NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Presentation - The accompanying financial statements of the State of Tennessee have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board. The financial statements of the Colleges and Universities have been prepared in conformity with generally accepted accounting principles for colleges and universities as prescribed by the Governmental Accounting Standards Board. Certain amounts presented for the preceding year have been reclassified for comparative purposes.

B. Financial Reporting Entity

Introduction - As required by generally accepted accounting principles, these financial statements present the primary government and its component units, entities for which the government is considered to be financially accountable. Discretely presented component units are reported in a separate column in the combined financial statements to emphasize they are legally separate from the primary government.

Discretely Presented Component Units.

1. The Tennessee Student Assistance Corporation (TSAC) (Governmental Fund Type) is responsible for guaranteeing student loans under both federal and state programs and administering federal and state grants and loans to students. The majority of the Board is either appointed by the Governor or are State officials. TSAC's budget is approved by the State.

2. The Community Services Agencies (CSAs) (Governmental Fund Types) listed below are to provide a mechanism to facilitate the provision of services for children and other citizens in need of services from state agencies:

   Northeast Community Services Agency
   East Tennessee Community Services Agency
   Upper Cumberland Community Services Agency
   Southeast Community Services Agency
   Mid-Cumberland Community Services Agency
   South Central Community Services Agency
   Northwest Community Services Agency
   Southwest Community Services Agency

   The Boards for these CSAs are appointed by the Governor and the budget must be approved by the State.

3. The Community Services Agencies (CSAs) (Governmental Fund Types) listed below are also to provide a mechanism to facilitate the provision of services for children and other citizens in need of services from state agencies:

   Davidson County Community Services Agency
   Knox County Community Services Agency
   Shelby County Community Services Agency
   Hamilton County Community Services Agency

   The Boards for these CSAs are appointed by the county. The State approves the budget and provides substantially all the funding.

4. TN 200 (Governmental Fund Type) was formed to develop a comprehensive program for celebrating the bicentennial of the State. The Board is comprised of State officials and appointees by the Governor, and the State provides a substantial amount of funding.

5. The Tennessee Woman's Suffrage Commission (Governmental Fund Type) was formed to commemorate the seventy-fifth anniversary of the passage of the Nineteenth Amendment to the U.S. Constitution. The majority of the Board was comprised of State officials or appointees of State officials, and the State provides a substantial amount of funding. This commission terminated during fiscal year 1996-1997.

6. The Tennessee Certified Cotton Growers Organization (Governmental Fund Type) was formed to aid in the eradication of the Boll Weevil. The majority of the Board is appointed by the Commissioner of the Department of Agriculture, and the State provides a substantial amount of funding.

7. The Tennessee Housing Development Agency (Proprietary Fund Type) is responsible for making loans and mortgages to qualified sponsors, builders, developers and purchasers of low and moderate income family dwellings. The Board of the agency is appointed by the Governor and its budget is approved by the State.

8. The Tennessee Local Development Authority (Proprietary Fund Type) provides financing assistance to local governments through the issuance of bonds and notes. In addition, the Authority assists non-profit corporations in the construction of mental health, mental retardation, or alcohol and drug facilities. The majority of the Board consists of State officials; therefore, the State can impose its will on the Authority.

9. The Tennessee Commodity Producer Indemnity Board (Grain Indemnity) (Proprietary Fund Type) is responsible for administering the grain indemnity fund. This fund receives monies from assessments on the sale of grain by producers. These monies are then used to compensate any claimant who has incurred a financial loss due to a failure of a commodity dealer or warehouseman. The Board is comprised of state officials and the State may impose its will since the State appoints, hires and dismisses those individuals responsible for the day-to-day management of the organization.

10. The Tennessee Comprehensive Health Insurance Pool (TCHIP) (Proprietary Fund Type) provides health insurance to residents of the State of Tennessee who have been denied health insurance for any reason. The TCHIP Board was appointed by the State and approves the budget and the plan of operation. As of June 30, 1997, this fund has been abolished.

11. The Tennessee State Veterans' Homes Board (Proprietary Fund Type) is responsible for the operation of nursing homes for honorably discharged veterans of the United States armed forces. The Board is appointed by the Governor and its budget is approved by the State. In addition, the issuance of bonds must be approved by the State Funding Board.

12. The Child Care Facilities Corporation (Proprietary Fund Type) purpose is to create new child care slots in Tennessee by guaranteeing loans, making direct loans, and making grants. The Board is comprised primarily of State officials. The State must approve the budget of the Corporation.

13. The Tennessee State School Bond Authority (Proprietary Fund Type) finances projects for the University of Tennessee, Tennessee Board of Regents or the Tennessee Student Assistance Corporation. The Board of the Authority consists primarily of State officials; therefore, the State is able to impose its will on the organization.

14. The University of Tennessee Board of Trustees (College and University Fund Type) is responsible for the operation of the University of Tennessee, located primarily on four campuses across the State. The Board is appointed by the Governor and the State provides a substantial amount of the funding.

15. The Tennessee Board of Regents (College and University Fund Type) is responsible for the operation of six universities, twelve community colleges, two technical institutes and twenty-seven technology centers. The Board is comprised of State officials and appointees by the Governor and the State provides a substantial amount of funding.

Complete financial statements for each of the individual component units may be obtained at the following addresses:

Tennessee Housing Development Agency
1114 Parkway Towers
404 James Robertson Parkway
Nashville, TN 37243

Tennessee Local Development Authority
Suite 1600, James K. Polk Building
Nashville, TN 37243

Tennessee State Veterans' Homes Board
345 Compton Road
Murfreesboro, TN 37130

Tennessee State School Bond Authority
Suite 1600, James K. Polk Building
Nashville, TN 37243

University of Tennessee
Office of the Treasurer
301 Andy Holt Tower
Knoxville, TN 37996-0100

Tennessee Board of Regents
1415 Murfreesboro Road, Suite 350
Nashville, TN 37217

All others may be obtained at the following address:

Finance & Administration
Division of Accounts
15th Floor Andrew Jackson Building
Nashville, TN 37243-0298

C. Fund Structure and Basis of Accounting - The financial activities of the state reported in the accompanying statements are classified into three fund categories and two account groups, all described below. The fund categories include governmental funds, proprietary funds and fiduciary funds. Account groups are presented for general fixed assets and general long-term obligations.

The state's governmental fund types include:

1. the General Fund - used to account for all financial transactions not required to be accounted for in other funds;
2. the Special Revenue Funds - used to account for specific revenues earmarked to finance particular or restricted programs and activities;
3. the Debt Service Fund - used to account for the payment of principal and interest on general long-term debt; and
4. the Capital Projects Fund - used to account for the acquisition or construction of all major governmental capital facilities.

All of the governmental funds are accounted for on the modified accrual basis of accounting. Under this basis, revenues are recognized when they become susceptible to accrual; that is, when they become both measurable and available to finance expenditures of the current period. Principal revenue sources accounted for on the modified accrual basis include federal grants, departmental services, interest on investments, sales taxes, petroleum and vehicular-related taxes and fees, and gross receipts taxes. Licenses, fines, fees and permits are accounted for on the cash basis. Expenditures are recognized when the related fund liability is incurred except:

a. Inventories generally are considered expenditures when consumed;
b. Prepayments usually are not recorded; and
c. Principal and interest on long-term debt are recorded when due.

Encumbrance accounting is utilized for budgetary control purposes in governmental fund types. Encumbrances outstanding at year-end are reported as reservations of fund balance for subsequent year expenditure.

The accounting and financial reporting treatment applied to a fund is determined by its measurement focus. All governmental funds and expendable trust funds are accounted for using a current financial resources measurement focus. With this measurement focus, only current assets and current liabilities generally are included on the balance sheet. Operating statements of these funds present increases (i.e., revenues and other financing sources) and decreases (i.e., expenditures and other financing uses) in net current assets.
The proprietary funds include:

1. the Enterprise Funds - used to account for the operations of self-sustaining state agencies providing goods or services to the general public on a user-charge basis; and
2. the Internal Service Funds - used to account for the operations of self-sustaining state agencies providing goods or services to other state agencies on a cost-reimbursement basis.

The proprietary funds are accounted for on the accrual basis. Under this method, revenues are recorded when earned and expenses at the time liabilities are incurred.

The fiduciary funds represent Trust and Agency Funds which are used to account for assets held by the state in a trust or agency capacity. These funds include:

1. the Expendable Trust Funds - used to account for the activities of trusts whose principal and income may be used for the purposes of the trust;
2. the Nonexpendable Trust Funds - used to account for the activities of trusts whose income is used to fund the trust purpose but whose principal is to be maintained intact;
3. the Pension Trust Fund - used to account for the activities of the state-administered retirement system; and
4. the Agency Funds - used to account for amounts held in custody for others. Agency funds are custodial in nature and do not present results of operations or have a measurement focus.

Expendable Trust and Agency Funds are accounted for on the modified accrual basis of accounting. Nonexpendable and Pension Trust Funds are accounted for on the accrual basis.

All proprietary funds and nonexpendable trust funds are accounted for on a flow of economic resources measurement focus. With this measurement focus, all assets and all liabilities associated with the operation of these funds are included on the balance sheet. Fund equity (i.e., net total assets) is segregated into contributed capital and retained earnings components. Proprietary fund-type operating statements present increases (e.g., revenues) and decreases (e.g., expenses) in net total assets.

The financial statements of the pension plans are prepared using the accrual basis of accounting. Plan member contributions are recognized in the period in which the contributions are due. The state’s contributions are recognized when due and a formal commitment to provide the contributions has been made. Benefits and refunds are recognized when due and payable in accordance with the terms of the plan.

The account group for general fixed assets is maintained to account for all fixed assets acquired or constructed for use by the state, other than those accounted for in the proprietary funds.

The account group for general long-term obligations is maintained to account for general obligation bonds outstanding, arbitrage payable, claims payable and accrued annual and compensatory leave not otherwise recorded in proprietary or fiduciary funds.

In addition to the forementioned fund categories and account groups, the component units also include colleges and universities which are accounted for using a different accounting and reporting model.

The college and university fund types (component units - discrete) include:

1. Current Funds - used to account for resources that will be expended in the near term for operating purposes of the institutions. These include (a) unrestricted funds over which the governing boards retain full control in achieving the institutions' purposes and (b) restricted funds which may be utilized only in accordance with externally-restricted purposes;
2. Fiduciary Funds - used to account for assets held by loan, endowment, life income and agency funds in which the universities act in a fiduciary capacity; and
3. Plant Funds - used to account for institutional property acquisition, renewal, replacement, debt service and investment.

The college and university fund types are accounted for on the accrual basis of accounting with the following exceptions:

A. Depreciation expense related to plant fund assets is not recorded; and
B. Revenues and expenditures of an academic term encompassing more than one fiscal year are solely reported in the fiscal year in which the term is predominantly conducted.

D. Proprietary Activity Accounting and Financial Reporting - Activities accounted for in the state's proprietary, non-expendable trust and pension trust funds and proprietary type component units follow all applicable GASB pronouncements as well as applicable private sector pronouncements issued on or before November 30, 1989.

E. College and University Accounting and Financial Reporting Model - The state uses the AICPA college guide model for accounting and reporting guidance for its colleges and universities, which are presented as component units-discrete.

F. Budgetary Process - Legislation requires the Governor to present his proposed budget to the General Assembly at the beginning of each annual session. Annual budgets are adopted for the general and special revenue funds, except the Supreme Court Boards, Fraud and Economic Crime and Dairy Promotion Board (accounted for as Special Revenue Funds). The General Assembly enacts the budget through passage of specific departmental appropriations, the sum of which may not exceed estimated revenues. Before signing the Appropriations Act, the Governor may veto or reduce any specific appropriation, subject to legislative override. Once passed and signed, the budget becomes the state's financial plan for the coming year.

Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes or intradepartmental transfers of an administrative nature, may be affected with certain executive and legislative branch approval. Only the legislature, however, may transfer appropriations between departments.

Unencumbered appropriations lapse at the end of each fiscal year, with the encumbered appropriations being carried forward to the next year. In order to provide sufficient funding for several programs during the year, supplemental appropriations of $7.62 million were required.

The state's annual budget is prepared on the modified accrual basis of accounting with several exceptions, principally the effect of encumbrance and contract obligations. Because these exceptions represent departures from generally accepted accounting principles (GAAP), actual amounts in the accompanying budgetary comparison statement are presented on the budgetary basis. A reconciliation of the differences between the budgetary and GAAP basis is presented in Note 2B. The budgetary comparison statement includes the General Fund and all budgeted Special Revenue Funds.

G. Cash and Cash Equivalents - This classification includes demand accounts, petty cash and monies in cash management pools. The liquidity of the cash management pools is sufficient to cover any withdrawal request by a participant. This classification also includes short-term investments with a maturity date within three months of the date acquired by the state. These short-term investments are stated at cost or amortized cost which at June 30, 1997 approximated market; with the exception of the Pension Fund which is stated at fair value. Collateral, as required by law, is pledged by the various banks and government securities dealers to guarantee state funds placed with them. It is the state's policy to include cash management pools as cash. In addition, all securities whose primary purpose is to facilitate the placement of funds in long-term investment vehicles are classified as investments.

H. Investments - This classification includes long-term investments which are stated at cost or amortized cost. Debt securities included in this classification are expected to be held to maturity and redeemed at face value. Investments in the Deferred Compensation Fund are valued at market.

Investments in the Pension Fund 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. Investments that do not have an established market are reported at estimated fair values. Investment income consists of realized and unrealized appreciation in the fair value of investments. Interest income is recognized when earned. Securities and security transactions are recorded in the financial statements on trade-date basis.

I. Receivables - Receivables in the state's governmental and fiduciary funds primarily consist of taxes, interest, departmental services and federal revenues, recorded when earned. The remaining governmental fund revenues are not considered susceptible to accrual prior to receipt; accordingly, licenses, fees, fines, permits and similar revenues are recognized on the cash basis. Certain Trust Fund receivables, representing taxes and benefits overpayments, have been reduced by an allowance for uncollectibles. Receivables in all other funds have arisen in the ordinary course of business. College and University receivables have also been reduced by an uncollectible allowance.

J. Interfund Transactions - The state basically has four types of interfund transactions, as follows:

1. Services rendered and employee benefit contributions. These transactions are accounted for as revenues, expenditures or expenses in the funds involved.
2. Operating appropriations/subsidies. These are accounted for as operating transfers in the funds involved.
3. Equity contributions. These are accounted for as equity transfers (additions to or deductions from beginning governmental fund balances or proprietary fund contributed capital).
4. College and university interfund borrowings. These transactions represent borrowings of a temporary nature and are reported as assets of the college and university fund making the advance and as liabilities of the fund receiving the advance.

The composition of the state's due to/from other funds at June 30, 1997 is presented in Note 2E.

K. Advances to Other Funds - Noncurrent portions of long-term interfund loan receivables are reported as advances and are offset equally by a fund balance reserve account which indicates that they do not constitute expendable available financial resources and therefore are not available for appropriation.

L. Inventories - Inventories of materials and supplies are determined by physical count and are valued at cost, principally using the first-in/first-out (FIFO) method. The average cost method is used for the Highway Fund (a Special Revenue Fund) and Motor Vehicle Management (an Internal Service Fund). The costs of governmental fund-type inventories are recorded as expenditures when consumed rather than when purchased.

M. Fixed Assets and Depreciation - General fixed assets are presented in the accompanying financial statements at cost or estimated historical cost. Donated fixed assets are stated at fair market value at the time of donation. Interest during construction has not been capitalized. Also, certain public domain fixed assets (including highways, bridges, highway lands and rights-of-way) are not capitalized. No depreciation is provided on general fixed assets.

Enterprise, Internal Service and Nonexpendable Trust Fund fixed assets are stated at cost or estimated historical cost. Donated fixed assets are stated at fair market value at the time of donation. They are being depreciated principally on a straight-line basis over estimated useful lives ranging from 20 to 50 years for Structures and Improvements and 5 to 10 years for Machinery and Equipment. It is the state's policy to capitalize interest expense incurred on significant assets during their construction.

A statement of changes in general fixed assets for the year ended June 30, 1997 is presented in Note 2A.

Generally, College and University component units fixed assets are stated at cost and are not depreciated. Donated fixed assets are stated at fair market value at the time of donation. Because of the magnitude of library holdings, however, it has been the state's policy to value library books at a standard amount per volume, currently $48, which approximates cost.

N. Accumulated Unpaid Vacation and Sick Pay - The state's liability for accumulated unpaid annual and compensatory time is reported in the accompanying General Long-Term Obligations Account Group for all governmental fund types. In the proprietary fund types and the college and university fund types, this obligation is reported as a fund liability.

There is no liability in the accompanying financial statements for unpaid accumulated sick leave since it is the state's policy to record the cost of sick leave only when paid. This contingency amount is disclosed in Note 8A.

O. Fiscal Year End - The fiscal year end of the primary government and component units is June 30, except for the following agencies reported as Special Revenue funds: Supreme Court Boards and Dairy Promotion Board. Both of these organizations have a December 31 year end. TN 200, Inc. and Woman's Suffrage, component units, also have a December 31 year end.

P. Fund Balance Reserves and Designations - The state's fund balance reserves represent those portions of fund balance (1) not appropriable for expenditure or (2) legally segregated for a specific future use. In the accompanying Combined Balance Sheet, reserves for related assets such as inventories, petty cash, advances, long-term receivable, and prepayments are examples of the former. Reserves for encumbrances, contracts, continuing appropriations and other specific purposes are examples of the latter. The state's fund balance designations reflect tentative plans for future use of financial resources. The General Fund designation for revenue fluctuations, has been established as protection in the event of future revenue shortfalls or expenditure overruns.

Q. Totals (Memorandum Only) - Total columns on the general-purpose financial statements are captioned "memorandum only" to indicate that they are presented only to facilitate financial analysis. Data in these columns do not present financial position, results of operations or cash flows in conformity with generally accepted accounting principles. Neither are such data comparable to a consolidation. Interfund eliminations have not been made in the aggregation of this data.

R. Comparative Data - Comparative total data for the prior year have been presented in the accompanying financial statements in order to provide an understanding of changes in the government's financial position and operations. However, comparative data have not been presented in all statements because their inclusion would make certain statements unduly complex and difficult to understand.

NOTE 2 - OTHER ACCOUNTING DISCLOSURES

A. General Fixed Assets - A statement of changes in general fixed assets for the year ended June 30, 1997 is shown below (expressed in thousands).

	Land	Structures and Improvements	Machinery and Equipment	Construction in Progress	Totals
Balance, July 1, 1996	$137,085	$1,036,005	$323,210	$ 13,369	$ 1,509,669
Additions	8,391	57,058	72,762	59,828	198,039
Deductions	(738)	(36,224)	(42,829)	(17,505)	(97,296)
Balance, June 30, 1997	$144,738	$1,056,839	$353,143	$ 55,692	$1,610,412

B. Budgetary Basis vs. GAAP - The accompanying Combined Statement of Revenues, Expenditures and Changes in Fund Balances - Budget and Actual - General Fund and All Budgeted Special Revenue Fund Types presents comparisons of the legally adopted budget with actual data on a budgetary basis. Since the budgetary and GAAP presentations of actual data differ, a reconciliation of the two is presented below (expressed in thousands).

	General Fund	All Special Revenue Funds
Fund Balances (Budgetary Basis), June 30, 1997	$ 341,034	$ 150,061
Add:		
Reserve for encumbrances and contracts	4,578	163,506
Highway construction appropriations carried forward		101,784
Unbudgeted Supreme Court Boards		2,122
Unbudgeted Fraud and Economic Crime		1,318
Unbudgeted Dairy Promotion Board		1
Fund Balances (GAAP Basis), June 30, 1997	$ 345,612	$ 418,792

C. Fund Equity Restatement During fiscal year 1997, the State implemented a new pension reporting standard. This standard required the valuation of investments at fair value and the restatement of prior years. The Special Revenue

Funds were restated for a change in reporting entity, Fraud and Economic Crime and two more Supreme Court Boards were added to the reporting entity. In addition, Facilities Revolving Fund, an Internal Service Fund, beginning fund equity was restated to correct for a prior year error in recording assets and liabilities. The Office for Information Resources, an Internal Service Fund, beginning equity was restated to correct for a prior year error in recording assets.

This change has been reported in the accompanying financial statements by restating beginning fund equity as shown below (expressed in thousands):

	Special Revenue Fund	Internal Service Fund	Pension Trust	Totals Primary Government	Totals Reporting Entity
Fund Equity and other credits as Previously Reported June 30, 1996	$ 400,642	$ 304,667	$ 14,738,658	$ 18,544,649	$ 22,331,336
Reporting Entity Change	2,311			2,311	2,311
Error in Recording Liabilities		(8,709)		(8,709)	(8,709)
Error in Recording Assets		6,813		6,813	6,813
Restatement of Pension Trust Fund Assets at fair value			1,333,519	1,333,519	1,333,519
Fund Equity and other credits as Restated June 30, 1996	$ 402,953	$ 302,771	$ 16,072,177	$ 19,878,583	$ 23,665,270

The effect of the change in reporting entity, reporting errors and new reporting standard on excess of revenue and other sources over (under) expenditures and other uses for the special revenue funds; income before extraordinary item and net income for the internal service fund; and net increase in assets held for pension benefits; is as follows (expressed in thousands):

	Special Revenue Funds 1996
Effect On:	
Excess of Revenue and Other Sources Over (Under) Expenditures and Other Uses	$378

	Internal Service Funds 1996
Effect On:	
Income Before Extraordinary Item and Net Income	($632)

	Pension Trust Fund 1996
Effect On:	
Net Increase in Assets Held for Pension Benefits	$211,606

In addition, the Capital Projects Fund had a prior period adjustment where assets and liabilities were both overstated by some $25.1 million. This change had no effect on fund balance or excess of revenues over expenditures.

D. Segment Information - Segment financial information for the state's Enterprise Funds for the year ended June 30, 1997, is presented below (expressed in thousands). These enterprise funds provide the following types of goods or services (in the order shown below): Sewage treatment loans, sewage treatment facilities loans, energy loans, insurance, insurance, and property distribution.

	State Loan Program	Sewer Treatment Loan	Energy Loan Program
Operating Revenues	$ 1,564	$ 9,874	$ 623
Depreciation and Amortization			
Operating Income (Loss)	(25)	9,874	623
Operating Grants, Entitlements, and Shared Revenues		836	1,262
Operating Transfers In			
Operating Transfers Out to Component Units	25		
Net Income (Loss)	(50)	9,874	1,885
Current Capital Transfers		31,417	
Equity Transfers In		3,435	
Property, Plant and Equipment:			
Additions			
Deletions			
Net Working Capital	2,807	70,880	9,521
Total Assets	34,481	267,089	13,844
Bonds and Other Long-Term Liabilities Payable from Operating Revenues	26,614		
Total Equity	4,018	266,918	13,686

Teacher Group Insurance	Local Government Group Insurance	Property Utilization	Totals
$ 94,056	$ 34,367	$ 1,586	$ 142,070
		4	4
(10,800)	6	(95)	(417)
			2,098
		1	1
			25
(9,671)	583	(94)	2,527
		12	31,429
			3,435
		19	19
		11	11
1,439	5,000	262	89,909
20,226	10,258	444	346,342
			26,614
1,439	5,000	278	291,339

E. Due To/Due From Other Funds - A summary of due from other funds and due to other funds at June 30, 1997 is shown below (expressed in thousands).

