1999 TREASURER'S REPORT

Steve Adams, Treasurer
State of Tennessee

1999
Treasurer's Report

Frozen Head State Park
East Tennessee

Steve Adams, Treasurer
State of Tennessee

Fiscal Year Ended June 30, 1999

Table of Contents

LETTER OF TRANSMITTAL

State of Tennessee
Treasury Department
State Capitol
Nashville, Tennessee 37243

December 31, 1999

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

The challenges of this year have been numerous. It is a pleasure to report to you that the Treasury Department staff has been successful in addressing these issues in an exemplary manner. The following pages outline our activities for the fiscal year ended June 30, 1999. Our outstanding performance and our achievements are the result of your support and the commitment and expertise of an outstanding Treasury staff.

Our Treasury website, www.treasury.state.tn.us, has proven to be a great way to communicate with Tennesseans and others regarding our programs. Our Unclaimed Property and TCRS benefits calculator sites seem to be the most popular with our members and visitors. In addition to our web presence, our electronic capabilities continue to enhance our financial operations by making transactions faster, more efficient and less expensive.

The new millenium is sure to bring even more requests for our services. With excitement, we look forward to the opportunity to serve each of you and to work with you to make Tennessee an even greater place to live.

Sincerely,

Steve Adams

Steve Adams

EXECUTIVE SUMMARY

INTRODUCTION

The 1999 Treasurer's Report contains reports on various programs administered by the Treasury Department, including Investments, the Tennessee Consolidated Retirement System, the Deferred Compensation Program, the Flexible Benefits Plan, Claims Administration, the Tennessee Claims Commission, Risk Management, the Unclaimed Property Program, the Chairs of Excellence Program, the Baccalaureate Education System Trust, and the Careers Now Program. The following comments represent a brief recap of the purpose and operations of each program administered by the department. The remainder of this report gives detailed data regarding these programs' activities during the 1998-99 fiscal year.

INVESTMENTS

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

State Cash Management - This section manages the State Pooled Investment Fund which includes the state's cash, the various dedicated reserves and trust funds of the state, and the Local Government Investment Pool. Investments during 1998-99 averaged $3.34 billion, producing $173.1 million in income for an average rate of return of 5.22%. Local governments participating in the Local Government Investment Pool received $78.1 million in interest at a net rate averaging 4.97%. 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 section manages the investments of the Tennessee Consolidated Retirement System (TCRS) which at June 30, 1999 totaled $22.8 billion at fair value. For the year, investments produced $1.9 billion in income for a realized rate of return of 9.47% on a fair value basis. This section also manages investments for the Chairs of Excellence Trust which at June 30, 1999 totaled $231.1 million at fair value.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

The Tennessee Consolidated Retirement System provides retirement coverage to state employees, higher education employees, teachers, and employees of political subdivisions that have elected to participate in the plan. As of June 30, 1999, there were 188,080 active TCRS members: 41,949 state employees; 62,456 K-12 teachers; 64,540 political subdivision employees; and 19,135 higher education employees. As of June 30, 1999, there were 71,646 retirees. TCRS paid out $637.7 million in benefits during fiscal year 1998-99. 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.

DEFERRED COMPENSATION PROGRAM

The State of Tennessee Deferred Compensation Program offers state employees the opportunity to accumulate supplemental retirement income on a tax deferred basis. Participants may direct the investment of their deferred salary into a variety of investment products contracted for the program. During the 1998-99 fiscal year, the state, the University of Tennessee and Board of Regents each matched their employees' contributions to the 401(k) plan at $20 per month. As of June 30, 1999, 47,449 state and higher education employees had accounts in the program. The market value of accumulated account balances totaled $540.4 million, an increase of $121.8 million during the year.

Executive Summary

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, 1999, 37,631 state employees were using the plan: 37,185 paid group medical premiums, 14,239 paid group dental premiums, 2,511 used the medical expense reimbursement account and 351 used the dependent care reimbursement account. The plan generated over $2.4 million in F.I.C.A. savings for the state during the 1998-99 fiscal year.

Claims Administration

The Division of Claims Administration is responsible for investigating and making determinations on claims made against the state for workers' compensation by state employees, employee property damage, tort liability and criminal injury compensation. Staff support from the Division of Claims Administration also assists the Board of Claims. The Division of Claims Administration received 6,110 claims for tort, employee property damage and workers' compensation. Payments made during the year for workers' compensation, tort, and employee property damage claims totaled $19 million.

The Board of Claims took action on seven matters regarding claims and insurance, and 1,544 victims of criminal injury and drunk driver claims were approved for payment. Payments made to victims of criminal injuries and drunk drivers totaled $6 million. Since the first payments were issued in 1982, over $97 million has been paid to crime victims.

Tennessee 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. Claims are payable from the Claims Award Fund by the Division of Claims Administration after adjudication by a commissioner. At June 30, 1999, the commission had 1,221 open claims (including claims transferred to administrative law judges). This represented a 16.6% reduction from cases open at June 30, 1998.

Division of Risk Management

The Division of Risk Management is responsible for administering the state's Property/Casualty Insurance Program, including the procurement of boiler insurance and employee fidelity bond coverage. All state-owned buildings and contents are provided all-risk, replacement cost coverage for the limits of liability listed in the state's Property Insurance Schedule. On July 1, 1998, the total scheduled values were $9.1 billion. The State Reserve for Casualty Losses, in the amount of $5 million, provides an annual aggregate retention for the payment of property claims. Excess property coverage is procured from an independent insurance carrier to provide claim payments in excess of the retention, should losses exceed $5 million in a given fiscal year. In fiscal year 1998-99, the premium cost for total property coverage without the $5 million retention was estimated to be $10.9 million. The actual cost of the program for the same period was $2.5 million, providing a savings to the state of approximately $8.4 million.

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 forgotten assets. The types of property covered by this act are primarily cash property such as bank accounts, insurance policies, utility deposits, etc. During the fiscal year, $16.4 million of unclaimed property was turned over to the Treasurer and $5.8 million was returned to owners or their heirs. Since the program began operations in 1979, over $162.7 million in unclaimed property has been reported to the Treasurer and over $47.9 million (29%) of that property has been returned to owners or their heirs.

EXECUTIVE SUMMARY

CHAIRS OF EXCELLENCE

The Chairs of Excellence Trust is a non-expendable trust fund authorized in 1984 to further the cause of education in Tennessee. The funding of the program is provided through contributions made by a private donor and a matching amount by the state, thus, creating a chair. Income from the chair is used to offset the cost of retaining a nationally or regionally recognized scholar at a state college or university who teaches in a specified academic area. During the 1999 fiscal year, one chair was created and private contributions of $304,250 were received. Since 1984, a total of 97 chairs have been created. The Trust totaled $233.6 million fair value at June 30, 1999 and produced income of $26.8 million during the year.

BACCALAUREATE EDUCATION SYSTEM TRUST (BEST)

The Tennessee Baccalaureate Education System Trust, or BEST, is a prepaid college tuition savings program that allows anyone to pay for higher education costs in advance on behalf of a beneficiary. Through the purchase of affordable tuition units, Tennesseans can pay for future tuition at today's price and ease their concerns about whether they will have enough funds to pay for their children's higher education. Flexibility is a key component of the program by allowing participants to determine when and how much to save, and by providing multiple payment options and unlimited school choices. In addition, state college savings programs provide favorable tax benefits to participants. The BEST program began accepting contributions in June 1997. The Trust totaled $15.2 million at fair value on June 30, 1999. During the 1998-99 fiscal year, 2,457 new contracts were opened, bringing the total under administration to 5,450.

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 therein by working in one of the three constitutional offices for a semester. The program has had 92 students since it began in January 1996.

BOND REFUNDING TRUST

The Treasurer has been appointed Refunding Trustee for the Tennessee Local Development Authority (TLDA), for the Tennessee State School Bond Authority, and for the Funding Board of the State of Tennessee in connection with the sale of bonds issued to refund, in advance of maturity, bonds and notes previously issued by the TLDA, School Bond Authority, and Funding Board. The Treasurer has established a Refunding Trust Fund for the benefit of the holders of the refunded bonds. A portion of the proceeds of the refunding bonds were used to acquire direct general obligations of the United States of America or obligations which are unconditionally guaranteed by the United States of America as to principal and interest. The assets of the Refunding Trust Fund totaled $72.5 million at fair value on June 30, 1999.

Treasury Numbers at a Glance
Fiscal Year 1998-99

Administrative	Number of Filled Positions		182
	Payroll Expenditures	$	7,967,823
	Other Expenditures	$	4,356,350
	Total Administrative Expenditures	$	12,324,173
Cash Management Program	General Fund Earnings	$	38,508,412
	LGIP Earnings	$	92,755,592
	Restricted Fund Earnings	$	41,653,199
	Total Cash Management Earnings	$	172,917,203
Retirement Program	Retirement Benefits	$	637,732,134
	Number of Retirees		71,646
	Number of Active Members		188,080
	Retirement Contributions	$	474,865,500
	Retirement Investment Earnings	$	1,932,716,042
Claims Administration Program	Workers' Compensation Payments	$	14,068,257
	Workers' Compensation Claims Filed		3,974
	Employee Property Damage Payments	$	33,990
	Employee Property Damage Claims Filed		226
	Tort Claims Payments	$	4,941,284
	Tort Claims Filed		1,910
	Criminal Injury Payments	$	6,049,873
	Criminal Injury Number of Payments Made		1,544
	Claims Award Fund Revenue	$	14,547,412
Risk Management Program	Property Values Insured	$	9,058,235,600
	Total Cost of Program	$	2,512,797
	Savings to the State over Private Insurance Rates	$	8,357,086
Chairs of Excellence Program	Chairs of Excellence Contributions	$	304,250
	Chairs Of Excellence Investment Earnings	$	26,856,551
	Chairs of Excellence Expenses	$	8,173,476
	Total Number of Chairs of Excellence		97
Other Programs	Deferred Compensation Contributions	$	50,377,859
	State Matching Contributions	$	5,019,855
	Deferred Compensation Participants		47,449
	Flexible Benefits Plan Payments	$	3,402,821
	FICA Savings Generated from Flex Plan	$	2,379,874
	Unclaimed Property Revenues	$	16,432,805
	Unclaimed Property Payments	$	5,838,266
	BEST Accounts		5,450
	BEST Contributions (net of fees)	$	7,409,891
Fair Value of Assets Under Management at 6/30/99	Retirement Trust Fund	$	23,056,668,747
	Chairs of Excellence Trust Fund	$	233,594,597
	State Pooled Investment Fund Investments	$	3,744,267,975
	Deferred Compensation (outside managers)	$	540,365,561
	Baccalaureate Education System Trust	$	15,178,367
	Bond Refunding Trust	$	72,581,095
	Total Assets Under Management	$	27,662,656,342

Program Administration

Bicentennial Mall State Park
Middle Tennessee

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 187 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 1998-99 fiscal year, the average balance of short term investments in the Treasurer's Cash Management program was $3,337,252,167 per month and interest income of $173,051,920 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 United States or any of its agencies; and repurchase agreements against obligations of the United States or its agencies. Securities underlying repurchase agreements must be book-entry and delivered to the State Trust of Tennessee. Funds may also be invested in prime commercial paper and prime banker's acceptances.

At June 30, 1999, investments had an average maturity of 65 days, and an average weighted yield of 4.98%. The total balance in the State Pooled Investment Fund at June 30, 1999 ($3,672,000,700 par value) was allocated as follows: U.S. Treasury government and agency securities, 21.04%; repurchase agreements, 5.85%; collateralized certificates of deposit, 46.63%; and commercial paper, 26.48%.

STATE CASH MANAGEMENT COMPARATIVE RETURNS

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

Fiscal Year	[1]Total Pool Funds	[2]Merrill Lynch Institutional Fund	[3]New Pool Funds	[4]90 Day Treasury (CD Equivalent Yield)
1998-99	5.22%	5.02%	5.03%	4.59%
1997-98	5.64	5.44	5.59	5.17
1996-97	5.50	5.25	5.40	5.17
1995-96	5.69	5.49	5.60	5.29
1994-95	5.34	5.33	5.47	5.45

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

State Cash Management

ADMINISTRATION OF AUTHORIZED STATE DEPOSITORY ACCOUNTS

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

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

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

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

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

STATE COLLATERAL PROGRAM

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

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

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

8-5-110 COLLATERAL

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

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

STATE CASH MANAGEMENT

COLLATERAL POOL

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

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

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

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

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

Currently, the Collateral Pool has 43 participant institutions collateralizing public funds in excess of $3 billion.

State Cash Management

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
1998-99	$ 1,403,271,417	$ 73,497,837	5.25%
1997-98	1,055,776,333	59,831,252	5.66%
1996-97	848,697,167	46,917,097	5.53%
1995-96	835,888,333	49,605,934	5.89%
1994-95	743,203,083	39,498,384	5.34%

Repurchase Agreements

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
1998-99	$ 139,544,000	$ 6,971,489	5.05%
1997-98	164,851,917	9,136,064	5.56%
1996-97	180,228,167	9,743,171	5.37%
1995-96	176,878,167	9,988,181	5.62%
1994-95	172,311,500	9,375,039	5.46%

Commercial Paper

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
1998-99	$ 1,113,779,417	$ 58,565,097	5.26%
1997-98	890,313,583	50,659,421	5.69%
1996-97	739,561,917	41,056,244	5.55%
1995-96	591,118,167	33,556,447	5.65%
1994-95	533,771,250	29,866,669	5.60%

U.S. Government Securities

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
1998-99	$ 680,657,333	$ 34,017,497	5.14%
1997-98	652,920,833	36,098,337	5.52%
1996-97	622,375,583	34,547,557	5.45%
1995-96	655,638,667	35,684,775	5.46%
1994-95	692,287,167	34,534,311	5.07%

Securities Lending Income

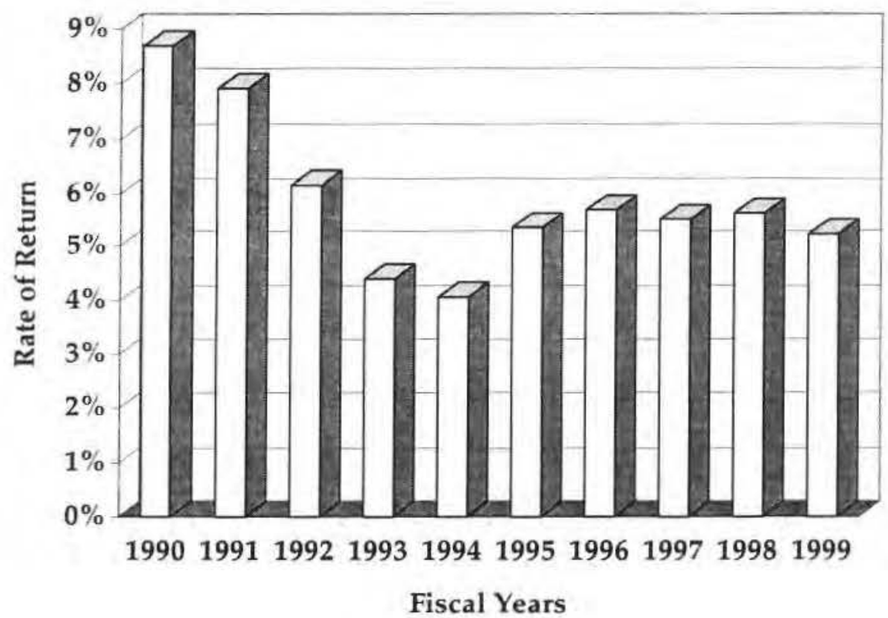
Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
1998-99	N/A	$ 0	N/A
1997-98	N/A	0	N/A
1996-97	N/A	0	N/A
1995-96	N/A	0	N/A
1994-95	N/A	487,467	N/A

Total Funds

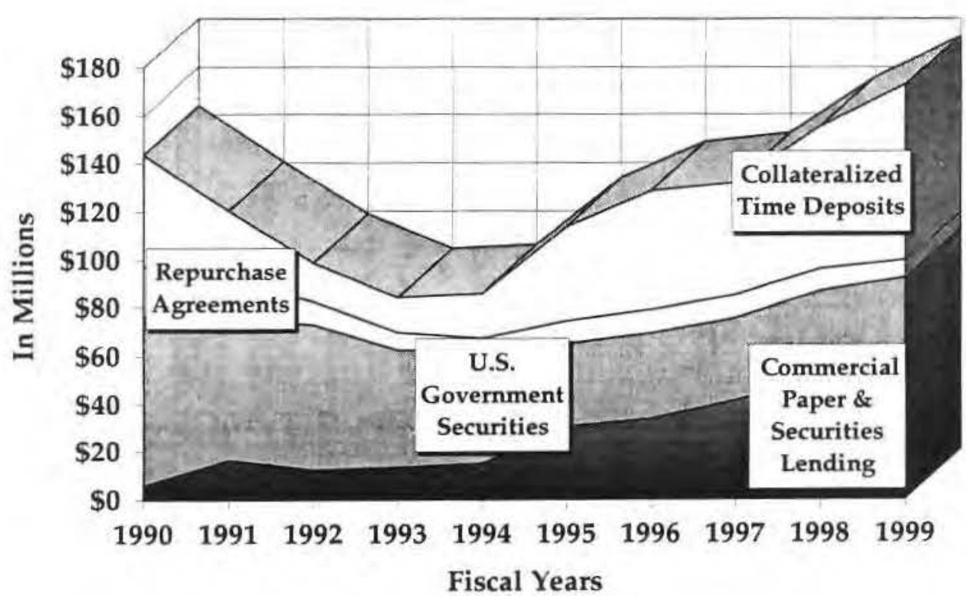
Fiscal Year	Average Total Funds Invested	Cash Management Investment Earnings	Composite Weighted Average Rate of Return
1998-99	$ 3,337,252,167	$ 173,051,920	5.22%
1997-98	2,763,862,666	155,725,074	5.64%
1996-97	2,390,862,834	132,264,069	5.50%
1995-96	2,259,523,334	128,835,337	5.69%
1994-95	2,141,573,000	113,761,870	5.34%

STATE CASH MANAGEMENT

CASH MANAGEMENT INVESTMENTS COMPOSITE WEIGHTED AVERAGE RATE OF RETURN
1990-1999



ANALYSIS OF STATE CASH EARNINGS
1990-1999



STATE CASH MANAGEMENT

CASH MANAGEMENT PORTFOLIO ANALYSIS
Fiscal Year Ended June 30, 1999

Date	Current Investment Yield	Total Portfolio Yield	Avg. Days to Maturity	Portfolio Composition: Certificates of Deposit	Repurchase Agreements	U.S. Treasury Notes	U.S. Agency	Commercial Paper
Jul-98	5.54%	5.59%	69	38.95%	3.38%	1.50%	22.39%	33.77%
Aug-98	5.59%	5.60%	67	36.87%	4.59%	1.44%	24.48%	32.62%
Sep-98	5.51%	5.58%	68	36.18%	4.60%	1.47%	23.89%	33.87%
Oct-98	5.07%	5.43%	85	44.46%	3.46%	1.53%	16.34%	34.21%
Nov-98	4.89%	5.22%	87	45.19%	5.41%	1.59%	13.34%	34.48%
Dec-98	4.93%	5.22%	76	47.31%	6.20%	1.67%	10.57%	34.26%
Jan-99	4.76%	5.08%	65	44.82%	4.14%	1.57%	15.47%	33.99%
Feb-99	4.80%	5.01%	68	42.95%	4.16%	1.06%	18.34%	33.49%
Mar-99	4.83%	5.06%	78	42.16%	4.13%	1.53%	18.13%	34.05%
Apr-99	4.83%	4.99%	74	39.72%	4.29%	1.45%	20.28%	34.27%
May-99	4.80%	4.94%	76	41.39%	2.64%	1.40%	22.58%	32.00%
Jun-99	4.84%	4.95%	68	45.55%	3.60%	1.41%	19.48%	29.96%
Dollar Weighted Avg.	5.03%	5.22%	73	42.13%	7.58%	1.47%	18.77%	33.41%

Date	General Fund Average	General Fund Percent	LGIP Average	LGIP Percent	Other Restricted Average	Other Restricted Percent	Total Average Invested
Jul-98	$ 853,100,232	25.75%	$ 1,675,545,568	50.58%	$ 784,121,200	23.67%	$ 3,312,767,000
Aug-98	997,249,225	28.76%	1,696,919,480	48.93%	773,631,295	22.31%	3,467,800,000
Sep-98	879,977,589	25.94%	1,739,771,036	51.28%	773,176,375	22.79%	3,392,925,000
Oct-98	741,975,277	22.70%	1,706,018,097	52.19%	820,899,626	25.11%	3,268,893,000
Nov-98	681,461,024	21.70%	1,690,757,800	53.84%	767,989,176	24.46%	3,140,208,000
Dec-98	570,628,972	19.12%	1,645,919,648	55.15%	768,149,380	25.74%	2,984,698,000
Jan-99	550,023,119	17.32%	1,841,227,989	57.97%	784,946,892	24.71%	3,176,198,000
Feb-99	456,652,231	14.18%	1,960,061,982	60.86%	803,803,787	24.96%	3,220,518,000
Mar-99	432,988,027	13.00%	2,134,484,221	64.07%	763,800,752	22.93%	3,331,273,000
Apr-99	603,382,284	17.18%	2,088,782,404	59.49%	819,174,312	23.33%	3,511,339,000
May-99	776,936,274	21.37%	2,019,896,718	55.57%	838,335,008	23.06%	3,635,168,000
Jun-99	806,521,697	22.37%	1,945,517,268	53.96%	853,200,035	23.67%	3,605,239,000
Avg.	$ 695,907,996	20.85%	$ 1,845,408,518	55.30%	$ 795,935,653	23.85%	$ 3,337,252,167

State Cash Management

LOCAL GOVERNMENT INVESTMENT POOL

Tennessee municipalities, counties, school districts, utility districts, community service agencies, local government units, and political subdivisions can deposit monies with the Treasurer to be invested in the state cash management investment pool. Of course, these local governments can invest their monies directly in the money market if they so desire. However, by allowing their dollars to be invested by the state they eliminate the complexities of managing day-to-day investment and collateral relationships with banks and/or securities dealers. This allows cash managers who have previously been limited either by the relatively small amount of funds available for investment or the complexities of today's investment environment to take advantage of the volume and expertise of the Treasurer's cash management program.

The Local Government Investment Pool began operations in November of 1980. Participation in the LGIP program currently stands at 910 active accounts, representing 302 local government units. In addition, 405 accounts are active in the Department of Transportation (DOT) program.

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.

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

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

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

Participants earn interest on LGIP deposits based on the average rate of interest earned on the investments acquired for the entire cash management pool each month. This average earnings rate is reduced each month by six one hundredths of one percent (.06%) as an administrative fee for participating in the LGIP program. During the 1998-99 fiscal year, the average rate participants earned on their deposits after the fee reduction was 4.97%. 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, 1999

	Account Balance 7/1/98	Net Deposits/ (Withdrawals) FY 1998-99	Net Interest Credited FY 1998-99	Account Balance 6/30/99
Cities	$ 306,822,901	$ (7,228,414)	$ 15,392,304	$ 314,986,791
Counties	733,845,508	(38,062,132)	36,961,712	732,745,088
Commitments to D.O.T.	54,554,001	(6,749,110)	2,814,878	50,619,769
Educational Institutions	378,169,548	42,591,777	25,853,253	446,614,578
Community Health Agencies	10,254,003	146,766	469,417	10,870,186
Restricted Accounts	926,097	(24,465)	46,242	947,874
Other	175,569,648	58,226,384	10,113,504	243,909,536
Total	$ 1,660,141,706	$ 48,900,806	$ 91,651,310	$ 1,800,693,822

State Cash Management

STATE TRUST OF TENNESSEE

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

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

The restrictions required the State Trust of Tennessee to contract with an agent bank to execute these transactions. First American National Bank in Nashville serves as the Trust's agent for the period July 1, 1999 through June 30, 2004.

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

STATE TRUST OF TENNESSEE FEDERAL RESERVE BANK TRANSACTIONS
Fiscal Year 1998-99

Transaction Type	Number	Amount
(1) Wire Disbursements	8,207	$ 6,658,985,381
(2) Wire Receipts	7,445	12,271,363,265
(3) Security Disbursements	1,072	37,563,740,529
(4) Security Receipts	1,041	37,432,380,291
(5) Check Redemptions	6,454,001	7,782,057,303
Total	6,471,766	$ 101,708,526,769

Explanation of Transaction Types:

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

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

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

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

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

TCRS INVESTMENTS

TCRS INVESTMENTS

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

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

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

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

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

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

INITIATIVES

Since the Tennessee General Assembly enacted legislation to authorize TCRS to further diversify its portfolio by allowing investments in real estate, the system has been active in establishing the necessary infrastructure to manage this asset class. The system hired an experienced real estate portfolio manager, employed the services of a real estate investment consultant, adopted internal operating procedures to carry out the provisions of the real estate policy as adopted by the TCRS Board of Trustees, and employed the services of real estate investment advisors. The first purchase of real estate occurred in September 1999.

