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State of Tennessee Treasurer's Report For the Fiscal Year Ended June 30, 2014

Tennessee. Department of Treasury.

TWO THOUSAND FOURTEEN

STATE OF TENNESSEE TREASURER'S REPORT

For the Fiscal Year Ended June 30, 2014

David H. Lillard, Jr.,
State Treasurer

Prepared by:
State of Tennessee
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STATE OF TENNESSEE

DAVID H. LILLARD, JR.
STATE TREASURER

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TREASURY DEPARTMENT
STATE CAPITOL
NASHVILLE, TENNESSEE 37243-0225

February 27, 2015

The Honorable Bill Haslam, Governor
The Honorable Ron Ramsey, Speaker of the Senate
The Honorable Beth Harwell, Speaker of the House of Representatives
Members of the General Assembly
Citizens of the State of Tennessee

Ladies and Gentlemen:

It is my privilege to present the annual Treasurer's Report for the fiscal year that ended June 30, 2014. While the presentation of the report is pursuant of the requirements set forth by Tennessee Code Annotated, Section 4-4-114, I relish the opportunity to share, in detail, the exciting efforts of the Tennessee Treasury Department.

Inside the pages of this report, you will find detailed information about the internal operations in our department, along with accomplishments and financial statements for Treasury programs. Our team is doing great work.

For your convenience, the Treasurer's Report is posted on-line at treasury.tn.gov/TreasurersAnnualReport_2014.pdf. You can download the report as a whole, or click on specific sections. We appreciate the time you take to review this information.

Thank you for your service to our state and her people.

Sincerely,

David H. Lillard, Jr.
Tennessee State Treasurer

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Vision Statement

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

Mission Statement

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

Treasury Team Commitment

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

Department Core Values

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

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

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

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

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

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

The 2014 Treasurer's Report contains reports on various programs administered by the Treasury Department. The following comments briefly explain the purpose or operations of programs and services administered by the Treasury Department. The remainder of this report gives detailed data regarding the activities of these programs during the 2014 fiscal year.

Public Employee Benefit Programs

Tennessee Consolidated Retirement System (TCRS)

The Tennessee Consolidated Retirement System provides the defined benefit portion of the retirement plan for state employees, higher education employees, teachers, and some political subdivisions that have elected to participate. As of June 30, 2014, there were 214,060 active TCRS members: 40,581 state employees, 78,506 K-12 teachers, 78,144 political subdivision employees and 16,829 higher education employees. As of June 30, 2014, there were 133,290 retirees. TCRS paid $2.06 billion in benefits during fiscal year 2014. The state of Tennessee is responsible for the pension liability for state employees and higher education employees and funds a significant portion of the retirement liability for teachers through the BEP. Each participating political subdivision is responsible for the liability of its employees.

Deferred Compensation

The State of Tennessee Deferred Compensation Program offers state employees the opportunity to accumulate supplemental retirement income on a tax-advantaged basis. Participants may direct the investment of their deferred salary into a variety of investment products contracted for the program. During the fiscal year, the state, the University of Tennessee and Board of Regents each matched their employees' contributions to the 401(k) plan at $50 per month. As of June 30, 2014, a total of 83,840 state and higher education employee accounts were held in the program. The market value of accumulated account balances totaled $2.15 billion.

Optional Retirement Plan

The Optional Retirement Plan is a defined contribution plan available to those higher education employees that are classified "exempt." Investments are participant-directed, selected from options offered through the plan service providers using bundled contracts. Contributions to ORP for the year ended June 30, 2014 were $97.9 million and ORP assets were $3.24 billion. There were 11,767 ORP participants at June 30, 2014.

Flexible Benefits

The State of Tennessee Flexible Benefits Plan is an optional benefit plan which enables state employees to pay for certain expenses with before-tax dollars. At June 30, 2014, state employees utilized the plan in the following manner: 36,573 paid group medical premiums, 29,166 paid group dental premiums, 3,923 used the medical expense reimbursement account and 387 used the dependent care reimbursement account. In addition, 222 and 68 state employees utilized the parking and transportation reimbursement accounts, respectively.

Certified Public Administrators

The University of Tennessee Institute for Public Service administers the "County Official's Certificate Training Program Act." Certain full-time county officers are eligible for an educational incentive payment if the officers have completed the continuing education requirements of the program. The educational incentive payments are issued by the State Treasurer, and must be issued no later than October 31 of each year.

PROGRAMS

TNSTARS™

The TNStars™ College Savings 529 Program (TNStars™) is Tennessee's own educational savings plan. The Tennessee Treasury Department created this program under the Baccalaureate Education System Trust due to the need for a highly-skilled workforce and the role that higher education plays in achieving that goal. As a 529 plan, qualified withdrawals are free from federal income tax and there is favorable treatment of contributions to the plan for both federal gift and estate tax purposes. The savings plan offers an aged-based option, where the allocation becomes more conservative as the beneficiary approaches college, as well as 14 self-selected investment options, including equities, fixed income and FDIC insured options. TNStars™ consistently offers financial incentives to Tennessee residents for enrolling in the plan, rolling over funds from other 529 plans, setting up automatic deposits and for saving for babies in their first year. TNStars™ offers the products at a competitive fee, currently 0.35 basis points for all investment options except the FDIC-insured option for which there is no fee. At June 30, 2014, the savings plan held net position totaling $17.6 million.

The Baccalaureate Education System Trust (BEST) is a Section 529 qualified tuition program that allows anyone to save for higher education cost in advance on behalf of a beneficiary. The current program open to participants for enrollment, the TNStars™ College Savings 529 Program (educational savings plan or savings plan), launched on September 18, 2012. The plan features smart and flexible investment options and, as a 529 plan, withdrawals for future qualified higher education expenses are tax-free.

TENNESSEE FINANCIAL LITERACY COMMISSION

The Tennessee Financial Literacy Commission was established in 2010 by act of the General Assembly with the mission to equip Tennesseans to make sound financial decisions when it comes to planning, saving and investing. Financial literacy enables individuals and families to make the best use of their financial resources at key decision points in life, such as college savings for children, getting the most for your money when buying a car or home, saving for retirement, and gaining the financial discipline to save regularly. The need for financial literacy education exists for Tennesseans of all age, economic status and educational background.

The Tennessee Financial Literacy Commission's approach is achieved in two ways: by training elementary and middle school teachers in personal financial literacy and how to teach financial literacy, and providing free curriculum for classroom use, and by educating students and parents directly through a financial literacy computer game. Since the Commission's beginning, over 2,000 teachers have been trained throughout Tennessee.

UNCLAIMED PROPERTY

The Unclaimed Property Division of Treasury administers the state's Uniform Disposition of Unclaimed Property Act. Under this act, the state provides one centralized location for the owners of abandoned property, or their heirs, to turn to when searching for checking accounts, savings accounts, insurance policies, utility deposits and securities. Unclaimed property results when a company or utility is unable to connect a payment with the appropriate person, and the companies are then required to turn the money over to the state. The Treasury's Unclaimed Property Division then utilizes various techniques to reunite the unclaimed property with its rightful owner.

During the 2014 fiscal year, $78.1 million of unclaimed property was collected, which consisted of $63.1 million that was remitted to Treasury and $15.0 million in the sale of securities. In addition, $26.1 million was returned to owners or their heirs, local governments, and other states. Since the program's inception in 1979, $990.4 million in unclaimed property has been reported to the Treasury and $320.8 million of that property has been returned to claimants.

Small and Minority-Owned Business Assistance Program

The Small and Minority-Owned Business Assistance Program is responsible for supporting outreach to new, expanding and existing businesses unable to derive benefit from conventional means of monetary resources and insight provided by traditional lenders and financial advisors. The principle function of the Small and Minority-Owned Business Assistance Program is to provide a significant state-wide platform through a support structure that fosters the expansion of small and minority-owned businesses.

Operational Programs

Investments

The Investment Division has the responsibility for investing all funds under management of the Treasury Department. Over 30 highly-skilled professionals make up the Treasury Department's Investments Division.

State Cash Management

This division manages the State Pooled Investment Fund, which includes the state's cash, the various dedicated reserves and trust funds of the state and the Local Government Investment Pool. During 2014, investments averaged $8.2 billion, producing $12.1 million in income for an average rate of return of .14%.

Pension Fund Investments

This division manages the investments of the Tennessee Consolidated Retirement System (TCRS), which at June 30, 2014, totaled $42.9 billion at fair market value. For the year, investment income was $6.16 billion, for a rate of return of 16.7% on a fair value basis.

The Investment Division also manages investments for the Chairs of Excellence Trust and the Baccalaureate Education System Trust (Prepaid) which, at June 30, 2014, had market values of $399.5 million and $87.4 million, respectively.

Chairs of Excellence

The Chairs of Excellence Trust is a permanent trust fund authorized in 1984 to further the cause of higher education in Tennessee. The funding of the program is provided through contributions made by a private donor and a matching amount by the state, thus, creating a chair. Income from the chair is used to offset the cost of retaining a nationally- or regionally-recognized scholar at a state college or university who teaches in a specified academic area. Since 1984, a total of 99 chairs have been created. The fair market value of the assets of the 99 chairs totaled $295.8 million at June 30, 2014. Since the inception of the program, $348.1 million of investment income has been generated. $169.4 million has been spent by the 99 chairs.

Risk Management

The Division of Risk Management is responsible for identifying the state's exposure to property and casualty risks and determining the appropriate risk control methods to protect the state against monetary loss due to unforeseen events. The division administers the state's property and casualty insurance program, including the procurement of all-risk, replacement cost property insurance for all state-owned buildings and contents, cyber liability insurance, fine arts insurance to protect all types of valuable artwork and items of antiquity, boiler insurance and inspection services for all state-owned boiler objects, fidelity and crime coverage to protect against employee dishonesty, and aviation insurance for the state's aircraft. The state procures its insurance with the aid of a qualified property and/or casualty insurance broker. Loss prevention and control services are also provided for workers' compensation and tort liability. As of July 1, 2014, the state's total insured property values were $19.3 billion.

Claims Commission

The Tennessee Claims Commission is an administrative tribunal created to determine monetary claims against the State of Tennessee. There are three commissioners, one from each grand division of the state. At June 30, 2014, the commission had 655 open claims.

Claims Administration

The Division of Claims Administration is responsible for investigating and making determinations on claims made against the state for workers' compensation by state employees, employee property damage, tort liability and criminal injury compensation. Staff support from the Division of Claims Administration also assists the Board of Claims. The Division of Claims Administration received 4,762 claims for tort, employee property damage and workers' compensation. Payments made during the year for workers' compensation, tort and employee property damage claims totaled $31.2 million.

The division also administers the Criminal Injuries Compensation Fund ("Fund"), which provides financial assistance to crime victims through two types of programs. Payments made under the Criminal Injuries Compensation Program are intended to defray the costs of medical services, loss of earnings, burial costs and other pecuniary losses to either an innocent victim of a crime or to the dependents of a deceased victim. Victims of drunk drivers are also paid from the Fund, and as of 2007 the Fund also provides reimbursement to some facilities that perform sexual assault forensic exams on victims of certain sexually-oriented crimes. The facilities cannot seek any additional payment from the victim after payment by the Fund.

The division received 4,536 criminal injury, drunk driver and sexual assault forensic exam claims. Payments made total $13.3 million. Since the first payments were issued in 1982, more than $254.3 million has been paid to crime victims.

TREASURY NUMBERS AT A GLANCE
FISCAL YEAR 2014

ADMINISTRATIVE	Number of Filled Positions	241
	Payroll Expenditures	$ 21,607,538
	Other Expenditures	$ 7,646,758
	Total Operating Expenditures	$ 29,254,296
CASH MANAGEMENT PROGRAM	General Fund Earnings	$ 4,820,824
	LGIP Earnings	$ 3,881,486
	Restricted Fund Earnings	$ 3,437,511
	Total Cash Management Earnings	$ 12,139,821
RETIREMENT PROGRAM	Retirement Benefits Paid During 2013	$ 2,060,889,702
	Number of Retirees	133,290
	Number of Active Members	214,060
	Retirement Contributions Received	$ 1,305,245,165
	Retirement Net Investment Income	$ 6,159,899,668
	Deferred Compensation Contributions	$ 146,353,149
	Deferred Compensation Accounts	83,840
CLAIMS ADMINISTRATION PROGRAM	Workers' Compensation Payments	$ 26,710,915
	Workers' Compensation Claims Filed	2,908
	Employee Property Damage Payments	$ 21,512
	Employee Property Damage Claims Filed	66
	Tort Payments	$ 4,509,437
	Tort Claims Filed	1,788
	Criminal Injury Fund Payments	$ 11,332,058
	Criminal Injury Fund Claims Filed	4,536
RISK MANAGEMENT PROGRAM	Estimated Gross Property Losses Incurred	$ 3,402,417
	Total Property Values Insured	$ 19,362,348,300
CHAIRS OF EXCELLENCE PROGRAM	Chairs of Excellence Investment Income	$ 41,908,051
	Chairs of Excellence Expenditures	$ 9,562,271
	Number of Chairs of Excellence	99
OTHER PROGRAMS	Aggregate Deferred Compensation Balances	$ 2,149,117,658
	Flexible Benefits Plan Payments	$ 6,309,921
	Unclaimed Property Revenues	$ 78,071,735
	Unclaimed Property Payments	$ 26,180,732
	BEST Prepaid Accounts	8,626
	Optional Retirement Plan Contributions	$ 97,863,635
	Optional Retirement Plan Participants	11,767
FAIR VALUE OF ASSETS UNDER MANAGEMENT AT JUNE 30, 2014	Retirement Trust Fund	$ 42,905,157,496
	Chairs of Excellence Trust Fund	$ 343,524,495
	State Pooled Investment Fund	$ 8,454,140,577
	Deferred Compensation (outside managers)	$ 2,149,117,658
	Optional Retirement Plan Assets (outside managers)	$ 3,237,158,729
	BEST Educational Services Plan	$ 87,427,034
	TNStars College Savings Program	$ 17,536,559
	Total Assets Under Management	$ 57,194,062,548

Treasurer's Office	
Treasurer	David H. Lillard, Jr., JD, LLM in Taxation
Chief of Staff	Joy Harris
Public Policy Advisor	Whitney Goetz
Director of Communications	Shelli King
Director of Human Resources	Greg Cason
Staff Assistant to the Treasurer	Ashley Humphrey
Special Assistant to the Treasurer	Mary Beth Franklyn
Executive Assistant to the Treasurer	Heather Sczepczenski
Legal, Compliance and Internal Audit	
Assistant Treasurer	Christy Allen, JD
Director of Internal Audit	Andrew Furlong, CPA, CFE
Investments and Deferred Compensation	
Chief Investment Officer	Michael Brakebill, CFA, CAIA
Deputy CIO and Director of Fixed Income	Andrew Palmer, CFA
Director of Equity	Michael Keeler, CFA
Director of Real Estate	J.P. Rachmaninoff
Assistant CIO and Director of Cash Management	Tim McClure, CCM
Director of Private Equity	Daniel Crews, CFA
Director of Deferred Compensation	Kaci Lantz, CFP®
Retirement Administration and Program Services	
First Deputy Treasurer	Steve Curry, CPA-inactive, CEBS, CCM
Senior Director of Program Services	Steve Summerall
Director of Treasury Outreach	Amanda Staggs
Director of TCRS	Jill Bachus, CPA
Assistant Director of TCRS	Jamie Wayman, CPA, CEBS
Assistant Director of Concord	Fred Marshall, CPA
Small and Minority-Owned Business Program Manager	Jaye Chavis
Director of TNStars 529 College Savings	LaKesha Page
Director of Unclaimed Property	John Gabriel
Assistant Director of Unclaimed Property	Kellie Williamson
Director of Claims Administration and Risk Management	Rodney Escobar
East Tennessee Claims Commissioner	William O. Shults, JD
Middle Tennessee Claims Commissioner	Robert Hibbett, JD
West Tennessee Claims Commissioner	Nancy Miller-Herron, JD
Claims Commission Clerk	Paula Swanson
Support Services	
Second Deputy Treasurer	Rick DuBray, CPA
Director of Accounting	Kim Morrow, CPA
Deputy Director of Accounting	Brian Derrick, CPA
Assistant Director of Accounting	Kevin Bradley, CPA, AAP
Director of Management Services	Kerry Hartley, CPA
Director of Information Systems	Tim Sundell
Assistant Director of Information Systems	David Bauer

The Treasurer is housed on the 1st floor of the State Capitol Building.
Divisions are housed on the 13th, 14th and 15th floors of the Andrew Jackson Building.

BOARDS AND COMMISSIONS	TENNESSEE CODE ANNOTATED SECTION
Advisory Board to Establish Compensation for Use of the Right-of-Way for Underground Fiber Optic Cable Facilities	54-16-112
Advisory Committee to the Trustees of the Fisk University Stieglitz Collection Art Endowment Fund	4-20-201
Advisory Council on Workers' Compensation	50-6-121
Appeals from Gift Tax Appraisals Board	67-8-116
Baccalaureate Education System Trust Board	49-7-804
Board of Claims	9-8-101
Catastrophic Injuries Fund Commission	29-20-408
Chairs of Excellence Endowment Trust	49-7-501
Collateral Pool Board	9-4-506
Commission to Purchase Surplus Federal Property	12-1-103
Council on Pensions & Insurance	3-9-101
Employee Misclassification Advisory Task Force	50-6-919
Governor's Commission on Crime Victims Assistance	Ex. Order 10 of 2003
Local Education Insurance Committee	8-27-301
Local Government Insurance Committee	8-27-207
Public Records Commission	10-7-302
Sick Leave Bank Board	8-50-903
State Board of Equalization	4-3-5101
State Building Commission	4-15-101
State Capitol Commission	4-8-301
State Funding Board	9-9-101
State Insurance Committee	8-27-101
State Protest Committee	4-56-103
State Trust of Tennessee	9-4-806
Tennessee Consolidated Retirement System Board of Trustees	8-34-302
Tennessee Financial Literacy Commission	49-6-1703
Tennessee Higher Education Commission	49-7-204
Tennessee Housing Development Agency	13-23-106
Tennessee Local Development Authority	4-31-103
Tennessee Sports Hall of Fame	4-3-5403
Tennessee State School Bond Authority	49-3-1204
Tennessee Student Assistance Corporation	49-4-202
Tuition Guaranty Fund Board	49-7-2018
Volunteer Public Education Trust	49-3-401, et seq.
Workers Compensation Insurance Fund Board	50-6-604

ADMINISTRATION	TENNESSEE CODE ANNOTATED SECTION
Advisory Council on Workers' Compensation	50-6-121, et seq.
Baccalaureate Education System Trust	49-7-801, et seq.
Board of Claims	9-8-101, et seq.
Chairs of Excellence Trust	49-7-501—49-7-503
Collateral Pool	9-4-501—9-4-523
Collateral Program	9-4-101—9-4-108
Council on Pensions and Insurance	3-9-101—3-9-104
Criminal Injury Compensation Fund	29-13-101, et seq.
Deferred Compensation	8-25-101, et seq.; 8-25-301, et seq.
Escheat	31-6-101, et seq.
Flexible Benefits Plan	8-25-501—8-25-502
Intermediate-Term Investment Fund	9-4-608
Investment Advisory Council	8-37-108
Investment of State Idle Cash Funds	9-4-602
Local Government Investment Pool	9-4-704—9-4-707
Old Age and Survivors Insurance Agency	8-38-101, et seq.
Pooled Investment Fund	9-4-603
Receipt and Disbursement of Public Funds	8-5-106—8-5-111; 9-4-301, et seq.
Small and Minority-Owned Business Assistance Program	65-5-113
State Cash Management	9-4-106—9-4-108; 9-4-401—9-4-409
State Treasurer's Office	4-3-2401, et seq.; 8-5-101, et seq.
State Trust of Tennessee	9-4-801, et seq.
Tennessee Claims Commission	9-8-301, et seq.
Tennessee Consolidated Retirement System and Miscellaneous Systems	Title 8, Chptrs. 34, 35, 36, 37 & 39
Tennesssee Interagency Cash Flow Committee	9-4-610
Tennessee Financial Literacy Program	49-6-1701, et seq.
Unclaimed Property	66-29-101, et seq.
Victims of Drunk Drivers Compensation Fund	40-24-107

PROGRAMS		
TNStars 529 College Savings Program	Program information, investment options, forms, savings calculator, videos, employer resources, FAQs	tnstars.com
Tennessee Financial Literacy Commission	Program information, clearinghouse of financial resources	treasury.tn.gov
Unclaimed Property	Search for unclaimed property, program information, links to other states' programs, holder reporting information, forms, instructions and free software	treasury.tn.gov/unclaim ClaimItTN.gov
Claims Commission	Program information, contacts, rules and statutes	treasury.tn.gov/claims
Criminal Injury Compensation Program	Program information, forms, links to victims' programs nationwide and victims' organizations	treasury.tn.gov/injury
Small and Minority-Owned Business Program	Program information, rules and legislation	treasury.tn.gov/smob
BEST	Program information, rate information, contracts, forms and newsletters	treasury.tn.gov/best
GOVERNMENT SERVICES		
Bank Collateral Pool	Program information, forms and participants	treasury.tn.gov/bank
Local Government Investment Pool	Information, forms, operations manual, newsletters, past rates, portfolio and investment policy	treasury.tn.gov/lgip
OASI/Social Security	Information, FICA rates, law and forms	treasury.tn.gov/oasi

PUBLIC EMPLOYEE BENEFIT PROGRAMS		
Deferred Compensation	Account access, program information, benefit projection calculator and forms	treasury.tn.gov/dc
Flexible Benefits Plan	Program information and forms	treasury.tn.gov/flex
Optional Retirement Program	Program information, forms, company contacts and product information	treasury.tn.gov/orp
Risk Management	Program and claim process information, property insurance report search, safety check lists, loss control reports and employee safety information/videos	treasury.tn.gov/risk
Tennessee Consolidated Retirement System	Program information, benefits calculator, newsletters, forms, annual report, frequently asked questions and retirement planning information	treasury.tn.gov/tcrs
WORKERS' COMPENSATION		
Advisory Council on Workers' Compensation	Program information, reports, video minutes/meetings and public notices	treasury.tn.gov/claims/wcadvisory.html
Workers' Compensation for State Employees Only	Program information, reporting accidents, filing claims, eligibility criteria and provider directory	treasury.tn.gov/wc
OTHER		
About the Treasurer	Statutory duties and biographical information	treasury.tn.gov/about
Annual Report	Treasurer's Report on-line	treasury.tn.gov/TreasurersAnnualReport_2014.pdf

PUBLIC EMPLOYEE BENEFITS PROGRAMS

Tennessee Consolidated Retirement System
Deferred Compensation
Flexible Benefits
Certified Public Administrator

Tennessee Consolidated Retirement System

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

Membership

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

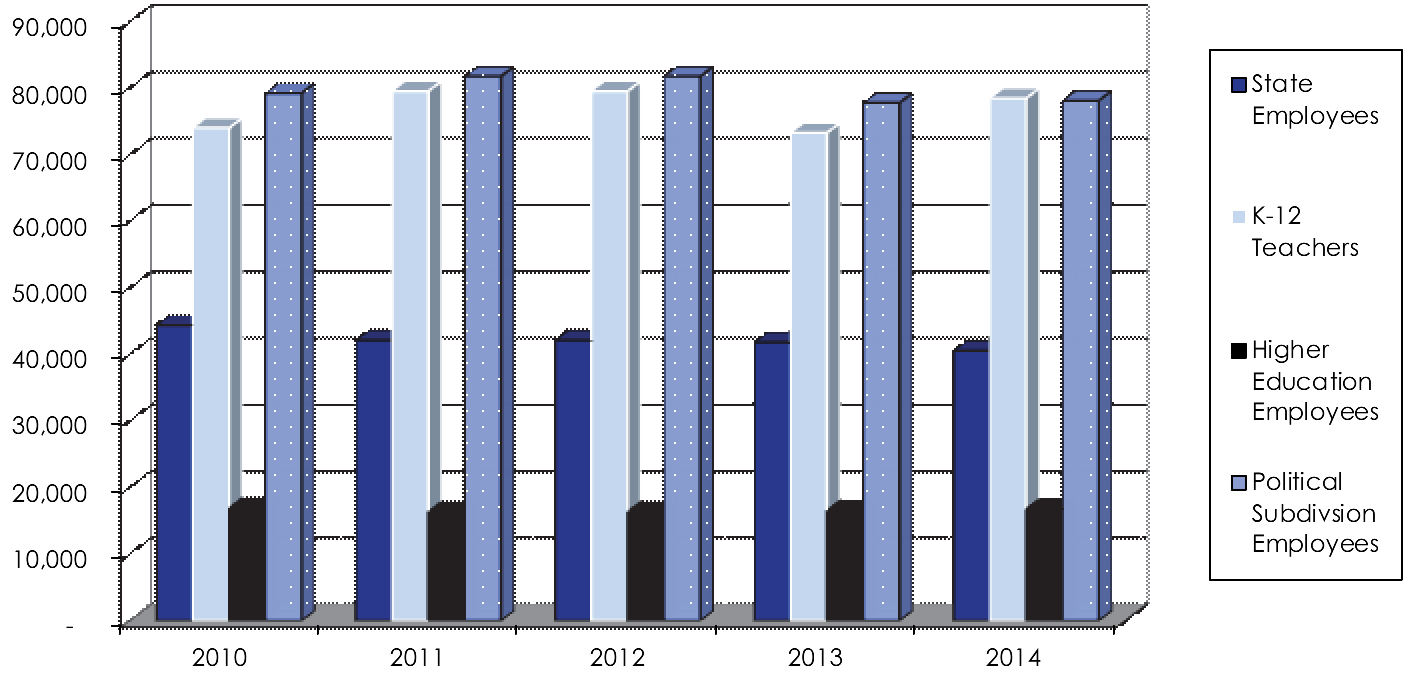
State employees and teachers become vested after five years of service. Political subdivision members attain vested status upon completion of 10 years unless five year vesting has been authorized. A vested member is guaranteed a retirement benefit once the age requirements are met.

As of June 30, 2014, there were 214,060 active members of TCRS and 11,767 higher education employees participating in the ORP.

Since July 1, 1976, all new members of the TCRS except state judges have been classified as Group I members. State judges have been permitted to enroll in Group IV since September 1, 1990. From July 1, 1972 to June 30, 1976, all employees were classified as Group I, with the exception of state policemen, wildlife officers, firemen and policemen who were classified as Group II and judges and elected officials who were classified as Group III. Members of seven superseded systems are permitted to retain their original rights and benefits.

Beginning July 1, 2014, new state employees and K-12 teachers are enrolled in the hybrid pension plan.

Active Members
Fiscal Years 2010-2014



Contributions

The funding of retirement benefits is financed by member contributions, employer contributions and the earnings of the invested assets. Effective July 1, 1981, the employee contributions of certain state employees and higher education employees were assumed by the state. Local governments can also adopt these noncontributory provisions for their employees. Group I K-12 teachers and contributory local government employees contribute to TCRS at the rate of 5% of gross salary. Employee contribution rates vary for superseded classifications.

Effective January 1, 1987, all state employees and teachers who contribute a portion of their income to the retirement system became covered by Section 414(h) of the Internal Revenue Code. Under 414(h), payment of federal income tax on an employee's retirement contributions is deferred until these contributions are withdrawn in the form of a refund or monthly benefit payments. Political subdivisions may pass a resolution adopting Section 414(h) coverage for their employees.

Upon termination of employment, a member may elect to withdraw his contributions and accumulated interest from the retirement system in a lump sum. By obtaining a lump sum refund, a member waives all rights and benefits in the retirement system. A vested member may leave his account balance in TCRS and apply for benefits upon meeting the age requirements. A non-vested member who terminates employment may only leave his account balance in TCRS for up to seven years. During the 2014 fiscal year, 5,683 refunds totaling $54.0 million were issued.

The contribution rate for the employers participating in the retirement system is determined by a biennial actuarial valuation performed by an independent actuarial firm. The contribution rates include funding for the basic benefit, the cost-of-living increase provisions and amortization of the accrued liability over a 40-year period which began in July of 1975. The employer contribution rates for the year ending June 30, 2014 were as follows:

- Overall Rate for Noncontributory State and Higher Education Employees 15.14%
- K-12 Teachers 8.88%
- Political Subdivisions Individually-Determined
- Faculty Members Electing to Participate in the ORP 10.0%*

*11% for salary above the Social Security wage base.

Retirement Benefits

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

As of June 30, 2014, 133,290 retirees were receiving monthly benefit payments. This represents a 4.0% increase over the previous year.

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

A Group I benefits calculator is available on the program's Internet site: tcrs.tn.gov.

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 benefits paid to active members whose disability is a result of an accident or injury occurring while the member was in the performance of duty.

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

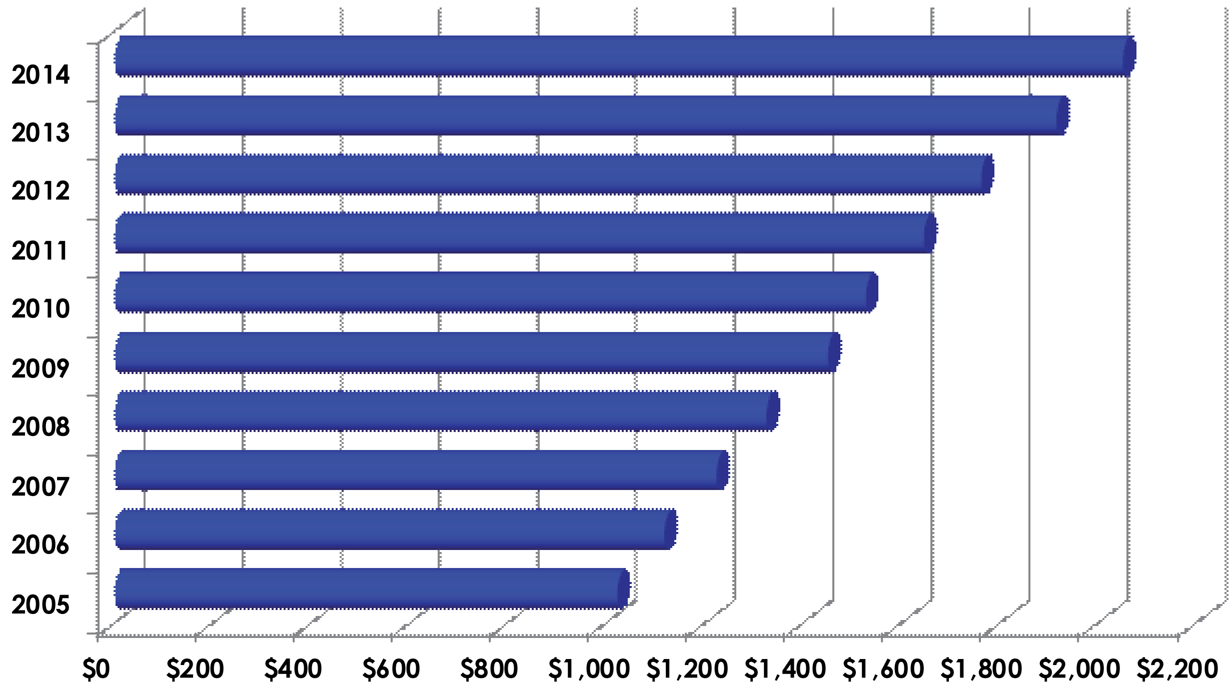
Certain death benefits are available to the beneficiary(s) of a member who dies prior to retirement. At retirement, a member may select an optional benefit that is actuarially reduced so that his beneficiary may continue to receive a benefit after his death.

Benefits paid in fiscal year 2014 totaled $2.06 billion, an increase of $137 million over 2013 benefit payments.

During 2013, legislation was enacted creating a Hybrid pension plan for state employees and teachers hired on or after July 1, 2014. The new plan contains both a defined benefit (TCRS) and a defined contribution (401k) component. Key elements of the Hybrid plan include increasing the eligibility for retirement, requiring employee contributions, requiring employer contributions to the 401k component on behalf of the employee and controls to manage employer cost and unfunded liability. Disability benefits, death benefits and COLA will continue to be available in the new plan.

Local governments can choose any of the plans offered to state employees and teachers while customizing certain options specifically for its employees. In addition, during 2012, new plan choices were enacted specifically for local governments. For more information on all of the plans offered by TCRS, please go to the TCRS website at www.treasury.tn.gov/tcrs.

