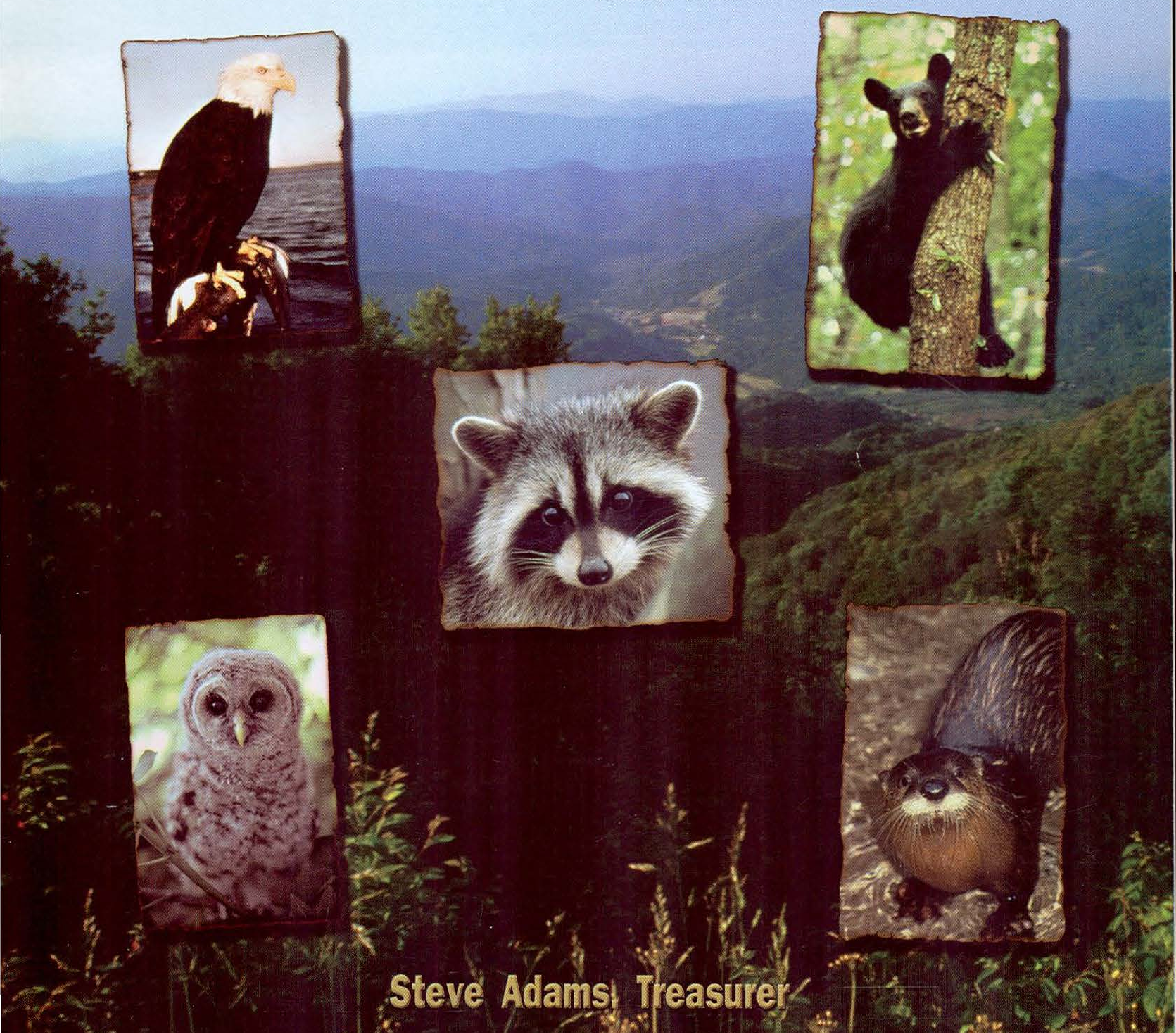
State of Tennessee 2002 Treasurer's Report



Steve Adams, Treasurer

2002 Treasurer's Report

Tennessee's state animal, the raccoon is most commonly found along wooded streams. Skilled swimmers and nighttime hunters, raccoons feed upon fish, frogs and various insects. Raccoons use their fingers to tear up their food before eating, often washing it first.

Steve Adams, Treasurer
State of Tennessee

Fiscal Year Ended June 30, 2002

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Letter of Transmittal

State of Tennessee
Treasury Department
State Capitol
Nashville, Tennessee 37243

December 31, 2002

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

Pursuant to the requirements of Section 4-4-114, *Tennessee Code Annotated*, I am pleased to transmit a report of the activity of the Treasury Department for the fiscal year ending June 30, 2002.

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

Sincerely,

Steve Adams

Executive Summary

Introduction

The 2002 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 2001-2002 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 2001-2002 averaged $4.37 billion, producing $118.6 million in income for an average rate of return of 2.67%. 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, 2002 totaled $23 billion at fair value. For the year, investment losses were $378.9 million, for a rate of return of (1.9)% on a fair value basis. This return compares favorably with the public fund index of (5.2)%. TCRS was ranked in the 9th percentile (1=best, 100=worst) in the Callan total plan sponsor database. In two separate studies by the Pennsylvania State Employees Retirement System and the Pension Fund Data Exchange, TCRS had the best performance of the largest public pension systems in the country for the year ended June 30, 2002. The Pension Fund Investment section also manages investments for the Chairs of Excellence Trust which at June 30, 2002 totaled $199.4 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, 2002, there were 197,971 active TCRS members: 43,628 state employees; 66,076 K-12 teachers; 70,348 political subdivision employees; and 17,919 higher education employees. As of June 30, 2002, there were 80,426 retirees. TCRS paid $818.1 million in benefits during fiscal year 2001-2002. 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.

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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 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, 2002, a total of 57,617 state and higher education employees had accounts in the program. The market value of accumulated account balances totaled $561.8 million.

Flexible Benefits Plan

The State of Tennessee Flexible Benefits Plan is an optional benefit plan which enables state employees to pay for certain expenses with before-tax dollars. At June 30, 2002, 39,690 state employees were using the plan: 39,083 paid group medical premiums, 17,013 paid group dental premiums, 2,925 used the medical expense reimbursement account and 367 used the dependent care reimbursement account. The plan generated over $3.3 million in F.I.C.A. savings for the state during the 2001-2002 fiscal year. Employees realized similar savings. The state's F.I.C.A. savings are used to fund the state wellness program and to help fund part of the 401(k) match for state employees.

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 6,074 claims for tort, employee property damage and workers' compensation. Payments made during the year for workers' compensation, tort, and employee property damage claims totaled $28.1 million. During the year, 1,822 victims of criminal injury and drunk driver claims were approved for payment. Payments made to victims of criminal injuries and drunk drivers totaled $10.9 million. Since the first payments were issued in 1982, more than $123.5 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, 2002, the commission had 648 open claims (including claims transferred to administrative law judges). This represented a 22% reduction from cases open at June 30, 2001.

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, 2001, the total scheduled values were $9.5 billion. The State Reserve for Casualty Losses provides

Executive Summary

an annual aggregate retention for the payment of property claims. Excess property coverage is procured from independent insurance carriers to provide claim payments in excess of the retention in any given fiscal year. In fiscal year 2001-2002, the premium cost for total property coverage without the retention was estimated to be $22.7 million. The actual cost of the program for 2001-2002 was $2.2 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 include cash property such as bank accounts, insurance policies, utility deposits and securities. During this fiscal year, $34.8 million of unclaimed property was turned over to the Treasurer and $9.7 million was returned to owners or their heirs, local governments and other states. Since the program's inception in 1979, more than $243.9 million in unclaimed property has been reported to the Treasurer and more than $71.8 million (29%) of that property has been returned to claimants.

Chairs of Excellence

The Chairs of Excellence Trust is a permanent trust fund authorized in 1984 to further the cause of higher education in Tennessee. The funding of the program is provided through contributions made by a private donor and a matching amount by the state, thus, creating a chair. Income from the chair is used to offset the cost of retaining a nationally or regionally recognized scholar at a state college or university who teaches in a specified academic area. No new chairs were created and no contributions were received during the 2002 fiscal year. Since 1984, a total of 99 chairs have been created. The Trust totaled $207.3 million fair value at June 30, 2002 and losses were $9.9 million for the year.

Baccalaureate Education System Trust (BEST)

The Baccalaureate Education System Trust, or BEST, is a program that allows anyone to pay for higher education costs in advance on behalf of a beneficiary. BEST provides two tax-favored savings vehicles: The Prepaid College Tuition Plan and the Savings Plan. The Prepaid College Tuition Plan (Educational Services Plan), introduced in 1997, is based on the average tuition inflation at Tennessee public universities. Through the purchase of affordable tuition units, Tennesseans can pay for future tuition at today's price and ease their concerns about whether they will have enough funds to pay for their children's higher education. The Savings Plan, which began accepting contributions in March 2000, offers two contribution choices: the Managed Allocation Option and the 100% Equity Option. At June 30, 2002, the Prepaid College Tuition Plan held 7,450 contracts and the Savings Plan held 1,371 contracts. At year-end, the Prepaid Tuition Plan and the Savings Plan had total assets of $39.1 million.

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 144 students since it began in January 1996. Since the program's inception, 28% of participants have accepted job offers from the state.

Treasury Numbers at a Glance
Fiscal Year 2001-2002

Administrative	Number of Filled Positions		185
	Payroll Expenditures	$	9,365,541
	Other Expenditures	$	3,943,466
	Total Administrative Expenditures	$	13,309,007
Cash Management Program	General Fund Earnings	$	33,839,816
	LGIP Earnings	$	59,677,453
	Restricted Fund Earnings	$	25,109,719
	Total Cash Management Earnings	$	118,626,988
Retirement Program	Retirement Benefits	$	818,091,137
	Number of Retirees		80,426
	Number of Active Members		197,971
	Retirement Contributions	$	536,137,611
	Retirement Net Investment Loss	$	378,856,317
Claims Administration Program	Workers' Compensation Payments	$	19,253,021
	Workers' Compensation Claims Filed		4,161
	Employee Property Damage Payments	$	42,386
	Employee Property Damage Claims Filed		195
	Tort Payments	$	8,821,104
	Tort Claims Filed		1,718
	Criminal Injury Payments	$	10,903,058
	Criminal Injury Number of Claims Paid		1,822
Risk Management Program	Property Values Insured	$	9,458,101,300
	Total Cost of Program	$	2,229,426
Chairs of Excellence Program	Chairs of Excellence Investment Loss	$	9,865,712
	Chairs of Excellence Expenditures	$	7,629,023
	Number of Chairs of Excellence		99
Other Programs	Deferred Compensation Contributions	$	66,485,655
	Deferred Compensation Participants		57,617
	Flexible Benefits Plan Payments	$	4,388,175
	Unclaimed Property Revenues	$	34,834,576
	Unclaimed Property Payments	$	9,728,782
	BEST Prepaid Accounts	$	7,450
	BEST Prepaid Contributions (net of fees)	$	8,789,681
Fair Value of Assets Under Management at June 30, 2002	Retirement Trust Fund	$	23,048,086,335
	Chairs of Excellence Trust Fund	$	207,287,364
	State Pooled Investment Fund Investments	$	3,972,429,939
	Deferred Compensation (outside managers)	$	561,795,729
	BEST Educational Services Plan	$	34,713,757
	BEST Educational Savings Plan (outside manager)	$	4,373,499
	Total Assets Under Management	$	27,828,686,623

Program Administration

Black bears, which once inhabited the entire state of Tennessee, are now located in the eastern portion of the state. Five sanctuaries were established in the Great Smoky Mountains National Park and the Cherokee National Forest to offer them refuge.

North American black bears are true hibernators: they go without food for up to seven months.

Cubs, like this one, generally arrive with one to three siblings. Cubs stay with their mother for nearly two years. In the wild, bears have a life span of up to 30 years.

Normally seen at dawn or dusk, white-tailed deer are among Tennessee's most popular animals. The deer population was estimated to be around 1,000 in 1900. It has now grown to approximately 800,000.

Females give birth once a year to one or two fawns, which are hidden in thickets. Bucks lose their calcium-rich antlers each autumn.

STATE CASH MANAGEMENT

The State of Tennessee receives revenues from many sources such as taxes, licenses, fees, and the federal government. As these monies are collected, they are deposited into one of the more than 60 financial institutions in Tennessee that have contracted with the state to serve as depositories. Under the state Constitution, the state may not spend more money on its programs than it has collected in revenues. Consequently, at any point in time the state has a sizable sum of money collected but not yet spent. These monies are invested by the Treasury Department until needed to pay for state expenses, payroll, or benefit program disbursements.

During the 2001-2002 fiscal year, the average balance of short term investments in the Treasurer's Cash Management program was $4,373,971,667 per month and interest income of $118,626,988 was earned. This includes deposits in the Local Government Investment Pool administered by the Treasury Department.

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

The current investment policy for the State Pooled Investment Fund was established to follow SEC Rule 2a-7-like guidelines for a money market fund. The maximum maturity of any security can not exceed 397 days and the weighted average maturity must be 90 days or less.

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

At June 30, 2002, investments had an average maturity of 76 days, and an average weighted yield of 2.02%. The total balance in the State Pooled Investment Fund at June 30, 2002, $3,972,429,939 fair value, was allocated as follows: U.S. Treasury government and agency securities, 37.77%; repurchase agreements, 3.00%; collateralized certificates of deposit, 42.35%; and commercial paper, 16.88%.

During November and December of 2000, the State Pooled Investment Fund purchased $51,706,000 par amount of PG&E commercial paper. At the time of purchase, the commercial paper had the highest rating by both Standard & Poor's and Moody's. Subsequently, the commercial paper was downgraded and eventually went into default. On April 6, 2001, PG&E filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code in San Francisco bankruptcy court. In April 2002, the fund sold all but $4 million of the commercial paper. The fund did not lose any money and realized an internal rate of return in excess of 5%. Two plans of reorganization have been filed, one by PG&E and the other by the California Public Utility Commission. Both plans provide for 100% repayment of principal with interest. Interest is being paid quarterly at the rate of 7.466%. This rate increases if the principal is not repaid by March 2003.

Given that the two reorganization plans provided for a 100% repayment of principal, it is believed there is limited risk for the remaining $4 million of PG&E commercial paper and expectations are that the principal will be redeemed during calendar year 2003. The ultimate resolution rests with the bankruptcy court.

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) col-

State Cash Management

lateralizing deposits; and (4) monitoring collateral and deposits. Financial institutions' requests to become authorized state depositories are received in Cash Management, reviewed, and forwarded to the appropriate state officials for consideration and approval.

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

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

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

STATE COLLATERAL PROGRAM

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

The state of the economy and the financial environment 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.

COLLATERAL POOL

The operation of a collateral pool for banks is authorized by *Tennessee Code Annotated*, Section 9-4-501, et seq. The Collateral Pool operates under the jurisdiction of the Collateral Pool Board, which is comprised of four bankers and three government members representing state and local government divisions. The Collateral Pool Board has established rules and procedures that provide a low amount of risk and a high degree of efficiency for participating institutions.

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

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

The Board has established three different collateral pledge levels: 115 percent, 100 percent and 90 percent. The pledge level is based on financial criteria set

State Cash Management

by the Collateral Pool Board with the financially strongest institutions being eligible for the lowest pledge level. Under the Collateral Pool, should a financial institution default with insufficient collateral to cover public deposits, then the other financial institutions must make up the difference on a pro rata basis. Accordingly, public funds are not at risk in the Collateral Pool.

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

The Collateral Pool provides collateral for both state funds and local government funds for those institutions participating in the pool. The Collateral Pool serves as a significant administrative advantage for local governments. Under the Collateral Pool, the Treasurer, rather than the local government, is responsible for monitoring the pledge level; pricing collateral daily; reconciling collateral monthly with the trustee custodian; monitoring collateral; pledging, releasing and substituting collateral; and maintaining a trustee custodian relationship.
Currently, the Collateral Pool has 53 participant institutions collateralizing public funds in excess of $3.5 billion.

8-5-110 COLLATERAL

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

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

STATE CASH MANAGEMENT COMPARATIVE RETURNS

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

Fiscal Year	[1] Total Pool Funds	[2] Merrill Lynch Institutional Fund	[3] Standard & Poor's 7-Day LGIP Yield Index	[4] 90-Day Treasury (CD Equivalent Yield)
2001-02	2.67%	2.37%	2.33%	2.17%
2000-01	5.94	5.77	5.66	5.26
1999-00	5.66	5.53	5.41	5.37
1998-99	5.22	5.02	4.87	4.59
1997-98	5.64	5.44	5.38	5.17

[1] Investment return on total portfolio.

[2] This index most closely resembles the structures and objectives of the total cash portfolio.

[3] Index is for LGIP benchmark pools rated AAAm & AAm by S&P.

[4] This approximates the reinvestment period for new funds for the period.

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
2001-02	$ 1,273,620,750	$ 32,205,432	2.52%
2000-01	1,341,893,500	81,814,311	6.09%
1999-00	1,648,537,750	91,881,629	5.58%
1998-99	1,403,271,417	73,497,837	5.25%
1997-98	1,055,776,333	59,831,252	5.66%

Repurchase Agreements and Overnight Deposit Accounts

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2001-02	$ 94,677,417	$ 3,646,680	2.28%
2000-01	74,052,750	5,109,695	5.73%
1999-00	79,427,917	4,343,921	5.62%
1998-99	139,544,000	6,836,772	5.05%
1997-98	164,851,917	9,324,688	5.56%

Commercial Paper

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2001-02	$ 1,240,681,750	$ 30,544,415	2.46%
2000-01	1,331,471,250	79,108,382	6.00%
1999-00	1,144,931,750	66,980,997	5.81%
1998-99	1,113,779,417	58,565,097	5.26%
1997-98	890,313,583	50,659,421	5.69%

U.S. Government Securities

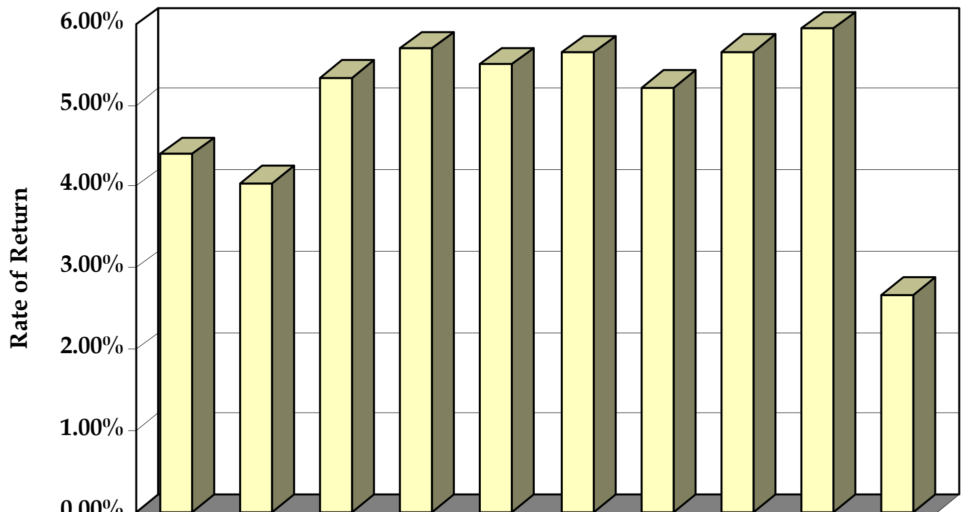
Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2001-02	$ 1,764,991,750	$ 52,230,461	2.92%
2000-01	1,394,438,333	78,460,393	5.62%
1999-00	647,764,750	38,291,206	5.58%
1998-99	680,657,333	34,017,497	5.14%
1997-98	652,920,833	36,098,337	5.52%

Total Funds

Fiscal Year	Average Total Funds Invested	Cash Management Investment Earnings	Composite Weighted Average Rate of Return
2001-02	$ 4,373,971,667	$ 118,626,988	2.67%
2000-01	4,141,855,833	244,492,781	5.94%
1999-00	3,520,662,167	201,497,753	5.66%
1998-99	3,337,252,167	172,917,203	5.22%
1997-98	2,763,862,666	155,913,698	5.64%

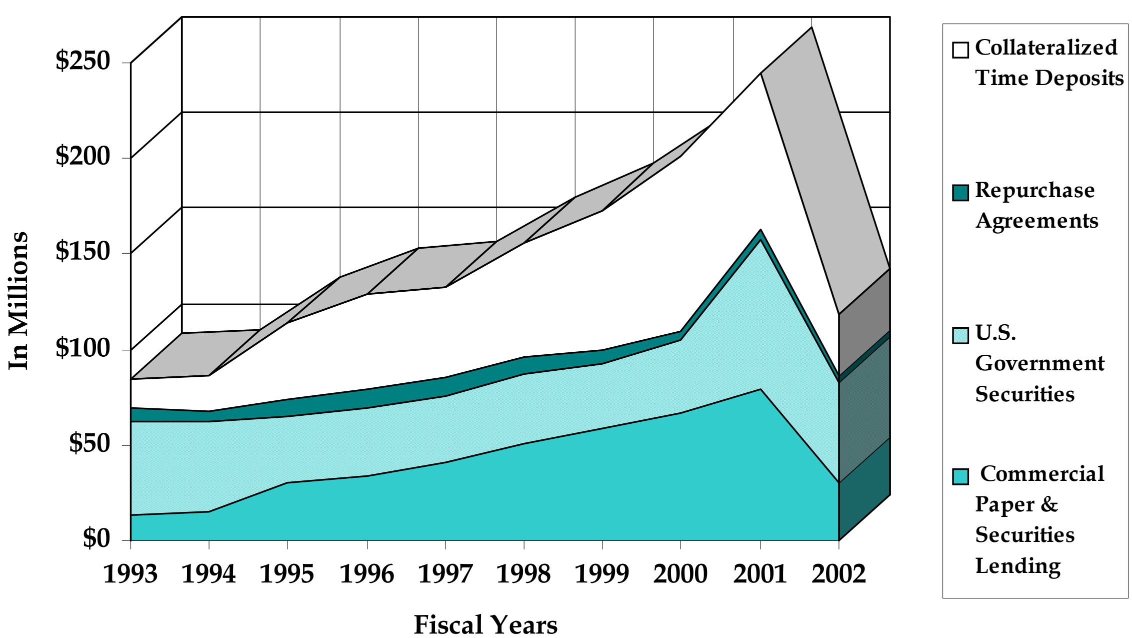
STATE CASH MANAGEMENT

CASH MANAGEMENT INVESTMENTS COMPOSITE WEIGHTED AVERAGE RATE OF RETURN
Fiscal Years 1993-2002



1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
4.39%	4.04%	5.34%	5.69%	5.50%	5.64%	5.22%	5.66%	5.94%	2.67%

ANALYSIS OF STATE CASH EARNINGS
Fiscal Years 1993-2002



State Cash Management

CASH MANAGEMENT PORTFOLIO ANALYSIS
Fiscal Year Ended June 30, 2002

Month	Total Portfolio Yield	Avg. Days to Maturity	Portfolio Composition: Certificates of Deposit	Repurchase Agreements	U.S. Treasury Notes	U.S. Agency	Commercial Paper
Jul-01	4.06%	88	25.59%	1.54%	7.60%	35.99%	29.28%
Aug-01	3.88%	75	27.15%	1.99%	7.84%	36.04%	26.98%
Sep-01	3.61%	72	25.64%	2.62%	13.72%	34.25%	23.78%
Oct-01	3.11%	67	20.80%	2.27%	9.85%	37.68%	29.40%
Nov-01	2.80%	65	21.73%	2.12%	7.10%	36.86%	32.18%
Dec-01	2.52%	73	24.65%	1.53%	4.52%	36.06%	33.23%
Jan-02	2.21%	84	28.47%	2.74%	0.00%	30.98%	37.80%
Feb-02	2.06%	87	33.87%	2.41%	0.00%	33.09%	30.63%
Mar-02	1.98%	78	33.85%	2.18%	0.00%	35.87%	28.10%
Apr-02	1.95%	76	33.02%	2.27%	0.00%	38.23%	26.48%
May-02	1.91%	72	33.92%	1.94%	1.43%	38.04%	24.67%
Jun-02	1.97%	77	39.68%	2.37%	0.00%	39.75%	18.20%
Average	2.67%	76	29.03%	2.16%	4.34%	36.07%	28.40%

Date	General Fund Average	General Fund Percent	LGIP Average	LGIP Percent	Other Restricted Average	Other Restricted Percent	Total Average Invested
Jul-01	$ 1,483,935,265	33.62%	$ 2,038,564,040	46.19%	$ 891,288,695	20.19%	$ 4,413,788,000
Aug-01	1,402,059,660	32.52%	1,989,037,794	46.13%	920,796,546	21.35%	4,311,894,000
Sep-01	1,177,490,290	27.93%	2,087,313,444	49.51%	951,166,266	22.56%	4,215,970,000
Oct-01	1,108,844,655	25.09%	2,341,489,135	52.99%	968,672,210	21.92%	4,419,006,000
Nov-01	823,007,757	19.58%	2,396,324,574	57.01%	984,142,669	23.41%	4,203,475,000
Dec-01	755,125,332	18.66%	2,399,457,994	59.30%	891,823,674	22.04%	4,046,407,000
Jan-02	772,961,809	17.91%	2,699,168,354	62.53%	844,550,837	19.56%	4,316,681,000
Feb-02	694,423,125	16.17%	2,738,880,818	63.79%	860,588,057	20.04%	4,293,892,000
Mar-02	484,959,127	10.50%	3,250,145,622	70.39%	882,020,251	19.11%	4,617,125,000
Apr-02	545,789,158	11.57%	3,220,355,418	68.27%	951,061,424	20.16%	4,717,206,000
May-02	782,037,808	16.56%	2,991,097,355	63.32%	950,481,837	20.12%	4,723,617,000
Jun-02	878,923,850	20.88%	2,353,979,463	55.94%	975,695,687	23.18%	4,208,599,000
Average	$ 909,129,820	20.78%	$ 2,542,151,168	58.12%	$ 922,690,679	21.10%	$ 4,373,971,667

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 1,296 accounts. The Department of Transportation (DOT) program has 256 active accounts.

