Tennessee State School Bond Authority
For the Year Ended
June 30, 2003

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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 12, 2004

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, 2003. 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

John G. Morgan
Comptroller of the Treasury

JGM/eb
04/018

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, 2003

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 bond resolutions); 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, 2003

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Tennessee State School Bond Authority
For the Year Ended June 30, 2003

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, 2002, through June 30, 2003, 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, 2003, and for comparative purposes, the year ended June 30, 2002. The Tennessee State School Bond Authority 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 bond resolutions);

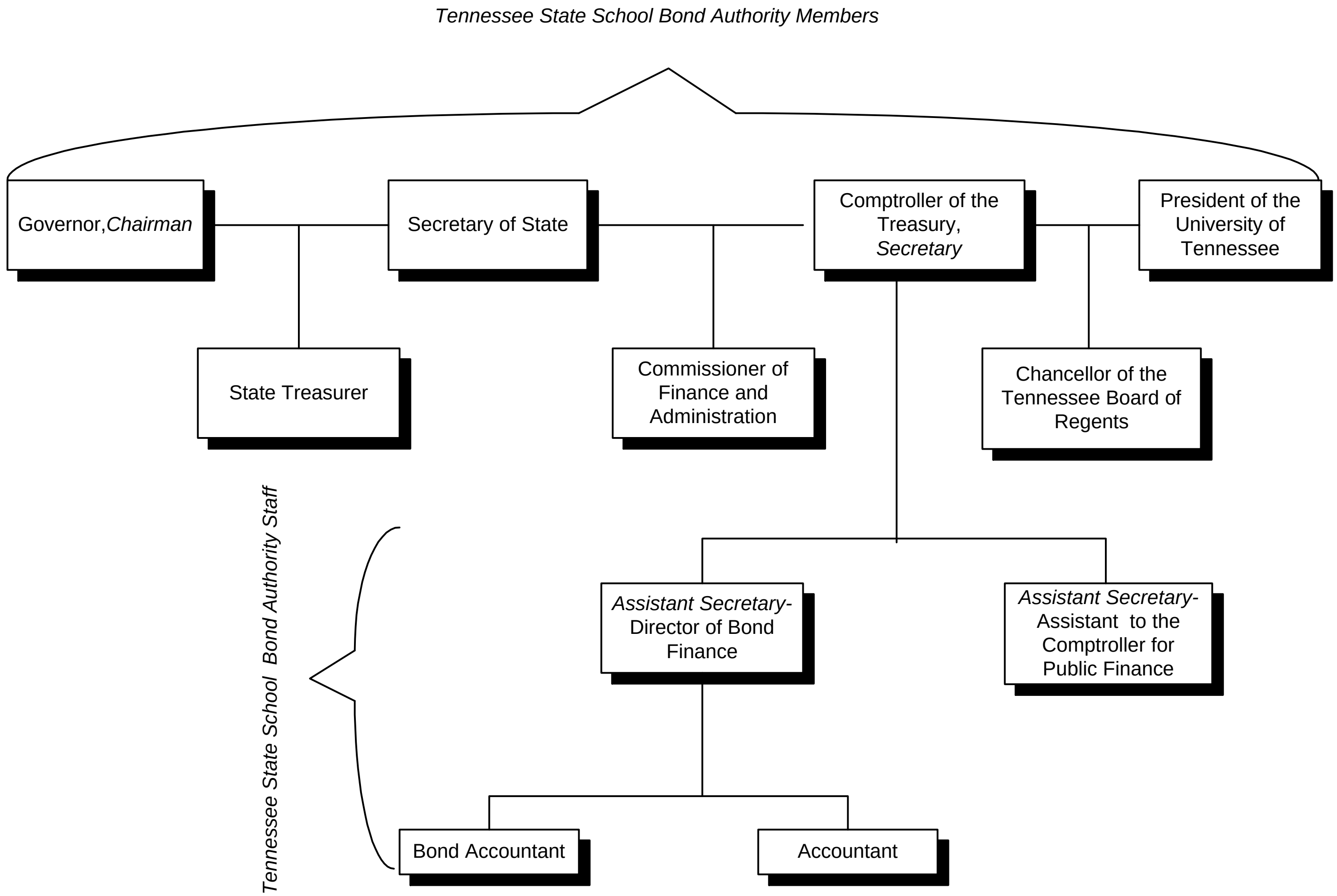
3. to determine the fairness of the presentation of the financial statements; and

4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDINGS

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Tennessee State School Bond Authority filed its

Tennessee State School Bond Authority
Organization Chart



report with the Department of Audit on August 6, 2003. A follow-up of the prior audit finding was conducted as part of the current audit. The current audit disclosed that the Authority has corrected the prior audit finding concerning the lack of controls relating to the Qualified Zone Academy Bond Program.

OBSERVATIONS AND COMMENTS

The Tennessee State School Bond Authority issued its first *Comprehensive Annual Financial Report* for the year ended June 30, 2002, and was awarded a Certificate of Achievement for Excellence in Financial Reporting by the Government Finance Officers Association of the United States and Canada (GFOA). In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements. A Certificate of Achievement is valid for a period of one year only. The Authority intends to submit its *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2003, to the GFOA Certificate of Achievement Program.

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, 2003, 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. 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
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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 24, 2003

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, 2003, and have issued our report thereon dated November 24, 2003. 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.