ANNUAL BENEFIT PAYMENTS
FISCAL YEARS 2005-2014
EXPRESSED IN MILLIONS



TENNESSEE'S RETIREMENT PROGRAM, TCRS AND SOCIAL SECURITY BENEFITS FOR CALENDAR YEAR 2014

Five-Year AFC*	Projected Annual Retirement Income	15 Years Service	% of AFC	20 Years Service	% of AFC	25 Years Service	% of AFC	30 Years Service	% of AFC	35 Years Service	% of AFC
$15,000	TCRS	$ 3,544		$ 4,725		$ 5,906		$ 7,088		$ 8,269	
	Social Security	9,756		9,756		9,756		9,756		9,756	
	Total	$13,300	88.7%	$14,481	96.5%	$ 15,662	104.4%	$16,844	112.3%	$18,025	120.2%
$20,000	TCRS	$ 4,725		$ 6,300		$ 7,875		$ 9,450		$ 11,025	
	Social Security	11,280		11,280		11,280		11,280		11,280	
	Total	$16,005	80.0%	$17,580	87.9%	$ 19,155	95.8%	$20,730	103.7%	$22,305	111.5%
$25,000	TCRS	$ 5,906		$ 7,875		$ 9,844		$ 11,813		$ 13,781	
	Social Security	12,804		12,804		12,804		12,804		12,804	
	Total	$18,710	74.8%	$20,679	82.7%	$ 22,648	90.6%	$24,617	98.5%	$26,585	106.3%
$30,000	TCRS	$ 7,088		$ 9,450		$ 11,813		$ 14,175		$ 16,538	
	Social Security	14,328		14,328		14,328		14,328		14,328	
	Total	$21,416	71.4%	$23,778	79.3%	$ 26,141	87.1%	$28,503	95.0%	$30,866	102.9%
$35,000	TCRS	$ 8,269		$ 11,025		$ 13,781		$ 16,538		$ 19,294	
	Social Security	15,852		15,852		15,852		15,852		15,852	
	Total	$24,121	68.9%	$26,877	76.8%	$ 29,633	84.7%	$32,390	92.5%	$35,146	100.4%
$40,000	TCRS	$ 9,450		$ 12,600		$ 15,750		$ 18,900		$ 22,050	
	Social Security	17,376		17,376		17,376		17,376		17,376	
	Total	$26,826	67.1%	$29,976	74.9%	$ 33,126	82.8%	$36,276	90.7%	$39,426	98.6%
$45,000	TCRS	$ 10,631		$ 14,175		$ 17,719		$ 21,263		$ 24,806	
	Social Security	18,900		18,900		18,900		18,900		18,900	
	Total	$29,531	65.6%	$33,075	73.5%	$ 36,619	81.4%	$40,163	89.3%	$43,706	97.1%
$50,000	TCRS	$ 11,813		$ 15,750		$ 19,688		$ 23,625		$ 27,563	
	Social Security	20,412		20,412		20,412		20,412		20,412	
	Total	$32,225	64.4%	$36,162	72.3%	$ 40,100	80.2%	$44,037	88.1%	$47,975	95.9%
$55,000	TCRS	$ 12,994		$ 17,325		$ 21,656		$ 25,988		$ 30,319	
	Social Security	21,936		21,936		21,936		21,936		21,936	
	Total	$34,930	63.5%	$39,261	71.4%	$ 43,592	79.3%	$47,924	87.1%	$52,255	95.0%
$60,000	TCRS	$ 14,175		$ 18,900		$ 23,625		$ 28,350		$ 33,075	
	Social Security	22,956		22,956		22,956		22,956		22,956	
	Total	$37,131	61.9%	$41,856	69.8%	$ 46,581	77.6%	$51,306	85.5%	$56,031	93.4%
$65,000	TCRS	$ 15,364		$ 20,486		$ 25,607		$ 30,728		$ 35,850	
	Social Security	23,664		23,664		23,664		23,664		23,664	
	Total	$39,028	60.0%	$44,150	67.9%	$ 49,271	75.8%	$54,392	83.7%	$59,514	91.6%
$70,000	TCRS	$ 16,742		$ 22,323		$ 27,904		$ 33,485		$ 39,065	
	Social Security	24,384		24,384		24,384		24,384		24,384	
	Total	$41,126	58.8%	$46,707	66.7%	$ 52,288	74.7%	$57,869	82.7%	$63,449	90.6%

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

This chart is based on a date of retirement in 2014. Social Security benefits have been calculated by Bryan, Pendleton, Swats & McAllister, actuarial consultants for the TCRS, utilizing the following assumptions:

(1) Retirement is taking place at age 65 in 2014;
(2) The retiree has worked a full career (TCRS plus other employers, if necessary) of 35 years or more; and
(3) Salary increases throughout the retiree's career have followed the same pattern as National Average Earnings.

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

Actuarial Valuation

An actuarial valuation of the TCRS is performed by an independent actuarial firm every two years. The purpose of the valuation is to assess the funding status and to determine the funding requirements for the employers participating in the TCRS. The valuation was performed July 1, 2011 to establish the employer contribution rates effective July 1, 2012 through June 30, 2014. The system's unfunded accrued liability at July 1, 2013 was $2.66 billion, of which $1.46 billion related to state employees, $806 million to teachers and $392 million collectively to political subdivisions. The state and teacher accrued liability is being amortized over an eight- and 13-year period, respectively. The amortization period for local governments varies by entity. Overall, the system had a 93.6% funded ratio. A valuation was performed as of July 1, 2013 to establish new employer contribution rates effective July 1, 2014.

In addition to the biennial actuarial valuation, an experience study is conducted every four years for the purpose of establishing actuarial and economic assumptions to be used in the actuarial valuation process. Following are the assumptions used in the July 1, 2011 actuarial valuation of the plan:

Economic Assumptions

(1) 7.5% annual return on investments

(2) Graded salary scale reflecting plan experience

(3) 3.5% annual increase in Social Security wage base

Actuarial Assumptions

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

(2) Post-Retirement mortality based on age

(3) Disability rate based on age

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

(5) Retirement age distribution based on age and service

Political Subdivisions

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

Political Subdivision Participation

Participation as of June 30, 2014:

Cities	177
Counties	88
Utility Districts	69
Special School Districts	19
Joint Ventures	22
Housing Authorities	11
911 Emergency Communication Districts	47
Miscellaneous Authorities	56
Total	489

1972 Benefit formula improved from 1.12 percent of salary up to the SSIL to 1.5 percent of salary up to the SSIL.

1973 Annual cost-of-living increase based on the CPI with a cap of 1.5 percent adopted for retirees.

1974 Disability retirement eligibility requirement reduced from 10 years to 5 years of service.

Maximum annual cost-of-living increase raised to 3 percent.

Provision to increase retirees' benefits whenever the benefit formula is improved.

Service credit authorized for unused accumulated sick leave.

1976 Service retirement eligibility requirements reduced from age 65 or 35 years of service to age 60 or 30 years of service.

Early retirement eligibility requirements reduced from age 60 or 30 years of service to age 55.

1978 A bonus cost-of-living increase granted to retirees at a lump-sum cost of $15.3 million.

An optional retirement plan established for teachers in the Board of Regents system.

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

1981 Noncontributory retirement for state employees and higher education employees adopted. Employees' contributions, up to 5 percent, were assumed by the state.

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

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

Retirement credit for armed conflict approved.

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

1985 $22 million ad-hoc increase granted to retirees.

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

$17 million ad-hoc increase granted to retirees.

Retirement incentive for state employees.

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

1990 Retirement incentive for state employees.

1991 3.6 percent indexing of salaries for noncontributory employees extended one year. Each succeeding year up to 1997, the 3.6 percent indexing was extended. In 1997, it was extended indefinitely.

1992 Minimum number of years required to qualify for retirement was reduced from 10 to 5 years.

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

Benefit improvement up to 5 percent authorized.

1997 Compounded COLA for retirees approved.

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

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

Mandatory retirement established with supplemental bridge benefit for all state public safety officers.

1999 Group 1 benefit maximum increased to 90 percent.

2000 Group 2 benefit maximum increased to 80 percent.

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

2005 Return to work statutes were reformed, including a temporary employment increase to 120 days.

2006 Ad-hoc increase granted to members retired prior to 1989.

2007 Public Safety Officer benefits were enhanced.

2012 New plan options offered to local governments.

2013 Hybrid plan enacted for state employees and teachers hired after July 1, 2014.

Optional Retirement Plan

The Optional Retirement Plan is a defined contribution plan. Investments are participant-directed and selected from options offered through the plan service providers using bundled contracts. ORP plan investment management and administrative services are offered by third-party administrators. Contributions to ORP for the year ended June 30, 2014 were $97.9 million and ORP assets were $3.23 billion. There were 11,767 ORP participants at June 30, 2014.

Social Security

When the Social Security Act (the Act) passed in 1935, government employees were determined to be excluded from coverage. However, the option to voluntarily join Social Security and Medicare was made available to state and local governments effective January 1, 1951.

As part of the legal requirements of the Social Security Act, the State of Tennessee is required to appoint a State Social Security Administrator (SSSA). Since the establishment of the Old Age & Survivors Insurance Agency (OASI) in the early 1950s, there have been only six SSSAs administering Section 218 of the Act for Tennessee public employees. Section 218 relates to coverage agreements and modifications as well as to coverage determinations.

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

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

The 1985 Budget Reconciliation Act mandated Medicare hospital insurance coverage for public employees hired after March 31, 1986 who do not have full Social Security coverage. In January 1987, the Internal Revenue Service took over collection of state and local government employee FICA taxes. Prior to 1987, the State and local entities turned the money over to the State Administrator who then turned the collected taxes over to the Social Security Administration by depositing the funds in the nearest Federal Reserve Bank. The Omnibus Budget Reconciliation Act of 1990 (OBRA) generally mandated full Social Security coverage for state and local government employees who are not covered by an employer-sponsored retirement plan.

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

Financial Statements for the Tennessee Consolidated Retirement System can be found on pages 113-141.

Deferred Compensation Program

The Deferred Compensation Program is a voluntary program designed to provide state employees with the opportunity to accumulate supplemental retirement income on a tax-advantaged basis. Participants may postpone income taxes on contributions and earnings by agreeing to defer receipt of a portion of their current income until retirement. The 401(k) Plan also offers employees a designated Roth 401(k) contribution option. The contributions are made after tax and the distributions are tax-advantaged, subject to timing restrictions.

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

As of June 30, 2014, accounts were held by 77,390 individuals in the 401(k) plan and 6,450 individuals in the 457 plan. At fiscal year end, 30,073 state employees, 9,635 University of Tennessee employees, 11,218 Tennessee Board of Regents and 581 Local Government employees were actively contributing to the 401(k) plan and 2,391 state employees, 774 University of Tennessee employees, 447 Tennessee Board of Regents and 85 Local Government employees were actively contributing to the 457 plan.

The program is used by state employees of all ages and salary levels. The majority of active contributors are under age 46 and earn below $46,000 per year.

IRS regulations for 2014 allow a maximum deferral in the 457 plan of 100% of compensation up to the maximum annual contribution of $17,500. The maximum deferral in the 401(k) plan is 100% of compensation up to the maximum annual contribution of $17,500. Participants who also use a 403(b) plan are subject to additional limits. Participants age 50 and older are eligible to make additional deferrals.

During the 2014 fiscal year, the state, the Tennessee Board of Regents and the University of Tennessee each matched their employees' contributions to the 401(k) plan at $50 per month as authorized by the General Assembly. The amount contributed by the state during the year was $29.0 million. Employees contributed $117.4 million.

Participants in the program at June 30, 2014 directed the investment of their deferred salary to the Nationwide Bank Account, Allianz NFJ Large Cap Institutional Fund, Calvert Income Fund, Columbia Acorn Z Fund, Columbia Midcap Value Z Fund, DFA International Value Fund, Fidelity Contra Fund, Fidelity International Discovery Fund, Fidelity OTC Portfolio Fund, Fidelity Puritan Fund, Brown Capital Management Small Company Fund, Invesco Van Campen Small Cap Value Fund, Vanguard Institutional Index Fund, Vanguard Total Bond Market Index and the ING Fixed Account. A self-directed brokerage account option provides access to additional mutual funds.

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

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

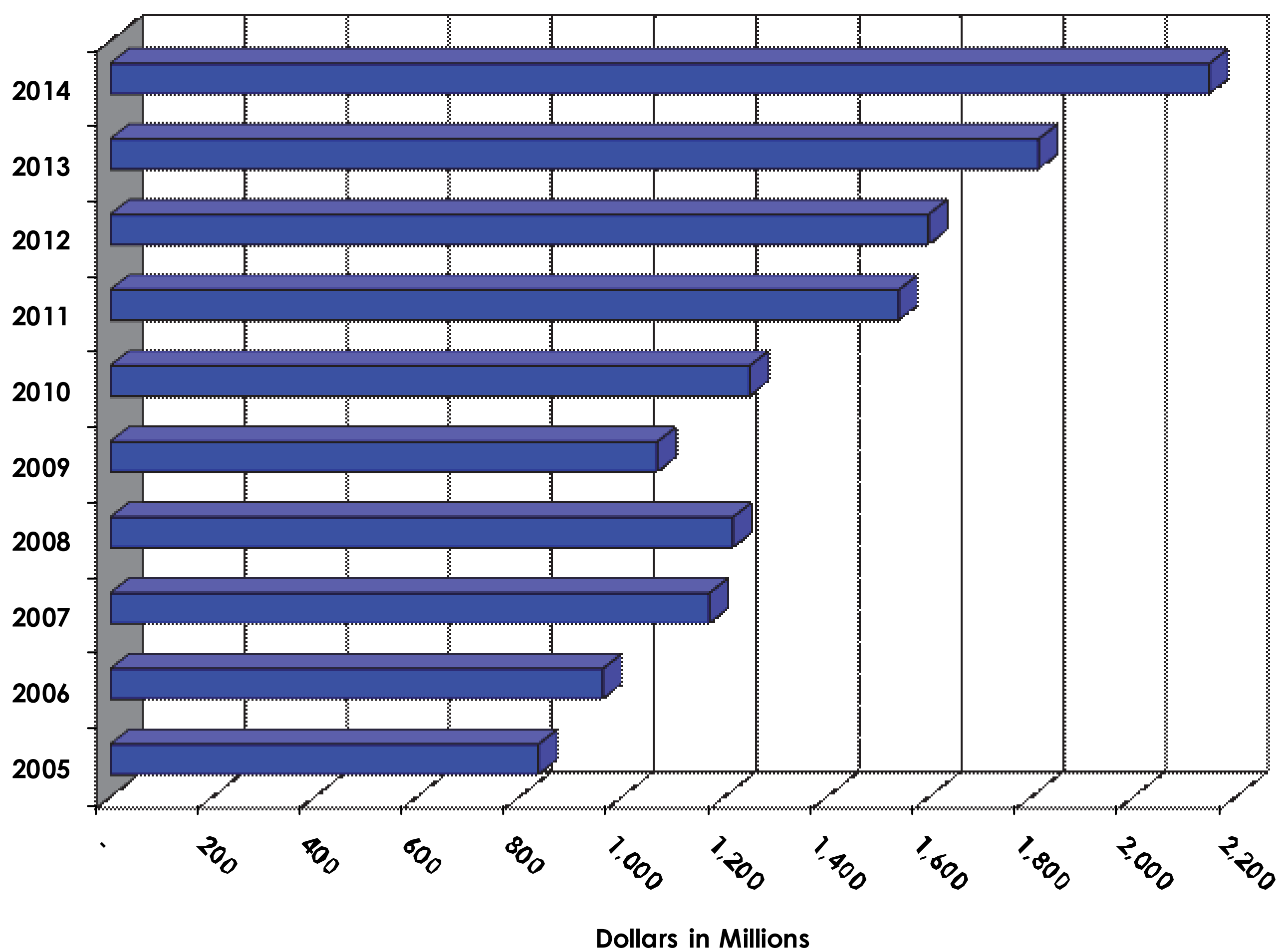
The Internet site, www.tn.gov/treasury/dc, provides full information about the program. Information available through the site includes forms, participation information and illustrations, descriptions of the investment choices and historical performance figures, an interactive benefit calculator, complete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

For the year ending June 30, 2014, contributions to the program totaled $146.4 million. Contributions are wired for immediate crediting. At June 30, 2014, accumulated account balances totaled $2.15 billion.

Under the loan program offered in the 401(k) plan, active employees who have accumulated $4,000 or more in their 401(k) account may borrow up to half of their account value. Participants repay principal and interest to their 401(k) account through salary deduction. Taxes continue to be deferred while funds accumulated in the plan are in loan status. As of June 30, 2014, there were 7,376 loans outstanding from the 401(k) plan. Outstanding loan balances totaled $31.8 million.

Benefits from the program may be distributed in periodic payments, in an annuity or in a lump sum. During the year ended June 30, 2014, there were 2,351 periodic payments made from the program. Members may choose monthly, quarterly, semi-annual or annual payments. In addition, 4,948 lump-sum distributions and 6,764 partial lump-sum distributions were issued during fiscal year 2014.

Deferred Compensation Program Assets
Expressed in Millions
Fiscal Years 2005-2014



Deferred Compensation Contributions and Market Value
Fiscal Year 2014

	Contributions FY 2013-2014	Market Value June 30, 2014
Plan I (457)		
Allianz	$ 319,243	$ 1,651,387
American General	5,655	441,405
Brown Capital	387,814	3,470,627
Calvert	750,661	8,841,668
Columbia	790,203	6,412,879
Dimensional	562,431	4,538,523
Fidelity	7,437,927	135,796,742
ING	2,349,979	46,577,290
Invesco	404,177	5,122,237
Nationwide	1,122,713	17,386,812
TD Ameritrade	0	391,433
Vanguard	7,944,263	38,973,921
	$ 22,075,066	$ 269,604,924
Plan II (401K)		
Allianz	$ 964,263	$ 9,625,794
Brown Capital	1,424,974	18,639,486
Calvert	3,598,558	49,947,438
Columbia	3,194,640	36,517,495
Dimensional	1,830,895	17,879,424
Fidelity	54,613,614	1,116,560,081
ING	15,771,280	242,740,318
Invesco	1,534,464	19,576,356
Nationwide	10,082,410	120,734,224
TD Ameritrade	0	2,360,091
Vanguard	31,262,986	244,932,027
	$ 124,278,084	$ 1,879,512,734
Total for Both Plans	**$ 146,353,150**	**$ 2,149,117,658**

Flexible Benefits Plan

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

In exchange for its favorable tax treatment, the plan must comply with specific rules set forth by the Internal Revenue Code and Regulations. Employees must decide what they will purchase through the plan and how much they will spend before the year begins. State employees enrolled in a group health or dental insurance program are automatically enrolled in the insurance premium portion of the plan. Use of the other benefit options requires a new election each year.

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

Effective January 1, 2009, the Flexible Benefits Plan offers employees the opportunity to open transportation and parking flexible benefits accounts as authorized by Section 132 of the Internal Revenue Code. These accounts benefit employees by allowing them to designate an amount, up to the established limitations, to be withheld from their paychecks as a pre-tax benefit. These deductions are exempt from Federal Income and Social Security taxes. Participation in this program will result in the employee having a lower tax obligation during each calendar year in which they participate.

Unlike medical and dependent care flexible benefits accounts, there is no requirement for new employees to enroll within 30 days of being hired and there is no annual enrollment period for existing employees. An employee may enroll in a transportation account and/or a parking account at any time during employment. Transportation and parking flexible benefits accounts can be terminated at any time by the employee.

At June 30, 2014, over 36,000 state employees were enrolled in one or more of the plan's four Section 125 options: 36,573 employees used the plan to pay medical insurance premiums, 29,166 paid dental insurance premiums, 3,923 used the medical expense reimbursement account and 387 used the dependent care reimbursement account. In addition, 222 and 68 state employees participated in the parking and transportation reimbursement accounts, respectively.

Financial Statements for the Flexible Benefits Plan can be found on pages 86-89.

Certified Public Administrator

The University of Tennessee Institute for Public Service administers the "County Official's Certificate Training Program Act." Certain full-time county officials are eligible for an educational incentive payment if the officials have completed the continuing education requirements of the program. The UT Institute for Public Service is required to provide the Treasurer's office a listing of those officers who have successfully completed all levels of the County Officials Certificate Training Program. The educational incentive payments are issued by the State Treasurer. The State Treasurer must issue such payments no later than October 31 of each year. The program began in 1998.

The following table sets out the number of county officials receiving payment in October, 2013:

County Official	Number Receiving Payment
Register of Deeds	58
Trustee	55
Clerk & Master	50
County Clerk	48
Circuit Court Clerk	43
County Mayor/County Executive	31
Assessor of Property	19
Chief Administrative Officer of Highways	12
Sheriff	5
Criminal Court Clerk	2
Juvenile Court Clerk	3
General Sessions Court Clerk	1
Probate Court Clerk	0
Total	327

The table below sets out a five-year history of recipients to receive educational incentive payments. The payment amount is determined by the number of eligible recipients and the appropriation amount in the annual state budget.

Fiscal Year Ended June 30	Recipients	Amount Paid Per Recipient	Total Payments
2014	327	$ 1,249	$ 408,423
2013	328	1,242	407,376
2012	299	1,362	407,238
2011	332	1,223	406,036
2010	312	1,500	468,000

County Provided Incentive Payment

Each county is encouraged and authorized to provide in its annual budget for payment of an annual educational incentive to certain employees who attain the designation of a "certified public administrator" in an amount not to exceed $3,000 less any incentive payment made by the State Treasurer. Such payments shall be paid by the county by October 31 of each year. The County Mayors shall provide to the State Treasurer the amount of any educational incentive paid by the county and the number of persons receiving such incentive. Summary information is provided below:

Number of counties that provided an incentive	12
Number of counties that did not provide an incentive	50
Number of counties that did not provide information	33
Total	95
Total amount of incentives paid	$217,792
Total number of recipients	173
Average incentive payment	$ 1,259

PROGRAMS FOR THE GENERAL PUBLIC

TNStars™ and Baccalaureate Education System Trust

Tennessee Financial Literacy Commission

Unclaimed Property Division

Small and Minority-Owned Business Assistance Program

TNStars™ College Savings 529 Program
Baccalaureate Education System Trust

The TNStars™ College Savings 529 Program is the State of Tennessee's educational savings plan. Recognizing the need for a highly-skilled workforce and the role that higher education plays in achieving that goal, the State of Tennessee has developed the TNStars™ College Savings 529 Program, a program of the Tennessee Treasury Department.

The TNStars™ College Savings 529 Program is designed to make college savings easy. The savings plan offers parents and other relatives a low-cost way to save for children's college expenses with attractive investment options, incentives for Tennessee residents and special tax advantages. The savings plan also offers financial incentives to encourage Tennessee families to save.

The savings plan offers an age-based track where the allocation becomes more conservative as the child approaches college. The savings plan also offers individual investment options including domestic and international equities, balanced fund options, fixed income options and an FDIC-insured option. The underlying funds for each of the options are from a range of fund companies including Vanguard, DFA, Primecap, Great West and First Tennessee Bank. The savings plan offers the products at a competitive fee of 0-35 basis points. At June 30, 2014, the savings plan held net position totaling $17.6 million.

Tennessee Code Annotated, Title 49, Chapter 7, Part 8 sets forth the Tennessee Baccalaureate Education System Trust (BEST) Act. The Act creates a tuition program, as an agency and instrumentality of the State of Tennessee, under which parents and other interested persons may assist students in saving for tuition cost of attending colleges and universities. The tuition program is known as the BEST Program and is comprised of two types of tuition plans: an educational services plan (prepaid plan) called the BEST Prepaid Plan and an educational savings plan (savings plan) called the TNStars™ College Savings 529 Program. The BEST Prepaid Plan began accepting contracts and contributions in June, 1997. On November 22, 2010, the BEST Board voted to stop selling units in the BEST Prepaid Plan. The remaining participants in the program receive the yearly increases in the weighted average tuition. At June 30, 2014, the prepaid plan held net position totaling $87.6 million. The TNStars™ College Savings 529 Program was launched in September 2012.

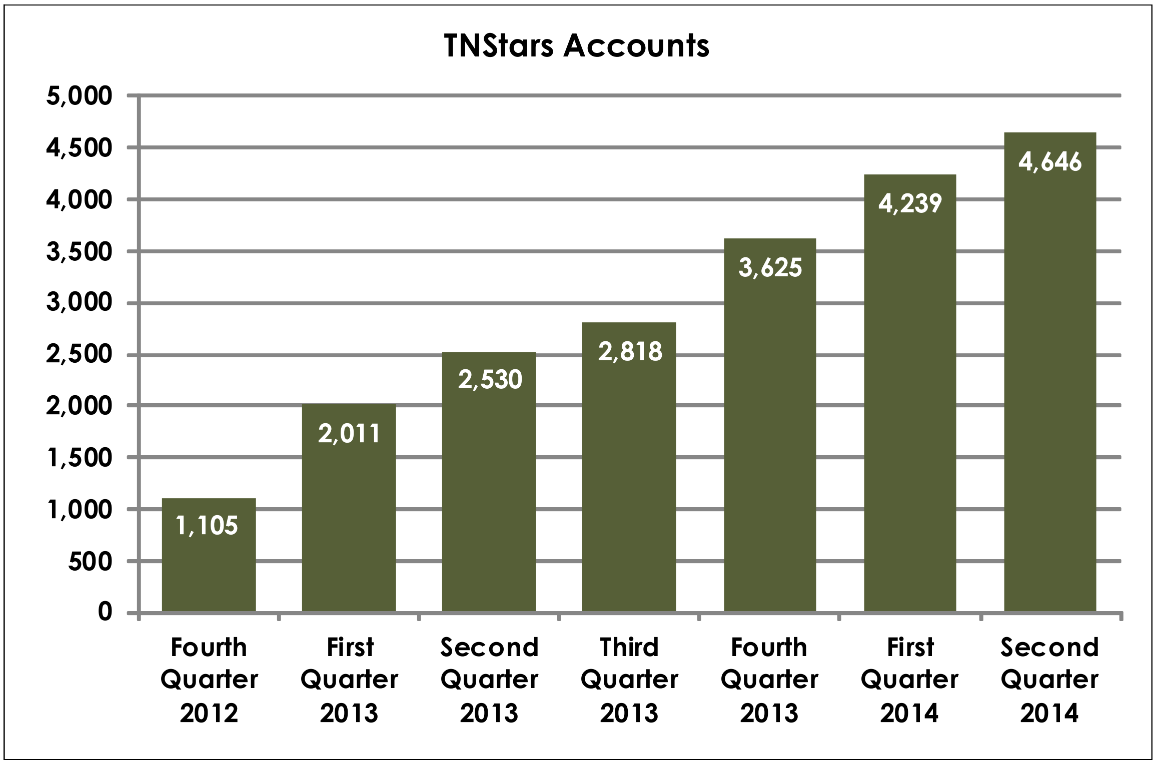
The federal guidelines for the 529 plans are contained in Section 529 of the Internal Revenue Code. The requirements for participation and administration of the Prepaid College Tuition Plan are contained in *Chapter 1700-5-1* of the *Official Compilation of the Rules and Regulations of the State of Tennessee*. The requirements for participation in the TNStars™ College Savings 529 Program are contained in *Chapter 1700-5-4 of the Official Compilation of the Rules and Regulations of the State of Tennessee.*

Both programs offer several favorable tax benefits to participants. Accounts are exempt from all federal, state and local taxes if used for qualified education expenses. In addition, earnings on any distribution used to pay for qualified higher education expenses are exempt from taxation. Qualified expenses include tuition, fees, supplies, books, room and board and supplies and equipment required for enrollment or attendance. Monies saved in the plans may be used at any accredited higher education institution (in-state or out-of-state), public or private. The funds may also be used at vocational, technical schools, professional and graduate schools. Participants do not have to choose a specific school when they enroll in either program. The maximum account limit for a beneficiary in both programs is $235,000.

Interested parties and participants may utilize the TNStars™ College Savings 529 Program website for information and to enroll and maintain their accounts online. The program website is www.tnstars.com. Questions or comments about the program may be emailed through this site or interested parties may call 855-3TN-STAR (386-7827).

Financial Statements for the TNStars™ College Savings 529 Program can be found on pages 142-148.

Financial Statements for the Baccalaureate Education System Trust can be found on pages 65-69.


TNStars Accounts
5,000
4,500
4,000
3,500
3,000
2,500
2,000
1,500
1,000
500
0
1,105
2,011
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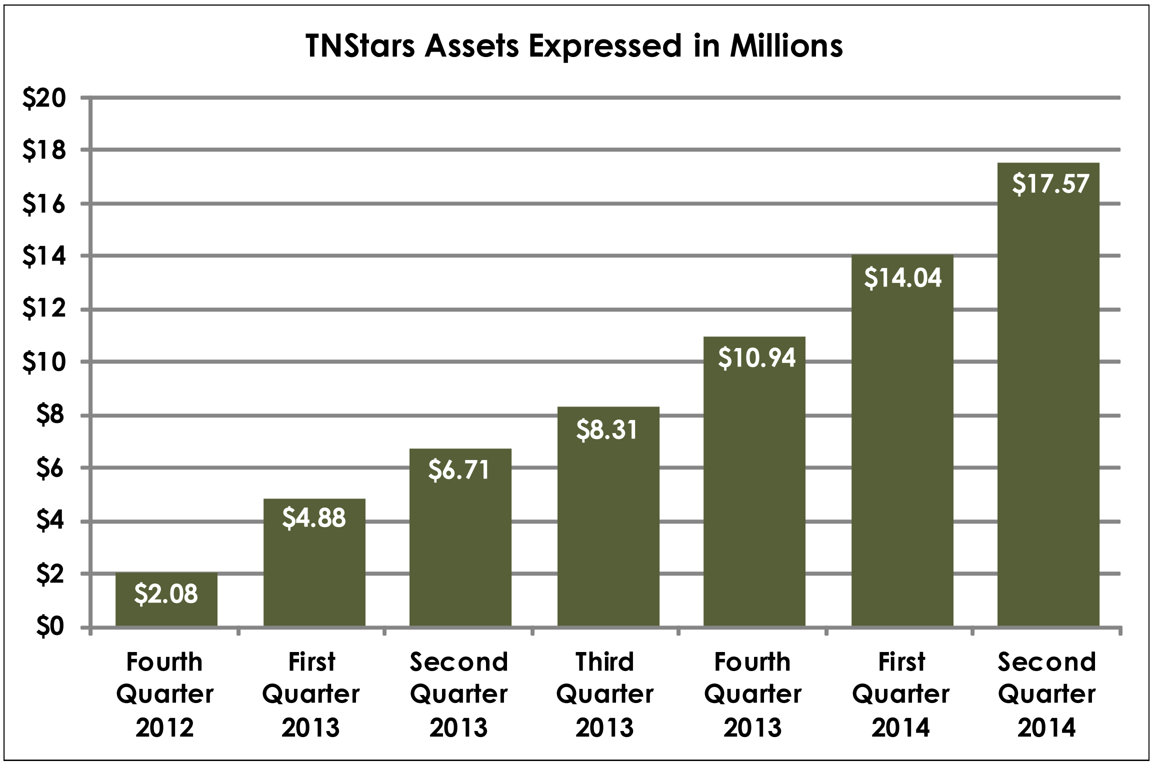
Fourth Quarter 2012
First Quarter 2013
Second Quarter 2013
Third Quarter 2013
Fourth Quarter 2013
First Quarter 2014
Second Quarter 2014


TNStars Assets Expressed in Millions
$20
$18
$16
$14
$12
$10
$8
$6
$4
$2
$0
$2.08
$4.88
$6.71
$8.31
$10.94
$14.04
$17.57
Fourth Quarter 2012
First Quarter 2013
Second Quarter 2013
Third Quarter 2013
Fourth Quarter 2013
First Quarter 2014
Second Quarter 2014

Tennessee Financial Literacy Commission

The Tennessee Financial Literacy Commission ("Commission") was established in 2010 by act of the General Assembly with the mission to equip Tennesseans to make sound financial decisions when it comes to planning, saving and investing. Financial literacy enables individuals and families to make the best use of their financial resources at key decision points in life, such as college savings for children, getting the most for your money when buying a car or home, saving for retirement, and gaining the financial discipline to save regularly. The need for financial literacy education exists for Tennesseans of all age, economic status and educational background.

The State Treasurer serves as the Chair of the Board of Directors for the Tennessee Financial Literacy Commission. Other members include the commissioners of the departments of education and financial institutions, and eight other Tennesseans appointed by the Lieutenant Governor and Speaker of the House. The Commission is a 501(c)(3) non-profit corporation and contributions are tax-deductible to the extent allowed by law. Over half of the Commission's budget comes from donations by Tennessee businesses and individuals who are committed to improving the financial literacy of our state.

For the recent fiscal year, the Commission sought to expand financial literacy in Tennessee through two primary ways:

(1) training elementary and middle school teachers in personal financial literacy and how to teach financial literacy, and providing free curriculum for classroom use ; and

(2) educating students and parents directly through a financial literacy computer game.

Unclaimed Property Division

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

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

During the period July 1, 2013 through June 30, 2014, $63.1 million of cash property was turned over to the Treasurer. This includes $10.4 million remitted by third party audit organizations from out-of-state, non-reporting holders for Tennessee residents. An additional $15.0 million in proceeds from stock sales was recognized as revenue.

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

The Treasurer utilizes various methods to locate owners of unclaimed property. Initially, notification to the last known address of each owner is sent. If no response is received, additional search efforts are made through the Department of Labor and Workforce Development records, telephone directories, drivers' license records, external locate research tool and other sources. Finally, the names of owners and last known addresses are advertised in newspapers throughout the state.

In addition, a searchable database of the owners' names is available on the division's Internet site: ClaimITTN.gov. In addition, the owners' names are available on the national website, Missing Money, at www.missingmoney.com. The records of unclaimed property owners are also available for viewing by the public in the Unclaimed Property office.

During the period July 1, 2013 through June 30, 2014, $26.1 million of cash property was returned by the Unclaimed Property Division to the owners or their heirs, local governments and reciprocal states.

Any local government in Tennessee that turns over unclaimed property to the state may request that the property be returned to the local government for safekeeping after it has been held by the state for 18 months. This fiscal year, $759,000 was refunded to 28 local governments.

Tennessee has reciprocal agreements with other unclaimed property programs in other states to exchange property held by one state for owners with a last known address in the other state. Tennessee received $654,000 for residents or former residents in exchange for $179,000 paid to other states' unclaimed property offices.

Since the program began operations in 1979, $990.4 million in unclaimed property has been reported to the Treasurer and $320.8 million has been returned to owners, heirs, local governments and reciprocal states.

After all location techniques are employed, the Unclaimed Property Division is able to return approximately 60% of property that is turned over with an owner's name.

After all location techniques are employed, the Unclaimed Property Division is able to return approximately 60% of property that is turned over with an owner's name.

