STATE OF TENNESSEE
DEPARTMENT OF FINANCE AND ADMINISTRATION
STATE CAPITOL
NASHVILLE, TENNESSEE 37243-0285

C. WARREN NEEL, Ph.D.
COMMISSIONER

November 29, 2000

The Honorable Don Sundquist
Governor of the State of Tennessee

I am pleased to submit the Comprehensive Annual Financial Report of the State of Tennessee for the fiscal year ended June 30, 2000. Responsibility for both the accuracy of the data, and the completeness and fairness of the presentation, including all disclosures, rests with the state. To the best of our knowledge and belief, the enclosed data are accurate in all material respects and are reported in a manner designed to present fairly the financial position and results of operations of the various funds and account groups of the state. All disclosures necessary to enable the reader to gain an understanding of the state's financial activities have been included.

The Comprehensive Annual Financial Report is presented in three sections: introductory, financial and statistical. The introductory section includes this transmittal letter and the state's organizational chart. The financial section includes the general-purpose financial statements and the combining and individual fund and account group financial statements and schedules, as well as the auditor's report on the general-purpose financial statements. The statistical section includes selected financial and demographic information, generally presented on a multi-year basis.

The financial reporting entity of the state includes all the funds and account groups of the primary government as well as all its component units. Component units are legally separate entities for which the primary government is financially accountable. The government provides a full range of services including education, health and social services, transportation, law, correction, safety, resources and regulation, and business and economic development.

ECONOMIC CONDITION AND OUTLOOK

The state's economic diversity has improved substantially over the last several years. Investments announced in new and expanding manufacturing businesses exceeded one billion dollars every year since 1983, and exceeded three billion dollars in the last two years. Announced manufacturing capital investments in 1999 were $3.7 billion. This growth has created 26,666 new jobs in this year alone, and has had a positive effect on employment and the state's economy. Additionally, investments in headquarters, distribution and selected services grew to $2.3 billion in 1999 and created 19,091 new jobs. For June 2000, the state unemployment rate of 3.7% was under the national average of 4.0%. The financial impact of these events is presented later in this letter. Based on current projections, the state's overall growth is expected to exceed the national average over the next several years. While having a positive impact, this growth also presents significant challenges for the state. If the present level of services is to be maintained and an ambitious program for major improvements in the educational system is to continue to be implemented, the state must continue to conservatively manage its financial resources.

The impressive U.S. economic expansion of the 1990's became the longest on record in February 2000, but has shown signs of slowing since then. As evidence, real (inflation-adjusted) gross domestic product, perhaps the most widely used measure of economic growth, increased at a seasonally adjusted annual rate of only 2.4 percent during the third quarter of 2000. This is down markedly from 1999's annual growth rate of 4.2 percent. The pattern of low inflation and unemployment has become the hallmark of the so-called "new economy". Inflation concerns remain because low unemployment increases the risk of rising labor costs, and hence greater inflation. Overall, though prices have accelerated slightly in recent quarters, inflation remains largely in check. Evidence of greater inflation could cause the Federal Reserve (whose primary goal is maintaining low inflation) to seek higher interest rates in an effort to slow the U.S. economy further. Tennessee's state government has taken appropriate steps to ensure that the state is able to successfully manage its finances in the future in the event of economic downturn.

MAJOR INITIATIVES

For the year. The Administration produced a budget to fund the daily operations of state government and its new initiatives along with a proposed state income tax. The proposed state income tax would have reduced the state's reliance on sales tax while funding enhancements to TennCare, the state-managed healthcare system, K-12 education, higher education and state employees' salaries. The Legislature did not enact the proposed income tax. As a result, rating agencies have downgraded the state's bond rating. Standard & Poor's downgraded the State's rating from AAA to AA+ with a negative outlook. Moody's downgraded the State's rating from Aaa to Aa1 with a stable outlook. The rationale to downgrade was based on the State's three-year trend of weak legislative budget practices, such as funding state operations with nonrecurring revenues. The State's bond rating provided by Fitch remains at AAA. The Administration will continue to develop a balanced budget to address the state's programmatic needs.

The Administration continues its strategic planning process that it began in 1997. The process includes organizational self-assessment, goal setting, strategy development and performance monitoring. Each state department in the executive branch developed their own departmental strategic plan aligned with the statewide strategic plan. The plans become the foundation for departmental budget requests and assist in prioritizing information systems development projects.