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

During Fiscal Year 2002, an electronic banking system was implemented to allow participants to access their accounts in a secure Internet application. Thus, participants are able to communicate their instructions by telephone, telefax, or the Internet.

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

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

Participants earn interest on LGIP deposits based on the total portfolio return of the cash management pool, less a monthly administrative fee of five one hundredths of one percent (.05%). During the 2001-2002 fiscal year, the average rate participants earned on their deposits after the fee reduction was 2.37%. 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, 2002

	Account Balance 7/1/2001	Net Deposits/ (Withdrawals) FY 2001-2002	Interest Credited FY 2001-2002	Account Balance 6/30/02
Cities	$ 396,013,032	$ 69,152,947	$ 17,163,284	$ 482,329,263
Counties	864,849,794	(56,848,170)	20,579,583	828,581,207
Commitments to D.O.T.	50,936,325	6,851,352	1,328,011	59,115,688
Educational Institutions	428,208,748	(3,112,598)	12,181,555	437,277,705
Community Health Agencies	5,771,842	1,206,963	178,160	7,156,965
Other	281,208,412	(27,404,574)	8,246,860	262,050,698
Total	$ 2,026,988,153	$ (10,154,080)	$ 59,677,453	$ 2,076,511,526

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. AmSouth Bank of Tennessee 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 2001 - 2002

Transaction Type	Number	Amount
(1) Wire Disbursements	7,674	$ 11,612,441,247
(2) Wire Receipts	6,947	15,161,589,060
(3) Security Disbursements	877	29,929,166,770
(4) Security Receipts	779	30,499,697,841
(5) Check Redemptions	8,057,906	7,601,494,922
Total	8,074,183	$ 94,804,389,840

Explanation of Transaction Types:

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

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

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

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

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

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.

To assist in the fiduciary responsibility for managing the TCRS portfolio, Callan Associates serves as the general investment consultant for TCRS. The Townsend Group serves as the real estate investment consultant.

The Bank of New York is the Master Trust Bank for TCRS which provides safekeeping and accounting services for the investment portfolio.

COST OF INVESTMENT OPERATION

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

PERFORMANCE MEASUREMENT

An independent external investment consultant, Callan Associates, provides performance measurement for TCRS. Performance measurement is determined in conformance with the standards established by the Association for Investment Management and Research (AIMR). During the 2001-2002 fiscal year, TCRS had a total return of (1.9)% which compares favorably to the public fund index return of (5.2)%. TCRS was ranked in the 9th percentile (1=best, 100=worst) in the Callan total plan sponsor database. In two separate studies by the Pennsylvania State Employees Retirement System and the Pension Fund Data Exchange, TCRS had the best performance of the largest public pension systems in the country for the year ended June 30, 2002.

TCRS INVESTMENTS

INVESTMENT SUMMARY
as of June 30, 2002

	Domestic		International		Total	
	Fair Value	**%**	**Fair Value**	**%**	**Fair Value**	**%**
Fixed Income						
Government Bonds	$ 8,299,599,468	36.15%	$ 400,617,024	1.75%	$ 8,700,216,492	37.90%
Corporate Bonds	2,587,024,127	11.27%	195,585,692	0.85%	2,782,609,819	12.12%
Convertible Bonds	0	0.00%	104,658	0.00%	104,658	0.00%
Total Bonds	$ 10,886,623,595	47.42%	$ 596,307,374	2.60%	$ 11,482,930,969	50.02%
Preferred Stock	0	0.00%	17,203,856	0.07%	17,203,856	0.07%
Total Fixed Income	$ 10,886,623,595	47.42%	$ 613,511,230	2.67%	$ 11,500,134,825	50.09%
Common Stock						
Commingled Fund	$ 0	0.00%	$ 17,673,510	0.08%	$ 17,673,510	0.08%
Consumer Discretionary	990,054,874	4.31%	399,308,372	1.74%	1,389,363,246	6.05%
Consumer Staples	713,204,222	3.11%	250,608,209	1.09%	963,812,431	4.20%
Energy	518,464,847	2.26%	154,938,137	0.67%	673,402,984	2.93%
Financials	1,311,175,040	5.71%	363,841,442	1.58%	1,675,016,482	7.29%
Health Care	951,359,516	4.14%	163,807,296	0.71%	1,115,166,812	4.85%
Industrials	790,531,096	3.45%	255,348,668	1.11%	1,045,879,764	4.56%
Information Technology	952,066,215	4.15%	192,313,557	0.84%	1,144,379,772	4.99%
Materials	230,391,045	1.00%	197,195,406	0.86%	427,586,451	1.86%
Miscellaneous	0	0.00%	2,850,379	0.02%	2,850,379	0.02%
Telecommunication Svc.	259,816,129	1.13%	162,390,895	0.71%	422,207,024	1.84%
Utilities	215,986,581	0.94%	68,981,257	0.30%	284,967,838	1.24%
Total Common Stock	$ 6,933,049,565	30.20%	$ 2,229,257,128	9.71%	$ 9,162,306,693	39.91%
Short-term Investments						
Commercial Paper	$ 762,737,102	3.32%	$ 0	0.00%	$ 762,737,102	3.32%
Corporate Bonds	90,489,362	0.39%	0	0.00%	90,489,362	0.39%
U.S. Gov't Securities	1,089,854,869	4.75%	0	0.00%	1,089,854,869	4.75%
Total Short-term Investments	$ 1,943,081,333	8.46%	$ 0	0.00%	$ 1,943,081,333	8.46%
Real Estate	$ 352,582,235	1.54%	$ 0	0.00%	$ 352,582,235	1.54%
Total Investments	$ 20,115,336,728	87.62%	$ 2,842,768,358	12.38%	$ 22,958,105,086	100.00%

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

TCRS Investments

TCRS INVESTMENTS BENCHMARK ANALYSIS

Fiscal Year	[1]Public Fund Index Median Total Return	[2]TCRS Total Return
2001-02	(5.2)%	(1.9)%
2000-01	(4.1)	(1.6)
1999-00	9.5	7.9
1998-99	10.0	9.5
1997-98	17.9	15.1
1996-97	18.9	15.7
1995-96	15.8	12.8
1994-95	15.4	12.8
1993-94	1.6	0.5
1992-93	13.2	15.1

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

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

SUMMARY OF TCRS EARNINGS
Fiscal Years 1997-1998 through 2001-2002

Fiscal Year	TCRS Portfolio Earnings
2001-02	$ (378,856,317)
2000-01	(327,511,701)
1999-00	1,761,074,099
1998-99	1,932,716,042
1997-98	2,758,267,944

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

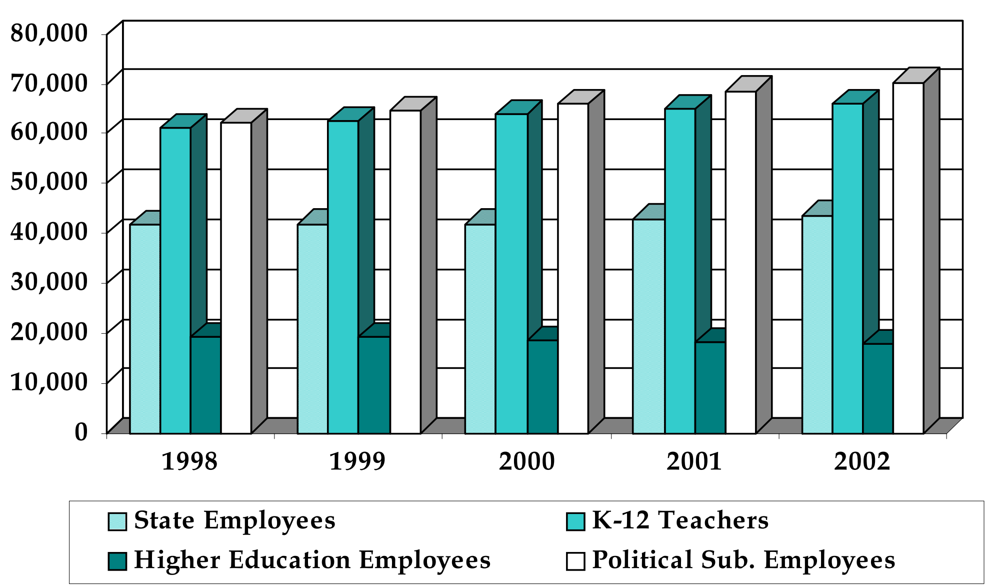
Membership in the retirement system is a condition of employment for full-time state employees, teachers, general employees in higher education, and the employees of local governments that participate in TCRS. Membership is optional for certain part-time employees. Faculty employees in higher education 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, 2002, there were 197,971 active members of TCRS and 11,298 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 1998-2002



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.

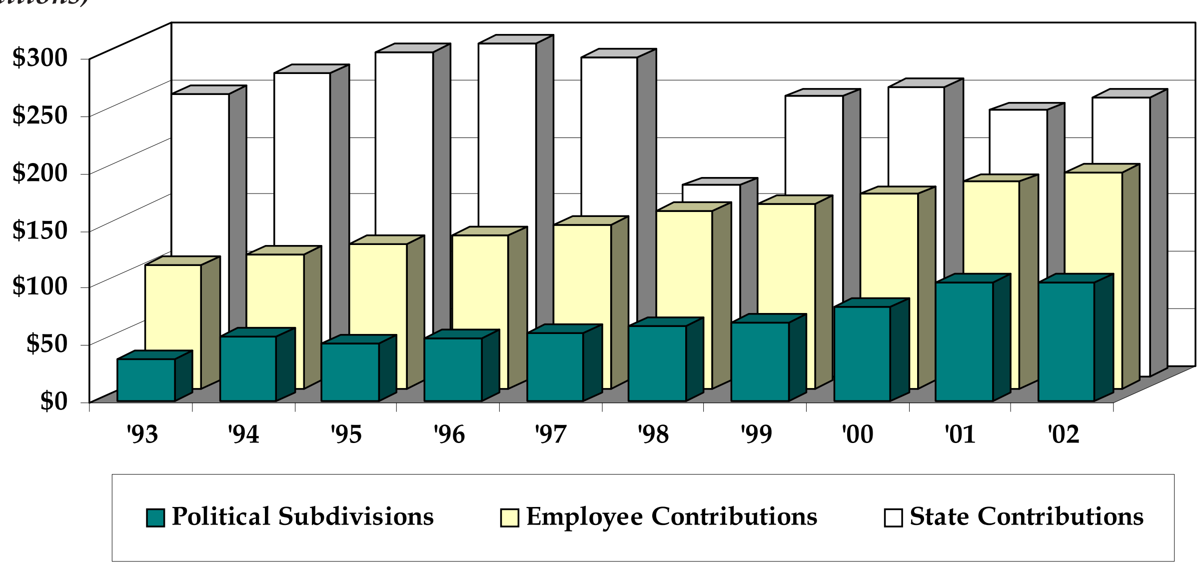
Upon termination of employment, a member may elect to withdraw his contributions and accumulated interest from the retirement system in a lump sum. By obtaining a lump sum refund, a member waives all rights and benefits in the retirement system. A vested member may leave his account balance in TCRS and 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 2001-2002 fiscal year, 4,259 refunds totaling $24.3 million were issued.

The contribution rate for the employers participating in the retirement system is determined by a biennial actuarial valuation performed by an independent actuarial firm. The contribution rates include funding for the basic benefit, the cost-of-living increase provisions, and amortization of the accrued liability over a 40 year period which began in July of 1975. The employer contribution rates for the year ending June 30, 2002 were as follows:

Noncontributory State and Higher Education Employees	6.19%
K-12 Teachers	3.72%
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 1993-2002
(in Millions)



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, 2002, 80,426 retirees were receiving monthly benefit payments. This represents a 3.45% increase over the previous year.

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

A Group I benefits calculator is available on our Internet site: www.treasury.state.tn.us/tcrs.

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

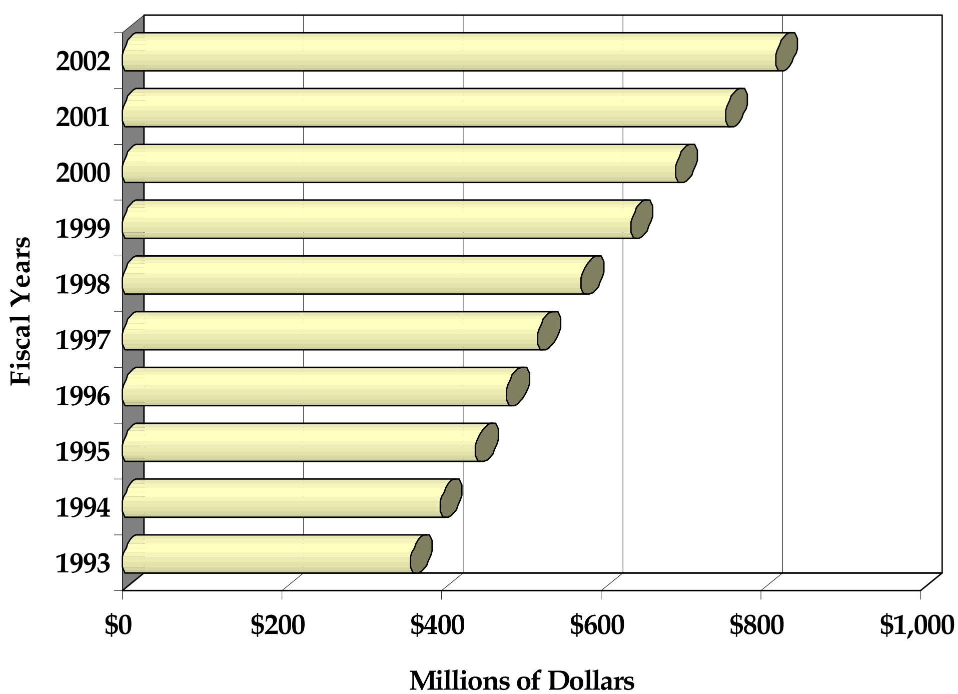
Cost-of-living adjustments after retirement are based on the Consumer Price Index (CPI). If there is an increase in the CPI of as much as .5% in any calendar year, the retired member's benefit will be adjusted by an amount equal to the increase in the CPI, not to exceed 3% nor be less than 1%.

Certain death benefits are available to the beneficiary(s) of a member who dies prior to retirement. At retirement, a member 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 2001-2002 totaled $818.1 million, an increase of $61.7 million over 2000-2001 benefit payments.

ANNUAL BENEFIT PAYMENTS

Fiscal Years 1993-2002
(in Millions)



TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

TENNESSEE'S RETIREMENT PROGRAM, TCRS AND SOCIAL SECURITY BENEFITS
for Calendar Year 2001

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	8,628		8,628		8,628		8,628		8,628	
	Total	$ 12,172	81.1%	$ 13,353	89.0%	$ 14,534	96.9%	$ 15,716	104.8%	$ 16,897	112.6%
$20,000	TCRS	$ 4,725		$ 6,300		$ 7,875		$ 9,450		$ 11,025	
	Social Security	10,236		10,236		10,236		10,236		10,236	
	Total	$ 14,961	74.8%	$ 16,536	82.7%	$ 18,111	90.6%	$ 19,686	98.4%	$ 21,261	106.3%
$25,000	TCRS	$ 5,906		$ 7,875		$ 9,844		$ 11,813		$ 13,781	
	Social Security	11,832		11,832		11,832		11,832		11,832	
	Total	$ 17,738	71.0%	$ 19,707	78.8%	$ 21,676	86.7%	$ 23,645	94.6%	$ 25,613	102.5%
$30,000	TCRS	$ 7,088		$ 9,450		$ 11,813		$ 14,175		$ 16,538	
	Social Security	13,440		13,440		13,440		13,440		13,440	
	Total	$ 20,528	68.4%	$ 22,890	76.3%	$ 25,253	84.2%	$ 27,615	92.1%	$ 29,978	99.9%
$35,000	TCRS	$ 8,269		$ 11,025		$ 13,781		$ 16,538		$ 19,294	
	Social Security	15,036		15,036		15,036		15,036		15,036	
	Total	$ 23,305	66.6%	$ 26,061	74.5%	$ 28,817	82.3%	$ 31,574	90.2%	$ 34,330	98.1%
$40,000	TCRS	$ 9,560		$ 12,747		$ 15,934		$ 19,121		$ 22,307	
	Social Security	16,584		16,584		16,584		16,584		16,584	
	Total	$ 26,144	65.4%	$ 29,331	73.3%	$ 32,518	81.3%	$ 35,705	89.3%	$ 38,891	97.2%
$45,000	TCRS	$ 10,938		$ 14,585		$ 18,231		$ 21,877		$ 25,523	
	Social Security	17,220		17,220		17,220		17,220		17,220	
	Total	$ 28,158	62.6%	$ 31,805	70.7%	$ 35,451	78.8%	$ 39,097	86.9%	$ 42,743	95.0%
$50,000	TCRS	$ 12,317		$ 16,422		$ 20,528		$ 24,633		$ 28,739	
	Social Security	17,820		17,820		17,820		17,820		17,820	
	Total	$ 30,137	60.3%	$ 34,242	68.5%	$ 38,348	76.7%	$ 42,453	84.9%	$ 46,559	93.1%
$55,000	TCRS	$ 13,695		$ 18,260		$ 22,824		$ 27,389		$ 31,954	
	Social Security	18,324		18,324		18,324		18,324		18,324	
	Total	$ 32,019	58.2%	$ 36,584	66.5%	$ 41,148	74.8%	$ 45,713	83.1%	$ 50,278	91.4%
$60,000	TCRS	$ 15,073		$ 20,097		$ 25,121		$ 30,146		$ 35,170	
	Social Security	18,828		18,828		18,828		18,828		18,828	
	Total	$ 33,901	56.5%	$ 38,925	64.9%	$ 43,949	73.2%	$ 48,974	81.6%	$ 53,998	90.0%

* 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 2002. 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 2002;

(2) The retiree has worked a full career (TCRS plus other employers, if necessary) of 35 years or more; and

(3) Salary increases throughout the retiree's career have followed the same pattern as National Average Earnings.

The department's Internet benefits calculator allows members to receive an immediate estimate: www.treasury.state.tn.us/tcrs/

ACTUARIAL VALUATION

An actuarial valuation of the TCRS is performed by an independent actuarial firm every two years. The purpose of the valuation is to determine the funding requirements for the employers participating in the TCRS. The latest valuation was performed July 1, 2001 to establish the employer contribution rates for July 1, 2002. The system's accrued liability at July 1, 2001 was $421.4 million. The accrued liability is being amortized over a 40 year period which began in 1975.

In addition to the biennial actuarial valuation, an experience study is conducted every four years for the purpose of establishing actuarial and economic assumptions to be used in the actuarial valuation process. Following are the assumptions used in the July 1, 2001 actuarial valuation of the plan:

Economic Assumptions

(1) 7.5% annual return on investments

(2) Graded salary scale reflecting plan experience

(3) 3.5% annual increase in social security wage base

Actuarial Assumptions

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

(2) Post-Retirement mortality based on age

(3) Disability rate based on age

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

(5) Retirement age distribution based on age and service

POLITICAL SUBDIVISIONS

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

POLITICAL SUBDIVISION PARTICIPATION

Participation as of June 30, 2002:

Cities	158
Counties	87
Utility Districts	40
Special School Districts	22
Joint Ventures	24
Development Agencies	13
Housing Authorities	10
911 Emergency Communication Districts	30
Miscellaneous Authorities	23
Total	407

Tennessee Consolidated Retirement System

MAJOR LEGISLATIVE IMPROVEMENTS
1980-2002

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

1981 Noncontributory retirement for state employees and higher education employees adopted. Employees' contributions–up to 5%–assumed by the state. Salaries of employees in active service on the date these provisions were adopted were indexed by 3.6%. Subsequent legislation continued this indexing each year until 1997, when it was permanently extended.

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

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

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

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

Retirement credit for armed conflict military service approved.

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

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

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

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

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

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

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

1991 The Board of Trustees 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.

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

A 5% benefit improvement authorized effective Jan. 1, 1994.

1996 An installment payment plan for prior service authorized.

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

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

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

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

1999 Group 1 benefit limitation increased to 90%.

2000 Group 2 benefit maximum increased to 80%.

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

SOCIAL SECURITY

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

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

The Tennessee Master Agreement was executed on August 16, 1951. It provided full social security coverage (retirement, survivors, disability, and hospital insurance) to public employees who were not covered by an employer-sponsored retirement plan.

