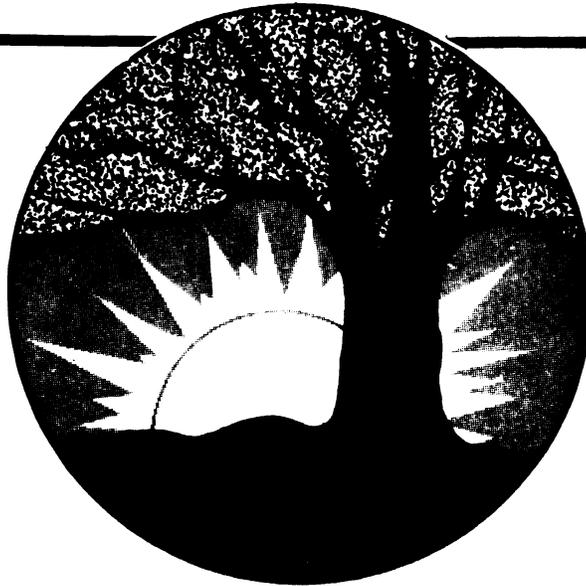


PERFORMANCE AUDIT

Tennessee Consolidated Retirement System
Board of Trustees and Medical Board
December 2007



John G. Morgan
Comptroller of the Treasury



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John G. Morgan
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December 18, 2007

The Honorable Ron Ramsey
Speaker of the Senate
The Honorable Jimmy Naifeh
Speaker of the House of Representatives
The Honorable Thelma M. Harper, Chair
Senate Committee on Government Operations
The Honorable Mike Kernell, Chair
House Committee on Government Operations
and
Members of the General Assembly
State Capitol
Nashville, Tennessee 37243

Ladies and Gentlemen:

Transmitted herewith is the performance audit of the Tennessee Consolidated Retirement System Board of Trustees and Medical Board. This audit was conducted pursuant to the requirements of Section 4-29-111, *Tennessee Code Annotated*, the Tennessee Governmental Entity Review Law.

This report is intended to aid the Joint Government Operations Committee in its review to determine whether the system's Board of Trustees and Medical Board should be continued, restructured, or terminated.

Sincerely,

John G. Morgan
Comptroller of the Treasury

JGM/dlj
06-024

State of Tennessee

Audit Highlights

Comptroller of the Treasury

Division of State Audit

Performance Audit
Tennessee Consolidated Retirement System
Board of Trustees and Medical Board
December 2007

AUDIT OBJECTIVES

The objectives of the audit were (1) to assess the timeliness and consistency of the Medical Board in carrying out its duties; (2) to assess the adequacy of the retirement system's processes for ensuring that Board of Trustees members have disclosed potential conflicts of interest and that board members have sufficient information to make knowledgeable decisions affecting the retirement system; (3) to determine the adequacy of the retirement system's controls over its real estate investments and the contractors that assist the system with the real estate program; (4) to determine the adequacy of controls and documentation related to soft dollar/recapture arrangements; (5) to determine the extent to which the retirement system's custodian meets its contractual requirements regarding the settling of trades and notifications of company mergers/splits; (6) to assess the retirement system's processes for developing and monitoring contracts or other agreements with consultants, advisors, brokers, etc.; (7) to assess the retirement system's process for verifying that retired employees who have returned to work are not exceeding certain limits set for retirees; (8) to summarize Title VI-related information for the Treasury Department; and (9) to develop possible alternatives for legislative and administrative action.

FINDING

Members of the Board of Trustees Do Not Sign Conflict-of-Interest Statements

According to interviews with board members and internal audit staff from the Department of the Treasury, the TCRS Board of Trustees members have not been required to sign conflict-of-interest statements. Members of the board stated they have never been asked to sign conflict-of-interest statements because the types of things they typically vote on (i.e., general policy issues) would not be affected by a conflict of interest. However, the board does vote on specific real estate investments that could raise questions regarding potential conflicts of interest (page 13).

OBSERVATIONS AND COMMENTS

The audit also discusses the following issues: compensation payments to some retired temporary workers exceeded TCRS salary limits; the reconciliation process for the soft dollar accounts needs improvement; and TCRS should consider adopting GFOA recommendations for broker/dealer agreements. Additional audit work regarding the real estate program, the TCRS custodian, and the Medical Board is also discussed (page 5).

**Performance Audit
Tennessee Consolidated Retirement System
Board of Trustees and Medical Board**

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**Performance Audit
Tennessee Consolidated Retirement System
Board of Trustees and Medical Board**

INTRODUCTION

PURPOSE AND AUTHORITY FOR THE AUDIT

The performance audit of the Board of Trustees and the Medical Board of the Tennessee Consolidated Retirement System was conducted pursuant to the Tennessee Governmental Entity Review Law, *Tennessee Code Annotated*, Title 4, Chapter 29. Under Section 4-29-228, the system's Board of Trustees and Medical Board were scheduled to terminate June 30, 2007. On June 12, 2007, the General Assembly passed Public Chapter 547, which extended this and other entities in the 2007 Sunset cycle that had not yet been heard, for one year or until a public hearing can be held. Section 4-29-111 authorizes the Comptroller of the Treasury to conduct a limited program review audit of the Tennessee Consolidated Retirement System's Board of Trustees and Medical Board and to report to the Joint Government Operations Committee of the General Assembly. The audit is intended to aid the committee in determining whether the Board of Trustees and the Medical Board should be continued, restructured, or terminated.

OBJECTIVES OF THE AUDIT

The objectives of the audit were

1. to assess the timeliness and consistency of the Medical Board in carrying out its duties;
2. to assess the adequacy of the retirement system's processes for ensuring that Board of Trustees members have disclosed potential conflicts of interest and that board members have sufficient information to make knowledgeable decisions affecting the retirement system;
3. to determine the adequacy of the retirement system's controls over its real estate investments and the contractors that assist the system with the real estate program;
4. to determine the adequacy of controls and documentation related to soft dollar/recapture arrangements;
5. to determine the extent to which the retirement system's custodian meets its contractual requirements regarding the settling of trades and notifications of company mergers/splits and if not, what actions have been or could be taken by the retirement system;

6. to assess the retirement system's processes for developing and monitoring contracts or other agreements with consultants, advisors, brokers, etc.;
7. to assess the retirement system's process for verifying that retired employees who have returned to work are not exceeding certain limits set for retirees;
8. to summarize Title VI-related information for the Department of the Treasury; and
9. to develop possible alternatives for legislative and administrative actions that could result in more efficient and effective operation of the department and the boards.

SCOPE AND METHODOLOGY OF THE AUDIT

The activities of the Tennessee Consolidated Retirement System and its Board of Trustees and Medical Board were reviewed for fiscal years 2002 through 2006. The audit was conducted in accordance with the standards applicable to performance audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States and included

1. a review of applicable legislation, rules, and regulations;
2. an examination of prior performance and financial and compliance audit reports;
3. an examination of board and investment committee meeting minutes;
4. a review of Tennessee Consolidated Retirement System documents, files, and information;
5. attendance at board and investment committee meetings;
6. interviews with employees of the Tennessee Consolidated Retirement System, board members, and other officials; and
7. a review of on-line information on securities and securities-related organizations.

The General Assembly has designated the Comptroller of the Treasury both to serve as a member of the Tennessee Consolidated Retirement System's Board of Trustees and to audit the entity. In addition to periodic Sunset audits of the Board of Trustees and the Medical Board, the Division of State Audit also conducts annual financial audits of the Tennessee Consolidated Retirement System.

ORGANIZATION AND RESPONSIBILITIES

The Department of the Treasury is responsible for the daily operation of the Tennessee Consolidated Retirement System (TCRS). TCRS was established in 1972 as a retirement program for the public employees of Tennessee. A variety of services are provided for members under the following major areas: the Director's office, Counseling Services, Member Services, and Financial Services. The Director's office of TCRS is responsible for the overall operation of the retirement system for state employees, teachers, higher education employees, and local

government employees. Responsibilities include holding quarterly Board of Trustees meetings; overseeing the actuarial process; and setting policy and establishing goals and objectives.

