Tennessee State School Bond Authority

For the Year Ended
June 30, 2002

Arthur A. Hayes, Jr., CPA, JD, CFE
Director

Edward Burr, CPA
Assistant Director

Elizabeth M. Birchett, CPA
Audit Manager

Donna L. Jewell, CPA, CFE
In-Charge Auditor

Robyn Probus, CFE
Staff Auditor

Gerry C. Boaz, CPA
Technical Analyst

Amy Brack
Editor

Comptroller of the Treasury, Division of State Audit
1500 James K. Polk Building, Nashville, TN 37243-0264
(615) 401-7897

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

John G. Morgan
Comptroller

April 1, 2003

The Honorable Phil Bredesen, 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, 2002. 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 disclosed certain deficiencies, which are detailed in the Results of the Audit section of this report. The authority's management has responded to the audit finding; the response is included following the finding. The Division of State Audit will follow up the audit to examine the application of the procedures instituted because of the audit finding.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/th
02/091

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, 2002

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 (including the bond resolutions); to determine the fairness of the presentation of the financial statements; and to recommend appropriate actions to correct any deficiencies.

AUDIT FINDING

INTERNAL CONTROL FINDING

The Qualified Zone Academy Bond Program Does Not Have Adequate Controls
There are no written procedures outlining the responsibilities concerning the administration of the Qualified Zone Academy Bond Program. In addition, the controls over the program are not adequate (page 7).

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, 2002

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Tennessee State School Bond Authority
For the Year Ended June 30, 2002

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. To date, the authority has not issued debt to fund a student loan program. 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, 2001, through June 30, 2002, and was conducted 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. Financial statements are presented for the year ended June 30, 2002, and for comparative purposes, the year ended June 30, 2001. The Tennessee State School Bond has been included as a component unit in the *Tennessee Comprehensive Annual Financial Report*.

OBJECTIVES OF THE AUDIT

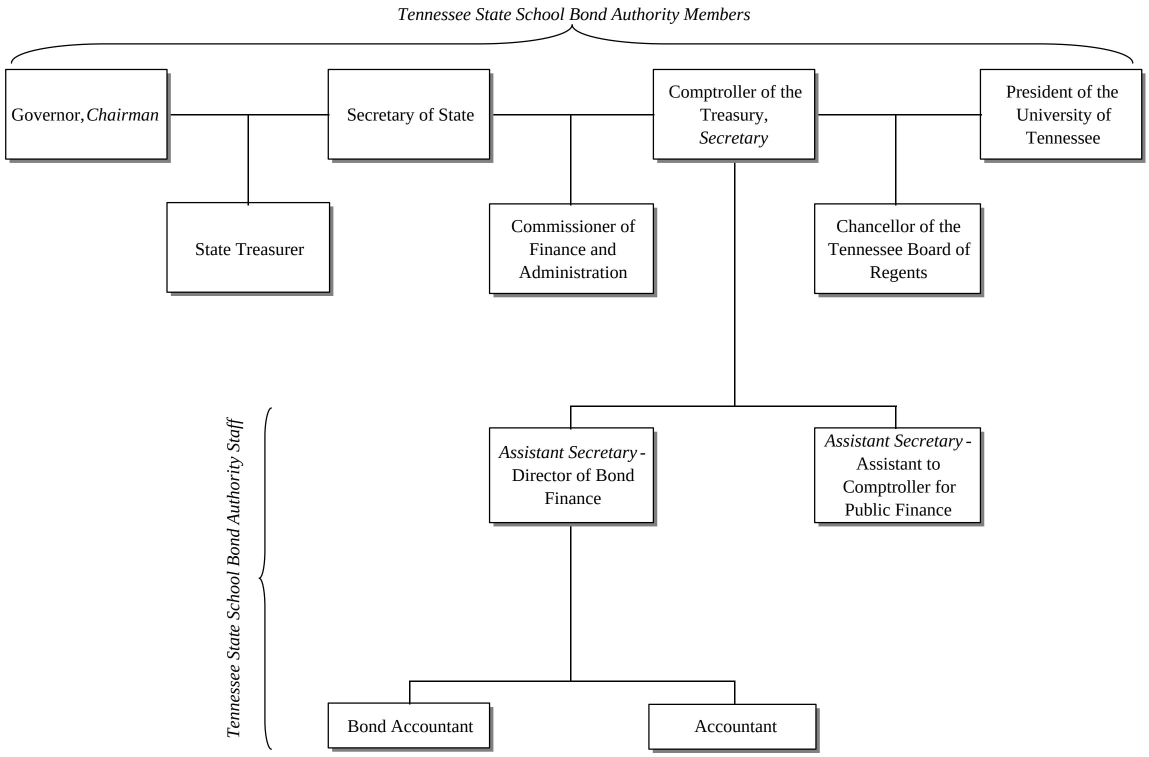
The objectives of the audit were

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 (including the bond resolutions);
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, 2002, 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 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. A reportable condition, along with the recommendation and management's response, is detailed in the finding and recommendation. 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.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

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

December 13, 2002

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, 2002, and have issued our report thereon dated December 13, 2002. As discussed in Note 1 to the financial statements, the Tennessee State School Bond Authority implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments.* 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.

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 (including the bond resolutions), 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*.

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. However, we noted a matter involving the internal control over financial reporting and its operation that we consider to be a reportable condition. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the authority's ability to record, process, summarize, and report financial data consistent with management's assertions in the financial statements.

The reportable condition noted was that the Qualified Zone Academy Bond Program does not have adequate controls. This condition is described in the Finding and Recommendation section of this report.

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. Our consideration of the internal control over financial reporting would not necessarily disclose all matters in the internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. However, we believe the reportable condition described above is not a material weakness.

We also noted other matters involving the internal control over financial reporting, which we have reported to the authority's management in a separate letter.

