Tennessee State School Bond Authority

For the Year Ended
June 30, 2004

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STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
State Capitol
Nashville, Tennessee 37243-0260
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John G. Morgan
Comptroller

March 8, 2005

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, 2004. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

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

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/eb
05/016

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, 2004

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 Report
Tennessee State School Bond Authority
For the Year Ended June 30, 2004

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Tennessee State School Bond Authority
For the Year Ended June 30, 2004

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, 2003, through June 30, 2004, 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, 2004, and for comparative purposes, the year ended June 30, 2003. 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 the bond resolutions);

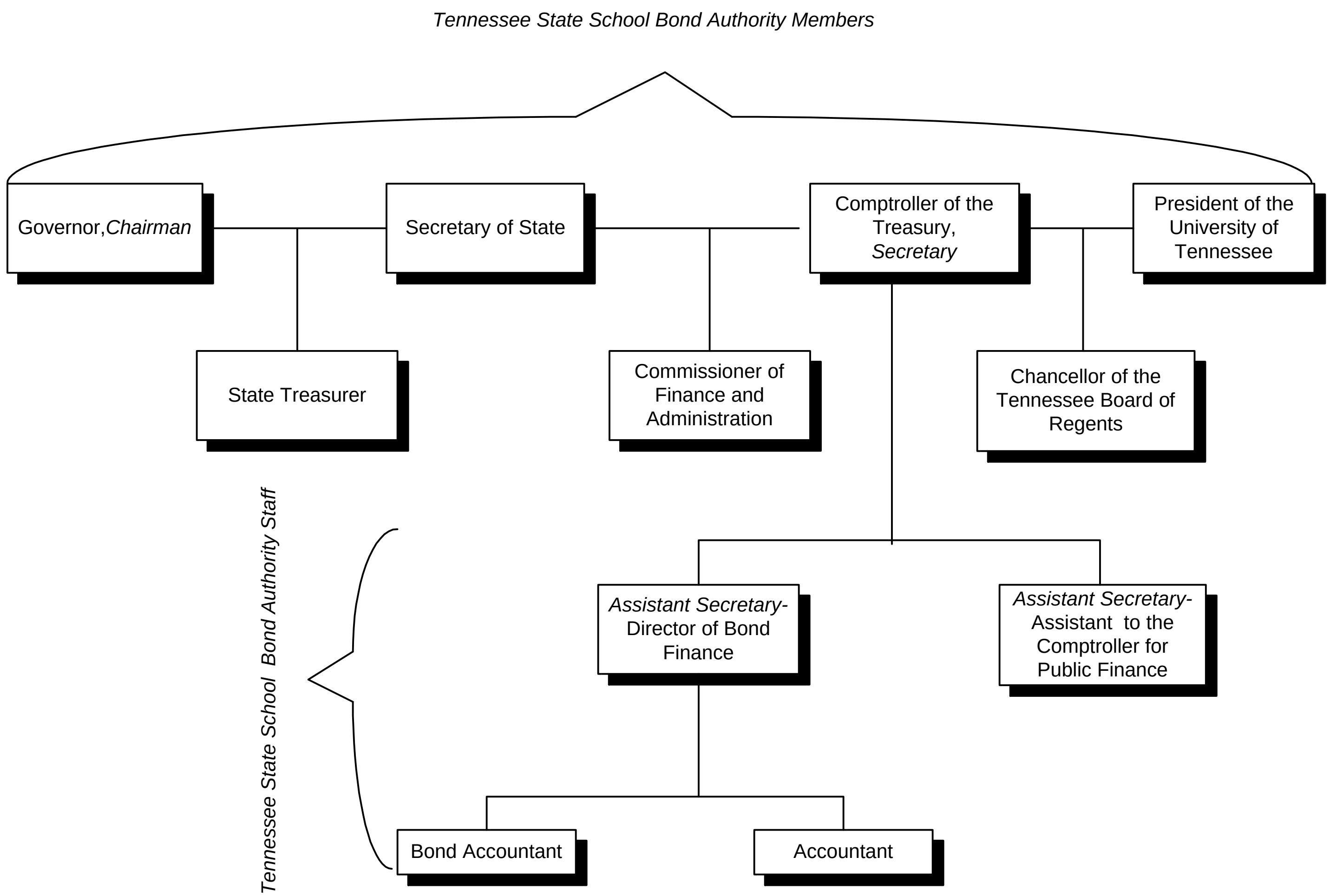
3. to determine the fairness of the presentation of the financial statements; and

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



OBSERVATIONS AND COMMENTS

CERTIFICATE OF ACHIEVEMENT FOR EXCELLENCE IN FINANCIAL REPORTING

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the Tennessee State School Bond Authority for its *Comprehensive Annual Financial Report* (CAFR) for the year ended June 30, 2003. This is the second year that the Authority has prepared a comprehensive annual financial report and received this prestigious award. 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 has submitted its *Comprehensive Annual Financial Report* for the fiscal year ended June 30, 2004, to the GFOA Certificate of Achievement Program.

FRAUD CONSIDERATIONS

Statement on Auditing Standards No. 99 promulgated by the American Institute of Certified Public Accountants requires auditors to specifically assess the risk of material misstatement of an audited entity's financial statements due to fraud. The standard also restates the obvious premise that management, and not the auditors, is primarily responsible for preventing and detecting fraud in its own entity. Management's responsibility is fulfilled in part when it takes appropriate steps to assess the risk of fraud within the entity and to implement adequate internal controls to address the results of those risk assessments.

During our audit, we discussed these responsibilities with management and how management might approach meeting them. We also increased the breadth and depth of our inquiries of management and others in the entity as we deemed appropriate. We obtained formal assurances from top management that management had reviewed the entity's policies and procedures to ensure that they are properly designed to prevent and detect fraud and that management had made changes to the policies and procedures where appropriate. Top management further assured us that all staff had been advised to promptly alert management of all allegations of fraud, suspected fraud, or detected fraud and to be totally candid in all communications with the auditors. All levels of management assured us there were no known instances or allegations of fraud that were not disclosed to us.

AUDIT COMMITTEE RECOMMENDATIONS

As a result of the fraud-related business failures of companies such as Enron and WorldCom in recent years, Congress and the accounting profession have taken aggressive measures to try to detect and prevent future failures related to fraud. These measures have included the signing of the *Sarbanes-Oxley Act of 2002* by the President of the United States and the issuance of Statement on Auditing Standards No. 99 by the American Institute of Certified Public Accountants. This new fraud auditing standard has not only changed the way auditors perform audits but has also provided guidance to management and boards of directors on creating antifraud programs and controls. This guidance has included the need for an independent audit committee.

