Tennessee State School Bond Authority

For the Year Ended
June 30, 2001

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
(615) 741-2501

John G. Morgan
Comptroller

February 8, 2002

The Honorable Don Sundquist, Governor
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243
and
Members of the Tennessee State School Bond Authority
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee State School Bond Authority for the year ended June 30, 2001. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

Consideration of internal control over financial reporting and tests of compliance resulted in no audit findings.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/cj
01/103

State of Tennessee

Audit Highlights

Comptroller of the Treasury Division of State Audit

Financial and Compliance Audit
Tennessee State School Bond Authority
For the Year Ended June 30, 2001

AUDIT OBJECTIVES

The objectives of the audit were to consider the authority's internal control over financial reporting; to determine compliance with certain provisions of laws, regulations, and contracts; to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report which contains all findings, recommendations, and management comments, please contact

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Audit Report
Tennessee State School Bond Authority
For the Year Ended June 30, 2001

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Tennessee State School Bond Authority
For the Year Ended June 30, 2001

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee State School Bond Authority. The audit was conducted pursuant to Section 4-3-304, *Tennessee Code Annotated*, which authorizes the Department of Audit to "perform currently a post-audit of all accounts and other financial records of the state government, and of any department, institution, office, or agency thereof in accordance with generally accepted auditing standards and in accordance with such procedures as may be established by the comptroller."

Section 8-4-109, *Tennessee Code Annotated*, authorizes the Comptroller of the Treasury to audit any books and records of any governmental entity that handles public funds when the Comptroller considers an audit to be necessary or appropriate.

BACKGROUND

The Tennessee State School Bond Authority was established by the Tennessee State School Bond Authority Act, Chapter 256 of the Public Acts of 1965. As provided in this act and in Chapter 429 of the Public Acts of 1999, the authority is to act as a corporate governmental agency of the State of Tennessee for financing projects of the state's higher education institutions and qualified zone academy projects for primary and secondary schools of local government. The authority is empowered to issue negotiable bonds and notes as a means of providing funds for financing approved projects. These projects include buildings, equipment, structures, and improvements. In 1980, the legislature amended the original act to include, as a project, a program for student loans. The amount of funds provided should be sufficient to cover the actual project costs, as well as the authority's administrative expenses, including the cost of conducting the bond and note sales.

ORGANIZATION

The Tennessee State School Bond Authority consists of seven members: the Governor, the State Treasurer, the Secretary of State, the Commissioner of Finance and Administration, the Comptroller of the Treasury, the Chancellor of the Tennessee Board of Regents, and the President of the University of Tennessee. The Governor serves as chairman, and the Comptroller of the Treasury serves as secretary. The Director of the Division of Bond Finance Serves as the assistant secretary; the division provides administrative and financial services to the Tennessee State School Bond Authority.

An organization chart for the authority is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 2000, through June 30, 2001, and was conducted in accordance with government auditing standards generally accepted in the United States of America. Financial statements are presented for the year ended June 30, 2001, and for comparative purposes, the year ended June 30, 2000. The Tennessee State School Bond Authority has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

The audit covered fund 32 of the State of Tennessee Accounting and Reporting System (allotment code 307.07).

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to consider the authority's internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements;

2. to determine compliance with certain provisions of laws, regulations, and contracts;

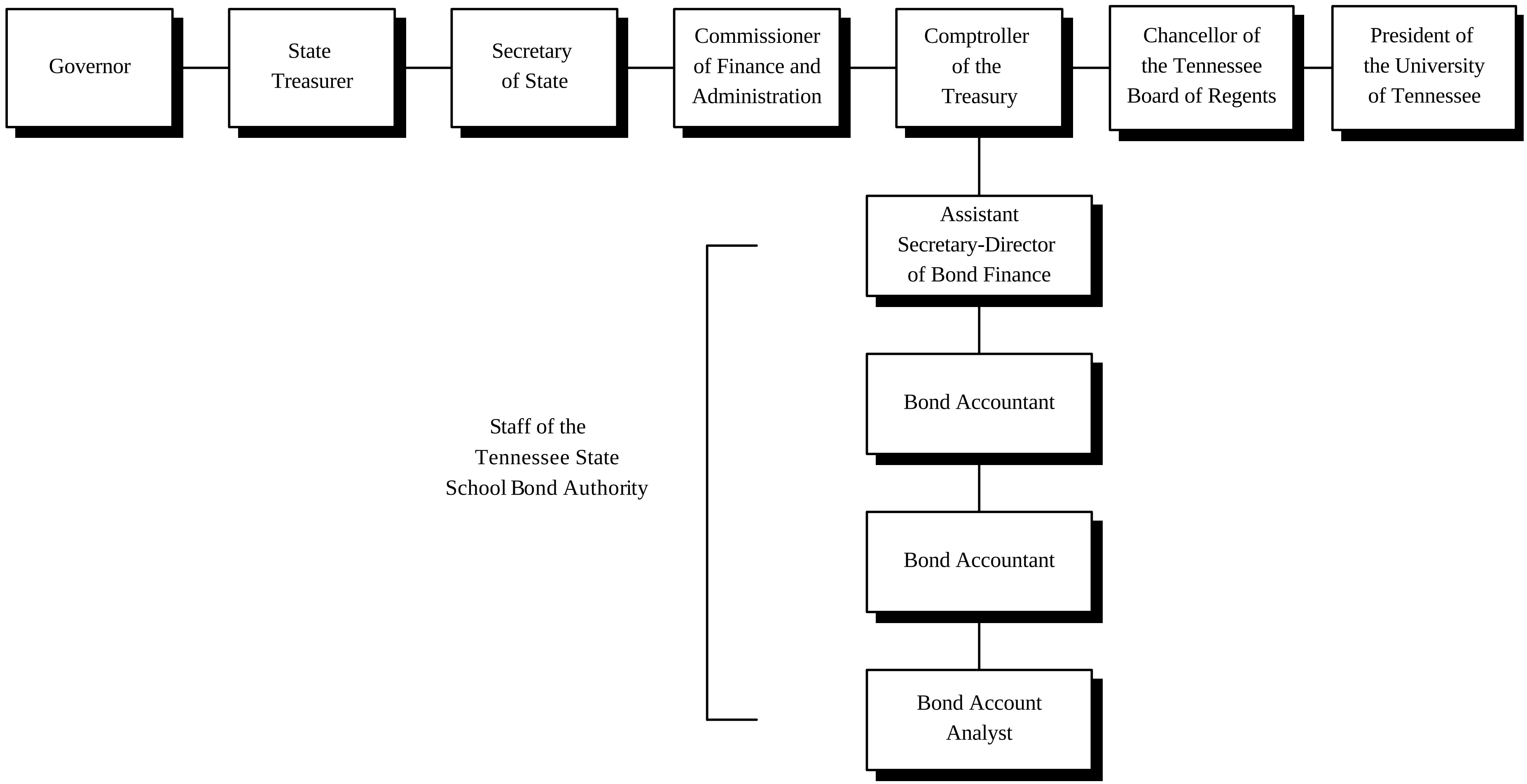
3. to determine the fairness of the presentation of the financial statements; and