Methods Used to Return Property
Fiscal Year 2014

Location Method	Value of Claims	Number of Accounts	Average Claim Value
Website Inquiries	$12,995,904	13,907	$ 934
Mailings to Last Known Address	2,993,190	7,678	390
Independent Locator	2,515,599	119	21,139
Holder Referral or Reimbursement	2,126,473	1,009	2,108
Staff or Other Outreach	1,804,627	1,869	966
Match with Dept. of Labor and Work Force Records	1,690,264	4,542	372
Advertisement	1,115,757	1,281	871
Total Claim Payments	$25,241,814	30,405	$ 830
Refunds to Local Governments	759,400	28	
Interstate Exchanges	179,518	2	
Total Payments	**$26,180,732**	**30,435**	

Sources of Unclaimed Property
Fiscal Years 2010-2014

	2014	2013	2012	2011	2010
Insurance Companies	32%	49%	22%	16%	19%
Financial Institutions	28%	18%	30%	27%	23%
Retailers, Services, Telecommunications, Colleges	18%	14%	19%	10%	14%
Cities and Counties	5%	8%	5%	8%	8%
Corporations, Transportation, Manufacturing, Natural Resources	4%	3%	7%	15%	18%
Hospitals and Healthcare	4%	3%	5%	5%	4%
Utilities	4%	2%	4%	6%	7%
Other States, Escheat and Other	3%	1%	1%	3%	4%
Securities and Brokerage Firms	2%	2%	7%	10%	3%
Total	**100%**	**100%**	**100%**	**100%**	**100%**

Activity
Fiscal Years 2010-2014

	2014	2013	2012	2011	2010
Number of Holders Reporting	7,071	7,177	7,236	7,577	6,931
Number of Properties Received	666,385	563,506	498,009	529,502	543,412
Cash Received (not including shares sold)	$63,123,121	$92,029,270	$56,866,754	$60,128,207	$50,158,392
Number of Shares Received	3,211,927	3,578,919	3,682,696	13,412,891	1,859,331
Value of Shares Sold	$14,948,614	$ 7,659,728	$ 8,189,532	$11,408,829	$13,659,794
Number of Claims Paid	30,435	19,889	14,800	18,884	19,446
Cash Paid	$26,180,732	$27,694,701	$20,726,913	$23,661,977	$23,648,637
Shares Paid	189,659	343,116	150,722	234,684	254,547

Small and Minority-Owned Business (SMOB) Assistance Program

Chapter 830 of the Tennessee Public Acts of 2004 created, within the Treasury Department, the Small and Minority-Owned Business Assistance Program (SMOB). Chapter 830 required the Department, by rule, to develop an assistance program for small and minority-owned businesses, as defined in Tennessee Code Annotated, Section 65-5-113, which will include loans, technical assistance, consulting and educational services. The legislative intent is for the Department to use the assistance provided by this program to support outreach to new, expanding and existing businesses in Tennessee that do not have reasonable access to capital markets and traditional commercial lending facilities.

The SMOB Program replaced the Small and Minority-Owned Telecommunications Business Assistance Program that was administered by the Department of Economic and Community Development. The Telecommunications Program provided loan guarantees to qualifying businesses. With all program obligations met, the program has been phased out. Whereas the Telecommunications Program focused on a specific facet of industry, the SMOB Program was designed to perpetuate growth on a less restrictive continuum.

The principle function of the SMOB Program is to provide a significant state-wide platform through a support structure that fosters the expansion of small and minority-owned businesses in Tennessee. The SMOB Program consists of two components: loans (including lines of credit) and program services. The loans provided must be for a specific project. Acceptable purposes for loan proceeds include:

- acquisition of machinery and equipment
- working capital
- supplies and materials
- inventory
- certain other business-related activity

There are certain types of businesses that are deemed ineligible to receive assistance from the SMOB Program. Ineligible businesses include:

- churches
- non-profit organizations
- insurance companies
- real estate contractors or developers
- night clubs and any similar entertainment-oriented business
- businesses that do not create or provide jobs
- businesses not incorporated or located in Tennessee.

The Treasury Department handles the daily operation of the program and oversees activities of the lenders who make the loans to the businesses that qualify for participation in the program.

Lenders for the SMOB Program are:

- Chattanooga Neighborhood Enterprises
- East Tennessee Development District
- Nashville Minority Business Development Loan Fund
- Pathway Lending
- South Central Tennessee Development District
- Tri-State Bank of Memphis

Interested parties may utilize the SMOB Program's website, located at www.tn.gov/treasury/smob, to learn about the program.

OUTSTANDING LOANS AS OF JUNE 30, 2014

Race	Male	Female	Number of Loans	Total Loans By Race
African-American	$ 424,522	$ 683,804	23	$ 1,108,326
White	162,395	121,699	8	284,094
Other	38,824	117,050	2	155,874
Total Loans	$ 625,741	$ 922,553	33	$ 1,548,294

OPERATIONAL PROGRAMS

Chairs of Excellence Trust
Risk Management
Claims Administration
Claims Against the State
Criminal Injuries Compensation
Claims Commission

Chairs of Excellence Trust

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

The funding of the program is provided through contributions (corpus) made by a private donor and a matching amount by the state, thus creating a chair. A chair is authorized to spend 4% of the 3-year average market value of the chair. However, the corpus can not be spent.

Since the beginning of the program in 1984, there have been 99 chairs created, with state appropriations totaling $44 million and matching contributions totaling $55.9 million.

Financial Statements for the Chairs of Excellence Trust can be found on pages 70-78.

Five-Year History
Fiscal Years 2010-2014

Fiscal Year	Investment Income/(Loss)	Total Spending of the Chairs	Asset Balance
2014	$41,908,051	$7,128,688	$294,554,531
2013	23,379,827	7,129,665	261,807,326
2012	10,300,357	7,108,557	245,745,038
2011	34,346,000	6,561,577	243,105,645
2010	22,324,590	6,937,327	215,665,629

Annualized Investment Return

	1 Year	5 Years	10 Years
Domestic Equity	24.56%	18.78%	7.77%
International Equity	22.72%	11.36%	-
Fixed Income	4.57%	5.52%	5.06%
Total Portfolio	13.90%	10.71%	6.15%

Authorized Chairs of Excellence

The University of Tennessee

Chattanooga

Cline COE in Rehabilitation Technology
COE in Judaic Studies
Frierson COE in Business Leadership
Harris COE in Business
Lyndhurst COE in Arts Education
McKee COE in Learning
Miller COE in Management and Technology
Sun Trust Bank COE in the Humanities
Unum COE in Applied Mathematics
West COE in Communications and Public Affairs

Knoxville

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

Martin

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

Memphis

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

Space Institute

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

Authorized Chairs of Excellence

Tennessee Board of Regents

Austin Peay State University

- Acuff COE in Creative Arts
- APSU Foundation Chair of Free Enterprise
- Harper/James and Bourne COE in Business
- Reuther COE in Nursing

East Tennessee State University

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

Middle Tennessee State University

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

Tennessee State University

- COE in Banking and Finance
- Frist COE in Business Administration

Tennessee Technological University

- Mayberry Chair of Business Administration
- Owen Chair of Business Administration

University of Memphis

- Arthur Andersen Company Alumni COE in Accounting
- Bornblum COE in Judaic Studies
- COE in Art History
- COE in English Poetry
- COE in Free Enterprise Management
- Federal Express COE in Management Information Systems
- Feinstone COE in Molecular Biology
- Fogelman COE in Real Estate
- Hardin COE in Combinatorics
- Hardin COE in Economics/Managerial Journalism
- Herff COE in Biomedical Engineering
- Herff COE in Computer Engineering
- Herff COE in Law
- Lowenberg COE in Nursing
- Moss COE in Philosophy
- Moss COE in Psychology
- Moss COE in Urban Education
- Plough COE in Audiology and Speech Language Pathology
- Sales and Marketing Executives of Memphis COE in Sales
- Shelby County Government COE in International Economics
- Sparks COE in International Relations
- Thompson-Hill COE in Accounting
- Wang COE in International Business
- Wunderlich COE in Finance

Division of Risk Management

The Division of Risk Management identifies and analyzes the state's exposure to property and casualty risks and implements certain risk management techniques to mitigate the state's exposure to loss. The state funds various levels of risk retention through the Risk Management Fund.

The state contracts with private insurance brokers to research the insurance marketplace and target only those insurance carriers with the highest A.M. Best ratings, which are capable and willing to provide competitive insurance quotes for the state's various lines of coverage. The lines of insurance coverage that the state acquires include property, builders' risk, aviation, fidelity and crime, boiler and machinery and fine arts. Fiscal year 2013-2014 premium costs for all lines of property and casualty coverage amounted to $5.8 million.

The state's primary level of property insurance limits was increased to $750 million. Flood coverage remained at $50 million, including properties in 100-year flood zones. Earthquake limits, once again, remained at $50 million for all zones except the New Madrid area, where limits were $25 million. The state, however, was able to purchase excess earthquake in the amount of $25 million, providing a total of $50 million coverage for New Madrid zones. The state's annual aggregate deductible is $10 million for property. The perils of earthquake and flood are a $10 million per occurrence deductible each. As of July 1, 2014, total insured property values were $19.3 billion.

Cyber Liability Insurance is a new line of coverage effective July 1, 2013. This policy provides coverage for UT, TBR and general government. The premium is $220,000 with a maximum limit of $5 million for the entire policy period. The policy has coverage for privacy breach response costs, customer notification, expenses, customer support and credit monitoring expense. Other lines of coverage are security and privacy liability, privacy regulatory defense and penalties, multi-media liability, network asset protection, cyber extortion and cyber terrorism.

Boiler and Machinery insurance is procured to protect the state's 2,300 boiler objects. This policy performs two major functions: (1) provides boiler breakdown coverage and (2) assumes the responsibility for jurisdictional inspections on all pressure vessels. Certified inspectors evaluate all boiler objects on a scheduled basis to ensure the safe operation of the objects which, in turn, will prevent loss to human life and property. This loss prevention program has proven very effective with results showing no major incidents within the past ten years.

To protect the state from financial loss due to employee dishonesty, a fidelity and crime policy is obtained. Coverage limits are provided in the amount of $3 million per occurrence. A policy endorsement is added to extend coverage to treasurers and tax collectors.

At June 30, 2014, seven state agencies had 54 aircraft where hull insurance and liability insurance coverage quotes were obtained. The purchase of hull insurance is a business decision made by each agency for each aircraft. Liability insurance is purchased for every aircraft. The level of liability coverage varies for each aircraft and is generally based on type of aircraft, usage and size as measured by the number of seats.

In case of losses, Risk Management administers the claims process for all lines of coverage. The division coordinates the activities of the insurance carrier, independent adjusters, state facility managers and state agency contacts. For emergency situations, a restoration company is under state contract to provide immediate response to prevent costly damages. A detailed property inventory (schedule) provides the current insurable values for both buildings and contents. Agency deductibles vary according to the type of claim: (1) Property - $25,000, (2) Cyber - $500,000, (3) Boiler - $10,000, (4) Fine Arts - $0 and (5) Fidelity and Crime - $100,000. If a loss exceeds the agency deductible, loss costs are paid from the Risk Management Fund until the state's annual aggregate deductibles are satisfied. Any remaining costs are the responsibility of the insurance carriers up to their policy limits.

The prevention and control of losses are important in managing the state's risks. In fiscal year 2013-2014, risk management staff conducted loss prevention surveys at approximately 30 locations. A total of 100 buildings were inspected for fire/life safety hazards. During these inspections, safety violations were recorded and corrective action reports were submitted to the agencies with recommendations for safety code compliance. Follow up for correction of safety violations is performed timely.

STATE PROPERTY
SUMMARY OF KEY POINTS
FISCAL YEAR 2013-2014

Insurance Coverage Information:		
Insured Property Values	$	19,362,348,300
Primary Property Limits (Per Occurrence)		750,000,000
Annual Aggregate Deductibles:		
Property	$	10,000,000
Earthquake (Per Occurrence)		10,000,000
Flood (Per Occurrence)		10,000,000

Financing of Estimated Property Losses:		
Cumulative Agency Deductibles (Agency Obligation)	$	750,000
Risk Management Fund Obligation		2,652,417
Total Property Losses	$	3,402,417

The amount of coverage, the level of the deductibles, the selection of the insurance companies to provide coverage and the amount of the insurance premium are reviewed and approved annually by the Board of Claims, which is our oversight committee.

Financial Statements for the Risk Management Fund can be found on pages 96-102.

Claims Against The State

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

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

The Division of Claims Administration contracts with a third-party administrator for the processing of workers' compensation claims and provides managed-care services to all State employees who are injured while performing their daily assignments. The third-party administrator has established a workers' compensation preferred provider network for medical treatment to ensure the best quality care for assisting injured employees with their recovery process. The third-party administrator managed-care services also provide 24/7 nurse triage, case management services such as pre-certification for inpatient hospital care, bill review, large case management and other services to manage the costs of workers' compensation claims. The use of a preferred provider network allows the state to negotiate further savings off workers' compensation medical bills after the mandated fee schedule reduction, which became required on January 1, 2006. Our ultimate goals are to assist the injured employee with their recovery process, to provide them access to exceptional medical services and providers and to ensure excellent customer service during the entire workers' compensation process.

In 2014, the Division of Claims Administration implemented a Pharmacy Network Program for state employees and higher education employees. The Pharmacy Network Program is designed to generate savings relative to pharmacy expenses in the following manner: (1) using economy of scale to obtain discounts beyond the fee schedule; (2) performing utilization review; (3) encouraging equivalent use of lower cost generic drugs; (4) encouraging lower cost home deliveries of medication; and (5) monitoring for abuse/misuse of both employee and medical prescribers. For fiscal year 2014, the savings with the pharmacy benefit manager (PBM) program was $993,945.

During fiscal year 2014, the Division of Claims Administration received 4,762 claims falling within these categories (including workers' compensation claims filed with the third-party administrator). In order for a claim to be acted upon by the Division of Claims Administration, notice must be filed with the division. The division then has 90 days to make a determination on the claim. If the division is unable to act, the claim is automatically referred to the Tennessee Claims Commission. This process ensures that claims will be processed in a timely fashion.

The Division of Claims Administration also provides staff support to the Board of Claims. The Board of Claims has the authority to hear claims which do not fall within the jurisdiction of the Tennessee Claims Commission. During the 2014 fiscal year, the Board took action on (2) two claims. The Board also reviews and approves the purchase of insurance policies by the state and makes recommendations to the Commissioner of Finance and Administration and the General Assembly regarding the required funding for the Risk Management Fund. In 2014, the Board also enacted a Conflict of Interest Policy for all members and associate members. The purpose of the policy is to identify, evaluate and disclose any actual or potential conflicts of interest that a Board member may have in serving on the Board of Claims and to ensure that the activities of Board members and associate members do not conflict or have the appearance of conflicting with the provision of full and unbiased service to the public.

Claims and Payment Activity
Fiscal Year 2014

Claims Activity	Payments Made
Worker's Compensation Claims	
Medical Payments	$ 14,476,573
Permanent Disability	8,353,721
Temporary Disability	3,625,925
Death Payments	254,697
Subtotal	26,710,915
Employee Property Damage	21,512
Tort Claims	
Bodily Injury Payments	2,516,951
Death Payments	1,064,705
Property Damage Payments	927,781
Subtotal	4,509,437
Total Claims Against the State	**$ 31,241,864**

Five-Year Claims History
Fiscal Years 2010-2014

Fiscal Year	Amount of Claims Paid
2014	$ 31,241,864
2013	30,447,464
2012	34,186,267
2011	31,249,686
2010	29,732,845

Claims Filed By Program
Fiscal Years 2010-2014

Fiscal Year	Workers' Compensation	Employee Property Damage	Tort	Total
2014	2,908	66	1,788	4,762
2013	3,078	94	1,616	4,788
2012	3,127	89	1,683	4,899
2011	3,296	132	1,708	5,136
2010	3,360	119	1,766	5,245

Criminal Injuries Compensation Fund

The Criminal Injuries Compensation Fund ("Fund") provides financial assistance to crime victims through two types of programs. The funding for the programs includes privilege taxes assessed in courts against criminal defendants and other offenders upon conviction, fees levied against parolees and probationers, the proceeds of bond forfeitures in felony cases and a federal grant. Jurors may also elect to donate their jury service reimbursement to the fund.

Criminal Injuries Compensation Program

Payments made under the Criminal Injuries Compensation Program are intended to defray the costs of medical services, loss of earnings, burial costs and other pecuniary losses to either an innocent victim of a crime or to the dependents of a deceased victim. Applications for Criminal Injuries Compensation are filed with the Division of Claims Administration. During the 2014 fiscal year, 2,428 new claims were filed.

The division's staff reviews the application and obtains supporting information from the appropriate District Attorney's Office to determine eligibility for payment from the Criminal Injuries Compensation Fund. If the division cannot process a claim within 90 days, then the claim is transferred to the Tennessee Claims Commission. Eligible payments are issued promptly and are payable directly to the service provider if the bill is unpaid, to the victim for out-of-pocket expenses and, if appropriate, his or her attorney. On average, the division renders a decision on claims within 54 days.

During the 2014 fiscal year, the Division of Claims Administration made payments to victims of crime totaling $11.3 million.

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

Since the first claims were paid in 1982, the program has awarded a total of more than $265.6 million to crime victims.

The Division of Claims Administration has made an effort to educate members of the public of the existence and benefits of the Criminal Injuries Compensation Program by printing and distributing informative brochures explaining the program. Public awareness efforts and the use of victim assistance coordinators in each judicial district have also aided in providing the public with information about the benefits provided through the Criminal Injuries Compensation Fund.

Sexual Assault Forensic Exam Reimbursement

In 2007, the General Assembly amended the Criminal Injuries Compensation Act to provide payment for services related to sexual assault forensic examinations. The Fund provides reimbursement to a facility that performs sexual assault forensic exams on victims of certain sexually-oriented crimes. Facilities must bill the Fund (not the victim) and cannot seek any additional payment from the victim after payment by the Fund. Payment is up to $750 for such services for crimes occurring on or after July 1, 2007. During the 2014 fiscal year, 2,108 forensic claims were filed. On average, the division renders a decision within 30 days.

Financial Statements for the Criminal Injuries Compensation Fund can be found on pages 79-85.

Sources of Funds
Fiscal Years 2012-2014

	2012		2013		2014	
Source	**Amount**	**Percentage**	**Amount**	**Percentage**	**Amount**	**Percentage**
Fines	$ 6,353,236	45%	$ 6,474,210	41%	$ 6,305,576	46%
Federal Funds	4,991,000	35%	5,650,000	36%	4,937,000	36%
Probation Fees	2,321,596	16%	2,261,368	14%	1,973,221	15%
Bond Forfeitures	569,550	4%	1,210,601	8%	368,841	3%
Other	20,163	0%	19,991	0%	9,049	0%
Total	$ 14,255,545	100%	$ 15,616,170	100%	$ 13,593,687	100%

Claims Paid by Crime or Claim Type
Fiscal Year 2014

Crime or Claim Type	**Number Paid**	**Percentage of Total Claims**	**Amount Paid**	**Percentage of Total Paid**
Assault	760	20.7%	$ 4,818,538	42.7%
Child Sexual Abuse	321	8.7%	781,523	6.9%
Homicide	291	7.9%	2,426,149	21.5%
Robbery by Force	167	4.5%	1,027,307	9.1%
Adult Sexual Assault	115	3.1%	323,174	2.9%
DUI	45	1.2%	277,792	2.5%
Hit and Run	26	0.7%	166,263	1.5%
Vehicular (Non-DUI)	13	0.4%	127,514	1.1%
Child Physical Abuse	1	0.0%	2,698	0.0%
Subtotal	1,739	47.3%	$ 9,950,958	88.2%
Forensic Exam	1,936	52.7%	1,330,037	11.8%
Grand Total	**3,675**	**100.0%**	**$ 11,280,995**	**100.0%**

New Claims Filed
Fiscal Year 2014

Crime or Claim Type	Number Filed
Assault	1,128
Child Sexual Abuse	418
Homicide	380
Adult Sexual Assault	160
Robbery by Force	147
Hit and Run	53
Vehicular (non-DUI)	53
DUI	49
Other	32
Child Physical Abuse	6
Arson	1
Kidnapping	1
Subtotal	2,428
Forensic Exams	2,108
Grand Total	**4,536**

Claims Denied
Fiscal Year 2014

Criminal Injuries Claims Reason Type	Number Denied	Percentage
Contributory Behavior	221	19.7%
Failure to Cooperate/Prosecute	184	16.4%
Insufficient Documentation	179	15.9%
Collateral Resource Covered Loss(es)	121	10.8%
Insufficient Proof of a Crime	76	6.8%
Ineligible Crime	69	6.1%
Other	59	5.3%
Ineligible Claimant	54	4.8%
Loss(es) Less than $100	52	4.6%
Late Filing of Claim	34	3.0%
No Collateral Resource Information	22	2.0%
Ineligible Loss(es)	15	1.3%
Passenger with Drunk Driver	15	1.3%
Crime Not Reported	9	0.8%
Late Reporting of Crime	8	0.7%
Claim Not Signed or Notarized	5	0.4%
Total Denial Reasons	**1,123**	**100.0%**

In fiscal year 2014, 920 criminal injuries claims were denied. Some claims are denied for more than one reason.

Claims Commission

The Claims Commission is an administrative tribunal created under Tennessee Code Annotated, Section 9-8-301, *et seq.*, to hear money damages claims against the state based on the acts or omissions of state employees in 22 statutory categories. Most notably, the Commission has jurisdiction over claims in tort (e.g. negligent care, custody and control of persons, property or animals; professional malpractice; negligent operation or maintenance of a motor vehicle; dangerous conditions on state maintained highways or state controlled real property); claims for breach of a written contract; claims for recovery of taxes paid under protest to the Department of Commerce and Insurance; state workers compensation claims and criminal injuries compensation claims. As a condition for the waiver of the state's sovereign immunity, state employees are immunized from liability for state law claims for acts or omissions within the scope of their employment, except for willful, malicious or criminal acts. Claims are payable from the Risk Management Fund.

Damages for tort claims falling within the Commission's jurisdiction are limited to $300,000 per claimant or $1,000,000 per occurrence. There is no limitation on awards for breach of contract. The maximum award for criminal injuries compensation claims is $30,000.

There are three Claims Commissioners, each of whom hears cases arising in his or her grand division. The current Commissioners are:

Nancy Miller-Herron, Western Division (Dresden)
Robert N. Hibbett, Middle Division (Nashville)
William Shults, Eastern Division (Newport)

As required by Tennessee Code Annotated, Section 9-8-302, each of the Commissioners was appointed by the Governor and confirmed by the General Assembly. In addition, the Commissioners have been residents of Tennessee for more than five years, have been residents of their respective grand divisions for more than one year, have practiced law for more than one year and do not maintain a private law practice.

The Commissioners' terms end as follows: The Eastern Division on June 30, 2017, the Middle Division on June 30, 2019 and the Western Division on June 30, 2015.

The Claims Commission has a Clerk's office in Nashville that serves all three grand divisions. The Clerk is manager and custodian of the official record of claims appealed or transferred from the Division of Claims Administration. The clerk is responsible for the management of the Commission's docket, receipt and filing of pleadings, preparation and filing of the appellate record in the cases before the Tennessee Court of Appeals and the Tennessee Supreme Court, responding to case inquiries from litigants and communicating with other state agencies on behalf of the Commission. In addition, the clerk acts as an administrative liaison between the Treasury Department and the Claims Commission.

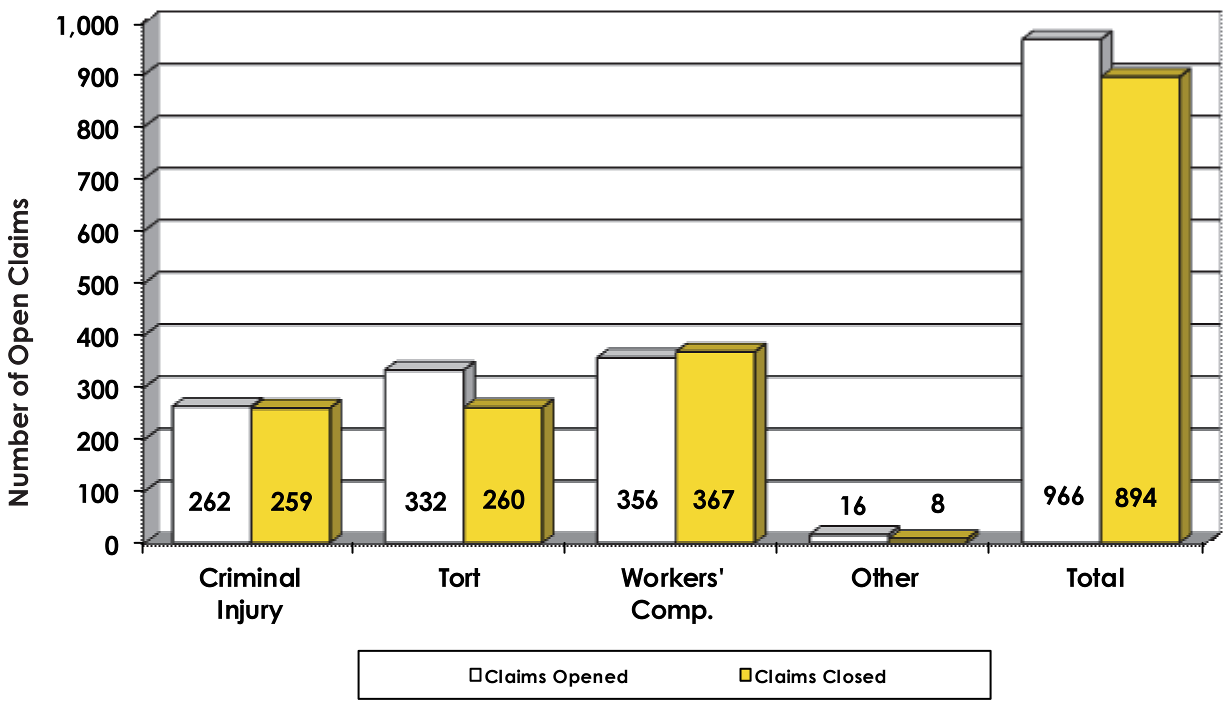
The Claims Commission is attached to the Department of Treasury for administrative purposes. The Treasury Department processes financial and personnel transactions on behalf of the Commission. The department also provides information technology support and other administrative support to the Commission.

Claims Commission's Operation

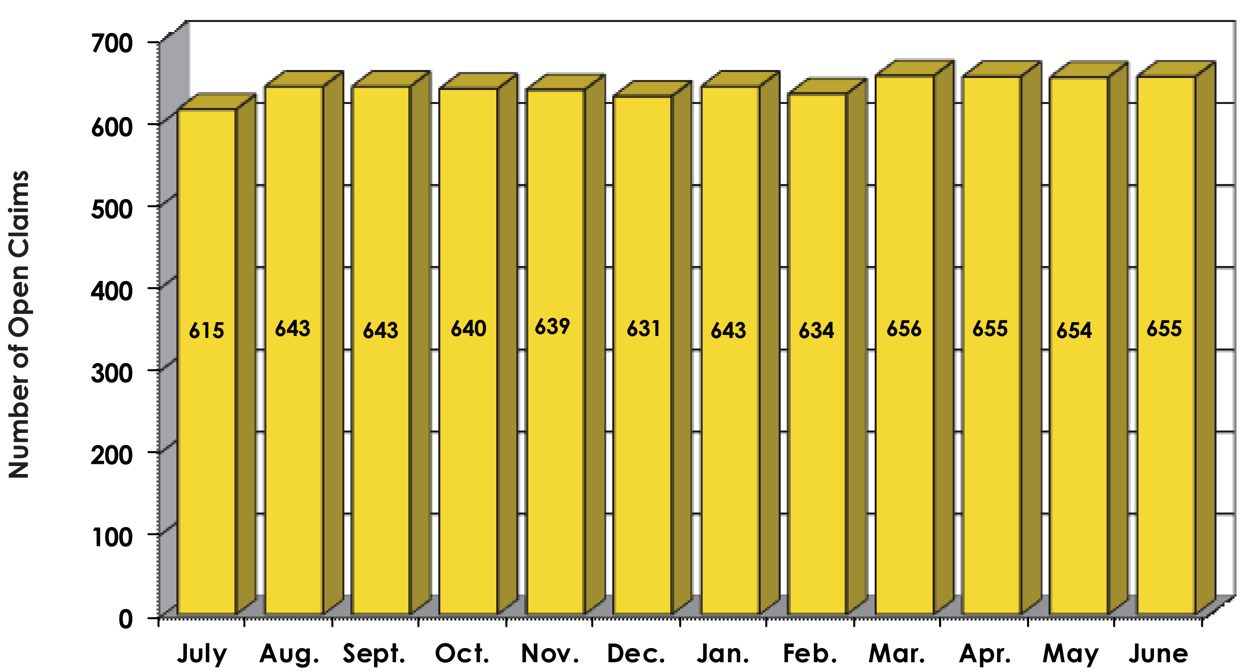
Except for claims for the recovery of taxes, which are initiated by filing with the clerk of the Claims Commission, claims are commenced by filing a notice of claim with the Division of Claims Administration or in the case of workers' compensation actions with the third party administrator. If the claim is denied, it may be appealed to the Claims Commission. Claims upon which no action is taken within 90 days automatically transfer to the Commission.

The state is represented before the Commission by the Office of the Attorney General or his delegatee. The Commission maintains two separate dockets: a regular docket consisting of claims with a monetary value of more than $25,000 and a small claims docket for claim of $25,000 and under. The Tennessee Rules of Civil Procedure are applicable. Commissioners are required to make written findings of fact and conclusions of law in all regular docket claims. At the request of two Commissioners, the Commission can sit en banc to decide any matter in which there is a disagreement among Commissioners. Decisions in regular docket claims may be appealed to the Tennessee Court of Appeals and workers' compensation cases may be appealed to the Tennessee Supreme Court. Judgments rendered against the state in the Claims Commission are paid by the Division of Claims Administration.

Number of Claims Opened and Number of Dispositions By Claim Type
Fiscal Year 2014



Claims Commission Open Claims
Fiscal Year 2014



INVESTMENTS

Statutory Investment Authority

The investment authority for the Board of Trustees of TCRS is set out in Tennessee Code Annotated, Section 8-37-104. Pursuant to this authority and the investment terms, conditions and limitations outlined therein, the Board of Trustees approves the TCRS' investment policy.

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

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

Funds in the retirement system are actively managed with a diversified portfolio of high-quality domestic and international bonds, domestic and international stocks, real estate, private equity and short-term instruments. From time to time, pursuant to Tennessee Code Annotated, Section 8-37-114, the Treasury Investment Division engages outside investment managers to manage a limited number of asset classes or subclasses. In those instances, the Investment Division endeavors to use emerging investment managers to the greatest extent feasible within the bounds of financial and fiduciary prudence, as prescribed under Tennessee Code Annotated, Section 8-37-113. During the fiscal year 2012-2013, no assets were under the control of emerging investment managers.

To assist in the fiduciary responsibility for managing the TCRS portfolio, Strategic Investment Solutions, Inc. serves as the general investment consultant for TCRS. The Townsend Group serves as the real estate investment consultant and Cambridge Associates serves as the private equity consultant to TCRS.

Northern Trust Company was the master bank custodian for TCRS, providing safekeeping and accounting services for the investment portfolio, during fiscal year 2014.

Cost of Investment Operation

The cost to operate the investment program for TCRS is about ten basis points (.10%) of assets. The cost of ten basis points includes the cost of personnel, operational cost, master bank custodian cost, record keeping and external manager fees. Commission cost for trades are capitalized. Recent peer comparisons of investment management fees and expenses indicate the investment program is managed very cost effectively.

Performance Measurement

TCRS' independent external investment consultant, Strategic Investment Solutions, Inc., provides performance measurement for TCRS. During the 2014 fiscal year, TCRS had a total return of 16.65%. Domestic stocks gained 25.19%, while the S&P 1500 Index gained 24.70%. Domestic bonds gained 7.73% versus the bond benchmark of 6.77%. International stocks gained 20.47% versus a gain of 21.56% for the benchmark. Real estate gained 10.72% versus 11.77% for the NCREIF index.

