SUPPORT SERVICES

Support Services Division
Rick DuBray, Second Deputy Treasurer

The Support Services divisions provide internal administrative support to the department, along with banking operations that support the State in general. Support Services is responsible for everything from infrastructure and technology support to facilities support and business resumption planning and implementation.

- Accounting
- Information Systems
- Management Services
- 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
  - Tennessee Promise Scholarship Endowment Trust Fund
  - TNStars™ College Savings 529 Program

Tennessee Department of Treasury

Accounting
Kim Morrow, Director

The Treasury Accounting Division performs various financial controls and bank reconciliations in controlling the cash transactions of the State and provides accounting support and financial reporting for the various programs, investment portfolios and funds administered by the Treasurer's Office. The staff of 25 fulfills several accounting functions, including:

- Investments Accounting
- Bank Accounting
- Program and TCRS Accounting
- Financial Reporting and Compliance

Information Services
David Bauer, Acting Director

The Information Systems Division supports the Treasury Department by creating, maintaining, and managing the technology infrastructure needed for Department operations. The 42-person staff maintains Treasury software and infrastructure along with coordinating and implementing plans for business continuation in the event of a disaster or any event preventing employees from accessing Treasury offices. Primary roles of the Information Systems Division include:

- Application Support and Development
- Infrastructure, Security and Business Resumption
- Project Management
- Relationship Management and Business Analysis

Management Services
Kerry Hartley, Director

The 16-person staff of the Management Services Division serves as general administrative support to all of Treasury. They are responsible for such critical functions as:

- Budget and payroll
- Employee expense claim processing
- Departmental Records Management
- Purchasing and Facilities Management

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500 JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-1402

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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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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 22, 2015, 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 22, 2015

BACCALAUREATE EDUCATION SYSTEM TRUST, EDUCATIONAL SERVICES PLAN
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2015 AND JUNE 30, 2014

	June 30, 2015	June 30, 2014
ASSETS		
Cash and cash equivalents	$ 5,275,451	$ 3,432,278
Receivables		
Investment income receivable	135,900	230,420
Investments, at fair value		
Investment in fixed income index fund	48,852,699	50,557,078
Investment in equity index fund	25,322,535	33,383,633
TOTAL ASSETS	79,586,585	87,603,409
LIABILITIES		
Accounts payable	75,496	90,149
Due to General Fund	7,942	86,226
TOTAL LIABILITIES	83,438	176,375
NET POSITION RESTRICTED FOR PLAN PARTICIPANTS	$ 79,503,147	$ 87,427,034

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, 2015 AND JUNE 30, 2014

	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014
ADDITIONS		
Investment income		
Net increase (decrease) in fair value of investments	$ (92,754)	$ 7,506,890
Interest and dividend income	1,983,582	2,096,817
Net investment income	1,890,828	9,603,707
TOTAL ADDITIONS	1,890,828	9,603,707
DEDUCTIONS		
Withdrawals	9,553,561	9,603,718
Administrative cost	261,154	345,541
TOTAL DEDUCTIONS	9,814,715	9,949,259
CHANGE IN NET POSITION	(7,923,887)	(345,552)
NET POSITION, BEGINNING OF YEAR	87,427,034	87,772,586
NET POSITION, END OF YEAR	$ 79,503,147	$ 87,427,034

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 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 under the contractual arrangement for master custody services. During the period from July 1, 2013 to August 31, 2014 cash would have been invested in the Northern Institutional Government Portfolio. During the period from September 1, 2014 to June 30, 2015 cash would have been invested in SSGA Government Money Market Fund.

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

(CONTINUED)

securities. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 114-121 of this report.

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. Funds are held at the bank in accordance with the contract for master custodian services which was with Northern Trust at June 30, 2014 but was awarded to State Street on September 1, 2015. The Northern Institutional Government Portfolio had a credit quality rating of AAA at June 30, 2014 while the SSGA Government Money Market Fund was not rated by a nationally recognized credit rating agency at June 30, 2015.

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 5.70 years and 5.60 years at June 30, 2015 and June 30, 2014, 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. <u>DESCRIPTION OF THE EDUCATIONAL SERVICES PLAN</u>

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 $7,289,795 more at June 30, 2015, and $10,014,407 more at June 30, 2014, 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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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 22, 2015, 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 22, 2015

CHAIRS OF EXCELLENCE
BALANCE SHEETS
JUNE 30, 2015 AND JUNE 30, 2014

	June 30, 2015	June 30, 2014
ASSETS		
Cash and cash equivalents	$ 7,739,584	$ 9,305,863
Investments, at fair value		
Government securities	83,151,470	126,334,658
Corporate securities	33,124,586	39,014,344
Investment in exchange traded equity fund	176,751,326	172,886,188
Total investments	293,027,382	338,235,190
Receivables		
Due from colleges and universities	762,583	972,172
Investment income receivable	1,387,422	1,990,426
Total receivables	2,150,005	2,962,598
TOTAL ASSETS	$302,916,971	$350,503,651
LIABILITIES AND FUND BALANCES		
LIABILITIES		
Due to colleges and universities	$ 2,063,959	$ 2,157,674
Due to the Academic Scholars Fund	4,526,418	4,751,718
Due to the TSAC Endowment Scholarship Fund	0	48,969,964
Due to General Fund	62,478	69,764
TOTAL LIABILITIES	6,652,855	55,949,120
FUND BALANCES		
Nonspendable corpus	100,358,388	100,358,388
Restricted	195,905,728	194,196,143
TOTAL FUND BALANCES	296,264,116	294,554,531
TOTAL LIABILITIES AND FUND BALANCES	$302,916,971	$350,503,651

See accompanying Notes to the Financial Statements.

CHAIRS OF EXCELLENCE
STATEMENTS OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES
FOR THE YEARS ENDED JUNE 30, 2015 AND JUNE 30, 2014

	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014
REVENUES		
Investment income	$ 9,443,434.61	$ 41,908,051.10
Contributions from private sources	0.00	1,425.65
TOTAL REVENUES	9,443,434.61	41,909,476.75
EXPENDITURES		
University of Tennessee	3,582,426.66	3,307,590.35
Tennessee Board of Regents	3,909,317.42	3,821,097.77
Academic Scholars Fund	0.00	2,172,864.46
Administrative cost	242,105.26	260,718.68
TOTAL EXPENDITURES	7,733,849.34	9,562,271.26
EXCESS OF REVENUES OVER EXPENDITURES	1,709,585.27	32,347,205.49
OTHER FINANCING SOURCES		
Transfer in from the General Fund	0.00	400,000.00
TOTAL OTHER FINANCING SOURCES	0.00	400,000.00
NET CHANGE IN FUND BALANCE	1,709,585.27	32,747,205.49
FUND BALANCES, BEGINNING OF YEAR	294,554,530.60	261,807,325.11
FUND BALANCES, END OF YEAR	$ 296,264,115.87	$ 294,554,530.60

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 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 generally expenditures are recognized when the related fund liability is incurred. 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 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 under the contractual arrangement for master custody services. During the period from July 1, 2013 to August 31, 2014 cash would have been invested in the Northern Institutional Government Portfolio. During the period from September 1, 2014 to June 30, 2015 cash would have been invested in State Street Government Money Market Fund.

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 trade date 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 disparity between the investment statutes and policies of the COE and TCRS regarding ETF limitations. 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. These changes eliminated the disparity between investing for COE and TCRS regarding ETF's. During the years ended June 30, 2015 and June 30, 2014, the COE Trust's equity investments were within the overall limits on equity securities per statutory and policy provisions.

As of June 30, 2015 and June 30, 2014, 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, 2015

(Expressed in Thousands)

Rating	Fair Value	Percentage of Total Investments
AAA	$ 3,204	1.09%
AA	11,599	3.96%
A	11,513	3.93%
BBB	12,369	4.22%
BB	0	0.00%
CCC	389	0.13%
Not Rated	25,541	8.72%
Total Debt Investments	64,615	
Government Agencies and Obligations*	51,661	
Total Fixed Income Securities	116,276	
Equity	176,751	
Total Investments as Shown on Statements	$ 293,027	

** Includes obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government which are not rated by credit rating agencies.*

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	

** Includes obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government which are not rated by credit rating agencies.*

(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, 2015 and June 30, 2014 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 State Street Government Money Market Fund is not rated at June 30, 2015 and the Northern Institutional Government Portfolio has a credit quality rating of AAA at June 30, 2014.

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 114-121 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, 2015 or June 30, 2014, 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, 2015		June 30, 2014	
Issuer Organization	**Fair Value**	**Percentage**	**Fair Value**	**Percentage**
Federal National Mortgage Association	$13,991,315	4.77%	$25,168,753	7.44%
Federal Home Loan Mortgage Corporation	9,563,384	3.26%	17,805,270	5.26%

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, 2015 and June 30, 2014 (expressed in thousands).

(CONTINUED)

(Expressed in Thousands)

Investment Type	Fair Value as of June 30, 2015	Effective Duration (years)	Fair Value as of June 30, 2014	Effective Duration (years)
Debt Investments				
U.S. Government Agencies	$ 7,556	2.68	$ 8,712	3.68
U.S. Government TIPS	28,143	6.89	38,145	8.06
U.S. Government Treasuries	17,206	7.78	22,526	4.39
Municipal Bonds	6,834	4.65	7,784	5.51
Government Asset Backed	1,725	6.25	2,654	5.69
Government Mortgage Backed	23,658	3.49	44,735	4.30
Corporate Asset Backed	577	4.14	1,779	2.43
Corporate Bonds	27,122	5.84	37,023	6.46
Corporate Mortgage Backed	3,455	2.99	1,991	1.88
Total Debt Investments	$116,276	5.54	$165,349	5.67

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, 2015 was $3,454,915 of which $3,179,383 were CMOs that are generally more sensitive to interest rate changes. 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.