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/th

FINDING AND RECOMMENDATION

1. <u>The Qualified Zone Academy Bond Program does not have adequate controls</u>

Finding

Neither the Tennessee Department of Education (the Department) nor the Tennessee State School Bond Authority (the Authority) has developed written procedures outlining the responsibilities of each entity concerning the administration of the Qualified Zone Academy Bond Program (QZAB), a federal program designed to issue bonds to provide zero-interest loans to qualifying local public school systems. The bondholders receive a tax credit in lieu of interest payments. Due to the tax implications, Section 1397E of the Internal Revenue Code (IRC) established and regulates this program. In order for a local public school system to be considered to be eligible for this program, it must qualify as a Qualified Zone Academy. As defined by the IRC, a Qualified Zone Academy must meet several criteria, including having the expectation that 35 percent or more of the students within the school qualify for the free or reduced-cost lunch program. The IRC also establishes restrictions for the use of bond proceeds and requires involvement from the community in which the academy is located. On the state-level, the QZAB program is administered jointly by the Department and the Authority. Bond proceeds are distributed to the borrowers on a reimbursement basis. The borrowers (mostly county or city public schools) make qualified expenses, provide documentation to the Department, and are reimbursed by the Authority. Section 49-3-1206 (d) (1), *Tennessee Code Annotated,* states that the Department and the Authority "shall develop the application and review procedure for loans under the program." Based on our review, controls over the QZAB program are not adequate and as a result, several problems were noted.

Complete applicant files are not maintained for the approved loans. In the file of one of the ten approved loans, the loan that was awarded per the official bond documents was $5 million. However, the requested loan amount on the application on file was $2.5 million, only half of the amount eventually awarded the borrower. Documentation to support the increased loan amount was not available.

Errors were also noted in the reimbursement requests paid by the Authority. For four of ten reimbursement requests tested (40%), invoices were missing, inadequate, or not properly computed. For two of these items, the requests slightly exceeded the total of the supporting invoices. One request exceeded the attached invoices by $6.90, while the other request exceeded the attached invoices by $466.11. One request contained 30 documents apparently generated internally from the borrower's accounting system rather than vendor invoices. These documents were the only support provided for the $9,650.82 expense that was reimbursed by the Authority. Furthermore, the copy of the attached vendor invoices for another request did not include all line items on the original invoice; therefore, the mathematical accuracy of the request could not be tested. The missing invoices totaled $103.60.

The incorrect object code was used to process the reimbursement requests in the State of Tennessee accounting system. The object code for Construction of Buildings (new construction and additions) was used although new construction is specifically prohibited by federal and state QZAB regulations. Based on our review of the vendor invoices, other object codes would have been more accurate. The types of expenses noted did not appear to be prohibited by QZAB regulations. In addition, the form used when submitting reimbursement requests requires the signature of the local official responsible for the project before submission to the Director of Local School Finance at the Tennessee Department of Education. The local official responsible for the project did not sign the request in one of the ten requests tested (10%).

Recommendation

The Tennessee State School Bond Authority and the Tennessee Department of Education should develop a written agreement defining the responsibilities of each entity. The Department, in conjunction with the Authority, should then develop policies and procedures outlining the guidelines to be followed with respect to the administration of the program. The guidelines should include sufficient procedures to ensure that the activities of the program are adequately controlled and documented. These guidelines should also include a comprehensive process to ensure that the requests are for qualified expenses and that these expenses are fully supported by vendor invoices. The process should ensure that the required approvals have been obtained prior to the reimbursement of loan funds. The guidelines should also ensure that the requests are coded correctly within the state's accounting system. Finally, complete files should be maintained on each borrower until the bonds are repaid.

Management's Comments

Tennessee State School Bond Authority:

We concur. We will work with the Department of Education to establish procedures and lines of responsibility relating to the administration of the program. We will also work with the Department of Finance and Administration to establish meaningful object codes for the types of invoices that we process.

Department of Education:

We concur. Guidelines will be developed defining the responsibilities of the Tennessee State School Bond Authority and the Department of Education. Policies and procedures will be developed outlining the administration of the program.

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
SUITE 1500
JAMES K. POLK STATE OFFICE BUILDING
NASHVILLE, TENNESSEE 37243-0264
PHONE (615) 401-7897
FAX (615) 532-2765

Independent Auditor's Report

December 13, 2002

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

Dear Mr. Morgan:

We have audited the accompanying statements of net assets of the Tennessee State School Bond Authority ("the Authority"), a component unit of the State of Tennessee, as of June 30, 2002, and June 30, 2001, and the related statements of revenues, expenses, and changes in net assets 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 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 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 Authority as of June 30, 2002, and June 30, 2001, and the changes in its financial position and cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 1 to the financial statements, the Authority implemented Governmental Accounting Standards Board Statement No. 34, *Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments*.

The management's discussion and analysis section is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board.

We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the required supplementary information. However, we did not audit the information and express no opinion on it.

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 34 through 36 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 December 13, 2002, 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 (including bond resolutions). 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., CPA,
Director

AAH/th

MANAGEMENT'S DISCUSSION AND ANALYSIS

As management of the Tennessee State School Bond Authority (the "Authority"), we offer readers of the Authority's financial statements this narrative overview and analysis of the financial activities of the Authority for the fiscal year ended June 30, 2002. These activities are compared to the results of the fiscal year ended June 30, 2001, in the financial statements.

Program Activity Highlights

The Authority's purpose is to provide loans to the State's higher education institutions and to local education agencies for the Qualified Zone Academy Bonds ("QZABs"). The table below summarizes this business activity.

	Higher Education Facilities Programs		Qualified Zone Academy Bond Program	
	2002	2001	2002	2001
Number of institutions with outstanding loans	12	11	9	7
Total number of outstanding loans	192	173	10	7
Total amount of outstanding loans	$ 416,263,828	$ 382,606,144	$ 9,484,761	$ 5,271,900
Number of loans approved in fiscal year	10	22	3	-
Amount of loans approved in fiscal year	$ 56,815,000	$ 53,065,000	$ 11,330,000	$ -
Amount of loans approved in fiscal year - unfunded	$ 55,358,652	$ 42,394,842	$ 10,588,577	$ -
Amount of loans paid in fiscal year	$ 56,609,920	$ 54,943,486	$ 4,646,695	$ 6,444,406
Amount of bonds issued in fiscal year	$ 119,135,000	$ 104,410,000	$ 11,330,000	$ -
Amount of commercial paper issued in fiscal year	$ 33,100,000	$ 45,050,000	$ -	$ -

The financial statements and the analysis provided in the remainder of this report reflect the financial results of this activity. For more specific financial information on long-term debt activity, see Note 5, Debt Payable, in the Notes to the Financial Statements.