INVESTMENT SUMMARY
AS OF JUNE 30, 2014

	Domestic		International		Total	
	Fair Value	%	Fair Value	%	Fair Value	%
Fixed Income						
Government Bonds	$ 4,529,807,462	10.62%	$ 0	0.00%	$ 4,529,807,462	10.62%
Corporate Bonds	4,373,262,408	10.26%	0	0.00%	4,373,262,408	10.26%
Municipal/Provincial Bonds	156,846,148	0.37%	0	0.00%	156,846,148	0.37%
Total Bonds	9,059,916,018	21.25%		0.00%	9,059,916,018	21.25%
Lehman Brothers Escrow Adjustment	2,906,251	0.01%	0	0.00%	2,906,251	0.01%
Asset Backed	718,751,207	1.69%	0	0.00%	718,751,207	1.69%
Commercial Mortgage Backed	444,741,903	1.04%	0	0.00%	444,741,903	1.04%
Government Agencies	245,508,403	0.58%	0	0.00%	245,508,403	0.58%
Government Mortgage Backed Securites	3,498,774,789	8.20%	0	0.00%	3,498,774,789	8.20%
Non-Government CMOs	127,911,593	0.30%	0	0.00%	127,911,593	0.30%
Preferred Stock	56,169,650	0.13%	40,307,782	0.09%	96,477,432	0.23%
Total Fixed Income	14,154,679,814	33.19%	40,307,782	0.09%	14,194,987,596	33.29%
Common Stock						
Consumer Discretionary	1,882,644,383	4.41%	860,757,146	2.02%	2,743,401,529	6.43%
Consumer Staples	1,344,733,100	3.15%	419,327,573	0.98%	1,764,060,673	4.14%
Energy	2,011,542,159	4.72%	329,270,589	0.77%	2,340,812,748	5.49%
Financials	3,228,902,222	7.57%	1,071,328,641	2.51%	4,300,230,863	10.08%
Healthcare	2,052,243,175	4.81%	592,174,503	1.39%	2,644,417,678	6.20%
Industrials	1,825,768,716	4.28%	926,449,619	2.17%	2,752,218,335	6.45%
Information Technology	2,937,524,545	6.89%	365,063,711	0.86%	3,302,588,256	7.74%
Materials	819,835,877	1.92%	350,115,334	0.82%	1,169,951,212	2.74%
Rights/Warrants	0	0.00%	118,883	0.00%	118,883	0.00%
Telecommunication Services	451,259,485	1.06%	154,959,832	0.36%	606,219,316	1.42%
Utilities	521,742,805	1.22%	114,810,025	0.27%	636,552,830	1.49%
Miscellaneous/Unclassified	14,842,612	0.03%	595,028,994	1.40%	609,871,606	1.43%
Equity Exchange Traded Fund	0	0.00%	1,829,908,866	4.29%	1,829,908,866	4.29%
Stapled Securities	0	0.00%	14,982,824	0.04%	14,982,824	0.04%
Total Common Stock	17,091,039,079	40.08%	7,624,296,540	17.88%	24,715,335,619	57.96%
Short-Term Investments						
Commercial Paper	149,988,810	0.35%	0	0.00%	149,988,810	0.35%
Pooled Funds and Mutual Funds	16,299,081	0.04%	0	0.00%	16,299,081	0.04%
Short-Term Bills and Notes	187,160,198	0.44%	0	0.00%	187,160,198	0.44%
Total Short-Term Investments	353,448,089	0.83%	0	0.00%	353,448,089	0.83%
Real Estate	2,278,482,101	5.34%	0	0.00%	2,278,482,101	5.34%
Private Equities and Strategic Lending	1,100,887,440	2.58%	0	0.00%	1,100,887,440	2.58%
Total Investments	34,978,536,523	82.03%	7,664,604,322	17.97%	42,643,140,845	100.00%
Derivatives and Options	3,282,847		0		0	
Short-Term Investments Classified as Cash Equivalents	(216,283,941)		0		(216,283,941)	
Total Investments as Shown on the Statement of Fiduciary Net Position	$ 34,765,535,430		$ 7,664,604,322		$ 42,430,139,752	

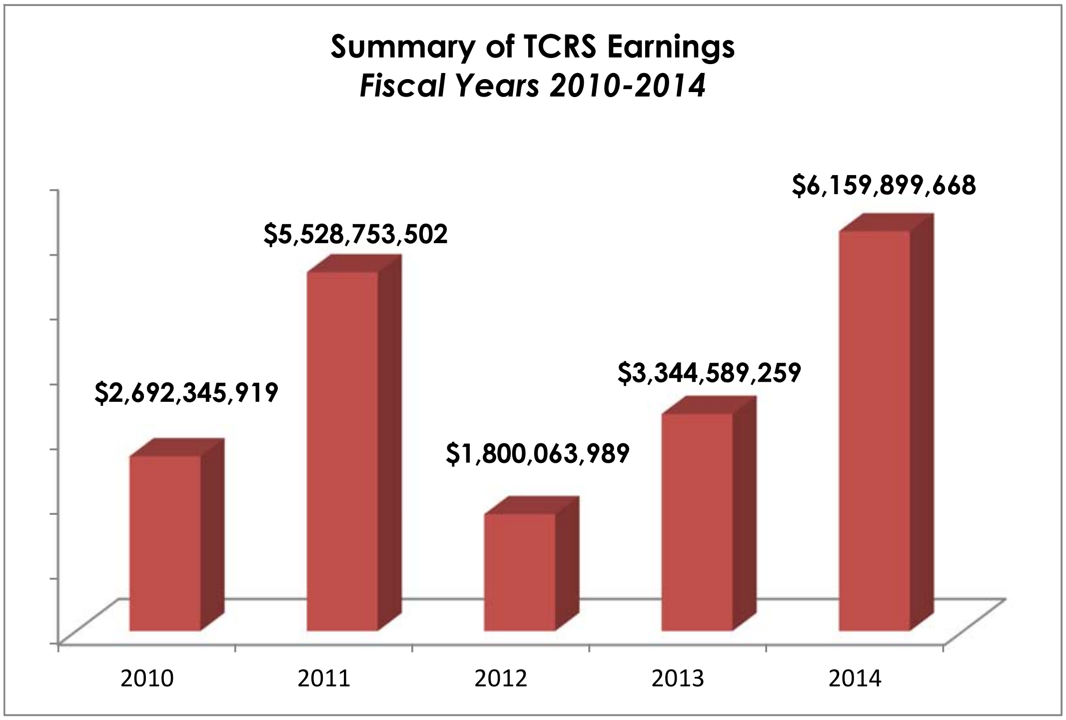
This schedule classifies Canadian investments as domestic securities, convertible bonds as fixed income securities and preferred stock as fixed income securities. For investment purposes convertible bonds and preferred stock are considered equity securities. Accordingly, the asset allocation percentages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

TCRS Investments Benchmark Analysis

Fiscal Year	(1) Public Fund Index Median Total Return	(2) TCRS Total Return
2014	16.4%	16.7%
2013	12.0%	9.9%
2012	1.1%	5.6%
2011	21.6%	19.6%
2010	13.5%	10.2%
2009	(17.9)%	(15.3)%
2008	(4.7)%	(1.2)%
2007	14.1 %	13.2 %
2006	6.9 %	6.9 %
2005	9.4 %	7.3 %

(1) This index most closely resembles the structure and objectives of TCRS.

(2) This is the time-weighted method used to calculate returns and is the most accurate way to measure performance.



Largest Stock Holdings
as of June 30, 2014
by Fair Value

Shares	Security Name	Fair Value
5,590,788	Apple Inc Com Stk	$ 519,551,929
2,933,315	Exxon Mobil Corp Com	295,326,154
4,472,892	Wells Fargo & Co New Com Stk	235,095,204
4,720,787	Microsoft Corp Com	196,856,818
1,799,346	Johnson & Johnson Com USD1	188,247,579
3,090,700	JP Morgan Chase & Co Com	178,086,134
1,365,553	Berkshire Hathaway Inc-Cl B	172,824,388
2,935,489	Merck & Co Inc New Com	169,818,039
3,416,020	Verizon Communications Com	167,145,859

Largest Bond Holdings
as of June 30, 2014
by Fair Value

Par Value	Security Name	Yield	Maturity	Moody's Rating	Fair Value
$ 139,900,000	U.S. Treasury Index Linked Note	(15.32)%	01/15/16	Aaa	$ 176,157,602
135,000,000	U.S. Treasury Note	0.58%	07/15/20	Aaa	160,802,952
127,000,000	U.S. Treasury Note	0.92%	01/15/21	Aaa	149,071,490
139,800,000	U.S. Treasury Index Linked Note	1.72%	01/15/22	Aaa	147,387,680
95,000,000	U.S. Treasury Index Linked Note	0.12%	01/15/25	Aaa	144,733,812
118,800,000	U.S. Treasury Note	2.89%	07/15/21	Aaa	131,613,743
126,144,967	FNMA POOL #AB6024	2.82%	08/01/42	NR	130,054,199
115,000,000	U.S. Treasury Note	(3.06)%	04/15/17	Aaa	124,145,428
85,000,000	U.S. Treasury Index Linked Note	0.93%	01/15/26	Aaa	119,607,869
107,874,000	U.S. Treasury Bonds	3.19%	08/15/43	Aaa	113,941,913

A complete portfolio listing is available upon request.

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

Moody's rates securities as follows:

Aaa	Best Quality
Aa	High Quality
A	Upper Medium Quality
Baa	Medium Quality
NR	Not Rated

State Cash Management

The State of Tennessee receives revenues from many sources such as taxes, licenses, fees and the federal government. As these monies are collected, they are deposited into one of the more than 80 financial institutions in Tennessee that have contracted with the state to serve as depositories. Under the state Constitution, the state may not spend more money on its programs than it has collected in revenues. Consequently, at any point in time the state has a sizable sum of money collected but not yet spent. These monies are invested by the Treasury Department until needed to pay for state expenses, payroll or benefit program disbursements.

During the 2014 fiscal year, the average balance of short term investments in the Treasurer's Cash Management program was $8,200,979,801 per month and interest income of $12,139,821 was earned for the fiscal year. This includes deposits in the Local Government Investment Pool administered by the Treasury Department.

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

The current investment policy for the State Pooled Investment Fund was established to follow SEC Rule 2a-7-like guidelines for a money market fund. The maximum maturity of any security can not exceed 397 days and the weighted average maturity must be 120 days or less.

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

At June 30, 2014, investments had an average maturity of 109 days and an average weighted yield of .121%. The total balance in the State Pooled Investment Fund at June 30, 2014, $8,460,632,521 fair value, was allocated as follows: U.S. Treasury government and agency securities, 74.88%; overnight deposits, 7.63%; collateralized certificates of deposit, 10.40% and commercial paper, 7.09%.

Financial Statements for the State Pooled Investment Fund can be found on pages 103-112.

Administration of Authorized State Depository Accounts

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

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

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

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

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

State Collateral Program

Collateral is required to secure state deposits held in authorized state depository institutions. Statute sets the required collateral level at a market value of 105 percent of the value of the deposit secured, less the amount secured by the Federal Deposit Insurance Corporation. However, if the state depository is operating with a capital-to-asset ratio of less than five percent, additional collateral with a market value of $100,000 is required. Alternatively, a financial institution may pledge collateral via the collateral pool. The types of investment instruments which are eligible to be pledged as collateral are listed in this report on page 25.

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

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

Collateral Pool

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

While participation in the Collateral Pool is voluntary, participation is subject to application to and approval by the Collateral Pool Board. The Board has established minimum financial performance levels for applicants which must be met to ensure that program risk is minimized.

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

The Board has established three different collateral pledge levels: 115 percent, 100 percent and 90 percent. The pledge level is based on financial criteria set by the Collateral Pool Board with the financially strongest institutions being eligible for the lowest pledge level. In March 2009, the Collateral Pool Board voted to suspend the 90% pledge level until further notice. Under the Collateral Pool, should a financial institution default with insufficient collateral to cover public deposits, then the other financial institutions must make up the difference on a pro rata basis. Accordingly, public funds are not at risk in the Collateral Pool.

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

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

Currently, the Collateral Pool has 93 participant institutions collateralizing public funds in excess of $8.8 billion.

State Trust

The State Trust of Tennessee, a not-for-profit corporation chartered in the State of Tennessee in 1979, continues to be utilized to obtain check clearing services through the Federal Reserve Bank with a check redemption volume of 1,006,200 during fiscal year 2014 at an estimated savings of $100,000.

State Cash Management Comparative Returns

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

Fiscal Year	(1) Total Pool Funds	(2) Merrill Lynch Institutional Fund	(3) Standard & Poor's 7-Day LGIP Yield Index	(4) 90-Day Treasury (CD Equivalent Yield)
2014	.14%	.03%	.10%	.04%
2013	.18%	.08%	.08%	.07%
2012	.17%	.05%	.09%	.05%
2011	.26%	.16%	.14%	.11%
2010	.40%	.16%	.39%	.12%

(1) Investment return on total portfolio.

(2) This index most closely resembles the structures and objectives of the total cash portfolio.

(3) Index is for LGIP benchmark pools rated AAAm & AAm by S&P.

(4) This approximates the reinvestment yield for new funds for the period.

Securities Acceptable as Collateral for State Deposits

1. U.S. Treasury Bills
2. U.S. Treasury Notes & Bonds
3. Federal Housing Administration (FHA) debentures
4. Government National Mortgage Associations (GNMA)*
5. Farm Credit System (FCS)
   a. Federal Land Bank Bond (FLBB)
   b. Farm Credit Systemwide Bonds (FCSB)
   c. Farm Credit Systemwide Discount Notes (FCDN)
   d. Farm Credit Systemwide Floating Rate Notes (FCFR)
6. Federal Home Loan Banks
   a. Bonds (FHLB)
   b. Discount Notes (FHDN)
   c. Floating Rate Notes (FHFR)
7. Federal Home Loan Mortgage Corporation (FHLMC)*
   a. Mortgage-Backed Participation Certificates and Adjustable Rate Securities (FMPC, FMAR)
   b. Discount Notes (FMDN)
8. Federal National Mortgage Association (FNMA)*
   a. Bonds, Debentures, Secondary Market Debt Obligations (FNSM)
   b. Discount Notes (FNDN)
   c. Floating Rate Notes (FNFR)
   d. Mortgage-Backed Pass-Through Certificates (FNRF)
   e. Residential Financing Securities (FNRF)
   f. Adjustable Rate Mortgage-Backed Bonds (FNAR)
9. Student Loan Marketing Association (SLMA)
   a. Discount Notes (SLDN)
   b. Fixed Rate Notes (SLMN)
   c. Floating Rate Notes (SLFR)
   d. Bonds (SLBD)
10. Tennessee Valley Authority Bonds and Notes (TVA)
11. Collateralized Mortgage Obligations (CMOs) and Real Estate Mortgage Investment Conduits (REMICs) that are direct obligations of a U.S. agency or FNMA/FHLMC, except that the “residual” class/tranche of such securities will not be acceptable. Sufficient excess securities should be pledged to allow for the periodic reduction of principal.
12. Certain Tennessee Municipal Bonds as specified in T.C.A. Section 9-4-103.
13. Surety Bonds issued by insurance companies meeting certain requirements, including licensure under the laws of Tennessee.
14. Standby Letters of Credit from approved Federal Home Loan Banks.

** Pass through securities must reflect current paid down values and be kept up to date.*

Historical Analysis of State Cash Investments

Collateralized Time Deposits

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2014	$ 418,475,250	$ 1,094,838	0.28%
2013	421,966,000	1,234,553	0.30%
2012	500,355,667	1,411,747	0.29%
2011	772,436,583	2,478,112	0.33%
2010	1,636,994,750	11,438,313	0.62%

Repurchase Agreements and Overnight Deposit Accounts

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2014	$ 756,419,384	$ 1,137,756	0.19%
2013	994,965,305	1,671,077	0.21%
2012	950,980,388	1,522,199	0.29%
2011	871,447,388	2,703,893	0.30%
2010	643,502,305	1,061,207	0.30%

Commercial Paper

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2014	$ 815,423,333	$ 595,938	0.06%
2013	764,026,167	997,068	0.10%
2012	876,477,417	731,024	0.07%
2011	1,524,625,250	2,384,177	0.16%
2010	1,302,143,334	2,167,028	0.17%

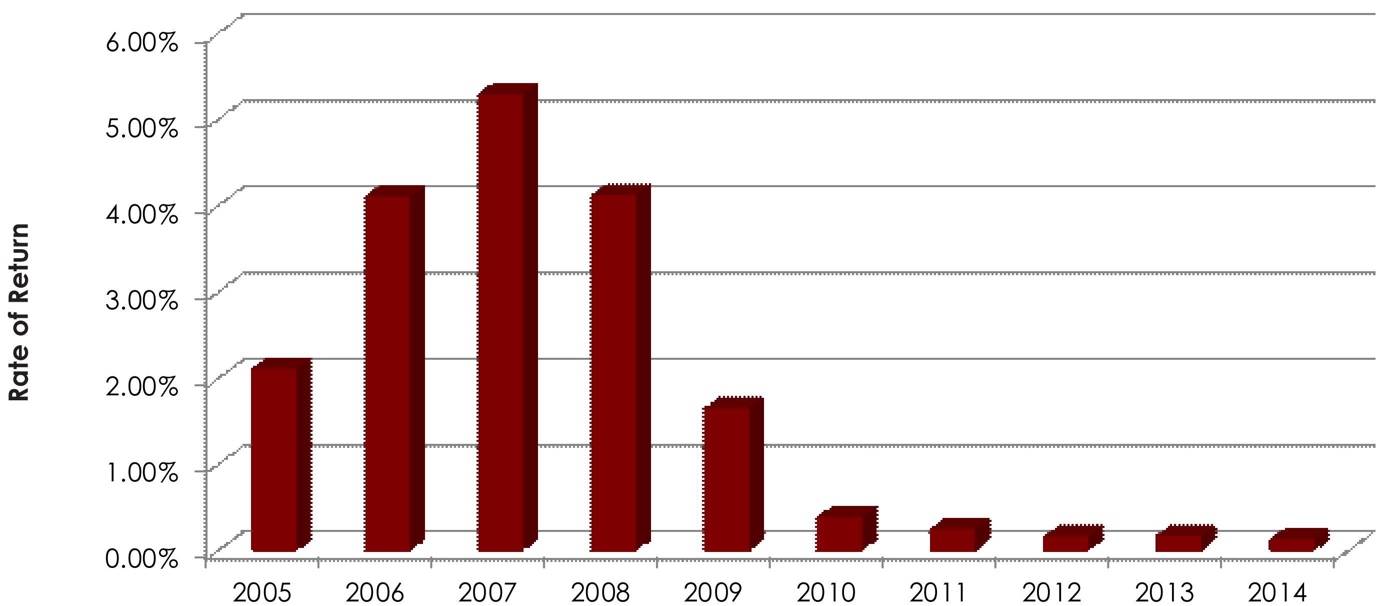
U.S. Government Securities

Fiscal Year	Average Amount Invested	Amount Earned	Rate of Return
2014	$ 6,210,661,833	$ 9,311,289	0.14%
2013	6,181,850,833	10,110,989	0.18%
2012	5,483,522,167	8,469,904	0.16%
2011	3,787,816,250	10,373,163	0.28%
2010	3,284,981,083	12,298,843	0.38%

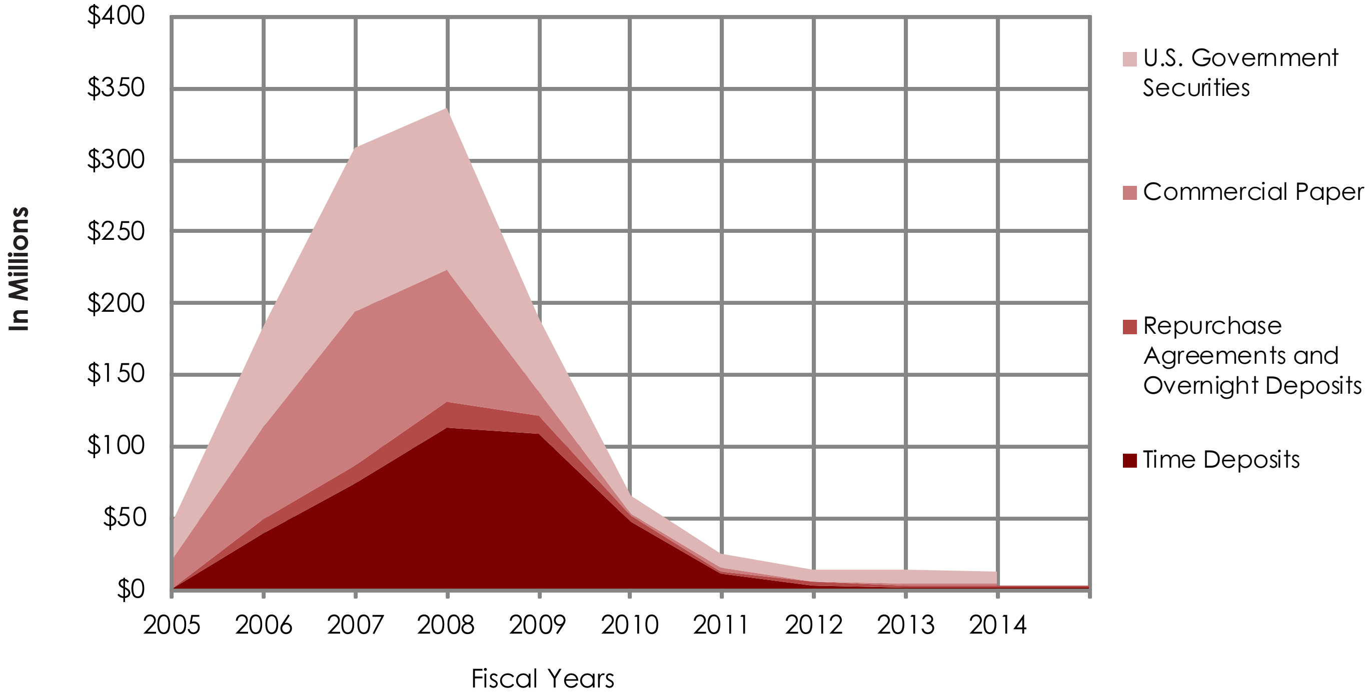
Total Funds

Fiscal Year	Average Total Funds Invested	Cash Management Investment	Composite Weighted Average Rate of
2014	$ 8,200,979,800	$ 12,139,821	0.14%
2013	8,362,808,305	14,013,687	0.18%
2012	7,811,335,639	12,134,874	0.17%
2011	6,956,325,471	17,939,345	0.26%
2010	6,867,621,472	26,965,391	0.40%

Cash Management Investments Composite Weighted Average Rate of Return
Fiscal Years 2005-2014



Analysis of State Cash Earnings
Fiscal Years 2005-2014



Cash Management Portfolio Analysis
Fiscal Year Ended June 30, 2014

Date	Current Investment Yield	Total Portfolio Yield	Average Days to Maturity	Portfolio Composition: Certificates of Deposit	Sweep	U.S. Treasury Notes	U.S. Agency	Commercial Paper
July 2013	0.07%	0.15%	114	4.58%	9.19%	25.44%	50.94%	9.86%
August 2013	0.06%	0.15%	116	4.85%	9.67%	27.89%	49.01%	8.59%
September 2013	0.05%	0.15%	115	4.94%	9.20%	27.83%	47.88%	10.16%
October 2013	0.06%	0.14%	113	5.30%	7.27%	26.79%	49.15%	11.49%
November 2013	0.06%	0.14%	111	5.36%	7.59%	26.56%	48.84%	11.65%
December 2013	0.06%	0.14%	115	5.15%	7.51%	29.54%	48.30%	9.50%
January 2014	0.06%	0.15%	107	5.12%	7.59%	28.31%	47.75%	11.23%
February 2014	0.05%	0.15%	113	5.02%	9.34%	28.83%	45.29%	11.52%
March 2014	0.06%	0.14%	109	3.66%	7.71%	29.43%	45.35%	13.85%
April 2014	0.06%	0.13%	110	4.34%	6.73%	24.89%	50.35%	13.69%
May 2014	0.06%	0.12%	116	4.77%	6.35%	29.36%	49.04%	10.48%
June 2014	0.05%	0.12%	107	10.41%	7.63%	26.24%	48.64%	7.09%
Average	0.06%	0.14%	112	5.29%	7.98%	27.59%	48.38%	10.76%

Month	General Fund Average	General Fund Percent	LGIP Average	LGIP Percent	Other Restricted Average	Other Restricted Percent	Total Average Invested
July 2013	$3,773,166,164	40.85%	$3,103,090,686	33.59%	$2,361,380,957	25.56%	$9,237,637,807
August 2013	3,657,410,976	41.49%	2,709,150,060	30.73%	2,448,925,470	27.78%	8,815,486,506
September 2013	3,481,736,161	40.91%	2,651,257,899	31.16%	2,376,839,372	27.93%	8,509,833,432
October 2013	3,240,299,014	39.48%	2,640,115,924	32.17%	2,327,381,059	28.36%	8,207,795,997
November 2013	2,551,206,134	32.42%	2,516,012,959	31.97%	2,802,714,379	35.61%	7,869,933,472
December 2013	3,009,335,305	38.32%	2,542,942,992	32.38%	2,300,157,426	29.29%	7,852,435,723
January 2014	2,733,586,211	34.84%	2,586,581,114	32.97%	2,525,647,653	32.19%	7,845,814,978
February 2014	2,729,292,247	34.52%	2,682,654,757	33.93%	2,495,421,806	31.56%	7,907,368,810
March 2014	2,497,365,401	30.35%	3,236,754,304	39.34%	2,493,927,665	30.31%	8,228,047,370
April 2014	2,793,199,572	33.14%	3,101,097,151	36.79%	2,534,482,371	30.07%	8,428,779,094
May 2014	3,310,647,272	37.89%	2,847,855,821	32.59%	2,579,793,845	29.52%	8,738,296,938
June 2014	3,625,796,888	40.88%	2,672,485,903	30.13%	2,571,120,605	28.99%	8,869,403,396
Average	$3,116,920,112	37.21%	$2,774,166,631	33.12%	$2,484,816,051	29.67%	$8,375,902,794

Local Government Investment Pool

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

The Local Government Investment Pool began operations in November of 1980. Participation in the LGIP program currently stands in excess of 2,800 accounts. The Department of Transportation (DOT) program has more than 800 active accounts.

Local governments which enter into agreements with the DOT often establish an LGIP account to fund the local matching portion of a highway project grant. These DOT accounts are available to provide the local match to the specific highway project in a timely manner while earning interest for the local government.

In a similar fashion, the Tennessee Board of Regents schools provide their matching portion of Capital Projects funds while earning interest for the benefit of the Board of Regents school.

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

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

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

Participants earn interest on LGIP deposits based on the total portfolio return of the cash management pool, less a monthly administrative fee of five one hundredths of one percent (.05%). During the 2014

Local Government Investment Pool Schedule of Activity by Entity Type
Fiscal Year Ended June 30, 2014

	Account Balance 6/30/2013	Net Deposits/ (Withdrawals)	Gross Interest Credited	Administrative Fees	Account Balance 6/30/2014
Cities	$ 1,391,109,903	$ (447,975,250)	$1,381,707	$ (493,974)	$ 944,022,386
Counties	442,014,878	(96,573,903)	588,649	(210,448)	345,819,176
Commitments to D.O.T.	29,409,694	(3,498,426)	37,909	(13,553)	25,935,624
Educational Institutions	958,468,167	(165,729,628)	1,310,637	(468,566)	793,580,610
Bond Finance	15,185,428	(7,319,422)	9,788	(3,499)	7,872,295
Other	464,173,443	(76,552,197)	552,801	(197,632)	387,976,415
Total	$ 3,300,361,513	$ (797,648,826)	$ 3,881,491	$ (1,387,672)	$ 2,505,206,506

Description	Maturity	Yield to Maturity	Par Value	Fair Value
U.S. TREASURY AND AGENCY OBLIGATIONS				
FAMC	12/23/14	0.18%	$ 25,000,000	$ 24,991,500
FAMC	10/24/14	0.16%	75,000,000	74,988,000
FAMC	04/17/15	0.13%	25,000,000	24,979,750
FAMC	12/01/14	0.17%	50,000,000	49,985,000
FAMC	05/27/15	0.12%	50,000,000	49,949,500
Federal Home Loan Bank	09/03/14	0.05%	23,000,000	22,998,390
Federal Home Loan Bank	08/26/14	0.17%	25,000,000	25,004,250
Federal Home Loan Bank	11/14/14	0.07%	100,000,000	99,988,000
Federal Home Loan Bank	08/08/14	0.17%	40,000,000	40,003,600
Federal Home Loan Bank	08/08/14	0.17%	71,000,000	71,006,390
Federal Home Loan Bank	07/17/14	0.19%	100,000,000	100,001,000
Federal Home Loan Bank	08/22/14	0.13%	68,350,000	68,354,785
Federal Home Loan Bank	08/22/14	0.13%	20,000,000	20,001,400
Federal Home Loan Bank	07/11/14	0.19%	74,000,000	74,002,220
Federal Home Loan Bank	04/21/15	0.13%	78,000,000	77,986,740
Federal Home Loan Bank	09/23/14	0.13%	75,000,000	75,008,250
Federal Home Loan Bank	07/15/14	0.18%	50,000,000	50,002,000
Federal Home Loan Bank	12/30/14	0.20%	50,000,000	50,005,500
Federal Home Loan Bank	04/24/15	0.20%	100,000,000	99,985,000
Federal Home Loan Bank	10/27/14	0.17%	50,000,000	50,013,000
Federal Home Loan Bank	10/03/14	0.05%	67,000,000	66,991,290
Federal Home Loan Bank	10/15/14	0.08%	68,575,000	68,564,714
Federal Home Loan Bank	07/09/14	0.06%	39,195,000	39,194,608
Federal Home Loan Bank	10/10/14	0.07%	30,000,000	29,995,800
FFCB Discount Notes	01/06/15	0.18%	100,000,000	100,025,000
FFCB Discount Notes	04/10/15	0.15%	115,751,000	115,738,267
FFCB Discount Notes	02/24/15	0.27%	24,600,000	24,613,530
FFCB Discount Notes	01/16/15	0.16%	65,000,000	65,010,400
FFCB Discount Notes	09/17/14	0.17%	75,000,000	75,012,750
FFCB Discount Notes	07/22/14	0.17%	50,000,000	50,000,500
FFCB Discount Notes	03/12/15	0.18%	91,678,000	91,685,334
FFCB Discount Notes	10/01/14	0.07%	32,000,000	31,995,840
FFCB Discount Notes	02/03/15	0.17%	50,000,000	49,973,000
FHLB Discount Note	03/25/15	0.12%	100,000,000	99,926,000
FHLB Discount Note	01/08/15	0.14%	50,000,000	49,979,000
FHLMC Note .055	09/22/14	0.06%	25,000,000	24,997,750
FHLMC Note .3	01/09/15	0.30%	75,000,000	75,067,500
FHLMC Note .32	12/03/14	0.32%	99,250,000	99,333,370

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Description	Maturity	Yield to Maturity	Par Value	Fair Value
FHLMC Note .375	08/28/14	0.38%	$ 79,000,000	$ 79,037,920
FHLMC Note .5	09/19/14	0.50%	57,950,000	58,002,155
FHLMC Note .75	11/25/14	0.75%	19,774,000	19,825,610
FHLMC Note 1.0	08/20/14	1.00%	52,437,000	52,500,973
FHLMC Note 1.0	08/20/14	1.00%	42,000,000	42,051,240
FNMA Discount Notes	09/15/14	0.06%	112,000,000	111,991,040
FNMA Discount Notes	05/27/15	0.50%	100,000,000	100,276,000
FNMA Discount Notes	10/15/14	0.07%	50,000,000	49,992,500
FNMA Discount Notes	07/15/14	0.05%	42,000,000	41,999,580
FNMA Discount Notes	07/03/14	0.04%	110,000,000	110,000,000
FNMA Discount Notes	09/10/14	0.06%	74,000,000	73,994,080
FNMA Discount Notes	09/24/14	0.06%	100,000,000	99,991,000
FNMA Discount Notes	09/24/14	0.06%	50,000,000	49,995,500
FNMA Discount Notes	10/15/14	0.04%	30,000,000	29,995,500
FNMA Discount Notes	10/07/14	0.07%	28,400,000	28,396,024
FNMA Discount Notes	10/15/14	0.05%	110,000,000	109,983,500
FNMA Discount Notes	08/15/14	0.06%	100,000,000	99,996,000
FNMA Discount Notes	08/15/14	0.06%	130,000,000	129,994,800
FNMA Discount Notes	11/20/14	2.63%	20,777,000	20,978,745
FNMA Discount Notes	11/20/14	2.63%	32,317,000	32,630,798
FNMA Discount Notes	11/20/14	2.63%	15,342,000	15,490,971
FNMA Discount Notes	09/09/14	0.05%	200,000,000	199,984,000
INTL BK FOR RECON	07/15/14	0.05%	50,000,000	49,999,500
INTL BK FOR RECON	09/15/14	0.07%	50,000,000	49,996,000
INTL BK FOR RECON	07/30/14	0.10%	50,000,000	49,999,000
INTL BK RECON DEV	06/05/15	0.20%	100,000,000	100,028,000
US Treasury Bills	07/03/14	0.03%	139,000,000	139,000,000
US Treasury Bills	08/14/14	0.02%	150,000,000	149,995,500
US Treasury Notes	11/30/14	2.13%	100,000,000	100,848,000
US Treasury Notes	10/31/14	2.38%	100,000,000	100,758,000
US Treasury Notes	07/31/14	2.63%	46,000,000	46,097,060
US Treasury Notes	07/15/14	0.63%	68,000,000	68,010,880
US Treasury Notes	07/15/14	0.63%	100,000,000	100,016,000
US Treasury Notes	09/15/14	0.25%	100,000,000	100,035,000
US Treasury Notes	08/15/14	0.50%	57,000,000	57,026,790
US Treasury Notes	08/15/14	0.50%	75,000,000	75,035,250
US Treasury Notes	10/15/14	0.50%	90,000,000	90,112,500
US Treasury Notes	09/30/14	2.38%	97,000,000	97,552,900
US Treasury Notes	09/30/14	2.38%	64,000,000	64,364,800

(continued)

Description	Maturity	Yield to Maturity	Par Value	Fair Value
US Treasury Notes	07/31/14	0.13%	$ 100,000,000	$ 100,000,000
US Treasury Notes	11/15/14	4.25%	48,000,000	48,742,560
US Treasury Notes	11/15/14	4.25%	100,000,000	101,547,000
US Treasury Notes	02/15/15	4.00%	50,000,000	51,217,000
US Treasury Notes	02/28/15	2.38%	116,000,000	117,753,920
US Treasury Notes	08/15/14	4.25%	100,000,000	100,516,000
US Treasury Notes	03/31/15	0.25%	88,000,000	88,099,440
US Treasury Notes	04/15/15	0.38%	100,000,000	100,219,000
US Treasury Notes	02/28/15	2.38%	100,000,000	101,512,000
US Treasury Notes	11/15/14	0.38%	100,000,000	100,109,000
US Treasury Notes	04/15/15	0.38%	58,000,000	58,127,020
US Treasury Notes	07/15/14	0.63%	27,000,000	27,004,320
US Treasury Notes	09/15/14	0.25%	30,000,000	30,010,500
TOTAL U.S. TREASURY AND AGENCY OBLIGATIONS			**$ 6,316,396,000**	**$ 6,328,199,804**
CERTIFICATES OF DEPOSIT				
Bank of Crockett, Bells	08/15/14	0.15%	$ 3,300,000	$ 3,300,000
Bank of Crockett, Bells	07/11/14	0.15%	2,000,000	2,000,000
Bank of Crockett, Bells	08/11/14	0.15%	3,000,000	3,000,000
Bank of Crockett, Bells	08/25/14	0.15%	1,500,000	1,500,000
Bank of Crockett, Bells	08/15/14	0.15%	2,000,000	2,000,000
CapitalMark Bank & Trust, Chattanooga	08/15/14	0.15%	20,000,000	20,000,000
CapitalMark Bank & Trust, Chattanooga	08/18/14	0.15%	10,000,000	10,000,000
CapitalMark Bank & Trust, Chattanooga	08/21/14	0.15%	20,000,000	20,000,000
First Advantage Bank, Clarksville	12/23/14	0.20%	2,500,000	2,500,000
Landmark Community, Collierville	07/01/14	0.15%	10,000,000	10,000,000
Landmark Community, Collierville	07/01/14	0.15%	2,000,000	2,000,000
Landmark Community, Collierville	07/01/14	0.15%	2,000,000	2,000,000
Landmark Community, Collierville	07/01/14	0.15%	5,000,000	5,000,000
Landmark Community, Collierville	07/01/14	0.15%	6,000,000	6,000,000
Landmark Community, Collierville	07/11/14	0.15%	5,000,000	5,000,000
Landmark Community, Collierville	07/11/14	0.15%	6,000,000	6,000,000
Community First Bank & Trust, Columbia	08/21/14	0.15%	2,000,000	2,000,000
Community National Bank, Dayton	10/31/14	0.20%	1,000,000	1,000,000
Community National Bank, Dayton	12/23/14	0.20%	1,000,000	1,000,000
First Citizens National Bank, Dyersburg	11/21/14	0.20%	20,000,000	20,000,000
First Citizens National Bank, Dyersburg	11/21/14	0.20%	3,000,000	3,000,000
Security Bank, Dyersburg	07/28/14	0.15%	1,500,000	1,500,000
Security Bank, Dyersburg	08/18/14	0.15%	2,000,000	2,000,000