A modification to the agreement, effective January 1, 1956, provided social security coverage to employees serving in positions which were then covered by the Tennessee State Retirement System and the Tennessee Teachers' Retirement System. After the Tennessee Consolidated Retirement System was established July 1, 1972, a statewide social security coverage referendum was held among eligible employees.

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

Effective in 1991, separate wage bases were implemented for social security and Medicare and separate reporting of withholding was required.

SCHEDULE OF HISTORICAL SOCIAL SECURITY CONTRIBUTION RATES

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

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, 2002, accounts were held by 53,833 individuals in the 401(k) plan and 3,784 individuals in the 457 plan. At June 30, 24,876 state employees, 8,051 University of Tennessee employees, and 8,563 Tennessee Board of Regents employees were actively contributing to the 401(k) plan and 1,143 state employees, 173 University of Tennessee employees, and 35 Tennessee Board of Regents employees were actively contributing to the 457 plan.

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

IRS regulations for 2002 allow a maximum deferral in the 457 plan of 100% of compensation up to the maximum annual contribution of $11,000. The maximum deferral in the 401(k) plan is 100% of compensation up to the maximum annual contribution of $11,000. Participants who also use a 403(b) plan are subject to additional limits.

During the 2001-2002 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 $5,849,227.

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 BenefitsCorp, a Great-West Life company. The use of an unbundled arrangement enables participants to receive an objective presentation of the investment products, to avoid the sales fees traditionally associated with bundled products, and to receive consolidated account statements and benefit estimates. All of the products available for new enrollment are offered without sales fees, surrender fees, mortality and expense risk fees, or minimum deposit requirements.

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

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

For the year ending June 30, 2002, contributions to the program totaled $66,485,655. Contributions are wired through the State Trust of Tennessee for immediate crediting.

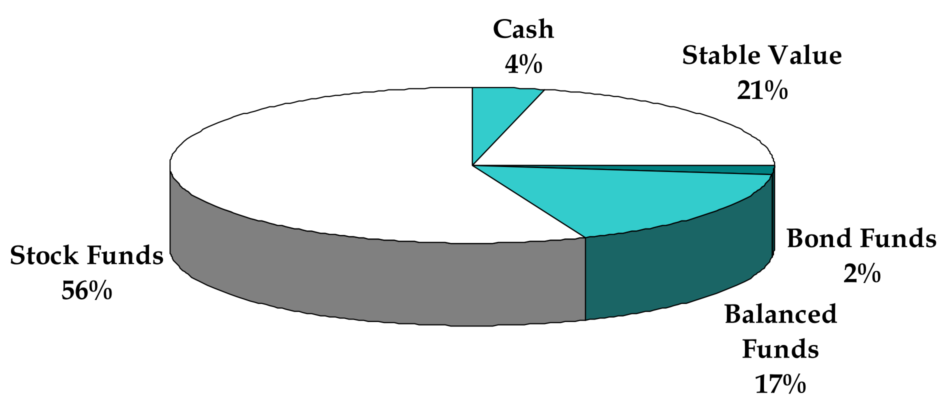
Deferred Compensation Program

At June 30, 2002, accumulated account balances totaled $561,795,729. Distribution of the program's assets among the program's investment providers is shown below.

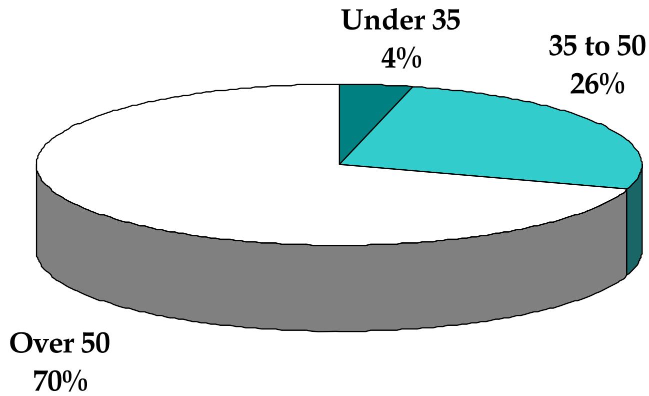
Under the loan program offered in the 401(k) plan, active employees who have accumulated $4,000 or more in their 401(k) account may borrow up to half of their account value. Participants repay principal and interest to their 401(k) account through salary deduction. Taxes continue to be deferred while funds accumulated in the plan are in loan status. As of June 30, 2002, there were 1,370 loans outstanding from the 401(k) plan. Outstanding loan balances totaled $4.7 million.

Benefits from the program may be distributed in periodic payments, in an annuity, or in a lump sum. During the year ended June 30, 2002, 898 individuals received periodic payments and 110 individuals received annuity payments from the program. In addition, a total of 2,206 lump sum distributions and 1,032 partial lump sum distributions were issued during 2001-2002.

DISTRIBUTION OF ASSETS
by Fund Category
as of June 30, 2002



DISTRIBUTION OF ASSETS
by Participant Age
as of June 30, 2002



Deferred Compensation Program

DEFERRED COMPENSATION CONTRIBUTIONS AND MARKET VALUE

	Contributions FY 2001-2002	Market Value June 30, 2002
Plan I (457)		
Aetna-ING	$ 421,596	$ 31,098,984
American General	30,656	751,774
Calvert	140,589	2,629,538
Fidelity	2,090,617	70,468,674
State Street	115,434	1,907,448
Union Planters	236,938	13,750,777
	$ 3,035,830	$ 120,607,195
Plan II (401k)		
Aetna-ING	$ 5,957,353	$ 54,241,796
Calvert	1,866,137	10,897,418
Fidelity	50,391,058	343,088,537
State Street	2,289,986	8,475,302
Union Planters	2,945,291	24,485,481
	$ 63,449,825	$ 441,188,534
Total for both plans	$ 66,485,655	$ 561,795,729

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 and initially administered by a third party vendor. The Treasury Department took over administration of the program effective January 1, 1992.

At June 30, 2002, a total of 39,690 state employees were enrolled in one or more of the plan's four options: 39,083 employees used the plan to pay medical insurance premiums, 17,013 paid dental insurance premiums, 2,925 used the medical expense reimbursement account, and 367 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 2001-2002, the state's F.I.C.A. savings totaled $3.3 million. Employees realize similar savings. Since the program began operation in January 1989, the state's F.I.C.A. savings have totaled $28 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, 2002, $23.3 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, all state employees have access to this network. The managed care organization also provides case management services such as pre-certification for inpatient hospital care, bill review, large case management and other services to manage the costs of workers' compensation claims. The use of a preferred provider network 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 2001-2002, the Division of Claims Administration received 6,074 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 2001-2002 fiscal year, the Board took action on a total of three 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 2001-2002

	Claims Filed	Payments Made
Workers' Compensation Claims	4,161	
Death Payments		$ 261,144
Medical Payments		9,639,268
Temporary Disability (Lost Time)		1,569,491
Permanent Disability		7,783,118
Subtotal		$ 19,253,021
Employee Property Damage	195	$ 42,386
Tort Claims	1,718	
Death Payments		$ 3,679,103
Bodily Injury Payments		3,978,676
Property Damage Payments		1,163,325
Subtotal		$ 8,821,104
Total	6,074	$ 28,116,511

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 Injury 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 Injury Compensation fund. If the division cannot process a claim within 90 days, then the claim is referred to the Tennessee Claims Commission.

During the 2001-2002 fiscal year, the Division of Claims Administration made payments on 1,822 criminal injury claims for a total of $10,903,058. 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.* Section 55-10-401, the victim's death or injury is eligible for compensation in the same manner as criminal injury compensation, not to exceed a maximum award of $18,000 per claim plus attorney fees for injuries occurring on or after July 1, 2001. A supplemental award of up to $12,000 was available for crimes occurring during the 2001-2002 fiscal year.

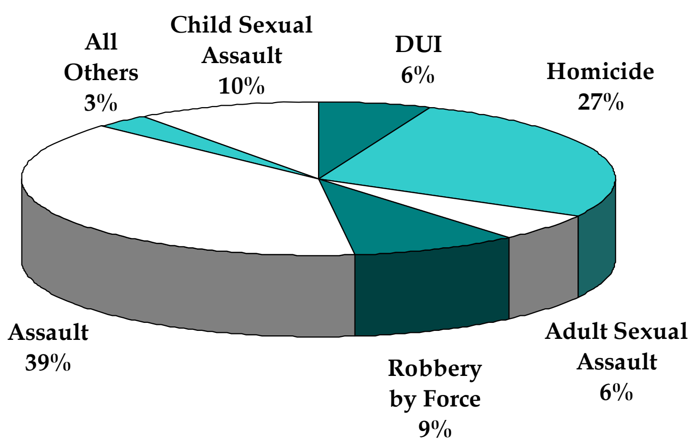
Since the first claims were paid in 1982, the program has awarded a total of more than $123.5 million to crime victims. The Division of Claims Administration has made an effort to educate members of the public of the existence and benefits of the Criminal Injury Compensation Program by printing and distributing 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. Information and resources are provided on its web page: www.treasury.state.tn.us/injury.

In the spring of 2002, the Tennessee General Assembly enacted Public Chapter 869 to increase compensation available for victims. The maximum compensation available for funeral and burial expenses was increased from $4,500 to $6,000 and the crime scene cleanup from $1,500 to $3,000. Crime scene cleanup was expanded to include residential crime scenes involving sexual assault and aggravated assault, in addition to crime scenes involving homicide. Program provisions were also expanded to cover a broader range of items damaged or destroyed by the crime or processing of these crime scenes. These changes were effective for claims arising from crimes occurring on or after August 1, 2002.

The legislation also amended the overall maximum award to $30,000 and disbanded the supplemental award program. However, in its place, a new mechanism was created to insure that the maximum compensation offered in Tennessee is 105 percent of the national average, based on maximums in other states having an overall limit. By October 1 of each year, a review is conducted of the overall program maximums available nationwide and the Treasurer determines whether Tennessee's maximum must be increased pursuant to the provisions of the section.

VICTIMS' COMPENSATION AWARDS PAID

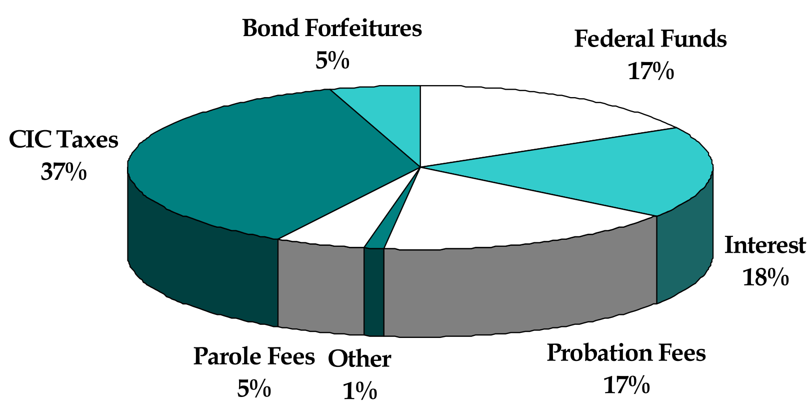
Percentage of Awards Based on Crime Classification
Fiscal Year 2001-2002



During fiscal year 2001-2002, 1,822 awards totaling $10,903,058 were made. Of that amount, $615,280 can be attributed to claims involving DUI with the remaining $10,287,778 related to all other crime types. The average award for all types was $5,984. Thirteen percent of all claims were the result of domestic violence.

CRIMINAL INJURY COMPENSATION FUND SOURCES OF FUNDS

Fiscal Year 2001-2002



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.

The commission has a central office in Nashville with an administrative clerk and an administrative services assistant. 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 Injury 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.

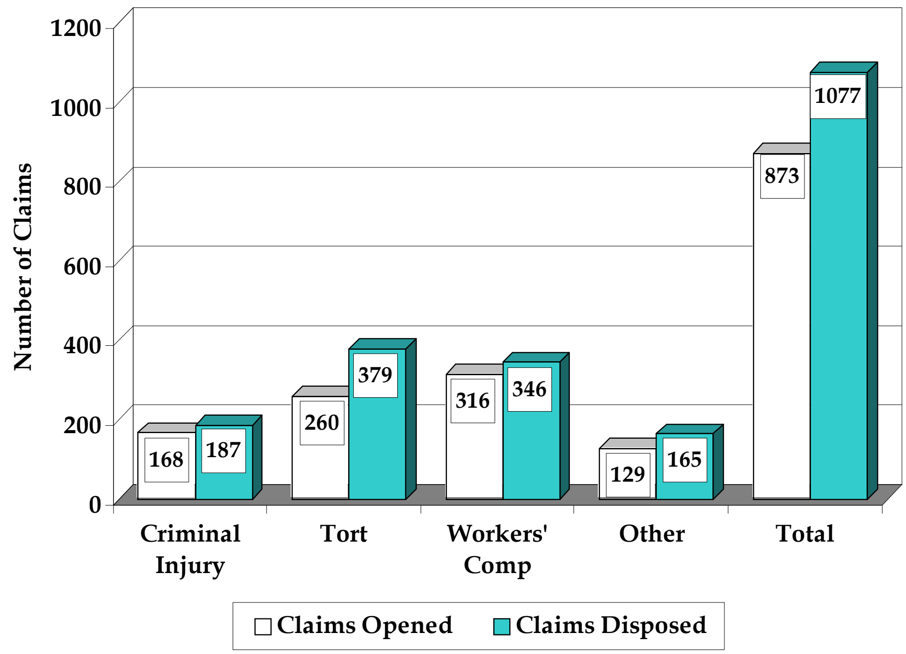
Both the Division of Claims Administration and the third party administrator have 90 days to accept or deny a claim before the claim is automatically transferred to the commission. Claimants can appeal both entities' decisions to the Claims Commission.

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.

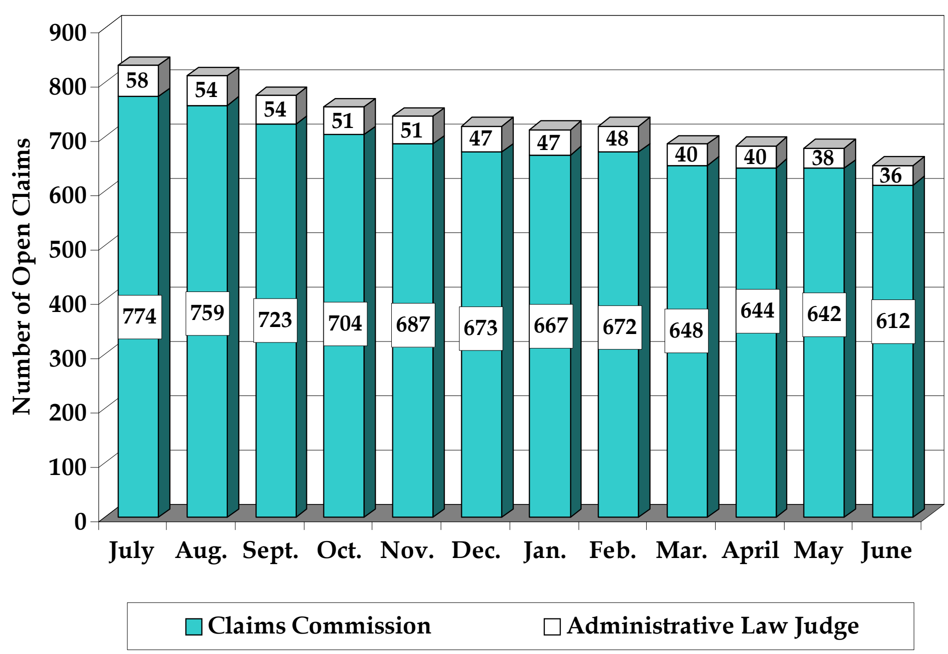
As of July 1, 1997, upon request by the Governor, by an individual claims commissioner, or by the majority of the claims commissioners, the Secretary of State may assign administrative law judges to "assist in the removal of unacceptable congestion or delay on the claims commission docket." In adjudicating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

CLAIMS COMMISSION

NUMBER OF CLAIMS OPENED AND NUMBER OF DISPOSITIONS BY CLAIM TYPE
(Including Dispositions by Administrative Law Judges)
Fiscal Year 2001-2002



CLAIMS COMMISSION AND ADMINISTRATIVE LAW JUDGE OPEN CLAIMS
Fiscal Year 2001-2002



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, for all state-owned buildings and contents. This is accomplished through an annual aggregate retention—a property/casualty reserve fund appropriated for the payment of property claims within a given fiscal year—and excess property insurance policies purchased from private carriers.

Due to increasing concerns over the property/casualty insurance market, the state obtained the insurance brokerage services of Marsh USA, Inc. Marsh obtained and reviewed various insurance proposals in an attempt to maintain the state's current level of protection. The property, builders' risk, and fidelity coverages, were procured as three separate policies, which, until now, were all combined under one package policy. As of July 1, 2001, the state's property values were $9.5 billion. The premium costs for excess property coverage, builders' risk insurance, and fidelity bond, amounted to $837,673. This was a premium increase of 26% over fiscal year 2000-2001. The annual property rate increased from .00727 to .00886 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 a fidelity bond. Fidelity coverage is provided in the amount of $1 million per incident/aggregate for all 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 $10,000 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 2001-2002, the state received 19 claims in excess of the $10,000 deductible. These losses amounted to $1,294,086 with a resulting net loss to the fund of $1,064,086.

The prevention and control of losses is an important part of managing the state's risks. A fire/life safety program was developed by the Division of Risk Management, to create an awareness among facility management and safety personnel, of inherent risks which could eventually lead to extensive property damage and/or loss of life. Also, with the dramatic increase in workers' compensation and tort liability loss costs, the Division has expanded its loss control program to address these challenges in an effort to mitigate the adverse growth in these areas.

COST OF PROPERTY/CASUALTY PROGRAM

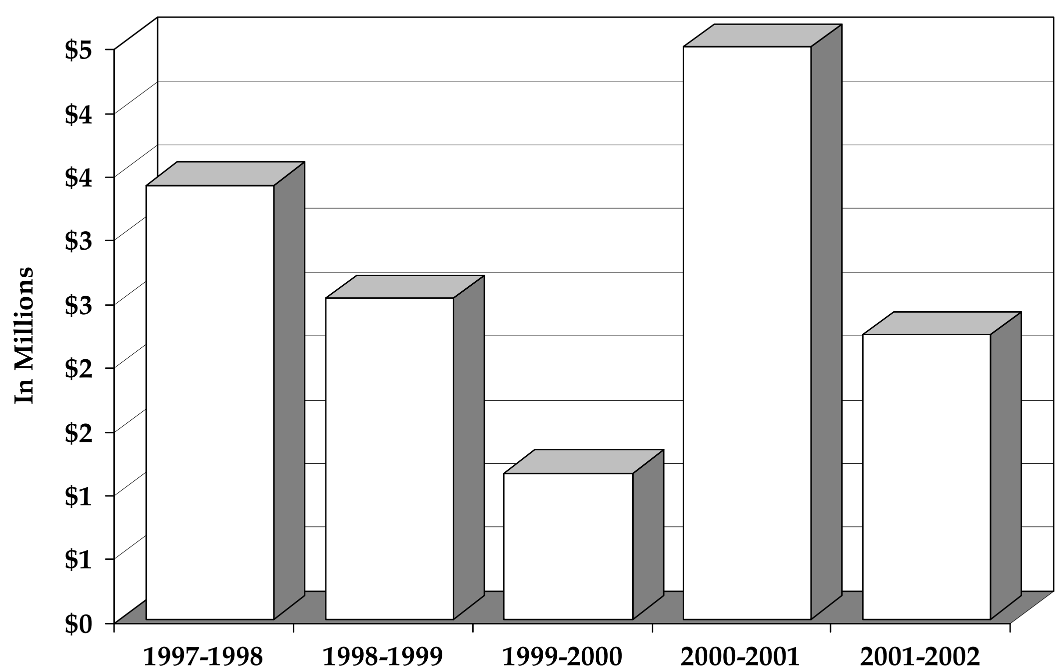
Fiscal Year 2001-2002

[1]Premiums		
Excess Property Insurance	$	696,418
Builder's Risk Insurance		96,390
Fidelity Bond		44,865
Boiler Insurance		57,525
Total Premiums	$	895,198
Administrative Costs		228,317
Insurance Brokerage Fee		41,825
Total Insurance Cost	$	1,165,340
Net Incurred Losses (excluding earthquake & flood)	$	529,934
Net Incurred Losses (flood only)		534,152
Total Net Incurred Losses	$	1,064,086
Total Cost of State Program	$	2,229,426

[1]Based on July 1, 2001 property values totaling $ 9,458,101,300.

COST OF PROPERTY/CASUALTY PROGRAM

Fiscal Years 1998-2002



Unclaimed Property Division

UNCLAIMED PROPERTY DIVISION

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

The Unclaimed Property Act provides that property 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 time, normally 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. There is no time limit on claiming this property.

Since the program began operations in 1979, $243.9 million in unclaimed property has been reported to the Treasurer and $71.8 million (29%) has been returned to owners, heirs, local governments and reciprocal states.

During the period July 1, 2001 through June 30, 2002, $30.6 million of cash property was turned over to the Treasurer. This includes $4.6 million remitted by third party audit organizations from out-of-state non-reporting holders for Tennessee residents. An additional $4.2 million in proceeds from stock sales was recognized as revenue. The chart on the following page illustrates the sources of cash collections for fiscal year 2001-2002.

In addition to advertising the property, the Treasurer makes 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 Department of Labor and Workforce Development records, telephone directories, drivers' license records, and other sources.

Further, a searchable database of the owners' names is available on the division's Internet site: www.treasury.state.tn.us/unclaim. This site logged 846,435 visitors at June 30, 2002, an increase of 353,445 for the fiscal year. The records of unclaimed property owners are also available for viewing by the public in the Unclaimed Property office.

During the period July 1, 2001 through June 30, 2002, more than $9.7 million of cash property was returned by the Unclaimed Property Division to the owners or their heirs, local governments and reciprocal states.

Any local government in Tennessee 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, $439,998 was refunded to 22 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 $1.1 million for residents or former residents and paid $591,538 to 37 other states' unclaimed property offices.

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

Legislation passed in 2001 provides for a safe harbor and amnesty from penalty for entities that come forward voluntarily in full compliance prior to notification of an audit examination and prior to May 1, 2002. Since the legislation provided the Treasurer an option to extend the deadline by one year, the Treasurer exercised this option and extended the amnesty to May 1, 2003.