Debt Administration

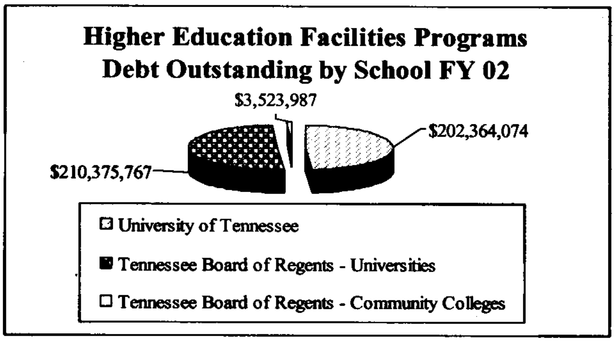
Pursuant to Section 49-3-1201 et seq., *Tennessee Code Annotated*, the General Assembly of the State created the Tennessee State School Bond Authority to issue bonds and notes to fund capital projects for the higher education institutions including both four-year institutions and two-year community colleges as well as to issue the QZABs on behalf of local education agencies throughout the State.

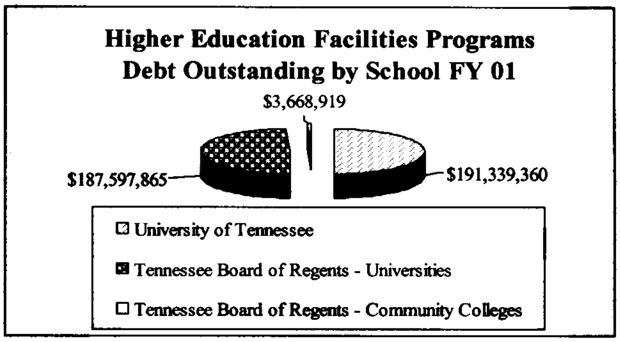
Higher Education Facilities Programs. A financial analysis of each loan is undertaken before it is approved by the Authority. Each higher education system must include in its annual budget sufficient funds to repay total debt service. This pledge is a gross revenue pledge of the institution and its system. The Authority is also authorized by statute to intercept the state appropriation to that institution and system if the institution fails to make timely debt service payments to the Authority.

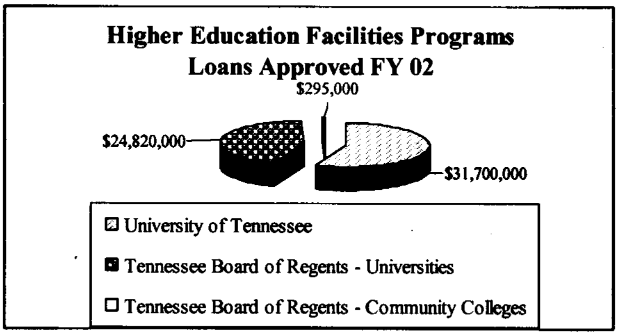
Under the financing program for higher education institutions, a project is generally funded through the Authority commercial paper program during its construction phase. When projects totaling $50 million or greater are completed or near completion, the Authority fixes the interest rate for the term of the project by issuing long-term debt. During the fiscal year 2002, commercial paper interest rates ranged from 1.2% to 3.0%. These rates were a function of the term of the commercial paper and a volatile capital market.

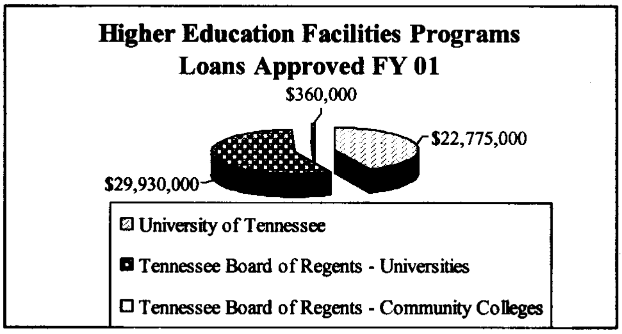
Liquidity for the commercial paper program is provided by an Advance Agreement with Westdeutsche Landesbank. The commitment fee is .195% paid quarterly in arrears. The Agreement expires on March 7, 2005. If the liquidity facility is called upon, the Authority has ninety days to repay the advance from the facility. Should the Authority fail to repay the loan within the ninety-day period, the loan converts to a term loan with the bank with four semi-annual payments. Thus, the commercial paper is reported as a long-term liability.

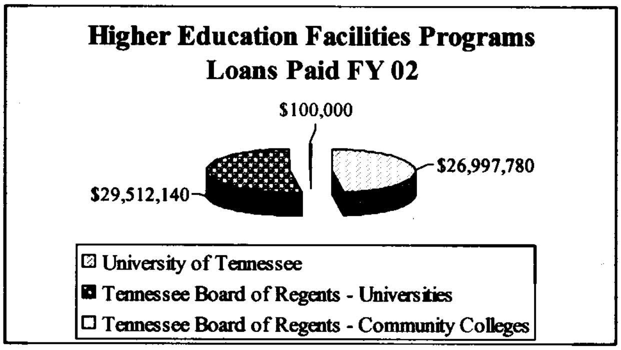
Interest rates on the higher educational facilities long-term fixed-rate bonds range from a low of 3.0% to a high of 7.75%. By pooling the financing of their capital needs, management believes that economic efficiencies of a single large borrowing administered by one agency were achieved. The creditworthiness of both large and small institutions is homogenized into one credit resulting in a lower cost of borrowing and providing a more equitable cost to students who repay the debt through their student debt service fees throughout the state. Additional benefits accrue to the higher education institutions and the two systems by having one point of debt issuance and administration for the entire state rather than multiple administrative offices.