C. **OTHER ACCOUNTING DISCLOSURES**

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

   Ninety-nine Chairs have been established with matching contributions received totaling $55,958,388 as of June 30, 2015 and June 30, 2014. Total contributions to the COE Trust totaled $100,358,388 as of June 30, 2015 and June 30, 2014. 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, 2015 and June 30, 2014.

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. The TN Promise Fund was established by Chapter No. 900 of the *Public Acts of 2014* for the purpose of funding the Tennessee Promise Scholarship Program. Funds held within the COE Trust for the Tennessee Student Assistance Corporation Endowment Scholarship Fund were transferred out to the TN Promise Trust Fund.

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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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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 22, 2015, 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 22, 2015

BALANCE SHEETS
JUNE 30, 2015 AND JUNE 30, 2014

	June 30, 2015	June 30, 2014
ASSETS		
Cash	$ 10,587,175	$ 11,012,199
Accounts receivable	551,538	540,754
Due from federal government	4,408,000	4,937,000
TOTAL ASSETS	$ 15,546,713	$ 16,489,953
LIABILITIES AND FUND BALANCE		
LIABILITIES		
Accounts payable	$ 173,690	$ 301,237
Claims liability	6,207,799	7,208,254
TOTAL LIABILITIES	6,381,489	7,509,491
FUND BALANCE		
Committed for victims of drunk drivers (see Note B.2)	1,402,159	833,377
Committed for compensation under the Criminal Injuries Compensation Act	7,763,065	8,147,085
TOTAL FUND BALANCE	9,165,224	8,980,462
TOTAL LIABILITIES AND FUND BALANCE	$ 15,546,713	$ 16,489,953

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, 2015 AND JUNE 30, 2014

	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014
REVENUES		
State		
Fines	$6,273,466	$6,305,576
Fees	2,130,431	1,973,221
Federal	4,408,000	4,937,000
Interest income	9,569	9,049
Other	342,329	368,841
TOTAL REVENUES	13,163,795	13,593,687
EXPENDITURES		
Claim payments	11,451,576	11,835,288
Victims' coalition grant	100,000	100,000
Administrative cost	1,174,126	1,142,403
TOTAL EXPENDITURES	12,725,702	13,077,691
EXCESS OF REVENUES OVER EXPENDITURES	438,093	515,996
OTHER FINANCING USE		
Transfer to General Fund for District Attorneys General Grant	253,331	256,100
NET CHANGE IN FUND BALANCE	184,762	259,896
FUND BALANCE, BEGINNING OF YEAR	8,980,462	8,720,566
FUND BALANCE, END OF YEAR	$9,165,224	$8,980,462

See accompanying Notes to the Financial Statements.

STATEMENT OF REVENUES, EXPENDITURES AND CHANGES IN FUND BALANCES

BUDGET AND ACTUAL (BUDGETARY BASIS) FOR THE YEARS ENDED JUNE 30, 2015 AND JUNE 30, 2014

For the Year Ended June 30, 2015

	Original Budget	Final Budget	Actual (Budgetary Basis)
REVENUES			
Fines	$8,344,500	$8,344,500	$6,273,466
Fees	2,603,400	2,603,400	2,130,431
Federal	4,930,000	4,930,000	4,408,000
Interest income	0	0	9,569
Other	472,100	472,100	342,329
TOTAL REVENUES	16,350,000	16,350,000	13,163,795
EXPENDITURES			
Claim payments	14,650,100	14,650,100	11,451,576
Victims' coalition grant	100,000	100,000	100,000
Administrative cost	1,350,000	1,350,000	1,174,126
TOTAL EXPENDITURES	16,100,100	16,100,100	12,725,702
EXCESS OF REVENUES OVER EXPENDITURES	249,900	249,900	438,093
OTHER USES OF FINANCIAL RESOURCES			
Transfer to General Fund for District Attorneys General Grant	249,900	249,900	253,331
NET CHANGE IN FUND BALANCE	0	0	184,762
FUND BALANCE, BEGINNING OF YEAR	8,980,462	8,980,462	8,980,462
FUND BALANCE, END OF YEAR	$8,980,462	$8,980,462	$9,165,224

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

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 114-121 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. **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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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 22, 2015, 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 22, 2015

FLEXIBLE BENEFITS PLAN
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2015 AND JUNE 30, 2014

	June 30, 2015	June 30, 2014
ASSETS		
Cash	$ 882,532	$ 1,012,226
Contributions receivable	200,095	216,145
TOTAL ASSETS	1,082,627	1,228,371
LIABILITIES		
Accounts payable	13,334	29,889
TOTAL LIABILITIES	13,334	29,889
NET POSITION		
Restricted for employees' flexible benefits	$ 1,069,293	$ 1,198,482

See accompanying Notes to the Financial Statements.

FLEXIBLE BENEFITS PLAN
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEARS ENDED JUNE 30, 2015 AND JUNE 30, 2014

	June 30, 2015	June 30, 2014
ADDITIONS		
Employee contributions	$ 6,047,207	$ 6,527,297
TOTAL ADDITIONS	6,047,207	6,527,297
DEDUCTIONS		
Employee reimbursements	6,054,494	6,309,921
Administrative cost	121,902	199,782
TOTAL DEDUCTIONS	6,176,396	6,509,703
CHANGE IN NET POSITION	(129,189)	17,594
NET POSITION, BEGINNING OF YEAR	1,198,482	1,180,888
NET POSITION, END OF YEAR	$ 1,069,293	$ 1,198,482

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 114-121 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.

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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 Intermediate Term Investment Fund as of June 30, 2015 and June 30, 2014, 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 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, 2015, and June 30, 2014, 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 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, 2015, and June 30, 2014, 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 22, 2015, 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 22, 2015

INTERMEDIATE TERM INVESTMENT FUND
STATEMENT OF FIDUCIARY NET POSITION
JUNE 30, 2015 AND JUNE 30, 2014

	June 30, 2015	June 30, 2014
ASSETS		
Cash and cash equivalents	$ 102,160,011	$ 325,435
Investment income receivable	276,846	793,224
Investments (at fair value)	59,411,494	199,962,737
TOTAL ASSETS	161,848,351	201,081,396
LIABILITIES AND NET POSITION		
NET POSITION HELD IN TRUST FOR POOL PARTICIPANTS	$ 161,848,351	$ 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, 2015 AND JUNE 30, 2014

	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014
OPERATIONS		
Investment Income	$ 846,414	$ 1,176,940
Expenses	86,924	95,544
NET INVESTMENT INCOME	759,490	1,081,396
CAPITAL SHARE TRANSACTIONS		
Shares Sold	0	200,000,000
Less Shares Redeemed	39,992,535	0
INCREASE (DECREASE) FROM CAPITAL SHARE TRANSACTIONS	(39,992,535)	200,000,000
TOTAL INCREASE (DECREASE) IN NET POSITION	(39,233,045)	201,081,396
NET POSITION, BEGINNING OF YEAR	201,081,396	0
NET POSITION,END OF YEAR	$ 161,848,351	$ 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, 2015 and 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 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 years ended June 30, 2015 and 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-

(CONTINUED)

recognized statistical ratings agency. The investment policy and required risk disclosures relative to the State Pooled Investment Fund are presented on pages 114-121 of this report.

At June 30, 2015 the ITIF's investments consisted of United States government agency securities of $59,411,494 at fair value and $59,350,000 at par value. Interest rates on the securities ranged from .570% to 2.375%, and the number of days to maturity ranged from 408 to 1,484 days. 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 ranged from .125% to 2.500%, and the number of days to maturity ranged 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, 2015 consisted of $44,410,894 in fair value of securities rated AA by Standard and Poor's rating scale, and $15,000,600 in fair value of securities implicitely guaranteed by the United States government but not rated by Standard and Poor's ratings agency. 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 ratings agency.

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:

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Issuer Organization	June 30,2015		June 30,2014	
	Fair Value	Percentage of Total Investments	Fair Value	Percentage of Total Investments
Federal Home Loan Banks	$21,482,442	36.16%	$67,700,568	33.86%
Federal Home Loan Mortgage Corporation	0	0.00%	62,849,070	31.43%
Federal Farm Credit Banks	22,875,952	38.50%	42,633,919	21.32%
Federal National Mortgage Association	15,053,100	25.34%	16,554,780	8.28%
Federal Agricultural Mortgage Corporation	0	0.00%	10,224,400	5.11%

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, 2015, the effective duration of the ITIF's debt securities was 2.54 years while the effective duration at June 30, 2014 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 ended June 30, 2015 and 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.

In the latter part of June of 2015, the ITIF began the sell of investment securities to fund the requested withdrawal of a participant. The cash was invested in the State Pooled Investment Fund until the settlement date of the withdrawal. Participants subsequently withdrew $100,000,000.00 on July 1, 2015.

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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, 2015, and June 30, 2014, 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.