	DUE FROM OTHER FUNDS						
		Special Revenue			Internal Service	Trust and Agency Funds	
DUE TO OTHER FUNDS	General Fund	Highway	Wildlife Resources Agency	Capital Projects Fund	Legislative Services	Employment Security	Local Government Investment
General					$ 1	$ 92	$ 434
Special Revenue:							
Education Trust	$ 221,263						34
Highway							18
Wildlife Resources Agency							
Solid Waste							
Hazardous Waste							
Underground Storage Tanks							
Driver Education							
Salvage Title Enforcement							
Drycleaner's Environmental Response							
Tennessee Regulatory Authority							
Enterprise:							
Property Utilization							
Internal Service:							
Office for Information Resources							
Motor Vehicle Management							
General Services Printing							
Facilities Revolving Fund	350						
Food Services							
Postal Services	920						
Purchasing							
Central Stores	240						
Records Management							
Trust and Agency:							
Local Government Investment				$ 867			
Employee Flexible Benefits	49	$ 12	$ 2				
Chairs of Excellence	35						
Totals	$ 222,857	$ 12	$ 2	$ 867	$ 1	$ 92	$ 486

DUE FROM OTHER FUNDS

Trust and Agency Funds

	Employee Flexible Benefits	Academic Scholars	Pension Trust	Contingent Revenue	Deferred Compensation	Totals
			$ 2,354	$ 4,924	$ 84	$ 7,889
			73	157	4	221,531
			340	715	12	1,085
			50	108	2	160
			2	4		6
			6	13		19
			7	15		22
				1		1
			2	1		3
			1	1		2
	$ 1		8	18		27
			2	4		6
	1		34	70		105
			3	5		8
			4	7		11
						350
				1		1
			4	7		931
			4	8		12
			1	3		244
			1	3		4
						867
						63
		$ 3,721				3,756
	$ 2	$ 3,721	$ 2,896	$ 6,065	$ 102	$ 237,103

F. Due to Primary Government From Component Units - A summary of due to the primary government from the component units at June 30, 1997 is shown below (expressed in thousands).

	DUE FROM COMPONENT UNITS					
			Enterprise Funds	Internal Service Funds		
DUE TO PRIMARY GOVERNMENT	General	Capital Projects	Property Utiliz.	Office for Information Resources	Motor Vehicle Management	Facilities Revolving Fund
TN Student Assistance Corporation						
Northeast CSA	$ 306			$ 8		
East TN CSA	21			108		
Upper Cumberland CSA	135			4		
Southeast CSA	190			6		
Mid-Cumberland CSA	24			42		
South Central CSA	113					
Northwest CSA	74			8		
Southwest CSA	301			13		
Knox Co. CSA	27			4		
Shelby Co. CSA	179			9		
Hamilton Co. CSA	201					
Tennessee Housing Development Agency	120					
Veteran's Nursing Home	316					
Board of Regents	533	$ 992	$ 1	434	$ 17	$ 7
University of Tennessee	9		1	6	1	36
Totals	$ 2,549	$ 992	$ 2	$ 642	$ 18	$ 43

DUE FROM COMPONENT UNITS

Trust and Agency Funds					
Employment Security	Chairs of Excellence	Pension Trust	Contingent Revenue	Deferred Compensation	Totals
		$ 2	$ 5		$ 7
$ 1					315
2		14			145
		6			145
		6			202
		20			86
					113
		12			94
					314
1					32
1		28			217
					201
		11	23		154
5					321
		1,752		$ 40	3,776
	$ 366	1,892		2	2,313
$ 10	$ 366	$ 3,743	$ 28	$ 42	$ 8,435

G. Due From Primary Government To Component Units - A summary of due to the component units from the primary government at June 30, 1997 is shown below (expressed in thousands).

DUE FROM PRIMARY GOVERNMENT	DUE TO COMPONENT UNITS: General	Special Revenue Education	Capital Projects	Local Govt. Group Insur.	Local Gov't. Invest. Pool	Chairs of Excellence	Totals
TN Student Assistance Corporation	$ 46,978	$ 1,434					$ 48,412
Northeast CSA	501				$ 798		1,299
East TN CSA	279				757		1,036
Upper Cumberland CSA	1				385		386
Southeast CSA					676		676
Mid-Cumberland CSA	242			$ 2	272		516
South Central CSA	114				566		680
Northwest CSA	95				558		653
Southwest CSA				1	1,324		1,325
Davidson County CSA	276				321		597
Knox County CSA	46				126		172
Shelby County CSA	31				686		717
Hamilton County CSA	64				354		418
Certified Cotton Growers	75						75
TN Housing Development Agency	33,318						33,318
TN Local Development Authority	15,355						15,355
Grain Indemnity	3,365						3,365
Veteran's Nursing Home	77				946		1,023
Child Care Loan Program	615						615
Tennessee State School Bond Authority	11,348						11,348
Tennessee Board of Regents					189,019	$ 886	189,905
University of Tennessee			$ 411			913	1,324
Total	$ 112,780	$ 1,434	$ 411	$ 3	$ 196,788	$ 1,799	$313,215

H. Due to Component Units From Component Units - A summary of due to the component units from component units at June 30, 1997 is shown below (expressed in thousands).

	DUE TO COMPONENT UNITS						
DUE FROM COMPONENT UNITS	Southeast CSA	Northwest CSA	Shelby Co. CSA	TN State School Bond Authority	Board of Regents	University of Tennessee	Totals
Northeast CSA	$ 3						$ 3
East TN CSA	3						3
Upper Cumberland CSA	1						1
Southeast CSA			$ 1				1
Mid-Cumberland CSA	1						1
South Central CSA	3						3
Northwest CSA	1						1
Southwest CSA	1	$ 2					3
Davidson Co. CSA	1						1
Knox Co. CSA	3						3
Shelby Co. CSA	3						3
Hamilton Co. CSA	1						1
TN State School Bond Authority					$ 6,069	$ 15,779	21,848
Board of Regents				$ 1,828			1,828
University of Tennessee				753			753
Totals	$ 21	$ 2	$ 1	$ 2,581	$ 6,069	$ 15,779	$ 24,453

I. Advances -

The General Fund has an advance of $200 thousand to a component unit, the Veterans' Nursing Home. The Veterans' Nursing Home is to repay the advance out of profits generated.

The Local Government Investment Pool, an Expendable Trust Fund, has an advance to Baccalaureate Education, an Expendable Trust Fund, for $528 thousand. Baccalaureate Education is to repay this from administrative fees.

Tennessee State School Bond Authority has made the following advances to other component units (expressed in thousands):

	Advances from Component Units
Tennessee Board of Regents	$ 65,370
University of Tennessee	242,350
	$ 307,720

These advances are due in varying amounts annually and are sufficient to pay the debt service on the bonds and notes payable that the Tennessee State School Bond Authority has issued.

J. Accounts and Notes Receivable - Receivables at June 30, 1997 consist of the following (expressed in thousands):

	General	Special Revenue	Debt Service	Capital Projects	Enterprise	Internal Service	Trust and Agency	Total
Accounts Receivable:								
Interest	$ 16,358				$ 23		$176,051	$ 192,432
Taxes	332,338	$ 303,531	$ 2,916				151,888	790,673
Accounts	9,880	245			4,697	$ 4,474	121,570	140,866
Intergovernmental	447,984	96,811		$ 2,324	229,803	924	56,407	834,253
Gross Accounts Receivable	806,560	400,587	2,916	2,324	234,523	5,398	505,916	1,958,224
Less: Allowance for Uncollectibles							(21,945)	(21,945)
Net Accounts Receivable	$806,560	$ 400,587	$ 2,916	$ 2,324	$ 234,523	$ 5,398	$483,971	$1,936,279

Component Units

	Tennessee Student Assistance Corporation	Tennessee Housing Development Agency	Tennessee Local Development Authority	Board of Regents	University of Tennessee	Other	Total
Accounts Receivable:							
Interest	$ 211	$ 21,902	$ 277	$ 2,411	$ 3,843		$ 28,644
Accounts	12,580	1,256,032	89,987	45,663	182,430	$ 2,408	1,589,100
Intergovernmental	4,326	108					4,434
Gross Accounts Receivable	17,117	1,278,042	90,264	48,074	186,273	2,408	1,622,178
Less: Allowance for Uncollectibles				(5,448)	(47,407)		(52,855)
Net Accounts Receivable	$ 17,117	$ 1,278,042	$ 90,264	$ 42,626	$ 138,866	$ 2,408	$ 1,569,323
Notes Receivable	$ 5,553			$ 25,582	$ 31,337		$ 62,472
Less: Allowance for Uncollectibles				(5,846)	(1,216)		(7,062)
Net Notes Receivable	$ 5,553			$ 19,736	$ 30,121		$ 55,410

K. Fund Balance Reserves and Designations - Specific purpose reserves represent current and past legislative appropriations requiring year-end segregation. A summary of the nature and purpose of these reserves at June 30, 1997 by fund type follows (expressed in thousands).

Reserved for Other Specific Purposes	General	Special Revenue	Trust and Agency
Highway Construction		$101,784	
Wildlife Resources Program		29,555	
Criminal Injuries Compensation		45,444	
Solid Waste		6,540	
Environmental Protection		12,879	
Hazardous Waste Program		7,831	
Parks Acquisition		13,248	
Underground Storage Tanks		6,732	
Unemployment Compensation Benefits			$ 912,030
Pension Benefits			18,519,341
Higher Education Chairs of Excellence			153,602
Civil Defense Disaster Relief	$ 418		
Health Access Incentive	804		
Commerce and Insurance Regulatory Boards	3,157	2,496	
Health Regulatory Boards	1,888		
Traumatic Brain Injury	1,228		
Sports Authority	3,682		
Other Non-Lapsing and Special Revenue Programs	4,088	14,829	2,888
Totals	$ 15,265	$241,338	$19,587,861

The General Fund designation for other specific purposes represents the following appropriations made by the Legislature to carry out tentative managerial plans for fiscal year 1998 (expressed in thousands):

Future Appropriations	$ 80,646
Casualty Losses	5,000
Industries for the Blind	132
	$ 85,778

The reserve for related assets represents assets which are not available for appropriation. A summary of these reserves at June 30, 1997 by fund type follows (expressed in thousands).

Reserved for Related Assets	General	Special Revenue
Inventories		$ 6,067
Advances to Component Units	$ 200	
Long-Term Receivables	2,346	
Prepayments	14	8
	$ 2,560	$ 6,075

L. Related Organizations - The State's officials are also responsible for appointing the members of the boards of other organizations, but the State's accountability for these organizations does not extend beyond making appointments. The State appoints the board members of the Beech River Watershed Development Authority, Carroll County Watershed Authority, Goodwyn Institute Commission, Watkins Institute Commission, Tennessee Alliance for Fitness and Health, Tennessee Competitive Export Corporation, Insurance Guaranty Association, Tennessee Sports Hall of Fame, Judicial Evaluation Committee, Local Neighborhood Development Corporations and Sports Festival, Inc.