The Tennessee State School Bond Authority has created an audit committee. The audit committee received initial training on its responsibilities and is in the process of creating its charter and calendar of events. The specific activities of any audit committee will depend on, among other things, the mission, nature, structure, and size of each agency. In creating its charter, the TSSBA board should examine the agency's particular circumstances. The following observations and comments regarding audit committees were presented to the TSSBA audit committee members for consideration during their initial training.

Anti-fraud literature notes that there are two categories of fraud: fraudulent financial reporting and misappropriation of assets. The audit committee should consider the risks of fraud in its agency in general as well as the history of its particular agency with regard to prior audit findings, previously disclosed weaknesses in internal control, and compliance issues. The audit committee should consider both the risk of fraudulent financial reporting and the risk of fraud due to misappropriation or abuse of agency assets. Also, the board and the audit committee should keep in mind that agencies receiving public funding should have a lower threshold of materiality than private sector entities with regard to fraud risks.

Boards should exercise professional judgment in establishing the duties, responsibilities, and authority of their audit committee. The factors noted below are not intended to be an exhaustive listing of those matters to be considered. The committee should not limit its scope to reacting to a preconceived set of issues and actions but rather should be proactive in its oversight of the agency as it concentrates on the internal control and audit-related activities of the entity. In fact, this individualized approach is one of the main benefits derived from an audit committee.

At a minimum, audit committees should:

1. Develop a written charter that addresses the audit committee's purpose and mission, which should be, at a minimum, to assist the board in its oversight of the agency.

2. Formally reiterate, on a regular basis, to the board, agency management, and staff their responsibilities for preventing, detecting, and reporting fraud, waste, and abuse.

3. Serve as a facilitator of any audits or investigations of the agency, including advising auditors and investigators of any information they may receive or otherwise note regarding risks of fraud or weaknesses in the agency's internal controls; reviewing with the auditors any findings or other matters noted by the auditors during audit engagements; working with the

agency management and staff to ensure implementation of audit recommendations; and assisting in the resolution of any problems the auditors may have with cooperation from agency management or staff.

4. Develop a formal process for assessing the risk of fraud at the agency, including documentation of the results of the assessments and assuring that internal controls are in place to adequately mitigate those risks.

5. Develop and communicate to staff of the agency their responsibilities to report allegations of fraud, waste, or abuse at the agency to the committee and the Comptroller of the Treasury's office as well as a process for immediately reporting such information.

6. Immediately inform the Comptroller's office when fraud is detected.

7. Develop and communicate to the board, agency management, and staff a written code of conduct reminding those individuals of the public nature of the agency and the need for all to maintain the highest level of integrity with regard to the financial operations and any related financial reporting responsibilities of the agency; to avoid preparing or issuing fraudulent or misleading financial reports or other information; to protect agency assets from fraud, waste, and abuse; to comply with all relevant laws, rules, policies, and procedures; and to avoid engaging in activities which would otherwise bring dishonor to the agency.

The charter of the audit committee should include, at a minimum, the following provisions:

1. The audit committee should be a standing committee of the board.

2. The audit committee should be composed of at least three members. The chair of the audit committee should preferably have some accounting or financial management background. Each member of the audit committee should have an adequate background and education to allow a reasonable understanding of the information presented in the financial reports of the agency and the comments of auditors with regard to internal control and compliance findings and other issues.

3. The members of the audit committee must be independent from any appearances of other interests that are in conflict with their duties as members of the audit committee.

4. An express recognition that the board, the audit committee, and the management and staff of the agency are responsible for taking all reasonable steps to prevent, detect, and report fraud, waste, and abuse.

5. The audit committee should meet regularly throughout the year. The audit committee can meet by telephone, if that is permissible for other committees. However, the audit committee is strongly urged to meet at least once a year in person. Members of the audit

committee may be members of other standing committees of the board, but the audit committee meetings should be separate from the meetings of other committees of the board.

6. The audit committee should record minutes of its meetings.

The Division of State Audit will be available to discuss with the board any questions it might have about the audit committee. There are also other audit committees which have already been established at other state agencies that the board may wish to contact for advice and further information.

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, 2004, 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 and Other Matters

The results of our audit tests disclosed no instances of noncompliance or other matters 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
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Report on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance With *Government Auditing Standards*

November 29, 2004

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, 2004, and have issued our report thereon dated November 29, 2004. 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.

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 an opinion 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 that might be material weaknesses. A material weakness is a reportable 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 caused by error or fraud 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.

Compliance and Other Matters

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 or other matters that are required to be reported under *Government Auditing Standards*.

This report is intended solely for the information and use of the General Assembly of the State of Tennessee, the board of directors, 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/eb

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DEPARTMENT OF AUDIT
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Independent Auditor's Report

November 29, 2004

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, 2004, and June 30, 2003, and the related statements of revenues, expenses, and changes in net assets and cash flows for the years then ended. These basic 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. Tennessee statutes, in addition to audit responsibilities, entrust certain other responsibilities to the Comptroller of the Treasury. Those responsibilities include serving as a member of the board of directors of the Tennessee State School Bond Authority; approving accounting policies of the state as prepared by the state's Department of Finance and Administration; approving certain Authority contracts; maintaining the accounting records for the Tennessee State School Bond Authority; and providing support staff to the Authority.

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, 2004, and June 30, 2003, 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 management's discussion and analysis on pages 12 through 18 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 38 through 40 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 audits 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 29, 2004, on our consideration of the Authority's internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, and contracts (including bond resolutions). The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. 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, 2004. These activities are compared to the results of the fiscal years ended June 30, 2003, and 2002.