During the next six months, the investment division will conduct an asset allocation study to evaluate the risk and return of various asset allocation strategies.

EXTERNAL MANAGERS FOR INTERNATIONAL EQUITY

TCRS utilizes external managers for the investment management of the international equity asset class. The use of external managers for this asset class began in November 1995 when the number of countries in which stock purchases could be made was increased from seven to 39. Pursuant to T.C.A. Section 8-3-113, the initial selection of external managers included one emerging investment manager. The initial allocation included $10 million for emerging managers. Subsequent allocations in April 1997 and November 1998 included $40 million for emerging managers.

TCRS Investments

INVESTMENT SUMMARY

As of June 30, 1999

	Domestic		International		Total	
	Fair Value	% of Total Fair Value	Fair Value	% of Total Fair Value	Fair Value	% of Total Fair Value
Fixed income						
Government bonds	$ 8,191,771,379	36.05%	$ 1,016,111,118	4.47%	$ 9,207,882,497	40.52%
Corporate bonds	2,902,474,974	12.77%	430,839,199	1.90%	3,333,314,173	14.67%
Convertible bonds	82,102,275	0.36%	6,512,667	0.03%	88,614,942	0.39%
Total bonds	$ 11,176,348,628	49.18%	$ 1,453,462,984	6.40%	$ 12,629,811,612	55.58%
Preferred stock	158,089,250	0.70%	11,534,349	0.05%	169,623,599	0.75%
Total fixed income	$ 11,334,437,878	49.88%	$ 1,464,997,333	6.45%	$ 12,799,435,211	56.33%
Common stock						
Banks	$ 610,760,852	2.69%	$ 161,351,608	0.71%	$ 772,112,460	3.40%
Business services	223,966,925	0.99%	211,818,954	0.93%	435,785,879	1.92%
Capital goods	372,393,812	1.64%	223,705,361	0.98%	596,099,173	2.62%
Commingled fund	0	0.00%	11,853,922	0.05%	11,853,922	0.05%
Consumer durables	115,605,903	0.51%	121,307,127	0.53%	236,913,030	1.04%
Consumer non-durables	527,432,292	2.32%	151,198,838	0.67%	678,631,130	2.99%
Consumer services	306,550,375	1.35%	113,011,896	0.50%	419,562,271	1.85%
Energy	384,990,906	1.69%	179,796,018	0.80%	564,786,924	2.49%
Financial services	503,652,137	2.22%	151,260,599	0.67%	654,912,736	2.89%
Health care	861,734,457	3.79%	75,396,869	0.33%	937,131,326	4.12%
Multi-industry	11,113,188	0.05%	48,800,878	0.21%	59,914,066	0.26%
Private placement	0	0.00%	15,780,481	0.07%	15,780,481	0.07%
Raw materials	247,501,469	1.09%	180,146,937	0.79%	427,648,406	1.88%
Retail	505,676,933	2.23%	66,416,422	0.29%	572,093,355	2.52%
Rights/warrants	0	0.00%	4,325,571	0.02%	4,325,571	0.02%
Technology	1,527,535,705	6.72%	225,286,202	0.99%	1,752,821,907	7.71%
Transportation	68,488,437	0.30%	54,256,970	0.24%	122,745,407	0.54%
Unclassified	0	0.00%	5,649,994	0.02%	5,649,994	0.02%
Utilities	813,661,521	3.58%	107,073,583	0.47%	920,735,104	4.05%
Total common stock	$ 7,081,064,912	31.17%	$ 2,108,438,230	9.27%	$ 9,189,503,142	40.44%
Short-term investments						
Commercial paper	$ 537,038,847	2.37%	$ 0	0.00%	$ 537,038,847	2.37%
U.S. gov't securities	196,069,017	0.86%	0	0.00%	196,069,017	0.86%
Total short-term investments	$ 733,107,864	3.23%	$ 0	0.00%	$ 733,107,864	3.23%
Total investments	$ 19,148,610,654	84.28%	$ 3,573,435,563	15.72%	$ 22,722,046,217	100.00%

TCRS Investments

TCRS INVESTMENTS BENCHMARK ANALYSIS

Fiscal Year	[1]Public Fund Index Median Total Return	[2]TCRS Total Return	[3]Yield To Maturity on New Bonds
1998-99	10.0%	9.5%	6.6%
1997-98	17.9	15.1	6.4
1996-97	18.9	15.7	6.7
1995-96	15.8	12.8	6.2
1994-95	15.4	12.8	7.3
1993-94	1.6	0.5	5.9
1992-93	13.2	15.1	6.5
1991-92	12.1	13.7	8.2
1990-91	7.9	7.8	8.7
1989-90	10.4	11.6	9.0

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

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

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

SUMMARY OF TCRS EARNINGS

Fiscal Years 1994-95 through 1998-99

Fiscal Year	TCRS Portfolio Earnings[1]
1998-99	$ 1,932,716,042
1997-98	2,758,267,944
1996-97	2,514,952,816
1995-96	1,806,673,555
1994-95	930,425,055

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

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

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

MEMBERSHIP

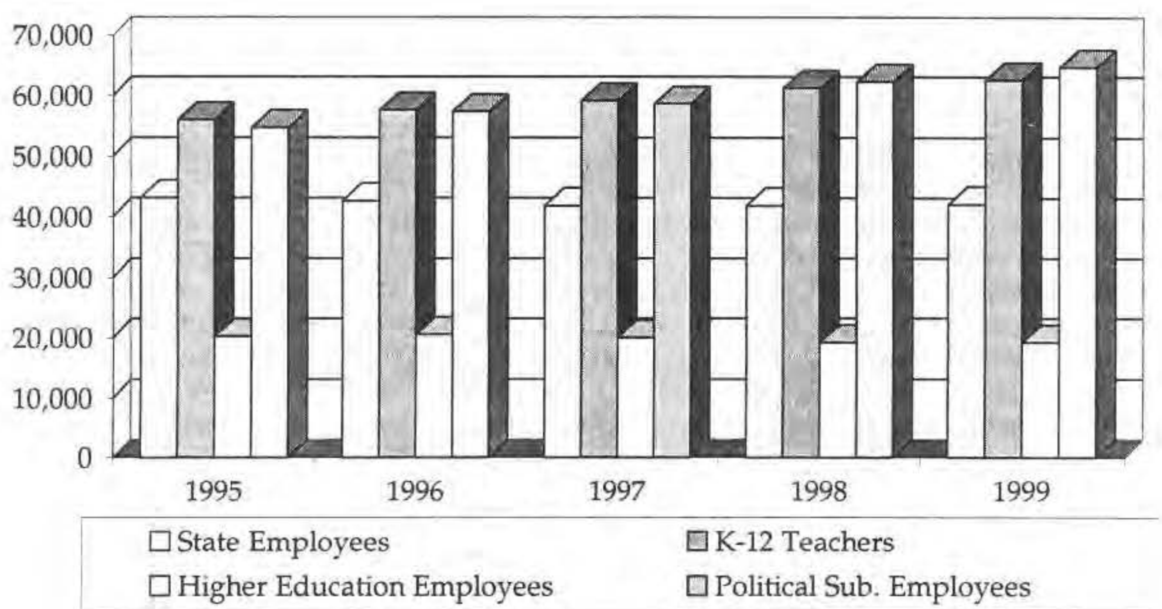
Membership in the retirement system is a condition of employment for full-time state employees, teachers, general employees in higher education, and the employees of local governments that participate in TCRS. Membership is optional for certain part-time employees. Faculty employees in higher education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

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

As of June 30, 1999, there were 188,080 active members of TCRS and 10,656 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 1995-1999



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.

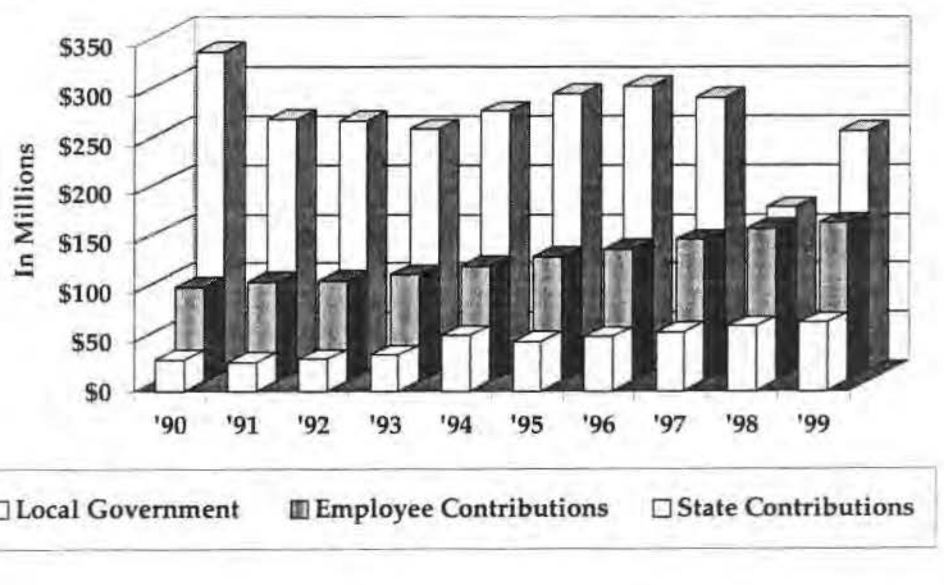
Upon termination of employment, a member may elect to withdraw his contributions and accumulated interest from the retirement system in a lump sum. By obtaining a lump sum refund, a member waives all rights and benefits in the retirement system. A vested member may leave his account balance in TCRS and 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 1998-99 fiscal year, 4,874 refunds totaling $25.6 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, 1999 were as follows:

Noncontributory State and Higher Education Employees	5.43%
K-12 Teachers	5.47%
Political Subdivisions	Individually Determined
Faculty Members Electing to Participate in the ORP	10.00%*

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

RETIREMENT CONTRIBUTIONS
Fiscal Years 1990-1999
(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, 1999, 71,646 retirees were receiving monthly benefit payments. This represents a 3.92% 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.

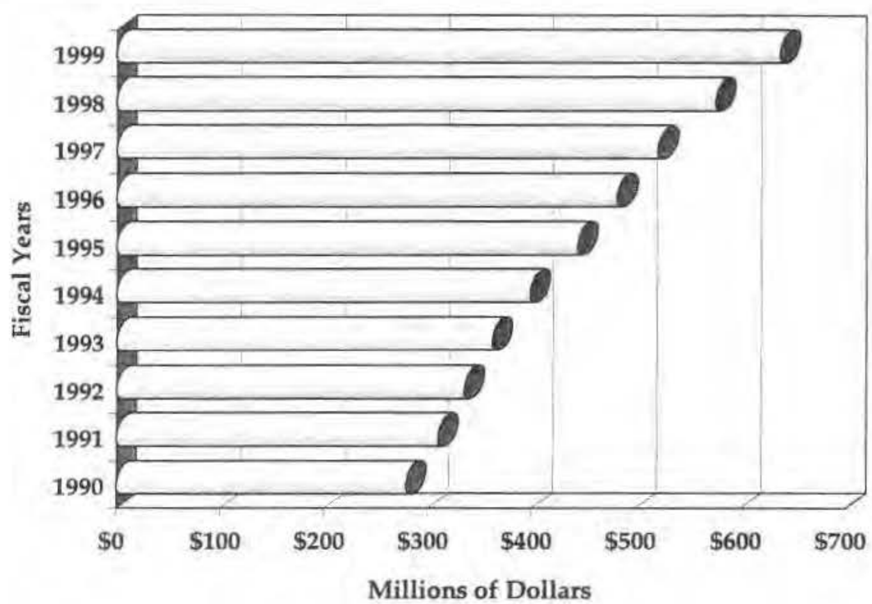
Disability benefits are available to active members with five years of service who become disabled and can not engage in gainful employment. There is no service requirement for disability benefits paid to active members whose disability is a result of an accident or injury occurring while the member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

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

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

Benefits paid in fiscal year 1998-99 totaled $637.7 million, an increase of $58.8 million over 1997-98 benefit payments.

ANNUAL BENEFIT PAYMENTS
Fiscal Years 1990-1999
(in Millions)



TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

TENNESSEE'S RETIREMENT PROGRAM, TCRS AND SOCIAL SECURITY BENEFITS
for Calendar Year 1999

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	7,968		7,968		7,968		7,968		7,968	
	Total	$ 11,512	76.7%	$ 12,693	84.6%	$ 13,874	92.5%	$ 15,056	100.4%	$ 16,237	108.2%
$20,000	TCRS	$ 4,725		$ 6,300		$ 7,875		$ 9,450		$ 11,025	
	Social Security	9,552		9,552		9,552		9,552		9,552	
	Total	$ 14,277	71.4%	$ 15,852	79.3%	$ 17,427	87.1%	$ 19,002	95.0%	$ 20,577	102.9%
$25,000	TCRS	$ 5,906		$ 7,875		$ 9,844		$ 11,813		$ 13,781	
	Social Security	11,124		11,124		11,124		11,124		11,124	
	Total	$ 17,030	68.1%	$ 18,999	76.0%	$ 20,968	83.9%	$ 22,937	91.7%	$ 24,905	99.6%
$30,000	TCRS	$ 7,088		$ 9,450		$ 11,813		$ 14,175		$ 16,538	
	Social Security	12,708		12,708		12,708		12,708		12,708	
	Total	$ 19,796	66.0%	$ 22,158	73.9%	$ 24,521	81.7%	$ 26,883	89.6%	$ 29,246	97.5%
$35,000	TCRS	$ 8,418		$ 11,225		$ 14,031		$ 16,837		$ 19,643	
	Social Security	14,064		14,064		14,064		14,064		14,064	
	Total	$ 22,482	64.2%	$ 25,289	72.3%	$ 28,095	80.3%	$ 30,901	88.3%	$ 33,707	96.3%
$40,000	TCRS	$ 9,797		$ 13,062		$ 16,328		$ 19,593		$ 22,859	
	Social Security	14,616		14,616		14,616		14,616		14,616	
	Total	$ 24,413	61.0%	$ 27,678	69.2%	$ 30,944	77.4%	$ 34,209	85.5%	$ 37,475	93.7%
$45,000	TCRS	$ 11,175		$ 14,900		$ 18,624		$ 22,349		$ 26,074	
	Social Security	15,096		15,096		15,096		15,096		15,096	
	Total	$ 26,271	58.4%	$ 29,996	66.7%	$ 33,720	74.9%	$ 37,445	83.2%	$ 41,170	91.5%
$50,000	TCRS	$ 12,553		$ 16,737		$ 20,921		$ 25,106		$ 29,290	
	Social Security	15,528		15,528		15,528		15,528		15,528	
	Total	$ 28,081	56.2%	$ 32,265	64.5%	$ 36,449	72.9%	$ 40,634	81.3%	$ 44,818	89.6%
$55,000	TCRS	$ 13,931		$ 18,575		$ 23,218		$ 27,862		$ 32,505	
	Social Security	15,936		15,936		15,936		15,936		15,936	
	Total	$ 29,867	54.3%	$ 34,511	62.7%	$ 39,154	71.2%	$ 43,798	79.6%	$ 48,441	88.1%
$60,000	TCRS	$ 15,309		$ 20,412		$ 25,515		$ 30,618		$ 35,721	
	Social Security	16,296		16,296		16,296		16,296		16,296	
	Total	$ 31,605	52.7%	$ 36,708	61.2%	$ 41,811	69.7%	$ 46,914	78.2%	$ 52,017	86.7%

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

This chart is based on a date of retirement in 1999. 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 1999;

(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.

An on-line benefits calculator has been added to the TCRS web site to allow 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 June 30, 1997 to establish employer contribution rates. The system's accrued liability at June 30, 1997 is $169.2 million. The accrued liability is being amortized over a 40 year period which began in 1975.

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

Economic Assumptions

(1) 7.5% annual return on investments

(2) 5.5% salary increases annually

(3) 4.5% annual increase in social security wage base

Actuarial Assumptions

(1) Pre-Retirement mortality based on age and sex

(2) Post-Retirement mortality based on age and sex

(3) Disability rate based on age

(4) Turnover rate based on age and length of service

(5) Retirement age distribution based on age and service

POLITICAL SUBDIVISIONS

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

POLITICAL SUBDIVISION PARTICIPATION
as of June 30, 1999

Cities	147
Counties	87
Utility Districts	34
Special School Districts	21
Joint Ventures	25
Regional Libraries	12
Development Agencies	14
Housing Authorities	10
911 Emergency Communication Districts	25
Miscellaneous Authorities	19
Total	394

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

MAJOR LEGISLATIVE IMPROVEMENTS
1980-1999

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

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

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

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

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

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

Retirement credit for armed conflict military service was approved.

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

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

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

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

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

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

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

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

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

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

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

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

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

1996 An installment payment plan for prior service was authorized.

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

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

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

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

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

Supplemental bridge benefit established in conjunction with reestablishment of mandatory retirement for all state public safety officers.

1999 Group I benefit limitation increased to 90%.

Tennessee Consolidated Retirement System

SOCIAL SECURITY

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

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

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

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

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

SCHEDULE OF HISTORICAL SOCIAL SECURITY CONTRIBUTION RATES

Calendar Year	Employee Rate	Employer Rate	Social Security Wage Base	Medicare Wage Base
2000	7.65%	7.65%	$ 76,200	No Limit
1999	7.65	7.65	72,600	No Limit
1998	7.65	7.65	68,400	No Limit
1997	7.65	7.65	65,400	No Limit
1996	7.65	7.65	62,700	No Limit
1995	7.65	7.65	61,200	No Limit
1994	7.65	7.65	60,600	No Limit
1993	7.65	7.65	57,600	$ 135,000
1992	7.65	7.65	55,500	130,200
1991	7.65	7.65	53,400	125,000

DEFERRED COMPENSATION PROGRAM

DEFERRED COMPENSATION PROGRAM

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

This program offers employees two plans. The 457 plan was implemented in the 1981-82 fiscal year, and the 401(k) plan was implemented in the 1983-84 fiscal year. In accordance with changes to *Internal Revenue Code Section 457*, the state's 457 plan was converted to a trust, effective January 1, 1999.

As of June 30, 1999, 43,621 individuals had accounts in the 401(k) plan and 3,828 individuals had accounts in the 457 plan. At June 30, 22,256 state employees, 7,628 University of Tennessee employees, and 7,401 Tennessee Board of Regents employees were actively contributing to the 401(k) plan and 1,281 state employees, 98 University of Tennessee employees, and four Tennessee Board of Regents employees were actively contributing to the 457 plan.

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

IRS regulations for 1999 allow a maximum deferral in the 457 plan of 25% of taxable salary up to the maximum annual contribution of $8,000. The maximum deferral in the 401(k) plan is 20% of taxable salary for most members, up to the maximum annual contribution of $10,000. Participants who use more than one tax-deferred savings plan are subject to additional limits.

During the 1998-99 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 $20 per month as authorized by the General Assembly. The amount contributed by the state during the year was $5,019,855.

Participants in the program may direct the investment of their deferred salary to Union Planters Time Deposit Account, Aetna's Fixed Account, Calvert's Income Fund, State Street Bank & Trust's S&P 500 Index Fund, Fidelity Investments' Magellan Fund, Puritan Fund, OTC Portfolio, Contrafund, International Growth and Income Fund, Asset Manager, and Government Money Market Portfolio.

Enrollment and record keeping services for the program are provided by Security First Group. 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 video, a handbook for participants, several booklets on special topics, investment seminars around the state, and a voice response telephone system which provides participants with telephone access to account balances account activity, and loan initiation 24 hours a day.

The Internet site, www.treasury.state.tn.us/dc/, provides full information about the program. Information available through the site includes forms, participation information and illustrations, descriptions of the investment choices and historical performance figures, an interactive benefit calculator,

DEFERRED COMPENSATION PROGRAM

complete information for participants who may be approaching retirement age or considering withdrawing funds from the program, and an e-mail address for participants to request additional personalized information. The National Association of Government Deferred Compensation Administrators awarded the site its outstanding achievement award in communication.

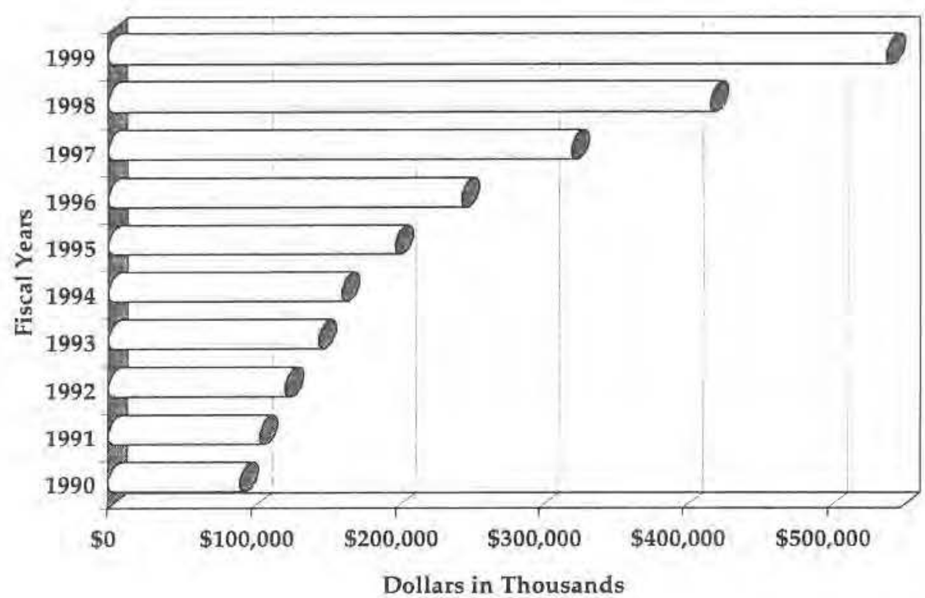
For the year ending June 30, 1999, employees contributions to the program totaled $55,397,714. Contributions are wired through the State Trust of Tennessee for immediate crediting.

At June 30, 1999, accumulated account balances totaled $540,365,561. At June 30, 1999, the program's assets were invested as follows: 80% in variable mutual funds, 3% in variable annuity products, 11% in insurance companies' fixed accounts, and 6% in a federally insured bank account. Distribution of the program's assets among the program's six investment providers is shown on the following page.

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, 1999, there were 650 loans outstanding from the 401(k) plan. Outstanding loan balances totaled $2.9 million.

Benefits from the program may be distributed in periodic payments, in an annuity, or in a lump sum. At June 30, 1999, there were 678 individuals receiving periodic payments and 177 individuals receiving annuity payments from the program. In addition, a total of 3,427 lump sum distributions were issued during 1998-99.

DEFERRED COMPENSATION PROGRAM ASSETS
Fiscal Years 1990-1999
(in Thousands)



Deferred Compensation Program

DEFERRED COMPENSATION CONTRIBUTIONS AND ASSETS

	Contributions		Market Value of Account Balances	
	FY 1998-99	FY 1997-98	June 30, 1999	June 30, 1998
Plan I: 457				
AEtna (closed)	$ 0	$ 0	$ 20,780,504	$ 21,235,441
AEtna (open)	338,204	448,825	16,346,539	15,080,164
American General	46,125	49,508	967,544	1,030,304
Calvert Group	36,792	39,302	1,021,916	737,749
Fidelity Investments	2,065,326	2,205,015	97,058,597	79,553,813
Great West	0	0	1,181,840	2,269,353
State Street	37,833	0	1,696,749	0
Union Planters	326,459	397,879	13,976,341	14,176,840
Total	$ 2,850,739	$ 3,140,529	$ 153,030,030	$ 134,083,664
Plan II: 401(k)				
AEtna (closed)	$ 0	$ 0	$ 9,654,444	$ 10,339,249
AEtna (open)	3,985,068	3,833,461	29,134,227	24,398,700
Calvert Group	641,808	523,770	3,661,617	2,469,652
Fidelity Investments	44,463,240	37,065,324	322,970,288	230,395,117
Great West	0	0	1,029,936	2,042,208
State Street	986,904	0	3,850,530	0
Union Planters	2,469,955	2,396,052	17,034,489	14,792,123
Total	$ 52,546,975	$ 43,818,607	$ 387,335,531	$ 284,437,049
Total for both plans	$ 55,397,714	$ 46,959,136	$ 540,365,561	$ 418,520,713

FLEXIBLE BENEFITS PLAN

FLEXIBLE BENEFITS PLAN

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

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

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

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

At June 30, 1999, 37,631 state employees were enrolled in one or more of the plan's four options: 37,185 employees used the plan to pay medical insurance premiums, 14,239 paid dental insurance premiums, 2,511 used the medical expense reimbursement account, and 351 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 1998-99, the state's F.I.C.A. savings totaled $2.4 million. Since the program began operation in January 1989, the state's F.I.C.A. savings have totaled $19.6 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, and funding matching contributions to the 401(k) plan. As of June 30, 1999, $16.4 million had been transferred to offset costs of other benefit programs.

