employee property damage claims totaled $25.9 million. The division received 2,623 criminal injury and drunk driver claims. Payments made to victims of criminal injuries and drunk drivers totaled $12.7 million. Since the first payments were issued in 1982, more than $176 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, 2007, the commission had 653 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 $40 per month. As of June 30, 2007, a total of 75,981 state and higher education employee accounts were held in the program. The market value of accumulated account balances totaled $1.2 billion.

Flexible Benefits Plan

The State of Tennessee Flexible Benefits Plan is an optional benefit plan which enables state employees to pay for certain expenses with before-tax dollars. At June 30, 2007, 43,679 state employees were using the plan: 42,519 paid group medical premiums, 24,951 paid group dental premiums, 4,824 used the medical expense reimbursement account and 432 used the dependent care reimbursement account. The plan generated over $6.4 million in F.I.C.A. savings for the state during the 2007 fiscal year. Employees realized similar savings. The State's F.I.C.A. savings are used to fund several state benefit programs 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 2007, investments averaged $6.7 billion, producing $351.9 million in income for an average rate of return of 5.30%. 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, 2007, totaled $32.4 billion at fair market value. For the year, investment income was $3.8 billion, for a rate of return of 13.15% 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, 2007, had market values of $252 million and $95.6 million, respectively.

Risk Management

The Division of Risk Management is responsible for identifying the state's exposure to property and casualty risks, and determining the appropriate risk control methods to protect the state against monetary loss due to unforeseen events. The division administers the state's Property/Casualty Insurance Program, including the procurement of all-risk, replacement cost property insurance for all state-

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 fidelity and crime coverage, to protect against employee dishonesty. The State procures its insurance with the aid of a qualified property/casualty insurance broker. This process expands the insurance marketplace, providing a more competitive atmosphere, which tends to produce better coverage at a reduced premium cost. Loss prevention and control services are also provided for workers' compensation and tort liability. As of July 1, 2007, the State's total insured property values were $13.7 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 every covered loss that exceeds the annual aggregate deductible, after the per occurrence, or working deductible, has been assumed by the agency that suffered the loss.

Small and Minority-Owned Business Assistance Program

The Small and Minority-Owned Business Assistance Program is responsible for supporting outreach to new, expanding and existing businesses unable to derive benefit from conventional means of monetary resources and insight provided by traditional lenders and financial advisors. The Program consists of two components: Loans and Program Services. The loans provided must be for a specific project, however, acceptable purposes for loan proceeds can include acquisition of machinery and equipment; working capital; supplies and materials; inventory and certain other business-related activity. Program Services include technical assistance, education and consulting services to facilitate support in the areas of strategy, planning and financial management. These Program components are deemed essential resources that will enable and enhance growth of the State's small business segment. The principal 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, 2007, there were 211,287 active TCRS members: 47,946 state employees; 70,145 K-12 teachers; 76,003 political subdivision employees; and 17,193 higher education employees. As of June 30, 2007, there were 98,100 retirees. TCRS paid $1.23 billion in benefits during fiscal year 2007. 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, $51 million of unclaimed property was collected, which consisted of $45 million that was remitted to Treasury and $6 million in the sale of securities. In addition, $17.5 million was returned to owners or their heirs, local governments and other states. Since the program's inception in 1979, more than $471.8 million in unclaimed property has been reported to the Treasury and more that $153.2 million of that property has been returned to claimants.

Treasury Numbers at a Glance
Fiscal Year 2007

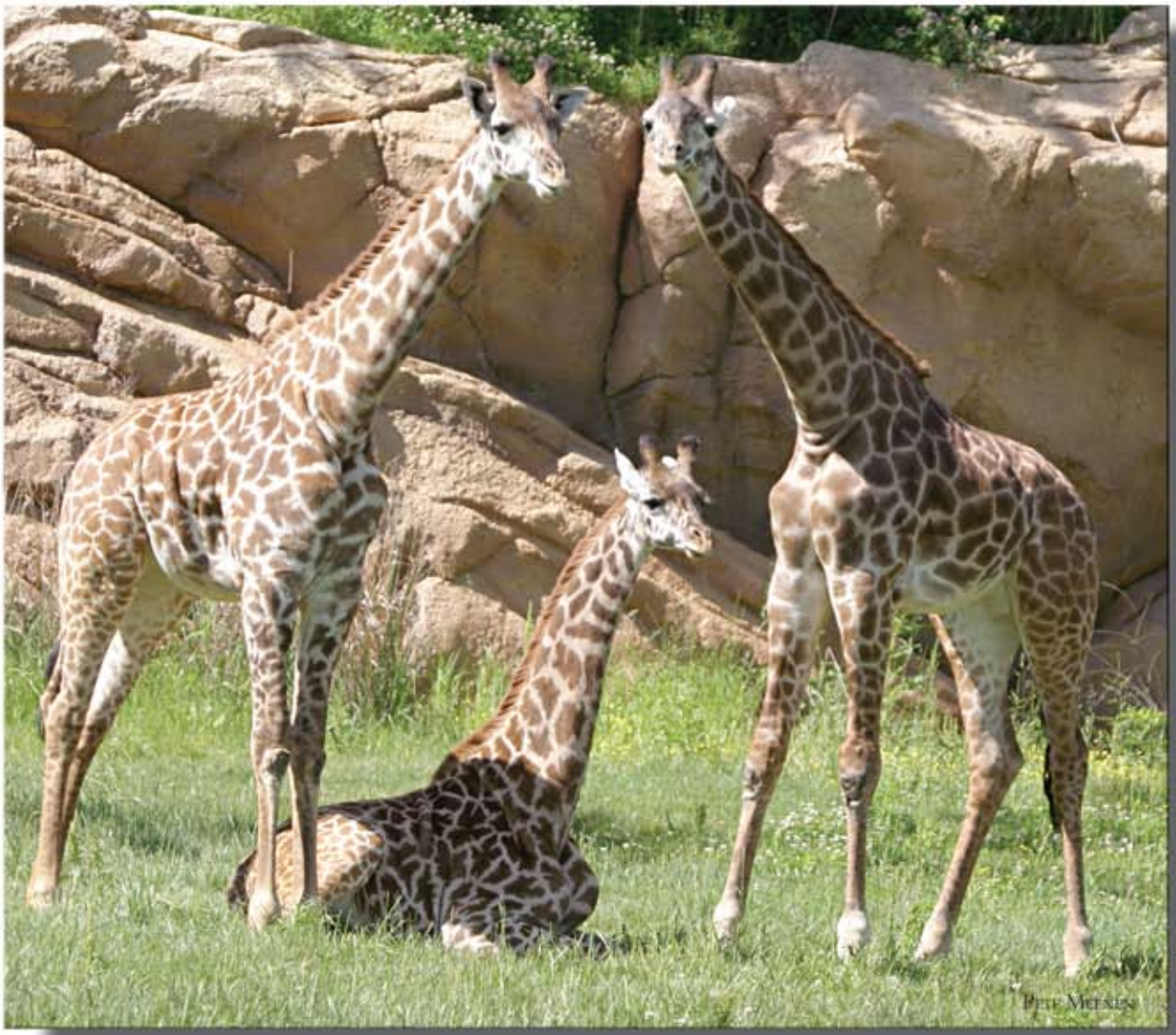
Administrative	Number of Filled Positions		197
	Payroll Expenditures	$	13,397,912
	Other Expenditures	$	4,816,936
	Total Administrative Expenditures	$	18,214,848
Cash Management Program	General Fund Earnings	$	116,190,715
	LGIP Earnings	$	133,035,063
	Restricted Fund Earnings	$	102,677,403
	Total Cash Management Earnings	$	351,903,181
Retirement Program	Retirement Benefits	$	1,230,431,596
	Number of Retirees		98,100
	Number of Active Members		211,287
	Retirement Contributions	$	1,027,174,038
	Retirement Net Investment Income	$	3,791,403,651
Claims Administration Program	Workers' Compensation Payments	$	19,526,292
	Workers' Compensation Claims Filed		3,579
	Employee Property Damage Payments	$	18,867
	Employee Property Damage Claims Filed		115
	Tort Payments	$	6,452,376
	Tort Claims Filed		1,162
	Criminal Injury Payments	$	12,738,450
	Criminal Injury Claims Filed		2,623
Risk Management Program	Estimated Gross Property Losses Incurred	$	8,686,000
	Total Property Values Insured	$	13,668,184,600
Chairs of Excellence Program	Chairs of Excellence Investment Income	$	33,163,435
	Chairs of Excellence Expenditures	$	6,875,842
	Number of Chairs of Excellence		99
Other Programs	Deferred Compensation Contributions	$	123,758,047
	Deferred Compensation Accounts		75,981
	Flexible Benefits Plan Payments	$	7,338,354
	Unclaimed Property Revenues	$	51,037,962
	Unclaimed Property Payments	$	17,459,932
	BEST Prepaid Accounts		8,826
	BEST Prepaid Contributions (net of fees)	$	5,578,640
	BEST Savings Plan Contributions	$	7,911,000
Fair Value of Assets Under Management at June 30, 2007	Retirement Trust Fund	$	32,365,968,970
	Chairs of Excellence Trust Fund	$	252,447,384
	State Pooled Investment Fund	$	7,855,671,217
	Deferred Compensation (outside managers)	$	1,171,993,550
	BEST Educational Services Plan	$	95,551,658
	BEST Educational Savings Plan (outside manager)	$	43,828,273
	Total Assets Under Management	$	41,785,461,052

Employee Benefits

Deana Underhill

Amycity Nichols

Jim Bartoo


Pete Meesen

Pete Meesen

Pete Meesen

Pete Meesen

Nashville Zoo

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

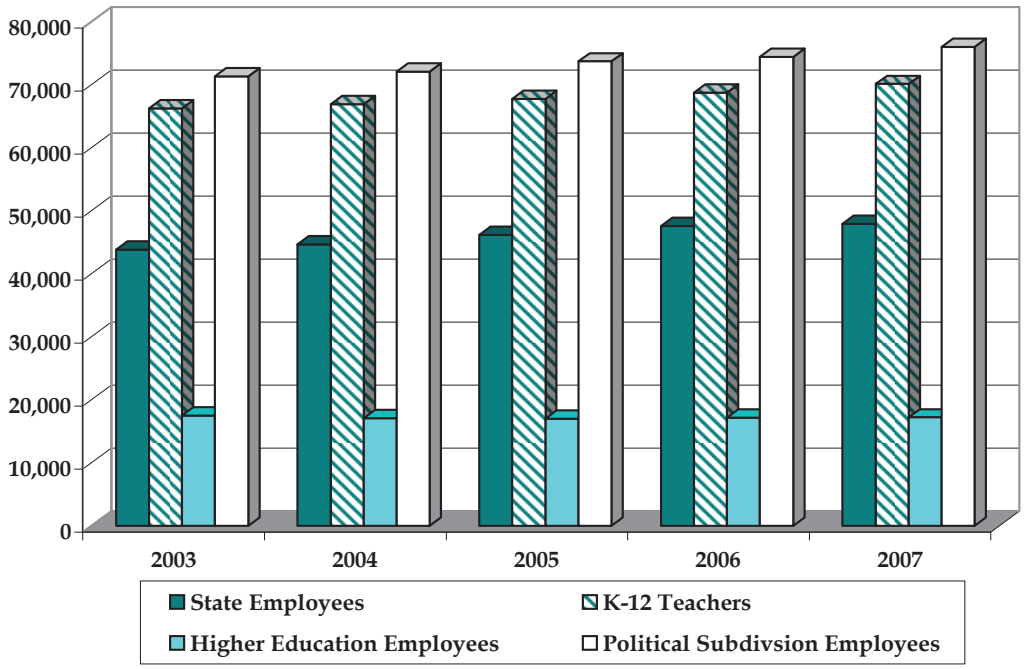
Membership in the retirement system is a condition of employment for full-time state employees, teachers, general employees in higher education, and the employees of local governments that participate in TCRS. Membership is optional for certain part-time employees. Faculty employees in higher education 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, 2007, there were 211,287 active members of TCRS and 11,600 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 2003-2007



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.

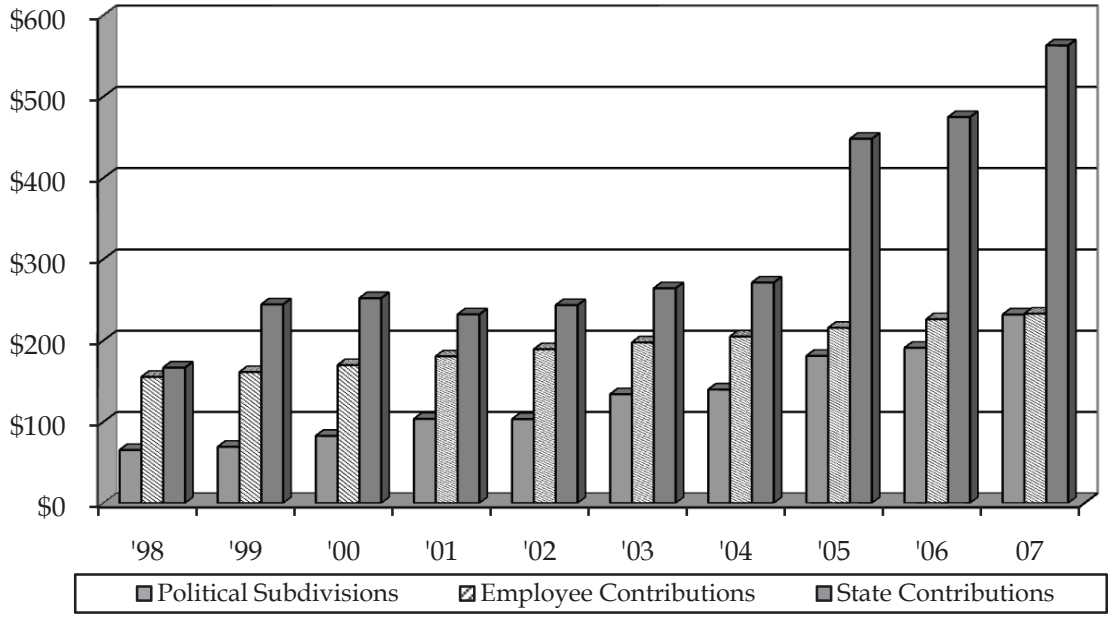
Upon termination of employment, a member may elect to withdraw his contributions and accumulated interest from the retirement system in a lump sum. By obtaining a lump sum refund, a member waives all rights and benefits in the retirement system. A vested member may leave his account balance in TCRS and 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 2007 fiscal year, 4,830 refunds totaling $36.3 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, 2007 were as follows:

Noncontributory State and Higher Education Employees	13.62%
K-12 Teachers	6.13%
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 1998-2007
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, 2007, 98,100 retirees were receiving monthly benefit payments. This represents a 5% 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.

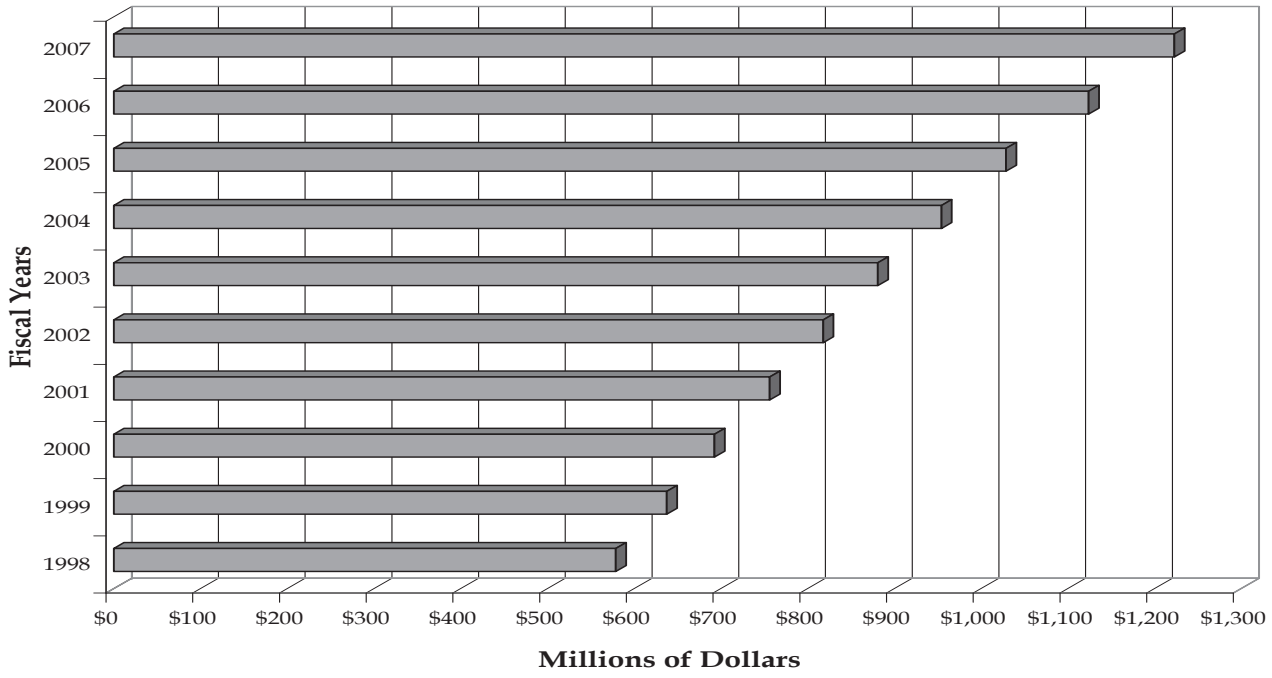
Disability benefits are available to active members with five years of service who become disabled and can not engage in gainful employment. There is no service requirement for disability benefits paid to active members whose disability is a result of an accident or injury occurring while the member 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 2007 totaled $1.23 billion, an increase of $106 million over 2006 benefit payments.

ANNUAL BENEFIT PAYMENTS
Fiscal Years 1998-2007
Expressed in Millions



TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

TENNESSEE'S RETIREMENT PROGRAM, TCRS AND SOCIAL SECURITY BENEFITS
for Calendar Year 2007

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	9,156		9,156		9,156		9,156		9,156	
	Total	$ 12,700	84.7%	$ 13,881	92.5%	$ 15,062	100.4%	$ 16,244	108.3%	$ 17,425	116.2%
$20,000	TCRS	$ 4,725		$ 6,300		$ 7,875		$ 9,450		$ 11,025	
	Social Security	10,728		10,728		10,728		10,728		10,728	
	Total	$ 15,453	77.3%	$ 17,028	85.1%	$ 18,603	93.0%	$ 20,178	100.9%	$ 21,753	108.8%
$25,000	TCRS	$ 5,906		$ 7,875		$ 9,844		$ 11,813		$ 13,781	
	Social Security	12,300		12,300		12,300		12,300		12,300	
	Total	$ 18,206	72.8%	$ 20,175	80.7%	$ 22,144	88.6%	$ 24,113	96.5%	$ 26,081	104.3%
$30,000	TCRS	$ 7,088		$ 9,450		$ 11,813		$ 14,175		$ 16,538	
	Social Security	13,872		13,872		13,872		13,872		13,872	
	Total	$ 20,960	69.9%	$ 23,322	77.7%	$ 25,685	85.6%	$ 28,047	93.5%	$ 30,410	101.4%
$35,000	TCRS	$ 8,269		$ 11,025		$ 13,781		$ 16,538		$ 19,294	
	Social Security	15,444		15,444		15,444		15,444		15,444	
	Total	$ 23,713	67.8%	$ 26,469	75.6%	$ 29,225	83.5%	$ 31,982	91.4%	$ 34,738	99.3%
$40,000	TCRS	$ 9,450		$ 12,600		$ 15,750		$ 18,900		$ 22,050	
	Social Security	17,016		17,016		17,016		17,016		17,016	
	Total	$ 26,466	66.2%	$ 29,616	74.0%	$ 32,766	81.9%	$ 35,916	89.8%	$ 39,066	97.7%
$45,000	TCRS	$ 10,631		$ 14,175		$ 17,719		$ 21,263		$ 24,806	
	Social Security	18,588		18,588		18,588		18,588		18,588	
	Total	$ 29,219	64.9%	$ 32,763	72.8%	$ 36,307	80.7%	$ 39,851	88.6%	$ 43,394	96.4%
$50,000	TCRS	$ 11,868		$ 15,824		$ 19,779		$ 23,735		$ 27,691	
	Social Security	19,656		19,656		19,656		19,656		19,656	
	Total	$ 31,524	63.0%	$ 35,480	71.0%	$ 39,435	78.9%	$ 43,391	86.8%	$ 47,347	94.7%
$55,000	TCRS	$ 13,246		$ 17,661		$ 22,076		$ 26,492		$ 30,907	
	Social Security	20,352		20,352		20,352		20,352		20,352	
	Total	$ 33,598	61.1%	$ 38,013	69.1%	$ 42,428	77.1%	$ 46,844	85.2%	$ 51,259	93.2%
$60,000	TCRS	$ 14,624		$ 19,499		$ 24,373		$ 29,248		$ 34,122	
	Social Security	21,024		21,024		21,024		21,024		21,024	
	Total	$ 35,648	59.4%	$ 40,523	67.5%	$ 45,397	75.7%	$ 50,272	83.8%	$ 55,146	91.9%
$65,000	TCRS	$ 16,002		$ 21,336		$ 26,670		$ 32,004		$ 37,338	
	Social Security	21,624		21,624		21,624		21,624		21,624	
	Total	$ 37,626	57.9%	$ 42,960	66.1%	$ 48,294	74.3%	$ 53,628	82.5%	$ 58,962	90.7%
$70,000	TCRS	$ 17,380		$ 23,174		$ 28,967		$ 34,760		$ 40,554	
	Social Security	22,212		22,212		22,212		22,212		22,212	
	Total	$ 39,592	56.6%	$ 45,386	64.8%	$ 51,179	73.1%	$ 56,972	81.4%	$ 62,766	89.7%

* Average Final Compensation (AFC)

This chart is based on a date of retirement in 2007. 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 2007;

(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/

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

ACTUARIAL VALUATION

An actuarial valuation of the TCRS is performed by an independent actuarial firm every two years. The purpose of the valuation is to determine the funding requirements for the employers participating in the TCRS. The latest valuation was performed July 1, 2005 to establish the employer contribution rates effective 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, 2007:

Cities	177
Counties	88
Utility Districts	56
Special School Districts	19
Joint Ventures	23
Housing Authorities	11
911 Emergency Communication Districts	40
Miscellaneous Authorities	53
Total	467

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.