M. Joint Ventures -The State is a participant in a joint venture, the Tennessee-Tombigbee Waterway Development Compact, with the states of Alabama, Kentucky and Mississippi. The purpose of this compact is to promote the development of a navigable waterway connecting the Tennessee and Tombigbee Rivers and provide a nine foot wide navigable channel. The fiscal year end of the Tennessee Tombigbee Waterway is December 31. Tennessee provides the Tennessee-Tombigbee Waterway with an annual grant of $40,000. Financial statements for the Tennessee Tombigbee Waterway may be obtained at: P. O. Drawer 671, Columbus, MS 39703.

Presented below is summary financial data for this joint venture (expressed in thousands):

	1996	1995
Current Assets	$ 203	$ 205
Property Plant & Equipment	19	19
Total Assets	222	224
Current Liabilities	11	7
Investment in General Fixed Assets	19	19
Fund Balance	192	198
Total Liabilities and Fund Balance	222	224
Revenues	295	272
Expenditures	301	270
Excess of Revenues over (under) expenditures	(6)	2
Beginning Fund Balance	198	196
Ending Fund Balance	$ 192	$ 198

N. Jointly Governed Organizations - The State in conjunction with 26 other states are members of the Pest Control Compact.

The State in conjunction with 13 other states are members of the Southern Growth Policies Board. Tennessee paid some $40,917 in fiscal year 1997 for membership dues.

The Southern Regional Education Compact was entered into with 14 other states. Tennessee paid $6,000 in dues in fiscal year 1997.

The Compact for Education was entered into with 49 other states. Tennessee paid an annual assessment of $54,400.

The Interstate Mining Compact has 18 member states, including Tennessee. Tennessee paid $8,716 in fiscal year 1997 for membership dues.

The Southern States Energy Board is comprised of 16 member states, including Tennessee.

The Southeast Interstate Low Level Radioactive Waste Compact has 7 member states.

O. Presented below are the condensed financial statements for the discretely presented component units (expressed in thousands):

CONDENSED FINANCIAL STATEMENTS - DISCRETELY PRESENTED COMPONENT UNITS

BALANCE SHEETS

	Tennessee Student Assistance Corporation	Tennessee Housing Develop. Agency	Tennessee Local Develop. Authority	Tennessee State School Bond Authority	Tennessee Board of Regents	University of Tennessee	Other	Total
Assets:								
Current Assets	$ 22,670	$ 404,847	$ 4,917	$ 1,232	$ 87,819	$ 447,520	$ 4,355	$ 973,360
Due from Primary Government	48,412	33,318	15,355	11,348	189,905	1,324	13,553	313,215
Due from Component Units				21,848	1,828	753	24	24,453
Advance to Component Units				307,720				307,720
Other Assets		1,648,805	103,867	49,157	130,704	271,362	725	2,204,620
Fixed Assets	139	130			1,773,002	1,761,522	12,884	3,547,677
Amounts to be Provided	80						993	1,073
Total Assets	$ 71,301	$ 2,087,100	$ 124,139	$ 391,305	$2,183,258	$ 2,482,481	$ 32,534	$7,372,118
Liabilities:								
Current Liabilities	$ 5,975	$ 78,734	$ 35,312	$ 46,069	$ 190,996	$ 163,899	$ 7,167	$ 528,152
Due to Primary Government	7	154			3,776	2,313	2,185	8,435
Due to Component Units				2,581	6,069	15,779	24	24,453
Bonds Payable		1,725,976	79,391	337,233	2,272		5,305	2,150,177
Advance From Primary Government							200	200
Advance from Component Units					65,370	242,350		307,720
Total Liabilities	5,982	1,804,864	114,703	385,883	268,483	424,341	14,881	3,019,137
Equity:								
Investment in General Fixed Assets	139				1,696,741	1,500,053	1,848	3,198,781
Contributed Capital		2,500					4,541	7,041
Retained Earnings		279,736	9,436	5,422			7,362	301,956
Fund Balances	65,180				218,034	558,087	3,902	845,203
Total Equity	65,319	282,236	9,436	5,422	1,914,775	2,058,140	17,653	4,352,981
Total Liabilities and Equity	$ 71,301	$ 2,087,100	$ 124,139	$ 391,305	$2,183,258	$2,482,481	$ 32,534	$7,372,118

STATEMENTS OF REVENUES, EXPENDITURES, AND CHANGES IN FUND BALANCES

	Tennessee Student Assistance Corporation	Other	Total
Revenues	$ 20,678	$ 4,755	$ 25,433
Expenditures:			
Current	29,292	41,519	70,811
Transfers From Primary Government	19,472	39,256	58,728
Excess of Revenues and Other Financing Sources Over (Under) Expenditures	10,858	2,492	13,350
Fund Balances, July 1	54,322	1,419	55,741
Equity Transfer to Primary Government		(9)	(9)
Fund Balances, June 30	$ 65,180	$ 3,902	$ 69,082

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN EQUITY

	Tennessee Housing Develop. Agency	Tennessee Local Develop. Authority	Tennessee School Bond Authority	Other	Total
Operating Revenues	$ 145,231	$ 7,554	$ 22,038	$ 8,978	$183,801
Operating Expenses	116,162	6,811	21,342	8,058	152,373
Operating Income (Loss)	29,069	743	696	920	31,428
Non-Operating Revenues (Expenses)	4,854			(163)	4,691
Transfers From Primary Government		25			25
Transfer (to) Primary Government				(149)	(149)
Extraordinary Items	(165)				(165)
Net Income (Loss)	33,758	768	696	608	35,830
Fund Equity, July 1	248,478	8,668	4,726	11,295	273,167
Fund Equity, June 30	$ 282,236	$ 9,436	$ 5,422	$ 11,903	$ 308,997

STATEMENTS OF CURRENT FUNDS REVENUES, EXPENDITURES AND OTHER CHANGES

	Tennessee Board of Regents	University of Tennessee	Total
Revenues	$ 554,349	$ 854,567	$ 1,408,916
Expenditures:			
Education and General	992,794	783,286	1,776,080
Auxiliary Enterprise and Hospital	63,681	397,006	460,687
Transfers To Other Colleges and University Funds	(20,110)	(48,005)	(68,115)
Transfers From Primary Government	522,509	366,947	889,456
Other Additions (Deductions)	(1,118)	9,152	8,034
Net Increase (Decrease) in Fund Balances	$ (845)	$ 2,369	$ 1,524

P. Individual Fund Deficits - The following individual funds have deficit retained earnings/fund balances at June 30, 1997 (expressed in thousands):

Capital Projects	$ (35,075)
Enterprise Funds:	
Property Utilization	$ (1,505)
Internal Service Funds:	
Food Services	$ (1,271)
Central Stores	$ (45)
Trust and Agency Funds:	
Baccalaureate Education	$ (501)
Component Units:	
Child Care Facilities	$ (208)
University of Tennessee	
Unrestricted	$ (435)
Unexpended Plant	$ (10,404)

The deficit in the capital projects fund will be eliminated as the State sells general obligation bonds to finance the various construction contracts encumbered. Increases in fees and charges for services and products are expected to eliminate the deficits in the other funds in fiscal years 1998 and beyond.

NOTE 3 - NOTES AND BONDS PAYABLE

A. Bonds Payable - Bonds Payable at June 30, 1997 are shown below (expressed in thousands).

	Bonds
Enterprise Funds:	
General obligation bonds, 5.0% to 7.5%, due in generally decreasing amounts of principal and interest ranging from $2.6 million in 2002 to $719 thousand in 2006	$ 15,565
General obligation refunding bonds, 1996 Series C, 4.6% to 5.0% principal and interest due in amounts ranging from $1.8 million in 1999 to $986 thousand in 2010	13,929
Total Enterprise Funds	29,494
Internal Service Funds:	
General obligation bonds, 4.3% to 7.0%, due in decreasing amounts of principal and interest from $15.2 million in 1998 to $.791 million in 2017	128,550
General obligation refunding bonds, 1996 Series B, 4.6% to 6% principal and interest due in amounts ranging from $2.1 million in 1998 to $8 thousand in 2011	14,747
Total Internal Service Funds	143,297
General Long-Term Debt:	
General obligation bonds, 4.3% to 7.0%, due in decreasing amounts of principal and interest from $70.0 million in 1998 to $1.7 million in 2019	590,695
General obligation refunding bonds, 1991 Series A, 5.8% to 6.375% principal and interest due in amounts ranging from $6.8 million in 1998 to $5.6 million in 2002	26,125
General obligation refunding bonds, 1996 Series B, 4.6% to 6% principal and interest due in amounts ranging from $21.7 million in 2002 to $3.9 million in 2011	150,278
Total General Long-Term Debt	767,098
Total Bonds Payable	$ 939,889

Bond sales during the year ended June 30, 1997 included the following issue:

May 1997 - General obligation bonds of $197.805 million.

The May 1997 $197.805 million general obligation bond issue above represents $183.635 million of bonds maturing serially through 2017 at interest rates ranging from 4.40% to 6.0%; $8.030 million in term bonds maturing in 2023 at a 5.5% interest rate; and $6.140 million in term bonds maturing in 2027 at a 5.5% interest rate.

In prior years, the state defeased certain general obligation bonds by placing the proceeds of new bonds in an irrevocable trust to provide for all future debt service payments on the old bonds. Accordingly, the trust account assets and liability for the defeased bonds are not included in the General Long-Term Debt Account Group. However, since the State Treasurer is holding these monies in a trustee capacity, the assets and an offsetting liability are reported in an agency fund. As of June 30, 1997, $73 million of bonds outstanding are considered defeased.

B. Notes Payable - Notes payable at June 30, 1997 are shown below (expressed in thousands).

	Notes
General Long-Term Debt:	
General Obligation bond anticipation notes, variable rate, due July 2001	$ 114,885
Internal Service Funds:	
General Obligation bond anticipation notes, variable rate, due July 2001	35,215
Total Notes Payable	$ 150,100

The full faith and credit of the state, together with certain tax revenues, are pledged to secure all general obligation bonds and bond anticipation notes listed above. Although the Enterprise (State Loan Program) and Internal Service Fund (Facilities Revolving Fund, Office of Information Resources, Motor Vehicle Management, and Equipment Revolving Fund) general obligation debt is being retired from resources of those funds, the state remains contingently liable for its payment.

C. Debt Service Requirements to Maturity - It is the state's intention to retire substantially all notes payable at June 30, 1997 within one year. Debt Service requirements to maturity for all general obligation bonds payable at June 30, 1997 are as follows (expressed in thousands):

For the Year(s) Ended June 30	General Obligation Bonds Principal	General Obligation Bonds Interest	Total Requirements
1998	$ 67,680	$ 50,215	$ 117,895
1999	67,690	46,679	114,369
2000	68,095	43,178	111,273
2001	65,915	39,656	105,571
2002	65,910	36,084	101,994
2003-2007	286,093	129,321	415,414
2008-2012	196,286	61,975	258,261
2013-2017	109,020	17,268	126,288
2018-2022	5,720	3,036	8,756
2023-2027	7,480	1,278	8,758
	$939,889	$428,690	$ 1,368,579

D. Changes in General Long-Term Obligations - A summary of changes in general long-term obligations for the year ended June 30, 1997 follows (expressed in thousands).

	Balance, July 1, 1996	General Obligation Debt Issued	General Obligation Debt Retired	Other Changes in General Long-Term Obligations	Balance, June 30, 1997
General Obligation Bonds Payable	$ 634,662	$ 182,737	$ (50,301)		$ 767,098
General Obligation Notes Payable	77,358	154,957	(112,061)	$ (5,369)	114,885
Claims Payable	75,669			24,430	100,099
Accrued Annual and Compensatory Leave	113,507			10,053	123,560
Lease Obligation Payable				631	631
Total General Long Term Obligations	$ 901,196	$ 337,694	$ (162,362)	$ 29,745	$1,106,273

The $100.099 million above for Claims Payable represents the long-term obligation of $62.943 million for Underground Storage Tanks, a Special Revenue Fund; $16.138 million for the Highway Fund right-of-way litigation, also a special revenue fund; and $21.018 million payable from the General Fund.

