Department of the Treasury
Tennessee Consolidated Retirement System

For the Year Ended
June 30, 2003

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

John G. Morgan
Comptroller

February 19, 2004

Members of the General Assembly
and
Members of the Board of Trustees
Tennessee Consolidated Retirement System
and
The Honorable Dale Sims, Treasurer
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the financial and compliance audit of the Tennessee Consolidated Retirement System for the year ended June 30, 2003. You will note from the independent auditor's report that an unqualified opinion was given on the fairness of the presentation of the financial statements.

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

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/mb
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State of Tennessee

Audit Highlights

Comptroller of the Treasury   Division of State Audit

Financial and Compliance Audit
Tennessee Consolidated Retirement System
For the Year Ended June 30, 2003

AUDIT OBJECTIVES

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

AUDIT FINDINGS

The audit report contains no findings.

OPINION ON THE FINANCIAL STATEMENTS

The opinion on the financial statements is unqualified.

"Audit Highlights" is a summary of the audit report. To obtain the complete audit report, please contact

Comptroller of the Treasury, Division of State Audit
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Audit Report
Department of the Treasury
Tennessee Consolidated Retirement System
For the Year Ended June 30, 2003

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Department of the Treasury
Tennessee Consolidated Retirement System
For the Year Ended June 30, 2003

INTRODUCTION

POST-AUDIT AUTHORITY

This is a report on the financial and compliance audit of the Tennessee Consolidated Retirement System. 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 Consolidated Retirement System (TCRS) was established in 1972 by an act of the Tennessee General Assembly. Seven existing retirement systems were consolidated to provide retirement, disability, and death benefits to state employees, public school teachers, higher education employees, and employees of participating local governments. State laws govern the retirement plan, and amendments to the plan can only be made by legislation enacted by the General Assembly of the State of Tennessee.

An 18-member board of trustees has the responsibility to manage and oversee the operation of the consolidated system. The board consists of nine *ex officio* members from the executive, legislative, and judicial branches of state government; eight representatives of the active TCRS memberships; and one representative of retirees. TCRS is administered by the Department of the Treasury under the legislative branch of state government. By state law, the State Treasurer serves as chairman of the board of trustees and as custodian of the funds of the system.

Membership in the retirement system is a condition of employment for full-time state employees, K-12 teachers, higher education general employees, and employees of participating local governments. Membership is optional for part-time state employees and part-time employees of political subdivisions which have authorized such coverage. Interim teachers and part-time teachers have optional memberships. Faculty and certain other employees of institutions of higher education may elect participation in either TCRS or an optional retirement program. TCRS membership has grown steadily since 1972, when there were approximately 93,000 members. As of June 30, 2003, there were 198,917 active members and 83,121 retirees.

ORGANIZATION

The Tennessee Consolidated Retirement System is organized into three major service areas: Counseling Services, Member Services, and Financial Services.

Counseling Services is responsible for preretirement counseling of members on their potential benefit payments under different options. The section processes claims for disability retirement and provides field support, including new employer coverage. The section also processes membership forms received from all state agencies, local boards of education, and participating political subdivisions.

Member Services is responsible for prior-service and benefit calculations. Prior service specialists assist in establishing prior-service credit for eligible members or former members who have requested such credit. Benefit calculation specialists compute new retiree benefits based on the option chosen.

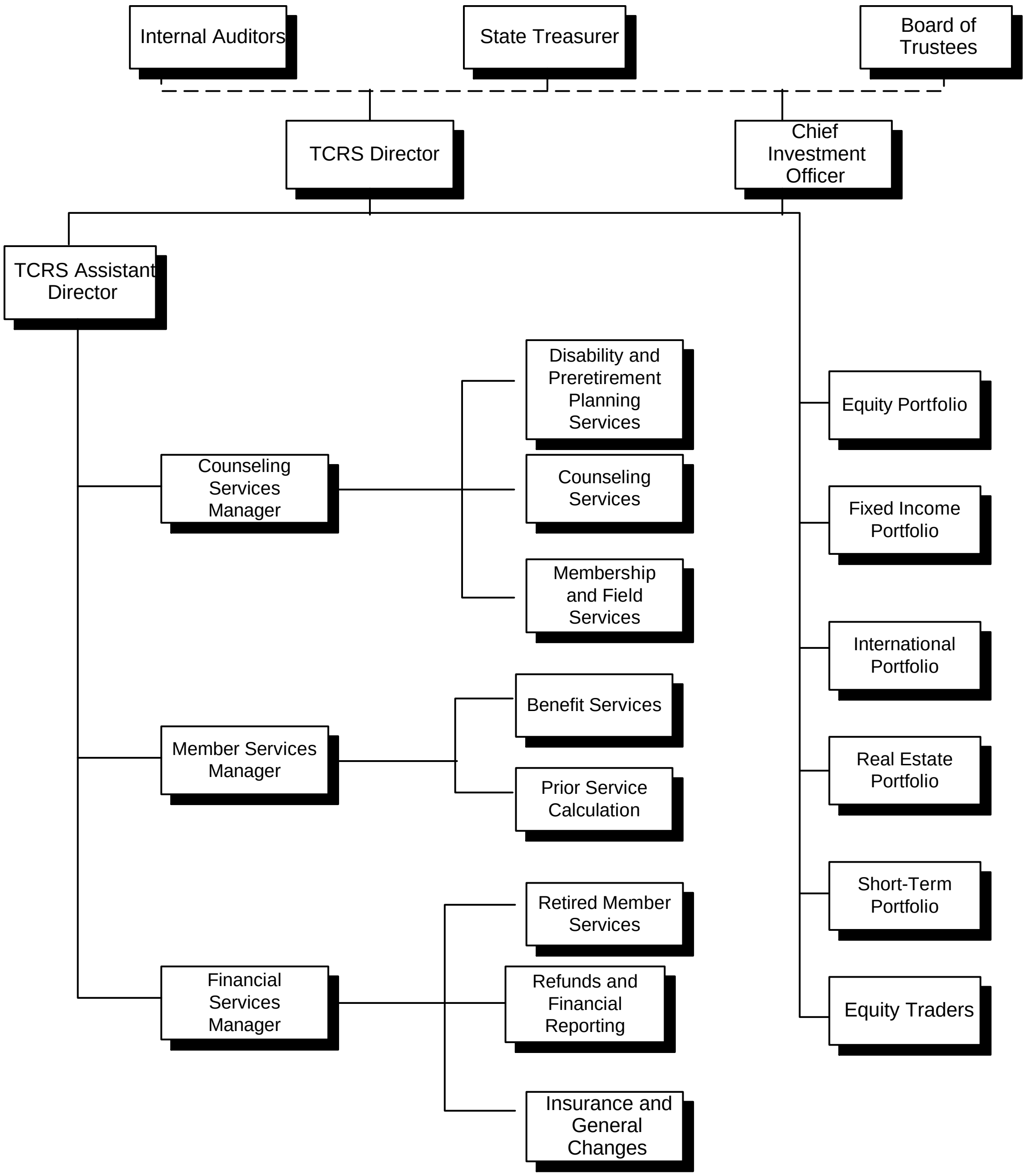
Financial Services processes refunds to terminated members, administers the retired payroll, distributes the pension payments, administers retiree insurance, and coordinates actuarial valuations. The section is also responsible for researching, controlling, and correcting member records on the Treasury Retirement Accounting and Control System.