<u>Compliance</u>

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 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. 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.

Arthur A. Hayes, Jr., CPA,
Director

AAH/eb

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DEPARTMENT OF AUDIT
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Independent Auditor's Report

November 24, 2003

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, a component unit of the State of Tennessee, as of June 30, 2003, and June 30, 2002, 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, 2003, and June 30, 2002, 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.

The Honorable John G. Morgan
November 24, 2003
Page Two

The management's discussion and analysis section is not a required part of the basic financial statements but is supplementary information required by accounting principles generally accepted in the United States of America. 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 November 24, 2003, 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.

Arthur A. Hayes, Jr., CPA,
Director

AAH/eb

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, 2003. These activities are compared to the results of the fiscal years ended June 30, 2002, and 2001.

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 tables below summarize this business activity.

	Higher Education Facilities Programs		
	2003	**2002**	**2001**
Number of institutions with outstanding loans	14	12	11
Total number of outstanding loans	200	192	173
Balance of outstanding loans	$ 454,172,896	$ 416,263,828	$ 382,606,144
Number of loans approved in fiscal year	15	10	22
Dollar value of loans approved in fiscal year	$ 82,014,000	$ 56,815,000	$ 53,065,000
Dollar value of loans approved in fiscal year - unfunded	$ 76,770,858	$ 55,358,652	$ 42,394,842
Dollar value of loans funded in fiscal year	$ 58,677,534	$ 56,609,920	$ 54,943,486
Bonds issued in fiscal year	$ -	$ 119,135,000	$ 104,410,000
Commercial paper issued in fiscal year	$ 42,300,000	$ 33,100,000	$ 45,050,000

	Qualified Zone Academy Bond Program		
	2003	**2002**	**2001**
Number of institutions with outstanding loans	9	9	7
Total number of outstanding loans	10	10	7
Balance of outstanding loans	$ 13,555,514	$ 9,484,761	$ 5,271,900
Number of loans approved in fiscal year	-	3	-
Dollar value of loans approved in fiscal year	$ -	$ 11,330,000	$ -
Dollar value of loans approved in fiscal year - unfunded	$ -	$ 10,588,577	$ -
Dollar value of loans funded in fiscal year	$ 5,383,748	$ 4,646,695	$ 6,444,406
Bonds issued in fiscal year	$ -	$ 11,330,000	$ -

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

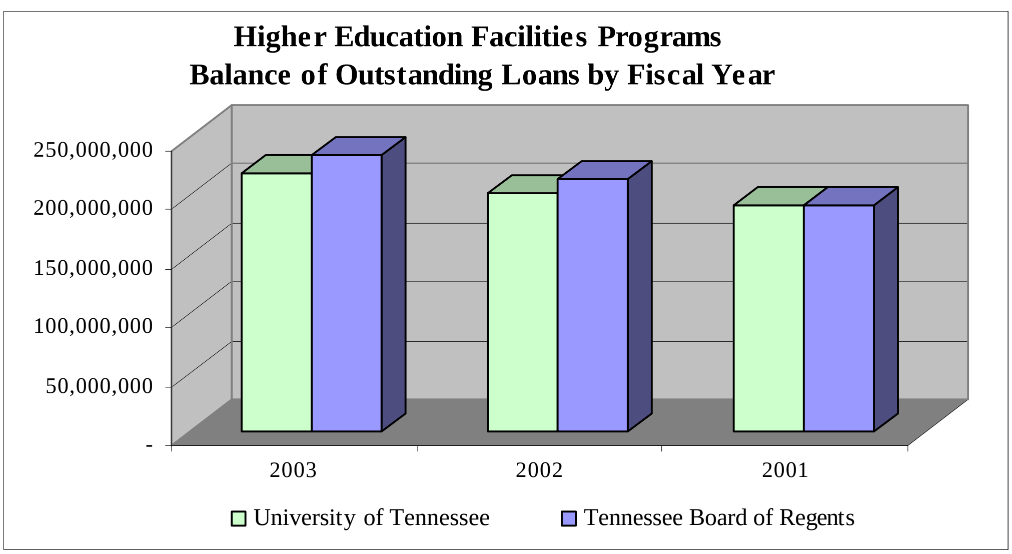
Pursuant to Section 49-3-1201 et seq., *Tennessee Code Annotated*, the General Assembly of the State created the Tennessee State School Bond Authority to issue bonds and notes to fund capital projects for the higher education institutions including both four-year institutions and two-year community colleges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