The Administration's first goal is to create a more effective, efficient and focused state government. During the fiscal year the state was successful in its Y2K remediation efforts. The Department of Finance & Administration continued to centralize monitoring of grant subrecipients to provide a consistent and uniform monitoring program. The Department also continued to work on internal accounting processing systems to bring efficiencies to operations and improve financial management reporting. The Department of Finance & Administration, the Office of the Comptroller of the Treasury, and the Treasurer's Office worked together to implement a commercial paper program for the General Obligation Debt Program. This program provides a more efficient and cost-effective method for obtaining short-term financing for capital projects. The Department of Personnel converted employment tests to its computer-based testing system and deployed imaging technology to improve document storage related to the personnel processes. The Department of Finance & Administration worked with the Department of Safety to provide the renewal of Tennessee drivers' licenses over the Internet. The drivers' license application was the first deployed across the State Portal to Tennessee citizens in an effort to provide convenient services to the taxpayer. Other applications are being scheduled for implementation during the year.

Another priority of the Administration was to offer every child a safe and healthy start. Three state agencies partnered to provide Early Periodic Screening Diagnosis and Testing to children in state custody. The Departments of Health, TennCare, and Children's Services are working together to develop sites with staff to make appointments and follow the child who needs support and counseling, to develop a network of providers to perform the screenings and to develop a process for managing the child's case once they have gone home to prevent reentry into state custody. The Department of Human Services has worked to improve the accessibility of quality day care in the state. Quality, developmentally appropriate early childhood education programs for three and four-year old children have proven to increase graduation rates among the economically "at risk" population. The Department of Education spent approximately $3 million to implement early childhood pilot programs, to establish family resource centers, and to ensure the quality of school based childcare programs.

Another Administration initiative is to achieve excellence in education. The Department of Education collaborates constantly with schools and school systems to provide workshops and seminars to improve the effectiveness of teaching staff. Administrative training is provided to school administrators, board members and new principals. The Tennessee Emergency Management Agency trained administrators on emergency preparedness. Information was provided to schools about the assistance available from state-level law enforcement and public safety agencies. Information on best practices, school nutrition program training, curriculum frameworks and performance indicators are provided via the Internet. Tennessee's assessment program for high school students has been restructured to broaden the expectations for student performance and link the curriculum with state-mandated testing.

Our fifth initiative is to maintain a climate for good, high-paying jobs. In 1999, Tennessee achieved a record $6 billion in announced private capital investment from new and expanding companies across the state, which will create more than 45,000 new jobs in Tennessee. Tennessee Business Services contributed to the record year of growth by establishing a public awareness campaign designed to promote the growing importance of high-tech manufacturing to the State. The Department of Economic and Community Development has a Three-Star Community Economic Preparedness Program that assists communities in developing the necessary leadership and infrastructure to become vibrant business locations and to encourage community prosperity. The department also began a new program called *Manufacturing for the New Millennium.* This awareness campaign was designed to promote the growing importance of high-tech manufacturing to the State of Tennessee. To assist in economic development and improve the quality of life within the state, the Department of Transportation worked on long-range budgeting for its commitments for new highway projects, including a methodology for projecting future costs to maintain and operate the current state highway system. A freeway service patrol was established for urbanized areas to maximize the efficiency of the existing transportation system.

For the Future: As with any strategic planning process for large organizations, work continues from year to year on established goals. The initiatives identified here reflect the issues facing Tennessee today. Continuing in this endeavor, these major initiatives will remain in the forefront of Tennessee State Government in the future.

Departmental Focus. The Tennessee Department of Labor and Workforce Development, as part of the Administration's initiative to streamline state government and make it more effective, was created by the Tennessee Workforce Development Act of 1999. Passing unanimously through the 101st General Assembly, this Act integrated the Departments of Labor and Employment Security, the Adult Education Program from the Department of Education, and the Food Stamps-Employment and Training Program from the Department of Human Services.

The mission at the Department of Labor and Workforce Development is to be a seamless organization with proactive employees who enhance economic success for both business and workers. The Department seeks to bring those who offer jobs and those who need jobs, job-related assistance, education, and training together in a safe, profitable workplace.

