

INVESTIGATIVE AUDIT REPORT

TENNESSEE SCHOOL BOARDS ASSOCIATION
TENNESSEE SCHOOL BOARDS-RISK MANAGEMENT TRUST
TENNESSEE SCHOOL BOARDS-UNEMPLOYMENT
COMPENSATION TRUST
JANUARY 1, 2000, THROUGH APRIL 30, 2005



State of Tennessee



**Comptroller of the Treasury
Department of Audit
Division of Municipal Audit**



STATE OF TENNESSEE

C O M P T R O L L E R O F T H E T R E A S U R Y

John G. Morgan

Comptroller

STATE CAPITOL

NASHVILLE, TENNESSEE 37243-0260

PHONE (615) 741-2501

January 5, 2006

Board of Directors and Board of Trustees
Tennessee School Boards Association
Tennessee School Boards Risk Management Trust
Tennessee School Boards Unemployment Compensation Trust
101 French Landing Drive
Nashville, TN 37228

Ladies and Gentlemen:

Presented herewith is the report on our investigative audit of selected records of the Tennessee School Boards Association, the Tennessee School Boards Risk Management Trust, and the Tennessee School Boards Unemployment Compensation Trust. This examination focused on the period January 1, 2000, through April 30, 2005. However, when warranted, this scope was expanded.

The purpose of our audit was to determine if the entities were operating in a sound financial manner and the extent of their compliance with certain laws and regulations.

The issues in this report relate to those conditions that we believe warrant your attention. Several of the issues are summarized in the Executive Summary Section of this report.

Copies of this report are being forwarded to Governor Phil Bredesen, the State Attorney General, the local District Attorney General, state legislators, and various other interested parties. A copy is available for public inspection in our office.

Very truly yours,

John G. Morgan
Comptroller of the Treasury



**STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF MUNICIPAL AUDIT**

John G. Morgan
Comptroller of the Treasury

SUITE 1600
JAMES K. POLK STATE OFFICE BUILDING
505 DEADERICK STREET
NASHVILLE, TENNESSEE 37243-0271
PHONE (615) 401-7871
FAX (615) 741-1551

Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

January 5, 2006

Mr. John G. Morgan
Comptroller of the Treasury
State Capitol
Nashville, TN 37243-0260

Dear Mr. Morgan:

Pursuant to a request from members of the state legislature, we have completed our investigative audit of selected records of the Tennessee School Boards Association, the Tennessee School Boards Risk Management Trust, and the Tennessee School Boards Unemployment Compensation Trust. This investigative audit focused on the period January 1, 2000, through April 30, 2005. However, when the examination warranted, this scope was expanded.

The purpose of our audit was to determine if the entities were operating in a sound financial manner and the extent of the entity's compliance with certain laws and regulations.

If after your review, you have any questions, I will be happy to supply any additional information which you may request.

Sincerely,

A handwritten signature in black ink, appearing to read "Dennis F. Dycus".

Dennis F. Dycus, CPA, CFE, Director
Division of Municipal Audit

Executive Summary

Tennessee School Boards Association

During the period January 1994 through February 2000, while serving as the executive director of the Tennessee School Boards Association, Dr. Dan Tollett requested and received illegal retirement benefits totaling \$276,856 from the Tennessee Consolidated Retirement System.

On February 19, 2002, the Tennessee School Boards Association's board of directors approved payment by TSBA of \$276,856 to the retirement system for illegal benefits Dr. Tollett had requested and received.

Dr. Tollett also received benefits, including \$107,909 in proceeds from a variable life insurance policy with a cash value, which were not included in his employment contract and were not approved by the board of directors.

Dr. Tollett prepared a fraudulent invoice and ordered payments totaling \$15,307 from the Tennessee School Boards Association and the Center for Educational Leadership bank accounts for legal fees to a number of attorneys apparently retained for the personal benefit of Dr. Tollett and another employee.

In an apparent attempt to circumvent retirement system rules and without the Tennessee School Boards Association board of directors' knowledge, Dr. Tollett entered into a contract to defer \$24,375 of his 2003 salary to 2004.

During the period January 1, 1994, through December 31, 2003, Dr. Tollett improperly received a second employer-funded pension while serving as the Tennessee School Boards Association's executive director. The pension ranged from 10 to 15 percent of Dr. Tollett's salary and totaled \$120,000 over 10 years.

The Tennessee School Boards Association board of directors presented Dr. Tollett and his wife with lavish retirement gifts, paid for with association operating funds, costing \$19,010, including a travel certificate, luggage, Rolex watch, and pearl necklace. In addition, association operating funds paid for a reception on Dr. Tollett's behalf costing at least \$6,740, which included 18 hotel rooms at the Loews Vanderbilt Hotel for board and trust members as well as over \$500 for alcoholic beverages.

Tennessee School Boards Risk Management Trust Tennessee School Boards Unemployment Compensation Trust

For the fiscal year ended June 30, 2005, the Tennessee School Boards Risk Management Trust program manager, John Evans, collected \$492,694 in fees and commissions from the trust that were not authorized by the board of trustees. This was in addition to \$2.7 million in authorized fees and commissions.

Mr. Evans collected at least \$59,000 during the two years ended June 30, 2005, from interest earned on Tennessee School Boards Risk Management Trust member premiums. These funds were not remitted for use in support of trust purposes.

The Tennessee School Boards Risk Management Trust board of trustees assigned duties to the program manager that created a potential conflict of interest.

According to claim development projections prepared by the Tennessee School Boards Risk Management Trust's actuary, the trust generated estimated losses exceeding \$10.2 million over the four-year period ending June 30, 2005.

An entire segment of Tennessee School Boards Risk Management Trust's operations had not been audited.

Dr. Tollett assumed multiple roles which appeared to create a conflict of interest between his fiduciary duties owed to the Tennessee School Boards Association, the Tennessee School Boards Risk Management Trust, and the Tennessee School Boards Unemployment Compensation Trust.

The Tennessee School Boards Risk Management Trust board of trustees apparently failed to fulfill required duties specified in the Intergovernmental Cooperative Agreement.

The board of trustees improperly offered and sold individual liability insurance to Tennessee teachers, including teachers whose school systems were not members of the Tennessee School Boards Risk Management Trust. Coverage was also extended to other ineligible members.

Additional details for these and other issues identified during the investigative audit are included in the body of the report.

**INVESTIGATIVE AUDIT OF THE RECORDS OF THE
TENNESSEE SCHOOL BOARDS ASSOCIATION
TENNESSEE SCHOOL BOARDS-RISK MANAGEMENT TRUST
TENNESSEE SCHOOL BOARDS-UNEMPLOYMENT COMPENSATION TRUST
FOR THE PERIOD JANUARY 1, 2000, THROUGH APRIL 30, 2005**

This investigative audit was initiated at the request of several members of the state legislature. Our office was mainly tasked with determining if the Tennessee School Boards Association and the Risk Management and Unemployment Compensation Trusts were operating in a sound financial manner and in compliance with certain laws and regulations. Our review consisted primarily of making inquiries, examining selected documents and financial records, and performing tests and other procedures as deemed necessary.

BACKGROUND

The Tennessee School Boards Association (TSBA) was formed in 1939 and was chartered as a not-for-profit corporation in 1955. Its primary mission was to assist school boards and school board members. Section 49-2-2001, *Tennessee Code Annotated*, pronounced it as the organization and representative agency of the members of school boards in Tennessee. TSBA is publicly funded, primarily through dues from member boards of education and also through grants from the State of Tennessee. It is governed by a board of directors selected from member school boards. The board of directors meets quarterly. Approximately 136 Tennessee school boards are members of TSBA. Dr. Dan Tollett served as executive director of TSBA from approximately September 1978 through December 2003.

Under the direction and leadership of TSBA, the Tennessee School Boards Risk Management Trust (TSB-RMT) and the Unemployment Compensation Trust (TSB-UCT) were formed¹. These trusts were interlocal agreements between local governmental entities created pursuant to Section 12-9-104, *Tennessee Code Annotated*, and were formed in order to create self-insurance pools as authorized by Section 29-20-401, *Tennessee Code Annotated*. The trusts operated risk pools that allowed members to pool and share liability, property and casualty, workers compensation, and unemployment compensation risk as an alternative to purchasing commercial insurance policies². TSBA provided all personnel to operate the trusts and also participated in the trusts as a member. TSBA also exerted certain control over the trusts because, by agreement, the association had authority to select and appoint the trusts' board of trustees. Initially, the interlocal agreement named the TSBA executive director to serve as the trust administrator. However, the interlocal agreements went through a series of modifications beginning in 1998. Trustees began to be nominated and elected from the membership. In addition, the TSBA executive director no longer served as the trust administrator. Therefore, the only influence

¹Since their creation and until 2004, although they had separate board of trustees, the trusts were operated more or less as a division of TSBA. The executive director of TSBA served as the administrator of the trusts. The organizations were considered one entity by their auditors and in certain reports to the Internal Revenue Service.

²Government self-insurance pools are not insurance companies and are not regulated by the Tennessee Department of Commerce and Insurance. Their authority is limited to determining that risk pool reserves are adequate.

TSBA could exert over the trusts would be by contractual agreement. Until 2001, the trusts membership was limited exclusively to school boards and TSBA. However, the makeup of the membership in the TSB-RMT was expanded to accept other local governments, including counties and utility districts. Approximately 105 school systems, and 62 local governments and utility districts are currently members of the TSB-RMT, while 53 school systems participate in the TSB-UCT.

