2004 Treasurer's Report
State of Tennessee
Dale Sims, Treasurer

2004 TREASURER'S REPORT

Red, White and Blue

Featuring Tennessee images by artist H.R. Lovell.

DALE SIMS, TREASURER
STATE OF TENNESSEE

FISCAL YEAR ENDED JUNE 30, 2004

Featured in this report are paintings by H.R Lovell, Tennessee's 2001-2003 Artist-in-Residence. His works of beauty and grace draw viewers into peaceful, relaxing settings, usually nostalgic in tone. Lovell's scenes truly express the spirit and assets of Tennessee.

Lovell primarily utilizes watercolor and egg tempera in his creations. Watercolor is used for brushed, pliable strokes, and egg tempera for intense depth of color and illumination. His paintings are often characterized by strong composition, late afternoon sunlight, and deep shadows. His meticulous attention to detail gives his paintings photo-realism.

Born and raised in Cheatham County, Tennessee, Lovell developed an awareness of his surroundings long before he picked up his first paintbrush. He is completely self taught and has been called, "The Andrew Wyeth of the South."

Lovell has painted commissioned pieces for Mel Tillis, Randy Travis, Don Light, and Mario Pasin, President of Radio Flyer. He was a featured artist at the first Farm Aid, "Colors of the Heartland," with John Mellencamp.

H.R. Lovell's gallery, Muzart, is located in the historic White Elephant Saloon in downtown Charlotte, Tennessee. Gallery director Maria Cherry proudly displays his paintings and prints. For more information, call (615) 789-6655.

Featured on the cover: Violin of James Rudolph Lovell

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Letter of Transmittal

State of Tennessee
Treasury Department
State Capitol
Nashville, Tennessee 37243

December 31, 2004

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

Ladies and Gentlemen:

Pursuant to the requirements of Section 4-4-114, *Tennessee Code Annotated*, I am pleased to transmit a report of the activity of the Treasury Department for the fiscal year ending June 30, 2004.

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

Sincerely,

Dale Sims

Dale Sims

Mission of The Treasury Department

Vision Statement

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

Mission Statement

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

Treasury Team Commitment

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

Department Core Values

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

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

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

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

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

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

Executive Summary

Introduction

The 2004 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 2003-04 fiscal year.

Investments

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

State Cash Management - This division manages the State Pooled Investment Fund which includes the state's cash, the various dedicated reserves and trust funds of the state, and the Local Government Investment Pool. During 2003-04, investments averaged $4.03 billion, producing $44.3 million in income for an average rate of return of 1.11%. The State Trust of Tennessee allows the department to use the Federal Reserve Wire Transfer System to transfer funds on a limited basis.

Pension Fund Investments - This division manages the investments of the Tennessee Consolidated Retirement System (TCRS) which, at June 30, 2004, totaled $25.6 billion at fair market value. For the year, investment income was $2.2 billion, for a rate of return of 9.3% on a fair value basis. The Investment Division also manages investments for the Chairs of Excellence Trust and the Baccalaureate Education System Trust which, at June 30, 2004, had market values of $215 million and $51.4 million, respectively.

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, 2004, there were 200,686 active TCRS members: 44,646 state employees; 66,910 K-12 teachers; 72,089 political subdivision employees; and 17,041 higher education employees. As of June 30, 2004, there were 86,205 retirees. TCRS paid $954.5 million in benefits during fiscal year 2003-04. 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.

Executive Summary

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, 2004, a total of 61,816 state and higher education employee accounts were held in the program. The market value of accumulated account balances totaled $749.2 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, 2004, 40,476 state employees were using the plan: 39,659 paid group medical premiums, 18,405 paid group dental premiums, 4,042 used the medical expense reimbursement account and 380 used the dependent care reimbursement account. The plan generated over $4.9 million in F.I.C.A. savings for the state during the 2003-04 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 5,825 claims for tort, employee property damage and workers' compensation. Payments made during the year for workers' compensation, tort, and employee property damage claims totaled $27.7 million. The division received 2,297 criminal injury and drunk driver claims. Payments made to victims of criminal injuries and drunk drivers totaled $10.5 million. Since the first payments were issued in 1982, more than $144.1 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 Risk Management Fund by the Division of Claims Administration after adjudication by a commissioner. At June 30, 2004, the commission had 649 open claims (including claims transferred to administrative law judges).

Division of Risk Management

The Division of Risk Management is responsible for identifying the state's exposure to property & casualty risks, and determining the appropriate risk control methods to protect the state against monetary loss due to unforeseen events. The division administers the state's Property/Casualty Insurance Program, including the procurement of all-risk, replacement cost property insurance for all state-owned buildings and contents, builders' risk insurance for new construction, boiler insurance and inspection services for all state-owned boiler objects, and a fidelity bond to protect against employee dishonesty. Loss prevention and control services are also provided for workers' compensation and tort liability. As of July 1, 2003, the state's total insured property values were $9.9 billion. A $5 million annual aggregate deductible retention was funded through the Risk Management Fund. A property insurance policy was procured from an independent insurance carrier, to indemnify the State for loss amounts over and above the aggregate deductible limit.

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 180 students since it began in January 1996. Since the program's inception, 13% of participants have accepted job offers from the state.

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 the fiscal year, $37.4 million of unclaimed property was turned over to the Treasurer and $13 million was returned to owners or their heirs, local governments and other states. Since the program's inception in 1979, more than $316 million in unclaimed property has been reported to the Treasurer and more than $97.5 million 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. Since 1984, a total of 99 chairs have been created. The Trust totaled $215 million fair value of net assets at June 30, 2004, and investment income was $17 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 future higher education. The Savings Plan offers two contribution choices: the Managed Allocation Option and the 100% Equity Option. At June 30, 2004, the Prepaid College Tuition Plan held 8,292 contracts and $51.4 million in net assets and the Savings Plan held 3,137 contracts and $18.3 million in net assets. At year-end, the Prepaid Tuition Plan and the Savings Plan had net assets of $69.7 million.

Treasury Numbers at a Glance Fiscal Year 2003-04

Administrative	Number of Filled Positions		181
	Payroll Expenditures	$	10,349,307
	Other Expenditures	$	4,541,176
	Total Administrative Expenditures	$	14,890,483
Cash Management Program	General Fund Earnings	$	10,043,210
	LGIP Earnings	$	22,682,824
	Restricted Fund Earnings	$	11,600,046
	Total Cash Management Earnings	$	44,326,080
Retirement Program	Retirement Benefits	$	954,451,314
	Number of Retirees		86,205
	Number of Active Members		200,686
	Retirement Contributions	$	616,089,783
	Retirement Net Investment Income	$	2,181,853,628
Claims Administration Program	Workers' Compensation Payments	$	20,859,248
	Workers' Compensation Claims Filed		3,881
	Employee Property Damage Payments	$	40,538
	Employee Property Damage Claims Filed		192
	Tort Payments	$	6,805,313
	Tort Claims Filed		1,752
	Criminal Injury Payments	$	10,525,090
	Criminal Injury Claims Filed		2,297
Risk Management Program	Estimated Property Losses Incurred	$	3,893,845
	Property Values Insured	$	9,963,556,000
Chairs of Excellence Program	Chairs of Excellence Investment Income	$	16,953,010
	Chairs of Excellence Expenditures	$	7,220,470
	Number of Chairs of Excellence		99
Other Programs	Deferred Compensation Contributions	$	74,835,750
	Deferred Compensation Accounts		61,816
	Flexible Benefits Plan Payments	$	5,421,598
	Unclaimed Property Revenues	$	40,880,985
	Unclaimed Property Payments	$	13,043,761
	BEST Prepaid Accounts		8,292
	BEST Prepaid Contributions (net of fees)	$	8,916,081
Fair Value of Assets Under Management at June 30, 2004	Retirement Trust Fund	$	25,586,516,252
	Chairs of Excellence Trust Fund	$	214,975,481
	State Pooled Investment Fund	$	4,528,390,162
	Deferred Compensation (outside managers)	$	749,179,967
	BEST Educational Services Plan	$	51,395,131
	BEST Educational Savings Plan (outside manager)	$	18,346,000
	Total Assets Under Management	$	31,148,802,993

PROGRAM ADMINISTRATION

Early Snow

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 2003-04 fiscal year, the average balance of short term investments in the Treasurer's Cash Management program was $4,026,295,916 per month and interest income of $44,326,080 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, 2004, investments had an average maturity of 76 days, and an average weighted yield of 1.25%. The total balance in the State Pooled Investment Fund at June 30, 2004, $4,528,390,162 fair value, was allocated as follows: U.S. Treasury government and agency securities, 33.15%; repurchase agreements and overnight deposits, 5.59%; collateralized certificates of deposit, 44.89%; and commercial paper, 16.37%.

ADMINISTRATION OF AUTHORIZED STATE DEPOSITORY ACCOUNTS

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

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

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

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

STATE CASH MANAGEMENT

monitor deposits and collateral based on appropriate bank ownership.

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

STATE COLLATERAL PROGRAM

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

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

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

COLLATERAL POOL

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

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

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

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

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

STATE CASH MANAGEMENT

Pool serves as a significant administrative advantage for local governments. Under the Collateral Pool, the Treasurer, rather than the local government, is responsible for monitoring the pledge level; pricing collateral; reconciling collateral monthly with the trustee custodian; monitoring collateral; pledging, releasing and substituting collateral; and maintaining a trustee custodian relationship.

Currently, the Collateral Pool has 69 participant institutions collateralizing public funds in excess of $4.8 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)
2003-04	1.11%	.93%	.84%	.97%
2002-03	1.64	1.41	1.29	1.31
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

[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
2003-04	$ 1,932,058,417	$ 20,858,498	1.11%
2002-03	1,794,136,750	29,042,346	1.64%
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%

Repurchase Agreements and Overnight Deposit Accounts

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2003-04	$ 293,922,333	$ 3,408,318	1.05%
2002-03	136,356,417	2,295,933	1.44%
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%

Commercial Paper

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2003-04	$ 894,287,583	$ 9,195,815	1.02%
2002-03	742,144,917	10,702,937	1.47%
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%

U.S. Government Securities

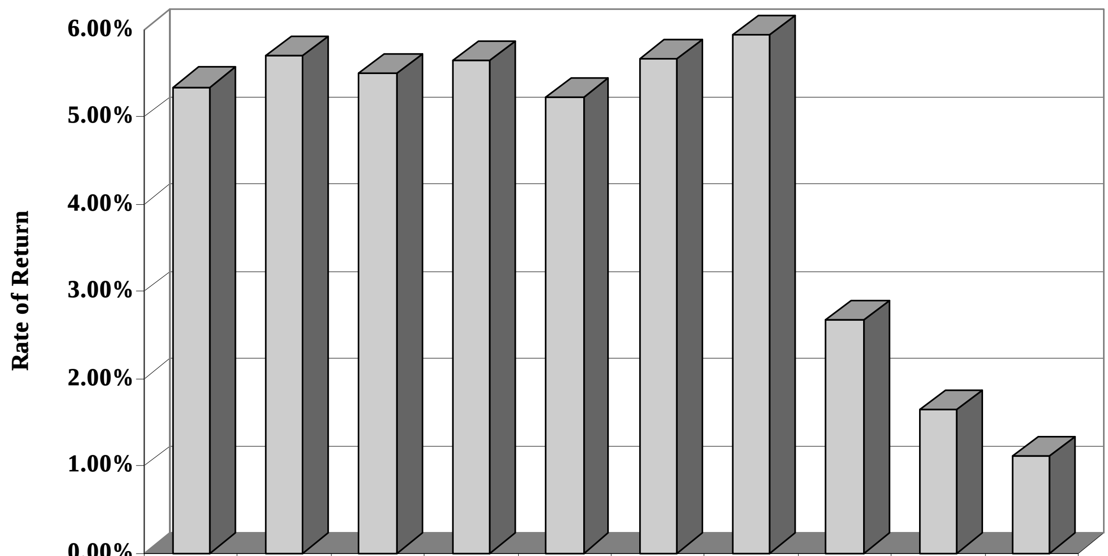
Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2003-04	$ 906,027,583	$ 10,863,449	1.19%
2002-03	890,260,833	16,329,936	1.83%
2001-02	1,764,991,750	52,230,461	2.92%
2000-01	1,394,438,333	78,460,393	5.62%
1999-00	647,764,750	38,291,206	5.58%

Total Funds

Fiscal Year	Average Total Funds Invested	Cash Management Investment Earnings	Composite Weighted Average Rate of Return
2003-04	$ 4,026,295,916	$ 44,326,080	1.11%
2002-03	3,562,898,917	58,371,152	1.64%
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%

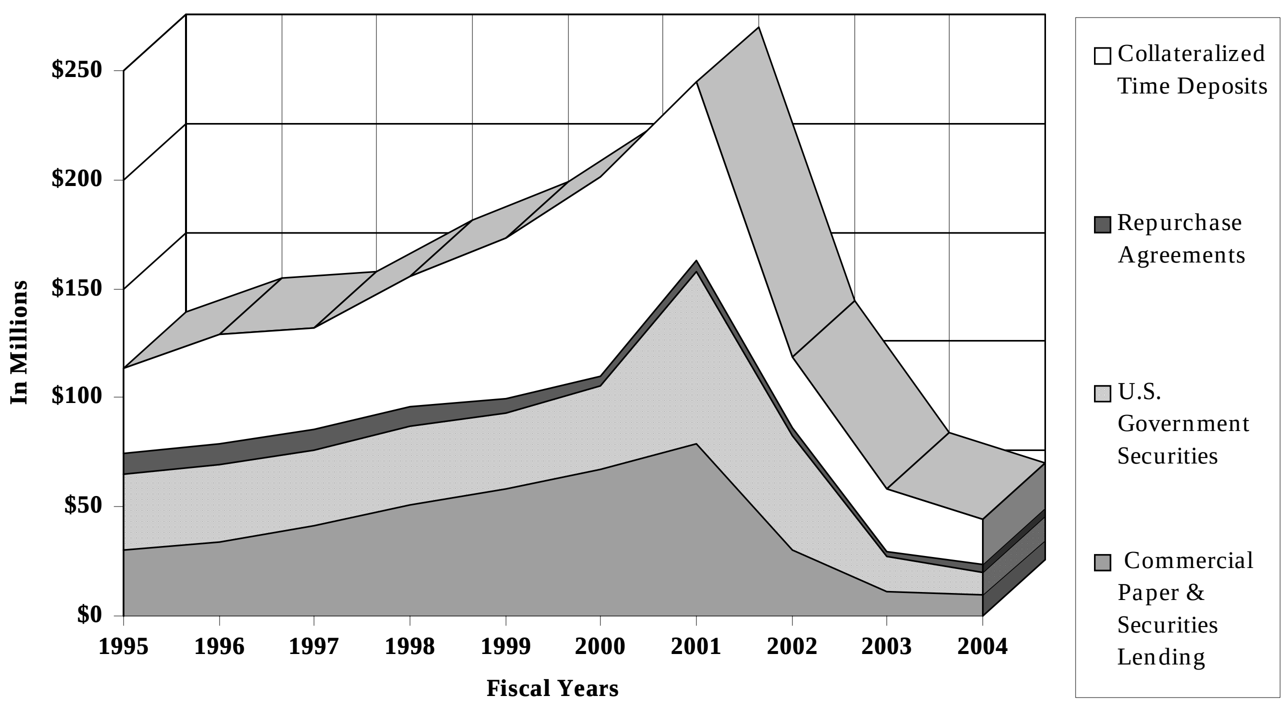
State Cash Management

CASH MANAGEMENT INVESTMENTS COMPOSITE WEIGHTED AVERAGE RATE OF RETURN
Fiscal Years 1995-2004



1995	1996	1997	1998	1999	2000	2001	2002	2003	2004
5.34%	5.69%	5.50%	5.64%	5.22%	5.66%	5.94%	2.67%	1.64%	1.11%

ANALYSIS OF STATE CASH EARNINGS
Fiscal Years 1995-2004



State Cash Management

CASH MANAGEMENT PORTFOLIO ANALYSIS
Fiscal Year Ended June 30, 2004

Month	Total Portfolio Yield	Average Days to Maturity	Portfolio Composition: Certificates of Deposit	Repurchase Agreements	U.S. Treasury Notes	U.S. Agency	Commercial Paper
Jul-03	1.14%	76	45.86%	6.88%	0.00%	21.46%	25.81%
Aug-03	1.11%	84	47.58%	7.51%	0.00%	21.32%	23.60%
Sep-03	1.10%	93	49.26%	7.90%	0.00%	21.09%	21.75%
Oct-03	1.09%	90	50.94%	7.84%	0.00%	23.49%	17.73%
Nov-03	1.08%	83	55.38%	8.24%	0.00%	19.66%	16.72%
Dec-03	1.08%	75	54.88%	8.34%	0.00%	18.05%	18.73%
Jan-04	1.08%	66	49.80%	8.20%	0.00%	20.24%	21.76%
Feb-04	1.09%	69	49.11%	7.30%	0.00%	21.10%	22.48%
Mar-04	1.09%	68	45.23%	7.13%	0.00%	19.89%	27.75%
Apr-04	1.10%	77	43.62%	6.70%	0.00%	22.34%	27.35%
May-04	1.13%	84	43.84%	6.12%	0.00%	27.88%	22.16%
Jun-04	1.17%	81	44.17%	6.20%	0.00%	30.68%	18.95%
Average	1.11%	79	48.31%	7.36%	0.00%	22.27%	22.07%

Month	General Fund Average	General Fund Percent	LGIP Average	LGIP Percent	Other Restricted Average	Other Restricted Percent	Total Average Invested
Jul-03	$ 977,167,909	25.26%	$ 1,945,882,791	50.31%	$ 945,030,300	24.43%	$ 3,868,081,000
Aug-03	1,067,772,527	27.86%	1,834,100,210	47.86%	930,292,263	24.28%	3,832,165,000
Sep-03	1,146,987,314	29.78%	1,784,347,255	46.33%	919,903,431	23.89%	3,851,238,000
Oct-03	1,106,695,772	29.28%	1,728,553,544	45.74%	943,870,684	24.98%	3,779,120,000
Nov-03	941,963,412	26.77%	1,637,304,127	46.54%	939,091,461	26.69%	3,518,359,000
Dec-03	852,933,686	24.09%	1,718,551,070	48.54%	968,831,244	27.37%	3,540,316,000
Jan-04	919,961,894	23.59%	2,027,052,067	51.97%	953,086,039	24.44%	3,900,100,000
Feb-04	769,668,254	19.45%	2,211,212,174	55.90%	975,406,572	24.65%	3,956,287,000
Mar-04	615,024,503	14.22%	2,655,014,289	61.39%	1,054,899,208	24.39%	4,324,938,000
Apr-04	835,743,827	18.35%	2,583,795,858	56.73%	1,134,940,315	24.92%	4,554,480,000
May-04	1,100,966,050	24.00%	2,330,105,118	50.80%	1,156,000,832	25.20%	4,587,072,000
Jun-04	1,325,202,926	28.79%	2,102,149,489	45.66%	1,176,042,585	25.55%	4,603,395,000
Average	$ 971,674,006	24.13%	$ 2,046,505,666	50.83%	$ 1,008,116,244	25.04%	$ 4,026,295,916

State Cash Management

LOCAL GOVERNMENT INVESTMENT POOL

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

The Local Government Investment Pool began operations in November of 1980. Participation in the LGIP program currently stands in excess of 1,800 accounts. The Department of Transportation (DOT) program has more than 600 active accounts.

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

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

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

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

Participants earn interest on LGIP deposits based on the total portfolio return of the cash management pool, less a monthly administrative fee of five one hundredths of one percent (.05%). During the 2003-04 fiscal year, the average rate participants earned on their deposits after the fee reduction was 1.06%. Other activity is shown on the following schedule by participant group.

LOCAL GOVERNMENT INVESTMENT POOL SCHEDULE OF ACTIVITY BY ENTITY TYPE

Fiscal Year Ended June 30, 2004

	Account Balance 7/1/2003	Net Deposits/ (Withdrawals) FY 2003-04	Interest Credited FY 2003-04	Account Balance 6/30/2004
Cities	$ 518,153,125	$ (36,728,417)	$ 5,459,005	$ 486,883,713
Counties	703,648,129	(188,246,438)	7,339,753	522,741,444
Commitments to D.O.T.	56,437,987	(363,169)	604,187	56,679,005
Educational Institutions	423,036,903	1,116,309	5,525,182	429,678,394
Community Health Agencies	5,320,935	(411,288)	53,489	4,963,136
Other	267,576,709	52,207,706	2,675,496	322,459,911
Total	**$ 1,974,173,788**	**$ (172,425,297)**	**$ 21,657,112**	**$ 1,823,405,603**

STATE TRUST OF TENNESSEE

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

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

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

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

STATE TRUST OF TENNESSEE FEDERAL RESERVE BANK TRANSACTIONS
Fiscal Year 2003-04

Transaction Type	Number	Amount
(1) Wire Disbursements	6,120	$ 24,056,172,992
(2) Wire Receipts	6,061	19,473,838,413
(3) Security Disbursements	750	26,694,612,161
(4) Security Receipts	804	27,326,602,712
(5) Check Redemptions	7,901,449	5,523,939,989
Total	**7,915,184**	**$103,075,166,267**

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, real estate and money market instruments.