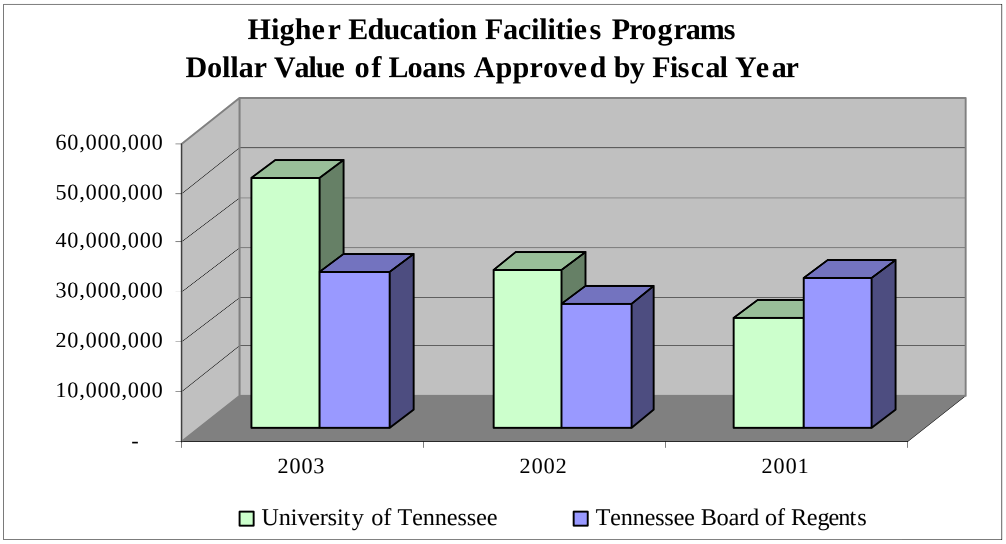
Higher Education Facilities Programs. An analysis of the financial feasibility of each loan application is undertaken before it is approved by the Authority. Each higher education system (the University of Tennessee and the Tennessee Board of Regents) must include in its annual budget sufficient funds 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.

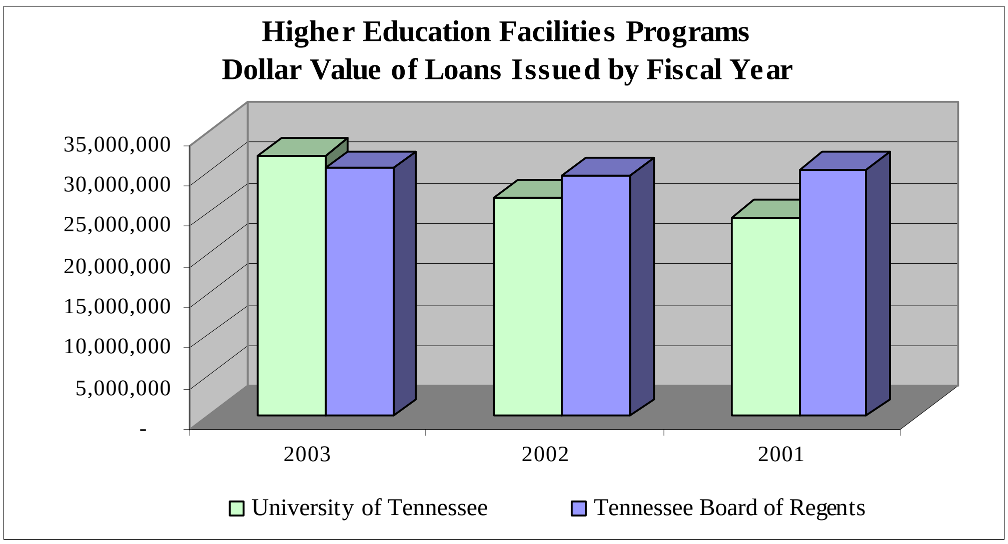
Under the financing program for higher education institutions, a project is generally funded through the Authority's commercial paper program during its construction phase. When projects totaling $50 million or greater are completed or near completion, the Authority fixes the interest rate for the term of the project by issuing long-term debt. Commercial paper interest rates ranged from 0.85% to 1.85% during the fiscal year 2003, 1.2% to 3.0% in fiscal year 2002 and 2.75% to 6.81% in fiscal year 2001. 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.