Claims Against the State

CLAIMS AGAINST THE STATE

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

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

The division contracts with a managed care organization which has established a workers' compensation preferred provider network for medical treatment for injured state employees. Currently, 98% of state employees have access to this network. The managed care organization also provides case management services such as pre-certification for inpatient hospital care, bill review, large case management and other services to manage the costs of workers' compensation claims. The use of a preferred provider network has enabled the state to obtain approximately 33% savings off billed charges on workers' compensation medical bills.

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

During fiscal year 1998-99, the Division of Claims Administration received 6,110 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 1998-99 fiscal year, the Board took action on a total of seven matters regarding claims and insurance. The Board also reviews and approves the purchase of insurance policies by the state and makes recommendations to the Commissioner of Finance and Administration and the General Assembly regarding the required funding for the Claims Award Fund.

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

Claims Against the State

CLAIMS AND PAYMENT ACTIVITY
Fiscal Year 1998-99

	Claims Filed	Payments Made
Workers' Compensation Claims	3,974	
Death Payments		$ 435,731
Medical Payments		7,087,668
Assault Injury Payments		0
Temporary Disability (Lost Time)		1,474,693
Permanent Disability		5,070,165
Subtotal		$ 14,068,257
Employee Property Damage	226	$ 33,990
Tort Claims	1,910	
Death Payments		$ 927,750
Bodily Injury Payments		3,014,917
Property Damage Payments		998,617
Subtotal		$ 4,941,284
Total	6,110	$ 19,043,531

Victims Compensation Program

VICTIMS COMPENSATION PROGRAM

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

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

During the 1998-99 fiscal year, the Division of Claims Administration made payments on 1,544 criminal injury claims for a total of $6,049,873. Payments are issued promptly to the victim and, if appropriate, his or her attorney. Federal funding assistance for the program has aided in allowing prompt claim payment.

Victims of drunk drivers are also paid from the Criminal Injury Compensation Fund. Identical monetary benefits are available to both drunk driver and criminal injury victims. When the proximate cause of a death or injury is the operator's intoxication as prohibited by *T.C.A. 55-10-401*, the victim's death or injury is eligible for compensation in the same manner as criminal injury compensation, not to exceed a maximum award of $8,000 per claim plus attorney fees for injuries occurring on or after July 1, 1997. A supplemental award of up to $4,000 was available for crimes occurring during the 1998-99 fiscal year.

Since the first claims were paid in 1982, the program has awarded a total of over $97 million to crime victims. The Division of Claims Administration has made an effort to educate members of the public of the existence and benefits of the Criminal Injury Compensation Program by printing and distributing informative brochures explaining the program. Public awareness efforts and the use of victim assistance coordinators in each judicial district have also aided in providing the public with information about the availability of criminal injury compensation.

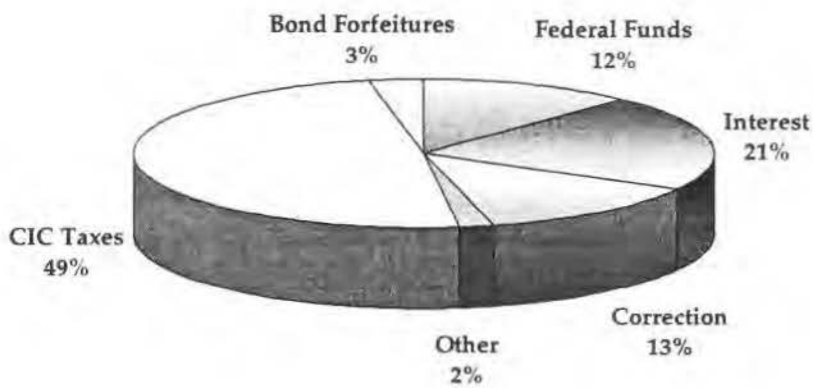
In the spring of 1999, the Tennessee General Assembly enacted legislation to increase compensation to victims. The maximum compensation available was increased from $8,000 to $12,000; the supplemental award was increased from $4,000 to $8,000; and the maximum funeral and burial reimbursement was increased from $3,000 to $4,500. In addition, the percentage of a victim's weekly wage used to calculate lost wages and disability was increased from 66.66% to 85%. New coverage to victims will include cleanup of the homicide scene occurring in the residence of a victim or a victim's relative reimbursable up to $1,500. The aforementioned changes are effective for crimes occurring on or after July 1, 1999.

VICTIMS COMPENSATION PROGRAM

VICTIMS COMPENSATION AWARDS PAID FISCAL YEAR 1998-99
Percentage of Awards Based on Crime Classification

During fiscal year 1998-99, 1,544 awards totaling $6,049,873 were made. Of that amount, $216,881 can be attributed to claims involving DUI with the remaining $5,832,992 related to all other crime types. The average award for all types was $3,918.

CRIMINAL INJURIES COMPENSATION FUND
Sources of Funds



Claims Commission

CLAIMS COMMISSION

Chapter 972 of the 1984 Public Acts (codified as Tennessee Code Annotated, Section 9-8-301 et seq.) created the Tennessee Claims Commission as the administrative tribunal to determine monetary claims against the state. The commission has three commissioners, one from each grand division of the state. The three commissioners, who are appointed by the Governor and confirmed by the General Assembly, serve staggered six-year terms. Each commissioner has a legal assistant and an executive secretary.

The commission has a central office in Nashville with an administrative clerk, an administrative services assistant and an administrative secretary. For administrative purposes, the commission is attached to the Department of the Treasury. (Prior to July 1, 1997, the commission was attached to the Department of Commerce and Insurance.)

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 Claims Award 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 Injuries Compensation Fund. The Department of the Treasury'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.

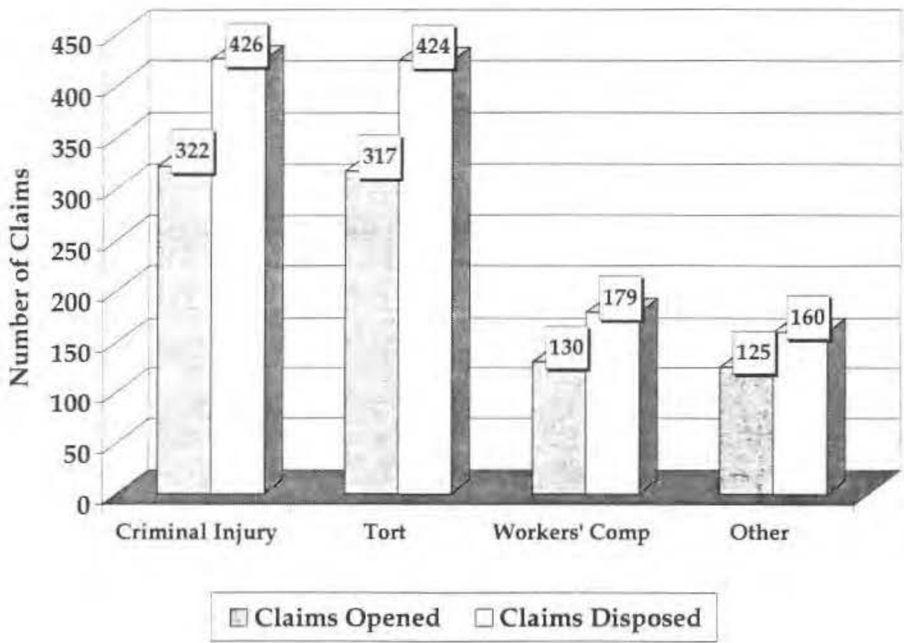
Both the Division of Claims Administration and the third party administrator have 90 days to accept or deny a claim before the claim is automatically transferred to the commission. Claimants can appeal both entities' decisions to the Claims Commission.

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.

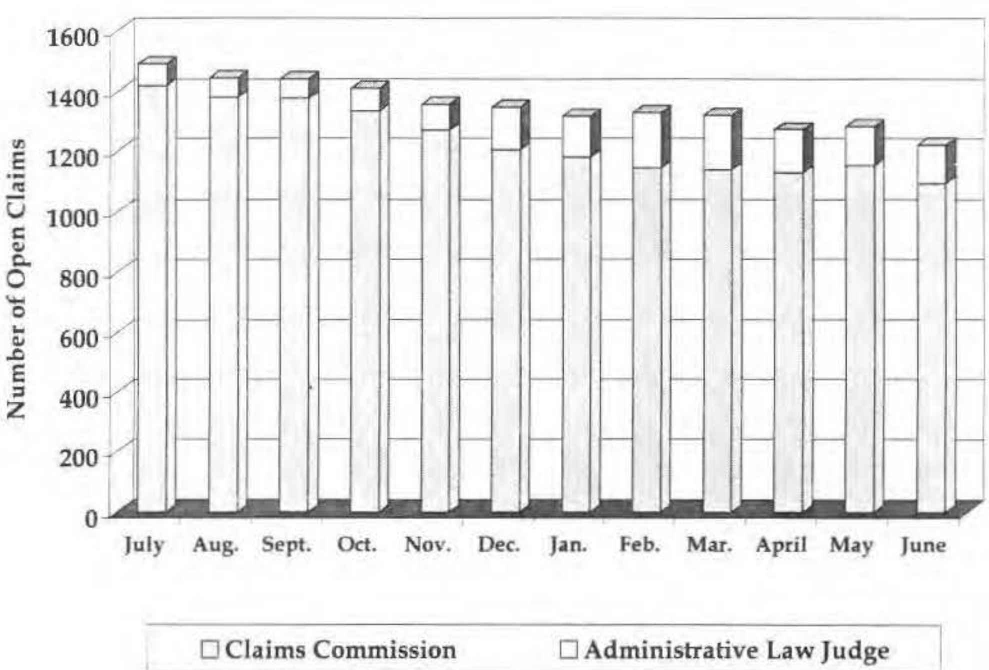
As of July 1, 1997, upon request by the Governor, by an individual claims commissioner, or by the majority of the claims commissioners, the Secretary of State may assign administrative law judges to "assist in the removal of unacceptable congestion or delay on the claims commission docket." In adjudicating claims, the administrative law judges have the same powers as commissioners.

CLAIMS COMMISSION

CLAIMS STATUS OPEN AND NUMBER OF DISPOSITIONS BY CLAIM TYPE
Fiscal Year 1999



CLAIMS COMMISSION AND ADMINISTRATIVE LAW JUDGE OPEN CLAIMS
Fiscal Year 1999



Division of Risk Management

DIVISION OF RISK MANAGEMENT

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

All property exposures are thoroughly inspected and evaluated to determine appropriate rates for premium development and allocation of premium costs to the various departments. As of July 1, 1998, the state's property values exceeded $9 billion. The premium cost for excess property coverage and fidelity bond amounted to $514,507. This translates to an annual rate of .0057 cents per $100 of coverage.

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

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

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

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

During fiscal year 1998-99, a total of 158 claims were reported. Of this number, 113 did not exceed the $5,000 deductible and were closed with no payment. The remaining 45 incurred losses amounted to $10,989,070, with resulting net losses of $10,764,070. Of this total, $8,915,000 was the result of the Jackson and Clarksville tornadoes. Fortunately, the actual loss to the state's property/casualty fund will only be $1,945,448. FEMA will provide disaster assistance of approximately $3,054,552, and the state's property insurance carrier, Royal and SunAlliance Insurance Company, will assume approximately $5,764,070 of the total losses. Considering actual losses of $1.9 million and a manual premium for first dollar coverage of $10.9 million, the state's pure property loss ratio would be 17.9%. Since the generally expected standard in the insurance industry for loss ratio break-even is approximately 48%, the state's property loss experience remains at an excellent level.

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

Division of Risk Management

COST OF PROPERTY/CASUALTY PROGRAM VERSUS PRIVATE INSURANCE

Fiscal Year 1998-99

[1]Premium - Excess Property & Bond Coverage	$ 514,507
Premium - Boiler Insurance Coverage	52,842
Total Premium	$ 567,349
[2]Total Net Incurred Losses	10,764,070
Less FEMA Disaster Assistance	(3,054,552)
Less Insurance Company Coverage	(5,764,070)
Total Cost of State Program	$ 2,512,797
[3]Private Insurance Premium Cost at Manual Rates with No State Retention	10,869,883
Net Savings to State	$ 8,357,086

[1] Based on July 1, 1998 values totaling $9,058,235,600

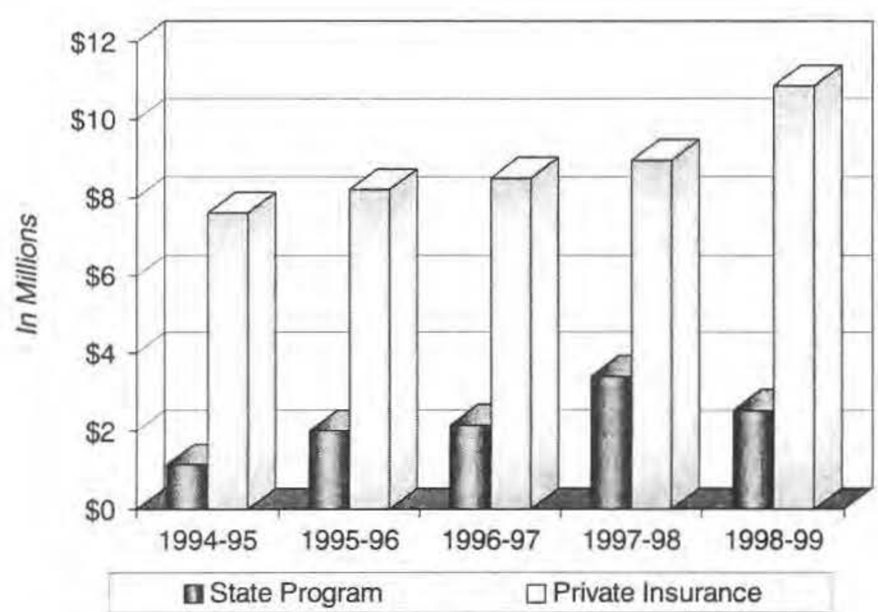
[2] Includes $8.9 million catastrophic loss (January tornadoes)

[3] Estimated based on July 1, 1998 values at .12 cents per $100 of coverage

Rates provided by Royal & SunAlliance Insurance Company

COST OF PROPERTY/CASUALTY PROGRAM VERSUS PRIVATE INSURANCE

Fiscal Years 1994-95 through 1998-99



Unclaimed Property Division

UNCLAIMED PROPERTY DIVISION

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

The Unclaimed Property Act provides that cash property which an organization or individual is holding for another person will be delivered to the Treasurer for custody if the holder of the property has had no contact with the owner for a period of five years and if the holder cannot locate the owner. Once property is delivered, the Treasurer advertises the owner's name and last known address in order to locate the owners. Since the program began operations in 1979, $162.7 million in unclaimed property has been reported to the Treasurer and $47.9 million (29%) has been returned to owners or heirs.

During the period July 1, 1998 through June 30, 1999, $16,432,805 of cash property was turned over to the Treasurer. This includes $3,960,171 in cash and stock remitted by third party audit organizations from out-of-state non-reporting holders for Tennessee residents. The pie chart on the following page illustrates the sources of cash collections for fiscal year 1998-99.

In addition to advertising the property, the Treasurer makes several other efforts to locate the rightful owner. Another location method used is to send notification to the last known address of each owner. If no response is received, additional search efforts are made through employment security records, telephone directories, drivers' license records, and other sources.

Further, a searchable database of the owners' names and addresses has been made available on our Internet site: www.treasury.state.tn.us/unclaim. This site logged more than 84,000 visitors at June 30, 1999.

The records of unclaimed property owners are also available for viewing by the public in the Unclaimed Property office. All property turned over to the Treasurer is held in trust for the rightful owner or his heirs in perpetuity, thereby allowing the owners or their heirs to make claims on it at anytime.

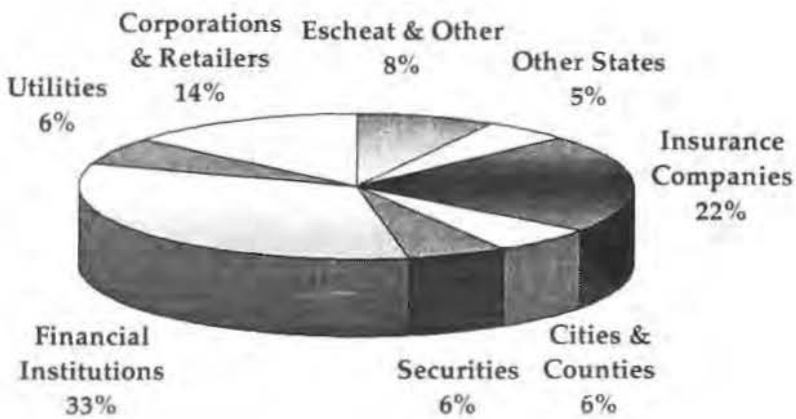
During the period July 1, 1998 through June 30, 1999, $5,838,266 of cash property was returned by the Unclaimed Property Division to the owners or their heirs. An analysis of the methods used to return this property is shown on the next page.

Any local government in Tennessee which turns over unclaimed property to the state may request that the property be returned to the local government for safekeeping after it has been held by the state for 18 months. This fiscal year, $534,709 was refunded to 13 local governments.

Tennessee has reciprocal agreements with other states' unclaimed property programs to exchange property held by one state for owners with a last known address in the other state. During this fiscal year, Tennessee received $814,327 for residents or former residents and paid $843,886 to 41 other states' unclaimed property offices.

UNCLAIMED PROPERTY DIVISION

SOURCES OF UNCLAIMED PROPERTY



METHODS USED TO RETURN PROPERTY
July 1, 1998 - June 30, 1999

Location Method	Number of Accounts	Value of Claims	Percentage of Claim Value
Post cards	3,531	$ 624,354	14%
Independent locator	240	312,177	7%
Advertisement and television	2,103	401,370	9%
Telephone directory	178	89,193	2%
Holder referral	526	222,984	5%
Web site inquiries and other	842	2,675,803	60%
Employment Security	495	89,193	2%
Legislator listing	65	44,597	1%
Total claim payments	7,980	$ 4,459,671	100%
Refunds to local governments	13	$ 534,709	
Interstate exchanges	41	843,886	
		$ 1,378,595	
Total payments	8,034	$ 5,838,266	

Chairs of Excellence Trust

CHAIRS OF EXCELLENCE TRUST

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

The funding of the program is provided through contributions made by a private donor and a matching amount by the state, thus, creating a chair. Interest and dividends on the trust are used to fund expenditures for the chair. Gaines and losses must be reinvested in the corpus of the fund for use in supporting the trust in future years.

Since the start of the program in 1984, there have been 97 chairs created, with state appropriations totaling $44,000,000 and matching contributions totaling $54,230,456. For the year ending June 30, 1999, investment income totaled $26,856,551 with expenses of $8,173,476.

THE UNIVERSITY OF TENNESSEE

Chattanooga

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

Knoxville

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

Martin

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

Memphis

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

Space Institute

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

CHAIRS OF EXCELLENCE TRUST

TENNESSEE BOARD OF REGENTS

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

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

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

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

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

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

* Chair established during fiscal year 1998-99.

Baccalaureate Education System Trust

BACCALAUREATE EDUCATION SYSTEM TRUST

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

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

Over the last 10 years, the weighted average tuition for Tennessee four-year public institutions has increased an average of 5.5% per year.

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

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

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

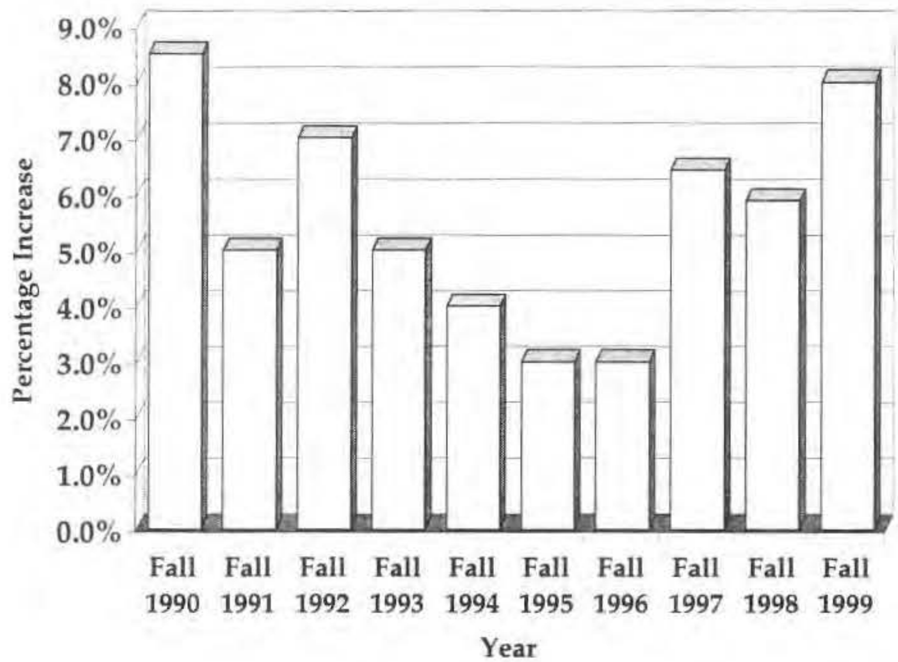
The Treasury Department uses technology to keep interested parties and participants informed about the BEST program. The Internet site, located at www.treasury.state.tn.us/best/ provides full information about BEST. The site also features the contract application which can be downloaded, completed, and mailed to the BEST office. Questions or comments to BEST staff can be e-mailed through this site. In addition, participants are provided with telephone access to account balances and activity 24 hours a day.

The Baccalaureate Education System Trust began accepting contracts and contributions in June 1997. Unit prices are calculated annually on August 1. At June 30, 1999, unit prices were $26.75 for ACH and payroll deduction while cash and check unit purchases were $28.00. The weighted average tuition value of one unit was $25.00.

During the 1998-99 fiscal year, 2,457 new contracts were opened, bringing the total under administration to 5,450. Contributions received during the year totaled $7.4 million. At year-end, the market value of the funds under management was $15.2 million.

BACCALAUREATE EDUCATION SYSTEM TRUST

AVERAGE TUITION INCREASES FOR TENNESSEE PUBLIC INSTITUTIONS
1990-1999



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.

The Careers NOW Program's first class of 12 students began in January 1996. Since the program's inception, 92 students have been selected to participate. Ninety percent of the students come from within an 80-mile radius.

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 Technology Center, University of Memphis, University of Tennessee at Martin, University of Tennessee at Knoxville, University of the South, and Vanderbilt University. The majority of the participants have been Business or Accounting majors and have come from Middle Tennessee State University, Tennessee State University and Tennessee Technology Center. Thirty-eight percent of the student participants have been minorities. Forty percent of the students come from Tennessee State University.

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. Based on participation, there has been about a 28 percent job offer rate.