(continued)

Description	Maturity	Yield to Maturity	Par Value	Fair Value
Security Bank, Dyersburg	08/28/14	0.15%	$ 3,000,000	$ 3,000,000
Gates Banking and Trust Company	07/28/14	0.15%	250,000	250,000
Gates Banking and Trust Company	07/28/14	0.15%	250,000	250,000
Gates Banking and Trust Company	08/08/14	0.15%	1,250,000	1,250,000
Gates Banking and Trust Company	08/08/14	0.15%	500,000	500,000
Gates Banking and Trust Company	07/18/14	0.15%	750,000	750,000
Gates Banking and Trust Company	08/15/14	0.15%	750,000	750,000
Gates Banking and Trust Company	07/03/14	0.15%	500,000	500,000
Gates Banking and Trust Company	08/07/14	0.15%	250,000	250,000
Gates Banking and Trust Company	07/21/14	0.15%	250,000	250,000
Gates Banking and Trust Company	08/04/14	0.15%	500,000	500,000
Gates Banking and Trust Company	08/14/14	0.15%	250,000	250,000
Gates Banking and Trust Company	08/14/14	0.15%	250,000	250,000
Gates Banking and Trust Company	07/31/14	0.15%	250,000	250,000
Gates Banking and Trust Company	08/18/14	0.20%	250,000	250,000
Gates Banking and Trust Company	08/18/14	0.15%	250,000	250,000
Gates Banking and Trust Company	08/18/14	0.15%	250,000	250,000
Bank of Gleason	10/10/14	0.30%	350,000	350,000
Bank of Gleason	07/22/14	0.30%	300,000	300,000
Bank of Gleason	09/30/14	0.30%	750,000	750,000
Bank of Gleason	12/02/14	0.20%	2,000,000	2,000,000
Bank of Halls	08/01/14	0.15%	2,450,000	2,450,000
Bank of Halls	08/22/14	0.15%	735,000	735,000
Bank of Halls	08/25/14	0.15%	3,185,000	3,185,000
Bank of Halls	07/17/14	0.15%	735,000	735,000
Carroll Bank And Trust, Huntingdon	09/26/14	0.30%	90,000	90,000
Bank of Jackson	07/31/14	0.15%	1,000,000	1,000,000
Bank of Jackson	08/25/14	0.15%	1,500,000	1,500,000
Citizens State Bank, Jasper	07/01/14	0.30%	100,000	100,000
Citizens State Bank, Jasper	07/01/14	0.30%	200,000	200,000
BB&T, Knoxville	06/10/15	0.20%	50,000,000	50,000,000
BB&T, Knoxville	04/21/15	0.20%	150,000,000	150,000,000
BB&T, Knoxville	05/06/15	0.20%	100,000,000	100,000,000
Coffee County Bank, Manchester	08/05/14	0.30%	240,000	240,000
The First National Bank of McMinnville	07/31/14	0.15%	3,000,000	3,000,000
The First National Bank of McMinnville	07/31/14	0.15%	4,000,000	4,000,000
First Tennessee Bank National Association, Memphis	07/15/14	0.10%	75,000,000	75,000,000
Metropolitan Bank, Memphis	07/03/14	0.15%	7,500,000	7,500,000
Metropolitan Bank, Memphis	07/07/14	0.30%	7,500,000	7,500,000

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Description	Maturity	Yield to Maturity	Par Value	Fair Value
Patriot Bank, Millington	08/22/14	0.15%	$ 3,000,000	$ 3,000,000
Patriot Bank, Millington	08/25/14	0.15%	3,000,000	3,000,000
Patriot Bank, Millington	07/03/14	0.15%	3,500,000	3,500,000
Patriot Bank, Millington	07/17/14	0.15%	6,000,000	6,000,000
Patriot Bank, Millington	07/21/14	0.15%	3,000,000	3,000,000
Civic Bank & Trust, Nashville	07/08/14	0.30%	1,000,000	1,000,000
Regions Bank, Nashville	09/09/14	0.15%	200,000,000	200,000,000
Regions Bank, Nashville	09/09/14	0.15%	100,000,000	100,000,000
Newport Federal Bank	08/04/14	0.30%	95,000	95,000
Newport Federal Bank	11/21/14	0.20%	500,000	500,000
Newport Federal Bank	11/21/14	0.20%	500,000	500,000
Newport Federal Bank	08/04/14	0.30%	300,000	300,000
TNBank, Oak Ridge	07/15/14	0.30%	1,000,000	1,000,000
TNBank, Oak Ridge	08/27/14	0.20%	1,000,000	1,000,000
The Hardin County Bank, Savannah	08/15/14	0.30%	3,000,000	3,000,000
Commerce Union Bank, Springfield	11/10/14	0.20%	2,000,000	2,000,000
Wayne County Bank, Waynesboro	08/22/14	0.30%	500,000	500,000
Wayne County Bank, Waynesboro	11/21/14	0.20%	900,000	900,000
TOTAL CERTIFICATES OF DEPOSIT			**$ 880,480,000**	**$ 880,480,000**
OVERNIGHT DEPOSIT ACCOUNTS				
First Tennessee Bank-Overnight Deposit Accounts	07/01/14	0.15%	$ 110,000,000	$ 110,000,000
First Tennessee Bank-Overnight Deposit Accounts	07/01/14	0.42%	234,908,334	234,908,334
Regions Bank-Overnight Deposit Account	07/01/14	0.10%	300,575,387	300,575,387
TOTAL OVERNIGHT DEPOSIT ACCOUNTS			**$ 645,483,721**	**$ 645,483,721**

DESCRIPTION	Rating	Maturity	Par Value	Fair Value
COMMERCIAL PAPER				
ADP	A1	07/01/14	$ 100,000,000	$ 99,999,861
UPS	A1	07/02/14	100,000,000	99,999,917
NARCO	A1	07/28/14	30,000,000	29,997,750
BASF	A1	07/31/14	50,000,000	49,996,250
TOYOTA	A1	07/29/14	100,000,000	99,995,333
BASF	A1	07/30/14	50,000,000	49,996,375
NARCO	A1	07/10/14	70,000,000	69,997,900
PEPSI	A1	08/08/14	100,000,000	99,993,667
TOTAL COMMERCIAL PAPER			**$ 600,000,000**	**$ 599,977,053**
TOTAL STATE CASH PORTFOLIO			**$ 8,442,359,721**	**$ 8,454,140,577**

Baccalaureate Education System Trust
as of June 30, 2014

	Units	Fair Value
Fixed Exchange Traded Funds		
Vanguard Total Bond Market	614,900	$50,557,078
Total Fixed Income Exchange Traded Funds		**50,557,078**
Equity Exchange Traded Funds		
Northern Institutional Fund	3,432,252	3,432,252
Ishares MSCI EAFE	137,450	9,397,457
Vanguard Index S&P 500	133,680	24,603,680
Total Equity Exchange Traded Funds		**37,433,389**
TOTAL PORTFOLIO		**$87,990,467**

Largest Bond Holdings
as of June 30, 2014
by Fair Value

Par Value	Security Name	Yield at Market	Maturity	Moody's Quality Rating	Fair Value
6,500,000	US Treasury Notes	0.39%	07/15/16	Aaa	$ 6,519,806
4,400,000	US Treasury Index Linked Notes	-0.13%	01/15/20	Aaa	5,290,487
4,550,000	US Treasury Notes	-4.04%	04/15/16	Aaa	5,014,602
3,769,291	GNMA POOL #MA0936	2.56%	04/20/43	NR	4,124,283
4,000,000	US Treasury Notes	1.81%	07/31/20	Aaa	4,021,564
3,590,267	FNMA POOL #AP5128	3.03%	09/01/42	NR	3,815,628
3,700,564	FNMA POOL #AB4686	2.68%	03/01/42	NR	3,815,244
2,475,000	US Treasury Index Linked Bonds	-0.30%	01/15/25	Aaa	3,770,697
3,609,410	FHLMC POOL #Q1-7944	3.15%	05/01/43	NR	3,714,841
3,025,000	US Treasury Index Linked Notes	1.33%	01/15/22	Aaa	3,189,183

A complete portfolio listing is available upon request

Exchange Traded Funds	Units	Fair Value
Vanguard S&P 500 Index	729,400	$ 130,876,242
Ishares MSCI EAFE	614,450	42,009,947
Total Exchange Traded Fund		$ 172,886,189

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

Moody's rates securities as follows:		
	Aaa	Best Quality
	Aa	High Quality
	A	Upper Medium Quality
	Baa	Medium Quality
	NR	Not Rated

Intermediate Term Investment Fund

The Intermediate Term Investment Fund (ITIF) is an external investment pool sponsored by the State of Tennessee. All funds in the ITIF at June 30, 2014 consist of funds belonging to entities outside of the State of Tennessee Financial Reporting Entity, and have been included as a separate investment trust fund in the *Tennessee Comprehensive Annual Financial Report*.

Financial Statements for the Intermediate Term Investment Fund can be found on pages 90-95.

FINANCIAL STATEMENTS

Baccalaureate Education System Trust
Chairs of Excellence Trust
Criminal Injuries Compensation Fund
Flexible Benefits Plan
Intermediate Term Investment Fund
Risk Management Fund
State Pooled Investment Fund
Tennessee Consolidated Retirement System
TNStars™ College Savings 529 Program

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Members of the General Assembly
Members of the Board of Trustees
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying statements of fiduciary net position of the Baccalaureate Education System Trust, Educational Services Plan, a private-purpose trust fund of the State of Tennessee, as of June 30, 2014, and June 30, 2013, the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, which collectively comprise the Baccalaureate Education System Trust, Educational Services Plan's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

(CONTINUED)

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of the Baccalaureate Education System Trust. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Baccalaureate Education System Trust, Educational Services Plan.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Baccalaureate Education System Trust, Educational Services Plan of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in fiduciary net position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Baccalaureate Education System Trust, Educational Services Plan, a private-purpose trust fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the Baccalaureate Education System Trust, Educational Services Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Baccalaureate Education System Trust, Educational Services Plan's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2014 AND JUNE 30, 2013

	June 30, 2014	June 30, 2013
ASSETS		
Cash and cash equivalents	$ 3,432,278	$ 1,821,912
Receivables		
Investment income receivable	230,420	172,914
Investments sold	0	1,530,073
Investments, at fair value		
Investment in fixed income index fund	50,557,078	51,132,336
Investment in equity index fund	33,383,633	33,219,287
TOTAL ASSETS	87,603,409	87,876,522
LIABILITIES		
Accounts payable	90,149	103,936
Due to General Fund	86,226	0
TOTAL LIABILITIES	176,375	103,936
NET POSITION RESTRICTED FOR PLAN PARTICIPANTS	$ 87,427,034	$ 87,772,586

See accompanying Notes to the Financial Statements.

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

	For the Year Ended June 30, 2014	For the Year Ended June 30, 2013
ADDITIONS		
Investment income		
Net increase in fair value of investments	$ 7,506,890	$ 4,239,455
Interest and dividend income	2,096,817	1,340,818
Less: Investment expense	0	(15,854)
Net investment income	9,603,707	5,564,419
TOTAL ADDITIONS	9,603,707	5,564,419
DEDUCTIONS		
Withdrawals	9,603,718	10,189,587
Administrative cost	345,541	276,061
TOTAL DEDUCTIONS	9,949,259	10,465,648
CHANGE IN NET POSITION	(345,552)	(4,901,229)
NET POSITION, BEGINNING OF YEAR	87,772,586	92,673,815
NET POSITION, END OF YEAR	$ 87,427,034	$ 87,772,586

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity -** The Tennessee Baccalaureate Education System Trust Fund (BEST), Educational Services Plan (ESEP) is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the BEST has been included in the *Tennessee Comprehensive Annual Financial Report* as a private-purpose trust fund.

2. **Measurement Focus and Basis of Accounting -** The accompanying financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred regardless of the timing of related cash flows.

3. **Cash and Cash Equivalents -** Cash and Cash Equivalents includes cash and short-term investments with a maturity date within three months of the acquisition date. Cash management pools are included as cash. Cash received by the ESEP that cannot be invested immediately in securities, or that is needed for operations, is invested in the State Pooled Investment Fund administered by the State Treasurer or a short-term, open-end mutual fund, Northern Institutional Government Portfolio, under the contractual arrangements for master custody services.

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

B. DEPOSITS AND INVESTMENTS

In accordance with State statute, the board shall cause the amount on deposit in the ESEP to be invested in any instrument or investment vehicle that the board deems reasonable and appropriate to achieve the objectives of the trust. The statutes also require the board establish an investment policy for the trust fund. The board has authorized assets of the trust fund to be invested in instruments, obligations, securities or other properties that constitute a legal investment for assets of the Tennessee Consolidated Retirement System (TCRS). State statute authorizes the TCRS to invest in bonds, debentures, preferred stock and common stock, real estate and in other good and solvent securities subject to the approval of the Board of Trustees. In addition, the assets of the ESEP may be pooled for investment purposes with the assets of the TCRS or any other assets under the custody of the State Treasurer. The authority for investing the assets of the ESEP is vested in its Board of Trustees and the responsibility for implementing the investment policy established by the Board is delegated to the State Treasurer.

The ESEP does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund (SPIF) is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 104 - 110 of this report.

(CONTINUED)

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The ESEP does not currently own specific fixed income securities, but chooses to invest in exchange traded funds (ETFs) that replicate the Vanguard Total Bond Market Index Fund. This ETF has been given a two-star rating by MorningStar and the underlying securities of the fund have an average credit quality rating of BBB or higher. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally recognized credit ratings agency. The Northern Institutional Government Portfolio had a credit quality rating of AAA at June 30, 2014 and June 30, 2013.

The ESEP's investment policy states that the trust may acquire securities which are rated within the four highest grades at the time of acquisition by any of the recognized rating agencies. In addition, the policy requires that only the highest quality short-term debt issues, including commercial paper with ratings of A1 or P1, may be purchased. The policy further states that index funds may be utilized as an alternative to selecting individual securities.

Interest Rate Risk - Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The investment policy for the ESEP states that bonds generally will be purchased and held to maturity, but when necessary, the portfolio will be actively managed in times of volatile interest rate swings to shorten the average maturity and protect principal value. The average duration for the Vanguard Total Bond Market Index Fund was 5.60 years and 5.49 years at June 30, 2014 and June 30, 2013, respectively. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price.

C. DESCRIPTION OF THE EDUCATIONAL SERVICES PLAN

The Tennessee Baccalaureate Education System Trust, Educational Services Plan, administered by the State Treasurer, was created under *Tennessee Code Annotated*, Title 49, Chapter 7, Part 8 for the purpose of improving higher education in the State of Tennessee by assisting students or their families to pay in advance, a portion of the tuition and other costs of attending colleges and universities. Under the program, a purchaser entered into a contract with the BEST Board of Trustees to purchase tuition units on behalf of a beneficiary. Each tuition unit purchased entitled the beneficiary to an amount no greater than one percent of the weighted average tuition of Tennessee's four-year public universities during the academic term in which it is used; however, the tuition unit or equivalent funds may be used at any accredited public or private, in-state or out-of-state institution. The purchase price of the tuition unit was determined annually by the BEST Board of Trustees with the assistance of an actuary to maintain the plan's financial soundness. The BEST Board of Trustees voted to discontinue selling new prepaid units of tuition as of November 22, 2010 due to the rising cost of tuition. This action had no effect on units purchased prior to that date. Refunds and tuition payments are guaranteed only to the extent that ESEP program funds are available and neither the State of Tennessee nor the BEST Board of Trustees is liable for any amount in excess of available program funds. The net position restricted for plan participants was $10,014,407 more at June 30, 2014, and $4,790,417 more at June 30, 2013, than the amounts needed to fund the outstanding tuition units at their weighted average tuition unit prices in effect at the respective dates.

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Members of the General Assembly
Members of the Board of Trustees
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying balance sheets of the Chairs of Excellence, a permanent fund of the State of Tennessee, as of June 30, 2014, and June 30, 2013, the related statements of revenues, expenditures, and changes in fund balances for the years then ended, and the related notes to the financial statements, which collectively comprise the Chairs of Excellence's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

(CONTINUED)

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of the Chairs of Excellence. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Chairs of Excellence.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Chairs of Excellence of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in financial position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Chairs of Excellence, a permanent fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the Chairs of Excellence's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Chairs of Excellence's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

CHAIRS OF EXCELLENCE
BALANCE SHEETS
JUNE 30, 2014 AND JUNE 30, 2013

	June 30, 2014	June 30, 2013
ASSETS		
Cash and cash equivalents	$ 9,305,863	$ 9,018,826
Investments, at fair value		
Government securities	126,334,658	80,887,286
Corporate securities	39,014,344	36,320,227
Investment in exchange traded equity fund	172,886,188	143,467,150
Total investments	338,235,190	260,674,663
Receivables		
Due from colleges and universities	972,172	82,000
Investments sold	0	2,044,698
Investment income receivable	1,990,426	1,507,820
Total receivables	2,962,598	3,634,518
TOTAL ASSETS	$350,503,651	$273,328,007
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Due to colleges and universities	$ 2,157,674	$ 1,816,154
Due to the Academic Scholars Fund	4,751,718	4,548,817
Due to the TSAC Endowment Scholarship Fund	48,969,964	0
Due to General Fund	69,764	0
Investments purchased	0	5,155,710
TOTAL LIABILITIES	55,949,120	11,520,681
FUND BALANCES		
Nonspendable corpus	100,358,388	99,956,963
Restricted	194,196,143	161,850,363
TOTAL FUND BALANCES	294,554,531	261,807,326
TOTAL LIABILITIES AND FUND BALANCES	$350,503,651	$273,328,007

See accompanying Notes to the Financial Statements.

STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES FOR THE YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

	For the Year Ended June 30, 2014	For the Year Ended June 30, 2013
REVENUES		
Investment income	$ 41,908,051	$ 23,379,827
Contributions from private sources	1,426	22,000
TOTAL REVENUES	41,909,477	23,401,827
EXPENDITURES		
University of Tennessee	3,307,590	3,658,873
Tennessee Board of Regents	3,821,098	3,470,792
Academic Scholars Fund	2,172,865	0
Administrative cost	260,719	209,874
TOTAL EXPENDITURES	9,562,272	7,339,539
EXCESS OF REVENUES OVER EXPENDITURES	32,347,205	16,062,288
OTHER FINANCING SOURCES		
Transfer in from the General Fund	400,000	0
TOTAL OTHER FINANCING SOURCES	400,000	0
NET CHANGE IN FUND BALANCE	32,747,205	16,062,288
FUND BALANCES, BEGINNING OF YEAR	261,807,326	245,745,038
FUND BALANCES, END OF YEAR	$294,554,531	$261,807,326

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2. **Measurement Focus and Basis of Accounting -** The accompanying financial statements have been prepared in accordance with generally accepted ac-counting principles as prescribed by the Governmental Accounting Standards Board (GASB), using the current financial resources measurement focus and the modified accrual basis of accounting. Revenues are recorded when they become both measurable and available, and expenditures are recognized when the related fund liability is incurred, regardless of the timing of related cash flows. Interest associated with the current fiscal year is considered to be available if received in six months.

3. **Cash and Cash Equivalents -** Cash and cash equivalents includes cash and shortterm investments with a maturity date within three months of the acquisition date. Cash management pools are included as cash. Cash received by the COE Trust that cannot be immediately invested in securities, or that is needed for operations, is invested in either the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer or a short-term, open-end mutual fund, Northern Institutional Government Portfolio, under the contractual arrangement for master custody services.

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

5. **Fund Balances -** Nonspendable fund balance includes amounts that cannot be spent because they are legally or contractually required to be maintained intact. The COE Trust's nonspendable corpus consists of funds provided by contributions from the state, colleges and universities, and private sources. Restricted fund balance includes amounts that are restricted for specific purposes stipulated by external resource providers, constitutionally, or through enabling legislation. The COE Trust's restricted fund balance consists of investment income that must be used for funding the Chairs of Excellence program.

B. DEPOSITS AND INVESTMENTS

State statute authorizes the funds of the COE Trust to be commingled for investment with other trust funds and other funds subject to investment by the State Treasurer. The COE Trust does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities.

State statute also authorizes the Board of Trustees of the COE Trust to adopt an investment policy for the trust in accordance with the laws, guidelines and policies that govern investments by the Tennessee Consolidated Retirement System. The State Treasurer is responsible for the investment of trust funds in accordance with the

(CONTINUED)

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

State statutes governing the COE Trust investments and the COE Trust's investment policy authorize the COE Trust to invest in certain Exchange Traded Funds ("ETFs"). By way of reference to the state statutes governing investments for the Tennessee Consolidated Retirement System (TCRS), which in turn reference the state statutes governing investments for domestic life insurance companies, the COE Trust's investment policy and state statutes governing investments for the COE Trust require ETFs to be considered an equity interest in a business entity for the purpose of determining compliance with the policy and statutes' investment restrictions. As a result of this reference, there was a one-percent (1%) limitation on the percentage of assets that can be invested in a single business entity exists for the COE Trust for the fiscal year ended June 30, 2013. While the COE Trust's investment policy provides for the investment in certain ETFs as an effective and efficient alternative to selecting individual securities for the equity portfolio, the COE Trust's investment in two ETFs both during and at the fiscal year ended June 30, 2013, did exceed the one-percent (1%) limitation on the percentage of assets that can be invested in a single business entity, as referenced within the domestic life insurance statutes. At June 30, 2013, 13% of COE's total assets were invested in one equity ETF (an ETF that replicates all the stocks in the MSCI EAFE index), and 40% of its total assets were invested in another equity ETF (an ETF that replicates all the stocks in the S&P 500 index). During the fiscal year ended June 30, 2014, the statutes applicable to the TCRS' investments were amended, providing that the investment limitations of domestic life insurance companies would apply to the TCRS, and in turn to the COE Trust, unless the TCRS' board establishes different limitations through its investment policy. During the Fiscal Year ended June 30, 2014, the TCRS' board revised its investment policy pertaining to ETF's, allowing them to be included within the equity portfolio asset class limitation. During the years ended June 30, 2014 and June 30, 2013, the COE Trust's equity investments were within the overall limits on equity securities per statutory and policy provisions.

As of June 30, 2014 and June 30, 2013, the COE Trust had the following investments (expressed in thousands):

(CONTINUED)

Credit Quality Distribution for Securities with Credit Exposure as a Percentage of Total Investments
June 30, 2014

(Expressed in Thousands)

Rating	Fair Value	Percentage of Total Investments
AAA	$ 5,733	1.69%
AA	12,479	3.69%
A	15,938	4.71%
BBB	17,129	5.06%
BB	516	0.15%
CCC	430	0.13%
Not Rated	40,580	12.00%
Total Debt Investments	92,805	
Government Agencies and Obligations	72,544	
Total Fixed Income Securities	165,349	
Equity	172,886	
Total Investments as Shown on Statements	$338,235	

Credit Quality Distribution for Securities with Credit Exposure as a Percentage of Total Investments
June 30, 2013

(Expressed in Thousands)

Rating	Fair Value	Percentage of Total Investments
AAA	$ 4,574	1.75%
AA	8,114	3.11%
A	14,914	5.72%
BBB	14,175	5.44%
BB	1,064	0.41%
CCC	442	0.17%
Not Rated	34,334	13.17%
Total Debt Investments	77,617	
Government Agencies and Obligations	39,590	
Total Fixed Income Securities	117,207	
Equity	143,467	
Total Investments as Shown on Statements	$260,674	

(CONTINUED)

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings for the COE Trust's investments in fixed income securities as of June 30, 2014 and June 30, 2013 are included in the above schedule. Securities are rated using Standard and Poor's and/or Moody's and are presented above using the Standard and Poor's rating scale. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally-recognized credit ratings agency. The Northern Institutional Government Portfolio has a credit quality rating of AAA at June 30, 2014 and June 30, 2013.

The COE Trust's investment policy states that the majority of investments should be placed in high quality debt securities to produce adequate income with minimal risk. In addition, for short-term investments, the investment policy states that only the highest quality short-term debt issues should be purchased.

As noted above, the COE Trust does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash purposes. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 104 -110 of this report.

Concentration of Credit Risk - A concentration of investments in any one single issuer of debt securities presents a greater risk for loss in the event that the issuer fails on its obligations. The COE Trust had the following investment amounts and percentages of total investments at June 30, 2014 or June 30, 2013, in organizations representing five percent or more of total investments, excluding those organizations whose issues are explicitly guaranteed by the United States government, and investments in mutual funds, external investment pools, and other pooled investments:

	June 30, 2014		June 30, 2013	
Issuer Organization	**Fair Value**	**Percentage**	**Fair Value**	**Percentage**
Federal National Mortgage Association	$25,168,753	7.44%	$22,311,895	8.56%
Federal Home Loan Mortgage Corporation	17,805,270	5.26%	11,381,669	5.13%

The COE Trust's investment policy does not specifically address limitations on investing in any one issuer.

Interest Rate Risk - Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The investment policy for the COE Trust states that the maturity of its debt securities may range from short-term instruments, including investments in the State Pooled Investment Fund, to long-term bonds, with consideration of liquidity needs. However, the policy does not specifically address limits on investment maturities. The fixed income portfolio is benchmarked against the Barclays Aggregate Index and tends to have a duration within a tight range around that index. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price. The COE Trust had the following investments and effective duration at June 30, 2014 and June 30, 2013 (expressed in thousands).

(CONTINUED)

(Expressed in Thousands)				
Investment Type	Fair Value as of June 30, 2014	Effective Duration (years)	Fair Value as of June 30, 2013	Effective Duration (years)
Debt Investments				
U.S. Government Agencies	$ 8,712	3.68	$5,728	4.20
U.S. Government TIPS	38,145	8.06	27,214	8.37
U.S. Government Treasuries	22,526	4.39	6,192	4.12
Municipal Bonds	7,784	5.51	4,358	7.11
Government Asset Backed	2,654	5.69	2,817	5.91
Government Mortgage Backed	44,735	4.30	34,577	4.62
Corporate Asset Backed	1,779	2.43	1,020	4.67
Corporate Bonds	37,023	6.46	32,590	6.82
Corporate Mortgage Backed	1,991	1.88	2,711	1.02
Total Debt Investments	$165,349	5.67	$117,207	6.10

Asset Backed Securities - The COE Trust invests in collateralized mortgage obligations (CMOs) which are mortgage backed securities. These securities are based on cash flows from interest and principal payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. The fair value of CMOs at June 30, 2014 was $1,990,815 of which $546,419 were CMOs that are generally more sensitive to interest rate changes. The fair value of CMOs at June 30, 2013 was $2,711,000 of which $1,083,196 were CMOs that are generally more sensitive to interest rate changes.

C. <u>OTHER ACCOUNTING DISCLOSURES</u>

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

   Ninety-nine hairs have been established with matching contributions received totaling $55,958,388 and $55,956,963 as of June 30, 2014 and June 30, 2013 respectively. Total contributions to the COE Trust totaled $100,358,388 and $99,956,963 as of June 30, 2014 and June 30, 2013 respectively. This includes $44,400,000 from the State, $10,321,300 from Colleges and Universities, and $45,637,088 from private contributions as of June 30, 2014 and 44,000,000 from the State, $10,321,300 from Colleges and Universities, and $45,635,663 from private contributions for June 30, 2013.

2. **Other Funds -** Funds from the Academic Scholars Fund and Tennessee Student Assistance Corporation (TSAC) Endowment Scholarship Fund are combined with the COE Trust for investment purposes only. Both of these funds general account receives only the income earned on its principal and does not receive any COE Trust state contributions or appropriations. These funds are invested in domestic fixed income securities.

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Members of the General Assembly
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying balance sheets of the Criminal Injuries Compensation Fund, a special revenue fund of the State of Tennessee, as of June 30, 2014, and June 30, 2013, the related statements of revenues, expenditures, and changes in fund balance and revenues, expenditures, and changes in fund balance (budget and actual) for the years then ended, and the related notes to the financial statements, which collectively comprise the Criminal Injuries Compensation Fund's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

(CONTINUED)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Criminal Injuries Compensation Fund of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in financial position and the budgetary comparison thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Criminal Injuries Compensation Fund, a special revenue fund, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in its financial position and the budgetary comparison for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the Criminal Injuries Compensation Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Criminal Injuries Compensation Fund's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

BALANCE SHEETS
JUNE 30, 2014 AND JUNE 30, 2013

	June 30, 2014	June 30, 2013
ASSETS		
Cash	$ 11,012,199	$ 9,534,887
Accounts receivable	540,754	486,289
Due from federal government	4,937,000	5,650,000
TOTAL ASSETS	$ 16,489,953	$ 15,671,176
LIABILITIES AND FUND BALANCE		
LIABILITIES		
Accounts payable	$ 301,237	$ 245,586
Claims liability	7,208,254	6,705,024
TOTAL LIABILITIES	7,509,491	6,950,610
FUND BALANCE		
Committed for victims of drunk drivers (see Note B.2)	833,377	739,445
Committed for compensation under the Criminal Injuries Compensation Act	8,147,085	7,981,121
TOTAL FUND BALANCE	8,980,462	8,720,566
TOTAL LIABILITIES AND FUND BALANCE	$ 16,489,953	$ 15,671,176

See accompanying Notes to the Financial Statements.

CRIMINAL INJURIES COMPENSATION FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

	For the Year Ended June 30, 2014	For the Year Ended June 30, 2013
REVENUES		
State		
Fines	$6,305,576	$6,474,210
Fees	1,973,221	2,261,368
Federal	4,937,000	5,650,000
Interest income	9,049	14,354
Other	368,841	1,216,238
TOTAL REVENUES	13,593,687	15,616,170
EXPENDITURES		
Claim payments	11,835,288	12,968,986
Victims' coalition grant	100,000	100,000
Administrative cost	1,142,403	1,120,132
TOTAL EXPENDITURES	13,077,691	14,189,118
EXCESS OF REVENUES OVER EXPENDITURES	515,996	1,427,052
OTHER FINANCING USE		
Transfer to General Fund for District Attorneys General Grant	256,100	249,900
NET CHANGE IN FUND BALANCE	259,896	1,177,152
FUND BALANCE, BEGINNING OF YEAR	8,720,566	8,821,672
Prior Perod Adjustment (Note B.3)	0	(1,278,258)
FUND BALANCE, BEGINNING OF YEAR RESTATED	8,720,566	7,543,414
FUND BALANCE, END OF YEAR	$8,980,462	$8,720,566

See accompanying Notes to the Financial Statements.

CRIMINAL INJURIES COMPENSATION FUND
STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
BUDGET AND ACTUAL (BUDGETARY BASIS) FOR THE YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

For the Year Ended June 30, 2014

	Original Budget	Final Budget	Actual (Budgetary Basis)
REVENUES			
Fines	$ 8,344,500	$ 8,344,500	$ 6,305,576
Fees	2,353,400	2,353,400	1,973,221
Federal	4,930,000	4,930,000	4,937,000
Interest income	0	0	9,049
Other	472,100	472,100	368,841
TOTAL REVENUES	16,100,000	16,100,000	13,593,687
EXPENDITURES			
Claim payments	14,650,100	14,650,100	11,835,288
Victims' coalition grant	100,000	100,000	100,000
Administrative cost	1,100,000	1,100,000	1,142,403
TOTAL EXPENDITURES	15,850,100	15,850,100	13,077,691
EXCESS OF REVENUES OVER EXPENDITURES	249,900	249,900	515,996
OTHER USES OF FINANCIAL RESOURCES			
Transfer to General Fund for District Attorneys General Grant	249,900	249,900	256,100
NET CHANGE IN FUND BALANCE	0	0	259,896
FUND BALANCE, BEGINNING OF YEAR	8,720,566	8,720,566	8,720,566
FUND BALANCE, END OF YEAR	$ 8,720,566	$ 8,720,566	$ 8,980,462

For the Year Ended June 30, 2013

	Original Budget	Final Budget	Actual (Budgetary Basis)
REVENUES			
Fines	$ 7,074,500	$ 7,074,500	$ 6,474,210
Fees	2,353,400	2,353,400	2,261,368
Federal	6,200,000	6,200,000	5,650,000
Interest income	0	0	14,354
Other	472,100	472,100	1,216,238
TOTAL REVENUES	16,100,000	16,100,000	15,616,170
EXPENDITURES			
Claim payments	14,650,100	14,650,100	12,968,986
Victims' coalition grant	100,000	100,000	100,000
Administrative cost	1,100,000	1,100,000	1,120,132
TOTAL EXPENDITURES	15,850,100	15,850,100	14,189,118
EXCESS OF REVENUES OVER EXPENDITURES	249,900	249,900	1,427,052
OTHER USES OF FINANCIAL RESOURCES			
Transfer to General Fund for District Attorneys General Grant	249,900	249,900	249,900
NET CHANGE IN FUND BALANCE	0	0	1,177,152
FUND BALANCE, BEGINNING OF YEAR	8,821,672	8,821,672	8,821,672
Prior Period Adjustment (Note B.3)	(1,278,258)	(1,278,258)	(1,278,258)
FUND BALANCE, BEGINNING OF YEAR, RESTATED	7,543,414	7,543,414	7,543,414
FUND BALANCE, END OF YEAR	$7,543,414	$ 7,543,414	$ 8,720,566

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

   Generally, the CICF receives both restricted and committed resources. Restricted funds are those that are restricted for specific purposes stipulated by external resource providers, constitutionally, or through enabling legislation. Committed funds can only be used for specific purposes as a result of constraints imposed by the Tennessee General Assembly-the fund's highest level of decision-making authority. Committed amounts cannot be used for any other purpose unless the Tennessee General Assembly removes those constraints by taking the same type of action (i.e., legislation). When both the restricted and other fund balance resources are available for use, it is the policy for the fund to use the restricted resources first, followed by the committed amounts.

3. **Cash -** The Criminal Injuries Compensation Fund does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Pooled Investment Fund is not rated by a nationally recognized statistical ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 104 - 110 of this report.

4. **Budgetary Process -** Legislation requires that annual budgets be adopted for special revenue funds. The proposed CICF budget is included in the budget proposal presented by the Governor to the General Assembly at the beginning of each annual legislative session. The CICF annual budget is prepared on the modified accrual basis of accounting. Budgetary control is maintained at the departmental level. Budget revisions during the year, reflecting program changes or administrative intradepartmental transfers, may be affected with certain executive and legislative branch approval. Only the legislature may transfer appropriations between departments.