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

The Investment Advisory Council established in *Tennessee Code Annotated*, Section 8-37-108 provides policy guidance to the Board of Trustees and the investment staff. The current Advisory Council is comprised of senior investment professionals from within the State of Tennessee.

To assist in the fiduciary responsibility for managing the TCRS portfolio, 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 2003-04 fiscal year, TCRS had a total return of 9.3%. Each asset class of the portfolio outperformed the policy benchmark established by the Board of Trustees. Domestic stocks earned 19.16%, while the S&P 500 Index was 19.11%. International stocks earned 34.99% versus 32.37% for the EAFE Index. Domestic bonds outperformed the Bond Index .36% versus .21%, while international bonds exceeded the benchmark 9.06% versus 7.74%. Real estate earned 9.92%, while the NCREF benchmark was 9.71%

TCRS Investments

INVESTMENT SUMMARY
As of June 30, 2004

	Domestic		International		Total	
	Fair Value	%	Fair Value	%	Fair Value	%
Fixed Income						
Government Bonds	$ 10,490,826,655	41.41%	$ 377,149,144	1.49%	$10,867,975,799	42.90%
Corporate Bonds	1,636,825,380	6.46%	241,372,067	0.95%	1,878,197,447	7.41%
Convertible Bonds	0	0.00%	0	0.00%	0	0.00%
Total Bonds	$ 12,127,652,035	47.87%	$ 618,521,211	2.44%	$12,746,173,246	50.31%
Preferred Stock	0	0.00%	11,678,396	0.05%	11,678,396	0.05%
Total Fixed Income	$ 12,127,652,035	47.87%	$ 630,199,607	2.49%	$12,757,851,642	50.36%
Common Stock						
Capital Goods & Services	$ 158,804,230	0.63%	$ 25,200,599	0.10%	$ 184,004,829	0.73%
Comingled Equity Funds	0	0.00%	1,574,366	0.01%	1,574,366	0.01%
Consumer Durables	123,790,496	0.49%	7,862,762	0.03%	131,653,258	0.52%
Consumer Non-Durables	1,606,076,930	6.34%	223,423,918	0.88%	1,829,500,848	7.22%
Energy	484,501,199	1.91%	80,787,750	0.32%	565,288,949	2.23%
Financial	1,495,858,324	5.90%	1,800,093,941	7.10%	3,295,952,265	13.00%
Materials & Services	1,766,571,885	6.97%	175,380,424	0.69%	1,941,952,309	7.66%
Miscellaneous Common Stock	0	0.00%	94,207	0.00%	94,207	0.00%
Real Estate Investment Trust	17,513,480	0.07%	0	0.00%	17,513,480	0.07%
Technology	1,329,238,153	5.25%	166,612,964	0.66%	1,495,851,117	5.91%
Transportation	117,081,501	0.46%	51,434,568	0.20%	168,516,069	0.66%
Unit - Compound Instrument	0	0.00%	135,677	0.00%	135,677	0.00%
Utilities	468,273,304	1.85%	164,734,142	0.65%	633,007,446	2.50%
Total Common Stock	$ 7,567,709,502	29.87%	$ 2,697,335,318	10.64%	$10,265,044,820	40.51%
Short-Term Investments						
Commercial Paper	$ 550,107,968	2.17%	$ 0	0.00%	$ 550,107,968	2.17%
Pooled Funds & Mutual Funds	106,167	0.00%	0	0.00%	106,167	0.00%
U.S. Government Securities	1,299,409,117	5.13%	0	0.00%	1,299,409,117	5.13%
Total Short-Term Investments	$ 1,849,623,252	7.30%	$ 0	0.00%	$ 1,849,623,252	7.30%
Real Estate	$ 463,382,896	1.83%	$ 0	0.00%	$ 463,382,896	1.83%
Total Investments	$ 22,008,367,685	86.87%	$ 3,327,534,925	13.13%	$25,335,902,610	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
2003-04	15.0%	9.3 %
2002-03	3.7	4.9
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

[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 1999-00 through 2003-04

Fiscal Year	TCRS Portfolio Earnings
2003-04	$ 2,181,853,628
2002-03	1,112,478,748
2001-02	(443,783,760)
2000-01	(327,791,020)
1999-00	1,761,074,099

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

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

MEMBERSHIP

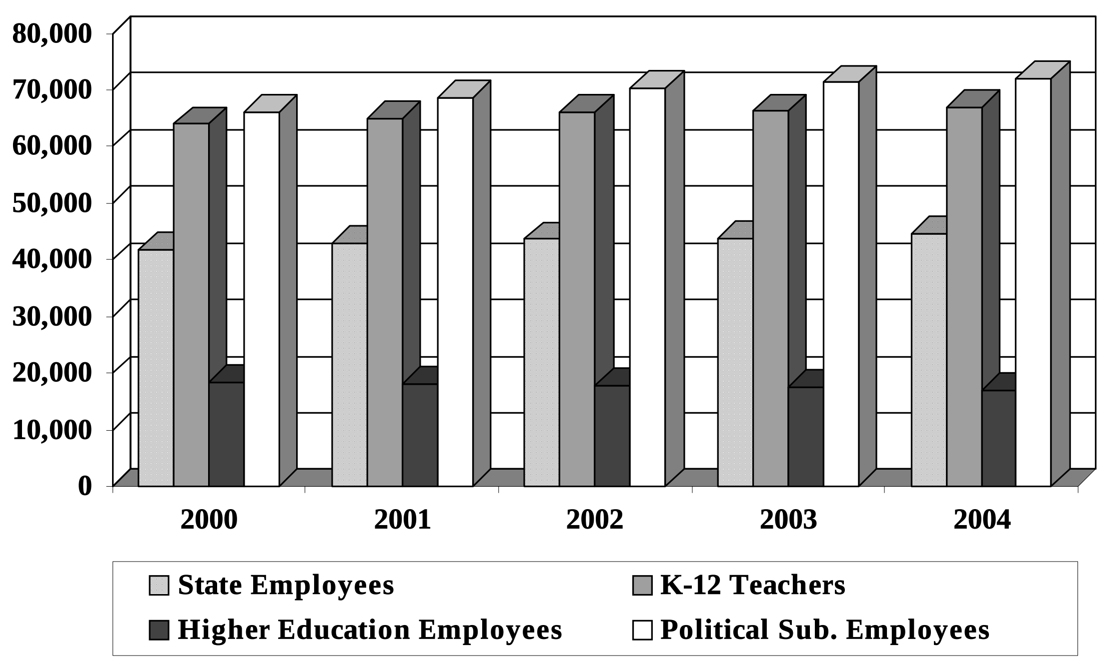
Membership in the retirement system is a condition of employment for full-time state employees, teachers, general employees in higher education, and the employees of local governments that participate in TCRS. Membership is optional for certain part-time employees. Faculty employees in higher education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

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

As of June 30, 2004, there were 200,686 active members of TCRS and 11,610 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 2000-2004



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.

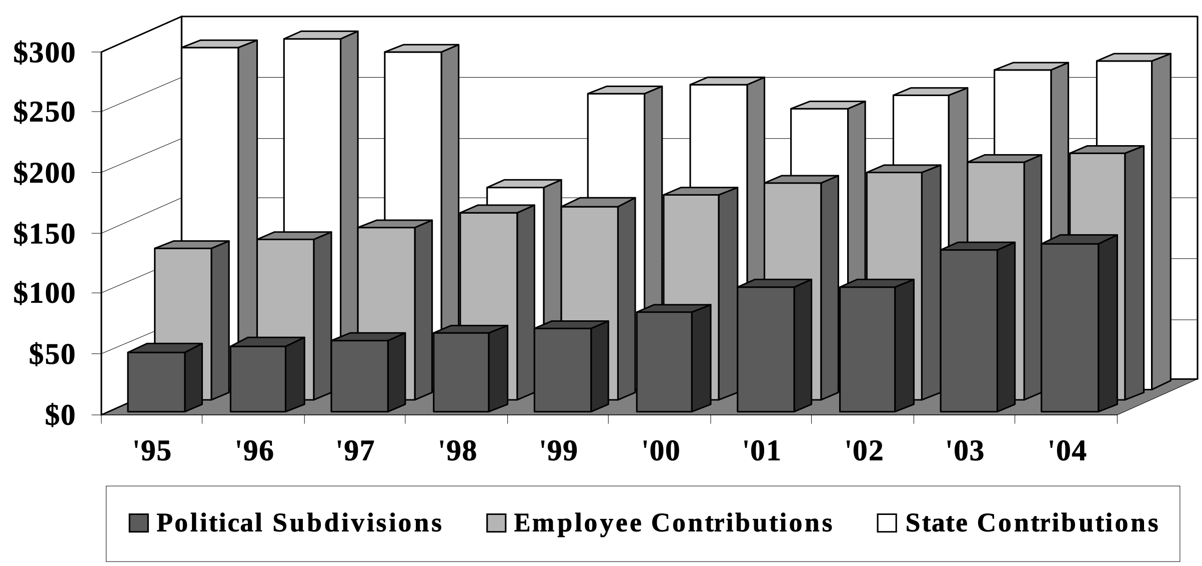
Upon termination of employment, a member may elect to withdraw his contributions and accumulated interest from the retirement system in a lump sum. By obtaining a lump sum refund, a member waives all rights and benefits in the retirement system. A vested member may leave his account balance in TCRS and 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 2003-04 fiscal year, 4,688 refunds totaling $29.9 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, 2004 were as follows:

Noncontributory State and Higher Education Employees	7.29 %
K-12 Teachers	3.39%
Political Subdivisions	Individually Determined
Faculty Members Electing to Participate in the ORP	10.0%*

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

RETIREMENT CONTRIBUTIONS
Fiscal Years 1995-2004
(in Millions)



TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

RETIREMENT BENEFITS

The benefits provided by TCRS are designed, when combined with the benefit payable from social security, to allow career employees to maintain their standard of living at retirement.

As of June 30, 2004, 86,205 retirees were receiving monthly benefit payments. This represents a 3.71% increase over the previous year.

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

A Group I benefits calculator is available on the program's Internet site: www.treasury.state.tn.us/tcrs.

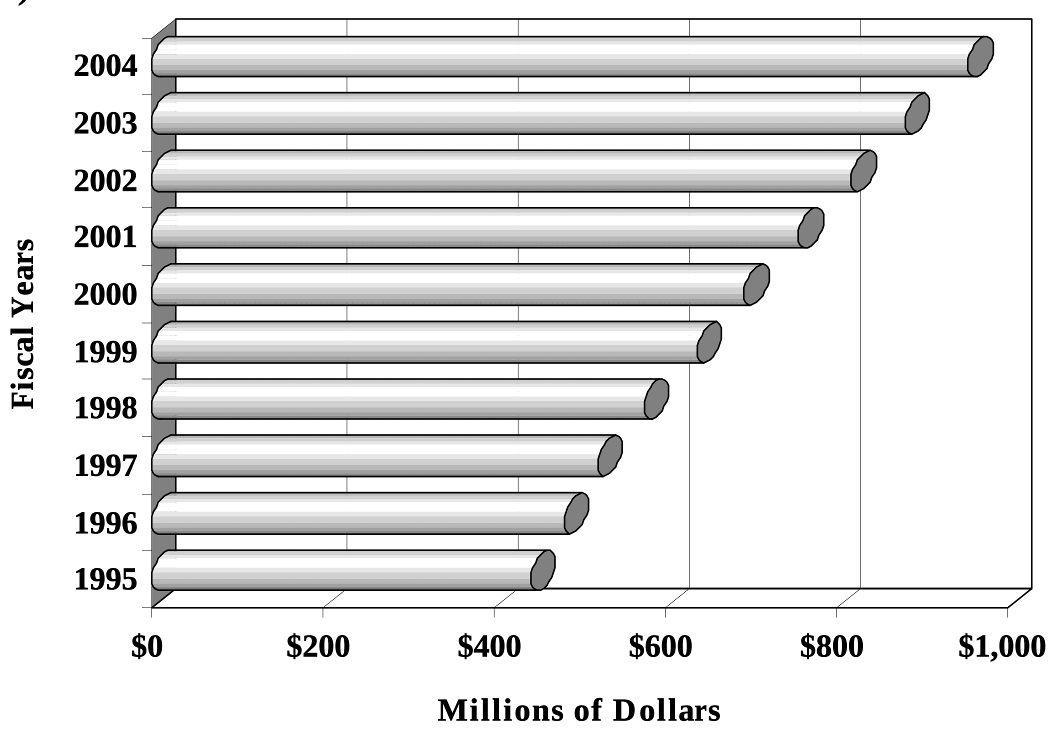
Disability benefits are available to active members with five years of service who become disabled and can not engage in gainful employment. There is no service requirement for disability benefits paid to active members whose disability is a result of an accident or injury occurring while the member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

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

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

Benefits paid in fiscal year 2003-04 totaled $954.5 million, an increase of $73.2 million over 2002-03 benefit payments.

ANNUAL BENEFIT PAYMENTS
Fiscal Years 1995-2004
(in Millions)



TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

TENNESSEE'S RETIREMENT PROGRAM, TCRS AND SOCIAL SECURITY BENEFITS
for Calendar Year 2004

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	8,760		8,760		8,760		8,760		8,760	
	Total	$ 12,304	82.0%	$ 13,485	89.9%	$ 14,666	97.8%	$ 15,848	105.7%	$ 17,029	113.5%
$20,000	TCRS	$ 4,725		$ 6,300		$ 7,875		$ 9,450		$ 11,025	
	Social Security	10,344		10,344		10,344		10,344		10,344	
	Total	$ 15,069	75.3%	$ 16,644	83.2%	$ 18,219	91.1%	$ 19,794	99.0%	$ 21,369	106.8%
$25,000	TCRS	$ 5,906		$ 7,875		$ 9,844		$ 11,813		$ 13,781	
	Social Security	11,916		11,916		11,916		11,916		11,916	
	Total	$ 17,822	71.3%	$ 19,791	79.2%	$ 21,760	87.0%	$ 23,729	94.9%	$ 25,697	102.8%
$30,000	TCRS	$ 7,088		$ 9,450		$ 11,813		$ 14,175		$ 16,538	
	Social Security	13,488		13,488		13,488		13,488		13,488	
	Total	$ 20,576	68.6%	$ 22,938	76.5%	$ 25,301	84.3%	$ 27,663	92.2%	$ 30,026	100.1%
$35,000	TCRS	$ 8,269		$ 11,025		$ 13,781		$ 16,538		$ 19,294	
	Social Security	15,060		15,060		15,060		15,060		15,060	
	Total	$ 23,329	66.7%	$ 26,085	74.5%	$ 28,841	82.4%	$ 31,598	90.3%	$ 34,354	98.2%
$40,000	TCRS	$ 9,450		$ 12,600		$ 15,750		$ 18,900		$ 22,050	
	Social Security	16,632		16,632		16,632		16,632		16,632	
	Total	$ 26,082	65.2%	$ 29,232	73.1%	$ 32,382	81.0%	$ 35,532	88.8%	$ 38,682	96.7%
$45,000	TCRS	$ 10,749		$ 14,333		$ 17,916		$ 21,499		$ 25,082	
	Social Security	17,820		17,820		17,820		17,820		17,820	
	Total	$ 28,569	63.5%	$ 32,153	71.5%	$ 35,736	79.4%	$ 39,319	87.4%	$ 42,902	95.3%
$50,000	TCRS	$ 12,128		$ 16,170		$ 20,213		$ 24,255		$ 28,298	
	Social Security	18,456		18,456		18,456		18,456		18,456	
	Total	$ 30,584	61.2%	$ 34,626	69.3%	$ 38,669	77.3%	$ 42,711	85.4%	$ 46,754	93.5%
$55,000	TCRS	$ 13,506		$ 18,008		$ 22,509		$ 27,011		$ 31,513	
	Social Security	19,068		19,068		19,068		19,068		19,068	
	Total	$ 32,574	59.2%	$ 37,076	67.4%	$ 41,577	75.6%	$ 46,079	83.8%	$ 50,581	92.0%
$60,000	TCRS	$ 14,884		$ 19,845		$ 24,806		$ 29,768		$ 34,729	
	Social Security	19,596		19,596		19,596		19,596		19,596	
	Total	$ 34,480	57.5%	$ 39,441	65.7%	$ 44,402	74.0%	$ 49,364	82.3%	$ 54,325	90.5%

* 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 2004. 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 2004;

(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, 2003 to establish the employer contribution rates for July 1, 2004. The system's accrued liability at July 1, 2003 was $370.4 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, 2003 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, 2004:

Cities	163
Counties	88
Utility Districts	44
Special School Districts	19
Joint Ventures	23
Housing Authorities	10
911 Emergency Communication Districts	33
Miscellaneous Authorities	50
Total	430

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM

MAJOR LEGISLATIVE IMPROVEMENTS
1980-2004

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 January 1, 1994.

A 5% benefit improvement authorized effective January 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
2005	7.65%	7.65%	$ 90,000	No Limit
2004	7.65	7.65	87,900	No Limit
2003	7.65	7.65	87,000	No Limit
2002	7.65	7.65	84,900	No Limit
2001	7.65	7.65	80,400	No Limit
2000	7.65	7.65	76,200	No Limit
1999	7.65	7.65	72,600	No Limit
1998	7.65	7.65	68,400	No Limit
1997	7.65	7.65	65,400	No Limit
1996	7.65	7.65	62,700	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, 2004, accounts were held by 57,327 individuals in the 401(k) plan and 4,489 individuals in the 457 plan. At June 30, 25,926 state employees, 8,099 University of Tennessee employees, and 8,759 Tennessee Board of Regents employees were actively contributing to the 401(k) plan and 1,780 state employees, 263 University of Tennessee employees, and 204 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 2004 allow a maximum deferral in the 457 plan of 100% of compensation up to the maximum annual contribution of $13,000. The maximum deferral in the 401(k) plan is 100% of compensation up to the maximum annual contribution of $13,000. Participants who also use a 403(b) plan are subject to additional limits. Participants age 50 and older are eligible to make additional deferrals.

During the 2003-04 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 $5,918,191.

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

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

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

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

DEFERRED COMPENSATION PROGRAM

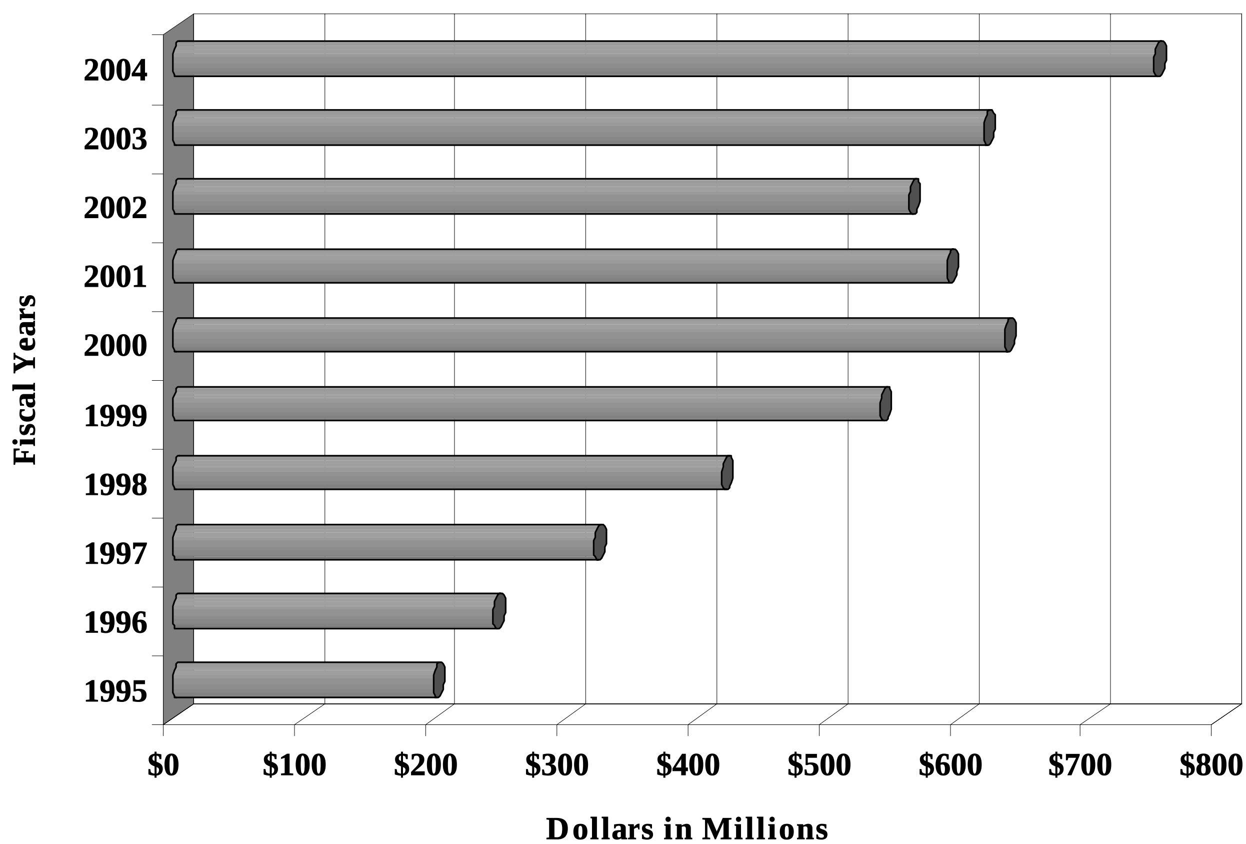
For the year ending June 30, 2004, contributions to the program totaled $74.8 million. Contributions are wired through the State Trust of Tennessee for immediate crediting.