(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 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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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 22, 2015, 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 22, 2015

STATEMENTS OF NET POSITION
JUNE 30, 2015 AND JUNE 30, 2014

	June 30, 2015	June 30, 2014
ASSETS		
Current assets		
Cash	$ 127,936,988	$ 116,276,475
Accounts receivable	0	13,458
Total current assets	127,936,988	116,289,933
Noncurrent assets		
Due from federal government	10,054,480	10,054,480
TOTAL ASSETS	137,991,468	126,344,413
LIABILITIES		
Current liabilities		
Accounts payable	1,563,395	1,071,319
Unearned revenue	8,000	8,000
Claims liability	31,804,791	33,594,233
Total current liabilities	33,376,186	34,673,552
Noncurrent liabilities		
Claims liability	111,887,661	108,951,000
TOTAL LIABILITIES	145,263,847	143,624,552
NET POSITION - UNRESTRICTED	$ (7,272,379)	$ (17,280,139)

See accompanying Notes to the Financial Statements.

RISK MANAGEMENT FUND
STATEMENTS OF REVENUES, EXPENSES AND CHANGES IN FUND NET POSITION
FOR THE YEARS ENDED JUNE 30, 2015 AND JUNE 30, 2014

	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014
OPERATING REVENUES		
Casualty premiums	$ 49,630,501	$ 49,094,900
Property premiums	9,765,193	8,931,200
TOTAL OPERATING REVENUES	59,395,694	58,026,100
OPERATING EXPENSES		
Torts		
Death	812,500	1,064,705
Bodily injury	2,233,298	2,516,951
Property damage	932,099	927,781
Total Torts	3,977,897	4,509,437
Workers' Compensation		
Death	189,348	254,697
Medical	14,528,347	14,476,573
Temporary disability	3,518,651	3,625,925
Permanent disability	8,312,299	8,353,721
Total Workers' Compensation	26,548,645	26,710,916
Property Damage		
Employee property	18,276	21,512
State owned property	2,716,206	4,379,252
Total Property Damage	2,734,482	4,400,764
Property insurance premiums	5,888,976	5,457,395
Professional/Administrative	10,699,119	9,389,667
Increase of accrued liability	2,825,662	46,199,592
TOTAL OPERATING EXPENSES	52,674,781	96,667,771
OPERATING INCOME/(LOSS)	6,720,913	(38,641,671)
NON-OPERATING REVENUES		
Grant revenue	0	(641,403)
Interest income	86,672	85,290
Taxes	175	2,575
TOTAL NON-OPERATING REVENUES	86,847	(553,538)
INCOME (DEFICIT) BEFORE TRANSFERS	6,807,760	(39,195,209)
TRANSFER FROM GENERAL FUND	3,200,000	0
CHANGE IN NET POSITION	10,007,760	(39,195,209)
NET POSITION, BEGINNING OF YEAR	(17,280,139)	21,915,070
NET POSITION, END OF YEAR	$ (7,272,379)	$ (17,280,139)

See accompanying Notes to the Financial Statements.

	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from premiums	$ 59,409,152	$ 58,012,642
Receipts for insurance proceeds	12,816,986	1,196,378
Payments for claims	(46,910,512)	(36,746,595)
Payments for administrative expenses	(11,052,984)	(9,319,079)
Payments for insurance premiums	(5,888,976)	(5,457,395)
NET CASH FROM OPERATING ACTIVITIES	8,373,666	7,685,951
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Transfer from General Fund	3,200,000	0
Taxes received	175	2,575
NET CASH FROM NONCAPITAL FINANCING ACTIVITIES	3,200,175	2,575
CASH FLOWS FROM INVESTING ACTIVITIES		
Interest received	86,672	85,290
NET CASH FROM INVESTING ACTIVITIES	86,672	85,290
NET INCREASE IN CASH	11,660,513	7,773,816
CASH, BEGINNING OF YEAR	116,276,475	108,502,659
CASH, END OF YEAR	$ 127,936,988	$ 116,276,475
RECONCILIATION OF OPERATING INCOME/(LOSS) TO NET CASH FROM OPERATING ACTIVITIES		
OPERATING INCOME/(LOSS)	$ 6,720,913	$ (38,641,671)
ADJUSTMENTS TO RECONCILE OPERATING INCOME/(LOSS) TO NET CASH FROM OPERATING ACTIVITIES		
Changes in assets and liabilities		
Increase (decrease) in accounts receivable	13,458	(13,458)
Increase in accounts payable	492,076	198,980
Increase in claims liability	1,147,219	46,142,100
TOTAL ADJUSTMENTS	1,652,753	46,327,622
NET CASH FROM OPERATING ACTIVITIES	$ 8,373,666	$ 7,685,951

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 114-121 of this report.

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 liability 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 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 occurrence. 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.

(CONTINUED)

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 $140,117,000 (discounted at 1.0%) at June 30, 2015 and $136,844,000 (discounted at 1.0%) at June 30, 2014**.** 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 $3,575,452.30 at June 30, 2015 and $5,701,233 at June 30, 2014. The changes in the balances of the claims liabilities during fiscal years 2014 and 2015 were as follows:

Fiscal Year	Beginning Claims Liability	Current Year Claims and Changes in Estimates	Claim Payments	Ending Claims Liability
2015	$142,545,233	$48,903,672	($47,756,453)	$ 143,692,452
2014	96,403,133	83,017,087	(36,874,987)	142,545,233

The RMF held $127.9 million in cash at June 30, 2015 and $116.3 million in cash at June 30, 2014 that is designated for payment of these claims.

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

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, 2015 were $25,640,907 while estimated proceeds from commercial insurance carriers above our deductible were $22,356,800 which includes the balance at June 30, 2015 of $291,346 of insurance proceeds on hand for the payment of claims. This results in a $3,284,107 liability for property losses to be established at June 30, 2015.

4. **Transfer to General Fund -** The RMF received a $3,200,000 transfer in from the general fund as part of a one-time appropriation in fiscal year 2015 to help reduce the fund deficit caused by the change in reserving methodology in fiscal year 2014. This is a non-recurring, miscellaneous appropriation.

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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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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, 2015, and June 30, 2014, 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 22, 2015, 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 22, 2015

STATE POOLED INVESTMENT FUND
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2015 AND JUNE 30, 2014

	June 30, 2015	June 30, 2014
ASSETS		
Cash and cash equivalents	$3,852,377,766	$ 2,568,101,968
Short-term investments, at amortized cost	5,358,307,955	5,828,165,563
Accrued income receivable	14,290,232	10,131,284
TOTAL ASSETS	9,224,975,953	8,406,398,815
LIABILITIES AND NET POSITION		
NET POSITION HELD IN TRUST FOR POOL PARTICIPANTS	$ 9,224,975,953	$ 8,406,398,815

See accompanying Notes to the Financial Statements.

STATE POOLED INVESTMENT FUND
STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEARS ENDED JUNE 30, 2015 AND JUNE 30, 2014

	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014
OPERATIONS		
Investment income	$ 11,125,712	$ 12,139,820
Expenses		
Administrative fee	4,055,337	4,029,649
Custodian and banking services fees	779,142	384,066
Total expenses	4,834,479	4,413,715
NET INVESTMENT INCOME	6,291,233	7,726,105
CAPITAL SHARE TRANSACTIONS (DOLLAR AMOUNTS AND NUMBER OF SHARES ARE THE SAME)		
Shares sold	40,336,053,715	38,107,770,622
Less shares redeemed	39,523,767,810	38,801,353,032
INCREASE (DECREASE) FROM CAPITAL SHARE TRANSACTIONS	812,285,905	(693,582,410)
TOTAL INCREASE (DECREASE) IN NET POSITION	818,577,138	(685,856,305)
NET POSITION, BEGINNING OF YEAR	8,406,398,815	9,092,255,120
NET POSITION, END OF YEAR	$ 9,224,975,953	$ 8,406,398,815

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 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** - 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, 2015 and 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 has not obtained a credit quality rating for the SPIF from a nationally recognized credit ratings agency.

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, 2015 and June 30, 2014, the principal amount of certificates of deposit in state depositories was $1,106,035,000 and $880,480,000 respectively. Interest rates on certificates of deposit held at June 30, 2015 ranged from 0.10% to .22% and at June 30, 2014 ranged from 0.10% to 0.30%. The days to maturity on certificates of deposit ranged from 7 to 365 days at both June 30, 2015 and June 30, 2014.

As of June 30, 2015 and June 30, 2014, the SPIF had the following investments:

(CONTINUED)

Investments

(Expressed in Thousands)

2015

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 120.)
U.S. Government Agencies	$4,579,838,286	$4,580,265,799	$4,575,616,000	.010% - 2.500%	12 - 396	
U.S. Government Treasuries	2,425,611,283	2,426,003,010	2,416,000,000	.025% - 4.500%	72 - 396	
Commercial Paper	749,982,688	749,982,941	750,000,000	.001% - 0.150%	1 - 41	
Total Cash Equivalents and Short-term Investments	$7,755,432,257	$7,756,251,750	$7,741,616,000			
Less: short-term investments classified as cash equivalents on Statement of Fiduciary Net Position	(2,986,224,302)					
Add: certificates of deposit classified as short-term investments on Statement of Fiduciary Net Position	589,100,000					
Short-term investments as shown on Statement of Fiduciary Net Position	$5,358,307,955					

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 120.)
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					

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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, 2015 and June 30, 2014 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. 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 state funds are required to be deposited with a financial institution that has been designated as a state depository. Statutes require that state deposits be secured by collateral securities with a market value of 105% of the face of the deposit secured thereby after considering the applicable FDIC coverage, or the depository must be a member of the State Collateral Pool and the pool must have securities pledged which in total equal the required percentage established by the Collateral Pool Board. All certificates of deposit are also 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.