(CONTINUED)

B. OTHER ACCOUNTING DISCLOSURES

1. **Due from Federal Government -** The receivable shown on the Balance Sheets as due from federal government includes funds for a grant awarded to the CICF under the Victims of Crime Act Formula Grant Program by the Department of Justice, Office of Justice Programs.

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

3. **Prior Period Adjustment -** During the year ended June 30, 2013, the method of calculating the accrued liability for claims was revised to include incurred but not reported claims and to revise the estimated percentage of payments for claims received. As a result, fund balance at June 30, 2012, was decreased by $1,278,258.

4. **Transfer to General Fund -** In accordance with the section 41, item 16 of Public Chapter 1029, of the 107th General Assembly of the State of Tennessee, a grant was awarded to the District Attorneys General for domestic violence prevention and drug enforcement activities from the CICF.

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Members of the General Assembly
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying statements of fiduciary net position of the Flexible Benefits Plan, an employee benefit trust fund of the State of Tennessee, as of June 30, 2014, and June 30, 2013, the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, which collectively comprise the Flexible Benefits Plan's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

(CONTINUED)

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Flexible Benefits Plan of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in fiduciary net position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Flexible Benefits Plan, an employee benefit trust fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the Flexible Benefits Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Flexible Benefits Plan's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

FLEXIBLE BENEFITS PLAN
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2014 AND JUNE 30, 2013

	June 30, 2014	June 30, 2013
ASSETS		
Cash	$ 1,012,226	$ 1,012,710
Contributions receivable	216,145	231,250
TOTAL ASSETS	1,228,371	1,243,960
LIABILITIES		
Accounts payable	29,889	63,072
TOTAL LIABILITIES	29,889	63,072
NET POSITION		
Restricted for employees' flexible benefits	$ 1,198,482	$ 1,180,888

See accompanying Notes to the Financial Statements.

FLEXIBLE BENEFITS PLAN
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

	June 30, 2014	June 30, 2013
ADDITIONS		
Employee contributions	$ 6,527,297	$ 7,184,359
TOTAL ADDITIONS	6,527,297	7,184,359
DEDUCTIONS		
Employee reimbursements	6,309,921	7,058,474
Administrative cost	199,782	158,505
TOTAL DEDUCTIONS	6,509,703	7,216,979
CHANGE IN NET POSITION	17,594	(32,620)
NET POSITION, BEGINNING OF YEAR	1,180,888	1,213,508
NET POSITION, END OF YEAR	$ 1,198,482	$ 1,180,888

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity -** The Flexible Benefits Plan is made available to state employees as an employee benefit. This plan is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the Flexible Benefits Plan is included in the *Tennessee Comprehensive Annual Financial Report (CAFR)* as an employee benefit trust fund. The state offers its employees a cafeteria plan created in accordance with *Internal Revenue Code Section 125*. The plan is available on an optional basis to all state employees. Through the plan, employees may elect to direct a portion of their salary to pay for certain benefits. Benefits which may be purchased through the plan include state group medical insurance, state group dental insurance, out-of-pocket medical expenses and/or dependent care expenses. Because elections must be filed before the salary or the benefits are received and because salary directed to the plan may not be withdrawn by participants for any other purpose, salary directed to the plan is exempt from federal income tax and social security tax. Elections made by employees may not be changed during the plan year except in the event of a corresponding change in the participant's family status. Participants may claim expenses incurred through March 15th following the end of the plan year. Any contributions to the plan not withdrawn are forfeited to the state and are used for defraying administrative costs. In calendar year 2009, the state added reimbursement accounts for transportation and parking expenses in accordance with *Internal Revenue Code Section 132*. These plans operate in much the same manner as the *Section 125* plans in that employees may elect to direct a portion of their salary tax-exempt to pay for transportation or parking expenses. However, there are no restrictions on time of enrollment or account changes and any contributions not used will be rolled forward to the following year instead of forfeited.

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

3. **Cash -** The Flexible Benefits Plan does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Pooled Investment Fund is not rated by a nationally recognized statistical ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 104 - 110 of this report.

4. **Participant Contribution Forfeitures and Plan Administration -** Participant contributions not reimbursed to participants and forfeited to the plan for the latest closed plan year are transferred to the Treasury Department and applied toward funding a portion of the plan administrative cost. The remaining administrative costs for the plan are recovered directly from funds of the participating employer agencies. The amount forfeited is reflected on the Statement of Changes in Fiduciary Net Position as administrative cost.

5. **Adoption of New Accounting Pronouncement -** The Flexible Benefits Plan implemented the Governmental Accounting Standards Board's Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on Flexible Benefits Plan was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

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Members of the General Assembly
Members of the State Funding Board
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying statement of fiduciary net position of the Intermediate Term Investment Fund as of June 30, 2014, the related statement of changes in fiduciary net position for the year then ended, and the related notes to the financial statements, which collectively comprise the Intermediate Term Investment Fund's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

(CONTINUED)

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the State Funding Board. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Intermediate Term Investment Fund.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Intermediate Term Investment Fund of the State of Tennessee as of June 30, 2014, and the changes in fiduciary net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Intermediate Term Investment Fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2014, and the changes in its financial position for the year then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the Intermediate Term Investment Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Intermediate Term Investment Fund's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

INTERMEDIATE TERM INVESTMENT FUND
STATEMENT OF FIDUCIARY NET POSITION
JUNE 30, 2014

		June 30, 2014
ASSETS		
Cash and cash equivalents	$	325,435
Investment income receivable		793,224
Investments (at fair value)		199,962,737
TOTAL ASSETS		201,081,396
LIABILITIES AND NET POSITION		
NET POSITION - RESTRICTED FOR POOL PARTICIPANTS	$	201,081,396

See accompanying Notes to the Financial Statements.

INTERMEDIATE TERM INVESTMENT FUND
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION
FOR THE FISCAL YEAR ENDED JUNE 30, 2014

		For the Year Ended June 30, 2014
OPERATIONS		
Investment Income	$	1,176,940
Expenses		95,544
NET INVESTMENT INCOME	$	1,081,396
CAPITAL SHARE TRANSACTIONS		
Shares Sold		200,000,000
Less Shares Redeemed		0
INCREASE FROM CAPITAL SHARE TRANSACTIONS		200,000,000
TOTAL INCREASE IN NET POSITION		201,081,396
NET POSITION BEGINNING OF YEAR		0
NET POSITION END OF YEAR	$	201,081,396

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity –** The Intermediate Term Investment Fund (ITIF) is an external investment pool sponsored by the State of Tennessee. All funds in the ITIF at June 30, 2014 consist of funds belonging to entities outside of the State of Tennessee Financial Reporting Entity, and have been included as a separate investment trust fund in the *Tennessee Comprehensive Annual Financial Report*.

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

3. **Cash and Cash Equivalents –** Cash received by the ITIF that cannot be immediately invested in securities, or that is needed for operations, is deposited in the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer. This classification also includes short-term investments with a maturity date within three months of the date acquired by the State.

4. **Method Used to Report Investments and Participant Shares –** The ITIF is not registered with the Securities and Exchange Commission (SEC) as an investment company. Through the investment policy adopted by the Funding Board of the State of Tennessee (Funding Board), the fair value of investment positions in the ITIF is determined daily based on the fair value of the pool's underlying portfolio. Accordingly, the investments of the ITIF are reported at fair value on the statement of fiduciary net position. Securities traded on a national exchange are valued at the last reported market prices. In accordance with investment policy, purchases and redemptions are limited to the first working day of each quarter. During the fiscal year ended June 30, 2014, the State had not obtained or provided any legally binding guarantees to support the value of participant shares. The State of Tennessee, or any other state or federal agency, does not guarantee that a participant will receive the value of its investment or interest thereon upon redemption of its shares. The State of Tennessee has not obtained a credit quality rating for the ITIF from a nationally recognized credit ratings agency.

B. INVESTMENTS

The ITIF is authorized by statute to invest funds in the investment instruments specified under statutes for the State Pooled Investment Fund (SPIF), and to invest funds in the State Pooled Investment Fund (SPIF), in accordance with policy guidelines for the ITIF as approved by the Funding Board. The current policy of the Funding Board for the ITIF gives the Treasurer approval to invest funds in 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, obligations guaranteed as to principal and interest by the federal home loan mortgage corporation, federal national mortgage association, student loan marketing association and other United States government-sponsored corporations, prime commercial paper, prime bankers' acceptances, and repurchase agreements for obligations of the United States or its agencies. The investment in derivatives and equity investments of any type is prohibited. Under the ITIF's investment policy, the SPIF may be used for the purpose of cash administration, but shall not be used for the purpose of investment.

The current policy of the Funding Board for the SPIF gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Pooled Investment Fund is not rated by a nationally

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recognized statistical ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 104 - 110 of this report.

At June 30, 2014, the ITIF's investments consisted of United States government agency securities of $199,962,737 at fair value and $199,600,000 at par value. Interest rates on the securities range from .125% to 2.500%, and the number of days to maturity ranges from 25 to 1,611 days.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The ITIF's investment policy requires that prime banker's acceptances must be issued by domestic banks with a minimum AA long term debt rating or foreign banks with an AAA long term debt rating by a majority of the designated rating services that have rated the issuer. The short-term debt rating must be at least A1 or the equivalent by all of the rating services that rate the issuer. Commercial paper should be rated in the highest tier by all rating agencies that rate the paper. Commercial paper on a credit rating agency's negative credit watch list cannot be purchased under the investment policy. The policy requires that a credit analysis report on the corporation be prepared prior to acquisition of the commercial paper. Repurchase agreements must be done with primary dealers in government securities which have executed a master repurchase agreement with the State. Credit quality ratings for the ITIF's investments in debt securities as of June 30, 2014 consisted of $43,325,592 in fair value of securities rated AA by Standard and Poor's rating scale, and $156,637,145 in fair value of securities implicitly guaranteed by the United States government but not rated by Standard and Poor's or Moody's ratings agencies.

Concentration of Credit Risk – A concentration of investments in any one single issuer of debt securities presents a greater risk for loss in the event that the issuer fails on its obligations. It is the policy of the ITIF to diversify the investment portfolio in order to reduce the risk of loss resulting from over-concentration of assets in a specific maturity, a specific issuer, or a specific class of securities. Commercial paper acquisitions are monitored by policy to assure that no more than five percent (5%) of the portfolio market value at the date of acquisition, is invested in prime commercial paper of a single issuing corporation. The total holdings of an issuer's paper should not represent more than five percent (5%) of the issuing corporation's total outstanding commercial paper. Furthermore, purchases of prime commercial paper shall not exceed thirty-five percent (35%) of the fund's market value at the date of acquisition. In addition, the ITIF's investment policy limits the book value of prime banker's acceptances to five percent (5%) of the total book value of the pool and limits such investments in any one commercial bank to the lesser of five percent (5%) of the portfolio's book value or $25 million. The ITIF had the following investment amounts and percentages of total investments, in organizations representing five percent (5%) or more of total investments, excluding those organizations whose issues are explicitly guaranteed by the United States government, and investments in mutual funds, external investment pools, and other pooled investments:

June 30,2014		
Issuer Organization	**Fair Value**	**Percentage of Total Investments**
Federal Home Loan Banks	$67,700,568	33.86%
Federal Home Loan Mortgage Corporation	62,849,070	31.43%
Federal Farm Credit Banks	42,633,919	21.32%
Federal National Mortgage Association	16,554,780	8.28%
Federal Agricultural Mortgage Corporation	10,224,400	5.11%

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Interest Rate Risk – Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The ITIF's investment policy with respect to maturity states that the dollar weighted average maturity of the Fund shall not exceed three (3) years, and that no security will be bought with a remaining life of over five (5) years. The maximum time period from the date of acquisition to maturity of government or agency securities may not exceed five (5) years. Prime commercial paper, including asset-backed commercial paper, shall not have a maturity that exceeds two hundred seventy (270) days. Individual repurchase agreement transactions shall not have a maturity that exceeds ninety (90) days. Prime banker's acceptances must have an original maturity of not more than two hundred seventy (270) days to be eligible for purchase, with the intent to hold to maturity, however they may be traded in the secondary market to maintain liquidity. At June 30, 2014, the effective duration of the ITIF's debt securities was 2.05 years.

C. OTHER ACCOUNTING DISCLOSURES

Description of the Intermediate Term Investment Fund – Pursuant to *Tennessee Code Annotated*, Section 9-4-608, the Funding Board was authorized to establish the Intermediate Term Investment Fund (ITIF) to provide a longer-term investment vehicle than the State Pooled Investment Fund (SPIF) for funds in the custody of a department or agency of the state, or a county trustee. The ITIF is administered by the State Treasurer within the guidelines established by the Funding Board, and the responsibility for the day-to-day administration of the ITIF, in accordance with investment policy, has been assigned to appropriate investment officials within the Treasury Department. Participants in the ITIF are advised to only invest monies in the pool that are not needed for short term liquidity, due to the daily pricing of the pool to the market and the potential for significant price volatility. Participants in the ITIF may include the general fund of the State and any department or agency of the State which is required by court order, contract, state or federal law or federal regulation to receive interest on invested funds, and which are authorized by the State Treasurer to participate in the ITIF. In addition, a county legislative body may authorize the county trustee to invest county funds in the ITIF. By statute, any entity that is eligible to participate in the State Pooled Investment Fund may participate in the ITIF. As indicated in Note 1 above, the ITIF is not registered as an investment company with the SEC. Investment in the ITIF is voluntary and participants may invest any amount for any length of time in the ITIF.

Participants' shares are sold and redeemed at a value based upon the daily fair value per share of the pool's underlying investments. For the fiscal years ending June 30, 2014 an administrative fee of .05 percent was charged against each participant's average daily balance to provide funding for administrative expenses to operate the ITIF.

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Members of the General Assembly
Members of the Board of Claims
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying statements of net position of the Risk Management Fund, an internal service fund of the State of Tennessee, as of June 30, 2014, and June 30, 2013, the related statements of revenues, expenses, and changes in fund net position and cash flows for the years then ended, and the related notes to the financial statements, which collectively comprise the Risk Management Fund's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the Board of Claims. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Risk Management Fund.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Risk Management Fund of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in financial position and cash flows thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Risk Management Fund, an internal service fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in its financial position and cash flows for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the Risk Management Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Risk Management Fund's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

RISK MANAGEMENT FUND
STATEMENTS OF NET POSITION
JUNE 30, 2014 AND JUNE 30, 2013

	June 30, 2014	June 30, 2013
ASSETS		
Current assets		
Cash	$ 116,276,475	$ 108,502,659
Due from federal government	0	10,695,883
Accounts receivable	13,458	0
Total current assets	116,289,933	119,198,542
Noncurrent assets		
Due from federal government	10,054,480	0
TOTAL ASSETS	126,344,413	119,198,542
LIABILITIES		
Current liabilities		
Accounts payable	1,071,319	872,339
Unearned revenue	8,000	8,000
Claims liability	33,594,233	31,286,133
Total current liabilities	34,673,552	32,166,472
Noncurrent liabilities		
Claims liability	108,951,000	65,117,000
TOTAL LIABILITIES	143,624,552	97,283,472
NET POSITION - UNRESTRICTED	$ (17,280,139)	$ 21,915,070

See accompanying Notes to the Financial Statements.

STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
FOR THE YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

	For the Year Ended June 30, 2014	For the Year Ended June 30, 2013
OPERATING REVENUES		
Casualty premiums	$ 49,094,900	$ 47,100,700
Property premiums	8,931,200	10,267,900
TOTAL OPERATING REVENUES	58,026,100	57,368,600
OPERATING EXPENSES		
Torts		
Death	1,064,705	1,934,531
Bodily injury	2,516,951	2,223,003
Property damage	927,781	1,112,205
Total Torts	4,509,437	5,269,739
Workers' Compensation		
Death	254,697	224,643
Medical	14,476,573	14,111,115
Temporary disability	3,625,925	3,535,887
Permanent disability	8,353,721	7,283,689
Total Workers' Compensation	26,710,916	25,155,334
Property Damage		
Employee property	21,512	22,391
State owned property	4,379,252	807,818
Total Property Damage	4,400,764	830,209
Property insurance premiums	5,457,395	5,356,668
Professional/Administrative	9,389,667	8,699,562
Increase (Decrease) of accrued liability	46,199,592	(682,860)
TOTAL OPERATING EXPENSES	96,667,771	44,628,652
OPERATING GAIN/(LOSS)	(38,641,671)	12,739,948
NON-OPERATING REVENUES		
Grant revenue	(641,403)	0
Interest income	85,290	107,194
Taxes	2,575	2,600
TOTAL NON-OPERATING REVENUES	(553,538)	109,794
CHANGE IN NET POSITION	(39,195,209)	12,849,742
NET POSITION, BEGINNING OF YEAR	21,915,070	9,065,328
NET POSITION, END OF YEAR	$ (17,280,139)	$ 21,915,070

See accompanying Notes to the Financial Statements.

RISK MANAGEMENT FUND
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

	For the Year Ended June 30, 2014	For the Year Ended June 30, 2013
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from premiums	$ 58,012,642	$ 57,368,600
Receipts for insurance proceeds	1,196,378	0
Payments for claims	(36,746,595)	(32,016,631)
Payments for administrative expenses	(9,319,079)	(8,821,954)
Payments for insurance premiums	(5,457,395)	(5,356,668)
NET CASH FROM OPERATING ACTIVITIES	7,685,951	11,173,347
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Taxes received	2,575	2,600
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES	2,575	2,600
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	85,290	107,194
NET CASH FROM INVESTING ACTIVITIES	85,290	107,194
NET INCREASE IN CASH	7,773,816	11,283,141
CASH, BEGINNING OF YEAR	108,502,659	97,219,518
CASH, END OF YEAR	$ 116,276,475	$ 108,502,659
RECONCILIATION OF OPERATING INCOME/(LOSS) TO NET CASH FROM OPERATING ACTIVITIES		
OPERATING INCOME/(LOSS)	$ (38,641,671)	$ 12,739,948
ADJUSTMENTS TO RECONCILE OPERATING INCOME/(LOSS) TO NET CASH FROM OPERATING ACTIVITIES		
Changes in assets and liabilities		
(Increase) decrease in accounts receivable	(13,458)	0
Increase in accounts payable	198,980	10,769
Increase (decrease) in claims liability	46,142,100	(1,577,370)
TOTAL ADJUSTMENTS	46,327,622	(1,566,601)
NET CASH FROM OPERATING ACTIVITIES	$ 7,685,951	$ 11,173,347

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

2. **Measurement Focus and Basis of Accounting -** The accompanying financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred, regardless of the timing of the related cash flows. The RMF distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from the services provided by the RMF. The principal operating revenue of the RMF consists of charges to its customers for insurance premiums. Operating expenses include claims expenses, insurance premiums, administrative expenses and the current charge to the accrued liability. Revenues and expenses not resulting from the services provided by the RMF are reported as nonoperating revenues and expenses.

3. **Cash -** The Risk Management Fund does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The State Pooled Investment Fund is not rated by a nationally recognized ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 104 - 110 of this report.

4. **Adoption of New Accounting Pronouncement -** The RMF implemented the Governmental Accounting Standards Board's Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the RMF was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

B. OTHER ACCOUNTING DISCLOSURES

1. **Risk Management -** It is the policy of the state not to purchase commercial insurance for the risks associated with casualty losses for general liability, automobile liability, professional medical malpractice liability, and workers' compensation. By statute, the maximum liablilty for general liability, automobile liability, and medical malpractice liability is $300,000 per person and $1 million per occurrence. The state's management believes it is more economical to manage these risks internally and set aside assets for claim settlement in its internal service fund, the RMF. The state purchases commercial insurance for real property, builder's risk (for construction projects starting prior to July 1, 2012) and crime and fidelity coverage on the state's officials and employees. The contractor is responsible for acquiring builder's risk insurance for all construction projects after June 30, 2012, thus builder's risk is no longer covered by the RMF. For property coverage, the deductible for an individual state agency is the first $25,000 of losses. The RMF is responsible for property losses for the annual aggregate deductible of $10 million for perils other than earthquake and flood. Purchased insurance coverage is responsible for losses exceeding the $10 million annual aggregate deductible. For earthquake and flood, there is a deductible of $10 million per occurrence. The maximum insurance coverage is $750 million per year for perils other than earthquake and flood. The maximum flood

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insurance coverage is $50 million per occurrence, except there is only $25 million of coverage in flood zones A and V. The maximum earthquake insurance coverage is $50 million per occurence. Settled claims resulting from these risks have not exceeded maximum commercial insurance coverage in any of the past three fiscal years. All agencies and authorities of the state participate in the RMF, except for the Dairy Promotion Board and the Certified Cotton Growers' Organization. The Tennessee Education Lottery Corporation participates in the RMF for general liability purposes but is responsible for its own worker's compensation coverage.

The RMF liabilities are reported when it is probable that a loss has occurred and the amount of that loss can be reasonably estimated. Liabilities include an amount for claims that have been incurred but not reported. Because actual claims liabilities depend on such complex factors as inflation, changes in legal doctrines, and damage awards, the process used in computing claims liability does not necessarily result in an exact amount. Claims liabilities are reevaluated annually to take into consideration recently settled claims, the frequency of claims, and other economic and social factors.

The present value of the casualty liability as actuarially determined was $136,844,000 (discounted at 1.0%) at June 30, 2014 and $89,292,000 (discounted at 1.0%) at June 30, 2013**.** During fiscal year 2014, the State determined to change the methodology for reserving workers compensation claims to a model more closely aligned to industry standards. The conversion of outstanding claims to the new methodology resulted in a substantially higher accrued liability for casualty losses than was seen in prior years. The accrued liability for incurred property losses was $5,701,233 at June 30, 2014 and $7,111,133 at June 30, 2013. The changes in the balances of the claims liabilities during fiscal years 2013 and 2014 were as follows:

The RMF held $116.3 million in cash at June 30, 2014 and $108.5 million in cash at June 30, 2013 that is designated for payment of these claims.

Fiscal Year	Beginning Claims Liability	Current Year Claims and Changes in Estimates	Claim Payments	Ending Claims Liability
2014	$96,403,133	$83,017,087	($36,874,987)	$ 142,545,233
2013	$97,980,503	$30,572,422	($32,149,792)	$ 96,403,133

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

2. **Receivable -** The receivables shown on the Statement of Net Position as due from federal government include funds to be received from the Federal Emergency Management Agency for property losses that were classified as a disaster. Current Receivables include claims for losses expected to be collected within 12 months.

3. **Insurance Proceeds -** The State receives property insurance proceeds from our commercial insurance carriers in excess of our deductible for losses. Current estimated property losses at June 30, 2014 were $40,629,076 while estimated proceeds from commercial insurance carriers above our deductible were $36,897,630 which includes the balance at June 30, 2014 of $1,969,788 of insurance proceeds on hand for the payment of claims. This results in a $3,731,445 liability for property losses to be established at June 30, 2014.

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Members of the General Assembly
Members of the State Funding Board
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying statements of fiduciary net position of the State Pooled Investment Fund as of June 30, 2014, and June 30, 2013, the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, which collectively comprise the State Pooled Investment Fund's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the State Funding Board. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the State Pooled Investment Fund.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the State Pooled Investment Fund of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in fiduciary net position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the State Pooled Investment Fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by Government Auditing Standards

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the State Pooled Investment Fund's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the State Pooled Investment Fund's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

STATE POOLED INVESTMENT FUND
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2014 AND JUNE 30, 2013

	June 30, 2014	June 30, 2013
ASSETS		
Cash and cash equivalents	$ 2,568,101,968	$ 2,475,926,454
Short-term investments, at amortized cost	5,828,165,563	6,410,991,115
Investment receivable	0	194,107,545
Accrued income receivable	10,131,284	11,230,006
TOTAL ASSETS	8,406,398,815	9,092,255,120
LIABILITIES AND NET POSITION		
NET POSITION RESTRICTED FOR POOL PARTICIPANTS	$ 8,406,398,815	$ 9,092,255,120

See accompanying Notes to the Financial Statements.

STATE POOLED INVESTMENT FUND
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEARS ENDED JUNE 30, 2014 AND JUNE 30, 2013

	For the Year Ended June 30, 2014	For the Year Ended June 30, 2013
OPERATIONS		
Investment income	$ 12,139,820	$ 14,013,687
Expenses		
Administrative fee	4,029,649	4,133,505
Custodian and banking services fees	384,066	31,999
Total expenses	4,413,715	4,165,504
NET INVESTMENT INCOME	7,726,105	9,848,183
CAPITAL SHARE TRANSACTIONS (DOLLAR AMOUNTS AND NUMBER OF SHARES ARE THE SAME)		
Shares sold	38,107,770,622	39,778,319,120
Less shares redeemed	38,801,353,032	38,922,364,548
INCREASE (DECREASE) FROM CAPITAL SHARE TRANSACTIONS	(693,582,410)	855,954,572
TOTAL INCREASE (DECREASE) IN NET POSITION	(685,856,305)	865,802,755
NET POSITION, BEGINNING OF YEAR	9,092,255,120	8,226,452,365
NET POSITION, END OF YEAR	$ 8,406,398,815	$ 9,092,255,120

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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

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

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

4. **Method Used to Report Investments and Participant Shares** - The SPIF is not registered with the Securities and Exchange Commission (SEC) as an investment company but, through its investment policy adopted by the Funding Board of the State of Tennessee (Funding Board), operates in a manner consistent with the SEC's Rule 2a7 of the *Investment Company Act of 1940*. Rule 2a7 allows SEC registered mutual funds to use amortized cost to report net assets in computing share prices. Likewise, the SPIF uses amortized cost accounting measures to report investments and share prices. During the fiscal years ended June 30, 2014 and June 30, 2013, the State had not obtained or provided any legally binding guarantees to support the value of participant shares. The State of Tennessee has not obtained a credit quality rating for the SPIF from a nationally recognized credit ratings agency.

5. **Adoption of New Accounting Pronouncement** - The SPIF implemented the Governmental Accounting Standards Board's Statement 63, *Financial Reporting of Deferred Outflows of Resources, Deferred Inflows of Resources, and Net Position*, during the year ended June 30, 2013. The effect on the SPIF was the renaming of the residual of all other elements in the statement of financial position as net position, rather than net assets.

B. DEPOSITS AND INVESTMENTS

The State Pooled Investment Fund is authorized by statute to invest funds in accordance with policy guidelines approved by the Funding Board. The current resolution of the Funding Board gives the Treasurer approval to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, bonds, notes, and treasury bills of the United States or other obligations guaranteed as to principal and interest by the United States or any of its agencies, repurchase agreements for obligations of the United States or its agencies, and securities lending agreements whereby securities may be loaned for a fee. Investments in derivative type securities and investments of high risk are prohibited.

At June 30, 2014 and June 30, 2013, the principal amount of certificates of deposit in state depositories was $880,480,000 and $506,275,000 respectively. Interest rates on certificates of deposit held at June 30, 2013 ranged from 0.10% to 0.30% and at June 30, 2012 ranged from 0.20% to 0.30%. The days to maturity on certificates of deposit ranged from 7 to 365 days at June 30, 2013, and from 7 to 270 days at June 30, 2012.

As of June 30, 2014 and June 30, 2013, the SPIF had the following investments:

(CONTINUED)

Investments
(Expressed in Thousands)

2014

Investment Type	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity	
Cash Equivalents and Short-term Investments:						(See Average Maturity Table on page 109.)
U.S. Government Agencies	$4,114,227,373	$4,114,489,364	$4,113,396,000	.035% - 2.63%	28 - 397	
U.S. Government Treasuries	2,213,470,463	2,213,710,440	2,203,000,000	.020% - 4.25%	15 - 397	
Commercial Paper	599,977,053	599,977,053	600,000,000	.030% - 0.12%	1 - 44	
Total Cash Equivalents and Short-term Investments	$6,927,674,889	$6,928,176,857	$6,916,396,000			
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Position	(1,449,334,326)					
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Position	349,825,000					
Short-term investments as shown on Statement of Fiduciary Net Position	$5,828,165,563					

2013

Investment Type	Carrying Amount	Fair Value	Par Value	Interest Rate Range	Days to Maturity	U.S. Treasury(1)	Carrying Amount Credit Quality Ratings			
							AAA	AA	A1(2)	Not Rated (3)
Cash Equivalents and Short-term Investments:										
U.S. Government Agencies	$4,349,368,434	$4,349,560,296	$4,342,092,000	.02% - 5.25%	12 - 397		$1,008,635,251	$1,823,391,093		$1,517,342,090
U.S. Government Treasuries	2,466,870,824	2,466,927,100	2,457,000,000	.03% - 4.25%	56 - 397	$2,466,870,824				
Commercial Paper	839,978,220	839,978,220	840,000,000	.015% - 0.15%	3 - 45				$839,978,220	
Total Cash Equivalents and Short-term Investments	$7,656,217,478	$7,656,465,616	$7,639,092,000			$2,466,870,824	$1,008,635,251	$1,823,391,093	$839,978,220	$1,517,342,090
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Position	(1,561,501,363)									
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Position	316,275,000									
Short-term investments as shown on Statement of Fiduciary Net Position	$6,410,991,115									

(1) Includes obligations of the U.S. government or obligations explicitly guaranteed by the U.S. government.

(2) A1 is the highest rating category for commercial paper.

(3) Includes securities that are implicitly guaranteed by the U.S. government, but are not rated by Standard and Poor's or Moody's.

(CONTINUED)

Credit Risk - Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. Credit quality ratings for the SPIF's investments in debt securities as of June 30, 2014 and June 30, 2013 are included in the above schedule. Securities are rated using Standard and Poor's and/or Moody's and are presented below using the Standard and Poor's rating scale. State statutes provide a process for financial institutions desiring to act as state depositories to be approved by the State Treasurer. Statutes also provide for the Commissioner of Financial Institutions to advise, on a timely basis, the Treasurer and the Commissioner of Finance and Administration of the condition of each state bank and state chartered savings and loan association, including his recommendations regarding its condition and safety as a state depository. Similar provisions apply to federally chartered banks and savings and loan associations designated as state depositories. This process ensures that institutions whose financial status is uncertain are monitored for collateral sufficiency. All certificates of deposit are required by policy to be placed directly with state depositories. All repurchase agreements are done with primary dealers in government securities which have executed a master repurchase agreement with the State. The SPIF's investment policy requires a AAA credit quality rating for the purchase of obligations of instrumentalities that are not fully guaranteed by the United States government. Prime banker's acceptances must be issued by domestic banks with a minimum AA long-term debt rating or foreign banks with a AAA long-term debt rating by a majority of the rating services that have rated the issuer. The short-term debt rating must be at least A1 or the equivalent by all of the rating services that rate the issuer. Commercial paper should be rated in the highest tier by all rating agencies that rate the paper. Commercial paper on a credit rating agency's negative credit watch list cannot be purchased under the investment policy. The policy requires that a credit analysis report on the corporation be prepared prior to acquisition of the commercial paper.

(CONTINUED)

Credit Quality Distribution for Securities with Credit Exposure as a Percentage of Total Investments June 30, 2014		
Credit Quality Rating	Carrying Value	Percentage of Total Short-Term Investments
US Treasury (1)	$ 2,213,470,463	31.95%
AAA	1,658,774,663	23.94%
AA	749,756,728	10.82%
A1 (3)	599,977,053	8.66%
NR (2)	1,705,695,982	24.62%
Total Fixed Income Securities	6,927,674,889	100.00%
Less Short-Term Investments Classified as Cash	(1,449,334,326)	
Add Certificates of Deposit Classified as Short-Term Investments	349,825,000	
Total Short-Term Investments as Shown on Net Position	$ 5,828,165,563	

Credit Quality Distribution for Securities with Credit Exposure as a Percentage of Total Investments June 30, 2013		
Credit Quality Rating	Carrying Value	Percentage of Total Short-Term Investments
US Treasury (1)	$ 2,466,870,824	32.22%
AAA	1,008,635,251	13.17%
AA	1,823,391,093	23.82%
A1 (3)	839,978,220	10.97%
NR (2)	1,517,342,090	19.82%
Total Fixed Income Securities	7,656,217,478	100.00%
Less Short Term Investments classified as Cash	(1,561,501,363)	
Add Certificates of Deposit classified as Short Term Investments	316,275,000	
Total Short Term Investments as shown on Net Position	$ 6,410,991,115	

(1) Includes obligations of the U. S. government or obligations explicitly guaranteed by the U. S. government.

(2) Includes securities that are implicitly guaranteed by the U.S. government, but are not rated by Standard and Poor's or Moody's.

(3) A1 is the highest rating category for commercial paper.