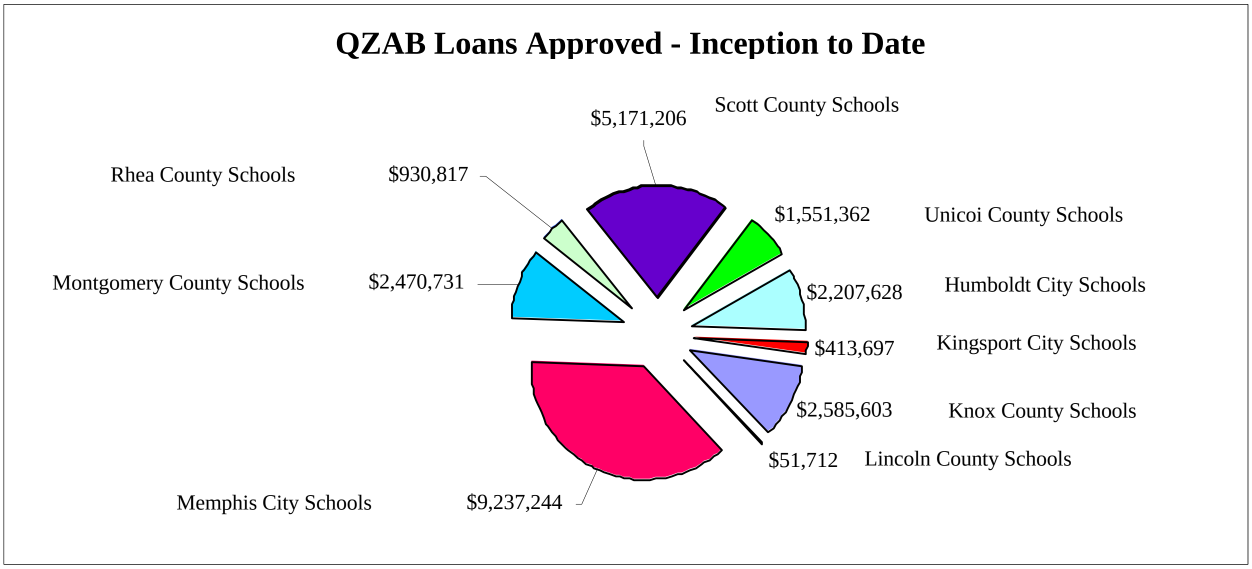




The Authority's higher education facilities program is rated AA, Aa3, and AA by Fitch, Moody's Investors Service and Standard & Poor's Rating Group, respectively. Fitch comments that the rating reflects the broad coverage provided by higher education fees and charges, the provision to intercept state 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. During fiscal year 2002, Moody's downgraded the Authority to reflect the revision of the State's Aa2 general obligation credit. 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 schools' renovation projects and equipment purchases. 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 in accordance with accounting principles generally accepted in the United States of America using the accrual basis of accounting and the flow of economic resources measurement focus. This basis recognizes revenues when earned and expenses at the time liabilities are incurred. Using 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 consist of the Statement of Net Assets, the Statement of Revenues, Expenses, and Changes in Net Assets, and the Statement of Cash Flows.

The Statements of Net Assets depict the Authority's financial position at June 30, 2003, and June 30, 2002. 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 summarize 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 for qualified education institutions 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 in 2002, 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 the inability to obtain capital funding.

Statements of Net Assets Summary (in thousands)			
	2003	2002	2001
Current assets	$ 54,377	$ 83,019	$ 51,296
Noncurrent assets	463,491	421,518	386,183
Total assets	517,868	504,537	437,479
Current liabilities	32,081	27,032	23,823
Noncurrent liabilities	479,617	469,554	405,629
Total liabilites	511,698	496,586	429,452
Net assets (unrestricted)	$ 6,170	$ 7,951	$ 8,027
Note: The Authority owns no capital assets.			

Current assets include approximately $14,508,000 of unexpended bond proceeds and commercial paper at June 30, 2003 that will fund approved loans, as compared to approximately $46,292,000 at June 30, 2002 and approximately $18,584,000 in the fiscal year 2001. During the year ended June 30, 2003, the Authority did not issue any new long-term debt. However, 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 $22,520,000 in 2003; $20,218,000 in 2002. During 2003 the Authority issued $42,300,000 in new commercial paper and redeemed $9,310,000 as compared to $33,100,000 of new issuances of commercial paper and the redemption of $79,620,000 during 2002.

The net assets are available to fund operations and other expenses necessary to meet the goals of the Authority. During the years ended June 30, 2003, and June 30, 2002, the Authority elected to reduce net assets by increasing its subsidy to borrowers and continuing to absorb 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)			
	2003	2002	2001
Operating Revenues			
Revenue from loans	$ 24,927	$ 21,553	$ 21,712
Investment earnings	781	1,056	2,624
Total operating revenue	25,708	22,609	24,336
Operating Expenses			
Interest expense	24,445	21,165	20,605
Subsidy to borrowers	2,382	811	1,655
Other expenses	662	709	779
Total expenses	27,489	22,685	23,039
Operating income (loss) and change in net assets	$ (1,781)	$ (76)	$ 1,297
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. Operating expenses include interest expense on outstanding bonds and commercial paper, administrative expenses, and the amortization of bond costs of issuance. The Authority elected to return 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. During 2003, the Authority elected to provide $1.7 million in subsidy to its borrowers from its unrestricted net assets. 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 the additional subsidy to its borrowers in 2003 and by a decrease in investment earnings in 2002. 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.

Economic and Demographic Factors Affecting Future Financing Activities

Higher Education Facilities Programs. In May 2003, the Tennessee General Assembly approved the Tennessee Lottery for Education Act ("the Act"). The Act authorized the creation of a state lottery, the net proceeds of which are dedicated primarily to post-secondary education. Through the Act, the state created a set of college scholarships focused upon increasing participation in post-secondary education. This scholarship program will ultimately serve to increase enrollment across all sectors of the post-secondary enterprise.

In addition to lottery generated growth, the demographic statistics portray a bubble in the population that will be of an age to enter post-secondary education institutions between 2005 and 2010. At this time the Tennessee Higher Education Commission is conducting studies to determine the effect of these events on the infrastructure needs of the higher education system in Tennessee and the financing of those improvements. Concurrently, the state is working on a program to redistribute enrollment across its post-secondary institutions. Enrollment caps have been placed on freshman enrollment at all four year institutions in order to control growth at the universities.

The preliminary results of the studies show that an increasing number of students will be accessing the post-secondary education system. As enrollment reaches maximum capacity at the four-year institutions, more students will be enrolling in the two-year institutions. These institutions will probably feel the most stress in expanding their campuses to meet the changing needs of their students. While a portion of the required infrastructure growth will be financed through other mechanisms, we anticipate that additional debt will be issued by TSSBA to fund the construction or renovation of those facilities that can be financed with a defined revenue stream.