UNCLAIMED PROPERTY DIVISION

METHODS USED TO RETURN PROPERTY
July 1, 2001 - June 30, 2002

Location Method	# of Accounts	Value of Claims	Average Claim Value
Web site inquiries and other	2,310	$ 2,348,923	$ 1,017
Mailings to last known address	3,206	1,443,158	450
Advertisement and television	3,684	1,434,047	389
UCP staff outreach/Telephone directory	83	1,064,950	12,831
Holder referral	357	1,022,779	2,865
Match with Dept. of Labor and Workforce records	2,863	659,088	230
Independent locator	81	299,828	3,702
Legislator listing	166	230,231	1,387
Reimburse holder	102	194,242	1,904
Total claim payments	12,852	$ 8,697,246	$ 677
Refunds to local governments	22	439,998	
Interstate exchanges	37	591,538	
Total payments	12,911	$ 9,728,782	

SOURCES OF UNCLAIMED PROPERTY
Fiscal Years 1998 - 2002

	2002	2001	2000	1999	1998
Financial institutions	29%	39%	29%	33%	35%
Insurance companies	15%	21%	17%	22%	23%
Securities	14%	8%	25%	6%	5%
Corporations, transportation, colleges, retailers	13%	13%	11%	14%	12%
Escheat and other	12%	6%	5%	7%	6%
Utilities	7%	3%	3%	6%	6%
Cities and counties	4%	4%	3%	6%	6%
Other states	4%	3%	4%	5%	6%
Hospitals and health care	2%	3%	3%	1%	1%
Total	100%	100%	100%	100%	100%

CLAIMS PAID BY SOURCE
Fiscal Years 1998 - 2002

	2002	2001	2000	1999	1998
Web site inquiries and other	27%	21%	22%	60%	8%
Mailings to last known address	17%	16%	27%	14%	26%
Advertisement and television	16%	15%	5%	9%	26%
UCP staff outreach/Telephone directory	12%	10%	19%	2%	4%
Holder referral	12%	8%	9%	5%	11%
Match with Dept. of Labor and Workforce records	8%	13%	1%	2%	3%
Independent locator	3%	11%	8%	7%	16%
Legislator listing	3%	2%	1%	1%	6%
Reimburse holder	2%	4%	8%	0%	0%
Total	100%	100%	100%	100%	100%

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. Gains 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 99 chairs created, with state appropriations totaling $44,000,000 and matching contributions totaling $55,523,375. For the year ending June 30, 2002, an investment loss totaled $9,865,712 with expenditures of $7,629,023.

THE UNIVERSITY OF TENNESSEE

Chattanooga

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

Knoxville

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

Baccalaureate Education System Trust

Tennessee Code Annotated, Title 49, Chapter 7, Part 8 sets forth the Tennessee Baccalaureate Education System Trust (BEST) Act. The Act creates a tuition program, as an agency and instrumentality of the State of Tennessee, under which parents and other interested persons may assist students in saving for tuition cost of attending colleges and universities. The tuition program is known as the BEST Program and is comprised of two types of tuition plans: The BEST Savings Plan and the BEST Prepaid College Tuition Plan. The requirements for participation and administration of the Prepaid College Tuition Plan are contained in *Chapter 1700-5-1* of the *Official Compilation of the Rules and Regulations of the State of Tennessee*. The requirements for participation and administration of the Savings Plan are contained in *Chapter 1700-5-2* of the *Official Compilation of the Rules and Regulations of the State of Tennessee*.

The BEST program offers several favorable tax benefits to its participants. BEST contracts are exempt from all state and local taxes. In addition, earnings on any distribution used to pay for qualified higher education expenses are exempt for taxation. Previously, earnings from qualified tuition plans were tax deferred and then taxed at the beneficiary's rate upon withdrawal. The maximum account limit in the BEST program is $235,000.

BEST PREPAID COLLEGE TUITION PLAN

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

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

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

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. Also available to participants in the program is telephone access to account balances and activity 24 hours a day.

The Baccalaureate Education System Trust prepaid program began accepting contracts and contributions in June 1997. At June 30, 2002, BEST had 7,450 contracts with assets totaling $34.7 million. Unit prices were $36.85. The BEST Prepaid Plan annually adjusts the unit price to reflect the current weighted average tuition of Tennessee's public colleges and universities.

Since the first school payout in Fall 1999, the BEST Prepaid program has issued a total of 726 payments totaling $1.4 million. Of the 726 payments issued, 554 were made to in-state schools and 172 were to out-of-state schools. Approximately 36% of the public payments were issued to the University of Tennessee-Knoxville, while the University of the South Sewanee received 17% of the private school payouts.

BEST SAVINGS PLAN

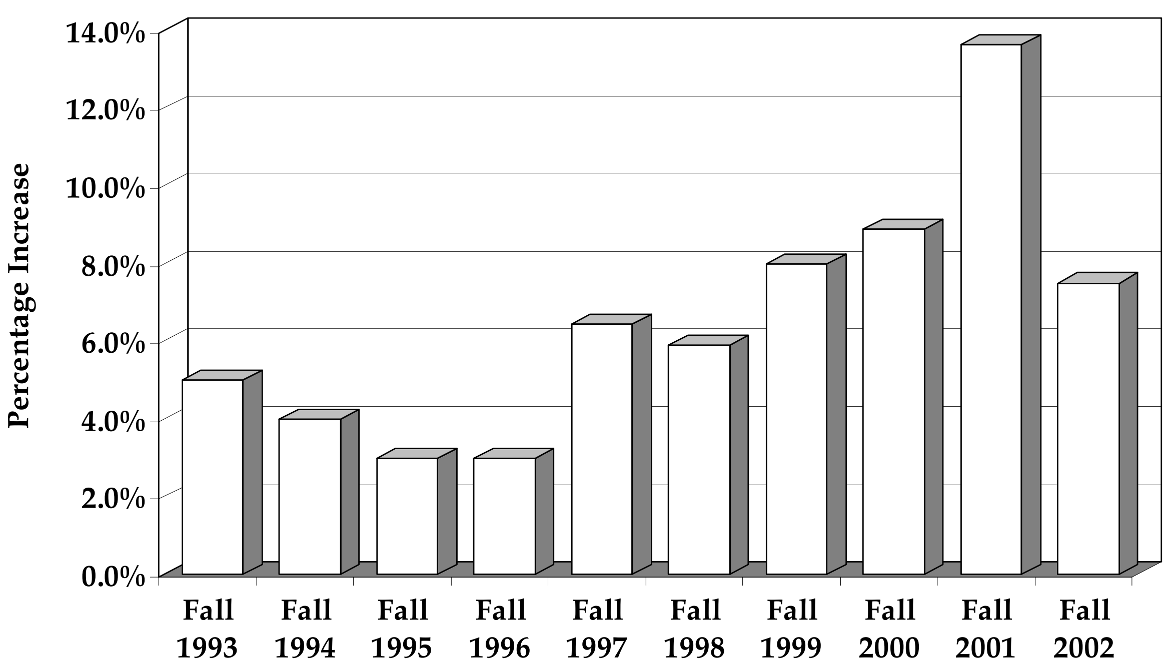
Anyone interested in investing for a college education can open an account on a child's behalf in the Savings Plan. There are no residency requirements. The account can be used to pay for qualified higher education expenses at any eligible college, university, trade or vocational school, or other post-secondary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

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

The BEST Savings Plan offers two contribution choices the Managed Allocation Option and the 100% Equity Option. These choices vary in their investment strategy and degree of risk. In the Managed Allocation Option, beneficiaries are grouped according to date of birth and contributions are allocated among equity, bond and money market investments in varying percentages depending on the Beneficiary's time horizon. The 100% Equity Option, available since April 2002, consists of a blend of TIAA-CREF Institutional Growth and Income Fund and the TIAA-CREF Institutional International Equity Fund. The allocation mix for this option does not change to reflect the age of the Beneficiary, unlike the Managed Allocation Option.

The Savings Plan began accepting contracts and contributions in March 2000. At June 30, 2002, there were 1,371 contracts with contributions totaling $4.4 million.

AVERAGE TUITION INCREASES FOR TENNESSEE PUBLIC INSTITUTIONS
1993-2002



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, 144 students have been selected to participate. New classes begin each fall, spring, and summer semester.

Applicants have come from Austin Peay State University, East Tennessee State University, Fisk University, David Lipscomb University, Middle Tennessee State University, Rhodes College, Tennessee State University, Tennessee Technological University, University of Memphis, University of Tennessee at Martin, University of Tennessee at Knoxville, University of the South, and Vanderbilt University. The majority of the participants have been Business or Accounting majors and have come from Middle Tennessee State University, Tennessee State University and Tennessee Technological University. Approximately 38 percent of the student participants have been minorities and 40 percent of the students have 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. The students receive hands on work experience and the participating institutions and constitutional offices jointly facilitate the development of a detailed curriculum to meet the academic commitment made to higher education institutions.

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

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

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

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

Treasury Internet Services

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

Statutory Duties of the State Treasurer

BOARDS AND COMMISSIONS

	Tennessee Code Annotated Section
Advisory Council on Workers' Compensation	50-6-121
Baccalaureate Education System Trust Board	49-7-801, 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
Natural 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 Injury Compensation Fund	29-13-101, et seq.
Deferred Compensation	8-25-101, et seq.
Escheat	31-6-101, et seq.
Flexible Benefits Plan	8-25-501
Investment Advisory Council	8-37-108
Investment of State Idle Cash Funds	9-4-602
Local Government Investment Pool	9-4-704
Old Age and Survivors Insurance Agency	8-38-101, et seq.
Pooled Investment Fund	9-4-704
Receipt and Disbursement of Public Funds	8-5-106—8-5-111; 9-4-301, et seq.
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) 532-1167
Human Resource Director/Careers Now Coordinator	Ann Taylor-Tharpe	(615) 532-9912
Investments		
Chief Investment Officer	Thomas Milne, CFA	(615) 532-1157
Director of Equity	Michael Keeler, CFA	(615) 532-1165
Senior Equity Portfolio Manager	Jeremy Conlin, CLU, ChFC, CFA	(615) 532-1152
Senior Equity Portfolio Manager	Jim Robinson, CFA	(615) 532-1177
Senior International Equity Portfolio Manager	Roy Wellington, CFA	(615) 532-1151
Senior Fixed Income International Portfolio Manager	Leighton Shantz, CFA	(615) 532-1183
Senior Short-Term Portfolio Manager	Randy Graves, CPA	(615) 532-1154
Director of Real Estate	Peter Katseff	(615) 532-1160
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/Web Developer	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
Accounting Manager	Kim Morrow, CPA	(615) 532-8051
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) 741-2314
Director of Unclaimed Property	Beth Chapman, CPA	(615) 741-6499
Manager of Administrative Services	Brian Derrick	(615) 532-8552
Manager of Treasury Operations	Gaylon Bandy	(615) 741-4985
Manager of Workers' Comp and Tort Claims	Anne Adams	(615) 741-2734
Manager of Criminal Injury Claims	Amy Dunlap	(615) 741-2734
East Tennessee Claims Commissioner	Vance Cheek, JD	(423) 854-5330
Middle Tennessee Claims Commissioner	William Baker, JD	(615) 792-7471
West Tennessee Claims Commissioner	Randy Camp, JD	(731) 696-5581
Administrative Clerk, Claims Commission	Marsha Richeson	(615) 532-5385
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.

Treasury Staff

Anne Adams
Steve Adams
Muriel Agnew
Rhonda Akins
Mary Alexander
Roger Amos
Sandra Anderson [5]
Kelly Armes
Sandra Arnold
Janice Atkins-Mobley
Ron Aymett
Jill Bachus
Linda Baker [30]
Sam Baker
Sherry Baker
William Baker
Gaylon Bandy [30]
Karen Baumgartel
Peggy Birthrong [10]
Gweneivere Blount
Velva Booker
Milkia Brady
Kim Brickles
Buffy Brown
Jennifer Brown
Bobby Burns [10]
Vernon Bush
Keith Butterfield
Randy Camp
Heath Campbell
Brenda Carr [25]
William Cavender
Beth Chapman
Shirley Chatman
Vance Cheek
Barbara Cole
Alva Coleman
Jeremy Conlin
Jamie Cope
Delcinia Costa
Liddye Cotter [25]
Janie Couch
Daniel Crews
Toni Crossfield
Janice Cunningham
Steve Curry
Shawn Curtis [5]
Chris Daniel
Ted Daniel
Ruth Daniels [25]
Pat Darrell
Mary Sue Davidson
Vivian Davidson
Terry Davis
Brian Derrick
Larissa Dills
Bridget Dorse
Rick DuBray
Aimee Duffey
Amy Dunlap [10]
Shaune Eberhart
Sharon Farmer
Yan Fei
Donna Finley
Peggy Fisher
Jamie Fohl [15]
Noy Fongnaly
Eddy Fonseca
Charlotte Fuller
Monica Fuqua
John Gabriel
Doug Gaines
Ann Gatewood [30]
Bernard Gentry
Connie Gibson
Teresa Gibson [10]
Kellie Givens
Randy Graves
Janice Green
Barbara Greene
Steve Gregory
Delores Griffin
Kellie Gwozdz
Deana Hannah
Tamara Hanserd
Kathy Hargrove
Sharon Harris
Kerry Hartley
David Head
Ed Hennessee
Kristen Hines
Ellen Hoffmann
Malinda Hudson
Amanda Hulsey
Robin Hunter
Patti Hyder-Allison
Angela Jennette
Roxanne Johnson
Tawana Johnson
Donna Jordan
Tom Jordan [25]
Peter Katseff
Michael Keeler
Natalie Kilgore
Jenny King [10]
George Ladd
Liren Li
Wanda Mackey
Vallie Majors
Fred Marshall
Brock Martin
Tim McClure [15]
Lonnie McWhorter
Mandy Meadows
Brenda Mercier
Henry Miller
Tom Milne
Newt Molloy [30]
Linda Moore [30]
Carrie Morgan
Prentice Morgan
Kim Morrow
Gail Moses
Tempra Mosley
Michael Moulder
Sareatha Murphy
Alicia Myles
Cristy Norment
Candy O'Leary [15]
Glenda Oshop
Kimberly Otts
Wendy Padgett
LaKesha Page
Yvonne Parlow
Floyd Parton
Marian Pinson
Brad Pritchett
Michael Ragland
William Redmond
Janice Reilly
Marsha Richeson
Carla Riley
Rachel Roberts
Mary Roberts-Krause [15]
Jim Robinson
Stephanie Sabin
Sharon Sanders
Tammie Scott
Sandra Sewell
Leighton Shantz
Dale Sims
David Singleton [5]
Kyle Skelley
Anita Smith
Mary Smith
Robert Smith
Rebecca Stapleton
Sandy Strickland
Ann Taylor-Tharpe
Katrina Tucker [5]
Shannon Tucker
Christie Vaughn [15]
Johnny Veach
Maxine Vinson
Malinda Wagner
Mark Wakefield [5]
Tracy Walker
Tracey Washington
Susanna Wassom
Jamie Wayman
Roy Wellington
Shirley Wheeler
Lucy White [45]
Teresa Williams
Kellie Williamson
Dianne Willocks [35]
Shirley Wilson
Genera Wimmer
Angela Woodrum
Dawn Young

[5] Received 5-year service award in 2002
[10] Received 10-year service award in 2002
[15] Received 15-year service award in 2002
[20] Received 20-year service award in 2002
[25] Received 25-year service award in 2002
[30] Received 30-year service award in 2002
[35] Received 35-year service award in 2002
[45] Received 45-year service award in 2002

Investment Portfolios

A member of the weasel family, the river otter was one of the first animals placed on Tennessee's list of protected species.

These sleek creatures are spectacular athletes on land and water. They are well adapted for diving: their ears and nostrils can be closed. River otters live in dens and have one to five pups per litter.

The river otters are making a strong comeback in the wetlands and rivers of West Tennessee.

The red fox sports a reddish-brown coat and has black feet and ears, with a white tip on the tail. The red fox has the ability to spring up to fifteen feet to capture prey.

STATE CASH PORTFOLIO
AS OF JUNE 30, 2002

Description	Rating	Maturity	Yield to Maturity	Par Value	Fair Value
U.S. TREASURY AND AGENCY OBLIGATIONS					
FFCB	Aaa	7/01/02	1.90	$ 65,000,000	$ 65,000,000
FFCB	Aaa	8/01/02	1.79	50,000,000	50,000,000
FFCB	Aaa	9/03/02	2.13	20,000,000	20,162,600
FFCB	Aaa	9/03/02	1.75	50,000,000	49,984,500
FHDN	Aaa	11/08/02	1.90	34,445,000	34,234,886
FHDN	Aaa	5/15/03	2.44	25,000,000	24,580,000
FHLB	Aaa	3/04/03	2.33	25,000,000	25,007,500
FHLB	Aaa	6/05/03	2.64	20,000,000	20,012,000
FHLB	Aaa	7/23/03	3.56	35,000,000	35,022,050
FHLMC	Aaa	1/24/03	2.38	40,000,000	40,008,000
FHLMC	Aaa	10/15/02	2.06	140,300,000	142,011,660
FHLMC	Aaa	11/27/02	2.30	25,000,000	25,010,000
FHLMC	Aaa	12/27/02	2.51	75,000,000	75,082,500
FHLMC	Aaa	7/15/03	2.58	25,000,000	25,930,000
FHLMC	Aaa	8/15/02	2.07	23,739,000	23,871,938
FMCDN	Aaa	7/25/02	1.76	100,000,000	99,880,000
FMCDN	Aaa	9/12/02	2.04	100,000,000	99,650,000
FNDN	Aaa	10/01/02	1.94	11,175,000	11,122,478
FNDN	Aaa	10/09/02	1.92	30,383,000	30,240,200
FNDN	Aaa	7/02/02	1.87	50,000,000	50,000,000
FNDN	Aaa	8/06/02	1.81	27,596,261	27,760,183
FNDN	Aaa	9/16/02	1.86	100,000,000	99,630,000
FNMA	Aaa	10/15/02	1.99	133,730,000	135,401,625
FNMA	Aaa	4/15/03	2.59	25,000,000	25,703,250
FNMA	Aaa	1/15/03	2.60	52,765,000	53,688,387
FNMA	Aaa	11/05/02	2.55	50,000,000	50,094,000
FNMA	Aaa	8/15/02	1.79	33,000,000	33,196,020
FNMA	Aaa	8/19/02	1.80	18,035,533	18,142,664
FNMA	Aaa	9/03/02	1.91	19,900,000	19,893,831
SLDN	Aaa	2/07/03	2.21	11,620,000	11,492,180
SLMA	Aaa	5/28/03	2.50	41,250,000	41,365,500
WBDN	Aaa	3/17/03	2.73	36,243,000	37,137,840
TOTAL U.S. TREASURY AND AGENCY OBLIGATIONS				**$1,494,181,794**	**$1,500,315,792**

	Maturity	Yield to Maturity	Par Value	Fair Value
CERTIFICATES OF DEPOSIT				
BANK OF ALAMO	7/2/02	1.75	$ 2,000,000	$ 2,000,000
BANK OF ALAMO	12/17/02	2.15	2,000,000	2,000,000
BANK OF CROCKETT, BELLS	7/9/02	1.75	300,000	300,000
BANK OF CROCKETT, BELLS	12/13/02	1.90	200,000	200,000
PEOPLES BANK OF POLK COUNTY, BENTON	7/9/02	1.75	200,000	200,000
FIRST SOUTH BANK, BOLIVAR	10/15/02	2.15	2,142,700	2,142,700
BANK OF BRADFORD	9/6/02	1.95	100,000	100,000
PEOPLE'S BANK & TRUST COMPANY, BYRDSTOWN	8/23/02	1.85	100,000	100,000
PEOPLE'S BANK & TRUST COMPANY, BYRDSTOWN	9/10/02	1.95	100,000	100,000
PEOPLE'S BANK & TRUST COMPANY, BYRDSTOWN	7/23/02	1.75	100,000	100,000
PEOPLE'S BANK & TRUST COMPANY, BYRDSTOWN	9/13/02	1.95	200,000	200,000
PEOPLE'S BANK & TRUST COMPANY, BYRDSTOWN	10/1/02	2.15	200,000	200,000
PEOPLE'S BANK & TRUST COMPANY, BYRDSTOWN	9/20/02	2.15	100,000	100,000
PEOPLE'S BANK & TRUST COMPANY, BYRDSTOWN	12/17/02	2.15	500,000	500,000
CITIZENS BANK, CARTHAGE	9/3/02	1.95	2,000,000	2,000,000

(continued)

STATE CASH PORTFOLIO AS OF JUNE 30, 2002

	Maturity	Yield to Maturity	Par Value	Fair Value
CUMBERLAND BANK, CARTHAGE	8/27/02	1.85	500,000	500,000
FIRST STATE BANK, CHAPEL HILL	10/18/02	2.15	200,000	200,000
FIRST FEDERAL SAVINGS BANK, CLARKSVILLE	7/19/02	1.75	3,000,000	3,000,000
FIRST FEDERAL SAVINGS BANK, CLARKSVILLE	9/27/02	2.15	2,000,000	2,000,000
FIRST FEDERAL SAVINGS BANK, CLARKSVILLE	7/26/02	1.75	100,000	100,000
LEGENDS BANK, CLARKSVILLE	7/3/02	1.85	500,000	500,000
LEGENDS BANK, CLARKSVILLE	8/2/02	2.00	500,000	500,000
LEGENDS BANK, CLARKSVILLE	8/30/02	1.85	500,000	500,000
THE BANK/FIRST CITIZENS BANK, CLEVELAND	8/22/02	2.00	5,000,000	5,000,000
PEOPLES BANK, CLIFTON	12/6/02	2.15	500,000	500,000
COMMUNITY FIRST BANK & TRUST, COLUMBIA	10/11/02	2.15	1,000,000	1,000,000
FIRST BANK OF POLK COUNTY, COPPERHILL	7/16/02	1.75	4,300,000	4,300,000
EFS FEDERAL SAVINGS BANK, CORDOVA	7/9/02	1.75	2,500,000	2,500,000
COMMUNITY NATIONAL BANK, DAYTON	7/1/02	1.75	1,000,000	1,000,000
COMMUNITY NATIONAL BANK, DAYTON	10/4/02	2.15	950,000	950,000
TRISTAR BANK, DICKSON	11/4/02	2.15	500,000	500,000
BANCORPSOUTH, DRESDEN	8/28/02	1.90	3,000,000	3,000,000
THE HOME BANK FSB, DUCKTOWN	10/4/02	2.15	1,000,000	1,000,000
THE HOME BANK FSB, DUCKTOWN	10/4/02	2.15	500,000	500,000
FIRST-CITIZENS NATIONAL BANK, DYERSBURG	8/21/02	1.90	30,425,000	30,425,000
SECURITY BANK, DYERSBURG	9/16/02	2.15	300,000	300,000
CITIZENS BANK, ELIZABETHTON	10/4/02	2.15	2,600,000	2,600,000
TENNESSEE COMMERCE BANK, FRANKLIN	8/2/02	1.75	750,000	750,000
TENNESSEE COMMERCE BANK, FRANKLIN	8/30/02	1.95	500,000	500,000
BANK OF FRIENDSHIP	7/26/02	1.75	1,550,000	1,550,000
BANK OF FRIENDSHIP	7/26/02	1.75	525,000	525,000
BANK OF FRIENDSHIP	7/26/02	1.75	50,000	50,000
BANK OF FRIENDSHIP	8/5/02	1.75	375,000	375,000
BANK OF FRIENDSHIP	10/11/02	2.15	90,000	90,000
GATES BANKING AND TRUST COMPANY	10/8/02	2.15	500,000	500,000
GATES BANKING AND TRUST COMPANY	10/1/02	2.15	450,000	450,000
GATES BANKING AND TRUST COMPANY	12/10/02	2.15	350,000	350,000
TRUST ONE BANK, GERMANTOWN	7/3/02	1.90	5,000,000	5,000,000
TRUST ONE BANK, GERMANTOWN	7/3/02	1.85	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	7/3/02	1.85	3,000,000	3,000,000
TRUST ONE BANK, GERMANTOWN	8/30/02	1.90	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	8/30/02	1.90	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	8/30/02	1.90	2,000,000	2,000,000
TRUST ONE BANK, GERMANTOWN	8/1/02	1.90	6,000,000	6,000,000
TRUST ONE BANK, GERMANTOWN	8/30/02	1.90	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	8/30/02	1.90	3,000,000	3,000,000
TRUST ONE BANK, GERMANTOWN	8/30/02	1.90	1,000,000	1,000,000
TRUST ONE BANK, GERMANTOWN	8/30/02	1.90	1,000,000	1,000,000
BANK OF GLEASON	7/23/02	1.75	350,000	350,000
BANK OF GLEASON	9/13/02	1.95	1,000,000	1,000,000
BANK OF GLEASON	9/13/02	1.95	1,000,000	1,000,000
BANK OF GLEASON	9/17/02	2.15	200,000	200,000
BANK OF GLEASON	11/26/02	2.15	300,000	300,000
BANK OF HALLS	8/21/02	1.90	300,000	300,000
BANK OF HALLS	7/12/02	1.75	200,000	200,000
BANK OF HALLS	7/26/02	1.75	400,000	400,000
BANK OF HALLS	9/4/02	1.90	700,000	700,000
BANK OF HALLS	9/25/02	1.90	200,000	200,000