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		
	2004	**2003**	**2002**
Number of institutions with outstanding loans	14	14	12
Total number of outstanding loans	208	200	192
Balance of outstanding loans	$ 477,867,414	$ 454,172,896	$ 416,263,828
Number of loans approved in fiscal year	20	15	10
Dollar value of loans approved in fiscal year	$ 113,686,550	$ 82,014,000	$ 56,815,000
Dollar value of loans approved in fiscal year - unfunded	$ 109,417,744	$ 76,770,858	$ 55,358,652
Dollar value of loans issued in fiscal year	$ 46,155,418	$ 58,677,534	$ 56,609,920
Bonds issued in fiscal year	$ 165,770,000	$ -	$ 119,135,000
Commercial paper issued in fiscal year	$ 39,000,000	$ 42,300,000	$ 33,100,000

	Qualified Zone Academy Bond Program		
	2004	**2003**	**2002**
Number of LEAs with outstanding loans	10	9	9
Total number of outstanding loans	12	10	10
Balance of outstanding loans	$ 17,375,137	$ 13,555,514	$ 9,484,761
Number of loans approved in fiscal year	2	-	3
Dollar value of loans approved in fiscal year	$ 2,445,000	$ -	$ 11,330,000
Dollar value of loans approved in fiscal year - unfunded	$ 1,732,093	$ -	$ 10,588,577
Dollar value of loans issued in fiscal year	$ 5,205,991	$ 5,383,748	$ 4,646,695
Bonds issued in fiscal year	$ 2,445,000	$ -	$ 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

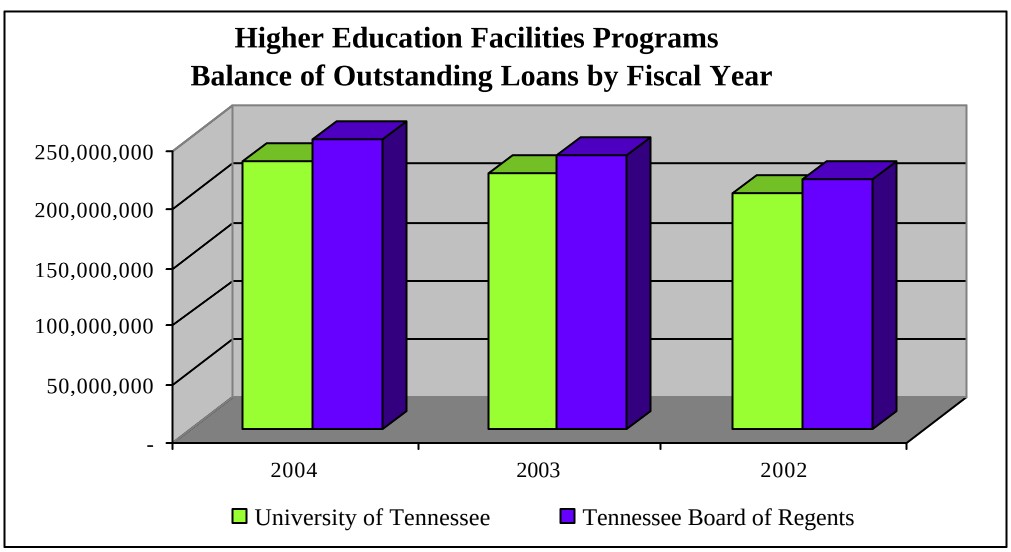
Pursuant to Section 49-3-1201 et seq., *Tennessee Code Annotated*, the General Assembly of the State created the Tennessee State School Bond Authority to issue bonds and notes to fund capital projects for the higher education institutions including both four-year institutions and two-year community colleges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

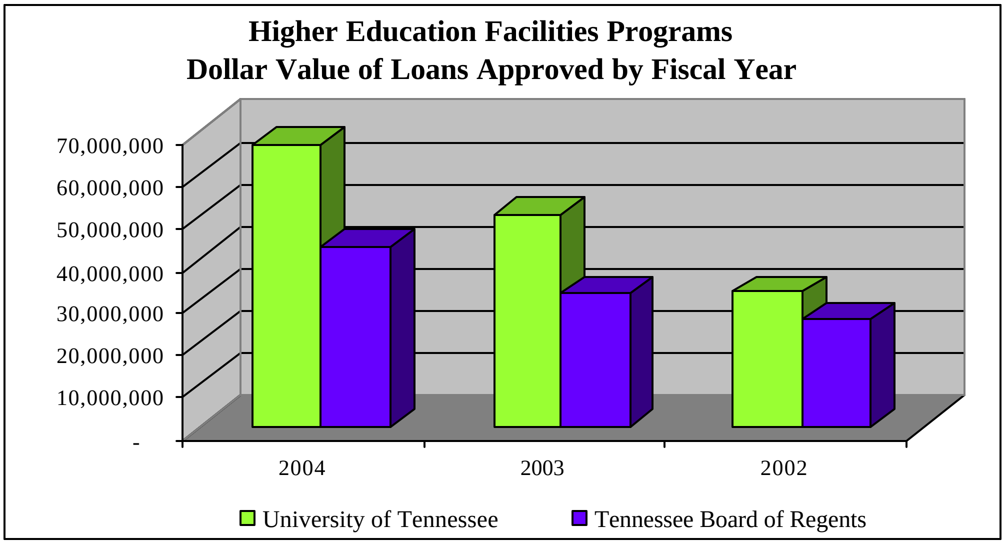
Higher Education Facilities Programs. An analysis of the financial feasibility of each loan application is undertaken before it is approved by the Authority. Each higher education system (the University of Tennessee and the Tennessee Board of Regents) must include in its annual budget sufficient funds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

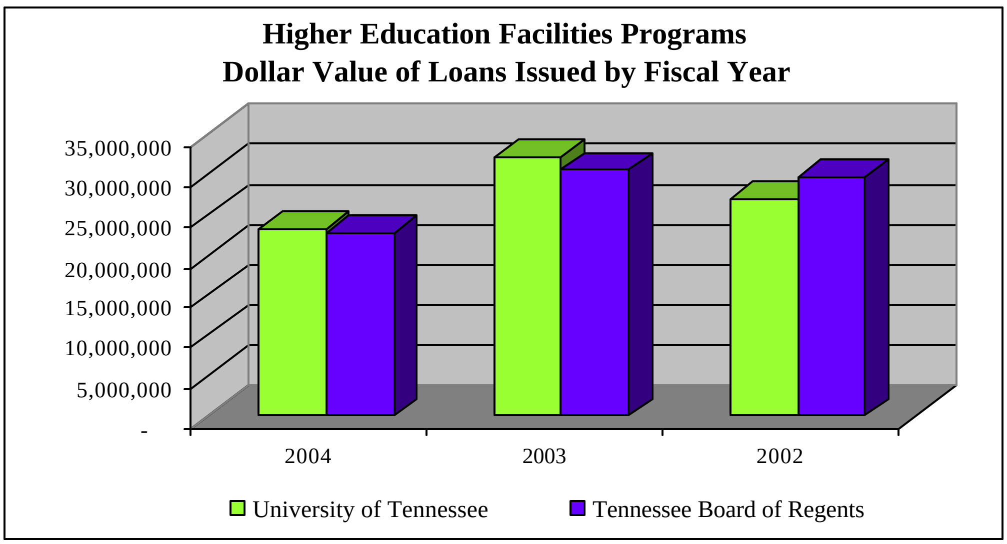
Under the financing program for higher education institutions, a project is generally funded through the Authority's commercial paper program during its construction phase. When projects totaling $50 million or greater are completed or near completion, the Authority fixes the interest rate for the term of the project by issuing long-term debt. Commercial paper interest rates ranged from 0.75% to 1.28% during the fiscal year 2004, 0.85% to 1.85% in fiscal year 2003 and 1.2% to 3.0% in fiscal year 2002. 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 1.30% 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.