The stress of a low performing economy has forced the state to delay infrastructure repairs and improvements on the campuses of the higher education institutions since 2000. The ability of the state to continue to provide access to post-secondary education will be only further taxed by the decaying infrastructure of its institutions. However, for fiscal year 2003-2004, the State Budget disclosed $99,450,000 in projects for debt financing by the Authority. The disclosed amounts were $51,500,000 for the University of Tennessee and $47,950,000 for the Tennessee Board of Regents. Of the disclosed projects $44,950,000 has already been approved for funding for the University of Tennessee and $36,950,000 for the Tennessee Board of Regents.

The Authority has a $150,000,000 line of credit for the issuance of commercial paper. The Authority expects to exceed the capacity of the line of credit within six to nine months due to the combination of the projects disclosed in the budget and the projects currently being financed with commercial paper. Therefore, the Authority anticipates issuing bonds no later than August 2004.

Qualified Zone Academy Bond Program. The QZAB program has an unused authorization of $20,140,000. Authority staff along with the staff of the State Department of Education is encouraging local education authorities, cities and counties to take advantage of these interest-free loans. Based on the perceived demand for these funds, the Authority may issue additional QZABs prior to August 2004.

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.

Exhibit A

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF NET ASSETS
JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	June 30, 2003	June 30, 2002
ASSETS		
Current assets:		
Cash (Note 2)	$ 25,567	$ 55,224
Cash with fiscal agent (Note 2)	2	37
Investments with fiscal agent (Note 2)	5	-
Loans receivable (Note 3)	24,893	23,693
Interest receivable (Note 3)	3,645	3,722
Receivables for administrative fees (Note 3)	265	343
Total current assets	54,377	83,019
Noncurrent assets:		
Restricted cash (Notes 2 and 4)	3,878	1,749
Restricted investments (Notes 2 and 4)	12,968	13,699
Loans receivable (Note 3)	442,836	402,056
Deferred charges	3,809	4,014
Total noncurrent assets	463,491	421,518
Total assets	517,868	504,537
LIABILITIES		
Current liabilities:		
Due to higher education institutions	4,104	-
Due to local education authorities	87	-
Accrued interest payable	3,707	3,866
Deferred revenue (Note 6)	611	794
Bonds payable (Note 5)	23,572	22,372
Total current liabilities	32,081	27,032
Noncurrent liabilities:		
Deferred revenue (Note 6)	6,633	7,033
Commercial paper payable (Note 5)	46,747	13,757
Bonds payable (Note 5)	426,237	448,764
Total noncurrent liabilities	479,617	469,554
Total liabilities	511,698	496,586
NET ASSETS		
Unrestricted	$ 6,170	$ 7,951

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

Exhibit B

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF REVENUES, EXPENSES, AND CHANGES IN NET ASSETS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	Year Ended June 30, 2003	Year Ended June 30, 2002
OPERATING REVENUES		
Revenue from loans	$ 24,927	$ 21,553
Investment earnings	781	1,056
Total operating revenues	25,708	22,609
OPERATING EXPENSES		
Interest expense-commercial paper	353	1,177
Interest expense-bonds	24,092	19,988
Subsidy to borrowers	2,382	811
Administrative expense	457	545
Amortization of bond issuance costs	205	164
Total operating expenses	27,489	22,685
Operating loss and change in net assets	(1,781)	(76)
Net assets, July 1	7,951	8,027
Net assets, June 30	$ 6,170	$ 7,951

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, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	Year Ended June 30, 2003	Year Ended June 30, 2002
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from borrowers for administrative fees	$ 349	$ 193
Payments to suppliers	(457)	(572)
Receipts from borrowers to the interest rate reserve fund	171	176
Payments to borrowers from the interest rate reserve fund	(354)	(29)
Net cash used in operating activities	(291)	(232)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from sale of bonds	-	129,672
Proceeds from sale of commercial paper	42,300	33,100
Bond issuance costs paid	-	(324)
Principal paid - bonds and commercial paper	(31,830)	(99,838)
Interest paid - bonds and commercial paper	(23,410)	(19,117)
Subsidy to borrowers	(2,472)	(953)
Net cash provided by (used in) noncapital financing activities	(15,412)	42,540
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(29,597)	(30,921)
Proceeds from sales and maturities of investments	30,553	32,915
Interest received on investments	544	621
Loans issued	(64,061)	(61,257)
Collections of loan principal	27,414	25,881
Interest received on loans	23,287	19,037
Net cash used in investing activities	(11,860)	(13,724)
Net increase (decrease) in cash	(27,563)	28,584
Cash, July 1	57,010	28,426
Cash, June 30	$ 29,447	$ 57,010

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TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	Year Ended June 30, 2003	Year Ended June 30, 2002
Reconciliation of cash to the Statement of Net Assets:		
Cash	$ 25,567	$ 55,224
Cash with fiscal agent	2	37
Restricted cash	3,878	1,749
Cash, June 30	$ 29,447	$ 57,010
Reconciliation of operating loss to net cash used in operating activities:		
Operating loss	$ (1,781)	$ (76)
Adjustments to reconcile operating loss to net cash used in operating activities:		
Amortization of bond issuance costs	205	164
Investment earnings	(781)	(1,056)
Interest expense	24,445	21,165
Subsidy to borrowers	2,382	811
Interest income from loans	(24,656)	(21,221)
Changes in assets and liabilities:		
(Increase) decrease in receivables for administrative fees	78	(152)
Decrease in accrued liabilities	-	(26)
Increase (decrease) in deferred revenue	(183)	159
Total adjustments	1,490	(156)
Net cash used in operating activities	$ (291)	$ (232)
Noncash financing activities:		
Accretion of capital appreciation bonds	$ 1,129	$ 1,233
Bond issuance costs	-	792
Total noncash financing activities	$ 1,129	$ 2,025
Noncash investing activities:		
Net appreciation in value of investments reported at fair value	$ 36	$ 53