2007 Public Safety Officer benefits were enhanced.

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
2007	7.65%	7.65%	$ 97,500	No Limit
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

Deferred Compensation Program

DEFERRED COMPENSATION PROGRAM

The Deferred Compensation Program is a voluntary program designed to provide state employees with the opportunity to accumulate supplemental retirement income on a tax advantaged basis. Participants may postpone income taxes on contributions and earnings by agreeing to defer receipt of a portion of their current income until retirement. For fiscal year 2007 the 401(k) plan began offering employees a designated Roth 401(k) after tax contribution option as payroll systems accommodate this change. The contributions are made after tax and the distributions are tax advantaged subject to timing restrictions. The University of Tennessee is the first payroll system to accommodate the Roth contributions.

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, 2007, accounts were held by 70,671 individuals in the 401(k) plan and 5,310 individuals in the 457 plan. At fiscal year end, 32,652 state employees, 9,667 University of Tennessee employees, and 11,130 Tennessee Board of Regents employees were actively contributing to the 401(k) plan and 2,231 state employees, 443 University of Tennessee employees, and 310 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 2007 allow a maximum deferral in the 457 plan of 100% of compensation up to the maximum annual contribution of $15,500. The maximum deferral in the 401(k) plan is 100% of compensation up to the maximum annual contribution of $15,500. Participants who also use a 403(b) plan are subject to additional limits. Participants age 50 and older are eligible to make additional deferrals.

During the 2007 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 $40 per month as authorized by the General Assembly. The amount contributed by the state during the year was $23 million. Beginning in the 2008 fiscal year, the state match will increase to $50 per month. Employees contributed $100 million.

Participants in the program at June 30, 2007 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. A self directed brokerage account option provides access to additional mutual funds.

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

Participants receive a quarterly statement showing their contributions and earnings during the quarter. In addition, once a year, participants receive a special statement projecting their account balance to a variety of retirement ages and showing the monthly income those account balances might provide. The program provides a variety of communication and education materials and services, including a comprehensive Internet site, a handbook for participants, several booklets on special topics, investment seminars around the state, plus a voice response telephone system and an Internet account access system which provide participants with immediate access to account balances and account transactions 24 hours a day.

Deferred Compensation Program

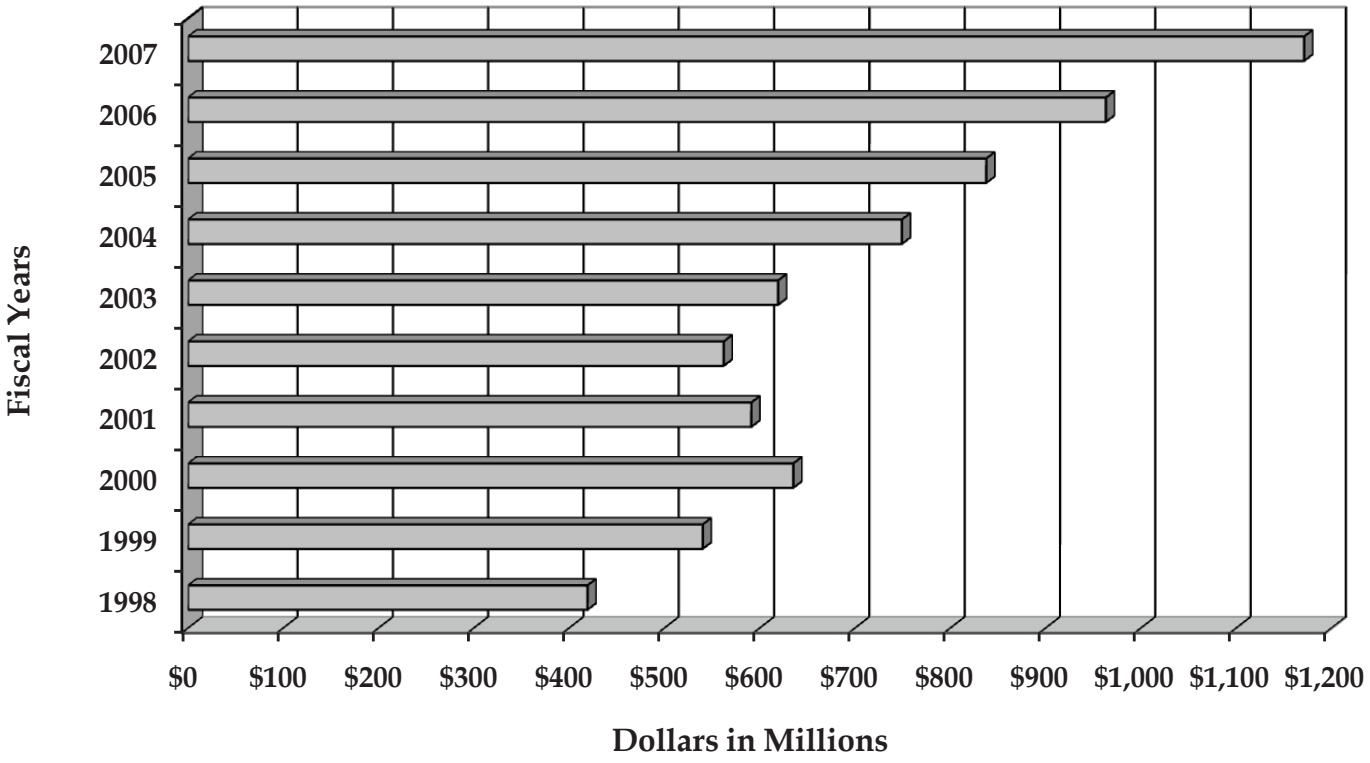
The Internet site, www.treasury.state.tn.us/dc/, provides full information about the program. Information available through the site includes forms, participation information and illustrations, descriptions of the investment choices and historical performance figures, an interactive benefit calculator,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

For the year ending June 30, 2007, contributions to the program totaled $123.8 million. Contributions are wired for immediate crediting. At June 30, 2007, accumulated account balances totaled $1.2 billion.

Under the loan program offered in the 401(k) plan, active employees who have accumulated $4,000 or more in their 401(k) account may borrow up to half of their account value. Participants repay principal and interest to their 401(k) account through salary deduction. Taxes continue to be deferred while funds accumulated in the plan are in loan status. As of June 30, 2007, there were 3,554 loans outstanding from the 401(k) plan. Outstanding loan balances totaled $11.2 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, 2007, 702 individuals received periodic payments and 66 individuals received annuity payments from the program. In addition, 3,379 lump sum distributions and 2,909 partial lump sum distributions were issued during fiscal year 2007.

DEFERRED COMPENSATION PROGRAM ASSETS
Expressed in Millions
Fiscal Years 1998-2007



Deferred Compensation Program

DEFERRED COMPENSATION CONTRIBUTIONS AND MARKET VALUE

	Contributions Fiscal Year 2007	Market Value June 30, 2007
Plan I (457)		
ING	$ 1,817,333	$ 33,728,031
American General	16,324	658,808
Calvert	1,020,036	6,373,742
Fidelity	9,681,796	108,541,869
State Street	1,254,353	6,520,778
Regions	898,421	15,890,896
Ameritrade	-	181,165
	$ 14,688,263	$ 171,895,289
Plan II (401k)		
ING	$ 13,803,005	$ 114,211,244
Calvert	4,765,489	32,292,696
Fidelity	77,459,486	757,206,634
State Street	5,209,605	34,637,931
Regions	7,832,199	61,181,687
Ameritrade	-	568,069
	$ 109,069,784	$ 1,000,098,261
Total For Both Plans	$ 123,758,047	$ 1,171,993,550

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.

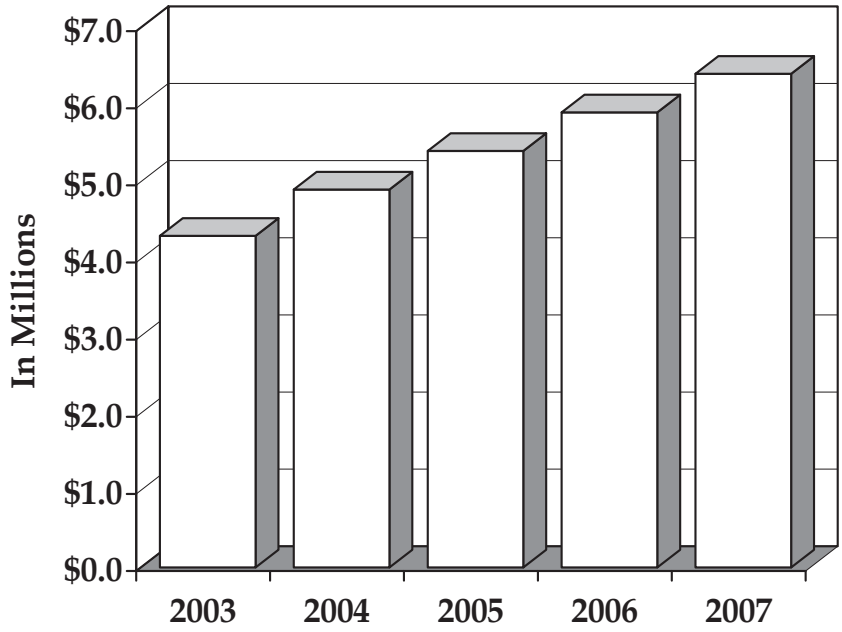
Enrollment in the plan is for a full calendar year. Enrollments may not be changed after the year has begun unless the employee experiences a change in family status and reports that change promptly. Employees must use the amounts set aside in each category for corresponding expenses incurred during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

At June 30, 2007, a total of 43,679 state employees were enrolled in one or more of the plan's four options: 42,519 employees used the plan to pay medical insurance premiums, 24,951 paid dental insurance premiums, 4,824 used the medical expense reimbursement account, and 432 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 2007, the State's F.I.C.A. savings totaled $6.4 million. Employees realize similar savings.

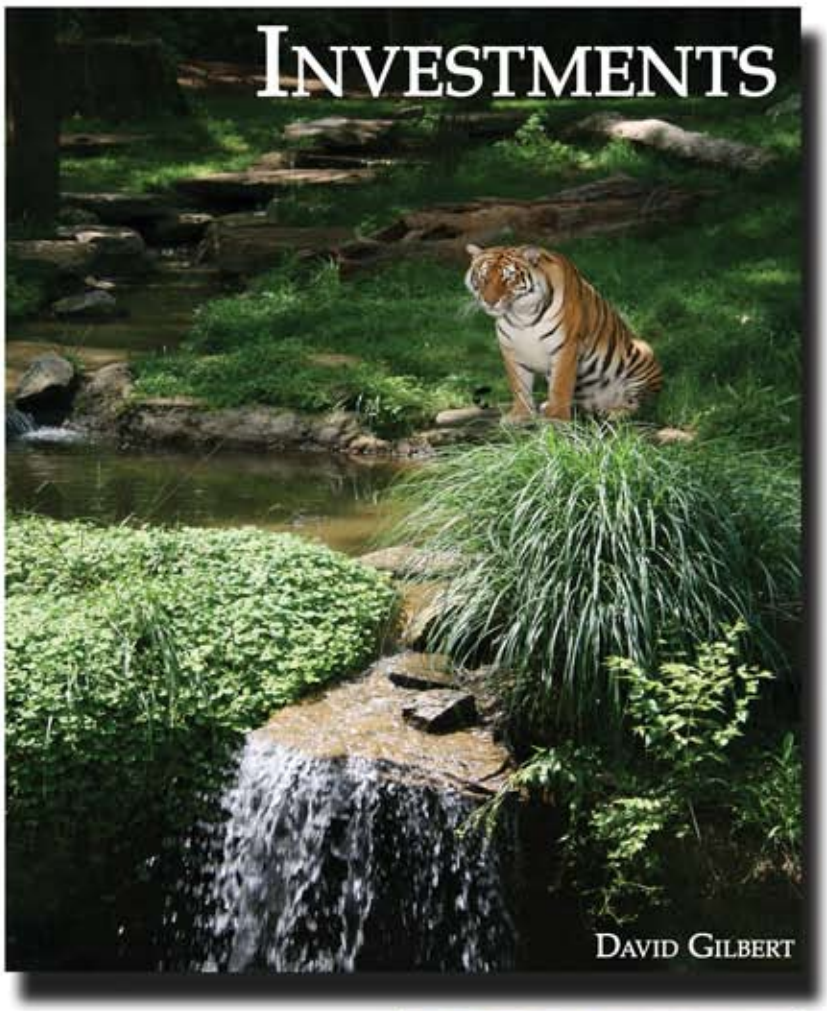
Since the program began operation in January 1989, the state's F.I.C.A. savings have totaled $54.9 million. Savings exceeding the costs of administering the plan have been designated for offsetting costs of the State's wellness program, providing assistance for day care programs, funding for employee sick leave bank administration and funding matching contributions to the 401(k) plan. As of June 30, 2007, $48.3 million had been transferred to offset costs of employee benefit programs.

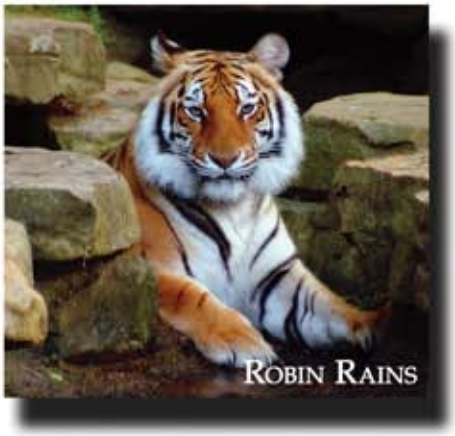
F.I.C.A. SAVINGS TO STATE
Fiscal Years 2003-2007
Expressed in Millions



Investments

Kim Rosier


David Gilbert


Robin Rains

Nashville Zoo

Pete Meenen

Michelle Cribbs

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.

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

COST OF INVESTMENT OPERATION

The administrative cost to operate the investment program for TCRS is less than 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. During the 2007 fiscal year, TCRS had a total return of 13.15%. Domestic stocks earned 20.58%, while the S&P 1500 Index was 20.23%. Domestic bonds earned 6.17% versus the bond index of 6.06%, while international stocks earned 27.19% versus 27.00% for the EAFE Index. Real estate earned 10.43%.

TCRS INVESTMENTS

INVESTMENT SUMMARY

As of June 30, 2007

	Domestic		International		Total	
	Fair Value	%	Fair Value	%	Fair Value	%
Fixed Income						
Government Bonds	$ 8,343,223,870	25.99%	$ 724,069,115	2.25%	$ 9,067,292,985	28.24%
Corporate Bonds	5,032,376,995	15.67%	278,482,214	0.87%	5,310,859,209	16.54%
Convertible Bonds	-	0.00%	67,092	0.00%	67,092	0.00%
Total Fixed Income	13,375,600,865	41.66%	1,002,618,421	3.12%	14,378,219,286	44.78%
Common Stock						
Capital Goods & Services	206,877,242	0.64%	102,272,604	0.32%	309,149,846	0.96%
Comingled Equity Funds	-	0.00%	2,253,709	0.01%	2,253,709	0.01%
Consumer Durables	167,451,244	0.52%	7,515,775	0.02%	174,967,019	0.54%
Consumer Non-Durables	1,991,052,849	6.20%	396,743,644	1.24%	2,387,796,493	7.44%
Energy	1,096,352,953	3.41%	163,995,103	0.51%	1,260,348,056	3.92%
Financial	2,240,099,712	6.98%	3,169,797,101	9.86%	5,409,896,813	16.84%
Materials & Services	2,309,691,828	7.19%	413,674,597	1.29%	2,723,366,425	8.48%
Miscellaneous Common Stock	-	0.00%	5,260,150	0.02%	5,260,150	0.02%
Technology	1,771,269,896	5.52%	133,683,548	0.42%	1,904,953,444	5.94%
Transportation	130,962,557	0.42%	118,952,883	0.37%	249,915,440	0.79%
Utilities	790,080,958	2.46%	334,939,277	1.04%	1,125,020,235	3.50%
Total Common Stock	10,703,839,239	33.34%	4,849,088,391	15.10%	15,552,927,630	48.44%
Short-Term Investments						
Certificates of Deposit	9,981,510	0.03%	-	0.00%	9,981,510	0.03%
Commercial Paper	566,543,139	1.77%	-	0.00%	566,543,139	1.77%
Pooled Funds and Mutual Funds	9,042	0.00%	-	0.00%	9,042	0.00%
U. S. Government Securities	517,613,240	1.61%	-	0.00%	517,613,240	1.61%
Total Short-Term Investments	1,094,146,931	3.41%	-	0.00%	1,094,146,931	3.41%
Real Estate	1,083,487,583	3.37%	-	0.00%	1,083,487,583	3.37%
Total Investments	26,257,074,618	81.78%	5,851,706,812	18.22%	32,108,781,430	100.00%
Short Term Investments Classified as Cash Equivalents	(566,552,181)		-		(566,552,181)	
Total Investments as Shown on the Statement of Plan Net Assets	$ 25,690,522,437		$ 5,851,706,812		$ 31,542,229,249	

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
2007	14.1%	13.1%
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

[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 2003-2007

Fiscal Year	TCRS Portfolio Earnings
2007	$3,791,403,651
2006	1,877,298,490
2005	1,850,367,215
2004	2,181,853,628
2003	1,112,478,748

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 70 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 2007 fiscal year, the average balance of short term investments in the Treasurer's Cash Management program was $6,736,021,528 per month and interest income of $351,903,181 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 Treasurer's account at the Custodian Bank. Funds may also be invested in prime commercial paper and prime banker's acceptances.

At June 30, 2007, investments had an average maturity of 77 days, and an average weighted yield of 5.35%. The total balance in the State Pooled Investment Fund at June 30, 2007, $7,855,671,217 fair value, was allocated as follows: U.S. Treasury government and agency securities, 32.82%; repurchase agreements and overnight deposits, 5.92%; collateralized certificates of deposit, 31.53%; and commercial paper, 29.73%.