In 1993, acting upon Dr. Tollett's suggestion, TSBA created a wholly owned subsidiary, the Center for Educational Leadership, Governance and Research (CEL). It was a not-for-profit corporation whose stated purpose, according to its charter, was to provide consulting, training, educational management and evaluation services to local boards of education and to local school systems. CEL's charter listed Dr. Tollett, executive director of TSBA, as the registered agent. TSBA's executive committee served as the initial CEL board of directors³ and thereafter appointed CEL board members. CEL ceased operations in January 2004, and was dissolved in February 2005.

Although all of the organizations operated under different statutes, state law required board members and trustees to act in their organization's best interest. In addition, board members and trustees were responsible for ensuring that employees and officials acted in their organizations' best interest. Trustees have an additional fiduciary duty to safeguard trust assets. As noted throughout this report, auditors identified conduct by current and former employees and officials of TSBA and the trusts that did not appear to be in the best interest of TSBA or the trusts. Although board members and trustees may not have personally participated in or benefited from the apparent improprieties, their failure to provide adequate oversight appeared to contribute to the climate that allowed the questionable conduct. Interviews of board members and trustees revealed that in most instances they failed to employ even modest independent examination or evaluation of staff proposals and action but instead relied entirely on the judgment and integrity of staff. Auditors found a number of staff proposals had been implemented that appeared to serve purely personal interests. We also noted that personnel did not always provide to board members and trustees complete or accurate information regarding proposed projects and plans. Therefore, it appears board members and trustees made decisions without being provided with or independently gathering essential information to determine if the proposals were in the best interest of TSBA or the trusts.

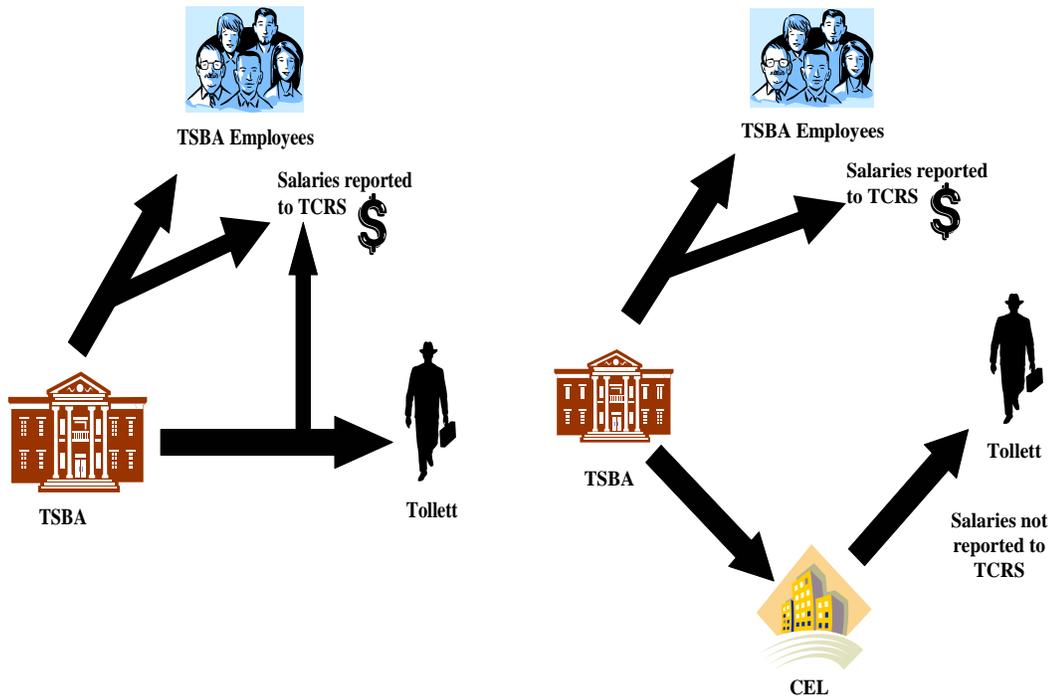
Auditor's Note: Throughout the existence of CEL, for policy decisions, the boards of CEL and TSBA appeared to be interchangeable. For instance, per contract, the former executive director was to be evaluated and his compensation set by the CEL board of directors. However, board documents indicated several years in which the TSBA board of directors performed that function. Therefore, for this report, unless the specific board that took action is relevant, the CEL and TSBA board members are referred to simply as the "board members" or collectively as "the board."

³The original board members of CEL were Charles Jenkins, Phillip White, Lana Leckie, Charles Bridwell, and Lois Taylor.

TENNESSEE SCHOOL BOARDS ASSOCIATION

1. **ISSUE:** **Violation of retirement provisions by former executive director Dr. Dan Tollett**

During the period January 1994 through February 2000, while serving as the executive director of TSBA, Dr. Dan Tollett requested and received illegal retirement benefits totaling \$276,856 from the Tennessee Consolidated Retirement System (retirement system). Apparently, in an effort to conceal from the retirement system his continued employment with and related compensation from TSBA, Dr. Tollett, with board of directors' approval, created a separate nonprofit corporation totally controlled by Dr. Tollett and TSBA, through which Dr. Tollett was compensated. Board members told auditors that Dr. Tollett had assured them that this venture was legal.



Flow of Salary Prior to Dr. Tollett Applying for Retirement Benefits

Flow of Salary After Dr. Tollett Applied for Retirement Benefits

Dr. Tollett notified the retirement system that he was retiring from TSBA at the end of 1993 and began drawing retirement benefits beginning in January 1994. Dr. Tollett continued to serve as executive director of TSBA; however, beginning in January 1994, his compensation passed through CEL. Retirement system personnel became aware of this arrangement in March 2000. They determined that TSBA and CEL was in fact the same employer, and therefore, Dr. Tollett was in violation of state statutes by drawing retirement benefits while at the same time drawing salary from an employer participating

in the retirement system. Section 8-36-203, *Tennessee Code Annotated*, states, "... [the] effective date of retirement follows the date of the member's separation from service." Section 8-36-801, *Tennessee Code Annotated*, states, "... any retired member of the Tennessee consolidated retirement system ... shall cease to draw the member's retirement allowance during the period of the employment." In March 2000, retirement system officials notified Dr. Tollett by letter that, "In general, the law governing the TCRS prohibits any retired TCRS member from receiving a publicly funded retirement benefit while also receiving a publicly funded salary." Retirement system personnel determined that, for the period January 1, 1994, through February 29, 2000, Dr. Tollett had received inappropriate retirement benefits totaling \$276,856.

In December 2000 correspondence with retirement system officials, Dr. Tollett disputed the notion that TSBA and CEL was the same employer, and continued to insist that his retirement was legitimate. However, in 1993, the year that CEL was created, Dr. Tollett had reported to the Internal Revenue Service that CEL was a wholly owned subsidiary of TSBA. In addition, a memo dated November 4, 1993, from then TSBA president-elect Phillip White to the TSBA Executive Council members, states, "As you will recall from previous discussions the primary purposes of this [CEL] are to allow Dan [Tollett] to retire from the State but to continue with TSBA as Executive Director...."

Steve Adams, the Treasurer of the State of Tennessee at the time, commented on this issue in a letter to Senator John Wilder dated January 26, 2001. He stated, in part:

It appears that TSBA may have created the Center for Educational Leadership (CEL) primarily to provide the appearance of termination of employment in order to qualify for retirement benefits while continuing to work in the same or a similar position controlled by TSBA.... CEL is an instrumentality of the TSBA. It appears that CEL may be a subterfuge for certain individuals to appear as terminated in order to claim benefits. Retirement law and the IRS require separation from service in order for one to qualify for the onset of benefits.... The idea that one can retire without truly terminating by creating an "independent" entity is troubling and potentially expensive. If anyone can do this, the system could face IRS qualification issues and the employer contributions would need to be substantially higher to support the increased pension liability....

The Attorney General of the State of Tennessee issued an informal opinion in April 2001 that determined that CEL was an instrumentality of TSBA and therefore, neither Dr. Tollett nor any other employee could draw retirement system benefits while employed by CEL.

Retirement system personnel also identified another former employee of TSBA, Deputy Director Dr. George Nerren, who had also apparently made use of CEL to simultaneously receive retirement benefits and salary. Retirement system personnel determined that Dr.

Nerren had improperly received retirement benefits as well. He was also ordered to repay the retirement benefits which he had improperly received during the period December 1, 1999, through February 29, 2000, totaling \$11,646.

Based on our investigative audit, CEL failed to meet any objective standard as a separate entity from TSBA. CEL provided services that could have been, and most were, provided by TSBA. While presumably employed by CEL, board documents indicate that for at least several years, Dr. Tollett was actually evaluated and his pay set by the TSBA executive committee. CEL's board was ostensibly appointed by the TSBA board. During CEL's 12 years of existence, the corporation's address was at all times the same as TSBA's; however, CEL paid neither rent nor utilities to TSBA. TSBA employees signed checks and prepared budgets on behalf of CEL although they were neither employees of nor appointed or elected officials of CEL.

Our investigative audit also revealed, through interviews with board members and Dr. Tollett, that legal counsel was never sought to determine the legitimacy of how CEL was being used. The board's failure to thoroughly investigate this enterprise prior to implementation allowed Dr. Tollett to use a TSBA subsidiary to circumvent retirement system rules.