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

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 Taxpayer 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 principals generally accepted in the United States of America as prescribed by the Governmental Accounting Standards Board. Private-sector standards of accounting and financial reporting issued prior to December 1, 1989, generally are followed in the financial statements to the extent that those standards do not conflict with or contradict guidance of the Governmental Accounting Standards Board. The Authority has the option of following subsequent private-sector guidance subject to this same limitation. The Authority has elected not to follow subsequent private-sector guidance.

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. 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.

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 for which the timely payment of the principal and interest 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, 2003, and June 30, 2002. The report may be obtained by writing to the Tennessee Department of Finance and Administration, Division of Accounts, 14th Floor William R. Snodgrass Tennessee Tower, 312 Eight Avenue North, Nashville, Tennessee 37243-0298, or by calling (615) 741-2140.

The Authority's deposits are 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 agreement, public fund accounts covered by the pool are considered to be insured for purposes of credit risk disclosure.

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, 2003, are categorized below (expressed in thousands):

	Category		
	1	2	3
Federal Home Loan Bank Discount Notes	$ 2,973	$ -	$ -

Authority investments at June 30, 2002, are categorized below (expressed in thousands):

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

NOTE 3. LOANS RECEIVABLE

Higher Education Facilities Programs

The Authority has entered into financing agreements 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). The First Financing Agreement and the Second Financing Agreement (the "Agreements"), are dated May 1, 1967 and November 1, 1997, respectively, as amended. Under the Agreements, the Authority agrees to finance construction projects for the Board of Trustees or the Tennessee Board of Regents. Annual financing charges payable under the Agreements must be sufficient to pay the debt obligations of the Authority and the costs of administering the programs.

Qualified Zone Academy Bonds Program

The Authority has entered into a loan 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 an annual 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, and 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. 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, 2003, and 2002 are as follows (expressed in thousands):

	Balance July 1, 2002	Additions	Deletions	Balance June 30, 2003
Commercial paper	$13,757	$42,300	$9,310	$46,747
Bonds payable	$473,696	$ 1,129	$22,520	$452,305
Less: unamortized bond discount/premium	(124)	-	89	(213)
Less: unamortized deferred amount on refundings	(2,436)	-	(153)	(2,283)
Total bonds payable	$471,136	$ 1,129	$22,456	$449,809

	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

Additions to bonds payable include accretion of interest in the amount of $1,129 in 2003 and $1,232 in 2002.

Bonds and commercial paper payable at June 30, 2003, and June 30, 2002, are as follows (expressed in thousands):

	June 30, 2003	June 30, 2002
Bonds Payable:		
1967 Series A at an interest rate of 4.10% maturing to 2007 (original par - $43,800)	$ 3,450	$ 4,230
1976 Series B at an interest rate of 3.0% maturing to 2011 (original par - $6,037)	1,607	1,842
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)	15,053	16,684
1996 Series A at interest rates from 5.0% to 6.0% maturing to 2026 (original par - $102,710)	71,140	73,855

	June 30, 2003	June 30, 2002
1996 Refunding Series B at interest rates from 5.0% to 6.0% maturing to 2011 (original par - $55,300)	9,370	10,330
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)	49,780	51,140
1998 Series B (Taxable) at interest rates from 5.80% to 6.70% maturing to 2028 (original - par $15,460)	14,555	14,825
1998 Refunding Series C at interest rates from 4.20% to 5.00% maturing to 2014 (original par - $48,735)	20,225	25,800
1998 Refunding Series D at interest rates from 3.90% to 4.85% maturing to 2021 (original par - $33,540)	24,115	25,765
2000 Series A at interest rates from 4.60% to 5.625% maturing to 2030 (original par - $70,680)	66,830	68,420
2000 Series B at interest rates from 6.50% to 7.75% maturing to 2020 (original par - $33,730)	30,095	31,835
2002 Series A at interest rates from 4.00% to 5.25% maturing to 2032 (original par - $119,135)	116,250	119,135
Qualified Zone Academy Bonds non-interest bearing maturing in 2011 (original par - $13,290)	13,290	13,290

	June 30, 2003	June 30, 2002
Qualified Zone Academy Bonds non-interest bearing maturing in 2015 (original par - $11,330)	11,330	11,330
Total Par Amount of Bonds Payable	452,305	473,696
Plus Unamortized Premium/Less Unamortized Discount	(213)	(124)
Bonds Payable Net of Unamortized Premium/ Discount	452,092	473,572
Less: Deferred Amount on Refundings	(2,283)	(2,436)
Net Bonds Payable	$ 449,809	$ 471,136
Commercial paper, at varied interest rates from 0.85 % to 1.85 %	$ 46,747	$ 13,757

Debt service requirements to maturity of the bonds payable at June 30, 2003, are as follows (expressed in thousands):

For the Year(s) Ending June 30	Principal	Interest	Total
2004	$ 22,105	$ 23,529	$ 45,634
2005	19,760	22,546	42,306
2006	17,811	21,668	39,479
2007	18,048	20,905	38,953
2008	17,910	20,118	38,028
2009-2013	101,422	81,112	182,534
2014-2018	88,580	55,368	143,948
2019-2023	69,342	34,926	104,268
2024-2028	60,881	17,155	78,036
2029-2032	27,228	3,376	30,604
Total	$443,087	$300,703	$ 743,790

The above principal for bonds is less than that presented on the accompanying financial statements by $6.722 million. Of this amount, $9.005 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 (2004-2010) in which the bonds mature. The $6.722 million also includes $2.283 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, 2003, and 2002, the Authority did not have a liability for arbitrage.