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Credit Quality Distribution for Securities with Credit Exposure as a Percentage of Total Investments June 30, 2015

Credit Quality Rating	Carrying Value	Percentage of Total Short-Term Investments
US Treasury (1)	$ 2,425,611,283	31.28%
AAA	1,727,808,021	22.28%
AA	1,289,701,086	16.63%
A1 (3)	749,982,688	9.67%
NR (2)	1,562,329,179	20.14%
Total Fixed Income Securities	7,755,432,257	100.00%
Less Short-Term Investments Classified as Cash	(2,986,224,302)	
Add Certificates of Deposit Classified as Short-Term Investments	589,100,000	
Total Short-Term Investments as Shown on Net Position	$ 5,358,307,955	

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	23.95%
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	

(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.

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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. 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 30,2015		
Issuer Organization	**Carrying Amount**	**Percentage of Total Investments**
Federal Home Loan Banks	$ 1,508,842,384	19.45%
Federal Home Loan Mortgage Corporation	857,128,941	11.05%
International Bank for Reconstruction and Development	814,985,669	10.51%
Federal Farm Credit Banks	745,288,102	9.61%
Federal National Mortgage Association	653,593,191	8.43%

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%

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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 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, 2015, the weighted average maturity of the pool was one hundred ten (110) days. At June 30, 2014, the weighted average maturity of the pool was one hundred nine (109) days. 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, 2015 and June 30, 2014, the SPIF portfolio had the following weighted average maturities on debt investments:

June 30, 2015		
Investment Type	**Carrying Amount**	**Weighted Average Maturity (Months)**
U.S. Government Agencies	$4,579,838,286	3.12
U.S. Government Treasuries	2,425,611,283	5.89
Commercial Paper	749,982,688	0.26
Total Debt Investments	$7,755,432,257	3.71
Total SPIF Portfolio	$9,290,690,706	3.67

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

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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, 2015 and 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 SPIF.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
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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 and for the year ended June 30, 2015, 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.

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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 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, 2015, 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, 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, 2015, and the changes in its financial position for the year 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 $4,683,390,636 (11.08 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.

Other Matter - 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.

Other Reporting Required by *Government Auditing Standards*

In accordance with *Government Auditing Standards*, we have also issued our report dated December 23, 2015, 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

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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 23, 2015

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, 2015. This section should be read in conjunction with the Independent Auditor's Report, the audited financial statements, and the accompanying notes.

FINANCIAL HIGHLIGHTS

- The net position for the TCRS plans (total assets minus total liabilities) at June 30, 2015 was $43.2 billion, increasing $0.3 billion (0.8 percent) from the plan net position at June 30, 2014. The net position is restricted for future benefit obligations. This increase in plan net position is mainly attributable to net investment income. Returns were led by strong returns of 20.5 percent for private equity and 12.8 percent for real estate.

- Net investment income for fiscal year 2015 was $1.3 billion. During fiscal year 2015, the TCRS received a time-weighted rate of return on its portfolio of 3.3 percent, compared to 16.7 percent for fiscal year 2014.

- Based on the latest actuarial valuation as of June 30, 2014 for accounting purposes pursuant to GASB 67 & 68, the overall funded ratio for all participating employers within TCRS is 98.8 percent.

- Contribution revenue for fiscal year 2015 totaled $1.29 billion, representing a decrease of 1.4 percent compared to fiscal year 2014. Effective July 1, 2014 a new retirement plan was established for newly hired state employees and teachers. The new retirement plan consists of a defined benefit component and a defined contribution component. The defined benefit component has a lower benefit structure than the previous defined benefit plan; as a result fewer contributions are required.

- Total benefits and refunds paid for fiscal year 2015 were $2.24 billion, representing an increase of 6.1 percent over fiscal year 2014 total benefits and refunds paid of $2.11 billion. The growth is primarily due to the retiring members' benefits exceeding the benefits of long-term retired members whose benefits ceased due to death. Additionally, a 1.5 percent cost of living adjustment was given in July 2014.

- Total administrative expenses for fiscal year 2015 were $15.06 million, representing an increase of 51.3 percent from fiscal year 2014 administrative expenses of $9.96 million. Administrative expenses represent three basis points (three one-hundredths of one percent) of the average of the beginning and ending net position.

OVERVIEW OF THE FINANCIAL STATEMENTS

The TCRS financial statements 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, 2015.

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

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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 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, 2015, the TCRS had a net position (total assets in excess of total liabilities) of $43.2 billion, an increase of $0.3 billion (0.8 percent) from $42.9 billion at June 30, 2014. 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 decreased 1.4 percent from June 30, 2014. Condensed financial information comparing the TCRS' fiduciary net position for the past two fiscal years follows:

FIDUCIARY NET POSITION

	June 30, 2015	June 30, 2014	Increase (Decrease) Amount	Percentage Change
ASSETS				
Cash and cash equivalents	$ 445,811,146	$ 279,661,206	$ 166,149,940	59.4 %
Cash collateral on loaned securities	5,892,943,764	3,611,068,696	2,281,875,068	63.2 %
Member and employer receivables	100,955,668	107,700,566	(6,744,898)	(6.3) %
Investment receivables	1,423,035,570	1,053,100,529	369,935,041	35.1 %
Short-term securities	206,266,693	137,164,148	69,102,545	50.4 %
Long-term investments	42,501,110,787	42,292,975,604	208,135,183	0.5 %
Capital assets	31,747,896	28,341,604	3,406,292	12.0 %
TOTAL ASSETS	50,601,871,524	47,510,012,353	3,091,859,171	6.5 %
LIABILITIES				
Death benefits, refunds and other payables	28,418,554	14,105,043	14,313,511	101.5 %
Investment payables	1,436,568,620	979,681,119	456,887,501	46.6 %
Securities Lending collateral	5,892,943,764	3,611,068,696	2,281,875,068	63.2 %
TOTAL LIABILITIES	7,357,930,938	4,604,854,858	2,753,076,080	59.8 %
NET POSITION RESTRICTED FOR PENSIONS	$ 43,243,940,586	$ 42,905,157,495	$ 338,783,091	0.8 %

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ANALYSIS OF REVENUES AND EXPENSES

Employer contribution rates for the TCRS did not change during fiscal year 2015; therefore, the 1.4 percent decrease in contributions from fiscal year 2014 to fiscal year 2015 was due to the transition of new employees to hybrid pension plans. Gross investment income for fiscal year 2015 decreased $4.8 billion (78.0 percent) over fiscal year 2014.

Investment expenses for fiscal year 2015 totaled $54.5 million for a 26.3 percent increase over fiscal year 2014. These expenses were split between portfolio management investment expenses of $46.7 million and $7.8 million in expenses attributed to the securities lending program that was initiated during the latter part of the 2014 fiscal year. The TCRS investment portfolio earned a time-weighted rate of return of 3.3 percent and net investment income of $1.3 billion.

Total benefits paid during the year ended June 30, 2015 were $2.2 billion, an increase of 6.1 percent over fiscal year 2014 total benefits which can be attributed to an increase in the number of retirees and a 1.5% cost of living adjustment given in July 2014. Total refunds paid decreased $6.1 million, a decrease of 11.3%, in fiscal year 2015 from fiscal year 2014. This was attributed to the change in structure of two large employers in 2014 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, 2015 were $15.1 million, an increase of 51.3 percent from fiscal year 2014 administrative expenses. The increase was primarily due to the new pension administration system being implemented in the July 2015 resulting in the amortization expense of the software development costs of $3.7 million for the year, an increase of $2.5 million over fiscal year 2014. Software development costs are capitalized and amortized over the ten year expected life of this capital asset. Additionally, Information Technology and Data Processing costs increased by $2.0 million during the systems' first full fiscal year of operations which included a maintenance phase with the pension administration system consultants.