Section 48-58-301, *Tennessee Code Annotated*, states:

A director shall discharge all duties as a director, including duties as a member of a committee ... (3) In a manner the director reasonably believes to be in the best interests of the corporation.

This matter has been referred to the local district attorney general, the Tennessee Attorney General, and the Internal Revenue Service for their consideration.

2. **ISSUE: Improper payment of Dr. Tollett's \$276,856 retirement debt**

Our investigative audit revealed that on February 19, 2002, the TSBA board of directors approved payment by TSBA of \$276,856 to the retirement system for illegal benefits Dr. Tollett had requested and received⁴. The directors had no legal or contractual requirement to pay this personal debt of Dr. Tollett's and we were unable to determine any benefit to TSBA or its members. Documentation indicated the board's decision was based, at least in part, on incomplete and inaccurate information provided by Dr. Tollett.

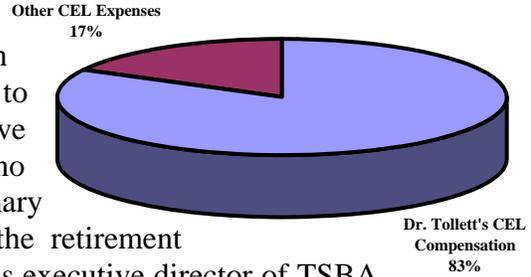
⁴According to the minutes for the February 19, 2002, meeting, the board members who were present and voted when this payment was approved were: Dr. Barbara Prescott, President; Clyde Smith, Jr., President-Elect; Mike Bevins, Vice-President; Patricia Gruenewald, Immediate Past-President; John Conley, Treasurer; Amy Martin, South Central District Director; Dr. Gordon Morris, Northwest District Director; Rodney Eubank, Delta District Director; Tom Hager, Northeast District Director; Ann McNees, East District Director; Gloria Sweet-Love, Southwest District Director; Butch Savage, Mid-Cumberland District Director; Maxine Frasier, Upper Cumberland District Director; Lora Jobe, At-Large Member; Horace Murphy, Jr., At-Large Member

Retirement system officials advised state auditors that the issue of improper receipt of retirement benefits created a personal debt of the retirees, not the employer. However, minutes of board of directors meetings and other TSBA correspondence indicated that Dr. Tollett and board members were intent on making the issue TSBA's responsibility. A memo dated January 29, 2002, from the 2001 CEL board President Patricia Gruenewald to the TSBA board of directors appeared to imply that CEL had been set up by an attorney and the retirement arrangement was legal. In addition, the memo contends that TSBA saved more than \$20,000 per year by using the CEL strategy while at the same time Dr. Tollett forfeited salary he could have earned. (Refer to Exhibit 1.) In interviews, board members indicated the information in this memo from Ms. Gruenewald had a significant impact on their decision to repay Dr. Tollett's retirement system debt.

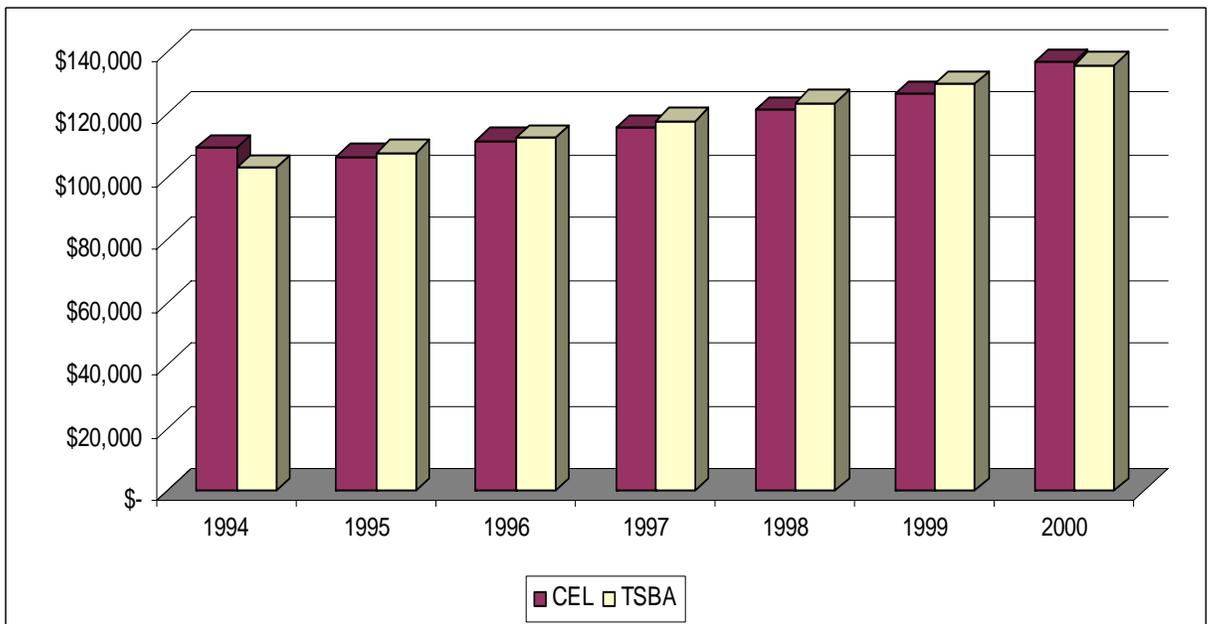
However, auditors determined that several material points in the memo may have significantly misled board members:

- ⇒ Ms. Gruenewald and Dr. Tollett both admitted to auditors that Dr. Tollett had actually prepared the memo. Ms. Gruenewald told auditors that, although she had no first-hand knowledge that the information in the memo was true, she trusted Dr. Tollett.
- ⇒ The memo indicated that attorney Chuck Cagle "did the legal work to establish CEL and prepare the necessary contracts." Board members told auditors that they had been assured by Dr. Tollett that the CEL retirement issue was legal. Mr. Cagle, who was TSBA's staff attorney at the time CEL was created, acknowledged to auditors that he did assist in incorporating CEL. However, he stated that he did not prepare or see the contracts between Dr. Tollett, CEL, and TSBA that detailed the compensation arrangement. In addition, he was never consulted by the former executive director or board members about the legality or propriety of the ultimate use of CEL, i.e., a ploy allowing employees to receive retirement benefits without actually retiring. Dr. Tollett admitted to auditors that, to his knowledge, Mr. Cagle was not asked about the propriety of this arrangement. Auditors spoke with several other individuals who served as TSBA staff attorney while Dr. Tollett was simultaneously receiving salary and retirement benefits. They indicated neither the former executive director nor any board members had ever apprised them of the details of the arrangement and they had not been consulted concerning the propriety of this arrangement.
- ⇒ The memo stated that "Its [CEL] primary purpose is to provide "management services for fees" (superintendent searches, superintendent evaluations, etc.) to school boards and other entities." However, all these services could have been, and currently are, provided by TSBA. In addition, our investigative audit showed that during the initial four years of its existence, over 98 percent of CEL's total expenses were for Dr. Tollett's payroll and compensation. From its inception through the year the retirement system suspended Dr. Tollett's benefits, over 83 percent of CEL's total expenses were for Dr. Tollett's payroll and compensation. Dr. Tollett's departure as TSBA executive director in December 2003 coincided with CEL operations coming to a close. CEL was never self supporting and could not have survived without transfers from TSBA and the risk pool trusts. The former president-elect of TSBA indicated in

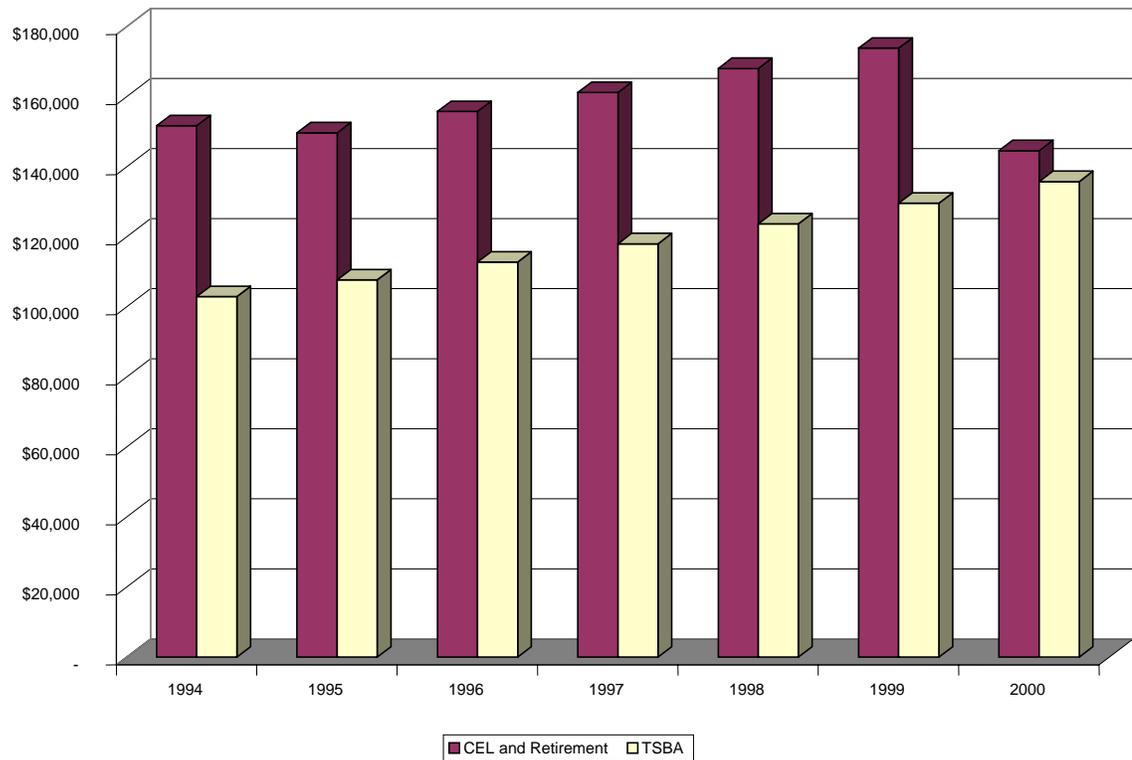
a 1993 memo that “the primary purposes of this [CEL] are to allow Dan [Tollett] to retire from the State but to continue with TSBA as Executive Director....” Because CEL provided no unique services, it appears that the primary purpose of CEL was to conceal from the retirement system the paying of Dr. Tollett’s salary as executive director of TSBA while he also received retirement benefits.