The Department consists of seven divisions: Employment and Workforce Development; Workers' Compensation; Occupational Safety and Health; Employment Security; Administration; Boilers, Elevators, Mines, Labor Standards and Labor Statistics; and Planning and Accountability. Each division not only believes in the Department's mission, but strives each day to fulfill it for all of Tennessee.

Since the successful integration of two departments and other programs, the new Department's main focus has been on operating more efficiently. In the Employment and Workforce Development Division, improving the delivery of workforce development services across the state has been top priority. The Administration's workforce development initiative created a new way to deliver workforce services across the state. The federal Workforce Investment Act (WIA) was fully implemented on July 1, 2000. Fourteen full-service Career Centers were opened across the state with affiliate sites located in almost every county. We have co-located offices to make services more accessible to our customers while lowering costs for the state.

As part of the new workforce development system in Tennessee, the Department is currently developing CMATS (Case Management and Activity Tracking System). CMATS is a central repository for tracking programs, services, activities, and costs among multiple agencies delivering services through the workforce development system. While making a presentation of CMATS to the U.S. Department of Labor, the federal office commented that Tennessee is "miles ahead" in the implementation of the federal WIA and its computer system.

In the Division of Workers' Compensation, a new integrated information system is being developed and will contain workers' compensation records for every employer in Tennessee. This new, efficient record keeping system will allow the agency administrators to effectively monitor workers' compensation operations, thereby dramatically improving efficiency and responsiveness while keeping error to a minimum.

The Department is avidly exploring all opportunities to electronically input information, which will reduce paperwork and save money. The Department is now "paperless" in the Boiler Inspection Section, with inspectors electronically sending in reports, and is currently attempting to go "paperless" in both the Elevator Inspection and Labor Standards Sections as well.

The Department's Veterans Staff was recently recognized as the best in the nation for placing veterans into jobs across Tennessee. The U.S. Department of Labor presented the staff an award for their 74 percent placement rate of veterans, which was the highest placement rate in the United States.

The first year of this new Department has certainly been one of accomplishments. But, while remaining proud of past accomplishments, the Tennessee Department of Labor and Workforce Development will remain steadfast with the Administration's vision and continually strive to improve the way the Department does business with the citizens of Tennessee.

FINANCIAL INFORMATION

In developing and modifying the state's accounting system, consideration is given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition and the reliability of financial records for preparing financial statements and maintaining accountability for assets. The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived, and the evaluations occur within the above framework. I believe that the state's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

Budgeting Controls. In addition to internal controls, the state maintains budgetary controls. The objective of these budgetary controls is to ensure compliance with legal provisions embodied in the annually appropriated budget approved by the legislature. Activities of the general fund and special revenue funds (except the Supreme Court Boards, Fraud and Economic Crime and the Dairy Promotion Board, accounted for as special revenue funds) are included in the annually appropriated budget. Budgetary control is maintained at the departmental level by the encumbrance of estimated purchase amounts prior to the release of purchase orders to vendors. Purchase orders which result in an overrun of available balances are not released until budget revisions are approved or additional appropriations are made. Open encumbrances are reported as reservations of fund balance at June 30, 2000.

General Governmental Functions. General governmental functions are accounted for in four governmental funds - the General, Special Revenue, Debt Service and Capital Projects funds. Revenues for general governmental functions totaled $15.0 billion in 2000. Taxes represented 48.9% of general revenues; it is a slight decrease of 1.5% in the percentage of the total funding over the prior year from 50.4% to 48.9%. The amount of revenues from various sources and the changes from last year are shown below (expressed in thousands).

Revenue Source	Amount	Percent of Total	Increase (Decrease) from 1999	Percent of Increase (Decrease)
Taxes	$ 7,343,069	48.9%	$ 559,165	8.2%
Licenses, fines, fees and permits	205,031	1.4	13,936	7.3
Interest on investments	53,819	.4	6,136	12.9
Federal	5,537,353	36.9	413,080	8.1
Departmental Services	1,512,483	10.1	229,849	17.9
Other	352,183	2.3	312,028	777.1
	$15,003,938	100%	$1,534,194	

The 8.2% increase in tax collections above is primarily due to the normal growth in the sales tax of some $244 million and an increase of some $200 million in franchise and excise taxes is due to changes in the law to include limited liability corporations.

Interest on investments increased by $6.1 million because more cash was available to invest.