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) managing 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 using uniform statewide procedures. In addition, Treasury Department staff monitors all pool activity through the monthly, quarterly, and annual reports

STATE CASH MANAGEMENT

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 $8.6 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

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)
2007	5.30%	5.11%	4.50%	5.02%
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

[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
2007	$ 2,124,406,667	$ 112,695,354	5.30%
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%

Repurchase Agreements and Overnight Deposit Accounts

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2007	$ 398,534,694	$ 17,529,090	5.45%
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%

Commercial Paper

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2007	$ 2,002,307,667	$ 106,634,748	5.34%
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%

U.S. Government Securities

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2007	$ 2,210,772,500	$ 115,043,989	5.26%
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%

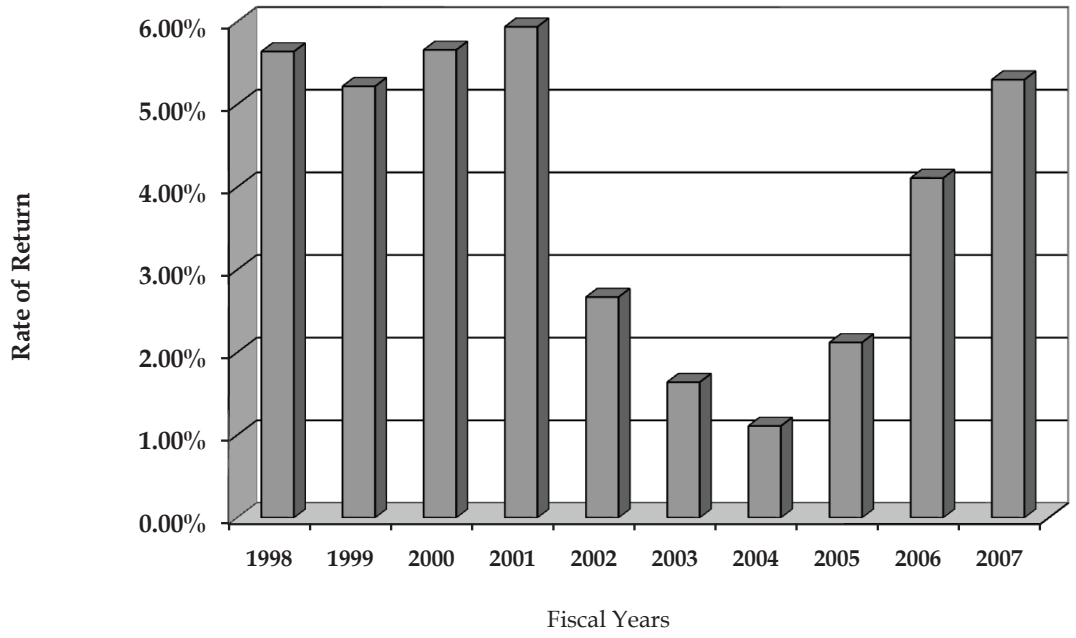
Total Funds

Fiscal Year	Average Total Funds Invested	Cash Management Investment Earnings	Composite Weighted Average Rate of Return
2007	$ 6,736,021,528	$ 351,903,181	5.30%
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%

STATE CASH MANAGEMENT

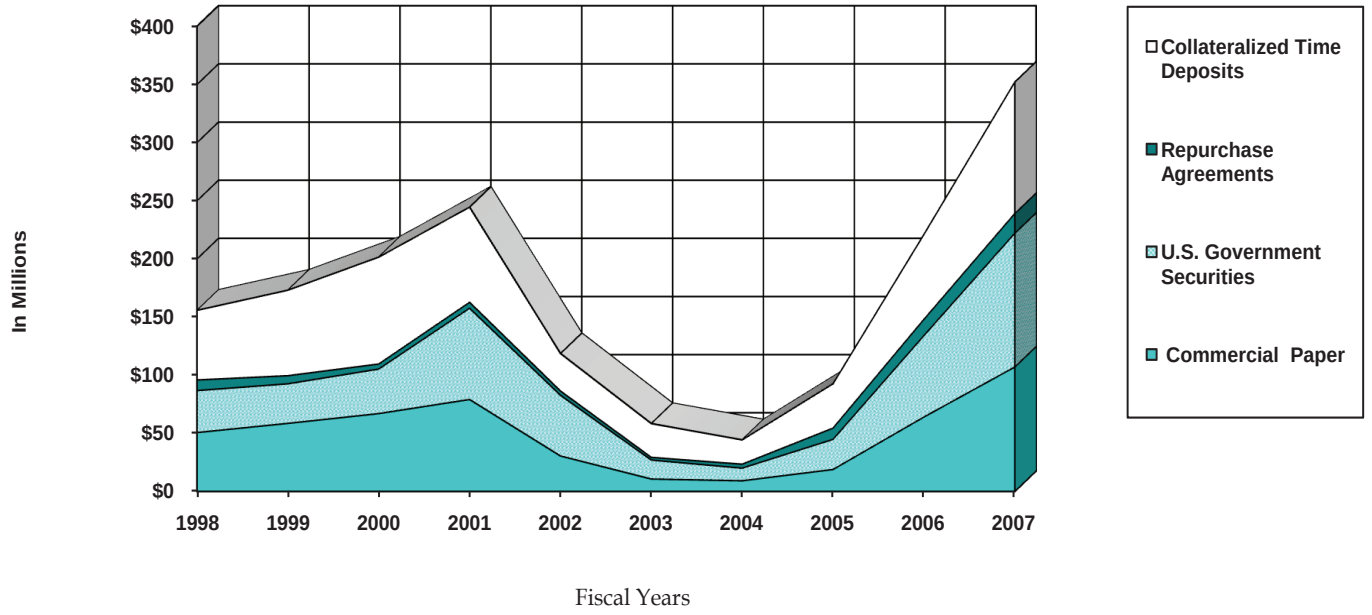
CASH MANAGEMENT INVESTMENTS COMPOSITE WEIGHTED AVERAGE RATE OF RETURN

Fiscal Years 1998-2007



ANALYSIS OF STATE CASH EARNINGS

Fiscal Years 1998-2007



STATE CASH MANAGEMENT

CASH MANAGEMENT PORTFOLIO ANALYSIS

Fiscal Year Ended June 30, 2007

Date	Current Investment Yield	Total Portfolio Yield	Avg. Days to Maturity	Portfolio Composition: Certificates of Deposit	Repurchase Agreements	U.S. Agency	Commercial Paper
July 2006	5.32%	5.14%	65	34.93%	6.11%	31.05%	27.91%
August 2006	5.32%	5.26%	70	35.16%	4.88%	32.91%	27.05%
September 2006	5.31%	5.29%	69	36.12%	4.66%	34.14%	25.08%
October 2006	5.32%	5.29%	74	37.10%	4.75%	36.06%	22.09%
November 2006	5.32%	5.32%	74	38.70%	4.80%	35.02%	21.48%
December 2006	5.33%	5.32%	75	37.24%	4.99%	33.90%	23.87%
January 2007	5.19%	5.35%	83	31.40%	5.00%	32.87%	30.73%
February 2007	5.20%	5.34%	86	28.45%	4.97%	35.66%	30.92%
March 2007	5.22%	5.34%	94	26.38%	4.90%	31.45%	37.27%
April 2007	5.24%	5.33%	90	26.05%	4.60%	31.71%	37.64%
May 2007	5.24%	5.33%	90	25.81%	4.15%	32.24%	37.80%
June 2007	5.26%	5.34%	83	28.51%	4.13%	32.17%	35.19%
Average	5.27%	5.30%	79	32.16%	4.82%	33.26%	29.76%

MONTH	General Fund Average	General Fund Percent	LGIP Average	LGIP Percent	Other Restricted Average	Other Restricted Percent	Total Average Invested
July 2006	$2,583,524,924	39.15%	$2,129,281,888	32.27%	$1,886,201,871	28.58%	$6,599,008,683
August 2006	2,561,197,769	39.58%	2,002,718,824	30.95%	1,906,946,912	29.47%	6,470,863,505
September 2006	2,485,763,627	39.01%	2,004,607,475	31.46%	1,881,775,218	29.53%	6,372,146,320
October 2006	2,435,717,135	37.47%	2,159,866,270	33.23%	1,904,767,977	29.30%	6,500,351,382
November 2006	2,175,146,095	34.81%	2,136,802,867	34.20%	1,936,577,074	30.99%	6,248,526,036
December 2006	2,111,699,562	33.37%	2,298,036,666	36.30%	1,919,294,367	30.33%	6,329,030,595
January 2007	2,129,037,755	32.38%	2,524,941,525	38.40%	1,920,955,445	29.22%	6,574,934,725
February 2007	2,054,027,521	31.04%	2,627,731,868	39.70%	1,936,355,453	29.26%	6,618,114,842
March 2007	1,826,649,276	26.47%	3,166,390,232	45.87%	1,908,838,120	27.66%	6,901,877,628
April 2007	1,916,457,621	27.43%	3,107,283,975	44.48%	1,962,791,319	28.09%	6,986,532,915
May 2007	2,465,593,958	32.79%	3,033,983,663	40.35%	2,019,660,141	26.86%	7,519,237,762
June 2007	2,817,660,603	36.54%	2,894,492,634	37.53%	1,999,480,700	25.93%	7,711,633,937
Average	$2,296,872,987	34.10%	$2,507,178,157	37.22%	$1,931,970,384	28.68%	$6,736,021,528

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 2007 fiscal year, the average rate participants earned on their deposits after the fee reduction was 5.25%. 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, 2007

	Account Balance 7/1/2006	Net Deposits/(Withdrawals) FY 2007	Interest Credited FY 2007	Account Balance 6/30/2007
Cities	$ 674,671,173	$ 171,215,497	$ 39,055,395	$ 884,942,065
Counties	564,700,956	127,077,130	36,584,438	728,362,524
Commitments to D.O.T.	46,096,130	(5,183,847)	2,425,646	43,337,929
Educational Institutions	587,376,723	67,680,837	36,238,874	691,296,434
Community Service Agencies	6,917,147	(484,277)	365,665	6,798,535
Other	304,518,947	40,308,157	18,365,045	363,192,149
	$ 2,184,281,076	$ 400,613,497	$ 133,035,063	$ 2,717,929,636

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. Regions Bank 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 2007

	Transaction Type	Number		Amount
(1)	Wire Disbursements	1,148	$	20,373,670,956
(2)	Wire Receipts	6,322		20,645,077,833
(3)	Check Redemptions	4,370,848		5,514,098,856
	Total	**4,378,318**	**$**	**46,532,847,645**

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

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
LARGEST HOLDINGS

LARGEST STOCK HOLDINGS
as of June 30, 2007
by Fair Value

Shares	Security Name	Fair Value
3,903,082	Exxon Mobil Corporation	$ 327,390,518
6,050,000	General Electric Company	231,594,000
4,435,364	AT&T Incorporated	184,067,606
3,538,000	Microsoft Corporation	104,264,860
1,781,715	Bank of America Corporation	87,108,046
1,695,000	Citigroup Incorporated	86,936,550
947,000	Chevron Corporation	79,775,280
2,826,000	CISCO Systems Incorporated	78,704,100
1,253,800	Procter & Gamble Company	76,720,022
2,881,000	Pfizer Incorporated	73,667,170

LARGEST BOND HOLDINGS
as of June 30, 2007
by Fair Value

Par Value	Security Name	Yield	Maturity	Moody's Quality Rating	Fair Value
$ 409,784,000	United States Treasury Infl Index Note	2.43%	01/15/17	Aaa	$ 400,083,593
416,364,000	United States Treasury Infl Index Note	2.11	01/15/16	Aaa	395,318,049
217,000,000	United States Treasury Bond	6.26	02/15/21	Aaa	273,064,120
250,000,000	FNMA Debenture	5.35	03/05/14	Aaa	245,390,625
229,808,000	United States Treasury Infl Index Note	2.94	07/15/12	Aaa	234,260,530
223,622,000	United States Treasury Infl Index Note	2.08	01/15/14	Aaa	214,904,320
212,428,000	United States Treasury Infl Index Note	1.98	07/15/15	Aaa	200,744,460
202,000,000	FHLMC Notes	6.06	09/19/16	Aaa	199,903,240
200,000,000	FHLMC Notes	5.57	12/28/09	Aaa	199,864,000
160,190,435	FHLMC Group #G08160	5.70	11/01/36	NR	154,578,965

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, 2007

	Rating	Maturity	Yield to Maturity	Par Value	Fair Value
U.S. TREASURY AND AGENCY OBLIGATIONS					
Fannie Mae	Aaa	07/02/07	5.29%	$ 50,000,000	$ 49,992,931
Fannie Mae Discount Notes	Aaa	07/02/07	5.20	37,415,000	37,409,668
Fannie Mae Discount Notes	Aaa	07/02/07	5.20	15,000,000	14,997,863
Fannie Mae Discount Notes	Aaa	07/02/07	5.20	50,000,000	49,992,875
Fannie Mae Discount Notes	Aaa	08/01/07	5.20	73,918,000	73,591,467
Farmer Mac	Aaa	01/16/08	5.25	44,500,000	44,464,400
Farmer Mac	Aaa	02/01/08	5.25	50,000,000	49,958,500
Federal Home Loan Bank	Aaa	09/05/07	5.19	24,480,000	24,464,822
Federal Home Loan Bank	Aaa	01/11/08	5.33	100,000,000	99,875,000
Federal Home Loan Bank	Aaa	01/24/08	5.13	55,000,000	54,914,200
Federal Home Loan Bank	Aaa	01/30/08	5.25	57,570,000	57,515,884
Federal Home Loan Bank	Aaa	01/30/08	5.25	100,000,000	99,906,000
Federal Home Loan Bank	Aaa	02/01/08	5.25	100,000,000	99,906,000
Federal Home Loan Bank	Aaa	02/05/08	5.25	50,000,000	49,953,000
Federal Home Loan Bank	Aaa	02/12/08	5.35	93,000,000	92,912,580
Federal Home Loan Bank	Aaa	02/22/08	5.30	159,395,000	159,146,344
Federal Home Loan Bank	Aaa	02/28/08	5.37	50,000,000	49,890,500
Federal Home Loan Bank	Aaa	03/05/08	5.30	100,000,000	99,938,000
Federal Home Loan Bank	Aaa	03/14/08	5.25	18,720,000	18,643,997
Federal Home Loan Bank	Aaa	03/19/08	5.30	150,000,000	149,859,000
Federal Home Loan Bank	Aaa	03/19/08	5.32	50,000,000	49,937,500
Federal Home Loan Bank	Aaa	04/18/08	5.25	32,355,000	32,314,556
Federal Home Loan Bank	Aaa	04/23/08	5.25	100,000,000	99,875,000
Federal Home Loan Bank	Aaa	05/07/08	5.30	50,000,000	49,953,000
Federal Home Loan Bank	Aaa	06/26/08	5.38	1,000,000	980,630
FFCB Discount Notes	Aaa	08/09/07	5.17	13,702,000	13,667,745
FHLMC Note 3.750	Aaa	08/03/07	5.22	24,235,000	24,199,859
FHLMC Note 4.000	Aaa	08/17/07	5.19	110,307,000	110,100,726
FHLMC Note 4.730	Aaa	08/14/07	5.26	44,000,000	43,963,040
FHLMC Note 5.125	Aaa	10/24/07	5.19	75,000,000	74,934,000
FHLMC Note 5.140	Aaa	12/14/07	5.22	92,000,000	91,895,120
FHLMC Note 5.140	Aaa	12/26/07	5.25	100,000,000	99,924,000
FHLMC Note 5.270	Aaa	04/25/08	5.27	100,000,000	99,881,000
FHLMC Note 5.270	Aaa	04/25/08	5.27	50,000,000	49,940,500
FHLMC Note 5.300	Aaa	03/05/08	5.30	39,625,000	39,589,734
FHLMC Note 5.350	Aaa	03/26/08	5.35	100,000,000	99,936,000
FNMA Discount Notes	Aaa	08/31/07	5.20	150,000,000	148,725,000
FNMA Discount Notes	Aaa	12/03/07	5.25	55,145,000	55,110,810
TOTAL U.S. TREASURY AND AGENCY OBLIGATIONS				**$ 2,566,367,000**	**$ 2,562,261,251**

(continued)

STATE CASH PORTFOLIO
AS OF JUNE 30, 2007

	Maturity	Yield to Maturity	Par Value	Fair Value
CERTIFICATES OF DEPOSIT				
Community Bank & Trust, Ashland City	07/17/07	5.30%	$ 1,000,000	$ 1,000,000
Community Bank & Trust, Ashland City	08/01/07	5.25	2,000,000	2,000,000
Community Bank & Trust, Ashland City	07/17/07	5.30	1,000,000	1,000,000
Community Bank & Trust, Ashland City	08/01/07	5.25	1,000,000	1,000,000
Community Bank & Trust, Ashland City	08/17/07	5.25	1,000,000	1,000,000
Bank of Crockett, Bells	11/23/07	5.30	300,000	300,000
Bank of Crockett, Bells	11/02/07	5.30	200,000	200,000
Bank of Bradford	08/24/07	5.30	100,000	100,000
People's Bank and Trust Company, Byrdstown	07/13/07	5.30	100,000	100,000
People's Bank and Trust Company, Byrdstown	07/31/07	5.30	100,000	100,000
People's Bank and Trust Company, Byrdstown	12/07/07	5.30	100,000	100,000
People's Bank and Trust Company, Byrdstown	11/06/07	5.30	200,000	200,000
Citizens Bank, Carthage	09/17/07	5.30	4,000,000	4,000,000
Citizens Bank, Carthage	09/17/07	5.25	2,000,000	2,000,000
First State Bank, Chapel Hill	12/04/07	5.17	200,000	200,000
Legends Bank, Clarksville	11/08/07	5.25	1,000,000	1,000,000
Legends Bank, Clarksville	08/29/07	5.25	1,000,000	1,000,000
Legends Bank, Clarksville	09/27/07	5.30	1,000,000	1,000,000
Bank of Cleveland	10/26/07	5.30	5,000,000	5,000,000
Bank of Cleveland	12/07/07	5.30	5,000,000	5,000,000
People's Bank, Clifton	10/26/07	5.30	500,000	500,000
Community First Bank & Trust, Columbia	12/14/07	5.30	3,000,000	3,000,000
Community First Bank & Trust, Columbia	09/14/07	5.30	2,000,000	2,000,000
Community First Bank & Trust, Columbia	08/31/07	5.30	2,000,000	2,000,000
Community First Bank & Trust, Columbia	08/31/07	5.30	1,000,000	1,000,000
Community National Bank, Dayton	11/20/07	5.30	2,000,000	2,000,000
Community National Bank, Dayton	07/06/07	5.30	1,000,000	1,000,000
TriStar Bank, Dickson	07/16/07	5.25	500,000	500,000
The Farmers & Merchants Bank, Dyer	07/18/07	5.25	2,500,000	2,500,000
The Farmers & Merchants Bank, Dyer	07/25/07	5.25	1,000,000	1,000,000
First Citizens National Bank, Dyersburg	11/23/07	5.30	3,000,000	3,000,000
First Citizens National Bank, Dyersburg	11/23/07	5.30	20,000,000	20,000,000
Security Bank, Dyersburg	09/04/07	5.30	1,000,000	1,000,000
Security Bank, Dyersburg	08/07/07	5.30	300,000	300,000
Security Bank, Dyersburg	08/07/07	5.30	500,000	500,000
Security Bank, Dyersburg	08/07/07	5.30	450,000	450,000
Tennessee Commerce Bank, Franklin	07/17/07	5.30	500,000	500,000
Tennessee Commerce Bank, Franklin	12/18/07	5.17	750,000	750,000

(continued)

State Cash Portfolio as of June 30, 2007

	Maturity	Yield to Maturity	Par Value	Fair Value
Tennessee Commerce Bank, Franklin	09/21/07	5.30	500,000	500,000
Tennessee Commerce Bank, Franklin	08/31/07	5.30	2,500,000	2,500,000
Tennessee Commerce Bank, Franklin	12/18/07	5.17	200,000	200,000
Tennessee Commerce Bank, Franklin	11/06/07	5.30	1,500,000	1,500,000
Tennessee Commerce Bank, Franklin	10/12/07	5.30	2,500,000	2,500,000
Tennessee Commerce Bank, Franklin	09/21/07	5.30	500,000	500,000
Tennessee Commerce Bank, Franklin	09/21/07	5.30	1,000,000	1,000,000
Friendship Bank	12/07/07	5.30	50,000	50,000
Friendship Bank	12/21/07	5.16	375,000	375,000
Friendship Bank	12/07/07	5.30	525,000	525,000
Friendship Bank	12/07/07	5.30	1,550,000	1,550,000
Gates Bank and Trust Company	08/28/07	5.30	500,000	500,000
Gates Bank and Trust Company	08/17/07	5.30	450,000	450,000
Gates Bank and Trust Company	09/28/07	5.30	500,000	500,000
Gates Bank and Trust Company	09/28/07	5.30	500,000	500,000
Gates Bank and Trust Company	10/30/07	5.30	350,000	350,000
Tennessee State Bank, Gatlinburg	10/16/07	5.30	20,000,000	20,000,000
Tennessee State Bank, Gatlinburg	08/31/07	5.30	10,000,000	10,000,000
Trust One Bank, Germantown	10/15/07	5.30	3,000,000	3,000,000
Trust One Bank, Germantown	07/16/07	5.30	3,000,000	3,000,000
Trust One Bank, Germantown	07/16/07	5.30	4,000,000	4,000,000
Trust One Bank, Germantown	08/15/07	5.30	2,000,000	2,000,000
Trust One Bank, Germantown	08/15/07	5.30	2,000,000	2,000,000
Trust One Bank, Germantown	08/15/07	5.30	2,000,000	2,000,000
Trust One Bank, Germantown	09/17/07	5.30	6,000,000	6,000,000
Trust One Bank, Germantown	08/15/07	5.30	1,000,000	1,000,000
Trust One Bank, Germantown	10/15/07	5.30	1,000,000	1,000,000
Trust One Bank, Germantown	10/15/07	5.30	1,000,000	1,000,000
Trust One Bank, Germantown	10/15/07	5.30	3,000,000	3,000,000
Bank of Gleason	09/18/07	5.25	300,000	300,000
Bank of Gleason	08/03/07	5.30	1,000,000	1,000,000
Bank of Gleason	12/07/07	5.30	350,000	350,000
Bank of Gleason	11/27/07	5.25	750,000	750,000
Bank of Gleason	08/03/07	5.30	1,000,000	1,000,000
Bank of Gleason	08/07/07	5.30	200,000	200,000
Bank of Halls	08/14/07	5.30	1,000,000	1,000,000
Bank of Halls	10/05/07	5.30	300,000	300,000
Bank of Halls	07/31/07	5.30	200,000	200,000
Bank of Halls	08/14/07	5.30	200,000	200,000
Bank of Halls	08/21/07	5.30	700,000	700,000

(continued)