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

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

Statutory Duties of the State Treasurer

BOARDS AND COMMISSIONS

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

ADMINISTRATION

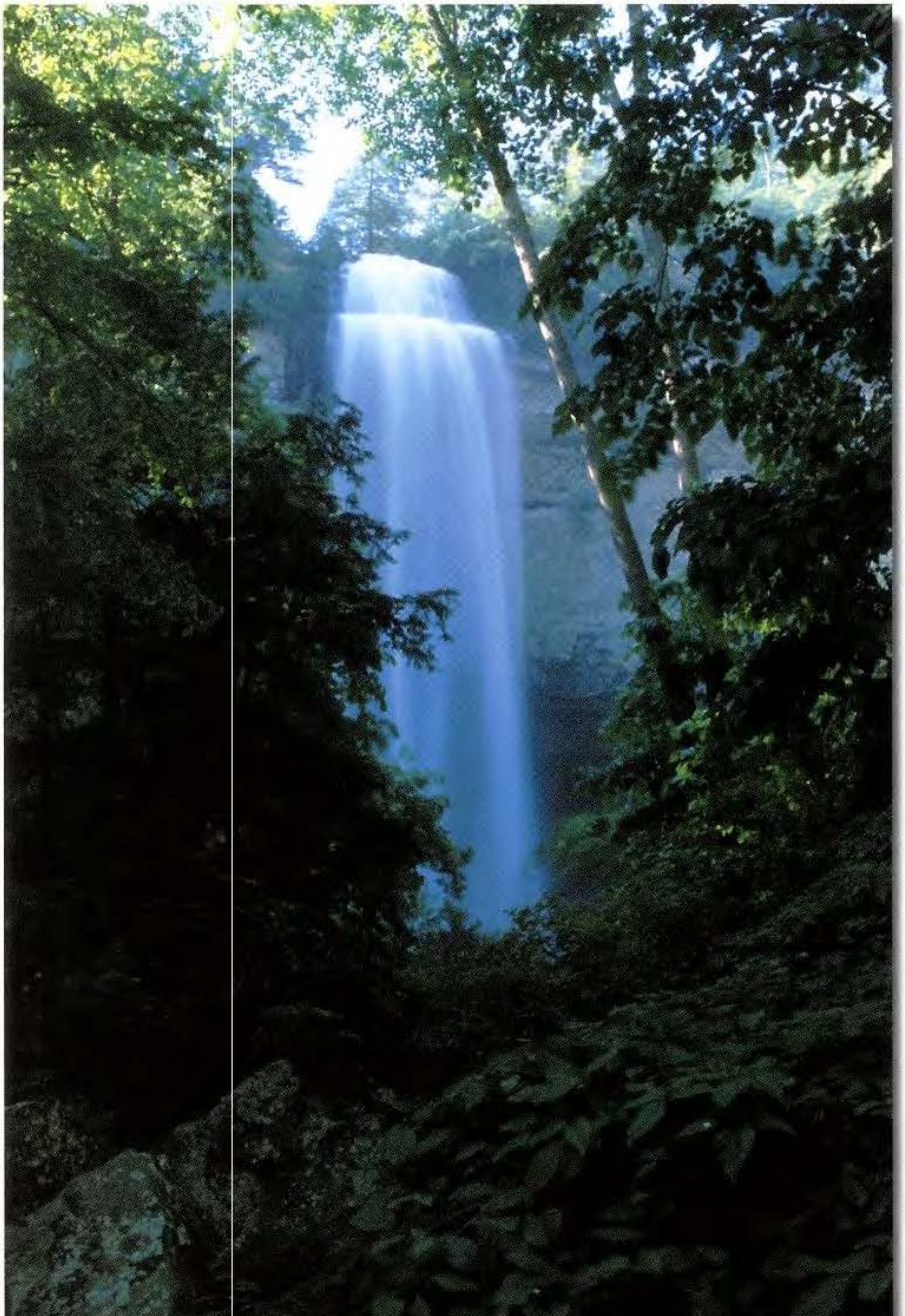
Baccalaureate Education System Trust	49-7-801, et seq.
Board of Claims	9-8-101, et seq.
Chairs of Excellence Trust	49-7-501 - 49-7-502
Collateral Pool	9-4-501 - 9-4-523
Collateral Program	9-4-101 - 9-4-105
Council on Pensions and Insurance	3-9-101
Criminal Injuries Compensation Fund	29-13-101, et seq.
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.
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	Steve Adams, CPA	(615) 741-2956
Executive Assistant	Dale Sims	(615) 741-2956
Executive Assistant	Janice Cunningham	(615) 741-2956
Assistant to the Treasurer	Steve Curry, CPA, CEBS, CCM	(615) 741-2734
Human Resource Director/Careers Now Coordinator	Ann Taylor-Tharpe	(615) 741-2956
Investments		
Chief Investment Officer	Thomas Milne, CFA	(615) 532-1157
Senior Fixed Income Portfolio Manager	Jeff Bronnenburg, CFA, CPA	(615) 532-1182
Fixed Income International Portfolio Manager	Leighton Shantz, CFA	(615) 532-1183
Senior Short-Term Portfolio Manager	Randy Graves, CPA	(615) 532-1154
Senior Equity Portfolio Manager	Jeremy Conlin, CLU, ChFC	(615) 532-1152
Senior Equity Portfolio Manager	Jim Robinson, CFA	(615) 532-1177
Director of Equity	Michael Keeler, CFA	(615) 532-1165
Senior International Portfolio Manager	Roy Wellington, CFA	(615) 532-1151
Retirement Administration		
Director of TCRS	Ed Hennessee, CFP	(615) 741-7063
Assistant Director of TCRS	Jill Bachus, CPA	(615) 741-7063
Director of Deferred Compensation, Research and Publications	Deana Reed Hannah, CRC, CRA	(615) 741-7063
Publications Editor	Janice Reilly	(615) 741-7063
General Counsel	Mary Roberts-Krause, JD	(615) 741-7063
Counsel	Vernon Bush, JD	(615) 741-7063
Director of Old Age and Survivors Insurance	Mary E. Smith	(615) 741-7902
Manager of Counseling Services	Donna Finley	(615) 741-1971
Manager of Member Services	Velva Booker	(615) 741-1971
Manager of Financial Services	Connie Gibson, CPA	(615) 741-4913
Other Divisions		
Director of Accounting	Rick DuBray, CPA	(615) 532-3840
Director of Administrative Services	Rhonda Hicks, CPA	(615) 532-8552
Director of Baccalaureate Education System Trust	Diana Collins	(615) 532-8045
Director of Computer Operations	Sam Baker, CCP, CDP	(615) 532-8026
Director of Information Systems	Newton Molloy, III, CDP	(615) 532-8035
Director of Internal Audit	Jamie Wayman, CPA	(615) 532-1164
Director of Risk Management	Steve Gregory	(615) 741-9076
Director of Unclaimed Property	Beth Chapman, CPA	(615) 741-6499
Manager of Treasury Operations	Gaylon Bandy	(615) 741-4985
East Tennessee Claims Commissioner	Michael Lacy, JD	(423) 854-5330
Middle Tennessee Claims Commissioner	William Baker, JD	(615) 792-7471
Executive Administrative Assistant, Claims Commission	Margie Douglas	(615) 741-0741
Budget Officer	Wendy Padgett	(615) 741-4985

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

Investment Portfolios



Fall Creek Falls State Park
Middle Tennessee

STATE CASH

	Rating	Maturity	Yield to Maturity	Par Value	Fair Value
U S TREASURY AND AGENCY OBLIGATIONS					
FED HOME LOAN MORTGAGE CORP DISC NOTES	Aaa	7/1/1999	4.80%	$50,000,000	$50,000,000
FED HOME LOAN MORTGAGE CORP DISC NOTES	Aaa	7/6/1999	4.74%	127,000,000	126,911,100
FED HOME LOAN MORTGAGE CORP DISC NOTES	Aaa	9/2/1999	4.86%	97,603,000	96,773,375
FED NATL MORTGAGE ASSOC DISCOUNT NOTES	Aaa	7/7/1999	4.75%	150,000,000	149,880,000
FEDERAL HOME LN BANK BONDS	Aaa	2/24/2000	5.01%	50,000,000	49,825,000
FEDERAL HOME LN BANK BONDS	Aaa	4/28/2000	5.03%	50,000,000	49,765,000
FEDERAL HOME LN BANK BONDS	Aaa	2/25/2000	5.01%	50,000,000	49,825,000
FEDERAL HOME LN BANK DISCOUNT NOTES	Aaa	7/28/1999	5.03%	150,000,000	149,460,000
UNITED STATES TREASURY NOTES	Aaa	2/29/2000	5.01%	50,000,000	50,625,000
TOTAL U.S. TREASURY AND OBLIGATIONS				$774,603,000	$773,064,475

	Maturity	Yield to Maturity	Par Value	Fair Value
CERTIFICATES OF DEPOSIT				
BANK OF ALAMO, ALAMO	11/5/1999	4.85%	$3,000,000	$3,000,000
PEOPLES BANK, BARRETVILLE	2/1/2000	5.25%	10,000,000	10,000,000
PEOPLES BANK, BARRETVILLE	12/23/1999	5.00%	10,000,000	10,000,000
BANK OF CROCKETT, BELLS	1/26/2000	5.25%	300,000	300,000
BANK OF CROCKETT, BELLS	1/7/2000	4.85%	200,000	200,000
PEOPLES BANK, BENTON	7/27/1999	4.85%	100,000	100,000
PEOPLES BANK, BENTON	11/8/1999	5.00%	200,000	200,000
FIRST SOUTH BANK, BOLIVAR	11/5/1999	4.85%	2,142,700	2,142,700
BANK OF BRADFORD	9/30/1999	5.00%	100,000	100,000
TWIN CITY FED SVGS BK, BRISTOL	2/18/2000	5.40%	500,000	500,000
PEOPLES BK & TR, BYRDSTOWN	10/26/1999	4.85%	200,000	200,000
PEOPLES BK & TR, BYRDSTOWN	10/13/1999	5.00%	100,000	100,000
PEOPLES BK & TR, BYRDSTOWN	11/15/1999	5.15%	100,000	100,000
PEOPLES BK & TR, BYRDSTOWN	10/8/1999	4.85%	200,000	200,000
PEOPLES BK & TR, BYRDSTOWN	9/17/1999	4.85%	100,000	100,000
PEOPLES BK & TR, BYRDSTOWN	10/4/1999	4.85%	100,000	100,000
CUMBERLAND BANK, CARTHAGE	10/12/1999	4.90%	90,000	90,000
CUMBERLAND BANK, CARTHAGE	2/1/2000	5.25%	500,000	500,000
CUMBERLAND BANK, CARTHAGE	1/7/2000	5.25%	1,000,000	1,000,000
FIRST STATE BANK, CHAPEL HILL	2/8/2000	5.40%	200,000	200,000
SUNTRUST, CHATTANOOGA	8/24/1999	4.75%	20,000,000	20,000,000
SUNTRUST, CHATTANOOGA	9/14/1999	4.75%	20,000,000	20,000,000
SUNTRUST, CHATTANOOGA	12/13/1999	5.25%	10,000,000	10,000,000
FIRST FED SVGS BK, CLARKSVILLE	10/22/1999	4.85%	2,000,000	2,000,000
FIRST FED SVGS BK, CLARKSVILLE	2/8/2000	5.40%	3,000,000	3,000,000
FIRST FED SVGS BK, CLARKSVILLE	2/15/2000	5.40%	100,000	100,000
HERITAGE BANK, CLARKSVILLE	9/21/1999	4.85%	1,900,000	1,900,000
FIRST BANK POLK CO, COPPERHILL	12/7/1999	5.00%	4,300,000	4,300,000
RHEA CO NAT'L BANK, DAYTON	9/17/1999	5.20%	1,200,000	1,200,000
RHEA CO NAT'L BANK, DAYTON	10/29/1999	4.85%	950,000	950,000
PEOPLES BANK, DICKSON	10/8/1999	4.85%	500,000	500,000
PEOPLES BANK, DICKSON	10/8/1999	4.85%	500,000	500,000
WEAKLEY CO BANK, DRESDEN	1/26/2000	5.25%	1,000,000	1,000,000
HOME BANK, DUCKTOWN	11/3/1999	4.75%	1,500,000	1,500,000
FIRST CITIZENS, DYERSBURG	10/1/1999	4.85%	2,000,000	2,000,000
FIRST CITIZENS, DYERSBURG	12/6/1999	5.00%	2,000,000	2,000,000
FIRST CITIZENS, DYERSBURG	10/8/1999	4.85%	2,000,000	2,000,000
FIRST CITIZENS, DYERSBURG	10/12/1999	4.85%	2,000,000	2,000,000
FIRST CITIZENS, DYERSBURG	10/12/1999	4.85%	1,000,000	1,000,000
FIRST CITIZENS, DYERSBURG	11/23/1999	4.85%	6,000,000	6,000,000

(continued)

STATE CASH

	Maturity	Yield to Maturity	Par Value	Fair Value
FIRST CITIZENS, DYERSBURG	11/24/1999	5.25%	5,425,000	5,425,000
FIRST CITIZENS, DYERSBURG	11/2/1999	5.00%	3,000,000	3,000,000
FIRST CITIZENS, DYERSBURG	9/21/1999	4.85%	3,000,000	3,000,000
SECURITY BANK, DYERSBURG	10/5/1999	4.85%	300,000	300,000
SECURITY BANK, DYERSBURG	10/12/1999	4.85%	300,000	300,000
SECURITY BANK, DYERSBURG	1/28/2000	5.25%	1,000,000	1,000,000
SECURITY BANK, DYERSBURG	1/21/2000	5.25%	250,000	250,000
BANK OF FRIENDSHIP	1/31/2000	5.25%	90,000	90,000
BANK OF FRIENDSHIP	9/29/1999	5.10%	525,000	525,000
CITIZENS BANK, GAINESBORO	9/27/1999	4.85%	300,000	300,000
JACKSON BANK & TRUST, GAINESBORO	2/18/2000	4.85%	2,500,000	2,500,000
JACKSON BANK & TRUST, GAINESBORO	9/17/1999	4.75%	1,000,000	1,000,000
JACKSON BANK & TRUST, GAINESBORO	2/1/2000	5.25%	500,000	500,000
JACKSON BANK & TRUST, GAINESBORO	9/24/1999	5.10%	500,000	500,000
JACKSON BANK & TRUST, GAINESBORO	1/31/2000	5.25%	500,000	500,000
JACKSON BANK & TRUST, GAINESBORO	10/29/1999	5.00%	1,000,000	1,000,000
JACKSON BANK & TRUST, GAINESBORO	2/25/2000	5.55%	250,000	250,000
GATES BANKING & TRUST	10/27/1999	4.60%	450,000	450,000
GATES BANKING & TRUST	11/2/1999	5.00%	350,000	350,000
TENNESSEE ST BANK, GATLINBURG	12/1/1999	5.25%	5,000,000	5,000,000
TENNESSEE ST BANK, GATLINBURG	10/29/1999	4.85%	4,000,000	4,000,000
TRUST ONE BANK, GERMANTOWN	12/7/1999	5.25%	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	2/16/2000	5.40%	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	9/21/1999	4.60%	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	10/7/1999	4.85%	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	9/21/1999	5.25%	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	12/2/1999	5.00%	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	1/27/2000	5.25%	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	9/21/1999	5.25%	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	12/2/1999	5.00%	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	1/27/2000	5.25%	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	10/7/1999	4.85%	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	12/7/1999	4.75%	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	2/16/2000	4.75%	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	9/21/1999	4.75%	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	11/10/1999	5.00%	3,000,000	3,000,000
BANK OF GLEASON	2/11/2000	5.40%	350,000	350,000
BANK OF GLEASON	12/20/1999	5.25%	300,000	300,000
BANK OF GLEASON	10/12/1999	4.85%	200,000	200,000
BANK OF HALLS	2/8/2000	5.40%	300,000	300,000
BANK OF HALLS	1/31/2000	5.25%	200,000	200,000
BANK OF HALLS	10/20/1999	5.00%	200,000	200,000
BANK OF HALLS	10/1/1999	4.85%	700,000	700,000
BANK OF HALLS	2/14/2000	5.40%	400,000	400,000
CITIZENS BANK, HARTSVILLE	12/24/1999	5.00%	2,000,000	2,000,000
CHESTER CO BANK, HENDERSON	10/12/1999	4.85%	100,000	100,000
VOLUNTEER BANK, JACKSON	11/22/1999	5.15%	2,500,000	2,500,000
FENTRESS CO BANK, JAMESTOWN	1/3/2000	5.25%	500,000	500,000
FENTRESS CO BANK, JAMESTOWN	10/15/1999	5.00%	200,000	200,000
FENTRESS CO BANK, JAMESTOWN	3/7/2000	5.55%	500,000	500,000
FENTRESS CO BANK, JAMESTOWN	10/13/1999	4.77%	450,000	450,000
FENTRESS CO BANK, JAMESTOWN	10/27/1999	4.60%	300,000	300,000
FENTRESS CO BANK, JAMESTOWN	11/16/1999	5.15%	500,000	500,000
PROGRESSIVE SAVINGS BANK, JAMESTOWN	2/25/2000	5.55%	300,000	300,000
CITIZENS BANK, JASPER	10/4/1999	4.85%	100,000	100,000

(continued)

STATE CASH

	Maturity	Yield to Maturity	Par Value	Fair Value
CITIZENS BANK, JASPER	10/5/1999	4.85%	200,000	200,000
CITIZENS BANK, JASPER	10/15/1999	4.85%	200,000	200,000
FIRST STATE BANK, KENTON	1/14/2000	5.25%	5,000,000	5,000,000
FIRST STATE BANK, KENTON	2/18/2000	5.40%	8,000,000	8,000,000
FIRST UNION BANK, KINGSPORT	1/7/2000	5.25%	1,050,000	1,050,000
NATL BANK OF COMMERCE, KNOXVILLE	10/1/1999	5.00%	2,000,000	2,000,000
NATL BANK OF COMMERCE, KNOXVILLE	10/14/1999	4.90%	10,000,000	10,000,000
SUNTRUST BANK, KNOXVILLE	9/17/1999	4.75%	40,000,000	40,000,000
SUNTRUST BANK, KNOXVILLE	11/12/1999	4.85%	15,000,000	15,000,000
SUNTRUST BANK, KNOXVILLE	12/8/1999	5.25%	15,000,000	15,000,000
SUNTRUST BANK, KNOXVILLE	12/3/1999	4.85%	50,000,000	50,000,000
SUNTRUST BANK, KNOXVILLE	12/8/1999	5.25%	25,000,000	25,000,000
SUNTRUST BANK, KNOXVILLE	12/8/1999	5.25%	10,000,000	10,000,000
CITIZENS BANK, LAFAYETTE	1/28/2000	5.25%	500,000	500,000
CITIZENS BANK, LAFAYETTE	3/3/2000	5.55%	100,000	100,000
CITIZENS BANK, LAFAYETTE	9/28/1999	5.10%	250,000	250,000
CITIZENS BANK, LAFAYETTE	11/3/1999	4.60%	100,000	100,000
FIRST CENTRAL BANK, LENOIR CITY	11/17/1999	5.15%	500,000	500,000
FIRST CENTRAL BANK, LENOIR CITY	10/8/1999	4.90%	500,000	500,000
FIRST NATL BANK, LENOIR CITY	9/21/1999	4.85%	200,000	200,000
FIRST NATL BANK, LENOIR CITY	1/25/2000	5.25%	300,000	300,000
FIRST NATL BANK, LENOIR CITY	12/7/1999	5.00%	100,000	100,000
COFFEE CO BANK, MANCHESTER	12/10/1999	5.00%	280,000	280,000
COFFEE CO BANK, MANCHESTER	2/1/2000	5.50%	350,000	350,000
CITY STATE BANK, MARTIN	10/19/1999	4.85%	500,000	500,000
CITY STATE BANK, MARTIN	1/18/2000	5.25%	2,000,000	2,000,000
CITY STATE BANK, MARTIN	10/29/1999	4.60%	1,500,000	1,500,000
PLANTERS BANK, MAURY CITY	10/12/1999	5.00%	200,000	200,000
BOATMAN'S BANK, MEMPHIS	10/4/1999	4.85%	10,000,000	10,000,000
BOATMAN'S BANK, MEMPHIS	2/4/2000	5.25%	10,000,000	10,000,000
BOATMAN'S BANK, MEMPHIS	10/4/1999	4.85%	5,000,000	5,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	9/21/1999	4.85%	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	9/21/1999	4.85%	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	10/22/1999	4.85%	1,000,000	1,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	9/24/1999	4.85%	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	12/28/1999	5.25%	1,000,000	1,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	9/30/1999	5.00%	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	2/22/2000	5.55%	500,000	500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	10/22/1999	4.60%	500,000	500,000
INDEPENDENT BANK, MEMPHIS	9/22/1999	4.85%	2,000,000	2,000,000
INDEPENDENT BANK, MEMPHIS	9/22/1999	4.75%	1,000,000	1,000,000
INDEPENDENT BANK, MEMPHIS	11/26/1999	4.85%	2,000,000	2,000,000
NATL BANK OF COMMERCE, MEMPHIS	1/10/2000	5.25%	20,000,000	20,000,000
NATL BANK OF COMMERCE, MEMPHIS	9/17/1999	5.20%	30,000,000	30,000,000
NATL BANK OF COMMERCE, MEMPHIS	10/25/1999	4.85%	25,000,000	25,000,000
NATL BANK OF COMMERCE, MEMPHIS	7/27/1999	4.75%	25,000,000	25,000,000
NATL BANK OF COMMERCE, MEMPHIS	11/24/1999	5.25%	30,000,000	30,000,000
NATL BANK OF COMMERCE, MEMPHIS	7/30/1999	5.10%	25,000,000	25,000,000
NATL BANK OF COMMERCE, MEMPHIS	11/10/1999	5.15%	25,000,000	25,000,000
NATL BANK OF COMMERCE, MEMPHIS	9/27/1999	4.85%	30,000,000	30,000,000
NATL BANK OF COMMERCE, MEMPHIS	7/28/1999	4.75%	50,000,000	50,000,000
NATL BANK OF COMMERCE, MEMPHIS	10/29/1999	5.00%	50,000,000	50,000,000
NATL BANK OF COMMERCE, MEMPHIS	10/14/1999	4.90%	50,000,000	50,000,000
NATL BANK OF COMMERCE, MEMPHIS	9/17/1999	5.20%	50,000,000	50,000,000
NATL BANK OF COMMERCE, MEMPHIS	9/21/1999	5.20%	50,000,000	50,000,000

(continued)

State Cash

	Maturity	Yield to Maturity	Par Value	Fair Value
NATL BANK OF COMMERCE, MEMPHIS	9/22/1999	5.20%	50,000,000	50,000,000
NATL BANK OF COMMERCE, MEMPHIS	11/26/1999	5.25%	50,000,000	50,000,000
SOUTHTRUST BANK, MEMPHIS	2/18/2000	5.40%	25,000,000	25,000,000
SOUTHTRUST BANK, MEMPHIS	12/15/1999	5.00%	25,000,000	25,000,000
SOUTHTRUST BANK, MEMPHIS	12/7/1999	5.00%	1,000,000	1,000,000
SOUTHTRUST BANK, MEMPHIS	10/15/1999	4.85%	1,000,000	1,000,000
SOUTHTRUST BANK, MEMPHIS	1/26/2000	5.25%	2,000,000	2,000,000
BANK OF MURFREESBORO	9/24/1999	4.75%	1,000,000	1,000,000
CAPITAL BANK AND TRUST, NASHVILLE	3/3/2000	5.55%	1,000,000	1,000,000
CAPITAL BANK AND TRUST, NASHVILLE	9/17/1999	4.85%	2,000,000	2,000,000
FIRST AMERICAN NATL BK, NASHVILLE	10/29/1999	4.60%	50,000,000	50,000,000
FIRST AMERICAN NATL BK, NASHVILLE	2/4/2000	5.25%	100,000,000	100,000,000
FIRST AMERICAN NATL BK, NASHVILLE	12/24/1999	5.00%	50,000,000	50,000,000
FIRST AMERICAN NATL BK, NASHVILLE	2/29/2000	5.55%	50,000,000	50,000,000
FIRST AMERICAN NATL BK, NASHVILLE	11/1/1999	4.85%	50,000,000	50,000,000
FIRST AMERICAN NATL BK, NASHVILLE	9/24/1999	4.85%	50,000,000	50,000,000
FIRST AMERICAN NATL BK, NASHVILLE	1/26/2000	5.25%	50,000,000	50,000,000
FIRST AMERICAN NATL BK, NASHVILLE	10/4/1999	4.85%	50,000,000	50,000,000
NAT'L BANK OF COMMERCE, NASHVILLE	10/25/1999	4.85%	50,000,000	50,000,000
SOUTHTRUST BANK, NASHVILLE	2/9/2000	5.55%	50,000,000	50,000,000
SOUTHTRUST BANK, NASHVILLE	3/7/2000	5.55%	40,000,000	40,000,000
SOUTHTRUST BANK, NASHVILLE	10/15/1999	5.00%	4,000,000	4,000,000
SOUTHTRUST BANK, NASHVILLE	2/9/2000	5.55%	10,000,000	10,000,000
SOUTHTRUST BANK, NASHVILLE	3/7/2000	5.55%	6,000,000	6,000,000
SOUTHTRUST BANK, NASHVILLE	11/1/1999	5.00%	3,500,000	3,500,000
SOUTHTRUST BANK, NASHVILLE	9/29/1999	5.00%	3,000,000	3,000,000
SOUTHTRUST BANK, NASHVILLE	9/29/1999	5.00%	2,800,000	2,800,000
SOUTHTRUST BANK, NASHVILLE	10/29/1999	5.00%	4,000,000	4,000,000
SOUTHTRUST BANK, NASHVILLE	2/4/2000	5.25%	30,000,000	30,000,000
NEWPORT FEDERAL S&L, NEWPORT	12/17/1999	5.00%	95,000	95,000
NEWPORT FEDERAL S&L, NEWPORT	9/28/1999	5.10%	500,000	500,000
NEWPORT FEDERAL S&L, NEWPORT	12/17/1999	5.00%	300,000	300,000
EFS FED SAVINGS BK, OAKLAND	2/4/2000	5.25%	2,500,000	2,500,000
EFS FED SAVINGS BK, OAKLAND	1/26/2000	5.25%	2,500,000	2,500,000
EFS FED SAVINGS BK, OAKLAND	10/15/1999	4.85%	2,500,000	2,500,000
EFS FED SAVINGS BK, OAKLAND	11/5/1999	4.85%	1,500,000	1,500,000
EFS FED SAVINGS BK, OAKLAND	10/22/1999	4.60%	1,500,000	1,500,000
FIRST NATL BANK, ONEIDA	2/22/2000	5.55%	500,000	500,000
FIRST NATL BANK, ONEIDA	9/29/1999	5.00%	500,000	500,000
FIRST NATIONAL BANK, PIKEVILLE	2/29/2000	5.55%	300,000	300,000
COMMUNITY BANK, PULASKI	12/31/1999	5.25%	790,000	790,000
COMMUNITY BANK, PULASKI	10/15/1999	4.90%	750,000	750,000
FIRST NATIONAL BANK, PULASKI	2/15/2000	5.40%	1,000,000	1,000,000
FIRST NATIONAL BANK, PULASKI	1/31/2000	5.25%	300,000	300,000
FIRST NATIONAL BANK, PULASKI	2/4/2000	5.25%	300,000	300,000
FIRST NATIONAL BANK, PULASKI	2/8/2000	5.40%	300,000	300,000
FIRST NATIONAL BANK, PULASKI	2/4/2000	5.25%	500,000	500,000
FIRST NATIONAL BANK, PULASKI	2/15/2000	5.40%	1,000,000	1,000,000
FIRST NATIONAL BANK, PULASKI	1/31/2000	5.25%	700,000	700,000
FIRST NATIONAL BANK, PULASKI	2/8/2000	5.40%	1,000,000	1,000,000
BANK OF RIPLEY	11/8/1999	5.00%	100,000	100,000
BANK OF RIPLEY	10/4/1999	5.00%	100,000	100,000
BANK OF RIPLEY	11/9/1999	5.00%	150,000	150,000
BANK OF RIPLEY	9/21/1999	4.85%	200,000	200,000
BANK OF RIPLEY	10/13/1999	5.00%	100,000	100,000