4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

There were no findings in the prior audit report.

TENNESSEE STATE SCHOOL BOND AUTHORITY
ORGANIZATION CHART



RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Tennessee State School Bond Authority's financial statements for the year ended June 30, 2001, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by government auditing standards generally accepted in the United States of America. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

The results of our audit tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Tennessee State School Bond Authority's financial statements.

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COMPTROLLER OF THE TREASURY
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Report on Compliance and on Internal Control Over Financial Reporting Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

November 16, 2001

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

Dear Mr. Morgan:

We have audited the financial statements of the Tennessee State School Bond Authority, a component unit of the State of Tennessee, as of and for the year ended June 30, 2001, and have issued our report thereon dated November 16, 2001. As discussed in Note 7 to the financial statements, the Tennessee State School Bond Authority implemented Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions.* We conducted our audit in accordance with government auditing standards generally accepted in the United States of America.

Compliance

As part of obtaining reasonable assurance about whether the authority's financial statements are free of material misstatement, we performed tests of the authority's compliance with certain provisions of laws, regulations, and contracts, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

The Honorable John G. Morgan
November 16, 2001
Page Two

Internal Control Over Financial Reporting

In planning and performing our audit, we considered the Authority's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and not to provide assurance on the internal control over financial reporting. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control over financial reporting that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over financial reporting and its operation that we consider to be material weaknesses.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee and management and is not intended to be and should not be used by anyone other than these specified parties. However, this report is a matter of public record.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/cj

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COMPTROLLER OF THE TREASURY
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Independent Auditor's Report

November 16, 2001

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

Dear Mr. Morgan:

We have audited the accompanying balance sheets of the Tennessee State School Bond Authority, a component unit of the State of Tennessee, as of June 30, 2001, and June 30, 2000, and the related statements of revenues, expenses, and changes in retained earnings and cash flows for the years then ended. These financial statements are the responsibility of the authority's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with government auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the Tennessee State School Bond Authority as of June 30, 2001, and June 30, 2000, and the results of its operations and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

The Honorable John G. Morgan
November 16, 2001
Page Two

As discussed in Note 7 to the financial statements, the Tennessee State School Bond Authority implemented Governmental Accounting Standards Board Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions.*

Our audits were conducted for the purpose of forming an opinion on the basic financial statements, taken as a whole. The accompanying financial information on pages 26 through 28 is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

In accordance with *Government Auditing Standards*, we have also issued our report dated November 16, 2001, on our consideration of the authority's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr.

Arthur A. Hayes, Jr., CPA,
Director

AAH/cj

Exhibit A

TENNESSEE STATE SCHOOL BOND AUTHORITY
COMPARATIVE BALANCE SHEETS
JUNE 30, 2001, AND JUNE 30, 2000

(Expressed in Thousands)

		June 30, 2001		June 30, 2000
Assets				
Current assets:				
Cash (Note 2)	$	27,535	$	26,695
Cash with fiscal agent (Note 2)		21		30
Investments with fiscal agent (Note 2)		34		53
Loans receivable (Note 3)		20,513		16,894
Interest receivable (Note 3)		3,002		2,633
Receivable from borrowers		191		272
Total current assets		51,296		46,577
Restricted assets (Notes 2 and 4):				
Cash		870		-
Investments		15,233		14,672
Total restricted assets		16,103		14,672
Other assets:				
Loans receivable (Note 3)		367,365		326,749
Deferred charges		2,715		2,111
Total other assets		370,080		328,860
Total assets	$	437,479	$	390,109
Liabilities and Equity				
Liabilities:				
Current liabilities:				
Accrued liabilities	$	26	$	-
Payable to borrowers		-		5
Accrued interest payable		3,136		2,661
Commercial paper payable (Note 5)		60,277		102,700
Bonds payable (Note 5)		20,070		16,894
Deferred revenue (Note 6)		6,788		6,199
Total current liabilities		90,297		128,459
Noncurrent liabilities:				
Net bonds payable (Note 5)		339,155		254,920
Total liabilities		429,452		383,379
Equity:				
Retained earnings, unreserved		8,027		6,730
Total liabilities and equity	$	437,479	$	390,109

The notes to the financial statements are an integral part of this statement.