At June 30, 2004, accumulated account balances totaled $749.2 million.

Under the loan program offered in the 401(k) plan, active employees who have accumulated $4,000 or more in their 401(k) account may borrow up to half of their account value. Participants repay principal and interest to their 401(k) account through salary deduction. Taxes continue to be deferred while funds accumulated in the plan are in loan status. As of June 30, 2004, there were 1,859 loans outstanding from the 401(k) plan. Outstanding loan balances totaled $6.2 million.

Benefits from the program may be distributed in periodic payments, in an annuity, or in a lump sum. During the year ended June 30, 2004, 1,087 individuals received periodic payments and 98 individuals received annuity payments from the program. In addition, 2,353 lump sum distributions and 1,807 partial lump sum distributions were issued during 2003-04.

DEFERRED COMPENSATION PROGRAM ASSETS
(Market Value in Millions)
Fiscal Years 1995-2004



Deferred Compensation Program

DEFERRED COMPENSATION CONTRIBUTIONS AND MARKET VALUE

	Contributions FY 2003-04	Market Value June 30, 2004
Plan I (457)		
ING (formerly Aetna)	$ 1,510,153	$ 33,334,640
American General	29,514	701,838
Calvert	568,295	3,599,901
Fidelity	4,689,764	76,159,371
State Street	542,850	2,883,266
Union Planters	642,189	13,894,373
	$ 7,982,765	$ 130,573,389
Plan II (401K)		
ING (formerly Aetna)	$ 8,984,740	$ 79,989,867
Calvert	2,757,937	18,310,100
Fidelity	48,155,259	468,768,211
State Street	2,708,014	16,034,894
Union Planters	4,247,035	35,503,506
	$ 66,852,985	$ 618,606,578
Total for Both Plans	$ 74,835,750	$ 749,179,967

FLEXIBLE BENEFITS PLAN

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

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

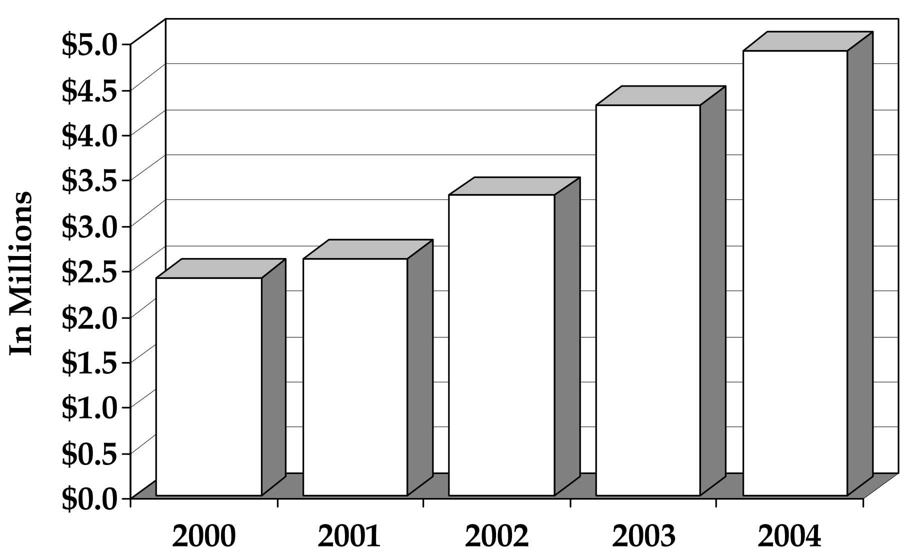
Enrollment in the plan is for a full calendar year. Enrollments may not be changed after the year has begun unless the employee experiences a change in family status and reports that change promptly. Employees must use the amounts set aside in each category for corresponding expenses incurred during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

At June 30, 2004, a total of 40,476 state employees were enrolled in one or more of the plan's four options: 39,659 employees used the plan to pay medical insurance premiums, 18,405 paid dental insurance premiums, 4,042 used the medical expense reimbursement account, and 380 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 2003-04, the state's F.I.C.A. savings totaled $4.9 million. Employees realize similar savings.

Since the program began operation in January 1989, the state's F.I.C.A. savings have totaled $37.2 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, 2004, $31.4 million had been transferred to offset costs of other benefit programs.

F.I.C.A. SAVINGS TO STATE
Fiscal Years 2000-2004
Expressed in Millions



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 2003-04, the Division of Claims Administration received 5,825 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 2003-04 fiscal year, the Board took action on a total of three claims. The Board also reviews and approves the purchase of insurance policies by the state and makes recommendations to the Commissioner of Finance and Administration and the General Assembly regarding the required funding for the Risk Management Fund.

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

The 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.

CLAIMS AGAINST THE STATE

CLAIMS AND PAYMENT ACTIVITY
Fiscal Year 2003-04

Claims Activity

	Claims Filed	Payments Made
Workers' Compensation Claims	3,881	
Death Payments		$ 496,244
Medical Payments		10,840,378
Temporary Disability		1,626,028
Permanent Disability		7,896,598
Subtotal		20,859,248
Employee Property Damage	192	$ 40,538
Tort Claims	1,752	
Death Payments		$ 1,645,449
Bodily Injury Payments		4,046,594
Property Damage Payments		1,113,270
Subtotal		6,805,313
Total	5,825	$27,705,099

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. During the 2003-04 fiscal year, 2,297 new claims were filed.

The division's staff reviews the application and obtains supporting information from the appropriate District Attorney's Office to determine eligibility for payment from the Criminal Injury Compensation fund. If the division cannot process a claim within 90 days, then the claim is referred to the Tennessee Claims Commission. Payments are issued promptly to the victim and, if appropriate, his or her attorney. On average, the division processes a claim in 85 days.

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

During the 2003-04 fiscal year, the Division of Claims Administration made payments on 1,496 criminal injury claims which represented 1,322 victims of crime. Regardless of when the initial claim was received, payments to victims during the 2003-04 fiscal year totaled $10.5 million. This total includes supplemental payments made on previously approved claims.

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

Since the first claims were paid in 1982, the program has awarded a total of more than $144.1 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.

Since the first claims were paid in 1982, the program has awarded a total of more than $144.1 million to crime victims.

VICTIMS' COMPENSATION PROGRAM

SOURCES OF FUNDS
Fiscal Year 2003-04

Source	Amount	Percentage of Total
Parole Fees	$ 599,897	4%
Probation Fees	2,025,173	16%
Bond Forfeitures	506,848	4%
Privilege Taxes	4,640,805	36%
Federal Funds	4,971,000	39%
Other	80,869	1%
Total	**$ 12,824,592**	**100%**

NEW CLAIMS FILED
Fiscal Year 2003-04

Crime Type	Number Filed	Crime Type	Number Filed
Homicide	291	Child Sexual Abuse	462
Adult Sexual Assault	209	DUI	98
Robbery by Force	208	Stalking	1
Assault	910	Kidnapping	8
Vehicular (Non-DUI)	66	Arson	1
Child Physical Abuse	7	Other	36
		Total	**2,297**

CLAIMS PAID BY CRIME TYPE
Fiscal Year 2003-04

Crime Type	Number Paid	Percentage of Total Claims	Amount Paid	Percentage of Total Paid
Homicide	242	16.2%	$ 2,648,578	25.2%
Adult Sexual Assault	162	10.8%	467,625	4.4%
Robbery by Force	141	9.4%	1,408,883	13.4%
Assault	526	35.3%	4,328,672	41.0%
Vehicular (Non-DUI)	12	0.8%	122,557	1.2%
Child Physical Abuse	3	0.2%	5,614	0.1%
Child Sexual Abuse	353	23.6%	890,909	8.5%
DUI	53	3.5%	643,144	6.1%
Kidnapping	2	0.1%	5,760	0.1%
Arson	2	0.1%	3,348	0.0%
Total*	**1,496**	**100.0%**	**$10,525,090**	**100.0%**

*Nine percent of all claims were the result of domestic violence.

Claims Commission

CLAIMS COMMISSION

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

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

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

CLAIMS PROCESSING

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

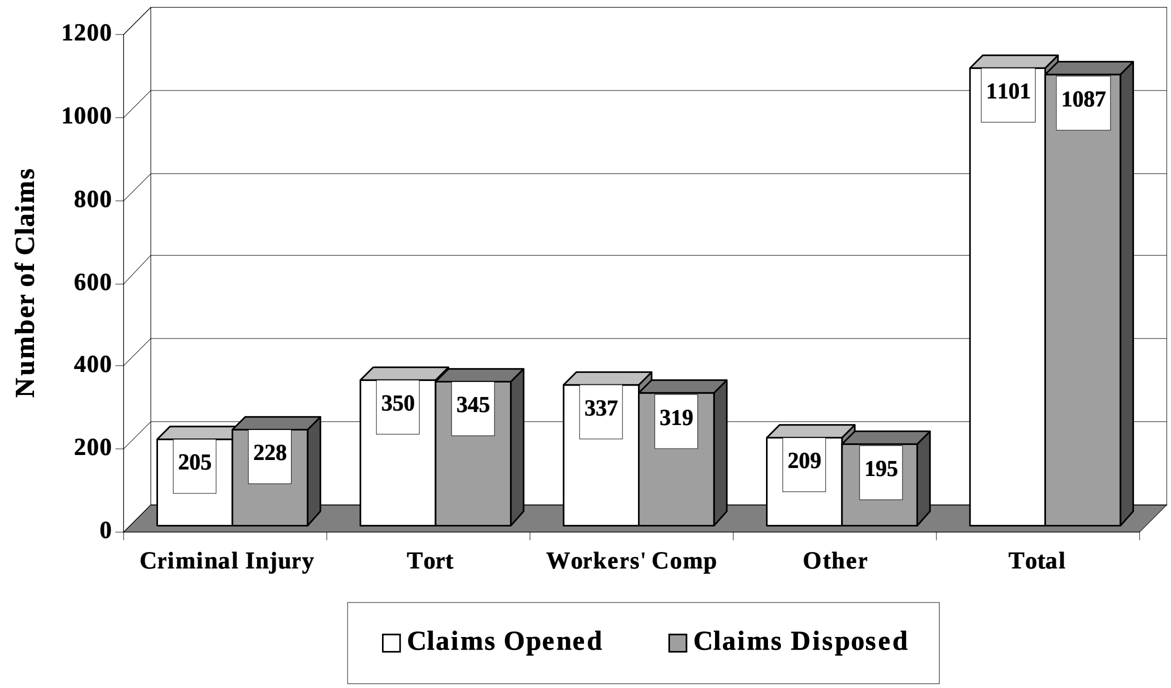
Both the Division of Claims Administration and the third party administrator have 90 days to accept or deny a claim before the claim is automatically transferred to the commission. Claimants can appeal both entities' decisions to the Claims Commission.

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

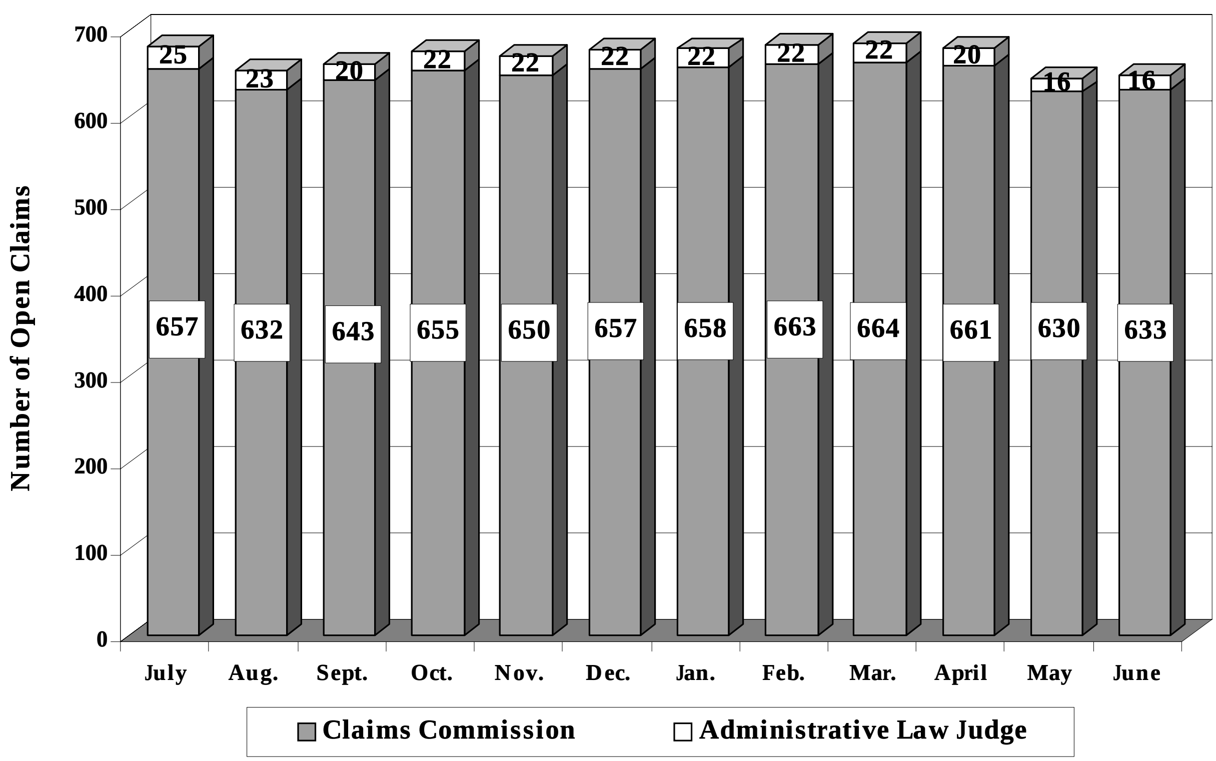
Upon request by the Governor, by an individual claims commissioner, or by the majority of the claims commissioners, the Secretary of State may assign administrative law judges to "assist in the removal of unacceptable congestion or delay on the claims commission docket." In adjudicating claims, the administrative 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 2003-04



CLAIMS COMMISSION AND ADMINISTRATIVE LAW JUDGE OPEN CLAIMS
Fiscal Year 2003-04



DIVISION OF RISK MANAGEMENT

The Division of Risk Management identifies and analyzes the state's exposure to property and casualty risks, and implements certain risk management techniques to mitigate the state's exposure to loss. The state funds various levels of risk retention through the "Risk Management Fund" (Chapter 212, Acts of 2003). In fiscal year 2003-04, the method used to fund the property annual aggregate deductible and allocate property premiums to state agencies was fundamentally changed. Previously, only the premiums paid for commercial property insurance were allocated to state agencies. Under the new funding mechanism, agencies also assume the additional premium costs for estimated losses falling within the annual aggregate deductible amount.

In fiscal year 2003-04, the insurance market showed some improvement in available capacity. The state's property policy limits increased from $100 million to $250 million per occurrence. Flood limits increased from $5 million to $10 million. Earthquake coverage limits of $25 million were reinstated. The state's aggregate deductible changed from $5 million to $5 million per occurrence and $7.5 million aggregate. As of July 1, 2003, the state's property values were $9.9 billion. Total premium costs for property and fidelity coverages amounted to $1,737,055. This was a premium increase of 19.1% over fiscal year 2002-03. The annual property rate increased from .01098 to .01422 per $100 of coverage.

The Builders' Risk Insurance Program provides coverage for building construction projects approved by the State Building Commission. The policy provides all-risk coverage for the state agency, general contractor and all subcontractors for the duration of the construction project. In fiscal year 2003-04, coverage limits were restricted to $25 million per location/$30 million per occurrence. Any project exceeding the $30 million limit had to be reported to the insurance company. No projects exceeded the limit in fiscal year 2003-04.

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, Risk Management procures a fidelity bond. Fidelity coverage is provided in the amount of $1 million per incident/aggregate for all state employees.

Risk Management 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 $25,000 deductible per occurrence which must be assumed by the individual departments. Documented losses above the deductible amount are indemnified by the Risk Management Fund up to the amount of the property insurance aggregate deductible amount.

During fiscal year 2003-04, the state received 10 claims in excess of the $25,000 deductible. These estimated losses from these claims amounted to $4,143,845 with a net estimated loss to the fund of $3,893,845.

The prevention and control of losses is an important part of managing the state's risks. In fiscal year 2003-04, the property carrier conducted fire/life safety inspections on selected high-risk buildings at UT Memphis, University of Memphis, and Memphis Mental Health Institute. In an effort to increase the number of these inspections, internal staff training is underway. A fire/life safety check-list is now accessible through the web, which allows agencies to provide self-inspection reports to Risk Management. To address worker's compensation losses, Risk Management has been analyzing loss information provided by Sedgwick's Juris System (VO1). This information has been the basis for developing loss control initiatives, including an early return-to-work pilot project, work-site safety evaluations, workstation ergonomics, and safety training.

CAREERS NOW PROGRAM

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

Since the program's inception in 1996, 180 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 North Alabama, St. Louis University, Samford 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 39 percent of the student participants have been minorities and 38 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 accepts Tennessee residents who are attending out-of-state colleges and universities including University of North Alabama, St. Louis University and Samford University. The expectation is that the program will benefit from a broadened base of experience and that the students will benefit from the opportunity to gain experience in state government leading to permanent employment opportunities in their home state of Tennessee.

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

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.

Unclaimed Property Division

UNCLAIMED PROPERTY DIVISION

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

The Unclaimed Property Act provides that property that an organization or individual is holding for another person will be delivered to the Treasurer for custody if the holder of the property has had no contact with the owner for a period of time, normally five years, and if the holder cannot locate the owner. Once property is delivered, the Treasurer utilizes various techniques to locate the owners. There is no time limit on claiming this property.

During the period July 1, 2003 through June 30, 2004, $37.4 million of cash property was turned over to the Treasurer. This includes $.9 million remitted by third party audit organizations from out-of-state non-reporting holders for Tennessee residents. An additional $3.4 million in proceeds from stock sales was recognized as revenue.

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

The Treasurer advertises owners' names and last known addresses in newspapers throughout the state. Another location method used is to send notification to the last known address of each owner. If no response is received, additional search efforts are made through Department of Labor and Workforce Development records, telephone directories, drivers' license records, and other sources.

In addition, a searchable database of the owners' names is available on the division's Internet site: www.treasury.state.tn.us/unclaim. This site logged 1.8 million visitors at June 30, 2004, an increase of 416,000 for the fiscal year. The records of unclaimed property owners are also available for viewing by the public in the Unclaimed Property office.

During the period July 1, 2003 through June 30, 2004, more than $13 million of cash property was returned by the Unclaimed Property Division to the owners or their heirs, local governments and reciprocal states.

Any local government in Tennessee that turns over unclaimed property to the state may request that the property be returned to the local government for safekeeping after it has been held by the state for 18 months. This fiscal year, $587,493 was refunded to 17 local governments.

Tennessee has reciprocal agreements with other states' unclaimed property programs to exchange property held by one state for owners with a last known address in the other state. Tennessee received $1.3 million for residents or former residents in exchange for $1.1 million paid to other states' unclaimed property offices.

Since the program began operations in 1979, $317 million in unclaimed property has been reported to the Treasurer and $97.5 million has been returned to owners, heirs, local governments and reciprocal states.

After all location techniques are employed, the Unclaimed Property Division is able to return approximately 55 percent of property that is turned over with an owner's name.