(continued)

STATE CASH

	Maturity	Yield to Maturity	Par Value	Fair Value
FIRST UNION BANK, ROGERSVILLE	2/1/2000	5.25%	1,650,000	1,650,000
FIRST UNION BANK, ROGERSVILLE	2/1/2000	5.25%	1,600,000	1,600,000
BANK OF SHARON	10/15/1999	4.85%	1,500,000	1,500,000
BANK OF SHARON	12/7/1999	5.00%	1,000,000	1,000,000
BANK OF SHARON	10/22/1999	4.60%	1,000,000	1,000,000
BANK OF SHARON	2/22/2000	5.55%	1,000,000	1,000,000
BANK OF SHARON	2/14/2000	5.40%	1,000,000	1,000,000
SOMERVILLE BANK AND TRUST	2/15/2000	5.40%	200,000	200,000
MERCHANTS & PLANTERS BK, TOONE	2/22/2000	5.55%	100,000	100,000
MERCHANTS & PLANTERS BK, TOONE	9/24/1999	5.10%	100,000	100,000
MERCHANTS & PLANTERS BK, TOONE	2/4/2000	5.25%	200,000	200,000
MERCHANTS & PLANTERS BK, TOONE	2/8/2000	5.40%	200,000	200,000
FIRST STATE BANK, UNION CITY	10/18/1999	4.60%	5,000,000	5,000,000
WAYNE COUNTY BANK, WAYNESBORO	10/29/1999	5.00%	900,000	900,000
TOTAL CERTIFICATES OF DEPOSIT			**$1,705,987,700**	**$1,705,987,700**

	Maturity	Yield to Maturity	Par Value	Fair Value
REPURCHASE AGREEMENTS				
LEHMAN - OVERNIGHT	7/1/1999	4.75%	$48,835,000	$48,835,000
LEHMAN - OVERNIGHT	7/1/1999	4.75%	48,835,000	48,835,000
LEHMAN - OVERNIGHT	7/1/1999	4.75%	48,835,000	48,835,000
LEHMAN - OVERNIGHT	7/1/1999	4.75%	48,835,000	48,835,000
LEHMAN - OVERNIGHT	7/1/1999	4.75%	3,660,000	3,660,000
SUNTRUST - TERM REPO	7/1/1999	4.75%	15,000,000	15,000,000
TOTAL REPURCHASE AGREEMENTS			**$214,000,000**	**$214,000,000**

	Maturity	Yield to Maturity	Par Value	Fair Value
COMMERCIAL PAPER				
APRECO	8/4/1999	5.23%	$50,000,000	$49,919,167
APRECO INC.	7/13/1999	4.89%	50,000,000	49,754,444
ASSOCIATES CAPITAL	8/17/1999	5.62%	25,000,000	24,836,153
BTR DUNLOP	9/15/1999	5.11%	100,000,000	98,933,889
CORP ASSET FUNDING COMPANY	8/9/1999	4.91%	50,000,000	49,737,292
CORPORATE RECEIVABLES CORP.	8/2/1999	4.91%	50,000,000	49,784,000
CORPORATE RECEIVABLES CORP.	8/9/1999	4.96%	75,000,000	74,600,250
CORPORATE RECEIVABLES CORP.	8/10/1999	4.91%	50,000,000	49,730,000
DELAWARE FUNDING	7/15/1999	5.05%	50,000,000	49,902,194
FALCON ASSET SECURITIZATION CORP.	8/17/1999	4.93%	30,000,000	29,809,258
GENERAL MOTORS ACCEPTANCE CORP.	8/4/1999	4.91%	50,000,000	49,770,500
HOUSEHOLD FINANCE CORP.	8/3/1999	4.89%	50,000,000	49,778,167
HOUSEHOLD FINANCE CORP.	8/9/1999	5.04%	50,000,000	49,729,167
MERRILL LYNCH & CO., INC.	7/9/1999	4.85%	40,000,000	39,957,244
NATIONAL RURAL ELECTRIC CORP.	10/4/1999	5.16%	50,250,000	49,463,139
NATIONAL RURAL UTILITY	9/16/1999	5.09%	50,000,000	49,576,371
RECEIVABLES CAPITAL CORP.	8/4/1999	5.07%	48,406,000	48,176,045
SHEFFIELD RECEIVABLES	7/20/1999	5.07%	63,754,000	63,584,078
US WEST COMMUNICATIONS	7/19/1999	5.12%	45,000,000	44,885,249
TOTAL COMMERCIAL PAPER			**$977,410,000**	**$971,926,607**
TOTAL PORTFOLIO			**$3,672,000,700**	**$3,664,978,782**

BACCALAUREATE EDUCATION SYSTEM TRUST

	Moody's Rating	Maturity	Yield to Maturity	Par Value	Fair Value
U.S. TREASURY AND AGENCY OBLIGATIONS					
FEDERAL HOME LN MTG CORP	NR	1/27/2005	5.31%	$ 450,000	$ 486,562
FEDERAL HOME LN MTG CORP	Aaa	4/29/2009	6.77%	200,000	192,938
FEDERAL NATL MTG ASSN	Aaa	11/12/2002	6.06%	1,100,000	1,134,199
FEDERAL NATL MTG ASSN MTN	Aaa	6/19/2003	6.03%	650,000	639,333
FEDERAL NATL MTG ASSN MTN	Aaa	3/4/2009	6.66%	350,000	334,306
STUDENT LN MARKETING ASSN	Aaa	9/14/2000	5.95%	600,000	603,000
UNITED STATES TREASURY BONDS	Aaa	11/15/2004	5.44%	275,000	347,058
UNITED STATES TREASURY BONDS	Aaa	11/15/2009	7.56%	250,000	298,828
UNITED STATES TREASURY BONDS	Aaa	11/15/2012	6.08%	200,000	255,124
UNITED STATES TREASURY NOTES	Aaa	10/31/2001	5.98%	475,000	481,826
UNITED STATES TREASURY NOTES	Aaa	6/30/2002	5.83%	150,000	152,508
UNITED STATES TREASURY NOTES	Aaa	7/31/2002	5.14%	1,750,000	1,768,043
UNITED STATES TREASURY NOTES	Aaa	3/31/2003	5.24%	725,000	720,244
UNITED STATES TREASURY NOTES	Aaa	11/15/2004	5.45%	400,000	437,564
TOTAL U.S. TREASURY AND AGENCY OBLIGATIONS					$ 7,851,533

	Moody's Rating	Maturity	Yield to Maturity	Par Value	Fair Value
CORPORATE BONDS					
CALIFORNIA INFRASTRUCTURE	Aaa	6/25/2004	6.10%	$ 200,000	$ 199,760
DUKE CAP CORPORATION	A3	7/15/2005	6.34%	200,000	193,248
FORD MTR CO DEL	A1	10/1/2008	6.09%	500,000	508,025
GENERAL ELEC CAP CORPORATION	Aaa	2/15/2003	5.93%	350,000	378,277
GENERAL MTRS ACCEPTANCE CORP.	A2	6/17/2004	6.84%	200,000	201,594
MERRILL LYNCH AND COMPANY, INC.	Aa3	3/15/2006	5.97%	100,000	101,395
MORGAN STANLEY GROUP INC.	Aa4	1/20/2004	5.94%	500,000	481,920
TELE COMMUNICATIONS INC.	Aa5	8/1/2005	5.83%	300,000	307,488
WAL MART STORES INC PASS THRU	Aa2	7/1/2004	7.22%	87,355	92,494
TOTAL CORPORATE BONDS					**$ 2,464,201**

	Units	Fair Value
MUTUAL FUND		
S & P 500	68,104	$ 4,058,016
TOTAL MUTUAL FUND		**$ 4,058,016**
TOTAL PORTFOLIO		**$14,373,750**

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
LARGEST STOCK HOLDINGS BY FAIR VALUE

Shares	Security Name	Fair Value
3,406,000	MICROSOFT CORPORATION	$307,178,625
2,392,000	GENERAL ELECTRIC COMPANY	270,296,000
1,344,000	INTERNATIONAL BUSINESS MACHINES	173,712,000
3,284,000	WALMART STORES INCORPORATED	158,453,000
2,281,500	CISCO SYSTEMS INCORPORATED	147,014,156
1,597,339	MCI WOLRDCOM INCORPORATED	137,470,988
2,018,250	LUCENT TECHNOLOGIES INC.	136,105,734
2,192,000	INTEL CORPORATION	130,424,000
1,666,000	MERCK & COMPANY, INC.	122,659,250
1,529,000	EXXON CORPORATION	117,924,125

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
LARGEST BOND HOLDINGS BY FAIR VALUE

Par Value	Security Name	Yield	Maturity	Moody's Quality Rating	Fair Value
250,000,000	UNITED STATES TREASURY BONDS	6.12%	8/15/2013	Aaa	$351,445,000
184,960,000	UNITED STATES TREASURY BONDS	6.28%	2/15/2019	Aaa	238,829,600
195,000,000	UNITED STATES TREASURY BONDS	6.28%	8/15/2019	Aaa	235,950,000
170,300,000	UNITED STATES TREASURY BONDS	6.27%	5/15/2017	Aaa	215,243,873
177,575,000	UNITED STATES TREASURY NOTES	5.81%	11/15/2004	Aaa	194,251,068
200,000,000	GNMA II POOL 002767	7.14%	6/20/2029	Aaa	192,062,000
200,000,000	FEDERAL NATIONAL MORTGAGE ASSN.	6.17%	2/13/2004	Aaa	191,906,000
199,698,660	GNMA II POOL 002754	7.14%	5/20/2029	Aaa	191,772,620
198,566,434	FEDERAL HOME LOAN PC C00716	6.96%	2/1/2029	Aaa	187,271,975
196,587,019	FEDERAL HOME LOAN PC C00680	6.97%	11/1/2028	Aaa	185,405,149

A complete portfolio listing is available upon request.

Chairs of Excellence
Largest Stock Holdings by Fair Value

Shares	Security Name	Fair Value
54,000	MICROSOFT CORPORATION	$ 4,870,125
37,600	GENERAL ELECTRIC COMPANY	4,248,800
48,000	INTEL CORPORATION	2,856,000
22,000	INTERNATIONAL BUSINESS MACHINES	2,843,500
39,500	CISCO SYSTEMS INCORPORATED	2,545,281
49,500	GAP INCORPORATED	2,493,563
50,000	WALMART STORES INCORPORATED	2,412,500
30,000	EXXON CORPORATION	2,313,750
29,000	MERCK & COMPANY, INCORPORATED	2,135,125
42,000	CITIGROUP INCORPORATED	1,995,000

Chairs of Excellence
Largest Bond Holdings by Fair Value

Par Value	Security Name	Yield	Yield to Maturity	Moody's Quality Rating	Fair Value
17,000,000	UNITED STATES TREASURY NOTES	5.92%	8/15/2007	Aaa	$ 17,220,490
10,000,000	TENNESSEE VALLEY AUTHORITY	8.04%	7/15/2024	Aaa	10,008,900
7,000,000	UNITED STATES TREASURY NOTES	5.85%	8/15/2005	Aaa	7,231,840
7,150,000	CALIFORNIA INFRA & ECONOMIC	6.55%	9/25/2005	Aaa	7,100,808
5,000,000	FORD CAPITAL BV	6.30%	11/15/2000	A1	5,247,500
5,000,000	MERRILL LYNCH & COMPANY, INC.	6.75%	5/15/2006	Aa3	5,170,000
5,000,000	AESOP FDGII, LLC	6.57%	10/20/2003	Aaa	4,989,000
5,000,000	INTERNATIONAL LEASE FIN. CORP. MTN.	6.49%	8/1/2001	A1	4,979,200
5,000,000	UNITED STATES TREASURY NOTES	5.69%	3/31/2003	Aaa	4,967,200
4,805,349	SMALL BUSINESS ADMIN. PARTNERSHIP CTF	6.94%	9/10/2001	NR	4,937,496

A complete portfolio listing is available upon request.

KEY TO RATINGS

All ratings presented are from Moody's Investors Service. 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

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

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

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

Financial Statements

State Pooled Investment Fund

Tennessee Consolidated Retirement System

Deferred Compensation

Flexible Benefits Plan

Claims Award Fund

Criminal Injuries Fund

Baccalaureate Education System Trust

Chairs of Excellence

Bond Refunding

Paris Landing State Park
West Tennessee

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) 741-3697

December 10, 1999

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 State Pooled Investment Fund as of June 30, 1999, and June 30, 1998, and the related statements of changes in 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 generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our report dated December 29, 1998, we qualified our opinion on the 1998 financial statements because insufficient audit evidence existed to support the State Pooled Investment Fund's disclosures required by the Governmental Accounting Standards Board (GASB) Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*. The State Pooled Investment Fund's year 2000 disclosures are now reported as required supplementary information as permitted by GASB Technical Bulletin 99-1, *Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1*. Accordingly, our present opinion on the 1998 financial statements, as expressed herein, is different from our prior report on the 1998 financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the State Pooled Investment Fund as of June 30, 1999, and June 30, 1998, and the results of its operations for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 1999, on our consideration of the State Pooled Investment Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr.

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

State Pooled Investment Fund
Comparative Statements of Net Assets
June 30, 1999 and June 30, 1998

	June 30, 1999	June 30, 1998
ASSETS		
Cash and cash equivalents	$ 1,996,757,469	$ 2,348,874,134
Short-term investments, at amortized cost	1,716,248,368	1,001,246,478
Accrued income receivable	31,262,138	20,257,957
TOTAL ASSETS	$ 3,744,267,975	$ 3,370,378,569
LIABILITIES AND NET ASSETS		
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS	$ 3,744,267,975	$ 3,370,378,569

See accompanying Notes to the Financial Statements

State Pooled Investment Fund
Comparative Statements of Changes in Net Assets
For the Years Ended June 30, 1999 and June 30, 1998

	For the Year Ended June 30, 1999	For the Year Ended June 30, 1998
OPERATIONS		
Investment income	$ 172,917,203	$ 155,913,698
Expenses		
Administrative fee	1,525,729	1,636,816
Custodian and banking services fees	37,741	58,656
Total expenses	1,563,470	1,695,472
NET INVESTMENT INCOME	171,353,733	154,218,226
CAPITAL SHARE TRANSACTIONS (DOLLAR AMOUNTS AND NUMBER OF SHARES ARE THE SAME)		
Shares sold	22,090,043,617	20,641,304,102
Less shares redeemed	21,887,507,944	20,170,760,242
INCREASE FROM CAPITAL SHARE TRANSACTIONS	202,535,673	470,543,860
TOTAL INCREASE IN NET ASSETS	373,889,406	624,762,086
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS		
BEGINNING OF YEAR	3,370,378,569	2,745,616,483
END OF YEAR	$ 3,744,267,975	$ 3,370,378,569

See accompanying Notes to the Financial Statements

State Pooled Investment Fund
Notes to the Financial Statements
June 30, 1999 and June 30, 1998

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). The SPIF follows all applicable GASB pronouncements, as well as applicable private sector pronouncements issued on or before November 30, 1989. The financial statements have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

3. Cash 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 years ended June 30, 1999 and June 30, 1998, the State had not obtained or provided any legally binding guarantees to support the value of participant shares.

B. DEPOSITS AND INVESTMENTS

1. Investment Policy

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 in certain obligations of the State of Tennessee pursuant to *Tennessee Code Annotated, Section 9-4-602(b)*. Investment in derivative type securities and investments of high risk is prohibited.

This resolution further states that the dollar weighted average maturity of the State Pooled Investment Fund shall not exceed 90 days and that no investment may be purchased with a remaining maturity of greater than 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 90 days or less to maturity.

The State Pooled Investment Fund is also authorized by policy to contractually loan securities to investment brokers. The contract for a security loan provides that the fund loan specific securities from its holdings to the broker in return for collateral securities. Statute requires that the loaned securities be collateralized at 102% of their market value. There were no securities on loan from the State Pooled Investment Fund during the years ended June 30, 1999 and June 30, 1998.

Statutes require that state deposits be secured by collateral securities with a market value of 105% of the face of the deposit secured thereby after considering the applicable FDIC coverage, or the depository must be a member of the State Collateral Pool and the pool must have securities pledged which in total equal the required percentage established by the Collateral Pool Board.

Certificates of deposit are not placed or renewed with a financial institution until adequate collateral is pledged. Open accounts maintained for deposit of state revenues are collateralized on an estimate of the average daily balance in the account based on previous balances and monitored for variation to actual balances. The Treasurer

(continued)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1999 AND JUNE 30, 1998

is required, by statute, to evaluate the market value of required collateral monthly, and more frequently if market conditions require. Statutes 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 repurchases are done with primary dealers in government securities which have executed a master repurchase agreement with the State which provides for securities underlying repurchase agreements to have a market value of not less than 100 percent (100%) nor more than 102 percent (102%) of the cost of the repurchase agreement plus accrued interest. Prime commercial paper may be acquired from authorized broker dealers or directly from the issuer. There is no collateral requirement for prime commercial paper.

2. **Deposits**

Deposits with financial institutions are required to be categorized to indicate the level of custodial credit risk assumed by the State. Category 1 consists of deposits that are insured or collateralized with securities held by the State or by its agent in the State's name. Category 2 consists of deposits collateralized with securities held by the pledging financial institution's trust department or agent in the State's name. Category 3 deposits are uncollateralized. This includes any bank balance that is collateralized with securities held by the pledging financial institution, or by its trust department or agent but not in the State's name.

As of June 30, 1999 and June 30, 1998, the carrying amounts of the State Pooled Investment Fund deposits were $1,754,023,326 and $1,453,344,189 respectively. The bank balance, including accrued interest, was $1,783,453,845 as of June 30, 1999 and $1,471,715,287 as of June 30, 1998. Of the bank balance, $1,783,274,895 at June 30, 1999 and $ 1,471,663,653 at June 30, 1998 was considered category 1, covered by insurance or collateral (at fair value) held in the state's name by independent custodial banks or in the state's account at the Federal Reserve Bank. At June 30, 1999, $178,950 (at fair value) and at June 30,1998, $51,634 (at fair value) was considered category 3, uninsured and uncollateralized. There were no material amounts uncollateralized during the years ended June 30, 1999 and June 30, 1998.

At June 30, 1999 and June 30, 1998, the principal amount of certificates of deposit in state depositories was $1,705,987,700 and $1,425,275,000 respectively. Interest rates on certificates of deposit held at June 30, 1999 ranged from 4.60% to 5.55% and at June 30, 1998 ranged from 5.40% to 6.00%. The days to maturity ranged from 27 to 365 days at June 30, 1999 and 3 to 360 days at June 30,1998

3. **Investments**

Investments are also required to be categorized to indicate the level of custodial credit risk assumed by the State. Category 1 includes investments that are insured or registered, or for which securities are held by the State or its agent in the name of the State. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the name of the State. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer or by the counterparty's trust department or agent but not in the name of the State.

	June 30, 1999				
	Carrying Amount	**Fair Value**	**Par Value**	**Interest Rate Range**	**Days to Maturity**
Cash equivalents and short-term investments					
Repurchase agreements	$ 214,000,000	$ 214,000,000	$ 214,000,000	4.75% to 4.75%	1 to 30 days
U.S. government and agency obligations	773,682,306	773,064,475	774,603,000	4.74% to 7.13%	28 to 369 days
Commercial paper	971,926,607	971,926,607	977,410,000	4.85% to 5.62%	26 to 104 days
Total cash equivalents and short-term investments	1,959,608,913	$1,958,991,082	$1,966,013,000		
Less: short-term investments classified as cash equivalents on Statement of Net Assets	(1,513,123,245)				
Add: certificates of deposit classified as short-term investments on Statement of Net Assets	1,269,762,700				
Short-term investments as shown on Statement of Net Assets	$ 1,716,248,368				

(continued)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1999 AND JUNE 30, 1998

	June 30, 1998				
	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity
Cash equivalents and short-term investments					
Repurchase agreements	$ 27,500,000	$ 27,500,000	$ 27,500,000	5.30% to 5.56%	1 day
U.S. government and agency obligations	742,642,713	739,214,751	745,167,000	4.95% to 5.70%	2 to 289 days
Commercial paper	1,126,633,710	1,126,633,710	1,131,629,000	5.50% to 5.73%	1 to 59 days
Total cash equivalents and short-term investments	1,896,776,423	$1,893,348,461	$1,904,296,000		
Less: short-term investments classified as cash equivalents on Statement of Net Assets	(1,424,964,945)				
Add: certificates of deposit classified as short-term investments on Statement of Net Assets	529,435,000				
Short-term investments as shown on Statement of Net Assets	$ 1,001,246,478				

The State Pooled Investment Fund's investments, shown above as of June 30, 1999 and June 30, 1998, are all considered category 1. All securities, whether owned outright or pledged as collateral against repurchases, are held in the State's account in the Federal Reserve Bank or at a third party trustee custodian in the State's name.

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. An administrative fee of .06 percent for LGIP participants and .08 percent for the State's departments and agencies was charged against each participant's average daily balance to provide funding for administrative expenses to operate the SPIF.

State Pooled Investment Fund Required Supplementary Information June 30, 1999 and June 30, 1998

UNAUDITED

YEAR 2000 ISSUE

The State Treasurer is currently addressing the "Year 2000" (Y2K) issue relating to computer systems and other electronic equipment. The Y2K issue refers to the fact that many computer software programs use only the last two digits of a data field to refer to "year" on the assumption that the first two digits are "19". These programs would interpret the Year 2000 as the Year 1900, the Year 2001 as 1901, etc. The issue therefore extends to computer hardware, electronics and other equipment dependent on microchip technology. In addition, some computer programs may not recognize that the Year 2000 is a leap year, resulting in incorrect date calculations. Without reprogramming, such software and equipment could impact the ability to input data into computer programs and the ability of such programs to correctly process data. Y2K affects the computer systems utilized directly by the SPIF as well as the other systems upon which the SPIF depends to fulfill its mission. The State Treasurer's Y2K initiatives relating to the SPIF did not result in the commitment of significant resources as of June 30, 1999 and June 30, 1998.

The State Treasurer has assessed the impact of Y2K on the SPIF computer systems and has determined that certain computer systems are mission-critical, certain are critical, and certain are supportive. Mission-critical computer systems are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the SPIF from fulfilling its mission. Critical computer systems are those for which there are manual alternatives, but the State Treasurer would be unlikely to be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer systems are those for which there are manual alternatives that could be performed if necessary.

The SPIF relies principally upon two major computer systems, the Treasury Earnings and Account Management System (TEAMS) for participant level accounting and the Cash Movement Control System (CMCS) for the actual transfer of funds between the Fund and participants. Other systems critical to the SPIF operations include the Statewide Accounting and Reporting System (STARS), utilized to record SPIF transactions and in the preparation of financial statements, the State Treasurer's general ledger accounting system, utilized to reconcile the subsidiary ledgers and to produce financial statements, and the investment system which maintains a perpetual inventory of all the securities owned by the SPIF and maintains a record of all acquisitions, dispositions and maturities of securities in the SPIF portfolio.

The State Treasurer has identified the above mentioned computer systems that are mission-critical and has subjected those systems to the following stages of work to address Year 2000 issues.

Awareness stage - Establishing a budget and project plan for dealing with the Year 2000 issue.
Assessment stage - Identifying the systems and components for which the Year 2000 compliant work is needed.
Remediation stage - Making changes to systems and equipment.
Validation/testing stage - Validating and testing the changes that were made during the remediation stage.

The State Pooled Investment Fund's Year 2000 remediation work for its mission-critical systems and electronic equipment are in the following stages of work. "C" means complete and "P" means in progress. While the completion of such stages is an indication of progress made in addressing the Y2K issue, it is not a guarantee that the systems and equipment will be Year 2000 compliant.