An organization chart for the Tennessee Consolidated Retirement System is on the following page.

AUDIT SCOPE

The audit was limited to the period July 1, 2002, through June 30, 2003, and was conducted in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Financial statements are presented for the year ended June 30, 2003, and for comparative purposes, the year ended June 30, 2002. The Tennessee Consolidated Retirement System forms an integral part of state government and as such has been included as pension trust funds in the *Tennessee Comprehensive Annual Financial Report.*

Tennessee Consolidated Retirement System
Organization Chart



OBJECTIVES OF THE AUDIT

The objectives of the audit were

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

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

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

4. to recommend appropriate actions to correct any deficiencies.

PRIOR AUDIT FINDING

Section 8-4-109, *Tennessee Code Annotated*, requires that each state department, agency, or institution report to the Comptroller of the Treasury the action taken to implement the recommendations in the prior audit report. The Tennessee Consolidated Retirement System filed its report with the Department of Audit on June 17, 2003. A follow-up of the prior audit finding was conducted as part of the current audit.

The current audit disclosed that the Tennessee Consolidated Retirement System has corrected the previous audit finding concerning controls for preventing, detecting, and collecting overpayments to deceased persons.

RESULTS OF THE AUDIT

AUDIT CONCLUSIONS

Internal Control

As part of the audit of the Tennessee Consolidated Retirement System's financial statements for the year ended June 30, 2003, we considered internal control over financial reporting to determine auditing procedures for the purpose of expressing an opinion on the financial statements, as required by auditing standards generally accepted in the United States of

America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Consideration of internal control over financial reporting disclosed no material weaknesses.

Compliance

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

Fairness of Financial Statement Presentation

The Division of State Audit has rendered an unqualified opinion on the Tennessee Consolidated Retirement System's financial statements.

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

December 15, 2003

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

Dear Mr. Morgan:

We have audited the financial statements of the Tennessee Consolidated Retirement System as of and for the year ended June 30, 2003, and have issued our report thereon dated December 15, 2003. As discussed in Note A.7. to the financial statements, the Tennessee Consolidated Retirement System changed its method of reporting certain derivatives. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

Compliance

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

We did, however, note a less significant instance of noncompliance, which we have reported to the system's management in a separate letter.

Internal Control Over Financial Reporting

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

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

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/mb

STATE OF TENNESSEE
COMPTROLLER OF THE TREASURY
DEPARTMENT OF AUDIT
DIVISION OF STATE AUDIT
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Independent Auditor's Report

December 15, 2003

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

Dear Mr. Morgan:

We have audited the accompanying statements of plan net assets of the Tennessee Consolidated Retirement System as of June 30, 2003, and June 30, 2002, and the related statements of changes in plan net assets for the years then ended. These financial statements are the responsibility of the Tennessee Consolidated Retirement System'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.

As discussed in Note A.1., the financial statements referred to above present only the Tennessee Consolidated Retirement System, pension trust funds of the State of Tennessee, and do not purport to, and do not, present fairly the financial position of the State of Tennessee, as of June 30, 2003, and June 30, 2002, and the changes in its financial position for the years then ended in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the financial statements referred to above present fairly, in all material respects, the plan net assets of the Tennessee Consolidated Retirement System as of June 30, 2003, and June 30, 2002, and the changes in its plan net assets for the years then ended in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note A.7. to the financial statements, the Tennessee Consolidated Retirement System changed its method of reporting certain derivatives.

The management's discussion and analysis and the schedules of funding progress and employer contributions on pages 11 through 15 and 26 through 27 are not required parts of the basic financial statements but are 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.

In accordance with *Government Auditing Standards*, we have also issued our report dated December 15, 2003, on our consideration of the Tennessee Consolidated Retirement System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, and contracts. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Sincerely,

Arthur A. Hayes, Jr., CPA,
Director

AAH/mb

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The Management of the Tennessee Consolidated Retirement System (TCRS) provides this discussion and analysis as an overview of the TCRS' financial activities for the fiscal years ended June 30, 2003 and June 30, 2002.

FINANCIAL HIGHLIGHTS

- The plan net assets (total assets minus total liabilities) of the TCRS at June 30, 2003 were nearly $23.8 billion, increasing over $795 million (3.5 percent) from the plan net assets at June 30, 2002. The net assets are held in trust to meet future benefit obligations.
- The TCRS relies upon contributions from employees and employers, along with investment income, to meet the funding requirements of an actuarially determined accrued liability. As of July 1, 2001, the date of the latest actuarial valuation, the TCRS' funded ratio was 99.6 percent for the SETHEEPP group and 90.4 percent for the PSPP group.
- Contribution revenue for fiscal year 2003 totaled $596,045,259 – an increase of 11.2 percent compared to fiscal year 2002.
- Net investment income for fiscal year 2003 was $1,112,478,748. During fiscal year 2003, the TCRS received an investment return on its portfolio of 4.9 percent, compared to a loss of 1.9 percent for fiscal year 2002.
- Total expenses for fiscal year 2003 were $912,919,221 – an increase of 7.7 percent over fiscal year 2002 total expenses.

OVERVIEW OF THE FINANCIAL STATEMENTS

The TCRS financial statements consist of the *Statement of Plan Net Assets (*on pages 22 through 23), the *Statement of Changes in Plan Net Assets* (on pages 24 through 25), and the *Notes to the Financial Statements* (on pages 26 through 31). In addition, *Required Supplementary Information* is presented, which includes this *Management's Discussion and Analysis,* as well as the schedules and notes on pages 32 through 33.

The *Statement of Plan Net Assets* and the *Statement of Changes in Plan Net Assets* report information about the plan net assets (total assets in excess of total liabilities) as of the end of the fiscal year and the changes in those plan net assets during the fiscal year. These statements include all assets and liabilities using the accrual basis of accounting. Under the accrual basis of accounting, the current year's revenues and expenses are included in the financial activity, regardless of when cash is received or paid. The difference between the total assets and total liabilities on the *Statement of Plan Net Assets*, or net assets held in trust for pension benefits, provides a measurement of the financial position of the TCRS as of the end of the fiscal year. The *Statement of Changes in Plan Net Assets* provides information on the activities that caused the financial position to change during the fiscal year. Over time, increases or decreases in the plan net assets of the TCRS are one indicator of whether the system's financial health is improving or deteriorating.