Exhibit B

TENNESSEE STATE SCHOOL BOND AUTHORITY
COMPARATIVE STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN RETAINED EARNINGS
FOR THE YEARS ENDED JUNE 30, 2001, AND JUNE 30, 2000

(Expressed in Thousands)

	Year Ended June 30, 2001	Year Ended June 30, 2000
OPERATING REVENUES		
Revenue from loans	$ 21,712	$ 18,565
Interest income	1,596	1,159
Net increase in the fair value of investments	1,028	952
Total operating revenues	24,336	20,676
OPERATING EXPENSES		
Interest expense - commercial paper	3,365	3,699
Interest expense - bonds	17,240	13,926
Subsidy to borrowers	1,655	1,372
Administrative expense	644	448
Amortization of bond issuance costs	135	94
Total operating expenses	23,039	19,539
Operating income	1,297	1,137
EXTRAORDINARY ITEM		
Loss on extinguishment of debt	-	930
Net income	1,297	207
Retained earnings, July 1	6,730	6,523
Retained earnings, June 30	$ 8,027	$ 6,730

The notes to the financial statements are an integral part of this statement.

Exhibit C

TENNESSEE STATE SCHOOL BOND AUTHORITY
COMPARATIVE STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2001, AND JUNE 30, 2000

(Expressed in Thousands)

	Year Ended June 30, 2001	Year Ended June 30, 2000
Cash flows from operating activities:		
Receipts from customers and users	$ 328	$ 708
Payments to suppliers	(618)	(448)
Receipts from borrowers to the Interest Rate Reserve Fund	6,178	168
Payments to borrowers from the Interest Rate Reserve Fund	(6,374)	(523)
Net cash used by operating activities	(486)	(95)
Cash flows from noncapital financing activities:		
Proceeds from sale of bonds	104,118	12,925
Proceeds from sale of commercial paper	45,050	37,050
Payments for escrow	-	(5,996)
Bond issuance costs paid	(316)	(62)
Call premiums paid	-	(65)
Principal payments - bonds and commercial paper	(105,534)	(117,625)
Interest payments - bonds and commercial paper	(19,201)	(16,964)
Subsidy to borrowers	(1,690)	(1,372)
Net cash provided (used) by noncapital financing activities	22,427	(92,109)
Cash flows from investing activities:		
Purchases of investments	(68,692)	(34,062)
Proceeds from sales and maturities of investments	69,195	46,448
Interest received on investments	1,597	1,225
Loans issued	(61,388)	(48,445)
Collections of loan principal	19,606	113,247
Interest received on loans	19,442	16,370
Net cash provided (used) by investing activities	(20,240)	94,783
Net increase in cash	1,701	2,579
Cash, July 1	26,725	24,146
Cash, June 30	$ 28,426	$ 26,725
Reconciliation of cash to the balance sheet:		
Cash	$ 27,535	$ 26,695
Cash - restricted	870	-
Cash with fiscal agent	21	30
Cash, June 30	$ 28,426	$ 26,725

TENNESSEE STATE SCHOOL BOND AUTHORITY
COMPARATIVE STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2001, AND JUNE 30, 2000

(Expressed in Thousands)

	Year Ended June 30, 2001	Year Ended June 30, 2000
Reconciliation of operating income to net cash used by operating activities:		
Operating income	$ 1,297	$ 1,137
Adjustments to reconcile operating income to net cash used by operating activities:		
Amortization of bond issuance costs	135	94
Investment income	(2,624)	(2,111)
Interest expense	20,605	17,625
Subsidy to borrowers	1,655	1,372
Interest income from loans	(21,466)	(17,953)
Changes in assets and liabilities:		
Decrease in receivable from borrowers	82	96
Increase in accrued liabilities	26	-
Decrease in deferred revenue	(196)	(355)
Total adjustments	(1,783)	(1,232)
Net cash used by operating activities	$ (486)	$ (95)
Noncash financing activities:		
Accretion of capital appreciation bonds	$ 1,329	$ 1,445
Bond issuance costs	776	365
Defeasance of bonds by third party (Note 5)	-	52,850
Total noncash financing activities	$ 2,105	$ 54,660

The notes to the financial statements are an integral part of this statement.

Tennessee State School Bond Authority
Notes to the Financial Statements
June 30, 2001, and June 30, 2000

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Reporting Entity

The Tennessee State School Bond Authority (the Authority) was created to provide a mechanism for financing capital projects for the state's higher education institutions. In addition, during 1999, the General Assembly empowered the Authority to issue Qualified Zone Academy Bonds (QZABs) for financing improvement projects to local government education authorities pursuant to the federal program authorized in the Tax Payer Relief Act of 1997.

The Authority is a component unit of the State of Tennessee (the State) and a separate legal entity. In accordance with the Governmental Accounting Standards Board's (GASB) Statement No. 14, *The Financial Reporting Entity*, the Authority is discretely presented in the *Tennessee Comprehensive Annual Financial Report* because the Authority's board consists of state officials and, therefore, the state has the ability to affect the day-to-day operations of the Authority.

Basis of Presentation

The accompanying financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. The Tennessee State School Bond Authority follows all applicable GASB pronouncements as well as applicable private sector pronouncements issued on or before November 30, 1989.

Measurement Focus and Basis of Accounting

The accompanying financial statements have been prepared using the accrual basis of accounting and the flow of economic resources measurement focus. Under this basis, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

Investments

Investments are stated at fair value.

Amortized Amounts

A. Bond Issuance Costs. The Authority amortizes bond issuance costs using the straight-line method over the life of the bonds. Unamortized bond issuance costs are reported as deferred charges.