STATE CASH PORTFOLIO
AS OF JUNE 30, 2007

	Maturity	Yield to Maturity	Par Value	Fair Value
Bank of Halls	09/14/07	5.30	400,000	400,000
Clayton Bank & Trust, Henderson	07/31/07	5.30	1,000,000	1,000,000
American Security Bank and Trust, Hendersonville	09/04/07	5.30	500,000	500,000
American Security Bank and Trust, Hendersonville	09/11/07	5.17	500,000	500,000
American Security Bank and Trust, Hendersonville	08/24/07	5.30	200,000	200,000
American Security Bank and Trust, Hendersonville	09/25/07	5.30	200,000	200,000
BancorpSouth, Jackson	08/14/07	5.30	15,000,000	15,000,000
BancorpSouth, Jackson	08/14/07	5.30	7,500,000	7,500,000
BancorpSouth, Jackson	07/23/07	5.25	2,000,000	2,000,000
BancorpSouth, Jackson	07/31/07	5.30	10,000,000	10,000,000
BancorpSouth, Jackson	07/27/07	5.30	40,000,000	40,000,000
BancorpSouth, Jackson	07/23/07	5.25	1,000,000	1,000,000
BancorpSouth, Jackson	07/23/07	5.25	7,500,000	7,500,000
Bank of Jackson	08/07/07	5.30	1,000,000	1,000,000
Bank of Jackson	08/07/07	5.30	500,000	500,000
First Volunteer Bank of Tennessee, Jamestown	07/03/07	5.25	500,000	500,000
First Volunteer Bank of Tennessee, Jamestown	08/15/07	5.21	500,000	500,000
First Volunteer Bank of Tennessee, Jamestown	08/15/07	5.21	300,000	300,000
First Volunteer Bank of Tennessee, Jamestown	08/15/07	5.21	200,000	200,000
First Volunteer Bank of Tennessee, Jamestown	08/15/07	5.21	500,000	500,000
First Volunteer Bank of Tennessee, Jamestown	08/15/07	5.21	450,000	450,000
Citizens State Bank, Jasper	08/28/07	5.30	100,000	100,000
Citizens State Bank, Jasper	08/28/07	5.30	200,000	200,000
Citizens State Bank, Jasper	08/10/07	5.30	200,000	200,000
BB& T, Knoxville	09/25/07	5.30	75,000,000	75,000,000
BB& T, Knoxville	11/09/07	5.30	40,000,000	40,000,000
BB& T, Knoxville	10/16/07	5.30	20,000,000	20,000,000
BB& T, Knoxville	07/18/07	5.25	100,000,000	100,000,000
BB& T, Knoxville	09/05/07	5.25	80,000,000	80,000,000
BB& T, Knoxville	09/05/07	5.25	80,000,000	80,000,000
BankEast, Knoxville	08/10/07	5.25	5,000,000	5,000,000
BankEast, Knoxville	08/13/07	5.30	5,000,000	5,000,000
Citizens Bank of Lafayette	08/24/07	5.30	500,000	500,000
Citizens Bank of Lafayette	07/03/07	5.30	100,000	100,000
Citizens Bank of Lafayette	07/24/07	5.30	250,000	250,000
Citizens Bank of Lafayette	08/24/07	5.30	100,000	100,000
United Community Bank, Lenoir City	12/11/07	5.30	500,000	500,000
United Community Bank, Lenoir City	08/03/07	5.30	500,000	500,000

(continued)

State Cash Portfolio as of June 30, 2007

	Maturity	Yield to Maturity	Par Value	Fair Value
The Coffee County Bank, Manchester	10/05/07	5.30	95,000	95,000
Planters Bank of Tennessee, Maury City	11/06/07	5.30	200,000	200,000
Cadence Bank, Memphis	09/14/07	5.25	3,000,000	3,000,000
Cadence Bank, Memphis	07/16/07	5.25	2,000,000	2,000,000
Cadence Bank, Memphis	08/06/07	5.25	2,000,000	2,000,000
Cadence Bank, Memphis	07/09/07	5.25	3,000,000	3,000,000
Cadence Bank, Memphis	08/10/07	5.25	2,000,000	2,000,000
Cadence Bank, Memphis	08/27/07	5.25	5,000,000	5,000,000
Cadence Bank, Memphis	07/23/07	5.25	5,000,000	5,000,000
Cadence Bank, Memphis	08/24/07	5.25	5,000,000	5,000,000
Cadence Bank, Memphis	07/25/07	5.18	5,000,000	5,000,000
Cadence Bank, Memphis	08/15/07	5.25	2,500,000	2,500,000
Cadence Bank, Memphis	09/01/07	5.25	1,000,000	1,000,000
First Tennessee Bank National Association, Memphis	08/22/07	5.25	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	08/13/07	5.25	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	09/14/07	5.25	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	08/13/07	5.25	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	09/19/07	5.18	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	08/14/07	5.25	50,000,000	50,000,000
First Tennessee Bank National Association, Memphis	08/14/07	5.25	50,000,000	50,000,000
First Tennessee Bank National Association, Memphis	08/14/07	5.25	50,000,000	50,000,000
First Tennessee Bank National Association, Memphis	08/14/07	5.25	50,000,000	50,000,000
First Tennessee Bank National Association, Memphis	08/14/07	5.25	50,000,000	50,000,000
First Tennessee Bank National Association, Memphis	09/10/07	5.25	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	08/17/07	5.25	20,000,000	20,000,000
First Tennessee Bank National Association, Memphis	08/22/07	5.25	20,000,000	20,000,000
Independent Bank, Memphis	07/02/07	5.25	2,500,000	2,500,000
Independent Bank, Memphis	12/07/07	5.30	3,000,000	3,000,000
Independent Bank, Memphis	07/02/07	5.25	2,000,000	2,000,000
Independent Bank, Memphis	07/02/07	5.25	2,000,000	2,000,000
Independent Bank, Memphis	07/02/07	5.25	500,000	500,000
Independent Bank, Memphis	07/02/07	5.25	2,000,000	2,000,000
Independent Bank, Memphis	11/29/07	5.30	6,500,000	6,500,000
Landmark Community Bank, Memphis	11/06/07	5.30	2,000,000	2,000,000
Paragon National Bank, Memphis	12/11/07	5.30	1,000,000	1,000,000
AmSouth Bank, Nashville	07/18/07	5.25	50,000,000	50,000,000
AmSouth Bank, Nashville	07/27/07	5.25	100,000,000	100,000,000
AmSouth Bank, Nashville	07/18/07	5.25	50,000,000	50,000,000
AmSouth Bank, Nashville	08/01/07	5.25	100,000,000	100,000,000

(continued)

State Cash Portfolio as of June 30, 2007

	Maturity	Yield to Maturity	Par Value	Fair Value
Bank of America, NA, Nashville	07/02/07	5.25	100,000,000	100,000,000
Bank of America, NA, Nashville	07/02/07	5.25	100,000,000	100,000,000
Bank of America, NA, Nashville	07/02/07	5.25	100,000,000	100,000,000
Bank of America, NA, Nashville	07/02/07	5.25	100,000,000	100,000,000
Bank of Nashville	08/22/07	5.25	5,000,000	5,000,000
Bank of Nashville	07/17/07	5.30	5,000,000	5,000,000
Bank of Nashville	09/12/07	5.25	20,000,000	20,000,000
Capital Bank & Trust Company, Nashville	12/04/07	5.30	2,000,000	2,000,000
Capital Bank & Trust Company, Nashville	12/18/07	5.30	3,500,000	3,500,000
Capital Bank & Trust Company, Nashville	09/28/07	5.30	1,000,000	1,000,000
Capital Bank & Trust Company, Nashville	07/13/07	5.30	2,000,000	2,000,000
Capital Bank & Trust Company, Nashville	11/13/07	5.30	3,000,000	3,000,000
Capital Bank & Trust Company, Nashville	10/26/07	5.30	5,000,000	5,000,000
Capital Bank & Trust Company, Nashville	12/04/07	5.30	5,000,000	5,000,000
Capital Bank & Trust Company, Nashville	09/14/07	5.30	3,000,000	3,000,000
Capital Bank & Trust Company, Nashville	09/25/07	5.30	3,000,000	3,000,000
Capital Bank & Trust Company, Nashville	12/04/07	5.30	1,000,000	1,000,000
Capital Bank & Trust Company, Nashville	12/24/07	5.30	4,000,000	4,000,000
Capital Bank & Trust Company, Nashville	11/30/07	5.30	4,000,000	4,000,000
Capital Bank & Trust Company, Nashville	09/21/07	5.30	2,500,000	2,500,000
Capital Bank & Trust Company, Nashville	11/23/07	5.30	3,000,000	3,000,000
Civic Bank & Trust, Nashville	11/02/07	5.30	1,000,000	1,000,000
Fifth Third Bank, Nashville	07/25/07	5.25	5,000,000	5,000,000
Fifth Third Bank, Nashville	07/30/07	5.25	15,000,000	15,000,000
Fifth Third Bank, Nashville	07/30/07	5.25	10,000,000	10,000,000
Fifth Third Bank, Nashville	09/19/07	5.18	25,000,000	25,000,000
Fifth Third Bank, Nashville	07/06/07	5.25	10,000,000	10,000,000
Fifth Third Bank, Nashville	07/25/07	5.25	10,000,000	10,000,000
Fifth Third Bank, Nashville	08/13/07	5.25	10,000,000	10,000,000
Fifth Third Bank, Nashville	09/12/07	5.25	25,000,000	25,000,000
Fifth Third Bank, Nashville	09/19/07	5.18	25,000,000	25,000,000
Fifth Third Bank, Nashville	09/19/07	5.18	10,000,000	10,000,000
Fifth Third Bank, Nashville	09/12/07	5.25	10,000,000	10,000,000
Fifth Third Bank, Nashville	07/23/07	5.25	10,000,000	10,000,000
Fifth Third Bank, Nashville	08/22/07	5.25	10,000,000	10,000,000
Fifth Third Bank, Nashville	08/31/07	5.25	30,000,000	30,000,000
Fifth Third Bank, Nashville	09/19/07	5.18	25,000,000	25,000,000
Fifth Third Bank, Nashville	09/26/07	5.25	25,000,000	25,000,000
Pinnacle National Bank, Nashville	07/20/07	5.30	5,000,000	5,000,000
Pinnacle National Bank, Nashville	07/13/07	5.25	10,000,000	10,000,000

(continued)

STATE CASH PORTFOLIO
AS OF JUNE 30, 2007

	Maturity	Yield to Maturity	Par Value	Fair Value
Pinnacle National Bank, Nashville	09/21/07	5.30	5,000,000	5,000,000
Pinnacle National Bank, Nashville	09/21/07	5.30	5,000,000	5,000,000
Pinnacle National Bank, Nashville	07/30/07	5.30	10,000,000	10,000,000
Pinnacle National Bank, Nashville	08/17/07	5.30	5,000,000	5,000,000
Pinnacle National Bank, Nashville	08/31/07	5.30	5,000,000	5,000,000
Pinnacle National Bank, Nashville	08/28/07	5.30	5,000,000	5,000,000
Newport Federal Bank	07/05/07	5.25	95,000	95,000
Newport Federal Bank	07/23/07	5.30	500,000	500,000
Newport Federal Bank	07/23/07	5.30	500,000	500,000
Newport Federal Bank	07/05/07	5.25	300,000	300,000
Community Trust & Banking Company, Ooltewah	12/21/07	5.30	500,000	500,000
Community Trust & Banking Company, Ooltewah	07/20/07	5.30	500,000	500,000
Community Trust & Banking Company, Ooltewah	11/06/07	5.30	500,000	500,000
First National Bank of Pulaski	11/27/07	5.30	300,000	300,000
First National Bank of Pulaski	08/28/07	5.30	300,000	300,000
First National Bank of Pulaski	11/30/07	5.30	500,000	500,000
First National Bank of Pulaski	11/30/07	5.30	300,000	300,000
First National Bank of Pulaski	12/07/07	5.30	1,000,000	1,000,000
First National Bank of Pulaski	12/07/07	5.30	1,000,000	1,000,000
First National Bank of Pulaski	11/27/07	5.30	700,000	700,000
First National Bank of Pulaski	12/04/07	5.30	300,000	300,000
First National Bank of Pulaski	12/04/07	5.30	1,000,000	1,000,000
First National Bank of Pulaski	11/27/07	5.30	500,000	500,000
First National Bank of Pulaski	12/21/07	5.30	2,000,000	2,000,000
First National Bank of Pulaski	11/23/07	5.30	2,000,000	2,000,000
First National Bank of Pulaski	07/03/07	5.30	6,000,000	6,000,000
Bank of Ripley	07/13/07	5.25	1,450,000	1,450,000
Bank of Ripley	07/12/07	5.25	550,000	550,000
People's Bank, Sardis	12/03/07	5.30	2,000,000	2,000,000
The Hardin County Bank, Savannah	07/24/07	5.30	1,000,000	1,000,000
First Century Bank, Tazewell	12/21/07	5.30	4,000,000	4,000,000
BancorpSouth, Trenton	07/23/07	5.25	1,500,000	1,500,000
Citizens City & County Bank, Trenton	11/27/07	5.30	95,000	95,000
First State Bank, Union City	10/05/07	5.30	3,000,000	3,000,000
First State Bank, Union City	12/07/07	5.30	5,000,000	5,000,000
First State Bank, Union City	10/02/07	5.30	1,000,000	1,000,000
First State Bank, Union City	10/12/07	5.30	1,000,000	1,000,000
First State Bank, Union City	08/24/07	5.30	1,500,000	1,500,000
First State Bank, Union City	10/26/07	5.30	2,500,000	2,500,000
Wayne County Bank	07/24/07	5.30	500,000	500,000
Wayne County Bank	08/24/07	5.30	900,000	900,000
TOTAL CERTIFICATES OF DEPOSIT			**$2,233,085,000**	**$2,233,085,000**

STATE CASH PORTFOLIO
AS OF JUNE 30, 2007

	Maturity	Yield to Maturity	Par Value	Fair Value
OVERNIGHT DEPOSIT ACCOUNTS				
Regions Bank - Overnight Deposit Account:	07/01/07	5.375%	$ 336,477,384	$ 336,477,384
TOTAL OVERNIGHT DEPOSIT ACCOUNTS			**$ 336,477,384**	**$ 336,477,384**

	Rating	Maturity	Par Value	Fair Value
COMMERCIAL PAPER				
A I G	A1	07/10/07	$ 100,000,000	$ 99,868,000
American Express	A1	07/10/07	100,000,000	99,868,750
Bear Stearns	A1	07/12/07	100,000,000	99,839,889
Cargill Global	A1	07/02/07	250,000,000	249,962,729
Citigroup	A1	07/05/07	50,000,000	49,970,917
Citigroup	A1	07/13/07	50,000,000	49,912,333
Citigroup	A1	07/02/07	275,000,000	274,959,132
General Electric	A1	07/02/07	375,000,000	374,944,479
H S B C	A1	07/02/07	275,000,000	274,959,514
H S B C	A1	07/11/07	100,000,000	99,853,333
Koch	A1	07/02/07	55,000,000	54,991,826
Koch	A1	07/03/07	50,000,000	49,985,444
Koch	A1	07/17/07	50,000,000	49,883,333
Merrill Lynch	A1	07/06/07	100,000,000	99,927,500
Metlife Funding	A1	07/02/07	45,240,000	45,233,277
Nestle	A1	07/13/07	50,000,000	49,913,250
Nestle	A1	07/19/07	50,000,000	49,869,875
Prudential Funding	A1	07/02/07	300,000,000	299,955,667
Toyota	A1	07/02/07	350,000,000	349,948,334
TOTAL COMMERCIAL PAPER			**$ 2,725,240,000**	**$ 2,723,847,582**
TOTAL STATE CASH PORTFOLIO			**$ 7,861,169,384**	**$ 7,855,671,217**

Baccalaureate Education System Trust Portfolio

BACCALAUREATE EDUCATION SYSTEM TRUST PORTFOLIO
as of June 30, 2007

Mutual Funds	Units	Fair Value
State Street S&P 500 Index Fund	371,075	$ 37,505,488
State Street Lehman Aggregate Index	2,535,293	30,727,757
JP Morgan Prime Money Market Premier	1,564,223	1,564,223
TOTAL MUTUAL FUNDS		**$ 69,797,468**
TOTAL PORTFOLIO		**$ 69,797,468**

Chairs of Excellence Largest Holdings

LARGEST BOND HOLDINGS

as of June 30, 2007
by Fair Value

Par Value	Security Name	Yield at Market	Maturity	Moody's Quality Rating	Fair Value
$ 10,000,000	United States Treasury Infl Index Note	2.11%	01/15/16	Aaa	$ 9,882,951
6,800,000	United States Treasury Notes	4.67	11/15/15	Aaa	6,558,813
5,000,000	United States Treasury Index Notes	3.27	01/15/12	Aaa	6,004,754
4,000,000	United States Treasury Bonds	5.47	05/15/30	Aaa	4,571,875
5,652,669	FNMA Pool #745250	5.17	01/01/21	NR	4,477,078
5,000,000	FNMA Pool #867662	6.44	05/01/36	NR	4,427,592
4,000,000	FNMA Debenture	6.24	06/15/09	Aaa	4,087,500
4,270,000	United States Treasury Infl Index Bond	2.21	01/15/26	Aaa	4,025,912
5,070,000	FNMA Pool #839272	5.69	09/01/35	NR	3,631,052
4,000,000	FNMA Pool #829070	4.74	09/01/20	NR	2,999,311

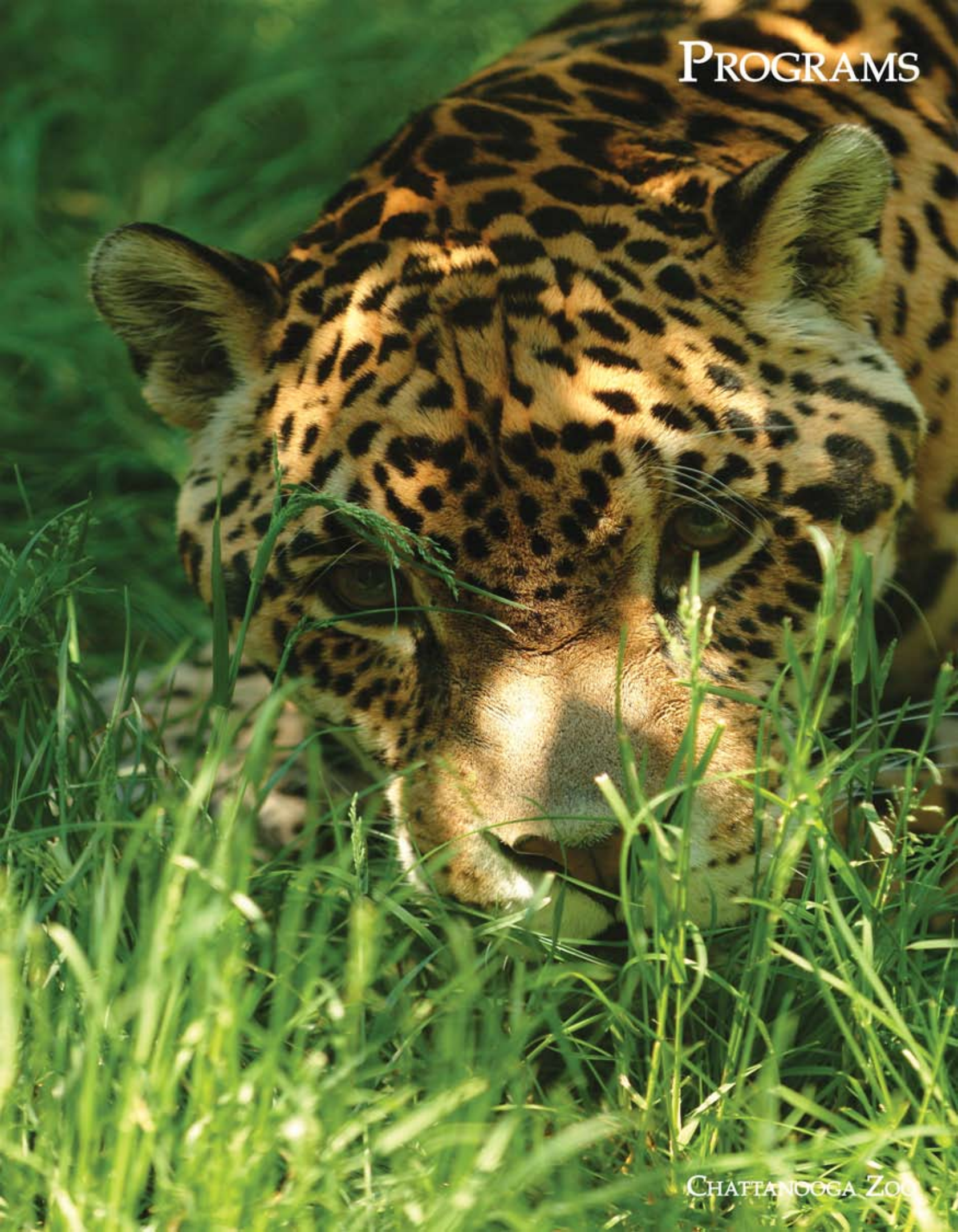
A complete portfolio listing is available upon request

Mutual Funds	Units	Fair Value
State Street S&P 500 Index Fund	1,563,935	$ 101,719,917
State Street MCSI EAFE Index Fund	2,257,197	44,171,086
JP Morgan Prime Money Market Premier	5,065,511	2,393,871
TOTAL MUTUAL FUND		$ 148,284,874

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

Chattanooga Zoo

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 Prepaid College Tuition Plan and the BEST Savings Plan. The requirements for participation and administration of the Prepaid College Tuition Plan are contained in *Chapter 1700-5-1 of the Official Compilation of the Rules and Regulations of the State of Tennessee*. The requirements for participation and administration of the Savings Plan are contained in *Chapter 1700-5-2 of the Official Compilation of the Rules and Regulations of the State of Tennessee.*

Both BEST programs are qualified tuition program under section 529 of the *Internal Revenue Code*. As 529 plans, several favorable tax benefits are offered to 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 federal taxation. The maximum account limit 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 and by providing multiple payment options.