In addition to the two basic financial statements, the reader should also review the *Schedules of Funding Progress*, the *Schedules of Employer Contributions* and the accompanying *Notes to Required Supplementary Information* to gain an understanding of the funded status of the TCRS over time. This information provides an indication of the TCRS' ability to meet both current and future benefit payment obligations. The *Notes to the Financial Statements* are also important to the reader's understanding of the financial statements and provide additional information regarding the TCRS, such as descriptions of the plans administered by the TCRS, including contribution and benefit provisions, and information about the accounting policies and investment activities.

ANALYSIS OF ASSETS, LIABILITIES AND PLAN NET ASSETS

At June 30, 2003, the TCRS had plan net assets (total assets in excess of total liabilities) of nearly $23.8 billion, an increase of over $795 million (3.5 percent) from $23.0 billion at June 30, 2002. The previous two fiscal years had seen declines in plan net assets of 3.2 percent during fiscal year 2002 and 2.5 percent during fiscal year 2001. The assets of the TCRS consist primarily of cash and investments. The decline in plan net assets, as seen over the two prior fiscal years, was the result of net negative investment income due primarily to the depreciation in the fair value of investments caused by unfavorable equity market conditions. During fiscal year 2003, equity market conditions improved, increasing the fair value of investments, and leading to a nearly $1.6 billion increase in net investment income over fiscal year 2002. Condensed financial information comparing the TCRS' plan net assets for the past three fiscal years is presented on the following page.

(continued)

PLAN NET ASSETS

	June 30, 2003	June 30, 2002	FY03 - FY02 Percentage Change	June 30, 2001	FY02 - FY01 Percentage Change
ASSETS					
Cash and cash equivalents	$ 1,717,734,541	$ 1,621,359,545	5.9 %	$ 779,786,367	107.9 %
Contributions receivable	46,850,736	46,238,224	1.3 %	44,992,609	2.8 %
Investment income receivables	134,284,002	147,069,784	(8.7)%	189,993,764	(22.6)%
Investments sold	59,060,030	31,817,111	85.6 %	269,774,623	(88.2)%
Forward contracts receivable	523,209,732	899,292,837	(41.8)%	17,113,000	5,155.0%
Short-term securities	498,577,125	317,388,429	57.1 %	519,748,610	(38.9)%
Long-term investments	21,736,948,082	21,015,023,754	3.4 %	22,599,841,303	(7.0)%
Invested securities lending collateral	0	0		113,685,867	(100.0)%
TOTAL ASSETS	24,716,664,248	24,078,189,684	2.7 %	24,534,936,143	(1.9)%
LIABILITIES					
Death benefits, refunds and other payables	1,244,060	1,141,905	8.9%	1,014,443	12.6 %
Investments purchased	387,262,530	127,034,613	204.8 %	662,796,260	(80.8)%
Other investment payables	2,154,173	2,633,994	(18.2)%	2,121,875	24.1 %
Forward contracts payable	547,519,127	964,499,600	(43.2)%	17,392,319	5,445.5%
Securities lending collateral	0	0		113,685,867	(100.0)%
TOTAL LIABILITIES	938,179,890	1,095,310,112	(14.3)%	797,010,764	37.4%
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS	$ 23,778,484,358	$ 22,982,879,572	3.5 %	$ 23,737,925,379	(3.2)%

ANALYSIS OF REVENUES AND EXPENSES

An increase in employer contribution rates adopted pursuant to the actuarial valuation performed as of July 1, 2001 and effective for fiscal year 2003, resulted in contributions for fiscal year 2003 increasing by $59.9 million (11.2 percent) over contributions for fiscal year 2002. Although employer contribution rates did not change between fiscal year 2002 and 2001, the increase of $19.7 million (3.8 percent) for these years is attributed to new employers joining TCRS and increased salaries. As mentioned in the *Analysis of Assets, Liabilities and Plan Net Assets* section above, the recovery of the equity investment market, along with an improved bond market, contributed to an increase in net investment income for fiscal year 2003 over fiscal year 2002 by $1,556,262,508, after seeing a decrease of $115,992,740 between fiscal years 2001 and 2002. Market conditions have resulted in a return to the TCRS portfolio of 4.9 percent during fiscal year 2003 and a loss of 1.9 percent for fiscal year 2002.

In addition, total expenses, including benefits and administrative expenses increased by 7.7 percent between fiscal year 2003 and fiscal year 2002 and by 7.5 percent between fiscal years 2002 and 2001. The increase in benefit expenses can be attributed to 1.6 percent and 3.0 percent cost of living adjustments awarded to retirees on July 1, 2002 and July 1, 2001, respectively. In addition, more retirees were added to payroll than removed during these fiscal years. Administrative expenses for fiscal year 2001 were greater than would appear. A one-time refund of $1.14 million related to several years of office space overbilling charges was returned to TCRS in fiscal year 2001, thus reducing the total administrative cost.

Condensed financial information comparing the TCRS' revenues and expenses for the past two fiscal years follows.

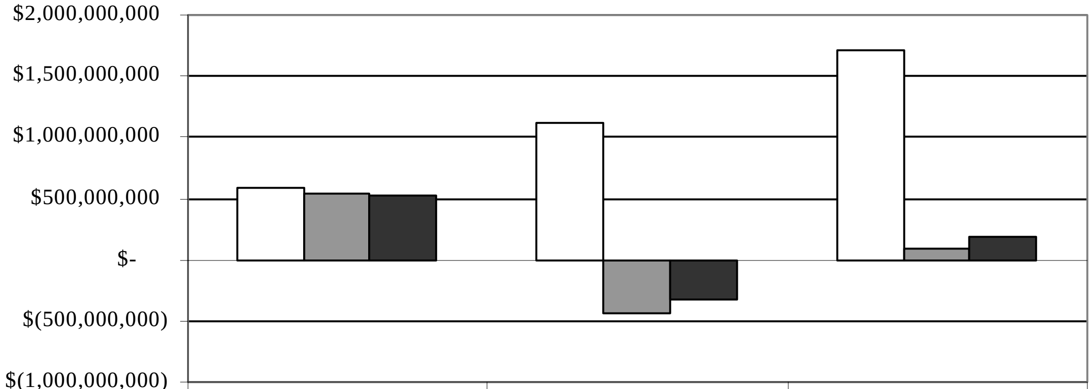
(continued)