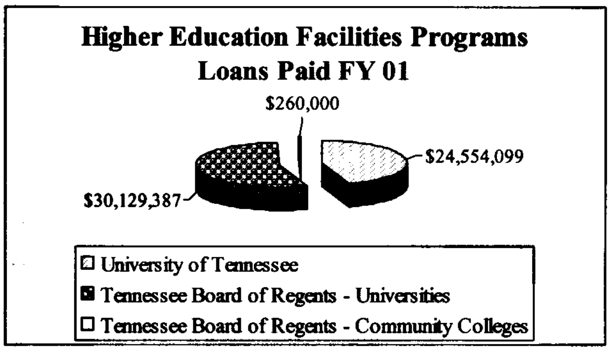








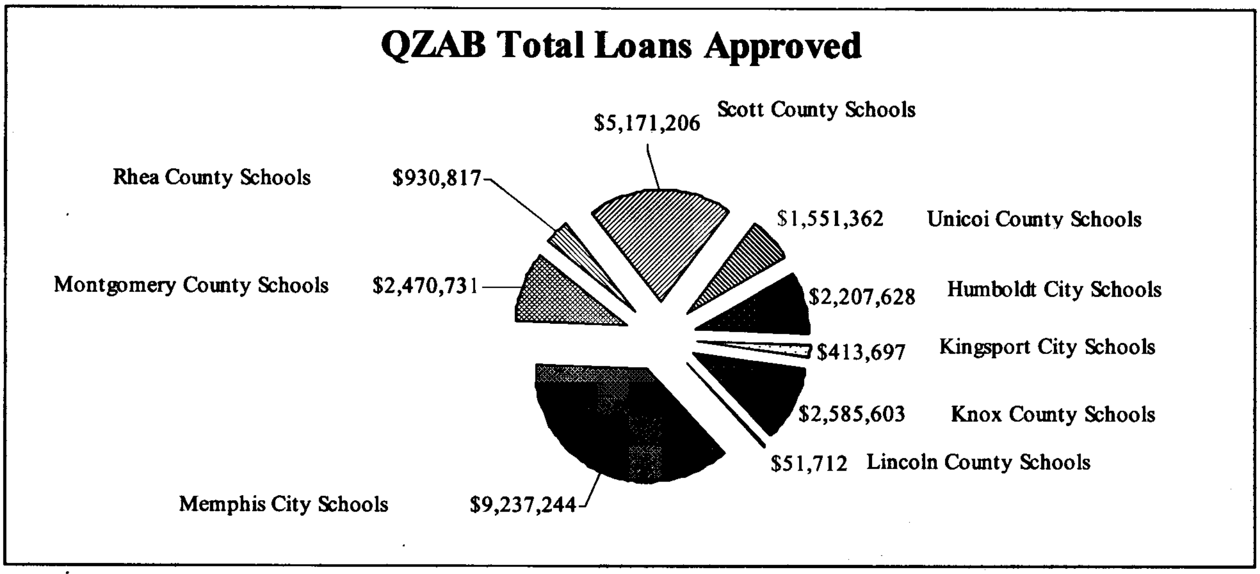




The Authority's higher education facilities program is rated AA, Aa3, and AA by Fitch, Moody's Investors Service and Standard & Poor's Rating Group, respectively. Fitch comments that the rating reflects the broad coverage provided by higher education fees and charges, the provision to intercept state appropriations and the State's intrinsic role in the Authority and its financings as the reason for the AA rating. Standard & Poor's also cites the broad pledge of fees and revenue, the intercept of the state appropriation and the underlying strong operating support as reasons for the AA rating. Moody's downgraded the Authority during the fiscal year to reflect the revision of the State's Aa2 general obligation bond rating. Moody's commented that the downgrade is largely due to the weakening of the State's credit fundamentals, with state funding serving as a significant source of operating support to Tennessee's higher education institutions.

Qualified Zone Academy Bond Program. The QZAB program is a capital financing program originally authorized by the federal government under the Taxpayer Relief Act of 1997, Section 227(a). A QZAB is a taxable bond issued by the State, whose proceeds are used to finance certain eligible public school's renovation and equipment purchases projects. During the time the bond is outstanding, an eligible holder of a QZAB is generally allowed annual federal income tax credits in lieu of receiving periodic interest payments from the issuer. These credits compensate the holder for lending money to the borrower and function as payments of interest on the bonds. The Tennessee Department of Education distributes the application for a QZAB allocation to all local education agencies in the State. The Department recommends those projects that best meet the requirements of the program to the Authority for funding.

The local education agencies and the city or county supporting the agency must provide a general obligation pledge to the Authority for the repayment of its loans. The Authority is authorized to intercept the local community's state-shared taxes, should the local education agency/local government fail to repay its loan timely.



Overview of the Financial Statements

The Authority is a discretely presented component unit of the State of Tennessee and uses proprietary fund accounting. The financial statements are 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. Under the economic resources measurement focus, a reader is presented information that allows him to determine the transactions and events that have increased or decreased the total economic resources for the period.

This discussion and analysis are intended to serve as an introduction to the Authority's basic financial statements. The Authority's basic financial statements comprise two components: 1) the basic financial statements and 2) notes to the financial statements. The basic financial statements are comprised of three separate and distinct statements. The Statements of Net Assets depict the Authority's financial position at June 30, 2002, and June 30, 2001. The

Statements of Revenues, Expenses and Changes in Net Assets show the results of operations and the change in net assets for the years presented. The Statements of Cash Flows summarizes the sources and uses of cash for the fiscal years presented. These statements are accompanied by notes to the financial statements that provide information that is essential to the reader's understanding of the financial statements. The Authority's basic financial statements are followed by supplementary information containing the financial statement information at the program level.

Financial Analysis of the Authority

Standard indicators of financial success are not applicable to the Authority. The financial goal of the Authority is to provide timely access to the capital markets at the lowest possible cost. The Authority successfully achieved this goal. The Authority frequently entered the short-term market with great success. Likewise, when long-term debt was sold at competitive sale, five syndicates placed bids. There were no incidents requiring the Authority to draw from the debt service reserve fund or refuse a loan from an applicant due to the inability to obtain capital funding.

Statements of Net Assets Summary

(in thousands)

	2002	2001	% Change
Current assets	$ 83,019	$ 51,296	61.84%
Noncurrent assets	421,518	386,183	9.15%
Total assets	504,537	437,479	15.33%
Current liabilities	27,032	23,823	13.47%
Noncurrent liabilities	469,554	405,629	15.76%
Total liabilites	496,586	429,452	15.63%
Net assets (unrestricted)	$ 7,951	$ 8,027	-0.95%

Note: The Authority owns no capital assets.

Current assets include cash of approximately $46,292,000 of unexpended bond proceeds and commercial paper at June 30, 2002 that will fund approved loans, as compared to approximately $18,584,000 in the fiscal year 2001. During the year ended June 30, 2002, the Authority issued $119,135,000 in Higher Education Facilities Second Program Bonds and $11,300,000 in Qualified Zone Academy Bonds. Principal payments were made on the long-term bonds in the amount of $20,218,000. The Authority also issued $33,100,000 in new commercial paper and redeemed $79,620,000 of commercial paper with the proceeds of the long-term debt and payments made by the higher education institutions.

The net assets are available to fund operations and other expenses necessary to meet the goals of the Authority. During the year ended June 30, 2002, the Authority elected to reduce net assets by absorbing certain administrative costs associated with bonded indebtedness of the higher education facilities program rather than passing those costs to the borrowers of the higher education facilities program.