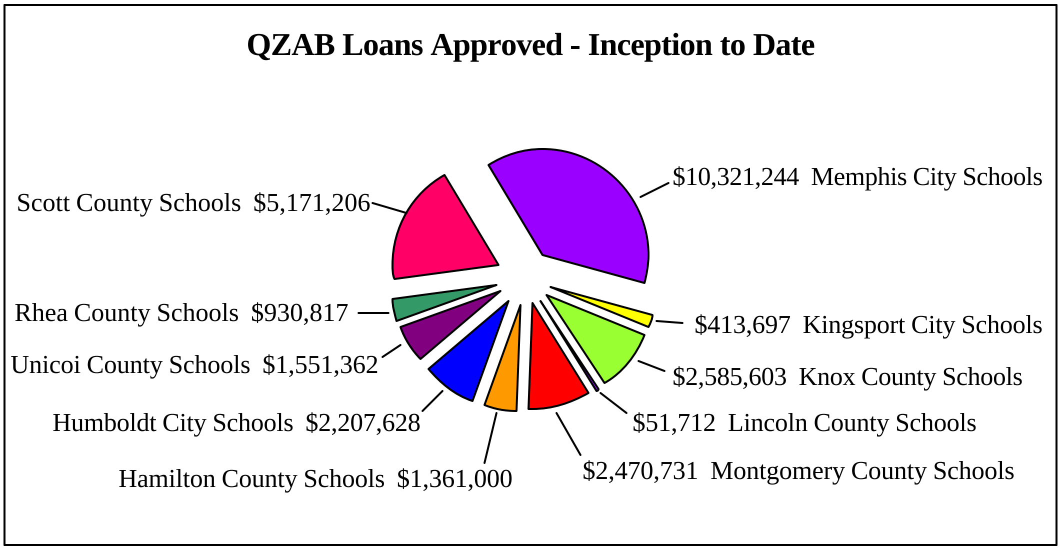




The Authority's higher education facilities program is rated AA, Aa3, and AA- by Fitch, Moody's Investors Service and Standard & Poor's Rating Group, respectively. Fitch comments that the rating reflects the broad coverage provided by higher education fees and charges, the provision to intercept state appropriations and the State's intrinsic role in the Authority and its financings as the reason for the AA rating. Moody's mentions that the rating of Aa3 reflects a strong demand for the state's educational institutions, support derived from the state's high rating, and the structural provisions of the program. Standard & Poor's 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.

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 purc hases. 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 conformity 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 is 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, 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, 2004, and June 30, 2003. 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 educational 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 2004, at competitive sale, seven 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)

	2004	2003	2002
Current assets	$ 86,801	$ 54,377	$ 83,019
Noncurrent assets	493,461	463,491	421,518
Total assets	580,262	517,868	504,537
Current liabilities	27,529	32,081	27,032
Noncurrent liabilities	546,553	479,617	469,554
Total liabilities	574,082	511,698	496,586
Net assets (unrestricted)	$ 6,180	$ 6,170	$ 7,951

Note: The Authority owns no capital assets.

Current assets include approximately $51,233,000 of unexpended bond proceeds and commercial paper at June 30, 2004 that will fund approved loans, as compared to approximately $14,508,000 at June 30, 2003 and approximately $46,292,000 in the fiscal year 2002. During the year ended June 30, 2004, the Authority issued $165,770,000 in Higher Education Facilities Second Program Bonds of which $67,965,000 was used to refund a portion of the 1987 and 1996A bonds that resulted in net present value savings of $4,044,540. Qualified Zone Academy Bonds also issued $2,445,000 during the year ended June 30, 2004. However, during the year ended June 30, 2003, the Authority did not issue any new long-term debt. Principal payments were made on the long-term bonds in the amount of $22,911,000 in 2004; $22,520,000 in 2003; and $20,218,000 in 2002. During 2004 the Authority issued $39,000,000 in new commercial paper and redeemed $53,591,000 as compared to $42,300,000 of new issuances of commercial paper and the redemption of $9,310,000 during 2003 and $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 year ending June 30, 2004, net assets did not significantly change. The Authority elected to reduce net assets for the year ended June 30, 2003 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)

	2004	2003	2002
Operating Revenues			
Revenue from loans	$ 22,956	$ 24,927	$ 21,553
Investment earnings	423	781	1,056
Total operating revenue	23,379	25,708	22,609
Operating Expenses			
Interest expense	22,273	24,445	21,165
Subsidy to borrowers	340	2,382	811
Other expenses	756	662	709
Total operating expenses	23,369	27,489	22,685
Operating income (loss) and change in net assets	$ 10	$ (1,781)	$ (76)

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 had elected to provide an additional $1.7 million in subsidy to its borrowers from its unrestricted net assets.

Pursuant to the bond resolution for the QZABs, Sinking Fund payments are invested in the Local Government Investment Pool (the "LGIP"). LGIP rates for 2004 ranged from 1.03% to 1.12%. 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 increase in operating income and change in net assets between the fiscal years 2004 and 2003 was affected by the savings from the 2004 refunding bond issuance, decrease in the amount given in subsidy to the Authority's borrowers, and from a stabilizing market. The decrease in the operating income and change in net assets between the fiscal years 2003 and 2002 was most affected by the additional subsidy given 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.