Qualified expenses include tuition, fees, books, room and board, and supplies or 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.

The program website, www.treasury.state.tn.us/best, 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.

The Baccalaureate Education System Trust prepaid program began accepting contracts and contributions in June 1997. At June 30, 2007, BEST had 8,826 contracts with assets totaling $95.6 million. The BEST Prepaid Plan annually adjusts the unit price to reflect the current weighted average tuition of Tennessee's public colleges and universities.

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

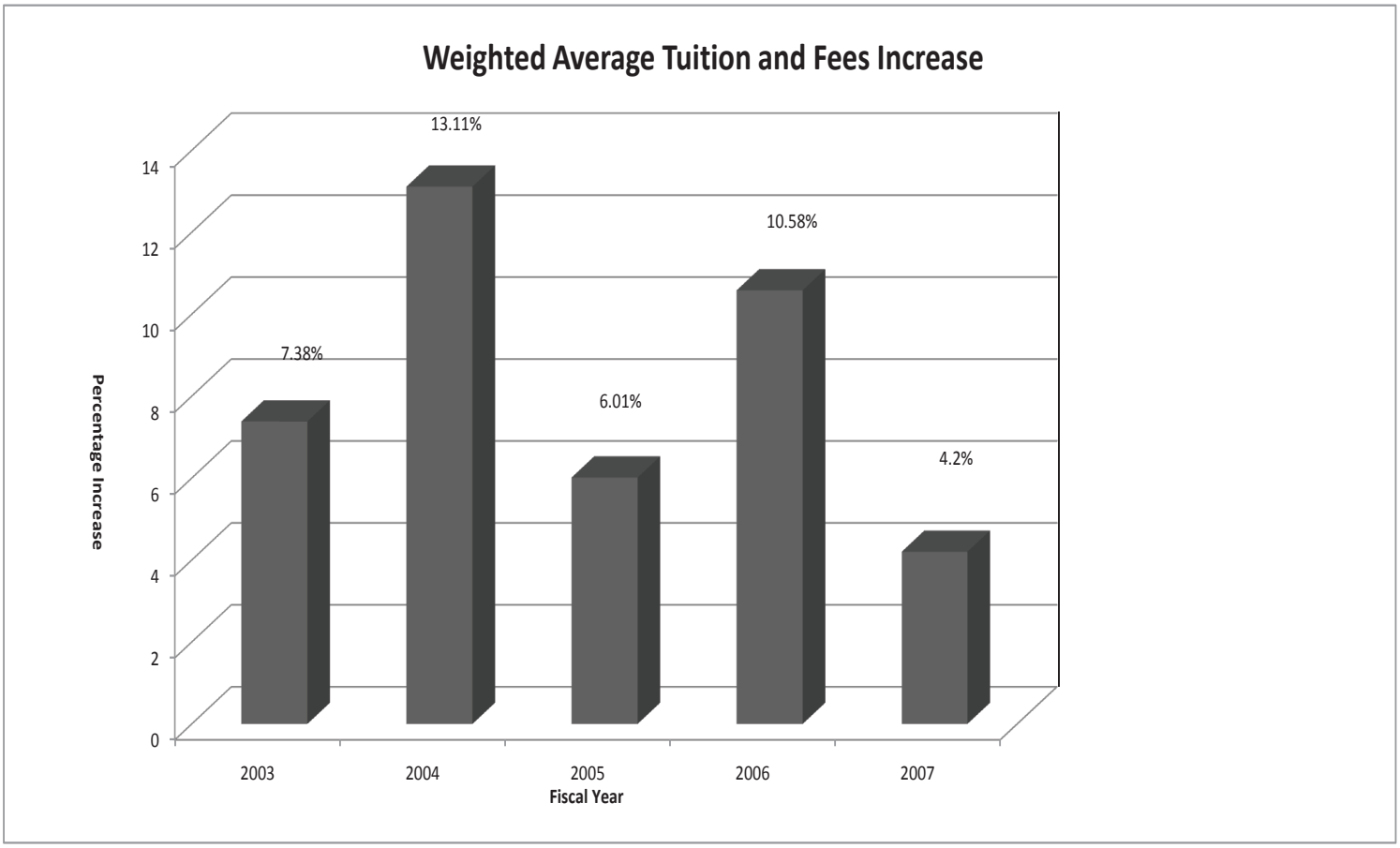
BACCALAUREATE EDUCATION SYSTEM TRUST

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, 2006 until June 30, 2007 was 3.4%.

The Savings Plan began accepting contracts and contributions in March 2000. At June 30, 2007, there were 4,974 contracts with assets totaling $43.8 million.

PREPAID TUITION PLAN
WEIGHTED AVERAGE TUITION AND FEE INCREASE
Fiscal Years 2003-2007



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
2008	53.79	3.13	4.56	61.48	2.15	63.63

*** Adjustment equal to 1/2 earnings rate assumption.**

BEST SAVINGS PLAN ACTIVITY
Fiscal Years 2003-2007

Assets	2003	2004	2005	2006	2007
(Expressed in Thousands)					
Total Cumulative Assets	$ 8,826	$ 18,346	$ 25,564	$ 32,311	$ 43,828
Contributions	$ 4,295	$ 9,088	$ 6,361	$ 6,365	$ 7,911
Redemptions	$ 317	$ 797	$ 828	$ 1,660	$ 1,681
Account Activity					
Total Cumulative Accounts	2,152	3,137	3,604	4,197	4,974
New Accounts	781	985	457	593	777

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 250 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 40 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, College of William and Mary, University of Washington 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

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 2003-2007

Fiscal Year	Investment Income	Total Spending of the Chairs	Asset Balance
2007	$ 33,163,435	$ 6,515,607	$ 252,447,384
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

ANNUALIZED INVESTMENT RETURN

	1 Year	5 Years	10 Years
Domestic Equity	20.58%	10.73%	6.78%
International Equity	27.06	-	-
Fixed Income	5.48	3.74	5.59
Short-Term	5.26	2.81	3.95
Total Portfolio	14.61%	7.80%	6.57%

Chairs of Excellence Trust

AUTHORIZED CHAIRS OF EXCELLENCE

THE UNIVERSITY OF TENNESSEE

Chattanooga

Miller COE in Management & Technology
SunTrust 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
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

(continued)

Chairs of Excellence Trust

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 Pathology

CLAIMS AGAINST THE STATE

CLAIMS AGAINST THE STATE

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

The Division of Claims Administration processes claims filed against the state for the negligent operation of motor vehicles or machinery; negligent care, custody and control of persons or property; professional malpractice; workers' compensation claims by state employees; dangerous conditions on state maintained highways and bridges; and nuisances created or maintained by the state. The Division of Claims Administration 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 40.6% savings off billed charges as a result of the fee schedule, plus an additional 7.5% 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 2007, the Division of Claims Administration received 4,856 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 2007 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 2007

Claims Activity	Claims Filed	Payments Made
Workers' Compensation Claims	3,579	
Death Payments		$ 431,084
Medical Payments		10,587,088
Temporary Disability		2,066,577
Permanent Disability		6,441,543
Subtotal		19,526,292
Employee Property Damage	115	18,867
Tort Claims	1,162	
Death Payments		1,957,966
Bodily Injury Payments		3,667,255
Property Damage Payments		827,155
Subtotal		6,452,376
Total Claims Against the State	**4,856**	**$ 25,997,535**

FIVE YEAR CLAIMS HISTORY
Fiscal Years 2003-2007

Fiscal Year	Claims Filed	Amount of Claims Paid
2007	4,856	$ 25,997,535
2006	4,906	24,420,318
2005	5,409	28,975,152
2004	5,825	27,705,099
2003	5,909	29,054,420

CRIMINAL INJURIES COMPENSATION FUND

CRIMINAL INJURIES COMPENSATION FUND

The Criminal Injuries Compensation Fund ("Fund") provides financial assistance to crime victims through two types of programs. The funding for the programs includes privilege taxes assessed in courts against criminal defendants and other offenders upon conviction, fees levied against parolees and probationers, the proceeds of bond forfeitures in felony cases, and a federal grant. Jurors may also elect to donate their jury service reimbursement to the Fund.

Criminal Injuries Compensation Program

Payments made under the Criminal Injuries Compensation Program are intended to defray the costs of medical services, loss of earnings, burial costs, and other pecuniary losses to either an innocent victim of a crime or to the dependents of a deceased victim. Applications for Criminal Injuries Compensation are filed with the Division of Claims Administration. During the 2007 fiscal year, 2,623 new claims were filed.

The division's staff reviews the application and obtains supporting information from the appropriate District Attorney's Office to determine eligibility for payment from the Criminal Injuries Compensation Fund. If the division cannot process a claim within 90 days, then the claim is transferred to the Tennessee Claims Commission. Eligible payments are issued promptly and are payable directly to the service provider if the bill is unpaid, to the victim for out-of-pocket expenses and, if appropriate, his or her attorney. On average, the division renders a decision on claims within 51 days.

During the 2007 fiscal year, the Division of Claims Administration made payments to victims of crime totaling $12.7 million.

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

Since the first claims were paid in 1982, the program has awarded a total of more than $176 million to crime victims.

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

Sexual Assault Forensic Exam Reimbursement

In 2007, the General Assembly amended the Criminal Injuries Compensation Act to provide payment for services related to sexual assault forensic examinations. The Fund will provide reimbursement to a facility that performs sexual assault forensic exams on victims of certain sexually-oriented crimes. Facilities must bill the Fund (not the victim) and cannot seek any additional payment from the victim after payment by the Fund. Payment will be up to $750 for such services for crimes occurring on or after July 1, 2007.

SOURCES OF FUNDS
Fiscal Years 2005-2007

	2005		2006		2007	
Source	**Amount**	**Percentage**	**Amount**	**Percentage**	**Amount**	**Percentage**
Privilege Taxes	$ 4,358,617	39%	$ 4,351,199	39%	$ 4,718,062	39%
Federal Funds	3,167,000	29%	3,177,000	29%	3,411,000	28%
Probation Fees	2,063,006	19%	2,107,481	19%	2,183,494	18%
Parole Fees	668,880	6%	764,503	7%	833,820	7%
Bond Forfeitures	515,005	5%	339,176	3%	536,720	5%
Other	191,431	2%	365,429	3%	333,891	3%
Total	**$ 10,963,939**	**100%**	**$ 11,104,788**	**100%**	**$ 12,016,987**	**100%**

Criminal Injuries Compensation Fund

CLAIMS PAID BY CRIME TYPE
Fiscal Year 2007

Crime Type	Number Paid	Percentage of Total Claims	Amount Paid	Percentage of Total Paid
Assault	747	40.3%	$ 6,207,306	48.7%
Homicide	341	18.4%	2,869,027	22.5%
Robbery by Force	179	9.7%	1,674,421	13.2%
Child Sexual Abuse	327	17.6%	804,986	6.3%
DUI	69	3.7%	620,812	4.9%
Adult Sexual Assault	167	9.0%	335,206	2.6%
Vehicular (non DUI)	17	0.9%	171,424	1.4%
Kidnapping	1	0.1%	30,000	0.2%
Child Physical Abuse	6	0.3%	25,268	0.2%
Total	**1,854**	**100.0%**	**$ 12,738,450**	**100.0%**

NEW CLAIMS FILED
Fiscal Year 2007

Crime Type	Number Filed
Assault	1,043
Child Sexual Abuse	493
Homicide	459
Robbery by Force	221
Adult Sexual Assault	184
DUI	106
Vehicular (Non DUI)	87
Other	18
Child Physical Abuse	9
Stalking	2
Kidnapping	1
Total	**2,623**

CLAIMS DENIED BY REASON
Fiscal Year 2007

Reason Type	Number Denied	Percentage
Contributory Behavior	225	22%
Insufficient Documentation	186	18%
Collateral Resource Covered Loss(es)	128	13%
Failure to Cooperate/Prosecute	124	12%
Ineligible Crime	84	8%
Ineligible Claimant	53	5%
Insufficient Proof of a Crime	44	4%
Late Filing of Claim	37	4%
Other	32	3%
No Collateral Resource Information	28	3%
Ineligible Loss(es)	27	3%
Loss(es) Less than $100	21	2%
Late Reporting of Crime	18	2%
Passenger with Drunk Driver	9	1%
No Report of Crime	3	0%
Lack of Proper Signature	2	0%
Total	**1,021**	**100%**

In fiscal year 2007, 816 claims were denied. Some claims are denied for more than one reason.

Claims Commission

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 Govenor 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

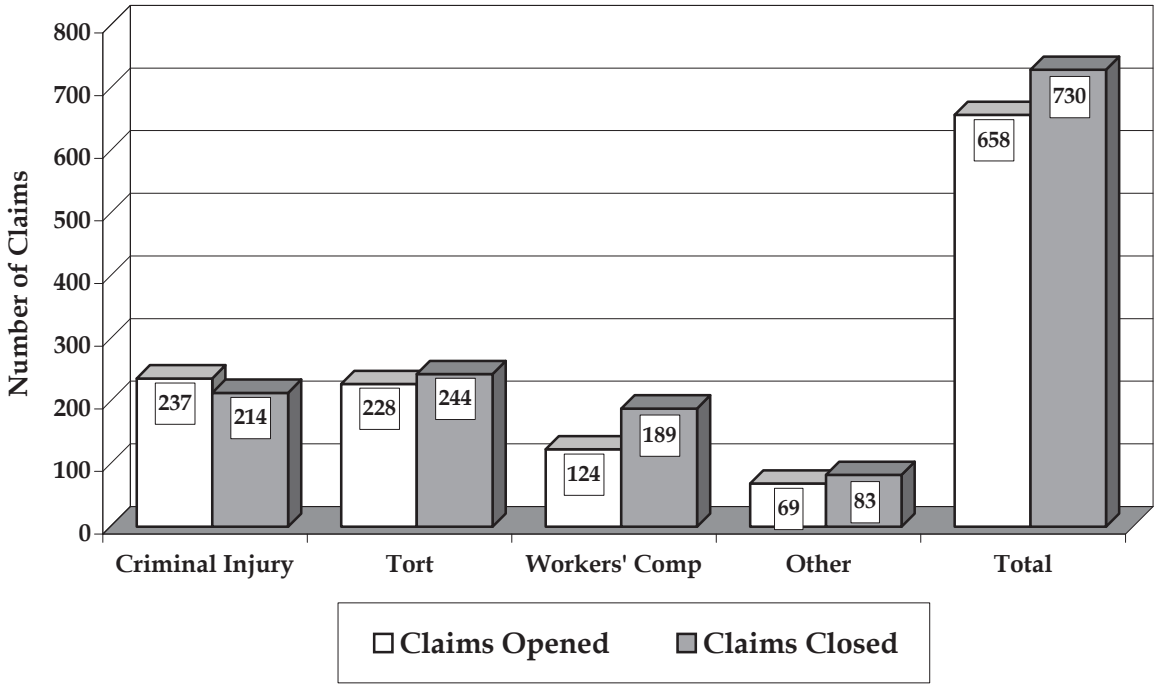
The vast majority of claims are first filed with the Division of Claims Administration. Claims involving taxes are filed directly with the Claims Commission, and claims involving workers' compensation are filed directly with a third-party administrator.

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.

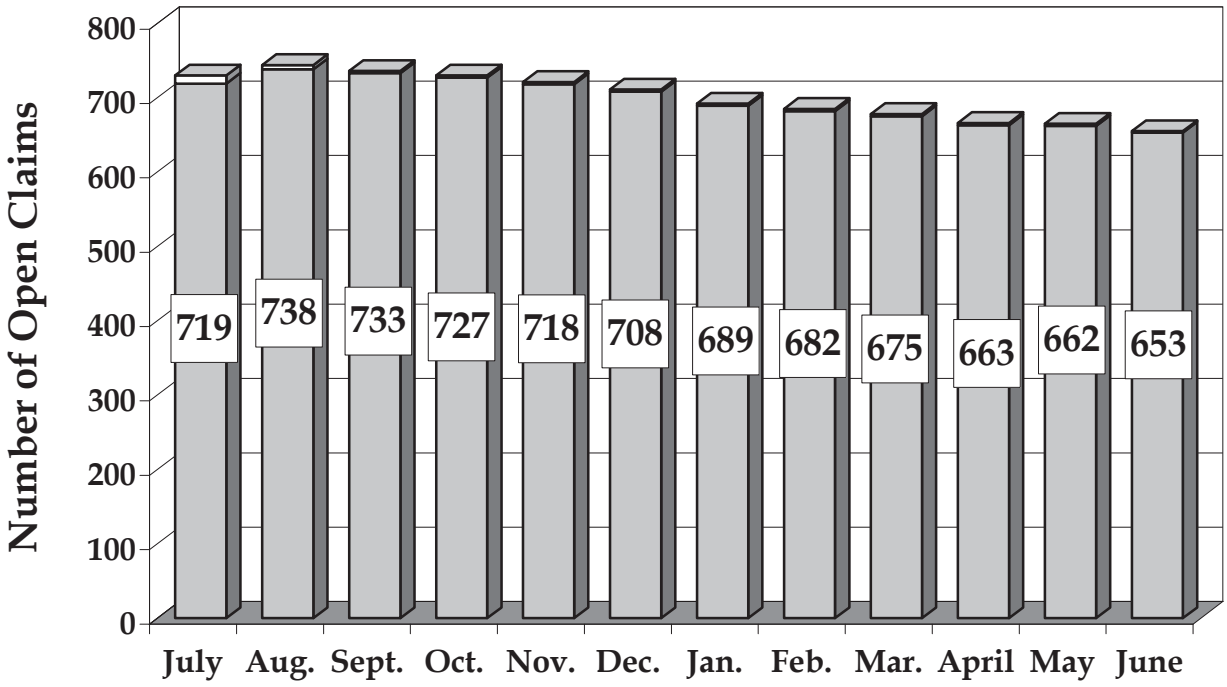
The commission has two separate dockets: a regular docket for claims greater than $15,000 and a small claims docket for claims under that amount. Commission decisions on regular docket claims can be appealed to the Tennessee Court of Appeals or, in the case of tax and workers' compensation claims, to 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 2007



CLAIMS COMMISSION AND ADMINISTRATIVE LAW JUDGE OPEN CLAIMS
Fiscal Year 2007



Risk Management

DIVISION OF RISK MANAGEMENT

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

The state contracts with 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.

Fiscal year 2007 was one of the most profitable years in the history of property insurance underwriting. As a result, there was approximately $150 billion of additional insurance capacity in the marketplace. The only area of concern for underwriters seemed to center around catastrophic losses. With West Tennessee sitting on the New Madrid fault, the State's broker continued to struggle in its efforts to achieve a respectable level of earthquake coverage. The State's primary level of property insurance limits remained at $250 million per occurrence, but an additional $250 million in excess coverage was negotiated, giving the State a total coverage (except flood and earthquake) in the amount of $500 million. The broker felt this level of coverage was needed due to high concentrations of insured properties in many areas throughout the state. Flood coverage limits remained at $50 million, with the exception of properties in the higher risk zones, which carry reduced limits. Earthquake limits, once again, remained at $50 million, except for properties in the New Madrid area, which continued at the $25 million level. 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, 2007, total insured property values were $13.7 billion. Total premium costs for all lines of property and fidelity coverages amounted to $2.5 million.

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 2007, two hundred insurance certificates were issued for new construction projects approved by the building commission. Due to the fact that insurance certificates are now written on a one-year term, the total of all projects extending beyond the end of the fiscal year required a renewal certificate to be issued to ensure continuity of coverage. Coverage limits remained at $25 million per location and $30 million per occurrence. Projects exceeding these limits must be reported to the insurance carrier immediately so that a review of such projects may be conducted. The carrier will notify the Division of Risk Management, through the State's broker, if additional premium will be billed for the increased coverage. These occurrences are few and the projects submitted for approval up to this point have resulted in no additional premium charges.

Boiler insurance must be provided to ensure protection for all of the State's 2,286 boiler objects. A boiler insurance policy is purchased from a private insurance carrier, which is not only responsible for boiler breakdown 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 fidelity and crime coverage. Coverage limits are provided in the amount of $1 million per incident/aggregate for all state employees. This coverage is extended to Treasurers and Tax Collectors through a policy endorsement, since such positions are normally excluded.

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 an independent adjusting service. This service works directly with Risk Management, to resolve all claims issues. For emergency situations a restoration company is under contract with the state, and will provide immediate response to prevent costly damages. A detailed property inventory provides the current insurable values for both buildings and

contents. Agency deductibles vary according to the type of claim. 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, until the end of the fiscal year.