	Awareness	Assessment	Remediation	Validation/Testing
TEAMS	C	C	C	C
CMCS	C	C	C	C
Investment System	C	C	C	C
General Ledger System	C	C	C	C
STARS	C	C	C	C
Electronic Equipment	C	C	C	P

The State Treasurer has solicited information from other organizations whose Y2K compliance could affect the SPIF regarding the status of their assessment, remediation, and testing of their computer systems. Of the organizations that have responded to date, all expect to achieve compliance in a manner that will not have a materially negative effect on the SPIF operations. The State Treasurer does not have full and complete information from these organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the SPIF operations or financial status.

Because of the unprecedented nature of the Year 2000 issue, its effects and success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the State Pooled Investment Fund is or will be Year 2000 ready, that the remediation efforts will be successful in whole or in part, or that parties with whom the SPIF does business will be Year 2000 ready.

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
INDEPENDENT AUDITOR'S REPORT

STATE OF TENNESSEE

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

December 10, 1999

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, 1999, and June 30, 1998, and the related statements of changes in plan 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 generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our report dated December 29, 1998, we qualified our opinion on the 1998 financial statements because insufficient audit evidence existed to support the Tennessee Consolidated Retirement System's disclosures required by Governmental Accounting Standards Board (GASB) Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*. The Tennessee Consolidated Retirement System's year 2000 disclosures are now reported as required supplementary information as permitted by GASB Technical Bulletin 99-1, *Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1*. Accordingly, our present opinion on the 1998 financial statements, as expressed herein, is different from our prior report on the 1998 financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Consolidated Retirement System as of June 30, 1999, and June 30, 1998, and the results of its operations for the years then ended in conformity with generally accepted accounting principles.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplementary schedule of actuarial balances on page 80 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 1999, on our consideration of the system's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr.

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

Tennessee Consolidated Retirement System
Comparative Statements of Plan Net Assets
As of June 30, 1999 and June 30, 1998

Expressed in Thousands	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)
ASSETS		
Cash	$ 10,024	$ 1,478
Receivables		
Member contributions receivable	13,467	2,911
Employer contributions receivable	20,131	5,230
Accrued interest receivable	159,933	23,581
Accrued dividends receivable	9,299	1,371
Other investment receivable	0	0
Investments sold	75,993	11,205
Total receivables	278,823	44,298
Investments, at fair value		
Short-term securities	638,904	94,204
Domestic securities		
Government bonds	7,139,133	1,052,638
Corporate bonds	2,601,061	383,516
Corporate stocks	6,308,927	930,227
International securities		
Government bonds	885,541	130,570
Corporate bonds	381,152	56,200
Corporate stocks	1,847,558	272,415
Total investments	19,802,276	2,919,770
TOTAL ASSETS	20,091,123	2,965,546
LIABILITIES		
Retired payroll payable	12,207	1,774
Warrants payable	599	533
Accounts payable		
Death benefits and refunds payable	851	655
Other	13	1
Investments purchased	206,994	30,520
Other investment payables	4,366	644
TOTAL LIABILITIES	225,030	34,127
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (Schedule of funding progress for the PSPP is presented on page 78)	$ 19,866,093	$ 2,931,419

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

June 30, 1999 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 1998 Total
$ 11,502	$ 23,097	$ 234	$ 23,331
16,378	12,681	2,596	15,277
25,361	13,491	4,899	18,390
183,514	140,343	20,395	160,738
10,670	8,442	1,227	9,669
0	927	135	1,062
87,198	26,631	3,870	30,501
323,121	202,515	33,122	235,637
733,108	802,397	116,608	919,005
8,191,771	6,426,129	933,874	7,360,003
2,984,577	2,697,109	391,956	3,089,065
7,239,154	5,655,385	821,866	6,477,251
1,016,111	994,674	144,551	1,139,225
437,352	370,476	53,840	424,316
2,119,973	1,264,607	183,778	1,448,385
22,722,046	18,210,777	2,646,473	20,857,250
23,056,669	18,436,389	2,679,829	21,116,218
13,981	12,463	1,778	14,241
1,132	408	298	706
1,506	789	428	1,217
14	54	58	112
237,514	35,760	5,197	40,957
5,010	1,308	190	1,498
259,157	50,782	7,949	58,731
$ 22,797,512	$ 18,385,607	$ 2,671,880	$ 21,057,487

Tennessee Consolidated Retirement System
Comparative Statements of Changes in Plan Net Assets
For the Years Ended June 30, 1999 and June 30, 1998

Expressed in Thousands	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)
ADDITIONS		
Contributions		
Member contributions	$ 122,564	$ 38,618
Employer contributions	244,453	69,230
Total contributions	367,017	107,848
Investment income		
Net appreciation in fair value of investments	883,577	129,430
Interest	705,107	103,288
Dividends	106,778	15,641
Total investment income	1,695,462	248,359
Less: Investment expense	9,682	1,423
Net income from investing activities	1,685,780	246,936
Securities lending activities		
Securities lending income	0	0
Less: Securities lending expense	0	0
Net income from securities lending activities	0	0
Net investment income	1,685,780	246,936
TOTAL ADDITIONS	2,052,797	354,784
DEDUCTIONS		
Annuity benefits		
Retirement benefits	414,149	60,182
Survivor benefits	25,934	3,769
Disability benefits	13,948	2,027
Cost of living	99,823	14,506
Death benefits	2,616	778
Refunds	13,491	12,143
Administrative expense	2,350	1,840
TOTAL DEDUCTIONS	572,311	95,245
NET INCREASE	1,480,486	259,539
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
BEGINNING OF YEAR	18,385,607	2,671,880
END OF YEAR	$ 19,866,093	$ 2,931,419

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

For the Year Ended June 30, 1999 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	For the Year Ended June 30, 1998 Total
$ 161,182	$ 116,196	$ 39,086	$ 155,282
313,683	166,756	65,276	232,032
474,865	282,952	104,362	387,314
1,013,007	1,655,047	239,084	1,894,131
808,395	655,178	94,644	749,822
122,419	108,996	15,745	124,741
1,943,821	2,419,221	349,473	2,768,694
11,105	9,332	1,350	10,682
1,932,716	2,409,889	348,123	2,758,012
0	2,080	301	2,381
0	1,857	268	2,125
0	223	33	256
1,932,716	2,410,112	348,156	2,758,268
2,407,581	2,693,064	452,518	3,145,582
474,331	378,485	53,991	432,476
29,703	24,127	3,441	27,568
15,975	12,694	1,811	14,505
114,329	88,435	12,615	101,050
3,394	2,557	746	3,303
25,634	14,311	10,338	24,649
4,190	2,191	1,694	3,885
667,556	522,800	84,636	607,436
1,740,025	2,170,264	367,882	2,538,146
21,057,487	16,215,343	2,303,998	18,519,341
$ 22,797,512	$ 18,385,607	$ 2,671,880	$ 21,057,487

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1999 AND JUNE 30, 1998

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 TCRS follows all applicable GASB pronouncements, as well as applicable private sector pronouncements issued on or before November 30, 1989. The financial statements have been prepared using the 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 in which the contributions are due. Plan employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

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

   Cash received by the TCRS that cannot be invested immediately in securities is invested in the State Pooled Investment Fund administered by the State Treasurer. 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned to brokers for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1999 and June 30, 1998. The classification of Cash also includes cash held in a custody account under a contractual arrangement for master custody services. Cash balances with the custodial agent are not classified into the credit risk categories established by Statement Number 3 of the Governmental Accounting Standards Board as the custody account relationship does not meet the definition for either a deposit with a financial institution or a security.

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. Short-term investments that do not have an established market are reported at cost plus accrued interest which approximates fair value. 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.

5. **Receivables** - Receivables primarily consist of interest which is recorded when earned. The receivables for contributions as of June 30, 1999 consist of $33.6 million due from other funds within the state and $8.1 million due from other governments. The receivables for contributions as of June 30, 1998 consist of $26.2 million due from other funds within the state and $7.5 million due from other governments.

(continued)

6. **Reclassification** - Investments in the amount of $208,047,651 that were classified as International Government Bonds on the June 30, 1998 Statement of Plan Net Assets have been reclassified as International Corporate Bonds.

B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

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

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

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% 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, 1999, the plan's Member Reserve and Employer Reserve were fully funded with balances of $2,396.9 million and $17,469.2 million, respectively. At June 30, 1998, the plan's Member Reserve and Employer Reserve were fully funded with balances of $2,268.7 million and $16,116.9 million, respectively.

(continued)

Tennessee Consolidated Retirement System Notes to the Financial Statements June 30, 1999 and June 30, 1998 (continued)

Political Subdivisions Pension Plan

Plan Description - PSPP is an agent multiple-employer defined benefit pension plan that covers the employees of participating political subdivisions of the state of Tennessee. Employee class differentiations are not made under PSPP. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan prior to July 1, 1979 are vested after four years of service. Members joining on or after July 1, 1979 are vested upon completion of 10 years of service, unless five years vesting is authorized by resolution of the chief governing body. Cost of living adjustments (COLA) are the same as provided by SETHEEPP except that the local government may elect (a) to provide no COLA benefits or (b) to provide COLA benefits under a non-compounding basis rather than the compounded basis applicable under SETHEEPP. Benefit provisions are established and amended by state statute. Pursuant to Article Two, Section 24 of the *Constitution of the State of Tennessee*, the state cannot mandate costs on local governments. Any benefit improvement may be adopted by the governing body of a governmental entity participating in the TCRS.

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

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve. At June 30, 1999, the plan's Member Reserve and Employer Reserve were fully funded with balances of $502.0 million and $2,429.4 million, respectively. At June 30, 1998, the plan's Member Reserve and Employer Reserve were fully funded with balances of $467.6 million and $2,204.3 million, respectively.

C. INVESTMENTS

State statute 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 and further subject to the following restrictions:

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

b. The total sum invested in notes and bonds or other fixed income securities exceeding one year in maturity shall not exceed seventy-five percent (75%) of the total funds of the retirement system. Private Placements are limited to 15% of the total fixed income portfolio.

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

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

e. The total sum invested in real estate shall not exceed five percent (5%) of the total of the funds of the retirement system.

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

(continued)

Tennessee Consolidated Retirement System
Notes to the Financial Statements
June 30, 1999 and June 30, 1998 (continued)

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

Expressed in Thousands

	Fair Value June 30, 1999	Fair Value June 30, 1998
INVESTMENTS - CATEGORY 1		
Short-term securities		
Commercial paper	$ 537,039	$ 730,938
Medium-term corporate notes	0	31,584
U. S. government securities	196,069	156,483
Long-term investments		
Domestic securities		
Government bonds	8,024,874	7,354,911
Corporate bonds	2,931,825	3,089,065
Corporate stocks	7,222,722	6,465,187
International securities		
Government bonds	1,016,111	1,139,225
Corporate bonds	437,352	424,316
Corporate stocks	2,108,893	1,412,509
TOTAL INVESTMENTS - CATEGORY 1	22,474,885	20,804,218
INVESTMENTS - CATEGORY 2	0	0
INVESTMENTS - CATEGORY 3		
Margin deposit on futures contracts		
Domestic government bonds	11,319	5,092
INVESTMENTS - NOT CATEGORIZED		
Unsettled investment acquisitions		
Domestic securities		
Government bonds	155,578	0
Corporate bonds	52,752	0
Corporate stocks	16,432	12,064
International securities		
Corporate stocks	11,080	35,876
TOTAL INVESTMENTS - NOT CATEGORIZED	235,842	47,940
TOTAL INVESTMENTS	$ 22,722,046	$ 20,857,250

As of June 30, 1999 and June 30, 1998, the TCRS had no concentrations of investments, other than those issued or guaranteed by the U.S. government, in any one organization that represents five percent or more of plan net assets.

Securities Lending - The TCRS is authorized by its investment policy, as adopted by the Board of Trustees, to enter into collateralized securities lending agreements whereby the TCRS loans its debt and equity securities for a fee to a select few of the

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1999 AND JUNE 30, 1998 (CONTINUED)

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

The loaned securities are initially collateralized at 102 percent of their fair value for domestic securities and 105 percent for international. Collateral is marked-to-market daily and additional collateral is pledged by the borrower if the fair value of the collateral subsequently falls below 100 percent for domestic securities and 105 percent for international. Although there is no specific policy for matching the maturities of collateral investments and the securities loans, the securities on loan can be terminated on demand by either the TCRS or the borrower. For the fiscal year ending June 30, 1999, the TCRS had no securities on loan. As of June 30, 1998, the TCRS had no securities on loan. The TCRS securities lending income, net of expenses, was $255,741 for the year ended June 30, 1998.

Financial Instruments with Off-Balance Sheet Risk

The TCRS is a party to financial instruments with off-balance sheet risk used in the normal course of business to generate earnings and reduce its own exposure to fluctuations in market conditions. The TCRS is authorized by state statute to engage in forward contracts to exchange different currencies at a specified future date and rate and in domestic stock index futures contracts. These contracts involve elements of custodial credit, market and legal risk in excess of amounts recognized in the Statements of Plan Net Assets as of June 30, 1999 and June 30, 1998. The TCRS may purchase or sell domestic stock index futures contracts for the purposes of making asset allocation changes and improving liquidity. Futures contracts are limited to the S&P 500 Index, the S&P Midcap 400 Index and the Russell 2000 Index. The contractual or notional amounts express the extent of the TCRS' involvement in these instruments and do not represent exposure to credit loss. The credit risk on forward and futures contracts is controlled through limits and monitoring procedures. Market risk, the risk that changing market conditions may make a financial instrument less valuable, is controlled through limitations on the use of such instruments. Legal risk is controlled through the use of only authorized instruments and brokers. The allowable currencies for hedging purposes are limited by policy of the Board of Trustees to the currencies of those countries otherwise authorized for investment.

At June 30, 1999, there were forward exchange contracts outstanding at a total net notional amount of $589,694,318 and a fair value of $569,519,506. At June 30, 1998, there were forward exchange contracts outstanding at a total net notional amount of $528,898,678 and a fair value of $524,041,284.

At June 30, 1999, the notional amount of futures contracts was $165,256,250 at a fair value of $172,712,500. At June 30, 1998, the notional amount of futures contracts was $138,731,250 at a fair value of $142,875,000. The changes in fair value of outstanding futures contracts are settled daily.

The TCRS is also authorized by investment policy to engage in the issuance of options. Activity is limited to selling covered call options. The TCRS had no options outstanding at June 30, 1999 and June 30, 1998.

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 CMOs held were issued by quasi-U.S. governmental agencies. The fair value of these securities was $65,145,109 at June 30, 1999, and $110,059,380 at June 30, 1998. The TCRS also invests in various asset-backed securities, representing ownership interests in trusts consisting of credit card or auto loan receivables. These securities are issued by organizations with AAA or AA credit ratings. TCRS invests in these securities primarily to enhance returns by taking advantage of opportunities available in this sector of the securities markets.

D. COMMITMENTS

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

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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
REQUIRED SUPPLEMENTARY INFORMATION
JUNE 30, 1999 AND JUNE 30, 1998

YEAR 2000 ISSUE

The TCRS is currently addressing the "Year 2000" (Y2K) issue relating to computer systems and other electronic equipment. The Y2K issue refers to the fact that many computer software programs use only the last two digits of a data field to refer to "year" on the assumption that the first two digits are "19". These programs would interpret the Year 2000 as the Year 1900, the Year 2001 as 1901, etc. The issue therefore extends to computer hardware, electronics and other equipment dependent on microchip technology. In addition, some computer programs may not recognize that the Year 2000 is a leap year, resulting in incorrect date calculations. Without reprogramming, such software and equipment could impact the ability to input data into computer programs and the ability of such programs to correctly process data. Y2K affects the computer systems utilized directly by the TCRS as well as the other systems upon which the TCRS depends to fulfill its mission. The TCRS' Y2K initiatives relating to the retirement system did not result in the commitment of significant financial resources as of June 30, 1999 and June 30, 1998.

The TCRS has assessed the impact of Y2K on its computer systems and has determined that certain computer systems are mission-critical, certain are critical, and certain are supportive. Mission critical computer systems are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the TCRS from fulfilling its mission. Critical computer systems are those for which there are manual alternatives, but the TCRS would be unlikely to be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer systems are those for which there are manual alternatives that could be performed if necessary.

The TCRS relies upon three major computer systems to manage the responsibilities of the retirement program. The retired payroll system generates monthly annuity payments to more than 70,000 retirees each month. The active membership system maintains the data of more than 200,000 active and inactive member records. This system is utilized to record employee and employer contributions; to record service and salary credit for each member; to process lump sum refunds to terminating members; to maintain records of each employer participating in the retirement plan; to maintain member data including beneficiary, date of birth, etc.; to provide annual statements to members; to invoice members for the purchase of service credit; and to provide benefit estimates. The third major system is the investment system which maintains a perpetual inventory of all the securities owned by TCRS. The investment system maintains a record of all the acquisitions, dispositions, and maturities of securities in the TCRS portfolio and initiates settlement with the TCRS investment custodian. Other important but less significant systems include the document inventory system and the general ledger accounting system. The document inventory system is utilized to maintain a record of the incoming and outgoing documents and correspondence. The general ledger accounting system is utilized to reconcile the subsidiary ledgers and to produce financial statements.

TCRS has identified the above mentioned computer systems that are mission-critical and has subjected those systems to the following stages of work to address Year 2000 issues.

Awareness stage - Establishing a budget and project plan for dealing with the Year 2000 issue.
Assessment stage - Identifying the systems and components for which the Year 2000 compliant work is needed.
Remediation stage - Making changes to systems and equipment.
Validation/testing stage - Validating and testing the changes that were made during the remediation stage.

TCRS' Year 2000 remediation work for its mission-critical systems and electronic equipment are in the following stages of work. "C" means complete and "P" means in progress. While the completion of such stages is an indication of progress made in addressing the Y2K issue, it is not a guarantee that the systems and equipment will be Year 2000 compliant.

	Awareness	Assessment	Remediation	Validation/Testing
Retired Payroll System	C	C	C	C
Active Membership System	C	C	C	C
Investment System	C	C	C	C
Document Inventory System	C	C	C	C
Accounting System	C	C	C	C
Electronic Equipment	C	C	P	P

The TCRS has contacted external organizations with a mission critical relationship whose Year 2000 compliance could affect the operations of the retirement system. Such organizations have responded that they are Year 2000 compliant or expect to achieve compliance prior to January 1, 2000. Other organizations with less critical relationships have been contacted to remind them of the potential problems surrounding Year 2000 and the need to evaluate their systems.

Because of the unprecedented nature of the Year 2000 issue, its effects and the success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that TCRS is or will be Year 2000 ready, that the TCRS' remediation efforts will be successful in whole or in part, or that parties with whom TCRS does business will be Year 2000 ready.

Tennessee Consolidated Retirement System
Required Supplementary Information
Schedules of Funding Progress and Employer Contributions

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SCHEDULE OF FUNDING PROGRESS

SETHEEPP

For budgetary purposes, the cost of funding the pension obligations of the state employees, teachers and higher education employees pension plan (SETHEEPP) is determined separately as follows:

(1) General state employees and higher education employees
(2) Teachers (grades K-12)
(3) State Judges employed after June 30, 1972
(4) Attorneys General employed after June 30, 1972
(5) State Judges and Attorneys General employed prior to July 1, 1972
(6) County Officials employed prior to July 1, 1972

All the groups above, except the County Officials group and the State Judges and Attorneys General group employed prior to July 1, 1972, are funded under the aggregate actuarial cost method. The frozen entry age actuarial method is utilized for these two groups not under the aggregate actuarial cost method. The aggregate actuarial cost method does not identify or separately amortize unfunded actuarial liabilities. The SETHEEPP groups funded under the aggregate method would not have an unfunded actuarial liability under the frozen entry age actuarial method.

In accordance with GASB 25, a schedule of funding progress is not presented since more than 98% of the liabilities are determined under the aggregate actuarial funding method.

PSPP

The political subdivision pension plan (PSPP) represents 365 participating entities at June 30, 1997, some of which are funded under the aggregate actuarial cost method and others under the frozen entry age actuarial method. The following data represents only those political subdivisions where the frozen entry age actuarial method is utilized.

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)
6/30/1997	1,020,240	1,078,231	57,991	94.62%	583,294	9.94%

An actuarial valuation of the TCRS is performed every two years with the next valuation scheduled to be effective July 1, 1999. There are 168 of the 365 political subdivisions in TCRS as of the June 30, 1997 actuarial valuation, with an unfunded actuarial accrued liability. Information according to the parameters for measuring pension expenditures, expense and related actuarially determined disclosure information, as required by GASB, is available beginning with the transition year.

See accompanying Notes to Required Supplementary Information

SCHEDULES OF EMPLOYER CONTRIBUTIONS

Expressed in Thousands

Year Ended June 30	SETHEEPP Annual Required Contribution	SETHEEPP Percentage Contributed	PSPP Annual Required Contribution	PSPP Percentage Contributed
1999	$ 244,453	100%	$ 69,230	100%
1998	166,756	100%		

An actuarial valuation of the TCRS is performed every two years with the next valuation scheduled to be effective July 1, 1999. The June 30, 1995 valuation determined the employer contribution rate for the year ended June 30, 1997 for the SETHEEPP and the PSPP, and for the year ended June 30, 1998 for the PSPP. Therefore, the Schedule of Employer Contributions, in accordance with the parameters of GASB Statement Number 25, is not available for the year ended June 30, 1997 for either plan or for the year ended June 30, 1998 for the PSPP.

See accompanying Notes to Required Supplementary Information

UNAUDITED

Tennessee Consolidated Retirement System
Notes to Required Supplementary Information
As of June 30, 1999 and June 30, 1998

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

	SETHEEPP	PSPP
Valuation Date	6/30/1997	6/30/1997
Actuarial cost method	Aggregate (1)	(2)
Amortization method	Level Dollar (3)	Level Dollar (3)
Remaining amortization period	18 years (3) closed period (3)	(4) closed period
Asset valuation method	5-year Moving Market Average	5-year Moving Market Average
Actuarial assumptions:		
Investment rate of return	7.5%	7.5%
Projected salary increases	5.5%	5.5%
Includes inflation at	(5)	(5)
Cost-of-living adjustments	3%	3%
Increase in Social Security wage base	4.5%	4.5%

(1) The frozen entry age actuarial method is utilized for two small closed groups: county officials employed prior to July 1, 1972, and a group of state judges and attorneys general employed prior to July 1, 1972.

(2) Some political subdivisions are funded under the aggregate actuarial funding method and some under the frozen entry age actuarial method.

(3) Applies to groups funded under the frozen entry age actuarial method.

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

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

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

	Political Subdivision Pension Plan (PSPP)	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEPP)	Total
ASSETS			
Present assets creditable to			
Employer accumulation fund	$ 1,800,448,644	$ 13,529,975,707	$ 15,330,424,351
Members' accumulation fund	426,442,166	2,141,702,347	2,568,144,513
Total present assets	2,226,890,810	15,671,678,054	17,898,568,864
Present value of prospective Contributions payable to			
Employer accumulation fund			
Normal	358,895,672	1,928,526,419	2,287,422,091
Accrued liability	57,991,294	111,172,072	169,163,366
Total employer accumulation	416,886,966	2,039,698,491	2,456,585,457
Members' accumulation fund	238,234,111	1,105,935,845	1,344,169,956
Total prospective contributions	655,121,077	3,145,634,336	3,800,755,413
TOTAL ASSETS	2,882,011,887	18,817,312,390	21,699,324,277
LIABILITIES			
Present value of prospective Benefits payable on account of			
Present retired members and beneficiaries	743,565,148	5,456,072,528	6,199,637,676
Present active members	2,096,342,374	13,156,059,038	15,252,401,412
Former members	42,104,365	205,180,824	247,285,189
TOTAL LIABILITIES	$ 2,882,011,887	$ 18,817,312,390	$ 21,699,324,277

UNAUDITED

Flexible Benefits Plan
Independent Auditor's Report

STATE OF TENNESSEE

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

December 10, 1999

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 Flexible Benefits Plan as of June 30, 1999, and June 30, 1998, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our report dated December 29, 1998, we qualified our opinion on the 1998 financial statements because insufficient audit evidence existed to support the Flexible Benefits Plan's disclosures required by the Governmental Accounting Standards Board (GASB) Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*. The Flexible Benefits Plan's year 2000 disclosures are now reported as required supplementary information as permitted by GASB Technical Bulletin 99-1, *Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1*. Accordingly, our present opinion on the 1998 financial statements, as expressed herein, is different from our prior report on the 1998 financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Flexible Benefits Plan as of June 30, 1999, and June 30, 1998, and the changes in fund balances for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 1999, on our consideration of the Flexible Benefits Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr.