CHANGES IN PLAN NET ASSETS

	For the Year Ended June 30, 2003	For the Year Ended June 30, 2002	FY03 - FY02 Percentage Change	For the Year Ended June 30, 2001	FY02 - FY01 Percentage Change
ADDITIONS					
Contributions	$ 596,045,259	$ 536,137,611	11.2 %	$ 516,416,729	3.8 %
Investment income					
Net appreciation (depreciation) in fair value of investments	268,965,778	(1,354,960,400)	119.9 %	(1,383,026,600)	2.0 %
Interest, dividends and other investment income	857,325,990	924,647,372	(7.3)%	1,066,991,030	(13.3)%
Less: Investment expense	(13,813,020)	(14,093,999)	(2.0)%	(12,375,102)	13.9 %
Net income from securities lending activities	0	623,267	(100.0)%	619,652	0.6 %
Net investment income	1,112,478,748	(443,783,760)	350.7 %	(327,791,020)	(35.4)%
TOTAL ADDITIONS	1,708,524,007	92,353,851	1,750.0 %	188,625,709	(51.0)%
DEDUCTIONS					
Annuity benefits					
Retirement benefits	662,075,122	610,554,871	8.4 %	566,721,390	7.7 %
Survivor benefits	42,638,112	38,723,935	10.1 %	36,024,095	7.5 %
Disability benefits	21,781,588	20,109,341	8.3 %	18,567,921	8.3 %
Cost of living	150,690,914	145,335,114	3.7 %	130,369,319	11.5 %
Death benefits	4,046,275	3,367,877	20.1 %	4,701,538	(28.4)%
Refunds	26,631,386	24,304,536	9.6 %	28,517,803	(14.8)%
Administrative expenses	5,055,824	5,003,984	1.0 %	3,477,600	43.9 %
TOTAL DEDUCTIONS	912,919,221	847,399,658	7.7 %	788,379,666	7.5 %
NET INCREASE (DECREASE)	795,604,786	(755,045,807)	205.4 %	(599,753,957)	(25.9)%
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS					
BEGINNING OF YEAR	22,982,879,572	23,737,925,379	(3.2)%	24,337,679,336	(2.5)%
END OF YEAR	$23,778,484,358	$22,982,879,572	3.5 %	$23,737,925,379	(3.2)%

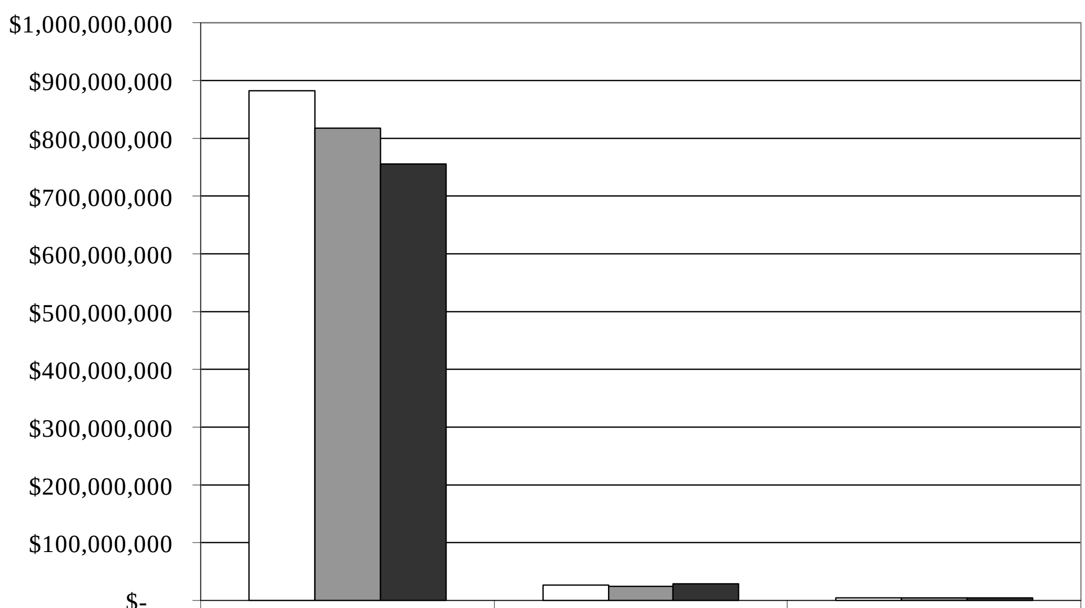
(continued)

REVENUES BY TYPE



	Contributions	Net Investment Income (Loss)	Total Additions
Year Ended 6/30/03	$596,045,259	$1,112,478,748	$1,708,524,007
Year Ended 6/30/02	$536,137,611	$(443,783,760)	$92,353,851
Year Ended 6/30/01	$516,416,729	$(327,791,020)	$188,625,709

EXPENSES BY TYPE



	Benefit Payments	Refunds	Administrative
Year Ended 6/30/03	$881,232,011	$26,631,386	$5,055,824
Year Ended 6/30/02	$818,091,137	$24,304,536	$5,003,984
Year Ended 6/30/01	$756,384,263	$28,517,803	$3,477,600

(continued)

ECONOMIC FACTORS, FUTURE FUNDING PROVISIONS, OVERALL OUTLOOK

Both the domestic and international stock markets continued to be under-performing asset classes. The S&P 500, the TCRS' domestic equity benchmark, had negative returns of 14.83 percent and 17.99 percent for the years ended June 30, 2001 and June 30, 2002, respectively. Fortunately, the S&P 500 made a remarkable recovery during the last quarter of the year ended June 30, 2003. A positive return of 15.39 percent during the quarter eliminated negative returns in the previous three quarters, to finish with a small, but positive return of .25 percent. Somewhat similar was the international stock market. Despite the EAFE index, a benchmark for the international stock market, realizing a positive return of 19.27 percent in the last quarter of fiscal year 2003, the international market ended with a negative return for the third straight year. At June 30, 2003, the EAFE index had a negative return of 6.46 percent. The losses in the prior two years were 23.83 percent and 9.49 percent. Fortunately, the bond market fared better with the domestic market yielding a positive return of 10.40 percent, as measured by the Lehman Aggregate benchmark, and the international market yielding 17.90 percent, as measured by the Salomon Brothers Non-U.S. Bond index.

The benefits of a diversified portfolio are evident based on the last three years of returns in the market place. The pension plan had a positive return of 4.90 percent at June 30, 2003 provided in the most part by the bond portfolios and the recovery in the domestic and international stock markets. The returns were negative during the prior two years, 1.92 percent at June 30, 2002 and 1.57 percent at June 30, 2001.

The TCRS had excellent performance relative to other public pension plans, with a positive return of 4.90 percent for the year ended June 30, 2003, versus a positive return of 3.74 percent as measured by Callan's Public Plan Sponsor Database. However, it must be recognized that the return was less than the actuarial assumption of 7.5 percent, which accordingly will put upward pressure on the employer contribution rate in the July 1, 2003 and subsequent actuarial valuations.

The first quarter of the 2004 fiscal year has been somewhat encouraging with the S&P 500 gaining 2.65 percent, the EAFE index gaining 8.13 percent, and the Salomon Brothers Non-U.S. Bond index gaining 2.75 percent. The Lehman Aggregate index was down slightly (.15 percent).

CONTACTING THE TCRS

This report is designed to provide a financial overview of the TCRS to state legislators, members of the Board of Trustees of the TCRS, state officials, participating employers and any other interested parties. Questions or requests for additional information regarding the financial information presented in this report may be addressed in writing to the Tennessee Treasury Department, Consolidated Retirement System, 10th Floor Andrew Jackson Building, Nashville, TN 37243-0230.