⇒ The memo includes a chart that purportedly compared Dr. Tollett’s compensation from CEL with what he would hypothetically have been paid had he stayed at TSBA. The memo used this comparison to conclude that Dr. Tollett sacrificed substantial compensation when he began receiving pay through CEL, while at the same time providing substantial savings to TSBA. However, the chart only recognized what is commonly considered “salary” paid by CEL to Dr. Tollett. It did not take into consideration the additional fringe benefits provided to Dr. Tollett by CEL, such as the simplified employee pension, the cash value life insurance policy and other specialized insurance policies that totaled up to \$30,000 annually. (Refer to Issue 3.) To provide a fair comparison, auditors calculated Dr. Tollett’s actual, comprehensive compensation from CEL, including fringe benefits, and compared that with what his comprehensive compensation from TSBA, including fringe benefits, **could** have been. The differences are actually marginal (refer to graph below), unlike the significant differences reported in the memo.



When the retirement benefits Dr. Tollett actually received from the retirement system are included in the calculation, his actual compensation *far exceeded* what his salary from TSBA **could** have been. (Refer to graph on the following page.)



Dr. Tollett could not explain to auditors why he did not consider the \$25,000 to \$30,000 in annual fringe benefits he received from CEL to be important for board members to consider. He maintained that the board members were free to ask questions regarding the information in the memo. He also maintained that board members could have looked at his employment contract to determine his fringe benefits. *(Note: Even if board members had reviewed Dr. Tollett’s contract, they would not have necessarily known his actual compensation. Auditors discovered through a detailed review of disbursements that Dr. Tollett was receiving fringe benefits beyond what he was entitled to according to his contract. (Refer to Issue 3.) Dr. Tollett did not make available to the board a complete account of his compensation package.)*

Even though Dr. Tollett acknowledged that he had prepared the memo requesting TSBA board members to repay his debt to the retirement system, he maintained to auditors that he never asked the board to repay his debt. He further told auditors that he was surprised by the generosity of the board⁵.

Auditors could not determine that the \$276,856 payment to the retirement system to satisfy Dr. Tollett’s personal debt created any benefit for TSBA and its membership. Had board members been provided accurate and complete information regarding CEL and Dr.

⁵Auditors found that the board never considered repaying the improperly received retirement benefits for Dr. Nerren, the former Deputy Director. Dr. Nerren apparently reached an arrangement with the retirement system for personally repaying his debt.

Tollett's compensation and fulfilled their duty to act in the best interest of TSBA and its membership, they may have made a different decision. It would have been prudent for the board to seek independent legal counsel and accounting advice prior to agreeing to make a payment for the personal benefit of the former executive director. The TSBA board of directors should seek legal counsel to determine if any civil action to recover funds from any party is warranted.

Section 48-58-301, *Tennessee Code Annotated*, states:

A director shall discharge all duties as a director, including duties as a member of a committee ... (3) In a manner the director reasonably believes to be in the best interests of the corporation.

This matter has been referred to the local district attorney general, the Tennessee Attorney General, and the Internal Revenue Service for their consideration.

3. **ISSUE: Former executive director's benefits exceeded contract**

Dr. Tollett received benefits, including \$107,909 in proceeds from a variable life insurance policy with a cash surrender value, which were not included in his employment contract and were not approved by the board of directors. The former executive director signed an employment contract with CEL in November 1993. The contract specified his compensation, including salary and contributions to an annuity. However, our investigative audit revealed that Dr. Tollett also received as benefits a variable life insurance policy, as well as several other insurance policies. Dr. Tollett told auditors that he believed the variable life insurance policy named CEL as the beneficiary. Auditors determined that, while the owner of the policy appeared to be CEL, the beneficiary was Dr. Tollett's spouse. An employee of the insurance company that issued the check payable to Dr. Tollett stated that she had been informed by Dr. Tollett that the CEL board of directors had approved surrendering the policy with the proceeds going to him. However, CEL board members contacted by auditors indicated that they had not approved giving the proceeds to Dr. Tollett because they were not aware the policy existed.

The former TSBA finance director Kristi Coleman initially told auditors that she was unaware of the policy or the disposition of the cash proceeds of the policy. However, auditors found that Ms. Coleman had signed the cash surrender form, as the director of finance of CEL, authorizing the payout to Dr. Tollett. (Refer to Exhibit 2.) She later acknowledged signing the document but insisted she did not recall many details. Ms. Coleman told auditors that for the benefits to be paid and released to Dr. Tollett, the form had to be signed by an official of CEL. She had initially told auditors that she never held any position, including director of finance, with CEL. However, she later suggested that Dr. Tollett had appointed her to that position. Dr. Tollett's filings with the Internal

Section 39-16-407, *Tennessee Code Annotated*, states:

A public servant commits an offense who, with intent to deceive, knowingly misrepresents material information related to an audit conducted by an auditor in the department of audit.

This matter has been referred to the local district attorney general and the Tennessee Attorney General for their consideration.

4. **ISSUE: Personal attorney fees totaling \$15,307 paid using TSBA funds**

Auditors found that Dr. Tollett prepared a fraudulent invoice and ordered payments totaling \$15,307 from TSBA and CEL bank accounts for legal fees to a number of attorneys apparently retained for his and another employee's personal benefit. The attorneys were apparently employed to resolve Dr. Tollett's and Dr. Nerren's retirement issue with the retirement system. However, because TSBA had no interest in this issue, auditors could not determine that TSBA and its membership benefited from these payments. According to retirement system representatives, TSBA was never asked to repay any money because the issue was between the retirement system and the two employees that requested and received the illegal retirement benefits. Board members that auditors spoke with were unaware that outside counsel had been retained in this matter. Dr. Tollett acknowledged that, to his knowledge, outside counsel did not discuss this issue with board members.

In one instance, an outside counsel acknowledged that the \$5,000 fee paid to him by TSBA was for personal services to a client other than TSBA. Dr. Tollett acknowledged to auditors that he was the client. The attorney also stated that, although he received the \$5,000 payment from TSBA, he had never seen nor had his office created the invoice

auditors found in TSBA records. Dr. Tollett admitted to auditors that he created the fraudulent invoice. In another instance, an outside council indicated that their engagement by TSBA included a "joint representation of Dr. Tollett."

Lyell, Seaman & Shelton
 611 Commerce Street, Suite 2704
 Nashville, TN 37203
 Phone 615-255-0033
 Fax 615-248-1971

Statement

Tennessee School Boards Assoc.
 1130 Nelson Merry St.
 Nashville, TN 37203

Payable upon receipt

Legal Services through 12/20/03

\$5,000

Section 48-58-301,
Tennessee Code
Annotated, states:

Fraudulent Invoice Created by Dr. Tollett

A director shall discharge all duties as a director, including duties as a member of a committee ... (3) In a manner the director reasonably believes to be in the best interests of the corporation.

Expending board assets in personal disputes between board employees and the retirement system does not appear to be in the best interest of TSBA and its membership. The TSBA board of directors should seek legal counsel to determine if any civil action to recover funds from any party is warranted.

This matter has been referred to the local district attorney general and the Tennessee Attorney General for their consideration.

5. **ISSUE: Improper deferral of 4th quarter salary without board approval and violation of 50 percent rule**

In an apparent attempt to circumvent retirement system rules and without the board of directors' knowledge, Dr. Tollett entered into a contract to defer \$24,375 of his 2003 salary to 2004. (Refer to Exhibit 3.) State statutes allowed retirement system retirees to return to work on a part-time basis, up to 100 days per year⁶, and not lose their retirement benefits. After being cited by the retirement system for receiving illegal benefits, Dr. Tollett entered into a 100-day contract with TSBA. Effective July 2002, the state legislature added a provision to Section 8-36-805, *Tennessee Code Annotated*, that limited the amount of salary retirees on part-time status could earn. Based on these rules, Dr. Tollett could have earned no more than \$63,668 in 2003 as a part-time employee. However, when auditors properly included the deferred salary, Dr. Tollett's compensation for that year was actually \$89,375. Dr. Tollett told auditors that he was aware of the salary limitation imposed by retirement system rules. He indicated that he had officially ended his 100-day contract August 31, 2003, and the additional compensation, which he received January 13, 2004, was for his continued employment until December 31, 2003.