UNCLAIMED PROPERTY DIVISION

METHODS USED TO RETURN PROPERTY
Fiscal Year 2003-04

Location Method	Number of Accounts	Value of Claims	Average Claim Value
Website Inquiries	5,768	$ 4,306,508	$ 747
Mailings to Last Known Address	4,042	2,126,133	526
Advertisement and Television	1,649	900,020	546
Match with Dept. of Labor and Workforce Records	2,380	586,969	247
Holder Referral	616	1,226,114	1,990
Independent Locator	156	1,579,599	10,126
Staff Outreach	64	652,188	10,190
Total Claim Payments	14,675	$11,377,531	$ 775
Refunds to Local Governments	17	587,493	
Interstate Exchanges	50	1,078,737	
Total Payments	**14,742**	**$13,043,761**	

SOURCES OF UNCLAIMED PROPERTY
Fiscal Years 2000 - 2004

	2004	2003	2002	2001	2000
Financial Institutions	28%	30%	29%	39%	29%
Insurance Companies	29%	18%	15%	21%	17%
Securities and Brokerage Firms	1%	2%	14%	8%	25%
Corporations, Transportation, Colleges, Retailers	19%	20%	13%	13%	11%
Escheat and Other	7%	7%	12%	6%	5%
Utilities	6%	8%	7%	3%	3%
Cities and Counties	5%	7%	4%	4%	3%
Other States	3%	5%	4%	3%	4%
Hospitals and Health Care	2%	3%	2%	3%	3%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

CLAIMS PAID BY SOURCE
Fiscal Years 2000 - 2004

	2004	2003	2002	2001	2000
Website Inquiries and Others	68%	71%	59%	56%	67%
Mailings to Last Known Address	19%	14%	17%	16%	27%
Advertisement and Television	8%	9%	16%	15%	5%
Match with Dept. of Labor and Workforce Records	5%	6%	8%	13%	1%
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 million and matching contributions totaling $55.7 million. For the year ending June 30, 2004, investment earnings totaled $17 million with expenditures of $7.2 million.

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 Management Information Systems
- Moss COE in Psychology
- Moss COE in Education
- Hardin COE in Combinatorics
- Hardin COE in Economics/Managerial Journalism
- Sparks COE in International Relations
- Plough COE in Audiology & Speech Language Pathology

Baccalaureate Education System Trust

BACCALAUREATE EDUCATION SYSTEM TRUST

Tennessee Code Annotated, Title 49, Chapter 7, Part 8 sets forth the Tennessee Baccalaureate Education System Trust (BEST) Act. The Act creates a tuition program, as an agency and instrumentality of the State of Tennessee, under which parents and other interested persons may assist students in saving for tuition cost of attending colleges and universities. The tuition program is known as the BEST Program and is comprised of two types of tuition plans: 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 from 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. Participants have several payment options including cash, check, payroll deduction and automatic bank withdrawal.

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

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

The Baccalaureate Education System Trust prepaid program began accepting contracts and contributions in June 1997. At June 30, 2004, BEST had 8,292 contracts with net assets totaling $51.4 million. The unit price for the July 1, 2004 – December 31, 2004 enrollment period is $48.96/unit. The unit price will increase to $50.80/unit for the January 1, 2005 – June 30, 2005 enrollment period. The BEST Board annually adjusts the unit purchase price and unit payout 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 2,093 payments totaling $3.9 million. Of the 2,093 payments issued, 1,692 were made to in-state schools and 401 were to out-of-state schools.

BEST SAVINGS PLAN

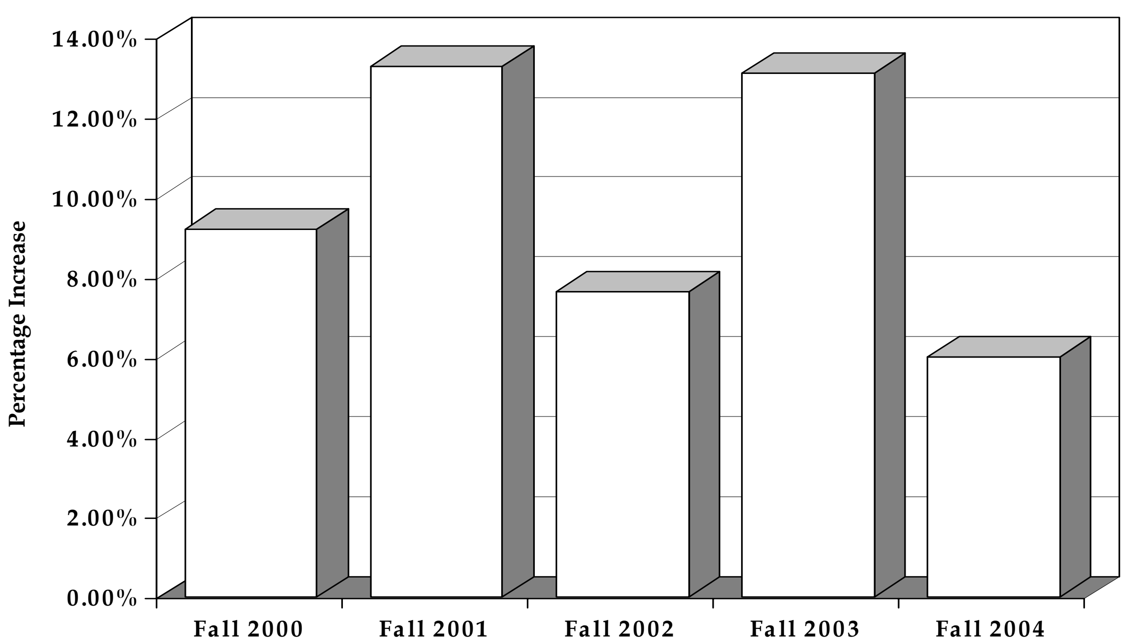
Anyone interested in investing for a college education can open an account on a child's behalf in the Savings Plan. There are no residency requirements. The account can be used to pay for qualified higher education expenses at any eligible college, university, trade or vocational school, or other post-secondary 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, 2004, there were 3,137 contracts with assets totaling $18.3 million.

WEIGHTED AVERAGE TUITION AND FEE INCREASES FOR TENNESSEE PUBLIC INSTITUTIONS
2000-2004



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, property insurance report search, safety check lists, agency loss control reports and employee safety information	www.treasury.state.tn.us/risk
Tort Reporting (GTLA)	Information, rules and reporting templates	www.treasury.state.tn.us/risk/tort
Workers' Compensation Program	Information on reporting accidents and filing claims, eligibility criteria, glossary, explanation of benefits and provider directory	www.treasury.state.tn.us/wc
Public Employee Benefit Programs		
Deferred Compensation Program	Account access (inquiry, transfers, allocation changes), participation and investment information, benefit projection calculator, withdrawal information and forms	www.treasury.state.tn.us/dc
Flexible Benefits Plan	Program information and forms	www.treasury.state.tn.us/flex
Optional Retirement Program	Program information, forms, company contacts and product information	www.treasury.state.tn.us/orp
Tennessee Consolidated Retirement System	Program information, benefits calculator, publications, newsletters, forms, annual report, frequently asked questions, political subdivision option search and retirement planning information	www.treasury.state.tn.us/tcrs
Other		
About the Treasurer	Statutory duties and biographical information	www.treasury.state.tn.us/about.html
Annual Report	Treasurer's Report on-line	www.treasury.state.tn.us/ann-report.htm
Bank Collateral Pool	Program information, forms and participants	www.treasury.state.tn.us/bank
Map to Treasury Offices	Directions to Treasury offices	www.treasury.state.tn.us/map.gif

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
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 Commission	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 Corporation	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 Corporation	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.
Small and Minority-Owned Business Assistance Program	65-5-213
State Cash Management	9-4-106—9-4-108; 9-4-401—9-4-409
State Treasurer's Office	8-5-101, et seq.
State Trust of Tennessee	9-4-801, et seq.
Tennessee Claims Commission	9-8-301, et seq.
Tennessee Consolidated Retirement System and Miscellaneous Systems	Title 8, Chptrs. 34, 35, 36, 37 & 39
Unclaimed Property	66-29-101, et seq.
Victims of Drunk Drivers Compensation Fund	40-24-107

Executive Staff Directory

Treasurer's Office		
Treasurer	Dale Sims	(615) 741-2956
Executive Assistant	Janice Cunningham	(615) 741-2956
Assistant to the Treasurer	Steve Curry, CPA-inactive, CEBS, CCM	(615) 532-1167
Staff Assistant	Nathan Burton	(615) 532-9908
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 Manager	Leighton Shantz, CFA	(615) 532-1183
Senior Fixed Income Portfolio Manager	Terry Davis, CFA	(615) 253-5416
Senior Short-Term Portfolio Manager	Randy Graves, CPA-inactive	(615) 532-1154
Director of Real Estate	Peter Katseff	(615) 532-1160
Senior Short-Term Portfolio Manager	Tim McClure, CCM	(615) 532-1166
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
Assistant Director of Accounting	Kim Morrow, CPA	(615) 532-8051
Manager of Administrative Services	Brian Derrick, CPA	(615) 532-8552
Director of Claims Administration	Anne Adams	(615) 741-2734
Manager of Criminal Injury Claims	Amy Dunlap	(615) 741-2734
East Tennessee Claims Commissioner	Vance Cheek, Jr., JD	(423) 854-5330
Middle Tennessee Claims Commissioner	Stephanie Reevers, JD	(615) 253-1625
West Tennessee Claims Commissioner	Nancy Miller-Herron, JD	(731) 364-2440
Administrative Clerk, Claims Commission	Marsha Richeson	(615) 532-5385
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
Manager of Treasury Operations	Gaylon Bandy	(615) 741-4985
Director of Unclaimed Property	Beth Chapman, CPA	(615) 741-6499

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

Treasury Staff

Adams, Anne
Alexander, Mary
Allison, Patti
Anderson, Sandra
Arnett, Ron
Arnold, Sandra
Atkins, Janice
Aymett, Ron
Bachus, Jill
Baker, Linda
Baker, Sam[30]
Baker, Sherry[25]
Bandy, Gaylon
Baumgartel, Karen[25]
Birthrong, Peggy
Blount, Gweneivere
Booker, Velva[30]
Brady, Milkia
Brown, Alex
Brown, Autumn
Brown, Brenda
Brown, Buffy[5]
Bryant, Cavandrea
Burns, Bobby
Burton, Nathan
Bush, Vernon
Butterfield, Keith
Campbell, Heath
Carr, Brenda
Cavender, William
Chapman, Beth[25]
Chatman, Shirley
Cheek, Jr. Vance
Cole, Barbara
Coleman, Alva
Conlin, Jeremy
Costa, Delcinia
Cotter, Liddye
Couch, Janie[5]
Crews, Daniel[5]
Cunningham, Janice
Curry, Steve
Curtis, Shawn
Dale, Tiffany
Daniel, Ted[10]
Daniels, Ruth
Darrell, Pat[15]
Davidson, Vivian
Davis, Melissa
Davis, Terry
Derrick, Brian
Dills, Larissa[10]
Dorse, Bridget
DuBray, Rick[20]
Duffey, Aimee
Dunlap, Amy
Eberhart, Shaune
Edmundson, Ray
Farmer, Sharon
Finley, Donna[35]
Fisher, Peggy
Fohl, Jamie
Fredin, Cort
Fuller, Charlotte[30]
Fuqua, Monica
Gabriel, John
Gaines, Doug[5]
Gatewood, Ann
Gentry, Bernard[15]
Gibson, Connie[15]
Glassell, Brad
Graves, Randy
Green, Carrie
Green, Janice
Greene, Barbara
Greer, Matthew
Gregory, Steve
Griffin, Delores[25]
Gwozdz, Kellie
Hannah, Deana Reed[25]
Hargrove, Kathy[25]
Harris, Sharon
Hartley, Kerry
Hedges, Matthew
Hennessee, Ed
Herron, Nancy-Miller
Hoffmann, Ellen
Hudson, Malinda
Hulsey, Amanda
Hunter, Robin
Hurt, Sandra
Jennette, Angela
Johnson, Roxanne
Johnson, Tawana
Jordan, Tom
Katseff, Peter
Keeler, Michael
Keller, Katrina
Kilgore, Natalie
King, Jenny
Ladd, George
LaMontagne, Carrie[5]
Layfield, Anthony
Li, Liren[5]
Mackey, Wanda[10]
Maddox, Teresa
Majors, Vallie
Marshall, Fred
Mason, Justin
McClure, Tim
Meadows, Mandy
Mercier, Brenda
Miller, Henry
Milne, Tom
Molloy, Newt
Moore, Linda
Morgan, Prentice
Morrow, Kim
Moses, Gail
Moulder, Michael[20]
Murphy, Sareatha
Myers, Rhonda
Myles, Alicia
O'Leary, Candy
O'Saile, Mandy
Oshop, Glenda
Otts, Kimberly
Oyster, David
Padgett, Wendy[25]
Page, LaKesha
Parker, Marcia
Parlow, Yvonne[5]
Parton, Floyd[5]
Patton, Candace
Pinson, Marian
Pritchett, Brad
Redmond, William
Reevers, Stephanie
Reilly, Janice
Richeson, Marsha[20]
Riley, Carla
Roberts-Krause, Mary
Roberts, Rachel[10]
Robinson, Mia
Robinson, Jim[10]
Rochelle, Dawn
Rothermich, Erica
Sabin, Stephanie
Sanders, Sharon
Sanford, Letha
Scott, Tammie
Sewell, Sandra
Shantz, Leighton[10]
Sims, Dale
Singleton, David
Smith, Anita[20]
Smith, Kimberly
Smith, Mary
Smith, Robert[20]
Stallings, Brittany
Strickland, Sandy
Swearingen, Nicole
Tackett, Chelsea
Taylor-Tharpe, Ann[30]
Thomas, Anita
Thompson, Jamie Lynn[5]
Tucker, Shannon
Veach, Johnny
Vinson, Maxine[15]
Wagner, Malinda
Wakefield, Mark
Walker, Tracy
Washington, Tracey
Wassom, Susanna
Wayman, Jamie
Wellington, Roy
Whaley, Kimberly
Wheeler, Shirley
Whitlow, Amber
Williams, Teresa[25]
Williamson, Kellie
Willocks, Dianne
Wilson, Martha
Wilson, Shirley
Wimmer, Genera
Woodrum, Angela
Wooten, Jennifer

[5] Received 5-year service award in 2004
[10] Received 10-year service award in 2004
[15] Received 15-year service award in 2004
[20] Received 20-year service award in 2004
[25] Received 25-year service award in 2004
[30] Received 30-year service award in 2004
[35] Received 35-year service award in 2004

INVESTMENT PORTFOLIOS

Pine Cones

State Cash Portfolio as of June 30, 2004

Description	Rating	Maturity	Yield to Maturity	Par Value	Fair Value
U.S. TREASURY & AGENCY OBLIGATIONS					
FFCB Discount Note	Aaa	07/12/04	1.03	$ 25,000,000	$ 24,990,000
FFCB Discount Note	Aaa	01/13/05	1.22	40,975,000	40,573,445
FFCB Discount Note	Aaa	01/14/05	1.22	18,000,000	17,821,800
FHLB Agency Note	Aaa	10/15/04	1.11	19,520,000	19,642,000
FHLB Agency Note	Aaa	04/11/05	1.30	25,000,000	24,867,250
FHLB Agency Note	Aaa	04/22/05	1.28	50,000,000	49,687,500
FHLB Agency Note	Aaa	04/27/05	1.30	50,000,000	49,687,500
FHLB Agency Note	Aaa	04/29/05	1.35	25,000,000	24,812,500
FHLB Agency Note	Aaa	05/04/05	1.50	81,750,000	81,341,250
FHLB Agency Note	Aaa	05/04/05	1.50	20,000,000	19,900,000
FHLB Agency Note	Aaa	05/20/05	1.69	50,000,000	49,797,000
FHLB Agency Note	Aaa	06/10/05	2.07	26,200,000	26,159,128
FHLB Agency Note	Aaa	06/21/05	2.08	30,000,000	29,943,900
FHLB Discount Note	Aaa	07/01/04	0.97	50,000,000	50,000,000
FHLMC Agency Note	Aaa	11/15/04	1.47	7,500,000	7,549,200
FHLMC Agency Note	Aaa	06/14/05	2.00	25,000,000	24,871,750
FHLMC Discount Note	Aaa	08/24/04	1.28	125,000,000	124,762,500
FHLMC Discount Note	Aaa	09/15/04	1.12	175,000,000	174,510,000
FHLMC Discount Note	Aaa	10/07/04	1.14	1,800,000	1,792,620
FHLMC Discount Note	Aaa	10/15/04	1.31	1,927,000	1,918,290
FNMA Agency Note	Aaa	05/16/05	1.65	25,000,000	24,898,500
FNMA Agency Note	Aaa	05/27/05	1.80	30,000,000	29,887,500
FNMA Discount Note	Aaa	07/01/04	1.01	100,000,000	100,000,000
FNMA Discount Note	Aaa	07/23/04	1.26	5,000,000	4,996,000
FNMA Discount Note	Aaa	08/02/04	1.09	58,930,000	58,872,903
FNMA Discount Note	Aaa	09/01/04	1.21	54,486,595	54,373,051
FNMA Discount Note	Aaa	09/13/04	1.08	36,887,467	36,806,335
FNMA Discount Note	Aaa	09/17/04	1.11	2,044,000	2,038,072
FNMA Discount Note	Aaa	10/01/04	1.26	11,152,000	11,116,376
FNMA Discount Note	Aaa	10/01/04	1.06	40,000,000	39,892,667
FNMA Discount Note	Aaa	10/15/04	1.56	50,000,000	49,780,000
FNMA Discount Note	Aaa	10/20/04	1.22	100,000,000	99,540,000
FNMA Discount Note	Aaa	11/01/04	1.22	98,000,000	97,605,956
FNMA Discount Note	Aaa	11/01/04	1.22	8,091,066	8,057,616
FNMA Discount Note	Aaa	11/15/04	1.08	3,654,000	3,631,638
FNMA Discount Note	Aaa	12/01/04	1.42	24,291,000	24,146,469
FNMA Discount Note	Aaa	01/15/05	1.39	3,420,000	3,386,655
FNMA Zero Coupon	Aaa	05/15/05	1.28	7,612,000	7,474,755
TOTAL U.S. TREASURY & OBLIGATIONS				**$ 1,506,240,128**	**$ 1,501,132,126**

(continued)

State Cash Portfolio as of June 30, 2004

Description	Maturity	Yield to Maturity	Par Value	Fair Value
CERTIFICATES OF DEPOSIT				
Community Bank & Trust Co., Ashland City	11/23/04	1.45	$ 2,000,000	$ 2,000,000
Community Bank & Trust Co., Ashland City	11/23/04	1.45	1,000,000	1,000,000
Bank of Crockett, Bells	11/26/04	1.45	200,000	200,000
Bank of Crockett, Bells	12/17/04	1.65	300,000	300,000
Peoples Bank of Polk County, Benton	07/09/04	1.10	200,000	200,000
Peoples Bank of Polk County, Benton	08/20/04	1.10	200,000	200,000
First South Bank, Bolivar	09/24/04	1.10	2,142,700	2,142,700
Bank of Bradford	08/20/04	1.10	100,000	100,000
Peoples Bank & Trust Co., Byrdstown	07/06/04	1.10	100,000	100,000
Peoples Bank & Trust Co., Byrdstown	08/06/04	1.10	100,000	100,000
Peoples Bank & Trust Co., Byrdstown	08/24/04	1.10	100,000	100,000
Peoples Bank & Trust Co., Byrdstown	08/27/04	1.10	200,000	200,000
Peoples Bank & Trust Co., Byrdstown	09/03/04	1.10	100,000	100,000
Peoples Bank & Trust Co., Byrdstown	09/14/04	1.10	200,000	200,000
Peoples Bank & Trust Co., Byrdstown	11/30/04	1.45	500,000	500,000
Citizens Bank, Carthage	08/17/04	1.10	2,000,000	2,000,000
Citizens Bank, Carthage	09/17/04	1.10	2,000,000	2,000,000
Cumberland Bank, Carthage	08/10/04	1.10	500,000	500,000
First State Bank, Chapel Hill	07/02/04	1.10	200,000	200,000
First Federal Savings Bank, Clarksville	07/09/04	1.10	100,000	100,000
Legends Bank, Clarksville	07/13/04	1.10	1,000,000	1,000,000
Legends Bank, Clarksville	08/03/04	1.10	1,000,000	1,000,000
Legends Bank, Clarksville	08/27/04	1.25	1,000,000	1,000,000
Legends Bank, Clarksville	09/27/04	1.35	1,000,000	1,000,000
The Bank/ First Citizens Bank, Cleveland	08/23/04	1.10	2,500,000	2,500,000
The Bank/ First Citizens Bank, Cleveland	11/19/04	1.45	5,000,000	5,000,000
The Bank/First Citizens Bank, Cleveland	08/16/04	1.10	5,000,000	5,000,000
Peoples Bank, Clifton	11/19/04	1.45	500,000	500,000
Community First Bank & Trust, Columbia	07/13/04	1.10	3,000,000	3,000,000
Community First Bank & Trust, Columbia	09/24/04	1.10	2,000,000	2,000,000
Community First Bank & Trust, Columbia	09/24/04	1.10	1,000,000	1,000,000
Community National Bank, Dayton	09/17/04	1.10	950,000	950,000
Community National Bank, Dayton	12/10/04	1.65	1,000,000	1,000,000
Community National Bank, Dayton	12/14/04	1.65	2,000,000	2,000,000
Tristar Bank, Dickson	07/02/04	1.10	500,000	500,000
The Farmers & Merchants Bank, Dyer	07/13/04	1.05	500,000	500,000
The Farmers & Merchants Bank, Dyer	07/27/04	1.10	500,000	500,000
The Farmers & Merchants Bank, Dyer	10/26/04	1.25	500,000	500,000
The Farmers & Merchants Bank, Dyer	11/05/04	1.25	500,000	500,000
The Farmers & Merchants Bank, Dyer	12/17/04	1.35	500,000	500,000
First Citizens National Bank, Dyersburg	07/09/04	1.10	20,000,000	20,000,000
Security Bank, Dyersburg	08/31/04	1.10	300,000	300,000
Citizens Bank Tri-Cities, Elizabethton	07/20/04	1.10	2,600,000	2,600,000
Franklin National Bank, Franklin	07/13/04	1.10	5,000,000	5,000,000
Franklin National Bank, Franklin	07/20/04	1.10	10,000,000	10,000,000
Franklin National Bank, Franklin	08/03/04	1.10	10,000,000	10,000,000
Franklin National Bank, Franklin	08/10/04	1.10	10,000,000	10,000,000