COMPARATIVE STATEMENTS OF PLAN NET ASSETS
AS OF JUNE 30, 2003 AND JUNE 30, 2002

Expressed in Thousands	**State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)**	**Political Subdivisions Pension Plan (PSPP)**
ASSETS		
Cash and cash equivalents	$ 1,477,468	$ 240,266
Receivables		
Member contributions receivable	14,863	3,586
Employer contributions receivable	18,194	10,208
Accrued interest receivable	104,068	16,938
Accrued dividends receivable	11,418	1,859
Other investment receivable	1	0
Forward contracts receivable	449,823	73,387
Investments sold	50,790	8,270
Total receivables	649,157	114,248
Investments, at fair value		
Short-term securities	428,785	69,792
Government bonds	8,955,774	1,457,697
Corporate bonds	1,988,160	323,605
Corporate stocks	7,430,045	1,209,359
Real estate	320,192	52,116
Total investments	19,122,956	3,112,569
TOTAL ASSETS	21,249,581	3,467,083
LIABILITIES		
Accounts payable		
Death benefits and refunds payable	686	542
Other	16	0
Investments purchased	333,050	54,213
Forward contracts payable	470,723	76,796
Other investment payables	1,852	302
TOTAL LIABILITIES	806,327	131,853
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS (Schedules of funding progress for the plans are presented on page 32)	$ 20,443,254	$ 3,335,230

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

June 30, 2003 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	June 30, 2002 Total
$ 1,717,734	$ 1,400,985	$ 220,375	$ 1,621,360
18,449	15,250	4,050	19,300
28,402	18,191	8,747	26,938
121,006	116,555	18,334	134,889
13,277	10,524	1,656	12,180
1	1	0	1
523,210	776,826	122,467	899,293
59,060	27,489	4,328	31,817
763,405	964,836	159,582	1,124,418
498,577	274,249	43,139	317,388
10,413,471	7,517,687	1,182,530	8,700,217
2,311,765	2,404,488	378,226	2,782,714
8,639,404	7,931,835	1,247,676	9,179,511
372,308	304,659	47,923	352,582
22,235,525	18,432,918	2,899,494	21,332,412
24,716,664	20,798,739	3,279,451	24,078,190
1,228	461	645	1,106
16	36	0	36
387,263	109,765	17,270	127,035
547,519	833,152	131,347	964,499
2,154	2,276	358	2,634
938,180	945,690	149,620	1,095,310
$ 23,778,484	$ 19,853,049	$ 3,129,831	$ 22,982,880

Tennessee Consolidated Retirement System
Comparative Statements of Changes in Plan Net Assets
For the Years Ended June 30, 2003 and June 30, 2002

Expressed in Thousands	**State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)**	**Political Subdivisions Pension Plan (PSPP)**
ADDITIONS		
Contributions		
Member contributions	$ 148,493	$ 49,218
Employer contributions	264,320	134,014
Total contributions	412,813	183,232
Investment income		
Net appreciation (depreciation) in fair value of investments	232,015	36,950
Interest	577,854	92,529
Dividends	137,167	21,963
Real estate income, net of operating expenses	23,974	3,839
Total investment income (loss)	971,010	155,281
Less: Investment expense	(11,900)	(1,913)
Net income (loss) from investing activities	959,110	153,368
Securities lending activities		
Securities lending income	0	0
Less: securities lending expense	0	0
Net income from securities lending activities	0	0
Net investment income (loss)	959,110	153,368
TOTAL ADDITIONS	1,371,923	336,600
DEDUCTIONS		
Annuity benefits		
Retirement benefits	571,703	90,372
Survivor benefits	36,818	5,820
Disability benefits	18,809	2,973
Cost of living	134,455	16,236
Death benefits	3,052	994
Refunds	14,250	12,381
Administrative expense	2,631	2,425
TOTAL DEDUCTIONS	781,718	131,201
NET INCREASE (DECREASE)	590,205	205,399
NET ASSETS HELD IN TRUST FOR PENSION BENEFITS		
BEGINNING OF YEAR	19,853,049	3,129,831
Cumulative effect of a change in accounting principle	0	0
BEGINNING OF YEAR, RESTATED	19,853,049	3,129,831
END OF YEAR	$ 20,443,254	$ 3,335,230

See accompanying Notes to the Financial Statements

(continued)

(CONTINUED)

For the Year Ended June 30, 2003 Total	State Employees, Teachers, Higher Education Employees Pension Plan (SETHEEPP)	Political Subdivisions Pension Plan (PSPP)	For the Year Ended June 30, 2002 Total
$ 197,711	$ 142,126	$ 47,139	$ 189,265
398,334	243,498	103,374	346,872
596,045	385,624	150,513	536,137
268,965	(1,170,322)	(184,638)	(1,354,960)
670,383	642,392	101,391	743,783
159,130	132,758	20,953	153,711
27,813	23,452	3,701	27,153
1,126,291	(371,720)	(58,593)	(430,313)
(13,813)	(12,190)	(1,904)	(14,094)
1,112,478	(383,910)	(60,497)	(444,407)
0	1,492	235	1,727
0	(953)	(150)	(1,103)
0	539	85	624
1,112,478	(383,371)	(60,412)	(443,783)
1,708,523	2,253	90,101	92,354
662,075	528,471	82,084	610,555
42,638	33,518	5,206	38,724
21,782	17,405	2,704	20,109
150,691	129,918	15,417	145,335
4,046	2,225	1,143	3,368
26,631	12,689	11,616	24,305
5,056	2,714	2,290	5,004
912,919	726,940	120,460	847,400
795,604	(724,687)	(30,359)	(755,046)
22,982,880	20,577,977	3,160,228	23,738,205
0	(241)	(38)	(279)
22,982,880	20,577,736	3,160,190	23,737,926
$ 23,778,484	$ 19,853,049	$ 3,129,831	$ 22,982,880

The Tennessee Consolidated Retirement System (TCRS) administers two defined benefit pension plans **-** State Employees, Teachers and Higher Education Employees Pension Plan (SETHEEPP) and Political Subdivisions Pension Plan (PSPP). Although the assets of the plans are commingled for investment purposes, each plan's assets may be used only for the payment of benefits to members of that plan, in accordance with the terms of the plan.

A. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1. **Reporting Entity -** The TCRS is included in the State of Tennessee Financial Reporting Entity. Because of the state's fiduciary responsibility, the TCRS has been included as pension trust funds in the *Tennessee Comprehensive Annual Financial Report.*

2. **Measurement Focus and Basis of Accounting -** The accompanying financial statements have been prepared in conformity with generally accepted accounting principles as prescribed by the Governmental Accounting Standards Board (GASB). The TCRS follows all applicable GASB pronouncements, as well as applicable private sector pronouncements issued on or before November 30, 1989. The financial statements have been prepared using the flow of economic resources measurement focus and the accrual basis of accounting. Under this method, revenues are recorded when earned and expenses are recorded at the time liabilities are incurred.