Board of Trustees. The 19-member Board of Trustees is responsible for the general administration and proper operation of the Tennessee Consolidated Retirement System. The board consists of nine ex-officio members, eight representatives of the active TCRS membership, and two representatives for retirees. The ex-officio members include the chair and vice-chair of the Council on Pensions and Insurance (as nonvoting members), the Commissioner of Human Resources, the Commissioner of Finance and Administration, the Comptroller of the Treasury, the Secretary of State, the Administrative Director of the Courts, the State Treasurer, and the Director of the Division of Retirement. Employee representation consists of three teachers (one from each grand division of the state), two state employees from departments other than those represented by the ex-officio members, and three representatives of local governments. The three teachers are elected for three-year terms by the representative assembly of the Tennessee Education Association. State employees elect two state employee representatives who also serve three-year terms. One representative is appointed for a two-year term by each of the following organizations: the Tennessee County Services Association, the Tennessee Municipal League, and the County Officials Association of Tennessee. All employee representatives must be vested members of TCRS. One retired state or higher education employee representative is appointed by the Governor for a two-year term. A retired teacher, selected by the Tennessee Retired Teachers Association, serves on the board in a non-voting capacity. The State Treasurer acts as the Chair of the board, and the Director of the Division of Retirement serves as Secretary.

Medical Board. The Medical Board of the Tennessee Consolidated Retirement System was created by Section 8-34-401, *Tennessee Code Annotated*, and consists of three physicians. The Medical Board is designated by the Board of Trustees through a competitive bid process. The contract terms for the three current Medical Board members began in 2002 and 2003. All contract terms end on June 30, 2008. The physicians serving on the Medical Board evaluate applications for disability retirement to determine if applicants are totally and permanently disabled and unable to engage in gainful employment. In addition, the panel reviews medical data submitted by disabled retirees who are subject to periodic evaluation.

Counseling Services. The Counseling Services section is responsible for helping members plan for their retirement and assisting new employers in obtaining coverage in TCRS. This section's component includes counseling, pre-retirement planning, disability retirement, and field services. The counseling component provides information about benefits, optional benefit plans available, insurance coverage after retirement, and income tax information, as well as benefit estimates. The field services component conducts employer and employee meetings, processes new employers into the plan, enrolls new employees, and coordinates communications with employers.

Member Services. The Member Services section supports activities related to member enrollment, account maintenance, benefit calculation, and prior-service calculations. The account services component enrolls new members, maintains active member accounts, and supports the retrieval of documents contained in each member's file. The prior-service area assists members in establishing the additional service credit. The benefit calculation area is

responsible for the on-line calculation of retirement benefits and for advising members applying for retirement.

Financial Services. The Financial Services section makes all TCRS disbursements; approves all additions and changes to the retired payroll; and supports annual financial reporting, actuarial valuations, and actuarial experience studies. The payroll area is responsible for making monthly payments to retirees, maintaining the members' records, and advising members in all aspects related to their retirement payments and deductions. The refunds area processes the refund of contributions for eligible members, issues payments to the beneficiaries of deceased active members, reissues lost warrants, advises members on tax provisions related to refunds, and distributes tax documents. The audit and financial reporting component audits all calculations of benefits to be added to the retired payroll and all prior-service billings for accuracy. The general change component provides maintenance of active member records and is responsible for the issuance of annual statements to members. The flexible benefits program is an optional benefit plan that enables state employees to pay for certain expenses with tax-free salary.

PENSION SYSTEM INFORMATION

The statute that established the Tennessee Consolidated Retirement System in 1972 specified the three following classifications of employment: Group I – Teachers and General Employees (State and Political Subdivisions); Group II – State Policemen, Wildlife Officers, Firemen, and Policemen; and Group III – State Judges, County Judges, Attorneys General, County Officials, and Public Service Commissions. Any person who was a member of a superseded system as of June 30, 1972, became a member of the Consolidated System on the date of establishment. TCRS is administered by the Department of the Treasury, under the legislative branch of state government. By state law, the State Treasurer serves as custodian of the funds of the system.

The state is responsible for the pension benefits of state employees and higher education employees, and funds a significant portion of the retirement liability for teachers through the Basic Education Program. Each participating political subdivision is responsible for the pension benefits of its employees. Any person who becomes a teacher not participating in a local retirement fund, a general state employee, a state policeman, or a wildlife officer on or after July 1, 1972, becomes a member of TCRS as a condition of employment. Membership is optional for any person who becomes a state judge, a part-time employee, a commissioner, a county judge or county official in a participating political subdivision, an attorney general, assistant attorney general, criminal investigator, or an elected or appointed official of the General Assembly. TCRS became noncontributory on July 1, 1981, for state employees and teachers in higher education. Teachers in grades K-12 and political subdivisions remained contributory, except that political subdivisions were given the option of electing to become non-contributory.

OBSERVATIONS AND COMMENTS

The topics discussed below did not warrant a finding but are included in this report because of their potential effect on the operations of the Tennessee Consolidated Retirement System.

COMPENSATION PAYMENTS TO SOME RETIRED TEMPORARY WORKERS EXCEEDED TCRS SALARY LIMITS

A review of the Temporary Employment program of the Tennessee Consolidated Retirement System (TCRS) revealed that employer compensation payments made to 43 TCRS retired temporary workers have exceeded TCRS salary limits. In addition, the review raised concerns about incomplete information in some records in the program database, the need for additional training or clarification for employers and retirees regarding program requirements, and the reliance on retiree employer agencies.

According to Section 8-36-805, *Tennessee Code Annotated*, all TCRS retirees returning to work in one of the TCRS subsystems (Political Subdivisions, Tennessee Board of Regents/University of Tennessee, Teachers, and State Government) should be in compliance with the following two criteria:

- Compensation paid to retirees for temporary work should not exceed a defined percentage of that person's final annual salary.
- In a 12-month time period, the retiree should not work more than a certain number of days. Currently the day total is 120 days.

Based on these statutory guidelines, compensation payments should have been no more than \$889,964 for the 43 workers. The actual payment amount, however, was \$1,018,295—exceeding the cumulative salary target by \$128,331.

In conducting our review, auditors requested retired worker data from TCRS and received 5,041 records (one record for each retiree each year they participated in the program), covering from 2000 into 2006. In analyzing the information, we calculated salary limits for each record and determined the following:

- Information from the Excel database showed projected compensation amounts exceeding salary limits for 119 records. In order to capture more accurate information and any adjustments to the projected figures, TCRS staff suggested reviewing the actual Temporary Employment Report (TER) forms (which detail the projected time and salary for which retirees expect to work)—this review found only 112 records that exceeded salary limits. Because these two information sources contained projected rather than actual compensation figures, we then contacted the

employers of the retired TER workers to obtain actual gross wage information for the 119 retirees whose records had indicated that they might be exceeding salary limits. In only 43 cases were the workers found to actually be exceeding salary limits. The vast majority (over 90%) of these workers were from the Teachers and Political Subdivision subsystems.

- 1,141 records, or 23% of the total records, had missing information such as social security numbers, date of retirement, final annual salary, etc., in the TCRS Excel database. Because all information needed to accurately calculate salary limits was not available, we did not include these records in our review.
- In reviewing the TER forms, we found information missing in several cases: two instances where required signatures were missing, eight instances of missing projected compensation amounts, and one instance of missing “begin” and “end” dates of employment. In addition, in reviewing the TCRS Excel database information, we found one obviously incorrect final annual salary figure of more than \$47,000,000.

**Summary of Information From TCRS Excel Database, TER Forms, and Employers
for Retired Temporary Workers
2000 to 2006**

| Compensation Source | Retirees With Projected Compensation Greater Than the Salary Limit | Percent | Retirees With Projected Compensation Less Than the Salary Limit | Percent | Retirees With Missing Information in Database | Percent | Total Records |
|---|---|----------------|--|----------------|--|----------------|----------------------|
| TCRS Excel Database (Projected Compensation Amounts) | 119 | 2% | 3,781 | 75% | 1,141 | 23% | 5,041 |

| Compensation Source | Records Reviewed | Retirees With Projected or Actual Compensation Greater Than the Salary Limit |
|---|-------------------------|---|
| TER Forms (Projected Compensation Amounts) | 119 | 112 |
| Employers of Retirees (Actual Compensation Amounts) | 119 | 43 |

Source: TCRS Excel Database, TCRS TER Forms, and Payroll Administrators from TCRS Subsystems.