Economic and Demographic Factors Affecting Future Financing Activities

Higher Education Facilities Programs. As Tennessee enters an economic era that emphasizes the human capital potential of its citizens rather than physical capital and natural resources, higher education must be positioned to serve the broader-based need for access to post-secondary education. A host of policy and environmental factors influence both demands for access and the means through which this demand will be met. These factors include:

- The advent of the Tennessee Education Lottery Scholarship program has allowed more Tennesseans to attend college. In Fall 2004, over forty thousand students received such scholarships. Experience in states with similar programs indicates that Tennessee must re-examine its structural delivery of undergraduate education including the availability of facilities where learning occurs.
- Tennessee will experience sustained enrollment growth throughout the remainder of the decade as a result of the baby-boom echo. According to the Southern Regional Education Board, the number of high school graduates in the state of Tennessee will increase by more than 4,000 students through the end of this decade. We anticipate that many of these students will matriculate through Tennessee's higher education system.
- The demographic composition of the state is changing dramatically and higher education must position itself to serve the needs of an increasingly diverse populace.

In the Knowledge Economy, the importance of receiving training beyond high school is significant. Presently, 19.6 percent of Tennesseans age 25 and older hold a college degree, compared to the national average of 25.2 percent. In order to reach the average educational attainment levels of our border-states, Tennessee would need to create more than 181,500 new college graduates overnight. Furthermore, the percentage of adults in the state with an associate degree or some college in 2000 was 27.1 percent, in comparison with the national average of 29.6 percent. The availability of new and/or improved learning facilities near work and home will have a major impact on the State's success in achieving these goals.

Qualified Zone Academy Bond Program. As of June 30, 2004, the QZAB program had unused allocations totaling $17,695,000. Subsequent to the year ended June 30, 2004, the Authority issued QZAB bonds in the amount of $12,600,000, dated November 24, 2004. The 2004 allocation made by the federal government to the Tennessee QZAB program totaled $9,182,000.

The State has two years after the annual allocations are made by the federal government to issue bonds or the allocations are forfeited. As of November 29, 2004 the total unused allocation was $14,277,000, which consisted of $5,095,000 expiring on December 31, 2005 and $9,182,000 expiring on December 31, 2006. The Authority staff along with the staff of the State Department of Education encourages local education authorities, cities and counties to take advantage of these tax-free loans.

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, 2004, AND JUNE 30, 2003

(Expressed in Thousands)

	June 30, 2004	June 30, 2003
ASSETS		
Current assets:		
Cash (Note 2)	$ 58,222	$ 25,567
Cash with fiscal agent (Note 2)	1	2
Investments with fiscal agent (Note 2)	5	5
Loans receivable (Note 3)	24,178	24,893
Interest receivable (Note 3)	4,024	3,645
Receivables for administrative fees (Note 3)	371	265
Total current assets	86,801	54,377
Noncurrent assets:		
Restricted cash (Notes 2 and 4)	5,299	3,878
Restricted investments (Notes 2 and 4)	11,601	12,968
Loans receivable (Note 3)	471,065	442,836
Deferred charges	5,496	3,809
Total noncurrent assets	493,461	463,491
Total assets	580,262	517,868
LIABILITIES		
Current liabilities:		
Due to higher education institutions	-	4,104
Due to local education authorities	-	87
Accrued interest payable	4,176	3,707
Deferred revenue (Note 6)	933	611
Bonds payable (Note 5)	22,420	23,572
Total current liabilities	27,529	32,081
Noncurrent liabilities:		
Deferred revenue (Note 6)	9,432	6,633
Commercial paper payable (Note 5)	32,156	46,747
Bonds payable (Note 5)	504,965	426,237
Total noncurrent liabilities	546,553	479,617
Total liabilities	574,082	511,698
NET ASSETS		
Unrestricted	$ 6,180	$ 6,170

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, 2004, AND JUNE 30, 2003

(Expressed in Thousands)

	Year Ended June 30, 2004	Year Ended June 30, 2003
OPERATING REVENUES		
Revenue from loans	$ 22,956	$ 24,927
Investment earnings	423	781
Total operating revenues	23,379	25,708
OPERATING EXPENSES		
Interest expense-commercial paper	515	353
Interest expense-bonds	21,758	24,092
Subsidy to borrowers	340	2,382
Administrative expense	527	457
Amortization of bond issuance costs	229	205
Total operating expenses	23,369	27,489
Operating income (loss) and change in net assets	10	(1,781)
Net assets, July 1	6,170	7,951
Net assets, June 30	$ 6,180	$ 6,170

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

Exhibit C

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2004, AND JUNE 30, 2003

(Expressed in Thousands)

	Year Ended June 30, 2004	Year Ended June 30, 2003
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts from borrowers for administrative fees	$ 268	$ 349
Payment to suppliers	(527)	(457)
Receipts from borrowers to the interest rate reserve fund	183	171
Payments to borrowers from the interest rate reserve fund	(30)	(354)
Net cash used in operating activities	(106)	(291)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES		
Proceeds from sale of bonds	101,527	-
Proceeds from sale of refunding bonds	70,377	-
Proceeds from sale of commercial paper	39,000	42,300
Bond issuance costs paid	(526)	-
Refunding bond proceeds placed in escrow	(70,130)	-
Principal paid - bonds and commercial paper	(80,811)	(31,830)
Interest paid - bonds and commercial paper	(20,718)	(23,410)
Subsidy to borrowers	(255)	(2,472)
Net cash provided by (used in) noncapital financing activities	38,464	(15,412)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(45,229)	(29,597)
Proceeds from sales and maturities of investments	46,736	30,553
Interest received on investments	374	544
Loans issued	(51,361)	(64,061)
Collections of loan principal	24,526	27,414
Interest received on loans	20,671	23,287
Net cash used in investing activities	(4,283)	(11,860)
Net increase (decrease) in cash	34,075	(27,563)
Cash, July 1	29,447	57,010
Cash, June 30	$ 63,522	$ 29,447

TENNESSEE STATE SCHOOL BOND AUTHORITY
STATEMENTS OF CASH FLOWS
FOR THE YEARS ENDED JUNE 30, 2004, AND JUNE 30, 2003

(Expressed in Thousands)