   Plan member contributions are recognized in the period in which the contributions are due. Plan employer contributions are recognized when due and the employer has made a formal commitment to provide the contributions. Benefits and refunds are recognized when due and payable in accordance with the terms of each plan.

3. **Cash and Cash Equivalents -** Cash and cash equivalents, by definition, includes cash and short-term investments with a maturity date within three months of the acquisition date. The state's accounting policy regarding the definition of cash and cash equivalents includes cash management pools as cash. Cash received by the TCRS that cannot be invested immediately in securities is invested in the State Pooled Investment Fund administered by the State Treasurer. The State Pooled Investment Fund is authorized by state statute to invest funds in accordance with policy guidelines approved by the Funding Board of the State of Tennessee. The current resolution of that board gives the Treasurer authority to invest in collateralized certificates of deposit in authorized state depositories, prime commercial paper, prime bankers' acceptances, certain repurchase agreements, various U.S. Treasury and Agency obligations, and in obligations of the state of Tennessee pursuant to *Tennessee Code Annotated*, Section 9-4-602(b). The State Pooled Investment Fund is also authorized to enter into securities lending agreements in which U.S. Government Securities may be loaned for a fee. The loaned securities are transferred to the borrower by the custodial agent upon simultaneous receipt of collateral securities. The pool's custodial credit risk is presented in the *Tennessee Comprehensive Annual Financial Report* for the years ended June 30, 2003 and June 30, 2002. That 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 Eighth Avenue North, Nashville, Tennessee 37243-0298. The classification of cash and cash equivalents also includes cash invested in a short-term, open-end mutual fund at June 30, 2003, and cash held in a custody account at June 30, 2002, under the contractual arrangements for master custody services. The cash balance held at June 30, 2002 with the custodial agent is not classified into credit risk categories established by Statement Number 3 of the Governmental Accounting Standards Board as the custody account relationship does not meet the definition for either a deposit with a financial institution or a security.

4. **Method Used to Value Investments -** Investments are reported at fair value. Securities traded on a national or international exchange are valued at the last reported sales price at current exchange rates. Short-term investments that do not have an established market are reported at cost plus accrued interest which approximates fair value. The fair value of real estate investments is determined at least every three years by qualified independent appraisers who are members of the Appraisal Institute and internally by real estate advisors for those years when independent appraisals are not performed. Investment income consists of realized and unrealized appreciation (depreciation) in the fair value of investments. Interest income is recognized when earned. Securities and securities transactions are recorded in the financial statements on trade-date basis.

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5. **Receivables -** Receivables primarily consist of interest which is recorded when earned. The receivables for contributions as of June 30, 2003 consist of member contributions of $14.9 million and $3.6 million due to SETHEEPP and PSPP respectively, and employer contributions of $18.2 million and $10.2 million due to SETHEEPP and PSPP respectively. The receivables for contributions as of June 30, 2002 consist of member contributions of $15.3 million and $4.0 million due to SETHEEPP and PSPP respectively, and employer contributions of $18.2 million and $8.7 million due to SETHEEPP and PSPP respectively.

6. **Adoption of New Accounting Pronouncements -** Effective July 1, 2001, the TCRS, along with the State of Tennessee, adopted the provisions of Statement No. 34 of the Governmental Accounting Standards Board, *Basic Financial Statements-and Management's Discussion and Analysis-for State and Local Governments* and its related *Omnibus* Statement No. 37. Accordingly, a management's discussion and analysis (MD&A) has been included in the presentation of required supplementary information (RSI). The TCRS has also adopted the provisions of Statement No. 38, *Certain Financial Statement Note Disclosures* and has included applicable disclosures in the Notes to the Financial Statements.

7. **Accounting Change –** During the year ended June 30, 2003, the TCRS changed its method of reporting foreign currency forward contracts to include their associated unrealized gains and losses on the financial statements. The receivables and payables relating to these contracts, previously treated as off-balance sheet items, have been included on the Comparative Statements of Plan Net Assets, and the unrealized gains and losses associated with these investment activities have been included in the Comparative Statements of Changes in Plan Net Assets. The cumulative effect of this change in accounting principle is reported in the accompanying financial statements as a restatement of Net Assets Held in Trust for Pension Benefits balance at July 1, 2001. In addition, the 2002 financial statements have been restated to reflect this change. As a result, the decrease in net assets for the year ended June 30, 2002, changed from $690,118,363 to $755,045,807.

B. PLAN DESCRIPTIONS AND CONTRIBUTION INFORMATION

At July 1, 2001, the date of the latest actuarial valuation, the membership of each plan consisted of the following:

	SETHEEPP	PSPP
Retirees and beneficiaries currently receiving benefits	56,444	21,298
Terminated members entitled to but not receiving benefits	15,895	3,500
Current active members	126,069	68,656
Total	198,408	93,454
Number of participating employers	140	404

State Employees, Teachers and Higher Education Employees Pension Plan

Plan Description - SETHEEPP is a cost-sharing, multiple employer defined benefit pension plan that covers the employees of the state, teachers with Local Education Agencies (LEA's) and higher education employees. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan on or after July 1, 1979 are vested after five years of service. Members joining prior to July 1, 1979 are vested after four years of service. Compounded cost of living adjustments (COLA) are provided each July based on the percentage change in the Consumer Price Index (CPI) during the previous calendar year except that (a) no COLA is granted if the CPI is less than one-half percent; (b) a COLA of 1 percent will be granted if the CPI increases between one-half percent and one percent; (c) the maximum annual COLA is capped at three percent. Benefit provisions are established by state statute found in Title Eight, Chapters 34 through 37 of the *Tennessee Code Annotated*. State statutes are amended by the Tennessee General

(continued)

Assembly. Ad hoc increases may only be authorized by the General Assembly. Public safety officers receive an additional supplemental benefit that is paid from age 60 to age 62.

Superseded Systems and Certain Employment Classifications - Members of superseded systems that became members of the TCRS at consolidation in 1972, have their rights preserved to the benefits of the superseded system, if the benefit from the superseded plan exceeds that provided by the Group 1 (teachers and general employees) TCRS formula. Likewise, public safety employees and officials of TCRS Groups 2, 3 and 4 are entitled to the benefits of those formulas, if better than the Group 1 benefits.

Contributions and Reserves - Effective July 1, 1981, the plan became noncontributory for most state and higher education employees. The contribution rate for teachers is five percent of gross salary. The employers contribute a set percentage of their payrolls, determined by an actuarial valuation. *Tennessee Code Annotated* Title Eight, Chapter 37 provides that the contribution rates be established and may be amended by the Board of Trustees of the TCRS. The administrative budget for the plan is approved through the state of Tennessee's annual budget process. Funding for the administrative budget is included in employer contributions.