(continued)

STATE CASH PORTFOLIO
AS OF JUNE 30, 2002

	Maturity	Yield to Maturity	Par Value	Fair Value
CITIZENS BANK, HARTSVILLE	12/20/02	2.15	700,000	700,000
BANCORPSOUTH, HUMBOLDT	7/29/02	1.75	1,000,000	1,000,000
BANCORPSOUTH, HUMBOLDT	8/23/02	1.85	1,000,000	1,000,000
BANCORPSOUTH, HUMBOLDT	8/26/02	1.90	1,000,000	1,000,000
BANCORPSOUTH, JACKSON	7/8/02	1.75	5,000,000	5,000,000
BANCORPSOUTH, JACKSON	9/23/02	1.90	5,000,000	5,000,000
BANCORPSOUTH, JACKSON	7/19/02	1.75	5,000,000	5,000,000
BANCORPSOUTH, JACKSON	7/31/02	1.75	5,000,000	5,000,000
BANCORPSOUTH, JACKSON	8/2/02	1.75	50,000,000	50,000,000
BANCORPSOUTH, JACKSON	8/2/02	1.75	50,000,000	50,000,000
BANCORPSOUTH, JACKSON	8/21/02	1.90	25,000,000	25,000,000
BANCORPSOUTH, JACKSON	8/23/02	1.85	1,000,000	1,000,000
BANCORPSOUTH, JACKSON	10/1/02	2.15	5,000,000	5,000,000
BANCORPSOUTH, JACKSON	7/8/02	1.75	10,000,000	10,000,000
BANCORPSOUTH, JACKSON	9/27/02	2.00	4,000,000	4,000,000
BANCORPSOUTH, JACKSON	9/24/02	2.00	5,000,000	5,000,000
BANK OF JACKSON	9/3/02	1.95	500,000	500,000
FENTRESS COUNTY BANK, JAMESTOWN	8/16/02	1.85	500,000	500,000
FENTRESS COUNTY BANK, JAMESTOWN	10/25/02	2.15	500,000	500,000
FENTRESS COUNTY BANK, JAMESTOWN	10/25/02	2.15	450,000	450,000
FENTRESS COUNTY BANK, JAMESTOWN	10/25/02	2.15	200,000	200,000
FENTRESS COUNTY BANK, JAMESTOWN	8/9/02	1.85	300,000	300,000
FENTRESS COUNTY BANK, JAMESTOWN	10/25/02	2.15	500,000	500,000
PROGRESSIVE SAVINGS BANK FSB, JAMESTOWN	8/6/02	1.75	300,000	300,000
CITIZENS STATE BANK, JASPER	10/8/02	2.00	100,000	100,000
CITIZENS STATE BANK, JASPER	10/8/02	2.00	200,000	200,000
CITIZENS STATE BANK,JASPER	9/20/02	2.15	200,000	200,000
BANKFIRST, KNOXVILLE	9/27/02	2.15	40,000,000	40,000,000
BB&T, KNOXVILLE	7/30/02	2.00	75,000,000	75,000,000
CITIZENS BANK OF LAFAYETTE	7/9/02	1.75	500,000	500,000
CITIZENS BANK OF LAFAYETTE	8/13/02	1.85	100,000	100,000
CITIZENS BANK OF LAFAYETTE	9/3/02	1.95	250,000	250,000
CITIZENS BANK OF LAFAYETTE	7/12/02	1.75	100,000	100,000
FIRST CENTRAL BANK, LENOIR CITY	9/13/02	1.95	500,000	500,000
FIRST CENTRAL BANK, LENOIR CITY	10/22/02	2.15	500,000	500,000
THE COFFEE COUNTY BANK, MANCHESTER	11/15/02	2.15	95,000	95,000
CITY STATE BANK, MARTIN	12/17/02	2.15	2,000,000	2,000,000
CITY STATE BANK, MARTIN	7/9/02	1.75	1,500,000	1,500,000
CITY STATE BANK, MARTIN	8/6/02	1.75	1,500,000	1,500,000
PLANTERS BANK OF MAURY CITY	12/17/02	2.15	200,000	200,000
THE FIRST NATIONAL BANK OF MCMINNVILLE	9/11/02	1.90	2,500,000	2,500,000
THE FIRST NATIONAL BANK OF MCMINNVILLE	7/26/02	1.90	5,000,000	5,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	7/12/02	1.75	5,000,000	5,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	7/26/02	1.75	1,000,000	1,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	7/30/02	1.75	2,500,000	2,500,000
ENTERPRISE NATIONAL BANK, MEMPHIS	12/24/02	2.15	3,000,000	3,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	9/27/02	2.15	1,000,000	1,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	11/26/02	2.15	5,000,000	5,000,000
ENTERPRISE NATIONAL BANK, MEMPHIS	9/27/02	2.15	500,000	500,000
INDEPENDENT BANK, MEMPHIS	7/30/02	1.75	4,000,000	4,000,000
INDEPENDENT BANK, MEMPHIS	8/30/02	1.95	500,000	500,000
INDEPENDENT BANK, MEMPHIS	10/1/02	2.15	1,500,000	1,500,000
INDEPENDENT BANK, MEMPHIS	11/26/02	2.15	2,000,000	2,000,000

(continued)

STATE CASH PORTFOLIO AS OF JUNE 30, 2002

	Maturity	Yield to Maturity	Par Value	Fair Value
INDEPENDENT BANK, MEMPHIS	12/24/02	2.15	2,000,000	2,000,000
INDEPENDENT BANK, MEMPHIS	7/16/02	1.75	1,000,000	1,000,000
INDEPENDENT BANK, MEMPHIS	8/27/02	1.85	1,000,000	1,000,000
INDEPENDENT BANK, MEMPHIS	11/5/02	2.15	2,000,000	2,000,000
INDEPENDENT BANK, MEMPHIS	11/26/02	2.15	5,000,000	5,000,000
MEMPHISFIRST COMMUNITY BANK	12/17/02	2.15	2,000,000	2,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	7/5/02	1.80	75,000,000	75,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	7/17/02	1.80	50,000,000	50,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	7/19/02	1.80	50,000,000	50,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	7/29/02	1.75	50,000,000	50,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	8/14/02	1.90	50,000,000	50,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	9/23/02	2.15	50,000,000	50,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	9/27/02	2.15	75,000,000	75,000,000
NATIONAL BANK OF COMMERCE, MEMPHIS	7/8/02	1.75	50,000,000	50,000,000
SOUTHTRUST BANK, MEMPHIS	8/16/02	1.90	1,000,000	1,000,000
SOUTHTRUST BANK, MEMPHIS	8/16/02	1.90	25,000,000	25,000,000
SOUTHTRUST BANK, MEMPHIS	11/1/02	2.15	25,000,000	25,000,000
SOUTHTRUST BANK, MEMPHIS	11/1/02	2.15	25,000,000	25,000,000
SOUTHTRUST BANK, MEMPHIS	11/1/02	2.15	1,000,000	1,000,000
SOUTHTRUST BANK, MEMPHIS	11/8/02	2.15	2,000,000	2,000,000
BANCORPSOUTH, MILAN	8/13/02	1.75	1,500,000	1,500,000
BANK OF MURFREESBORO	12/17/02	2.15	4,000,000	4,000,000
AMSOUTH BANK, NASHVILLE	8/12/02	1.85	50,000,000	50,000,000
AMSOUTH BANK, NASHVILLE	8/30/02	1.85	50,000,000	50,000,000
AMSOUTH BANK, NASHVILLE	12/13/02	2.15	100,000,000	100,000,000
AMSOUTH BANK, NASHVILLE	11/12/02	2.15	50,000,000	50,000,000
BANK OF NASHVILLE	7/12/02	1.75	5,000,000	5,000,000
BANK OF NASHVILLE	7/19/02	1.75	5,000,000	5,000,000
CAPITAL BANK & TRUST COMPANY, NASHVILLE	8/23/02	1.85	2,000,000	2,000,000
CAPITAL BANK & TRUST COMPANY, NASHVILLE	8/2/02	1.75	3,500,000	3,500,000
CAPITAL BANK & TRUST COMPANY, NASHVILLE	8/13/02	1.85	1,000,000	1,000,000
SOUTHTRUST BANK, NASHVILLE	7/2/02	1.75	50,000,000	50,000,000
SOUTHTRUST BANK, NASHVILLE	8/26/02	1.90	50,000,000	50,000,000
SOUTHTRUST BANK, NASHVILLE	9/13/02	1.90	50,000,000	50,000,000
SOUTHTRUST BANK, NASHVILLE	9/13/02	1.90	2,800,000	2,800,000
SOUTHTRUST BANK, NASHVILLE	9/13/02	1.90	3,000,000	3,000,000
SOUTHTRUST BANK, NASHVILLE	9/13/02	1.90	40,000,000	40,000,000
SOUTHTRUST BANK, NASHVILLE	9/13/02	2.00	10,000,000	10,000,000
SOUTHTRUST BANK, NASHVILLE	7/2/02	1.75	4,000,000	4,000,000
SOUTHTRUST BANK, NASHVILLE	8/16/02	1.90	50,000,000	50,000,000
SOUTHTRUST BANK, NASHVILLE	8/26/02	1.90	50,000,000	50,000,000
SOUTHTRUST BANK, NASHVILLE	9/13/02	1.90	50,000,000	50,000,000
SOUTHTRUST BANK, NASHVILLE	8/5/02	1.75	3,500,000	3,500,000
SOUTHTRUST BANK, NASHVILLE	8/5/02	1.75	4,000,000	4,000,000
SOUTHTRUST BANK, NASHVILLE	9/13/02	1.90	6,000,000	6,000,000
SOUTHTRUST BANK, NASHVILLE	7/5/02	1.75	30,000,000	30,000,000
NEWPORT FEDERAL BANK	8/22/02	1.85	95,000	95,000
NEWPORT FEDERAL BANK	8/22/02	1.85	300,000	300,000
NEWPORT FEDERAL BANK	9/3/02	1.95	500,000	500,000
NEWPORT FEDERAL BANK	9/3/02	1.95	500,000	500,000
EFS FEDERAL SAVINGS BANK, OAKLAND	7/16/02	1.75	2,500,000	2,500,000
THE FIRST NATL BANK OF ONEIDA	8/2/02	1.75	500,000	500,000
THE FIRST NATL BANK OF ONEIDA	9/3/02	1.95	500,000	500,000

(continued)

State Cash Portfolio as of June 30, 2002

	Maturity	Yield to Maturity	Par Value	Fair Value
THE FIRST NATL BANK OF ONEIDA	8/26/02	1.85	2,500,000	2,500,000
FIRST NATIONAL BANK OF PIKEVILLE	8/9/02	1.85	300,000	300,000
FIRST NATIONAL BANK OF PULASKI	7/12/02	1.75	300,000	300,000
FIRST NATIONAL BANK OF PULASKI	7/16/02	1.75	500,000	500,000
FIRST NATIONAL BANK OF PULASKI	7/16/02	1.75	300,000	300,000
FIRST NATIONAL BANK OF PULASKI	7/12/02	1.75	700,000	700,000
FIRST NATIONAL BANK OF PULASKI	7/19/02	1.75	300,000	300,000
FIRST NATIONAL BANK OF PULASKI	7/19/02	1.75	1,000,000	1,000,000
FIRST NATIONAL BANK OF PULASKI	7/26/02	1.75	1,000,000	1,000,000
FIRST NATIONAL BANK OF PULASKI	7/26/02	1.75	1,000,000	1,000,000
BANK OF RIPLEY	7/16/02	1.75	100,000	100,000
BANK OF RIPLEY	7/16/02	1.75	150,000	150,000
BANK OF RIPLEY	11/19/02	2.15	200,000	200,000
BANK OF RIPLEY	12/6/02	2.15	100,000	100,000
BANK OF RIPLEY	12/13/02	2.15	100,000	100,000
THE HARDIN COUNTY BANK, SAVANNAH	11/29/02	2.15	1,000,000	1,000,000
BANK OF SHARON	9/27/02	2.15	1,000,000	1,000,000
BANK OF SHARON	11/12/02	2.15	1,000,000	1,000,000
BANK OF SHARON	12/10/02	2.15	1,000,000	1,000,000
BANK OF SHARON	12/20/02	2.15	1,500,000	1,500,000
BANK OF SHARON	8/2/02	1.75	1,000,000	1,000,000
SOMERVILLE BANK & TRUST COMPANY	7/26/02	1.75	200,000	200,000
MERCHANTS & PLANTERS BANK, TOONE	7/19/02	1.75	200,000	200,000
BANCORPSOUTH, TRENTON	7/26/02	1.75	1,500,000	1,500,000
WAYNE COUNTY BANK, WAYNESBORO	12/3/02	2.15	500,000	500,000
WAYNE COUNTY BANK, WAYNESBORO	7/8/02	1.75	900,000	900,000
TOTAL CERTIFICATES OF DEPOSIT			**$ 1,682,647,700**	**$ 1,682,647,700**

	Maturity	Yield to Maturity	Par Value	Fair Value
REPURCHASE AGREEMENTS AND OVERNIGHT DEPOSIT ACCOUNTS				
LEHMAN BROTHERS - OVERNIGHT	7/1/02	1.91	$ 18,000,000	$ 18,000,000
LEHMAN BROTHERS - OVERNIGHT	7/1/02	1.91	55,820,000	55,820,000
LEHMAN BROTHERS - OVERNIGHT	7/1/02	1.91	24,180,000	24,180,000
AMSOUTH BANK - OVERNIGHT DEPOSIT ACCOUNT	7/1/02	1.80	21,000,000	21,000,000
TOTAL REPURCHASE AGREEMENTS			**$ 119,000,000**	**$ 119,000,000**

	Rating	Maturity	Yield to Maturity	Par Value	Fair Value
COMMERCIAL PAPER					
AMERICAN EXPRESS	A1	7/8/02	1.76	$ 50,000,000	$ 49,982,889
BMW US CAPITAL CORPORATION	A1	7/1/02	1.98	91,698,000	91,698,000
CARGILL GLOBAL FUNDING	A1	7/1/02	1.96	25,000,000	25,000,000
KOCH INDUSTRIES	A1	7/1/02	1.98	180,000,000	180,000,000
PACIFIC GAS & ELECTRIC	WR	1/23/01	6.50	4,000,000	3,880,000
PRUDENTIAL FUNDING	A1	7/8/02	1.76	70,000,000	69,976,044
SALOMON SMITH BARNEY	A1	7/1/02	1.93	200,000,000	200,000,000
TOYOTA MOTOR CREDIT	A1	7/30/02	1.75	50,000,000	49,929,514
TOTAL COMMERCIAL PAPER				**$ 670,698,000**	**$ 670,466,447**

TOTAL PORTFOLIO	**$ 3,966,527,494**	**$ 3,972,429,939**

Baccalaureate Education System Trust Portfolio as of June 30, 2002

Description	Maturity	Yield to Maturity	Par Value	Fair Value
U.S. TREASURY AND AGENCY OBLIGATIONS				
UNITED STATES TREASURY NOTES	5/31/04	2.82	$ 20,000,000	$ 20,156,200
TOTAL U.S. TREASURY AND AGENCY OBLIGATIONS			**$ 20,000,000**	**$ 20,156,200**

	Units	Fair Value
MUTUAL FUND		
STATE STREET S&P 500 INDEX FUND	244,461	$ 10,501,305
TOTAL MUTUAL FUND		**$ 10,501,305**

TOTAL PORTFOLIO	**$ 30,657,505**

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
LARGEST HOLDINGS

LARGEST STOCK HOLDINGS
as of June 30, 2002
by Fair Value

Shares	Security Name	Fair Value
3,940,000	MICROSOFT CORPORATION	$ 215,518,000
7,073,000	GENERAL ELECTRIC COMPANY	205,470,650
4,916,594	EXXON MOBIL CORPORATION	201,187,026
3,388,000	WAL-MART STORES INCORPORATED	186,373,880
4,858,000	PFIZER INCORPORATED	170,030,000
3,846,004	CITIGROUP INCORPORATED	149,032,655
1,913,035	AMERICAN INTL GROUP INCORPORATED	130,526,378
2,378,742	JOHNSON & JOHNSON	124,313,057
1,901,000	THE COCA-COLA COMPANY	106,456,000
1,492,743	BANK OF AMERICA CORPORATION	105,029,397

LARGEST BOND HOLDINGS
as of June 30, 2002
by Fair Value

Par Value	Security Name	Yield	Maturity	Moody's Quality Rating	Fair Value
353,500,000	U.S. TREASURY NOTES	3.77%	5/15/2006	Aaa	$ 392,494,585
305,000,000	U.S. TREASURY NOTES	4.29%	5/15/2008	Aaa	325,587,500
267,000,000	U.S. TREASURY BONDS	3.23%	11/15/2009	Aaa	310,053,750
206,400,000	U.S. TREASURY BONDS	4.63%	8/15/2014	Aaa	303,602,016
187,000,000	U.S. TREASURY BONDS	5.61%	5/15/2021	Aaa	241,114,060
220,000,000	FEDERAL HOME LN MTG CORP	3.50%	2/15/2005	Aaa	222,475,000
140,000,000	U.S. TREASURY BONDS	5.60%	2/15/2021	Aaa	176,268,400
152,862,214	FNMA POOL 545338	4.61%	11/1/2031	Aaa	158,307,166
150,000,149	FNMA POOL 254262	6.05%	4/1/2032	Aaa	149,625,149
143,634,500	FED HM LN PC C00702	6.10%	1/1/2029	Aaa	143,858,570

A complete portfolio listing is available upon request.

Chairs of Excellence
Largest Holdings

LARGEST BOND HOLDINGS
as of June 30, 2002
by Fair Value

Par Value	Security Name	Yield to Maturity	Maturity	Moody's Quality Rating	Fair Value
11,200,000	UNITED STATES TREASURY NOTES	4.69%	8/15/2010	Aaa	$ 11,980,528
10,000,000	UNITED STATES TREASURY NOTES	4.49%	5/15/2009	Aaa	10,581,300
7,000,000	FEDERAL NATL MTG ASSOCIATION	4.97%	6/15/2009	Aaa	7,570,920
6,000,000	UNITED STATES TREASURY NOTES	4.79%	8/15/2011	Aaa	6,082,500
5,000,000	MERRILL LYNCH & COMPANY INC	4.84%	5/15/2006	Aa3	5,435,900
5,000,000	BOEING CAP CORPORATION	4.36%	9/27/2005	A3	5,409,150
5,000,000	FEDERAL NATL MTG ASSOCIATION	2.99%	5/14/2004	Aaa	5,237,500
5,000,000	VIRGINIA ELECTRIC & POWER COMPANY	4.80%	3/31/2006	A3	5,161,350
5,000,000	SALOMON INCORPORATED	2.51%	5/15/2003	Aa1	5,159,000
5,000,000	ALLSTATE CORPORATION	4.67%	12/01/2006	A1	5,131,000

A complete portfolio listing is available upon request.

	Units	Fair Value
MUTUAL FUND		
STATE STREET S&P 500 INDEX FUND	2,150,015	$ 92,358,174
TOTAL MUTUAL FUND		**$ 92,358,174**

Key to Ratings: All ratings presented are from Moody's Investors Service with the exception of some of the government agency securities. Moody's does not rate these securities. Standard & Poor's does provide ratings for the securities (AAA is Standard & Poor's highest rating). Government Securities are not rated per se' but are considered the best quality securities.

Moody's rates securities as follows:

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

Financial Section

The bald eagle nests each year near Tennessee's 530,000 acres of reservoirs.

Bald eagles gain their full adult plumage between four and eight years of age, turning slowly from their juvenile brown color to white-headed and white-tailed.

The bald eagle was declared the National Emblem of the U.S. by the 2nd Continental Congress on June 20, 1782. In celebration, June 20 is designated as "Tennessee Bald Eagle Day."

The wild turkey is the forefather of all domesticated turkeys. Considered strong fliers, turkeys can also run at speeds up to 12 miles per hour.

Raised tail feathers form a fan, as seen on this turkey. The fan is displayed during aggressive behavior or during courtship.

A survey of Tennessee landowners in the 1950s revealed that wild turkeys inhabited only 16 counties. After a successful restoration project, the wild turkey population reached 100,000 by the late 1990s.

State Pooled Investment Fund
Independent Auditor's Report

STATE OF TENNESSEE

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

December 17, 2002

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

Dear Mr. Morgan:

We have audited the accompanying statements of fiduciary net assets of the State Pooled Investment Fund as of June 30, 2002, and June 30, 2001, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

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

As discussed in Note A.1., the financial statements referred to above present only the fiduciary net assets and changes in fiduciary net assets of the State Pooled Investment Fund of the State of Tennessee and are not intended to present fairly the financial position and changes in financial position of the State of Tennessee, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the State Pooled Investment Fund as of June 30, 2002, and June 30, 2001, and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A.5. to the financial statements, the State Pooled Investment Fund implemented GASB Statements 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and 38, *Certain Financial Statement Note Disclosures*.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2002, 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

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

STATE POOLED INVESTMENT FUND
COMPARATIVE STATEMENTS OF FIDUCIARY NET ASSETS
JUNE 30, 2002 AND JUNE 30, 2001

	June 30, 2002	June 30, 2001
ASSETS		
Cash and cash equivalents	$ 1,285,364,727	$ 2,167,004,978
Short-term investments, at amortized cost	2,499,164,953	2,129,904,122
Accrued income receivable	19,489,192	17,911,769
TOTAL ASSETS	3,804,018,872	4,314,820,869
LIABILITIES AND NET ASSETS		
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS	$ 3,804,018,872	$ 4,314,820,869

See accompanying Notes to the Financial Statements

STATE POOLED INVESTMENT FUND
COMPARATIVE STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001

	For the Year Ended June 30, 2002	For the Year Ended June 30, 2001
OPERATIONS		
Investment income	$ 118,626,988	$ 244,492,781
Expenses		
Administrative fee	1,947,379	1,922,720
Custodian and banking services fees	106,285	48,781
Total expenses	2,053,664	1,971,501
NET INVESTMENT INCOME	116,573,324	242,521,280
CAPITAL SHARE TRANSACTIONS (DOLLAR AMOUNTS AND NUMBER OF SHARES ARE THE SAME)		
Shares sold	26,807,679,281	25,623,679,484
Less shares redeemed	27,435,054,602	25,374,558,361
INCREASE(DECREASE)FROM CAPITAL SHARE TRANSACTIONS	(627,375,321)	249,121,123
TOTAL INCREASE(DECREASE) IN NET ASSETS	(510,801,997)	491,642,403
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS		
BEGINNING OF YEAR	4,314,820,869	3,823,178,466
END OF YEAR	$ 3,804,018,872	$ 4,314,820,869

See accompanying Notes to the Financial Statements

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001

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 fiscal years ended June 30, 2002 and June 30, 2001, the State had not obtained or provided any legally binding guarantees to support the value of participant shares.