Federal revenue for TennCare increased some $264.9 million.

Departmental services increased by some $230 million due to an overall increase in statewide collections for services.

Other revenue increased primarily from the collection of $203 million in the tobacco settlement lawsuit.

Expenditures for general governmental purposes totaled $13.5 billion in 2000, an 8.9% increase over the previous year. Changes in expenditures by function from 1999 levels are presented in the following tabulation (expressed in thousands).

Function	Amount	Percent of Total	Increase (Decrease) from 1999	Percent of Increase (Decrease)
General government	$ 330,255	2.4%	$ (15,491)	(4.5)%
Education	2,947,577	21.8	88,274	3.1
Health and social services	7,446,923	55.0	850,889	12.9
Law, Justice and public safety	872,353	6.4	47,343	5.7
Recreation and resources development	429,389	3.2	46,775	12.2
Regulation of business and professions	49,325	.4	2,979	6.4
Transportation	1,271,170	9.4	106,394	9.1
Debt service	123,783	.9	12,253	11.0
Capital outlay	70,866	.5	(35,023)	(33.1)
	$13,541,641	100%	$1,104,393	

Education increased $88 million due to the emphasis placed on education as a result of the Education Improvement Act and increased federal funding.

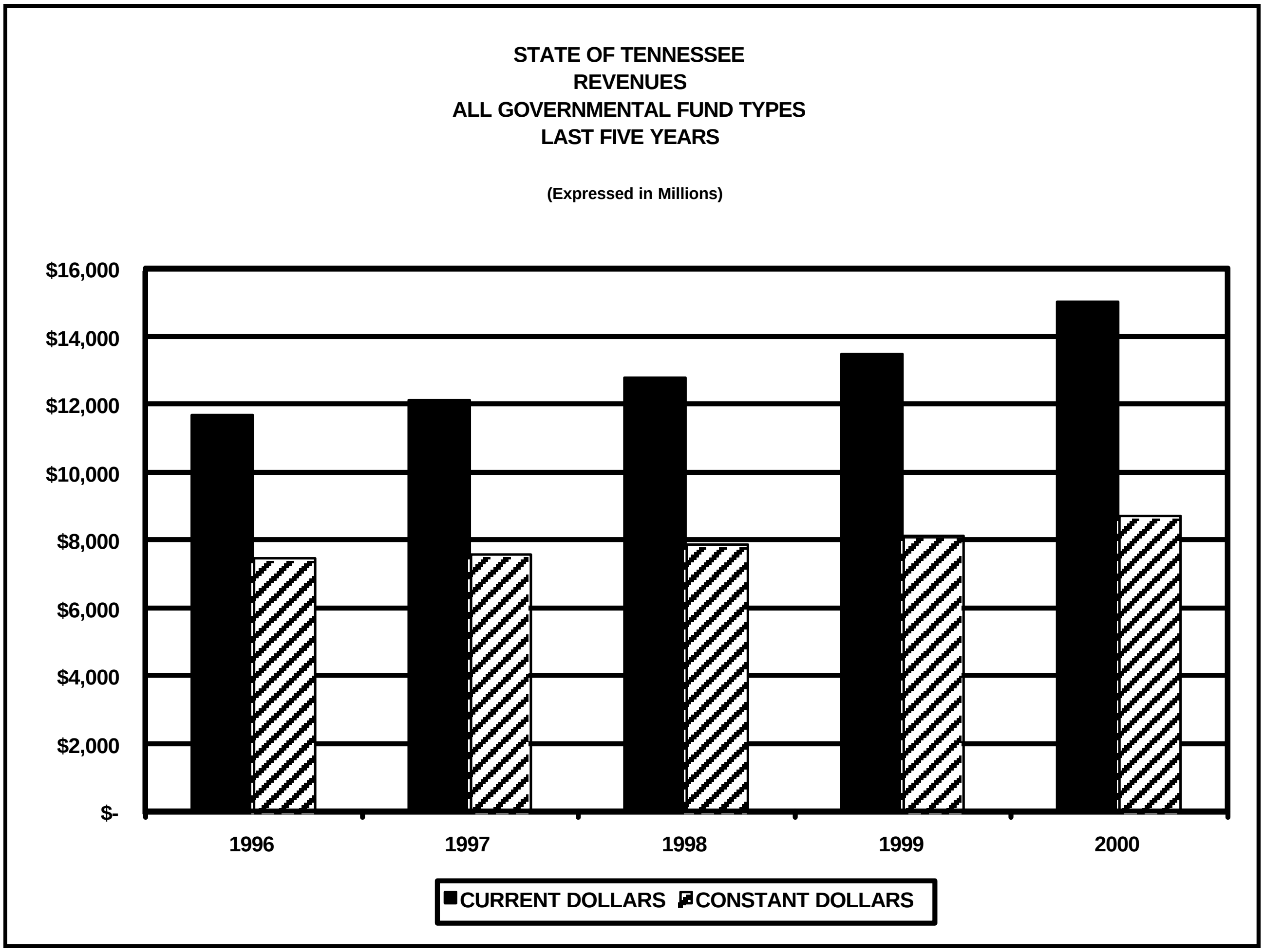
Health and social services increased primarily due to an increase in TennCare expenditures of $562 million.