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

Flexible Benefits Plan
Comparative Balance Sheets
June 30, 1999 and June 30, 1998

	June 30, 1999		June 30, 1998	
ASSETS				
Cash	$	367,025	$	458,712
Due from other funds		58,074		1,842
TOTAL ASSETS	$	425,099	$	460,554
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Warrants payable	$	5,038	$	3,151
Accounts payable		107,459		103,253
Dependent care deposits		141,270		140,051
Medical reimbursement deposits		102,477		146,849
Due to other funds		389		67,250
TOTAL LIABILITIES		356,633		460,554
FUND BALANCES RESERVED FOR EMPLOYEE BENEFITS		68,466		0
TOTAL LIABILITIES AND FUND BALANCES	$	425,099	$	460,554

See accompanying Notes to the Financial Statements

Flexible Benefits Plan
Comparative Statements of Revenues, Expenditures and Changes in Fund Balances
For the Years Ended June 30, 1999 and June 30, 1998

	For the Year Ended June 30, 1999	For the Year Ended June 30, 1998
REVENUES		
FICA savings	$ 2,379,874	$ 2,302,902
Flexible benefit forfeiture	6,699	2,937
TOTAL REVENUES	2,386,573	2,305,839
EXPENDITURES		
Deferred compensation match	1,508,802	4,569,728
Administrative fees	200,789	185,557
Employee benefit program	71,909	67,813
TOTAL EXPENDITURES	1,781,500	4,823,098
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	605,073	(2,517,259)
OTHER FINANCING SOURCES (USES)		
Operating transfer from State General Fund	0	427,598
Operating transfer to State General Fund	(182,122)	(151,946)
Operating transfer to State Internal Service Fund	(354,485)	(232,994)
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES AND OTHER FINANCING SOURCES (USES)	68,466	(2,474,601)
FUND BALANCES, BEGINNING OF YEAR	0	2,474,601
FUND BALANCES, END OF YEAR	$ 68,466	$ 0

See accompanying Notes to the Financial Statements

FLEXIBLE BENEFITS PLAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1999 AND JUNE 30, 1998

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 expendable trust fund. The state offers its employees a cafeteria plan created in accordance with *Internal Revenue Code Section 125*. The plan is available on an optional basis to all state employees. Through the plan, employees may elect to direct a portion of their salary to pay for certain benefits. Benefits which may be purchased through the plan include state group medical insurance, state group dental insurance, out-of-pocket medical expenses and/or dependent care expenses. Because elections must be filed before the salary or the benefits are received and because salary directed to the plan may not be withdrawn by participants for any other purpose, salary directed to the plan is exempt from federal income tax and social security tax. Elections made by employees may not be changed during the calendar plan year except in the event of a corresponding change in the participant's family status. Contributions to the plan not withdrawn by the end of the plan year are forfeited to the state and are used for 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) using the flow of current financial resources measurement focus and the modified accrual basis of accounting. Under this method, revenues are recorded when they become both measurable and available, and expenditures are recognized at the time the fund liabilities are incurred.

3. Cash

Cash deposited in the Flexible Benefits Plan is pooled with the State Pooled Investment Fund, administered by the State Treasurer, which is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to Tennessee Code Annotated, Section 9-4-602(b). The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The Pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1999, and June 30, 1998.

B. OTHER ACCOUNTING DISCLOSURES

1. The *Appropriations Act of 1997 (Public Chapter 552, Section 12, item 21)* provided for the State match of employee deferrals into the State's 401(k) to be funded first by the Flexible Benefits Fund. The Appropriations Act further provided that should the match exceed the fund balance, an operating transfer from the general fund would be made to bring the fund balance to zero. At June 30, 1998 an operating transfer of $427,598.11 was received from the State General Fund in accordance with the appropriations act. Effective July 1, 1998, the Flexible Benefits Fund funded only thirty percent (30%) of the expenses of the State match of employee deferrals.

UNAUDITED

Flexible Benefits Plan
Required Supplementary Information
June 30, 1999 and June 30, 1998

YEAR 2000 ISSUE

The State Treasurer is currently addressing the "Year 2000" (Y2K) issue relating to computer systems and other electronic equipment. The Y2K issue refers to the fact that many computer software programs use only the last two digits of a data field to refer to "year" on the assumption that the first two digits are "19". These programs would interpret the Year 2000 as the Year 1900, the Year 2001 as 1901, etc. The issue therefore extends to computer hardware, electronics and other equipment dependent on microchip technology. In addition, some computer programs may not recognize that the Year 2000 is a leap year, resulting in incorrect date calculations. Without reprogramming, such software and equipment could impact the ability to input data into computer programs and the ability of such programs to correctly process data. Y2K affects the computer systems utilized directly by the Flexible Benefits Plan as well as the other systems upon which the Flexible Benefits Plan depends to fulfill its mission. The State Treasurer's Y2K initiatives relating to the Flexible Benefits Plan did not result in the commitment of significant resources as of June 30, 1999 and June 30, 1998.

The State Treasurer has assessed the impact of Y2K on the Flexible Benefits Plan computer systems and has determined that certain computer systems are mission-critical, certain are critical, and certain are supportive. Mission-critical computer systems are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the Flexible Benefits Plan from fulfilling its mission. Critical computer systems are those for which there are manual alternatives, but the State Treasurer would be unlikely to be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer systems are those for which there are manual alternatives that could be performed if necessary.

The Flexible Benefits Plan relies principally upon one major computer system, the Flexible Benefit System for managing flexible benefits reimbursement requests. Other systems critical to the Flexible Benefits Plan operations include the State Treasurer's general ledger accounting system and the Statewide Accounting and Reporting System (STARS) which are both utilized to make payments on approved reimbursement claims, to reconcile the subsidiary ledger and to produce financial statements. Another system that is important, but less significant, is the document inventory system (MODOC) utilized to maintain a record of the incoming and outgoing documents and correspondence.

The State Treasurer has identified the above mentioned computer systems that are mission-critical and is subjecting those systems to the following stages of work to address Year 2000 issues.

Awareness stage - Establishing a budget and project plan for dealing with the year 2000 issue.
Assessment stage - Identifying the systems and components for which the year 2000 compliant work is needed.
Remediation stage - Making changes to systems and equipment.
Validation/testing stage - Validating and testing the changes that were made during the remediation stage.

As of June 30, 1999, the awareness, assessment, and remediation stages had been completed for the Flexible Benefits System. The Flexible Benefit System is in the validation/testing stage. The STARS, MODOC, and general ledger systems had completed the awareness, assessment, remediation and validation/testing stages. While the completion of such stages provides an indication of progress made in addressing the Y2K issue, it is not a guarantee that the systems and equipment will be Year 2000 compliant.

The State Treasurer has solicited information from other organizations whose Y2K compliance could affect the Flexible Benefits Plan regarding the status of their assessment, remediation, and validation/testing of their computer systems. Of the organizations that have responded, all expect to achieve compliance in a manner that will not have a materially negative effect on the Flexible Benefits Plan operations. The State Treasurer does not have full and complete information from these organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the Flexible Benefits Plan operations or financial status.

Because of the unprecedented nature of the Year 2000 issue, its effects and success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the Flexible Benefits Plan is or will be Year 2000 ready, that the remediation efforts will be successful in whole or in part, or that parties with whom the Flexible Benefits Plan does business will be Year 2000 ready.

Claims Award Fund
Independent Auditor's Report

STATE OF TENNESSEE

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

December 10, 1999

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 Claims Award Fund as of June 30, 1999, and June 30, 1998, and the related statements of revenues, expenses, and changes in retained earnings and cash flows for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our report dated December 29, 1998, we qualified our opinion on the 1998 financial statements because insufficient audit evidence existed to support the Claims Award Fund's disclosures required by the Governmental Accounting Standards Board (GASB) Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*. The Claims Award Fund's year 2000 disclosures are now reported as required supplementary information as permitted by GASB Technical Bulletin 99-1, *Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1*. Accordingly, our present opinion on the 1998 financial statements, as expressed herein, is different from our prior report on the 1998 financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Claims Award Fund as of June 30, 1999, and June 30, 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 1999, on our consideration of the Claims Award Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr.

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

Claims Award Fund
Comparative Balance Sheets
June 30, 1999 and June 30, 1998

	June 30, 1999	June 30, 1998
ASSETS		
Cash	$ 72,309,967	$ 83,703,656
Accounts receivable	27,600	0
TOTAL ASSETS	$ 72,337,567	$ 83,703,656
LIABILITIES AND EQUITY		
LIABILITIES		
Warrants payable	$ 125,832	$ 161,114
Checks payable	710,119	339,347
Accounts payable	170,080	239,761
Claims liability	61,560,925	55,663,634
TOTAL LIABILITIES	62,566,956	56,403,856
EQUITY		
Retained earnings, reserved for claims	9,770,611	27,299,800
TOTAL LIABILITIES AND EQUITY	$ 72,337,567	$ 83,703,656

See accompanying Notes to the Financial Statements

Claims Award Fund
Comparative Statements of Revenues, Expenses and Changes in Retained Earnings For the Years Ended June 30, 1999 and June 30, 1998

	For the Year Ended June 30, 1999	For the Year Ended June 30, 1998
OPERATING REVENUES		
Insurance premiums	$ 10,689,200	$ 10,651,600
OPERATING EXPENSES		
Torts		
Death	927,750	1,211,049
Bodily injury	3,014,917	5,491,359
Property damage	998,617	701,577
Total Torts	4,941,284	7,403,985
Workers' Compensation		
Death	435,731	236,394
Medical	7,087,668	5,201,781
Assault injury	0	1,734
Temporary disability	1,474,693	1,035,185
Permanent disability	5,070,165	5,535,865
Total Workers' Compensation	14,068,257	12,010,959
Employee property damage	33,990	28,095
Professional/administrative	7,135,779	6,663,967
Addition to actuarial liability	5,897,291	2,201,931
TOTAL OPERATING EXPENSES	32,076,601	28,308,937
OPERATING INCOME	(21,387,401)	(17,657,337)
NON-OPERATING REVENUES		
Interest income	3,855,517	5,256,941
Taxes	2,695	3,785
TOTAL NON-OPERATING REVENUES	3,858,212	5,260,726
NET INCOME	(17,529,189)	(12,396,611)
RETAINED EARNINGS, BEGINNING OF YEAR	27,299,800	39,696,411
RETAINED EARNINGS, END OF YEAR	$ 9,770,611	$ 27,299,800

See accompanying Notes to the Financial Statements

Claims Award Fund
Comparative Statements of Cash Flows
For the Years Ended June 30, 1999 and June 30, 1998

	For the Year Ended June 30, 1999	For the Year Ended June 30, 1998
CASH FLOWS FROM OPERATING ACTIVITIES		
Operating income	$ (21,387,401)	$ (17,657,337)
Adjustments to reconcile operating income to net cash provided by operating activities		
Change in assets and liabilities		
Increase in accounts receivable	(27,600)	0
Increase (decrease) in warrants payable	(35,282)	58,547
Increase in checks payable	370,772	137,809
Decrease in accounts payable	(69,681)	(233,873)
Increase in claims liability	5,897,291	2,201,931
Total adjustments	6,135,500	2,164,414
NET CASH USED BY OPERATING ACTIVITIES	(15,251,901)	(15,492,923)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Taxes	2,695	3,785
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	2,695	3,785
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest on State Pooled Investment Fund	3,855,517	5,256,941
NET CASH PROVIDED BY INVESTING ACTIVITIES	3,855,517	5,256,941
NET DECREASE IN CASH	(11,393,689)	(10,232,197)
CASH, BEGINNING OF YEAR	83,703,656	93,935,853
CASH, END OF YEAR	$ 72,309,967	$ 83,703,656

See accompanying Notes to the Financial Statements

CLAIMS AWARD FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1999 AND JUNE 30, 1998

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

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

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The Claims Award Fund follows all applicable GASB pronouncements as well as applicable private sector pronouncements issued on or before November 30, 1989. The 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

Cash deposited in the Claims Award Fund is pooled with the State Pooled Investment Fund, administered by the State Treasurer, which is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated, Section 9-4-602(b)*. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The Pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1999, and June 30, 1998.

B. OTHER ACCOUNTING DISCLOSURES

1. Risk Management

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

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

CAF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. At June 30, 1999, the present value of these liabilities discounted at 5.35% was $61,560,925. Changes in the balances of claims liabilities during fiscal years 1999 and 1998 were as follows:

	Beginning of Fiscal Year Liabilitiy	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year End
1998-99	$ 55,663,634	$ 24,940,823	$ (19,043,532)	$ 61,560,925
1997-98	$ 53,461,703	$ 21,644,970	$ (19,443,039)	$ 55,663,634

At June 30, 1999, CAF held $72.3 million in cash designated for payment of these claims.

UNAUDITED

CLAIMS AWARD FUND
REQUIRED SUPPLEMENTARY INFORMATION
JUNE 30, 1999 AND JUNE 30, 1998

YEAR 2000 ISSUE

The State Treasurer is currently addressing the "Year 2000" (Y2K) issue relating to computer systems and other electronic equipment. The Y2K issue refers to the fact that many computer software programs use only the last two digits of a data field to refer to "year" on the assumption that the first two digits are "19". These programs would interpret the Year 2000 as the Year 1900, the Year 2001 as 1901, etc. The issue therefore extends to computer hardware, electronics and other equipment dependent on microchip technology. In addition, some computer programs may not recognize that the Year 2000 is a leap year, resulting in incorrect date calculations. Without reprogramming, such software and equipment could impact the ability to input data into computer programs and the ability of such programs to correctly process data. Y2K affects the computer systems utilized directly by the CAF as well as the other systems upon which the CAF depends to fulfill its mission. The State Treasurer's Y2K initiatives relating to the CAF did not result in the commitment of significant resources as of June 30, 1999 and June 30, 1998.

The State Treasurer has assessed the impact of Y2K on the CAF computer systems and has determined that certain computer systems are mission-critical, certain are critical, and certain are supportive. Mission-critical computer systems are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the CAF from fulfilling its mission. Critical computer systems are those for which there are manual alternatives, but the State Treasurer would be unlikely to be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer systems are those for which there are manual alternatives that could be performed if necessary.

The CAF relies principally upon one major computer system, the Division of Claims System (DOCS) for managing claims filed against the state. Other systems critical to the CAF operations include the Statewide Accounting and Reporting System (STARS) utilized to make payments on approved claims filed with the state, to reconcile the subsidiary ledger and to produce financial statements.

The State Treasurer has identified the above mentioned computer systems that are mission-critical and is subjecting those systems to the following stages of work to address Year 2000 issues.

Awareness stage - Establishing a budget and project plan for dealing with the year 2000 issue.
Assessment stage - Identifying the systems and components for which the year 2000 compliant work is needed.
Remediation stage - Making changes to systems and equipment.
Validation/testing stage - Validating and testing the changes that were made during the remediation stage.

As of June 30, 1999, the awareness, assessment, and remediation stages had been completed for all mission-critical systems and electronic equipment. The validation/testing stage has been completed for all mission-critical systems and is in process for all electronic equipment. While the completion of such stages provides an indication of progress made in addressing the Y2K issue, it is not a guarantee that the systems and equipment will be Year 2000 compliant.

The State Treasurer has solicited information from other organizations whose Y2K compliance could affect the CAF regarding the status of their assessment, remediation, and validation/testing of their computer systems. Of the organizations that have responded, all expect to achieve compliance in a manner that will not have a materially negative effect on the CAF operations. The State Treasurer does not have full and complete information from these organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the CAF operations or financial status.

Because of the unprecedented nature of the Year 2000 issue, its effects and success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the CAF is or will be Year 2000 ready, that the remediation efforts will be successful in whole or in part, or that parties with whom the CAF does business will be Year 2000 ready.

Criminal Injuries Compensation Fund
Independent Auditor's Report

STATE OF TENNESSEE

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

December 10, 1999

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 as of June 30, 1999, and June 30, 1998, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our report dated December 29, 1998, we qualified our opinion on the 1998 financial statements because insufficient audit evidence existed to support the Criminal Injuries Compensation Fund's disclosures required by the Governmental Accounting Standards Board (GASB) Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*. The Criminal Injuries Compensation Fund's year 2000 disclosures are now reported as required supplementary information as permitted by GASB Technical Bulletin 99-1, *Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1*. Accordingly, our present opinion on the 1998 financial statements, as expressed herein, is different from our prior report on the 1998 financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Criminal Injuries Compensation Fund as of June 30, 1999, and June 30, 1998, and the changes in fund balances for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 1999, on our consideration of the Criminal Injuries Compensation Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grants.

Sincerely,

Arthur A. Hayes Jr.

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

Criminal Injuries Compensation Fund
Comparative Balance Sheets
June 30, 1999 and June 30, 1998

	June 30, 1999	June 30, 1998
ASSETS		
Cash	$ 68,949,350	$ 60,010,113
Accounts receivable	775,032	646,447
TOTAL ASSETS	$ 69,724,382	$ 60,656,560
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Warrants payable	$ 552,336	$ 597,808
Accounts payable	150,140	379,773
Claims liability	4,471,817	5,449,522
TOTAL LIABILITIES	5,174,293	6,427,103
FUND BALANCES		
Reserved for future benefits	63,899,447	53,239,801
Reserved for victims of drunk drivers	650,642	989,656
TOTAL FUND BALANCES	64,550,089	54,229,457
TOTAL LIABILITIES AND FUND BALANCES	$ 69,724,382	$ 60,656,560

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, 1999 and June 30, 1998

	For the Year Ended June 30, 1999	For the Year Ended June 30, 1998
REVENUES		
State		
Taxes	$ 8,089,079	$ 7,712,237
Fines	2,344,259	2,302,448
Federal	1,855,000	1,605,000
Interest income	3,204,462	3,007,089
TOTAL REVENUES	15,492,800	14,626,774
EXPENDITURES		
Claim payments	5,072,168	5,640,148
Victim's coalition grant	100,000	100,000
Administrative cost - Public Awareness Program	0	101,025
TOTAL EXPENDITURES	5,172,168	5,841,173
Excess of revenues over expenditures	10,320,632	8,785,601
FUND BALANCES, BEGINNING OF YEAR	54,229,457	45,443,856
FUND BALANCES, END OF YEAR	$ 64,550,089	$ 54,229,457

See accompanying Notes to the Financial Statements

Criminal Injuries Compensation Fund
Notes to the Financial Statements
June 30, 1999 and June 30, 1998

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

3. **Cash**
Cash deposited in the Criminal Injuries Compensation Fund is pooled with the State Pooled Investment Fund, administered by the State Treasurer, which is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated, Section 9-4-602(b)*. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The Pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1999, and June 30, 1998.

B. OTHER ACCOUNTING DISCLOSURES

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

CRIMINAL INJURIES COMPENSATION FUND
REQUIRED SUPPLEMENTARY INFORMATION
JUNE 30, 1999 AND JUNE 30, 1998

UNAUDITED

YEAR 2000 ISSUE

The State Treasurer is currently addressing the "Year 2000" (Y2K) issue relating to computer systems and other electronic equipment. The Y2K issue refers to the fact that many computer software programs use only the last two digits of a data field to refer to "year" on the assumption that the first two digits are "19". These programs would interpret the Year 2000 as the Year 1900, the Year 2001 as 1901, etc. The issue therefore extends to computer hardware, electronics and other equipment dependent on microchip technology. In addition, some computer programs may not recognize that the Year 2000 is a leap year, resulting in incorrect date calculations. Without reprogramming, such software and equipment could impact the ability to input data into computer programs and the ability of such programs to correctly process data. Y2K affects the computer systems utilized directly by the CIC program as well as the other systems upon which the CIC program depends to fulfill its mission. The State Treasurer's Y2K initiatives relating to the CIC program did not result in the commitment of significant resources as of June 30, 1999 and June 30, 1998.

The State Treasurer has assessed the impact of Y2K on the CIC program computer systems and has determined that certain computer systems are mission-critical, certain are critical, and certain are supportive. Mission-critical computer systems are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the CIC program from fulfilling its mission. Critical computer systems are those for which there are manual alternatives, but the State Treasurer would be unlikely to be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer systems are those for which there are manual alternatives that could be performed if necessary.

The CIC program relies principally upon one major computer system, the Criminal Injury System (CIS) for managing claims filed by victims of a crime or dependents of deceased victims. Other systems critical to the CIC program operations include the Statewide Accounting and Reporting System (STARS) utilized to make payments on approved claims, to reconcile the subsidiary ledger and to produce financial statements.

The State Treasurer has identified the above mentioned computer systems that are mission-critical and is subjecting those systems to the following stages of work to address Year 2000 issues.

Awareness stage - Establishing a budget and project plan for dealing with the year 2000 issue.
Assessment stage - Identifying the systems and components for which the year 2000 compliant work is needed.
Remediation stage - Making changes to systems and equipment.
Validation/testing stage - Validating and testing the changes that were made during the remediation stage.

As of June 30, 1999, the awareness, assessment, and remediation stages had been completed for all mission-critical systems and electronic equipment. The validation/testing stage has been completed for all mission-critical systems and is in process for electronic equipment. While the completion of such stages provides an indication of progress made in addressing the Y2K issue, it is not a guarantee that the systems and equipment will be Year 2000 compliant.

The State Treasurer has solicited information from other organizations whose Y2K compliance could affect the CIC program regarding the status of their assessment, remediation, and validation/testing of their computer systems. Of the organizations that have responded, all expect to achieve compliance in a manner that will not have a materially negative effect on the CIC program operations. The State Treasurer does not have full and complete information from these organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the CIC program operations or financial status.

Because of the unprecedented nature of the Year 2000 issue, its effects and success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the CIC program is or will be Year 2000 ready, that the remediation efforts will be successful in whole or in part, or that parties with whom the CIC program does business will be Year 2000 ready.

Baccalaureate Education System Trust
Independent Auditor's Report

STATE OF TENNESSEE

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

December 10, 1999

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 Baccalaureate Education System Trust as of June 30, 1999, and June 30, 1998, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our report dated December 29, 1998, we qualified our opinion on the 1998 financial statements because insufficient audit evidence existed to support the Baccalaureate Education System Trust's disclosures required by the Governmental Accounting Standards Board (GASB) Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*. The Baccalaureate Education System Trust's year 2000 disclosures are now reported as required supplementary information as permitted by GASB Technical Bulletin 99-1, *Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1*. Accordingly, our present opinion on the 1998 financial statements, as expressed herein, is different from our prior report on the 1998 financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Baccalaureate Education System Trust as of June 30, 1999, and June 30, 1998, and the changes in fund balances for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 1999, on our consideration of the Baccalaureate Education System Trust's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr.

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

Baccalaureate Education System Trust
Comparative Balance Sheets
June 30, 1999 and June 30, 1998

	June 30, 1999		June 30, 1998	
ASSETS				
Cash	$	78,016	$	408,961
Contributions receivable		8,716		3,121
Investment income receivable		175,016		66,644
Investments, at fair value				
Short-term investments		542,870		705,720
Long-term investments				
Government bonds		7,851,533		4,287,537
Corporate bonds		2,464,201		487,533
Investment in equity mutual fund		4,058,015		1,120,374
TOTAL ASSETS	$	15,178,367	$	7,079,890
LIABILITIES AND FUND BALANCES				
LIABILITIES				
Advance from State General Fund	$	0	$	940,000
FUND BALANCES				
Fund balances reserved for plan participants		14,514,560		5,987,551
Fund balances, unreserved		663,807		152,339
TOTAL FUND BALANCES		15,178,367		6,139,890
TOTAL LIABILITIES AND FUND BALANCES	$	15,178,367	$	7,079,890

See accompanying Notes to the Financial Statements

Baccalaureate Education System Trust
Comparative Statements of Revenues, Expenditures and Changes in Fund Balances
For the Years Ended June 30, 1999 and June 30, 1998

	For the Year Ended June 30, 1999	For the Year Ended June 30, 1998
REVENUES		
Contributions	$ 7,409,891	$ 5,856,165
Investment income		
Net increase in fair value of investments	351,615	155,580
Interest and dividend income	608,703	228,651
Administrative fees	693,062	705,058
TOTAL REVENUES	9,063,271	6,945,454
EXPENDITURES		
Refunds	2,359	4,325
Administrative cost	962,435	483,777
TOTAL EXPENDITURES	964,794	488,102
EXCESS OF REVENUES OVER EXPENDITURES	8,098,477	6,457,352
OTHER FINANCING SOURCES		
Operating transfer from State General Fund	940,000	0
Excess of revenues and other financing sources over expenditures	9,038,477	6,457,352
FUND BALANCES, BEGINNING OF YEAR	6,139,890	(317,462)
FUND BALANCES, END OF YEAR	$ 15,178,367	$ 6,139,890

See accompanying Notes to the Financial Statements

Baccalaureate Education System Trust
Notes to the Financial Statements
June 30, 1999 and June 30, 1998

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

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

2. Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements have been prepared using the flow of current financial economic 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 at the time the fund liabilities are incurred.

3. Cash

The classification of Cash and Cash Equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash. In addition, short-term securities in portfolios where the primary purpose is to facilitate the placement of funds in long-term investments are classified as investments. Cash received by the BEST that cannot be invested immediately in securities is invested in the State Pooled Investment Fund administered by the State Treasurer. 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned to brokers for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The Pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1999 and June 30, 1998.

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. Short-term investments are reported at cost plus accrued interest which approximates fair value. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments and interest and dividend income. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.

5. Fund Balance, Reserved for Plan Participants

The amount of Fund Balance Reserved for Plan Participants is based on the number of outstanding tuition units and the weighted average tuition unit price in effect at year-end.