5. **Adoption of New Accounting Pronouncements** - Effective July 1, 2001, the SPIF, along with the State of Tennessee, adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments* and its related *Omnibus* Statement No. 37. The SPIF has also adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures,* and has included applicable disclosures in the Notes to the Financial Statements.

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, 2002 and June 30, 2001.

(*continued*)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001

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 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. The policy guidelines approved by the State Funding Board require that the market value of the securities underlying the repurchase agreement be at least 102% of the cash investment. The policy also requires that collateral securities be marked-to-market daily and be maintained at a value equal to or greater than the cash investment. 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, 2002 and June 30, 2001, the carrying amounts of the State Pooled Investment Fund deposits were $1,517,330,714 and $1,007,886,383 respectively. The bank balance, including accrued interest, was $1,753,313,524 as of June 30, 2002 and $1,201,535,579 as of June 30, 2001. Of the bank balance, $1,752,980,119 at June 30, 2002 and $1,200,943,362 at June 30, 2001 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, 2002, $333,405 (at fair value) and at June 30, 2001, $592,217 (at fair value) was considered category 3, uninsured and uncollateralized. There were no material amounts uncollateralized during the years ended June 30, 2002 and June 30, 2001.

At June 30, 2002 and June 30, 2001, the principal amount of certificates of deposit in state depositories was $1,682,647,700 and $1,138,372,700 respectively. Interest rates on certificates of deposit held at June 30, 2002 ranged from 1.75% to 2.15% and at June 30, 2001 ranged from 3.60 % to 5.50%. The days to maturity on certificates of deposit ranged from 28 to 187 days at June 30, 2002 and 7 to 179 days at June 30, 2001.

(*continued*)

State Pooled Investment Fund
Notes to the Financial Statements
June 30, 2002 and June 30, 2001

	June 30, 2002				
	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity
Cash Equivalents and Short-term Investments:					
Repurchase Agreements	$ 98,000,000	$ 98,000,000	$ 98,000,000	1.91%	3 days
U.S. Government and Agency Obligations	1,498,639,546	1,500,315,792	1,494,181,794	1.75% to 3.56%	77 to 397 days
Commercial Paper	670,559,420	670,466,447	670,698,000	1.75% to 6.72%	3 to 53 days
Total Cash Equivalents and Short-term Investments	2,267,198,966	$ 2,268,782,239	$ 2,262,879,794		
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Assets	(801,756,713)				
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Assets	1,033,722,700				
Short-term investments as shown on Statement of Fiduciary Net Assets	$ 2,499,164,953				

	June 30, 2001				
	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity
Cash Equivalents and Short-term Investments:					
Repurchase Agreements	$ 57,000,000	$ 57,000,000	$ 57,000,000	4.10%	3 days
U.S. Government and Agency Obligations	2,095,418,733	2,097,669,386	2,097,768,000	3.82% to 5.31%	53 to 393 days
Commercial Paper	1,136,603,984	1,121,092,184	1,137,706,000	3.69% to 4.13%	3 to 54 days
Total Cash Equivalents and Short-term Investments	3,289,022,717	$ 3,275,761,570	$ 3,292,474,000		
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Assets	(1,688,916,295)				
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Assets	529,797,700				
Short-term investments as shown on Statement of Fiduciary Net Assets	$ 2,129,904,122				

The State Pooled Investment Fund's investments, shown above as of June 30, 2002 and June 30, 2001, 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.

(continued)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001

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.

   During Fiscal Year 2001, the SPIF purchased commercial paper issued by Pacific Gas and Electric Company (PG&E) which was due to mature at $51,706,000. PG&E defaulted on the maturity payment and filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. During Fiscal Year 2002, all but $4,000,000 of the $51,706,000 PG&E commercial paper was sold, resulting in a total return on investment of over 5%. As of the date of issuance of the SPIF financial statements, the PG&E reorganization plan was still pending.

C. OTHER ACCOUNTING DISCLOSURES

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

Investment in the SPIF by local governments and certain state agencies is optional and participants may invest any amount for any length of time in the SPIF. However, some deposits made to the LGIP are contractually required and committed to the State Department of Transportation (DOT). The only withdrawals allowed from these accounts are to pay the DOT in accordance with progress billings for construction projects contracted between the entity and the DOT.

An average rate of return is calculated on the investments made each month in the SPIF and is used to credit earnings to LGIP participants and the State departments and agencies required to earn interest. The State's general fund is credited with the residual earnings. Accordingly, participants' shares are sold and redeemed at a value equal to the amount of the principal plus accrued earnings while investments are reported at amortized cost. For the period of July 1, 2000 through December 31, 2001, an administrative fee of .06 percent for LGIP 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. Effective January 1, 2002, the administrative fee was lowered to .05 percent for all participants of the SPIF.

Tennessee Consolidated Retirement System
Independent Auditor's Report

STATE OF TENNESSEE

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

December 11, 2002

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, 2002, and June 30, 2001, 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 auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audits 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.

As discussed in Note A.1., the financial statements referred to above present only the plan net assets and changes in plan net assets of the Pension Trust Funds of the State of Tennessee and are not intended to present fairly the financial position and changes in financial position of the State of Tennessee, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Tennessee Consolidated Retirement System as of June 30, 2002, and June 30, 2001, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A.6. to the financial statements, the Tennessee Consolidated Retirement System implemented GASB Statements 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments,* 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus,* and 38, *Certain Financial Statement Note Disclosures*.

The management's discussion and analysis and the schedules of funding progress and employer contributions are not required parts of the basic financial statements but are supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of

(continued)

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

The Honorable John G. Morgan
December 11, 2002
Page Two

management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The actuarial balance sheet on page 82 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 11, 2002, 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

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

Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Year Ended June 30, 2002

The Management of the Tennessee Consolidated Retirement System (TCRS) provides this discussion and analysis as an overview of the TCRS' financial activities for the fiscal year ended June 30, 2002.

FINANCIAL HIGHLIGHTS

- The plan net assets (total assets minus total liabilities) of the TCRS at June 30, 2002 were over $23.0 billion. This is a decrease of over $690 million (2.9 percent) from the plan net assets at June 30, 2001. The net assets are held in trust to meet future benefit obligations.
- The TCRS relies upon contributions from employees and employers, along with investment income, to meet the funding requirements of an actuarially determined accrued liability. As of July 1, 2001, the date of the latest actuarial valuation, the TCRS' funded ratio was 99.61 percent for the SETHEEPP group and 90.36 percent for the PSPP group.
- Total revenues for fiscal year 2002 were $157,281,294 (decrease of 16.7 percent compared to fiscal year 2001), which consisted of $536,137,611 in contributions (increase of 3.8 percent compared to fiscal year 2001) and $378,856,317 of net investment loss (increase of 15.7 percent compared to fiscal year 2001).
- Total expenses for fiscal year 2002 were $847,399,657 – an increase of 7.5 percent over fiscal year 2001 total expenses.

OVERVIEW OF THE FINANCIAL STATEMENTS

The TCRS financial statements consist of the *Statement of Plan Net Assets (*on pages 70 through 71), the *Statement of Changes in Plan Net Assets* (on pages 72 through 73), and the *Notes to the Financial Statements* (on pages 74 through 79). In addition, *Required Supplementary Information* is presented, which includes this *Management Discussion and Analysis,* as well as the schedules and notes on pages 80 through 81.

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

In addition to the two basic financial statements, the reader should also review the *Schedules of Funding Progress*, the *Schedules of Employer Contributions* and the accompanying *Notes to Required Supplementary Information* to gain an understanding of the funded status of the TCRS over time. This information provides an indication of the TCRS' ability to meet both current and future benefit payment obligations. The *Notes to the Financial Statements* are also important to the reader's understanding of the financial statements and provide additional information regarding the TCRS, such as descriptions of the plans administered by the TCRS, including contribution and benefit provisions, and information about the accounting policies and investment activities.

ANALYSIS OF ASSETS, LIABILITIES AND PLAN NET ASSETS

At June 30, 2002, the TCRS had plan net assets of over $23.0 billion, down over $690 million (2.9 percent) from $23.7 billion as of June 30, 2001. The assets of the TCRS consist primarily of cash and investments. The decrease in plan net assets, as seen over the past two fiscal years, is the result of net negative investment income due primarily to the depreciation in the fair value of investments, caused by unfavorable equity market conditions. Condensed financial information comparing the TCRS' plan net assets for the past two fiscal years is presented on the following page.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2002 (CONTINUED)

PLAN NET ASSETS AT JUNE 30, 2002 AND JUNE 30, 2001

	June 30, 2002	June 30, 2001	Percentage Change
ASSETS			
Cash and cash equivalents	$ 1,621,359,545	$ 779,786,367	107.9 %
Contributions receivables	46,238,224	44,992,609	2.8 %
Investment income receivables	147,069,784	189,993,764	(22.6)%
Investments sold	17,336,115	269,774,623	(93.6)%
Short-term securities	317,388,429	519,748,610	(38.9)%
Long-term investments	21,015,023,754	22,599,841,303	(7.0)%
Invested securities lending collateral	0	113,685,867	(100.0)%
TOTAL ASSETS	23,164,415,851	24,517,823,143	(5.5)%
LIABILITIES			
Death benefits, refunds and other payables	1,141,905	1,014,443	12.6 %
Investments purchased	112,553,617	662,796,260	(83.0)%
Other investment payables	2,633,994	2,121,875	24.1 %
Securities lending collateral	0	113,685,867	(100.0)%
TOTAL LIABILITIES	116,329,516	779,618,445	(85.1)%
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 23,048,086,335	$ 23,738,204,698	(2.9)%

ANALYSIS OF REVENUES AND EXPENSES

While contributions to TCRS for fiscal year 2002 increased by $19.7 million (3.8 percent) over contributions for fiscal year 2001, net investment income for fiscal year 2002 decreased by more than $51.3 million (15.7 percent) compared to fiscal year 2001. Overall, revenues for fiscal year 2002 declined 16.7 percent compared to revenues for fiscal year 2001. Although employer contribution rates did not change during fiscal year 2002, the increase in contributions can be attributed to new employers joining TCRS and increased salaries. Market conditions resulted in reduced investment income with an overall loss to the TCRS investment portfolio of 1.9 percent.

In addition, total expenses, including benefits and administrative expenses for fiscal year 2002 increased by 7.5 percent over fiscal year 2001. The increase in benefit expenses can be attributed to a 3 percent cost of living adjustment awarded to retirees on July 1, 2001 in addition to more retirees being added to payroll than removed during the fiscal year. Administrative expenses were more consistent than would appear. A one-time refund of $1.14 million related to several years of office space overbilling charges was returned to TCRS in fiscal year 2001, thus reducing the total administrative cost. Additionally during fiscal year 2002, a biennial actuarial study was performed increasing actuarial consulting costs.

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

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEAR ENDED JUNE 30, 2002 (CONTINUED)

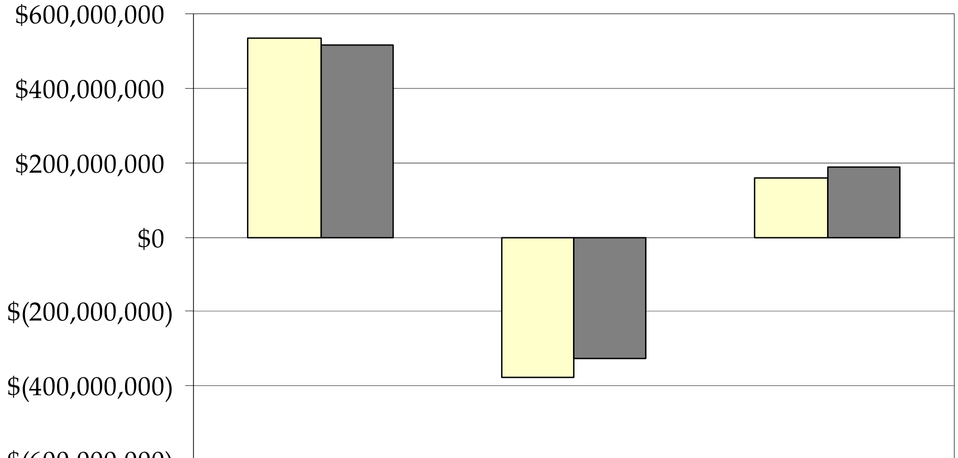
STATEMENT OF CHANGES IN PLAN NET ASSETS

	For the Year Ended June 30, 2002	For the Year Ended June 30, 2001	Percentage Change
ADDITIONS			
Contributions	$ 536,137,611	$ 516,416,729	3.8 %
Investment income			
Net depreciation in fair value of investments	(1,290,032,957)	(1,382,747,281)	(6.7)%
Interest, dividends and other investment income	924,647,372	1,066,991,030	(13.3)%
Less: Investment expense	(14,093,999)	(12,375,102)	13.9%
Net income from securities lending activities	623,267	619,652	0.6 %
Net investment loss	(378,856,317)	(327,511,701)	15.7%
TOTAL ADDITIONS	157,281,294	188,905,028	(16.7)%
DEDUCTIONS			
Annuity benefits			
Retirement benefits	610,554,871	566,721,390	7.7 %
Survivor benefits	38,723,935	36,024,095	7.5 %
Disability benefits	20,109,341	18,567,921	8.3 %
Cost of living	145,335,114	130,369,319	11.5 %
Death benefits	3,367,876	4,701,538	(28.4)%
Refunds	24,304,536	28,517,803	(14.8)%
Administrative expenses	5,003,984	3,477,600	43.9 %
TOTAL DEDUCTIONS	847,399,657	788,379,666	7.5 %
NET DECREASE	(690,118,363)	(599,474,638)	15.1%
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS			
BEGINNING OF YEAR	23,738,204,698	24,337,679,336	(2.5)%
END OF YEAR	$ 23,048,086,335	$ 23,738,204,698	(2.9)%

(continued)

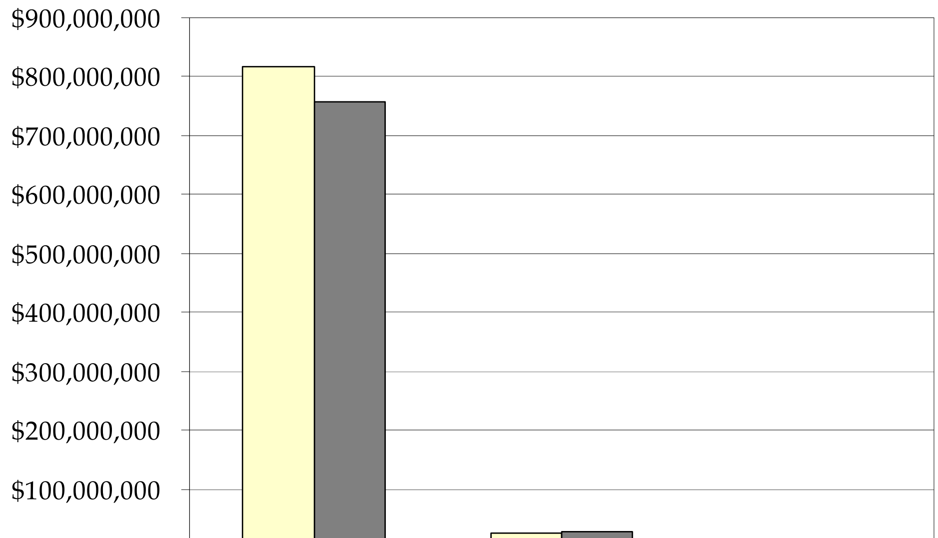
Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Year Ended June 30, 2002 (continued)

REVENUES BY TYPE FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001



	Contributions	Net Investment Income (Loss)	Total Additions
Year Ended 6/30/02	$536,137,611	$(378,856,317)	$157,281,294
Year Ended 6/30/01	$516,416,729	$(327,511,701)	$188,905,028

EXPENSES BY TYPE FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001



	Benefit Payments	Refunds	Administrative
Year Ended 6/30/02	$818,091,137	$24,304,536	$5,003,984
Year Ended 6/30/01	$756,384,263	$28,517,803	$3,477,600

(continued)

Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Year Ended June 30, 2002 (continued)

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

The past two years have been difficult for both the domestic and international stock markets. The S & P 500, TCRS's domestic equity benchmark, was down 14.83 percent at June 30, 2001 and 17.99 percent at June 30, 2002. The NASDAQ, an index that includes the hard hit technology sector, small cap stocks, and dot.com companies, was down 45.37 percent and 32.05 percent during the same period. The international markets, as measured by the EAFE index, did not fair any better being down 23.83 percent and 9.49 percent. Fortunately, the domestic bond market performed better with positive results of 11.22 percent and 8.63 percent.

The last two years proved the benefits of having a diversified portfolio. Despite large negative stock returns, the TCRS portfolio had losses of only 1.57 percent at June 30, 2001 and 1.92 percent at June 30, 2002. TCRS was ranked near the top in investment performance of public pension plans during this period.

The first quarter of the 2002-03 fiscal year was even more difficult with the domestic stock market down 17.28 percent (nearly the same as the previous 12 months) and the international market down 19.73 percent. Again, the bond market had positive returns of 4.58 percent.

While the TCRS has had excellent performance on a relative basis, it must be recognized that the losses during the last two years as compared to the 7.5 percent actuarial earnings assumption will put upward pressure on the employer contribution rate at the next actuarial valuation set for July 1, 2003, as well as subsequent valuations.

CONTACTING THE TCRS

This report is designed to provide a financial overview of the TCRS to state legislators, members of the Board of Trustees of the TCRS, state officials, participating employers and any other interested parties. Questions or requests for additional information regarding the financial information presented in this report may be addressed in writing to the Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, TN 37243-0230.

Tennessee Consolidated Retirement System
Comparative Statements of Plan Net Assets
As of June 30, 2002 and June 30, 2001

Expressed in Thousands	**State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)**	**Political Subdivisions Pension Plan (PSPP)**
ASSETS		
Cash and cash equivalents	$ 1,400,985	$ 220,375
Receivables		
Member contributions receivable	15,250	4,050
Employer contributions receivable	18,191	8,747
Accrued interest receivable	116,555	18,334
Accrued dividends receivable	10,524	1,656
Other investment receivable	1	0
Investments sold	14,980	2,356
Total receivables	175,501	35,143
Investments, at fair value		
Short-term securities	274,249	43,139
Government bonds	7,517,687	1,182,530
Corporate bonds	2,404,488	378,226
Corporate stocks	7,931,835	1,247,676
Real estate	304,659	47,923
Invested securities lending collateral	0	0
Total investments	18,432,918	2,899,494
TOTAL ASSETS	20,009,404	3,155,012
LIABILITIES		
Accounts payable		
Death benefits and refunds payable	461	645
Other	36	0
Investments purchased	97,256	15,298
Other investment payables	2,276	358
Securities lending collateral	0	0
TOTAL LIABILITIES	100,029	16,301
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (Schedules of funding progress for the plans are presented on page 80)	$ 19,909,375	$ 3,138,711

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

June 30, 2002 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2001 Total
$ 1,621,360	$ 676,173	$ 103,613	$ 779,786
19,300	15,055	3,809	18,864
26,938	17,681	8,447	26,128
134,889	160,809	24,641	185,450
12,180	3,840	588	4,428
1	101	15	116
17,336	233,929	35,846	269,775
210,644	431,415	73,346	504,761
317,388	450,688	69,061	519,749
8,700,217	7,795,671	1,194,563	8,990,234
2,782,714	3,100,092	475,040	3,575,132
9,179,511	8,449,363	1,294,730	9,744,093
352,582	251,798	38,584	290,382
0	98,580	15,106	113,686
21,332,412	20,146,192	3,087,084	23,233,276
23,164,416	21,253,780	3,264,043	24,517,823
1,106	644	359	1,003
36	11	0	11
112,554	574,728	88,068	662,796
2,634	1,840	282	2,122
0	98,580	15,106	113,686
116,330	675,803	103,815	779,618
$ 23,048,086	$ 20,577,977	$ 3,160,228	$ 23,738,205

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
COMPARATIVE STATEMENTS OF CHANGES IN PLAN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001

Expressed in Thousands	**State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)**	**Political Subdivisions Pension Plan (PSPP)**
ADDITIONS		
Contributions		
Member contributions	$ 142,126	$ 47,139
Employer contributions	243,498	103,374
Total contributions	385,624	150,513
Investment income		
Net depreciation in fair value of investments	(1,114,237)	(175,796)
Interest	642,392	101,391
Dividends	132,758	20,953
Real estate income, net of operating expenses	23,452	3,701
Total investment loss	(315,635)	(49,751)
Less: Investment expense	(12,190)	(1,904)
Net loss from investing activities	(327,825)	(51,655)
Securities lending activities		
Securities lending income	1,492	235
Less: securities lending expense	(953)	(150)
Net income from securities lending activities	539	85
Net investment loss	(327,286)	(51,570)
Transfer of assets from PSPP	0	0
TOTAL ADDITIONS	58,338	98,943
DEDUCTIONS		
Annuity benefits		
Retirement benefits	528,471	82,084
Survivor benefits	33,518	5,206
Disability benefits	17,405	2,704
Cost of living	129,918	15,417
Death benefits	2,225	1,143
Refunds	12,689	11,616
Administrative expense	2,714	2,290
Transfer of assets to SETHEEPP	0	0
TOTAL DEDUCTIONS	726,940	120,460
NET DECREASE	(668,602)	(21,517)
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
BEGINNING OF YEAR	20,577,977	3,160,228
END OF YEAR	$ 19,909,375	$ 3,138,711

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

June 30, 2002 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2001 Total
$ 189,265	$ 135,154	$ 45,433	$ 180,587
346,872	232,149	103,681	335,830
536,137	367,303	149,114	516,417
(1,290,033)	(1,198,688)	(184,059)	(1,382,747)
743,783	806,941	123,906	930,847
153,711	101,496	15,585	117,081
27,153	16,525	2,538	19,063
(365,386)	(273,726)	(42,030)	(315,756)
(14,094)	(10,738)	(1,637)	(12,375)
(379,480)	(284,464)	(43,667)	(328,131)
1,727	2,078	319	2,397
(1,103)	(1,540)	(237)	(1,777)
624	538	82	620
(378,856)	(283,926)	(43,585)	(327,511)
0	12,604	0	12,604
157,281	95,981	105,529	201,510
610,555	491,204	75,517	566,721
38,724	31,224	4,800	36,024
20,109	16,094	2,474	18,568
145,335	116,892	13,477	130,369
3,368	3,720	982	4,702
24,305	16,484	12,034	28,518
5,004	1,795	1,683	3,478
0	0	12,604	12,604
847,400	677,413	123,571	800,984
(690,119)	(581,432)	(18,042)	(599,474)
23,738,205	21,159,409	3,178,270	24,337,679
$ 23,048,086	$ 20,577,977	$ 3,160,228	$ 23,738,205

Tennessee Consolidated Retirement System
Notes to the Financial Statements
June 30, 2002 and June 30, 2001

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 and Cash Equivalents** - Cash and cash equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. Cash received by the TCRS that cannot be invested immediately in securities 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 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, 2002 and June 30, 2001. The classification of cash and cash equivalents 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. The fair value of real estate investments is determined at least every three years by qualified independent appraisers who are members of the Appraisal Institute and internally by real estate advisors for those years when independent appraisals are not performed. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.