Recreation and resources development increased primarily due to an expenditure of $33.9 million received from a one-time tobacco settlement used for payments to farmers.

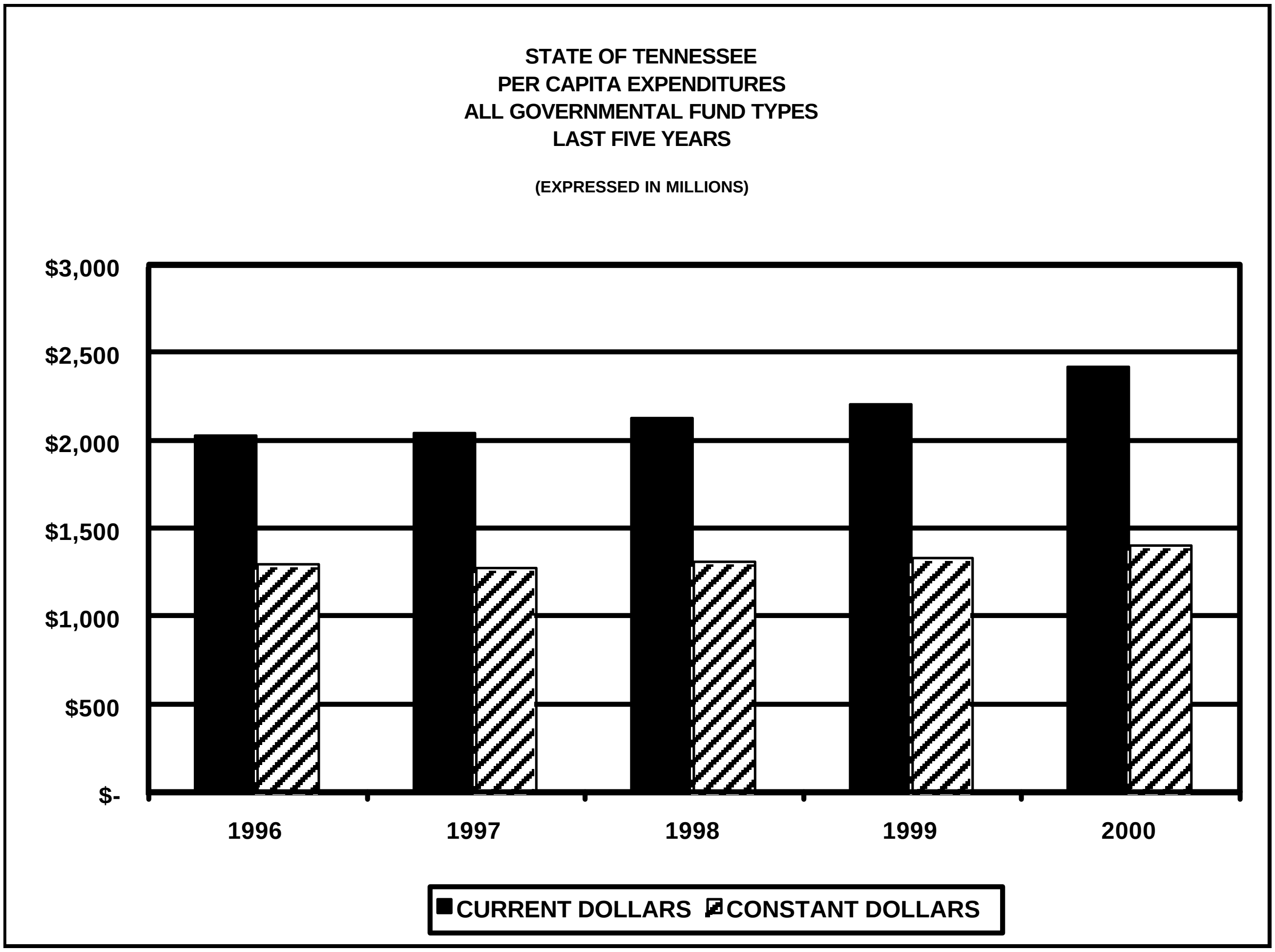
Transportation increased some $106 million primarily due to an increase of $80 million from federally funded highway construction.