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 workers' compensation losses, risk management has been analyzing loss information provided by the State's 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 2007

Insurance Coverage Information		
Insured Property Values	$	13,668,184,600
Primary Property Limits Per Occurrence	$	250,000,000
Excess 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
Insurance Company Obligation		3,461,000
Risk Management Fund Obligation		5,000,000
Total Property Losses	$	8,686,000

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

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 by rule to develop an assistance program for small and minority-owned businesses, as defined in *Tennessee Code Annotated Section 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 development process, the Department held hearings around the state, conferred 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 with 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 Economic and Community Development. The Telecommunications Program provided loan guarantees to qualifying businesses. With all guaranty obligations being paid, rescinded or released as of September 30, 2007, there are no outstanding guaranty obligations therefore, the Program has formally ceased to function. Whereas the Telecommunications Program focused on a specific facet of industry, the Small and Minority-Owned Business Assistance Program will be 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 improved cash flow management, implementing internal financial management systems, strategic planning and identifying procurement opportunities with state, federal and local government systems.

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 Department utilizes various techniques to locate the owners. There is no time limit on claiming this property.

During the period July 1, 2006 through June 30, 2007, $45 million of cash property was turned over to the Treasurer. This includes $2.3 million remitted by third party audit organizations from out-of-state non-reporting holders for Tennessee residents. An additional $6 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 Department advertises the 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 2.9 million visitors at June 30, 2007, an increase of 275,000 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, 2006 through June 30, 2007, $17.5 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, $595,996 was refunded to 24 local governments.

Tennessee has reciprocal agreements with other unclaimed property programs in other states to exchange property held by one state for owners with a last known address in the other state. Tennessee received $1.3 million for residents or former residents in exchange for $1.6 million paid to other states' unclaimed property offices.

Since the program began operations in 1979, $471.8 million in unclaimed property has been reported to the Treasurer and $153.2 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 58% of property that is turned over with an owner's name.

UNCLAIMED PROPERTY DIVISION

METHODS USED TO RETURN PROPERTY
Fiscal Year 2007

Location Method	Number of Accounts	Value of Claims	Average Claim Value
Website Inquiries	8,021	$ 6,872,934	$ 857
Staff or Other Outreach	658	3,155,807	4,796
Holder Referral or Reimbursement	404	1,711,283	4,236
Mailings to Last Known Address	2,489	1,407,115	565
Independent Locator	126	932,400	7,400
Advertisement and Television	1,648	686,419	417
Match with Dept. of Labor and Workforce Records	2,007	543,099	271
Total Claim Payments	**15,353**	**$ 15,309,057**	997
Interstate Exchanges	53	1,554,879	
Refunds to Local Governments	24	595,996	
Total Payments	**15,430**	**$ 17,459,932**	

SOURCES OF UNCLAIMED PROPERTY
Fiscal Years 2003-2007

	2007	2006	2005	2004	2003
Financial Institutions	28%	29%	37%	28%	30%
Corporations, Transportation, Colleges, Retailers	22%	19%	11%	19%	20%
Insurance Companies	20%	21%	20%	29%	18%
Escheat and Other	7%	6%	7%	7%	7%
Hospitals and Health Care	6%	4%	3%	2%	3%
Securities and Brokerage Firms	5%	4%	8%	1%	2%
Utilities	5%	6%	5%	6%	8%
Cities and Counties	4%	8%	5%	5%	7%
Other States	3%	3%	4%	3%	5%
Total	100%	100%	100%	100%	100%

ACTIVITY
Fiscal Years 2003-2007

	2007	2006	2005	2004	2003
Number of Holders Reporting	5,531	5,251	5,228	4,784	4,675
Number of Properties Received	223,703	290,254	226,918	294,446	180,539
Cash Received *(Not including Shares Sold)*	$ 45,016,106	$ 40,233,068	$ 40,397,209	$ 37,425,232	$ 35,395,003
Number of Shares Received	1,364,190	1,685,649	489,767	830,379	521,971
Value of Shares Sold	$ 6,021,856	$ 23,277,122	$ 8,908,304	$ 3,455,735	$ 2,410,387
Number of Claims Paid	15,430	15,245	16,504	14,742	14,282
Cash Paid	$ 17,459,932	$ 20,727,999	$ 17,560,719	$ 13,043,762	$ 12,727,784
Shares Paid	148,952	348,525	265,790	308,569	105,681

Administration

Nashville Zoo
Michelle Cribbs

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
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	Amycity (Misty) Nichols	(615) 253-3853
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	Sandra Sewell	(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 Management 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 of Small and Minority-Owned Business Assistance Program	Jaye Chavis	(615) 253-6661
Manager of BEST Program	LaKesha Page	(615) 532-5888
Director of Unclaimed Property	John Gabriel	(615) 253-5354
Assistant Director Unclaimed Property	Kellie Williamson	(615) 253-5356
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[10]
Arnett, Ron
Arnold, Sandra
Atkins, Sandra
Atkins, Janice
Aymett, Ron
Bachus, Jill
Baker, Linda[35]
Baker, Sam
Baker, Sherry
Bandy, Gregory
Barrett, Billy
Battle, Keevia
Bauer, David
Baumgartel, Karen
Birthrong, Peggy[15]
Booker, Velva
Brown, Buffy
Burcham, Janet
Burns, Bobby[15]
Burton, Nathan
Bush, Vernon
Butterfield, Keith[5]
Campbell, Heath[5]
Carr, Brenda[30]
Cavender, William
Chandler, Jerry
Chapman, Beth
Chatman, Shirley
Chavis III, Jordan
Coleman, Alva
Conlin, Jeremy
Costa, Delcinia
Cotter, Liddye[30]
Couch, Janie
Crews, Daniel
Crosby, Cindy
Culberson, Cavandrea[5]
Cunningham, Janice
Curry, Steve
Curtis, Karen
Curtis, Shawn[10]
Daniel, Ted
Daniels, Ruth[30]
Darrell, Pat
Davis, Amanda[5]
Davis, Melissa
Davis, Terry
Denney, Pam
Derrick, Brian
Dickens, Sarah
Dills, Larissa
Dorse, Bridget
DuBray, Rick
Dunlap, Amy[15]
Edmundson, Ray
Esaka, Cassandra
Esters, Adrienne
Faehr, Karen[5]
Farmer, Sharon
Fisher, Peggy
Fohl, Jamie[20]
Fredin, Cort
Freeman, Jerry
Fuller, Charlotte
Fuqua, Monica
Gabriel, John
Gaines, Doug
Gatewood, Ann[35]
Gibson, Connie
Graves, Randy
Gray, Tammy
Green, Carrie
Green, Janice
Greene, Barbara
Gregory, Nikki
Gregory, Steve
Griffin, Delores
Hadley, Cris
Hall, Sherry
Hargrove, Kathy
Hart, Tracy[5]
Hartley, Kerry
Hedges, Matthew
Hennessee, Ed
Hurt, Sandra
Hyder, Patti
Ingle, Harry
Jacobsen, Mark
Javner, Donnie
Jennette, Angela[5]
Johnson, Roxanne
Johnson, Tawana[5]
Jones, Chris
Katseff, Peter
Keeler, Mike
King, Jenny[15]
Klar, Markus
Ladd, George
Li, Liren
Mackey, Wanda
Maddox, Teresa
Majors, Vallie
Manson, Cathy
Marshall, Fred
Mason, Justin
McAdams, Keniqua
McClure, Tim[20]
McDade, Joshua
McMillan, Bruce
Mercier, Brenda
Miller, Henry
Miller-Herron, Nancy[5]
Milne, Thomas
Molloy, Newt[35]
Moore, Crystal
Morgan, Prentice
Morrow, Kim
Moses, Gail
Moulder, Mike
Murphy, Aimee
Myers, Barbara
Myers, Rhonda
Newberry, Lori
Nichols, Amycity
Norment, Christy
Oakley, Heather
O'Leary, Candy[20]
O'Saile, Mandy
Oliphant, Sarah
Otts, Kim
Oyster, David
Padgett, Wendy
Page, LaKesha
Palmer, Andy
Parlow, Yvonne
Parton, Floyd
Patel, Abhi
Payne, Jana
Picunko, Jesse
Pinson, Marian
Pritchett, Brad[5]
Redmond, William
Reevers, Stephanie
Reynolds, Ian
Richeson, Marsha
Riley, Carla
Roberts-Krause, Mary[20]
Roberts, Rachel
Robinson, Jim
Robinson, Mia
Rochelle, Dawn
Sabin, Stephanie
Sanders, Sharon
Sanders, Teresa
Sanford, Letha
Scott, Tammie
Sewell, Sandra
Shults, William O.
Simpson, Ben
Sims, Dale
Singleton, David[10]
Skinner, Jamie
Smith, Anita
Smith, Brett
Smith, Kimberly
Smith, Mary
Smith, Robert
Staggs, Amanda
Taylor-Tharpe, Ann
Thomas, Issac
Thompson, Jamie Lynn
Tucker, Anthonio
Veach, Johnny
Vinson, Maxine
Wagner, Malinda
Wakefield, Mark[10]
Washington, Tracey
Wayman, Jamie
Wellington, Roy
Whaley, Kimberly
Wheeler, Shirley
Whitworth, Deborah
Wilkins, Natasha
Williams, Teresa
Williamson, Kellie
Willocks, Dianne[40]
Wilson, Martha
Wilson, Shirley
Wimmer, Genera
Wood, Britt
Woodard, Vivian
Woodrum, Angela
Wooten, Jennifer
Younglove, Sigourney

[5] Received 5-year service award in 2007
[10] Received 10-year service award in 2007
[15] Received 15-year service award in 2007
[20] Received 20-year service award in 2007
[25] Received 25-year service award in 2007
[30] Received 30-year service award in 2007
[35] Received 35-year service award in 2007
[40] Received 40-year service award in 2007

Treasury Internet Services

Program	Internet Site Features	Internet Address
Services to the Public		
BEST	529 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
TN Claims Commission	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
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

Knoxville Zoo

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 7, 2007

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

Dear Mr. Morgan:

We have audited the accompanying 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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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 7, 2007, on our consideration of the Baccalaureate Education System Trust, Educational Services Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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., CPA
Director

Baccalaureate Education System Trust, Educational Services Plan
Comparative Statements of Fiduciary Net Assets
June 30, 2007 and June 30, 2006

ASSETS	June 30, 2007	June 30, 2006
Cash and cash equivalents	$ 27,312,565	$ 6,367,546
Receivables		
Contributions receivable	8,362	8,575
Investment income receivable	5,297	24,209
Investments, at fair value		
Investment in fixed income index fund	30,727,757	39,895,827
Investment in equity index fund	37,505,487	14,492,166
TOTAL ASSETS	95,559,468	60,788,323
LIABILITIES		
Other investment payable	7,810	4,820
TOTAL LIABILITIES	7,810	4,820
NET ASSETS HELD IN TRUST FOR PLAN PARTICIPANTS	$ 95,551,658	$ 60,783,503

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, 2007 and June 30, 2006

ADDITIONS	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006
Contributions	$ 5,578,640	$ 6,193,944
Investment income		
Net increase (decrease) in fair value of investments	6,559,337	(1,600,940)
Interest and dividend income	2,398,731	2,760,189
Less: Investment expense	(27,420)	(11,842)
Net investment income	8,930,648	1,147,407
Administrative fees	351,988	332,411
Operating transfer from general fund	25,950,000	-
TOTAL ADDITIONS	40,811,276	7,673,762
DEDUCTIONS		
Refunds	731,244	503,502
Payments	4,939,836	3,557,595
Administrative cost	372,041	320,302
TOTAL DEDUCTIONS	6,043,121	4,381,399
CHANGE IN NET ASSETS	34,768,155	3,292,363
NET ASSETS HELD IN TRUST FOR PLAN PARTICIPANTS		
BEGINNING OF YEAR	60,783,503	57,491,140
END OF YEAR	$ 95,551,658	$ 60,783,503

See accompanying Notes to the Financial Statements

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 or a short-term, open-end mutual fund, J P Morgan Prime Money Market 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.

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

(continued)

investment policy established by the Board is delegated to the State Treasurer. The ESEP does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund 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. 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.

Credit Risk

The ESEP does not currently own specific fixed income securities, but chooses to invest in a Lehman Government Aggregage Index Fund. At June 30, 2007 and June 30, 2006, the ESEP had $30,727,757 and $ 39,895,827 respectively, invested in the Lehman Government Aggregate Index Fund.

Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings for the ESEP's investments in fixed income securities as of June 30, 2007 and June 30, 2006 are not available since the Lehman Government Aggregate Index Fund is not traded on an exchange and is unrated; however the average rating for the securities in the fund is AA2 for both years. Neither the State Pooled Investment Fund nor the J P Morgan Prime Money Market Fund has 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. The policy further states that index funds may be utilized as an alternative to selecting individual securities.

(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 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 effective duration for the index fund that ESEP utilizes was 4.72 at June 30, 2007 and 4.79 at June 30, 2006. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price.

C. 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 $13,856,044 more at June 30, 2007, and $18,192,516 less at June 30, 2006, 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.

D. OTHER ACCOUNTING DISCLOSURES

In accordance with *Public Chapter 603, Acts of 2007*, a transfer of $25,950,000 from the general fund was made June 30, 2007 to meet the obligations of the ESEP program.

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 7, 2007

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, 2007, and June 30, 2006, 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.

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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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 7, 2007, on our consideration of the Chairs of Excellence's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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., CPA
Director

Chairs of Excellence
Comparative Balance Sheets
June 30, 2007 and June 30, 2006

	June 30, 2007	June 30, 2006
ASSETS		
Cash and cash equivalents	$ 4,892,461	$ 8,879,532
Investments, at fair value		
Government securities	78,964,587	86,969,505
Corporate securities	25,128,948	15,633,140
Investment in equity mutual fund	145,870,688	121,614,333
Total investments	249,964,223	224,216,978
Receivables		
Due from colleges and universities	698,000	635,710
Investment income receivable	1,998,280	1,817,057
Total receivables	2,696,280	2,452,767
TOTAL ASSETS	$ 257,552,964	$ 235,549,277
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Due to colleges and universities	$ 1,861,610	$ 1,923,006
Due to the Academic Scholars Fund	3,227,367	3,184,277
Investments purchased	0	4,266,547
Other investment payable	16,603	15,656
TOTAL LIABILITIES	5,105,580	9,389,486
FUND BALANCES		
Reserved for non-expendable corpus	99,929,963	99,929,963
Unreserved	152,517,421	126,229,828
TOTAL FUND BALANCES	252,447,384	226,159,791
TOTAL LIABILITIES AND FUND BALANCES	$ 257,552,964	$ 235,549,277

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, 2007 and June 30, 2006

	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006
REVENUES		
Investment income	$ 33,163,435	$ 12,471,255
Contributions from private sources	0	96,665
TOTAL REVENUES	33,163,435	12,567,920
EXPENDITURES		
University of Tennessee	3,180,266	3,453,129
Tennessee Board of Regents	3,335,341	3,236,174
Academic Scholars Fund	164,790	43,019
Administrative cost	195,445	182,878
TOTAL EXPENDITURES	6,875,842	6,915,200
EXCESS OF REVENUES OVER EXPENDITURES	26,287,593	5,652,720
FUND BALANCES, BEGINNING OF YEAR	226,159,791	220,507,071
FUND BALANCES, END OF YEAR	$ 252,447,384	$ 226,159,791

See accompanying Notes to the Financial Statements

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007 AND JUNE 30, 2006

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 either the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer or a short-term, open-end mutual fund 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.

(continued)

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. As of June 30, 2007 and June 30, 2006, the COE Trust had investments as shown on the following page. The COE Trust also invests idle cash in a short term investment with our master custodian, JP Morgan Prime Money Market Fund. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities.

State statute also authorizes the 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.

As of June 30, 2007 and June 30, 2006, the COE Trust had the following investments:

(continued)

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007 AND JUNE 30, 2006

Expressed in Thousands			Credit Quality Ratings				
Investment Type	**Fair Value As of June 30, 2007**	**United States Treasury/Agency**	**AAA**	**AA**	**A**	**BBB**	**Not Rated**
Debt Investments							
U.S. Government							
U.S. Treasuries	$ 17,422	$ 17,422					
U.S. Government TIPS	21,193	21,193					
U.S. Agencies	7,520		$ 7,520				
Mortgage Backed							
Government Pass-through	32,830	3,867					$ 28,963
Corporate							
Corporate Bonds	16,486		2,036	$ 5,398	$ 6,402	$ 2,650	
Corporate Asset Backed	7,326		6,324		1,002		
Private Placements	1,317			493		824	
Yankee Bonds	0						
ShortTerm							
Agencies	0						
Total Debt Investments	$ 104,094	$ 42,482	$ 15,880	$ 5,891	$ 7,404	$ 3,474	$ 28,963
Other Investments							
Commingled Funds							
U.S. Equity	$ 101,720						
Non - U.S. Equity	44,151						
Money Market Funds	5,066						
Total Other Investments	$ 150,937						
Total Investments	$ 255,031						
Less: Investments Classified as Cash Equivalents on Balance Sheet	(5,066)						
Total Investments as Shown on Balance Sheet	$ 249,965						

Expressed in Thousands			Credit Quality Ratings				
Investment Type	**Fair Value As of June 30, 2006**	**United States Treasury/Agency**	**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
Other Investments							
Commingled Funds							
U.S. Equity	$ 76,263						
Non - U.S. Equity	45,351						
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						

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)

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, 2007 and June 30, 2006 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. Neither the State Pooled Investment Fund nor the J P Morgan Prime Money Market Fund has 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, 2007		June 30, 2006	
Issuer Organization	Fair Value	Percentage	Fair Value	Percentage
Federal National Mortgage Association	$30,023,756	11.78%	$30,437,840	13.06%

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

Interest Rate Risk

Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The investment policy for the COE Trust states that the maturity of its debt securities may range from short-term instruments, including investments in the State Pooled Investment Fund, to long-term bonds, with consideration of liquidity needs. However, the policy does not specifically address limits on investment maturities. The fixed income portfolio is benchmarked against the Lehman Government/Corporate Intermediate Index and tends to have a duration within a

(continued)

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, 2007 and June 30, 2006.

Chairs of Excellence
Debt Investments
(Expressed in Thousands)

Investment Type	Fair Value As of June 30, 2007	Effective Duration (years)
Debt Investments		
U.S. Government		
U.S. Treasuries	$ 17,421	9.17
U.S. TIPS		
Inflation Indexed Bonds	4,026	7.03
Inflation Indexed Notes	17,167	2.21
U.S. Agencies	7,520	1.67
Mortgage Backed		
Government Pass-through		
GNMA	3,867	5.32
FHLMC	3,964	4.83
FNMA	24,999	4.49
Corporate		
Corporate Bonds	16,486	3.22
Corporate Asset Backed	7,326	5.77
Private Placements	1,317	5.00
Total Debt Investments	$ 104,093	4.80

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

(continued)

Chairs of Excellence
Notes to the Financial Statements
June 30, 2007 and June 30, 2006

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, 2007, 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, 2007. 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 7, 2007

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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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 7, 2007, on our consideration of the Criminal Injuries Compensation Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, 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., CPA
Director

Criminal Injuries Compensation Fund
Comparative Balance Sheets
June 30, 2007 and June 30, 2006

	June 30, 2007	June 30, 2006
ASSETS		
Cash	$ 8,266,771	$ 9,485,341
Accounts receivable	450,120	401,514
TOTAL ASSETS	$ 8,716,891	$ 9,886,855
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Accounts payable	$ 104,878	$ 171,136
Claims liability	6,748,933	6,579,809
TOTAL LIABILITIES	6,853,811	6,750,945
FUND BALANCES		
Reserved for victims of drunk drivers (see Note B.1)	1,862,436	1,738,764
Unreserved	644	1,397,146
TOTAL FUND BALANCES	1,863,080	3,135,910
TOTAL LIABILITIES AND FUND BALANCES	$ 8,716,891	$ 9,886,855

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, 2007 and June 30, 2006

	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006
REVENUES		
State		
Taxes	$ 4,718,062	$ 4,351,199
Fees	3,017,314	2,871,984
Federal	3,411,000	3,177,000
Interest income	331,847	362,985
Other	538,764	341,620
TOTAL REVENUES	12,016,987	11,104,788
EXPENDITURES		
Claim payments	12,907,574	10,516,432
Victims' coalition grant	100,000	100,000
District Attorneys General grant	197,591	164,400
Administrative cost	686,652	679,182
TOTAL EXPENDITURES	13,891,817	11,460,014
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(1,874,830)	(355,226)
OTHER FINANCING SOURCES		
Transfer from general fund	602,000	0
TOTAL OTHER FINANCING SOURCES	602,000	0
NET CHANGE IN FUND BALANCES	(1,272,830)	(355,226)
FUND BALANCES, BEGINNING OF YEAR	3,135,910	3,491,136
FUND BALANCES, END OF YEAR	$ 1,863,080	$ 3,135,910

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, 2007 and June 30, 2006

	For the Year Ended June 30, 2007			For the Year Ended June 30, 2006		
	Original Budget	Final Budget	Actual (Budgetary Basis)	Original Budget	Final Budget	(Budgetary Basis)
SOURCES OF FINANCIAL RESOURCES						
FUND BALANCES, BEGINNING OF YEAR	$ 3,135,910	$ 3,135,910	$ 3,135,910	$ 3,491,136	$ 3,491,136	$ 3,491,136
REVENUES						
Taxes	5,900,000	5,900,000	4,718,062	5,772,100	5,772,100	4,351,199
Fees	3,406,900	3,406,900	3,017,314	3,100,000	3,100,000	2,871,984
Federal	3,415,100	3,415,100	3,411,000	3,200,400	3,200,400	3,177,000
Interest income	0	0	331,847	0	0	362,985
Other	603,000	603,000	538,764	602,000	602,000	341,620
OTHER FINANCIAL SOURCES						
Transfer in	0	602,000	602,000	0	0	0
TOTAL SOURCES OF FINANCIAL RESOURCES	16,460,910	17,062,910	15,754,897	16,165,636	16,165,636	14,595,924
USES OF FINANCIAL RESOURCES						
EXPENDITURES						
Claim payments	12,500,000	13,397,600	12,907,574	12,500,000	12,500,000	10,516,432
Victims' coalition grant	0	100,000	100,000	0	0	100,000
District Attorneys General grant	0	204,400	197,591	0	0	164,400
Administrative cost	825,000	825,000	686,652	776,500	776,500	679,182
TOTAL USES OF FINANCIAL RESOURCES	113,325,000	14,527,000	13,891,817	13,276,500	13,276,500	11,460,014
FUND BALANCES, END OF YEAR	$ 3,135,910	$ 2,535,910	$ 1,863,080	$ 2,889,136	$ 2,889,136	$ 3,135,910

See accompanying Notes to the Financial Statements

CRIMINAL INJURIES COMPENSATION FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007 AND JUNE 30, 2006

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. 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 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.