	Year Ended June 30, 2004	Year Ended June 30, 2003
Reconciliation of cash to the Statement of Net Assets:		
Cash	$ 58,222	$ 25,567
Cash with fiscal agent	1	2
Restricted cash	5,299	3,878
Cash, June 30	$ 63,522	$ 29,447
Reconciliation of operating income (loss) to net cash used in operating activities:		
Operating income (loss)	$ 10	$ (1,781)
Adjustments to reconcile operating income (loss) to net cash used in operating activities:		
Amortization of bond issuance costs	229	205
Investment earnings	(423)	(781)
Interest expense	22,273	24,445
Subsidy to borrowers	340	2,382
Interest income from loans	(22,581)	(24,656)
Changes in assets and liabilities:		
(Increase) decrease in receivables for administrative fees	(106)	78
Increase (decrease) in deferred revenue	152	(183)
Total adjustments	(116)	1,490
Net cash used in operating activities	$ (106)	$ (291)
Noncash financing activities:		
Accretion of capital appreciation bonds	$ 1,018	$ 1,129
Bond issuance costs	(3,689)	-
Total noncash financing activities	$ (2,671)	$ 1,129
Noncash investing activities:		
Net appreciation in value of investments reported at fair value	$ 8	$ 36

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 principles 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.

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, 2004, and June 30, 2003. 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, 2004, are categorized below (expressed in thousands):

	Category		
	1	2	3
Federal Home Loan Bank Discount Notes	$ 11,606	$ -	$ -

Authority investments at June 30, 2003, are categorized below (expressed in thousands):

	Category		
	1	2	3
Federal Home Loan Bank Discount Notes	$ 12,973	$ -	$ -

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 loan agreements with the local education agencies for the 1999 QZABs, dated November 30, 1999, the 2001 QZABs dated December 18, 2001, and the 2003 QZABs dated December 23, 2003. Under the agreements, the Authority agrees to finance construction projects for the local education agencies. On the annual date of the agreements, 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; 2002 Series A; and 2004 Series A, B, and C 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 secured solely by the payments made by the borrowers under the Loan Agreements, including amounts collected from unobligated state-shared taxes in the event of non-payment by the local education agencies and by certain funds held under the Qualified Zone Academy Bond Resolution. The Authority has no taxing power. Furthermore, the State of Tennessee shall not be liable on the bonds and the bonds shall not be a debt of the State of Tennessee.

Changes in debt payable for the year ended June 30, 2004, and 2003, are as follows (expressed in thousands):

	Balance June 30, 2003	Additions	Deletions	Balance June 30, 2004
Commercial paper	$ 46,747	$ 39,000	$ 53,591	$ 32,156
Bonds payable	$ 452,305	$ 169,233	$ 90,326	$ 531,212
Less: unamortized bond discount/premium	(213)	5,374	(390)	5,551
Less: unamortized deferred amount on refundings	(2,283)	(7,331)	(236)	(9,378)
Total bonds payable	$ 449,809	$ 167,276	$ 89,700	$ 527,385

	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

Additions to bonds payable include accretion of interest in the amount of $1,018 in 2004 and $1,129 in 2003.

Bonds and commercial paper payable at June 30, 2004, and June 30, 2003, are as follows (expressed in thousands):

	June 30, 2004	June 30, 2003
Bonds Payable:		
1967 Series A at an interest rate of 4.10% maturing to 2007 were called on May 1, 2004 (original par - $43,800)	$ –	$ 3,450
1976 Series B at an interest rate of 3.0% maturing to 2011 (original par - $6,037)	1,366	1,607
1987 Refunding Series A at an interest rate of 4% maturing in 2012 were called on May 1, 2004 (original par – $70,686)	–	1,170
1989 College Saver Bonds with yields of 6.8% to 6.9% maturing to 2010 (at accreted value); (original principal - $21,935)	13,311	15,053
1996 Series A at an interest rate of 6.0% maturing to 2006 (original par - $102,710); see additional disclosures regarding the 2004 advance refunding	5,475	71,140
1996 Refunding Series B at interest rates from 5.0% to 6.0% maturing to 2011 (original par - $55,300)	8,355	9,370
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)	48,365	49,780
1998 Series B (Taxable) at interest rates from 5.80% to 6.70% maturing to 2028 (original - par $15,460)	14,265	14,555
1998 Refunding Series C at interest rates from 4.20% to 5.00% maturing to 2014 (original par	14,375	20,225

	June 30, 2004	June 30, 2003
- $48,735)		
1998 Refunding Series D at interest rates from 4.00% to 4.85% maturing to 2021 (original par - $33,540)	22,400	24,115
2000 Series A at interest rates from 4.60% to 5.625% maturing to 2030 (original par - $70,680)	65,150	66,830
2000 Series B at interest rates from 6.70% to 7.75% maturing to 2020 (original par - $33,730)	28,240	30,095
2002 Series A at interest rates from 4.50% to 5.25% maturing to 2032 (original par - $119,135)	113,030	116,250
2004 Series A at interest rates from 2.00% to 4.50% maturing to 2026 (original par - $67,965)	67,965	–
2004 Series B at interest rates from 2.00% to 4.50% maturing to 2034 (original par - $60,575)	60,575	–
2004 Series C at interest rates from 1.30% to 5.50% maturing to 2034 (original par - $37,230)	37,230	–
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	11,330
Qualified Zone Academy Bonds non-interest bearing maturing in 2018 (original par - $2,445)	2,445	–
Total Par Amount of Bonds Payable	531,212	452,305

	June 30, 2004	June 30, 2003
Plus Unamortized Premium/Less Unamortized Discount	5,551	(213)
Bonds Payable Net of Unamortized Premium/ Discount	536,763	452,092
Less: Deferred Amount on Refundings	(9,378)	(2,283)
Net Bonds Payable	$ 527,385	$ 449,809
Commercial paper, at varied interest rates from 0.75 % to 1.28 %	$ 32,156	$ 46,747

Debt service requirements to maturity of the bonds payable at June 30, 2004, are as follows (expressed in thousands):

For the Year(s) Ending June 30	Principal	Interest	Total
2005	$ 21,205	$ 26,191	$ 47,396
2006	20,756	24,622	45,378
2007	21,065	23,786	44,851
2008	21,863	23,031	44,894
2009	22,726	22,202	44,928
2010-2014	118,673	88,140	206,813
2015-2019	112,085	61,775	173,860
2020-2024	91,458	38,425	129,883
2025-2029	66,642	18,378	85,020
2030-2034	31,971	3,871	35,842
	$ 528,444	$ 330,421	$ 858,865

The above principal for bonds is more than that presented on the accompanying financial statements by $1.059 million. Of this amount, $8.319 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 (2005-2010) in which the bonds mature. The $1.059 million also includes $9.378 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, 2004, and 2003, the Authority did not have a liability for arbitrage.