Capital outlay decreased because some large capital projects completed early in fiscal year ended June 30, 2000 were largely financed in fiscal year ended June 30, 1999.

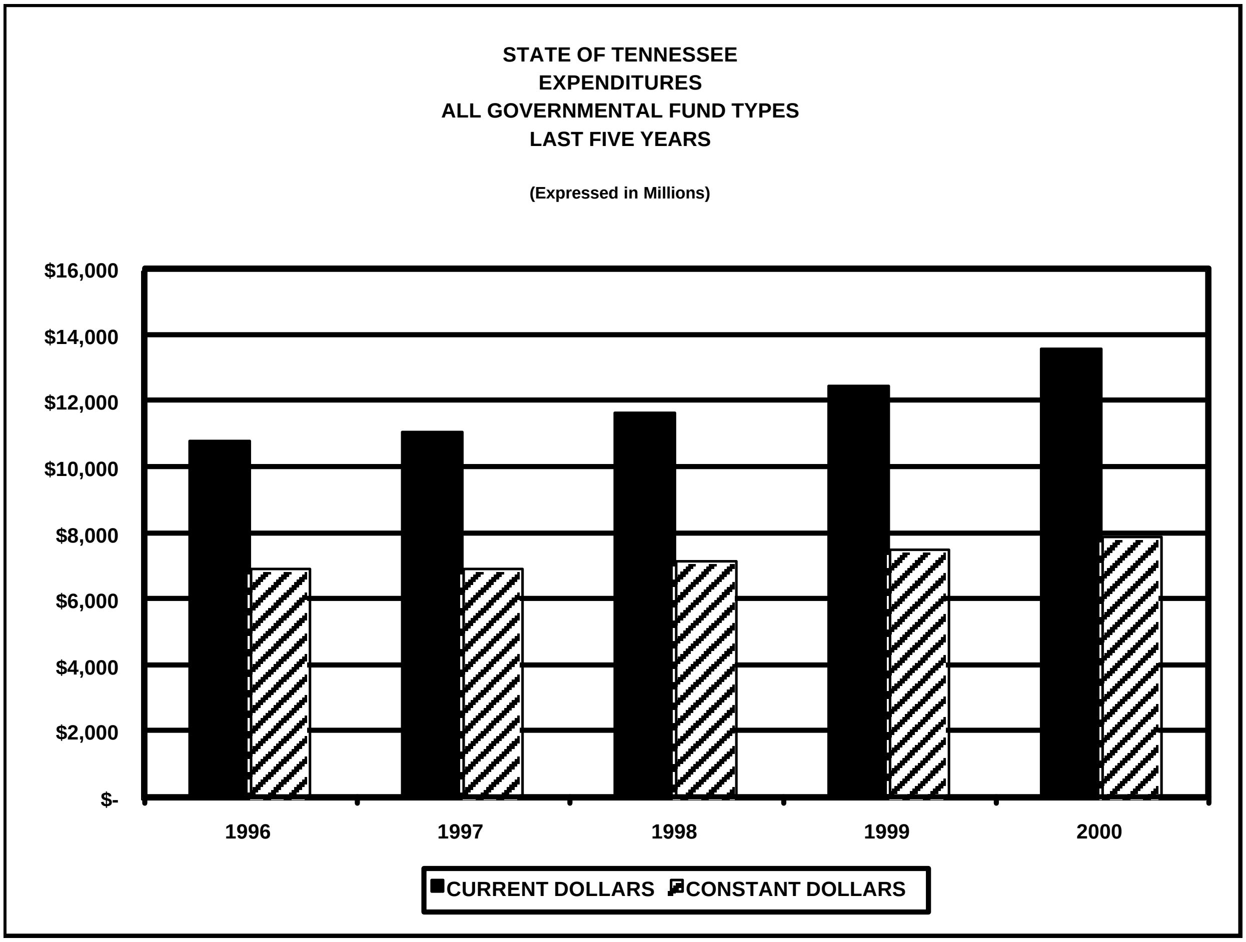
Presented below are tables depicting revenues and expenditures for the last five years on a current dollar and constant dollar basis. In addition, a chart showing per capita expenditures on a current and constant dollar basis is presented.