(continued)

Criminal Injuries Compensation Fund
Notes to the Financial Statements
June 30, 2007 and June 30, 2006

B. OTHER ACCOUNTING DISCLOSURES

1. 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.

2. Other Financing Sources

Effective June 30, 2007, $602,000 was transferred from the State's general fund in accordance with *Chapter 963 of the Public Acts of 2006* to meet the expenditure requirements of the fund.

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 7, 2007

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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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 07, 2007, on our consideration of the Flexible Benefits Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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., CPA
Director

Flexible Benefits Plan
Comparative Statements of Fiduciary Net Assets
June 30, 2007 and June 30, 2006

	June 30, 2007	June 30, 2006
ASSETS		
Cash	$ 1,891,250	$ 3,412,426
Due from other funds	286,025	246,495
TOTAL ASSETS	2,177,275	3,658,921
LIABILITIES		
Accounts payable	118,442	128,571
Due to other funds	274,354	193,425
TOTAL LIABILITIES	392,796	321,996
NET ASSETS		
Held in trust for employee benefit programs	$ 1,784,479	$ 3,336,925

See accompanying Notes to the Financial Statements

Flexible Benefits Plan
Comparative Statements of Changes in Fiduciary Net Assets
For the Years Ended June 30, 2007 and June 30, 2006

	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006
ADDITIONS		
Employee contributions	$ 7,677,605	$ 7,113,229
FICA savings	6,371,652	5,920,975
TOTAL ADDITIONS	14,049,257	13,034,204
DEDUCTIONS		
Employee reimbursements	7,338,354	7,027,764
Employee benefit programs		
Deferred compensation match	7,175,371	4,912,145
Wellness program	499,387	500,048
Employee daycare assistance	48,895	69,953
Sick leave bank administration	101,377	101,861
Total employee benefit programs	7,825,030	5,584,007
Administrative fees	438,319	317,843
TOTAL DEDUCTIONS	15,601,703	12,929,614
CHANGE IN NET ASSETS	(1,552,446)	104,590
NET ASSETS, BEGINNING OF YEAR	3,336,925	3,232,335
NET ASSETS, END OF YEAR	$ 1,784,479	$ 3,336,925

See accompanying Notes to the Financial Statements

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. Participants may claim expenses incurred through March 15th following the end of the plan year. Any contributions to the plan not withdrawn are forfeited to the state and are used for defraying administrative costs, in 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. 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, 2007 and June 30, 2006

B. OTHER ACCOUNTING DISCLOSURES

1. The FICA savings and forfeitures of reimbursement accounts generated by the Flexible Benefits Plan are used by the State for other employee benefit programs. During the years ended June 30, 2007 and June 30, 2006 the following amounts were paid or transferred to other State funds for these employee benefit programs:

Program	FY 2007	FY 2006
Deferred Compensation Contribution Match	$ 7,175,371	$ 4,912,145
State Wellness Program	499,387	500,048
State Day Care Assistance	48,895	69,953
Sick Leave Bank	101,377	101,861

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 2007	FY 2006
Due from General Fund	$ 230,432	$ 196,330
Due from Internal Service Fund	11,170	11,726
Due from Enterprise Fund	4,684	4,059
Due from Special Revenue Fund	11,128	8,955
Due from Highway Fund	17,578	15,742
Due from Education Trust Fund	11,033	9,683

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

	FY 2007	FY 2006
Due to General Fund	$ 223,665	$ 156,398
Due to Internal Service Fund	5,798	4,356
Due to Enterprise Fund	1,570	1,060
Due to Special Revenue Fund	7,300	5,411
Due to Highway Fund	30,003	21,973
Due to Education Trust Fund	6,018	4,227

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 7, 2007

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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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 7, 2007, on our consideration of the Risk Management Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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., CPA
Director

Risk Management Fund
Comparative Statements of Net Assets
June 30, 2007 and June 30, 2006

	June 30, 2007	June 30, 2006
ASSETS		
Cash	$ 116,768,941	$ 133,255,401
Due from federal government	3,332,653	0
Accounts receivable	12,100	0
TOTAL ASSETS	120,113,694	133,255,401
LIABILITIES		
Current liabilities		
Accounts payable	684,502	535,628
Deferred revenue	6,000	6,000
Claims liability	28,934,275	28,216,362
Total current liabilities	29,624,777	28,757,990
Noncurrent liabilities		
Claims liability	59,525,524	55,249,996
TOTAL LIABILITIES	89,150,301	84,007,986
NET ASSETS - UNRESTRICTED	$ 30,963,393	$ 49,247,415

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, 2007 and June 30, 2006

	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006
OPERATING REVENUES		
Casualty premiums	$ 15,017,600	$ 47,518,100
Property premiums	5,450,320	6,023,600
TOTAL OPERATING REVENUES	20,467,920	53,541,700
OPERATING EXPENSES		
Torts		
Death	1,957,966	1,088,114
Bodily injury	3,667,255	2,671,663
Property damage	827,155	715,682
Total Torts	6,452,376	4,475,459
Workers' Compensation		
Death	431,084	362,168
Medical	10,587,088	10,645,745
Temporary disability	2,066,577	1,661,706
Permanent disability	6,441,543	7,250,563
Total Workers' Compensation	19,526,292	19,920,182
Property Damage		
Employee property	18,867	24,677
State owned property	5,831,067	5,046,249
Total Property Damage	5,849,934	5,070,926
Property insurance premiums	2,482,031	1,985,685
Professional/Administrative	9,134,944	8,549,073
Addition to (reduction of) accrued liability	4,993,441	(7,623,977)
TOTAL OPERATING EXPENSES	48,439,018	32,377,348
OPERATING INCOME (LOSS)	(27,971,098)	21,164,352
NON-OPERATING REVENUES		
Grant revenue	3,332,653	1,301,904
Interest income	6,352,648	4,757,524
Taxes	1,775	3,225
TOTAL NON-OPERATING REVENUES	9,687,076	6,062,653
CHANGE IN NET ASSETS	(18,284,022)	27,227,005
NET ASSETS, BEGINNING OF YEAR	49,247,415	22,020,410
NET ASSETS, END OF YEAR	$ 30,963,393	$ 49,247,415

See accompanying Notes to the Financial Statements

Risk Management Fund
Comparative Statements of Cash Flows
For the Years Ended June 30, 2007 and June 30, 2006

	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from premiums	$ 20,455,820	$ 53,541,700
Payments for claims	(31,687,655)	(30,266,195)
Payments for administrative expenses	(9,223,185)	(8,545,256)
Payments for insurance premiums	(2,385,863)	(1,926,931)
NET CASH FROM OPERATING ACTIVITIES	(22,840,883)	12,803,318
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Grant revenue received	0	1,301,904
Taxes received	1,775	3,225
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES	1,775	1,305,129
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	6,352,648	4,757,524
NET CASH FROM INVESTING ACTIVITIES	6,352,648	4,757,524
NET INCREASE (DECREASE) IN CASH	(16,486,460)	18,865,971
CASH, BEGINNING OF YEAR	133,255,401	114,389,430
CASH, END OF YEAR	$ 116,768,941	$ 133,255,401
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES		
OPERATING INCOME (LOSS)	$ (27,971,098)	$ 21,164,352
ADJUSTMENTS TO RECONCILE OPERATING INCOME (LOSS) TO NET CASH FROM OPERATING ACTIVITIES		
Changes in assets and liabilities		
(Increase) decrease in accounts receivable	(12,100)	0
Increase (decrease) in accounts payable	148,874	(737,057)
Increase (decrease) in claims liability	4,993,441	(7,623,977)
TOTAL ADJUSTMENTS	5,130,215	(8,361,034)
NET CASH FROM OPERATING ACTIVITIES	$ (22,840,883)	$ 12,803,318

See accompanying Notes to the Financial Statements

RISK MANAGEMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007 AND JUNE 30, 2006

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. 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. Reclassification

Funds received from the Federal Emergency Management Agency that were reported as a reduction of expenses on the June 30, 2006 financial statements have been reclassified as grant revenue.

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 commercial

(continued)

Risk Management Fund
Notes to the Financial Statements
June 30, 2007 and June 30, 2006

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. Settled claims resulting from these risks have not exceeded commercial insurance coverage in any of the past three fiscal years. All agencies and authorities of the state participate in the RMF, except for the Dairy Promotion Board and the Certified Cotton Growers' Organization. The Tennessee Education Lottery Corporation participates in the RMF for general liability purposes but is responsible for its own worker's compensation coverage.

The RMF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. The present value of the casualty liability as actuarially determined was $83,836,098 (discounted at 3.50%) at June 30, 2007 and $81,121,245 (discounted at 3.50%) at June 30, 2006. The accrued liability for incurred property losses was $4,623,701 at June 30, 2007 and $2,345,113 at June 30, 2006. The changes in the balances of the claims liabilities during fiscal years 2006 and 2007 were as follows:

Fiscal Year	Beginning Claims Liability	Current Year Claims and Changes in Estimates	Claim Payments	Ending Claims Liability
2007	$83,466,358	$36,822,043	$(31,828,602)	$88,459,799
2006	$91,090,335	$21,842,590	$(28,466,567)	$83,466,358

The RMF held $116.8 million in cash at June 30, 2007 and $133.2 million in cash at June 30, 2006 that is designated for payment of these claims

The RMF allocates the cost of providing claims servicing and claims payment by charging a premium to each agency based on a percentage of each organization's expected loss costs which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole.

2. Receivable

The receivable shown on the Statement of Net Assets as due from federal government includes funds to be received from the Federal Emergency Management Agency for property losses that were classified as a disaster.

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 7, 2007

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, 2007, and June 30, 2006, and the related statements of revenues, expenditures, and changes in fund balance and revenues, expenditures, and changes in fund balance (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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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 7, 2007, on our consideration of the Small and Minority-Owned Business Assistance Program'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., CPA
Director

Small and Minority-Owned Business Assistance Program Fund
Comparative Balance Sheets
June 30, 2007 and June 30, 2006

	June 30, 2007	June 30, 2006
ASSETS		
Cash	$ 12,117,094	$ 11,794,577
TOTAL ASSETS	12,117,094	11,794,577
LIABILITIES AND FUND BALANCE		
FUND BALANCES		
Unreserved	12,117,094	11,794,577
TOTAL FUND BALANCES	12,117,094	11,794,577
TOTAL LIABILITIES AND FUND BALANCES	$ 12,117,094	$ 11,794,577

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, 2007 and June 30, 2006

	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006
REVENUES		
Interest income	$ 630,066	$ 468,431
TOTAL REVENUES	630,066	468,431
EXPENDITURES		
Loan guarantee payments	201,946	0
Contract payments	59,550	0
Administrative cost	46,053	22
TOTAL EXPENDITURES	307,549	22
EXCESS OF REVENUES OVER EXPENDITURES	322,517	468,409
FUND BALANCES, BEGINNING OF YEAR	11,794,577	11,326,168
FUND BALANCES, END OF YEAR	$ 12,117,094	$ 11,794,577

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, 2007 and June 30, 2006

	For the Year Ended June 30, 2007			For the Year Ended June 30, 2006		
	Original Budget	Final Budget	Actual (Budgetary Basis)	Original Budget	Final Budget	Actual (Budgetary Basis)
SOURCES OF FINANCIAL RESOURCES						
FUND BALANCES, BEGINNING OF YEAR	$ 11,794,577	$ 11,794,577	$11,794,577	$11,326,168	$ 11,326,168	$11,326,168
REVENUES						
Interest income	80,100	80,100	630,066	80,100	80,100	468,431
TOTAL SOURCES OF FINANCIAL RESOURCES	11,874,677	11,874,677	12,424,643	11,406,268	11,406,268	11,794,599
USES OF FINANCIAL RESOURCES						
EXPENDITURES						
Loan guarantee payments	80,100	140,100	201,946	80,100	80,100	0
Contract payments	0	2,000,000	59,550			
Administrative cost	0	0	46,053	0	0	22
TOTAL USES OF FINANCIAL RESOURCES	80,100	2,140,100	307,549	80,100	80,100	22
FUND BALANCES, END OF YEAR	$ 11,794,577	$ 9,749,577	$12,117,094	$11,326,168	$ 11,326,168	$11,794,577

See accompanying Notes to the Financial Statements

SMALL AND MINORITY-OWNED BUSINESS ASSISTANCE PROGRAM FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007 AND JUNE 30, 2006

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. 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 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, 2007 AND JUNE 30, 2006

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, 2007, the Fund was under loan guarantee obligations in the amount of $58,979 in the event of loan defaults. At June 30, 2006, the Fund had obligations in the aggregate amount of $1,040,290.

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 7, 2007

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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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 7, 2007, on our consideration of the State Pooled Investment Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on 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., CPA
Director

State Pooled Investment Fund
Comparative Statements of Fiduciary Net Assets
June 30, 2007 and June 30, 2006

	June 30, 2007	June 30, 2006
ASSETS		
Cash and cash equivalents	$ 4,867,617,896	$ 3,027,096,548
Short-term investments, at amortized cost	2,860,015,701	3,394,281,562
Accrued income receivable	51,184,845	37,334,560
TOTAL ASSETS	7,778,818,442	6,458,712,670
LIABILITIES AND NET ASSETS		
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS	$ 7,778,818,442	$ 6,458,712,670

See Accompanying Notes to the Financial Statements

State Pooled Investment Fund
Comparative Statements of Changes in Fiduciary Net Assets
For the Years Ended June 30, 2007 and June 30, 2006

	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006
OPERATIONS		
Investment income	$ 351,903,181	$ 221,242,015
Expenses		
Administrative fee	3,330,233	2,660,973
Custodian and banking services fees	32,549	105,101
Total expenses	3,362,782	2,766,074
NET INVESTMENT INCOME	348,540,399	218,475,941
CAPITAL SHARE TRANSACTIONS (DOLLAR AMOUNTS AND NUMBER OF SHARES ARE THE SAME)		
Shares sold	34,691,661,275	33,453,314,191
Less shares redeemed	33,720,095,902	31,828,960,116
INCREASE FROM CAPITAL SHARE TRANSACTIONS	971,565,373	1,624,354,075
TOTAL INCREASE IN NET ASSETS	1,320,105,772	1,842,830,016
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS		
BEGINNING OF YEAR	6,458,712,670	4,615,882,654
END OF YEAR	$ 7,778,818,442	$ 6,458,712,670

See Accompanying Notes to the Financial Statements

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007 AND JUNE 30, 2006

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, 2007 and June 30, 2006, 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.

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.

(continued)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007 AND JUNE 30, 2006

At June 30, 2007 and June 30, 2006, the principal amount of certificates of deposit in state depositories was $2,233,085,000 and $2,285,152,700 respectively. Interest rates on certificates of deposit held at June 30, 2007 ranged from 5.25% to 5.3% and at June 30, 2006 ranged from 4.5% to 5.4%. The days to maturity on certificates of deposit ranged from 29 to 357 days at June 30, 2007 and 29 to 268 days at June 30, 2006.

As of June 30, 2007 and June 30, 2006, the SPIF had the following investments:

JUNE 30, 2007						Carrying Amount Credit Quality Ratings		
Investment Type	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity	AAA	A1	Not Rated
Cash Equivalents and Short-term Investments:								
U.S. Government Agencies	$ 2,564,259,618	$ 2,562,261,251	$ 2,566,367,000	2.88% to 5.38%	72 to 391 days	$ 2,065,461,749		$ 498,797,869
Commercial Paper	2,723,847,582	2,723,847,582	2,725,240,000	5.21% to 5.37%	3 to 45 days		$ 2,723,847,582	
Total Cash Equivalents and Short-term Investments	5,288,107,201	$ 5,286,108,833	$ 5,291,607,000			$ 2,065,461,749	$ 2,723,847,582	$ 498,797,869
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Assets	(2,922,531,500)							
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Assets	494,440,000							
Short-term investments as shown on Statement of Fiduciary Net Assets	$ 2,860,015,701							

JUNE 30, 2006						Carrying Amount Credit Quality Ratings		
Investment Type	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity	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		$ 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							

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's

(continued)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007 AND JUNE 30, 2006

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, 2007 and June 30, 2006 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

(continued)

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:

	June 30, 2007	
Issuer Organization	Carrying Amount	Percentage of Total Investments
Federal Home Loan Banks	$ 1,291,383,217	24.42%
Federal Home Loan Mortgage Corporation	734,889,721	13.90
Federal National Mortgage Association	429,817,869	8.13
G E	374,944,479	7.09
CITIGROUP	374,842,382	7.09
H S B C	374,812,847	7.09
TOYOTA	349,948,333	6.62
PRUDENTIAL FUNDING	299,955,667	5.67

	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
G E	339,900,833	8.98
Federal Agriculture Mortgage Corporation	308,037,521	8.14
H S B C	249,927,083	6.60

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

(continued)

shall not have a maturity that exceeds ninety (90) days. As of June 30, 2007 and June 30, 2006, the SPIF portfolio had the following weighted average maturities on debt investments:

JUNE 30, 2007 Investment Type	Carrying Amount	Weighted Average Maturity (Months)
U.S. Government Agencies	$ 2,564,259,618	6.27
Commercial Paper	2,723,847,582	0.17
Aggregate Portfolio	$ 5,288,107,201	3.13

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

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, 2007 and June 30, 2006, 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 7, 2007

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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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, 2007, and June 30, 2006, 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 7, 2007
Page 2

In accordance with *Government Auditing Standards*, we have also issued our report dated December 7, 2007, 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., CPA
Director

Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Years Ended June 30, 2007 & June 30, 2006

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, 2007 and June 30, 2006. This section should be read in conjunction with the Independent Auditor's Report, the audited financial statements, and the accompanying notes.

FINANCIAL HIGHLIGHTS

- The plan net assets (total assets minus total liabilities) of the TCRS at June 30, 2007 were $32.4 billion, increasing over $3.5 billion (12.3 percent) from the plan net assets at June 30, 2006. 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 2007 totaled $1,027,174,038 – an increase of 15.1 percent compared to fiscal year 2006.

- Net investment income for fiscal year 2007 was $3,791,403,651. During fiscal year 2007, the TCRS received an investment return on its portfolio of 13.1 percent, compared to 6.9 percent for fiscal year 2006.

- Total benefits and refunds paid for fiscal year 2007 were $1,266,775,568 – an increase of 9.3 percent over fiscal year 2006 total benefits and refunds paid of $1,158,901,860.

- Total administrative expenses for fiscal year 2007 were $6,468,558 – an increase of 4.1 percent over fiscal year 2006 administrative expenses of $6,213,597.

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, 2007 & June 30, 2006 (continued)

ANALYSIS OF ASSETS, LIABILITIES AND PLAN NET ASSETS

At June 30, 2007, the TCRS had plan net assets (total assets in excess of total liabilities) of $32.4 billion, an increase of over $3.5 billion (12.3 percent) from $28.8 billion at June 30, 2006. The assets of the TCRS consist primarily of investments. During fiscal year 2007, the domestic and international equity portfolios realized positive returns, thus contributing to $3.8 billion in net investment income. Condensed financial information comparing the TCRS' plan net assets for the past three fiscal years follows.

PLAN NET ASSETS

	June 30, 2007	June 30, 2006	FY07 - FY06 Percentage Change	June 30, 2005	FY06 - FY05 Percentage Change
ASSETS					
Cash and cash equivalents	$ 569,035,627	$ 826,611,111	(31.2)%	$ 804,694,718	2.7 %
Member and employer receivables	86,352,774	71,671,617	20.5 %	59,611,297	20.2 %
Investment income receivables	169,973,211	172,541,678	(1.5)%	168,791,063	2.2 %
Investments sold	16,256,391	33,287,736	(51.2)%	28,751,524	15.8 %
Foreign currency receivable	5,796,800	19,732,929	(70.6)%	177,749,703	(88.9)%
Short-term securities	527,594,750	503,846,988	4.7 %	231,988,352	117.2 %
Long-term investments	31,014,634,498	27,255,904,731	13.8 %	25,968,351,692	5.0 %
TOTAL ASSETS	32,389,644,051	28,883,596,790	12.1 %	27,439,938,349	5.3 %
LIABILITIES					
Death benefits, refunds and other payables	2,750,418	$ 2,319,549	18.6 %	6,721,778	(65.5)%
Investments purchased	10,520,944	38,344,946	(72.6)%	41,541,888	(7.7)%
Other investment payables	4,606,919	2,563,959	79.7 %	2,295,936	11.7 %
Foreign currency payable	5,796,800	19,732,929	(70.6)%	173,116,862	(88.6)%
TOTAL LIABILITIES	23,675,081	62,961,383	(62.4)%	223,676,464	(71.9)%
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 32,365,968,970	$ 28,820,635,407	12.3%	$ 27,216,261,885	5.9 %

ANALYSIS OF REVENUES AND EXPENSES

Employer contribution rates changed effective for fiscal year 2007 resulting in a $135 million (15.1 percent) increase in contributions over fiscal year 2006. The increase in contributions for fiscal year 2006 of $47 million (5.6 percent) is attributable to increased covered payroll. 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, 2007 totaled $3,791,403,651, an increase of $1,914.1 million versus fiscal year 2006. 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. The TCRS portfolio earned 13.15 percent during fiscal year 2007 and 6.94 percent during fiscal year 2006.