Former TSBA director of finance Kristi Coleman, who is the current director of finance and administration for Tennessee School Board-Risk Management Trust, told auditors that, although she could not specifically recall, she may have prepared the deferred compensation contract. She admitted that she signed the contract and acknowledged that, although the deferred compensation contract was dated June 20, 2003, it had actually been prepared in August or September 2003. She also acknowledged that the contract did not serve the best interest of TSBA or CEL, but was for Dr. Tollett's personal benefit. Since, according to retirement system statutes, a retiree may not work more than 100 days per year or receive compensation in excess of the limitations, Dr. Tollett apparently violated at least one of those provisions.

⁶The statute was recently amended to allow retired employees to work up to 120 days per year.

It should be noted that this apparent deliberate circumvention of retirement rules occurred after Dr. Tollett had already been ordered to repay \$276,856 in illegal benefits he requested and received.

This matter has been referred to the district attorney general and the Tennessee Consolidated Retirement System for their consideration.

6. **ISSUE: Executive director's fringe benefit not properly reported**

Dr. Tollett received fringe benefits totaling \$10,922 which were not properly recorded and reported as compensation to the Internal Revenue Service (IRS). TSBA provided a vehicle for use by the former executive director; however, these additional fringe benefits were not properly reported to the IRS on Dr. Tollett's annual Form W-2.

Dr. Tollett acknowledged to auditors that while he used the employer-provided vehicle for personal use, TSBA had no written policy regarding this. The Internal Revenue Service considers use of an employer-provided vehicle to be taxable as personal use of the vehicle unless personnel policies specifically prohibit such use. IRS Publication 15-B states that the value of the fringe benefit is the annual lease value of the vehicle. Applying the requirements of IRS Publication 15-B, the unreported fringe benefit realized by the former executive director during calendar years 2002 and 2003 totaled \$10,922. The former finance director, Kristi Coleman, told auditors that she was unaware of this IRS requirement at the time.

This matter has been referred to the Internal Revenue Service for their consideration.

7. **ISSUE: Violation of prohibition against second pension**

Our investigative audit revealed that during the period January 1, 1994, through December 31, 2003, Dr. Tollett improperly received a second employer-funded pension while serving as TSBA executive director. This simplified employee pension was 100 percent funded by TSBA/CEL. The pension ranged from 10 to 15 percent of Dr. Tollett's salary and totaled \$120,000 over 10 years. However, state law prohibits retirement system employees from having multiple pensions funded by public dollars.

Section 8-35-111, *Tennessee Code Annotated*, states, "The general assembly finds and declares that the public policy of this state is that no public official or employee shall have multiple memberships in any retirement program or programs financed from public funds...." In addition, this statute prohibits a public official or employee from participating in a second retirement system which exceeds three percent of the employee's salary. Therefore, it appears that Dr. Tollett may be required to forfeit either his retirement system benefits or his simplified employee pension.

This matter has been referred to the Tennessee Consolidated Retirement System for their consideration.

8. **ISSUE: Expensive retirement gifts**

In 2003, the TSBA board of directors presented Dr. Tollett and his wife with lavish retirement gifts costing \$19,010, including a travel certificate, luggage, Rolex watch, and pearl necklace. The gifts were purchased with TSBA operating funds. In addition, in September 2003, the TSBA paid for a reception on Dr. Tollett's behalf costing at least \$6,740, which included 18 hotel rooms at the Loews Vanderbilt Hotel for TSBA Board and Risk Management Trust members as well as over \$500 for alcoholic beverages. Auditors could not determine that these expenditures were in the best interest of TSBA or its members.

Section 48-58-301, *Tennessee Code Annotated*, states:

A director shall discharge all duties as a director, including duties as a member of a committee ... (3) In a manner the director reasonably believes to be in the best interests of the corporation.

This matter has been referred to the Internal Revenue Service for their consideration.

9. **ISSUE: Original records destroyed without board approval**

The former TSBA director of finance allowed certain original financial records to be destroyed without board approval and against board policy. These records had apparently been scanned and stored electronically prior to being destroyed. However, auditors found no indication that the board of directors approved this action. TSBA's policy requires financial records to be retained for five years. Auditors could not determine that destroying original records was in the best interest of TSBA or its members.

Section 48-58-301, *Tennessee Code Annotated*, states:

A director shall discharge all duties as a director, including duties as a member of a committee ... (3) In a manner the director reasonably believes to be in the best interests of the corporation.

10. **ISSUE:** **Questionable financial transactions**

As set forth below, auditors found that the former TSBA director of finance, Kristi Coleman, made entries in the accounting records of TSBA that appeared to conceal the true nature of certain transactions in the financial statements. We were unable to determine that the transactions served the best interest of TSBA or the members.

⇒ The repayment of Dr. Tollett’s debt to the retirement system was not shown as an expense for the period. It was initially properly recorded as an expense; however, the former TSBA director of finance, through an internal accounting entry, ordered that this expense be removed so it would not show on the income statement. As a result, the income statement for the period ending August 31, 2002, presented at the September 2002 meeting of the board of directors, indicated that TSBA had generated a \$115,225 net income. However, properly recognizing the repayment of Dr. Tollett’s debt would have more accurately shown a \$(161,631) loss for the period.

⇒ Our investigative audit also indicated that the former TSBA director of finance ordered the disbursements for Dr. Tollett’s retirement gifts totaling \$19,010 to be inaccurately recorded as office supplies and contractual services.

Ms. Coleman told auditors that she did not seek expert accounting advice prior to ordering the entries. These improper accounting entries resulted in inaccurate and possibly fraudulent information being provided to board members.

In addition, our investigative audit revealed that for several years, TSBA checks amounting to several thousand dollars were made payable to “Cash,” cashed by an employee, and apparently distributed to employees as Christmas bonuses. According to minutes of meetings, the board did not authorize this practice. The former director of finance maintained no documentation confirming that individual employees received the specified bonuses. Preparing checks payable to cash increases the risk that the proceeds will not be used for the intended purpose.

Section 48-58-301, *Tennessee Code Annotated*, states:

A director shall discharge all duties as a director, including duties as a member of a committee ... (3) In a manner the director reasonably believes to be in the best interests of the corporation.

This matter has been referred to the Tennessee Attorney General for his consideration.

11. **ISSUE:** **Personal purchases made using non-tax status**

The TSBA board of directors permitted a policy allowing employees to circumvent the state sales tax provisions. TSBA’s “Computer Repayment Plan” policy allowed

employees to purchase computers through the association for use at their personal residence. Although the policy indicated that the computers would be “utilized for work related purposes,” Dr. Tollett acknowledged to auditors that the computers belonged to the employees. Auditors noted that the personal computer purchases utilized TSBA’s not-for-profit sales tax exemption.

Section 67-1-804(c), *Tennessee Code Annotated*, states:

(1) When any person fails to report and pay the total amount of taxes determined to be due by the commissioner, if such failure is determined by the commissioner to be due to fraud, there shall be imposed against the taxpayer a penalty in the amount of one hundred percent (100%) of the underpayment.

(2) For the purpose of this section, “fraud” includes any deceitful practice or willful device resorted to with intent to evade the tax.

Section 67-1-1440, *Tennessee Code Annotated*, states:

(d) It is a Class E felony for any person to delay, hamper, hinder, impede, obstruct or thwart the state of Tennessee in the collection of any of its lawful revenue, or to deprive the state of the realization of such revenue at the time it is lawfully entitled thereto by any artifice, design, false weight or measure, stratagem, or by the falsification of any record, report or return required by law. Each act done in violation hereof is a separate offense ...

(g) It is a Class E felony for any person willfully to attempt in any manner to evade or defeat any tax due the state of Tennessee....

This matter has been referred to the Department of Revenue for their consideration.

**TENNESSEE SCHOOL BOARDS RISK MANAGEMENT TRUST
AND UNEMPLOYMENT COMPENSATION TRUST**

1. **ISSUE: Unauthorized commission of \$492,694**

For the fiscal year ended June 30, 2005, the Tennessee School Boards Risk Management Trust (TSB-RMT) program manager, John Evans, collected \$492,694 in fees and commissions from the trust that were not authorized by the board of trustees. This was in addition to \$2.7 million in authorized fees and commissions.

In June 2004, TSB-RMT signed a ten-year contract with John Evans and Next Generation Underwriters, Incorporated, to serve as the program manager. The contract specified that Mr. Evans would be acting as an agent of the TSB-RMT. According to Mr. Evans and trustees, this contract formalized the duties and compensation under which Mr. Evans had been operating for 17 years without a contract.⁷ Mr. Evans compensation, per the contract, included two components. First, he received a minimum fee of 3.5 percent of the workers compensation premiums paid by trust members. For the fiscal year ended June 30, 2005, that fee totaled \$619,268. Secondly, Mr. Evans received all commissions or fees paid by primary insurers, re-insurers or excess insurance companies for policies he placed as program manager. For the fiscal year ended June 30, 2005, those commissions totaled more than \$2.1 million. The TSB-RMT also contracted with another company operated by Mr. Evans, Safety Engineering Consultants (SEC) in June 2004. SEC provided loss control and claims service to the trust. During the fiscal year ended June 30, 2005, SEC was compensated \$590,512 by the trust.