Auditors found several factors that could lead to salary limits being exceeded. First, TCRS management relies on the employers of TCRS retirees to prevent and detect salary limit overages. Our review of the TER form indicated that TCRS should be able to prevent some salary overages by reviewing the projected compensation amounts shown on the completed TER forms. However, according to TCRS management, they rely on the “honor system” and expect employers or the retired workers themselves to inform TCRS when retiree compensation amounts are exceeding salary limits. Our review, however, indicates that the “honor system”

was not always effective, resulting in some workers being paid more than allowed by law. According to TCRS staff, three retirees had been identified by the “honor system” as exceeding the day limit (i.e., 120 days currently; 100 days prior to July 2005). None were mentioned as being identified as exceeding the salary limit. (One person identified by staff as exceeding the day limit was found by auditors to have also exceeded the salary limit.) When limit requirements are exceeded and identified, TCRS calculates payment amounts and considers this a liability owed by the retiree.

We found that some employers were not clear about the appropriate percentage amounts to use, whether both limits needed to be satisfied, or the information needed for calculating salary limits. Two employer representatives indicated using 60% to determine salary limits on workers with less than 12 months but more than 60 days since retirement. According to TCRS staff, however, 63% should be used. (The guidance provided in the TER form was not clear. According to guidelines, retired workers should not begin a 120-day work period until 60 days have elapsed since their retirement date, unless a waiver has been received [i.e., because no other qualified person is available to fill the position]). The salary limit chart on the TER form shows percentages to use when trying to calculate the maximum compensation payment that a retiree can receive. The first percentage shown is 63%, and it appears under the label “Year 1.” Within the TER form, an initial percentage of 60% is introduced for calculating the salary limits. The growth in percentage amounts increases annually by 5%. When the time since retirement is more than 60 days but less than one year, it is unclear whether 60% or 63% should be used. Another employer representative indicated not understanding the need for obtaining past earning information for workers.

Tennessee Consolidated Retirement System management should work with TCRS staff, including information systems staff, to ensure that all relevant information (e.g., date of retirement and final annual salary) for retirees returning to work is maintained and available so that staff can easily determine the salary constraints for each retiree.

TCRS management should review their procedures and take action to ensure that retirees and employers fully understand the statutory requirements for retirees returning to work and that the retirees comply with the statutory criteria. Management should consider the need for providing additional training or explanations of the requirements to employers and retirees, as well as the need for additional clarification of the Temporary Employment Report form. Management should also consider directing TCRS staff to take a more active role in monitoring compliance with statutory criteria, rather than relying so heavily on “the honor system” to prevent or detect salary overages.

Management’s Comment to the Observation and Comment (see pages 5-7)

TCRS places reliance on employers and retirees to adhere to temporary-return-to-work requirements. TCRS will investigate abuses brought to our attention. However, it is difficult to justify the cost involved in a detailed review of each retiree who returns to work as compared to the actual work overage. The law (Section 8-36-805, *TCA*) does not require that TCRS audit each situation. Additional staff would be required to handle this task.

TCRS would not characterize the process as the “honor system.” From member enrollment to retirement, TCRS relies heavily on employer certification and reporting. The employer is assumed to be honest and competent. All employer certification is subject to audit by the Comptroller or audit designee.

TCRS continues to inform employers and retirees of the return-to-work restrictions. Examples of these communications include:

- The temporary employment form is completed by the retiree, and the employer lists the restrictions on the form.
- TCRS regularly discusses temporary employment standards at employee and employer meetings at which TCRS is invited to speak.
- Dating back to at least July 2004, letters sent to employers with legislation changes and administrative reminders have included information on temporary employment of retirees.
- Information on temporary employment has been included in retiree newsletters on at least three occasions since 2001.

THE RECONCILIATION PROCESS FOR THE SOFT DOLLAR ACCOUNTS NEEDS IMPROVEMENT

Public pension plan investment programs involve numerous security transactions which generate millions of dollars of trade commissions. The pension plan’s managers negotiate a level of commission with the broker that the managers believe will justify the cost of both the execution of these trades and the research services provided. The portion of the commission set aside or credited back to the plan in order to provide or pay for investment research services is known as “soft dollars.” As a result of accumulating “soft dollars” through trades, the pension plan’s staff receive invoices for the resources accumulated and services provided so that they can reconcile the transactions to ensure all transactions are valid, properly authorized, and properly recorded. This process should include following up on any differences or discrepancies identified.

As part of the performance audit, we reviewed the reconciliation process for the soft dollar accounts. Although we did not identify any actual improprieties, we did identify two areas of concern.

The Same Individual Performs Both the Trading and Reconciliation Functions Related to Soft Dollars

Trading and reconciling are two key functions for the soft dollars accounts. At the time of our audit, the same TCRS staff person—the senior trader—handled both the equity trading, which provides the soft dollars, and the reconciliation of the funds accumulated and services provided. According to *Government Auditing Standards*, a system of internal controls should include proper segregation of duties so no one individual is capable of handling all phases of a

process from beginning to end. A lack of segregation of duties increases the risk of possible errors and irregularities.

Review Identified a Lack of Reconciliation and Differences Between Information Obtained from Different Sources

The soft dollar brokers are paid based on a payout ratio used to distinguish between the dollars used for services TCRS utilizes and the expense the broker receives for providing the trade services. In trying to reconcile the soft dollar commissions, we compared the following: (1) soft dollar totals found on hard copy broker invoices, (2) the amount TCRS staff documented as being expended for services, and (3) the totals calculated from TCRS database reports. (See table below.)

Our assumption was that the amount of documented soft dollar funds generated and used for the fiscal years would reconcile and, if necessary, be further explained through available documentation. However, our review of a soft dollar broker did not reveal reconcilable dollar amounts and identified differences between information obtained from the TCRS database report, broker documentation and invoices, and staff documentation. The following displays the differences in the documentation:

| Fiscal Year | Research Dollars per Broker Documentation (1) | TCRS Database (QED) Reports (2) | Staff Documentation of Expenses (3) |
|--------------------|--|--|--|
| 2002-03 | \$500,749 | \$508,916 | \$639,708 |
| 2003-04 | \$690,043 | \$691,876 | \$564,773 |
| 2004-05 | \$520,450 | \$520,450 | \$621,655 |

Columns (1) and (2) are based on trade date.

(2) The dollar totals are calculated by multiplying the QED report total by a payout factor.

(3) TCRS documented amounts spent on research services.

*Note: There are small differences between broker documentation and QED reports for 02-03 and 03-04.

Auditors' main concern is that staff documentation expense totals [Column (3) above] are not equal to the amount of documented research dollars available [Column (1)]. According to TCRS staff, if excess soft dollar commissions are available, they will eventually be used by TCRS for research services. In some years, TCRS may have an ending negative balance with the broker who pays the vendors for the services used by TCRS. In this instance, the broker will pay for the service and recover the negative balance through trades in the future. This explanation appears reasonable, and it appears the expenditures were used for legitimate research purposes. However, our concern was that we were unable to reconcile the differences between the documented expenditures and research dollars available for use. It seems reasonable that TCRS staff should periodically reconcile the funds even if it requires the use of additional documentation.

TCRS management should ensure that reconciliation of the soft dollars account is performed independently of the trading function. It may be beneficial, however, for the trading desk to be involved in providing information to staff performing the reconciliation, and the

trading desk may also need to be apprised of the results of the reconciliation, to effectively manage the soft dollar budget.

T CRS management should develop a process to reconcile the soft dollar resources documented between the broker, T CRS database reports, and T CRS staff. In the event there are differences between the various types of documentation, there should be a procedure to document and explain those differences.