(CONTINUED)

Concentration of Credit Risk - A concentration of investments in any one single issuer of debt securities presents a greater risk for loss in the event that the issuer fails on its obligations. An objective stated in the SPIF's investment policy is that the investment portfolio will be diversified to avoid incurring unreasonable and avoidable risks regarding specific security types or individual financial institutions. Acquisitions are monitored by policy to assure that no more than twenty percent (20%) of the book value of the pool, at the date of acquisition, is invested in a single United States government agency security and that such acquisition does not cause the SPIF's aggregate United States government agency holdings to exceed fifty percent (50%) of the total book value of the pool on such date. In addition, the SPIF's investment policy limits the book value of prime banker's acceptances to five percent (5%) of the total book value of the pool and limits such investments in any one commercial bank to the lesser of five percent (5%) of the portfolio's book value or $25 million. Prime commercial paper investments are limited to five percent (5%) of the total portfolio book value invested in any one single issuing corporation and the total holdings of an issuer's paper should not represent more than five percent (5%) of the issuing corporation's total outstanding commercial paper, with the maximum amount of a specific corporation's commercial paper limited to $100 million, not including commercial paper maturing on the next business day. The SPIF held $141,000,000 of commercial paper from one corporation from September 26, 2012 through September 27, 2012, $180,000,000 of commercial paper from one corporation from September 28, 2012 through October 3, 2012 and $120,000,000 of commercial paper from one corporation from April 15, 2013 through May 2, 2013, in violation of the investment policy. Prime commercial paper shall not exceed forty percent (40%) of the total pool's book value. The SPIF had the following investment amounts and percentages of total investments, in organizations representing five percent (5%) or more of total investments, excluding those organizations whose issues are explicitly guaranteed by the United States government, and investments in mutual funds, external investment pools, and other pooled investments:

June 30,2014		
Issuer Organization	**Carrying Amount**	**Percentage of Total Investments**
Federal Home Loan Banks	$ 1,278,947,422	18.46%
Federal National Mortgage Association	1,255,719,421	18.13%
Federal Farm Credit Banks	828,835,052	11.96%
Federal Home Loan Mortgage Corporation	500,731,985	7.23%

June 30,2013		
Issuer Organization	**Carrying Amount**	**Percentage of Total Investments**
Federal Home Loan Banks	$ 1,547,793,126	20.22%
Federal Farm Credit Banks	1,063,957,364	13.90%
Federal National Mortgage Association	633,110,530	8.27%
International Bank for Reconstruction and Development	586,887,337	7.67%
Federal Home Loan Mortgage Corporation	517,687,293	6.76%
BNP	439,998,900	5.75%

(CONTINUED)

Interest Rate Risk - Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The SPIF's investment policy with respect to maturity states that the dollar weighted average maturity of the pool shall not exceed one hundred twenty (120) days and that no investment may be purchased with a remaining maturity of greater than three hundred ninety seven (397) calendar days. At June 30, 2013, the weighted average maturity of the pool was one hundred nine (109) days. At June 30, 2012, the weighted average maturity of the pool was one hundred thirteen (113) days, which was in violation of the investment policy. The SPIF was in compliance with the policy at June 28, 2012 but was over the limit due to large outflows at year end. The weighted average maturity for the pool returned to one hundred twenty (120) days on July 5, 2012. It is the intent of the Funding Board that the fair value of the SPIF not deviate more than one-half percent (0.5%) from amortized cost. If it does, actions may include, but not be limited to, selling securities whose fair value substantially deviates from amortized cost, and investing in securities with ninety (90) days or less to maturity. Agency variable rate notes are permitted by investment policy provided they are indexed to treasury bill, commercial paper, federal funds, LIBOR or the prime rates. It is the intent of the Funding Board that variable rate notes must move in the same direction as general money market rates. Prime banker's acceptances must have an original maturity of not more than two hundred seventy (270) days to be eligible for purchase, with the intent to hold to maturity. Prime commercial paper shall not have a maturity that exceeds one hundred eighty (180) days, and individual repurchase agreement transactions shall not have a maturity that exceeds ninety (90) days.

As of June 30, 2014 and June 30, 2013, the SPIF portfolio had the following weighted average maturities on debt investments:

June 30, 2014		
Investment Type	**Carrying Amount**	**Weighted Average Maturity (Months)**
U.S. Government Agencies	$4,114,227,373	4.25
U.S. Government Treasuries	2,213,470,463	3.87
Commercial Paper	599,977,053	0.65
Total Debt Investments	$6,927,674,889	3.82
Total SPIF Portfolio	$8,453,638,610	3.63

June 30, 2013		
Investment Type	**Carrying Amount**	**Weighted Average Maturity (Months)**
U.S. Government Agencies	$4,349,368,434	4.72
U.S. Government Treasuries	2,466,870,824	4.80
Commercial Paper	839,978,220	0.35
Total Debt Investments	$7,656,217,478	4.27
Total SPIF Portfolio	$8,947,459,042	3.77

(CONTINUED)

C. OTHER ACCOUNTING DISCLOSURES

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

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

An average rate of return is calculated on the investments made each month in the SPIF and is used to credit earnings to LGIP participants and the State departments and agencies required to earn interest. The State's general fund is credited with the residual earnings. Accordingly, participants' shares are sold and redeemed at a value equal to the amount of the principal plus accrued earnings while investments are reported at amortized cost. For the fiscal years ending June 30, 2014 and June 30, 2013, an administrative fee of .05 percent was charged against each participant's average daily balance to provide funding for administrative expenses to operate the SPIF.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Members of the General Assembly
Members of the Board of Trustees
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying statement of fiduciary net position of the Tennessee Consolidated Retirement System, pension trust funds of the State of Tennessee, as of June 30, 2014, the related statement of changes in fiduciary net position for the year then ended, and the related notes to the financial statements, which collectively comprise the Tennessee Consolidated Retirement System's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

(CONTINUED)

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of trustees of the Tennessee Consolidated Retirement System. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Tennessee Consolidated Retirement System.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Tennessee Consolidated Retirement System as of June 30, 2014, and the changes in fiduciary net position thereof for the year then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matters

As discussed in Note A.1, the financial statements present only the Tennessee Consolidated Retirement System, pension trust funds, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2014, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

As discussed in Note C, the financial statements of the Tennessee Consolidated Retirement System include investments valued at $3,379,369,542 (7.88 percent of net position) whose fair values have been estimated by management in the absence of readily determinable fair values. Management's estimates are based on information provided by the fund managers or the general partners. Our opinion is not modified with respect to this matter.

As discussed in Note A.6, the Tennessee Consolidated Retirement System implemented Governmental Accounting Standards Board Statement 67, *Financial Reporting for Pension Plans*, during the year ended June 30, 2014. Our opinion is not modified with respect to this matter.

Other Matters

Required Supplementary Information

Accounting principles generally accepted in the United States of America require that management's discussion and analysis, schedule of changes in net pension liability, schedule of net pension liability, schedule of investment returns, and schedule of pension plan contributions be presented to supplement the basic financial statements. Such information, although not a part of the basic financial statements, is required by the Governmental Accounting Standards Board, which considers it to be an essential part of financial reporting for placing the basic financial statements in an appropriate operational, economic, or historical context. We have applied certain limited procedures to the required supplementary information in accordance with auditing standards generally accepted in the United States of America, which consisted of inquiries of management about the methods of preparing the information and comparing the information for consistency with management's responses to our inquiries, the basic financial statements, and other knowledge we obtained during our audit of the basic financial statements. We do not express an opinion or provide any assurance on the information because the limited procedures do not provide us with sufficient evidence to express an opinion or provide any assurance.

(CONTINUED)

Other Information

Our audit was conducted for the purpose of forming an opinion on the basic financial statements as a whole. The actuarial balance sheet is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and accordingly, we do not express an opinion or provide any assurance on it.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the Tennessee Consolidated Retirement System's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Tennessee Consolidated Retirement System's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

MANAGEMENT'S DISCUSSION AND ANALYSIS

The Management of the Tennessee Consolidated Retirement System (TCRS) provides this discussion and analysis as an overview of the TCRS' financial activities for the fiscal year ended June 30, 2014. This section should be read in conjunction with the Independent Auditor's Report, the audited financial statements, and the accompanying notes.

FINANCIAL HIGHLIGHTS

- The plan net position (total assets minus total liabilities) of the TCRS at June 30, 2014 was $42.9 billion, increasing $5.3 billion (14.2 percent) from the plan net position at June 30, 2013. The net position is restricted for future benefit obligations. This increase in plan net position is mainly attributable to net investment income where the money-weighted rate of return was 16.5 percent. The strong rate of return was driven by domestic equity returns of more than 25 percent and international equity returns of more than 20 percent.

- Net investment income for fiscal year 2014 was $6.16 billion. During fiscal year 2014, the TCRS received a time-weighted rate of return on its portfolio of 16.7 percent, compared to 9.9 percent for fiscal year 2013.

- Based on the latest actuarial valuation as of July 1, 2013, the overall funded ratio for all participating employers within TCRS is 93.6% on an actuarial value of assets basis. The funded ratio would be 89.6% using market value of assets.

- Contribution revenue for fiscal year 2014 totaled $1.31 billion, representing an increase of 2.1 percent compared to fiscal year 2013. Since the actuarially required employer contribution rate did not change, this increase is largely attributable to an increase in the member salary base.

- Total benefits and refunds paid for fiscal year 2014 were $2.11 billion, representing an increase of 7.7 percent over fiscal year 2013 total benefits and refunds paid of $1.96 billion. The growth is due to retiring members' benefits exceeding the benefits of long-term retired members whose benefits ceased due to death.

- Total administrative expenses for fiscal year 2014 were $9.96 million, representing an increase of 21.7 percent from fiscal year 2013 administrative expenses of $8.18 million. Administrative expenses represent less than one-half of one percent of the total deductions from the TCRS. Administrative expenses represent two basis points (two one-hundredth of one percent) of the average of the beginning and ending net position.

OVERVIEW OF THE FINANCIAL STATEMENTS

The TCRS financial statements, which consist of the *Statement of Fiduciary Net Position*, the *Statement of Changes in Fiduciary Net Position*, and the *Notes to the Financial Statements*. In addition, *Required Supplementary Information* and the *Notes to the Required Supplementary Information* are presented, which includes this *Management's Discussion and Analysis*. These financial statements, notes to the financial statements and required supplementary information were prepared in conformity with GASB Statement No. 67, Financial Reporting for Pensions Plans. Collectively, this information presents the combined net position held in trust for pensions for each of the plans administered by TCRS as of June 30, 2014.

(CONTINUED)

The *Statement of Fiduciary Net Position* and the *Statement of Changes in Fiduciary Net Position* report information about the fiduciary net position (total assets in excess of total liabilities) as of the end of the fiscal year and the changes in the fiduciary net position during the fiscal year. These statements include all assets and liabilities using the accrual basis of accounting. Under the accrual basis of accounting, the current year's revenues and expenses are included in the financial activity, regardless of when cash is received or paid. The difference between the total assets and total liabilities on the *Statement of Fiduciary Net Position*, or net position restricted for pensions, provides a measurement of the financial position of the TCRS as of the end of the fiscal year. The *Statement of Changes in Fiduciary Net Position* provides information on the activities that caused the financial position to change during the fiscal year. Over time, increases or decreases in the fiduciary net position of the TCRS are one indicator of whether the system's financial health is improving or deteriorating. The change in fiduciary net position is not the sole basis for evaluating the system's financial health. Other factors include, but are not limited to, actuarial data, investment performance, demographic data, and actuarial assumptions.

The *Notes to the Financial Statements* are essential to the reader's understanding of the financial statements and provide additional information regarding the TCRS, such as descriptions of the plans administered by the TCRS, including contribution and benefit provisions, and information about the accounting policies and investment activities.

ANALYSIS OF ASSETS, LIABILITIES AND PLAN NET POSITION

At June 30, 2014, the TCRS had net position (total assets in excess of total liabilities) of $42.9 billion, an increase of $5.3 billion (14.2 percent) from $37.6 billion at June 30, 2013. The assets of the TCRS consist primarily of investments. The increase in plan assets is primarily the result of investment return for the year since contributions increased only slightly from June 30, 2013. Condensed financial information comparing the TCRS' fiduciary net position for the past two fiscal years follows.

(*CONTINUED*)

PLAN NET POSITION

	June 30, 2014	June 30, 2013	Increase (Decrease) Amount	Percentage Change
ASSETS				
Cash and cash equivalents	$ 279,661,206	$ 732,917,328	$ (453,256,122)	(61.8) %
Cash collateral on loaned securities	3,611,068,696	0	3,611,068,696	--
Member and employer receivables	107,700,566	105,368,164	2,332,402	2.2 %
Investment receivables	1,053,100,529	1,851,534,173	(798,433,644)	(43.1) %
Short-term securities	137,164,148	74,880,166	62,283,982	83.2 %
Long-term investments	42,292,975,604	36,550,793,912	5,742,181,692	15.7 %
Capital assets	28,341,604	21,887,170	6,454,434	29.5 %
TOTAL ASSETS	47,510,012,353	39,337,380,913	8,172,631,440	20.8 %
LIABILITIES				
Death benefits, refunds and other payables	14,105,043	50,816,303	(36,711,260)	(72.2) %
Investment payables	979,681,119	1,721,659,248	(741,978,129)	(43.1) %
Securities Lending collateral	3,611,068,696	0	3,611,068,696	--
TOTAL LIABILITIES	4,604,854,858	1,772,475,551	2,832,379,307	159.8 %
NET POSITION RESTRICTED FOR PENSIONS	$ 42,905,157,495	$ 37,564,905,362	$5,340,252,133	14.2 %

ANALYSIS OF REVENUES AND EXPENSES

Employer contribution rates for the TCRS did not change during fiscal year 2014; therefore, the change of 2.1 percent in contributions from fiscal year 2013 to fiscal year 2014 was due to changes in reported salary of participants and any increase in the number of participants. Gross investment income for fiscal year 2014 increased $2.8 billion (83.4 percent) over fiscal year 2013.

Investment expenses for fiscal year 2014 totaled $43.1 million for a 14.9 percent increase over fiscal year 2013. These expenses were split between portfolio management investment expenses of $42.2 million and $934 thousand in expenses attributed to the securities lending program that was initiated during the 2014 fiscal year. The TCRS investment portfolio earned a time-weighted rate of return of 16.7 percent and net investment income of $6.2 billion.

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Total benefits paid during the year ended June 30, 2014 were $2.06 billion, an increase of 7.1 percent over fiscal year 2013 total benefits which can be attributed to an increase in the number of retirees and a 1.7% cost of living adjustment given in July 2013. Total refunds paid increased $14.5 million, an increase of 36.8 percent, in fiscal year 2014 from fiscal year 2013 and were attributed to the change in structure of two large employers where the members of these employers chose to withdraw their funds when they were not rehired by the new employer.

Administrative expenses for the year ended June 30, 2014 were $9.96 million, an increase of 21.7 percent from fiscal year 2013 administrative expenses. The increase was primarily due to the first and second phases of the new pension administration system being implemented in the last quarter of fiscal year 2012 resulting in the amortization expense of the software development costs of $1.2 million for the year. Software development costs are capitalized and amortized over the ten year expected life of this capital asset.

REVENUE BY TYPE
(Expressed in Thousands)

	Year Ended June 30, 2013		Year Ended June 30, 2014	
	Amount	Percentage of Total	Amount	Percentage of Total
Employee Contributions	$ 268,557	5.8%	$ 270,551	3.6%
Employer Contributions	1,010,425	21.9%	1,034,694	13.9%
Net Investment Income	3,344,589	72.3%	6,159,900	82.5%
Total	$ 4,623,571	100.0%	$ 7,465,145	100.0%

EXPENDITURES BY TYPE
(Expressed in Thousands)

	Year Ended June 30, 2013		Year Ended June 30, 2014	
	Amount	Percentage of Total	Amount	Percentage of Total
Benefit Payments	$ 1,923,742	97.6%	$ 2,060,890	97.0%
Refunds	39,518	2.0%	54,046	2.5%
Administrative	8,179	0.4%	9,957	0.5%
Total	$ 1,971,439	100.0%	$ 2,124,893	100.0%

(continued)

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

CHANGES IN FIDUCIARY NET POSITION

	For the Year Ended June 30, 2014	For the Year Ended June 30, 2013	Increase (Decrease) Amount	Percentage Change
ADDITIONS				
Contributions	$ 1,305,245,165	$ 1,278,982,124	$ 26,263,041	2.1 %
Investment income				
Net appreciation in fair value of investments	5,123,250,163	2,334,383,940	2,788,866,223	119.5 %
Interest, dividends and other investment income	1,073,491,403	1,047,724,725	25,766,678	2.5 %
Less: Investment expense	(42,190,619)	(37,519,406)	(4,671,213)	12.5 %
Net income from securities lending activities	5,348,721	0	5,348,721	--
Net investment income	6,159,899,668	3,344,589,259	2,815,310,409	84.2 %
TOTAL ADDITIONS	7,465,144,833	4,623,571,383	2,841,573,450	61.5 %
DEDUCTIONS				
Annuity benefits	2,056,977,497	1,918,686,339	138,291,158	7.2 %
Death benefits	3,912,205	5,056,081	(1,143,876)	(22.6) %
Refunds	54,045,937	39,517,877	14,528,060	36.8 %
Administrative expenses	9,957,061	8,178,696	1,778,365	21.7 %
TOTAL DEDUCTIONS	2,124,892,700	1,971,438,993	153,453,707	7.8 %
NET INCREASE	5,340,252,133	2,652,132,390	2,688,119,743	101.4 %
NET POSITION RESTRICTED FOR PENSIONS				
BEGINNING OF YEAR	37,564,905,362	34,912,772,972	2,652,132,390	7.6 %
END OF YEAR	$ 42,905,157,495	$ 37,564,905,362	$ 5,340,252,133	14.2 %

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

For the year ended June 30, 2014 the portfolio delivered a return of 16.7 percent, which exceeded the actuarial-assumed return of 7.5%, by 9.2 percent. The return of the portfolio for the 2014 fiscal year was satisfying on an absolute basis and also exceeded the returns for the majority of its peers. For the trailing three year period, the fund returned 10.6 percent which exceeded the actuarially required return by over 3 percent and also beat almost 80 percent of comparable portfolios.

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The strong results in the 2014 fiscal year were led by a 27.1 percent return for the Canadian Equity portfolio, a 25.2 percent return for the U.S. Equity portfolio and the 20.5 percent return for the International Equity portfolio. Returns were generally good for all asset classes. The Domestic Fixed Income portfolio returned 7.7 percent for the year which is a good result given the low level of interest rates. The Treasury Inflation Protected Securities portfolio gained 4.7 percent which produced the lowest return for the major asset classes.

The Federal Reserve slowed its purchases of fixed income securities throughout the year, in a process widely described as the "taper". Interest rates rose in the fall of 2013 due to concerns about the taper and subsequently fell throughout the first half of 2014 as the limited impact of the taper became more understood. Economic growth in the United States was generally robust during the fiscal year and international growth appeared to rebound for most of the year only to end the year at a tepid rate. Investors began to discount weaker global economic growth late in the year, while the outlook for U.S. growth remained solid.

An actuarial valuation was performed as of July 1, 2011 that determined the employer contribution rates for the period July 1, 2012 through June 30, 2014. The July 1, 2013 actuarial valuation determined the employer contribution rates for the period July 1, 2014 through June 30, 2016. An actuarial experience study to establish demographic and economic assumptions was completed effective June 30, 2012, was adopted by the Board of Trustees during fiscal year 2013, and was utilized in the July 1, 2013 actuarial valuation.

In December 2010, TCRS contracted with Deloitte Consulting, LLC, to provide a new pension administration system to replace the retirement information system. The new pension administration system, referred to as Concord, will replace five separate operating systems with one integrated web-based system that will greatly improve the level of service we provide to our members and employers. The multi-year Concord project will be implemented in three major phases: document imaging, retired payroll, and active member. The first and second phases of Concord have been implemented by the end of fiscal year 2013. Software development costs have been capitalized and are being amortized over the useful life of the system as each phase is implemented. The third and final phase will be implemented during fiscal year 2015.

During the 2013 legislative session, a new pension plan for state employees, higher education and K-12 public school teachers hired on or after June 30, 2014 was enacted into law. Members and retirees currently enrolled in TCRS will remain in the legacy plan. The new hybrid plan contains elements of a defined benefit plan and a defined contribution plan. The goals of the new plan were to provide a sufficient retirement benefit to members, a long term sustainable pension plan, and an affordable plan to employers. The new plan contains provisions to control employer cost and unfunded liability.

CONTACTING THE TCRS

This report is designed to provide a financial overview of the TCRS to state legislators, members of the Board of Trustees of the TCRS, state officials, participating employers and any other interested parties. Questions or requests for additional information regarding the financial information presented in this report may be addressed in writing to the Tennessee Treasury Department, Consolidated Retirement System, 502 Deaderick Street, Nashville, TN 37243-0201.

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STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2014

Expressed in Thousands

	Public Employee Retirement Plan	Teacher Legacy Pension Plan	Total
ASSETS			
Cash and cash equivalents	$ 141,454	$ 138,207	$ 279,661
Cash collateral on loaned securities	1,826,303	1,784,766	3,611,069
Receivables			
Member receivable	5,627	22,027	27,654
Employer receivable	40,458	39,589	80,047
Accrued interest receivable	46,767	45,703	92,470
Accrued dividends receivable	27,749	27,118	54,867
Real estate income receivable	899	878	1,777
Derivative instruments receivable	286,521	280,004	566,525
Investments sold	170,672	166,790	337,462
Total receivables	578,693	582,109	1,160,802
Investments, at fair value			
Short-term securities	69,371	67,793	137,164
Government securities	4,290,150	4,192,577	8,482,727
Corporate securities	2,888,771	2,823,071	5,711,842
Corporate stocks	12,500,018	12,215,726	24,715,744
Derivative instruments	1,665	1,627	3,292
Strategic lending	162,654	158,954	321,608
Private equities	394,122	385,158	779,280
Real estate	1,152,345	1,126,137	2,278,482
Total investments	21,459,096	20,971,043	42,430,139
Capital assets (net)	14,333	14,008	28,341
TOTAL ASSETS	24,019,879	23,490,133	47,510,012
LIABILITIES			
Accounts payable			
Death benefits and refunds payable	3,603	2,003	5,606
Retiree insurance premium payable	4,203	4,077	8,280
Other	111	108	219
Investments purchased	202,310	197,708	400,018
Derivative instruments payable	287,082	280,552	567,634
Other investment payables	6,083	5,946	12,029
Securities lending collateral	1,826,303	1,784,766	3,611,069
TOTAL LIABILITIES	2,329,695	2,275,160	4,604,855
NET POSITION RESTRICTED FOR PENSIONS	$ 21,690,184	$ 21,214,973	$ 42,905,157

See accompanying Notes to the Financial Statements.

STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEAR ENDED JUNE 30, 2014

Expressed in Thousands

	Public Employee Retirement Plan	Teacher Legacy Pension Plan	Total
ADDITIONS			
Contributions			
Member contributions	$ 75,030	$ 195,521	$ 270,551
Employer contributions	686,219	348,475	1,034,694
Total contributions	761,249	543,996	1,305,245
Investment income			
Net appreciation in fair value of investments	2,583,110	2,540,140	5,123,250
Interest	236,137	232,209	468,346
Dividends	250,622	246,452	497,074
Real estate income, net of operating expenses	54,489	53,583	108,072
Total investment income	3,124,358	3,072,384	6,196,742
Less: Investment expense	(21,273)	(20,918)	(42,191)
Net income from investing activities	3,103,085	3,051,466	6,154,551
Securities lending activities			
Securities lending income	3,168	3,115	6,283
Less: securities lending expense	(471)	(463)	(934)
Net income from securities lending activities	2,697	2,652	5,349
Net investment income	3,105,782	3,054,118	6,159,900
TOTAL ADDITIONS	3,867,031	3,598,114	7,465,145
DEDUCTIONS			
Annuity benefits	1,043,927	1,013,051	2,056,978
Death benefits	2,275	1,637	3,912
Refunds	31,720	22,326	54,046
Administrative expense	7,294	2,663	9,957
TOTAL DEDUCTIONS	1,085,216	1,039,677	2,124,893
NET INCREASE	2,781,815	2,558,437	5,340,252
FIDUCIARY NET POSITION RESTRICTED FOR PENSIONS			
BEGINNING OF YEAR (prior to change in accounting principle)	7,080,898	30,484,007	37,564,905
Change in Accounting Principle			
Report State with other Agent Multiple Employer Plans	11,827,471	(11,827,471)	0
BEGINNING OF YEAR, RESTATED	18,908,369	18,656,536	37,564,905
END OF YEAR	$21,690,184	$21,214,973	$42,905,157

See accompanying Notes to the Financial Statements.

The Tennessee Consolidated Retirement System (TCRS) is a public employee retirement system comprised of defined benefit pension plans covering Tennessee State employees, including employees of the state's higher education systems, teachers, and employees of political subdivisions in Tennessee. The TCRS was established in 1972 by a statutory enactment of the Tennessee General Assembly. The provisions of the TCRS are codified in Tennessee Code Annotated Title 8, Chapters 34-37. In accordance with Tennessee Code Annotated Title 8, Chapter 34, Section 202, all funds invested, securities, cash, and other property of the TCRS are held in trust and can be expended only for the purposes of the trust. Although the assets for all pension plans within the TCRS are commingled for investment purposes, the assets of each separate plan may legally be used only for the payment of benefits to the members of that plan and for its administration, in accordance with the terms of the plan.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity –** The TCRS is included in the state of Tennessee financial reporting entity. Because of the state's fiduciary responsibility, the TCRS has been included as a pension trust fund in the Tennessee Comprehensive Annual Financial Report.

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

   Plan member and employer contributions are recognized in the period of time for which they are due, in accordance with legal provisions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

3. **Cash and Cash Equivalents –** Cash and cash equivalents includes cash, short-term investments with a maturity date within three months of the acquisition date, cash management pools, and cash invested in a short-term, open-end mutual fund under the contractual arrangement for master custody services. Cash received by the TCRS, that cannot be invested immediately in securities or is needed for operations, is invested in the State Pooled Investment Fund sponsored by the State of Tennessee and administered by the State Treasurer.

4. **Method Used to Value Investments –** Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. The fair value of real estate investments is determined at least every three years by qualified, independent appraisers who are members of the Appraisal Institute. In those years independent appraisals are not conducted, appraisals are completed internally by real estate advisors. The fair value of private equity investments is determined by the fund managers using various methodologies, as applicable under GAAP. In many cases, these valuations are additionally reviewed by advisory boards comprised of a subgroup of the fund's investors. These valuations are audited on an annual basis by independent accounting firms engaged by the private equity fund managers. Investment income includes realized and unrealized appreciation (depreciation) in the fair value of investments. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis. Real estate transactions are recorded in the financial statements at the time of closing.

5. **Capital Assets –** Capital assets consist of internally generated computer software in development and in the first two phases of implementation, reported at historical cost less any applicable amortization. Capital assets are defined by the state as assets with an initial individual cost of $5,000 or more and an estimated useful life in excess of two years. Software in development was valued at $17,978,338 at year end and will

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be amortized using the straight line method over the ten year estimated life of the system once a phase is implemented. The first phase (document imaging) and second phase (retired payroll) of the computer software have been implemented at June 30, 2014 and amortization has been initiated. The final phase (active membership, employer membership, and accounting) of the computer software began implementation after June 30, 2014 and expected to be substantially completed by June 30, 2015. The computer software was valued at $10,363,266 and amortization expense was $1,204,036.

6. **Adoption of New Accounting Pronouncement –** During the year ended June 30, 2014, the TCRS financial statements included the adoption of GASB Statement No. 67 which addresses accounting and financial reporting requirements for pension plans. The requirements for GASB Statement No. 67 necessitate changes in presentation of the financial statements, notes to the financial statements, and required supplementary information. Significant changes include an actuarial calculation of total pension liability and net pension liability. It also includes comprehensive footnote disclosure regarding the pension liability, the sensitivity of the net pension liability to the discount rate, and increased investment activity disclosures. The implementation of GASB Statement No. 67 did not significantly impact the accounting for accounts receivable and investment balances. This pronouncement also resulted in renaming the statement of plan net position as the statement of fiduciary net position, and the statement of changes in plan net position as the statement of changes in fiduciary net position. The total pension liability, determined in accordance with GASB Statement No. 67, is presented in Note 4 for the cost-sharing Teacher Legacy Pension Plan.

7. **Change in Accounting Principle –** During the 2014 fiscal year, the Tennessee General Assembly passed legislation which clarified that assets accumulated on behalf of teachers of Local Education Agencies (LEAs) shall be for the exclusive benefit of teachers, and assets accumulated on behalf of state employees shall be for the exclusive benefit of state employees. Pursuant to this clarification relative to the legal separation of assets for these two groups of employees, the teachers group, previously reported by the TCRS in the State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP), is now reported under a separate cost-sharing Teacher Legacy Pension Plan. The state employees are reported, along with employees of political subdivisions (previously reported as Political Subdivision Pension Plan (PSPP), within the Public Employee Retirement Plan, an agent multiple-employer pension plan. The net position of the SETHEEPP at June 30, 2013 of $30,484,007,172 was separated into two groups, with the amount attributed to the Teacher Legacy Pension Plan being $18,656,535,899, and the amount attributed to the Public Employee Retirement Plan being $11,827,471,273. The PSPP amount was $7,080,898,191. The beginning balance of each of the plans has been adjusted for this change in accounting principle.

B. Plan Descriptions

Plan Administration – The Tennessee Treasury Department, an agency in the legislative branch of state government, administers the plans of the TCRS.

At June 30, 2014, there were two defined benefit pension plans within the TCRS. The Public Employee Retirement Plan is an agent, multiple-employer defined benefit pension plan for state government employees and political subdivisions electing to participate in the TCRS. The Teacher Legacy Pension Plan is a cost-sharing, multiple-employer defined benefit pension plan for teachers of LEAs. The Teacher Legacy Pension Plan closed to new membership on June 30, 2014, but will continue providing benefits to existing members and retirees. Beginning July 1, 2014, the Teacher Retirement Plan becomes effective for teachers employed by LEAs after June 30, 2014. The Teacher Retirement Plan will be a separate cost-sharing, multiple-employer defined benefit plan.

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The general administration and responsibility for proper operation of the TCRS plans are vested in a 20 member Board of Trustees, consisting of 18 voting members and two non-voting members. The Board has nine ex-officio members, two of whom are non-voting. The seven voting ex-officio members are the State Treasurer, Secretary of State, Comptroller of the Treasury, Commissioner of Finance and Administration, Commissioner of Human Resources, Director of the TCRS, and the Administrative Director of the Courts. The two non-voting ex-officio members are the chair and vice-chair of the Legislative Council on Pensions and Insurance.

Three active teacher members, one from each grand division of the state, and a retired teacher member are selected for three year terms by the Speaker of the House of Representatives and the Speaker of the Senate. Two active state employee members, who are from departments other than those represented by ex-officio members, are elected by state employees for three year terms. A board member is appointed for a two year term by each of the following organizations: Tennessee County Services, Tennessee Municipal League, and the Tennessee County Officials Association. Two members, a public safety employee and a retired state employee, are appointed by the Governor for two year terms. All members must be vested members of the TCRS, except for ex-officio members.

Plan Membership – At June 30, 2014, the membership of the pension plans consisted of the following:

	Public Employee Retirement Plan	Teacher Legacy Pension Plan	Total
Inactive plan members or beneficiaries currently receiving benefits	87,421	45,869	133,290
Inactive vested plan members entitled to but not yet receiving benefits	31,813	7,334	39,147
Inactive non-vested plan members entitled to refund of member account balance	27,353	17,262	44,615
Active plan members	135,554	78,506	214,060
Total membership	282,141	148,971	431,112
Number of participating employers	520	142	662

Membership above includes all plans whether open or closed.

Benefits Provided – The TCRS provides retirement, disability, and death benefits. The benefits of the TCRS are established by state law (Tennessee Code Annotated, Title 8, Chapters 34-37). In general, the benefits may be amended prospectively by the General Assembly for employees becoming members of the TCRS after June 30, 2014. Amendments of benefits for employees becoming members before July 1, 2014 may be restricted by precedent established by the Tennessee Supreme Court.

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Teacher Legacy Pension Plan

Members of the Teacher Legacy Pension Plan are eligible to retire at age 60 with five years of service credit or after 30 years of service credit regardless of age. Plan members are entitled to receive unreduced service retirement benefits which are determined by a formula using the member's highest five consecutive year average compensation and the member's years of service credit. Service related disability benefits are provided regardless of length of service. Five years of service is required for non-service related disability eligibility. The service related and non-service related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10 percent and include projected service credits. A variety of death benefits are available under various eligibility criteria. Member and beneficiary annuitants are entitled to automatic cost of living adjustments (COLAs) after retirement. A COLA is granted each July for annuitants retired prior to the 2nd of July of the previous year. The COLA is based on the change in the consumer price index (CPI) during the prior calendar year, capped at three percent, and applied to the current benefit. No COLA is granted if the change in the CPI is less than one-half percent. A one percent COLA is granted if the CPI change is between one-half percent and one percent.

Public Employee Retirement Plan

State employees are eligible to retire at age 60 with five years of service credit or after 30 years of service credit regardless of age. Plan members are entitled to receive unreduced service retirement benefits which are determined by a formula using the member's highest five consecutive year average compensation and the member's years of service credit. Service related disability benefits are provided regardless of length of service. Five years of service is required for non-service related disability eligibility. The service related and non-service related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10 percent and include projected service credits. A variety of death benefits are available under various eligibility criteria. Member and beneficiary annuitants are entitled to automatic COLAs after retirement. A COLA is granted each July for annuitants retired prior to the 2nd of July of the previous year. The COLA is based on the change in the CPI during the prior calendar year, capped at 3 percent, and applied to the current benefit. No COLA is granted if the change in the CPI is less than one-half percent. A one percent COLA is granted if the CPI change is between one-half percent and one percent. There are additional classes of employees that include state judges, elected members of the general assembly, and public safety officers which have different benefit structures and eligibility requirements. These classifications represent an immaterial percentage of the state employee membership.

For political subdivision employees, there are various tiers of benefits and eligibility requirements. Each political subdivision adopts the benefit structure that the entity provides to its employees. Unreduced service retirement benefits are determined using a multiplier of the member's highest five consecutive year average compensation multiplied by the member's years of service credit. Plan members are eligible for service related disability benefits regardless of length of service. Five years of service is required for non-service related disability eligibility. The service related and non-service related disability benefits are determined in the same manner as a service retirement benefit but are reduced 10 percent and include projected service credits. A variety of death benefits are available under various eligibility criteria. If adopted as a benefit provision by the political subdivision, member and beneficiary annuitants are entitled to automatic COLAs after retirement. A COLA is granted each July for annuitants retired prior to the 2nd of July of the previous year. The COLA is based on the change in the CPI during the prior calendar year, capped at 3 percent, and applied to the current benefit. No COLA is granted if the change in the CPI is less than one-half percent. A one percent COLA is granted if the CPI change is between one-half percent and one percent. There are additional classes of employees, local judges, elected officials, and public safety officers, which may have different benefit structures and eligibility requirements. These classifications represent an immaterial percentage of the political subdivisions' membership.

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Contributions – Pursuant to Tennessee Code Annotated Title 8, Chapter 37, the Board of Trustees adopted an actuarially-determined contribution (ADC) for each participating employer, as recommended by an independent actuary following an actuarial valuation.

For the Teacher Legacy Pension Plan, LEAs are required by statute to contribute the ADC. The ADC is the estimated amount necessary to finance the costs of benefits earned by plan members during the year, the unfunded accrued liability, and the cost of administration. Teachers are required by statute to contribute five percent of salary. For the year ended June 30, 2014, the required ADC for LEAs was 8.88 percent of covered-employee payroll.