B. Bond Discounts, Premiums, and Deferred Amount on Refundings. The Authority amortizes bond discounts and premiums using the straight-line method over the life of the bonds. The deferred amount on refundings is amortized using the straight-line method over the remaining life of the old debt or the life of the new debt, whichever is shorter. Bonds payable are reported net of the applicable unamortized bond discount or premium and the unamortized deferred amount on refundings.

   Amortization of bond discount, premium, and deferred amount on refundings is reported with bond interest expense in the financial statements.

C. Accretion. The difference between the face amount of College Saver Bonds (capital appreciation bonds) and the public offering price is not treated as bond discount. Capital appreciation bonds are subject to redemption at prices which increase from the initial public offering price to the face amount. The carrying amount of these bonds is adjusted semi-annually and at June 30 to reflect the increased liability, with a corresponding charge to interest expense.

D. Deferred Revenue. When the Authority issues bonds to finance capital projects, the par amount of the bonds is adjusted by certain amounts (such as bond discount/premium, underwriters' fees, and other costs of issuance) in order to arrive at the amount of bond proceeds available for capital expenditures. These amounts, discussed above, are capitalized and amortized pursuant to accounting principles generally accepted in the United States of America. A similar situation arises when accounting for the loans to the higher education institutions and local government education authorities. Because of the adjustments mentioned above (discount, costs of issuance, etc.), the principal amount of the loan differs from the actual amount of funds available for capital expenditures. Because the higher education institutions and the local government education agencies bear the cost of this difference, it is carried on the balance sheet as deferred revenue and amortized on a straight-line basis over the life of the related bond.

   The Authority requires the higher education institutions to contribute funds to the Interest Rate Reserve Fund based on the amount of outstanding commercial paper.

The principal of the Interest Rate Reserve Fund is credited back to the institution as commercial paper is redeemed. The Interest Rate Reserve Fund is reported on the balance sheet as deferred revenue and is not amortized.

Reclassifications

Effective June 30, 2001, the Authority discontinued reporting warrants payable as a liability on the balance sheet. The issuance of warrants, rather than the subsequent acceptance by the treasurer of the warrants, is deemed to effectively reduce the cash balance. The June 30, 2000, warrants payable amount previously reported has been reclassified against the cash balance for comparative purposes.

Effective June 30, 2001, the Authority discontinued reporting the amount equal to the interest portion of the maximum annual debt requirement in the Debt Service Fund as deferred revenue on the balance sheet. These funds which were paid by the higher education institutions should effectively reduce the loans receivable balance. The prior year's amount equal to the interest portion of the maximum annual debt requirement included in deferred revenue has been reclassified against the loans receivable balance to be consistent with the current year's presentation.

The Authority has prepared the statements of cash flows using the direct method of reporting cash flows. The direct method presents the cash receipts and cash disbursements of the Authority for the year, including cash flows from operating activities. Operating activities are generally the cash effects of transactions and other events that enter into the determination of operating income. A reconciliation of the operating income to net cash flow from operating activities is also presented in this statement. The statement of cash flows for the year ended June 30, 2000, was previously presented using the indirect method of reporting cash flows. Under the indirect method, the operating income is reconciled to the net cash flow from operating activities, and nonoperating cash receipts and cash disbursements are presented. The June 30, 2000, statement has been restated using the direct method for comparative purposes.

The Authority has changed its accounting under the QZABs program for credits to local schools (borrowers). Under the QZABs first program bond resolution, interest earnings on unspent bond proceeds and the special trust fund (sinking fund) are to be credited to the borrowers. Thus, these earnings are reported as a direct reduction of the loans receivable. In the prior year, these earnings were reported as an expense—credits to local schools and all interest earnings as earned were reported by the

Authority. The prior-year credits to local schools have been eliminated and interest income has been reduced to be consistent with the current year's presentation.

In addition, certain other amounts have been reclassified for comparative purposes.

NOTE 2. DEPOSITS AND INVESTMENTS

Under the general bond resolutions of the Tennessee State School Bond Authority, the funds of the Authority can be invested in obligations of the State or United States government or obligations for which the principal and interest are guaranteed by the State or United States government; obligations of the United States or its agencies under flexible repurchase agreements which are fully collateralized by obligations of the United States or obligations the timely payment of the principal of and interest on which are guaranteed by the United States; the state investment pool; and any other investment authorized by the state investment policy adopted by the state funding board pursuant to *Tennessee Code Annotated*, Section 9-4-602.

Deposits

The Tennessee State School Bond Authority has cash on deposit in the Pooled Investment Fund administered by the State Treasurer. The fund's investment policy and custodial credit risk are presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 2001, and June 30, 2000.

The Tennessee State School Bond Authority also has cash on deposit with the fiscal agent. Until December 10, 2000, these deposits were held in a financial institution which participates in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts are pledged in the aggregate rather than against each individual account. The members of the pool may be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure. After December 10, 2000, these deposits were in financial institutions that do not participate in the bank collateral pool. All bank balances were insured.

Investments

Investments are categorized to indicate the level of custodial risk assumed by the Authority at year-end. Category 1 includes investments that are insured or registered or for which the securities are held by the Authority or its agent in the Authority's name. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the Authority's name. Category 3 includes uninsured and unregistered investments for which the securities are held by the counterparty or by its trust department or agent but not in the Authority's name.