Statements of Revenues, Expenses, and Changes in Net Assets Summary (in thousands)

	2002	2001	% Change
Operating Revenues			
Revenue from loans	$ 21,553	$ 21,712	-0.73%
Investment earnings	1,056	2,624	-59.76%
Total operating revenue	22,609	24,336	-7.10%
Operating Expenses			
Interest expense	21,165	20,605	2.72%
Subsidy to borrowers	811	1,655	-51.00%
Other expenses	709	779	-8.99%
Total expenses	22,685	23,039	-1.54%
Operating income (loss) and change in net assets	$ (76)	$ 1,297	-105.86%

Note: The Authority has no non-operating revenues or expenses.

The Authority's operating expenses are supported by revenue from loans in the form of administrative fees, interest on loans and investment income earned on cash and cash equivalents. Operating expenses include interest expense on outstanding bonds and commercial paper, administrative expenses, and the amortization of bond costs of issuance. The Authority returns the investment income that it earns on funds held by the Trustee and interest earned on unspent bond proceeds as a subsidy to its borrowers in the higher education facilities program. Pursuant to the bond resolution for the QZABs, investment earnings related to the QZAB program are held by the Authority for the benefit of the local education agencies and credited to their individual loans annually.

The decrease in the operating income and change in net assets was most affected by a decrease in investment earnings. The investment earnings are a function of prevailing market interest rates and the daily invested balance. During the year ended June 30, 2002, the capital markets were affected by a declining economy and the economic effect of the terrorist actions. As a result, the average interest rate on investments was significantly less in fiscal year 2002 than in fiscal year 2001.

Contacting the Authority's Management Team

This discussion and analysis is designed to provide our citizens, education agencies, investors and creditors with a general overview of the Authority's finances and to demonstrate its accountability for the monies it receives. If you have questions about this report or need additional financial information, contact the Director of Bond Finance, State of Tennessee, Suite 1600, James K. Polk Building, Nashville, Tennessee 37243-0273 or visit our website at www.comptroller.state.tn.us/cpdivbf.htm.

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF NET ASSETS
JUNE 30, 2002, AND JUNE 30, 2001

(Expressed in Thousands)

	June 30, 2002	June 30, 2001
ASSETS		
Current assets:		
Cash (Note 2)	$ 55,224	$ 27,535
Cash with fiscal agent (Note 2)	37	21
Investments with fiscal agent (Note 2)	-	34
Loans receivable (Note 3)	23,693	20,513
Interest receivable (Note 3)	3,722	3,002
Receivables for administrative fees (Note 3)	343	191
Total current assets	83,019	51,296
Noncurrent assets:		
Restricted cash (Notes 2 and 4)	1,749	870
Restricted investments (Notes 2 and 4)	13,699	15,233
Loans receivable (Note 3)	402,056	367,365
Deferred charges	4,014	2,715
Total noncurrent assets	421,518	386,183
Total assets	504,537	437,479
LIABILITIES		
Current liabilities:		
Accrued liabilities	-	26
Accrued interest payable	3,866	3,136
Deferred revenue (Note 6)	794	591
Bonds payable (Note 5)	22,372	20,070
Total current liabilities	27,032	23,823
Noncurrent liabilities:		
Net deferred revenue (Note 6)	7,033	6,197
Commercial paper payable (Note 5)	13,757	60,277
Net bonds payable (Note 5)	448,764	339,155
Total noncurrent liabilities	469,554	405,629
Total liabilities	496,586	429,452
NET ASSETS		
Unrestricted	$ 7,951	$ 8,027

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

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2002, AND JUNE 30, 2001

(Expressed in Thousands)

	Year Ended June 30, 2002	Year Ended June 30, 2001
OPERATING REVENUES		
Revenue from loans	$ 21,553	$ 21,712
Investment earnings	1,056	2,624
Total operating revenues	22,609	24,336
OPERATING EXPENSES		
Interest expense-commercial paper	1,177	3,365
Interest expense-bonds	19,988	17,240
Subsidy to borrowers	811	1,655
Administrative expense	545	644
Amortization of bond issuance costs	164	135
Total operating expenses	22,685	23,039
Operating income and change in net assets	(76)	1,297
Net assets, July 1	8,027	6,730
Net assets, June 30	$ 7,951	$ 8,027

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

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2002, AND JUNE 30, 2001

(Expressed in Thousands)

	Year Ended June 30, 2002	Year Ended June 30, 2001
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from borrowers for administrative fees	$ 193	$ 328
Payment to suppliers	(572)	(618)
Receipts from borrowers to the interest rate reserve fund	176	255
Payments to borrowers from the interest rate reserve fund	(29)	(451)
Net cash used in operating activities	(232)	(486)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from sale of bonds	129,672	104,118
Proceeds from sale of commercial paper	33,100	45,050
Bond issuance costs paid	(324)	(316)
Principal paid - bonds and commercial paper	(99,838)	(105,534)
Interest paid - bonds and commercial paper	(19,117)	(19,201)
Subsidy to borrowers	(953)	(1,690)
Net cash provided by noncapital financing activities	42,540	22,427
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(30,921)	(68,692)
Proceeds from sales and maturities of investments	32,915	69,195
Interest received on investments	621	1,597
Loans issued	(61,257)	(61,388)
Collections of loan principal	25,881	19,606
Interest received on loans	19,037	19,442
Net cash used in investing activities	(13,724)	(20,240)
Net increase in cash	28,584	1,701
Cash, July 1	28,426	26,725
Cash, June 30	$ 57,010	$ 28,426
Reconciliation of cash to the balance sheet:		
Cash	$ 55,224	$ 27,535
Cash with fiscal agent	37	21
Cash - restricted	1,749	870
Cash, June 30	$ 57,010	$ 28,426

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TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2002, AND JUNE 30, 2001

(Expressed in Thousands)

	Year Ended June 30, 2002	Year Ended June 30, 2001
Reconciliation of operating income (loss) to net cash used in operating activities:		
Operating income	$ (76)	$ 1,297
Adjustments to reconcile operating income (loss) to net cash used in operating activities:		
Amortization of bond issuance costs	164	135
Investment income	(1,056)	(2,624)
Interest expense	21,165	20,605
Subsidy to borrowers	811	1,655
Interest income from loans	(21,221)	(21,466)
Changes in assets and liabilities:		
(Increase) decrease in receivable from borrowers	(152)	82
Increase (decrease) in accounts payable	(26)	26
Increase (decrease) in deferred revenue	159	(196)
Total adjustments	(156)	(1,783)
Net cash used in operating activities	$ (232)	$ (486)
Noncash financing activities:		
Accretion of capital appreciation bonds	$ 1,233	$ 1,329
Bond issuance costs	792	776
Total noncash financing activities	$ 2,025	$ 2,105
Noncash Investing activities:		
Net appreciation in value of investments reported at fair value	$ 53	$ 95

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, 2002, and June 30, 2001

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 education agencies 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.