(continued)

STATE CASH PORTFOLIO
AS OF JUNE 30, 2004

Description	Maturity	Yield to Maturity	Par Value	Fair Value
Franklin National Bank, Franklin	08/20/04	1.10	5,000,000	5,000,000
Franklin National Bank, Franklin	09/21/04	1.10	10,000,000	10,000,000
Franklin National Bank, Franklin	09/24/04	1.10	10,000,000	10,000,000
Franklin National Bank, Franklin	10/15/04	1.10	25,000,000	25,000,000
Tennessee Commerce Bank, Franklin	07/15/04	1.10	750,000	750,000
Tennessee Commerce Bank, Franklin	08/10/04	1.10	500,000	500,000
Tennessee Commerce Bank, Franklin	10/15/04	1.10	500,000	500,000
Tennessee Commerce Bank, Franklin	10/19/04	1.10	1,000,000	1,000,000
Tennessee Commerce Bank, Franklin	12/17/04	1.65	1,500,000	1,500,000
Friendship Bank	07/09/04	1.10	50,000	50,000
Friendship Bank	07/09/04	1.10	525,000	525,000
Friendship Bank	07/09/04	1.10	1,550,000	1,550,000
Friendship Bank	07/20/04	1.10	375,000	375,000
Friendship Bank	09/24/04	1.10	90,000	90,000
Friendship Bank	12/23/04	1.65	1,500,000	1,500,000
Gates Banking & Trust Co.	09/14/04	1.10	450,000	450,000
Gates Banking & Trust Co.	09/21/04	1.10	500,000	500,000
Gates Banking & Trust Co.	11/23/04	1.45	350,000	350,000
Tennessee State Bank, Gatlinburg	09/24/04	1.10	10,000,000	10,000,000
Trust One Bank, Germantown	07/13/04	1.10	2,000,000	2,000,000
Trust One Bank, Germantown	07/13/04	1.10	2,000,000	2,000,000
Trust One Bank, Germantown	07/13/04	1.10	2,000,000	2,000,000
Trust One Bank, Germantown	07/13/04	1.10	1,000,000	1,000,000
Trust One Bank, Germantown	08/10/04	1.10	6,000,000	6,000,000
Trust One Bank, Germantown	09/07/04	1.25	3,000,000	3,000,000
Trust One Bank, Germantown	09/07/04	1.25	1,000,000	1,000,000
Trust One Bank, Germantown	09/07/04	1.25	1,000,000	1,000,000
Trust One Bank, Germantown	09/07/04	1.25	3,000,000	3,000,000
Trust One Bank, Germantown	10/12/04	1.45	3,000,000	3,000,000
Trust One Bank, Germantown	10/12/04	1.45	4,000,000	4,000,000
Bank of Gleason	07/06/04	1.10	350,000	350,000
Bank of Gleason	08/27/04	1.10	1,000,000	1,000,000
Bank of Gleason	08/27/04	1.10	1,000,000	1,000,000
Bank of Gleason	08/31/04	1.10	200,000	200,000
Bank of Gleason	11/09/04	1.45	300,000	300,000
Bank of Halls	08/03/04	1.10	300,000	300,000
Bank of Halls	08/17/04	1.10	700,000	700,000
Bank of Halls	09/07/04	1.10	200,000	200,000
Bank of Halls	10/08/04	1.10	400,000	400,000
Bank of Halls	10/22/04	1.10	200,000	200,000
Citizens Bank, Hartsville	08/02/04	1.10	2,500,000	2,500,000
Bancorpsouth, Jackson	08/24/04	1.10	50,000,000	50,000,000
Bancorpsouth, Jackson	09/10/04	1.10	15,000,000	15,000,000
Bancorpsouth, Jackson	09/10/04	1.10	7,500,000	7,500,000
Bancorpsouth, Jackson	10/15/04	1.10	2,000,000	2,000,000
Bancorpsouth, Jackson	10/15/04	1.10	1,000,000	1,000,000
Bancorpsouth, Jackson	10/15/04	1.10	7,500,000	7,500,000
The Bank of Jackson	08/17/04	1.10	1,000,000	1,000,000

(continued)

State Cash Portfolio as of June 30, 2004

Description	Maturity	Yield to Maturity	Par Value	Fair Value
The Bank of Jackson	08/17/04	1.10	500,000	500,000
The Bank of Jackson	12/21/04	1.65	1,000,000	1,000,000
First Volunteer Bank, Jamestown	07/23/04	1.10	300,000	300,000
First Volunteer Bank, Jamestown	07/30/04	1.10	500,000	500,000
First Volunteer Bank, Jamestown	10/08/04	1.10	200,000	200,000
First Volunteer Bank, Jamestown	10/08/04	1.10	500,000	500,000
First Volunteer Bank, Jamestown	10/08/04	1.10	450,000	450,000
First Volunteer Bank, Jamestown	10/08/04	1.10	500,000	500,000
Progressive Savings Bank, FSB, Jamestown	07/20/04	1.10	300,000	300,000
Citizens State Bank, Jasper	09/03/04	1.10	200,000	200,000
Citizens State Bank, Jasper	09/21/04	1.10	100,000	100,000
Citizens State Bank, Jasper	09/21/04	1.10	200,000	200,000
BB&T, Knoxville	07/23/04	1.10	75,000,000	75,000,000
BB&T, Knoxville	09/09/04	1.10	40,000,000	40,000,000
BB&T, Knoxville	10/08/04	1.25	20,000,000	20,000,000
Citizens Bank of Lafayette	07/27/04	1.10	100,000	100,000
Citizens Bank of Lafayette	08/17/04	1.10	250,000	250,000
Citizens Bank of Lafayette	09/17/04	1.10	500,000	500,000
Citizens Bank of Lafayette	09/17/04	1.10	100,000	100,000
United Community Bank, Lenoir City	07/09/04	1.10	500,000	500,000
United Community Bank, Lenoir City	08/27/04	1.10	500,000	500,000
The Coffee County Bank, Manchester	10/29/04	1.25	95,000	95,000
First State Bank, Martin	07/20/04	1.10	1,500,000	1,500,000
First State Bank, Martin	11/30/04	1.45	2,000,000	2,000,000
First State Bank, Martin	12/17/04	1.65	1,500,000	1,500,000
Planters Bank of Maury City	11/30/04	1.45	200,000	200,000
The First National Bank of McMinnville	08/09/04	1.10	2,500,000	2,500,000
The First National Bank of McMinnville	08/09/04	1.10	5,000,000	5,000,000
Enterprise National Bank, Memphis	07/09/04	1.10	1,000,000	1,000,000
Enterprise National Bank, Memphis	07/13/04	1.10	2,500,000	2,500,000
Enterprise National Bank, Memphis	08/27/04	1.10	5,000,000	5,000,000
Enterprise National Bank, Memphis	11/09/04	1.45	5,000,000	5,000,000
Enterprise National Bank, Memphis	12/21/04	1.65	5,000,000	5,000,000
Independent Bank, Memphis	07/13/04	1.10	4,000,000	4,000,000
Independent Bank, Memphis	08/10/04	1.10	1,000,000	1,000,000
Independent Bank, Memphis	08/13/04	1.10	500,000	500,000
Independent Bank, Memphis	08/20/04	1.10	2,000,000	2,000,000
Independent Bank, Memphis	09/07/04	1.10	2,000,000	2,000,000
Independent Bank, Memphis	09/14/04	1.10	1,500,000	1,500,000
Independent Bank, Memphis	10/01/04	1.10	1,000,000	1,000,000
Independent Bank, Memphis	10/19/04	1.10	2,000,000	2,000,000
Independent Bank, Memphis	11/01/04	1.25	2,000,000	2,000,000
Independent Bank, Memphis	11/05/04	1.25	5,000,000	5,000,000
Independent Bank, Memphis	11/09/04	1.45	2,000,000	2,000,000
Independent Bank, Memphis	11/09/04	1.45	5,000,000	5,000,000
Independent Bank, Memphis	12/23/04	1.65	1,000,000	1,000,000
MemphisFirst Community Bank	11/30/04	1.45	2,000,000	2,000,000
National Bank of Commerce, Memphis	07/02/04	1.00	75,000,000	75,000,000

(continued)

State Cash Portfolio as of June 30, 2004

Description	Maturity	Yield to Maturity	Par Value	Fair Value
National Bank of Commerce, Memphis	07/02/04	1.00	75,000,000	75,000,000
National Bank of Commerce, Memphis	07/02/04	1.00	50,000,000	50,000,000
National Bank of Commerce, Memphis	07/16/04	1.10	50,000,000	50,000,000
National Bank of Commerce, Memphis	07/16/04	1.10	50,000,000	50,000,000
National Bank of Commerce, Memphis	07/23/04	1.10	75,000,000	75,000,000
National Bank of Commerce, Memphis	07/23/04	1.10	75,000,000	75,000,000
National Bank of Commerce, Memphis	08/18/04	1.10	100,000,000	100,000,000
SouthTrust Bank, Memphis	10/01/04	1.10	25,000,000	25,000,000
SouthTrust Bank, Memphis	10/01/04	1.10	25,000,000	25,000,000
SouthTrust Bank, Memphis	10/01/04	1.10	1,000,000	1,000,000
SouthTrust Bank, Memphis	10/19/04	1.10	28,000,000	28,000,000
AmSouth Bank, Nashville	08/13/04	1.10	50,000,000	50,000,000
AmSouth Bank, Nashville	08/13/04	1.10	50,000,000	50,000,000
AmSouth Bank, Nashville	11/24/04	1.45	100,000,000	100,000,000
Capital Bank & Trust Co., Nashville	07/16/04	1.10	3,500,000	3,500,000
Capital Bank & Trust Co., Nashville	07/20/04	1.10	2,500,000	2,500,000
Capital Bank & Trust Co., Nashville	07/27/04	1.10	1,000,000	1,000,000
Capital Bank & Trust Co., Nashville	08/06/04	1.10	2,000,000	2,000,000
Capital Bank & Trust Co., Nashville	08/24/04	1.10	5,000,000	5,000,000
Capital Bank & Trust Co., Nashville	12/10/04	1.65	3,000,000	3,000,000
Capital Bank & Trust Co., Nashville	12/23/04	1.65	4,000,000	4,000,000
Pinnacle National Bank, Nashville	08/17/04	1.10	5,000,000	5,000,000
Pinnacle National Bank, Nashville	09/14/04	1.10	5,000,000	5,000,000
Pinnacle National Bank, Nashville	10/15/04	1.10	5,000,000	5,000,000
Pinnacle National Bank, Nashville	11/12/04	1.45	5,000,000	5,000,000
Pinnacle National Bank, Nashville	12/10/04	1.65	5,000,000	5,000,000
SouthTrust Bank, Nashville	07/22/04	1.10	50,000,000	50,000,000
SouthTrust Bank, Nashville	08/11/04	1.10	50,000,000	50,000,000
SouthTrust Bank, Nashville	08/13/04	1.10	50,000,000	50,000,000
SouthTrust Bank, Nashville	08/13/04	1.10	4,000,000	4,000,000
SouthTrust Bank, Nashville	08/18/04	1.09	10,000,000	10,000,000
SouthTrust Bank, Nashville	08/27/04	1.10	50,000,000	50,000,000
SouthTrust Bank, Nashville	08/27/04	1.10	30,000,000	30,000,000
SouthTrust Bank, Nashville	09/03/04	1.10	50,000,000	50,000,000
SouthTrust Bank, Nashville	09/03/04	1.10	50,000,000	50,000,000
SouthTrust Bank, Nashville	09/28/04	1.10	25,000,000	25,000,000
SouthTrust Bank, Nashville	10/01/04	1.10	3,500,000	3,500,000
SouthTrust Bank, Nashville	10/01/04	1.10	4,000,000	4,000,000
SouthTrust Bank, Nashville	10/05/04	1.10	51,800,000	51,800,000
SouthTrust Bank, Nashville	11/05/04	1.25	50,000,000	50,000,000
The Bank of Nashville	07/02/04	1.10	5,000,000	5,000,000
The Bank of Nashville	12/21/04	1.65	5,000,000	5,000,000
U S Bank, Nashville	07/02/04	1.10	50,000,000	50,000,000
U S Bank, Nashville	08/10/04	1.10	25,000,000	25,000,000
U S Bank, Nashville	10/19/04	1.10	25,000,000	25,000,000
U S Bank, Nashville	08/06/04	1.10	25,000,000	25,000,000
U S Bank, Nashville	10/22/04	1.10	25,000,000	25,000,000
Newport Federal Bank	08/06/04	1.10	95,000	95,000

(continued)

State Cash Portfolio as of June 30, 2004

Description	Maturity	Yield to Maturity	Par Value	Fair Value
Newport Federal Bank	08/06/04	1.10	300,000	300,000
Newport Federal Bank	08/16/04	1.10	500,000	500,000
Newport Federal Bank	08/16/04	1.10	500,000	500,000
The First National Bank of Oneida	07/16/04	1.10	500,000	500,000
The First National Bank of Oneida	08/10/04	1.10	2,500,000	2,500,000
The First National Bank of Oneida	08/17/04	1.10	500,000	500,000
Community Trust & Banking Co., Ooltewah	08/20/04	1.10	500,000	500,000
First National Bank of Pikeville	09/21/04	1.10	300,000	300,000
First National Bank of Pulaski	07/02/04	1.10	300,000	300,000
First National Bank of Pulaski	07/02/04	1.10	1,000,000	1,000,000
First National Bank of Pulaski	07/09/04	1.10	1,000,000	1,000,000
First National Bank of Pulaski	07/09/04	1.10	1,000,000	1,000,000
First National Bank of Pulaski	12/17/04	1.65	2,000,000	2,000,000
First National Bank of Pulaski	12/21/04	1.65	300,000	300,000
First National Bank of Pulaski	12/21/04	1.65	700,000	700,000
First National Bank of Pulaski	12/21/04	1.65	500,000	500,000
First National Bank of Pulaski	12/23/04	1.65	500,000	500,000
First National Bank of Pulaski	12/23/04	1.65	300,000	300,000
Bank of Ripley	11/02/04	1.25	200,000	200,000
Bank of Ripley	11/19/04	1.45	100,000	100,000
Bank of Ripley	11/26/04	1.45	100,000	100,000
Bank of Ripley	12/23/04	1.65	100,000	100,000
Bank of Ripley	12/23/04	1.65	150,000	150,000
The Hardin County Bank, Savannah	08/17/04	1.10	1,000,000	1,000,000
Citizens National Bank, Sevierville	08/27/04	1.25	3,000,000	3,000,000
First State Bank, Sharon	07/16/04	1.10	1,000,000	1,000,000
First State Bank, Sharon	09/10/04	1.10	1,000,000	1,000,000
First State Bank, Sharon	10/26/04	1.25	1,000,000	1,000,000
First State Bank, Sharon	11/23/04	1.45	1,000,000	1,000,000
First State Bank, Sharon	12/03/04	1.45	1,500,000	1,500,000
Somerville Bank & Trust Co.	09/07/04	1.10	200,000	200,000
Bancorpsouth, Trenton	10/15/04	1.10	1,500,000	1,500,000
Citizens City & County Bank, Trenton	09/21/04	1.10	95,000	95,000
Wayne County Bank, Waynesboro	08/18/04	1.10	500,000	500,000
Wayne County Bank, Waynesboro	09/17/04	1.10	900,000	900,000
TOTAL CERTIFICATES OF DEPOSIT			**$ 2,032,817,700**	**$ 2,032,817,700**

STATE CASH PORTFOLIO
AS OF JUNE 30, 2004

Description	Maturity	Yield to Maturity	Par Value	Fair Value
OVERNIGHT DEPOSIT ACCOUNTS				
AmSouth Bank - Overnight Deposit Account	07/01/04	1.05	$ 253,000,000	$ 253,000,000
TOTAL OVERNIGHT DEPOSIT ACCOUNTS			**$ 253,000,000**	**$ 253,000,000**

Description	Rating	Maturity	Yield to Maturity	Par Value	Fair Value
COMMERCIAL PAPER					
BMW	A1/P1	07/01/04	1.45	$ 154,903,000	$ 154,903,000
Cargill Global	A1/P1	07/01/04	1.42	38,000,000	38,000,000
Citigroup	A1+/P1	07/02/04	1.05	73,700,000	73,697,850
General Electric	A1+/P1	07/20/04	1.22	100,000,000	99,935,611
Merrill Lynch	A1/P1	07/01/04	1.45	200,000,000	200,000,000
Morgan Stanley	A1/P1	07/20/04	1.23	100,000,000	99,935,083
Toyota Motor Credit	A1+/P1	07/15/04	1.07	75,000,000	74,968,792
TOTAL COMMERCIAL PAPER				**$ 741,603,000**	**$ 741,440,336**

TOTAL PORTFOLIO	**$ 4,533,660,828**	**$ 4,528,390,162**

Baccalaureate Education System Trust Portfolio

BACCALAUREATE EDUCATION SYSTEM TRUST PORTFOLIO
as of June 30, 2004
by Fair Value

Par Value	Security Name	Yield at Market	Maturity	Moody's Quality Rating	Fair Value
U.S. TREASURY AND AGENCY OBLIGATIONS					
15,000,000	U. S. Treasury Notes	1.50%	02/28/05	Aaa	$14,971,875
10,000,000	Federal National Mortgage Assn Deb	3.30%	11/15/07	Aaa	9,859,375
8,000,000	U. S. Treasury Notes	4.72%	02/15/12	Aaa	8,262,500
TOTAL U.S. TREASURY AND AGENCY OBLIGATIONS					**$33,093,750**

	Units	Fair Value
MUTUAL FUNDS		
State Street S&P 500 Index Fund	253,058	$12,541,822
Collective Short-Term Investment Fund	5,353,389	5,353,389
TOTAL MUTUAL FUNDS		**$17,895,211**

TOTAL PORTFOLIO	**$50,988,961**

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
LARGEST HOLDINGS

Largest Stock Holdings
as of June 30, 2004
by Fair Value

Shares	Security Name	Fair Value
8,007,000	Microsoft Corporation	$ 228,679,920
6,966,000	General Electric Company	225,698,400
4,713,594	Exxon Mobil Corporation	209,330,710
5,562,420	Pfizer, Inc.	190,679,758
4,026,004	Citigroup, Inc.	187,209,186
2,978,800	Wal-Mart Stores, Inc.	157,161,488
4,908,000	Intel Corporation	135,460,800
1,878,104	American International Group, Inc.	133,871,253
1,496,574	Bank of America Corporation	126,640,092
2,165,000	Johnson & Johnson	120,590,500

Largest Bond Holdings
as of June 30, 2004
by Fair Value

Par Value	Security Name	Yield	Maturity	Moody's Quality Rating	Fair Value
1,900,000,000	U.S. Treasury Notes	1.50%	02/28/05	Aaa	$ 1,896,437,500
1,035,000,000	U.S. Treasury Bonds	5.58%	05/15/30	Aaa	1,158,876,563
500,000,000	U.S. Treasury Notes	3.04%	02/15/08	Aaa	493,125,000
500,000,000	U.S. Treasury Notes	3.22%	04/15/09	Aaa	485,781,250
400,000,000	U.S. Treasury Notes	6.39%	05/15/06	Aaa	430,625,000
400,000,000	Canada Government	4.03%	06/01/06	Aaa	297,484,992
167,000,000	U.S. Treasury Bonds	6.15%	05/15/21	Aaa	220,648,750
150,000,000	U.S. Treasury Bonds	8.95%	08/15/14	Aaa	209,578,125
155,000,000	U.S. Treasury Bonds	9.09%	08/15/13	Aaa	204,600,000
150,000,000	U.S. Treasury Bonds	6.10%	02/15/21	Aaa	193,640,625

A complete portfolio listing is available upon request.