For the Public Employee Retirement Plan, each governmental entity is required by statute to contribute the ADC. The ADC is the estimated amount necessary to finance the costs of benefits earned by plan members during the plan year, the unfunded accrued liability, and the cost of administration. For the year ended June 30, 2014, the required ADC varied for each participating employer with 20 percent of all employer rates between 8% and 20 percent. By statute, state employees are noncontributory. As adopted by the governmental entity, political subdivision employees may be noncontributory, contribute 2.5 percent of salary, or contribute five percent of salary.

C. DEPOSITS AND INVESTMENTS

Statutory Authority – State statute authorizes the TCRS to maintain cash, not exceeding ten percent of the total amount of funds in the retirement system, on deposit in one or more banks, savings and loan associations or trust companies that are qualified as state depositories. The TCRS does not utilize its own bank accounts but invests in the State Pooled Investment Fund for the initial deposit of funds and for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities.

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

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

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

c. Within the restrictions in (a) and (b) above, an amount not to exceed twenty-five percent (25 percent) of the total of the funds of the retirement system may be invested in securities of the same kinds, classes, and investment grades as those otherwise eligible for investment in various approved foreign countries, provided that such percentage may be increased by the board with the subsequent approval of the council on pensions and insurance.

d. Within the restrictions in (a) and (b) above, funds may be invested in Canadian securities which are substantially of the same kinds, classes and investment grades as those otherwise eligible for investment.

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

f. The total sum invested in real estate shall not exceed ten percent (10 percent) of the market value of total assets.

g. The total sum invested in private equities shall not exceed ten percent (10 percent) of the market value of total assets.

State statute also authorizes the TCRS to invest in forward contracts to hedge its foreign currency exposure and to purchase or sell domestic equity index futures contracts for the purpose of asset allocation relating to the domestic equity portfolio. The total amount of the financial futures contract obligation shall not exceed ten percent (10 percent) of the market value of total assets. Gross exposure to approved fixed income financial instruments will be limited to 10% of the market value of the System's total assets for risk mitigating positions and 10% for risk positions. Position sizes will be measured by notional amounts. Options will be measured in their notional equivalents.

Investment Policy – The TCRS investment authority is established pursuant to Tennessee Code Annotated Title 8, Chapter 37. The statute provides the Board of Trustees with the responsibility to establish the investment policy of the TCRS. The investment policy may be amended by the Board. The TCRS plan assets are managed on a total return basis with a long-term objective of achieving and maintaining a fully funded status for the benefits provided by the TCRS. The following was the TCRS Board's adopted asset allocation policy as of June 30, 2014:

Authorized Asset Class	Target Allocation
U.S. Equity	33%
Canadian Equity	4%
Developed Market International Equity	13%
Emerging Market International Equity	5%
Private Equity	3%
U.S. Fixed Income	25%
Inflation Indexed Fixed Income	4%
International Fixed Income	0%
Strategic Lending	5%
Real Estate	7%
Short-Term Securities	1%
Total	100%

Securities Lending – The TCRS is authorized to invest in securities lending investments by TCA 8-37-104(a)(6) with the terms established in the investment policy whereby TCRS loans securities to brokers and dealers (borrower) and in turn, TCRS receives cash as collateral. TCRS pays the borrower interest on the collateral received and invests the collateral with the goal of earning a higher yield than the interest rate paid to the borrower. Loans are limited to no more than thirty percent (30%) of the market value of the total assets in the TCRS portfolio and provided further that such loans are secured by collateral. Securities received as collateral hereunder shall

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have a market value equal to at least one hundred two percent (102%) of the market value of the loaned domestic security or one hundred five percent (105%) of any foreign security. Cash received as collateral shall equal at least one hundred percent (100%) of the market value of the loaned securities and may be invested by or on behalf of the TCRS in any instrument the TCRS may be directly invested.

The TCRS securities lending program is managed by a third party lending agent, Deutsche Bank AG. The TCRS may loan any debt or equity securities which is owned by TCRS. At June 30, 2014, the TCRS had the following securities on loan and received the cash collateral as shown below:

Securities on Loan	Fair Value of Securities on Loan	Cash/Non-Cash Collateral Received
Fixed	$1,580,955,871	$1,623,590,738
Equity	1,935,287,556	1,987,477,958
Total	$3,516,243,427	$3,611,068,696

The TCRS has the ability to sell the collateral securities only in the case of a borrower default.

As of June 30, 2014 the TCRS had the following investments:

Credit Quality Distribution for Securities with Credit Exposure as a Percentage of Total Investments

Rating	Fair Value (in thousands)	Percentage of Total Investments
AAA	$ 906,618	2.137%
AA	548,236	1.292%
A	1,079,470	2.544%
BBB	2,917,707	6.901%
BB	295,057	0.671%
B	49,484	0.117%
CCC	110,158	0.260%
CC	1,576	0.004%
D	45,704	0.108%
NR	3,155,001	7.436%
	9,109,011	
Government Agencies and Obligations*	5,323,742	
Total Fixed Income Securities	$14,432,753	

**Includes obligations of the U.S. government or obligations explicitly guaranteed by U.S. government.*

(CONTINUED)

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations. The credit quality distribution for the TCRS' investments in fixed income securities at year end is included in the above schedule. Securities are rated using Standard and Poor's and/or Moody's and are presented above using the Standard and Poor's rating scale. The State Pooled Investment Fund has not obtained a credit quality rating from a nationally recognized credit ratings agency.

The TCRS' investment policy specifies that bond issues subject for purchase are investment grade bonds rated in the four highest ratings by one of the recognized rating agencies. In addition, the policy states that private placements that do not have an active secondary market shall be thoroughly researched from a credit standpoint and shall be viewed by TCRS' investment staff as having the credit quality rating equivalent of an AA rating on a publicly traded issue. For short-term investments, the TCRS' investment policy provides for the purchase of only the highest quality debt issues. Commercial paper should be rated in the highest tier by all rating agencies which rate the paper, with a minimum of two ratings required. Commercial paper cannot be purchased if a rating agency has the commercial paper on a negative credit watch. The investment policy also requires preparation of a credit analysis report on the corporation prior to purchasing commercial paper.

As noted above, the TCRS does not utilize its own bank accounts but invests in the State Pooled Investment Fund for its operating cash purposes. Required risk disclosures relative to the State Pooled Investment Fund are presented in the State of Tennessee Treasurer's Report. That report is available on the state's website at http://www.tn.gov/treasury/.

Interest Rate Risk – Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The TCRS' investment policy does not specifically address limits on investment maturities. The fixed income portfolio, however, is benchmarked against the Citigroup Broad Investment Grade Index and tends to have duration within a range around that index. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price. The TCRS had the following investments and effective duration at year end.

Investment Type	Fair Value as of June 30, 2014	Effective Duration (years)
Government Agencies	$ 245,508	7.24
Government Bonds	2,049,684	12.97
Government Inflation Indexed	2,480,124	8.23
Government Mortgage Backed	3,495,299	4.15
Government Asset Backed	51,791	2.48
Municipal Bonds	156,846	9.94
Non-Government Backed CMOs	127,912	2.04
Commercial Mortgage Backed	429,665	1.82
Corporate Asset Backed Securities	670,436	1.39
Corporate Bonds	4,388,339	8.64
Short-Term Commercial Paper	149,989	0.08
Short-Term Bills & Notes	187,160	0.23
Total Debt Investments	$14,432,753	7.27

(CONTINUED)

Asset-Backed Securities – The TCRS invests in various collateralized mortgage obligations (CMOs) which are mortgage-backed securities. These securities are based on cash flows from interest and principal payments on underlying mortgages and could therefore be more sensitive to prepayments by mortgagees as a result of a decline in interest rates. The fair value of CMOs at June 30, 2014 was $557,576,973 of which $341,517,633 were CMOs that are generally more sensitive to interest rate changes.

Foreign Currency Risk – Foreign currency risk is the risk that changes in exchange rates will adversely affect the fair value of an investment or deposit. The TCRS' investment policy limits the asset allocation for international investments to twenty-five percent of total assets. The TCRS' exposure to foreign currency risk was as follows:

Currency	Total Fair Value June 30, 2014	Fixed Income	Equity	Cash
Australian Dollar	$ 283,539	$0	$ 283,448	$ 91
British Pound Sterling	1,095,088	0	1,085,973	9,115
Canadian Dollar	1,919,373	0	1,919,233	140
Danish Krone	127,596	0	127,571	25
Euro Currency	1,519,998	0	1,500,315	19,683
Hong Kong Dollar	179,740	0	177,918	1,822
Japanese Yen	1,287,069	0	1,274,238	12,831
New Israeli Shekel	6,513	0	6,513	0
New Zealand Dollar	6,131	0	6,131	0
Norwegian Krone	78,057	0	78,007	50
Singapore Dollar	74,181	0	74,009	172
Swedish Krona	136,993	0	136,993	0
Swiss Franc	457,132	0	455,376	1,756
Total	$7,171,410	$0	$7,125,725	$45,685

Custodial Credit Risk – Custodial credit risk for deposits is the risk that in the event of a bank failure, the TCRS' deposits may not be returned to TCRS. The TCRS does not have an explicit policy with regards to Custodial Credit Risk for deposits. At year end, the TCRS had uninsured and uncollateralized cash deposits of $45,684,593 in foreign currency held by our master custodian, Northern Trust, in Northern Trust's name. These deposits were used for investments pending settlement.

Rate of Return – For the year, the money-weighted rate of return on pension plan investments, net of pension plan investment expense, was 16.5 percent. The money-weighted rate of return expresses investment performance, net of investment expense, adjusted for the changing amounts actually invested.

Derivatives:

Futures – The TCRS may buy or sell fixed income and equity index futures contracts for the purposes of making asset allocation changes in an efficient and cost effective manner and to improve liquidity. Gains (losses) on futures hedge losses (gains) produced by any deviation from the TCRS' target allocation. The gains and losses resulting from daily fluctuations in the fair value of the outstanding futures contract are settled daily, on the

(CONTINUED)

following day, and a receivable or payable is established for any unsettled gain or loss as of the financial statement date. Any resulting payable is reflected in the financial statements at fair value.

Foreign Currency Forward Contracts – The international securities expose the TCRS to potential losses due to a possible rise in the value of the US dollar. The TCRS investment managers can reduce foreign currency exposure by selling foreign currency forward contracts, at agreed terms and for future settlement, usually within a year. The manager will reverse the contract by buying the foreign currency before the settlement date. A gain (loss) on this transaction pair will hedge a loss (gain) on the currency movement of the international security. The TCRS can sell up to 80% of its foreign currency exposure into US dollars. Foreign currency forward contracts expose the TCRS to foreign currency risk as they are denominated in foreign currency. Any unrealized gain on foreign currency forward contracts has been reflected in the financial statements as an investment. The notional amount of the foreign currency forward contracts has been reflected in the financial statements as a receivable and a payable. Any unrealized loss on foreign currency forward contracts has been included in the payable established for the contracts.

Mortgages – The TCRS is authorized to invest in To Be Announced (TBA) mortgage backed securities similar to the foreign currency forward contracts. The TCRS enters into agreements to purchase pools of mortgage backed securities prior to the actual security being identified. The TCRS will roll this agreement prior to settlement date to avoid taking delivery of the security. Any unrealized gain on TBA mortgage backed securities has been reflected in the financial statements as an investment. Any unrealized loss on TBA mortgage backed securities has been included in the payable established for the mortgages. The notional amounts of these agreements have been included in the financial statements as a receivable and a payable. The TCRS invests in these derivatives to adjust its exposure to mortgage coupon risk and to replicate the return on mortgage backed securities portfolios without actually purchasing the security.

Options – The TCRS is authorized to enter into option contracts and any income earned on option contracts has been included in investment income in the financial statements.

The fair value balances and notional amounts of derivative instruments outstanding at year end, classified by type, and the changes in fair value of derivative instrument types for the year ended as reported in the financial statements are as follows:

(CONTINUED)

	Changes in Fair Value		Fair Value at June 30, 2014			
	Financial Statement Classification	Amount	Financial Statement Classification	Amount	Notional Amount	Currency
Foreign Currency Forward Contracts						
		($200)		($200)	23,203	EUR
		(909)		(909)	14,101,216	JPY
	Investment Income	($1,109)	Instruments Payable	($1,109)		
Futures Contracts						
	Investment Income	$6,481	Instruments Receivable	$3,381	$930,356	
TBA Mortgage Backed Securities						
	Investment Income	$3,292	Derivative Instruments	$3,292	$399,932	

The fair values of foreign currency forward contracts are estimated based on the present value of their estimated future cash flows. Futures, Options and TBA mortgage backed securities are exchange traded and their price is based on quoted market prices at year end. It is the TCRS policy to conduct derivative transactions through the custodian bank and high quality money center banks or brokerage firms. The credit risk of foreign currency forward contracts is managed by limiting the term of the forward contracts and restricting the trading to high quality banks. The credit risk of futures contracts is managed by maintaining a daily variation margin.

Alternative Investments – The TCRS has investments in private equity funds and real estate with an estimated fair value of $3,379,369,542 at June 30, 2014. Because these investments are not readily marketable, the estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for the investments existed, and such differences could be material. Title to real property invested in by TCRS is held by real estate investment holding companies.

Commitments:

Standby Commercial Paper Purchase Agreement – The TCRS has agreed to serve as standby commercial paper purchaser for commercial paper issued by the Funding Board of the State of Tennessee. By serving as a standby commercial paper purchaser, the TCRS receives an annual fee of 25 basis points on the $350 million maximum issuance under this agreement during times when both Moody's and Standard and Poor's investment ratings assigned to the State of Tennessee's general obligation bonds are Aaa and AAA respectively, 40 basis points during times when either Moody's or Standard and Poor's has assigned ratings of Aa and AA respectively, or 75 basis points during times when either Moody's or Standard and Poor's has assigned ratings lower than Aa and AA respectively. In the unlikely event that the TCRS would be called upon to purchase the commercial paper, the TCRS would receive interest at a rate equal to prime plus 75 basis points during the first 30 consecutive days, plus an additional 50 basis points for each consecutive 30 days thereafter, up to a maximum rate allowed by state law.

(CONTINUED)

Alternative Investments – The TCRS had unfunded commitments of $2,708,699,810 in private equity, strategic lending, and real estate commitments at year end.

D. NET PENSION LIABILITY (ASSET) OF THE TEACHER LEGACY PENSION PLAN FOR LOCAL EDUCATION AGENCIES

The components of net pension liability of the Teacher Legacy Pension Plan at June 30, 2014, were as follows:

Total Pension Liability	$21,151,810,794
Plan Fiduciary Net Position	21,214,973,134
Net Pension Liability (Asset)	$ (63,162,340)
Fiduciary Net Position as a Percentage of the Total Pension Liability	100.30%

Actuarial Assumptions – The total pension liability was determined by an actuarial valuation as of July 1, 2013, updated to roll forward to June 30, 2014, using the following actuarial assumptions applied to all prior periods included in the measurement:

Inflation	3.0 percent
Salary Increases	Graded salary ranges from 8.97 to 3.71 percent based on age, including inflation, averaging 4.25 percent
Investment Rate of Return	7.5 percent, net of pension plan investment income, including inflation
Cost-of-Living Adjustment	2.5 percent

Mortality rates were based on actual experience from the June 30, 2012 actuarial experience study plus some adjustment for expected future improvement in life expectancy.

The actuarial assumptions used in the July 1, 2013 actuarial valuation were based on the results of an actuarial experience study performed for the period July 1, 2008 through June 30, 2012. The demographic assumptions were adjusted to more closely reflect actual and expected future experience.

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees in conjunction with the June 30, 2012 actuarial experience study by considering the following three techniques: (1) the 25-year historical return of the TCRS at June 30, 2012, (2) the historical market returns of asset classes from 1926 to 2012 using the TCRS investment policy asset allocation, and (3) capital market projections that were utilized as a building-block method in which best-estimate ranges of expected future real rate of return (expected returns, net of pension plan investment expense and inflation) are developed for each major asset class. Four sources of capital market projections were blended and utilized in the third technique. The blended capital market projection established the long-term expected rate of return by weighting the expected future real rate of return by the target asset allocation percentage and by adding inflation of 3 percent. The target allocation and best estimates of arithmetic real rates of return for each major asset class are summarized in the following table:

(CONTINUED)

Asset Class	Long-Term Expected Real Rate of Return	Target Allocations
U.S. Equity	6.46%	33%
Equity	6.26%	17%
Equity	6.40%	5%
Lending	4.61%	8%
U.S. Fixed Income	0.98%	29%
Real Estate	4.73%	7%
Short-Term Securities	0.00%	1%
		100%

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees as 7.5 percent based on a blending of the three techniques described above.

Discount Rate – The discount rate used to measure the total pension liability was 7.5 percent. The projection of cash flows used to determine the discount rate assumed that employee contributions from plan members will be made at the statutorily required contribution rates and that employer contributions from LEAs will be made at the actuarially determined rate as required by statute. Based on those assumptions, the pension plan's fiduciary net position was projected to be available to make all projected future benefit payments of current plan members. Therefore, the long-term expected rate of return on plan investments was applied to all periods of projected benefit payments to determine the total pension liability.

Sensitivity of Net Pension Liability (Asset) to Changes in the Discount Rate – The following presents the Teacher Legacy Pension Plan's net pension liability for LEAs using the discount rate of 7.5 percent, as well as what its net pension liability would be if it were calculated using a discount rate that is one percentage point lower (6.5%) or one percentage point higher (8.5%) than the current rate:

	One Percent Decrease (6.5%)	Current Discount Rate (7.5%)	One Percent Increase (8.5%)
Net Pension Liability (Asset)	$2,677,321,642	$(63,162,340)	$(2,332,660,416)

(CONTINUED)

SCHEDULE OF CHANGES IN NET PENSION LIABILITY
Fiscal Year Ended June 30

	2014
Total pension liability	
Service cost	$ 404,576,942
Interest	1,483,656,307
Change of benefit terms	
Difference between expected and actual experience	
Change of assumptions	
Benefit payments, including refunds of member contributions	(1,037,013,093)
Net change in total pension liability	851,220,156
Total pension liability - beginning	20,300,590,638
Total pension liability - ending (a)	21,151,810,794
Plan fiduciary net position	
Contributions – employer	348,474,888
Contributions - members	195,520,938
Net investment income	3,054,117,821
Benefit payments, including refunds of member contributions	(1,037,013,093)
Administrative expense	(2,663,319)
Net change in plan fiduciary net position	2,558,437,235
Plan fiduciary net position - beginning	18,656,535,899
Plan fiduciary net position - ending (b)	21,214,973,134
Net pension liability (asset) - ending (a) - (b)	$ (63,162,340)

NET PENSION LIABILITY
Fiscal Year Ended June 30

	2014
Total pension liability	$ 21,151,810,794
Plan fiduciary net position	21,214,973,134
Net pension liability (asset)	$ (63,162,340)
Plan fiduciary net position as a percentage of the total pension liability	100.30%
Covered-employee payroll	$ 3,925,131,835
Net pension liability (asset) as a percentage of covered-employee payroll	-1.61%

SCHEDULE OF CONTRIBUTIONS
Fiscal Year Ended June 30

	Actuarially-Determined Contribution	Contributions in Relation to the Actuarially-Determined Contributions	Contribution Deficiency	Covered-Employee Payroll	Contributions as a Percentage of Covered-Employee Payroll
2014	$348,474,888	$348,474,888	$0	$3,931,983,889	8.88%
2013	344,534,643	344,534,643	0	3,879,878,989	8.88%
2012	343,594,496	343,594,496	0	3,796,077,699	9.05%
2011	339,833,421	339,833,421	0	3,754,600,827	9.05%
2010	236,545,072	236,545,072	0	3,683,968,661	6.42%
2009	233,214,598	233,214,598	0	3,632,637,952	6.42%
2008	218,862,049	218,862,049	0	3,507,360,900	6.24%
2007	204,370,625	204,370,625	0	3,333,693,142	6.13%
2006	175,719,201	175,719,201	0	3,194,957,343	5.50%
2005	170,392,879	170,392,879	0	3,098,164,695	5.50%

SCHEDULE OF INVESTMENT RETURNS
Fiscal Year Ended June 30

	2014
Annual Money-Weighted Rate of Return, Net of Investment Expense	16.49%

Method and Assumptions Used in Calculations of Actuarially-Determined Contributions – The actuarially determined contribution rates for the fiscal year ended June 30, 2014 for Local Education Agencies were calculated as the result of an actuarial valuation performed as of July 1, 2011. The following actuarial methods and assumptions were used to determine contribution rates reported in the schedule:

Actuarial Cost Method	Frozen Initial Liability Method
Amortization Method	Level Dollar Amortization
Remaining Amortization Period	Six Years
Inflation	3.0 Percent
Salary Increases	Graded Salary Ranges from 9.49 Percent to 4.22 Percent, Including Inflation, Averaging 4.75 Percent
Investment Rates of Return	7.50 Percent, Net of Pension Plan Investment Expense, Including Inflation

ACTUARIAL BALANCE SHEET
as of July 1, 2013

	Teacher Legacy Pension Plan	Public Employee Retirement Plan	Total
ASSETS			
Present assets creditable to:			
Employer accumulation fund	$ 16,306,892,102	$ 17,986,207,216	$ 34,293,099,318
Members' accumulation fund	3,186,908,392	1,769,310,216	4,956,218,608
Total present assets	19,493,800,494	19,755,517,432	39,249,317,926
Present value of prospective contributions payable to:			
Employer accumulation fund			
Normal	1,900,941,405	2,834,849,121	4,735,790,526
Accrued liability	806,790,144	1,857,325,810	2,664,115,954
Total employer accumulation	2,707,731,549	4,692,174,931	7,399,906,480
Member's accumulation fund	1,842,985,351	565,516,463	2,408,501,814
Total prospective contributions	4,550,716,900	5,257,691,394	9,808,408,294
TOTAL ASSETS	$ 24,044,517,394	$ 25,013,208,826	$ 49,057,726,220
LIABILITIES			
Present value of prospective benefits payable on account of:			
Present retired members and beneficiaries	11,179,309,840	10,643,750,163	21,823,060,003
Present active members	12,528,153,285	13,541,859,239	26,070,012,524
Former members	337,054,269	827,599,424	1,164,653,693
TOTAL LIABILITIES	$ 24,044,517,394	$ 25,013,208,826	$ 49,057,726,220

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Members of the General Assembly
Members of the Board of Trustees
The Honorable David H. Lillard, Jr., Treasurer

Report on the Financial Statements

We have audited the accompanying statements of fiduciary net position of the Tennessee Stars 529 College Savings Plan, a private-purpose trust fund of the State of Tennessee, as of June 30, 2014, and June 30, 2013, the related statements of changes in fiduciary net position for the years then ended, and the related notes to the financial statements, which collectively comprise the Tennessee Stars 529 College Savings Plan's basic financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting principles used and reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

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We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of the Tennessee Stars 529 College Savings Plan. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Tennessee Stars 529 College Savings Plan.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the Tennessee Stars 529 College Savings Plan of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in fiduciary net position thereof for the years then ended in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter

As discussed in Note A.1., the financial statements present only the Tennessee Stars 529 College Savings Plan, a private-purpose trust fund of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee as of June 30, 2014, and June 30, 2013, and the changes in its financial position for the years then ended in accordance with accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 19, 2014, on our consideration of the Tennessee Stars 529 College Savings Plan's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the Tennessee Stars 529 College Savings Plan's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 19, 2014

TNSTARS COLLEGE SAVINGS 529 PROGRAM
STATEMENT OF FIDUCIARY NET POSITION
JUNE 30, 2014 AND JUNE 30, 2013

	June 30, 2014	June 30, 2013
ASSETS		
Cash	$ 30,201	$ 53,395
Receivables		
Contributions receivable	3,070	2,370
Investments, at fair value		
Investment in money market account	704,852	324,743
Investment in mutual funds (fixed income)	933,731	350,522
Investment in mutual funds (blended)	10,516,280	4,376,223
Investment in mutual funds (equity)	5,412,735	1,670,807
TOTAL ASSETS	17,600,869	6,778,061
LIABILITIES		
Due to General Fund	32,097	63,857
Accounts payable	32,213	194
TOTAL LIABILITIES	64,310	64,051
NET POSITION - RESTRICTED FOR PLAN PARTICIPANTS	$17,536,559	$6,714,010

See accompanying Notes to the Financial Statements.

TNSTARS COLLEGE SAVINGS 529 PROGRAM
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION
JUNE 30, 2014 AND JUNE 30, 2013

	For the Year Ended June 30, 2014	For the Year Ended June 30, 2013
ADDITIONS		
Contributions	$ 8,991,794	$6,239,932
Investment income		
Net increase in fair value of investments	1,396,648	208,962
Interest and dividend income	386,193	70,810
Total investment income	1,782,841	279,772
Transfers from General Fund	353,566	203,200
TOTAL ADDITIONS	11,128,201	6,722,904
DEDUCTIONS		
Withdrawals	290,563	8,894
Administrative cost	15,089	-
TOTAL DEDUCTIONS	305,652	8,894
CHANGE IN NET POSITION	10,822,549	6,714,010
NET POSITION - RESTRICTED FOR PLAN PARTICIPANTS		
BEGINNING OF YEAR	6,714,010	-
END OF YEAR	$17,536,559	$6,714,010

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity –** The TN Stars College Savings 529 Plan, Educational Savings Plan (ESP) is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the ESP has been included in the *Tennessee Comprehensive Annual Financial Report* as a private-purpose trust fund.

2. **Measurement Focus and Basis of Accounting –** The accompanying financial statements have been prepared in accordance with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The financial statements have been prepared using the economic resources measurement focus and the accrual basis of accounting. Revenues are recorded when earned and expenses are recorded at the time liabilities are incurred regardless of the timing of related cash flows.

3. **Cash –** The ESP does not maintain its own bank accounts but utilizes the State Pooled Investment Fund for its operating cash needs. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, and various U.S. Treasury and Agency obligations. The State Pooled Investment Fund (SPIF) is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 104 - 110 of this report.

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

5. **Cash Transfer –** At June 30, 2014 the TNStars 529 Plan had a deficit in cash of $1,896. This is a result of net daily cash outflows exceeding daily cash inflows. On this date TNStars sent, via EFT, $32,097 to the investment custodian. Also on this day, TNStars issued debit EFT transactions to plan participant's financial institutions for $32,097. The debit EFT transactions would settle with the State on July 1, 2014 or the next business day. To eliminate the deficit cash position, the State General Fund transferred $32,097 to TNStars on June 30, 2014. The resulting settlement of the debit transactions on July 1, 2014 would transfer the funds back to the General Fund. The same circumstances existed at June 30, 2013 with the Plan having a deficit cash balance of $10,462 and transferring $63,857 from the General Fund to eliminate the deficit cash position. The resulting settlement of the debit transactions on July 1, 2013 transferred the funds back to the General Fund.

6. **Reclassifications and Restatements –** The DFA Enhanced U.S. Large Company Portfolio Institutional Class previously reported as an equity investment option on the June 30, 2013 Statement of Fiduciary Net Position was reclassified as a blended investment option.

B. DEPOSITS AND INVESTMENTS

In accordance with State statute, the ESP assets may be invested in any instrument, obligation, security or property that constitutes a legal investment for assets of the Tennessee Consolidated Retirement System (TCRS) or any other investment deemed appropriate by the Board. The authority for investing the assets of the ESP is vested in the Baccalaureate Education System Trust (BEST) Board of Trustees (the "Board") and the responsibility for implementing the investment policy established by the Board is delegated to the State Treasurer.

(CONTINUED)

Recognizing that plan participants may have an investment horizon ranging from a few months to more than twenty years, the ESP has selected a group of investment products that have an investment risk profile ranging from conservative to aggressive. The investment products selected are evaluated based on a number of factors including but not limited to fees, investment performance, investment strategy, any available ratings of the products, and suitability of products for participants. It is the responsibility of the ESP to provide products to plan participants; however it is the participants who select the options that suit their individual investment needs.

Credit Risk – Credit risk is the risk that an issuer or other counterparty to an investment will not fulfill its obligations with regard to debt. The ESP does not currently own specific fixed income securities, but provided options to plan participants to invest in mutual funds that invest in fixed income securities. Mutual funds with 100% allocations in fixed income securities are considered to be fixed income investments while mutual funds with some portion of their assets invested in fixed income securities are considered blended investments. At June 30, 2014 and June 30, 2013, these funds were not specifically rated by any rating agency; however the underlying securities of the funds had an average credit quality rating of Baa (4th highest) or better. At June 30, 2014, 65% of the total plan assets have some portion of their portfolio invested in fixed income securities. Another 4% of the total plan assets are invested in a money market account which is FDIC insured and is not considered to be exposed to credit risk. At June 30, 2013, 70% of the total plan assets had some portion of their portfolio invested in fixed income securities while 5% was invested in the money market account.

Interest Rate Risk – Interest rate risk is the risk that future changes in prevailing market rates of interest will have an adverse effect on the fair value of debt investments. The fair values of securities with long terms to maturity may be highly sensitive to interest rate changes. The ESP provides investment products for participants to select, however it is the participant that is responsible for selecting an option(s) that best suit their investment needs. As such, the ESP does not have a policy regarding the management of interest rate risk in periods of volatile interest rates.

The weighted average maturity for the fixed income investments that ESP utilizes was 7.44 years at June 30, 2013. Additionally, for the blended mutual funds with fixed income components, the approximate portion of investments in fixed income had a weighted average maturity of 8.41 years at June 30, 2013. These weighted average maturities were calculated based on fund classifications prior to the reclassification disclosed in note A.5. Weighted Average Maturity (WAM) is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the average time to maturity weighted for all investments as a percentage of the investment's full price.

During fiscal year 2014 the decision was made to present effective duration as the measure of interest rate risk instead of the weighted average maturity (WAM) presented in 2013. Although both methods are consistent with GAAP, the change in accounting principle was made in order to be consistent with management practices and disclosure presentation of other funds including the BEST prepaid plan. Duration is a measure of a debt investment's exposure to fair value changes arising from changing interest rates. It uses the present value of cash flows weighted for those cash flows as a percentage of the investment's full price. The effective duration at June 30, 2014 was not obtainable. Therefore, the best information available was used to determine the duration of the underlying funds listed below:

(CONTINUED)

Fund Name	Ending Balance	Effective Duration
Blended		
Vanguard Wellington Fund Admiral Shares	$ 3,631,032.47	6.26
DFA Enhanced U.S. Large Company Portfolio Institutional Class	3,212,026.93	1.53
Vanguard LifeStrategy Conservative Growth Fund	2,185,384.42	5.85
Vanguard Life Strategy Income Fund	1,487,836.25	5.85
Fixed Income		
Vanguard Total Bond Market Signal Shares	657,978.76	5.70
Vanguard Intermediate-Term Investment-Grade Fund Admiral Shares	123,528.52	5.24
DFA Inflation-Protected Securities Portfolio Institutional Class	103,017.54	7.79
Vanguard Intermediate-Term Treasury Admiral Shares	49,206.48	5.15

C. DESCRIPTION OF THE EDUCATIONAL SAVINGS PLAN

The Tennessee Stars College Savings 529 Plan (TNStars), Educational Savings Plan (ESP), administered by the State Treasurer, was created under Tennessee Code Annotated, Title 49, Chapter 7, Part 8 and is designed to help people save for the costs of education after high school. The ESP is administered by the Baccalaureate Education System Trust (BEST) Board of Trustees (the "Board"). The Board has the authority to appoint an ESP manager, adopt rules to implement and administer the ESP and establish investment policies for the ESP, to invest moneys of the trust in investments determined by the Board to be appropriate and to administer the funds of the Trust Fund. The ESP called TNStars began operations on September 18, 2012.

When opening an account, the owner may select two types of investment options, the Aged-Based Option and the Self Selected Investment Option. Within the Aged-Based Option, contributions are allocated among five age bands, based on the age of the beneficiary. Each Age Band is invested in specific Dimensional Fund Advisors (DFA) or Vanguard mutual funds from our slate of investment options ("an Underlying Fund"). The Age Bands become more conservatively invested as the beneficiary ages. The Self Selected Investment Option allows owners to invest in any underlying Fund. The list of investment options or underlying funds is listed below:

Fund Name	Ticker Symbol	CUSIP	Age Band Option (yrs)
Equity			
Vanguard 500 Index Signal Shares	VIFSX	922908496	
Great-West American Century Growth Fund	MXGRX	57776T546	
PRIMECAP Odyssey Aggressive Growth Fund	POAGX	74160Q202	
Vanguard Mid-Cap Growth Investor Shares	VMGRX	921946307	
DFA Large Cap International Portfolio Institutional Class	DFALX	233203868	
Blended			
DFA Enhanced U.S. Large Company Portfolio Institutional Class	DFELX	233203637	0-4
Vanguard Wellington Fund Admiral Shares	VWENX	921935201	5-10
Vanguard LifeStrategy Conservative Growth Fund	VSCGX	921909305	11-14
Vanguard Life Strategy Income Fund	VASIX	921909206	15-17
Fixed Income			
DFA Inflation-Protected Securities Portfolio Institutional Class	DIPSX	233203355	
Vanguard Total Bond Market Signal Shares	VBTSX	921937868	18+
Vanguard Intermediate-Term Investment-Grade Fund Admiral Shares	VFIDX	922031810	
Vanguard Intermediate-Term Treasury Admiral Shares	VFIUX	922031828	

Participants in the ESP can make withdrawals at any time after contributions have been invested for 60 days. Withdrawals used for qualifying higher educational expenses receive certain tax incentives; additionally those not used for qualifying higher educational expenses receive certain tax penalties based on the participant's individual circumstances.

Pursuant to state statute, the Board may establish an incentive plan or plans to encourage Tennessee residents to participate in TNStars. Such plans may include, but are not limited to, matching contributions using state funds and shall be restricted to Tennessee residents only. In addition, for fiscal years ended June 30, 2013 and June 30, 2014 the Board authorized the program to subsidize, using state appropriations, the program management fee and the estimated underlying mutual fund expense so that the total annual asset-based fee, after subsidy, for any account does not exceed 35 basis points. The resulting transfers from the General Fund to cover the incentives and subsidy from state appropriations amounted to $353,566 for the year ended June 3, 2014 and $203,200 for the year ended June 30, 2013.

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