On December 23, 2003, the Authority issued $2,445,000 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 23, the 2003 QZAB borrowers make annual principal payment into a bond fund held by the State Treasurer to pay the bonds at maturity on December 23, 2018.

On March 25, 2004, the Authority issued three new series of bonds, 2004 Series A, B, and C. The 2004 Series A tax-exempt bond proceeds in the amount of $67,965,000 along with $963,296 in debt service reserves, $3,422,774 from borrower prepayment, and $10,483 of equity contribution went to redeem the remaining $3,450,000 principal of the 1967 Series A bonds, partially redeem and partially current refund $1,170,000 of outstanding 1987 Refunding Series A bonds, and advance refund $62,795,000 aggregate principal amount of the 1996 Series A bonds. The funds provided for the advance refunding were placed in an irrevocable trust to pay interest on the 1996 Series A bonds until May 1, 2006, at which time the bonds will be redeemed. The refunding resulted in a difference between the reacquisition price and the net carrying amount of the old debt of $7,310,081 on the advance refunding and $20,344 on the current refunding. This amount is reported as a deduction from bonds payable and is being charged to operations through the year 2026. The refunding resulted in a reduction of total debt service payments of $6,027,725 over the next 22 years and an economic gain (difference between the present values of the old and new debt service payments) of $1,661,465. The 2004 Series B tax-exempt bonds in the amount of $60,575,000 were issued to redeem $42,415,000 of the Authority’s tax-exempt commercial paper, and the 2004 Series C taxable bonds in the amount of $37,230,000 were issued to redeem $8,980,000 of the Authority’s taxable commercial paper. The balance of the proceeds was used to pay for new construction projects and various costs of issuance.

Prior-Year Defeasance of Debt

In prior years, certain Authority bonds were defeased by placing the proceeds of new bonds in irrevocable trusts to provide for all future debt service on the old bonds. Accordingly, the trust account assets and the liability for the defeased bonds are not included in the Authority's financial statements. On June 30, 2004, $38,390,000 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, 2004, $30,836,000 of tax-exempt commercial paper and $1,320,000 of taxable commercial paper was outstanding. At June 30, 2003, $39,447,000 of tax-exempt commercial paper and $7,300,000 of taxable 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 0.75% to 1.28% 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, 2004, and 2003, are as follows (expressed in thousands):

	Balance July 1, 2003	Additions	Deletions	Balance June 30, 2004
Interest rate reserve fund	$ 210	$ 183	$ 30	$ 363
Other deferred revenue	7,034	3,936	968	10,002
Total deferred revenue	$ 7,244	$ 4,119	$ 998	$ 10,365

	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

Deferred revenue at June 30, 2004, and June 30, 2003, is as follows (expressed in thousands):

	June 30, 2004	June 30, 2003
Interest Rate Reserve Fund	$ 363	$ 210
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
1996 Series B bonds; amortized through 2011	315	360

	June 30, 2004	June 30, 2003
1996 Series C bonds, which was a cross-over refunding of the 1989 Current Interest Bonds; amortized through 2020	124	132
1998 Series A bonds; amortized through 2028	552	575
1998 Series B bonds; amortized through 2028	179	187
1998 Series C bonds; amortized through 2014	192	212
1998 Series D bonds, which was an advance refunding of the 1992 Series A bonds; amortized through 2021	2,358	2,498
1999 Qualified Zone Academy Bonds; amortized through 2012	272	309
2000 Series A bonds; amortized through 2030	807	839
2000 Series B bonds; amortized through 2020	187	199
2001 Qualified Zone Academy Bonds; amortized through 2015	241	262
2002 Series A bonds; amortized through 2032	890	921
2003 Qualified Zone Academy Bonds; amortized through 2018	117	–
2004 Series A bonds; amortized through 2026	4,803	–
2004 Series B bonds; amortized through 2034	(1,516)	–
2004 Series C bonds; amortized through 2034	481	–
Total	$ 10,365	$ 7,244

NOTE 7. SUBSEQUENT EVENTS

On November 29, 2004, the Authority had outstanding $42,332,000 in tax-exempt commercial paper and $1,320,000 in taxable commercial paper. Between June 30, 2004, and November 29, 2004, the Authority has issued $13,000,000 in commercial paper to pay construction expenditures.

On November 24, 2004, the Authority issued $12,600,000 of Qualified Zone Academy Bonds.

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY STATEMENTS OF NET ASSETS - PROGRAM LEVEL
JUNE 30, 2004, AND JUNE 30, 2003

(Expressed in Thousands)

	June 30, 2004			June 30, 2003		
	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total	Higher Education Facilities Program	Qualified Zone Academy Bonds Program	Total
ASSETS						
Current assets:						
Cash	$ 53,755	$ 4,467	$ 58,222	$ 18,251	$ 7,316	$ 25,567
Cash with fiscal agent	1	-	1	2	-	2
Investments with fiscal agent	5	-	5	5	-	5
Loans receivable	22,420	1,758	24,178	23,571	1,322	24,893
Interest receivable	4,024	-	4,024	3,645	-	3,645
Receivables for administrative fees	366	5	371	260	5	265
Total current assets	80,571	6,230	86,801	45,734	8,643	54,377
Noncurrent assets:						
Restricted cash	-	5,299	5,299	-	3,878	3,878
Restricted investments	11,601	-	11,601	12,968	-	12,968
Loans receivable	455,448	15,617	471,065	430,602	12,234	442,836
Deferred charges	5,030	466	5,496	3,369	440	3,809
Total noncurrent assets	472,079	21,382	493,461	446,939	16,552	463,491
Total assets	552,650	27,612	580,262	492,673	25,195	517,868
LIABILITIES						
Current liabilities:						
Due to higher education institutions	-	-	-	4,104	-	4,104
Due to local education authorities	-	-	-	-	87	87
Accrued interest payable	4,176	-	4,176	3,707	-	3,707
Deferred revenue	867	66	933	553	58	611
Bonds payable	22,420	-	22,420	23,572	-	23,572
Total current liabilities	27,463	66	27,529	31,936	145	32,081
Noncurrent liabilities:						
Deferred revenue	8,869	563	9,432	6,120	513	6,633
Commercial paper payable	32,156	-	32,156	46,747	-	46,747
Bonds payable	478,006	26,959	504,965	401,710	24,527	426,237
Total noncurrent liabilities	519,031	27,522	546,553	454,577	25,040	479,617
Total liabilities	546,494	27,588	574,082	486,513	25,185	511,698
NET ASSETS						
Unrestricted	$ 6,156	$ 24	$ 6,180	$ 6,160	$ 10	$ 6,170