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

REVENUE BY TYPE
(Expressed in Thousands)

	Year Ended June 30, 2014		Year Ended June 30, 2015	
	Amount	Percentage of Total	Amount	Percentage of Total
Employee Contributions	$ 270,551	3.6%	$ 274,532	10.6%
Employer Contributions	1,034,694	13.9%	1,011,445	38.9%
Other Contributions	0	0.0%	384	0.0%
Net Investment Income	6,159,900	82.5%	1,311,262	50.5%
Total	$7,465,145	100.0%	$2,597,623	100.0%

EXPENDITURES BY TYPE
(Expressed in Thousands)

	Year Ended June 30, 2014		Year Ended June 30, 2015	
	Amount	Percentage of Total	Amount	Percentage of Total
Benefit Payments	$2,060,890	97.0%	$2,195,814	97.2%
Refunds	54,046	2.5%	47,961	2.1%
Administrative	9,957	0.5%	15,064	0.7%
	$2,124,893	100.0%	$2,258,839	100.0%

(CONTINUED)

CHANGES IN FIDUCIARY NET POSITION

	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014	FY15 - FY14 Increase (Decrease) Amount	FY15 - FY14 Percentage Change
ADDITIONS				
Contributions	$ 1,286,361,016	$ 1,305,245,165	$ (18,884,149)	(1.4) %
Investment income				
Net appreciation in fair value of investments	79,983,802	5,123,250,163	(5,043,266,361)	(98.4) %
Interest, dividends and other investment income	1,251,528,694	1,073,491,403	178,037,291	16.6 %
Less: Investment expense	(46,712,686)	(42,190,619)	4,522,067	10.7 %
Net income from securities lending activities	26,461,821	5,348,721	21,113,100	394.7 %
Net investment income	1,311,261,631	6,159,899,668	(4,848,638,037)	(78.7) %
TOTAL ADDITIONS	2,597,622,647	7,465,144,833	(4,867,522,186)	(65.2) %
DEDUCTIONS				
Annuity benefits	2,190,289,366	2,056,977,497	133,311,869	6.5 %
Death benefits	5,524,605	3,912,205	1,612,400	41.2 %
Refunds	47,961,414	54,045,937	(6,084,523)	(11.3) %
Administrative expenses	15,064,171	9,957,061	5,107,110	51.3 %
TOTAL DEDUCTIONS	2,258,839,556	2,124,892,700	133,946,856	6.3 %
NET INCREASE	338,783,091	5,340,252,133	(5,001,469,042)	(93.7) %
NET POSITION RESTRICTED FOR PENSIONS				
BEGINNING OF YEAR	42,905,157,495	37,564,905,362	5,340,252,133	14.2 %
END OF YEAR	$ 43,243,940,586	$ 42,905,157,495	$ 338,783,091	0.8 %

(CONTINUED)

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

For the year ended June 30, 2015 the portfolio delivered a return of 3.3 percent which was below the actuarial assumed return of 7.5 percent. The fund gained 9.8 percent for the trailing three year period which exceeded the actuarially required return by over 2.3 percent annually. Additionally, the fund generated more return for unit of risk employed than 84 percent of peers for the trailing five-year period.

Private equities and real estate generated strong returns of 20.5 percent and 12.8 percent, respectively, while Canadian and emerging markets stocks lost 14.1 percent and 11.9 percent, respectively. U.S. stocks generated 7.9 percent and U.S. bonds delivered 2.8 percent.

The investment environment in 2015 was characterized by a strengthening dollar and weakening commodity prices which led to generally poor returns from international and commodity-based assets. Yields fell slightly during the year, but the volatility of rates was pronounced with a sharp fall in yields through the first part of the year followed by a similar rise near the end of the year as investors began to anticipate the Federal Reserve tightening cycle.

An actuarial valuation was performed as of July 1, 2013 that 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. Annual actuarial valuations will begin in July 2015.

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, replaced 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 final phase of Concord was implemented in July 2014. Software development costs have been capitalized and are being amortized over the useful life of the system.

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. New members were enrolled in the plan beginning July 1, 2014.

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, members of the TCRS 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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TENNESSEE CONSOLIDATED RETIREMENT SYSTEM
STATEMENTS OF FIDUCIARY NET POSITION
JUNE 30, 2015

Expressed in Thousands

	Public Employee Retirement Plan	Teacher Retirement Plar	Teacher Legacy Pension Plan	Total
ASSETS				
Cash and cash equivalents	$ 226,338	$ 163	$ 219,310	$ 445,811
Cash collateral on loaned securities	2,990,874	2,275	2,899,795	5,892,944
Receivables				
Member receivable	5,924	1,127	19,520	26,571
Employer receivable	37,563	902	35,919	74,384
Accrued interest and dividends receivable	73,422	56	71,186	144,664
Real estate income receivable	1,218	1	1,180	2,399
Derivative instruments receivable	267,616	204	259,467	527,287
Investments sold	379,984	289	368,413	748,686
Total receivables	765,727	2,579	755,685	1,523,991
Investments, at fair value				
Short-term securities	104,688	79	101,500	206,267
Government securities	4,371,589	3,325	4,238,463	8,613,377
Corporate securities	2,802,686	2,132	2,717,337	5,522,155
Corporate stocks	12,019,535	9,142	11,653,511	23,682,188
Strategic Lending	475,264	361	460,791	936,416
Private equities	539,095	410	522,679	1,062,184
Real estate	1,362,625	1,037	1,321,129	2,684,791
Total investments	21,675,482	16,486	21,015,410	42,707,378
Capital assets (net)	16,114	12	15,622	31,748
TOTAL ASSETS	25,674,535	21,515	24,905,822	50,601,872
LIABILITIES				
Accounts payable				
Death benefits and refunds payable	1,029	5	1,642	2,676
Federal withholding payable	7,920	0	7,591	15,511
Retiree insurance premium payable	4,330	0	4,150	8,480
Other	888	1	862	1,751
Investments purchased	444,206	338	430,678	875,222
Derivative instruments payable	268,264	204	260,095	528,563
Other investment payables	16,640	12	16,132	32,784
Securities lending collateral	2,990,874	2,275	2,899,795	5,892,944
TOTAL LIABILITIES	3,734,151	2,835	3,620,945	7,357,931
NET POSITION RESTRICTED FOR PENSIONS	$21,940,384	$18,680	$21,284,877	$43,243,941

See accompanying Notes to the Financial Statements.

STATEMENTS OF CHANGES IN FIDUCIARY NET POSITION
FOR THE YEAR ENDED JUNE 30, 2015

Expressed in Thousands

	Public Employee Retirement Plan	Teacher Retirement Plan	Teacher Legacy Pension Plan	Total
ADDITIONS				
Contributions				
Member contributions	$ 77,020	$ 10,390	$ 187,122	$ 274,532
Employer contributions	664,834	8,310	338,301	1,011,445
Other contributions	384	0	0	384
Total contributions	742,238	18,700	525,423	1,286,361
Investment income				
Net appreciation in fair value of investments	40,523	17	39,444	79,984
Interest & Dividends	596,689	266	580,579	1,177,534
Real estate income, net of operating expenses	37,488	16	36,491	73,995
Total investment income	674,700	299	656,514	1,331,513
Less: Investment expense	(23,667)	(10)	(23,036)	(46,713)
Net income from investing activities	651,033	289	633,478	1,284,800
Securities lending activities				
Securities lending income	17,331	8	16,869	34,208
Less: securities lending expense	(3,924)	(2)	(3,820)	(7,746)
Net income from securities lending activities	13,407	6	13,049	26,462
Net investment income	664,440	295	646,527	1,311,262
TOTAL ADDITIONS	1,406,678	18,995	1,171,950	2,597,623
DEDUCTIONS				
Annuity benefits	1,118,386	0	1,071,903	2,190,289
Death benefits	3,154	0	2,371	5,525
Refunds	25,790	35	22,136	47,961
Administrative expense	9,148	280	5,636	15,064
TOTAL DEDUCTIONS	1,156,478	315	1,102,046	2,258,839
NET INCREASE	250,200	18,680	69,904	338,784
FIDUCIARY NET POSITION RESTRICTED FOR PENSIONS				
BEGINNING OF YEAR	21,690,184	0	21,214,973	42,905,157
END OF YEAR	$ 21,940,384	$ 18,680	$ 21,284,877	$ 43,243,941

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, 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. <u>SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES</u>

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, 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. The computer software was valued at $31.7 million at year end and is being amortized using the straight line method over the ten year estimated life of the system. The amortization expense for the current year was $3.7 million.

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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, 2015, there were three 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 for 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 local education agencies (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 became effective for teachers employed by LEAs after June 30, 2014. The Teacher Retirement Plan is a separate cost sharing, multiple employer defined benefit pension plan.

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, 2015 the membership of the pension plans consisted of the following:

	Public Employee Retirement Plan	Teacher Retirement Plan	Teacher Legacy Pension Plan	Total
Inactive Plan Members or Beneficiaries Currently Receiving Benefits	91,683	0	47,292	138,975
Inactive Vested Plan Members Entitled to But Not Yet Receiving Benefits	32,989	3	8,000	40,992
Inactive Non-Vested Plan Members Entitled to Refund of Member Account Balance	30,015	523	18,341	48,879
Active Plan Members	138,267	5,516	69,140	212,923
Total Membership	292,954	6,042	142,773	441,769
Number of Participating Employers	545	142	142	687

Membership above includes all plans whether open or closed.

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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 can be restricted by precedent established by the Tennessee Supreme Court.

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 ten percent (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 (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 (1 percent) COLA is granted if the CPI change is between one-half percent and one percent.

Teacher Retirement Plan

Members of the Teacher Retirement Plan are eligible to retire at age 65 with five years of service credit or pursuant to the rule of 90 where age and years of service total 90. 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 ten percent (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 (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 (1 percent) COLA is granted if the CPI change is between one-half percent and one percent. The Teacher Retirement Plan includes provisions to control employer contributions and unfunded liabilities. As such, plan provisions are automatically changed when employer contributions and unfunded liabilities exceed statutory limits.

Public Employee Retirement Plan

For state employees, there are two major tiers of benefits and eligibility requirements. State employees becoming members before July 1, 2014 are eligible to retire at age 60 with five years of service credit or after 30 years of service credit regardless of age. State employees becoming members after June 30, 2014 are eligible to retire at age 65 with five years of service or pursuant to the rule of 90 where age and years of service total 90. 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

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in the same manner as a service retirement benefit but are reduced ten percent (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 three percent (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 (1 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 ten percent (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 three percent (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 (1 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.

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 (5 percent) of salary. For the year ended June 30, 2015, the required ADC for LEAs was 9.04 percent of covered-employee payroll.