Authority investments at June 30, 2001, are categorized below (expressed in thousands):

	Category		
	1	2	3
Federal Home Loan Bank Notes	$ 719	$ -	$ -
Federal Home Loan Bank Discount Notes	14,548	-	-
Total investments	$ 15,267	$ -	$ -

Authority investments at June 30, 2000, are categorized below (expressed in thousands):

	Category		
	1	2	3
Federal Home Loan Bank Discount Notes	$ 14,725	$ -	$ -

NOTE 3. LOANS TO HIGHER EDUCATION INSTITUTIONS

The Authority has entered into a financing agreement with both the Board of Trustees of the University of Tennessee (the Board of Trustees) and the Tennessee Board of Regents of the State University and Community College System of the State of Tennessee (the Tennessee Board of Regents). Each agreement is dated November 1, 1997, as amended. Under the agreement, the Authority agrees to finance construction projects for the Board of Trustees or the Tennessee Board of Regents. Annual financing charges payable under the agreement must be sufficient to pay the debt service of the notes and bonds of the Authority and the costs of administering the programs.

NOTE 4. RESTRICTED ASSETS

Cash and Investments

The first program bond resolution of the QZABs requires the establishment of a special trust fund, the bond fund (or sinking fund) account. These accounts represent the funds set aside to redeem the QZABs at maturity.

The General Higher Education Facilities Bond Resolution (the First Program) requires that an amount equal to the maximum annual debt service requirement be placed in a debt service reserve account with the trustee. The first general bond resolution is effective for all bonds issued prior to 1998.

The Higher Education Facilities Second Program General Bond Resolution, effective for all bonds issued in 1998 and thereafter, permits the Authority to satisfy the debt service reserve requirement by maintaining a Reserve Fund Credit Facility. The Authority obtained a surety bond, constituting a Reserve Fund Credit Facility under the Resolution, in lieu of maintaining a debt service reserve fund for the 1998 Series A, B, C, and D and 2000 Series A and B bonds.

NOTE 5. DEBT PAYABLE

Higher Education Facilities Programs

A. Bonds. The bonds issued under the First and Second Program Higher Education Facilities Bond Resolutions constitute special obligations of the Authority. The First Program, which commenced in 1967, is no longer utilized, but any payments by the Boards thereunder will be superior to the Boards' payments under the Second Program Higher Education Facilities Bond Resolution. The principal, Sinking Fund Installments, if any, and Redemption Price of and interest on the bonds are payable solely from the Annual Financing Charges, Legislative Appropriations, and other moneys and securities held or set aside under the Resolutions.

B. Commercial Paper. The Commercial Paper constitutes a special obligation of the Authority. Principal of and interest on the Commercial Paper is payable from the following sources: (i) as to principal only, the proceeds of the sale of Commercial Paper issued to pay the principal of other outstanding Commercial Paper, (ii) the proceeds of draws on the Liquidity Facility, (iii) available revenues, (iv) the moneys and securities (if any) on deposit in the Reimbursement Fund and in the Debt Service Fund, (v) the moneys and securities (if any) on deposit in the Project Construction Account for such projects, and (vi) the proceeds of bonds or notes issued to make such payments.

Qualified Zone Academy Bonds Program

On September 9, 1999, the Authority adopted a Qualified Zone Academy Bond Resolution authorizing the issuance of Qualified Zone Academy Bonds to local governments for the purpose of financing eligible costs of certain projects. The State Department of Education recommends the projects to the Authority that should be funded under the QZABs program. The Taxpayer Relief Act of 1997 provided this financial tool whereby interest on QZABs is paid by the federal government in the form of an annual tax credit to the financial institutions that hold the QZABs. The bonds are not general obligations of the State of Tennessee and are secured by the general obligation pledge of the local jurisdiction and the state-shared taxes of the local jurisdiction.

Bonds and commercial paper payable at June 30, 2001, and June 30, 2000, are as follows (expressed in thousands):

	June 30, 2001	June 30, 2000
Bonds Payable:		
1967 Series A at an interest rate of 4.10% maturing to 2007	$ 6,030	$ 7,760
1976 Series B at an interest rate of 3.0% maturing to 2011	2,070	2,291
1987 Refunding Series A at an interest rate of 4% maturing in 2012	1,170	1,170
1989 Current Interest Bonds at an interest rate of 7% maturing in 2020 and 1989 College Saver Bonds with yields of 6.7% to 6.9% maturing to 2010 (at accreted value)	18,212	19,643
1996 Series A at interest rates from 5.0% to 6.0% maturing to 2026	76,415	78,935
1996 Refunding Series B at interest rates from 5.0% to 6.0% maturing to 2011	11,610	12,830
1996 Refunding Series C at interest rates from 5.375% to 6.0% maturing to 2020	4,045	4,045
1998 Series A at interest rates from 4.30% to 5.00% maturing to 2028	52,435	53,675
1998 Series B (Taxable) at interest rates from 5.80% to 6.70% maturing to 2028	15,080	15,325
1998 Refunding Series C at interest rates from 3.65% to 5.00% maturing to 2014	31,120	36,300
1998 Refunding Series D at interest rates from 3.65% to 4.85% maturing to 2021	27,350	29,275

	June 30, 2001	June 30, 2000
2000 Series A at interest rates from 4.625% to 5.625% maturing to 2030	69,930	-
2000 Series B at interest rates from 6.50% to 7.75% maturing to 2020	33,460	-
Qualified Zone Academy Bonds non-interest bearing maturing in 2011	13,290	13,290
Total Par Amount of Bonds Payable	362,217	274,539
Plus Unamortized Premium/Less Unamortized Discount	(403)	17
Bonds Payable Net of Unamortized Premium/ Discount	361,814	274,556
Less: Deferred Amount on Refundings	(2,589)	(2,742)
Net Bonds Payable	$ 359,225	$ 271,814
Commercial paper, variable rate	$ 60,277	$ 102,700

Debt service requirements to maturity of the bonds payable at June 30, 2001, are as follows:

For the Year(s) Ending June 30	Principal	Interest	Total
2002	$ 18,736	$ 19,267	$ 38,003
2003	18,075	18,490	36,565
2004	18,861	17,718	36,579
2005	16,381	16,863	33,244
2006	14,277	16,137	30,414
2007-2030	265,670	157,454	423,124
Total	$ 352,000	$ 245,929	$ 597,929

The above principal for bonds is less than that presented on the accompanying financial statements by $7.225 million. Of this amount, $9.814 million represents accretion to date on the unmatured portion of the 1989 College Saver Bonds. This accretion has been reported as bond principal in the accompanying financial statements. In the debt service schedule above, however, it has been reported as interest in the years (2002-2010) in which the bonds mature. The $7.225 million also includes $2.589 million, representing the deferred amount on bond refundings. This amount is presented as a deduction from bonds payable in the accompanying financial statements but is not reflected in the debt service schedule above.