THE TENNESSEE CONSOLIDATED RETIREMENT SYSTEM SHOULD CONSIDER ADOPTING GFOA RECOMMENDATIONS FOR BROKER/DEALER AGREEMENTS

Government Finance Officers Association (GFOA) publications regarding broker/dealer relations suggest that government officials should identify risks and avoid problems associated with broker/dealer relationships. GFOA identifies safeguards for minimizing risks and recommends actions public officials should take when conducting business with brokers/dealers. Specific activities include

- signing broker/dealer acknowledgements or “certifications” to assure public officials that investment policies have been both read and understood;
- conducting investigative reviews of brokers/dealers prior to finalizing arrangements, with particular attention being given to determining the quality of the firm’s public image, the firm’s status with regulatory and licensing boards, and the firm’s financial and legal status; and
- using broker/dealer agreements to address risks associated with broker/dealer relationships (e.g., types of investments marketed, the suitability of recommended transactions, and the risk of excessive spreads, etc.).

Based on our review, T CRS’ current agreements with brokers and dealers do not follow all GFOA recommendations. Three areas in which improvements could be made are detailed below.

Assurance Regarding Knowledge of Investment Policies. We obtained a list of 71 authorized brokers/dealers associated with T CRS investments. All authorized brokers/dealers are provided signed “Letters of Authorization” prior to providing service to the T CRS. The letters give names of the T CRS investment staff, investment responsibilities, and where brokers/dealers can go on-line (i.e., website addresses) to obtain copies of T CRS’ investment policy. Currently, the policy does not require that brokers/dealers read and understand the investment policy.

Investigative Reviews of Brokers/Dealers. The T CRS operating policy states that all broker/dealer firms (for stock and all other securities) shall be selected for use according to their financial standing, execution capabilities, underwriting capabilities, research capabilities, price, and other services provided. An additional selection criterion mentioned by the system’s Chief Investment Officer is the “public image” of the firm in the investment community. A GFOA document indicates that, before entering into business transactions with brokers/dealers, public

officials should conduct background checks on both the firms and representatives within the firms. One way TCRS could address public image concerns is by reviewing National Association of Securities Dealers (NASD) disclosure information. (The NASD is the security industry regulator of brokers and dealers and writes rules to govern broker/dealer behaviors, as well as overseeing brokers' and dealers' activities.) Types of disclosure information accessible from NASD include (1) criminal events, (2) financial disclosure events such as bankruptcies or liens, (3) regulatory actions such as suspensions, and (4) customer complaints, etc.

According to TCRS staff, it has not been TCRS' practice to obtain NASD disclosure information when reviewing firms. It seems, however, that such information could be useful when reviewing potential brokers/dealers. For example, a December 2005 TCRS memo suggested adding four new firms to the broker/dealer list. The memo included comments about each firm's strong points but no disclosures about potential issues. After reviewing preliminary data within the NASD database, we determined that all four firms had a NASD disclosure event noted. The database lists pending items, and the disclosure events may have subsequently been appealed or resolved, but a disclosure event indicates a potential problem that merits additional review. The details and current status can be obtained from the NASD database and on-line access to NASD information is provided free of charge to state regulatory agencies.

Use of Broker/Dealer Agreements. Although TCRS uses Letters of Authorization (see above), no contractual arrangements are in place for brokers/dealers. The GFOA Standing Committee on Cash Management developed a sample agreement for governments to use when engaging the services of brokers/dealers. Furthermore, according to the GFOA, written contractual agreements are necessary for effective internal controls. TCRS staff seemed willing to consider the use of such agreements, but believed that some of the brokers/dealers would be hesitant to enter into such formal agreements.

The Tennessee Consolidated Retirement System management should consider reviewing GFOA's sample broker/dealer agreement and developing a customized agreement suitable for brokers/dealers providing services to the TCRS.

ADDITIONAL AUDIT WORK PERFORMED

Real Estate Program

The Division of State Audit also reviewed documentation and interviewed Department of the Treasury staff to assess the adequacy of controls over TCRS real estate investments and the contractors that assist the system with the real estate program. Our review indicated that staff and contractors were performing proper due diligence (e.g., appropriate information and reports obtained and prepared, property visited, and meetings held) before purchasing a property. In addition, monitoring of advisors (contractors that manage the properties for TCRS) appears reasonable. The advisor submits monthly and quarterly reports regarding the property and related expenses, as well as an annual report and audited financial statements. The TCRS' contract consultant also reviews quarterly data collected from each advisor and prepares a Performance Measurement Report for TCRS. In addition, TCRS Investment Guidelines state

that staff should “inspect one or more real estate assets managed by each advisor at least once during any three-year period . . .” Although staff do not keep formal records of these visits, other documentation (notes in the file, and travel request and claim forms) indicate that such visits are being conducted.

TCRS Custodian

TCRS contracts with a firm to be the custodian of its securities. The custodian is responsible for notifying TCRS of market actions that affect TCRS’ portfolios (e.g., mergers, spin-offs, and stock splits). Because notification must occur before the TCRS investment staff can manage the securities, auditors reviewed equity spin-off transactions to assess the timeliness of confirmation. According to investment staff, they cannot manage a stock until it has been confirmed in the QED database. (TCRS contracts with QED Financial Systems for an automated investment accounting and inventory system.)

We reviewed stock spin-off information queried from TCRS’ QED database for fiscal years 2002-2005. The transactions included the initial parent company spin-offs and the newly created companies. According to the RFP, TCRS is to have real-time access to stock information in QED through the custodian’s system. Of the spin-off transactions reviewed, the confirmation dates were consistent with the date the stock began trading on the market.

Medical Board

The three physicians serving on the Medical Board of the Tennessee Consolidated Retirement System evaluate applications for disability retirement to determine whether the applicants are totally and permanently disabled and unable to engage in gainful employment. According to their contracts, each physician must submit a written report to the state containing his or her conclusions and recommendations regarding disability within 21 calendar days of receiving any disability application. An applicant who has been denied disability retirement may request that the case be reconsidered if there is new evidence to support the request. The applicant may request an appeal with the Director of TCRS if the reconsideration is denied.

The auditors reviewed 200 disability applications for calendar year 2005 to determine the Medical Board’s timeliness in evaluating the applications. The review identified a need for TCRS staff to reassess their system for tracking disability applications, as well as some timeliness problems, usually just with one of the three doctors. (If the first two doctors responding make the same recommendation, the disability process moves ahead without waiting for the third doctor’s response.)

FINDING AND RECOMMENDATION

Members of the Board of Trustees do not sign conflict-of-interest statements

Finding

According to interviews with board members and internal audit staff from the Department of the Treasury, the Tennessee Consolidated Retirement System (TCRS) Board of Trustees members have not been required to sign conflict-of-interest statements. Members of the board stated they have never been asked to sign conflict-of-interest statements because the types of things they typically vote on (i.e., general policy issues) would not be affected by a conflict of interest. However, the board does vote on specific real estate investments that could raise questions regarding potential conflicts of interest.

Executive Order 3, issued by Governor Bredesen, states that the maintenance of high standards of honesty, integrity, impartiality, and conduct by employees and agents of the state is essential to ensure proper performance of government business and the maintenance of confidence by citizens in their government; avoiding misconduct and conflicts of interest on the part of employees of the state is essential. The board is in the process of gathering more information on how to address conflict-of-interest issues in regard to the TCRS board structure Discussion, and possible action regarding conflict-of-interest statements was expected at the March 2007 meeting.

Recommendation

All board members should complete conflict-of-interest statements annually as a reminder to be aware of actual or potential conflicts of interest or the appearance of such conflicts. The board members should update the forms as their situations (which could lead to potential conflicts) change. The board should adopt formal policies to prohibit members from voting on investments in which the member has a direct financial interest.

Management's Comment

We concur. Even though the Board's duties have been designed to limit the member's conflicts of interest, the Audit Committee and the Director of Internal Audit have developed a conflict-of-interest statement process that is pending approval by the Board of Trustees.

RECOMMENDATION

ADMINISTRATIVE

The Tennessee Consolidated Retirement System (TCRS) Board of Trustees and the Medical Board should address the following area to improve the efficiency and effectiveness of the boards' operations.

1. All board members should complete conflict-of-interest statements annually as a reminder to be aware of actual or potential conflicts of interest or the appearance of such conflicts. The board members should update the forms as their situations (which could lead to potential conflicts) change. The board should adopt formal policies to prohibit members from voting on investments in which the member has a direct financial interest.