Chairs of Excellence Largest Holdings

LARGEST BOND HOLDINGS
as of June 30, 2004
by Fair Value

Par Value	Security Name	Yield at Market	Maturity	Moody's Quality Rating	Fair Value
U.S. TREASURY AND AGENCY OBLIGATIONS					
13,200,000	U. S. Treasury Notes	5.27%	8/15/2010	Aaa	$ 14,392,125
13,000,000	U. S. Treasury Notes	3.25%	8/15/2007	Aaa	13,012,188
9,000,000	U. S. Treasury Notes	4.79%	8/15/2011	Aaa	9,396,563
7,000,000	Federal National Mortgage Assn Deb	5.83%	6/15/2009	Aaa	7,656,250
5,500,000	Federal Home Loan Mtg. Corporation	4.70%	3/15/2007	Aaa	5,707,969
5,000,000	Merrill Lynch & Company, Inc.	6.82%	5/15/2006	Aa3	5,405,250
5,000,000	Boeing Capital Corporation	6.72%	9/27/2005	A3	5,279,950
5,000,000	General Electric Capital Corporation	6.00%	6/15/2012	Aaa	5,276,450
5,000,000	Target Corporation	5.22%	4/01/2007	A2	5,271,700
5,000,000	Allstate Corporation	5.15%	12/01/2006	A1	5,222,350

A complete portfolio listing is available upon request.

	Units	Fair Value
MUTUAL FUNDS		
State Street S&P 500 Index Fund	2,150,015	$ 106,556,870
Collective Short-Term Investment Fund	3,795,363	3,795,363
TOTAL MUTUAL FUNDS		**$ 110,352,233**

Key to Ratings: All ratings presented are from Moody's Investors Service. Government Securities are not rated per se', but are considered the best quality securities.

Moody's rates securities as follows:

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

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

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

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

FINANCIAL STATEMENTS

Milk Cans

STATE POOLED INVESTMENT FUND
INDEPENDENT AUDITOR'S REPORT

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

December 3, 2004

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, 2004, and June 30, 2003, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and serving as a member of the board of the State Trust of Tennessee and the State Funding Board.

As discussed in Note A.1., the financial statements referred to above present only the State Pooled Investment Fund of the State of Tennessee and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the State Pooled Investment Fund of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2004, on our consideration of the State Pooled Investment Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

STATE POOLED INVESTMENT FUND
COMPARATIVE STATEMENTS OF FIDUCIARY NET ASSETS
JUNE 30, 2004 AND JUNE 30, 2003

	June 30, 2004	June 30, 2003
ASSETS		
Cash and cash equivalents	$1,806,806,057	$2,171,111,986
Short-term investments, at amortized cost	2,582,734,138	1,609,370,764
Accrued income receivable	6,324,857	7,276,494
TOTAL ASSETS	4,395,865,052	3,787,759,244
LIABILITIES AND NET ASSETS		
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS	$4,395,865,052	$3,787,759,244

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, 2004 AND JUNE 30, 2003

	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003
OPERATIONS		
Investment income	$ 44,326,080	$ 58,371,152
Expenses		
Administrative fee	2,018,272	1,782,044
Custodian and banking services fees	147,340	129,243
Total expenses	2,165,612	1,911,287
NET INVESTMENT INCOME	42,160,468	56,459,865
CAPITAL SHARE TRANSACTIONS (DOLLAR AMOUNTS AND NUMBER OF SHARES ARE THE SAME)		
Shares sold	30,181,542,413	27,277,329,622
Less shares redeemed	29,615,597,073	27,350,049,115
INCREASE(DECREASE) FROM CAPITAL SHARE TRANSACTIONS	565,945,340	(72,719,493)
TOTAL INCREASE(DECREASE) IN NET ASSETS	608,105,808	(16,259,628)
NET ASSETS HELD IN TRUST FOR POOL PARTICIPANTS		
BEGINNING OF YEAR	3,787,759,244	3,804,018,872
END OF YEAR	$4,395,865,052	$3,787,759,244

See accompanying Notes to the Financial Statements

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The State Pooled Investment Fund (SPIF) is an external investment pool sponsored by the State of Tennessee. The external portion of the State Pooled Investment Fund, consisting of funds belonging to entities outside of the State of Tennessee Financial Reporting Entity, has been included as a separate investment trust fund in the *Tennessee Comprehensive Annual Financial Report.* The internal portion, consisting of funds belonging to the State and its component units, has been included in the various participating funds and component units in the *Tennessee Comprehensive Annual Financial Report*.

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

3. **Cash and Cash Equivalents** - This classification includes deposits in demand accounts as well as short-term investments with a maturity date within three months of the date acquired by the State.

4. **Method Used to Report Investments and Participant Shares** - The SPIF is not registered with the Securities and Exchange Commission (SEC) as an investment company but, through its investment policy adopted by the Funding Board of the State of Tennessee (Funding Board), operates in a manner consistent with the SEC's Rule 2a7 of the *Investment Company Act of 1940*. Rule 2a7 allows SEC registered mutual funds to use amortized cost to report net assets in computing share prices. Likewise, the SPIF uses amortized cost accounting measures to report investments and share prices. During the fiscal years ended June 30, 2004 and June 30, 2003, the State had not obtained or provided any legally binding guarantees to support the value of participant shares.

B. DEPOSITS AND INVESTMENTS

1. **Investment Policy** - The State Pooled Investment Fund is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board. The current resolution of the Funding Board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, bonds, notes, and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies, repurchase agreements for obligations of the United States or its agencies, and in certain obligations of the State of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). Investments in derivative type securities and investments of high risk are 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, 2004 and June 30, 2003.

   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

(continued)

State Pooled Investment Fund
Notes to the Financial Statements
June 30, 2004 and June 30, 2003

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, 2004 and June 30, 2003, the carrying amounts of the State Pooled Investment Fund deposits were $2,144,448,430 and $1,858,008,690 respectively. The bank balance, including accrued interest, was $2,404,583,277 as of June 30, 2004 and $2,048,910,651 as of June 30, 2003. Of the bank balance, $2,404,583,277 at June 30, 2004 and $2,047,057,724 at June 30, 2003 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, 2003, $1,852,927 (at fair value) was considered category 3, uninsured and uncollateralized. There were no material amounts uncollateralized during the years ended June 30, 2004 and June 30, 2003.

   At June 30, 2004 and June 30, 2003, the principal amount of certificates of deposit in state depositories was $2,032,817,700 and $1,776,222,700 respectively. Interest rates on certificates of deposit held at June 30, 2004 ranged from 1.00% to 1.65% and at June 30, 2003 ranged from 1.00 % to 1.50%. The days to maturity on certificates of deposit ranged from 28 to 394 days at June 30, 2004 and 9 to 268 days at June 30, 2003.

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.

(continued)

State Pooled Investment Fund
Notes to the Financial Statements
June 30, 2004 and June 30, 2003

	June 30, 2004				
	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity
Cash Equivalents and Short-term Investments:					
Repurchase Agreements	$ 0	$ 0	$ 0		
U.S. Government and Agency Obligations	1,503,667,223	1,501,132,126	1,506,240,128	.97% to 2.08%	8 to 396 days
Commercial Paper	741,424,543	741,440,336	741,603,000	1.05% to 1.45%	1 to 44 days
Total Cash Equivalents and Short-term Investments	2,245,091,766	$ 2,242,572,462	$ 2,247,843,128		
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Assets	(941,175,328)				
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Assets	1,278,817,700				
Short-term investments as shown on Statement of Fiduciary Net Assets	$ 2,582,734,138				

	June 30, 2003				
	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity
Cash Equivalents and Short-term Investments:					
Repurchase Agreements	$74,000,000	$74,000,000	$74,000,000	1.30%	1 day
U.S. Government and Agency Obligations	742,767,876	742,844,565	741,690,000	1.00% to 2.58%	32 to 396 days
Commercial Paper	1,105,706,184	1,105,735,139	1,105,917,000	.96% to 1.31%	1 to 44 days
Total Cash Equivalents and Short-term Investments	1,922,474,060	$1,922,579,704	$1,921,607,000		
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Assets	(1,262,225,996)				
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Assets	949,122,700				
Short-term investments as shown on Statement of Fiduciary Net Assets	$1,609,370,764				

The State Pooled Investment Fund's investments, shown above as of June 30, 2004 and June 30, 2003, 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. The SPIF also invested in repurchase agreements during the year ended June 30, 2004.

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

(continued)

STATE POOLED INVESTMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003

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, 2002 through June 30, 2004, an administrative fee of .05 percent was charged against each participant's average daily balance to provide funding for administrative expenses to operate the SPIF.

Tennessee Consolidated Retirement System
Independent Auditor's Report

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

December 3, 2004

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, 2004, and June 30, 2003, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Tennessee Consolidated Retirement System's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of trustees of the Tennessee Consolidated Retirement System; approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

As discussed in Note A.1., the financial statements present only the Tennessee Consolidated Retirement System, pension trust funds of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2004, and June 30, 2003, 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.

(continued)

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

The Honorable John G. Morgan
December 3, 2004
Page Two

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, 2004, and June 30, 2003, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

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

Our audits were conducted for the purpose of forming an opinion on the basic financial statements taken as a whole. The accompanying financial information listed as supporting schedules in the table of contents is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The introductory, investment, actuarial, and statistical sections, as listed in the table of contents, are presented for purposes of additional analysis and are not required parts 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 3, 2004, on our consideration of the Tennessee Consolidated Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA
Director

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2004 & JUNE 30, 2003

The Management of the Tennessee Consolidated Retirement System (TCRS) provides this discussion and analysis as an overview of the TCRS' financial activities for the fiscal years ended June 30, 2004 and June 30, 2003.

FINANCIAL HIGHLIGHTS

- The plan net assets (total assets minus total liabilities) of the TCRS at June 30, 2004 were nearly $25.6 billion, increasing over $1.8 billion (7.6 percent) from the plan net assets at June 30, 2003. 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, 2003, the date of the latest actuarial valuation, the TCRS' funded ratio was 99.8 percent for the SETHEEPP group and 91.9 percent for the PSPP group.
- Contribution revenue for fiscal year 2004 totaled $616,089,783 – an increase of 3.4 percent compared to fiscal year 2003.
- Net investment income for fiscal year 2004 was $2,181,853,628. During fiscal year 2004, the TCRS received an investment return on its portfolio of 9.3 percent, compared to 4.9 percent for fiscal year 2003.
- Total benefits and refunds paid for fiscal year 2004 were $984,377,076 – an increase of 8.4 percent over fiscal year 2003 total benefits and refunds paid of $907,863,397.
- Total administrative expenses for fiscal year 2004 were $5,534,441 – an increase of 9.5 percent over fiscal year 2003 administrative expenses of $5,055,824.

OVERVIEW OF THE FINANCIAL STATEMENTS

The TCRS financial statements consist of the *Statement of Plan Net Assets (*on pages 72 through 73), the *Statement of Changes in Plan Net Assets* (on pages 74 through 75), and the *Notes to the Financial Statements* (on pages 76 through 80). In addition, *Required Supplementary Information* is presented, which includes this *Management's Discussion and Analysis,* as well as the schedules and notes on pages 81 through 83.

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

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

ANALYSIS OF ASSETS, LIABILITIES AND PLAN NET ASSETS

At June 30, 2004, the TCRS had plan net assets (total assets in excess of total liabilities) of nearly $25.6 billion, an increase of over $1.8 billion (7.6 percent) from $23.8 billion at June 30, 2003. The assets of the TCRS consist primarily of investments. During fiscal year 2004, the domestic and international equity markets provided double-digit positive returns, thus contributing to a nearly $1.1 billion increase in net investment income over fiscal year 2003. Condensed financial information comparing the TCRS' plan net assets for the past three fiscal years is presented on the following page.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2004 & JUNE 30, 2003 (CONTINUED)

PLAN NET ASSETS

	June 30, 2004	June 30, 2003	FY04 - FY03 Percentage Change	June 30, 2002	FY03 - FY02 Percentage Change
ASSETS					
Cash and cash equivalents	$ 1,287,694,472	$ 1,717,734,541	(25.0) %	$ 1,621,359,545	5.9 %
Contributions receivable	52,655,042	46,850,736	12.4 %	46,238,224	1.3 %
Investment income receivables	136,353,991	134,284,002	1.5 %	147,069,784	(8.7) %
Investments sold	84,576,463	59,060,030	43.2 %	31,817,111	85.6 %
Foreign currency receivable	46,030,024	523,209,732	(91.2) %	899,292,837	(41.8) %
Short-term securities	564,645,773	498,577,125	13.3 %	317,388,429	57.1 %
Long-term investments	23,486,279,358	21,736,948,082	8.0 %	21,015,023,754	3.4 %
TOTAL ASSETS	25,658,235,123	24,716,664,248	3.8 %	24,078,189,684	2.7 %
LIABILITIES					
Death benefits, refunds and other payables	2,350,420	1,244,060	88.9 %	1,141,905	8.9 %
Investments purchased	20,722,128	387,262,530	(94.6) %	127,034,613	204.8 %
Other investment payables	2,127,641	2,154,173	(1.2) %	2,633,994	(18.2) %
Foreign currency payable	46,518,682	547,519,127	(91.5) %	964,499,600	(43.2) %
TOTAL LIABILITIES	71,718,871	938,179,890	(92.4) %	1,095,310,112	(14.3) %
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 25,586,516,252	$ 23,778,484,358	7.6 %	$ 22,982,879,572	3.5 %

ANALYSIS OF REVENUES AND EXPENSES

Contributions for fiscal year 2004 increased by $20.0 million (3.4 percent) over contributions for fiscal year 2003 as the employer contribution rates remained constant. An increase in employer contribution rates adopted pursuant to the actuarial valuation performed as of July 1, 2001 and effective for fiscal years 2003 and 2004, resulted in contributions for fiscal year 2003 increasing by $59.9 million (11.2 percent) over contributions for fiscal year 2002. As mentioned in the *Analysis of Assets, Liabilities and Plan Net Assets* section above, the continued recovery of the equity investment markets contributed to increases in net investment income. Net investment income for the year ended June 30, 2004 totaled $2,181,853,628, an increase of $1.1 billion versus fiscal year 2003. Net investment income for the year ended June 30, 2003 totaled $1,112,478,748, an increase of $1.6 billion versus fiscal year 2002. Market conditions have resulted in a return to the TCRS portfolio of 9.3 percent during fiscal year 2004 and 4.9 percent during fiscal year 2003.

Total benefits and refunds paid during the year ended June 30, 2004 were $984,377,076, an increase of 8.4 percent over fiscal year 2003 total benefits and refunds paid. Total refunds and benefits paid during the year ended June 30, 2003 of $907,863,397 increased 7.8 percent over fiscal year 2002 total benefits and refunds paid. The increase in benefit expenses can be attributed to 2.4 percent and 1.6 percent cost of living adjustments awarded to retirees on July 1, 2003 and July 1, 2002, respectively. In addition, more retirees were added to payroll than removed during these fiscal years.

In addition, administrative expenses for the year ended June 30, 2004 were $5,534,441, an increase of 9.5 percent over fiscal year 2003 administrative expenses. This increase was due primarily to additional expenses relating to the actuarial valuation and experience studies performed during fiscal year 2004. Administrative expenses for fiscal year 2003 of $5,055,824 increased 1.0 percent over administrative expenses for fiscal year 2002.

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

(continued)

Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Years Ended June 30, 2004 & June 30, 2003 (continued)

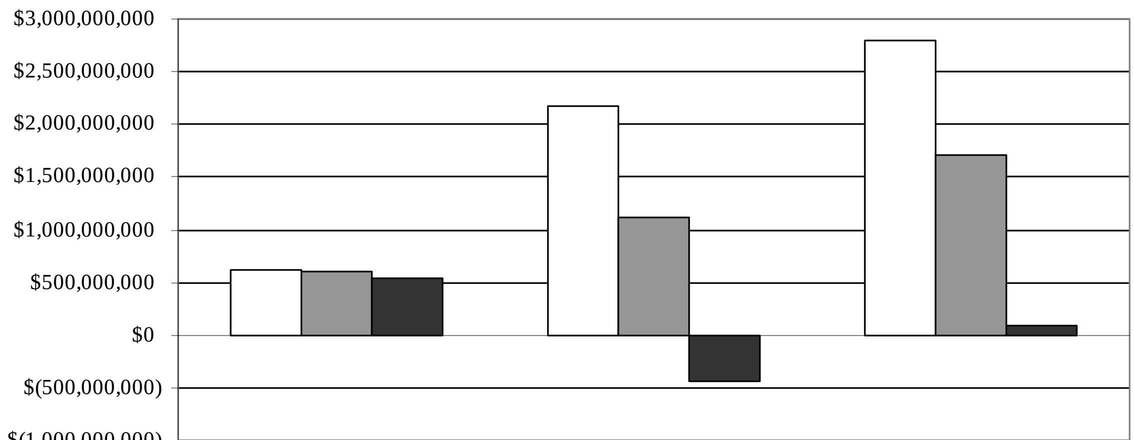
CHANGES IN PLAN NET ASSETS

	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003	FY04 - FY03 Percentage Change	For the Year Ended June 30, 2002	FY03 - FY02 Percentage Change
ADDITIONS					
Contributions	$ 616,089,783	$ 596,045,259	3.4 %	$ 536,137,611	11.2 %
Investment income					
Net appreciation (depreciation) in fair value of investments	1,310,811,851	268,965,778	387.4 %	(1,354,960,400)	119.9 %
Interest, dividends and other investment income	885,509,528	857,325,990	3.3 %	924,647,372	(7.3) %
Less: Investment expense	(14,467,751)	(13,813,020)	4.7 %	(14,093,999)	(2.0) %
Net income from securities lending activities	0	0	0.0 %	623,267	(100.0) %
Net investment income	2,181,853,628	1,112,478,748	96.1 %	(443,783,760)	350.7 %
TOTAL ADDITIONS	2,797,943,411	1,708,524,007	63.8 %	92,353,851	1,750.0 %
DEDUCTIONS					
Annuity benefits					
Retirement benefits	716,339,066	662,075,122	8.2 %	610,554,871	8.4 %
Survivor benefits	46,416,539	42,638,112	8.9 %	38,723,935	10.1 %
Disability benefits	23,590,867	21,781,588	8.3 %	20,109,341	8.3 %
Cost of living	163,627,253	150,690,914	8.6 %	145,335,114	3.7 %
Death benefits	4,477,589	4,046,275	10.7 %	3,367,877	20.1 %
Refunds	29,925,762	26,631,386	12.4 %	24,304,536	9.6 %
Administrative expenses	5,534,441	5,055,824	9.5 %	5,003,984	1.0 %
TOTAL DEDUCTIONS	989,911,517	912,919,221	8.4 %	847,399,658	7.7 %
NET INCREASE (DECREASE)	1,808,031,894	795,604,786	127.3 %	(755,045,807)	205.4 %
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS					
BEGINNING OF YEAR	23,778,484,358	22,982,879,572	3.5 %	23,737,925,379	(3.2) %
END OF YEAR	$ 25,586,516,252	$ 23,778,484,358	7.6 %	$ 22,982,879,572	3.5 %

(continued)

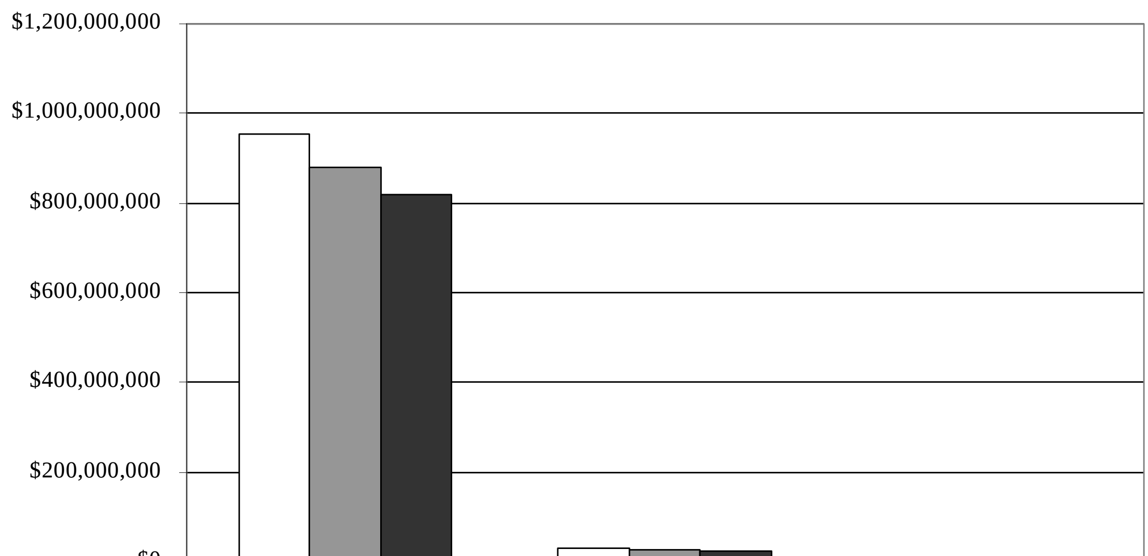
Tennessee Consolidated Retirement System
Management's Discussion and Analysis
For the Years Ended June 30, 2004 & June 30, 2003 (continued)

REVENUES BY TYPE



	Contributions	Net Investment Income (Loss)	Total Additions
□ Year Ended 6/30/04	$616,089,783	$2,181,853,628	$2,797,943,411
■ Year Ended 6/30/03	$596,045,259	$1,112,478,748	$1,708,524,007
■ Year Ended 6/30/02	$536,137,611	$(443,783,760)	$92,353,851

EXPENSES BY TYPE



	Benefit Payments	Refunds	Administrative
□ Year Ended 6/30/04	$954,451,314	$29,925,762	$5,534,441
■ Year Ended 6/30/03	$881,232,011	$26,631,386	$5,055,824
■ Year Ended 6/30/02	$818,091,138	$24,304,536	$5,003,984

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
MANAGEMENT'S DISCUSSION AND ANALYSIS
FOR THE YEARS ENDED JUNE 30, 2004 & JUNE 30, 2003 (CONTINUED)

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

There were dramatic improvements in both the domestic and international stock markets for the year ended June 30, 2004 after two years of sub par returns. The S&P 500, TCRS' domestic equity benchmark, had a double digit negative return of 17.99 % for the fiscal year ended June 30, 2002, followed by a small positive return of .25% for fiscal year 2003, and then a double digit positive return of 19.11% for fiscal year 2004. The international equity market, as represented by the EAFE index, had negative returns of 6.46% and 9.49% for fiscal years 2003 and 2002, respectively. Fortunately, the international markets rebounded nicely for the year ended June 30, 2004 with a 32.37 % return. On the other hand, the domestic bond market, as measured by the Lehman Aggregate index, had an annual return of only .32% at June 30, 2004 compared with 10.40% and 8.63% in the previous two years. The international bond market return of 7.74% and real estate at 9.71% represent positive market returns.