5. **Receivables** - Receivables primarily consist of interest which is recorded when earned. The receivables for contributions as of June 30, 2002 consist of member contributions of $15.3 million and $4.0 million due to SETHEEPP and PSPP respectively, and employer contributions of $18.2 million and $8.7 million due to SETHEEPP and PSPP respectively. The receivables for contributions as of June 30, 2001 consist of member contributions of $15.1 million and $3.8 million due to SETHEEPP and PSPP respectively, and employer contributions of $17.7 million and $8.4 million due to SETHEEPP and PSPP respectively.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001 (CONTINUED)

6. **Adoption of New Accounting Pronouncements** - Effective July 1, 2001, the TCRS, along with the State of Tennessee, adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments* and its related *Omnibus* Statement No. 37. Accordingly, a management's discussion and analysis (MD&A) has been included in the presentation of required supplementary information (RSI). The TCRS has also adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures* and has included applicable disclosures in the Notes to the Financial Statements.

B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

At July 1, 2001, the date of the latest actuarial valuation, the membership of each plan consisted of the following:

	SETHEEPP	PSPP
Retirees and beneficiaries currently receiving benefits	56,444	21,298
Terminated members entitled to but not receiving benefits	15,895	3,500
Current active members	126,069	68,656
Total	198,408	93,454
Number of participating employers	140	404

State Employees, Teachers and Higher Education Employees Pension Plan

Plan Description - SETHEEPP is a cost-sharing, multiple employer defined benefit pension plan that covers the employees of the state, teachers with Local Education Agencies (LEA's) and higher education employees. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan on or after July 1, 1979 are vested after five years of service. Members joining prior to July 1, 1979 are vested after four years of service. Compounded cost of living adjustments (COLA) are provided each July based on the percentage change in the Consumer Price Index (CPI) during the previous calendar year except that (a) no COLA is granted if the CPI is less than one-half percent; (b) a COLA of 1 percent will be granted if the CPI increases between one-half percent and one percent; (c) the maximum annual COLA is capped at three percent. Benefit provisions are established by state statute found in Title Eight, Chapters 34 through 37 of the *Tennessee Code Annotated*. State statutes are amended by the Tennessee General Assembly. Ad hoc increases may only be authorized by the General Assembly. Public safety officers receive an additional supplemental benefit that is paid from age 60 to age 62.

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

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

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve. At June 30, 2002, the plan's Member Reserve and Employer Reserve

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001 (CONTINUED)

were fully funded with balances of $2,781.9 million and $17,127.5 million, respectively. At June 30, 2001, the plan's Member Reserve and Employer Reserve were fully funded with balances of $2,640.7 million and $17,937.3 million, respectively.

Political Subdivisions Pension Plan

Plan Description - PSPP is an agent multiple-employer defined benefit pension plan that covers the employees of participating political subdivisions of the state of Tennessee. Employee class differentiations are not made under PSPP. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan prior to July 1, 1979 are vested after four years of service. Members joining on or after July 1, 1979 are vested upon completion of 10 years of service, unless five years vesting is authorized by resolution of the chief governing body. Cost of living adjustments (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, 2002, the plan's Member Reserve and Employer Reserve were fully funded with balances of $643.7 million and $2,495.0 million, respectively. At June 30, 2001, the plan's Member Reserve and Employer Reserve were fully funded with balances of $592.3 million and $2,567.9 million respectively.

C. PLAN TRANSFERS

During Fiscal Year 2001, assets in the amount of $12.6 million, relating to the Regional Library System, were transferred from the PSPP to the SETHEEPP. Under *Tennessee Code Annotated*, Section 10, Chapter 5, Part 2, the employees of the Regional Library System, whose retirement assets were included in the PSPP, became employees of the Department of State, which is under the SETHEEPP plan.

D. 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 percent) of the total of the funds of the retirement system.

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

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001 (CONTINUED)

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

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

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

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, 2002**	**Fair Value June 30, 2001**
Investments - Category 1		
Cash equivalents and short-term securities		
Commercial paper	$ 762,737	$ 751,889
Corporate notes	90,489	15,320
Government bonds	1,089,855	533,584
Long-term investments		
Government bonds	8,588,873	8,872,472
Corporate bonds	2,782,714	3,575,132
Corporate stocks	9,167,281	9,102,052
Total Investments - Category 1	22,481,949	22,850,449
Investments - Category 2	0	0
Investments - Category 3		
Short-term securities lending collateral investments held by custodian bank		
Government bonds	0	63,135
Tri-party repurchase agreements	0	50,551
Margin deposit on futures contracts		
Government bonds	9,438	0
Total Investments - Category 3	9,438	113,686
Investments - Not Categorized		
Investments held by broker-dealers under securities on loan contracts for cash collateral		
Corporate stocks	0	97,563
Real estate	352,582	290,382
Unsettled investment acquisitions		
Government bonds	101,906	117,762
Corporate stocks	12,230	544,478
Total Investments - Not Categorized	466,718	1,050,185
Total investments and invested securities lending collateral	22,958,105	24,014,320
Less: Short-term securities classified as cash equivalents on the Statements of Plan Net Assets	(1,625,693)	(781,044)
Total investments and invested securities lending collateral as shown on the Statements of Plan Net Assets	$ 21,332,412	$ 23,233,276

(continued)

Tennessee Consolidated Retirement System
Notes to the Financial Statements
June 30, 2002 and June 30, 2001 (continued)

As of June 30, 2002 and June 30, 2001, 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 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 must deliver cash collateral to the lending agent. The cash 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. As of June 30, 2002, there were no securities on loan. The TCRS securities lending income, net of expenses, for the year ended June 30, 2002 was $623,267. As of June 30, 2001, the fair value of securities on loan to brokers was $97,563,290 and the fair value of collateral pledged for the securities on loan was $113,685,867. At June 30, 2001, the TCRS had no credit risk exposure to borrowers as the amounts owed to borrowers exceeded the amounts the borrowers owed the TCRS.

Financial Instruments with Off-Balance Sheet Risk **-** The TCRS is a party to financial instruments with off-balance sheet risk used in the normal course of business to generate earnings and reduce its own exposure to fluctuations in market conditions. The TCRS is authorized by statute to engage in forward contracts to exchange different currencies at a specified future date and rate and in domestic stock index futures contracts. These contracts involve elements of custodial credit, market and legal risk in excess of amounts recognized in the Statement of Plan Net Assets as of June 30, 2002 and June 30, 2001. 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, 2002, there were forward exchange contracts outstanding at a total net notional amount of $896,129,128 and a fair value of $961,336,292. At June 30, 2001, there were forward exchange contracts outstanding at a total net notional amount of $17,113,000 and a fair value of $17,392,319.

At June 30, 2002, the notional amount of futures contracts was $128,868,750 at a fair value of $123,762,500. At June 30, 2001, the TCRS was not under any futures contracts.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, 2002 and June 30, 2001.

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. There were no CMOs held at June 30, 2002 and June 30, 2001. 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.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001 (CONTINUED)

TCRS invests in these securities primarily to enhance returns by taking advantage of opportunities available in this sector of the securities markets.

During Fiscal Year 2001, the TCRS purchased commercial paper issued by Pacific Gas and Electric Company (PG&E) which was due to mature at $25,994,000. PG&E defaulted on the maturity payment and filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. As of the date of the issuance of the TCRS financial statements, the TCRS continued to hold the PG&E commercial paper and the reorganization plan was still pending.

E. COMMITMENTS

Standby Commercial Paper Purchase Agreement - The TCRS has agreed to serve as standby commercial paper purchaser for commercial paper issued by the Funding Board of the State of Tennessee. By serving as a standby commercial paper purchaser, the TCRS receives an annual fee of 7.5 basis points on the $250 million maximum issuance under this agreement during times when both Moody's and Standard and Poor's investment ratings assigned to the State of Tennessee's general obligation bonds are Aaa and AAA respectively, and 12 basis points during times when either Moody's or Standard and Poor's has assigned ratings other than Aaa and AAA respectively. In the unlikely event that the TCRS would be called upon to purchase the commercial paper, the TCRS would receive interest at a rate equal to prime plus 75 basis points during the first 30 consecutive days, plus an additional 50 basis points for each consecutive 30 days thereafter, up to a maximum rate allowed by state law.

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

SCHEDULES OF FUNDING PROGRESS

Expressed in Thousands

	Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Frozen Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
SETHEEPP	7/1/01	$ 20,760,989	$ 20,842,216	$ 81,227	99.61%	$ 4,451,452	1.82%
	7/1/99	18,327,133	18,420,156	93,023	99.49%	4,132,409	2.25%
	6/30/97	15,671,678	15,782,850	111,172	99.30%	3,810,231	2.92%
PSPP	7/1/01	3,187,990	3,528,137	340,147	90.36%	1,545,593	22.01%
	7/1/99	2,690,781	2,890,942	200,161	93.08%	1,341,363	14.92%
	6/30/97	2,226,891	2,287,904	61,013	97.33%	1,130,585	5.40%

The SETHEEPP is comprised of a number of employee groups. However, the unfunded liability of $81.2 million at July 1, 2001 is attributable to two employee groups: 1) County Officials employed prior to July 1, 1972 and 2) State Judges and Attorneys General employed prior to July 1, 1972. The PSPP represents 404 participating entities at July 1, 2001. The unfunded liability of $340.1 million is attributable to 318 of the 404 entities.

See accompanying Notes to Required Supplementary Information

SCHEDULES OF EMPLOYER CONTRIBUTIONS

Expressed in Thousands

	SETHEEPP		PSPP	
Year Ended June 30	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
2002	$ 243,498	100%	$ 103,374	100%
2001	232,149	100%	103,681	100%
2000	252,162	100%	82,749	100%
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, 2003. 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

Tennessee Consolidated Retirement System
Notes to Required Supplementary Information
As of June 30, 2002 and June 30, 2001

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the July 1, 2001 actuarial valuation follows.

	SETHEEPP	PSPP
Valuation Date	July 1, 2001	July 1, 2001
Actuarial cost method	Frozen Entry Age	Frozen Entry Age
Amortization method	Level Dollar	Level Dollar
Remaining amortization period	14 years closed period	(1) closed period
Asset valuation method	5-year Moving Market Average	5-year Moving Market Average
Actuarial assumptions:		
Investment rate of return	7.50%	7.50%
Projected salary increases	4.75% (3)	4.75% (3)
Includes inflation at	(2)	(2)
Cost-of-living adjustments	3.00%	3.00%
Increase in Social Security wage base	3.50%	3.50%

(1) The length of the amortization period varies by political subdivision. For political subdivisions entering the plan on or after July 1, 1994, the amortization period does not exceed 20 years.

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

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

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
ACTUARIAL BALANCE SHEET

ACTUARIAL BALANCE SHEET
as of July 1, 2001

ASSETS	Political Subdivision Pension Plan (PSPP)	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEPP)	Total
Present assets creditable to			
Employer accumulation fund	$ 2,595,966,677	$ 18,122,409,253	$ 20,718,375,930
Members' accumulation fund	592,023,782	2,638,579,836	3,230,603,618
Total present assets	3,187,990,459	20,760,989,089	23,948,979,548
Present value of prospective contributions payable to			
Employer accumulation fund			
Normal	562,004,620	1,858,475,622	2,420,480,242
Accrued liability	340,147,400	81,226,933	421,374,333
Total employer accumulation	902,152,020	1,939,702,555	2,841,854,575
Members' accumulation fund	322,137,337	1,219,837,846	1,541,975,183
Total prospective contributions	1,224,289,357	3,159,540,401	4,383,829,758
TOTAL ASSETS	$ 4,412,279,816	$ 23,920,529,490	$ 28,332,809,306
LIABILITIES			
Present value of prospective benefits payable on account of			
Present retired members and beneficiaries	1,104,213,183	7,837,600,100	8,941,813,283
Present active members	3,223,007,501	15,723,108,792	18,946,116,293
Former members	85,059,132	359,820,598	444,879,730
TOTAL LIABILITIES	$ 4,412,279,816	$ 23,920,529,490	$ 28,332,809,306

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) 401-7897

December 17, 2002

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

Dear Mr. Morgan:

We have audited the accompanying statements of fiduciary net assets of the Flexible Benefits Plan as of June 30, 2002, and June 30, 2001, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

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

As discussed in Note A.1., the financial statements referred to above present only the fiduciary net assets and changes in fiduciary net assets of the Flexible Benefits Plan of the State of Tennessee and are not intended to present fairly the financial position and changes in financial position of the State of Tennessee, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the Flexible Benefits Plan as of June 30, 2002, and June 30, 2001, and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A.4. to the financial statements, the Flexible Benefits Plan implemented GASB Statements 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and 38, *Certain Financial Statement Note Disclosures*.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2002, 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

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

Flexible Benefits Plan
Comparative Statements of Fiduciary Net Assets
June 30, 2002 and June 30, 2001

	June 30, 2002		June 30, 2001	
ASSETS				
Cash	$	1,001,683	$	386,383
Due from other funds		147,611		142,526
TOTAL ASSETS		1,149,294		528,909
LIABILITIES				
Accounts payable		69,509		76,299
Due to other funds		64,785		65,502
TOTAL LIABILITIES		134,294		141,801
NET ASSETS				
Held in trust for employee benefit programs	$	1,015,000	$	387,108

See accompanying Notes to the Financial Statements

Flexible Benefits Plan
Comparative Statements of Changes in Fiduciary Net Assets
For the Years Ended June 30, 2002 and June 30, 2001

	For the Year Ended June 30, 2002		For the Year Ended June 30, 2001	
ADDITIONS				
Employee contributions	$	4,411,106	$	4,115,583
FICA savings		3,309,946		2,625,270
TOTAL ADDITIONS		7,721,052		6,740,853
DEDUCTIONS				
Employee reimbursements		4,388,175		4,048,834
Employee benefit programs				
Deferred compensation match		1,754,768		1,732,441
Wellness program		450,000		409,095
Employee daycare center		186,074		204,350
Other benefits		12,775		47,018
Total employee benefit programs		2,403,617		2,392,904
Administrative fees		301,368		300,924
TOTAL DEDUCTIONS		7,093,160		6,742,662
CHANGE IN NET ASSETS		627,892		(1,809)
NET ASSETS, BEGINNING OF YEAR		387,108		388,917
NET ASSETS, END OF YEAR	$	1,015,000	$	387,108

See accompanying Notes to the Financial Statements

Flexible Benefits Plan
Notes to the Financial Statements
June 30, 2002 and June 30, 2001

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Flexible Benefits Plan is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as an employee benefit trust fund. The state offers its employees a cafeteria plan created in accordance with *Internal Revenue Code Section 125*. The plan is available on an optional basis to all state employees. Through the plan, employees may elect to direct a portion of their salary to pay for certain benefits. Benefits which may be purchased through the plan include state group medical insurance, state group dental insurance, out-of-pocket medical expenses and/or dependent care expenses. Because elections must be filed before the salary or the benefits are received and because salary directed to the plan may not be withdrawn by participants for any other purpose, salary directed to the plan is exempt from federal income tax and social security tax. Elections made by employees may not be changed during the calendar plan year except in the event of a corresponding change in the participant's family status. Contributions to the plan not withdrawn by the end of the plan year are forfeited to the state and are used for defraying administrative costs, in accordance with *IRS Proposed Regulation* 1.125-2 (Q7).

2. **Measurement Focus and Basis of Accounting** - The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) 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 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, 2002, and June 30, 2001. The primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash.

4. **Adoption of New Accounting Pronouncements** - Effective July 1, 2001, the Flexible Benefits Plan, along with the State of Tennessee, adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments* and its related *Omnibus* Statement No. 37. As a result of implementing these GASB statements, the Flexible Benefits Plan, which was previously reported as an expendable trust fund in the *Tennessee Comprehensive Annual Financial Report* using the flow of current financial resources measurement focus and the modified accrual basis of accounting, is now reported as an employee benefit trust fund using the flow of economic resources measurement focus and the accrual basis of accounting. In addition, the Statement of Fiduciary Net Assets is now presented instead of the Balance Sheet and the Statement of Changes in Fiduciary Net Assets is presented instead of the Statement of Revenues, Expenditures, and Changes in Fund Balance. Therefore, the June 30, 2001 Balance Sheet and Statement of Revenues, Expenditures, and Changes in Fund Balance have been restated for comparative purposes. The Flexible Benefits Plan has also adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures* and has included applicable disclosures in the Notes to the Financial Statements.

B. OTHER ACCOUNTING DISCLOSURES

1 The FICA savings generated by the Flexible Benefits Fund are used by the State for other employee benefit programs. During the years ended June 30, 2002 and June 30, 2001 the following amounts were paid or transferred to other State funds for these employee benefit programs:

(continued)

Flexible Benefits Plan
Notes to the Financial Statements
June 30, 2002 and June 30, 2001

Program	FY 2002	FY 2001
Deferred Compensation Contribution Match	$1,754,768	$1,732,441
State Wellness Program	450,000	409,095
State Day Care	186,074	204,350
Automated Teller Machines in State Buildings	12,775	47,018

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

	FY 2002	FY 2001
Due from General Fund	$117,796	$114,822
Due from Internal Service Fund	6,598	6,438
Due from Enterprise Fund	2,211	2,386
Due from Special Revenue Fund	6,195	5,676
Due from Highway Fund	9,012	8,126
Due from Education Trust Fund	5,799	5,078

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

	FY 2002	FY 2001
Due to General Fund	$51,423	$52,050
Due to Internal Service Fund	1,548	1,518
Due to Enterprise Fund	360	342
Due to Special Revenue Fund	1,980	2,016
Due to Highway Fund	7,938	8,061
Due to Education Trust Fund	1,536	1,515

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) 401-7897

December 17, 2002

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 Claims Award Fund as of June 30, 2002, and June 30, 2001, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

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

As discussed in Note A.1., the financial statements referred to above present only the financial position, changes in financial position, and cash flows of the Claims Award Fund of the State of Tennessee and are not intended to present fairly the financial position, changes in financial position, and cash flows of the State of Tennessee, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Claims Award Fund as of June 30, 2002, and June 30, 2001, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A.4. to the financial statements, the Claims Award Fund implemented GASB Statements 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and 38, *Certain Financial Statement Note Disclosures*.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2002, 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

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

Claims Award Fund
Comparative Statements of Net Assets
June 30, 2002 and June 30, 2001

	June 30, 2002	June 30, 2001
ASSETS		
Cash	$ 72,722,096	$ 76,200,051
TOTAL ASSETS	72,722,096	76,200,051
LIABILITIES		
Current liabilities		
Accounts payable	932,794	543,069
Deferred revenue	4,000	3,000
Claims liability	27,982,655	25,501,026
Total current liabilities	28,919,449	26,047,095
Noncurrent liabilities		
Claims liability	52,927,319	44,337,961
TOTAL LIABILITIES	81,846,768	70,385,056
NET ASSETS RESTRICTED FOR CLAIMS	$ (9,124,672)	$ 5,814,995

See accompanying Notes to the Financial Statements

CLAIMS AWARD FUND
COMPARATIVE STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN FUND NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001

	For the Year Ended June 30, 2002	For the Year Ended June 30, 2001
OPERATING REVENUES		
Insurance premiums	$ 30,382,100	$ 30,382,100
OPERATING EXPENSES		
Torts		
Death	3,679,103	1,580,182
Bodily injury	3,978,676	3,767,891
Property damage	1,163,325	880,142
Total Torts	8,821,104	6,228,215
Workers' Compensation		
Death	261,144	549,144
Medical	9,639,268	8,417,821
Temporary disability	1,569,491	1,618,426
Permanent disability	7,783,118	6,463,915
Total Workers' Compensation	19,253,021	17,049,306
Employee property damage	42,386	30,150
Professional/Administrative	7,944,017	7,035,723
Addition to actuarial liability	11,070,987	6,732,018
TOTAL OPERATING EXPENSES	47,131,515	37,075,412
OPERATING LOSS	(16,749,415)	(6,693,312)
NON-OPERATING REVENUES		
Interest income	1,806,798	4,736,732
Taxes	2,950	3,125
TOTAL NON-OPERATING REVENUES	1,809,748	4,739,857
CHANGE IN NET ASSETS	(14,939,667)	(1,953,455)
NET ASSETS, BEGINNING OF YEAR	5,814,995	7,768,450
NET ASSETS, END OF YEAR	$ (9,124,672)	$ 5,814,995

See accompanying Notes to the Financial Statements

CLAIMS AWARD FUND
COMPARATIVE STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001

	For the Year Ended June 30, 2002	For the Year Ended June 30, 2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from premiums	$ 30,382,100	$ 30,382,100
Payments for claims	(28,115,511)	(23,304,671)
Payments for administrative expenses	(7,554,292)	(7,275,630)
NET CASH USED BY OPERATING ACTIVITIES	(5,287,703)	(198,201)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Taxes received	2,950	3,125
NET CASH PROVIDED BY NONCAPITAL FINANCING ACTIVITIES	2,950	3,125
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	1,806,798	4,736,732
NET CASH PROVIDED BY INVESTING ACTIVITIES	1,806,798	4,736,732
NET INCREASE (DECREASE) IN CASH	(3,477,955)	4,541,656
CASH, BEGINNING OF YEAR	76,200,051	71,658,395
CASH, END OF YEAR	$ 72,722,096	$ 76,200,051
RECONCILIATION OF OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
OPERATING LOSS	$ (16,749,415)	$ (6,693,312)
ADJUSTMENTS TO RECONCILE OPERATING LOSS TO NET CASH USED BY OPERATING ACTIVITIES		
Changes in assets and liabilities		
Increase (decrease) in accounts payable	389,725	(239,907)
Increase in deferred revenue	1,000	3,000
Increase in claims liability	11,070,987	6,732,018
TOTAL ADJUSTMENTS	11,461,712	6,495,111
NET CASH USED BY OPERATING ACTIVITIES	$ (5,287,703)	$ (198,201)

See accompanying Notes to the Financial Statements

Claims Award Fund
Notes to the Financial Statements
June 30, 2002 and June 30, 2001

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Claims Award Fund (CAF) 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. The CAF distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses result from the services provided by the CAF. The operating revenue of the CAF consists of charges to its customers for insurance premiums. Operating expenses include claims and administrative expenses and the current charge to the actuarial liability. Revenues and expenses not resulting from the services provided by the CAF are reported as nonoperating items.