Our investigative audit revealed that Mr. Evans added a “retail commission” of six percent to the workers compensation premiums of non-school trust members in July 2002. Dr. Tollett, the trust administrator, told auditors that he was aware of this additional commission, although he did not approve it. He also admitted to auditors that he did not make trustees aware of this additional commission. According to Mr. Evans and Dr. Tollett, this additional fee, which totaled \$100,215 for the year ended June 30, 2003, was to offset expenses related to marketing risk pool membership to potential non-school members. The retail commission was increased to nine percent for the fiscal year beginning July 1, 2003. According to Mr. Evans and Dr. Tollett, the increase in the retail commission was to offset a decrease in Mr. Evans revenue in other areas. The trust had apparently switched to a reinsurance carrier that charged lower premiums that year. This decrease in reinsurance premiums could have been passed on to members in the form of lower premiums. However, this also would have reduced Mr. Evans commission in the placement of the reinsurance policy. According to Mr. Evans and Dr. Tollett, rather than passing the savings on to the participating local governments, the retail commission was raised to nine percent in order to offset the lower commissions Mr. Evans received

⁷According to the Secretary of State, Next Generation Underwriters was incorporated by Mr. Evans in April 1999. Prior to that, Mr. Evans served the TSB-RMT as either an employee of, or a consultant with Arthur J. Gallagher & Company. In February 2000, Mr. Evans purchased the TSB-RMT account from Arthur J. Gallagher & Company for \$1.3 million.

related to the reinsurance policies. Mr. Evans and Dr. Tollett told auditors that this increase had also not been approved by the TSB-RMT board of trustees. However, Mr. Evans later insisted that the board of trustees had approved the retail commission. He further indicated that he would fix that at the next trustees meeting.

Mr. Evans continued to charge non-school trust members the nine percent during the fiscal year beginning July 1, 2004, even though he had a written contract, dated June 7, 2004, that did not authorize such fees or commissions. Mr. Evans told auditors that his written contract with the board of trustees did not prevent him from charging other commissions not provided for by the contract. The unauthorized commission totaled \$492,694 for the year ending June 30, 2005.

Interviews of trustees revealed that they were unaware of this extra commission. Minutes of the meetings of the board of trustees did not reveal any discussion or approval for such commission. In addition, according to the minutes of the October 3, 2003, board of trustees meeting, when Mr. Evans detailed the breakdown of premiums to trustees, he failed to disclose this extra nine percent commission. It should be noted that this fee was not disclosed on the premium invoices to those governments that were charged the additional commission. An example of governments that paid the unauthorized fee are shown in the table below:

Entity	Unauthorized Commission for Fiscal Year Ended June 30, 2004	Unauthorized Commission for Fiscal Year Ended June 30, 2005
Wilson County Government	Did not participate	\$51,268
Anderson County Government	\$38,137	\$40,140
Jefferson County Government	\$11,515	\$26,434
Bradley County Government	\$30,478	\$24,872
Washington County Government	\$22,172	\$24,157
Hardeman County Government	\$16,083	\$16,707

Based on interviews, none of the trustees knew, and the majority stated that they did not care, what the actual amount of commissions and fees Mr. Evans earned. (Refer to Exhibit 4.) However, trustees have an obligation to act in the best interest of the trust. That would include an awareness and comprehension of the details of all trust agreements, both written and unwritten.

A detail of compensation from the TSB-RMT to Mr. Evans and his companies for the two years ended June 30, 2005, is shown on the following page:

Compensation to John Evans and His Companies	2003-2004	2004-2005
Fees taken but not authorized by contract		
Non-schools “retail commission” 9% workers compensation premium	\$ 375,808	\$ 492,694
Program manager compensation		
Commissions authorized by contract	2,113,991	2,155,328
3.5% of annual workers compensation premium	531,147	619,268
Service fees permitted by contract		
Safety Engineering Consultants		
Program loss control and claims administration	546,958	590,512
Total Fees and Commissions	<u>\$3,567,904</u>	<u>\$3,857,802</u>

Section 35-15-804, *Tennessee Code Annotated*, states:

A trustee shall administer the trust as a prudent person would, by considering the purposes, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.

Section 35-15-807, *Tennessee Code Annotated*, states:

(a) A trustee may delegate duties and powers that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill, and caution in:

- (1) Selecting an agent;
- (2) Establishing the scope and terms of the delegation, consistent with the purpose and terms of the trust; and
- (3) Periodically reviewing the agent’s actions in order to monitor the agent’s performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

Section 35-15-813, *Tennessee Code Annotated*, states:

A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests.

This matter has been referred to the local district attorney general and the Tennessee Attorney General for their consideration.

2. **ISSUE: Interest revenue on premiums did not accrue to the TSB-RMT**

Trust members typically were required to pay their premiums in one payment at the beginning of the fiscal year. However, Mr. Evans paid for the associated reinsurance policies on an installment basis. As a result, he held government funds on which he earned interest for extended periods of time. Our investigative audit revealed that Mr. Evans had in his custody trust members' premiums of at least \$3.5 and \$3.3 million dollars for six or more months for the fiscal years ending in 2004 and 2005, respectively. Based on prevailing interest rates during those periods, Mr. Evans earned at least \$59,000 during those two years. However, Mr. Evans failed to turn over to the TSB-RMT the interest revenue he earned on member premiums.

This matter has been referred to the local district attorney general and the Tennessee Attorney General for their consideration.

3. **ISSUE: Conflict of interest in program manager's duties**

The TSB-RMT board of trustees assigned duties to the program manager that created a potential conflict of interest. For non-school governmental TSB-RMT members, Mr. Evans marketed and priced policies, billed and collected member premiums, acquired reinsurance policies, paid reinsurance premiums, and received commissions from reinsurance policies. According to Mr. Evans, he set premiums on a market-based approach. It would have been prudent to have premiums set by someone independent of the marketing and brokering process. Since the program manager's compensation was primarily based on the total value of the trust, his marketing and brokering duties could conflict with the goal of operating a financially sound risk pool.

4. **ISSUE: Losses to the TSB-RMT risk pool**

According to claim development projections prepared by the TSB-RMT trust actuary, the trust generated estimated losses exceeding \$10.2 million over the four-year period ending

June 30, 2005. The actuarial forecast represents actual claims as well as an estimate of future claims; therefore, these projections could ultimately increase or decrease. Actuarial projections and analysis is a specialized area in which the Division of Municipal Audit does not have expertise. However, these projections suggest that the portion of the premium that reached the risk pool fund may not have been sufficient to cover claims over the last four years. Auditors also noted that the audited financial statements for the TSB-RMT indicated operating losses of \$(11,338,718), with net losses of \$(5,082,379) over the last four years.

Members of the TSB-RMT are liable for their proportionate share of all losses incurred during their participation, regardless of their withdrawal or the complete termination of the trust. Therefore, should the risk pool fund become depleted, members would continue to be responsible for the debts of the trust and would be reassessed to satisfy any outstanding claims. Additional assessments could be required until all outstanding claims incurred during the period of the member's participation have been met.⁸

This matter has been referred to the Tennessee Department of Commerce and Insurance for their consideration.

5. **ISSUE:** **Trust records maintained by Next Generation Underwriters, Inc.**

Our investigative audit revealed that certain TSB-RMT records, including virtually all records related to non-school trust members, were maintained at the offices of Next Generation Underwriters. Mr. Evans made all collections of premiums for those members. However, related records had not been submitted for audit and the related information did not appear in the financial statements presented to the trustees. According to a letter from Dr. Tollett to the trusts' contracted auditor, all financial records and data had been provided for audit. However, the contract auditor informed state auditors that he had not audited records maintained at Next Generation Underwriters. Mr. Evans and Dr. Tollett also acknowledged that those records had not been submitted for audit. Therefore, total trust revenue as well as certain fees and commissions received by the program manager had not been subject to audit.

⁸In 1995, as an employee of Arthur J. Gallagher & Company (AJG), Mr. Evans helped to start the Local Government Insurance Corporation (LoGIC), a pooling arrangement that provided workers' compensation insurance for Tennessee governmental entities. Mr. Evans left AJG as a full-time employee in April 1999, and broke ties with LoGIC in November 1999. From the date the pool was organized in May 1995 until it ceased doing business in June 30, 2001, for a variety of reasons, the pool incurred substantial losses. As a result of losses to the pool from its inception through June 30, 2000, AJG, which had provided almost all of the services required to manage the LoGIC pool, agreed to cover losses exceeding \$4 million. In addition, members were assessed approximately \$1.8 million for losses to the pool for the fiscal year ending June 30, 2001, and approximately \$2.3 million as a result of the failure of a reinsurance company retained by LoGIC.

Section 35-15-804, *Tennessee Code Annotated* states:

A trustee shall administer the trust as a prudent person would, by considering the purpose, terms, distribution requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.

Section 35-15-807, *Tennessee Code Annotated* states:

(a) A trustee may delegate duties and powers that a prudent trustee of comparable skills could properly delegate under the circumstances. The trustee shall exercise reasonable care, skill and caution in:

- (1) Selecting an agent;
- (2) Establishing the scope and terms of the delegation, consistent with the purpose and terms of the trust; and
- (3) Periodically reviewing the agent's actions in order to monitor the agent's performance and compliance with the terms of the delegation.

(b) In performing a delegated function, an agent owes a duty to the trust to exercise reasonable care to comply with the terms of the delegation.

Section 35-15-813, *Tennessee Code Annotated*, states:

A trustee shall keep the qualified beneficiaries of the trust reasonably informed about the administration of the trust and of the material facts necessary for them to protect their interests.