On November 30, 1999, the Authority issued $13,290,000 of Qualified Zone Academy Bonds (QZABs) to finance improvement loans for qualifying primary and secondary (K-12) schools in the state. The bonds are part of a federal government program administered by the Tennessee Department of Education in which a federal tax credit is given to investors in lieu of interest on the bonds. On each November 30, the QZAB borrowers make annual principal payments into a bond fund held by the State Treasurer to pay the bonds at maturity on November 30, 2011.

On July 16, 1999, the University of Tennessee (the University) transferred its sole ownership in UHS Ventures, Inc., a component unit formerly known as University Health System, Inc., to a newly formed 501(c) 3 corporation also named University Health System, Inc. On July 29, 1999, the University transferred ownership and control of its hospital, UT Memorial Research Center and Hospital located in Knoxville, Tennessee, to University Health Systems, Inc. (UHS). In conjunction with the University's hospital conversion, the Authority defeased $96,400,000 of commercial paper and $52,850,000 of bonds on July 29, 1999. The bonds included $4,080,000 of 1987 Series A, $1,605,000 of 1990 Series A, $11,290,000 of 1996 Series A, $31,475,000 of 1996 Series B and $4,400,000 of 1996 Series D. Defeasance of the bonds resulted in a difference of $809,585 between the reacquisition price and the net carrying amount of the old debt adjusted for unamortized deferred revenue. This difference is reported on the financial statements as a loss on extinquishment of debt.

On May 1, 2000, the Authority liquidated $4,375,000 of crossover refunding investments to call $4,310,000 of 1990 Series B Bonds. Call premiums of $64,650 were paid on the refunding. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the refunded debt of $120,066, which is reported as a loss on extinguishment of debt. The 1996 Series D crossover refunding bonds were defeased in conjunction with the University hospital conversion.

On November 1, 2000, the Authority issued two series of bonds. The 2000 Series A tax-exempt bonds in the amount of $70,680,000 were issued to redeem $67,500,000 of the Authority's tax-exempt commercial paper, and the 2000 Series B taxable bonds in the amount of $33,730,000 were issued to redeem $19,400,000 of the Authority's taxable commercial paper. The balance of the proceeds was used to pay for new construction projects and various costs of issuance.

Prior-Year Defeasance of Debt

In prior years, certain Authority bonds were defeased by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Authority's financial statements. On June 30, 2001, $82,610,000 of bonds outstanding are considered defeased.

Commercial Paper Program

The Tennessee State School Bond Authority issues short-term debt to finance certain capital projects for the State of Tennessee's higher education institutions. The Authority approved an increase in the maximum principal amount authorized from $150,000,000 to $200,000,000 on January 7, 1999, in anticipation of funding the construction projects that would be related to the University of Tennessee sale of assets to the non-profit corporation. On October 14, 1999, the Authority approved a reduction in the maximum principal amount authorized from $200,000,000 to $150,000,000. Commercial paper may be issued as tax-exempt or as taxable. At the program's inception, commercial paper refinanced certain outstanding bond anticipation note indebtedness that the Authority had previously issued to finance capital projects. The commercial paper dealer is J.P. Morgan & Co. At June 30, 2001, $60,277,000 of tax-exempt commercial paper was outstanding. At June 30, 2000, $102,700,000 of commercial paper was outstanding ($89,300,000 of tax-exempt and $13,400,000 of federally taxable commercial paper).

The maturity of the paper may not exceed 270 days, and the maximum interest rate may not exceed 12%. Upon maturity, the paper is remarketed by the commercial paper dealer, redeemed, or extinguished with long-term debt. The commercial paper bears interest at a variable rate that is paid upon maturity.

The commercial paper liquidity provider, under an Advance Agreement, is *Westdeutsche Landesbank Girozentrale*, New York branch. The total available commitment is $152,250,000. The obligation of *Westdeutsche Landesbank Girozentrale* is to purchase unremarketed commercial paper.

NOTE 6. DEFERRED REVENUE

Deferred revenue at June 30, 2001, and June 30, 2000, is as follows (expressed in thousands):

	June 30, 2001	June 30, 2000
Interest Rate Reserve Fund	$ 244	$ 477
Difference in bond proceeds available for capital expenditure and the par value of bonds to be repaid—adjustments for discount/premium, underwriters' fees, and other costs of issuance:		
1996 Series A bonds; amortized through 2026	587	610
1996 Series B bonds; amortized through 2011	450	495
1996 Series C bonds, which was a cross-over refunding of the 1989 Current Interest Bonds; amortized through 2020	148	156
1998 Series A bonds; amortized through 2028	621	645
1998 Series B bonds; amortized through 2028	202	209
1998 Series C bonds; amortized through 2014	251	270
1998 Series D bonds, which was an advance refunding of the 1992 Series A bonds; amortized through 2021	2,778	2,918
1999 Qualified Zone Academy Bonds; amortized through 2012	382	419