Appendix 1
Department of the Treasury
Title VI Information

Title VI of the Civil Rights Act of 1964 requires that “No person in the United States shall, on the ground of race, color, or national origin, be excluded from participation in, be denied the benefits of, or be subject to discrimination under any program or activity receiving federal financial assistance.” In response to a request from members of the Government Operations Committee, we compiled information concerning federal financial assistance received by the Tennessee Department of the Treasury, and the department’s efforts to comply with Title VI requirements. The results of the information gathered are summarized below.

The Department of the Treasury receives one federal grant each year, the Victims of Crime Act’s Victim Compensation Grant, which assists the Criminal Injury Compensation Fund. The Treasurer applies annually for the Victims of Crime Act (VOCA) grant through the U.S. Department of Justice’s Office of Justice Programs, Office for Victims of Crime. In fiscal year 2006, the amount of the grant was \$3,177,000. The application process for this grant involves completing various documents and requirements and submitting them to the Department of Justice throughout the fiscal year. Each December, the department submits a Performance Report, which includes statistics for payments made, how many victims are served, and the time it takes to provide a payment. The department also completes financial status reports and certified payout reports. All of these documents are used by the Department of Justice to determine the amount of the grant to be awarded.

The Department of the Treasury performs Title VI educational and awareness activities to ensure it is meeting the Title VI requirements. In monthly meetings with senior staff, managers, and directors, the Treasurer emphasizes the importance of compliance with Title VI’s requirements as an integral part of accomplishing the department’s mission and living by its core values.

To help ensure awareness of the latest Title VI guidance, the Director of Personnel, who also serves as the department’s Title VI Coordinator, attends Title VI Compliance Commission hearings. During fiscal year 2006, the coordinator attended one meeting. In the area of employment, the department reports information relative to workforce demographics, recruitment activities, promotion activities, and the Careers NOW program. As of September 30, 2006, the department employed a total of 200 full-time employees, of whom 53 employees (26.5%) were African-American and an additional 3 employees (1.5%) were other ethnic minorities. (See pages 27-29.) Three of the department’s eight senior staff members are African-American, helping to ensure that a minority viewpoint is provided when conducting needs assessments or any other discussions regarding program needs.

The Treasurer has administrative responsibility for 24 programs. However, as noted above, only one program, the Criminal Injury Compensation Fund, is federally funded. The Criminal Injury Compensation Fund assists victims of violent crimes or, in the case of a victim’s death, dependent family members, in paying out-of-pocket expenses incurred as the direct result of personal injuries sustained because of a criminal offense. This assistance is available if the

victim and/or claimant(s) meet the eligibility criteria, have incurred eligible expenses, and have exhausted all other public and private means of reimbursement before seeking victims' compensation. The table below details the program's participants by ethnicity.

**Criminal Injury Compensation Fund
Program Participants by Ethnicity
For Fiscal Year 2006**

| | Black | Hispanic | Other | Unknown | White | American Indian | Asian American | Spanish American |
|--------------------|--------------|-----------------|--------------|----------------|--------------|------------------------|-----------------------|-------------------------|
| Active | 111 | 4 | 2 | 2 | 77 | 0 | 0 | 0 |
| Approved | 578 | 40 | 18 | 4 | 507 | 6 | 1 | 1 |
| Deficient | 138 | 6 | 2 | 6 | 89 | 0 | 0 | 1 |
| Denied | 262 | 11 | 3 | 3 | 192 | 1 | 1 | 0 |
| No Decision | 91 | 3 | 0 | 3 | 58 | 0 | 0 | 1 |
| Suspended | 27 | 4 | 0 | 1 | 39 | 0 | 0 | 0 |
| Transferred | 32 | 0 | 1 | 1 | 31 | 0 | 0 | 0 |

Explanation of Terms:

Active—Claim received substantially complete with enough documentation to warrant a decision of any sort. Appeals, etc., may also return from commission as “active” once Treasury reopens on the system, as it would a reconsideration.

Approved—Completed investigation either by DCA staff or Claims Commission, with benefits approved for payment.

Deficient—Only for a new claim/track received substantially incomplete with little to no documentation upon which to base a decision; becomes active upon receiving sufficient information.

Denied—Completed investigation either by DCA staff or Claims Commission, with benefits denied.

No Decision—A track closed after 180 days in deficient status; not approved or denied; can be reopened at any time with sufficient information (which would be a “reconsideration”).

Suspended—As permissible by statute, claim suspended by offender or District Attorney (DA much more commonly) when there is pending or imminent litigation in the criminal case upon which the claim is based. Once litigation is complete, Treasury can proceed however appropriate, generally an immediate decision.

Transferred—Transferred responsibility/processing/handling of claim to Claims Commission.

**Compensation Received by Participants
Criminal Injury Compensation Fund
Fiscal Year 2006**

| Ethnicity | Status | Amount |
|------------------|---------------|---------------|
| American Indian | Approved | \$ 51,064 |
| Black | Approved | \$ 3,747,886 |
| Hispanic | Approved | \$ 300,518 |
| Other | Approved | \$ 94,899 |
| Unknown | Approved | \$ 8,359 |
| White | Approved | \$ 2,444,615 |
| Black | Transferred | \$ 39,364 |
| Total | | \$ 6,686,705 |

The Criminal Injuries Compensation program offered the following training sessions for fiscal year 2006.

| Agency/Event | Month/Year | Location | Impact | Number of Attendees |
|---|-------------------|----------------------------|---------------------------|----------------------------|
| CIC Workshop | June 2006 | Nashville | Statewide | 26 |
| Child Advocacy Centers - Family Advocate Meeting | May 2006 | Nashville | Statewide | 30 |
| East TN Seminars | April 2006 | Cleveland and Madisonville | Middle and East Tennessee | 68 |
| Government Services Fair | April 2006 | Memphis | Local | 15 |
| Minority Health Fair | April 2006 | Nashville | Local | 15 |
| Hispanic Community Advocates | April 2006 | Nashville | Nashville | 7 |
| Victim Witness Coordinator Conference | October 2005 | Memphis | Statewide | 70 |
| “Three Days in Autumn” - Tennessee Victim Assistance Conference | September 2005 | Gatlinburg | Statewide | 15 |

Reports

According to its Title VI Plan, the Department of the Treasury provides copies of the Title VI Implementation Plan, in its entirety, to the following:

- the Tennessee Comptroller of the Treasury,
- the Tennessee Legislative Black Caucus, and
- the Tennessee Title VI Compliance Commission.

Title VI Complaints

Any person alleging discrimination based on race, color, or national origin has a right to file a complaint within 180 days of the alleged discrimination. At the complainant’s discretion, the complaint can be filed with the federal department or the Tennessee Department of the Treasury. If filed with the Department of the Treasury, the complaint should be directed to the attention of the personnel director. All complaints, written or verbal, are to be accepted and should be handled within 90 days of receipt of the complaint. A letter is to be sent acknowledging receipt of the complaint and requesting a time and date the personnel director can reach the complainant by phone to discuss the complaint. Complainants are not parties to a Title VI investigation and do not enjoy a status different from other persons interviewed. A preliminary inquiry is to be conducted by the personnel director on all complaints to substantiate or refute the allegations. If the preliminary inquiry indicates that there may be a problem, then a full complaint investigation will be initiated.

No complaints relating to compliance with Title VI were filed with the department during fiscal year 2005 or fiscal year 2006.

Boards

By statute, the Treasurer serves on 32 boards and commissions and has administrative responsibility for 24 programs. The membership of the TCRS Board of Trustees is detailed below.