For the Teacher Retirement Plan, LEAs are required by statute to contribute greater of the ADC or four percent (4 percent). 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 (5 percent) of salary. For the year ended June 30, 2015, the required ADC for LEAs was two and one-half percent (2.5 percent) of covered-employee payroll while actual contributions were four percent (4 percent) of covered-employee payroll.

For the Public Employee Retirement Plan, each governmental entity is required by statute to contribute the ADC except that the contribution rate for state employees hired after June 30, 2014 is the greater of the ADC or four percent (4 percent). 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, 2015, the required ADC varied for each participating employer, with approximately fifty percent (50 percent) of all employer rates between eight percent (8 percent) and twenty percent (20 percent) and contributions from these same employers accounting for over ninety percent (90 percent) of the contributions

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for this plan. By statute, state employees hired before July 1, 2014 are noncontributory while employees hired after June 30, 2014 contribute five percent (5 percent) of salary. As adopted by the governmental entity, political subdivision employees may be noncontributory, contribute two and one-half percent (2.5 percent) of salary, or contribute five percent (5 percent) of salary.

Reserves - The statute governing the Teacher Retirement Plan and certain employers in the Public Employee Retirement Plan provide for a minimum employer contribution rate of four percent (4 percent). The statute further provides that the amount of the employer contributions in excess of the actuarially determined contribution rate is deposited into a stabilization reserve for each plan. The statute may be amended by the Tennessee General Assembly. Assets in the stabilization reserve are commingled for investment purposes and receive a pro rata share of investment earnings. The amount in the stabilization reserve is not considered in calculating the actuarially determined employer contribution rate for each plan. The statute provides that the assets in the stabilization reserve will be utilized should the actuarially determined contribution rate exceed four percent (4 percent). In such case, the required employer contribution in excess of four percent (4 percent) will be transferred from the stabilization reserve to the account of the Teachers Retirement Plan or certain Public Employee Retirement Plan employers. By statute, the Board of Trustees may adopt a policy to suspend the deposits into the stabilization reserve in any given year when the stabilization reserve reaches a certain level that is determined by the Board. If deposits are suspended, then the employer contribution will be the actuarially determined contribution rate for that year rather than the higher four percent (4 percent). The Board has not adopted a policy at this time. At June 30, 2015, there was $3,232,080 in the stabilization reserve on behalf of the Teachers Retirement Plan and $1,987,839 in the various stabilization reserves on behalf of the Public Employee Retirement Plan.

C. DEPOSITS AND INVESTMENTS

Statutory Authority - State statute authorizes the TCRS to maintain cash, not exceeding ten percent (10 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.

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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.

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 ten percent (10 percent) of the market value of the System's total assets for risk mitigating positions and ten percent (10 percent) 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, 2015:

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%

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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 percent) 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 have a market value equal to at least one hundred two percent (102 percent) of the market value of the loaned domestic security or one hundred five percent (105 percent) of any foreign security. Cash received as collateral shall equal at least one hundred percent (100 percent) 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. Cash Collateral is held in the TCRS name and is not subject to custodial credit risk. During the year there were no violations of legal or contractual provisions by the TCRS.

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, 2015, 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	$2,031,510,790	$2,077,594,484
Equity	3,730,719,970	3,815,349,280
Total	$5,762,230,760	$5,892,943,764

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

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As of June 30, 2015 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	$ 876,554	2.052%
AA	521,115	1.220%
A	1,077,924	2.524%
BBB	2,757,564	6.457%
BB	183,838	0.430%
B	39,467	0.092%
CCC	90,396	0.212%
CC	1,181	0.003%
D	35,069	0.082%
NR	3,400,589	7.963%
	$ 8,983,697	
U. S. Government Agencies and Obligations Explicitly Guaranteed by the U.S. Government	5,627,671	
Total Fixed Income Securities	$ 14,611,368	
Equity	$ 23,757,978	
Real Estate	2,684,791	
Private Equities	1,062,184	
Strategic Lending	936,416	
Derivative Instruments (not rated)	0	
Escrow Claim (not rated)	0	
Short Term Investment Fund with Custodian (NR)	1,772	
Add Back Short Term Investments Classified as Cash	(347,131)	
Total Investments as Shown on Fiduciuary Net Position	$ 42,707,378	

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. 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.

(CONTINUED)

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, 2015 *(in thousands)***	**Effective Duration (years)**
Government Agencies	$ 288,764	8.18
Government Bonds	2,255,342	14.11
Government Inflation Indexed	2,604,278	8.45
Government Mortgage Backed	3,466,373	4.30
Government Asset Backed	45,411	7.15
Municipal Bonds	156,099	10.22
Commercial Mortgage Backed	470,623	2.40
Corporate Asset Backed Securities	236,558	2.41
Corporate Bonds	4,536,294	8.31
Short Term Bills and Notes	551,626	0.05
Total Debt Investments	$14,611,368	7.70

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, 2015 was $470,622,689 of which $317,431,678 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 (25 percent) of total assets. The TCRS' exposure to foreign currency risk was as follows:

(CONTINUED)

Currency	Total Fair Value June 30, 2015 *(in thousands)*	Fixed Income	Equity *(in thousands)*	Cash *(in thousands)*
Australian Dollar	$ 246,507	$0	$ 246,300	$ 207
British Pound Sterling	1,112,564	0	1,103,194	9,370
Canadian Dollar	1,577,942	0	1,562,054	15,888
Danish Krone	122,986	0	122,986	0
Euro Currency	1,519,192	0	1,512,236	6,956
Hong Kong Dollar	203,728	0	201,594	2,134
Japanese Yen	1,373,639	0	1,356,066	17,573
New Israeli Shekel	19,773	0	19,661	112
New Zealand Dollar	6,146	0	6,146	0
Norwegian Krone	48,326	0	48,121	205
Singapore Dollar	54,479	0	54,375	104
Swedish Krona	166,508	0	166,494	14
Swiss Franc	545,066	0	543,181	1,885
Total	$6,996,856	$0	$6,942,408	$54,448

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 $54,448,276 in foreign currency held by our master custodian, State Street Bank, in State Street'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 3.29 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 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 eighty percent (80 percent) of its foreign currency exposure into US dollars. Foreign currency

(CONTINUED)

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:

	Changes in Fair Value *(in thousands)*		Fair Value at June 30, 2015 *(in thousands)*			
	Financial Statement Classification	Amount	Financial Statement Classification	Amount	Notional Amount	Currency
Foreign Currency Forward Contracts						
		$142		$142	16,390	EUR
		(332)		(332)	16,845,184	JPY
	Investment Income	($190)	Derivative Instruments Payable	($190)		
Futures Contracts						
	Investment Income	($22,559)	Derivative Instruments Receivable	$352	$859,140	
TBA Mortgage Backed Securities						
	Investment Income	($734)	Derivative Instruments Receivable	($734)	$369,403	

(CONTINUED)

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 strategic lending, private equity funds and real estate with an estimated fair value of $4,683,390,636 at June 30, 2015. 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 55 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.

Alternative Investments – The TCRS had unfunded commitments of $1,978,496,528 in private equity, strategic lending, and real estate commitments at year end.

D. NET PENSION LIABILITY (ASSET) FOR COST-SHARING PLANS

The components of net pension liability at June 30, 2015, were as follows:

	Teacher Legacy Pension Plan	Teacher Retirement Plan
Total Pension Liability	$ 22,073,402,943	$ 16,129,977
Plan Fiduciary Net Position	(21,284,877,037)	(18,680,373)
Net Pension Liability (Asset)	$ 788,525,906	$ (2,550,396)
Plan Fiduciary Net Position	96.43%	115.81%

(CONTINUED)

Actuarial Assumptions - The total pension liability was determined by an actuarial valuation as of July 1, 2014, updated to roll forward to June 30, 2015, 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, 2014 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 three percent (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:

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

(CONTINUED)

The long-term expected rate of return on pension plan investments was established by the TCRS Board of Trustees as seven and one-half percent (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 seven and one-half percent (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 and Teacher Retirement Plan's net pension liability for LEAs using the discount rate of seven and one-half percent (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 percent) or one percentage point higher (8.5 percent) than the current rate:

Plan	One Percent Decrease (6.5%)	Current Discount Rate (7.5%)	One Percent Increase (8.5%)
Teacher Legacy Pension Plan	$3,633,924,606	$788,525,906	($1,567,286,797)
Teacher Retirement Plan	$589,448	($2,550,396)	($5,179,946)

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

	2015	2014
Total pension liability		
Service cost	$ 393,173,920	$ 404,576,942
Interest	1,578,251,721	1,483,656,307
Change of benefit terms	0	0
Difference between expected and actual experience	46,576,630	0
Change of assumptions	0	0
Benefit payments, including refunds of member contributions	(1,096,410,122)	(1,037,013,093)
Net change in total pension liability	921,592,149	851,220,156
Total pension liability - beginning	21,151,810,794	20,300,590,638
Total pension liability - ending (a)	22,073,402,943	21,151,810,794
Plan fiduciary net position		
Contributions – employer	338,301,211	348,474,888
Contributions - members	187,121,567	195,520,938
Net investment income	646,526,936	3,054,117,821
Benefit payments, including refunds of member contributions	(1,096,410,122)	(1,037,013,093)
Administrative expense	(5,635,689)	(2,663,319)
Net change in plan fiduciary net position	69,903,903	2,558,437,235
Plan fiduciary net position - beginning	21,214,973,134	18,656,535,899
Plan fiduciary net position - ending (b)	21,284,877,037	21,214,973,134
Net pension liability (asset) - ending (a) - (b)	$ 788,525,906	$ (63,162,340)