2000 Series A bonds; amortized through 2030		902		-
2000 Series B bonds; amortized through 2020	$	223	$	-
Total	$	6,788	$	6,199

NOTE 7. CHANGE IN ACCOUNTING PRINCIPLE

As of July 1, 2000, the Authority implemented GASB Statement No. 33, *Accounting and Financial Reporting for Nonexchange Transactions*. Certain interest earnings of the Authority that are credited to the borrowers are considered voluntary nonexchange transactions. Prior to implementation of GASB No. 33, these amounts were reported as a reduction of Revenue from Loans in the financial statements. With the implementation of GASB No. 33, these amounts are reported as an expense—subsidy to borrowers. The effect of this change on the prior-year financial statements had no impact on net income; however, revenue from loans was increased in the amount of $1,372,049, and a corresponding expense for the subsidy to borrowers is reported in the Statement of Revenues, Expenses, and Changes in Retained Earnings. In addition, on the Statement of Cash Flows, the prior-year interest received on loans was increased by $1,372,049, and the subsidy paid to borrowers is reported in the corresponding amount.

NOTE 8. SUBSEQUENT EVENTS

On October 31, 2001, the Authority had outstanding $74,277,000 in tax-exempt commercial paper. Between June 30, 2001, and October 31, 2001, the Authority has issued $15,600,000 in commercial paper to pay construction expenditures.

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY BALANCE SHEETS - PROGRAM LEVEL
JUNE 30, 2001, AND JUNE 30, 2000

	June 30, 2001			June 30, 2000		
	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total
Assets						
Current assets:						
Cash	$ 21,094,663	$ 6,439,856	$ 27,534,519	$ 13,382,313	$ 13,312,451	$ 26,694,764
Cash with fiscal agent	21,001	-	21,001	29,862	-	29,862
Investments with fiscal agent	33,703	-	33,703	53,518	-	53,518
Loans receivable	20,069,806	443,874	20,513,680	16,893,846	-	16,893,846
Interest receivable	2,996,372	5,702	3,002,074	2,632,833	-	2,632,833
Receivable from borrowers	187,640	3,103	190,743	272,589	-	272,589
Total current assets	44,403,185	6,892,535	51,295,720	33,264,961	13,312,451	46,577,412
Restricted assets:						
Cash	-	870,875	870,875	-	-	-
Investments	14,513,935	718,760	15,232,695	14,672,017	-	14,672,017
Total restricted assets	14,513,935	1,589,635	16,103,570	14,672,017	-	14,672,017
Other assets:						
Loans receivable	362,536,338	4,828,026	367,364,364	326,748,813	-	326,748,813
Deferred charges	2,459,788	255,372	2,715,160	1,831,513	279,888	2,111,401
Total other assets	364,996,126	5,083,398	370,079,524	328,580,326	279,888	328,860,214
Total assets	$ 423,913,246	$ 13,565,568	$ 437,478,814	$ 376,517,304	$ 13,592,339	$ 390,109,643
Liabilities and Equity						
Liabilities:						
Current liabilities:						
Accrued liabilities	$ 26,301	$ -	$ 26,301	$ -	$ -	$ -
Payable to borrowers	-	-	-	-	5,320	5,320
Accrued interest payable	3,136,383	-	3,136,383	2,661,182	-	2,661,182
Commercial paper payable	60,277,000	-	60,277,000	102,700,000	-	102,700,000
Bonds payable	20,069,806	-	20,069,806	16,893,846	-	16,893,846
Deferred revenue	6,405,597	381,945	6,787,542	5,779,780	418,611	6,198,391
Total current liabilities	89,915,087	381,945	90,297,032	128,034,808	423,931	128,458,739
Noncurrent liabilities:						
Net bonds payable	325,979,932	13,174,636	339,154,568	241,756,852	13,163,561	254,920,413
Total liabilities	415,895,019	13,556,581	429,451,600	369,791,660	13,587,492	383,379,152
Equity:						
Retained earnings, unreserved	8,018,227	8,987	8,027,214	6,725,644	4,847	6,730,491
Total liabilities and equity	$ 423,913,246	$ 13,565,568	$ 437,478,814	$ 376,517,304	$ 13,592,339	$ 390,109,643

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY STATEMENTS OF REVENUES,
EXPENSES, AND CHANGES IN RETAINED EARNINGS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2001, AND JUNE 30, 2000

	Year ended June 30, 2001			Year ended June 30, 2000		
	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total
OPERATING REVENUES						
Revenue from loans	$ 21,672,501	$ 39,769	$ 21,712,270	$ 18,543,625	$ 21,389	$ 18,565,014
Interest income	1,596,616	-	1,596,616	1,154,586	4,204	1,158,790
Net increase in the fair value of investments	1,027,746	-	1,027,746	952,486	-	952,486
Total operating revenues	24,296,863	39,769	24,336,632	20,650,697	25,593	20,676,290
OPERATING EXPENSES						
Interest expense-commerical paper	3,364,797	-	3,364,797	3,699,084	-	3,699,084
Interest expense-bonds	17,229,160	11,075	17,240,235	13,919,746	6,445	13,926,191
Subsidy to borrowers	1,655,296	-	1,655,296	1,372,049	-	1,372,049
Administrative expense	644,551	38	644,589	447,662	-	447,662
Amortization of bond issuance costs	110,476	24,516	134,992	79,378	14,301	93,679
Total operating expenses	23,004,280	35,629	23,039,909	19,517,919	20,746	19,538,665
Operating income	1,292,583	4,140	1,296,723	1,132,778	4,847	1,137,625
EXTRAORDINARY ITEM						
Loss on extinguishment of debt	-	-	-	929,640	-	929,640
Net income	1,292,583	4,140	1,296,723	203,138	4,847	207,985
Retained earnings, July 1	6,725,644	4,847	6,730,491	6,522,506	-	6,522,506
Retained earnings, June 30	$ 8,018,227	$ 8,987	$ 8,027,214	$ 6,725,644	$ 4,847	$ 6,730,491