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, 2002, and June 30, 2001. The primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash.

4. **Adoption of New Accounting Pronouncements** - Effective July 1, 2001, the CAF, along with the State of Tennessee, adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments* and its related *Omnibus* Statement No. 37. As a result of implementing these GASB statements, CAF began presenting the assets and liabilities in a classified format on the Statement of Net Assets. For comparative purposes, the June 30, 2001 claims liability has been reclassified into current and non-current portions of the liability. The CAF has also adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures* and has included applicable disclosures in the Notes to the Financial Statements.

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 Supreme Court Boards, The Dairy Promotion Board, 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, 2002, the present value of these liabilities discounted at 3.25% was $80,909,974**.** Changes in the balances of claims liabilities during fiscal years 2002 and 2001 were as follows:

	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year End
2001-2002	$ 69,838,987	$ 39,187,498	$ (28,116,511)	$ 80,909,974
2000-2001	$ 63,106,969	$ 30,039,689	$ (23,307,671)	$ 69,838,987

At June 30, 2002, CAF held $72.7 million in cash designated for payment of these claims.

Criminal Injuries Compensation Fund
Independent Auditor's Report

STATE OF TENNESSEE

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

December 17, 2002

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, 2002, and June 30, 2001, and the related statements of revenues, expenditures, and changes in fund balances and revenues, expenditures, and changes in fund balances (budget and actual) for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

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

As discussed in Note A.1., the financial statements referred to above present only the financial position, changes in financial position, and budgetary comparisons of the Criminal Injuries Compensation Fund of the State of Tennessee and are not intended to present fairly the financial position, changes in financial position, and budgetary comparisons of the State of Tennessee, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Criminal Injuries Compensation Fund as of June 30, 2002, and June 30, 2001, the changes in its financial position, and budgetary comparisons for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A.6. to the financial statements, the Criminal Injuries Compensation Fund implemented GASB Statements 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and 38, *Certain Financial Statement Note Disclosures*.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2002, 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

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

CRIMINAL INJURIES COMPENSATION FUND
COMPARATIVE BALANCE SHEETS
JUNE 30, 2002 AND JUNE 30, 2001

	June 30, 2002	June 30, 2001
ASSETS		
Cash	$ 6,760,525	$ 82,552,417
Accounts receivable	390,694	502,402
TOTAL ASSETS	$ 7,151,219	$ 83,054,819
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Accounts payable	$ 234,369	$ 175,753
Claims liability	5,071,008	4,164,658
TOTAL LIABILITIES	5,305,377	4,340,411
FUND BALANCES		
Reserved for future benefits	0	75,478,264
Reserved for related assets (see Note B.1)	0	2,118,455
Reserved for victims of drunk drivers (see Note B.1)	1,845,842	1,117,689
TOTAL FUND BALANCES	1,845,842	78,714,408
TOTAL LIABILITIES AND FUND BALANCES	$ 7,151,219	$ 83,054,819

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, 2002 and June 30, 2001

	For the Year Ended June 30, 2002	For the Year Ended June 30, 2001
REVENUES		
State		
Taxes	$ 4,635,216	$ 4,748,773
Fines	2,683,126	2,401,978
Federal	2,070,000	1,529,000
Interest income	2,161,584	4,711,792
Other	607,398	612,499
TOTAL REVENUES	12,157,324	14,004,042
EXPENDITURES		
Claim payments	11,809,408	8,829,803
Victims' coalition grant	100,000	100,000
Administrative cost	592,873	750,673
TOTAL EXPENDITURES	12,502,281	9,680,476
EXCESS (DEFICIENCY) OF REVENUES OVER (UNDER) EXPENDITURES	(344,957)	4,323,566
OTHER FINANCING USES		
Operating transfer to State General Fund	76,523,609	92,956
TOTAL OTHER FINANCING USES	76,523,609	92,956
NET CHANGE IN FUND BALANCES	(76,868,566)	4,230,610
FUND BALANCES, BEGINNING OF YEAR	78,714,408	74,483,798
FUND BALANCES, END OF YEAR	$ 1,845,842	$ 78,714,408

See accompanying Notes to the Financial Statements

Criminal Injuries Compensation Fund
Comparative Statements of Revenues, Expenditures, and Changes in Fund Balances Budget and Actual (Budgetary Basis) For the Years Ended June 30, 2002 and June 30, 2001

	For the Year Ended June 30, 2002			For the Year Ended June 30, 2001		
	Original Budget	Final Budget	Actual (Budgetary Basis)	Original Budget	Final Budget	Actual (Budgetary Basis)
SOURCES OF FINANCIAL RESOURCES						
FUND BALANCES, BEGINNING OF YEAR	$ 78,714,408	$ 78,714,408	$ 78,714,408	$ 74,483,798	$ 74,483,798	$ 74,483,798
REVENUES						
Taxes	0	0	4,635,216	0	0	4,748,773
Fines	0	0	2,683,126	0	0	2,401,978
Federal	2,022,000	2,070,000	2,070,000	1,614,000	1,614,000	1,529,000
Interest income	0	0	2,161,584	0	0	4,711,792
Other	0	0	607,398	0	0	612,499
TOTAL SOURCES OF FINANCIAL RESOURCES	80,736,408	80,784,408	90,871,732	76,097,798	76,097,798	88,487,840
USES OF FINANCIAL RESOURCES						
EXPENDITURES						
Claim payments	9,400,000	11,677,453	11,809,408	9,400,000	9,400,000	8,829,803
Victims' Coalition Grant	0	0	100,000	0	0	100,000
Administrative cost	860,000	860,000	592,873	832,800	832,800	750,673
OTHER FINANCING USES - TRANSFERS OUT	0	0	76,523,609	0	0	92,956
TOTAL USES OF FINANCIAL RESOURCES	10,260,000	12,537,453	89,025,890	10,232,800	10,232,800	9,773,432
FUND BALANCES, END OF YEAR	$ 70,476,408	$ 68,246,955	$ 1,845,842	$ 65,864,998	$ 65,864,998	$ 78,714,408

See accompanying Notes to the Financial Statements

CRIMINAL INJURIES COMPENSATION FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Criminal Injuries Compensation Fund (CICF) is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as a special revenue fund. The Criminal Injuries Compensation Program (CIC) is funded through privilege and litigation taxes assessed in courts against certain criminal defendants upon conviction, fees levied against parolees, probationers and employed releasees, proceeds from sales of illegal contraband and bond forfeitures in felony cases, donations from individuals serving as jurors, interest income and a federal grant. Payments made under the CIC program are intended to defray the costs of medical services, loss of earnings, burial costs, and other pecuniary losses to either the victim of a crime or to the dependents of deceased victims.

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

3. **Cash -** Cash deposited in the CICF is pooled with the State Pooled Investment Fund (SPIF), administered by the State Treasurer, which is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, 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 SPIF is also authorized to enter into securities lending agreements in which U.S. Government securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The SPIF's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 2002, and June 30, 2001. The primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash.

4. **Budgetary Process** - Legislation requires that annual budgets be adopted for special revenue funds. The CIC budget is included in the budget presented by the Governor to the General Assembly at the beginning of each annual legislative session. The General Assembly enacts the budget by passing specific appropriations which may not exceed estimated revenues. The CIC annual budget is prepared on the modified accrual basis of accounting. Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes or administrative intradepartmental transfers, may be affected with certain executive and legislative branch approval. Only the legislature may transfer appropriations between departments.

5. **Reclassification -** Revenue categories previously presented in the June 30, 2001 financial statements have been reclassified for comparative purposes. Specifically, $439,993 previously classified as taxes and $172,506 previously classified as fines have been reclassified as other revenue.

6. **Adoption of New Accounting Pronouncements** - Effective July 1, 2001, the CIC, along with the State of Tennessee, adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments* and its related *Omnibus* Statement No. 37. The CIC has also adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures,* and has included applicable disclosures in the Notes to the Financial Statements.

B. OTHER ACCOUNTING DISCLOSURES

1. **Reserves** - At June 30, 2001, a reserve for related assets had been established for the CIC program's share of the SPIF's investment in commercial paper issued by Pacific Gas and Electric Company (PG&E). PG&E defaulted on the maturity payment and filed for reorganization under Chapter 11 of the U.S. Bankruptcy Code. During fiscal year 2002, all but $4,000,000 of the $51,706,000 principal was sold by SPIF, resulting in a total return on investment of over 5%; therefore, the reserve was reversed in fiscal year 2002.

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

2. **Other Financing Uses** - During the fiscal year that ended June 30, 2001, an operating transfer was made to the District Attorneys General Conference for domestic violence prevention and drug enforcement activities. In accordance with Public Chapters 825 & 827 of the Public Acts of 2002, the statutory reserve balance of $76,523,609 was transferred to the State's general fund as of June 30, 2002.

Baccalaureate Education System Trust, Educational Services Plan
Independent Auditor's Report

STATE OF TENNESSEE

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

December 17, 2002

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

Dear Mr. Morgan:

We have audited the accompanying statements of fiduciary net assets of the Baccalaureate Education System Trust, Educational Services Plan as of June 30, 2002, and June 30, 2001, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

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

As discussed in Note A.1., the financial statements referred to above present only the fiduciary net assets and changes in fiduciary net assets of the Baccalaureate Education System Trust, Educational Services Plan of the State of Tennessee and are not intended to present fairly the financial position and changes in financial position of the State of Tennessee, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the Baccalaureate Education System Trust, Educational Services Plan as of June 30, 2002, and June 30, 2001, and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A.5. to the financial statements, the Baccalaureate Education System Trust, Educational Services Plan implemented GASB Statements 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and 38, *Certain Financial Statement Note Disclosures*.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2002, on our consideration of the Baccalaureate Education System Trust, Educational Services Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

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

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN COMPARATIVE STATEMENTS OF FIDUCIARY NET ASSETS JUNE 30, 2002 AND JUNE 30, 2001

	June 30, 2002	June 30, 2001
ASSETS		
Cash and cash equivalents	$ 3,960,235	$ 1,635,783
Contributions receivable	9,556	7,821
Investment income receivable	86,461	277,459
Investments, at fair value		
Government bonds	20,156,200	8,998,350
Corporate bonds	0	8,413,293
Investment in equity mutual fund	10,501,305	8,675,134
TOTAL ASSETS	34,713,757	28,007,840
NET ASSETS HELD IN TRUST FOR PLAN PARTICIPANTS	$ 34,713,757	$ 28,007,840

See accompanying Notes to the Financial Statements

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN COMPARATIVE STATEMENTS OF CHANGES IN FIDUCIARY NET ASSETS FOR THE YEARS ENDED JUNE 30, 2002 AND JUNE 30, 2001

	For the Year Ended June 30, 2002	For the Year Ended June 30, 2001
ADDITIONS		
Contributions	$ 8,789,681	$ 5,469,239
Investment income		
Net decrease in fair value of investments	(2,154,378)	(623,720)
Interest and dividend income	743,875	1,349,515
Administrative fees	368,933	418,900
TOTAL ADDITIONS	7,748,111	6,613,934
DEDUCTIONS		
Refunds	104,637	65,435
Payments	701,752	323,734
Administrative cost	235,805	402,882
TOTAL DEDUCTIONS	1,042,194	792,051
CHANGE IN NET ASSETS	6,705,917	5,821,883
NET ASSETS HELD IN TRUST FOR PLAN PARTICIPANTS		
BEGINNING OF YEAR	28,007,840	22,185,957
END OF YEAR	$ 34,713,757	$ 28,007,840

See accompanying Notes to the Financial Statements

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity -** The Tennessee Baccalaureate Education System Trust Fund (BEST), Educational Services Plan (ESEP) is an integral part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as a private-purpose trust fund.

2. **Measurement Focus and Basis of Accounting** - The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB) using the flow of economic resources measurement focus and the accrual basis of accounting. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

3. **Cash and Cash Equivalents** - Cash and Cash Equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The primary government's policy regarding the definition of cash and cash equivalents includes cash management pools as cash. Cash received by the ESEP that cannot be invested immediately in securities 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 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, 2002 and June 30, 2001. The classification of cash and cash equivalents 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 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. In addition, cash and cash equivalents at June 30, 2001 include funds invested in a portfolio of short-term investments maintained by the Tennessee Consolidated Retirement System (TCRS). These short-term securities may include U.S. Treasury and Agency obligations, commercial paper, medium-term corporate notes, promissory notes and repurchase agreements and are valued at cost plus accrued interest, which approximates fair value. During fiscal year 2002, the ESEP funds invested with the TCRS were transferred to the custody bank and maintained in the cash balances with the custodial agent.

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

5. **Adoption of New Accounting Pronouncements -** Effective July 1, 2001, the ESEP, along with the State of Tennessee, adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments* and its related *Omnibus* Statement No. 37. As a result of implementing these GASB statements, the ESEP, previously reported as an expendable trust fund in the *Tennessee Comprehensive Annual Financial Report*, is now reported as a private-purpose trust fund. The ESEP has also adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures* and has included applicable disclosures in the Notes to the Financial Statements.

B. INVESTMENTS

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

The ESEP investments included SEC-registered open-end mutual funds of $10,501,305 as of June 30, 2002 and $8,675,134 as of June 30, 2001.

(continued)

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2002 AND JUNE 30, 2001

The ESEP 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 ESEP or its agent in the name of the ESEP. 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 ESEP. 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 ESEP. 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, 2002 Fair Value	June 30, 2001 Fair Value
INVESTMENTS - CATEGORY 1		
Cash equivalents and short-term investments		
Commercial paper	$ 0	$ 1,434,596
Government bonds	0	55,629
Long-term investments		
Government bonds	20,156,200	8,998,350
Corporate bonds	0	8,413,293
TOTAL INVESTMENTS - CATEGORY 1	20,156,200	18,901,868
INVESTMENTS - CATEGORY 2	0	0
INVESTMENTS - CATEGORY 3	0	0
INVESTMENTS - NOT CATEGORIZED		
Investment in open-end mutual fund	10,501,305	8,675,134
TOTAL INVESTMENTS - NOT CATEGORIZED	10,501,305	8,675,134
TOTAL INVESTMENTS	30,657,505	27,577,002
Less: Short-term securities classified as cash equivalents on the Statements of Fiduciary Net Assets	0	(1,490,225)
TOTAL INVESTMENTS AS SHOWN ON THE STATEMENT OF FIDUCIARY NET ASSETS	$ 30,657,505	$ 26,086,777

C. DESCRIPTION OF THE EDUCATIONAL SERVICES PLAN

The Tennessee Baccalaureate Education System Trust, Educational Services Plan, administered by the State Treasurer, was created under *Tennessee Code Annotated*, Title 49, Chapter 7, Part 8 for the purpose of improving higher education in the State of Tennessee by assisting students or their families to pay in advance, a portion of the tuition and other costs of attending colleges and universities. Under the program, a purchaser may enter into a contract with the BEST Board of Trustees to purchase tuition units on behalf of a beneficiary. Each tuition unit purchased entitles the beneficiary to an amount no greater than one percent of the weighted average tuition of Tennessee's four-year public universities during the academic term in which it is used; however, the tuition unit or equivalent funds may be used at any accredited public or private, in-state or out-of-state institution. The purchase price of the tuition unit is determined annually by the BEST Board of Trustees with the assistance of an actuary to maintain the plan's financial soundness. Refunds and tuition payments are guaranteed only to the extent that ESEP program funds are available and neither the State of Tennessee nor the BEST Board of Trustees is liable for any amount in excess of available program funds. The net assets held in trust for plan participants were $5,835,368 less at June 30, 2002, and $756,417 less at June 30, 2001, than the amounts needed to fund the outstanding tuition units at their weighted average tuition unit prices in effect at the respective dates.

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

Chairs of Excellence
Independent Auditor's Report

STATE OF TENNESSEE

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

December 17, 2002

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, 2002, and June 30, 2001, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

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

As discussed in Note A.1., the financial statements referred to above present only the financial position and changes in financial position of the Chairs of Excellence of the State of Tennessee and are not intended to present fairly the financial position and changes in financial position of the State of Tennessee, in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Chairs of Excellence as of June 30, 2002, and June 30, 2001, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A.6. to the financial statements, the Chairs of Excellence implemented GASB Statements 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments*, 37, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments: Omnibus*, and 38, *Certain Financial Statement Note Disclosures*.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 17, 2002, 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. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

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

Chairs of Excellence
Comparative Balance Sheets
June 30, 2002 and June 30, 2001

	June 30, 2002	June 30, 2001
ASSETS		
Cash and cash equivalents	$ 5,234,909	$ 20,909,956
Investments, at fair value		
Government bonds	69,106,019	80,409,368
Corporate bonds	37,945,888	22,972,170
Corporate stocks	0	99,524,805
Investment in equity mutual fund	92,358,174	0
Total investments	199,410,081	202,906,343
Receivables		
Due from College and University Fund	1,166,000	762,000
Investment income receivable	1,476,374	1,151,528
Total receivables	2,642,374	1,913,528
TOTAL ASSETS	$ 207,287,364	$ 225,729,827
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Due to College and University Fund	$ 2,356,518	$ 2,046,493
Due to the Academic Scholars Fund	3,319,970	3,425,471
Investments purchased	0	1,152,252
TOTAL LIABILITIES	5,676,488	6,624,216
FUND BALANCES		
Reserved for non-expendable corpus	190,001,280	208,210,933
Reserved for expendable income	11,609,596	10,894,678
TOTAL FUND BALANCES	201,610,876	219,105,611
TOTAL LIABILITIES AND FUND BALANCES	$ 207,287,364	$ 225,729,827

See accompanying Notes to the Financial Statements

Chairs of Excellence
Comparative Statements of Revenues, Expenditures and Changes in Fund Balances
For the Years Ended June 30, 2002 and June 30, 2001

	For the Year Ended June 30, 2002	For the Year Ended June 30, 2001
REVENUES		
Investment income	$ (9,865,712)	$ (6,654,858)
Contributions from private sources	0	625,000
TOTAL REVENUES	(9,865,712)	(6,029,858)
EXPENDITURES		
University of Tennessee	3,410,678	3,112,107
Tennessee Board of Regents	3,838,971	3,701,770
Academic Scholars Fund	208,198	226,722
Administrative cost	171,176	184,877
TOTAL EXPENDITURES	7,629,023	7,225,476
DEFICIENCY OF REVENUES UNDER EXPENDITURES	(17,494,735)	(13,255,334)
FUND BALANCES, BEGINNING OF YEAR	219,105,611	232,360,945
FUND BALANCES, END OF YEAR	$ 201,610,876	$ 219,105,611

See accompanying Notes to the Financial Statements

Chairs of Excellence
Notes to the Financial Statements
June 30, 2002 and June 30, 2001

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2. **Measurement Focus and Basis of Accounting** - The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). 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 current financial resources measurement focus and the modified accrual basis of accounting. Under this basis, revenues are recorded when they become both measurable and available, and expenditures are recognized when the related fund liability is incurred. The COE Trust follows the State of Tennessee's revenue recognition period, in which taxes and fees are considered to be available if received in the first sixty days of the new year. Federal grants, departmental services, and interest associated with the current fiscal year are all considered to be available if received in twelve months. All other revenue items are considered to be measurable and available only when cash is received by the COE Trust.

3. **Cash and Cash Equivalents** - Cash and cash equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. Cash received by the COE Trust that cannot be immediately invested in securities 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 secutities 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, 2002 and June 30, 2001. The classification of cash and cash equivalents 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. In addition, cash and cash equivalents at June 30, 2001 include 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 and are valued at cost plus accrued interest, which approximates fair value. During fiscal year 2002, the COE funds invested with the TCRS were transferred to the custody bank and maintained in the cash balances with the custodial agent.

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

5. **Fund Balances** - The reserve for non-expendable corpus includes funds provided by contributions from the state, colleges and universities and private sources, 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 reserve for expendable income. At the discretion of the Board of Trustees of the COE Trust, the reserve for expendable income may be used for future nonrecurring expenditures or to supplement corpus or income.

6. **Adoption of New Accounting Pronouncements** - Effective July 1, 2001, the COE Trust, along with the State of Tennessee, adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments* and its related *Omnibus* Statement No. 37. As a result of implementing these GASB statements, the COE Trust, which was previously

(continued)

reported as a non-expendable trust fund in the *Tennessee Comprehensive Annual Financial Report* using the flow of economic resources measurement focus and the accrual basis of accounting, is now reported as a permanent fund using the flow of current financial resources and the modified accrual basis of accounting. In addition, the statement of cash flows, previously presented for the COE Trust, is not a required financial statement for permanent funds and is no longer presented. The COE Trust has also adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures* and has included applicable disclosures in the Notes to the Financial Statements.

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

The COE Trust investments as of June 30, 2002 included SEC-registered open-end mutual funds of $92,358,174.

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, 2002 Fair Value	June 30, 2001 Fair Value
INVESTMENTS - CATEGORY 1		
Cash equivalents and short-term securities		
Commercial paper	$ 0	$ 20,172,690
Government bonds	0	782,226
Long-term investments		
Government bonds	69,106,019	80,409,368
Corporate bonds	37,945,888	22,972,170
Corporate stocks	0	98,416,355
TOTAL INVESTMENTS - CATEGORY 1	107,051,907	222,752,809
INVESTMENTS - CATEGORY 2	0	0
INVESTMENTS - CATEGORY 3	0	0
INVESTMENTS - NOT CATEGORIZED		
Investment in open-end mutual fund	92,358,174	0
Unsettled investment acquisitions		
Corporate stocks	0	1,108,450
TOTAL INVESTMENTS	199,410,081	223,861,259
Less: Short-term securities included in cash and cash equivalents on the Balance Sheets	0	(20,954,916)
TOTAL INVESTMENTS AS SHOWN ON THE BALANCE SHEETS	$ 199,410,081	$ 202,906,343

(continued)

Chairs of Excellence
Notes to the Financial Statements
June 30, 2002 and June 30, 2001

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. During the years ended June 30, 2002 and June 30, 2001, the COE Trust had no securities on loan.

C. OTHER ACCOUNTING DISCLOSURES

1. Chairs of Excellence Endowment Trust

The COE Trust is authorized by the 94th General Assembly to further the cause of education in Tennessee. The COE Trust is administered by the State Treasurer. The Trust is set up into two general accounts which equally divide any state appropriations: one for the University of Tennessee and one for the Tennessee Board of Regents. As each Chair is designated, a portion of the appropriation is transferred to a sub-account for that Chair. The awarding college or university must provide matching contributions, of which at least 50 percent of the funds are from private contributions.

As of June 30, 2002, 99 Chairs have been established with matching contributions received totaling $55,523,375. Total contributions to the COE Trust totaled $99,523,375 as of June 30, 2002. This includes $44,000,000 from the State, $10,321,300 from Colleges and Universities, and $45,202,075 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.

Special thanks to the
Tennessee Wildlife Resources Agency
for sharing these animal photographs.

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

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