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

	2015
Total pension liability	
Service cost	$15,581,497
Interest	583,011
Change of benefit terms	0
Difference between expected and actual experience	0
Change of assumptions	0
Benefit payments, including refunds of member contributions	(34,531)
Net change in total pension liability	16,129,977
Total pension liability - beginning	0
Total pension liability - ending (a)	16,129,977
Plan fiduciary net position	
Contributions – employer	8,310,132
Contributions - members	10,390,077
Net investment income	294,742
Benefit payments, including refunds of member contributions	(34,531)
Administrative expense	(280,047)
Net change in plan fiduciary net position	18,680,373
Plan fiduciary net position - beginning	0
Plan fiduciary net position - ending (b)	18,680,373
Net pension liability (asset) - ending (a) - (b)	$ (2,550,396)

TEACHER LEGACY PENSION PLAN
SCHEDULE OF NET PENSION LIABILITY
Fiscal Year Ended June 30

	2015	2014
Total pension liability	$ 22,073,402,943	$ 21,151,810,794
Plan fiduciary net position	21,284,877,037	21,214,973,134
Net pension liability (asset)	$ 788,525,906	$ (63,162,340)
Plan fiduciary net position as a percentage of the total pension liability	96.43%	100.30%
Covered-employee payroll	$ 3,742,270,034	$ 3,925,131,835
Net pension liability (asset) as a percentage of covered-employee payroll	21.07%	(1.61%)

TEACHER RETIREMENT PLAN
SCHEDULE OF NET PENSION LIABILITY
Fiscal Year Ended June 30

	2015
Total pension liability	$ 16,129,977
Plan fiduciary net position	18,680,373
Net pension liability (asset)	$ (2,550,396)
Plan fiduciary net position as a percentage of the total pension liability	115.81%
Covered-employee payroll	$ 207,753,299
Net pension liability (asset) as a percentage of covered-employee payroll	(1.23%)

TEACHER LEGACY PENSION PLAN
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
2015	$ 338,301,211	$ 338,301,211	$0	$3,742,270,034	9.04%
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%

PUBLIC EMPLOYEE RETIREMENT PLAN,
TEACHER LEGACY PENSION PLAN, AND
TEACHER RETIREMENT PLAN
SCHEDULE OF INVESTMENT RETURNS
Fiscal Year Ended June 30

	2015	2014
Annual Money-Weighted Rate of Return, Net of Investment Expense	3.29%	16.49%

Method and Assumptions Used in Calculations of Actuarially-Determined Contributions - The actuarially-determined contribution rates for the fiscal year ended June 30, 2015 for Local Education Agencies were calculated as the result of an actuarial valuation performed as of July 1, 2013. The following actuarial methods and assumptions were used to determine contribution rates reported in the schedule:

	Teacher Legacy Pension Plan	Teacher Retirement Plan
Actuarial Cost Method	Frozen Initial Liability Method	N/A
Amortization Method	Level Dollar Amortization	N/A
Remaining Amortization Period	Eight Years	N/A
Inflation	3.0 Percent	3.0 Percent
Salary Increases	Graded Salary Ranges from 8.97 Percent to 3.71 Percent, Including Inflation, Averaging 4.25 Percent	Graded Salary Ranges from 8.97 Percent to 3.71 Percent, Including Inflation, Averaging 4.25 Percent
Investment Rates of Return	7.50 Percent, Net of Pension Plan Investment Expense, Including Inflation	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 balance sheet of the Tennessee Promise Scholarship Endowment Trust Fund, a special revenue fund of the State of Tennessee, as of June 30, 2015, the related statement of revenues, expenditures, and changes in fund balance for the year then ended, and the related notes to the financial statements, which collectively comprise the Tennessee Promise Scholarship Endowment Trust 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 board of the Tennessee Promise Scholarship Endowment Trust Fund. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the Tennessee Promise Scholarship Endowment Trust Fund.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee Promise Scholarship Endowment Trust Fund of the State of Tennessee as of June 30, 2015, and the changes in financial 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 Tennessee Promise Scholarship Endowment Trust 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, 2015, 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 22, 2015, on our consideration of the Tennessee Promise Scholarship Endowment Trust 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 Tennessee Promise Scholarship Endowment Trust Fund's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 22, 2015

	June 30, 2015
ASSETS	
Cash and cash equivalents	$ 19,846,017
Investments, at fair value	
Government securities	42,743,913
Corporate securities	138,267,308
Investment in exchange traded equity fund	164,019,326
Total investments	345,030,547
Receivables	
Investments sold	10,310,027
Investment income receivable	2,382,490
Total receivables	12,692,517
TOTAL ASSETS	$377,569,081
LIABILITIES AND FUND BALANCE	
LIABILITIES	
Due to general fund	273,947
TOTAL LIABILITIES	273,947
FUND BALANCE	
Nonspendable corpus	361,381,325
Restricted for Scholarships	15,913,809
TOTAL FUND BALANCE	377,295,134
TOTAL LIABILITIES AND FUND BALANCE	$377,569,081

See accompanying Notes to the Financial Statements.

	For the Year Ended June 30, 2015
REVENUES	
Investment income	$ 6,187,756
Contributions from Tennessee Student Assistance Corporation (TSAC)	10,000,000
TOTAL REVENUES	16,187,756
EXPENDITURES	
Administrative cost	273,947
TOTAL EXPENDITURES	273,947
EXCESS OF REVENUES OVER EXPENDITURES	15,913,809
OTHER FINANCING SOURCE	
Transfer in from education fund	361,381,325
TOTAL OTHER FINANCING SOURCE	361,381,325
NET CHANGE IN FUND BALANCE	377,295,134
FUND BALANCE, BEGINNING OF YEAR	0
FUND BALANCE, END OF YEAR	$377,295,134

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity** - The Tennessee Promise Endowment Fund (the TN Promise Fund) forms an integral part of the primary government and has been included as a special revenue 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 (GAAP) 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 generally expenditures are recognized when the related fund liability is incurred. 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 short-term investments with a maturity date within three months of the acquisition date. Cash management pools are included as cash. Cash received 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 under the contractual arrangement for master custody services. During the period from July 1 - August 31, 2014, the short-term, open-end mutual fund was with Northern Trust invested in the Northern Institutional Government Portfolio. During the period from September 1, 2014 to June 30, 2015, the short-term, open-end mutual fund would have been with State Street Bank invested in State Street Government Money Market Fund.

4. **Method Used to Report Investments and Participant Shares** - 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 trade date 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 TN Promise Fund's non-spendable corpus consists of the initial deposit of (i) the program-generated revenues plus the earnings as of June 30, 2014 of the Tennessee Student Assistance Corporation (TSAC) invested as part of the Chairs of Excellence Endowment Fund established by *Tennessee Code Annotated* Section 49-7-501 and pursuant to Chapter 98 of the *Public Acts of 2013*; and (ii) the June 30, 2014 balance of the lottery for education account established in accordance with Tennessee Code Annotated Section 4-51-111(b), but excluding the general shortfall reserve subaccount provided in *Tennessee Code Annotated* Section 4-51-111(b)(3) and the sum of ten million dollars ($10,000,000). The TN Promise Fund's restricted fund balance, which may be subject to future allocation and/or distribution in accordance with the Tennessee Promise Scholarship Endowment Trust agreement, includes all amounts that are transferred to the TN Promise Fund, except the initial deposit constituting the corpus, and all investment income of the TN Promise Fund.

B. DEPOSITS AND INVESTMENTS

State statute authorizes the trustees of the TN Promise Fund to adopt an investment policy for the trust in accordance with the laws, policies and guidelines that govern investments by the Tennessee Consolidated Retirement System. The State Treasurer is responsible for the investment of the TN Promise Fund in accordance with the policy established by the trustees. The current policy of the trustees for the TN Promise Fund gives the Treasurer approval to invest and reinvest the TN Promise Fund assets in the same securities or investments in which the Tennessee Consolidated Retirement System is permitted to invest. The policy also allows assets to be invested in shares of publicly traded investment companies, including Unit Investment Trusts (UIT's), Exchange Traded Funds (ETF's) and open-end and closed-end mutual funds. In addition, it permits investment in publicly traded foreign securities that are the same kinds, classes and investment grades otherwise eligible for investment, and in non-investment grade, fixed income securities, including but not limited to, high yield bonds.

State statute also authorizes the TN Promise Fund to be commingled for investment purposes with other trust funds and other funds subject to investment by the State Treasurer. The TN Promise Fund does not maintain its own bank accounts but utilizes the State Pooled Investment Fund (SPIF) for its operating cash needs. The SPIF 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 bank-ers' acceptances, certain repurchase agreements and various U.S. Treasury and Agency obligations. The SPIF is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities.