**Tennessee Consolidated Retirement System
Board of Trustees
As of 9/30/2006**

| Name | Gender | Ethnicity |
|---------------------------|---------------|------------------|
| Michael Fort | Male | White |
| Judy Wahlstrom | Female | White |
| Rebecca Reel | Female | White |
| Erick Huth | Male | White |
| Sammy Jobe | Male | White |
| Patsy Mathews | Female | White |
| Michael Barker | Male | White |
| Bill Kemp | Male | White |
| David Seivers | Male | White |
| James H. Crumley | Male | White |
| Ex-Officio Members | | |
| Dale Sims | Male | White |
| John Morgan | Male | White |
| David Goetz | Male | White |
| Riley Darnell | Male | White |
| Jill Bachus | Female | White |
| Craig Fitzhugh | Male | White |
| Randy McNally | Male | White |
| Deborah Story | Female | African American |
| Libby Sykes | Female | White |

The Treasurer has the authority to appoint some members to the following three boards: the Baccalaureate Education System Trust (BEST) Board; the Collateral Pool Board; and the Investment Advisory Council.

Baccalaureate Education System Trust (BEST) Board of Trustees. The board oversees the operation of the BEST Program, which was established for the purpose of providing parents and other interested persons tax-advantaged ways to save for a child's higher education. BEST

provides two vehicles to save: the Prepaid College Tuition Plan and the Savings Plan. The Prepaid College Tuition Plan is based on the average tuition inflation at Tennessee public colleges and universities. The tuition units, however, can be used anywhere in the United States. The state's Treasury Department manages the investments to keep up with increases in state university costs. The Savings Plan provides investment returns closely tied to market performance. The contributions to the Savings Plan are invested in portfolios that change asset allocation over time based on the age of the beneficiary/child. The board consists of eight ex-officio members and one representative appointed by the State Treasurer from a list of two nominees submitted by the Board of Directors of the Tennessee Independent Colleges and Universities Association. The Treasurer encourages the board to include minorities among the list of nominees.

**Baccalaureate Education System Trust (BEST) Board of Trustees
Board Members by Gender and Ethnicity
As of 8/31/2006**

| Name | Gender | Ethnicity |
|---------------------------|---------------|------------------|
| Dale Sims | Male | White |
| John Morgan | Male | White |
| David Goetz | Male | White |
| Riley Darnell | Male | White |
| Dr. Charles Manning | Male | White |
| Dr. John Peterson | Male | White |
| Dr. Robert Ruble | Male | White |
| Dr. Richard Rhoda | Male | White |
| Dr. Claude Pressnell, Jr. | Male | White |

Collateral Pool Board. The board oversees the operations of the Collateral Pool for the Public Deposits which was created to provide an alternative method for securing public deposits held by banks and savings institutions. The board consists of two ex-officio members, four representatives of the banking and savings industry appointed by the Treasurer from lists of nominees submitted by the Tennessee Bankers Association board of directors, and one representative of local government appointed by the Treasurer from a list of nominees submitted by the Tennessee County Services Association, the Tennessee Municipal League, or the Tennessee County Officials Association. The Treasurer encourages the nominating entities to include minorities among the list of nominees.

**Collateral Pool Board
Board Members by Gender and Ethnicity
As of 8/31/2006**

| Name | Gender | Ethnicity |
|----------------------|---------------|------------------|
| Bill Adams | Male | White |
| Thomas C. Adams | Male | White |
| Tom Boyd | Male | White |
| James L. Bailey, Jr. | Male | White |
| McCall Wilson | Male | White |
| Greg Gonzales | Male | Hispanic |
| Dale Sims | Male | White |

Investment Advisory Council. The council assists the Treasurer and the investment staff of the Tennessee Consolidated Retirement System by providing advice and recommendations on the most appropriate investment strategy for Retirement System assets. The council consists of five persons, who at the time of their appointment must have at least five years' professional experience as a portfolio manager, economist, or as an investment advisor in any field for which investments of Retirement System funds are authorized. The Treasurer may nominate, at his discretion, two additional members to the investment advisory council. One of the additional members shall be of a racial minority and the other shall be female.

**Investment Advisory Council
Council Members by Gender and Ethnicity
As of 8/31/2006**

| Title | Gender | Ethnicity |
|-------------------------|---------------|------------------|
| Frederick S. Crown, Jr. | Male | White |
| Chuck Webb | Male | White |
| Henry Delicata | Male | White |
| George Stadler | Male | White |
| Susan Logan Huffman | Female | White |

Contractors/Brokers

Below are breakdowns of Treasury Department and TCRS contractors and brokers.

**Tennessee Consolidated Retirement System
Medical Board
As of 7/28/2006**

| Title | Gender | Ethnicity |
|------------------------|---------------|------------------|
| Barry R. Siegel, M.D. | Male | White |
| Jeffery Summers, M.D. | Male | White |
| Suzanne Fletcher, M.D. | Female | Jamaican |

The Tennessee Consolidated Retirement System (TCRS) has 42 authorized brokers which include 13 (31%) minority brokers. The following is a list of the minority firms authorized as of fiscal year 2006 to execute trades for TCRS.

- M.R. Beal – Chicago, IL
- Blaylock & Partners – New York
- BOE Securities – Philadelphia, Pennsylvania
- Divine Capital – New York
- Guzman & Co. – Coral Gables, Florida
- Jackson, Partners & Associates – New York
- Jackson Securities – New York
- Loop Capital Markets – Chicago, Illinois
- SBK – Brooks – Cleveland, Ohio
- Sturdivant & Co. – New Jersey
- Utendahl Capital – New York
- Veritas Securities – New York
- Williams Capital – New York

**Agency Contracts by Title, Services, Amount, and Ethnicity
As of Fiscal Year 2006**

| Contract | Service Description | Procurement Source | Amount | Ethnicity of Contractor/ Business Owner |
|---|---|---------------------------|------------------|--|
| Fidelity Investments Institutional Services Company, Inc. | Investment product for Deferred Comp. Program | Sole Source | No-cost contract | Non-minority |
| Calvert Distributors Incorporated | Investment product for Deferred Comp. Program | Sole Source | No-cost contract | Non-minority |
| ING Insurance & Annuity Co. | Investment product for Deferred Comp. Program | Sole Source | No-cost contract | Non-minority |
| Regions Bank | Investment product for Deferred Comp. Program | Sole Source | No-cost contract | Non-minority |
| State Street Bank and Trust Company | Investment product for Deferred Comp. Program | Sole Source | No-cost contract | Non-minority |
| Bank of New York | Custodian of TCRS, COE and BEST securities | Competitive Bid | \$4,564,847 | Non-minority |
| Great-West Life & Annuity | Third-party administrator of Deferred Comp. Program | Competitive Bid | No-cost contract | Non-minority |

| Contract | Service Description | Procurement Source | Amount | Ethnicity of Contractor/ Business Owner |
|--|--|---------------------------|------------------|--|
| QED Information Systems, Inc. | Computer software license for automated investment accounting and inventory | Competitive Bid | \$860,000 | Non-minority |
| Southeast Financial Credit Union (formerly, Tennessee Workers' Credit Union) | Maintenance of three ATM machines in the Legislative Plaza, the James K. Polk Bldg, and the William R. Snodgrass Tower | Sole Source | No-cost contract | Non-minority |
| Computrol Holdings LLC | Maintenance for a software system for state cash management which was licensed from Computrol | Sole Source | \$500,000 | Non-minority |
| TIAA-CREF Tuition Financing, Inc. | Administration & investment management services for BEST's Educational Savings Plan | Competitive Bid | No-cost contract | Non-minority |
| Affiliated Computer Services, Inc. | Unclaimed property holder audit services | Sole Source | \$3,000,000 | Non-minority |
| Audit Services, U.S. LLC | Unclaimed property holder audit services | Sole Source | \$3,000,000 | Non-minority |
| Abandoned Property Experts | Unclaimed property holder audit services | Sole Source | \$359,000 | Non-minority |
| Affiliated Computer Services, Inc. | Unclaimed property owner location services | Competitive Bid | \$229,950 | Non-minority |
| Seisint, Inc. | Data-based Web research resources to locate owners of unclaimed property being held by the state | Sole Source | \$120,000 | Non-minority |
| Affiliated Computer Services, Inc. | National Internet database to enable residents to perform free searches for their lost or forgotten assets | Sole Source | No-cost contract | Non-minority |
| Kelmar Associates, LLC | Unclaimed property holder audit services | Sole Source | \$500,000 | Non-minority |