The "Other Change" in notes payable above is due to $5.369 million being reported in error as a General Long Term liability in the prior year. This is reported as a correction of a prior period error in the Facilities Revolving Fund, an Internal Service Fund.

Some $15.068 million in bonds payable and $.89 million in notes payable were issued to finance construction projects for facilities owned by the Facilities Revolving Fund, an Internal Service fund. These notes payable and bonds payable are reported as a liability of the Facilities Revolving Fund as the Facilities Revolving Fund will be responsible for paying the debt service. These contruction projects were managed by the Capital Projects Fund.

E. General Obligation Bonds Authorized and Unissued - A summary of general obligation bonds authorized and unissued at June 30, 1997 is shown below (expressed in thousands). It is anticipated that a significant amount of these bonds will not be issued but will be canceled because of sufficient fund balances.

Purpose	Unissued July 1, 1996	Authorized	Sold	Canceled	Unissued June 30, 1997
Highway	$ 813,900	$ 75,000		$ 162,800	$ 726,100
Education	105,284		$ 57,628		47,656
Correction	1,600		1,600		0
Environment and Conservation	83,118		100		83,018
General Government	581,451	60,800	138,248	21,500	482,503
Other	2,102		229	500	1,373
Totals	$ 1,587,455	$ 135,800	$ 197,805	$ 184,800	$ 1,340,650

F. Capital Lease Obligations - Capital lease obligations are payable from resources of the General Fund. Debt Service requirements to maturity at June 30, 1997 are as follows (expressed in thousands):

For the Year(s) Ended June 30		Lease Obligation Payable
1998		$ 74
1999		74
2000		74
2001		74
2002		74
2003-2007		370
2008-2012		92
Total	832	
Less - Interest (5.1%)		201
Present value of lease payments		$631

G. Component Units -Tennessee Housing Development Agency (THDA):

Bonds Payable at June 30, 1997, are shown below (expressed in thousands):

Revenue Bonds Payable - Tennessee Housing Development Agency mortgage finance program revenue bonds, various Series, 3.75% to 8.5%, due in amounts of principal and interest ranging from $304.4 million in 1998 to $2 million in 2029	$1,727,248
Less: Unamortized bond refunding costs	1,272
Net Bonds Payable	$1,725,976

The revenue bonds listed above are not obligations of the state. They are secured by pledge of resources from the facilities to which they relate and by certain other revenues, fees and assets of the Tennessee Housing Development Agency (THDA).

Debt service requirements to maturity for these revenue bonds payable at June 30, 1997, are as follows (expressed in thousands):

For the Year(s) Ended June 30	Revenue Bonds Principal	Revenue Bonds Interest	Total Requirements
1998	$ 195,485	$ 108,910	$ 304,395
1999	51,933	98,574	150,507
2000	36,986	96,084	133,070
2001	36,909	94,797	131,706
2002	38,042	92,752	130,794
2003-2007	218,278	433,485	651,763
2008-2012	240,739	357,605	598,344
2013-2017	306,153	254,676	560,829
2018-2022	343,669	140,678	484,347
2023-2027	238,610	31,825	270,435
2028-2029	9,504	322	9,826
	$1,716,308	$1,709,708	$ 3,426,016

The above principal for revenue bonds is less than that presented on the accompanying financial statements by $10.94 million. This represents accretion to date of interest on deep discount bonds in those years preceding the first principal payment on these bonds. This accretion has been reported above as interest in the years on which the bonds mature (2000-2010).

Bond sales during the year ended June 30, 1997 included the following issues:

September 1996 - THDA program bonds of $115 million.
January 1997 - THDA program bonds of $57.885 million.
May 1997 - THDA program bonds of $115 million.

The September 1996 $115 million THDA bond issue above represents $13.535 million of bonds maturing serially through 2011 at interest rates ranging from 4.35% to 6.%, $8.975 million term bonds at 6.05% due 2016, $15.485 million term bonds at 6.375% due 2022, $16.4 million term bonds at 6.45% due 2027, and $.605 million of serial bond at 5.85% maturing in 2011, and $60 million in bonds maturing in August 1997 at 4%.

The January 1997 $57.885 million THDA bond issue above represents $57.885 million of bonds maturing in 2028 at 3.75%.

The May 1997 $115 million THDA bond issue above represents $16.490 million of bonds maturing serially through 2012 at interest rates ranging from 4.3% to 5.65%, $10.670 million term bonds at 5.85% due 2017, $18.54 million of term bonds at 5.85% due 2023, $19.3 million term bonds at 6.% due 2028, $50 million in bonds maturing in 2029 at 4%.

THDA Bonds Payable were retired at par before maturity in the year ended June 30, 1997, in the Mortgage Finance Program Bonds in the amount of $1.8 million and in the Homeownership Program Bonds in the amount of $15.745 million. The respective carrying values of these bonds were $1.79 million and $15.59 million. This resulted in a loss to the Mortgage Finance Program of $10 thousand and the Homeownership Program of $155 thousand. This loss is classified as an extraordinary loss.

On June 20, 1996, THDA issued $41.4 million in Homeownership Program Bond, the carrying amount of those bonds was $41.191 million. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $209 thousand. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2024 using the straight-line method. THDA completed the refunding to reduce its total debt service over the next 31 years by $13.2 million and to obtain an economic gain (the difference between the present value of the old and new debt service payments) of $14.652 million.

On September 19, 1996, THDA issued $115 million in Homeownership Program Bonds, of which $14.185 million was used for refunding bonds outstanding. The carrying amount of those bonds was $14.125 million. The refunding resulted in a difference of $60 thousand between the reacquisition price and the net carrying amount of the old debt. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2022 using the straight-line method. THDA completed the refunding to reduce its total debt service over the next 31 years by $7.174 million and to obtain an economic gain (the difference between the present value of the old and new debt service payments) of $12.245 million.

On February 5, 1997, THDA issued $57.885 million in Homeownership Program Bonds, which was used for refunding bonds outstanding. The carrying amount of those bonds was $57.781 million. The refunding resulted in a difference of $104 thousand between the reacquisition price and the net carrying amount of the old debt. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2022 using the straight-line method. The refunding was accomplished using proceeds of short-term bonds, which will in turn be refunded upon maturity; therefore, the full economic impact of these refundings could not be determined as of June 30, 1997.

On May 29, 1997, THDA issued $50 million in Homeownership Program Bonds, of which $29.725 will be used to refund certain bonds in the Mortgage Finance Program and Homeownership Program on July 1, 1997. The refunding was accomplished using proceeds of short-term bonds, which will in turn be refunded upon maturity; therefore, the full economic impact of these refundings could not be determined as of June 30, 1997.

Under the bond resolutions, the Agency has the option to redeem bonds at an initial price of 103 percent and subsequently at prices declining to par. Generally, the redemption option cannot be exercised prior to the time the bonds have been outstanding for ten years. Certain special redemption options, as governed by the bond resolutions, are permitted prior to that time. The bonds are secured, as described in the applicable bond resolutions, by the revenues, monies, investments, mortgage loans, and other assets in the funds and accounts established by the resolutions.

H. Component Units - Tennessee Local Development Authority (TLDA)

Bonds Payable and Notes Payable at June 30, 1997, are shown below (expressed in thousands):

Tennessee Local Development Authority revenue bonds, 2.5% to 9.4%, due in generally decreasing amounts of principal and interest from $9.6 million in 1998 to $.3 million in 2023	$79,391
Tennessee Local Development Authority revenue bond anticipation notes, $32.6 million at 3.86% due May 1998	$32,600

The revenue bonds and notes listed above are not obligations of the state. They are secured by pledge of resources from the facilities to which they relate and by certain other revenues, fees and assets of the Tennessee Local Development Authority (TLDA).

Debt Service requirements to maturity for TLDA's revenue bonds payable at June 30, 1997 are as follows (expressed in thousands):

For the Year(s)	Revenue Bonds		Total
Ended June 30	Principal	Interest	Requirements
1998	$ 4,827	$ 4,815	$ 9,642
1999	4,677	4,575	9,252
2000	4,927	4,331	9,258
2001	4,117	4,064	8,181
2002	4,352	3,832	8,184
2003-2007	19,900	15,400	35,300
2008-2012	17,813	9,717	27,530
2013-2017	11,968	4,486	16,454
2018-2022	6,315	1,210	7,525
2023-2024	495	32	527
	$ 79,391	$ 52,462	$ 131,853

I. Component Units - Tennessee State School Bond Authority (TSSBA)

Bonds and Notes Payable at June 30, 1997 are shown below (expressed in thousands).

Tennessee State School Bond Authority revenue bonds, various Series, 3.0% to 5.8%, due in decreasing amounts of principal and interest from $19.7 million in 1999 to $1 million in 2011	$ 116,631
Tennessee State School Bond Authority 1972 Refunding Revenue bonds, maturing 2005	21,890
Tennessee State School Bond Authority 1977 Refunding Revenue bonds, maturing 2011	31,149
Tennessee State School Bond Authority 1985 Tax-Exempt Exchangeable Securities, maturing to 2015	27,185
Tennessee State School Bond Authority 1987 Refunding Revenue bonds, maturing to 2012	5,250
Tennessee State School Bond Authority 1989 Current Interest and College Savings Bonds, Maturity 2020	28,838
Tennessee State School Bond Authority 1990 Series A Taxable and Series B Tax Exempt Revenue Bonds, Maturity 2011	6,395
Tennessee State School Bond Authority 1992 Series A Tax-Exempt Revenue Bonds, Maturity 2022	42,187
Tennessee State School Bond Authority 1996 Refunding Revenue Bonds, maturing to 2011	60,047
Bonds Payable	339,572
Less: Unamortized bond refunding costs	(2,339)
Net Bonds Payable	337,233
Tennessee State School Bond Authority bond anticipation notes, variable weekly demand rate, due 1998	$ 42,095

The revenue and notes bonds listed above are not obligations of the state. They are secured by pledge of resources from the facilities to which they relate and by certain other revenues, fees and assets of the Tennessee State School Bond Authority (TSSBA).

Tax-Exempt Exchangeable Securities. The $27.185 million TSSBA bond issue above represents tax-exempt exchangeable securities, maturing in 2015, at 7%, requiring increasing sinking fund payments from 1998 to 2015. On semi-annual payment dates, each holder of the 7% securities may exercise a one-time election to convert to another interest rate, not to exceed 10%, as established by an independent municipal securities evaluation service pursuant to a prescribed formula.

TSSBA Notes Payable of $104.5 million consist of monies drawn from the Bond Anticipation Notes (BANs) Program established February 24, 1993, with Prudential Securities, Incorporated, as the underwriter and remarketing agent, to fund projects under construction. Under the BANs Program, the notes will mature on March 1, 1998, and may bear interest at a variable rate (daily, weekly, monthly, quarterly, semiannually, or annually) or a fixed rate (long-term) determined by the remarketing agent for periods selected by the authority. Currently, interest is determined on a weekly basis and payable monthly. The notes are subject to purchase by the remarketing agent on the demand of the holder on any business day pursuant to the conditions established in the Note Resolution, as described in the Official Statement relating to the notes. The remarketing agent is to use its best efforts to sell the notes to another holder. If the agent is unable to resell any notes that are “put”, the standby note purchaser is required, subject to certain conditions, to purchase the notes. On June 26, 1996, the authority contracted with Union Bank of Switzerland to serve as standby note purchaser through June 25, 1997, the total available under this agreement was $106.174 million.