The Tennessee State School Bond Authority distinguishes operating revenues and expenses from nonoperating items. Operating revenues and expenses generally result from providing services and producing and delivering goods in connection with principal ongoing operations. The Authority's principal operation is to provide loans to higher educational facilities through the issuance of revenue bonds or notes. Therefore, the Authority also recognizes income on investments as operating revenue. The Authority's operating expenses include interest paid on borrowings, subsidies to borrowers, bond issuance costs, arbitrage, and administrative expenses. Any revenues and expenses not meeting this definition would be reported as nonoperating revenues and expenses.

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 education agencies. 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 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.

New accounting pronouncement

Effective July 1, 2001, the Authority adopted GASB Statement No. 34, *Basic Financial Statements – and Management's Discussion and Analysis – for State and Local Governments.* To conform to the requirements of GASB 34, the following changes have been made to the Authority's financial statements:

A. Retained Earnings have been reclassified into the following categories of Net Assets - invested in capital assets, net of related debt; restricted; and unrestricted. (The Authority has no net assets invested in capital assets or restricted net assets.)

B. The statement of financial position is now presented in a statement of net assets format rather than a balance sheet format.

C. Management's Discussion and Analysis has been added as required supplementary information.

Reclassification

Commercial paper payable and deferred revenue are deemed to be noncurrent and are reported as a noncurrent liability. The prior year amounts, exclusive of the current portion, have been reclassified to a noncurrent liability.

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, 2002, and June 30, 2001.

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 participated in the bank collateral pool administered by the State Treasurer. The securities pledged to protect these accounts were pledged in the aggregate rather than against each individual account. The members of the pool could be required by agreement to pay an assessment to cover any deficiency. Under this additional assessment, public fund accounts covered by the pool were 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 Federal Deposit Insurance Corporation ("FDIC") insured, except during the week of April 25, through April 30, 2002, of which certain funds held by the bond trustee were not insured or collateralized. The amounts not collateralized ranged from $1,975,734 to $17,573,978 during this period.

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, 2002, are categorized below (expressed in thousands):

	Category 1	Category 2	Category 3
Federal Home Loan Bank Notes	$ 711	$ -	$ -
Federal Home Loan Bank Discount Notes	12,988	-	-
Total investments	$ 13,699	$ -	$ -

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

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

NOTE 3. LOANS RECEIVABLE

Higher Education Facilities Programs

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 bonds of the Authority and the costs of administering the programs.

Qualified Zone Academy Bonds Program

The Authority has entered into a financing agreement with the local education agencies. The agreements for the 1999 QZAB's are dated November 30, 1999 and December 18, 2001 for the 2001 QZAB's. Under the agreement, the Authority agrees to finance construction projects for the local education agencies. On the annual date of the agreement, the borrower makes a principal payment into a bond fund held by the State Treasurer that will pay the bonds at maturity.

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, D, 2000 Series A and B, and 2002 Series A 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 education agencies 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.

Changes in debt payable for the year ended June 30, 2002 and 2001 are as follows (expressed in thousands):

	Balance July 1, 2001	Additions	Deletions	Balance June 30, 2002
Commercial paper	$60,277	$33,100	$79,620	$13,757
Bonds payable	$362,217	$131,697	$20,218	$473,696
Less: unamortized bond discount/premium	(403)	347	68	(124)
Less: unamortized deferred amount on refundings	(2,589)	-	(153)	(2,436)
Total bonds payable	$359,225	$132,044	$20,133	$471,136

	Balance July 1, 2000	Additions	Deletions	Balance June 30, 2001
Commercial paper	$102,700	$45,050	$87,473	$60,277
Bonds payable	$274,539	$105,739	$18,061	$362,217
Less: unamortized bond discount/premium	17	(352)	68	(403)
Less: unamortized deferred amount on refundings	(2,742)	-	(153)	(2,589)
Total bonds payable	$271,814	$105,387	$17,976	$359,225

Additions to bonds payable includes accretion of interest in the amount of $1,232 in 2002 and $1,329 in 2001.

Bonds and commercial paper payable at June 30, 2002, and June 30, 2001, are as follows (expressed in thousands):

	June 30, 2002	June 30, 2001
Bonds Payable:		
1967 Series A at an interest rate of 4.10% maturing to 2007 (original par - $43,800)	$ 4,230	$ 6,030
1976 Series B at an interest rate of 3.0% maturing to 2011 (original par - $6,037)	1,842	2,070
1987 Refunding Series A at an interest rate of 4% maturing in 2012 (original par – $70,686)	1,170	1,170
1989 Current Interest Bonds at an interest rate of 7% maturing in 2020 (original par - $15,630) and 1989 College Saver Bonds with yields of 6.75% to 6.9% maturing to 2010 (at accreted value); (original principal - $21,935)	16,684	18,212

	June 30, 2002	June 30, 2001
1996 Series A at interest rates from 5.0% to 6.0% maturing to 2026 (original par - $102,710)	73,855	76,415
1996 Refunding Series B at interest rates from 5.0% to 6.0% maturing to 2011 (original par - $55,300)	10,330	11,610
1996 Refunding Series C at interest rates from 5.375% to 6.0% maturing to 2020 (original par - $4,045)	4,045	4,045
1998 Series A at interest rates from 4.30% to 5.00% maturing to 2028 (original par - $54,865)	51,140	52,435
1998 Series B (Taxable) at interest rates from 5.80% to 6.70% maturing to 2028 (original par - $15,460)	14,825	15,080
1998 Refunding Series C at interest rates from 4.20% to 5.00% maturing to 2014 (original par - $48,735)	25,800	31,120
1998 Refunding Series D at interest rates from 3.90% to 4.85% maturing to 2021 (original par - $33,540)	25,765	27,350
2000 Series A at interest rates from 4.60% to 5.625% maturing to 2030 (original par - $70,680)	68,420	69,930
2000 Series B at interest rates from 6.50% to 7.75% maturing to 2020 (original par - $33,730)	31,835	33,460
2002 Series A at interest rates from 4.00% to 5.25% maturing to 2032 (original par - $119,135)	119,135	-