B. INVESTMENTS

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

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

(continued)

BACCALAUREATE EDUCATION SYSTEM TRUST
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1999 AND JUNE 30, 1998 (CONTINUED)

The BEST investments included SEC-registered open-end mutual funds of $4,058,015 as of June 30, 1999 and $1,120,374 as of June 30, 1998.

The BEST investment securities are categorized below according to the level of custodial credit risk associated with the custodial arrangements at year-end. Category 1 consists of investments that are insured or registered, or for which securities are held by the BEST or its agent in the name of the BEST. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the name of the BEST. Category 3 consists of uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent, but not in the name of the BEST. The open-end mutual fund is not categorized as the investment is not evidenced by securities that exist in physical or book entry form.

	June 30, 1999 Fair Value	June 30, 1998 Fair Value
INVESTMENTS - CATEGORY 1		
Short-term investments		
Commercial paper	$ 397,680	$ 705,720
Government bonds	145,190	0
Long-term investments		
Government bonds	7,851,533	4,287,537
Corporate bonds	2,464,201	487,533
TOTAL INVESTMENTS - CATEGORY 1	10,858,604	5,480,790
INVESTMENTS - CATEGORY 2	0	0
INVESTMENTS - CATEGORY 3	0	0
INVESTMENTS - NOT CATEGORIZED		
Investment in open-end mutual fund	4,058,015	1,120,374
TOTAL INVESTMENTS	$ 14,916,619	$ 6,601,164

C. DESCRIPTION OF THE BEST

The Tennessee Baccalaureate Education System Trust, administered by the State Treasurer, is created under *Tennessee Code Annotated, Title 49, Chapter 7, Part 8* for the purpose of improving higher education in the State of Tennessee by assisting students or their families to pay in advance, a portion of the tuition costs of attending colleges and universities. Under the program, a purchaser may enter into a contract with BEST to purchase tuition units on behalf of a beneficiary. Each tuition unit purchased entitles the beneficiary to an amount 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 price of the tuition unit is determined annually by the BEST Board of Trustees. Refunds and tuition payments are guaranteed only to the extent that BEST 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.

D. OTHER ACCOUNTING DISCLOSURES

Advance from State General Fund

The advance from the State General Fund to the BEST was authorized by Chapter 1083 of the *Public Acts of the 99th General Assembly* for the purpose of covering implementation and other costs for the BEST program from the administrative revolving account maintained by the State Treasurer. The BEST's obligation to repay the advance was forgiven by provision of the *Public Acts of 1999* (Chapter 539, Section 41, Item 25) and recorded as an operating transfer to the BEST. The advance was reported as "Advance from State Contingent Revenue Fund" on the Comparative Balance Sheets as of June 30, 1998 and June 30, 1997, but should have been reported as "Advance from State General Fund."

BACCALAUREATE EDUCATION SYSTEM TRUST
REQUIRED SUPPLEMENTARY INFORMATION
JUNE 30, 1999 AND JUNE 30, 1998

UNAUDITED

YEAR 2000 ISSUE

The State Treasurer is currently addressing the "Year 2000" (Y2K) issue relating to computer systems and other electronic equipment. The Y2K issue refers to the fact that many computer software programs use only the last two digits of a data field to refer to "year" on the assumption that the first two digits are "19". These programs would interpret the Year 2000 as the Year 1900, the Year 2001 as 1901, etc. The issue therefore extends to computer hardware, electronics and other equipment dependent on microchip technology. In addition, some computer programs may not recognize that the Year 2000 is a leap year, resulting in incorrect date calculations. Without reprogramming, such software and equipment could impact the ability to input data into computer programs and the ability of such programs to correctly process data. Y2K affects the computer systems utilized directly by the BEST as well as the other systems upon which the BEST depends to fulfill its mission. The State Treasurer's Y2K initiatives relating to the BEST did not result in the commitment of significant resources as of June 30, 1999 and June 30, 1998.

The State Treasurer has assessed the impact of Y2K on the BEST computer systems and has determined that certain computer systems are mission-critical, certain are critical, and certain are supportive. Mission-critical computer systems are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the BEST from fulfilling its mission. Critical computer systems are those for which there are manual alternatives, but the State Treasurer would be unlikely to be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer systems are those for which there are manual alternatives that could be performed if necessary.

The BEST relies principally upon one major computer system (the BEST system) for maintenance of data and participant accounting. Other systems critical to the BEST operations include the State Treasurer's general ledger accounting system, utilized to reconcile the subsidiary ledgers and to produce financial statements, the document inventory system, utilized to maintain a record of incoming and outgoing documents and correspondence and the investment system, which maintains a perpetual inventory of all the securities owned by BEST, maintains a record of all acquisitions, dispositions and maturities of securities in the BEST portfolio, and initiates settlement with the BEST investment custodian.

The State Treasurer has identified the above mentioned computer systems that are mission-critical and has subjected those systems to the following stages of work to address Year 2000 issues.

Awareness stage - Establishing a budget and project plan for dealing with the year 2000 issue.
Assessment stage - Identifying the systems and components for which the year 2000 compliant work is needed.
Remediation stage - Making changes to systems and equipment.
Validation/testing stage - Validating and testing the changes that were made during the remediation stage.

As of June 30, 1999, the awareness, assessment and remediation stages had been completed for all mission-critical systems and electronic equipment. The validation/testing stage had been completed for all mission-critical systems and was in progress for electronic equipment. While the completion of such stages is an indication of progress made in addressing the Y2K issue, it is not a guarantee that the systems and equipment will be Year 2000 compliant.

The State Treasurer has solicited information from other organizations whose Y2K compliance could affect the BEST regarding the status of their assessment, remediation, and validation/testing of their computer systems. Of the organizations that have responded to date, all expect to achieve compliance in a manner that will not have a materially negative effect on the BEST operations. The State Treasurer does not have full and complete information from these organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the BEST operations or financial status.

Because of the unprecedented nature of the Year 2000 issue, its effects and success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the BEST is or will be Year 2000 ready, that the remediation efforts will be successful in whole or in part, or that parties with whom the BEST does business will be Year 2000 ready.

Chairs of Excellence
Independent Auditor's Report

STATE OF TENNESSEE

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

December 10, 1999

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 as of June 30, 1999, and June 30, 1998, and the related statements of revenues, expenses, and changes in fund balances and cash flows for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our report dated December 29, 1998, we qualified our opinion on the 1998 financial statements because insufficient audit evidence existed to support the Chairs of Excellence's disclosures required by the Governmental Accounting Standards Board (GASB) Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*. The Chairs of Excellence's year 2000 disclosures are now reported as required supplementary information as permitted by GASB Technical Bulletin 99-1, *Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1*. Accordingly, our present opinion on the 1998 financial statements, as expressed herein, is different from our prior report on the 1998 financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Chairs of Excellence as of June 30, 1999, and June 30, 1998, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 1999, on our consideration of the Chairs of Excellence's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr.

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

Chairs of Excellence
Comparative Balance Sheets
June 30, 1999 and June 30, 1998

	June 30, 1999	June 30, 1998
ASSETS		
Cash	$ 0	$ 35,227
Investments, at fair value		
Short-term investments	12,176,332	15,549,349
Long-term investments		
Domestic securities		
Government bonds	66,243,892	68,176,079
Corporate bonds	27,078,058	15,385,900
Corporate stocks	115,653,946	103,821,869
International securities		
Corporate bonds	5,418,895	5,617,335
Corporate stocks	4,496,215	2,315,187
Total investments	231,067,338	210,865,719
Receivables		
Due from College and University Fund	460,000	410,000
Investment income receivable	1,547,313	1,573,740
Investments sold	519,946	0
Total receivables	2,527,259	1,983,740
TOTAL ASSETS	$ 233,594,597	$ 212,884,686
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Due to College and University Fund	$ 2,638,557	$ 1,783,159
Due to the Academic Scholars Fund	3,621,389	3,673,891
Due to State General Fund	58,765	0
Investments purchased	860,925	0
TOTAL LIABILITIES	7,179,636	5,457,050
FUND BALANCES		
Endowment reserve	219,007,482	200,558,716
Special reserve	7,407,479	6,868,920
TOTAL FUND BALANCES	226,414,961	207,427,636
TOTAL LIABILITIES AND FUND BALANCES	$ 233,594,597	$ 212,884,686

See accompanying Notes to the Financial Statements

Chairs of Excellence
Comparative Statements of Revenues, Expenses and Changes in Fund Balances
For the Years Ended June 30, 1999 and June 30, 1998

	For the Year Ended June 30, 1999	For the Year Ended June 30, 1998
OPERATING REVENUES		
Investment income	$ 26,856,551	$ 33,649,111
Contributions from private sources	304,250	732,000
TOTAL OPERATING REVENUES	27,160,801	34,381,111
OPERATING EXPENSES		
Payments to the University of Tennessee	3,595,830	3,418,265
Payments to the Tennessee Board of Regents	4,103,766	2,911,168
Interest payments to the Academic Scholars Fund	300,246	298,230
Administrative cost	173,634	157,373
TOTAL OPERATING EXPENSES	8,173,476	6,785,036
NET INCOME	18,987,325	27,596,075
FUND BALANCES, BEGINNING OF YEAR	207,427,636	153,601,997
Add: Cumulative effect of change in accounting principle (Note A.4)	0	26,229,564
RESTATED FUND BALANCES, BEGINNING OF YEAR	207,427,636	179,831,561
FUND BALANCES, END OF YEAR	$ 226,414,961	$ 207,427,636

See accompanying Notes to the Financial Statements

Chairs of Excellence
Comparative Statements of Cash Flows
For the Years Ended June 30, 1999 and June 30, 1998

	For the Year Ended June 30, 1999	For the Year Ended June 30, 1998
CASH FLOWS FROM OPERATING ACTIVITIES		
NET INCOME	$ 18,987,325	$ 27,596,075
ADJUSTMENTS TO RECONCILE NET INCOME TO NET CASH USED BY OPERATING ACTIVITIES		
Investment income	(26,856,551)	(33,649,111)
Interest paid to the Academic Scholars Fund	300,246	298,230
Changes in assets and liabilities		
Increase in due from College and University Fund	(50,000)	(44,000)
Increase (decrease) in due to College and University Fund	855,398	(15,797)
Decrease in due to Academic Scholars Fund	(52,502)	(46,970)
Increase (decrease) in due to State General Fund	58,765	(35,519)
NET CASH USED BY OPERATING ACTIVITIES	(6,757,319)	(5,897,092)
CASH FLOWS FROM INVESTING ACTIVITIES		
Investment income received	8,739,153	8,313,828
Proceeds from sales and maturities of investments	142,729,741	246,084,070
Purchase of investments	(144,446,556)	(248,167,349)
Interest paid to the Academic Scholars Fund	(300,246)	(298,230)
NET CASH PROVIDED BY INVESTING ACTIVITIES	6,722,092	5,932,319
NET INCREASE(DECREASE) IN CASH	(35,227)	35,227
CASH, BEGINNING OF YEAR	35,227	0
CASH, END OF YEAR	$ 0	$ 35,227

NONCASH INVESTING, CAPITAL AND FINANCING ACTIVITIES

The Chairs of Excellence Trust had $860,925 of unsettled investment purchases and $519,946 unsettled investment sales at June 30, 1999. There were no unsettled investment purchases or sales at June 30, 1998.

See accompanying Notes to the Financial Statements

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1999 AND JUNE 30, 1998

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

The Chairs of Excellence (COE) Trust forms an integral part of the primary government and has been included as a nonexpendable trust fund in the *Tennessee Comprehensive Annual Financial Report*.

2. Measurement Focus and Basis of Accounting

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

3. Cash

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

Cash received by the COE Trust that cannot be immediately invested in securities is invested in the State Pooled Investment Fund administered by the State Treasurer. 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, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated, Section 9-4-602(b)*. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned to brokers for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1999, and June 30, 1998. The classification of Cash also includes cash held in a custody account under a contractual arrangement for master custody services. Cash balances with the custodial agent are not classified into the credit risk categories established by Statement Number 3 of the Governmental Accounting Standards Board as the custody account relationship does not meet the definition for either a deposit with a financial institution or a security.

4. Changes in Accounting Principles

Effective July 1, 1997, the COE Trust adopted Statement Number 31 of the Governmental Accounting Standards Board (GASB), *Accounting and Financial Reporting for Certain Investments and for External Investment Pools*. The provisions of this statement require that the investments of the COE Trust be reported at fair value on the balance sheet. The cumulative effect of the change in accounting principle as of July 1, 1997 resulted in increases to both Investments and Fund Balance of $26,229,564.

5. 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. Short-term investments are reported at cost plus accrued interest, which approximates fair value. 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.

6. Fund Balance

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

Chairs of Excellence
Notes to the Financial Statements
June 30, 1999 and June 30, 1998 (continued)

B. INVESTMENTS

The investment policy of the COE Trust requires that public funds, capital gains on public funds, and all current income exceeding withdrawals be invested in fixed income securities. Private contributions may be invested in equity securities, including domestic and foreign common stocks, preferred stocks and convertible bonds. Subsequent to the initial funding of a chair, funds may be transferred from equity corpus to the fixed income corpus but not from the fixed income corpus to the equity corpus.

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

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

	June 30, 1999 Fair Value	June 30, 1998 Fair Value
INVESTMENTS - CATEGORY 1		
Short-term Investments		
Commercial Paper	$ 8,919,783	$ 15,549,349
Government Bonds	3,256,549	0
Long-term Investments		
Domestic Securities		
Government Bonds	66,243,892	68,176,079
Corporate Bonds	27,078,058	15,385,900
Corporate Stocks	114,779,446	103,821,869
International Securities		
Corporate Bonds	5,418,895	5,617,335
Corporate Stocks	4,496,215	2,315,187
TOTAL INVESTMENTS - CATEGORY 1	230,192,838	210,865,719
INVESTMENTS - CATEGORY 2	0	0
INVESTMENTS - CATEGORY 3	0	0
INVESTMENTS - NOT CATEGORIZED		
Unsettled Investment Acquisitions		
Domestic Securities		
Corporate Stocks	874,500	0
TOTAL INVESTMENTS	$ 231,067,338	$ 210,865,719

(continued)

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

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

During the years ended June 30, 1999 and June 30, 1998, the COE Trust had no securities on loan.

C. OTHER ACCOUNTING DISCLOSURES

1. Chairs of Excellence Endowment Trust

The COE Trust is a nonexpendable trust fund authorized by the 94th General Assembly to further the cause of education in Tennessee. The 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, 1999, 97 Chairs have been established with matching contributions received totaling $54,230,456. This is an increase of 1 Chair and $304,250 since June 30, 1998. Total contributions to the COE Trust totaled $98,230,456 as of June 30, 1999. This includes $44,000,000 from the State, $10,321,300 from Colleges and Universities, and $43,909,156 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.

CHAIRS OF EXCELLENCE
REQUIRED SUPPLEMENTARY INFORMATION
JUNE 30, 1999 AND JUNE 30, 1998

UNAUDITED

YEAR 2000 ISSUE

The State Treasurer is currently addressing the "Year 2000" (Y2K) issue relating to computer systems and other electronic equipment. The Y2K issue refers to the fact that many computer software programs use only the last two digits of a data field to refer to "year" on the assumption that the first two digits are "19". These programs would interpret the Year 2000 as the Year 1900, the Year 2001 as 1901, etc. The issue therefore extends to computer hardware, electronics and other equipment dependent on microchip technology. In addition, some computer programs may not recognize that the Year 2000 is a leap year, resulting in incorrect date calculations. Without reprogramming, such software and equipment could impact the ability to input data into computer programs and the ability of such programs to correctly process data. Y2K affects the computer systems utilized directly by the COE Trust as well as the other systems upon which the COE Trust depends to fulfill its mission. The State Treasurer's Y2K initiatives relating to the COE Trust did not result in the commitment of significant resources as of June 30, 1999 and June 30, 1998.

The State Treasurer has assessed the impact of Y2K on COE Trust computer systems and has determined that certain computer systems are mission-critical, certain are critical, and certain are supportive. Mission-critical computer systems are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the COE Trust from fulfilling its mission. Critical computer systems are those for which there are manual alternatives, but the State Treasurer would be unlikely to be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer systems are those for which there are manual alternatives that could be performed if necessary.

The COE Trust relies principally upon one major computer system , the Treasury Earnings and Account Management System (TEAMS) for participant level accounting. Other systems critical to the COE Trust operations include the State Treasurer's general ledger accounting system, utilized to reconcile the subsidiary ledgers and to produce financial statements, and the investment system which maintains a perpetual inventory of all the securities owned by the COE Trust, maintains a record of all acquisitions, dispositions and maturities of securities in the COE Trust portfolio, and initiates settlement with the COE Trust investment custodian.

The State Treasurer has identified the above mentioned computer systems that are mission-critical and is subjecting those systems to the following stages of work to address Year 2000 issues.

Awareness stage - Establishing a budget and project plan for dealing with the year 2000 issue.
Assessment stage - Identifying the systems and components for which the year 2000 compliant work is needed.
Remediation stage - Making changes to systems and equipment.
Validation/testing stage - Validating and testing the changes that were made during the remediation stage.

As of June 30, 1999, the awareness, assessment and remediation stages had been completed for all mission-critical systems and electronic equipment. The validation/testing stage had been completed for all mission critical systems and was in process for electronic equipment. While the completion of such stages is an indication of progress made in addressing the Y2K issue, it is not a guarantee that the systems and equipment will be Year 2000 compliant.

The State Treasurer has solicited information from other organizations whose Y2K compliance could affect the COE Trust regarding the status of their assessment, remediation, and validation/testing of their computer systems. Of the organizations that have responded to date, all expect to achieve compliance in a manner that will not have a materially negative effect on the COE Trust operations. The State Treasurer does not have full and complete information from these organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the COE Trust operations or financial status.

Because of the unprecedented nature of the Year 2000 issue, its effects and success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the COE Trust is or will be Year 2000 ready, that the remediation efforts will be successful in whole or in part, or that parties with whom the COE Trust does business will be Year 2000 ready.

BOND REFUNDING TRUST
INDEPENDENT AUDITOR'S REPORT

STATE OF TENNESSEE

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

December 10, 1999

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 Bond Refunding Trust as of June 30, 1999, and June 30, 1998, and the related statement of changes in assets and liabilities for the year ended June 30, 1999. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our report dated December 29, 1998, we qualified our opinion on the 1998 financial statements because insufficient audit evidence existed to support the Bond Refunding Trust's disclosures required by the Governmental Accounting Standards Board (GASB) Technical Bulletin 98-1, *Disclosures about Year 2000 Issues*. The Bond Refunding Trust's year 2000 disclosures are now reported as required supplementary information as permitted by GASB Technical Bulletin 99-1, *Disclosures about Year 2000 Issues—an amendment of Technical Bulletin 98-1*. Accordingly, our present opinion on the 1998 financial statements, as expressed herein, is different from our prior report on the 1998 financial statements.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Bond Refunding Trust as of June 30, 1999, and June 30, 1998, and the changes in assets and liabilities for the year ended June 30, 1999, in conformity with generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 10, 1999, on our consideration of the Bond Refunding Trust's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts.

Sincerely,

Arthur A. Hayes Jr.

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

BOND REFUNDING TRUST
COMPARATIVE BALANCE SHEETS
JUNE 30, 1999 AND JUNE 30, 1998

	June 30, 1999	June 30, 1998
ASSETS		
Cash	$ 430	$ 1,068
Investments, (see Note C)	72,249,005	99,022,489
Accrued interest receivable	331,660	365,966
TOTAL ASSETS	$ 72,581,095	$ 99,389,523
LIABILITIES		
Amounts held in custody for others	$ 72,581,095	$ 99,389,523

See accompanying Notes to the Financial Statements

BOND REFUNDING TRUST
STATEMENT OF CHANGES IN ASSETS AND LIABILITIES
FOR THE YEAR ENDED JUNE 30, 1999

	Balance July 1, 1998	Additions	Deductions	Balance June 30, 1999
ASSETS				
Cash	$ 1,068	$ 78,450,252	$ 78,450,890	$ 430
Investments	99,022,489	51,369,172	78,142,656	72,249,005
Accrued interest receivable	365,966	331,660	365,966	331,660
TOTAL ASSETS	$ 99,389,523	$ 130,151,084	$ 156,959,512	$ 72,581,095
LIABILITIES				
Amounts held in custody for others	$ 99,389,523	$ 0	$ 26,808,428	$ 72,581,095

See accompanying Notes to the Financial Statements

BOND REFUNDING TRUST
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 1999 AND JUNE 30, 1998

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. Reporting Entity

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

2. Measurement Focus and Basis of Accounting

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

3. Method Used to Value Investments

U.S. Government Securities are valued at the last reported market price and State and Local Government Series Securities are reported at cost.

B. CASH

Cash held by the trustee is pooled with the State Pooled Investment Fund administered by the State Treasurer which is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee (Funding Board). The current resolution of the Funding Board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated, Section 9-4-602(b)*. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Pooled Investment Fund's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 1999 and June 30, 1998.

C. INVESTMENTS

The investments held by the trustee at June 30, 1999 consisted of U.S. Government Securities at a fair value of \$53,162,625 and State and Local Government Series Securities reported at cost of \$19,086,380. As of June 30, 1998, investments consisted of U.S. Government Securities at a fair value of \$78,953,699 and State and Local Government Series securities reported at cost of \$20,068,790. The trust is restricted by the Tennessee Local Development Authority's and the Funding Board's Bond Resolutions to investing in direct general obligations of, or obligations the payment of the principal and interest of which are unconditionally guaranteed by, the United States of America, which are non-callable at the option of the issuer. All securities are held in accounts with the Federal Reserve Bank or the Bureau of Public Debt in the state's name.

D. OTHER ACCOUNTING DISCLOSURES

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

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

In November, 1997 the Tennessee Local Development Authority issued refunding bonds of \$37,385,000 to refund \$19,515,000 of the 1991 Series A State Loan Program Revenue bonds, dated June 25, 1991 maturing on and after March 1, 1998 and \$16,495,000 of the 1997 Series A State Loan Program Revenue Bond Anticipation Notes. The Note refunding matured and paid out in May 1998.

Bond Refunding Trust
Required Supplementary Information
June 30, 1999 and June 30, 1998

UNAUDITED

YEAR 2000 ISSUE

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The State Treasurer has assessed the impact of Y2K on the Bond Refunding Trust computer systems and has determined that certain computer systems are mission-critical, certain are critical, and certain are supportive. Mission-critical computer systems are those for which there are no reliable manual alternatives, and for which failure to be in Y2K compliance would prevent the Bond Refunding Trust from fulfilling its mission. Critical computer systems are those for which there are manual alternatives, but the State Treasurer would be unlikely to be able to fully or efficiently perform the functions manually, because of the volume of manual activity that would be required. Supportive computer systems are those for which there are manual alternatives that could be performed if necessary.

Systems critical to the Bond Refunding Trust operations include the State Treasurer's general ledger accounting system, utilized to reconcile the subsidiary ledgers and to produce financial statements, and the investment system, which maintains a perpetual inventory of all the securities owned by the Bond Refunding Trust and maintains a record of all acquisitions, dispositions and maturities of securities in the Bond Refunding Trust portfolio.

The State Treasurer has identified the above mentioned computer systems that are mission-critical and has subjected those systems to the following stages of work to address Year 2000 issues.

Awareness stage - Establishing a budget and project plan for dealing with the year 2000 issue.
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The State Treasurer has solicited information from other organizations whose Y2K compliance could affect the Bond Refunding Trust regarding the status of their assessment, remediation, and validation/testing of their computer systems. Of the organizations that have responded to date, all expect to achieve compliance in a manner that will not have a materially negative effect on the Bond Refunding Trust operations. The State Treasurer does not have full and complete information from these organizations regarding the status of implementing Y2K compliance. Any failure by some or all of these organizations to be in Y2K compliance may have a material negative impact on the Bond Refunding Trust operations or financial status.

Because of the unprecedented nature of the Year 2000 issue, its effects and success of related remediation efforts will not be fully determinable until the Year 2000 and thereafter. Management cannot assure that the Bond Refunding Trust is or will be Year 2000 ready, that the remediation efforts will be successful in whole or in part, or that parties with whom the Bond Refunding Trust does business will be Year 2000 ready.

On the cover:

Norris Dam State Park, located in East Tennessee, is famous not only for Norris Dam but also the 18th Century Rice Grist Mill that still grinds corn meal in the summer. The park also offers several seasonal programs including Hill Cave tours, the Spring Heritage Festival, annual wildflower hikes and many more exciting adventures.

Tennessee is well known for its state parks and natural areas. From the rolling Mississippi to the mountains of East Tennessee there are over 50 state parks with activities including hiking, biking, fishing, boating, camping and golf. Several parks offer resort inns.

For more information about Tennessee State Parks, visit them on the web at www.state.tn.us/environment/parks/ or call toll free 1-888-TN-PARKS.

Photos furnished by State of Tennessee Photographic Services.

Treasury Department
December 1999
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