It is expected that a portion of the notes will be redeemed with the proceeds of the sale of bonds at the end of the construction period for the projects being financed. The commitment fee is payable quarterly in arrears, at a rate of 6 basis points for the utilized and 5 basis points for the unutilized portion of the commitment based on a 360 day year. If the Bank purchases bond anticipation notes, there is a drawing fee of $500. The interest rate on the notes while held by the Bank is the higher of the Bank's Prime Rate or Fed Funds rate plus 1% per annum. There was no acceptance fee, but the Authority paid certain expenses of the Bank in connection with the delivery of the agreement. On May 27, 1997, Union Bank of Switzerland extended the Standby Note Purchase Agreement to March 1, 1998, the expiration date of the BAN's Program. The commitment was reduced to $64.523 million to provide liquidity for the $63.810 million remaining principal authorization under the BAN's Program and interest for 34 days at 12% thereon. All fees remained the same.

Debt Service requirements to maturity for TSSBA's revenue bonds payable at June 30, 1997 are as follows (expressed in thousands):

For the Year(s) Ended June 30	Revenue Bonds Principal	Revenue Bonds Interest	Total Requirements
1998	$ 18,978	$ 19,188	$ 38,166
1999	19,739	18,417	38,156
2000	19,383	17,563	36,946
2001	17,691	16,460	34,151
2002	18,381	15,648	34,029
2003-2007	83,706	65,120	148,826
2008-2012	69,748	42,094	111,842
2013-2017	36,582	19,469	56,051
2018-2022	29,265	9,847	39,112
2023-2026	16,295	2,454	18,749
	$329,768	$226,260	$ 556,028

The above principal for revenue bonds is less than that presented on the accompanying financial statements by $7.465 million. Of this amount, $9.804 million represents accretion to date of interest on deep discount bonds in those years preceding the first principal payment on these bonds. This accretion has been reported above as interest in the years on which the bonds mature (1998-2010). In addition, $2.339 million, which is a deduction from bonds payable for the deferred amount on refundings is not reflected in above presentation.

TSSBA issued $55.3 million of revenue bonds (1996 Refunding Series B) for a current refunding which, along with an equity contribution of $3.164 million provided resources to purchase securities that were placed in an irrevocable trust to redeem $56.184 million of the 1987 Series A Bonds on November 1, 1996 and pay the costs of issuance of the bonds. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $2.47 million. This difference, reported in the accompanying financial statements as a deduction from bonds payable, is being charged to operations through the year 2011 using the straight line method. The authority completed the refunding to reduce its total debt service payments over the next 14 years by $7.3 million and to obtain an economic gain (difference between the present values of the old and new debt service payments) of $4.4 million.

The authority issued $4.045 million of revenue bonds (1996 Refunding Series C) as a crossover refunding which provided resources to purchase securities that were placed in an irrevocable trust to pay interest on the 1996 Refunding Series C Bonds until May 1, 1999 and on May 1, 1999 to redeem $3.88 million of the 1989 Current Interest Bonds maturing on May 1, 2020. Proceeds of the refunding are invested in United States Treasury Securities - State and Local Government Series maturing on certain dates and in various amounts through May 1, 1999. This issue represents an advance refunding investment through May 1, 1999, during which time both issues will be reported on the authority's financial statements. During the period prior to the defeasance, the educational institutions will continue to provide funds necessary to meet the debt service on the refunded issue. Interest earnings from the investment will be used to satisfy the debt requirements of the refunding issue to the crossover date. On the crossover date, the authority will reduce its total debt service payment over a 20 year period by $561 thousand and obtain an economic gain of $333 thousand.

The authority issued $4.4 million of revenue bonds (1996 Refunding Series D) as a crossover refunding which provided resources to purchase securities that were placed in an irrevocable trust to pay interest on the 1996 Refunding Series D Bonds until May 1, 2000 and on May 1, 2000 to redeem $4.31 million of the 1990 Series B Bonds maturing 2004-2011. Proceeds of the refunding are invested in United States Treasury Securities - State and Local Government Series maturing on certain dates and in various amounts through May 1, 2000. This issue represents an advance refunding investment through May 1, 2000, during which time both issues will be reported on the State's financial statements. During the period prior to the defeasance, the educational institutions will continue to provide funds necessary to meet the debt service on the refunded issue. Interest earnings from the investment will be used to satisfy the debt requirements of the refunding issue to the crossover date. On the crossover date, the authority will reduce its total debt service payment over an 11 year period of $414 thousand and obtain an economic gain of $269 thousand.

NOTE 4 - INSURANCE RELATED ACTIVITIES

A. Teacher Group Insurance - The Teacher Group Insurance Fund, a public entity risk pool, was established in January 1986 to provide a program of health insurance coverage for the teachers of the political subdivisions of the state. In accordance with Tennessee Code Annotated 8-27-302 all local education agencies are eligible to participate. Fund members at June 30, 1997, included 106 local education agencies and two education cooperatives, with 29,842 teachers and support personnel, and 1,448 retirees enrolled in the basic plan or a health maintenance organization. The state does not retain any risk for losses by this fund.

The Teacher Group Insurance Fund assumes responsibility for: determining plan benefits and eligibility, establishing premiums sufficient to fund plan obligations, recording and reporting financial transactions accurately, reporting enrollment to vendors, processing of claims submitted for services provided to plan participants, communicating with plan participants, and complying with appropriate state and federal law and regulation. Plan participants are required to: pay premium on time, file claims for services received, report changes in eligibility of themselves or their dependents, and insure that only eligible expenses are paid by the plan. Individuals who cancel coverage may be required to demonstrate insurability to rejoin the plan. Employers must wait twenty-four months before rejoining the plan should the employer elect to withdraw from the plan. In the case of individuals or groups rejoining the plan, a preexisting condition exclusion currently applies.

The Teacher Group Insurance Fund establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Teachers and providers have 13 months to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which are 16.5% of the prior 12 months claims. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Teacher Group Insurance Fund considers investment income in determining if a premium deficiency exists.

As discussed above, the Teacher Group Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years (expressed in thousands):

	1997	1996
Unpaid Claims at Beginning of Year	$14,001	$13,099
Incurred Claims, Provision for Insured Events of the Current Year	86,086	78,678
Total Incurred Claims Expenses	100,087	91,777
Payments	85,070	77,776
Total Unpaid Claims at End of the Year	$15,017	$ 14,001

B. Local Government Group Insurance - The Local Government Group Insurance Fund, a public entity risk pool, was established in July 1991 to provide a program of health insurance coverage for employees of local governments and quasi-governmental organizations that were established for the primary purpose of providing services for or on the behalf of state and local governments. In accordance with Tennessee Code Annotated 8-27-207 all local governments and quasi-governmental organizations described above are eligible to participate. Fund members at June 30, 1997, included 31 counties, 63 municipalities and 149 quasi-governmental organizations, with 10,737 employees and 142 retirees maintaining coverage through the basic plan or a health maintenance organization. The state does not retain any risk for losses by this fund.

The Local Government Group Insurance Fund assumes responsibility for: determining plan benefits and eligibility, establishing premiums sufficient to fund plan obligations, recording and reporting financial transactions accurately, reporting enrollment to vendors, the processing of claims submitted for services provided to plan participants, communicating with plan participants, and complying with appropriate state and federal law and regulation. Plan participants are required to: pay premium on time, file claims for services received, report changes in eligibility of themselves or their dependents, and insure that only eligible expenses are paid by the plan. Individuals who cancel coverage may be required to demonstrate insurability to rejoin the plan. Employers must wait twenty-four months before rejoining the plan should the employer elect to withdraw from the plan. In the case of individuals or groups rejoining the plan, a preexisting condition exclusion currently applies.

The Local Government Group Insurance Fund establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which are 17% of the prior 12 months claims. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Local Government Group Insurance Fund considers investment income in determining if a premium deficiency exists.

As discussed above, the Local Government Group Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years (expressed in thousands):

	1997	1996
Unpaid Claims at Beginning of Year	$ 5,618	$ 6,277
Incurred Claims, Provision for Insured Events of the Current Year	23,673	30,526
Total Incurred Claims Expenses	29,291	36,803
Payments	25,040	31,185
Total Unpaid Claims at End of the Year	$ 4,251	$ 5,618

C. Risk Management - It is the policy of the state not to purchase commercial insurance for the risks of losses for general liability, automobile liability, professional malpractice and workers' compensation. The state management believes it is more economical to manage its risks internally and set aside assets for claim settlement in its internal service fund, the Claims Award Fund (CAF). CAF services claims for risk of loss to which the state is exposed, including general liability, automobile liability, professional malpractice, and workers' compensation. All agencies and authorities of the state participate in CAF, except for the Supreme Court Boards, The Dairy Promotion Board, TN 200 (a component unit), Woman’s Suffrage (a component unit), and Certified Cotton Grower’s Organization (a component unit). CAF allocates the cost of providing claims servicing and claims payment by charging a premium to each agency based on a percentage of each organization's expected loss costs which include both experience and exposures. This charge considers recent trends in actual claims experience of the state as a whole. An actuarial valuation is performed as of each fiscal year end to determine the fund liability and premium allocation.

CAF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process does not result in an exact amount. Claims liabilities are reevaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors. At June 30, 1997 the amount of these liabilities was $53.462 million, which are discounted at 5.82%. Changes in the balances of claims liabilities during fiscal years 1996 and 1997 were as follows (expressed in thousands):

	Beginning of Fiscal Year Liability	Current Year Claims and Changes in Estimates	Claim Payments	Balance at Fiscal Year-End
1995-96	$ 55,013	$ 11,509	$ (14,912)	$ 51,610
1996-97	$ 51,610	$ 18,774	$ (16,922)	$ 53,462

At June 30, 1997, CAF held $93.9 million in cash and cash equivalents designated for payment of these claims.

The state purchases commercial insurance for real property losses above $5 million per year and surety bond coverage on the state's officials and employees. In the past three fiscal years the state has not had any claims filed with the commercial insurer. A designation for casualty losses in the amount of $5 million has been established in the General Fund to provide for any property losses other than the commercial insurance coverage.

D. Employee Group Insurance - The Employee Group Insurance Fund, an entity other than a pool, was established in 1979 to provide a program of health insurance coverage for the employees of the state with the risk retained by the state, therefore it is accounted for as an Internal Service Fund. In accordance with Tennessee Code Annotated 8-27-201 all state employees, retirees, and former employees with work related injuries are eligible to participate. Fund members at June 30, 1997, included 64,085 employees and 4,226 retirees enrolled in the Basic Plan or Health Maintenance Organization.

The Employee Group Insurance Fund establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Employees and providers have 13 months to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed periodically using actuarial and statistical techniques to produce current estimates, which are 17% of the prior 12 months claims. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Employee Group Insurance Fund considers investment income in determining if a premium deficiency exists.

As discussed above, the Employee Group Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years (expressed in thousands):

	1997	1996
Unpaid Claims at Beginning of Year	$ 33,176	$ 34,677
Incurred Claims, Provision for Insured Events of the Current Year	184,062	182,681
Total Incurred Claims Expenses	217,238	217,358
Payments	183,995	184,182
Total Unpaid Claims at End of the Year	$ 33,243	$ 33,176

E. Comprehensive Health Insurance - The Tennessee Comprehensive Health Insurance Fund, a component unit providing insurance coverage to others, was established in July 1986 to provide a program of health insurance coverage for the individuals who do not have insurance coverage in the state. In accordance with Tennessee Code Annotated 56-39-104 all individuals who had been a resident of Tennessee one year and are not eligible for other health insurance coverage were eligible to participate. Coverage for all participants was terminated on July 1, 1995, as the Pool was discontinued. The state does not retain any risk for losses in the Tennessee Comprehensive Health Insurance Fund.