The past three years reflect the benefits of a diversified portfolio where the weak stock market was countered by a positive bond market during fiscal years 2002 and 2003. In 2004 the opposite occurred where a strong stock market balanced an under-performing bond market.

The employer contribution rate increased July 1, 2004 for most of the employers participating in TCRS. The increase was the result of the July 1, 2003 actuarial valuation that took into consideration that investment results were less than the earnings assumptions for the two years since the last actuarial valuation. With the asset smoothing method utilized for valuation purposes that recognized only a portion of the underperformance of investment income, upward pressure on the employer rate is expected for the next actuarial valuation to be performed effective July 1, 2005. However, some upward pressure will be mitigated by the positive return of 9.32% realized for the year ended June 30, 2004. It was refreshing to realize such a return after three straight years where returns were less than the actuarial assumption of 7.5%. With TCRS being such a strongly funded plan, volatility in investment income will cause employer contribution rates to fluctuate.

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, 2004 and June 30, 2003

Expressed in Thousands	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)
ASSETS		
Cash and cash equivalents	$ 1,102,224	$ 185,470
Receivables		
Member contributions receivable	17,687	3,954
Employer contributions receivable	19,905	11,109
Accrued interest receivable	100,996	16,995
Accrued dividends receivable	15,719	2,644
Other investment receivable	0	0
Foreign currency receivable	39,400	6,630
Investments sold	72,395	12,182
Total receivables	266,102	53,514
Investments, at fair value		
Short-term securities	483,319	81,327
Government bonds	9,302,636	1,565,340
Corporate bonds	1,607,676	270,521
Corporate stocks	8,796,542	1,480,181
Real estate	396,641	66,742
Total investments	20,586,814	3,464,111
TOTAL ASSETS	21,955,140	3,703,095
LIABILITIES		
Accounts payable		
Death benefits and refunds payable	1,038	1,267
Other	45	0
Investments purchased	17,737	2,985
Foreign currency payable	39,819	6,700
Other investment payables	1,821	307
TOTAL LIABILITIES	60,460	11,259
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (Schedules of funding progress for the plans are presented on page 81.)	$ 21,894,680	$ 3,691,836

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

June 30, 2004 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2003 Total
$ 1,287,694	$ 1,477,468	$ 240,266	$ 1,717,734
21,641	14,863	3,586	18,449
31,014	18,194	10,208	28,402
117,991	104,068	16,938	121,006
18,363	11,418	1,859	13,277
0	1	0	1
46,030	449,823	73,387	523,210
84,577	50,790	8,270	59,060
319,616	649,157	114,248	763,405
564,646	428,785	69,792	498,577
10,867,976	8,955,774	1,457,697	10,413,471
1,878,197	1,988,160	323,605	2,311,765
10,276,723	7,430,045	1,209,359	8,639,404
463,383	320,192	52,116	372,308
24,050,925	19,122,956	3,112,569	22,235,525
25,658,235	21,249,581	3,467,083	24,716,664
2,305	686	542	1,228
45	16	0	16
20,722	333,050	54,213	387,263
46,519	470,723	76,796	547,519
2,128	1,852	302	2,154
71,719	806,327	131,853	938,180
$ 25,586,516	$ 20,443,254	$ 3,335,230	$ 23,778,484

Tennessee Consolidated Retirement System
Comparative Statements of Changes in Plan Net Assets
For the Years Ended June 30, 2004 and June 30, 2003

Expressed in Thousands	**State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)**	**Political Subdivisions Pension Plan (PSPP)**
ADDITIONS		
Contributions		
Member contributions	$ 154,334	$ 50,650
Employer contributions	271,298	139,808
Total contributions	425,632	190,458
Investment income		
Net appreciation in fair value of investments	1,124,041	186,771
Interest	579,747	96,331
Dividends	157,233	26,126
Real estate income, net of operating expenses	22,357	3,715
Total investment income	1,883,378	312,943
Less: Investment expense	(12,406)	(2,062)
Net investment income	1,870,972	310,881
TOTAL ADDITIONS	2,296,604	501,339
DEDUCTIONS		
Annuity benefits		
Retirement benefits	617,659	98,680
Survivor benefits	40,022	6,394
Disability benefits	20,341	3,250
Cost of living	145,767	17,860
Death benefits	3,149	1,329
Refunds	15,305	14,621
Administrative expense	2,935	2,599
TOTAL DEDUCTIONS	845,178	144,733
NET INCREASE	1,451,426	356,606
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
BEGINNING OF YEAR	20,443,254	3,335,230
END OF YEAR	$ 21,894,680	$ 3,691,836

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

For the Year Ended June 30, 2004 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	For the Year Ended June 30, 2003 Total
$ 204,984	$ 148,493	$ 49,218	$ 197,711
411,106	264,320	134,014	398,334
616,090	412,813	183,232	596,045
1,310,812	232,015	36,950	268,965
676,078	577,854	92,529	670,383
183,359	137,167	21,963	159,130
26,072	23,974	3,839	27,813
2,196,321	971,010	155,281	1,126,291
(14,468)	(11,900)	(1,913)	(13,813)
2,181,853	959,110	153,368	1,112,478
2,797,943	1,371,923	336,600	1,708,523
716,339	571,703	90,372	662,075
46,416	36,818	5,820	42,638
23,591	18,809	2,973	21,782
163,627	134,455	16,236	150,691
4,478	3,052	994	4,046
29,926	14,250	12,381	26,631
5,534	2,631	2,425	5,056
989,911	781,718	131,201	912,919
1,808,032	590,205	205,399	795,604
23,778,484	19,853,049	3,129,831	22,982,880
$ 25,586,516	$ 20,443,254	$ 3,335,230	$ 23,778,484

Tennessee Consolidated Retirement System
Notes to the Financial Statements
June 30, 2004 and June 30, 2003

The Tennessee Consolidated Retirement System (TCRS) administers two defined benefit pension plans - State Employees, Teachers and Higher Education Employees Pension Plan (SETHEEPP) and Political Subdivisions Pension Plan (PSPP). Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to members of that plan, in accordance with the terms of the plan.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity -** The TCRS is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the TCRS has been included as pension trust funds in the *Tennessee Comprehensive Annual Financial Report*.

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

   Plan member contributions are recognized in the period 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*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298. The classification of cash and cash equivalents also includes cash invested in a short-term, open-end mutual fund under the contractual arrangement for master custody services.

4. **Method Used to Value Investments -** Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate investments is determined at least every three years by qualified independent appraisers who are members of the Appraisal Institute and internally by real estate advisors for those years when independent appraisals are not performed. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.

5. **Receivables -** Receivables primarily consist of interest which is recorded when earned. The receivables for contributions as of June 30, 2004 consist of member contributions of $17.7 million and $3.9 million due to SETHEEPP and PSPP respectively, and employer contributions of $19.9 million and $11.1 million due to SETHEEPP and PSPP respectively. The receivables for contributions as of June 30, 2003 consist of member contributions of $14.9 million and $3.6 million due to SETHEEPP and PSPP respectively, and employer contributions of $18.2 million and $10.2 million due to SETHEEPP and PSPP respectively.

(continued)

Tennessee Consolidated Retirement System
Notes to the Financial Statements
June 30, 2004 and June 30, 2003 (continued)

6. **Accounting Change -** During the year ended June 30, 2003, the TCRS changed its method of reporting foreign currency forward contracts to include their associated unrealized gains and losses on the financial statements. The receiveables and payables relating to these contracts, previously treated as off-balance sheet items, have been included on the Comparative Statements of Changes in Plan Net Assets.

B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

At July 1, 2003, the date of the latest actuarial valuation, the membership of each plan consisted of the following:

	SETHEEPP	PSPP
Retirees and beneficiaries currently receiving benefits	59,959	23,162
Terminated members entitled to but not receiving benefits	16,721	3,972
Current active members	127,597	71,320
Total	204,277	98,454
Number of participating employers	140	418

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, 2004, the plan's Member Reserve and Employer Reserve were fully funded with

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003 (CONTINUED)

balances of $3,059.2 million and $18,835.5 million, respectively. At June 30, 2003, the plan's Member Reserve and Employer Reserve were fully funded with balances of $2,909.3 million and $17,533.9 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, 2004, the plan's Member Reserve and Employer Reserve were fully funded with balances of $746.9 million and $2,944.9 million, respectively. At June 30, 2003, the plan's Member Reserve and Employer Reserve were fully funded with balances of $691.1 million and $2,644.1 million, respectively.

C. INVESTMENTS

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

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.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003 (CONTINUED)

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. TCRS investments as of June 30, 2004 and June 30, 2003 included SEC-registered open-end mutual funds of $106,167 and $108,761, respectively.

Expressed in Thousands	**Fair Value June 30, 2004**	**Fair Value June 30, 2003**
Investments - Category 1		
Cash equivalents and short-term securities		
Commercial paper	$ 550,108	$ 717,397
Government bonds	1,299,409	1,501,324
Long-term investments		
Government bonds	10,867,976	10,081,502
Corporate bonds	1,876,185	2,293,728
Corporate stocks	10,258,064	8,613,755
Total Investments - Category 1	24,851,742	23,207,706
Investments - Category 2	0	0
Investments - Category 3	0	0
Investments - Not Categorized		
Investment in open-end mutual fund	106	109
Real estate	463,383	372,308
Unsettled investment acquisitions		
Government bonds	0	331,969
Corporate bonds	2,012	18,037
Corporate stocks	18,659	25,649
Total Investments - Not Categorized	484,160	748,072
Total investments	25,335,902	23,955,778
Less: Short-term investments classified as cash equivalents on the Statements of Plan Net Assets	(1,284,977)	(1,720,253)
Total investments as shown on the Statements of Plan Net Assets	$ 24,050,925	$ 22,235,525

As of June 30, 2004 and June 30, 2003, 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.

(continued)

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003 (CONTINUED)

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, 2004 and June 30, 2003, there were no securities on loan.

Derivatives – The TCRS may buy or sell equity index futures contracts for the purposes of making asset allocation changes in an efficient and cost effective manner and to improve liquidity. The futures contracts are limited to the S&P 500 Index, the S&P Midcap 400 Index and the Russell 2000 Index. The TCRS can increase (decrease) equity market exposure by buying (selling) the equity index future to obtain its target domestic equity allocation. Gains (losses) on equity index futures hedge losses (gains) produced by any deviation from the TCRS' target equity allocation. The gains and losses resulting from daily fluctuations in the fair value of the outstanding futures contracts are settled daily, on the following day, and a receivable or payable is established for any unsettled gain or loss as of the financial statement date. As of June 30, 2004 and June 30, 2003, the TCRS was not under any futures contracts.

The international securities expose the TCRS to potential losses due to a possible rise in the value of the US dollar. The TCRS investment managers can reduce foreign currency exposure by selling foreign currency forward contracts, at agreed terms and for future settlement, usually within a year. The manager will reverse the contract by buying the foreign currency before the settlement date. A gain (loss) on this transaction pair will hedge a loss (gain) on the currency movement of the international security. The TCRS can sell up to 80% of its foreign currency exposure into US dollars. The fair value of foreign currency forward contracts outstanding as of June 30, 2004 and June 30, 2003 has been reflected in the financial statements.

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, 2004 and June 30, 2003.

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 mortgages, which may result from a decline in interest rates. There were no CMOs held at June 30, 2004. The fair value of CMOs at June 30, 2003 was $9,715,380. The TCRS also invests in various asset-backed securities, representing ownership interests in trust consisting of credit card and auto loan receivables. These securities are issued by organizations with AAA or AA credit ratings. TCRS invests in these securities primarily to enhance returns by taking advantage of opportunities available in this sector of the securities markets.

D. COMMITMENTS

Standby 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

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	7/1/2003	$ 22,099,252	$ 22,151,745	$ 52,493	99.76%	$ 4,773,297	1.10%
	7/1/2001	20,760,989	20,842,216	81,227	99.61%	4,451,452	1.82%
	7/1/1999	18,327,133	18,420,156	93,023	99.49%	4,132,409	2.25%
PSPP	7/1/2003	3,605,529	3,923,475	317,946	91.90%	1,731,135	18.37%
	7/1/2001	3,187,990	3,528,137	340,147	90.36%	1,545,593	22.01%
	7/1/1999	2,690,781	2,890,942	200,161	93.08%	1,341,363	14.92%

The SETHEEPP is comprised of a number of employee groups. However, the unfunded liability of $52.5 million at July 1, 2003 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 418 participating entities at July 1, 2003. The unfunded liability of $317.9 million is attributable to 353 of the 418 entities.

See accompanying Notes to Required Supplementary Information

Tennessee Consolidated Retirement System
Required Supplementary Information
Schedules of Employer Contributions

SCHEDULES OF EMPLOYER CONTRIBUTIONS
Expressed in Thousands

	SETHEEPP		PSPP	
Year Ended June 30	**Annual Required Contribution**	**Percentage Contributed**	**Annual Required Contribution**	**Percentage Contributed**
2004	$ 271,298	100%	$ 139,808	100%
2003	264,320	100%	134,014	100%
2002	243,498	100%	103,374	100%
2001	232,149	100%	103,681	100%
2000	252,162	100%	82,749	100%
1999	244,453	100%	69,230	100%

An actuarial valuation of the TCRS is performed every two years with the next valuation scheduled to be effective July 1, 2005.

See accompanying Notes to Required Supplementary Information

Tennessee Consolidated Retirement System
Notes to Required Supplementary Information
As of June 30, 2004 and June 30, 2003

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, 2003 actuarial valuation follows.

	SETHEEPP	**PSPP**
Valuation Date	July 1, 2003	July 1, 2003
Actuarial cost method	Frozen Entry Age	Frozen Entry Age
Amortization method	Level Dollar	Level Dollar
Remaining amortization period	12 years closed period	(1) closed period
Asset valuation method	5-year Moving Market Average	5-year Moving Market Average
Actuarial assumptions:		
Investment rate of return	7.50%	7.50%
Projected salary increases	4.75% (3)	4.75% (3)
Includes inflation at	(2)	(2)
Cost-of-living adjustments	3.00%	3.00%
Increase in Social Security wage base	3.50%	3.50%

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

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

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

TENNESSEE CONSOLIDATED RETIREMENT SYSTEM ACTUARIAL BALANCE SHEET

ACTUARIAL BALANCE SHEET
as of July 1, 2003

ASSETS	State Employees, Teachers, Higher Ed. Employees Pension Plan (SETHEEPP)	Political Subdivision Pension Plan (PSPP)	Total
Present assets creditable to			
Employer accumulation fund	$ 19,191,061,582	$ 2,914,374,745	$ 22,105,436,327
Members' accumulation fund	2,908,190,130	691,154,611	3,599,344,741
Total present assets	22,099,251,712	3,605,529,356	25,704,781,068
Present value of prospective contributions payable to			
Employer accumulation fund			
Normal	3,004,425,125	967,109,743	3,971,534,868
Accrued liability	52,493,209	317,945,618	370,438,827
Total employer accumulation	3,056,918,334	1,285,055,361	4,341,973,695
Members' accumulation fund	1,294,805,852	376,265,035	1,671,070,887
Total prospective contributions	4,351,724,186	1,661,320,396	6,013,044,582
TOTAL ASSETS	$ 26,450,975,898	$ 5,266,849,752	$ 31,717,825,650
LIABILITIES			
Present value of prospective benefits payable on account of			
Present retired members and beneficiaries	9,071,081,541	1,304,957,688	10,376,039,229
Present active members	16,960,751,035	3,851,255,879	20,812,006,914
Former members	419,143,322	110,636,185	529,779,507
TOTAL LIABILITIES	$ 26,450,975,898	$ 5,266,849,752	$ 31,717,825,650

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 / FAX (615) 532-2765

December 3, 2004

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

Dear Mr. Morgan:

We have audited the accompanying statements of fiduciary net assets of the Flexible Benefits Plan, an employee benefit trust fund of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

As discussed in Note A.1., the financial statements referred to above present only the Flexible Benefits Plan, an employee benefit trust fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the Flexible Benefits Plan of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2004, on our consideration of the Flexible Benefits Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Flexible Benefits Plan
Comparative Statements of Fiduciary Net Assets
June 30, 2004 and June 30, 2003

	June 30, 2004	June 30, 2003
ASSETS		
Cash	$1,751,677	$ 664,353
Due from other funds	214,593	161,836
TOTAL ASSETS	1,966,270	826,189
LIABILITIES		
Accounts payable	105,356	82,818
Due to other funds	113,240	64,470
TOTAL LIABILITIES	218,596	147,288
NET ASSETS		
Held in trust for employee benefit programs	$1,747,674	$ 678,901

See accompanying Notes to the Financial Statements

Flexible Benefits Plan
Comparative Statements of Changes in Fiduciary Net Assets
For the Years Ended June 30, 2004 and June 30, 2003

	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003
ADDITIONS		
Employee contributions	$5,565,233	$4,664,825
FICA savings	4,894,544	4,256,312
TOTAL ADDITIONS	10,459,777	8,921,137
DEDUCTIONS		
Employee reimbursements	5,421,598	4,549,774
Employee benefit programs		
Deferred compensation match	2,959,095	3,733,616
Wellness program	482,646	430,800
Employee daycare center	149,815	220,000
Sick leave bank administration	85,500	0
Other benefits	0	16,888
Total employee benefit programs	3,677,056	4,401,304
Administrative fees	292,350	306,158
TOTAL DEDUCTIONS	9,391,004	9,257,236
CHANGE IN NET ASSETS	1,068,773	(336,099)
NET ASSETS, BEGINNING OF YEAR	678,901	1,015,000
NET ASSETS, END OF YEAR	$1,747,674	$ 678,901

See accompanying Notes to the Financial Statements

FLEXIBLE BENEFITS PLAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

3. **Cash** - 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.* That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298. The primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash.