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY STATEMENTS OF CASH FLOWS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2001, AND JUNE 30, 2000

	Year Ended June 30, 2001			Year Ended June 30, 2000		
	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total
Cash flows from operating activities:						
Receipts from customers and users	$ 328,261	$ -	$ 328,261	$ 707,749	$ 22	$ 707,771
Payments to suppliers	(618,251)	(38)	(618,289)	(447,662)	(6)	(447,668)
Receipts from borrowers to the Interest Rate Reserve Fund	6,177,609	-	6,177,609	168,256		168,256
Payments to borrowers from the Interest Rate Reserve Fund	(6,373,795)	-	(6,373,795)	(523,380)		(523,380)
			-			
Net cash provided (used) by operating activities	(486,176)	(38)	(486,214)	(95,037)	16	(95,021)
Cash flows from noncapital financing activities:						
Proceeds from sale of bonds	104,117,581	-	104,117,581	-	12,924,525	12,924,525
Proceeds from sale of commercial paper	45,050,000	-	45,050,000	37,050,000	-	37,050,000
Payments for escrow	-	-	-	(5,996,492)	-	(5,996,492)
Bond issuance costs paid	(314,955)	-	(314,955)	-	(61,614)	(61,614)
Call premiums paid	-	-	-	(64,650)	-	(64,650)
Principal payments - bonds and commercial paper	(105,534,000)	-	(105,534,000)	(117,625,000)	-	(117,625,000)
Interest payments - bonds and commercial paper	(19,200,092)	-	(19,200,092)	(16,964,257)	-	(16,964,257)
Subsidy to borrowers	(1,690,250)	-	(1,690,250)	(1,372,049)	-	(1,372,049)
Net cash provided (used) by noncapital financing activities	22,428,284	-	22,428,284	(104,972,448)	12,862,911	(92,109,537)
Cash flows from investing activities:						
Purchases of investments	(67,989,357)	(702,702)	(68,692,059)	(34,061,963)	-	(34,061,963)
Proceeds from sales and maturities of investments	69,195,000	-	69,195,000	46,448,132	-	46,448,132
Interest received on investments	1,596,616	-	1,596,616	1,220,946	4,207	1,225,153
Loans issued	(54,943,486)	(6,444,405)	(61,387,891)	(48,445,029)	-	(48,445,029)
Collections of loan principal	18,460,364	1,145,425	19,605,789	112,801,909	445,317	113,247,226
Interest received on loans	19,442,244	-	19,442,244	16,369,531	-	16,369,531
Net cash provided (used) by investing activities	(14,238,619)	(6,001,682)	(20,240,301)	94,333,526	449,524	94,783,050
Net increase (decrease) in cash	7,703,489	(6,001,720)	1,701,769	(10,733,959)	13,312,451	2,578,492
Cash, July 1	13,412,175	13,312,451	26,724,626	24,146,134	-	24,146,134
Cash, June 30	$ 21,115,664	$ 7,310,731	$ 28,426,395	$ 13,412,175	$ 13,312,451	$ 26,724,626
Reconciliation of cash to the balance sheet:						
Cash	$ 21,094,663	$ 6,439,856	$ 27,534,519	$ 13,382,313	$ 13,312,451	$ 26,694,764
Cash - restricted	-	870,875	870,875	-	-	-
Cash with fiscal agent	21,001	-	21,001	29,862	-	29,862
			-			
Cash, June 30	$ 21,115,664	$ 7,310,731	$ 28,426,395	$ 13,412,175	$ 13,312,451	$ 26,724,626
Reconciliation of operating income to net cash used by operating activities:						
Operating income	$ 1,292,583	$ 4,140	$ 1,296,723	$ 1,132,778	$ 4,847	$ 1,137,625
Adjustments to reconcile operating income to net cash provided (used) by operating activities:						
Amortization of bond issuance costs	110,476	24,516	134,992	79,378	14,301	93,679
Investment income	(2,624,362)	-	(2,624,362)	(2,107,072)	(4,204)	(2,111,276)
Interest expense	20,593,957	11,075	20,605,032	17,618,830	6,461	17,625,291
Subsidy to borrowers	1,655,296	-	1,655,296	1,372,049	-	1,372,049
Interest income from loans	(21,429,190)	(36,666)	(21,465,856)	(17,931,836)	(21,389)	(17,953,225)
Changes in assets and liabilities:						
Decrease in receivable from borrowers	84,949	(3,103)	81,846	95,960	-	95,960
Increase in accrued liabilities	26,301	-	26,301	-	-	-
Decrease in deferred revenue	(196,186)	-	(196,186)	(355,124)	-	(355,124)
			-			
Total adjustments	(1,778,759)	(4,178)	(1,782,937)	(1,227,815)	(4,831)	(1,232,646)
Net cash provided (used) by operating activities	$ (486,176)	$ (38)	$ (486,214)	$ (95,037)	$ 16	$ (95,021)
Noncash financing activities:						
Accretion of capital appreciation bonds	$ 1,328,964	$ -	$ 1,328,964	$ 1,445,156	$ -	$ 1,445,156
Bond issuance costs	775,947	-	775,947	-	365,475	365,475
Defeasance of bonds by third party	-	-	-	52,850,000	-	52,850,000
			-			
Total noncash financing activities	$ 2,104,911	$ -	$ 2,104,911	$ 54,295,156	$ 365,475	$ 54,660,631