The Tennessee Comprehensive Health Insurance Fund establishes claims liabilities based on estimates of the ultimate cost of claims that have been reported but not settled, and of claims that have been incurred but not reported. Individuals and providers have 13 months to file medical claims. The process used to compute claims liabilities does not necessarily result in an exact amount. Claims liabilities are recomputed quarterly using an actuary to produce current estimates. Adjustments to claims liabilities are charged or credited to expense in the period in which they are made. The Tennessee Comprehensive Health Insurance Fund considers investment income in determining if a premium deficiency exists.

As discussed above, the Tennessee Comprehensive Health Insurance Fund establishes a liability for both reported and unreported insured events, which includes estimates of both future payments of losses and related claim adjustment expenses. The following represents changes in those aggregate liabilities during the past two years (expressed in thousands):

	1997	1996
Unpaid Claims at Beginning of Year	$ 0	$ 501
Incurred Claims, Provision for Insured Events of the Current Year	0	(101)
Total Incurred Claims Expenses	0	400
Payments	0	400
Total Unpaid Claims at End of the Year	$ 0	$ 0

NOTE 5 - PENSION PLANS

A. State Defined Benefit Plan - The State of Tennessee contributes to the State Employees, Teachers, and Higher Education Employees Pension Plan (SETHEEPP), a cost-sharing multiple employer defined benefit pension plan administered by the Tennessee Consolidated Retirement System (TCRS) and consisting of 142 participating employers. 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. Benefit provisions are established by state statute found in Title 8, Chapters 34-37 of the Tennessee Code Annotated (TCA). State statutes are amended by the Tennessee General Assembly. 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. No COLA is granted if the CPI increases less than one percent. The maximum annual COLA is capped at three percent.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for SETHEEPP. That report may be obtained by writing to the Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, TN 37243-0230 or by calling (615) 741-7063.

Plan members are noncontributory. The State of Tennessee is required to contribute at an actuarially determined rate. The current rate is 7.36% of annual covered payroll. The contribution requirements of the State of Tennessee are established and may be amended by the TCRS Board of Trustees. The State's contributions to TCRS for the years ending June 30, 1997, 1996, and 1995 were $278.417 million, $290.222 million and $282.626 million respectively, equal to the required contributions for each year.

In accordance with GASB 27, a standard implemented this year, the amount of the pension liability at transition was zero and the previously reported pension liability was zero.

B. Political Subdivision Defined Benefits Plan - TCRS administers the Political Subdivision Pension Plan (PSPP), which is an agent multiple-employer defined benefit pension plan that covers employees of 365 participating political subdivisions. The PSPP 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. Benefit provisions are established and amended by state statute. Cost of living adjustments, if adopted by a political subdivision, are provided each July based on the percentage change in the Consumer Price Index (CPI) during the previous calendar year. No COLA is granted if the CPI increases less than one percent. The maximum annual COLA is capped at three percent. 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.

The TCRS issues a publicly available financial report that includes financial statements and required supplementary information for PSPP. The PSPP report may be obtained by writing to the Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, TN 37243-0230 or by calling (615) 741-7063.

C. Defined Contribution Plan - The Optional Retirement Plan (ORP) as administered by the Tennessee Treasury Department is a defined contribution plan. The ORP was established by state statute in Title 8, Chapter 35, Part 4 of the TCA. This statute also sets out the plan provisions. State statutes are amended by the Tennessee General Assembly. The ORP was designed to provide benefits at retirement to faculty and staff of the Tennessee Board of Regents institutions and the University of Tennessee system who are exempt from the overtime provision of the Fair Labor Standards Act and who waive membership in the TCRS. In a defined contribution plan, benefits depend solely on amounts contributed to the plan plus investment earnings. Plan members are noncontributory. The State of Tennessee contributes 10% of the employee's base salary up to the social security wage base and 11% above the social security wage base. Members are fully vested upon entry into the plan. The required contributions made by the State of Tennessee to the ORP were $51.5 million for the year ending June 30, 1997.

D. Deferred Compensation - The state offers its employees two deferred compensation plans, one established pursuant to IRC Section 457 and the other pursuant to IRC Section 401 (k). All costs of administering and funding these programs are the responsibility of plan participants.

Section 457 plan balances have been reported in the accompanying financial statements in an Agency Fund at June 30, 1997. All amounts of compensation deferred under this plan, all property purchased with those amounts, and all income attributable thereto are, until paid or made available to the employee or other beneficiary, solely the property of the state, subject only to claims of the state's general creditors. Participants' rights under the plan are the same as those of general creditors in an amount equal to the fair market value of their deferred accounts. The state has no liability for losses under the plan but does have the duty of due care that would be required of an ordinary prudent investor. The state believes it is unlikely that it will use these assets to satisfy such claims in the future.

Since Section 401(k) plan assets remain the property of the contributing employees, they are not presented in the accompanying financial statements. IRC Section 401 (k) establishes participation, contribution and withdrawal provisions for the plan. During the year ended June 30, 1997, contributions totaling $24.2 million were made by employees participating in the plan. Another $4.4 million was contributed by the State as matching contributions up to $20 per employee per month.

NOTE 6 - POST EMPLOYMENT HEALTH INSURANCE BENEFITS

A. General - The state offers an opportunity to its employees and eligible retirees to participate in a self-insured indemnity policy or health maintenance organizations. This post employment benefit is authorized under Tennessee Code Annotated 8-27-205. The indemnity policy provides benefits to plan participants in a comprehensive, major medical format involving a $200 calendar year deductible and a $1,000 per individual out-of-pocket limit. The plan incorporates typical provisions relating to utilization review, medical necessity, pre-existing conditions, coordination of benefits and subrogation of expenses. The plan offers benefit incentives for the use of designated providers and the plan maintains limitations on benefits provided for the treatment of mental illness and substance abuse.

B. Retirees - Retirees who are not yet eligible for Medicare benefits may continue participation in the plan subject to certain length of service and participation requirements. Upon Medicare eligibility, the retiree is afforded the opportunity to participate in a fully-insured supplement policy not associated with the plan. The state pays a service determined amount for retirees who participate in the state sponsored Medicare supplement policy.

The funds collected for the plan's operation are recorded in the employee group insurance account. The plan's premiums are intended to fund benefits on a pay-as-you-go basis and no specified reserves have been established to fund retiree health benefits. Current retiree premium rates are based upon the retiree’s length of service and range from 20 percent to 40 percent of the plan’s total premium. The state provides no direct funding of retiree health benefits.

During the 1996-97 fiscal year, the Basic Plan provided approximately $20.5 million in benefits to an average of 3,954 retired employee participants.

C. Cobra - Federal law requires large employers to continue health insurance benefits to employees who have terminated employment for up to 18 months. The former employees must pay 102 percent of the total premium (employee plus employer share), funded on a pay as you go basis. Insurance coverage is not mandatory if the former employee is eligible for Medicare or has coverage with another group medical plan. The state covered 360 former employees as of June 30, 1997. During fiscal year 1996-97, the Basic Plan paid approximately $2.686 million in benefits to this group.

NOTE 7 - DEPOSITS AND INVESTMENTS

A. Investment Policy - The Pooled Investment Fund, administered by the State Treasurer, is authorized by statute to invest funds in accordance with policy guidelines approved by the State Funding Board. The current resolution of that Board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories; prime commercial paper and prime banker's acceptances; bonds, notes and bills of the United States Treasury or other obligations guaranteed as to principal and interest by the United States or any of its agencies and in repurchase agreements for obligations of the United States or its agencies which are fully guaranteed as to principal and interest by the United States; mutual funds which are limited to investments of the above permitted kinds; and in certain obligations of the state. 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. Provided however, an amount not to exceed the lesser of $300 million or twenty percent (20%) of the book value of the State Pooled Investment Fund at the time such investments are made, may be invested in maturities greater than one year but not greater than five years. The State Pooled Investment Fund is also authorized by policy to contractually loan securities to investment brokers. On January 17, 1995, the State terminated the securities lending contract and therefore had no securities on loan from the State Pooled Investment Fund.

Statutes require the state deposits be secured by collateral securities with a market value of 105% of the face of the deposit secured thereby after considering the applicable FDIC coverage, or the depository must be a member of the State Collateral Pool and the pool must have securities pledged which in total equal the required percentage established by the Collateral Pool Board. In addition, statutes require that financial institutions with a capital-to-assets ratio of less than five percent (5%) must pledge an additional $100 thousand of collateral securities.

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. Further, statutes provide the Commissioner of Financial Institutions to advise, on a timely basis, the Treasurer and the Commissioner of Finance and Administration of the condition of each state bank and state chartered savings and loan association, including his recommendations regarding its condition and safety as a state depository. Similar provisions apply to federally chartered banks and savings and loan associations designated as state depositories. This process ensures that institutions whose financial status is uncertain are monitored for collateral sufficiency. All repurchases are done with primary dealers in government securities which have executed a master repurchase agreement with the State which provides for securities underlying repurchase agreements to have a market value of not less then 100 percent nor more than 102 percent of the cost of the repurchase agreement plus accrued interest. Prime commercial paper may be acquired from authorized broker dealers or directly from the issuer. There is no collateral requirement for prime commercial paper.

The Tennessee Consolidated Retirement System (TCRS), in addition to the guidelines outlined for the Pooled Investment Fund, may invest in long-term investments. The TCRS may invest in bonds, debentures, preferred stock and common stock, and other good and solvent securities subject to the TCRS Board of Trustees approval. The Board has also authorized limited investments of securities in some foreign countries. TCRS may also invest in multifamily residential real estate through direct equity investment vehicles including, but not limited to, sole proprietorship and joint ventures.

B. Securities Lending - The TCRS and the Chairs of Excellence (COE), a non-expendable trust fund, are authorized by their investment policies, as adopted by their boards, to enter into collateralized securities lending agreements whereby the TCRS and COE 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' and COE's assets. The TCRS' and COE's custodian bank manages the lending program and maintains the collateral on behalf of the TCRS and COE. The borrower may deliver collateral to the lending agent in the form of cash or bonds, notes, and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies or by the Federal Home Loan Mortgage Corporation, Federal National Mortgage Association, Student Loan Marketing Association and other United States government sponsored corporations or enterprises. Cash received as collateral may be reinvested by the lending agency in accordance with the investment policy, as further restricted under the TCRS and COE securities lending agreement. Collateral securities cannot be pledged or sold unless the borrower defaults.

The loaned securities are initially collateralized at 102 percent of their fair value for domestic securities and 105 percent for international. Collateral is marked-to-market daily and additional collateral is pledged by the borrower if the fair value of the collateral subsequently falls below 100 percent for domestic securities and 105 percent for international. At year-end, the TCRS had no credit risk exposure to borrowers because the amounts the TCRS owed the borrowers exceeded the amounts the borrowers owed the TCRS. At year-end, COE had no securities on loan.

Although there is no specific policy for matching the maturities of the collateral investments and the securities loans, all securities on loan can be terminated on demand by either the TCRS/COE or the borrower. At June 30, 1997, substantially all cash collateral for TCRS was invested in overnight or on-demand investments with a weighted-average term to maturity of four days.

C. Deposits - Deposits with financial institutions are required to be categorized to indicate the level of 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.