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the Employer Reserve. At June 30, 2003, the plan's Member Reserve and Employer Reserve were fully funded with balances of $2,909.3 million and $17,533.9 million, respectively. At June 30, 2002, the plan's Member Reserve and Employer Reserve were fully funded with balances of $2,781.9 million and $17,071.1 million, respectively.

Political Subdivisions Pension Plan

Plan Description - PSPP is an agent multiple-employer defined benefit pension plan that covers the employees of participating political subdivisions of the state of Tennessee. Employee class differentiations are not made under PSPP. The TCRS provides retirement benefits as well as death and disability benefits to plan members and their beneficiaries. Benefits are determined by a formula using the member's high five-year average salary and years of service. Members become eligible to retire at the age of 60 with five years of service or at any age with 30 years of service. A reduced retirement benefit is available to vested members who are at least 55 years of age or have 25 years of service. Disability benefits are available to active members with five years of service who become disabled and cannot engage in gainful employment. There is no service requirement for disability that is the result of an accident or injury occurring while the member was in the performance of duty. Members joining the plan prior to July 1, 1979 are vested after four years of service. Members joining on or after July 1, 1979 are vested upon completion of 10 years of service, unless five years vesting is authorized by resolution of the chief governing body. Cost of living adjustments (COLA) are the same as provided by SETHEEPP except that the local government may elect (a) to provide no COLA benefits or (b) to provide COLA benefits under a non-compounding basis rather than the compounded basis applicable under SETHEEPP. Benefit provisions are established and amended by state statute. Pursuant to Article Two, Section 24 of the *Constitution of the State of Tennessee*, the state cannot mandate costs on local governments. Any benefit improvement may be adopted by the governing body of a governmental entity participating in the TCRS.

Contributions and Reserves - Political subdivisions may elect contributory or noncontributory retirement for their employees. The contribution rate for contributory employees of political subdivisions is five percent of gross salary. The employers contribute a set percentage of their payrolls, equal to at least, the percentage determined by an actuarial valuation. State statute provides that the contribution rates be established and may be amended by the Board of Trustees of the TCRS. The administrative budget for the plan is approved through the state's annual budget process. Funding for the administrative budget is included in employer contributions.

The net assets of the plan are legally required to be reserved in two accounts, the Member Reserve and the Employer Reserve. The Member Reserve represents the accumulation of employee contributions plus interest. The Employer Reserve represents the accumulation of employer contributions, investment income and transfers from the Member Reserve for retiring members. Benefit payments and interest credited to the members' accounts are reductions to the

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Employer Reserve. At June 30, 2003, the plan's Member Reserve and Employer Reserve were fully funded with balances of $691.1 million and $2,644.1 million, respectively. At June 30, 2002, the plan's Member Reserve and Employer Reserve were fully funded with balances of $643.7 million and $2,486.1 million, respectively.

C. INVESTMENTS

State statute authorizes the TCRS to invest in bonds, debentures, preferred stock and common stock, real estate and in other good and solvent securities subject to the approval of the Board of Trustees and further subject to the following restrictions:

a. The total sum invested in common and preferred stocks shall not exceed seventy-five percent (75 percent) of the total of the funds of the retirement system.

b. The total sum invested in notes and bonds or other fixed income securities exceeding one year in maturity shall not exceed seventy-five percent (75 percent) of the total funds of the retirement system. Private Placements are limited to 15 percent of the total fixed income portfolio.

c. Within the restrictions in (a) and (b) above, an amount not to exceed fifteen percent (15 percent) of the total of the funds of the retirement system may be invested in securities of the same kinds, classes, and investment grades as those otherwise eligible for investment in various approved foreign countries.

d. The total amount of securities loaned under a securities lending program cannot exceed thirty percent (30 percent) of total assets.

e. The total sum invested in real estate shall not exceed five percent (5 percent) of the total of the funds of the retirement system.

The TCRS investment securities are categorized on the chart that follows according to the level of custodial credit risk associated with the custodial arrangements. Category 1 includes investments that are insured or registered, or for which the securities are held by the TCRS or its agent in the name of the TCRS. Category 2 includes uninsured and unregistered investments for which the securities are held by the counterparty's trust department or agent in the name of the TCRS. Category 3 includes uninsured and unregistered investments for which the securities are held by the broker or dealer, or by the counterparty's trust department or agent, but not in the name of the TCRS. TCRS investments as of June 30, 2003 included SEC – registered open-end mutual funds of $108,761.

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Expressed in Thousands	**Fair Value June 30, 2003**	**Fair Value June 30, 2002**
Investments - Category 1		
Cash equivalents and short-term securities		
Commercial paper	$ 717,397	$ 762,737
Corporate notes	0	90,489
Government bonds	1,501,324	1,089,855
Long-term investments		
Government bonds	10,081,502	8,588,873
Corporate bonds	2,293,728	2,782,714
Corporate stocks	8,613,755	9,167,281
Total investments - Category 1	23,207,706	22,481,949
Investments - Category 2	0	0
Investments - Category 3		
Margin deposit on futures contracts		
Government bonds	0	9,438
Total investments - Category 3	0	9,438
Investments - Not Categorized		
Investment in open-end mutual fund	109	0
Real estate	372,308	352,582
Unsettled investment acquisitions		
Government bonds	331,969	101,906
Corporate bonds	18,037	0
Corporate stocks	25,649	12,230
Total investments - Not Categorized	748,072	466,718
Total investments	23,955,778	22,958,105
Less: Short-term investments classified as cash equivalents on the Statements of Plan Net Assets	(1,720,253)	(1,625,693)
Total investments as shown on the Statements of Plan Net Assets	$ 22,235,525	$ 21,332,412

As of June 30, 2003 and June 30, 2002, the TCRS had no concentrations of investments, other than those issued or guaranteed by the U.S. government, in any one organization that represents five percent or more of plan net assets.

Securities Lending - The TCRS is authorized by its investment policy, as adopted by the Board of Trustees, to enter into collateralized securities lending agreements whereby the TCRS loans its debt and equity securities for a fee to a select few of the highest quality securities firms and banks. Loans must be limited so the total amount on loan does not exceed 30 percent of the TCRS' assets. The TCRS' custodian bank manages the lending program and maintains the collateral on behalf of the TCRS. The borrower must deliver cash collateral to the lending agent. The cash collateral may be reinvested by the lending agent in accordance with the investment policy, as further restricted under the TCRS securities lending agreement. Collateral securities cannot be pledged or sold unless the borrower defaults.

The loaned securities are initially collateralized at 102 percent of their fair value for domestic securities and 105 percent for international. Collateral is marked-to-market daily and additional collateral is pledged by the borrower if the fair value of the collateral subsequently falls below 100 percent for domestic securities and 105 percent for international. Although there is no specific policy for matching the maturities of collateral investments and the

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securities loans, the securities on loan can be terminated on demand by either the TCRS or the borrower. As of June 30, 2003 and June 30, 2002, there were no securities on loan. The TCRS securities lending income, net of expenses, for the year ended June 30, 2002 was $623,267.