	1996	1997	1998	1999	2000
CURRENT DOLLARS	$ 11,671	$ 12,098	$ 12,776	$ 13,470	$ 15,004
CONSTANT DOLLARS	$ 7,448	$ 7,547	$ 7,838	$ 8,105	$ 8,703
PERCENT INCREASE OVER PRIOR YEAR IN CURRENT DOLLARS	3.7%	3.7%	5.6%	5.4%	11.4%
PERCENT INCREASE OVER PRIOR YEAR IN CONSTANT DOLLARS	1.0%	1.3%	3.9%	3.4%	7.4%



	1996	1997	1998	1999	2000
CURRENT DOLLARS	$ 2,025	$ 2,043	$ 2,129	$ 2,207	$ 2,415
CONSTANT DOLLARS	$ 1,293	$ 1,274	$ 1,306	$ 1,328	$ 1,401
PERCENT INCREASE OVER PRIOR YEAR IN CURRENT DOLLARS	0.8%	0.9%	4.2%	3.7%	9.4%
PERCENT INCREASE OVER PRIOR YEAR IN CONSTANT DOLLARS	-1.9%	-1.4%	2.5%	1.7%	5.5%



	1996	1997	1998	1999	2000
CURRENT DOLLARS	$ 10,789	$ 11,026	$ 11,639	$ 12,437	$ 13,542
CONSTANT DOLLARS	$ 6,885	$ 6,878	$ 7,140	$ 7,483	$ 7,855
PERCENT INCREASE OVER PRIOR YEAR IN CURRENT DOLLARS	2.2%	2.2%	5.6%	6.9%	8.9%
PERCENT INCREASE OVER PRIOR YEAR IN CONSTANT DOLLARS	-0.6%	-0.1%	3.8%	4.8%	5.0%

General Fund Balance. The fund balance of the general fund increased by $395.4 million in 2000. Of this increase, $203 million was because of the tobacco settlement.

Proprietary Funds. Combined operating results for the State's enterprise funds remained strong in 2000 and were paced by the insurance activities for local government and local government teacher employees. Operating revenues were $206.5 million, an increase of $29.4 million over 1999. Operating expenses increased to $192.5 million from $167.0 million, an increase of $25.5 million.

Combined operating results for the State's internal service funds also remained strong in 2000. Operating revenues and expenses for these cost-reimbursement agencies aggregated $603.6 million and $618.2 million, respectively, as compared to 1999 amounts of $578.3 million and $599.5 million. The principal internal service operations provide data processing services, third party liability claims processing, agency housing, and employee group insurance.

Pension Plan. Total assets of the State's pension trust fund reached $24.4 billion at June 30, 2000. The net assets held in trust for pension benefits total $24.3 billion.

Debt Administration. At June 30, 2000, the State had a number of debt issues outstanding. These issues included $858.3 million of general obligation bonds, $20.3 million of enterprise fund debt with state commitment, and $125.4 million of internal service fund debt with state commitment. Tennessee continues to receive above average bond ratings from Moody's Investors Service (Aa1), Standard and Poor's Corporation (AA+), and Fitch Investors Service, Inc. (AAA) on general obligation bond issues, reflecting our long-standing record of sound financial management. Under current state statutes, the state's general obligation bonded debt issuances are subject to an annual legal debt service limitation based on a pledged portion of certain current year revenues. As of June 30, 2000, the state's annual legal debt service limit of $580.2 million was well above the debt service required of $138.5 million, with a legal debt service margin of $441.7 million. Debt per capita equaled $190.0, and the ratio of net general long-term bonded debt to assessed property valuation was 1.3 percent.