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 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, 2003, $72,825,000 of bonds outstanding is 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, 2003, $39,447,000 of tax-exempt commercial paper and $7,300,000 of taxable commercial paper was outstanding. At June 30, 2002, $13,757,000 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 0.85% to 1.85% 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

Changes in deferred revenue for the year ended June 30, 2003, and 2002 are as follows (expressed in thousands):

	Balance July 1, 2002	Additions	Deletions	Balance June 30, 2003
Interest rate reserve fund	$ 393	$ 171	$ 354	$ 210
Other deferred revenue	7,434	-	400	7,034
Total deferred revenue	$ 7,827	$ 171	$ 754	$7,244

	Balance July 1, 2001	Additions	Deletions	Balance June 30, 2002
Interest rate reserve fund	$ 244	$ 178	$ 29	$ 393
Other deferred revenue	6,544	1,255	365	7,434
Total deferred revenue	$ 6,788	$1,433	$ 394	$ 7,827

Deferred revenue at June 30, 2003, and June 30, 2002, is as follows (expressed in thousands):

	June 30, 2003	June 30, 2002
Interest Rate Reserve Fund	$ 210	$ 393
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	540	563
1996 Series B bonds; amortized through 2011	360	405
1996 Series C bonds, which was a cross-over refunding of the 1989 Current Interest Bonds; amortized through 2020	132	140
1998 Series A bonds; amortized through 2028	575	598
1998 Series B bonds; amortized through 2028	187	194
1998 Series C bonds; amortized through 2014	212	231
1998 Series D bonds, which was an advance refunding of the 1992 Series A bonds; amortized through 2021	2,498	2,638

	June 30, 2003	June 30, 2002
1999 Qualified Zone Academy Bonds; amortized through 2012	309	345
2000 Series A bonds; amortized through 2030	839	871
2000 Series B bonds; amortized through 2020	199	211
2002 Qualified Zone Academy Bonds; amortized through 2015	262	284
2002 Series A bonds; amortized through 2032	921	954
Total	$ 7,244	$ 7,827

NOTE 7. SUBSEQUENT EVENTS

On November 24, 2003, the Authority had outstanding $54,567,000 in tax-exempt commercial paper and $8,300,000 in taxable commercial paper. Between June 30, 2003, and November 24, 2003, the Authority has issued $17,000,000 in commercial paper to pay construction expenditures.

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY STATEMENTS OF NET ASSETS - PROGRAM LEVEL
JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	June 30, 2003			June 30, 2002		
	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total
ASSETS						
Current assets:						
Cash	$ 18,251	$ 7,316	$ 25,567	$ 42,522	$ 12,702	$ 55,224
Cash with fiscal agent	2	-	2	37	-	37
Investments with fiscal agent	5	-	5	-	-	-
Loans receivable	23,571	1,322	24,893	22,372	1,321	23,693
Interest receivable	3,645	-	3,645	3,716	6	3,722
Receivables for administrative fees	260	5	265	341	2	343
Total current assets	45,734	8,643	54,377	68,988	14,031	83,019
Noncurrent assets:						
Restricted cash	-	3,878	3,878	-	1,749	1,749
Restricted investments	12,968	-	12,968	12,987	712	13,699
Loans receivable	430,602	12,234	442,836	393,892	8,164	402,056
Deferred charges	3,369	440	3,809	3,531	483	4,014
Total noncurrent assets	446,939	16,552	463,491	410,410	11,108	421,518
Total assets	492,673	25,195	517,868	479,398	25,139	504,537
LIABILITIES						
Current liabilities:						
Due to higher education institutions	4,104	-	4,104	-	-	-
Due to local education authorities	-	87	87	-	-	-
Accrued interest payable	3,707	-	3,707	3,866	-	3,866
Deferred revenue	553	58	611	736	58	794
Bonds payable	23,572	-	23,572	22,372	-	22,372
Total current liabilities	31,936	145	32,081	26,974	58	27,032
Noncurrent liabilities:						
Deferred revenue	6,120	513	6,633	6,462	571	7,033
Commercial paper payable	46,747	-	46,747	13,757	-	13,757
Bonds payable	401,710	24,527	426,237	424,248	24,516	448,764
Total noncurrent liabilities	454,577	25,040	479,617	444,467	25,087	469,554
Total liabilities	486,513	25,185	511,698	471,441	25,145	496,586
NET ASSETS						
Unrestricted	$ 6,160	$ 10	$ 6,170	$ 7,957	$ (6)	$ 7,951