Derivatives - The TCRS may buy or sell equity index futures contracts for the purpose of making asset allocation changes in an efficient and cost effective manner and to improve liquidity. The futures contracts are limited to the S&P 500 Index, the S&P Midcap 400 Index and the Russell 2000 Index. The TCRS can increase (decrease) equity market exposure by buying (selling) the equity index future to obtain its target domestic equity allocation. Gains (losses) on equity index futures hedge losses (gains) produced by any deviation from the TCRS' target equity allocation.

At June 30, 2003, the TCRS was not under any futures contracts. As of June 30, 2002, the notional amount of futures contracts was $128,868,750 at a fair value of $123,762,500. The gains and losses resulting from daily fluctuations in the fair value of the outstanding futures contracts are settled daily, on the following day, and a receivable or payable is established for any unsettled gain or loss as of the financial statement date.

The international securities expose the TCRS to potential losses due to a possible rise in the value of the US dollar. The TCRS investment managers can reduce foreign currency exposure by selling foreign currency forward contracts, at agreed terms and for future settlement, usually within a year. The manager will reverse the contract by buying the foreign currency before the settlement date. A gain (loss) on this transaction pair will hedge a loss (gain) on the currency movement of the international security. The TCRS can sell up to 80% of its foreign currency exposure into US dollars. As described in Note A.7 above, the fair value of foreign currency forward contracts outstanding as of June 30, 2003 and June 30, 2002 have been reflected on the financial statements.

The TCRS is also authorized by investment policy to engage in the issuance of options. Activity is limited to selling covered call options. The TCRS had no options outstanding at June 30, 2003 and June 30, 2002.

Asset-Backed Securities – The TCRS invests in collateralized mortgage obligations (CMOs) which are mortgage-backed securities. These securities are based on cash flows from interest and principal payments on underlying mortgages. Therefore, they are sensitive to prepayments by mortgagees, which may result from a decline in interest rates. The CMOs held were issued by quasi-U. S. governmental agencies. The market value of CMOs held at June 30, 2003 was $9,715,380 and no CMOs were held at June 30, 2002. The TCRS also invests in various asset-backed securities, representing ownership interests in trusts consisting of credit card and auto loan receivables. These securities are issued by organizations with AAA or AA credit ratings. TCRS invests in these securities primarily to enhance returns by taking advantage of opportunities available in this sector of the securities markets.

D. COMMITMENTS

Standby Commercial Paper Purchase Agreement - The TCRS has agreed to serve as standby commercial paper purchaser for commercial paper issued by the Funding Board of the State of Tennessee. By serving as a standby commercial paper purchaser, the TCRS receives an annual fee of 7.5 basis points on the $250 million maximum issuance under this agreement during times when both Moody's and Standard and Poor's investment ratings assigned to the State of Tennessee's general obligation bonds are Aaa and AAA respectively, and 12 basis points during times when either Moody's or Standard and Poor's has assigned ratings other than Aaa and AAA respectively. In the unlikely event that the TCRS would be called upon to purchase the commercial paper, the TCRS would receive interest at a rate equal to prime plus 75 basis points during the first 30 consecutive days, plus an additional 50 basis points for each consecutive 30 days thereafter, up to a maximum rate allowed by state law.

SCHEDULES OF FUNDING PROGRESS

Expressed in Thousands

	Actuarial Valuation Date	Actuarial Value of Plan Assets (a)	Actuarial Accrued Liability (AAL) Frozen Entry Age (b)	Unfunded AAL (UAAL) (b-a)	Funded Ratio (a/b)	Annual Covered Payroll (c)	UAAL as a Percentage of Covered Payroll ((b-a)/c)
SETHEEPP	7/1/2001	$ 20,760,989	$ 20,842,216	$ 81,227	99.61%	$ 4,451,452	1.82%
	7/1/1999	18,327,133	18,420,156	93,023	99.49%	4,132,409	2.25%
	6/30/1997	15,671,678	15,782,850	111,172	99.30%	3,810,231	2.92%
PSPP	7/1/2001	3,187,990	3,528,137	340,147	90.36%	1,545,593	22.01%
	7/1/1999	2,690,781	2,890,942	200,161	93.08%	1,341,363	14.92%
	6/30/1997	2,226,891	2,287,904	61,013	97.33%	1,130,585	5.40%

The SETHEEPP is comprised of a number of employee groups. However, the unfunded liability of $81.2 million at July 1, 2001 is attributable to two employee groups: 1) County Officials employed prior to July 1, 1972 and 2) State Judges and Attorneys General employed prior to July 1, 1972. The PSPP represents 404 participating entities at July 1, 2001. The unfunded liability of $340.1 million is attributable to 318 of the 404 entities.

See accompanying Notes to Required Supplementary Information

SCHEDULES OF EMPLOYER CONTRIBUTIONS

Expressed in Thousands

	SETHEEPP		PSPP	
Year Ended June 30	Annual Required Contribution	Percentage Contributed	Annual Required Contribution	Percentage Contributed
2003	$ 264,320	100%	$ 134,014	100%
2002	243,498	100%	103,374	100%
2001	232,149	100%	103,681	100%
2000	252,162	100%	82,749	100%
1999	244,453	100%	69,230	100%
1998	166,756	100%		

An actuarial valuation of the TCRS is performed every two years with the next valuation scheduled to be effective July 1, 2003. The June 30, 1995 valuation determined the employer contribution rate for the year ended June 30, 1997 for the SETHEEPP and the PSPP, and for the year ended June 30, 1998 for the PSPP. Therefore, the Schedule of Employer Contributions, in accordance with the parameters of GASB Statement Number 25, is not available for the year ended June 30, 1998 for the PSPP.

See accompanying Notes to Required Supplementary Information

The information presented in the required supplementary schedules was determined as part of the actuarial valuations at the dates indicated. Additional information as of the July 1, 2001 actuarial valuation follows.

	SETHEEPP	PSPP
Valuation Date	July 1, 2001	July 1, 2001
Actuarial cost method	Frozen Entry Age	Frozen Entry Age
Amortization method	Level Dollar	Level Dollar
Remaining amortization period	14 years closed period	(1) closed period
Asset valuation method	5-year Moving Market Average	5-year Moving Market Average
Actuarial assumptions:		
Investment rate of return	7.50%	7.50%
Projected salary increases	4.75% (3)	4.75% (3)
Includes inflation at	(2)	(2)
Cost-of-living adjustments	3.00%	3.00%
Increase in Social Security wage base	3.50%	3.50%

(1) The length of the amortization period varies by political subdivision. For political subdivisions entering the plan on or after July 1, 1994, the amortization period does not exceed 20 years.

(2) No explicit assumption is made regarding the portion attributable to the effect of inflation on salaries.

(3) Uniform rate that approximates the effect of a graded salary scale.