As of June 30, 2015 the TN Promise Fund had the following investments (expressed in thousands):

Credit Quality Distribution for Securities with Credit Exposure as a Percentage of Total Investments
June 30, 2015

(Expressed in Thousands)

Rating	Fair Value	Percentage of Total Investments
AAA	$ 5,534	1.60%
AA	20,014	5.80%
A	61,847	17.93%
BBB	41,016	11.89%
Not Rated	29,897	8.67%
Total Debt Investments	158,308	
Government Agencies and Obligations*	22,703	
Total Fixed Income Securities	181,011	
Equity	164,019	
Total Investments as Shown on Statements	$ 345,030	

** Includes obligations of the U.S. Government or obligations explicitly guaranteed by the U.S. Government which are not rated by credit rating agencies.*

(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 TN Promise Fund's investments in fixed income securities as of June 30, 2015 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 State Street Government Money Market Fund is not rated at June 30, 2015. The investment policy and required risk disclosures relative to the SPIF are presented on pages 114-121 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 TN Promise Fund the following investment amounts as a percentage of total investments at June 30, 2015 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, 2015	
Issurer Organization	**Fair Value**	**Percentage**
Federal Home Loan Mortgage Corporation	$ 17,618,297	5.11%

The TN Promise Fund'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 TN Promise Fund does not specifically address limits on investment maturities. The TN Promise Fund had the following investments and effective duration at June 30, 2015:

(Expressed in Thousands)		
Investment Type	**Fair Value as of June 30, 2015**	**Effective Duration (years)**
Debt Investments		
U.S. Government Treasuries	$ 12,742	6.88
Municipal Bonds	2,933	8.25
Government Asset Backed	7,060	6.01
Government Mortgage Backed	27,069	4.92
Corporate Bonds	119,032	4.68
Corporate Mortgage Backed	12,175	4.39
Total Debt Investments	$181,011	4.96

(CONTINUED)

Asset Backed Securities - The TN Promise Fund 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, 2015 was $12,174,688 of which none of these CMOs were CMOs that are generally more sensitive to interest rate changes.

C. OTHER ACCOUNTING DISCLOSURES

Description of the Tennessee Promise Scholarship Endowment Fund - The TN Promise Fund was established by Chapter No. 900 of the *Public Acts of 2014* for the purpose of funding the Tennessee Promise Scholarship Program, a scholarship program for Tennessee residents seeking an associate's degree, certificate or diploma from an eligible postsecondary institution. The TN Promise Fund consists of the Tennessee Promise Endowment Account and the Tennessee Promise Scholarship Special Reserve Account. The Tennessee Promise Endowment Account is comprised of the initial deposit of $361,381,325 and is the non-spendable corpus amount of the TN Promise Fund. All income and subsequent deposits and transfers to the TN Promise Fund will be credited to the Tennessee Promise Scholarship Special Reserve Account, to be used only for the payment of scholarships and expenses relative to the administration and investment of assets.

STATE OF TENNESSEE
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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 TN Stars College Savings 529 Program, a private-purpose trust fund of the State of Tennessee, as of June 30, 2015, and June 30, 2014, 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 TN Stars College Savings 529 Program'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 TN Stars College Savings 529 Program. We do not believe that the Comptroller's service in this capacity affected our ability to conduct an independent audit of the TN Stars College Savings 529 Program.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the fiduciary net position of the TN Stars College Savings 529 Program of the State of Tennessee as of June 30, 2015, and June 30, 2014, 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 TN Stars College Savings 529 Program, 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, 2015, and June 30, 2014, 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 22, 2015, on our consideration of the TN Stars College Savings 529 Program'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 TN Stars College Savings 529 Program's internal control over financial reporting and compliance.

Deborah V. Loveless

Deborah V. Loveless, CPA
Director
December 22, 2015

TNSTARS COLLEGE SAVINGS 529 PROGRAM
STATEMENT OF FIDUCIARY NET POSITION
JUNE 30, 2015 AND JUNE 30, 2014

	June 30, 2015	June 30, 2014
ASSETS		
Cash	$ 11,188	$ 30,201
Receivables		
Contributions receivable	2,745	3,070
Investments, at fair value		
Investment in money market account	1,063,077	704,852
Investment in mutual funds (fixed income)	1,971,903	933,731
Investment in mutual funds (blended)	12,663,131	10,516,280
Investment in mutual funds (equity)	17,169,469	5,412,735
TOTAL ASSETS	32,881,513	17,600,869
LIABILITIES		
Due to General Fund	0	32,097
Accounts payable	29,153	32,213
TOTAL LIABILITIES	29,153	64,310
NET POSITION - RESTRICTED FOR PLAN PARTICIPANTS	$32,852,360	$17,536,559

See accompanying Notes to the Financial Statements.

TNSTARS COLLEGE SAVINGS 529 PROGRAM
STATEMENT OF CHANGES IN FIDUCIARY NET POSITION
JUNE 30, 2015 AND JUNE 30, 2014

	For the Year Ended June 30, 2015	For the Year Ended June 30, 2014
ADDITIONS		
Contributions	$14,465,521	$ 8,991,794
Investment income		
Net increase (decrease) in fair value of investments	(314,037)	1,396,648
Interest and dividend income	1,506,934	386,193
Total investment income	1,192,897	1,782,841
Transfers from General Fund	474,426	353,566
TOTAL ADDITIONS	16,132,844	11,128,201
DEDUCTIONS		
Withdrawals	781,750	290,563
Administrative cost	35,293	15,089
TOTAL DEDUCTIONS	817,043	305,652
CHANGE IN NET POSITION	15,315,801	10,822,549
NET POSITION - RESTRICTED FOR PLAN PARTICIPANTS		
BEGINNING OF YEAR	17,536,559	6,714,010
END OF YEAR	$32,852,360	$17,536,559

See accompanying Notes to the Financial Statements.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity –** The TN Stars College Savings 529 Program, 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 114-121 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.

B. DEPOSITS AND INVESTMENTS

Overview - 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.

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

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mutual funds with some portion of their assets invested in fixed income securities are considered blended investments. At June 30, 2015 and June 30, 2014, 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, 2015, 25% of the total plan assets have some portion of their portfolio invested in fixed income securities. Another 3% 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, 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 the money market account.

Interest Rate Risk – IInterest 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. 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. Presented below is a comparative statement of Effective Duration as of June, 30, 2015 and June 30, 2014:

	Fiscal Year 2015		Fiscal Year 2014	
Fund Name	Ending Balance	Effective Duration	Ending Balance	Effective Duration
Blended				
Vanguard Wellington Fund Admiral Shares	$ 6,322,794	5.94	$ 3,631,032	6.26
DFA Enhanced U.S. Large Company Portfolio Institutional Class	0	1.48	3,212,027	1.53
Vanguard LifeStrategy Conservative Growth Fund	3,881,004	6.13	2,185,384	5.85
Vanguard Life Strategy Income Fund	2,459,333	6.14	1,487,836	5.85
Fixed Income				
Vanguard Total Bond Market Signal Shares	1,499,883	5.70	657,979	5.70
Vanguard Intermediate-Term Investment-Grade Fund Admiral Shares	228,750	5.44	123,529	5.24
DFA Inflation-Protected Securities Portfolio Institutional Class	165,409	7.95	103,018	7.79
Vanguard Intermediate-Term Treasury Admiral Shares	77,861	5.30	49,206	5.15

C. DESCRIPTION OF THE EDUCATIONAL SAVINGS PLAN

The TNStars College Savings 529 Program, 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.

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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 Admiral Shares	VFIAX	922908710	
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	
DFA US Small Cap Fund	DFSTX	233203843	
DFA US Large Cap Value Fund	DFLVX	233203827	0-4
Blended			
DFA Enhanced U.S. Large Company Portfolio Institutional Class*	DFELX	233203637	
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 Admiral Shares	VBTLX	921935201	18+
Vanguard Intermediate-Term Investment-Grade Fund Admiral Shares	VFIDX	922031810	
Vanguard Intermediate-Term Treasury Admiral Shares	VFIUX	922031828	

* Funds are no longer an investment option as of June 30th. Money has been transferred out of these options. See Note D.2.

Participants in the ESP can make withdrawals at any time after contributions have been invested for 21 days. This time period was reduced from 60 days in FY 2014, by the Baccalaureate Education System Trust Board. 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, 2015 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 $400,326 for the year ended June 30, 2015 and $353,566 for the year ended June 30, 2014.

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

Cash Transfer – At June 30, 2015 the ESP had a surplus in cash of $11,188. On June 30, 2015, TNStars sent, via EFT, $104,111 to the investment custodian. Also on this day, TNStars issued debit EFT transactions to plan participant’s financial institutions for $104,111. The debit EFT transactions would settle with the State on July 1, 2015 or the next business day. 2015. In addition, $74,100 was transferred from the General Fund to TNStars to be used to fund the Tennessee Investments Preparing Scholars (TIPS) program. The TIPS funding was invested in July 2015. On June 30, 2014, 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 transferred the funds back to the General Fund.

Fund Mergers and Additions – On September 30, 2014, Vanguard Total Bond Market Index - Signal Shares (VBTSX) and Vanguard 500 Index - Signal Shares (VIFSX) were deleted from the 529 plan. The assets in these funds were converted to Vanguard Total Bond Market Index - Admiral Shares (VBTLX) and Vanguard 500 Index - Admiral Shares (VFIAX), respectively. On June 30, 2015, all assets held in DFA Enhanced US Large Company (DFELX) and Great West American Century (MXGRX) were transferred to the DFA US Large Cap Value Fund (DFLVX). Also on that date, the DFA US Small Cap Fund (DFSTX) was added to the TNStars portfolio. This was due to underperformance of MXGRX and DFELX when benchmarked against other similar mutual funds in the same classification.