	June 30, 2002	June 30, 2001
Qualified Zone Academy Bonds non-interest bearing maturing in 2011 (original par - $13,290)	13,290	13,290
Qualified Zone Academy Bonds non-interest bearing maturing in 2015 (original par - $11,330)	11,330	-
Total Par Amount of Bonds Payable	473,696	362,217
Plus Unamortized Premium/Less Unamortized Discount	(124)	(403)
Bonds Payable Net of Unamortized Premium/ Discount	473,572	361,814
Less: Deferred Amount on Refundings	(2,436)	(2,589)
Net Bonds Payable	$ 471,136	$ 359,225
Commercial paper, at varied interest rates from 1.45 % to 1.50 %	$ 13,757	$ 60,277

Debt service requirements to maturity of the bonds payable at June 30, 2002, are as follows:

For the Year(s) Ending June 30	Principal	Interest	Total
2003	$ 20,985	$ 24,631	$ 45,616
2004	22,105	23,529	45,634
2005	19,760	22,545	42,305
2006	17,811	21,668	39,479
2007	18,048	20,905	38,953
2008-2012	103,765	87,663	191,428
2013-2017	89,228	59,521	148,749
2018-2022	71,964	38,841	110,805
2023-2027	62,135	20,557	82,692
2028-2032	38,271	5,474	43,745
Total	$ 464,072	$ 325,334	$ 789,406

The above principal for bonds is less than that presented on the accompanying financial statements by $7.064 million. Of this amount, $9.500 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 (2003-2010) in which the bonds mature. The $7.064 million also includes $2.436 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.

The Authority may issue taxable and/or tax-exempt bonds. Proceeds for the tax-exempt bonds issued after September 1, 1986, are subject to the 1986 Tax Reform Act. The Authority invests, records, and reports these proceeds in the manner set forth by the U.S. Treasury and Internal Revenue Service to maintain the tax-exempt status of the bonds. Arbitrage liabilities, when applicable, are reported as a current accrued liability. At June 30, 2002, the Authority did not have a liability for arbitrage. At June 30, 2001, the Authority had an accrued liability for arbitrage in the amount of $25,775.

On December 18, 2001, the Authority issued $11,330,000 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 December 18, the 2001 QZAB borrowers make annual principal payment into a bond fund held by the State Treasurer to pay the bonds at maturity on December 18, 2015.

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.

On April 18, 2002, the Authority issued a new series of bonds. The 2002 Series A tax-exempt bonds in the amount of $119,135,000 were issued to redeem $73,420,000 of the Authority's tax-exempt 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, 2002, $77,615,000 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 maximum principal to be issued by the Authority is $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, 2002, $13,757,000 of tax-exempt commercial paper was outstanding. At June 30, 2001, $60,277,000 of tax-exempt commercial paper was outstanding.

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. Interest on commercial paper is at varied rates, ranging from 1.2% to 3.0% during the fiscal year. Interest is payable upon maturity.

The commercial paper liquidity provider, under an Advance Agreement, is Westdeutsche Landesbank Girozentrale, New York branch and expires March 7, 2005. The total available commitment is $152,250,000. The obligation of Westdeutsche Landesbank Girozentrale is to purchase unremarketed commercial paper. In the event the liquidity facility is called upon, the Authority has ninety days to repay the advance from the facility. Should the Authority fail to repay the loan within the ninety-day period, it converts to a term loan with four semi-annual payments. In accordance with Financial Accounting Standards Board Statement No. 6, Classification of Short-Term Obligations Expected to Be Refinanced, this agreement meets the criteria of a financing agreement, thus, the commercial paper payable is classified as a long-term liability.

NOTE 6. DEFERRED REVENUE

Deferred revenue at June 30, 2002, and June 30, 2001, is as follows (expressed in thousands):

	June 30, 2002	June 30, 2001
Interest Rate Reserve Fund (see Note 7)	$ 393	$ 244
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	563	587
1996 Series B bonds; amortized through 2011	405	450
1996 Series C bonds, which was a cross-over refunding of the 1989 Current Interest Bonds; amortized through 2020	140	148
1998 Series A bonds; amortized through 2028	598	621
1998 Series B bonds; amortized through 2028	194	202
1998 Series C bonds; amortized through 2014	231	251
1998 Series D bonds, which was an advance		

	June 30, 2002	June 30, 2001
refunding of the 1992 Series A bonds; amortized through 2021	2,638	2,778
1999 Qualified Zone Academy Bonds; amortized through 2012	345	382
2000 Series A bonds; amortized through 2030	871	902
2000 Series B bonds; amortized through 2020	211	223
2002 Qualified Zone Academy Bonds; amortized through 2015	284	0
2002 Series A bonds; amortized through 2032	954	0
Total	$ 7,827	$ 6,788

NOTE 7. SUBSEQUENT EVENTS

As a result of the issuance of the 2002 series A bonds, and the refunding of the commercial paper principal from the issuance, the Authority refunded back to the higher education institutions $336,519 from the interest rate reserve fund on the November semiannual billing.

On December 13, 2002, the Authority had outstanding $24,807,000 in tax-exempt commercial paper and $2,300,000 in taxable commercial paper. Between June 30, 2002, and December 13, 2002, the Authority has issued $15,300,000 in commercial paper to pay construction expenditures.

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY SCHEDULES OF NET ASSETS - PROGRAM LEVEL
JUNE 30, 2002, AND JUNE 30, 2001

(Expressed in Thousands)

	June 30, 2002			June 30, 2001		
	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Total	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Total
ASSETS						
Current assets:						
Cash	$ 42,522	$ 12,702	$ 55,224	$ 21,095	$ 6,440	$ 27,535
Cash with fiscal agent	37	-	37	21	-	21
Investments with fiscal agent	-	-	-	34	-	34
Loans receivable	22,372	1,321	23,693	20,069	444	20,513
Interest receivable	3,716	6	3,722	2,996	6	3,002
Receivables for administrative fees	341	2	343	188	3	191
Total current assets	68,988	14,031	83,019	44,403	6,893	51,296
Noncurrent assets:						
Restricted cash	-	1,749	1,749	-	870	870
Restricted investments	12,987	712	13,699	14,514	719	15,233
Loans receivable	393,892	8,164	402,056	362,537	4,828	367,365
Deferred charges	3,531	483	4,014	2,460	255	2,715
Total noncurrent assets	410,410	11,108	421,518	379,511	6,672	386,183
Total assets	479,398	25,139	504,537	423,914	13,565	437,479
LIABILITIES						
Current liabilities:						
Accrued liabilities	-	-	-	26	-	26
Accrued interest payable	3,866	-	3,866	3,136	-	3,136
Deferred revenue	736	58	794	554	37	591
Bonds payable	22,372	-	22,372	20,070	-	20,070
Total current liabilities	26,974	58	27,032	23,786	37	23,823
Noncurrent liabilities:						
Net deferred revenue	6,462	571	7,033	5,852	345	6,197
Commercial paper payable	13,757	-	13,757	60,277	-	60,277
Net bonds payable	424,248	24,516	448,764	325,980	13,175	339,155
Total noncurrent liabilities	444,467	25,087	469,554	392,109	13,520	405,629
Total liabilities	471,441	25,145	496,586	415,895	13,557	429,452
NET ASSETS						
Unrestricted	$ 7,957	$ (6)	$ 7,951	$ 8,019	$ 8	$ 8,027