Cash Management. The State Treasurer has pursued an aggressive cash management and investment program. One aspect of this, which we believe is unique to Tennessee, is our direct access into the Federal Reserve wire system. Through the State Trust of Tennessee, wire services in the federal system are available via a terminal located in the State's investment offices. This provides the State flexibility in investing and concentrating cash balances and pension fund assets, and in redeeming warrants and checks issued against the Treasury. During fiscal year 2000, uncommitted State funds were invested in short-term collateralized deposits as follows (averaged): certificates of deposit (47%); repurchase agreements (2%); commercial paper (32%); U.S. Treasuries (18%); and money market accounts (1%). The composite average yield on these investments was 5.66%, up from 5.22% last year.

Risk Management. In 1989, the state initiated a loss prevention program. A loss prevention specialist has been employed to assist the state in analyzing the underlying cause of losses and in recommending measures to minimize the reoccurrence of similar losses. All state property is insured under an all risk policy for full value, with no upper limit on aggregate claims for losses. The insurance policy has an annual $5 million aggregate deductible which is covered by $5 million of the state designation for casualty losses.

OTHER INFORMATION

Securities and Exchange Commission Disclosures. The State Funding Board, the Tennessee State School Bond Authority, and the Tennessee Local Development Authority have each entered into Continuing Disclosure Undertakings with respect to certain debt issues. These Undertakings were made for the benefit of the holders of the debt pursuant to U.S. Securities and Exchange Commission Rule 15c2-12. The issuers have covenanted to provide certain Annual Financial Information, including audited financial statements as well as certain additional financial and operating data. With the exceptions of information related to Tennessee Consolidated Retirement System and of certain local government financial information related to the Tennessee Local Development Authority provided to the Nationally Recognized Municipal Securities Information Repositories (NRMSIRs) under separate cover, financial and operating data required pursuant to the Undertakings is located in this Comprehensive Annual Financial Report. The reader should use the index located at the end of this report to identify the specific page where the information is presented.

Independent Audit. State statutes require an annual audit of all fund types and account groups of the State. The accompanying financial statements have been examined by the Office of the Comptroller of the Treasury, Division of State Audit. Their examination was conducted in accordance with generally accepted government auditing standards, and their opinion appears elsewhere herein.

In conjunction with this examination, the Division of State Audit conducted an organization-wide audit as described in the Single Audit Act of 1984 as amended and Office of Management and Budget Circular A-133, Audits of State, Local Governments, and Non-Profit Organizations. The audit included tests of compliance with applicable federal laws and regulations as well as a study and evaluation of internal controls, including internal accounting and administrative controls used in administering federal financial assistance programs. The results of this single audit are published under separate cover by the Division of State Audit.

Awards. The Government Finance Officers Association of the United States and Canada (GFOA), awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Tennessee for its Comprehensive Annual Financial Report for the year ended June 30, 1999. This is the twenty-first consecutive year that the state has received this prestigious award. In order to be awarded a Certificate of Achievement, a governmental unit must publish an easily readable and efficiently organized comprehensive annual financial report whose contents conform to program standards. Such reports must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. We believe our current report continues to conform to the Certificate of Achievement Program requirements, and we are submitting it to GFOA to determine its eligibility for another certificate.

In addition, the Tennessee Consolidated Retirement System has received this award for twelve consecutive years for its Comprehensive Annual Financial Report.

Acknowledgments. The preparation of the comprehensive annual financial report was made possible by the dedication of the entire staff of the Division of Accounts in the Department of Finance and Administration. This report could not have been prepared without the cooperation of all state agencies and branches.

Respectfully submitted,

/s/ C. Warren Neel

C. Warren Neel, Ph.D., Commissioner
Department of Finance and Administration

CWN/jmc

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
STATE CAPITOL
NASHVILLE, TENNESSEE 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

November 29, 2000

To the Members of the General Assembly
of the State of Tennessee
and
The Honorable Don Sundquist, Governor
of the State of Tennessee

Ladies and Gentlemen:

In accordance with Section 4-3-304, Tennessee Code Annotated, transmitted herewith is the auditor's report on the Comprehensive Annual Financial Report of the State of Tennessee for the fiscal year ended June 30, 2000.

Respectfully,

/s/ John G. Morgan

John G. Morgan
Comptroller of the Treasury

JGM/jmc