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY STATEMENTS OF REVENUES,
EXPENSES AND CHANGES IN NET ASSETS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	Year ended June 30, 2003			Year ended June 30, 2002		
	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	$ 24,857	$ 70	$ 24,927	$ 21,500	$ 53	$ 21,553
Investment earnings	780	1	781	1,054	2	1,056
Total operating revenues	25,637	71	25,708	22,554	55	22,609
OPERATING EXPENSES						
Interest expense-commercial paper	353	-	353	1,177	-	1,177
Interest expense-bonds	24,081	11	24,092	19,977	11	19,988
Subsidy to borrowers	2,381	1	2,382	809	2	811
Administrative expense	457	-	457	524	21	545
Amortization of bond issuance costs	162	43	205	129	35	164
Total operating expenses	27,434	55	27,489	22,616	69	22,685
Operating income (loss) and change in net assets	(1,797)	16	(1,781)	(62)	(14)	(76)
Net assets, July 1	7,957	(6)	7,951	8,019	8	8,027
Net assets, June 30	$ 6,160	$ 10	$ 6,170	$ 7,957	$ (6)	$ 7,951

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY STATEMENTS OF CASH FLOWS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2003, AND JUNE 30, 2002

(Expressed in Thousands)

	Year ended June 30, 2003			Year ended June 30, 2002		
	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 borrowers for administrative fees	$ 340	$ 9	$ 349	$ 188	$ 5	$ 193
Payments to suppliers	(457)	-	(457)	(550)	(22)	(572)
Receipts from borrowers to the interest rate reserve fund	171	-	171	176	-	176
Payments to borrowers from the interest rate reserve fund	(354)	-	(354)	(29)	-	(29)
Net cash used in operating activities	(300)	9	(291)	(215)	(17)	(232)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Proceeds from sale of bonds	-	-	-	118,540	11,132	129,672
Proceeds from sale of commercial paper	42,300	-	42,300	33,100	-	33,100
Bond issuance costs paid	-	-	-	(260)	(64)	(324)
Principal paid - bonds and commercial paper	(31,830)	-	(31,830)	(99,838)	-	(99,838)
Interest paid - bonds and commercial paper	(23,410)	-	(23,410)	(19,117)	-	(19,117)
Subsidy to borrowers	(2,471)	(1)	(2,472)	(951)	(2)	(953)
Net cash provided by (used in) noncapital financing activities	(15,411)	(1)	(15,412)	31,474	11,066	42,540
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchases of investments	(29,597)	-	(29,597)	(30,921)	-	(30,921)
Proceeds from sales and maturities of investments	29,853	700	30,553	32,915	-	32,915
Interest received on investments	543	1	544	619	2	621
Loans issued	(58,678)	(5,383)	(64,061)	(56,610)	(4,647)	(61,257)
Collections of loan principal	25,997	1,417	27,414	25,144	737	25,881
Interest received on loans	23,287	-	23,287	19,037	-	19,037
Net cash used in investing activities	(8,595)	(3,265)	(11,860)	(9,816)	(3,908)	(13,724)
Net increase (decrease) in cash	(24,306)	(3,257)	(27,563)	21,443	7,141	28,584
Cash, July 1	42,559	14,451	57,010	21,116	7,310	28,426
Cash, June 30	$ 18,253	$ 11,194	$ 29,447	$ 42,559	$ 14,451	$ 57,010
Reconciliation of cash to the Statement of Net Assets:						
Cash	$ 18,251	$ 7,316	$ 25,567	$ 42,522	$ 12,702	$ 55,224
Cash with fiscal agent	2	-	2	37	-	37
Restricted cash	-	3,878	3,878	-	1,749	1,749
Cash, June 30	$ 18,253	$ 11,194	$ 29,447	$ 42,559	$ 14,451	$ 57,010
Reconciliation of operating income (loss) to net cash used in operating activities:						
Operating income (loss)	$ (1,797)	$ 16	$ (1,781)	$ (62)	$ (14)	$ (76)
Adjustments to reconcile operating income (loss) to net cash used in operating activities:						
Amortization of bond issuance costs	162	43	205	129	35	164
Investment earnings	(780)	(1)	(781)	(1,054)	(2)	(1,056)
Interest expense	24,434	11	24,445	21,154	11	21,165
Subsidy to borrowers	2,381	1	2,382	809	2	811
Interest income from loans	(24,598)	(58)	(24,656)	(21,171)	(50)	(21,221)
Changes in assets and liabilities:						
(Increase) decrease in receivables for administrative fees	81	(3)	78	(153)	1	(152)
Decrease in accrued liabilities	-	-	-	(26)	-	(26)
Increase (decrease) in deferred revenue	(183)	-	(183)	159	-	159
Total adjustments	1,497	(7)	1,490	(153)	(3)	(156)
Net cash used in operating activities	$ (300)	$ 9	$ (291)	$ (215)	$ (17)	$ (232)
Noncash financing activities:						
Accretion of capital appreciation bonds	$ 1,129	$ -	$ 1,129	$ 1,233	$ -	$ 1,233
Bond issuance costs	-	-	-	594	198	792
Total noncash financing activities	$ 1,129	$ -	$ 1,129	$ 1,827	$ 198	$ 2,025
Noncash investing activities:						
Net appreciation in value of investments reported at fair value	$ 36	$ -	$ 36	$ 53	$ -	$ 53