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY SCHEDULES OF REVENUES,
EXPENSES AND CHANGES IN NET ASSETS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2002, AND JUNE 30, 2001

(Expressed in Thousands)

	Year ended June 30, 2002			Year ended June 30, 2001		
	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Total	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Total
OPERATING REVENUES						
Revenue from loans	$ 21,500	$ 53	$ 21,553	$ 21,673	$ 39	$ 21,712
Investment earnings	1,054	2	1,056	2,623	1	2,624
Total operating revenues	22,554	55	22,609	24,296	40	24,336
OPERATING EXPENSES						
Interest expense-commercial paper	1,177	-	1,177	3,365	-	3,365
Interest expense-bonds	19,977	11	19,988	17,229	11	17,240
Subsidy to borrowers	809	2	811	1,654	1	1,655
Administrative expense	524	21	545	644	-	644
Amortization of bond issuance costs	129	35	164	110	25	135
Total operating expenses	22,616	69	22,685	23,002	37	23,039
Operating income (loss) and change in net assets	(62)	(14)	(76)	1,294	3	1,297
Net assets, July 1	8,019	8	8,027	6,725	5	6,730
Net assets, June 30	$ 7,957	$ (6)	$ 7,951	$ 8,019	$ 8	$ 8,027

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY SCHEDULES OF CASH FLOWS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2002, AND JUNE 30, 2001

(Expressed in Thousands)

	Year ended June 30, 2002			Year ended June 30, 2001		
	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Total	Higher Education Facilities Programs	Qualified Zone Academy Bonds Program	Total
CASH FLOWS FROM OPERATING ACTIVITIES						
Receipts from borrowers for administrative fees	$ 188	$ 5	$ 193	$ 328	$ -	$ 328
Payment to service providers	(550)	(22)	(572)	(617)	(1)	(618)
Receipts from borrowers to the interest rate reserve fund	176	-	176	255	-	255
Payments to borrowers from interest rate reserve fund	(29)	-	(29)	(451)	-	(451)
			-			
Net cash used in operating activities	(215)	(17)	(232)	(485)	(1)	(486)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Proceeds from sale of bonds	118,540	11,132	129,672	104,118	-	104,118
Proceeds from sale of commercial paper	33,100	-	33,100	45,050	-	45,050
Bond issuance costs paid	(260)	(64)	(324)	(316)	-	(316)
Principal payments - bonds and commercial paper	(99,838)	-	(99,838)	(105,534)	-	(105,534)
Interest paid - bonds and commercial paper	(19,117)	-	(19,117)	(19,201)	-	(19,201)
Subsidy to borrowers	(951)	(2)	(953)	(1,689)	(1)	(1,690)
Net cash provided by (used in) noncapital financing activities	31,474	11,066	42,540	22,428	(1)	22,427
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchases of investments	(30,921)	-	(30,921)	(67,989)	(703)	(68,692)
Proceeds from sales and maturities of investments	32,915	-	32,915	69,195		69,195
Interest received on investments	619	2	621	1,596	1	1,597
Loans issued	(56,610)	(4,647)	(61,257)	(54,944)	(6,444)	(61,388)
Collections of loan principal	25,144	737	25,881	18,461	1,145	19,606
Interest received on loans	19,037	-	19,037	19,442		19,442
Net cash used in investing activities	(9,816)	(3,908)	(13,724)	(14,239)	(6,001)	(20,240)
Net increase (decrease) in cash	21,443	7,141	28,584	7,704	(6,003)	1,701
Cash, July 1	21,117	7,309	28,426	13,413	13,312	26,725
Cash, June 30	$ 42,560	$ 14,450	$ 57,010	$ 21,117	$ 7,309	$ 28,426
Reconciliation of cash to the balance sheet:						
Cash	$ 42,522	$ 12,702	$ 55,224	$ 21,095	$ 6,440	$ 27,535
Cash with fiscal agent	37	-	37	21	-	21
Restricted cash	-	1,749	1,749	-	870	870
Cash, June 30	$ 42,559	$ 14,451	$ 57,010	$ 21,116	$ 7,310	$ 28,426
Reconciliation of operating income (loss) to net cash used in operating activities:						
Operating income (loss)	$ (62)	$ (14)	$ (76)	$ 1,294	$ 3	$ 1,297
Adjustments to reconcile operating income (loss) to net cash used in operating activities:						
Amortization of bond issuance costs	129	35	164	110	25	135
Investment earnings	(1,054)	(2)	(1,056)	(2,623)	(1)	(2,624)
Interest expense	21,154	11	21,165	20,594	11	20,605
Subsidy to borrowers	809	2	811	1,654	1	1,655
Revenues from loans	(21,171)	(50)	(21,221)	(21,429)	(37)	(21,466)
Changes in assets and liabilities:						
(Increase) decrease in receivables for administrative fees	(153)	1	(152)	85	(3)	82
Increase (decrease) in accrued liabilities	(26)	-	(26)	26	-	26
Increase (decrease) in deferred revenue	159	-	159	(196)	-	(196)
Total adjustments	(153)	(3)	(156)	(1,779)	(4)	(1,783)
Net cash used in operating activities	$ (215)	$ (17)	$ (232)	$ (485)	$ (1)	$ (486)
Noncash financing activities:						
Accretion of capital appreciation bonds	$ 1,233	$ -	$ 1,233	$ 1,329	$ -	$ 1,329
Bond issuance costs	594	198	792	776	-	776
Total noncash financing activities	$ 1,827	$ 198	$ 2,025	$ 2,105	$ -	$ 2,105
Noncash investing activities:						
Net appreciation in value of investments reported at fair value	$ 53	$ -	$ 53	$ 95	$ -	$ 95