| Contract | Service Description | Procurement Source | Amount | Ethnicity of Contractor/ Business Owner |
|---|---|---------------------------|------------------|--|
| AmSouth Bank | Banking services for state funds | Competitive Bid | \$1,300,000 | Non-minority |
| Willis of Tennessee, Inc. | Risk management actuarial services for Claims Award Fund | Competitive Bid | \$320,573 | Non-minority |
| Eckman/Freeman & Associates | Preferred provider network for workers' compensation program | Competitive Bid | \$2,500,000 | Woman-owned |
| Sedgwick Claims Management Services, Inc. | Third-party administrator of Workers' Compensation Program | Competitive Bid | \$5,252,600 | Non-minority |
| Willis of Tennessee, Inc. | Insurance broker services in connection with the acquisition of property/casualty insurance | Competitive Bid | \$195,000 | Non-minority |
| The Berwyn Group | Death match of pension files | Competitive Bid | \$8,846 | Non-minority |
| Bryan, Pendleton, Swats & McAllister | Actuarial services for TCRS pension plan and BEST | Sole Source | \$1,900,000 | Non-minority |
| Barry R. Siegel, M.D. | TCRS medical panelist - evaluated applications for disability retirement | Competitive Bid | \$87,232 | Non-minority |
| Jeffery Summers, M.D. | TCRS medical panelist - evaluated applications for disability retirement | Competitive Bid | \$72,155 | Non-minority |
| Suzanne Fletcher, M.D. | TCRS medical panelist - evaluated applications for disability retirement | Competitive Bid | \$64,309 | Jamaican |
| Strategic Investment Solutions, Inc. | Investment advisory services for TCRS pension fund | Competitive Bid | \$1,735,000 | Non-minority |
| The Variable Annuity Life Insurance Co. | Investment product for Optional Retirement Program (ORP) | Sole Source | No-cost contract | Non-minority |
| ING Life Insurance & Annuity Co. | Investment product for ORP | Sole Source | No-cost contract | Non-minority |

| Contract | Service Description | Procurement Source | Amount | Ethnicity of Contractor/ Business Owner |
|---|--|---------------------------|------------------|--|
| Teachers Insurance & Annuity Association/College Retirement Equities Fund | Investment product for ORP | Sole Source | No-cost contract | Non-minority |
| Walter Scott & Partners Limited | External International Equity Investment Manager Services | Competitive Bid | \$16,270,493 | Non-minority |
| Putnam Advisory Company, Inc. | External International Equity Investment Manager Services | Competitive Bid | \$16,657,869 | Non-minority |
| Marathon Asset Management Limited | External International Equity Investment Manager Services | Competitive Bid | \$21,160,985 | Non-minority |
| SG Yamaichi Asset Management, Inc. | External International Equity Investment Manager Services | Competitive Bid | \$7,800,000 | Non-minority |
| The Townsend Group | Real estate investment consulting services to TCRS | Competitive Bid | \$500,000 | Non-minority |
| Clarion Partners, LLC | Real estate investment advisory services to TCRS | Competitive Bid | \$20,000,000 | Non-minority |
| J.P. Morgan Investment Management Inc. | Real estate investment advisory services to TCRS | Competitive Bid | \$20,000,000 | Non-minority |
| Cornerstone Real Estate Advisers, Inc. | Real estate investment advisory services to TCRS | Competitive Bid | \$20,000,000 | Non-minority |
| TA Associates Realty | Real estate investment advisory services to TCRS | Competitive Bid | \$20,000,000 | Non-minority |
| Principal Real Estate Investors, LLC | Real estate investment advisory services to TCRS | Competitive Bid | \$20,000,000 | Non-minority |
| State Street Bank and Trust Company | Investment management services for the BEST fund | Sole Source | \$280,000 | Non-minority |
| Wagers & Associates | Computer software services in connection with the state's Unclaimed Property Program | Sole Source | \$220,000 | Non-minority |
| Tennessee Department of Labor and Workforce Development | Computer matching of TCRS disability recipients against its earnings database | Sole Source | \$4,600 | N/A |

| Contract | Service Description | Procurement Source | Amount | Ethnicity of Contractor/ Business Owner |
|---|---|---------------------------|---------------|--|
| Tennessee Department of Labor and Workforce Development | Computer matching of abandoned property owners against its earnings database | Sole Source | \$4,600 | N/A |
| CheckFree Services | ACH transaction processing software application | Competitive Bid | \$980,000 | Non-minority |
| CheckFree Services | ARP/SMS software system and maintenance | Competitive Bid | \$240,000 | Non-minority |
| Tennessee Foreign Language Institute | Translation services for the Criminal Injuries Compensation Program to serve non-English speaking victims of crimes | Sole Source | \$5,000 | N/A |

Source: Department of the Treasury Title VI Implementation Plan FY2005-2006

Staff

Below is a breakdown of Treasury Department staff by title, gender, and ethnicity.

**Treasury Department
Personnel by Title, Gender, Ethnicity
As of 9/30/2006**

| Title | Gender | | Ethnicity | | | | |
|--------------------------------------|---------------|---------------|------------------|--------------|-----------------|---------------|--------------|
| | Male | Female | Asian | Black | Hispanic | Indian | White |
| Accounting Technician 1 | 1 | 13 | 0 | 4 | 0 | 0 | 10 |
| Accounting Technician 2 | 2 | 8 | 0 | 4 | 0 | 0 | 6 |
| Accountant 2 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Accountant/Auditor 1 | 5 | 3 | 1 | 1 | 0 | 0 | 6 |
| Administrative Services Assistant 2 | 0 | 3 | 0 | 0 | 0 | 0 | 3 |
| Administrative Secretary | 1 | 5 | 0 | 1 | 0 | 0 | 5 |
| Associate Portfolio Manager | 2 | 0 | 0 | 1 | 0 | 0 | 1 |
| Assistant Director of Retirement | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| Executive Assistant to the Treasurer | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| Assistant Financial Analyst | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

| Title | Gender | | Ethnicity | | | | |
|--|--------|--------|-----------|-------|----------|--------|-------|
| | Male | Female | Asian | Black | Hispanic | Indian | White |
| Assistant to the Treasurer | 3 | 0 | 0 | 0 | 0 | 0 | 3 |
| Attorney 3 | 1 | 1 | 0 | 1 | 0 | 0 | 1 |
| Audit Director 2 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Auditor 2 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| Chief Investment Officer | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Computer Operations Specialist 2 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| Commission Member | 1 | 2 | 0 | 1 | 0 | 0 | 2 |
| Director of Accounting | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Director of Claims Administration | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Director of Equities | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Director of Fiscal Services | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Director of Fixed Income | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Director of Information Systems - Treasury | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Director of Old Age Survivors Insurance | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Director of Personnel | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| Director of Real Estate | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Director of Research and Publications | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Director of Tennessee Consolidated Retirement System | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Director of Unclaimed Property | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Executive Secretary 1 | 1 | 3 | 0 | 1 | 0 | 0 | 3 |
| Executive Secretary 2 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Executive Secretary 3 | 0 | 6 | 0 | 0 | 0 | 0 | 6 |
| Facilities Specialist | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Financial Analyst Portfolio Manager | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Financial Analyst | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Financial Analyst Trainee | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Information Resource Support Specialist 2 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| Information Resource Support Specialist 3 | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Information Resource Support Specialist 4 | 3 | 0 | 1 | 1 | 0 | 0 | 1 |
| Information Resource Support Specialist 5 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |

| Title | Gender | | Ethnicity | | | | |
|--|--------|--------|-----------|-------|----------|--------|-------|
| | Male | Female | Asian | Black | Hispanic | Indian | White |
| Information Systems Project Manager | 1 | 1 | 0 | 0 | 0 | 0 | 2 |
| Information Systems Analyst 3 | 1 | 0 | 0 | 0 | 0 | 1 | 0 |
| Information Systems Analyst 4 | 2 | 0 | 0 | 0 | 0 | 0 | 2 |
| Information Systems Manager 1 | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| Information Systems Manager 4 | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Insurance Benefits Analyst | 0 | 6 | 0 | 2 | 0 | 0 | 4 |
| Investment Technician | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Mail Technician 1 | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Manager 1 | 1 | 4 | 0 | 2 | 0 | 0 | 3 |
| Manager 2 | 0 | 5 | 0 | 0 | 0 | 0 | 5 |
| Manager 3 | 4 | 5 | 0 | 4 | 0 | 0 | 5 |
| Manager 4 | 2 | 3 | 0 | 1 | 0 | 0 | 4 |
| Manager Cash Investments | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Portfolio Manager | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Programmer Analyst 3 | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Programmer Analyst Supervisor | 2 | 1 | 0 | 0 | 0 | 0 | 3 |
| Procurement Coordinator | 0 | 1 | 0 | 0 | 0 | 0 | 1 |
| Publications Officer | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| Records Technician 1 | 0 | 8 | 0 | 3 | 0 | 0 | 5 |
| Records Tech 2 | 1 | 1 | 0 | 1 | 0 | 0 | 1 |
| Risk Analyst | 1 | 1 | 0 | 0 | 0 | 0 | 2 |
| Risk Management Director | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Service Counselor 1 | 6 | 6 | 0 | 6 | 0 | 0 | 6 |
| Service Counselor 2 | 6 | 12 | 0 | 7 | 0 | 0 | 11 |
| Service Counselor 3 | 1 | 5 | 0 | 2 | 0 | 0 | 4 |
| Senior Portfolio Manager | 6 | 0 | 0 | 0 | 0 | 0 | 6 |
| Staff Assistant | 1 | 0 | 0 | 1 | 0 | 0 | 0 |
| Stock Trader | 0 | 2 | 0 | 0 | 0 | 0 | 2 |
| State Treasurer | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Treasury Trainee | 0 | 1 | 0 | 1 | 0 | 0 | 0 |
| Website Developer 2 | 1 | 0 | 0 | 0 | 0 | 0 | 1 |
| Total | 72 | 128 | 2 | 53 | 0 | 1 | 144 |

Source: Tennessee Department of the Treasury.

Appendix 2
Tennessee Consolidated Retirement System
Financial Information

Tennessee Consolidated Retirement System
Plan Net Assets
For Fiscal Years Ended June 30, 2006 and 2005

| Assets | June 30, 2006 | June 30, 2005 | Percent Change |
|--|--------------------------------|--------------------------------|-----------------------|
| Cash and cash equivalents | \$826,611,111 | \$804,694,718 | 2.7% |
| Member and employer receivables | 71,671,617 | 59,611,297 | 20.2% |
| Investment income receivable | 172,541,678 | 168,791,063 | 2.2% |
| Investments sold | 33,287,736 | 28,751,524 | 15.8% |
| Foreign currency receivables | 19,732,929 | 177,749,703 | (88.9)% |
| Short-term securities | 503,846,988 | 231,988,352 | 117.2% |
| Long-term investments | <u>27,255,904,731</u> | <u>25,968,351,692</u> | 5.0% |
| Total Assets | 28,883,596,790 | 27,439,938,349 | 5.3% |
| | | | |
| Liabilities | | | |
| Death benefits, refunds, and other payables | 2,319,549 | 6,721,778 | (65.5)% |
| Investments purchased | 38,344,946 | 41,541,888 | (7.7)% |
| Other investments payable | 2,563,959 | 2,295,936 | 11.7% |
| Foreign currency payable | <u>19,732,929</u> | <u>173,116,862</u> | (88.6)% |
| Total Liabilities | <u>62,961,383</u> | <u>223,676,464</u> | (71.9)% |
| | | | |
| Net Assets Held In Trust For Pension Benefits | <u>\$28,820,635,407</u> | <u>\$27,216,261,885</u> | 5.9% |

**Tennessee Consolidated Retirement System
Schedules of Administrative Expenses
For the Year Ended June 30, 2006**

| | State Employees, Teachers, Higher Education Employees Pension Plan (SETHEPP) | Political Subdivisions Pension Plan (PSPP) | Total |
|---|---|---|--------------------|
| Personnel Services | | | |
| Salaries and wages | \$1,150,278 | \$992,228 | \$2,142,506 |
| Employee benefits | <u>377,486</u> | <u>325,620</u> | <u>703,106</u> |
| Total Personnel Services | 1,527,764 | 1,317,848 | 2,845,612 |
| Professional Services | | | |
| Accounting | 117,192 | 101,090 | 218,282 |
| Actuarial Services | 163,159 | 140,741 | 303,900 |
| Data processing | 217,974 | 188,025 | 405,999 |
| Disability Review | 49,506 | 42,704 | 92,210 |
| Information Systems | 404,829 | 349,206 | 754,035 |
| Management Services | 157,293 | 135,681 | 292,974 |
| Medical Review | 22,576 | 19,469 | 42,045 |
| Administrative, Internal Audit, Legal, Personnel | <u>333,059</u> | <u>287,297</u> | <u>620,356</u> |
| Total Professional Services | 1,465,588 | 1,264,213 | 2,729,801 |
| Communication | | | |
| Travel | 17,573 | 15,159 | 32,732 |
| Telephone | 28,252 | 24,371 | 52,623 |
| Printing | 45,350 | 39,118 | 84,468 |
| Postage | <u>114,880</u> | <u>99,095</u> | <u>213,975</u> |
| Total Communication | 206,055 | 177,743 | 383,798 |
| Miscellaneous | | | |
| Office space | 93,945 | 81,036 | 174,981 |
| Supplies and maintenance | 19,328 | 16,674 | 36,002 |
| Equipment | 11,864 | 10,234 | 22,098 |
| Other services and charges | <u>11,437</u> | <u>9,868</u> | <u>21,305</u> |
| Total Miscellaneous | <u>136,574</u> | <u>117,812</u> | <u>254,386</u> |
| Total Administrative Expenses | <u>\$3,335,981</u> | <u>\$2,877,616</u> | <u>\$6,213,597</u> |

**Tennessee Consolidated Retirement System
Schedules of Investment Expenses
For the Year Ended June 30, 2006**

| | SETHEEPP | PSPP | Total |
|---|---------------------|--------------------|---------------------|
| Personnel Services | | | |
| Salaries and wages | \$1,396,116 | \$247,903 | \$1,644,019 |
| Employee benefits | <u>360,026</u> | <u>63,928</u> | <u>423,954</u> |
| Total Personnel Services | 1,756,142 | 311,831 | 2,067,973 |
| Professional Services | | | |
| Accounting | 157,315 | 27,933 | 185,248 |
| Legal Services | 91,208 | 16,196 | 107,404 |
| Data processing | 71,626 | 12,718 | 84,344 |
| Information systems | 115,199 | 20,455 | 135,654 |
| Management Services | 9,873 | 1,753 | 11,626 |
| External investment manager fees | 8,637,269 | 1,533,691 | 10,170,960 |
| Investment consulting fees | 311,879 | 55,379 | 367,258 |
| Investment custodian fees | 741,179 | 131,609 | 872,788 |
| Real Estate manager fees | 3,719,340 | 660,430 | 4,379,770 |
| Administrative, Internal Audit Personnel | <u>286,416</u> | <u>50,858</u> | <u>337,274</u> |
| Total Professional Services | 14,141,304 | 2,511,022 | 16,652,326 |
| Communication | | | |
| Travel | 28,334 | 5,031 | 33,365 |
| Telephone | 16,665 | 2,958 | 19,623 |
| Printing | 742 | 132 | 874 |
| Postage | <u>3,081</u> | <u>547</u> | <u>3,628</u> |
| Total Communication | 48,822 | 8,668 | 57,490 |
| Miscellaneous | | | |
| Office Space | 67,018 | 11,900 | 78,918 |
| Supplies and maintenance | 8,501 | 1,510 | 10,011 |
| Other services and charges | <u>76,800</u> | <u>13,637</u> | <u>90,437</u> |
| Total Miscellaneous | <u>152,319</u> | <u>27,047</u> | <u>179,366</u> |
| Total Investment Expenses | <u>\$16,098,587</u> | <u>\$2,858,568</u> | <u>\$18,957,155</u> |

Source: *Tennessee Consolidated Retirement System Comprehensive Annual Financial Report for the Fiscal Year Ended June 30, 2006.*