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, 2004 and June 30, 2003 the following amounts were paid or transferred to other State funds for these employee benefit programs:

Program	**FY 2004**	**FY 2003**
Deferred Compensation Contribution Match	$2,959,095	$3,733,616
State Wellness Program	482,646	430,800
State Day Care	149,815	220,000
Automated Teller Machines in State Buildings	0	16,888
Sick Leave Bank	85,500	0

(continued)

Flexible Benefits Plan
Notes to the Financial Statements
June 30, 2004 and June 30, 2003

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 2004	FY 2003
Due from General Fund	$169,048	$128,478
Due from Internal Service Fund	10,811	7,712
Due from Enterprise Fund	2,714	2,380
Due from Special Revenue Fund	8,930	7,057
Due from Highway Fund	14,993	10,524
Due from Education Trust Fund	8,097	5,685

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

	FY 2004	FY 2003
Due to General Fund	$89,940	$50,982
Due to Internal Service Fund	2,885	1,587
Due to Enterprise Fund	620	351
Due to Special Revenue Fund	3,460	2,001
Due to Highway Fund	13,730	8,058
Due to Education Trust Fund	2,605	1,491

Risk Management Fund
Independent Auditor's Report

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

December 3, 2004

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

Dear Mr. Morgan:

We have audited the accompanying statement of net assets of the Risk Management Fund, an internal service fund of the State of Tennessee, as of June 30, 2004, and the related statements of revenues, expenses, and changes in fund net assets and cash flows for the year then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit 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 audit provides a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and serving as a member of the Board of Claims.

As discussed in Note A.1., the financial statements referred to above present only the Risk Management Fund, an internal service fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2004, and the changes in its financial position and cash flows for the year then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Risk Management Fund of the State of Tennessee, as of June 30, 2004, and the changes in its financial position and cash flows for the year 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 State of Tennessee's property insurance program, formerly accounted for in the General Fund, has been combined with the former Claims Award Fund to create the Risk Management Fund. Also as discussed in Note A.4., management has changed the classification of net assets from restricted to unrestricted.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2004, on our consideration of the Risk Management Fund's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

RISK MANAGEMENT FUND
STATEMENT OF NET ASSETS
JUNE 30, 2004

ASSETS	
Cash	$ 101,059,276
Accounts receivable	137,355
TOTAL ASSETS	101,196,631
LIABILITIES	
Current liabilities	
Accounts payable	448,433
Deferred revenue	7,000
Claims liability	35,981,681
Total current liabilities	36,437,114
Noncurrent liabilities	
Claims liability	56,575,279
TOTAL LIABILITIES	93,012,393
NET ASSETS - UNRESTRICTED	$ 8,184,238

See accompanying Notes to the Financial Statements

Risk Management Fund
Statement of Revenues, Expenses, and Changes in Fund Net Assets
For the Year Ended June 30, 2004

OPERATING REVENUES	
Casualty premiums	$ 53,494,500
Property premiums	9,589,250
TOTAL OPERATING REVENUES	63,083,750
OPERATING EXPENSES	
Torts	
Death	1,645,449
Bodily injury	4,046,594
Property damage	1,113,270
Total Torts	6,805,313
Workers' Compensation	
Death	496,244
Medical	10,840,378
Temporary disability	1,626,028
Permanent disability	7,896,598
Total Workers' Compensation	20,859,248
Property Damage	
Employee property	40,538
State owned property	216,126
Total Property Damage	256,664
Property insurance premiums	1,737,055
Professional/Administrative	8,401,282
Addition to accrued liability	1,949,217
TOTAL OPERATING EXPENSES	40,008,779
OPERATING INCOME	23,074,971
NON-OPERATING REVENUES	
Interest income	800,443
Taxes	3,225
TOTAL NON-OPERATING REVENUES	803,668
CHANGE IN NET ASSETS	23,878,639
NET ASSETS, BEGINNING OF YEAR	(15,694,401)
NET ASSETS, END OF YEAR	$ 8,184,238

See accompanying Notes to the Financial Statements

Risk Management Fund
Statement of Cash Flows
For the Year Ended June 30, 2004

CASH FLOWS FROM OPERATING ACTIVITIES	
Receipts from premiums	$ 62,946,395
Payments for claims	(27,962,977)
Payments for administrative expenses	(8,391,391)
Payments for insurance premiums	(1,682,718)
NET CASH FROM OPERATING ACTIVITIES	24,909,309
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES	
Taxes received	3,225
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES	3,225
CASH FLOWS FROM INVESTING ACTIVITIES	
Interest received	800,443
NET CASH FROM INVESTING ACTIVITIES	800,443
NET INCREASE IN CASH	25,712,977
CASH, BEGINNING OF YEAR	75,346,299
CASH, END OF YEAR	$ 101,059,276
RECONCILIATION OF OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES	
OPERATING INCOME	$ 23,074,971
ADJUSTMENTS TO RECONCILE OPERATING INCOME TO NET CASH FROM OPERATING ACTIVITIES	
Changes in assets and liabilities	
Increase in accounts receivable	(137,355)
Increase in accounts payable	20,476
Increase in deferred revenue	2,000
Increase in claims liability	1,949,217
TOTAL ADJUSTMENTS	1,834,338
NET CASH FROM OPERATING ACTIVITIES	$ 24,909,309

See accompanying Notes to the Financial Statements

Risk Management Fund
Notes to the Financial Statements
June 30, 2004

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Risk Management Fund (RMF) is part of the primary government and has been included in the *Tennessee Comprehensive Annual Financial Report* as an internal service fund.

2. **Measurement Focus and Basis of Accounting** - The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The RMF generally follows private sector standards of accounting and financial reporting issued prior to December 1, 1989, to the extent that these standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The financial statements have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred. The RMF distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from the services provided by the RMF. The principal operating revenue of the RMF consists of charges to its customers for insurance premiums. Operating expenses include claims expenses, insurance premiums, administrative expenses and the current charge to the accrued liability. Revenues and expenses not resulting from the services provided by the RMF are reported as nonoperating revenues and expenses.

3. **Cash** - Cash deposited in the RMF 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.* That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298. The primary government's policy regarding the definition of Cash and Cash Equivalents includes cash management pools as cash.

4. **Accounting Changes** - Effective July 1, 2003, pursuant to Chapter 212 of the Public Acts of 2003, the financial activities relating to the State's property insurance program were combined with the Claims Award Fund, creating a consolidated internal service fund named the Risk Management Fund. Previously, the designation of funds to cover aggregate deductibles and associated incurred losses, and the insurance premium billing and payment activities were recorded within the State's General Fund. Accordingly, beginning net assets of the RMF for fiscal year 2004 includes all assets and liabilities relating to the former Claims Award Fund internal service fund, and the property insurance program formerly accounted for within the State's General Fund.

   In prior years, the net assets were reported as restricted; however, the balance should have been reported as unrestricted.

B. OTHER ACCOUNTING DISCLOSURES

1. **Risk Management** - It is the policy of the state not to purchase commercial insurance for the risks of casualty losses for general liability, automobile liability, professional malpractice, and workers' compensation. The state's management believes it is more economical to manage these risks internally and set aside assets for

(continued)

RISK MANAGEMENT FUND
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004

claim settlement in its internal service fund, the RMF. The state purchases commercial insurance for real property, flood, earthquake, and builder's risk losses and surety bond coverage on the state's officials and employees. The RMF is also responsible for claims for damages to state owned property up to the amount of the property insurance aggregate deductible amount. The insurance policy deductibles vary from $25,000 per occurrence, depending on the type of coverage, to an aggregate of $7.5 million. All agencies and authorities of the state participate in the RMF, except for the Dairy Promotion Board, the Certified Cotton Growers' Organization, and the Tennessee Education Lottery Corporation.

The RMF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. The present value of the casualty liability as actuarially determined was $84,738,510 (discounted at 3.00%) at June 30, 2004. An accrued liability of $6,985,500 for incurred property losses, as well as $832,950 for the settlement of a wrongful imprisonment claim filed after June 30, 2004 and not originally included in the liability estimates has been included in the claims liability at June 30, 2004. The change in the balance of the claims liability during the fiscal year was as follows:

Beginning Claims Liability	Current Year Claims and Changes in Estimates	Claim Payments	Ending Claims Liability
$90,607,743	$29,870,442	$(27,921,225)	$92,556,960

At June 30, 2004, the RMF held $101.1 million in cash designated for payment of these claims.

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

Criminal Injuries Compensation Fund
Independent Auditor's Report

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

December 3, 2004

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

Dear Mr. Morgan:

We have audited the accompanying balance sheets of the Criminal Injuries Compensation Fund, a special revenue fund of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the related statements of revenues, expenditures, and changes in fund balances and revenues, expenditures, and changes in fund balances (budget and actual) for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; and participating in the negotiation and procurement of services for the state.

As discussed in Note A.1., the financial statements referred to above present only the Criminal Injuries Compensation Fund, a special revenue fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its financial position and budgetary comparisons for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Criminal Injuries Compensation Fund of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its financial position and budgetary comparisons for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2004, 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 grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Criminal Injuries Compensation Fund
Comparative Balance Sheets
June 30, 2004 and June 30, 2003

	June 30, 2004	June 30, 2003
ASSETS		
Cash	$ 9,811,512	$8,670,999
Accounts receivable	378,698	264,378
TOTAL ASSETS	$10,190,210	$8,935,377
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Accounts payable	$ 260,666	$ 348,366
Claims liability	5,549,819	4,409,238
TOTAL LIABILITIES	5,810,485	4,757,604
FUND BALANCES		
Reserved for future benefits (see Note B.1)	2,398,628	2,964,421
Reserved for victims of drunk drivers (see Note B.1)	1,981,097	1,213,352
TOTAL FUND BALANCES	4,379,725	4,177,773
TOTAL LIABILITIES AND FUND BALANCES	$10,190,210	$8,935,377

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, 2004 and June 30, 2003

	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003
REVENUES		
State		
Taxes	$4,640,805	$4,320,820
Fees	2,625,070	2,646,388
Federal	4,971,000	5,095,000
Interest income	78,981	95,201
Other	508,736	540,230
TOTAL REVENUES	12,824,592	12,697,639
EXPENDITURES		
Claim payments	11,665,671	9,453,516
Victims' coalition grant	100,000	100,000
District Attorneys General grant	152,230	146,431
Administrative cost	704,739	665,761
TOTAL EXPENDITURES	12,622,640	10,365,708
EXCESS OF REVENUES OVER EXPENDITURES	201,952	2,331,931
FUND BALANCES, BEGINNING OF YEAR	4,177,773	1,845,842
FUND BALANCES, END OF YEAR	$4,379,725	$4,177,773

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, 2004 and June 30, 2003

	For the Year Ended June 30, 2004			For the Year Ended June 30, 2003		
	Original Budget	Final Budget	Actual (Budgetary Basis)	Original Budget	Final Budget	Actual (Budgetary Basis)
SOURCES OF FINANCIAL RESOURCES						
FUND BALANCES, BEGINNING OF YEAR	$ 4,177,773	$ 4,177,773	$ 4,177,773	$ 1,845,842	$ 1,845,842	$ 1,845,842
REVENUES						
Taxes	0	0	4,640,805	0	0	4,320,820
Fees	0	0	2,625,070	0	0	2,646,388
Federal	4,451,000	4,451,000	4,971,000	3,396,000	3,396,000	5,095,000
Interest income	0	0	78,981	0	0	95,201
Other	0	0	508,736	0	0	540,230
TOTAL SOURCES OF FINANCIAL RESOURCES	8,628,773	8,628,773	17,002,365	5,241,842	5,241,842	14,543,481
USES OF FINANCIAL RESOURCES						
EXPENDITURES						
Claim payments	11,800,000	11,800,000	11,665,671	10,800,000	10,800,000	9,453,516
Victims' coalition grant	0	100,000	100,000	0	0	100,000
District Attorneys General grant	0	0	152,230	0	0	146,431
Administrative cost	776,500	776,500	704,739	841,300	841,300	665,761
TOTAL USES OF FINANCIAL RESOURCES	12,576,500	12,676,500	12,622,640	11,641,300	11,641,300	10,365,708
FUND BALANCES, END OF YEAR	$ (3,947,727)	$ (4,047,727)	$ 4,379,725	$ (6,399,458)	$ (6,399,458)	$ 4,177,773

See accompanying Notes to the Financial Statements

Criminal Injuries Compensation Fund
Notes to the Financial Statements
June 30, 2004 and June 30, 2003

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

3. **Cash** - Cash deposited in the Criminal Injuries Compensation Fund is pooled with the State Pooled Investment Fund (SPIF), administered by the State Treasurer, which is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, 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*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298. 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.

B. OTHER ACCOUNTING DISCLOSURES

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

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

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

December 3, 2004

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

Dear Mr. Morgan:

We have audited the accompanying statements of fiduciary net assets of the Baccalaureate Education System Trust, Educational Services Plan, a private-purpose trust fund of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the related statements of changes in fiduciary net assets for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and serving as a member of the board of the Baccalaureate Education System Trust.

As discussed in Note A.1., the financial statements referred to above present only the Baccalaureate Education System Trust, Educational Services Plan, a private-purpose trust fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net assets of the Baccalaureate Education System Trust, Educational Services Plan, of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its fiduciary net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2004, on our consideration of the Baccalaureate Education System Trust, Educational Services Plan's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Baccalaureate Education System Trust, Educational Services Plan
Comparative Statements of Fiduciary Net Assets
June 30, 2004 and June 30, 2003

	June 30, 2004	June 30, 2003
ASSETS		
Cash and cash equivalents	$ 5,321,386	$ 3,006,326
Receivables		
Contributions receivable	10,048	8,628
Investment income receivable	267,969	221,012
Investments sold	22,591,678	2,046,130
Investments, at fair value		
Government bonds	33,093,750	29,455,000
Investment in equity mutual fund	12,541,822	10,530,494
TOTAL ASSETS	73,826,653	45,267,590
LIABILITIES		
Investments purchased	22,431,522	2,260,614
NET ASSETS HELD IN TRUST FOR PLAN PARTICIPANTS	$ 51,395,131	$ 43,006,976

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, 2004 and June 30, 2003

	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003
ADDITIONS		
Contributions	$ 8,916,081	$ 7,825,678
Investment income		
Net increase in fair value of investments	578,021	891,813
Interest and dividend income	1,344,532	1,075,568
Administrative fees	340,474	281,333
TOTAL ADDITIONS	11,179,108	10,074,392
DEDUCTIONS		
Refunds	295,892	229,615
Payments	2,182,451	1,257,070
Administrative cost	312,610	294,488
TOTAL DEDUCTIONS	2,790,953	1,781,173
CHANGE IN NET ASSETS	8,388,155	8,293,219
NET ASSETS HELD IN TRUST FOR PLAN PARTICIPANTS		
BEGINNING OF YEAR	43,006,976	34,713,757
END OF YEAR	$ 51,395,131	$ 43,006,976

See accompanying Notes to the Financial Statements

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

3. **Cash and Cash Equivalents** - Cash and Cash Equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The 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*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298. The classification of cash and cash equivalents also includes cash invested in a short-term, open-end mutual fund, under the contractual arrangements for master custody services.

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

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 $17,895,211 as of June 30, 2004 and $13,618,937 as of June 30, 2003.

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.

(*continued*)

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003

	June 30, 2004 Fair Value	June 30, 2003 Fair Value
INVESTMENTS - CATEGORY 1		
Long-term investments		
Government bonds	$33,093,750	$27,231,880
TOTAL INVESTMENTS - CATEGORY 1	33,093,750	27,231,880
INVESTMENTS - CATEGORY 2	0	0
INVESTMENTS - CATEGORY 3	0	0
INVESTMENTS - NOT CATEGORIZED		
Investment in open-end mutual funds	17,895,211	13,618,937
Unsettled investment acquisitions - Government Bonds	0	2,223,120
TOTAL INVESTMENTS - NOT CATEGORIZED	17,895,211	15,842,057
TOTAL INVESTMENTS	50,988,961	43,073,937
Less: Investments classified as cash and cash equivalents on the Statements of Fiduciary Net Assets	(5,353,389)	(3,088,443)
TOTAL INVESTMENTS AS SHOWN ON THE STATEMENTS OF FIDUCIARY NET ASSETS	$45,635,572	$39,985,494

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 $11,636,568 less at June 30, 2004, and $6,843,125 less at June 30, 2003, than the amounts needed to fund the outstanding tuition units at their weighted average tuition unit prices in effect at the respective dates.

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

Chairs of Excellence
Independent Auditor's Report

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

December 3, 2004

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

Dear Mr. Morgan:

We have audited the accompanying balance sheets of the Chairs of Excellence, a permanent fund of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the related statements of revenues, expenditures, and changes in fund balances for the years then ended. These financial statements are the responsibility of management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain state contracts; participating in the negotiation and procurement of services for the state; and serving as a member of the board of the Chairs of Excellence Trust.

As discussed in Note A.1., the financial statements referred to above present only the Chairs of Excellence, a permanent fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Chairs of Excellence of the State of Tennessee, as of June 30, 2004, and June 30, 2003, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 3, 2004, on our consideration of the Chairs of Excellence's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA
Director

Chairs of Excellence
Comparative Balance Sheets
June 30, 2004 and June 30, 2003

	June 30, 2004	June 30, 2003
ASSETS		
Cash and cash equivalents	$ 3,387,318	$ 8,366,883
Investments, at fair value		
Government bonds	64,730,071	71,802,733
Corporate bonds	43,599,835	42,775,022
Investment in equity mutual fund	106,556,870	90,982,164
Total investments	214,886,776	205,559,919
Receivables		
Due from colleges and universities	577,000	684,000
Investment income receivable	1,696,609	1,515,521
Total receivables	2,273,609	2,199,521
TOTAL ASSETS	$ 220,547,703	$ 216,126,323
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Due to colleges and universities	$ 2,425,464	$ 2,500,732
Due to the Academic Scholars Fund	3,146,758	3,200,879
Investments purchased	0	5,181,771
TOTAL LIABILITIES	5,572,222	10,883,382
FUND BALANCES		
Reserved for non-expendable corpus	202,682,915	193,312,901
Reserved for expendable income	12,292,566	11,930,040
TOTAL FUND BALANCES	214,975,481	205,242,941
TOTAL LIABILITIES AND FUND BALANCES	$ 220,547,703	$ 216,126,323

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, 2004 and June 30, 2003

	For the Year Ended June 30, 2004	For the Year Ended June 30, 2003
REVENUES		
Investment income	$ 16,953,010	$ 10,738,917
Contributions from private sources	0	160,512
TOTAL REVENUES	16,953,010	10,899,429
EXPENDITURES		
University of Tennessee	3,604,089	3,516,488
Tennessee Board of Regents	3,258,568	3,401,728
Academic Scholars Fund	185,079	189,177
Administrative cost	172,734	159,971
TOTAL EXPENDITURES	7,220,470	7,267,364
EXCESS OF REVENUES OVER EXPENDITURES	9,732,540	3,632,065
FUND BALANCES, BEGINNING OF YEAR	205,242,941	201,610,876
FUND BALANCES, END OF YEAR	$ 214,975,481	$ 205,242,941

See accompanying Notes to the Financial Statements

Chairs of Excellence
Notes to the Financial Statements
June 30, 2004 and June 30, 2003

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

3. **Cash and Cash Equivalents** - Cash and cash equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. Cash received by the COE Trust that cannot be immediately invested in securities 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*. That report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eighth Avenue North, Nashville, Tennessee 37243-0298. The classification of cash and cash equivalents also includes cash invested in a short-term, open-end mutual fund under the contractual arrangements for master custody services.

4. **Method Used to Value Investments -** Investments are reported at fair value. 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.

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.

(continued)

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003

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, 2004 and June 30, 2003 included SEC-registered open-end mutual funds of $110,352,233 and $99,694,274 respectively.

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. 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, 2004 Fair Value	June 30, 2003 Fair Value
INVESTMENTS - CATEGORY 1		
Long-term investments		
Government bonds	$ 64,730,071	$ 66,635,545
Corporate bonds	43,599,835	42,775,022
TOTAL INVESTMENTS - CATEGORY 1	108,329,906	109,410,567
INVESTMENTS - CATEGORY 2	0	0
INVESTMENTS - CATEGORY 3	0	0
INVESTMENTS - NOT CATEGORIZED		
Investment in open-end mutual funds	110,352,233	99,694,274
Unsettled investment acquisitions - government bonds	0	5,167,188
TOTAL INVESTMENTS - NOT CATEGORIZED	110,352,233	104,861,462
TOTAL INVESTMENTS	218,682,139	214,272,029
Less: Investments included in cash and cash equivalents on the Balance Sheets	(3,795,363)	(8,712,110)
TOTAL INVESTMENTS AS SHOWN ON THE BALANCE SHEETS	$ 214,886,776	$ 205,559,919

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, 2004 and June 30, 2003, 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

CHAIRS OF EXCELLENCE
NOTES TO THE FINANCIAL STATEMENTS
JUNE 30, 2004 AND JUNE 30, 2003

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, 2004, 99 Chairs have been established with matching contributions received totaling $55,683,887. Total contributions to the COE Trust totaled $99,683,887 as of June 30, 2004. This includes $44,000,000 from the State, $10,321,300 from Colleges and Universities, and $45,362,587 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.

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

Treasury Department, December 2004, Authorization No. 309208, 350 copies.
This public document was printed at a cost of $8.38 each.