At year end, the carrying amount of deposits in all funds was $963.130 million and the bank balance, including accrued interest, was $977.174 million. Of the bank balance, $977.146 million was (category 1) covered by insurance or collateral (valued at market) held in the state's name by independent custodial banks or segregated in the Federal Reserve Bank in the state's account and $28 thousand was (category 3) uninsured and uncollateralized.

Cash on deposit with fiscal agent includes $25.285 million of cash held in a custody account by Mellon Trust Company under a contractual arrangement for master custody services. Monies with the custodial agent are not classified by credit risk, as the custody account relationship does not meet the definition for either a deposit with a financial institution or a security.

D. Investments - Investments are also required to be categorized to indicate the level of risk assumed by the state. Category 1 consists of investments that are insured or registered or for which the securities are held by the state or its agent in the state's name. Category 2 consists of uninsured and unregistered investments for which the securities are held by the counterparties' trust department or agent in the state's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparties' trust department or agent but not in the state's name. Investments are categorized below for all funds (expressed in thousands):

PENSION TRUST, POOLED INVESTMENT, AND OTHER FUNDS

	Category 1	Category 2	Category 3	Carrying Amount	Market Value 6/30/97
Cash Equivalents and Short-Term Investments:					
Commercial Paper	$ 1,687,872			$ 1,687,872	$ 1,687,872
Repurchase Agreements	157,000			157,000	157,000
Government Securities	814,515			814,515	814,310
Total Cash Equivalents and Short-Term Investments	2,659,387			2,659,387	2,659,182
Long-Term Investments:					
Domestic Securities:					
Government Securities - not on loan	5,581,679			5,581,679	5,580,657
Corporate Bonds	3,319,220			3,319,220	3,318,936
Corporate Stocks	5,518,960			5,518,960	5,544,157
Short-Term Securities Lending Collateral Investments Held by Custodial Bank			$ 349,935	349,935	349,935
Margin Deposits on Future Contracts:					
Domestic Government Bonds			19,036	19,036	19,036
International Securities:					
Government Bonds	1,195,959			1,195,959	1,195,959
Corporate Bonds	329,593			329,593	329,579
Corporate Stocks	1,320,654			1,320,654	1,321,033
Total Long-Term Investments	17,266,065		368,971	17,635,036	17,659,292
	$19,925,452		$ 368,971	20,294,423	20,318,474
Investments Held by Broker-Dealers Under Securities on Loan Contracts:					
Domestic Securities:					
Corporate Bonds				78,986	78,986
Corporate Stocks				63,265	63,265
International Securities:					
Corporate Stocks				192,304	192,304
Unsettled Investment Acquisitions:					
Domestic Securities:					
Government Bonds				28,316	28,316
Corporate Bonds				13,648	13,648
Corporate Stocks				18,278	18,278
International Securities:					
Government Bonds				20,422	20,422
Corporate Stocks				48,729	48,729
Investments in Deferred Compensation				115,774	115,774
Unemployment Compensation Pool				856,526	856,526
Total Investments and Cash Equivalents				$21,730,671	$21,754,722

D. Component Units

The various component units are generally governed by the same basic State statutes as the State's investments described in Note 7A.

1. University of Tennessee

At year end, the carrying amount of deposits for the University of Tennessee was $14.335 million and the bank balance was $19.991 million. The entire bank balance was (category 1) covered by insurance or collateral (valued at market) held in the University's name by independent custodial banks.

The investments for the University of Tennessee are categorized below (expressed in thousands):

	Category				Market
	1	2	3	Carrying Amount	Value 6/30/97
Cash Equivalents:					
Commercial Paper	$ 56,674			$ 56,674	$ 56,915
Government Securities	208,672			208,672	209,261
Total Cash Equivalents	265,346			265,346	266,176
Investments:					
Domestic Securities:					
Government Securities	54,609			54,609	54,980
Corporate Bonds	38,933			38,933	39,166
Corporate Stocks	76,051			76,051	122,010
Collateralized Mortgage Securities	2,927		$ 5	2,932	2,966
Other	29			29	29
International Securities:					
Government Bonds	15			15	15
Corporate Bonds	604			604	600
Corporate Stocks	3,282			3,282	4,166
Total Investments	176,450		5	176,455	223,932
	$ 441,796		$ 5	441,801	490,108
Limited Partnership-Venture Capital Funds				10,524	9,933
Real Estate Equity				16,369	17,031
International Equity				13,000	21,280
Mutual Funds				5,603	6,452
Real Estate Gifts				7,362	7,221
Domestic Bond Fund				5,000	5,204
Cash Equivalents - assets with bank as custodian				14,258	14,258
Other				4,359	4,568
Total Investments and Cash Equivalents				$ 518,276	$ 576,055

2. Tennessee Board of Regents -

At year end, the carrying amount of deposits for the Tennessee Board of Regents was $46.987 million and the bank balance was $55.320 million. Of the bank balance, $52.976 million was (category 1) covered by insurance or collateral (valued at market) held in the University's name by independent custodial banks or segregated in the Federal Reserve Bank in the University's name, $1.81 million was (category 2) collateralized with securities held by the pledging financial institution's trust department or agent in the University's name, and $.534 million was (category 3) uninsured and uncollateralized.

The investments for the Tennessee Board of Regents are categorized below (expressed in thousands):

	Category				Market
	1	2	3	Carrying Amount	Value 6/30/97
Investments:					
Domestic Securities:					
Commercial Paper	$ 4,897			$ 4,897	$ 4,897
Government Securities	44,404	$ 6,954	$ 2,056	53,414	54,195
Corporate Bonds	2,423	718	555	3,696	3,723
Corporate Stocks	4,592	6,380	803	11,775	15,151
Other	2,352	47		2,399	2,352
Total Investments	$ 58,668	$ 14,099	$ 3,414	$ 76,181	$ 80,318
Mutual Funds				7,424	8,767
Total Investments and Cash Equivalents				$ 83,605	$ 89,085

3. Tennessee Housing Development Agency

At year end, the carrying amount of deposits was $7.211 million for the Tennessee Housing Development Agency (THDA). THDA's deposits are in financial institutions which participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of custodial credit risk disclosure.

The investments for the Tennessee Housing Development Agency are categorized below (expressed in thousands):

	Category				Market
	1	2	3	Carrying Amount	Value 6/30/97
Cash Equivalents and Short-Term Investments:					
Repurchase Agreements	$ 148,600			$ 148,600	$ 148,600
Government Securities	197,901			197,901	197,664
Total Cash Equivalents and Short-Term Investments	346,501			346,501	346,264
Long-Term Investments					
Government Securities	411,340			411,340	429,458
Citibank Investment Agreement	7,769			7,769	7,769
Long-Term Investments	419,109			419,109	437,227
Total Investments and Cash Equivalents	$ 765,610			$ 765,610	$ 783,491

4. Tennessee State School Bond Authority

At year end, the carrying amount of deposits was $844 thousand for the Tennessee State School Bond Authority (TSSBA). TSSBA's deposits are in financial institutions which participate in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment agreement, public fund accounts covered by the pool are considered to be insured for purposes of custodial credit risk disclosure.

The investments for the Tennessee School Bond Authority are categorized below (expressed in thousands):

	Category				Market
	1	2	3	Carrying Amount	Value 6/30/97
Investments:					
Domestic Securities:					
Government Securities	$ 47,974			$ 47,974	$ 48,025
	$ 47,974			47,974	48,025
Mutual Funds				388	388
Total Investments				$ 48,362	$ 48,413

NOTE 8 - COMMITMENTS AND CONTINGENCIES

A. Sick Leave - It is the state's policy to record the cost of sick leave when paid. Generally, since sick leave (earned one day per month with unlimited accumulation) is paid only when an employee dies or is absent due to illness, injury or related family death, there was no liability for sick leave at June 30, 1997. The estimated accumulated amount of unused sick leave at that date was $302.0 million.

B. Operating Leases - The state has entered into various operating leases for land, buildings and equipment. All leases contain termination clauses providing for cancellation after 30, 60 or 90 days' written notice to lessors. In addition, all leases contain appropriation clauses indicating that continuation of the lease is subject to funding by the legislature. It is expected that in the normal course of business most of these leases will be replaced by similar leases. Facilities Revolving Fund, an Internal Service Fund, has entered into various operating leases which have noncancelable lease terms. Below is a schedule of future minimum lease payments under these leases (expressed in thousands).

For the Year(s) Ended June 30	Noncancelable Operating Leases
1998	$ 10,242
1999	7,882
2000	5,469
2001	2,854
2002	1,690
later years	3,687
Total Minimum Payments Required	$31,824

Expenditures for rent under leases for the years ended June 30, 1997 and 1996 amounted to $35.6 million and $29.9 million, respectively.

C. Highway Construction Projects - At June 30, 1997, the Department of Transportation had contractual commitments of approximately $514.9 million for construction of various highway projects. Funding of these future expenditures is expected to be provided from federal grants ($379.8 million) and general obligation bond proceeds ($135.1 million).

D. Litigation - Litigation has been brought against the State which challenges the conditions at Arlington Developmental Center. The State is under court order to remedy the situation and believes the Center is making satisfactory progress. In addition, the State was involved in litigation involving the Clover Bottom Developmental Center. During the fiscal year, a settlement was reached in the Clover Bottom litigation under which the State would work toward community placement of persons with developmental disabilities from all three developmental centers. The State is also party to numerous other legal proceedings, many of which normally recur in governmental operations. In the opinions of the Attorney General and General Counsel for the University of Tennessee system, final settlement of these matters will have no material effect on the accompanying financial statements.

E. Federal Grants - The state has received federal grants for specific purposes that are subject to review and audit by the grantor agencies. Although such audits could generate expenditure disallowances under terms of the grants, it is believed that any required reimbursements will not be material. The Health Care Financing Administration (HCFA) is corresponding with several states which impose taxes on nursing homes and also provide grants to help needy private pay patients meet their nursing home payment burdens. Tennessee is one of the states in discussion with HCFA. To date HCFA has not asserted a claim related to this issue.

F. Loan Guarantees - The Tennessee Student Assistance Corporation (TSAC), a component unit, operates the Guaranteed Student Loans Program. The U. S. Department of Education (USDE) reinsures the student loans up to 100% of their principal amounts. At June 30, 1997, TSAC was guarantor of $1.734 billion in student loans, substantially all of which were reinsured by the USDE. The state has no obligation under these student loan guarantees in the event of default.

G. Performance Collateral - The state is custodian for other securities which collateralize contractor/vendor performance. These securities total some $130.4 million at June 30, 1997 and are not reported elsewhere in the accompanying financial statements.

H. Nashville Correctional Facilities Revenue Bonds - In June 1991, revenue bonds were issued by the Metropolitan Government of Nashville which have an outstanding balance of some $21.48 million as of June 30, 1997. These bonds are obligations of the Metropolitan Government of Nashville. The state is committed to pay Nashville for the housing of locally sentenced inmates, including debt service on the bonds.

NOTE 9 - SUBSEQUENT EVENTS

Component Units - Subsequent to June 30, 1997, TSSBA issued $21.715 million in notes under the BAN's program. In September 1997, TSSBA redeemed $2.475 million of the notes. The remaining $61.3 million in notes were redeemed with proceeds of a commercial paper program. THDA issued Homeownership Program Bonds issue 1997 Series 3 in October for $88.008 million. THDA redeemed 1974 resolution in July for $9.42 million and redeemed 1985 resolution in July for $18.91 million.

In November 1997, TSSBA entered into a new short-term note program to provide initial funding for various construction projects and funding for short-lived assets. The commercial paper notes dealer is J. P. Morgan and an advance agreement is with Union Bank of Switzerland.

Under the appropriations bill for FY 97-98, THDA will be required to transfer to the General Fund $43 million on June 30, 1998.