6. **ISSUE:** **Failure of fiduciary duties by allowing misuse of trust assets**

Dr. Tollett assumed multiple roles which appeared to create a conflict of interest with his fiduciary duties to each separate entity. For at least the years 1987 through 2003, Dr. Tollett served as the administrator of the TSB-RMT and the TSB-UCT trusts as well as the executive director of TSBA. In addition, he served as executive vice president of CEL during its 10 active years. As a result, he was in a unique position to oversee, initiate, and control transactions between all the entities.

Auditors learned that in February 1991, according to the minutes of the TSB-UCT trustee meeting, Dr. Tollett proposed that the TSB-UCT loan TSBA \$250,000 for a proposed

expansion to their office. The trustees voted to accommodate this proposal. That loan amount was increased to \$450,000 in November 1992, and designated for the “Risk Management and Education Center.” The expansion was ultimately completed at a cost to the TSB-UCT of \$445,237. However, auditors could not locate any loan documents in TSBA, TSB-RMT, or TSB-UCT records. In addition, the audited financial statements indicated there was no loan. Dr. Tollett admitted that this was never intended to be a loan. It appears that TSB-UCT funds were apparently improperly used for the benefit of the TSB-RMT and TSBA.

Our investigative audit also revealed that in 1984, the TSB-UCT agreed to loan funds eventually amounting to \$185,000 to TSBA. However, the TSB-UCT and TSBA apparently entered into a long-term lease agreement in 1985, whereby the TSB-UCT would pay rent in advance and apply it against what TSBA owed on the loan. The lease was for three offices at \$125 per month for 99 years, totaling \$148,500. TSBA apparently repaid the remainder of the loan in December 1986. According to the trust’s director of finance and administration, there currently are no employees dedicated only to TSB-UCT. Therefore, the lease does not appear to serve any legitimate business purpose.

Auditors determined that during the fiscal years ended June 30, 2003, and June 30, 2004, the non-school governmental members of TSB-RMT paid \$42,178 and \$94,900, respectively, to TSBA as an “Administrative Fee.” However, as noted in Issue 3, billing, collection, and marketing services for non-school members were performed by Mr. Evans. In addition, claims and loss control were provided by SEC, a company owned by Mr. Evans. Therefore, these payments did not appear to serve a valid, documented trust purpose.

Dr. Tollett served in apparently incompatible positions in which a decision in the best interest of one entity may not have been in the best interest of another. However, the trustees of each trust had the ultimate authority and duty to oversee all transactions. As such, they were required to ensure that trust funds were used to benefit the contributing governments. In addition, the trustees were required to exercise reasonable care by considering the purpose, terms, and other circumstances of all transactions. Finally, the trustees had a fiduciary duty to safeguard the trust assets. Therefore, expenditure of trust funds for no legitimate purpose is prohibited.

Section 29-20-401, *Tennessee Code Annotated*, states:

... The general assembly hereby finds and determines that all contributions of financial and administrative resources made pursuant to an [risk pool] agreement as authorized herein are made for a public and governmental purpose and that all such contributions benefit the contributing governmental entity.

Section 35-15-804, *Tennessee Code Annotated*, states:

A trustee shall administer the trust as a prudent person would, by considering the purpose, terms, distributional requirements, and other circumstances of the trust. In satisfying this standard, the trustee shall exercise reasonable care, skill and caution.

Members of the TSB-UCT and TSB-RMT trusts should seek legal counsel to determine if any civil action to recover funds from any party is warranted.

This matter has been referred to the Tennessee Attorney General for his consideration.

7. **ISSUE: Trustees failure to fulfill required duties**

The TSB-RMT board of trustees apparently failed to fulfill required duties specified in the Intergovernmental Cooperative Agreement. The program manager added a “retail commission” to non-school governmental members in July 2002. However, according to minutes of the meetings of the board of trustees, this additional commission was never discussed or approved. Non-school governments were allowed to join the risk pool in July 2001. However, the minutes reflect no previous board approval authorizing this action. The first indication that trustees were aware of this action was in the minutes of the October 5, 2001, board of trustees meeting, in which the program manager announced to the trustees that non-school governments were participating as members. In the minutes of the February 26, 2001, meeting, the program manager announced that he had marketed an alternate method of recognizing claims in order to enroll two school boards. However, according to minutes of meetings, the board had not previously approved that change in the method for recognition of claims.

The Tennessee School Boards Risk Management Trust Intergovernmental Cooperative Agreement, Section 7.2, states:

The board shall carry out the purposes and duties of the Trust, as set forth in Articles I and III of this Agreement, through its Administrator or other agents and employees, including, but not limited to, the following:

- (a) Making changes in policy for the Trust...
- (c) Determining the compensation of all such agents, and independent contractors...
- (i) Approving new Members

8. **ISSUE:** **Prohibited marketing of teacher liability insurance**

The board of trustees improperly offered liability insurance to Tennessee teachers including teachers employed by non-TSB-RMT member schools. In the May 2002 board meeting, the TSB-RMT trustees approved offering “teacher liability” insurance to Tennessee teachers at a cost of \$25 to each participant. However, the TSB-RMT was not an insurance company and therefore could not market or provide insurance to any individual or entity other than a potential qualified member. Next Generation Underwriters collected the fees, which totaled \$15,875, from 635 teachers. Next Generation Underwriters retained \$3,175 as a commission and forwarded the remainder to TSB-RMT personnel. However, according to Mr. Evans and Dr. Tollett, the liability for a teacher in Tennessee acting within the scope of their employment is with their board of education. Therefore, teachers who were sold this coverage had no need of this, or any other additional coverage. Both Mr. Evans and Dr. Tollett acknowledged to auditors that there was no liability to the trust for insuring these teachers.

Section 29-20-401, *Tennessee Code Annotated*, states:

... The general assembly hereby finds and determines that all contributions of financial and administrative resources made pursuant to an [risk pool] agreement as authorized herein are made for a public and governmental purpose and that all such contributions benefit the contributing governmental entity.

This matter has been referred to the Department of Commerce and Insurance and the Tennessee Attorney General for their consideration.

9. **ISSUE:** **Prohibited extension of coverage**

TSB-RMT improperly attempted to extend liability coverage to ineligible members. Auditors determined that during the May 2003 trust meeting, the TSB-RMT trustees approved extending risk coverage to teachers who were not employed by members of the TSB-RMT. Also, in the 2001 coverage proposal, the TSB-RMT offered insurance coverage to contracted bus drivers at an annual cost of \$400. Currently the coverage proposal includes coverage for contracted bus drivers under certain circumstances. However, state statutes do not permit individual teachers, contract bus drivers, or any other third parties as members of the risk pool and therefore the TSB-RMT could not extend coverage to those individuals.

It must be noted that extending coverage to assume claims arising from the conduct of third parties, such as contract bus drivers, would potentially commit the TSB-RMT to unknown and unlimited liability. Third parties are not limited to the recovery amounts set forth by the Governmental Tort Liability Act. For that and other reasons, the Tennessee Attorney General stated, in Tenn. Op. Atty. Gen. No. 93-01, “it is our opinion that a local

government does not have the power to enter into an indemnity clause which extends its liability beyond that imposed by law because it constitutes an unauthorized unconstitutional act by the entity.”

Section 29-20-401, *Tennessee Code Annotated*, states:

The general assembly hereby finds and determines that all contributions of financial and administrative resources made pursuant to an [risk pool] agreement as authorized herein are made for a public and governmental purpose and that all such contributions benefit the contributing governmental entity.

The statute further limits membership in the risk pools to governmental entities.

This matter has been referred to the Department of Commerce and Insurance and the Tennessee Attorney General for their consideration.

10. **ISSUE: Ineligible member**

TSB-RMT and TSB-UCT allowed an ineligible member to participate in the risk pooling agreements. Since their inception, the TSB-RMT (formerly the Board Liability Trust and the Workers Compensation Trust) and the TSB-UCT had included TSBA, a not for profit, as a member. However, because the trusts are risk pooling agreements created pursuant to Section 29-20-401, *Tennessee Code Annotated*, only “governmental entities” are authorized to enter into these agreements. The Attorney General of the State of Tennessee determined in his Opinion No. 05-135 dated August 26, 2005, that TSBA is not a governmental entity under this statute, and is therefore not permitted to participate.

11. **ISSUE: Unauthorized investments**

The TSB-UCT board of trustees placed reserve funds in unauthorized investments, such as equities traded on national and regional stock exchanges as well as other corporate debt. All local governments in Tennessee must follow the investment guidelines outlined in Section 9-4-602, *Tennessee Code Annotated*. Those guidelines primarily authorize investment in United States governmental obligations. Therefore, investing TSB-UCT funds in any other equities and obligations is prohibited.

At the time this report was printed, personnel from the Department of Commerce and Insurance were performing a review to determine if TSB-RMT retained adequate pool reserves.

APPENDIX

THIS PAGE LEFT BLANK INTENTIONALLY.

Exhibit 1

Confidential

Memorandum

From the President

To: TSBA Board of Directors
From: Patricia Gruenewald
Date: 1/29/02
Re: Recommendation from CEL Board of Directors

The Center for Educational Leadership (CEL) was created in 1993 and became operational in 1994. CEL is an IRS approved 501(c) 3 nonprofit corporation. Attorney Chuck Cagle did the legal work to establish CEL and prepare the necessary contracts.