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY STATEMENTS OF REVENUES,
EXPENSES AND CHANGES IN NET ASSETS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2004, AND JUNE 30, 2003

(Expressed in Thousands)

	Year ended June 30, 2004			Year ended June 30, 2003		
	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	$ 22,884	$ 72	$ 22,956	$ 24,857	$ 70	$ 24,927
Investment earnings	423	-	423	780	1	781
Total operating revenues	23,307	72	23,379	25,637	71	25,708
OPERATING EXPENSES						
Interest expense-commercial paper	515	-	515	353	-	353
Interest expense-bonds	21,746	12	21,758	24,081	11	24,092
Subsidy to borrowers	340	-	340	2,381	1	2,382
Administrative expense	527	-	527	457	-	457
Amortization of bond issuance costs	183	46	229	162	43	205
Total operating expenses	23,311	58	23,369	27,434	55	27,489
Operating income (loss) and change in net assets	(4)	14	10	(1,797)	16	(1,781)
Net assets, July 1	6,160	10	6,170	7,957	(6)	7,951
Net assets, June 30	$ 6,156	$ 24	$ 6,180	$ 6,160	$ 10	$ 6,170

TENNESSEE STATE SCHOOL BOND AUTHORITY
SUPPLEMENTARY STATEMENTS OF CASH FLOWS - PROGRAM LEVEL
FOR THE YEARS ENDED JUNE 30, 2004, AND JUNE 30, 2003

(Expressed in Thousands)

	Year ended June 30, 2004			Year ended June 30, 2003		
	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	$ 259	$ 9	$ 268	$ 340	$ 9	$ 349
Payment to suppliers	(527)	-	(527)	(457)	-	(457)
Receipts from borrowers to the interest rate reserve fund	183	-	183	171	-	171
Payments to borrowers from the interest rate reserve fund	(30)	-	(30)	(354)	-	(354)
Net cash used in operating activities	(115)	9	(106)	(300)	9	(291)
CASH FLOWS FROM NONCAPITAL FINANCING ACTIVITIES						
Proceeds from sale of bonds	99,130	2,397	101,527	-	-	-
Proceeds from sale of refunding bonds	70,377	-	70,377	42,300	-	42,300
Proceeds from sale of commercial paper	39,000	-	39,000	-	-	-
Bond issuance costs paid	(477)	(49)	(526)	(31,830)	-	(31,830)
Refunding bond proceeds placed in escrow	(70,130)	-	(70,130)	(23,410)	-	(23,410)
Principal paid - bonds and commercial paper	(80,811)	-	(80,811)	-	-	-
Interest paid - bonds and commercial paper	(20,718)	-	(20,718)	-	-	-
Subsidy to borrowers	(255)	-	(255)	(2,471)	(1)	(2,472)
Net cash provided by (used in) noncapital financing activities	36,116	2,348	38,464	(15,411)	(1)	(15,412)
CASH FLOWS FROM INVESTING ACTIVITIES						
Purchases of investments	(45,229)	-	(45,229)	(29,597)	-	(29,597)
Proceeds from sales and maturities of investments	46,736	-	46,736	29,853	700	30,553
Interest received on investments	374	-	374	543	1	544
Loans issued	(46,155)	(5,206)	(51,361)	(58,678)	(5,383)	(64,061)
Collections of loan principal	23,105	1,421	24,526	25,997	1,417	27,414
Interest received on loans	20,671	-	20,671	23,287	-	23,287
Net cash used in investing activities	(498)	(3,785)	(4,283)	(8,595)	(3,265)	(11,860)
Net increase (decrease) in cash	35,503	(1,428)	34,075	(24,306)	(3,257)	(27,563)
Cash, July 1	18,253	11,194	29,447	42,559	14,451	57,010
Cash, June 30	$ 53,756	$ 9,766	$ 63,522	$ 18,253	$ 11,194	$ 29,447
Reconciliation of cash to the Statement of Net Assets:						
Cash	$ 53,755	$ 4,467	$ 58,222	$ 18,251	$ 7,316	$ 25,567
Cash with fiscal agent	1	-	1	2	-	2
Restricted cash	-	5,299	5,299	-	3,878	3,878
Cash, June 30	$ 53,756	$ 9,766	$ 63,522	$ 18,253	$ 11,194	$ 29,447
Reconciliation of operating income (loss) to net cash used in operating activities:						
Operating income (loss)	$ (4)	$ 14	$ 10	$ (1,797)	$ 16	$ (1,781)
Adjustments to reconcile operating income (loss) to net cash used in operating activities:						
Amortization of bond issuance costs	183	46	229	162	43	205
Investment earnings	(423)	-	(423)	(780)	(1)	(781)
Interest expense	22,261	12	22,273	24,434	11	24,445
Subsidy to borrowers	340	-	340	2,381	1	2,382
Interest income from loans	(22,518)	(63)	(22,581)	(24,598)	(58)	(24,656)
Changes in assets and liabilities:						
(Increase) decrease in receivables for administrative fees	(106)	-	(106)	81	(3)	78
Increase (decrease) in deferred revenue	152	-	152	(183)	-	(183)
Total adjustments	(111)	(5)	(116)	1,497	(7)	1,490
Net cash used in operating activities	$ (115)	$ 9	$ (106)	$ (300)	$ 9	$ (291)
Noncash financing activities:						
Accretion of capital appreciation bonds	$ 1,018	$ -	$ 1,018	$ 1,129	$ -	$ 1,129
Bond issuance costs	(3,736)	47	(3,689)	-	-	-
Total noncash financing activities	$ (2,718)	$ 47	$ (2,671)	$ 1,129	$ -	$ 1,129
Noncash investing activities:						
Net appreciation in value of investments reported at fair value	$ 8	$ -	$ 8	$ 36	$ -	$ 36