Total benefits and refunds paid during the year ended June 30, 2007 were $1,266,775,568, an increase of 9.3 percent over fiscal year 2006 total benefits and refunds paid. 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. The increase in benefit expenses can be attributed to 3.0 percent cost of living adjustments awarded to retirees on both July 1, 2006 and July 1, 2005. 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, 2007 & JUNE 30, 2006 (CONTINUED)

In addition, administrative expenses for the year ended June 30, 2007 were $6,468,558, an increase of 4.1 percent over fiscal year 2006 administrative expenses. 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.

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

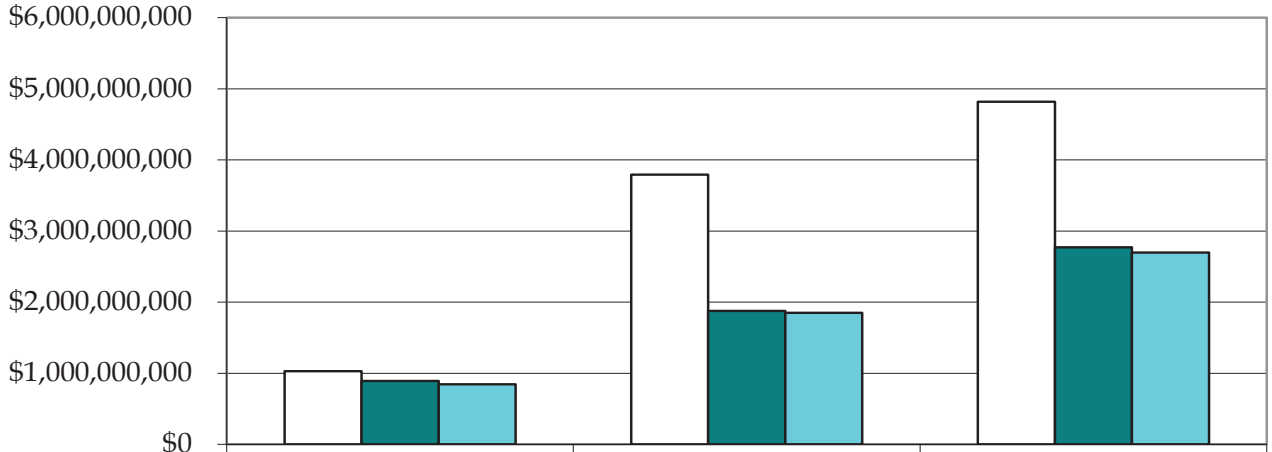
CHANGES IN PLAN NET ASSETS

	For the Year Ended June 30, 2007	For the Year Ended June 30, 2006	FY07 - FY06 Percentage Change	For the Year Ended June 30, 2005	FY06 - FY05 Percentage Change
ADDITIONS					
Contributions	$ 1,027,174,038	$ 892,190,489	15.1%	$ 844,856,748	5.6 %
Investment income					
Net appreciation in fair value of investments	2,717,644,583	893,530,576	204.1 %	938,346,880	(4.8)%
Interest, dividends and other investment income	1,097,511,473	1,002,725,069	9.5 %	927,714,221	8.1 %
Less: Investment expense	(23,752,405)	(18,957,155)	25.3 %	(15,693,886)	20.8 %
Net investment income	3,791,403,651	1,877,298,490	102.0 %	1,850,367,215	1.5 %
TOTAL ADDITIONS	4,818,577,689	2,769,488,979	74.0 %	2,695,223,963	2.8 %
DEDUCTIONS					
Annuity benefits					
Retirement benefits	918,540,446	843,183,130	8.9 %	775,283,016	8.8 %
Survivor benefits	58,202,209	53,991,908	7.8 %	50,388,267	7.2 %
Disability benefits	26,722,134	25,808,859	3.5 %	24,626,014	4.8 %
Cost of living	221,463,825	195,538,793	13.3 %	173,707,939	12.6 %
Death benefits	5,502,982	5,668,204	(2.9)%	4,911,365	15.4 %
Refunds	36,343,972	34,710,966	4.7 %	30,815,699	12.6 %
Administrative expenses	6,468,558	6,213,597	4.1 %	5,746,030	8.1 %
TOTAL DEDUCTIONS	1,273,244,126	1,165,115,457	9.3 %	1,065,478,330	9.4 %
NET INCREASE	3,545,333,563	1,604,373,522	121.0 %	1,629,745,633	(1.6)%
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS					
BEGINNING OF YEAR	28,820,635,407	27,216,261,885	5.9 %	25,586,516,252	6.4 %
END OF YEAR	$ 32,365,968,970	$28,820,635,407	12.3 %	$ 27,216,261,885	5.9 %

(continued)

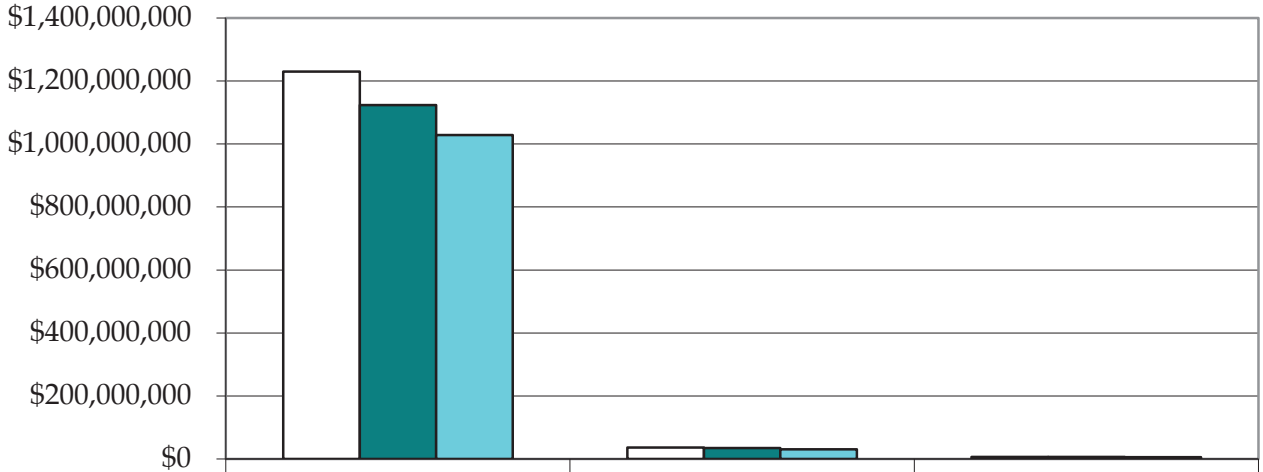
Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Years Ended June 30, 2007 & June 30, 2006 (continued)

REVENUES BY TYPE



	Contributions	Net Investment Income	Total Additions
Year Ended 6/30/07	$1,027,174,038	$3,791,403,651	$4,818,577,689
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

EXPENSES BY TYPE



	Benefit Payments	Refunds	Administrative
Year Ended 6/30/07	$1,230,431,596	$36,343,972	$6,468,558
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

(continued)

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

For the year ended June 30, 2007, the domestic and international stock portfolios remained strong with 20.58% and 27.19% returns respectively. The S&P 1500 index, TCRS' domestic equity benchmark, reported a 20.23% increase for the fiscal year ended June 30, 2007. This followed a domestic equity return during fiscal year 2006 for TCRS of 9.33%, which closely matched the 9.23% growth in the index. The international equity market, as represented by the EAFE index, grew 27% in fiscal year 2007 preceded by a 26.56% growth in fiscal year 2006. The domestic core bond portfolio earned 6.17% measured by the Citigroup Broad Investment Grade index return of 6.06% for the year ended June 30, 2007. This represented an improvement on domestic fixed income performance from the negative .5% return during fiscal year 2006. The real estate portfolio earned 10.43% for the year ended June 30, 2007 which lagged the NCREIF index benchmark of 16.59%. The real estate return for the fiscal year 2006 was 24.59% which exceeded the NCREIF index of 20.19%.

Broad equity market strength was realized during 2006 and 2007. The strong domestic and international stock markets, coupled with a rebounding bond market provided substantial excess return over the investment assumption of 7.5%.

The employer contribution rate increased July 1, 2006 for most of the employers participating in TCRS. Since the actuarial valuations are conducted every two years, the higher contribution levels will continue through the fiscal year ended June 30, 2008. 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 strong returns for the 2007 fiscal year, an easing of the upward pressure on employer contribution rates is expected from the actuarial valuation to be conducted as of July 1, 2007.

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
June 30, 2007 and June 30, 2006

Expressed in Thousands	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)
ASSETS		
Cash and cash equivalents	$ 479,656	$ 89,379
Receivables		
Member receivable	20,405	5,023
Employer receivable	40,814	20,111
Accrued interest receivable	122,665	22,857
Accrued dividends receivable	19,480	3,630
Real estate income receivable	1,131	211
Foreign currency receivable	4,886	910
Investments sold	13,703	2,553
Total receivables	223,084	55,295
Investments, at fair value		
Short-term securities	444,725	82,870
Government securities	7,643,081	1,424,212
Corporate securities	4,476,732	834,194
Corporate stocks	13,110,008	2,442,920
Real estate	913,303	170,185
Total investments	26,587,849	4,954,381
TOTAL ASSETS	27,290,589	5,099,055
LIABILITIES		
Accounts payable		
Death benefits and refunds payable	1,396	1,063
Other	291	0
Investments purchased	8,869	1,653
Foreign currency payable	4,886	910
Other investment payables	3,883	724
TOTAL LIABILITIES	19,325	4,350
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (Schedules of funding progress for the plan are presented on page 127.)	$ 27,271,264	$ 5,094,705

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

June 30, 2007 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2006 Total
$ 569,035	$ 700,553	$ 126,058	$ 826,611
25,428	18,553	4,800	23,353
60,925	31,931	16,388	48,319
145,522	127,526	22,947	150,473
23,110	17,536	3,156	20,692
1,342	1,166	210	1,376
5,796	16,724	3,009	19,733
16,256	28,212	5,076	33,288
278,379	241,648	55,586	297,234
527,595	427,010	76,837	503,847
9,067,293	9,072,529	1,632,519	10,705,048
5,310,926	2,652,679	477,326	3,130,005
15,552,928	10,580,082	1,903,790	12,483,872
1,083,488	794,090	142,890	936,980
31,542,230	23,526,390	4,233,362	27,759,752
32,389,644	24,468,591	4,415,006	28,883,597
2,459	1,646	589	2,235
291	85	0	85
10,522	32,498	5,848	38,346
5,796	16,723	3,009	19,732
4,607	2,173	391	2,564
23,675	53,125	9,837	62,962
$ 32,365,969	$ 24,415,466	$ 4,405,169	$ 28,820,635

Tennessee Consolidated Retirement System
Comparative Statements of Changes in Plan Net Assets
For the Years Ended June 30, 2007 and June 30, 2006

Expressed in Thousands	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)
ADDITIONS		
Contributions		
Member contributions	$ 175,743	$ 57,003
Employer contributions	562,729	231,699
Total contributions	738,472	288,702
Investment income		
Net appreciation in fair value of investments	2,295,671	421,974
Interest	618,197	113,632
Dividends	258,925	47,594
Real estate income, net of operating expenses	49,977	9,186
Total investment income	3,222,770	592,386
Less: Investment expense	(20,064)	(3,688)
Net investment income	3,202,706	588,698
TOTAL ADDITIONS	3,941,178	877,400
DEDUCTIONS		
Annuity benefits		
Retirement benefits	789,603	128,937
Survivor benefits	50,032	8,170
Disability benefits	22,971	3,751
Cost of living	196,439	25,025
Death benefits	3,719	1,784
Refunds	19,231	17,113
Administrative expense	3,385	3,084
TOTAL DEDUCTIONS	1,085,380	187,864
NET INCREASE	2,855,798	689,536
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
BEGINNING OF YEAR	24,415,466	4,405,169
END OF YEAR	$ 27,271,264	$ 5,094,705

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

For the Year Ended June 30, 2007 TOTAL	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	For the Year Ended June 30, 2006 TOTAL
$ 232,746	$ 166,984	$ 59,327	$ 226,311
794,428	474,879	191,000	665,879
1,027,174	641,863	250,327	892,190
2,717,645	758,789	134,741	893,530
731,829	594,856	105,627	700,483
306,519	223,813	39,742	263,555
59,163	32,854	5,833	38,687
3,815,156	1,610,312	285,943	1,896,255
(23,752)	(16,098)	(2,859)	(18,957)
3,791,404	1,594,214	283,084	1,877,298
4,818,578	2,236,077	533,411	2,769,488
918,540	726,109	117,074	843,183
58,202	46,495	7,497	53,992
26,722	22,225	3,584	25,809
221,464	173,624	21,915	195,539
5,503	4,227	1,441	5,668
36,344	17,751	16,960	34,711
6,469	3,336	2,877	6,213
1,273,244	993,767	171,348	1,165,115
3,545,334	1,242,310	362,063	1,604,373
28,820,635	23,173,156	4,043,106	27,216,262
$ 32,365,969	$ 24,415,466	$ 4,405,169	$ 28,820,635

Tennessee Consolidated Retirement System
Notes to the Financial Statements
June 30, 2007 and June 30, 2006

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.

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	65,094	24,799
Terminated members entitled to but not receiving benefits	19,468	7,129
Current active members	132,026	74,124
Total	216,588	106,052
Number of participating employers	140	444

(continued)

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, 2007, the plan's Member Reserve and Employer Reserve were fully funded with balances of $3,386.5 million and $23,884.7 million, respectively. 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.

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

(continued)

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, 2007, the plan's Member Reserve and Employer Reserve were fully funded with balances of $896.1 million and $4,198.6 million, respectively. 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.

C. DEPOSITS AND INVESTMENTS

State statute authorizes the TCRS to maintain cash, not exceeding ten percent of the total amount of funds in the retirement system, on deposit in one or more banks, savings and loan associations or trust companies that are qualified as state depositories. The TCRS does not utilize its own bank accounts but invests in the State Pooled Investment Fund for the initial deposit of funds and for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities.

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

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

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

c. Within the restrictions in (a) and (b) above, an amount not to exceed fifteen percent (15 percent) of the total of

(continued)

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, 2007 and June 30, 2006, the TCRS had investments as shown on the following page.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2007 AND JUNE 30, 2006 (CONTINUED)

Investments

(Expressed in Thousands)

Investment Type	Fair Value as of June 30, 2007	U.S. Treasury/ Agency (1)	Credit Quality Ratings							
			AAA	AA	A	BBB	BB	B	(2) A1	(3) Not Rated
Debt Investments										
U.S. Govt. Treasuries, Notes, Bonds	$ 825,413	$ 825,413								
U.S. Govt. STRIPS	264,838	264,838								
U.S. Govt. TIPS	1,959,797	1,959,797								
U.S. Govt. Agencies	1,252,600		$ 1,252,600							
Mortg.-Backed Govt. Pass-Through	3,923,008	217,693								$ 3,705,315
Mortg.-Backed Corporate Pass-Through	1,524,326		1,504,335	$ 19,991						
Govt. CMO's	117,568		117,568							
Corporate CMO's	23,933		23,933							
Corporate Bonds	2,294,723		49,523	300,677	$ 818,312	$ 1,097,950	$ 9,782	$ 18,479		
Corporate Asset-Backed	772,069		652,730	20,035	9,019	90,285				
Private Placements	399,024		77,963	108,899	69,798	142,364				
Yankee Bonds	18,369				9,122	9,247				
Supranationals	41,217		41,217							
Non-U.S. Govt./Sovereign	724,069		359,185	100,506	264,378					
Non-U.S. Corporate	237,265		237,265							
Short-Term Commercial Paper	566,543								$ 566,543	
Short-Term Certificate of Deposit	9,982			9,982						
Short-Term Agencies	517,613									517,613
Total Debt Investments	$ 15,472,357	$ 3,267,741	$ 4,316,319	$ 560,090	$ 1,170,629	$ 1,339,846	$ 9,782	$ 18,479	$ 566,543	$ 4,222,928
Other Investments										
U.S. Equity	10,765,940									
Non-U.S. Equity	4,786,988									
Real Estate	1,083,488									
Commingled Money Market Funds	9									
Total Other Investments	16,636,425									
Total Investments	32,108,782									
Less: Short-Term Investments Classified as Cash Equivalents on the Statements of Plan Net Assets	(566,552)									
Total Investments as Shown on Statements of Plan Net Assets	31,542,230									

(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 and Poor's or Moody's.

Investment Type	Fair Value as of June 30, 2006	U.S. Treasury/ Agency (1)	Credit Quality Ratings							
			AAA	AA	A	BBB	BB	B	(2) A1	(3) Not Rated
Debt Investments										
U.S. Govt. Treasuries, 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-Through	3,554,902	376,348								$ 3,178,554
Mortg.-Backed Corporate Pass-Through	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				
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	$ 0	$ 645,358	$ 3,852,607
Other Investments										
U.S. Equity	$ 8,266,427									
Non-U.S. Equity	4,217,445									
Real Estate	936,980									
Commingled 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 and 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, 2007 and June 30, 2006 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, 2007		June 30, 2006	
Issuer Organization	**Fair Value**	**Percentage**	**Fair Value**	**Percentage**
Federal Home Loan Mortgage Corp.	$2,043,123,831	6.31%	$2,279,598,268	7.91%
Federal National Mortgage Assoc.	2,865,385,846	8.85%	2,899,810,512	10.06%

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, 2007 and June 30, 2006 (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 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, 2007 and June 30, 2006.

Debt Investments

(Expressed in Thousands)

Investment Type	Fair Value As of June 30, 2007	Effective Duration (years)
Debt Investments		
Government Agencies	$ 1,256,788	2.87
Government Bonds	1,500,391	8.04
Government STRIPS	264,838	12.77
Government Notes	40,648	0.27
Government Inflation Indexed	1,959,797	3.57
Government State and Local Obligations	4,255	0.19
Government National Mortgage Association (GNMA)	217,693	3.47
Federal Home Loan Mortgage Corporation (FHLMC)	1,390,664	4.69
Federal National Mortgage Association (FNMA)	2,314,651	4.60
Government Collateralized Mortgage Obligations (CMO)	117,568	7.49
Corporate Collateralized Mortgage Obligations (CMO)	23,933	13.44
Asset Backed Securities	2,296,395	5.16
Corporate Bonds	2,586,646	6.13
Private Placements	399,024	7.38
Miscellaneous Other Fixed Income	4,928	6.93
Short Term Commercial Paper	566,543	0.03
Short Term Certificate of Deposit	9,982	0.00
Short Term Agencies	517,613	0.43
Total Debt Investments	$ 15,472,357	4.99

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

(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, 2007 and June 30, 2006 was as follows:

Foreign Currency-Denominated Investments

(Expressed in Thousands)

Currency	Total Fair Value June 30, 2007	Fixed Income	Equity	Cash
Australian Dollar	$ 259,144	$ 8,443	$ 250,425	$ 276
British Pound Sterling	1,263,570	77,543	1,183,999	2,028
Canadian Dollar	49,779	67	49,571	141
Danish Krone	62,477		62,475	2
Euro Currency	1,806,669	312,885	1,493,692	92
Hong Kong Dollar	134,801		134,750	51
Japanese Yen	1,569,152	569,953	995,983	3,216
New Zealand Dollar	10,640		10,606	34
Norwegian Krone	82,993	33,727	49,171	95
Singapore Dollar	84,307		84,119	188
Swedish Krona	164,588		164,150	438
Swiss Franc	302,380		302,334	46
Total	$ 5,790,500	$ 1,002,618	$ 4,781,275	$ 6,607

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

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, 2007 and June 30, 2006 has been reflected in the financial statements.

(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, 2007 was $141,501,440. The fair value of CMOs at June 30, 2006 was $103,212,549.

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, 2007 the TCRS had unfunded commitments of $32,777,459 for pending real estate purchases. At June 30, 2006 the TCRS had unfunded commitments of $131,460,280 for pending real estate purchases.

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
2007	$ 562,729	100.00%	$ 231,699	100.00%
2006	474,879	100.00%	191,000	100.00%
2005	448,154	100.00%	181,096	100.00%
2004	271,298	100.00%	139,808	100.00%
2003	264,320	100.00%	134,014	100.00%
2002	243,498	100.00%	103,374	100.00%

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
June 30, 2007 and June 30, 2006

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)
Included 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