Its primary purpose is to provide "management services for fees" (superintendent searches, superintendent evaluations, etc) to school boards and other entities. The TSBA Board of Directors wanted TSBA's services to local boards to be related to their governance function and provided at no additional cost to member boards. An additional benefit was that CEL could provide contracted services to local boards without having to pay NSBA the approximately 5% membership dues that would be assessed if the services were offered through TSBA¹.

TSBA's Executive Committee served as charter members of the Board of Directors of the CEL. Thereafter, the TSBA Board of Directors appointed the seven members of the Board of Directors. Following is the 2001 board which is making this recommendation.

¹ TSBA pays annual NSBA dues of nearly \$50,000.

Memo from Patricia Gruenewald

2

Confidential**The 2001 CEL Board of Directors**

Patricia Gruenewald	President
Dr. Fred Ford	Vice President (Risk Management Trust Chairman)
Roger Greene	Secretary (Unemployment Compensation Trust Chairman)
Dr. Barbara Prescott	
Clyde Smith	
David Jones	
Linda Blevins-Fenley	

Since TSBA Executive Director, Dan Tollett, had completed more than 30 years in the Tennessee Consolidated Retirement System (TCRS) in 1994, he was eligible to retire and receive benefits from TCRS. TSBA would save more than \$20,000 each year by contracting with CEL for his services rather than paying him the salary and benefits that he would earn as an employee of the association. He agreed to what we all thought was a legal contract with CEL, at a \$14,250 decrease in salary and loss of family medical, disability, and dental insurance amounting to an additional \$6,200 per year.

His contract provided that he would serve as TSBA Executive Director and as administrator of both the Risk Management Trust and the Unemployment Compensation Trust.

During the 2000 legislative session, at the request of the late Senator Pete Springer who was greatly irritated at TSBA's support of appointed superintendents, TCRS ruled that since TSBA owned CEL, Dan was still an employee of TSBA during the time between January 1, 1994 and December 31, 2000.

The ruling held that TSBA should have been paying benefits for him during the seven years when he was an employee of CEL and that the compensation that he received from TCRS during the seven-year period (\$276,856) must be repaid. This ruling was subsequently supported by an attorney general opinion. Effective January 1, 2000 his employment contract was revised to comply with TCRS rules.

Exhibit 1 (continued)

Memo from Patricia Gruenewald

3

Confidential

In its November meeting, the CEL Board of Directors voted unanimously to recommend that TSBA reimburse TCRS for the compensation it paid to Dan which would have been paid by TSBA.² The chart on the following page shows this calculation:

Compensation Earned but Unpaid

Year	CEL Salary	Salary due as TSBA Employee	Benefits earned as a TSBA Employee	Compensation earned but unpaid as TSBA employee
1994	\$80,000.00	\$94,250.00	\$6,220.00	\$20,470.00
1995	\$80,000.00	\$98,950.00	\$6,220.00	\$25,170.00
1996	\$85,000.00	\$103,900.00	\$6,220.00	\$25,120.00
1997	\$89,250.00	\$109,000.00	\$6,220.00	\$25,970.00
1998	\$95,000.00	\$114,550.00	\$6,220.00	\$25,770.00
1999	\$100,000.00	\$120,300.00	\$6,220.00	\$26,520.00
2000	\$105,000.00	\$126,300.00	\$6,220.00	\$27,520.00
Total				\$176,540.00

1994-2000

TSBA's income over expenses for 2001 was more than enough to reimburse the salary that was earned but not paid by TSBA to the Executive Director. Also, TSBA currently has an accumulated reserve of \$1.6 million.

I hope that this memorandum provides you with information necessary for you to support this recommendation. In the meantime, if you have questions that you would like to discuss before the meeting, please call Dan or me.

Please treat this information as confidential for discussion and action in executive session only.

² Money repaid to TCRS will go into TSBA's dedicated account in the TCRS.

THIS PAGE LEFT BLANK INTENTIONALLY.

Exhibit 2

ING Financial Serv 12/22/2003 11:03 PAGE 4/5 RightFax



RECEIVED
JAN 19 2004
Educational
Insurance Inc.

2003 JAN 26 AM 8:55

CASH SURRENDER FORM

JAN 12 AM 8:02

POLICY(S): 7030316
INSURED(S): DAN TOLLETT

RECEIVED - MINGT
RECEIVED - MINGT

RECEIVED
JAN 26 2004
RECEIVED

I request ING ReliaStar to surrender the above policy and pay all cash surrender values to me. I agree to release ING ReliaStar from all claims under this policy.

I understand that payments received from my ING ReliaStar contract are subject to Federal Income Tax withholding. Withholding will only apply to the portion (net gain) of the payment that is subject to federal income tax.

I understand that I may elect not to have withholding apply to my payment. Should I do this, I may be responsible for payments of estimated tax. I understand I may also incur penalties under the estimated tax rules if my withholding and estimated tax payments are not sufficient.

If I elect to have withholding applied to my payment, the amount will be 10% (28% if my social security number is not available) of the taxable portion of my payment.

I do not want to have Federal Income Tax withheld from my payment.
 I elect to have Federal Income Tax withheld from my payment.

TAXPAYER ID CERTIFICATION: Under penalties of perjury, I certify (1) that the number shown on this form is my correct taxpayer identification number, and (2) that I am not subject to backup withholding because (a) I have not been notified by the IRS that I am subject to backup withholding as a result of failure to report all interest or dividends, or (b) the Internal Revenue Service has notified me that I am no longer subject to backup withholding.

CERTIFICATION INSTRUCTION: Cross out item (2) above if you have been notified by the IRS that you are subject to backup withholding because of underreporting interest or dividends on your tax return. However, if after being notified by the IRS that you were subject to backup withholding you received another notification that you were no longer subject to backup withholding, do not cross out item (2).

Owner's Social Security # _____ Date December 30, 2003
Dan Tollett Signature Christi Coleman Other Required Signatures
146 LaView Road Hendersonville, TN 37075 Owner's Full Address
ReliaStar Life Insurance Company

P.O. Box 5011
Minnet, MD 38702-5011
Toll Free: 877.886.5050
www.ingfinancial.com

ReliaStar Life Insurance Company

THIS PAGE LEFT BLANK INTENTIONALLY.

Exhibit 3

Contract Agreement between the Center for Educational Leadership and
Dr. Daniel J. Tollett

THIS AGREEMENT made on Friday, June 20th, 2003, by and between Center for Educational Leadership (the "Corporation"), a corporation organized under the laws of the State of Tennessee, and Dr. Daniel J. Tollett (the "employee") residing in the City of Hendersonville.

WITNESSETH THAT:

In consideration of the agreements hereinafter contained the parties hereto agree as follows:

1. The Corporation agrees to employ the Employee and the Employee agrees to serve the corporation in such capacity as the Board of Directors of the Corporation (the "Board") may designate from time to time, beginning September 1st, 2003 and continuing until December 31st, 2003.
2. During the term of his employment, the Employee shall devote all of his time, attention, skill and efforts to the performance of his duties for the Corporation.
3. The Corporation shall pay the Employee on or after January 1st, 2004 a lump sum payment of \$24,375.00.
4. (a) The Corporation shall credit a book reserve (the "Deferred Compensation Account") established for this purpose, on the 15th day of each month commencing September 15 and ending on December 15th in equal installments of \$8,125.00 each month.

(b) Any such funds so credited to the Deferred Compensation Account will be kept in cash.
5. If the Employee dies before the lump sum payment has been made, the employee's designated beneficiary will be paid promptly the funds that are available at that time in the Deferred Compensation Account.

(a) If no beneficiary has been designated, the funds will be paid to the employee's estate.
6. Any deferred compensation payable under this Agreement shall not be deemed salary or other compensation to the Employee for the purpose of computing benefits to which he may be entitled under any pension plan or other arrangement of the Corporation for the benefit of its employees.

Exhibit 3 (continued)

7. The Board shall have full power and authority to interpret, construe, and administer this Agreement and the Board's interpretations and construction thereof, and actions thereunder, including any valuation of the Deferred Compensation Account, or the amount or recipient of the payment to be made therefrom, shall be binding and conclusive on all persons for all purposes. No member of the Board shall be liable to any person for any action taken or omitted in connection with interpretation and administration of this Agreement unless attributable to his own willful misconduct or lack of good faith.
8. This Agreement shall be binding upon and inure to the benefit of the Corporation, its successors and assigns, and the Employee and his heirs, executors, administrators, and legal representatives.
9. This Agreement shall be construed in accordance with and governed by the law of the State of Tennessee.

In WITNESS WHEREOF, the Corporation has caused this Agreement to be executed by its duly authorized officers and the Employee has hereunto set his hand and seal as of the date first above written.

Center for Educational Leadership

Clyde W. Smith, Jr.
President

Kristi Coleman
Attest

Mr. Smith
Employee

Exhibit 4

Excerpt from TSB-RMT May 5, 2005, Meeting

Appreciation of John Evans. Ms. Gruenewald said that she wanted to take time to express appreciation to John Evans and Next Generation Underwriters. She said that this Trust would not be where it is today if it were not for his guidance in helping to develop this Trust. She said that John makes a living as a program manager and that no one here works for nothing. She further stated that this is the United States of America where people are allowed to make a profit. She said that the statements suggesting that he had done things in a devious way and over charged the Trust were wrong. She thanked him for being very responsible to the Trust.